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Higher-Yielding Investment Strategies for Small Insurance Companies: Worth the Risk?

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For many insurance companies with investment portfolios under $5 billion, the current interest rate environment has apparently limited how chief financial officers (CFOs) and investment teams construct their fixed-income portfolios. We are now seeing examples of organizations that have historically invested in fixed income utilize one of two general strategies, neither of which we think is universally appealing.

1. **Maintain the Status Quo.** Many insurance companies are keeping the yield curve short and sticking to tried-and-true investment types (government agencies, municipal bonds, short-term bonds, money market funds, etc.). However, this strategy tempers prospects for returns, and in some cases, requires that companies lower their expectations for yield.

2. **Seek Higher Yield.** Insurers can seek higher yield either by (a) lengthening portfolio duration or b) broadening the asset allocation mix to include nontraditional asset classes like syndicated loans, options, limited partnerships, real estate investment trusts (REITs) and mortgage loans. However, such yield-seeking strategies increase exposure to risk—sometimes significantly.

Without question, risks as well as potential rewards are associated with each strategy. The future direction of interest rates is unclear. Will low rates persist? Will they spike? Will there be a gradual rise? Given the uncertainty, committing to either strategy can be difficult.

Ultimately, many insurance companies are simply too conservative—often for good reason—to consider any approach other than the status quo for their own portfolios. Among their CFOs and investment teams, nontraditional asset classes are often perceived as undesirable, either because of the inherent risk or the accompanying operational complexity of accounting and regulatory reporting.

But is this really the case—can the potential benefits of a higher yield strategy be worth the operational and strategic risks? This paper will attempt to provide some information by examining the accounting implications, investment risks and reporting challenges for select nontraditional asset classes.

Background: Results from Clearwater's 2014 Benchmark Survey

In 2014, Clearwater Analytics, a Software-as-a-Service (SaaS) provider of investment accounting, reporting and analytics, conducted research to find out how the investment climate was affecting U.S. insurers' current portfolio allocations as well as asset classes under consideration for the future.[1]

The usual suspects were represented on the list of asset classes included in insurers' portfolios, led by government agencies (88 percent) and followed by corporate debt (85 percent), municipal bonds (79 percent), mortgage-backed securities (79 percent), short-term bonds (76 percent) and money market funds (74 percent). In contrast, working capital finance notes (3 percent) represented the least common asset class, followed by forwards (9 percent), futures (10 percent), swaps (11 percent), commingled funds (12 percent) and options (12 percent).

We feel that this data suggests that, under pressure to generate higher returns, many investment professionals either already include, or have expressed a willingness to explore, alternatives to traditional fixed-income securities. To illustrate: Just five years ago, bank loans were uncommon investments among insurers. Today, 24 percent of insurance companies are investing in them, and another 9 percent are considering them as potential investments. Our analysis is that as insurance companies increasingly seek more yield, their exposure to nontraditional asset classes is growing. For example, the survey revealed that 7 percent of insurers are considering, or are already invested in, working capital

finance notes (WCFI), which were only added as an admitted asset in late 2013.

Implications for Accounting and Reporting

It is important for CFOs and investment teams considering these asset classes to understand the accounting and reporting implications. Below, we examine five nontraditional asset classes—syndicated loans, options, limited partnerships, REITS and mortgage loans—and certain associated accounting and regulatory challenges for each.

Syndicated Loans

Overview

As an alternative to traditional fixed-income securities, syndicated loans (commonly referred to as bank loans) are designed to provide companies with an alternative source of funding outside of traditional fixed-income securities. This market also provides funding access for issuers who may not be able to borrow in the traditional fixed-income markets. The issuers in this market are of lower credit quality and all are below-investment-grade-rated. Bank loans are senior in the capital structure, which can provide more security in the event of default. Bank loans typically provide a higher level of income with an additional feature of a floating rate coupon. Bank loans are typically structured on five distinct levels:

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Level 1: Issuer—Provides information about the entity borrowing the funds.

Level 2: Agent Bank—Provides information about the bank organizing and syndicating the loan.

Level 3: Deal—Outlines the general terms and conditions of the overall loan, including the global loan amount, underwriters and basic covenant information.

Level 4: Facility—Defines the details surrounding maturity date, various fees, and type of facility, including revolver, delayed draw, term loan and others.

Level 5: Contract—At the contract level, lenders have the ability to negotiate specific terms and conditions such as floating-rate indexes, accruals and float spreads.

Certain Accounting Implications

***Statutory Financial Reporting (STAT)**:* Unlike corporate bonds, for which terms and conditions are fixed once issued, syndicated loan contracts are updated and re-signed on a fairly regular basis (typically quarterly). Updates may be immaterial, such as place of notice, or material, such as information about rate changes, amount outstanding, or tenure. When details of a re-signed loan are deemed materially different, old facilities are exchanged for new ones.

Syndicated loans trade flat with long, sometimes unpredictable settlement dates. As such, they do not accrue until the trade settles. Best practices allow for private placements to be recorded as of the date the security is recognized as legally changing hands. Because syndicated loans are often treated as private placements with respect to reporting, they too are recorded as of the date they legally change hands.

Due to the tiered structure of syndicated loans, data provided at the most granular level most accurately reflects security information. Contract-level information is preferable, but if unavailable, facility level is sufficient for accounting needs.

Third-party data tends to be limited for these securities. Wall Street Office (WSO) is currently seen as the premier data source and trading platform for syndicated loans, though some other data providers offer third-party data as well. Available third-party data (including that from WSO) is typically facility-level data rather than contract-level data.

Since syndicated loans are not registered with the SEC, they do not require a mandatory, standardized security identifier. However, many issuers do take advantage of traditional CUSIP assignments by the CUSIP Bureau.

***International Financial Reporting Standards (IFRS)**:* Currently, syndicated loans are covered under IAS 39 Financial Instruments: Recognition and Measurement. Over the next few years, we believe most companies will convert to IFRS; although, in the United States, IFRS may not be required of many small insurance companies. Once completed, the accounting treatment of bank loans will be covered under IFRS 9, which requires that assets pass the business model test and cash flow test in order to be reported at amortized cost. If the asset does not qualify for amortized cost, it may be measured at fair value—Other

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Comprehensive Income (OCI), but only if it passes the cash flow test, and if assets are managed to achieve the business model objectives through both the collection of contractual cash flows and sales. Interest income using the effective interest rate method and impairment losses (and reversals) is recognized in profit and loss, and the net cumulative fair value gain or loss is recognized in OCI.

GAAP: FAS115 (also known as ASC-320) is the pronouncement that covers these assets and addresses accounting and reporting for all investments in debt securities. Classification of securities by ability and intent as trading, available for sale, or held to maturity becomes relevant when determining the treatment of unrealized gain or loss impact on income, and in conjunction with the balance sheet representation. Further information about this pronouncement can be found in Clearwater Analytics' Market Insight Paper "FAS 115-2: A Practical Analysis."[2]

Investment Risk

As previously mentioned, syndicated loans are a fixed-income asset class with a below-investment-grade rating and are not securitized. They pay interest on a floating rate basis, typically LIBOR plus a spread. Oftentimes there is a LIBOR floor in the structure that provides a minimum level of income. This floating-rate nature reduces interest rate risk versus other areas of fixed income. Therefore, the primary risk inherent in bank loans is credit risk as the borrowers tend to be lower in quality than other areas of fixed income. Additionally, bank loans tend to have a higher level of liquidity risk as the market is entirely private and trades differently than other areas of fixed income. Therefore, robust back office operations are required to manage liquidity risk as well as recognition of the longer settlement periods.

Reporting Challenges

From a STAT perspective, syndicated loans are fairly straightforward in concept. Non-fund direct investments are treated like a traditional corporate bond and reported on a firm's Schedule DB Part 1. As noted elsewhere, however, the private placement nature of bank loans limits the availability of third-party data to investors for reporting purposes; consequently, the largest challenges tend to be primarily data-related.

The stratified nature of these securities naturally leads to hierarchical data collection. Priority is given to data collected at lower levels, but also allows for potential inheritance of data from higher-level modeling. Multiple feeds for both security master data and reconciliation data are required. Without a system of daily data validation, this added layer of reporting complexity (not seen with traditional corporate bonds) can cause data errors and reporting delays. In addition, data may not be available or finalized at the time the reporting cycle comes due. To compensate for missing data the reporting system may need to be able to default to more conservative approaches while simultaneously incorporating the updated data when available.

Data is not only difficult to obtain; it can come at a premium cost. Data providers for these securities are few, and many insurers, especially at the smaller end of the market, may only have access to the data through their asset manager. Consequently, a special data feed may need to be built by the asset manager or other provider for security characteristics more commonly obtained through conventional third-party data providers. A system that can interface with a variety of systems and data formats is needed to provide the necessary flexibility.

Options

Overview

Options are derivative securities. Their value is based on the performance of an underlying asset or basket of assets such as equities, indexes, commodities and currencies. Though often considered a risky investment, the right option strategy in the right hands has the potential to help an insurer significantly mitigate risk as well as generate income. Based on regulatory requirements, however, insurance companies are not to buy options for speculative reasons but only to hedge an existing risk.

"Plain vanilla" options, which are the most basic options available to investors, typically lack any special characteristics and are quite simple. Option contracts involve two parties: the writer (the party selling the option) and the holder (the buyer of the option). Option writers maintain short positions and are obligated to either purchase or sell the underlying asset, depending on the nature of the contract. Conversely, holders maintain long positions and have the right, but not the obligation, to sell or purchase the underlying asset.

Contracts fall into two basic categories: "puts" and "calls."

Put option: The holder has the right to force the writer to purchase the underlying asset from the holder (that is, "put" the asset to the writer).

Call option: The holder has the right to force the writer to sell the underlying asset to the holder ("call" the asset from the writer).

Whether "plain vanilla" or a more complex variety, options are issued with a strike price (also called an exercise price), which is effectively the break point at which an option either becomes valuable or loses value with respect to the current market price of the underlying asset. When exercising an option, holders need to be aware of three stages:

In the money: If exercised, the holder stands to benefit financially.

At the money: If exercised, there is no benefit or loss to the holder.

Out of the money: The holder loses money exercising the option.

In the case of both "at-the-money" and "out-of-the-money" options, the holder is highly unlikely to exercise the option.

Accounting Implications

Insurers have two ways of accounting for options: hedge accounting and fair value accounting. The qualitative nature of hedge accounting requires a greater degree of manual intervention by the individual or firm preparing the financial statements, making it difficult to automate. Conversely, fair value accounting for options behaves much like traditional accounting for equities; it is quite simple from a reporting standpoint and easier to automate. When fair value accounting is used, changes in the fair value of the option during the holding period will flow through unrealized valuation gain or loss in statutory accounting, which ultimately affects surplus.

The default treatment for both GAAP and IFRS accounting standards requires that changes in fair value during the holding period flow through net income.

Investment Risk

Options are typically used in an effort to offset investment risks of other asset classes. For example, options may be purchased with the goal of offsetting the unwanted risk in the movement of interest rates. With options, there is the risk to lose your entire investment as they will not always mature "in the money."

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Reporting Challenges

Nearly all insurers, large and small, choose to use the fair value approach when accounting for their derivative exposure because hedge accounting is completely voluntary. With options, this becomes an especially important distinction for two reasons. First, most small- to medium-sized insurers employ an income generation strategy in conjunction with an equity portfolio, which is not considered an effective hedge strategy; therefore, hedge accounting becomes inapplicable. Second, hedge effectiveness testing (required for treatment of the derivative under hedge accounting) is difficult to complete and demands arbitrary judgment on behalf of the individual or firm preparing the statements. In the absence of a standard for classifying the effectiveness of a hedge, this type of accounting carries a large amount of audit risk for what typically results in nonmaterial differences. In short, the cost/benefit payoff of hedge accounting is not worth the headache for most insurers.

Limited Partnerships

Overview

Limited partnerships are defined in Statement of Statutory Accounting Principles (SSAP) No. 48—Joint Ventures, Partnerships and Limited Liability Companies as partnerships having two outstanding classes of partners: (a) general partners, who manage the partnership and have a personal liability in the general obligations of the partnership (i.e., active investors who can be held fiscally liable for outstanding obligations of the partnership); and (b) limited partners, who are restricted in the scope of their involvement and cannot be held personally liable for fiscal obligations of the partnership (i.e., passive investors). These partnerships are basic in structure and are classified as admitted assets under SSAP No. 4 – Assets and Non-Admitted Assets.

Accounting Implications

Limited partnership shareholders holding 10 percent or less (minority ownership) should account for their partnership interest based on the underlying audited GAAP equity of

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the investee. If the audited GAAP financial statements are unavailable, the value of the limited partnership may be recorded based on the underlying U.S. tax-basis equity.

Shareholders with 10 percent or more interest in the partnership are directed to value the partnership in one of three ways: market valuation (subject to paragraph 8.a. of SSAP No. 97), U.S. GAAP (subject to paragraph 8.b. of SSAP No. 97), or U.S. statutory accounting (subject to paragraph 9 of SSAP No. 97).

For the purposes of SSAP Nos. 48 and 97, affiliated entities maintaining separate ownership in a limited partnership are determined to each hold the sum of the ownership. For example, if entity A is a 5 percent shareholder in a limited partnership, and entity B (an affiliate of entity A) is an 8 percent shareholder in the same partnership, then each entity is presumed to control 13 percent of the partnership. In this case they would each surpass the 10 percent threshold and therefore value the partnership according to SSAP No. 97.

Investment Risk

For income-oriented investors, master limited partnerships (MLPs) have the potential to provide an attractive source of after-tax yield along with potential for capital appreciation. Exchange-traded MLPs are subject to equity market volatility. Over 80 percent of exchange-traded MLPs are in the energy sector and may include exploration and production, pipelines, and processing and storage facilities. While industry concentration risk is a factor, potential upside is possible as the asset class is "repriced" due to increased demand from institutional investors. Institutional investors must consider that MLPs typically generate unrelated business taxable income (UBTI). Many MLPs may provide for disproportionate economic sharing of cash distributions and entity valuations between general partnerships (GPs) and limited partnerships (LPs). In addition, the favorable pass-through tax treatment of MLPs may be subject to unpredictable changes in U.S. tax laws.

Reporting Challenges

Investments in limited partnership are filed on Schedule BA, which has special reporting requirements that can present a challenge for insurers. Transactions involving Schedule BA assets must be tracked separately from other acquisitions on regulatory reporting schedules. Moreover, certain fields require judgment from the insurer and are not necessarily applicable to other investment types. For example, Column 9 of Schedule BA requires that insurers declare the type and strategy associated with the partnership investment, of which there are 13 possible arbitrary designations.

REITS

Overview

REITs are trusts, corporations or associations managed by one or more trustees or directors, where beneficial ownership may be transferred to investors through shares or certificates of beneficial interest.

REITs would otherwise be taxable as a domestic corporation, except that (a) they are neither a financial institution nor an insurance company, (b) there are 100 or more beneficial owners, (c) the trust, corporation or association is not closely held, and (d) it meets certain legal requirements with respect to distributions, interest, income generation and tax elections on an annual basis.

For investment reporting purposes, direct investments in REITs are treated as equities irrespective of whether they are publicly traded or privately held, so long as they meet the designations set forth in 26 US Code § 856. Tax treatment of REITs is unlike traditional equities, although equally straightforward. To maintain REIT status, the U.S. tax code requires that an REIT distribute at least 90 percent of its capital gains. Distributions may be allocated to ordinary income, capital gains or return of capital, depending on the election of the shareholder.

One of the primary benefits of this structure is that REITs do not pay corporate taxes. Though investors are taxed on capital gains, they avoid the double taxation that typically accompanies traditional corporate equities and fixed-income securities.

Insurers can also gain access to this market indirectly through debt issued by an REIT, commonly in the form of senior secured debt, which is treated much like a corporate bond.

Accounting Implications

The accounting treatment for REITs is fairly straightforward. The key consideration is that acquisition and disposition of a publicly traded REIT must be reported on trade date, much like any other common stock. Like similar private-placement transactions, insurers record transactions in private REIT securities as of the funding date. Both publicly traded and private placement REIT investments are recorded at fair value, inclusive of any associated brokerage fees. Reporting entities entering into a subscription agreement commit to purchasing an equity or equity-type security (such as an REIT), but cannot fund and settle the purchase until the actual security is issued and the trans-

action has been ruled to be settled, either by the Financial Industry Regulatory Agency (FINRA) or the listing exchange.

Investment Risk

Listed REITs are exchange-traded and are subject to equity market volatility. Risk factors include:

- Potential changes in the regulatory environment and other equity risk factors such as activities or changes in company management;
- Underlying supply and demand fundamentals;
- Macroeconomic factors such as changes in interest rates; and
- Changes to the 1960 Act of Congress that introduced REITs and their favorable tax treatment.

Across the industry, dividend yields have recently ranged between 3 and 4 percent, and dividend payments have grown significantly over the past 20 years. Dividend yields vary by property sector and individual company. The table below illustrates the historical returns of REITs in the context of the broader U.S. equity and fixed-income markets. All data is as of Dec. 30, 2014.

Indexes	5 Yr. Annl Return	5 Yr. Std Dev	5 Yr. Sharpe Ratio	10 Yr. Annl Return	10 Yr. Std Dev	10 Yr. Sharpe Ratio	20 Yr. Annl Return	20 Yr. Std Dev	20 Yr. Sharpe Ratio
FTSE NAREIT All Equity REITs Total Return	16.9%	16.1%	1.04	8.3%	25.3%	0.27	11.5%	20.1%	0.44
S&P 500	15.5%	12.9%	1.19	7.7%	14.6%	0.43	9.9%	15.1%	0.47
Barclays U.S. Aggregate	4.4%	2.7%	1.64	4.7%	3.2%	1.01	6.2%	3.6%	0.98
Barclays U.S. Treasury— Bills	0.1%	0.0%	1.84	1.6%	0.6%	0.25	2.9%	0.7%	0.25

Source: FactSet as of Dec. 30, 2014.

Private REITs are an illiquid asset class with moderate to high investment risk. They are available in two varieties: one for retail investors and the other for institutional investors (often in lieu of a commingled fund or partnership structure). Dividend yields for retail-distributed private REITs are typically in the 5 to 6 percent range. Private REITs tend to exhibit less price volatility than listed REITs, but liquidity is poor and management is frequently less active. Agency conflicts in private REITs are an ongoing risk.

Reporting Challenges

As with many other nontraditional assets, access to third-party data can be limited for REITs, especially in privately placed REIT investments. Further, while the accounting requirements for these instruments are often quite simple and do not require the abundance of inputs associated with other security types, the risk exposure in an REIT investment may be fairly high and the transparency of the underlying assets may be inadequate.

Mortgage Loans

Overview

Mortgage loans are direct (whole) mortgage loans (e.g., commercial mortgage loans), as opposed to mortgage-backed securities (MBS). Because the investor purchases the whole loan rather than shares, they are not considered securities by the National Association of Insurance Commissioners (NAIC) (where a security is a share, interest or participation), although they meet the definition of an "admitted asset" under SSAP No. 4.

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Mortgage loans are typically non-recourse loans secured by mortgages on real estate (buildings, shopping centers, etc.). In the event of a default, asset sales—rather than builder or owner finances— are used to repay the lender.

Accounting Implications

The NAIC addresses accounting for mortgage loans in SSAP No.37, which states that all costs associated with the purchase (including origination, acquisition, or commitment to purchase) are to be charged to expense as incurred, and that mortgage loans are to be assessed at fair value. A common practice among insurers is to originate a mortgage loan for an asset such as a building and report it on the Schedule B. Companies engaging in this practice are required to report the loan net of any commitment and origination fees associated with the origination of the loan. Loans originated by an entity other than the reporting entity are to be recorded at the amount paid to the seller, which sometimes results in a difference between the actual amount paid and the principal amount.

In the hands of a skilled manager adhering to a disciplined investment process that includes stringent risk oversight, we believe the risks inherent in higher-yielding investments are both manageable and worthwhile.

SSAP No. 37 also requires that amortization of these loans be recognized as an adjustment of yield over the life of the loan in order to produce a constant yield. Insurers that maintain a large portfolio of similarly priced and valued loans, with reasonably predictable repayment schedules, are to include estimates of future prepayments. Any adjustments to yield are to be credited or charted to interest income.

Other important accounting implications include (a) recognizing prepayments as liabilities, with prepayment penalties assessed to the borrower recorded as investment income; and (b) understanding when and how to report a loan as impaired. Mortgage loans are considered impaired when the reporting entity can reasonably assume they will not be repaid. The value of the impairment is the difference between the net value of the collateral and the reporting entity's investment in the loan. Reporting entities required to maintain an asset valuation reserve (AVR) must include the unrealized gain or loss on the impairment in the AVR calculation.

Investment Risk

Mortgage loans are a highly rated, illiquid asset class that we believe has historically provided compelling risk-adjusted returns. The relative high yields, versus other similarly rated securities, tend to be stable, paid current and call-protected. However, additional risks to consider before investing in whole loans include:

- Adverse changes in international, national or local economics or demographics
- Reduction or change in sources of debt or equity financing, including changes in interest rates
- Increases in real estate taxes and/or operating expenses, including energy prices
- Adverse changes in law, regulations or government policies, including environmental and zoning laws
- Portfolio concentration risk as it relates to property type or geographic mix
- Natural and unnatural disasters, including terrorism.

Reporting Challenges

Automation of reconciliation and data acquisition can be problematic for direct mortgage loan reporting. All too frequently, insufficient third-party data means servicers or servicing departments within an insurer must provide the data. This creates singular challenges if the position is entered at either a premium or discount, as the amortization schedule is necessary for calculating yield and amortization expense or accretion income. Another common pain point for insurers is that a lack of reporting infrastructure requires them to complete the Schedule B regulatory reports required for direct mortgage loans by hand. Companies with a high number of these investments (usually life insurers) may have systems that support the origination or servicing of the loans, but not the regulatory reporting. In many cases, the evaluation and reporting infrastructure for these securities is separated from the rest of their portfolio. For a full portfolio view, insurers must manually aggregate their mortgage loan investments. Ideally, a single system would be used for both the investment activity and the mortgage loan activity.

Other Key Considerations: Asset Class Reporting Schedules, Classifications and Risk-Based Capital (RBC) Charges

	Reporting Schedule and Classification	RBC Charges and Projection
Syndicated Loans	Reported on Schedule DB Part 1 as "Long-Term Bonds Owned December 31 of Current Year." Classification depends on the investment quality of the security and is similar to that of a long-term bond.	Treated as long-term bonds with a relatively low RBC charge.
Options	Reported on Schedule DB Part A.	Relatively low RBC charges.
Limited Partnerships (LPs)	Reported on Schedule BA as "Other Long-Term Invested Assets Owned December 31 of Current Year." Classification depends on the investment quality of the security and is similar to that of a long-term bond.	LPs tend to have a higher RBC charge depending on the underlying asset, the type of insurance company, and the NAIC designation, as it is often difficult to accurately determine the investment risk.
REITs	Reported on Schedule D Part 2 as "Common Stock Owned December 31 of Current Year." These are treated and classified as equities.	Treatment as an equity (Common Stock—Unaffiliated) results in a high RBC charge that may be between 15 and 45 percent, depending on the entity and whether the entity will be making tax (AVR) adjustments.
Mortgage Loans	Reported on Schedule B as "Mortgage Loans Owned December 31 of Current Year." Classification of these assets is largely dependent on the type of mortgage purchased.	Mortgages in good standing generally have a relatively low RBC charge (with the exception of Farm Mortgages and Commercial Mortgages—Other, both of which will have higher RBC charges). Mortgages that are not in good standing (for example, those that are more than 90 days past due/are delinquent) will be assessed a higher RBC charge.

Conclusion

The current low-interest-rate environment has apparently compelled many insurance companies to actively seek a more diverse set of investment strategies in an attempt to offset the loss of investment income from traditional asset classes. However, these diversified investment strategies inherently lead to riskier investments.

With this caveat in mind, some of the asset classes discussed in this paper potentially lend themselves to greater return with proportionately less risk. For example, syndicated loans have historically behaved much like a traditional fixed-income security and are somewhat more familiar to investors. In addition to their classification as senior debt of the issuer, these investments often carry the financial backing of their agent bank or banks, which in the event of a default can offer a greater likelihood that the lender will be repaid.

Options—in particular those of the exchange-traded variety—are another class of investments with a risk/reward structure that may be more palatable for investors. Similar to other exchange-traded securities, the counterparty risk in an exchange-traded option investment is significantly lower than that of an over-the-counter offer, thereby removing a significant portion of uncertainty for investors. Of course, this does not remove the risk inherent in options investments; rather, it should render virtually irrelevant the question of whether the counterparty will uphold its end of the contract.

The equity-like treatment of REITs means investors maintain an ownership right in the company or trust. In the event of a default, they are not personally liable for any repayment of debt on behalf of the issuer. However, this also means they are the last to be repaid (assuming there is enough money to make any repayments to investors and creditors), and could potentially lose their entire investment.

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Limited partnerships and commercial mortgage loans are often considered riskier than syndicated loans, options and REITS, largely due to their structure. Contracts may lack the safeguards of the aforementioned investments unless the investor has been diligent throughout the negotiation process. In the event of a default, investors run a significantly higher risk of losing their invested capital. However, they hold the potential for a higher return compared to more traditional investments. For investors with an appetite and tolerance for the risk involved, these investments may be a worthwhile addition to the portfolio.

In the hands of a skilled manager adhering to a disciplined investment process that includes stringent risk oversight, we believe the risks inherent in higher-yielding investments are both manageable and worthwhile. With no clear direction for interest rates in sight, it is our view that nontraditional asset classes warrant thoughtful consideration by insurance companies for inclusion in their investment portfolios.

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ENDNOTE

[1] The 2014 Insurance Peer Benchmark Survey polled finance and accounting professionals from a broad range of insurance companies in 2014. Responses were received from over 400 participants.

[2] *http://info.clearwater-analytics.com/fas115-2-practical-analysis.*