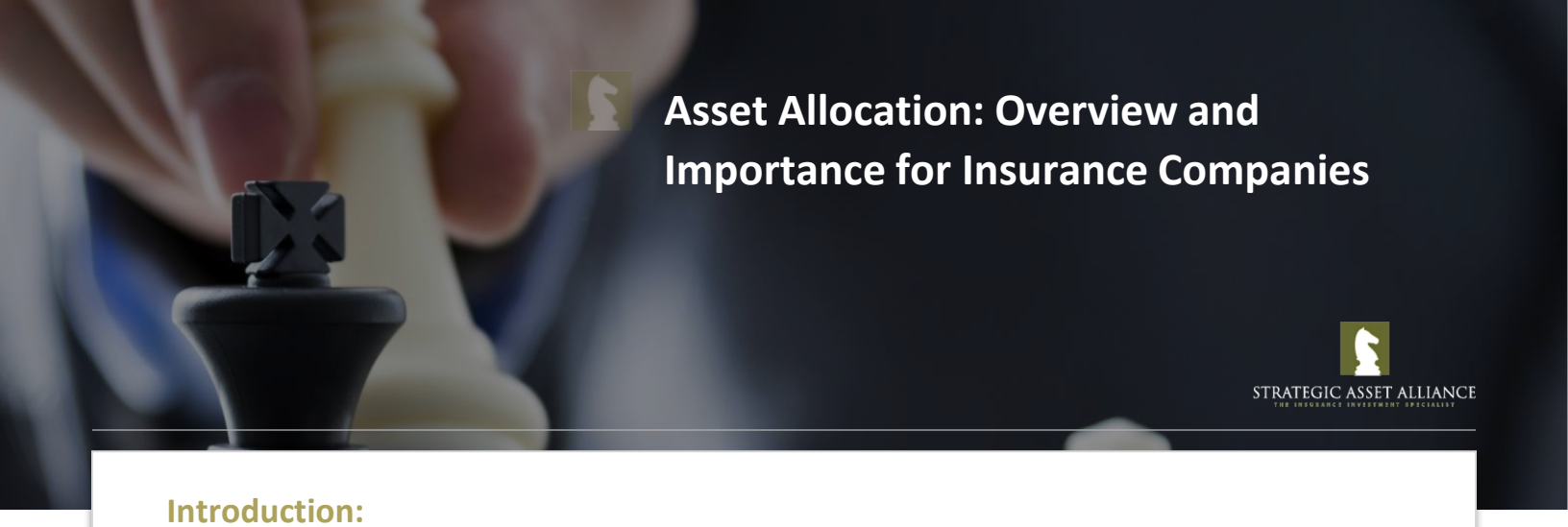


Asset Allocation: Overview and Importance for Insurance Companies

STRATEGIC ASSET ALLIANCE

Introduction:

Essentially, asset allocation is your insurer's investment strategy; the types and quantity of investments your insurer selected based on desired return, tolerable (potential) risk of loss and organization goals.

Determining your insurer's strategic asset allocation structure is the most important decision that you will make throughout the investment process. Over 90% of your company's investment performance and re-turns will be determined by the allocation decision.

Types of Asset Classes

Investment-Grade Fixed Income:

Fixed income is a type of investment debt security (aka bond) that pays investors fixed interest payments until its maturity date, when the principal investment amount is repaid.

Investment-Grade Ratings:
S&P: "BBB" and Above
Moody's: "Baa" and Above
NAIC: Bonds Rated 1 to 2

Fixed Income bonds are evaluated by rating agencies on the probability that the issuer will repay its debt. Any issuer or bond with an investment-grade rating are considered highly likely to repay debt by the maturity date.

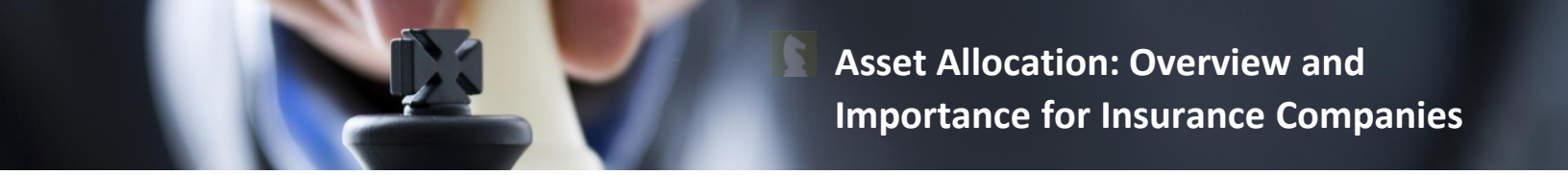
Due to policy holder obligations, necessary reserves and risk capital, most insurer portfolios are heavily allocated towards investment-grade fixed income.

Government and corporate bonds are the most common types of fixed-income allocations. Insurers also commonly utilize fixed-income ETFs and/or mutual funds

2025 © Strategic Asset Alliance

The information on this website is only intended for institutional investors, such as insurers. Always contact a professional before making any investment decision.

The information contained herein has been obtained from sources believed to be reliable, but the accuracy of information cannot be guaranteed.



Asset Allocation: Overview and Importance for Insurance Companies

Types of Asset Classes *(Continued)*

Risk Assets:

Risk assets are any investment outside of investment-grade fixed income. This includes, High-Yield Bonds, Common Stock (or Equities) and Preferred Stock, as well as certain Long-Term Schedule Ba Investments.

Risk assets provide greater potential returns, but with greater risk of loss and/or return volatility. Risk assets may also potentially help insurers maximize portfolio diversification.

Risk Assets Primer:
Review how insurers are utilizing risk assets.

View Risk Assets Primer >>

Alternatives:

Alternative assets are any investment outside of stocks and bonds, such as hedge funds or private equity.

Generally, insurers do not invest in alternative assets due to the high level of fees, the potential lack of liquidity, agency problems, and the impact to capital ratios.

Key Considerations & Next Steps

Understanding Regulatory Constraints on Allowable Asset Classes:

Regulations can impose constraints on potential allocations to certain asset classes. For example, many insurers can be limited to certain investments outside of investment-grade fixed income.

Thus, a review of the applicable regulatory framework is an integral part of any asset allocation modeling.

Model Different Allocations:
Easily model various allocation scenarios to determine your company's expected portfolio return.

Test Asset Allocation >>

Determining Risk Appetite:

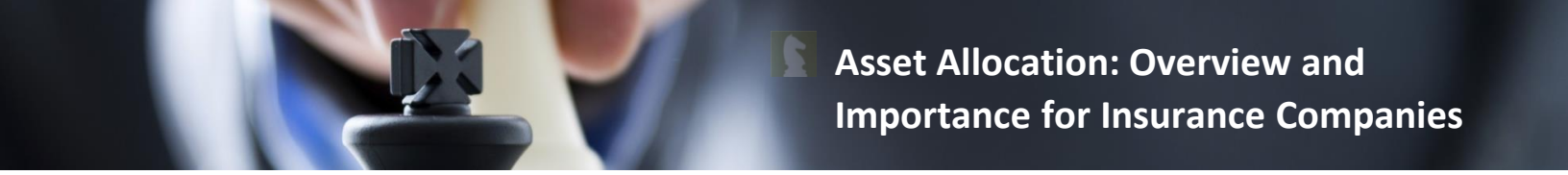
The risk tolerance of your insurer's executive staff and Board/Investment Committee is important to the developing an optimal asset allocation. Various scenarios based upon different investment structures can gauge the impact of these scenarios on key investment and company metrics.

This can determine how much in terms of 'potential loss' your staff and Board/Committee are willing to take on the investment side.

2025 © Strategic Asset Alliance

The information on this website is only intended for institutional investors, such as insurers. Always contact a professional before making any investment decision.

The information contained herein has been obtained from sources believed to be reliable, but the accuracy of information cannot be guaranteed.



Key Considerations & Next Steps *(Continued)*

Review Current Asset Allocation and Potential Alternatives:

Insurers can compare their current asset allocation to other potential models in various ways. Potential asset allocation models can be focused on the asset side of the balance sheet or can also include the impact of insurance reserves.

Many insurers also model asset allocations by considering reserves, surplus, and other financial considerations.

It may also be beneficial to utilize an 'asset only' approaching; Testing how your portfolio may perform by simply changing the allocated amount to certain asset classes.

Revising the Investment Policy Statement:

Once the strategic asset allocation has been completed, the investment policy should be revised to reflect changes made to the investment portfolio.

This includes target allocations to certain asset classes, procedures to rebalance the portfolio and assigned roles to staff or outsourced firms within the investment process.

IPS Primer:
What's Important and Why?

View Primer >>

About Strategic Asset Alliance:

SAA is an independent investment consulting firm that works exclusively with insurance companies and insurance-oriented public entities. Founded in 1994, our experience and focus enable us to help clients improve their investment process and enhance the value added by their portfolios; critical components of their business.

We provide insurers and risk pools with independent investment advisory services (we do not manage assets) to aid their board members and staff in meeting fiduciary responsibilities, along with strengthening their investment program.

2025 © Strategic Asset Alliance

The information on this website is only intended for institutional investors, such as insurers. Always contact a professional before making any investment decision.

The information contained herein has been obtained from sources believed to be reliable, but the accuracy of information cannot be guaranteed.