The Ellsberg paradox seems to represent a significant departure from expected utility maximization. The theory of ambiguity aversion (or uncertainty aversion) has developed largely in response to the paradox. The goal of this session is to provide you a gateway both to the theoretical tools related to ambiguity aversion and to applications in finance. In the session, we will only be able to touch on a couple of specific applications. A number of other recent applications in finance are listed at the end of this document.

The session will cover the following topics:

- Ellsberg paradox and multiple priors.

- Some common theoretical approaches to ambiguity aversion.
  - Maxmin expected utility, smooth ambiguity aversion, multiplier preferences.

- Some applications of ambiguity aversion in finance.
  - Non-participation in financial markets, security design.

Readings for the session

We will focus on the readings marked (*). The paper titles embed links to the papers.

Ellsberg paradox and theoretical approaches to ambiguity aversion


Non-participation in financial markets


Security design


Idiosyncratic sample of other applications of ambiguity aversion


