National Association of Insurance Commissioners

2016 Summer National Meeting
San Diego, California

VALUATION OF SECURITIES (E) TASK FORCE

Sunday, August 28, 2016
2:30 – 4:30 p.m.

Summary Report

The Valuation of Securities (E) Task Force conducted a special session Aug. 28, 2016. During this meeting, the Task Force heard presentations from interested parties on infrastructure investments.

Director Anne Melissa Dowling (IL) opened the session, citing the importance of exploring infrastructure investments as an investment opportunity for insurance companies.

Director John M. Huff (MO) provided introductory remarks, emphasizing the exploratory nature of the day's session and repeating comments he had made in the past that the idea is not to encourage or incentivize U.S. insurers to do anything that did not make sense from an investment perspective or is not financially prudent.

Dirk Kempthorne (American Council of Life Insurers—ACLI) began the discussions, addressing the need for infrastructure investment in the U.S. and the alignment that such investments would have with life insurers' long-term promises to their policyholders.

Joshua Zwick (Oliver Wyman) observed that characteristics of infrastructure investments make them particularly attractive to insurers for several reasons: 1) long-duration, many with a 15+ year average life and 35-year maturities; 2) relatively illiquid, which fits with the non-callable and stable nature of liabilities; 3) stable and secure cash flows, which are often influenced by regulatory regimes, as well as structural benefits due to the monopolistic or quasi-monopolistic nature of assets; 4) diversification in a different asset class with risk drivers that have low observed correlations with other asset classes like corporate bonds; and 5) attractive risk-adjusted returns for both debt- and equity-related investments, which is particularly important in the current low interest rate environment.

Tod Nasser (Pacific Life) moderated the ACLI representatives' presentations. He noted that some projects are already in process at the NAIC that would have an impact on these discussions, in particular at different risk-based capital (RBC) working groups under the Capital Adequacy (E) Task Force.

Nicole Allen (Swiss Re) discussed the goal of creating a transparent, harmonized and accessible asset class on a global level to attract long-term investors, catalyzed through guidelines set by groups like the NAIC. Specifically, infrastructure loans would benefit from being standardized with: 1) common contract terms; 2) regular, standardized reporting, documentation and disclosure to bond investors; and 3) universal servicer and trustee guidelines. She pointed to the need for information-sharing and disclosure for infrastructure projects across the world. Success would also be dependent on reducing policy uncertainty through consistent global regulatory roadmaps. One concern is the pro-cyclicality of regulatory changes currently underway in some jurisdictions. Ms. Allen also discussed financing arms of what are commonly referred to as public-private partnerships.

Lisa Ferraro (Teachers Insurance and Annuity Association of America—TIAA) contributed insights on TIAA's investment strategy and actual case studies with empirical results demonstrating the likely success of an effort to modernize regulation to encourage life insurance company investments in infrastructure.

Michelle Werner (American International Group—AIG) delivered a granular appraisal of the challenges of non-traditional analyses warranted by infrastructure investing. Focusing on transactions not rated by a rating agency, she queried whether a better way could be developed to transmit information that would expedite deal review. She pointed to a major issue in focusing on an individual credit without reaching agreement concerning a structural element of a transaction's effectiveness in relieving or mitigating a specific risk. One example of this is disagreement about collateral that is difficult to value. Ms. Werner pointed to existing NAIC processes for assessing transactions that benefit only a specific transaction; where sharing the structural elements of that transaction more broadly could benefit an entire group of investments. She noted that in some areas there is clear and concise guidance on key structural elements; for example, in replications and credit tenant loans. This could be useful in structuring infrastructure investments, and she urged the development of deal models through a collaborative partnership with the NAIC.

Daniel Chen (MetLife) provided a detailed example of one proposal in the current NAIC work stream; i.e., the reconsideration of RBC charges for collateral on Federal Home Loan Bank advances. He observed that, currently, life insurance companies face a triple set of RBC charges for such collateral. Realignment of the charges would increase attractiveness for life insurers to invest in some infrastructure classes and encourage other insurers to pursue membership as a possible contingent liquidity source.

Stephen Dreyer (Standard & Poor's—S&P) described briefly the approach taken by S&P in defining investments within its infrastructure group. Its criteria emphasize an analytical approach that focuses on the source of risk and cash flows for a project.

A.J. Sabatelle (Moody's) discussed data found in a report dated July 2016 titled, "Infrastructure Default and Recovery Rates." The report found that: 1) in the aggregate, infrastructure bonds and loans are less likely to incur credit losses than non-financial corporate issuers, especially over longer horizons; 2) as of year-end 2015, 92% of total infrastructure ratings held an investment-grade rating, compared to 41% for non-financial corporate issuer ratings; and 3) infrastructure ratings are more stable than non-financial corporate ratings.

Doug Barnert (Barnert Associates) provided insights into the discussions occurring internationally, focusing specifically on work streams at the Asia-Pacific Economic Cooperation (APEC) group.

Director Dowling closed the session, pointing to the many comments raised and positive examples given by the various presenters that will require considerable thought.

