

Subject Index

- Absolute VaR, 304
American option, 79
Antithetic variables, 56
Arrays and matrices, 13
 dynamic array, 13
 multidimensional array, 13
 one-dimensional array, 13
 two-dimensional array, 13
Arrow-Debreu price, 132
Asset path simulation functions, 30
At-the-money (ATM) straddle, 152

Back-testing, 339
Basket default swap, 280
Bayesian framework, 171
 Bayes' Theorem, 172
 conjugate prior, 171
 Gibbs sampling, 173
 posterior, 171
Bermudan swaption, 249, 372
 co-terminal Bermudan swaption, 250
 fixed-maturity Bermudan swaption, 250
BGM model, 221

Binomial tree, 348
Black formula, 201
Black forward rate volatility, 223
Black-Scholes equation, 43
Black-Scholes formula, 48
Black swap rate volatility, 225
Bootstrapping, 321
Brownian motion, 36
 exponential martingale, 36
 Markov property, 36
 martingale property, 36
 multidimensional Brownian motion, 38
 quadratic variation, 36

Calibration, 55
Call period, 289
Callable equity-linked note, 163
Caplet, 222
Cholesky decomposition, 109, 144, 146, 380
CIR process, 41
Clamped cubic spline, 180
Clean price, 183

408 *SUBJECT INDEX*

- Coherent risk measure, 332
component VaR, 336
conditional value-at-risk (CVaR), 333
incremental VaR, 336
marginal VaR, 336
monotonicity, 332
positive homogeneity, 332
sub-additivity, 332
translation invariance, 333
- Collateralized debt obligation (CDO),
 266
 lower attachment point, 266
 upper attachment point, 266
- Collateralized exposure, 289
- Component VaR, 336
- Conditional statements, 14
 if-then-else statement, 14
 multi-lined form, 14
 single-lined form, 14
 select-case statement, 15
- Conditional value-at-risk (CVaR), 333
- Const* statement, 10
- Contract-level exposure, 287
- Control variates, 58
- Copula, 273
 t-copula, 276
 dependence structure, 273
 Gaussian copula, 274
 marginal behavior, 273
 Sklar's theorem, 273
- Counterparty credit risk, 286
- Counterparty-level exposure, 288
 call period, 289
 collateralized exposure, 289
 contract-level exposure, 287
 cure period, 289
 default unwind date, 289
 margin agreement, 289
 margin period of risk, 289
 netting agreement, 288
 non-collateralized exposure, 289
- Credit derivatives
 basket default swap, 280
 collateralized debt obligation (CDO),
 266
 default correlation, 261
 first-to-default swap, 280
 Merton model, 256
 Vasicek single-factor model, 260
- Credit value adjustment (CVA), 290
 right-way risk, 298
 sensitivity to credit spreads, 292
 sensitivity to underlying market
 variables, 292
- term structure of credit spreads, 291
- unconditional risk-neutral probability of
 default, 291
 wrong-way risk, 298
- Cubic spline discount function, 185
- Cubic spline interpolation, 179
- Cure period, 289
- Currency-translated options, 116
- Damped Fourier transform, 136
- Data input and output, 14
- Declaration of Constants, 10
- Declaration of Variables, 8
 date data type, 9
 numeric data type, 9
 Booleans, 9
 byte, 9
 decimal, 9
 double, 9
 integer, 9
 long, 9
 single, 9
 string data type, 9
 variant data type, 9
 empty, 9
 error code, 9
 null, 9
- Default correlation, 261
- Default leg, 280
- Default unwind date, 289
- Delta hedging, 345
- Delta-gamma approximation, 317
- Delta-normal approximation, 314
- Differential evolution (DE), 139
- Digital call option, 374
- Dirty price, 183
- Discontinuous payoffs, 374
- Discounted loss, 290
- Downhill Simplex, 139
- Early redemption request, 94
- Empirical martingale correction, 149
- Empirical martingale simulation (EMS),
 87

- Equity linked note (ELN), 72
Euler discretization, 361
Euler scheme, 42, 144
Exposure at default, 262
Extended Vasicek model, 195
- Factor sensitivity, 261
Fast Fourier transform, 137
Filtration switching formula, 299
Finite difference approximation, 350
 central difference estimator, 352
 central difference scheme, 351
 forward difference estimator, 351
 forward difference scheme, 351
- First passage time, 259
First-to-default swap, 280
Floorlet, 222, 224
Fokker-Plank equation, 124
Forward measure, 241
Forward rate, 192
Forward rate curve, 192
Forward swap rate, 225
Fourier inversion operator, 137
Function procedure, 19
FX accumulator, 95
 CITIC Pacific Limited, 95
 sensitivity analysis, 103
 valuation, 97
 with target redemption, 100
 with target redemption and barrier rate, 101
 without knock-out feature, 99
- Gamma neutral, 345
GARCH option pricing model, 156
 bumping, 162
 estimation, 157
 generalized autoregressive conditional, heteroskedastic (GARCH), 156
Ljung-Box test, 159
locally risk-neutral valuation relationship (LRNVR), 161
long-run average variance, 157
maximum likelihood estimation (MLE), 157
mean reversion level, 157
risk-neutral process, 161
standardized residuals, 159
stationarity, 157
- variance targeting, 159
volatility clustering, 157
Gaussian copula, 274
Generalized error distribution, 307
Geometric Brownian motion (GBM), 73
Girsanov's theorem, 48
Greeks
 binomial tree, 348
 closed-form solutions, 346
 delta, 343
 delta hedging, 345
 discontinuous payoffs, 374
 finite difference approximation, 350
 gamma, 344
 gamma neutral, 345
 Greeks of a portfolio, 344
 likelihood ratio method, 355
 option elasticity, 345
 pathwise derivative estimates, 360
 psi, 345
 rho, 344
 speed, 345
 theta, 344
 vanna, 345
 Vega, 344
 Vomma, 345
- Hazard rate, 279
Heston model, 136
 calibration, 139
 correlation between the stock and variance, 141
 implementation, 138
 initial variance, 141
 long-term average variance, 141
 mean-reverting speed, 141
 parameter bounds, 141
 parameter constraint, 141
 quadratic-exponential discretization scheme, 143
 volatility of variance, 141
- Historical simulation, 319
Historical volatility, 51
Holding period adjustment, 312
Hull and White's formula, 226
Hull-White model, 194
 calibration, 197
 mean-reverting speed, 195
 volatility, 195

410 *SUBJECT INDEX*

- Implied binomial tree, 130
Implied volatility, 51
Importance sampling, 65
Incremental VaR, 336
Intensity process, 279
Interest rate range accrual note, 207
Interest rate swap, 224
inverse Fourier transform, 137, 166
Itô's process, 39
 discretization methods, 41
 Euler scheme, 42
 Milstein scheme, 42
 Ito's lemma, 40
 SDE, 39
 stochastic differential equation, 39
- Jump-diffusion model
 Bayesian framework, 171
 Gibbs sampling, 173
 simulation, 167
- Kolmogorov equation, 124
- Levenberg-Marquardt, 139
LIBOR market model, 219
 Black forward rate volatility, 223
 Black swap rate volatility, 225
 caplet, 222
 floorlet, 222
 forward measure, 241
 Hull and White's formula, 226
 predictor-corrector method, 242
 Rebonato's formula, 226
- Life insurance contract, 105
 bonus payment, 106
 expected future life, 107
 linear smoothing scheme, 106
 mortality table, 107
 reserve, 106
 smoothing mechanism, 106
- Likelihood ratio method, 355
 likelihood ratio method estimator, 356
 score, 356
 score function, 356
- Ljung-Box test, 159
- Local volatility model, 122
 estimation, 123
 implied binomial tree, 130
 simulation, 123
- Loops, 16
 Do loop, 16
 Do Until loop, 17
 Do While loop, 17
 For-Next loop, 16
- Loss given default, 262
Lower attachment point, 266
- Malliavin calculus, 374
Margin agreement, 289
Margin period of risk, 289
Marginal VaR, 336
Mark to market (MTM), 53
Martingale, 34
 continuous martingale, 35
 discrete martingale, 35
- Memoryless property, 162
- Merton model, 256
 probability of default, 257
- Milstein scheme, 42
- Moody's KMV, 258
- Multi-asset instruments, 108
 Cholesky decomposition, 109
 multi-asset range accrual equity linked note, 112
 multidimensional geometric Brownian motion, 108
 multivariate normal random vector, 109
- Multi-asset range accrual equity linked note, 112
- Multivariable declaration, 10
- Multidimensional geometric Brownian motion, 108
- Multiple linear regression, 23
- Natural cubic spline, 180
Nelson-Siegel model, 182
Netting agreement, 288
Non-collateralized exposure, 289
- Operators, 11
 assignment operators, 11
 equal sign, 11
 comparative operators, 11
 equal to, 11
 greater than, 11
 greater than or equal to, 11
 less than, 11
 less than or equal to, 11
 not equal to, 11

- Logical operators, 11
And, 11
Eqv, 11
Imp, 11
Not, 11
Or, 11
Xor, 11
- Mathematical operators, 11
addition, 11
division, 11
exponentiation, 11
multiplication, 11
subtraction, 11
- Option elasticity, 345
- Outstanding notional amount, 267
- Over-the-counter OTC, 89
- Parametric VaR, 305
heavy-tailed distribution, 307
t-distribution, 311
generalized error distribution, 307
holding period adjustment, 312
multiple assets, 306
normal VaR, 305
- Pathwise derivative estimates, 360
- Payer swaption, 225
- Portfolio loss distribution, 261
- Portfolio Replication, 72
- Predictor-corrector method, 242
- Premium leg, 280
- Probability of default, 257
- Proxy approach, 260
- Pseudo-random, 25
- Random number generation, 25
acceptance-rejection method, 26
Box-Muller transform, 27
inverse transform, 25
randomize, 25
rnd, 25
- Range accrual note (RAN), 89
European, 89
- Rebonato's formula, 226
- Receiver swaption, 225
- Regression spline, 192
- Relative VaR, 304
- Right-way risk, 298
- Risk measure, 304
- Risk-neutral probability, 35
- Risk-neutral valuation, 258
- Risk reversal (RR), 152
- Short rate, 195
- Sklar's theorem, 273
- Stratified sampling, 61
- Sub procedure, 19
- Survival function, 279
- Swap market model, 219
- Swaption formula, 224
- t*-copula, 276
- t*-distribution, 311
- Target redemption note, 206
- Term structure of credit spreads, 291
- Tranche, 266
- Tranche premium, 267
- UDTs, 28
- Unconditional risk-neutral probability of default, 291
- Upper attachment point, 266
- User-defined data types, 11
- Value at Risk, VaR, 54, 304
absolute VaR, 304
bootstrapping, 321
historical simulation, 319
Monte Carlo simulation, 323
parametric VaR, 305
percentile, 304
quantile, 304
relative VaR, 304
risk measure, 304
- Value-at-Risk
Gibbs sampling, 327
- Variance reduction techniques, 55
antithetic variables, 56
control variates, 58
importance sampling, 65
stratified sampling, 61
- Vasicek, 260
- Vasicek single-factor model, 260
exposure at default, 262
factor sensitivity, 261
loss given default, 262
portfolio loss distribution, 261

412 *SUBJECT INDEX*

- VBA, 1
VBA Built-in Functions, 22
 Abs, 23
 Atn, 23
 Cos, 23
 Exp, 23
 Int, 23
 Log, 23
 MInverse, 25
 MMult, 25
 Sgn, 23
 Sin, 23
 Sqr, 23
 Tan, 23
 Transpose, 25
 UBound, 25
 Round, 23
VBA
 command button, 5
 comment, 5
 macro, 2
 macro recorder, 3
 module, 2
 project, 2
Visual Basic Editor, 2
Visual Basic for Application, 1
Vega-weighted butterfly, 152
Vibrato Monte Carlo simulation, 376
Volatility, 50
Volatility clustering, 53
Volatility smile, 52
Volatility surface, 52
Volatility
 historical volatility, 51
 implied volatility, 51
 volatility clustering, 53
 volatility smile, 52
 volatility surface, 52
Wrong-way risk, 298
Yield curve, 179
 clamped cubic spline, 180
 clean price, 183
 cubic spline discount function, 185
 cubic spline interpolation, 179
 dirty price, 183
 natural cubic spline, 180
 Nelson-Siegel model, 182
 zero rate, 179
Zero rate, 179