

BEST'S REVIEW® ISSUES & ANSWERS: ASSET MANAGEMENT

Managers and investors discuss opportunities in collateralized loan obligations as well as the importance of analyzing asset allocations and developing an effective strategy for financing.



Interviewed Inside:



Dan Byrnes
Asset Allocation & Management LLC



Mark Yu
New England Asset Management



Melissa Ricco
Barings

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Client-Focused Investing

Dan Byrnes, President and Principal at Asset Allocation & Management LLC, said that AAM has built a reputation for delivering customized investment strategies that align with the unique needs of insurers. “AAM emphasizes a client-first approach, combining deep insurance expertise with a nimble investment process,” he said. Following are excerpts from an interview.



You're new to the role of president. What do you see for the future of AAM?

I'm fortunate to have worked at AAM for over 20 years. The culture we've built here combines top-tier client service with good investment results. We have an experienced team that's been together a long time delivering on that promise. My first goal is to maintain that culture. We collaborate with our clients, and as the investment and regulatory landscape continues to evolve, we aim to stay nimble to take advantage of opportunities as they arise and make sure our reporting reflects regulatory changes. Big picture, I see a continued focus on delivering through cycles.

How does fixed income as an asset class meet the unique needs of insurers, and what trends are you seeing?

Traditionally, investment-grade fixed income has been a source of liquidity and stability. Recently, yields have improved. Over the past five years, book yields are up 14% for life insurers, 33% for property/casualty, and more than 50% for health insurers. That's bringing real stability back to portfolios. At the same time, insurers are absorbing more illiquidity by allocating to private credit, private placements, and commercial real estate debt. We think that trend will continue. Insurers will get added income from those private assets, while their core investment-grade portfolios will provide liquidity and yield again.

As we have seen recently, volatility can emerge at any time. How does AAM prepare for volatility in portfolios?

We build portfolios based on long-term strategic targets and in modeling those strategic allocations, we have inputs for expected return and expected volatility, but the really critical component is to understand the goals and objectives of the client. We help clients build portfolios across sectors beyond just investment-grade fixed income taking into account mark-to-market volatility, return needs and capital efficiency. And, as our client's business changes, we revisit allocations to be sure they remain appropriate. Within the fixed income portfolio, we have a very good and very experienced analyst team consistently evaluating the risk/reward trade-offs in the market. When we are not being adequately compensated for risks in sectors, we exit those positions. In the fourth quarter of last year we began reducing risk in portfolios. Credit spreads were

Dan Byrnes

President and Principal
Asset Allocation & Management LLC



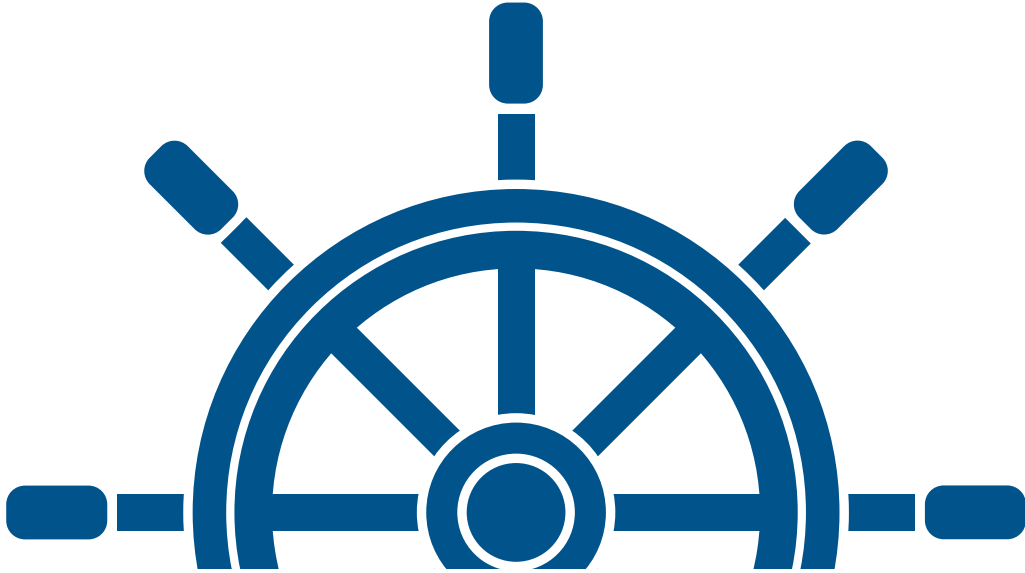
“At AAM, we strive for no surprises in our client portfolios. That means, when we're building portfolios, we want to make sure our clients have a good understanding of the way a portfolio is constructed and why it fits their business.”

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very tight at the time, and we were expecting the possibility that policy changes, including tariffs, may induce some volatility. While the tariff announcement exceeded even our bear case scenario, we had already reduced portfolio risk. We cannot predict the future, but ongoing diligence constantly prepares the portfolios for volatility to come.

Given the recent volatility, what should insurance investors feel good about today?

It's easy to get caught up in daily headlines, but there are positives. First, book yields on fixed-income portfolios have risen significantly and insurers can still invest new capital at compelling yields, bringing stability and income to their portfolio. Second, if you look at equities, from early 2024 through April 2025, the S&P 500 is still up 19%. So, despite volatility, equity allocations have benefited portfolios. If you have a solid asset allocation plan, you can weather the storm and come out stronger.



Charting the course for your insurance company investments.

NEAM focuses on managing assets for insurance companies which allows us to craft tailored investment solutions anchored by deep industry knowledge for our insurance company clients. Let our focus guide you as you navigate investment challenges.

How far can you go with NEAM at the helm?

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Asset Allocation Analysis

Mark Yu, Head of Enterprise Capital Strategy at New England Asset Management, said that stress and scenario testing are crucial components of the company's asset allocation analysis. "These tests help us understand the potential implications of our assumptions regarding returns and risks across different asset classes and their interdependencies within recommended portfolios," he said. Following are excerpts from an interview.



Can you provide an overview of NEAM's insurance-focused asset allocation and explain how it benefits your clients?

We analyze asset and liability characteristics beyond traditional asset liability management approaches, along with the enterprise profile in our return and risk trade-off analysis. Additionally, we consider desired capitalization levels, which may be influenced by regulatory or rating agency capital requirements. By incorporating these needs, we aim to ensure our strategies are well suited to each client's circumstances. This approach allows us to provide customized asset allocation analyses that reflect our clients' risk tolerance and desired return profiles, ultimately aligning their investments with their financial goals.

What is the significance of stress and scenario testing in your asset allocation analysis?

By stress testing our modeling assumptions, we gain insights into the drivers of expected risk and return performance. Additionally, we can assess how our recommended portfolio allocations might perform during periods of market stress. This helps evaluate whether our strategies remain robust and meet insurers' expectations under various economic conditions.

What types of stress tests do you conduct and how do your clients leverage the results in their risk management and strategic planning processes?

We conduct stress and scenario tests using both historical and hypothetical perspectives. These tests help us understand the potential downside scenarios of our recommended asset allocations, including performance under historical stress events and hypothetical scenarios. Additionally, we incorporate adverse underwriting scenarios with investment scenarios to stress test both sides of the balance sheet. This process is essential before finalizing our recommendations.

Mark Yu

Head of Enterprise Capital Strategy
New England Asset Management



"Our asset allocation framework is specifically designed for the insurance industry, considering both sides of the balance sheet."

Visit the Issues & Answers section at bestsreview.ambest.com to watch an interview with Mark Yu.

Our clients use the results to help decide between different asset allocation options, strengthen risk management reporting, and communicate with their boards, management committees, regulators, and rating agencies.

Looking ahead, what are the key challenges and opportunities in asset allocation and stress testing for insurance clients?

One key challenge is the increasing liquidity risk as insurers invest more in illiquid private debt and equity. While some insurance liabilities may be long-tailed and do not require high levels of liquidity, companies need to perform additional stress and scenario testing to clearly understand the liquidity needs of their investment portfolios under stress events. This area will continue to evolve as private investments become more prevalent in the insurance industry, presenting both challenges and opportunities for effective asset allocation and risk management.

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Winning With CLOs

Melissa Ricco, Co-Head of Barings' Structured Credit Investment Team, said that the opportunity in collateralized loan obligations for insurance investors remains compelling. "Insurers with access to experienced CLO investment managers with robust underwriting capabilities are well positioned to capitalize on these opportunities," she said. Following are excerpts from an interview.

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What are CLOs?

A CLO is an actively managed securitized product backed by a highly diversified pool of leveraged loans. CLOs provide an efficient, scalable way to invest in floating rate loans while offering structural protection and have historically performed well through multiple credit cycles. CLOs have been around since the 1990s and have now matured into a market worth more than \$1.3 trillion with an actively traded secondary market.

Why have CLOs been one of the fastest-growing asset classes for insurance companies?

CLOs offer diversification by providing exposure to a broad range of leverage loans, typically involving 150-250 borrowers and across 15-20 industries. This diversity helps mitigate risk, as the performance of the CLO is not overly dependent on any single borrower. Additionally, the structural features of CLOs provide further risk mitigation by redirecting cash flows from lower-rated tranches to more senior-rated tranches if the underlying portfolio's credit quality weakens. Lastly, the perceived complexity of the asset class offers the potential for higher spreads on a like-for-like basis in credit rating and regulatory capital.

How do regulatory changes impact the investment in CLOs by insurance companies?

Regulatory changes, particularly those from the National Association of Insurance Commissioners, NAIC, can significantly impact CLO investments by insurance companies. For instance, recent NAIC initiatives have aimed to revise capital requirements for CLO investments, potentially altering the risk-based capital, or RBC, factors for these assets, depending on what part of the capital stack an investor is in. This, of course, could affect the demand for CLO investments, making it crucial for insurers to stay informed and adapt their strategies accordingly.

Melissa Ricco

Co-Head, Structured Credit Investment Team
Barings



"There's never been a default of an AAA-rated tranche in its 30-year-plus history, and defaults in the rest of the capital stack have been relatively minor compared to their corporate counterparts."

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What does it take to win in this asset class?

Most important is partnering with an experienced team that has strong access to the market and a commitment to underwriting. Barings has a long, consistent track record across multiple market cycles and is well positioned to navigate different market conditions. Given the complexity and specialization of CLOs, a dedicated team is key to capitalizing on opportunities in the asset class. Second, managers with longstanding and active participation in the CLO ecosystem can often negotiate favorable terms for their clients, including allocations to coveted new-issue CLO tranches, early first looks at primary and secondary market investment opportunities, and strong trade execution. Also very important, an effective CLO manager should employ rigorous, bottoms-up fundamental credit analysis. CLO teams with investment managers that have a broad public and private fixed income team can leverage the firm's wider research and market insights. For CLO tranche investors, it's critical to have the resources to better understand the impact, the quality and relative value of potential investments.

