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INSURANCE FROM THE INVESTMENT ANGLE

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CONNING CIO RICHARD SEGA EXPLAINS WHY HIS MOTTO IS: FIRST, DO NO HARM.

Richard L. Sega is the chief investment officer at Conning, where he is responsible for portfolio management and trading at the Hartford, CT-based insurance asset management firm. We invited Sega for an interview in January, shortly after Conning had completed a remarkably successful year during 2008 in the face of the financial crisis by recording a 10% increase in assets under management (specifically, non-affiliated general account insurance company assets, the key marker for measuring insurance asset managers). Sega's background and training is actuarial. He graduated from Fordham University with a degree in mathematics, earned an MA in statistics from Columbia University, and is a member of the CFA Institute. After starting out as a pension actuary, he eventually switched to the investment side and was president and CEO of Charter Oak Capital Management, Inc. (originally an Aetna, Inc. spin-off) when Conning acquired Charter Oak in 2000. Alex McCallum, editor of Insurance Asset Manager (IAM) asked the questions, and started with this easy one:

IAM: Rich, How has Conning managed to weather these recent turbulent times, and what's your secret?

Sega: First, let's stipulate that nobody is unaffected by this. But we have held up pretty well. A couple of reasons for this, I think. First, at Conning we have a blend, a great mix of seasoned veterans and young market enthusiasts and we have put that combination together effectively. Secondly, this is not our first crisis. We have had several crises in the past decade. While admittedly they were not similar in magnitude and duration, they were virtually identical in the way a crisis affects the mindset of an investment manager doing its best for a client. We don't overreact and keep a long-term view.

As for our secret, the truth is there really is no secret, unless you want to call it an open secret. By this, I mean active communication, both inside and outside the firm. We talk to our clients constantly, letting them know what we are thinking, what we consider ought to be done, and what the impact is likely to be

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-- and, in turn, we get their ideas too. Talking to each other, that's the secret!

IAM: In addition to continuous dialogue, though, what is it about Conning's process that clients value?

Sega: The mindset helps too, that's for sure. Insurance companies are surplus bound so protecting the downside is important. Since I started in this business, I frequently refer to a motto that I borrowed from history -- a Hippocratic Oath for portfolios, if you will: "First, do no harm." In other words, make sure to protect the downside. I think in times like this, clients appreciate that!

IAM: You have obviously done very well retaining clients over the past year, but you must have been tested from time to time, if not quite frequently. What makes them stick around?

Sega: First of all, let me say that, historically, we have had very good client retention here at Conning. This is a very competitive business, as you know, and we are proud and grateful to have that record. But again, it comes round to having the right mindset, knowing there are people out there who would love to eat our lunch. We can't sit pat on an investment history or record of achievement. We need to earn our clients' favor over and over again every day. That's the mindset I encourage around here and I think it has contributed a lot to Conning's long-term record.

IAM: Changing direction a little bit...every year I notice smaller firms trying to establish themselves in the insurance asset management area. Do you think there is room for a smaller firm to come into the business and develop a foothold and even become very competitive? What kind of talents and capabilities would it take?

Sega: Being a free market guy, I have to say there is always room for another good competitor in this business. That may mean a marginal player has to get knocked out, but there is always room for a competent player.

As you know, out of the 10,000 or more money management firms in the country, there are very few that really focus on the insurance arena. There are a number of reasons for this, and I'll try to sum them up in the following way:

It's not that there aren't any smart money managers in all those other 10,000 firms. But insurance companies are a particularly special challenge. They are leveraged, they need surplus, they are long-funded, they have contingent liabilities, and so forth. Most asset managers are disinclined to take on the task of managing money with added complications like these, a task I often refer to as "constrained optimization".

So it's not only good trading and asset management asset skills that are needed to be successful in this market, but a genuine all-out commitment to the insurance business. You can see that here at Conning, and I suspect it's true in the other firms that are insurance focused, because I know many of our own people have insurance backgrounds. There are some individuals, like myself, from the liability side, others from the accounting side, or from the investment group, within an insurance company. It's a background like this that we look for at Conning when we hire people.

IAM: So if you are a money manager contemplating having insurance clients, you can't just jump in and hope for the best, can you?

Sega: You're right. Now, as far as finding a good pathway into the business is concerned, an active manager might focus on one or two specialty asset classes as, for example, municipal bonds or equities for a property & casualty company. That would be an easier way to get your foot in the door than trying to cover the bases as we do at Conning, with our insurance industry research, expertise in asset liability management, strategic asset allocation capability and staffing that includes actuaries like myself creating strategies for our portfolio managers to work on.

IAM: One reason I asked about new entrants into the business was the increasing number of inquiries about asset outsourcing I'd heard were coming from insurance companies as the financial crisis began to deepen. It occurred to me that this might prompt interest from asset

managers that were not yet in the insurance asset management field.

Sega: I guess that could happen. We have had similar inquiries ourselves, and in fact the pipeline for new business is quite robust right now. Not all of that is takeaway business, either. Some of it is newly-outsourced assets, from insurers that managed their money just fine through the good times, either internally or with a manager lacking insurance investment experience, but are now facing difficult challenges. In some cases, more quantitative analysis is needed, in others it might be assistance with OTTI reporting that is required, and so on. These firms have started to figure out that maybe it's time to look for someone who has a broader background and more depth of experience in the specific channels.

IAM: *I can see that. As you talk to your clients and potential clients, you must be getting a good feel as to what kinds of strategies are going to be needed as the financial crisis continues and plays out. I wonder if you had any thoughts about that.*

Sega: It's almost a cliché to say we are in uncharted territory but, in fact, we are in uncharted territory. So we don't know for sure how people will react. This is bigger and longer than any other financial event we've been through -- although I'd argue that, in some respects, we have been through this sort of thing before.

For some folks, and I put Conning in this category, we are measured on our approach to taking risk through both the good times and the bad times. Other folks don't have the same consistent discipline, and are more willing to take a swing. A year ago, you could get a 4% yield and people thought that was a good value. Now a Class 1 railroad trades at 8%, and people think it's too rich. That's the range of responses that you find out there so, as I said, it's hard to say how people are going to react. We try to keep an even keel.

To give you another slant, I'm sure there are some asset managers out there who are saying, "Please God, just get me through it this time and I'll never do it again." In other words, it's the kind of situation when, as soon as things get better, they are right back doing it again. We hope we are not that way at Conning! After looking at our clients' objectives, we take long-term views and, given this philosophy, I think the traditional quality income-producing assets that we invest in will be the ones that will serve our clients well over time.

IAM: *Having said that, Rich, there must be problems that insurance companies have to deal with in the short run in order to get to that long run.*

Sega: Yes, indeed. Take P&C companies, for instance. They generally have a fairly large allocation to municipal bonds when they are making money, and municipal bonds right now are under great pressure. The equity market hasn't done their surplus any good either as of late. So the traditional practices are no longer adequate.

On the Life side, as another example, it has been very difficult to make a spread using the credit intermediation model if you want to hold on to your risk tolerance strings. There is not enough yield available in the credits they're now willing to buy.

Meanwhile, adding to the near-term complications is the fact that structured products and leveraged types of assets have disappeared from sight for a while. But, as I said, in the longer run, I have no doubt that the traditional approaches will work.

IAM: *Finally, how would you assess international investments in the context of looking at current and post-crisis investment strategy?*

Sega: One thing I'd say about international investing is that the idea of decoupling -- that somehow there were economies around the world that were not highly correlated with the US -- is dead, at least for now. Fact is, we're a little out of phase, but we still have a lot of interdependencies across economies, and I think these will continue, and be particularly obvious when we start to pull out of this crisis. So we are enthusiastic about our presence in Dublin and London, both from the standpoint of sourcing investments for clients, and obtaining mandates from non-US companies.

IAM: *Thank you.*