German Alternative Investor Landscape
Insurance Companies

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German Alternative Investor Landscape - Insurance companies

At the end of last year, the BAI Investor Survey 2021 was published and received wide attention. Now with this publication, we start a sequence of detailed carve-outs about different investor types in the German Alternative Investor Landscape.

Alternative Investments (AI) have become firmly established in insurance companies' portfolios. Currently the average allocation of insurance companies in AI is already 17.9 %. It is generally evident that German insurance companies differ less from other investors than it is the case in the global context. Insurance companies in Germany started earlier with Corporate Private Equity in a global comparison, but have a clear need to catch up in all private debt asset classes. However, insurance companies still have catch-up potential in AI, compared to other investor types, which have an average allocation of 22.7 %.

One of the most important frictions for insurance companies when investing in AI is regulation. Their investment is highly influenced by Solvency II regulation. The review process of the Solvency II regulation of insurance companies is currently underway and the European Parliament is working on a report on the Commission's proposal. Hereby, special attention is also being paid to the discussion on long-term equities. In order to encourage insurance companies to use their equity more strongly for goals such as the creation of a Capital Markets Union, new growth impulses after the Covid 19 pandemic and the achievement of climate neutrality within the framework of the European Green Deal, the Commission wants to create incentives in the form of capital relief.

The planned reforms of the EU Commission for Solvency II include a stronger weighting of sustainability. For this reason, we also look at the role ESG aspects are already playing and which ESG-strategies are being used.

In order to be able to evaluate these proposals more soundly, it is worth taking a closer look at the German insurance company landscape – what role AI plays for insurance companies, which alternative asset classes they invest in, how they may change in Strategic Asset allocation, and how they invest in AI.

In the following we provide a detailed carve-out to the BAI Investor Survey 2021 regarding German insurance companies and answer these questions about how they are invested in AI:

1. Why do insurance companies invest in AI?
2. Which alternative asset classes do insurance companies invest in?
3. Which alternative asset classes show increases or decreases in the number of invested insurance companies?
4. To what extent are insurance companies invested in AI and what are strategic asset allocations?
5. What are the main challenges for insurance companies in AI?
6. Which investment vehicles do insurance companies use for AI investments?
7. What role does ESG play for insurance companies?
8. Which ESG strategies do insurance companies use?

Structure and representation of the participating insurance companies

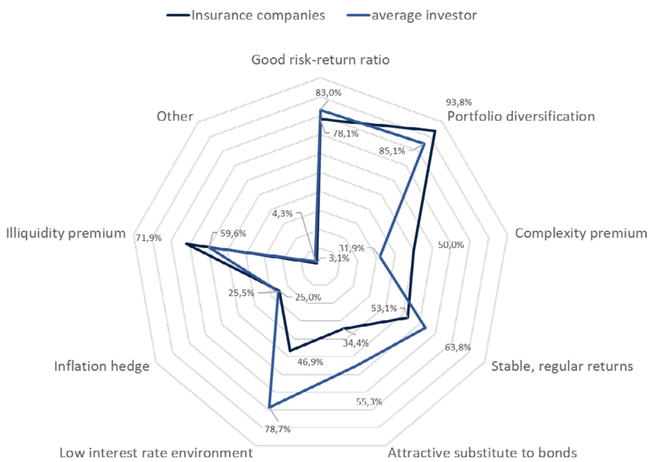
Insurance companies are the largest group in the BAI investor survey with 31%. 90.6 % of the participating insurance groups are regulated under Solvency II, only the minority is regulated under AnIV. The insurance companies surveyed have an average of EUR 41 billion Assets under Management (AuM). However, the participating insurance companies are not evenly distributed - the median is EUR 8.1 billion AuM. The German Insurance Association (GDV) states, that the German insurance industry manages a combined amount of EUR 1,800 billion. To get an appreciation for the size and significance, this number equals about four times the German federal budget, 53 % of the German GDP, and 1.5 times the volume of all investment funds in Germany.[1] Our survey covers around 70 % of the total assets under management of the insurance industry. Therefore, we can claim to have a representative sample of the German insurance sector. The highest share of the participating insurance companies is involved in the life insurance sector (56 %), followed by the health insurance and property and casualty insurance sector (44 % each) and the reinsurance sector (22 %).

1 https://www.gdv.de/de/zahlen-und-fakten/versicherungsbereiche/kapitalanlagen-24114, 01.03.2022

1. Why do insurance companies invest in AI?

AI is attractive to insurance companies for a variety of reasons. The main motivation for insurance companies to engage in AI is portfolio diversification, which 94 % of respondents indicate. The good risk-return ratio (78 %) and the potential illiquidity premium (72 %) are also key. The low interest rate environment (47 %) puts pressure on insurance companies and is motivating AI investments, however with a lower importance relative to other investor types.

Figure 1: Main reasons for insurance companies to invest in AI*



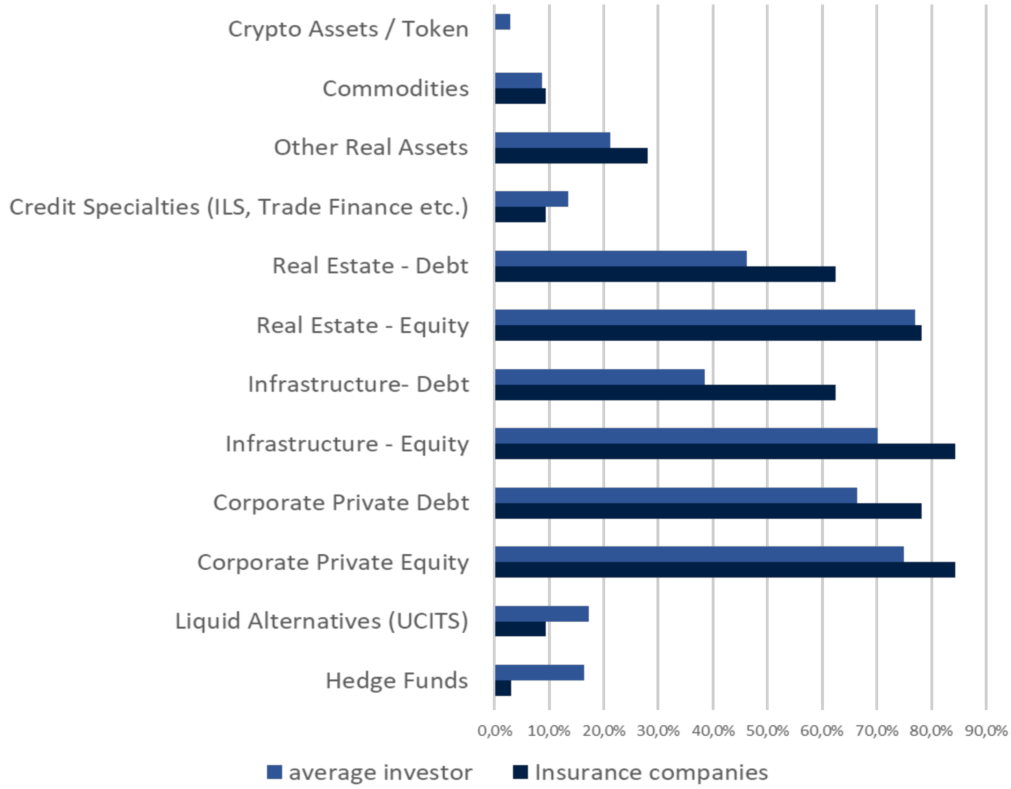
2. Which alternative asset classes do insurance companies invest in?

The relative importance of different alternative asset classes is similar for insurance companies as for the average of all investor types. In line with the average participating investor, insurance companies have the highest participation rates in Corporate Private Equity, Corporate Private Debt, Infrastructure Equity, and Real Estate Equity. In contrast to other investors, the Private Equity, Private Debt and Infrastructure Equity participation rates[2] are significantly higher. Insurance companies still invest disproportionately less in Hedge Funds and Liquid Alternatives.

2 Share of all investors invested in the respective asset classes

* All graphics in this paper are based on the BAI Investor Survey 2021

Figure 2: Participation rates



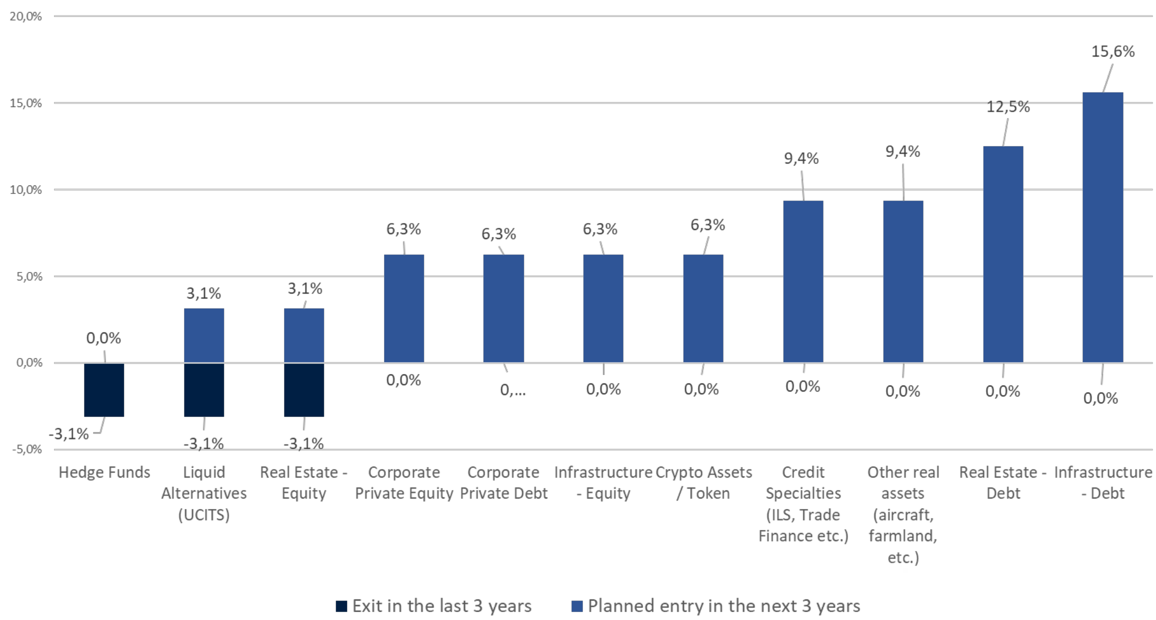
3. Which alternative asset classes show increases or decreases in the number of invested insurance companies?

The only asset class with more insurance companies exiting than entering is Hedge Funds. Liquid Alternatives face an equal number of expected entries and exits. Insurance companies are thus no exception to the flight from Liquid Alternatives and Hedge Fund strategies that can be observed among many investor types. In our view, Hedge Funds and Liquid Alternatives have tended to be neglected by investors in the past, but they continue to be an important portfolio component and, especially in volatile times, we need hedging strategies more than ever. It remains to be seen whether this trend will continue in phases of greater volatility in the liquid markets. Real Estate Equity is another asset class in which the number of invested insurance companies is not expected to increase significantly, since the participation rate is already high.

Although insurance companies are already disproportionately invested, compared to the average investor in Real Estate Debt and Infrastructure Debt, those assets show the highest potential for more investors to enter these assets classes in the next three years. Infrastructure can benefit from the relief for insurance companies under Solvency II regulation in the context of qualified infrastructure[3].

3 compare the BAI information brochure Infrastructure: https://www.bvai.de/fileadmin/Veroeffentlichungen/BAI_Publikationen/BAI_Informationsbroschueren/Informationsbroschuere_Infrastruktur_0122.pdf

Figure 3: Proportion of insurance companies that have exited or plan to enter asset class



4. To what extent are insurance companies invested in AI and what are strategic asset allocations?

Current allocations show that AI have become firmly established in insurance companies portfolios. Currently the average allocation of insurance companies in AI is already 17.9 %. Insurance companies still have catch-up potential compared to other investor types, which have an average allocation of 22.7 %.

The outlook for AI in the German insurance sector is positive, with a projected 2 % increase in strategic asset allocation, the same level of expected increase as the average investor.

The Black Rock insurance report[4] provides insight into the tendencies regarding allocation change of insurance companies across Europe and worldwide and shows that the higher strategic importance of AI follows a global trend. 40 % of European insurance companies say they plan to increase their allocation to AI, and only 15 % plan to reduce it. Globally, the view is not quite as positive, with 33 % aiming for an increase and 20 % for a reduction. It should be noted here that the study lists Hedge Funds separately.

Currently, insurance companies in Germany are invested to the greatest extent in Real Estate Equity (4.8 %). There is a further expected increase in the allocation with an average strategic asset allocation of 5.3 %. The Black Rock insurance report shows that globally real estate equity is gaining importance for insurance companies as well. It is the asset class with the highest percentage of insurance companies planning to increase their allocation in the next 1-2 years (37 % planned increases versus 19 % decreases). The same holds for Europe. Nearly all asset classes show an expected increase in strategic asset allocation.

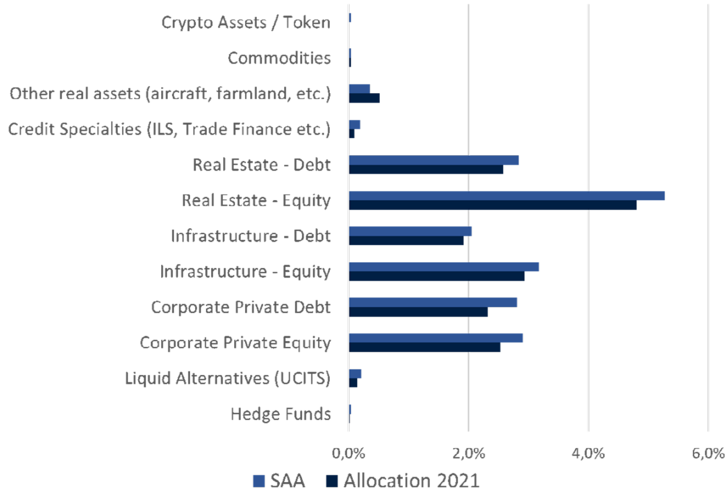
4 https://www.blackrock.com/sg/en/institutional-investors/insights/global-insurance-report-2021

The largest increase in strategic importance is seen among German insurance companies in Corporate Private Debt, with a projected relative increase in allocation of 22 %, from 2.3 %. to 2.8 %. A more detailed look at the sub asset classes to invest in Corporate Private Debt, shows that senior loans (64 %) and unitranche (56 %) dominate.

According to the Black Rock data, the trend of decreasing allocations in Infrastructure Debt is holding internationally too, making it the asset class with the highest percentage of insurance companies planning to decrease their allocations.

It is generally evident that German insurance companies differ less from other investors than it is the case in the global context. One factor that cannot be gleaned from the figures, as they cannot reflect the temporal component, is that the insurance companies in Germany started earlier with Corporate Private Equity in a global comparison, but have a clear need to catch up in all private debt asset classes. This has recently become even more the case in the floating rate segment, especially corporate debt. Higher inflation and rising interest rates play a role here.

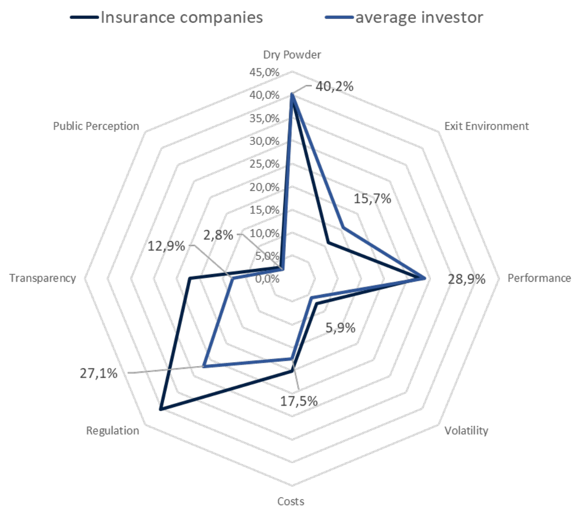
Figure 4: Approximate current allocation and SAA of insurance companies



5. What are the main challenges for insurance companies in AI?

For the most important asset classes from an insurance companies point of view - Corporate Private Equity, Corporate Private Debt, Infrastructure Equity, Infrastructure Debt, Real Estate Equity, and Real Estate Debt - dry powder is cited as the greatest challenge in the upcoming years, roughly on a par with regulation and ahead of the performance. While in general the challenges of insurance companies are very similar to those of the average investor, regulation is mentioned more often, which can possibly be explained by the particular challenge posed by Solvency II regulation.

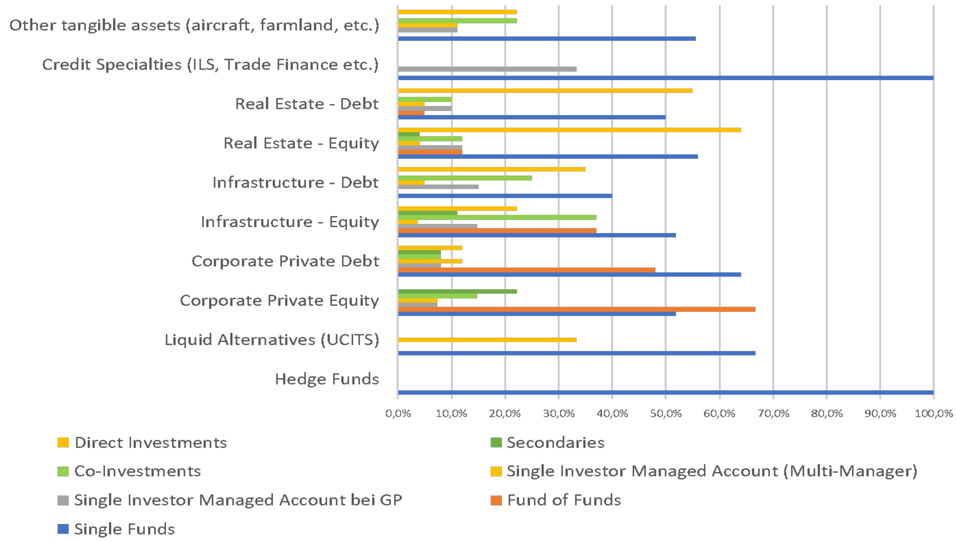
Figure 5: Main challenges in the coming years (Corporate Private Equity/ Private Debt, Infrastructure Equity/ Debt, Real Estate Equity/ Debt)



6. Which investment vehicles do insurance companies use for AI investments?

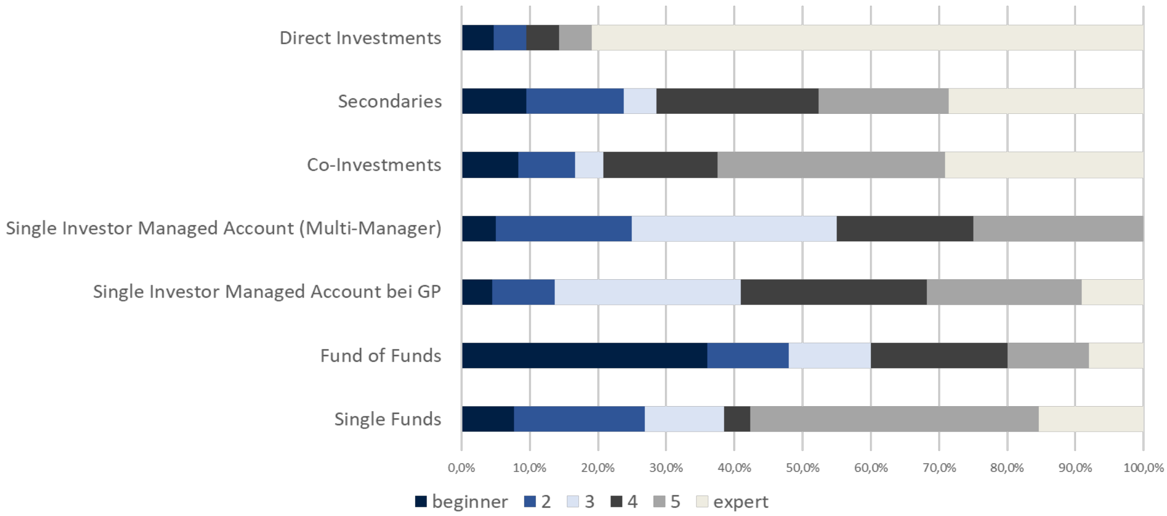
Due to their size, insurance companies have a high level of experience in alternative investments, which enables them to use diverse access channels such as co-investments. The most frequently used access channels differ from asset class to asset class. It should be noted that investments of one insurance company in an asset class can be made via different access channels.

Figure 6: Investment vehicles in AI for insurance companies



Data shows that Fund of Funds are considered the investment vehicle best suited for beginners in AI, while direct investments are considered those requiring the most experience among insurance companies. 28 % of the investors consider themselves as experts and another 34 % give themselves a level of 5 of 6 regarding expertise, while only 3 % consider themselves a newcomer in the AI universe.

Figure 7: Access routes of insurance companies according to necessary level of experience



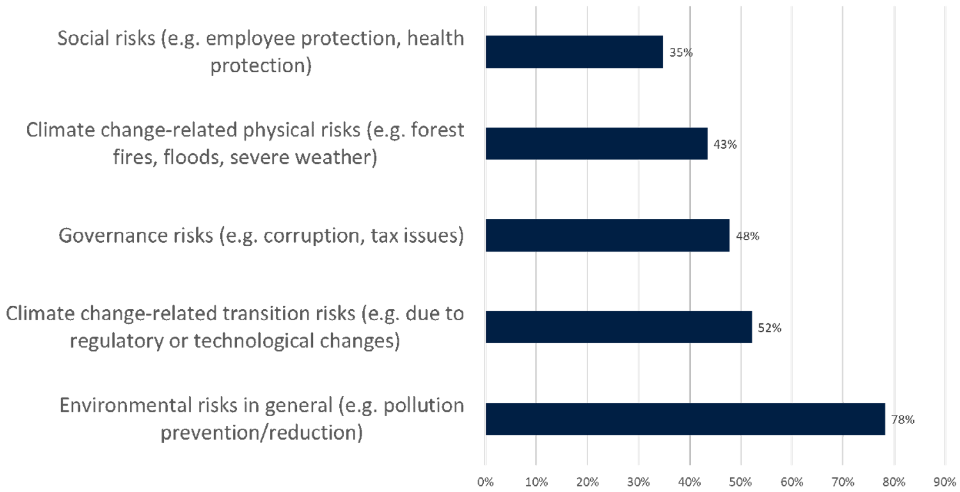
7. What role does ESG play for insurance companies?

ESG plays an increasing role for insurance companies. In the BAI investor survey 2021, 77 % answered they already implemented an ESG strategy in general. According to the BaFin sustainability study[5], however, only about half of the insurance companies surveyed have already reviewed and adjusted their business or risk strategies concerning sustainability risks.

5 https://www.bafin.de/SharedDocs/Veroeffentlichungen/DE/Fachartikel/2022/fa_bj_2201_Nachhaltigkeitsumfrage.html

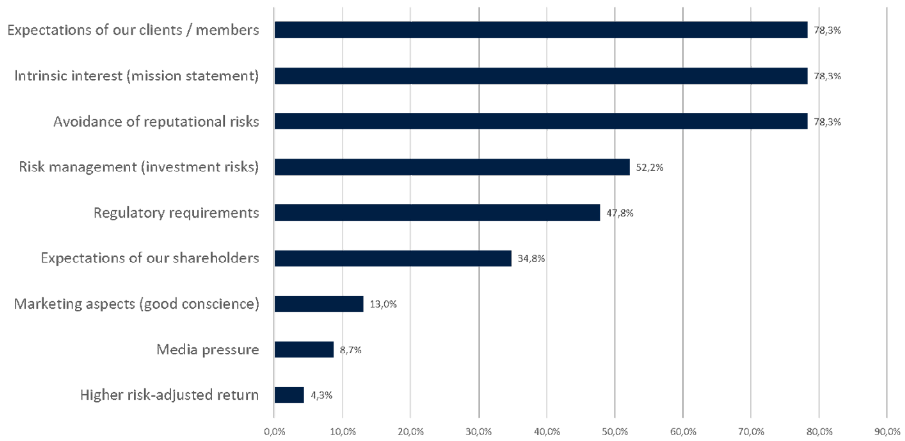
But many of them are in the planning or implementation phase and corresponding projects are underway, which is why a great deal of momentum can be assumed. The focus for German insurance companies lies on environmental topics, with minor importance on governmental and social ones.

Figure 8: Proportion of insurance companies citing factor as biggest ESG risk



Investors in insurance companies state to react on ESG challenges especially by demanding data and new reports on assets (78 %). 57 % call “Greenwashing” a problem and only 35 % see the EU Sustainable Finance Initiative as a possible solution to avoid it.

Figure 9: Reasons to invest in ESG-compliant AI for insurance companies



The main reason to invest in ESG compliant AI for insurance companies are expectations of clients/members, intrinsic interests, and avoidance of reputational risks. The BaFin[6] study on ESG among insurance companies confirms that insurance companies are primarily concerned with identifying and monitoring sustainability risks (98 %) and avoiding reputational damage (97 %). According to the data, although most respondents assume that ESG risks influence all known risk categories, only a very small proportion of this influence is classified as significant. Reputational risk is considered the most material (51 %), followed by market risk (45 %).

6 https://www.bafin.de/SharedDocs/Veroeffentlichungen/DE/Fachartikel/2022/fa_bj_2201_Nachhaltigkeitsumfrage.html

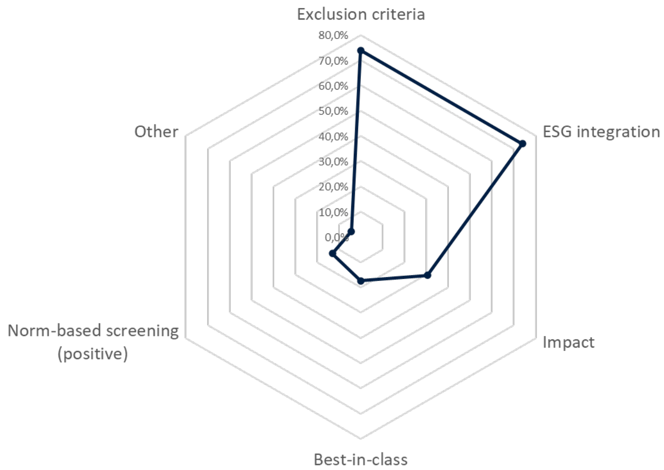
The study further differentiates between individual business areas, showing that investments, especially equities and fixed-income securities, are most often considered to be significantly affected by sustainability risks, with physical and transitory climate risks dominating.

8. Which ESG strategies do insurance companies use?

As ESG strategy, most interviewed investors name the use of exclusion criteria for non-ESG-compliant assets and ESG integration and the attempt to take ESG aspects into account in investment decisions using indicators (74 % each).

The BaFin study undertakes a more granular analysis of ESG strategies among insurance companies. Thus, the so-called "alignment" is mentioned most frequently as a strategic implementation with about 50 %: An orientation of business activities towards political objectives, both to benefit from their promotion and to avoid negative consequences of the implementation of these political objectives. Examples include the Paris Climate Agreement and a decarbonisation pathway. This is followed as a strategic design by targeted „engagement", which entails an active influence of investors on corporate decision-making processes.

Figure 10: ESG strategies among insurance companies



Quellen:
1) BAI Investor Survey 2021
2) Black Rock 2021 Global Insurance Report
3) BaFin Bericht Nachhaltigkeit in der deutschen Versicherungswirtschaft
4) Gesamtverband der Deutschen Versicherungswirtschaft

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