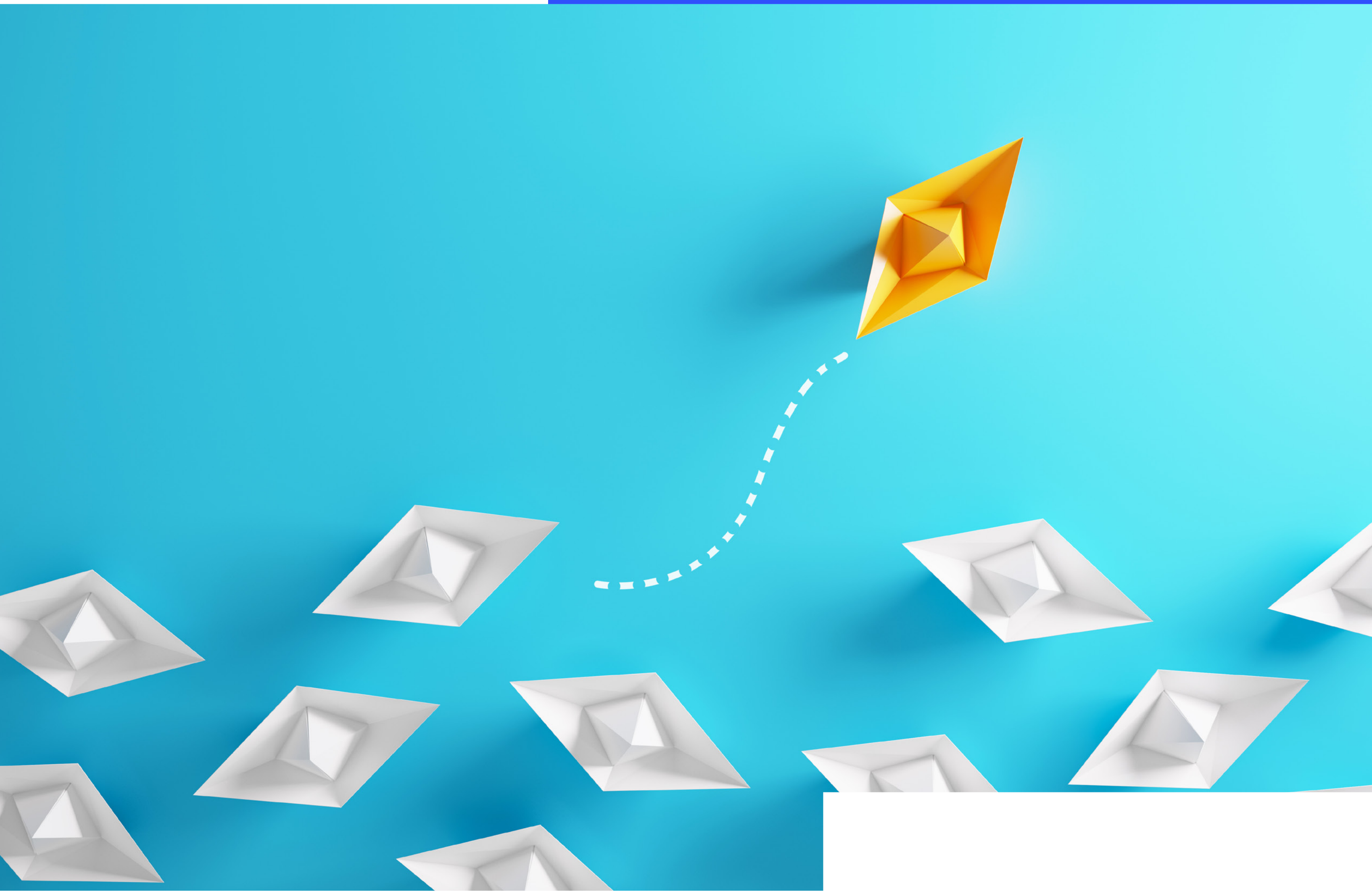

SHIFTING APPROACHES

Insurers turn to internal and external talent strategies to broaden their investment platforms

A Caldwell Whitepaper

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Insurers turn to internal and external talent strategies to broaden their investment platforms

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Years of low returns from treasuries and investment grade bonds are leading insurance companies to expand their portfolios beyond those foundational investments into alternative investments, especially private market assets. Insurers are increasingly willing to view asset management strategies as a central tool for enhancing profitability. This broadening of insurer risk and liquidity exposures across a wide range of assets, including private equity, private real estate, direct lending, and infrastructure assets, has been underway for a few years.

Insurer exposure to those riskier assets increased by 3.3% during 2018, according to the National Association of Insurance Commissioners, while assets outsourced to unaffiliated managers for investment in hedge funds, private equity, and real estate increased by 9%. Both trends have significant implications, for the companies themselves, as well as the sector.

The challenge for insurers, of course, is that while private debt, bank loans, structured finance, and commercial real estate debt and equity have the potential to generate higher returns, expertise in those asset classes is typically not resident among insurance company asset management teams. Additionally, sector regulation applies capital efficiency standards to insurers, which means that any assets managed for insurers must also comply with overall portfolio efficiency targets. This standard for insurers is unique in the asset management sector, which potentially limits the population of qualified asset managers for insurer needs.

While pension funds, college endowments, family offices, and other institutional investors seeking greater returns have already beaten a steady path into private market assets, insurers are later to the market, thanks to regulatory limits for exposure to these asset classes. Insurers must balance their entries into higher yield assets with their obligation to prudent management and mitigation of risk. So, this controlled climb up the

REGARDLESS OF THE PATH INSURERS CHOOSE TO EXPAND THEIR PRIVATE MARKET ASSETS, MOST WILL NEED TO UPGRADE THEIR INTERNAL FINANCE, ACCOUNTING, RISK, AND COMPLIANCE ORGANIZATIONS TO HANDLE THESE NEW ASSET CLASSES FROM AN ACCOUNTING AND REGULATORY PERSPECTIVE.

risk and liquidity ladder presents a few challenges—especially talent management challenges—for insurers.

Our ongoing work in the insurance and asset management sectors provides us with a continuing dialog with a highly skilled and innovative population of sector professionals. We understand the business goals of insurers, and we have developed valuable insights to the talent solutions.

TENSION POINTS

In broad strokes, insurers choose from three strategic paths when it comes to accessing management capability in these targeted asset classes. An insurer can seek to add managers with the desired areas of expertise to the company's internal asset management team; the insurer can outsource the management of specialized asset classes, perhaps to an insurance-focused manager; or the insurer can acquire a money management firm or recruit a team to manage the insurer's private market assets, potentially developing a new line of business in managing assets for other clients. The size of the insurer, its current business model, and the cost/benefit analysis of paying fees to external managers versus the cost of managing the assets internally will all be significant factors in these decisions.

Yet, there are tension points to watch when assembling this new asset management team. Not only must insurers identify the right level of additional risk, they also need to achieve a business and cultural fit between their existing asset managers and the enhanced performance management team. To work together effectively, whether internally or externally, all asset managers will need a technical understanding of insurance, including the regulatory and accounting nuances, to avoid stepping across critical lines.

The risk appetite and potentially the investment mindset would differ between the traditional managers and the alternative investment managers. And it would not be surprising for subtle competition to develop between asset classes. Afterall, every asset manager worth his or her salt is competitive regarding performance. Suffice to say, repositioning an insurer's asset management strategy and team is not a simple process, but rather somewhat akin to turning a battleship.

CURRENT MARKETPLACE ACTIVITY

For insurers, the defining questions become: How will the management of these new asset classes best fit in with the company's current business model? And should asset management be a revenue stream or simply a cost center? Insurers are already a diverse group when it comes to asset management. For instance, Chubb outsources all asset management to outside managers. Conversely, New York Life manages most of its assets inhouse. And MetLife has chosen to build a third-party asset management business, managing assets for its own balance sheet, as well as for other clients.

Other insurers that have expanded their asset management capabilities include

TIAA, which owns asset manager Nuveen. AIG is considering re-adopting the third-party asset management model, after exiting that business in the wake of the financial crisis. In addition to helping offset the costs of asset management, the third-party model allows insurers in the retail space to cross-sell a variety of investment products to their insurance clients. And yet, insurers that manage all assets internally without a third-party asset management business can also be cost-effective, especially when delivering superior performance.

Private equity firms have taken an interest in insurers as a source of capital, with a number of PE sponsors acquiring or partnering with insurance companies. The relationship is nearly symbiotic. While insurers seek enhanced investment performance, PE firms happily tap the continuing stream of premium dollars that can become investment dollars.

In other situations, insurers are doing the acquiring, or taking ownership positions in businesses that work in a targeted investment area. For instance, AIG, TIAA, and Aflac all have acquired or taken a position in a company or team with expertise in the area of direct lending.

Not surprisingly, more than a few asset management firms are responding to this expanding opportunity by amplifying their understanding of the insurance industry and creating dedicated investment products that will both meet the performance goals of insurers and the regulatory standards of the sector. Managing insurance assets requires an alternate investment lens than the usual singular focus on beating a market benchmark. BlackRock's 2018 Global Insurance report finds that 35% of respondents fully outsource management of their private market holdings, while another 52% outsource that management partially, according to the survey's 372 respondents.

Insurers increasingly are hiring 'managers of managers' to retain and supervise external relationships with these specialist asset managers. These roles often are broken down by market segment, so one leader might specialize in PE and real estate investments and managers, while another focuses on credit and fixed

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income. One Caldwell insurance client that was growing its PE and real estate platform hired a leader both to increase allocations to funds and to handle more co-investing and direct investing.

Regardless of the path insurers choose to expand their private market assets, most insurers will need to upgrade their internal finance, accounting, risk, and compliance organizations to handle these new asset classes from an accounting and regulatory perspective. External asset managers also may need to upgrade some functions in order to sell products to insurers, but generally the upgrading requirements will be more significant for insurers.

TALENT PROFILES IN DEMAND

Threading the eye of this narrow talent needle requires identifying investment professionals that understand the insurance balance sheet while also having expertise in more sophisticated asset classes.

These specialized asset class managers, who might come from investment banks or asset management firms, often draw higher compensation, and these managers will be carefully considering the attractiveness of an insurance role and its value proposition. Additionally, the cultural fit on the asset management team should not be overlooked, nor the need to have the right talent team in place to manage a more volatile credit or rising interest rate environment, if one arrives.

The COO role is also front-and-center at this time, as the COO plays an important role in this asset management transition for insurers, often leading the development of corporate strategy and acquisition plans. Chief Risk Officers and boards of directors may also contribute significantly to these discussions and decisions.

Other roles in demand include CFO, investment accounting, and compliance roles, responding to the need for insurer finance groups to be able to properly assess and manage a broader investment product universe. These leaders often come from the pension space or other asset managers.

Caldwell has a proven track record of successful partnership with insurers and asset managers that have grown and diversified their organizations around these trends. As we assist clients in achieving innovative strategies by identifying forward-thinking and highly skilled talent, we also take an experienced measure of a candidate’s cultural fit with the organization. While this investment policy shift offers new opportunities for insurers, they also shoulder an important obligation to risk mitigation. Caldwell provides significant experience in the risk/reward assessment of leaders and talent strategies.

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WE BELIEVE TALENT TRANSFORMS

At Caldwell we believe Talent Transforms. As a leading provider of executive talent, we enable our clients to thrive and succeed by helping them identify, recruit and retain the best people. Our reputation–nearly 50 years in the making–has been built on transformative searches across functions and geographies at the very highest levels of management and operations. We leverage our skills and networks to also provide agile talent in the form of flexible and on-demand advisory solutions for companies looking for support in strategy and operations. With offices and partners across North America, Europe and Asia Pacific, we take pride in delivering an unmatched level of service and expertise to our clients

Understanding that transformative talent is not limited to executive levels, our Caldwell Advance solution focuses on emerging leaders and advancing professionals who can also have a profound impact on a company's ability to turn potential into success. We also leverage our skills and networks to provide agile talent solutions in the form of flexible and on-demand advisory solutions for companies looking for support in strategy and operations. Also, we are a leading licensed certified partner of The Predictive Index (PI), an award-winning talent optimization platform with a suite of talent strategy and assessment tools that – when integrated with our search process – helps clients hire the right people, then manage and inspire them to achieve maximum business results as fast as possible.

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