Insurer Investment Concerns and Solutions

March 30th, 2023

inflation
higher expected returns
equity drawdowns
demand destruction
higher interest rates
cash flow reinvestment
valuation of bonds

Trends vs Reactions

2 years

1	Cost-of-living crisis
2	Natural disasters and extreme weather events
3	Geoeconomic confrontation
4	Failure to mitigate climate change
5	Erosion of social cohesion and societal polarization
6	Large-scale environmental damage incidents
7	Failure of climate change adaptation
8	Widespread cybercrime and cyber insecurity
9	Natural resource crises
10	Large-scale involuntary migration


The Washington Post

Democracy Dies in Darkness

Financial system jitters persist after bank rescue

BIDEN URGES CALM, INVESTORS PULL BACK

Speculation grows over Fed and FDIC's next moves

BY DAVID J. LYNCH AND TONY ROMM

Washington's banking rescue had a rocky start Monday on Wall Street, as the government's response to the collapse of Silicon Valley Bank failed to quell doubts about the health of some midsize banks and left investors debating whether the Federal Reserve would be forced to change course in its fight against inflation.

The day began with President Biden at the White House seeking

Trends

Impact long-term strategic positioning

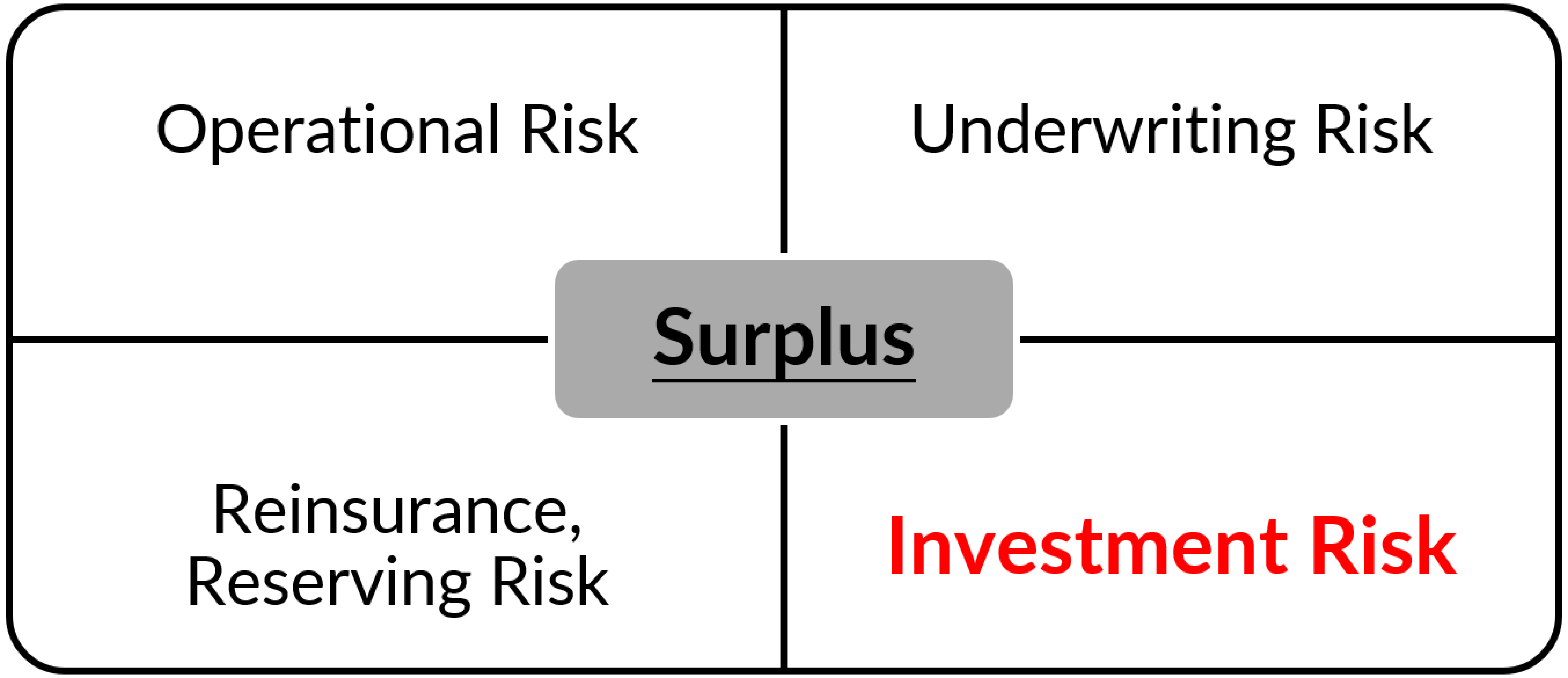
Reactions

FED policy drives economic and market headlines and… "noise"

"Federal Reserve, People, Inflation"

AI Generated

Surplus



Adequate surplus level?

Importance of liquidity / yield-driven returns to mitigate surplus volatility?

Provide comfort for reinsurance long-term, how?

Key Concerns and Solutions

Liquidity

Asset Valuations

Asset Allocation

Liquidity

Concern & Solution #1

AM Best Commentary..

Our Insight, Your Advantage™

March 14, 2023

Silicon Valley Bank Collapse Highlights Critical Lessons for the Insurance Industry

The ramifications could be more significant for insurers' equity portfolios than for their

Principal Takeaways

- The Silicon Valley Bank collapse highlights the critical importance of enterprise risk management, asset/liability management, and liquidity profiles—especially for annuity writers in a rising interest rate environment.
- Issues related to D&O may emerge if the FDIC and other shareholders put the board and executive management under examination.

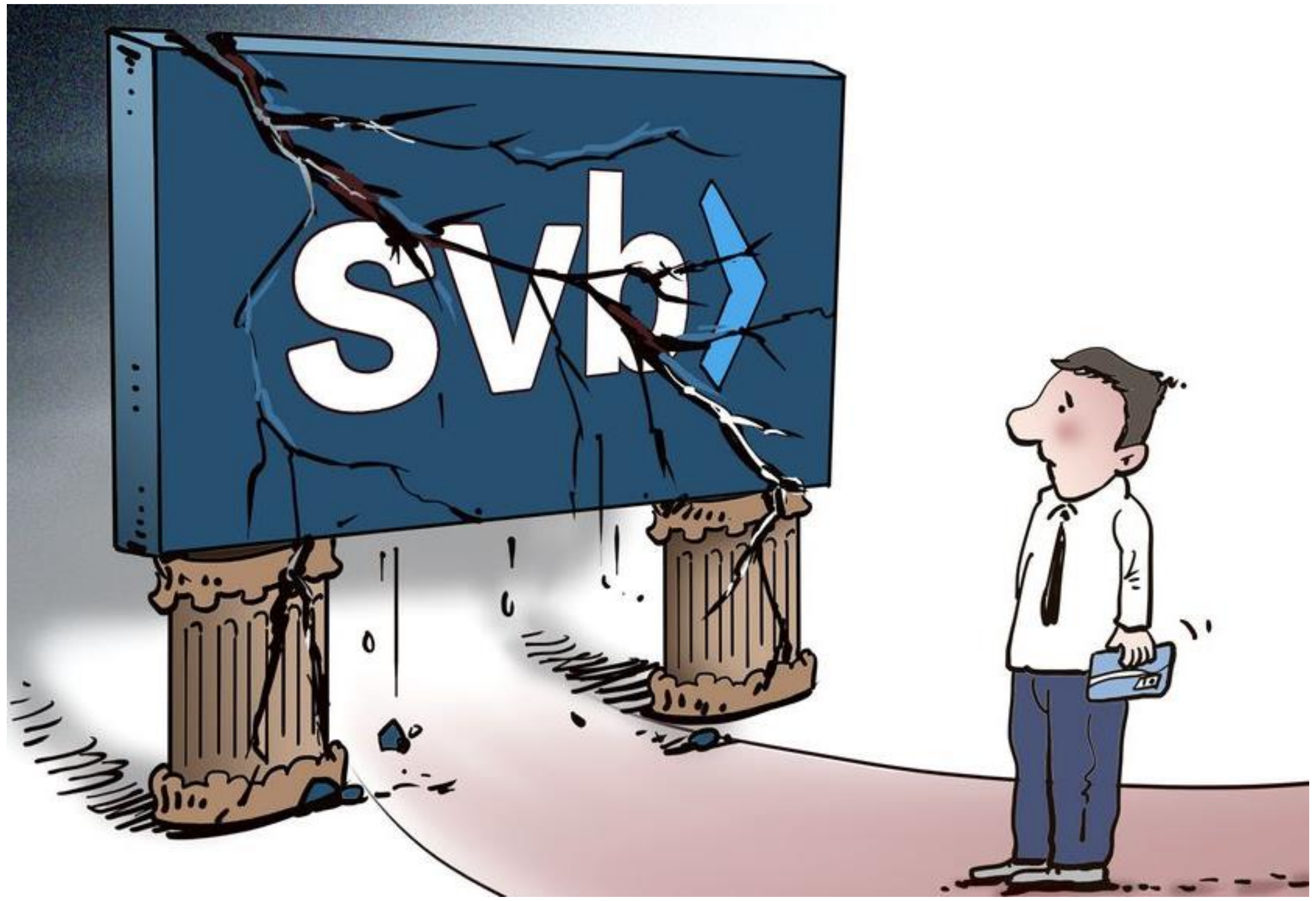
The failure of Silicon Valley Bank, along with the recent shutdown of Silvergate Bank by regulators, has impacted several banks. The ramifications for insurers' equity portfolios could be more significant than for bondholdings, as some major bank stocks have already lost significant value. Five US insurers have equity exposures concentrated in the bank and trusts sector greater than their capital, and 17 have exposures totaling at least half their capital (**Exhibit 1**).

Banks vs Insurers

Banks		Insurers
Interconnected	Institutional interconnectedness	Stand alone operator
ST deposits -> LT Loans	Maturity transformation	Asset/Liability matching
Withdrawable at Will	Liquidity risk	Not Callable at Will
Highly Levered & Must Withstand Shocks to avoid contagion	Absorption of systemic risk	Not as highly levered & capital not for crisis prevention/stabilization

Future Case Study…

What did SVB get wrong, and why liquidity matters for Insurers



Short-Term Reinvestment T-Bills

Maturity	Mid Yield
28 Mar '23	3.78%
04 Apr '23	3.81%
11 Apr '23	3.88%
18 Apr '23	3.89%
25 Apr '23	3.99%
02 May '23	4.14%
01 Jun '23	4.54%
05 Jul '23	4.74%
03 Aug '23	4.69%
07 Sep '23	4.75%

Despite market noise, can manage liquidity in 2023 and get paid for it

Source: FactSet, 3/23/2023

What Can We Do?

Operating cash work harder

Liquidity Portfolio

Reinvest shorter end of curve

FHLB

Operating Cash

Optimize balance being carried earning less than investments

Liquidity Portfolio

Liquidity backstop that sits in front of investment portfolio

Reinvest Differently

Investment income reinvested <2 years, lowers portfolio duration

FHLB

Leverage to add incremental invested assets

What Can We Do?

Understand cash flow schedules

Improve internal cash flow process

Stress Test Claims Demands

Cash held at other pools

Cash flow targets

Intentional with reinvestment targets for coupons, principal, dividend income, maturities

Internal resources

Personnel, tools, internal resources?

Stress Test

What would a bad month look like?

Pooled Funds

Pooled investment funds for liquidity

Key Takeaways

1) Liquidity concerns are top of mind for regulatory bodies and rating agencies

2) Lessons from SVB/bank saga, should make us pause and ask questions

3) Despite market noise, can manage liquidity in 2023 and get paid for it

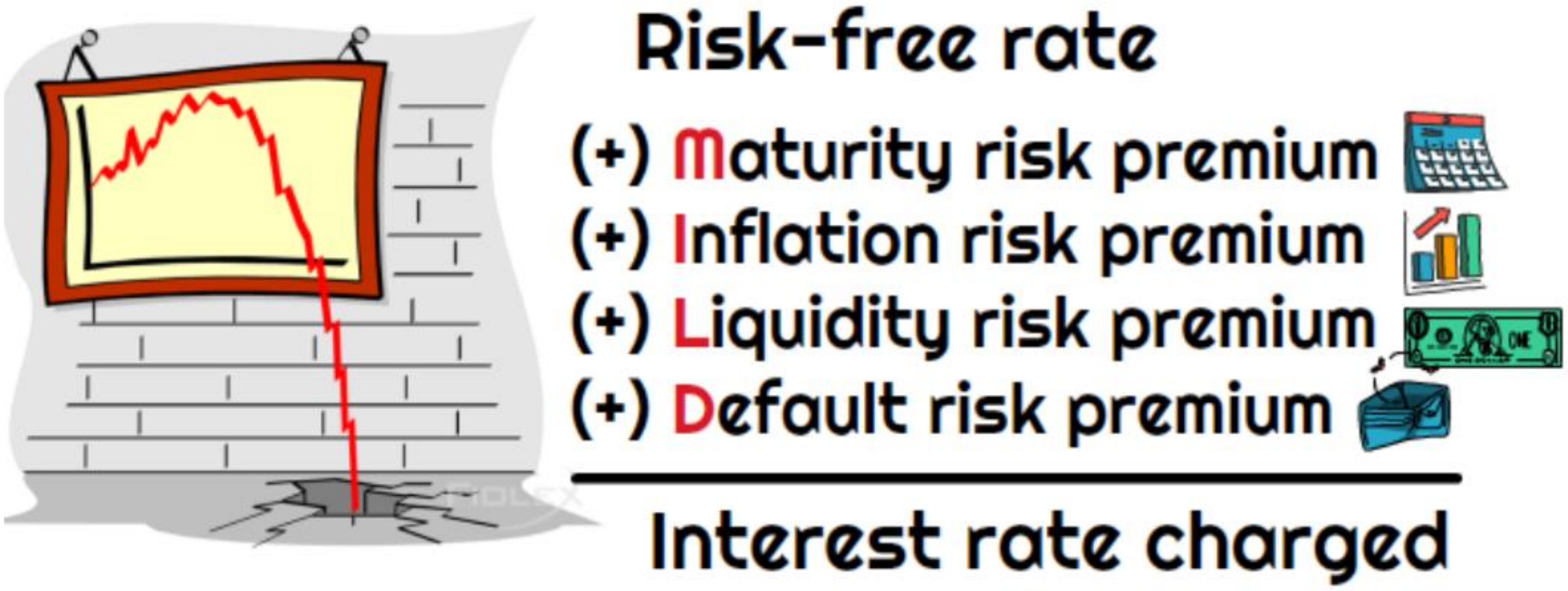
4) Higher reinvestment yields are expanding our options on managing liquidity

Asset Valuations

Concern & Solution #2

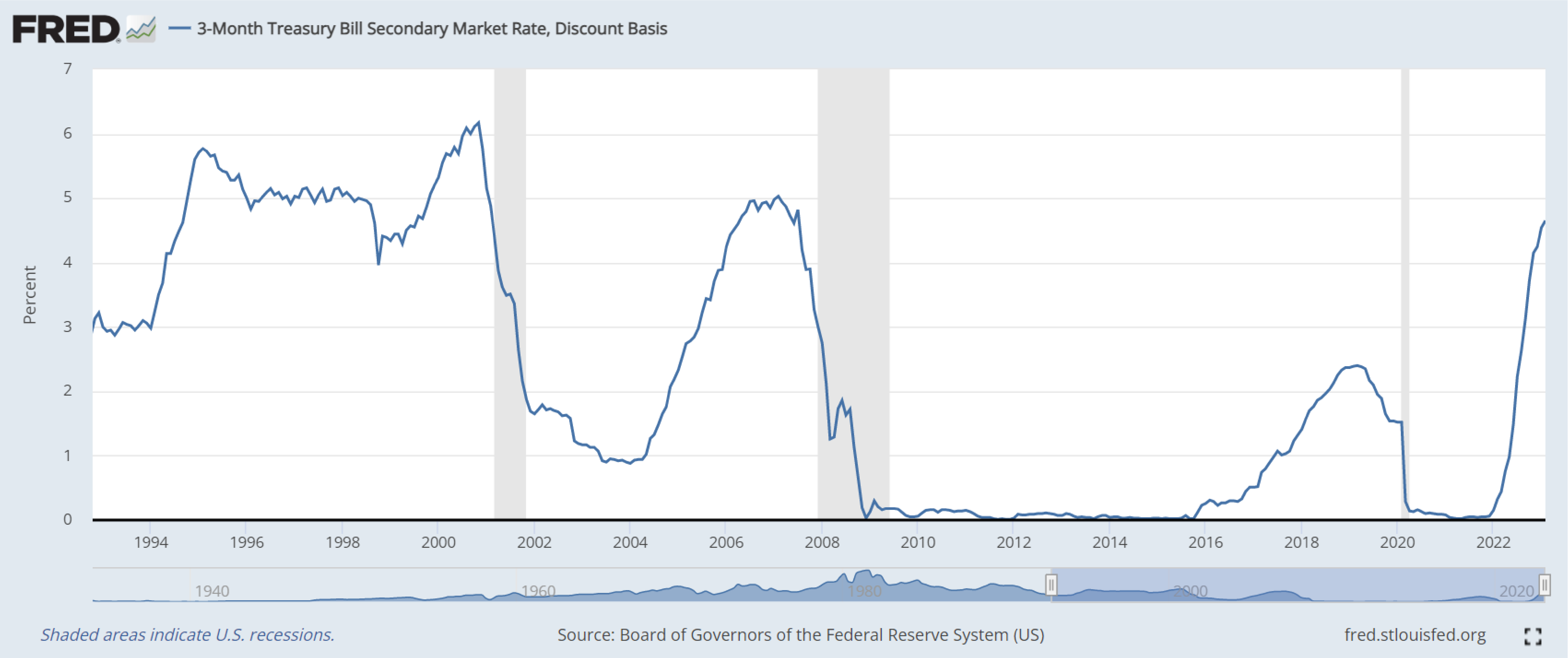
Fixed Income

- Your portfolio's market value changes as interest rate premiums change in the market



Fixed Income

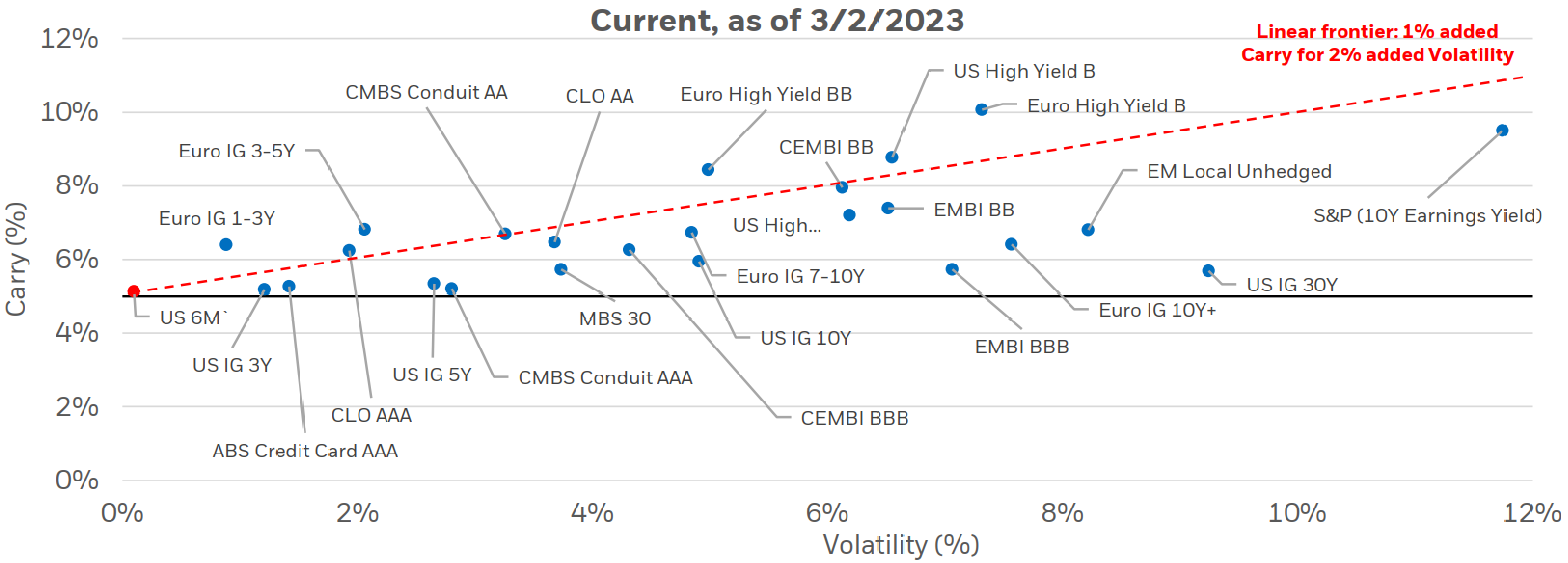
➢ **Largest contributor to higher yields today in your portfolio is the risk-free rate.**



Source: St. Louis Federal Reserve

Fixed Income

➢ **Higher yields may not be worth the added volatility, relative to cash..**

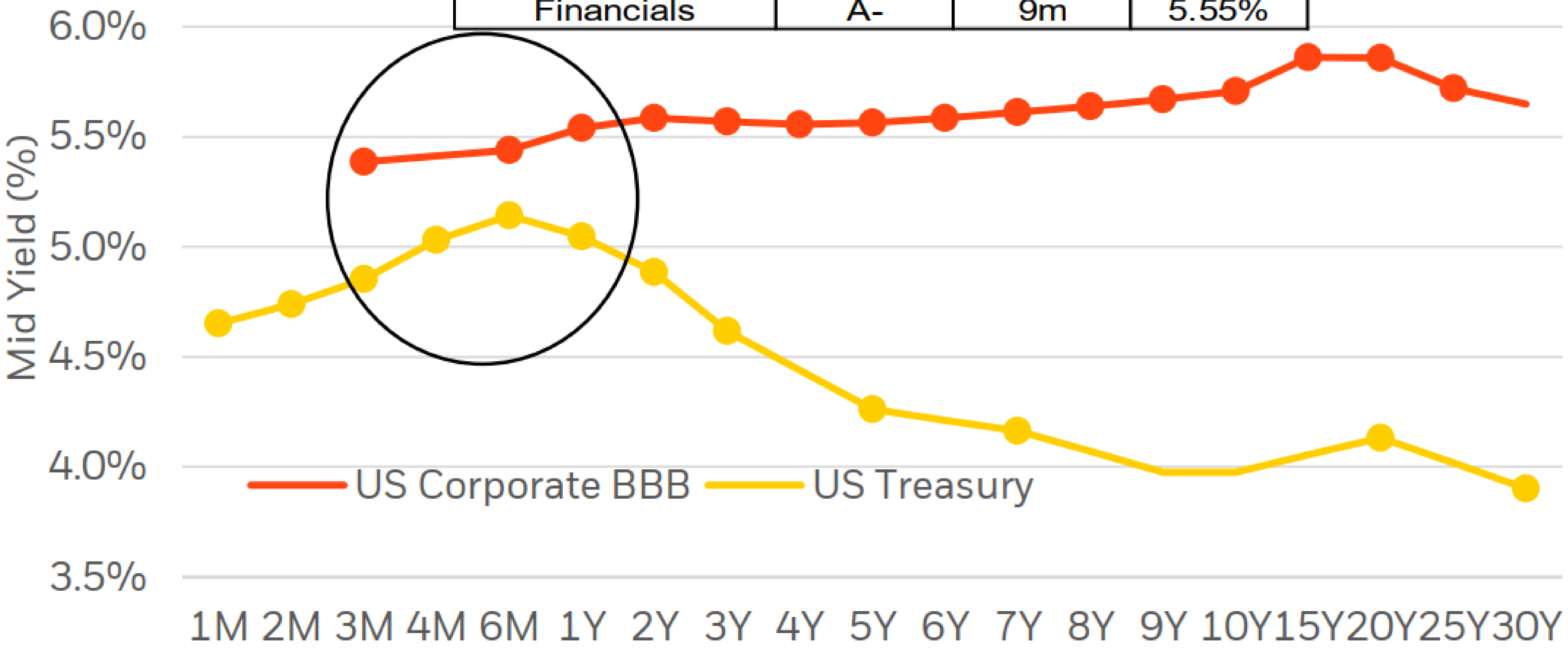


Source: BlackRock

Fixed Income

- Cash has changed the current paradigm in how we think about strategy moving forward. As of 3/3/2023, Commercial paper rated A to BBB+ is yielding between 5.5% and 5.9%.

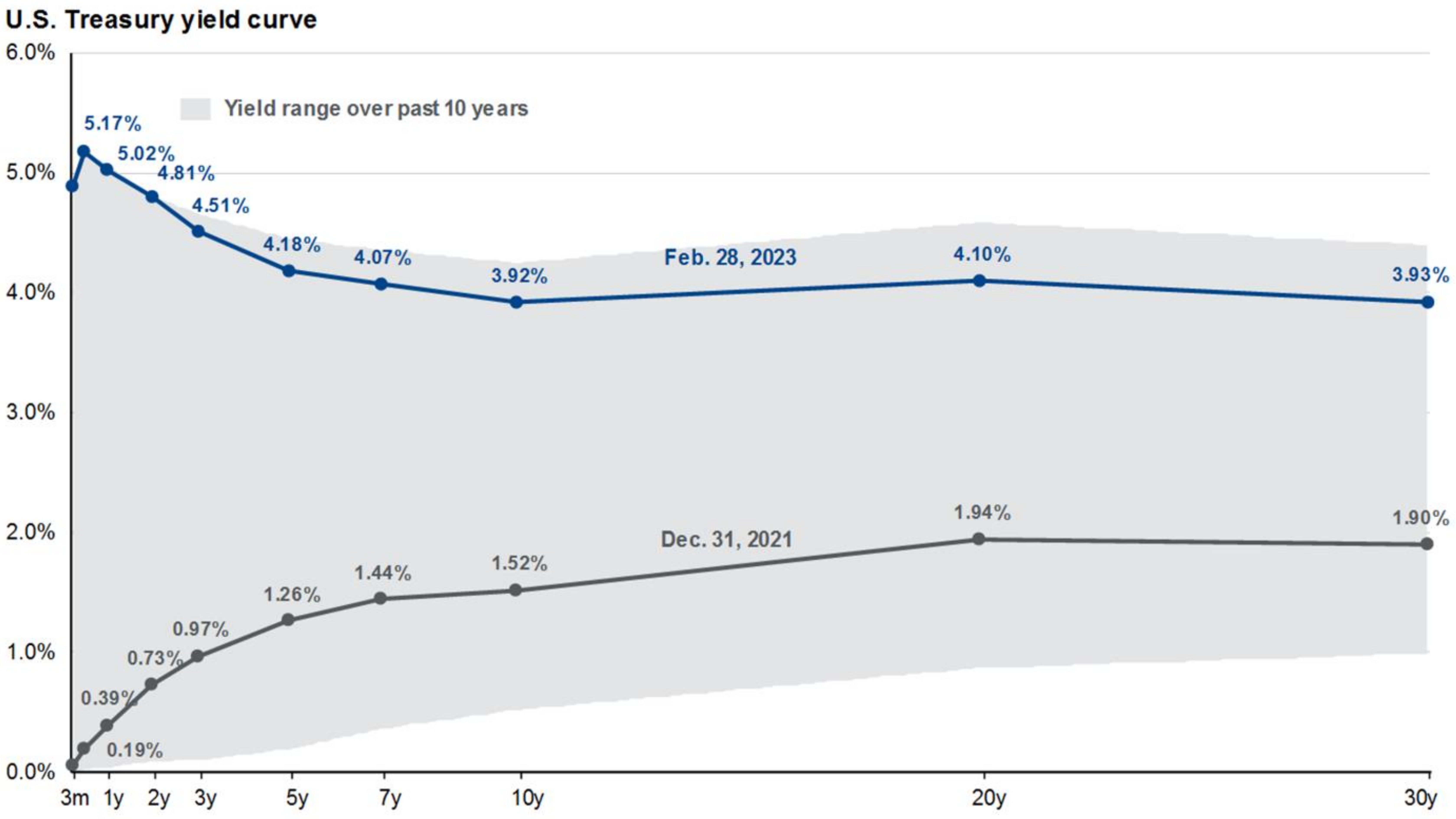
Sector	Rating	Maturity	Yield
Communications	BBB+	1Y	5.93%
Financials	A	1Y	5.70%
Auto	BBB+	9m	5.65%
Financials	BBB+	9m	5.60%
Financials	A-	9m	5.55%



Source: BlackRock

Fixed Income

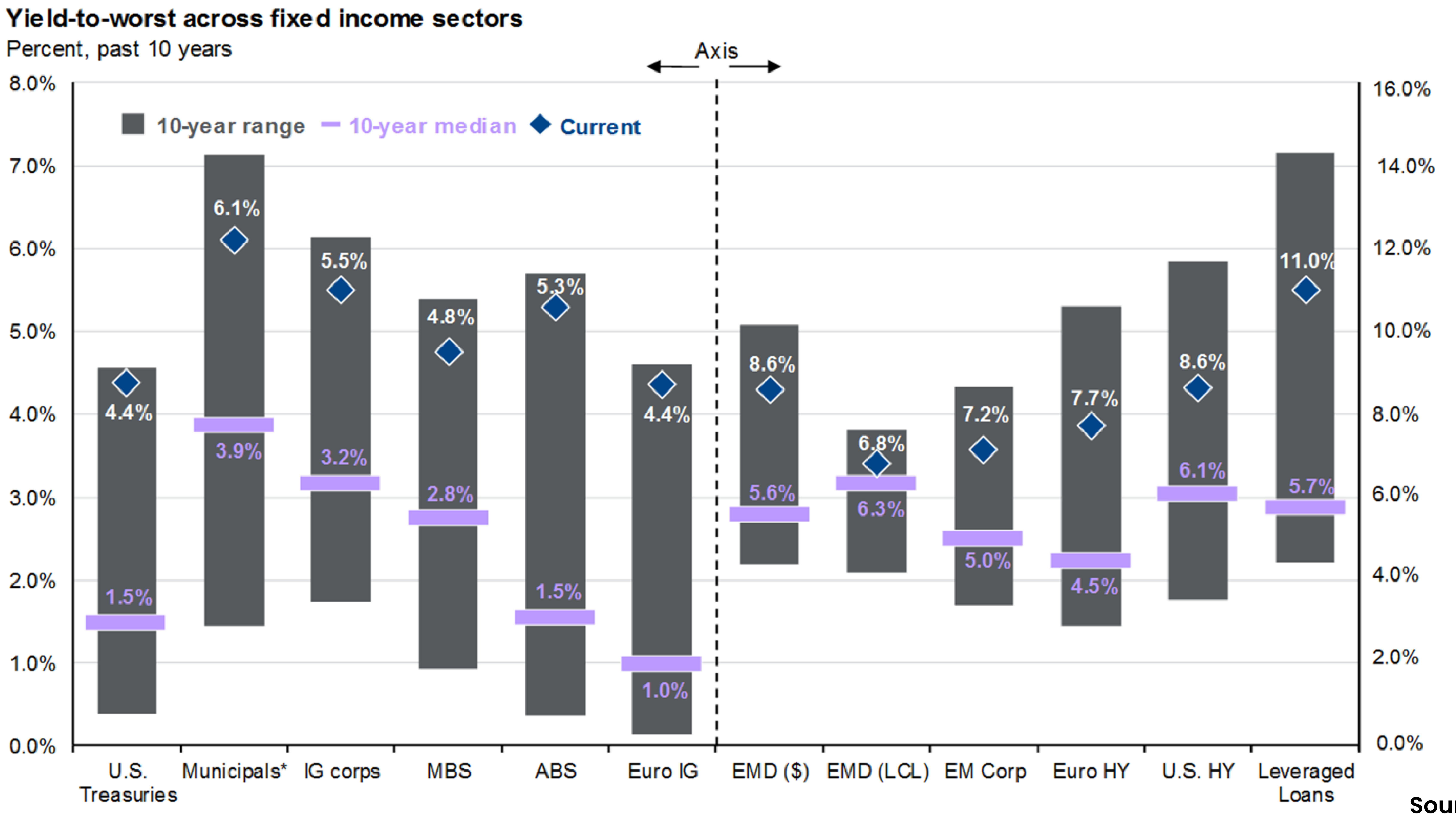
➢ **Inverted yield curve, gives us time to consider long-term options, instead of locking in duration risk…**



Source: JP Morgan, 2/28/2023

Fixed Income

➢ **Alternatively, reinvesting within your current allocation will "lock in" yields longer term**



Source: JP Morgan, 2/28/2023

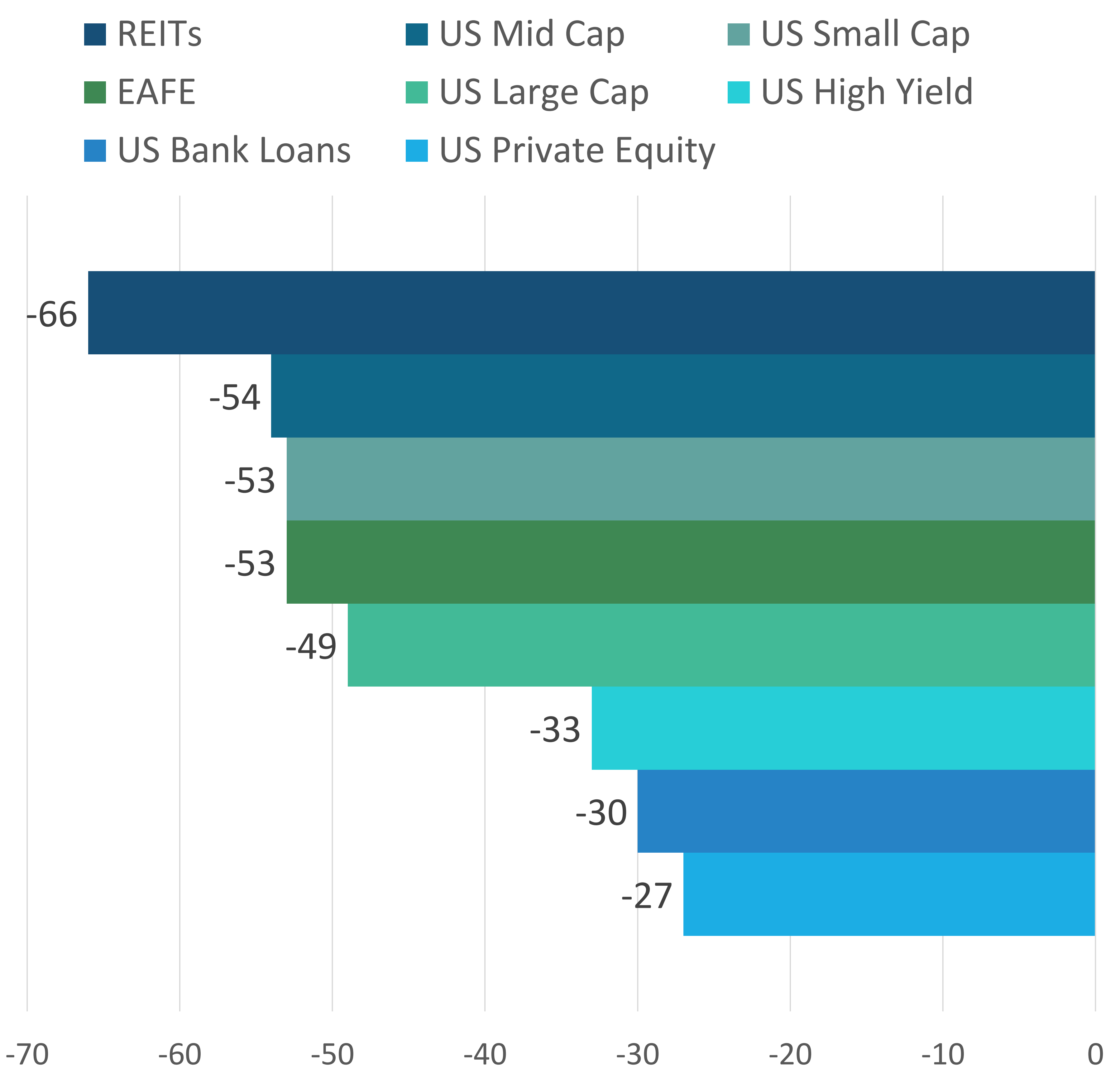
Fixed Income vs Equity

- Valuations in fixed income and equity were painful in 2022.

- Our investment horizon gives guidance as we navigate changing yields, relative upside, drawdowns, diversification benefits…

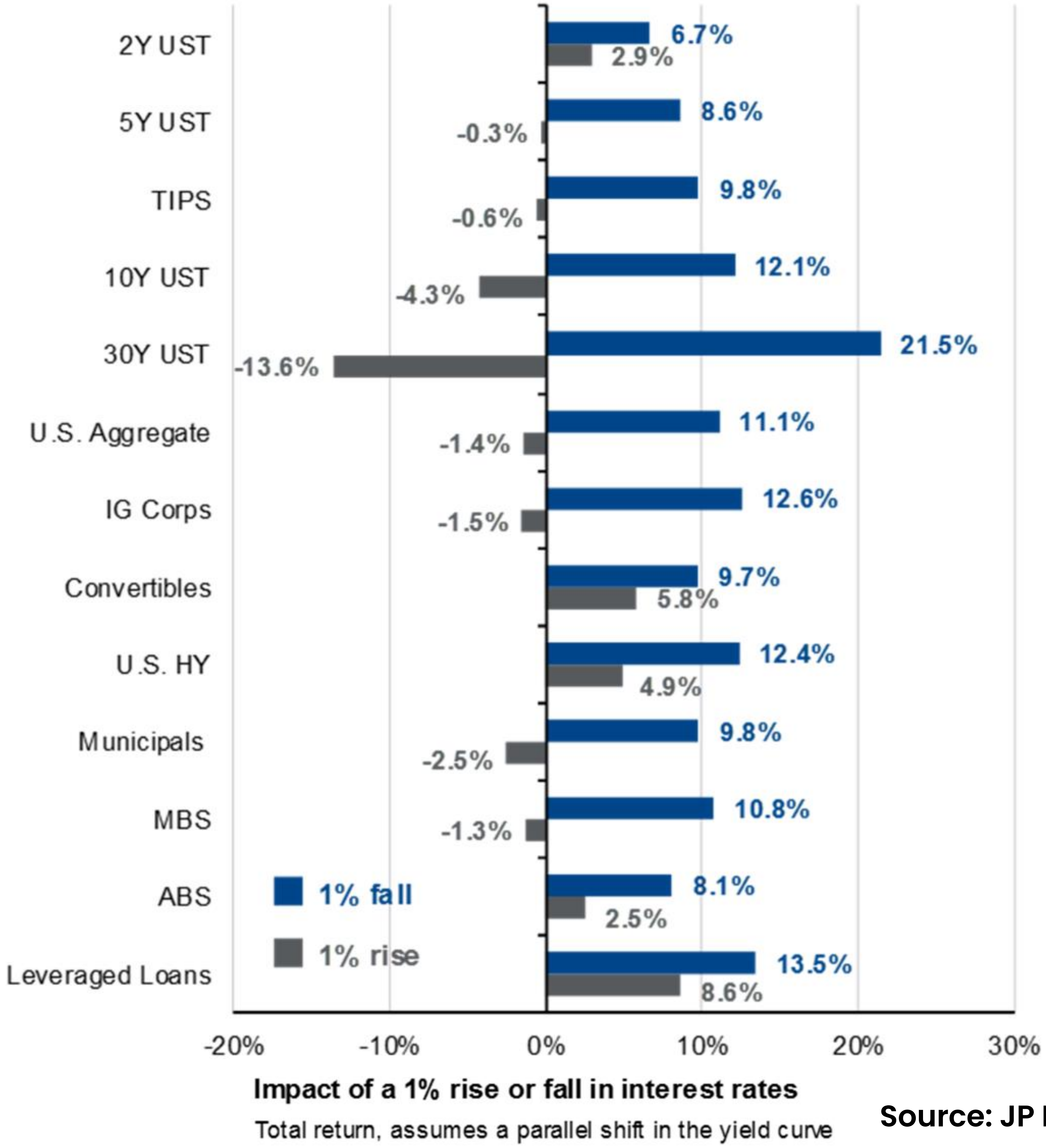
Fixed Income vs Equity

Risk Asset Drawdowns



Source: SAA; Zephyr; using month end data

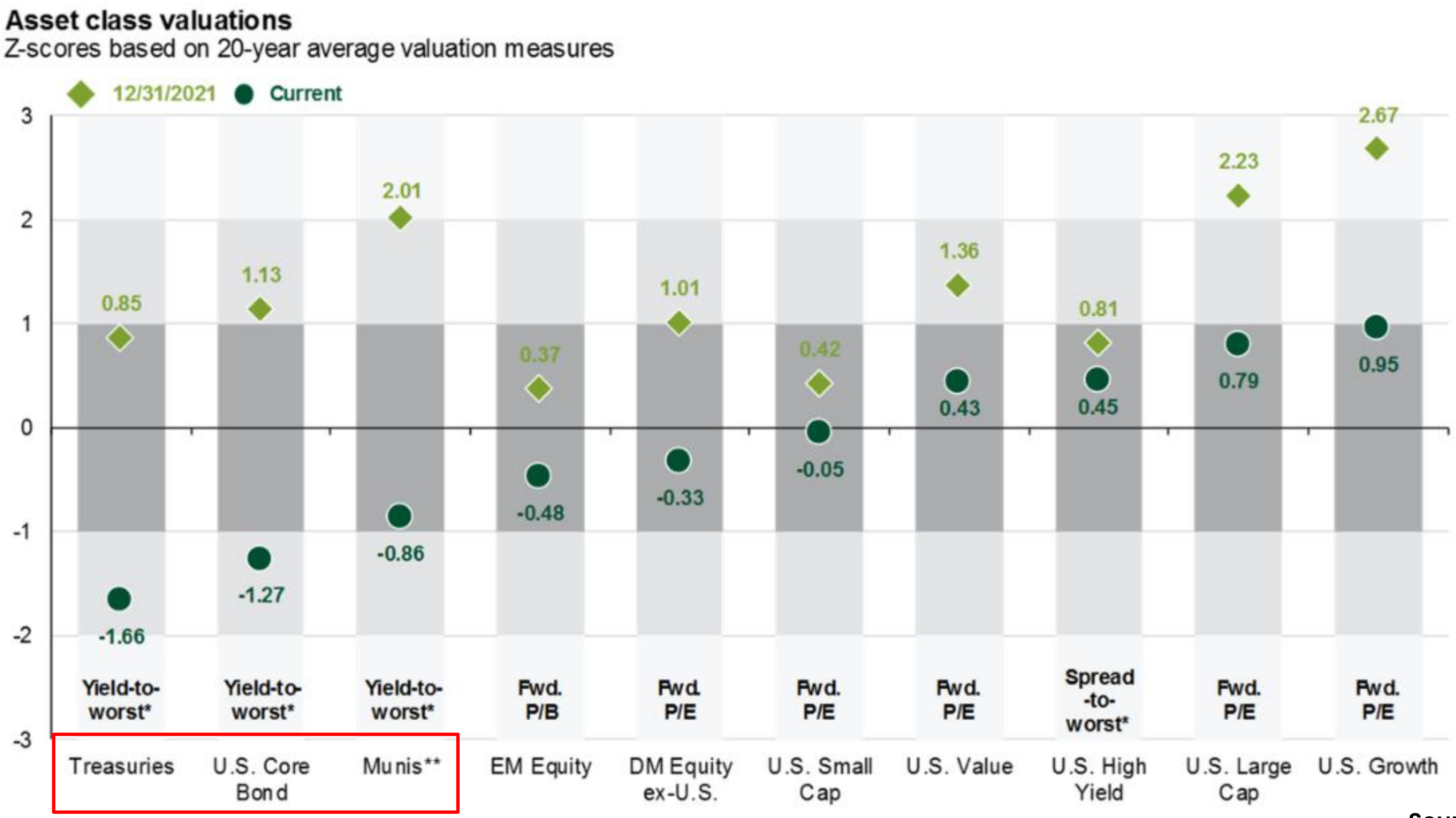
Interest Rate Risk (Total Return w/ 1% change in rates)



Source: JP Morgan, 2/28/23

Fixed Income vs Equity

➢ **Relative valuations favor higher quality fixed income**



Source: JP Morgan, 2/28/2023

Fixed Income vs Equity

What if a new regime takes root, with more frequent positive stock-bond correlations?

More volatile performance

Wider set of potential long-term outcomes

More extreme tail events

Deeper max drawdown

Key Takeaways

1) Yield premium driven by increased risk-free rate

2) Higher yields may not be worth the added volatility, relative to cash

3) Locking in higher yields vs getting paid for staying short, could both be good decisions

4) High quality fixed income may look more competitive vs equities

5) Equity tilt towards quality – and healthy balance sheets

Asset Allocation

Concern & Solution #3

Short-Term vs Long-Term

Short-Term	Long-Term
Headline Noise	Trends
Tactical Positioning	New Asset Classes
Manage Risk Appetite	Strategic Asset Allocation

Industry Trends

- Recognizing trends allows us to make informed strategic decisions within our Asset Allocation and Investment Policy Statement.

Example 1 - Properly account for unexpected liquidity needs due to material increase in illiquid assets across the industry

Example 2 - Growth of BBB Credit, variety of securitization, country/ regional factors

Example 3 - Asset classes are becoming more accessible

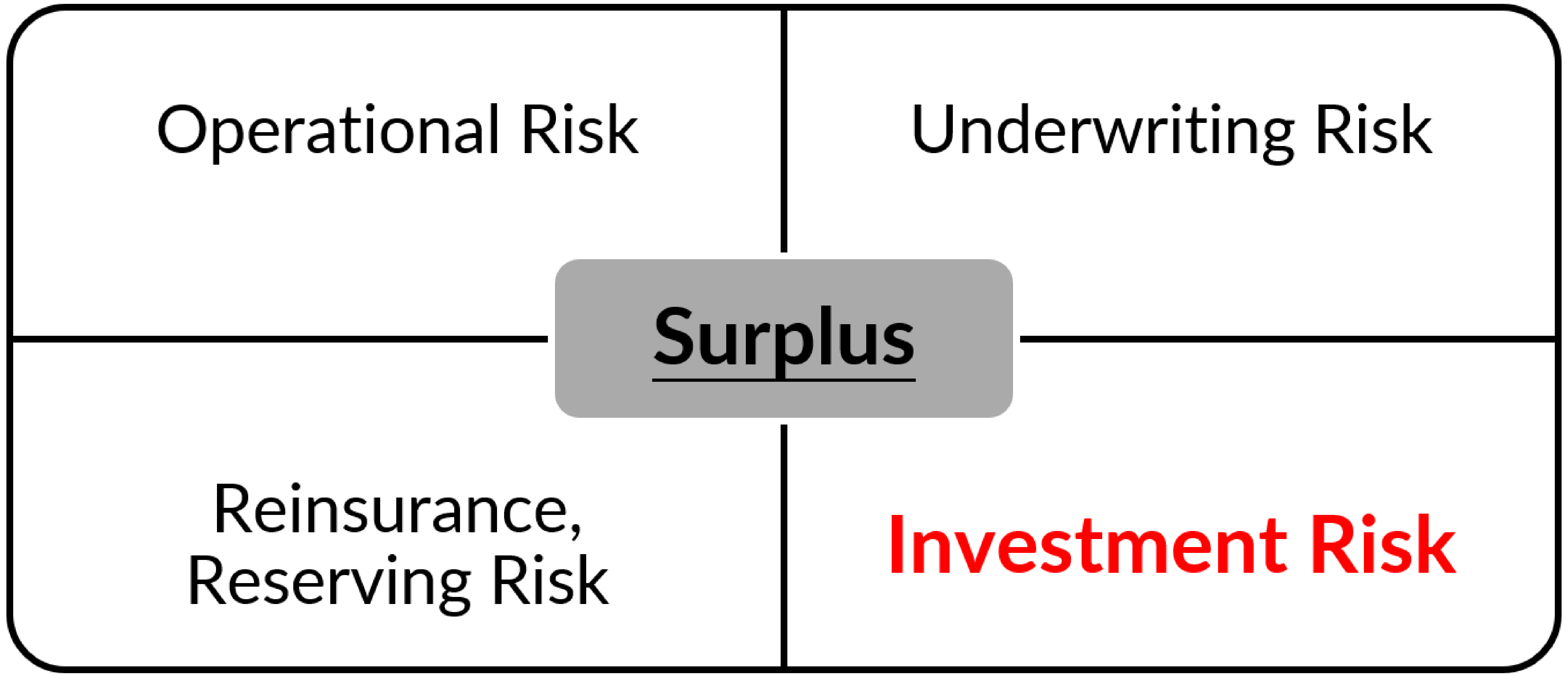
Identify Risks

1. Enterprise Risk Management (ERM)

2. Stress testing, Monte-Carlo, and scenario analysis

3. Proactive Management, Board Education, Discussion

Capital Efficiency



1) **Liquidity** – Can manage liquidity in 2023 and get paid for it
2) **Asset Valuations** – Avoid realizing losses for liquidity needs; higher yields provide options
3) **Allocation Considerations** – Tactical issues may not materially impact strategic outlook

Thank you

Questions?