

## Insurance Investment Advisory Services: A Buyers Guide

Our unique industry has less than a handful of **Insurance Investment Advisory** firms providing true Insurance Consulting Services. By investment industry standards, each of these firms would be considered small specialty boutiques. On the other hand, there is an abundance of “investment advisory/consulting firms” in the marketplace. The smaller firms lack insurance expertise and the larger firms may have several insurance clients and some dedicated resources for the insurance industry, but are not considered insurance investment advisory firms. Here’s why....

### 10 questions to ask:

- 1) What percentage of the investment advisors client base represents insurers, by revenue and by relationship? What percentage is institutional vs. high net worth?
  - i. The answer should be ALL or very nearly 100% to be truly an Insurance Investment Advisory firm. Otherwise the small dedicated insurance group of a larger concern, that focuses resources on higher priority “target” market segments, will not be a meaningful profit center that gets necessary resources and personnel of the highest level expertise to focus on insurance clients. Most managers pursue the more lucrative markets of pension, 401k, endowment and foundation and public funds sectors of the institutional marketplace.
  - ii. Wealth management-oriented advisory firms are seldom equipped to properly service institutional clients and if so, typically do so for “retail” rather than “institutional” fees.
- 2) In what segment of the insurance market does the advisor specialize or have the most experience?
  - i. P& C insurers and the L&H markets are two distinct markets for true insurance investment advisors. Their issues vary greatly on both sides of the balance sheet. For example, the volatility of their liabilities, the investment time horizon and corresponding risk tolerances as well as the sensitivity to interest rate changes are all substantially different. The Alternative Risk market, while sharing many similarities with the commercial P&C
  - ii. market, has its own nuances related to thin capitalization, domicile oversight, etc.
- 3) What specialization does the investment advisor have, in terms of services, analytic systems and expertise, to consider themselves an insurance investment advisor?
  - i. You can check the firm’s ADV Part II filing with the SEC as well as review the firm’s website and marketing materials for verification of specific services and expertise related to insurers. Many of these related requirements are explored in more detail below.
- 4) Can the advisor demonstrate that they are recognized in the industry as “insurance advisors”?
  - i. This answer should include the ability to provide references of industry leaders and luminaries, cite editorial contributions to insurance-related publications and have a reputation as proven by being called upon for speaking engagements.
- 5) Is the investment advisor familiar with your company’s regulatory, tax and accounting environment?
  - i. The answer should be the advisor knows the domicile regulations and perhaps the regulators themselves. They should have a thorough understanding of your regulatory constraints. Are they familiar with the SVO and RBC schedules applying to the portfolio?

- ii. If the advisor has not asked about your tax situation, then they are not insurance focused as the vast majority of insurance entities require activities in the investment portfolio to be tightly coordinated with the insurer's tax situation, typically driven by their liabilities. Do they understand OTTI and its potential impact on financial statements?
  - iii. If they don't know to ask about schedule D filings and what held to maturity, trading and available for sale are, then their insurance expertise is rather shallow.
- 6) Does the investment advisor use strategic asset allocation software that has the ability to model both insurance liabilities and investments?
- i. The answer should be that the analytic system was built by insurance actuaries and therefore appropriately models and incorporates the insurance company's liabilities' volatility and correlation, under various market scenarios, to investment behavior. An "asset-only" strategic allocation methodology is insufficient and inappropriate for insurance companies.
- 7) Has the advisor asked for actuarial reports and liability durations prior to any discussions about tactical portfolio construction?
- i. The answer should be "yes" as this data is critical for properly constructing your reserve portfolio and represents the basics of Asset/Liability Matching (ALM). The portfolio's maturity structure will be dependent on projected cash flows and claims payments. In addition the portfolio duration should generally be matched to the liability duration to immunize the portfolio for changes in interest rates.
- 8) Does the investment advisor recommend "investment managers" or "insurance asset managers" for your client's reserve assets?
- i. If the advisor does not know the difference between these types of managers, then they are not an Insurance Investment Advisory firm! The preferred answer should be that suggested managers are included on the Insurance Asset Manager list in our industry's singularly recognized authoritative publication. If not on this list, what expertise does the manager have in the unique construction of portfolios around projected cash flows and claims payments?
- 9) Does the advisor focus on maximizing "total returns"?
- i. Insurers should primarily focus on risk adjusted, after-tax returns with an objective on "book yield or income maximization" as an investment objective. A total return objective is almost always inappropriate for the reserve portfolio and is typically only considered for the surplus portfolio?
- 10) How does the investment advisor evaluate and report the performance of your portfolio?
- i. Rather than measuring manager performance vs. benchmark over a variety of periods, this answer should be on a risk adjusted, after-tax return basis using modern portfolio theory statistics to understand the risks the manager took to achieve the performance returns reported. Furthermore, MPT stats can help gauge the manager's efficacy in navigating up and down markets to provide the stable and predictable return stream desired by insurers.