

# In a Divergent World, Readiness Rules

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# Partnering with insurers since 1990

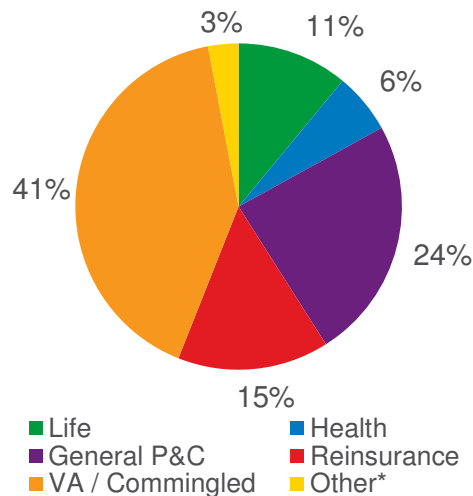
We leverage our scale and industry insights to create deep, lasting partnerships with insurers

- ▶ Team of 86 client service professionals located in New York, San Francisco, Princeton, London, Munich, Copenhagen, and Milan
- ▶ Manage \$352 billion in unaffiliated general account and subadvisory assets for 145 insurers in 25 countries

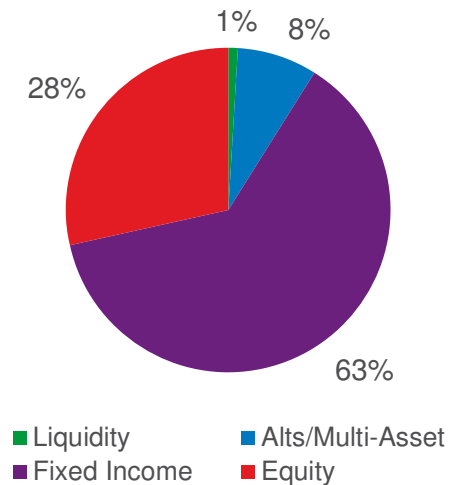
Extensive experience working with clients of all sizes across asset classes, geographies, and regulatory regimes

## Asset management capabilities

AUM by line of business

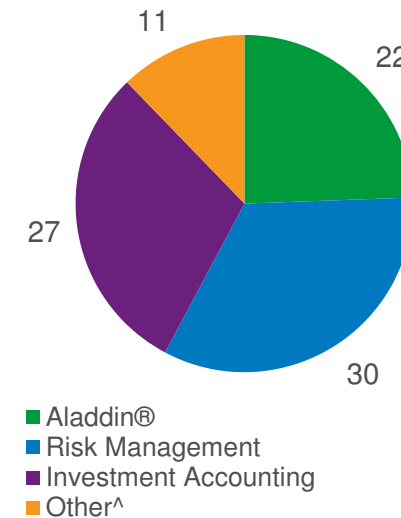


AUM by Asset Class



## Risk management expertise

Number of clients by service provided\*\*

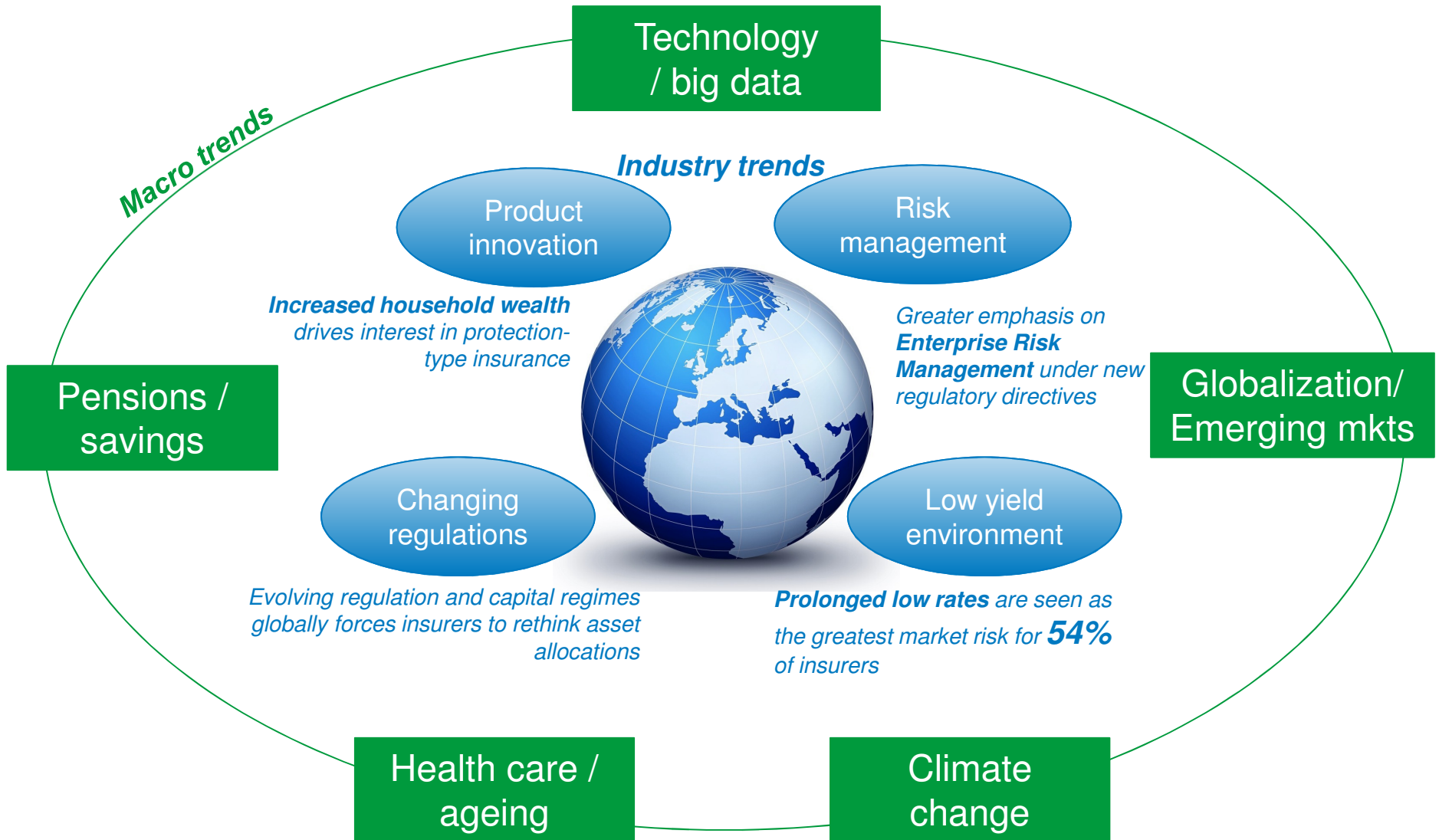


As of 30 September 2014; AUM does not include iShares®. \*Includes Settlement Trusts and Financial Guaranty

\*\* Because some clients engage BlackRock Solutions (BRS) for multiple services, the total number of assignments does not equal the total number of BRS clients

^Includes Financial Markets Advisory & operations outsourcing

# Global trends



Base: North America (n=63) EMEA (n=106) APAC (n=44) LAI (n=30); Q2: Which of the following do you consider to be the most serious market risks to your firm's investment strategy / portfolio over the next three years? Select up to two. Source: The Economist intelligence Unit hereinafter referred to as the "EIU Survey." Please see Important Notes for more information about the survey.

# Amid a challenging environment for insurers, readiness rules in 2015

Insurers continue to be pressured by a flood of alternative capital and 'low for longer' yields



*With uncertainty ahead, build your portfolio for the long term; diversify thoughtfully and look for idiosyncratic opportunities*

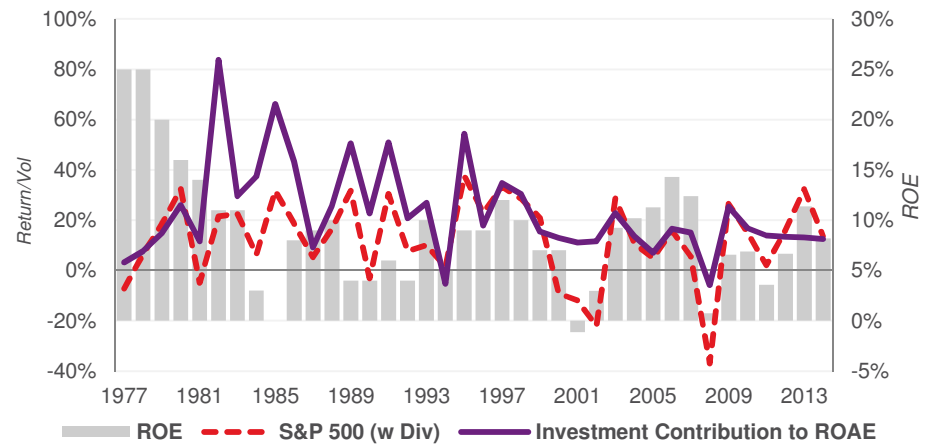
Source: The above represents BlackRock's views as of 12/31/2014

# Is the cycle dead?

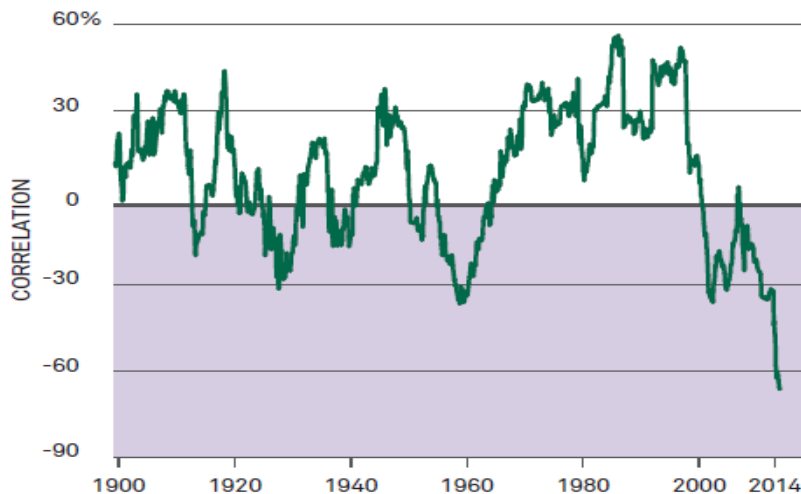
## Investment contribution to ROAE: low returns / low leverage

- ▶ Volatility in most assets classes is around 20-year median
- ▶ Diversification in traditional equity and fixed income portfolios is challenged
- ▶ Very little room for rates to fall further, implying cost of bonds to hedge equity exposure is rising
- ▶ The cost of being wrong is increasing when surplus capital is at risk

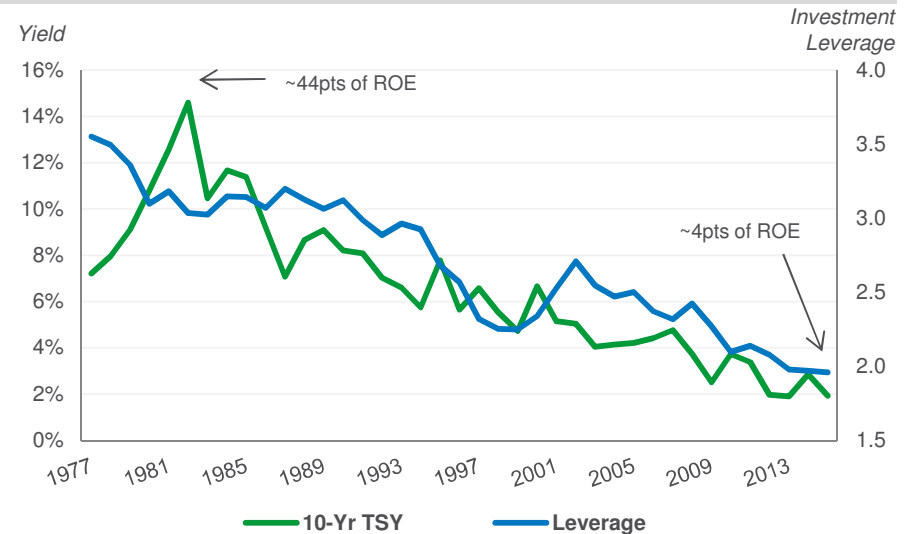
Realized Volatility by Asset Class 1994 - 2014



U.S. Equity and Bond Price Correlation, 1900–2014



Income under pressure; low yields and low leverage



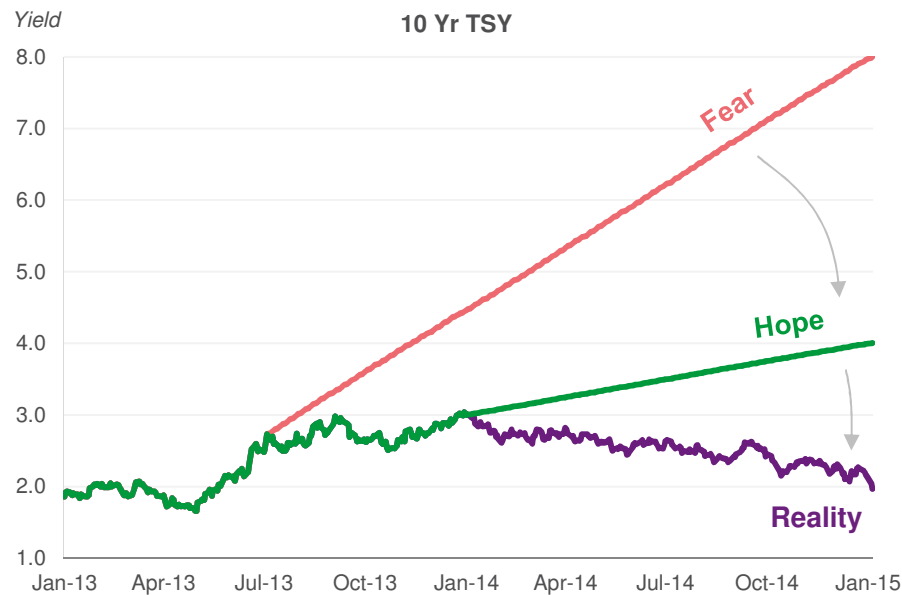
Sources: Blackrock Investment Institute and Thomson Reuters, Top Right – December 2014

# Investment income drives capital generation, but where will you find it?

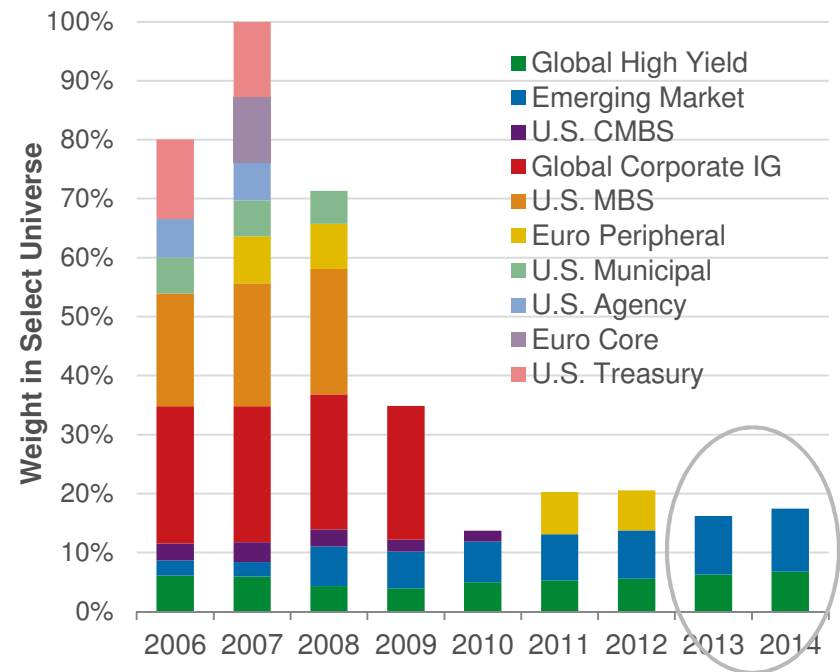
Despite having lived through years with large drawdowns, insurers have been reliant on investment income to maintain capital

Despite past fear of a sharp rise in rates, yields are expected to remain under pressure

Re-evaluate asset allocation in a prolonged low yield environment



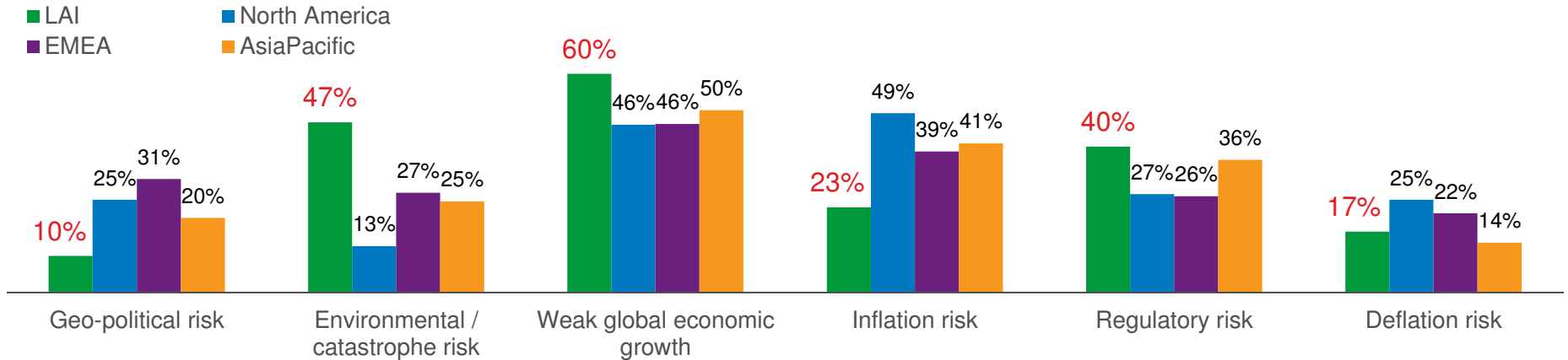
Investment income drives capital accumulation



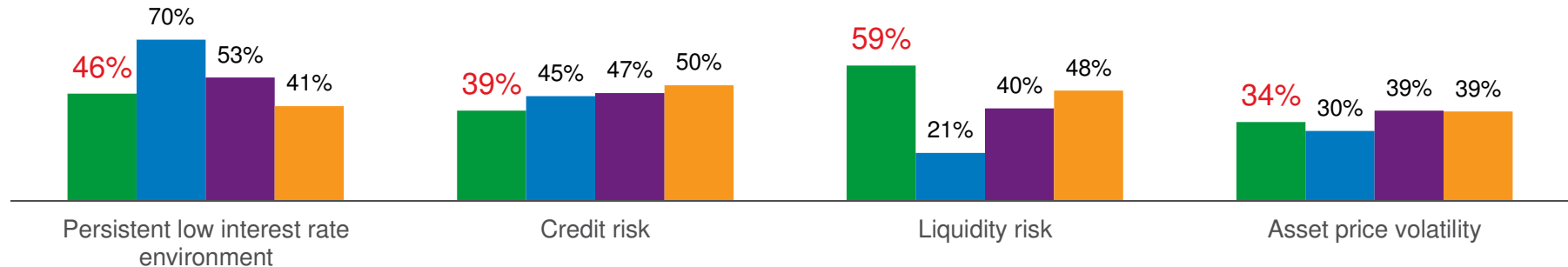
Source: Bloomberg, SNL  
Data is based on statutory holdings and does not capture unrealized changes in fixed income

# Mixed concerns across the globe on macro and market risks

## Weak global economic growth is seen as the top macro risk

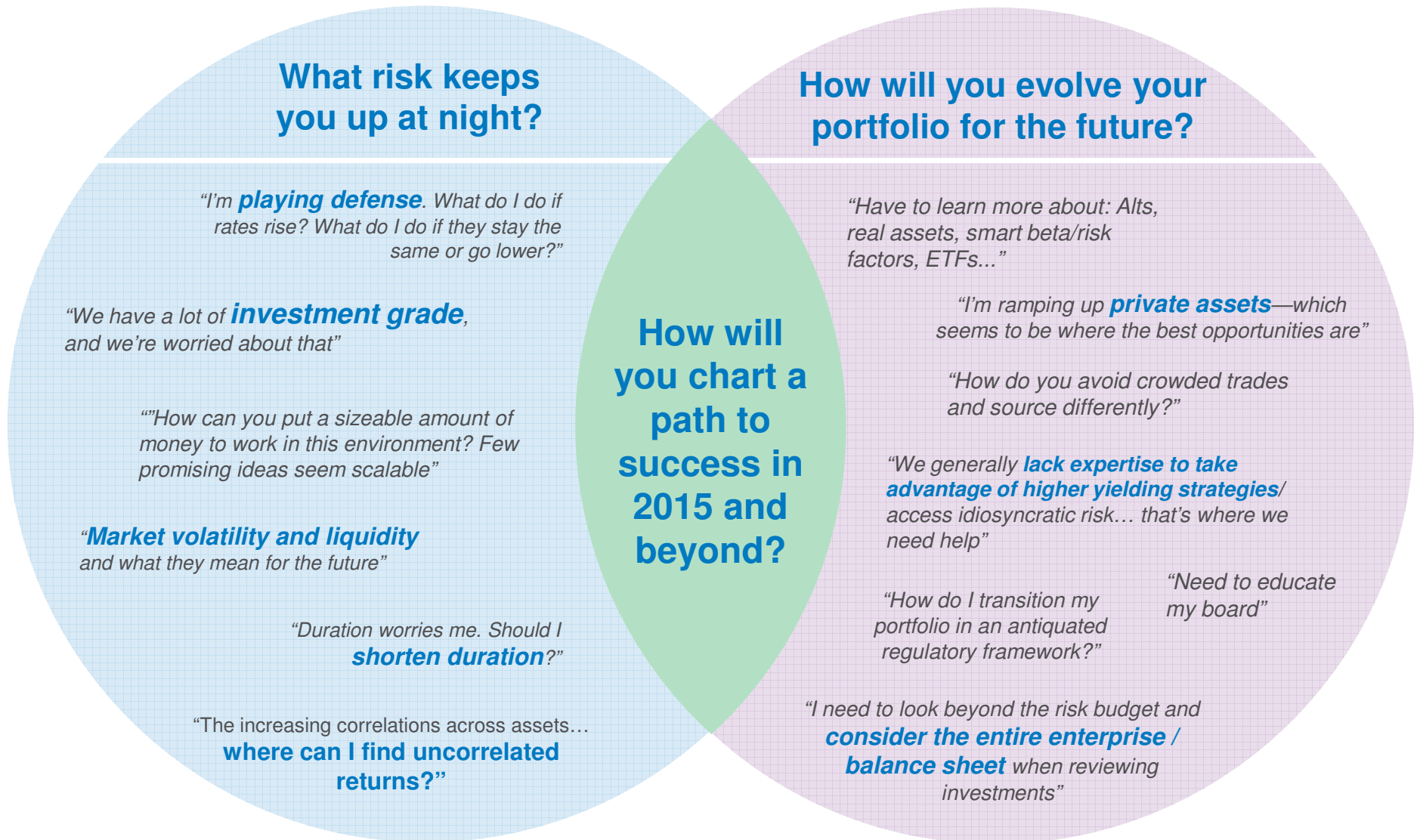


## Meanwhile, LAI investors are concerned about liquidity risk



Base: North America (n=63) EMEA (n=106) APAC (n=44) LAI (n=30); Q1: Which of the following do you consider to be the most serious macro risks to your firm's investment strategy/ portfolio over the next three years? Select up to two.; Q2: Which of the following do you consider to be the most serious market risks to your firm's investment strategy / portfolio over the next three years? Select up to two. Source: EIU Survey

# What our clients are saying

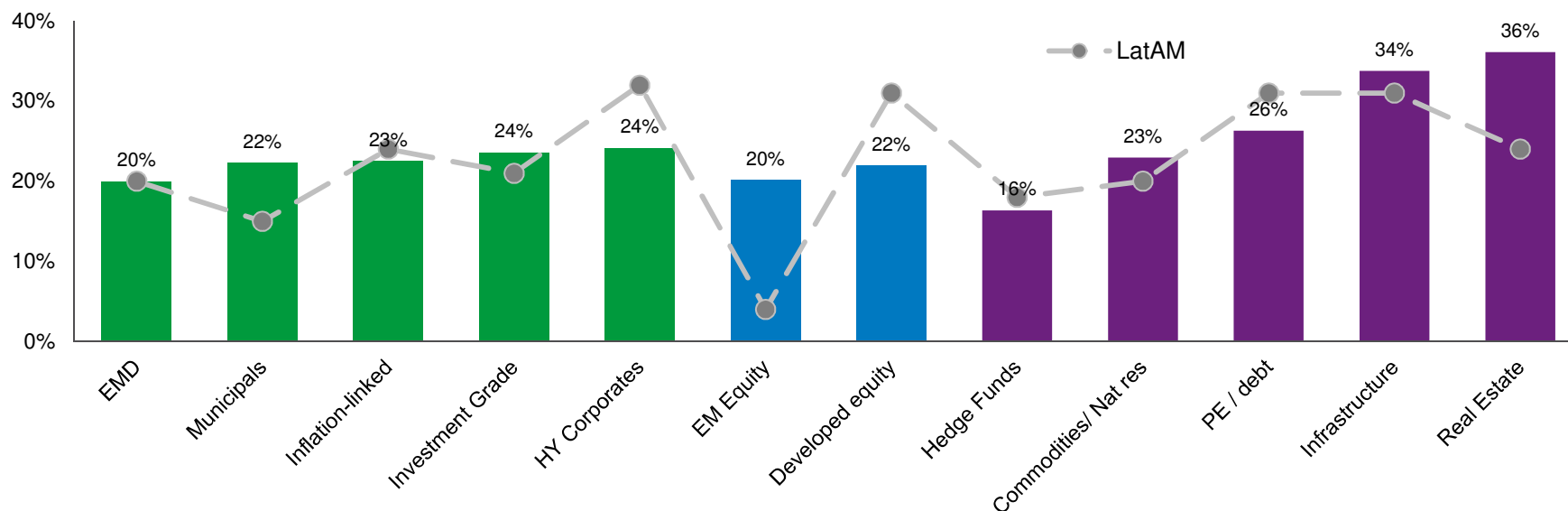


Source: Blackrock



# Insurers are reacting by changing their portfolio compositions

In light of the perceived risks and challenges in traditional fixed income investments, many intend to **increase their exposure to investments in diversifying asset classes over the next 12 months:**



BlackRock's Positioning	Fixed Income	Equity	Alternatives
	<ul style="list-style-type: none"> <li><b>US:</b> Short front end rates with curve flattening bias / <b>Europe:</b> Long duration, but with steepening bias in long end</li> <li><b>UK:</b> Spreads have room to compress /</li> <li><b>Europe:</b> ECB activity to benefit spreads</li> <li>Some potentially attractive entry points for <b>EMD</b> but expect continued volatility</li> </ul>	<ul style="list-style-type: none"> <li><b>US:</b> Prefer energy, technology and mega cap to expensive consumer and small cap</li> <li><b>Europe:</b> Reasonable valuations are balanced against a still soft recovery</li> <li><b>EM:</b> Volatile, but relatively cheap valuations. Prefer EM Asia.</li> </ul>	<ul style="list-style-type: none"> <li>Maintain a <b>strategic allocation to hard assets</b></li> <li><b>Real estate</b> drivers include urbanization and demographics, funding gap left by bank shrinkage; favor Asia</li> <li><b>Infrastructure debt</b> can offer stable cash flows and long duration at attractive yields</li> </ul>

Base: Global (n=243)

Question: For each of the following assets classes, please indicate how, if at all, you will be changing your investments over the next 12 months? % saying 'Increase'

Source: EIU Survey

# Dealing with divergence in 2015 – some thoughts to discuss

1

## Understand your asset allocation within the context of new regulations

Know what you own and ensure it delivers the diversification, performance, and rewarded risk that you expect

2

## Employing real assets for return and diversification

Expand your real asset allocation to support your need for income, return, diversification, and inflation protection

3

## Constructing a diversified fixed income portfolio

Utilize the full fixed income toolkit for diversification and flexibility

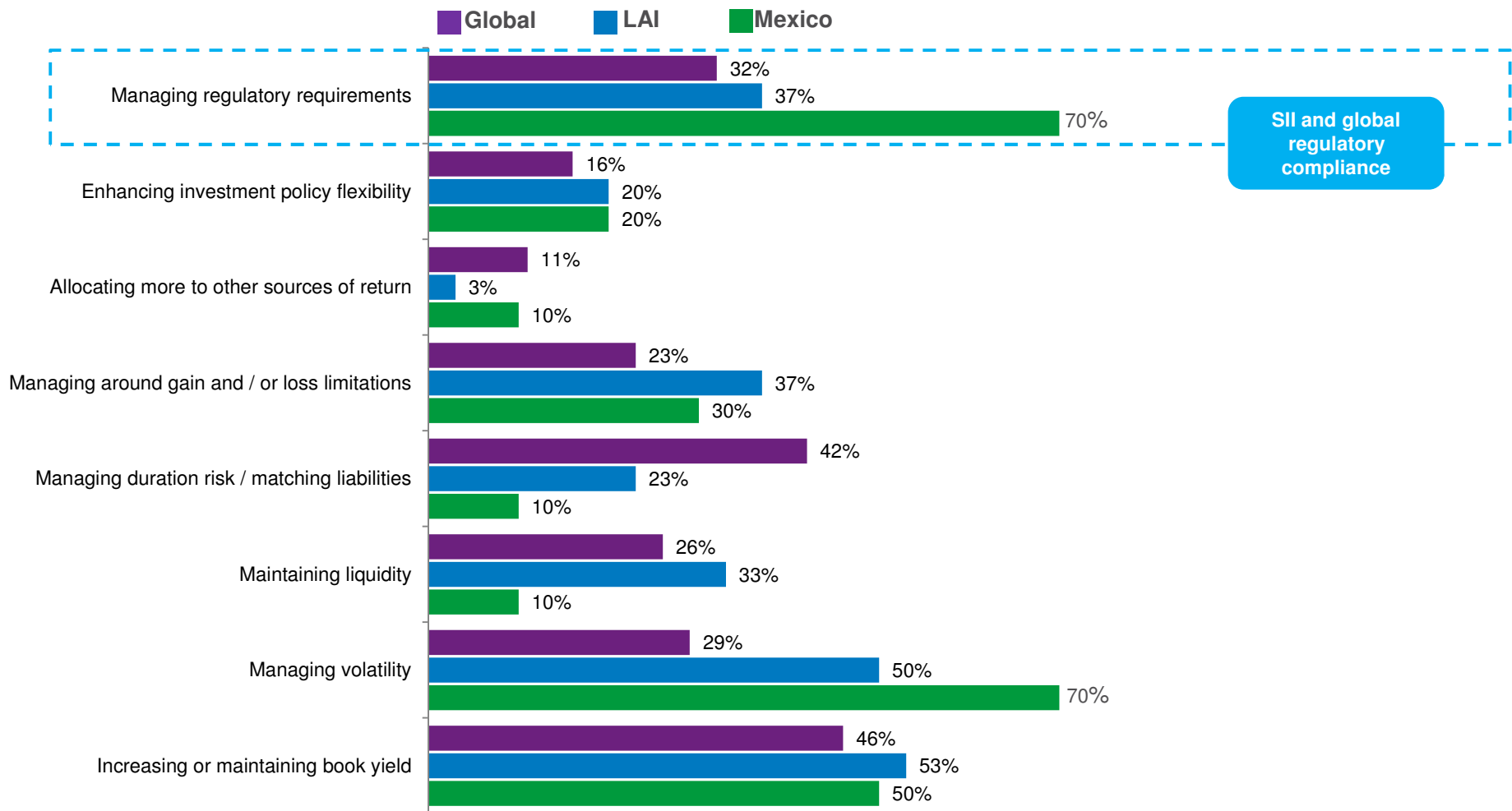
4

## Considering better beta

Expand the use of ETFs to complement traditional investments and gain access to more markets

# Managing regulatory requirements is a top priority

## ► Top priorities for insurers managing Investment Grade FI portfolios



Source: The Economist Intelligence Unit, July 2014

Base: Global (n=243), LAI (n=30). Q: What are your top priorities in managing your investment grade core fixed-income portfolio now and over the next three years?

# Rethinking asset allocations in a new regulatory landscape

## Solvency II

### Pillar I Capital Adequacy



- Establishes minimum capital levels and outlines calculation methodologies
- Computes the solvency position of an insurance company and its ability to protect policyholders against unforeseen risks

### Pillar II Enterprise risk management

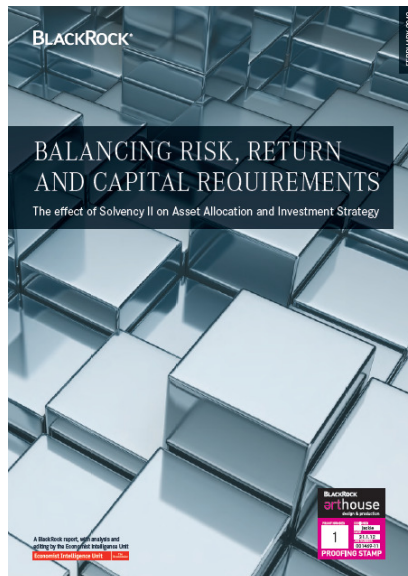


- Establishes standards for effective firm-wide risk management and governance processes
- Requires insurers to have adequate processes and controls to identify, measure, monitor, and report all of the firm's risks

### Pillar III Disclosure and reporting



- Establishes public and regulatory disclosure requirements supporting I and II
- Over 60 Quantitative Reporting Templates that provide transparency into an insurer's balance sheet and operational risks



## Key Findings from EIU Survey

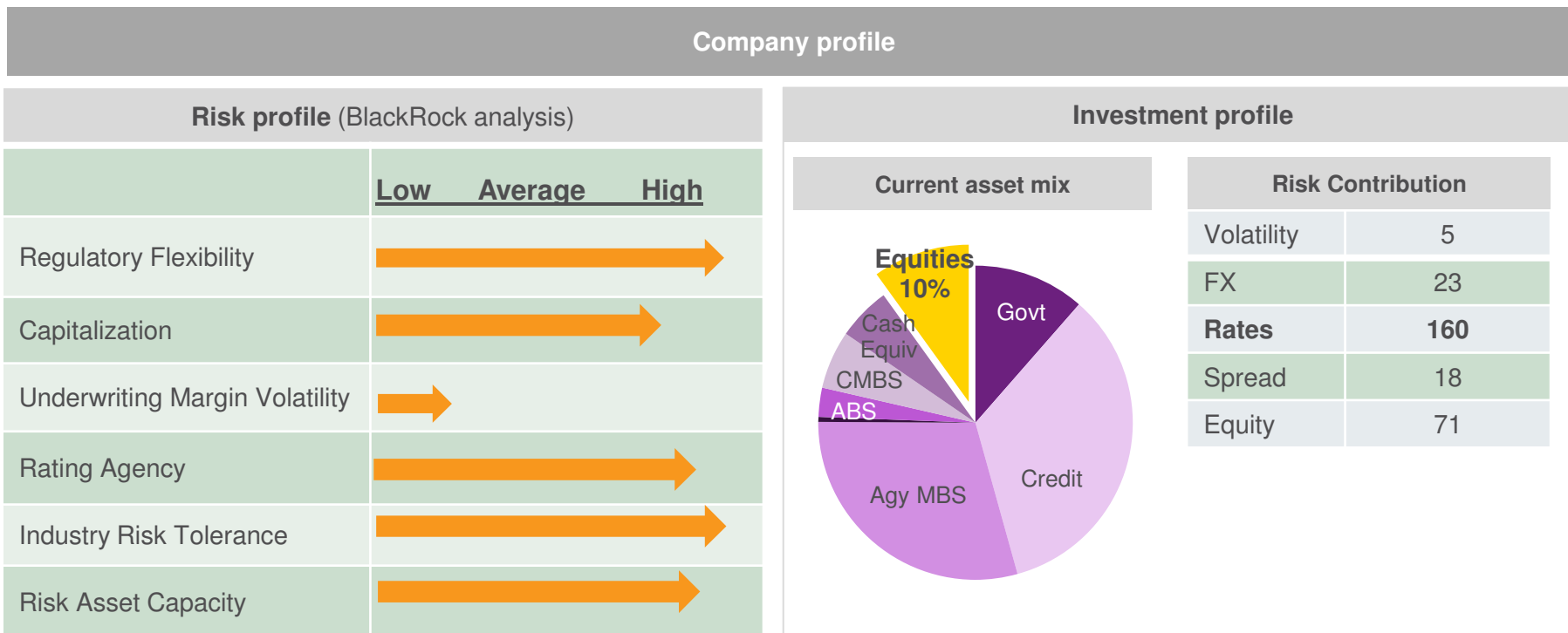
- **Allocations to alternatives are set to increase**
- **Allocations to derivatives will increase under Solvency II**
- **Insurers will re-examine guaranteed products, which may become prohibitively expensive**
- **Meeting Solvency II data requirements is a major concern, while Pillar III commands the least budget**

<sup>1</sup> October 2011 *Balancing Risk, Return and Capital Requirements, The Effect of Solvency II on Asset Allocation and Investment Strategy*

# Case study: Optimizing allocation to risk assets

## Insurance client objectives

- ▶ Reduce rate risk / diversify risk exposures , do not impact yield
- ▶ Increase risk assets from 10%



**Well-capitalized company,  
room to add risk**

**Over-exposure to rates,  
desire to add yield**

Source: SNL, BlackRock Solutions; Risk represented by 95% Value at Risk (VaR) ; VaR is calculated at a 95% confidence interval; 120 monthly observations, constant weighted  
 This hypothetical case study is for illustrative purposes only and was selected to show that increased diversification can reduce the risk of an investment portfolio.  
 There is no guarantee that an actual strategy will be executed or executed as demonstrated above or that if executed, will be profitable.  
 See Appendix slide "Asset Class Assumptions" for more detail on expected risk and return assumptions.

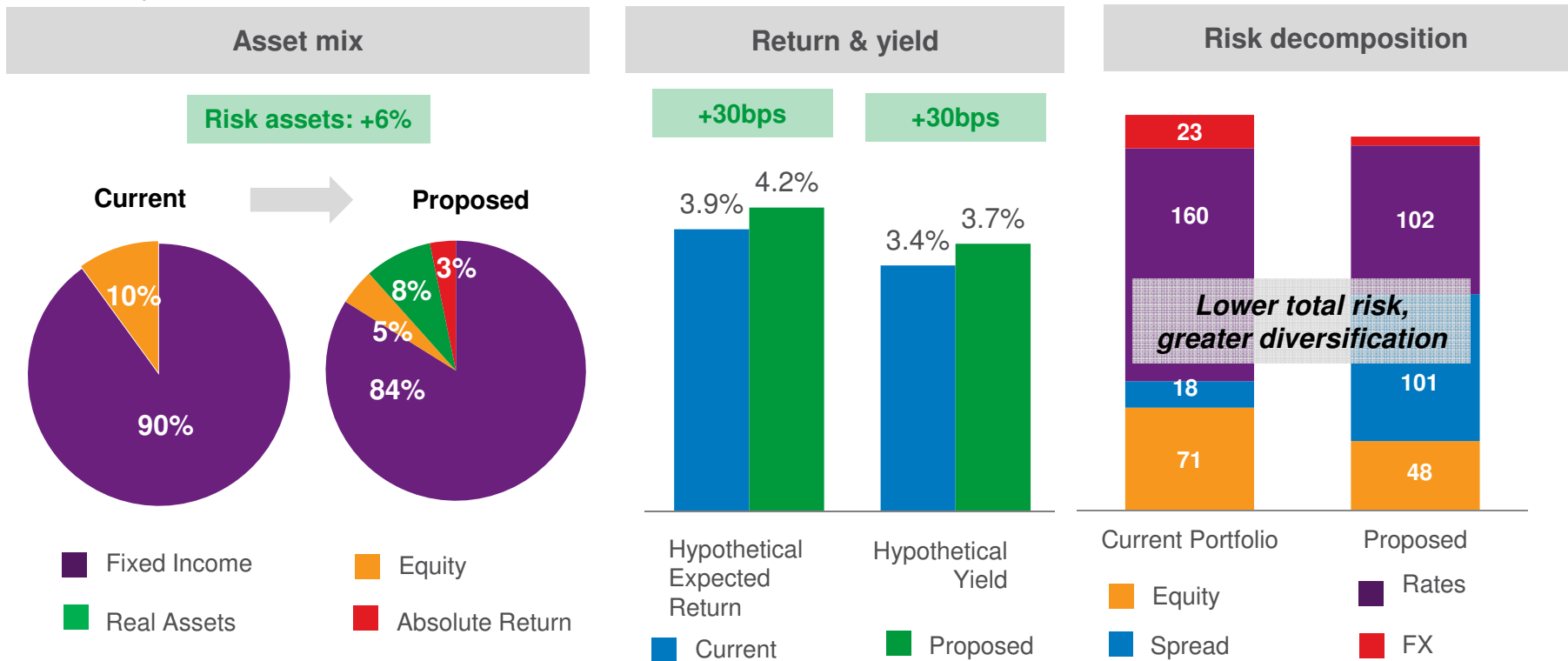
# Case study: Optimized portfolio has higher yields and returns

## Look at risk-asset portfolio optimization:

- ▶ Introduce asset classes with low correlations to fixed income portfolio
- ▶ Diversification into income-focused equities, real asset, and absolute return strategies

## Results:

- ▶ Increase total risk allocation from 10% to 16% and remain highly liquid
- ▶ Diversify risk allocation



Source: SNL, BlackRock Solutions; Risk represented by 95% Value at Risk (VaR) ; VaR is calculated at a 95% confidence interval; 120 monthly observations, constant weighted  
 This hypothetical case study is for illustrative purposes only and was selected to show that increased diversification can reduce the risk of an investment portfolio.

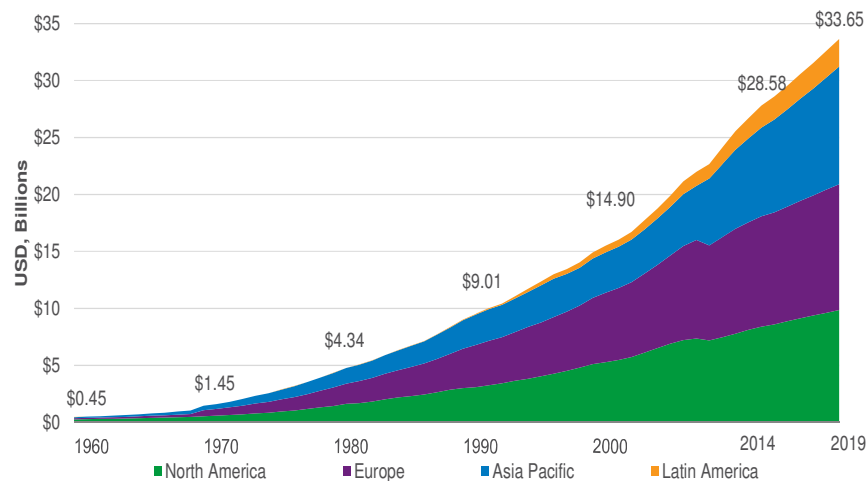
There is no guarantee that an actual strategy will be executed or executed as demonstrated above or that if executed, will be profitable.

See Appendix slide "Asset Class Assumptions" for more detail on expected risk and return assumptions.

# For many investors, current conditions — and the medium-term outlook — have triggered a strategic rebalancing into real assets

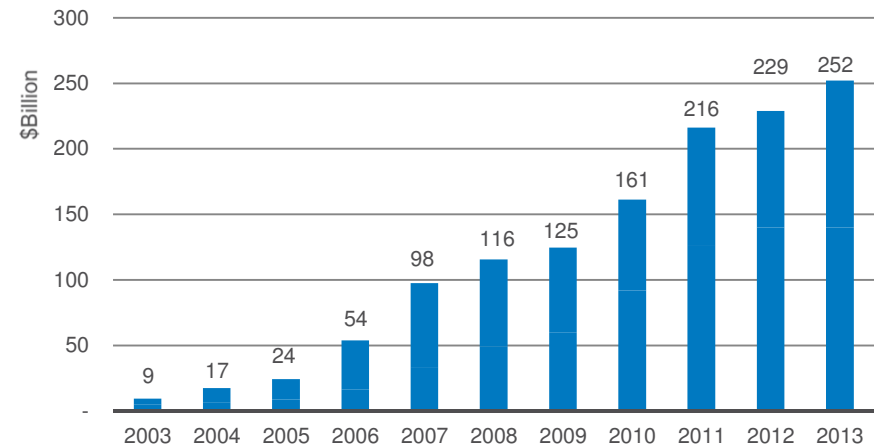
New investment flows and a strong demand for capital are spurring the development of real asset sectors. Infrastructure investing is maturing. Real estate investing is becoming more global.

## The investable real estate market is sizable and growing



Source: BlackRock, World Bank World Development Indicators; IHS Global Insight, and Oxford Economic Forecasting, as well as estimated and projected values developed by the Economic Research Service all converted to a 2010 base year. All currency denoted in USD as of January 2, 2015

## Growth of global infrastructure funds in global market






Source: 2014 Preqin Global Infrastructure Report  
All currency denoted in USD as of January 2, 2015

# Expand real asset investment for income, return, diversification, and inflation protection

**Step 1:** Determine where your overall portfolio needs strengthening

**Step 2:** Tailor allocations based on your preferences and real asset characteristics

	Real Estate	Infrastructure	Commodities
			
<b>Opportunity set</b>	<ul style="list-style-type: none"> <li>• Office</li> <li>• Industrial</li> <li>• Retail</li> <li>• Apartments</li> <li>• Hotels</li> <li>• Land</li> </ul>	<ul style="list-style-type: none"> <li>• Power &amp; Renewables</li> <li>• Energy</li> <li>• Transport</li> <li>• Social Infrastructure</li> </ul>	<ul style="list-style-type: none"> <li>• Energy</li> <li>• Metals</li> <li>• Agriculture</li> <li>• Livestock</li> </ul>
<b>Investment options</b>	<p><b>Public &amp; Private Equity</b></p> <ul style="list-style-type: none"> <li>• Core</li> <li>• Value-add</li> <li>• Opportunistic</li> <li>• REITS</li> </ul> <p><b>Public &amp; Private Debt</b></p> <ul style="list-style-type: none"> <li>• Mezzanine</li> <li>• Inflation-matching</li> </ul>	<p><b>Equity</b></p> <ul style="list-style-type: none"> <li>• Core</li> <li>• Core Plus</li> <li>• Value-add</li> <li>• Opportunistic</li> </ul> <p><b>Debt</b></p> <ul style="list-style-type: none"> <li>• Senior debt</li> <li>• Junior debt</li> </ul>	<ul style="list-style-type: none"> <li>• Natural Resources Equities</li> <li>• Index/Enhanced Index Commodity Funds</li> <li>• Hedge Funds</li> </ul>
<b>Outcome: Desired blend of...</b>	<div style="display: flex; flex-wrap: wrap;"> <div style="background-color: #4a90e2; color: white; padding: 5px; margin: 2px;">Income</div> <div style="background-color: #4a90e2; color: white; padding: 5px; margin: 2px;">Return</div> <div style="background-color: #4a90e2; color: white; padding: 5px; margin: 2px;">Inflation-protection</div> <div style="background-color: #4a90e2; color: white; padding: 5px; margin: 2px;">Diversification</div> <div style="background-color: #4a90e2; color: white; padding: 5px; margin: 2px; width: 100%;">Address long-duration liabilities</div> </div>	<div style="display: flex; flex-wrap: wrap;"> <div style="background-color: #f79646; color: white; padding: 5px; margin: 2px;">Income</div> <div style="background-color: #f79646; color: white; padding: 5px; margin: 2px;">Return</div> <div style="background-color: #f79646; color: white; padding: 5px; margin: 2px;">Inflation protection</div> <div style="background-color: #f79646; color: white; padding: 5px; margin: 2px;">Diversification</div> <div style="background-color: #f79646; color: white; padding: 5px; margin: 2px; width: 100%;">Address long-duration liabilities</div> </div>	<div style="display: flex; flex-wrap: wrap;"> <div style="background-color: #f1c40f; color: white; padding: 5px; margin: 2px;">Diversification</div> <div style="background-color: #f1c40f; color: white; padding: 5px; margin: 2px;">Return</div> <div style="background-color: #f1c40f; color: white; padding: 5px; margin: 2px;">Inflation-protection</div> <div style="background-color: #f1c40f; color: white; padding: 5px; margin: 2px;">Natural resource scarcity</div> </div>



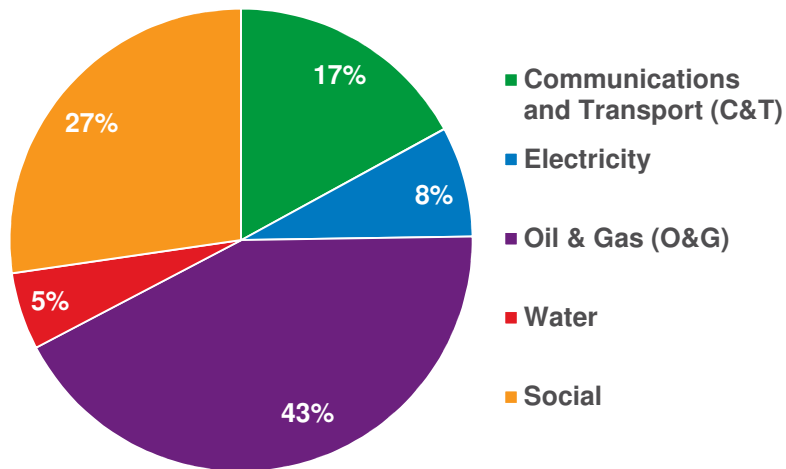
# The Mexican Infrastructure Opportunity

## Energy Reform and the NIP

The 2014-2018 National Infrastructure Program (NIP) announced by President Peña Nieto's administration has outlined a comprehensive set of goals targeting ~\$220bn in private investment across all major infrastructure sectors.

- ▶ Nearly 45% of the proposed \$596.2bn investment across 743 projects will be deployed to close the capex gap in the Mexican energy sector (CFE and PEMEX) creating interesting dynamics for industry partnerships
- ▶ Following a preliminary scan of the market, BlackRock believes there are attractive risk-adjusted returns in projects across upstream, midstream, oil & gas, electricity, transportation, and social infrastructure

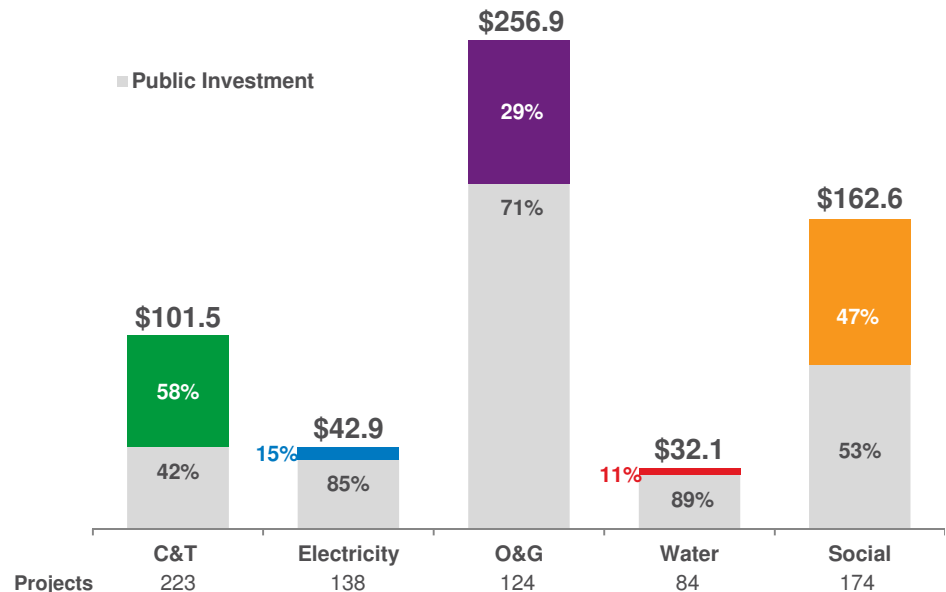
Breakdown of Investments per Sector



Total Investment: \$596.2 bn



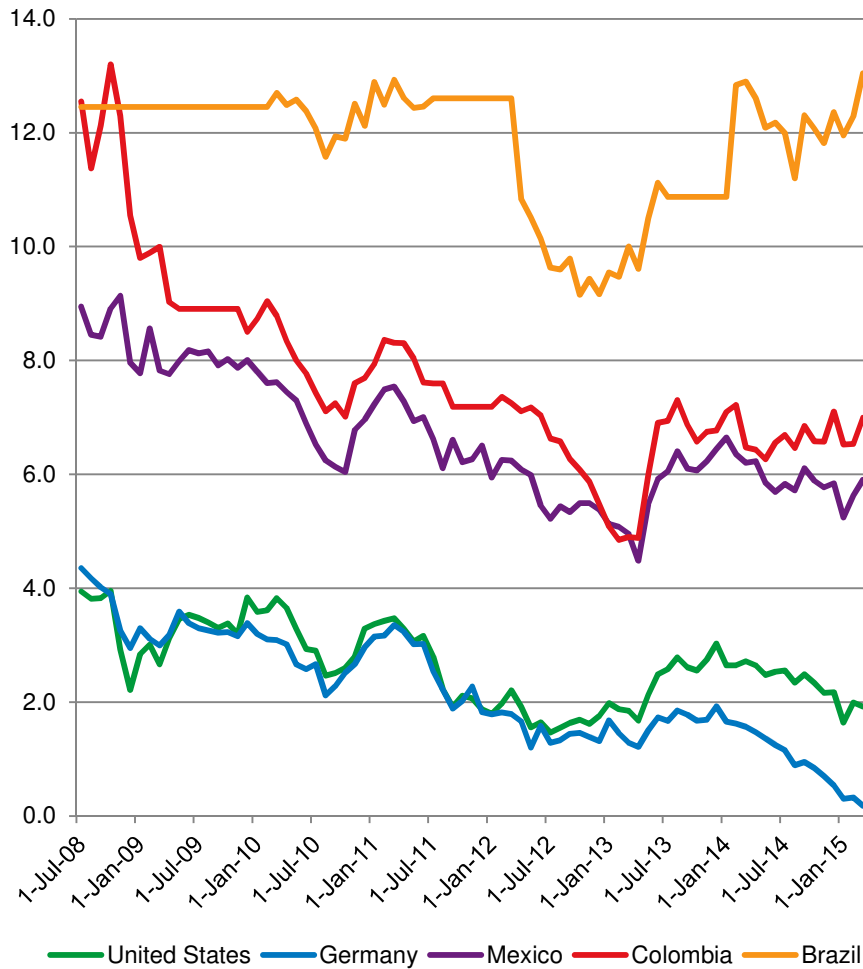
Public vs Private Sector Breakdown (in USD bn)



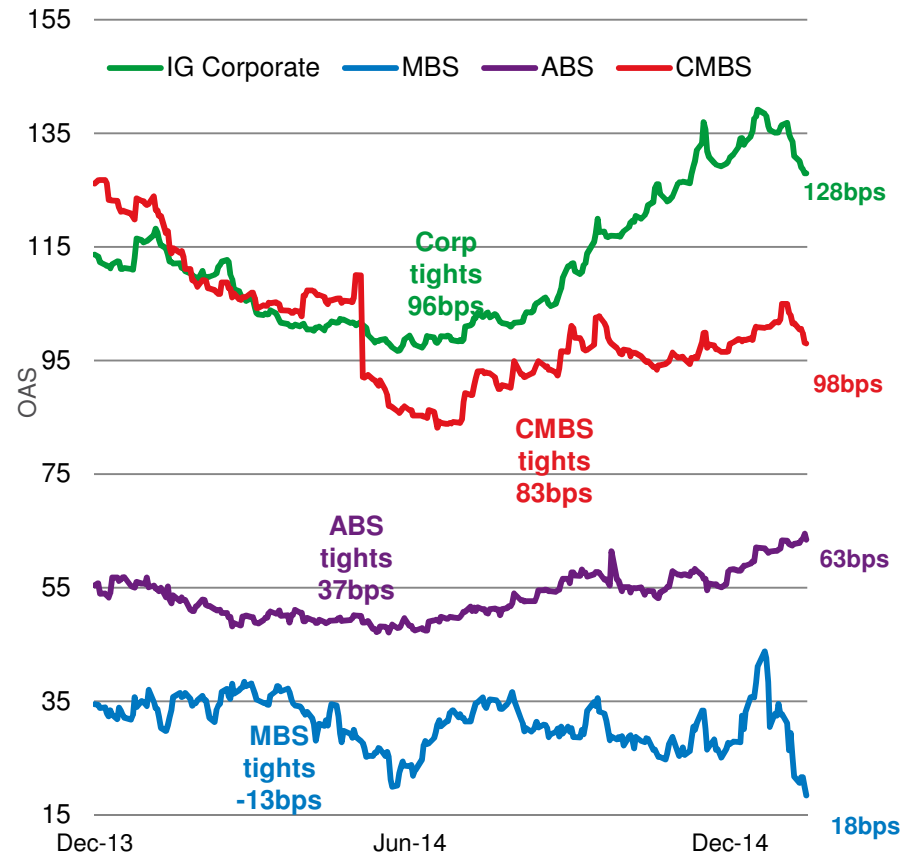
Source: Economic Research BANORTE April 29, 2014

# The search for spread and yield continues

Global 10 Year Government Bond Yields (%)



US Spread Sector OAS (bps)

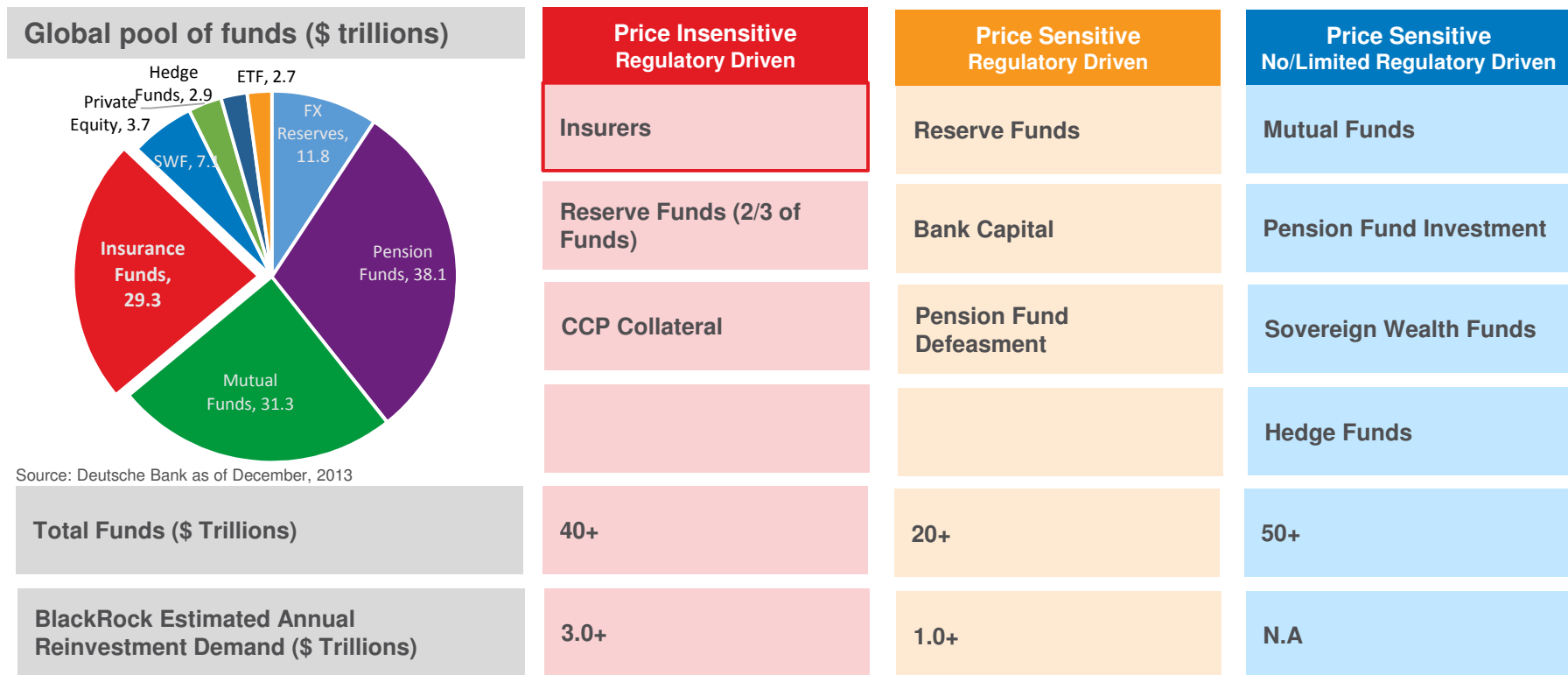


Source: Bloomberg as of 03/31/15

Tights measured over period since financial crisis. Period shown is 2014 to 2015 YTD (02/13/15)  
Source: Barclays, Bloomberg as of February, 2015

# Global demand for high quality liquid assets

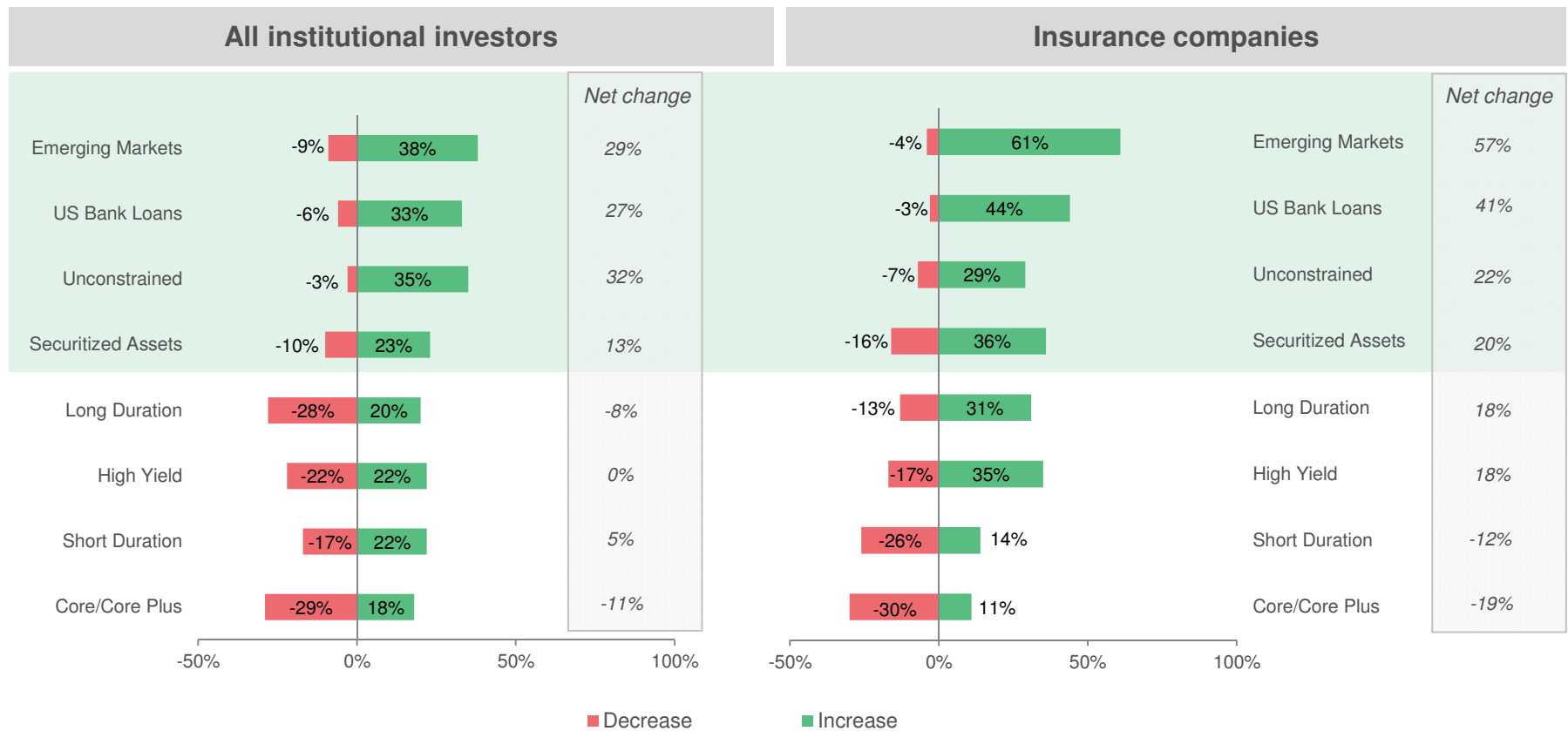
- ▶ Estimates are just that; no real figures exist which can be treated as empirical. Any and all figures for demand are based on assumptions
- ▶ That said, we can divide investment demand into three broad buckets:



Source: BlackRock; January 2015

# Within fixed income, insurers continue to cast a broader net in search for yield and diversification

**Question:** Specific to your fixed income portfolio, how do you anticipate changing your allocations next year?\*



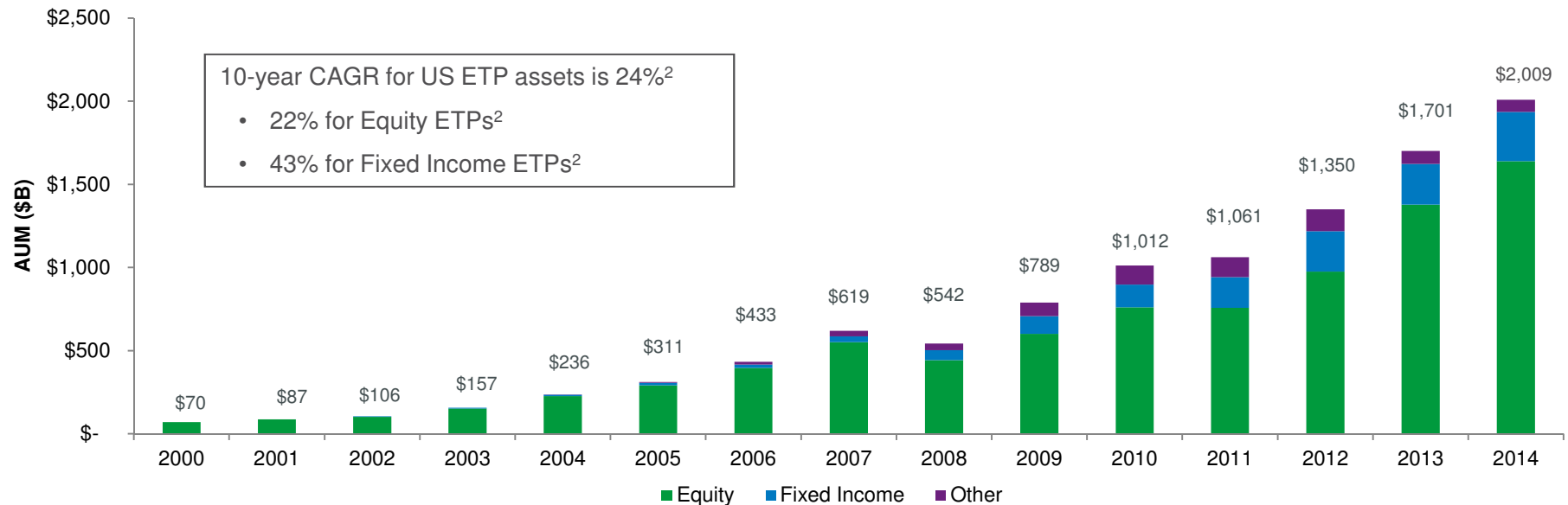
\*Percentages not shown represent "no change"

In 2015, how do you anticipate changing your allocations to the following? Base sizes vary: **Information above reflects** 2015 Global Institutional Rebalancing Survey. Target respondents were BlackRock's largest institutional clients globally (34% Public Pension, 21% Corporate Pension, 2% Official Institution, 29% Insurance, 7% Investment Manager, 2% Endowment or Foundation, 5% Other). Fieldwork period from November 11 to December 1, 2014. Client assets represented approximately \$8 trillion. Results based on global survey with 169 participants (40% North America, 29% EMEA, 11% Latin America, 20% APAC), Equities (164), Fixed Income (166), Hedge Funds (114), Private Equity (137), Real Estate (150), Real Assets (139), Cash (155). *Please note this material represents an assessment of the market environment as of December 1, 2014 and is not intended to be a forecast of future events or a guarantee of future results. This information should not be relied upon by the reader as research, investment advice or a recommendation regarding the BlackRock products or any security in particular. This information is strictly for illustrative and educational purposes and is subject to change*

# Growth of Exchange Traded Funds

- ▶ Number of insurers ETF adopters in the U.S. has more than tripled in last 2.5 years
- ▶ ~30% of general accounts have now used an ETF

## Increasing adoption of exchange traded products (ETPs)<sup>1</sup>



### Notable statistics<sup>3</sup>

- ▶ US ETP AUM has risen from \$70.6 billion in 2000 to \$2 trillion in 2014. US ETPs had ~\$124 billion of inflows in 2014
- ▶ iShares is the largest ETP provider in the US, with \$763 billion of the \$2 trillion in 2014, representing a 38% market share
- ▶ ETFs represented ~25% of U.S. daily equity trading volume in 2014<sup>3</sup>

1. "ETP" (or exchange traded product) as referred to above means any portfolio exposure security that trades intraday on a US exchange. ETPs include exchange traded funds (ETFs) registered with the SEC under the Investment Company Act of 1940 (open-end funds and unit investment trusts or UITs) and certain trusts, commodity pools and exchange traded notes (ETNs) registered with the SEC under the Securities Act of 1933. Statistics as of 12/31/14 unless otherwise noted.
2. 10-year CAGR as of December 31, 2014. ETP flows and assets are sourced using shares outstanding and net asset values from Bloomberg. Inflows for years prior to 2010 are sourced from Strategic Insights Simfund. Asset classifications are assigned by the BlackRock based on product definitions from provider websites and product prospectuses. Other static product information is obtained from provider websites, product prospectuses, provider press. The 10-year CAGR for Equity and Fixed Income ETPs are calculated by BlackRock.
3. Source: NYSE Arcvision.

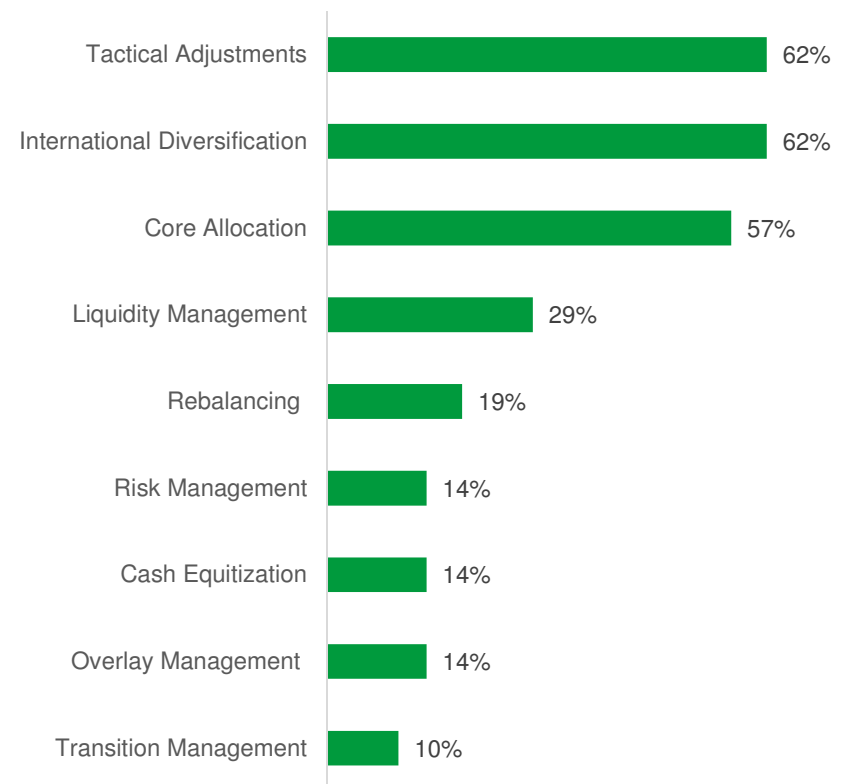
## Insurers are increasingly using ETFs in their portfolios

- ▶ Insurance companies employ ETFs primarily within their core investment funds (core allocation/international diversification), and are increasingly holding them for longer term periods

Main ETF Applications – U.S. Insurance Portfolio



Main ETF Applications – Europe Insurance Portfolio



Source: Greenwich Associates. US data – “ETFs: An Evolving Toolset for U.S. Institutions.” Report is based on interviews with 31 insurance companies conducted between February and April 2014. European Data – “ETFs: Broad usage increases amongst European institutional investors.” Report is based on interviews with 21 insurance companies conducted between August and October 2014.

# Conclusion and Roadmap

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# Going forward: Reconsider your asset allocation in a divergent world

		Helps to protect against...				Potential capture....	
		Book yield bleed today	Rising rates tomorrow	Inflation	Volatility	Dis-intermediation	Uncorrelated returns
Investment grade non-core	Infrastructure debt	*			*	*	
	EMD	*					
	CLOs	*	*	*			
	Securitized	*	*				
High yield non-core	High yield	*					
	Bank loans	*	*	*			
Equity	Min volatility equity			*	*		*
	Private equity				*		*
Real assets	Infrastructure equity	*	*	*		*	*
	Real estate equity	*	*	*			*
	Real estate mezz debt	*	*			*	*
Absolute return	Opportunistic credit	*				*	*
	Hedge funds		*		*	*	*



# How to partner with investment managers

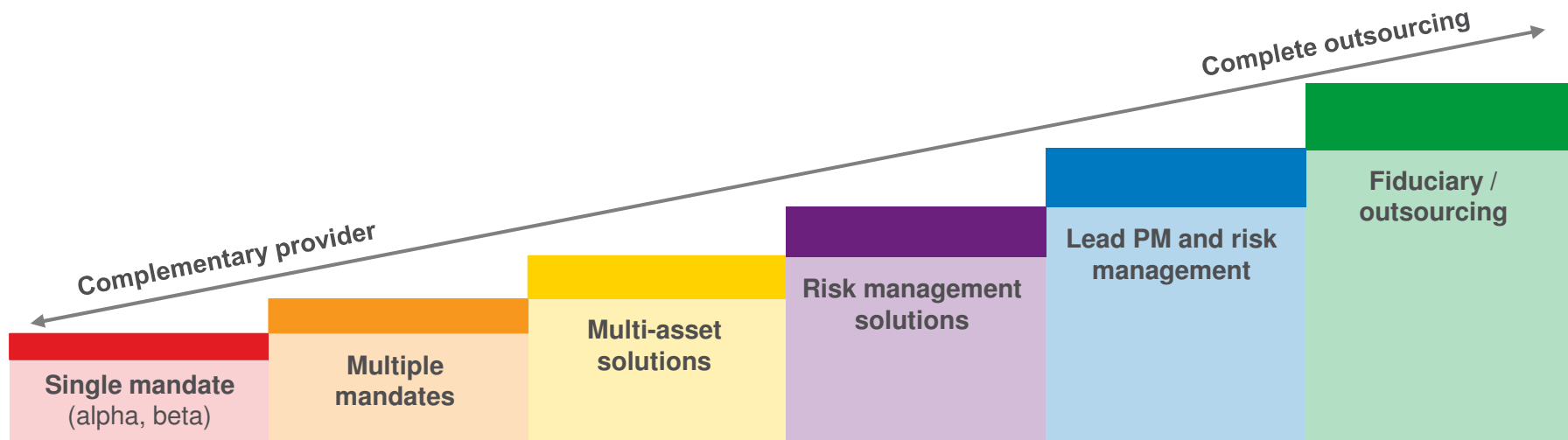
**BlackRock can act as a complete outsourcing provider or as a complement to other providers**

- ▶ Partner with insurers that are fully outsourced, fully in-sourced, or somewhere in between
- ▶ Tailored combinations of asset management, risk management, and strategic services

**Across all relationships, active exchange of information and collaboration around common objectives**

- ▶ Seek to think broadly across investment, risk management, and operational challenges

We seek to provide what investors need – from a single asset class mandate to full outsourcing



# BlackRock: A fiduciary and a partner

## BlackRock strives to be a comprehensive partner to our insurance clients

- ▶ Act as a true fiduciary at all times: we seek to earn our clients' confidence and trust every day
- ▶ Pursuing excellence through relentless improvement: We anticipate our clients' needs and explore new ways to achieve their goals
- ▶ One team - one platform – one solution: we recognize our client's aggregate experience of the firm always depends on more than one individual

### BlackRock partnership approach

Dedicated insurance expertise

True partnership mindset

Powerful scale and breadth

Strong risk management culture

# Asset Class Assumptions

Asset Class	Expected Return	Expected Risk
US cash	1.2%	0.0%
US treasuries	1.3%	4.8%
US corporate bonds	2.2%	5.2%
US equities	5.0%	17.1%
Emerging equity	8.5%	25.8%
Global high yield	3.9%	12.3%
EMD (USD denominated)	4.9%	8.9%
EMD (local currency)	3.8%	14.1%
Global real estate	5.9%	19.1%
Private equity	8.1%	28.5%
Hedge funds (defensive)	2.9%	6.6%
Hedge funds (aggressive)	3.7%	10.5%
Global infrastructure	5.4%	16.7%
Bank Loans	4.7%	11.1%
US agency MBS	0.9%	2.5%
US ABS/CMBS	2.0%	1.8%

The projections in the chart above are based on BlackRock's proprietary mid-term capital markets assumptions (5 years) for risk and return (above) and correlations between major asset classes. These asset class assumptions are passive only and do not consider the impact of active management. The assumptions are presented for illustrative purposes only and should not be used, or relied upon, to make investment decisions. The assumptions are not meant to be a representation of, nor should they be interpreted as BlackRock's investment recommendations. Allocations, assumptions, and expected returns are not meant to represent BlackRock performance. Long-term capital markets assumptions are subject to high levels of uncertainty regarding future economic and market factors that may affect actual future performance. Ultimately, the value of these assumptions is not in their accuracy as estimates of future returns, but in their ability to capture relevant relationships and changes in those relationships as a function of economic and market influences. Please note all information shown is based on assumptions, therefore, exclusive reliance on these assumptions is incomplete and not advised. The individual asset class assumptions are not a promise of future performance.

## BlackRock's Long-Term Capital Markets Assumption Disclosures

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## Survey Participants (source: EIU Survey)

Insurers were grouped by AuM: there were 47 with more than \$75bn in AuM (19%); 34 with \$25bn-75bn (14%); 33 with \$10bn-25bn (14%); 32 with \$5bn-10bn (13%); 74 with \$1bn-5bn (30%); and 23 with \$500m-999m. Life insurers accounted for 79 responses (33%); health for 33 (14%); property and casualty for 49 (20%); multiline for 55 (23%); and 27 were reinsurers (11%).

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