

Strategic Asset Allocation Approach

June 2024

FOR PROPERTY/CASUALTY INSURERS

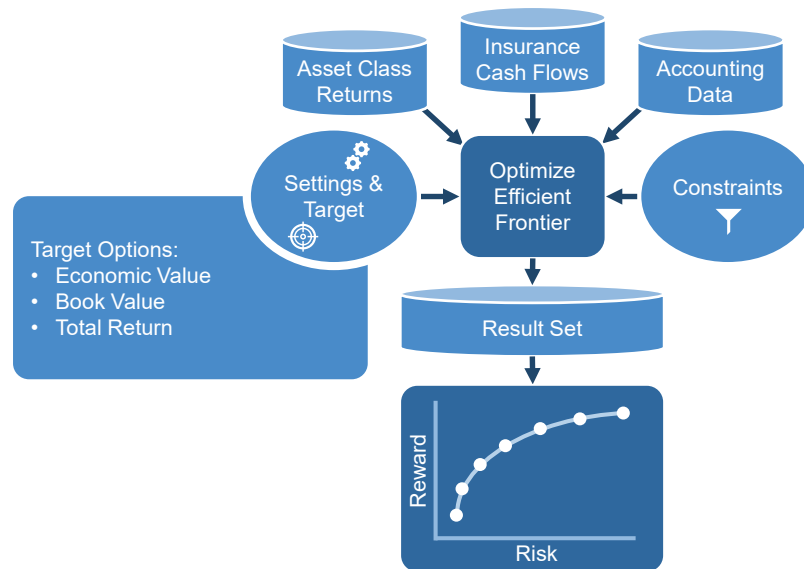
Conning's Strategic Asset Allocation for P&C Insurers: Empowering Financial Decision-Making for Executives

Property and Casualty (P&C) insurers as capital constrained entities must constantly measure, assess, and plan allocations for the various risks they take. These risks include their balance sheet leverage, underwriting performance, reinsurance program, reserving practices and investment strategy. All of this is further complicated by meeting the varied needs of regulators, rating agencies, policyholders or other stakeholders and the expected return of the organization. For all these reasons a P&C insurer's investment strategy cannot be optimized in isolation.

Each P&C insurer pursues different strategies based on the risks written, the company's unique profit goals and most importantly the firm's risk tolerance. A successful strategy requires a comprehensive approach to analyzing and establishing an investment strategy that aligns with the company's overall business objectives. Failing to analyze the investment choices along with all these considerations can result in suboptimal enterprise outcomes.

Figure 1 Model of Conning's Holistic SAA Approach

Conning's philosophy for managing the investment portfolio of P&C insurers relies on a Strategic Asset Allocation (SAA) approach (Figure 1.). While some might approach this exercise through the lens of optimizing the investment returns only, Conning views the role of the portfolio within the entire operation of an insurance company, i.e., a holistic company framework. Once we capture the totality of the operations, Conning then looks to think about portfolio optimization.

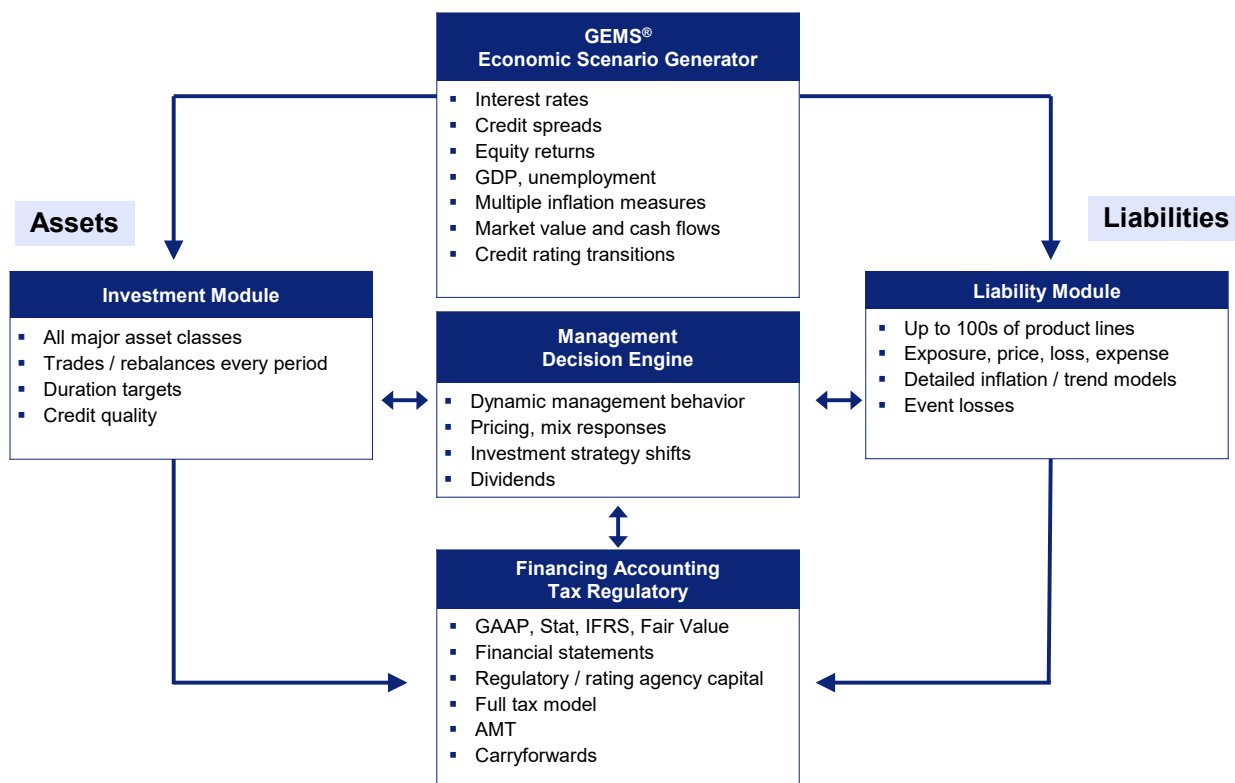


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Conning also differentiates itself by optimizing the value of the company through an efficient frontier framework with **Economic Value** as a driving metric. **Economic Value** is the market value of a company's assets minus the discounted value of future liability payouts plus value from future business operations.

At the commencement of the process, Conning utilizes its award-winning¹ economic scenario generator, GEMS[®] Economic Scenario Generator software (Figure 2). The software produces real-world economic and capital market scenarios involving inflation, interest rates and equity returns all to be used in the calculations of a company's financial model. This provides stochastic scenarios for a range of paths across a multi-year time frame to optimize company value, not just investment returns.

Figure 2 Conning's GEMS[®] Optimization Process



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This holistic view allows us to incorporate P&C assets and liabilities into a single optimization. As such, we can capture impacts on the business, impacts on the investment portfolio and the interdependencies and interplay between the two. This provides a framework for assessing the company's value across a range of accounting, tax, and regulatory regimes to ensure stakeholders' key considerations are factored in.

When helping clients evaluate investment strategies, Conning takes great care in understanding their objectives and risk tolerance, which enables them to think through and communicate how the strategic decisions support profitability and financial strength. For instance, ensuring that liability payments and inflation risks affecting reserves are incorporated provides stakeholders a more in-depth understanding of the impact on the entire organization and not just projected investment returns. Having communicated extensively with the client's management and having completed thousands of different economic simulations using GEMS[®] software, we can dive deeper into different forms of analysis.

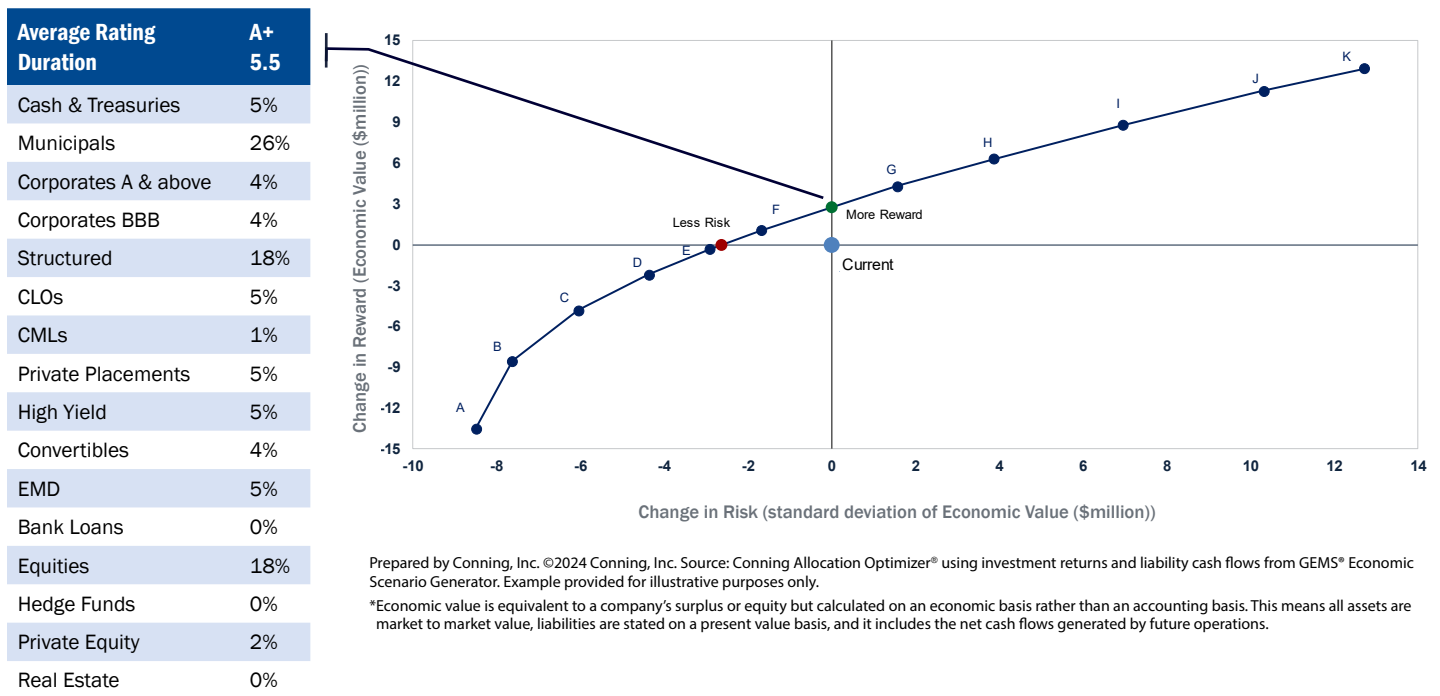
Examples of Analysis Employed During Conning’s SAA Process:

Optimizing Investment Strategies: The efficient frontier (Figure 3) shows how a company’s risk and reward can change from portfolio A (lower risk and return) to portfolio K (higher risk and return) by shifting the allocations to a wide selection of investment vehicles with different risk factors such as credit quality, liquidity and duration.

The company’s current investment strategy is plotted with the efficient frontier to show opportunities for more optimal enterprise outcomes that may result from varying alternative portfolio strategies.

We can also demonstrate the value of increased limits to certain types of investments, such as increasing equity and alternative allocations or adding new asset classes, to help generate additional value by improving returns for each level of risk or increasing diversification.

Figure 3 Investment Optimization: Efficient Frontier

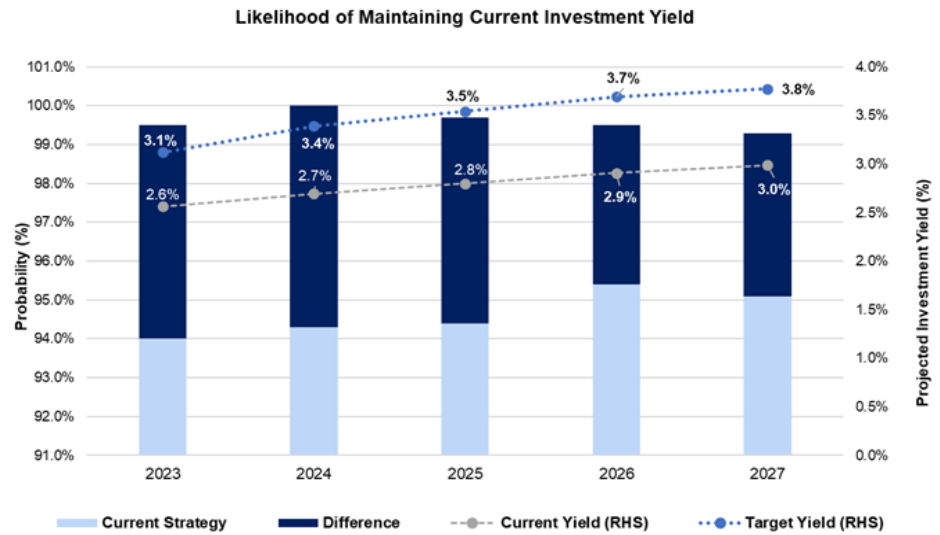


Evaluating Alternative Investment Strategies:

To identify the most efficient risk/reward strategy, Conning can display the impact of significant investment decisions (such as fixed income duration or a particular asset class allocation), to determine how it affects key financial metrics such as investment income, surplus volatility, and economic value. Ignoring those measures could lead to less optimal choices.

For example, the chart illustrates how an investment strategy can increase the likelihood of a company achieving a specific investment yield over time. (Figure 4).

Figure 4 Evaluating Alternative Investment Strategies

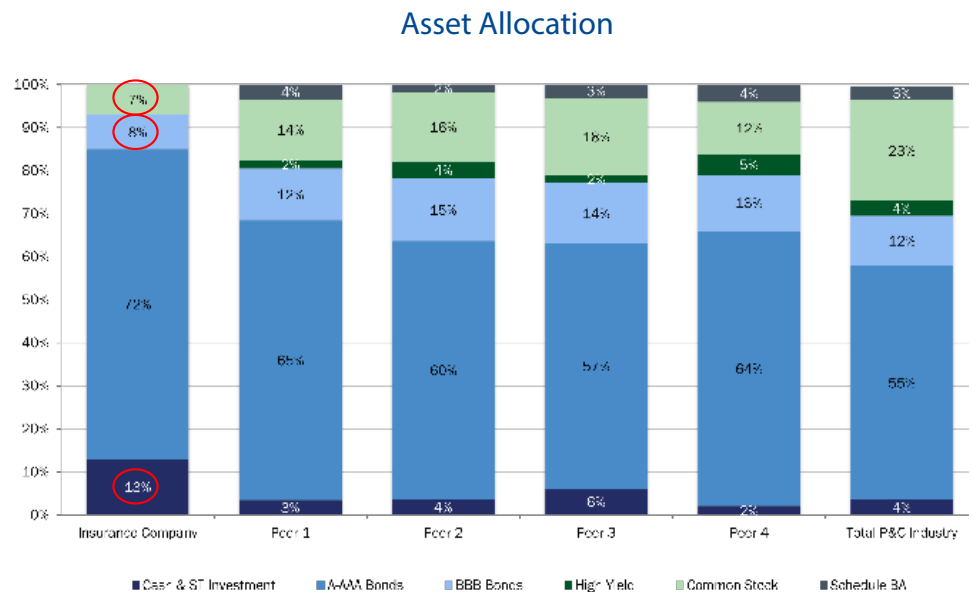


Prepared by Conning, Inc. ©2024 Conning, Inc. Source: Conning Allocation Optimizer® using investment returns and liability cash flows from GEMS® Economic Scenario Generator. Example provided for illustrative purposes only.

Peer Analysis: Conning assembles peer analysis reports for its clients which include information on the investment portfolio, underwriting & operational aspects of their business. With this tool a client can see how their competitors' portfolios are structured to help them evaluate their current positioning relative to industry or peer norms.

Peer analysis provides a company's management useful insight into trends and opportunities to assist in determining how much risk they are comfortable taking on the investment side of the balance sheet. Peer analysis can also inform where a company might be an outlier relative to their peers and industry. This can prepare management for possible questions from regulators and rating agencies who are often using similar tools.

Figure 5 Peer Analysis: Asset Allocation



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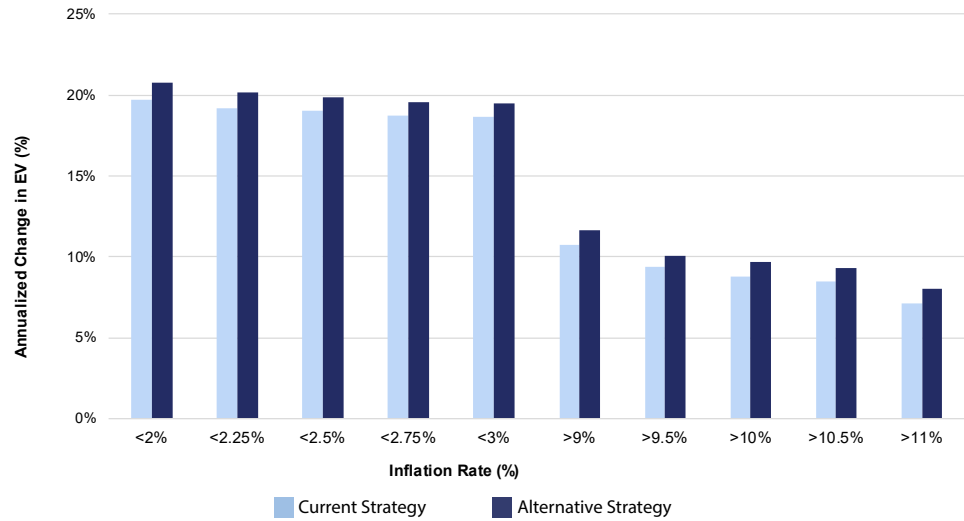
Figure 5 demonstrates how an insurance company profile might be more conservative relative to its peers, which translates to a less optimal portfolio and more forgone investment opportunities.

Managing Risk: A valuable step in validating an investment decision is managing risks. This involves assessing how an investment strategy can help mitigate specific risks. The chart demonstrates how an alternative strategy can enhance the impact on a company's financials at various levels or at different points in time.

To further validate an investment decision is to expand understanding of downside risk. This entails breaking down risks and measuring the value added or the diversification benefits.

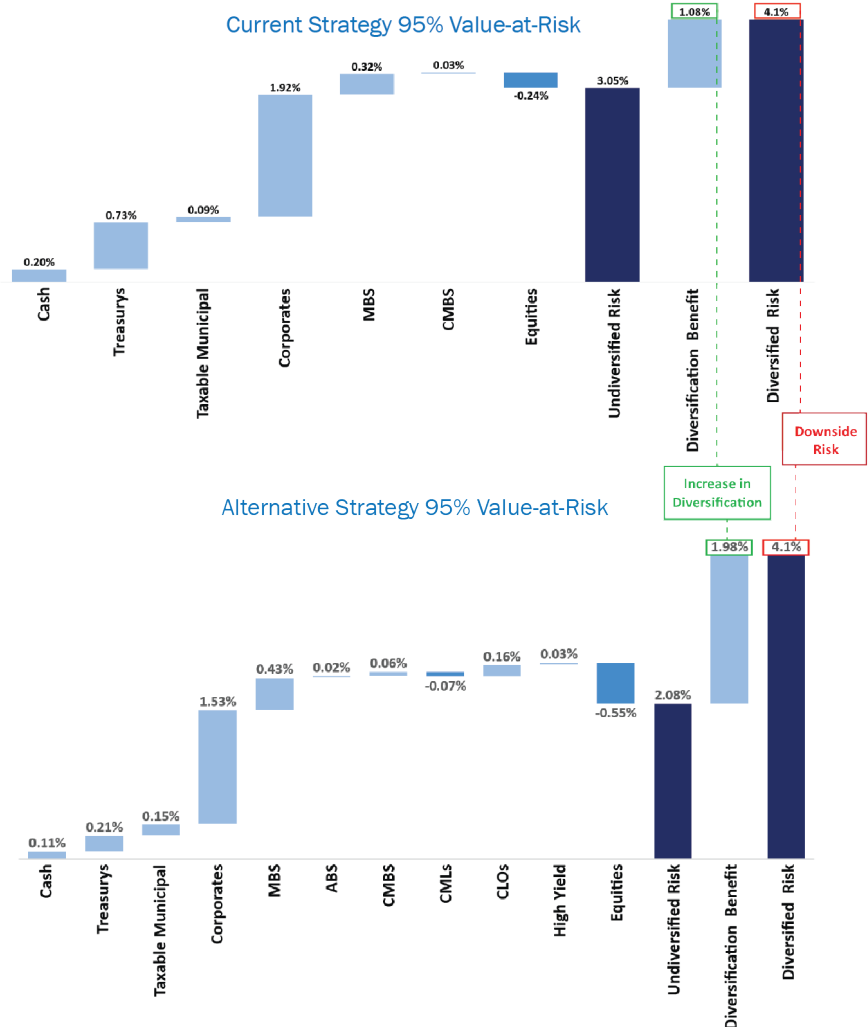
Figure 7 illustrates how we can adjust the investment portfolio with an optimal asset allocation, resulting in no change to downside risk (as measured by the 95% Value-at-Risk) but improving diversification benefits by 90 bps.

Figure 6 Inflation's Impact on 2025 Economic Value



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Figure 7 Historical Stress Test

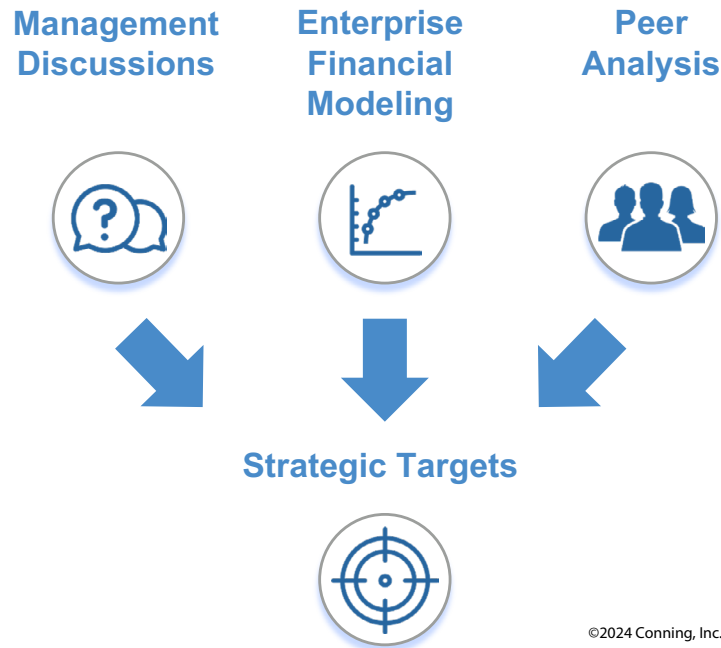


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Strategic Targets

Through the various types of analysis involved in the SAA process, Conning works to empower insurers to not only find an optimal investment strategy that fits their unique needs and risk tolerance, but also to communicate why a particular strategy is the most optimal for their company (Figure 8).

Figure 8 Strategic Targets



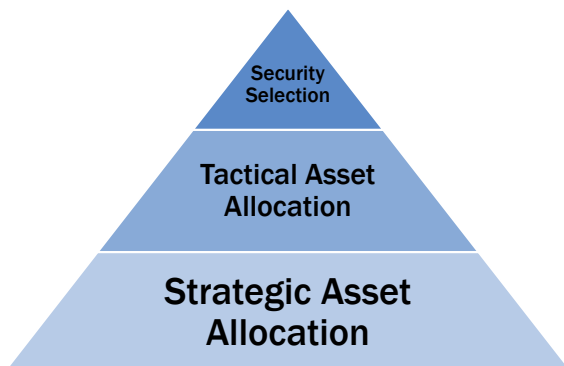
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The optimal result is an investment strategy customized to fit a P&C insurer’s risk profile that aims to improve return and reduce risk both economically and in statutory terms. With an optimal investment strategy in hand, the next step in the process is a revision to the investment policy, guidelines, and performance benchmark(s) to reflect the new strategy.

Conning’s institutional solutions and portfolio management teams work with clients to implement the SAA output, which sets a long-term framework for the enterprise to meet its stated goals and risk preferences. The SAA process essentially structures the portfolio risk factors or beta to achieve long term success. The portfolio manager can stay focused on executing through sector calls and security selections to deliver the insurance company’s alpha or excess returns targets.

Strategic Asset Allocation is an important extension of an insurer’s risk & capital management. Conning’s SAA approach is customized for each client and supports the company’s unique insurance operations and risk profile. When partnering with P&C insurers, Conning strives to become an important extension of a client’s financial, risk, and capital management process. We collaborate to find new opportunities to ensure the company’s unique needs are satisfied while enhancing company value and mitigating unnecessary risks.

Figure 9 Customized Portfolio Approach



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Model output, including the efficient frontier, and recommended investment strategies and portfolios are used to illustrate Conning's approach to insurance asset management. These were developed using publicly available data. It is not intended that any recommendations be implemented without preparing an updated strategic asset allocation analysis, incorporating private company information.

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