STRATEGIC ASSET ALLIANCE
THE INSURANCE INVESTMENT SPECIALIST

Insurer Investment Forum: Sample Case Study
"Strategic Asset Allocation Concerns: Frequency"

Background

Alan Glazer was reviewing the financials, Board meeting minutes, actuarial reports and other pertinent documents in preparation for his first meeting as a new Board member for The Escutcheon Group, a regional workers' compensation insurer. Mr. Glazer was also appointed to the Investment Committee and was reviewing the strategic asset allocation process over the past three years.

As Mr. Glazer swam through the torrent of documents in preparation, he naturally gravitated to the investment portfolio and the strategic asset allocation process embraced by the organization. As a workers' compensation writer primarily, Mr. Glazer understood the impact that investment returns had on the Escutcheon Group's long-term profitability given its "long-tail" business.

Although state regulations and investment policy allowed prudent flexibility, Mr. Glazer was a bit surprised by the frequency and scope of the strategic asset allocation process.

The process was conducted every year even though the underlying strategic plan and direction of the business had remained consistent for many years. Under closer scrutiny, strategic asset allocation recommendations were often contradictory (especially risk assets) and could swing materially year-over-year.

Wouldn't this confuse the Board and, even worse, place the investment manager/advisor in a difficult position?

Investment Committee Meeting

(1) If business strategy does not materially change, does conducting a strategic asset allocation every year make sense? Consider scenarios?

   a. Additionally, asset allocation is reviewed quarterly to consider rebalancing as necessary.

(2) Mr. Glazer observed that the risk/return assumptions are currently based on "yield & growth" assumptions. He wondered if the process could be enhanced by comparing the current process with a "valuation dependent" or "mean reversion" approach across asset

classes as illustrated by the Research Associates?

   a. The Valuation Dependent model includes reversion toward the mean based on the expectation of changes in valuation metrics.

   b. The Yield + Growth model assumes valuations do not change in the future.

(3) Mr. Glazer didn't want to be considered a maverick (at least not at his first meeting), but really wanted to hear from the Committee and Staff as to why this annual process is in place. Specifically, he wanted staff to provide a list of pros/cons to discuss.

   a. Based on the pros/cons list and considering both staff and Board perspectives, what is your recommendation to Mr. Glazer?