The Latest News in Japan's Life Insurance Market 2021: Why ESG investing and financing is necessary for life insurance companies?

Aggressive investment in growing and new business fields amidst the prolonged ultra-low interest rates

The wave of ESG is approaching to the life insurance companies' investment practices in Japan as well.

ESG stands for Environment, Social and Governance. The interest in ESG investing, which gives weight on these three factors ESG represents, is increasing year by year.

According to the Global Sustainable Investment Alliance (GSIA), the total ESG investment in 2020 reached JPY 3,880 trillion, increased by about 15% compared with the previous survey conducted in 2018. Japan accounted for JPY 320 trillion, which is about 32% increase. The survey is conducted once every two years, and the latest survey was published on July 19.

As an institutional investor, the life insurance industry also pays a lot of attention to the investment method that focuses on ESG factors. Mr. Takada, the chairperson of the Life Insurance Association of Japan, also emphasizes as "Through ESG investing and financing, and stewardship activities, we would like to further promote initiatives toward the improvement of corporate values and the contribution to the sustainable economic growth of investee companies."

For life insurance companies as well, ESG enhances its presence as it is no longer just a responsible investing but becoming an important investment factor that is linked directly to risk mitigation and return improvement.

In this report, I would like to introduce how life insurance companies are engaging in ESG investing and financing.

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Before we get to the main point, let me briefly explain about the changes in the financial market surrounding life insurance companies' asset management.

The year 2016 was another epoch-making year as the negative interest rate policy was introduced and it became a big turning point for life insurance companies toward improving their asset management operation. Nippon Life Insurance Company commented on the impact as follows.

“The days are over where we can earn yields simply by investing or financing companies, or buying JGBs. In today’s bond market, even 20-year bonds or 30-year bonds yield only around 0.3% and it is not even close to our expected interest rates [promised to policyholders] so that they are not the best place at all to invest our operating funds. We are now in an era where we have to earn yields by carefully controlling risks. Each company has to make full use of its knowledge and skills to quickly find and make higher-return investments. This is one of the ways to improve asset managements.”

While the ultra-low interest rate environment remains with no end in sight, the profitability-oriented investment has been weighed heavily. Under such investment direction, investing in JGBs has been restrained, but diversified international investments have been further promoted by allocating funds into foreign bonds with or without currency hedging, or domestic and foreign stocks and corporate bonds.

Moreover, venturing into overseas credit investment and overseas project finance as growing and new fields has been kicked into gear. ESG investment and finance, by the way, is included here.

For example, Nippon Life invested and financed a total of JPY2,193.2 billion in growing and new fields over three years. That is, Nippon Life achieved a target amount of JPY2 trillion set in its medium-term management plan (FY2017-2020) a year ahead of schedule.

Nippon Life has implemented its new medium-term management plan, *Going Beyond* since FY2021. As for its asset management, Nippon Life says, “In addition to the continuation of low growth and low interest rates, the impact of COVID-19 would also continue to some extent. Given this assumption, we will focus on two points in order to realize profitability and a sustainable society. One is transforming portfolio and the other is strengthening ESG investing and financing.”

Important factors affecting investment returns in 10 or 20 years

Positioning *Integration* whereby the ESG factors will be incorporated into the investment and financing process, as one of the important approaches---. This is Nippon Life’s basic stance toward its ESG investing and financing. Main points for each asset type are as follows.

<Stocks/Loans/Corporate bonds>

When investing and financing companies, information of investee companies’ ESG initiatives obtained through dialogues with them will be also evaluated in addition to basic information whether or not there are ESG initiatives.

ESG evaluations are incorporated into Nippon Life’s investment and financing decisions from the standpoints such as for stocks, how the given company’s ESG initiatives affect its corporate values, and for loans and corporate bonds, how they affect its creditworthiness.

<Government bonds/Sovereign bonds>

Regarding investment decisions from the standpoint of how they affect the creditworthiness of the country, dialogues with investees will be held as necessary, based on international statistics and information from ESG rating agencies. Incidentally, sovereign bond is a general term for any bond issued or guaranteed by governments or governmental agencies.

<Real Estate investments>

The socially and environmentally friendly building standard will be set up and the third-party certification will be obtained for each investment property. As for the selection of contractors, the status of ESG initiatives will be confirmed.

There is another important ESG related process called *Engagement* beside *Integration*. This is to have conversation with investee companies about the evaluation result through the integration process and evaluation factors. Nippon Life positions Integration and Engagement as the core [of ESG investing and financing] and aims to support the ESG initiatives of investee companies.

Nippon Life has left the task of raising up the level of both processes the newly established ESG Investment Strategy Office.

Nippon Life has integrated ESG criteria into some assets such as stocks and corporate bonds; however, since April 2021 in order to increase the effectiveness of ESG investing and financing, ESG integration has been implemented to the investment process of all the asset management including sovereign bonds as well.

So can only highs or lows of scores, ratings provided by external agencies or internal ratings, be the source of investment decisions at the time of actually making ESG investments?

“We move forward with the comprehensive evaluation from the standpoint of whether or not it leads to better investment returns, whether or not it leads to reduce investment risks and so on. It is never like assigning ‘good’ or ‘bad’ to ESG scores and then buying ‘good’ and selling ‘bad’. For those of us who make long-term investments, ESG criteria will be an important factor to affect our investment returns in 10 or 20 years from now,” explains Nippon Life.

In July this year, the board of the Principles for Responsible Investment, or PRI appointed one of its directors from Nippon Life. The Principles for Responsible Investment suggests that institutional investors reflect environmental, social and corporate governance issues to investment practices. There are more than 4,000 signatories and it represents USD121 trillion. Nippon Life is the first insurance company in the world producing a director of PRI from its organization.

Considering this year as the year aiming to get ESG integration into full-swing

Dai-ichi Life Insurance Company has been continuously improving its ESG investment activities since signing the PRI in 2015.

During the FY2019, Dai-ichi Life added the climate change mitigation to its core issues and actively invested in or financed renewable energy related business or SDG bonds including green bonds. At the same time, Dai-ichi Life has established a systematic integrated assessment method for climate-related information.

Furthermore, Dai-ichi Life positioned FY2020 as the year to aim for a full-scale ESG integration and established its basic policy on ESG investing. The specifics are as follows.

① Completing incorporation of ESG into all the asset management policy and process by the end of FY2023.

② Doubling the ESG investment amount, at least, over the next 4 years.

③ Supporting positive actions and changes of investee companies to solve social issues.

FY2023 is the final year of Dai-ichi Life's medium-term management plan, *Re-connect 2023*, and by incorporating ESG perspectives into its investment process, Dai-ichi Life will make, for example, environment conscious investment decisions.

Dai-ichi Life speaks emphatically that it would like to build a portfolio that manage both of earning-opportunities and resolution of social issues by reducing ESG risks and taking opportunities.

The company has steadily made a total of JYP 550 billion for 7 years since 2013 and it will accelerate the pace of progress.

Building a portfolio focused on financing toward a low carbon society

Meiji Yasuda Life Insurance Company has been working on the major reforms on its asset management considering changes in the market environment and international capital regulations scheduled to be introduced in 2025.

Specifically, Meiji Yasuda Life will engage in strengthening the core function of its asset management and the company aims for securing sustainable total return for 4 years from EY2020 to FY2023.

"It used to be common to earn yields through long-term or even super long-term investments; however, we are now setting our eye on not only interest and dividend income but also total profits by optimizing investment timing and diversifying and upgrading asset management methods," says Meiji Yasuda Life.

During FY2020, Meiji Yasuda Life announced its ESG investing and financing policy, executed a total amount of JPY150 billion for ESG investments, and implemented incorporation of ESG factors into its investment practice for domestic stocks and corporate bonds.

Major ESG investments during 2020, by the way, include JPY11.9 billion for green bonds, JPY10.8 billion for sustainable development bonds and JPY6.3 billion for gender bonds.

Moreover, concerning the improvement of ESG investing and financing methods, analysis, utilization and evaluation of any ESG data will be incorporated into the investment and financing process for all the asset by the end of FY2021. By so doing, Meiji Yasuda Life pursues the portfolio contributing to the realization of a carbon-free society. During its medium-term management plan (FY2021-2023), JPY500 billion has been set aside for ESG investing and financing. In addition to project finance to renewable energy facilities and green bond investments, transition finance such as financing a transition to a low-carbon society will be proactively promoted.

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Insurance companies have a historical background that they have long practiced asset management concerning its public aspect in addition to profitability and soundness such as funding infrastructure-related business including powerplants and railways which have high affinity with insurance liabilities in terms of length of duration.

There is an idea toward ESG investing and financing coming into the spotlight these years that it has the same root as a life insurance company′s penchant for long-term investment as a policy. As institutional investors, life insurance companies are expected to enhance ESG investing and financing and have a part in solving social issues.

About the writer:

Kenichi Suzuki is an insurance journalist working for a major insurance trade paper for 35 years. From 2000 onward, he covers a wide range of insurance news including on-line life insurers, insurance shops, overseas expansion of Japanese major life insurers, business strategies, Insurance Council, InsurTech, to name a few. He hosts a private study group, Insurance Marketing Study Group. He occasionally takes a role of a speaker for OLIS seminars and has previously lectured at OLIS overseas seminars in Taipei, Seoul, Beijing, Bangkok and Jakarta.