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Abstract

We investigate the effect of line-of-business diversification on asset risk-taking in the U.S. property-liability industry. The coordinated risk management hypothesis (Schrand and Unal, 1998) implies a negative relation between underwriting risk and investment risk. Consistent with this hypothesis we find that diversified insurers take more asset risk than non-diversified insurers, and that the degree of asset risk-taking is positively related to diversification extent. Our results are robust to corrections for potential endogeneity bias, selectivity bias, and alternative diversification and asset risk measures. We also provide event study evidence that further supports the coordinated risk management hypothesis. Specifically, we find that when a focused firm diversifies, it increases its asset risk relative to firms that remain focused, and when a diversified firm refocuses, it reduces its asset risk relative to firms that remain diversified.

JEL classification: G22, G32, G39, M49

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