

Risk

Definition, Types and Sources



RISK

- Uncertainty
- It is not loss. It is possibility of loss
- Proportional to return, usually
- Analogous to Standard Deviation
- Management is required
- Usually managed by considering historical behaviors and outcomes
- Risks can be reduced using diversification and hedging strategies



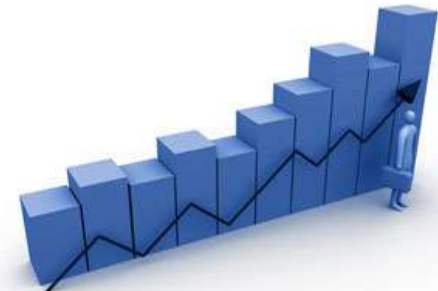
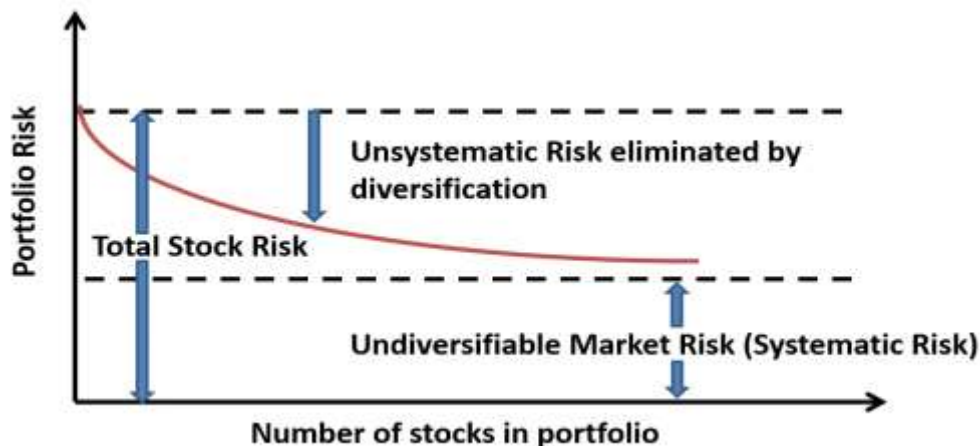
TYPES OF RISK

Systematic Risk

- Market risk or Non-diversifiable risk
- Uncertainty inherent to entire market and not just particular stock or industry
- It cannot be reduced by diversification

Un Systematic Risk

- Company Specific or Diversifiable risk
- Uncertainty that comes with company or stocks you invest in
- It can be reduced by diversification



SOURCES OF RISK

Market Risk :

It is the possibility of an investor experiencing losses due to factors that affect the overall performance of the financial **markets** in which he or she is involved.

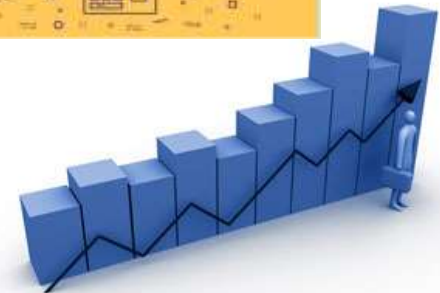


Credit Risk:

It is the risk of default on a debt that may arise from a borrower failing to make required payments. It is measured using credit spread or swap spread

Liquidity Risk:

The risk of not being able to buy or sell a security when needed. Bid-ask spread or large price movements is used as a measure of liquidity



SOURCES OF RISK(continuing...)

Operational Risk:

It is the prospect of loss resulting from inadequate or failed procedures, systems or policies, employee errors, systems failures. Fraud or other criminal activity.



Model Risk:

Risk that a model performs inadequately and lead to adverse outcome for the firm

Settlement Risk:

Risk that one party could be in process of paying the counterparty while the counterparty is declaring bankruptcy.

It is associated with timings difference between parties.



SOURCES OF RISK(continuing...)

Regulatory Risk:

Risk of changes in laws, regulations or an unregulated market becoming a regulated market. It could impact a security, business, sector or market



Legal Risk/Contract Risk:

The possibility of loss arising from the legal's system failure to enforce a contract in which an enterprise has a stake. The chances of facing losses from the deal performing poorly.

Tax Risk:

Risk due to uncertainty with tax laws. It is the chance that tax rules may change resulting in losses due to higher than expected taxes



SOURCES OF RISK(continuing...)

Accounting Risk:

Resulting from uncertainty about how a transaction should be recorded and the potential for accounting rule to change. Accounting experts are hired to deal with this risk



Sovereign and Political Risk:

Sovereign risk is a form of credit risk in which borrower is the government of sovereign nation. Political risk is associated with changes in political environment

Other risk:

ESG risk-Risk to a company's market valuation resulting from environmental, social and governance factors.

