# Insurance Asset Management

*Spring 2022*

**Asian Credit**
The benefits of investing in this asset class for insurers

**Bulk Purchase Annuities**
Outlook for the UK BPA market and the role insurers play within this

**Association of British Insurers**
The ABI's assistant director, head of prudential regulation, checks in

## A balancing act

**2022 will see CIOs continue in their battle with medium-term macroeconomic drags and longer-term ESG pressures**

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An overview of the prestigious winners and their talents

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Key opportunities and how insurers can access these

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A round-up of all the major discussions from leading industry professionals

# Editorial Comment

> The growing demand for UK BPAs remains one of the best long-term opportunities in the European insurance sector

Inflationary pressures, soaring energy prices and tensions between Russia and Ukraine make for grim reading in the media, and the effects on the general investment environment can't be ignored. Insurers are not exempt from these market forces, but I am delighted to say in this issue we have chosen to cover a whole range of investment areas in which chief investment officers and asset managers can look to for healthy returns.

Our roundtable on p.64 looks at the Asian Credit space, for example, and we also provide a review of our IAM Conference held at the end of last year at the Hilton London Tower Bridge. Hundreds of delegates from the insurance industry gathered to hear about key opportunities in fixed income, alternatives and the ESG environment. Heads of investment and chief investment officers from the likes of Aviva, L&G and Phoenix Group to name but a few, all provided their expertise. Emerging markets corporate debt, investment grade credit and the convertibles space were also put forward as areas in which insurers can reap rewards.

This issue also explores latest developments in the bulk purchase annuity (BPA) market (p.24). Moody's recently said the growing demand for UK BPAs remains one of the best long-term opportunities in the European insurance sector, and will support the profitability of European life insurers going forward. It's particularly exciting to see just how far this market can go.

To whet your appetite even further, this latest edition of the magazine incorporates an Insurance Asset Management Winners Brochure detailing all insurance industry winners from our prestigious event held in November, with selected winners profiles providing in depth write-ups on leading investment strategies conducted by insurers and asset managers over the past year.

With increased volatility and a material reduction in funds held by insurers to withstand shocks likely to arise from Solvency II reforms, 2022 is set to be a busy year. It will be interesting to see just how the Solvency II reforms pan out. As the BoE governor Andrew Bailey said recently, "I do not for a moment consider that the Solvency II we transposed from EU law and regulation is best suited to the UK. Why would it be, since it was designed to cover 27 countries? The case for reform is clear".

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# Spring 2022

News focus

# 'Increased volatility' likely to arise from proposed Solvency II reforms

## 'Material reduction in funds' held by insurers to withstand shocks a possibility

Written by **Adam Cadle**

Increased volatility and a material reduction in the funds held by insurers to withstand shocks are a likely outcome of any reforms to Solvency II that resemble those explored in the PRA's Quantitative Impact Study (QIS), Willis Towers Watson (WTW) has argued in its latest report commissioned by the ABI.

Following HM Treasury's call for evidence on re-shaping the UK insurance regulatory regime in light of the UK's withdrawal from the EU, the PRA undertook a QIS to explore variations in several technical aspects of particular importance to writers of long-term insurance.

WTW stated that the QIS framework "does not satisfy the collective objectives of the HM Treasury review of Solvency II, as it would lead, if implemented, to material reductions in, and increasing volatility of, insurers' funds available to withstand shocks, prioritising increased prudence to the detriment of competition and growth".

> The framework will hinder, rather than stimulate, growth and investment in the UK, especially for infrastructure and long-term productive assets

Furthermore, it argued that the framework will hinder, rather than stimulate, growth and investment in the UK, especially for infrastructure and long-term productive assets that the UK government is keen for insurers to invest in. WTW said the framework "could lead to higher and more volatile annuity prices with resulting lower demand for such products and impact the broader pensions sector, ultimately leading to reduced income security for pensioners".

The WTW report includes an analysis of life insurer data submitted in the QIS, representing approximately three-quarters of the life insurance industry by technical provisions. It has been prepared by the UK insurance practice of WTW for the ABI.

> The framework could lead to higher and more volatile annuity prices with resulting lower demand for such products

The findings from the WTW analysis of the two scenarios explored in the QIS (Scenario A and Scenario B) using this sample of data are:

- The Matching Adjustment (MA) would reduce by 44% in Scenario A and by 13% under Scenario B, equating to an increase in annuity liabilities of £14.1bn and £4.3bn, respectively.
- The Risk Margin (RM) for annuity business would reduce by 56% under Scenario A, while Scenario B would lead to a 21% reduction. The RM for non-annuity life business would reduce by 42% and 18% for Scenario A and Scenario B respectively.
- In aggregate, insurers' funds available to withstand shocks would reduce by 4.2% under Scenario A and by 1.0% under Scenario B.
- For firms with MA portfolios, the average reduction in solvency ratio is 8% and 2% for Scenario A and Scenario B, respectively, based on holding the SCR constant across the scenarios. For firms that specialise in annuities, the average solvency ratio drops by 31% and 11% under Scenario A and Scenario B, respectively.
- Under an "extreme spread" stress, as specified by the PRA, the MA under the QIS scenarios offset the spread movement by approximately 30% less than the current approach.

Carrying on the theme of Solvency II, PwC recently argued that "simple solutions" could be adopted for the risk margin to better align it with the specific features of the UK insurance market. These include a margin over current estimate (MOCE) approach, a risk tapering (lambda) approach, and a cost of capital approach. PwC said the cost of capital should respond to market conditions if it is to represent the current cost of transfer to a third party (i.e. it should be dynamic so it does not introduce unintended volatility and sensitivity of the risk margin to changes in underlying interest rates).

## News in brief

■ The Association of Mutual Insurers and Insurance Cooperatives in Europe (AMICE) has become a supporting institution of the United Nations Environment Programme Finance Initiative Principles for Sustainable Insurance (UNEP PSI).

■ German insurer group, Gothaer, has joined the Net-Zero Asset Owner Alliance, and in doing so has committed to making its investment portfolio climate-neutral by 2050.

■ The total assets of Chinese insurance companies at the end of Q4 2021 amounted to 24.9trn yuan, an increase of 2.6trn yuan from the beginning of the year or 11.5%, the China Banking and Insurance Regulatory Commission (CBIRC) has said. The total assets of property and casualty insurance companies were 2.5trn yuan, an increase of 6% over the beginning of the year and the total assets of life insurance companies were 21.4trn yuan, an increase of 12.4% over the beginning of the year.

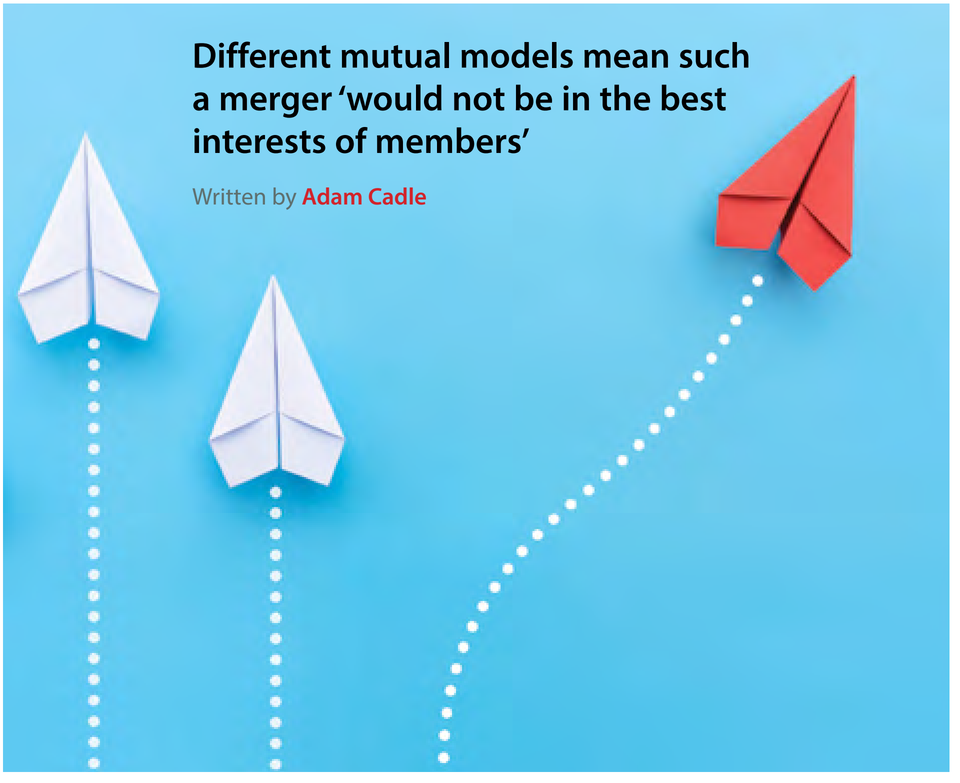
■ French life insurance premiums amounted to €151.1bn in 2021, a record level, and net inflows rose to +€23.7bn, a level not seen since 2021, according to latest figures published by France Assureurs. In December, net inflows amounted to +€2.7bn, up by €1.7bn compared to December 2020.

■ Hungary's insurance industry is projected to grow at a compound annual growth rate (CAGR) of 6.3% from HUF1,204.86bn ($3.91bn) in 2020 to HUF1,635.5bn ($5.67bn) in 2025, in terms of GWP, according to GlobalData.

# Merger talks between LV= and Royal London collapse

## Different mutual models mean such a merger ‘would not be in the best interests of members’

Written by **Adam Cadle**



We continue to maintain our strong capital position, are trading well and building a successful future for LV=

LV= has confirmed that its discussions with Royal London over a potential merger have ceased.

Talks between the pair had started at the beginning of the year after Royal London issued a statement in December suggesting that it could offer an “attractive future” for the members of LV=.

However, a statement released by LV= recently has revealed that the different mutual models of the companies mean such a merger would not be in the best interests of its members.

LV=’s incoming chair Seamus Creedon thanked Royal London for its engagement and added that the insurer is looking forward to operating alongside it as part of a “vibrant mutual sector”.

“The strength of LV=’s business performance over the past 18 months combined with its operational progress has strengthened the board’s belief in, and commitment to, the continuation of our status as an independent mutual,” Creedon commented.

“We have heard what our members have said about the importance of mutuality and the continuation of the LV= brand. We continue to maintain our strong capital position, are trading well and building a successful future for LV=, its members, employees and wider communities. We will shortly update our members on our business strategy and will continue to engage with them over the coming weeks and months.”

Royal London group chief executive Barry O’Dwyer added: “Mutuals are owned by their customers and are run for their benefit. Our offer to preserve LV=’s mutuality through a merger with Royal London was based on an understanding that LV= did not have a viable future as an independent company.

“For Royal London’s customers and members, nothing changes. We remain committed to delivering great value products, backed up by market-leading customer service. We look forward to sharing a substantial level of profits with our eligible customers in April, as we normally do.”

In December, it was announced that the proposed £530m sale of LV= to Bain Capital was off the cards after mutual members voting in support of the deal fell below the 75% threshold.

# Global insurance M&A activity close to the heights of 2019 - Clyde & Co

## 418 deals were recorded in 2021 as Americas and Europe see uptick in activity

Written by **Adam Cadle**

UK M&A activity in the global insurance sector for 2021 was 418 deals, close to the heights of 2019 (419), and up from 407 in 2020, Clyde & Co has reported.

Deals in the Americas were up strongly between 2020 and 2021 (192 to 224), while M&A in Europe saw a marked uptick in activity in H2 2021. However, Asia Pacific saw the number of completed transactions drop to their lowest level since 2017 (41). Activity in the Middle East & Africa was also down in 2021 compared to 2020 (32 to 17), despite a relatively strong second six months.

Despite a growing number of deals in Europe in 2021, the market still remains depressed post pandemic, Clyde & Co said. "There is lots of interest from potential buyers but there simply are not enough suitable targets. In contrast, general market sentiment in the US – once again the world's most active market for M&A by some margin – is more buoyant, which propelled the country's deal total in 2021 to a six-year high. We expect this strong appetite for deal-making to endure in the coming year. Meanwhile, in Asia Pacific, the ongoing impact of COVID-19 continues to dampen appetite for M&A, and significant caution around making investments will remain."

> We expect this strong appetite for deal-making to endure in the coming year

# Majority of asset managers expecting private equity interest

## 80% of managers think demand will increase in 2022

Written by **Adam Cadle**

Eighty per cent of asset managers expect increased demand for private equity mandates in 2022, and 75% expect demand for other private investment mandates, new research published by Cerulli has revealed.

Current income (92%), diversification (85%), growth/enhanced returns (77%), and volatility dampening (54%) are the top objectives managers of private investment strategies seek to fulfill for investors.

"Many portfolios benefit from the smoothing effects of private investments," Cerulli Associates associate director James Tamposi stated. "Because these investments are not marked to market but are instead marked at book value, having them in a portfolio helps limit volatility."

The research detailed views from 10 of the world's leading asset managers: Brevan Howard, Hamilton Lane, Oaktree Capital Management, RBC Global Asset Management/BlueBay Asset Management, Western Asset Management Company, BlackRock, JP Morgan Asset Management, Morgan Stanley, Putnam Investments, and Wellington Management.

# European insurers' exposures to macro risks remain at high level

## Solvency position for insurance groups decreases, but remains above year-end 2020 level

Written by **Adam Cadle**

European insurers' exposures to macro risks have remained at a high level, while all other risk categories, such as insurance as well as profitability and solvency risks have stayed at medium levels, EIOPA's latest risk dashboard based on Solvency II data from the third quarter of 2021 has shown.

Macro risks remain at a high level, amid upward revision of inflation forecasts. The 10 year swap rates increased across currencies in the third quarter of 2021. Unemployment rates remain high, and monetary policies remain accommodative. Asset purchases continue at a slower pace and are expected to decelerate further.

After six quarters of increasing trends, the solvency position for groups decreased, but still remains above year-end 2020 level. The SCR ratio for solo life undertakings slightly improved, and profitability indicators reported a slight deterioration, with a rise in the net combined ratio for non-life business.

Insurance groups' exposure to banks decreased, while the median investments in insurances and other financial institutions rose slightly. Insurance risks remain at a medium level with year-on-year premium growth for life insurance showing a slight deterioration.

> All other risk categories, such as insurance, as well as profitability and solvency risks have stayed at medium levels

ESG related risks are at a medium level, and the catastrophe loss ratio decreased slightly compared to the previous quarter.

EIOPA also recently published its Supervisory Convergence Plan 2022.

In line with EIOPA's mandate to build a common supervisory culture and consistent supervisory practices in the European Union, the Supervisory Convergence Plan identifies EIOPA's priorities to enhance supervisory convergence over the course of 2022. The priorities revolve around the following three main areas: common supervisory culture and tools, risks to the internal market and level playing field, and supervision of emerging risks.

With regards to risks to the internal market and the level playing field, which may lead to supervisory arbitrage, EIOPA will focus on supervisory convergence tools in the area of calculating technical provisions and benchmark studies on internal models. In addition, EIOPA intends to address inconsistencies in the way National Competent Authorities treat reinsurance undertakings with the head office in third countries.

# 'Company-specific analysis' should be at heart of liquidity risk supervision

## Insurers warn IAIS against overengineering monitoring tools for assessing global liquidity trends

Written by **Adam Cadle**

The microprudential supervision of liquidity risk must be based on company-specific analysis and frameworks which cannot be standardised at a global level, Insurance Europe has argued.

In its response to a consultation by the International Association of Insurance Supervisors (IAIS) on the development of liquidity metrics, Insurance Europe said it supports the implementation of the proposed Exposure Approach (EA) which it considers to be the most appropriate candidate metric for global macro liquidity risk monitoring.

It also supports the development and implementation of a single metric, assessed under a single time horizon. "The design of the liquidity metric should align with its macroprudential objective and remain as simple as possible to avoid unnecessary regulatory burden," it stated.

Insurance Europe said it recognises the efforts made by the IAIS to develop the cashflow projection approach (CPA).

"As the CPA relies on a prescriptive "one size fits all" list of stress parameters which are not suitable for each individual insurer, it cannot, however, replace internally developed metrics used to manage liquidity and would create additional work and a parallel calculation without material benefits."

> A multiphase delivery of standards should be allowed for

Insurance Europe also recently published its updated key messages on EC proposals for CSRD.

For insurers to make appropriate investment decisions and comply with sustainability regulation it is vital that consistent, comparable and machine-readable sustainability data is available, and that it can be accessed and used efficiently, Insurance Europe argued.

Insurance Europe said the option to report at consolidated (group) level is key and should apply to public interest entities, as it does for others.

In addition it said a multiphase delivery of standards should be allowed for.

"It is vital that any delays (such as those under discussion by co-legislators) do not apply to data needed for mandatory reporting requirements. The legislation should therefore make it clear that the European Financial Reporting Advisory Group can develop standards in a multiphase approach. This will allow it to give priority, and avoid delays, to information needed for reporting under the Sustainable Finance Disclosure Regulation and EU Taxonomy Regulation."

Insurance Europe argued that there needs to be a SME definition which works for insurance. "Insurers have fundamentally different balance sheets and revenues to other industries due to the nature of their business. The definition of SME undertakings in the draft text should therefore be refined to reflect SME insurers' characteristics."

# NZAOA pledges to at least halve portfolio emissions by 2030

## Range of 49%-65% or beyond targeted

Written by **Adam Cadle**

The UN-Convened Net-Zero Asset Owner Alliance has released the second edition of its Target Setting Protocol detailing that overall absolute emission reductions for its 69 asset owners should range between 49% to 65% or beyond for the period 2020 to 2030.

The focus of the Protocol is set around portfolio emissions, also known as Scope 3 emissions (or 'financed emissions'), which typically represent the vast majority of an asset owner's emissions (95-97%) in their respective portfolios.

Guenther Thallinger, board member Allianz SE & chair UN-convened Net-Zero Asset Owner Alliance said: "This advanced guidance will help investors already committed to net-zero to take the urgent shorter-term action that climate science demands.

"Where the first edition of this Protocol focused on 2020 to 2025, the latest ambition towards 2030 stresses the need for powerful, credible and rapid action to achieve a net-zero emissions world. Action is needed now, and every company is challenged to follow the lead of Alliance members and adjust business models, develop plans for the transition to a low-carbon, climate-resilient future, and then implement those plans.

"The Alliance Commitment requires its members to publish interim targets on a five-year cycle. Targets must be ambitious enough to signal an Alliance member's expectations while considering that the real economy is only just beginning its net-zero transition."

> Action is needed now, and every company is challenged to follow the lead of Alliance members

February saw Scottish Widows become the first UK insurer to publish its roadmap to net-zero, planning to invest up to £25bn into companies leading on decarbonisation and climate solutions by 2025.

Its Climate Action Plan said that of the £25bn, £1bn will be specifically invested in climate solutions such as renewable energy, low carbon buildings, and energy efficient technologies. It will ensure climate impacts are at the core of asset allocation decision-making and exclude high carbon investments that are at high risk of becoming stranded assets. In addition, Scottish Widows said it will focus stewardship activity on companies failing to address climate change risks.

An additional £3bn investment has been made in BlackRock's Climate Transition World Equity Fund. The fund has a bias towards firms with improved climate credentials. This brings the total investment in the fund by Scottish Widows to £5bn.

As part of its ambition to achieving a fully net-zero portfolio by 2050, Scottish Widows has previously committed to halving the carbon footprint of all its investment portfolios by 2030, and last year relaunched Scottish Widows Environmental Fund as fully fossil fuel-free. In recent years, the company has also financed over £400m of direct flows into green energy solutions such as wind power generation and solar farms and divested near £1.4bn from companies that haven't met their ESG standards.


> We have conducted rigorous due diligence on our carbon removal options

# Rothesay signs 10-year carbon dioxide removal agreement with Climeworks

## 'Ground-breaking' technology a pull

Written by **Adam Cadle**

Rothesay has signed a 10-year carbon dioxide removal agreement with Climeworks.

The agreement will remove Rothesay's expected residual emissions for this entire decade, making the insurer's own operations over the next ten years net-zero by 2030.

"As part of Our Pathway to Net-Zero, we have conducted rigorous due diligence on our carbon removal options and have chosen Climeworks because its ground-breaking technology allows us to measurably neutralise the environmental impact of our operations," Rothesay's head of investment strategy and chair of its Climate Change Working Group David Land said.

"Like Rothesay, Climeworks is an innovative, purpose-built company that is delivering highly effective solutions for its clients, and we look forward to a long-term partnership."

Other recent climate strategy moves included Aegon ceasing to invest in companies that derive 5% or more of their total oil equivalent production from oil sands, down from a previous threshold of 30%.

Aegon is to also stop investing in companies that derive 5% or more of their revenue from oil and gas exploration and production in the Arctic.

# US insurers' interest in incorporating ESG factors into investment strategies grows significantly

## Corporate reputation and regulatory requirements key drivers

Written by **Adam Cadle**

The interest of US insurance companies in incorporating ESG factors into their investment strategies grew significantly in the past two years, according to a new survey by Conning.

The survey, sent to more than 7,000 insurance industry representatives, resulting in 280 qualified responses from US insurance decision-makers in the life and P&C sectors, revealed that 41% of respondents began incorporating ESG factors this past year, 79% the past two years, and only 12% more than two years ago.

The leading driver influencing insurers' commitment to incorporating ESG factors into their investment strategy is the potential impact on their corporate reputation. Other drivers include customer and employee concerns, regulatory requirements, leadership concerns about social issues, and the potential for competitive advantage.

# People on the move

**ANNE SIMPSON**

**Global Head of Sustainability, Franklin Templeton**

Franklin Templeton has appointed Anne Simpson as global head of sustainability, a newly-created role charged with driving the firm's overall strategic direction on stewardship, sustainability and ESG investment strategy globally. She joins the firm from the California Public Employees Retirement System, where she served as managing investment director for board governance and sustainability.

**KHALID KAHN**

**Managing Director, Investment Team, Aeon Investments**

Khalid Kahn has joined Aeon Investments as a managing director in the investment team. He is responsible for originating and structuring new investments, and managing existing credit portfolios in commercial real estate and SME lending. Prior to his new role, Kahn worked at Federated Hermes International, where he was senior credit structurer in the fixed income group.

**THU HA CHOW**

**Head of Fixed Income Asia, Robeco**

Robeco has appointed Thu Ha Chow to the newly created role of head of fixed income Asia. Prior to joining Robeco in 2022, Chow was portfolio manager and Asia strategist at Loomis Sayles & Co and head of asian credit at Aberdeen Asset Management, both in Singapore. Previously, she held senior fixed income positions at Deutsche Asset Management and Threadneedle Asset Management.

**KEN NORGROVE**

**CEO, UK & International, RSA Group**

RSA Group has appointed Ken Norgrove as CEO, UK & International. Norgrove succeeds Scott Egan, and he was most recently CEO of RSA Scandinavia and prior to that was CEO of RSA Ireland. He will report to Charles Brindamour, CEO Intact Financial Corporation, and Mark Hodges, UK & International board. The appointment sees Norgrove also sitting on the IFC operating committee.

**MARKUS AHO**

**Head of Private Investments, Varma**

Finnish insurer, Varma, has appointed Markus Aho as head of private investments. Aho previously served as head of private equity, working as a supervisor in Varma's private equity team. In his new position, he replaces Mikko Koivusalo, who will serve as the director responsible for special projects and will continue as a member of the investment operations management team at Varma.

**TREVOR JONES**

**UK Head of Insurance, KPMG**

KPMG UK has appointed Trevor Jones as the new head of its insurance practice. Jones replaces Simon Ranger, who will now focus on leading the vice chairs' office. Jones will lead KPMG's team serving clients across the insurance spectrum, including insurers, reinsurers and brokers. He previously led the firm's UK actuarial practice and has over 30 years of insurance experience, 24 of those with KPMG.

# Opinion

## On M&G acquiring impact investor responsAbility Investments AG

"We are excited to join forces with M&G, as this will bring our vision for impact investing to the next level. M&G's financial strength, distribution network and its strong commitment to sustainability will accelerate our endeavours to meet the massive unmet demand in developing countries and the needs for climate finance. Together we can achieve an even more meaningful contribution to a sustainable world."

**Rochus Mommartz**
**responsAbility CEO**

## On L&G investing in eco tech firm, Sero Technologies

"Housing is a major contributor to carbon emissions, requiring some of the most challenging and immediate overhauls of any sector. We are delighted, therefore, to be investing in a business that will play a major role in putting UK housing on a pathway to net-zero, whilst providing significant job creation in the clean energy sector and supporting the UK's SMEs. We look forward to working with the Sero team to grow their innovative business going forward."

**John Bromley**
**Head of Clean Energy**
**Legal & General Capital**

## On LV= and Royal London merger talks collapsing

**Seamus Creedon**
**Incoming interim chair**
**LV=**

"The strength of LV='s business performance over the past 18 months combined with its operational progress has strengthened the board's belief in, and commitment to, the continuation of our status as an independent mutual. We have heard what our members have said about the importance of mutuality and the continuation of the LV= brand. We continue to maintain our strong capital position, are trading well and building a successful future for LV=, its members, employees and wider communities."

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**David Land**
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**Rothesay**

"As part of Our Pathway to Net-Zero, we have conducted rigorous due diligence on our carbon removal options and have chosen Climeworks because its ground-breaking technology allows us to measurably neutralise the environmental impact of our operations. Like Rothesay, Climeworks is an innovative, purpose-built company that is delivering highly effective solutions for its clients."

## On PIC investing £130m in UK's largest urban regeneration project

**Hayley Rees**
**Head of Investment Strategy**
**Pension Insurance Corporation**

"Our investment in Wirral Waters One (WWO) is another step in the development of our purposeful investment strategy and ultimately is a model for how long-term investors can play a key role in the levelling up agenda. We need secure long-term cashflows to back the pensions of our 300,000 policyholders and so seek to invest in assets with a high degree of social value, because what makes sense for society helps us achieve our purpose over decades."

## Soapbox

# What's hot?

Written by **Adam Cadle**

2021 was a turbulent year in the financial arena for many reasons, so I thought it would be interesting to look at some of the most read stories and key themes on the *Insurance Asset Management* website over this period, and what we can expect in 2022.

Interestingly, the most read story concerned cat bond issuance in 2020 reaching a record high, as the market saw over $11bn of cat bonds issued for the first time. A total of $761m of cat bonds supporting specialty, life, or health insurance risks were issued and recorded during the year, as well as almost $351m of private cat bonds, and just over $4.3bn of mortgage insurance linked-securities. The cat bond market is a way for insurers and reinsurers to transfer risk to new sources of capital.

Insurance company and market financial updates were also a key theme in the most read list. Readers were particularly interested in the US. Fourth most read in the top 10 was about US insurers reporting mortgage loans totalling $626.5bn, up 4% from 2019. The NAIC said mortgage loans were about 8% of total cash and invested assets at year-end 2020. Life insurance companies held the majority, or 96%, of the industry's total mortgage loans, as "they match well with the long-term nature of their liabilities". News also filtering out from the US in 2021, was a life/annuity update which saw this industry's net income cut nearly in half in 2020, to $24bn from $45bn.

> Companies will use a transformed economic landscape following COVID-19 to pursue growth opportunities

One key theme drawn out from the list, and one which I would have expected, is around sustainable investment and climate change. The fifth most read article concerned eight of the world's leading insurers and reinsurers establishing the UN-convened Net-Zero Insurance Alliance. Axa, Allianz, Aviva, Munich Re, SCOR, Swiss Re and Zurich will individually set science-based intermediate targets every five years and independently report on their progress publicly and annually to contribute to achieving the goals of the Paris Climate Agreement, in cooperation with the respective competition authorities.

Our eighth most read story concerned MAPFRE launching its first renewables fund, MAPFRE Energías Renovables I FCR, further leveraging the ongoing strategic alliance with Spanish energy company, Iberdrola, towards creating sustainable investment products. Energías Renovables I FCR will be used by the insurance group both to channel its own investments into renewables, but also to allow other institutional investors to tap into the strategy, as is the case with similar MAPFRE investments in real estate, infrastructure, venture capital and traditional assets.

So what can we expect in 2022? Well obviously, I would expect the ESG space to gather pace, and also information around the SII reforms to attract a lot of readers, but two areas I think will be popular are around bulk purchase annuities and global insurance M&A activity. M&A activity reached 418 deals in 2021 close to the heights of 2019 (419). Companies will use a transformed economic landscape following COVID-19 to pursue growth opportunities.

# TIME FOR INSURERS TO EMBRACE THE ESG OPPORTUNITY

Sustainability is rapidly becoming a core focus in investment strategies and access to reliable data is key to putting money to work with the right fund managers

WRITTEN BY SEAN THOMPSON, MANAGING DIRECTOR & SAM BUTTRESS, ASSOCIATE, BUSINESS DEVELOPMENT, CAMRADATA

The Covid-19 pandemic has disrupted almost every industry and the insurance sector is no exception. Yet, while this broad range of companies and institutions, quick to respond to the crisis, have sustained the pressure relatively well, now is no time for congratulation and complacency.

As the economy recovers from the pandemic, many challenges remain – and new ones are coming along all the time. But there are opportunities on the horizon too and insurers must equip themselves with the right tools to spot, study and seize them.

During this period of recovery, throughout 2022 and beyond, insurers need to find a balance between higher returns on capital, lower solvency capital requirements and longer duration if they are to meet their immediate, mid-term and long-dated obligations.

Low interest rates have been a feature of the last decade, allowing insurers to move into higher-risk, higher-yielding assets. But the return of inflation – potentially not as transitory as some had predicted – is likely to see rates rise again, setting the stage for insurers to further re-risk their portfolios.

Yet, adding risk is not the only solution to generating yield and in order to get where they and their


clients need them to be, casting a wider and more innovative net could be a wise investment.

### New dawn

In this post-Covid environment, the insurance sector has been presented with an opportunity to be more proactive on making environmental, social and governance (ESG) a key part of their investment strategies. Among the largest global, institutional investors, few in this sector have been at the forefront of a push towards sustainability, so it is a positive sign that we saw a growing number of insurance companies beginning to address ESG in 2021.

Many have even committed to reaching net zero by 2050 – but there is work to do before then.

While initiatives have been launched on the underwriting side to stop insuring certain lines of business – namely coal and other industries considered detrimental to the environment – companies must now shift their focus to aligning the targets they have already set with their asset allocation and investment.

While underwriting may steal the headlines and most manhours in this sector, insurers need to grapple with the risk that is woven into the very fabric of the assets they need to cover a maelstrom of obligations.

The bottom line is that insurers seeking to reduce portfolio risks and generate returns can no longer afford to ignore the importance of integrating ESG criteria in their investing decision-making.

What is happening in the world around us ultimately impacts every asset and security in their portfolio. If the underwriting side of the business is changing, their portfolio should too, and they need to develop the expertise to comprehend and monitor the impact of the growing body of regulation on their portfolios.

ESG has been a talking point in the European Union for some time now. The Sustainable Finance Disclosure Regulation (SFDR), for example, governs sustainability in financial services operating across the continent. In the US market, however, ESG is really only just appearing on radars, with no real national regulations to speak of. However, Gary Gensler, the recently appointed US Securities and Exchange Commission (SEC) chairman, has stated he wants the agency to move with urgency to change this.

## New opportunities

Yet, it is not all just about avoiding the risk a changing climate, society and tolerance for poor governance is creating – there is plenty of upside as well. The development of technology and innovative solutions for global issues needs short, medium and long-term capital – and insurers are well placed to both provide it and reap the return on investment it may bring.

But while insurers are exploring new investment opportunities, there are limitations on the assets and securities in which they can invest. In the EU, for example, Solvency II capital requirements can have an impact on ESG-focused investing. US insurers, however, can invest in a broader range of asset classes because they do not have to meet the same solvency requirements as their EU counterparts. Nevertheless, they must still think about factors such as duration and liability, while maintaining an ESG-focus.

Compared to sectors like private equity, which is spearheading sustainable investment in many areas, fixed income has been slow to integrate ESG. For insurers, whose main allocation is to the asset class, this could pose an issue if left unconfronted by managers and financiers.

Yet companies are now realising and being advised that sustainability is an important factor within a fixed income portfolio and progress is being made. Increasing numbers of asset managers are pushing forward with an ESG or sustainability agenda within their fixed income strategies, so having partners who understand the need for this is key.

## Data is king

As insurers start to align their portfolios with ESG commitments and net-zero targets, data will play a vital role in conducting in-depth manager research. Specialist analytics companies provide in-depth manager research to investors to help them better understand both asset classes and managers that best align with their portfolio.

For example, CAMRADATA's system, allows insurers to run ESG-focused reports on their existing manager or explore and compare new and different options. These reports can also collate information on a company's background, size, strategic focus, and diversity, along with its underlying investment vehicles, fees, risk, volatility and performance track record.

Insurers – along with other institutional investors – face the challenge of a lack of standardisation around ESG data. By standardising our information gathering, we enable investors to compare a wide range of global managers, which helps them to analyse whether their current status meets their needs.

We require every manager to answer the same question on a range of ESG-related factors. These include how they approach ESG, and integrate practices into investment policies, and how well managers and analysts are trained on ESG issues. We also ask them how often they review specific portfolio ESG risk exposure.

We based these questions on research conducted with investment consultants, who worked with institutional investors to understand the types of questions they wanted answered by asset managers.

The information created then helps investors to easily find and compare ESG strategies pursued by each asset manager, their underlying ESG processes and policies and how they decide on investments and allocations. Importantly for insurers, our research also digs into an asset manager's credit research, allowing investors to challenge any element of their process either before allocating or within the terms of a mandate.

We also invite managers to publish their stewardship reports on our platform, providing insurers with further research resources in one, accessible place.

The insurance sector has proved its stability over the ages, but now faces the challenge of proving and embracing its sustainability. With the right partner and support, we believe this transition can be a seamless one that manages risk and seizes opportunity.

CAMRADATA offers insurers a single platform to run manager research, peer group analysis and assisted searches for free. Access is available at https://www.camradata.com/gdpr-registration/

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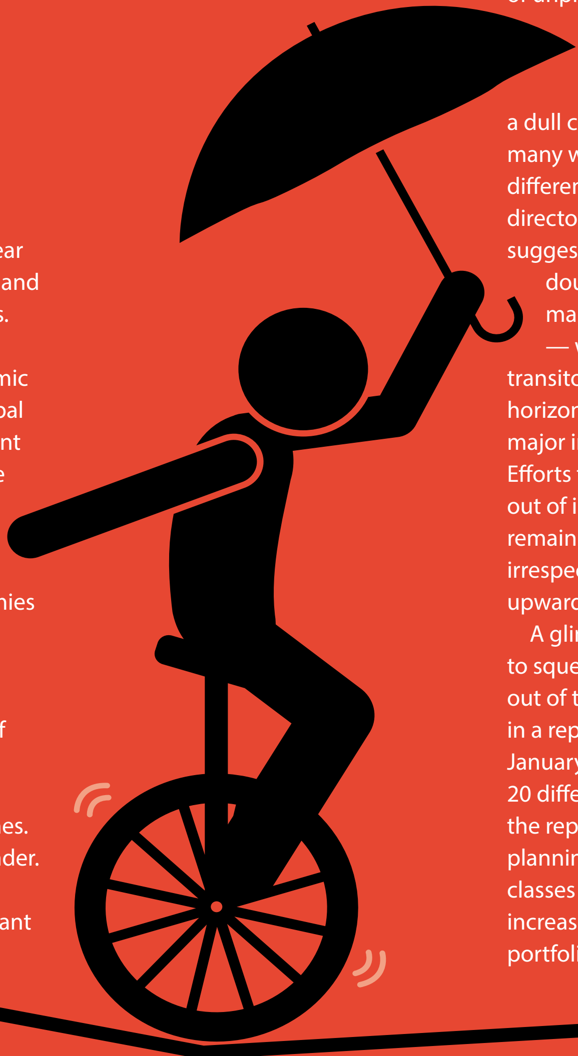
# A balancing act

WRITTEN BY **MAREK HANDZEL, A FREELANCE JOURNALIST**

2022 will see CIOs continue in their battle with medium-term macroeconomic drags and longer-term ESG pressures



In many ways, 2022 should be a year of renewed optimism for insurers and their somewhat beleaguered CIOs.

Despite continued uncertainty in financial markets, the global economic recovery remains on track, with global GDP expected to grow by 4.9 per cent in 2022, according to Accenture. The consultant has also estimated that global insurance industry revenues will hit $7.5 trillion (€6.7 trillion) by the end of 2025, as buoyant economies create more demand for insurance products and services.

Then again, given the events of the past two years, a healthy dose of pessimism may prevent investment portfolios from suffering any more than they already have in recent times. After all, there remains much to ponder. Putin posturing on the Ukrainian border; talk of vaccine-resistant variants of SARS-Cov-2; supply chain bottlenecks; and the full implications of unprecedented government fiscal support that punctuated the pandemic.

Or perhaps we can expect a dull case of business-as-usual. "In many ways, 2022 may not be all that different to 2021," Rob Andrew, senior director, insurance solutions at abrdn, suggests. "The pandemic will no doubt continue to create jitters in markets, whereas higher inflation — while still perceived by some as transitory, though over a lengthening horizon, is likely to continue to have a major impact on European economies. Efforts to wring every last basis point out of investments are also likely to remain a feature across EMEA in 2022, irrespective of any tentative moves upwards in interest rates."

A glimpse into how CIOs are planning to squeeze the most that they can out of their allocations can be found in a report published by bfinance in January. Of the 90 insurers based in 20 different countries surveyed for the report, 61 per cent said they are planning to enter unfamiliar asset classes and 74 per cent expect to increase the illiquidity within their portfolios. Key findings from the

survey include changes that are expected over the next 18 months: 61 per cent of respondents expect to enter unfamiliar asset classes in this period — with popular options including emerging market debt, private debt, private equity, infrastructure debt and infrastructure equity.

Insurers are naturally taking different approaches to diversification. Some are seeking improvements to overall portfolio risk-adjusted returns, while others are more focused on their capital requirements. Nevertheless they are fundamentally facing the same challenges. In a recent note to clients, Lorenzo Garcia, head of investment solutions, EMEA and APAC at Columbia Threadneedle Investments, said that the fact that Western economies are facing the highest inflation levels for more than 10 years cannot be ignored. "Bond yields remain historically low despite rising since the beginning of 2022, and central bank interest rate rises are coming, even if the inflation spike eventually proves transitory. This means portfolios need to build a stronger link to inflation through risk assets, as the outlook for bonds is not so favourable."

At the same time, greater instability in inflation and interest rates tends to trigger higher currency volatility, leading to renewed discussions on how currencies should be hedged. Garcia argues that the old dictum of hedging your bond currency exposure but leaving equities unhedged does not work in a diversified portfolio. In times when inflation and interest rates are racing away, it is important to hedge currency in informed and smart ways.

> "Portfolios need to build a stronger link to inflation through risk assets, as the outlook for bonds is not so favourable

Another factor behind diversification is a clear shift away from the straight-jacket that Solvency II seemed to impose on insurance capital not so long ago.

"We are now over half a decade on from the introduction of Solvency II. We have started to see considerable and refreshing changes in the way that insurers invest and the asset classes they are prepared to consider," Andrew says.

"These are different days from just prior to the introduction of Solvency II when insurers drew in their investing horns and took significant risks out of their portfolios. As familiarity with the regulation has increased, so too has insurer investor confidence and sophistication. We are regularly having conversations with insurers about private equity, venture capital, complex social projects and an ever more esoteric suite of asset classes, making the old adage of Solvency II — "bonds good; everything else bad" — feel like an increasingly distant memory for insurance asset management."

**The net-zero conundrum**

Diversification is all very well and good, but without a net-zero underpin, it almost feels futile in the current environment.

According to bfinance's survey, the amount of insurers committing to net-zero investment goals has risen from 24 per cent in March 2020 to 64 per cent. Ed Collinge, global head of insurance at Robeco, has tapped into similar findings. The manager carried out a survey of institutional investors who cover some $25 trillion (€22 trillion) worth of assets, and discovered that about a third of insurance groups had signed up to a net-zero goal by 2050 at the latest. Tellingly however, two-thirds of insurers questioned said they would be signing up to the net-zero agenda within the next three to five years. "And even since we did that survey, some 10 months ago, we've probably seen about 10% of the insurance market sign up to net-zero," Collinge says.

Until recently, insurers seemed happy to rely on their asset management partners to fulfil their ESG goals for

them, Andrew says. "That dynamic will continue to shift in 2022 as insurers and the trillions of assets they manage, look to embed the commitments made last year. We anticipate much greater intensity of dialogue between insurers and their asset managers around impact investing strategies."

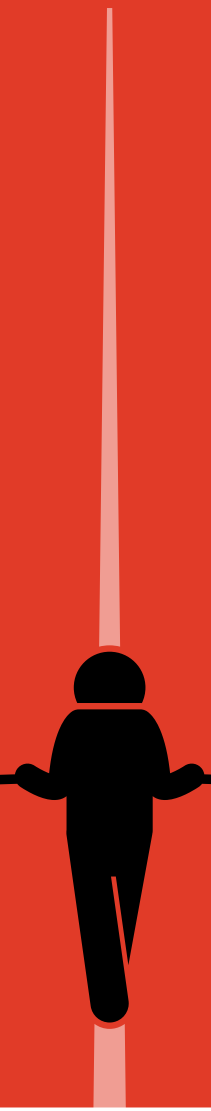
One of the reasons for this extra dialogue, however, is that insurers are still unsure as to how to actually get to net-zero. In essence, there are two avenues that can be taken to reduce carbon footprints. The first is through active engagement and ownership in the equity and corporate bond space. The other is making pro-active change to decarbonise portfolios, Collinge says. "It's about taking a step back and saying, 'This is my carbon position today. And this is how it runs off over the next five to ten years.'"

Given the fact that CIOs do not want to oversee heavy periods of portfolio turnover for the usual transaction cost and accounting reasons, a carbon-heavy asset run-off is not, however, a straightforward exercise. A priority for 2022 therefore, says Collinge's colleague, Remmert Koekkoek, head of sustainable multi-asset at Robeco, will be detailed analyses of how portfolios can be de-carbonised.

There is a clear synergy in this area between how insurance companies allocate capital and the investment options that they provide for their clients. And regulation is playing a major part too, with the EU's Sustainable Finance Disclosure Regulation (SFDR) helping to clarify the demarcation lines between "green" and "brown" or "sin" investments.

As Collinge says, the SFDR labelling of non-ESG investments (Article Six offerings), ESG-integrated investments (Article Eight) and pure impact investing (Article Nine) is creating change in insurers' thinking. This flagging has made its way into insurance wholesale platforms, and is now entering the segregated account, or balance sheet, sphere.

> “We've seen across Europe, particularly in countries such as France, a real desire to actually stop selling Article Six offerings, and start selling Article Eight and Nine offerings



"We've seen across Europe, particularly in countries such as France, a real desire to actually stop selling Article Six offerings, and start selling Article Eight and Nine offerings," he says. "That's changing what you see from asset managers in terms of what is being put into the market in terms of new products, but also in terms of new flows.

"And insurance groups can really embrace that sort of message of ESG integration and sustainability by actually moving from Article Six to Article Eight offerings within their own investments as well."

**The power of real assets**

With net-zero dominating long-term horizons and rising inflation clouding the short-term view, it is easy to sympathise with CIOs who wish to assuage the latter threat, while staying true to the former goal. All investors, however, need to remember that rising interest rates will not necessarily transition into high interest rates any time soon, Justin Curlow, global head of research and strategy, AXA IM Alts, says.

"Central banks need to walk the tightrope of tightening monetary policy to combat this more persistent inflation, even if it is expected to start to wane by the end of this year," Curlow says. "But it's important to remind ourselves that we're still going to be in a pretty low interest rate environment. So for insurance companies, they're still looking for yielding returns. And that's where the alternatives landscape continues to screen quite well from a relative value standpoint."

In terms of real assets, and real estate in particular, this means focusing on some of the less crowded areas of the market. Defensive property types such as industrial logistics, residential, data centres, and healthcare-related real estate such as life sciences remain areas that insurers would do well to focus on. Not only are they sectors that have performed well throughout the pandemic, but they are also driven by long-term megatrends.

"Pricing [in these areas] continues to be a challenge and finding enough deal opportunities to put capital to work remains a characteristic of large parts of the [alternatives] market," Curlow states. "But that being said, transaction volumes continue to eclipse recent new peaks and it remains a large part of real estate investment activity out there."

Away from alternative real estate sectors, however, lie some dangers.

Take the office market as a prime example. Curlow explains that it is widely accepted now that the hybrid office-home model will dominate employee work patterns from now on. At the same time, companies are scrambling to find the best quality office space, knowing that ESG, as well as health and wellbeing considerations are at the top of employee agendas. "And they're realising, particularly here in Europe, where you've got a much older average age of office buildings than you do in the US or Asia Pacific, by comparison, that the amount of existing stock that qualifies for that quality of office space is very limited," Curlow says.

"If we look at the vacancy rates of grade-A buildings across Europe, the average vacancy rate is one and a half percent. This compares to the wider market average of six to seven per cent vacancy rates. As more tenants focus on that top quality of office space, there's a risk that you get some stranded assets out there that can't be retrofitted to become desirable. So you will probably need to consider some sort of change

> "Industrial logistics, residential data centres, and healthcare-related real estate such as life sciences remain areas that insurers would do well to focus on

of use or other solution to make them economically viable.

"This is going to be a topic and theme over the coming years that we're going to be living with for quite some time as this plays through."

**Inflation hedge**

Despite the potential hazards in the office market, real estate, in general, holds another appeal as an inflation hedge. As Moiz Khan, head of insurance and pension solutions at Aviva Investors, points out, inflation-linked real assets strategies such as long-lease real estate can provide insurers with significantly better nominal and real yields than the traditional government bond route. "They are therefore, quite rightly, being recognised as a more effective way for insurers to hedge their inflation risk," Khan says.

"I ascribe to the fact that property is an inflation hedge, but it is partial," Curlow says. "It's not a pure inflation edge."

Intuitively, real estate is a partial inflation hedge because of two key attributes, he explains. The first is the lease structure that underpins an income stream. By and large, most property sectors include some sort of indexation that allows inflationary pressures to be passed through to tenants. "The second point is around the cost to build properties and inflationary pressures coming through into construction costs. These need to be borne by tenants through rents, in order for developers to be incentivised to actually build the new space that is demanded." As well as acting as a buffer against inflation, real assets — in general — give insurers significant opportunities to access green and sustainability-linked investments, whether through real estate financing, direct investment in infrastructure and real estate projects, or private debt.

But, perhaps more excitingly, argues Alex Wharton, head of insurance relationships at Aviva Investors, there are opportunities for insurers to engage in sustainability-linked financing — where assets are managed in a way that increases their social value by reducing climate impact over time. Aviva Investors launched its own Sustainable Transition Loans framework in 2020, which rewards borrowers who meet a prescribed set of sustainability-linked KPIs. "It requires buy-in from the asset owner and asset manager, as well as the borrower themselves, but can ultimately deliver significant societal impact through reduced costs for the borrower, better energy performance or usage of the physical asset itself, as well as a lower carbon footprint for the underlying portfolio," Wharton says.

Insurers can expect to see more of these types of initiatives through the coming year across all asset class types, giving them and their beneficiaries comfort that they are responsible for genuine positive change.

# 'An unstoppable train'

Dave Adams examines the outlook for the UK BPA market and the role insurers play within this

WRITTEN BY **DAVE ADAMS**

It seems unlikely that anyone ever created a Defined Benefit (DB) pension scheme with the intention of helping the insurance industry. Yet in recent years it has become apparent that the final destination for many of these schemes will be a buy-out: a de-risking exercise that transfers the scheme's assets and liabilities from the employer's balance sheet to an insurer. Schemes may also arrange one or more buy-in deals, instead of or prior to a buy-out. With a buy-in, scheme liabilities are insured via a premium that the insurer invests, before paying monthly lump sums back to the scheme.

Both these arrangements are Bulk Purchase Annuity (BPA) deals; and the UK BPA market is booming. Total annual transaction values have grown from £3 billion in 2007 and £14 billion in 2014 to a record-breaking £43.8 billion in 2019. LCP now expects the BPA market to see annual transaction volumes of between £30 billion and £50 billion every year until 2025.

This growing demand has also stimulated competition, with Aviva, Standard Life (formerly branded as Phoenix), Scottish Widows, Canada Life and the Just Group all taking some market share from long-established market leaders Legal & General, Pension Insurance Corporation (PIC) and Rothesay.

"The market is in a great place and we're delighted to be a part of it," Dominic Moret, head of origination and execution, pension risk transfer, at Legal & General, says. "Four years in a row the market has delivered over £25 billion of business in volume; and 2019 was a record year, with over £40 billion of transactions – but that included five transactions worth over £3 billion each." (The latter included the largest BPA transaction so far:

Rothesay's £4.7 billion buy-out of the telent GEC 1972 scheme.)

Despite the pandemic BPA transactions worth £31.7 billion were completed in 2020. While the first half of 2021 saw relatively small numbers of transactions, data from the most recent edition of the Legal & General Group's Global PRT [Pension Risk Transfer] Monitor (February 2022), shows there were BPA transactions worth £22 billion in the UK during the second half of the year, suggesting that the final total for 2021 will be about £30 billion.

"Things are looking very buoyant," Imogen Cothay, partner in the pensions actuarial practice at LCP, says. "Insurers are reporting very strong pipelines of business." Transactions announced recently have included two buy-in deals for Standard Life: one for £1.8 billion, covering about 6,600 members of the Imperial Tobacco Pension Fund; and a £1.7 billion buy-in covering all 7,600 members of the Gallaher DB Pension Scheme.

**Improved funding is driving demand**

Market growth is driven by improved funding levels within DB schemes, which have been lifted by improved investment returns and other factors such as a slowing in the increase of life expectancy, which has reduced longevity risks. Demand has also led to insurers and reinsurers building up new capacity to support more and larger BPA transactions.

The support of sponsoring employers is also vital. Most of these schemes are closed to new members and are often also closed to future accrual, so the schemes represent expensive legacy liabilities on company balance sheets that are also of little use to most current employees. Growing numbers of employers see an advantage in providing additional financial assistance to help these schemes reach the endgame more quickly.

"Schemes come to us either because they are fully funded, or because the sponsor is prepared to close the gap," Sammy Cooper-Smith, head of business development at Rothesay, states.

A recent survey of 120 UK pension schemes by Aon found that 34 per cent are targeting buy-out; 26 per cent expect to reach their endgame within the next five years; and 47 per cent within the next five to ten years.

"Many of the volumes completed in the last few years have been through the largest transactions," Justin Grainger, managing director, DB solutions, at Standard Life, says. He highlights the role of increased reinsurance capacity, which enables support for larger numbers of deferred scheme members as well as pensioners to be included within BPA arrangements. This is important because insurers need to reinsure most of the longevity risks they take on as part of a BPA transaction, in order to meet Solvency II requirements.

Insurers participating in this market also need to adjust investment strategies, increasing exposure to high yield, illiquid assets such as real estate and commercial or residential mortgage loans, to match the liabilities they take on. Moody's Investor Services has said it expects continued growth in the BPA market will eventually result in insurers writing annuities increasing the share of illiquid assets in their portfolios to between 40 per cent and 50 per cent; at present the total is just under 25 per cent.

"The nature of pension liabilities: long term, with certain cashflows, means that real assets that deliver an additional illiquidity premium are a great match for the pension liabilities we're taking on," Moret underlines. "This really unlocks pensions wealth. You've got £2 trillion of pensions liabilities in the UK. While that is held by pension schemes and invested by pension schemes, it's in gilts and corporate bonds. Continued growth in the bulk purchase annuities market unlocks that wealth to benefit the wider economy."

**The influence of ESG**

Insurers in this market also need to incorporate environmental, social and governance (ESG) considerations into investment and overall strategies. Since October 2021, the largest pension schemes (those with assets of £5 billion or more) have been subject to disclosure and reporting requirements based on the Taskforce for Climate-related Financial Disclosures (TCFD) recommendations. From October 2021 this will apply to schemes with more than £1 billion in assets and we can expect the rules to be applied to smaller schemes in the future. The Pensions Regulator's proposed new code of practice will also include new climate change-related elements.

Many scheme sponsors are also making commitments to improve environmental, social and governance performance, so are likely to want the pension scheme and by extension any insurer involved in de-risking the scheme, to be pursuing ESG goals broadly aligned with their own.

"[ESG] is becoming much more important to trustees and sponsors making decisions about their bulk insurer," Cothay says. "We're seeing much more interest even from smaller pension schemes in ESG considerations when choosing between insurers."

"Currently, ESG factors are something of a hygiene or compliance consideration for trustees and their advisers," Marcus Mollan, director, annuity asset origination, at Aviva, says. "However, we anticipate this will change in the near to mid-term, to become a key decision-making criterion

> “The longer term trajectory is one of growth. There’s a long way to go for this market

in de-risking transactions.”

All eight of the insurers operating in the BPA market have made commitments to achieving net-zero by 2040 or 2050. Some are also putting ESG considerations at the heart of the investment strategies that will support their BPA business. Grainger points to Standard Life’s investments in illiquid assets that deliver ESG benefits, including social housing and social infrastructure.

At Legal & General, Moret points to the actions of the insurer’s in-house asset manager, LGIM. “We use LGIM … to influence boards to implement change, not just related to environmental matters, but to social and governance matters as well,” he says, citing shareholder activism designed to improve diversity and inclusion within company workforces.

Mollan cites similar policies at Aviva: “Aviva can point to many success stories of engaging through its in-house asset manager Aviva Investors, to deliver positive change at the companies we invest in.”

**“An unstoppable train”**

Beyond its predictions for the next five years, LCP has suggested that annual BPA transactions could top £70 billion by the end of the 2020s, with individual ‘mega’ transactions for the largest schemes worth £10 billion or more. In the longer term, annual volumes may eventually exceed £100 billion.

“We will have a very busy market,” Moret says. “But I hope we see greater standardisation and streamlining of processes, particularly at the smaller end of the market. Seventy five per cent of schemes have assets of under £100 million, so it’s really important that we can deliver for those schemes.”

But Cothay highlights the challenges faced by insurers seeking to work with the largest schemes. “When we’re looking at what is needed from insurers to make those really big transactions work, you need sufficient assets with a high enough yield; and the insurer needs the capital to be able to back the business; and enough operational resources,” she says. “I think the operational piece is unlikely to be a constraining factor, as insurers have been scaling up their businesses. The main barrier could be the ability of the insurers to get enough assets to give them a sufficiently attractive yield.” As BPA becomes an ever more important line of business for these insurers this could become a defining challenge within investment strategies

The different forms of BPA will also continue to evolve. Moret highlights other models that may be used more often in future. One is an Assured Payments Policy (APP), a buy-in or buy-out that does not include longevity cover, with an insurer providing a series of cashflows, agreed in advance and unaffected by longevity or demographic factors. “It’s providing a cheaper way of accessing insurance for schemes that aren’t quite there yet, in terms of their funding,” he explains.

We may also see more use of deferred premium solutions, which allow full de-risking, but with some of the premium (typically, for the deals Legal & General agrees, about 30 per cent) deferred for several years. This could be useful if a scheme has agreed a recovery plan that will lead to full buy-out, or if it has illiquid assets that cannot be sold in the near or medium term to pay for a buy-out. Continued growth of the BPA market in the UK cannot yet be taken for granted – it may be that as time passes other de-risking approaches become more popular; or some other twist of history may alter the financial landscape. But if this market does continue to grow, insurers may find there are other opportunities to pursue in other markets, particularly the US. In the UK, Cooper-Smith says, the BPA market is now “an unstoppable train”. “While there are going to be moments when the state of the financial markets mean volumes increase or decrease over the short term, the longer term trajectory is one of growth,” he says. “There’s a long way to go for this market.”

# In the spotlight: David Otudeko

Adam Cadle discusses Solvency II, IFRS 17 and the effects of ESG on prudential regulatory frameworks with ABI assistant director, head of prudential regulation, David Otudeko

WRITTEN BY **ADAM CADLE**

**Q Please could you describe your day to day role at the ABI?**

It sounds like a cliché, but no two days are the same in my role. The team and I cover a really broad range of topics from IFRS 17 and Solvency II to ESG matters and insurer recovery and resolution. On all the aforementioned topics there is a lot of activity. On Solvency II our aim is to collaborate effectively with the Prudential Regulation Authority (PRA), Her Majesty's Treasury (HMT) and the Government on the Solvency II review to deliver meaningful reform. This would ensure that the UK's long-term savings and insurance industry benefits from the post Brexit dividend of a regulatory framework that is fit for purpose and enables the industry to increase its role in supporting the Government's Levelling Up agenda and the transition to a net-zero economy. On climate change and ESG we are very active in the Bank of England's (BoE) climate risk financial forums (CFRF) and will actively engage with the regulators on the recently launched climate biennial exploratory scenario (CBES) second round exercise. We are also proactively driving the agenda on the development of an insurance recovery and resolution regime that not only acknowledges the effectiveness of existing tools that support insurer recovery and resolution but also recognises the uniqueness of insurers (as say compared to banks) when it comes to firm level failure.

Our daily activities are also driven to a large extent by the various stakeholders we engage with to deliver our objectives. Not all our stakeholders are deep technical experts, consequently we tailor our messages and approaches to our tasks with our stakeholders firmly in mind. Ultimately in whatever we do the team and I are guided by our own internal raison d'être which is to provide expertise, drive thought leadership and ultimately promote our members' views.

**Q Are you satisfied with the capital adequacy of insurers in the UK at the moment? Where can capital be optimised?**

Overall, my answer is a resounding yes, however this question must be considered alongside the role of capital and the objectives of the regulatory regime. Solvency II requires insurers to hold enough capital to withstand extreme events and cover unexpected losses. As part of their risk management and governance insurers also hold additional buffers above their capital requirements to ensure they are even more adequately capitalised. We know that the PRA's insurance specific statutory objective is to secure an appropriate level of policyholder protection and that it does not run a zero-failure regime but instead aims to ensure that if insurers should fail, they do so in an orderly manner. Therefore, the role of capital is not to stop all insurers from failing as some failure is unavoidable in an efficient market. If capital is viewed as the sole means for achieving policyholder protection, I would argue that considered in isolation, no amount of capital is enough to achieve this. Capital requirements must work with (amongst other things) strong risk management, appropriate governance arrangements and effective internal controls and actuarial functions to deliver high levels of policyholder protection and to ensure the sector remains stable.

I often feel the term "capital optimisation" has a bit of a bad reputation so I tend not to use it. Our aim with the Solvency II review is to make targeted changes to aspects of the regime such as the risk margin and matching adjustment primarily to make the framework fit for the UK's long-term saving and insurance sector. In areas such as the risk margin even the PRA recognises that change is required because it is too large, too sensitive to low interest rates, and inappropriate for long-term business. So, this isn't about capital optimisation. It is about ensuring that regulation that was originally developed to suit 28 EU member states is now appropriately tailored to suit the UK and to help insurers play an even bigger role in supporting the Government's Levelling Up agenda, increasing infrastructure investment and the transition to net- zero.

> **I am a big fan of Solvency II, and the improvements it offers over its forerunner Solvency I are clear**

## Q Looking at Solvency II, are you happy with its direction so far, and where do you see improvements?

I am a big fan of Solvency II, and the improvements it offers over its forerunner Solvency I are clear. It has enhanced the regulatory framework for insurers by (amongst other things) ensuring that solvency requirements are driven by an insurer's risk profile and incentivises good risk management. It has also introduced greater transparency ensuring that various stakeholders including policyholders have access to information on how insurers operate. It is Solvency II, (and amongst other things) the Matching Adjustment framework and the 1 in 200 Solvency Capital Requirement that ensured insurers were able to ride out market turning events like the peak of the Covid pandemic in 2020. However, there is no escaping the fact that Solvency II was built to harmonise Solvency regulation across 28 EU member states and therefore needs to be reformed to fit the UK market.

As I alluded to earlier, the ABI has called for targeted changes to specific aspects of Solvency II as part of HMT's Solvency II Review focusing in particular on the risk margin, matching adjustment and regulatory reporting. The debate on reforming both the risk margin and matching adjustment is ongoing, and we are working closely with the PRA and HMT to ensure that meaningful reform that meets all the objectives of the Solvency II review is delivered. In tandem, we are also working closely with the PRA to reform and streamline regulatory reporting to reduce the burden this important but at times onerous and costly exercise places on industry. Some initial progress was made by way of changes to reporting templates proposed by the PRA as part of Phase 1 of reforming regulatory reporting and we expect much more in Phase 2. Our main ask is for Phase 2 reporting reforms to be far reaching and ambitious, whilst continuing to meet the information needs of the regulator and other connected stakeholders.

## Q How do you view the transition to IFRS 17 for insurers so far? Has it presented unwanted challenges?

Like Solvency II, IFRS 17 has been years in the making. The global consistency in insurance contract accounting the standard provides is a clear advantage over its predecessor IFRS 4. Challenges in implementing something new are inevitable and this is no different with IFRS 17. Industry has had to develop appropriate data, systems and processes in readiness for reporting on this new basis. IFRS 17 is a principles-based standard, and a key benefit of such a standard over a rules-based approach is the ability to apply judgement and interpretations in given circumstances. In my view, a key challenge would be for stakeholders to remain true to the principles-based nature of IFRS 17 and ensure this is not eroded by narrow interpretations of the standard. Another key challenge is the need to bring the investor community along with us on our IFRS 17 journey. Preparers might be primed and ready to report on an IFRS 17 basis, but investors and other stakeholders will be new to concepts like the contractual service margin (CSM), discount rates and the different measurement models the standard allows. I anticipate an increase in investor presentations and education sessions on IFRS 17 financial statements this year to mitigate this issue and ensure that these stakeholders understand reported figures. Also required is not only consideration of if and how existing metrics and key performance indicators (KPI's) are revised to reflect the standard but also the need to consider if new ones are needed to support the understandability of IFRS 17 financial statements. These are all difficult issues

to address but I do not consider them insurmountable challenges.

I must commend the UK Endorsement Board (UKEB) for its thorough and detailed analysis in the draft endorsement criteria assessment (DECA) launched in November 2021. The DECA highlights and analyses a number of outstanding issues impacting different players in the insurance sector that need to be resolved. A material outstanding issue relates to the amortisation of the CSM for annuity providers and good progress is being made through the IFRIC to agree potential alternative but equally acceptable interpretations of the standard in this respect. We await the outcome of IFRIC deliberations in March 2022.

**Q Where have you seen ESG impacting prudential regulatory frameworks?**

On the "E" there have been several developments that have rightly placed climate change at the top of the agenda. The PRA in Supervisory Statement SS3/19 outlined the need for insurers to take a more strategic approach to managing the financial risks from climate change, considering risk management, governance, scenario analysis and disclosures. In its recent climate change adaptation report the regulator also puts insurers on notice of its intention to actively supervise firms against the requirements in SS3/19. In the same report, the PRA also highlighted plans to begin widespread discussions with stakeholders on the role of capital requirements in managing the financial risks from climate change. We have seen plans to extend TCFD reporting requirements to the largest UK-registered companies and financial institutions including insurers (and across the entire UK economy by 2025), the FCA's publication of DP21/4 on the application of sustainability disclosure requirements and plans to release a UK Green taxonomy setting a common framework for the identification of environmentally sustainable investments.

On the "S" the joint PRA, FCA and BoE discussion paper on Diversity DP21/2 aimed at accelerating the pace of meaningful change in creating a truly diverse, equitable and inclusive sector is an important development. Regulatory requirements in this area would help further focus the minds on this important issue and give clear indications of what good looks like.

On the "G" it could be argued that current practice here is perhaps the most established of the 3 ESG elements. In Pillar 2 of Solvency II, there are clear systems of governance requirements covering general governance (including the role of the board, decision making, segregation of duties to mention a few) remuneration, risk management and fit and proper requirements. These all ensure that insurers are well run, but we must guard against complacency. Governance is an area that requires constant reassessment and review to ensure arrangements remain fit for purpose on an ong basis.

**Q What are your aims and ambitions for the rest of the year both personally and in your role at the ABI?**

A key reason behind my decision to join the ABI is my desire to see Solvency II reformed in a meaningful way that suits the UK insurance and long-term saving industry. Delivering meaningful reform is therefore my primary focus for the year ahead. Coupled with this is also a desire to see IFRS 17 fully endorsed for UK use subject to the current live outstanding issues I alluded to earlier being resolved. My intention is for the ABI prudential regulation team to play a leading role in shaping how capital requirements are used to mitigate the financial risks from climate change and to continue to influence the development of a fit for purpose insurance recovery and resolution regime. We will continue to work constructively and closely with the PRA, UKEB and other stakeholders to deliver the priorities outlined above. I also have a passion for diversity, equity and inclusion and I will continue to focus relentlessly on supporting Industry's journey toward becoming a truly diverse, inclusive, and equitable sector envied by other sectors. Finally, I have an excellent team of professionals supporting me and our members and a key priority for me for the rest of the year is to continue to support my team in their development, ensuring they continue to find their roles fulfilling and stimulating and continue to deliver excellent value to our members. Consequently, I would like to thank members of the ABI's prudential regulation team Xavier Solano, Robert Warren, Callum Tanner and Rebecca Lea for all their hard work in support of our members and in delivering our team and wider ABI goals.

# PODCAST: Opportunities in alternative fixed income

Adam Cadle speaks to Frank Meijer, Head of Alternative Fixed Income at Aegon Asset Management, about the key opportunities within the alternative fixed income space and how insurers can access these

IAM: **With interest rates remaining stubbornly low, the hunt for yield remains a real challenge for investors, and we are seeing a range of alternative fixed income strategies proving attractive to insurers. How do you define alternative fixed income and can you provide some examples of strategies within this asset class?**

MEIJER: On one side of alternative fixed income you have ABS structured finance and on the other side private debt, so anything that is not liquid and often doesn't have a rating. Structured finance examples include a AAA strategy that delivers LIBOR plus 80-100 or investment grade ABS that delivers LIBOR plus 125, or perhaps a B/BB high yield ABS that would deliver something like LIBOR plus 400-500. Many people think of private debt as corporate private debt, but private debt is obviously a lot broader. Investment grade examples include government guaranteed loans, residential mortgages, private placements or loans. Direct lending is also incorporated into the alternative fixed income space. We try to achieve a good yield pickup above traditional fixed income.

IAM: **Looking at Aegon Asset Management's insurance clients, what are the main drivers in considering alternative fixed income?**

MEIJER: First and foremost it is the yield. Yield on traditional fixed income is very low and the reason for that is the ECB and the Federal Reserve have been buying a huge amount of those securities. This has pushed down yields. Essentially you have zero yield on government bonds EUR or even negative yields. The ECB is not buying anything in the private space, not anything in private debt. So that market is much less crowded and therefore you can obtain quite a nice yield on it. This is also true for ABS to a certain extent. Yield is by far the most dominant driver of flows in alternative fixed income therefore. Diversification also plays a crucial role however. If you look at the universe of normal fixed income, you can only choose so many governments out there. This is the same for corporate credit. If you look at the bigger names who issue these bonds, there are only a couple hundred of them that you can invest in. In the private markets, the universe is a lot bigger. There are around 25 million SMEs in Europe that you could potentially invest in. ESG is also a strong driver, and this area is becoming increasingly more important. If you invest in government guaranteed loans for example, so perhaps social housing guaranteed by a government, you essentially have government risk but you also have impact or high sustainability factor in it. The private debt market also has many examples of how you can implement ESG in your portfolio without taking more risk, and actually getting more yield. Some alternative fixed income strategies also work tremendously well under Solvency II regulations and the biggest example of that is residential mortgages. The capital charge here is very low and capital generation is very high.

> "Yield is by far the most dominant driver of flows in alternative fixed income

IAM: **How should insurers think about factors such as liquidity and complexity when considering alternative fixed income?**

MEIJER: This depends from insurer to insurer. If you are a life insurer, you have long term liabilities, so you can think about long term investments. Illiquidity should not be a big issue therefore as they can match long term investments with long term liabilities. If you are a

P&C insurance company you might not want to invest in 10-20 year illiquid investments, but instead short dated assets. Generally, however, liquidity should not be a big issue for insurance companies. With our own insurance company, it has invested anywhere between 30-50% in illiquid assets and the remainder in more liquid assets. For our other external investors, specifically insurance companies, they typically have anywhere between 20 and 50% in illiquid assets on the balance sheet.

IAM: **How are insurers incorporating alternative fixed income within their asset allocation? Is this viewed tactically or are insurers making strategic allocations within general account portfolios? Does this differ in the UK relative to European markets?**
MEIJER: It is more strategic than tactical, for the simple reason you are investing in illiquid assets, especially in the private debt market. By nature of the private debt asset class it is a more long term strategy and therefore it is more of a strategic play. In the UK, matching adjustment is very important which is not a topic at all in continental Europe. This impedes UK insurance companies investing in some asset classes. In continental Europe you only see insurers focusing on the SCR. So this results in different approaches to private debt markets.

IAM: **What does it mean in terms of processes, skills and indeed reporting requirements for an insurer to build an exposure towards alternative fixed income?**
MEIJER: It starts with the insurers understanding the asset classes. This takes time, and involves talking to risk management. It could be that if the asset allocation is large, they would have to talk to the regulator. This would be appropriate if allocation to private debt is large for example. Low level data is available for private debt which will contain some risk parameters and Solvency II parameters like the SCR. Reporting is fairly similar to liquid fixed income. In terms of skills, I think the big question is does the insurance company do it in-house or do they choose to go with an asset manager, outsourcing the investments. This often depends on scale.

> Some alternative fixed income strategies also work tremendously well under Solvency II regulations

IAM: **Can yield and responsible investing truly go hand in hand in alternative fixed income?**
MEIJER: I think this is the case, especially in illiquid markets. We run a £5bn strategy where we invest in, for example, hospitals, wind parks and social housing. There is a strong ESG and impact angle here and these loans are all fully guaranteed by a central government or government body. If the hospital goes bankrupt it doesn't matter we get our money back from the government. If the wind park has no wind we also get our money back from the central government and the same with social housing. The yield you can achieve on these kind of investments is still anywhere between 50bps on the low side to 100-150bps on the high side above government bonds. This is the same in the ABS space, for example solar ABS.

IAM: **What impact has the COVID-19 pandemic had on the alternative fixed income space, and how do you see the market evolving in the future?**
MEIJER: COVID-19 has not had a big impact on risk so far. Rates have been very low, the market is flooded with cash and the governments stepped in to help. Default rates in liquid, illiquid and private debt markets have been low. The impact from a debt perspective is low. But COVID-19 did have some indirect impacts. Central banks are still supporting economies by keeping rates low, and this low yield has accelerated investments into private debt.

*In association with*

AEGON Asset Management

# Insurance Asset Management Awards 2021

## GALA DINNER & CEREMONY

**25 November 2021, Hilton London Tower Bridge**

*Celebrating excellence in the UK and global insurance space*

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# Insurance Asset Management Awards 2021










# Insurance Asset Management Awards 2021

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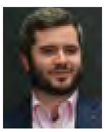
## 2021 JUDGING PANEL



*Chair of the judges:* **Adam Cadle**
Editor
Insurance Asset Management

**Shazia Azim**
Partner
PwC

**Michael Eakins**
Chief Investment Officer and
Group Executive Committee Member
Phoenix Group plc

**Neil Holmes**
Director – Insurance, Client Consulting
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**Rebecca Lea**
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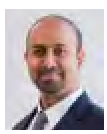

**Raymond Sagayam**
Chief Investment Officer,
Fixed Income
Pictet Asset Management

**Deepak Seeburrun**
Head of Insurance, EMEA
HSBC Asset Management

## OVERVIEW

The fifth annual Insurance Asset Management Awards came back with a bang as a physical event, after COVID-19 had forced the previous year's award's to take place as a virtual affair.

Hundreds of insurance industry professionals gathered at the Hilton London Tower Bridge, after the Insurance Asset Management Conference 2021 earlier in the day, to celebrate excellence, professionalism and innovation in the insurance space.

Insurance companies, asset managers, technology providers and consultants were all in attendance, as trophies were handed out by award-winning comedian Holly Walsh. Walsh really entertained those in attendance, clearly using her popularity on shows such as Mock the Week, Would I Lie to You? and 8 out of 10 Cats, to draw in the audience to her stand-up routine.

Award categories on the night ranged from Insurance Company of the Year through to Emerging Markets Manager of the Year, ESG Investment Strategy of the Year, and Passive Manager of the Year.

Congratulations to all the prize winners and a very well done to all those shortlisted firms. Many thanks to all those who helped make the event such a success, particularly our sponsors - BNP Paribas Asset Management, Franklin Templeton, HSBC Asset Management, Moody's Analytics, Nordea Asset Management, Pictet Asset Management, and State Street Global Advisors SPDR. Your ongoing support allows a fantastic night like this to happen.

We look forward to welcoming you all with open arms again this year and rewarding all those continuing to excel in the insurance arena. 2022 is set to be another challenging but rewarding year for the global insurance space, and it will be exciting to see the latest examples of development and innovation within investment strategies that aim to meet changes in the economic climate and the needs of clients.

For more information on our events please visit www.insuranceassetmanagement.net, where you can also read all the latest news and commentary in the global insurance industry, listen to our latest podcasts, view our latest roundtables, and watch our Q&A videos with leading industry investment professionals from the global insurance arena.

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# THE WINNERS 2021

Insurance Company of the Year
WINNER: Phoenix Group

Investment Strategy of the Year
WINNER: MetLife Investment Management

ESG Investment Strategy of the Year
WINNER: Royal London Asset Management

Insurance Investment Consultancy of the Year
WINNER: EY

Passive Manager of the Year
WINNER: Invesco

Active Manager of the Year
WINNER: Pictet Asset Management

Fixed Income Manager of the Year (up to €100bn AUM)
WINNER: Robeco

Fixed Income Manager of the Year (over €100bn AUM)
WINNER: M&G Investments

Alternatives Manager of the Year
WINNER: BNP Paribas Asset Management

Infrastructure Manager of the Year
WINNER: MetLife Investment Management

Property Manager of the Year
WINNER: Invesco

Multi Asset Manager of the Year
WINNER: Morgan Stanley Investment Management

Emerging Markets Manager of the Year
WINNER: HSBC Asset Management

Technology Firm of the Year
WINNER: RNA Analytics

Innovation Provider of the Year
WINNER: Aviva Investors
Highly commended: abrdn

Risk Management Firm of the Year
WINNER: abrdn

Stewardship Initiative of the Year
WINNER: Robeco

Diversity Award
WINNER: HSBC Asset Management

# RISK MANAGEMENT FIRM OF THE YEAR

## abrdn


With risk management at the top of insurance companies' agendas, de-risking propositions continue to flood the market. The Risk Management Firm of the Year award rewards the provider that has provided truly innovative solutions to help insurers manage their risks and meet their objectives.

Standing head and shoulders above the rest in this category is abrdn. The firm's ability to leverage its ALM heritage to empower Asian insurers is second to none. As much of Asia transitions through a regulatory paradigm shift, insurers in the region are currently facing up to the challenge of increased sophistication in their financial risk management. All face a consistent set of risk management themes, but their specific requirements are typically idiosyncratic. abrdn's Liability Aware Investing (LAI) team consists of ALM portfolio managers averaging over 15 years of industry experience who work closely with its Insurance Solutions team and insurance clients to design, structure and implement cash flow matching and derivatives-based hedging strategies. In total, the LAI team have mandates, hedges and structures amounting to over £18bn in AUM with c.£35m of DV01 and c.£17m of equity option vega for insurance clients.

Since the start of 2020, abrdn has been working with one of the largest insurers in APAC to help them define their strategy in advance of the adoption of the ICS regulations, expected to commence in 2025. This expert support spanned the broad advisory spectrum – key highlights being management consultancy on ALM operating model best practice in UK/Europe, implementing a stochastic strategic asset allocation optimisation framework, line-by-line portfolio construction meeting the ICS 'Middle Bucket' rules, and the design of a derivative overlay to hedge the residual interest rate sensitivities.

*"The firm is uniquely positioned to design solutions which are innovative, practical, effective and capital efficient for Asian insurers as they look to the future"*

As well as such extensive support in relation to the ICS regulations, abrdn has been working at the forefront of other emerging regulations in Asia. Whether it be Singapore's RBC2, Hong Kong's RBC or Korean-ICS, abrdn have been engaging with insurers and building expertise, capability and tools to ensure we are a leader in supporting clients across the region.

The judges said as a result of the combination of abrdn's insurance expertise and deep capital markets experience, with its command of the modern, nascent risk-based capital regimes, the firm is uniquely positioned to design solutions which are innovative, practical, effective and capital efficient for Asian insurers as they look to the future.

Congratulations to all at abrdn for an outstanding award's entry and business year.

abrdn

# The next steps for insurers on their road to net zero

## In this article, we explore the targets that insurers need to set on the road to net zero

Our research tells us that when insurers set measurable environmental, social & governance (ESG) objectives, 96% of them relate to climate change. That was one of the key findings of our recent survey 'Sustainable investment in European Insurance', which saw us interview 60 insurers, covering 42% of European insurance assets under management.

For 58 of our 60 interviewees, dedicating a percentage of their portfolio to green assets was a key ESG objective. This is how many insurers plan to help finance the energy transition. Around half of the insurers interviewed also focus on broader considerations, such as seeking to reduce their portfolio's carbon footprint relative to a benchmark. And for around a quarter of insurers (14/60), this has evolved further still, encompassing a commitment to net zero.

These findings are useful, but we must remember that each insurer is unique and will set different objectives that consider the specifics of their own firm and investment strategy.

Our research shows insurers are targeting a range of decarbonisation objectives, often with the ultimate goal of committing to net zero by 2050. For many, setting robust and meaningful interim targets provides a framework for achieving this most ambitious of objectives. Although only a quarter of our interviewees currently have a formal net zero target, it was clear many others are building towards this goal.

Interim targets also provide a means for measuring progress and building in future re-assessment points. It's important to take account of future climate-related developments – be it policy, data or technological developments. Things are changing fast and it's hard to look too far ahead with great confidence.

**Figure 1: Climate-related measurable portfolio objectives**


*Source: abrdn ESG Insurance Survey, April 2021*

**The importance of setting realistic targets**

Setting interim targets requires careful consideration to ensure they are robust, based in science and achievable. The Net Zero Asset Owners Alliance (NZAOA), which represents a group of asset owners committed to achieving net zero by 2050 , have recently published guidance on how firms can approach developing and setting such targets. The emphasis may be on setting targets for achieving net zero by 2050, but the framework is of equal value to any insurer with a decarbonisation objective – whether it is aligned to net zero 2050 or not.

The NZAOA's framework provides guidance for setting targets in four distinct areas:

- **Overall portfolio targets**
- **Engagement targets**
- **Sector level targets**
- **Financing transition targets**

**Overall portfolio targets** are perhaps the most common decarbonisation targets. The NZAOA's work suggests that an emissions reduction of 16-29% is needed by 2025 to ensure a pathway to net zero by 2050 – informed by work from the Intergovernmental Panel on Climate Change (IPCC).

Just to look that little bit further ahead, using our climate-scenario analysis tool calibrated to the Bank of England NGFS 2050 Net Zero scenario, we estimate that around 40-50% emission reductions are required by 2030 to be on track to achieve net zero in 2050.

As we mention in our recent Investing for Net Zero article, behind the tools, figures and targets, it's real-world decarbonisation that is key. One could easily decarbonise a portfolio by reducing or eliminating companies in carbon-intensive sectors such as steel, cement and power generation – your portfolio's temperature-alignment score would certainly look impressive. We will still need these sectors in 2050, and they need investor capital to be able to innovate, decarbonise and transition. Therefore, we think the key is to invest in companies with ambitious and credible decarbonisation targets, rather than divesting. This will have a bigger impact on achieving net zero in the real world.

And that is why engagement, and setting **engagement targets**, is a powerful weapon in an asset owner's (and their asset manager's) arsenal. A continuous dialogue can help hold companies to the targets they have set themselves.

**Financing transition targets** can also help drive real-world impact. As we noted in our introduction, our research shows that allocating a proportion of the balance sheet to green investment is often the first decarbonisation step taken by insurers. This can be achieved through taking a forward-looking view and investing in climate solutions (assets and companies that help the world decarbonise) – from renewable infrastructure and low carbon buildings to electric-vehicle manufacturers and energy-efficient technology providers.

**What to consider when setting decarbonisation targets**

Each insurer who commits to decarbonising their portfolio – setting interim progress targets in the process – will have a unique set of circumstances to consider:

- Different starting points – to what extent are climate considerations are already embedded?
- Varying investment approaches – will you, for example, use asset-management partners or an in-house team?
- Different levels of new business and growth – how will this affect the shape and size of your future asset base?
- Different liability characteristics – how will your liabilities affect your investments and the level of buying and selling that can take place?
- Different firm-level risk appetites – how will these impact on the range of feasible asset actions available?

And in addition to your decarbonisation objectives, insurance asset managers still need to consider asset liability management, solvency efficiency and generating appropriate returns.

**In conclusion**

Although most insurers are joining a path with the same ultimate destination, each journey will likely look very different in terms of timeframe and actions, and will evolve over time. This highlights the importance of working with asset managers who are committed to helping you identify the journey that is right for your firm. And then going on that journey in partnership with you.

*"There is an evident opportunity for asset managers to market ESG or impact products. However, there is a much wider opportunity to build a dialogue with us on new tools and analyses. It can reinforce some partnerships and weaken others."*

*UK Life Insurer*

*Source: https://www.abrdn.com/en/uk/institutional/investment-capabilities/insurance/insurance-european-esg-survey*

We've been helping clients on their journey to setting interim targets and assessing how those targets can best be achieved. And we look forward to assisting many more.

*Richard Roberts, Investment Director, Global Insurance*

# INSURANCE COMPANY OF THE YEAR
## Phoenix Group


The Insurance Company of the Year award looks to reward the insurance firm demonstrating a commitment to meeting customer needs and to delivering a high quality of service across all activities as part of the overall financial strategy, where the operational activities are both driven by, and reinforce the investment policy.

Standing out from the rest is Phoenix Group whose ESG considerations and responsible investment philosophy underpin its strategy. Environmental considerations in particular are at the core of what Phoenix does – both in terms of investing its customers' money in a way they're happy with, but also as a driver of the company's purpose for employees.

Phoenix, as part of its ESG strategy, has made a Net-Zero Carbon Commitment, whereby it will decarbonise its investment portfolio to be net-zero carbon by 2050. It also has a clear responsible investment philosophy based on the principles of the UN PRI of which it is a signatory. .. The insurance company is also committed to having senior leaders in the business who are experts in their field to help achieve ESG ambitions. A new centre of research, Phoenix Insights, has also been established that will drive forward greater public engagement and challenge society to help everyone live better longer lives.

With c.£300bn assets under administration, Phoenix Group is committed to investing responsibly across a broad range of asset types, including renewable energy and infrastructure, with a dedicated £9.3bn illiquid asset portfolio.

*"Environmental considerations in particular are at the core of what Phoenix does - both in terms of investing its customers' money in a way they're happy with, but also as a driver of the company's purpose for employees"*

Phoenix Group is committed to establishing robust investment policies and procedures for understanding and addressing ESG risk across all portfolios. The insurance company has therefore committed to acting on stewardship responsibilities to engage and influence positive change, support transition to a sustainable economy and expand its range of ESG investment solutions. The group has joined global market leading initiatives in pursuit of industry wide and further collaboration to achieve the goals of the Paris Climate Agreement. By being active members within these, it has been able to share and learn with peers to continue to refine its ESG investment strategy. These initiatives range from being insurance specific (e.g. Andy Briggs' role as head of the ABI's climate sub group), to the global Net-Zero Asset Owners Alliance.

Special praise must be given to all at Phoenix Group for their work during 2021. Its ESG strategy is genuinely differentiating, and it has clear evidence to prove it. Congratulations on taking home this prestigious accolade at the Insurance Asset Management Awards 2021.

PHOENIX GROUP


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# INVESTMENT STRATEGY OF THE YEAR
## MetLife Investment Management


Implementing the appropriate investment strategy is one of the biggest challenges an insurance company or asset manager has to overcome, particularly given the current economic environment. The Investment Strategy of the Year award rewards the insurance company or asset manager that has implemented an investment strategy that sets the standards for the industry to follow.

MetLife Investment Management (MIM) is exemplary in this field, impressing the judges with its corporate private placement strategy underpinned by its strong origination capabilities. As an asset manager MIM originates and manages assets that are suitable from an asset-liability matching perspective for both MetLife's general account and unafilliated institutional clients. It offers a corporate private placement strategy that seeks to originate well-structured, high quality, investment grade private debt with enhanced yield potential and diversification characteristics. MIM offers managed accounts customised to each client's unique needs or circumstances. Clients' investments can be tailored to a wide range of maturities and risk parameters, as well as by sector, geography and currency.

One of the unique propositions of MIM's Corporate Private Placement strategy consists of its ability to combine strong credit quality and solid deal structures with real financial covenant protections with an attractive yield premium to more liquid public credit investments. The breadth and depth of MIM's origination capabilities ensure that the team typically has a large number of investment opportunities to consider at any time. Of critical importance, underlying every investment decision MIM makes is a strong ESG focus, and ESG considerations are a vital part of its due diligence. Key tenets of MIM's approach are credit quality, transaction structure, relative value, origination and ESG. The investment process is built on rigorous credit analysis, and the team of experienced credit analysts offer sector specialisations as well as critical local market knowledge and understanding. In the transaction structure, the inclusion of financial maintenance covenants afford meaningful downside protection and potential return enhancement in the form of built-in prepayment provisions and other negotiated income opportunities. Private debt transactions originated by MIM also offer superior relative value by way of a yield pick-up versus comparable public investment grade credits. On an annual basis, MIM's dedicated origination team meets with over 750 companies in-person. The close and frequent engagement with borrower clients enables MIM to apply a true finer-on-the-pulse approach in terms of ongoing credit risk management.

In conclusion, MIM is a real leader in this field and a huge congratulations must go to all those who help put this investment strategy together.

*MetLife Investment Management Limited ("MIM") is authorised and regulated by the UK Financial Conduct Authority (FCA reference number 623761), registered address Level 34 One Canada Square London E14 5AA United Kingdom.*

MetLife Investment Management

# What role does corporate private placement debt have within an investment portfolio?

Private credit is a large and diverse market. MetLife Investment Management's (MIM) expertise and focus is in the investment-grade private placement segment. We believe the cornerstones to our success over the years have been our long-standing relationships with management teams and the design and implementation of innovative transaction structures with meaningful financial covenants. Working collaboratively with our investors and borrowers during the most challenging times has further fortified our long-term relationships and reputation as a reliable partner.

The private placement market originated as an insurance company asset class given the desire of insurance companies to find stable, intermediate-to-long duration income to match their liabilities. The ability to negotiate covenant protections along with customizable tenors, structures and currencies fits nicely with an insurance company's staggered liability streams. There are also diversification benefits as many companies are not public market issuers. The ability to negotiate targeted covenants protection is a key attraction that has bolstered the asset class, demonstrated in a track record of lower historical losses relative to other asset classes. In addition, the yield pick-up, due mainly to an illiquidity premium, as well as other types of incremental income, engenders an attractive risk-adjusted return over public markets and is one reason for continued increases in allocation to the asset class over the past several decades.

As a global asset management company, we have the unique advantage of understanding and analyzing a vast array of industries, businesses and management teams. We look to lend to borrowers who have solid business models, excellent management teams and assets with good long-term value. Nevertheless, it is in the more challenging times, be it past recessions, the Global Financial Crisis, and more recently through the COVID pandemic, where our experience, long-term approach and inclination for flexibility in driving outcomes serves us well. During all of these past economic trials, our focus has been to find a solution that meets the needs of the different parties. We believe these trying times require such adaptability, which in turn will pay dividends in the future in the form of better overall results and deliver even deeper long-term relationships.

We feel the outlook remains quite positive going forward with investors increasing the capital that they are committing to the asset class. MIM's role as investor and manager will continue to be to generate and uncover a deep and broad set of private placement investment opportunities for our clients, aligned with their investment objectives. From an issuer standpoint, as the economic recovery continues to unfold and we continue to see more positive news, we expect increased issuance. We believe an increase in capital expenditure and M&A activity will present new opportunities in the private placement market globally.

MetLife Investment Management

## INFRASTRUCTURE MANAGER OF THE YEAR

## MetLife Investment Management


At one of the most challenging times in insurance firm investment, infrastructure is now being taken seriously as an asset class among insurance companies. This award recognises those players that understand this complex asset class and are working hard to help insurance firms reap the potential rewards.

The judges said this firm is a top infrastructure manager with an in-depth team and structuring capabilities. An impressive level of new investments was maintained during the COVID-19 crisis. The winner is MetLife Investment Management (MIM).

The infrastructure debt group within MIM is one of the largest private infrastructure debt investors globally managing a portfolio of $30bn in over 300 issuers. MIM's infrastructure initiatives began in the UK when MIM was a pioneer in offering long-term financing for local UK assets previously financed with short term bank debt. Since then, MIM has grown its private infrastructure debt presence in the UK, Europe, and globally investing in 29 countries.

Infrastructure investments allow MIM to diversify into long term, essential assets often backed by stable and predictable cashflows. Airports, roads, power, renewables, water, and pipelines are example of these assets that are essential to the economy and benefit from high barriers to entry and allow investors to hedge inflation risk. In addition, the essentiality and importance of these assets overlap with long-term ESG considerations.

MIM's brand and recognition within the broader infrastructure market allows MIM early opportunities to structure and originate transactions that benefit both lenders and issuers. MIM underwrites every transaction with a focus on credit, structure, and relative value. Unlike some of its peers, MIM has the ability to invest across the risk spectrum from A-rated credits down to below investment grade with many of these transactions externally unrated.

Infrastructure investments are often single asset transactions with a feature of demand risk or guaranteed payments. MIM's team of credit analysts analyse each transaction to validate the stability of cashflows. Given MIM's global presence, the team benefits from sovereign analysts that provide macro level analysis. Each transaction is also structured to include relevant financial covenants that protect lenders in downside scenarios.

MIM's established presence in the UK has allowed us to develop long-term partnerships with local authorities and Sponsors. Approximately 25% of MIM's global infrastructure debt portfolio is comprised of UK assets. MIM continues to be a market leader in several sectors in the UK including social housing, ports, rail, water utilities, and renewables. In 2020, MIM expanded into the digital infrastructure space in addition to adding investments in the core transport/utility/power/energy/renewables sectors.

Well done on a well deserved award.



MetLife Investment Management

## ESG INVESTMENT STRATEGY OF THE YEAR

## Royal London Asset Management


The ESG Investment Strategy of the Year Award rewards the UK/European/Global insurance company or asset manager that can demonstrate it has conscientiously considered its investment decisions in an ethical and fair way, and produced exceptional returns for its clients. The winner is Royal London Asset Management (RLAM).

Impressing the judges with the clarity of its ESG principles and strong supporting ESG analysis, RLAM is a shining light in the industry. The RLAM sustainable team is led by Mike Fox, RLAM's head of sustainable investments. Overall, the team has over 15 years' experience of investing in sustainable multi-asset funds, honing and improving the process since its first implementation in 2003, and the lead managers have been involved with the funds since inception. The company has been dedicated to constructing and managing sustainable funds for over 26 years, and the firm added the Global Sustainable Credit Fund to its range in February 2021.

RLAM's sustainable investing has three core principles. Firstly, financial returns – well managed companies by ESG metrics are likely to be financially well run, and sustainable investing improves returns. Secondly, social and environmental improvement – companies that address social issues or environmental challenges are more likely to succeed over time. Thirdly, engagement – after investing RLAM engages with companies to make the case for higher standards. It also engages with clients via thought leadership, viewing it as a platform for the effective communication of ideas, and the ever-evolving education of clients.

Whilst RLAM makes use of external quantitative ESG and financial research, it applies a bespoke internal qualitative analysis for every company it analyses. This helps it to understand the companies it invests in better and enables it to identify additional risks and opportunities.

*"It applies a bespoke internal qualitative analysis for every company it analyses"*

This style of investment can produce strong, risk adjusted returns, and as a result of RLAM's investment approach, it has seen progression and innovation in healthcare, cloud computing, artificial intelligence, social and economic development of emerging markets, urban regeneration, and the transition to a low carbon economy. RLAM screens out companies involved with human rights abuses, tobacco and armaments manufacturing, nuclear power generation, animal fur products, pornography, irresponsible gambling and worker exploitation or exploitative consumer practices and others. Different people are comfortable with different levels of risk and have different objectives. RLAM's sustainable fund range reflects this, with different combinations of UK and global shares and bonds.

Congratulations to RLAM for an outstanding year and for deploying an ESG investment strategy that is clearly head and shoulders above the rest.

ROYAL LONDON
ASSET MANAGEMENT

# Building a sustainable future

## Insurance Asset Management Editor Adam Cadle talks to RLAM head of sustainable investments Mike Fox about the firm's sustainable investment approaches now and going forward

*Mike Fox, head of sustainable investments, RLAM*

**Do you have plans to further expand your sustainable fund range and solutions and strong inflows to continue?**
We have successfully expanded both our assets managed under our sustainably focused strategies (from around £1bn in 2013 to over £13bn currently) as well as the range of implementation solutions we offer in this area. In terms of further expansion, we use the same hurdle as we do for all potential new funds: are our clients asking us for this type of solution, and can we provide something unique that will help them achieve their goals? If the answer to both is 'yes' then we will. We expect flows into this area will continue to grow materially over coming years, particularly given the material expectations for institutional investors, including insurers, to play a key role in the transition to a lower carbon and more sustainable economy and society. In addition, sustainable strategies such as ours still account for a relatively small proportion of overall investment portfolios, and ultimately we think that all investing will be sustainable to some extent.

**How important is the engagement part of the process for your sustainable investment approach?**
We regard initial and ongoing engagement with issuers to be a key component of the sustainability process and framework. We on the sustainable investment team work closely with our wider responsible investment team who help us to look at corporate governance, voting and building the long-term engagement that encourages positive corporate behaviour.

**Is active investment the key in ESG/sustainable investing?**
We see active investment and insights to be a significant driver in ensuring ESG / sustainable investment delivers both the financial and environmental / social outcomes that our clients are expecting. A purely passive, quantitative driven approach does not address the complexity and nuances of longer-term sustainability themes. Our investment process is based on the belief that markets often undervalue companies that can have a positive influence on society and the environment. And assessing whether a company can have that positive influence isn't something that can be boiled down to a single number or rating. On that basis, I think that a sustainable strategy has to be actively researched and managed.

**Do you see every investment fund eventually incorporating an ESG process in the future?**
We see the integration of ESG criteria to be key in delivering an appropriate investment outcome for any investment – across different assets and investment approaches.  One of my colleagues in credit research once said: it's not credit research and ESG research - it is all just credit research. Successful investment means buying the right stocks at the right price. If you don't factor in those elements that can affect those stocks, then we don't think you can be successful in the long term. At RLAM not all funds are sustainable, but all include ESG analysis.

The value of investments and the income from them may go down as well as up and is not guaranteed. Investors may not get back the amount invested.

# PASSIVE MANAGER OF THE YEAR
## Invesco


The Passive Manager of the Year award celebrates the investment manager that demonstrates strong returns and shows a true understanding of the needs of their clients.

The judges were particularly impressed with the articulation of this firm's award entry, with a strong focus on indexing, rebalancing and returns. The winner is Invesco.

Invesco's passive business currently boasts assets of over US$500bn globally and its ETF business has US$67bn of AUM in UCITS products listed across major European exchanges. The vast majority of these assets are in passive investments providing low-cost, efficient exposure to equity, fixed income and commodity benchmarks. Standout examples are the Invesco S&P 500 UCITS ETF (US$17bn in AUM) and Invesco Physical Gold ETC (US$14bn).

Invesco understands that, for passive investments, most insurance investors evaluate performance based on the consistency of the returns versus the index being tracked. Costs play a big part in the relative performance of a passive fund, and Invesco offers extremely competitive costs across the board on its passive range. When looking to buy, sell or switch into any of its ETFs, its experienced Capital Markets team works diligently with clients to understand their trading requirements and preferences, guiding them to find the most optimal method for execution.

In the case of passive ETFs, Invesco takes an agnostic approach to the way in which it replicates the reference benchmark. For many indices, it is able to generate much closer and consistent tracking with its synthetic replication method. Invesco does this by holding a portfolio of quality equities, which are not necessarily the same as the index, and improve tracking with the use of a swap overlay, generally with multiple swap counterparties. When replicating US equity indices,

*"In the case of passive ETFs, Invesco takes an agnostic approach to the way in which it replicates the reference benchmark. For many indices, it is able to generate much closer and consistent tracking with its synthetic replication method"*

Invesco's replication method enables its ETFs to capture a greater level of dividends (100% with no dividend withholding tax) than competing physical products. It gains the same performance advantage with its global equity ETFs. Other improvements to performance can be found in Invesco's fixed income ETFs, including enhancements to some of the indices that makes tracking more effective. Invesco also has securities lending on selected ETFs, with 90% of revenues retained within the fund for investors.

With dedicated ETF specialists and country teams across the globe helping clients meet their specific requirements, Invesco is ahead of the game. Invesco never sits still and is always looking for ways to improve. Congratulations.

# Passive offers much more than you may think

We are delighted to have been named Passive Manager of the Year, capping a successful 2021 for our ETFs and indexed strategies. Our passive ETFs have seen particularly strong growth with these low-cost vehicles featuring increasingly in insurance portfolios. We've been working closely with insurers to better understand their objectives and areas of concern or shortfalls, with many now using our passive ETFs to reduce risks, increase yield, integrate ESG into their portfolios, capture specific market opportunities or simply reduce costs.

Passive is more than just primary index trackers. While ETFs that track key benchmarks such as the S&P 500 or MSCI World indices are still core components of diversified portfolios, you can also find ETFs that passively track secondary, niche or even bespoke indices. Which replication method we use is driven by several factors including market dynamics and investor preference. Our objective is to find the solution that offers the best total outcome for investors for that index.

We focus on the total cost of owning our ETFs, which includes some of the lowest ongoing charges in the industry for most exposures. That tells part of the story. A more comprehensive version is told by an ETF's tracking error – how closely does it track the performance of its reference benchmark? Even if the difference between competing ETFs tracking the same index is only a few basis points, each one adds to or detracts from performance.

ESG was the clear winner last year in terms of ETF flows across the industry and from our own range. Passive exposures to equity and fixed income ESG indices generally took in more net new assets from investors than exposures to their parent, non-ESG variants. This trend was most evident in the largest markets including US and World equities, with many investors converting portfolios to ESG. We know through more than three decades of experience that ESG does not have a "one size fits all" solution. It has different meanings to different investors, each one having their own objectives. We are seeing this expressed through ETF flows.

We have been building out our ESG ETF range in Europe since 2019 to meet increasing demand from large investors, some wanting to improve ESG characteristics in their portfolios without sacrificing investment performance. Other investors want to factor in the impact on the environment, and this is becoming increasingly relevant as increased regulation and investor preference evolves. Our more recent ETF launches have specific climate-related targets, including Paris-aligned benchmarks.

The need to address climate risks has escalated for insurers in particular. We now offer investors passive ETFs that seek to reduce exposure to transition and physical climate risks while pursuing opportunities arising from the transition to a lower carbon economy. Engagement is also important to many investors, as it is to us on passive and active strategies. We exercise our proxy voting rights and leverage global size and resources to actively engage with companies on key ESG issues.

Passive offers much more than you may think.

https://www.invesco.com/uk/en/capabilities/etfs.html
https://www.invesco.com/uk/en/institutional/clients/insurance-companies

*Investment risks*
*The value of investments and any income will fluctuate (this may partly be the result of exchange rate fluctuations) and investors may not get back the full amount invested.*
*Important information*
*Where individuals or the business have expressed opinions, they are based on current market conditions, they may differ from those of other investment professionals and are subject to change without notice.*
*Data as at 31 December 2021, unless otherwise stated.*
*This is marketing material and not intended as a recommendation to buy or sell any particular asset class, security or strategy. Regulatory requirements that require impartiality of investment/investment strategy recommendations are therefore not applicable nor are any prohibitions to trade before publication.*

Invesco

# PROPERTY MANAGER OF THE YEAR
## Invesco


The Property Manager of the Year award rewards the investment manager that has shown a true understanding of regional and global property markets, and has been able to translate that knowledge into risk adjusted returns for the benefit of their insurance clients.

The judges were impressed with how this firm's Global Real Estate Fund is expanding, offering access to both direct and enhanced liquidity through the addition of real estate in one wrapper. The winner is Invesco.

Its dedicated Invesco Insurance Solutions team works hand-in-hand with the real estate team utilising its unique Vision tool with real estate allocation to optimise insurance clients' portfolio risk/diversification requirements.

While the firm prides itself on managing over 700 assets worldwide for over 450 global clients, it is also a sustainable investment manager, with 12 of its real estate portfolios submitted to the 2021 Global Real Estate Sustainability Benchmark (GRESB) Assessment. GRESB is the leading international benchmark for real asset ESG performance. In 2021, Invesco achieved five 'green stars' out of five for seven of its funds globally, with a further three funds achieving four out of five stars.

As a global manager, Invesco Real Estate has one of the most wide-ranging product ranges in the industry and in EMEA, North America and APAC, thus enabling it to satisfy insurance client's demands for both equity and debt, as well as provide global coverage across listed/direct, equity/debt and from core and core plus, debt/income to value-add and opportunistic. This global offering was completed in 2020 when Invesco Real Estate reached an agreement with GAM to transfer GAM's commercial real estate debt finance business of US$300m, including its European real estate debt team and corresponding European assets and investor relationships.

*"Invesco Real Estate has one of the most wide-ranging product ranges in the industry and in EMEA, North America and APAC, thus enabling it to satisfy insurance client's demands for both equity and debt, as well as provide global coverage across listed/direct, equity/debt and from core and core plus, debt/income to value-add and opportunistic."*

Supported by 597 staff worldwide, responsible for US$87bn of AUM, the firm's underlying investment strategies are based on top-down economic fundamentals combined with bottom-up local market intelligence. The starting point for achieving investment objectives is to develop a general view of the real estate markets (House View). The House View is a collective belief of the way a firm should invest in the institutional real estate markets to help achieve a client's investment objectives and is comprised of target weightings by property type for Invesco Real Estate's (IRE) model portfolio; market ratings for each qualified market; and investment strategies for each market targeted for investment.

All of this makes Invesco an outstanding firm. Well done.

Invesco

# How one extra letter makes ESG different at Invesco Real Estate

Insurance companies are increasingly seeking investment strategies that produce positive environmental, social & governance (ESG) outcomes while also delivering sustainable returns.

At Invesco Real Estate, ESG+R (environmental, social, governance & resilience) has been a fundamental commitment for many years. We believe that ESG+R can deliver competitive financial returns and opportunities for business growth and innovation.

**Our ESG+R objectives**

Our environmental objectives include measuring and reporting building energy usage, emissions, water and waste within our control, whilst improving environmental performance across our managed portfolios. We're targeting[1]:

- A 3% annual reduction in energy intensity and carbon emissions by 2030 (from a 2018 baseline) which will align us with the Paris Accord goal of limiting global warming to 1.5 degrees Celsius above pre-industrial levels and help us to reach net-zero carbon emissions by 2050 or sooner.
- A 1% annual reduction in water consumption.
- A 1% annual increase in waste diversion rates by implementing low-cost measures, capital improvements and new technologies.

On social aspects, we're encouraging sustainable practices to our tenants through engagement tools and providing services and amenities at our properties – such as gyms and bicycle storage – that encourage healthier lifestyles. We support diversity and inclusion in our workforce through education and creating an environment that optimises our employees' full potential. We also encourage our employees to be active in the development of their own communities.

Our governance objectives include integrating ESG into our decision-making and due diligence processes. Furthermore, we provide annual reports as part of the Global Reporting Initiative and the European Association for Investors in Non-Listed Real Estate Vehicles (INREV), which aims to improve transparency, professionalism and best practices across the sector. As for resilience, we're evaluating the physical risks our assets may face through climate change, including single catastrophic events like hurricanes and extreme flooding, or changes over time such as higher temperatures or rising sea levels. Additionally, we monitor our properties' exposure to (low-carbon economy) transition risk.

**How we align ESG+R with investing**

Since 2012, we've reported to GRESB – the leading international benchmark for real asset ESG performance. In 2021, seven of our funds achieved five 'green stars' out of five, with three funds achieving four out of five.[2]

We've aligned our ESG+R initiatives with the United Nations Sustainable Development Goals by taking action against climate change, promoting sustainable cities and responsible consumption at the property level. Invesco has been a signatory to the UN's Principles for Responsible Investment since 2013, scoring an 'A+' rating for our overall responsible investment approach in 2021 and an 'A' rating in the Property module for the sixth consecutive year.

We are a signatory of the Taskforce for Climate-Related Financial Disclosure and a member of the Net Zero Asset Manager initiative. Find out how we could help you align with your stakeholders' ESG expectations too.

https://www.invesco.com/uk/en/capabilities/real-estate
https://www.invesco.com/uk/en/institutional/clients/insurance-companies

*[1] Invesco cannot guarantee that these targets will be realised.*
*[2] Any reference to a ranking, a rating or an award provides no guarantee for future performance results and is not constant over time.*

***Investment risks***
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***Important information***
*Data as of 31 December 2021 unless stated otherwise.*

*This document is marketing material and is not intended as a recommendation to invest in any particular asset class, security or strategy. Regulatory requirements that require impartiality of investment/investment strategy recommendations are therefore not applicable nor are any prohibitions to trade before publication. The information provided is for illustrative purposes only, it should not be relied upon as recommendations to buy or sell securities.*

*Where individuals or the business have expressed opinions, they are based on current market conditions, they may differ from those of other investment professionals, they are subject to change without notice and are not to be construed as investment advice.*

Invesco

# ALTERNATIVES MANAGER OF THE YEAR
## BNP Paribas Asset Management


Alternatives have become an essential part of UK/European and Global insurance firms portfolios. The Alternatives Manager of the Year award recognises the firm that has shown a true flair for extracting value from the alternatives space to the benefit of its insurance clients.

The leader of the pack is BNP Paribas Asset Management (BNPP AM), with the judges praising the firm's diversified private credit capabilities as exemplary, taking into account liability cashflows, accounting and financial objectives, and specific risk constraints.

BNPP AM has continued to develop its offering for institutional investors seeking illiquid assets as liability matching assets or as a low volatility multi-asset growth asset and those with longer term horizons, that were able to access the illiquidity premium, seeking diversification from credit and equity holdings. Its investment universe for private credit has continued to grow to include new asset classes that diversified private credit will benefit from such as mezzanine infrastructure debt and mezzanine commercial real estate. The investment process has also been refined, from the optimisation of the risk/return profile through to risk monitoring and portfolio review, with specialist teams from the Multi-Asset, Quantitative & Solutions (MAQS) and Private Debt & Real Assets (PDRA) investment divisions responsible for each step. The strategy continues to evolve its approach to liquidity, implementing a number of features to enhance the liquidity profile of the diversified private credit strategy. Key to suitability is an annual mapping of the liquidity risk profile to the maturity profile of the scheme members. This is done via annual governance arrangements that allow for modifications to the strategic asset allocation and key characteristics of the strategy e.g. switching from total return to income paying.

*"The firm's diversified private credit capabilities are ideal for insurers who are drawn to private debt"*

Furthermore, the firm's diversified private credit capabilities are ideal for insurers who are drawn to private debt as its offering allows insurers to pick and choose investments in line with their investment return and volatility risk requirements.  Private credit investments are not led by market volatility, as traditional listed bonds are, therefore the diversified private credit portfolios BNPP AM is able to tailor for insurers are, by structure,  less volatile – ideal when insurers have low risk requirements as they ultimately land a lower solvency capital risk.

BNPP AM's solution also provides full ESG integration through a rigorous assessment process conducted by its Sustainability Centre, measuring and reporting of projects' environmental and climate impact, with impact investing asset classes available for inclusion. Integration is also achieved at portfolio level as analysts and portfolio managers integrate a consideration of relevant ESG factors into their investment decision-making processes.

Well done on a richly deserved award.

BNP PARIBAS
ASSET MANAGEMENT

# Where can attractive Alternatives be found?

Negative cash flows, pressure to diversify risk exposures, stricter investment regulations – institutional investors are facing many issues and as a result many are shunning the volatility associated with listed equities and investing in other asset classes.

Private markets can be an attractive substitute to listed equities and bonds. One way to improve the risk/return profile of institutional portfolios is to capture the credit and/or equity illiquidity premiums by investing in diversified private debt and private equity portfolios.

Indeed, private debt and equity offer a number of advantages over their listed equivalents.

- Higher returns, captured through an illiquidity premium
- Lower volatility and a lower market beta (which for insurance companies under risk-based capital regulation is crucial)
- Potentially more targeted environmental, social and governance (ESG) oriented investments (based, for example, on line-by-line selection of well-defined projects)
- Lower immediate liquidity as most of these assets are valued once a month or once a quarter and are usually held to maturity to avoid liquidation costs.

**Investment strategies**

In practice, asset managers have developed different types of investment strategies to meet investors' objectives when entering the private credit and private debt universe:

- **Diversified private credit strategies** generally aim to incorporate various types of real asset debt and corporate lending with some structured finance sub-asset classes and to capture a credit illiquidity premium. They offer a blend of senior and mezzanine investments, countries, currencies, credit ratings and liquidity. They can be structured as cash-flow matching portfolios and can be suitable for mature defined benefit pension schemes (with a large majority of retirees) as well as insurance companies operating under risk-based capital regulations (capital requirements are less punitive because private debt assets have a lower volatility than their listed equivalents).
- **Diversified private markets** strategies add exposures to private equity, direct real estate and infrastructure equity to a diversified private credit portfolio. They aim to capture a blended illiquidity premium. They are structured as alternative growth engines and are suitable for defined benefit pension schemes with active members and defined contribution pension plans with long time-horizons. They typically offer higher expected returns with lower volatility levels than their listed counterparts do.

Because of their nature, these strategies are customised to individual client needs and have varying features when it comes to:

- The investment universe can be narrow (for example, focused on corporate lending) or wide (including semi-liquid asset classes such as leveraged loans)
- The strategic asset allocation (SAA) can be directive or just indicative, with loosely set ranges allowing for active asset allocation over time
- They can be evergreen or established only for a pre-determined amount of time
- They can rely on a fund-of-funds structure or include only single investments.

For all these reasons, we believe diversified private credit or private market approaches have a strong edge over investing in single asset classes as well as over listed asset classes.

*Julien Halfon, Head of Pension and Corporate Solutions, BNP Paribas Asset Management*

## MULTI-ASSET MANAGER OF THE YEAR

# Morgan Stanley Investment Management


The Multi-Asset Manager of the Year award is given to the multi-asset manager that has delivered exemplary performance over the past year, delivering strong returns for insurance clients through a wide range of investment strategies.

The judges were impressed with this firm's strong performance in its Global Balanced Risk Control (GBaR) strategy in conjunction with its highly innovative approach to include Solvency II capital requirements. The winner is Morgan Stanley Investment Management (MSIM).

With fixed income yields low, solvency capital costs high and volatility set to continue, insurers increasingly use bespoke tactical multi-asset solutions to dynamically access economic and Solvency II capital efficient returns. MSIM's GBaR strategy is an established approach to managing multi-asset portfolios, following a process designed to provide stable risk-adjusted returns. It follows a four-stage process.

Firstly, risk profile, whereby MSIM's GBaR team anticipate future changes in volatility and dynamically manage a broad asset mix, targeting a specific volatility level, as agreed with the client. Using historical data, the team create an initial efficient frontier for the portfolio's investment universe. Based on proprietary research of future event risks, they shift the frontier to the left or right, in anticipation of lower or higher volatility. If the volatility of the asset mix is subsequently too high, for example, they adjust this mix by lowering equity exposure, thereby bringing the portfolio back to the target volatility.

Secondly, tactical positioning is deployed, where the team captures key qualitative themes, determining sub-sector and regional preferences within broader asset classes – an opportunity for alpha generation. Thirdly, MSIM implements quantitative position sizing whereby tactical preferences are translated into implied expected returns. Finally, a Solvency capital is applied via guideline limits, and efficient capital management approaches incorporated. Hence the GBaR process is closely aligned with the dynamic capital objectives of insurance clients.

The GBaR strategy has built a strong track record. Annualised returns of 7.1% and a Sharpe Ratio of 1.22 since inception have been recorded (in euro terms, since inception, as of 31 December 2021). It is well suited to meet the needs of UK and European insurers seeking higher returns whilst meeting solvency capital requirement (SCR) constraints. The facility to limit SCR allows clients to retain control of capital budgeting, essential for risk management when insurers outsource multi-asset mandates.

MSIM has clearly had a successful year in the insurance space and its entry underlines why it is head and shoulders above the rest in this area. Congratulations to all at the firm.

## Global Balanced Risk Control (GBaR) Strategy:

# Aligning Active Risk Management with Capital Objectives

Risk has always been a starting point for clients of our Global Balanced Risk Control (GBaR) strategy. Since 2009, the GBaR team has managed globally diversified multi-asset portfolios, expanding our offering to meet evolving client needs. Indeed, as part of Morgan Stanley Investment Management's (MSIM) Custom Solutions group, developing innovative solutions is what we do. However, risk-control has always remained core to our approach.

Partnering with MSIM's European Insurance Solutions team, we have designed innovative ways to harness our flexibility and risk management capabilities to enable our insurance clients with solvency capital requirement (SCR) constraints to access our strategy.

We apply a flexible asset allocation process enabling dynamic adjustment of positioning to navigate changing market conditions and maintain a stable risk profile. To anticipate and control volatility, the GBaR team continually surveys the macroeconomic conwditions, identifying potential sources of risk and aiming to adjust portfolio exposures before volatility strikes. For example, during the escalation of the COVID pandemic in February 2020, we adjusted our equity allocation quickly from an above neutral equity positioning in the context of a healthy economy, to a lower equity, defensive positioning.

In addition, we have further flexibility in our tactical positioning, where regional, sub-asset class and sector tilts may provide opportunities for alpha. For example, in 2021, the two top performing sectors in the MSCI World were financials and energy, on which we held positions for almost the entire year, trimming towards close to take profits.

This applies also to fixed income. We are currently low duration in the face of rising rates, but have the ability to adjust should our view change. As yields increase, we can increase duration if appropriate. Our flexible strategy enables us to adjust fixed income allocations, for instance moving more into investment grade credit and into high yield when rates peak.

The GBaR strategy's flexibility allows for wide portfolio constraints, enabling potential alpha generation and reduction of risk across evolving reward/risk profiles. Thus, economic optimisation can be maintained while adhering to Solvency II regulations.

It is in this context that the GBaR investment process seeks to:

- maximise returns, while actively managing total portfolio volatility and incorporating Solvency II constraints
- dynamically allow for clients' changing risk management and SCR criteria
- participate in rising markets and provide downside protection in volatile markets, for a smoother performance profile
- add value from tactical insights into global markets

Finally, we are pragmatic – depending on market conditions, it is not always necessary to use the entire SCR limit to maximise returns.

When insurers outsource a part of their investment activities, they remain fully responsible for adhering to all aspects of Solvency II. This includes maintaining a risk management system, which defines risk tolerance limits and actions to ensure limits are met. The GBaR team's ability to incorporate clients' SCR limits means that each client has control of their capital budget.

Given the above, we believe the GBaR strategy is well suited to meet the needs of insurers seeking higher returns and to help them meet their Solvency II capital requirements.



Morgan Stanley

INVESTMENT MANAGEMENT

# EMERGING MARKETS MANAGER OF THE YEAR

## HSBC Asset Management


The Emerging Markets Manager of the Year award rewards the investment manager truly embracing the emerging market space to the benefits of UK/European and global insurance clients.

The judges said this manager's approach in making its EMD Total Return Strategy more efficient in terms of the SCR market was exemplary. The winner is HSBC Asset Management.

HSBC Asset Management has US$182bn invested in global, regional and single country emerging market investment solutions, including a comprehensive range of EMD and global emerging market equity strategies. Its global EMD offering includes hard and local currency strategies (and blends of the two), investment-grade, corporate, inflation-linked and total-return strategies. HSBC Asset Management applies three steps to make an EMD Total Return Strategy more efficient in terms of SCR market. Firstly, an optimisation of the bond portfolio to reduce SCRspread is applied, resulting in a c.15-25% reduction in spread. Secondly, only the USD exposure to EUR is hedged, as opposed to using a EUR-hedged share class), reducing SCR FX by typically around 20%. Thirdly, it omits or limits CDS to sell protection, further reducing SCRspread. The result is a SCR Market of around 15%-18% depending on positioning and EM currency return potential is still available.

Innovation is also at the heart of all that HSBC Asset Management does. 2020 saw the second close of the HSBC Real Economy Green Investment Opportunity (REGIO) GEM Bond Fund raising a total of $538m, creating the first and largest EM Green Corporate fund in the world. Anchored by the IFC, a member of the World Bank Group and HSBC, this innovative solution supports climate risk-mitigation investments across emerging markets, helping EM countries limit the effects of climate change. Additionally, within emerging markets debt, HSBC Asset Management is planning to launch a suite of ESG SFDR Article 8 solutions including an EMD hard currency, local currency and a corporate improvers fund, all managed against ESG benchmarks. These funds will offer investors a better ESG score, better carbon scores and greater access to labelled bonds compared to transitional EMD benchmarks.

*"The judges said this manager's approach in making its EMD Total Return Strategy more efficient in terms of the SCR market was exemplary"*

The firm also provides a range of thematic publications, white papers, videos on various topics of current interest as well as hosting roundtable discussions for insurance CIOs. The objective of the client content is to provide a good understanding of global regulator[y developments relating to insurance investments.

Congratulations to HSBC Asset Management on an outstanding entry and for its leading work in the emerging markets arena.

HSBC Asset Management

# Uncovering the benefits of EMD for insurers

There is a strong investment case for insurance companies to consider a long-term strategic allocation to Emerging Markets (EM) debt as a solid building block in their overall portfolio mix, especially when comparing to other traditional fixed income asset classes.

One of the most apparent advantages of EMD is the attractive yield when compared to lower yielding Developed Market (DM) fixed income. The yield of the standard EM hard currency benchmark (JPM EMBIGD) is currently 5.75% compared to the Global Investment Grade (IG) index which is yielding 2.08% while maintaining a similar duration to EMD of around 7 years. In terms of unit of yield per duration and taking into account regulatory capital implications, this equates to 0.74 for EMD, which is clearly more attractive than the Global IG score of 0.29. Given the Global High Yield (HY) index yield of 4.13% and shorter duration of ~ 4 years, the unit of yield per duration is higher than that of EMD; however, the default rate for EM is much lower than Global HY.

Another attractive feature of EM bonds comes from the long maturity of EM bonds. In the standard EM hard currency benchmark, 40% of bonds have maturities of at least 10 years, which results in EM bonds providing a reliable source of income for long-term investors (eg Life companies and annuity writers). Additionally, the risk of bonds being called or tendered before their maturities is much lower in EM compared to HY. For example, more than 50% of the entire US HY universe was called before maturity, compared to 17% of emerging market hard currency sovereign and corporate debt. Therefore, EMD can increase the predictability of cash flows to match long term liabilities compared to comparable asset classes.

Furthermore, EM bonds offer diversification benefits with over 70 sovereigns and 800 corporates in the hard currency universe representing over one-third of the world's economy and global bond market. Given the vast size, the asset class is broad and deep enough to tailor individual portfolio needs. For example, popular amongst insurance companies are EM allocations that focus on investment-grade issuers, for which there are currently 24 sovereigns and over 400 corporates.

Another significant advantage of EMD is the lower Solvency II capital charges, especially compared to EM equities. According to our calculations, the SCR for equities is 55%[1] compared to only 23% for the standard EM hard currency index. The SCR drops to just 13% for EM investment grade hard currency bonds and even lower to 9% for a fully flexible EM total return strategy which has a shorter duration with a higher average credit quality and incorporates a mix of hard and local currency bonds and EM FX. The capital charge for EM is also attractive to other comparable asset classes such as US HY at 21%.

*"EM bonds offer diversification benefits with over 70 sovereigns and 800 corporates in the hard currency universe representing over one-third of the world's economy and global bond market"*

Finally, a portfolio including EM bonds can help insurance companies meet their ESG and sustainability goals, particularly in terms of decarbonization, where emerging market countries represent 60% of the world's CO2 output. There are a number of ESG and sustainable solutions that can be created through an EM allocation, thanks in large part to the rapidly growing EM Green and labeled bond market, which has tripled in size in just the last year and now stands at over $50 billion dollars. HSBC AM has been at the forefront of creating such solutions with the launch of EM Green Bond and ESG funds which can be further tailored to insurance companies' specific needs.

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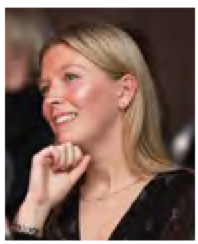
HSBC Asset Management

[1] *Type 2 equities as a proxy, incl. symmetrical adjustment as of January 2022*

# Insurance Asset Management Awards 2021



CHAIR

**DR MICHAEL GANSKE**
**CFA Fixed Income Portfolio Specialist, T. Rowe Price**

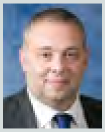
Michael is a portfolio specialist in the fixed income division. He is a member of the global fixed income team, focusing on the firm's emerging markets local currency debt strategy and supporting the firm's emerging markets debt strategies in Europe, the Middle East, and Africa. He is a vice president of T. Rowe Price Group, Inc., and T. Rowe Price International Ltd.

**PAUL WHELAN**
**CFA, Partner, Co-Head of Fixed Income Manager Research, Aon**

Paul is co-head of global fixed income manager research at Aon, based in the UK where he is responsible for providing advice on the full spectrum of fixed income asset classes to investors globally. Paul joined Aon Hewitt in November 2012 after more than 10 years in asset management where he managed long-only and absolute return mandates.

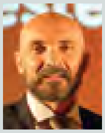
**CHRIS BRAY**
**Investment Analyst, Hiscox**

Chris has been an investment analyst in Hiscox Group's investment team since 2019, after graduating in 2017 and having previously worked in financial consulting and equity fund management. In his day-to-day role, Bray focuses on quantitative analytics relating to the group's investments, including risk modelling, performance analysis, and strategic asset allocation.



**KEITH GOODBY**
**Head of Shareholder Investments and Strategy, Aviva**

Keith is head of shareholder investments at Aviva responsible for investment strategy, manager oversight and portfolio management oversight with a focus on the matching adjustment. Previous roles include head of the insurance investment solutions group at Willis Towers Watson and portfolio director for the with profits fund at L&G.



**CORRADO PISTARINO**
**Chief Investment Officer, Forresters Friendly Society**

Corrado has 25 years' experience in investment banking and asset management. He is CIO at Foresters Friendly Society. Previously, he was head of insurance LDI at Aviva Investors, responsible for £10bn of insurance funds and £30bn of derivatives. Corrado has a degree in Physics from Turin University and a Master in Finance from London Business School.

In association with

T. Rowe Price

# INVESTING IN ASIAN CREDIT

**OUR PANEL OF EXPERTS ANALYSE THE BENEFITS ON OFFER IN THIS SPACE**

**GANSKE**: It's difficult to find value in fixed income markets and to generate income nowadays because yields are negative in many cases, and risk premia are artificially low. This is primarily a consequence of easy monetary policy and quantitative easing by central banks in the last 18 months, due to COVID.

Looking at the opportunity set, particularly at fixed income credit, how would you assess the credit market? Does it offer value in your opinion? How do you manage your credit exposure and run your strategy?

**GOODBY**: You're right it's difficult, everything is tightly priced. We've recovered from pre-COVID levels and in some cases, spreads are even tighter. It means we must be highly selective in the names we invest in, to ensure we're getting the right risk-return ratio on those names. For me, the opportunities are running out slowly. There's still some risk premia in emerging market debt (EMD) but it's slowly getting taken away as well, making it difficult.

I think there are three additional challenges right now. Firstly Omicron or other variants; inflation, which I'm sure we'll spend a lot of time on today; and the other is climate, which is certainly a bigger focus for us in our investment decisions.

**PISTARINO**: A typical credit portfolio has seen a migration towards weaker credit ratings. A significant amount of bonds that used to be A or higher have migrated towards the BBB cohort, reflecting degradation in credit quality – that's a negative.

The positive is that central banks, for variety of reasons will be very cautious to hike rates aggressively. One of those reasons is the amount of leverage in the economy – so, all considered, I believe there is still value in the asset class.

I think there is marginally more value in the high yield market for the same reason. With rates increasing at moderate pace and a reflating economy, I can still see a pick-up compared to investment grade. It is also a much smaller market, and not particularly appealing in terms of solvency. On balance though, we believe that an allocation to the asset class is warranted. Because of its additional complexity, the allocation is under constant monitoring and review.

**GANSKE**: Developed market central banks seem to be more relaxed about the pick-up in inflation than emerging markets central banks. Many also already started a hiking cycle a while ago. The question is, what will be the impact on credit markets when developed markets central banks start tightening monetary policies?

In my opinion, the first step is to taper off quantitative easing. We are seeing this already and this has an impact on the supply and demand dynamics in fixed income markets. The next step is to start hiking policy rates which increases the risk-free reference rate. This is changing the relative value metric between risk free rates and credit risk premia in fixed income markets. I think emerging markets hard currency debt offers better value than other credit markets, but spreads are relatively tight and this aspect is very important. Where do you see value in credit?

**WHELAN**: Opportunities in private credit are still there. There are some areas of that market that are getting stretched, especially where there's a lot of dry powder by fund managers left to deploy, and as a result obligors can get away with tighter yields.

There's still some reasonable carry in the more liquid market space, in particular there are opportunities within the securitised market, where in many sectors spreads appear attractive versus similarly rated corporate bonds. I recognise for Insurers the solvency charges on holding securitised assets can be quite penal however. But increasingly, we're moving from a period where defaults especially in investment credit have been very low and markets supported by huge liquidity provisions from central banks, to a scenario where there are more idiosyncratic risks and opportunities, such as the global supply chain issues and expectations of quantitative tightening and tighter monetary policy against a backdrop of the highest realised inflation for a generation.

There are still enough corporates out there who can pass that pricing pressure onto customers, who can raise their margins accordingly. But I think there are many issuers in that BBB area which are losing their support from the wider credit markets.

Within emerging markets, I think your assessment is fair, Michael. The biggest challenges within emerging market debt are that some investors are not aware of the dynamics and transformations happening in emerging markets and there are still negative connotations associated with the term 'emerging markets' similar to how there was with the use of 'junk bonds' to describe high yield debt thirty years ago. As ESG considerations and in particular combatting climate change

becomes increasingly to the forefront of investors' minds, there is also a challenge for some emerging market nations as to the role they have to play in portfolios aligned to climate objectives.

**GANSKE**: There are many question marks. How do you think about risks and what do you see as the biggest risk in the next six months?

**BRAY**: We're a little bit concerned about some kind of taper tantrum – because the Federal Reserve does have to hike rates a bit more than expected to calm down inflation. But at least EMD has a slightly better risk-reward balance, and that's why we're a bit more comfortable.

There are some issues with the climate aspect, as mentioned, and from what we've looked at I think we must be more realistic and pragmatic in that space. If energy prices keep going up then it could impact some of these more fragile economies, such as Turkey. Emerging market central banks hiking rates was mentioned earlier, and Brazil is an example there.

There's a lot of very different things to think about in EMD, which is useful in one sense because it is diversifying risk, but that's also why we prefer hard currency, as we don't have to try and discuss Brazilian central banking policy with our manager, which would be quite difficult.

In terms of other risk, we are also a little worried about Chinese real estate, as it's something we've recently invested in and have a bit of exposure to.

**GANSKE**: This climate argument has come up several times. Many emerging markets are commodity based, and their macroeconomic structure is such that sectors that put a high burden on the environment are outsized. Furthermore, as many are poorer transformation economies, energy efficiency is poor as well. As a result, net zero as a target can be difficult to achieve.

In more advanced economies, such as Germany for example where there is a strong focus on the environment, the marginal benefit of investing into greener technologies is low. On the other hand, the impact of these investments in emerging markets, such as changing the way they can utilise energy and are running the economy, is much higher.

The climate problem has been generated by richer countries over many decades. In India and China there was not so much pollution in the past but it's there now. This creates challenges for investors who are concerned about the carbon footprint of their portfolio, and these challenges are more pronounced in emerging markets. Looking to the second biggest economy in the world, what is your outlook for China ?

**PISTARINO**: My outlook on China is positive. They are in a long process of rebalancing an economy driven by manufacturing exports, and heavy over-investment in areas like construction. With the emergence of a wider middle class, there is a natural shift towards higher levels of internal consumption and further expansion in services.

Hopefully, the present predicament could just be a momentary bump in a long process of rebalancing. There is no doubt that China is rapidly evolving into a fully developed economy: the debate is only whether it will become the leading economy in GDP terms over the next decade or not. And – similarly to other major economies – China is actively engaged in reducing their levels of pollution and shifting towards a greener economy.

It is worth noting there is a cultural element that informs their actions. China has a unique capacity in planning ahead. Part of this plan is to create a more sustainable path to economic growth by reducing inequalities in the name of a "harmonious society".

**GOODBY**: I think you're absolutely right there. The five-year plan has two fundamental themes. Common prosperity, which is sharing the wealth equally, and regulatory rectification. I think they're giving clear messages that certain activities such as the property bubble, and the lack of debt discipline, are not aligned with those fundamental principles anymore.

We're going to see a marked change in the way they grow and regulate the Chinese economy, so we might see that the pace of growth will slow and it will be more about the quality of the growth rather than the quantity. Rather than infrastructure, green infrastructure for example.

I think this means we can expect slower Chinese growth going forwards, which will have a knock-on impact on other emerging markets – particularly the commodity driven markets that are supplying to China. China is following the same path taken by Japan and South Korea – a move to a middle-class income, consumer and tech driven society.

**WHELAN**: I wonder if there are parallels that can be drawn to the situation in the UAE and Dubai, particularly around a decade ago, where an economy was built up around one natural resource, had witnessed a huge real estate boom and subsequent bust but more recently has been booming again. In China there's potentially more concern over it moving to a more equal footing economy, away from central banks and towards more private capital markets and more global capital. That could lead to such an enormous supply of corporate debt issuance into the market that, if anything, could take a long time to digest as I don't think there is a natural buyer of it, certainly not in the Dollar or harder currencies, as Chris said.

Again, there's a lack of knowledge and understanding of the marketplace and arguably many misplaced preconceptions, and that fear brings about a complexity premia into the market. That said I don't think this knocks them off their five-year plan.

**BRAY**: I agree and I think something more worrying in the short-term is Taiwan and the geopolitical aspect there. Does that occur at the same time as Russia trying to invade Ukraine, or Iran and Israel – all of these are to some degree emerging market issues and they are a lot more worrying than a few property developers. This China and Taiwan situation and whether it would mean NATO has to get involved, it could potentially be hot and therefore far harder to resolve.

**PISTARINO**: Geopolitical risks are very relevant because of their close interaction with fundamental economic forces. The key consideration here is that China is the second biggest economy in the world. While there is still a long journey ahead in terms of GDP per capita, I'm not sure the "emerging markets" label is still appropriate. We cannot compare China with Taiwan, or Vietnam, or South Korea, precisely because of its size and its relevance on the world stage. We are increasingly moving to a level of awareness whereby China will be looked at separately from a host of other developing countries.

**GOODBY**: I was going to throw a question back to you, Michael, on what your investors think. Are investors aware of the wide range of credit quality in the region? In the Middle East, these are AA sovereigns and the discussion is on oil dependency and how well they're diversified from it. If you look in other places there's AA names, such as Taiwan, South Korea, Hong Kong. Do investors appreciate the diversity of quality within EMD? And that there's this level of quality to be had investing selectively? You've got Singapore as well at AAA.

> "Asia, and China in particular, have dominated issuance in the corporate space

**GANSKE**: It's a very interesting question and I think that has changed fundamentally. When I started over 20 years ago as a portfolio manager, emerging markets was a concentrated highly correlated asset class, very similar in credit quality for a portfolio of 18 countries. But now we are investing in over 60 countries.

Countries in the Middle East, for example, are strong in terms of credit quality and credit metric. At the same time, you have countries like Brazil where economic volatility and an ineffective political system translates into high asset price volatility. In the extreme cases, in Venezuela for example, you have a broken political regime that led to a collapse in the economy. I believe it could make sense for investors to have a more focused approach to the asset class and investors with a lower risk tolerance can build an emerging markets fixed income strategy with a lower risk profile.

When you think about the global emerging markets universe, Asia on average is much more stable, has higher per capita income, higher growth rates, and better credit quality. So, I would say it's the more stable region of emerging market debt.

You have the riskier markets in Latin America, but then this is still perceived as a convergence region. There is Central Europe which benefits from the EU accession process and has the next countries coming through. Then there are the CIS countries further east, many of them commodity-based economies, autocratic and of mixed credit quality. The biggest of them is Russia, which is pricing a geopolitical risk premium due to the standoff with NATO that is playing out in Ukraine.

Over the last couple of years, when we speak to clients about emerging markets, Asian credit has become much more interesting for them. Asia, and China in particular, have dominated issuance in the corporate space, which is why the property sector will now make more headline news. Would you change your view based on what's going on in China?

**GOODBY**: I think I'd see it as a long-term positive that they're going to put their shop in order. So short-term yes, there may be some volatility. But in the longer-term we should see better, more transparent well managed credit markets across China.

**WHELAN**: I appreciate this is a credit roundtable, but do you see different attitudes from investors if you're talking about emerging market equity versus emerging market debt? Is there a more strategic allocation on the equity side where it would be more opportunistic on the private and public credit side?

**GANSKE**: I think for a lot of investors, yes. These faster growing transformation economies offer attractive business opportunities for many companies and a natural cost advantage in the global economy. From an evaluation perspective, emerging market equities are historically cheap at the same point in time when developed markets equities are expensive, so from an asset allocation perspective we like them.

**GOODBY**: If you're an equity investor you should be investing for the long-term. There's a long-term theme to support an allocation and that's the transfer of wealth from the west to emerging markets which seems unstoppable. Emerging markets are likely to be the dominant markets at some point in the future.

There's another long-term theme for China around demographics. They have a big problem because of the one child policy, an ageing population and a big shortage of workers coming up in the near term. That for me is a bigger threat for China.

**GANSKE**: I agree, although I would also say it is a threat for the global economy. China has been the extended workbench of the global economy for decades with abundant human capital fuelling Chinese economic growth and being a disinflationary global force. This is changing with the change in demographics and economic model of the country. The authorities are trying to avert the demographic trend with a two-child policy, but we will have to see how effective this approach will be.

**BRAY**: From what I've read people in China are also not taking it up. The interesting thing is that the decline in working population has ultimately given them a bit more bargaining power. One counterargument to this could be Japan, but that happened at a time when China was pushing hundreds of millions of workers into the world, so I don't necessarily think this makes a good counterargument.

I disagree with some of the discussion here, in saying that China is going to overtake the US and become highly developed. Maybe because of demographics and the fact that productivity is stagnating a bit, they could be near the end of the road. While their productivity growth might be like the US, there isn't the same demographic push. Do these keep converging? I'm not convinced and maybe the US will still stay as the number one economy.

**GOODBY**: I don't know whether China will overtake the US, but the shift of wealth isn't just going to China. For example, India has a highly trained workforce that speaks English and is on much lower wages, so there are still plenty more areas where the wealth could transfer to.

> Asia as a whole is clearly growing and many Asian countries offer attractive opportunities

We are overpaid in the Western world relative to emerging market wages, and there is someone in emerging markets who could do our job equally well in the future. For the younger generations that don't have years of experience to fall back on, in a global market they'll be competing with someone from an emerging country who is cheaper than them. And now that we can do most things virtually, geography isn't so much of a barrier.

**PISTARINO**: I broadly agree with you, although I don't foresee a net transfer of wealth between economies; rather, a process of wealth creation, which will reduce difference between developed markets and emerging markets.

**GANSKE**: We've talked a lot about China, so how about India, because the demographics are better there. How do we see India as an investment theme?

**BRAY**: I've recently been reading about the heavy concentration at the top of the Indian economy, where some of the largest companies are run by huge billionaires. I think the long-term story is more positive, but it's maybe counterbalanced by corruption being a little worse, and less effective policy. I think there is a bit of tradeoff there.

**GANSKE**: You're right. I think India has a general problem of bureaucratic inefficiency. Just looking at the numbers, India's population growth is higher than China's. It's a big and fast growing economy and should offer more investment opportunities going forward. When I started as an emerging markets investor, it was almost impossible to buy fixed income instruments in India, but now that is changing. It's becoming another major economic power, but in Asia there are many economies.

Vietnam is highly effective at integrating the economy into the global supply chain. Philippines is strong in IT outsourcing, and Indonesia is also a big economy with high growth rates and transformation potential. The Chinese share of the market is of course very high, but Asia as a whole is clearly growing and many Asian countries offer attractive opportunities. If you look at corporate market growth rates and issuance size, Asia really is growing quite dramatically compared to other regions.

**PISTARINO**: You mentioned big investment opportunities in Asia, led by China. What about other geographies? When it comes to Latin America, developing Europe, the Middle East or South Africa, where do you see value at current prices?

**GANSKE**: Looking across the global credit spectrum, emerging markets are relatively attractive, Asia in particular.

That said, investors should keep in mind that they are buying into an asset class that is facing challenges such as stubborn inflation, the ongoing COVID pandemic, and global interest rate normalisation. We think we can manage the risk, and our investors think about finding risk premia that is fairly priced. I believe the payoff in emerging markets is much better than European or US credit, especially when we consider that the risk factors we are mentioning have a global fallout. Omicron and other variants, as well as the geopolitical landscape in places like Taiwan or Russia and Ukraine, are not just impacting emerging markets. What's your view?

**GOODBY**: Another concern I would flag is the balance sheets at central banks are growing. That's true of most countries globally, but to some extent the US has a license to grow its balance sheets to whatever it wants whereas emerging markets don't have that license, so there must be some concern on the growth of the balance sheets there.

When you put that together you've got risk from future COVID variants; possible slowdown in China, in turn slowing down the commodity-based countries and those in the production supply chain such as Malaysia and the Philippines. You've also got rates already rising in some emerging markets. These are all factors for slower growth.

**GANSKE**: True. Think about what has happened with COVID and how policy makers reacted to the pandemic. The reaction function of developed market central banks was massive. When you look at the balance sheets at the European Central Bank, or the Federal Reserve for example, we can see the effects of quantitative easing, a massive expansion. Emerging markets central banks reacted in a much more moderate way.

On the fiscal side, the long-term fallout from COVID is a sharp increase in public debt in many countries because of the fiscal stimulus that has been implemented to minimise the economic fallout of the pandemic and the lockdown measures. This step-up in indebtedness is much less severe in emerging markets countries as they have been broadly much less anti-cyclical in their policy approach. After we move past COVID, the credit quality looks relatively better in many emerging markets than in the developed world.

**WHELAN**: One thing we haven't discussed is corporate credit within Asia. What do you think from a banking perspective? Because some of these issues happening, in terms of inflation, rising rates, and steeper curves, it's relatively beneficial for senior debt holders in financial markets whilst being painful for many corporates.

Do you think there's a potential opportunity in financial services sectors rather than industrial and physical consumer goods sectors? When you talked about there being a more positive credit aspect is that across the board in those countries, or is it sector-specific?

**GANSKE**: That's a good point. When you look at the composition of the emerging market corporate credit market, it's very much skewed towards financials. In general, we have a structural underweight to financials because we want to strip out the intermediary and prefer to underwrite debt directly by investing in corporate bonds. But you are right, you see more value for banks in a more normal interest rate environment.

I'm not too concerned about most of the Asian corporates because they have much more solid balance sheets and business models. Admittedly, there are defaults, but looking across the global credit spectrum, default rates look much better than for example in US high yield.

**BRAY**: I read an interesting piece recently which said that around 50 years ago or so, the Deutsche Mark was the anti-fragile asset, because it would always fight inflation and rates. But that isn't true anymore, and equally you can't ignore that isn't true with US Dollars because they're keeping rates artificially low and letting inflation erode debts.

The only place where people might take a conventional view of rates and policy could be in China. Maybe they're the anti-fragile bond market now and pursuing a stronger currency policy as well. It could be the market for a more unconstrained investor, and as I've said we generally look at hard currency. If you had a choice you would probably buy Chinese bonds in Renminbi and prefer them to the Euro longer-term, as they're a bit more realistic in setting interest rates. I think there's good reason to think what was the Deutsche Mark is now the Renminbi.

**GANSKE**: This is a very good point. Would you consider investing in Renminbi from a portfolio perspective?

**PISTARINO**: Possibly. However, going

back to a point made earlier, you could also see it as a weakness that emerging markets – not China, but smaller economies – were not able to expand their balance sheet to an extent comparable to what developed economies have done. That includes both fiscal and monetary policy, which represent portions of the same balance sheet at a consolidated level.

Because of the ability of the US, and Europe, to bring about a significant fiscal expansion to reflate – and inflate – their economies out of COVID, I remain quite positive on credit spreads.

**GANSKE**: I agree. Emerging markets have less flexibility, but when you expand the balance sheet you're borrowing against the future, and at some stage you will have to pay it back. Quantitative easing is an elegant way to do it, it's basically the financing of the state by the central banks. It is not writing debt off, but logging it away in the balance sheet of the central bank. It's still there, but no market supply.

I have seen many credit events which were triggered by debt becoming out of control. With the history of emerging markets, central banks have to remain credible. This credibility thinking was the main reason why emerging markets central banks started hiking early and I see this as strength. Plus, they seem to have had the right call with inflation now a more persistent problem and not transitory.

If you remember the Eurozone debt crisis, it started in Greece, but then investors started looking at Spain, Italy and Portugal. All of a sudden, their debt profile didn't appear sustainable anymore and the market started to price a higher risk premium which made debt sustainability even more questionable and created almost a self-fulfilling prophecy. Indebtedness can be perceived as sustainable for a prolonged period, but there is risk in having too much debt. Therefore, I see the less aggressive fiscal expansion in emerging markets as a positive.

**PISTARINO**: The European crisis had similarities to the Asian crisis, in the sense that countries in the Eurozone, and particularly members of the monetary union perceived as weaker, borrow against a hard currency, on which they only have partial control. After the debt crisis, we have seen the ECB increasingly acting as a lender of last resort, like a textbook central bank. The US have been in a special position for decades, with the US dollar acting as the global reserve currency. But

> I see the less aggressive fiscal expansion in emerging markets as a positive

you also mentioned Japan, and Japan is the basket case, albeit a peculiar one, for understanding the impact of government debt on the economy.

**GANSKE**: This is similar to China, where debt is also high, and a lot of it is domestic. And we should not forget that the country is a net creditor to the world.

**GOODBY**: Everybody around this table has said that it's inevitable rates are going to rise, and I believe that myself. I think the discussion is more by how much. In the US, Jerome Powell has said inflation is not transitory, but are the drivers there to justify raising rates by more than just a small amount?

If you think about what's driving inflation there's the supply chain disruption, and raising rates is not going to fix that. There's been the commodities boom, which may be now softening potentially with China slowing. Then there's pent-up demand from people not doing anything during COVID. It's unclear whether that's going to unwind or if we're going to have a period of sustained demand. If it flows through to wage inflation then we may see greater pressure on rates.

**BRAY**: That has started to happen a little bit.

**GOODBY**: It's happening in pockets, in sectors such as transportation, but that's not enough for it to be widespread yet. The other point I'd make is that my personal view is central banks are more scared of recessions and the damage they can cause than inflation, so they will always err on the side of caution when managing inflation.

**WHELAN**: The fact it's more of a global issue is lessening the central bank credibility argument. In the past there's been inflation episodes in countries where investors have questioned credibility in the central bank. Here, if it's more systemic, is that credibility argument less so? I can see Keith's point about things becoming more political and if anything, they end up underdelivering on the rate increases.

**BRAY**: It's a very fair point and it is a good example here. What the Bank of England was signalling it was going to do, it then didn't, and now the Pound has lost around 5%. It feels a bit crazy that this is the situation we are in, and that no one feels like raising rates even very slightly, especially in the Eurozone.

We run stress tests about different scenarios happening and we have an inflation shock one. We'd still expect Canada, the UK and the US to raise rates but in the Eurozone we don't, ever. Maybe it's one of those 'through the looking glass' moments' and I suppose this is the same as what I said about buying Chinese bonds. Perhaps it's a bit crazy but less crazy than buying some other options.

**GANSKE**: You're right. There seems to me a reluctance of the Federal Reserve and the European Central Bank in particular to end their accommodative policy stance. Easy money lowered the cost of debt burden and when they start raising rates they probably need to be more aggressive in their hiking cycle. That's a problem because it's more expensive for a leveraged economy and it's not very credible.

In emerging markets, central banks have less credibility and therefore less flexibility, so they have to raise rates early as they can't afford to be perceived being behind the curve. In general, for emerging markets, the best way to manage the economy is to be more proactive. A good example here is the way China is approaching the property sector. Trying to tackle asset price inflation and leverage when it is not too late and the adjustment costs are manageable.

**WHELAN**: Coming back to that debt restructuring point, what credence would you give to the willingness to pay versus ability to pay argument?. In certain countries, should investors focus more on investing in local currency versus the Dollar debt from a political or willingness to pay aspect?

**GANSKE**: There is a big difference in market structure between these two asset classes. Local currency debt is held in big parts by local institutional investors, insurance companies and pension schemes. There is a very high hurdle politically to default on that debt. You can, for example Russia in 1998, but also you can always print money and deflate the real value of debt by creating inflation. There's a difference when you have hard currency debt compared to local currency debt which you can control through financial repression.

**WHELAN**: You'd always expect more liquidity in a local market, wouldn't you?

**GANSKE**: Yes, there is much better liquidity. Local currency debt typically has the highest liquidity in emerging markets. Hard currency sovereign debt is less liquid because governments are increasingly financing themselves in their own currency, and hard currency corporate debt, although a growing asset class, is less liquid as many institutional investors have more of a buy and hold approach here. In general, since the global financial crisis the sell side has much less leeway to warehouse risk through tighter regulation which diminished their role as liquidity provider for risky assets such as emerging markets fixed income.

**PISTARINO**: Does it then make more sense to invest in local currencies rather than hard currencies?

**GANSKE**: That's how I feel. From an asset allocation perspective, local currency markets have more compelling yields and offer a degree of inflation protection, as emerging markets central banks have hiked policy rates already in many cases and local market yield curves already reflect the change in inflationary environment and monetary policy outlook. Looking at real yields, they are very attractive compared to what is offered in developed markets.

The problem is that there is a strong negative correlation between the Dollar and emerging markets currencies. This year's currency depreciation in emerging markets has not necessarily been driven by weakness of these economies, but more by the strength of the Dollar. That relation creates much more volatility from a hard currency-based investor perspective and makes risk-return patterns difficult to assess.

The spread of emerging markets hard currency debt is fair and currently offers better credit risk compensation than developed markets credits, but the underlying treasury curve will likely cause capital losses in an interest rate normalisation environment, where the federal reserve is hiking rates. Consequently, emerging markets corporate debt is, with its shorter duration compared to sovereign debt, the more attractive segment.

**GOODBY**: If you want to think about local currency EMD investment when setting investment strategy, you don't want to think of it as a fixed income replacement for liability matching, rather an alternative risk asset or equity replacement given the higher volatility.

You need to be prepared to ride out the short-term volatility in the currency movements. In the long run, if we believe there's a transfer of wealth to emerging markets then their currencies should strengthen and the currency exposure will be a benefit.

**PISTARINO**: Absolutely.

**GANSKE**: I think we probably agree that investors are facing many challenges with the global economy still suffering from supply chain disruptions, higher and more persistent inflation than anticipated, and a COVID pandemic that is dragging on and continues to create challenges for many countries. That said, for fixed income investors who want to get exposure to credit risk, Asian credit offers opportunities. This is despite China going through structural adjustments, with the deflation of the property sector the most prominent one.

For you as insurance investors, in what is a very challenging time, I hope that after this discussion you can see a few more opportunities in emerging markets fixed income, and that it's an asset class that can generate attractive risk adjusted returns.

Insurance Asset Management Conference

# Insurance Asset Management Conference 2021

Delegates heard from some of the leading spokespeople in the insurance sector on latest developments in the industry

WRITTEN BY MICHAEL GRIFFITHS

Following a virtual outing in 2020, the Insurance Asset Management Conference returned as a physical event in 2021, bringing insurance leaders back in one place to address the key regulatory and investment challenges facing the sector.

Delegates gathered at the Hilton London Tower Bridge on 25 November as we approached the end of another fascinating year of development for the insurance space. Chief investment officers, asset managers and policy directors from across the globe spoke to a room brimming with investment expertise to discuss an array of investment topics from a packed agenda.

Sessions covered fixed income instruments, alternative assets, regulatory concerns around Solvency II, and the use of analytics and data in investment decision making, before the final panel of the day gave attendees one last opportunity to explore the latest state of play regarding ESG.

**Solvency II**

The day's opening keynote speech was delivered by director of regulation at the Association of British Insurers, Charlotte Clark, who talked through several key issues impacting the insurance landscape, including the sector's investment gap.

"We have around £2 trillion worth of assets within the sector, and if you look at how much investment is required over the next 15 years to meet the 1.5% target and 78 per cent reduction in emissions, the estimate is we need to invest about £2.7 trillion across the whole economy," Clark said.

"Our analysis suggests that insurers could provide around a third of that, which equates to about £60 billion a year from the flows coming within the industry which could be put to investments that would help the transition. How the system works together and making it work together better feels like a big priority moving forward.

"When you think about those big moving blocks around a post-pandemic world, a post-Brexit world, and climate, the decisions around Solvency II will be a tremendous bellwether as to how the regulatory system and the government is seeing this."

Another keynote speech was delivered by Bank of England executive director, insurance, Charlotte Gerken, who continued discussing several areas of reform in the context of Solvency II.

"Since the introduction of Solvency II, firms have expanded the range of assets they include within their investment portfolios, particularly to back annuity business, including a wide range of internally valued and rated assets," Gerken told the room. "These make up a large and growing proportion of assets in firms' matching adjustment portfolios.

"In many ways, the Solvency II regime accommodates such assets through allowance of internal ratings and securitisations. The PRA has responded positively to this development within the constraints of the Solvency II regime but doing so has often involved us acting as a gatekeeper for investments. This has meant not just extensive publication of expectations but also lengthy supervisory review and approval processes.

"If we are to change our gatekeeping approach, changes will be needed in some firms to strengthen their investment risk management capabilities, including governance, particularly where there is less experience of the assets whose performance provide security to annuities."

“If we are to change our gatekeeping approach, changes will be needed in some firms to strengthen their investment risk management capabilities

### Changing landscape

A significant proportion of the conference was dedicated to the changing landscape of the fixed income investment space. Delegates heard a range of views on the day including a speech from vice president at Franklin Templeton Fixed Income, Robert Nelson.

"The key message is that we now have a great deal of choice in what is a deep market, and by sector there's a wide range of opportunities for investors to build portfolios out of," Nelson said. "The overall message is one of relative comfort when it comes to the performance of emerging market (EM) corporates.

"Due to COVID, the outflows that were experienced from EM debt in the first half of 2020 have been less extreme, sovereigns are in a better position, corporates are in good shape, valuations are reasonable and there's a decent spread cushion there to absorb US Treasury moves. The toughest part of this is thinking through the outlook for China, and the growth of its economy is very important to this puzzle."

In another speech, head of investment grade credit at Pictet Asset Management, Jon Mawby, stated that hard currency EM corporate bonds are an "under-appreciated and under-owned" area of fixed income.

"You have to use liquidity within markets to effectively reposition before time," Mawby added. "Very much within credit, but also if you think about fixed income more broadly, we look at a timeline of US high yield credit spreads as a proxy for wider risk aversion, and again today we are approaching all-time highs.

"It is very much the case that the gun is cocked, and we are waiting for a catalyst – it could be COVID, it could be inflation, or China. But when we get to these extremes, we will use our contrarian and value-driven approach to position the strategy to take advantage of the next bout of volatility."

A panel discussion on fixed income brought together several industry leaders to exchange views on where they think the market is heading. The panel was chaired by insurance investment lead at Hymans Robertson, Daniel Becker, who quizzed five panellists on where each sees "pockets of value".

Lloyd's head of LTIM, Achilles Sofroniou, said: "In general, we are seeing a risk-averse positioning for the marketplace. However, we're also seeing a bit more of a desire to go into assets which historically haven't been as attractive, such as private assets.

"We're looking at changing some of the oversight frameworks to allow investors to invest in those assets more freely. That also ties in with the ESG and climate growth stream, which I think is very encouraging."

Aviva chief investment officer, Ashish Dafria, agreed that there is still value to be found in private assets.

"Our allocation to privates is less so now than it was three years back," Dafria told the room. "The relative value is not quite as attractive, but I still think there are opportunities there.

"There is a big policy dimension to this. There's been a big alignment of social policy objectives, and towards the ability to create and find new investments. We do view climate as existential, so investing in entities for sectors which we think are well-positioned is also interesting to us, such as climate transition funds.

"So, there are plenty of pockets of opportunity, but I think perhaps also more minefields to be aware of."

> Deploying into a volatile market is potentially a good thing, particularly if you're investing in the very long-term

HSBC Asset Management global chief investment officer, Xavier Baraton, added: "There is a risk that the transitionary factors we're observing will last much longer than investors and policymakers think.

"The opportunities are out there, if you think about the property market in China, or recently in Turkey. The markets need to price these shocks properly, but it's important in this world of low yields to diversify the asset allocation properly."

Phoenix Group chief investment officer, Michael Eakins, shared the panel's optimism about investing in a volatile environment.

"Deploying into a volatile market is potentially a good thing, particularly if you're investing in the very long-term," Eakins said. "The key for us is being able to invest sufficiently in a wide range of assets, to ensure the portfolio is suitably diversified, and to give us opportunity.

"This allows us to spread the net wide into different geographies and different asset classes, and particularly in private markets. We do believe there's a fundamental opportunity there to lock in yields that are sufficient for our policyholders but also for our shareholders too."

Also sitting on the panel was chief investment officer at PIC, Rob Groves, who concluded: "No matter how positive or negative you feel about the fixed income space, if you're buying assets at potentially the most expensive they'll ever be, you are likely to get a negative outcome.

"Across most asset classes though, they're currently significantly overvalued, not because of fundamentals but more because of central banks around the world slashing rates. However, at some point this is going to unwind, and perhaps that will then lead to better outcomes."

**Branching out**

With the low-rate environment a key factor on the minds of speakers, another area of the fixed income universe visited on the day came in the form of ETFs, when attendees heard a presentation from State Street Global Advisors pair, Antoine Lesne and Josh Gibbs.

"Convertible bonds fit within a modern portfolio, but you also get a hybrid performance," Gibbs said. "Was 2020 in some ways the perfect storm for convertible bonds in terms of the low-rate environment?"

Lesne responded: "In March 2020, rates were relatively low, and spreads were high, so we saw a rise in those coming to the convertible bond market. What we like in convertible bonds is the potential equity upside, and they also have a non-linear equity sensitivity.

"It is not necessarily the biggest market in the world, and there are some challenges to be aware of, but this is a

market that is performing relatively well over the long-term."

"We expect this to continue into 2022 especially," he added.

Moving even further afield in the investment universe, the conference also heard a panel discussion on alternative assets chaired by Willis Towers Watson senior director, Gareth Sutcliffe, who stated that "what is considered an alternative is changing over time".

LV= capital initiatives and investment director, Emily Penn, discussed how inflation is affecting private debt investment, which she added is to predominantly to back annuity liabilities.

"For our long-dated cashflows to match our annuity liabilities, inflation is less of a concern," Penn commented. "Private debt absolutely offers us opportunities to match those liabilities.

"As an annuity investor, we are required to close the cashflow nature of our liabilities, so there are certain pinch points in the liquid market where it's a struggle, or have concentration or diversification issues, but the private debt market offers opportunity."

Head of pension solutions at BNP Paribas AM, Julien Halfron, said: "In the case of rising inflation, you can expect rising interest rates to follow. Interestingly, with Dutch mortgages for example, for the first batch we would have a lower yield. If rates do go up due to inflation, we can compensate with high yield on these Dutch mortgages in private debt, and this also extends to wider illiquid debts."

"When you go private, in some ways you don't go back," he added. "In general, we ask our clients to be careful with any investments. Caution is always good."

Portfolio strategy and risk manager at Canopius, Conor Sweeney, suggested that a key question for investors when considering alternative investments concerns the operating model.

"The due diligence process in general is very manual and resource intensive," Sweeney told the room. "Whatever the investment opportunity is, it will come in time, but for us we always have liquidity considerations.

"There's a lot more focus and analytics required around understanding the tolerance for liquidity. At the end of the day, yes that does have a research requirement, but it's about the extent to which we can educate about the nature of the asset class."

**Future**

Talk of a heightened focus on analytics extended to another speech on the day delivered by senior director at Moody's Analytics, Phil Mowbray. He explored further how data and analytics are helping insurers build more robust and optimised strategies.

"There's a need for data models that encapsulate a range of new asset classes, and there's now a real imperative to manage investments in a way that contributes to sustainability and to the net zero objectives of the organisation," Mowbray said.

"One specific area where insurers are coming to us concerns the development of macro-economic scenarios based on defined climate pathways. These can be used to power an asset liability modelling exercise and to help organisations understand which strategies might be more resilient to certain climate outcomes.

"In terms of insurers building this analysis into their climate-based investment strategies, it's fair to say they are at different points in the process. Some are more advanced than others, but all insurers and asset managers are in that process of developing their ESG and climate investment framework."

ESG, as ever, was a recurring topic throughout the entire conference. The final session of the day gave delegates one last opportunity to hear industry views via a dedicated ESG panel chaired by director of policy and public affairs at the Chartered Insurance Institute, Matthew Connell. He opened with the idea of investors acting as "stewards" in the ESG landscape.

Investment specialist at Brit Insurance, Catherine Bermingham, stated her belief that there should be a broad review about understanding risk across each E, S and G component.

"We've been looking at incorporating ESG more broadly across the portfolios, but there's a lack of consistency within ESG ratings," Bermingham said. "We don't just take a rating, we like to make sure that there's thought going into every individual decision. In doing that, we're monitoring the research and capability of our asset managers, making sure that ESG guidelines are being applied to the portfolio."

Hiscox investment analyst, Chris Bray, added: "In terms of ratings, you can look at many things such as diversity, percent of revenue, or carbon. I prefer any of these to an ESG score out of 10 because that can be hard to dissect. As a firm we're looking to use these more quantitative economic metrics because there's so much more data there. You wouldn't just give a great CEO a score of eight out 10."

Chief investment officer at Foresters Friendly Society, Corrado Pistarino, agreed with the panel when it comes to ratings. He commented: "The world is not one-dimensional, so by developing one metric you are effectively cutting out a lot of information. Implementing ESG should effectively be a balance between what you want to achieve and the infrastructure or resources that you can deploy."

Pistarino later explored the economics of transitioning to a more sustainable investment universe.

"On the economic side, think about stranded assets, and for example you could have a plant which is producing steel in the UK using renewable energy," he added. "This is very much a stranded asset because it must face competition from China where they use coal.

"The only way of escaping that is to basically raise the barriers, which would mean regenerating the supply chains, and this means creating inflation. This is another way we could pay for the transition."

Legal & General head of investment solutions, Sumit Mehta, also discussed the fundamentals of the sector's transition.

"If you're looking for a healthy transition, it's not in just doing investment grade renewable energy. While this is an important part of the transition, it's not sufficient and we still need more types of investment," he told the room.

"Then we need to ask whether we are mandated by our shareholders, and whether we are taking on enough risk to transition. I think that's another difficult question, but I think that's where we are currently."

Mehta added: "As insurers, our own journey has mirrored what is happening globally. In this industry we've done the easy part by deciding our trajectory, but now there are difficult questions coming through."

# Current ponderings on industry themes

GOTHAER

## On joining the Net-Zero Asset Owner Alliance

**By joining the Net-Zero Asset Owner Alliance, we are living up to our responsibility as a large financial investor and are showing once again that we want to be credibly sustainable. As an insurance company with over 200 years of experience and as a market leader in the insurance of wind turbines, it is our goal to invest our customers' premiums responsibly and sustainably. By joining, we confirm that we are making our contribution to the 1.5 degree target of the Paris climate protection agreement and want to actively support the transformation to a net-zero economy. The ESG team at Gothaer Asset Management AG will be closely involved in the working groups.**

## On Travelers ruling out underwriting new coal-fired power plants

Adopting a coal and tar sand exclusion policy is a notable first step from Travelers. The insurance industry is being forced to wake up to the threat posed by climate change, and to its role and responsibilities. There is real momentum now for insurance companies in the US to align their policies with climate science and end support for new fossil fuels.

TOM SWAN
**Connecticut Citizen Action Group executive director**

## On insurers' investments of over US$7.9bn in North Sea oil and gas companies

LINDSAY KEENAN
**Insure Our Future European coordinator**

*Insurers' investments of over US$7.9bn in North Sea oil and gas companies reveals their staggering hypocrisy. Global insurers are excluding insurance or increasing premiums for households in climate change affected areas, while simultaneously funding the oil and gas companies that are exacerbating the climate crisis. Insurance companies should not be investing in nor insuring fossil fuel companies that have oil and gas expansion plans or which do not have credible urgent transition plans.*

**TRACY BLACKWELL**
PIC CEO

## On SII reform freeing up £20bn of investments for PIC

**We have a once in a lifetime opportunity to channel new investment into communities across the UK, building quality homes, decarbonising our economy, creating jobs and levelling up.**

**The life chances and financial security of millions of people across the country depend on the timely and successful reform of this key piece of financial services regulation. Success would incentivise tens of billions of pounds of long-term investment and enhance consumer protections.**

## On inflation being the second biggest risk for US insurers after cyber

Indications so far are that we are not living in a perfect world and prices are rising faster than they have since the 1980s in most of the developed world. Insurers will be hit with a double whammy as the real value of invested assets decays and the cost of claims increases at the same time.

**ACTUARIAL RISK MANAGEMENT**

**MICHELE GIUDITTA**
Cerulli director

## On nearly one third of US investors committing to net-zero goal

*The rules of engagement have changed for the industry as a number of stakeholders, including peers, are putting pressure on investors to commit to net-zero. Given that achieving net-zero is a rapidly evolving endeavour, the details of investor climate plans will change as policy, information, frameworks, and investment solutions advance. While progress on standardisation of disclosure and measurement is being made, there are multiple publicly available and service provider tools using varying methodologies, different data sources, and different metrics. This makes it challenging for investors to navigate and identify climate risk and alignment to net-zero goals. To alleviate skepticism around whether these commitments are real, shorter-term goals with time-bound milestones, consequences for inaction, and transparency into progress are necessary.*