Navigating uncharted waters

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13rd Annual Roundtable of Chief Risk Officers (ART of CROs)
“Risk Management beyond Solvency II”

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The worst beginning in two decades
Diminishing expectations across the board
Central banks have lost their lustre
(but monetary policy is no panacea)
AN ANALYTICAL FRAMEWORK

- What is mere trend?
- What is cyclical?
- What is structural?

- An eclectic framework
- Six leading paradigms
- Reach and relevance
- Implications for insurance

Economic and policy implications
- Protracted stagnation
- Protracted low interest rate environment
- Policy pressure on exchange rates
- Growing protectionism

Implications for insurance
- Subdued growth in life and non-life
- Declining investment income and
- Pressure to search for yield
- Erosion of profitability (mainly life)
- And growing solvency challenges
- Hail “Mary Passes” into EMEs
SLOW RECOVERY FROM THE GLOBAL FINANCIAL CRISIS (PARADIGM 2)

Leading proponents: Carmen Reinhart and Kenneth Rogoff (2009), “This time is different”

### “Big Five” financial crises

- Finland (1990-93)
- Japan (1993)
- Norway (1988)
- Spain (1978-79)
- Sweden (1990-93)

### Post-crisis GDP development U.S. / Euro-19

- **U.S.**
  - Pre-crisis peak = 100
  - Recovery to previous peak = 110
- **Euro-19**
  - Pre-crisis peak = 100
  - Recovery to previous peak = 110

Source: OECD
European banks are ill prepared to cope with financial headwinds.
➤ Eurozone banks penalised with six-year handicap
➤ Adverse consequences for the economic recovery
PARADIGM 2: IMPLICATIONS FOR INSURERS

Economic and policy implications

• Distressed financial intermediation
• Fragile zombie banks
• Costly rights issues
• Protracted low interest rate environment
• Subdued economic growth (mainly Eurozone)

Implications for insurance

• Subdued growth prospects for life and non-life and
• Pressure on European insurers to expand geography
• Declining investment income
• Erosion of profitability and solvency pressure
• Zombie insurers?
THE NEXT CRISIS IS COMING (PARADIGM 3)

Leading proponents: BIS research department

If debt was the problem...

...will more debt be the solution?

<table>
<thead>
<tr>
<th></th>
<th>Growth of global debt</th>
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<tbody>
<tr>
<td></td>
<td>USD trillion</td>
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<tr>
<td>4Q 2000</td>
<td>19</td>
<td>87</td>
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<tr>
<td>4Q 2007</td>
<td>33</td>
<td>141</td>
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<tr>
<td>2Q 2014</td>
<td>38</td>
<td>40</td>
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</table>

- Households
- Corporate sector
- Government
- Financial sector

Source: McKinsey

Debt service ratios
Private non-financial sector

Source: BIS Quarterly March 2016

➤ Will debt be monetised?
➤ Will sovereigns default?
Economic and policy implications

• Continued financial market volatility in AMEs and EMEs
• New bubbles (mainly in EMEs)
• Growing financial crisis potential in EMEs and Eurozone
• Risk of run-away inflation
• Regulatory over-stretch

Implications for insurance

• Challenge for investment management
• Risk of double hit (mainly life)
• Risk of financial market induced regulation
SLOW PRODUCTIVITY GROWTH (PARADIGM 4)


Labour productivity growth 1955-2010
10-year centred moving average of annual per cent growth in output/hour

Economic and policy implications
- Low income growth; mainly in AMEs
- Protracted low interest rates
- Fear of globalisation
- Growing protectionism

Implications for insurance
- Subdued demand in AMEs
- Declining investment income and
- Erosion of profitability (mainly life)
- Global business models at risk

Source: Council of Economic Advisers, Annual Report 2016
“THE FUTURE OF FARMING IS DIGITAL” (PARADIGM 5)
THE SECOND MACHINE AGE OR THE FOURTH INDUSTRIAL REVOLUTION


U.S. labour productivity growth during the electrification era (1890-1940) and the IT era (1970-2012)

Economic and policy implications
- Golden Age of growth ahead
- Faster income growth for some
- Divisive IT gaps across the world

Implications for insurance
- New bundling of financial services
- Traditional business models at risk
- New competitors at the horizon
- Margin pressure, mainly non-life
- Growing demand for new solutions
- Costly and risky IT investments

DISTRIBUTIONAL DRAWBACKS

Wages for full-time, full-year male U.S. workers, 1963-2008

Economic and policy implications
- War for talent
- Skewed income distribution leads to politics of redistribution
- Fear of globalisation
- Political backlash for centre parties

Implications for insurance
- Challenge for global business models

Source: Açıkgöz and Autor (2010), “Skills, tasks, and technologies”
THE RISE OF PELOTS AND GROWING POPULISM (PARADIGM 6)

“Politics must take precedence over economics”
V.I. Lenin

Economic and policy implications
- Confrontation over political cooperation
- Political fundamentalism and nationalism
- Protectionism; anti-migration
- Sceptical view of multilateralism (Brexit)
- Fear of, and backlash to, globalisation

Implications for insurance
- Growth retarding if implemented
- Global business models at risk

Putin, Vladimir
Erdogan, Recep Tayyip
Le Pen, Marine
Orban, Viktor
Trump, Donald
<table>
<thead>
<tr>
<th>Leading paradigm</th>
<th>Key driver(s)</th>
<th>Economic impact</th>
<th>Relevance</th>
<th>Impact on insurance</th>
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</thead>
<tbody>
<tr>
<td>Secular stagnation</td>
<td>Excess savings</td>
<td>Stagnation</td>
<td>Many AMEs</td>
<td>• Subdued demand for L and NL</td>
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<td>• Declining investment income and erosion of profitability</td>
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<td>Wake of global financial crisis</td>
<td>Weak banks; Deleveraging cont.</td>
<td>Stagnation; Banking crisis</td>
<td>Mainly Europe</td>
<td>• Subdued demand for L and NL</td>
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<td>• Declining investment income and erosion of profitability</td>
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<td>Financial market fragility</td>
<td>Excessive monetary stimulus; lack of debt consolidation</td>
<td>Market turbulence; Eurozone crisis; EME crisis</td>
<td>Eurozone; Many EMEs</td>
<td>• Challenge for investment management</td>
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<td>• Risk of FM-induced regulation</td>
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<tr>
<td>Growth pessimism</td>
<td>Low productivity</td>
<td>Anaemic growth</td>
<td>Most AMEs</td>
<td>• Subdued demand for L and NL</td>
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<td>• Declining investment income and erosion of profitability</td>
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<td>Digital economy</td>
<td>Digital transformation</td>
<td>Growth acceleration</td>
<td>Global</td>
<td>• Pressure on traditional business</td>
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<td>• New competitors</td>
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<td>• Challenge for global business</td>
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<td></td>
<td>• Costly IT investments</td>
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<td>• New growth opportunities</td>
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<td>Rise of PELOTs</td>
<td>Populism and protectionism</td>
<td>Growth retarding</td>
<td>Global</td>
<td>• Growth retarding if implemented</td>
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<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>• Global business models at risk</td>
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<tr>
<td>Outcome</td>
<td>Nature</td>
<td>Occurrence</td>
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<td>--------------------------------------------------------------</td>
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<td>Financial market turbulence and new financial crisis</td>
<td>Long cycle Paradigms 2 + 3</td>
<td>Likely</td>
<td>20%</td>
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<td>Prolonged growth stagnation and low interest rates</td>
<td>Structural and long cycle Paradigms 1 + 4</td>
<td>Highly likely</td>
<td>80%</td>
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<tr>
<td>Globalisation setback</td>
<td>Very long cycle Paradigms 5 + 6</td>
<td>Possible</td>
<td>10%</td>
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<tr>
<td>Onset of Golden Age fuelled by IT</td>
<td>Structural (medium term) Paradigm 5</td>
<td>Possible</td>
<td>5%</td>
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Thank you

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