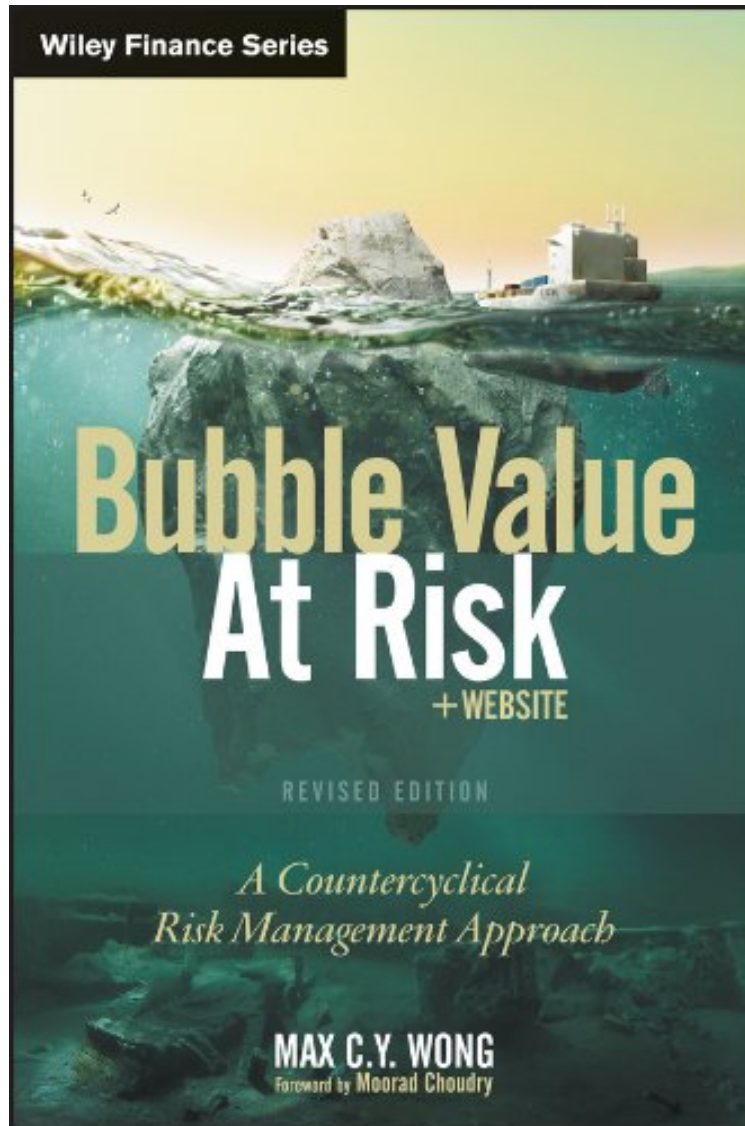


(Free read ebook) Bubble Value at Risk: A Countercyclical Risk Management Approach (Wiley Finance)

## Bubble Value at Risk: A Countercyclical Risk Management Approach (Wiley Finance)

Max C. Y. Wong

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**Max C. Y. Wong : Bubble Value at Risk: A Countercyclical Risk Management Approach (Wiley Finance)**  
before purchasing it in order to gauge whether or not it would be worth my time, and all praised Bubble Value at Risk: A Countercyclical Risk Management Approach (Wiley Finance):

0 of 0 people found the following review helpful. New VaRBy Armand Castiela new way of measuring VaR, a new methodology, more realistic, more adapted, more global, an new frontier in Risk Management!6 of 6 people found the following review helpful. Bubble Value at Risk...way to an ideal capital regimeBy Jayaradha Shankar"If you are

distressed by anything external, the pain is not due to the thing itself but to your own estimate of it; and this you have the power to revoke at any moment". Marcus Aurelius has summed it up appropriately in his "Meditations on Stoic Philosophy" and Bubble Value-at-Risk exercises this power not to revoke but to refine. Value-at-risk has a rather dubious track record as a basis for calculation of risk capital. Exaggerated reliance on this tool by the regulatory authorities only exacerbated the fall out of bad judgments based on this "intuitive" estimate of risks. Can "Stressed Value-at-risk" generate sufficient prudence to save for the proverbial rainy day? Are the regulators geared up to face "adaptive challenges" or have they become prisoners of their own system? Max Wong's book is an ideal expression of his self-reflection on the issue of capital buffers (or rather the lack of them!). The concept of BuVaR (Bubble Value-at-Risk) germinates from his ideas of an "ideal capital regime" based on his own way of processing business cycles as a risk management practitioner. Distorting or even drowning the VaR noises and re-viewing patterns in the risk environment led him to a simple but key question "isn't the risk of a crash higher at the peak than at the trough?" And, what is more, crashes always occur one way, downwards! The BuVaR attempts to do away with the major shortcomings of VaR - Too Little, Too Late. BuVaR is sure to appeal to regulators as it is conservative and penalizes position taking in the direction of a bubble (in the case of Market BuVaR) and its extension into the world of credit (Credit BuVaR) helps aggregate default risk with credit VaR to sound the alarm of credit deterioration way ahead of time.\* What makes the book highly readable is the fact that the author cares enough for the mathematically-challenged to re-build the entire VaR architecture with simple building blocks, along with common sense assessments of the model along the way. The reader is thus prepared to understand BuVaR in the right context.\* The "New Interpretation" of Classical Decomposition is a way to make distributional forecasts more aligned with business cycles. This view definitely appeals to the economist in me who perpetually wonders about the "thin veil of money over the real world".\* What gives this book a "double thumbs" up is the easy conversational style of writing, particularly in delineating technical concepts. The axiomatic frame of reference is well-defined and conclusions are consistent with underlying axioms. Bankers and non-bankers alike would find this book an informative read. However, I personally believe the primary audience for this book will be those who wish to soften the effect of speculative crashes on the unsuspecting public. Regulators and other policy makers would benefit from reading the book as it will sharpen their understanding of widely-used mathematical models from premises that are purely philosophical.- Jayaradha Shankar (formerly Assistant General Manager, Reserve Bank of India)3 of 3 people found the following review helpful. Bubble Value At Risk - Highly TopicalBy Kindle CustomerHaving worked in the insurance industry for a number of years, I have had strong doubts about using standard VAR metrics to manage regulatory capital. In particular, it seemed strange to me that VAR did not seem to take account of market cycles, was highly reliant on historical data and only recognised regime shifts after the fact. The result of this would seem to be a highly procyclical capital regime, forcing regulated entities into large sell offs at the bottom of the market and resulting in the type of risk aversion and liquidity trap we are all too familiar with in recent years. This book works on two levels. Firstly, it provides an easy to understand critique of the mathematical assumptions underpinning VAR, going beyond the well rehearsed issues with assumptions of normal distribution and fat tails. Secondly, even more importantly, it provides suggestions for the way forward both for calculating capital at the entity level and managing systemic risk at the global level. While a basic understanding of statistics would be useful, a lot of the most important ideas are explained in a way that you do not need any mathematical background to understand. I highly recommend this book for anyone with an interest in the calculation of regulatory capital and management of systemic risk - both extremely topical in the current business environment.

Introduces a powerful new approach to financial risk modeling with proven strategies for its real-world applications The 2008 credit crisis did much to debunk the much touted powers of Value at Risk (VaR) as a risk metric. Unlike most authors on VaR who focus on what it can do, in this book the author looks at what it cannot. In clear, accessible prose, finance practitioner, Max Wong, describes the VaR measure and what it was meant to do, then explores its various failures in the real world of crisis risk management. More importantly, he lays out a revolutionary new method of measuring risks, Bubble Value at Risk, that is countercyclical and offers a well-tested buffer against market crashes. Describes Bubble VaR, a more macro-prudential risk measure proven to avoid the limitations of VaR and by providing a more accurate risk exposure estimation over market cycles Makes a strong case that analysts and risk managers need to unlearn our existing "science" of risk measurement and discover more robust approaches to calculating risk capital Illustrates every key concept or formula with an abundance of practical, numerical examples, most of them provided in interactive Excel spreadsheets Features numerous real-world applications, throughout, based on the author's firsthand experience as a veteran financial risk analyst

From the Author From the preface: This is a story of the illusion of risk measurement. Financial risk management is in a state of confusion. The 2008 credit crisis has wreaked havoc on the Basel pillars of supervision by highlighting all the cracks in the current regulatory framework that had allowed the credit crisis to fester, and ultimately leading to the greatest crisis since the Great Depression. Policy responses were swift--UK's Financial Services Authority (FSA)

published the Turner which calls for a revamp of many aspects of banking regulation, the Bank of International Settlements (BIS) speedily passed a Revision to its Basel II, while the Obama administration calls for a reregulation of the financial industry reversing the Greenspan legacy of deregulation. The value-at-risk risk measure, VaR, a central ideology for risk management, was found to be wholly inadequate during the crisis. Critically, this "riskometer" is used as the basis for regulatory capital--the safety buffer money set aside by banks to protect against financial calamities. The foundation of risk measurement is now questionable. The first half of this book develops the VaR riskometer with emphasis on its traditionally-known weaknesses, and talks about current advances in risk research. The underlying theme throughout the book is that VaR is a faulty device during turbulent times and by its mathematical sophistication misled risk controllers into an illusion of safety. The author traces the fundamental flaw of VaR to its statistical assumptions--of normality, i.i.d. and stationarity--the "gang of three". These primitive assumptions are very pervasive in the frequentist statistics philosophy where probability is viewed as an objective notion and can be measured by sampling. A different school of thought, the Bayesians, argues for subjective probability and has developed an entire mathematical framework to incorporate the observer's opinion into the measurement (but this is a subject matter for another publication). We argue that the frequentist's strict mathematical sense often acts as a blinder that restricts the way we view and model the real world. In particular, two "newly" uncovered market phenomena-- extremistan and procyclicality--cannot be engaged using the frequentist mindset. There were already a few other well-known "market anomalies" that tripped the VaR riskometer during the 2008 crisis. All these will be detailed later. In Part IV of the book, the author proposes a new risk metric called bubble VaR (buVaR) which does not invoke any of the said assumptions. BuVaR is not really a precise measurement of risk; in fact it presumes that extreme loss events are unknowable (extremistan) and moves on to the more pressing problem--how do we build an effective buffer for regulatory capital that is countercyclical, and that safeguards against extreme events. This book is an appeal (as is this preface) to the reader to consider a new paradigm of viewing risk--that one need not measure risk (with precision) to protect against it. By being obsessively focused on measuring risk, the risk controller may be fooled by the many pitfalls of statistics and randomness. This could lead to a false sense of security and control over events which are highly unpredictable. It is ultimately a call for good judgment and pragmatism. This book is intended to reach out to the top management of banks (CEOs and CROs), to regulators, to policy makers and to risk practitioners--not all of whom may be as quantitatively inclined as the specialized risk professional. But they are the very influencers of the coming financial reregulation drama. We are living in epic times and ideas help shape the world for the better (or for worst). It is hoped that the ideas in this book can open up new and constructive research into countercyclical measures of risk. With this target audience in mind, this book is written in plain English with as few Greek letters as possible, the focus is on concepts (and illustrations) rather than mathematics. Because it is narrowly focused on the topic, it can be self-contained. No prior knowledge of risk management is required; pre-university level algebra and some basic financial product knowledge are assumed. A word on the use of Excel: All the spreadsheets used in this book can be downloaded from the companion website: [bubble-value-at-risk.com](http://bubble-value-at-risk.com). From the Inside Flap Most risk management books introduce Value at Risk (VaR) by focusing on what it can do and its statistical measurements. The credit crisis in 2008 was a tidal wave that debunked this well-established risk metric. In this book, the author introduces VaR by looking at its failures instead and explores possible alternatives for effective crisis risk management, including a new method of measuring risks called Bubble Value at Risk that is countercyclical and can potentially buffer against market crashes. The frequentist statistics-based VaR is predictive during normal circumstances but often fails patently during rare crisis episodes. In reality, crisis periods span only a tiny portion of financial market history. By relying on VaR for crisis risk management, we are using a tried-and-tested tool for the wrong occasion -- mistaking the trees for the forest. The book argues that we need to unlearn our existing "science" of risk measurement and discover more robust ways of managing risk and calculating risk capital. The book illustrates virtually every key concept or formula with a practical, numerical example, many of which are contained in interactive Excel spreadsheets. From the Back Cover "Bubble Value at Risk offers a critical rethinking of some of the deficiencies in the calculation of risk capital. I particularly liked the more applied wisdom scattered throughout the text. Here is a practitioner explaining how things really work, or for that matter, don't work in the real world. These remarks will definitely open the eyes of the more academic researcher." --Paul Embrechts, Director of RiskLab, ETH Zurich "Reading Bubble Value at Risk is an intensive master class in risk management. As a busy risk management practitioner, I found Bubble Value at Risk extremely worthwhile in that Wong, with the theoretic detail of an academic but with the intuition of a practitioner, very efficiently surveys the evolution of financial risk management thought since the credit crisis. The book is well written, organized, thought-provoking, and to the point. After constructively critiquing pre-crisis risk management for its conceit that it could precisely model extreme events, Wong pragmatically breaks with risk dogma and introduces the concept of Bubble Value at Risk as a more prudent means of allocating sufficient capital to buffer tail risk in light of the fact that tail risk is inherently unknowable. The book is simply a very good use of time for anyone fighting the guerrilla war with risk." --David P. Belmont, CFA and Chief Risk Officer, Commonfund "John Maynard Keynes is famous for many things, including this quote on bankers: 'A sound banker, alas, is not one who foresees danger and avoids it, but one who, when he is ruined, is ruined

in a conventional way along with his fellows, so that no one can really blame him.' This quote, originally found in *The Consequences to the Banks of the Collapse of Money Values* (1931), describes very accurately the robotic use of the Value at Risk concept at many financial institutions. Max Wong skewers the conventional wisdom on Value at Risk in this original book from a very talented and experienced market participant. Mr. Wong illustrates the mathematical problems with Value at Risk with many worked examples and insights from the 2007-2011 credit crisis. He suggests an alternative to the conventional wisdom, 'Bubble Value at Risk,' which addresses many of the shortcomings in conventional VaR calculations that were starkly revealed during the credit crisis. We highly recommend this candid and enlightening book to any risk analyst who finds himself surrounded by a large contingent of 'sound bankers.'"

—Donald R. van Deventer, PhD, Chairman and Chief Executive Officer, Kamakura Corporation ([www.kamakuraco.com](http://www.kamakuraco.com)), and coauthor of *Advanced Financial Risk Management*, 2nd Edition "Wong establishes his reputation as an inventive risk manager with the innovative idea to express expected shortfall (also called expected tail loss, or conditional VaR) in terms of previous price levels. This book also has some interesting ideas on financial regulatory reform and should be attractive to non-quant readers seeking knowledge of the pitfalls of Value at Risk, as it is usually measured." —Professor Carol Alexander, Subject Lead, Finance and Accounting, School of Business, Management and Economics, University of Sussex