

IASA 2018 **POWER UP!**

EDUCATIONAL CONFERENCE & BUSINESS SHOW
JUNE 3 - 6, 2018 | GAYLORD OPRYLAND | NASHVILLE, TN

Session 403: Improving Methods for Selecting and Evaluating Investment Managers

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#IASA2018

Session 403: Improving Methods for Selecting and Evaluating Investment Managers

Carl Terzer

Carl Terzer is Founder and Principal of CapVisor Associates, LLC, He brings more than 32 years of insurance asset management experience to the task of correlating clients' investment strategy with their business objectives, risk tolerance, liability structure and accounting and regulatory environments. His expertise encompasses investment plan design, strategic asset allocation and tactical portfolio optimization and manager search/evaluation and after tax, risk adjusted performance analysis. Mr. Terzer's experience spans insurers in all sizes and lifecycle stages: from 831B's to multi-billion dollar internationals and from start-ups to run-offs



CapVisor Associates, LLC

The Insurance Industry's Typical Bad Buying Behavior

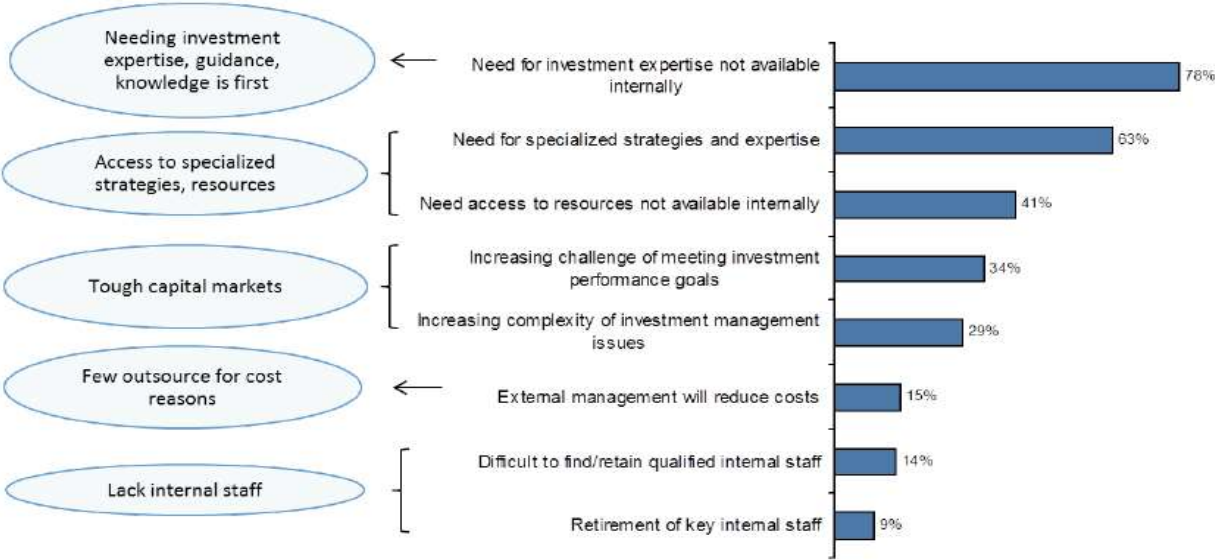
- Selecting an investment manager before an investment plan is designed
- Allowing the investment manager to provide boilerplate investment guidelines and pick their own performance benchmark
- Selecting the manager primarily on the basis of recommendations rather than a rigorous qualitative and quantitative screening process
- Ignoring the importance of Enterprise Risk Management (ERM) and Asset/Liability Management (ALM) in the investment planning process
- Selecting the manager with little or no knowledge of their “risk-adjusted” performance or investment style considerations

Pitfalls to avoid at the start

- When you are deciding which investment managers to evaluate, these are usually worth skipping:
 - their brother-in-law, the broker
 - the guy who handles the board members' personal account
 - the insurer's pension/401k investment manager
 - the most conveniently located manager
 - the "one stop shop for all your financial needs" manager
 - the investment managers that are conference exhibitors
 - the firm that provides the best "accounting" reports and seems to have "decent" performance
 - the firm(s) recommended by insurance business associates unless their investment acumen is very high

Drivers of outsourcing

Insurers seeking investment knowledge and specialized strategies



Source: Insurance Asset Outsourcing Exchange Insurance Investment Officer Survey

Sources used to identify candidate managers

Recommendations from peers, conferences, reputation and sales calls

Do you want to select a “Well Known” manager....or a superior manager that can produce outperformance?

How does your marketing mix align with these information sources?
Your sales effort should be supported with:

- Conference attendance
- White papers
- Insurance-focus visible on web site
- Excellent client service

Relationship, not performance driven!

Indicates likely differences between this segment versus others. Caution: Small base sizes may prevent strong conclusions.

	TOTAL	COMPANY TYPE		TOTAL ADMITTED ASSETS			
		PC	LH	<\$200 MM	\$200MM to \$999MM	\$1B to \$5B	>\$5B
BASE:	103	63	34	25	35	31	12*
Recommendation from our peers	84%	87%	76%	100%	80%	87%	58%
Investment managers we are familiar with through industry conference activities	67%	76%	59%	72%	71%	68%	42%
Reputation of the investment firm	63%	62%	68%	60%	63%	68%	58%
Investment managers we know through in-person sales calls	42%	43%	47%	36%	34%	55%	42%
Investment managers we are familiar with through web sites, webinars, white papers, advertising, etc.	40%	44%	38%	52%	29%	39%	50%
Recommendation from consultant firm	37%	35%	32%	32%	31%	52%	25%
Investment firms we or our affiliates currently use	35%	41%	21%	28%	40%	29%	50%
Performance databases	33%	27%	35%	28%	20%	45%	50%
Investment managers listed in insurance-oriented industry publications/websites	29%	35%	21%	32%	26%	32%	25%
Insurance Asset Outsourcing Exchange	21%	19%	21%	12%	11%	35%	33%
We would publicly announce an RFP in industry publications, and/or our website	2%	3%	0%	8%	0%	0%	0%

* Caution: Small base size prevents statistical comparison to other segments

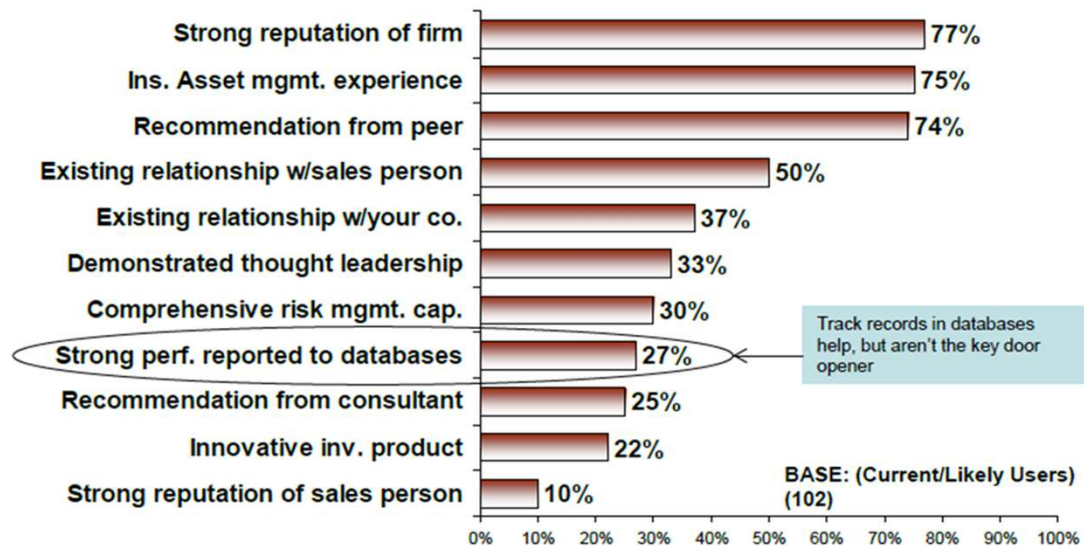
Question: Regardless of whether you would use an RFP process or not, which source(s) would you likely use to determine the managers to consider in your selection process?

Source: Insurance Outsourcing Exchange Investment Officer Survey

How investment managers get in the door...

Insurers value relationships, insurance experience and reputation

Factors Influencing Acceptance of First Sales Call From Investment Manager



Question: Which of the following factors would be important in influencing you to accept a first sales call from an investment manager?

Source: Insurance Outsourcing Exchange Investment Officer Survey

Eager, Davis & Holmes LLC

8

Insurance
Asset Outsourcing Exchange

Manager selection criteria by product type

“Soft” criteria are key: Comfort with investment approach, trust and confidence in manager. Broad fixed income roles also emphasize insurance knowledge

More often a requirement
 Less often a requirement
 Insurance Fluency/Capabilities Requirements
 Higher ←————→ Lower

	BROAD FIXED INCOME	SPECIALIZED FIXED INCOME	EQUITY ROLES	ALTERNATIVE INVESTMENTS
BASE: CURRENT/LIKELY USERS	88	66	68	38
Ins. Knowledge key for broad fixed income roles; often a factor for other product types	92%	67%	62%	55%
Two key criteria for all product types	89%	92%	93%	89%
	85%	86%	91%	92%
Performance composites more often important in equity and alternatives roles	75%	76%	79%	66%
	70%	76%	60%	58%
	60%	56%	53%	45%
	60%	47%	49%	37%
	43%	52%	25%	37%
	42%	47%	62%	68%
	42%	15%	13%	16%
	41%	29%	32%	32%
	36%	12%	15%	16%
	34%	26%	34%	26%
30%	12%	13%	13%	

Question: Which of the following selection criteria are requirements for an investment manager your company would hire for [insert products used] roles?

Source: Insurance Outsourcing Exchange Investment Officer Survey

Are you ready to pick an investment manager?

1. Do you have an Investment Policy Statement (IPS)?
2. Do you have a Strategic Asset Allocation?
3. Do you have Investment Guidelines?
4. Have you designed Performance Benchmarks?

Key Steps in the Manager Selection Process

- Define the mandate/assignment along with its specific requirements and constraints
- Create/obtain a “Universe” of potential managers fitting the mandate’s criterion
- Apply elimination criterion to reduce the Universe to a “Consideration Set”
- Evaluate Finalists from “Consideration Set”
 - (RFP, Presentations, On-Site visits, Telephone Interviews, etc.)

Manager Selection Criterion

- **Philosophy**
 - “Total Return” or “Yield Maximization”
 - Active, passive or blended management
- **Process**
 - Top down or bottom up
 - Alpha attribution: duration, yield curve, sector, security selection
 - Style analysis
 - Tax efficiency
- **Performance**
 - MPT Statistical assessment (Risk-adjusted return analysis)
 - After-tax performance
 - Adherence to guidelines
 - Universe comparison
- **Personnel**
 - Insurance asset management experience
 - Insurance regulatory, tax and accounting expertise
 - Insurance Accounting and reporting capabilities
- **Client-specific criteria**
 - Execution of policy objective & adherence to guidelines and regulations
 - Fees/Value for service
 - Portfolio tax liability management
 - Client service and other administrative responsibilities
 - Accounting & Reporting efficacy
 - Overall relationship efficiency

Quantitative criterion

...Finding Superior RISK-ADJUSTED, AFTER TAX PERFORMANCE

Performance vs. benchmark (rolling YTD, one, three, five year periods)

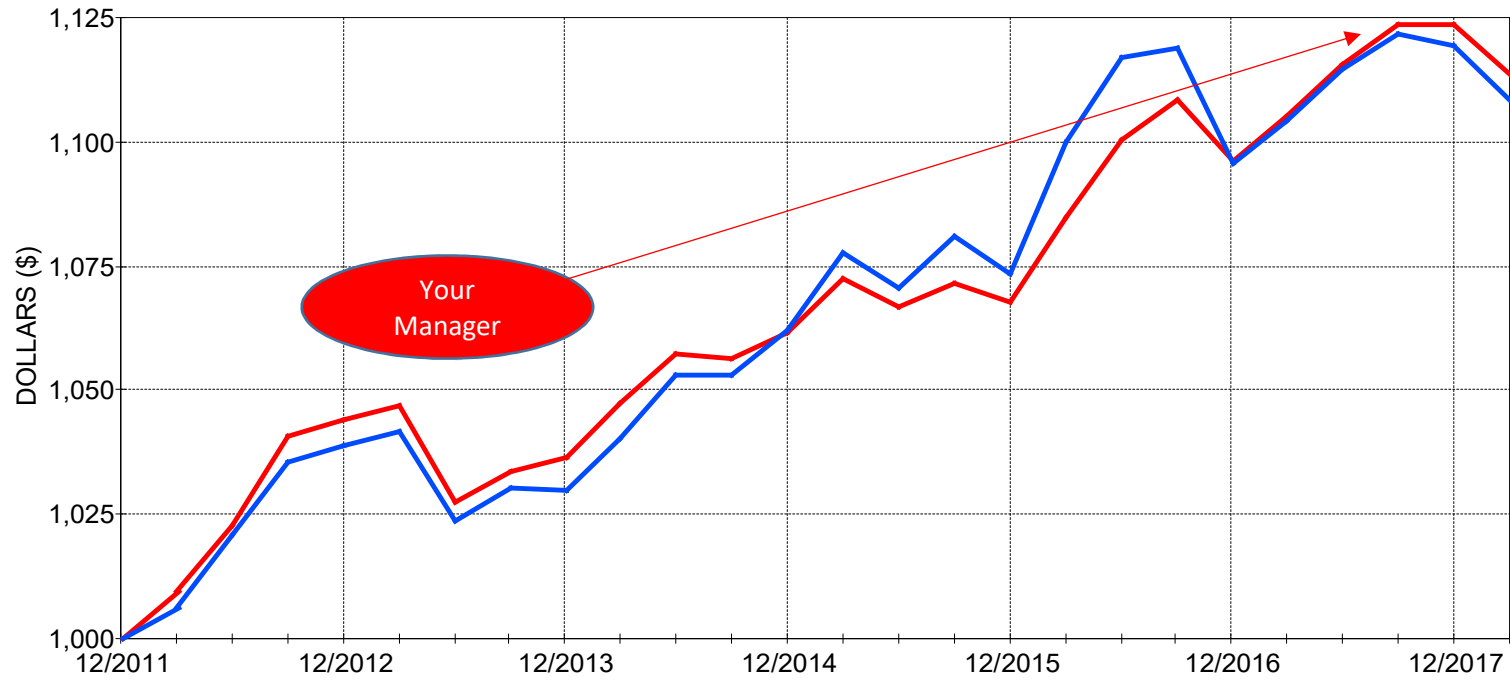
Modern Portfolio Theory (MPT) statistical evaluation

- **Alpha** –measures managers risk adjusted performance
- **Beta**- measures manager's systemic risk
- **R-squared** - comparison measurement of managers returns to market index
- **Standard deviation** –measures managers return dispersion or variance
- **Tracking error** –measures how closely manager tracks index returns
- **Sharpe ratio** –measures manager's excess return over risk – free rate of return
- **Sortino ratio** - Sharpe ratio refinement which differentiates harmful volatility from volatility in general by replacing standard deviation with downside deviation in denominator
- **Up-market capture ratio** -measures manager's performance in up markets relative to index
- **Down-market capture ratio** –opposite of up-market capture ratio
- **Batting average** –measures manager's ability to meet or beat market consistently
- ... And many more statistical risk-adjusted performance measurements

CASE STUDY

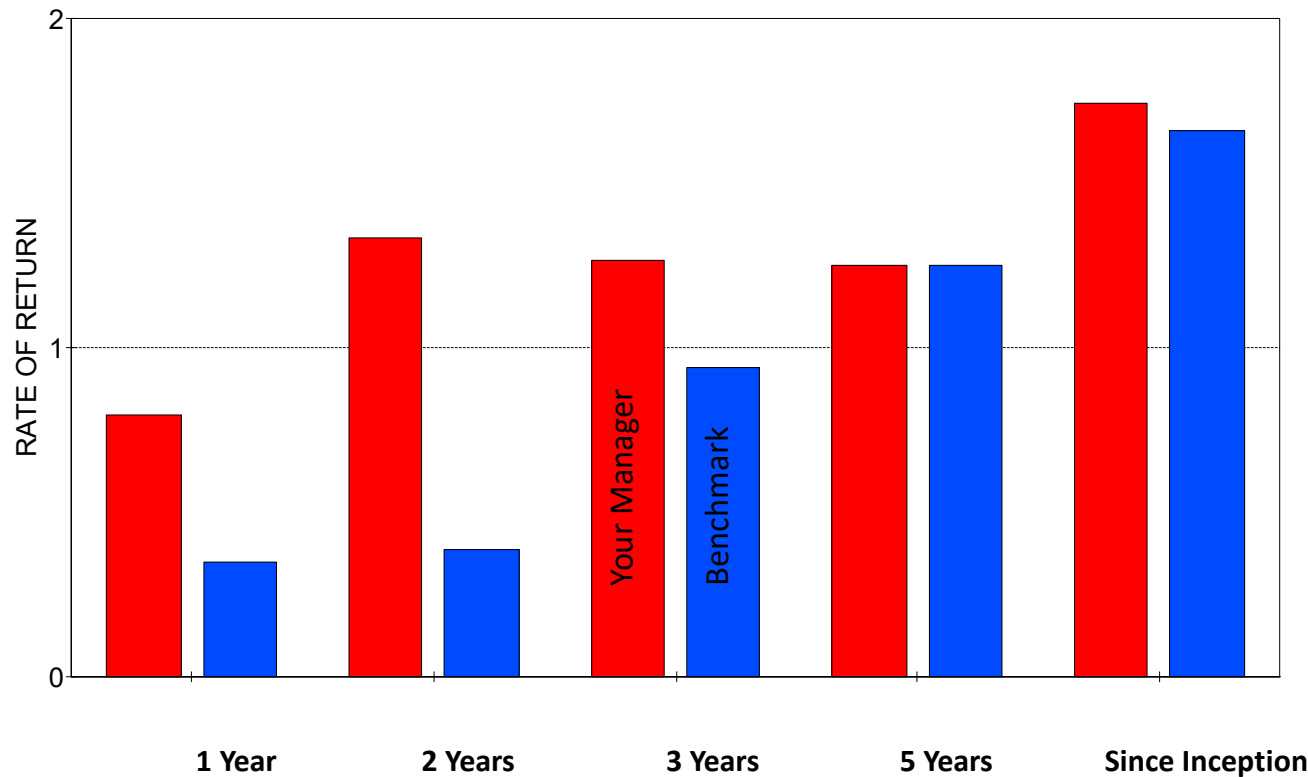
- A comparative analysis of an incumbent manager's risk-adjusted returns.
- Benchmark: Bloomberg Barclay's Intermediate Government/Credit Index

GROWTH OF AN INVESTMENT DECEMBER 31, 2011 TO MARCH 31, 2018



	Latest Quarter	1 Year	2 Years	3 Years	5 Years	Since Inception
— Your Manager, Perhaps	991	1,008	1,027	1,038	1,064	1,114
— Bloomberg Barclays Intermediate Govt/Credit	990	1,004	1,008	1,029	1,064	1,108

**PERFORMANCE BAR
PERIODS ENDING MARCH 31, 2018**

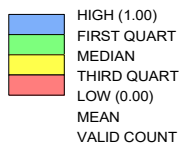
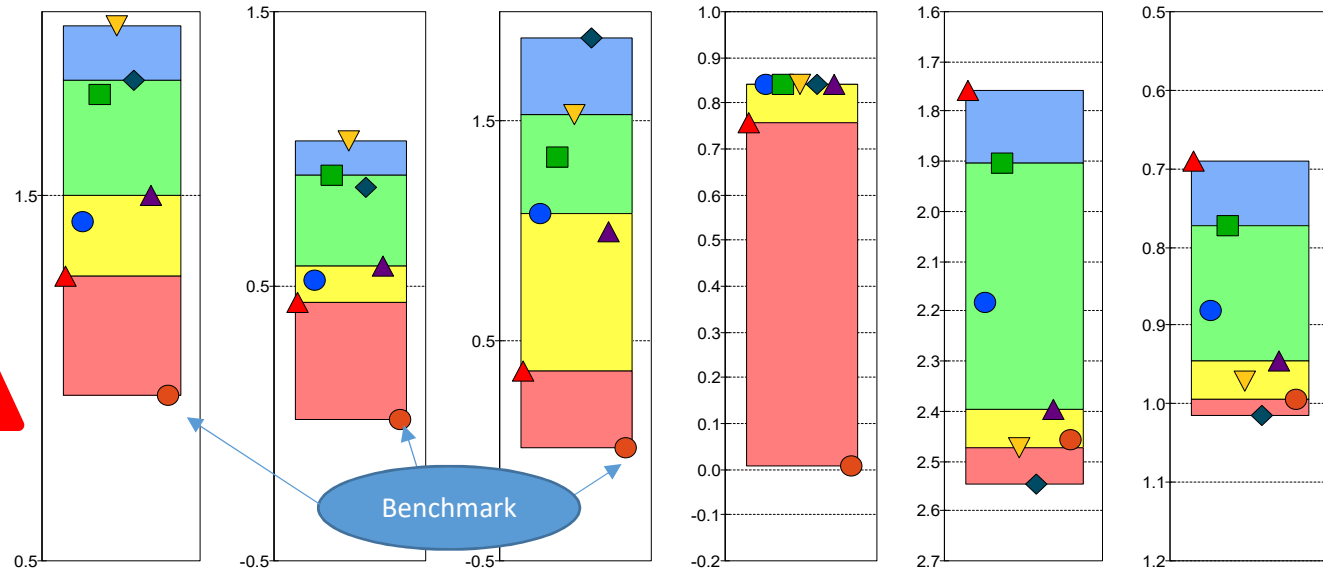


	1 Year	2 Years	3 Years	5 Years	Since Inception
■ Your Manager, Perhaps	0.79	1.33	1.27	1.25	1.74
■ Bloomberg Barclays Intermediate Govt/Credit	0.35	0.39	0.94	1.25	1.66

So, we have a great manager, right?

MULTI-STATISTIC QUARTILE RANKING BAR

MARCH 31, 2015 TO MARCH 31, 2018

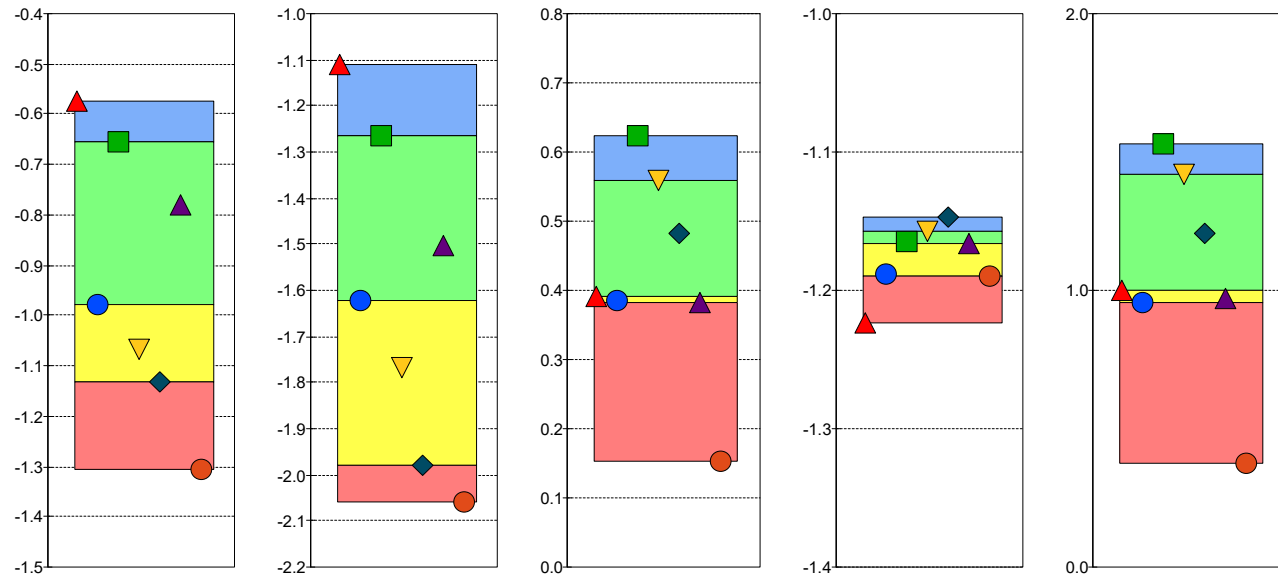


	ROR	Alpha	Info Ratio Sample	Batting Avg	Std Dev Sample	Beta
HIGH (1.00)	1.95	1.01	1.86	0.83	1.77	0.69
FIRST QUART	1.80	0.89	1.51	0.83	1.91	0.78
MEDIAN	1.49	0.56	1.07	0.83	2.41	0.95
THIRD QUART	1.27	0.42	0.34	0.75	2.48	1.00
LOW (0.00)	0.94	0.00	0.00	0.00	2.55	1.02
MEAN	1.52	0.61	1.01	0.70	2.25	0.90
VALID COUNT	7	7	7	7	7	7

	VALUE	RANK	VALUE	RANK	VALUE	RANK	VALUE	RANK	VALUE	RANK	VALUE	RANK
▲ Your Manager, Perhaps	1.27	85	0.42	85	0.34	85	0.75	85	1.77	1	0.69	1
● Manager 1	1.42	71	0.51	71	1.07	57	0.83	1	2.19	29	0.89	29
■ Manager 2	1.76	42	0.89	28	1.32	42	0.83	1	1.91	15	0.78	15
▼ Manager 3	1.95	1	1.01	1	1.51	28	0.83	1	2.48	72	0.98	58
◆ Manager 4	1.80	28	0.84	42	1.86	1	0.83	1	2.55	99	1.02	99
▲ Manager 5	1.49	57	0.56	57	0.98	71	0.83	1	2.41	43	0.95	43
● Bloomberg Barclays Intemed	0.94	99	0.00	99	0.00	99	0.00	99	2.47	58	1.00	72

MULTI-STATISTIC QUARTILE RANKING BAR

MARCH 31, 2015 TO MARCH 31, 2018

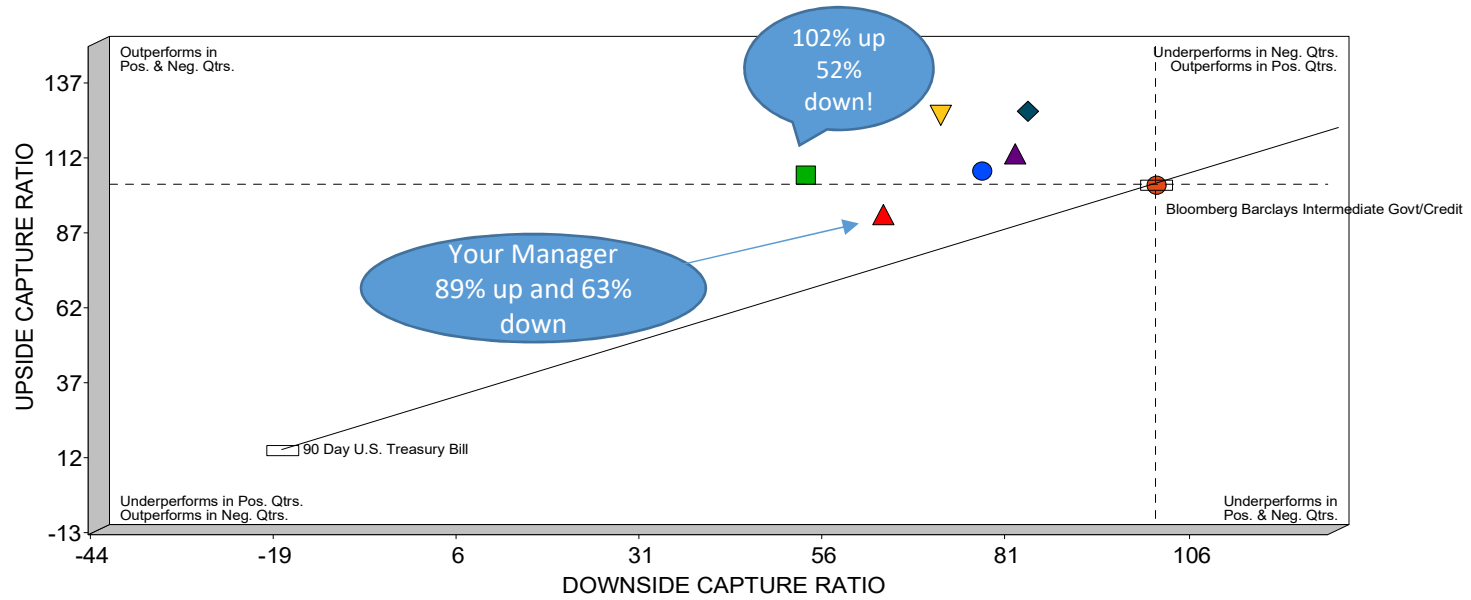


	Avg Ddown%	Max Ddown%	Sharpe Ratio Samp	Sortino	Treynor Ratio
HIGH (0.00)	-0.58	-1.12	0.62	-1.15	1.52
FIRST QUART	-0.66	-1.28	0.55	-1.16	1.40
MEDIAN	-0.98	-1.63	0.39	-1.17	0.98
THIRD QUART	-1.14	-1.99	0.38	-1.19	0.94
LOW (1.00)	-1.31	-2.07	0.15	-1.23	0.36
MEAN	-0.94	-1.62	0.42	-1.18	1.05
VALID COUNT	7	7	7	7	7

	VALUE	RANK	VALUE	RANK	VALUE	RANK	VALUE	RANK	VALUE	RANK
▲ Your Manager, Perhaps	-0.58	1	-1.12	1	0.39	57	-1.23	99	0.98	57
● Manager 1	-0.98	57	-1.63	57	0.38	71	-1.19	71	0.94	85
■ Manager 2	-0.66	28	-1.28	28	0.62	1	-1.17	42	1.52	1
▼ Manager 3	-1.08	71	-1.78	71	0.55	28	-1.16	28	1.40	28
◆ Manager 4	-1.14	85	-1.99	85	0.48	42	-1.15	1	1.19	42
▲ Manager 5	-0.79	42	-1.51	42	0.38	85	-1.17	57	0.95	71
● Bloomberg Barclays Intermid	-1.31	99	-2.07	99	0.15	99	-1.19	85	0.36	99

MARKET CAPTURE

MARCH 31, 2015 TO MARCH 31, 2018



	Up Mkt Capt Retrn	Up Cap Ratio	Dnside Cap Return	Dnside Cap Ratio	R-Squared
▲ Your Manager, Perhaps	3.86	89.33	-2.26	62.74	0.92
● Manager 1	4.50	104.12	-2.75	76.24	0.98
■ Manager 2	4.45	102.90	-1.88	52.20	0.98
▼ Manager 3	5.30	122.48	-2.55	70.75	0.93
◆ Manager 4	5.35	123.80	-2.98	82.53	0.97
▲ Manager 5	4.76	110.00	-2.92	80.86	0.95
● Bloomberg Barclays Intermediate Govt/Credit	4.32	100.00	-3.61	100.00	1.00

RISK BENCHMARK USED FOR THIS ANALYSIS: BLOOMBERG BARCLAYS INTERMEDIATE GOVT/CREDIT

Summary

- Generally, insurers should execute a more extensive search and a more disciplined analysis when selecting an investment manager(s)
- Access to a broad manager database is a very important consideration
- Ask for, and compare, risk-adjusted statistics
- Understand manager style and strategy
- Extensive “insurance asset management” knowledge, e.g. ERM and ALM, should be a priority for reserve assets
- If the expertise, time and/or resources are not available, consider hiring outside expertise for the project



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Questions & Answers

Thank you!

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