# APAC Insurance Investment Landscape

## Current challenges and future priorities

April 2023

abrdn

QUINLAN & ASSOCIATES

# Foreword

2022 was a challenging year for the global investment community, with investors facing a plethora of headwinds on a number of fronts, including rising inflation, declining asset prices, and heightened geopolitical tensions. And insurance companies, as major institutional investors, were by no means immune to these developments, prompting many firms to revisit their investment strategies.

Against this backdrop, insurers are also looking to tackle – and capitalise on – various industry-specific issues, including risk-based capital obligations, IFRS 9 / 17, ESG / net-zero integration, as well as delivering on their broader digital transformation efforts.

In light of these developments, Quinlan & Associates is proud to partner with abrdn to release our inaugural *APAC Insurance Investment Landscape*, exploring the key challenges and opportunities facing insurers' investment teams in the region.

We are pleased to present the findings of our 2023 *APAC Insurance Investment Landscape* with consulting firm Quinlan & Associates. The report offers insights into how insurers in Asia Pacific are seeking to optimise their investments and risk management against a backdrop of major regulatory change.

Given our nearly 200-year history and heritage as an insurer ourselves, before the firm transitioned into an independent asset manager in 2018, we believe abrdn is uniquely positioned as a partner to insurers. From accounting standards to capital management and regulatory reporting, we know that investing for insurers is about more than just investing.

In an increasingly complex operating environment, these survey findings will help us to adapt our solutions to meet Asian insurers' evolving needs. We trust you find our insights useful.

**Benjamin Quinlan**
CEO & Managing Partner
**Quinlan & Associates**

**Rene Buehlmann**
CEO
**abrdn Asia Pacific**

# Executive summary

## Survey methodology

In order to better understand the priorities of – and challenges facing – APAC insurers with respect to their investment strategies, we surveyed 56 senior executives across 43 insurance companies covering 8 markets, including Hong Kong, Singapore, Australia, South Korea, Thailand, Malaysia, Taiwan, and Mainland China. Respondent profiles consisted of both regional and local CEOs, CIOs, CROs, Heads of Investment, Heads of Risk, and various other department heads.

# Executive summary

## Key findings & recommendations

Our survey questions focused on 6 overarching topics related to insurers' current and future investment strategies, including: (1) regulatory adoption; (2) ESG / net-zero; (3) investment strategy; (4) hedging strategy; (5) investment-linked product ("ILP") business; and (6) external partnerships.

### 1. Regulatory adoption

The implementation of IFRS 9 / 17 and RBC regulations ranks at the top of APAC insurers' priority lists. However, most respondents said they were encountering difficulties in adopting – and optimising their businesses for – these regulations. We see considerable scope for insurers to conduct scenario analysis in order to better understand the implications of IFRS 9 / 17 on their existing financial reporting practices, while addressing challenges associated with RBC optimisation by developing a robust optimisation framework and instituting appropriate regulatory initiatives (e.g. matching adjustment)

### 2. ESG / net-zero

Regulatory expectations and reputational / branding considerations play crucial roles in driving insurers' ESG / net-zero integration efforts. However, challenges around data quality and converting ESG / net-zero considerations into clear investment strategies remain key implementation barriers. To address this, we believe insurers must develop a proactive ESG data strategy from the ground up while enhancing their end-to-end ESG investment capabilities. This can be done either in-house or by leveraging the capabilities of third-party ESG specialists, making ESG a true point of strategic differentiation for insurers who embrace it (vs. being a "regulatory box ticking" exercise for the rest)

### 3. Investment strategies

Most APAC insurers intend to increase their investment allocations to private assets (e.g. private credit / equity) and international markets in the coming years at the expense of both public equities and digital assets. In addition to engaging the expertise of specialised managers, we believe insurers' investment processes will need to incorporate additional insurance-specific considerations (e.g. RBC risk charge, liability matching, asset classifications under IFRS 9, etc.) to deliver more capital-efficient returns

### 4. Hedging strategies

Many insurers are struggling to implement effective hedging strategies due to high costs and limited availability of hedging instruments. Given the volatile market environment, we believe there is greater scope for insurers to further optimise their hedging strategies based on their individual risk profiles, asset & liability positions, and internal capabilities, including engaging external partners who are capable of structuring highly tailored hedging solutions

### 5. Investment-linked product ("ILP") business

ILPs remain a key focus area for many insurers. However, there is a recognition by most respondents that designing an appropriate advisory model and digitalising the ILP value chain are needed in order to unlock the full potential of ILPs. In addition to exploring the strategic, operational, and financial business case for different ILP advisory models, we believe APAC insurers will need to invest considerable time and resources in upskilling their agent workforce (i.e. both technical and soft-skill training) to more effectively pitch ILPs to end customers, given the importance of agents in driving product distribution in Asia

### 6. External partnerships

Given the various challenges facing APAC insurers, a number of firms are outsourcing parts of their investment operations to external partners, particularly ESG integration, investment execution, and hedging, with key selection criteria being a partners' brand / reputation and performance track record. We see scope for insurers to more holistically review the business case for outsourcing across their entire investment value chain. We believe this will be critical in allowing each firm to focus on delivering its core value proposition(s) in-house, while addressing potential roadblocks in a faster, more cost-efficient, and scalable manner with external partners

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Section 1

# Survey overview

## Respondent demographics

### Summary

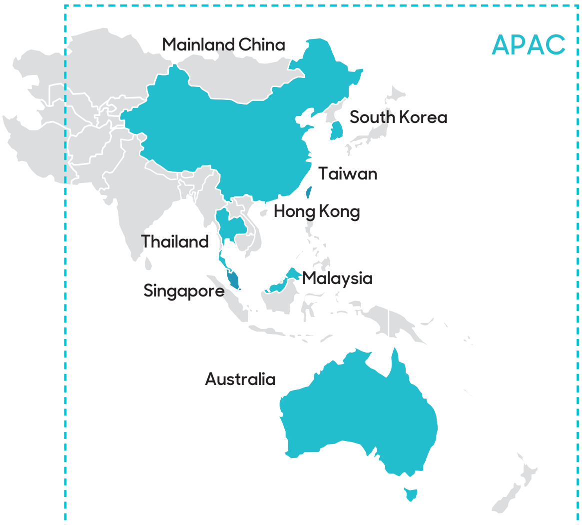
- Amidst a backdrop of heightened geopolitical turbulence, regulatory pressure, and macroeconomic uncertainty, the investment landscape is becoming increasingly challenging for industry participants to navigate, including insurers
- To this end, we sought to get a better understanding of the priorities, challenges, and focus areas of insurance companies in Asia Pacific ("APAC") in the coming years via a detailed survey with senior insurance executives in the region
- We surveyed 56 senior executives across 43 insurance companies covering 8 markets. Respondent profiles consisted of:

| 21 | 13 | 22 |
|---|---|---|
| 21 C-suite executives, including 5 CIOs, 6 CROs, and 5 CEOs | 13 Heads of Departments, including 5 Heads of Investments and 4 Heads of Risk | 22 other senior-management executives |

**We surveyed 56 senior executives from 43 insurers across 8 jurisdictions in the APAC region, with a focus on risk-/ investment-related executives**

**Respondent Profiles**

Share of markets covered by respondents, %




Hong Kong | **21%**

Singapore | **18%**

Mainland China | **14%**

Malaysia | **13%**

Thailand | **12%**

Australia | **8%**

Taiwan | **8%**

South Korea | **7%**

### Insurance companies

**43** 43 insurance companies across 8 jurisdictions in APAC participated in the survey

### Professionals

**56** Within the 43 insurance companies, 56 professionals shared insights on their insurance investment practices

**Risk-related professionals:**
6 Chief Risk Officers
1 Chief Financial Officer
4 Heads of Risk Management

**Investment-related professionals:**
5 Chief Investment Officers
5 Heads of Investment
5 Senior Investment Managers

**Other professionals:**
5 Chief Executive Officers
4 Other C-Suite Executives
4 Other Heads of Departments
17 Other Senior Executives

Source: abrdn and Quinlan & Associates analysis

# Survey topics covered

**Summary**

- To better understand the priorities of – and challenges facing – APAC insurers, we broke our survey questions down into 6 overarching categories, covering key topics related to their current and future investment strategies
- The 6 topics relate to every detailed aspect of insurers' current and future investment strategies, ranging from regulatory adoption to ESG / net-zero and external partnerships

## Our survey questions covered 6 key topics related to the current and future investment strategies of APAC insurers

**Topics covered**
Overview

| | Category | Coverage |
| --- | --- | --- |
| 1 | **Regulatory adoption** How will respondents optimise investment and risk operations with upcoming regulatory requirements? | · RBC[1] regulations (including matching adjustment portfolio for HK & SG insurers)<br>· IFRS 9 / 17 adoption |
| 2 | **ESG[2] / Net-zero** What are the motivations and challenges that insurers encounter along their ESG integration journey? | · ESG regulatory outlook<br>· Integration motivations<br>· ESG / Net-zero challenges |
| 3 | **Investment strategy** What are insurers' preferred asset classes and markets over the next 3 years and why? | · Asset allocation plans<br>· Decision factors for investments<br>· Market preferences |
| 4 | **Hedging strategy** What are the current practices, key focus areas, and current challenges of different hedging strategies? | · Currency / Interest rate risk hedging practices<br>· Hedging strategy challenges |
| 5 | **ILP business[3]** What challenges face insurers in their ILP business and to what extent is the business being digitalised? | · ILP business outlook<br>· ILP challenges<br>· Level of digitalisation across ILP value chain |
| 6 | **External partnerships** Which initiatives do insurers want to address through partnerships, and what are the deciding factors? | · Operation model preferences<br>· Partnership consideration factors |

Note: [1]Risk-Based Capital; [2]Environmental, Social and Governance; [3]Investment-Linked Products
Source: abrdn and Quinlan & Associates analysis

Section 2
# Survey findings

Section 2

# Survey findings

## Key takeaways

We have summarised the key takeaways of our survey findings below

| | | Motivations / Expectations | Description | Key gaps identified |
|---|---|---|---|---|
| 1 | REGULATORY ADOPTION | Looking to actively adopt as the highest priority of insurers | · 91% and 71% of respondents consider adopting IFRS 9 / 17 and RBC as either high or very high priorities, respectively<br>· 89% of respondents plan to adopt (or have adopted) a certain level of optimisation to manage their capital risk charges (i.e. SAA-level or both SAA-and security-level), although two-thirds of respondents find this to be difficult<br>· 36% of respondents plan to elect more investments under amortised cost or other comprehensive income, while half have not yet made a decision under IFRS 9 / 17 | Lack of clarity around managing regulatory impact, with slow progress on implementation<br>●●●●○ |
| 2 | ESG & NET-ZERO | Passively motivated by local ESG regulatory developments | · 62% of respondents expect regulators to more strictly enforce ESG regulations, especially those in Australia, Malaysia, Hong Kong, and Mainland China<br>· Over 70% of respondents say that one of their key motivations to integrate ESG is stricter regulatory expectations, though branding and reputation are seen as more crucial motivations<br>· Despite this, 30% of respondents have not yet started to integrate ESG (50% for net-zero), citing challenges around data quality and investment conversion | Low urgency, with a notable lag in ESG integration efforts, hampered by poor data quality<br>●●●●● |
| 3 | INVESTMENT STRATEGY | Seeking yield enhancement while more sensitive to risks | · Around 40% of respondents plan to allocate more investments to private debt and private equity, with 33% planning to decrease their investments in equities<br>· Insurers prioritise investment risks and liability duration / cash flow matching when deciding on their investment strategy, followed by solvency risks<br>· While 73% of respondents plan to allocate more assets towards international markets, other insurers prefer domestic (mainly due to regulations) | Better capabilities in private and global markets needed to guide future asset allocation strategy<br>●●○○○ |
| 4 | HEDGING STRATEGY | More complex risk management that is challenging to address | · Many respondents find embedded option hedging the most difficult to implement, followed by credit risk hedging, while currency hedging is seen as relatively easy<br>· Among the respondents who do hedge currency risks, 64% partially hedge based on liabilities, where investment experts have discretion, and for interest rate risk, more than half directly match asset-liability duration as closely as possible<br>· The major challenges in implementing hedging strategies are costs and limited choices of hedging instruments | Gaps in implementing hedging strategy, given high hedging costs and limited instruments<br>●●●○○ |
| 5 | ILP BUSINESS | Key expansion focus, with plans to digitalise client engagement | · With ongoing global convergence between insurance and wealth (i.e. "wealthcare"), 65% of respondents are very likely / likely to expand their ILP business, particularly insurers in Thailand, Korea, and Malaysia<br>· Nearly 50% of respondents consider creating an appropriate ILP fund advisory model to be a major challenge that they are looking to address<br>· Insurers prioritise digitalising client functions due to low digitalisation levels across the ILP value chain | Low digitalisation levels across the ILP value chain, with an urgent need for agent upskilling<br>●●●●● |
| 6 | EXTERNAL PARTNERSHIPS | Focus on performance and reputation in specific niches | · Many surveyed insurers are planning to outsource their ESG integration, investment execution, as well as hedging strategies to external partners / third-party experts, in order to address their challenges more efficiently<br>· 96% of surveyed insurers believe that brand / reputation and performance track record are very important or important factors to consider when they are selecting outsourcing partners, while independence is not a concern | Heavy reliance on in-housing efforts, with scope to better leverage external partners<br>●●●○○ |

**Magnitude of gap:** Low ●●●○○ High

## Section 2-1

# Overall priorites

### Initiative prioritisation

**Objective(s)**

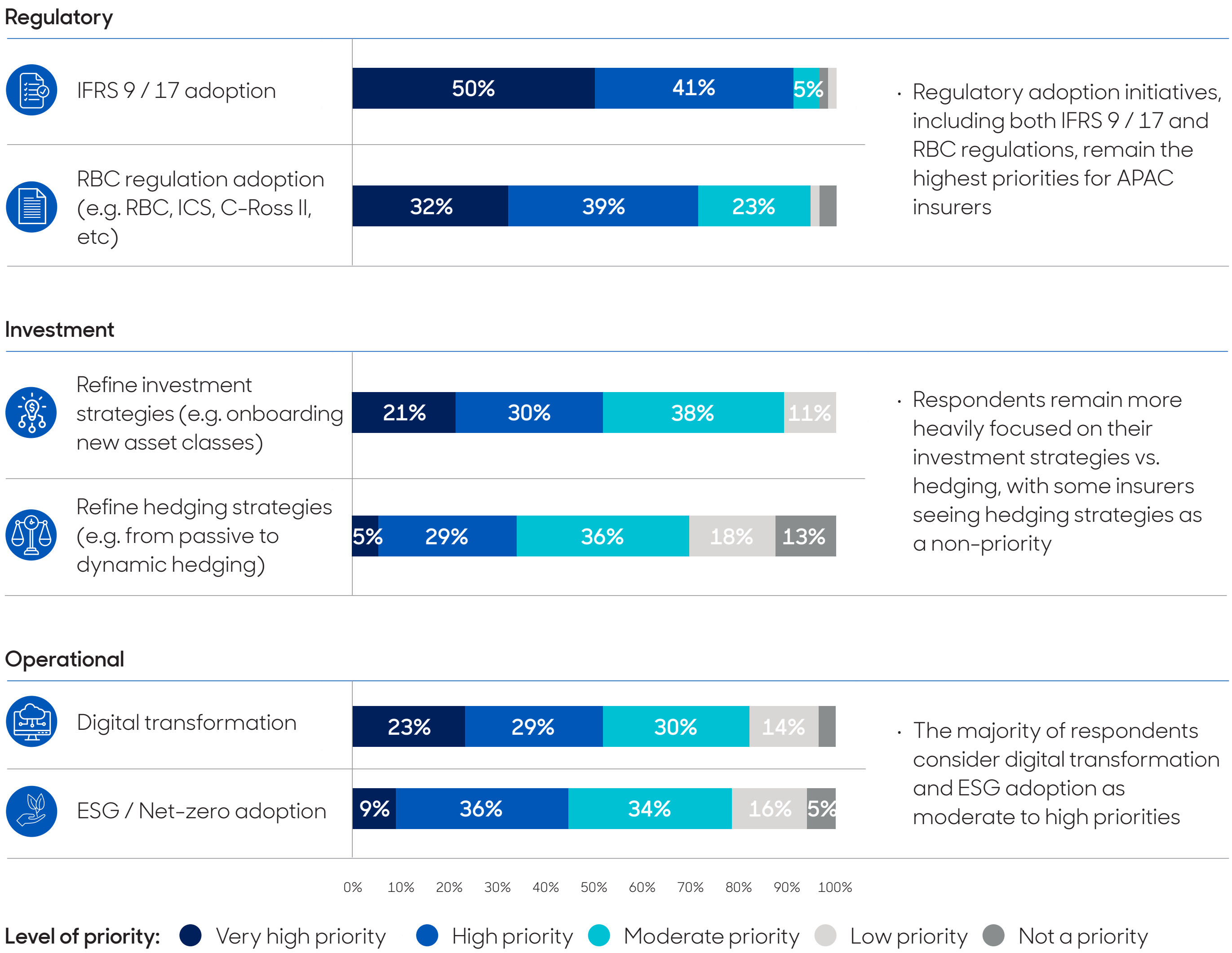
- Faced with new regulatory requirements, an uncertain economic outlook, and fast- changing stakeholder expectations, we wanted to understand the key overall priorities of APAC insurers in 2023

**Key takeaway(s)**

- Over 90% of respondents consider IFRS 9 / 17 adoption to be amongst their highest priorities, while RBC regulation adoption considered to be a very high / high priority by more than 70% of insurers
- More than half of the insurance executives surveyed perceive investment strategies and digital transformation as very high / high priorities for 2023
- APAC insurers tend to place relatively less priority on the refinement of their hedging strategies and the adoption of ESG / net-zero

## APAC insurers view regulatory adoption (e.g. RBC, IFRS 9 / 17) as their highest priority focus area, followed by refining their investment strategies

**Prioritisation of initiatives**
Value alignment, % of respondents*




- Regulatory adoption initiatives, including both IFRS 9 / 17 and RBC regulations, remain the highest priorities for APAC insurers
- Respondents remain more heavily focused on their investment strategies vs. hedging, with some insurers seeing hedging strategies as a non-priority
- The majority of respondents consider digital transformation and ESG adoption as moderate to high priorities

Note: *Percentage values in this survey may not add up to 100% due to rounding
Source: abrdn and Quinlan & Associates analysis

Section 2-2

# Regulatory adoption

## Regulatory overview

### Summary

- Issued in 2014 and 2017 respectively, IFRS 9 and 17 provide guidance on how insurers should classify and measure financial assets and liabilities, helping to improve financial reporting transparency, comparability between global insurers, as well as capital and risk management visibility
- In 2018, Ping An Insurance was the first insurer in Mainland China to implement IFRS 9, which led to a higher proportion of investments being classified as Fair Value Through Profit or Loss ("FVTPL") and increased susceptibility to market fluctuation. This amplified the volatility of Ping An's investment returns in 2018, when both equity and bond markets declined

## Although IFRS 9 / 17 aims to improve transparency in risk management, APAC insurers must carefully consider adoption implications

**IFRS 9 / 17 overview**
Timeline & expected benefits

| Timeline | | Expected benefits |
|---|---|---|
| 2014 IFRS 9 ISSUANCE | 1 | **Improved transparency** Additional metrics and balance sheet items in IFRS 9 / 17 help improve the transparency of insurers' financial statements |
| 2017 IFRS 17 ISSUANCE | 2 | **Optimised capital management** IFRS 9 / 17 guides insurers to account for financial instruments and improve risk management and transparency / consistency |
| 2018 IFRS 9 EFFECTIVE | 3 | **Better risk management** IFRS 9 / 17 adoption better reflects market risks and interest rate impacts, hence insurers can better align risk management strategies |
| 2021 IFRS 17 EFFECTIVE | 4 | **Enhanced comparability** With a common set of reporting standards and valuation principles for global insurers, comparability across the industry is enhanced |

**Case study**
Ping An Insurance[1], Mainland China

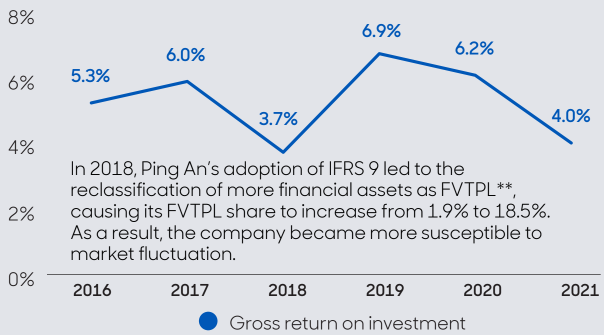
中国平安 PING AN

Ping An Insurance, one of the largest insurance companies globally, is headquartered in Shenzhen and listed on Shanghai Stock Exchange

**IFRS 9 adoption**
Overview

**Initiative**
In 2018, Ping An became the first insurer in Mainland China to adopt IFRS 9, while other Chinese insurers did not implement the standard until 2021

**Impact**
Given the reclassification of OCI[2], Ping An changed its investment strategy, with greater allocations to large long-term equity investments




Note: [1]Company selected for illustrative purposes only to demonstrate the investment management style described herein and not as an investment recommendation or indication of future performance; [2]Other Comprehensive Income
Source: © Ping An Insurance, KPMG, Allianz, Sina, Yicai, Quinlan & Associates analysis

## IFRS 9 / 17 asset election

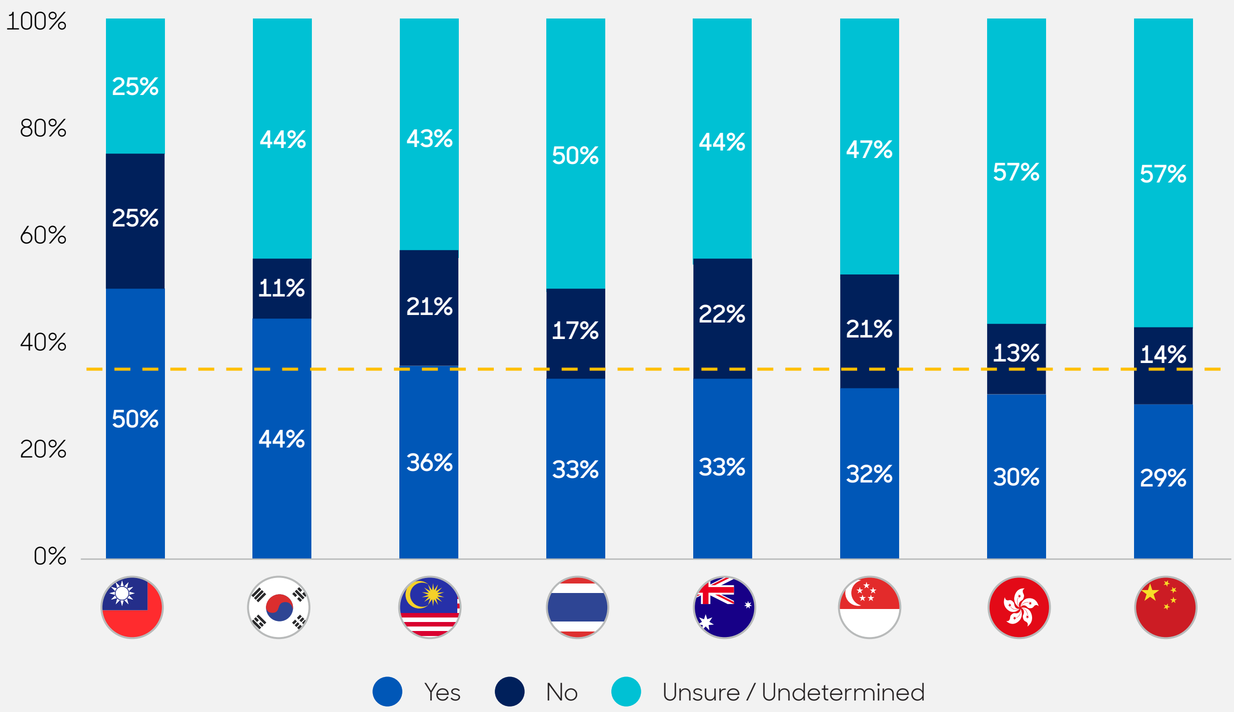
**Objective(s)**

- As IFRS 9 and 17 allow insurers to elect classification and measurement options for their assets and liabilities, we wanted to understand whether insurers plan to elect more investment assets under Amortised Cost or Other Comprehensive Income ("OCI")

**Key takeaway(s)**

- 36% of insurers in APAC plan to elect more investment assets under IFRS 9 / 17 regulations, while more than half of the surveyed insurers are yet to arrive at a determination
- While nearly half of all surveyed from Taiwan and South Korean insurers plan to reclassify investments under amortised cost or OCI, insurers from Hong Kong and Mainland China appear to be progressing quite slowly on this decision

**Insurers' plan of IFRS 9 / 17 election of investment assets**
% of respondents




**36%** of APAC insurers surveyed, on average, plan to reclassify their investment assets under Amortised Cost or OCI

Source: abrdn and Quinlan & Associates analysis

## Capital risk optimisation

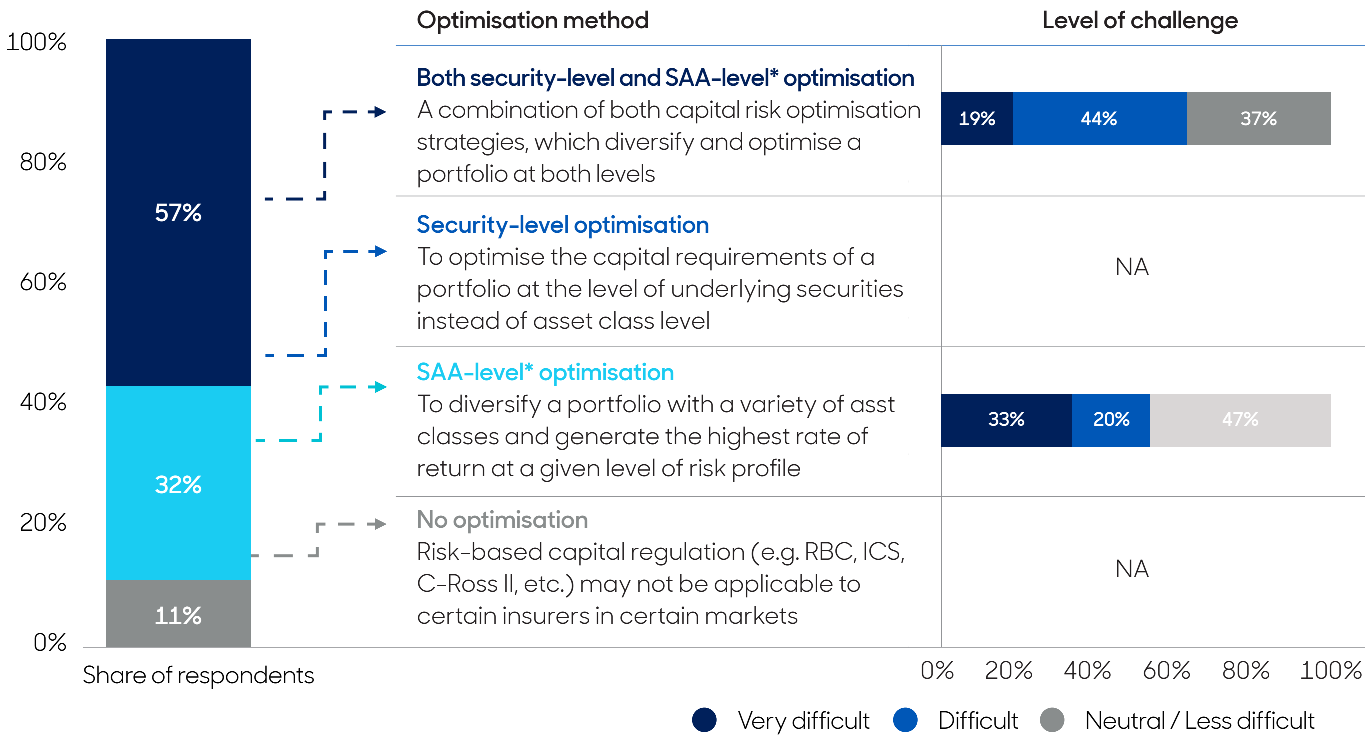
### Objective(s)

- In consideration of asset / market risk capital requirements, we wanted to know at which level insurers intend to optimise their investment portfolios (i.e. whether security-level or SAA-level* optimisation is preferred), as well as how challenging this is

### Key takeaway(s)

- Over half of the APAC insurers surveyed plan to adopt (or have adopted) both security-level and SAA-level optimisation to manage their capital risks, while around one-third prefer to optimise at only the SAA level
- 63% of insurers who are adopting both security-level and SAA-level optimisation consider it very difficult / difficult to implement

**Capital risk optimisation**
% of respondents




**89%** of respondents plan to adopt (or have adopted) a certain level of optimisation; however, the majority find this to be challenging

Note: *Strategic asset allocation
Source: abrdn and Quinlan & Associates analysis

## Matching adjustment

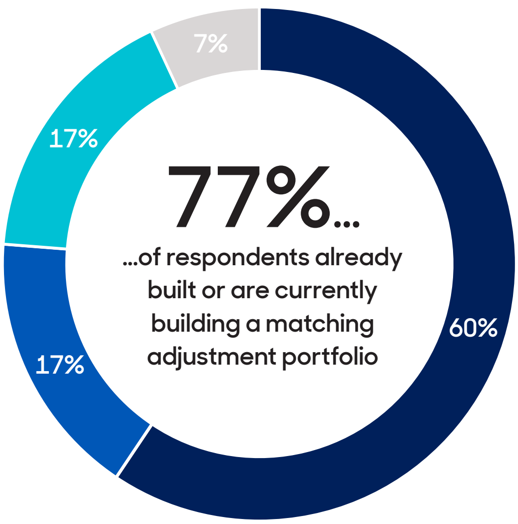
### Objective(s)

- We wished to understand the progress made by insurers in Hong Kong and Singapore with regard to building a matching adjustment portfolio, as well as the challenges that they are encountering in the process

### Key takeaway(s)

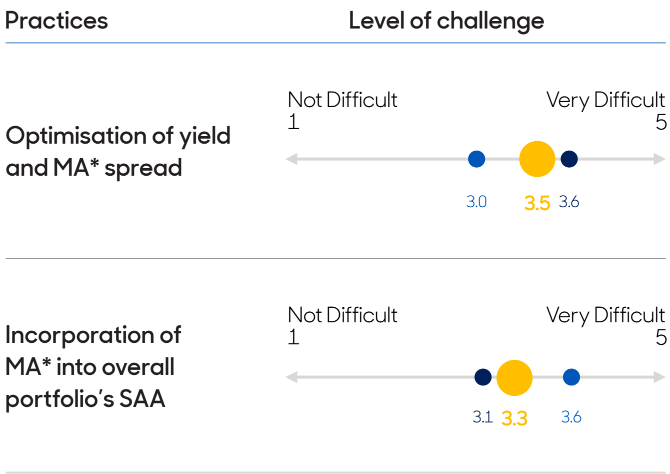
- 60% of insurers in Hong Kong and Singapore have already built a matching adjustment portfolio, while 17% are currently in the process of doing so, and another 17% are still in the planning phase
- For insurers who have already built MA portfolios, optimisation of yield and MA spread is proving to be challenging
- On the other hand, for insurers who are still building up their MA portfolios, incorporating MA* into their overall portfolio's SAA is seen as difficult to implement

**Matching adjustment portfolio progress & challenges**
% of respondents, average rating, Hong Kong & Singapore




Already built
Building in progress
Planning to build
Not planning to build

**SAA integration is a major challenge for insurers who are still building MA portfolios, while for those who have already built the portfolio, optimisation of yield and MA spread appears to be a challenge**




Average
Insurers who already built MA portfolios
Insurers who are still building MA portfolios in progress

Note: *Matching adjustment
Source: abrdn and Quinlan & Associates analysis

Section 2-3

# ESG / Net-zero

## ESG trends in insurance

### Summary

- In recent years, regulators in APAC have set out rapidly evolving expectations on ESG integration requirements for regional insurers, focusing in particular on environmental initiatives (e.g. net-zero), as well as risk management strategies
- In response, leading insurers in APAC have started to align their ESG integration and disclosure initiatives with global standards, with a growing number signing the UN Principles for Sustainable Insurance ("PSI')
- Taking QBE as an example, the insurer has launched and promoted an investment product, named *Premiums4Good*, which allows customers to contribute their premiums to the firms' impact investing portfolio, specialising in social / green bonds, as well as sustainable infrastructure projects

## With the rapid development of ESG regulations in APAC, insurers are incorporating ESG considerations into their operations and investments

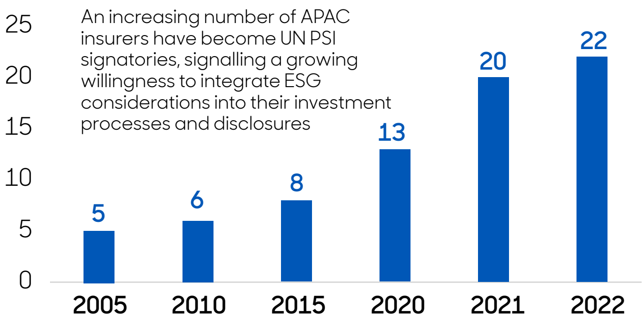
**ESG regulation developments for insurers in APAC**
Select examples

**Guidelines on environmental risk management for insurers**
Issued in 2020, the Guidelines for Insurers set out the regulator's expectations on environmental risk management for all insurers

**Suggested disclosures of ESG risks in insurers' investments**
In a discussion with FSDC in 2020, The Insurance Authority encouraged authorised insurers to publish and explain their ESG risks considerations in investments

**Green finance guidelines for the insurers**
In 2022, CBIRC[1] issued guidelines that insurers should ultimately achieve carbon neutrality in their portfolios while simultaneously disclosing ESG risks

**No. of UN PSI[2] signatories in APAC**
# of insurance companies, 2005-22



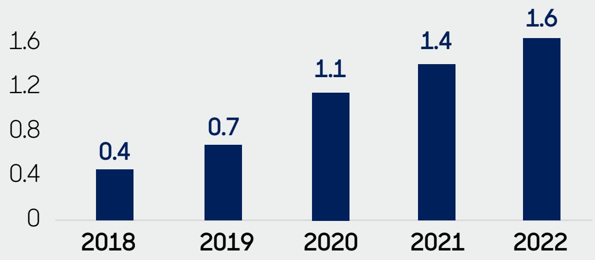

**Case study**
QBE[3], Australia

QBE Insurance Group is a leading general insurance and reinsurance company headquartered in Sydney and listed on the Australian Securities Exchange

**Premiums4Good investment**
Overview, Product AuM Size in USD Billions, 2018-22

**Investment product overview**
Customers can choose to contribute and allocate their premiums to the *Premiums4Good* portfolio, which is dedicated to impact investing

**Portfolio construction**
Multiple asset classes, including social impact bonds, green bonds, initiatives / projects (e.g. renewable energy initiatives, sustainable infrastructure), etc.




Note: [1]China Banking and Insurance Regulatory Commission; [2]United Nations Environment Programme Finance Initiative – Principles for Sustainable Insurance; [3]Company selected for illustrative purposes only to demonstrate the investment management style described herein and not as an investment recommendation or indication of future performance
Source: © QBE, UNEP, MAS, Financial Services Development Council, Green Finance & Development Centre, Quinlan & Associates analysis

## ESG regulation expectations

**Objective(s)**

- We wanted to gauge APAC insurers' expectations of the local ESG / net-zero regulatory enforcement outlook in the coming 3 years

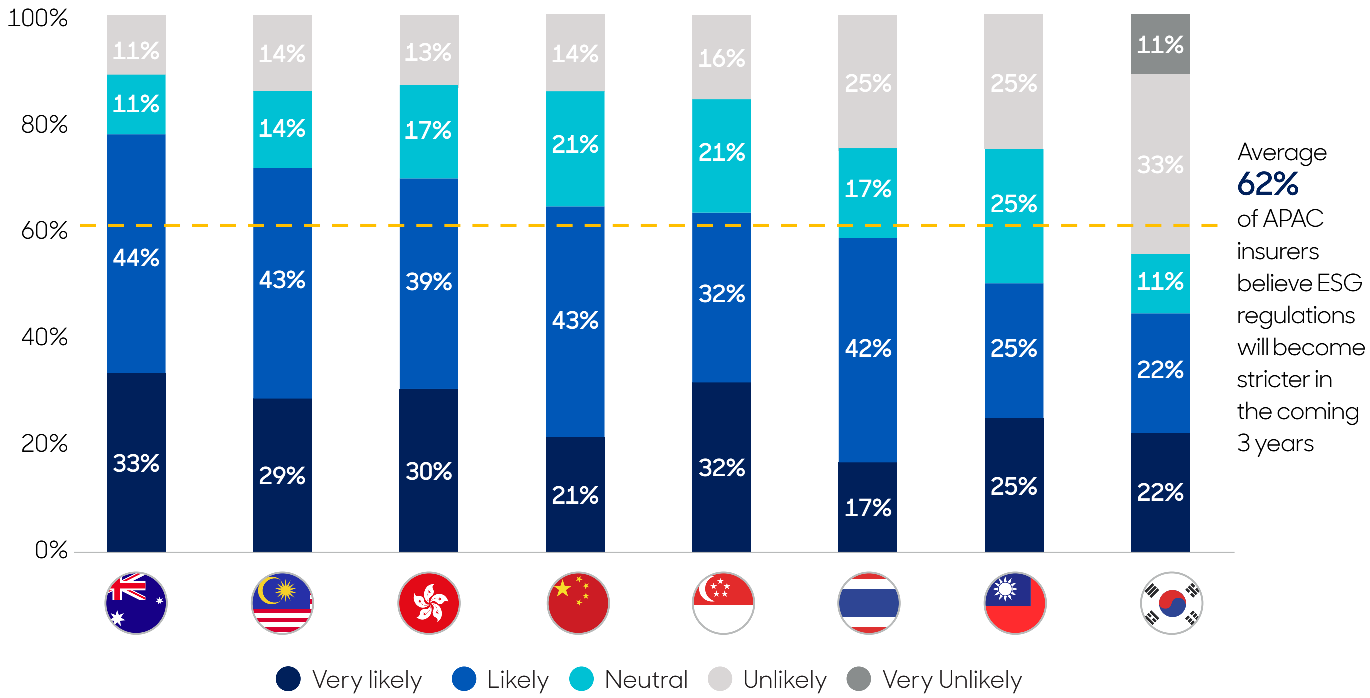
**Key takeaway(s)**

- The majority of insurers in Australia (77%), Malaysia (72%), and Hong Kong (69%) expect regulators to more strictly enforce ESG / net zero regulations, whereas only about 50% of insurers in Taiwan and South Korea see stricter enforcement as likely

### Most APAC insurers believe local ESG regulations will be further enforced in the coming 3 years, especially in Australia, Malaysia and Hong Kong

**ESG regulation enforcement expectations**

% of respondents, 3-Year period




Note: as some respondents have regional roles (e.g. APAC CEO, North Asia CIO), their survey responses covered multiple jurisdictions

Source: abrdn and Quinlan & Associates analysis

## ESG integration (1/2) – Motivations

### Objective(s)

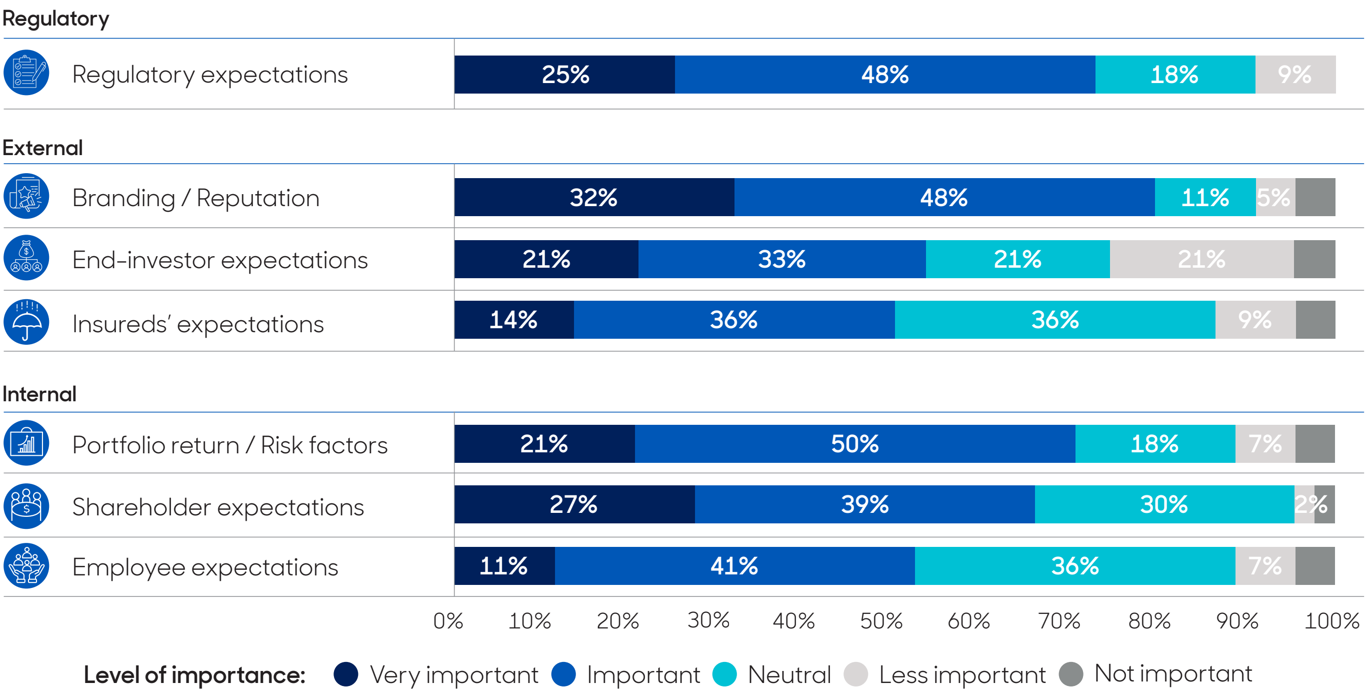
- We wanted to get a better understanding of the most important motivations that APAC insurers have for integrating ESG into their investment operations, including regulatory, as well as various external and internal motivations

## Insurers are highly motivated by regulatory, as well as branding / reputation and portfolio return / risk factors, to integrate ESG

### Key takeaway(s)

- Over 70% of insurers consider regulatory expectations to be very important or important, but their branding and reputation to be even more crucial motivations, for integrating ESG
- Amongst external stakeholders, the expectations of end-investors are considered to be marginally more important than those of customers (i.e. insureds)
- When it comes to internal factors, portfolio return and risk factors are being prioritised, with employee expectations being the least important driver of ESG integration

**Motivations for ESG integration**
Level of importance, % of respondents




Source: abrdn and Quinlan & Associates analysis

## ESG integration (2/2) – Challenges

**Objective(s)**

- We wished to understand the degree to which insurers have already integrated ESG / net-zero into their investment strategies, as well as identify the hurdles insurers are facing when doing so

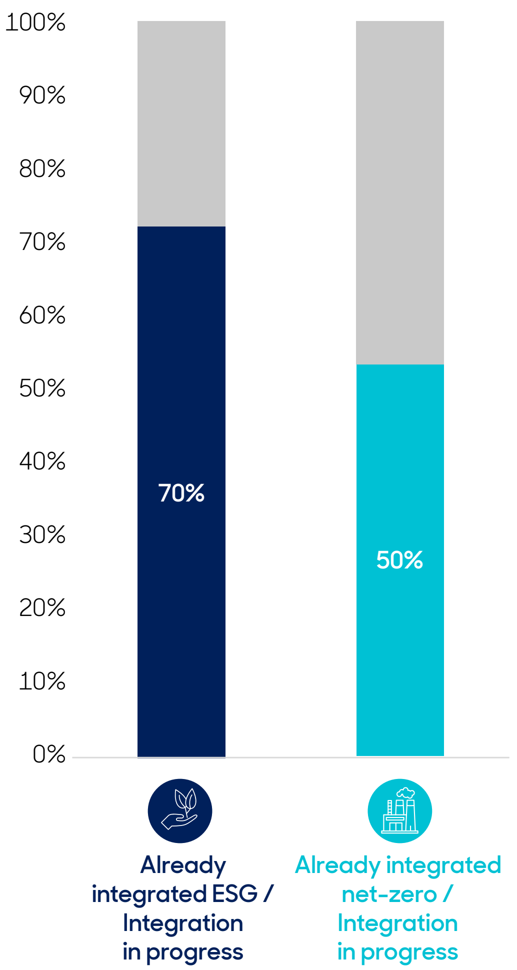
# 30% / 50%

**of insurers have not yet started to integrate ESG / net-zero, with data quality and investment management being major roadblocks**

**Key takeaway(s)**

- 70% of APAC insurers have either already integrated ESG into their investment strategies or are in the progress of doing so, compared to 50% for net-zero integration
- The largest integration barrier for both ESG and net-zero is data quality, followed by investment management, which are the starting points of the entire integration value chain

**ESG / Net-zero integration in investment strategy**
% of respondents




**ESG / Net-zero integration difficulty**
% of insures who rate "Very difficult" / "Difficult"

| Integration barriers | ESG | Net-zero |
|---|---|---|
| **Data quality** (e.g. lack of data availability, inconsistent methodologies, etc.) | 81% | 78% |
| **Investment management** (e.g. incorporating ESG factors into SAA or security valuation, etc.) | 51% | 57% |
| **Stakeholder management** (e.g. meeting investor expectations, actively engaging with investees, etc.) | 30% | 44% |
| **Regulatory reporting** (e.g. ESG-related reporting / disclosures, etc.) | 35% | 35% |
| **Governance** (e.g. developing ESG governance frameworks and policies, etc.) | 37% | 17% |

Rank 1st  Rank 2nd  Others

**With data quality a pre-requisite to robust ESG integration, which insurers consider very difficult, many ESG steps are "on hold" by insurers in the region**

Source: abrdn and Quinlan & Associates analysis

# Section 2-4

# Investment strategy

## APAC investment landscape

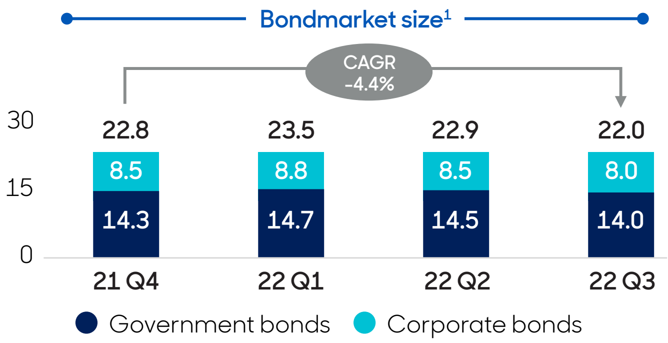

**Summary**

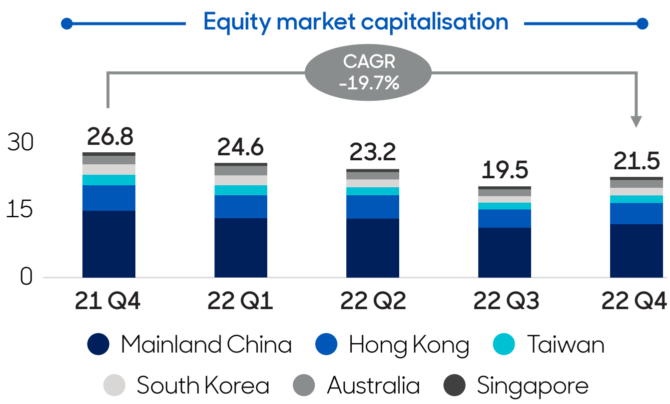
- APAC equity and bond valuations fell markedly in 2022, creating additional challenges with respect to insurers' investment and risk management strategies
- As a result, a growing number of APAC insurers, taking AXA Hong Kong as an example, are increasing their portfolio allocations to alternative investments, especially in an environment when interest rates are hiking


### Amidst a backdrop of declining equity and bond valuations, many insurers are looking for new ways to drive their investment returns

**APAC bond & Equity market capitalisation**

USD Trillion, Q4 21-Q3 22 /Q4 21-Q4 22



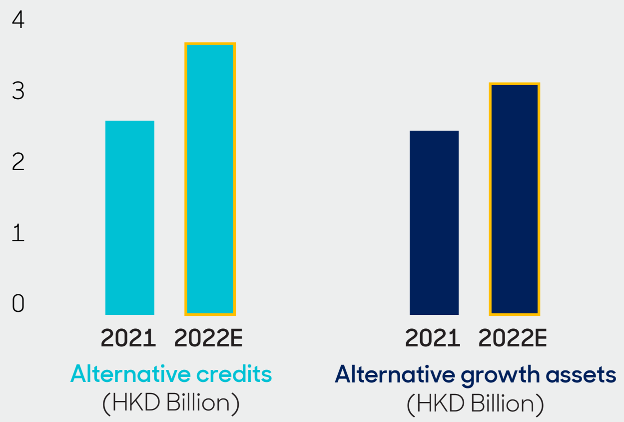

**Case study**

AXA[2], Hong Kong

AXA, headquartered in France and presented in 50 countries, offers a wide range of insurance products and investment solutions in Hong Kong

**Alternative investment plans**

AXA Hong Kong, 2021-22E




AXA Hong Kong planned to invest HKD 1.4 billion in alternative assets in 2022, overweighting alternative credits under tightened credit spreads

Note: [1]Asia ex-Japan Bond Market Size. [2]Company selected for illustrative purposes only to demonstrate the investment management style described herein and not as an investment recommendation or indication of future performance

Source: ©AXA, Asia Development Bank, Insurance Authority, MAS, China Banking and Insurance Regulatory Commission, Statista, World Exchanges, Asian Investors, Quinlan & Associates analysis

## Asset allocation plans

### Objective(s)

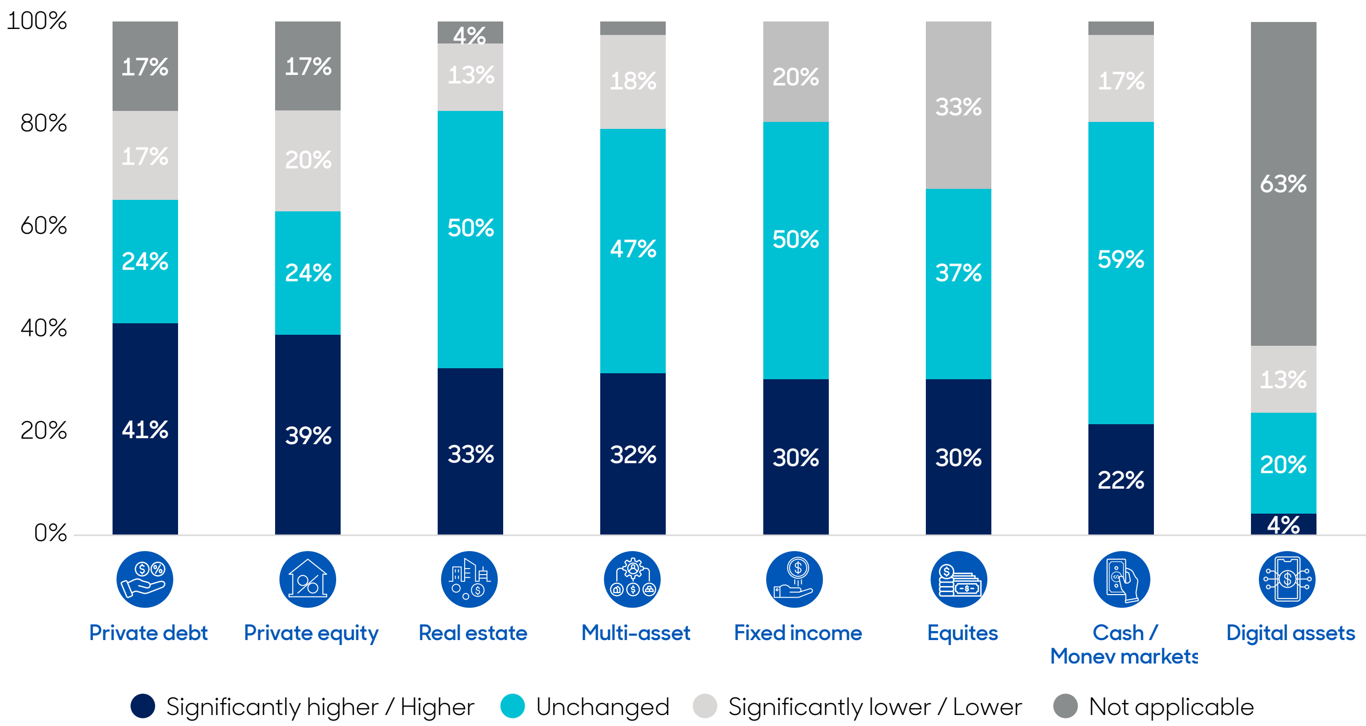
- We wanted to explore how insurers plan to allocate their asset pool to different asset classes over the next 3 years, providing us with a high-level view of the demand for various assets and insurers' underlying investment strategies

### Insurers' interest in private market (e.g. private debt, private equity) has increased at the expense of digital assets and equities

### Key takeaway(s)

- Around 40% of all surveyed insurers plan to allocate more of their investments to private market products, including private debt and private equity
- Around one-third of the surveyed insurers plan to decrease their allocation to equities, reflecting a negative market outlook
- As for real estate, multi-asset, fixed incomes, and money market / cash investments, around half of the surveyed insurers plan to retain their current allocation levels
- The majority of insurers do not have access to digital assets, while most of those who have access plan not to increase allocation

**Asset allocation plans in three years**
% of respondents




Source: abrdn and Quinlan & Associates analysis

## Investment decision factors

### Objective(s)

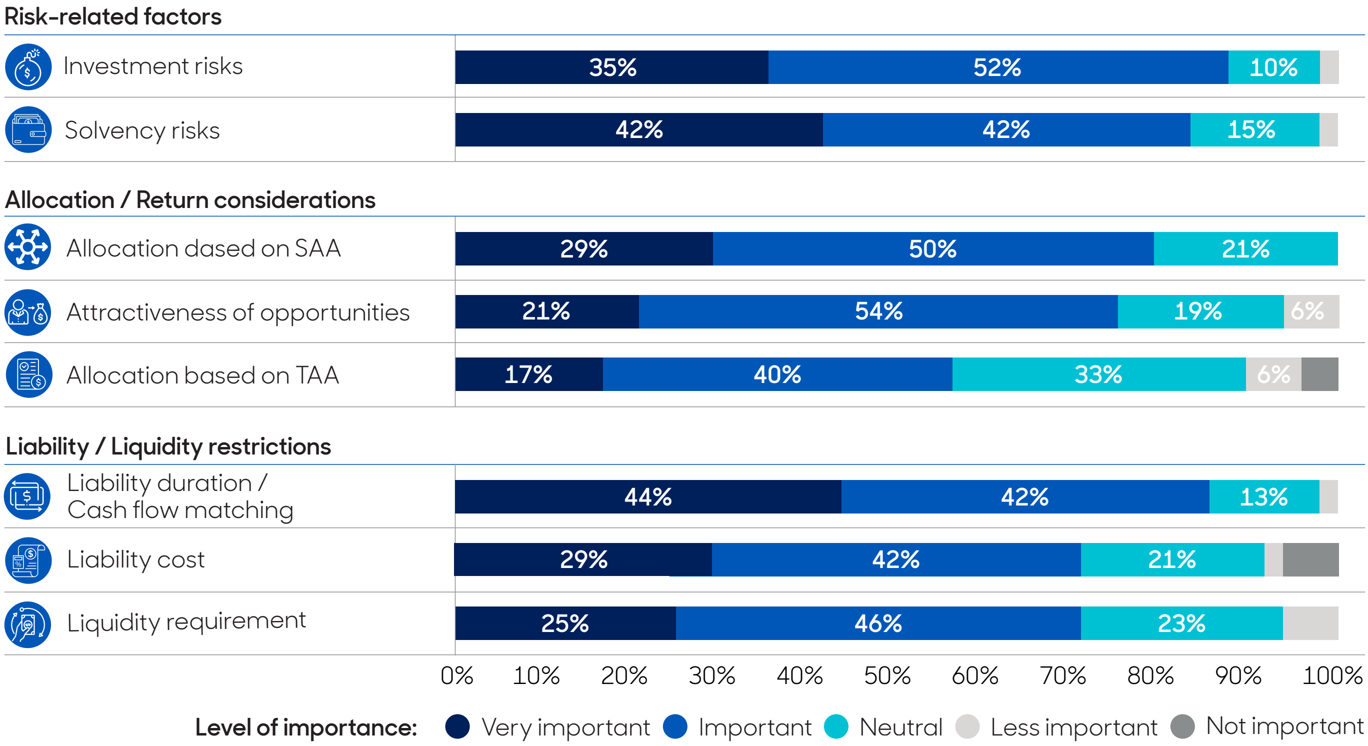
- In order to better understand the investment strategy decision-making process that insurers typically undertake, we reviewed risk factors, allocation and returns, as well as liability and liquidity considerations

### Investment risks, solvency risks, and liability duration / cash flow matching are the top factors driving insurers' future investment strategies

**Key takeaway(s)**

- Insurers generally prioritise risk-related factors as most important to their investment strategy, in which investment risks rank at the top of all investment strategy decision factors, followed by solvency risks (with 42% of respondents viewing solvency risk as very important)
- Liability duration / cash flow matching is also of great importance, though liability cost and liquidity requirements are not as crucial
- Allocation based on SAA is also of high priority for APAC insurers when deciding on their investment strategies

**Factors for investment strategy decision**
Level of importance, % of respondents




Source: abrdn and Quinlan & Associates analysis

## Domestic vs. international

### Objective(s)

- In terms of preferred markets, we wanted to understand where insurers intend to allocate more of their investments (i.e. international markets vs. domestic markets) over the next three years relative to their current allocations

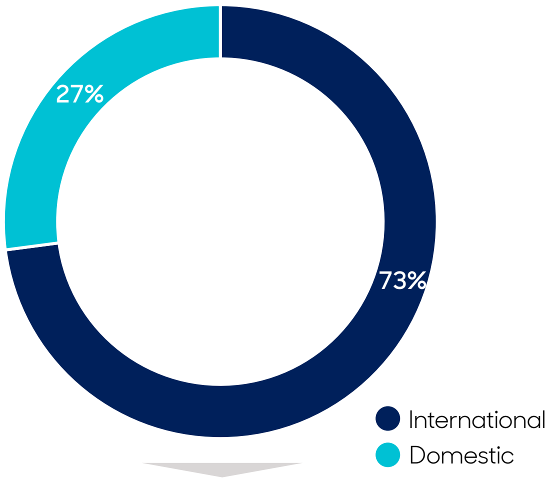
### Key takeaway(s)

- While 73% of insurers plan to allocate more investments towards international markets, insurers in South Korea, Mainland China, Thailand, and Malaysia still prefer domestic markets
- Among those who prefer domestic markets, regulatory requirements stand out as the most crucial motivations for greater domestic allocations

**73%**

**of insurers plan to allocate more capital to international markets, although those who prefer domestic are mainly motivated by regulatory requirements**

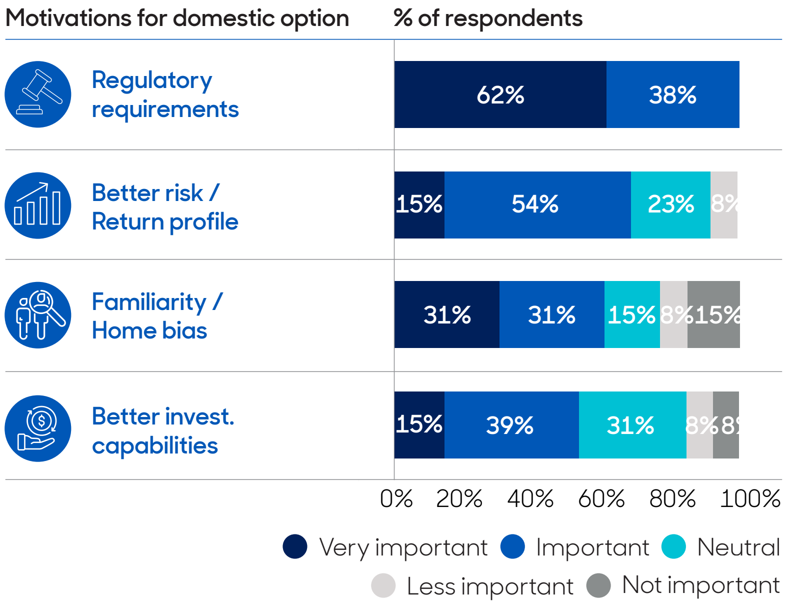
**Market allocation in three years**
% of respondents




**Top 4 markets with domestic preference**

100% 67% 50% 50%

**As the regulatory requirements in Mainland China, Malaysia, Thailand, and South Korea are relatively more strict, insurers are motivated to choose domestic investments**




Source: abrdn and Quinlan & Associates analysis

Section 2-5

# Hedging strategy

## Risk hedging overview

### Summary

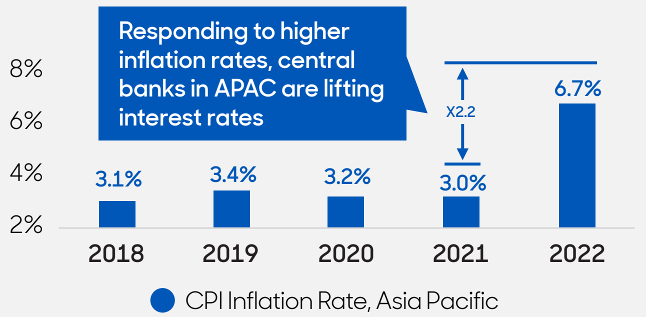
- The APAC financial market, especially the risk environment, is becoming increasingly more difficult for insurers to navigate, given rising inflation rates, volatile FX markets, turbulent equity markets, and rising default rates
- As a result, insurance companies would need to tailor hedging strategies for four typical categories of risks brought by their investment assets and liabilities, including interest rate risks, currency risks, equity risks, and credit risks

## The increasingly challenging (and complex) risk environment in APAC is prompting many insurers to optimise their risk hedging strategies

**Risk hedging overview**
Types of risks, APAC

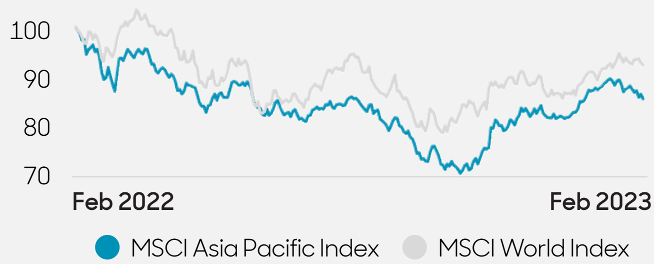
**Rising inflation**

*Insurers need to hedge against interest rate fluctuations for their liabilities, resulting from rapidly rising inflation, potentially via interest rate swaps or forward contracts*



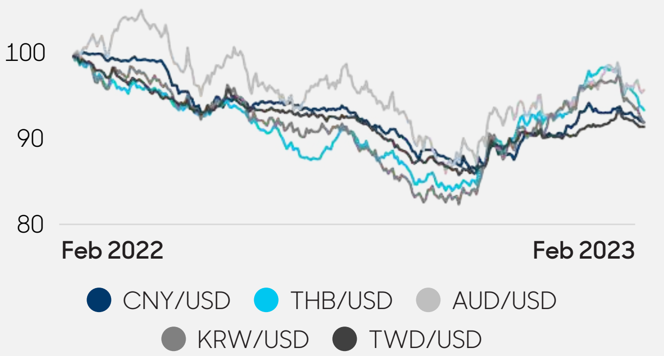

**Turbulent equity markets**

*Insurers need to hedge against greater equity market volatility by using futures, options, or swaps to reduce their risk exposure*



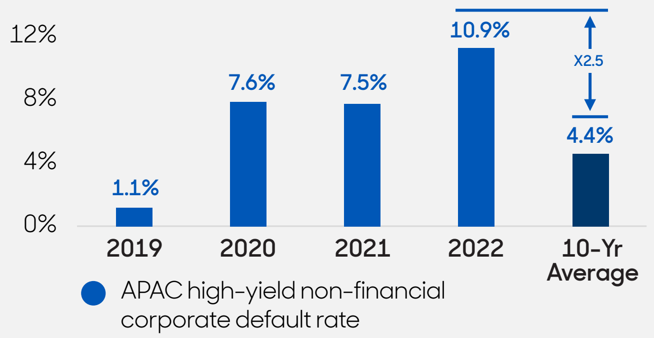

**Volatile FX markets**

*Insurers need to hedge against currency exchange rate volatility between the currencies of their global assets (e.g. premiums, investments) and liabilities*




**Rising default rates**

*Insurers need to hedge against credit default risks in their underlying investments, potentially through the use of credit default swap contracts*




Source: IMF, MSCI, WSJ, Investing.com, Moody's, Quinlan & Associates analysis

## Key hedging challenges

### Objective(s)

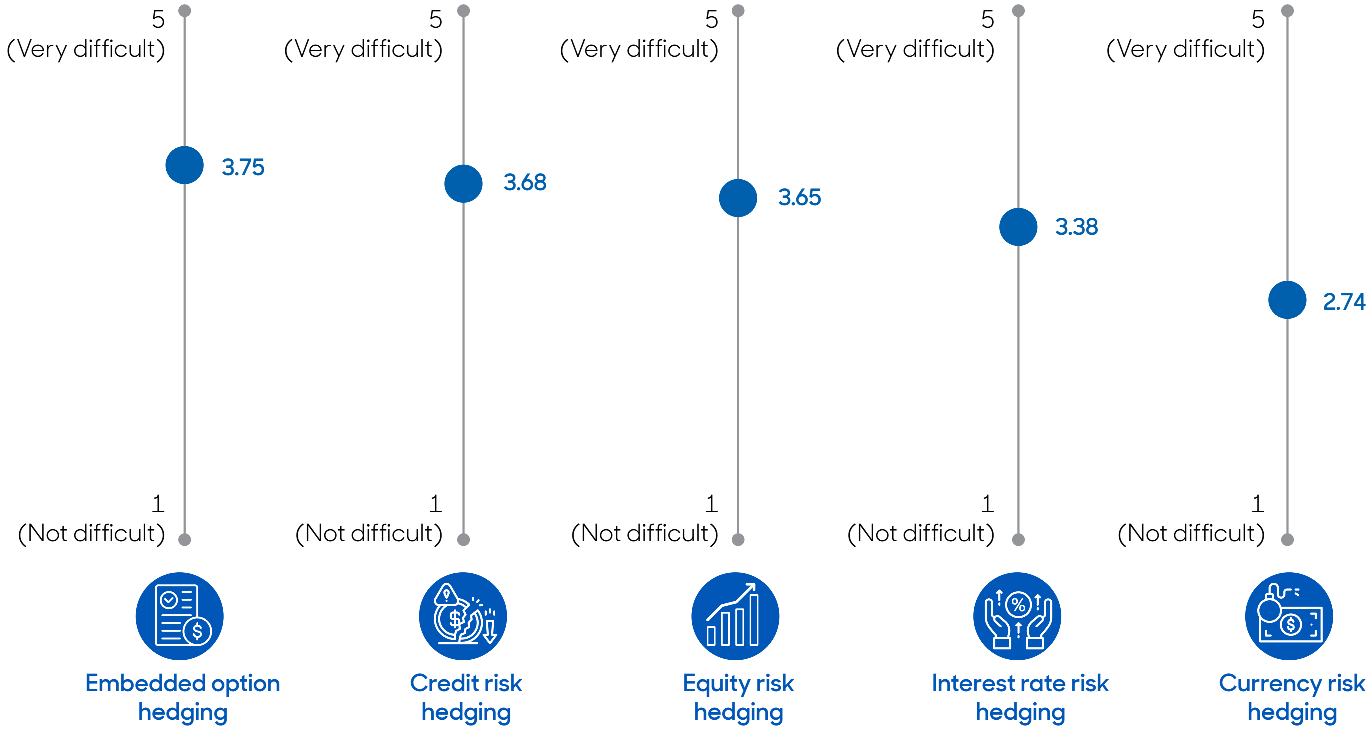
- Amongst all the different varieties of risk hedging strategies, we wanted to know the most challenging ones for APAC insurers to implement

**Key takeaway(s)**

- Embedded option risk hedging is considered as the most challenging hedging strategy to implement, followed by credit risk hedging
- Currency risk hedging is considered as relatively easy in terms of implementation

### APAC insurers find embedded option hedging to be the most challenging to implement, followed by credit risk hedging

**Risk hedging strategies challenges**
Overall average based on responses




Source: abrdn and Quinlan & Associates analysis

## Key hedging strategies

### Objective(s)

- We wished to further understand the practices that insurers adopt when they hedge currency and interest rate risks for their investments

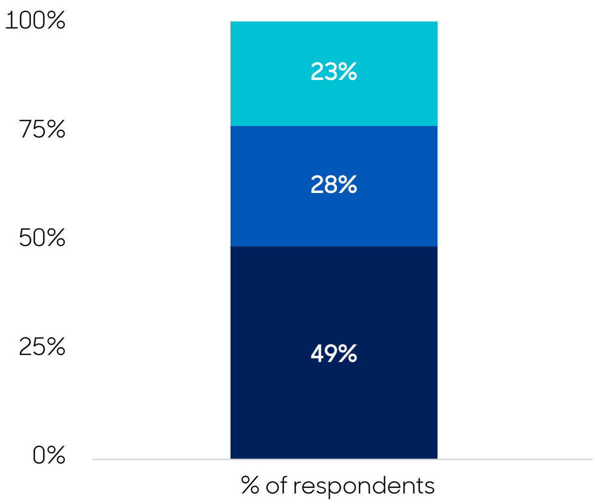
### For currency hedging, insurers prefer a partial hedge, while for interest rate risk hedging, many insurers choose to match asset-liability duration

**Key takeaway(s)**

- Around 30% of APAC insurers fully hedge currency risks based on liabilities, compared to nearly half of them adopting partial hedging strategies, in which investment experts have discretion over the extent of hedging
- As for interest rate risk hedging strategies, more than half of all surveyed insurers directly match asset-liability duration as closely as possible, while 46% of insurers choose to dynamically manage duration

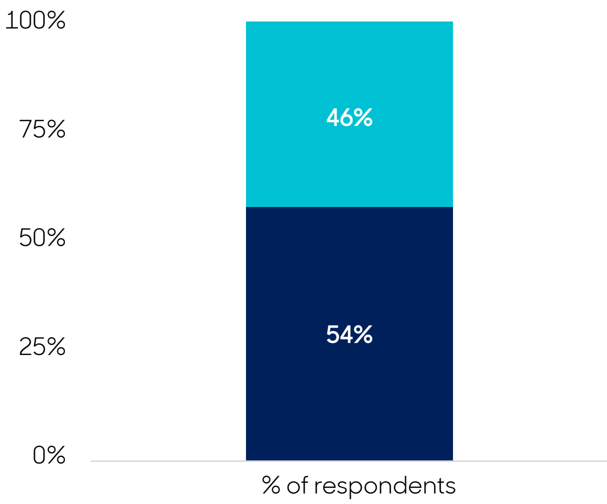
**Currency and interest rate risk hedging strategies**
% of respondents

**Currency hedging**




- Partially hedge (i.e. professionals have discretion to express view to add value)
- Fully hedge (i.e. portfolio currency hedged to liability currency)
- Do not hedge

**Interest rate hedging**




- Match asset-liability duration as close as possible
- Dynamically manage duration based on interest rate outlook and asset-liability profile

Source: abrdn and Quinlan & Associates analysis

## Implementation challenges

### Objective(s)

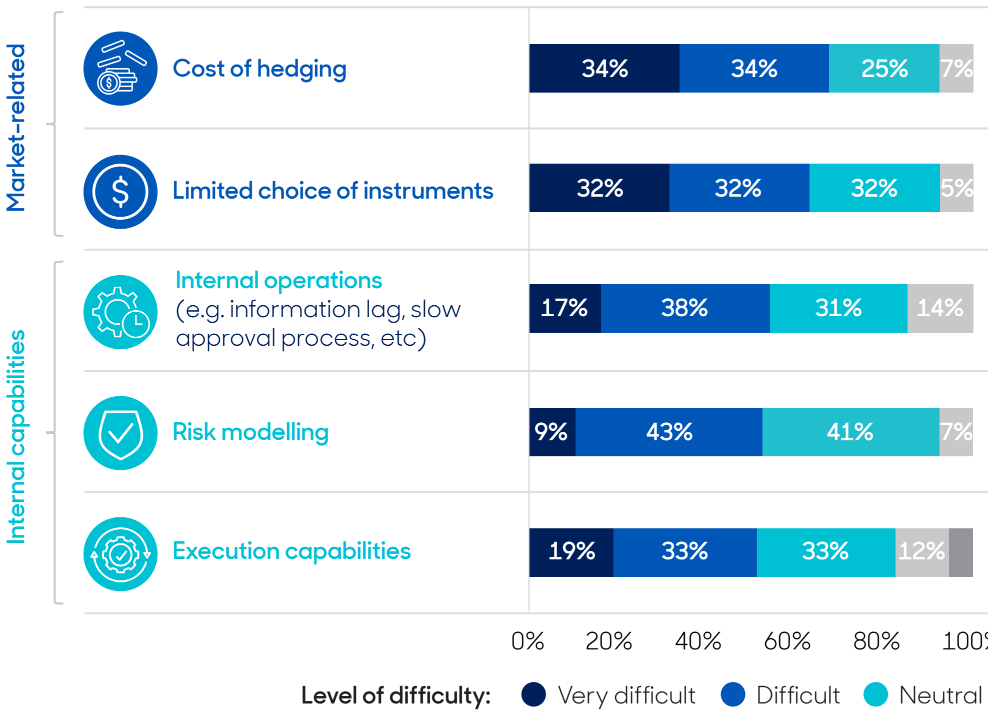
- As insurers may encounter a variety of challenges while they conduct risk hedging, we wanted to know the most difficult challenges that they struggle with

### The major challenges for insurers in implementing hedging strategies are the cost of hedging and limited choice of instruments

**Key takeaway(s)**

- Insurers consider the cost of hedging and limited choice of instruments to be their biggest challenges, both of which are market-related external factors.
- Compared to external market factors, insurers find internal capabilities to be less challenging However, over 50% of them still believe that their internal operations, risk modelling, and execution capabilities are not efficient enough

**Key challenges in risk hedging**
Level of challenge, % of respondents




- Market-related factors are the major challenges that insurers encounter in their hedging strategies, especially for those located in South Korea, Taiwan, Malaysia, and Singapore
- More than 50% of APAC insurers still consider internal capabilities, including operations, risk modelling, and execution capabilities, as key obstacles to their hedging strategies

Source: abrdn and Quinlan & Associates analysis

Section 2-6

# ILP business

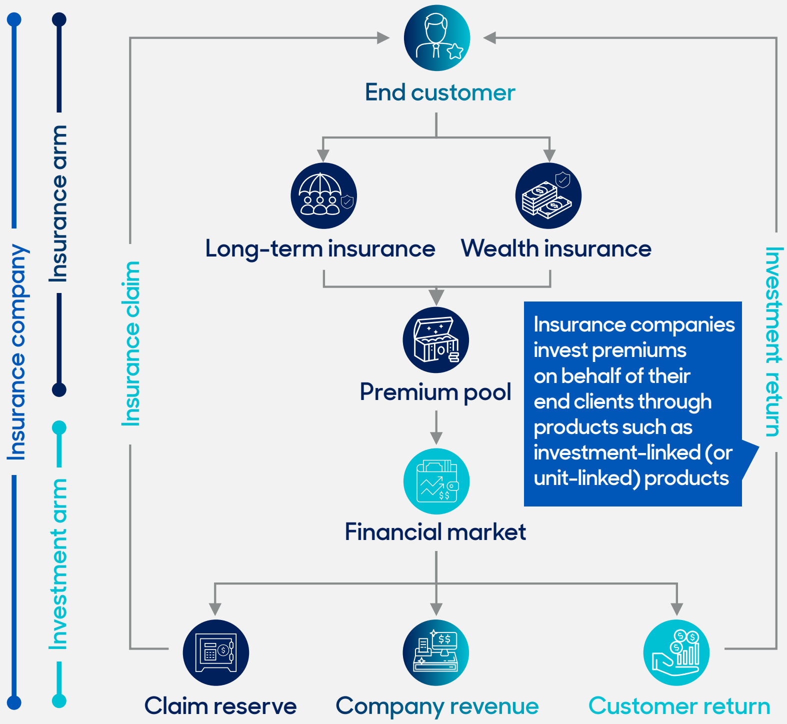
## ILP market overview (1/2)


**Summary**

- In response to increased capital requirements imposed by RBC regulations, a growing number of insurance companies are exploring the adoption of –or are re-focusing on – ILPs, a capital-light investment product
- However, in more recent years, a growing number of insurers are leveraging their investment expertise and capabilities to provide investment services to clients, through products such as ILPs and unit-linked insurance plans ("ULIPs")


### We are seeing greater convergence between the insurance and wealth management industries as insurers place more focus on ILPs

**Insurance / Wealth convergence**
ILP model




**Insurance service development**
Phase 1–3

| | |
|---|---|
| Phase 1: Protection | · Protection insurance cover, such as fire, property, health, life, accident, and business insurance |
| Phase 2: Planning | · Wealth plans in the form of annuities, pensions, etc. for retirement and wealth transfer |
| Phase 3: Investment | · Hybrid products, including ILPs and ULIPs |

Source: Quinlan & Associates analysis

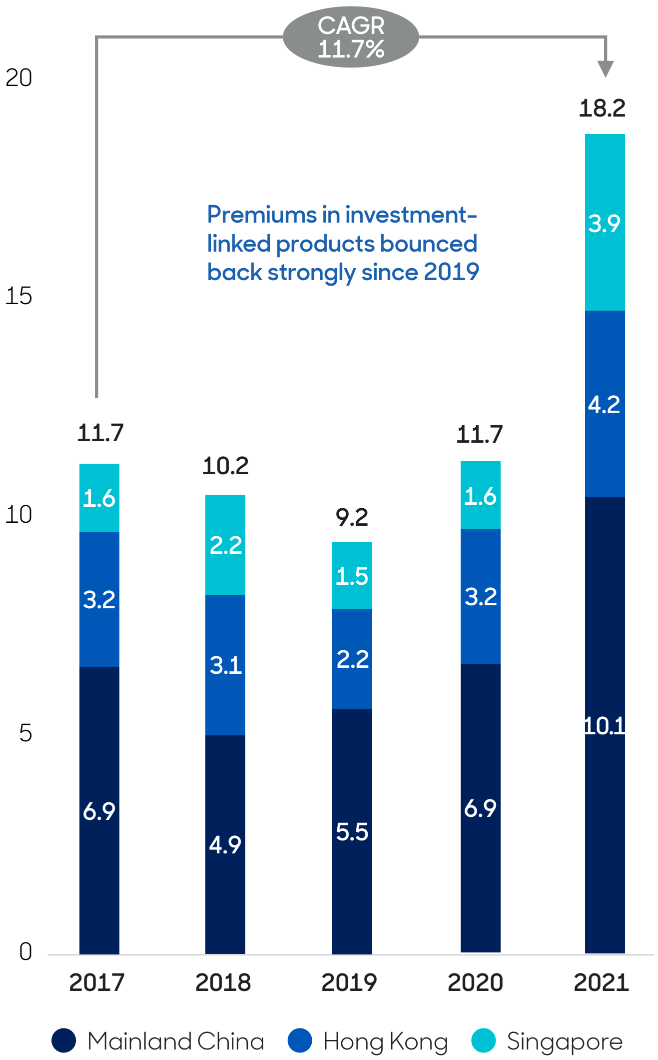
## ILP market overview (2/2)

### Summary

- Premiums for ILPs doubled from 2019-21, attributed to growing customer demand to hedge against inflation (particularly in 2021) and favourable regulatory developments
- In response, a number of APAC insurers have launched several initiatives designed to further boost their ILP business in the region, including new product launches and setting up new distribution channels

## Guided by recent regulations, the ILP business has attracted increased attention while also playing an essential role in hedging against inflation

**ILP premium size**
Key APAC markets, USD Billion, 2017-21




**Case study**
Zurich[1], Hong Kong

ZURICH 蘇黎世

Zurich Insurance Group is a leading multi-line insurer with operations in more than 200 markets, and is listed on the SIX Swiss Exchange

**HKD 1.3 billion**
ILP Premium in Hong Kong (2021)

**ILP business plan**
Zurich Hong Kong, 2023

| | |
|---|---|
| Q1 2023 | **Universal Life ("UL") Insurance aunch**<br>Zurich plans to launch the company's first saving-linked life insurance product in Hong Kong |
| Q1 2023 | **Digital DIY platform launch**<br>Zurich expects to expand its distribution channel of life insurance to its digital DIY platform |
| Q2 2023 | **Protection Linked Plan ("PLP") launch**<br>Zurich aims to enrich its ILP offerings by adding several PLP products, offering a higher level of protection |
| Q3 2023 | **VIP Centre for ILP clients set-up**<br>As the Mainland China-Hong Kong border opens, Zurich plans to set up a VIP centre for visiting customers to boost its ILP businesses |

Note: [1]Company selected for illustrative purposes only to demonstrate the investment management style described herein and not as an investment recommendation or indication of future performance
Source: ©Zurich Hong Kong, Insurance Authority, MAS, China Banking and Insurance Regulatory Commission, Yahoo, Quinlan & Associates analysis

## ILP expansion plans

**Objective(s)**

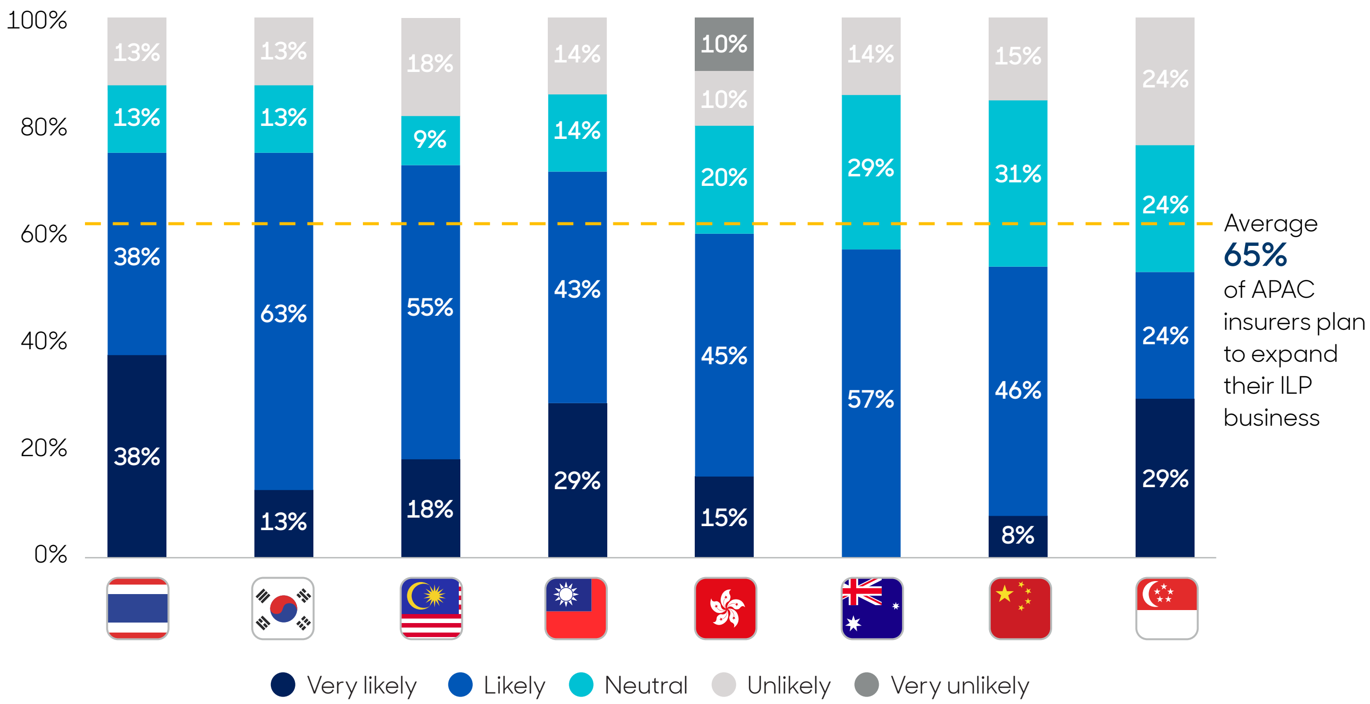
- Given that ILPs are capital-light, we wanted to understand whether APAC insurers plan to focus more on expanding the business in coming years

**The majority of APAC insurers plan to expand their ILP businesses, especially those who operate in Thailand, South Korea, and Malaysia**

**Key takeaway(s)**

- A regional average of 65% of insurers say that they are either very likely or likely to expand their ILP businesses, taking the market outlook into consideration
- In particular, insurers from Thailand, South Korea, and Malaysia are very keen to explore future expansion of their ILP business

**Plan to expand ILP business**
% of respondents




Source: abrdn and Quinlan & Associates analysis

## Capability challenges

### Objective(s)

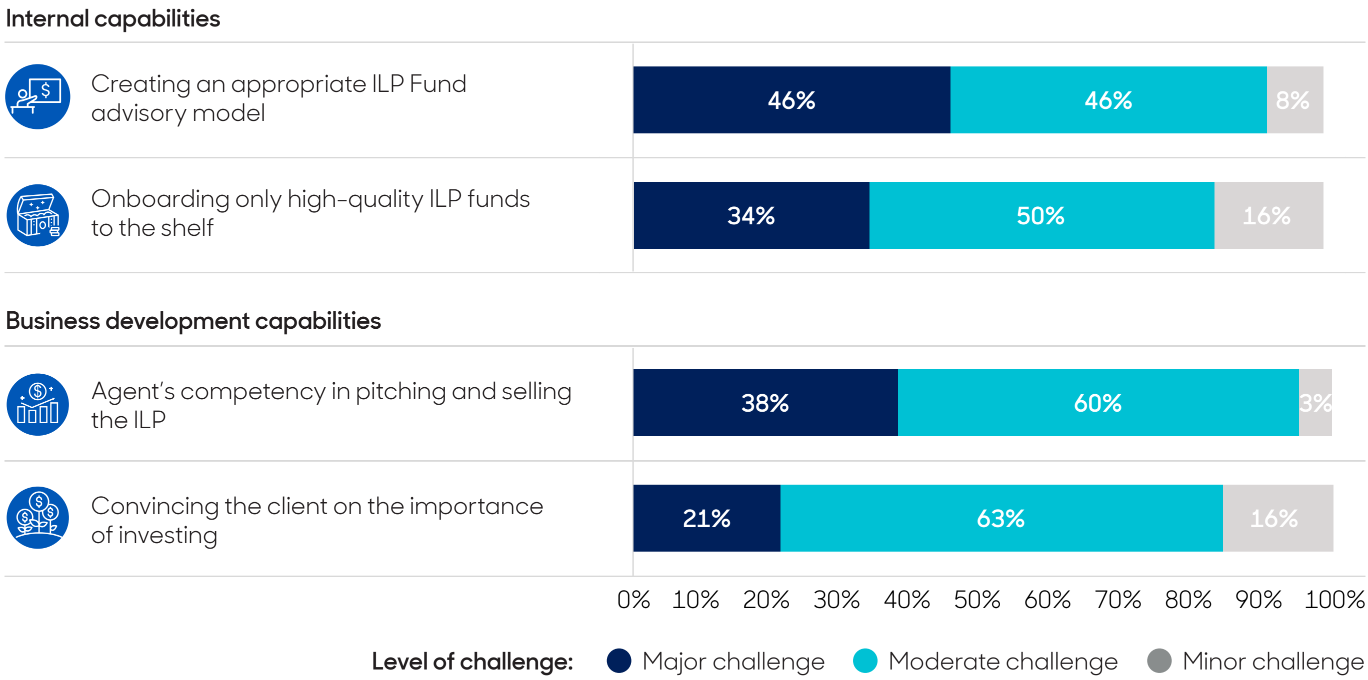
- Given that establishing and expanding an ILP business can be challenging, we wanted to understand some of the internal and/or business development capability limitations facing regional insurers

### The key challenges for insurers' ILP businesses are creating an appropriate ILP advisory model, as well as their agents' competency in pitching ILPs

### Key takeaway(s)

- Almost half of all surveyed insurers consider creating an appropriate ILP fund advisory model to be a major challenge that they are looking to address
- Insurers find it less of a challenge to convince clients of the importance of investing, which indicates that APAC clients may be more aware of ILPs

**Key challenges in ILP business**
Level of challenge, % of respondents




Source: abrdn and Quinlan & Associates analysis

## Digitalisation efforts

### Objective(s)

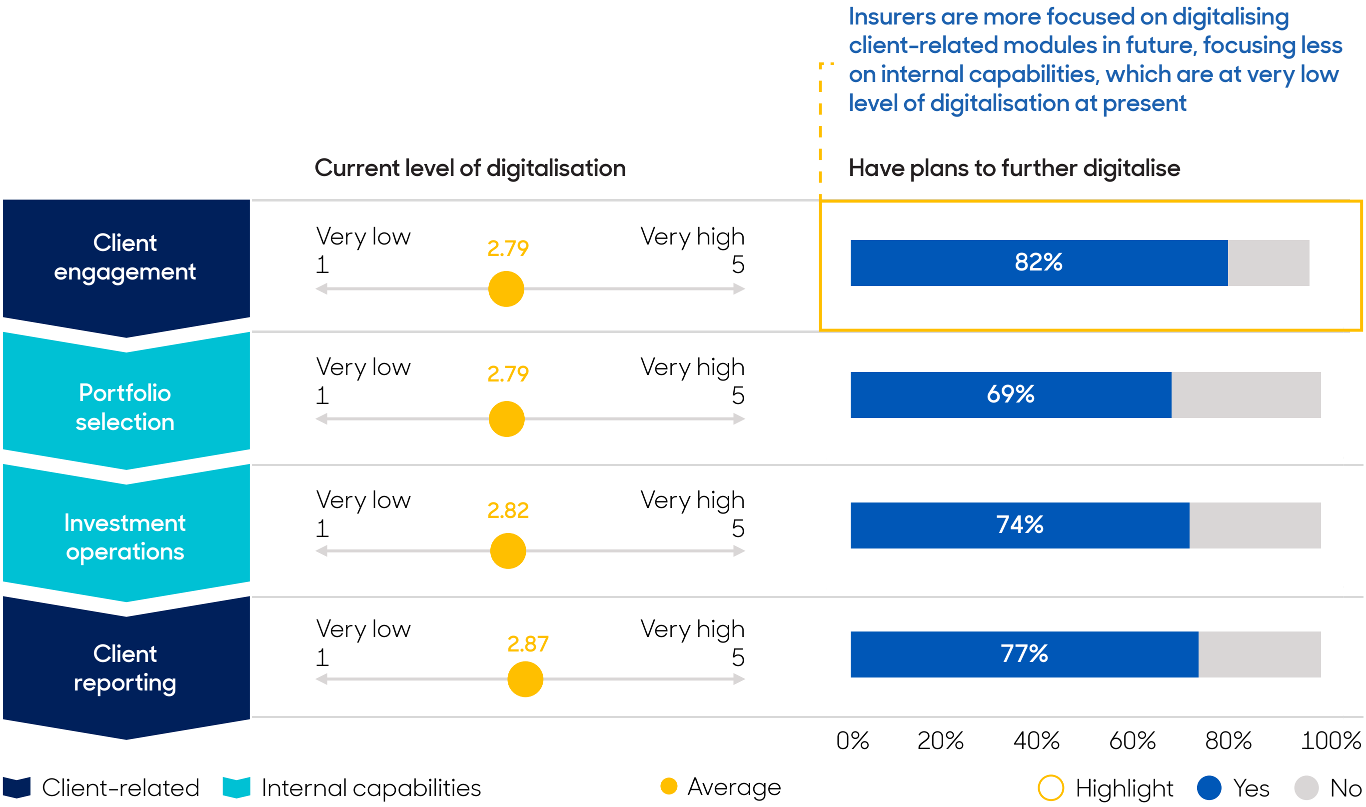
- As the digital transformation of the insurance industry continues to progress, we wished to understand the current level of digitalisation across the ILP value chain, as well as insurers' future plans regarding the same

**Key takeaway(s)**

- Although the general level of digitalisation of the ILP value chain is still low, client-related steps (i.e. client engagement and reporting) have a higher level of digitalisation than internal capabilities, on average
- Insurers plan to continue digitalising client-related functions, ranking slightly higher in priority than digitalising their internal capabilities

### The digitalisation level of ILPs is generally low, especially with respect to internal capabilities, with plans to further digitalise client-related operations

**Digitalisation of the ILP value chain**
Average rating, % of respondents




Source: abrdn and Quinlan & Associates analysis

Section 2-7

# External partnerships

## Outsourcing partnerships

### Summary

- The investment management value chain in the insurance industry typically involves (1) growing the premium pool, (2) developing investment strategies based on missions and risk profiles, (3) executing the investment plans based on research and assessment, (4) monitoring and managing risks while optimising and rebalancing portfolios, as well as (5) client reporting / compliance
- On account that outsourcing the above-mentioned practices brings in the expertise and resources of third-party partners and improves operational efficiency, APAC insurers would typically cooperate with specialists (e.g. asset managers) to help address different challenges along the value chain

## Some insurers are choosing to outsource parts of their investment value chain to external partners with specific areas of expertise

**Investment operation value chain**
Potential outsourcing practices

| Investment operation value chain | Potential outsourcing practices |
|---|---|
| Premium pool maintenance | Maintain and grow the premium pool from insurance policies to increase investment assets |
| Investment strategy development | Build investment strategies and portfolios based on investment targets, risk profiling, market outlook, and insurance-related needs |
| Investment execution / Asset allocation | Assess and execute investments in a variety of instruments |
| Risk management / hedging | Establish risk-hedging strategies, monitor and manage investment risks, and rebalance portfolios |
| Client reporting / compliance | Prepare a full set of reporting statements and materials, adopting international standards |

**Case study of partners**
Select examples (anonymised)

**Investment capabilities expansion**

**Asset manager**

Leveraging the partner's thematic expertise, the insurer was able to expand its investment capabilities to the logistics and industrial real estate industry while incorporating ESG-related considerations

**New investment product development**

**Sustainability specialist**

The insurer brought in the partner in order to offer a new, multi-thematic fund for ILP investors that invests in different ESG / sustainable themes, bringing diversified impact investing to ILP customers

Source: Quinlan & Associates proprietary research & analysis

## Partnership preferences

### Objective(s)

- In order to better facilitate insurers in addressing the challenges covered earlier in this report, we also investigated insurers' preference for conducting initiatives in-house vs. through outsourcing

**In general, insurers need the facilitation of third-party partners to tackle key challenges, especially in ESG / net-zero, investment execution, and hedging**

### Key takeaway(s)

- IFRS 9 / 17 adoption and RBC optimisation are highly prioritised by insurers, with many firms planning to outsource these activities to third-party experts
- Insurers also expressed strong demand to outsource their ESG integration efforts, investment execution, as well as hedging strategies to external partners

**Outsourcing trends**
Priorities & Outsourcing demand

| | Priorities | Outsourcing demand |
|---|---|---|
| Risk-based capital optimisation for investment portfolios | ●●●●● | ●●●●○ |
| Mitigation of IFRS 9 / 17 impacts to investment portfolios | ●●●●● | ●●●●○ |
| Executing specific investment strategies (e.g. private market assets, buy-and-maintain, etc.) | ●●●●○ | ●●●●● |
| ESG / Net-zero adoption for investment management | ●●●○○ | ●●●●● |
| SAA setting | ●●●○○ | ●●●○○ |
| Risk hedging strategies | ●●○○○ | ●●●●● |
| TAA setting | ●●○○○ | ●●●○○ |

Low ●●●○○ High

Source: abrdn and Quinlan & Associates analysis

## Partnership decision factors

### Objective(s)

- We wished to understand the key decision-drivers of APAC insurers when they are deciding who to partner with for outsourcing their operational modules

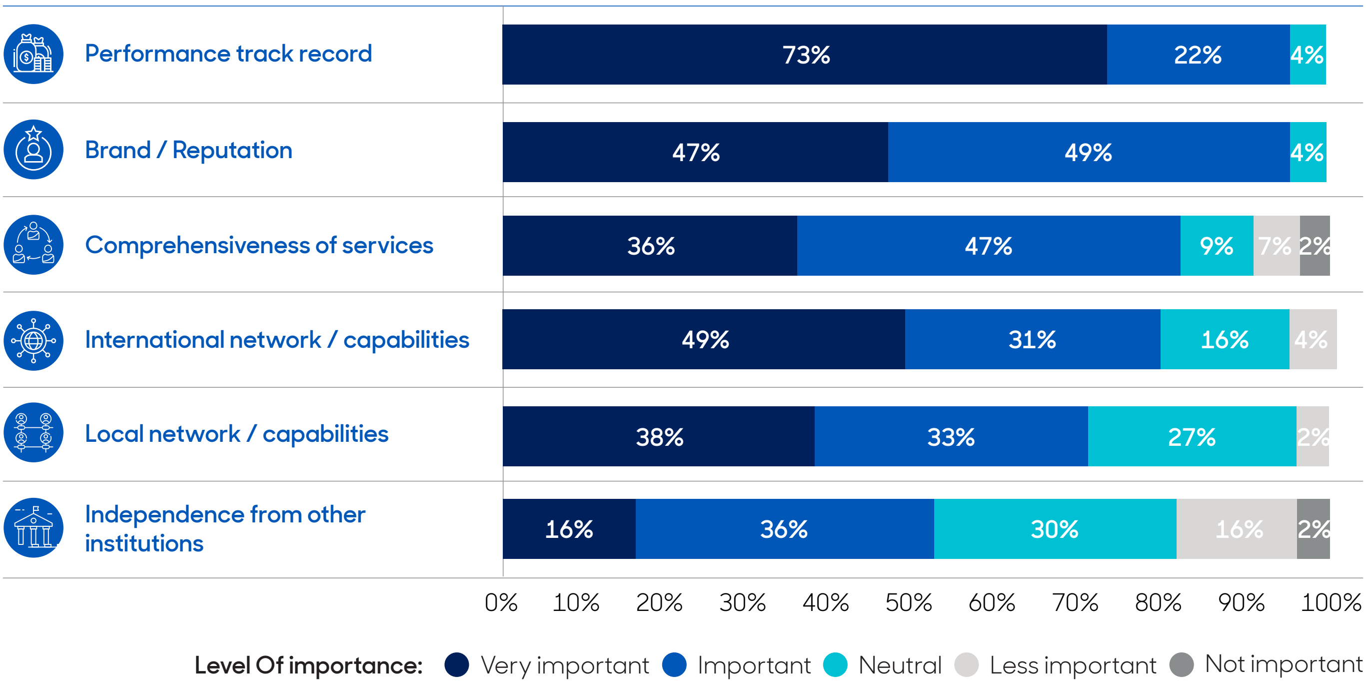
## Performance track record, brand / reputation, and comprehensive services are the most important considerations for insurers when selecting partners

### Key takeaway(s)

- Almost every surveyed insurer agrees that brand/ reputation and performance track record are very important / important factors to consider when outsourcing to an external partner
- Insurers focus less on third-party partners' independence from other institutions, as long as they provide high-quality and comprehensive services

**Key decision factors**

Level of importance, % of respondents




Source: abrdn and Quinlan & Associates analysis

Section 3

# The way forward

Section 3

# Next steps for the industry


### Summary

- As the investment landscape in APAC has become more challenging for insurance companies to navigate, we have outlined numerous recommendations for APAC insurers to further explore in each of the six key areas covered in this report
- In particular, we see regulatory adoption and ESG integration as high priority focus areas for regional insurers, with a need to move from a reactive, compliance-led mindset to one that is much more proactive, focused on leveraging RBC, IFRS 9 / 17, and ESG as strategic points of differentiation (and, ultimately, to gain a competitive advantage)
- We also believe there is considerable scope for insurers to further digitalise their ILP businesses, given the rising digital-savviness of their customer base and the capability limitations of their agent network in effectively pitching ILP products to target customers


## Taking into account the insights gathered in this survey, we have outlined various recommendations for APAC insurers to further explore

**Next steps**
APAC insurers

| Focus area | Priority | Recommendations |
|---|---|---|
| Regulatory adoption | | · Proactively manage the potential adverse impacts of adopting IFRS 9 / 17 by conducting scenario analysis to understand the implications on existing financial reporting practices, taking relevant steps to mitigate any identified risks<br>· Address challenges in RBC optimisationby developing a robust optimisation framework (supplemented by relevant technologies) and instituting appropriate regulatory initiatives (e.g. matching adjustment) |
| ESG integration | | · Build a proactive ESG data strategy (i.e. sourcing, cleansing, and utilising relevant internal and 3rd-party data sources) to better enable / activate downstream ESG efforts (e.g. investment management, reporting, governance, etc.)<br>· Enhance end-to-end ESG investment capabilities (e.g. thematic products, ESG / net-zero based optimisation, active stewardship, ESG governance and reporting) by leveraging capabilities of external managers to make ESG a point of strategic differentiation |
| Investment strategy | | · Modernise insurance investment strategies by incorporating insurance-specific considerations (e.g. RBC risk charge, liability matching, asset classifications under IFRS 9, etc.) into existing investment processes that ensure capital efficient return<br>· Explore yield enhancement opportunities through greater allocations to alternative assets (e.g. private equity / credit), as well as international markets, leveraging the expertise of specialised fund managers, where required / available |
| Hedging strategy | | · Design a tailored hedging strategy based on individual company's risk profile, asset & liability position, and internal capabilities, as well as key risk events to be considered in the current –and future –economic climate<br>· Source external partners capable of structuring highly tailored hedging solutions that are aligned with companies' risk management strategy and overall investment goals |
| ILP business | | · Provide comprehensive training modules that cover both technical aspects (e.g. product knowledge) and professional skills (e.g. sales / communication) to ensure that agents are fully equipped to pitch ILPs more effectively to end customers<br>· Evaluate the business case for different ILP advisory models (e.g. full-digital, hybrid, agent-enabled), review customer preferences, and institute necessary operating model adaptations in light of key internal constraints and external considerations |
| External partnerships | | · Decide on the most suitable initiatives and / or functions to outsource, based on a careful evaluation of various factors, including current breadth and depth of existing capabilities, upfront and ongoing costs, key risks, and the quality of vendor offerings<br>· Select high performing, reputable partners who are best positioned to address key capability gaps and / or further enable thedelivery of core value proposition(s) through providing additional functional / investment expertise and / or resource bandwidth |

Source: abrdn and Quinlan & Associates analysis

**Level of urgency:** Low High

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