BEST'S REVIEW® ISSUES & ANSWERS:

• Environmental Risk

• CEO Perspective

• Asset Allocation

Industry professionals discuss the current state of the environmental liability market, the future of the reinsurance business and asset allocation strategies.

Interviewed Inside:

Ann Bryant
Barings

View past Issues & Answers sections at
www.bestreview.com/issuesanswersarchive.asp

Asset Allocation Strategies

Ann Bryant, Head of the Insurance Solutions Group for Barings, said that when it comes to the strategic asset allocation process, the models are only as good as their inputs. "So you need to take that with a grain of salt," she said. Following are excerpts from an interview.

BARINGS

- A $387 billion global investment management firm
- A subsidiary of MassMutual

Ann Bryant
Head of the Insurance Solutions Group
Barings

"If some liquidity can be given, then strategic asset allocation can enhance yield without sacrificing other components of risk."

Go to the Issues & Answers section at *www.bestreview.com* to watch an interview with Ann Bryant.

Can insurers enhance yield without taking on more risk in their asset allocations?

Yes, they can. I think one key thing there is the definition of risk. If we are talking about volatility, that is one thing. Liquidity is another. Default is a third, it really does depend on your definition there, but we do believe asset allocation can offer investors an opportunity to enhance yield without taking on more default risk. It can also reduce volatility in the process. Often, though, insurers need to sacrifice something, and, if there is room, liquidity.

What are some recent asset allocation strategies that insurers are considering?

When it comes to illiquid private assets, those strategies have been considered for some time, especially by life and annuity writers, and now even by property/casualty—although property/casualty insurers typically require more liquidity. Insurers have been considering commercial mortgage loans, private placements, infrastructure debt,and investment grade type private assets—where they can get diversification in their portfolio and enhance yield, while potentially taking on less risk because the covenants are negotiated privately and can be tighter than with public investments.

Can you explain the strategic asset allocation process, including liquidity and other asset liability management considerations?

Strategic asset allocation (SAA) is a modeling process. Models are only as good as their inputs, so you need to take that with a grain of salt, in some ways. Also, models are meant to be directional. Even so, taking in the information about the liability to develop constraints around risk parameters—such as how much can be in illiquid assets—can help identify an optimal solution. Also, with regard to asset liability management, because most SAA models do not incorporate the liability cashflows directly, you can use duration, convexity, and key rate duration to try to match those cash flows as well as possible to reduce that type of liquidity risk and to be able to have cash flows to pay off the liabilities as needed.

Do solvency rules come into play when considering asset allocation?

Yes, they do. Solvency is a broad term, and I would argue that all of the regulations are about solvency and making sure that insurers are solvent. I think, though, when that specific term is used, it's often thought of with regard to the European regulations, so Solvency II. Then, also, in Bermuda, the solvency rules there. Really, the key difference that that points out between the United States and other parts of the world is that the discount rate includes the yield on assets under a solvency regime. In the U.S., the discount rate tends to be more of a prescribed rate, versus a yield on the assets themselves. In the rest of the world, the yield on the assets themselves is used to calculate the liability, so there is an extra benefit from yield enhancing assets under a solvency regime. That folds into the overall SAA process.

Share this edition at ***www.bestreview.com/issuesanswersarchive.asp.***