

LLOYD'S GBP AND EUR ENHANCED YIELD LIQUIDITY FUNDS

WHAT ARE STS ABS?

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LLOYD'S

A key component of the strategy for the Lloyd's GBP and EUR Enhanced Yield Liquidity Funds is the exposure they will have to high credit quality asset-backed securities (ABS) but only those classified as STS (simple, transparent and standardised).

Use of senior STS ABS positions in the Funds provides the portfolio manager with the opportunity to seek higher returns through the capture of a complexity premium whilst carefully managing downside risk and avoiding the punitive capital charges faced by insurers on other non-STS ABS.

INTRODUCTION TO ABS

What are ABS?

ABS are assets in which the interest (coupons) and principal payments associated with the asset are backed by a ring-fenced pool of underlying assets.

Examples of these underlying assets include residential or commercial mortgages or corporate loans, many of which are secured against physical assets, which provide investors with protection in the event the underlying borrower defaults.

Why use ABS within the Funds?

ABS markets can offer higher credit spreads than comparably rated corporate bonds and greater security.

These higher spreads are available because of the complexity of the analysis required to understand each security's composition. This constrains the number of eligible buyers and leads to more attractive credit spreads.

When investing in ABS instruments, managers need to analyse both the deal structure and the underlying loans backing a deal, which requires specialist expertise, resource, and process sophistication. An originator might issue several ABS transactions and each one will be different as it is the collateral and credit enhancements that primarily drives credit risk, even if the deal is from the same originator.

How are ABS instruments structured?

Banks create a separate legal structure known as a special purpose vehicle (SPV). This SPV issues bonds that essentially fund the purchase of a defined pool of loans (such as residential mortgages) from the originating bank.

How do ABS structures enhance credit quality?

ABS instruments are structured into different classes of bonds with different credit ratings. Principal and interest payments from the underlying asset pools flow through to a bankruptcy remote SPV which then distributes the payments to holders of the highest-rated bonds, senior bondholders first. Typically, only once these bondholders have been paid in full are proceeds distributed to the holders of lower-rated bonds (mezzanine or junior).

Effectively, the bonds higher up the capital structure have a higher credit quality than the underlying asset pool in aggregate. The credit enhancement (excess collateral in the SPV) provides additional security for senior bondholders in the structure to cover losses in stressed scenarios.

WHY STS SECURITIES ARE IMPORTANT FOR INSURERS

Capital treatment of ABS assets

Prior to 2019, under the Solvency II standard formula approach, ABS assets were divided into type 1 or type 2 ABS. This categorisation was based on a long list of criteria, some of which were subjective, requiring the insurer (or the asset manager of their behalf) to determine which bucket assets should fall into, on an ongoing basis.

Type 1 assets were treated more favourably, but the required capital allocation was still multiples of the capital for a similarly-rated corporate bond (see Figure 1 overleaf). Senior STS securities now benefit from a favourable capital treatment for insurers reporting under the Solvency II standard formula approach, being closely-aligned with similarly-rated corporate bonds.

Simple, transparent, and standardised (STS) ABS

The STS framework was introduced in 2019 to help identify the highest quality, most vanilla securitisations, based on the underlying collateral and the instrument structure.

Some of the key conditions for STS categorisation are as follows:

Simple

- The originator, sponsor and Securitisation Special Purpose Entity (SSPE) must be established in the EU
- The securitisation must contain homogenous underlying exposures which contain binding and enforceable obligations with full recourse to the borrower
- The assets underlying the securitisation must be static, not actively managed and cannot contain synthetic exposures, commercial mortgage-backed securities or assets in default

Transparent

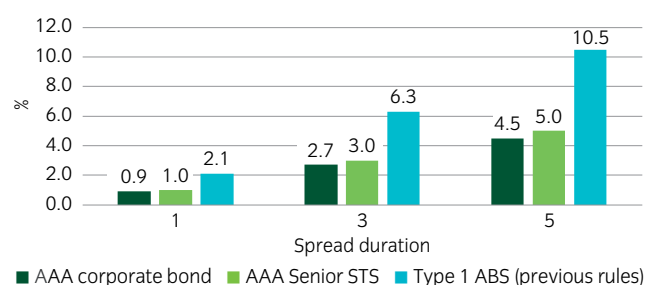
- Investors must have access to appropriate historical data on the default and loss performance of the underlying pool, verified by an independent party
- Investors should receive quarterly performance data and cashflow projections on an ongoing basis

Standardised

- The EU risk retention rules must be satisfied for the transaction
- Interest rate and currency risks must be mitigated as far as possible and the process used for doing so must be disclosed to investors
- Interest payments should reference a recognised market index
- There must be clear documentation governing the ongoing management of the deal, including counterparty replacement provisions and conflict resolution

From a practical perspective, as the STS category is agreed between the issuer of the security and the regulator (who maintains a database of eligible assets), it is straightforward for insurers or their asset manager to identify suitable securities.

Figure 1: Solvency II standard formula SCR (credit risk)¹



Targeting STS ABS in the Lloyd's GBP and EUR Enhanced Yield Liquidity Funds provides the potential for enhanced returns, whilst maintaining a focus on security, and importantly without introducing an adverse capital impact.

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Insight manages over £23 billion² in assets for 80 insurance clients spanning the UK, US, Europe and Asia.

- Insight has a long track record of managing insurance assets as a result of our insurance company heritage
- We manage assets for a diverse range of insurance liabilities including property and casualty, health, life, and annuity
- Our dedicated insurance team has extensive experience in supporting our insurance clients
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- We focus on capital-efficient investment solutions for insurers

¹ Source: PRA Solvency UK regulation / EIOPA Solvency II regulation. ² Source: As at 30 September 2025. Assets under management (AUM) are represented by the value of cash securities and other economic exposure managed for clients. Where the methodology defines it, some asset reporting focuses on cash securities only. Figures shown in GBP. Reflects the AUM of Insight, the corporate brand for certain companies operated by Insight Investment Management Limited (IIIML). Insight includes, among others, Insight Investment Management (Global) Limited (IIIMG), Insight Investment International Limited (IIIL), Insight Investment Management (Europe) Limited (IIIMEL) and Insight North America LLC (INA), each of which provides asset management services.

To discuss how we can help you optimise your investment portfolio, contact our specialists



Chris Brown

Head of Money Markets
Portfolio manager for Lloyd's Enhanced Yield
Liquidity Funds



Simon Richards

Head of Insurance Solutions
simon.richards@insightinvestment.com
+44 20 4570 1739



Robert O'Riordan

Institutional Business Development Director
robert.oriordan@insightinvestment.com
+44 20 4570 1687



Lloyd Raynor

Client Director
lloyd.raynor@insightinvestment.com
+44 20 4583 3571

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Taxes and costs incurred when purchasing, holding, converting or selling any investment, will impact returns. Costs may increase or decrease as a result of certain currency conversions, such as currency hedging, investment exposure to international markets, and exchange rate fluctuations.

Any target performance aims are not a guarantee, may not be achieved and a capital loss may occur.

ASSOCIATED INVESTMENT RISKS

Fixed income, Secured Finance and Cash

Investments in bonds are affected by interest rates and inflation trends which may affect the value of the portfolio.

The issuer of a debt security may not pay income or repay capital to the bondholder when due. The return risk to a portfolio is higher where a portfolio is highly concentrated in such an issuer.

Where high yield assets are held, their low credit rating indicates a greater risk of default, which would affect the value of the portfolio.

The specific collateral used to secure a loan may decline in value or become illiquid, which would adversely affect the loan's value. Also, many loans are not actively traded, which may impair the ability of the portfolio to realise full value in the event of the need to liquidate such assets.

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