# Enterprise Risk Management: The Case For “and/or” Against Investment in Stocks in a P&C Insurance Company

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# Enterprise Risk Management

- Many metrics imply extremes today
  - E.G., total market value to GDP
- Others are near/above 2007 or 1999
- Look for contrarian indicators and be careful
- Review balance sheet
- Look for clusters of risk
  - Commercial mortgage, group life contract at WTC
  - Commercial mortgage, auto coverage along Gulf Coast

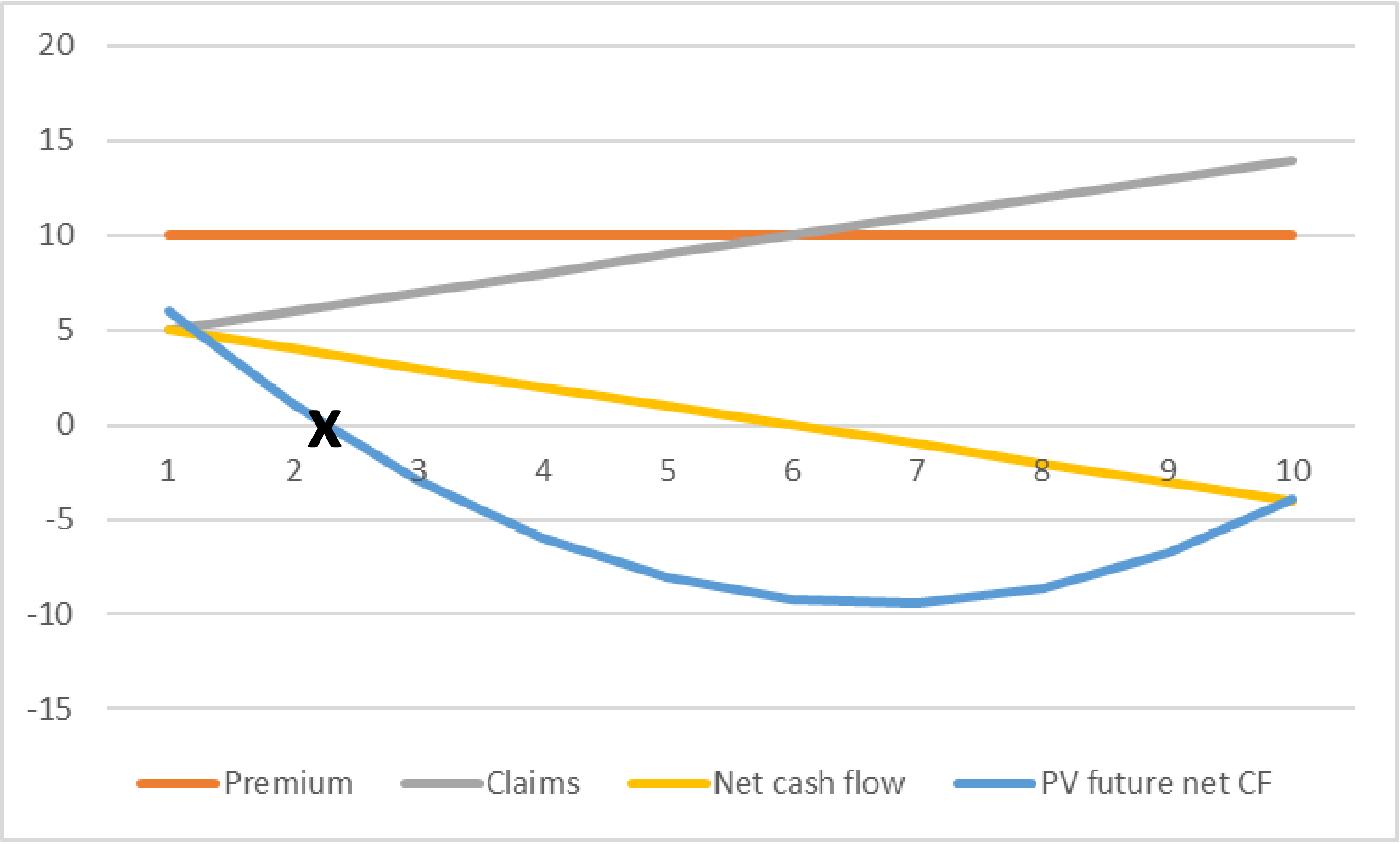
# Asset-Liability Management (ALM)

- Life insurers model interactions between assets and liabilities to set credited rates
- P&C insurers
  - Limited interaction between assets/liabilities
  - Liabilities are a form of leverage (float)
  - Most liabilities are relatively short
  - More focus on liquidity
  - When combined ratio is less than 100% less need for asset cash flow constraints
  - Premiums as an asset class
- Try to put yourself in shoes of outlier insurers
  - E.G., Berkshire Hathaway holds BNSF in insurer

# ALM - Duration

- What duration should you use for equities?
  - 0 since no interest rate sensitivity
  - Same as company as a whole (you own a portion)
  - Arbitrary (e.g., 5)

# Premiums as asset class



# Float – risky for some

- Short liabilities – float acts as form of leverage
  - Works best when loss ration is less than 100%
- Longer liabilities can kick-start results in both ways
  - Susceptible to interest rates
    - Parallel shifts of the yield curve
    - Twists – non parallel shift in yield curve
    - Higher order interactions like convexity
      - Not always obvious results in advance
- Worth thinking about even if not part of board packet
  - How do private equity firms think about this?

# Diversification

- Equities are separate asset class
- Correlations are less than 100% until you need them to be less than 100%
  - Not worth solvency threat
- But
  - Do you have expertise?
  - Do you have track record?
- Perhaps limit to percent of surplus constraint
  - Similar to below investment grade constraint

# Reaching for yield

- Everyone's doing it!
  - Be very careful
  - Consider the downside
  - Who is the sucker in the room?

# Lessons from the pandemic

- Don’t fight the Fed!
  - A rising tide lifts all boats – passive investing is great!
- You don’t know who has been swimming naked until the tide goes out
- How does this position our portfolio?
  - Cycles (The Fourth Turning)
  - What needs to be unwound
    - Stimulus
    - Interest rates
    - Credit cycle
  - Insurers are the providers of liquidity

# Risk Based Capital

- Why are equities all given the same capital charge?
  - Is the risk for a AAA rated insurer the same as for a CCC- natural gas company?
  - Splits by
    - Credit rating
    - Size
    - Other?
- Encourages risk arbitrage
  - Recent situations
    - BBB- bonds
    - Rating pay for play – securitized instruments susceptible
    - Investment grade CLO

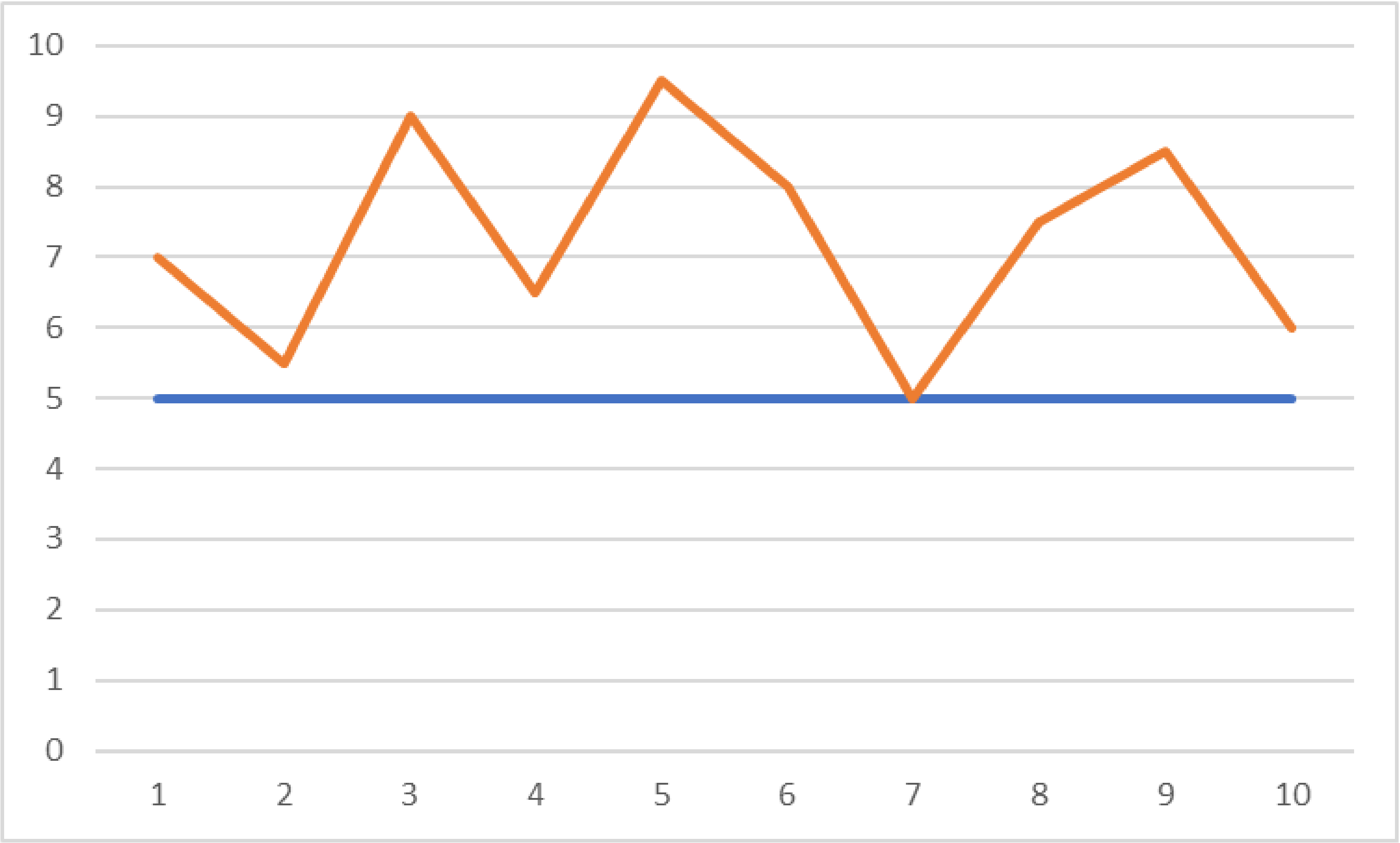
# Demographics and GDP

- OECD countries are aging
  - As are China and others
  - Elderly buy services and sell their assets for experiences and help
- Climate change is a threat multiplier
  - Forced migration
  - Diverts funds to repair and prepare
  - Conflict over resources

# Equity filters

- Beta assumes
  - Efficient markets
  - Price volatility
- Alternative
  - Circle of competence
  - Intrinsic value
  - Filters
    - Margin of safety
    - Leverage
    - Narrative (e.g., 5G, cost-plus pricing, demographics, infrastructure, renewable energy)
- What is the person on the other side of your trade thinking? You should be able to debate both sides.
- Rational human versus behavioral finance (reality)

# Which CF stream do you prefer?



# Thank you!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