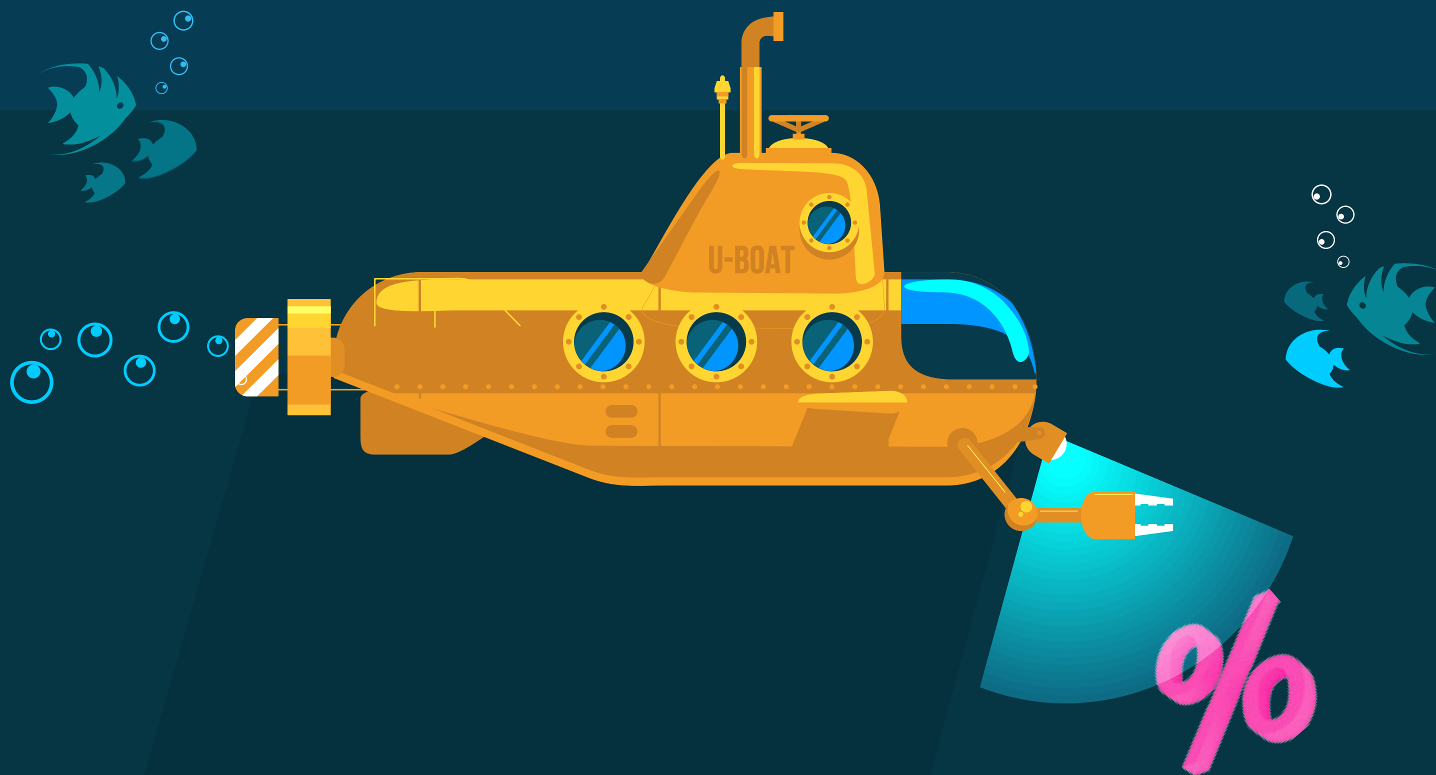
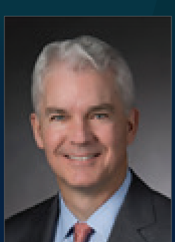
Insurance AUM Journal
Q4 2019
VOL 3 | ISS 4

How low can we go?





INTERVIEW

Anthony R. Malloy
Executive Vice President & Chief Investment Officer,
New York Life Insurance Company

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Thought Leadership for the Insurance Investment Community

Guest Q&A With

Tony Malloy

Our editor speaks with the Executive Vice President and Chief Investment Officer of New York Life Insurance Company.

Tony Malloy is a third-generation Yankees fan and still lives in the New Jersey town he grew up in. His grandfather and great uncles watched Babe Ruth play in the 1927 World Series. His dad saw Joe DiMaggio's team defeat Jackie Robinson's Brooklyn Dodgers in seven games in 1947. Tony subsequently took his father and son to see Derek Jeter and the Bronx Bombers win five world championships, extending the generational streak to four. I mentioned that I grew up in St. Louis and that the Cardinals were second behind the Yankees in World Series wins to which he quickly replied, "yeah, but there's a pretty big gap, though" and we all had a good laugh.

In addition to being a rabid Yankees fan, he is also the Chief Investment Officer of New York Life, the largest mutual life insurance company in the country* with over $600 billion in total assets under management. New York Life is in the business of making long-term promises and guarantees. It's a mission driven company that provides its policy owners with peace of mind when protecting their loved ones to make sure they keep their home; their kids go to college and they can enjoy a comfortable retirement. New York Life and its affiliates manage all their assets across a wide swath of asset classes and strategies. It's a world-class shop that is responsible for managing the assets of a company that will celebrate its 175th anniversary in 2020. There is a significant amount of weight that comes with that task. We talk with Tony about topics nearly as diverse as their portfolio.

IAUM: *Tell me about you, your path getting here and was there a particular event that set your career trajectory?*

MALLOY: My parents believed very strongly in education and hard work. They also believed strongly in the Liberal Arts. I attended Middlebury College as an aspiring basketball player but without knowing what I was going to study. I took a course in Economics as a freshman and got hooked. I knew that I wanted to go into business and asked my father, who was a successful reinsurance executive, for advice about the kinds of skills I'd need to compete and be successful in the business world. He said the ability to write and communicate were crucial, so I decided to double-major in Economics and English. This provided a great foundation that has served me well throughout my career. A Liberal Arts background is great for investing because one needs to understand disparate subjects, history and people. This includes an ability to connect the dots and weave a story into a narrative. However, I was lacking technical skills. That's why I went back to business school to get my MBA from NYU. Thanks to the combination of a Liberal Arts undergraduate degree and the training in finance at business school, I was well-prepared to start my career. Like a lot of business school graduates around that time, I went into banking because they offered strong credit training programs. After spending nearly a decade in banking, I discovered that I was a lot more interested in principal investing as opposed to transactional banking. That's what led me to New York Life. I've been with the company for nearly 21 years and it's been a great journey.

IAUM: *What do you think is the biggest risk facing insurance investment portfolios today and how are you managing it?*

MALLOY: There are several challenges that all insurance companies face today. The first is the persistently low interest rate environment that has prevailed for the past ten years. Interest rates are the most important economic variable for an insurance company since most of our general account portfolios are invested in fixed income. Low interest rates function like gravity. As the bonds that we invested in years ago mature, we are reinvesting those funds at today's interest rates which are considerably lower. That puts downward pressure on investment income, earnings, crediting rates and dividends. The second challenge that investors deal with today is historically tight credit spreads and rich valuations across virtually all asset classes. We're simply not getting paid as much to take risk. With interest rates near all-time lows and distorted by central bank policies, investors are increasingly throwing caution to the wind in search of yield. We are mindful that the economic expansion is the longest in history but won't last forever. This late cycle risk taking is worrisome because investors may be adding risk at the worst possible time.

At New York Life, we've successfully managed through the low interest rate environment in three different ways. First, we were an early investor in private asset classes such as private placements, commercial mortgage loans, private equity and private real estate equity that generate higher returns due in part to an illiquidity premium. We can afford to take liquidity risk since our liabilities tend to be quite sticky. We have been investing in these asset classes for more than twenty years and they have served our policyholders extremely well. Second, we have also developed direct origination capabilities in such areas as structured credit, infrastructure and sponsor finance that allow us to manufacture the assets in which we invest. We control better economics, we develop relationships with the borrower or the private equity firm, and we get the repeat and refinancing business as a result. This has served our investment portfolio very well. Third, what we've done differently at New York Life is that we have also diversified our business so that we're not just a life company. We have built a diversified portfolio of what we call strategic businesses, including annuities, asset management, group membership, long-term care, and an operation in Mexico, among others. The strategic businesses throw off a healthy amount of capital and the earnings from these businesses help support the dividends we pay to our participating policy owners. As a mutual insurance company, we operate on behalf of these policy owners.

"We've built what we believe to be an all-weather investment portfolio that will continue to perform well..."

IAUM: *What do you think the performance of public vs. private markets will be in the event of another market dislocation?*

MALLOY: At New York Life, we try not to attempt to predict where the economy, interest rates, or markets are headed. Instead, we work to prepare for any and all scenarios. We've built what we believe to be an all-weather investment portfolio that will continue to perform well regardless of the environment and support the long-term promises and guarantees that we've made to our policy owners and our clients. That was our experience 10 years ago during the financial crisis and we believe that would be our experience should another downturn come. We draw comfort from the asset classes in which we have invested. We have a high-quality portfolio with over 90 percent in investment grade bonds, along with exposure to high yield, bank loans, public equity, private equity and private real estate equity. Those are the major food groups in which we operate. Having invested in private asset classes for quite a long time, we believe we have the expertise and track record to be confident in our ability to generate attractive risk-adjusted returns for our clients. Where we get concerned is that there is a proliferation of money that is flooding into private asset classes. There are a lot of new managers, quite frankly, that are a little wet behind the ears and have only operated in the market for the last 10 years where the market has been one way - up. There is probably some imprudent risk taking going on out there. This is where we have an advantage as a mutual – we take the long-term view, we don't stretch for yield like some of the publicly listed companies do to meet the needs of not just their insurance clients, but also their shareholders. We believe in our mutual company model, we've seen that the strategy works, and it is reinforced by our long-term orientation.

IAUM: *How do you incorporate ALM into your investment strategy?*

MALLOY: Our investment strategy is developed and executed in an ALM framework. Every product we have has its own asset portfolio to support it. There's not one general account to support everything, each product has its own portfolio. They all have their own characteristics related to duration and convexity, among others. For example, we target a 10 percent allocation to equities in our ordinary life portfolio, which we use to enhance the dividend yield. Through a smoothing mechanism, we can pass along the gains and losses in the equity portion of that portfolio over many years so there's limited volatility in the dividend associated with equity performance. If you looked at our fixed deferred annuity business, which is a much shorter duration product, we don't have any equities in that portfolio. That is backed by high-quality, investment-grade bonds. Then we have some longer duration businesses such as long-term care, structured settlements and guaranteed-income annuities. These products may have durations of 18 -20 years. It's difficult to find long assets and with the ever-changing technological environment, there aren't many companies you'd want to lend money to for 30 years. It's a shrinking universe. We have allocated a small portion of those portfolios to equities which covers the tail liability cash flows and we think we are appropriately matched. We're not trying to take interest rate risk unintentionally; we try to add value through the credit and equity risk we take and to maintain a well-diversified portfolio.

IAUM: *Some asset classes have an onerous RBC charges, particularly for life companies. Do you look at investments in terms of yield-per-unit of RBC, for example?*

MALLOY: Everything we do is focused on generating current income and preserving capital in a way that is consistent with a company like ours that is committed to honoring our long-term promises and maintaining the highest possible financial strength. At New York Life, we have our own capital management system, our own view of how much risk resides in the portfolios and then we set aside capital accordingly. We do rigorous stress testing. We'll run scenarios consistent with the pandemic in the early 1900's, the Great Depression, the financial crisis, stock market correction and then we'll ask, 'what if they all happen at the same time?'. We want to have more than enough capital to meet the long-term guarantees that we've made going out 20, 30, 40, and in some cases 50 years. We'll be here to fulfill the promises that we've made – that's the philosophy of the company. We do pay attention to RBC because the rating agencies and other constituents look at it, but it's not the driver of our decision making.

IAUM: *What advice would you give to a third-party asset manager that wants to manage assets of insurance companies?*

MALLOY: New York Life is somewhat unique in that it doesn't have an obvious or critical need to outsource the management of its assets. Operating under the New York Life Investments umbrella, our captive asset manager is focused primarily on the management of the general account, while our affiliated boutiques are focused primarily on third party asset management. A few of these affiliates manage a portion of our general account assets where we don't have internal capabilities, such as municipal bonds, middle-market bank loans and private equity. There is an alignment of interests because we own those companies. We can work closely with them to make sure they fully understand the nature of those liabilities and how those assets play in support of them. We can also be very clear about the investment guidelines and constraints that we might want to put into place. This arrangement has worked very well for New York Life, with our investment managers serving as alpha generators and earnings contributors.

Third-party asset managers need to offer something differentiated, that insurance companies can't do on their own. There is a role for outsourcing, particularly for the smaller players that don't have access to all asset classes or don't have enough scale to attract a first-class team. There is a lot of money that has been outsourced and I'm sure there will be a lot more. But here's where insurance companies need to be careful: They shouldn't just outsource solely to reduce their management fee. Sometimes you get what you pay for. How many credit losses do you need to give back on anything you've saved on fees? And the second thing is that insurers need to be careful in shifting to passive index or ETF-like products in fixed-income which tend to be market cap weighted. Market cap weighted is fine in equities, but fixed income brings the highest exposure to companies that have borrowed the most.

IAUM: *It seems to me that there is a lot of capital chasing a limited number of assets and risk premia seem to be very tight – that it's priced to perfection in a lot of ways. What is your view?*

MALLOY: Interest rates are off August lows but we're within the same zip code of the all-time historic lows on interest rates. Spreads on investment grade and high yield are as tight as they have been since the financial crisis and equity valuations are close to their highs and that's true really across all asset classes. This reflects excess savings around the world chasing returns and central banks policies that have distorted what the true risk-free rate is. Everyone is in search of yield and at some points there will be an event. We've seen pockets of volatility over the last year and a half – it's remarkable to me how much the markets have moved in the last three months based on not much new information. The U.S. economy is holding up reasonably well due to the consumer, but the manufacturing sector is weak, the global economy remains fragile, particularly in Europe and China – where we don't have a trade deal. And then we have political events around the impeachment, the election next year and Brexit so the markets feel very complacent to me right now. That's the biggest risk overall. At some point, one of these things will play itself out and we should expect volatility in the markets next year. That's one prediction I'll offer.

Also, if you look at returns across asset classes this year, they are up double-digits almost across the board. Investment grade and high-yield bonds are both up about 12 percent and the stock market is up 25 percent year-to-date. Seeing this repeated next year is extremely unlikely.

IAUM: *New York Life has identified LifeTech as an ecosystem of start-ups with relevancy to life insurers that is distinctly different from the prevailing Insurtech and Fintech spaces. How does technology fit into your investment strategy?*

MALLOY: Going back to 2012, New York Life was one of the earlier firms in the insurance industry to recognize that we are living through a world of rapid technological change with industry after industry being disrupted. We thought that neither the insurance industry nor asset management is immune from that existential threat. We set up a corporate venture capital unit called New York Life Ventures to help us identify technologies that we could potentially test, invest in, and/or import into the company that would be useful, that would make us more competitive, more efficient and make us aware of technologies that could be disruptive, enabling, or adjacent so that we can get out in front of them. Ultimately, the group's mission is to help accelerate the pace of innovation at New York Life. Early on, we established relationships with some leading venture capital funds, and by investing in their funds, we gained access to their insights, proof-of-concepts and co-investment opportunities. On average, the team has supported a proof-of-concept test every 2.5 weeks since 2012 with much testing and learning along the way. We have incorporated a number of these technologies into the core life insurance business. It's helped us with the overall digital transformation of New York Life, trying to move from an analog legacy system to a more modern digital footprint. We have also stood up our Center for Data Science and Artificial Intelligence, a new data science organization that is embedded in both the life insurance and the investment management businesses. While our investments have generated terrific returns, that wasn't the primary reason we did it. The number one reason for the effort is to gain access to insights and identify the necessary changes to stay one step in front of the curve.

"You control your effort, you control your attitude and you control (what I call) your 'bounce back'."

IAUM: *What advice would you give a young person just graduating from college or early in their career?*

MALLOY: I think about this question all the time because I have three children, two who have graduated from college and a third who is in college. I have three recommendations: First, to the best of your ability, identify what you're interested in and what you're good at. Look for the intersection of that Venn diagram – that's the key to success because it won't feel like work. That's true for me – I can't believe I get paid to do what I do. I love following the economy, I love following the markets, I love making investments, that whole intersection between the economy, finance and investments, to me – it's like breathing. The second is, and I think this is especially important, is go to where you can learn and develop your skills and experiences. Do not think that you have to find the job that you're going to stay in for 30 or 40 years – I think those days are largely gone. Don't even focus on how much you're making right away, that will come. But are you developing skills and experiences that will position you for different things? Because the world is always changing, and you can go and do different things. The third is that you have to own your career and invest in yourself. Take a class, go back to school, read a lot. You can learn so much from other people. Model yourself after people that you observe as successful people – get to know them, spend time with them. They can become mentors; they can become coaches and they can become contacts that can refer you to other opportunities if your interests lie in another area. I don't think it's one thing, there's no silver bullet – I think it's a combination of all of those things. And the last thing is, and I told this to my kids every day when they were growing up and now, they are finally repeating it back to me, you control your effort, you control your attitude and you control what I call your "bounce back." You will have your setbacks; you're not going to succeed at everything. Learn from it but don't let it define you. You define where you want to be. Work hard and enjoy the process and the journey.

IAUM: *What would you tell your 21-year-old self? And, you didn't have the advice you just gave your kids.*

MALLOY: (Long pause). Probably laugh a little bit more, don't take everything so seriously. Invest in relationships, find some balance, play the long game. It's taken me a long time to figure that out – it's still a work in progress.

About Our Guest

Anthony R. Malloy

Tony Malloy is Executive Vice President and Chief Investment Officer of New York Life Insurance Company. He is also the CEO of NYL Investors, the firm's insurance asset management subsidiary. Mr. Malloy is responsible for the management of the company's more than $250 billion general account portfolio, which is made up of public and private fixed income, public and private equities, commercial mortgage loans and real estate equities, and venture capital. Mr. Malloy is a member of New York Life's Executive Management Committee and serves on its Risk Steering Committee.

Mr. Malloy joined New York Life in 1999 and has more than 30 years of investment management and financial services experience. He previously held the position of Senior Managing Director and head of Fixed Income. He also served as Managing Director and head of Leveraged Finance.

Prior to joining New York Life, Mr. Malloy achieved positions of increasing responsibility in lending, risk management, and debt capital markets with J.P. Morgan, Toronto-Dominion, and First Chicago.

Mr. Malloy received his BA in English and Economics from Middlebury College and his MBA in Finance from New York University. Mr. Malloy is a director of Seguros Monterey New York Life and serves on the board of trustees of Good Shepherd Services.

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