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AN END IS A BEGINNING

He couldn't believe it. He had just been fired! Robert E. Short was the Chief Investment Officer for a medium sized insurance company—or rather, he had been. He had thought his work was well respected. Two months earlier his CEO had slapped him on the shoulder, asserting, "You've got a bright future with us, Bob." Fast forward to two minutes ago. Voices in the hall and a knock on his door. Sixty seconds later he was unemployed. It was that quick.

Jim Greening, the Chief Financial Officer, was still talking across the desk. He'd said what he had come to say, and now he had the nerve to smile. Couldn't the man summon the courtesy to shut his mouth and walk away? Bob tried to listen, but the shock of the moment left him battle-deaf, mute. He tried to concentrate, but his mind kept drifting off—to Iraq, of all places. And that was nearly twenty years ago!

Staring at Greening's face, Bob was aware that his brain was blocking the other's words. The odd thing was the flashback that replaced them. He was seeing himself in the hatch of his M2A2 Bradley Fighting Vehicle. The night was wonderfully clear and he was moving at speed over the rough desert surface of sun-split rocks while the hatch's steel rim punched his ribs black and blue.

In 1991 Bob had been a young officer commanding a unit in the 24th Mechanized Infantry Division assigned to Desert Storm. To the left of them the French 6th Light Armored Division; to the right, the British 1st Armored Division. The combined Allied force had been ordered to attack into Iraq early on Sunday, February 24, 1991, from a point just west of Kuwait. Their wing formed part of the "left-hook" intended to knock out the Iraqi 45th Infantry Division before swinging east for a flanking attack on Saddam Hussein's Republican Guard.

It was the French who hit the Iraqi 45th that night; it was the French who took the casualties.

"So that's it, Bob. Times are tough and we have to hone our investment side to this department's full potential." Bob surfaced intermittently, listening to Greening's words in equal parts shock, disbelief and fear. "I'm afraid you're not the man to lead us forward here. We need someone more aggressive." Bob recognized the fear in himself as he listened. He had known it before his unit had started to roll. It had seemed to dissipate the moment his Bradley's wheels began to churn. [NOTE 1-1]

Bob was looking at Greening, but thinking about Susan. She had quit work before their child was born, and they had a year-old baby daughter to support. Without an income. The thought didn't last. The starry orb of an Iraqi night eclipsed even his family from Bob's mind.

Out in the desert, armed with the sophistication of modern weaponry, he had needed neither compass nor GPS. The vehicles advancing in line abreast behind him were driving through a storm of sand and grit churned by the leaders; but Bob, in the front line, was running in the clear. For minutes on end that night he could have charted their course by the North Star. West Point had taught him advanced electronics, battle tactics, command techniques—and celestial navigation for survival.

Across the desk Greening was saying, "…a chance to refresh your skills, Bob." Then came the word "lacking," and "Maybe you should take more courses in communication. We could arrange that in your outplacement package."

Maybe, Bob told himself, he should have been a history teacher. The Academy's Department of History (Motto: "Wisdom Through History") had been the source of his favorite courses.

The moment the 24th Mechanized got its fighting orders, a glance at the map had told him their heading would put them on course for Cunaxa. Twenty-four centuries earlier the brothers Cyrus and Artaxerxes had battled each other at Cunaxa to rule the Persian Empire. Artaxerxes lost the battle; Cyrus lost his life, leaving 10,000 Greek mercenaries stranded in enemy territory far from home. One of those men, Xenophon, survived to write a book that still figured in leadership courses. At least, it did at West Point. It was no coincidence that Bob had taken Xenophon's Anabasis to Iraq, even—so it seemed as they roared through the night—into battle. At forty miles an hour on rough terrain the M2A2 Bradley's diesel was designed to keep pace with an M1 Abrams battle tank. Bob had stuffed several books in his jacket pockets that night, Xenophon's Anabasis among them, to pad the blows from the rim of the Bradley's hatch.

Across the desk, Greening was wrapping up. "I'm glad we had this conversation, Bob." Improbably, the VP advanced his hand and Bob shook it, dazed. "When you're ready to do the paperwork, see Martha in HR. She's got it waiting."

She's got it waiting! How long had this ambush lain in store, ready to be sprung?

Bob sat a moment, feeling for all the world as Xenophon must have done, a man marooned a thousand miles behind enemy lines, very far from home. [NOTE 1-2]

It was time to act. Bob packed his family photos and his personal files, turned off his computer and the Bloomberg monitor, dropped his keys and left. Security would do the rest. The CEO's recently voiced line, "You've got a bright future with us, Bob," would have to happen elsewhere.

The 24th Mechanized Infantry never reached Cunaxa. The French disengaged from the smoking remains of the Iraqi 45th Infantry and the whole line wheeled right, the Americans and British slowing to maintain the Allies' arcing line abreast to attack the Republican Guard. That didn't happen. The Guard joined the general Iraqi retreat, where Allied aircraft bombed men and materiel to destruction on the "Highway of Death." Three days later Bob's U.S. 24th Infantry played a major role in the battle at Rumailah (the battle of the junkyard), hammering Republican Guard vehicles into the sand. That was where Bob tasted fear again, keeping one eye on the sky. The Air Force killed more "friendlies" than Iraqis did.

Eighteen years earlier, Lt. Robert S. Short had done his bit to win a bigger battle than he faced now. He could do it again. He must. As he escaped the building he was once again keeping his eye on a metaphorical sky—avoiding the most familiar faces. He made it to the parking lot and the refuge of his car, wondering what to tell his wife. He reasoned that Susan might not be surprised. She knew that her husband was bright, but his communication skills were another matter.

That had been the brunt of Greening's criticism.

Bob toyed with his car key. How had his apparent failures short-changed the company? Greening had listed other factors to justify dismissing him but Bob had been too shell-shocked to take it in. No matter. He'd piece it together. He had to before he could move on.

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CHAPTER NOTES

What does the story of Bob Short have to do with investing for insurance companies?

What does the story of Bob Short have to do with investing for insurance companies?

Whether you have worked for an insurer, are currently doing so, or may do so in the future, parts of Short's story may sound familiar. In fact, it plays an integral part in learning about how best to organize and execute the investment process for an insurer.

Short works—I should say 'worked'—for a medium-sized insurer, so some of his challenges may be too simple compared to those you face. However, the basic challenges are here, and you will have to confront them successfully if you are to provide the best possible investment results for the insurer.

So, how does one develop a successful investment process?

An excellent question. And one that we deal with every day as investment consultants for insurance companies. You should know that our firm, Strategic Asset Alliance, is the only investment consulting company serving the insurance industry exclusively. We don't manage assets, but we help companies to improve their investment process with a focus on improving their financial results. You can find more information about us, as well as information that can assist in improving your company's investment process at our web site (www.saai.com).

You will get the benefit of Short's experience in this book, of course, but you will also get the benefit of the perspectives from our firm, whose principals are all former Chief Investment Officers of insurers, and who have collectively been responsible for over $30 billion in assets.

So, back to our key question: How to develop a successful investment process? Start with the 'end result' in mind. What is your priority? Portfolio yield, total return, no realized losses, or something else?

We submit that the investment portfolio of an insurer exists primarily to support the business of that insurer. The portfolio would not exist without the insurance business written, and being held, as reserves to cover future claims, losses, surrenders, etc.

And, the portfolio would also not exist without the capital (raised or accumulated over time) in the company. It is there for a reason—to provide shareholders (or policyholders in the case of a mutual company) with a fair return. But, the desired return would never come about without a successful insurance business.

So, first and foremost, it is important to keep the role of the Chief Investment Officer in perspective. It is a vital position within corporate senior management. It exists to serve the goals and objectives of the company.

What is the 'end result' then? For many insurers, it is not portfolio yield or total return; it is return on surplus (shareholders' equity), net income, earnings per share, or another similar measure tied to the overall financial performance of the company. We call these measures 'key performance indicators' (KPI) of success.

Corporate goals and objectives are tied to the desired KPIs over a given time period. It follows that the investment process must have a series of goals and objectives directly related to achieving that end result.

For example, if Short's company wants return on surplus, he should fully understand the accounting ramifications of how return on surplus is calculated, and how the investment portfolio contributes to that.

For an insurer, such a KPI usually means a fixed income portfolio focused on investment income as well as total return, and an equity portfolio (if applicable) focused on total return. Importantly, investment income should be viewed net of credit impairments, an increasingly difficulty issue from both an economic and accounting perspective.

Many times, we see companies whose investment goals are disconnected from corporate KPIs to some degree. That can pose an underlying problem that festers until the two really do diverge significantly. This can result in a series of unintended consequences.

Consider the environment Bob faced during 2008. Equities down over 40%. Supposedly safe fixed income investments buffeted by a near total lack of liquidity, and pricing that expects the worst in defaults and then some. Mortgage-backed securities that would pay in full, corporate bonds that were the pillars of the economy, and other ‘rock solid’ investments all valued at ‘fire sale’ prices.

On top of that, we found auditors effectively calling the shots on what must be written down as ‘Other Than Temporarily Impaired’ and pushing the dangerous standards of ‘fair value’ found in ‘mark to market’ accounting. Meanwhile, rating agencies, running scared from their own problems, delve into investment portfolios as much to salvage their own reputations as to understand the risks in the portfolio.

To this, we can add senior management and a Board of Directors stunned that a ‘conservative’ portfolio can get into trouble so quickly.

If all the above factors wouldn’t make Bob Short feel marooned, it most surely made many other CIO’s feel that way—even without the added pressure presented to Short at the beginning of our story.