

# Unknown Unknowns

Reduced form hedging and model risk

**Andrey Chirikhin**  
Head of Risk Management

LetterOne Treasury Services

Global Derivatives, 15 May 2014

# Summary

- ▶ Parameters to financial models are **assumed** constant.
  - ▶ Anything that is estimated from the past.
- ▶ Big question:
  - ▶ How to construct a modelling framework to quantify and mitigate risk resulting from such assumptions?
- ▶ Answer:
  - ▶ Adapt EPE-like long term MC-based parametric models.
  - ▶ A lot is known about how to construct and implement them.
  - ▶ They are relatively easy to estimate and stress intelligently.
  - ▶ They are "recursive" by construction.
- ▶ Challenge: a steep learning curve for traditional investment management community.