Proprietary Benchmarks Aligned with Insurers' Needs

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For insurers, accurately measuring asset manager performance has been an ongoing challenge. Their portfolio income objectives can render traditional 'total return' success metrics impractical. While bits and pieces of a solution have been offered in the past, no one has offered a comprehensive solution.

THE CHALLENGE

Insurers typically build products with an expected yield based on their guidelines (e.g., regulations, taxes) and what is available in the investing universe (e.g., durations, yields, ratings). Internal or external asset managers are then often charged with managing premiums (cash inflows) to help meet the product's stated yield objective. How does an insurer know if the asset manager was successful? It's not as easy as one might think.

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Limitations of Total Return Benchmarks for Insurers

Asset managers and insurers alike can find total-return benchmarks lacking when it comes to offering an accurate measure of portfolio performance. One significant reason in our view is total-return benchmarks evolve. For example, holdings can be subject to maturity, mergers & acquisition events, defaults and illiquidity. Over time, a total-return benchmark can drift away from an insurer's portfolio. Attribution at the end of the period may show a security as having made a significant contribution to the total-return benchmark—a security the portfolio manager may not have been able to buy because it never traded.

Building on Loomis Sayles' Skills

Loomis Sayles was positioned to push the limits of technology and asset management to meet insurers' specific benchmark needs. From our experience and perspective, a solution would have to draw on a team of insurance, technology, and asset manager professionals—a team we already had in place. We believe an added advantage for developing a solution was our ongoing partnership with an insurer who could help provide necessary critiques as the solution evolved. Such a working group foresaw issues and efficiently vetted ideas to tackle them.

"Benchmark Snapping"

How can you hold an asset manager to a benchmark that loses creditability over time? We would say that you can't. In our judgement, the challenge was to create a benchmark solution that considered the implications of the timing of an insurance company's cash inflows into a portfolio.

We needed to analyze all the investment options within the insurer's directive that an asset manager could actually buy. With that established we could seek to create a representative universe for the asset manager. Each time there was a cash inflow, we took a snapshot and time stamped the possible universe—we call this "benchmark snapping." This static picture of holdings shows what the asset manager could have bought at the time of the cash flow.

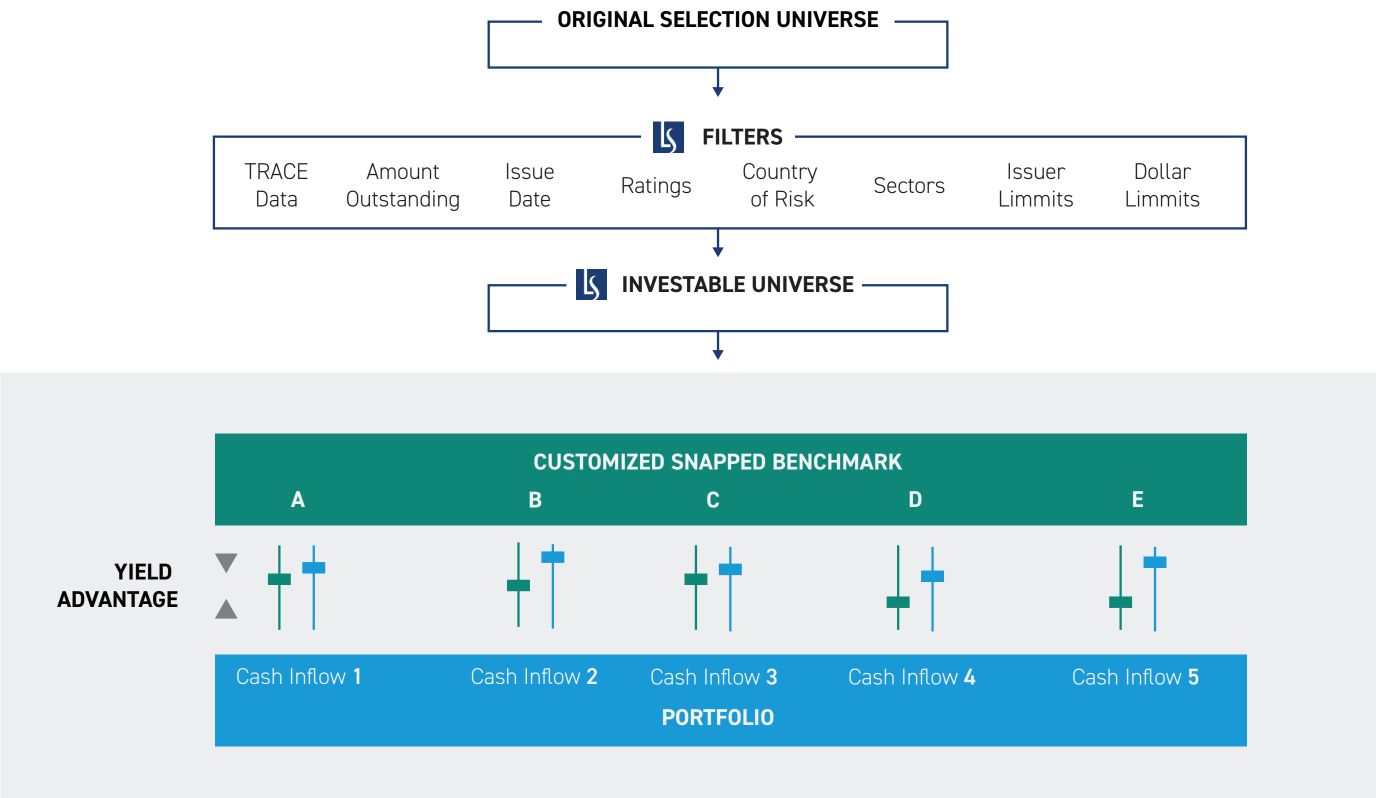
The Process

Once a client defines its portfolio constraints (e.g., security limits on sectors, ratings, countries, etc.) the Loomis Sayles algorithm takes into consideration additional issues that can influence a benchmark's effectiveness for insurers. Using a pragmatic lens we set up criteria to measure a variety of critical factors with a focus on whether the benchmark is investible.

The next step is to confer with our client to create an applicable universe and take a snapshot of it. Each time a cash flow comes in we look to create a universe and take a snapshot of it. Multiple universes can be created during the process and they are melded together.

Our intention is to provide a portfolio manager with a universe of securities they could actually buy and trade at the outset—not always possible with a total-return benchmark. With this in place we believe an insurer can get an accurate measure of an asset manager's relative performance.

HYPOTHETICAL GRAPHIC INTENDED TO SHOW HOW BENCHMARK SNAPPING WORKS



Source: Loomis Sayles.
Charts are shown for illustrative purposes only as a sampling of risk management tool output.
Some, or all, of the information on these charts may be dated, and, therefore, should not be the basis to purchase or sell any securities.
The information is not intended to represent any actual portfolio.

Summary

A great deal of teamwork was necessary to create the Loomis Sayles Benchmark Snapping tool. We cannot overstate the contribution to the development of the tool by the Loomis Sayles technology team. Having a reliable in-house resource assisted the Insurance Team in taking development steps relatively quickly. The result is a nuanced and pragmatic tool for a variety of insurers.

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