Deva Mishra

Episode 222: Prosperity Asset Management's CEO Deva Mishra on How to Build an Attractive Investment Portfolio for Insurers

GUEST Q & A

Stewart: Welcome to another edition of the InsuranceAUM.com Podcast. My name is Stewart Foley, I'll be your host. Thanks for joining us. We're thrilled to have you. We did a survey of the registrants for the upcoming symposium and private credit and private structure were tied for the number one topic. And today we're going to be talking about asset-based finance, or otherwise known as private structure, with Deva Mishra, who is the CEO of Prosperity Asset Management. Deva, thanks so much for being on. It's a pleasure to have you. Thanks for taking the time.

Deva: Thanks for having me. Looking forward to the discussion.

Stewart: We are thrilled to have you. I can't wait to get neck deep with you on this topic, but before we get going too far, let's start them off the way we start them all, which is, where is the town that you grew up in? What was your first job? Not the fancy one. And how did you get into the rarefied air of managing insurance assets?

Deva: Great. Well, I was born and raised outside of Rochester, New York, a wonderful town of Webster, New York where life is worth living, as they say. Both my parents were lifelong Xerox employees. In the 1970s and 1980s, Rochester, New York was fairly dynamic. I mean, it was Western New York, cold winters, but it was a great place to grow up. My first job, first real job was landscaping. I was planting trees with a couple buddies trying to make some extra bucks to spend at the grocery store and whatnot. So, planting trees. I think I was in pretty good shape back then.

Stewart: Absolutely.

Deva: Before... And then the last question was how did I find my way into insurance asset management?

Stewart: Yeah, I mean, it's a long way from tree planting. At least in my experience, it's a long way from tree planting to asset based finance for insurance companies. It's interesting to note that insurance assets is the only capital that Prosperity manages, and your background is unique. Versus a lot of people that come on our show, I think you've got really deep chops in this world. So give us a little on your background and on Prosperity. And, you refer to it as PAM, but I want to make sure that people know when we say PAM, we're talking about Prosperity Asset Management. So with that, give us a little bit of the background so that we know a little bit about how you got into this chair.

Deva: Yeah. Most of my career was spent ... I was a computer scientist in the early 2000s right after the dot com bubble, and at that time, finance was hiring, so a lot of the jobs out of school were in New York City doing financial modeling of some sort. I started my career as an analyst at Goldman in the mortgage business, went through the crisis and then shortly after at the firm, they typically, for certain leaders or folks that want diverse experience, they move them around in different departments. And I had the opportunity to join what was then called Goldman Sachs Reinsurance Group. That was the predecessor of a business that's now called Global Atlantic, which is a fairly large insurance business. So it was a great perspective coming out of the financial crisis, learning all things that could go wrong in mortgage credit at a very young part of your career, and then moving into almost like an entrepreneurial environment, growing an insurance business from inception. I had no prior background in insurance. I think a lot of us have fallen into the industry, as they say.

But at that time, the department was doing transactions that were owning an insurance balance sheet, but at a Wall Street firm. So a lot of the how to operate an insurance business, what types of risks in insurance business is it appropriate to take? How does this business actually function? I got the opportunity to learn that basically just from scratch. There was no one really around to teach you because it was a small little entrepreneurial business. So I learned insurance regs by going to websites and learning, having to read about what insurance regs are about, what can insurance companies invest in. And so the fundamental building blocks of understanding how this business operates and is structured, I had a great opportunity to learn all of that from the bottoms up. And then I was with that team for almost 10 years.

I wore several hats during my journey there. I ran the structure product business for them. I oversaw risks and systems development for both assets and liabilities. And then my last job before I departed and started Prosperity Asset Management was as Deputy CIO. And at that point, that firm had about between $50 and $60 billion of assets. So it was a good comprehensive underpinning of what building an insurance company is about, and I found that to be really useful. I had the opportunity, again after working for 10 years in that role, I had the opportunity to start again and do it generally my way with a little bit more ownership and a little bit more say, as a second time building a business. So, starting in 2019, we had about $2 billion of assets under management when I was brought in to lead this initiative. And we fast-forward to today, we have about $15 billion of assets under management, and our year-end target is pretty close to $25 billion. So it's been a good amount of growth for us all within the confines of insurance.

Stewart: That's really interesting and a great success story. When we were talking just before we picked up the podcast, you had mentioned that you were doing structure... These ABS or what we would refer to as private structure deals way back in 2013 when that market was really forming. Can you talk a little bit about the history of asset-based financing back in those times when it was first starting out?

Deva: Yeah, we learned very early on, and I think it's applicable today in terms of what happened, and the fundamental building blocks of fixed income is oftentimes it's rules-based. And coming out of the financial crisis, there was an opportunity where certain securities were very efficiently held on insurance balance sheets. A lot of the people talk about banks retrenching and Basel and all these regulatory capital rules, but it's not only applicable to banks. It's applicable to every single financial repository, whether it's a fund, a REIT, a business development company or insurance company. So at that time, insurance companies could hold things like non-agency RMBS securities or commercial mortgage backed securities. A lot of the things or assets that had distress, insurance companies could hold very efficiently. So there was a large disconnect between how other participants could hold those securities and how insurance companies could hold those securities. And that gave us an underpinning of understanding what's the objective? Why is this the case? And are there other opportunities outside of those two non-agencies and CMBS where we could effectively find assets that were more efficiently held on an insurance company's balance sheets?

And so we canvassed a lot of different fixed income assets and started expanding the breadth of origination activity across what people generally call ABF now, and always with the guidelines of understanding what the core objective is. And in our mind, it was to maximize both the return of the equity in the insurance company as well as providing stable, secure income for all the policyholders and the ultimate beneficiaries on the insurance company side.

Stewart: It seems like right now there's almost like a second level of consideration when people are making an allocation. There's the asset class itself, then there's how it's held, which has to do with, and you're touching on this directly, which is the way insurance companies think is return on statutory capital or risk-adjusted capital, which is based on some insurance regulations that you were laughing about earlier, getting on those websites and scouring and figuring it out. So when you think about the current environment today, what is the current state of play in the private credit ABF market?

Deva: Yeah, in general, most insurance companies and ABF participants are taking a wide variety of fixed income instruments. Those are loans or royalties or certain unlevered assets, and they're securitizing them. They're putting them into effectively a corporation that's issuing rated notes. Some people call those rated feeders, some people call them asset-backed securities. But effectively what's happening is you're taking some asset and you're establishing credit, a credit criteria, you're getting it rated for the purposes of establishing how much capital you have to hold against that asset. And that process has been around in structured finance for a long period of time. But I think what's more prevalent right now is that a lot of insurance companies are doing that themselves or with the help of certain asset managers as opposed to that channel happening generally prior to the GFC, certainly just through the banks.

Stewart: And so can you talk a little bit about what the ABF sub-sectors are and what you see as opportunities and if anything, you are cautious about?

Deva: Sure. So I mean, I think of the ABF landscape in two or three broad categories. Real assets, which are infrastructure, both renewables, specialized real estate. Then there's transportation assets. And then core real estate, both residential and commercial. Then specialty finance, I mean that's a term that gets thrown around. I think of specialty finance, I think of consumer-oriented products, student loans, auto loans, you've seen a prevalence of royalties, really any type of contracted cash flow between two parties. You see this in the music space or certain mining scenarios. And then there's the public structured arena, which is what people generally know, which is securitized asset backs, commercial mortgage backed securities, RMBS, and CLOs. Prosperity Asset Management traffics in all three of those heavily with an emphasis on both public and private in the first two: real assets and specialty finance.

Stewart: That's super helpful. So I've got a couple of friends that let me borrow their CIO hats from time to time. They told me not to touch any buttons, but I can wear the hat. But at the end of the day, a lot of times, and as you well know, a lot of people want specific exposures or something that's bespoke and custom to them. Can you talk a little bit about PAM's ability to create custom solutions and some examples of what a custom solution might look like for a given insurance mandate?

Deva: Sure. The benefit that we have when you build a company from scratch is you get to do everything, or you can execute a vision on a small scale and then grow it. And what we had with our vision for Prosperity Asset Management was to build not just an asset manager contraction, but a real fundamental way to model behaviors on both sides of the balance sheet, and create portfolio allocations and sector allocations and origination that fit comprehensively on both the assets and the liabilities. A lot of folks say they do this, they say they understand insurance, but we fundamentally built a system to be able to model it. So when we're looking at a fixed annuity block, which is something that a lot of participants in our space are issuing, like a lot of insurance companies have been issuing fixed annuities for quite some time, we model the inherent risks of those fixed annuities. What are the lapse rates? How long are those annuities going to stay around?

Without understanding those key risks, it's really hard to build an optimal portfolio because ... Or that's someone else's job. It's not the job of the asset manager. And then you have to translate the liabilities to the assets. But what we've set up here is we have a fundamental architecture that does both. So we understand the liabilities extremely well, and then we can optimally find assets that meet the risk characteristics of those liabilities.

A tangible example of this, and it's not super innovative, but the fact that we have a risk infrastructure that allows us to come up with these conclusions where three years ago when interest rates were really low, we thought if interest rates actually go up, that some of these insurance liabilities could have behavioral issues, some of them could leave if they have low crediting rate guarantees. So we built a portfolio that had a lot of floating rate assets, a lot of CLOs and structured finance that participate as interest rates go up. That ended up being a very good decision and a way to construct a portfolio. So when you have a holistic approach like that, you can make those decisions that are very complicated, you can make them more rationally. And I'm really excited and proud that we were able to build this over two to three years under the leadership of our key people. And it's very differentiated. I am pretty excited to continue to do that development and then roll out some of this for our clients as we do further and further development.

Stewart: The ability to build a structured finance portfolio to a set of liabilities, I mean, you may say that it's not that innovative, but that's a heck of a capability. I mean, that's not a little bit of analysis. That takes some real horsepower and it takes real capital to build those systems. Can you talk about what your vision was? I mean, obviously you started the firm, there was no guarantee that the world was going to beat a path to your door, but what you're doing is it seems to me, to be truly differentiated in the marketplace, to actually be able to create bespoke solutions that are effectively... There is a risk management component there that may not exist if you don't do that work. And you talked about the translation. So I'm not sure I'm asking a great clear question here, but-

Deva: No, I get it. Yeah.

Stewart: You know what I'm talking about. I mean, it's like what you're doing is really .. There's a lot of horsepower there. And how did you really set out to do it?

Deva: I think it was a function of our... We are our experience. So my experience at Global Atlantic was this is an entrepreneurial organization where if you saw different problems, you always try to do things better or do things in an improvement or an entrepreneurial way, which is like improving systems, improving risk infrastructure, spending time on more cohesive dialogue between your portfolio managers, your risks managers, your actuaries. And so when we set out to do that here, we wanted that dialogue to be, and the structure of managing that risk to be fairly cohesive. And I am glad you appreciate that because you go to some of these larger companies and it becomes harder. You have siloed departments and they become insular and the problems become larger.

But that's the benefit you have from starting from scratch is if you create really great infrastructure at a ground level, it allows you to create building blocks and then you don't have different silos. You have people speaking the same language, and you don't have as many interdependencies. So I think it probably comes from the fact I was a computer scientist, I like doing this stuff, I like building risk systems, I like making things efficient. And that part of the business is often overlooked, but is super important to building a really great business versus just focusing on origination or risk-reward on the asset side, because I think you've said it in some of your older podcasts, insurance is really complicated.

Stewart: Yes, it is. It's really complicated. And for the most part, I think the more you look at it, the more complicated it gets. I mean, you start talking about all the ways that an annuity block can experience disintermediation and that list... And you start talking about the kinds of what that same economic scenario is going to do to a structured security portfolio. I mean, you're doing a lot of lifting there. And what I'm wondering is if I'm a CIO and I hear that and I go, "Oh, that's too much," can you take inputs from, for example, if someone has liability key rates, can you take that as an input or is your process dependent upon doing the liability work yourselves?

Deva: No, it's both. And, Stewart, it comes from part of the other philosophy is there's a lot of transaction in the market that are called reinsurance transactions or transactions where an insurance company is in need of capital and they want to assign both their assets and liabilities to a different party. And in doing so, the reinsurer needs to evaluate both sides of the balance sheet, they need to know both what the liabilities are and the assets are. And oftentimes the asset manager will be tasked with enhancing portfolio yield or improving the NII characteristics of the assets.

But again, without knowing the interplay of both and just looking at improving income, you might not appreciate how much liquidity you have. You might not appreciate the tenor or the embedded risks that the liability may have, such that you might need to improve your income profile or something. So I think I've done, or I've worked on, I don't know, 18 or 19 re-insurance deals where you've had to turn over portfolios and take on liabilities and understand this complicated risk package. And in some sense, it's just a function of experience. Once you've done so many of these, you're like, "Gosh, this is really complicated. I need some architecture to help me make these complicated decisions." And then you have to worry about macro risks and what's happening in the economy and how do I originate all of these assets? That's like 80% of a lot of folks' job, but it's 50% of the true CIO or the true insurance executive's job.

Stewart: Yeah. And I mean, there's not a lot of people that understand that. And so let me just ask a question just totally out of curiosity. So if you're able to do that work, you've clearly got a team that is not simply ABF professionals, not just people who trade securities. There has to be significant tech resources and there also has to be significant resources, the people who are using that tech. So can you talk a little bit about the team at Prosperity Asset Management and what that looks like?

Deva: Our core team is approaching 40 professionals of which 15 are core investment professionals. And a good portion of the others are either quantitative analysts, programmers, or operations professionals, but a good portion of it are technologists. We also have contracted with certain development consultants who have... They're almost project-level consultants that supplement our own development staff and our COO leads that initiative for us. But that has been a two-year development cycle where we've continuously, we effectively took our portfolio at a certain point in our size, and we basically said, "Hey, we want to model everything on our portfolio systematically." And two years later, we've gotten almost all of it completely modeled in a portable infrastructure that I've been talking to you about. And a big portion of my... I'm CIO as well as CEO so I have to worry about putting good risk on our client's balance sheet, understanding macro markets, but I also have to work on the business side, which is I have to staff and budget for technology resources in my own budget.

But that was why having a really great board and really patient investors to allow us to do that work and give us the capital, not only to invest, but again, to build really great risk systems was paramount and it was a big part of our operating budget. And we'll continue to do so because I think you hit the nail on the head when you said, "You always learn more." So once you model something and then you start to look at it and something changes or macro markets change, then you're like, "Wow, wait, wait a minute, this looks a little strange. I need to look at that again." Then your level of understanding improves and hopefully then you're a better fiduciary for your policyholders and shareholders and clients.

Stewart: So Deva, I've gotten a phenomenal education today, not only about ABF, but also about Prosperity. Are there a couple of takeaways that you could leave our audience with before I ask you the super fun questions on the way out the door?

Deva: No, I think we're pretty unique in that we're a young, entrepreneurial organization that knows the business really well, and I think our perspectives on how to manage these balance sheets are super interesting and we have flexible capital and we traffic in a lot of these asset classes and would love to engage with your community and talk to others.

Stewart: That's super helpful. I've gotten a tremendous education. I've got a couple of fun ones for you out the door.

Deva: Yeah, for sure.

Stewart: So the first one is we have a lot of folks who listen to our podcast that are a little earlier in their career. In fact, this podcast is required reading for some of our clients' teams, which I'm really happy to hear. So what is a piece of advice that you would give a 25-year-old Deva Mishra today if you were starting out in your career? What's the advice you'd give someone as they were coming out of school?

Deva: I think the one piece of advice I got very early in my career from an associate that I worked for, which I hold to this day is if you have a problem or if you see a problem, you own it. So if you're sitting in a corporation or at some business and you see some issue, whether it's bad risk or a bad process, that's yours now, that's yours to fix. And if you go into that mindset, you always have this improvement philosophy or you're a good advocate for your firm because you're improving something that your firm didn't have, and you always have work and you're always productive. So everybody goes into their jobs saying, "Okay, this is a problem. That's a problem. I've got to..." But when you observe that that's yours to fix. And I think that's really valuable advice for people starting out.

Stewart: That is very valuable advice and very interesting, and it's a first on our show. And so here's the second question. You can have lunch with up to three people, alive or dead. You can choose just one or you can do all three. Who would you most like to have lunch with, alive or dead?

Deva: Oh wow.

Stewart: This is why they pay me the big money, Deva, is questions like this.

Deva: I think it would probably be ... I would love to have lunch with Alexander Hamilton.

Stewart: There you go.

Deva: I think just the vision for some of how... When you're a capital markets geek like I am, and you think about how all of our financial system was set up. Again, we talked a little bit about the rules that govern insurance companies or other financial institutions. A lot of the building blocks on that were from the original; he was the first secretary of the Treasury and had a vision for how the system was going to evolve. So I'd love to have a conversation with what his vision was, how he thought about everything, what's actually transpired. I think that would be a great topic. My kids would be really happy having gone to the play.

Stewart: Oh, wow. There you go. Well, that's good. Make them happy. So, Alexander Hamilton, that's fantastic. What a great answer. I've really enjoyed our conversation today. I've learned a bunch, and it's been great to get to know you, and I really appreciate you coming on and taking the time.

Deva: Thank you so much, Stewart, and thanks for doing this podcast. It's super informative and I really enjoyed the time. Stewart: My pleasure. We've been joined by Deva Mishra, who is the CEO of Prosperity Asset Management. If you have ideas for podcasts, please shoot me a note. It's stewart@insuranceaum.com. Please rate us, like us, and review us on Apple Podcasts, Spotify, Google Play, Amazon, or wherever you listen to your favorite shows. My name's Stewart Foley. We'll see you next time. Thanks for listening.