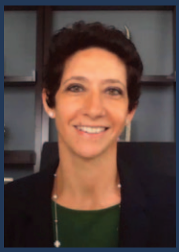
BEST'S REVIEW® ISSUES & ANSWERS:

• Asset Management

• Risk Analytics

Industry experts discuss investment strategies in an inflationary environment; the role of real estate in insurers' portfolios; and how advanced analytics are helping insurers with risk management.

Interviewed Inside:



Allison Weisnicht
AAM

John Ockerbloom
Barings

Salil Donde
Ventiv Technology

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Alternative Asset Classes

Allison Weisnicht, CFA, Senior Portfolio Manager for AAM, said the best part of owning convertible bonds in an insurance company portfolio is the regulatory and statutory accounting treatment that they receive. “Convertible bonds are carried on the Schedule D, just like traditional fixed income, and they also receive favorable RBC treatment,” she said.

AAM

Allison Weisnicht
CFA, Senior Portfolio Manager
AAM

“At AAM, we believe in working with our clients to establish a duration target based off of their line of business and/or their risk tolerance.”

Visit the Issues & Answers section at *www.bestreview.com* to watch an interview with Allison Weisnicht.

How are you managing your clients’ portfolios under the current rate of inflation?

We think inflation has likely peaked at this point, and we would expect to see it moderate in the coming months but remain at historically elevated levels through year-end. Interest rates have risen quickly in anticipation of the Fed hiking short-term rates this year. The futures market is pricing in a 2.8% Fed funds rate by year-end. With the curve so flat, market participants fear that the Fed will raise rates to the point of pushing the economy into a recession. The biggest impacts that fixed-income investors are facing today are rising interest rates as well as a possible deterioration in fundamentals of corporate issuers should recession possibilities increase. As for mitigating the risk of rising interest rates, we’re advising our clients to explore opportunities in alternative asset classes, particularly those offering floating rate debt, as well as downside equity market protection.

Which alternative asset classes are most advantageous given the current environment?

On the debt side of the market, asset classes like high-yield bank loans and direct lending offer floating rates with coupons that reset as interest rates rise. These debt instruments have a shorter duration profile than we typically see with traditional fixed income and help cushion the impact of rising rates and, hence, income. They are a great complement to an investment-grade fixed income portfolio, and offer higher yields than a traditional bond portfolio given the illiquidity. Turning to the equity side of the market, we prefer the equity-like asset class of convertible bonds. A convertible bond offers an equity-like return with a lot less risk than a direct equity investment. Downside risk is limited and defined, but the convertible bond still has the ability to capture upside performance if the underlying equity appreciates. They are a great complement to a fixed-income portfolio in that they have a low correlation with traditional fixed income and they outperform fixed income over the long run, particularly in a rising rate environment.

How does the Fed-tightening cycle affect an insurer’s portfolio, and what are the corresponding actions you advise in response?

Insurance companies are very highly regulated on both the state level as well as by the NAIC. The vast majority of their portfolio holdings are required to be invested in investment-grade bonds. The biggest downside an insurer faces during a Fed-tightening cycle is the negative impact of rising interest rates. Luckily, due to the statutory accounting treatment that insurers’ portfolios receive, a large number, if not all of the bonds, are carried at amortized cost, and they’re not mark-to-market, meaning as long as these bonds are not sold, the unrealized loss will not affect the insurer’s income statement or surplus. We maintain a disciplined duration management style and do not try to turn interest rates. Instead, we have added these high-quality floating rate debt securities to enhance income in our clients’ portfolios. For those clients whose risk tolerance allows for an allocation to the equity markets, we’ve added convertible bonds to provide downside equity market protection.

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Investing in Real Estate

John Ockerbloom, Managing Director and Co-Head of U.S. Real Estate at Barings, said ESG within the commercial real estate industry is very much a focus, particularly on the equity side, also on debt. "Sound ESG practices are a critical piece of effective real estate investing. It's not an either/or," he said. Following are excerpts from an interview.

BARINGS

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- Committed to creating a more sustainable future

John Ockerbloom
Managing Director and Co-Head of U.S. Real Estate
Barings

"We're seeing more investor interest from the insurance channel in closed-end funds with higher return of thresholds."

Visit the Issues & Answers section at *www.bestreview.com* to watch an interview with John Ockerbloom.

What is the role of real estate in insurance portfolios?
Real estate is an income-oriented asset class. It has inflation-protection characteristics. So far as you're able to reset your rent periodically—for apartments every year, for hotels every day, for office buildings maybe every three to five years—there is an inflation-protected income stream that matches up well with many of the liabilities of insurance companies. It also has growth characteristics, particularly on the equity side. You can match current liabilities as well as longer-dated liabilities within the portfolio. It's a multipurpose tool for insurance companies, and we're finding that to be more the case every day.

How are insurance investors accessing this asset class?
It really depends upon size. Many insurance companies are participants in funds, which can be focused on real estate debt or real estate equity and span the risk-return spectrum. Open-ended funds have periodic liquidity and are generally more income-focused, whereas closed-in funds—which have more closed-end periods, as the name implies—tend to be more focused on growth. So, there are many different options available for insurance companies to access the asset class, both in debt and equity. For larger investors, separate accounts are a frequent point of access.

What are some real estate allocation trends among insurance investors?
On the equity side, we are seeing greater interest in value add from an investment standpoint. We've had a lot of activity from insurance investors seeking to be more oriented toward total return as opposed to income focused. From a debt standpoint, insurance investors have historically been substantial investors in mortgages on very high-quality commercial real estate assets, so very secure, very stable, very safe. More recently, we are seeing insurance investors expand their purview, both on the fund side and the separate account side, as they seek additional return within the debt space. That may take the form of construction lending, as an example.

What do you see as next for insurance investors in their ESG journey?
ESG within the commercial real estate industry is very much a focus, particularly on the equity side, but also on the debt side. By nature, real estate is a long-dated asset class, and we need to think about where assets will fit in the marketplace over a long period of time. To the extent that you are not focused on the ESG elements of an asset, you almost by definition cannot be doing effective and modern design. In that capacity, ESG has really become woven into the fabric of real estate investing.

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Advanced Analytics

Salil Donde, CEO of Ventiv Technology, said decision science is a much broader area than simple analytics. “I think that’s the area that’s the next trend. I think it’s going to drive pretty significant returns for companies that embrace it,” he said. Following are excerpts from an interview.

ventiv TECHNOLOGY

What are some of the top areas of innovation in the risk management space?

First and foremost would be the concept of improving efficiencies as symbolized by straight-through processing, which has reduced costs and expenses in our industry quite significantly. The second is digitalization as it pertains to data and as it pertains to processes. Digitalization has sped up claims settlement, information gathering, and delivery of the information to the right people. The third area that I think is just now coming up is what I refer to as decision sciences. It’s the ability to make decisions. It’s the ability for technology to provide you with options that you can choose from, that you make a decision from, or, in some cases, for the technology itself to prescribe a decision for you.

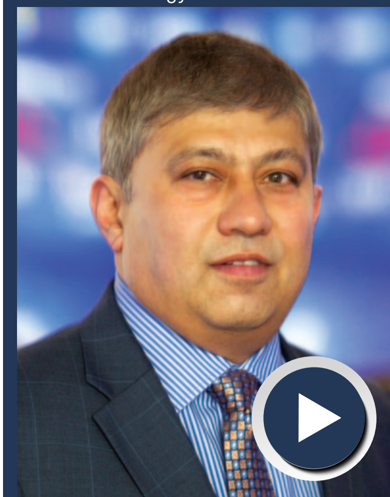
What types of analytics offer the greatest impact to insurers, brokers, and TPAs?

The insight that drives a business outcome, the insight that delivers a true return on investment. To give you an example, one of our customers uses our predictive analytics from our decision sciences tool set to understand the cost of a claim if it were to go into litigation versus if it were to not go into litigation. What they found is that a litigated claim in some cases could be as high as 50 times as much as a non-litigated claim. As soon as they get the information, our system flags for them the propensity of a claim to go to litigation or not. Based on that information, you can assign the right adjuster to adjudicate the claim based on the experience of the person. There are direct savings stemming out of it.

Do you think advanced analytics are the best tool in identifying a complex risk?

Advanced analytics encompasses a whole spectrum. There are different tools in the spectrum. Which tool you apply to the problem can drive real value. There are some problems that can be solved with predictive analytics. Some can be solved with just simple statistical analysis. As we all know, there are a significant number of data elements, a significant number of events that lead to a risk event. The human mind simply can’t comprehend all those variables. Therefore, a machine can leverage these, identify the right solution, and give insights into the unknown for your decision making. So it depends on the problem.

Salil Donde
CEO
Ventiv Technology



“Ventiv has the ability to use the right type of analytics for the right problem.”

Visit the Issues & Answers section at *www.bestreview.com* to watch an interview with Salil Donde.

How do analytics differentiate Ventiv from other RMIS and claims administration providers?

At the root of it, most risk management information systems or claims processing, claims administration systems are workflow systems. Pretty much every company out there has the right workflows, the right user interfaces, the right dashboards, and the right reports. What really separates the leaders from the others is the ability to provide decisioning tools supported by decision science tools or analytics. That’s where Ventiv shines. Ventiv goes beyond providing a dump of data and instead provides actionable insights. Where Ventiv really excels is taking the rich data that we get and coming up with insights for our customers. That’s what sets Ventiv apart from our competition.

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