

### Hard questions must be asked on investments



Now that the dust from the financial crisis is settling, insurers must be prepared to make critical decisions about the future of their investment strategies. This will likely result in fundamental changes to the way the industry manages its asset portfolios, says Sherry Manetta, director of consulting services at Conning.

"Now is the time for insurers to ask hard questions about what got them here," Manetta told the *IIS Reporter* in Amman, Jordan yesterday. "Clearly the capital markets situation, no matter what companies were doing, was going to affect them. They must ask some tough questions about their investment process and if it is being optimally managed."

Over the past couple of years companies were reaching for yield, so much so that they reached a stage where their risk and reward was 'totally out of whack' with their overall strategy, Manetta says. She adds that companies are starting to talk about operational risk within their risk management strategies.

"As a third-party asset manager and strategic consultant, we are there to look at a firm's risk appetite, look at the structure of its investment portfolio and what happens in its asset allocation," she says. "Firms need to bring a process in place to evaluate when deviations from the benchmark occur."

"We hope to see companies focusing on risk tolerance and have a more dynamic process where they look constantly at integrating what is happening on the liability side with what is happening on the asset side."

Most insurers have been affected by the financial crisis in some way, whether through direct investment losses, mark-to-market accounting or liquidity effects, and have been frantically de-risking their balance sheets by pulling out of certain riskier asset classes, which had been gaining popularity in the industry such as equities, hedge funds, and other alternative investments, in order to redeploy their capital in low-risk, low-return areas, like government bonds.

"The biggest risk insurers face is liquidity risk," says Manetta. "They are de-risking but the question is how fast they can do that and at what pace they can take toxic assets off their balance sheets."

Instead of the alternative investment strategies previously favoured by the industry, insurers are building up cash and short-term investments in an attempt not to sell assets with unrealised losses attached to them.

While banks have struggled to maintain liquidity by de-risking their portfolios and selling assets at reduced prices, insurers have been able to hold back and wait for value to return to their asset portfolios. Maintaining cash has also given insurers the flexibility to support their liquidity without being forced to sell assets.

"Life and annuity insurers were hit hard by the crisis and the potential for higher lapse rates and surrenders and were not certain of their cash flow in the short term," says Manetta. "That interplay between liability and assets got lost when companies were managing their asset portfolios. It is important to look at the underlying business and have an asset strategy that makes sense."

However, Manetta adds that the industry still has a long way to go to get from where it is today to achieving its long-term strategy.