

**Exchanges at Goldman Sachs
Facing Rising Rates, Insurers Turn
to Private Assets, Real Estate — even Crypto
Mike Siegel, Global Head, Insurance
Asset Management and Liquidity Solutions
Businesses, Asset Management, Goldman Sachs
Allison Nathan, Host
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Allison Nathan: In a sharp reversal from prior years, the world's largest investors now see inflation as the biggest threat to their portfolios.

Mike Siegel: The most fundamental concern is inflation. And some of it is because of a concern that inflation has on the balance sheet. But more specifically, the concern is higher inflation rates drive more monetary tightening. If they overshoot and slow down too much, we'll end up with a recession. A recession tends to be very bad for corporate credit, of which that's a very important part of the balance sheet.

Allison Nathan: I'm Allison Nathan and this is Exchanges

at Goldman Sachs.

[MUSIC INTRO]

Allison Nathan: Insurance companies have long been considered a key source of stability for financial systems. That's because insurers manage multi billion-dollar investment portfolios, the sheer size of which can move assets and markets. Today, we'll get a look at what's on the minds of this influential investor base. To do that, I'm sitting down with Mike Siegel, global head of the insurance asset management and liquidity solutions businesses in Goldman Sachs Asset Management. Mike, welcome back to the program.

Mike Siegel: Allison, great to see you. And I'm really thrilled to be here.

Allison Nathan: It's always great to see you, Mike, and catch up with what's going on in the world of insurance. There's so much going on now. And I think it's a particularly interesting moment given the volatility in the markets that insurers have exposure to.

But before we get into that, first, just remind us why this investor base, insurers, matters so much.

Mike Siegel: Well, Allison, globally the industry represents over \$26 trillion dollars' worth of assets that need to be invested. It's one of the two largest pools of assets in the marketplace. The other being the pension plans. But more specifically, the insurers are able to invest for a very long period of time. They're able to invest in 10-to-30-year bonds, into 10-to-30-year mortgages, into real estate, into permanent capital, into ports, wind farms, other long-term investments. So, they represent a very large pool of capital, but also a pool of capital that can invest for a very long period of time.

Allison Nathan: And that's basically because they essentially don't have to pay out this capital on any near term or regular basis even, right? So, they just need to have the capital on hand when they need to pay out. Which, on average, occurs over a long period of time.

Mike Siegel: The business is very predictable, within reason, and in particularly the life business. So, you start insuring somebody in their 20s or 30s, hopefully they'll be

around for another 30 to 40 years before they need to make a claim on that policy. On the property/casualty side, it's a little bit shorter. So, the auto policies and the homeowner policies turn over quite frequently. But in general, it's reasonably predictable. There isn't a concept of a quote/unquote "run on the insurer." So, when they have the premiums to invest, they take a longer-term view of how they invest them.

Allison Nathan: Right. And there's not a concept of redemptions, which is what a lot of the broader investor base is concerned about, correct? Like, they're not going to be losing a substantial amount of capital unexpectedly.

Mike Siegel: That's right. There really isn't a concept of redemption. People sign up for their policies. Even for an auto policy, which is annually renewable, for the most part, consumers stay with their companies over a fairly long period of time.

Allison Nathan: Right. And if we think about the insurance industry, as you just said, they're massive investors. So, talk to us a little bit about how that works and why they are investing so much.

Mike Siegel: Well, the basic job of an insurance company is to pool risk or write policies. So, they might insure you for your life. They might insure you for your health. So, that would be a life company or a health company. Maybe they insure your auto or home or apartment. That's a property/casualty company. In fact, they insure this building. So, they write insurance against anything that could happen in this building. So, that's the primary business.

But in doing that, in writing those policies, they take in premium. They take in money. And they need to invest that money so that they can have the monies to then pay for policy claims. So, it's very important that that money is invested safely. But also, very important that it gets a good return because that's what they use to run their business.

Allison Nathan: So, you just published your annual report. I think it's the 11th edition, correct me if I'm wrong. So, what does that entail?

Mike Siegel: So, Allison, it is the 11th year that we've surveyed the industry. This year we had respondents that

represented over \$13 trillion dollars' worth of assets, which is about half of the global industry's assets. So, we think that the survey is very representative of what the industry is thinking.

We ask a number of different questions about the macro economic outlook. What do companies think rates are going to be doing, equity markets? What asset classes do they think are going to perform well? What asset classes do they think will not perform well? We ask questions about asset allocation. Where are you planning on putting capital to work? We also ask about ESG. How important is this as a factor in your investment?

This year, we surveyed for the first time on crypto, which I thought we would get no respondents. But I was surprised. A good 6 percent of the industry respondents indicated that they're either invested in crypto, or more specifically, considering investing in crypto.

By the way, we did some follow up questions on that. And generally, the companies that are either invested or considering crypto are doing so to understand the market and to understand the infrastructure. But if this becomes a

transactable currency, they want to have the ability down the road to denominate policies in crypto. And also accept premium in crypto, just like they do in, say, dollars or yen or sterling or euro.

Allison Nathan: So, given the complicated macroeconomic and geopolitical backdrop we're in right now, how are insurers thinking about the investment landscape?

Mike Siegel: So, the most fundamental concern is inflation. And some of it is because of a concern that inflation has on the balance sheet. So, particularly for property/casualty companies, if inflation is going up, the cost of an auto repair or a home repair goes up. So, that affects them on their cost side.

But more specifically, the concern is higher inflation rates drive more monetary tightening. Monetary tightening drives a slow down. If they overshoot and slow down too much, we'll end up with a recession. A recession tends to be very bad for corporate credit, of which that's a very important part of the balance sheet. So, you start with inflation, rising inflation rates leading to all these other concerns.

Having said that, the industry is of the view, for the most part, that while things are going to slow down, we're not likely to see a recession in the next few years. So, it's still a pretty good investing environment out there.

Allison Nathan: Right. And I think you've even said in the report that there was more investment opportunity today than perhaps there was in 2020 or 2021. So, what's really driving that optimism?

Mike Siegel: Well, two different things. One, we've recently seen a very significant equity sell off. So, the companies always have new capital to put to work. They'd rather put it to work with lower equity prices than higher equity prices. But the vast majority of the balance sheet is fixed income. And higher rates are good for reinvesting.

Now, they don't want rates to rise too rapidly because then it gets back into that scenario of too rapid a rise ends up too quick a slowdown, ends up in recession. But anything short of that, the opportunity to put monies to work at higher and higher yields is better for the companies.

Allison Nathan: And so, where are insurers planning to put capital this year?

Mike Siegel: So, a couple of different trends. One, the movement from public markets to private markets has been in place for quite a while now. A lot of that is driven by the fact that these companies have a lot of liquidity and don't have an immediate need for liquidity. So, they might as well put it into less liquid assets and earn the illiquidity premium.

But more recently, the concerns about inflation are driving investments into things such as real estate, which over a long period of time is a good inflation hedge, but also into floating rate assets because rising rates will increase the yield on floating rate assets. And that's another place where they're investing.

Allison Nathan: So, you mentioned that these are less liquid, but that's not a huge problem for this type of investor. But are there risks associated with going into the private markets, less liquid markets, credit markets where default risk could be rising in a potential recession scenario, that isn't the most likely, you know, as the

insurers think, but could happen?

Mike Siegel: Allison, as you know, there's risks to everything, including if they simply sat in cash. That has a risk of not being able to have good reinvestment earnings going forward.

When they move into less liquid asset classes, the give up of liquidity is not an issue because there's never a, quote/unquote, "run on an insurance company" such that they have an immediate need to liquidate. But as you get into less liquid asset classes and less better understood asset classes, you can have risks there. Although, in some parts of the market, the covenances are much stronger than you see in the public markets, for example, in investment grade private placements.

So, on one hand I'm giving up a bit of liquidity. On the other hand, I could be picking up stronger credits or stronger credit covenances.

Allison Nathan: It's interesting, right, because I think it's an underappreciated fact that some of the most skilled investors in the world sit at insurers.

Mike Siegel: Allison, that's absolutely the case. For an insurance company, it's very important to get it right on the product side of the balance sheet. That's their core business. But also, it's very important to get it right on the investment side of the balance sheet.

If you're a good insurance underwriter and then you fritter away all of the monies on the investments, you're not in very good stead. So, yes, these are very sophisticated investors involved in virtually every market that we have from the government markets to the mortgage markets to the corporate markets, investment grade corporates, below investment grade corporates, high yield, securitized. And then, large players in the private markets: private equity, privately debt, real estate, infrastructure.

Allison Nathan: When we talk to various investor bases, ESG, environmental, social, governance, seems to be on everyone's mind. Is that something on the minds of insurers right now?

Mike Siegel: It is front and center. ESG affects these companies in many different ways. So, for example, they

could be insuring homes in California subject to wildfires. They could be insuring homes or autos in Florida subject to hurricanes. So, environmental change is directly affecting these companies on the business side of the balance sheet.

On the other hand, on the investment side, one, they don't want to double up on those risks. But being good stewards of capital and being good stewards of our society, they are very concerned about environmental, social, and governance. They are continuing to look at their portfolios to see ways to improve their portfolios with respect to those three areas. And even put capital to work in a positive fashion for change, whether it's sustainability, solar farms or wind farms. Whether it's low-income housing to help rebuild neighborhoods that need the capital investment. So, it is front and center for these companies.

Allison Nathan: Right, and actually, as you just said, they live and breathe it everyday because they really face, tangibly, the risk of climate change in their portfolios.

Mike Siegel: Absolutely.

Allison Nathan: If we think about this from a regional perspective, are there trends between US, EMEA, from an ESG perspective? Is there a different emphasis? Or even beyond?

Mike Siegel: I think the movement got started in Europe first. The ESG or sustainability movement is being taken very seriously there. It is top of mind of most of the companies in the industry there, also, as demonstrated in the report. In addition, the regulators in Europe are asking for more disclosure. And maybe down the road, maybe, using their capital regime to either benefit companies that are more responsive or penalize companies that are less responsive.

In Asia, it's also a very important factor. Here in the States, it's been slower to develop. But we're catching up quite quickly to Europe and Asia.

Allison Nathan: And if we talk about Asia, you know, we've been having this broader conversation about the macroeconomic landscape, China is certainly a place where we are seeing some real growth concerns given the COVID related lockdowns and the drop in activity we've seen there.

So, how big of a concern is that for the insurers?

Mike Siegel: So, on a very narrow level, the global insurers investments in China are not that material to the balance sheet. I'm not going to say it's zero, but not that material. More importantly, it's the Chinese economy and how important that is in the world economy. And in particular, as you mentioned with the COVID lockdowns, reducing the production of goods and services just creates another inflationary element which adds to all the other inflationary concerns that companies are having.

So, I would say in the beginning of the year, China was something that was being watched, but not closely. And now it's being watched very closely.

Allison Nathan: And the survey you did was conducted early in the year and it was actually conducted before Russia's invasion of Ukraine. And we talk about inflationary concerns skyrocketing. So, what are you hearing from clients more recently in terms of that situation evolving and the broader macroeconomic implications?

Mike Siegel: So, the survey was conducted in February 2022. There was a lot of discussion about Russia/Ukraine, and it was starting to affect the markets. But yes, the invasion hadn't taken place yet. Since the invasion has taken place, without addressing all of the very significant human cost elements of all this, loss of life, loss of property, et cetera, there are two things that companies are very concerned about. One is the European economy. What are the implications for the European economy? And again, an economic slowdown may have equity market and credit market implications. But secondly, the inflationary aspects, both in food and energy. And again, it's one more thing that's supporting a higher inflation rate. Which may force higher interest rates. Which may then lead to the economic slowdown, if not recession, that companies are watching for. Again, not base case, but definitely one of the scenarios that are being assessed.

Allison Nathan: Right, so, we have this challenging macroeconomic environment, recessionary concern out there, but not the major concern as you said. And at Goldman Sachs, we are not forecasting a recession either. But then you've got better entry points for this very large investor base.

If we turn for a moment from the institutional investor perspective, but you know, insurance companies also deal with the policy holders, you know, you and I who are buying insurance policies. What's the trickle-down impact of insurers' investment management practices to the individual consumer?

Mike Siegel: Well, first, I think the consumer, and when we say the consumer, by the way, it's the individual, but it's also companies that buy insurance, want to make sure that their insurers are healthy, solvent. You don't want to be buying a policy from somebody that's not going to be there to make good on the policy if you do have a claim.

But the current environment is the yields are rising, which is providing more investment income for the insurers. And then that translates back into either lower policy premiums, because they don't have to charge as much because they've got more investment income. Or particularly in the case of products such as variable annuities, they're able to pay out higher interest rates on those annuity products because they're able to earn higher interest rates on the premiums that they're taking in. So, it

has a direct affect on the purchasers of policies, whether they're consumers or businesses.

Allison Nathan: Right. And so, if you think about where we've come from in terms of the investment and how that's trickled down and where we're going, you know, do you see a shift? Better environment for policy holders potentially?

Mike Siegel: I think particularly on the savings products, which again, which be the annuity products, or in Europe the unit linked products, yes, the higher interest rates are translating directly into better policy yields on those policies. Slowly, over time, it's also going to trickle down into lower premiums on homeowners and auto. It's more subtle. It will take more time to see that.

Allison Nathan: Thank you so much, Mike. It's always a pleasure having you here to discuss the report.

Mike Siegel: Thank you, Allison. It's wonderful to be here.

Allison Nathan: Thanks so much for joining us this Monday, May 23rd, 2022, for another episode of Exchanges at Goldman Sachs.

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