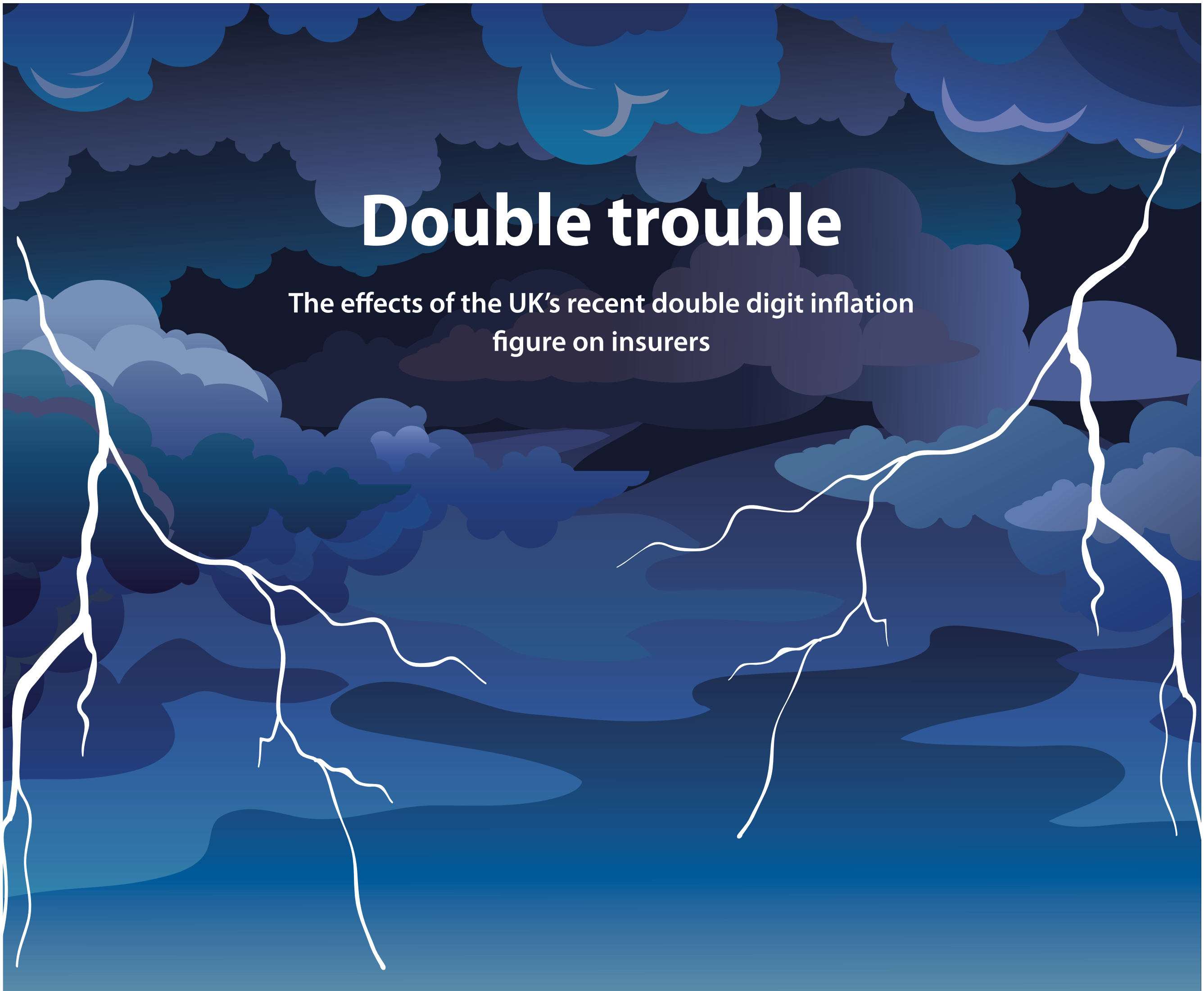
Insurance Asset Management

Winter 2022

Vietnam
Why this country can no longer be ignored by investors

Just Group
A fireside chat with the company's head of investment strategy

Aspen Insurance
An insight into the insurer from its UK chief investment officer



Double trouble

The effects of the UK's recent double digit inflation figure on insurers

EMERGING MARKET DEBT
Sustainability remains strong for this asset class

AROUND THE GLOBE
The latest insurance developments occurring around the world

INFRASTRUCTURE DEBT
How this asset class can deliver in a tough economic environment


A heart for sustainability, and an eye for insurance
Decarbonisation and SDG alignment for insurance portfolio's
For insurers looking for return optimisation in their portfolios, it is no longer enough to just look at regulatory and investment objectives. Today's key requirements are climate and sustainability. We help to decarbonise insurance portfolios and, if desired, also create a positive impact by aligning them to UN SDG framework, while striving for an optimal risk/return profile. One size fits all? Not at all. Robeco works with insurance companies to create innovative solutions to meet their distinct insurance and sustainability challenges.
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Editorial Comment

> Global economic slowdowns, increasing debt burdens, inflationary pressures, and geopolitical tensions are all running riot

It's rather an interesting world in which we find ourselves living in right now. Global economic slowdowns, increasing debt burdens, inflationary pressures, and geopolitical tensions are all running riot. With a cost of living crisis biting the UK as well, it could well be a tough winter for many. Insurers are not immune to all of these issues and in our cover feature (p.24), we look into the inflation trends and risk mitigation strategies being deployed by insurers after the UK recently registered a double digit inflation figure above 10%.

Here at *Insurance Asset Management*, we also like to explore different, and sometimes slightly unusual geographies, as to where institutional investors, such as insurers, can gain healthy returns in a difficult global economic environment.
In this issue, we travel to Vietnam, a country with strong fundamentals and growth prospects, and one which can no longer be ignored by investors looking to diversify their exposure in Asia.

Other investment areas covered in this issue include private markets, as we focus on infrastructure debt and private debt. Infrastructure debt can also deliver in a tough economic climate, and private debt as a whole can be a perfect match for institutional investors at this moment in time.

As I always say, it's all very good reporting from the outside on these issues, but what about talking to the experts having to manage insurance investment portfolios on a daily basis? I'm delighted to say we have two interviews in this issue, with Aspen Insurance's UK chief investment officer Kedi Huang, and Just Group's head of investment strategy Nenna Gilmour-Platt, both providing us with an insight into how their insurance companies are navigating the current environment, and the make-up of their investment portfolios.

So, with Russian President Vladimir Putin threatening nuclear weapons on Ukraine, deep recession fears engulfing the UK, and a cost of living crisis present, the financial services arena is in for a tough ride. The resilience of insurance spaces across the globe are also set to be tested. One thing is for sure though, all of these issues never fail to deliver a dull day on the journalistic side of the spectrum!

Enjoy the issue!

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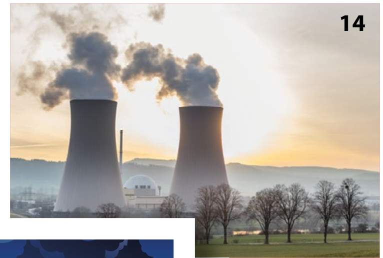
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Winter 2022

News focus

Inflation top market concern for global insurers; bond ETF adoption on the rise

Asset price volatility and liquidity other major concerns for insurers

Written by **Adam Cadle**

Sixty per cent of global insurers are now reporting inflation as their top market concern, with 79% planning to review their long-term SAA and almost half (48%) reviewing risk appetite thresholds this year, latest research published by BlackRock has revealed.

In its 11th annual *Global Insurance Report*, BlackRock found that asset price volatility (59%) and liquidity (58%) are other major concerns for global insurers. To further diversify their portfolios, most insurers (87%) plan to increase allocations to private investments over the next two years, which would represent a 3% average increase versus their current allocation. Insurers also plan to increase allocations to liquid assets, suggesting a barbell approach, with 37% of respondents intending to

> Most insurers (87%) plan to increase allocations to private investments over the next two years

allocate to cash and 31% to fixed income.

The insurers surveyed are also driving adoption of new investment approaches such as bond ETFs. Insurers reported they plan to increase the use of fixed income ETFs in their portfolios, primarily to potentially improve liquidity (54%) and yield (48%). According to BlackRock's research, eight of the 10 largest US insurers now report using bond ETFs, with five having adopted them after the volatile markets of March 2020. So far this year, BlackRock has identified 17 insurers throughout Europe, the Middle East, and Africa who are using ETFs for the first time. Given fixed income ETFs are often seen as efficient vehicles to generate yield and income in a low-cost and scalable way, BlackRock recently forecast that global bond ETF assets under management could reach $5trn by 2030 – and insurance investors are a major driver of this new approach.

> Eight of the 10 largest US insurers now report using bond ETFs

More than two-thirds of the survey respondents reported they are either likely or very likely to implement broad ESG targets in their portfolios in the next 24 months. In addition, 85% reported they are either likely or very likely to commit to specific climate objectives for their portfolio. Sixty-two per cent of insurers surveyed see decision making related to sustainability as a major trend shaping their industry in the coming years. BlackRock said the right technologies and tools will be critical for insurers to ensure consistency across sustainability analytics, with applications including regulatory disclosure and reporting, through to evaluating investment allocations.

Sixty-five per cent of insurers reported digital transformation and technology as the most important trend in the insurance industry over the next 12-24 months, compared to 44% in 2021. Nearly all (98%) reported using artificial intelligence, machine learning, predictive analytics, blockchain, or a combination of these technologies, with predictive analytics being utilised both for the management of insurance business (65%) and investment operations (72%). When it comes to future tech spend, the vast majority of insurers surveyed plan to prioritise investments for asset and liability management (68%), along with regulatory compliance (54%) and market data (53%).

This year's survey conducted in June-July 2022 encapsulated the views of 370 senior industry executives in 26 markets.

News in brief

- The US property/casualty industry's six-month net premiums written rose 10.3% to $387.25bn in the first half of 2022, according to a new Best's Ranking report.

- French life insurance premiums amounted to €8.6bn in August 2022, down by €1.5bn compared to August 2021, France Assureurs has revealed. Since the beginning of the year, life insurance premiums amounted to €96.9bn, down by €1.1bn compared to the same period in 2021.

- The total US life/health industry's admitted assets of $8.1bn at the midpoint of 2022 represents a 6.1% drop compared with the same point in 2021, according to a new Best's Rankings report.

- Just Group has become a signatory to the Asset Owner Diversity Charter (AODC) joining 21 other signatories with combined AuM of over £1trn. As signatories to the AODC, Just Group is committed to holding its investment managers to account on the subject of diversity and inclusion, and the Charter's standards will form part of the group's manager selection and monitoring process. Just Group has also joined the AODC working group.

- Private equity insurers now have a 10% share of the US life/annuity's total assets, more than double the share from five years ago, AM Best has said. Its report, *Private Equity Continues to Make Inroads in Insurance Industry*, said an active year for mergers and acquisitions in 2021 and large block reinsurance transactions led to a 41% increase in admitted assets owned by private equity firms.

Institutional investors want best ideas/wide asset class access from FMs

Asia-Pacific investors see portfolio sustainability as an important benefit

Written by **Adam Cadle**

Almost two-thirds (64%) of institutional investors say access to the best ideas and managers is one of the most important benefits of hiring a fiduciary manager (FM) or outsourced chief investment officer (OCIO), according to a CoreData Research study of nearly 300 global institutional investors.

The majority of investors also cited access to a wide range of asset classes including alternatives (55%) and dedicated expertise and specialism (52%) as the other benefits.

Regionally, European and Asia-Pacific investors (both 67%) are more likely to pick out access to the best ideas and managers as a key benefit. European investors are more likely (60%) to see dedicated expertise and specialism as one of the most important benefits. Over a quarter (26% vs.18% globally) of Asia-Pacific investors said helping to make portfolios more sustainable is an important benefit of fiduciary management.

> "Access to the best ideas and managers and lower investment costs are favoured by smaller investors

North American investors are more likely to say access to a wide range of asset classes including alternatives (58% vs.55% globally) and freeing up time are the key benefits.

By AuM, access to the best ideas and managers and lower investment costs are favoured by smaller investors (less than $5bn AuM) as key benefits. Large investors ($50bn plus AuM) are more likely to see a bespoke solution with a scheme-specific benchmark and portfolio as an important benefit.

LDI fallout will spur pension funds to seek life sector arrangements, Fitch says

Rapid drop in gilt prices led to sharp increase in collateral requirements from many LDI funds

Written by **Adam Cadle**

The sudden need for pension funds to put up large amounts of extra collateral due to tumbling gilt prices will lead more UK DB pension funds to favour pension risk transfer deals with life insurers over LDI arrangements with asset managers, Fitch Ratings has said.

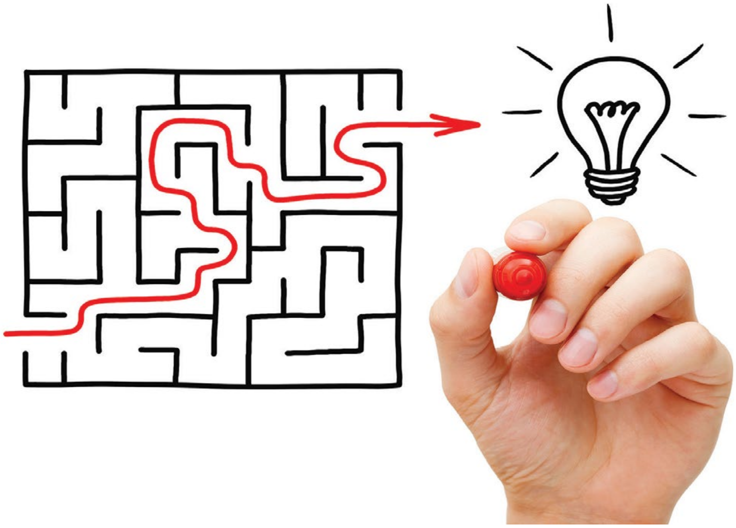
The rapid drop in gilt prices following the UK's 'mini-Budget' on 23 September led to a sharp increase in collateral requirements from many LDI funds as derivative contracts protecting against lower interest rates moved significantly out of the money. The scale of the extra collateral requirements triggered a sell-off of gilts as pension funds scrambled to find the necessary cash. This exacerbated the fall in gilt prices and led to the Bank of England intervening to stabilise the market.

Fitch said "the crisis highlighted the risks of LDI funds that make substantial use of derivatives" and it believes pension schemes' appetite for LDI solutions will be "greatly reduced as a result".

"In particular, demand for leveraged LDI structures will have been dealt a severe blow," Fitch Ratings added.

"We also expect pension schemes to be warier of untested non-insurance pension consolidators due to heightened risk aversion."

> Demand for leveraged LDI structures will have been dealt a severe blow



£18bn of UK bulk annuities/longevity swaps disclosed in H1

Bulk annuities amounted to £12bn in H1 2022 across 78 transactions

Written by **Adam Cadle**

A total £18bn of bulk annuities and longevity swaps were disclosed in H1 2022, according to Aon's UK Risk Settlement Market Update, and the firm expects 2022 to be the fourth year in a row that the market surpasses the £25bn mark for bulk annuities.

Bulk annuities amounted to £12bn in H1 2022 across 78 transactions. Aon said a higher volume is expected for the second half of the year, albeit this will be tempered by further yield rises which have reduced the value of any individual transactions.

The first half of 2022 still marks a significant step-up from the first half of 2021, when 60 transactions were written covering £7.7bn of liabilities, as the market recovered from the effects of prolonged lockdowns and the resulting economic uncertainty.

US insurers' common stock exposure exceeds $1trn, NAIC reveals

Figure represents a 21% increase from year-end 2020

Written by **Adam Cadle**

US insurers' common stock exposure increased to about $1.2trn at year-end 2021, representing a 21% increase from year-end 2020, figures published by the NAIC have shown.

Total common stock was about 14.6% of US insurers' total cash and invested assets at year-end 2021, up from 13.3% at year-end 2020.

Property/casualty companies accounted for the largest exposure, at 76% of the total for both year-end 2021 and year-end 2020. Unaffiliated common stock totalled $567.8bn, or 48% of total common stock, relatively consistent in percentage terms with years prior.

Approximately 98% of US insurers' total common stock exposure was publicly traded. The NAIC Capital Markets Bureau's analysis of US insurers' publicly traded common stock investments showed that its market value decreased by 13.4% year-to-date through August 2022, compared to a 17% decrease for the Standard & Poor's 500 index.

Figures also published by the NAIC recently revealed that the US insurance industry's exposure to derivatives in notional value reached $3trn at year-end 2021, representing an increase of 6.2% compared to year-end 2020 and 29.2% compared to year-end 2017.

> Property/casualty companies accounted for the largest exposure at 76% of the total

Year-over-year growth in derivatives exposure was slightly lower than the 7% growth in the industry's cash and invested assets in 2021. In terms of book/adjusted carrying value (BACV), derivatives exposure totalled $122bn, accounting for less than 2% of the industry's $8trn cash and invested assets.

The composition of the industry's exposure by derivatives type has remained consistent over time. Swaps and options were the most used derivatives, accounting for approximately 50% and 40% of the total exposure, respectively. Forwards and futures were used less often and together represented less than 10% of the exposure.

Derivatives are not broadly used across US insurance companies, according to the NAIC, with only 7.2% of all active insurers reporting activity at year-end 2021.

EC calls on Slovakia's NBS to fully comply with Solvency II

Slovak insurance company non-compliant with a number of regulatory rules

Written by **Adam Cadle**

The European Commission (EC) has adopted a formal opinion requiring the Slovak insurance supervisory authority (Národná banka Slovenska, NBS) to fully comply with Solvency II.

This opinion follows the recommendation issued by EIOPA under Article 17 of the EIOPA Regulation concerning breach of Union law.
Under the breach of Union law procedure, EIOPA has gathered evidence that a Slovak insurance company, under the supervision of the NBS as home supervisor, has been non-compliant over the past years with Solvency II rules in relation to technical provisions, capital requirements, investments and systems of governance. EIOPA investigated and concluded that the Slovak supervisor failed to take the necessary corrective measures to address the firm's non-compliance.

> The Slovak supervisor should make additional efforts

EIOPA recommended NBS to take appropriate steps to ensure a structural and sustainable recovery of all infringements or, if appropriate or mandatory, withdraw the firm's authorisation.

Pursuant to EIOPA's recommendation, the NBS announced an integrated supervisory strategy and initiated several supervisory actions, including the launch of a sanctioning procedure against the insurer. Based on a careful monitoring, the EC has welcomed the actions taken by the Slovak supervisor since EIOPA issued the recommendation. However, the EC noted that as long as no decisive supervisory measures have been taken, the NBS is not compliant with the Solvency II Directive. For those reasons, the EC considers that the Slovak supervisor should make additional efforts, in particular to finalise the sanctioning procedure and adopt final conclusive supervisory actions that ensure compliance with Union law.

Commissioner for financial services, financial stability and Capital Markets Union, Mairead McGuinness, said: "Introduced in 2016, Solvency II was a major change in the European rulebook for insurers, aligning prudential rules with state-of-the-art risk management practices. In the years since, it has worked well and strengthened the insurance market to the benefit of policyholders and firms – but we need to ensure that it is enforced with the same high standards across the EU."

EIOPA outlines strategy for 2023-26

Six strategic priorities identified

Written by **Adam Cadle**

The European Insurance and Occupational Pensions Authority (EIOPA) has set out its strategy for 2023-2026, which aims to strengthen the resilience and sustainability of the insurance and pensions sectors.

It stated that the need for effective supervision had been magnified by the ongoing market volatility and inflation amid current geopolitical tensions due to the lingering effects of the COVID-19 pandemic and Russia's invasion of Ukraine.

EIOPA has identified six strategic priorities to focus on to meet its aim of building a safe and sustainable EU for citizens.

It wants to contribute to building up sustainable insurance and pensions, including by addressing protection gaps; support the supervisory community and industry to mitigate the risks and seize the opportunities of the digital transformation, including by promoting a data-driven culture; and promote sound, efficient and consistent prudential and conduct supervision in Europe, particularly in view of increased cross-border business.

> EIOPA will continue to work in a collaborative and consultative way

The authority also wants to deliver high-quality advice and policy work, taking into account changing and growing needs of society; further enhance financial stability, with particular focus on the analysis of financial sector risks, vulnerabilities and emerging threats; and be a model EU authority with high professional standards, cost-effective governance and a positive reputation within the EU and globally.

To fulfil these objectives, EIOPA stated that it will "continue to work in a collaborative and consultative way, valuing the guidance of its board of supervisors, and the input from a range of stakeholders".

Alongside its strategy, the authority has published its Single Programming Document, which includes its Annual Work Programme for 2023.

Its key activities planned for 2023 include integrating ESG risks in the prudential frameworks on insurers and pension funds, initiating a one-off coordinated climate change stress test, and implementing the Digital Operational Resilience Act.

EIOPA has also been vocal recently on the issue of deterioration in asset quality. Alongside the EBA and ESMA, it said developments in assets that benefited from temporary measures related to the pandemic and those that are particularly vulnerable to a deteriorating economic environment should be monitored.

Photo by: cktravels.com / Shutterstock.com

> Valuation uncertainty still represents a potentially material source of concentration risk

Valuation uncertainty 'even greater' for securitised private assets than sub-prime mortgages

Insurers 'over-reliant' on models

Written by **Adam Cadle**

Valuation uncertainty is expected to be "even greater" for securitised private assets than sub-prime mortgages, the BoE's executive director for insurance Charlotte Gerken has said.

Speaking about concentration risks in life insurance at the Bank of America's 27th Annual Financials CEO Conference, Gerken said: "During the benign credit conditions in the lead-up to the global financial crisis, investors moved heavily into assets such as sub-prime mortgages, which, as risk of understatement – suffered from an over-valuation problem. Valuation uncertainty is expected to be even greater for securitised private assets, and for all private assets under stressed conditions. Firms have reported that more than half of the credit risky assets in their MA portfolios are not based on quoted prices in active markets. Despite the heterogeneity of these assets, valuation uncertainty still represents a potentially material source of concentration risk."

Gerken said the PRA is seeing a "risk of insurers becoming over-reliant on models to drive investment and capital decisions, models that are inherently reliant on public market performance as proxies and limited history".

European life consolidation activity picks up

Germany, the Netherlands and the UK the locations for the latest deals

Written by **Adam Cadle**

European life consolidation activity picked up following a slow start to 2022 with four acquisitions announced within less than two months, Fitch Ratings has said, bringing the year-to-date deal volume by liabilities to around €60bn.

Of the recent deals announced, two were in Germany, with one each in the Netherlands and the UK.

Fitch said it expects the proportion of life consolidation transaction volumes with EU markets to rise, while UK volume growth will be lower given the large volumes seen since 2016. The UK was the dominant market for such deals from 2016 to 2019, with around 77% of life liabilities transacted in European consolidation deals. However, this dropped to 25% after 2020, while the contribution from transactions involving German liabilities rose to 30%.

According to Fitch, the strong drivers supporting consolidation in European life insurance markets remain intact, and it does not expect a high interest rate environment to materially affect the merits for buyers and sellers.

ESAs develop standards for fossil gas/nuclear energy

Standards relate to investment disclosures

Written by **Adam Cadle**

> The ESAs have also proposed some additional minor technical corrections to the delegated regulation

The European Supervisory Authorities (ESAs), through the Joint Committee, have developed regulatory technical standards on the content and presentation of information to be provided about the exposure of financial products to investments in fossil gas and nuclear energy.

The standards relate to the disclosure of information to be provided in pre-contractual documents, on websites and in periodic reports, and come under the Sustainable Finance Disclosure Regulation (SFDR).

Following the request of the European Commission on 8 April, the aim of the amendments is to ensure that disclosures about the degree to which investments are in taxonomy-aligned activities allow for full transparency in fossil gas and nuclear energy activities.

This particularly relates to the proportion such investments represent within all investments and in environmentally sustainable economic activities.

The ESAs have also proposed some additional "minor technical corrections" to the delegated regulation.

They noted that the existing sector exposure disclosures requiring for periodic disclosures would now include fossil gas and nuclear energy.

The report stated: "The changes to the pre-contractual templates include a yes/no question to identify that a product intends to invest in gas and/or nuclear taxonomy-aligned activities.

"If the product intends to invest in such activities, the graphical representation will require the identification of the relevant proportions. If the product does not intend to invest in such activities, such breakdowns are not required in the graphical representation and the existing graphical representations from the already published version of Commission Delegated Regulation (EU) 2022/1288 should be used instead.

"A footnote was added to the yes/no question to provide an indication of certain conditions under which such activities are aligned with the EU taxonomy. Similar changes were inserted in the templates for periodic disclosures.

"Considering that the European Commission's Climate Delegated Act applies from 1 January 2023 and that the amendment of the disclosure framework is urgent, also based on the mandate received from the European Commission, the ESAs have not conducted open public consultations or analysis of the potential related costs and benefits and have proposed that the entry into force should take place the day after the publication of the delegated act in the Official Journal, rather than the standard 20 days."

Munich Re rules out oil and gas as part of expanding climate strategy

Policy will commence 1 April 2023

Written by **Adam Cadle**

Munich Re will no longer invest in or insure contracts/projects exclusively covering the planning, financing, construction or operation of new oil and gas fields, new midstream oil infrastructure and new oil fired power plants, as of 1 April 2023.

The reinsurer said this applies to direct illiquid investments, and in its own listed equities & corporates portfolio, it will cease to conduct new direct investments in pure-play oil and gas companies.

As of 1 January 2025, Munich Re will require a credible commitment to net-zero greenhouse gas emissions by 2050 including corresponding short- and mid-term milestones from listed integrated oil and gas companies with the highest relative and absolute emissions.

Regine Richter, insurance campaigner at urgewald, said: "We welcome that Munich Re is catching up with the leading insurers on climate by ruling out support for new oil and gas fields, new oil infrastructure and new oil plants. The world's largest reinsurer has now shown that it's starting to take its own climate warnings seriously."

> The world's largest reinsurer has now shown that it's starting to take its own climate warnings seriously

HSBC Asset Management to phase out thermal coal

Set to transition away from thermal coal in the EU and OECD markets by 2030; globally by 2040

Written by **Adam Cadle**

HSBC Asset Management has announced its policy to phase out coal-fired power and thermal coal mining from its listed holdings.

The company will actively work with company boards to support the transition away from thermal coal in the EU and OECD markets by 2030, and globally by 2040. Those companies who do not show credible plans to transition away from thermal coal within the timeframe will lose the support of the asset manager, including voting against company chairs at AGMs or, ultimately, divesting.

Nicolas Moreau, CEO at HSBC Asset Management, said: "We believe in working in partnership with our clients to transition away from thermal coal, while supporting a just transition. But we are clear that we will need to walk away from companies who don't or won't take active credible steps to reduce emissions."

People on the move

DON GUO

Group Chief Investment Officer, Prudential

Prudential has appointed Don Guo as group chief investment officer. Guo will be responsible for the formulation and execution of Prudential's investment strategies across its markets in Asia and Africa. He joins from Catalina Holdings where he was chief investment officer Asia & Europe, responsible for managing investments for the company's regulated insurance and reinsurance entities.

HENEG PARTHENAY

Head of Insurance EMEA, Franklin Templeton

Franklin Templeton has appointed Heneg Parthenay as head of insurance EMEA. Parthenay will lead and drive the development of Franklin Templeton's business with insurers across the EMEA region. He joins from Insight Investment where he was head of insurance. Prior to this, Parthenay worked for BNY Mellon Asset Management, Aviva Investors and Aviva Group.

JANINE SPIEKER

Head of Real Estate, Gothaer Asset Management

Gothaer Asset Management has appointed Janine Spieker as its new head of real estate. Spieker will be responsible for all of the company's real estate investments and reports directly to CEO Christof Kessler. She succeeds Markus Habbig. Spieker started her career at E.On SE in 2003 where she held various positions in the finance department.

GUIDO FÜRER

Group Chief Investment Officer, Swiss Re

Swiss Re's Group CIO and country president Switzerland, Guido Fürer, has decided to retire effective 31 March 2023, after 25 years with the company and having served as group CIO for a full decade. Fürer has spent 35 years in the financial sector and has said he wants to enjoy more time with his family, and dedicate himself to his pro bono activities on various foundation boards.

MICHAELIS DITSAS

Investment Director - Fixed Income, Federated Hermes

Federated Hermes has appointed Michaelis Ditsas as investment director - fixed income. Ditsas will be a client-facing representative for all fixed income strategies across public and private markets. He joins the firm from AllianceBernstein where he spent two years as a fixed income investment specialist, and held a similar role at SYZ Asset Management.

RENÉ ZEIDAN

Director - Institutional Client Group, MIM

MetLife Investment Management (MIM) has named René Zeidan a director in its institutional client group, where he will be responsible for institutional client strategy and the delivery of investment solutions to clients in Europe. Based in Frankfurt, Zeidan will primarily focus on the German and Austrian markets. Prior to joining MIM, Zeidan was a director at Allianz Global Investors.

Opinion

On the BoE further intervening in an attempt to calm market volatility

"The move by the BoE to include index-linked gilts in its emergency quantitative easing programme is probably sensible given the massive rise in yields that occurred, however, it is going to be an incredibly difficult balancing act at a time when the Bank wants to be raising interest rates in order to bring inflation down. It is stuck between a rock and the hard place in combatting inflation at the same time as fiscal policy causes shockwaves in markets."

Richard Carter
Head of Fixed Interest Research
Quilter Cheviot

On Varma joining the Science Based Targets initiative

"By committing to the SBTi initiative, we want to increase the transparency of our operations and ensure that our own climate actions are in line with international goals. As a responsible investor, this is important to us, as we require our investment targets to consider climate issues as well."

Hanna Kaskela
Director of Sustainability
Varma

On input on the Climate Resilience Investment Framework

Stephanie Pfeifer
CEO
IIGCC

"Critically, not only does the proposed Climate Resilience Investment Framework aim to help investors better understand their exposure to physical climate risk, but it also seeks to promote investor action that will build climate resilience at an asset, portfolio and wider societal level. We look forward to collaborating with interested parties on the future development of the framework."

On unrealised losses in US insurers' fixed income portfolios

Jason Hopper
Associate director, industry research and analytics
AM Best

"With the Federal Reserve raising interest rates further in September 2022 and bond rates continuing to rise, unrealised losses are expected to grow further through the third quarter. Bonds maturing in the near term will be a favourable development, as the proceeds from these bonds can be invested at a higher rate in the higher interest rate environment."

On life insurance segment fundamentals

Picture by: Osugi / Shutterstock.com

Fitch Ratings

"UK life insurers' fundamentals were strong in H1 2022, despite high inflation and capital market volatility. Insurers' underlying performance was resilient and new business growth strong, whilst the Solvency II capital position benefited from rising interest rates."

US inflation seems to be peaking and we are probably moving into a period of disinflation

Market commentary

Government bonds

Written by Michael Griffiths

This year has seen bond yields rise significantly in response to high levels of inflation and central bank tightening.

In the first half of 2022, yields in almost all bond categories went up "surprisingly fast", stated head of rates fixed income at DWS, Oliver Eichmann, while prices went further down.

July then brought a stronger backlash which was "as surprising", according to Eichmann, who said: "In the face of a substantial economic slowdown, it is generally expected that future rate hikes of the major central banks will be somewhat lower than expected."

He added: "After years of negative rates and risk premiums kept artificially low by central banks, we can now recognise a stronger differentiation between different bond classes.

"Active rate managers are thus given substantially more scope to achieve positive yields by smart positioning."

In view of these adjusted interest rate expectations, Generali reported that it had raised its yield forecasts. However, the insurer said it would continue to expect that the peak in the US is "not far off", adding that on the contrary, bond yields still have "further upside potential" even in the medium-term.

"One reason why we are not raising the forecast even more is that the low liquidity in summer has likely contributed to the recent increase," senior bond strategist at Generali, Florian Späte, said. "This should unwind again in the weeks to come."

In the UK market, however, the Bank of England (BoE) has just increased the daily buying limit of its bond intervention from £5bn to £10bn, in an attempt to calm fears of a pension fund sell-off and ensure sufficient capacity for gilt purchase.

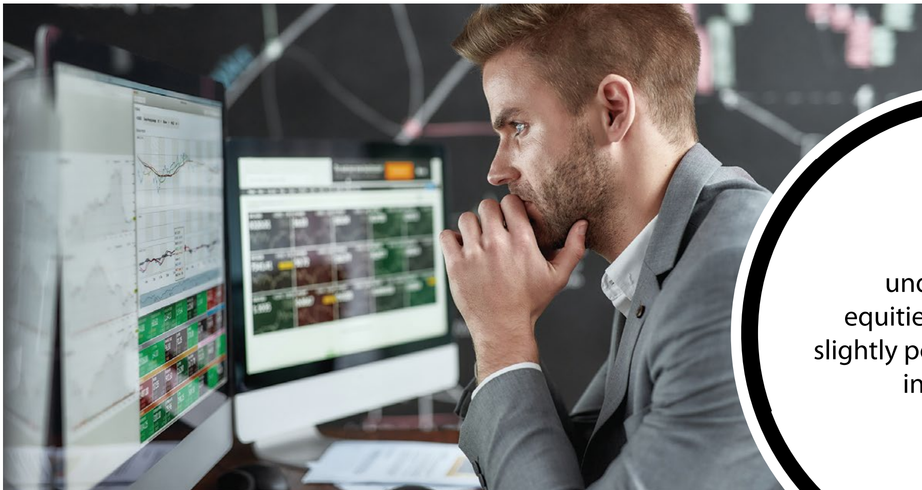
The move to purchase up to £65bn of gilts was first announced on 28 September, in response to Chancellor Kwasi Kwarteng's mini-Budget and concerns liability driven investment (LDI) strategies operated by defined benefit (DB) pension funds could be forced to sell gilts to meet hedge fund collateral calls.

CIO of public fixed income at M&G, Jim Leaviss, noted that in response to the central bank policy, UK gilt yields have risen to the highest level since before the global financial crisis.

"I think inflation should start to come down from this point," Leaviss commented.

"US inflation seems to be peaking and we are probably moving into a period of disinflation, coupled with a slowing in global economic growth.

"In such an environment we think government bonds are starting to look attractive. In essence, markets appear to be pricing in an extended period of high and rising rates, but without factoring in the prospect of weaker economic growth and lower inflation."



> We stay underweight on equities but still expect slightly positive total returns in 12 months

Market commentary

Equities

Written by **Michael Griffiths**

A recession prompted by interest rate rises to combat inflation would cause equities to fall, and Robeco has suggested that this is making it difficult to know where to allocate capital.

The asset manager recently described the health of the US economy as "vital" for planning multi-asset investments, since it influences the values of trillions of dollars worth of equities, as well as the value of the dollar itself.

Head of multi-asset strategies at Robeco, Colin Graham, said: "Central banks are talking down the second-round effects of inflation and are moving to be more data-dependent. Our interpretation is that the central banks are moving to more real-time assessments of economic strength. In other words, watching inflation and employment levels is like driving a car by looking in the rear-view mirror."

Robeco has warned of concern around over-tightening monetary policy, because interest rates are "a blunt tool", as Graham described, and since supply-side issues are independent of central bank policy.

"The Fed has never slowed the economy from these levels of employment and inflation without it resulting in a recession," he added.

Stock markets did rally in August as a result of improving financial conditions, however, although with the Fed as well as the Bank of England's confirmed intentions to raise interest rates and get a grip on high inflation, this may not continue. According to Generali, the market may be tempted to price in a more severe economic slowdown, with equities suffering, especially over the next three to six months. Equity strategist and head of insurance and asset management research, Michele Morganti, and senior quantitative analyst, Vladimir Oleinikov, suggested that global growth momentum will "likely continue fading", which the market has yet to discount.

"We stay underweight on equities but still expect slightly positive total returns in 12 months," Generali stated.

The Italian insurer also reported margins trend in equities being down, albeit mostly due to high sales growth, after banks have pushed up the cost of risk in order to be more cautious. Capacity utilisation momentum is trending down too, which is correlated to return on equity (ROE) and margins, to trend lower.

"Global revisions (MSCI World) are in negative territory for the first time since 2020 but year-on-year changes of revisions are already very low, near a cyclical through, so we could see some relief short-term also because the market already discounted a big earnings per share (EPS) slump in the months before," it added.

"Overall, we see declining EPS momentum in progress. We expect margins to continue staying under pressure and see earnings deterioration ahead, thus maintaining our earnings forecast below analysts' expectation in 2022, 2023 and 2024."

SUSTAINABILITY STAYS STRONG IN EMERGING DEBT MARKETS

In an otherwise ugly environment for bond issuers and investors, the future for emerging market debt looks unquestionably green

WRITTEN BY **MARY-THERESE BARTON, HEAD OF EMERGING MARKET FIXED INCOME, PICTET ASSET MANAGEMENT**

Rising global interest rates and volatile markets have weighed heavily on both supply and demand of bonds, particularly in emerging markets (EM). Yet one segment has remained surprisingly resilient. Our research shows that bonds with a tilt towards environmental, social and governance (ESG) factors have continued to increase in popularity among issuers and investors.

This should prove supportive for EM debt more broadly, ultimately paving the way for better structural development of the asset class. In the first half of 2022, EM borrowers issued a total of USD81.9 billion of ESG-labelled bonds – an increase of 2 per cent compared to the same period of 2021.

The resilience of ESG-labelled issuance in EM stands in stark contrast to what is happening in the wider fixed income universe. For emerging markets generally, issuance dropped 48 per cent (although Asian local currency supply bucked the trend, rising nearly a quarter). Meanwhile, overall global debt issuance dropped 14 per cent to USD4.8 trillion during the first half of the year compared to 2021, according to Refinitiv.[1]

Emerging markets tend to have more work to do on ESG factors than developed peers, which is one reason why investors particularly welcome ESG-linked issuance from them. That in turn underpins demand, which can appeal to borrowers. Sometimes they also benefit from a 'greenium' – the potential that investors may be willing to pay a premium for such bonds, resulting in lower yields and thus lower borrowing costs for the issuers.

ESG-labelled bonds have proved particularly popular among investment grade-rated issuers (which accounted for over half of all issues in the first six months of the year). For investors, they can thus offer comparable yields to developed market high yield debt but with a significantly better credit risk – a particularly attractive proposition in a time of heightened market volatility and rising rates.

Accountability and transparency

More long term, the growth of ESG-labelled bonds encourages sustainable reforms which ultimately leads to improving sovereign fundamentals. However, not all ESG bonds are created equal, and strict controls are needed. As investors, we actively engage with EM issuers to encourage them to endorse the EMIA Enhanced Labeled Bond Principles and to apply them to future issues.

The creation of a robust framework for the issuance of ESG-labelled bonds provides us, as investors with a better view of governments' (or issuers' in general) policy priorities and reform objectives. This is true even if the issuance does not eventually materialise.

We believe that improving accountability, transparency and reporting helps create a virtuous cycle. Third party oversight is also very important, although it is no silver bullet – investors are still very much required to do their own work in assessing the credibility of sustainable bond frameworks and any issuance that follows.

Green priorities

Drilling deeper into the issuance data, corporate borrowers in particular have strongly embraced the benefits of ESG-labelled bonds. In the first half of the year, EM corporates issued around 40 per cent more ESG labelled bonds compared to the same period in 2021, totalling some USD56 billion.

Among sectors, such bonds remain particularly popular with financial and energy companies (about 54 per cent and 7 per cent of the total year-to-date, respectively) but the trend has broadened into other sectors as well, such as industrials, utilities and cyclical consumer companies.

After the strong issuance in the past two years, ESG bonds now make up about 7.5 per cent of the JP Morgan Corporate Emerging Markets Bond Index (CEMBI). Perhaps as a result of the widening universe, we have noticed that in general 'greeniums' have declined, although this varies a lot by sector and even issuer. Greeniums are typically lower where there is more supply of ESG bonds, like for some Korean utilities or Chinese financials where we have seen increased issuance. In areas with limited choices meanwhile, such as in Indonesian green sukuk bonds, greeniums can be high and persistent.

Chile's example

Among sovereigns, Chile remains one of the leaders on ESG debt, having issued green, social and sustainable bonds. We see Chile as an example of an issuer with a clear focus on sustainability and would expect this to continue given its strategic aim to reduce carbon emissions, as well as the social pressures that have arisen following the effects of the pandemic.

Notably, some of its issues have been in local currency – in contrast to most of the rest of the universe, which is denominated in dollars or euros. This could be a potentially interesting growth area.

In aggregate, the volume of issuance dipped slightly among sovereigns, year-on-year, and was down sharply among supranationals. We believe this could be pandemic-related. Last year, both countries and supranational institutions issued bonds to help pay for measures to stem the pandemic and its effects. But with mass vaccination this has become less of a pressing need.

That can also be seen in the types of ESG-labelled bonds being issued. Social-linked bond issuance has fallen sharply relative to 2021. In contrast, issuance was up nearly 12 per cent for green bonds and leapt 40 per cent for sustainability bonds, which are becoming increasingly popular with corporates in particular. A spate of extreme weather events – including recent heatwaves and wildfires – has helped keep climate change and the environment top of the agenda around the world.

> We expect the growth of ESG-labelled bonds within EM to continue

We expect the growth of ESG-labelled bonds within EM to continue. Research from Pictet Asset Management and the Institute of International Finance suggests that annual ESG-labelled bond issuance in emerging markets could reach USD360 billion by 2023. This, in turn, will help emerging economies to generate more of the capital needed to meet the United Nations' Sustainable Development Goals by 2030.

In our own emerging market debt funds – both sovereign and corporate – ESG considerations are integrated into fundamental analysis and decision making. While we don't automatically favour ESG bonds, we assess each issue on its own merits, and our exposure to such debt is organically growing.

Overall, the trend should help emerging markets to develop and become more sustainable – which is good news both for the economies and for those who invest in them.

[1] Data for non-SDG issuance from Refinitiv, https://www.refinitiv.com/perspectives/market-insights/global-capital-markets-hit-the-brakes-in-h1/

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PICTET Asset Management

Double trouble

WRITTEN BY **MICHAEL GRIFFITHS**

Michael Griffiths looks into inflation trends affecting insurers after the UK recently registered a double digit inflation figure above 10%

Just three previous occasions in the last 70 years have seen the inflation rate in the UK climb into double digits. These were during the Korean war in the early 1950s, and in the aftermath of the two oil shocks in the middle and towards the end of the 1970s.

But for the first time in more than 40 years, following continued upwards pressure on prices since the re-emergence from COVID lockdowns in 2021, as well as the ongoing impact on the global economy from the war in Ukraine, 2022 has seen UK inflation once again in double digit territory – hitting 10.1% for the 12 months to July.

Latest Consumer Price Index (CPI) data from the Office for National Statistics, however, now has the UK's 12-month inflation rate dipping back under at 9.9% in the year to August, although Bank of England (BoE) forecasts still indicate it will make a return above the 10% mark in Q4, potentially surpassing 13%.

More gloomy outlooks have recently been reported by Citigroup, which has UK price gains peaking at 18.6% next year, and Goldman Sachs, who warned it could even top 22% in 2023, should natural gas prices remain elevated in the coming months.

Rise before the fall

The evidence hints it may be some time before inflation returns to the BoE's desired 2% target, although history also suggests that such heightened inflationary pressure will not last forever.

"We're not into runaway inflation yet, and I think that people are hoping that things come down next year," comments head of insurance solutions at M&G, Russell Lee. "There's been a really high spike this year, which will potentially be followed by a fall, and I think a lot of people are hanging their hats on the idea that this fall will be pretty large."

In terms of the impact that such inflation forecasts are having on portfolios, Lee outlines a distinction between the short-tail insurer, and longer-tail life insurer. He dissects the impact that high inflation is having on portfolios, highlighting the effect on larger liabilities due to higher future claims, which then feeds through to the insurer's amount of capital.

Lee tells *Insurance Asset Management*: "As central banks try to tackle inflation with higher interest rates, the value of liabilities not exposed to inflation are actually reducing due to higher discount rates. That's on the liability side.

"On the asset side, you don't necessarily see any impact directly from inflation, it's the negative impact on asset values as interest rates go up."

He adds: "Life insurers tend to be

well hedged on the liability side and their assets tend to be really well matched, so therefore if interest rates go up, both assets and liabilities move together. This means the impact is secondary and is on the capital, and insurers tend to invest their capital broadly in line with the duration of the liabilities. That way, they hedge their solvency balance sheet.

"For shorter-tail insurers, such as general and P&C insurers, they typically have a more fluid approach to hedging the interest rate duration in their liabilities. How those insurers are doing will depend on how their asset managers have been positioning the interest rates based on the portfolio.

"It's all about following the logic through from inflation being higher, as well as interest rates being higher, and asking if you are well matched on your liabilities, suffering any loss on your liabilities or seeing some fall in value on your capital base."

Lee also believes that P&C insurers used to pick very little investment risk but suggests they have now moved a "long way" from that, because of a need to stretch for yield.

"The obvious way to stretch for yield without taking credit risk is to take more duration risk," states Lee. "Therefore, I think a few of them might be a little more exposed in terms of rates rising because they've perhaps pushed the duration a little bit further in terms of yield, rather than take more credit risk.

"In an inflationary environment almost nothing is being eroded faster than cash holdings. No asset classes are outperforming 10% inflation right now and in the short-term, but there are ones that are generating something close to zero, and there are ones that have some return. I suppose it is about finding the balance between generating some incremental return in the portfolio, mitigating some of the rising interest rate risk, and then still maintaining liquidity, which insurers really want and need."

> We hedge inflation risk and do not look at assets based on their direct sensitivity to inflation

Lee adds: "All asset classes are fairly and fully valued, so whenever we think about where people are going to put their money, we're trying to provide a solution slightly better than what they have currently, rather than a panacea for all their problems, because I don't think that exists."

One insurer that is particularly well hedged on the liability side is Phoenix Group. Group chief investment officer at Phoenix, Mike Eakins, tells *Insurance Asset Management* that Phoenix has a "particularly low appetite" to equity, interest rate, inflation and currency risks, which the group sees as "unrewarded".

"We use a range of hedging instruments to hedge these exposures in order to stabilise our Solvency II surplus, so the primary impact of higher rates and inflation is limited on our balance sheet," Eakins says.

"However, I would say that the secondary impacts of higher rates are twofold. On the one hand, the recent pick-up in rates and inflation has increased outright credit spreads and credit spreads volatility. On the other hand, the cost of living crisis and a plausible recession in the UK are likely to generate a higher risk of rating migration in any credit portfolio.

"We see credit risk as rewarded and we have been growing our portfolio management and credit analysis capacity as credit selection will be key to improve return and reduce downgrade risk in these more volatile markets.

"We hedge inflation risk and do not look at assets based on their direct sensitivity to inflation, however, I would argue that liquid markets tend to reprice faster than illiquid markets, and that holding liquid assets give us more flexibility to adjust exposures by sector or country to navigate these uncertain times."

Minimising the damage

Eakins reveals that Phoenix has been able to actively manage its sector exposures to minimise risk, and he states the group's portfolio has remained "resilient" throughout recent market volatility. He adds that Phoenix is "better positioned" than its UK peers, due to the group's unique hedging strategy.

"Spreads and yields on public bonds have widened significantly in 2022, this has created a new dynamic not seen in recent years where insurance investors are not as inclined to invest in illiquid private assets over public assets in order to pick-up the required yield and instead can adopt a balanced approach where there are attractive opportunities in both public and private markets,"

> We expect pension risk transfer to play an even larger role as the main revenue driver for UK life insurers

comments Eakins.

"Rising yields on public and private credit is allowing insurance investors to gradually rotate into higher yielding assets, a significant paradigm change following the post-GFC low interest rate and low yield regime."

Recent highlights for Phoenix include a reduction of its BBB exposure to 19%, as of H1 2022, as the group continues to operate within its risk appetite and maintain BBB exposure at less than 20% of shareholder credit. The insurer also fully divested its shareholder credit exposure to Russia and Ukraine in March this year, with no exposure to sanctioned entities.

Phoenix currently possesses an average rating of A in its illiquid credit portfolio, and Eakins believes insurance investors are generally "well positioned" to endure the high inflation and rising interest rate environment that is currently being experienced across the economy.

He adds: "We have not observed any material changes in asset allocation in response to the high inflation, rising rates environment. One clear theme in both US and UK insurers, has been a preference for assets in more defensive sectors, and for higher rated – A and above – assets that typically outperform lower BBB rated assets in such a scenario."

The case of Phoenix demonstrates a clear and strong hedging strategy towards dealing with risk amid market volatility. While high inflation and high rates may not mark material movement in terms of asset allocation, there are still assets that are performing better than others.

Head of insurance solutions, EMEA at PineBridge Investments, Vladimir Zdorovenin, believes that in the current inflationary environment, insurers would benefit from greater exposure to private-market and real assets.

"Under a scenario of entrenched inflation, low growth, and falling real incomes, we expect pension risk transfer to play an even larger role as the main revenue driver for UK life insurers," comments Zdorovenin.

"The performance of these portfolios will be driven by their allocation to high-quality illiquid credit and income-generating real assets, with some market participants targeting illiquid allocations as high as 50%. The ongoing review of matching adjustment and fundamental spread mechanisms could further accelerate insurers' realignment towards private markets.

"For Lloyd's market participants and other non-life insurers with limited capacity for illiquidity risk, actively managed multi-asset strategies can offer a source of capital-efficient uncorrelated return.

"UK insurers also remain highly concentrated in their domestic market. Diversifying their portfolios more broadly across developed and emerging markets could help build more resilient portfolios."

The UK is not alone

While the UK reacquaints itself with double digit inflation figures for the first time in four decades, much of the rest of the world is not lagging behind.

Recent analysis from Fitch Ratings reported that the world economy saw an "unusual combination" of falling GDP set against high and rising inflation in this year's second quarter, as supply shocks and ongoing pandemic related disruptions blighted the recovery. According to Fitch, falling activity and rapidly rising prices in Q2 have highlighted the risks of a "stagflation environment" emerging in the medium-term.

This is perhaps evident in the US, where the world's largest economy saw its annual inflation rate ease for a second straight month in the 12 months to August, to 8.3%, the lowest in four months and down from 8.5% in July. This latest figure, according to the US Bureau of Labor Statistics, still remained above market forecasts of 8.1%, however.

"To combat rising rates and inflation, US insurers have generally favoured higher-yielding private assets, such as private credits and income-oriented real assets," Zdorovenin adds. "The secured nature of these assets can also protect insurers against default losses.

"Compared to their British peers, US life insurers allocate significantly more to real estate debt, both in the form of commercial mortgage loans and mortgage-backed securities. For UK life insurers, allocation to these asset classes is hindered by matching adjustment eligibility considerations and by Solvency II capital requirements. Regulatory evolution in the UK could help direct more of insurers' assets into the real estate sector.

"Overall, insurers can be well positioned to take advantage of rising rates by judiciously investing in inflation-friendly assets and strategies that best fit their asset-liability management and regulatory needs."

As the BoE and the US Federal Reserve (Fed) continue to hike interest rates to combat inflation, governments will also be trying to figure out what else can be done.

According to President of Europe and Asia at Clearwater Analytics, Gayatri Raman, there remains a question of whether the most recent hikes by the central banks are sufficient to get inflation under control, or whether things will get worse before they get better.

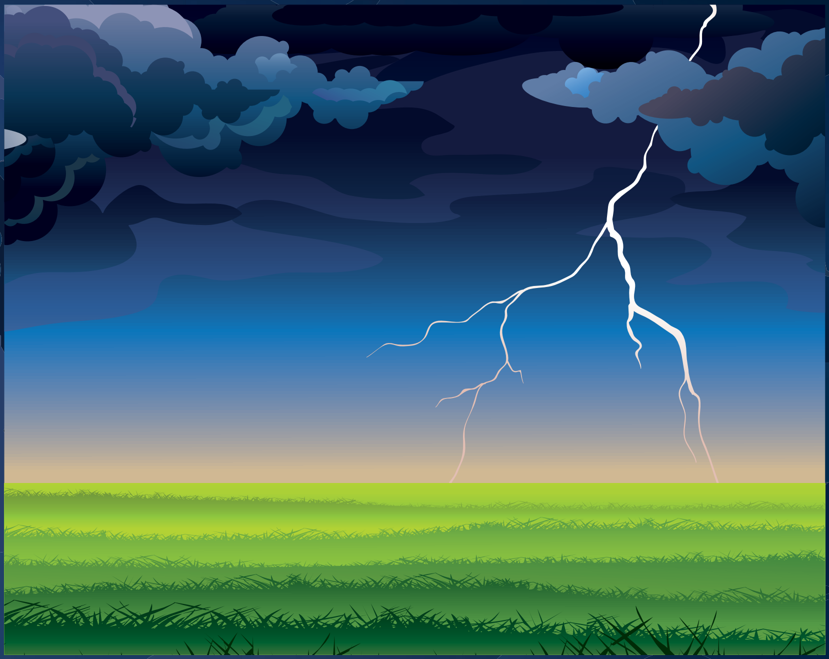
Software firm Clearwater Analytics, which provides automated investment accounting, performance, compliance, and risk reporting for insurance companies, asset managers, corporations, and other institutions, carried out research earlier this year among institutional investors representing approximately $9trn in assets under management (AuM). These findings showed that 90% were "increasingly concerned" over a prolonged recession.

Raman comments: "When it comes to the impact of inflation on investment strategies, interest in floating rate securities fell surprisingly, from almost 50% all the way down to around 20%. A third said their fixed income risk reduction was focused on duration."

The firm's findings also highlight a growing need for investors to be able to easily see exposures across sectors and risk parameters amid heavy market volatility – with two thirds stressing the importance of this.

"High levels of global inflation and recessionary fears are forcing institutional investors to radically shift their portfolios away from equities and bonds," adds Raman. "Money markets and real assets appear to be preferred investments in the current climate – with 38% and 30% citing them respectively.

"Profits are also being squeezed for investors, both in investment return and across the company due to inflation. More than half of institutional investors, according to our findings, are avoiding trading and the resulting realisation of unrealised market losses, 40% are just absorbing costs and lower profitability, while another 40% are raising fees or cutting costs."



> Interest in floating rate securities fell surprisingly, from almost 50% all the way down to around 20%

He adds: "The power pincer movement of low growth and rising inflation paints the bleakest of bleak pictures. But while profits are being squeezed for investors, both in investment return and across their companies given inflation, there is still an underlying sense of optimism amongst insurers.

"Key to realising these opportunities is getting a more granular understanding of exactly how portfolios are being affected to help manage expectations. Being able to project cashflows and income provides perspectives that can help investors navigate through the likely recession and make better informed long-term decisions."

Given the exceptional circumstances of the last few years that have reshaped the world's economy, it would take a brave investor to suggest that inflation here in the UK it takes another four decades to climb back into double digit territory.

With a new leader in government, a cost of living crisis affecting millions, and an energy crisis extending far beyond these shores, a more appropriate timescale would perhaps be closer to four minutes.

Whether the gloomy market forecasts of Citigroup and Goldman Sachs are accurate, and whether the question of things worsen before they improve is answered to be correct, it still seems that insurers are both well hedged and well equipped to tackle whatever comes next.

No longer the new kid on the block

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

With strong fundamentals and growth prospects, Vietnam can no longer be ignored by investors looking to diversify their exposure in Asia

In December last year, amid much fanfare, the LEGO group announced plans to build its first carbon neutral factory in Vietnam. The Danish toy company said that it would invest more than $1 billion in a 44-hectare site in the Binh Duong Province, some 50 kilometres from Ho Chi Minh City. The plant could create up to 4,000 jobs over the next 15 years and will be the LEGO group's second manufacturing site in Asia.

The announcement came after Denmark and Vietnam had celebrated 50 years of diplomatic relations. The Danish ambassador to Vietnam and Laos, Kim Højlund Christensen, praised LEGO's investment, calling it a sign of confidence and optimism in the fast-growing southeast Asian nation.

In some ways, LEGO's commitment marked the finishing touch to Vietnam's reputation as Asia's next mini powerhouse. The country's stock has been rising on a steep trajectory since becoming the WTO's 150th member on 11 January 2007, encouraging foreign direct investment (FDI), which has been the economy's primary growth driver. "It first started with labour-intensive sectors, such as textiles, then evolved into higher value-added manufacturing sectors, such as electronics," explains the CFA Institute's Vietnam community of investment professionals steering committee strategic member, Nguyen Hoai Thu. Vietnam's hardworking and competitively priced workforce has also helped accelerate this process, she says.

In August of this year, Dragon Capital — the first foreign manager to launch a closed-end Vietnam equity fund in 1995 — found that capital allocators are increasingly focusing on Vietnam, specifically in its technology and financial services sectors. After China (34%), Vietnam (26%) was identified as the second most attractive Asian market by 100 institutional investors across Europe. Nearly half (47%) of those questioned also revealed that they had invested in the country for the first-time in 2021, while 29% said they were considering entering the market in the near future.

As KPMG pointed out in its report *Redrawing the horizon*, Vietnam is now one of the leading investment destinations in southeast Asia. "With the advantages of geography, natural resources, and an affordable labour force, Vietnam attracts a large amount of capital each year," wrote the firm. "[It] is expected to have a more significant contribution to the global and regional manufacturing landscape with regards to textiles, garments and apparel, as well as hi-tech sectors like electronics."

A low tariff landscape

Vietnam's integration into the global economy has been enabled by its willingness to aggressively pursue favourable trade agreements.

The country has deals in place through the ASEAN Economic Community (AEC), as well as the Comprehensive and Progressive agreement for Trans-Pacific Partnership (CPTPP). And as Quynh Le Yen, a fund manager at Dragon Capital points out, Vietnam also has the highest number of free trade agreements (FTAs) in its region, which include the EU-Vietnam FTA (EVFTA) and the UK — Vietnam FTA. "Of course, that is one of the attractive points for FDI companies when they come to Vietnam, because when they produce their products they can benefit from the low tax [enabled by the FTAs]. That has that translated into sustainably increasing FDI over the years," she says.

In addition, cross-border capital inflows have been increasing at a stronger rate this year, due to the woes experienced by Vietnam's neighbours and economic rivals. China's zero-COVID policy, for example, has seen companies having to shift manufacturing operations to Vietnam in order to keep goods flowing. While problems in the BRIC nations have shone a favourable light on Vietnam's stable currency, economy, and attractive long-term development trends.

> "Vietnam is now one of the leading investment destinations in southeast Asia

Strong foundations

Demographically speaking, Vietnam is also in a strong position. It is estimated to have 55 million working age people among its 97.6 million population, says Dragon Capital. Within that working cohort, it also has a rapidly growing and well-educated middle class.

Crucially, labour costs currently sit at half the level found in China and the workforce has a high degree of ethnic and linguistic homogeneity, allowing for fluid movement of labour around the country. Vietnam is also culturally compatible with East Asia's key three FDI powerhouses in China, South Korea and Japan.

To help make the most of its current favourable FDI position, Vietnam's government has approved new infrastructure projects that are estimated to be worth over $125 billion up until the end of 2025, as part of a stimulus package that could add a further 1% of GDP growth each year. This comes at a time when other ASEAN countries are reducing their own economic stimulus plans.

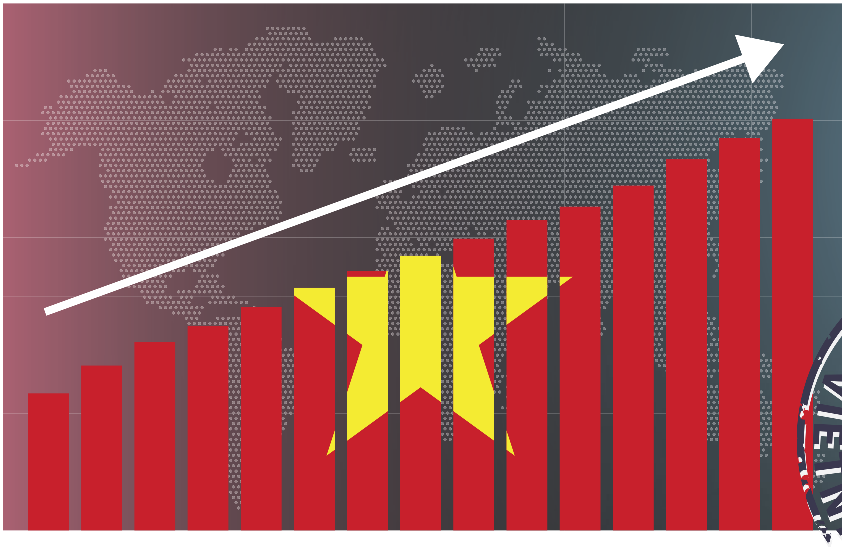
According to AQUIS capital, which runs the Lumen Vietnam UCITS fund, first quarter 2022 GDP growth for Vietnam ran at 5%, with the manager forecasting 7% growth for the whole year. Vietnam also posted positive GDP growth in both years of the pandemic.

Currency resilience is also a clear plus point for investors, says Hoai Thu: "The Vietnam dong is currently the best performing currency in ASEAN, supported by a healthy trade balance and resilient FDI. At the same time, inflation has remained manageable. "Headline CPI growth remains below the government's target of 4% at this point, driven by ample room for fiscal subsidies such as fuel tax cuts," adds Hoai Thu.

Economic expansion

The spillover effects of Vietnams' ever-strengthening manufacturing base can be seen in revenue growth in supporting sectors, such as banking and real estate, as well as disposable income growth among the working population.

As a result, says Hoai Thu, domestic private businesses are making more visible contributions to economic growth. "These span across different sectors, such as manufacturing (F&B, materials, cars), banks, real estate and other services," she says. "These companies are gradually taking advantage of local knowledge to grow their portfolio of products and services that cater to both domestic and export markets."



"Vietnam can be a good satellite within a broad, diversified portfolio

"Even with headwinds from interest rate hikes and currency depreciation, EPS growth looks set to remain in double digit territory in 2023, supported by these strong economic fundamentals."

Vietnam's key exports lie in smartphones and accessories; textiles and footwear; computers and electrical products; and machinery and equipment. This has created an opportunity for equity investors to hold a healthy mix of stocks in their portfolios. AQUIS capital's Lumen Vietnam fund, for example, holds equities in financials (29.5%), real estate (19.5%), industrials (12.6%) and I.T. (8.1%), among others.

The robust Vietnamese economy has translated into strong performance. The Vietnam Index's 10-year annualised total return is currently more than 15%, with total returns on the index registering at 10% (2019), 17% (2020) and 37% (2021), respectively.

"The Vietnam market is trading at a 12m forward P/E of below 11x against double digit earnings growth outlook, as the risk-off mode intensifies," says Hoai Thu.

What is more, Vietnam's returns have been showing a low correlation to indices such as the MSCI Emerging Markets index, MSCI World, the S&P and EURO STOXX, therefore increasing diversification benefits for investors.

"Vietnam can be a good satellite within a broad, diversified portfolio," argues Mario Timparano, the fund manager of the Lumen Vietnam Fund.

"There is a very low correlation between the big index names and Vietnam. This is one of the major reasons why we have to see so much inflow. Because even though the market is also shaky right now in Vietnam, this low correlation acts as a value add [play] in a portfolio."

Remedial work

Barriers within Vietnam's financial markets still exist, however.

Entry into the corporate bond market is limited, with the government limiting the amount of foreign currency corporate debt in Vietnam through an annual quota. And real estate holdings, particularly in the residential sector, are also off limits for many cross-border investors.

Another issue is that the Vietnamese stock market remains classified as a frontier market, with certain constraints being in place for trading that apply to both local and foreign investors. However, this situation could soon be resolved, suggests Timparano, with the possibility of MSCI placing Vietnam on a shortlist for its Emerging Markets Index in 2024 and then upgrading it to the index by 2025.

"This will be an important upgrade to the system," he says, as it will allow for fully fledged derivatives trading. A reclassification of the Vietnamese stock market could also trigger a market rally driven by increased foreign fund flow. AQUIS Capital points to the market rallies of up to 30%, enjoyed by both Saudi Arabia and Kuwait, when they were upgraded. The manager also estimates that in the event of an MSCI upgrade, Vietnam could have a weighting within the MSCI Asia Index that sits anywhere between 4% and 6%.

"What we see in Vietnam is opportunity," says Timparano. "If you compare it to China in 2008, 2009, you see that there is a similar "Goldilocks" moment now, where the country is similarly well situated to how China was then.

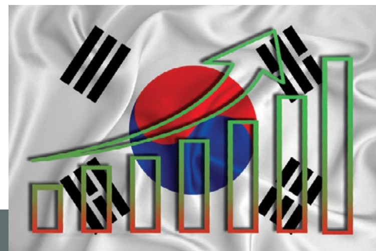
"Vietnam is in an amazing position."

Around the globe

Insurance Asset Management looks at the latest insurance developments happening around the world

1 French life insurance premiums amounted to €8.6bn in August 2022, down by €1.5bn compared to August 2021, France Assureurs has revealed. Since the beginning of the year, life insurance premiums amounted to €96.9bn, down by €1.1bn compared to the same period in 2021. Net inflows stood at -€0.7bn in August 2022, the figures also revealed.

2 The Japanese life insurance industry is expected to grow at a compound annual growth rate (CAGR) of 2.6% from JPY29,427.8bn ($274.9bn) in 2021 to JPY33,545.4bn ($313.3bn) in 2026, in terms of direct written premiums, GlobalData has said. The country's life insurance industry registered 2.4% growth in 2021 after two consecutive years of decline in 2019 and 2020. However, GlobalData said the road ahead looks difficult for life insurers because of the country's aging demographic and economic factors.



3 The South Korean reinsurance industry will grow at a compound annual growth rate (CAGR) of 7% from KRW9.6trn ($8.4bn) in 2021 to KRW 13.4trn ($11.9bn) in 2026, in terms of gross written premiums (GWP), supported by climate change and positive regulatory developments, GlobalData has predicted. According to GlobalData, the South Korean reinsurance industry registered a 6.6% growth in 2021, recovering from a subdued 0.7% growth in 2020 due to the economic impact of the COVID-19 pandemic. General reinsurance accounted for 78% of the country's reinsurance market, while life reinsurance occupied a share of 22%.

4 French bank insurer, Crédit Mutuel Alliance Fédérale, has initiated a review in order to create an asset management division. The objective is to gather all the third-party asset management structures within a multi-boutique business model and to build a client-centric organisation. The new organisation would draw on the strengths of each structure and require the pooling of support functions around a single framework and a common holding company. Distribution would be carried out by two distinct structures with distribution support teams covering all the products of the group's asset management companies. Crédit Mutuel Investment Managers would focus on internal clients of the group's network banks as well as corporate clients and employment/pension savings plans, whereas La Française Finance Services would focus on external clients in France, namely institutional investors, and international clients.

"The objective is to gather all the third-party asset management structures within a multi-boutique business model

5 L&G's solvency coverage ratio (SCR) is estimated to be between 235-240% as at 30 September 2022, the insurer has said, up at least 23 percentage points from HY 2022 (212%). The group said this principally reflects the contribution from higher interest rates and strong ongoing operational surplus generation. Group liquidity remains strong with c.£2.3bn of available cash across the Treasury and the LGC Traded portfolio, and is in addition to the large amount of cash and gilts held by the annuity portfolio. On the annuity side, L&G said its annuity portfolio continues to perform well and the demand for global PRT is accelerating.

Photo by: T. Schneider / Shutterstock.com

6 Asia-Pacific (APAC) life insurers will remain disciplined in asset and liability management as interest rates rise, Moody's has said. Moody's surveyed 16 life insurers in four markets in the APAC region, and said this discipline will "alleviate insurers' negative spread risk and their balance sheet sensitivity to interest rate movements if insurers act as responded". APAC life insurers plan to moderately increase asset allocations to fixed-income investments over the next 12-18 months to take advantage of rising yields and reduce their asset-liability duration mismatches. Moody's said they will generally be cautious about asset allocations to equities and uphold the credit quality of their bond holdings.

"APAC life insurers plan to moderately increase asset allocations to fixed-income investments

Photo by: Casimiro PT / Shutterstock.com

7 Prudential has been selected alongside MetLife to participate in a $16bn pension risk transfer (PRT) transaction with International Business Machines Corporation (IBM), the second-largest PRT ever in the US market. Under the terms of the agreement, The Prudential Insurance Company of America, a subsidiary of Prudential Financial, Inc. (NYSE: PRU), and Metropolitan Life Insurance Company (MLIC), a subsidiary of MetLife, Inc. (NYSE: MET), will each insure 50% of the pension benefit payments for each of the approximately 100,000 IBM plan participants and beneficiaries included in the transaction. Prudential will act as the lead administrator in providing protected retirement income payments to this full population of retirees and their beneficiaries included in the transaction beginning 1 January 2023. MLIC will settle the liabilities under its group annuity contract directly with Prudential.

8 The average comprehensive solvency ratio of Chinese insurance companies at the end of Q2 2022 was 220.8%, and the average core solvency ratio was 148.1%, figures published by the China Banking and Insurance Regulatory Commission (CBIRC) have revealed. The average comprehensive solvency ratios of property and casualty insurance companies, life insurance companies and reinsurance companies were 238.5%, 214.7% and 310.4% respectively, and the average core solvency ratios of property and casualty insurance companies, life insurance companies and reinsurance companies were 203.7%, 134.1% and 281.2% respectively.

> “The average comprehensive solvency ratio of Chinese insurance companies at the end of Q2 2022 was 220.8%

9 State Farm is to make a $1.2bn equity investment in smart home and small business security brand, ADT, and therefore will acquire around 15% of the company. The deal will make the insurer ADT’s second-largest investor after Apollo Global Management. Citi and Evercore were the financial advisers to ADT, and Cravath, Swaine & Moore LLP acted as legal advisor. Morgan Stanley & Co. LLC was the financial advisor to State Farm, and Sidley Austin LLP acted as legal adviser.

Photo by: JJava Designs / Shutterstock.com

10 Generali has held informal deal talks with Guggenheim Partners on a range of options including a full acquisition of the US investment firm’s asset management business, sources have said. According to *Bloomberg News*, citing sources, a partnership or a strategic investment in Guggenheim are also being explored. Generali earmarked up to €3bn for mergers and acquisitions in insurance and asset management businesses, citing possible deals in Europe, Asia and the United States. Guggenheim Investments, the asset management and investment advisory unit of Guggenheim Partners, has more than $228bn in assets across fixed income, equity and alternative strategies.

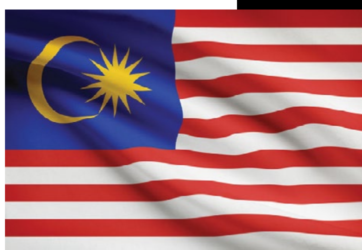
11 Vaudoise Insurance Group has announced that it achieved a consolidated profit of CHF 66.8m in H1. The figure was an increase of 2.5% compared to the same period in 2021. Gross written premiums in non-life grew by 5.6% in the first half of the year, the Swiss insurer confirmed, although this does not include the portfolio of Epona, Allgemeine Tierversicherungsgesellschaft AG. Taking into account this portfolio, acquired by Vaudoise at the end of 2021, the growth was 6.5%.

12 Swiss Life has successfully placed a €700m senior bond with investors in the European market, with maturity in 2029 and a 3.25% coupon. The proceeds will be used for general corporate purposes, including future refinancing of outstanding debt instruments. The Swiss Life Group is one of Europe's leading comprehensive life and pensions and financial solutions providers.

Photo by: sylv1rob1 / Shutterstock.com

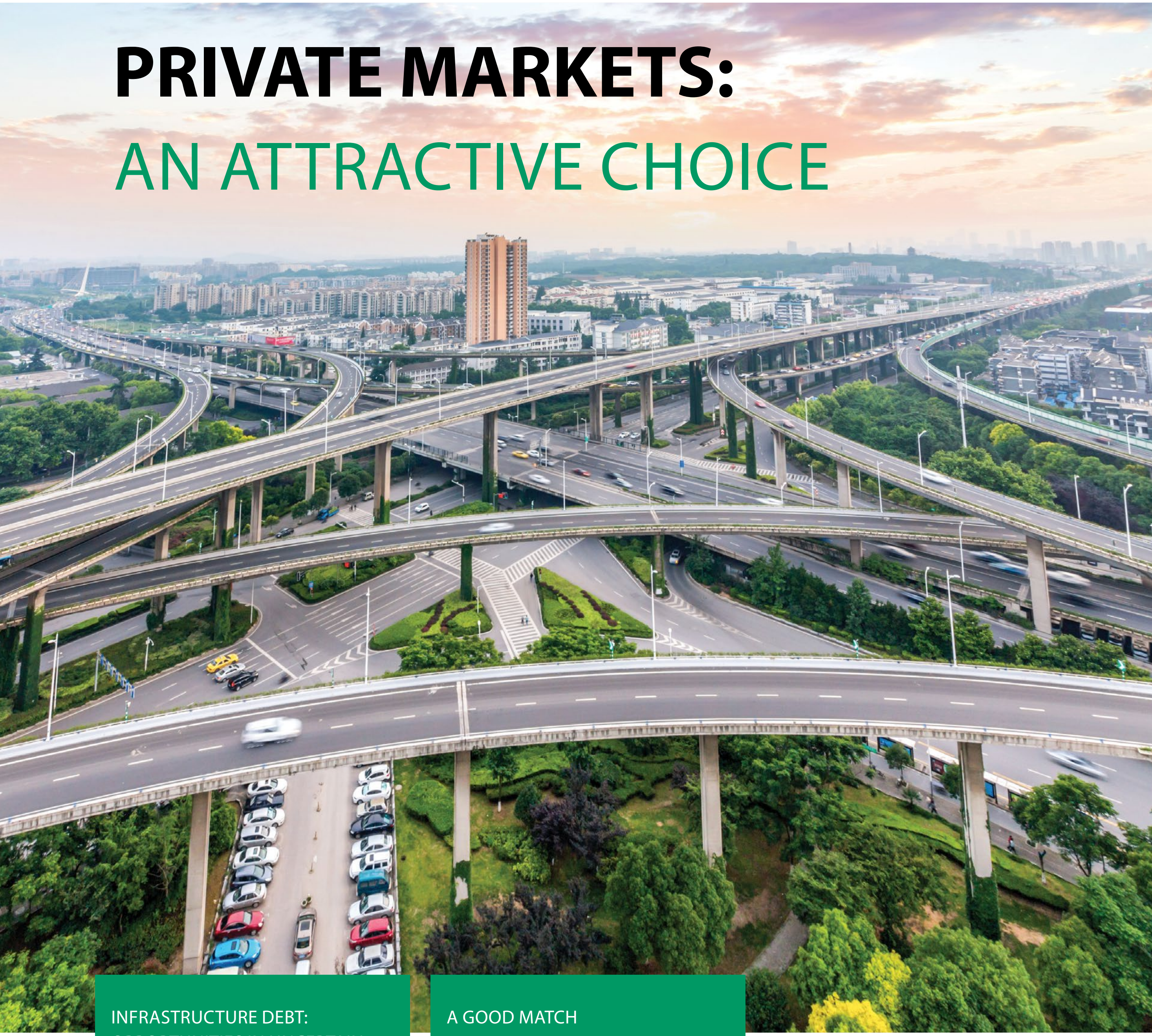
13 Finnish pension insurance company, Elo, made a return of -4.5% in the first half of 2022. Publishing its interim results, Elo revealed that the market value of its investments was €28bn, and the result of Elo's investment operations at fair values was €-1,141.3m. The solvency ratio was 123.6% and solvency capital was 1.5 times the solvency limit.

> Malaysia's insurance industry grew by 7.6% in 2021 after declining by 2.8% in 2020



14 The Malaysian insurance industry will grow at a compound annual growth rate (CAGR) of 8.4% from MYR 73.1bn ($17.6bn) in 2021 to MYR 109.6bn ($26.7bn) in 2026, in terms of written premium, led by the life insurance and pension segment, GlobalData has estimated. GlobalData said Malaysia's insurance industry grew by 7.6% in 2021 after declining by 2.8% in 2020 due to the COVID-19 pandemic-induced economic slowdown. The life insurance and pension segment accounted for 75.8% of written premiums in 2021. It is expected to grow at a CAGR of 9.5% during 2021-26. General insurance accounted for the remaining 24.2% share of insurance premiums in 2021. The segment is expected to grow at a CAGR of 4.8% over 2021-26.

PRIVATE MARKETS:
AN ATTRACTIVE CHOICE



INFRASTRUCTURE DEBT: OPPORTUNITIES IN UNCERTAIN MARKETS

How infrastructure debt can deliver in a tough economic climate

A GOOD MATCH

David Adams looks at the benefits of investing in private debt for institutional investors

In association with

BNP PARIBAS ASSET MANAGEMENT

INFRASTRUCTURE DEBT: opportunities in uncertain markets

BNP Paribas Asset Management head of investment specialists, private debt and real assets, Tim Li, explains how infrastructure debt can deliver in a tough economic climate

WRITTEN BY **TIM LI, HEAD OF INVESTMENT SPECIALISTS, PRIVATE DEBT AND REAL ASSETS, BNP PARIBAS ASSET MANAGEMENT**

Infrastructure debt has proven to be a resilient asset class over the past few years.

Even as the pandemic and subsequent lockdowns prompted an unprecedented economic slowdown, infrastructure debt has delivered attractive yields and stable income streams. While the listed bond and equity markets struggled with volatility, European infrastructure debt investments rode out the storm with comparative comfort.

Despite an easing of the Covid health crisis, there has been no "return to normal" in financial markets. Instead, investors now face the twin challenges of higher inflation and rising interest rates. This has produced negative returns across bond and equity markets and raised fears of an impending recession in Europe, the UK and the US.

The question for investors is whether infrastructure debt as an asset class can continue to deliver in this increasingly uncertain economic climate.

The simple answer to the question is "yes". The salient features of these debt instruments make them well-positioned to navigate any downturn in the economy, offering investors effective protection against inflation and rising interest rates.

However, it is important to stress that infrastructure debt remains a broad and diverse investment universe, covering a range of investment solutions and strategies with varying risk-return profiles. Investors must ensure they invest in the appropriate segment and sector of this market to meet their objectives.

Resilient income streams

The European infrastructure debt market has grown significantly in recent years. In 2021, about $310 billion worth of deals were arranged — 70% of which were financed through debt arrangements.[1]

Primarily, these infrastructure deals finance essential services straddling several different sectors, including transport, energy, renewables, water, communications, education and healthcare services.

From an investors' point of view, these defensive sectors are especially attractive during periods of higher inflation, or recession — as demand is likely to remain, regardless of any economic downturn.

In other words, people might cut back on discretionary spending when times are tough, and this will affect profitability in those more cyclical sectors. But they will still need to use broadband services, rail networks, energy to heat and light their homes, and education and healthcare.

Many of these infrastructure projects are also operating in areas where structural changes indicate good long-term growth prospects. Infrastructure designed to support increased digitisation of key industries, or the transition towards a lower-carbon economy to meet net-zero goals, falls into this category.

Infrastructure debt offers investors the opportunity to participate in the funding of these multi-billion pound projects. As a result, it provides a reliable income stream to investors over the medium- to long-term.

Junior infrastructure debt — attractive yield opportunities

Over the past 10 years, infrastructure debt has offered consistently higher yields than the bond markets.

This is partly due to the 'illiquidity premia' — the additional return offered to investors for forgoing the flexibility of fixed-income investments listed on publicly traded markets. This differential widened over the past 10 years, as ultra-low interest rates pushed corporate bond yields down to record lows.

But while returns on infrastructure debt have remained fairly consistent of late, rate hikes by central banks in

Europe, the UK and US have given yields on government and corporate bonds a boost. Euro BB corporate bonds yields, for example, rose from 2.4% in February to close to 7.0% in late September 2022.[2]

Junior infrastructure debt, which delivers higher, equity-like returns while maintaining debt-like protections and not over-extending on risk, is one attractive option for these investors.

Several European junior infrastructure debt transactions have offered returns of more than 6.5%. Although equivalently rated European high yield bonds can offer higher returns in the current environment, they are unsecured and typically have little (or no) covenant protection, whereas junior debt investments feature both covenants and underpinning collateral.

Demand from investors has created more competition across the infrastructure market. Project sponsors have become more sophisticated in their financing structures, to reduce debt servicing costs. This had led to a wider range of debt tranches being issued, designed to appeal to specific segments and distinct risk-return objectives among the wider investor community.

Linked to this is the fact that infrastructure equity reserves have been growing significantly — pushing up underlying equity prices.

Equity holders are using junior infrastructure debt as a mechanism to increase leverage and increase their internal rate of return. This segment of the market is now well established in Europe and growing at a steady rate.

Despite growth in infrastructure debt as a whole, the junior debt segment remains relatively uncrowded. This is in part due to regulatory changes, and the Solvency II capital charges, which to date have enticed investors to focus on senior, or investment-grade, debt. Junior infrastructure debt has so far escaped this competitive pricing tension, whereby banks and insurance companies compete heavily to buy up investments – pushing up prices and driving down yields.

An increase in supply of junior debt, coupled with more muted investor demand, means the junior debt segment of the market offers a highly attractive risk-return profile. This appeals to insurers who may need to adjust for Solvency II capital requirements, as well as other investors seeking higher yields in the current climate.

This is not to say that the senior debt market should be overlooked entirely. Although the pricing in this area remains challenging, particularly in the current climate, it offers stability and resilient returns for investors in need of secure income throughout the economic cycle.

Challenges ahead

No-one can pretend everything will be plain sailing in the financial markets. The infrastructure debt market faces its own particular challenges: the rising cost of raw materials can have a direct impact on construction costs of many of these projects, and may affect returns on new issues going forward. At the same time, the increased cost of energy may also affect the operating costs of projects.

Despite these challenges, this remains a buoyant sector with a strong pipeline of transactions looking to come on stream over the next six months to a year. This will create opportunities for investors, whether they are looking for higher returns at a subordinated level, or the reassurance of investment-grade opportunities.

Experienced infrastructure debt managers, such as BNP Paribas Asset Management, will, before launching, analyze a wide spectrum of factors that might affect long-term asset performance.

Regardless of whether investors are looking for junior or senior debt options European infrastructure debt represents a compelling solution to help investors manage the inevitable market challenges that lie ahead.

[1] Infranews, Jan 2022
[2] Bloomberg, BaML Euro High Yield BB Index, 27 September 2022

A STRONG MATCH

David Adams looks at the benefits of investing in private debt for institutional investors

WRITTEN BY **DAVID ADAMS, A FREELANCE JOURNALIST**

The private debt markets began to assume their current form after the Great Financial Crisis (GFC), as more investors saw opportunities to lend to businesses or projects that banks and other traditional lenders were unwilling (or unable, for regulatory reasons) to finance. During the long period of low interest rates that followed, steadily growing investor appetite nurtured the development of an extensive marketplace of unlisted financial instruments and funds offering exposure to private debt assets. Data from Preqin shows that private debt is the only private markets asset class for which fundraising has increased every year since 2011; and that by late 2021 the global private debt market was worth more than $1 trillion.

There are many reasons why institutional investors have used private debt during the past decade. It has been a relatively low risk source of higher yields than those offered by many other, investment-grade securities. It can offer an illiquidity premium for those investors, like insurers, able to invest for the longer term. It can act as a relatively low volatility diversifier, not correlated to broader economic cycles and often offering a hedge against interest rate risks; through exposure to a broad range of underlying assets. Private debt can enable insurance companies completing bulk purchase annuity transactions to meet some regulatory obligations, by matching assets to liabilities. It can also help investors pursue Environmental, Social and Governance (ESG) strategies.

While the Covid-19 pandemic wreaked havoc across the financial landscape, the private debt market continued to grow and develop. Investors can now choose between many different types of private debt fund, varying by structure and underlying assets. These include businesses sectors including energy, utilities, transport and telecoms, alongside private equity, real estate and infrastructure debt. The latter has proved to be a particularly resilient segment in recent years.

Mercer principal for insurance investment, advisory and implementation, William Gibbons says that while yields from other asset classes have increased during the instability of 2022, many insurance companies he speaks to are still very keen to use private debt seeking strong income flows, diversification and asset and liability matching.

Other experts concur. “The private debt side is probably the busiest part of our business,” says bfinance insurance client consulting director Neil Holmes. “In the last four years either people have got private debt in their books, or are on the cusp of doing so.” WTW (formerly Willis Towers Watson) director for insurance investment, Anthony Plotnek says that new business bulk purchase annuity portfolios he and his colleagues advise on sometimes incorporate between 50 and 60 per cent private debt assets.

“There’s good reason to think this is a good diversifier,” says bfinance managing director, private markets, Trevor Castledine. He highlights the many different ways that investors with different strategies can select or combine specific niches to create a portfolio that suits their strategic goals. There are funds dedicated to commercial real estate investments, including long lease or ground rent funds that act as inflation hedges because rents and leases can be inflation-linked. There are funds for different aspects of infrastructure investments, from public sector projects to utilities, offering different levels of income and risk. There are also funds based on lending to companies backed by venture capital, or to businesses in distress.

“It doesn’t matter what your needs are, there’s something in the private debt world that can deliver on it,” says Castledine. “Risk, diversification, yield, long duration or fairly liquid – there are strategies where the underlying assets are less than a year in maturity.”

Insurance companies active in the

bulk purchase annuities space use some private debt investments for matching adjustment, through which insurers can discount valuations of long-term liabilities, unlocking significant financial and operational benefits. Private debt assets used like this today include equity release mortgages, commercial real estate loans, ground rents and project infrastructure.

UK-regulated insurers may find they can do this in more flexible ways in future, including investment in private debt in other markets, although the future direction of post-Brexit regulatory divergence from the Solvency II regime is unclear at present: a consultation on the Treasury's review of Solvency II ended in the summer of 2022 but has not yet been acted upon by a government that has itself been reformed during the past few months.

When regulatory reform does come, it may entail some loosening of the rules governing which assets can be used for the matching adjustment, but eligible assets will still need to deliver adequate cashflow matching. All investments will need to meet the prudent person requirements, with firms demonstrating an understanding of the underlying risk exposures.

Whatever the composition of an insurer's private debt allocation, "the key thing insurers have to understand is, what is the level of default risk the portfolio might have?" says Plotnek. In other words, how sound are these – mostly unrated – investments?

"The resilience of this asset class is quite high," Castledine insists. He suggests that while some private debt investments in businesses would not be rated as investment grade by ratings agencies, this would often be because the underlying businesses in which funds are invested are small. In addition, some private debt funds are rated. "You can also get a rated note structure to wrap around a portfolio," Castledine points out.

Meanwhile, investment in some private debt assets, such as infrastructure and real estate projects, can help insurers meet ever more rigorous ESG obligations being urged or imposed by insurance companies' own investors, employees and customers, as well as by policymakers and regulators.

"With real estate and infrastructure you've got accessibility to ESG," says Holmes. "You might have the E through infrastructure, or the S with social housing, say."

But private debt is not a quick fix for ESG. "You still need to get through regulatory approval and you need to understand the risks," says Plotnek. "This is still an area that's quite new to the actuarial community – but it is something that will develop substantially over the next few years."

It remains to be seen how development of private debt as an asset class will be influenced by the current volatility in the financial markets in the face of inflationary forces, rising interest rates, political conflict and general economic uncertainty.

But Castledine wonders if these conditions might actually reinforce the case for using private debt. "We could see a default cycle and trouble across all the markets – and then everybody would say: diversify your risk," he says. "With a lot of private markets you've got less interest rate duration risk because they're floating assets. So you've got a different type of credit risk and investment risk exposure than with the public markets."

He points out that the private markets emerged from the GFC in a relatively healthy state. "I don't see why that would be different this time."

But there are other risks to consider. While some private debt investments help investors to meet ESG targets, other investments could increase ESG transition or reputational risks. It is also possible that future regulatory changes may create new ESG-related risks that could reduce the value of investments in some funds or assets.

Finally, says Gibbons, there is the risk of a lack of expertise within insurance companies seeking to use this potentially valuable, flexible, but also highly complex asset class. "Do insurers have the expertise they need to understand the risk they're getting into?" he asks.

Castledine's suggestion that private debt may be an asset class to which some investors will turn in difficult times is plausible, although of course some investments will be adversely affected by those conditions. Either way, says Gibbons, when dealing with an asset class characterised by such variety and complexity, "doing your due diligence properly up front is even more important."

If insurers can make the right choices around private debt, it could offer many long-term benefits. "I think insurers that have diversified into private credit will have a better performance over the next couple of years than those who haven't," Castledine asserts.

But no-one can take any of that for granted. "Make sure you know what you're getting into," Holmes warns, delivering advice that seems extremely sensible: "Set out what you want and get yourself the right manager."

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ASSET MANAGEMENT

A fireside chat with Nenna Gilmour-Platt

Adam Cadle sits down with Just Group's head of investment strategy Nenna Gilmour-Platt to talk about investment strategy at the insurer

WRITTEN BY **ADAM CADLE**

Q Could you provide an overview of Just Group and your day-to-day role?
Just Group provides retirement income products and services in the UK. Our purpose is to help people achieve a better later life. We provide individual guaranteed income for life products as well as defined benefit corporate pension scheme de-risking through buy-out and buy-in solutions. As of the end of June 2022, our overall assets under management were c. £23bn, broadly comprised of lifetime mortgages and credit assets. We invest across the credit spectrum, focusing on investment grade assets in the portfolio which matches our liabilities.

I look after the investment strategy team, whose function is to assess new asset classes and new asset managers, as well as look after our existing assets and asset manager relationships. My team also has responsibility for the investment decision on individual assets where we retain control.

We have a hybrid insourced / outsourced investment model, where we manage a large liquid corporate bond portfolio internally, and outsource the management of the majority of our illiquid assets to external asset management partners.

Q What is your overall investment portfolio structure?
Our portfolio broadly falls into two: one which backs the majority of our liabilities (matching adjustment portfolio) and the other which supports the matching portfolio in times of stress (non-matching portfolio). In the matching portfolio, we look for high quality (investment grade) fixed cash flows where we fully understand the risks of the transaction and where we exercise control over each investment. We have a large liquid corporate bond portfolio and typically invest in secured illiquid assets such as commercial mortgages and infrastructure debt.

In the non-matching portfolio, we seek to generate excess return on capital, and this has led us to make investments in senior secured middle market direct lending, for example.

> **We are particularly keen on long-dated inflation-linked cashflows which support the longer dated and largely inflation-linked nature of our liabilities**

Q What are your views on current market sentiment and macro-economic issues?
We believe that there is more pain to come in spread markets, and in particular, that we will see a widening of credit spreads as we move into year-end. We do not believe the market is fully pricing in the effect of higher energy costs, supply constraints and the impact of tighter monetary policy. We see this as both a risk and an opportunity. We are carefully monitoring our back book for signs of credit weakness, such as potential for credit rating downgrades, and actively looking for opportunities

Photo by: Piotr Swat / Shutterstock.com

to invest new money at attractive risk-adjusted spreads.

Q You are heavily involved in the origination of illiquid opportunities. Where do you see opportunities opening up at the moment in this space?

The illiquid credit market is going through a re-pricing as borrowers become accustomed to higher interest rates and therefore a higher overall cost of financing. We are experiencing a slowdown of M&A transactions which is in turn leading to a fall in the volume of acquisition financing. That said, there remains a healthy flow of refinancing opportunities at more attractive all-in rates than the last few years. We are particularly keen on long-dated inflation-linked cashflows which support the longer dated and largely inflation-linked nature of our liabilities. Alternative credit is getting a lot of attention at the moment as the structural tailwind of bank capital retreating from private lending creates a supply/demand imbalance and opportunity for institutional capital to take its place. We are seeing opportunities for our non-matching portfolio to diversify into different geographies, either within asset-backed financing or more traditional corporate floating rate debt.

> **We have pledged to become net-zero by 2050, with a 50% reduction in carbon emissions by 2030**

Q Could you explain Just Group's focus on ESG?

We have pledged to become net-zero by 2050, with a 50% reduction in carbon emissions by 2030, and are working on a transition plan to achieve this. These goals, in particular, require us to further scrutinise prospective investments for their prospects of supporting our climate objectives.

Our Responsible Investment Framework guides the way that we incorporate ESG into our investment decisions. We have developed a proprietary scoring system to assess the responsible investment credentials for each investment in our back book and each prospective investment, which has allowed us to identify and take action to manage the key ESG risks in our portfolio.

We have a dedicated responsible investment team within the investment team which has allowed us to hone our strategy and progress our thinking in this fast-moving space.

Q Away from the day-to-day role, what do you like to do to relax?

Relax? What's that? Away from the desk, I like to further my sporting skills. I'm currently trying to improve my surfing, which is difficult given we are so far from the sea!

A green world

Insurance Asset Management looks at the key sustainable/impact investment developments over recent months

1 Gothaer has invested €10m in GreenTech company Wegatech. Wegatech is a leading national provider of sustainable energy technology and a specialist in photovoltaic systems, battery storage, heat pumps and charging stations. As part of its energy initiative, Gothaer wants to support 500 small and medium-sized companies in reducing their CO2 emissions by 50% over the next five years.

Photo by: Birgit Reitz-Hofmann / Shutterstock.com

Photo by: testing / Shutterstock.com

2 HSBC Asset Management has announced its policy to phase out coal-fired power and thermal coal mining from its listed holdings. The company will actively work with company boards to support the transition away from thermal coal in the EU and OECD markets by 2030, and globally by 2040. Those companies who do not show credible plans to transition away from thermal coal within the timeframe will lose the support of the asset manager, including voting against company chairs at AGMs or, ultimately, divesting.

3 Groupama has strengthened its commitment to the climate by joining the Net-Zero Asset Owner Alliance (NZAOA). The NZAOA is a United Nations-supported initiative that brings together international insurers and pension funds committing to transition their investment portfolios to carbon neutrality by 2050. The members wish to contribute to limiting global warming to 1.5°C above pre-industrial temperatures, in line with the Paris Agreement.

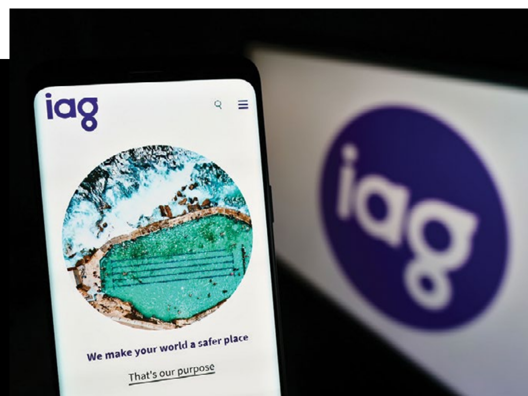
Photo by: NeydtStock / Shutterstock.com

4 Global specialty (re)insurance group Chaucer, in collaboration with Moody's, has rolled out a ESG Balanced Scorecard across investments, underwriting, and operations.The Scorecard uses 158 unique data points to assign scores for corporates across ESG factors and is designed to be a holistic approach to ESG measurement. Metrics upon which corporates are rated include disclosure of greenhouse gas emissions; integration of environmental factors into the supply chain; health and safety conditions of workers; involvement in the local community and support of local infrastructure; and boardroom diversity.

> "The Scorecard uses 158 unique data points to assign scores for corporates across ESG factors

5 Ping An has upgraded its proprietary ESG evaluation system to meet the group's rising demand for high quality ESG scoring data. The insurance company unveiled its ESG evaluation system in 2021 powered by natural language processing (NLP), knowledge graph, machine learning, and satellite remote sensing. The system was able to collect ESG regulatory disclosure-based data as well as alternative non-disclosure-based data to provide richer, multi-dimensional information. The recently upgraded ESG evaluation system has further improved the accuracy and comprehensiveness of data, according to the insurer. It consists of 21 first-level indicators, 90 second-level indicators, and 278 data points to measure ESG risks and opportunities for 37 industry sectors. The system can make real-time adjustments based on public news and sentiment.

6 IAG, Australia and New Zealand's largest general insurer, has joined the United Nations convened Net-Zero Insurance Alliance (NZIA) as part of its overall commitment to achieving net-zero. As a NZIA member, IAG joins 28 other leading insurers globally, representing close to 15% of the world's premium volume.



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7 Varma has signed the 2022 Global Investor Statement to Governments on the Climate Crisis petition. The petition, which has been signed by 533 international investors with assets totalling US$39trn, calls for governments and political decision-makers to increase measures to combat climate change. Investors have demanded stricter climate goals from states by 2030 to help ensure that the climate does not warm by more than the 1.5 degrees outlined in the Paris Climate Agreement. In the petition, states are required to specify their climate goals for 2030 before the 27th UN Climate Conference (COP27) in November, so that they are in line with international climate agreements.

Photo by: IgorGolovniov / Shutterstock.com

9 Germany's third largest insurer, Talanx, is the latest (re)insurance company to confirm to the #StopEACOP Coalition that it will not (re)insure the East African Crude Oil Pipeline (EACOP).Talanx joins 11 other (re)insurers, including four of the world's largest (re) insurance companies – Munich Re, Swiss Re, Hannover Re, and SCOR. Argo Group, Axis Capital and RSA Group have also recently confirmed they would not be in involved in underwriting EACOP.

8 Japanese insurer, Dai-ichi Life, has invested JPY 500m in JEPLAN, a company that uses proprietary recycling technologies to promote the circulation of PET bottles and other resources. This latest impact investment is a part of the firm's ESG investments to realise a sustainable society as well as to improve its investment returns through sophisticated and diverse investment methods.

Photo by: IgorGolovniov / Shutterstock.com

> "The investment will support Arevia's accelerated growth and development of new solar and wind projects throughout the US

10 Global investment firm, KKR, has led a significant structured investment in Arevia Power (Arevia), a US renewable energy developer, through its managed insurance accounts. Strategic participation has been carried out by GCM Grosvenor, a global alternative asset management solutions provider, and the investment will support Arevia's accelerated growth and development of new solar and wind projects throughout the US.

A fireside chat with Kedi Huang

Adam Cadle speaks to Aspen Insurance Group's UK chief investment officer

WRITTEN BY **ADAM CADLE**

Q Could you provide an overview of Aspen and your day-to-day role?

Aspen is a global leading specialty insurance and reinsurance company with main operations across the UK, Bermuda and the US. My principal objectives are improving outcomes of our investment portfolio while supporting delivery of business strategy via collaboration projects. Therefore, my day-to-day role ranges widely, from portfolio optimisation projects, strategic/tactical asset allocation, ALM strategy and solution designs, innovative portfolio solutions or strategies for yield enhancement, as well as due diligence of certain private credit deals.

Q What is your overall investment portfolio structure?

Our investment strategy is tailored to each entity based on business growth strategy and risk appetite. There is no doubt that a core fixed income strategy with investment in government bond, municipals, US Agency MBS, Investment-Grade Corporates etc. is the fundamental pillar of our structure, overlaid with a diversified short-duration, high-quality private credit portfolio, as well as exposures in real-estate and ESG-led infrastructure equity funds.

Q What are your views on current market sentiment and macro-economic issues?

The current market sentiment is quite bearish given high inflation and its implication on potential and further upside in the interest rate hiking path; combined with early signs of potential US and Europe recessions in 2023, and the concerned energy crisis in Europe.

We think the recession narrative may continue to weigh on the market sentiment and pricing of risk assets, at least in the first half of 2023. Being tactical and agile in the portfolio strategy would be crucial.

Q You are heavily involved in the origination of illiquid opportunities. Where do you see opportunities opening up at the moment in this space?

We have been disciplined to construct a dynamic and diversified illiquid portfolio that fits our macro views, risk appetite, capital budgets and liquidity risk framework. A "diversified" portfolio is achieved via a range of private credit strategies, while a "Dynamic" portfolio is built via flexible access to each deal through either co-investment or secondaries opportunities.

As liquidity will be gradually tightened in the rate hiking and quantitative tightening cycles in the major DM countries, we expect there will be many deals particularly via the secondary market with attractive pricing and we will take a measured and disciplined approach to deploying into the illiquid opportunities.

Q Could you explain Aspen's focus on ESG?

Aspen understands the importance of environmental, social and governance issues. We have joined the United Nations Global Compact (UNGC) initiative, a voluntary leadership platform for the development, implementation and disclosure of responsible business practices. We are committed to reducing or offsetting our carbon footprint and have taken numerous steps to do so over many years.

We continuously review our investment policies and practices to find ways to address ESG risks and opportunities. In this vein, we are making meaningful progress on formally integrating ESG considerations into our investment decisions and to expand the tools we use to assess climate-related risk in our portfolio, including for example, climate scenario analyses. As knowledge of ESG is evolving at the accelerated pace, we will not only continue enhancement in our ESG integration process, but also work closely with other areas of the business, such as the underwriting team, to share knowledge and insights.

Q Away from the day-to-day role, what do you like to do to relax?

Sporting activities and reading are my two primary ways to relax and recharge. I am committed to playing in a competitive basketball league once a week, combined with two golf and three gym sessions all packed in weekends. Mixing team-based and individual driven sports indeed help reduce stress. On the other hand, there is scientific proof that engaging the brain to focus on a single task helps to reduce stress. It clearly works for me as I find reading mainly in non-fictions across a wide range of topics helps enhance relaxation to some extent.

Current ponderings on industry themes

EUGENIA KOROBOVA
senior debt origination manager – public finance at PIC Capital

On PIC investing in Clanmil

We are very happy to have invested in Clanmil, one of Northern Ireland's largest social housing providers. Sourcing long-dated cash flows is important to PIC in order to help us to achieve our purpose, which is to fund the pensions of our current and future policyholders. Investing in social housing and other illiquid assets allows PIC to generate enhanced yield, helping us to secure more pension liabilities. This, in turn, means more trustees can guarantee their members' pensions through buy-ins and buyouts, greatly improving their financial security in retirement.

On factor investors increasing allocations to weather market volatility and integrate ESG

Factor investing is clearly emerging as a solution to mitigate potential unintended biases from ESG integration in equities, and even more so in fixed income, where the task is more challenging. With ESG especially front of mind in EMEA, this is yet another trigger for re-intensifying demand for factor-based investment strategies.

GEORG ELSAESSER
Invesco senior portfolio manager, quantitative strategies

ARDEA INVESTMENT MANAGEMENT

On the launch of its insurance portfolio optimisation tool

Introducing the capital charge to the portfolio optimisation process creates a complex multi-objective optimisation problem unsolvable by traditional financial models. By improving on the existing traditional 2-dimensional techniques used to date, the new tool optimises across the three dimensions of market risk, return and regulatory capital, and also takes liabilities into account. The result is an optimisation technique which exceeds the capacity of existing financial models, developed specifically for optimising insurance portfolios and which addresses the complex asset allocation problem faced by insurers.

On private equity insurers now having a 10% share of US L/A total assets

More-experienced private equity firms have gotten comfortable managing insurance assets while adhering to constraints imposed on their portfolios, such as regulatory compliance and rating agency capital charges on asset and liability risks, ALM matching requirements and liquidity concerns. As these firms take advantage of the more-permanent capital and premium flows afforded them through ownership of an insurer, there is less of a need to look for a quick exit from their investment.

JASON HOPPER
AM Best associate director, industry research and analytics

On 80% of institutional investors expecting strong growth in non-UK fund managers seeking to list on LSE

There is a considerable amount of pent-up demand in the market with companies waiting until conditions stabilise. There is increasing awareness of the benefits of listing in the UK worldwide but, fund managers wishing to successfully list must be aware of the challenges they could encounter and plan ahead to put in place strategies to address these.

GERRY WARWICK
Ocorian director of fund services in UK and Ireland

On the mini-Budget being 'music to the ears' of UK insurers

This mini-budget will be music to the ears of numerous insurers, who have been keeping a close eye on the progress of the Solvency II reforms. There is no doubt that the current requirements imposed by the EU have proven to be overkill in the eyes of many. There is a view that insurers have been forced to hold a huge pile of cash which, until now, they have been unable to put to work elsewhere – such as on alternative investment projects like green infrastructure. Insurers looking to invest in such projects will need to have the capabilities in place to support more alternative investment strategies, in the search for higher yields.

GAYATRI RAMAN
Clearwater Analytics President Europe and Asia

On the current economic environment being 'manageable' for UK insurers

Many UK life insurers would have faced cash calls to satisfy variation margin requirements on their interest rate hedge positions this week – this would have been most meaningful for insurers with large annuity books – however we expect this to me manageable given their strong liquidity buffers

BRANDAN HOLMES
Moody's analyst

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