



The Emperor's Wardrobe Manager – making fun of the latest fads in financial services...

Hans Christian Andersen wrote a tale called 'The Emperor's New Clothes' which started like this:

"Once upon a time there lived a vain Emperor whose only worry in life was to dress in elegant clothes. He changed clothes almost every hour and loved to show them off to his people..."

We all know how the story continued – a couple of scoundrels took advantage of the Emperor's vanity by selling him some very expensive invisible clothes. Although no-one could see these 'clothes', none of his advisers dared to admit as much, until a little child came out with the simple truth: *"But he's not wearing anything!"*

It strikes me that this story applies very aptly to the industry where most actuaries work – the financial services industry. Our industry certainly is an 'Emperor' – fabulously wealthy, fabulously important – and surely no-one will doubt for a moment that he is also fabulously vain. And the bit about changing clothes every hour...

ABOUT THIS COLUMN

This column is a light-hearted attempt to poke fun at some of the 'fashionable clothes' that our industry loves to dress itself up in. There is, of course, a serious side to this job – if someone doesn't tell the Emperor that he is naked, he's bound to make a fool of himself! Nevertheless, it seems to me that actuaries are ideally placed to expose the Emperor's nakedness. Consider:

1. We work in the industry, so we know what makes it tick;
2. We understand (better than most) the theory of how financial services ought to work; and
3. We're mathematically minded and love to come to grips with complex mathematical problems – and most of the 'new fashions' involve some new-fangled and complex mathematics to bedazzle our vain Emperor and his courtiers.

So, that is what this column is about – part serious, part light-hearted, but hopefully fully thought-provoking. I have a few topics in mind that should keep us going for a few months, at least, but I am very much open to new suggestions. If you have any, please email them to me.

TO START THE BALL ROLLING ...

The last time our Emperor went public, he really made a fine spectacle! Not only did he embarrass himself, he also sent the whole western world into a spin that all but brought down his whole empire. I am referring, of course, to the Global Financial Crisis (GFC). And what was our Emperor wearing on that occasion? Some beautiful clothes made of complex invisible fabrics called 'securitisation' and 'diversification' and the like.

The advisers (who made millions out of the wardrobe change) were

very persuasive: "Don't worry! You may be lending money to people who can't afford it, but once you apply securitisation and diversification to the process, they'll all end up as AAA-rated risks." All the courtiers nodded sagely and said, "Yes, I see how that will work." But it didn't.

The pop diva P!nk (assuming she understood about financial services) might have expressed it like this:

*Guess I just lost a trillion, I don't know where it went.
Lent it to some poor buggers who can't even pay their rent.
Gave 'em a triple-A rating, used to be triple-G.
The system's gone into meltdown, they call it a GFC.*

*So, so what, I'm still a banker,
I got my bailout, and now I'm all right,
And guess what, I know there's no dough, but I've got cashflow,
and I'll be all right thanks.*

ON A SERIOUS NOTE

It's easy enough to be wise after the event, but don't you think anybody who knew the first thing about economic modelling ought to have seen the GFC coming? Why did we allow it to happen? And what new fashions are out there, ready to beguile our vain Emperor next time he goes out in public? Have we really learnt anything from the GFC? I welcome your comments.

Next month, I will be talking about the latest in fashion accessories, coming out of Europe this time. It's called 'Solvency II' and no fashionable Emperor should be seen in public without it. **A**

