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Investing in euro high yield: Key considerations for insurers



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Investing in euro high yield: Key considerations for insurers

- **Despite modest allocations today, euro high-yield credit can offer insurers a way to potentially enhance income, diversify portfolios and improve resilience beyond traditional fixed-income exposures**
- **Implementation choices, notably duration of the strategy, funding source of a high-yield position and accounting requirements, are key elements to consider for integrating high yield in a portfolio while managing volatility, Solvency Capital Requirement (SCR) and IFRS constraints**
- **The euro high-yield universe also makes it possible to build diversified portfolios while respecting climate commitments of insurers (as for example the SBTi-aligned objectives)**

Across European insurers' portfolios, allocations to high-yield public corporate credit remain modest, at around just 2%[1]. This is unsurprising, as insurers naturally prioritise assets that align closely with their liability profiles. As a result, they tend to favour asset classes offering predictable cash flows, low default risk and low capital charges under Solvency II.

High yield, by contrast, is a market largely composed of mid-sized leveraged companies, often in transition, which therefore entails higher credit risk and greater volatility than its investment-grade counterpart. This universe can also be broadened to include financial companies through senior or subordinated debt.

Nevertheless, high yield can offer meaningful benefits to insurance portfolios, including:

- Higher credit spreads and therefore higher coupons with all-in yields supporting income objectives
- Diversification of the investable universe by expanding it beyond investment grade issuers
- Potentially greater resilience than other total return assets such as listed equities

The asset class also remains relatively liquid[2]. When comparing the US's older and larger market to Europe's, average durations as of early 2026 are close, at around three years.

In terms of spread levels, both markets[3] generally exhibit similar orders of magnitude (excluding the impact of foreign exchange hedging): around 290 basis points[4] on average over the past year, despite the US market's average rating being lower (BB/B+) at end of March 2026 than the euro market (BB/BB-)[5].

Given the multifaceted nature of insurance balance sheets, any high-yield allocation needs to be assessed across several dimensions: economic efficiency with regards to a portfolio's risk measured as volatility and with regards to required regulatory capital; accounting treatments; and sustainability considerations. This paper reviews them in turn, focusing primarily on a euro strategy.

1 Source: Financial Stability Report, June 2025. Average 1.8% over time, ranging between 1.6% and 2.1%.
2 The US market accounting for around $1.5 trillion and the euro market for around €460 billion - Source: ICE BofA as at 28/02/2026
3 We use as proxy for the US market the BBG US Corp High Yield 2% issuer capped index and for the Euro the BBG Euro High Yield index.
4 Based on Bloomberg
5 Range including ratings of Fitch, S&P, Moody's and Barclays.
No assurance can be given that any forecast, target or opinion will materialise.

Efficiency in insurance portfolios

As a starting point, we use a 'reference' portfolio (benchmark) as a simplified illustrative example of a typical insurer's asset allocation.

IN OUR CASE STUDY, the portfolio is largely composed of fixed income, with 40% allocated to sovereign debt and 35% to euro investment grade credit, complemented by 5% in equities, 10% in unlisted real estate and 10% in alternative assets.

Over a projected 10-year horizon, this reference portfolio is expected to generate an annualised return of approximately 4.5%[6], with a volatility of 4.2%, and a Solvency Capital requirement based on Solvency 2 of around 9.8%.

Within this context, euro high yield is considered as a lever to improve portfolio efficiency. A 5% allocation to the asset class is assessed under two implementation approaches.

The first is based on a traditional duration euro high-yield universe (around three years as of end-March 2026) and is designed to capture the full credit spread and carry available in this market.

The second approach focuses on a shorter duration strategy (slightly below two years) to reduce sensitivity to spread, and potentially to default risk, given greater visibility over the short term.

As a result, it should help limit the associated regulatory capital charge while still capturing a significant share (at around 60% to 70%) of the overall euro high-yield risk premium.

Through these approaches, and to reflect realistic portfolio construction, the euro high-yield allocation is assumed to be funded through various reallocations reducing exposure to euro sovereign bonds, investment-grade credit, listed equities, or a combination of these assets.

This results in 10 distinct allocations, enabling a detailed comparison of outcomes across a range of funding strategies. Note that, in this analysis, the impact on the portfolio's overall duration remains very limited.[7]

Efficiency in volatility and expected return plan

The analysis' results illustrated in Graph 1, **over a projected 10-year horizon**, indicates that euro high yield's impact on the portfolio depends on both the funding source and the segment of the selected universe.

Graph 1 depicts the change in terms of expected return and of risk (here, the volatility) from investing 5% in traditional euro high yield (**green zone**) and in short-duration high yield (**grey zone**). The different points in each zone represent the funding source of this 5% investment in high yield.

6 Expected return and volatility are based on a proprietary model. The numbers presented in this document are based on data at the end of March 2026

7 A larger allocation could have a more significant effect on duration, depending on the funding source. In such a case, the duration impact of the high-yield exposure could be offset through interest rate swaps or futures.

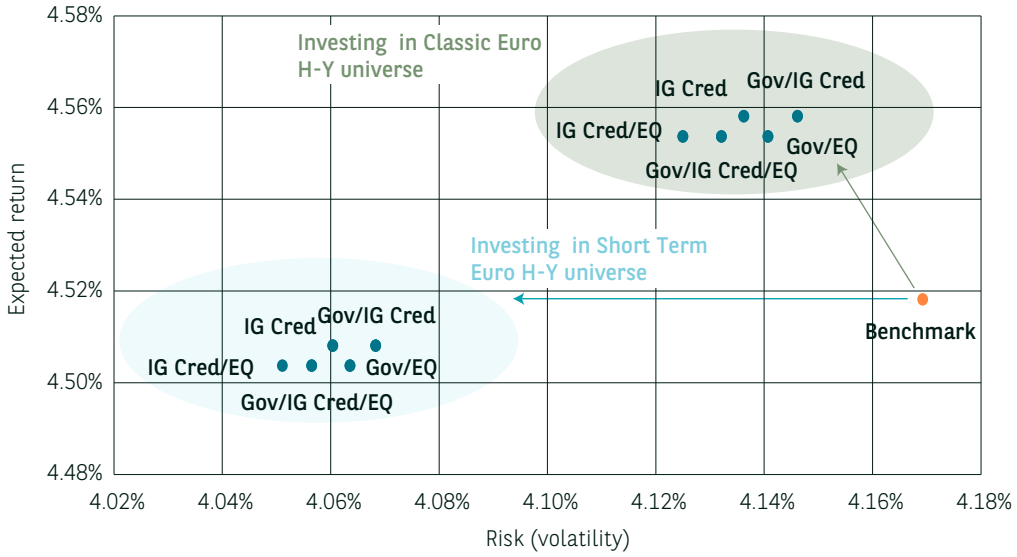
While the changes' magnitude remains modest because of the limited amplitude of the reallocation, it provides interesting insights:

- Traditional euro high yield both diversifies the portfolio and improves its expected return whatever the source of funding is

- A reallocation to short-duration euro high yield typically implies a lack of impact on, or a very small decrease in, expected returns[8], whatever the funding source; but it delivers a more important reduction in volatility

Globally, the diversification benefit, and the reallocations' return are stronger when the funding source includes listed equities and/or IG Credit and conversely, are slightly lower when the funding source includes sovereign bonds.

Graph 1: Expected risk and return (economic) of the different allocations



Source: BNPP AM, March 2026

Efficiency in the Solvency II SCR and expected return plan

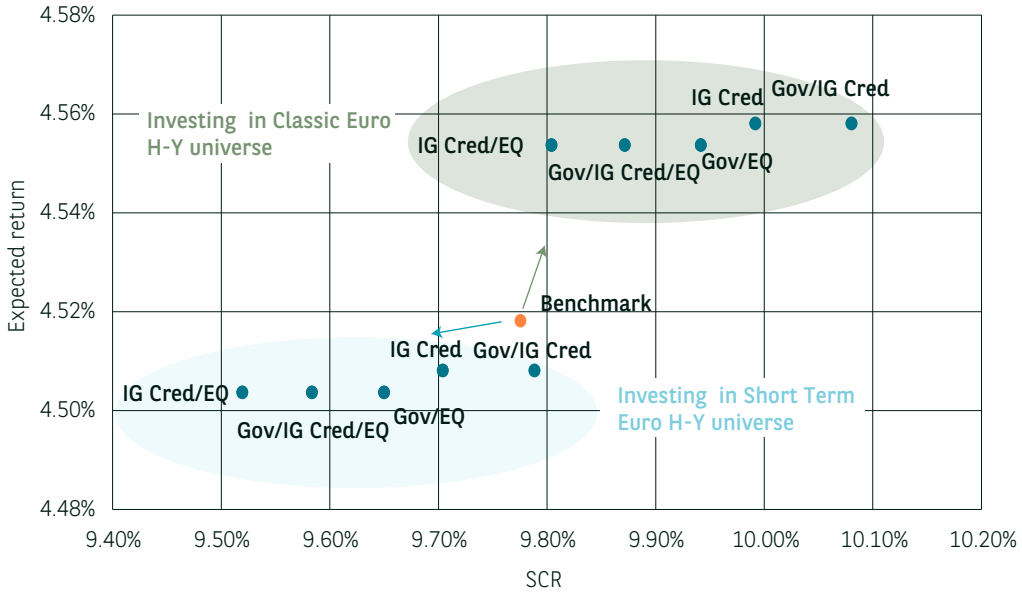
As depicted by Graph 2, the traditional euro high-yield allocation increases the return but also tends to raise the SCR; this is expected, as its SCR is typically in the upper part of the 10%–20% range, while investment-grade credit and sovereigns are generally in the lower part of that range.

This effect is contained when the allocation is funded partly from equities (where the SCR fluctuates between 29% and 49% in function of the asymmetric adjustment). The magnitude of both the return improvement and the SCR increase depend on the funding source.

By contrast, short-duration high yield tends to reduce the portfolio's SCR; its SCR is generally in the lower part of the 10%–20% range in most cases, with a very limited reduction in expected returns.

8 This comes from the 10y projections' assumptions in which the interest rates converge, on average, toward lower levels. Under this scenario, the Sovereign bonds bucket benefits from its longer duration. Longer term projections, once the rates convergence reached, may display different results.

Graph 2: SCR (regulatory) and expected return of the different allocations



Source: BNPP AM, March 2026

The Sharpe and expected excess return / SCR ratios perspective

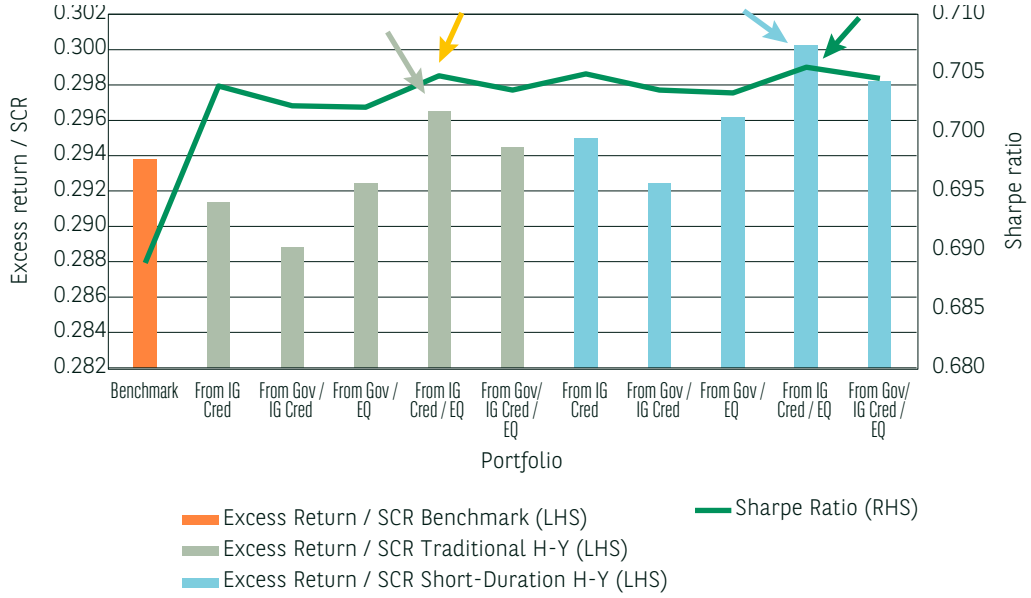
Graph 3 shows the expected excess return / SCR ratio (**green bars** representing traditional high yield and **blue bars** representing short duration high yield), as well as the Sharpe ratio (**green line**) for both traditional high yield and short-duration high yield.

The best efficiency relative to required regulatory capital, i.e. the highest excess return per unit of SCR (blue arrow), as well as the best Sharpe ratio, i.e. excess return per unit of risk (dark green arrow) comes from an investment in short-duration high yield funded from a mix of equities and investment-grade credit.

This reflects the strategy's greater resilience in periods of market stress, while still offering attractive performance potential.

It appears that traditional high yield also exhibits the best excess return per unit of SCR (light green arrow) and the best Sharpe ratio (yellow arrow) when funded from a mix of equities and investment grade credit, albeit at slightly lower levels than for short-duration high yield.

Graph 3: Excess Return / SCR and Sharpe Ratio

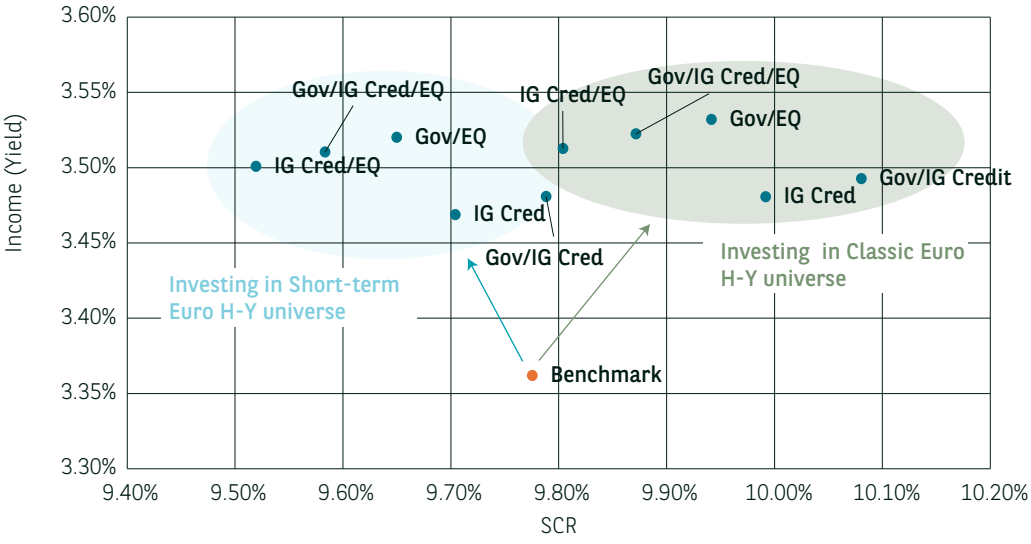


Source: BNPP AM, March 2026

A last efficiency perspective in the SCR / income plan

Graph 4 exhibits the improvement in the 'spot' (i.e. not a multi-year projection) portfolio's income, encompassing bonds' yields and listed equities' dividends. Note that under International Financial Reporting Standards – IFRS - if adequately treated accounting-wise (see the Section Accounting under IFRS), this directly translates into earnings for non-Variable Fee Approach (VFA) books. We observe that both the traditional duration strategy and the short duration one improve these metrics (while the impacts on SCR are as described earlier).

Graph 4: Income (measured by the Yield) and SCR (regulatory) of the different allocations



Source: BNPP AM, March 2026

TO SUMMARISE, our analysis on a simplified portfolio and under our reallocation assumptions shows that euro high yield can help serve multiple objectives for an insurer's portfolio, as it brings diversification, potentially increases the long-term expected return (for the traditional duration strategy), can decrease the SCR (for the short-duration strategy) and can help enhance both the return / SCR ratio and Sharpe ratio.

Accounting under IFRS

Accounting treatment under IFRS is a key consideration for insurers. The choice of investment vehicles in which to implement a high-yield strategy depends on the characteristics of the liabilities, in particular whether they are measured under the Variable Fee Approach (VFA) or the Building Block Approach (BBA).

Variable Fee Approach
For liabilities measured under the VFA, where liability cash flows are linked to the performance of underlying assets, open-ended funds may be more suitable. Open-ended funds are normally measured at fair value through profit or loss (FVPL) under IFRS 9.

But for VFA portfolios, profit-or-loss volatility on the assets are offset by the change of the liabilities and the Contractual Service Margin (CSM), which is released to profit or loss over time. In this setting, implementing high yield via an open-ended fund does not impact the volatility of the profit and loss account.

Building block approach
For liabilities measured under the BBA, where liabilities are not linked to the performance of underlying assets, it may be preferable to hold high-yield bonds measured at fair value through other comprehensive income (FVOCI), provided they meet the SPPI (Solely Payments of Principal and Interest) test in order to avoid profit-and-loss volatility (outside of impairment).

In this context, a segregated mandate or a dedicated fund may be more appropriate than a mutual fund investment. The SPPI test is therefore a key determinant of the appropriate accounting classification.

It is important to assess what proportion of the high-yield universe is SPPI eligible to confirm that the investable set is sufficiently large to build a diversified FVOCI portfolio. Insurers typically perform this analysis using internal methodologies and/or external data providers.

To assess the high-yield universe's eligibility for the SPPI test, we tested the universe using both our proprietary methodology and data from market providers. In both cases, the analysis indicates that a significant share of the high-yield universe passes the SPPI test.

This is a key input when assessing the feasibility of building a sufficiently diversified portfolio of SPPI-eligible high-yield bonds, while remaining consistent with accounting constraints.

In summary, where FVOCI is the client's preferred accounting outcome under IFRS, high yield can in many cases be measured at FVOCI, given that a substantial share of the universe passes the SPPI test.

Other considerations
An additional consideration under IFRS 9 is expected credit loss (ECL), a forward-looking estimate of potential credit losses based on probability of default, exposure at default and loss given default. ECL requires impairment to be recognised earlier, as it accounts for expected losses rather than only incurred losses. It is recorded as a provision in the profit and loss account when a bond is purchased.

The ECL allowance may increase in the event of a credit rating downgrade or an increase in the probability of default, resulting in an additional provision and potential P&L volatility.

Given the specific characteristics of the high-yield universe, issuer selection is therefore crucial and should be entrusted to specialists in order to minimize the impact of ECL on P&L.

Climate considerations

As asset owners, many insurers aim to address sustainability challenges such as climate change. In practice, this ambition is often formalised through decarbonisation targets or commitments to framework such as the Science Based Targets initiative (SBTi) and/or membership of the Net-Zero Asset Owner Alliance.

These commitments require insurers to transition their investment portfolios in line with clear climate objectives and timelines. As a result, when introducing a new asset class, insurers need to assess whether it can be implemented in a way that remains compatible with their climate strategy (target setting, monitoring and engagement requirements).

To illustrate, we consider an insurer that has committed to SBTi[9]. We based our case study on that framework as it is an independent one with specific rules. Within that framework we selected the portfolio coverage approach to measure progress.

With this approach, the insurer targets an increase in the share of portfolio issuers with SBTi-validated targets, with the objective of reaching a level above 95% by 2040.

We therefore compared the proportion of issuers that are SBTi approved in the euro high-yield universe with the euro investment-grade universe. The results are broadly similar: 47.5% of euro high-yield issuers are SBTi approved versus 50.5% for investment grade. However, the aggregate figures mask meaningful sector differences, as shown in Graph 5.

Graph 5 : SBTi target status of high-yield universe and investment-grade universe by sector



Source: BNPP AM, March 2026

9 Science Based Target initiative

Graph 5 suggests that SBTi-approved issuers are currently absent in the Energy sector and remain limited in Financials compared with other sectors. This matters because, under a portfolio coverage approach, constraints on SBTi coverage could translate into unintended sector tilts.

For example, an investment grade-focused implementation may face a material bias away from Financials given the sector's high weight in the investment grade universe. By contrast, euro high yield is more evenly distributed across sectors, which can make it easier to progress toward coverage targets without creating excessive concentration or sector exclusions and therefore limiting concessions on the yield or spread.

In practice, this supports the case that euro high yield can be integrated into SBTi-aligned portfolios, provided the insurer complements allocation decisions with active engagement and ongoing monitoring of issuer target validation.

This example, based on the SBTi portfolio coverage framework, could be extended to assess the impact of high yield on other climate key performance indicator (e.g., implied temperature rise).

TO CONCLUDE, Euro high yield can play a significant role in insurance portfolios by potentially enhancing returns, improving diversification and offering flexibility across economic efficiency relative to a portfolio's volatility, required regulatory capital, as well as accounting and ESG dimensions.

By appropriately selecting duration, funding sources and sustainability approaches, insurers can integrate high yield in a way that aligns with their strategic objectives and constraints.



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