German Insurance Companies 2024: Sophisticated Investors in the Global Alternatives Market

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Executive Summary

As inflation has subsided and the ECB and Fed have reduced interest rates, economic and geopolitical uncertainties still linger. Our quantitative and qualitative research offers an update on the role of alternative investments for German insurance companies.

We discuss how German insurance companies approach alternative assets, with a special emphasis on Corporate Private Equity, their unique challenges, and how their strategies diverge from those of other investor types and global peers.

How do German insurance companies invest in alternative investments, which challenges do they face, and how do they differ from other investor types?

Insurance companies, being large asset holders, invest more extensively in alternative asset classes than other investors, supported by specialized teams and in-depth expertise. This advanced alternative investments portfolio development often meets regulatory and internal risk-return targets, leading fewer insurers to plan to expand further into new alternative asset classes compared to other institutional investors. Insurance companies frequently view regulatory constraints on alternative investments portfolio expansions, illiquidity, and lengthy capital commitments as major challenges. They also report facing valuation issues more often than other investor types. However, the higher proportion of insurance companies invested in alternatives does not necessarily mean comparatively higher individual ratios in the asset allocation.

Nonetheless, the outlook for illiquid alternatives remains positive, with expected growth in most asset classes - except Real Estate. Corporate Private Debt, less dominant in insurance companies' debt portfolios, shows significant catch-up potential, with more insurers planning to enter this asset class than their peers. The normalization of interest rates has contributed to a healthier and more balanced market for alternative investments, and there continues to be robust demand. Real Estate and Infrastructure Equity are crucial due to benefits like diversification, ESG, inflation protection, megatrend exposure, and regular investment income.

While insurance companies' portfolios are heavily weighted in fixed income, despite the increased attractiveness of liquid bonds, alternative investments continue to play a crucial role in their portfolios.

How do German insurance companies differ in comparison with their international peers?

German insurance companies have a distinct investment outlook compared to their international peers. They show a stronger inclination to increase allocations to Infrastructure Debt and Equity while also significantly reducing Real Estate Debt and Equity exposure. In contrast, international insurers maintain a more optimistic view of the real estate market.

What are the differences in the role of Alternative Investments depending on the type of insurance company?

Due to regulatory and strategic differences, primary insurers and reinsurers have distinct approaches to alternative investments. Reinsurers, benefiting from greater regulatory flexibility, often focus on equity-based alternatives like Private Equity and Infrastructure Equity, leveraging illiquidity premiums and capital growth. In contrast, primary insurers, particularly in the life and health sectors, prioritize income-generating debt alternatives such as Real Estate Debt and Infrastructure Debt, aligning with regulatory requirements and stable returns for meeting guaranteed obligations.

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1. Structure and representation of the participating insurance companies in the BAI Investor Survey 2024

111 German institutional investors (limited partners - LPs) participated in the BAI Investor Survey 2024. The sample combines more than EUR 2.3 trillion in assets under management (AuM) and can, therefore, be considered representative of the market in Germany.

Insurance companies are the largest group of investors. 35.1% of the investors surveyed stated that they were larger insurers regulated under Solvency 2. 13.5% are smaller investors under AnlV regulation.

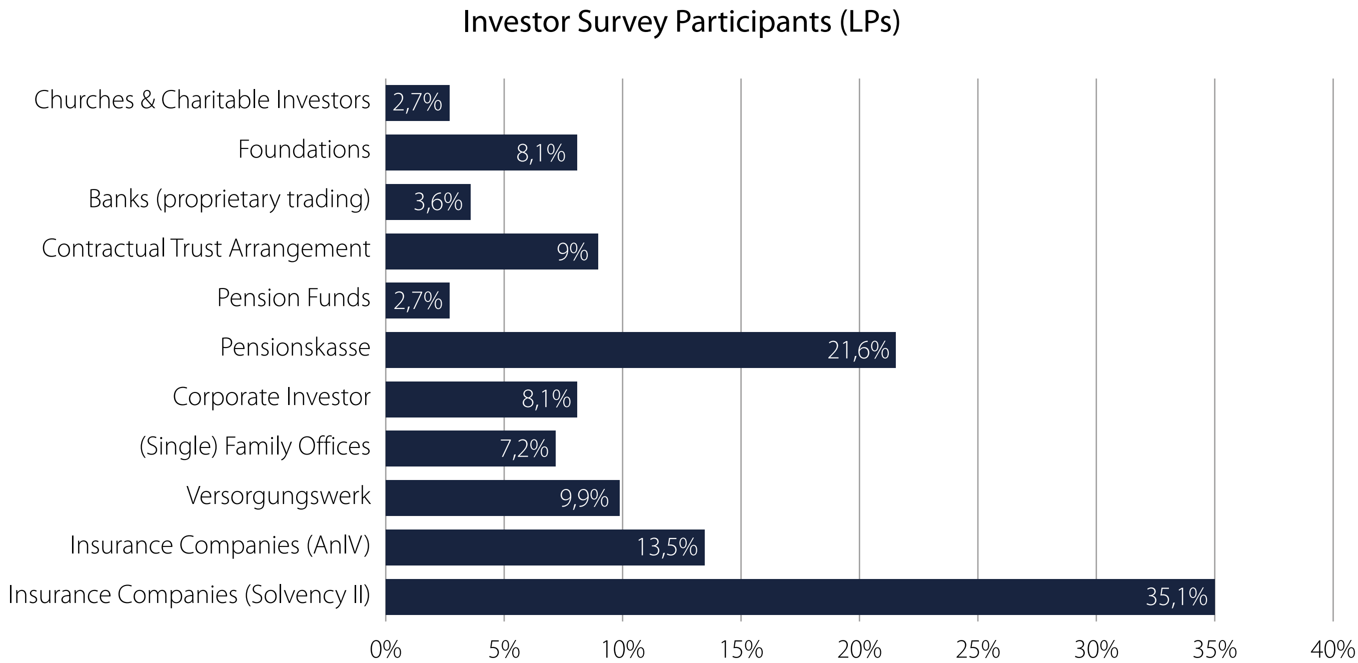

Figure 1: Investor types participating in the BAI Investor Survey 2024.

However, multiple answers are possible, and LPs sometimes categorize themselves as several investor types. For example, 6.4 % of the entire sample is assigned to the 'insurance company AnlV' and the 'pension fund' categories.

For this study, we use the BAI Investor Survey 2024 data to form a sub-sample of investors categorized as Solvency 2 and/or AnlV insurers and compare them with the other German investors surveyed. These 41.4% of LPs comprise pure 27.9% Solvency 2 investors, 6.3% pure AnlV investors, and 7.2% who fall under both categories.

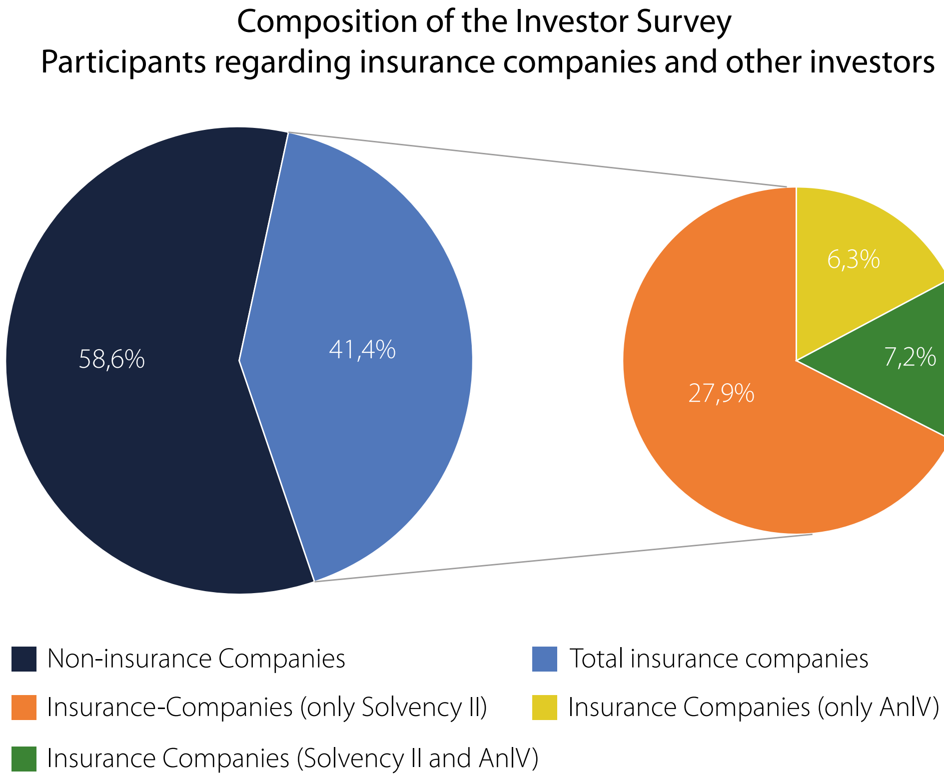

Figure 2: Split of Investor Survey Participants regarding types of insurance companies and other investor types.

Insurance companies differ from other investor types also in their average size. About 10% of all surveyed LPs have more than €50 bn assets under management; among insurance companies, this is the case for 16.5%. The largest investor category in terms of AuM, with more than 200 bn AuM, accounts for 2% of all investors, while the figure for insurance companies is 4.4%.

The following chapters examine how insurance companies differ from other investors in their alternative investments.

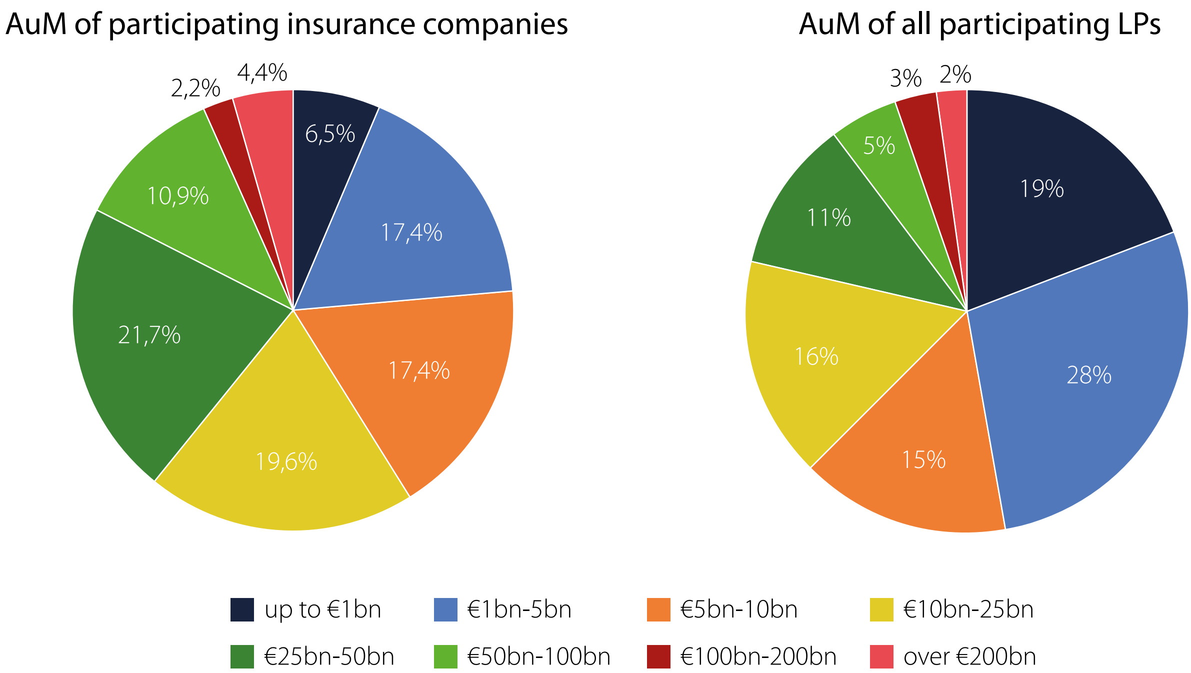

Figure 3: How high are the assets under management by your company? AuM of insurance companies (Solvency 2 and Anlv), and AuM of all participating LPs, source: BAI Investor Survey 2024.

2. The weight of alternative investments in insurance companies' portfolios

Alternative investments play a central role in the portfolios of German insurance companies. The most common of these investments is still Real Estate Equity (95.65%), which has a long tradition among German insurers. Real Estate investments play a vital role in diversifying portfolios, particularly those heavily concentrated in bonds, with 60.87% of surveyed insurance companies affirming this benefit. Additionally, Real Estate Equity provides a steady income stream, much like bonds, a feature valued by 52.17% of respondents.

Infrastructure Equity is the second most popular alternative asset class for insurance companies. With 93.48% of insurance companies already invested, infrastructure project investments have overtaken Corporate Private Equity investments in importance. However, Infrastructure Equity has different characteristics from Real Estate Equity, and the reasons for investing differ accordingly. Capital appreciation, ESG, and megatrends also play a role.

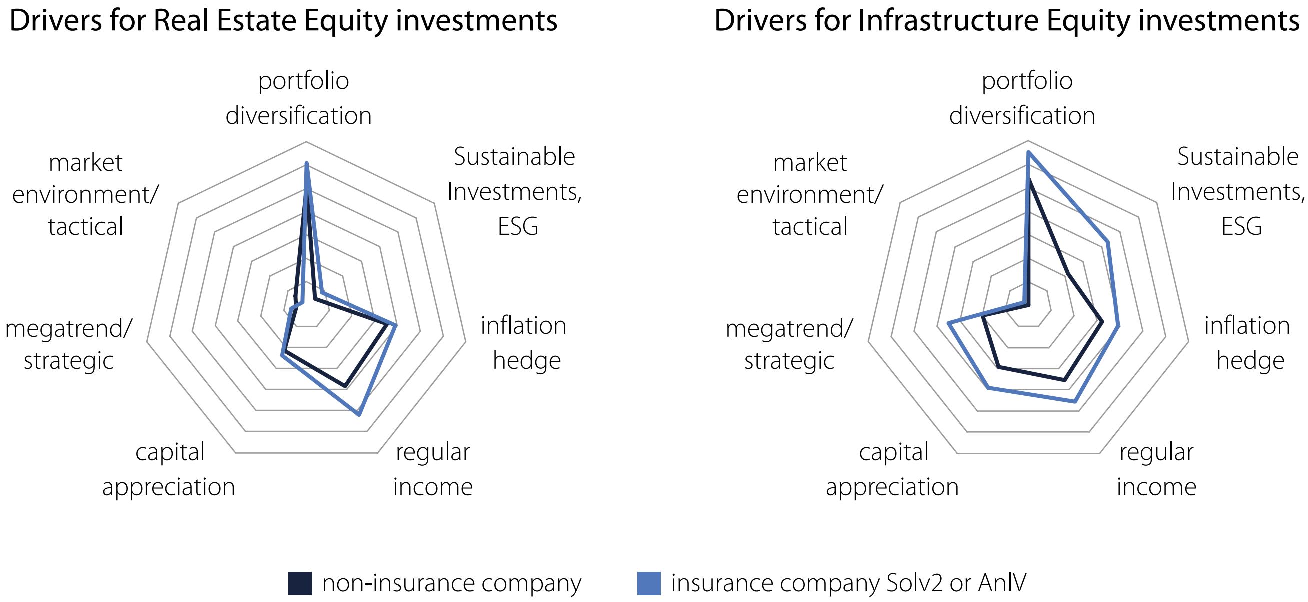

Figure 4: Drivers of Real Estate Equity and Infrastructure Equity investments of German insurance companies, source: BAI Investor Survey 2024.

The data indicates that a substantially larger proportion of insurance companies are investing in all alternative asset classes compared to other types of investors. The smallest discrepancy in investment patterns is observed between the proportion of insurance companies and other LPs investing in Hedge Funds and Liquid Alternatives, which have the lowest percentage of investors. Only 21.7% of the insurance companies and 20.0% of all other LPs have these strategies in their portfolios.

At just 7%, the difference between insurance companies and their peers in institutional investment is also relatively small for Corporate Private Debt. Interestingly, almost as many insurance companies are invested in Infrastructure Debt and Real Estate Debt. These two asset classes, characterized by attractive continuous income streams for insurance companies, are more than twice as popular with insurance companies as they are with pension funds, company pension schemes, etc.

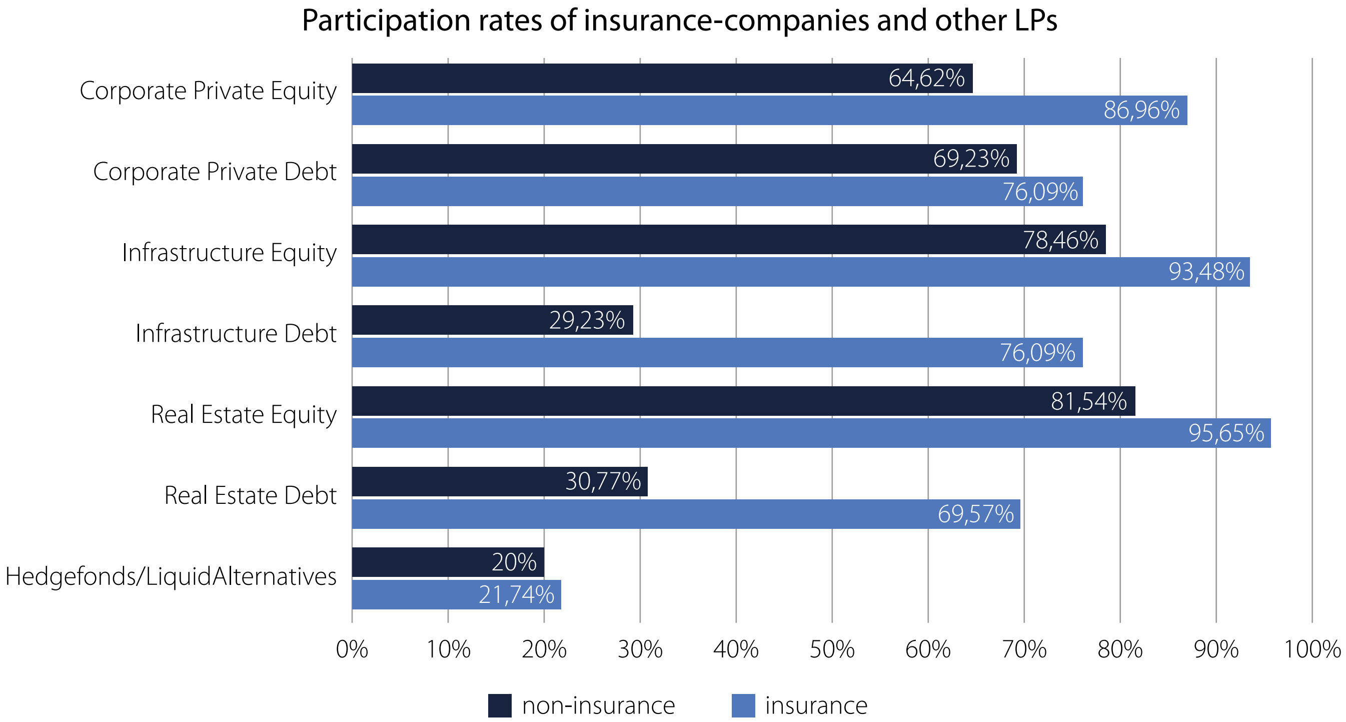

Figure 5: The share of insurance companies and non-insurance companies invested in alternative asset classes, source: BAI Investor Survey 2024.

The systematically higher proportions of alternative investments by insurance companies can also be explained by the fact that the respondents in the sample had significantly more experience in the field of alternative investments. On a scale of 1 – beginner to 6 – expert/in-house team, 37% of the insurance companies surveyed said they were experts in alternatives, compared to only 24.6% of the other investors. More insurance companies are also represented in experience levels 5 and 4. By contrast, levels 2 and 3, with relatively less experience in alternative investments, are significantly more frequently cited by non-insurance companies.

Their bigger average size can also explain the higher expertise of insurance companies in alternatives. While about 10% of the total sample of the BAI Investor Survey 2024 has more than € 50 bn assets under management, the share among insurance companies is 16.5%. Conversely, the higher proportion of invested insurance companies also means that insurance companies invest more in alternative investments or buy larger tickets due to their structurally higher AuM.

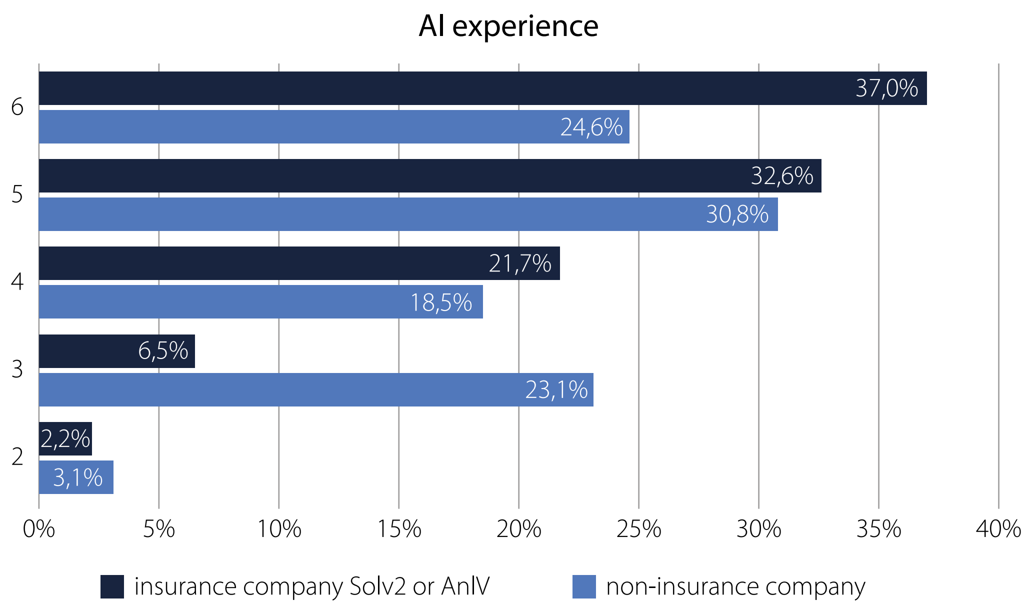

Figure 6: How would you rate your in-house experience in relation to your alternative portfolio as an investor? From 1 = Entrance to 6 = Experts/ Inhouse Team, source: BAI Investor Survey 2024.

Larger investors with more assets under management have more resources, allowing them to build alternative investments' expertise with specialized in-house teams. This could potentially explain why insurance companies tend to have more developed alternative portfolios.

However, the higher proportion of insurance companies invested in alternative investments does not necessarily mean that they have higher alternative investment ratios than other types of investors. More developed alternative portfolios, in the sense that insurance companies are invested in more alternative asset classes, should not be interpreted to mean that alternative investments necessarily have a higher portfolio share in absolute terms. Rather, they may already be closer to the theoretical target returns.[1]

The significant increase in alternatives allocations in the past means that insurance companies are at a more advanced stage of development, and some are already meeting allocation targets. This may be due to regulatory factors or internal risk-return factors. Those factors inhibit further increases in alternative investments' allocation by new investments in alternative asset classes or expansions in existing allocations.

We will clarify this further on the basis of interviews with experts.

Kathrin Schmidt,
Portfolio Manager at GVV Kommunalversicherung VVaG

Kathrin Schmidt, Portfolio Manager at GVV Kommunalversicherung VVaG, explains that the company's current allocation to alternative investments, (including Real Estate), is close to its target, with plans for only slight further increases. While the company could potentially increase the allocation further, liquidity and risk concerns act as a natural limit. In this regard, the regulatory framework aligns well with their internal risk and liquidity management strategy.

Philipp Kratzer,
Head of Alternatives Strategy & Advisory, MEAG

Philipp Kratzer, Head of Alternatives Strategy & Advisory, MEAG, notes that the period of low interest rates over the past 15 years significantly boosted the attractiveness of alternative investments, as traditional investment grade bond investments offered little appeal. This trend led to a surge in alternative demand to the point where they may have become somewhat exaggerated.

With the rise in interest rates starting around 2022, traditional bonds have regained their appeal, making alternatives slightly less attractive in relative terms. However, Kratzer believes this shift to normalization of interest rates has made the market for alternative investments healthier and more balanced. There remains a strong and ongoing demand, particularly for Infrastructure and Real Estate, suggesting that these asset classes will continue to grow and present solid investment opportunities.

Armin Beerwart,
Head of Private Markets at W&W Asset Management GmbH

According to **Armin Beerwart, Head of Private Markets at W&W Asset Management GmbH**, the rapid expansion of alternative investments has come to an end after a period of substantial growth that saw their volume double over the last four years. The company has now reached a point where further significant increases in alternative investments allocations are unlikely, primarily due to the current levels of exposure and the influence of the denominator effect caused by declining interest rates. While the focus will now be on maintaining the existing investment volumes and reinvesting distributions, he regrets further growth isn't feasible, especially given the favorable market conditions at the moment.

The market environment is considered very promising, with asset prices in Real Estate

1 Depending on the source and weighting, the alternatives investment ratio of insurance companies is lower than that of other investors. In the past, it was comparatively lower for German insurance companies. Cf. https://www.bvai.de/fileadmin/Veroeffentlichungen/BAI_Publikationen/BAI_Investor_Survey/German_Alternative_Investor_Landscape_NEU_17_03_14_54.pdfhttps://www.bvai.de/fileadmin/Veroeffentlichungen/BAI_Publikationen/BAI_Investor_Survey/German_Investor_Landscape_-_Insurance_Companies.pdf, https://www.bvai.de/fileadmin/Veroeffentlichungen/BAI_Publikationen/BAI_Investor_Survey/German_Alternative_Investor_Landscape_NEU_17_03_14_54.pdf, and Private Equity coming down from previous highs, making these areas more attractive. Additionally, Private Debt offers compelling returns, and major trends such as digitalization, energy transition and artificial intelligence present strong opportunities, particularly well-suited to alternative asset classes.

Philipp Kratzer suggests that while the drivers for investments in alternative asset classes have not fundamentally changed, their relative importance may have shifted. Previously, alternatives were by some seen as a replacement for bonds, especially during the low-interest-rate period. Factors like diversification, inflation hedging and the potential for higher returns over the risk-free rate have become more prominent, particularly in sectors like Infrastructure. He acknowledges that some investors initially entered the market mainly as a substitute for bonds, contributing to the growing demand for alternatives. With interest rates rising, those investors may have shifted back to bonds, leaving behind a core group that focuses on the long-term benefits of alternatives, such as diversification, inflation protection and the illiquidity premium.

3. The role of different alternative asset classes for insurance companies

How do these developments affect the attractiveness and importance of alternative investments in insurance companies' portfolios, and how do they differ from other investor types? To answer these questions, we look at the planned new investments by asset class in the BAI Investor Survey 2024.

According to this, significantly fewer insurance companies than other institutional investors are planning to enter the illiquid asset classes of Corporate Private Equity and Infrastructure Debt. Only 2.17% and 5.57% of insurance companies, respectively, would like to invest in these asset classes for the first time, while more than 12% of other investor types would. No insurance company surveyed stated that it wanted to invest newly in Infrastructure Equity. This can be explained by the fact that, as described above, the development of alternative portfolios is already more advanced at insurance companies. Since more insurance companies than other investors are already invested in these asset classes, there is less potential for new investors.

Corporate Private Debt is less dominant for insurance companies in the debt asset classes than for their peer LPs. Rather, a relatively larger number of insurance companies are already invested in Infrastructure Debt and Real Estate debt to generate stable income. This results in a catch-up potential for Corporate Private Debt investments at insurance companies, which is also reflected in the fact that, at 6.52%, significantly more are planning to enter the asset class than other LPs.

Although a significant number of insurance companies have ventured into Real Estate Debt, it remains the debt asset class with the lowest overall participation rate among insurers.

However, with 8.7% of the insurance companies surveyed planning to enter the market, Real Estate Debt is catching up with the other debt asset classes in terms of popularity. This could be due to a stabilising real estate market, as interest rates fall, which insurance companies see as a good entry opportunity.

Insurance companies are also seeing more newcomers than other investors in the asset classes of Credit Specialties, Hedge Funds/Liquid Alternatives, and Other Real Assets, which, in some cases, require greater expertise and know-how.

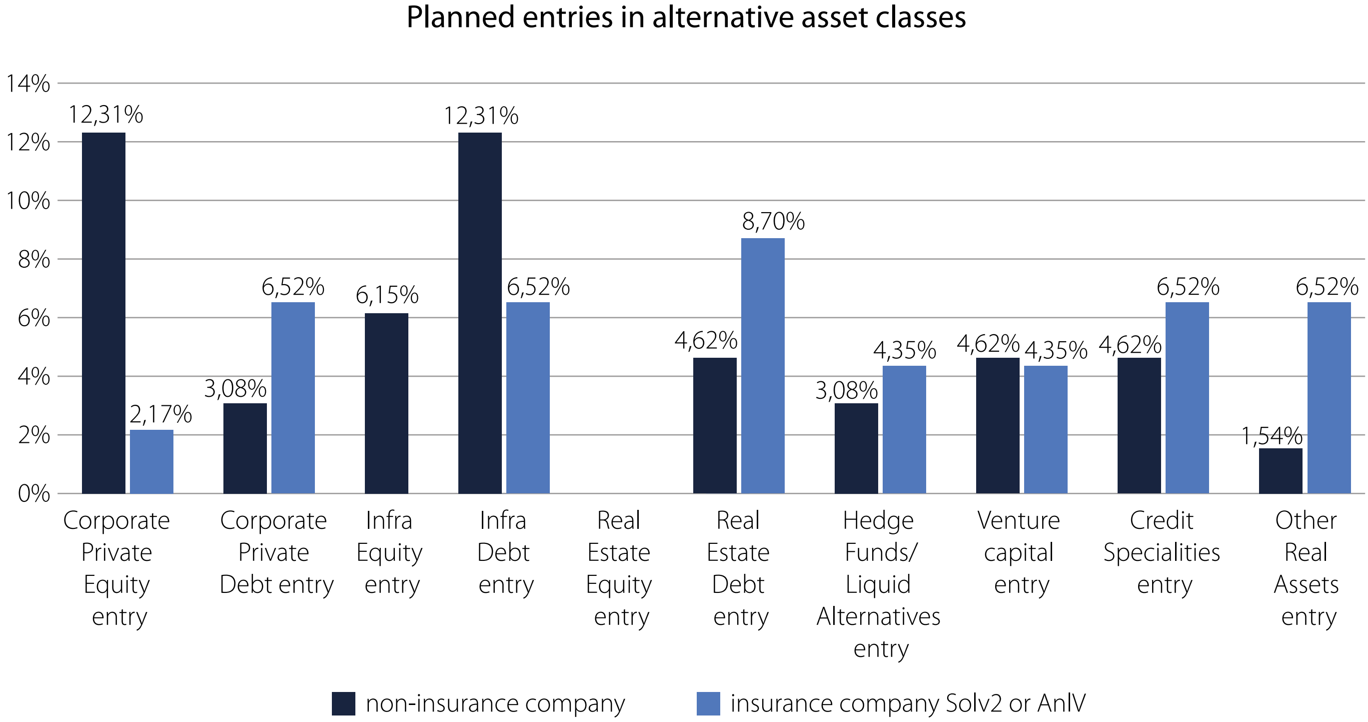

Figure 7: Are you planning to enter a new alternative asset class in the next few years? Source: BAI Investor Survey 2024.

In addition to the attractiveness of the individual alternative asset classes for newcomers, we now look at the proportion of already invested investors who would like to adjust their allocation.

For every illiquid alternative asset class, except for Real Estate, more insurance companies currently desire to increase their allocations than reduce them. As a result, alternatives remain attractive to insurance companies, with the majority looking to expand their existing investments. This also coincides with the voices of the LPs cited above.

However, the analysis also reveals that except for Corporate Private Debt, expected allocation increases in alternative assets are smaller for insurance companies than for other investor types. Insurance companies already have more mature alternative portfolios, which means they are, on average, closer to their allocation targets.

Due to significant past increases in alternatives allocations, many insurers are closer to meeting their targets, potentially limited by regulatory or internal risk-return factors that constrain further investments in alternative assets.

Regulatory factors like Solvency 2 impose stringent capital requirements, making alternative investments more expensive due to their perceived higher risk. Consequently, insurance companies encounter limits on expanding alternative allocations beyond a certain threshold, as they are required to hold additional capital to buffer against potential losses. Moreover, interviews with investors indicate that internal risk-return assessments also significantly restrict further expansion into alternative assets.

The catch-up potential of the Private Debt asset class in insurance company portfolios is reflected in the fact that a significantly higher share of insurance companies (56.67%) than other institutional investors (52.38%) plan to increase their allocation. Therefore, this is the alternative asset class where the largest share of insurance companies would like to expand their allocation. On the other hand, an above-average number also want to reduce the allocation.

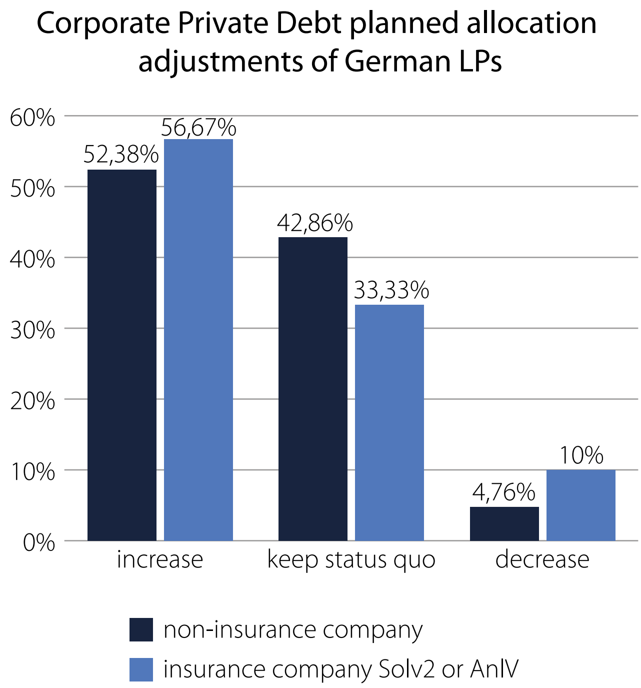

Figure 8: How do you plan to adjust your allocations in Corporate Private Debt? Source: BAI Investor Survey 2024.

Infrastructure Debt is the only other asset class for which a higher proportion of insurance companies would like to increase their allocations (50.0%) rather than maintain the current status quo (46.4%). According to investors, additional diversification and a risk profile different from liquid assets, with longer durations, have emerged as a driver for increased investments, particularly in long-term investments such as Infrastructure Debt.

On the other hand, the advanced stage of development of Infrastructure Equity means that insurance companies are participating less strongly in the growth of the asset class compared to other German LPs. 44.74% of the insurance companies surveyed would like to further expand their existing allocation, compared to 47.37% who want to maintain the status quo and 2/3 of the other LPs who want to increase their investments in infrastructure projects further.

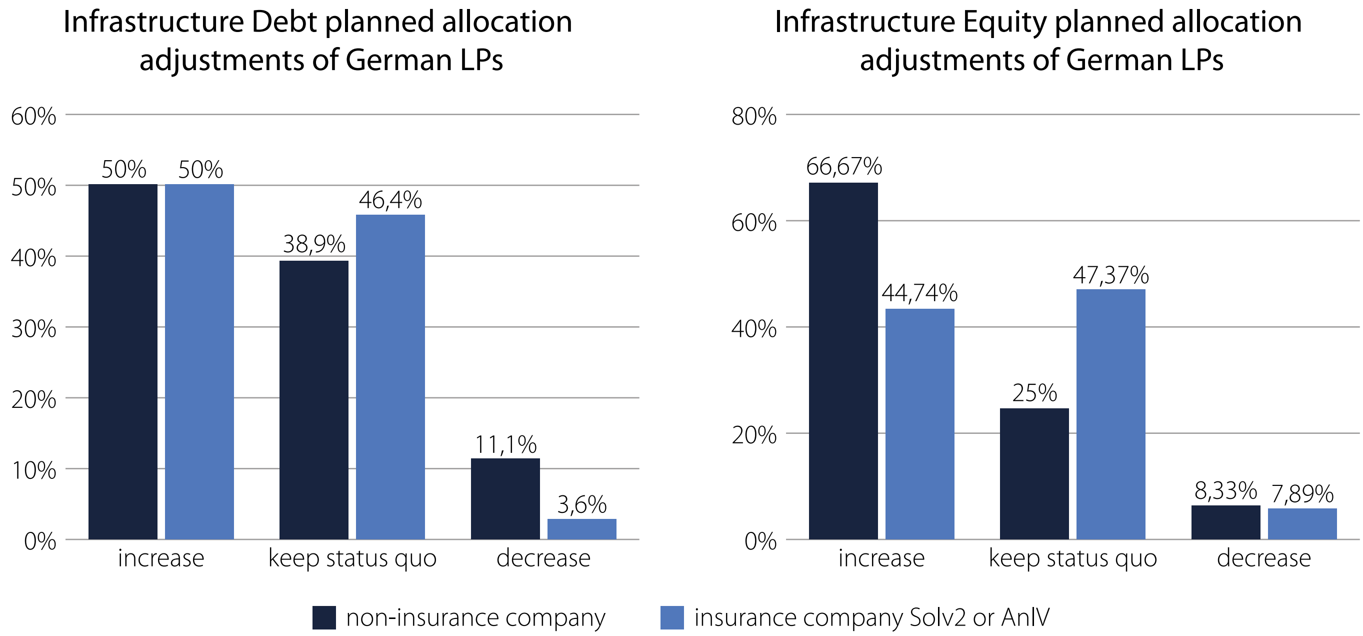

Figure 9: How do you plan to adjust your allocations in Infrastructure Debt and Infrastructure Equity? Source: BAI Investor Survey 2024.

As described above, a positive trend is emerging for new investments; at least, insurance companies see opportunities in Real Estate Debt. However, sentiment regarding existing allocations remains less favorable. Therefore, more insurance companies want to reduce their existing allocation to Real Estate Equity and Real Estate Debt than want to increase it. This applies to both insurance companies and other investors.

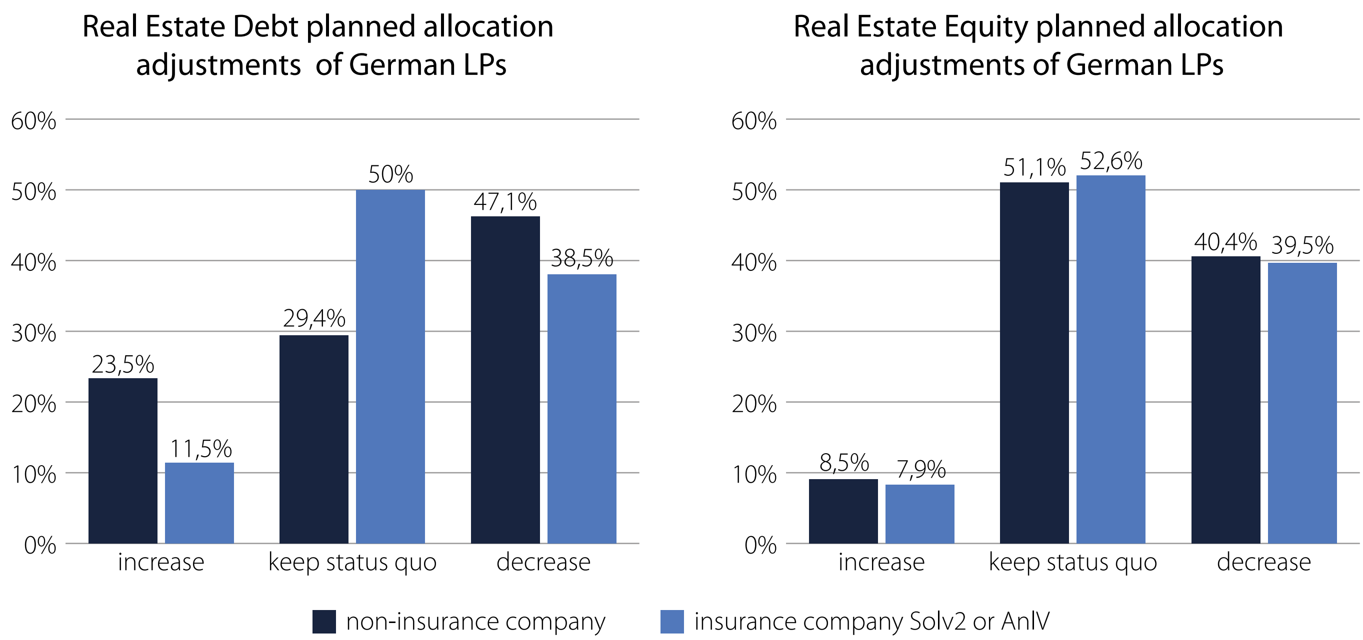

Figure 10: How do you plan to adjust your allocations in Real Estate Debt and Real Estate Equity? Source: BAI Investor Survey 2024.

The increasing attractiveness of liquid bonds for insurance companies is also reflected in the fact that 30% want to expand them, while only 22% plan to reduce them. However, the tendency towards bonds is less pronounced than for other investor types.

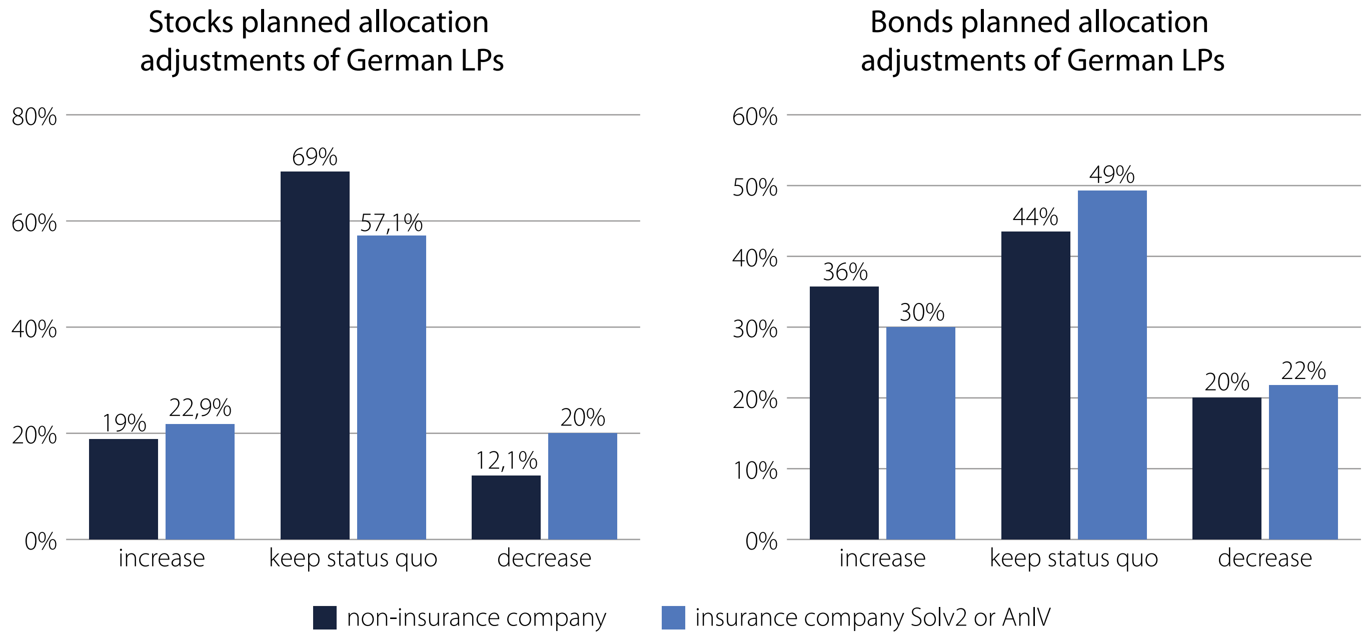

Figure 11: How do you plan to adjust your allocations in Stocks and Bonds? Source: BAI Investor Survey 2024.

We are placing the 2024 BAI Investor Survey data in the context of international peer data to provide additional context on planned asset allocation changes by German insurance companies. To this end, we are comparing the BlackRock Global Insurance Survey data[2] on global insurance companies and those from the Europe, Middle East, and Africa regions (EMEA). These were collected almost parallel with the BAI Investor Survey from July to September 2024, and 410 senior executives with USD 27 billion in assets under management were surveyed. 42% of them operate in the EMEA region. The international investors in insurance companies were asked the following question: *„In the next 2 years, how do you anticipate changing your allocations to each of the following asset classes?"*

The global outlook of insurance companies, including those in the EMEA region, as well as the outlook from Germany, is generally favorable for Infrastructure Debt and Infrastructure Equity, with anticipated increases outpacing reductions in these asset classes. Notably, a significantly higher proportion of German insurance companies plan to increase allocations in Infrastructure than their global and EMEA counterparts. The data also reveals that the investment outlook for Corporate Private Debt in Germany is better than at their international peers. While globally also more insurance companies plan to increase their allocations than decrease, within the EMEA-region even a negative trend is anticipated according to the BlackRock data.

2 BlackRock Global Insurance Report 2024: Resilience through change - Agility for success.

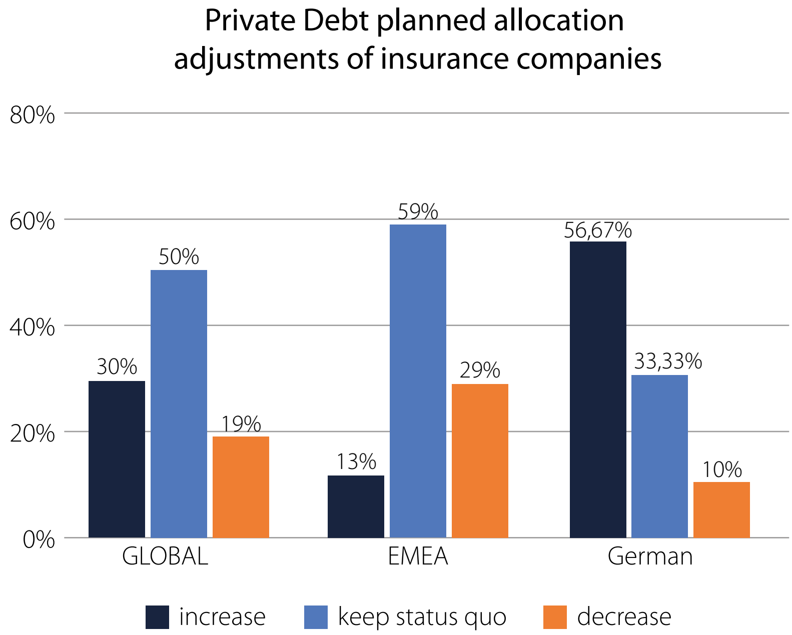

Figure 12: Planned allocation adjustments in Private Debt of international insurance companies (source: BlackRock Global Insurance Survey 2024) and Corporate Private Debt of German insurance companies (source: BAI Investor Survey 2024).

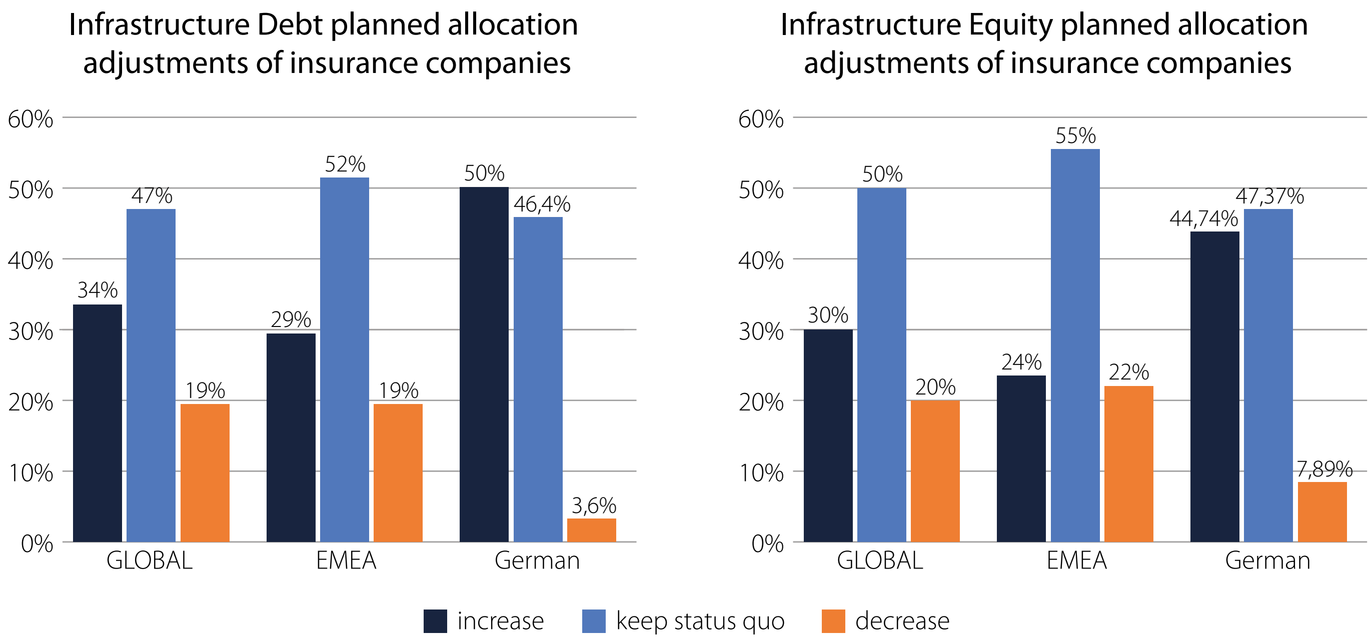

Figure 13: Planned allocation adjustments in Infrastructure Debt and Infrastructure Equity of international insurance companies (source: BlackRock Global Insurance Survey 2024) and German insurance companies (source: BAI Investor Survey 2024).

The outlook for Real Estate allocation reveals a marked difference between German and international insurance companies. German insurers are significantly inclined towards reducing both Real Estate Debt and Equity allocations, suggesting an overall reduction in Real Estate weight within their portfolios. This contrasts with the global and EMEA regions, where Real Estate prospects appear more favorable. Notably, 29% of insurers globally and 28% within EMEA plan to increase their allocation to Real Estate Debt, compared to only 23% and 21% who aim to reduce it.

The fact that German LPs have always had a high real estate component and therefore may have limited upside potential could play a role in this context. Also, this more optimistic outlook internationally may indicate that insurance companies outside Germany expect the real estate market crisis, triggered by rising interest rates, to subside more quickly. This anticipation creates potential opportunities for real estate financing. Even within Germany, as outlined above, the trend is positive for new entrants on the debt side.

Regarding Real Estate Equity, the international picture is slightly mixed. Globally, 26% of insurers intend to reduce their allocation compared to 23% who plan to increase it, a sharp difference compared to Germany, where 39.5% are reducing versus only 7.9% increasing. However, the trend reverses within the EMEA region, with more insurers planning to increase (29%) rather than reduce (24%) their Real Estate Equity allocations. This demonstrates regional variations in response to the real estate market and economic conditions affecting investment strategies.

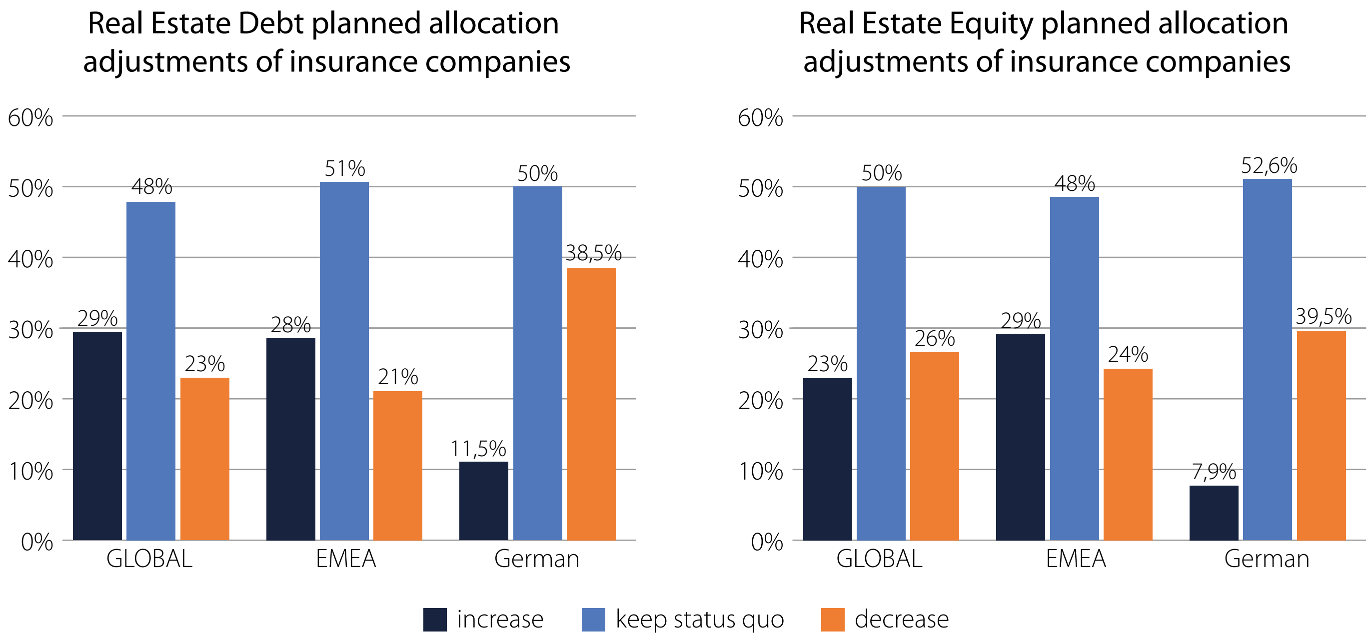

Figure 14: Planned allocation adjustments in Real Estate Debt and Real Estate Equity of international insurance companies (source: BlackRock Global Insurance Survey 2024) and German insurance companies (source: BAI Investor Survey 2024).

Based on the BAI Investor Survey 2024 data, we have shown how the outlook for various alternative asset classes differs between German insurance companies and other types of investors and how the outlook looks in international comparison.

To get a better understanding of the data, and since the differences between individual insurers are very specific, we will now let the investors have their say:

While the fundamental belief in the long-term potential of different alternative asset classes remains strong, there has been a slight shift in focus among them. **Philipp Kratzer** observes that Real Estate, for example, is currently facing mixed sentiments. Although market conditions may seem challenging, there are opportunities to acquire quality assets at better prices for investors with substantial equity capital who aren't heavily reliant on debt financing. Despite these opportunities, the overall demand for Real Estate has declined somewhat.

In contrast, Kratzer notes a subtle shift toward Infrastructure Debt over the past 18 months. This asset class has adapted more quickly to rising interest rates due to its floating-rate structure, often tied to benchmarks like Euribor, which allows returns to adjust immediately with interest rate changes. On the other hand, Infrastructure Equity has been slower to reflect these rising rates in its returns. While the adjustment in Real Estate is ongoing, this flexibility in Infrastructure Debt has made it a more attractive option in the contemporary market environment.

Kathrin Schmidt currently sees varying levels of attractiveness across different illiquid alternative asset classes. Due to high pre-existing allocations and declining valuations driven by rising interest rates, they are taking a more cautious approach to Real Estate Equity. The company is not actively increasing exposure in this area, as the current environment makes it less appealing.

Private Debt, on the other hand, has the highest allocation within their alternative investments, as high as Real Estate Equity, and remains a core focus. This asset class receives the most attention, and the company plans to maintain or even increase its allocation in the future. In contrast, infrastructure investments are stable but are not being expanded further currently, as the allocation meets their needs. So, they invest to keep the quota stable but indeed not to increase the quota.

Due to its variable financing structure, which delivers strong returns in the present market environment Private Debt is the most attractive illiquid asset class for Schmidt at the moment. She highlights its favorable return-to-capital requirement ratio (SCR), further enhancing its appeal and making it a key focus for investment.

In contrast, Schmidt views Infrastructure Debt as less attractive since it does not achieve the same level of returns. Real Estate Debt is not prioritized due to the already significant exposure to Real Estate risk on the equity side. She also argues that Infrastructure Equity has underperformed in distribution yields, with actual returns over the past seven years not meeting expectations, leading to a more cautious approach. Following Private Debt in terms of attractiveness is Private Equity, which Schmidt finds promising due to its high return potential and the advantage of being classified as Type 1 equities, resulting in reduced capital requirements for these investments.

On the other hand, **Armin Beerwart** indicates that no significant shifts are expected within the allocation to different illiquid asset classes in the near future. The company's portfolios, which include Private Equity, Private Debt, Infrastructure Equity, and Real Estate, have reached a stable state. All these asset classes are currently performing well, with no notable issues in any of them. Given the positive performance across the board, there is no reason to make substantial changes to the existing allocation strategy.

3.1. Focus on Private Equity

In the previous section, we provided a brief overview of the outlooks for various illiquid alternative asset classes from the perspective of German and international insurance companies. In this section, however, we will focus specifically on the asset class of Corporate Private Equity, which was not covered earlier. We will also publish our new Corporate Private Equity information brochure shortly, including an introduction to the asset class and an update on the latest survey data.

The Corporate Private Equity asset class experienced strong growth during the low-interest rate phase. Low capital procurement costs enabled strong leverage effects, and low discount rates led to rising multiples. The rise in interest rates since the coronavirus pandemic reversed this effect. Investors argue that the focus is now more on real operational improvements and less on multiple expansions.

According to the BAI Investor Survey 2024, German insurance companies hold a positive outlook for Corporate Private Equity, with 38.9% planning to increase their allocation and only 11.1% aiming to reduce it. Other investor types, however, show even more interest, with 47.5% planning to raise their allocations and only 5% reducing. This difference can be attributed to the strong presence of Corporate Private Equity in German insurers' portfolios; 86.96% of surveyed insurers are already invested in the asset class, compared to 64.62% of other investors. Reflecting this established position, only 2.17% of German insurers are still considering entering Corporate Private Equity, while 12.31% of other investors are planning initial entry.

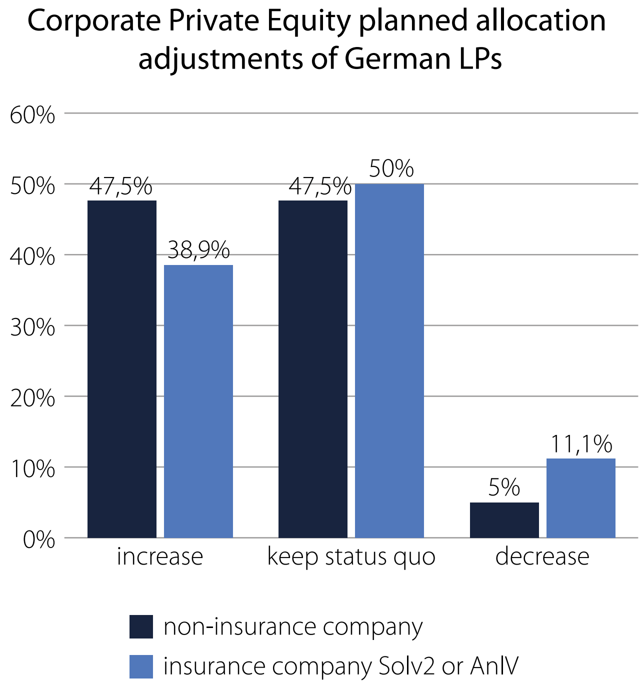

Figure 15: How do you plan to adjust your allocations in Corporate Private Equity? Source: BAI Investor Survey 2024.

The international comparison shows that the outlook for Corporate Private Equity investments by German insurance companies is viewed much more positively at the moment. 38.9% in Germany plan to increase their allocation, while the figure is only 29% worldwide and 22% in the EMEA region. 11.1% of German insurance companies plan to reduce their allocation, compared to 25% worldwide and 24% in the EMEA region.

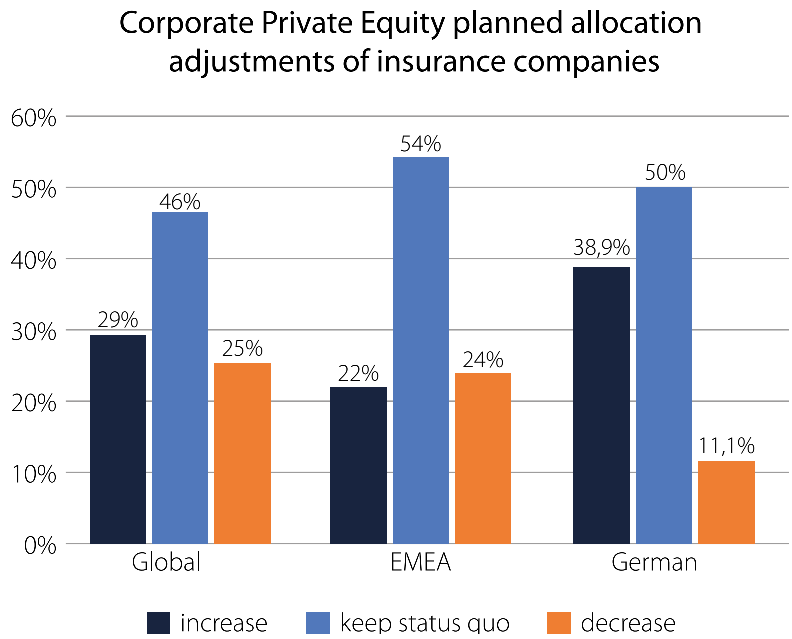

Figure 16: Planned allocation adjustments in Corporate Private Equity of international insurance companies (source: BlackRock Global Insurance Survey 2024) and German insurance companies (source: BAI Investor Survey 2024).

We spoke to insurance company investors to better understand the reasons behind this more favorable outlook for Private Equity in Germany compared to other countries and to get a sense of the asset class's role in the current market environment. The discussions also showed that Germany is seen as an attractive Private Equity market, distinct from infrastructure investments.[3]

Regarding Private Equity, which the company only began allocating to two years ago, **Kathrin Schmidt** confirms it remains a significant area of interest and will continue to grow. While the company's allocation strate-

3 Cf. Between Short-term Headwinds and Strong Long-term Tailwinds: Infrastructure 2024 - Focus on Germany, https://www.bvai.de/fileadmin/Veroeffentlichungen/BAI_Publikationen/BAI_Infrastruktur_2024.pdf.

gy generally aims for regular, rhythmic investments, they may make tactical adjustments based on short-term macroeconomic developments, such as shifting investments to the following year or adjusting the timing within a year.

Armin Beerwart notes that the market is improving regarding Corporate Private Equity, with exits becoming more feasible as the gap between buyer and seller expectations narrows. Although distributions were limited in recent years due to valuation differences, this trend seems to be reversing, potentially leading to increased capital flows.

The current market environment is favorable for new investments, with lower valuations making them more attractive than in previous years. However, the higher cost of debt emphasizes the need for fund managers who can drive operational improvements rather than rely on financial leverage. This shift will likely differentiate stronger performers as a focus on organic growth and efficiency gains becomes crucial.

In terms of sectors, Beerwart highlights Germany as a key market for Private Equity. The country's economy offers significant opportunities with its many family-owned businesses seeking growth and succession solutions. Unlike the more saturated markets in the U.S. or U.K., Germany still has room for Private Equity growth. Beerwart also underscores the importance of fund managers focusing on implementing strategies for artificial intelligence and technological advancements to their portfolio companies.

While some investors try to time the market, others advocate continuous investments:

Regarding Private Equity, **Philipp Kratzer** likens the investment approach to an ETF savings plan, where it consistently invests regardless of the market phase, believing that good investment opportunities can be found in nearly any economic environment. Even though multiples are lower and financing costs are higher, Kratzer emphasizes that a good investment remains valuable across different interest rate scenarios. While the market has moved away from the high returns driven by multiple expansions seen in recent years, Kratzer views the current conditions as more normalized and sustainable.

Armin Beerwart suggests the fundraising environment has also changed, with fund managers now needing to put more effort into attracting capital, unlike a few years ago when nearly any manager could secure funding quickly. Beerwart appreciates this development, as it means fund managers must now prove their worth and work harder to achieve fundraising success, making the market conditions more favorable for investors.

4. Challenges for insurance companies to invest in alternative investments

Insurance companies most often cite illiquidity and long capital commitment periods as significant challenges (47.8%), a much higher concern than for other investor types (23.1%). The primary liquidity issue arises from fewer exits over the past 1-2 years, limiting capital available for new investments - a shift from the low-interest-rate era, when investors increased alternative allocations by cutting fixed-income investments. As bond yields become more appealing, fixed income is back on the table. Additionally, the "denominator effect" has led to higher alternative portfolio allocations due to the relative decline in other asset values, inhibiting further alternatives expansions in the portfolio. A factor impacting insurers (23.9%) significantly more than their peers (10.8%), which is due to their strong focus on fixed income. This effect, tied to valuation challenges, is cited more frequently by insurers as a notable difficulty.

However, the market environment, inflation, and interest rates have become less important across all investor types than the previous year, and the market is increasingly stabilizing.

Regulation is the second biggest challenge for the insurance companies surveyed and continues to be seen as a challenge by significantly more insurance companies (45.7%) than by other investors surveyed (32.3%).

In talks, investors primarily cited the issue of qualified infrastructure as a regulatory challenge for insurance companies in the context of Solvency 2 Regulation.

Under Solvency 2, insurance companies can reduce capital requirements for "qualified infrastructure" investments, which offers regulatory advantages. However, investors find it challenging to qualify these assets due to strict data requirements (like high-quality Tripartite Template data from asset managers) and intensive reviews, especially for fund investments. LPs note that the process is time-consuming, particularly with changing fund portfolios, and while some fund managers assist with preliminary assessments, simplifying these reviews would make infrastructure investments more attractive.

However, for investors subject to the AnlV, the latest developments regarding the introduction of a nationwide infrastructure quota based on the NRW model point to regulatory simplifications for infrastructure investments.[4]

In our upcoming new publication on infrastructure, we will examine the issues of qualified infrastructure under Solvency 2 and the infrastructure quota in the AnlV in detail. We will present both survey data and original statements from investors from expert interviews.

4 https://www.bvai.de/fileadmin/Veroeffentlichungen/Presse/2024/PM_BAI_Infrastrukturinvestitionen.pdf, https://www.private-banking-magazin.de/asset-portfolio-management-deshalb-ist-bei-infarstruktur-investments-die/

The biggest challenges when investing in alternative investments

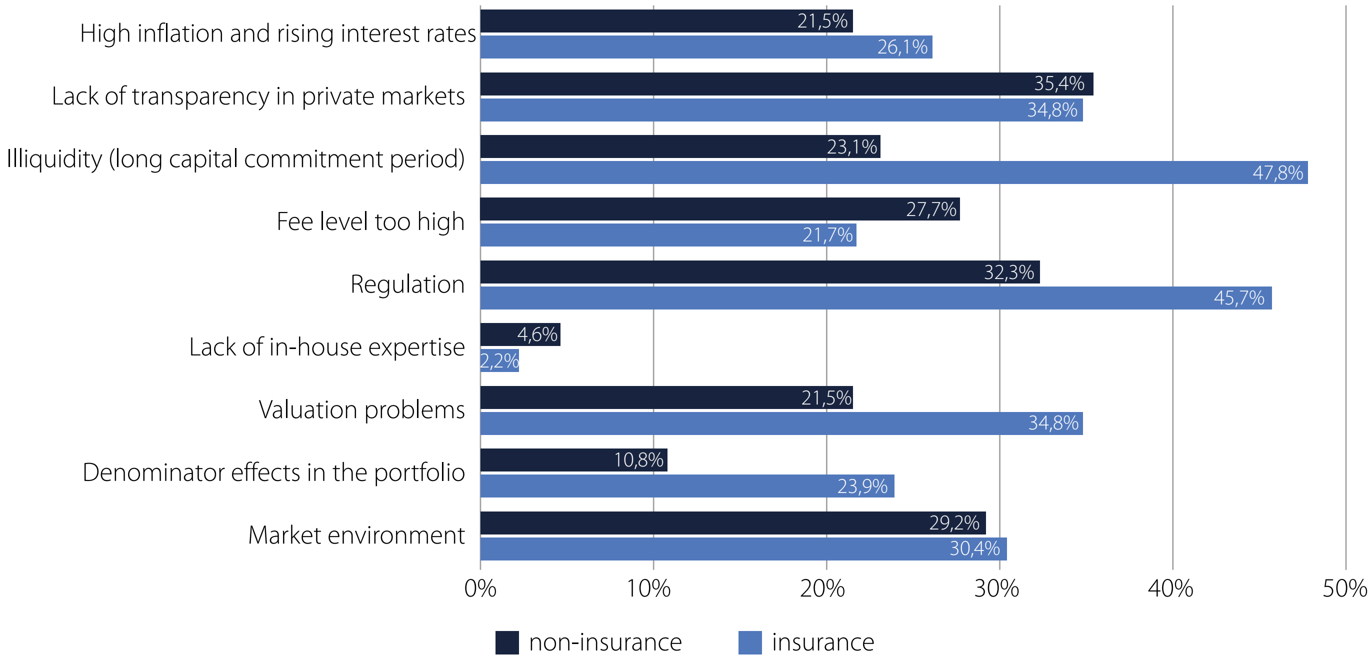

Figure 17: What are the biggest challenges you currently face when investing in alternative investments? Insurance companies (Solvency 2 and Anlv), and non-insurance companies, source: BAI Investor Survey 2024.

5. Differences in the role of alternative investments depending on the type of insurance company

However, there are also significant differences between the various types of insurance companies when it comes to the importance of alternative investments. Different regulations play a role here, influencing the opportunities to invest in alternative investments.

Varying risk/return objectives also influence the role of the various alternative asset classes in the portfolio.

Furthermore, the macroeconomic environment and interest rate changes also have different effects. For many insurance companies, liquid bonds are crucial in providing regular income to meet liability obligations, such as those of health insurance companies. During the low interest rate phase, the small interest coupons from bonds increasingly posed a challenge for these insurance companies. They made investments in asset classes such as Corporate Private Debt and Infrastructure Debt more attractive. The renewed increase in interest rates and the renewed greater attractiveness of bonds are bringing other drivers for alternative investments into focus, such as their role in diversification.

In the following, we let LPs have their say in explaining dissimilarities between different types of insurance companies.

Philipp Kratzer explains significant differences in how primary insurers and reinsurers approach investments in alternative assets, largely due to varying regulatory constraints. Reinsurers have more flexibility, as they are less restricted by regulations, allowing them to freely allocate to alternatives based on their strategic goals and market conditions. They usually have to cover long-term payment obligations, which enables them to receive illiquidity premiums. This allows them to focus more on equity and capital growth in their portfolios.

In contrast, primary insurers face stricter requirements, especially those in highly regulated sectors like life and health insurance. For these insurers, bond yields play a crucial role in meeting their guaranteed interest rate obligations, which are nominally fixed regardless of inflation. As a result, rising bond yields have become particularly attractive to primary insurers, prompting a higher allocation to fixed-income investments to ensure regulatory requirements.

When primary insurers invest in alternatives, they tend to prefer debt investments, such as Real Estate Debt or Infrastructure Debt, due to their long-term predictability and regulatory advantages. This focus on stable, income-generating assets contrasts with the reinsurers' emphasis on equity investments, where capital appreciation plays a larger role. Therefore, while both types of insurers find alternative assets valuable, their allocation strategies and priorities differ significantly based on their regulatory environment and investment objectives.

The limitations on increasing the allocation to alternative investments stem mainly from internal risk-return targets, regulatory requirements, and the need to align investments with Asset Liability Management (ALM) strategies, as **Armin Beerwart** outlines. ALM considerations are particularly important in ensuring that the investment approach matches the long-term payout obligations of their insurance products, especially life insurance, which requires a cautious and strategic plan extending 15 to 20 years into the future.

The potential for increasing alternative investments differs for other types of insurance within the group. Property and casualty insurance and health insurance have smaller capital bases but still offer some room for growth in alternative investments, although on a more limited scale. Beerwart highlights new product types as fund-linked life insurances, are particularly significant because they allow for the flexibility to invest up to 100% in alternative investments or private markets. If this product proves successful in the market, it could create opportunities to expand the company's allocation to alternative investments, offering more diversification beyond the constraints of the traditional life insurance capital pool.

Regarding the question of how different types of insurance companies differ, **Kathrin Schmidt** explains that as a municipal insurer, the company pays close attention to potential reputational risks when selecting asset managers, which influences their asset allocation. Being in the public eye, they are particularly cautious about investments that could attract negative attention. For this reason, Private Equity has only been included in their portfolio for the past two years, and they invest so far only through fund-of-funds. But when the allocation is growing also direct funds are an option. Similarly, in sectors like Real Estate and Social Infrastructure, the company is mindful of avoiding projects that might become controversial or attract unwanted media attention. This focus on reputational risk shapes their investment decisions.

Given that capital appreciation plays a significant role in reinsurers' investment strategy, with a strong focus on equity-based alternative asset classes, the current market conditions for entry points and valuations are particularly relevant. **Philipp Kratzer** describes the current market as favorable for Real Estate investments due to improved valuations, though they don't anticipate a significant expansion in this area because their existing allocation is already substantial.

Kratzer takes a similar stance for Infrastructure Equity as to Corporate Private Equity, maintaining the belief in its potential due to its relatively stable cash flows and higher returns than liquid assets. Despite rising interest rates, they see no reason to shift focus back to bonds, remaining committed to Private and Infrastructure Equity for their long-term growth potential.

About BAI

REPRESENTING ALTERNATIVE INVESTMENTS

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