Insurers embrace risk
Searching for sustainable yield
Navigating this report

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The report represents our 10th annual Global Insurance Report, with survey responses from 362 senior executives across 26 markets, at insurers with total assets under management of over US$27tn, representing approximately two thirds of the global insurance industry. Our research has uncovered three key themes, which you can explore by clicking the section tabs on the navigation bar at the top of the page and the contents page below. Throughout the sections, we complement our global findings with regional results, comments from your peers and insights from BlackRock experts.

Any opinions expressed reflect our survey and interview results as at the end of August 2021. They are not intended to be a forecast or guarantee of future results. The global sample size is all 362 respondents throughout unless indicated otherwise, comprising 149 in Europe, 111 in Asia-Pacific, 72 in North America and 30 in Latin America. Throughout the document, some numbers or percentages may not add up to 100 due to rounding or because we asked insurers to provide more than one answer. The number of people who answered the question is shown alongside each chart.
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Key findings

Setting the scene: navigating risks to accelerate strategic trends

54% of respondents identify geopolitical risk as the most serious macro risk to their investment strategy over the next two years. But environmental risk has doubled in importance in the eyes of respondents since 2015, with 36% now citing it as one of the most serious macro risks. Nearly half of the respondents see three current trends intensifying: the overhaul of insurance distribution models, the increased focus on sustainability, and the application of digital technology. Around a third of insurers expect M&A activity to accelerate in the industry.

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01 Diversification into non-core assets in search of income

60% of insurers expect to increase their appetite for investment risk over the next two years, which would be the highest level since we started tracking this information in 2015. Insurers are striving to reallocate out of core fixed income and into private assets (including higher-yielding fixed income) while compensating for lost liquidity through additional cash allocations. As insurers increase their risk appetite, credit quality and increased liquidity needs remain key priorities. Insurers are increasingly looking to ETFs as effective tools for managing their liquidity and enhancing yields.

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02 Growing focus on sustainability

95% of respondents believe climate risk will have a significant or very significant impact on portfolio construction and strategic asset allocation over the next two years. Insurers are embedding sustainability ever more deeply into their investment selection processes, and expect to increase their allocations to sustainable investments by about 30% over the next two years.

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03 Accelerating advances in technology

Nearly 60% of insurers plan to increase their investments in technology over the coming years. Insurance companies are moving quickly towards integrated, end-to-end investment platforms covering the whole spectrum of asset classes, from public to private. This is to enable integrated asset-liability management and multi-asset risk management. In this year’s survey, insurers said they will use increases in technology spending to assist the move into alternatives and to integrate climate risk into their portfolio management.

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As we reflect on the past year, we find cause for optimism, as many economies have made a strong restart following mass vaccinations and unparalleled financial stimulus from central banks. Against this backdrop, 362 insurance company executives shared their experiences and perspectives on the global insurance industry with us. Together, their firms manage US$27tn of assets and represent approximately two-thirds of the sector.

This year’s edition of the Global Insurance Report is particularly special, as it marks the report’s 10th anniversary. The findings point to three major themes driving momentum within the industry, against the backdrop of an evolving M&A landscape: investment risk appetite is increasing; sustainability is embedded more deeply than ever into the investment process; and technology continues to transform the industry.

60% of insurers plan to increase their investment risk exposure over the next two years, the highest number since we started collecting this information in 2015. The ongoing low-rate regime is pressuring margins, and insurers continue to shift their investment allocations to alternatives (including higher-yielding fixed-income assets) and to diversify their investment portfolios geographically in search of higher returns.

Sustainability considerations are at the front and centre of insurers’ investment strategies. Insurers are increasing their allocations to sustainable investments and integrating a sustainability lens into their investment processes.

Climate risk is challenging insurers to rethink their investment strategies: 95% of respondents believe that climate risk will significantly impact their portfolio construction and strategic asset allocation.

The pandemic accelerated the pace of technology investment, and insurance companies are acutely aware of the need to digitise their business. Insurers are moving towards integrated, end-to-end investment platforms that cover the whole spectrum of asset classes and integrate climate risk into portfolio management.

As a fiduciary, our role at BlackRock is to leverage our insurance expertise and diversified global platform across asset management, technology, sustainability and advisory solutions to deliver for our insurance clients. We would like to thank all those who participated in the survey, many of whom have partnered with us for the last 10 years. We hope the findings in this report prove insightful and look forward to engaging with you on these topics.
Setting the scene: navigating risks to accelerate strategic trends
Geopolitical risk remains the key macro concern for insurers. 54% of our survey’s respondents believe this to be the most serious macro risk to insurers’ investment strategies over the next 12-24 months. This consensus reflects the significance of the geopolitical implications of Covid-19 – such as European populism, emerging-market instability and US-China strategic competition – as well as new risks such as climate policy gridlock and major cyberattacks (see our BII “Geo-political risk dashboard” article.)

Aside from geopolitical risk, the other notable macro risks identified by insurers include weak global economic growth and environment risk. Despite a powerful restart of economic activity after the Covid-19 shock, economies continue to grapple with the second year of the pandemic and its impact on economic growth. In relation to environmental risk, insurers in 2021 are more than twice as likely to say environmental risk is one of their top macro concerns than they were in 2015. Section 2 of this report provides a deep dive into this finding.

Only 16% of respondents told us that they consider a persistently low interest rate environment to be the most serious macro risk to their firms’ investment strategies, compared with around 30% of respondents in 2020.

Vlad Barbalat, President and Chief Investment Officer at Liberty Mutual, reaffirms this view, saying: "While we are mindful of the near-term inflation pressures, we do not believe that the next 12-24 months will see a decisive move to a materially higher interest rate regime. A meaningful resetting of productivity growth, which could pave the way for structurally higher levels of real economic growth, is a key risk to this view."

Inflationary pressures had already been building up in corporate supply chains, arising from the supply-demand disruption brought about by the pandemic. To defend our portfolios from the potential rise in bond yields, we will look to tilt the portfolio towards more inflation-defensive assets, such as inflation-linked bonds and income-generating real assets."

Ai Ning Wee
Group Chief Investment Officer, Great Eastern Life
Q.01 Which of the following do you consider to be the most serious macro risks to your firm’s investment strategy over the next 12-24 months?

- Geo-political risk: 54%
- Weak global economic growth: 46%
- Environmental risk: 36%
- Health-related risk such as COVID-19: 35%
- Regulatory risk: 33%
- Currency risk: 27%
- Inflation risk: 24%
- Persistent low interest rate environment: 16%
- Deflation risk: 14%

“Inflation is not our top risk from an investment point of view. However, over the next 18 months uncertainty related to Covid-19 can manifest itself in many ways, whether through slower growth or higher inflation. What is clear is that inflation is likely to be higher going forward than it was during the pandemic. While inflation elements in the US are expected to be transient, Eurozone and many Emerging Markets inflation trends are now rising and could prove to be more disruptive than market pricing currently expects. Consequently, bond yields in many regions seem too depressed currently, with risks to the upside.”

Julian Temes
Head of Strategy Implementation, Zurich

Main market risk concerns

Insurers continue to be vigilant about market risks, and this year’s report shows that they are mostly concerned about asset price volatility. Tim Boroughs, Executive Vice President and Chief Investment Officer at Chubb, highlights that “although we can withstand a fair amount of near-term volatility to weather a rate shock on the fixed-income portfolio, it’s the potential downside as risk assets reprice in the face of a normalised yield curve that concerns us more.”

Insurers also view asset price volatility as an opportunity to redeploy capital at attractive levels.

Mark Konyn, Group Chief Investment Officer at AIA, states that

“For long-term investors, short-term asset price volatility can present opportunities on the assumption of efficient capital deployment. Designing and implementing dynamic allocation strategies that seek to identify asymmetric risk tradeoffs caused by shorter term price volatility is a key point of focus for us.”

In addition to asset price volatility, liquidity risk also features highly among insurers’ market risk concerns. Achilles Sofroniou, Head of Lloyd’s Treasury and Investment Management, highlights the concern that “surging valuations, and an increasing number of insurers investing in more illiquid assets, in combination with government or central bank support, has created bubbles of liquidity risk.”
Q.02 Which of the following do you consider to be the most serious market risks to your firm’s investment strategy over the next 12-24 months?

- **Asset price volatility**: 66%
- **Liquidity risk**: 62%
- **Interest rate risk**: 48%
- **Spread risk**: 38%
- **Ratings migration**: 33%

Accelerating structural trends

Among the backdrop of these macro and market considerations, insurers believe that a number of strategic trends will accelerate in their industry in the next 12-24 months. More than 40% of respondents see three trends intensifying with particular vigour: the overhaul of insurance distribution models; the increased focus on sustainability; and the application of digital technology.

Additionally, around a third of insurers believe M&A activity will increase in the industry. To free up capital, insurers have been divesting legacy policy portfolios and exiting non-core businesses with low returns on equity. This has increased appetite from private equity players and insurers looking to evolve their businesses.

“The insurance market is changing rapidly. Disruption can come from new customer demands, capital markets, new competitors and new technologies. Organic growth might not be sufficient to face all of them, but M&A can complement organic growth.”
Francesco Martorana
Group Chief Investment Officer, Generali
Q.03 What major strategic trends do you see accelerating in the insurance industry over the next 12-24 months?

- **54%** Major changes in the distribution landscape
- **47%** Increased focus on sustainability
- **44%** Acceleration of digital technology projects
- **36%** M&A in the insurance industry
- **30%** A material review of operating expenses
- **26%** Acceleration of new product development
- **24%** Investment portfolio diversification in search for yield

Diversification into non-core assets

01

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Six in ten insurers plan to increase their risk exposures over the next two years - the highest number since we started collecting this information in 2015. This particularly large increase is less of a preference and more of a necessity as the ongoing low interest rate regime continues to reduce margins and force insurers to consider investments in higher-yielding asset classes in search of income.

Joel Coleman, Chief Investment Officer at Nationwide, stresses that “The low-yield environment has pushed most insurers to take more risk to offset shrinking margins on current products. In addition, the increased market presence of (mostly) private equity-backed insurers, often with a significantly higher risk appetite than traditional insurers, is pushing life insurance companies to take more risk to maintain competitiveness in new sales.”

With sustained low yields and spreads, it is no surprise that we see an increase in the appetite for alternative assets and strategies (in order) to maintain the stream of revenue to policyholders and shareholders.”

Pascal Chirstory
Group Chief Investment Officer, AXA
Q.04 Over the next 12-24 months, how do you expect your firm’s appetite for investment risk to change?

- Increase risk exposure
- Maintain current risk profile
- Reduce risk exposure

60% 62% 54% 73% 64%

32% 30% 34% 23% 35%

8% 8% 12% 3% 1%

Global Asia Pacific Europe Latin America North America

Resilience through quality and diversification

As insurers look to increase their risk appetite, our respondents flag diversification as a key driver for their portfolio allocation. Interest rates remain low, challenging insurers’ ability to generate sufficient investment income. In response, insurers have shifted their investment allocations to alternatives, including higher-yielding fixed-income assets, and diversified their investment portfolios geographically (e.g., China) in search of higher yield and returns.

For Ai Ning Wee, Group Chief Investment Officer at Great Eastern Life, “China’s independent monetary policy, which steers away from unconventional quantitative easing and debt monetisation, makes its government bond market a good diversifier for institutional portfolios.”

Q.05 Thinking about the changes to your portfolio as a whole, what is driving your changes?

- Moving higher up in quality: 59%
- Diversification: 54%
- Increased liquidity needs: 43%
- Targeting higher yields/returns: 39%
- Increasing duration, where possible: 28%
- Reducing duration, where possible: 22%
- Actively targeting mispriced opportunities across the risk spectrum: 22%

However, as insurers increase their risk appetite, credit quality and increased liquidity needs remain key priorities for respondents. The need for credit quality reinforces the importance of robust credit research processes that provide in-depth analysis and security selection over a long investment horizon. The intended outcome is to deliver strong performance across credit mandates, enabling them to outperform markets with limited downside risk.

Asset allocation considerations

In search of yield, insurers are reallocating from traditional fixed income into alternative solutions. However, they are compensating for this loss of liquidity with a growing allocation to cash assets.

“We see structurally challenged expectations for real returns in traditional fixed income and find the private asset premium across credit and equity attractive in the current environment.” He adds: “We plan to continue to build on our private asset capabilities and increase allocation to private credit and equity investments.”

Vlad Barbalat
President and Chief Investment Officer, Liberty Mutual
Q.06 In the next 12-24 months, how do you anticipate changing your allocations to each of the following asset classes?

<table>
<thead>
<tr>
<th>Asset Class</th>
<th>Increase</th>
<th>Unchanged</th>
<th>Decrease</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>41%</td>
<td>37%</td>
<td>22%</td>
</tr>
<tr>
<td>Alternatives</td>
<td>46%</td>
<td>33%</td>
<td>20%</td>
</tr>
<tr>
<td>Hedge funds</td>
<td>46%</td>
<td>27%</td>
<td>27%</td>
</tr>
<tr>
<td>Equities</td>
<td>50%</td>
<td>25%</td>
<td>25%</td>
</tr>
<tr>
<td>Fixed income</td>
<td>46%</td>
<td>30%</td>
<td>23%</td>
</tr>
</tbody>
</table>

Over the past years, insurers have optimised their fixed income allocations to contain diversified sources of yield and risk.

This year’s findings indicate an anticipated (and continued) rotation from government bonds to higher-yielding fixed-income strategies. Allocations to inflation-linked bonds could represent an exception to this rotation, given concerns about the persistence of elevated inflation.

More than half of insurers plan to increase allocations to emerging-market debt, as the asset class offers diversification and can benefit from the increase in global growth anticipated in 2021, generating attractive returns on capital.

Forty-five percent of insurers plan to increase allocations to investment-grade corporate credit, which remains an attractive, high-quality and liquid alternative to government bonds, especially for those insurers in need of longer-duration assets. Furthermore, we see insurers continuing to build allocations to ESG and impact investments.

As insurers allocate more to higher-yielding fixed-income strategies, including private-market opportunities, it appears that they are looking to barbell their fixed-income allocations. Ultimately, a whole-portfolio approach that combines core allocations with yield-enhancing exposures is crucial in a multi-dimensional context such as the one faced by insurers. Considerations around asset-liability management (ALM), regulation, accounting and economic volatility have to be analysed and combined in the design of investment strategies.

We will look to manage duration more actively and are considering increasing allocation to inflation-linked bonds. At current spread levels, we will also be more selective about credits to mitigate idiosyncratic downside risks. Beyond these issues, yield and diversification remain important considerations.”

Ai Ning Wee
Group Chief Investment Officer,
Great Eastern Life
Thinking more about your fixed-income portfolio in the next 12-24 months, how do you anticipate changing your allocations to each of the following?

Enhancing fixed-income yield opportunities and portfolio diversification

Peter Gailliot
Global CIO of the Financial Institutions Group and Head of Fixed Income FIG Portfolio Management

Despite the year-to-date backup in government bonds, insurers continue to be challenged by the yields available in fixed-income markets. With investment-grade yields still hovering near to historical lows, insurers are struggling to replace higher-yielding, higher-quality legacy assets.

To enhance income and returns in this environment, the combination of an expanded investment universe and more flexibility within existing fixed-income investment guidelines can significantly improve an insurer’s competitiveness and potential profitability. While introducing new asset classes may increase the potential risk profile of an insurer’s balance sheet, these new risks can be materially offset by focusing more closely on diversification.

The massive fiscal and monetary-policy effort in response to the Covid-19 crisis created a perceived floor to default risk. Nonetheless, a market awash with liquidity almost always results in pockets of excess that are unlikely to be bailed out during times of lower systemic risk. With global investors reaching for new, unfamiliar sources of return, valuation cushions have been significantly eroded, and being on the wrong side of a single name or sector could wipe out a year’s worth of carry in a few trading sessions. A recent example of this has been the regulatory crackdown in China, which has weighed heavily on both debt and equity from sectors including real estate, education, and gaming. We have also begun to see heightened leveraged-buyout (LBO) activity, particularly in secularly challenged sectors such as UK retail. As insurers increase their risk to earn the same returns or income, diversification looks set to become an increasingly important factor in the effort to mitigate balance-sheet volatility.

Traditional issuer and security-level diversification remain the backbone of the insurance investment process. Given the holding period on most investments, there are almost always going to be unforeseen challenges to long-term investments that require action to mitigate downside risk. Maintaining a larger number of smaller investments minimises the impact on the bottom line. The more low-correlation positions that are held in a portfolio, the more opportunities the investment manager has to pair an underperforming asset with an offsetting gain.

Beyond these traditional diversification ideas, we see several other important ways in which insurers can increase their fixed-income portfolio yields while maintaining – or indeed improving – diversification.

1) Cross-currency allocations: The yield-pickup argument for multi-currency investing is clear: the varying shape of the yield curve in different currencies creates opportunities through the cycle for investors to tactically shift allocations to other currencies and pick up meaningful income, even after hedging out the FX risk. But what is less appreciated is that non-base currency allocations broaden the opportunity set and allow for access to markets with different compositions in terms of issuers, sectors, geographies, and tenors. This enables risk reduction via superior diversification across these factors (and more). It also allows for the identification and harnessing of relative-value opportunities between markets, from both a top-down and bottom-up perspective.

2) Core plus allocations: High-yield, emerging-market debt, private assets, and securitisations (outside Solvency II-regulated balance sheets) offer exposure to risk factors that have significantly lower correlations to an insurer’s traditional portfolio of investment-grade credit and developed-market government bonds. A complimentary allocation to these assets has the potential to be income-accretive and capital-aware, and to diversify risk, while only sacrificing a small amount of liquidity. In the case of securitised assets, well-structured deals offer opportunities across the capital stack, while portions of the esoteric asset-backed securities (ABS) market provide capital-efficient yields with collateral-pool compositions that are less closely correlated to traditional macro factors.

3) Incorporating bespoke sector opportunities into the multi-sector framework: While we advocate enhancing exposures to include the wide range of asset classes noted above, we also believe that a fully integrated, comprehensive portfolio construction approach is necessary to maximise income and returns while minimising risk. A holistic portfolio approach allows risks across individual names and subsectors to be managed at the headline level, and unforeseen correlations to be avoided for smaller, specialty mandates.
Growing adoption of ETFs

Insurers are increasingly looking to ETFs to manage liquidity and enhance yield. ETFs enable institutional investors to gain access to investments across liquidity profiles and asset classes, while also achieving exposure to yield-enhancing sectors such as emerging-market sovereign debt and high-yield corporate credit in an efficient way.

For Francesco Martorana at Group Chief Investment Officer at Generali, ETFs are a useful tool to access specific strategies and geographies that have proved challenging to access effectively in the past.

“We will continue to manage the bulk of our equity and bond exposures to the euro area through managed accounts. However, for other geographies and specific strategies, we already use ETFs for tactical purposes or for entering new market segments, or for products with simpler accounting and capital requirements, such as unit-linked.”

Francesco Martorana
Group Chief Investment Officer, Generali
The development of listed options on fixed-income ETFs makes it easier for insurers to implement yield-enhancement strategies such as covered calls, where the insurer sells a call option on an ETF that they own. It also facilitates strategies to help reduce the capital needed under Solvency II. This could be done through optimisation strategies that acquire downside protection by buying puts.

As insurance companies become increasingly comfortable with using fixed-income ETFs within their portfolios, they are likely to use them to become more precise in their asset allocation. To do this, they will utilise a broader set of ETFs, including those providing more focused exposures.

Q.08 How do you anticipate the following factors changing your allocation to ETFs over the next 12-24 months?

- **Liquidity management**
  - Increase: 87%
  - Unchanged: 12%
  - Decrease: 1%

- **Yield enhancement**
  - Increase: 74%
  - Unchanged: 24%
  - Decrease: 1%

- **Precision exposures**
  - Increase: 34%
  - Unchanged: 60%
  - Decrease: 6%

- **Core asset allocation**
  - Increase: 10%
  - Unchanged: 74%
  - Decrease: 15%

- **Tactical asset allocation**
  - Increase: 7%
  - Unchanged: 76%
  - Decrease: 16%

Private assets move into the mainstream

Private markets are playing an increasingly fundamental role in insurers' portfolios. The shift into private markets is happening faster than anticipated. Over the past three years, insurers have raised their average private-market allocations from 7% to 11%. This rapid increase in the asset class has exceeded the expectations of investment professionals within the industry who, in the 2019 Global Insurance Report, projected an allocation of 9% to private markets by 2022. The industry is clearly on track to surpass this estimate by a considerable amount: our respondents believe private-market allocations will reach around 14% of total portfolio allocations by 2023; this represents a 30% increase from current allocation levels.

By this stage, nearly seven in ten insurers plan to have strategic asset allocations of at least 10% in private assets. Notably, by 2023, no insurer expects to have an allocation to private markets below 5% of their strategic asset allocation.

The attractiveness of the asset class is clear to Swiss Re's Pascal Zbinden, who says: "Private equity and particularly private debt are attractive as enhancers and diversifiers of return."

Q.09 Overall, what percentage of your firm’s total portfolio is currently allocated to private market assets, and what do you expect this percentage to be in two years?

<table>
<thead>
<tr>
<th>2019 allocation</th>
<th>Current allocation</th>
<th>Predicted allocation in two years</th>
</tr>
</thead>
<tbody>
<tr>
<td>7%</td>
<td>11%</td>
<td>14%</td>
</tr>
</tbody>
</table>

By 2023, insurers expect private-market allocations to reach around 14% of total portfolio allocations, representing a 30% increase from current allocation levels. The shift into private markets is happening faster than anticipated, and nearly seven in ten insurers plan to have strategic asset allocations of at least 10% in private assets. No insurer expects to have an allocation to private markets below 5% of their strategic asset allocation.
“We still see value in private markets as a source of diversification, superior risk-adjusted returns and resiliency in stressed market conditions. At the same time, given the stretched valuations caused by a prolonged hunt for yield from every investor base, we remain cautious and selective in deploying capital.”

Francesco Martorana  
Group Chief Investment Officer, Generali
Integrating private assets into portfolios

Diversification and returns are the main reasons why insurers seek to strengthen their private-market allocations within the confines of the regulatory framework. Portfolio risk governance was highlighted by respondents as the most important barrier to allocating more to private markets.

Mark Konyn at AIA explains: “The move into private assets presents a number of challenges for institutional investors. Data availability and the relative underdevelopment of relevant risk tools are potential barriers to risk-management integration with the full investment programme. Developing strong partnerships with specialist managers and investment in technology will help overcome these challenges.”

Insurers also highlighted that they are starting to see capital returned. They cited the requirement to recommit capital to maintain the same level of allocation as a further barrier to allocations in the asset class. In our view, a predefined recommitment programme could help insurers maintain exposures at the desired levels and lead to cashflow and portfolio optimisation opportunities.

Akiko Osawa, Director, Executive Officer, Chief Investment Officer at Nippon Life, recognises the diversification benefits of private assets: “Since we are a long-term investor, we can take on liquidity risk. Alternatives also add diversification from other asset classes, and we will continue to invest while keeping our portfolio balanced.”
Q.10 What are the most important factors driving your allocation to private markets?

- **Increase diversification**: 72%
- **Total return**: 47%
- **Income generation**: 42%


Q.11 What are your barriers, if any, to allocating more to private markets in the next 12-24 months?

- **Portfolio risk monitoring & governance**: 52%
- **Recommitment requirements to maintain allocation levels**: 49%
- **Internal portfolio construction and management (e.g. SAA, ALM, risk budgeting)**: 46%

Investing in private-market strategies

Multi-alternatives strategies, which opportunistically select a range of asset classes within private markets, look likely to benefit the most from the inflow of insurer capital. In our view, this is driven by insurers’ appetite to increase their exposure to cost-effective private asset portfolios with specific risk-based returns, which also support diversification across product types.

Commercial real estate, private equity and direct lending to small and medium sized enterprises (SMEs) also look set to benefit from new insurance capital. However, respondents to the survey anticipate decreasing their allocations to infrastructure debt over the coming years. Insurers have allocated significant capital to such strategies over the years. In our view, this finding underlines insurers’ appetite to deploy committed capital before further increasing their allocation in relevant strategies.

“Standalone risk or capital adjusted returns are just one metric that we consider when building our allocation to private markets. We also consider illiquidity premium, overall fit within portfolio construction and associated diversification needs, ALM fit and ESG factors, amongst others. Over the next two years, we plan to increase our allocation to private markets as well as selectively shift sector exposures (mainly private debt and real estate equity). We believe that all the sub-sectors in the private debt space that we are invested in continue to offer well compensated risk and our focus will be mainly on continuing to grow the infrastructure portfolio and ramp up our allocation to middle market loans. In regards to real estate equity, growth will be more focused on more Covid-19 resilient sectors, such as residential and logistics with reduced emphasis on traditional office and retail.”

Julian Temes
Head of Strategy Implementation, Zurich
Q.12 Thinking specifically about your private market assets in the next 12–24 months, please describe how you anticipate changing your allocations to the following?

M&A accelerates asset allocation trends

Mark Azzopardi
Global Head of Insurance within the Capital Markets & Portfolio Advisory team at BlackRock’s Financial Markets Advisory Group

This year’s survey confirms that the asset allocation and investment trends seen in the insurance industry over the last few years show no sign of abating. These include a push into private-market strategies, the incorporation of sustainability into portfolios and an increase in risk appetite to maintain returns and income.

Many of these trends are further accelerated by the significant volume of M&A and corporate restructuring, particularly in the North American and European life insurance markets, and the marked increase in private equity-backed insurers.

These firms tend to have more appetite for investment risk, as well as some specific expertise and a more general willingness to consider private-market assets. This is often accompanied by in-house asset origination capability and a strong focus on enterprise returns, which makes it essential to maximise the efficiency of investment portfolios.

To date, one of the key drivers of many insurers’ investment strategy optimisation efforts is the need to improve portfolio returns to deliver guarantees historically promised to policyholders. The higher returns available in private markets have played a useful role in achieving this objective, helping to explain the increase in interest over the last few years. Private equity firms have historically tended to concentrate predominantly on the closed books of the insurance business, but recently they are increasingly acquiring companies still writing new policies. In such cases, returns from a more aggressive investment strategy concentrating on private markets can be passed on to policyholders through more attractive crediting rates and investment guarantees, as well as more attractive pricing for companies transferring their pension liabilities to insurers.

This introduces a new dynamic whereby insurers’ investment strategies will need assessment not just against the returns required to meet historical investment guarantees, but also against what is essential to compete with private equity-backed insurers for new business. This may require a more fundamental reassessment of how each insurer wishes to differentiate itself in the marketplace. This may be by delivering superior risk-adjusted investment returns, or the insurers may think strengths in underwriting, distribution and policyholder services could be better differentiators. Many private equity-backed insurers focus on businesses where the investment component is critical, such as the US spread-based life business and UK annuities, so it is likely that other players in these markets will have no choice but to adapt their investment strategies appropriately.

This will likely involve a push into more niche areas of private markets where higher returns may still be on offer, balanced with the need to deploy resources to areas with sufficient sourcing potential. In this case, asset class expertise can be developed internally or supplied through external managers. Further diversification into core-plus or semi-liquid assets, such as emerging-market debt, high-yield and private placements, may also be necessary.

This next stage of the portfolio optimisation journey will also likely require significant enhancements to asset-liability modelling and risk systems to incorporate new asset classes into strategic asset allocations while managing the associated risk. The imperative to incorporate ESG considerations into portfolios, whether to mitigate future investment risks or because of broader stakeholder considerations, must also be part of this journey. This could be an area where publicly-owned insurers making significant public disclosures may enjoy a communication advantage.
02
Growing focus on sustainability
ESG activity is trending upwards, and insurers continue to embed sustainability ever more deeply into their investment processes and strategies. The past year has seen a 10-percentage point jump in the number of insurers publishing ESG-related commitments, with insurers in Asia-Pacific driving the increase.

This past year, we have also seen insurers become more selective in the types of ESG strategy they invest in.

This has been particularly prevalent in North America, with Vlad Barbalat, President and Chief Investment Officer at Liberty Mutual, stressing that “Material ESG issues should inform investment decision making and risk-management practices.” He adds: “We think of ESG integration as an enhancement to our overall investment process, rather than a separate investment strategy.”

The trend towards sustainable assets will be driven by institutions setting ambitious targets. We can no longer expect policy-driven initiatives to lead this transition, and the private sector is coming to terms with its obligations.”

Mark Konyn
Group Chief Investment Officer, AIA
Q.13 | Thinking about ESG, has your firm done any of the following?

58%  We have published ESG-related commitments

54%  We have invested in specific ESG strategies in the last 12 months

53%  We have made ESG risk a key component of our investment risk assessment for new investments

42%  We have turned down an investment opportunity in the last 12 months due to ESG concerns

Climate and social risks heightened by the pandemic

The pandemic has sharpened insurers’ focus on sustainable activities. The findings of our survey highlight that although insurance companies are committed to increasing their allocations to sustainable solutions, the pandemic underscored insurers’ emphasis on the societal aspect of ESG investing, and increased their awareness of the need for climate-risk mitigation.

At the regional level, the results mirror the global landscape, with Asia-Pacific insurers more focused on climate-risk mitigation, while European insurers focus on the ‘S’ factor in ESG.

“The pandemic has heightened concerns about climate, biodiversity and social issues, and there are increasing demands for clearer corporate accountability.”

Achilles Sofroniou
Head of Lloyd’s Treasury and Investment Management, Lloyd’s of London
Q.14 Has Covid-19 made you rethink the focus of your sustainable investment activity?

- **61%** Yes - greater focus on the “S” factor for ESG
- **57%** Yes - more awareness of the need for climate risk mitigation
- **50%** Yes - greater focus on risk management and governance
- **32%** Yes - more investments in sustainable solutions

Allocations to sustainable investment are growing

This year’s report offers further confirmation that sustainable solutions are moving into the mainstream across global insurance portfolios. Over the next two years, insurers’ average allocation to sustainable investments is expected to grow by about 30%.

Q.15 What percentage of your assets are invested in sustainable solutions? And what is your estimate for the percentage of assets under management that will be invested in sustainable solutions in two years’ time?

For Pascal Christory of AXA, this growing phenomenon of reallocation to sustainable solutions is already underway: “In 2020 alone, we increased our allocation to green assets by about 40%. The main challenge in the future will be the availability of assets/deals, which depends on issuers’ commitments to reduce their emissions and transition towards more sustainable businesses and operations.”

Julian Temes, Head of Strategy Implementation at Zurich, highlights that “allocation to sustainable assets remains low, and as such a 30% increase is deemed feasible. However, the challenge lies in the types of instruments that are fit for purpose from an admissibility and implementability in scale point of view. Government green bonds are only 0.3% of outstanding government debt, so it will be easy to achieve growth in this specific area. Beyond green bonds, there is a need for regulatory changes coupled with increased alignment between ‘sustainable product ideas’ and implementable investment solutions. Current challenges are related to taxonomies, scale of investment opportunities and portfolio integration and admissibility.”

Note: Sustainable solutions are defined as portfolios that have a distinct ESG objective (e.g. thematic, impact, apply exclusionary screens, or optimise towards ESG).
The vast majority of our respondents (95%) believe that climate risk will have a significant or very significant impact on portfolio construction and strategic asset allocation over the next two years.

For Pascal Zbinden, Co-Head Strategic Asset Allocation and Markets at SwissRe, “Portfolio construction matters greatly in managing climate risks in the portfolio, with our research showing that targeted security selection is more impactful than divesting from a company or industry altogether. We acknowledge that managing the risk of stranded assets may require selective divestment. However, engagement with portfolio companies on climate risk is more beneficial as it supports the transition to a net-zero economy.”

Tim Boroughs, Executive Vice President and Chief Investment Officer at Chubb, also recognises the necessity to integrate climate risk into portfolio construction and strategic asset allocation: “As a P&C insurer, catastrophe risk is right at the surface as we look at how to position ourselves in alignment with the broader business. We have already made certain adjustments, such as limiting coal, but we expect to make further adjustments as we focus on the long-term implications of climate change.”

Integrating sustainability into portfolios

The growing significance of ESG integration into balance sheet investing is clear. Our survey suggests that the main drivers for reallocating capital to sustainable solutions are better risk-adjusted performance over the long term, regulatory compliance and the need to meet public commitments to sustainability. For Swiss Re, the benefits of ESG integration are clear.

Pascal Zbinden, Co-Head Strategic Asset Allocation and Markets at Swiss Re, explains: “We are convinced that ESG makes economic sense. Taking ESG criteria into account has had a measurably positive long-term impact on the risk-adjusted performance of Swiss Re’s investment portfolios. It reduced volatility and helped absorb financial market risk shocks.”

However, regulation is also highlighted in our findings as the biggest barrier to greater allocation. This shows how important regulators will be in helping or hindering the adoption of sustainable investing. If regulators harmonise their rules and achieve global consensus, they can act as catalysts for growth.

The EU Plan on Sustainable Finance, including initiatives such as the EU taxonomy, will provide a progressively clearer definition of what is sustainable. This will create transparency for investors, enabling them to avoid greenwashing. On the other hand, adapting to new regulation will represent a significant effort for asset owners in the near future.”

Francesco Martorana
Group Chief Investment Officer, Generali
Q.17 What are the key factors driving reallocation of existing assets to more sustainable solutions?

- Better risk-adjusted performance: 49%
- Regulations require considering ESG risks: 49%
- Public commitments to sustainability: 49%

Q.18 What are the biggest hurdles you’ve faced over the past 12 months in implementing an ESG strategy?

- Compliance with regulatory requirements: 62%
- Asset allocation framework constraints: 56%
- Poor quality or availability of data and analytics: 36%

Source: BlackRock Global Insurance Survey, June-July 2021. Respondents selected up to two responses. Note: Sustainable solutions are defined as portfolios that have a distinct ESG objective (e.g. thematic, impact, apply exclusionary screens, or optimise towards ESG).

Growing tailwinds for sustainable investing

Paul Bodnar
Global Head of Sustainable Investing at BlackRock

This year’s survey confirms that the insurance industry is increasingly recognising that climate risk is investment risk. Insurers, some of whom are directly exposed to the physical risks presented by climate change (including flood and fire), have long been at the forefront of sustainable investing.

With their inherent focus on the long term, insurers were among the first institutional investors to recognise two important dynamics: that climate risk must be taken into account from an investment perspective, and more recently, that climate risk will reshape the global economy whether it is managed successfully or not.

Understanding these dynamics is driving insurers to continue increasing their investments in sustainable funds. This year’s survey confirms that insurers are planning to increase these allocations further over the coming years, matching the overall global move towards sustainable investment vehicles.

Another important dynamic driving these flows is significant regulatory change, a factor that insurers highlight in the survey as a driver of their move to sustainable investing. At the core of these changes is the European Union’s (EU) Sustainable Finance Disclosure Regulation (SFDR), which seeks to harmonise sustainability disclosures and create a framework for classifying sustainable funds. SFDR is in its initial implementation phase, but will continue to impact and shape the sustainable investing market as it goes through subsequent phases.

Insurers are also alert to new or proposed regulation in other jurisdictions. This includes the US, where action is being considered to address climate risk in the insurance sector, and where the Securities and Exchange Commission (SEC) is evaluating its approach to climate disclosures.

Insurers are being driven by their investment conviction, new regulation, and the improved availability and quality of climate risk analytics. Our survey shows that more insurers are embracing sustainable investing and demanding sustainable products, and we expect this trend to continue apace.
03

Accelerating advances in technology
Technology as an enabler

The pandemic has accelerated the pace of tech investment and insurance firms are acutely aware of the need to digitise their business. Insurers are moving rapidly towards integrated, end-to-end investment platforms to enable growth and help them respond quickly to changing industry trends.

This year’s survey shows particular growth in technology spending on investment processes. Insurers’ progressively greater investment in private assets poses a notable challenge. As a result, insurers are looking for technology solutions that cover the whole spectrum of asset classes – from public to private – on a single platform, including integrated tools for managing alternatives.

Many insurers also plan to increase technology and data investment in measuring, managing and integrating climate risk in core investments and business decision processes, a point underscored by Francesco Martorana from Generali: “Climate risk is becoming a key sustainability topic which we need to integrate more into our investments.”

Assessing and quantifying the risks associated with climate change is a necessity for both underwriting and investment management. The next three years will usher in a new era in the application of technology and quantitative techniques to managing these risks.”

Mark Konyn
Group Chief Investment Officer, AIA
Q.19 In the next two years, how do you anticipate changing your spending/investment in your technology and infrastructure (compared with 2020 spend)?

Unified technology solutions drive change

The insurance industry is moving towards more integrated ALM because of the exceptional speed of change in the competitive landscape, regulatory complexity and the economic environment. Over the next two years, 56% of respondents plan to focus on ALM integration, with 45% prioritising multi-asset risk management. Both imperatives underline the need for integrated investment platforms.

Akiko Osawa, Director, Executive Officer, Chief Investment Officer at Nippon Life, says: “We need to concentrate our tech spend on improving the risk management of our portfolios.” Ms. Osawa also states that: “From 2025, Japan will have new regulations for insurers that focus on solvency based on economic value. As enterprise risk management accelerates, we will need an integrated risk-management framework. In addition, with changes to International Financial Reporting Standards, accounting considerations will need further improvement. We have been investing in our system to help it meet these various changes in a holistic way.”

Integration of climate risks with traditional portfolio construction measures of risk, performance and asset liability management is a very relevant topic that demands more investment.”

Pascal Christory
Group Chief Investment Officer, AXA
Q.20 Thinking specifically about investment management over the next two years, where will you be prioritising your tech and infrastructure investments?

- Integrated Asset and Liability Management (ALM): 56%
- Multi-asset risk management: 45%
- Compliance with regulatory needs and reporting requirements: 41%
- Strategic balance-sheet steering: 38%
- Increased operational efficiency and reduced cost: 36%
- Integration of new risk types, such as Climate Risk: 35%

Investing for net zero – the role of technology

Kunal Khara
Global Head of Financial Institutions for the Aladdin business

Antonio Silva
Head of Analytics and Modeling and the Chief Risk Strategist at BlackRock

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There is a growing coalition of governments, companies and financial institutions around the world that have committed to reaching net zero emissions by 2050. However, actually achieving net zero will require a major transition – in policy, in the way companies do business and in technology – and this will all have vast implications for the financial sector. As providers and risk managers of long-term capital, insurers have a key role to play in understanding and supporting the transition to a sustainable economy.

It is important to note that there are many different potential transition pathways to a net zero economy. One challenge in navigating the transition is measuring the economic impact of these pathways, in order to effectively manage risk and embrace opportunities. Overcoming this challenge is paramount for insurance companies because of their long-term exposure to transition risk on both sides of the balance sheet, as well as heightened regulatory disclosure requirements.

Modelling the financial implications of transition risk is complex. It requires climate science expertise and the creation of different scenarios based on educated assumptions on the future state of the global economy - new policies that will be enacted, the pace of adoption of new technologies and the disruption of supply chains. Each of these changes will have a profound impact on consumer behavior and how entire industries operate and connect with one another over the short- and long-terms. Measuring the economic impact associated with these changes requires converting various emissions pathways into economic forecasts by sector. It also requires analysis on how “transition-ready” companies are. This analysis demands high-quality data on carbon emissions and company commitments to reducing their carbon footprint. The combination of this sector- and company-specific analysis must be supported by precise and scalable analytics.

All of this is largely new for the financial sector, but it has become critical to embed the management of transition risk across one’s strategy, business and operations, including for insurers, given their significant role in the global economy. Like other financial institutions, insurers need technology that puts transition-risk measurement at the fingertips of investment, underwriting and risk-management teams, and integrates with the existing systems and models used to measure traditional risks.

Technology investment on climate-risk capabilities should focus on three areas:

**Data**

Climate-related metrics are typically spread across multiple vendors with different degrees of coverage, consistency and quality. It is essential to invest in approaches and solutions that can combine data in a coherent framework, capable of providing high-quality input in a consistent way.

**Analytics**

The ability to develop high-conviction climate analytics, which can measure climate risk with precision, is pivotal to the re-allocation of capital necessary for a low-carbon economy. The financial services ecosystem is evolving fast and breaking new ground, but standards are still far from being well-defined.

**Platform integration**

Insurers need a technology platform that integrates climate analytics and data into the investment process and connects them (via Application Programming Interfaces or similar services) to business and regulatory processes.

These capabilities will enable insurers to 1) understand climate factors at the security, portfolio and enterprise levels; 2) act on climate analytics and insights through portfolio construction and enterprise risk management and 3) report on climate risk to fulfil regulatory, Board and other stakeholder obligations. Technology will help support insurers as they transition and support the world in its transition to a net zero economy.
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