



**Investment**  
**SYMPOSIUM**  
Assessing the State of Global Economic Stability

## I1: Financial Reform – Too Little or Too Much, On-Track or Off-Course?

April 11 9:30-10:45 am

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**Actuaries**  
Risk is Opportunity.®



# Same Old Tune?

- Leverage
- Incentives
- Liquidity
- Culture
- Accountability
- Tail exposures/correlations



# Dodd-Frank Reform

- Transparency
  - Counterparty risk
    - Leads to rumor/liquidity fears
    - Bailout at 100% was nuts
      - Markets learn and extrapolate
      - Start with Continental Illinois...
- Accrual accounting
  - What answer do you want?



# Dodd-Frank Reform

- Risks taken or Too Big to Fail?
  - Driver should not be size
  - FDIC should differentiate bank guarantees
  - Interactions between risks are being ignored
- Enablers
  - Banks found buyers for securitized assets
  - Investment banks encouraged leverage
- Fiduciary requirement needed for all advisors



# Dodd-Frank Reform

- Concentration Risk
  - Hedge funds found they used the same strategy
  - Risk managers use the same model(e.g., VaR)
  - Methods (e.g., FHLB for liquidity)
  - What if we all adopt the same regulatory framework?
  - What if we all use Black-Scholes?
  - What if we all use the same reinsurers?
- Debrief events



# Drivers of Success

- Skepticism
- Peer review by contrarian thinkers challenge status quo
- Brainstorm alternative scenarios
- Transparency
- Don't focus
  - Single report/number
- Latticework of knowledge
- Common sense



# Risk Officer for the US?

- Great idea, but how would it work?
- Interaction with politicians
- Suggestion
  - Like CBO, independent but not accountable
  - Like Fed, offices around country/world
    - Not just in the beltway
    - Financial risks
    - Risks differ by region
      - Earthquakes
      - Drought
  - Search for bubbles, Black Swans, common risks

# What is a Black Swan?

- Per Nassim Taleb
  - The event is a surprise (to the observer)
  - The event has a major impact
  - After its first recording, the event is rationalized by hindsight, as if it could have been expected
- Was the BP oil spill a Black Swan?





# Essay - Prelude to a Perfect Storm

- Perfect Storm
  - Gaussian copout
- Perfect Sunrise
  - Highly correlated positive returns
  - “It’s different this time!”
  - Why no concern in 2006?
    - Everything is going great
    - Low volatility
    - Entering a new era
    - Greenspan put



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# Thank you!

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