

Index

- Absolute risk aversion (ARA), 10
- Acceptance, 21
- Active acceptance, 21
- Advanced approach, 488
- Advanced IRR hedging, 494
 - duration vectors, 496–499
 - hedging with fixed income derivatives, 499–502
 - M-absolute and M-squared models, 494–496
- Advanced Measurement Approaches (AMAs), 360, 366
- Adverse selection, 37
- Aggregation, 18
- Alternative risk transfer (ART), 507, 514
 - insurance derivatives, 519–522
 - market, 514–516
 - primary contracts, 516–519
- Alternative standardized approach, 366
- Altman z score model, 260–262
- Analytic approximations, 201–203
- Annualized variance, 380
- Anti-money laundering (AML), 531
- Arbitrage, 23–25, 130
 - trading, 131
- Arbitrage pricing theory (ATP), 62
- Arbitrageurs, 130–131
- Arithmetic returns, 175
- Arrow-Pratt coefficient, 10
- Arrow-Pratt relative risk aversion coefficient, 324
- Assessments, 351
- Asset-backed securities (ABS), 462
- Assets, 14, 341
 - return volatility, 375
 - swaps, 450–454
- Asymptotic normality, 71
- Autocorrelation of financial returns, 89–93
- Autoregressive conditional heteroscedasticity model (ARCH model), 85–89
- Autoregressive model, 86
- Available amount of stable funding (ASF), 328
- Average rate of trading, 315

- Backtesting, 112, 203–206, 406–408
- Bands, 238
- Bank for International Settlement (BIS), 286
- Bank of America, 144
- Bank risk, 550–552

- Banking sector, 550
 - areas of future improvements, 556–558
 - bank risk and business models, 550–552
 - risk management systems, 552–556
- Banks, 173, 251
- Basel Accord, 113
- Basel Committee, 329–330, 444
- Basel II Accord, 195
- Basel II Approach, 362–367
- Basel III framework, 330
- Basic indicator approach (BIA), 364
- Basis point value method (BPV method), 239
- Basis risk, 237
- Bayesian probability models, 114
- BEKK model, 425–426
- Bernoulli utility functions, 10
- Bernoulli variable, 29, 103–104
- Bid–ask spreads, 302, 305
- Big data, 525, 529–532
- Binomial distribution, 102–106, 406–407
- Binomial trees, 154–158, 165, 478
- Bitcoin, 536
 - derivatives on, 536–539
 - hedging techniques, 536–538
 - impact on markets and investments, 538–539
- Bivariate survival function, 396
- Black model, 145
- Black-76 model, 142
- Black/Scholes framework, 25
- Black–Scholes pricing formula, 263
- Black–Scholes–Merton model (BSM model), 65–66, 127, 153, 158–162
- Blockchain, 526
- Bonds, 12–13
 - prices, 212–217
- Bootstrapped historical simulation method, 511
- Bootstrapping, 229
- Bottom-up approach, 360
- Breakeven asset swap spread, 454
- Brownian motion, 28–33, 236, 513
- Business models, 550–552
- Business risk, 1, 11, 15
- Butterfly shifts, 221

- Calendar effects, 95
- Calibration, 273
- Call option, 131

- Callable bonds, 377–380
- Capital, 444
 - relief, 467–468
 - requirement, 361
- Capital asset pricing model (CAPM), 25, 40, 52, 60–63
 - model assumptions, 52–55
 - SML, 55–60
- Capital market line (CML), 49–50
- Caps, 141–143
- Captives, 515
- Cash CDO, 464
- Catastrophe reinsurance swaps, 520
- Central bank, 308
- Central limit theorem, 29
- Certainty equivalent of lottery, 9
- Chain rule, 57
- Chance nodes, 114
- Characteristic function of random variable, 110
- Chebyshev's inequality, 180
- Chicago Board of Trade (CBOT), 289
- Chicago Board Options Exchange (CBOE), 536
- Chicago Mercantile Exchange (CME), 289
- Chief executive officers (CEOs), 342
- Chief information officer (CIO), 353
- Cholesky composition, 206
- Cholesky decomposition, 189
- Citigroup, 144
- Classic risk management, 340
- Classic theory, 17
- Classical MC simulation method, 513
- Classical portfolio problem, 4
- Classical random walk, 29
- Clayton copula, 392
- Coefficient of lower tail dependence, 396
- Collateral, 331
- Collateralization, 463
- Collateralized debt obligations (CDOs), 439, 463–467
- Commercial banks, 238–239
- Committee of Sponsoring Organizations (COSO), 339, 341
 - ERM, 344–346
- Commodity Exchange (COMEX), 289
- Commodity futures, 290–294
- Commodity markets, 285
 - commodity types and classification, 286–288
 - risk for traders and investors, 288–289
- Commodity options, 294–298
- Commodity prices, 287
- Commodity risk, 285
 - commodity markets, 285–289
 - hedging, 290–298
- Commodity seller, 295
- Company, 17
- Competitive bidding, 36
- Compliance risk, 344
- Component VaR, 197–198
- Compound interest, 212
- Compounding frequencies for interest rates, 226
- Concavity of utility function, 5
- Concentration of funding, 331
- Concentration reports, 553
- Conditional correlation, 83–85
- Conditional covariance, 82–83
- Conditional default probability, 273
- Conditional dependence, 81
 - financial comovements, 82–85
 - time series analysis, 85–95
- Conditional expected value, 178
- Conditional heteroscedasticity, 86
- Conditional risk analysis
 - multivariate return distributions, 424–426
 - VaR, 420–424
- Conditional VaR (CVaR), 411, 419, 422–424
- Consistency, 71
- Constant absolute risk aversion (CARA), 15
- Constant conditional correlation (CCC), 426
- Constant relative risk aversion (CRRA), 15
- Consumption-based capital asset pricing model (CCAPM), 60
- Continuous auction market, 302
- Continuous compounding, 212
- Contractual maturity mismatch, 330
- Control activities, 346
- Conversion factors (CF), 256
- Convexity adjustment for interest rate derivatives, 501–502
- Convexity hedging, 240–244
- Cooling degree day (CDD), 519
- Copula functions, 389–390
 - application to risk management, 396–399
 - basic properties, 390–393
 - measures of dependence, 393–396
- Cornish–Fisher approximation, 320, 412, 423, 510
- Corporate (managerial) appetite for risk, 349
- Corporate governance, 543–544
 - management fails, 544–547
 - postcrisis perspectives, 549–550
 - remuneration and incentive systems, 547–549
- Corporate Governance Committee (CGC), 544
- Corporate stockholders, 17
- Corporate value dilution, 342
- Correction factor, 181
- Correlation, 40, 63–73, 206, 393
- Correlation coefficient, 44
- Correlogram, 91
- Cost of hedging, 167–170, 480–483
- Counterparties, 251
- Counterparty credit risk, CDS spreads with, 458–460
- Coupon bond value, 272
- Covariance, 66–69

-
- Covariance matrix, 187
 - of financial returns, 72
 - Cox, Ingersoll and Ross model (CIR model), 232
 - Cramer–Rao lower bound, 71
 - Credit analysis, 259
 - Credit crunch, 440
 - Credit default swaps (CDS), 441, 454–457
 - Credit derivatives, 450
 - asset swaps, 450–454
 - CDS spreads with counterparty credit risk, 458–460
 - credit default swaps, 454–457
 - Credit event, 455
 - Credit rating agencies (CRAs), 442
 - Credit ratings, 259–262
 - Credit risk, 11–13, 18, 251, 552
 - credit ratings, 259–262
 - default probabilities, 252–255
 - loss, 255–259
 - reduced-form models, 271–277
 - structural models, 262–271
 - Credit risk hedging, 475, 483
 - CVA, 487–491
 - modeling exposure, 483–487
 - Monte Carlo methods, 491–494
 - Credit score, 13
 - Credit value adjustment (CVA), 487–491
 - CreditMetrics™ model, 269–271
 - CreditRisk+™, 275–277
 - Critical rate, 223
 - Critical value, 186–187, 196
 - Cross hedge, 499
 - Cross-currency asset swap, 452
 - Crypto tokens, 538
 - Crypto traders, 535
 - Cryptocurrencies, 527, 535
 - Cumulative distribution, 98, 101
 - Cumulative distribution function (c. d. f.), 511
 - Cumulative positions, 238
 - Currency forward, 369
 - Currency risk, 11, 367
 - foreign exchange derivatives, 369–373
 - risk hedging in FX markets, 373–375
 - types, 367–369
 - Currency swap, 373
 - Current exposure (CE), 256
 - Current exposure method (CEM), 256, 489
 - Customer assets, 341

 - Data, 350
 - analysis, 350
 - errors, 431
 - filtering, 429–432
 - protection, 533
 - visualization, 351
 - Database Italiano delle Perdite Operative (DIPO), 360
 - Debt financing, 18
 - Decision nodes, 114
 - Decision trees, 113–116
 - Decomposition, 196–199
 - Dedication, 244
 - Default probability (DP), 12, 252–255, 492
 - Delta hedge, 163
 - Delta hedging, 163–165, 476–478
 - Delta neutral, 163
 - Delta of derivative, 163
 - Delta of payer swaption, 146
 - Delta-neutral, 476
 - Delta-normal approach, 201
 - Delta–gamma approach, 202, 509
 - Delta–gamma minimization method, 510
 - Delta–gamma–Johnson method, 510
 - Depth, 309
 - Derivative securities, 127
 - Derivatives arbitrage, 24
 - Diagonal VEC model (DVEC model), 425
 - Diamond–Dybvig model, 322–325
 - Digital finance, 525
 - derivatives on bitcoin, 536–539
 - Fintech revolution, 526–535
 - Digital payments, 532
 - Digitalization, 528
 - Direct costs, 17
 - Direct implied volatility estimate (DIVE), 66
 - Dispersion, 7
 - Distance to default (DD), 263, 265
 - Distributions, 97–98
 - binomial distribution, 102–106
 - Pareto distribution, 98–102
 - Poisson distribution, 106–112
 - of stock price fluctuations, 95
 - Diversification, 11, 18, 40
 - Documentation, 469
 - Dollar duration, 241
 - Downside risk, 178
 - measures, 200
 - Dual trigger contracts, 518
 - Duffie–Singleton model, 273–274
 - Dupire’s model, 377
 - Duration, 240–244
 - of callable bond, 379
 - vectors, 496–499
 - Duration Vector Models (DVM), 496
 - Durbin–Watson test, 92

 - Econometric models, 66, 97
 - Economic risk, 367–368
 - Economic theories of consumption, 6
 - Economies of scale, 36
 - Effective convexity, 244
 - Effective duration, 240, 242
 - Efficiency, 71
 - Efficient frontier, 45–46

- Efficient market hypothesis (EMH), 6, 25–28
Elasticity, 305
Employee/supplier assets, 341
Energy derivatives, 559–562
Enron, 546
Enterprise risk, 339
 building and enhancing capabilities, 347–352
 COSO ERM, 344–346
 ERM framework, 343–344
 fundamentals, 340–346
 identification and assessment, 340–343
 implementation and models, 354–355
 management, 352–354
 practical implementation, 352–355
 process view, 347–350
 technological capabilities, 350–352
Entrepreneurial risk management (ERM), 339
 framework, 343–344
Environmental risk, 342
Equal weighting of observations, 184
Equilibrium, 307
 gross return, 312
Equity, 18
Estimation methods, 86
Euler's theorem, 197
 on homogeneous functions, 189–190
European Financial Stability Facility (EFSF), 446
European Union (EU), 445
Event identification, 345
Event risk category, 358
Excel statistical functions, 111–112
Exception monitoring, 351
Exchange rate risk management, 357
Exchange-traded insurance derivatives (ET
 insurance derivatives), 519
Expected cash inflows (ECI), 327
Expected cash outflows (ECO), 327
Expected default frequency (EDF), 266
Expected exposure (EE), 12, 488
Expected losses (EL), 363
Expected return on the stock, 25
Expected shortfall (ES), 178, 409–411, 419–422
Expected value of lottery, 7
Explanatory simulation, 117
Exponential smoothing, 85
Exposure-at-default (EaD), 256
Exposure-at-recovery (EaR), 258
External consultants, 20
Extreme value theory (EVT), 389, 399
 data application, 403–404
 extreme VaR, 404–406
 theoretical background, 399–403
Extreme VaR, 404–406
Factor analysis, 193
Factor mapping for VaR, 193–194, 209–210
Fair strike, 381
Fama–French model, 62
Fannie Mae (FMA), 449
Fat tails, 95
Financial Accounting Standards Board, 553
Financial and reporting risks, 344
Financial assets, 341
Financial comovements, 82
 conditional correlation, 83–85
 conditional covariance, 82–83
Financial crisis, 439
 credit derivatives, 450–460
 in Europe, 444–448
 impact on financial industry, 448–450
 lack of regulatory framework, 440–444
 and regulation, 440–450
 securitization, 461–469
Financial deregulation, 441
Financial derivatives, 127, 130
 interest rate derivatives, 139–147
 options and futures, 128–138
Financial fraud, 531
Financial instability, 37
Financial institutions, 18, 211
Financial instruments, 1
Financial investors, 45
Financial markets, 1, 39
 CAPM, 52–63
 MPT, 40–51
Financial returns, 95
Financial risk, 1, 15–16
 banking sector, 550–558
 challenges for research, 558–565
 corporate governance, 544–550
 management, 543
Financial Stability Board, 442
Financial volatility, 63
Fintech, 525
 big data, 529–532
 revolution, 526–535
 and risk management, 532–535
First difference, 90
First passage models, 266–268
First-order conditions, 73
Fixed income futures, 217–222
Fixed trigger, 518
Flat volatility approach, 143
Floorlet, 141
Floors, 141–143
Foreign currencies, 13
Foreign exchange derivatives, 369–373
Foreign exchange risk, 13, 552
Forward, 134–137
 contracts, 127, 136, 290–294
 points, 371
 price of asset, 135
Foucault model, 306
Frank copula, 392

- Fraud risk, 14
- Fréchet distribution form, 400
- Freddie Mac (FMC), 449
- Free-market rule, 441
- Funding liquidity, 308–314
- Funding risk, 13
- Futures, 127–138
 - market, 539
 - price, 320
 - price of commodity, 308
 - value, 212
- FX forward, 370

- G20, 442
- Gamma distribution, 101
- Gamma hedging, 165–167, 478–480
- Gamma swaps, 383
- Gap analysis, 238
- Gap method, 554
- Gaussian (normal) distribution, 41
- Gaussian copula model, 269, 391–392
- Gaussian estimator, 89
- Gaussian likelihood, 89
- Gaussian multi-factor model, 234–235
- Generalized autoregressive conditional heteroscedasticity model (GARCH model), 85–89
 - GARCH (p, q) modeling, 424–426
 - for variance estimation, 185
- Generalized Brownian motion, 31
- Generalized extreme value (GEV), 390, 401
- Generalized Pareto distribution (GPD), 403
- Generalized Wiener process, 31
- Geometric Brownian motion, 32
- Geometric returns, 176, 186–187
- Global Association of Risk Professionals (GARP), 18
- Global Operational Loss Database (GOLD), 360
- Globalization of financial markets, 357
- Grace period, 486
- Gramm–Leach–Bliley Act, 442
- Greeks of swaptions, 146
- Gross income, 364
- Gross return, 312
- Group captives, 517
- Gumbel copula, 392
- Gumbel distribution, 400

- Hazard rate, 271
- Heating degree day (HDD), 519
- Hedge ratio, 225
- Hedged assets, 326
- Hedgers, 128–129, 217
- Hedging, 18
 - advanced IRR hedging, 494–502
 - credit risk hedging, 483–494
 - with fixed income derivatives, 499–502
 - market risk hedging, 476–483
 - techniques, 158, 475, 536–538
- Heterogeneous ARCH process (HARCH process), 433
- Heterogeneous volatility, 433–435
- Heteroscedasticity, 86
- High minus low (HML), 62
- High-frequency data, 429
 - high-frequency trading, 429–433
 - intraday risk analysis, 433–435
- High-frequency trading, 429
 - basic stylized facts, 432–433
 - data filtering, 429–432
- High-quality assets (HQAs), 325
- Hill estimator of tail index, 404
- Historical assessment, 359
- Historical data, 113
- Historical simulation approach, 184–185, 240, 511–513
- Historical volatility, 63
- Holding periods, 310
- Ho–Lee model, 233
- Hot wallets, 535
- Hotline management, 351
- Hull–White model, 233

- Illicit financial flows, 531
- Illiquidity, 306
- Immunization, 220–226, 244
- Implied forward rate, 140
- Implied volatility, 65, 375–377
- Incentive systems, 547–549
- Incremental VaR, 198
- Indirect costs, 17
- Information and communication, 346
- Inside value at risk, 195
 - VaR features, 195–203
 - VaR testing, 203–207
- Insurance, 22, 37
 - contracts, 519
 - derivatives, 519–522
- Interbank risk, 543, 558–559
- Interest rate cap (IRC), 141
- Interest rate floor (IRF), 141
- Interest rate risk (IRR), 11, 211, 552
 - duration and convexity hedging, 240–244
 - dynamics of, 212–226
 - management, 236
 - measurement techniques, 238–240
 - short rate models, 226–236
 - sources and identification, 236–238
- Interest rate swaps (IRSs), 127, 139–141
- Interest rates, 12
 - caps and floors, 141–143
 - derivatives, 139
 - interest rate swaps, 139–141
 - swaptions, 144–147

- Internal control process, 362
 Internal data processing, 366
 Internal environment, 345
 Internal rate of return (IRR), 214
 International Monetary Fund (IMF), 287, 442
 Intraday effects, 95
 Intraday risk analysis, 433
 heterogeneous volatility, 433–435
 Intuition assessment, 359
 Inverse functions, 391
 Investment banks, 442
 Investors, 4, 6, 39, 306
 Itô process, 31
 Ito's lemma, 123–125
- January effect, 27–28, 95
 Jarrow–Turnbull model, 271–273
 Jensen's inequality, 9
 Joint probability density function, 69
 JP Morgan Chase, 144
- Kendall's tau, 394–395
 KMV-Merton approach, 262–266
 Kupiec's test, 204–205
- Lagged value, 89
 Lagrangian function, 46
 Lagrangian multipliers, 46–47
 Latent variable models, 397
 Learning, 22
 Legal risk, 358
 Lehman Brothers (LB), 441
 Leverage, 50, 238
 Likelihood function, 69–71, 108
 Likelihood ratio, 407
 test, 204
 Limit law, 400
 Limit order, 303
 Linear correlation, 389, 393
 Linear utility, 14
 Liquidity, 305, 468
 black holes, 313–314
 CAPM, 337–338
 Liquidity coverage ratio (LCR), 325–328
 Liquidity models, 314
 Diamond–Dybvig model, 322–325
 theoretical models, 314–318
 traceable models, 318–322
 Liquidity risk, 11, 13, 301, 552
 liquidity models, 314–325
 market prices, 302–314
 and regulation, 325–332
 Liquidity-adjusted VaR (LVA_R), 314, 319
 Log-likelihood, 89, 105, 108
 function, 70–71
 London Inter Bank Offered Rate (LIBOR),
 139
- Loss, 255–259
 frequency, 363
 function, 492
 severity, 363
 Loss given default (LGD), 488
 Losses and profits (L/P), 175
 Lower tail dependence coefficient, 396
- M-absolute models, 494–496
m-dimensional copula, 390
 M-squared models, 494–496
 Macaulay duration, 240, 242
 Macro hedge, 500
 Maintenance margin, 304
 Managed CDOs, 467
 Managers, 17
 Mapping, 193, 209
 to regulation, 350
 Margin Agreements (MAs), 486
 Marginal scrubbing error, 431
 Marginal VaR, 196–197
 Market clearing condition, 311
 Market efficiency, 36
 Market failures, 36
 types of, 36–37
 Market inefficiencies, 36
 Market liquidity, 308–314
 risk, 14
 Market microstructure, 302–306
 Market portfolio, 52–53
 Market prices, 302
 funding vs. market liquidity, 308–314
 market microstructure, 302–306
 price formation, 306–308
 of risk, 150–152
 Market risk, 11, 18, 173
 metrics, 174–178
 overview, 174–176
 quantile metrics and VaR, 176–179
 VaR calculation methods, 184–189
 VaR rationale and definition, 180–182
 Market risk hedging, 476
 cost of hedging, 480–483
 delta hedging, 476–478
 gamma and Vega hedging, 478–480
 Marking to market, 137, 293
 Markov chain, 282
 Markov process, 28
 for transition matrices, 282–283
 Mass function of binomial distribution, 104
 Matching, 244
 Maturity model, 355
 Maximum likelihood estimation (MLE), 69
 Maximum likelihood estimator
 for binomial distribution, 105
 for time-independent probability, 282
 Maximum likelihood methods, 69–73

- Mean of binomial distribution, 105
- Mean reversion effect, 28
- Mean-excess function (MEF), 403
- Measurement techniques, 238–240
- Merton latent variable model, 397
- Metrics, 330–332
- Miners, 527
- Minimization problem, 316
- Minimum transfer amount, 486
- Minimum variance portfolio (MVP), 45
- Mispricing, 27
- Modern portfolio theory (MPT), 40
 - optimal portfolios of risky assets, 45–48
 - optimal portfolios with risk-free asset, 48–51
 - risk/return trade off, 40–44
- Modified Delta-VaR, 508–510
- Modified duration, 240, 242
- Modified MC and scenario analysis, 513–514
- Monitoring tools, 330–332
- Monte Carlo kernel, 397
- Monte Carlo methods, 491–494
- Monte Carlo simulation (MC simulation), 117, 187–189, 507
 - of copulas, 399
- Moral hazard, 37
- Mortgages, 440
- Multi-factor models, 234–236
- Multidimensional approach, 14
- Multiperiod model, 60
- Multiple peril products, 517
- Multivariate GARCH (MGARCH), 419
- Multivariate return distributions, 424
 - GARCH (p, q) modeling, 424–426
- Mutual funds, 441

- n -copula, 391
- n -dimensional copula, 390
- n -dimensional covariance matrix, 82
- Nationally Recognized Statistical Rating Organization (NRSRO), 443
- Natural monopoly, 36
- Negative externalities, 36
- Net cash outflows (NCO), 325
- Net liquidity demand (NLD) indicator, 309
- Net present values (NPVs), 115
- Net return, 312
- Net Stable Funding Ratio (NSFR), 328–330
- Net working capital, 19
- Netting agreement, 484
- New York Mercantile Exchange (NYMEX), 289
- Newton–Raphson method, 460
- No-arbitrage models, 233
- Nonlinearity, 94, 202
- Nonnormal percentile, 320
- Nonparallel shifts, 220
- Normal distribution, 98

- Normality, 173
- Null hypothesis, 92, 204–205, 408

- Objective-setting, 345
- Obligations, 251
- One-factor copula model, 398
- One-period return on security, 60
- Operational risk, 11, 14, 18, 344, 358
 - Basel II Approach, 362–367
 - identification and assessment, 358–361
 - treatment and control, 361–362
- Operational Riskdata eXchange (ORX), 360
- Optimal asset value, 312
- Optimal bid price, 307
- Optimal contract, 324
- Optimal portfolios
 - with risk-free asset, 48–51
 - of risky assets, 45–48
- Optimal trading model, 314
- Optimization approach, 374
- Option contracts, 294
- Option pricing, 153
 - binomial trees, 154–158
 - BSM model, 158–162
 - models, 154–162
 - theory, 202
- Option spreads, 295
- Option structure, 131–133
- Option value, 376
- Optionality, 238
- Options, 127–138
- Order statistic, 409
- Order-driven markets, 306
- Ordinary least squares (OLS), 86
- Organization for Economic Cooperation and Development (OECD), 544
- Organizational assets, 341
- Over-the-counter markets (OTC markets), 127, 288

- Par yield, 216
- Parallel shifts, 220
- Parametric method, 185–187
- Pareto distribution, 98–102
- Passive acceptance, 21
- Past stock price, 25
- Path-dependent simulation, 485
- Payoffs
 - to bondholders at time, 263
 - equation, 456
 - of forward contract, 134, 290
 - at maturity, 380
- Payout, 131–133
- Peak over threshold method (POT method), 402
- Permanent impact, 316
- Physical assets, 341
- Piecewise constant random function, 29
- Poisson distribution, 106–112

- Poisson process, 494
- Portfolio hedging, 163
 - cost of hedging, 167–170
 - delta hedging, 163–165
 - gamma and Vega hedging, 165–167
- Portfolio optimization in Excel, 51
- Portfolio return, 49
- Portfolio value, 43
- Portfolio weights, 49
- Positive and negative outcomes, 3–4
- Positive externality, 36
- Postcrisis perspectives, 549–550
- Potential future exposure (PFE), 256
- Power law (PL), 437
 - for intraday data, 437–438
- Premium, 52
- Present value, 457
 - of bond in discrete compounding, 216
- Preventive controls, 362
- Prices, 63
 - cycle, 287
 - drop, 316
 - dynamics, 315
 - formation, 302, 306–308
 - tree, 157
- Primary contracts, 516–519
- Principal component analysis of term structure, 248–249
- Probabilistic approaches, 112
 - decision trees, 113–116
 - scenario analysis, 112–113
 - simulations, 116–118
- Probability
 - and consequences, 3
 - mass function, 106
- Probability density function (p. d. f.), 40, 102, 511
- Probability of default (PD), 456, 488
- Process risk, 342, 358
- Product copula, 391
- Profit/loss data (P/L data), 174
- Proportion of failures test (POF test), 204–205, 407
- Public economic policies, 6
- Public goods, 36
- Put option, 131
- Put-call parity formula, 373
- Quantile metrics, 176–179
- Quantile of return distribution, 423
- Quasi-Monte Carlo methods (QMC methods), 513
- Random error component, 25
- Random walk theory of financial assets, 6
- Randomness, 2–5
- Rating agencies, 259
- Rational expectations theory, 5–6
- Rationality, 5–10
- Real options, 127
- Recovery rate (RR), 12, 255
- Reduced-form models, 271 (*see also* Structural models)
 - CreditRisk+™, 275–277
 - Duffie–Singleton model, 273–274
 - Jarrow–Turnbull model, 271–273
- Reference entity, 455
- Regression formula, 58
- Regret operator, 201
- Reinsurers, 520
- Relative liquidity-adjusted total risk, 321
- Relative risk aversion (RRA), 14
- Remargin period, 486
- Remuneration system, 543, 547–549
- Replication argument, 381
- Reputational risk, 358
- Required amount of stable funding (RSF), 328
- Resiliency, 309
- Response management, 351
- Return of equity (ROE), 468
- Return on assets (ROA), 19
- Risk, 1, 4, 39, 357
 - acceptance, 349
 - arbitrage, 24
 - assessment, 20, 345
 - avoidance, 22, 349
 - in corporations and financial institutions, 15–18
 - currency risk, 367–375
 - dashboards, 351
 - factor, 320
 - hedging in FX markets, 373–375
 - identification, measurement and mitigation, 19–21
 - impact, 20
 - likelihood, 20
 - management, 15–22
 - measure, 410
 - mitigation, 22, 362
 - operational risk, 358–367
 - or threat, 3
 - premium, 8, 22, 52, 54
 - priority, 21
 - process, 16
 - randomness and uncertainty, 2–5
 - rationality and risk aversion, 5–10
 - reduction, 349
 - repository, 350
 - response, 345
 - response strategies, 21–22
 - scoring, 351
 - sharing, 349
 - theory of markets, 22–33
 - for traders and investors, 288–289
 - transfer, 362
 - types, 10–15
 - volatility risk, 375–383

- Risk aversion, 5–10
 - relationship, 9
- Risk management, 97, 532–535
 - systems, 552–556
- Risk mapping
 - to objectives, 350
 - to policies, 350
- Risk-Adjusted Return on Capital (RAROC), 386–387
- Risk-averse investors, 50
- Risk-neutral probability, 155–156
- Risk-purchasing groups, 515
- Risk-retention groups, 515
- Risk–return trade-off, 39–44
- Rolling yield, 537

- Sampling of Brownian Motion paths in Excel, 32–33
- Sarbanes–Oxley Act (2002), 546
- Scaling laws, 94, 433
- Scenario analysis, 112–113, 366
- Scorecards, 359, 361
- Securitization, 439, 461, 551
 - advantages and disadvantages, 467–469
 - CDOs, 463–467
 - structure and participants, 461–463
- Security market line (SML), 52, 55–60
- Semistrong-form version of EMH, 26
- Semivariance operator, 201
- Sensitivity of portfolio, 201
- Sensitivity-based risk measures, 200
- Shape of utility function, 8
- Short rate models, 226
 - multi-factor models, 234–236
 - single-factor models, 230–234
 - term structure of interest rates, 226–229
- Significance level, 179
- Simple interest, 212
- Simulations, 116–118, 240
- Single-factor models, 230–234
- Sister captives, 517
- Skewing, 95
- Small firm effect, 28
- Small minus big (SMB), 62
- Soft storage wallets, 535
- Sovereign risk dynamics, 562–565
- Spearman’s rho, 394–395
- Special purpose vehicle (SPV), 446, 472–473
- Specialized analytics, 351
- Specific risk, 11
- Speculation, 129
- Speculators, 129–130, 217
- Spot rates, 219
- Spot volatility approach, 143
- Spot–forward parity, 136
- Stabilization of rates, 238
- Stable funding, 328–329
- Stablecoins, 538
- Standard deviation, 40, 56
- Standard duration, 495
- Standard error of estimation, 64
- Standard normal distribution, 78–79
- Standardized approach, 364, 488
- Static risk management processes, 340
- Static simulations, 240
- Statistical analysis, 97
 - distributions, 98–112
 - probabilistic approaches, 112–118
- Steady state distribution function, 30
- Stocks, 4, 12, 55
 - prices, 158
- Stop-loss order, 303
- Strategic risks, 344
- Stress testing, 206–207
- Strike, 131
- Strong-form version of theory, 26
- Structural models, 262 (*see also* Reduced-form models)
 - CreditMetrics™ model, 269–271
 - first passage models, 266–268
 - KMV-Merton approach, 262–266
- Student-*t* factor model, 492
- Student’s *t*-copula, 391–392
- Stylized facts, 93–95
- Subadditivity, 409, 420
- Subprime mortgages, 461
- Sum of square deviation from mean, 64
- Super cycles, 287
- Survival function, 253
 - of Pareto variable, 98
- Survival probability, 272
- Swaps, 294–298
 - cash flows, 140
 - payments, 453
- Swaptions, 144–147
- Synthetic CDO, 464
- System integration, 351–352
- Systematic risk, 10, 52

- Tail, 98
 - dependence of copulas, 395
 - index, 433
- Tangency point, 49
- Temporary impact, 315
- Term structure of interest rates, 226–229
- Tether, 538
- Theoretical models, 314–318
- Theory of markets, 22–33
- Three-factor model, 61
- Threshold, 486
- Tick frequencies, 430
- “Tick” loss target function, 413
- Tightness, 309
- Time horizon, 179, 514

- Time series, 81
 - analysis, 85
 - ARCH/GARCH models, 85–89
 - autocorrelation of financial returns, 89–93
 - stylized facts, 93–95
- Time Until First Failure test (TUFF test), 204, 407
- Top-down approach, 360
- Total cost of trading, 316
- Total portfolio VaR, 197
- Traceable models, 318–322
- Traders in market, 128–131
- Trading
 - path, 318
 - strategy, 315
- Trans-European Automated Real-time Gross Settlement Express Transfer System, 445
- Transaction cost calculations, 318
- Transaction risk, 367
- Transfer risk, 22
- Transition matrix, 269
- Transition periods, 508
- Transition thresholds, 271
- Translation risk, 367
- Transparency, 305, 545
- Transparent financial reporting, 21
- Trial and error approach, 215
- Twice differentiable payoff function, 381
- Twist shift, 221
- 12-point Gauss–Hermite integration, 512

- Uncertainty, 2–5, 339
- Utility functions
 - common forms of, 14–15
 - of investor, 4

- Value at Risk (VaR), 12, 195, 256, 314, 406, 419, 507, 554
 - advances, 507–514
 - analysis, 173, 176–179
 - analytic approximations, 201–203
 - backtesting, 406–408
 - calculation methods, 184–189
 - choice of parameters for, 183
 - conditional VaR, 411–413
 - decomposition, 196–199
 - expected shortfall, 409–411
 - features, 195–203
 - historical simulation approach, 184–185
 - limitations, 199–201
 - Monte Carlo simulation, 187–189
 - parametric method, 185–187
 - for portfolios of derivatives, 416–417
 - rationale and definition, 180–182
 - testing, 203–207
- Value tokens, 538
- Variable trigger, 518
- Variance decomposition of returns, 59
- Variance of portfolio, 43
- Variance swaps, 380–383
- Vasicek model, 230, 232
- Vector of optimal weights, 47
- Vega hedging, 147, 165–167, 478–480
- Vigilance, 21
- Volatility, 40, 63–73
 - strategy with strangles, 138
 - surface, 376
 - types, 63–66
- Volatility risk, 11, 357, 375
 - callable bonds, 377–380
 - implied volatility, 375–377
 - variance swaps, 380–383
- Volume, velocity, variability or veracity, 529–530

- Weak-form efficiency, 25
- Weekend effects, 95
- Weibull distribution, 401
- Weighted spread, 322
- Weighting factor, 185
- Worst-case scenario (WCS), 514

- Yield curve, 223, 226
 - risk, 200, 237
- Yield shifts, 220–226
- Yield to call, 377–378
- Yield to maturity (YTM), 214
- Yield to worst, 377
- Yields, 212–217

- Zero-coupon bond price, 235
- Zero-coupon rate, 495
- Zero-volatility spread, 454
- Zipf’s law, 437