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Inflation Risks and Thirst for Yield Drive Insurers to Private Markets

- *BlackRock research shows insurers migrating to infrastructure and real estate*
- *Macro challenges driving insurers to take on more risk and into private markets*

29 September 2014, New York – Insurance firms are making a significant move toward private market assets to diversify against the risks that have traditionally underpinned their businesses, a new BlackRock-commissioned study of insurers with over $6.2 trillion of assets has found.

The ability of insurers to maintain portfolio returns is critical to the types of products they can offer consumers and their ability to meet liabilities. Against the backdrop of anaemic economic growth, depressed bond yields and loose monetary policy, many insurers are reconfiguring their asset mix to ensure these liabilities can be effectively managed. BlackRock's research, conducted by the Economist Intelligence Unit, found that the number of insurers with over 15 per cent of their portfolio in private market assets had more than quadrupled to 26 per cent from 6 per cent three years ago, and is expected to nearly double again to 46 per cent by 2017.

David Lomas, global head of BlackRock's insurance asset management unit, said, "It used to almost be 'buy your bonds in the morning and relax in the afternoon', but insurers are now faced with a far more complex operating environment. This research shows insurers that are having to make a great migration toward private markets to diversify income streams and maintain returns on equity."

Taking measured risks

Lackluster yield from traditional fixed income instruments is driving many insurers up the risk spectrum. Globally, one in three insurers intends to increase their risk exposure over the next three years compared to 15 per cent who intend to decrease risk. Of the risk-takers, 68 per cent are hoping to replace or enhance investment income, while 66 per cent point to the diversification benefits it would afford.

Lomas added: "The fixed income challenge is well known, but what is interesting is the level of conviction CIOs seem to now have towards things like real estate debt and infrastructure assets. Industry leaders seem to be much more comfortable with investing in illiquid private market assets for income. Fundamentally, a shift up the risk spectrum needs to be achieved in a measured and targeted way."

Migration challenges

Re-allocating for yield is proving challenging, the study suggests, with insurers having to assess and invest in previously unchartered territories.

Two fifths of insurers cite lack of access to the right opportunities as a challenge and the same amount have concerns regarding pricing and transparency of private assets. A third of insurers (33 per cent) are also uncertain over how regulators would treat such moves in allocation.

Lomas commented: "The risk characteristics of these investments are different to the more main stream assets that insurers have typically bought. The complexity of re-locating assets to private markets can be a challenge for investors, but given the potential returns and inflation protection, as well as the diversification benefits and risk profile that they can bring to a portfolio, the challenge may be worthwhile."

The research

The Economist Intelligence Unit, on behalf of BlackRock, surveyed 243 senior executives from insurance and reinsurance companies around the world to understand how they were responding to the pressures their fixed income portfolios are under, and how they viewed private market asset classes such as real estate and infrastructure as an investment opportunity.

BlackRock's Financial Institutions Group is the leading asset manager for insurance assets in the world, managing 337 billion in unaffiliated general account and subadvisory assets for 201 insurers in 28 countries as at the end of June 2014. It is a team of 80 client service professionals located in New York, San Francisco, Princeton, London, Munich, Copenhagen and Milan. BlackRock also provides risk management services to 61 insurers through BlackRock Solutions, BlackRock's risk management and advisory business. This material represents an assessment of the market environment at a specific time and is not intended to be a forecast of future events or a guarantee of future results. This information should not be relied upon by the reader as research or investment advice.

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