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To cite this version:
Dominique Guegan, Bertrand Hassani, Kehan Li. An alternative class of distortion operators: alternative tools to generate asymmetrical multimodal distributions. 2017. halshs-01543251

HAL Id: halshs-01543251
https://halshs.archives-ouvertes.fr/halshs-01543251
Submitted on 20 Jun 2017

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An alternative class of distortion operators
Alternative tools to generate asymmetrical multimodal distributions

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2017.30
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Received: date / Accepted: date

Abstract The distortion operator proposed by Wang (2000) has been developed in the actuarial literature and that are now part of the risk measurement tools inventory available for practitioners in finance and insurance. In this article, we propose an alternative class of distortion operators with explicit analytical inverse mapping. The distortion operators are based on tangent function allowing to transform a symmetrical unimodal distribution to an asymmetrical multimodal distribution.

Keywords Distortion operator · Multimodal distribution · Asymmetry · Invertibility

JEL classification C20 · G32

1 Introduction

To integrate financial and actuarial insurance pricing theories, Wang (2000) proposes a form of insurance risk pricing based on the standard Gaussian cumulative distribution function (cdf) distortion operator with one parameter. He points out that this operator is either concave (when the parameter is
positive) or convex (when the parameter is negative). Hamada and Sherris (2003) suggests that this operator can shift the quantile of a distribution to the left, thereby assigning higher probabilities to low outcomes. A number of papers propose applications of distortion operators. For example, Härlimann (2004) obtains an optimal economic capital formula, under suitable assumptions on insurance market prices, the collection of possible losses, and the distortion function. Lin and Cox (2005) successfully applies Wang transform to price mortality risk bonds. Hamada et al. (2006) shows a formal treatment of risk measures based on distortion functions in discrete-time setting. They conclude that the risk neutral computational approach is well adapted to portfolio optimisation with such measures that do not lie within the expected utility framework. De Jong and Marshall (2007) provides a method for analysing and projecting mortality based on the Wang Transform. Denuit et al. (2007) designs the survivor bonds with the help of Wang transform (Wang (2000)) which could be issued directly by insurers.

However, Godin et al. (2012) argues that it is a well-known fact that the returns of most financial assets have semi-heavy tails. Consequently he recognizes that a downside of the normal distortion of Wang (2000) is its underlying symmetrical that poses some constraints in applications. More precisely, Guégan and Hassani (2015) criticize that Wang (2000) applies the same perspective of preference to quantify the risk associated to gain and risk. Thus, the risk manager evaluates the risk associated to the upside and downside risks with the same function that implies a symmetrical consideration for the two effects due to the distortion.

Accordingly, a number of papers make proposals on how to avoid the problem of symmetry in the previous distortion operators. For example, van der Hoek and Sherris (2001) proposes to use two different distortion functions $g(x)$ and $h(x)$ (for instance when $g(x)$ is concave, a convex $h(x) = 1 - g(1 - x)$ would be one possible choice), to allow a different treatment of the upside and downside of the risk. In Wang (2004) a Student-t distribution based distortion operator is introduced allowing for skewness. Sereda et al. (2010) proposes to use two different functions issued from the same polynomial with different coefficients. Godin (2012) introduces a distortion operator based on the Normal Inverse Gaussian (NIG) distribution, which can asymmetrically distort the underlying distribution. Guégan and Hassani (2015) suggests the use of an inverse S-shaped polynomial function of degree 3 as a distortion operator to create an asymmetrical distribution. Additionally this operator can have a concave part and a convex part by varying its parameters.

Wirch and Hardy (1999) concludes that there is an interest in investigating measures for capital adequacy that utilise the shape of the loss distribution, particularly in the right tail. Specifically, multimodality is one of the important characteristics of probability distribution. A number of papers related to the income distribution find evidence of multimodality (for a review, see, e.g.,
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Bianchi (1997), Jones (1997), Quah (1996a, 1996b, 1997) and Zhu (2005)), for instance the results of Zhu (2005) indicate that the US personal income distribution has been multimodal in 1962, 1972, 1982, 1992 and 2000. Also, he suggests that changes in the shape of the income distribution over the entire income range provide rich information and shed light on issues of income inequality, poverty traps and convergence. Moreover, he argues that theoretical models should be capable of explaining and generating multimodal income distributions.

Importantly, motivated by the crisis, the multimodal characteristic of distributions of some economic variables, for example some stock market indexes like S&P 500 index (the Standard & Poor’s 500), SHCOMP index (Shanghai Stock Exchange Composite Index) and FTSE Index (the Financial Time Stock Exchange 100 Index), can include useful information of systemic risk. Accordingly it is necessary to find a model such that it is flexible enough to accommodate various shapes of continuous distributions with leptokurtic, skewed and multimodal characteristics.

Additionally, the financial industry has extensively used quantile-based downside risk measures based on the Value-at-Risk (VaR). In actuarial terms, VaR is a quantile reserve, often using the $p^{th}$ percentile of the loss distribution. We should emphasize that when we compute the VaR, the explicit analytical form of the inverse mapping of cdf is crucial. Consequently, we propose an alternative class of distortion operators allowing to build an asymmetrical multimodal distribution, with explicit analytical inverse mapping.

We proceed as follows. Section 2 describes the definition and some basic properties of distortion operators. Section 3 presents our model. Section 4 assess the properties of three distortion operators by simulation. Section 5 concludes.

2 Distortion operator

For a continuous distribution with cdf $F$ ($f$ is its probability density function (pdf)), we recall the definitions of distortion operator and multimodal distribution.

**Definition 1 (Distortion operator)** From Wang (2000), a mapping $g: [0, 1] \rightarrow [0, 1]$ is a distortion operator if: $g$ is continuous and increasing; $g(0) = 0$ and $g(1) = 1$.

**Definition 2 (Multimodal distribution)** We call $F$ a multimodal distribution if its pdf $f$ has multiple local maxima.

Then we give a definition
Definition 3 (Changing point of concave-convex property) A point \( x_0 \in (0, 1) \) is called a changing point of concave-convex property for a distortion operator \( g \) if \( g''(x_0) = 0 \), \( g''(x) < 0 \) when \( x \in [0, x_0) \) and \( g''(x) > 0 \) when \( x \in (x_0, 1] \).

In his article Wang (2000) specifies that the distortion operator \( g \) can be applied to any distributions. A distortion operator \( g \) can always transform a cdf \( F \) to another cdf \( g \circ F \) (denotes the composition function of \( g \) and \( F \)). Denoting \( \Phi \) the cdf of the standard Gaussian distribution with mean 0 and variance 1 (\( N(0,1) \)), Wang (2000) proposes a distortion operator \( g_W \) as follows:

\[
g_W(x) = \Phi[\Phi^{-1}(x) + a], \quad x \in [0, 1]
\]

By illustrating the impact of \( g_W \) on the logistic distribution, Guégan and Hassani (2015) observes the shift of the mode of the initial distribution only. Furthermore the close form of \( g_W \) is not straightforward.

To create multi-modal distributions \( g \circ F \), assuming \( f \) is differentiable and \( g \) is twice differentiable, we can derive its associated pdf \( (g \circ F(x))' = (g(F(x)))' = g'(F(x))f(x) \) and

\[
(g \circ F(x))'' = g''(F(x))f^2(x) + g'(F(x))f'(x).
\]

By definition, \( g'(F(x)) \) is always positive. Thus to add hump in \( (g \circ F(x))' \) for a given \( F \), we need to manipulate the sign of \( g''(F(x)) \). Consequently concave-convex property of \( g \) need to be considered.

Guégan and Hassani (2015) provides an inverse S-shaped polynomial function of degree 3 given by the following equation and characterized by a location parameter \( \delta \) and a shape parameter \( \beta \)

\[
g_p(x) = a\left[\frac{x^3}{6} - \frac{\delta^2}{2}x^2 + \frac{\delta^4}{2} + (\delta^2 + \beta)x\right], \quad x \in [0, 1]
\]

where \( a = (\frac{1}{6} - \frac{\delta^2}{2} + \frac{\delta^4}{2} + \beta)^{-1} \), \( \delta \in [0, 1] \) and \( \beta \in R \). They remark that \( g_p \)'s curve exhibits a concave part and a convex part. We can derive that \( g'' = a(x - \delta) \). Thus when \( F(x) = \delta \), \( g''(F(x)) \) equals to 0. However, the sign of \( g''(F(x)) \) depends on the sign of \( a \), for \( F(x) \in [0, \delta) \) and \( F(x) \in (\delta, 1] \). Consequently to locate the changing point of concave-convex property of \( g \) by \( \delta \) is confusing.

3 A new class of distortion operators

The objective is to construct a distortion operator \( g \) with property below
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Property 1 It is twice differentiable. It contains a changing point of concave-convex property \( x_0 \), with a location parameter to locate \( x_0 \) and with a shape parameter to control the concave-convex level of \( g \) (characterised by \(|g''|\): the absolute value of \( g'' \)). Furthermore the inverse mapping of \( g \) has a straightforward closed-form.

In order to construct a \( g \) satisfying Property 1, first we construct a distortion operator \( g_1 \) by tangent function (since \( \tan(x), x \in (-\frac{\pi}{2}, \frac{\pi}{2}) \) is a smooth function (it has derivatives of all orders) containing \( x_0 \), and its inverse mapping is \( \text{arctan}(x) \))

**Definition 4 (Distortion operator \( g_1 \))** For \( x \in [0, 1] \) with a shape parameter \( 0 < a < \pi \)

\[
g_1(x) = \frac{1}{2 \tan \frac{a}{2}} (\tan(ax - \frac{a}{2}) + \tan \frac{a}{2})
\]

The first and second derivatives of \( g_1 \) are

\[
g'_1(x) = \frac{a}{2 \tan \frac{a}{2}} \frac{1}{\cos^2(ax - \frac{a}{2})}
\]

\[
g''_1(x) = \frac{a^2}{\tan^2 \frac{a}{2}} \tan(ax - \frac{a}{2})
\]

The inverse mapping of \( g_1(x) \) is

\[
g_1^{-1}(x) = \frac{1}{2} + \frac{1}{a} \arctan(2xtan \frac{a}{2} - tan \frac{a}{2})
\]

One can verify that \( g_1(x) \) is a distortion operator and it has \( x_0 = \frac{1}{2} \). Thus the concave-convex property of \( g_1 \) is symmetrical.

Comparing with Property 1 for \( g_1 \), a location parameter to locate \( x_0 \) is needed, which allows \( g_1 \) to have an asymmetrical concave-convex property.

**Definition 5 (Distortion operator \( g_2 \))** For \( x \in [0, 1] \) with shape parameter \( 0 < a < \pi \) and location parameter \( b \in (\frac{1}{2}, \infty) \)

\[
g_2(x) = \begin{cases} 
\frac{1}{2b \tan \frac{a}{2}} \tan(\frac{abx}{2} - \frac{a}{2}) + \frac{1}{2b}, & 0 \leq x \leq \frac{1}{2b} \\
\frac{2b - 1}{2b \tan \frac{a}{2}} \tan(\frac{ab}{2b - 1} x + \frac{a}{2} \frac{1}{2b}) + \frac{1}{2b}, & \frac{1}{2b} < x \leq 1 
\end{cases}
\]

One can verify that \( g_2 \) satisfies all conditions in Property 1, whose first and second derivatives are
\[
\begin{align*}
g_2'(x) &= \frac{a}{\tan \frac{a}{2}} \frac{1}{\cos^2(abx - \frac{a}{2})}, \quad 0 \leq x \leq \frac{1}{2b} \\
g_2'(x) &= \frac{a}{\tan \frac{a}{2}} \frac{1}{\cos^2\left(\frac{ab}{2} - x + \frac{a}{2} - 2b\right)}, \quad \frac{1}{2b} < x \leq 1
\end{align*}
\]

\[
\begin{align*}
g_2''(x) &= \frac{a^2b}{\tan \frac{a}{2}} \tan(ax - \frac{a}{2}), \quad 0 \leq x \leq \frac{1}{2b} \\
g_2''(x) &= \frac{a^2b}{(2b-1)\tan \frac{a}{2}} \tan\left(\frac{ab}{2b-1}x + \frac{a}{2} - 4b\right), \quad \frac{1}{2b} < x \leq 1
\end{align*}
\]

The inverse mapping of \( g_2 \) is

\[
\begin{align*}
g_2^{-1}(x) &= \frac{1}{ab} \arctan(2bx\tan \frac{a}{2} - \tan \frac{a}{2}) + \frac{1}{2b}, \quad 0 \leq x \leq \frac{1}{2b} \\
g_2^{-1}(x) &= \frac{2b-1}{ab} - \arctan\left(\frac{2b\tan \frac{a}{2} - \tan \frac{a}{2}}{2b-1}x - \frac{a}{2} - 2b\right) + \frac{1}{2b}, \quad \frac{1}{2b} < x \leq 1
\end{align*}
\]

## 4 Simulation

In this section, first we show the evolution of \( g_p, g_1 \) and \( g_2 \) w.r.t (with respect to) different values of their parameters by simulation (\( g_p \) is the benchmark), which allows to compare these distortion operators and remark the difference of two properties of them: concave-convex property level and location of \( x_0 \).

Second \( g_2 \) is applied to transform a unimodal \( F \) to a multimodal \( g_2 \circ F \). We plot the pdf associated to \( g_2 \circ F \) to check the influence of \( g_2 \).

### 4.1 Evolution of distortion operators

Firstly we check the concave-convex level of \( g_p, g_1 \) and \( g_2 \) affected by the shape parameter. Thus we always fix the location parameter. In Fig. 1, the value of \( \delta \) is given by 0.5, then we plot the function \( g_p \) for different values of \( \beta \) (\( \beta = 0.00003, 0.003, 0.03, 0.3 \)). The purpose of Fig. 1 is to show how \( \beta \) can effect the concave-convex level of \( g_p \). We observe in this picture that the curve has symmetrical concave and convex parts, and low values of \( \beta \) are corresponding to high concave-convex level.

For \( g_1 \), to understand the influence of the parameter \( a \) on the shape of curve, we plot \( g_1 \) for \( a = 0.1\pi, 0.8\pi, 0.9\pi, 0.95\pi \) in Fig. 2. The curves show that the function \( g_1 \) is always symmetrical. We observe that if \( a \) tends to 0 then \( g_1 \) tends to the identity mapping and when \( a \) tends to \( \pi \) the curve exhibits higher concave-convex level.
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Fig. 1 Curves of the distortion function \( g_p \) introduced in equation (3) for several value of \( \beta \) (\( \beta = 0.00003, 0.003, 0.03, 0.3 \) and fixed value of \( \delta = \frac{1}{2} \)).

![Graph of \( g_p \)](image1)

Fig. 2 we plot \( g_1 \) in equation (4) for \( a = 0.1\pi, 0.8\pi, 0.9\pi, 0.95\pi \).

![Graph of \( g_1 \)](image2)

Fig. 3 illustrates the effect of the shape parameter \( a \) on \( g_2 \) using the same values of \( a \) as in Fig. 2 and fixed \( b = 1 \). We observe that the curve is symmetrical and in this case the shape parameter has the same effects as in Fig. 2.

Secondly we check the effects of location parameters of \( g_p \) and \( g_2 \) on the location of \( x_0 \). The location of \( x_0 \) characterises the asymmetrical concave-convex property of distortion operators.

For \( g_p \), to illustrate the role of \( \delta \) on the location of \( x_0 \), we use two graphs in Fig. 4. The left graph corresponds to the curve of \( g_p \) for \( \delta = 0.45 \) and \( \beta = 0.00003, 0.003, 0.03, 0.3 \). The right graph provides the curve of \( g_p \) for
Fig. 3 we plot $g_2$ in equation (8) for $a = 0.1\pi, 0.8\pi, 0.9\pi, 0.95\pi$ and fixed $b = 1$.

$\delta = 0.3$ and $\beta = 0.00003, 0.003, 0.03, 0.3$. We observe that through $\delta$ one can indeed manipulate the location of $x_0$, but the relationship of them are confusing.

Fig. 4 The left graph corresponds to the curve of $g_p$ for $\delta = 0.45$ and $\beta = 0.00003, 0.003, 0.03, 0.3$. The right graph provides the curve of $g_p$ for $\delta = 0.3$ and $\beta = 0.00003, 0.003, 0.03, 0.3$.

For $g_2$, to understand the influence of the parameter $b$ on the location of $x_0$, we provide two graphs in Fig. 5. The left graph corresponds to the curve of $g_2$ for $b = 2.5$ and $a = 0.1\pi, 0.8\pi, 0.9\pi, 0.95\pi$. The right graph provides the curve of $g_2$ for $= \frac{2}{\pi}$ and $a = 0.1\pi, 0.8\pi, 0.9\pi, 0.95\pi$. We observe the location of $x_0$ is
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exactly \( \frac{1}{2\pi} \).

Fig. 5 The left graph corresponds to the curve of \( g_2 \) for \( b = 2.5 \) and \( a = 0.1\pi, 0.8\pi, 0.9\pi, 0.95\pi \). The right graph provides the curve of \( g_2 \) for \( = \frac{5}{

From the argumentation and simulation above, we can summarize that \( g_2 \) meets all the conditions in Property 1.

4.2 Transform a unimodal distribution to a multimodal distribution

To explain how to use \( g_2 \) to transform a given unimodal \( F \) to a new asymmetrical multimodal \( g_2 \circ F \), we begin with the \( N(0,1) \) with cdf \( F_G \) and pdf \( f_G \).

By plotting the pdf of \( N(0,1) \) and the distorted density \( g'_2(F_G(x))f_G(x) \) with fixed \( b = 1 \) and \( a = 0.5\pi, 0.8\pi, 0.9\pi, 0.99\pi \), Fig. 6 shows the effect of shape parameter \( a \) of \( g_2 \) on \( N(0,1) \). For \( b = 1 \), \( g'_2(F_G(x))f_G(x) \) are always symmetrical. As \( a \) increases, \( g'_2(F_G(x))f_G(x) \) associates a small probability in the centre of the distribution and puts bigger weight in the tails. We observe two humps in the distorted density when \( a \) is large enough.

To investigate how the location parameter \( b \) of \( g_2 \) introduces asymmetrical property into \( g'_2(F_G(x))f_G(x) \), we provide two graphs in Fig. 7 using the same values of the shape parameters than those used in Fig. 6, but \( b \) is 2.5 for the left graph and \( b \) is \( \frac{5}{8} \) for the right one. From Fig. 7 we can remark that the values of \( a \) control the information under the humps and the values of \( b \) control the locations of the humps. When \( b \neq 1 \), \( g'_2(F_G(x))f_G(x) \) is asymmetrical. More precisely, when the original distribution is symmetrical, the relatively
We plot the pdf of $N(0,1)$ and distorted density $g_2^2(F_G(x))f_G(x)$ with fixed $b = 1$ and $a = 0.5\pi, 0.8\pi, 0.9\pi, 0.99\pi$.

The high hump of the distorted density is in the right tail for the high value of $b$ in $g_2$; the relatively high hump of the distorted density is in the left tail for the low value of $b$ in $g_2$.

The left graph corresponds to the curves of $g_2^2(F_G(x))f_G(x)$ for $b = 2, 5$ and $a = 0.5\pi, 0.8\pi, 0.9\pi, 0.99\pi$. The right graph provides the curves of $g_2^2(F_G(x))f_G(x)$ for $b = \frac{5}{8}$ and $a = 0.5\pi, 0.8\pi, 0.9\pi, 0.99\pi$.

Besides assessing the location parameter $b$ with $F$ coming from the symmetrical, thin-tail distribution from the elliptical distribution family, it is also necessary to check the influence of $b$ with $F$ coming from the asymmetrical,
fat-tail distribution. Let $F_E$ (the associated density) be $\text{GEV}(0.2,0.05,-0.01)$ (Generalized extreme value distribution with shape parameter $k = -0.4$, scale parameter $\sigma = 0.05$ and location parameter $\mu = -0.01$). Using the same value of the shape parameter $a = 0.95\pi$ but different location parameters $b = 0.625, 0.54$, we plot the distorted density $g_2(F_E(x))f_E(x)$ in Fig. 8. Unexpectedly, instead of controlling the locations of the humps, we observe $b$ controls the information under the humps. Especially lower value of $b$ is associated to higher left hump and lower right hump.

![Figure 8](image)

**Fig. 8** Using the same value of the shape parameter $a = 0.95\pi$ but different location parameters $b = 0.625, 0.54$, we plot the distorted density $g_2(F_E(x))f_E(x)$.

To check if parameter $a$ can affect the locations of the humps or not, we plot the pdf of $\text{GEV}(0.2,0.05,-0.01)$ and $g_2(F_E(x))f_E(x)$ with the same $b = 1$ but different $a = 0.95\pi, 0.999\pi$ in Fig. 9. The graph suggests that the parameter $a$ indeed affects the locations of the humps. We observe that the left hump shifts to the left when $a$ increases. It is important to point out that in this simulation, the concave-convex property of $g_2$ is symmetrical since $b = 1$.

Motivated by Fig. 9, we plot the pdf of $\text{GEV}(0.2,0.05,-0.01)$ and $g_1(F_E(x))f_E(x)$ in Fig. 10 using the same values of the shape parameters than those used in Fig. 9. Comparing Fig. 9 and Fig. 10, we observe the same result. Consequently, we can remark that when the original distribution is asymmetrical, it is enough to use $g_1$ if the main purpose is to create an asymmetrical distorted density with two humps, which possesses the flexibility of shifting the positions of the humps.
We plot $g_2'(F(x))f_E(x)$ with the same $b = 1$ but different $a = 0.95\pi, 0.999\pi$.

We plot $g_1'(F_E(x))f_E(x)$ using the same values of the shape parameters than those used in Fig. 9., i.e. $a = 0.95\pi, 0.999\pi$.

5 Conclusion

In this article, we propose an alternative class of distortion operators with explicit analytical inverse mapping. The distortion operators are based on tangent function allowing to transform a symmetrical unimodal distribution to an asymmetrical multimodal distribution.

More precisely, when the original distribution is symmetrical, the first distortion operator with just shape parameter can only generate symmetrical distorted density. Its shape parameter controls the information under the humps. Consequently, to introduce asymmetry into the distorted density in this case,
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it is necessary to use the second distortion operator with both shape parameter and location parameter. Especially, the values of shape parameter control the information under the humps and the values of location parameter control the locations of the humps.

However, when the original distribution is asymmetrical, unexpectedly we observe that instead of controlling the locations of the humps, the location parameter of the second distortion operator controls the information under the humps. Further more, in this case its shape parameter indeed effect the locations of the humps. Additionally we remark that it is enough to use the first distortion operator which is more concise, if the main purpose is to create an asymmetrical distorted density with more than one humps from an asymmetrical original density, and at the same time possess the flexibility of shifting the positions of the humps.

6 Acknowledgments

This work was achieved through the Laboratory of Excellence on Financial Regulation (Labex ReFi) supported by PRES heSam under the reference ANR10LABX0095. It benefited from a French government support managed by the National Research Agency (ANR) within the project Investissements d’Avenir Paris Nouveaux Mondes (investments for the future Paris New Worlds) under the reference ANR11IDEX000602.

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