Mercer

Staying the course through challenging times

Findings from the 2022 Global Insurance Investment Survey

November 2022

welcome to brighter

Navigating this report

This document has interactive features and works best using full-screen mode in Adobe Reader, which can be downloaded for free.

Click the icon to navigate to the Contents page.

Hover over the buttons to see different chart data options.

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Executive summary — Staying the course through challenging times

Recent market volatility and rising inflation are the primary concerns highlighted by global insurers responding to Mercer's 2022 global survey.

That said, our survey (conducted May to August 2022) finds a clear and strong trend toward investing in private debt. Insurers have been reducing their core fixed income exposures in favor of less liquid areas, such as private credit and real estate and infrastructure debt.

This is reflective of a long-term trend we have observed across many types of institutional investors. Ultra-low interest rates and bond yields have prompted many asset owners to explore alternative sources of income, while the retreat of banks from private finance has attracted new kinds of investors into unlisted debt markets.

It remains to be seen whether this period of volatility and higher inflation — and the central bank actions that have come with it — will prompt a rethink of the move to less-liquid assets. Although public fixed income yields have become more comparable to private credit yields, private credit still offers investors diversification benefits, downside protection (via structural protections and covenants) and, potentially, inflation protection (via floating-rate loans or direct exposure to inflation-linked cash flows). In addition, we believe that the illiquidity premium is persistent over the long term.

Environmental, social and governance (ESG)-themed investing is now mainstream as investors and their stakeholders have become more aware of — and concerned by — the broader impact of capital decisions on society and the planet. One-third of insurers said ESG issues were among the biggest challenges they currently faced.

In common with other institutional investor groups, insurers have broadly embraced ESG investing and sustainability concerns. However, a geographical difference remains in take-up of these approaches, with US insurers somewhat lagging other regions. We note, though, that the gap is closing.

Key issues highlighted by our respondents are the quality, availability and consistency of ESG data and the need for and approach to net-zero portfolios. Some insurance companies have set targets for reducing the overall carbon footprint of their investment portfolios to net zero, but many have not — and have no plans to do so.

The study also revealed concern among some insurers that they do not have the internal resources required to manage increasingly complex investment portfolios. Internal teams are often small, with many having fewer than six investment staff, meaning it can be a challenge to enter new asset classes and monitor external managers while keeping within stringent insurance investment rules.

This is holding insurers back from accessing important sources of yield, returns, diversification and risk mitigation. Scale is less of an issue as accessibility for many private asset classes has improved significantly over the years.

Instead, some insurance companies find that private markets are out of reach because they do not have the internal expertise to dedicate to the asset class. Meanwhile, the demands of ESG and sustainable investing are also putting pressure on in-house teams to add to their skill sets within a limited budget.

We work with insurance companies around the world to help them solve these and other challenges for the benefit of their financial position, their stakeholders, and their clients.

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Key findings summary

Investment risk on the increase

48% plan to increase investment risk within their portfolios.

43% cite the use of illiquidity as a top-three opportunity for the next 12 months.

24% intend to add to exposures such as high-yield bonds, bank loans, private equity, international listed equity and infrastructure.

ESG investing — Part of the mainstream

54% of respondents say they do not feel they need to compromise on investment returns when incorporating ESG considerations.

25% have set a net-zero carbon emissions target for their investment portfolios.

85% say data reliability and consistency is one of the main ESG-related challenges they face.

Private debt — A primary opportunity set

35% are increasing investment in investment-grade private debt.

44% of insurers plan to reduce portfolio liquidity over the course of the next 12 months.

41% are reducing their public fixed income exposure.

Complex investments are stretching internal teams

63% say a lack of internal expertise limits their ability to invest in private markets.

25% say operational complexity is one of their major concerns.

21% say they find it hard to make dynamic or tactical asset allocation decisions.

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01 Investment risk on the increase

For the first time in over a decade, insurers can access high-quality yield at attractive levels. However, there is notable downside risk to the global economy. Diversification remains key.

Action points

- Re-optimize your fixed income holdings and allocations in light of higher interest rates and inflation. It may be worth considering flexible options such as absolute-return fixed income or multi-asset credit solutions.
- Investigate your liquidity position to assess whether you can take more long-term positions to capture the diversification, downside-protection and inflation-protection benefits of illiquid assets.
- Consider scenario analysis to test the behavior of your portfolio in different economic environments and inform your future decisions.
- Explore how to optimize your investment portfolio and operations to diversify without adding undue complexity.

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What has changed

Fixed income — long the core holding of most insurance companies — is evolving. The retreat of banks from private debt markets has opened up a universe of new opportunities for institutional investors, while investment returns on core government and corporate bonds have been low in recent years, or indeed negative in 2022 as yields have risen.

Exposure to private fixed income asset classes globally sits at around 4%, according to our survey, including 2% in investment-grade and 2% in high-yield private debt. This exposure has been increasing for some time and remains the most likely area where insurance companies will add allocations. This is probably due to historically higher yields than comparable public bonds without additional credit or interest-rate risk and lower correlations to traditional portfolio exposures, resulting in enhanced portfolio diversification. Private debt also offers improved downside protection due to stronger covenants relative to public fixed income, which can be important in a contracting economy.

What is your current asset allocation? (Regions)

Roll over the buttons below to reveal chart data

Source: Mercer's *2022 Global Insurance Investment Survey*.

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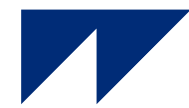

Investment grade fixed income remains the foundation of insurance company portfolios, with private markets and high yield increasing meaningfully over the last decade.

Greg Halagan, Head of Insurance, US

What is your current asset allocation? (Insurer type)

Roll over the buttons below to reveal chart data

Source: Mercer's *2022 Global Insurance Investment Survey*.

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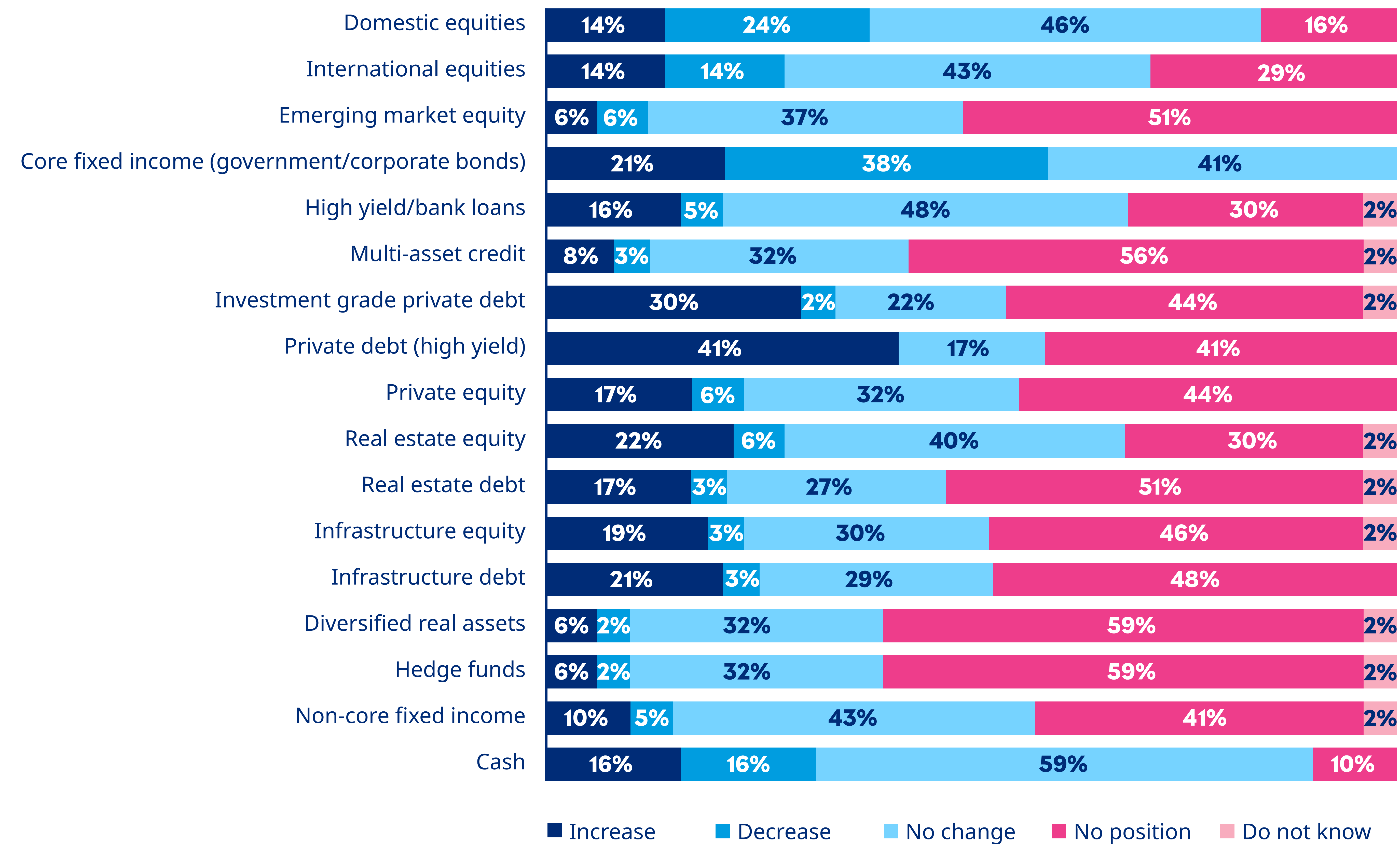
Respondents that have made changes to their portfolios in the past 12 months have been reducing their core fixed income holdings in favor of private debt, real estate and infrastructure. Domestic listed equity exposures have also been reduced by 24% of respondents.

These changes reflect a long-term trend toward private markets that we have observed in multiple client groups, including pension funds and wealth managers. We will explore private markets in more depth on page 30.

How has the asset allocation of your portfolio changed over the last 12 months?



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What will change

Private debt is by far the most popular destination for insurers seeking to adjust their asset allocations over the next 12 months. More than one-third (35%) plan to increase investment-grade private debt, and a similar proportion (33%) are targeting high-yield private debt.

How do you expect the asset allocation of your portfolio to change over the next 12 months? (Regional)

Roll over the buttons below to reveal chart data

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Insurers mostly plan to rotate from fixed income or cash into private debt, with 41% saying they will reduce core fixed income exposure in the year ahead.

This is likely due to more than half (52%) of respondents having excess liquidity in their portfolios that they may wish to put to work. A similar proportion (44%) say they plan to reduce liquidity in the next 12 months, potentially to capture complexity premium and enhanced returns while benefiting from stronger covenant protection and structure offered in private fixed income versus public fixed income.

> ***44% say they plan to reduce liquidity in the next 12 months.***

How do you expect the asset allocation of your portfolio to change over the next 12 months? (Insurer)

Roll over the buttons below to reveal chart data

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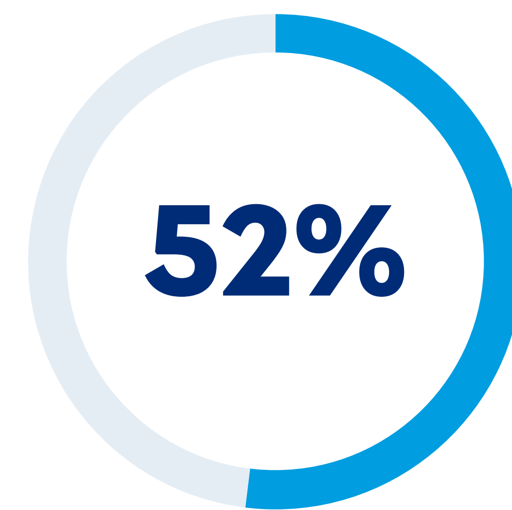
In addition, 43% of respondents identified the use of illiquidity as a return driver as one of their top three opportunities for the year ahead.

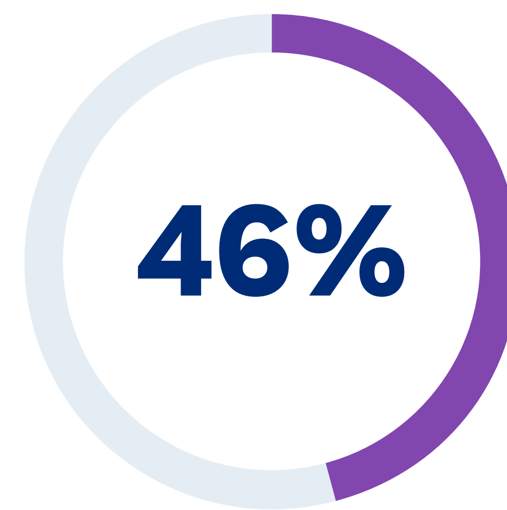
Other asset classes of interest to our respondents include high-yield bonds and bank loans, private equity, international equities and infrastructure equity. In each case, 24% of respondents plan to increase their exposure.

This willingness to take on investment risk is likely linked to insurers having excess portfolio liquidity-but could also reflect the environment of lower investment returns from traditional fixed income assets experienced over the past few years. However, as yields in public markets have risen in 2022, future expected returns from listed fixed income are likely to be higher.

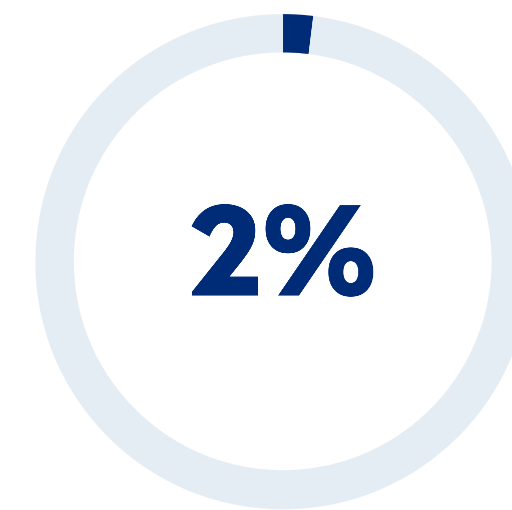
Do you believe you have excess liquidity in your portfolio?



Yes, we have excess liquidity in our portfolio



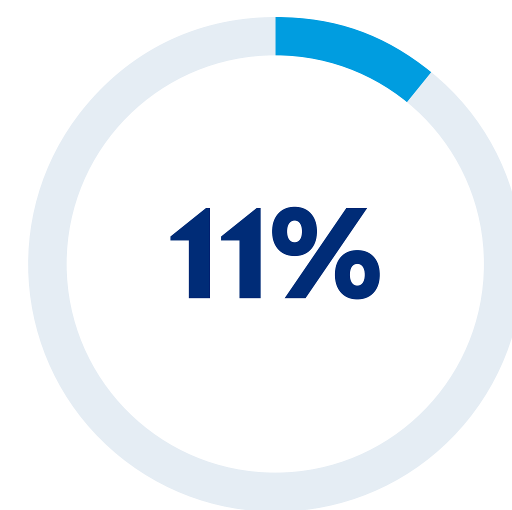
No, we have the right amount of liquidity in our portfolio



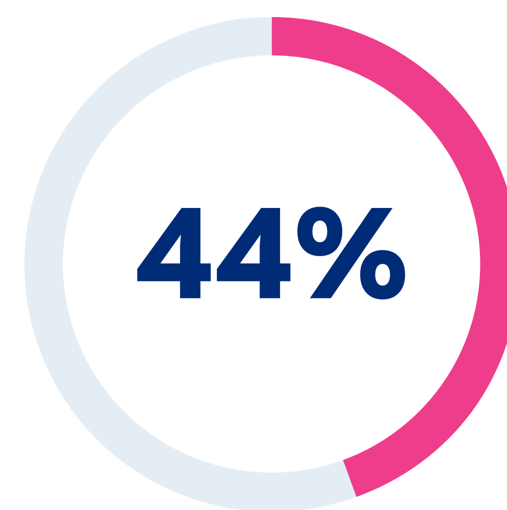
No, we do not have enough liquidity in our portfolio

43% of respondents identified the use of illiquidity as a return driver as one of their top three opportunities for the year ahead.

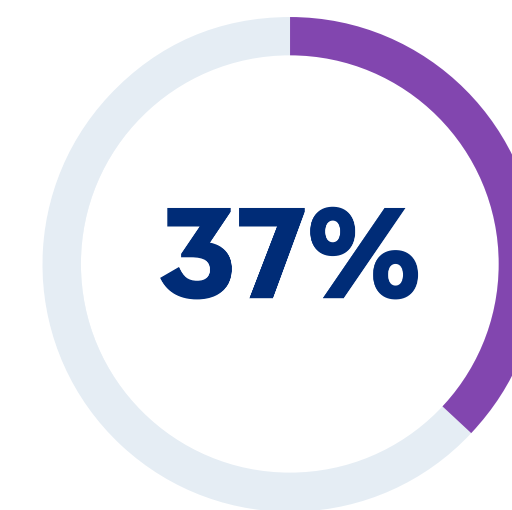
How is the overall investment liquidity of your portfolio likely to change over the next 12 months?



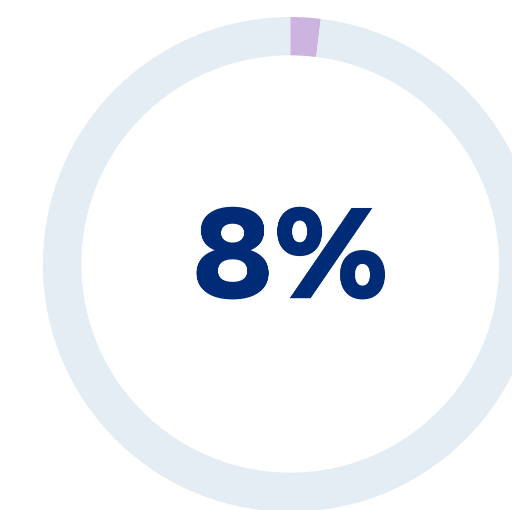
Increase



Decrease



No change



Do not know

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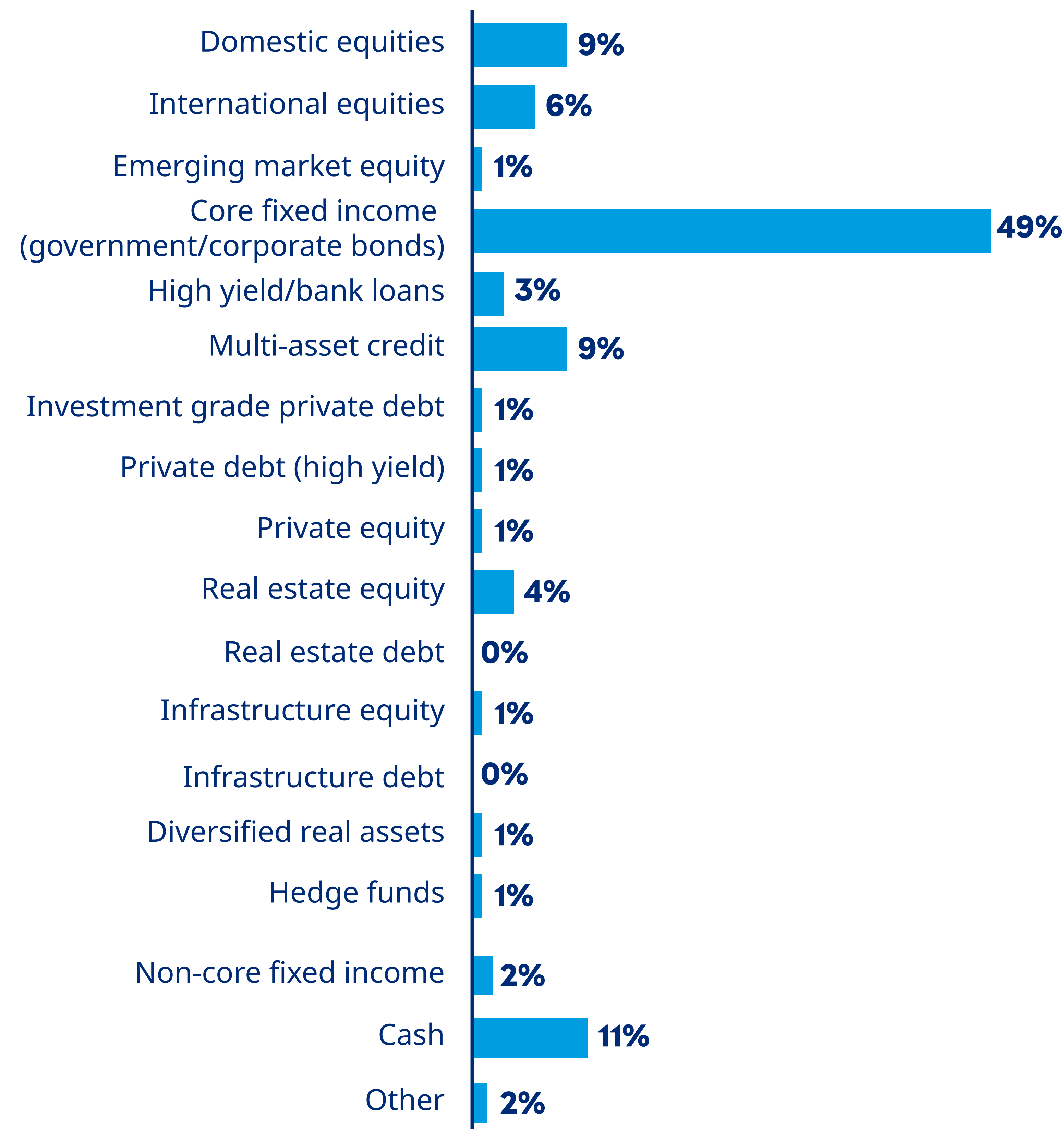
Spotlight on: Health insurers

According to the results of our asset allocation survey, health insurance companies' plans for the next 12 months appear to buck the overall trend.

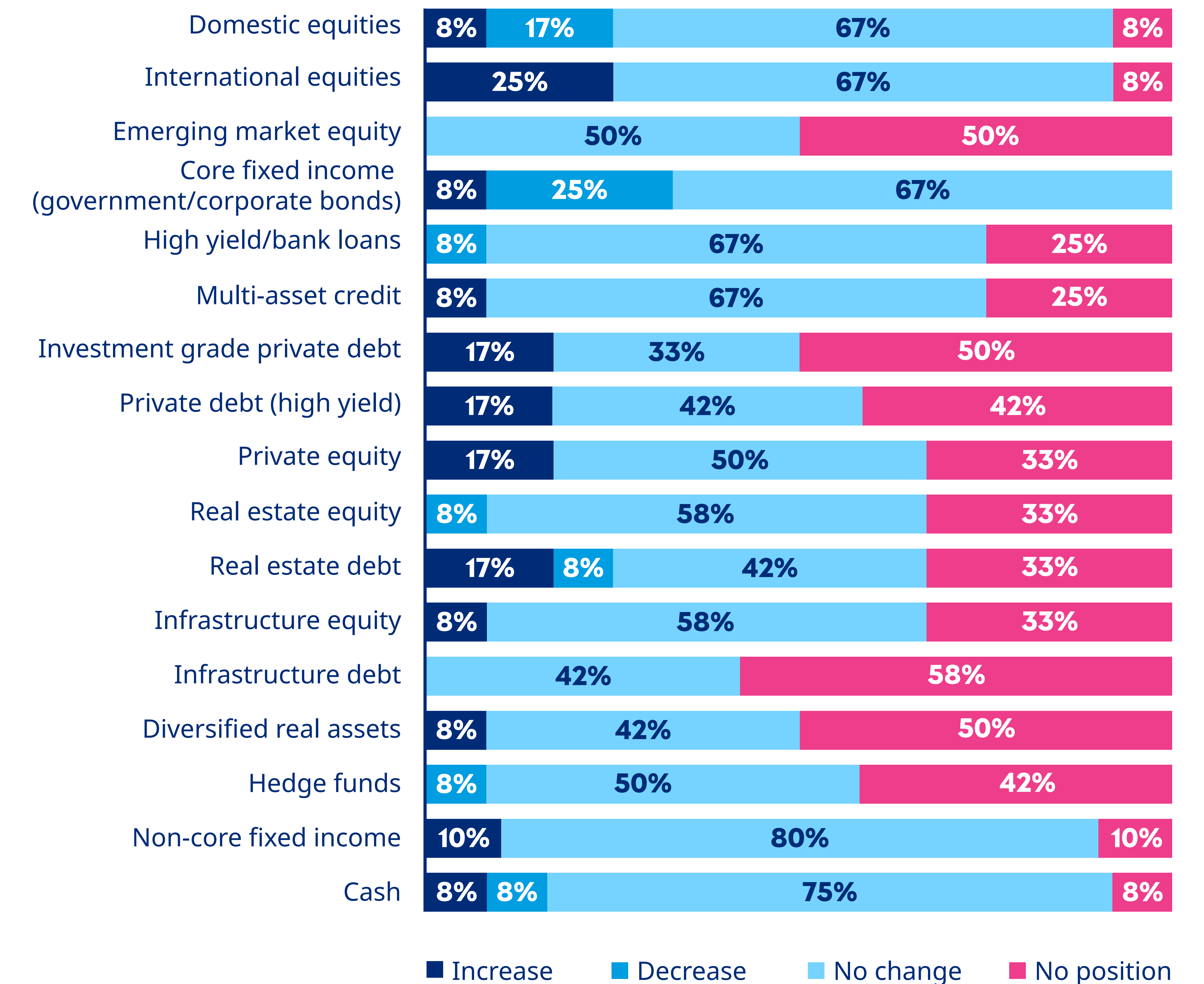
Health insurers are the lowest allocators to core fixed income (49% versus an overall average of 60%) and have the highest allocation to domestic and international equities (15% in total, compared to the overall average of 12%).

Over the past 12 months, while most insurers have been reducing core fixed income and adding to private debt, health insurers have shown more appetite for international equities, with 25% increasing holdings.

What is your current approximate asset allocation mix? (Health)



How has the asset allocation of your portfolio changed over the last 12 months? (Health)



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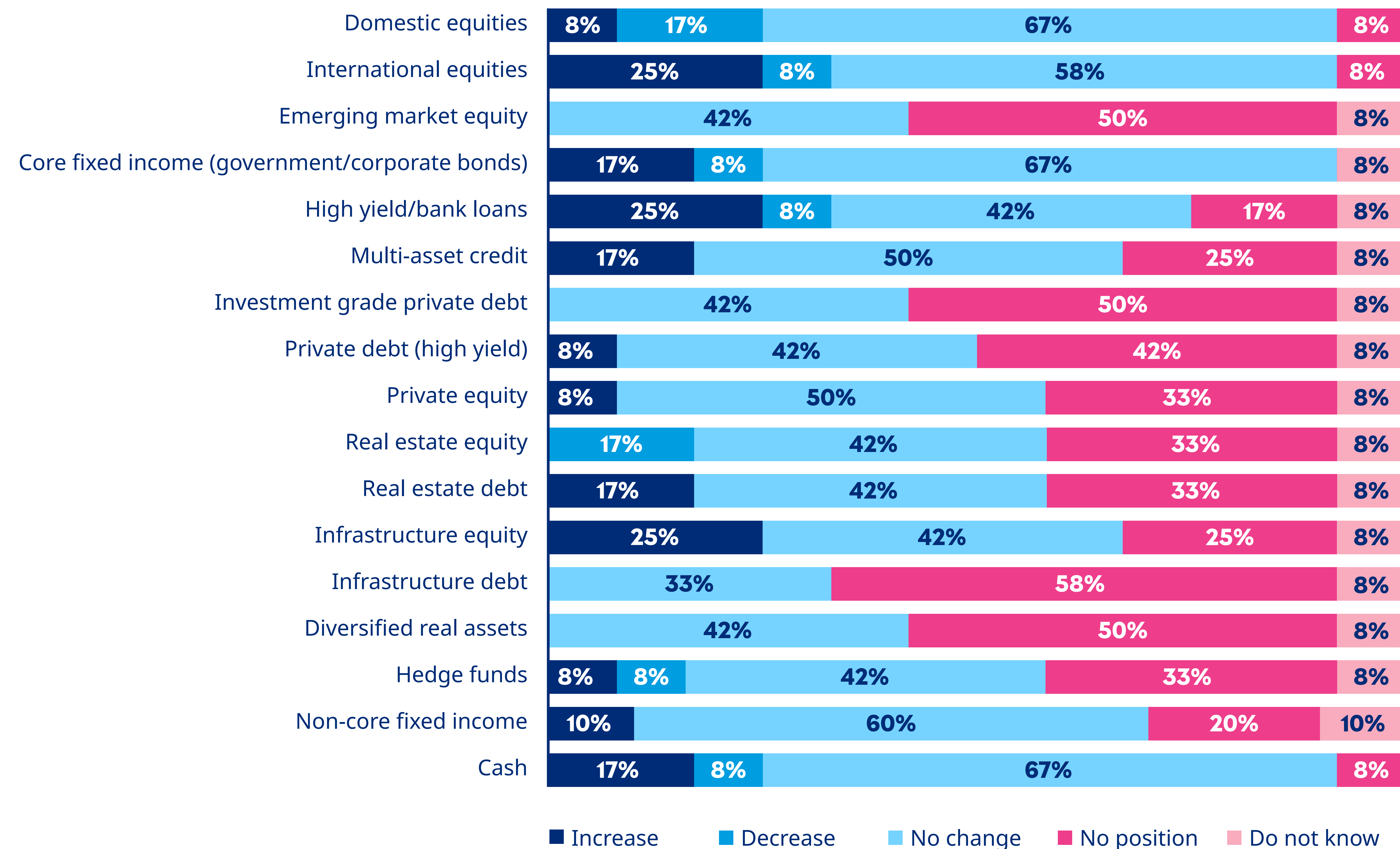
Looking ahead 12 months, some health insurers are planning to add investment risk. International equities, high-yield bonds and bank loans, and infrastructure equity are all of interest, with 25% of respondents planning to add to these asset classes in each case.

However, the survey results indicate that some may be looking to take risk off the table. Only 8% are planning to decrease core fixed income, whereas real estate equity and domestic equity exposures are the main areas health insurers plan to decrease (17% each). This may reflect regional differences as Australian health insurers are now subject to more stringent capital rules that may require a review of portfolio risk levels.

> ***Over the past 12 months, while most insurers have been reducing core fixed income and adding to private debt, health insurers have shown more appetite for international equities.***

How do you expect the asset allocation of your portfolio to change over the next 12 months? (Health only)



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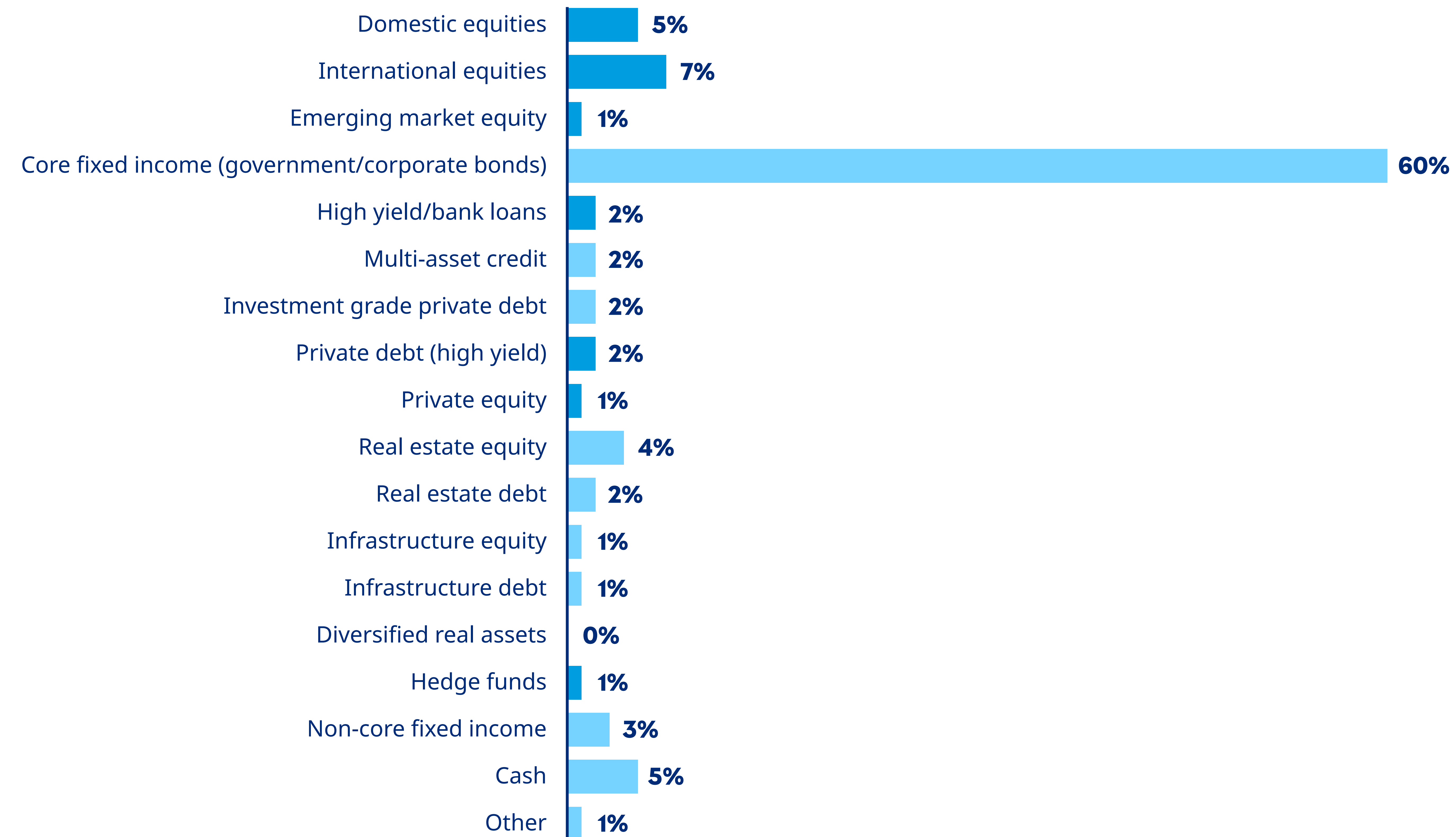
Risk assets

Overall, the asset-allocation plans of our respondents indicate an increased willingness to take on investment risk. Whether they are in search of better diversification across asset classes or the specific protections available in some private markets asset classes, most just desire to hold less in traditional core fixed income and are prepared to hold more in risk assets.

For example, 20% of P&C and non-life insurers in the survey indicated risk assets exposure of 80%–100% of their surplus. This may reflect decreased capital sensitivity due to their large size or strong capitalization levels.

What is your current approximate asset allocation mix?



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Most insurers have a low exposure to risk assets of less than 20% (38% of respondents), with another quarter holding 20%–40%. Others hold much more outside core fixed income and cash, and this reflects the nature of their businesses and the jurisdictions in which they operate.

For example, 20% of P&C and non-life insurers in the survey indicated a risk assets exposure of 80%–100% of their surplus portfolios. This may reflect decreased capital sensitivity due to their large size or strong capitalization levels.

What percentage of your surplus is invested in risk assets (risk-asset-surplus ratio)?*

Roll over the buttons below to reveal chart data

* In this survey, risk assets are defined as non-core fixed income or cash. The category includes equities, high-yield, bank loans and alternatives.

Source: Mercer's *2022 Global Insurance Investment Survey*.

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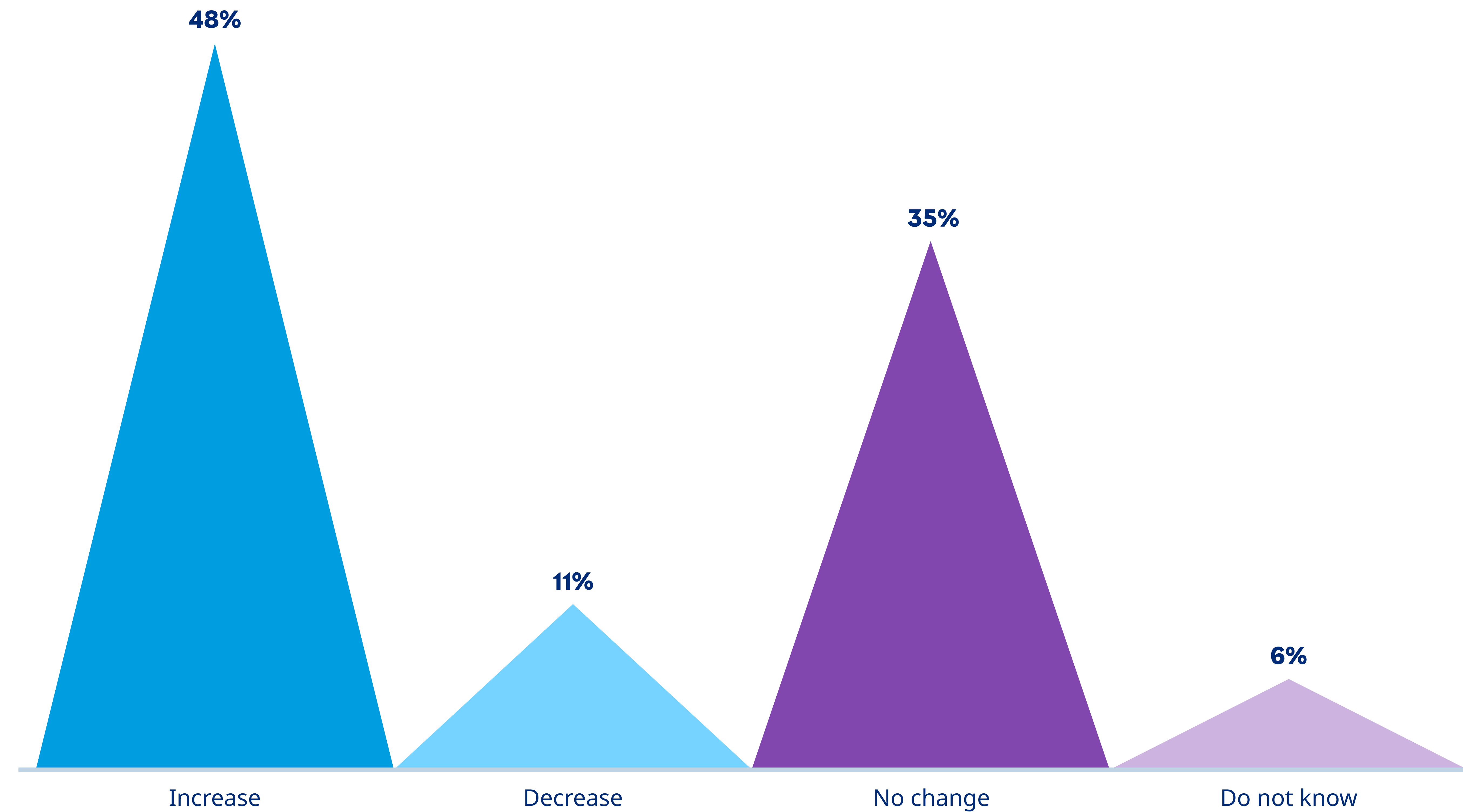
Over the next 12 months, almost half (48%) of all respondents plan to increase investment risk in their portfolios, while a similar proportion (44%) plan to decrease overall portfolio liquidity. Just over one-third plan no change to either.

We will explore insurers' plans for risk asset exposures in greater detail on page 30.

Over the next 12 months, almost half (48%) of all respondents plan to increase investment risk in their portfolios.

How is the overall investment risk in your portfolio likely to change over the next 12 months?



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Insurers' top challenges ...

The events of 2022 have clearly posed challenges for insurance companies — and will continue to do so for some time.

General market volatility caused by geopolitics, as well as monetary and fiscal tightening is the primary concern for insurance investors over the next 12 months, with two-thirds (67%) citing it as a major challenge.

Global inflation (63%) and action by central banks to increase interest rates (48%) are also high on the list of concerns, reflecting the sensitivity of insurance company investment portfolios to factors affecting bond markets.

One-quarter (25%) of respondents cited operational complexity as a major concern, which may reflect the growing complexity of portfolios, covered later in this report. It also chimes with the nature of most respondents: Most are insurers with less than US$10 billion in investment assets or fewer than five people in their investment teams, indicating limited internal resources. (See About This Survey on page 43 for respondent details.) Accessing private assets and risks related to ESG factors are also key growing concerns for some insurers.

What do you believe are your organization's top three investment challenges over the next 12 months?

Roll over the buttons below to reveal chart data

Source: Mercer's *2022 Global Insurance Investment Survey*.

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> *Investment portfolio optimization is the biggest opportunity cited by our respondents, with 68% of insurers putting the optimization of core fixed income in their top three for the next 12 months.*

… and opportunities

Investment portfolio optimization is the biggest opportunity cited by our respondents, with 68% of insurers ranking the optimization of core fixed income in their top three for the next 12 months.

As we will explore later in this report, the rotation from public core fixed income to private debt and other alternative asset classes is another major opportunity. More than half (56%) say diversification away from traditional assets is a top priority, while 44% specify private markets as among their main focuses for the coming year.

ESG-related investments were cited as a top-three opportunity by 38% of insurers in our survey. It is clear that insurance companies are increasingly seeing this as an opportunity rather than a risk or compliance requirement.

What do you believe are your organization’s top three investment opportunities over the next 12 months?

Roll over the buttons below to reveal chart data

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02 ESG investing — Part of the mainstream

Sustainable investment continues to be a key issue for insurance clients. Activity remains higher in Europe, the UK and Australia, but we have seen a meaningful increase in evaluation and engagement by US insurers. For some insurers, this is driven by a desire to be a leader in their industry, while others are preparing to respond to a higher level of disclosure requirements by rating agencies and regulators.

Action points

- Work with your consultants to understand the best sustainable investment approach to suit your portfolio and organization.
- Engage with your managers to understand how they obtain, verify, process and report ESG-related data. Ensure you have the resources to do the same internally.
- Explore whether setting a net-zero carbon emissions target for your investment portfolio is feasible, and where you might identify investment opportunities.
- Take a forward-looking approach where possible. This will help identify long-term opportunities as well as mitigate risks.

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The growing importance of ESG

Environmental, social and governance (ESG) themes have become core tenets of mainstream investment strategies over the past few years.

The COVID-19 pandemic and increasing instances of extreme weather have shown beyond all doubt that climate change is having a real and significant impact on our world. At the same time, these and other events have also shone a spotlight on inequality — whether racial, gender or financial.

Investors of all kinds are increasingly conscious of these themes and willing to incorporate them into their strategies to ensure their capital allocations not only improve their financial positions but also benefit wider society.

Most respondents (83%) incorporate ESG factors into their investment decision-making processes, and of the few that do not, most (64%) plan to do so in the near future.

Does your organization incorporate ESG factors into its investment decision-making?

Roll over the buttons below to reveal chart data

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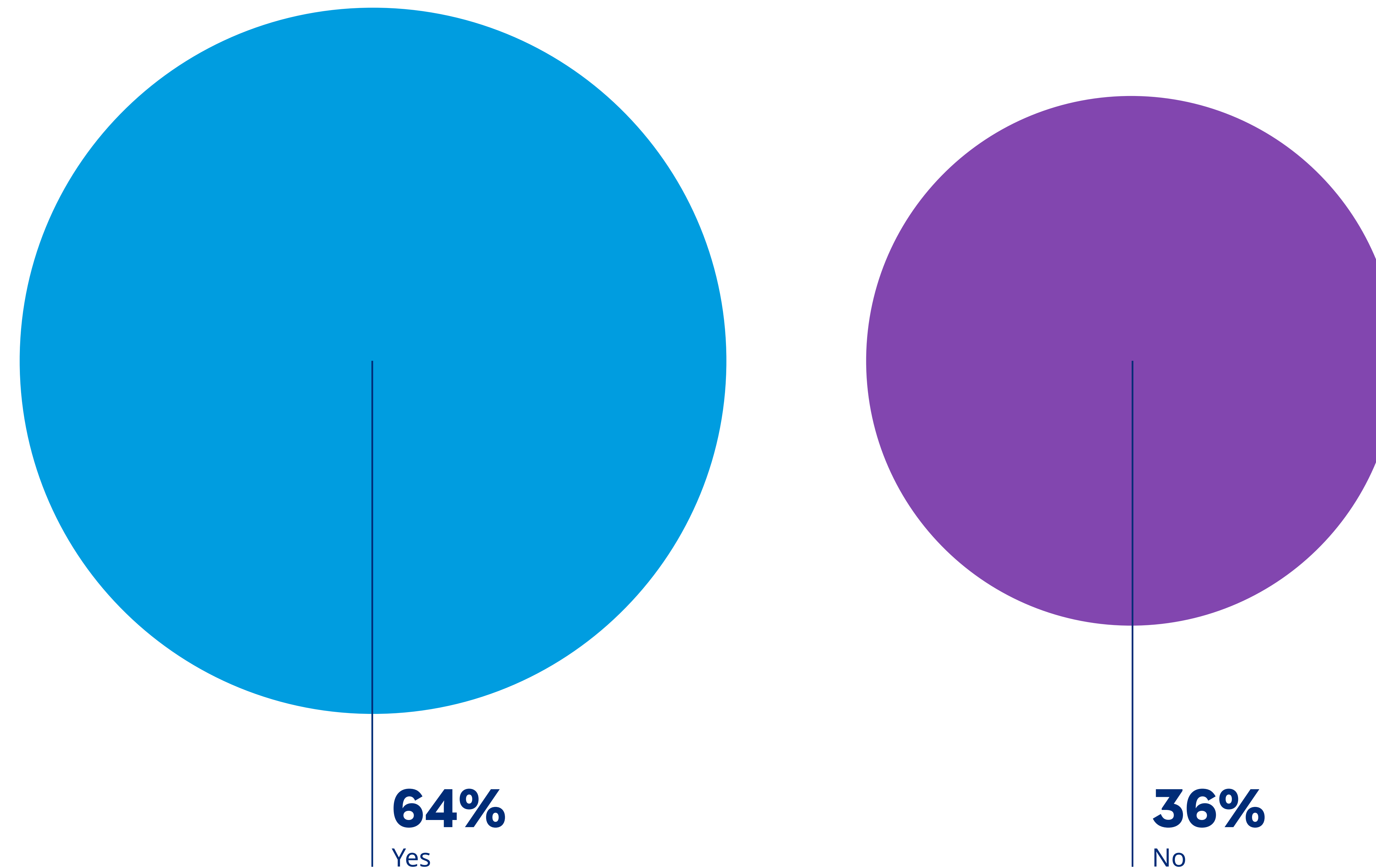
Of the few organizations that do not factor in ESG and don't plan to do so imminently, the main reasons are organization specific, such as the approach not being a priority at the board or investment-committee level or a lack of demand from stakeholders.

In addition, respondents also cite a lack of data and information transparency and poor standardization of reporting as reasons they have not adopted ESG.

> ***Overall, our survey demonstrates that the momentum behind ESG investing is apparent and shows little sign of slowing. However, significant challenges remain.***

Are you planning to incorporate ESG factors into your investment decision-making within the next 12 months?



Source: Mercer's *2022 Global Insurance Investment Survey*.

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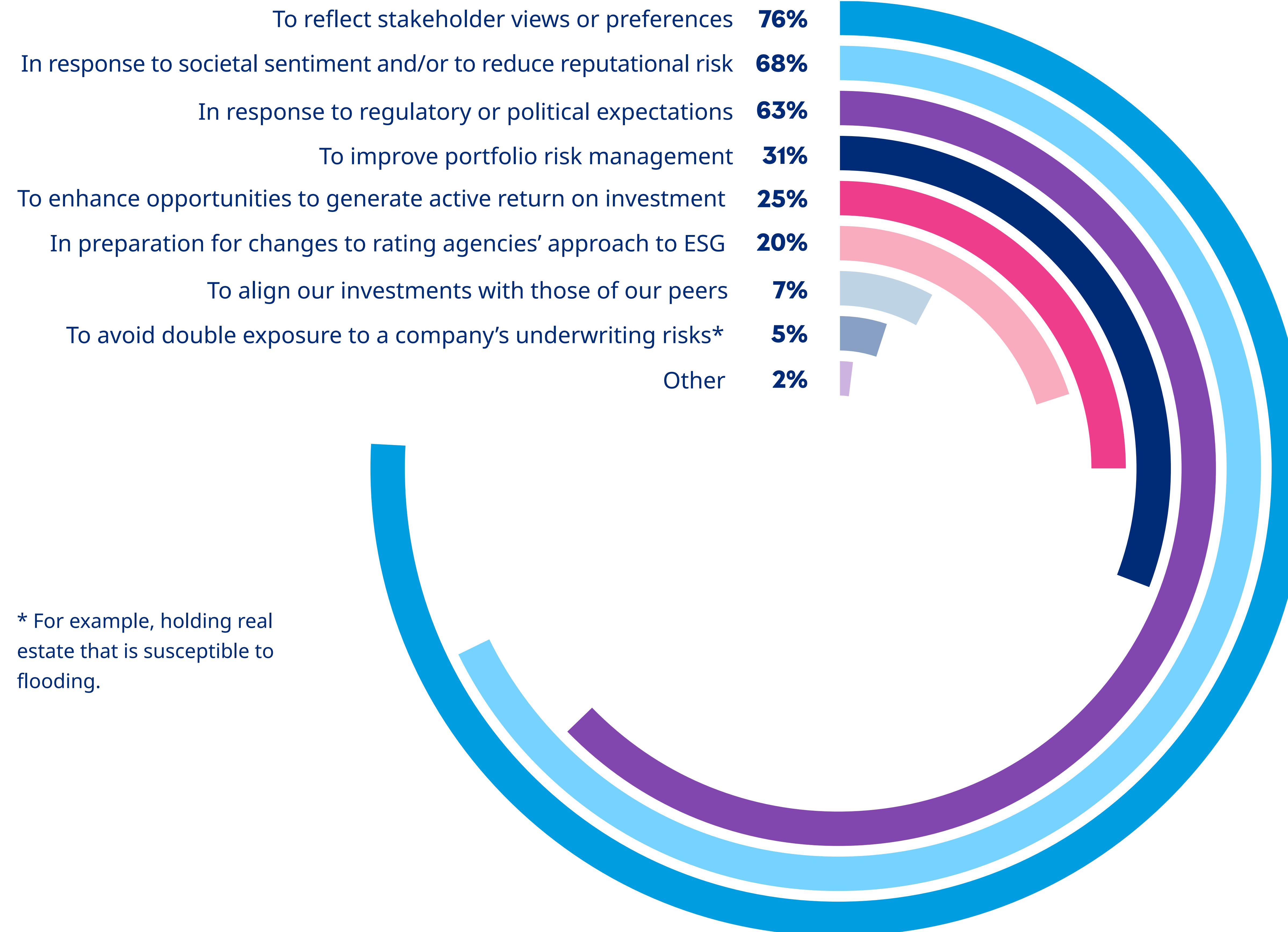
Positive momentum

Insurers across the board in our survey are satisfied with the way in which their external managers incorporate ESG criteria into their investment strategies. In addition, they do not feel they are giving up on performance in a material way when adopting an ESG approach — something we have also observed in other client groups.

The momentum is driven at least in part by regulation and actions by policymakers.

> ***63% of respondents say regulatory or political expectations are among the top three reasons for incorporating ESG considerations.***

What are the three main factors driving your organization's decision to consider ESG in its investments?



* For example, holding real estate that is susceptible to flooding.

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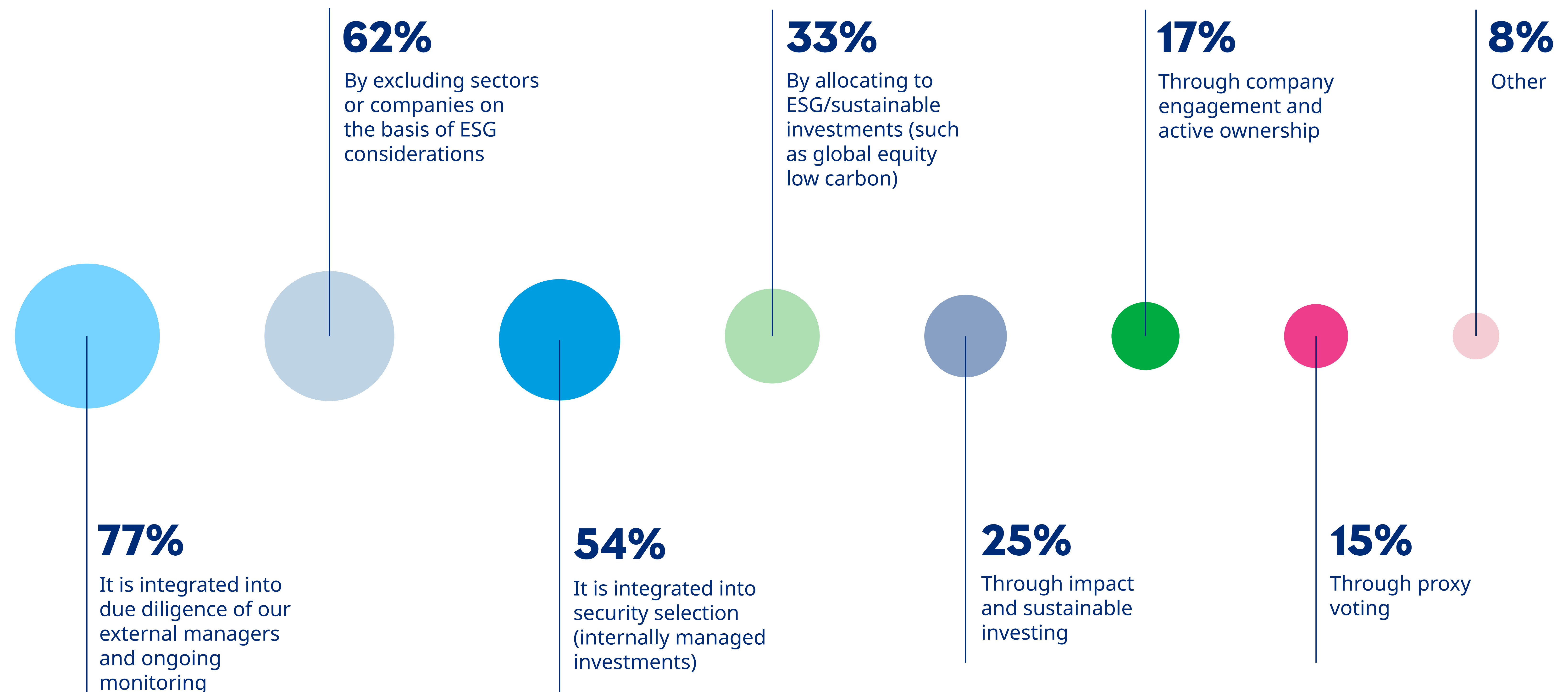
In Europe, the Sustainable Finance Disclosure Regulation has significantly raised the bar for asset managers and other financial services organizations, bringing in stricter definitions for assets and mandates.

The UK is working on similar legislation and has already introduced requirements for the largest pension funds to report on climate metrics in line with the Task Force for Climate-related Financial Disclosures (TCFD).[1] The Securities and Exchange Commission in the US is exploring ESG-related rules for listed companies.[2]

It is not just policymakers who are shaping ESG strategies, though; it is mostly client demand. More than three-quarters (76%) of insurers in our survey say stakeholders are urging them to incorporate these criteria as well.

Reputational risk and events in wider society are also influencing ESG decisions for some insurers (68%), indicating that respondents are becoming more sensitive to external factors that could indirectly affect their balance sheets.

How does your organization incorporate ESG considerations into investment decisions?



Source: Mercer's *2022 Global Insurance Investment Survey*.

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The data challenge

The main challenge facing insurers is one they share with many other investors: the lack of consistent, high-quality ESG data and reporting standardization.

For example, carbon emissions is a key data point required to comply with TCFD reporting standards; however, reporting of this data is often inconsistent or unreliable as it is not disclosed regularly and is often not independently audited as happens with financial information. Forward-looking disclosures — important when assessing a long-term issue such as climate change — are also lacking, according to research.[3]

More broadly, the plethora of third-party data providers — including MSCI, Sustainalytics, Arabesque and Bloomberg — mean investors have a huge amount of choice, but no single provider has yet emerged as a true leader or standard-setter. In private markets, the issue is compounded by the fact that much fewer data generally are publicly available, including financial and ESG data.

What are the top three reasons why your organization does not plan to integrate ESG factors into its investment decisions?

Source: Mercer's *2022 Global Insurance Investment Survey*.

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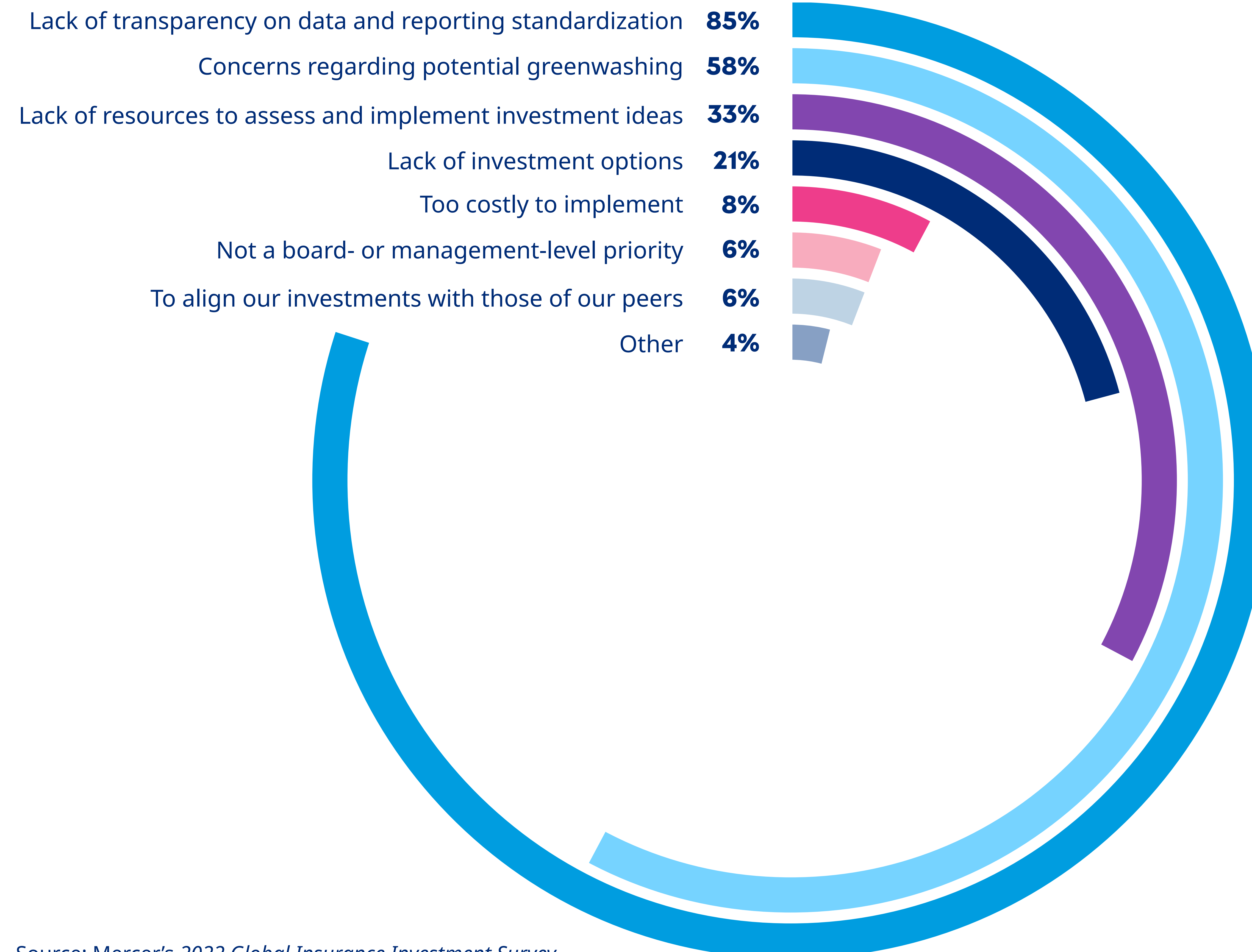
US and European insurers are most concerned about this — almost every European respondent (92%) cites it as a top challenge.

Regulators and data providers are slowly but surely increasing their collaborative efforts in an attempt to provide investors with information that is more universally comparable, but this work is still at an early stage for most asset classes.

“Greenwashing”[4] is also a significant concern for insurers, with 58% citing it as a challenge, as is their internal capability with regard to ESG integration (33%). These two concerns are potentially linked, as an insurer without an adequately resourced internal team will find it hard to put external managers under sufficient scrutiny.

What are the challenges your organization faces when integrating ESG factors into its investment decisions?



Source: Mercer’s *2022 Global Insurance Investment Survey*.

In total, 85% of respondents cite data as a main challenge.

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Net zero

In some jurisdictions, asset owners are already facing regulatory pressure to adapt their portfolios to a low-carbon future.

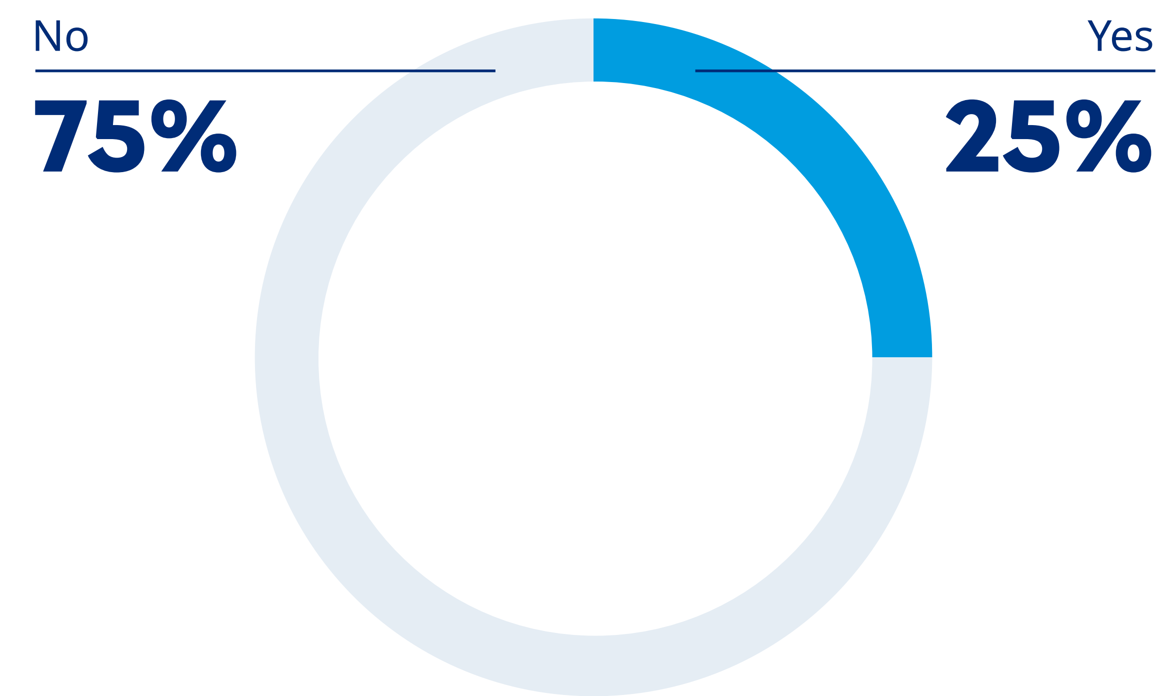
A growing number of organizations are also seeking to adapt their businesses and investment portfolios to a net-zero approach by transitioning away from fossil fuels and high polluters and toward renewable energy sources and cleaner, greener investments.

Most are aiming to reach this level by 2050, but a few are more ambitious, targeting 2040, 2035 or even 2030.

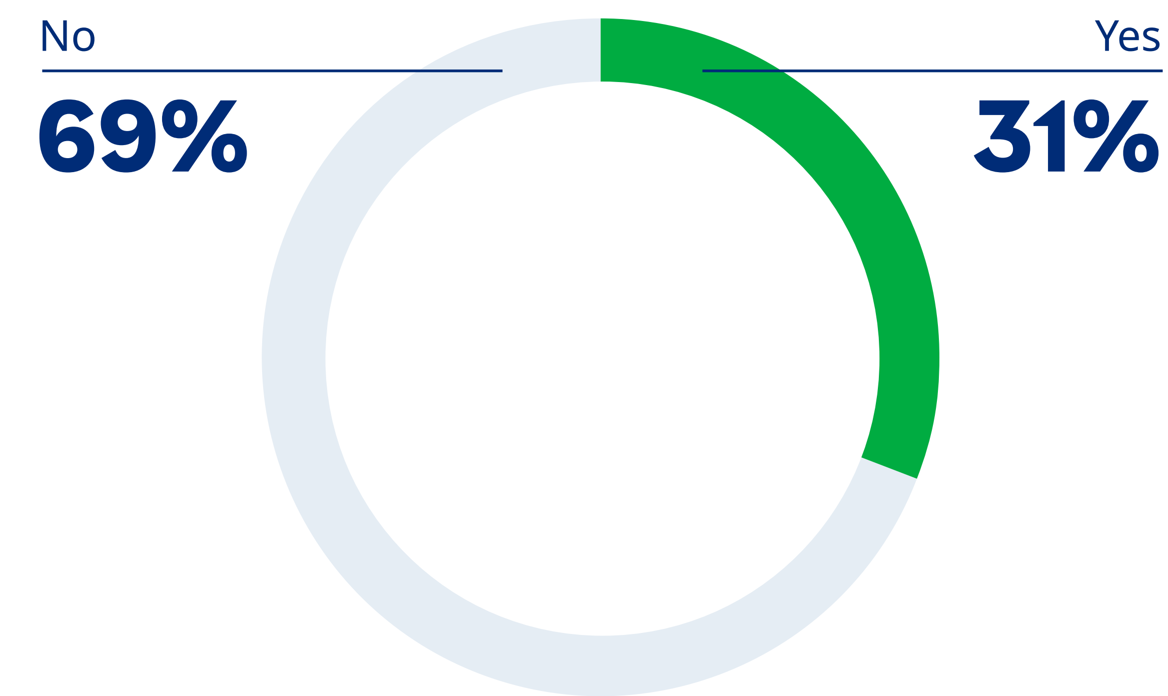
Of those yet to set a net-zero target, more than two-thirds (69%) have no intention of doing so in the next 12 months.

> *One-quarter of insurance company respondents to our survey have set a net-zero target for their investment portfolios.*

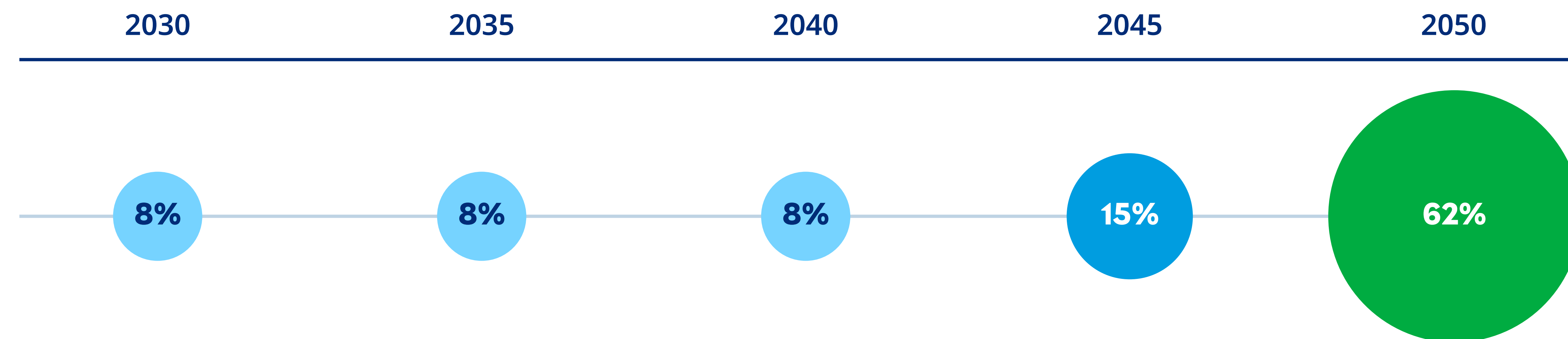
In relation to your investment portfolio, have you set a net-zero target?



Do you plan to set a net-zero target in the next 12 months?

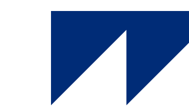


If yes, please specify the year.



May not sum 100 due to rounding

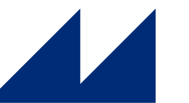
Source: Mercer's *2022 Global Insurance Investment Survey*.



Although the integrity and availability of ESG data represent acknowledged challenges for insurers' policy setting and reporting obligations, this has not diminished the increasing numbers of insurers we see adopting net-zero emission targets.

Thoughtful integration of sustainability frameworks, which serve to manage and mitigate ESG risks while also positioning for return opportunities, represents the overarching intent for many insurers.

Denis Walsh,
Head of Insurance Australia



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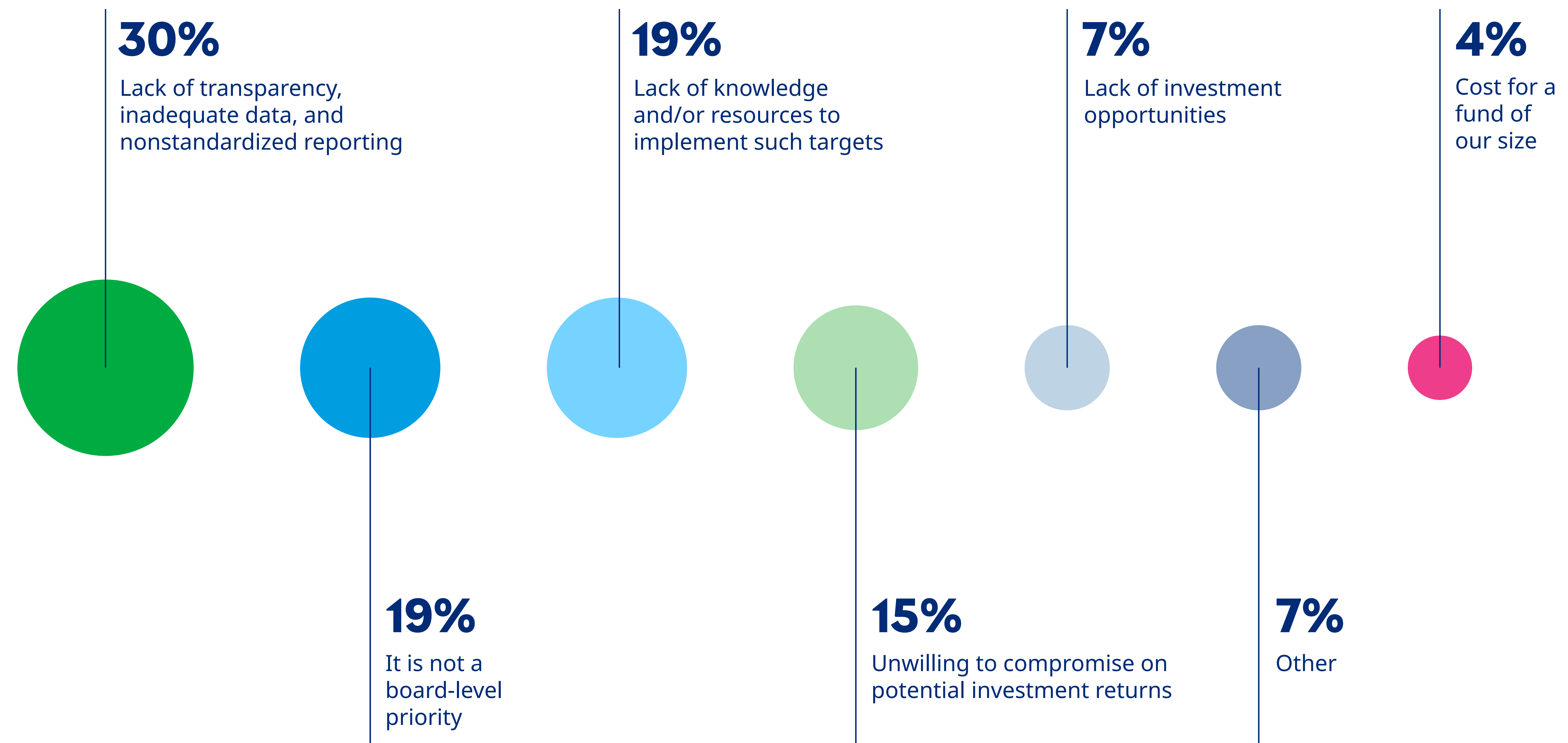
Once again, this is primarily a data issue: 30% of insurers that do not plan to set a net-zero target cite a lack of transparency, inadequate data and nonstandardized reporting as the main reasons for their choice.

For some, it is simply not a priority at board level (19%), while others lack the resources or knowledge to make this move (19%) — potentially another example of the ESG data challenge. Remember, nearly half (48%) of respondents have investment teams of five people or fewer — and nearly one-fifth (19%) have no dedicated investment staff at all.

What is the primary reason your organization has not set, and does not plan to set, a net-zero target?



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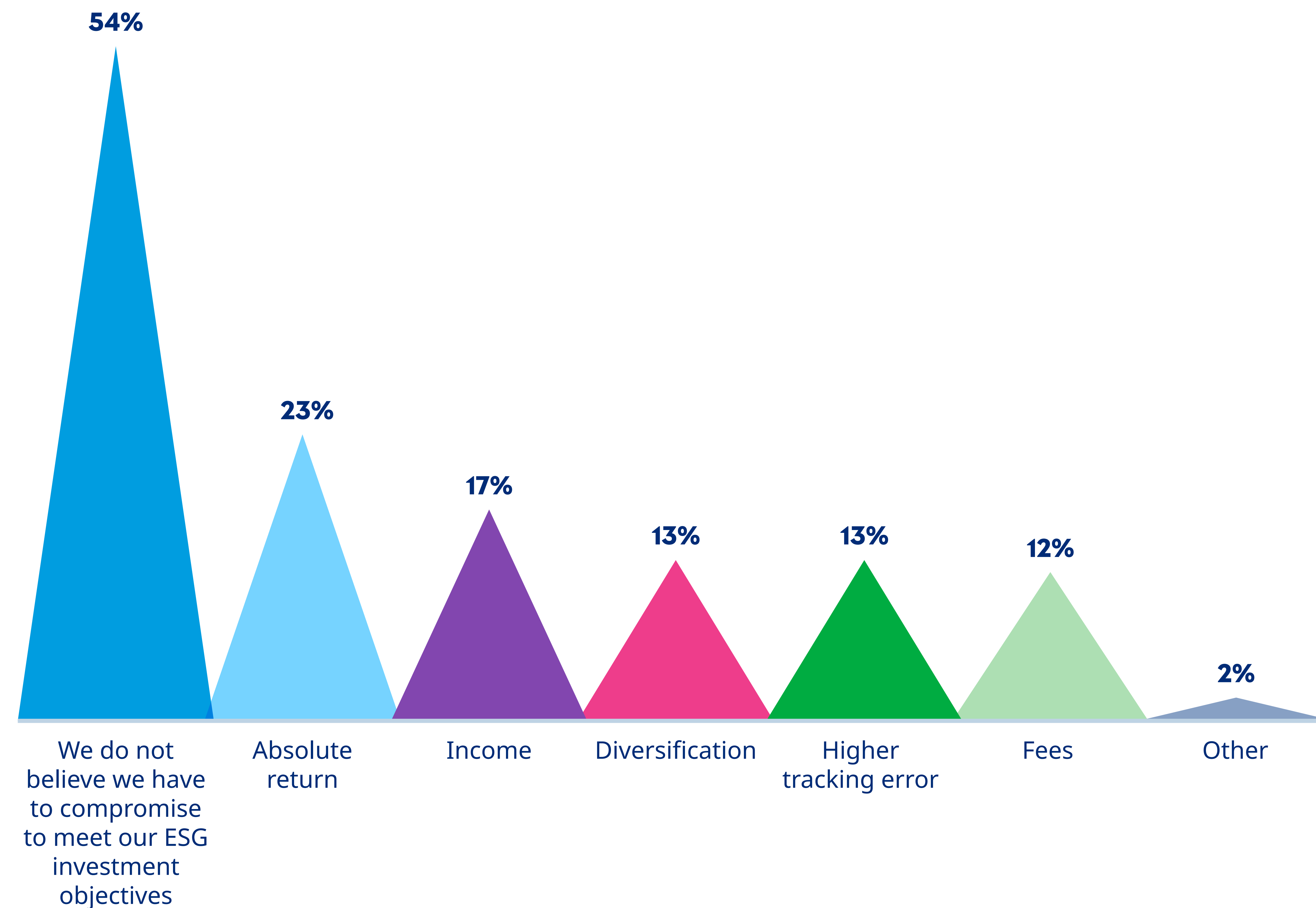
Other concerns

Although most respondents embrace ESG and its place within insurers' investment strategies, it is important to acknowledge where concerns remain.

As well as the challenge of obtaining high-quality and consistent data, focusing on ESG-related investments often involves excluding certain sectors or strategies. As demand for such investments has grown, in some cases, we have observed a premium emerging on some "green" assets.[5]

The majority (54%) of insurers do not believe they need to compromise at all to achieve their ESG goals. This feeling is strongest in the US, where 71% of respondents agree that they do not need to compromise.

Do you believe your organization will have to compromise on any of the following in order meet its ESG investment objectives?



Source: Mercer's *2022 Global Insurance Investment Survey*.

However, there are still some that believe that asset owners must accept some sacrifices to make progress on ESG goals. In Europe, in particular, insurers believe they may have to accept slightly lower absolute returns, limits on diversification or higher investment costs (27% of respondents in each case).

Overall, however, an increasing body of evidence shows that an ESG approach can help investors identify long-term opportunities while also avoiding some kinds of risks, such as potential reputational damage or stranded asset risk as we transition to a low-carbon economy.

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03 Private debt — A primary opportunity set

Insurers continue to find value in private debt as the asset class provides enhanced income, diversification, and structural protection, which may become increasingly important as the economic environment shifts. As the asset class has grown, so have the various strategies available to investors.

Action points

- Conduct a portfolio review to assess how private markets exposure could benefit your investments through enhanced return and diversification.
- Engage with consultants to help you understand the opportunities available and identify the most appropriate managers.
- Assess whether exposure to some forms of private debt, infrastructure and real estate could help hedge against inflation or improve return and diversification.
- Be sure to monitor costs and consider the risk premium you are receiving for different private markets exposures.
- Be aware of your implementation options and any effects these may have on reporting requirements and internal resources.

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Private markets take center stage

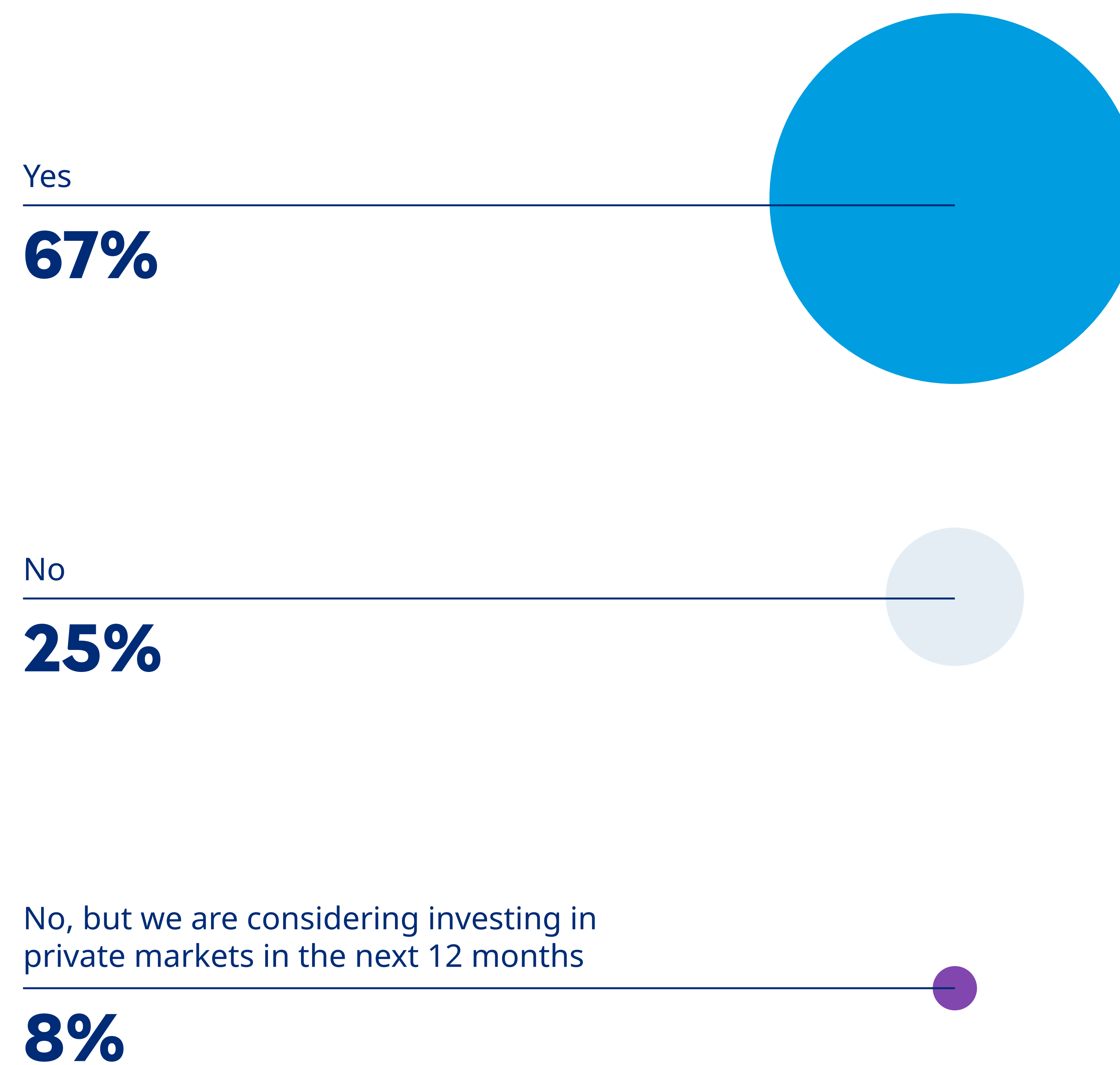
As investors have widened their search for yield and returns, private markets have become more popular. This has coincided with many banks withdrawing from private lending markets in the wake of the 2007–2009 financial crisis, resulting in a significant opportunity for institutional investors to access private market deal flow.

Two-thirds (67%) of our respondents already have some kind of exposure to private markets, and another 8% plan to make an initial allocation in the next 12 months.

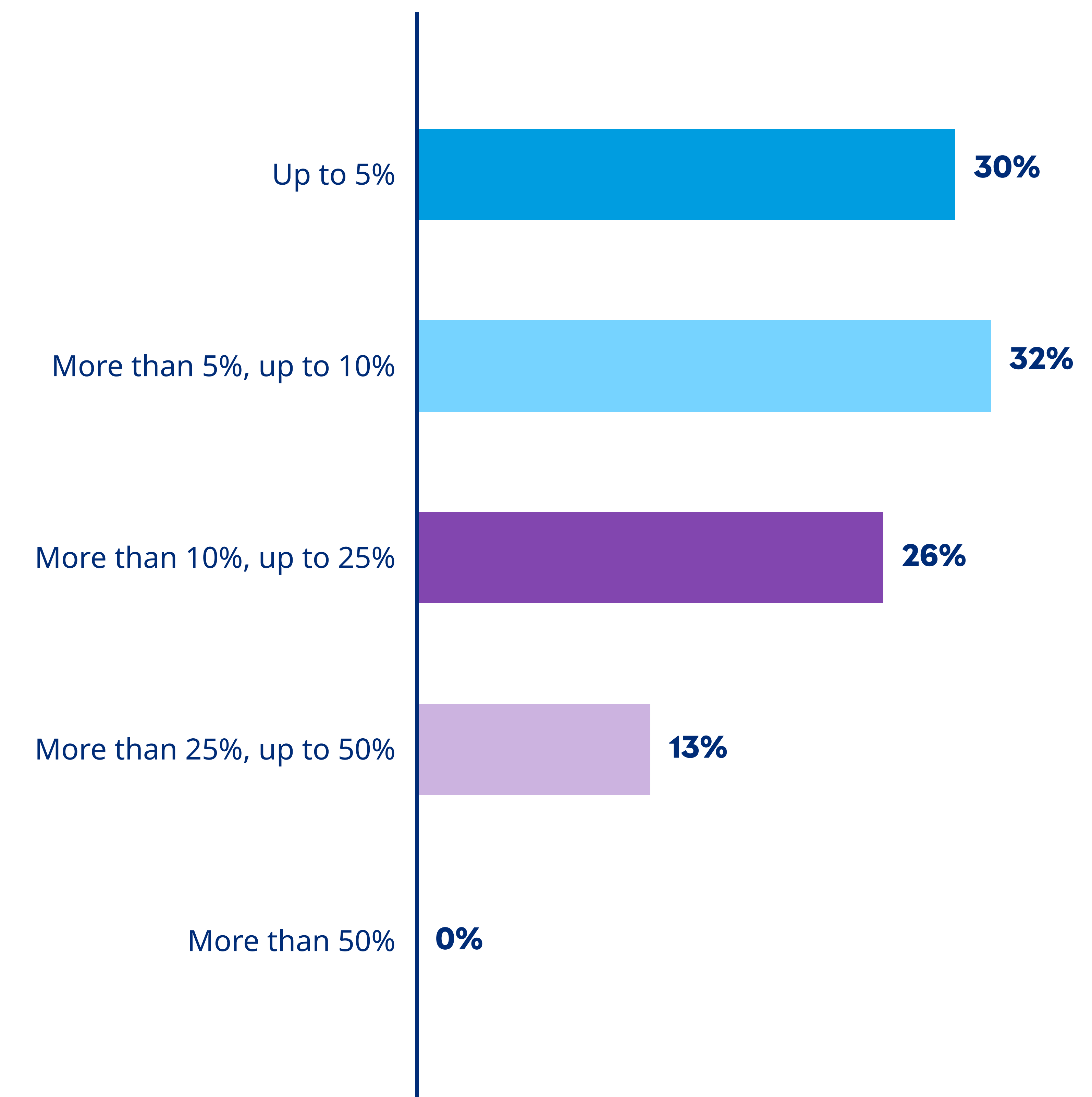
Our broader questions on asset allocation showed a significant appetite for private debt among respondents, with 51% indicating plans to increase their exposure to investment-grade private debt over the next 12 months. Respondents plan to add to high-yield private debt in the same period, while there is also interest in real estate and infrastructure debt allocations.

> ***Two-thirds (67%) of our respondents already have some kind of exposure to private markets.***

Does your organization invest in private markets?



What is the target allocation to private markets in your portfolio?



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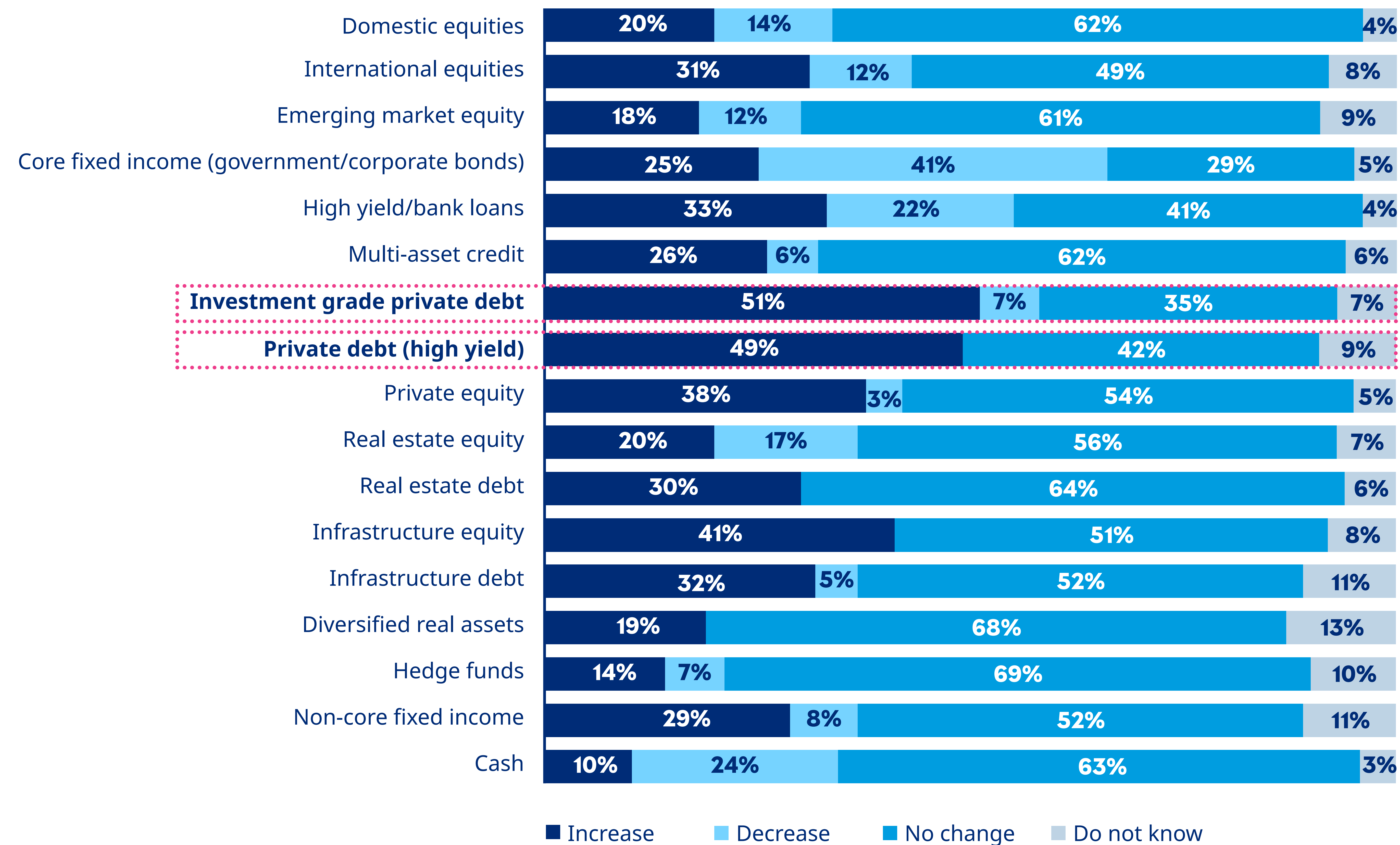
Like many other areas of private markets, this is a multifaceted asset class with multiple subsets, each of which has its own idiosyncrasies, risk factors and requirements. As such, it requires significantly more investment in time, resources and expertise to research these opportunities.

As private markets allocations grow, insurance company portfolios are growing more complex, and they are taking on more illiquidity risk. This is changing insurers' needs from an investment perspective — and introducing a new set of opportunities and challenges.

How do you expect the asset allocation of your portfolio to change over the next 12 months?



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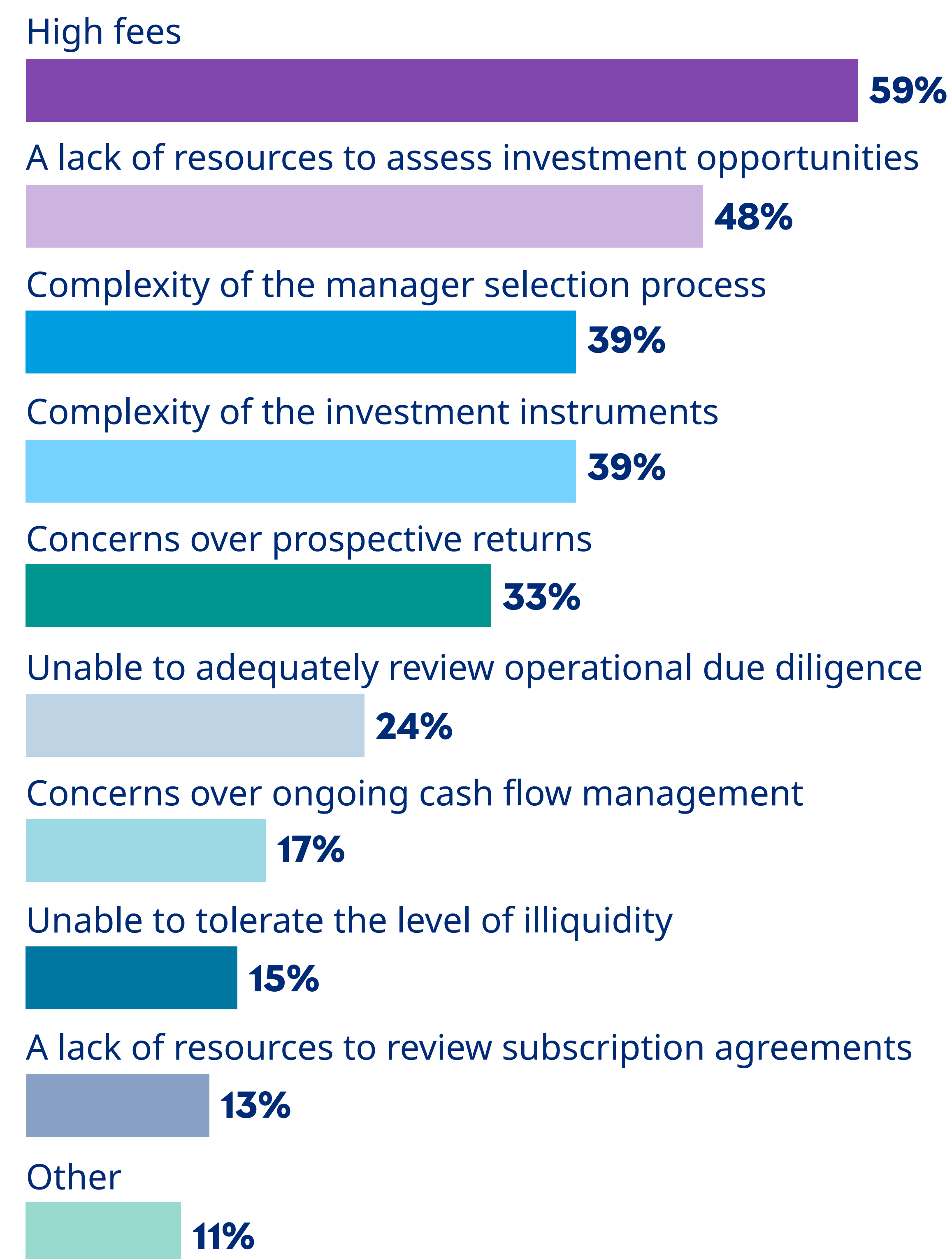
Building resources

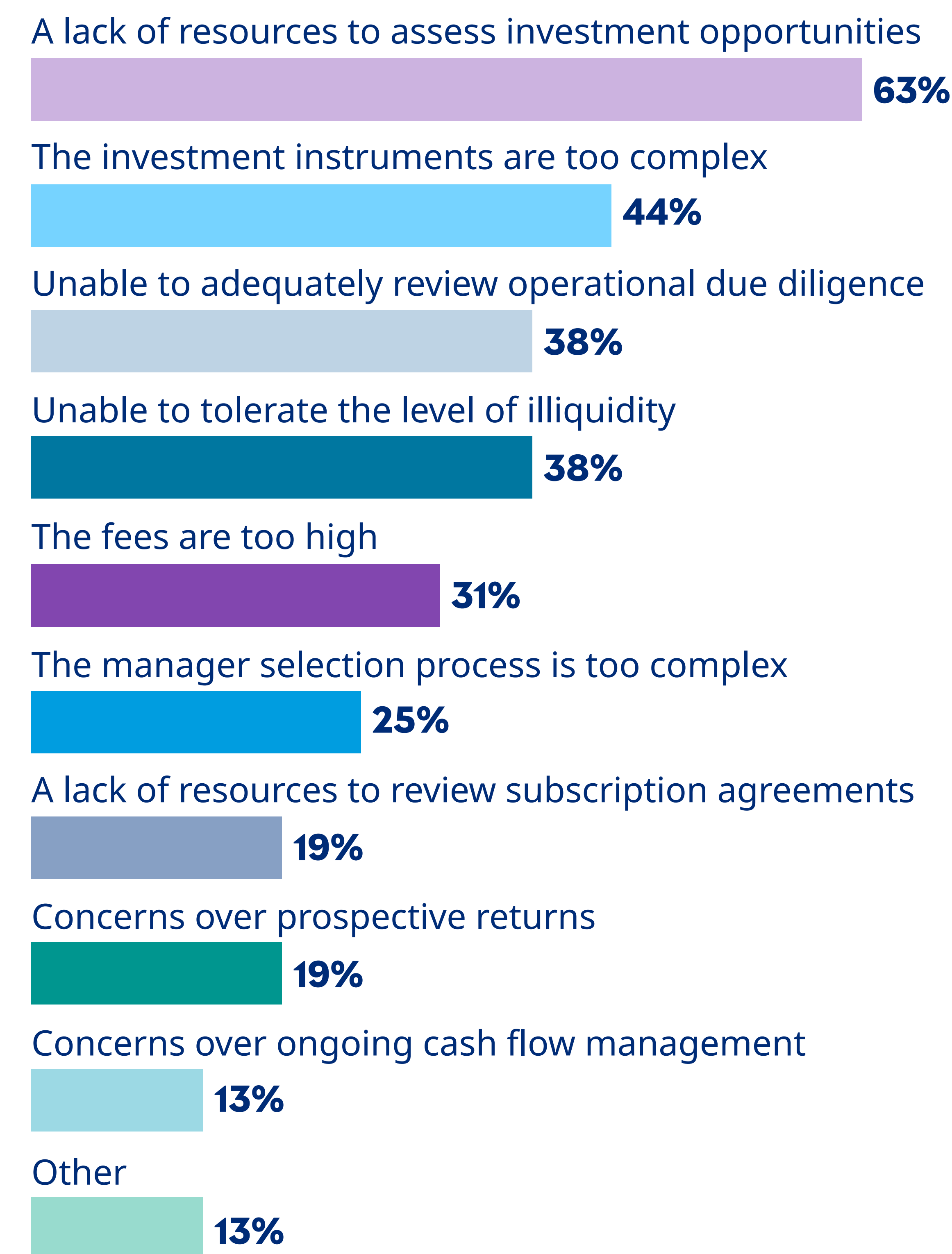
The key issue holding insurers back from private markets is a lack of resources; 63% cite this as one of the three main reasons they do not allocate to private markets.

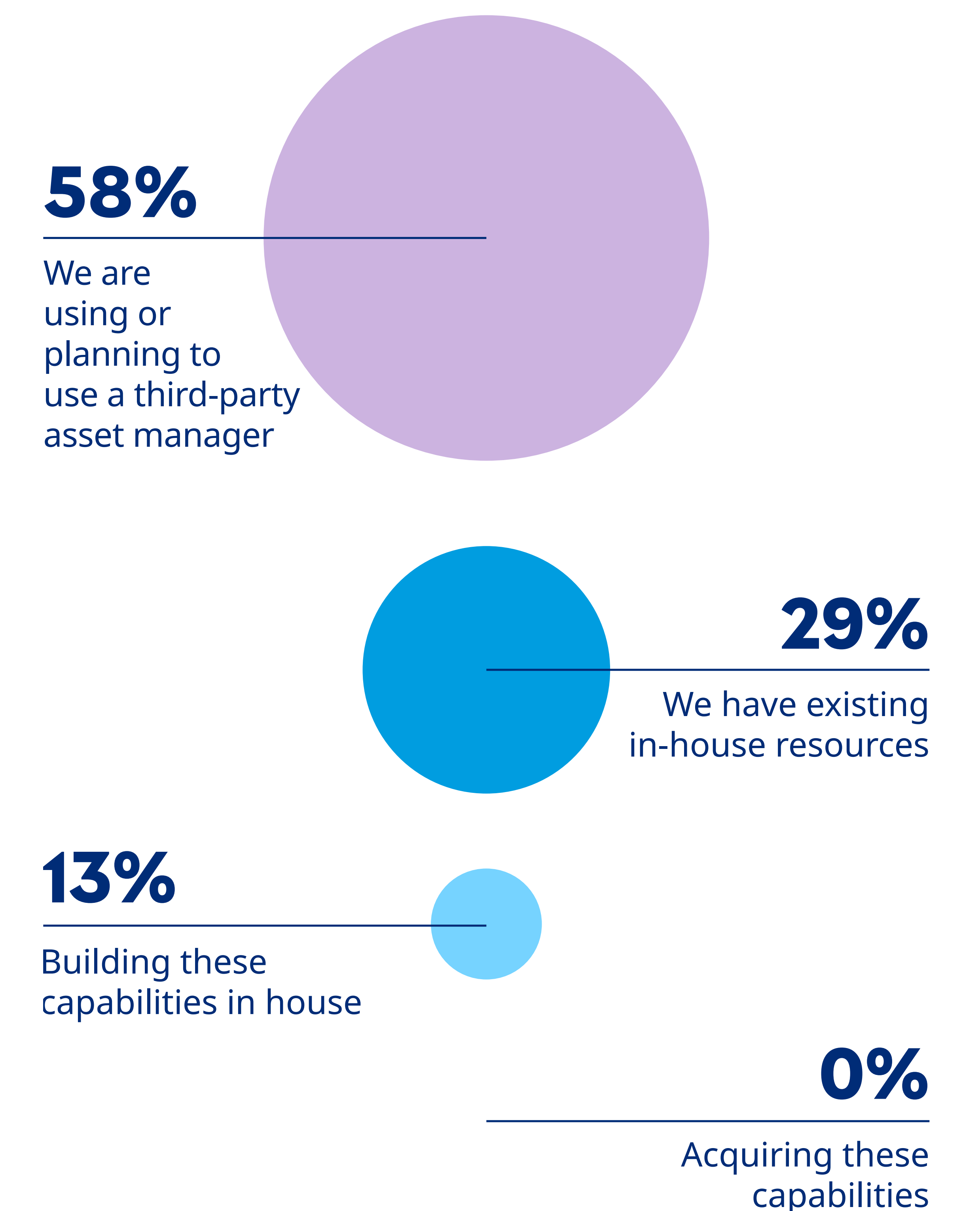
The universe of potential investments is large and demands significant time, expertise and capital investment from insurers in order to succeed.

Other than high fees associated with private markets exposures, major challenges include the complexity of instruments (39%), selecting managers (39%) and a lack of internal resources (48%). It is no surprise, therefore, that most respondents (58%) either use third-party asset managers to access private markets or plan to do so.

Getting external support will be vital for smaller investment teams to succeed in private markets.







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Tapping the illiquidity premium

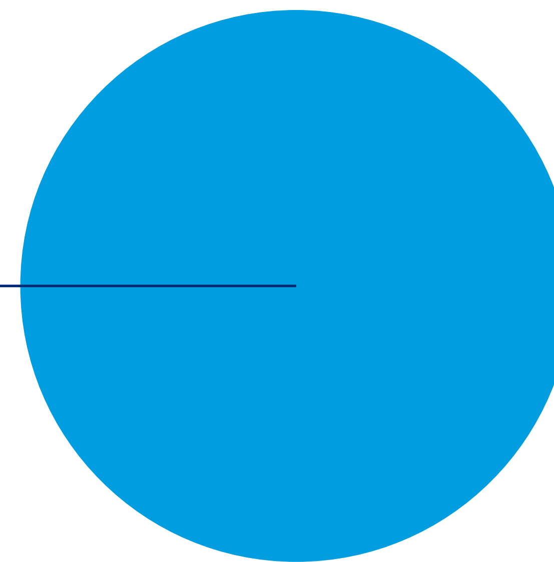
More than half of respondents (52%) report having excess liquidity in their investment portfolios, and 44% indicate they are willing to decrease their portfolio liquidity over the next 12 months. A similar proportion (48%) are willing to increase investment risk at the same time.

This gives insurers the ability to invest in less-liquid private assets that have the potential to generate higher returns over time than public assets. This is reflected in the growing appetite for private debt.

Do you believe you have excess liquidity in your portfolio?

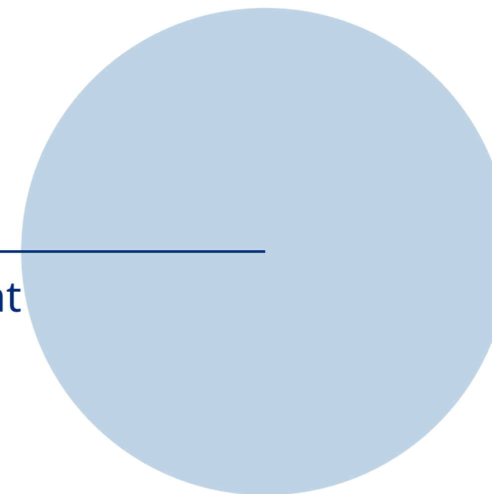
52%

Yes, we have excess liquidity in our portfolio



46%

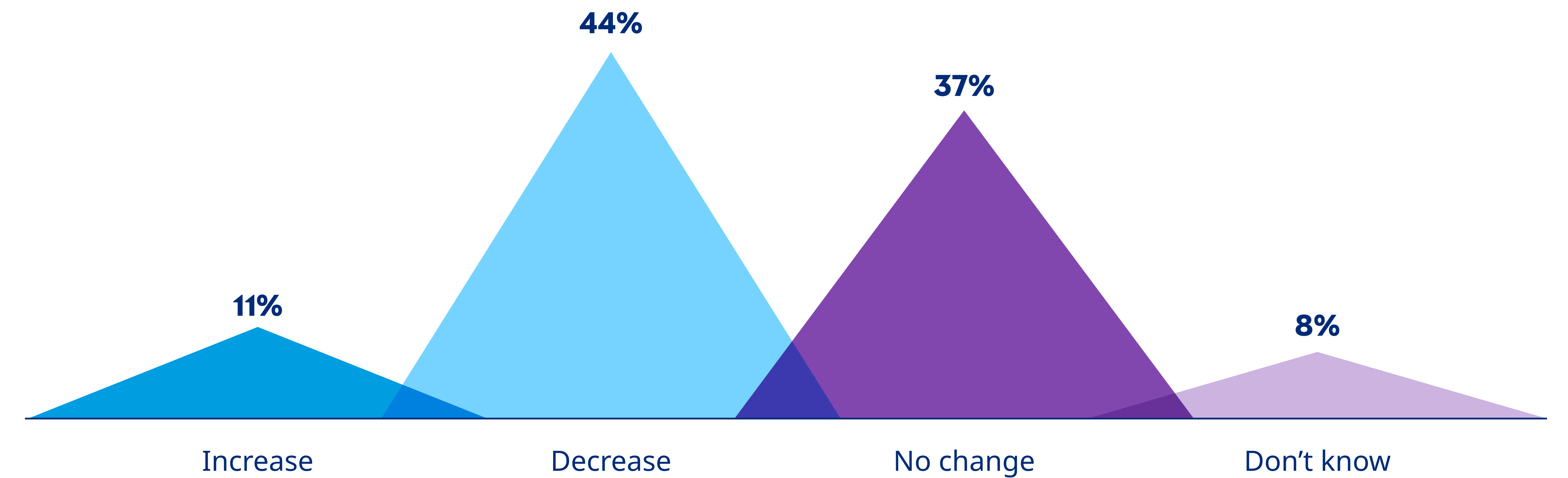
No, we have the right amount of liquidity in our portfolio



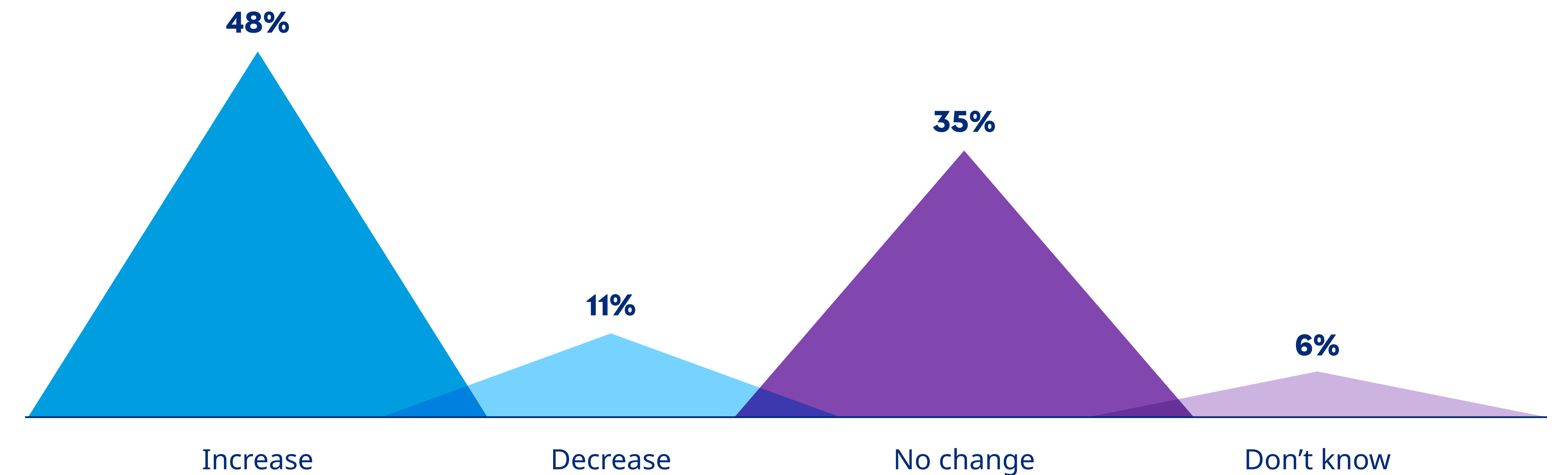
2%

No, we do not have enough liquidity in our portfolio

How is the overall investment liquidity of your portfolio likely to change over the next 12 months?



How is the overall investment risk in your portfolio likely to change over the next 12 months?



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Most insurers currently have a relatively low allocation to private markets: 62% have 10% or less of their portfolios dedicated to these asset classes. Thirteen percent have invested between one-quarter and one-half of their portfolios in private markets, indicating a willingness to take on substantial illiquidity risk.

The appetite and ability to invest in illiquid assets will vary according to insurer type and jurisdiction. The European Union's Solvency II regime for insurance companies requires a high level of capital to be held against investments in collateralized loan obligations, for example. In the US, the situation is complex and evolving as the National Association of Insurance Commissioners is reviewing certain investment structures used for private markets investments, with new rules expected in 2024.[6]

What is the target allocation to private markets in your portfolio? (Regions)

Roll over the buttons below to reveal chart data

Source: Mercer's *2022 Global Insurance Investment Survey*.

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Splitting the responses by insurer type indicates that life insurance companies, particularly in the US, are more likely to allocate a larger proportion of their portfolios toward private markets. This indicates that, as well as regulatory differences, the long-term nature of these companies' liabilities provides more scope for insurers to take on assets with a longer time horizon.

What is the target allocation to private markets in your portfolio? (Insurer)

Roll over the buttons below to reveal chart data

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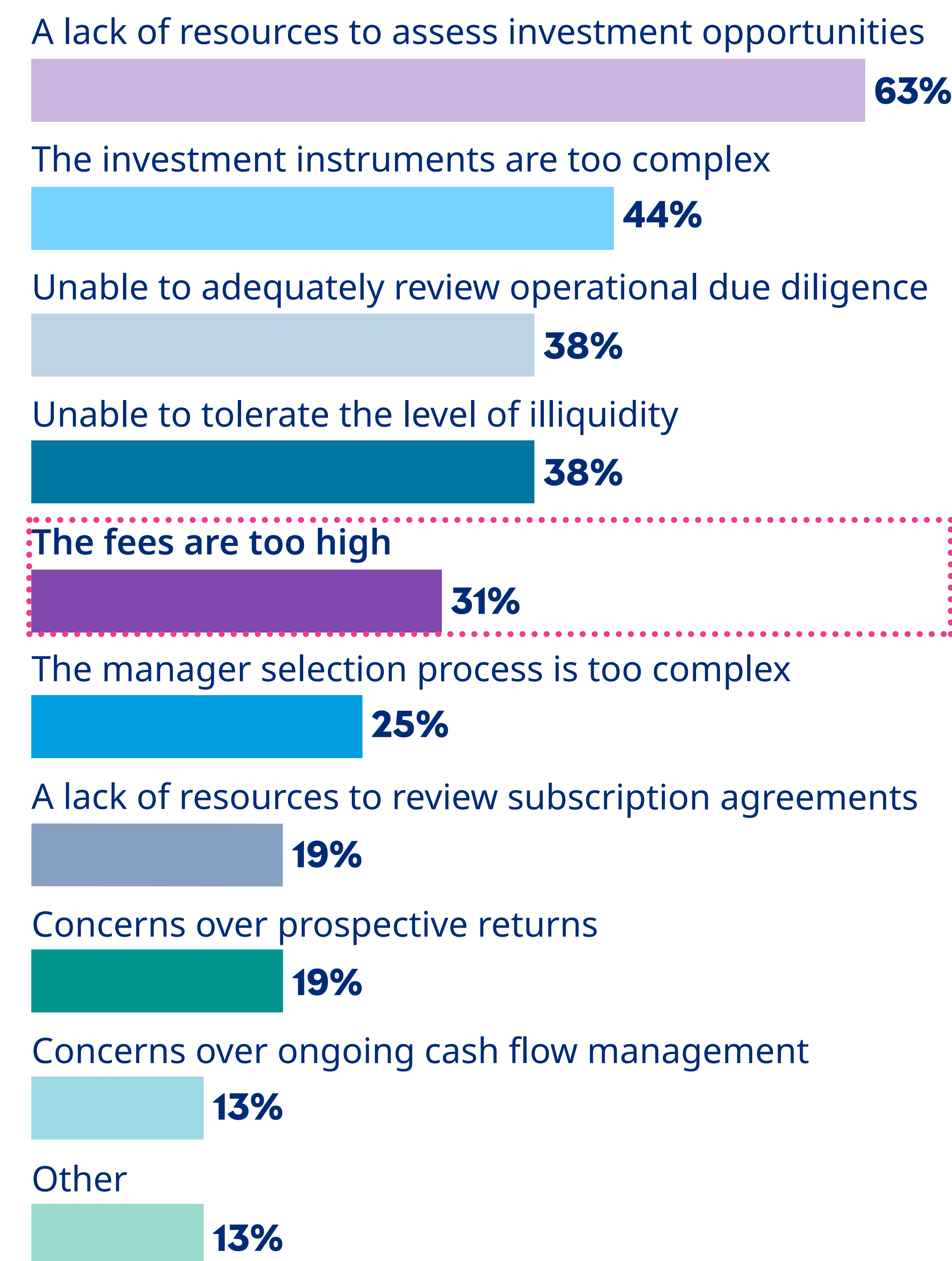
Tackling costs

The biggest challenge for private markets investors cited by our respondents is the cost of allocating to these asset classes, with 59% naming high fees in their top three concerns. In addition, almost one-third (31%) of respondents say high fees have dissuaded them from investing in private markets.

This concern may be fueled by the rotation into private debt from government and corporate bonds and the subsequent increase in fees. Insurers making this asset-allocation shift will likely have experienced a significant uptick in costs, from less than 10 basis points for a typical listed bond strategy to 80–100 basis points for private debt strategies.

What are the three main challenges your organization faces with regard to investing in private markets?

What are the three main reasons your organization is not invested in private markets?



Source: Mercer's *2022 Global Insurance Investment Survey*.

This cost issue appears to be limited to private markets, however — when asked more broadly about their biggest implementation challenges, just 6% of respondents cite uncompetitive fees.

Although the traditional private markets fee model of a 2% annual charge and 20% performance fee — the "2 and 20" model — is still in use, in reality, many more remuneration methods are available to managers and investors.

Larger investors can often negotiate more favorable fees using their size or the size of their consultants as a bargaining tool, and smaller investors can access a growing number of pooled options to take advantage of the same economies of scale.

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04 Complex investments are stretching internal teams

Complex investment opportunities and market uncertainty underscore the need for asset owners to review their investment programs, including governance, resources and external relationships.

Action points

- Review your governance structure to ensure that decision-making processes remain appropriate. Are you sufficiently positioned to make tactical or dynamic asset-allocation changes when needed?
- Balance internal teams with external resources to optimize your operations, focusing on your core areas of expertise and leveraging outside help appropriately.
- Engage with and review your external manager relationships to ensure they remain appropriate to your long-term strategy.
- Consider whether an alternative outsourcing approach, such as delegated investment solutions, could help you optimize operations.

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Operational challenges

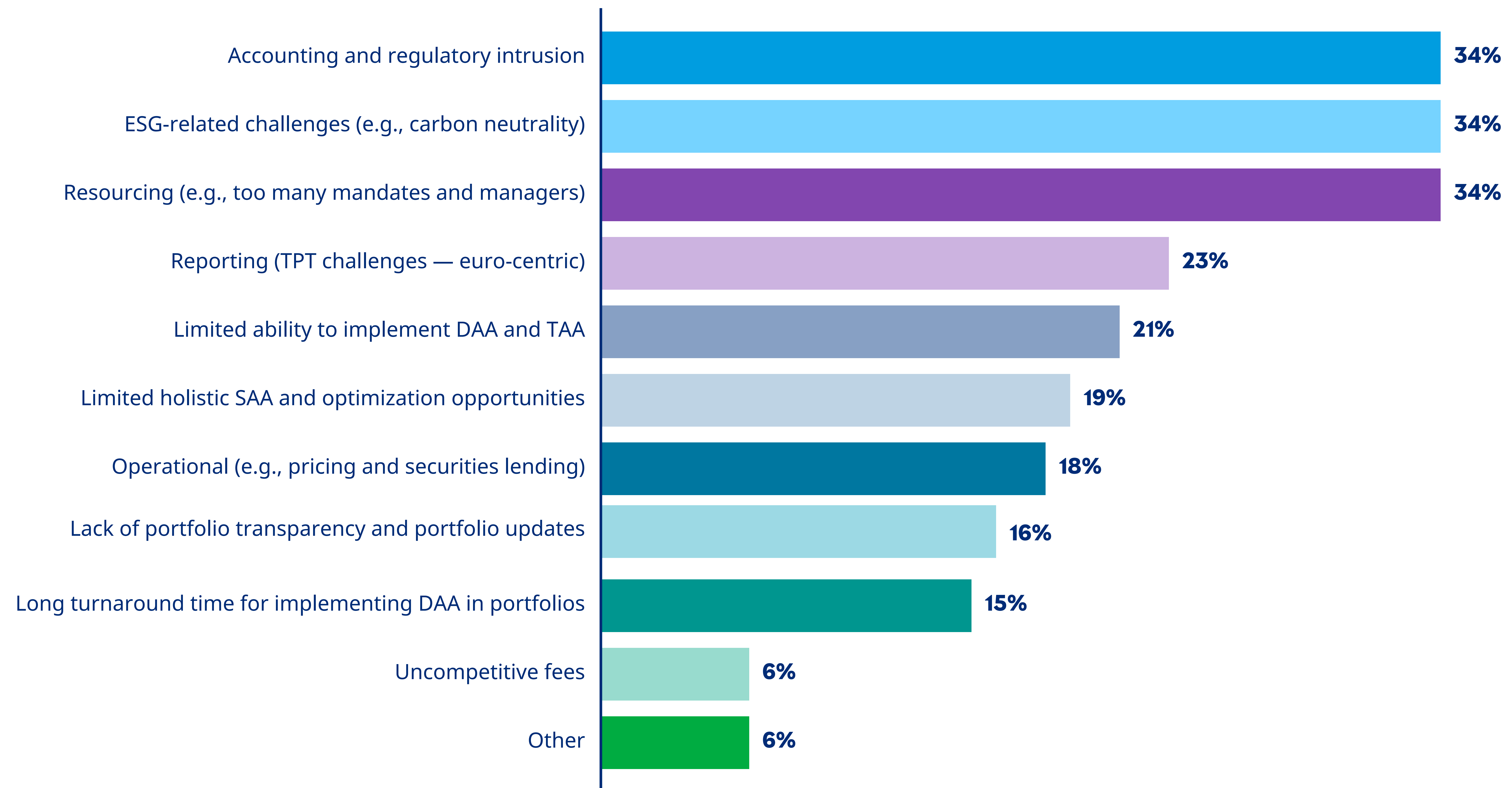
Insurance companies face many different challenges as part of their day-to-day operations.

The three most cited issues relate to ESG, resourcing, and accounting and regulatory reporting, each selected by 34% of respondents.

As previously explored, ESG-related challenges, such as achieving carbon neutrality in investment portfolios, are taking up a great deal of time and resources for insurers.

A lack of internal resources and the limitations this brings is a running theme throughout this survey as it creates difficulties in many areas. Approximately one-fifth (21%) of respondents cite a limited ability to make dynamic or tactical asset-allocation changes, while a similar proportion (19%) say they struggle to optimize their strategic asset allocations. We will explore this in greater detail over the next few pages.

What are the biggest implementation challenges your organization faces as it relates to your portfolio?



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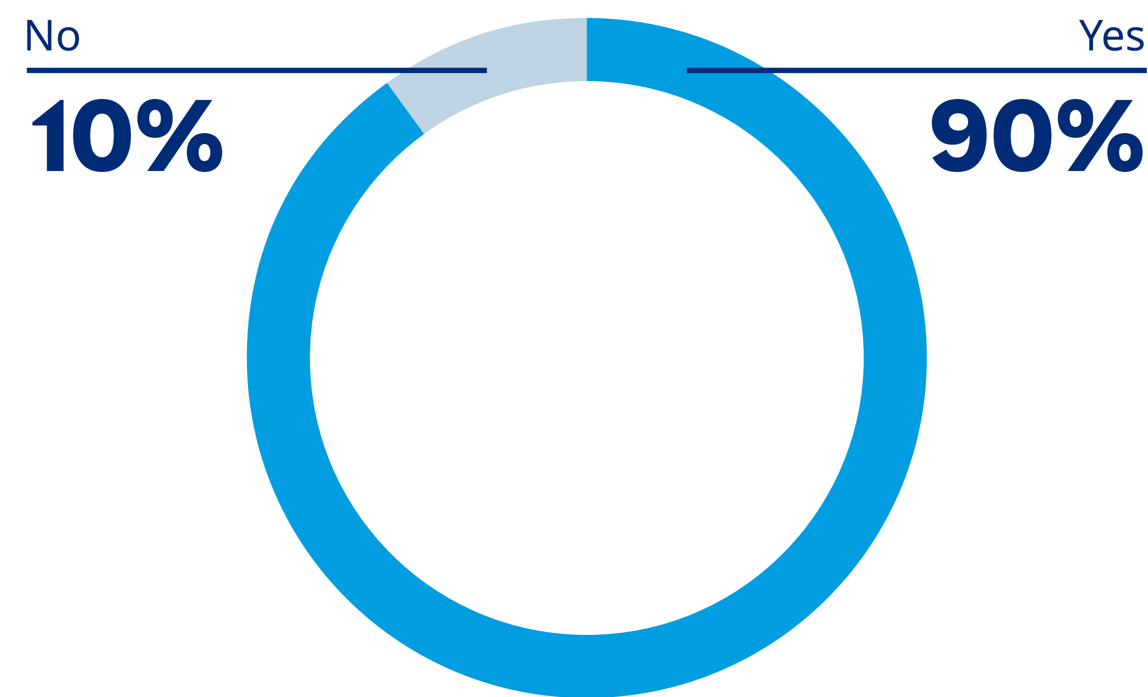
Internal resources

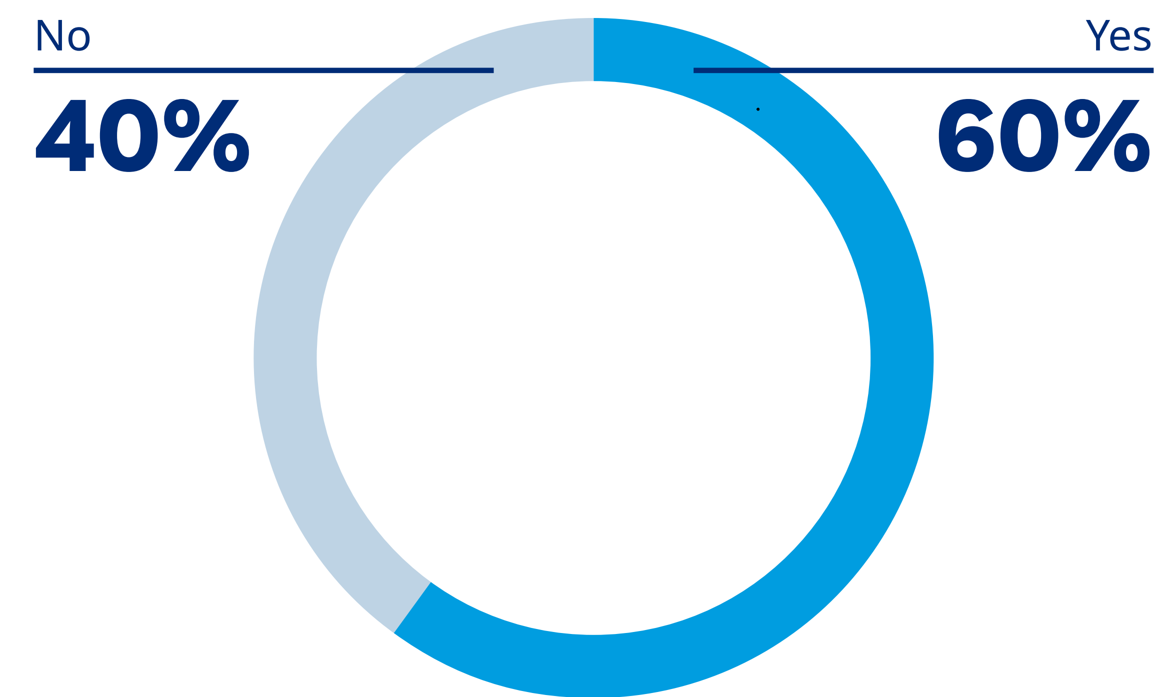
Having access to adequate resources is vital for an insurance company to achieve its investment objectives. However, internal teams are stretched, making it more difficult for institutions to move into new asset classes or address new opportunities and challenges.

For many insurers, the board makes major investment decisions, such as those related to investment policy (51%) or strategic asset allocation (41%). Investment or finance committees are more commonly tasked with strategic (49%) and dynamic asset allocation (57%).

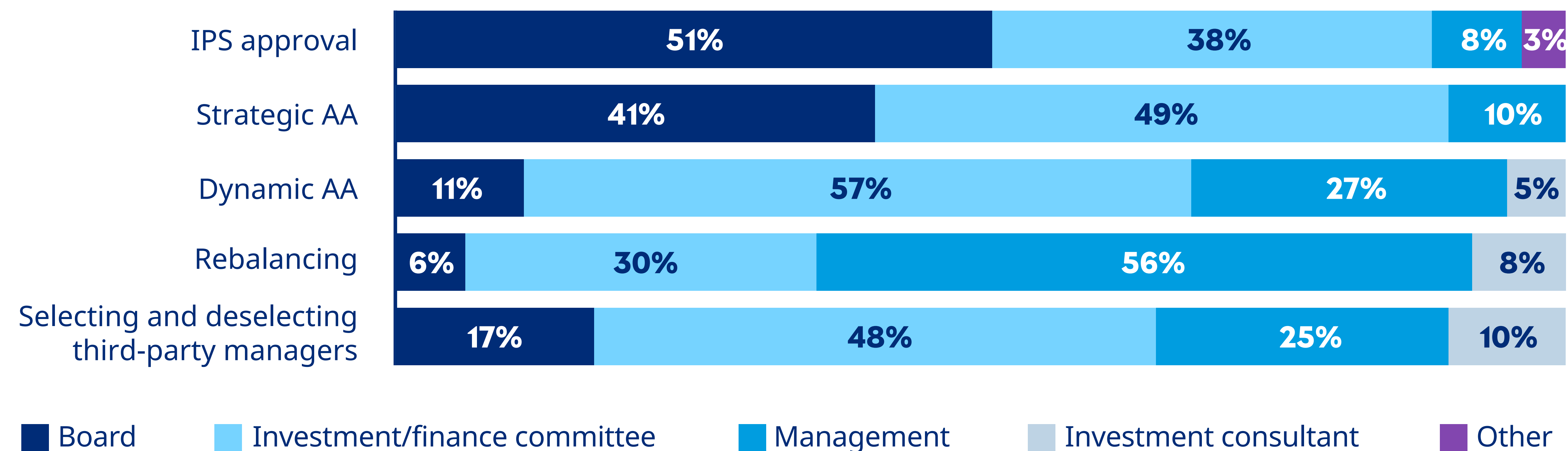
Does your organization have an investment committee?



Does your organization have a dedicated chief investment officer?



Which party carries the authority to make the following investment decisions?



Source: Mercer's *2022 Global Insurance Investment Survey*.

However, in fast-moving markets, committees that only meet once per quarter cannot act quickly enough to respond appropriately to new challenges.

This is reflected in the 21% of respondents that say they struggle to make dynamic or tactical changes to asset allocation.

Management or investment teams may not have the resources or the time to take on tasks such as rebalancing, dynamic asset allocation or manager selection. This is where, for many asset owners, employing a third party to provide a delegated investment function can help by leveraging significantly deeper resources to respond more quickly to market movements.

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Of our respondents, 71% say they outsource more than 75% of their portfolios.

External managers

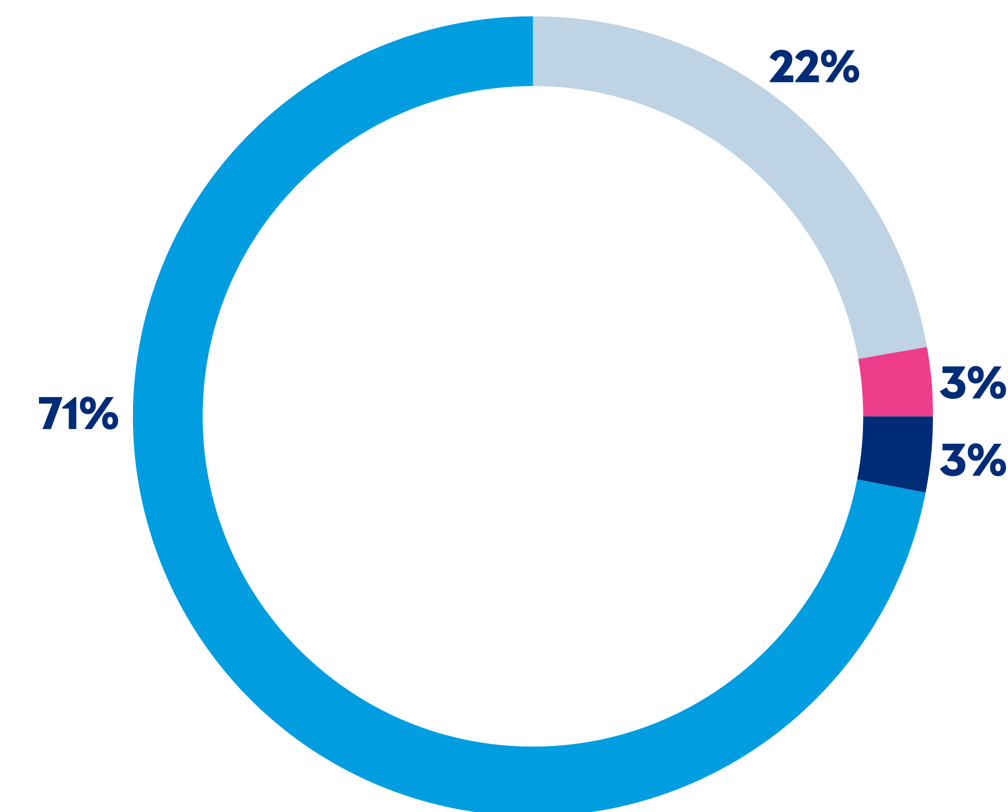
Limited internal resources naturally mean that the majority of insurance companies outsource investment management to external managers.

As we see insurers adapt to a post-pandemic landscape, they now face a more familiar set of challenges, including a volatile geopolitical environment and — for those with long memories — inflation and rising interest rates. The impact of this on their investment portfolios and the need to balance a risk-on approach with preservation of capital and income will, in my view, remain front and center for insurers globally.

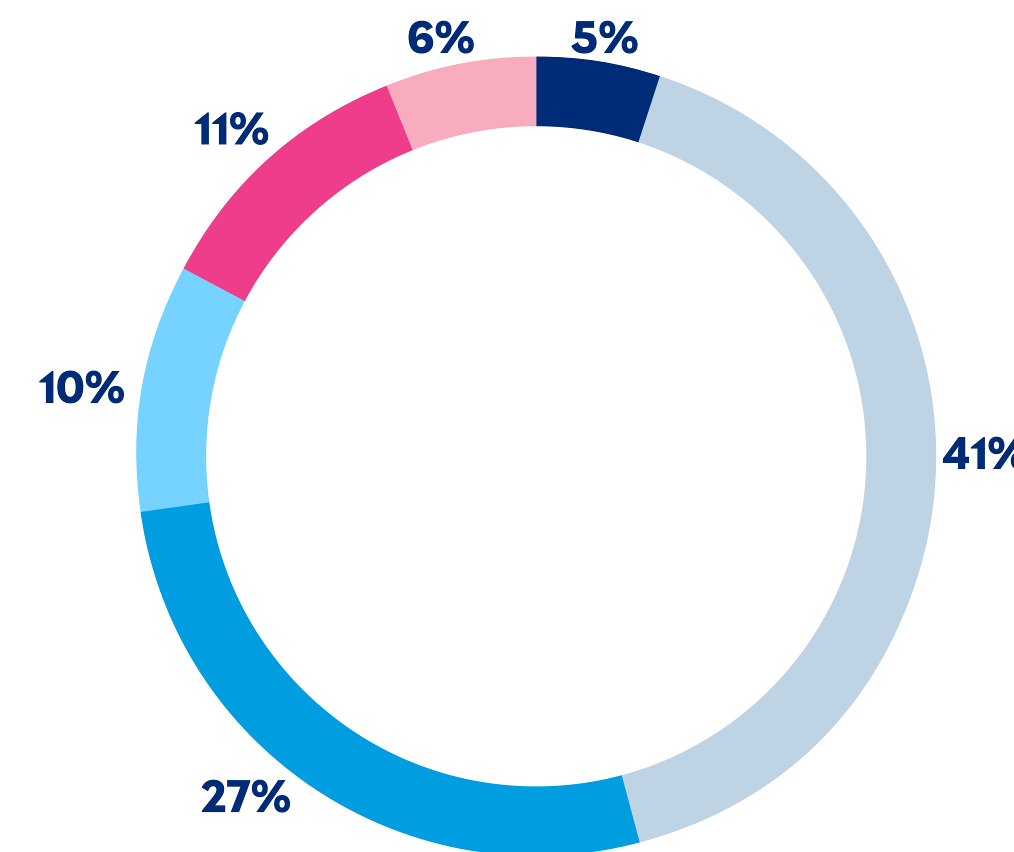
Designing — and in some cases re-designing — investment strategy will continue to dominate the agenda, as will the need to seek external help on implementing portfolios efficiently and at an acceptable cost.

Colin Tipping,
Head of Insurance, UK & Europe

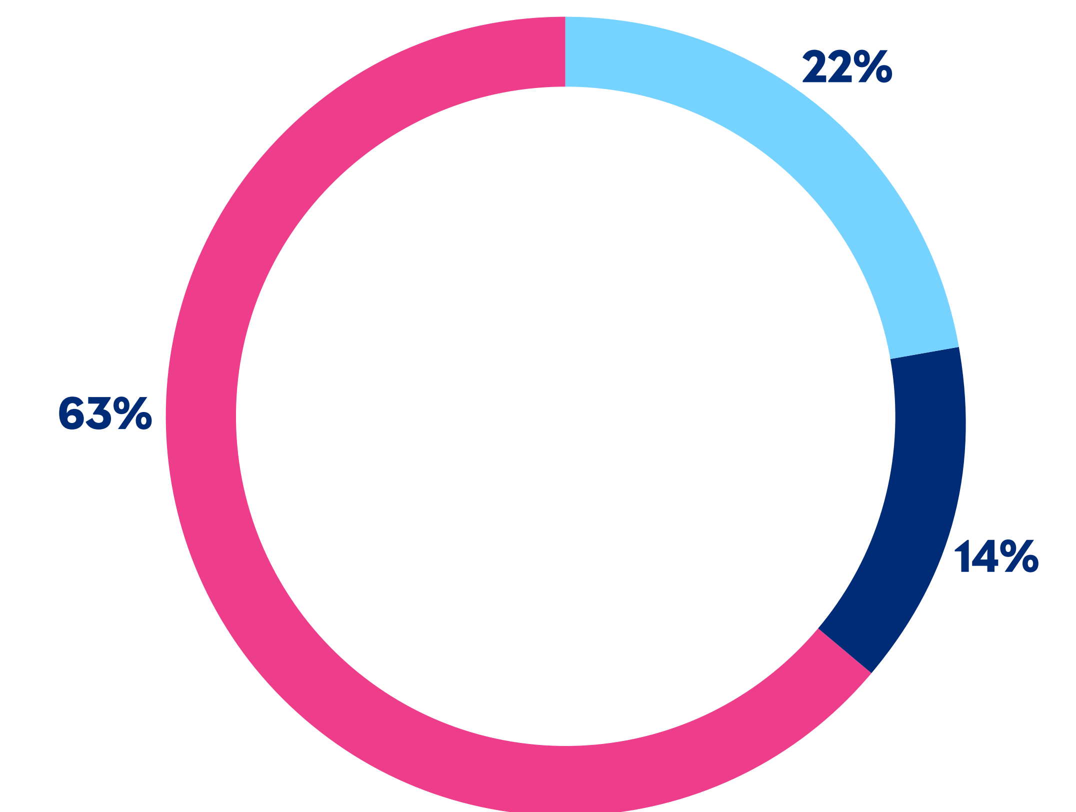
What percentage of your portfolio is externally managed?



How many external, third-party investment managers do you have in your investment portfolio?



Over the next 12 months, is the number of external, third-party managers in your investment portfolio most likely to:



Only 5% say they do not use any external managers. Most only use a small number: 41% allocate to between one and five, and 27% use six to ten managers, most likely to ensure portfolios do not become too complex.

Although most respondents (63%) are not expecting to change how many external managers they use, more than one-fifth (22%) intend to increase this number.

Given the complexity and resource-related challenges explored in this report, it is clear that outsourcing — including through delegated investment solutions — can help insurers broaden their opportunity sets, streamline their operations, and add scale and flexibility to their investment approaches.

Source: Mercer's *2022 Global Insurance Investment Survey*.

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Plotting a steady course

Higher inflation and rising interest rates pose major challenges to insurers as they seek to maintain diversity and achieve sufficient investment returns — often with significant limitations on asset allocation.

However, the “mainstreaming” of private markets — in particular, private debt — offers substantial and varied investment opportunities for insurance companies looking to diversify away from public markets. We have yet to see what, if any, long-term impact on private markets allocations there will be from market conditions observed in 2022.

One of the biggest themes from this year’s survey, though, has been the lack of internal resources available to many insurance investors. Insufficient in-house expertise is making investors reluctant to allocate to assets that may bring real diversification, return-generation and inflation-hedging benefits.

This situation is also raising concerns about insurers’ ability to adequately assess ESG risks, process sustainability information and hold third-party managers accountable for their “green” promises.

The months and years ahead are likely to present increasing difficulties as the macroeconomic and geopolitical challenges we face continue to play out. Ensuring that investment portfolios and operations are well prepared for a wide range of eventualities is paramount to insurers’ resilience and long-term success.

Source: Mercer’s *2022 Global Insurance Investment Survey*.

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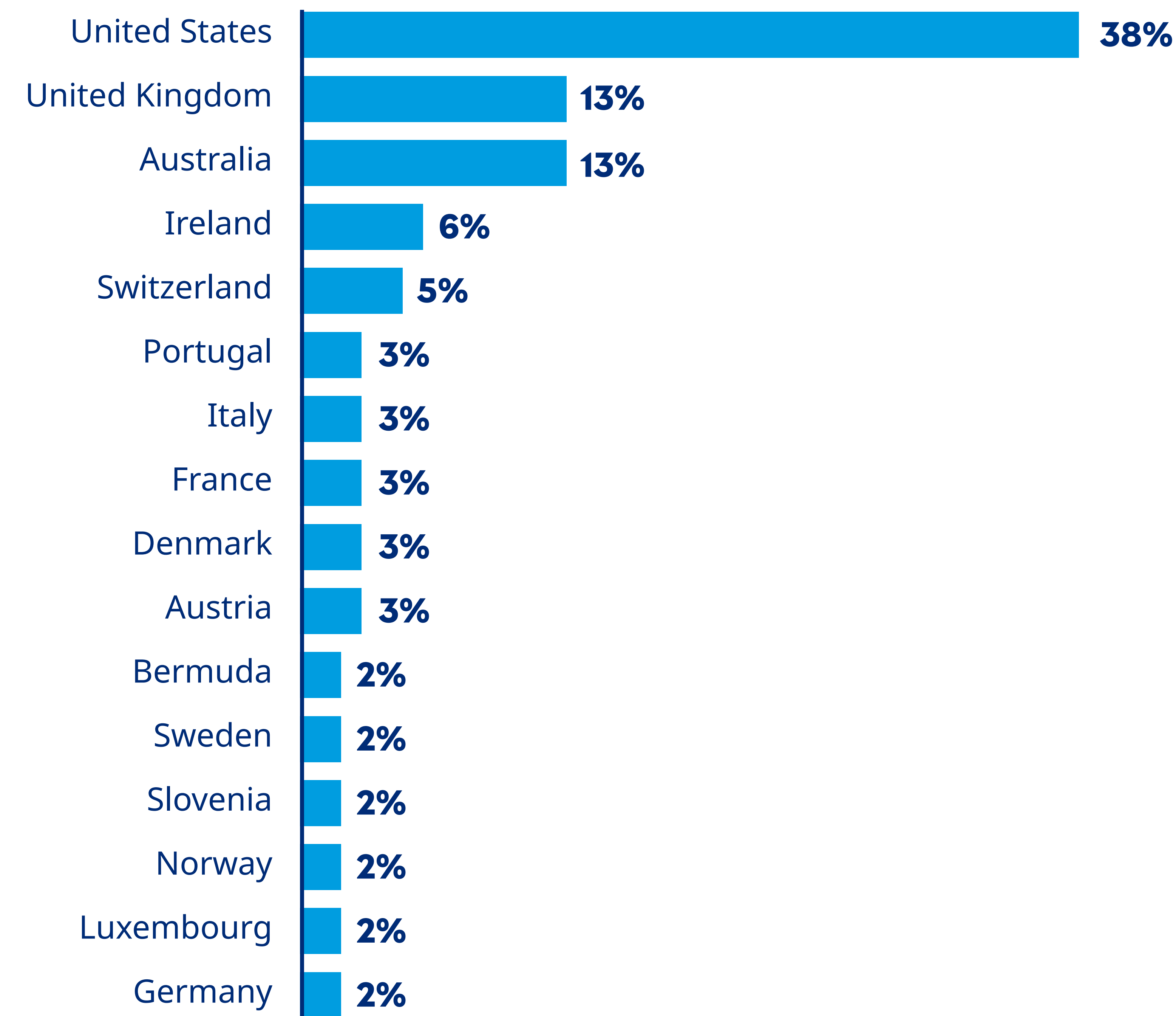
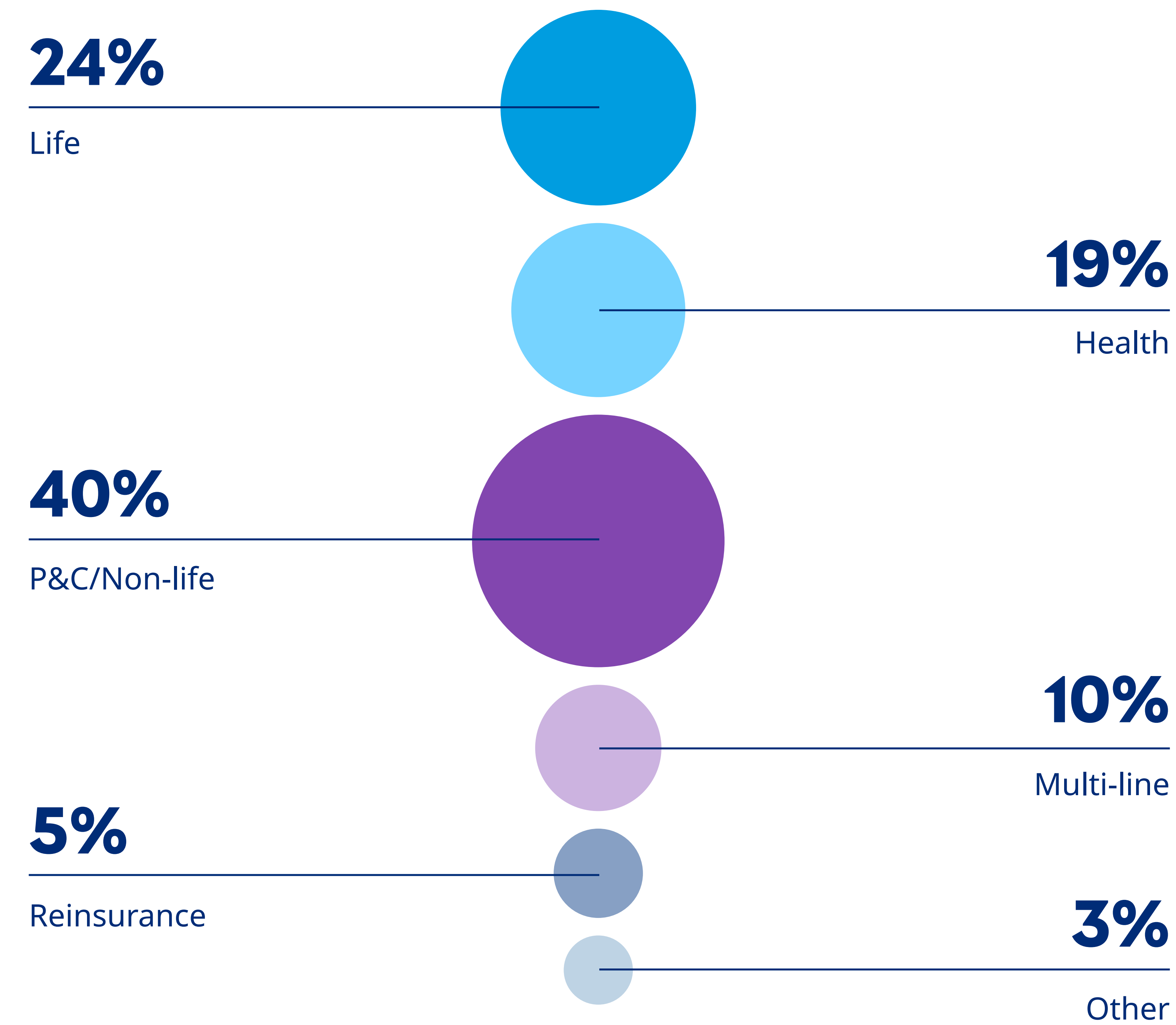
About this survey

The survey, conducted by Mercer in the third quarter of 2022, was completed online by 63 participants.

Where is your organization primarily located?



What is your organization's primary line of business?



Survey parameters

Mercer sought to vary participants across the following categories:

* Regions: Asia-Pacific, UK/Europe and Americas.

Source: Mercer's *2022 Global Insurance Investment Survey*.

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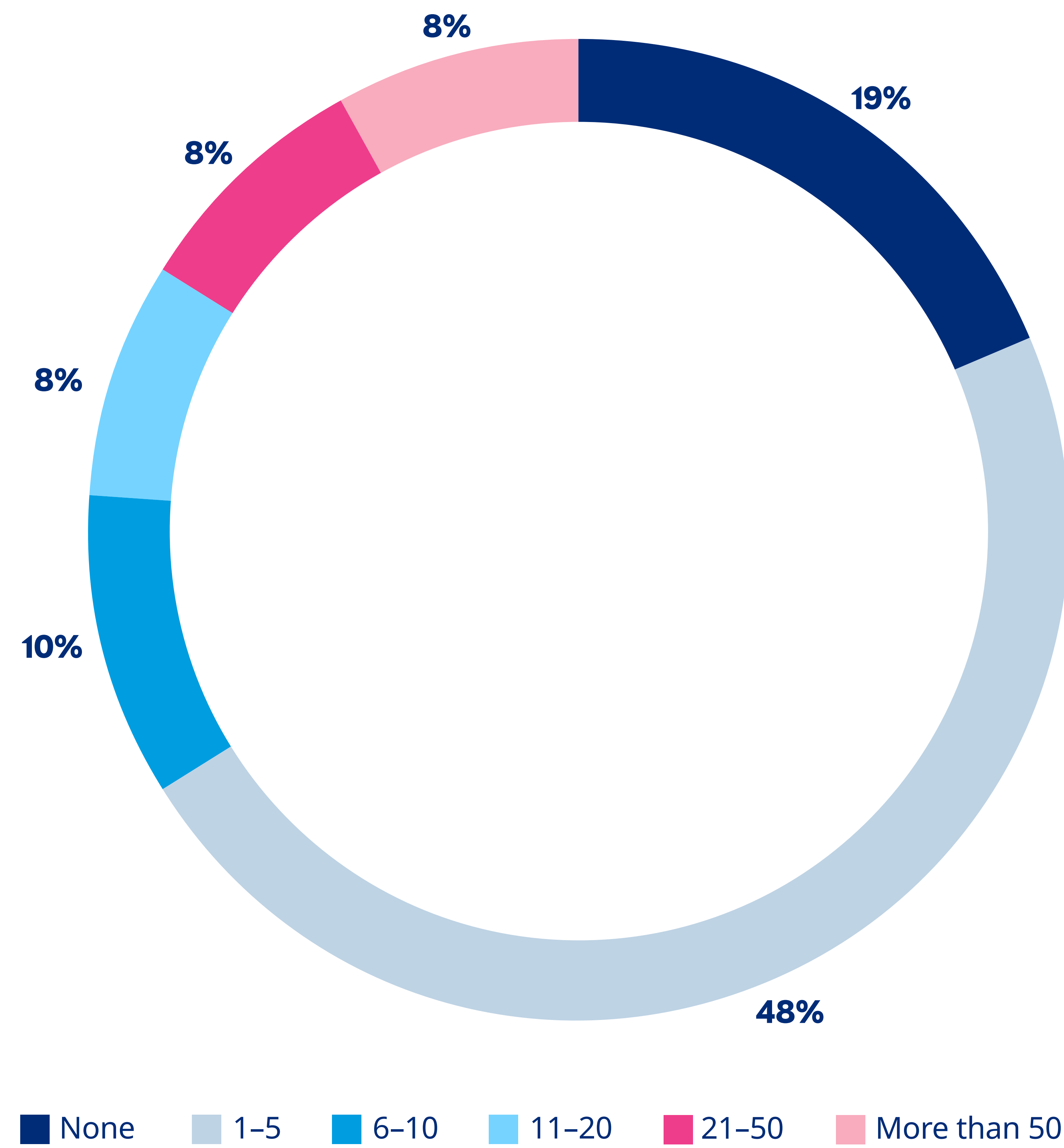
How many employees are dedicated, on a full-time basis, to investments within your organization?



In reference to your general account only, what is the size of your organization's insurance investment portfolio?

Roll over the buttons below to reveal chart data

Source: Mercer's *2022 Global Insurance Investment Survey*.

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Contact us

If you would like to explore the findings within this report in more detail or discuss how we may be able to support your organization, please feel free to contact your local representative.

Contributing team

Europe/UK

William Gibbons
william.gibbons@mercer.com

Andrew Berwick
andrew.berwick@mercer.com

Chris Bewley
chris.bewley@mercer.com

US

Eryn Bacewich
eryn.bacewich@mercer.com

Richard Silvan
richard.silvan@mercer.com

Kyle Ekstrom
kyle.ekstrom@mercer.com

Leadership team

Global Head, Insurance Solutions

Colin Tipping
colin.tipping@mercer.com

US

Greg Halagan
greg.halagan@mercer.com

Chris Tschida
christopher.tschida@mercer.com

Pacific

Denis Walsh
denis.walsh@mercer.com

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ESG investing refers to environmental, social and governance considerations that may have a material impact on financial performance and therefore are taken into account, alongside other economic and financial metrics, in assessing the risk and return potential of an investment. Thematic investing involves investing with a goal, at least in part, to achieve an impact on an environmental, social or governance issue, alongside generating return and mitigating risk. As always, the decision whether to invest in ESG-themed options, like all options, must be made pursuant to a prudent process with the objective of advancing the financial interest of the plan and its participants.

Funds of private capital funds are speculative and involve a high degree of risk. Private capital fund managers have total authority over the private capital funds. The use of a single advisor applying similar strategies could mean lack of diversification and, consequently, higher risk. Funds of private capital funds are not liquid and require investors to commit to funding capital calls over a period of several years; any default on a capital call may result in substantial penalties and/or legal action. An investor could lose all or a substantial amount of his or her investment. There are restrictions on transferring interests in private capital funds. Funds of private capital funds' fees and expenses may offset private capital funds' profits. Funds of private capital funds are not required to provide periodic pricing or valuation information to investors. Funds of private capital funds may involve complex tax structures and delays in distributing important tax information. Funds of private capital funds are not subject to the same regulatory requirements as mutual funds. Fund offering may only be made through a private placement memorandum (PPM).

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Endnotes

[1] Department for Work and Pensions. "Aligning Your Pension Scheme With the Taskforce on Climate-related Financial Disclosures Recommendations," 2021, available at www.gov.uk/government/publications/aligning-your-pension-scheme-with-the-taskforce-on-climate-related-financial-disclosures-recommendations.

[2] US Securities and Exchange Commission. "SEC Proposes to Enhance Disclosures by Certain Investment Advisers and Investment Companies About ESG Investment Practices," 2022, available at www.sec.gov/news/press-release/2022-92.

[3] Kirby A. "Why Data Remains the Biggest ESG Investing Challenge for Asset Managers," 2021, available at www.ey.com/en_gl/financial-services-emeia/why-data-remains-the-biggest-esg-investing-challenge-for-asset-managers.

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