



Strategic Asset Allocation for Insurance Total Return Portfolios

Over the past decade, Canadian insurers have navigated a wide range of sweeping changes – including a global pandemic, evolving regulatory frameworks and heightened geopolitical and financial market volatility.

Most recently, the International Financial Reporting Standards (IFRS) 17 framework - which came into effect on January 1, 2023 and replaced IFRS 4 as the accounting practice for insurance contracts - fundamentally changed how Canadian insurers manage capital and income volatility. As insurers are now operationally ready for IFRS 17 reporting, they are

increasingly focused on implementing new investment strategies that are better aligned with the standard.

This article builds on the insights shared in [New Frontiers: Optimizing Liability-Backing Portfolio Construction Under IFRS 17 >](#), with a specific focus on total return portfolio design and management.

Segmentation Approach Under IFRS 17

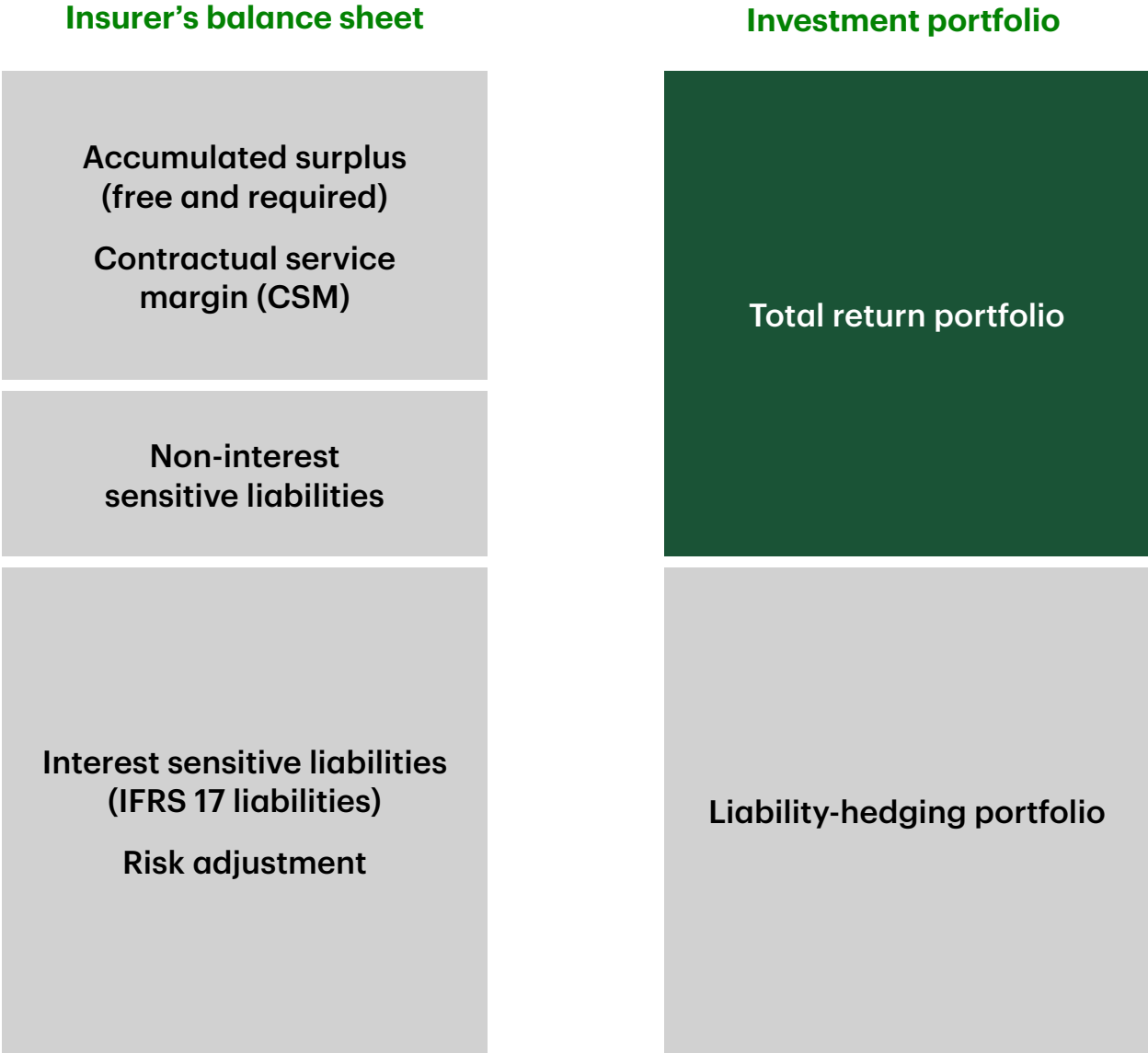
Under IFRS 4, the reserving framework and its relation to the corresponding asset portfolio created direct incentives for insurers to segment their investment portfolio into a liability-backing portfolio and a total return portfolio. Some insurers took this idea a step further by also segmenting their assets according to lines of business or types of liabilities.

Under IFRS 17, the incentives for insurers to segment their portfolios became less direct. While the direct linkage between liabilities and the asset portfolio has weakened under IFRS 17, segmenting the portfolio

between liability-backing assets and total return assets can potentially still deliver meaningful benefits to the insurer. Those include:

- Greater flexibility of IFRS 9 accounting designations, helping to better manage income levels and volatility.
- Clearer differentiations between various sources of earnings across investment segments.
- A natural evolution of the total portfolio asset mix due to a change in investment objectives (liability-hedging objectives vs. total return objectives).

Figure 1: Illustration of portfolio segmentation approach



Modified Total Return Approach

A **modified** total return approach refers to the portfolio's objective of achieving favourable risk-adjusted total returns while taking into account liquidity, actuarial, tax and accounting considerations. While this approach is often applicable to an insurer's surplus portfolio, including both required and excess surplus portions, it can be extended to include other investment assets. Depending on the objectives of the insurer, assets that correspond to non-interest-rate-sensitive liabilities can be considered as part of the modified total return approach as well. Non-interest-rate-sensitive liabilities can often include:

- Liabilities for remaining coverage (LRC) associated with property and casualty insurance, where incident rates (and therefore expected claims) are unpredictable.
- Liabilities linked to the long-term ultimate risk-free rate associated with the IFRS 17 discount curve, which is sticky in nature.

Rather than being considered traditional actuarial liabilities backed with fixed income, non-interest-rate-sensitive liabilities can often be thought of as static hurdle rates that the portfolio must exceed.



Portfolio Composition

Given the absence of liability-relative considerations from the modified total return portfolio, insurers often have a wider investment universe to choose from, where each asset class can help achieve their desired investment outcome.

Figure 2: Asset return profiles

Asset Class	Potential Return Profile	Options to Consider
Public Market Assets		
Common Equities	Generate long-term expected return and potential for upside growth	<ul style="list-style-type: none"> • Canadian equities • Global equities
Preferred Shares	Generate strong income return on a tax-efficient basis	<ul style="list-style-type: none"> • Canadian preferred shares
Fixed Income	Diversification benefits compared to equities and risk reduction	<ul style="list-style-type: none"> • Investment-grade bonds • High-yield bonds • Global bonds • Limited recourse capital notes (LRCNs)
Private Market Assets and Commodities		
Private Fixed Income	Illiquidity premium above public fixed income assets and sectoral diversification	<ul style="list-style-type: none"> • Investment-grade private debt • Commercial mortgages • Global private credit
Alternatives	Keep pace with inflation while generating returns comparable to equities in a diversified fashion	<ul style="list-style-type: none"> • Real estate • Infrastructure • Commodities
Derivatives	Hedge undesired exposures or enhance return potential	<ul style="list-style-type: none"> • Currency hedging • Total return swaps • Futures

Considerations for Modified Total Return Strategic Asset Allocation

Given the absence of liability-relative considerations from the modified total return portfolio, insurers often have a wider investment universe to choose from, where each asset class can help achieve their desired investment outcome.

1 Enhancing risk-adjusted returns

Private assets, such as real estate and infrastructure, now offer insurers broader access and the potential for higher returns. By integrating these into their portfolios, insurers achieve better diversification and capitalize on illiquidity premiums.

2 Building capital-efficient portfolios

Insurers must balance expected returns with regulatory capital requirements. Asset classes like preferred shares and private fixed income may deliver higher returns relative to capital charges, but the link between capital efficiency and downside risk requires robust management.

3 Aligning accounting designations

Selecting the right accounting designation for each asset class is crucial. Insurers can manage income recognition and volatility more effectively by choosing between Fair Value Through Other Comprehensive Income (FVOCI) and Fair Value Through Profit and Loss (FVTPL), aligning reporting outcomes with portfolio objectives.

4 Managing liquidity needs

Strategic asset allocation should ensure both sufficient and flexible liquidity. Insurers can benefit from dedicated operational liquidity pools and contingency plans, which allow them to meet routine and stress-driven cash demands without compromising their long-term investment strategies.

5 Maximizing tax efficiency

Tax considerations play a significant role in portfolio construction for Canadian insurers. Tax-exempt dividend income from Canadian corporations and well-planned portfolio management strategies can help insurers to optimize after-tax returns and enhance overall financial results.

6 Effective capital and risk budget allocation

Finally, segmenting portfolios into liability-backing and total return strategies could allow insurers to allocate capital and risk budgets more effectively. The optimal split depends on business structure and market conditions, ensuring both regulatory compliance and return optimization.

Strategy

How TDAM Can Help

Over the past three decades, TD Asset Management Inc. (TDAM) has cultivated extensive experience in managing assets for insurance companies, offering one of the broadest suites of investment products and portfolio management services across Canada. In recent years, TDAM has created a portfolio management platform to manage insurance and other institutional portfolios – the [TD Portfolio Navigator >](#).

In light of the complex regulatory landscape and volatile market environment, TDAM stands ready to support our insurance clients. Our team includes numerous professionals with investment and actuarial expertise. Leveraging this expertise, we are committed to delivering insights and addressing our clients' most important challenges. ■

If you'd like to explore your investment options or receive a more in-depth version of this article, please reach out to your Relationship Manager to schedule a meeting.





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TD Portfolio Navigator is a suite of tools used to create Asset Liability Management solutions for Canadian institutional clients.

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