SHOWCASING BANKING EXPERTISE TO ACTUARIAL SOCIETIES IN THE AMERICAS

BY **RONALD KOZLOWSKI** AND **MICHAEL TICHAREVA**

Actuaries are increasingly involved in banking practice in various jurisdictions around the world. South Africa and Australia currently lead, with banking practice for actuaries being well established. In South Africa, about 12% of actuarial professionals, roughly about 560 members of the Actuarial Society of South Africa, are involved in banking practice. In North America and Europe, the involvement of actuaries is still at its infancy, although there are also a number of individual actuarial professionals already involved in banking in those jurisdictions.

SHOWCASING BANKING EXPERTISE

We initially met in early December 2022, while attending the 32nd Caribbean Actuarial Association Conference in Barbados, where Michael presented in three different sessions on actuaries working in banking practice. Ron attended all three sessions where, in one of the sessions, Michael used South African banking case studies to highlight professionalism issues that actuaries need to consider in banking.

As Ron sat through Michael's sessions on banking, he heard him say that property & casualty (or general insurance) actuaries are naturals for entry into banking. With Ron having worked on a variety of industries such as construction, retail, food services, health care, pharmaceuticals, transportation, energy, manufacturing, and public entities on risks, applying actuarial skills in a wide range of risk areas resonated well with him.

One concept Ron learnt from his catastrophe modelling days was that of contagion risks, where multiple risks can have losses at the same time. In that same realm, banks are exposed to many risks, including credit, market, and operational risks, that they need to look at on an individual basis as well as in aggregate. This scenario is a natural fit for actuaries as risk management professionals. Actuaries already have risk management and modelling skills relevant to banking, and they only need to understand banks' business models, products, markets, and regulations to understand the underlying risks that they need to model. >

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Ron was impressed with Michael's pitch for actuaries to move into banking that he asked him to present at the 2023 Casualty Actuarial Society (CAS) Spring Meetings, that took place between May 7th and 10th in Boston. Michael came to Boston in May 2023 and presented on banking practice for actuaries. His talk resonated well with a few initiatives that CAS is pushing, the first of which is having actuaries work in different industries given their risk management expertise.

THE BANK FAILURES OF 2023

The bank failures of 2023, with the failure of Silicon Valley Bank, Signature Bank of New York, First Republic Bank in North America, and the rescue of Credit Suisse in Europe, present great opportunities for the involvement of actuaries in banking.

The Basel Committee on Banking Supervision (BCBS) published a report in October 2023 on the banking turmoil, grouping recurring themes into three broad categories as outlined below.

1. **Faulty risk management practices and governance arrangements of banks**
   The following fault-lines were highlighted in this area:

- fundamental shortcomings in basic risk management of traditional banking risks such as interest rate risk, liquidity risk, and various forms of concentration risk;
- a failure to appreciate how the build-up of various individual risks were interrelated and could compound one another;
- inadequate and unsustainable business models, including an excessive focus on growth and short-term profitability at the expense of appropriate risk management;
- a poor risk culture, as well as ineffective senior management and board oversight; and
- a failure to adequately respond to supervisory feedback and recommendations.

2. **Importance of strong and effective supervision across various dimensions**
   The following issues were highlighted in this area:

- the ability and willingness of supervisors to not only actively identify weaknesses in banks, but to also take and enforce prompt actions;
- the need to ensure supervisory teams have the appropriate quantity and quality of resources;
- the need to continuously monitor exogenous and structural changes to the banking system and adapt supervisory approaches to overseeing risks; and
- maintaining effective and timely cross-border supervisory cooperation across a wide network. >

3. **Importance of prudent and robust regulatory standards**
   The following initial lessons were highlighted:

- the importance of a full and consistent implementation of Basel standards;
- the importance of a robust design and calibration of global standards for internationally active banks given that banks can be vulnerable to rapid changes in market sentiment;
- the need for a balanced approach between Pillar 1 regulation and Pillar 2 supervision, with robust and rigorous Pillar 2 approaches pursued as complements, and not substitutes, to Pillar 1 requirements;
- the potential for banks that are deemed to be not internationally active in a jurisdiction to pose cross-border financial stability risks;
- the need for proportionate regulatory frameworks to reflect the BCBS' expectations that any proportionate approaches are commensurate with a bank's risk profile and systemic importance.

IMPLICATIONS FOR ACTUARIES

As the global banking industry considers areas that may require attention following these bank failures, actuaries can bring complementary skills to multi-disciplinary teams in banking.
A key issue for such teams is understanding and judgement versus 'tick box compliance'. Actuaries across jurisdictions can, therefore, be involved in designing enhanced solutions that help banks, supervisors, and regulators in understanding banking risks, and how banks can manage such risks in a more holistic manner.

Actuaries can, for example, add value in asset-liability management, liquidity risk management, and in stress testing allowing for interactions between risks. These are areas that require understanding and judgement in setting assumptions, choosing appropriate methodologies, and designing appropriate banking risk management frameworks, which are key areas in which actuaries are well trained in applying judgement. <

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