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Finance, Investment & ERM

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February 2019

Article of the month:

Cause for concern? The top 10 risks to the global economy 2019

February 2019. A report by The Economist Intelligence Unit

The outlook for the global economy is worsening. Given concerns over slowing growth in key economies, including China and the EU, and the wider impact of a trade war between the US and China, The Economist Intelligence Unit expects global growth to decelerate from 2.9% in 2018 to 2.8% in 2019 and 2.6% in 2020. However, even when taking into account this downbeat assessment, there remain a number of risks emanating from three key areas that could drive growth even lower than we currently forecast in 2019-20. First, geopolitical uncertainty is on the rise and will remain a source of significant risk, potentially impacting trade, financial markets and the oil sector….

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Return Seasonalities in Government Bonds and Macroeconomic Risk

February 2019. Mateusz Mikutowski (Poznan University of Economics), Andreas Karathanasopoulos (University Dubai), Adam Zaremba (University Dubai & Ponzan University)

We present a novel explanation of the cross-sectional seasonality anomaly in government bond returns. The macroeconomic risk premia may accrue unevenly during the calendar year, and the pattern may be transferred to government bond prices. We decompose the seasonality strategy payoffs into predicted and unexpected components. The seasonality effect plays a role only for the predicted component, linking the sources of the phenomenon with macroeconomic risk factors.

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US economy: Overpricing recession risk

February 2019. Vanessa Drucker (Writer at Investments & Pensions Europe)

Financial markets have suffered a nasty bout of indigestion since October. The interplay of sentiment and volatility induced widespread pessimism, with added concern that market tantrums could subsequently bleed into the real economy. In fact, Duke University's Global Business Outlook Survey in December 2018 showed that 48.6% of American CFOs foresee a US recession by the end of 2019.

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Asset owners 'should push for strategy, fee innovation' at hedge funds

February 2019. Rachel Fixsen (Writer at Investments & Pensions Europe)

Investors should put pressure on hedge fund managers to innovate and reduce fees, consultancy giant Willis Towers Watson has argued. Asset owners should change their approach to hedge fund investment by isolating and taking advantage of the unique skills a manager may have, the consultancy said a in a recent report. In the report – titled 'Hedge funds: A new way' – Willis Towers Watson also suggested avoiding generalist, multi-strategy hedge funds. In addition, investors should refuse simply to accept products that are available, instead influencing managers to make innovative new mandates, designed in the context of a total portfolio.

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Hedging Climate Change News

January 2019. Robert F. Engle, Stefano Giglio, Heebum Lee, Bryan T. Kelly & Johannes Stroebel

We propose and implement a procedure to dynamically hedge climate change risk. To create our hedge target, we extract innovations in climate news series that we construct through textual analysis of high-dimensional data on newspaper coverage of climate change. We then use a mimicking-portfolio approach to build climate change hedge portfolios using a large panel of equity returns. We discipline the exercise by using third-party ESG scores of firms to model their climate risk exposures. We show that this approach yields parsimonious and industry-balanced portfolios that perform well in hedging innovations in climate news both in sample and out of sample.

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Swaps market heading for Libor fallbacks clash

February 2019. Helen Bartholomew (Writer at Risk.net)

The swaps market is heading for a clash on the vital question of how contracts respond to the death of scandal-hit Ibor benchmarks, after participants in the euro market ignored guidelines laid down by international regulators, and diverged from the results of the market's first consultation on four other swaps currencies.

Any split in the choice of the so-called fallback – to replace an interbank offered rate (Ibor) when it stops being published – would undermine attempts to safeguard….

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Time running out for Brexit data compliance, Bailey warns

February 2019. Alexander Campbell (Writer at Risk.net)

Time has run out for the country's financial sector to prepare fully for a crash exit from the European Union, according to Andrew Bailey, chief executive of the UK Financial Conduct Authority (FCA).

Bailey told the House of Lords' EU financial affairs subcommittee on February 27: "If we go into a no-deal exit… firms will not be able to do all the changes in their systems and documentation for day one. We are giving firms priorities to focus on, and giving them leeway on the side of them..

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Operational risk measurement

February 2019. Xiaoqian Zhu, Yinghui Wang and Jianping Li

In the loss distribution approach (LDA), the most widely used approach of operational risk measurement, the modeling dependencies across different risk cells have been extensively studied. However, it has not been recognized that the dependencies between high-frequency, low-impact (HFLI) and low-frequency, high-impact (LFHI) operational risk losses are naturally different.

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Top 10 operational risk losses of 2018
January 2019. ORX News and Jamie Ryder

Operational risk losses rose by more than a quarter in 2018, reversing the trend of previous years that had seen annual falls in the loss total. However, a large part of last year's $34 billion total is a single loss: Chinese insurer Anbang's $12 billion embezzlement case. The number of individual loss events has increased, though, with 2018 seeing 728 incidents against 2017's 710. The figures refer to losses that are publicly reported.

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Banks rocked by U-turn on FRTB equity risk weights
February 2019. Samuel Wilkes

A surprise decision by global rulemakers to abandon plans to lower standardised risk-weights for equity trading has been met with dismay from bankers, who fear stiff capital charges under the latest version of the market risk regime.

The Basel Committee on Banking Supervision had previously proposed changes to its Fundamental Review of the Trading Book in a bid to soften the capital impact of the new rules. But the final text released on January 14 reversed those changes – a move that one senior risk manager at a European bank describes as a "mystery".

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The Actuary Magazine:
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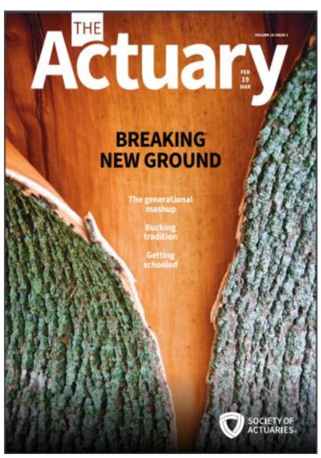

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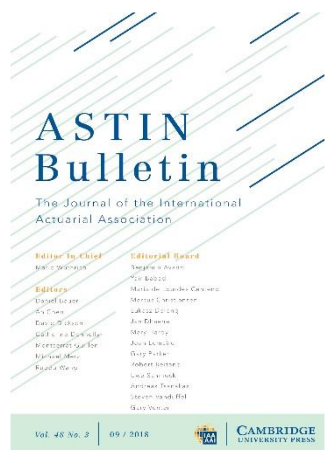

Irish SoA Database:
https://web.actuaries.ie/press/erm-resource-database

UPCOMING EVENTS

Quantitative Risk Management

10th April 2019. Intercontinental Hotel, Bulgaria

Modern risk assessment practice is its ability to quantify risks to be relevant for financial sustainability and sound business decisions. This is an Enterprise Risk Management workshop for delegates in the Life Insurance and Pension sectors, with a special focus on risk-based product development.

This workshop will be presented by Dr. Ermanno Pitacco, from the Faculty of Economics, University of Trieste and the MIB Trieste School of Management.

Find out more

AFIR-ERM Colloquium, Florence 2019

21st to 24th May 2019. Florence, Italy

The Istituto Italiano degli Attuari and Ordine degli Attuari (ISOA) and the AFIR-ERM Section are pleased to invite you to the AFIR-ERM Colloquium 2019: "Innovating Actuarial Research on Financial Risk and ERM", that will be held from 21 to 24 May 2019 in Florence, Italy, the cradle of Renaissance. Come enjoy from its artistic heritage as you walk along in an "open-air museum". Find out more about the event.

Find out more

UPCOMING EVENTS

Webinar Series with Dave Ingram (CERA, FRM, PRM, FSA, MAAA, and member of AFIR-ERM)

6th February, 2019. Rational Adaptability and ERM
8th May, 2019. Risk Intelligence
11th September, 2019. Risk Culture
11th December, 2019. Risk Appetite/Tolerance

Before, during and after the Financial Crisis, financial institutions can be seen to have been acting rationally, but only if you can admit that in the absence of a perfect view of the future, there are a number of different rational ways to imagine how the future will unfold. An idea is at the core of the anthropology theory of Plural Rationality. This webinar will explain how this theory provides vast explanatory power to understand the variety of approaches that have been and that are taken by financial institutions in response to risk.

Find out more