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ILA / ALFI Dirigeant Forum

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Risk Monitoring Process

Portfolio and market data

Risk measures

Detecting changes

Risk Profile

Deviation reporting

Document. of rationale

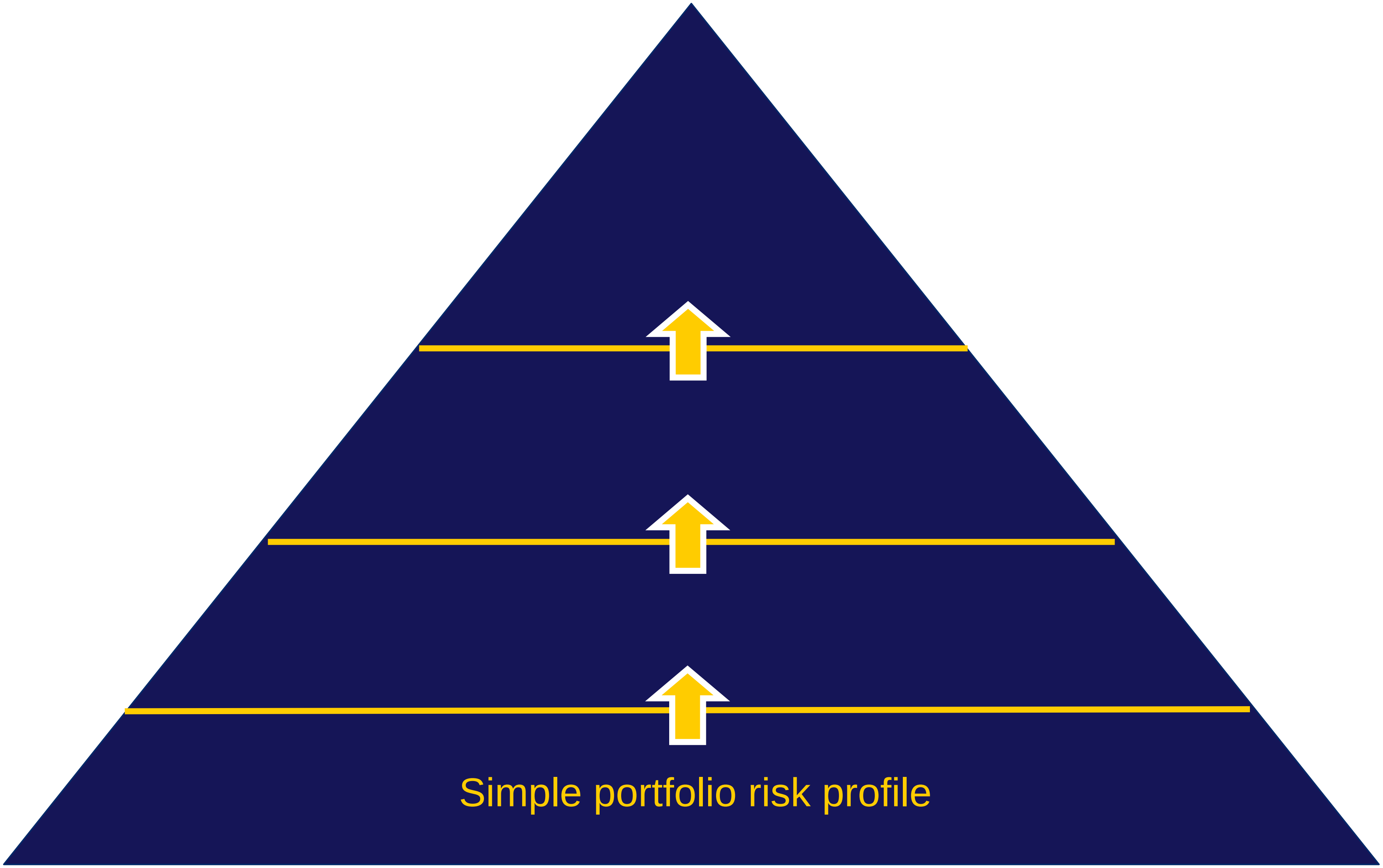
?

Issuance of (additional) guidelines

Quantitative:Technology requirement

Qualitative:
Investment process experience

All portfolios need to be covered

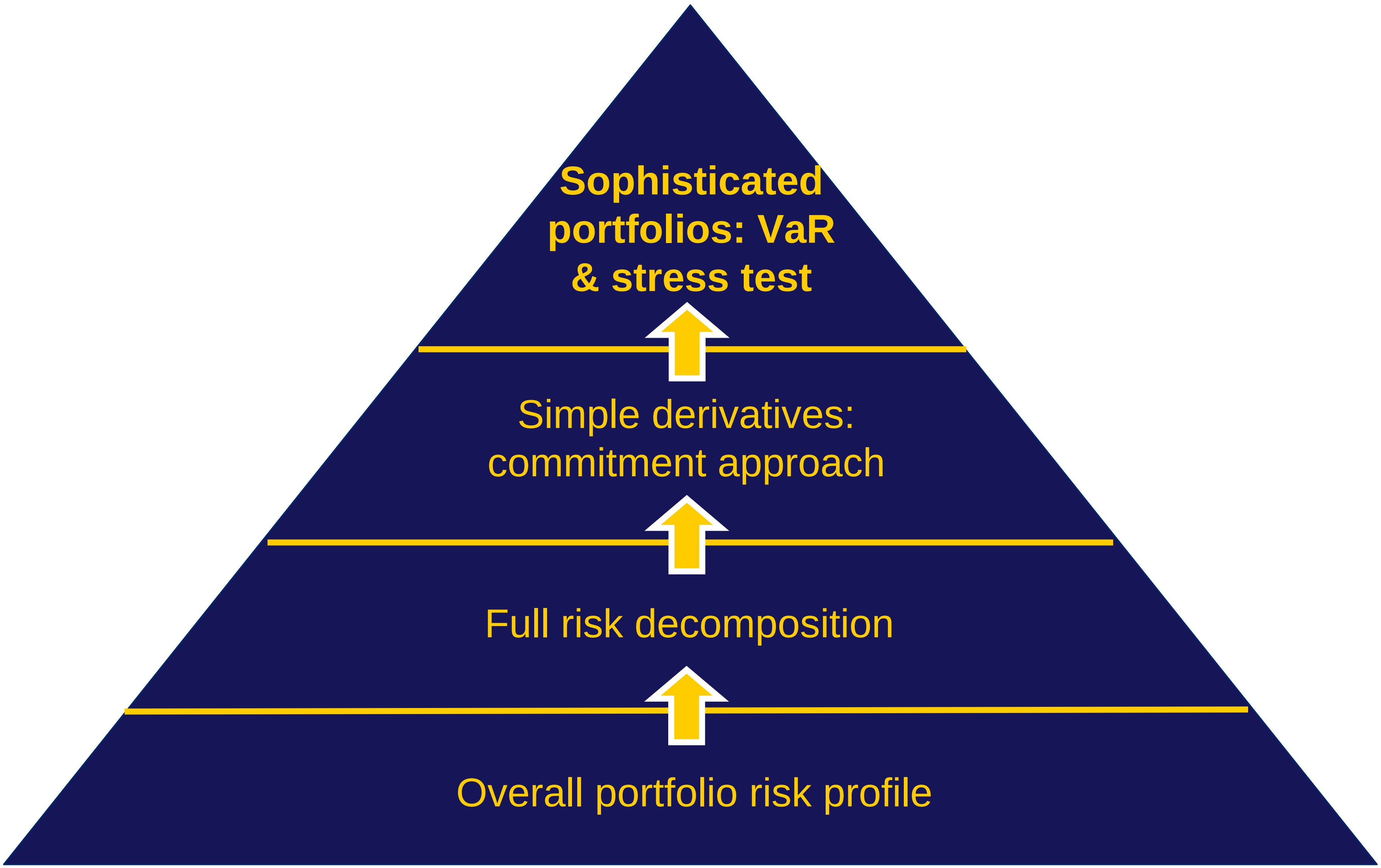


Simple risk profile

1. Compare total risk of portfolio vs. that of its universe and detect changes
2. Detect and track potential usage of (OTC) derivatives
3. Detect illiquid positions

No such thing as a riskless portfolio

Escalating levels of complexity



How reliable are the models?

- Variance-covariance model (normal distribution)
- Historical simulations
- Monte Carlo simulations
- Hybrid models

Back test / Pre tests

<u>Concentrated</u> Emerging Market Portfolio

- Normal 99% VaR
  12 fails (red curve)

- Historical 99%VaR
  9 fails ("yellow" curve)

- Hybrid 99%VaR
  1 fail (green curve)

Lessons learned

- Independence of the risk measures
- Clear escalation process
- Clear risk guidelines
- Deviations represent questions rather than violation
- Changes and order of magnitude more important than precision
- Always be wary of model risk and wonder what could go wrong

Conclusion

- Quantitative processes are just the first step and are only useful in enabling the right question to be asked at the right time

- Overall requirement: <u>demonstrate</u> understanding of what the portfolio manager is doing at all times

- Comprehensive product profiles and formal escalation procedures are the keystone of the process