Society of Actuaries

Article from:

Risk Management

December 2012 – Issue 26

Letter from the Editor

By Pierre Tournier

IN THE LAST FEW MONTHS we've seen significant loss events driven by model error. Knight Capital Group announced a loss of $440 million over 45 minutes of trading. The error was traced back to recently installed software. Knight ultimately sold around 70 percent of its equity to survive. At JPMorgan, estimates on hedge losses range from $2 billion to $8 billion. While JPMorgan seems big enough to absorb this loss, it suffered public embarrassment and increased regulatory scrutiny.

As these events become more common, model risk will be more important for risk managers. Seeing these highly public events should make us think about our employers' models. Could a model error jeopardize your company? Where do these models sit, and what controls are in place? We can use the awareness of model risk to revisit our own models and push for better management if necessary.

In this quarter's newsletter, we have papers covering a variety of topics. David Ingram and Daniel Bar Yaacov provide a framework to help compare different risk mitigation strategies in "Trifurcation: Divide to Conquer Risk."

Shuyi He discusses the role of credit ratings in "Rethinking the Ratings-Based Approach." This paper discusses how, within specific credit ratings, securities can have widely varying risk profiles, reducing the overall value of ratings themselves.

In "Pension Risk Management: The Importance of Oversight," Dr. Susan Mangiero lays out the risk management process from the trustee perspective. This paper is a good reminder that fiduciary duty to plan participants or policyholders is also a powerful argument for effective risk management policies.

The editorial, "Thinking a Lot About Risk Lately, Too" by James Ramenda discusses the current state of the CERA designation and the role of actuaries in nontraditional risk management positions. It's an interesting perspective on the evolution of actuarial work and puts current trends in a longer-term perspective.

Finally, "Lump Sum and Risk Transfer" by Sean Brenan is an interesting response to current market conditions for pension plans. This paper discusses how active plan design management can help sponsors manage their profiles, reducing the plan's overall risk when the opportunity presents itself. ■

Pierre Tournier, FSA, CERA, is an assistant actuary in the profitability management area at Allianz Life Insurance Co. in Minn. He can be reached at *Pierre.Tournier@allianzlife.com.*