WHEN WAS YOUR LAST INVESTMENT CHECK-UP?

Bill Piel of Opus Investment Management highlights the importance in keeping track and managing your investments

There is a lot of conversation in the marketplace regarding Corporate Governance Annual Disclosure (CGAD) reporting requirements for insurance companies, new in 2020. While CGAD does not specifically address an insurer's investment portfolio, we at Opus feel that it is a best practice to have a third party provide a review, or 'check-up', of your portfolio. There are various ways to approach an investment check-up, and a good question to ask yourself is what type of check-up and frequency is best for your organisation.

Bill Piel

Bill Piel joined Opus Investment Management in 2007 as an assistant portfolio manager and currently holds the position of vice president, co-head of portfolio management. In this capacity, he provides oversight of Opus' client portfolios as well as Opus' sales and marketing efforts. Piel's portfolio management responsibilities include the investment grade core, intermediate broad market, and short broad market strategies.

The 'physical' – a full diagnosis, focuses on these questions:

- Does the asset allocation of the investment portfolio complement your firm's long-term strategy?
- Does the duration of your investment-grade, fixed income portfolio align with the liabilities you are writing today?
- Is the level of risk appropriate given your balance sheet strength?
- Has the portfolio objective changed?
- Are you in compliance with all regulatory changes?

- When was the last time you reviewed/updated your investment policy statement?
- How do you compare to peers?

To accomplish this comprehensive analysis, it is important to view the investment portfolio in conjunction with the characteristics of the insurance business to evaluate how the performance of one can impact the other. Payout profiles of insurance policies can vary significantly and can lead to different cashflow or liquidity needs. For example, auto property claims can generally be closed quickly, whereas workers' compensation liabilities can have long tails. Additionally, some liability types have low frequencies, but when they occur, the severity can be quite high. Lastly, an insurer's historical underwriting performance should be factored into an analysis addressing liquidity needs.

An insurer's financial strength is another key component in determining the appropriate investment mix. The level of liabilities to capital and surplus correlates to broader asset allocation decisions. While liquidity, capital preservation, and income are preferred for assets supporting liabilities, assets backing surplus can have a growth bias and can have higher volatility without impacting the claims paying ability of the insurance entity. This results in insurance companies having a predominant amount of assets invested in investment grade fixed income securities and a portion of their surplus in higher risk assets such as equities.

It would be wise to point out that an insurer's asset allocation decision is not a static assessment. Insurance is dynamic, therefore so should the asset allocation be as well. As a company considers expanding its product offerings, entering new geographies, or changing its pricing structure, the asset allocation needs to adjust accordingly. Underwriting leverage can alter the level of risk an insurer is willing to take with higher volatility asset classes. Navigating the requirements of regulators and rating agencies also comes into play.

A dialogue between the leadership team and the investment manager should take place to review the above information and determine if the investment portfolio and the accompanying policy statement fulfil the needs identified by this analysis. As a best practice, we recommend completing this more extensive review every 3-5 years.

"Insurance is dynamic, therefore so should the asset allocation be as well"

The 'oil change' – a quick look to ensure optimal performance

What is the performance of the portfolio versus the benchmark? Do the investment holdings look appropriate? Are regulatory and investment policy parameters being met?

This is a good time to ask such questions, not only to evaluate the performance of your existing portfolio, but also the positioning. You also may want to evaluate if you are measuring yourself against the most suitable benchmark. Many times, we have found the evolution of the investment policy statement has not kept pace with the holdings and objectives of the portfolio. This creates challenges when monitoring or measuring performance of the current investment manager.

The 'oil change' is perfect for quarterly updates with a more robust one occurring annually. With an oil change we would recommend looking at just the investment portfolio. Potentially different parts of the above-described 'physical' each quarter.

The primary goal of answering the above questions is to ensure that your investment portfolio is working to accomplish the existing objectives of your organisation both operationally and strategically. It provides an opportunity to evaluate yourself and make corrections or tweaks if needed.

This is not a comprehensive list but a good starting point when thinking about your next investment check-up and could also be included in board education. If you do not know where to begin don't fret – there are different companies in the marketplace that can provide these check-ups for you. Opus provides a comprehensive first check-up complimentary to interested insurance companies.

MOST COMMON INVESTMENT POLICY STATEMENT SUGGESTIONS AND RATIONALE

SUGGESTION	RATIONALE
Set max equity exposure to % of surplus or fund balance	Historically volatile asset classes should not be backing reserves
Clearly define an investment benchmark	Defining a specific benchmark allows management and the board to see how the investments are performing
Reference the state regulations that govern the investment portfolio	Provides transparency to all parties (both internal and external) involved in investment decisions
Add overall portfolio duration limitations	Usually set as a +/- percent versus a benchmark, would assist in liability matching objectives