ALTERNATIVES: A GROWING AND CHALLENGING ASSET CLASS FOR INSURERS

As insurance companies increase portfolio exposure to alternative assets, the challenge of managing administrative requirements also rises.

OPERATIONAL AND ADMINISTRATIVE CONSIDERATIONS

Alternative assets, such as private equity, real assets and hedge funds, used to receive less attention after initial due diligence. But today's regulatory, accounting and data requirements have increased pressure on investors for greater oversight – something insurance companies may be unprepared to manage.

What's considered a well-traveled road for other institutional investors has become a serious burden for traditionally risk-averse insurers. Without proper tools, technology and processes to adequately monitor and manage alternative investments, insurance companies continue to face obstacles with routine, yet critical, administrative tasks.

Institutional investors like the strong returns alternatives promise but struggle with administrative demands of managing and monitoring an alternatives program

- Accounting, data management and reporting
- Performance and risk management
- Technology and IT infrastructure

ACCOUNTING, DATA MANAGEMENT AND REPORTING

Accounting challenges exist for many alternatives, such as private equity, because the manager acts as the source of information. The manager (known as the general partner or simply GP) determines the fair value of the investment, often by appraisal and without a market exchange. The GP also controls when contributions are made, in the form of capital calls, and when money is returned to the investments via distributions after the GP exits the fund.

Without visibility into the GP's valuation methodology, insurance companies become concerned about data access, availability and accuracy. Reporting in various formats often requires investors to scrape and normalize data across investments, causing them to scramble to prepare information for timely reporting. Access to real-time, high-quality data is crucial for accounting and analysis but can be difficult and costly to obtain.

Outdated technology in the insurance statutory accounting marketplace adds to these concerns. Insurance companies spend inordinate effort stitching together disparate systems, tools and workflows to manage and monitor a broad range of information about alternatives. Such administrative demands are virtually nonexistent in public markets investments.

Servicing alternative assets is already complex, creating even greater challenges across accounting, data management and reporting

- Capital call execution
- Liquidity projections
- Valuations
- Consolidated pricing
- Statement tracking
- Data aggregation, reconciliation and normalization

PERFORMANCE AND RISK MANAGEMENT

Performance measurement, benchmarking and risk management are additional obstacles for investors. Because insurers often lack access to flexible tools for comparative analysis, they find it difficult to establish and articulate success with the same certainty as public market assets. Already distracted from their core business of investing, insurance companies continue to spend unnecessary time attempting to solve their own technology and data problems.

Key Considerations for Performance and Risk in Alternative Assets

Performance and Funding Analysis

- Various types of internal rates of return
- Funding multiples, such as paid-in to committed, distributed to paid-in and residual value to paid-in
- Public markets equivalence benchmarking
- Vintage year and style universe comparisons

Holdings Analysis

- Company names and histories
- Exposures by industry sector, geography, country and region
- Cross partnership holdings
- Return and multiple analysis by holding
- Valuation type
- Holdings level operating metrics

Risk Management

- Partnership and program level CAPM analyses
- Commitment pacing analysis and testing
- Cash flow behavior of capital calls and distributions
- Long-term funding, distribution and valuation analyses
- Contribution to value at risk

UNDERSTANDING WHAT THE FUTURE HOLDS

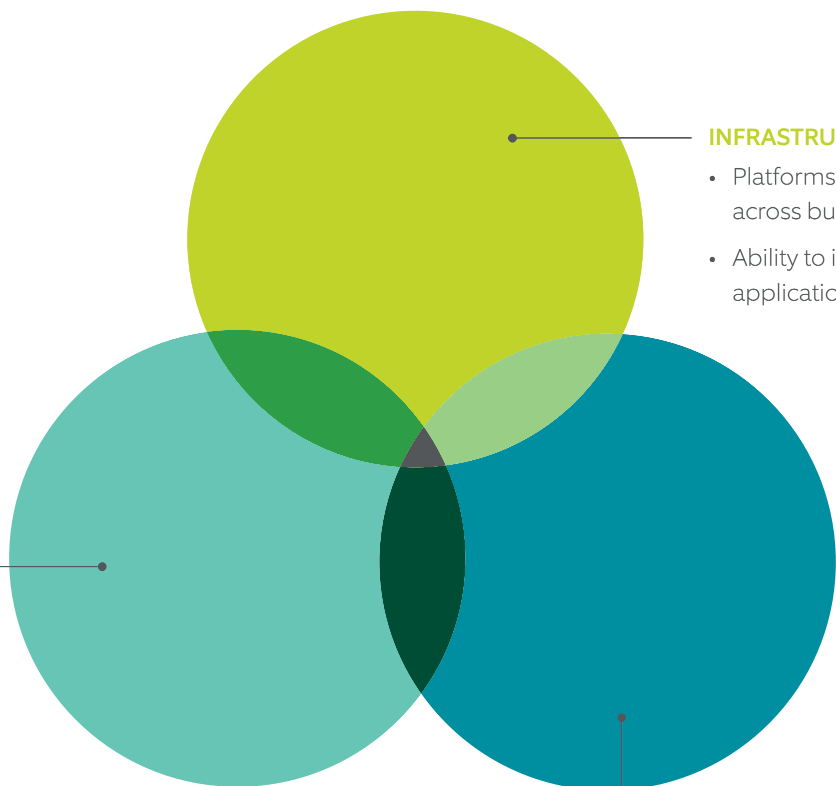
Insurance companies need to demonstrate command of this asset class to auditors and investment stakeholders. But they can struggle to focus on underlying exposures that better prepare them to respond to detailed inquiries about investor responsibility. Although it's beneficial to know about industry and geographic exposures, investing is no longer just about numbers – insurers must know what's happening beneath the surface.

Reducing cash flow and allocation surprises, anticipating potential liquidity needs, understanding unrealized valuation levels and replacing winding-down partnerships are additional factors that can help improve confidence.

TECHNOLOGY AND INFRASTRUCTURE

Secure, flexible and scalable technology is a virtual requirement for successful alternatives administration. The reality for many insurance companies, however, remains rooted in spreadsheets. Compiling and normalizing large volumes of complex data in Excel and hoping it correctly imports into an aging accounting platform simply doesn't cut it. Legacy systems common in the insurance industry weren't built to handle these types of assets. Along with lack of modern functionality and siloed environments, insurance investors continue to face serious technology obstacles.

Key Technology Functionality for Managing Alternative Assets



INFRASTRUCTURE

- Platforms not siloed or redundant across business lines and geographies
- Ability to integrate with downstream applications and systems

CUSTOMIZED ANALYTICS & REPORTING

- Daily transaction processing
- Data reconciliation and validation
- Integrated cash flow, risk, analytics, performance and compliance reporting
- Portfolio holdings, earned income, transaction and cash activity reports

FLEXIBLE & SCALABLE

- Fast performance and modern functionality
- Real-time access to transparent data
- Ability to manage large volumes of big data

CONCLUSION

The very nature of alternative assets increases the need for administrative control. Depending on staff sizes for accounting, performance, risk and administrative tasks, the highly specialized nature of alternative assets creates significant challenges for investors to manage internally.

Although many administrative functions can be outsourced to alleviate these burdens, fiduciary responsibility cannot. Building a strong framework for managing and monitoring alternative assets helps investors focus on the value alternatives add to a portfolio rather than administrative and accounting demands.

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