Liability-driven investors: A perfect match

June 2025

"Insurance investment professionals face a unique and challenging mandate. As consultants to insurance companies, we understand the complexity of your role, which often feels like striving for utopia. It's not an easy task!" said Elie Saikaly, Head of Frontier's Liability Driven Investors and Government Team.

The challenge lies in balancing competing priorities that usually include:

Operating environment	Internal factors	External factors
• ASX listed general insurer • Peer aware • RoE target • Preference for low profit volatility	• Increasing risk appetite • Well-resourced and experienced investment function • Liquidity requirements • Business strategy	• Regulated by APRA • Subject to LAGIC: Asset risk charge (ARC) • Healthy prescribed capital amount (PCA) • Climate change and Responsible Investment

In this session the team's aim was to share some insights on how Frontier thinks about investment strategy for insurers and how we work with clients to design and implement the strategy considering the challenges each insurer might face.

To bring this to life, the team detailed how they advised a fictional A$5 billion ASX listed, general insurance company; *Accidental Insurance* who appointed Frontier Advisors to conduct a strategic review.

Similar to a typical APRA regulated insurer, *Accidental Insurance* notionally has two investment portfolios (listed below) and follows the investment trilemma of return, risk and capital.

- Technical reserves: Assets backing insurance liabilities which begins with a matched or immunised approach.
- Shareholder funds: Excess capital over liabilities which can act as a buffer and supports broader strategic initiatives.

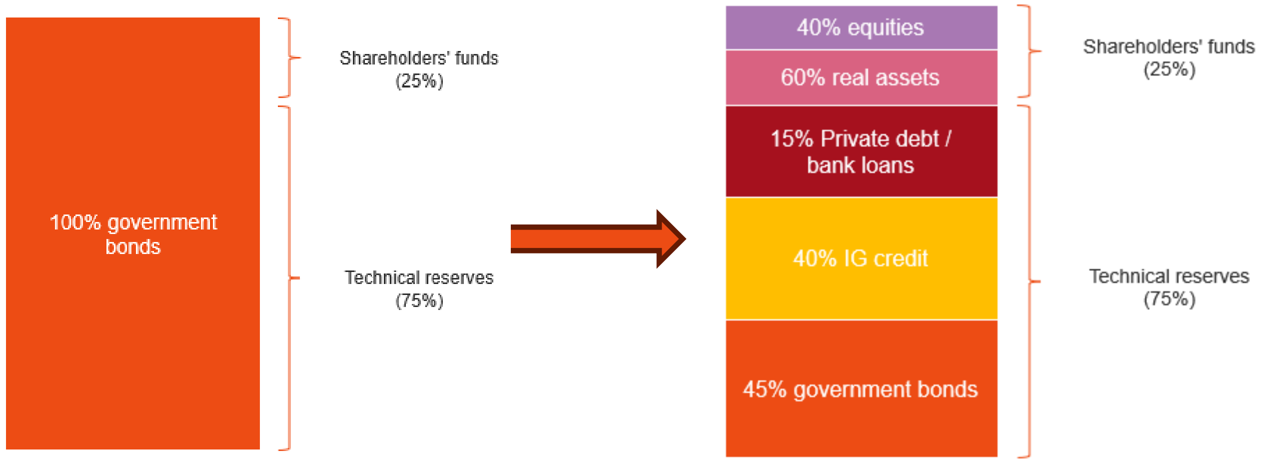
The aim of the technical reserves portfolio is immunising the portfolio (that is to match assets with liability cash flows). This aim brings stability and greater certainty for stakeholders but also presents broader opportunity costs. The portfolio also has relatively consistent and predictable cashflows that allow for greater appetite for illiquidity risk in the portfolio. However, there is always the possibility of future acquisitions to support inorganic business growth which could be partly funded from retained earnings.

Efficient capital management involves maintaining disciplined capital ratios within approved ranges. Organisations with greater capital-raising flexibility can operate on a more capital-lite basis, unlike those with limited options, who tend to adopt more conservative approaches and maintain higher capital buffers (e.g. mutual insurers). This balance between flexibility and conservatism ensures financial stability while optimising capital efficiency.

However, as Andrew Longmore, Deputy Head of the LDI and Government Team said, “Higher underwriting risk is leading to higher premiums and some parts of the market being seen as ‘uninsurable’.” This trend not only has financial implications but also poses reputational risks, with public backlash against companies like *Accidental*, which some perceive as profiteering. Additionally, policyholders are increasingly demanding greater transparency on sustainable investment practices, pressuring insurers to act as responsible corporate citizens.

After considering various factors in building an investment portfolio, *Accidental* started with a 100% matched portfolio by investing in government bonds to immunise against movements in interest rates, “But classic immunisation doesn’t always work,” said Joanna Yang, Consultant at Frontier.

At different points in the cycle, it makes sense from an investments point of view to adopt a mismatch. This can be done by adding more assets that add diversification and yield to the portfolio.



As Yang explained, allowing for a mismatch can result in an asymmetric payoff, which was demonstrated through a systematic development of a portfolio by incorporating new asset classes. This approach created a portfolio to achieve higher returns, enhanced diversification (leading to lower risk) and more efficient capital deployment. It marked a shift away from a traditional insurance portfolio, paving the way for higher real returns to better align with the growth in liabilities. By adopting this strategy, the trilemma conundrum of balancing return, risk, and capital was effectively addressed.

This session underscored the importance of balancing liability matching with strategic opportunities for growth as demonstrated by *Accidental Insurance*. By carefully considering the implications for capital, risk, and return, insurers can make informed decisions that align with their long-term objectives. But there are several different factors the insurers should consider when building a portfolio that requires good implementation including active versus passive management; ESG considerations within each asset class; private equity versus public equity; and how dynamic asset allocation (DAA) can play a role in the short to medium term.

Next steps

Get in touch with Joanna Yang, Consultant in Frontier's Liability-driven and Government Investor Team at jyang@frontieradvisors.com.au for more information and to learn more about our processes and how we can help.