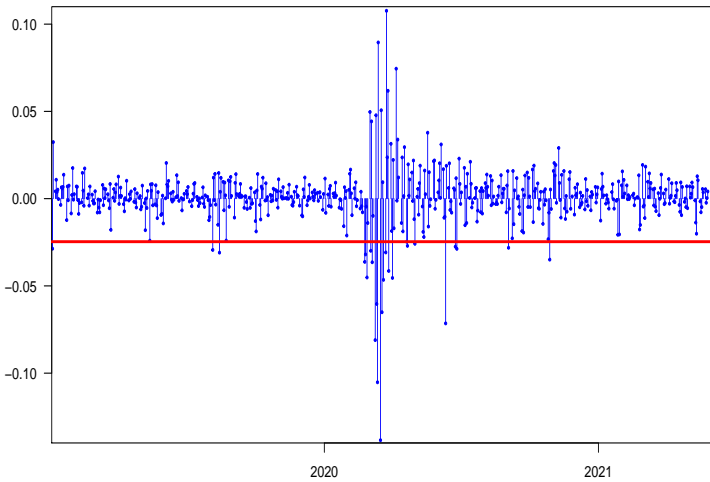


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Notes on

Financial Risk and Analytics



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<https://personal.ntu.edu.sg/nprivault/index.html>

Preface

The topics covered in these notes include an introduction to stochastic modeling with discrete-valued stochastic processes, a basic coverage of Value at Risk and Expected Shortfall, as well as structures of random dependence. Various types of risk, see *e.g.* [Gourieroux and Jasiak \(2010\)](#), can be classified into: market risk, liquidity risk, credit risk, counterparty risk, model risk, estimation risk. For insurance businesses, a more detailed classification can be set as follows.

a) Financial risk

Investment risk

Credit risk,

Market risk (*e.g.* depreciation),

Counterparty risk.

Liability risk

Catastrophe risk,

Non-catastrophe risk (*e.g.* claim volatility).


b) Operational risk

Business risk (*e.g.* lower production),


Event risk (*e.g.* system failure),

Policy risk ...

Part I introduces tools for stochastic modeling, with applications in option pricing, portfolio allocation, and insurance, starting with the use of random walks and geometric Brownian motion for financial modeling in Chapter 1. This is followed by the discrete and continuous-time modeling of time-dependent events using time series and processes with jumps, respectively in Chapters 2 and 3. In particular, the risk theory considered in Chapter 3 is relevant to liability, catastrophe and operational risks such as business or event risk. Correlation and dependence are treated via the use of copulas in Chapter 4.

Financial, investment, market and non-catastrophe risks are dealt with in Part II which focuses on risk measures. This includes the superhedging risk measure in Chapter 5, and Value at Risk and Expected Shortfall in Chapter 6 and 7. Chapter 8 is devoted to credit scoring, using discriminant analysis and logistic regression. Risk theory and credit scoring are presented with illustrative examples in .

Credit risk is considered Part III, including the structural and reduced-form approaches to credit risk and valuation in Chapters 9 and 10. Credit default is treated via defaultable bonds, Credit Default Swaps (CDS) and collateralized debt obligations (CDOs) in Chapter 11 on credit derivatives.

Parts of this material have been used for teaching in the Masters of Science in Financial Engineering (MFE), Analytics (MSA), and Business Analytics (MSBA) at the Nanyang Technological University in Singapore. The pdf file contains external links and 159 figures, including 10 animated figures and an embedded video in Figure 1.8, that may require using Acrobat Reader for viewing on the complete pdf file. It also contains 14 Python codes and 81  codes.

This text also includes 70 exercises with solutions. Clicking on an exercise number inside the solution section will send to the original problem text inside the file. Conversely, clicking on the problem number sends the reader to the corresponding solution, however this feature should not be misused.

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Contents

Part I Stochastic Modeling

1	Modeling Market Returns	3
1.1	Random Walks	3
1.2	Geometric Brownian Motion	10
1.3	Distribution of Market Returns	25
1.4	Gram-Charlier Expansions	30
	Exercises	32
2	Time Series	35
2.1	Autoregressive Moving Average	35
2.2	Autoregressive Heteroskedasticity	45
2.3	Time Series Stationarity	48
2.4	Fitting Time Series to Financial Data	55
2.5	Application: Pair Trading	61
	Exercises	70
3	Processes with Jumps	75
3.1	The Poisson Process	75
3.2	Compound Poisson Process	84
3.3	Claim and Reserve Processes	90
3.4	Ruin Probabilities	92
	Exercises	99
4	Correlation and Dependence	103
4.1	Joint Bernoulli Distribution	103
4.2	Joint Gaussian Distribution	104
4.3	Copulas and Dependence Structures	106
4.4	Examples of Copulas	111

Exercises	118
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Part II Risk Measures

5 Superhedging Risk Measure	125
5.1 Historical Sketch	125
5.2 Financial Derivatives	126
5.3 Black-Scholes Analysis	139
Exercises	146
6 Value at Risk	151
6.1 Risk Measures	151
6.2 Quantile Risk Measures	156
6.3 Value at Risk (VaR)	162
6.4 Numerical estimates	170
Exercises	172
7 Expected Shortfall	175
7.1 Tail Value at Risk (TVaR)	175
7.2 Conditional Tail Expectation (CTE)	176
7.3 Expected Shortfall (ES)	181
7.4 Numerical Estimates	187
Exercises	192

Part III Credit Risk

8 Credit Scoring	201
8.1 Discriminant Analysis	201
8.2 Decision Rule	205
8.3 Logistic Regression	208
8.4 ROC Curve	214
Exercises	219
9 Credit Risk - Structural Approach	223
9.1 Merton Model	223
9.2 Default Bonds	227
9.3 Black-Cox Model	228
9.4 Correlated Default Times	232
Exercises	237

10 Credit Risk - Reduced-Form Approach	239
10.1 Survival Probabilities	239
10.2 Stochastic Default	241
10.3 Defaultable Bonds	245
Exercises	249
11 Credit Derivatives	253
11.1 Credit Default Swaps (CDS)	253
11.2 Collateralized Debt Obligations (CDO)	258
11.3 Credit Valuation Adjustment (CVA)	264
Exercises	267
Part IV Appendix	
Background on Probability Theory	273
A.1 Probability Sample Space and Events	273
A.2 Probability Measures	277
A.3 Conditional Probabilities and Independence	279
A.4 Random Variables	281
A.5 Probability Distributions	283
A.6 Expectation of Random Variables	291
A.7 Conditional Expectation	304
Exercises	309
Some Useful Identities	313
Exercise Solutions	317
Chapter 1	317
Chapter 2	320
Chapter 3	328
Chapter 4	330
Chapter 5	340
Chapter 6	344
Chapter 7	349
Chapter 8	358
Chapter 9	363
Chapter 10	367
Chapter 11	371
Background on Probability Theory	375
Index	381
Author index	387

References 389



List of Figures

1.1	Graph of $120 = \binom{10}{7}$ paths with $n = 5$ and $k = 2^*$	4
1.2	Two sample paths of one-dimensional Brownian motion	5
1.3	Sample paths of a one-dimensional Brownian motion	6
1.4	Brownian motion as a random walk*	7
1.5	Statistics of one-dimensional Brownian paths <i>vs.</i> Gaussian distribution	9
1.6	Statistics of S&P 500 yearly return graphs from 1950 to 2022	10
1.7	Returns <i>vs.</i> cumulative returns	12
1.8	“As if a whole new world was laid out before me.”*	14
1.9	Geometric Brownian motion started at $S_0 = 1^*$	16
1.10	Ten sample paths of geometric Brownian motion	18
1.11	Underlying market prices	19
1.12	Simulated geometric Brownian motion	19
1.13	Graph of the Gaussian Cumulative Distribution Function (CDF)	21
1.14	Statistics of geometric Brownian paths <i>vs.</i> lognormal distribution	22
1.15	Market returns <i>vs.</i> normalized Gaussian returns	26
1.16	Empirical <i>vs.</i> Gaussian CDF	26
1.17	Quantile-Quantile plot	27
1.18	Empirical density <i>vs.</i> normalized Gaussian density	28
1.19	Empirical density <i>vs.</i> normalized lognormal density	29
1.20	Empirical density <i>vs.</i> power density	29
1.21	Gram-Charlier expansions	32
1.22	Sample path of a geometric Brownian motion	33
2.1	MA(2) Samples	37
2.2	AR(2) Samples	40
2.3	ARMA(2, 2) Samples	41
2.4	ARIMA(1, 2, 3) Samples	44
2.5	ARCH(2) Samples	46
2.6	GARCH(2, 1) Samples	48

2.7	Autocovariances of AR(2) Samples	50
2.8	Nonstationarity of AR(2) time series with $a_1 = 1$ and $a_2 = -1$	53
2.9	Hypothesis testing	55
2.10	Stock returns	56
2.11	ARIMA(0, 0, 3) samples	57
2.12	ARIMA(2, 0, 2) samples	58
2.13	GARCH samples	59
2.14	Cumulative stock returns	60
2.15	ARIMA(2, 1, 2) Samples*	61
2.16	MSFT <i>vs.</i> AAPL graphs	62
2.17	Comparison graph before linear regression	62
2.18	Comparison graph after linear regression	63
2.19	Spread graph	64
2.20	Pair trading signals	65
2.21	Illustration of the self-financing condition (2.26)	67
2.22	Pair trading performance	69
2.23	Pair trading performance	70
3.1	Sample path of a counting process $(N_t)_{t \in \mathbb{R}_+}$	76
3.2	Sample path of the Poisson process $(N_t)_{t \in \mathbb{R}_+}$	79
3.3	Sample path of the Poisson process $(N_t)_{t \in \mathbb{R}_+}$	82
3.4	Sample path of the compensated Poisson process $(N_t - \lambda t)_{t \in \mathbb{R}_+}$	83
3.5	Probability density function	84
3.6	Sample path of a compound Poisson process $(Y_t)_{t \in \mathbb{R}_+}$	86
3.7	Sample path of a compensated compound Poisson process	90
3.8	Sample path (without ruin) of a reserve process $(R_x(t))_{t \in \mathbb{R}_+}$	91
3.9	Sample path (with ruin) of a reserve process $(R_x(t))_{t \in \mathbb{R}_+}$	92
3.10	Sample paths of reserve process*	96
4.1	Joint Gaussian probability density	105
4.2	Copula graphs	107
4.3	Gaussian copula graphs	112
4.4	Different Gaussian copula density graphs	112
4.5	Different Gaussian copula density graphs	113
4.6	Samples with uniform marginals and given copulas	115
4.7	Samples with Gaussian marginals and given copulas	116
4.8	Joint densities with Gaussian marginals and given copulas	117
4.9	Joint density contour plots with Gaussian marginals and given copulas	117
4.10	Samples with exponential marginals and given copulas	118
4.11	Truncated two-dimensional Gaussian density	121
5.1	Comparison of WTI <i>vs.</i> Keppel price graphs	126
5.2	Hang Seng index	127

5.3	Two put option scenarios	128
5.4	Payoff function of a put option	128
5.5	Two call option scenarios	130
5.6	Payoff function of a call option	130
5.7	Brent and WTI price graphs	132
5.8	Price map of a four-way collar option	132
5.9	Payoff function of a four-way call collar option	133
5.10	Four-way call collar payoff as a combination of call and put options*	133
5.11	Implied probabilities	138
5.12	One hundred sample price paths used for the Monte Carlo method	139
5.13	Graph of the Gaussian Cumulative Distribution Function (CDF)	141
5.14	Black-Scholes call price map*	142
5.15	Time-dependent solution of the Black-Scholes PDE (call option)*	142
5.16	Delta of a European call option	143
5.17	Black-Scholes put price function*	144
5.18	Time-dependent solution of the Black-Scholes PDE (put option)*	144
5.19	Delta of a European put option	145
5.20	Graphs of call/put payoff functions.	149
6.1	Estimating liabilities by a conditional mean over 346 market returns	154
6.2	Cumulative distribution function with discontinuities*	157
6.3	Cumulative distribution functions	158
6.4	Example of quantiles given as percentiles	159
6.5	Gaussian quantile $q_Z^p = 1.644854$ at $p = 0.95$	160
6.6	Exponential quantile $q_X^p = 2.995732$ at $p = 0.95$	160
6.7	Cumulative distribution function	161
6.8	Empirical cumulative distribution functions	162
6.9	Continuous CDF and symmetric VaR	166
6.10	Discontinuous CDF and nonsymmetric VaR	166
6.11	Cumulative distribution function	168
6.12	Cumulative distribution function	168
6.13	Market returns <i>vs.</i> Value at Risk	171
6.14	Cumulative distribution function	173
7.1	Two distributions having the same Value at Risk $V_X^{95\%} = 2.145$	176
7.2	Value at Risk and Conditional Tail Expectation	180
7.3	Value at Risk and Expected Shortfall	189
7.4	Value at Risk <i>vs.</i> Expected Shortfall	190
7.5	Historical <i>vs.</i> Gaussian estimates of Value at Risk	190
7.6	Quantile function	191
7.8	Cumulative distribution function	194
7.9	Cumulative distribution function	195

8.1	Probability default curve $x \mapsto \mathbb{P}(B X = x)$	204
8.2	Probability acceptance curve $x \mapsto \mathbb{P}(G X = x)$	204
8.3	Animated graph of optimal decision rule*	208
8.4	Logistic CDF	210
8.5	GLM Regression	211
8.6	Logistic regression output on 5 criteria	212
8.7	Logistic regression output on 61 criteria	213
8.8	Gaussian ROC curves	216
8.9	ROC curves based on 5 criteria and 61 criteria	217
9.1	Graph of the function $x \mapsto \Phi(\Phi^{-1}(x) + (\mu - r)\sqrt{T-t}/\sigma)$	227
11.1	CDS price evolution	256
11.2	A representation of CDO tranches	258
11.3	A Titanic-style representation of cumulative tranche losses	260
11.4	Function $f_t(x) = \min((x - N\alpha_{t-1})^+, Np_t)$	262
11.5	Internal Ratings-Based (IRB) formula	264
11.6	Cashflow data	268
11.7	CDS Market data	269
A.1	Probability density function	284
A.2	Exponential CDF and PDF	286
A.3	Probability computed as a volume integral	287
S.1	Twenty sample paths of geometric Brownian motion	320
S.2	Exponential copula function $u, v \mapsto C(u, b)$	334
S.3	Density of $X + Y$	336
S.4	Survival copula graph	339
S.5	Survival copula density graph	340
S.6	Pareto cumulative and probability density functions	345
S.7	Cumulative distribution function	345
S.8	Value at Risk and Expected Shortfall for small data	352
S.9	Cumulative distribution function	353
S.10	Cumulative distribution function	354
S.11	Cumulative distribution function	354
S.12	Exponential ROC curves	361
S.13	Uniform ROC curves	362
S.14	CDS Price data	373

* Animated figures (work in Acrobat Reader).



List of Tables

5.1	Call and put options on the Hang Seng Index (HSI).....	150
7.1	Summary of Risk Measures	191
10.1	Mortality table	240
10.2	Cumulative historic default rates	248
S.1	CDS Market data	373
S.2	Spread and survival probabilities	375