



LET'S TALK ABOUT...

FINANCIAL LEXICON EDITED BY THE SWISS ASSOCIATION OF ASSET MANAGERS

Sistemic

The term is not to be confused with “systematic”, which denotes something orderly, precise, recurring on a regular basis. The former instead applies to an element which spreads from a part to the whole system. The concept comes from biology and medicine, as refers to diseases which, after affecting just an organ, develop through the whole body. Whichever the domain, a shock or a factor may be called systemic if it breaks a condition of equilibrium and negatively influences other areas. Today it mainly refers to the economic and financial sectors: “systemic crisis” and “systemic risk” relate to chains of events which may take to the collapse not just of the financial market, but the whole economic system itself. Obviously risks are always present in the market: rate risk, default risk, counterpart risk, that is the impossibility to clear a transaction, liquidity risk, volatility risk, exchange rate risk and so on. Against many of them it is possible to hedge through valid strategies and specific instruments, as well as with a careful portfolio diversification. But if the turmoil is deep and a cascade effect involves most institutions and counterparts, the protection becomes much more difficult and even the diversification is of no help. Mutual interactions cause the collapse, fuel panic, sudden withdraws from banks, huge selling of securities, so taking to illiquidity and defaults. In such a scenario, very few investments may withstand to the storm. The strict and wide network of correlations among financial institutions may be a point of weakness: should one of them fall, particularly if a big one is involved, dramatic consequences may spread to the whole environment, and today just that is the main worry of politicians, central bankers, economists and investors of course. Two new concepts have thus emerged, which often stand out in the financial news: TBTF-Too Big to Fail, meaning those “key” financial bodies whose fall might afflict the whole system (e.g. a big bank), and TICTF-Too Interconnected to Fail: they are to be rescued and made able to survive, anyway. - *GLT*

The views expressed are not necessarily those of the Swiss Association of Asset Managers
