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Insurers' investment outsourcing grows

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Questioning: David Holmes said insurers ask if they can navigate the markets themselves.

North American insurance companies decided to outsource investing in increasing numbers last year, a trend that followed massive insurer investment losses during the financial meltdown of 2007-2008, consultants and managers say.

And the trend shows no sign of abating in 2010, said David Holmes, a consultant with Eager, Davis & Holmes in Louisville, Ky.

"Insurers are continuing to question whether they have the internal expertise and knowledge to navigate the financial markets,' " said Mr. Holmes, whose firm tracks third-party insurance money management placements.

Data from the firm's Insurance Asset Outsourcing Exchange shows for the first nine months of 2009, the most recent data available, insurers awarded 141 investment mandates to money managers totaling $53.7 billion. That compared with 105 mandates totaling $17.9 billion for all of 2008 and 133 mandates totaling $15 million in all of 2007.

The exchange estimates that for all of 2009, insurers will have awarded 188 accounts totaling $71.6 billion to money managers.

“It's huge,” said Mr. Holmes. “2009 is absolutely a record for the number of managers being hired for new mandates and the associated assets they represent.”

Not only are the numbers way up, but larger insurers — those with more than $5 billion in assets — are joining their smaller counterparts in outsourcing investment management.

“There has been an explosion in larger placements; it's a pretty strong trend,” Mr. Holmes said.

Mr. Holmes, who consults with money managers looking to expand their share of the insurance outsourcing business, said the credit crisis and insurer investment losses have clearly fueled the trend. “There is a realization by insurance companies that they need more expertise than they have in-house,” he said.

Northbrook, Ill.-based Allstate Insurance Co. in October hired Goldman Sachs Asset Management Inc. to manage a $4.6 billion portfolio of public equities. Allstate spokeswoman Maryellen Thielen said in an interview the insurer decided to switch to a passive index approach from an active investment strategy and felt Goldman had expertise in that area.

Swiss Re decided to outsource the management of $23 billion in corporate bonds and non-agency securitized products to BlackRock Inc. last fall because it felt the money manager has the expert knowledge required to manage the portfolio.

“Obviously the market is challenging, the management of complex assets required a specialist,'' said Swiss Re spokeswoman Alayna Francis, based in New York.

Madison, Wis.-based American Family Insurance Co. spokesman Ken Muth confirmed that the company had outsourced part of its asset management in 2009 but would not provide details.

Insurers typically are skittish about revealing outsourcing relationships, Mr. Holmes said; revelations that they aren't managing their own money might not sit well with the public or investors.

But money managers say the relationship makes sense because it allows insurers to focus on underwriting.

“While insurers have always focused on risk management, most of that emphasis has been on the liability portion of their balance sheet, assessing the likelihood of an insurance payout,” said Kristen Dickey, managing director and head of New York-based BlackRock's Financial Institutions Group. “They haven't tended to put the same level of emphasis on risk management on the asset side.“

Ms. Dickey said BlackRock had a record year in inflows from insurers, but she refused to release dollar figures or identify any clients.

Other major money managers also reported that 2009 was their best year for winning insurance business, but would not provide details.

Randy Brown, Deutsche Bank's New York-based global head of insurance asset management, said 2009 was a year of significant growth in insurance outsourcing for his company, the strongest in its history. Deutsche would not provide data about inflows before the quarter end.

Mr. Brown said: “Insurers have traditionally invested in high-grade fixed income, a sector that historically provided stable returns. Last year's market dislocations exposed significant risks that many were not equipped to manage, causing insurers to examine whether they should outsource. “

“The complexities of the market have increased. There is greater need for depth of research,” he said.

New business boom

Eric Kirsch, the New York-based managing director and head of global insurance asset management at Goldman Sachs, said his unit had its best new business year in 2009, winning one $15 billion mandate from a U.S. life insurance company — which he wouldn't identify — to provide a full array of services, including discretionary and advisory investment management, insurance strategy, and investment and risk reporting services.

Mr. Kirsch said the company continued to win additional mandates in the last quarter of 2009, but did not provide specifics.

He said the trend should continue in 2010 as insurers realize that investing financial assets has become more complicated.

“As the financial crisis unfolded, more and more insurers realized that running their own asset business is very complex, it takes a lot of resources and scale and it's not their core competency,” he said. “This led to increased desires to outsource to third-party asset managers.”

Sunny Patpatia, president of consulting firm Patpatia & Associates Inc., Berkeley, Calif., said $965.8 billion was being outsourced at the end of 2008, according to figures from the 53 largest money managers doing business for insurers. He said that number grew dramatically in 2009, but his firm has yet to calculate totals for last year.

Mr. Patpatia's data show the five biggest money managers of outsourced insurance assets as of Dec. 31, 2008, are Deutsche Asset Management at $176.9 billion, BlackRock at $164 billion, State Street Global Advisors at $97.3 billion, Conning Asset Management at $75.3 billion and General Re-New England Asset Management at $48.2 billion.

The consultant said he sees the trend to outsource rapidly accelerating over the next several years. Insurers are still assessing their losses from the financial crisis and evaluating the wisdom of outsourcing, he said.

Mr. Patpatia, who advises insurers on outsourcing, said most insurance companies don't have the investment resources that the major external money managers can bring to the table.

“The internal insurance investment manager with a small staff can't compete with someone like BlackRock with 300 people assessing different investment opportunities around the world, he said.”

For smaller insurers, it's often simply not economical to have their own investment staff, agreed economist Robert Hartwig, chief economist and president of the New York-based Insurance Information Institute.

"It can be done for a lower expense ratio by an outside manager," he said.

Even smaller money managers are reaping the rewards of insurance outsourcing. Robert G. Smith, chief investment officer of Sage Advisory Services in Austin, Texas, said his firm has seen a 22% to 25% growth in the amount of assets under management from insurers over the last three years. While final figures are not in from 2009, Smith expects it to be a record year and continue into 2010.

He said his company has $8.5 billion under management from insurers and has been successful by focusing on smaller insurers, risk retention groups and captive insurers. "It's not true that all money flows to PIMCO and Black Rock," he said.