

Insurance Bonds

Current Situation in the Banking Sector. Insurers are not Banks!

Insurance Bonds remain solid - Higher Quality at a lower Price

In light of the recent events surrounding Silicon Valley Bank, Credit Suisse and others we reiterate that the situation is not a crisis of the insurance sector. Contagion risk for the insurance sector is very remote in our view and the recent revaluation of subordinated insurance paper is in our view an opportunity to add subordinated insurance paper. In this context we would like to highlight the following:

- The insurance sector remains generally well capitalised and most insurers in our coverage maintain plenty of excess capital
- The insurance business is usually pre-financed by its customers as premiums are paid in at the beginning of the insurance coverage
- The main risk for insurance carriers is reserving, not liquidity
- There is hardly any empiric evidence of a run risk in the insurance sector
- Asset Liability Mismatches are usually limited
- Insurers are not forced sellers of assets. This was e.g. demonstrated by the sector during the last financial crisis
- Insurers have reduced their exposures to banks in their investment portfolios over the recent years. Life insurers are also able to pass on most potential impairment losses to policyholder
- A drop in the Solvency II ratio of an insurer is no indicator for a change in liquidity, but shows available capital relative to capital required to survive a 1-in-200 year balance sheet shock
- Only a small number of institutional bonds have a first call date in 2023, some of which have already been refinanced. We do not see the sector's strong track record of calling all traded institutional bonds at the first call date at risk

Conclusion

Against this background there is in our view no fundamental support for the recent revaluation of subordinated insurance debt which was caused by a general financials sell-off and rebalancing of portfolios. Instead investors benefit from the limited impact of the current situation in the banking sector on the credit quality of insurers and the absence of contagion risk into the insurance sector. I.e. the recent sell-off offers a good window of opportunity for investors to invest in the high quality of insurance balance sheets at very low levels.

Comparison of insurers and banks

	Insurance	Banks
Main Risk	Reserve adequacy	Liquidity
Empiric evidence of «run risk»	Little	High
Extension Risk	Strong Track Record of «meeting investor expectations»	Opportunistic behaviour in «meeting investor expectations»
Asset- & Liability Mismatch	Event driven liabilities, Asset-Liability Mismatch is low and not part of business	Asset-Liability Mismatch is source of earnings and risk
Probability of regulatory intervention	Large capital buffers; regulatory interventions are rare	Several additional capital buffers (Systemic Risk Buffer, Countercyclical Buffer) make required capital more volatile and regulatory interventions more likely
Claims/Losses	Claims are pre-financed by premiums; settlement of claims can take weeks or even years. Time lag enables insurers to consider their options to maintain their capitalisation	Losses occur quickly and can develop into “self-fulfilling prophecies” damaging trust in the financial institution

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