

Policy Development

Objectives. A client was interested in developing an Internet based futures market that traded sports assets in order to allow investors to hedge their risk that originated from sports outcomes. The client needed an analysis of the financial size and sources of risk in the market in order to determine potential market size, and to show regulatory authorities that there was a need for the market.

Challenges & Methodologies. Measuring the size of a market is one thing, but measuring the size and sources of risk in the market is a much more complex problem. A further issue was to separate systematic risk (that could be predictably hedged) from idiosyncratic risk (that would be difficult to create a hedging instrument).

Risk was measured using variation over time and across similar situations (two methods in which to control for changes in the underlying factors that affect financial success). Additionally, many case studies were examined to determine the ex ante risk for that situation. Case study results were then used to estimate the total size of risk in the market by aggregating individual results using numerous controls for heterogeneity.

Outcomes. A white paper was submitted to the client to be used for market size determination and as part of the package presented to the regulatory bodies. The client was very happy with the estimation of the size of the market for risk, and utilized the results of the analysis in its presentation to regulatory authorities.