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*By Max J. Rudolph, FSA CFA CERA MAAA*

### ***Musings from the ERM Symposium 2010***

The ERM Symposium provided yet another opportunity to share ideas, steal good ideas from others, and network with colleagues. Frank Sabatini did a great job as chair this year, and I was very pleased to see Towers Watson endow an award tied to the call for papers and The Actuarial Foundation in honor of my good friend Hubert Mueller. His wife and daughters were in attendance as his profession shared this great honor. As a strong supporter of both TAF and the call for papers I am ecstatic that this gives the call for papers a permanence it did not have before.

The keynote lunch speaker was Simon Johnson, co-author of 13 Bankers. He makes a case for Too Big to Fail tied to the systemic risk created by just a few banks. When I listened to him I thought there was another solution that had not been discussed, that if retail banks had no proprietary investments I was okay with them being big. Since returning home I now agree with Professor Johnson, but for a different reason. The current financial reform bill has no mention of proprietary trading. This is because lobbying efforts of these big banks has taken it off the table. When firms are big enough to control the government, they are too big to fail and thus too big. We saw the same thing with Fannie and Freddie. When their lobbying efforts got big they could do whatever they wanted. S&Ls had large lobbying powers. I said earlier this year that any firm that is bailed out by the government should immediately have their lobbying arms shut down, and while that will never happen I believe it to be a leading indicator of systemic risk. I wonder, does anyone track cumulative lobbying efforts in Washington? I'm sure someone does.

### **Review of Uncertain Times: A Chief Investment Officer's Journey, by Alton R. Cogert CFA, CPA, CAIA**

*By Max J. Rudolph, FSA CFA CERA MAAA, former chair of the Investment Section*

*This article was submitted to Risk and Rewards, the SOA Investment Section's newsletter.*

Actuaries have been active in the risk management field for many years, and recently added the CERA to our international stable of credentials. To manage risk holistically requires a firm to look at risk from many perspectives, both qualitatively and quantitatively. Alton Cogert has used his years of experience as an investment consultant for insurance companies to write a book detailing the levers available to manage investment risks. Using alternating fiction and technical discussions, a Chief Investment Officer at an insurer is fired and uses a teaching gig at the local university to keep himself occupied while he looks for a new job. Of course teaching investment policy requires him to come to grips with his own skill set and he emerges stronger from the experience.

The book is an easy read for someone who works at an insurer, and is especially valuable to someone interested in better understanding the perspective of an investment professional in that setting. It is interesting to see the many tools an investment pro has to work with. While admitting that actuaries can be a key ally to understand risks across the enterprise, the actuarial role is limited to providing liabilities as a single scenario best estimate. Better solutions are not developed. A broadly written book short on formulas and developing solutions focused on the interactions between investment and liability cash flows would be valuable.

The main character, Bob Short (perhaps Alton is a baseball fan who named his character for the owner who moved the Washington Senators to Texas? Or is this a reference to height or stature?), has taken the fall for GAAP income results that do not meet senior management expectations. The Army veteran with a young family now is unemployed. Many professionals have recently had a similar experience and this book will help them to cope and move forward to bigger and better opportunities.

Not surprisingly, the higher ups at Short's firm did not understand the nuances of insurance accounting and were caught by surprise when impairments were taken on the investment portfolio. Much like a political scenario, someone (else) had to take the fall or the CEO might be held accountable. Using book yield returns at purchase and meshing that with GAAP requirements for portfolio reporting led to inconsistency between expectations and results.

As the class develops, Short teaches his students about the investment process. Cogert's experience working with companies has leads him appropriately to put emphasis on understanding risk appetite and how it changes based on the current environment. These discussions are highlights of the book. But then he states that alternative names for risk management are Enterprise Risk Management, Asset/Liability Management, or Dynamic Financial Analysis. While ALM and DFA are excellent tools to understand a part of a firm's risks, they do nothing to evaluate operational risk, strategic risks or the culture at an entity. He also assumes that actuaries provide the liability cash flow streams so the investment team can develop the strategic asset allocation when best practices would require an integrated process looking at a combined asset/liability portfolio. A detailed discussion of constraints typical to insurers, beyond how to abuse benchmarks, would add a lot of value.

The book warns of hidden dangers, or unintended consequences, of specific investment strategies. This good advice was shown to be true during the recent global financial crisis.

At one point Cogert shares a distribution of net investment income. As the only lever available to the investment silo this is useful, but better would be the resulting distributable earnings resulting from each strategy reflecting the interactions between assets and liabilities.

Where *Uncertain Times* is strongest is the book-long development of the process used by an insurance company to build an investment portfolio. By developing one lecture at a time as Short teaches the local class, various concepts are described and build toward the overall process. Especially useful is the discussion that boards and senior managers should feel comfortable challenging the investment manager for the relationship to work well. The portfolio manager should be able to explain what their actions are and why. This will lead to a successful two-way conversation that helps both groups make better decisions. Of course this is true for each member of the senior management team.

Cogert's book is useful as we try to understand how others think and provides a stepping stone to an ultimate solution. The reader with an actuarial background will find that it helps them to understand how their teammates in the investment department approach a problem. Ultimately this will help the team grow stronger and more productive.

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