

“Economics & Finance Cross-Functional Working Group” update for the Risk Management Committee

5th October 2023

Samuel Achord, BA MA FIA CERA DDA

Agenda

- Intro & *raison d'être*
- *Samarbejde* (working together)
- Projects & Collaboration
- Appendix – Inflation update
- Appendix – Liquidity update



Intro & *raison d'être*

ECONOMICS & FINANCE CROSS-FUNCTIONAL WORKING GROUP

TERMS OF REFERENCE

AIM

The Economics & Finance (E&F) Cross-Functional Working Group, from the point of view of the actuarial profession and in line with the mission, vision and strategic objectives of the AAE, will consider matters relating to macro and micro aspects of economics and finance and the impacts these have on insurance, pensions and social care.

} *what*

The E&F Working Group will strive to help Insurance, Risk Management and Pensions Committee to interpret the impacts of changes in the economy and financial system. In particular, the E&F Working Group will:

- Provide support for the committees, via professional analysis & deliverables, in understanding and managing change, volatility and uncertainty in the macro economy and financial system as it relates to insurance, pensions and social care (SO2 & SO3)
- On topics that closely relate to finance or economics, support ideas relevant to multiple Committees and Working Groups, ensure strategically-aligned projects and deliverables and promote projects of value to the committees (SO1, SO2 & SO3)
- Incorporate technical solutions and approaches from multiple practice areas, using a variety of credible economics and finance methods. The E&F Working Group will formalise problems to be solved and seek expertise from the Insurance, Risk Management and Pensions areas. (SO3)
- Build a centre of excellence for actuaries, support a feeling of community and shared purpose, share tools and insights, and attract volunteers with valuable and relevant expertise (SO3)

} *how*

Raison d'être

The new “Economics & Finance Cross-Functional Working Group” is...

- An open invitation for you to propose projects where you see value
 - A challenge to identify things of value and refine them to viable “projects”
 - A duty of professionalism in seeking collaboration and buy-in across the AAE, its Committees and other Working Groups
-
- So...what do you *want* to do?
 - Let's discuss it, refine it, and see if there's value in it

Open discussion on... High-Level Goals

Engagement

**Excellent Collaboration,
Valuable Projects &
Deliverables**

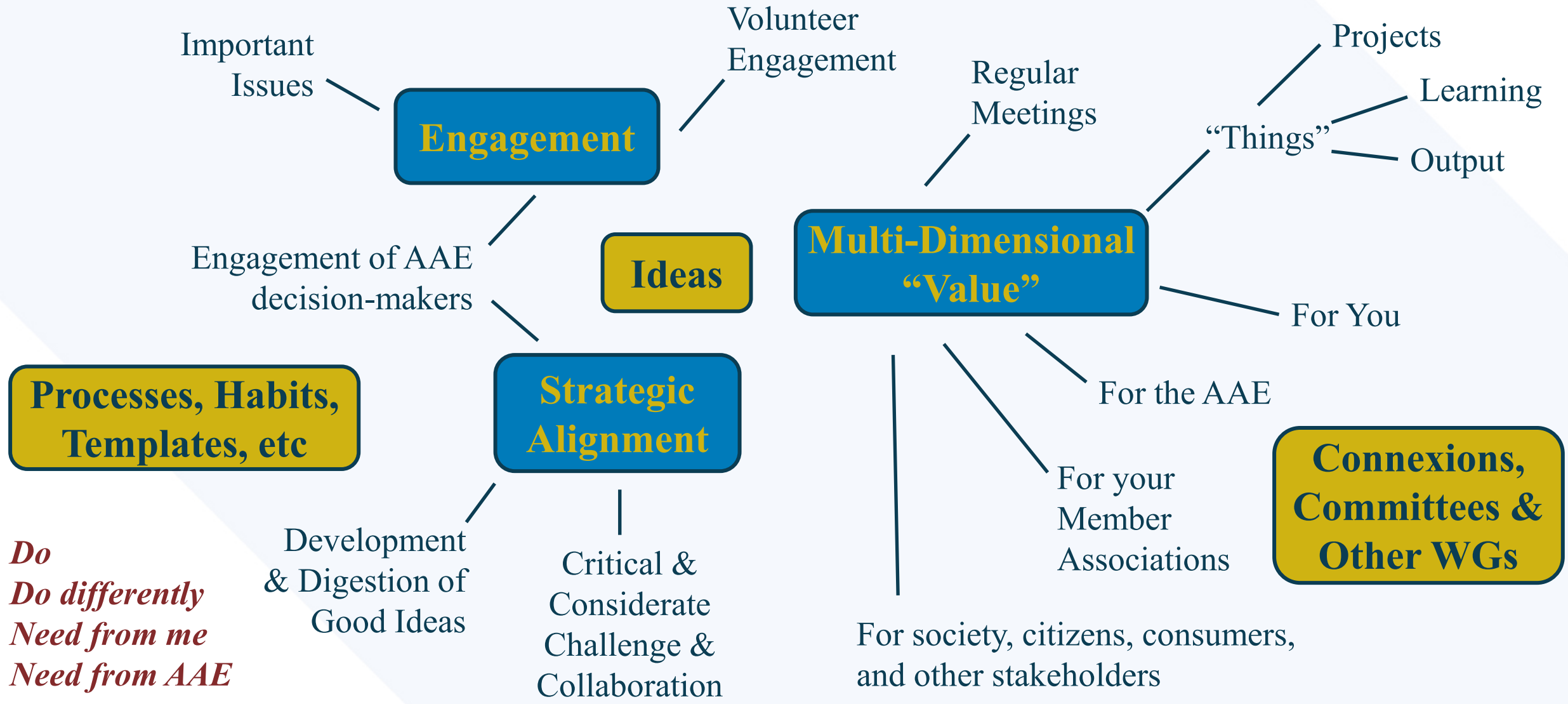
**Multi-Dimensional
“Value”**

**Strategic
Alignment**

Open discussion on... High-Level Goals

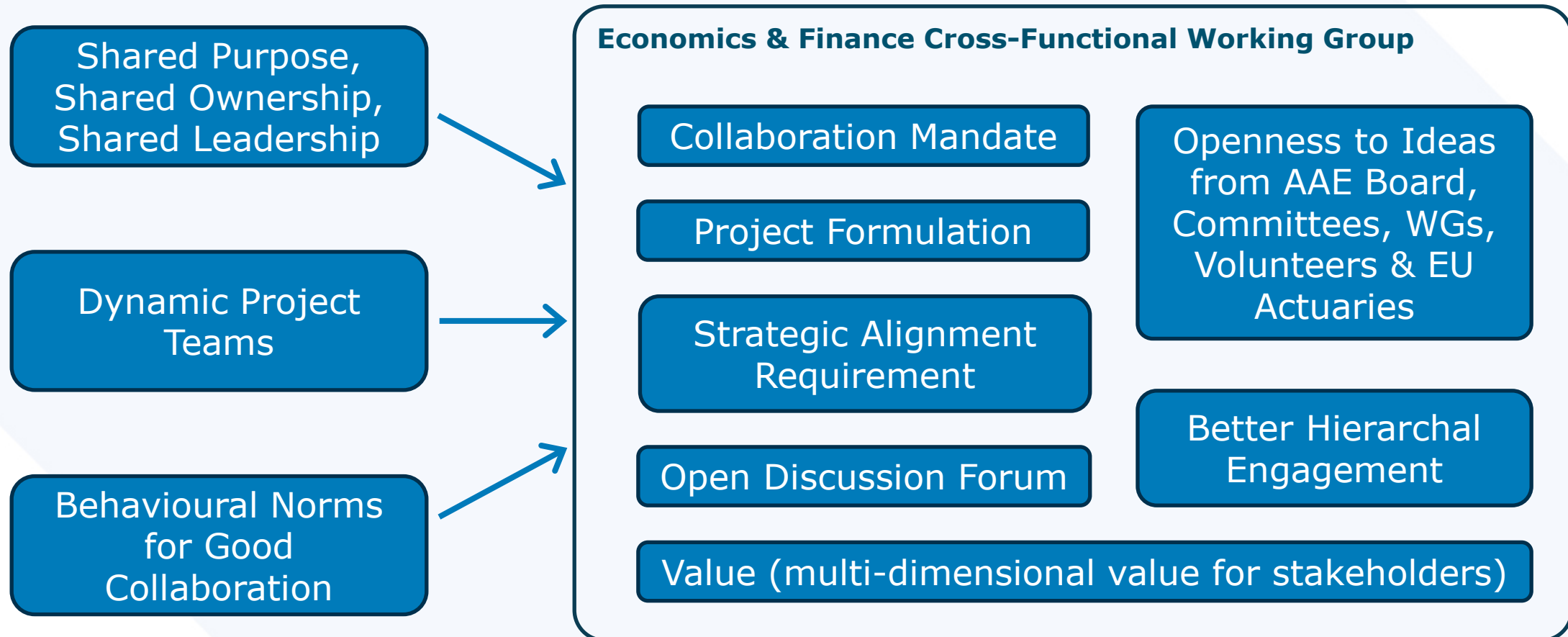


Open discussion on... How to Achieve Our HL Goals



*Do
Do differently
Need from me
Need from AAE*

Culture, Processes & Soft Things...



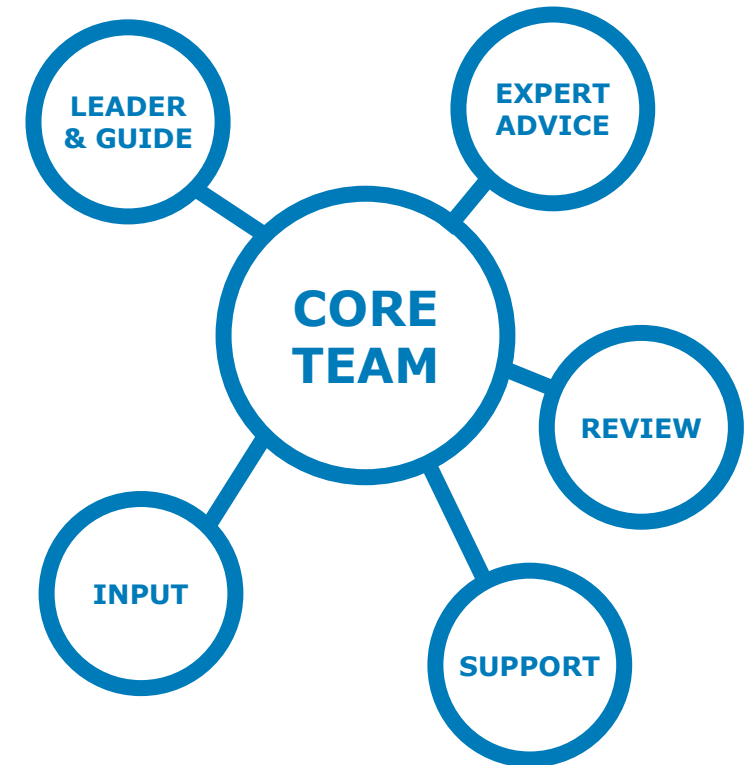


Samarbejde (Working Together)

Dynamic Project Teams & *Samarbejde*

- **Ideas** need to be bounced around, challenged & improved
- **People are different**, with different skills
- The goal is to make those **skills complementary** and get those **people to collaborate**
- **Experts** need to be consulted, perhaps included in a project team
- **Leaders** need to guide projects
- When people generate **good ideas**, they need to bring them to the group
- **Roles are dynamic** over time and projects

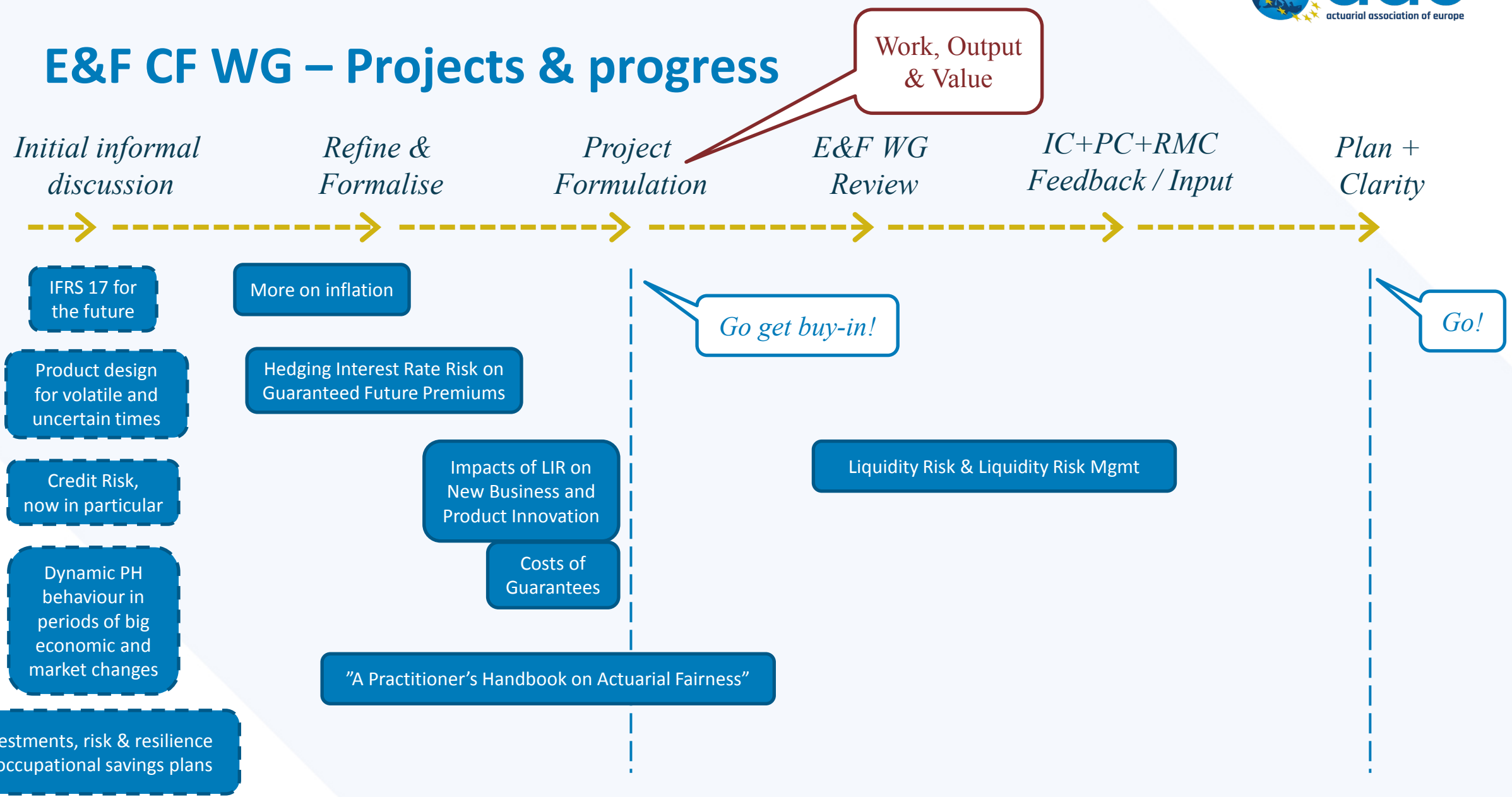
The *Samarbejde* Skildpadde





Projects & Collaboration

E&F CF WG – Projects & progress



Projects & stages – *your input welcome!*

New Ideas

IFRS 17 for the future

Product design for volatile and uncertain times

Thinking ahead...
Falling Interest Rates

Credit Risk,
now in particular

Dynamic PH behaviour in periods of big economic and market changes

Investments, risk & resilience of occupational savings plans

Set to Refine

More on inflation

Hedging Interest Rate Risk on Guaranteed Future Premiums

Potential output

Technical summary paper on hedging (long-term) IR risk and inflation risk. BS effects, P&L effects, effects *over time*, effects under different macro scenarios

Projects in Waiting

"A Practitioner's Handbook on Actuarial Fairness"

Active Projects

Liquidity Risk & Liquidity Risk Mgmt

Impacts of LIR on New Business and Product Innovation

Costs of Guarantees

Yellow → strong case for collaboration

More on inflation – *open discussion*

If we look at the slides on “Inflation – so what?” (slides 19-20), where are there useful KPIs and KRIs?

What’s important to you / your company / your customers to keep an eye on?



Appendix – Inflation Update

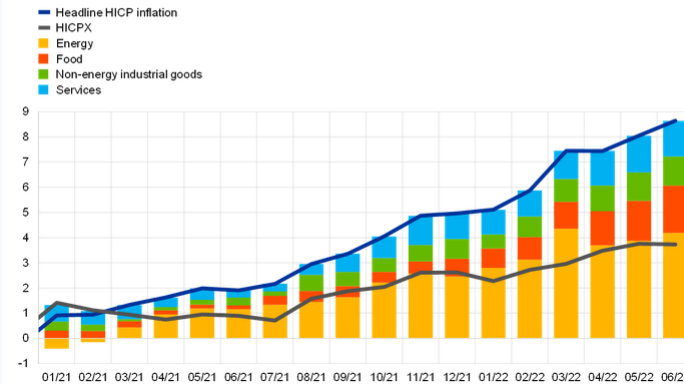
For reference – discussed earlier this morning at the Joint IC-PC-RMC Meeting

Inflation since June 2022

Chart 8

Headline inflation and its main components

(annual percentage changes; percentage point contributions)



2022 Q2

2023 Q2

Chart 10

Headline inflation and its main components

(annual percentage changes; percentage point contributions)

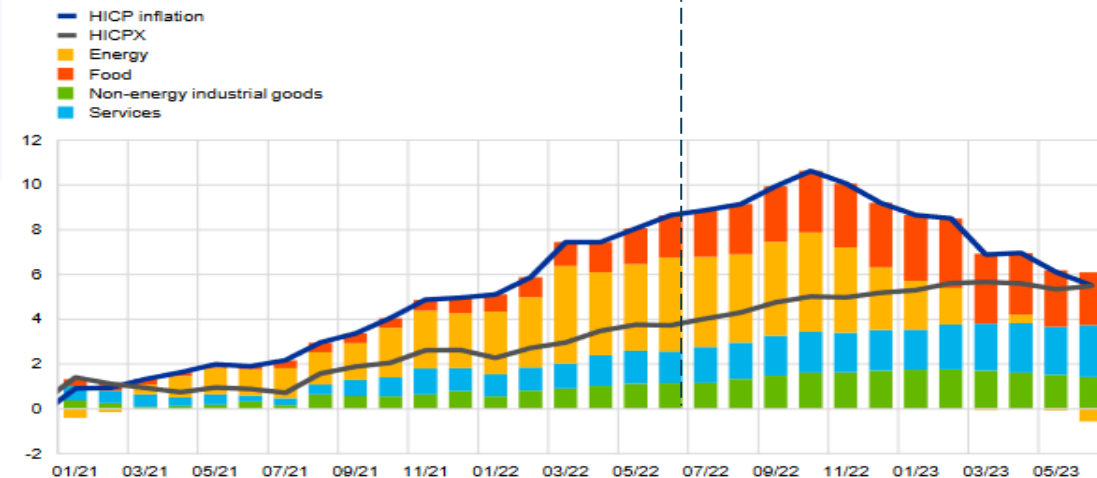


Chart 11

Survey-based indicators of inflation expectations and market-based indicators of inflation compensation

(annual percentage changes)

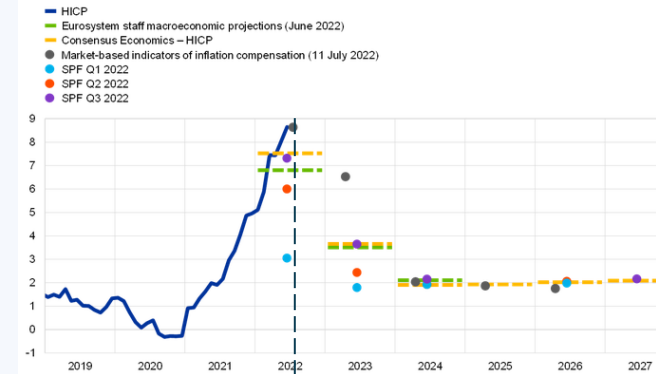
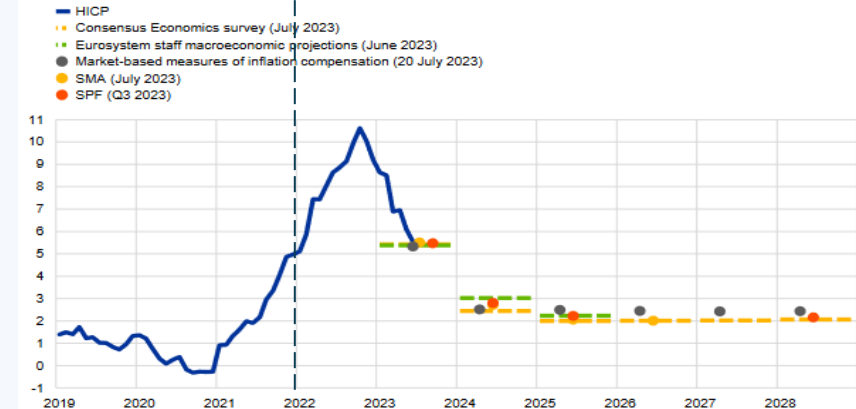


Chart 14

Survey-based indicators of inflation expectations and market-based measures of inflation compensation

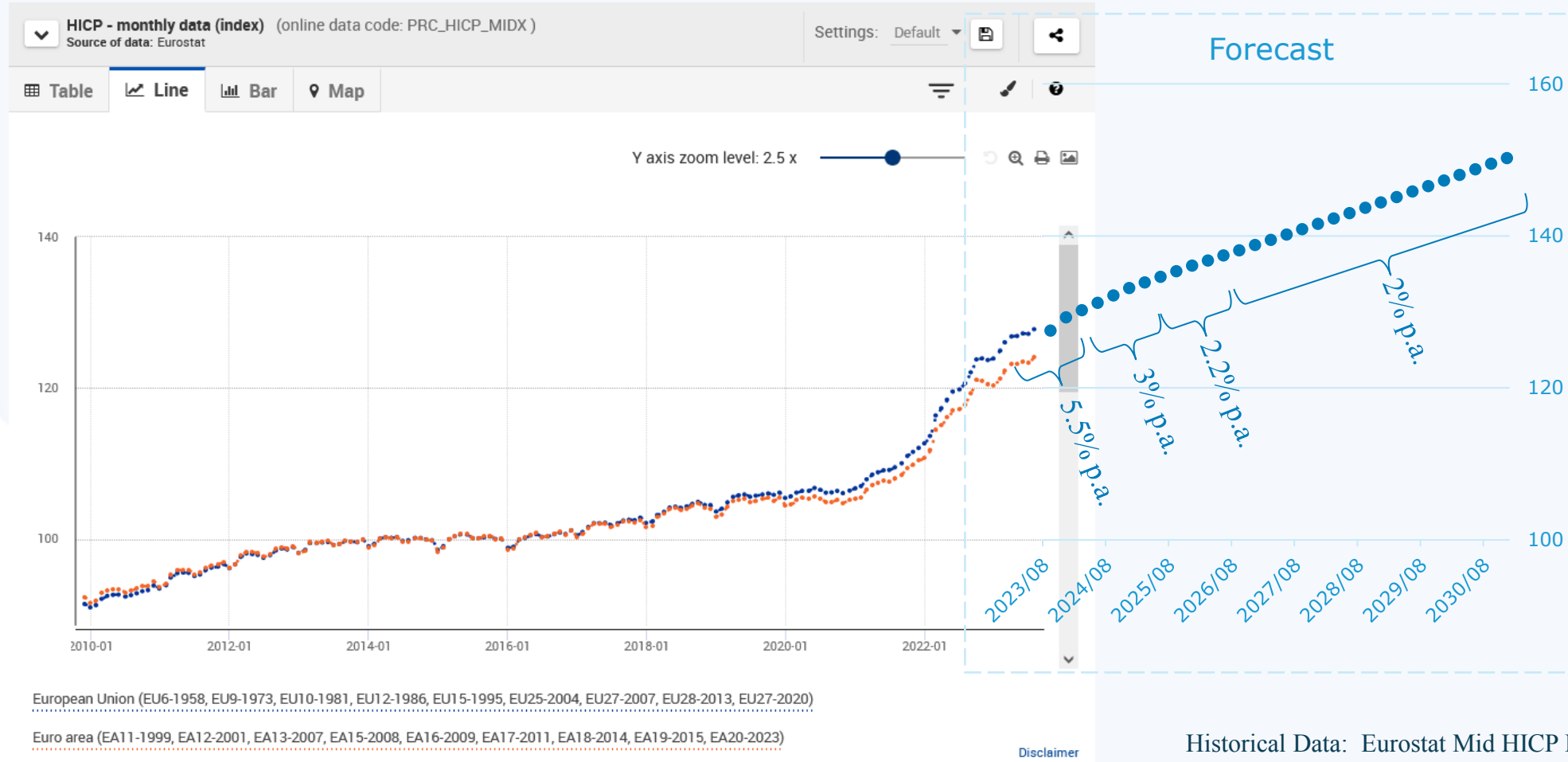
(annual percentage changes)



Sources: ECB Economic Bulletin #5, 2022
ECB Economic Bulletin #5, 2023

Inflation & Purchasing Power

HICP index: historical data back to 2010; forecast to 2030



Sources

Historical Data: Eurostat Mid HICP Index, 2010-2023.08
Forecast: ECB Economic Bulletin #5, 2023 & own calculations

Inflation – so what?

Macroeconomics & impacts

2020 – Today

- Lower nominal (ΔR) and real ($\Delta \text{inflation}$) values of debt / borrowing / credit / bonds
- Increased debt-servicing costs
- Increased refinancing roll-over risk
- Energy inflation feed-through
- Core inflation on everyday goods
- Start of wage inflation
- Reserve currency, financial flows & supply chains

Today – 2030

- r^* (EU, US, China)
- Structural pressure (upwards) on r^* from increased sovereign debt, crisis expenditure, infrastructure investment, etc
- Wage Inflation vs Monetary Policy
- In general, input factors: labour, energy, materials, financing costs
- EU & US long-term inflation targets

Inflation – so what?

Impacts on insurance and pensions

Retrospectively

- Lost purchasing power
- Nominal guarantees are cheaper, but only via *reinvested* money
- Real guarantees are harder—is there hedge / matching slippage?
- PC: losses due to lag between claims inflation (earlier) and premium reactions (later)
- Risk products (L, H, PC): real premium volumes?

Prospectively

- Risk products
 - Price & demand elasticity
 - Real vs nominal premium volumes
 - Real vs nominal claims
 - Pressure on profits due to price lag
- Savings / pensions
 - Real vs nominal savings / contrib
 - Purchasing power & forecasts
- Consumer preferences in a world of stable 2% inflation → product design

Inflation – Feedback & Input

Feedback #1: questions & open discussion

Feedback #2: leverage

- How can we make further use of this?
- What else can we do?



Appendix – Liquidity Update

For reference – discussed earlier this morning at the Joint IC-PC-RMC Meeting

Liquidity Risk & Liquidity Risk Mgmt

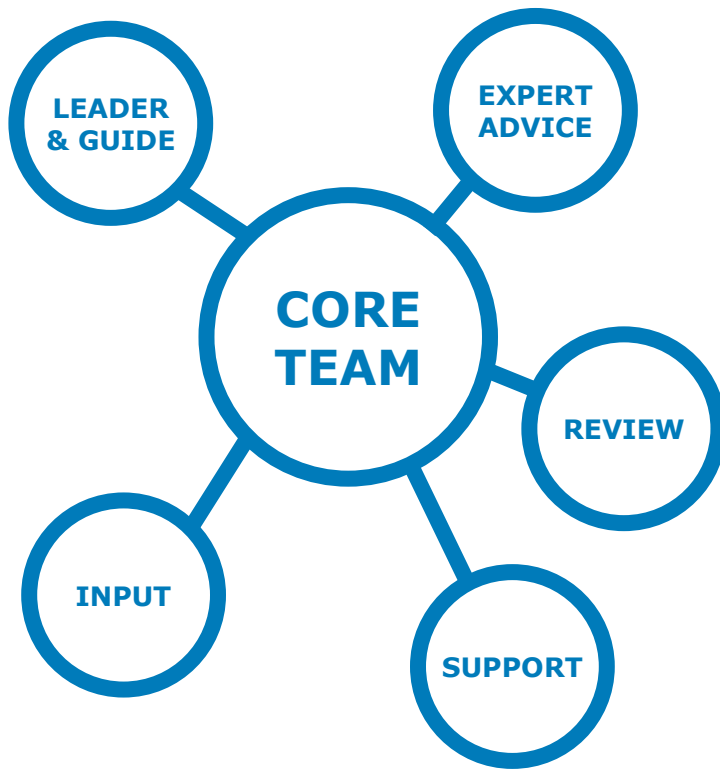
Check out the “Liquidity 2-pager”

Overall, the deliverables in total aim to achieve two things: (A) ensuring liquidity risk is properly understood by stakeholders and (B) supporting the development of a framework for managing and reporting on liquidity risk. *Thus, we want to produce...*

1. **Initial report on liquidity risk:** definitions of liquidity risks; resources & regulations; relevance to P&C, life & pensions
2. **Framework:** a practical and theoretical approach to liquidity stress testing, analysis and reporting, to help ensure that EU authorities’ analyses, discussions, and future draft legislation is suitable to the EU insurance and pensions markets
3. **Survey of current practices** in liquidity risk management, which leads to #4
4. **An AAE opinion on good practice** currently and emerging good practices. This opinion should motivate that other stakeholders take into consideration our report and framework (#1 & #2).

Liquidity – *the perfect project for collaboration*

The Samarbejde Skildpadde



- There are multiple interested parties
- There is momentum
- There is interest
- The ideal “core team” is bigger than the current “core team”—who wants in?
- The “wider team” (all of you, in varying roles) will help the project along
- How do the IC, PC & RMC want to participate?

Liquidity – Feedback & Input

Feedback #1: questions & open discussion

Feedback #2: leverage

- How can we make further use of this?
- What else can we do?

ACTUARIAL ASSOCIATION OF EUROPE

www.actuary.eu

Follow us on LinkedIn and twitter: @InfoAAE