

INSURANCE ASSET MANAGER

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ADJUSTING TO POST-CRISIS MARKETS WILL TAKE TIME AND PATIENCE, SAYS ASSET MANAGER ADVISOR JEFF MARGOLIS

When you look at the history of the third-party insurance asset management business, you'll see that it really started to take root in the 1980s, and that's how Jeff Margolis became a pioneer. After graduating from Cornell in 1980, he joined Continental Corp. in 1983 and was assigned to the asset management unit. Shortly thereafter, he found himself reporting to Walter J. Blasberg, who subsequently has had a successful career at insurance investment specialist firm Conning & Co.

Continental colleagues of Margolis who have also enjoyed long careers in the insurance asset management arena include Peter Noris, Roberto Plaja, Larry Shaw, Rob Stricker and Fred Weinberger. He remembers that Brown Brothers and Stein Roe became competitors at that time, and that BlackRock wasn't even founded until 1988. He also pays tribute to Scudder, eventually to be absorbed by Deutsche Asset Management, for being the original pioneer back in the 1970s.

Working for Blasberg at Continental Asset Management, Margolis focused on asset & liability management and asset allocation strategies for the P&C side of the company. One thing led to another, and before long his group was building a successful record attracting outsourced assets from third-party P&C companies. Ten years later, Continental Asset Management was acquired by TCW Group, Inc., before becoming part of Conning in 1999. By 1994, though, Margolis had joined Morgan Stanley Investment Management where he stayed for nine years (1994-2003), becoming global head of the institutional business, before moving to TIAA-CREF as head of asset management business development.

In 2009, more than 25 years after joining Continental, Margolis launched his own consulting firm, Margolis Advisory Group, Inc., that advises asset management firms, including managers of insurance assets. He is based in Roslyn Heights, NY, on Long Island. Last summer, IAM editor Alex McCallum did a short interview with Margolis centered on his decision to go-it-alone. This time round, Margolis answered a wider range of questions involving the state of the asset management industry and the outlook for 2010.

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IAM: What are some of the significant changes you have seen in the community of insurance asset management firms since the outbreak of the financial crisis? Are some firms dropping out? Are new ones coming in?

Margolis: The business seems to have gotten more competitive, and this is reflected in pricing. At the same time, new entrants have come in; I am not aware of many firms that have formally dropped out, but some are reevaluating their commitment. While the trend continues to be toward increased outsourcing, thus attracting new entrants, the environment has caused insurers to be more cautious with their investments and the selection of managers.

IAM: How would you gauge the overall reaction by insurance asset managers, in responding to their clients, at the onset of the crisis and over the course of the past year?

Margolis: Insurance asset managers, like all asset managers, have been forced to redouble their client service efforts. Communications have been critical, as clients got concerned about their portfolios. Many managers have had to make more presentations to their clients' boards of directors. While the peak of this activity has passed, I don't see it abating completely.

IAM: Many asset managers have been running tighter budgets since the crisis, of course. How much do you think this is affecting their attention to marketing, and has it encouraged them to look for advisors like yourself and outsource more?

Margolis: Budgets have been tight which has limited their ability to expand resources. In tight budget situations, investment professionals tend to be top priorities, understandably. As a result, marketing resources have been squeezed. One trend I've seen during this period amongst all managers is to consider outsourcing production functions such as RFPs, data base management, and marketing communications. This allows for variable cost solutions which provide budget flexibility. There are surprisingly high quality options for these functions in the marketplace. In addition, demand for advisors like myself has picked up as firms try to navigate the more uncertain environment. Most firms are re-examining how to best play in this marketplace.

IAM: When you study the insurance industry sector and compare it with the entire institutional investment spectrum, what are the different skills that an asset management firm working for insurance companies should possess in order to be a successful player?

Margolis: Asset managers pursuing insurance companies as clients must exhibit a thorough understanding of the insurance company investing environment, including investment objectives and constraints, asset liability concerns, the tax, accounting, and regulatory environment they manage within, and their competitive environment. These issues manifest in a variety of potential ancillary services managers can provide such as asset-liability analysis, tax optimization, accounting statements, and regulatory analysis. Insurance asset managers should deliberately choose how to position their brand along the spectrum of services offered in the marketplace.

I'd add one more observation: With insurance, you become a very close partner with your clients in a way that goes beyond a typical manager/client relationship in other sectors, because you have to really understand the client and how they want to drive their strategy. On an intellectual level, if you will, it is a very interesting and demanding challenge.

IAM: Do you see any signs that asset managers new to the field of insurance investment are having any success? And do you think these newcomers have the potential to create a wider distribution of outsourced insurance assets, the majority of which are tightly concentrated among the top dozen or so managers?

Margolis: Even though the marketplace is concentrated at the top, new entrants can be successful by competing across a number of dimensions: specialized investing capabilities; ancillary services; price; and personalized advice. Being a dominant player provides compelling advantages, but some clients prefer the

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products and services they get from smaller, niche competitors.

IAM: Do you think lessons you have learned over the years in the insurance sector could be applied to other sections of the investment arena?

Margolis: Certainly. For example, with managing investments for corporate pension funds, there are obviously asset/liability issues that demand extensive actuarial treatment. But, generally speaking, you don't see the same very tight linkage between client, actuary and investment manager that you do in the insurance sector. In other words, risk management is second nature to insurance companies and their advisors, and has been part of their culture for a long time.

IAM: As an advisor to asset managers, what aspects of the business do they especially want the Margolis Advisory Group for? Investment? Business development? Regulatory and industry intelligence?

Margolis: The focus of my firm is to help asset managers with growth and retention strategies and the execution of those strategies. Because of my hands on experience of 25+ years, I find managers are attracted to my pragmatic approach that helps them drive results. I have a particular expertise in tying strategy to execution; that is, focusing on the forest, but being able to navigate around the trees successfully. My extensive background in insurance asset management has been attractive to a number of industry competitors.

IAM: How have you adjusted your business in reaction to the financial crisis in order to keep and cultivate asset manager relationships, and how do you see the outlook shaping up in 2010 – especially in relation to the insurance asset management sector?

Margolis: I have had dialogues with dozens of managers about ways to navigate through what I call the "new normal" industry environment. This environment will be characterized by an extended period of lower margins and increased competition. Only managers who adopt best practices will prosper. These managers clearly see the need for expert advice which has led to a wide variety of engagement discussions. This is no different in the insurance asset management sector which will also exhibit increased competition and margin pressures. One advantage in this sector, though, is the ongoing trend toward increased outsourcing which at least provides a tailwind for managers.

IAM: You talk about a "new normal" environment that's developing. As my final question, could you expand on what you mean by this?

Margolis: Well, firstly, I can't take complete credit for "new normal" because Bill Gross of PIMCO has been talking it up, and I've heard it elsewhere. So I'm joining the crowd. Either way, I think it's a great term to help us try to understand what is happening. Here's how I see it:

When I talk with investment managers around the industry, they are not acting as if this recovery has legs, they are very cautious about spending and are waiting to see how things are going to play out. This is not a normal recession or normal recovery, I hear them say -- there is something else going on.

Back in 1987 with the October equity crash, followed by Long-Term Capital Management ten years later, Mexico problems, Russian problems, Asian problems, it seemed like every few years there was a shock to the system. They were shocks, yes, but they didn't damage the overall system. We all bounced back rather swiftly. As time went by, we became more and more complacent, believing a system that had demonstrated this kind of resilience crisis after crisis would continue in the same vein. Wrong!

So I don't see world economies and confidence coming back quickly in 2010, even if the investment markets continue to recover in some measure. Caution is going to be the watchword, and patience a virtue. The "new normal" environment will be very challenging, I think, for at least two or three years -- until we all have greater experience with the markets and a better understanding of the changes that are taking place in the post-crisis world.

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