



Survey: Exchange-Traded Funds & Active Fixed Income Management for Insurers

How have Fixed Income ETFs impacted active managers in the insurance space?



STRATEGIC ASSET ALLIANCE
THE INSURANCE INVESTMENT SPECIALIST

Introduction:

By design, insurance companies are never fully diversified; heavily allocating their portfolios towards investment-grade fixed income to account for policy holder obligations, reserves, and sufficient risk capital. Whether conducted internally or externally, insurers' fixed income allocations have predominantly been actively managed via a separate account. However, within the overall bond market, Fixed Income ETFs have become a pillar of the sector.

Given this shift, our team at Strategic Asset Alliance (SAA) conducted a survey focused on the impact that fixed income ETFs have had on active investment-grade fixed income managers working in the insurance space. This report summarizes our key findings.

Survey Overview:

SAA invited a myriad of fixed income managers working in the U.S. insurance space to participate in this survey - Thirty (30) firms submitted responses for this report.

Participating firms provided responses to ten (10) open-ended questions asked by SAA. SAA then reviewed each response and summarized the key takeaways and insights that will help insurance companies better understand how the rise of Fixed Income ETFs has affected active fixed income managers, such as their fees and management process.

For more information, please visit www.saai.com

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Survey: Exchange-Traded Funds & the Effect on Active Fixed Income Management

Thank You to Our Survey Participants!

We'd like to thank the investment management firms that participated in this survey to share their perspectives on how fixed income ETFs have affected active bond managers in the insurance space.

**Not all participating firms are listed below, per request*

AAM – Insurance Investment Management



Insurance Investment Management

Allspring Global Investments



American Century Investments



ASB Capital Management



Barings



Clearwater Advisors



Community Capital Management



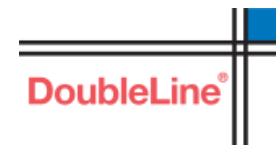
Conning



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(Continued)

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Garcia Hamilton & Associates



Manulife Investment Management



Invesco



Neuberger Berman



Income Research + Management



New England Asset Management



Nuveen



Longfellow Investment Management



Payden & Rygel



Macquarie



PMA Asset Management



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Principal Asset Management



Spectrum Asset Management



T. Rowe Price



TCW Group





Survey: ETFs & Active Fixed Income Management for Insurers

Executive Summary:

- Most firms view the rise of Fixed Income ETFs as a positive development in the bond market, particularly for liquidity, transparency, and diversification access, even if it technically generates greater competition for their firm.
- The growing prominence of Bond ETFs has essentially had no (or little) effect on firms' active management process.
- In the long-running debate of active vs. passive management, over a third of firms see a shift in the pros/cons of the debate.
- Most firms say active management fee schedules for fixed income management have been compressed (lowered) due to the growth of the Bond ETF market.
- While firms were split, the main area where technology has helped active bond management is operational efficiency.
- A small majority of firms still find the *Bloomberg Barclay U.S. Aggregate Index* to be an appropriate benchmark for fixed income portfolios.
- Nearly every firm believes the biggest impact Bond ETFs have had on fixed income markets is in liquidity or pricing.
- While most firms agree that A.I. will help both active and passive management in some way, it is still too early to truly tell the role that it will play.

Active Bond Manager Views: The Rise of Fixed Income ETFs

Overall, most firms believe the expansion of Fixed Income ETFs in the marketplace is a positive development for bond managers. While ETFs do create more competition for active management firms, the increased asset class flexibility provides more benefit to investors; which firms can utilize and leverage as part of their own processes.

Liquidity access, lower costs, and greater transparency were generally regarded as the key benefits seen by firms. Although, a few firms mentioned that Bond ETF's may not generally match the liquidity of the underlying securities.

For more information, please visit www.saai.com

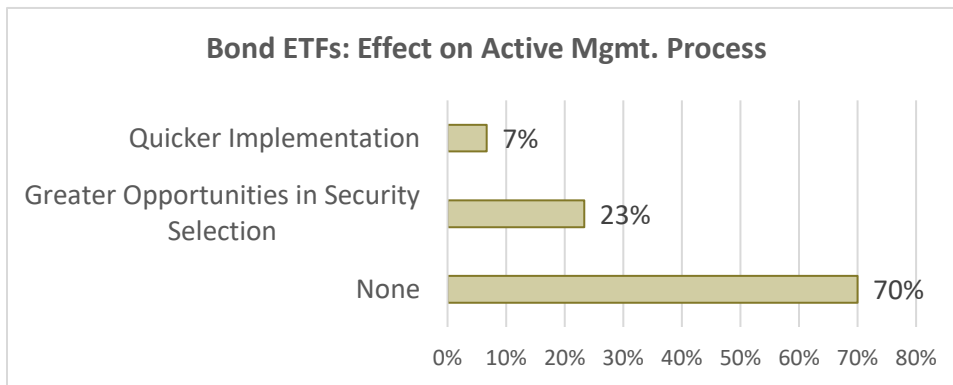
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For insurance companies, firms see Bond ETFs as a significant development, because it provides another (potential) vehicle for insurers to tailor their portfolio to match specific liability profiles and risk appetites. However, a few firms highlighted that although developments in the ETF space have grown rapidly, they still lag active managers when it comes to providing a fully customized portfolio that insurance companies typically require.

Effects on the Active Management Process

The growth of Bond ETFs has fundamentally had no effect on firms’ active management process, although some firms believe it has led to greater opportunities in security selection, as well as faster implementation.

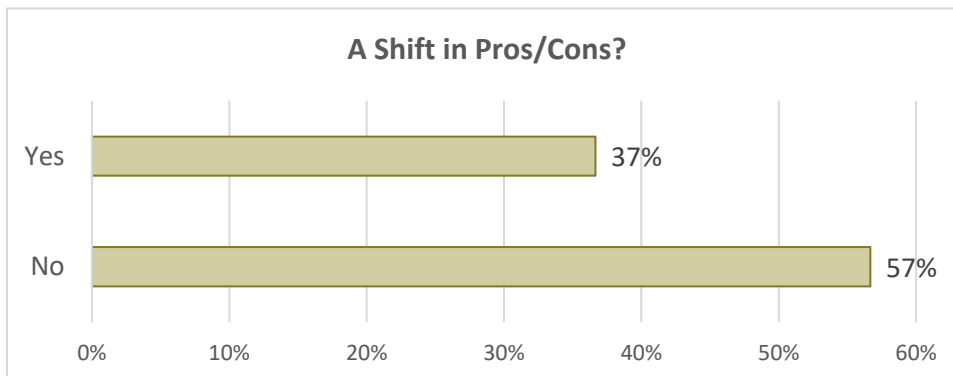


Active Management:

A “Buy and Sell” strategy, where securities are directly bought and sold to make up the portfolio, with trades conducted constantly to outperform a benchmark.

Active vs. Passive Management: Have Pros/Cons Shifted?

In the long-running debate of active vs. passive management, over a third of firms see a shift in the pros/cons of the debate. These firms primarily believe the shift has moved towards active management, with its benefits now becoming more pronounced in the marketplace.



Passive Management:

A “Buy and Hold” strategy, where securities are held for longer periods (with minimal trading) to match a certain benchmark over the long-term.

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Pros & Cons: Active Management vs. Passive Management:

Regardless of their views on shifts within the ongoing debate, firms found these to be the pros and cons of active and passive management in the current fixed income environment:

Active Management:

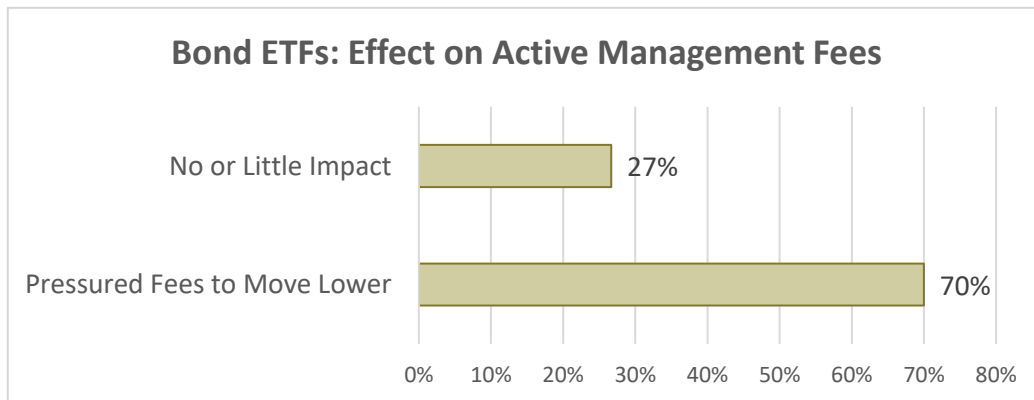
- Pros:**
 - Greater Control & Opportunity with Security Selection
 - Greater Potential for Outperformance
- Cons:**
 - Higher Costs and Greater Return Variability
 - Evaluating an Appropriate Active Manager Carries More Nuances

Passive Management:

- Pros:**
 - Lower Fees (Typically) & Simplicity
 - Liquidity and Price Discovery
 - The Availability of NAIC-Rated ETFs is Growing
- Cons:**
 - More Difficult to Match Risk and Duration for Insurance Portfolios
 - Performance Tied to the Selected Benchmark

Are Bond ETFs Affecting Fee Schedules for Active Managers?

Most firms say active management fee schedules for fixed income have been compressed (lowered) due to the growth of the Bond ETF market. Many firms believe that this fee compression would have occurred with or without the prominence of Fixed Income ETFs; However, it did speed up the process.



For firms that say there's been no or little impact on fee schedules, their general reasoning is that fee trends and expectations are shifting for reasons completely unrelated to the ETF space.

For example, a couple firms noted that it is not uncommon for active managers to lower fee schedules in order to gain greater access to client assets (thus, increasing AUM). Others state that fees for insurers have always been lower than other investor types, regardless of whether its for passive or active management.

Lastly, a few firms noted that the industry itself is simply facing expectations to lower costs, while still providing exemplary service.

Fixed Income Management: Standard Fee Comparison

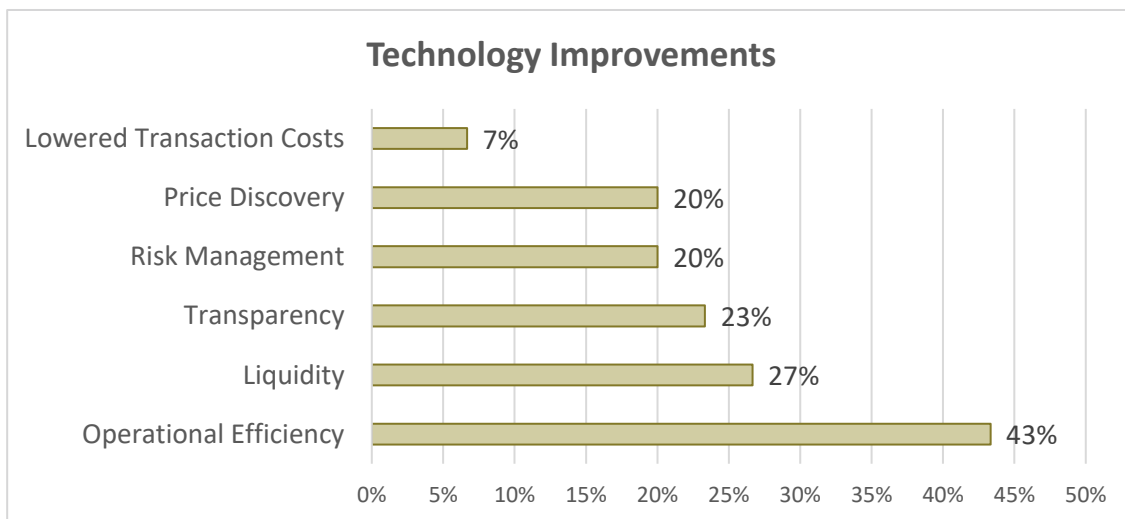
As a resource for insurers, we've compared fees, across various portfolio sizes, among managers in the insurance space.

[View Here >>](#)

Technology Improvements for Active Management

While firms were split, the main area where technology has helped active bond management is operational efficiency, which has provided active managers with the ability to manage more clients, as well as higher asset totals. Whether via trading platforms or other advanced data analytics, firms also stated that technology advancements provided their staff with more robust ways to assess pricing data, as well as manage risk based on current market conditions.

In general, technology advancements, particularly the ability to quickly receive and analyze data, has made managers more connected with the fixed income space. Thus, allowing for real-time transparency, greater capacity, and faster reactions to shifts in the market.



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Bloomberg Barclay's U.S. Aggregate Index: Still an Appropriate Benchmark?

A (small) majority of firms still find the *Bloomberg Barclay U.S. Aggregate Index* (“The Agg”) to be an appropriate benchmark for fixed income portfolios. While these firms generally agree that The Agg is not perfect, they also agree that it still works very well in capturing the broader investment-grade marketplace. Additionally, The Agg continues to evolve, which helps it remain a consistently reliable benchmark.

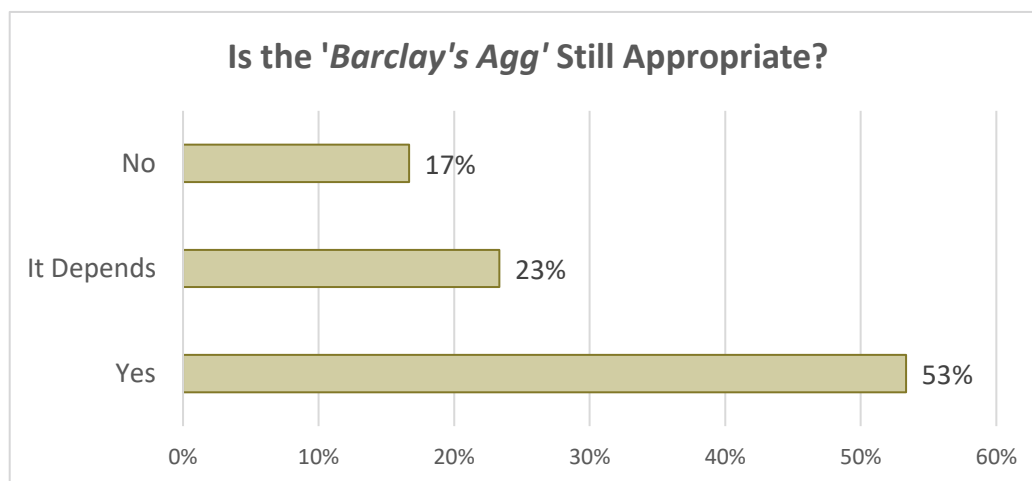
Nearly a quarter of firms believe The Agg is still an appropriate benchmark for the same reasons noted above. However, they add that its suitability as a benchmark truly depends on the client’s portfolio structure and needs, especially for insurance companies. For example, a client may need to be slightly more liquid than what The Agg represents, so that needs to be taken into account when measuring performance. Risk profiles (*i.e. credit quality*) also differ greatly across insurance companies, which is another factor in assessing how suitable The Agg is as a benchmark.

For firms that don’t believe The Agg is still an appropriate benchmark, the main reason is due to the makeup of the index. Most will point to The Agg’s heavy concentration towards U.S. Treasury debt. There is also a lower inclusion of Corporate Bonds than what would likely be seen in an insurer’s portfolio. This has resulted in The Agg having a longer duration and lower book yield than many clients will see within their portfolio. Some firms even stated that The Agg “can easily be beat.”

“The Agg”

The “*Bloomberg U.S. Aggregate Bond Index*” is structured to broadly represent the performance of U.S. traded investment-grade bonds.

For decades, The Agg has been the industry-standard benchmark for comparing fixed income portfolios.

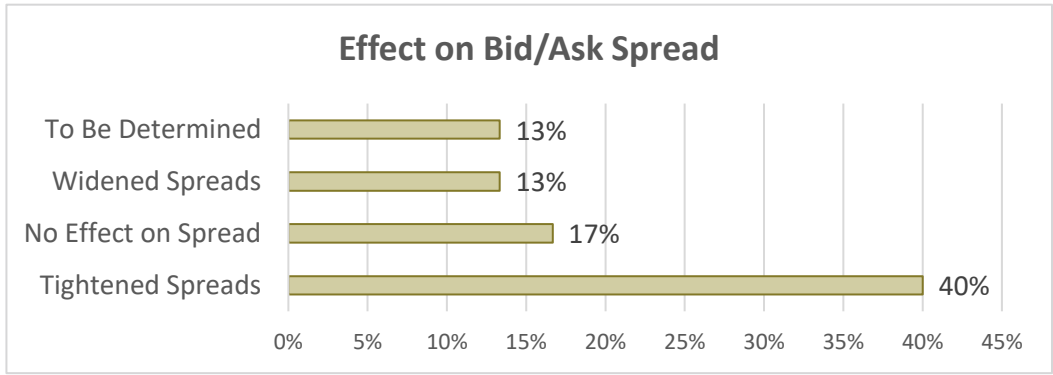


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Effect on Bid/Ask Spreads for Fixed Income Securities

Responses were mixed, with most firms believing that the ETF market has created tighter spreads across fixed income markets, driven by the improved liquidity that Bond ETFs have been able to provide investors.



Bid/Ask Spread:

The difference between the highest price a buyer is willing to pay for a security vs. the lowest price a seller is willing to accept.

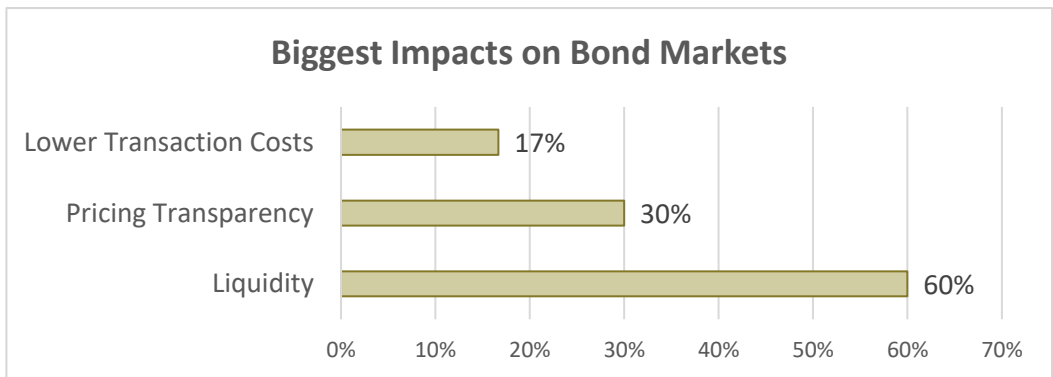
A 'wider' spread typically indicates higher transaction costs and less liquidity in the marketplace. Conversely, a 'tighter' spread typically indicates the opposite.

Bond ETFs: Biggest Impact on Fixed Income Markets

Most firms believe the biggest impact Fixed Income ETFs have had on the bond market is in improving liquidity. Firms agree these liquidity improvements are due to the fact that ETFs are providing more access and more efficient way for investors to trade.

Nearly a third of firms say the biggest impact is in the transparency of pricing. Since ETFs are traded on exchanges, it has generated more real-time pricing information that can be used by investors and asset managers.

Lastly, a handful of firms say the biggest impact can be seen in lower transaction costs. Since Bond ETFs offer the ability for a large list of bonds to be traded within one transaction, it has driven lower transaction costs within the bond space.



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— The Role of A.I. in Fixed Income Management

While most firms agree that A.I. will help both active and passive management in some way, the general consensus among firms is that it is still too early to truly tell how A.I. will be used by bond managers.

For active management, firms say A.I. will likely play a role in extracting insights from marketplace data and securities research.

For passive management, firms say A.I. will likely provide support in the implementation and trading process.

About Strategic Asset Alliance:

SAA is an independent investment consulting firm that works exclusively with insurance companies and insurance-oriented public entities. Founded in 1994, our experience and focus enable us to help clients improve their investment process and enhance the value added by their portfolios; critical components of their business.

We provide insurers and risk pools with independent investment advisory services (we do not manage assets) to aid their board members and staff in meeting fiduciary responsibilities, along with strengthening their investment program.