



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 returns 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.

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.

#### 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.

#### 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.

#### Investment-Grade Ratings:

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

#### Risk Assets Primer:

Review how insurers are utilizing risk assets.

[View Risk Assets Primer >>](#)

[Continue to Key Considerations & Next Steps >>](#)





### 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.

#### **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.

#### **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' approach; 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.

[View Investment Policy: What's Important and Why >>](#)

#### **Model Your Risk Appetite:**

With SAA Solutions, your insurer can review and test various risk allocations and potential downside impacts

[Determine Risk Appetite >>](#)

#### **Model Different Allocations:**

Easily model various allocation scenarios to determine your company's expected portfolio return

[Test Asset Allocation >>](#)

