

## **Mispricing of Risk & Market Failure**

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The current Global Economic crisis is one of the most severe financial crises in terms of reach and the impact. The crisis has raised a number of issues with respect to the pricing of risk, market functioning and their relations thereof. The root cause of the crisis was the under pricing of risks as the financial sector interacted with the non financial sector.

The second important culprit is Asymmetric leverage & the systemic risk, which were reflected in a large volume of the derivative contracts that were contracted in OTC market. The market participants did not understand the complexity of a number of recently launched innovative derivative contracts in terms of risk characteristics. This led to the mispricing of risk, which got reflected in the prices of the underlying financial assets. Mispricing in the financial markets has wider and deeper impact on the real economy. It is widely believed that market failure is an outcome of mispricing of risk and assets. Market failure is generally attributed to asymmetric information, Imperfect market structure, problems of Moral hazard and principal- Agent conflicts. In this paper, we have examined in details about the reasons of mispricing of risks & assets in markets and also the relationship between the reasons of market failure and Mispricing.

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