



## Enterprise Driven Investing for Insurance Companies: The Hot Mess – and Future – of Asset Management

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### *About the Author*

*Bill Poutsiaka is a senior financial services executive and consultant with considerable depth as CEO, CIO and Board member in the insurance and the asset management businesses. As SVP & Chief Investment Officer of AIG Property Casualty, Bill established an effective global CIO function and contributed to the company's overall recovery, working closely with other members of senior management. From 2005 to 2010 Bill served as an active director on the boards of public, private and non-profit organizations and designed an investment adviser dedicated to managing equities owned by insurance companies. From 1999 to 2005 he was Chief Executive Officer of PanAgora Asset Management, a leading quantitative institutional investment advisory firm. Bill was at Arkwright Mutual Insurance Company from 1989 to 1999, starting as Senior Vice President of Investments, promoted to President in 1993, then President and CEO in 1994. Bill designed and effected the merger of Arkwright with principle competitors to create FM Global, the definitive world leader in commercial property insurance and associated risk management.*

### What is an Enterprise?

*A project or undertaking that is especially difficult, complicated, or risky<sup>1</sup>*

### What is Enterprise Driven Investing (EDI)?

**Enterprise Driven Investing for insurers is a business management process that attempts to address several pitfalls, improve decision-making and enhance results.** The goal of EDI is to achieve a high level of portfolio customization in the most financially efficient manner.

The multivariate complexity of insurance company investing exceeds that of most

<sup>1</sup>[www.Miriam-Webster.com](http://www.Miriam-Webster.com)

other institutional mandates. Shrink-wrap solutions, while helpful at some level, have shortcomings. These include the following:

- A one-size-fits-all answer to the agency problem, where multiple constituents have different objectives.
- Over or under utilization of quantitative models.
- Design flaws, especially in establishing the portfolio objective.
- Weak customization, most often from the absence of clear financial priorities.
- Treating all limits as rigid and precise with little sense of the variable cost (e.g. risk avoidance rather than risk management.)
- Failure to adopt emerging financial techniques that have the potential to provide investors an edge.
- Absence of a framework to facilitate discussion that can lead to large gains by restructuring key trade-offs.

The EDI process uses quantitative insights to inform team-based decisions. All applications of EDI principles have common steps, but there is a high level of customization that begins with industry segmentation and ends with circumstances idiosyncratic to each company. While successful implementation is dependent on the quality of underlying models, high value EDI is more reflective of management's (1) collective business and capital market expertise, (2) skill in prioritizing and making the right trade-offs, requiring full recognition of secondary impacts; and (3) creativity in restructuring key financial relationships to improve the risk-reward economics.

## Changes Taking Place in Investment Management

This article is focused on the enterprise aspects of EDI. EDI principles are agnostic to the selection of underlying models and adoption of emerging financial theories, but EDI's success is not. New developments are raising fundamental questions with all investors. These questions and their linkage to EDI are described below.

**What is the Appropriate Capital Market Taxonomy?** New vehicles for portfolio construction are growing by order of magnitude, headlines about the "end of active management" (e.g. equity security selection) notwithstanding. The way in which investors classify opportunities for the purpose of top-down allocation is a long-standing challenge that has been restated with the growth of ETF's, benchmark revisions, alternative betas, smart betas, risk factors, etc. Numerous studies have concluded that top-down decisions determine approximately 90% of portfolio results, and market taxonomy is the lens through which managers view these choices. Selection of market taxonomy is the active management elephant in the room.

**Which Portfolio Optimization Model & Inputs Should be Used?** Model selection and validation are critical components for success. More computing power, larger data/information sets, machine learning, hybrid deterministic/stochastic scenario generators and emerging econometric models have created exciting new portfolio construction possibilities. EDI has very specific requirements that need to be recognized by these technologies from the

start, not determined by them as something incidental to model design. Of equal importance is avoidance of black boxes and the false sense of precision they convey, or the complete dismissal of the insights robust models do provide. The complexity of EDI necessitates quantitative analyses that elevate, not replace, judgment.

**What is the Most Effective Decision Architecture?** Board and management governance of investments is highly developed and, for many institutions, prescribed by law. However, statutes give latitude in how companies comply with these regulations. Adoption of a different market taxonomy or modeling technique can also alter the decision-making architecture. For example, does it still make sense for a Committee meeting quarterly to reset portfolio weights for separate small-cap value and growth sleeves, or should it set risk premia weights, leaving sector and security selection to managers who track intra-premia exposures for a living?

Like EDI, these innovations will disrupt the industry and be led by top researchers, modeling and software firms, third-party managers, start-up and legacy insurers. For this reason, current approaches to deciding whether or not to outsource and, if so, in what way and to whom, will become increasingly irrelevant. The business model of asset management is changing dramatically.

### Why Do Some Investment Professionals and Third-Party Managers Avoid Insurance Company Asset Management?

The short answer is enterprise restrictions, lack of domain expertise, and complexity. Let's look briefly at some of the separate asset pools with which managers are most comfortable (because there is traditionally less customization), and move step-by-step away from their comfort zone. Eventually, we'll enter what is, for some, the tortured world of conventional, insurance company balance sheet investing, but for others is the ultimate challenge of institutional management. Specifically, the challenge is to optimize the balance between customization and investment efficiency, as shown in [Exhibit 1](#). Achieving this end result is the future for all investors, and the insurance sector is a window on this future.

#### Unconstrained Investing: Hedge Funds

Even the most highly customized portfolios can allocate a sleeve to strategies with few if any constraints, such as hedge funds. Although there is variation by category, hedge funds generally have the largest opportunity set in the business, often including the freedom to move between multiple private and public asset classes, apply leverage, use derivatives and short. Hedge fund CIO's consider advances in financial theory based exclusively on the investment merits as they judge them. The quid pro quo for this latitude (and high fees) are higher expectations for performance in general and specific attribution in particular. Managers who promote alpha but deliver beta have lost clients to low-cost replication. In addition, clients of these alternative beta managers experience unintended risk concentration when unconstrained strategies, with factor indifference, are introduced to a larger portfolio. Ironically, multi-strategy and

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macro managers with strong portfolio construction and an equally strong commitment to understanding EDI are in an excellent position to provide active customization for insurers using a completion portfolio including betas. For now, HF's are the closest thing to pure investment freedom, and clients have set their expectations for performance accordingly.

### Mission Driven Investing: Foundations

Foundations also have significant investment latitude. Regulation focuses primarily on tax treatment and varies depending on the funding source (private versus public). ESG limits are a standard practice, but compliance is straightforward through adherence to restricted security or sector lists. Managers must also maintain liquidity to fund grants and a portion of the operating expenses of an administrative

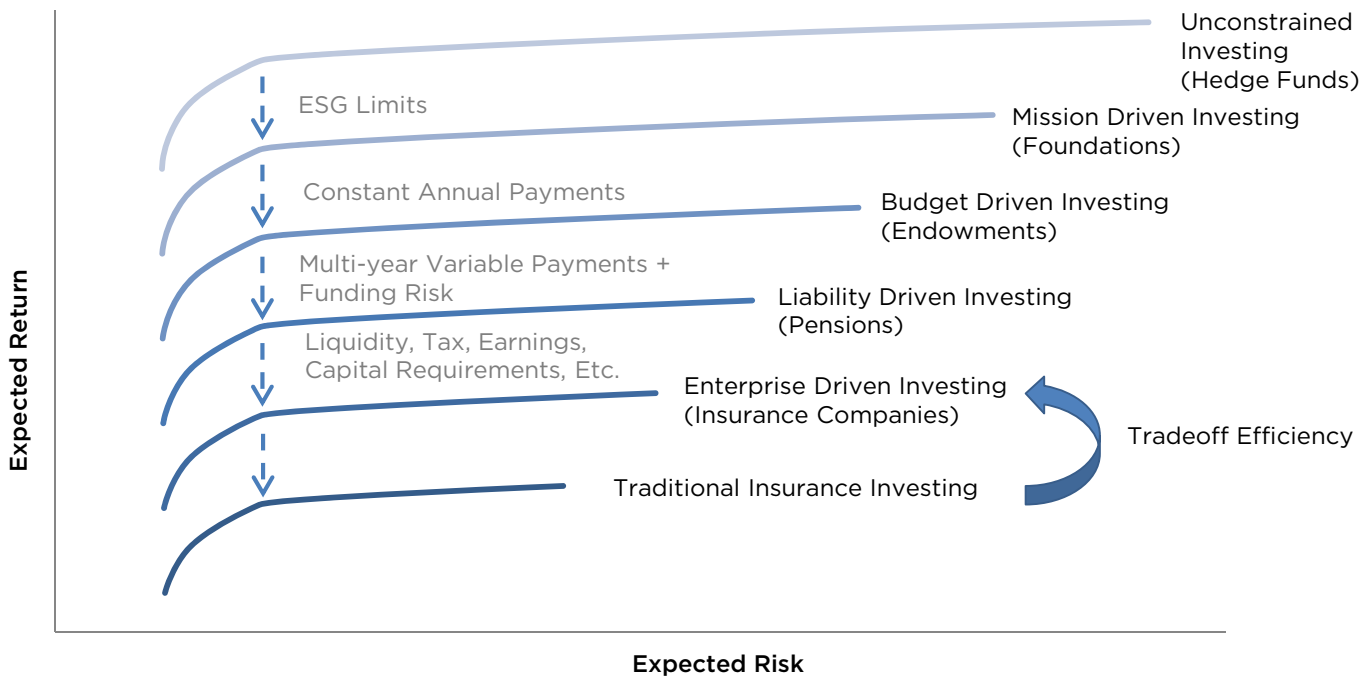
entity. Otherwise, they are given few sponsor-specific considerations as they go about their business, and an increasingly difficult business it is ... trying to achieve a performance that exceeds benchmarks, model portfolios, and competitors.

### Budget-Driven Investing: Endowments

Classic endowment portfolios typically have a fixed annual contribution to the budget of the non-profit entity. The conditions of the non-profit impact the variability of this obligation, but the range is relatively narrow due to the near-term operating stability of the non-profit. In some cases, there are restrictions similar to those found with foundations, and portfolio strategy may be impacted by the rating agencies if the operating entity has issued debt. However, the board typically does not expect investment managers to be

### Exhibit 1

*EDI: Mitigating the Investment Cost of Customization*



intimately knowledgeable about the operations of the organization. Expectations about this depth of institutional knowledge are rising, as exemplified by the highly developed and fully integrated program at the University of Chicago and elsewhere.

### **Liability Driven Investing: Pension Plans**

Pension portfolio strategy has similarities to the management of insurance company assets in two respects that establish complexity for non-investment reasons. First, the portfolio has liabilities with a longer duration and comprised of specific actuarial components. These components are the number of retirees, their expected mortality, and plan features including benefit formulas, early retirement and other options. Second, there are multiple stakeholders with different financial interests and appetites for risk: the plan sponsor, plan trustees, PBGC and plan beneficiaries. LDI is an essential framework for portfolio construction that recognizes these important characteristics.

But there are also two critical differences between pension and insurance asset management. Although both possess liability uncertainty, there is a much narrower range of outcomes on the pension side. The exception to this would be straight life coverages. The unfunded pension liability that now exists for many plans is more a function of unrealistic asset return assumptions than missed liability forecasts. More significantly, as a separate pool, pension portfolio management avoids numerous financial particulars attached to the balance sheet of a complex enterprise. For these reasons, LDI is an incomplete construct for the direction of insurance company assets.

### **Traditional Insurance Investing**

Insurers' portfolios, as balance sheets of highly-regulated entities with all possible forms of held- and contingent-capital, and assuming almost every known risk exposure, bring the investment challenge to a much higher level. Various forms of reinsurance and other risk transfer mechanisms can reduce the scale, nature, and variation of these liabilities – the tail that wags the balance sheet dog. Ultimately, however, additional enterprise factors (described below) compound the problem to a sometimes incomprehensible state. This problem is then handed to the investment and risk teams as the hot mess of institutional management. **The EDI framework sorts this out and attempts to achieve greater financial efficiency through a superior management of trade-offs.**

### **HOW DOES EDI WORK?**

EDI provides a roadmap for tackling the objectives and constraints that insurance companies face through a four step process.

#### **Step 1: Establish the full set of financial variables and set priorities.**

EDI begins by establishing and prioritizing the complete set of financial considerations. The multiplicity and cross currents of business factors are the principle characteristic that distinguishes EDI from LDI and creates this first step. These considerations include form of ownership, liabilities from a global encyclopedia of risk, actuarially complex policy terms and product options, taxes, liquidity requirements, colliding capital objectives, affiliate structures, competing rating agencies, and

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several regulatory regimes that are rarely coordinated and, in combination, are the most complex in business. EDI's first step captures the complete set of these variables and then challenges the Board and senior management team to establish those that are primary, secondary and less relevant to their organization.

As we'll see in Steps 2, 3, and 4, Step 1 is the easy part. Nevertheless, errors of omission are common in Step 1 for several reasons, including the agency problem.

**9:00 AM Meeting:** CEO's office, The Who's-The-Captain-Of-This-Ship? Insurance Company

**CIO:** "We need to sell some high-grade bonds and buy more equities!"

**CEO:** "Why?"

**CIO:** "The relative values and gap in risk-adjusted, total-return trajectories will be historically wide."

**CEO:** "Set up a meeting."

**CIO:** "OK." To herself on the way out... "Can you believe this guy is running the company with a question like that? We're in deep trouble."

**9:30 AM Meeting:**

**CRO:** "We need to sell some equities and buy more high-grade bonds!"

**CEO:** "Why?"

**CRO:** "The expected return on capital charges for high grade is substantially higher than for equities, and we need to improve our RBC and debt ratings."

**CEO:** "Set up a meeting."

**CRO:** "OK." To himself on the way out... "Sheesh. Can you believe this guy is running the company with a question like that?"

**10:00 AM Meeting:**

**CFO:** "We need to sell anything at a gain."

**CEO:** "Why?"

**CFO:** "Our underwriting results this quarter are horrible, and we need earnings to keep our shares from getting hammered."

**CEO:** "Set up a meeting."

**CFO:** "OK." To herself on the way out..."I should be running this company."

**10:30 AM Meeting:**

**CEO:** "Let me guess. We need to sell anything at a loss, and buy tax-exempts because of the AMT threshold."

**Director of Tax:** "Exactly! How did you know?"

**CEO:** "Pure luck. Set up a meeting, with everyone on the senior management team."

**Director of Tax:** "Sure thing." To himself on the way out..."Guy's a genius. No wonder he's running this place."

Increasingly sophisticated and robust financial modeling packages and services are now available to insurers. However, they do not replace management's judgment in setting priorities. Prioritization and sorting issues between goals and constraints only take place with executives from all functional areas working closely together as a super-coordinated team.

Senior management avoids errors of omission by raising one question as a point of reference with every EDI decision....”If there was a representative of every one of our constituencies in the room, how would they respond to this decision and how we made it?”

Certain variables are, by definition, more important than others to particular industry segments (**Exhibit 2**). For example, balance sheet strength is more important than earnings consistency for a short-tail P&C mutual company. For a public Bermuda reinsurer in the asset intensive lines, asset liability management (ALM) management is more important than tax-optimization of the portfolio. Conditions unique to the firm drive a second layer of customization. When accounting measures that depart from economic reality dominate priorities, this should be a red flag. Success with EDI is also dependent on the level of expertise evidenced in the individual metrics. It is relatively easy, and equally dangerous, to adopt an incomplete or stale measurement of capital efficiency. The same can be said for each of the variables used in the examples below. EDI is a chain only as strong as the weakest link.

**Exhibit 2**

*EDI: First Layer of Customization by Segment*

	Mutual P&C Company	Large Public Life Company
<b>Enterprise Objective</b>		
Growth in Book Value	Primary	N/A
NII	N/A	Primary
<b>Enterprise Consideration</b>		
ROE	Secondary	Primary
Liquidity Requirement	Primary	Secondary
Capital Objectives	Primary	Primary
Asset/Liability Range	Secondary	Primary
Risk Factor Limits	Primary	Secondary
Earnings Stability	Secondary	Primary
Tax Efficiency	Secondary	Secondary

**Step 2: Design a portfolio objective, and related performance measures, from the financial priorities.**

Insurance asset management in any form is as much a design challenge as an investment one. Careful design of the primary objective is the gatekeeper to successful EDI. Portfolio objectives for these entities are no different than for other portfolios in that they are two-dimensional measurements of risk and return. The definition of each, however, has financial attributes linked to an operating company. Return can be total, net investment income (NII), cash flow, a combination, or something else entirely. Risk can be portfolio volatility, CVaR, TVaR, economic shortfall, Solvency II capital charges, etc. Even the best selection will have shortcomings. A poorly conceived objective alone can offset, entirely, the talents of a high performing investment team. Success in the design phase will occur if four guide rails are in place.

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**Company-Specific Customization:** The selection of an investment objective should be dictated by market segment based on lines of business, ownership structure, scale, and domicile. Public underwriters and private companies in spread businesses emphasize earnings growth and consistency as their return, whereas other mutual, and private entities are more focused on expansion in book value (total return) with less importance to sourcing it through financial statement income. Risk measures also need to reflect business segmentation. Public companies optimize return on capital, and mutuals are more interested in compensation for the level of volatility assumed in the portfolio, subject to an end range set by their binding capital constraint. These are generalizations, and the right objective is determined after consideration of all the alternatives by the senior management team.

**Clarity of Timeframe:** The investment horizon for investment decisions should be longer term, but explicit (e.g. 3-years, etc.).

**Proper Selection and Calibration of Constraints:** Companies will select constraints and set their levels without regard to changing circumstances or understanding the costs at a given time. Sensitivity analysis is the radar that is used to navigate through these uncharted waters, as demonstrated in the following example regarding refinement of a portfolio objective.

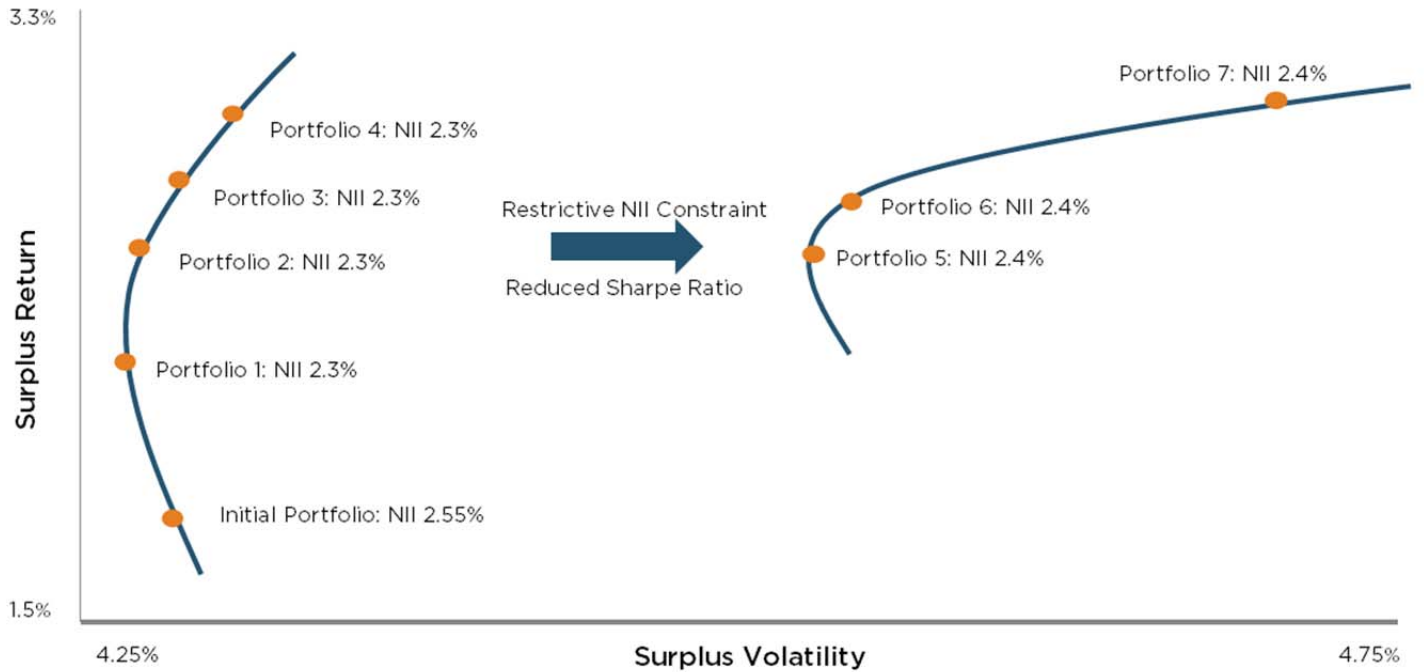
A European general insurance company seeking to optimize surplus growth, with a portfolio concentrated in high grade

bonds, conducted a rebalancing analysis with a constraint of maintaining NII. Participants expected that the introduction of higher return, diversifying assets would increase returns while reducing volatility. Accounting conventions in Europe mark portfolios, so reported volatility is a reflection of economic reality. When the team examined the NII constraint as part of the company's EDI framework, it became evident that the limit was, in this case, extremely expensive. Strict adherence would have consumed 40-60% of the improvement in Sharpe ratio, whereas minuscule relaxation eliminated the adverse effect altogether ([Exhibit 3](#)). NII stability is critical to public market valuation, but investors will accept some wiggle when firms have a solid track record of profitability. Ultimately, senior management and the regulator agreed to the small reduction in NII based on the analytical evidence that the EDI framework provided.

**Establishment of Investment Skill Metrics:** Legitimate performance evaluation of both internal and external managers remains one of the most challenging and increasingly important design requirements in insurance asset management. It is essential to address this policy at the time management sets the enterprise portfolio objective, rather than as an afterthought or not at all. Many companies estimate returns for peer comparison purposes. These calculations can be helpful for financial analysis but, for many reasons, should not be confused with a credible evaluation of investment skill.



**Exhibit 3**  
Effects of NII Constraint



*\*For Illustrative purposes only*

Of particular importance is the consistency of performance criteria, at various levels of responsibility, with the overall objective. The form of the objective itself will dictate how skill measurement should take place. For example, an objective that defines return as absolute yield or NII should include indicators of anticipatory skill in credit quality. There are numerous approaches that exceed the scope of this article. Some additional examples are summarized below.

- Estimate strategic performance by calculating the value of departing from a model portfolio constructed with enterprise constraints and the returns implied by market pricing.
- Achieve enterprise customization through asset allocation, rather than asset class portfolio construction, using beta portfolios, hedging and

overlay strategies to manage RBC, liquidity, and ALM. This approach enables asset class performance scrutiny using conventional measures, including attribution analysis that reveals “alpha” sourced from outside a benchmark.

- When customization must take place within asset classes, create small total return carve-outs to evaluate investment skill unconstrained by the enterprise.
- For actively managed sleeves, execute tax and earnings-driven gain/loss recognition in predetermined months for which returns are assumed to have been equal to the benchmark for performance evaluation purposes.

The central point is that skill can, and should, be measured while maintaining consistency with the company’s customized portfolio objective.

**STEP 3:** Establish a strategy to meet the portfolio objective with full consideration of the impact on factors not directly expressed in this objective.

A portfolio objective expresses an insurer's most important return and risk measurements. The challenge in Step 3 is balancing the portfolio objective with other important financial parameters, all of which are dynamic. One response to this challenge has been portfolio optimization with multiple constraints. While helpful, relying on a single output from these analyses has weaknesses, including (1) introduction of black box risk and naïve precision, (2) failure to consider important variables and, most importantly, (3) masking the relative significance of various assumptions and financial relationships.

As a practical decision making tool, EDI avoids these weaknesses by highlighting the collateral impact on key trip wires from changes motivated by the portfolio objective. While all companies estimate the changes in portfolio strategy against the portfolio objective, many do not grasp the shadow-pricing sensitivity of the objective to variation in constraints or, conversely, are blind to the impact of rebalancing on the full set of financial variables. For many companies, this sensitivity is both substantial and unknown. Managing sensitivity, to self-imposed limits, in particular, advances EDI from a passive to an active philosophy.

## Second Layer of Customization Based on Company Specifics: Liquidity Example

Consider the following hypothetical case study regarding liquidity requirements. Three public companies are direct competitors in a buyer's market in the cycle. They choose investments from the same set of capital market sectors, endorse the same metrics for portfolio return and risk, use identical policies for minimum liquidity (a three standard deviation liquidity event for the core business and portfolio), have strong cash flow, enjoy the same access to abundant contingent liquidity (bank facilities, repo market, accommodative monetary policy, etc.) and rely on an EDI framework.

Selection of the liquidity constraint for evaluation was not arbitrary. This limit was chosen because the financial system was assumed to be providing additional headroom to internal, substantial sources of liquidity. The question here is: "How much value does this excess liquidity manufacture for the portfolio objective?" In other circumstances, the question could be how to best increase the liquidity buffer, or release capital, or improve debt ratings, etc. EDI is a flexible approach for management to understand the interaction between the portfolio objective and other financial priorities, not a formula to establish which such relationships deserve a review.

As shown in [Exhibit 4](#), companies A, B, and C differ in their capital market outlook and, for this reason, efficient frontier (assuming they use the same model). As

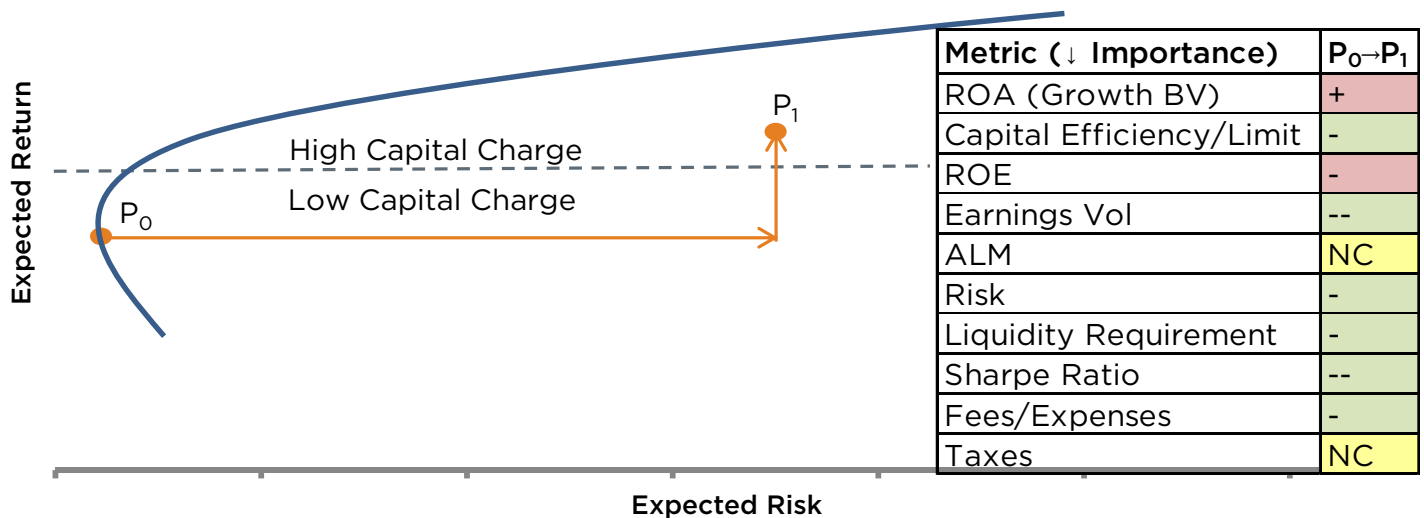
described below, they have different capital and liquidity positions, and asset allocations. The starting points, in the range of acceptability, for each of the other financial factors in the adjacent tables also varies by company, as indicated by color. Despite all the segment similarities, these contrasts result in a different stacking of priorities, which also impacts future direction.

*The way to view this information is to compare the magnitude of portfolio improvement against the table of factors, especially those that are critical (high in the table), start from a low score (red) and, as a result of the rebalancing, deteriorate ("--").*

**Company A:** This is a company with well-diversified portfolio and substantial capital

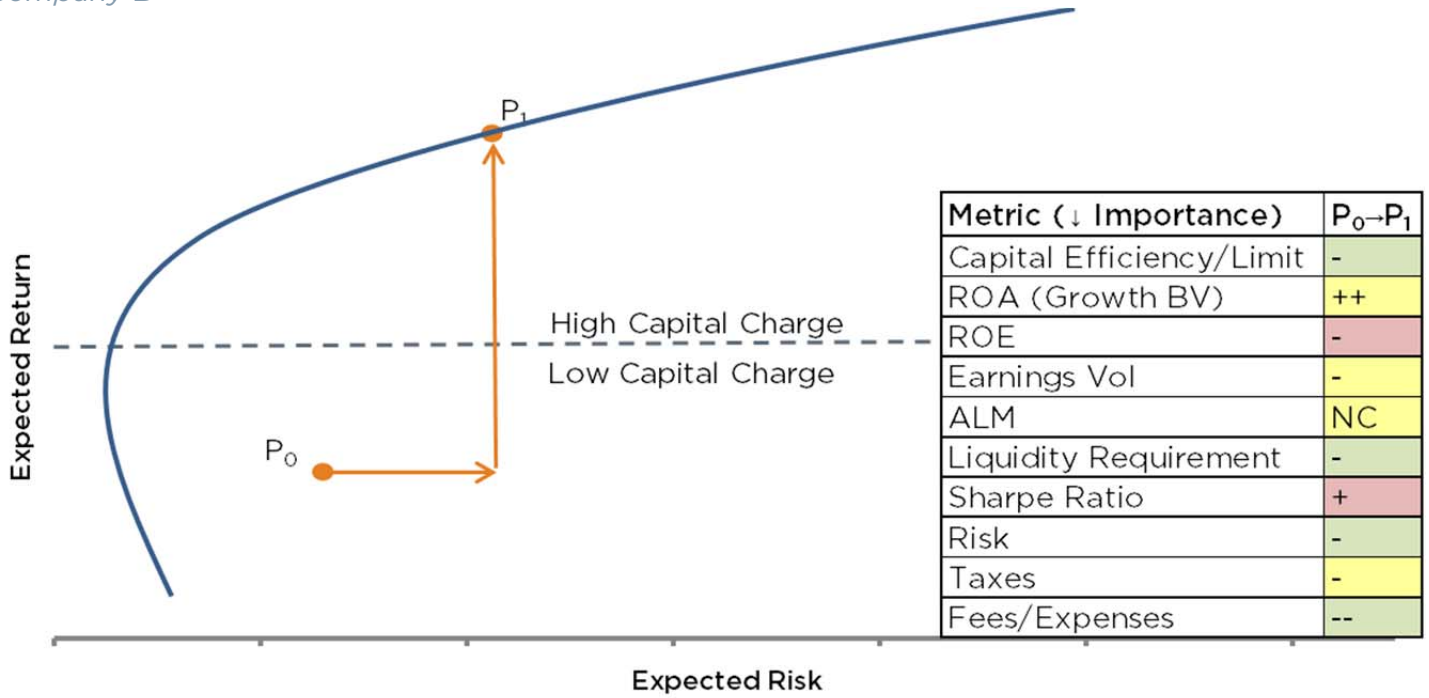
that can tolerate some loss of diversification. The portfolio would gain absolute return with a modest direct holding of real estate equity. As shown, the increase in return is relatively small, requires a disproportionately large increase in risk, and comes at the expense of other factors shown in the adjacent table. This rebalancing constitutes a marginal argument for the use of excess liquidity, which should lead to an expanded discussion of other possibilities tied to the core business. For example, is the excess balance sheet liquidity better deployed for attractive premium financing to clients? EDI often guides the dialogue to another place, rather than concludes with a decision.

**Exhibit 4**  
Company A

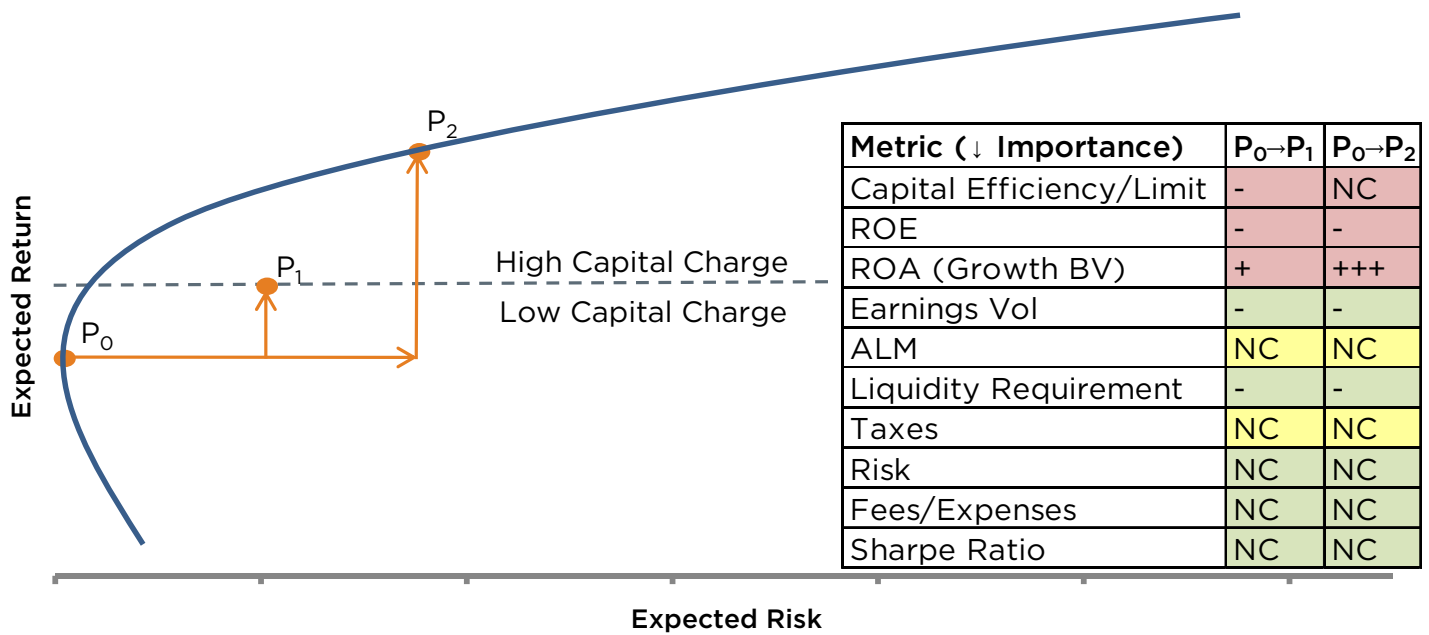


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Company B



Company C



**Company B:** This company has excess capital and, for this reason, and because of the weak insurance pricing, is considering a share repurchase. The Investment Committee has

concentrated the portfolio in liquid high grade corporates and sovereigns. In the capital market, there is a significant discount to NAV for secondary private equity due to

technical factors. Reduction in the liquidity requirement allows a rebalancing that captures substantial return through (1) the attractive illiquidity premium, and (2) a higher returning asset, while also improving diversification. As the table shows, this portfolio change would lead to meaningful improvements in both book value growth, from a mediocre rate, and the Sharpe ratio, from a low point. However, it also creates more risk in ROE, to which management has assigned above-average importance. In certain cases, the greatest benefit of EDI is to identify the most important question. Do Company B's investors have a long-term horizon that will place more value on the significant improvement in book value, or will the risk to ROE and near-term benefits of a repurchase program have more importance?

**Company C:** Company C has a well-diversified portfolio. But its RBC is low, and this limits the private market options to high-grade debt markets, making the rebalancing exercise more tactical than strategic. The illiquidity premium in this sector is historically low, despite light covenants, due to dominance by absolute yield buyers. Management can obtain an unimpressive gain in return from this small increase in yield spread. Although the company will realize a trade-off similar to Company B, the scale is much less impressive. While success can come from a series of small wins, management also needs to recognize the uncertainty associated with their projections. A potentially larger scale result (P2) for Company C is described in Step 4.

**Step 4:** [Explore ways to improve tradeoffs through higher order changes.](#)

EDI begins by creating a comprehensive set of company-specific financial considerations, then establishes priorities (including the portfolio objective), and forms investment strategy after highlighting relationships between these variables regarding direction and leverage, through sensitivity analysis. In its most advanced form, creative reengineering resets trade-offs to a more favorable state and forms new ones. A few categories for these ideas are summarized below, but the opportunities are by no means confined to these topics.

### Improved Capital and Tax Efficiency

Several strategies have been designed to increase returns, reduce volatility, improve portfolio diversification and, most notably, reduce the capital charges for those asset classes with high capital charges in their conventional form. These benefits are achieved through structured finance, credit backstops, placing assets in unconsolidated entities while channeling their returns to the parent company, or with insurance wrappers. Similar strategies have been available in different forms for decades. But they have proliferated, through the marketing equivalent of an engineering arms race, as a less risky response to the low yields now deeply embedded in portfolios. Various rulings have also reduced the tax and accounting risks. Company C in our liquidity example is an excellent candidate for the introduction of a structured response that offers capital efficiency. By purchasing private equity with an ICOLI wrapper, the Company creates capacity and can enjoy the

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same rebalancing benefits as Company B in [Exhibit 4](#).

These vehicles also represent a potential way to address a major conundrum associated with solvency investing for highly regulated industries: the pairing of projected asset class returns using deterministic scenarios (or pricing distributions) that include non-tail events, with capital charges based on disaster scenarios exclusively. Portfolio objectives to maximize return on capital using asset class inputs having this mismatch will, if realized, produce economically suboptimal portfolios. Like derivatives, these capital enhancement strategies mitigate this shortcoming, while still meeting critical objectives for financial strength, by syncing the trade-off between expected return and capital charges with a more consistent relationship. In some cases, tax efficiency is also achieved.

While these restructuring strategies have merit, they are by no means a panacea. They are complex, sometimes carry high fees, often have limitations in scale, and are difficult to compare using common criteria. For some, these considerations in combination with the due diligence time and expense, and residual tax/regulatory/accounting risk, may offset the benefits. For others, like Company C, these considerations are more than offset by substantial portfolio improvements.

### **Bifurcation of Assets Based on Line of Business Volatility Rather Than Asset Class Volatility**

One common practice with LDI is to separate assets between those that are

liability supporting and those that are performance enhancing assets. Describing assets in these broad terms is a helpful communication technique. However, EDI does not advocate separate management of liability and performance portfolios. Although this is an appealing characterization due to its simplicity, the boundary creates enterprise inefficiencies regarding diversification, risk factor concentration, ALM, and tax management.

A more interesting and potentially valuable balance sheet separation is the full partition of reserves and capital based on the volatility of the lines of business. Public shareholders reject the principle that higher equity returns carry with them more uncertainty. This behavior leads public companies writing inherently volatile lines to purchase reinsurance despite being overcapitalized, and recognized for this financial position with high claims reliability ratings.

Holding companies can own both public and private underwriting entities subject to full regulatory oversight. Such organizations can establish multiple benefits by offering volatile lines through mutuals or privately owned companies, and lines of business with a narrower distribution of outcomes through their public entities. The potential benefits include the option of investing in higher returning assets while retaining high claims and debt ratings, increasing ROE and valuations for the public entities, reducing costs, and greater pricing competitiveness.

## New Approaches to Asset/Liability Management (ALM)

There are many untapped investment opportunities in the area of ALM. Structured finance experts should create bespoke products that improve ALM, in the same way they have used their expertise for capital efficiency. Also, characterizing claims patterns with risk factors or economic conditions creates the option of hedging certain liabilities with conventional securities. Presently, many companies limit their ALM programs to interest rate exposure despite underwriting much more than the risk associated with the time value of money. ALM should apply to more than rate hedging. The basis risk associated with ALM v2.0 can be reinsured, transferred to the capital markets, or retained by clients. For example, inflation risk for long-tail P&C lines can be reduced by providing clients the option of lower premiums in return for discounting future claims by an agreed upon inflation index, and simultaneously offering a pooled inflation-hedging vehicle in a separate account. This choice is no different than presenting different deductibles, coverages, etc. Customers decide the form of risk transfer most valuable to them. An EDI management philosophy reveals these opportunities.

### Summary

Adoption of EDI principles provides an effective blueprint for creating an appropriate portfolio objective and balanced strategy based on full consideration of the enterprise's segment profile and particular circumstances. Along the way, executives obtain a richer understanding of the trade-offs that define

financial management of their company. This understanding is attained through guided discussion, and from quantitative output that supports management decisions but does not give "the" answer. Finally, management implements EDI through teamwork involving all functional areas, which increases the scope of each member's enterprise knowledge, their value to the company, and personal opportunity for growth.

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**AUTHOR**

Bill Poutsiaka  
[wpoutsiaka@comcast.net](mailto:wpoutsiaka@comcast.net)

**NEW YORK OFFICE**

320 Park Avenue, 20<sup>th</sup> Floor  
New York, NY 10022

**HARTFORD OFFICE**

One State Street, 20<sup>th</sup> Floor  
Hartford, CT 06103

**INQUIRIES**

Gillian Tullman  
Director of Investor Relations  
and Marketing  
[gillian.tullman@qweiss.com](mailto:gillian.tullman@qweiss.com)  
+1 212 390-3451

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