Actuarial Risk Management
Global Actuarial Consultancy

Strategies & Risk Solutions for Executives
4Q2023 Issue 8

To Our Subscribers

We want to thank our new subscribers and welcome everyone to the eighth issue of the ARM quarterly newsletter! Thanks to our new subscribers. We hope that you all find this publication valuable. With a few short articles meant to provide unique insights, we present ideas about how to address specific problems and introduce potential risks and opportunities that may not yet be on your radar.

The primary authors are Dave Ingram and Max Rudolph. We have been active participants in the risk management, actuarial, investment and insurance spaces for many years.

Subscribers are encouraged to suggest topics for articles and ask questions of the authors during our follow-up webinars and podcasts. Ever cognizant of regulatory requirements, leveraging them to add value to your company in practical ways, is our focus.

Sponsored by Actuarial Risk Management (ARM), the Strategic and Risk Solutions for Executives (SRSE) subscription is free to all readers.

A free webcast is also available and our podcasts covering these topics is called Crossing Thin Ice. If you would like to further engage the authors as consultants, for continuing education purposes or to join our ERM Discussion Group, please reach out. More info can be found throughout this newsletter. We hope to help you find a solution that meets your needs!

Please forward to others who study risk.

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We hope you will join us on our journey!

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The content of this newsletter is meant to be educational and thought provoking. Nothing in it should be interpreted as investment advice.

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Using Risk Appetite:
Contrarian Views

Risk appetite defines the strategy chosen around risk. Many insurers formally adopt a policy at the board level, making changes to it sticky and avoiding frequent changes. Our personal risk strategy provides similarities that firms can learn from.

Adding Risk at the Wrong Time

When we exhibit normal behavior of fear and greed this leads to an unstable risk appetite, willing to take more risk when conditions are positive and stable, and reducing risk during a crisis. When the switch between risk on and risk off occurs is often obvious to the so-called rational investor, with others continuing to "buy the dip" very late in a cycle and just before a crash. This group of latecomers is often referred to as dumb money (mostly retail investors) but that's not true. There are plenty of professional investors who have gotten burned when they

Each of us thinks we are rational but are likely to fall prey to the fear of missing out (greed) when conditions are good and fear, when extreme conditions appear during a crisis. Did you buy the dotcoms in 1999, financial stocks in 2006, Bitcoin or meme stocks in this most recent cycle? The current financial run hasn't been completed, but do you own concentrated positions in an asset class, financial products or distribution networks? Have you become highly levered? How did you react to earlier corrections? More importantly, what did you learn?

Check out the Crossing Thin Ice podcast

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Using Risk Appetite (cont'd)

were late to the party and got caught swimming naked when the tide went out and the true situation was revealed. This has been true for institutional investors and their boards.

I authored a research paper following the financial crisis of 2008 that concluded insurers outperformed banks during that period because their investment policy statements (IPS), required by regulators and formally approved by the board, provided some friction and made it harder to add new asset classes in concentrated positions. Slowing down the ability to add the latest hot asset class kept existing strategies intact, avoiding many of the losses when conditions weakened.

Companies that stress test and scenario plan also have an advantage, especially if the results are used to manage the business rather than a checkbox exercise for regulators and rating agencies.

Behavioral finance encourages us to be aware of our shortcomings and biases. Recency bias is especially prevalent in the financial markets. When others do well, we feel obliged to follow their lead (herding) even if it's not clear why the decision makes sense for our unique circumstances. When others are having success it's hard not to follow their lead. This can lead to adding to risk appetite levels at inopportune moments. It's always better to take a deep breath and think about what might be missing from the analysis done to date.

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Using Risk Appetite (cont'd)

Excitement of New Things

When a product or new asset class is being considered that comes with new characteristics, there is excitement in the room and expectations of high returns. It may have been brought to the company by an external hire with prior success at a competitor. Everyone wants them to succeed. A contrarian viewpoint is often discouraged, but it is important for someone to consider the product or asset class over a longer time horizon within a full business cycle. Some products today have had success over the last ten years, perhaps driven by government stimulus, and can demonstrate high historical returns.

How will these products or asset classes perform during a recession, spike in interest rates, quantitative tightening or deflationary period? Demographic trends are expected to slow growth in the western democracies and previous growth engines like China. Climate change and reversing stimulus will also stress these products, making it hard for them to meet client needs and insurer ROI targets.

Winning the Long Game

There are times when different approaches are appropriate, and plural rationality concepts address how to match up preferred responses to current conditions. That discussion extends the simple "slow it down" and "contrarian" thought processes discussed here.

Formal risk appetites make it harder to repeatedly change practices without making it impossible. That is a good thing, providing time for additional analysis to be completed. A risk manager can often provide contrarian views that lead to thought-provoking discussions before decisions are made. It may seem like everyone else is being successful at your expense, but maintaining a mostly stable risk appetite will pay off in the long run.

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Now providing three ways for you to get insights, strategies and solutions from ARM consultants to help resolve your risk issues.

Newsletter

- 3 to 5 articles quarterly
- Written by Dave Ingram, Max Rudolph and other ARM consultants focusing on risks faced by insurers and risk management strategies
- Available on the ARM website

Webcast

- One-hour live webcast once each quarter following the newsletter publication
- Webcast includes brief presentations, interviews with authors and live Q&A with your questions answered regarding the newsletter topics

Podcasts

- Two per month
- Delivered by Dave Ingram & Max Rudolph
- Presenting material from the newsletters and webcasts in a totally audio format.
- Available wherever you download podcasts

* No charge for subscriptions to ay of the three services

“While insurers have been challenged by low interest rates and the pandemic, the next few years will see a radically changing environment for insurers. We will be using this provocative platform to identify emerging risks and delve into what we see as the drivers of future success.”

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