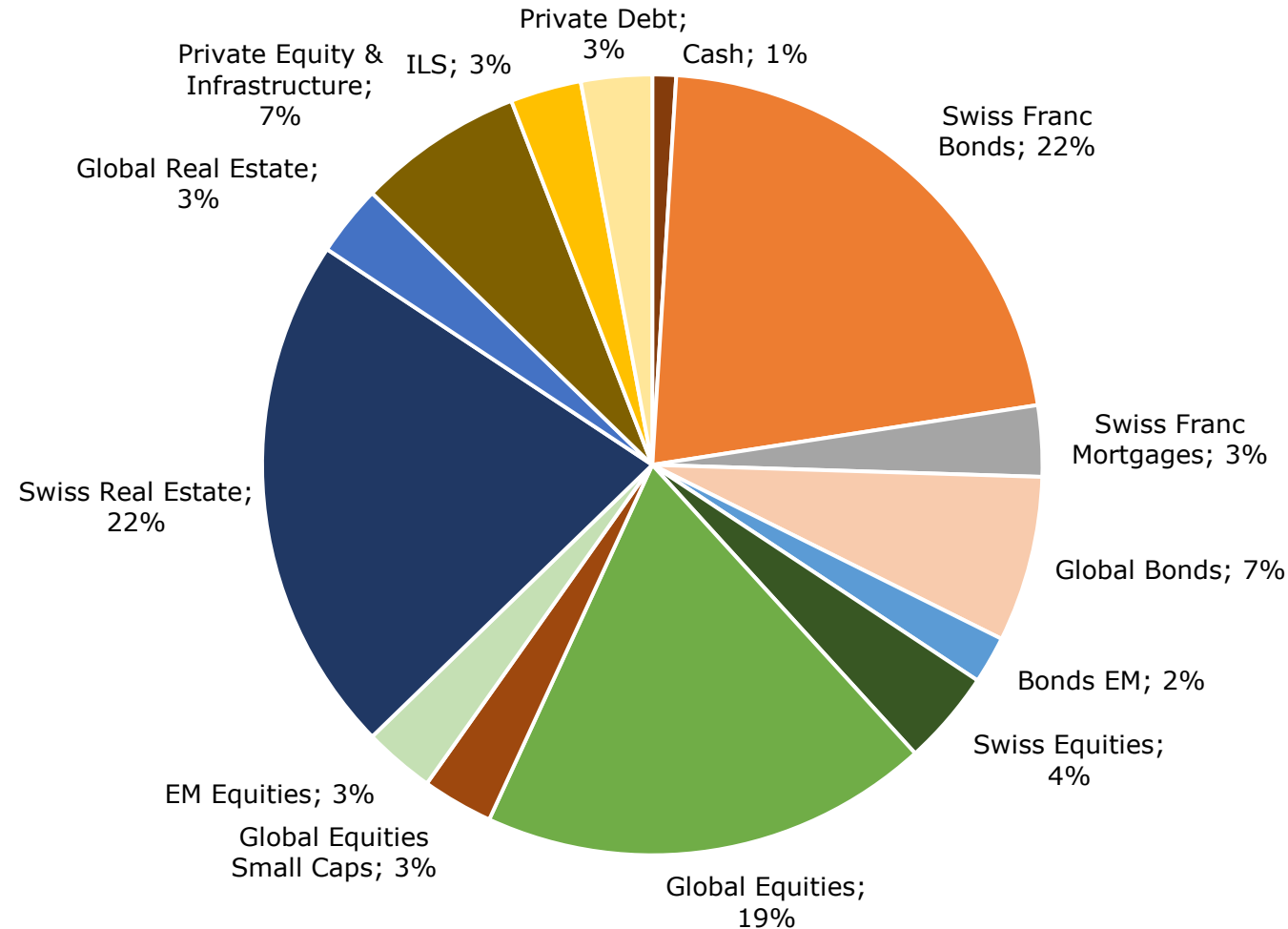


An institutional investor's challenges when investing into ILS

Diego Liechti

Swiss Re Centre for Global Dialogue, November 14, 2024

- Collective foundation for small and mid-sized firms without an own pension fund:
 - **The pioneer in Switzerland in sustainable investing** (since 1983)
 - More than 4'200 firms with more than 29'000 insured people
 - **Assets under management of CHF 4.2 billion**
 - **Coverage Ratio 108.8% (economic)**, 111.2% (technical)
 - Conversion rate: 5.5% (5.3% in 2026)
 - **Employees vs. retiree's ratio: 9:1**
 - Performance since 2006: 4.0% p.a. (vs. 3.2% p.a. UBS PK Index)
 - **Total expense ratio: 0.39%**



- **Key aspects of the current asset-liability management-study:**

- Home bias in bonds?
- Home bias in equities?
- Global real estate?
- Alternative credit?
- Emerging market debt?
- ...
- **ILS allocation is undisputed**

Nest at a glance

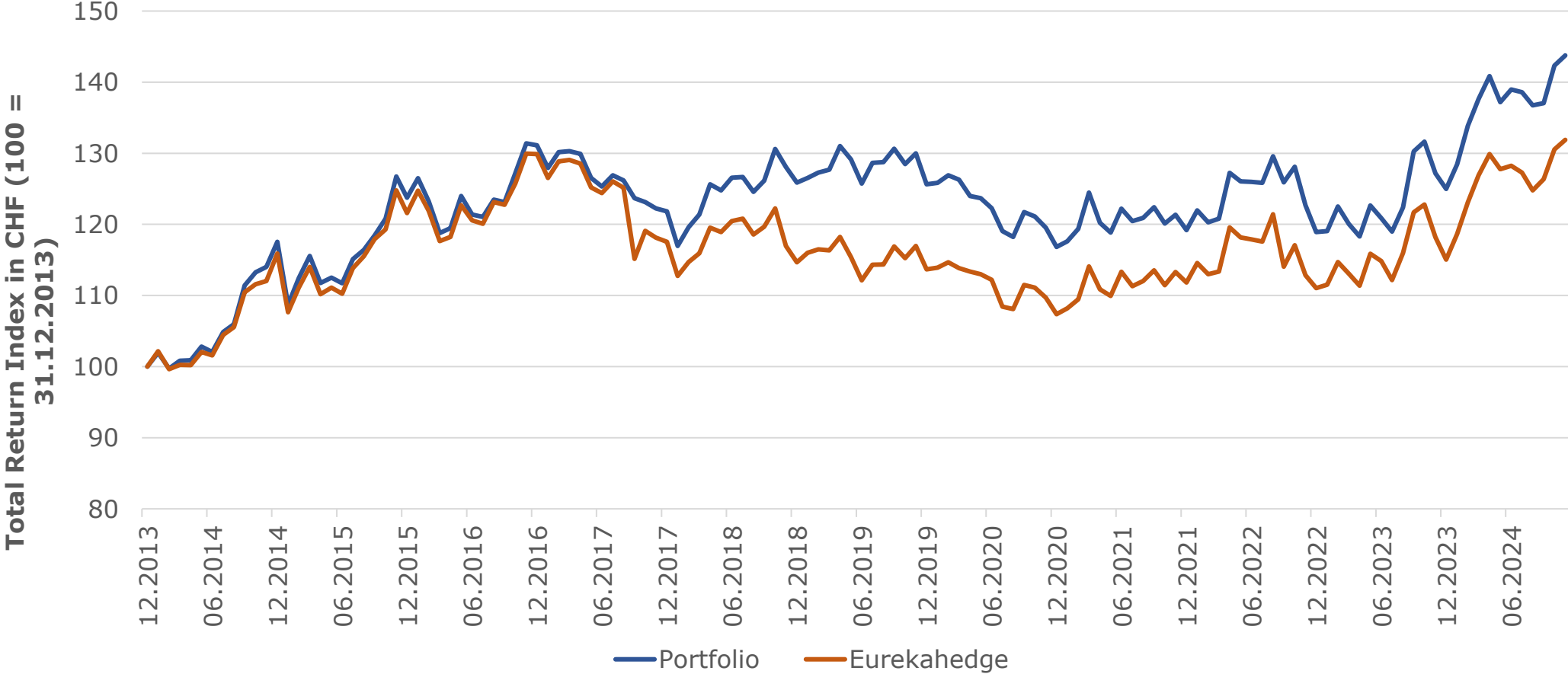
History of the ILS allocation of Nest



- 2011: Opportunistic investment in two sidecars
- 2013: **Allocation to 2%** (under alternative investments), **multi-manager approach with an advisor**
 - Non-discretionary: cat bond funds, hybrid funds, closed end funds (life)
- 2017: **Increase of the allocation to 4%** and introduction as a strategic asset class
- 2020: Discretionary multi-manager approach
- 2021: **Reduction of the allocation to 3%**
- 2023: **Simplification of the mandate structure**: focus on cat risks with two single funds: one cat bond fund and one private fund

Nest at a glance

ILS Performance in CHF (unhedged)

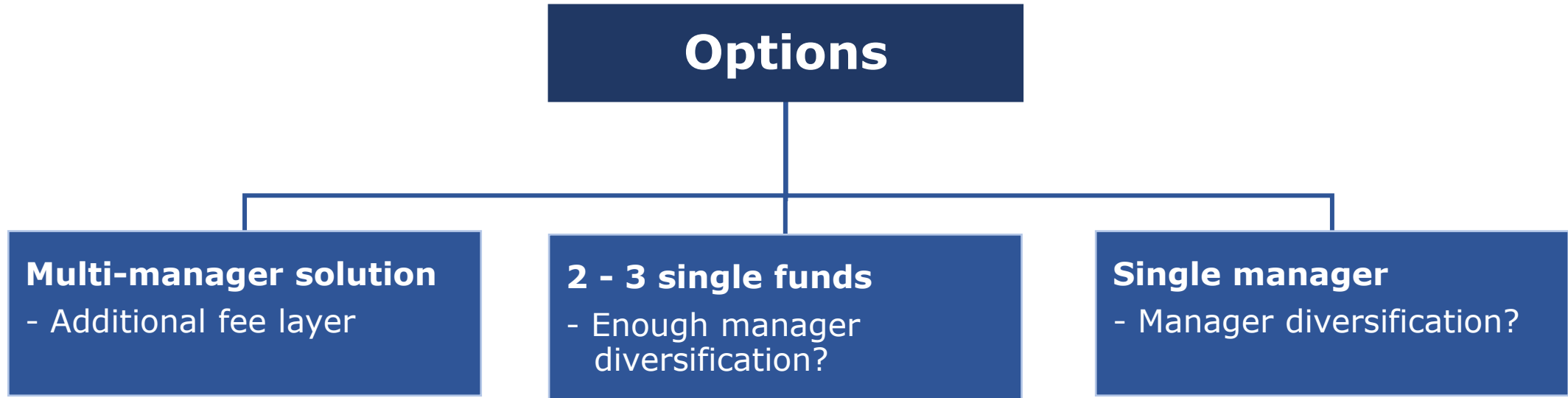


- **Diversifying asset** (low correlation with other assets)
 - No arbitrage principle (no replication possible)
- **No or little credit risk**
 - Since the bankruptcy of Lehman Brothers with TRS collateral management
- **Little interest rate risk**
- Less important:
 - Potential high returns
 - ESG: provide disaster risk financing and recovery funding
 - Rising risk premium through climate risk

- There can be **correlation in extreme events** (e.g., 9/11, tsunami)
- The market is **dominated by US wind risk**
- Theoretically, an ILS investment can be replicated by investments in insurance companies (but there is much “noise” and “nonlinearities”)
- **High transaction cost** (e.g. for structuring a cat bond)
- **Moral hazard and adverse selection problems** with indemnity-based triggers
 - Insurance companies have much better data than managers/investors...
- **Not much historical data**
- **ILS market is very small**

Mandate structure

Fund of funds vs. single manager (1)

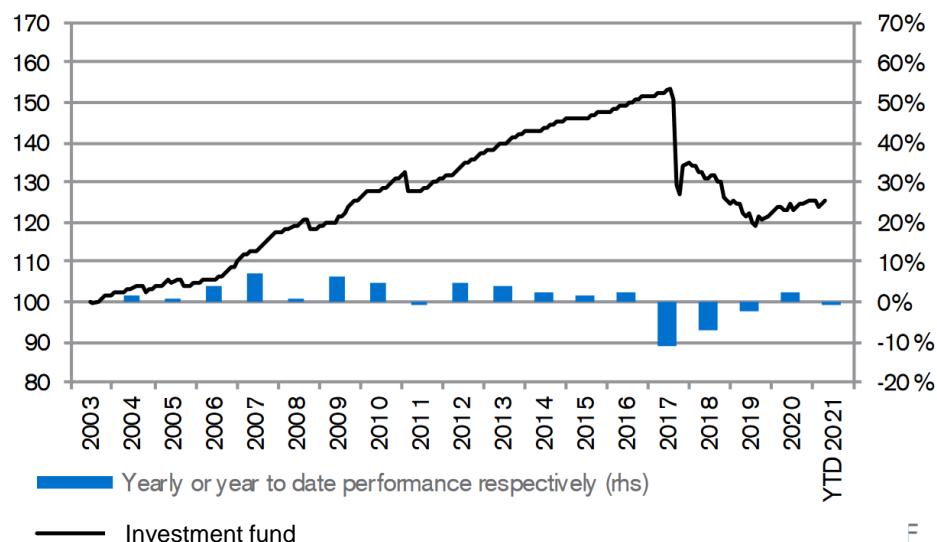


- **Why manager diversification?**

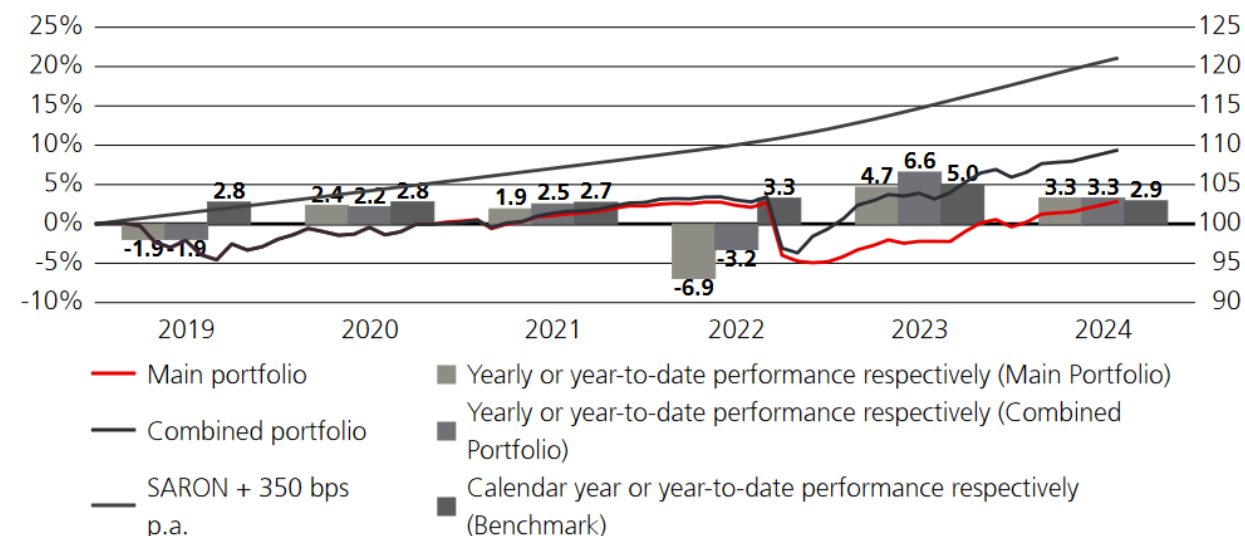
Mandate structure

Fund of funds vs. single manager (2)

Track Record Performance since Inception



Net performance in CHF (rebased to 100) and yearly performance



- The lack of manager diversification can be deadly....

Problems with asset manager selection

Some aspects to consider



- **Assessing the risk of a fund is challenging**
 - Volatility is not very helpful, EL or CEL doesn't show the full amount of risk,...
 - Structure of underlying contracts
- Beware of the **conflict of interests**
- **Stay away from performance fees**
 - Luck is way more important than in other asset classes, moral hazard problems
- **Benchmarking is not easy**
 - Eureka hedge ILS Advisers Index vs. Swiss Re Cat Bond Index
- **No (additional) risk in the collateral** (management)
- **Side pockets are annoying but necessary**
 - ... but some managers are lazy with their liquidation

Take-aways

- ILS is **one of the few alternative asset classes** that **offer real diversification**
 - **Patience is crucial**, i.e. bad years in ILS are coming for sure
 - **Implementation is critical** due to idiosyncratic risk (“manager selection risks”), but there is no “best practice”
 - **Manager selection is difficult**
 - luck vs. skill
- ▶ **Asset class is worth the “pain”**