EDMOND DE ROTHSCHILD

ASSET MANAGEMENT

Lo scenario degli investimenti azionari europei in ottica Solvency II

"Preserve European equities performance while reducing SCR and Volatility"

JUNE 2017

EDMOND DE ROTHSCHILD ASSET MANAGEMENT (FRANCE)

THE REGULATORY FRAMEWORK ON EQUITIES

› The SOLVENCY II regulatory approach overview

- Risk that the value of equity will change due to drastic fluctuations
- A shock or instantaneous decrease is based on type with a symmetric adjustment
- A base shock is 39% on type 1 (OECD Equities) whereas strategic participation equity approaches may instead apply 22% shock
- Symmetric adjustment included to avoid pro-cyclical effects of regulatory requirements (+/- 10%)
  - Decrease shock accounts for period of low valuation when current index value is low compared with its average over the last three years
  - Increase shock accounts for period of high valuation when current index value is high compared with its average over the last three years
- Consequently, equity market shock and the capital requirement could evolve around 39% bet ween +29 and 49%.

› Our approach eligible to the regulatory framework

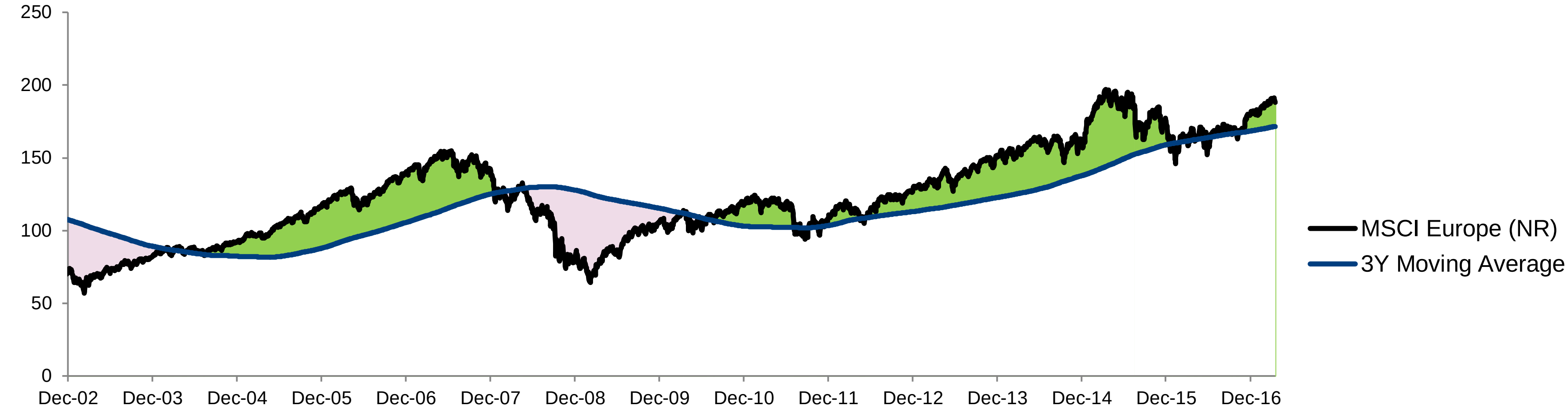
- Implementation of structural hedging (Delegated acts 10/10/2014 – section 10 article 209-212 & Technical Specifications 14 /209)
- Validation of the eligibility of the approach by a well-known auditor (Big four)
- Permanent monitoring of Solvency II principles

› Solvency II needs :

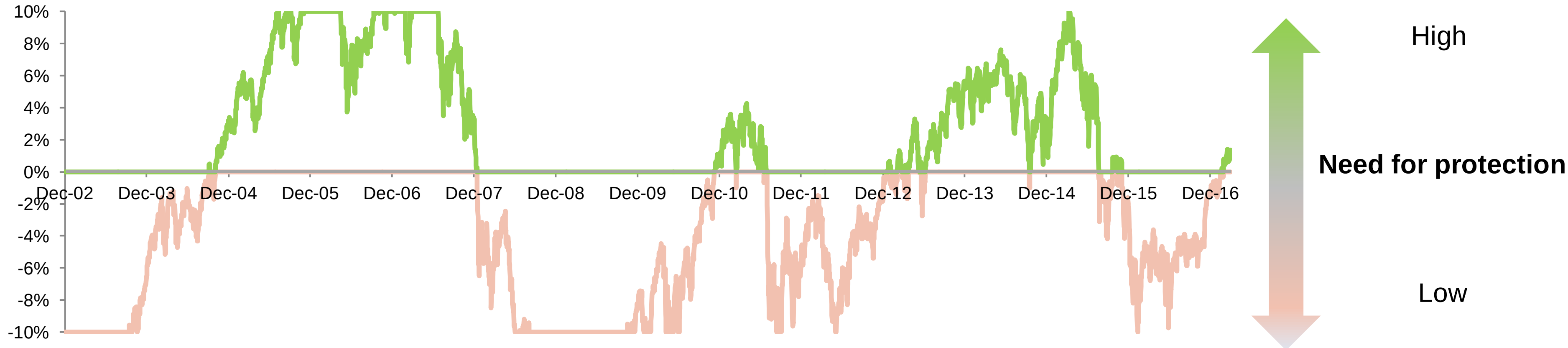
- A solution implemented with hedging strategies that are adapted to the underlying equity portfolio (low basis risk)
- A solution using in-depth knowledge of option based hedging techniques
- **A lower Target SCR of 22%** with both an attractive risk/return profile and cost of capital/return profile

THE DAMPENER EFFECT :
THE BENEFITS OF CONTRA-CYCLICAL APPROACH

› 3 year moving average provides for a good proxy long term indicator of the evolution of the market cycle

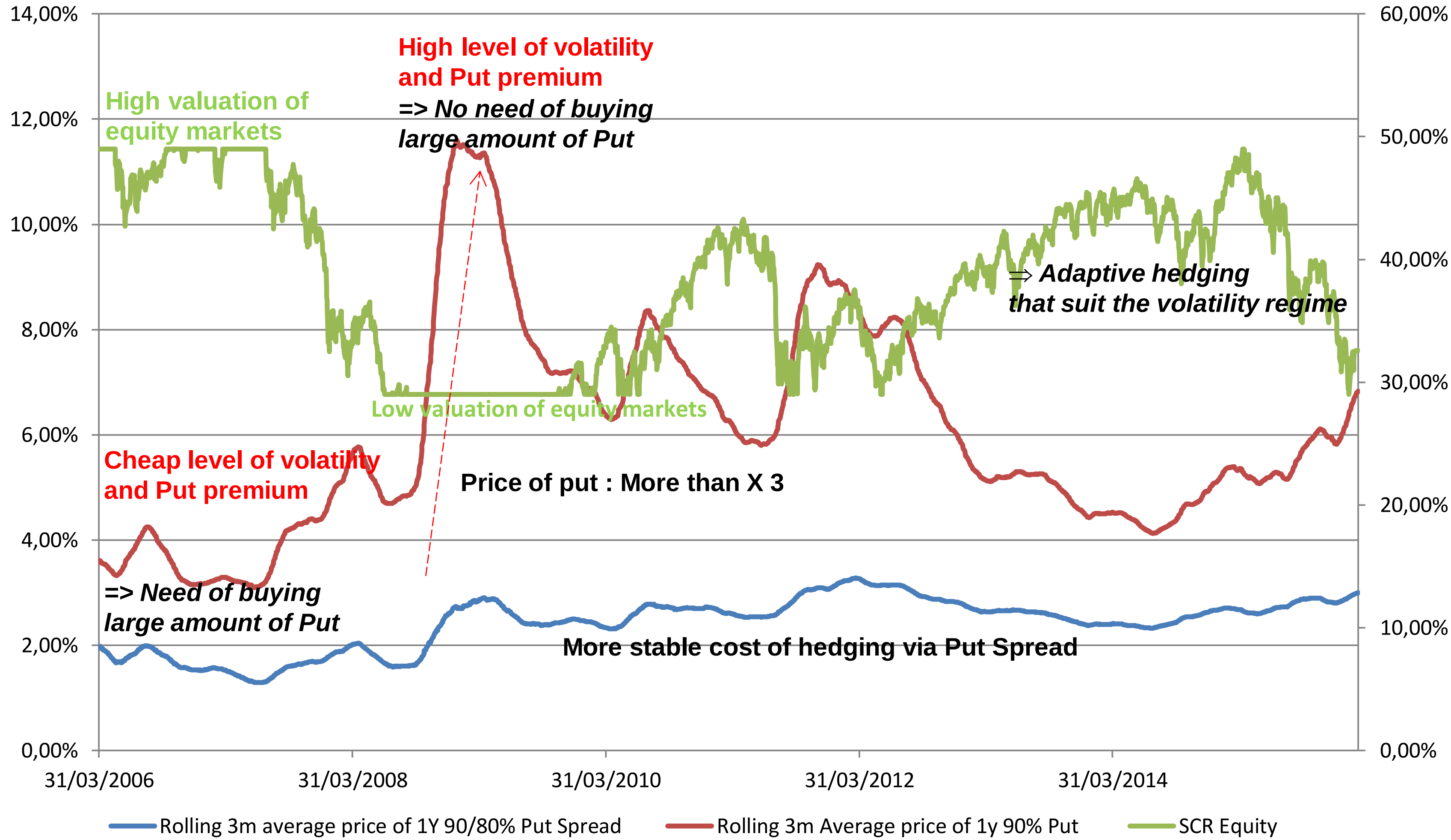


› Such a approach has been implemented by insurance companies (evolution of EIOPA dampener)

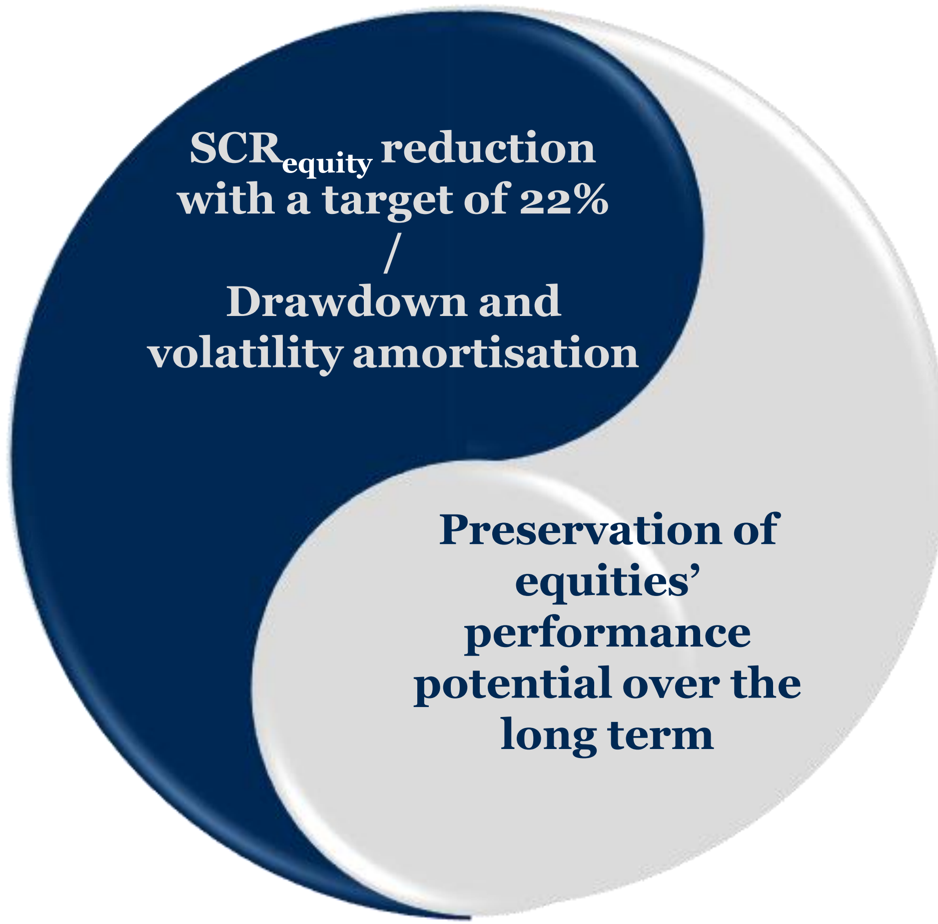


Source : Edmond de Rothschild Asset Management (France), data at 31/12/2016. Past performance is not a reliable indicator of future returns.

THE BENEFITS OF CONTRA-CYCLICAL REGULATORY APPROACH



A DUAL OBJECTIVE

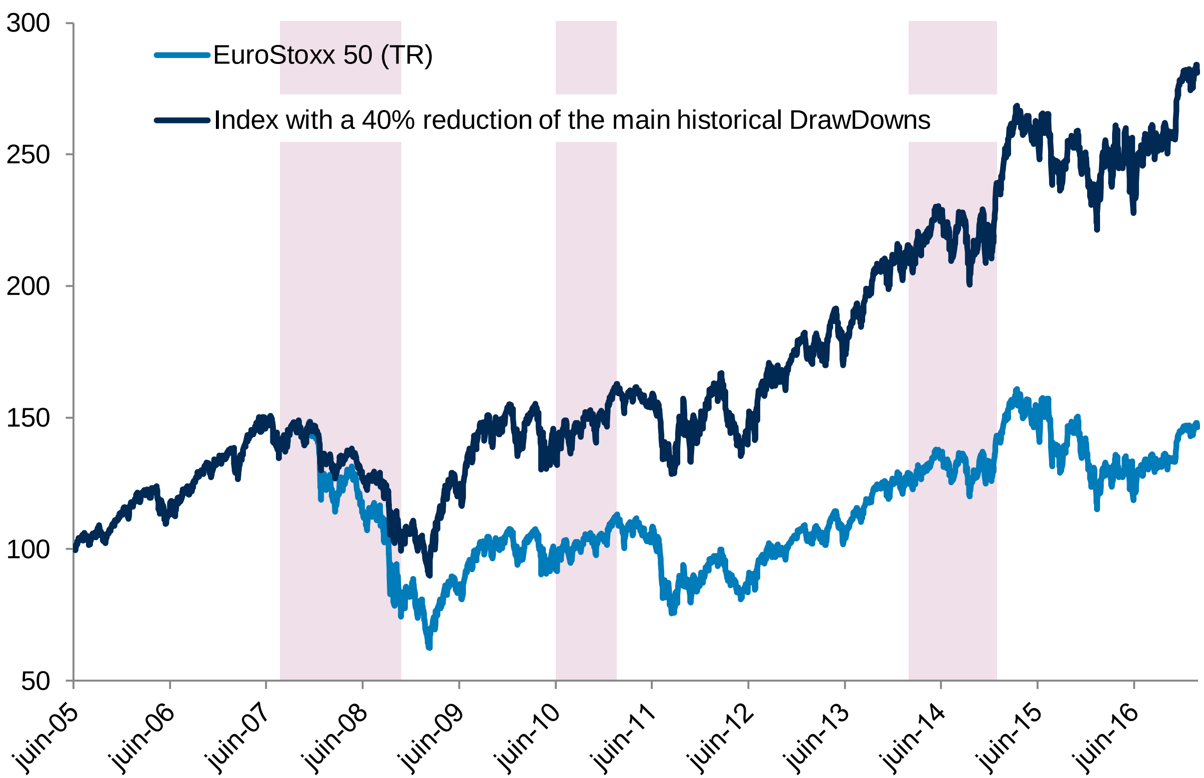


- Reducing the regulatory capital cost for insurance ...
- ...Mitigate downside risk and potential drawdowns of an equity exposure via a permanent hedging strategy using our option expertise
- ...While maximising upside potential by seeking to capture a large part of rising market phase

An attractive cost of capital/return BUT ALSO risk/return profile

THIS OBJECTIVE TO AVOIDE MARKET DRAWDOWN PERMITS TO INCREASE THE ATTRACTIVENESS OF LISTED EQUITIES

SIMULATION : EUROSTOXX 50 VS. INDEX WITH THE 5 STRONGEST MAXIMUM DRAWDOWN REDUCED BY 40%



› **Market movements can be a real challenge in terms of Mark-to-Market :**

➥ Reducing market volatility:

- 17,9% on an annualized basis for Eurostoxx 50 versus…
- …14,9% on annualized basis for our proprietary index

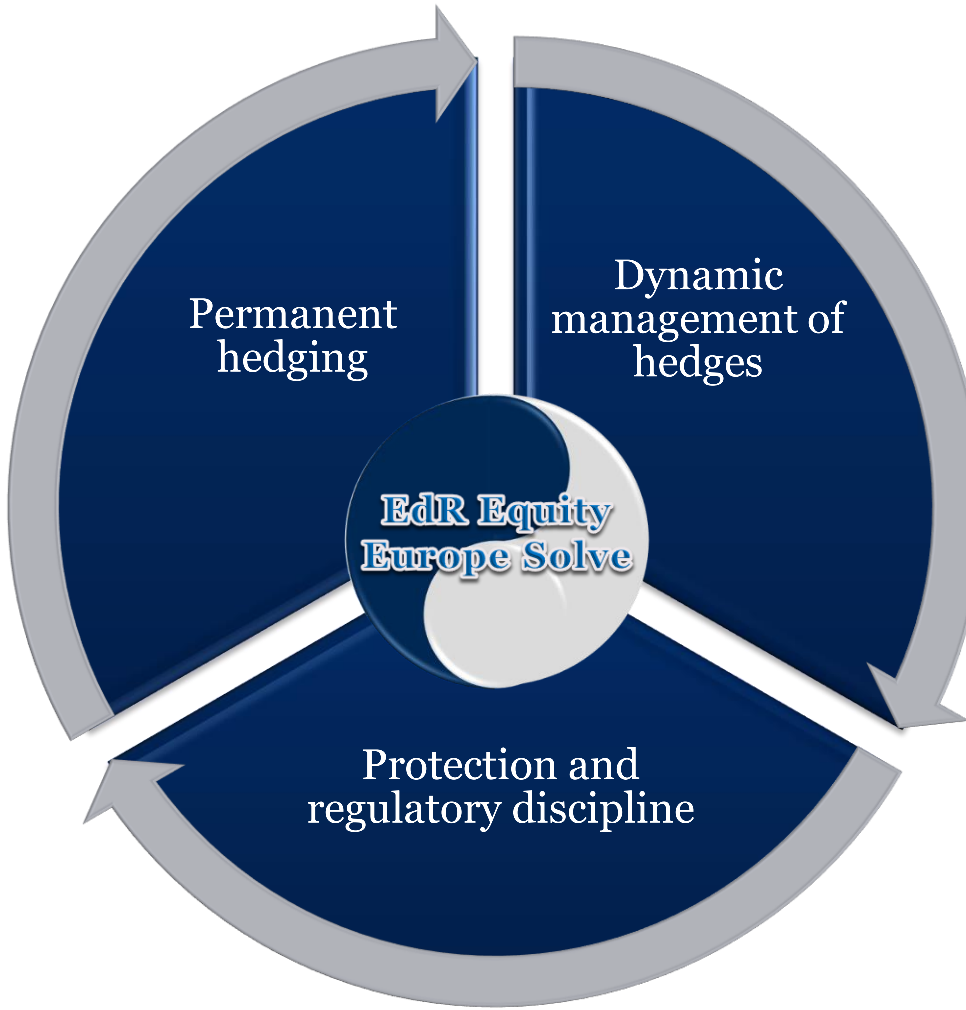
➥ Limiting Drawdowns:

- -58,6% (as per 09/03/2009) for Eurostoxx 50 versus…
- …-36% for our proprietary index (28/02/2009)

The good is the absence of the worst

Source : Edmond de Rothschild Asset Management (France), data as of 27/02/2017. Data provided have been computed on the basis of simulations and past performance does not guarantee future results

HOW DO WE ACHIEVE THIS DUAL OBJECTIVE



Allowing any type of investor to maintain its exposure with a lesser volatility and drawdowns or to increase its equity exposure for a similar risk budget

SOLVE : HOW DOES IT WORKS

- An efficient solution adapted to insurance company prudential constraints which benefits from our expert management of equity risk (via hedging)

- We offer insurers strategic, structural hedging of extreme risk by deploying option strategies to :

    1) Cut SCR_{equity} to 22% while optimising hedging costs

    2) Hedge portfolios against market shocks and control volatility

- How does it work ? The strategy is built upon two legs

EQUITY UNDERLYING		PERMANENT PROTECTION LEG		A FINANCING LEG
EdRAM stock selection expertise	+	Put on equities 1 year or more	+	Short term call on equities

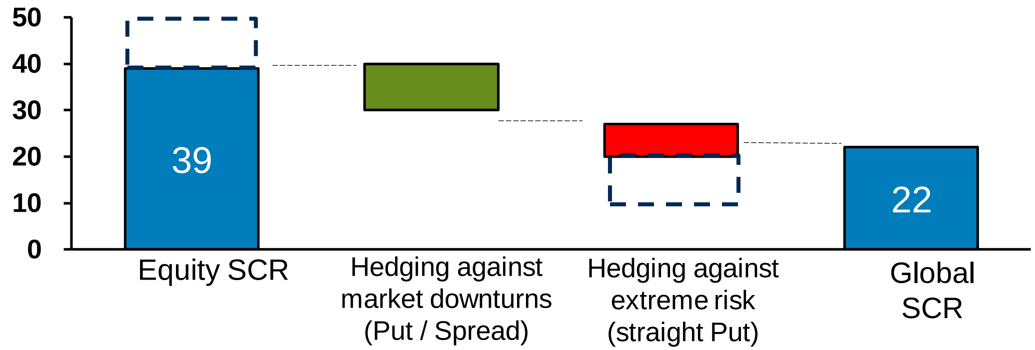
SOLVE SOLUTION: IMPLEMENTATION OF ACTIVE HEDGING

Strategic hedging

› **Structural mitigation of regulatory and financial risks**

- **Hedging against « regular » market drawdowns*** : purchasing of Put Spreads (maturity of 1 year or more)
- **Hedging against « extreme » market moves**: purchasing of straight Puts (maturity of 1y or more) whose notional is determined by SCR target of 22%

EXAMPLE FOR A SCREquity OF 39%



Dynamic hedging

› **Adapting positions in accordance to prevailing market conditions** (volatility, skew, etc) and SCR level when rolling positions

Permanent hedging of the portfolio

Source : Edmond de Rothschild Asset Management (France), *up to circa -20% : conviction of the Asset Manager

SOLVE SOLUTION:
FINANCING OF HEDGING COSTS AND SMOOTHING RETURNS

› **Approach implemented:** Short term Call writing

› **The selling of short term Call options benefit the portfolio** in different markets environments

- **<u>Bear markets</u>: highly performing**; we are seller of volatility when the latter is high
- **<u>Stable markets</u>: minimizes the cost of Put Spreads** via the received premium
- **<u>Bull markets</u>:** the **cost is limited** in the light of the **appreciation of the underlying** & the **short maturity**

Illustration of P&L linked to the selling of 1 month Calls with a 105% strike

Year	SOLVE Strategy	Systematic writting	Year	SOLVE Strategy	Systematic writting
2007	-2,4%	-0,9%	2012	0,9%	0,2%
2008	10,9%	12,8%	2013	-0,7%	-4,3%
2009	6,5%	3,3%	2014	-1,1%	-3,0%
2010	0,1%	6,8%	2015	-0,3%	-1,7%
2011	5,8%	8,2%			

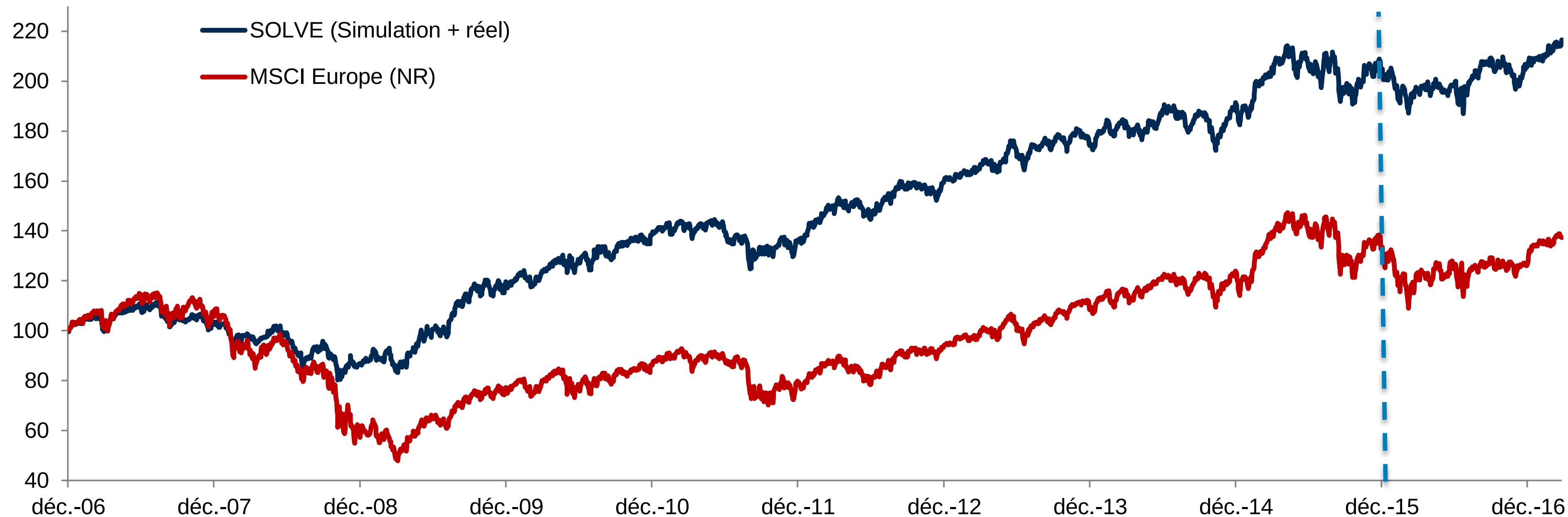
› **An efficient solution:** Call writing strategies are not systematic. They are implemented in the light of our objectives and expectations for global markets

Source : Edmond de Rothschild Asset Management (France), data as of 31/12/2015. Past performance does not guarantee future results

PERFORMANCE IS FULLY ALIGNED WITH ITS OBJECTIVE

Historical backtest (2006-2016) followed by the live track record (as from Dec. 2015)

SIMULATION + LIVE TRACK RECORD (DEC 2006 – FEB 2017)



	Annualised Performance	**Annualsied Volatility**	**MaxDrawDown**	**Recovery***
EdR Equity Europe SOLVE T	**7,84%**	**11,74%**	**-28,06%**	**210 days**
MSCI Europe (NR)	**3,15%**	**20,54%**	**-58,41%**	**1 248 days**

* In business days

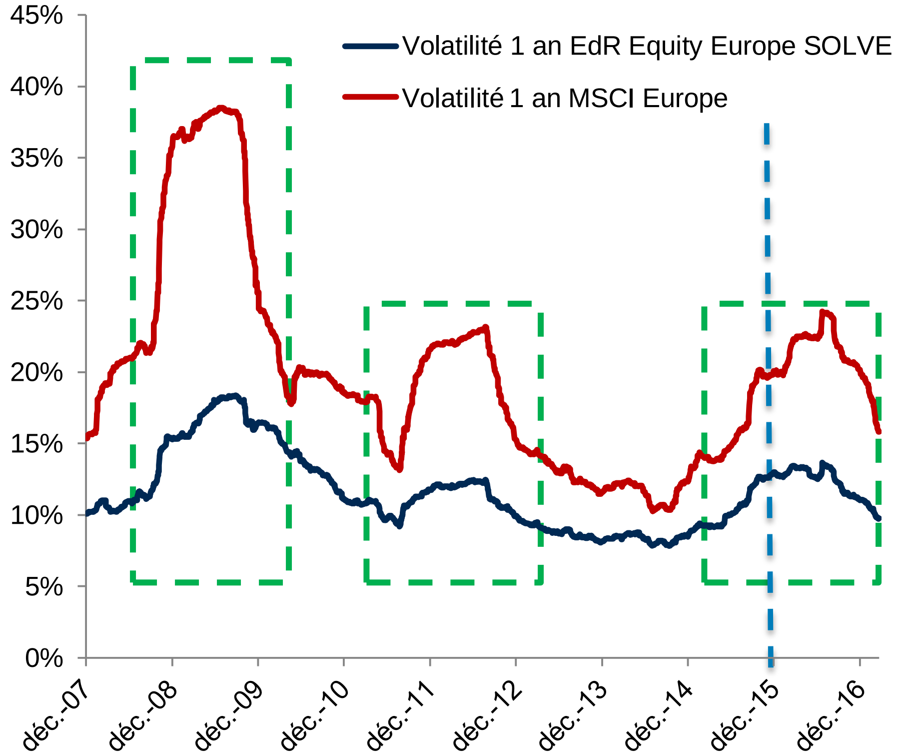
An real solution in adverse market environments combined with strong upside participation
A live track record completely validating the backtest result, doing even better !

Source : Edmond de Rothschild Asset Management (France), data as of 31/01/2017. Past performance does not guarauntee future results

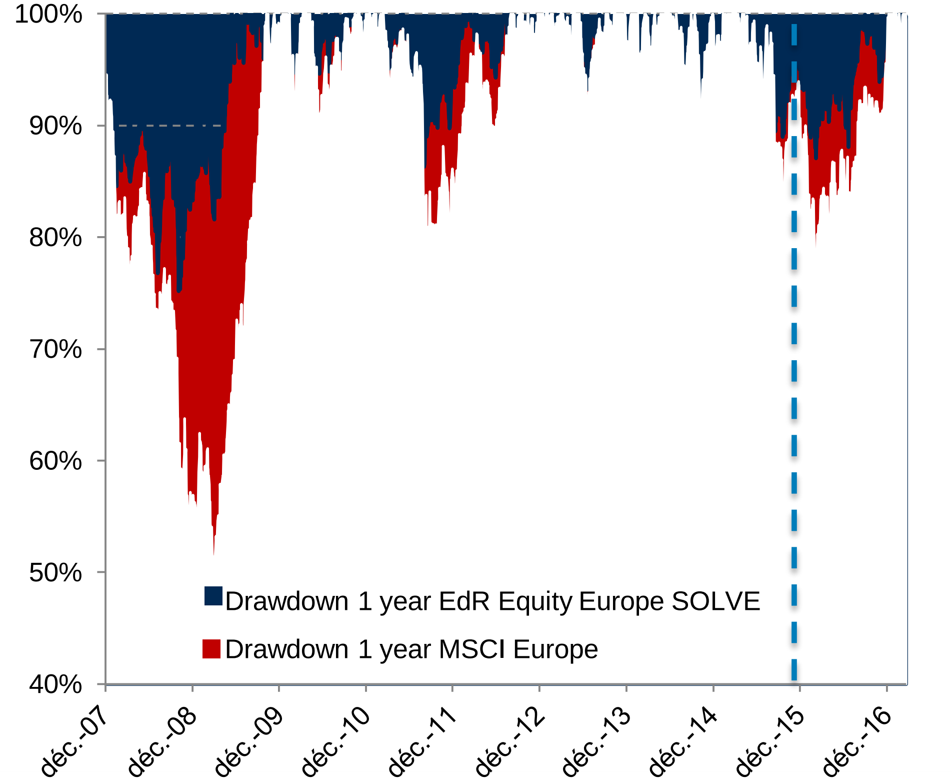
RISK INDICATORS ARE FULLY ALIGNED WITH OBJECTIVES

Historical backtest (2006-2016) followed by the live track record (as from Dec. 2015)

EVOLUTION OF 1 YEAR VOLATILITY
FOR THE MSCI EUROPE AND SOLVE



EVOLUTION OF DRAWDOWN
MSCI EUROPE VS SOLVE



SOLVE offers a significant reduction in both drawdowns and volatility

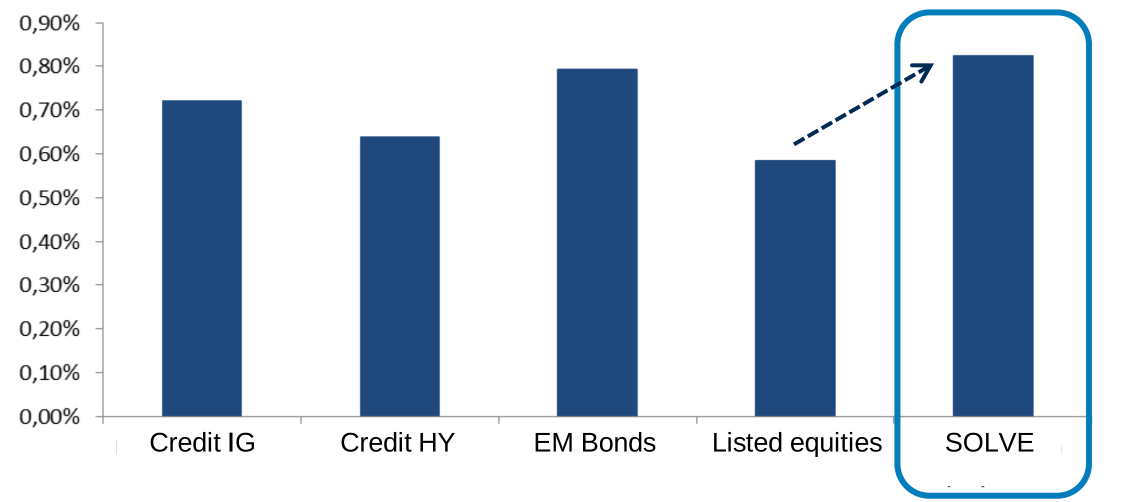
Source : Edmond de Rothschild Asset Management (France) past performance does not guarantee future results

CONCLUSION

- **Equities are strategic within an asset allocation** for investors seeking performance and diversification, and even more so in a low interest rate environment
- **Yet, listed equities are subject to high volatility and significant drawdowns;** not necessarily compatible with risk tolerance and/or institutional investors constraints
- **Make it a less volatile asset class, more asymmetric and less subject to mark-to-market constraints** has become an important area of focus to maintain its attractiveness as well as its role in portfolios
- Since the end of 2015, we have developed **an innovative protected equity strategy, SOLVE,** which allows for:
  - **Limiting market risk** and as such improve the **asymmetrical** risk/return profile of investments
  - **Reducing the volatility of accounting income** for institutional investors

Assumptions	1Y vol.	Expected returns p.a.
Credit IG	1,8%	1,3%
Credit HY	4,7%	3%
EM bonds	6,3%	5%
Listed equities	13,7%	8%
EdR European Equity SOLVE	8,0 %	6,5%

EXPECTED ANNUAL RETURNS (%) PER POINT OF VOLATILITY



Source : Edmond de Rothschild Asset Management (France), as 28/02/2017. Past performance does not guarantee future results

DISCLAIMER

Written on March 2017. This document is non-binding and its content is exclusively for information purpose.

All potential investors must take prior measures and specialist advice in order to analyse the risks and establish his or her own opinion independent of Edmond de Rothschild Asset Management (France) in order to determine the relevance of such an investment to his or her own financial situation. To this end, any investor shall read the key investor information document (KIID) delivered before any investment is made. Such a document is available online at www.edram.fr or upon request for free to the registered office of Edmond de Rothschild Asset Management (France). The Morningstar ratings are not market rankings and cannot be interpreted as recommendations to buy, sell or hold the shares or units of the above mentioned Fund. The references to market rankings or awards of these funds are not a reliable indicator of the future results of the Fund or of the Management Company.

EDMOND DE ROTHSCHILD ASSET MANAGEMENT (France)

47, rue du Faubourg Saint-Honoré, 75401 Paris Cedex 08

Société anonyme governed by an executive board and a supervisory board with capital of 11,033,769 euros

AMF Registration number GP 04000015

332.652.536 R.C.S. Paris