

Collateral Markets and Implications for Investors

Andreas Gruber, Group CIO
Allianz Investment Management SE

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Executive Summary

- § Collateral markets and their regulations have changed in the aftermath of the Global Financial Crises (GFC). Changes and initiatives underway provide opportunities and challenges for investors.
- § Collateralization and effective collateral management are key for Allianz to ensure our portfolios are protected in “worst case scenarios”.
- § Allianz as investor is a counterparty in collateral markets globally through selected asset managers. Besides collateral management related to OTC derivatives, our focus is on term securities lending as well as agency securities lending, where we capture illiquidity premium with low additional risks.
- § These collateralized transactions allowed Allianz to provide financing and liquidity to banks during the GFC. In current markets with strong support from the ECB, liquidity and funding is not a constraint. We observe significant cheapening of liquidity premium
- § Increasing regulatory scrutiny lead to additional administrative effort, largely on the side of our asset managers. Restrictions on types and use of collateral will impact market liquidity and bond valuations.

Counterparty Risk: Key Investor Considerations

§ Counterparty risk is

- whether the entity with which we transacted a security or derivative can fulfill its trading commitments.
- Risk is to the “in-the-money” portion of OTC derivatives and forward settled transactions and to potential replacement cost.

§ Allianz holds most assets via funds and segregated accounts. Requirements for the asset managers :

- Solid formal process to identify, evaluate and monitor counterparties
- Derivative documentation to protect client portfolios (e.g. master agreements to minimize OTC risk with mutual termination rights based on credit events)
- Robust collateral management process to protect our portfolios in “worst case scenarios”

Regulatory Changes and Challenges

	Key Requirements	Implications
Dodd-Frank EMIR ¹	<ul style="list-style-type: none"> § Central Clearing § Electronic Trading (Swap Execution Facilities) § Trade Reporting 	<ul style="list-style-type: none"> § Higher collateral requirements § Standardization of instruments § Reduction of offsetting positions (portfolio compression)
Basel III	<ul style="list-style-type: none"> § Capital buffers § Liquidity coverage § Consider unweighted assets (supplemental leverage ratio) 	<ul style="list-style-type: none"> § Higher costs for financing positions § Emergence of new liquidity premia

1) European Market Infrastructure Regulation

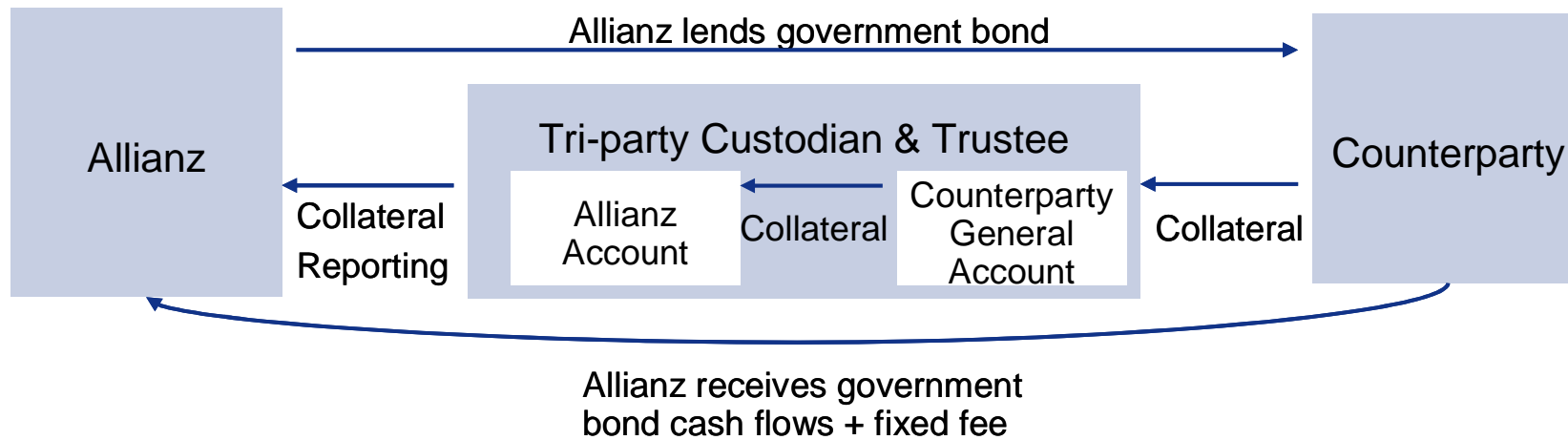
- § Investors need to adapt internal processes and operations and enable their portfolio managers to comply with increasing collateral requirements.
- § Our selected asset managers manage counterparty, collateral, liquidity and regulatory risks. Overall framework is set by Allianz standards and Allianz risk limits
- § EMIR requirement to report to central repository is expected to be enforced in 2018. Regarding our lending activities, information requirements will be fully outsourced to Euroclear and Agent Lender (e.g. Bank).
- § Change in financing needs for banks offer opportunities for non-bank investors positioned to take illiquidity risk

Term Securities Lending

- § Under a term securities lending transaction highest quality government bonds are lent out for several years. The lender receives lower quality/liquidity predefined collateral and is protected by overcollateralization and daily remargining.
- § Securities lending offers a diversifying risk return profile to Allianz' existing bond portfolio. Allowing us to capture illiquidity premium with low additional risks
- § Systemic risk considerations :
 - Allianz is not rehypothecating collateral and has ability to hold collateral to maturity
 - Unlike banks, Allianz has ability to hold illiquid collateral and does not amplify repo market crisis
- § Regulatory considerations :
 - encumbrance of assets may limit our ability for securities lending
 - European Market Infrastructure Regulation (EMIR) will lead to increased transparency requirements and reporting complexity. (We outsource to tri-party agent)
- § Tighter spreads lead to fewer attractive opportunities over the course of the last 3 years

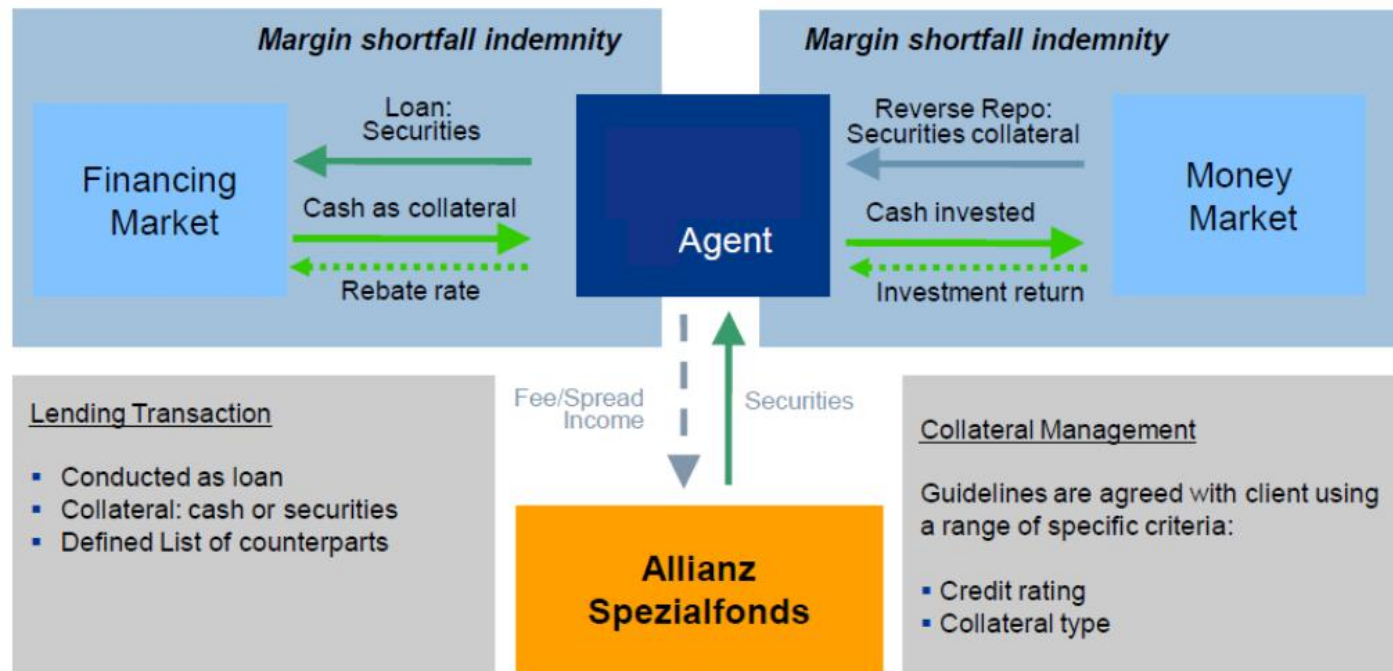
Term Securities Lending – How Does It Work ?

Illustrative overview of term securities lending structure



Agency Securities Lending

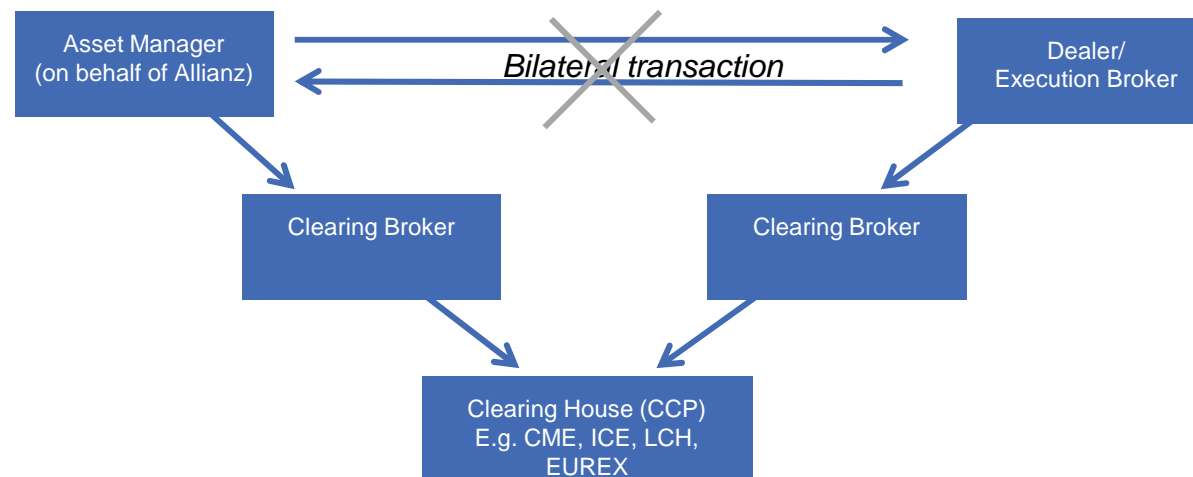
- § Under an agency securities lending transaction an external agent is mandated by Allianz to pursue lending on the basis of entire portfolios of equities or bonds against a predefined pool of collateral. Overcollateralization and daily remargining exist as well.
- § All transactions can be terminated on any day. Typically agents compensate the lender should defaults occur.
- § Regulatory considerations as above.



BACKUP

Managing Counterparty Risk – What is Changing ?

- § Central clearing includes the benefits of reduced counterparty risk and ability to transfer positions and collateral if clearing broker defaults.
- § Transactions are cleared through a central counterparty (CCP) clearing house, which is responsible for settling trades, monitoring margin requirements, collecting margin and reporting transaction data.
- § All market participants must post both initial and variation margin. Initial margin requirements are set by applicable law and the clearinghouses. The asset manager only posts the exchange-minimum required margin with the clearing broker.
- § Initial margin is segregated and held under the Legal Segregation with Operational Commingling model (“LSOC”).



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The statements contained herein may include prospects, statements of future expectations and other forward-looking statements that are based on management's current views and assumptions and involve known and unknown risks and uncertainties. Actual results, performance or events may differ materially from those expressed or implied in such forward-looking statements.

Such deviations may arise due to, without limitation, (i) changes of the general economic conditions and competitive situation, particularly in the Allianz Group's core business and core markets, (ii) performance of financial markets (particularly market volatility, liquidity and credit events) (iii) frequency and severity of insured loss events, including from natural catastrophes, and the development of loss expenses, (iv) mortality and morbidity levels and trends, (v) persistency levels, (vi) particularly in the banking business, the

extent of credit defaults, (vii) interest rate levels, (viii) currency exchange rates including the Euro/U.S. Dollar exchange rate, (ix) changes in laws and regulations, including tax regulations, (x) the impact of acquisitions, including related integration issues, and reorganization measures, and (xi) general competitive factors, in each case on a local, regional, national and/or global basis. Many of these factors may be more likely to occur, or more pronounced, as a result of terrorist activities and their consequences.

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