

2011 Outlook: Serving the Evolving Needs of the Insurance Industry

ERIC TANAKA, *director of Financial Reserves Management (FRM), and Rich Coffman, business development manager for FRM, spoke recently about the investment environment in which insurers are operating, and about Wellington Management's insurance asset management solutions.*

Q: What are the investment issues facing insurers this year, and what kind of counsel are you and the FRM team providing?

Tanaka: There are a number of challenges insurers are thinking about. Following several years of highly accommodative monetary and fiscal policy, and in light of rising commodity prices and signs of inflation in emerging markets, the possibility of higher inflation is certainly something many are focused on, particularly given the potential impact on fixed income-oriented portfolios. We think the solution is not just typical inflation hedges, like inflation-linked bonds, but a

more diversified mix of asset classes, including precious metals and natural resource and energy stocks, which may respond well to different sources of inflation.

In addition, clients are still very focused on the need for income, and one solution we've been discussing is allocations to equity investments focused on dividend-paying stocks. Also, the budget strains on many municipalities and the loss of the financial guaranty market have impacted insurance companies and, in our view, made active management of municipal bond portfolios critical, with a focus on essential debt service.

Coffman: We have to recognize that low interest rates might be with us for a while and so we are trying to engage our clients on prudent ways to allow our fixed income teams greater freedom to capture any incremental return possible. That might mean broader guideline flexibility and fewer turnover restrictions, allowing for overweights to particular spread sectors, or a larger duration window. It might even mean the potential use of more mainstream derivatives. Of course, this all has to be done within each client's regulatory framework and risk parameters.



Eric Tanaka
Director of Financial
Reserves Management



Rich Coffman
Business Development
Manager for FRM

Q: As insurance clients' investment challenges become more complex, what are we doing to ensure that we can serve them well?

Tanaka: We are doing more of what has worked for our clients historically: We're looking to enhance our team with people who have strong insurance industry backgrounds. We are continuing to grow a dedicated, global staff of 30 professionals with insurance company knowledge. For example, we recently brought in Mike Thompson, a relationship manager on the FRM team. He has more than 20 years of experience managing investments for insurance companies, and joins an already strong, experienced team of professionals within FRM.

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— Rich Coffman

Coffman: While we manage US\$82 billion for over 100 insurers, we are also thoughtful in terms of how we add clients. Just as we think about capacity issues for our investments, we think carefully about our capacity to serve clients. When we take on a new client, we want to give them our full focus and ensure that we can add value and grow with them over time. In fact, many of our existing client relationships started small and then grew organically. Our goal is not to find the largest possible clients to work with; it's to find clients with whom we can truly be a thought partner.

Q: Eric, you are an example of the firm's preference for hiring insurance professionals. Since you joined Wellington Management last year, has anything surprised you?

Tanaka: It's hard to be surprised when you've been working with a firm for over a decade. I had a long relationship with Wellington Management, as a client and as a consultant, and I continue to view the culture and the people as the strongest selling points of the firm. When I interviewed here, two words I heard used that seemed to perfectly capture the firm's approach to serving insurance clients were "planned and purposeful." As a client, I always found Wellington Management to be very diligent and thoughtful, whether it was in initiat-

ing a client relationship or launching an investment approach. There was always a sense that the firm would never rush into anything, and would only offer a solution if it was going to be what clients needed and it was going to be world-class.

The other thing that really stands out, though again I would not call it a surprise, is how closely the firm's interests are aligned with those of our clients, given our private partnership ownership model. We have no outside financing issues or outside agendas. We can focus all our attention on bringing new ideas to our clients.

Q: Looking ahead, how do you see the insurance team and its capabilities evolving to serve client needs?

Tanaka: Like our clients, our team is becoming much more global, as we continue to add resources to already strong groups in Europe and Asia. In the past, the issues of interest to insurance clients in the Asian, European, US, and Bermuda markets were very different. Today, we know from working with insurance clients in 18 countries around the world that the challenges are much more coordinated across markets. Wellington Management's ability to have not just an office in these other markets, but a true presence, will help us better serve our clients, whether it's through global investment solutions or knowledge transfer that results from our on-the-ground experience in areas like regulation. We're not just selling products in places like Hong Kong and Singapore, we have dedicated resources there, including senior-level management, and we'll be adding more.

Q: Rich, how has our insurance asset management practice grown in your 15 years with the firm?

Coffman: The most notable change is the broadening of the asset classes being used by clients. We've moved from being primarily a fixed income solution provider to being a multi-asset solution provider. Our insurance clients currently use 55 of our investment styles across all asset classes, including emerging market equities, dividend-yielding equities, and inflation-sensitive investments.

Of course, for many of our insurance clients, core fixed income and crossover strategies continue to be the bread and butter of their accounts with us. To serve those needs as effectively as possible, we've recently structured a dedicated FRM portfolio management team.

Tanaka: We continue to be focused on recognizing that each insurance client is unique and therefore each solution needs to be customized accordingly. For example, we don't recommend emerging market equities to all of our clients. For some, it just will not work within their business model or their risk platform. So we make sure we understand the client fully before we recommend a single investment idea.

Q: Insurance clients look for more than investments; they look for specialized tools and resources that can help optimize their portfolios and manage risk. What are we doing for clients in this respect?

Coffman: I think that our LiEF (Liquidity Evaluation Framework) tool is a good example, given its potential application in the insurance space. At first glance, it might appear to be just a liquidity measurement tool, but in fact it is a risk management tool. Insurance clients have come to understand that it can fit into their ERM (enterprise risk management) process.

With LiEF, we can go back and pick historical periods when the markets were stressed, and then we can do a review of a portfolio and determine how it would have performed in those periods. We can actually define a client's risk management and investment policy statement around these historical events.



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— Eric Tanaka

Q: What are you anticipating over the next 12 months relative to client investment strategies and our ability to service our clients?

Tanaka: Of course, each client is unique in their investment and business needs, which means investment solutions will vary across our client base. Within this framework, we will continue to work with clients as a thought partner. In addition to the solutions we've already mentioned, we find clients interested in high-yield bonds, bank loans, and REITs, to name just a few. We anticipate discussions regarding these potential solutions will increase over the next 12 months as clients analyze the impact of capital market developments. Given our multi-asset-class platform and experienced staff, we are well positioned to engage in these discussions and add value. ■



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