

## SYNOPSIS

### **Confluence of the Actuaries and Economists Viewpoints in the New Economic Environment**

***Don Johnstone, Martin Lam, Sen Nagarajan, Michael Thomas***

**Key words:** Stress testing, macro-economic scenarios, model calibration, management actions, life insurance, general insurance, banking

**Purpose of your paper:** Provide viewpoints and approaches on how different financial institutions can use stress testing to understand the vulnerability of their business to macro-economic shocks.

**Synopsis:** Stress testing is an integral part of risk and capital assessment. It is a prerequisite for regulated financial institutions. Banks, life insurers and general insurers are required to carry out regular internal stress testing as part of their ICAAP. APRA also regularly runs industry wide stress tests. APRA's expectation is that financial institutions continue to develop and evolve their stress testing capabilities.

An integral part of stress testing is understanding where vulnerabilities to macro-economic shocks lie. This is however a challenging problem. Key challenges include

- Lack of data to calibrate models
- Changes in the business and macro-economic environment which mean that the use of historic experience may not be valid

Financial institutions must also consider how they will respond to the stress events. They need to think through the implication of an economic shock, how it will impact both their clients and suppliers (of services, liquidity and capital). The institution will need to develop a set of actions which must be feasible in this scenario.

In this presentation we look at different approaches to tackling this challenge. We take in the viewpoint of both actuaries and economists. The actuary is often tasked with translating a specific shock or adverse scenario of the world into forecasts of financial metrics. Economists can provide an important perspective on how scenarios can work itself through the segments of the economy, and the potential responses of different economic agents.

The current environment is continuing to evolve. We are in an unprecedented low interest environment. The speed of information flow is rapid amongst both other institutions as well as consumers. Further capital and liquidity flows are global and can turn on or off very rapidly. The impact of new and agile disruptors who may be service provider or competitors also needs to be considered.

This is a continuously evolving area where close cooperation between experts with different viewpoints and backgrounds can provide greater insights, and help understand the impact from macro-economic scenarios.