

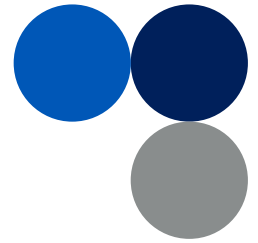
APAC Insurance Investment Landscape

Current challenges and future priorities

April 2023



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



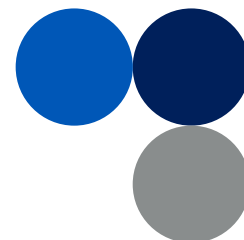
Rene Buehlmann
CEO
abrdn Asia Pacific

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.





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



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

21 C-suite executives, including 5 CIOs, 6 CROs, and 5 CEOs

13

13 Heads of Departments, including 5 Heads of Investments and 4 Heads of Risk

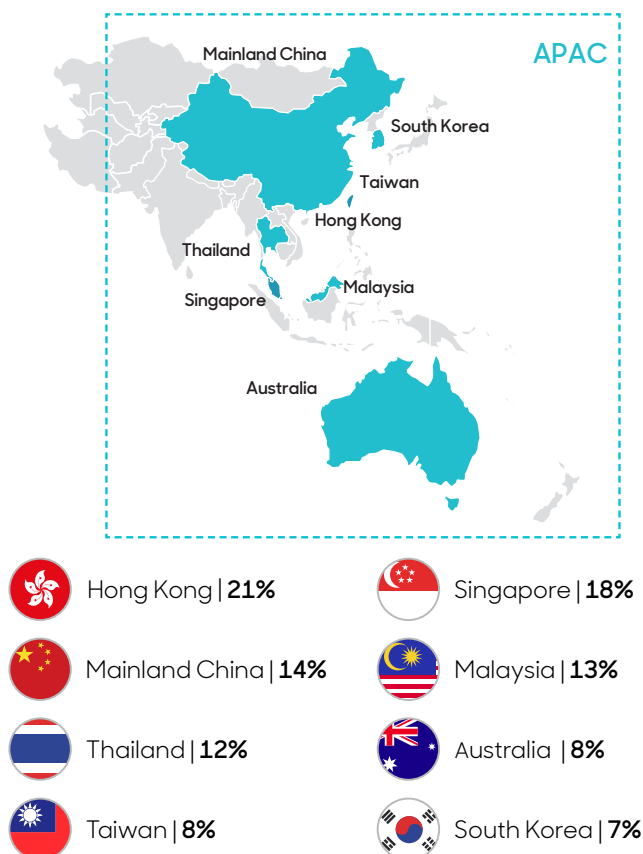
22

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, %



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:

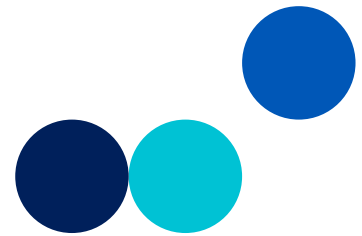
- 5 Chief Investment Officers
- 5 Heads of Investment
- 5 Senior Investment Managers

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		Category	Coverage
1	 Regulatory adoption How will respondents optimise investment and risk operations with upcoming regulatory requirements?	<ul style="list-style-type: none"> · RBC¹ regulations (including matching adjustment portfolio for HK & SG insurers) · IFRS 9 / 17 adoption 	4	 Hedging strategy What are the current practices, key focus areas, and current challenges of different hedging strategies?	<ul style="list-style-type: none"> · Currency / Interest rate risk hedging practices · Hedging strategy challenges
2	 ESG² / Net-zero What are the motivations and challenges that insurers encounter along their ESG integration journey?	<ul style="list-style-type: none"> · ESG regulatory outlook · Integration motivations · ESG / Net-zero challenges 	5	 ILP business³ What challenges face insurers in their ILP business and to what extent is the business being digitalised?	<ul style="list-style-type: none"> · ILP business outlook · ILP challenges · Level of digitalisation across ILP value chain
3	 Investment strategy What are insurers' preferred asset classes and markets over the next 3 years and why?	<ul style="list-style-type: none"> · Asset allocation plans · Decision factors for investments · Market preferences 	6	 External partnerships Which initiatives do insurers want to address through partnerships, and what are the deciding factors?	<ul style="list-style-type: none"> · Operation model preferences · Partnership consideration factors

Note: ¹Risk-Based Capital; ²Environmental, Social and Governance; ³Investment-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	<p>Looking to actively adopt as the highest priority of insurers</p> <ul style="list-style-type: none"> · 91% and 71% of respondents consider adopting IFRS 9 / 17 and RBC as either high or very high priorities, respectively · 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 · 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 	<p>Lack of clarity around managing regulatory impact, with slow progress on implementation</p> <p>● ● ● ● ○</p>
2 	ESG & NET-ZERO	<p>Passively motivated by local ESG regulatory developments</p> <ul style="list-style-type: none"> · 62% of respondents expect regulators to more strictly enforce ESG regulations, especially those in Australia, Malaysia, Hong Kong, and Mainland China · 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 · Despite this, 30% of respondents have not yet started to integrate ESG (50% for net-zero), citing challenges around data quality and investment conversion 	<p>Low urgency, with a notable lag in ESG integration efforts, hampered by poor data quality</p> <p>● ● ● ● ●</p>
3 	INVESTMENT STRATEGY	<p>Seeking yield enhancement while more sensitive to risks</p> <ul style="list-style-type: none"> · Around 40% of respondents plan to allocate more investments to private debt and private equity, with 33% planning to decrease their investments in equities · Insurers prioritise investment risks and liability duration / cash flow matching when deciding on their investment strategy, followed by solvency risks · While 73% of respondents plan to allocate more assets towards international markets, other insurers prefer domestic (mainly due to regulations) 	<p>Better capabilities in private and global markets needed to guide future asset allocation strategy</p> <p>● ● ○ ○ ○</p>
4 	HEDGING STRATEGY	<p>More complex risk management that is challenging to address</p> <ul style="list-style-type: none"> · Many respondents find embedded option hedging the most difficult to implement, followed by credit risk hedging, while currency hedging is seen as relatively easy · 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 · The major challenges in implementing hedging strategies are costs and limited choices of hedging instruments 	<p>Gaps in implementing hedging strategy, given high hedging costs and limited instruments</p> <p>● ● ● ○ ○</p>
5 	ILP BUSINESS	<p>Key expansion focus, with plans to digitalise client engagement</p> <ul style="list-style-type: none"> · 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 · Nearly 50% of respondents consider creating an appropriate ILP fund advisory model to be a major challenge that they are looking to address · Insurers prioritise digitalising client functions due to low digitalisation levels across the ILP value chain 	<p>Low digitalisation levels across the ILP value chain, with an urgent need for agent upskilling</p> <p>● ● ● ● ●</p>
6 	EXTERNAL PARTNERSHIPS	<p>Focus on performance and reputation in specific niches</p> <ul style="list-style-type: none"> · 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 · 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 	<p>Heavy reliance on in-housing efforts, with scope to better leverage external partners</p> <p>● ● ● ○ ○</p>

Magnitude of gap: Low ● ● ● ○ ○ High

Section 2-1

Overall priorities

Initiative prioritisation

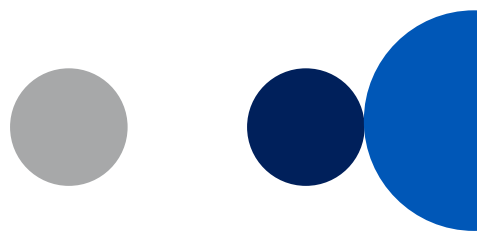
Objective(s)

- 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



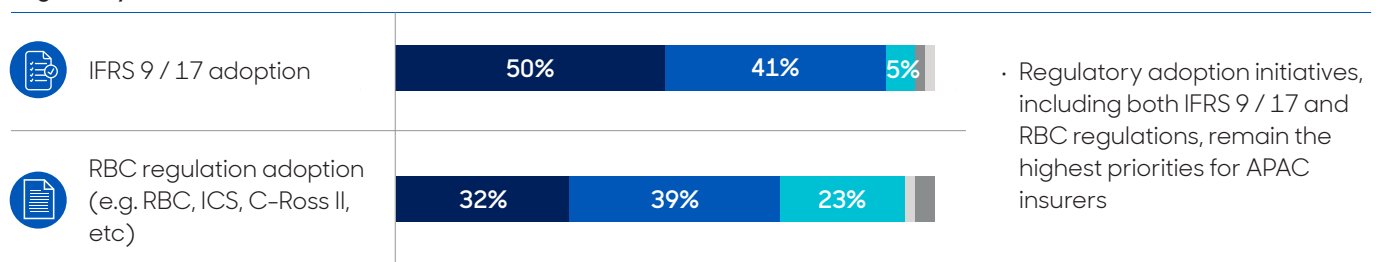


APAC insurers view regulatory adoption (e.g. RBC, IFRS 9 / 17) as their highest priority focus area, followed by refining their investment strategies

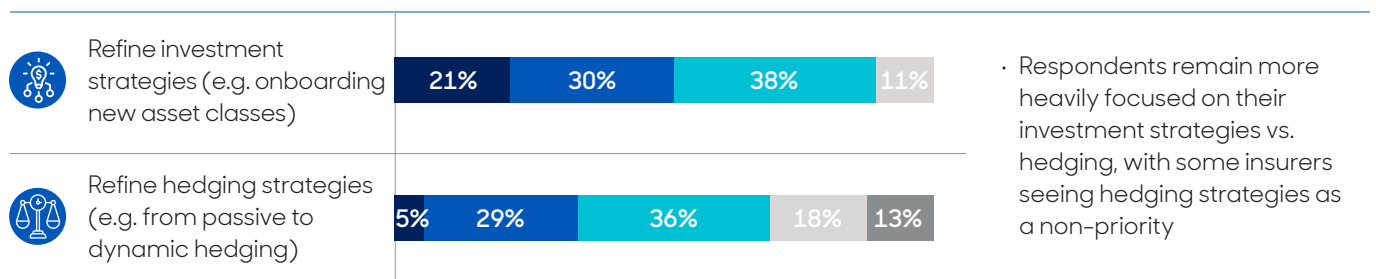
Prioritisation of initiatives

Value alignment, % of respondents*

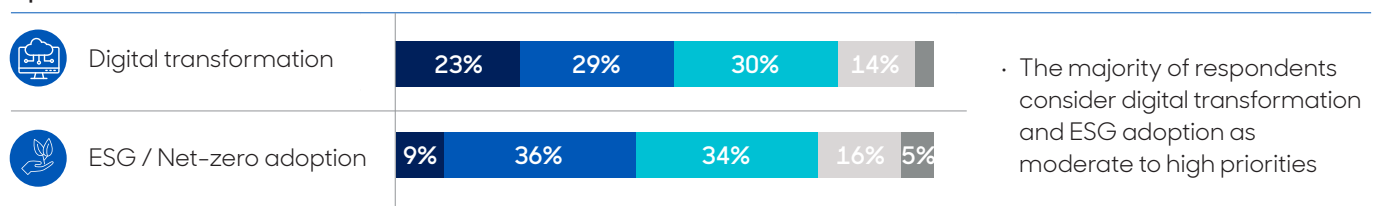
Regulatory



Investment



Operational



0% 10% 20% 30% 40% 50% 60% 70% 80% 90% 100%

Level of priority: ● Very high priority ● High priority ● Moderate priority ● Low priority ● Not a priority

Note: *Percentage values in this survey may not add up to 100% due to rounding

Source: abrdn and Quinlan & Associates analysis

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 Insurance¹, Mainland China



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

IFRS 9 adoption

Overview



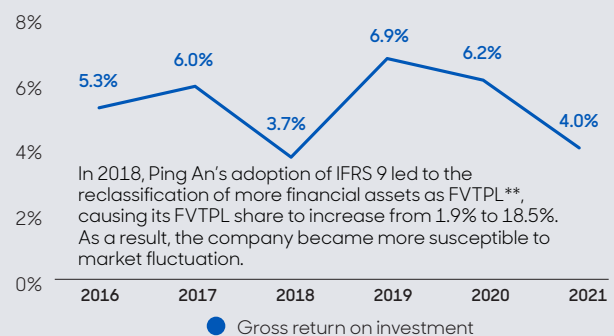
Initiative

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 OCI², Ping An changed its investment strategy, with greater allocations to large long-term equity investments



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

IFRS 9 / 17 asset election

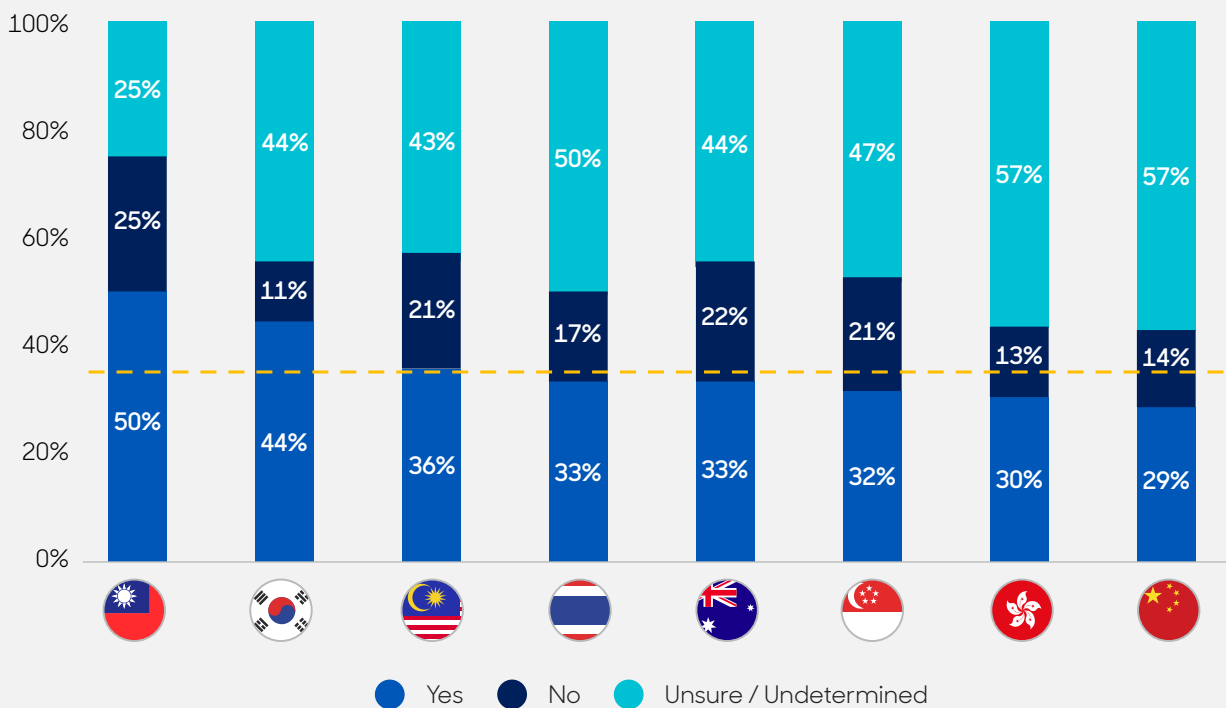
Objective(s)

- 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

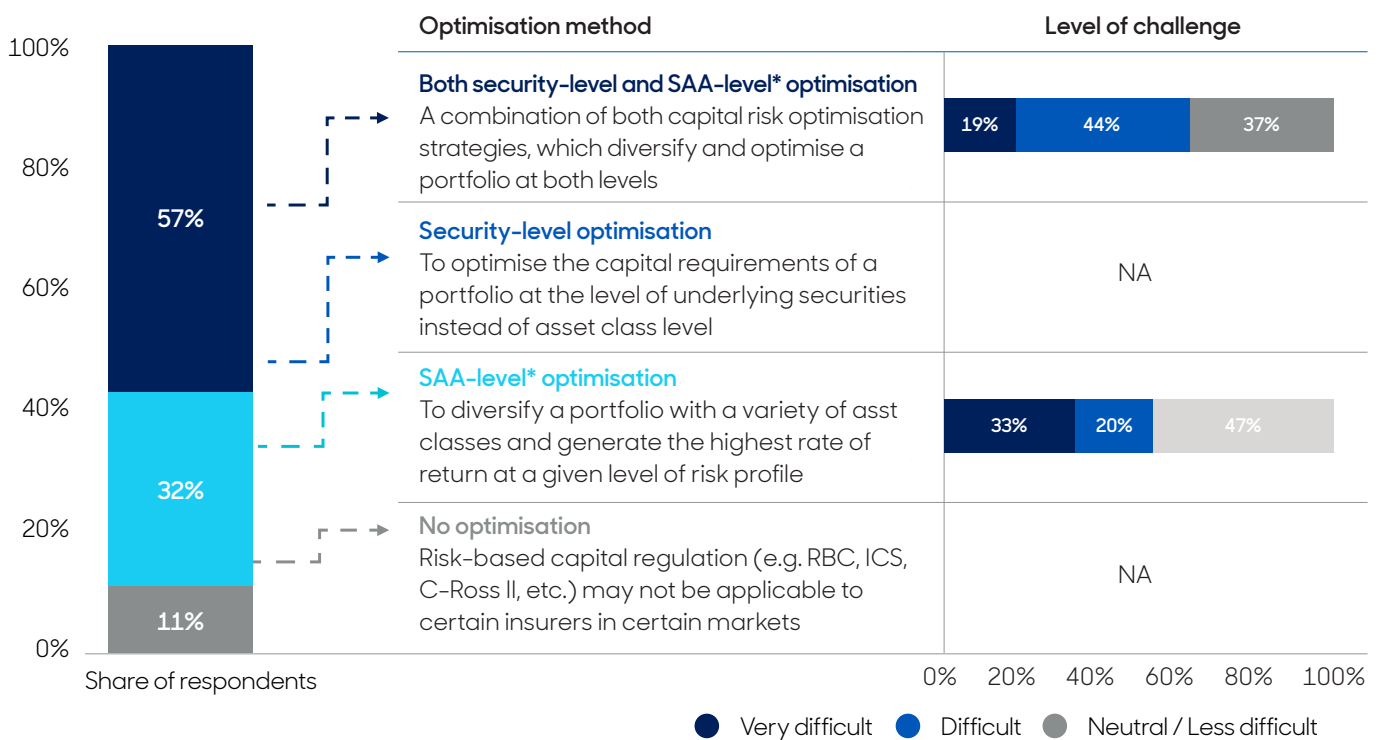
Objective(s)

- 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)

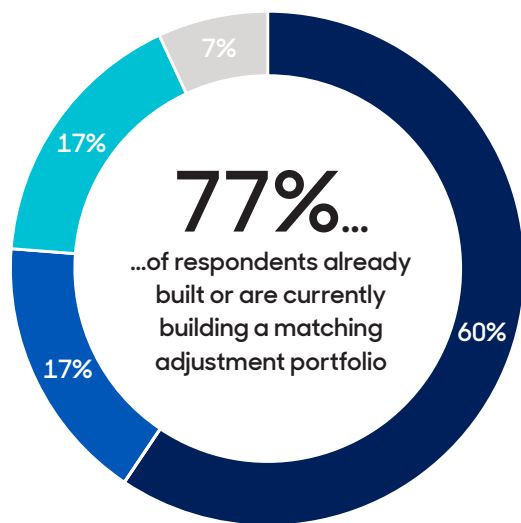
- We wished to understand the progress made by insurers in Hong Kong and Singapore with regard to building a matching adjustment portfolio, as well as the challenges that they are encountering in the process

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

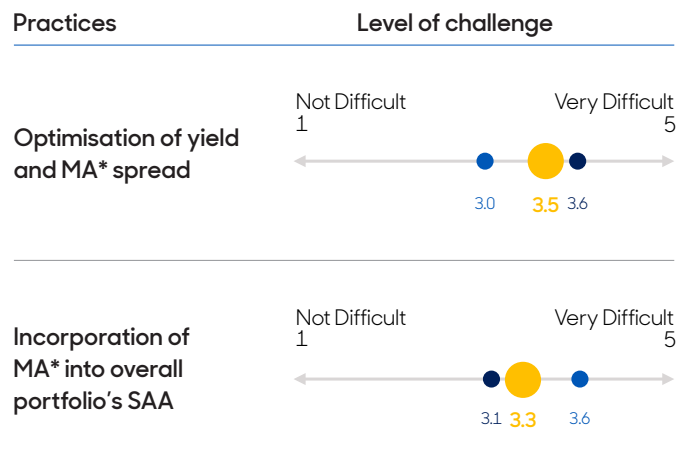


- Already built
- Building in progress
- Planning to build
- Not planning to build

Note: *Matching adjustment

Source: abrdn and Quinlan & Associates analysis

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

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

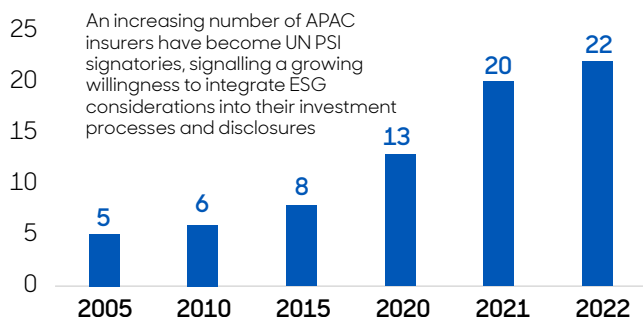


Green finance guidelines for the insurers

In 2022, CBIRC¹ issued guidelines that insurers should ultimately achieve carbon neutrality in their portfolios while simultaneously disclosing ESG risks

No. of UN PSI² signatories in APAC

of insurance companies, 2005-22



Case study

QBE³, 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



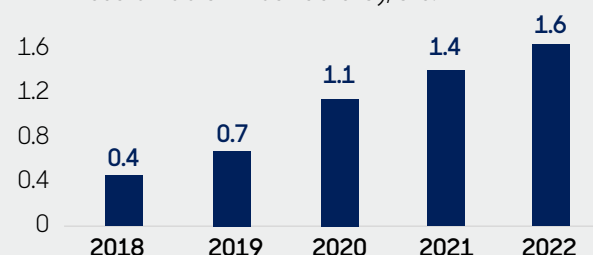
Investment product overview

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: ¹China Banking and Insurance Regulatory Commission; ²United Nations Environment Programme Finance Initiative – Principles for Sustainable Insurance; ³Company 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

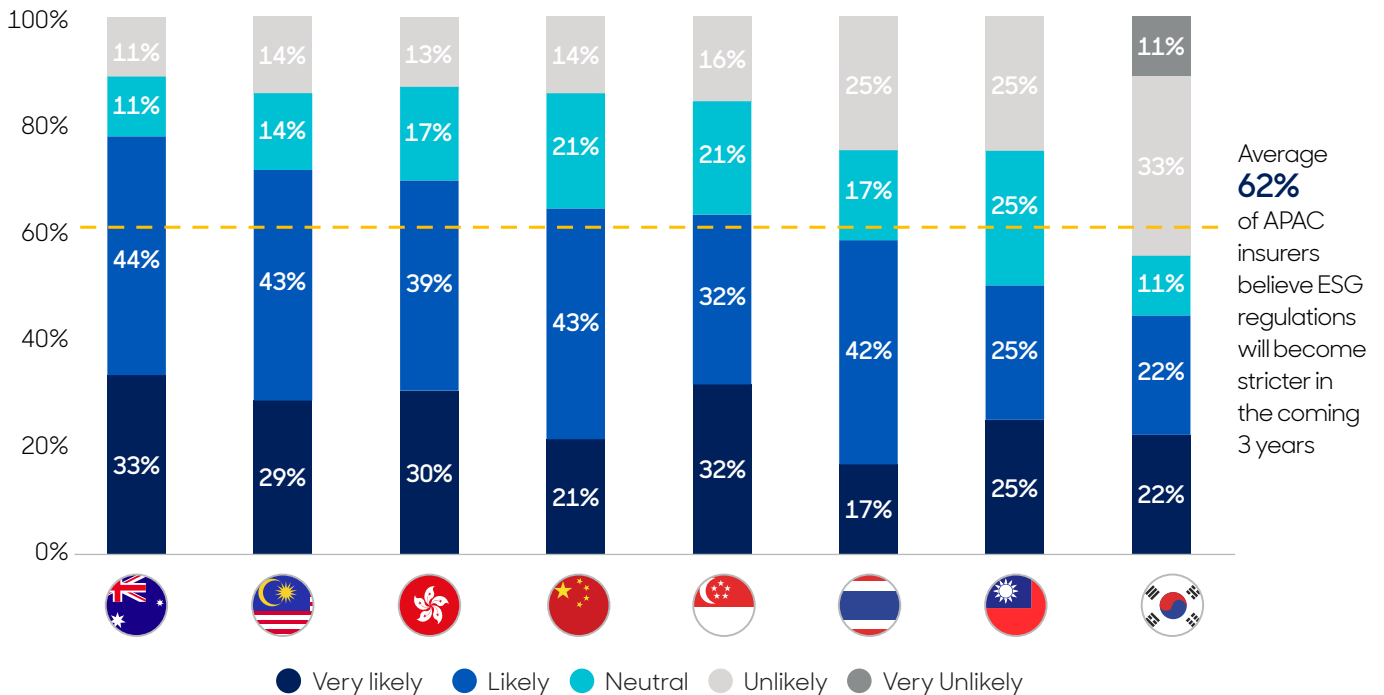
Most APAC insurers believe local ESG regulations will be further enforced in the coming 3 years, especially in Australia, Malaysia and Hong Kong

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

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

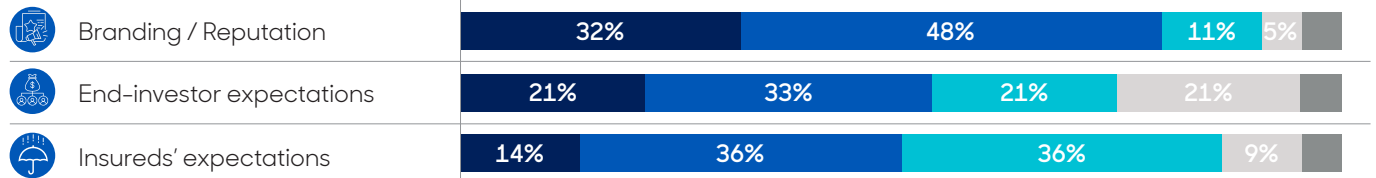
Motivations for ESG integration

Level of importance, % of respondents

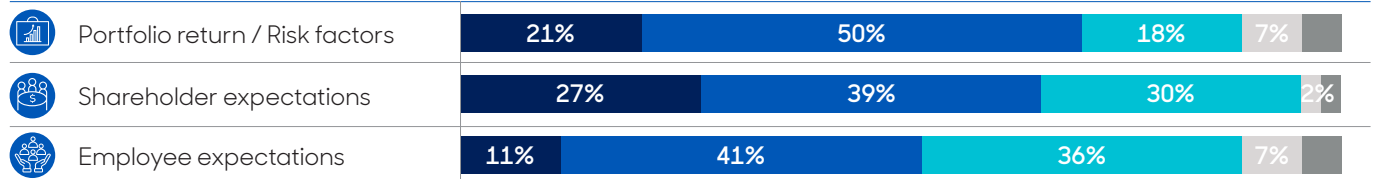
Regulatory



External



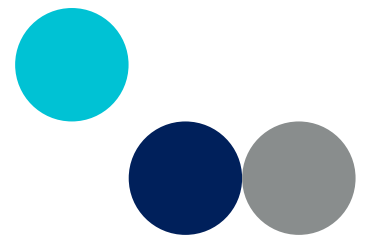
Internal



0% 10% 20% 30% 40% 50% 60% 70% 80% 90% 100%

Level of importance: ● Very important ● Important ● Neutral ● Less important ● Not important

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

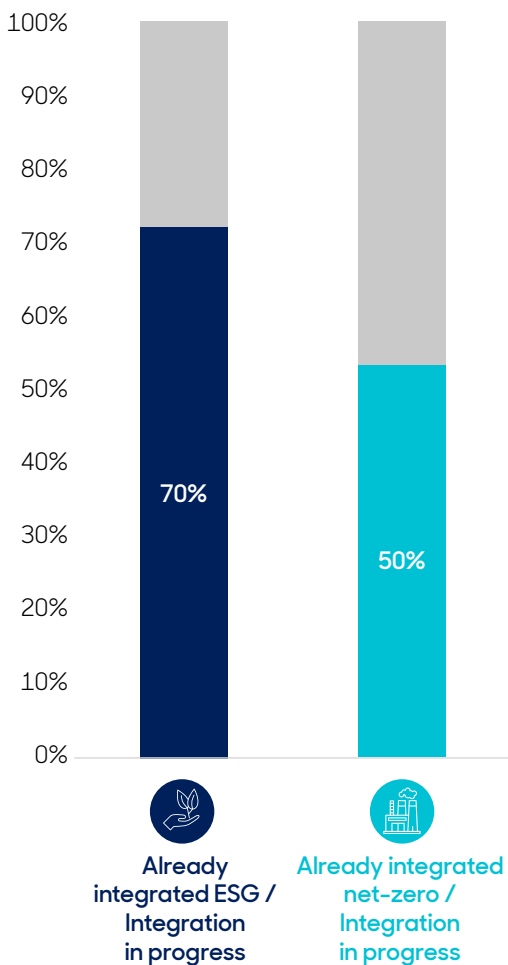
30% / 50%

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 insurers who rate "Very difficult" / "Difficult"

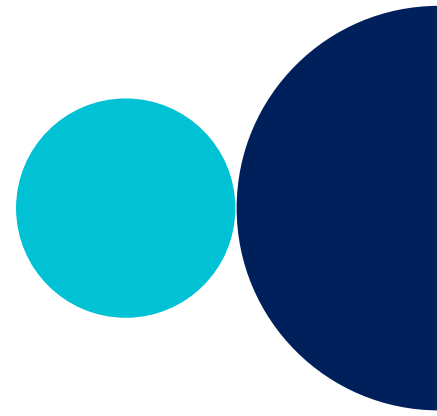
Integration barriers	ESG	Net-zero
Data quality (e.g. lack of data availability, inconsistent methodologies, etc.)	81%	78%
Investment management (e.g. incorporating ESG factors into SAA or security valuation, etc.)	51%	57%
Stakeholder management (e.g. meeting investor expectations, actively engaging with 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

Investment strategy



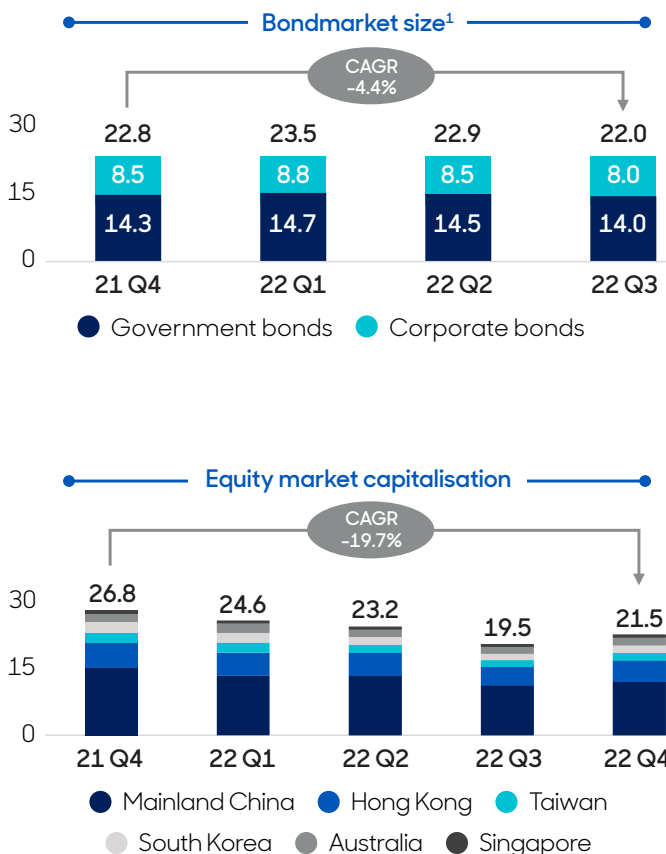
APAC investment landscape

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

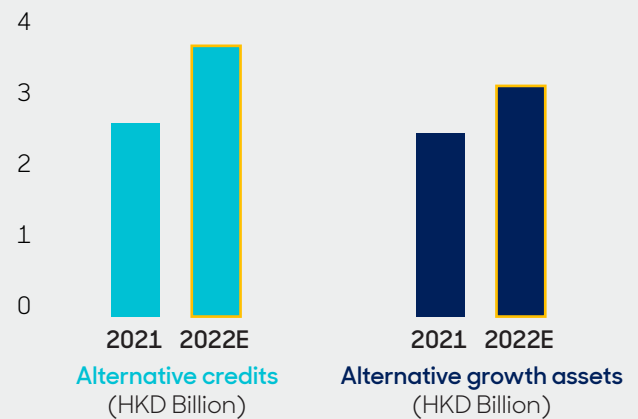


Case study AXA², Hong Kong



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: ¹Asia ex-Japan Bond Market Size. ²Company 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

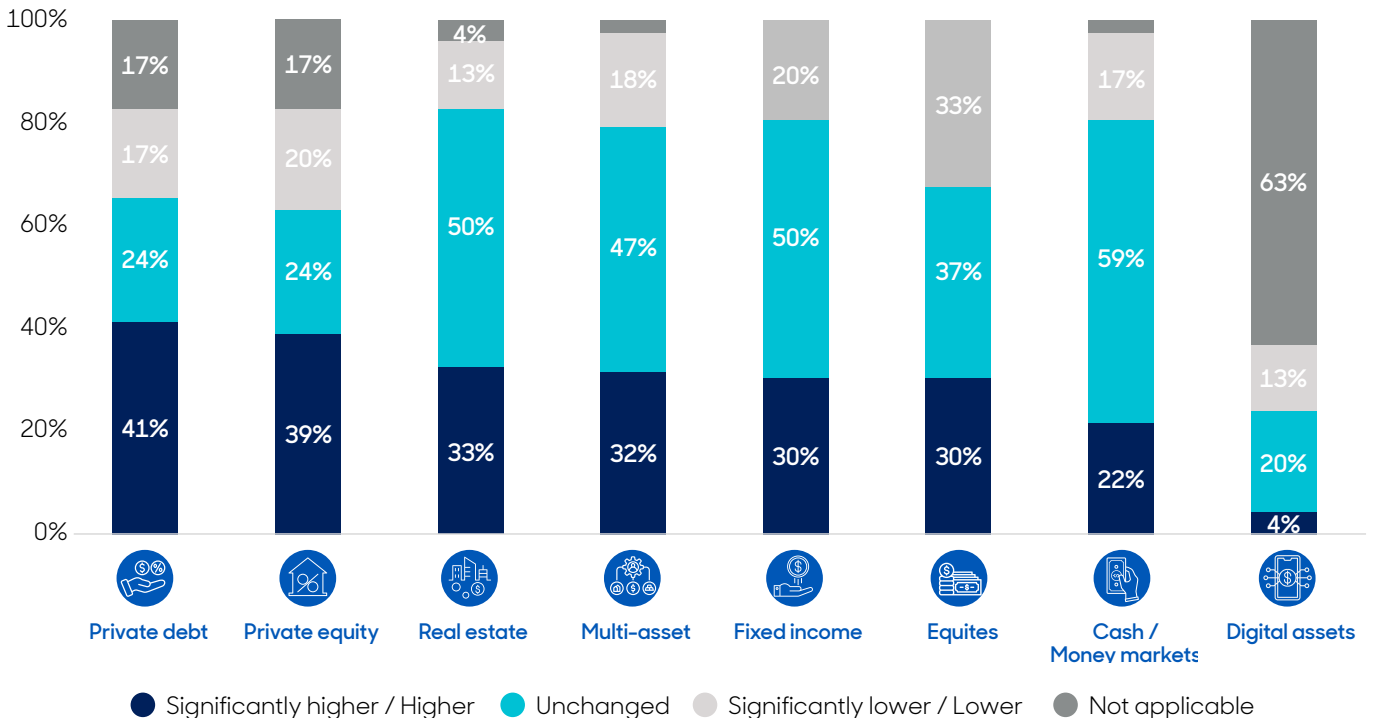
Insurers' interest in private market (e.g. private debt, private equity) has increased at the expense of digital assets and equities

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

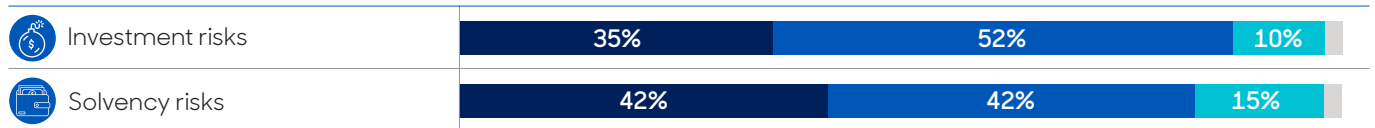
Key takeaway(s)

- 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

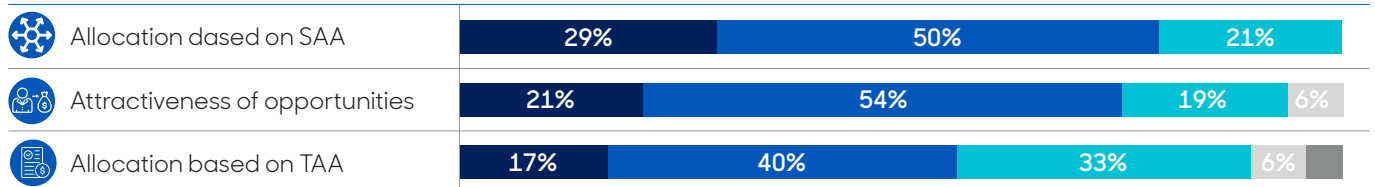
Factors for investment strategy decision

Level of importance, % of respondents

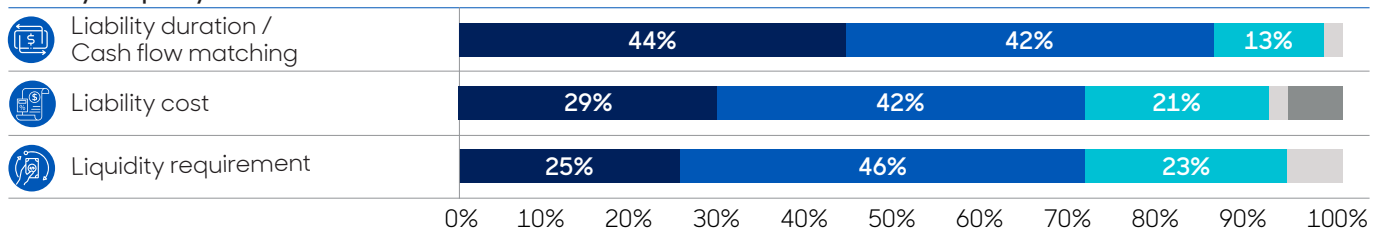
Risk-related factors



Allocation / Return considerations

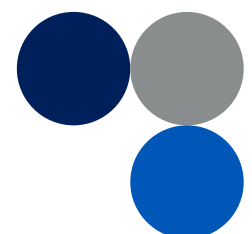


Liability / Liquidity restrictions



Level of importance: ● Very important ● Important ● Neutral ● Less important ● Not important

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

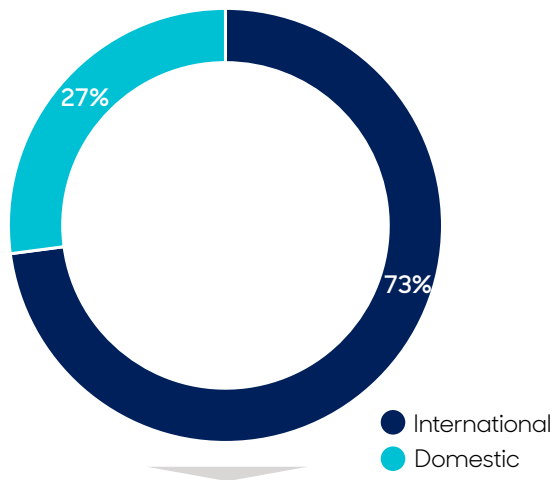
73%

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

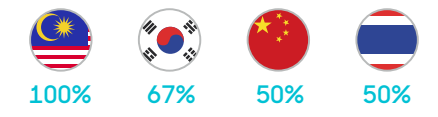
Key takeaway(s)

- 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

Market allocation in three years % of respondents



Top 4 markets with domestic preference

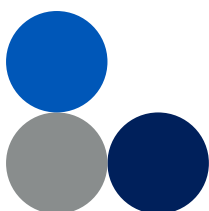


As the regulatory requirements in Mainland China, Malaysia, Thailand, and South Korea are relatively more strict, insurers are motivated to choose domestic investments

Motivations for domestic option	% of respondents				
Regulatory requirements	62%	38%			
Better risk / Return profile	15%	54%	23%	8%	
Familiarity / Home bias	31%	31%	15%	8%	15%
Better invest. capabilities	15%	39%	31%	8%	8%

Legend: ● Very important (dark blue), ● Important (medium blue), ● Neutral (teal), ● Less important (light grey), ● Not important (dark grey)

Source: abrdn and Quinlan & Associates analysis



Hedging strategy



Risk hedging overview

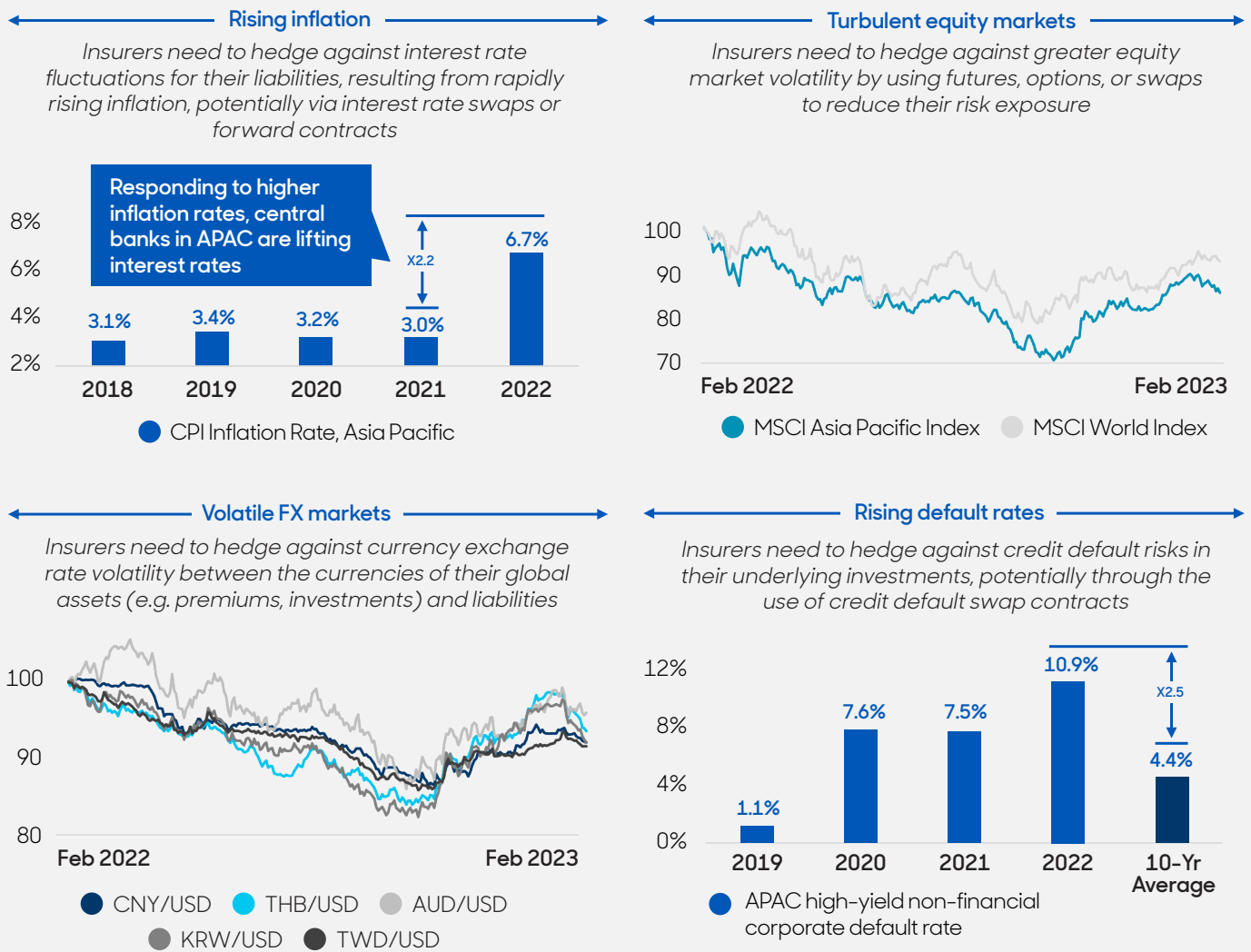
Summary

- 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



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

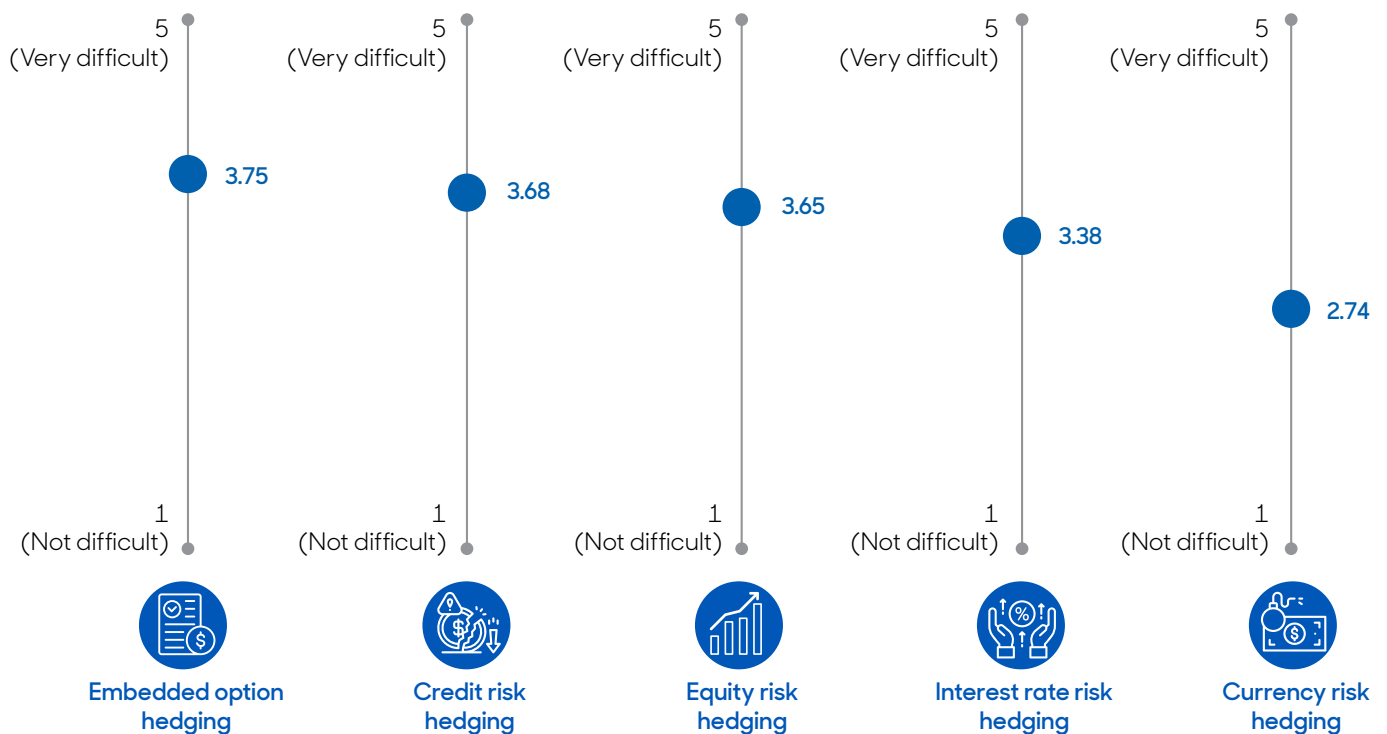
APAC insurers find embedded option hedging to be the most challenging to implement, followed by credit risk hedging

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

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

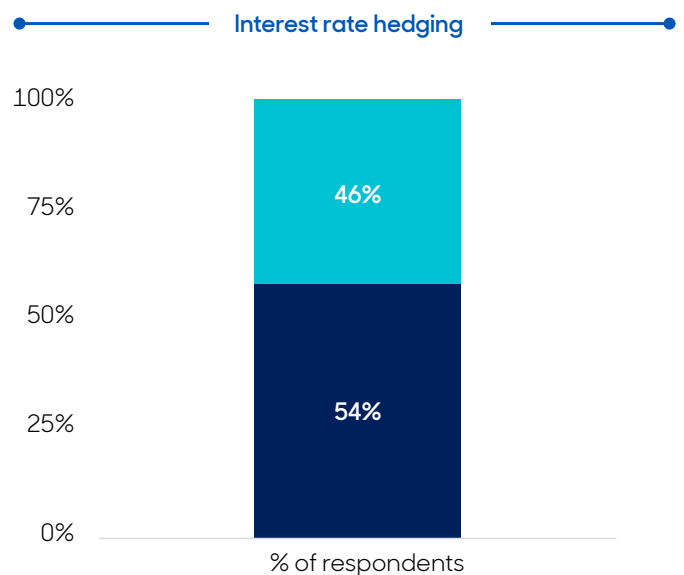
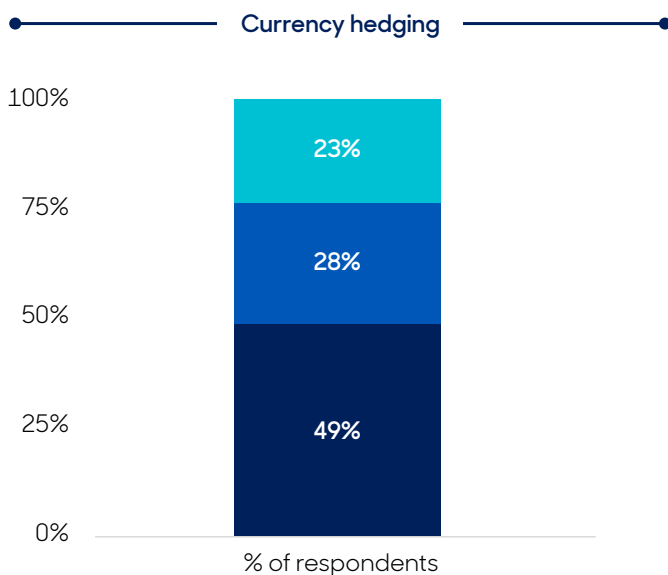
For currency hedging, insurers prefer a partial hedge, while for interest rate risk hedging, many insurers choose to match asset-liability duration

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



- 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

- 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

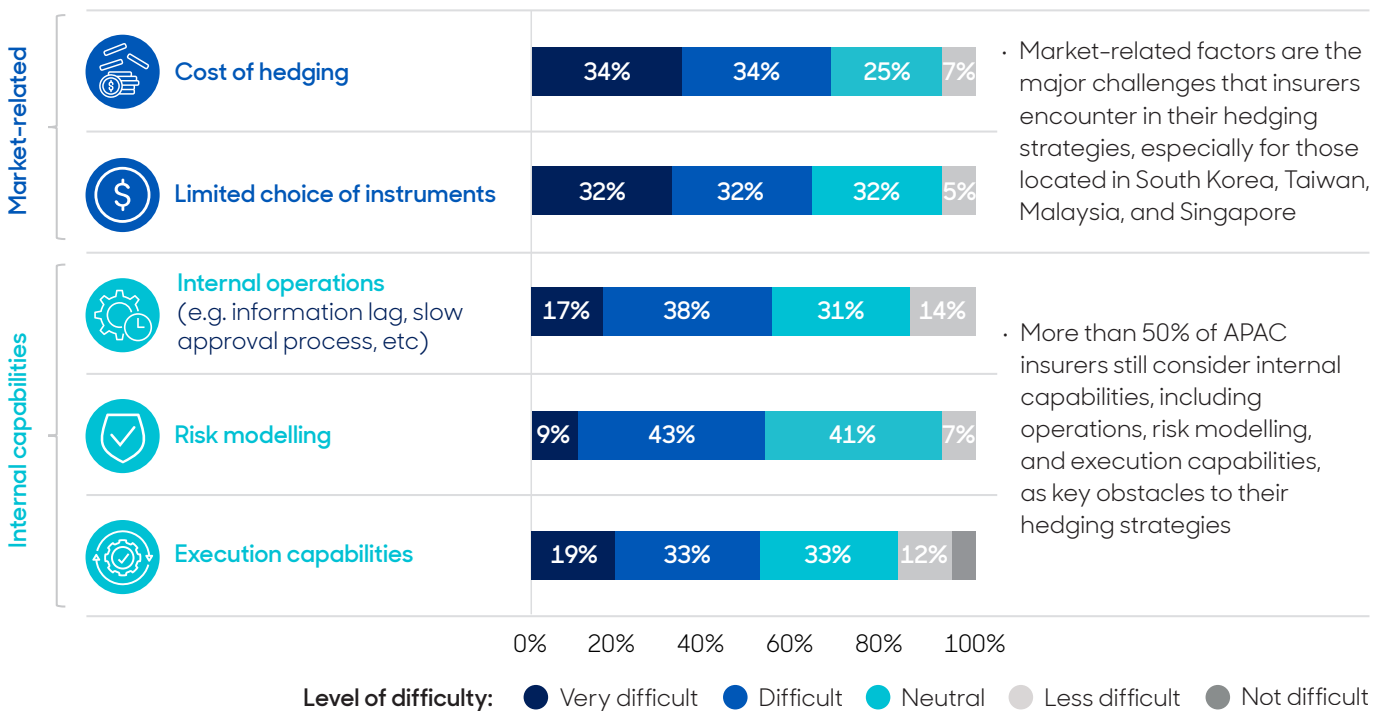
The major challenges for insurers in implementing hedging strategies are the cost of hedging and limited choice of instruments

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



Source: abrdn and Quinlan & Associates analysis



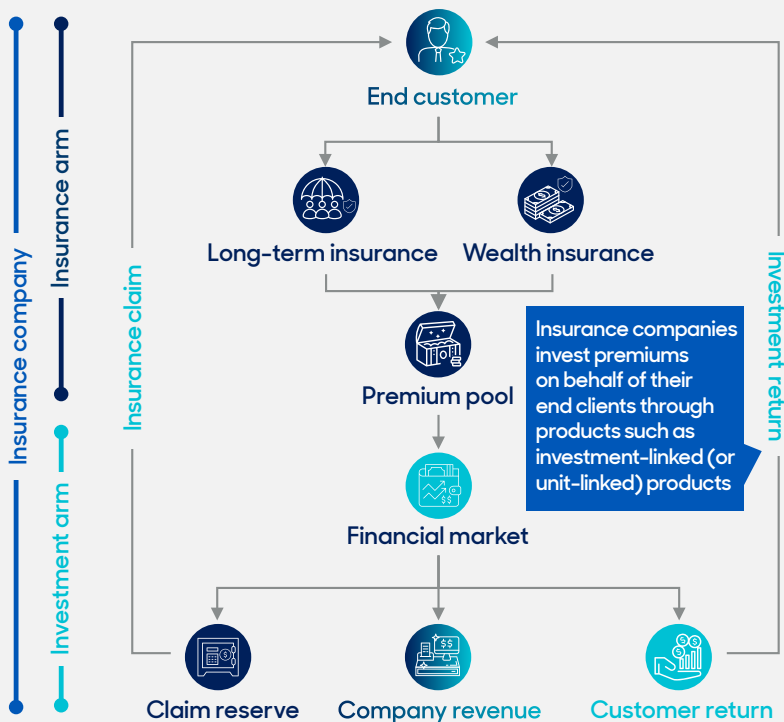
ILP market overview (1/2)

Summary

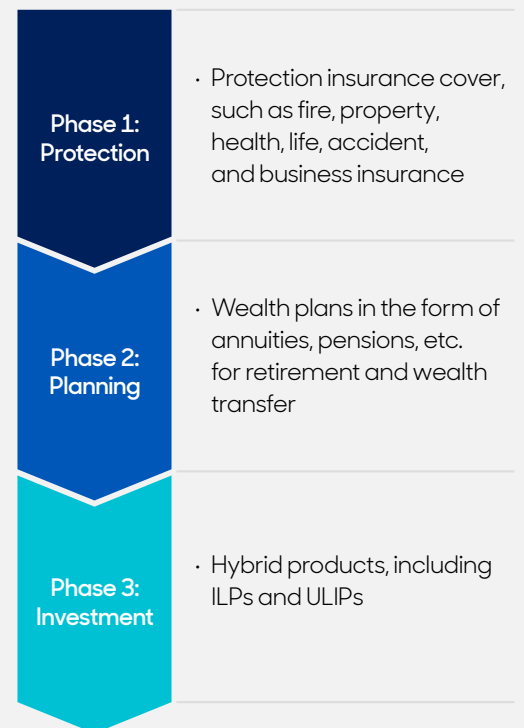
- In response to increased capital requirements imposed by RBC regulations, a growing number of insurance companies are exploring the adoption of –or are re-focusing on – ILPs, a capital-light investment product
- However, in more recent years, a growing number of insurers are leveraging their investment 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



Source: Quinlan & Associates analysis

ILP market overview (2/2)

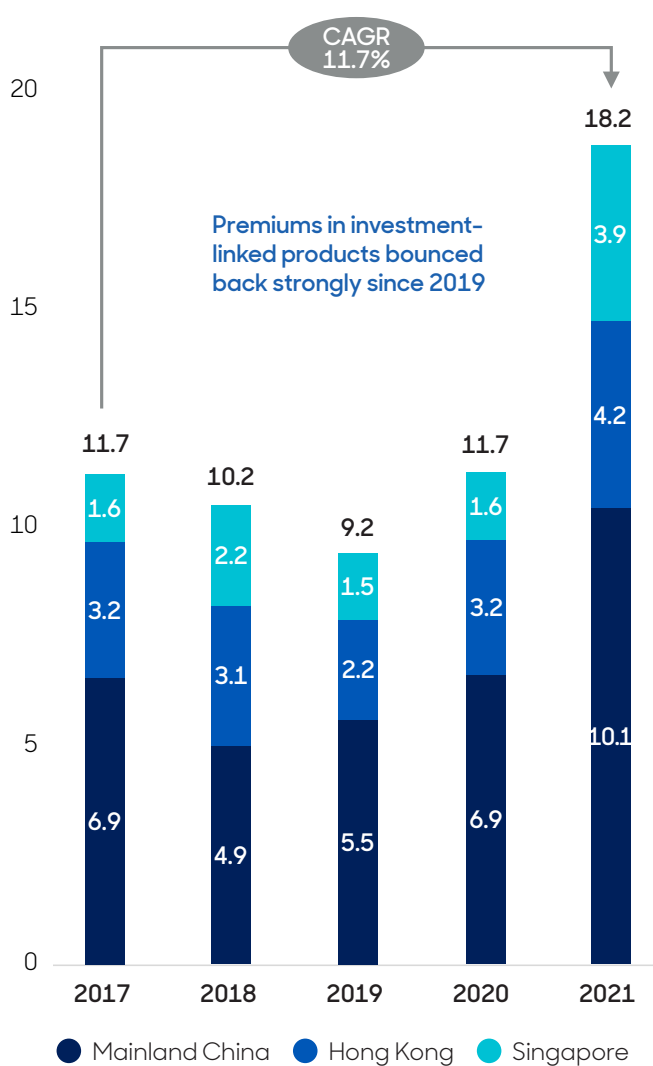
Summary

- 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

Zurich¹, Hong Kong



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



Note: ¹Company 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

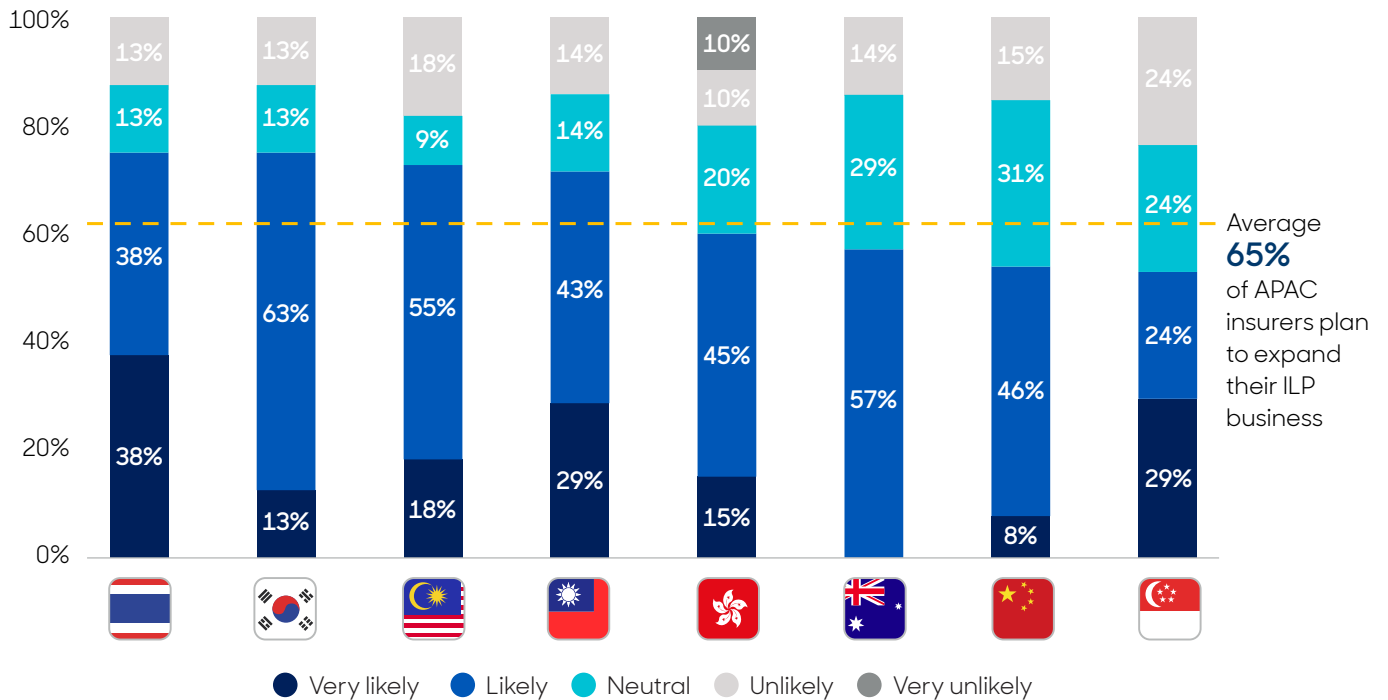
The majority of APAC insurers plan to expand their ILP businesses, especially those who operate in Thailand, South Korea, and Malaysia

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

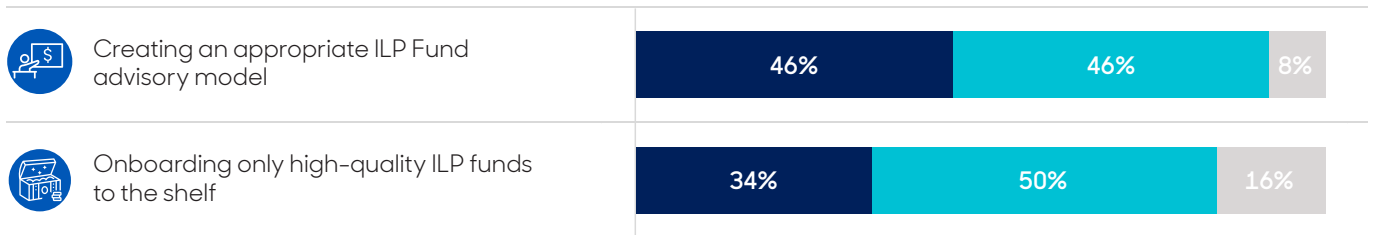
Key takeaway(s)

- 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

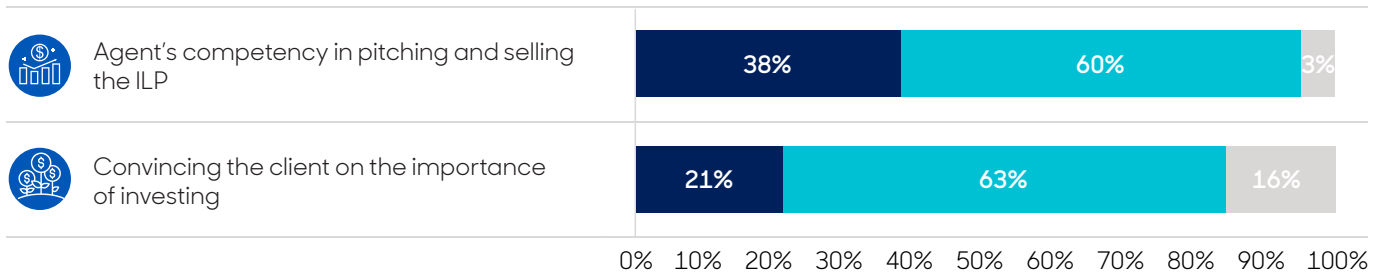
Key challenges in ILP business

Level of challenge, % of respondents

Internal capabilities

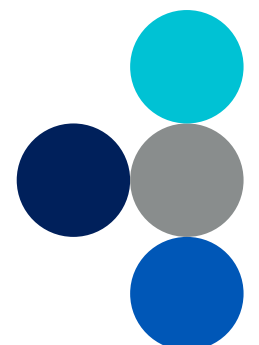


Business development capabilities



Level of challenge: ● Major challenge ● Moderate challenge ● Minor challenge

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

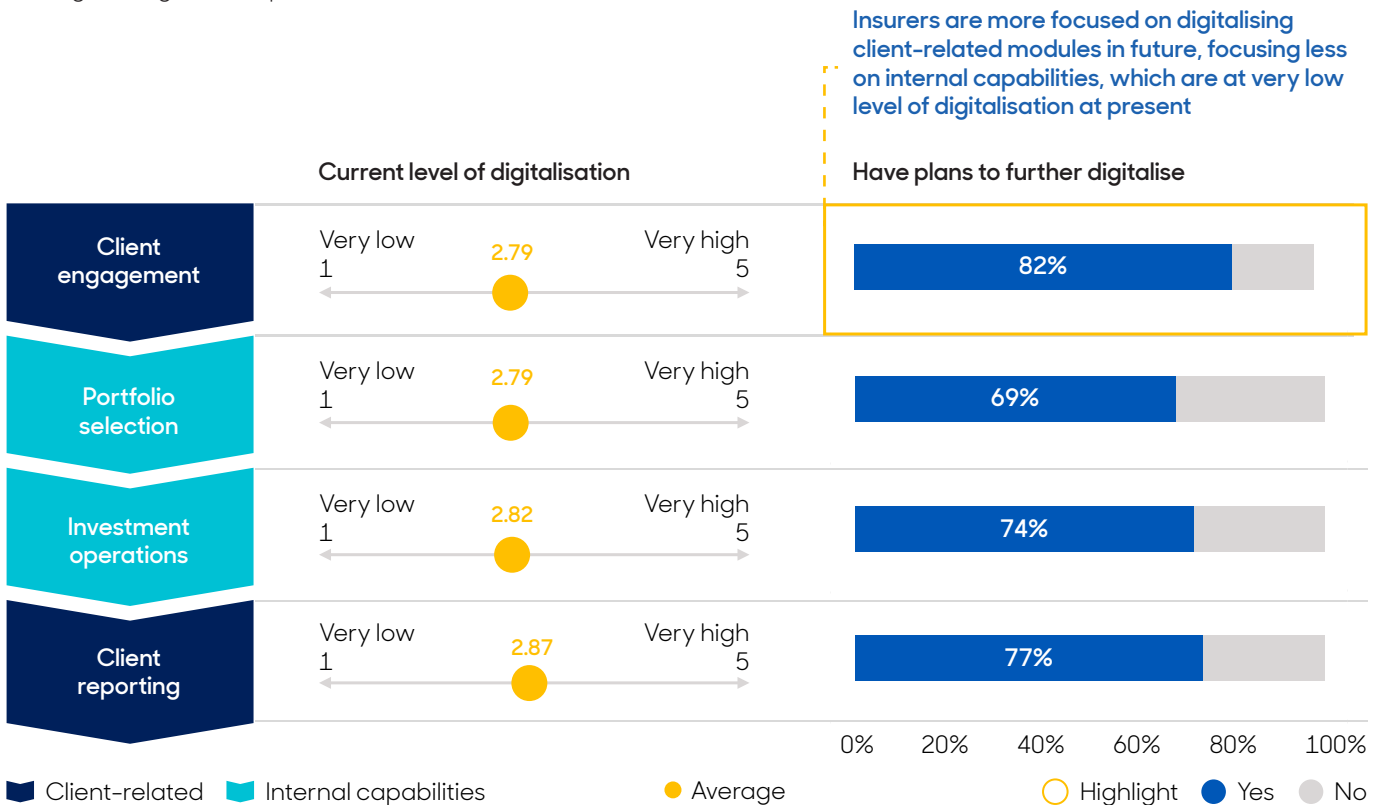
The digitalisation level of ILPs is generally low, especially with respect to internal capabilities, with plans to further digitalise client-related operations

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

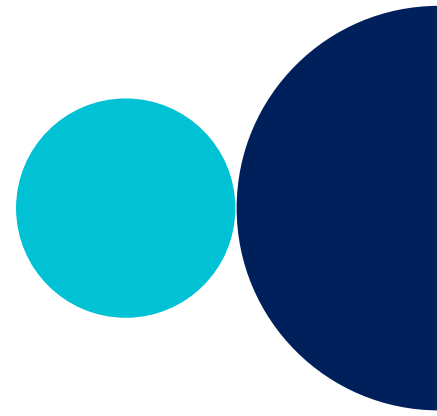
Digitalisation of the ILP value chain

Average rating, % of respondents



Source: abrdn and Quinlan & Associates analysis

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



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

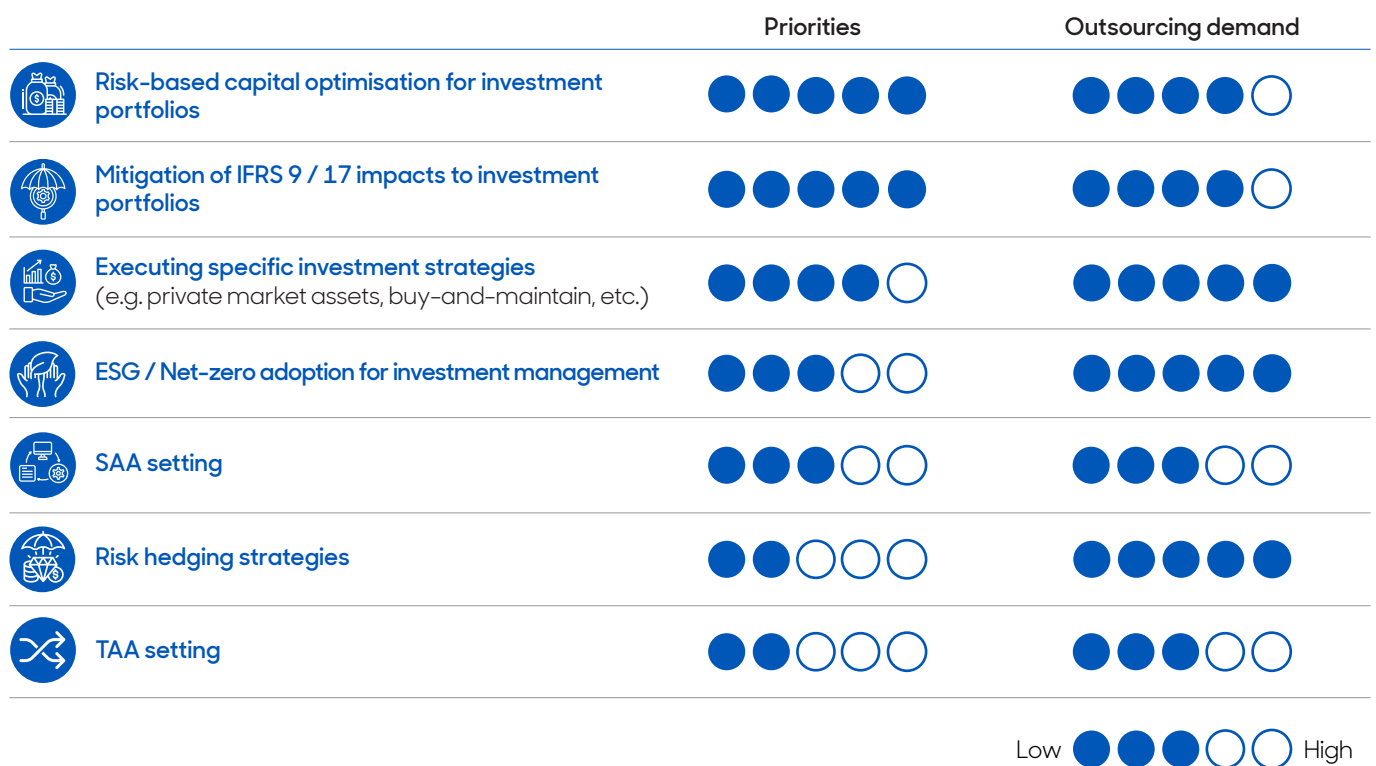
In general, insurers need the facilitation of third-party partners to tackle key challenges, especially in ESG / net-zero, investment execution, and hedging

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



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

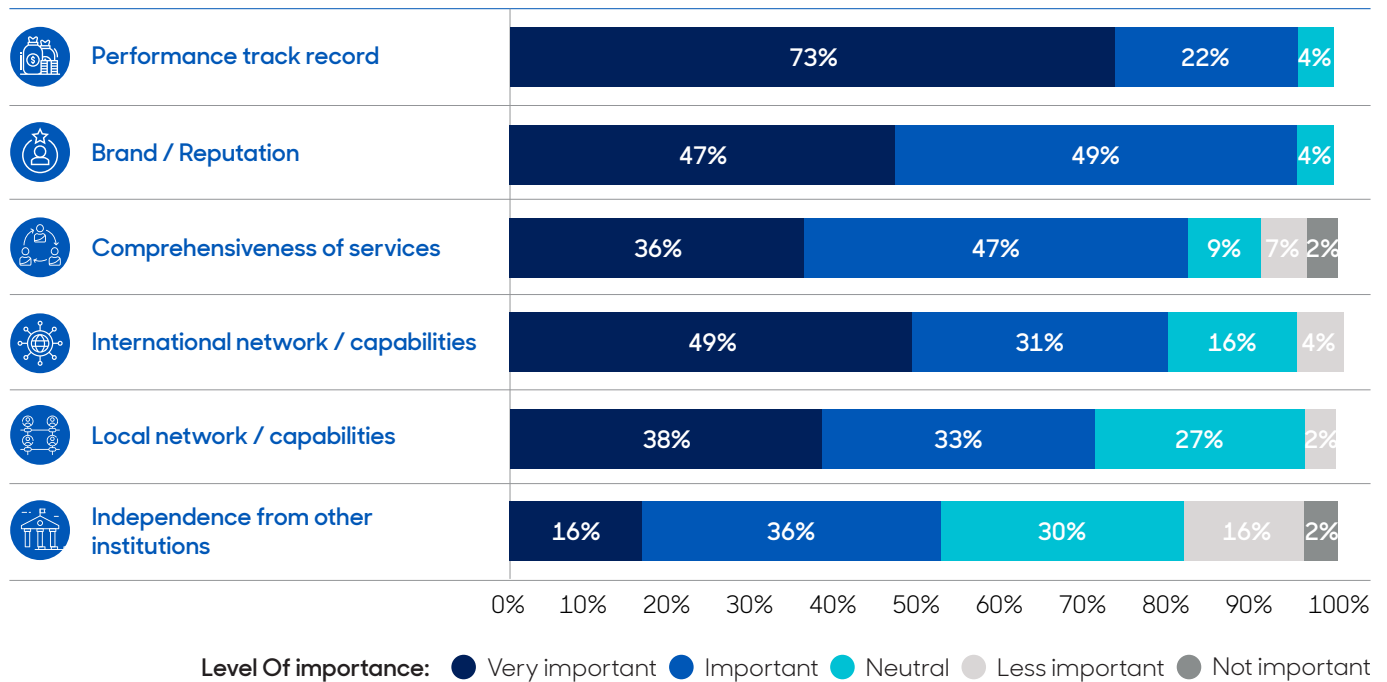
Performance track record, brand / reputation, and comprehensive services are the most important considerations for insurers when selecting partners

Key takeaway(s)

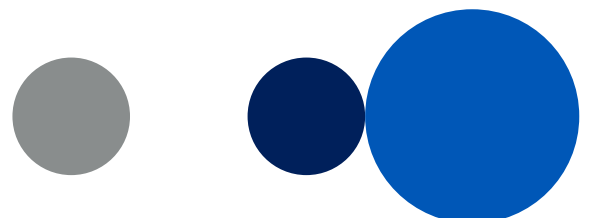
- Almost every surveyed insurer agrees that brand/ reputation and performance track record are very important / important factors to consider when outsourcing to an external partner
- Insurers focus less on third-party partners' independence from other institutions, as long as they provide high-quality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

Key decision factors

Level of importance, % of respondents



Source: abrdn and Quinlan & Associates analysis



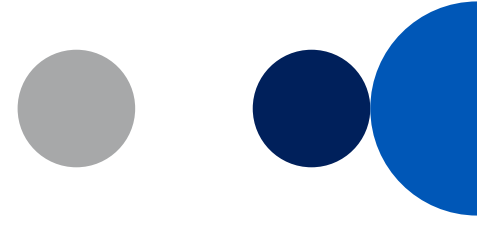
Section 3

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		<ul style="list-style-type: none"> 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 Address challenges in RBC optimisation by developing a robust optimisation framework (supplemented by relevant technologies) and instituting appropriate regulatory initiatives (e.g. matching adjustment)
 ESG integration		<ul style="list-style-type: none"> 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.) 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		<ul style="list-style-type: none"> 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 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		<ul style="list-style-type: none"> 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 Source external partners capable of structuring highly tailored hedging solutions that are aligned with companies' risk management strategy and overall investment goals
 ILP business		<ul style="list-style-type: none"> 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 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		<ul style="list-style-type: none"> 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 Select high performing, reputable partners who are best positioned to address key capability gaps and / or further enable the delivery 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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