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Into the Tails of Risk: An Intervention into the Process of Risk Evaluation

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Abstract

People naturally observe risk as the range of experienced gains and losses represented in statistical terms by standard deviation. Statistical techniques are used to develop values for extreme tails of the distribution of gains and losses. These processes are essentially an extrapolation from the “known” risk of volatility near the mean to “unknown” risk of extreme losses. This paper will propose a tail risk metric (the coefficient of riskiness) that can be used to enhance discussion between model builders and model users about the fatness of the tails in risk models.