31 December 2019

# Conning: Sipping at the top table

**Channels:** Managers, Outsourcing, USA focus

Insurance assets are the mine asset managers have been looking to tap into in the last few years. Conning has built out its business to do exactly that, and now takes a place on the top table. Chief executive Woody Bradford explains how. By **Sarfraz Thind**

What does it take to serve the asset management needs of the insurance industry? Many, of course, want to do so, given the vast size of assets on offer, but few succeed. Conning spotted the niche a decade ago and has been honing its business to become a player in the insurance asset management market. From a $75bn base, Woody Bradford, chief executive, has led the company's assets under management to $171bn globally, two-thirds of which is for insurance clients.

"We are insurance specialists and clients can see it in our DNA," he says. "We have actuaries, accounting specialists and CFAs which enables us to talk the language of insurance companies. We are not an asset manager who bolted insurance onto our model—when we talk to insurers the entire business model is tailored to the unique qualities of the insurance client."

Given these unique qualities of the insurance business, the company has had to invest in resources. Bradford says when he came in 10 years ago he started to look at insurers' biggest problems and formulated a toolbox to address these. Thus the acquired businesses—the $6bn fixed income book purchased from Brookfield in 2014 or the $13bn credit manager Octagon in 2015 and then a 45% share in emerging market debt manager Global Evolution in 2017—to give it a leg up.

It has been a global expansion, broadening the investment product set and toolbox for both smaller and now large companies.

"I think that today we have got the most tools to help clients," Bradford says.

## Heterogenous concerns

Nonetheless the challenges of addressing the insurance sector remainInsurers' heterogenous needs puts more demands on an asset manager working in the sector.

"Every conversation is unique and bespoke," Bradford says. "You have to know where every insurer is, its capital and risk tolerance to decide what it is willing and able to do. If it is entirely in investment grade fixed income adding private placements can make a real difference to bond yield. Ones who have already played those will go to esoteric asset backed, or emerging markets or private equity. It is unique to each company."

While its expansion allows Conning to give advice to larger insurers and other institutional investors today, the asset manager's main client base remains small- to mid-sized insurance companies in the $5bn to $10bn range. It is, Bradford says, "a very demanding segment."

"Smaller insurers have realised the need to be more sophisticated than they were before the financial crisis," Bradford says. "And the last five to seven years have seen a lot of progress in scope and sophistication in the segment. Many are either adding more talent or spending more time learning about their choices but the learning will continue."

Conning occasionally come across some surprisingly unsophisticated larger insurers too, he adds.

The sophistication of an insurer is also linked to type of insurer it is. For example, an auto insurer will need to be good at short-dated assets but not as much long-dated. On the other hand a long-duration life company can sacrifice liquidity but has to be sophisticated in long-term assets. In any case smaller companies are trying to find more efficient ways to get exposure to new assets—things like commercial mortgage loans, emerging market assets, diverse equities.

## Competition

And, of course, there is competition. Bradford says he has seen more money managers trying to get into the segment as fees dry up in other areas but entering is not easy.

"Some parts of the asset management markets are very challenging—the US retail mutual fund business is very difficult; pension fund asset management is very difficult—so some firms have to some degree looked to insurance out of desperation and see an opportunity," he says. "But firms coming in discover that managing money for insurers is very complex and requires a bespoke model for each insurer you deal with."

In any case, few firms have a cultural understanding of the insurance nitty gritty. Certainly, pretending to be savvy won't work.

"You can't fake it—insurers don't have time to waste on someone who doesn't understand their specific needs."

These specific needs include capital, risk tolerance, regulations—how state level rules interact with federal regulations—accounting, tax implications.

Bradford says Conning has had people going to National Association of Insurance Commissioner (NAIC) meetings for 15 years and is regularly publishing material on regulatory and market developments to keep clients up to speed. Conning now competes against a handful of folks—"but it is a very short list," he says.

## Low rates

And with that the conversation inevitably turns to the topic of low rates. It is clear that low rates are the number one issue for insurers right now and new ideas are, therefore, needed. It is an issue common to insurance companies around the world and one that has proven unexpected in its severity.

"Negative yields are causing most insurance companies to redouble their efforts around the world to get yield," Bradford says. "These are conversations we are having with almost every insurer we support. Many investors thought we would get out of this situation at some point over the last five or six years. But low rates continue."

Given the relative lack of tools at their disposal, smaller insurers, he says, have been hit harder than larger ones. For many, the first stage was to extend duration and move further down the credit spectrum. As that ran out of steam so insurers have diversified returns, moving into private placement debt or mortgage backed securities or taxable municipal bonds and high yield assets. But now these assets are also expensive so now insurers are looking at even more sources of return to diversify.

## Risks

This, of course, brings additional complexity. Going into the later part of the credit cycle requires need for greater care. Bradford says insurance boards are looking at weaker covenants and are concerned about what will happen when recession hits. Nonetheless, many continue to take risk.

"We see some investors still taking a lot of interest rate risk," he says. "That happens when the asset portfolio is differently positioned compared to the liabilities. Doing that, investors are assuming they can predict the direction of interest rates. History suggests otherwise and people were—erroneously—predicting rising rates before."

The propensity to take more asset risk is potentially leaving insurers open to greater asset-liability mismatches. Bradford says insurers could be more proactive about rotating between weaker sectors and diversify risk and return. And, while this is a global trend, some aspects of asset diversification are potentially more complicated outside the US.

"Investors in the US can find most of what they need to improve portfolio diversification with dollar-based investment options," Bradford says. "Outside the US investors need to look at hedging costs too. Insurers in other parts of the world are doing a similar analysis – how do you diversify in dollars and what the cost is it to hedge back. The currency aspect adds a level of complexity for non-US insurers."

He mentions the case of Brexit in the UK as adding to local complexity. Also, while Asia is dealing with a complexity of regulations, Asian companies are catching up to their global counterparts in terms of sophistication. As rate growth stalls managing yield and the hedging costs involved will become ever more important.

Conning has also looked to aid clients via its economic scenario generator (ESG) GEMS.

The company leases it to insurers and Bradford believes it is one of the world's best. The transition of GEMS onto the cloud has made it easier for insurers to use it. Bradford says Conning has also been working in the field of artificial intelligence, though he is reluctant to divulge too many details. But we might get a sneak peek next year.

"There has been an extraordinarily thoughtful push into AI across the industry we are publishing on this," he says. "We are working on something in NLP (Natural Language Processing)—it is very proprietary. We will have something to say next year."

And the search for growth opportunities--particularly in Asia—continues as Conning seeks to broaden its global business even further. Certainly, the asset manager is working hard to keep its position at the top table.



↑