

Risk tolerance is vital to the strategic asset allocation process. The amount of risk an insurer or risk pool's staff, Board/Trustees and Investment Committee is comfortable taking on within the portfolio will shape the overall investment program.

As the Board and management are made up of individuals, each individual's personal biases and history influences their tolerance for risk.

A short questionnaire to staff, Board members and trustees can help put some constraints around any asset allocation models your insurer or risk pool is reviewing.

Sample Questions:

- How do you define risk?
- How familiar are you with these risk asset classes?

Most importantly, scenario-based impact analyses can be helpful in identifying and adopting an appropriate asset allocation framework for your insurance company or risk pool.

These models are based on different investment structures and gauge the impact of various scenarios on key investment and company metrics.

This analysis can help the Board/Committee and management identify the amount of risk they are collectively willing to implement within the investment program, given objectives and constraints on the underlying business (*i.e. surplus levels, profitability, regulation, etc.*).

Example: Surplus Volatility Testing

Risk Assets-to-Surplus Ratio	Net Assets/Surplus (\$MM)	Risk Assets (\$MM)	Risk Assets As % of Total Portfolio	Surplus Level (\$MM): Worst Negative Return Trend	Downside Impact: As % of Surplus	Surplus Level (\$MM): Worst Calendar Year Decline	Downside Impact: As % of Surplus
100%	\$1,200	\$1,200	60.00%	\$581.10	-51.60%	\$725.10	-39.60%
85%	\$1,200	\$1,020	51.00%	\$669.30	-44.20%	\$791.70	-34.00%
75%	\$1,200	\$900	45.00%	\$728.10	-39.30%	\$836.10	-30.30%
50%	\$1,200	\$600	30.00%	\$875.10	-27.10%	\$947.10	-21.10%
40%	\$1,200	\$480	24.00%	\$933.90	-22.20%	\$991.50	-17.40%
30%	\$1,200	\$360	18.00%	\$992.70	-17.30%	\$1,035.90	-13.70%
25%	\$1,200	\$300	15.00%	\$1,022.10	-14.80%	\$1,058.10	-11.80%
20%	\$1,200	\$240	12.00%	\$1,051.50	-12.40%	\$1,080.30	-10.00%
15%	\$1,200	\$180	9.00%	\$1,080.90	-9.90%	\$1,102.50	-8.10%
10%	\$1,200	\$120	6.00%	\$1,110.30	-7.50%	\$1,124.70	-6.30%

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