

The Insurance *perspective*

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Industry Insight

Proper succession planning is beneficial to an insurance company on many levels. Unfortunately, organizations often dedicate limited resources to this important topic. Almost everyone will agree in concept of the importance; however, it is sometimes viewed simply as insurance or something that might benefit the organization “someday”. The key is developing a mindset that succession planning is part of and beneficial to the past, present and future of an organization.

At its core, succession planning is a part of good governance, which is a core competency of a successful insurance company. When structured properly and part of the strategic planning of an organization, it can add significant value from an outside perspective. Examples of this are regulatory preparedness and rating agency value. As discussed in a previous version of the Perspective, AM Best rates a company based upon both subjective and non-subjective criteria. The non-subjective includes the BCAR score and the ratio comparison with insurers of similar size. Just as important are the subjective factors that are qualified through the discussion with management. The governance of an organization are often discussed in detail. AM Best and other rating agencies clearly want a very positive view of the on-going concern of an organization. Questions are often structured in order to understand both the written and unwritten procedures of an insurer and how efficiently an organization could operate in the event of both staff and management turnover. Successful companies often have defined programs to help them prepare for successful transition and education of key officers and this is viewed very favorably by the rating agencies.

If programs are in place to ensure proper training and transition, an insurer will be much better prepared to respond to CGAD. As most are aware, all states will soon incorporate the Corporate Governance Annual Disclosure Act. Good succession planning helps ensure that appropriate suitability standards are in place and that any transition is seamless. CGAD currently requires only disclosure; however, it is evident by the trends in exams, regulation, and the questions within rating audits that the trend is towards deeper regulation in this area.

The emergence of Enterprise Risk Management (ERM) for insurance companies has helped bring to light the overall lack of procedures dedicated to succession planning. While developing an ERM program, insurers are now listing lack of succession planning as a key risk and developing mitigation strategies that will allow for a seamless transition.

While the topics above demonstrate several immediate benefits of a succession planning program, I would recommend that it should be perceived as something much more profound. Succession planning is an opportunity to build an organization and ensures that the legacy of both the organization and the employees are maintained. Life is a beautiful gift from the Lord, but our time on earth is limited. Life can also be fragile. A comprehensive succession planning program can include a mentor program that



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allows for growth and development of both the mentor and the mentee. When done properly, this builds relationships and helps ensure the legacy of all involved. A key to the success of these programs building teams that are void of protectionism. Too often organizations develop politics that creates a fear in executives and employees alike that sharing all of your knowledge with another employee could eventually threaten your position. I believe that the best leaders hire and train others that are much better than they are in some or all areas. This all ties to culture and to work efficiently it must be embraced and promoted by the top of an organization. Ultimately an organization wants leaders that train other leaders that can train other leaders. A book that I would highly recommend is "The Five Levels of Leadership" by John Maxwell. I absolutely love this book and I am very passionate about recommending it. I also enjoy visiting on this topic and enjoy sharing this book with others. If you would like to visit on this topic, just call me at 325-795-2111 and I will send you a complimentary copy of this book.

Succession planning and building a great team for the future is something that means a lot to me and my organization has dedicated a great deal of time and resources to improving. As practical examples can be useful, I wanted to end my article detailing some of the key elements to the succession planning program of my organization. We do embrace the concept of a mentor program that was discussed above. In this program we look for both mentee and mentor volunteers that participate in an organized program. Deeper than this, we work diligently on cross training of every position. Cross training is brought to much greater emphasis every 7 years as we have a sabbatical program. Every seven years all employees are offered 30 consecutive days off. This is to encourage relaxation, self-development, rejuvenation, and an opportunity to give back to the community, God, the church, or those in need. As you can imagine, employees greatly look forward to this opportunity and to prepare for the time off, cross training and working as a team is essential. Every summer, we run an apprentice program that allows the development of a senior college student. Many of these from the past have ended up as employees of Parkway or another organization in our corporate structure. The time in the program helped prepare them to be a good employee. Additionally, we also participate in the intern programs of the local universities. Each executive is challenged to develop a plan for transition in the event that they are unable to carry on with their duties. We also recently incorporated a program that we call "The Leadership Development Academy." This program is an 18 month paid program that is basically an extended apprentice. Top recent graduates apply for this program and are selected based upon qualities and character. The program takes the participant through all levels of the organization and is designed to demonstrate biblical principles of business. Many of these participants eventually become employees that are later able to train others. While the program has a core element of giving back, it is amazing the fresh ideas that are generated by this approach. The key is that every year we are growing, training and building for the team of the future. The ultimate objective is to have a company that is much better a hundred years into the future. This preserves the legacy of all that helped create this positive environment.

Economic Commentary



Chad B. Hoes,
Investment Officer

Chief

Another new year has arrived and the stage is set for a new US President, eight scheduled FOMC meetings and an equity market that is near all-time highs and earnings multiples at overvalued levels. While our new “tweeter in chief” has been vocal on many topics, 2017 will provide the proverbial pudding proof of Trump’s presidency. Below is a recap of major fourth quarter 2016 economic items.

Bond Market – The US bond market continued its trajectory of increasing yields in the fourth quarter, reaching levels not seen in some time. Not only did the “bounce back” after Brexit continue but the post-election rally (coined “Trump rally”) caused a very large pop in rates. Over the fourth quarter, the three-month Treasury increased 23 basis points to 0.416%, the largest percentage increase on the curve over the quarter. The 10-year Treasury yield surged 85

basis points to conclude the year at 2.44%. The long-end of the Treasury yield curve popped up to 3.07%, shifting 75 basis points higher in the fourth quarter. It is interesting to note that while there was significant movement in the last half of 2016 in Treasury yields, the 30-year Treasury finished 2016 only 5 basis points higher than 2015.

FOMC – There were two scheduled Federal Reserve meetings in the fourth quarter and as anticipated only one move in short-term borrowing rates which took place in December. Many postulated the timing of the November Fed meeting, which occurred on November 2nd, was a primary driver for a ‘hold’ determination. Other analysts believe the incentive to hike rates in November was lessened since the meeting did not include a scheduled press conference from Fed Chair Yellen, which are slated for alternating meetings. As widely anticipated, the December Fed meeting resulted in a quarter-point increase in the federal funds rate. In fact, leading up to the Fed announcement implied probabilities predicted a 100% likelihood of an increase in rates. A unanimous FOMC decision increased the overnight lending rate between banks to a range of 0.5 to 0.75 percent. The Fed stated consumer spending is “rising moderately”, business investment has “remained soft” and job gains have been “solid.” Moreover, the Fed projects three quarter-point hikes in 2017. If policymakers are able to squeeze in three hikes, analysts are assuming they will take place in the second half of the year. Any 2017 rate actions must consider potential inflationary concerns stemming from infrastructure spending plans, tax reform and more expansive government spending.

Stock Market – The Trump rally was also present in the US stock market. From the end of the third quarter through the Friday before the election (November 4th), the S&P 500 Index was down 3.8%. From that low the S&P climbed an incredible 8.9% to its high twenty-six trading days later. Although it closed off highs, the S&P was up 3.8% for the fourth quarter and 11.9% for the year. The Dow Jones finished the fourth

quarter 8.6% higher and 16.4% over the previous year-end. There were multiple occasions in December when the Dow came extremely close to reaching an unprecedented 20k level. While it has not yet, I anticipate the Index will at least touch this aspiration in 2017. The NASDAQ Index rose only 1.7% in the fourth quarter despite its impressive third quarter positive momentum. For the year, the NASDAQ gained 8.9%, finishing 1.9% off all-time highs.

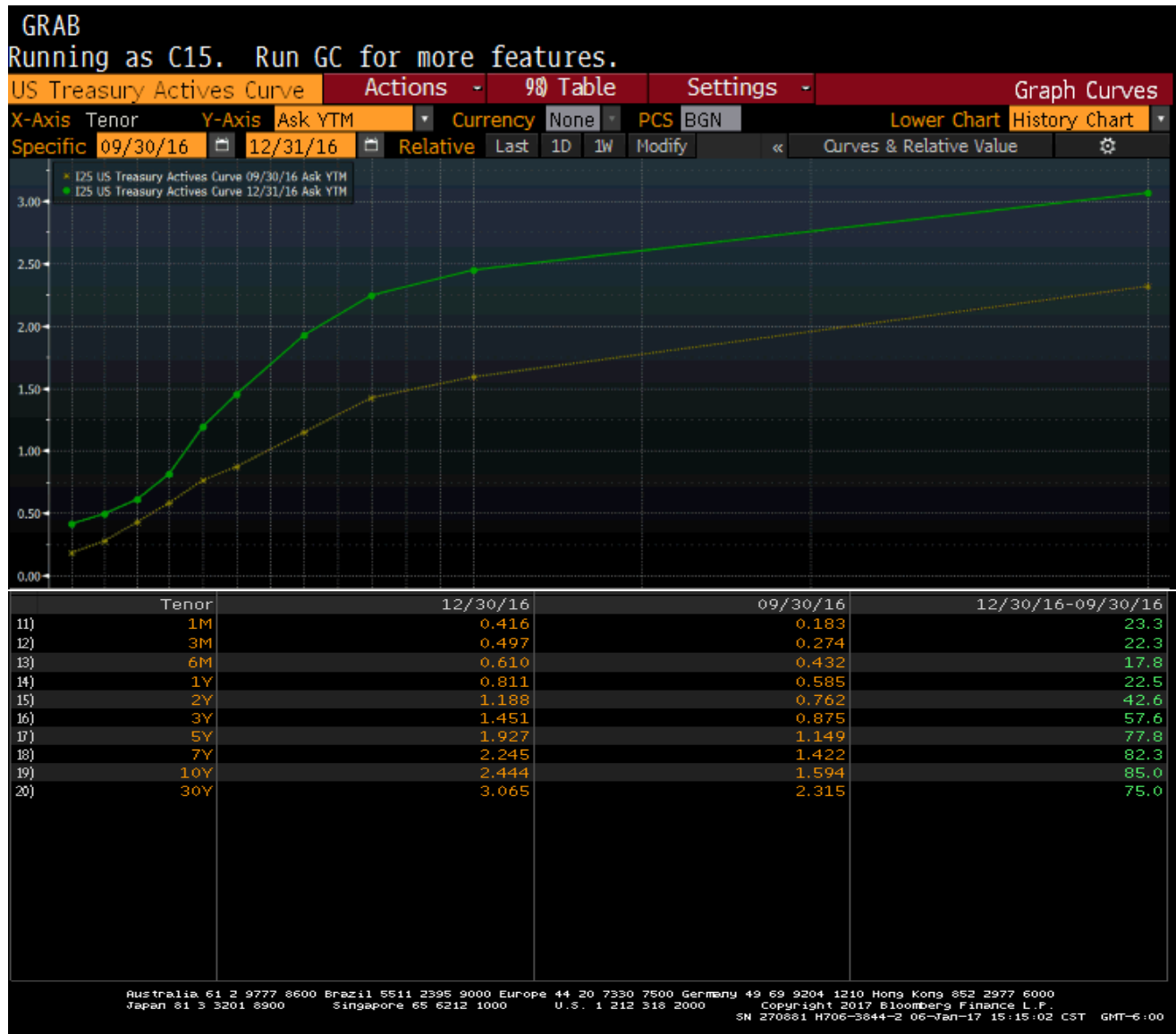
Summary – We are on track for an action-packed year. I expect a flattening of the Treasury yield curve. Also, I would anticipate a pullback in the general US equity market and a predominately level trading year.

Interest Rate Spreads

As of: 12/30/2016

Term	Treasury Yield	US Composite BVAL AA Curve		US Composite BVAL A Curve		US Composite BVAL BBB Curve		BFV USD Composite BB	
		Yield	Spread	Yield	Spread	Yield	Spread	Yield	Spread
1yr	0.85	1.287	0.437	1.423	0.573	1.724	0.874	2.7705	1.9205
2yr	1.2	1.614	0.414	1.796	0.596	2.148	0.948	3.347	2.147
3yr	1.47	1.914	0.444	2.126	0.656	2.518	1.048	3.8197	2.3497
5yr	1.93	2.418	0.488	2.615	0.685	3.071	1.141	4.5612	2.6312
7yr	2.25	2.833	0.583	2.994	0.744	3.51	1.26	5.1701	2.9201
10yr	2.45	3.279	0.829	3.371	0.921	3.948	1.498	5.8263	3.3763
20yr	2.79	3.969	1.179	4.212	1.422	4.82	2.03	6.9998	4.2098
30yr	3.06	4.157	1.097	4.192	1.132	4.74	1.68	N/A	N/A

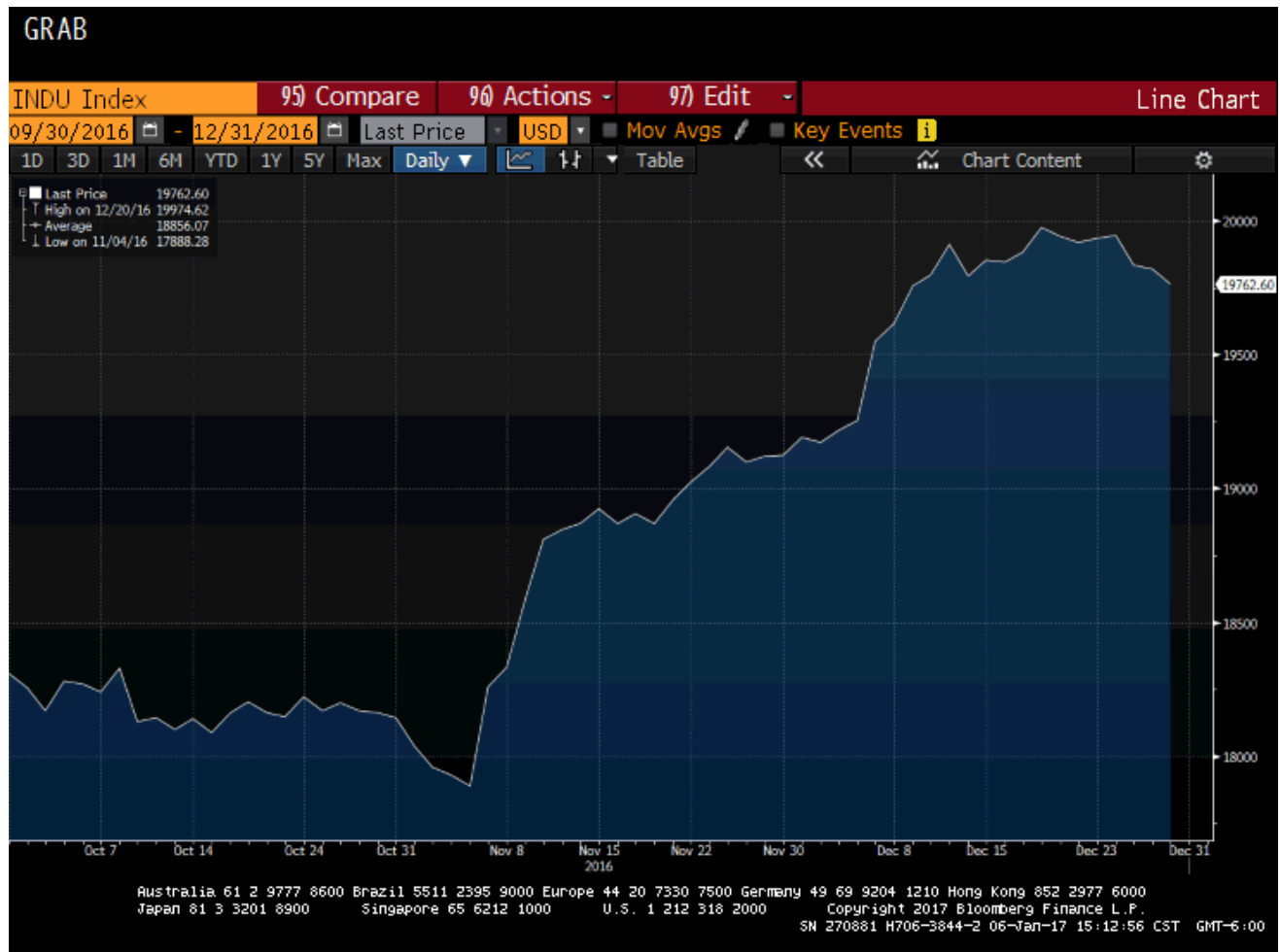
US Treasury Yield Curve



S&P 500 Index



Dow Jones Industrial Average



Regulatory Update



Trevor R. Rupe,
Portfolio Manager

Department of Labor Fiduciary Rule

In April of 2016, Obama endorsed and fast-tracked implementation of a new set of regulations regarding the advice and guidance given to individuals surrounding their retirement plan assets. The rules were put into place in an effort to ensure advisors are acting in the best interest of their clients and are putting the client's interest above their own. Prior to this update the rules governing advice and fiduciary responsibility were regulated under the Employee Retirement Income Security Act (ERISA), which was enacted back in 1974. Since that time there has been a major shift in the industry from defined benefit plans (pensions) to defined contributions plans (401ks) and a huge growth in Individual Retirement Accounts. The rule is set to govern the new landscape.

When someone retires, a popular trend with advisors is to recommend that the client move all of their retirement assets to an IRA. Within IRAs, the investment options are vast, including thousands of mutual funds, annuity products, stocks, ETFs, bonds, and even illiquid private placement or private securities. They are not limited to what the plan administrator decides is available to its participants, as seen in a 401(k) plan. This leaves the ability for advisors to recommend investments to the account holder, some of which will then pay a commission to the advisor. This could potentially pose a conflict of interest. A 2015 report by the White House Council of Economic Advisors found that this advice could have cost upwards of 17 billion dollars a year, money that ended up leaving retirement assets. The new guidelines that are set to become applicable April 10 of this year would require advisors to clearly disclose all fees and commissions received to clients for whom they provide advice. For advisors working on commission, clients will need to be provided an agreement called a Best Interest Contract Exemption (BICE) form that discloses the potential conflict of interest. This new rule will primarily affect advisors that are paid through the investments they sell, such as a mutual fund with a front end load or annuity products held in a retirement account. The Insured Retirement Institute found that industrywide annuity sales in the third quarter of 2016 had already experienced an 8.2 percent drop from the second quarter of 2016, and a 12.3 percent decline from the third quarter of 2015. Additionally, fund companies have already begun introducing new classes of funds for advisors that have lower commissions/fees investors pay in anticipation of the increased fee sensitivity that the disclosures will create. Ultimately, if you are a company involved with products containing embedded fees/commissions such as an annuity, you may need to re-evaluate your products in anticipation of the changes and potential decline in inflows.

While many believe that an update to the rule is necessary given the amount of time since the last update and the latest trends in the industry, not all have welcomed the Fiduciary Rule. Compliance costs could increase dramatically as companies look to make sure they are following all of the guidelines and reporting required to adhere to the regulations, which can put smaller advisors out of business. These new costs and potential reduction in commissions could force advisors to impose fees on the individuals.

Additionally, all the compliance and “fee talk” could further deter individuals from taking the necessary steps to set themselves up for financial success in retirement. Many people believe more time is needed to iron out the regulations in order to find a middle ground that allows clients to receive the advice they need that also enables advisors the ability to be fairly compensated for the expertise they provide. A bill was introduced by Republican Joe Wilson on January 6 that would delay the rule’s April 10, 2017 effective date for another two years. The bill has received tremendous support from groups including the National Association of Insurance and Financial Advisors and Chamber of Commerce. Factoring in the scale and number of advisors that would be subject to the rule and its requirements, you can definitely expect to hear more about the progress of the bill as we get closer to the effective date. We will provide additional details on our next Perspective once we have more information on how the regulations could affect insurers directly.

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About this Publication

The Insurance Perspective is a quarterly publication prepared by the staff of Parkway Advisors, L.P. Each issue focuses on the U.S. economy and specific insurance industry issues and/or concepts. Our clients and prospective clients enjoy Parkway's dedication and unique focus on the insurance industry.

For More Information

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