INSURANCE ASSET RISK

Insurers now taking a more blended approach to public and private investing, Barings says

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By Rob Leeming

***Insurance Asset Risk* sat down with Patrick O'Sullivan, head of international insurance solutions at investment manager Barings to discuss his role and the sector's changing approach to investing in private markets.**

O'Sullivan took on the newly created position at the MassMutual-owned asset manager's sleek Old Bailey office in London just over six months ago. His task is expanding the firm's ability to deliver investment solutions to insurers, at a time when their investment universe is growing ever larger.

You're just over six months into your new role. Has it been what you expected?

Six months, it's really flown by. The focus at the start was to get Barings to be a better partner for insurance companies. We have fixed income capabilities across public and private markets, and we want to deploy them in the most insurer-friendly ways.

What I thought was interesting is if you look at what insurance companies are doing and how they're looking to fund their liabilities, they are trying to generate as much return as possible within their risk constraints. Currently more and more insurance companies are looking to private markets and private credit, including infrastructure investments and private placements.

Barings has an extensive range of private credit capabilities, given we are owned by the US insurer MassMutual.

So how are insurers' attitudes towards private credit investments evolving? What are you hearing from them?

We are certainly seeing an evolution in the private credit space. It's not just about traditional direct lending anymore. More and more insurance companies want to access investment-grade quality debt right across the spectrum, so that's infrastructure debt, private placements, and real estate debt.

Insurance companies have been investing in some of these asset classes for a very long time. MassMutual, for example, has been investing in private markets for decades. So, I think it's a natural evolution in some respects.

One of the things that I've been seeing happen, though, is a shift away from insurers thinking about public assets and private assets very separately, towards a scenario in which more insurers are viewing public/private allocation in terms of investment-grade versus sub-investment grade. So, there is becoming less of a differentiation between public and private markets over time.

Ultimately this is a good thing. There are some very attractive investment opportunities that can be gained in private markets that you can't necessarily get in the public space, such as mid-market loans, for example. You need to access those through private assets, you can't really get them through public offerings.

So, for insurers looking to broaden their investments universe, thinking about capital considerations, thinking around ultimately giving good value to policyholders, I think that blend between public and private markets is going to continue happening.

So, what asset classes within the private credit space are looking particularly attractive to insurance investors at the moment?

We're seeing a lot of interest in investment-grade private credit in particular, and that is really about finding new ways to finance companies. Plus, some of the really attractive opportunities we are seeing at the moment are in the fund financing space.

Why has insurers' interest in private credit seemingly skyrocketed recently?

Well, starting with the risk-return trade-off, it's very high-quality investment grade-quality debt. It's well collateralized by underlying loans and other securities and it gives very attractive spreads from an insurance perspective.

Just thinking about the US for a moment, the annuity market pricing is so competitive there that insurers need to be generating as much return as possible, because your policyholders are demanding as much return as possible, and private credit is very capital-efficient as an asset class.

Are you noticing, over time, an change in attitude from insurers? Traditionally they've always been seen as being a little stand-offish to new ideas. Are they become more daring?

I wouldn't say 'daring'. In many ways, when I think about private credit and how insurers should be allocating, it is really taking that kind of investment-grade mindset for the bulk of their applications. It just gives them a natural place to diversify risk, from just having a standalone or pure public bond market portfolio.

Allocating to the private markets gives you access to new investment opportunities, which gives you better diversification. It gives you opportunities to, oftentimes, have a lot of structural protection behind the loans you make. So, it's beneficial from that perspective.

There's been a lot of regulatory change in the UK recently with Solvency UK and on-going changes to the matching adjustment. Do you think those reforms went far enough in freeing up insurer's ability to invest more widely?

I think the matching investment reform has been a good step towards loosening, or providing more flexibility for insurance companies to allocate across the investment universe, particularly in fixed income. Obviously, we are still waiting to see long-term changes.

Moving forward, the PRA has sign-posted where some of their changes are going to come. You're going to see more liquidity stress testing being introduced and obviously funded reinsurance gets a lot of press, and we've seen the regulators start talking about doing stress testing for recapture risk.

These are all good initiatives, and they make sense. Illiquid investments can really help diversify an insurer's portfolio and enhance returns, but insurers, like any investor, need to also be attuned to liquidity needs, to make sure they've got sufficient liquidity in place to withstand shocks.

Are insurers in the UK turning against ESG? We have seen something of a move against the term in the US, where some insurers view it as too political.

I think ESG is still front of mind. Insurers still mention the term, and it is still very topical with most insurance companies that we're dealing with, particularly on the international side.

The way I've interpreted this perceived mood change is that it isn't necessarily against ESG, it is just about making sure that ESG is one of the considerations, rather than the principle. So, it's making sure that people are still fulfilling their fiduciary duties, rather than just purely going by ESG.

You need to be mindful about risks from an ESG perspective, in terms of potentially legal or regulatory changes that could impact the portfolio. So, I view ESG as another layer of good investment analysis.

What do you think are going to be the key themes in your conversations with insurers through this year?

Regulation is super important for insurance companies, and making sure that they're running as capital efficiently as they can be.

Accounting changes are going to be a big topic, we've seen a lot of change from IFRS 9 and 17 being introduced in the last couple of years, and that's a challenge.

Insurers as predominantly fixed income investors, and looking at markets today, seeing how tight public market spreads are, helping them to generate better returns

for themselves and their policyholders, and looking to public and private markets to solve that challenge, rather than just public markets, will also be part of the conversation.