

Perspectives

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OUR VIEW ON INSURANCE CAPITAL MANAGEMENT TOPICS

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Alternative Investments – What is New?

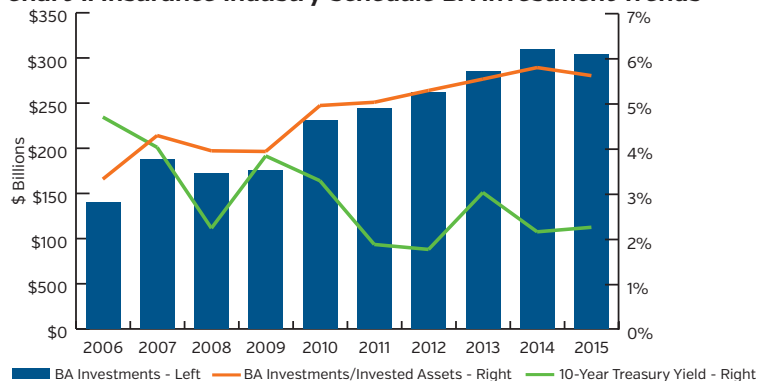
The challenging low-interest-rate environment has compelled the insurance industry to consider non-traditional asset classes to generate higher investment returns. Alternative investments¹, reported under schedule BA of U.S. statutory reporting, have received substantial attention and interest. In the last 10 years, the U.S. insurance industry has doubled its allocations to Schedule BA investments from \$141 billion to \$304 billion; however, the levels of allocation vary by industry segment and company size. The increasing allocation to alternative asset class has been driven by large insurance companies and remains highly concentrated. More than half of Schedule BA assets are reported as affiliated investments, which accounted for most of the growth in BA investments.

In this issue of *Perspectives*, we review trends of the Schedule BA investments of the U.S. insurance industry and compare those investments across the Property/Casualty, Life, and Health segments.

HISTORICAL TRENDS AND OBSERVATIONS OF SCHEDULE BA INVESTMENTS

At year-end 2015, the industry's Schedule BA investments had a book/adjusted carrying value (BACV) of \$304 billion, which accounted for 5.6% of the industry's \$5.4 trillion of total invested assets. Ratios for the industry's BA investment/invested assets increased steadily until 2015 when they experienced a slight decline. This trend in BA allocation contrasts with the drop in the 10-year Treasury yield.

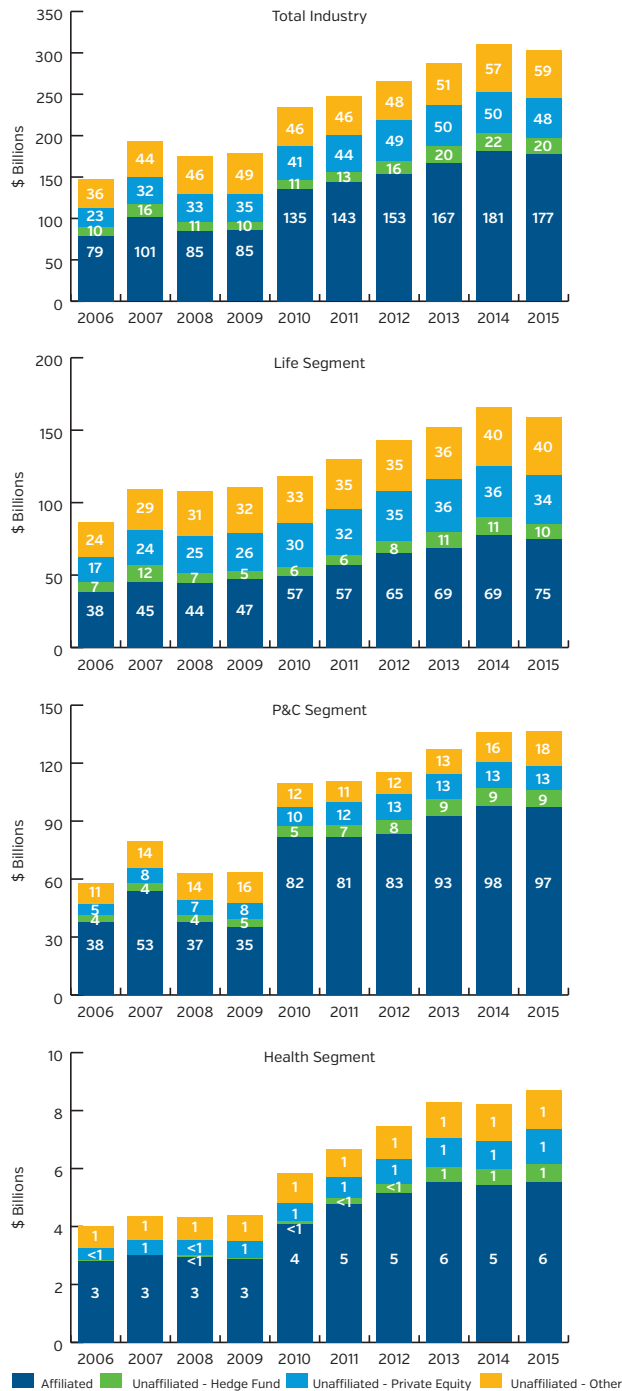
Chart 1. Insurance Industry Schedule BA Investment Trends



Source: SNL Financial and NEAM

Chart 2 shows Schedule BA investments, both affiliated and unaffiliated, for the overall industry and individual segments. All segments experienced significant growth in these investments in the past 10 years. Within the BA assets of the overall industry, the affiliated exhibited a 125% growth while the unaffiliated showed an 83% increase from 2006 to 2015. Property/Casualty and Health showed a notable BA investment increase in 2010, while the Life segment's BA assets trended up gradually and steadily. As of year-end 2015, the industry's \$304 billion BA assets were split among segments: Life = \$158 billion, Property/Casualty = \$137 billion and Health = \$9 billion.

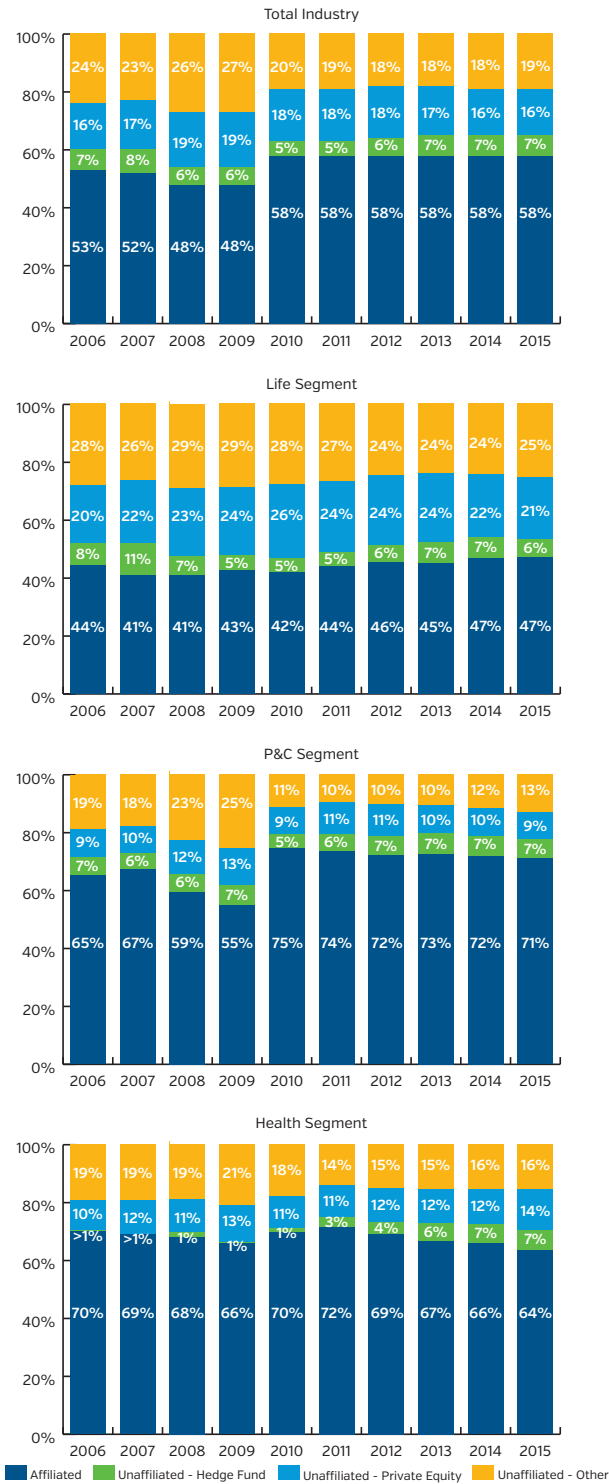
Chart 2. Schedule BA Assets by Affiliation and Segment (Amount)



Source: SNL Financial and NEAM

Chart 3 shows a breakdown of percentages of Schedule BA investments by affiliated and unaffiliated, the overall industry and individual segments. As of year-end 2015, 58% of the industry's BA investments were categorized as affiliated. Industry breakdowns (affiliated and unaffiliated) have remained consistent since 2010. Across segments, Property/Casualty holdings are predominately affiliated, while Life holdings are split more evenly between affiliated and unaffiliated. Private equity is more dominant in the Life segment than in Property/Casualty and Health.

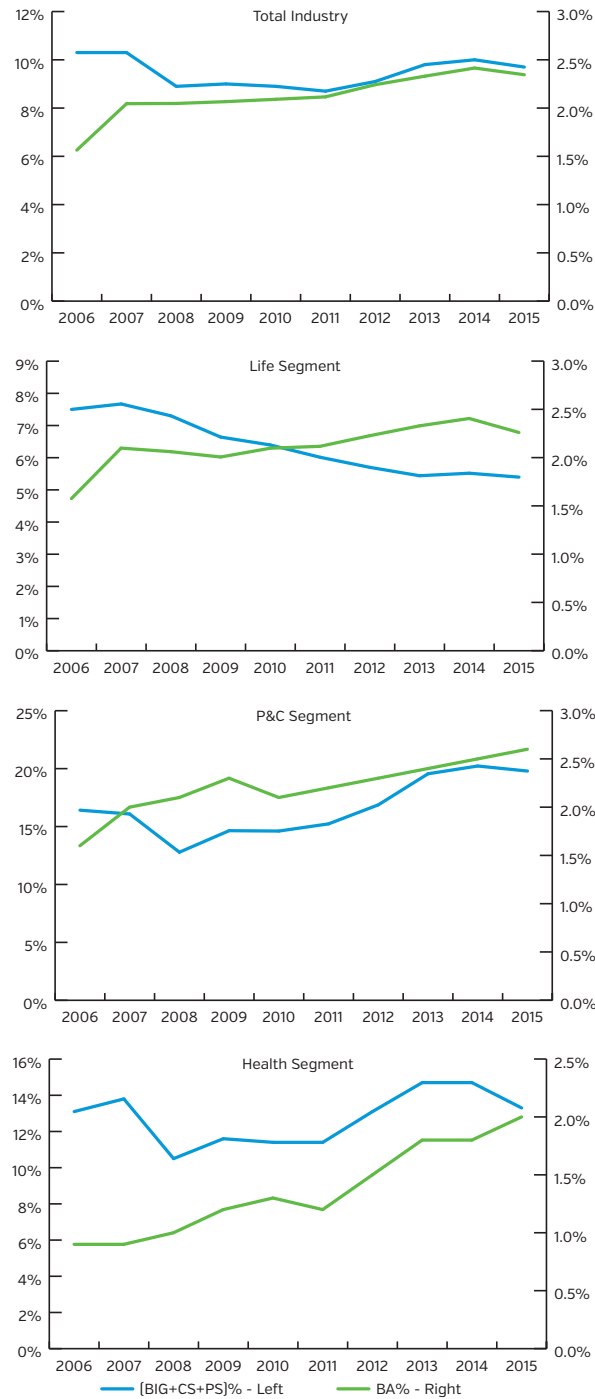
Chart 3. Schedule BA Assets by Affiliation and Segment (Percent)



Source: SNL Financial and NEAM

Chart 4 compares the “unaffiliated” Schedule BA investments with the “unaffiliated” risk assets [i.e., unaffiliated common stock, preferred stock and below investment grade bonds] as a percent of the invested assets. Overall, the industry has been increasing BA investments and risk assets modestly since the 2009 financial crisis. The Life segment, unlike the Property/Casualty and Health segments, has reduced its risk asset allocation while increasing its BA allocation.

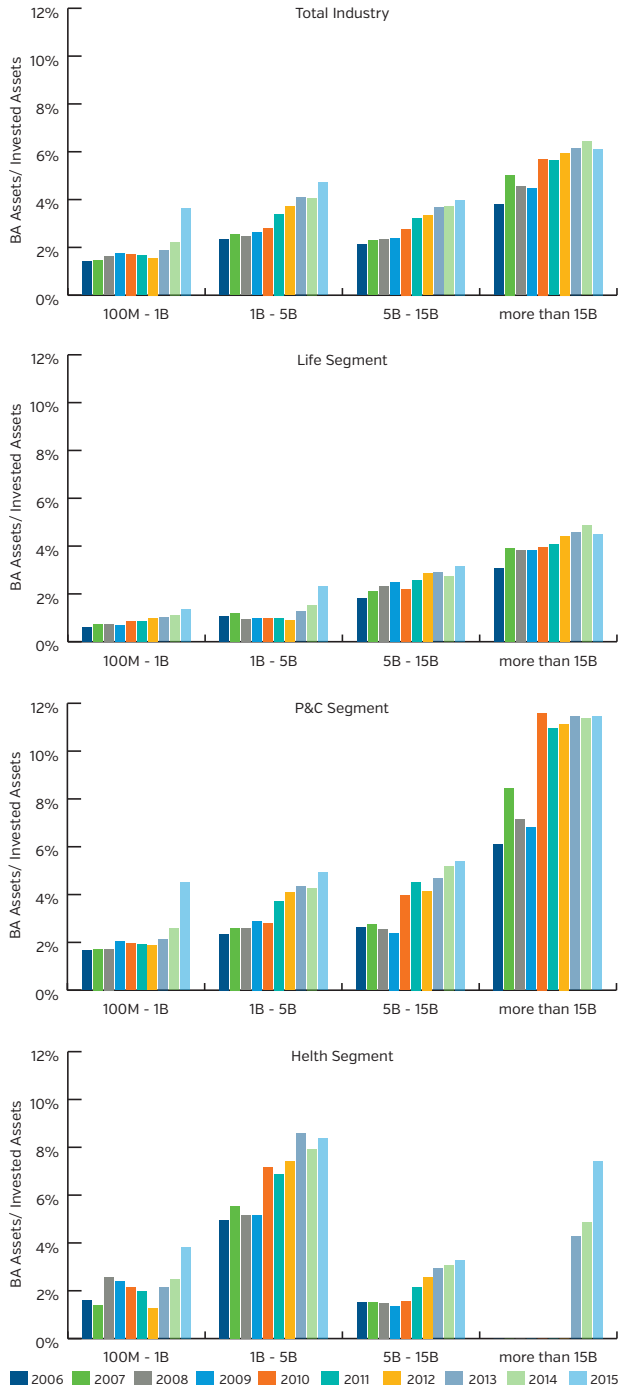
Chart 4. Unaffiliated Schedule BA Assets vs. Unaffiliated Risk Assets Allocations



Source: SNL Financial and NEAM

Chart 5 shows Schedule BA allocations, as a percent of invested assets, by company size for each segment. In general, larger companies have higher BA allocations than smaller companies, except for the Health industry. The Property/Casualty segment has the highest allocations among all industry segments, and is driven primarily by one insurance group.

Chart 5. Schedule BA Assets by Company Size and Segment

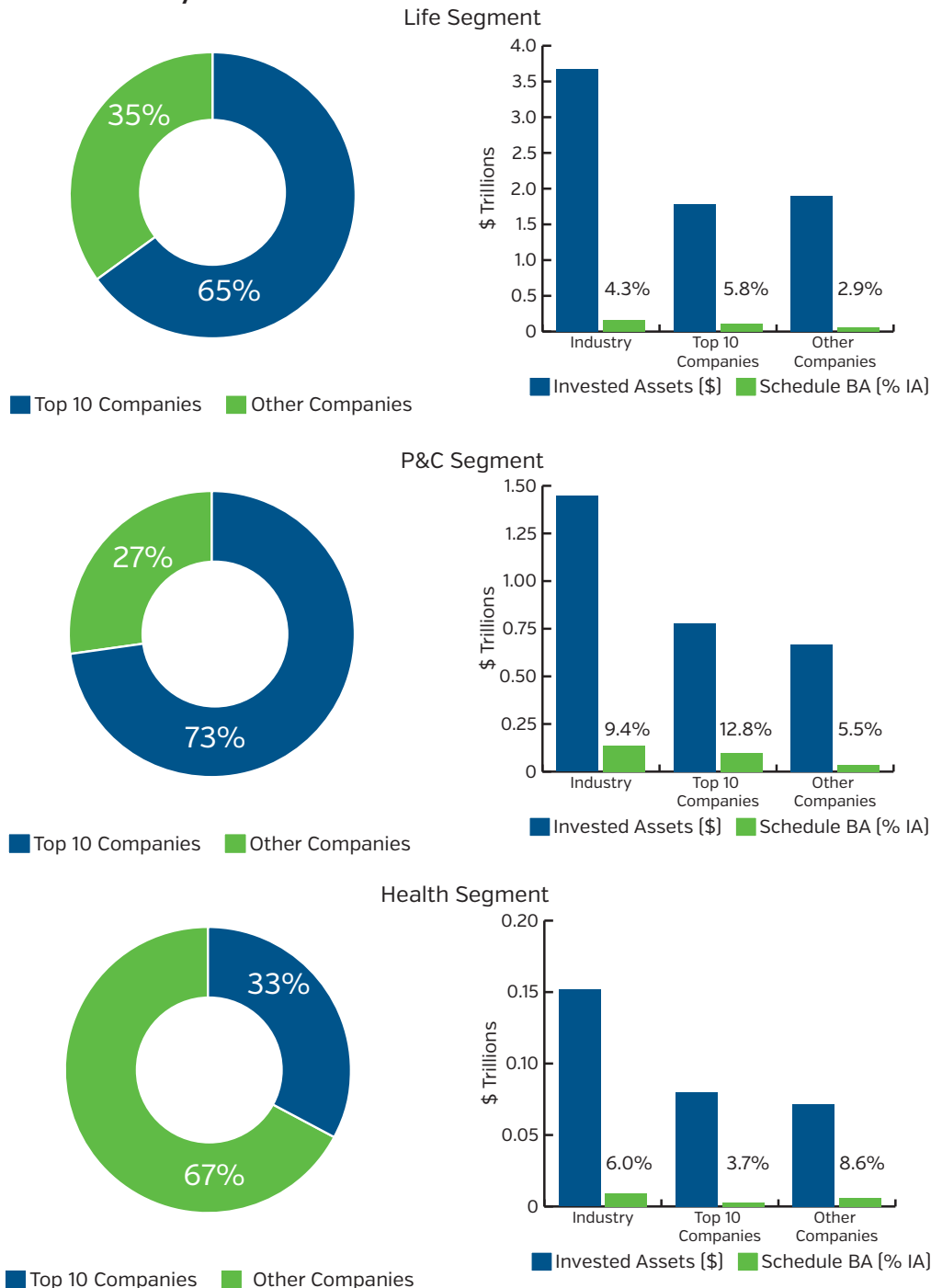


Source: SNL Financial and NEAM

YEAR-END 2015 SCHEDULE BA INVESTMENTS BY SEGMENT

Chart 6 shows that the industry's BA assets are concentrated significantly within large insurers, except for the Health segment. The top 10 Property/Casualty insurers own 73% of the segment's BA investments and their BA allocations, as a percent of their total invested assets, are much higher than the rest of the segment [12.8% vs. 5.5%]. The top 10 Health insurers' BA investments only represent 3.2% of their total invested assets.

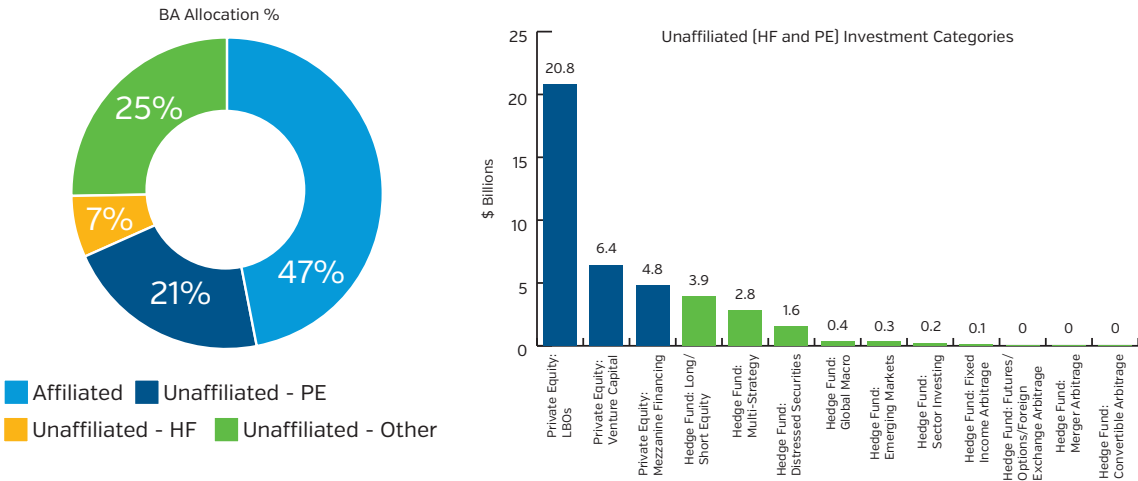
Chart 6. Industry Schedule BA Distribution



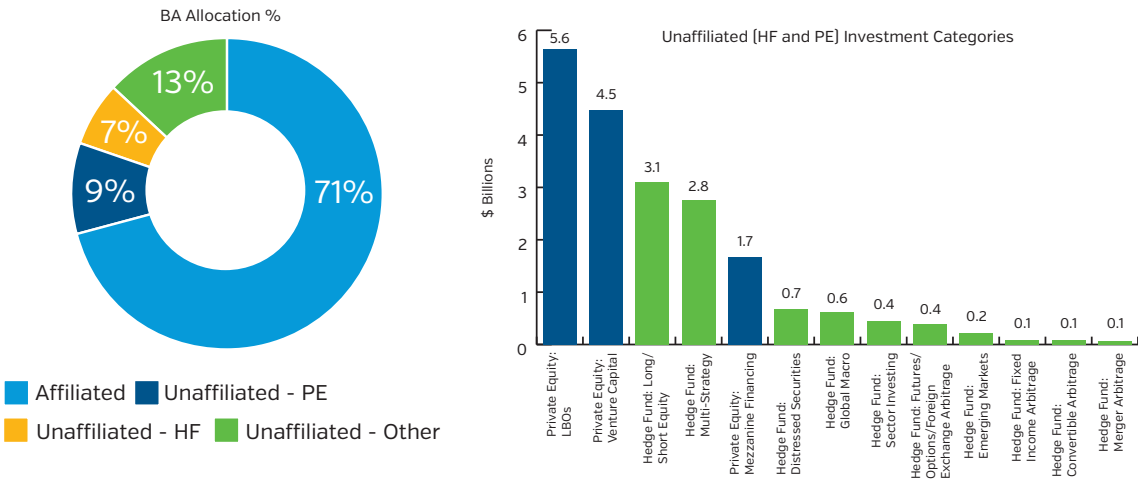
Source: SNL Financial and NEAM

Chart 7 shows that private equity and hedge funds represent the lion's shares of BA unaffiliated investments. Private equity is dominated by leverage buyout (LBO) and venture capital (VC) types. Hedge fund investments can have myriad strategies and focuses and long or short equity appears to be the most popular among the insurance industry. As of year-end 2015, private equity allocations are relatively higher than hedge funds across Life, Property/Casualty and Health segments.

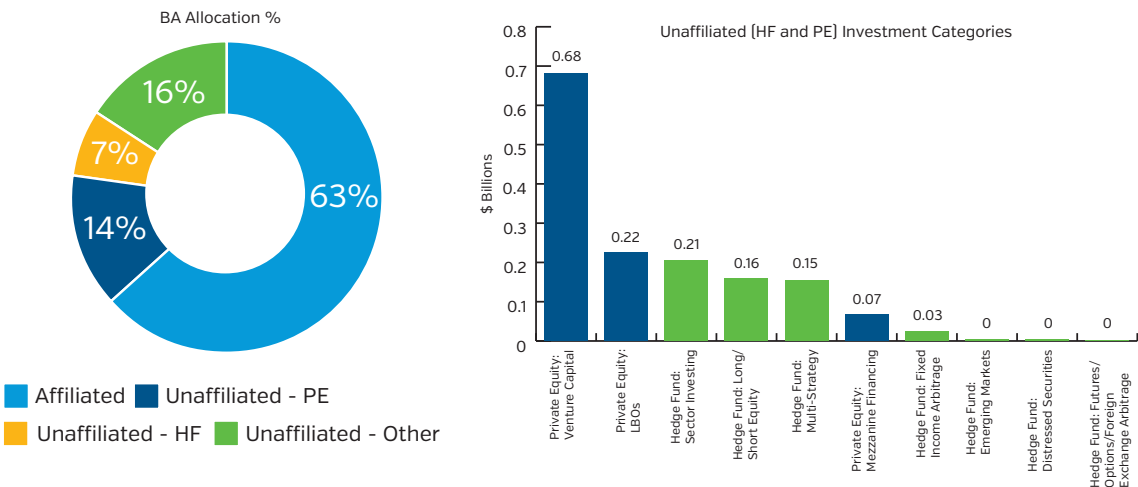
Chart 7. 2015 Private Equity and Hedge Fund BA Unaffiliated Investments by Segment
Life Segment



P&C Segment



Health Segment



Source: SNL Financial and NEAM

SUMMARY AND CONCLUDING REMARKS

Insurers' alternative investments in dollar terms have doubled for the last 10 years, driven by growth in Schedule BA investments by large companies. The top 10 insurers own roughly two thirds of the industry's total BA investments. BA allocations, as a percent of invested assets, generally increase with the size of the company, except for the Health segment.

Although Property/Casualty had less Schedule BA investments in dollar terms than Life, its' allocation percentage was more than double that of the Life segment. Fifty-eight percent [\$177 billion] of the industry's \$304 billion BA assets were reported as affiliated, with the percent of the Property/Casualty segment's affiliated investment significantly higher than the Life and Health segments.

The modest upward trend of increasing unaffiliated BA investments coincides with similar movement seen in the unaffiliated risk assets allocation for the overall industry; however, the Life segment appears to offset the additional BA assets by reducing its allocation to risk assets.

Large companies dominate Schedule BA investments. This is particularly the case within the Property/Casualty segment, where the top 10 insurance companies represent 54% of the segment's invested assets but own 73% of the segment's BA assets. Although the Health segment's BA investments are not as concentrated in the top 10 insurance companies as the Property/Casualty and Life segments, this segment only represents 3% of the overall industry's BA assets [\$9 billion of \$304 billion as of 2015].

Schedule BA assets are invested in a wide range of asset types. Private equity and hedge funds are two major categories of reported BA investments. Private equity is more prevailing in the Life segment and hedge fund allocations are at a similar level [approximately 7%] across Life, Property/Casualty and Health.

We will continue to monitor BA assets and provide insights and implications for the industry. Please contact us if you would like to benchmark your schedule BA investments with your peers.

ENDNOTE

¹ Schedule BA assets encompass a wide range of long-term assets, including private equity, hedge funds, mineral rights, transportation equipment, surplus notes, secured and unsecured loans, and housing tax credits.



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