Asian Markets: Filling the Knowledge gap about risks

More than ever, practitioners are looking to work with academics to better analyze risk. Marie Kratz, Professor of statistics and risk management at ESSEC Business School (IDS Department) and Director of the Center of Research in Economics, finance & Actuarial sciences on Risk (CREAR) and Michel Dacorogna, SCOR Scientific Advisor explain.

29/10/13

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As the western world slowly starts to come out of crisis mode, the narrative we built around the "emerging" economies looks like it might start to unravel. Opportunity and growth are linked to increased risks, Investors are thus turning their attention towards volatility and risk to better optimize their investment in those markets. But how much do we really know about risk in the region?

"One of the key lessons learned from the financial crises of 2008/2009 financial crisis is that we need to identify extreme risks as quickly and as accurately as possible," explains Marie Kratz, Professor of statistics andrisk management at ESSEC Business School (IDS Department) and Director of the Center of Research in Economics, finance & Actuarial sciences on Risk (CREAR). "But for the most part, we have yet to go beyond a qualitative analysis and actually attach some numbers to what we're seeing in Asia."

Indeed, most actuarial research is currently concentrated on the American and European markets because they are the most developed and data is readily available. Paradoxically, even though the 2008/ 2009 crisis revealed their vulnerabilities, developed economies are generally less subject to extreme risks than are emerging economies. While more than ever is at stake, a knowledge gap is widening.

In the context of an always more complex and interdependent international system, one of CREAR's main goals is to attach real data to new theoretical models that will better quantify risks that are hard to define, like those related to longevity, morbidity or natural disasters. On the question of Asian markets amongst others, CREAR works closely with their partners, among them SCOR – the French-based reinsurance and financial services company.

More than ever, practitioners are keen to work with academics to analyze risk

"More than ever, practitioners are looking to work with academics to better analyze risk," says Michel Dacorogna, SCOR Scientific Advisor. "In Asia, for example, Professor Kratz and I participated to a conference on insurance risk organized by the Centre for Financial Research at Nanyang Business School (IRFRC). This event was very well attended by professionals from the insurance and finance industries as well as by regulators seeking to learn about the newest developments in the field of quantitative risk management for financial institutions. Risk analysis is one of those key areas in the world of business where practitioners are hungry to work with academics and tap into their expertise."

Indeed, as Professor Kratz goes on to explain, Asian companies will face new challenges in the coming years, and it's more important than ever for them to look beyond the accounting balance sheet. Traditional risk analysis and portfolio diversification proved largely ineffective during the 2008/2009 crisis – companies and investors alike had hugely underestimated the crash that was to come, although the means were there to properly model its probability. So researchers can play a big role in helping professionals prepare for bad surprises. Plus, for companies, better risk analysis capabilities means increased competitiveness by choosing the right amount of risk for a certain return or by reducing the risk for a another return.

Research advancement means clarifying risk management, not complicating it

"Unfortunately, one of the major trends in the financial sector today is increased complexity of structured financial products and interactions between agents, which makes it difficult to model the risks," she says. "Centers like CREAR or IRFRC of Nanyang Business School are looking to develop more realistic approaches based on data and more advanced theories, while taking into account the needs of the Asian market because it's very specific."

Complexity masks dangerous risks because it contains a lot of hidden dependencies that are difficult to assess and to model. Therefore, CREAR is looking to develop more suited approaches to this complexity, while preserving a more universal modeling. The specificity of the Asian market is starting to get more attention: The IRFRC for example, sponsored by SCOR, is one of the first research centers on insurance risks in Asia.

“As Warren Buffet once said, ‘you should only insure what you understand,” adds Dr. Dacorogna. “When research helps us predict the kind of extreme outcomes that characterized the 2009 crisis, we’re better prepared because we understand the mechanisms. Unfortunately, the trend is still towards increased complexity, but we’re pushing for better, fundamental understanding.”

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