A Theoretical and Empirical Comparison of Systemic Risk Measures

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Abstract

We propose a theoretical and empirical comparison of several popular systemic risk measures that can be estimated from public data: Marginal Expected Shortfall (MES), Systemic Risk Measure (SRISK), and Delta Conditional Value at Risk (CoVaR). First, we assume that the time-varying correlation completely captures the dependence between the firm and market returns and we show that (i) MES corresponds to the product of the market expected shortfall (market tail risk) and the firm beta (firm systematic risk) and that (ii) CoVaR corresponds to the product of the firm VaR (firm tail risk) and the linear projection coefficient of the market return on the firm return. We also derive (iii) conditions under which different systemic risk measures lead to consistent rankings of systemically important financial institutions. Second, we relax our fundamental assumption and empirically validate our theoretical findings for a sample of US financial institutions. Collectively, our results indicate that the best systemic risk measure very much depends on the considered objective: MES helps little to rank systemically important financial institutions, whereas CoVaR brings limited added value over and above VaR to forecast systemic risk. Overall, SRISK offers the best compromise between the too-big-to-fail and too-interconnected-to-fail dimensions.

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1 Introduction

The recent financial crisis has fostered extensive research on systemic risk, either on its definition, measurement, or regulation.\(^1\) Of particular interest is the identification of the financial institutions that contribute the most to the overall risk of the financial system—the so-called Systemically Important Financial Institutions (SIFIs). The following definition has been proposed by the Financial Stability Board (2011): “SIFIs are financial institutions whose distress or disorderly failure, because of their size, complexity and systemic interconnectedness, would cause significant disruption to the wider financial system and economic activity.” As they pose a major threat to the system, regulators and policymakers from around the world have called for tighter supervision, extra capital requirements, and liquidity buffers for SIFIs (Financial Stability Board, 2011). This recent shift from focusing on single institutions’ risk in isolation (micro-prudential approach) to focusing on a firm contribution to system-wide risk (macro-prudential approach) is at the heart of the Basel 3 regulatory framework.

In practice, measuring the contribution of a given firm to the overall risk of the system is challenging. A first approach, called the supervisory approach, relies on firm-specific information concerning size, leverage, liquidity, interconnectedness, complexity, and substitutability. This approach is both quantitative and qualitative and can rely on proprietary data provided by the financial institution to the regulator (Financial Stability Board – International Monetary Fund – Bank for International Settlements, 2009, Basel Committee on Banking Supervision, 2011, Financial Stability Oversight Council, 2012, and Greenwood, Landier and Thesmar, 2012).

A second approach only relies on publicly available market data, such as stock or asset returns, option prices, or CDS spreads. Three prominent examples of such measures are the Marginal Expected Shortfall (MES) of Acharya et al. (2010), the Systemic Risk Measure (SRISK) of Brownlees and Engle (2011) and Acharya, Engle et Richardson (2012), and the Delta Conditional Value-at-Risk (\(\Delta\text{CoVaR}\)) of Adrian and Brunnermeier (2011).\(^2\) Very few crisis-related papers made a higher impact both in the academia and on the regulatory debate than this series of papers. Over the past four years, dozens of research papers have discussed, implemented, and sometimes generalized these systemic risk measures.\(^3\) They are nowadays regularly discussed in the financial press and other media. Some have been specifically recommended by Fed Chairman Bernanke, while others are computed in real-time for hundreds of financial institutions in the world and publicly disclosed

\(^1\) Bisias et al. (2012) survey 31 measures of systemic risk in the economic and finance literature.

\(^2\) Other related papers include Elsinger et al. (2005), Huang et al. (2009), Gauthier et al. (2009), Manganelli et al. (2010), Drehmann and Tarashev (2011), Kritzman et al. (2011), and Billio et al. (2012).

These three systemic risk measures have some nice economic interpretation. First, the MES corresponds to a firm’s expected equity loss when the market falls below a certain threshold over a given horizon, namely a 2% market drop over 1 day for the short-run MES, and a 40% market drop over six months for the long-run MES (LRMES). The basic idea is that the banks with the highest MES contribute the most to market declines; thus, these banks are the greatest drivers of systemic risk. Second, the SRISK measures the expected capital shortfall of an institution conditional on a crisis occurring. The intuition is that the firm with the largest capital shortfall will contribute the most to a crisis and therefore should be considered the most systemically risky. Third, the CoVaR corresponds to the VaR of the financial system conditional on a specific event affecting a given firm. The contribution of a firm to systemic risk ($\Delta$CoVaR) is the difference between its CoVaR when the firm is, or is not, in financial distress.

In this paper, we propose a theoretical and empirical comparison of the major market-data based systemic risk measures (MES, SRISK, and $\Delta$CoVaR) in a common framework. There are two main steps in our analysis. First, we assume that the dependence between firm and market returns is completely captured by the time-varying correlation. Under this assumption, we show that (i) MES corresponds to the product of the market’s expected shortfall (market tail risk) and the firm beta (firm systematic risk), and that (ii) $\Delta$CoVaR corresponds to the product of the firm VaR (firm tail risk) and the linear projection coefficient of the market return on the firm return. Furthermore, we derive (iii) conditions under which different systemic risk measures would lead to consistent rankings of financial institutions. Second, we relax the assumption that the dependence between firm and market returns is fully captured by time-varying correlation. Because of potential nonlinear dependencies, there is no closed form for the considered risk measures anymore. Hence, we propose an empirical comparison for a panel of 94 top US financial institutions over the period January 2000 - December 2010. For each measure, we propose two types of systemic risk analyses: a ranking of firms at one point in time (cross-sectional analysis) and a forecasting analysis for a given firm (time-series analysis).

Our empirical analysis delivers three main results. First, we show that different risk measures lead to identifying different SIFIs. On most days, there is not a single institution simultaneously identified as a top 10 SIFI by all three measures. Second, there is a strong empirical relationship between MES and firm beta, which implies that systemic risk rankings of financial institutions based on MES mirror rankings obtained by sorting firms on betas. Third, the empirical $\Delta$CoVaR
of a firm is strongly correlated with its VaR. Hence, $\Delta$CoVaR brings limited added value over and above VaR to forecast systemic risk. The main take-away of our study is that the best systemic risk measure very much depends on the considered objective and that SRISK offers the best compromise between the too-big-to-fail and too-interconnected-to-fail dimensions.

Our paper makes several contributions to the academic literature on systemic risk. This paper is, to the best of our knowledge, the first to derive all the major market-data based systemic risk measures within a common framework. For all systemic risk measures, we derive some analytical forms that allow us to uncover the theoretical link between systemic risk and standard risks (systematic risk, tail risk, correlation, and beta), as well as firm characteristics (leverage and market capitalization). These expressions permit to quantify the added value of each systemic risk measure, both theoretically and empirically. Our conclusions not only have academic value, they also contribute to the current debate about enhanced systemic risk regulation in telling which measure should be used – and when they should not be.

The rest of the paper is organized as follows. Section 2 provides the general definitions of the three systemic risk measures and presents the common framework used for the comparison. Section 3 proposes a theoretical analysis of the MES, SRISK, and $\Delta$CoVaR under the assumption that the dependence between firm and market return is completely captured by the time-varying correlation. In Section 4, we describe the data and present the main empirical findings. Section 5 summarizes and concludes.

2 Methodology

2.1 Definitions

In this section, we provide a formal definition for the considered systemic risk measures. We consider $N$ firms and denote $r_{it}$ the return of firm $i$ at time $t$. Similarly, the market return is the value-weighted average of all firm returns, $r_{mt} = \frac{\sum_{i=1}^{N} w_{it} r_{it}}{\sum_{i=1}^{N} w_{it}}$, where $w_{it}$ denotes the relative market capitalization of firm $i$.

MES

First, the MES measures the marginal contribution of an institution $i$ to systemic risk, as measured by the Expected Shortfall (ES) of the system. Originally proposed by Acharya et al. (2010), the MES was recently extended to a conditional version by Brownlees and Engle (2011). By definition, the ES at the $\alpha\%$ level is the expected return in the worst $\alpha\%$ of the cases, but it can be extended to the general case, in which the returns exceed a given threshold $C$. Formally,
the conditional ES of the system is defined as:

\[
    ES_{mt}(C) = E_{t-1}(r_{mt} \mid r_{mt} < C) = \sum_{i=1}^{N} w_{it} E_{t-1}(r_{it} \mid r_{mt} < C).
\]  

(1)

Then, the MES corresponds to the partial derivative of the system ES with respect to the weight of firm \(i\) in the economy (Scaillet, 2004).

\[
    MES_{it}(C) = \frac{\partial ES_{mt}(C)}{\partial w_{it}} = E_{t-1}(r_{it} \mid r_{mt} < C).
\]  

(2)

The MES can be viewed as a natural extension of the concept of marginal VaR proposed by Jorion (2007) to the ES, which is a coherent risk measure (see Artzner et al., 1999). It measures the increase in the risk of the system (measured by the ES) induced by a marginal increase in the weight of firm \(i\) in the system. The higher the firm MES (in absolute value), the higher the individual contribution of the firm to the risk of the financial system.

**SRISK**

Second, the SRISK measure proposed by Brownlees and Engle (2011) and Acharya, Engle and Richardson (2012) extends the MES in order to take into account both the liabilities and the size of the financial institution. The SRISK corresponds to the expected capital shortfall of a given financial institution, conditional on a crisis affecting the whole financial system. In this perspective, the firms with the largest capital shortfall are assumed to be the greatest contributors to the crisis and are the institutions considered most systemically risky. The SRISK is defined as:

\[
    SRISK_{it} = \max \left[0 ; k (D_{it} - (1 - k) W_{it} (1 - LRMES_{it})) \right],
\]  

(3)

where \(k\) is the prudential capital ratio, \(D_{it}\) is the quarterly book value of total liabilities, and \(W_{it}\) is the daily market capitalization or market value of equity. Note that the SRISK, which is positive by convention, is an increasing function of the liabilities and a decreasing function of the market capitalization. Then, the SRISK can be viewed as an implicit increasing function of the quasi-leverage (leverage thereafter) defined by the ratio of the book value of total liabilities to the market capitalization.

This systemic risk measure also considers the interconnection of a firm with the rest of the system through the LRMES. The LRMES denotes the long-run marginal expected shortfall: it

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5. We follow the original notations of the different authors: ES, MES, VaR, CoVaR and ΔCoVaR are typically negative. The only exception is the SRISK which is typically a positive number when a firm suffers from a capital shortage.

6. To simplify the notation, we use \(MES_{it}\) (respectively \(ES_{it}\)) instead of \(MES_{i,t;t-1}\) (respectively \(ES_{i,t;t-1}\)), but it should be understood as the conditional MES (respectively ES) computed at time \(t\) given the information available at time \(t-1\).

7. Brownlees and Engle (2011) define a short-run SRISK that is defined over one day: \(SRISK_{it}^{SR} = \max \left[0 ; k D_{it} - (1 - k) W_{it} MES_{it} \right]\). In this paper, we focus on the long-run version of the SRISK because as it is the standard measure (see Stern-NYU’s V-Lab).
corresponds to the expected drop in equity value the firm would experiment should the market fall by more than a given threshold within the next six months. Acharya, Engle and Richardson (2012) propose to approximate it using the daily MES (defined for a threshold \(C\) equal to 2%) as
\[
LRMES_{it} \simeq 1 - \exp(18 \times MES_{it}).
\]

\(\Delta\text{CoVaR}\)

The third systemic risk measure is the \(\Delta\text{CoVaR}\) of Adrian and Brunnermeier (2011). This measure is based on the concept of Value-at-Risk, denoted \(\text{VaR}(\alpha)\), which is the maximum dollar loss within the \(\alpha\%-\text{confidence interval}\) (see Jorion, 2007). Then, the CoVaR corresponds to the VaR of the market returns obtained conditional on some event \(C(r_{it})\) observed for firm \(i\):
\[
\Pr\left( r_{mt} \leq \text{CoVaR}_{t}^{m|r_{it}=C(r_{it})} \Big| C(r_{it}) \right) = \alpha. \tag{4}
\]
The \(\Delta\text{CoVaR}\) of firm \(i\) is then defined as the difference between the VaR of the financial system conditional on this particular firm being in financial distress and the VaR of the financial system conditional on firm \(i\) being in its median state. To define the distress of a financial institution, various definitions of \(C(r_{it})\) can be considered. Because they use a quantile regression approach, Adrian and Brunnermeier (2011) consider a situation in which the loss is precisely equal to its VaR:
\[
\Delta\text{CoVaR}_{it} (\alpha) = \text{CoVaR}_{t}^{m|r_{it}=\text{VaR}_{it}(\alpha)} - \text{CoVaR}_{t}^{m|r_{it}=\text{Median}(r_{it})}. \tag{5}
\]
A more general approach would consist in defining the financial distress of firm \(i\) as a situation in which the losses exceed its VaR (see Girardi and Ergun, 2011):
\[
\Delta\text{CoVaR}_{it} (\alpha) = \text{CoVaR}_{t}^{m|r_{it}\leq\text{VaR}_{it}(\alpha)} - \text{CoVaR}_{t}^{m|r_{it}=\text{Median}(r_{it})}. \tag{6}
\]

2.2 A Common Framework

The different systemic risk measures analyzed in this paper have been developed within very different frameworks. For instance, Adrian and Brunnermeier (2011) assume tail dependences and use a quantile regression approach to estimate the CoVaR and the \(\Delta\text{CoVaR}\). Differently, Brownlees and Engle (2011) model time-varying linear dependencies and use a multivariate GARCH-DCC model to fit the MES. Hence, their direct comparison is not straightforward since some empirical differences may be due to the estimation methods. In contrast, we derive all these risk measures within a unified theoretical framework to provide a level playing field. Formally, we consider the linear market model of Brownlees and Engle (2011):
The main features of this framework are the following. First, the return of firm $i$ depends on the market return $r_{mt}$ and on an orthogonal firm-specific component $\xi_{it}$. Second, the conditional standard deviations $\sigma_{it}$ and $\sigma_{mt}$, and the conditional correlation $\rho_{it}$ are supposed to be time-varying. Third, we assume that the process $\nu_t = (\varepsilon_{mt}, \xi_{it})'$ is i.i.d. and satisfies $\mathbb{E}(\nu_t) = 0$ and $\mathbb{E}(\nu_t \nu_t') = I_2$, a two-by-two identity matrix. Fourth, no particular assumption is made about the bivariate distribution $D$ of the standardized innovations, which is assumed to be unknown. In this very flexible framework, there is only one additional assumption we need to make to be able to derive a theoretical expression for MES, SRISK, and $\Delta$CoVaR:

**Assumption A1:** We assume that the dependence between firm and market returns is fully captured by the time-varying conditional correlations $\rho_{it}$.

This assumption means that the standardized innovations $\varepsilon_{mt}$ and $\xi_{it}$ are assumed to be independently distributed at time $t$. This is a rather mild assumption that is made, for instance, in the CAPM. In particular, we do not impose anything about the joint distribution of the returns (e.g., normal, Student’s $t$). However, if there exists some nonlinear dependencies between firm and market returns, like tail dependence for instance, this assumption is violated. In order to generalize our conclusion, we will relax the A1 assumption in Section 4.

### 3 A Theoretical Comparison of Systemic Risk Measures

#### 3.1 MES

Given Equations (7) to (9), the MES can be expressed as a function of the firm return volatility, its correlation with the market return, and the comovement of the tail of the distribution:

$$
MES_{it}(C) = \sigma_{it} \rho_{it} \mathbb{E}_{t-1} \left( \varepsilon_{mt} \mid \varepsilon_{mt} < \frac{C}{\sigma_{mt}} \right) \\
+ \sigma_{it} \sqrt{1 - \rho_{it}^2} \mathbb{E}_{t-1} \left( \xi_{it} \mid \varepsilon_{mt} < \frac{C}{\sigma_{mt}} \right).
$$

MES is expressed as a weighted function of the tail expectation of the standardized market residual and the tail expectation of the standardized idiosyncratic firm residual. Under A1, the dependence between market and firm returns is completely captured by their correlation and, in turn, the conditional expectation $\mathbb{E}_{t-1} \left( \xi_{it} \mid \varepsilon_{mt} < \frac{C}{\sigma_{mt}} \right)$ is null. In order to facilitate the comparison with the $\Delta$CoVaR, we consider a threshold $C$ equal to the conditional VaR of the market return, which is defined as $\Pr [r_{mt} < VaR_{mt}(\alpha)] = \alpha$. 


Proposition 1  Under the A1 assumption, the MES of a given financial institution $i$ is proportional to its systematic risk, as measured by its time-varying beta. The proportionality coefficient is the conditional expected shortfall of the market:

$$MES_{it}(\alpha) = \beta_{it} \cdot ES_{mt}(\alpha),$$  \hfill (11)

where $\beta_{it} = \text{cov}(r_{it}, r_{mt}) / \text{var}(r_{mt}) = \rho_{it} \sigma_{it} / \sigma_{mt}$ denotes the time-varying beta of firm $i$ and $ES_{mt}(\alpha) = \mathbb{E}_{t-1}(r_{mt} \mid r_{mt} < \text{VaR}_{mt}(\alpha))$ is the conditional expected shortfall of the market.

The proof of Proposition 1 is in the Appendix A.\textsuperscript{9} This proposition has two main implications. First, on a given date, the systemic risk ranking of financial institutions based on MES (in absolute value) is strictly equivalent to the ranking that would be produced by sorting firms according to their betas. Indeed, since the system ES is not firm-specific, the greater the sensitivity of the return of a firm with respect to the market return, the more systemically-risky the firm is. Consequently, under A1, identifying SIFIs using MES is equivalent to considering the financial institutions with the highest betas. Second, for a given financial institution, the time profile of its systemic risk measured by its MES may be different from the evolution of its systematic risk measured by its conditional beta. Since the market ES may vary over time, forecasting the systemic risk of firm $i$ may not be sufficient to forecast the future evolution of its contribution to systemic risk.

Note that Proposition 1 is robust with respect to the choice of the threshold $C$ that determines the system crisis. For any threshold $C \in \mathbb{R}$, the MES is still proportional to the time-varying beta (see the proof in Appendix A). The only difference is that the proportionality coefficient, $\mathbb{E}_{t-1}(r_{mt} \mid r_{mt} < C)$, is different from the system ES if $C \neq \text{VaR}_{mt}(\alpha)$. However, this coefficient remains common to all firms.

3.2 SRISK

We show in Section 2 that SRISK is a linear function of the MES. As a result, a corollary of Proposition 1 is that SRISK can be expressed as a linear function of beta, liabilities, and market capitalization:

$$SRISK_{it} \simeq \max [0 \ ; \ k \ D_{it} - (1 - k) \ W_{it} \ \exp (18 \times \beta_{it} \times ES_{mt}(\alpha))].$$  \hfill (12)

Under the A1 assumption, the SRISK is an increasing function of the systematic risk, as measured by the conditional beta. However, unlike with MES, systemic-risk rankings based on SRISK are

\textsuperscript{9}For some particular distributions, both the ES and the MES of the market returns can be expressed in closed form. For instance, if $\varepsilon_{mt}$ follows a standard normal distribution, then $\text{VaR}_{mt}(\alpha) = \sigma_{mt} \Phi^{-1}(\alpha)$ and $ES_{mt}(\alpha) = -\sigma_{mt} \phi(\Phi^{-1}(\alpha)) / \alpha$, where $\phi(\cdot)$ and $\Phi(\cdot)$, respectively, denote the standard normal probability distribution function and cumulative distribution function. Therefore, $MES_{it}(\alpha) = -\beta_{it} \sigma_{it} \lambda(\Phi^{-1}(\alpha))$, where $\lambda(z) = \phi(z) / \Phi(z)$ denotes the Mills ratio.
not equivalent to rankings based on betas. SRISK-based rankings also depend on the liabilities and on the market capitalization of the financial institution.\(^\text{10}\) Recall that the system \(ES\) is typically a negative number, \(ES_{mt}(\alpha) < 0\). Consequently, when \(\beta_{it} > 0\), SRISK is a decreasing function of the market capitalization. Then, if we consider a given level of liabilities, SRISK increases with the leverage.

### 3.3 \(\Delta\text{CoVaR}\)

Under A1, it is possible to express \(\Delta\text{CoVaR}\), defined for a conditioning event \(C(r_{it}) : r_{it} = \text{VaR}_{it}(\alpha)\), as a function of the conditional correlations and volatilities. Given Equations (7) to (9), we obtain the following result:

**Proposition 2** Under the A1 assumption, the \(\Delta\text{CoVaR}\) of a given financial institution \(i\) is proportional to its tail risk, as measured by its VaR. The proportionality coefficient corresponds to the linear projection coefficient of the market return on the firm return.

\[
\Delta\text{CoVaR}_{it}(\alpha) = \gamma_{it} [\text{VaR}_{it}(\alpha) - \text{VaR}_{it}(0.5)] ,
\]

where \(\gamma_{it} = \rho_{it}\sigma_{mt}/\sigma_{it}\) and \(\text{VaR}_{it}(\alpha)\) denotes the VaR(\(\alpha\)) of the firm return. If the marginal distribution of the returns is symmetric around zero, \(\Delta\text{CoVaR}\) is strictly proportional to VaR:

\[
\Delta\text{CoVaR}_{it}(\alpha) = \gamma_{it} \text{VaR}_{it}(\alpha) .
\]

The proof of Proposition 2 is in the Appendix B.\(^\text{11}\) The fact that the proportionality coefficient between \(\Delta\text{CoVaR}\) and VaR is firm-specific has some strong implications. Let us, for instance, consider two financial institutions \(i\) and \(j\), with \(\text{VaR}_{it} < \text{VaR}_{jt}\). Given the relative correlations between the returns of firms \(i\) and \(j\) with the market return, which are denoted \(\rho_{it}\) and \(\rho_{jt}\), and the volatilities \(\sigma_{it}\) and \(\sigma_{jt}\), we could observe \(\Delta\text{CoVaR}_{it} < \Delta\text{CoVaR}_{jt}\) or \(\Delta\text{CoVaR}_{it} > \Delta\text{CoVaR}_{jt}\). This means that the most risky institution in terms of VaR is not necessarily the most systemically risky institution. In other words, on a given date, the systemic risk ranking over \(N\) financial institutions based on \(\Delta\text{CoVaR}\) is not equivalent to a VaR-based ranking. In that sense, \(\Delta\text{CoVaR}\) is not equivalent to VaR as already pointed out by Adrian and Brunnermeier (2011) in their Figure 1 (page 4). Indeed, they report a weak relationship between an institution’s risk in isolation, measured by its VaR, and its contribution to system risk, measured by its \(\Delta\text{CoVaR}\). However, for

\(^{10}\)Given Equation 8, the market value of the financial institution can be expressed as a function of the number of stocks at time \(t\), denoted \(N_{it}\), and the sequence of past volatilities, correlations and innovations: \(W_{it} = N_{it} \times \exp \left[ \sum_{t=0}^{t} \left( \sigma_{it}\rho_{it}\xi_{mt} + \sigma_{it}\sqrt{1 - \rho_{it}^2}\xi_{mt} \right) + \log(P_{i0}) \right]\) where \(P_{i0}\) denotes the initial price of stock \(i\).

\(^{11}\)Adrian and Brunnermeier (2011) derive the CoVaR and the \(\Delta\text{CoVaR}\) under the normality assumption. They show that \(\Delta\text{CoVaR}_{it}(\alpha) = \rho_{it}\sigma_{mt}\Phi^{-1}(\alpha)\) or equivalently \(\gamma_{it}\sigma_{it}\Phi^{-1}(\alpha)\), where \(\sigma_{it}\Phi^{-1}(\alpha)\) denotes the VaR(\(\alpha\)) of the firm.
a given institution, $\Delta \text{CoVaR}$ is proportional to VaR. Consequently, forecasting the future evolution of the contribution of firm $i$ to systemic risk is equivalent to forecasting its risk in isolation.

It is important to notice that Proposition 2 is robust with respect to the choice of a constant (unconditional) or time-varying (conditional) variance/covariance framework. It is also robust with respect to the form of the dependence between returns. Under A1, $\Delta \text{CoVaR}$ is a function of the linear dependence between the returns, which is measured by $\gamma_{it}$. As we will see in the next section, Adrian and Brunnermeier (2011) estimate the $\Delta \text{CoVaR}$ through quantile regression in order to capture the potential non-linear dependencies between the returns. But even in this case, $\Delta \text{CoVaR}$ remains proportional to the VaR, and the proportionality coefficient is constant over time.

Furthermore, Proposition 2 highlights two important differences between the MES, SRISK, and $\Delta \text{CoVaR}$ measures. First, MES is a marginal risk measure (defined by the first derivative of the system ES) whereas $\Delta \text{CoVaR}$ is an incremental risk measure (defined by the difference between two conditional VaRs). SRISK is a compromise between both approaches in the sense that it is based on a marginal measure of the return interconnectedness, through the MES, but also on nominal values such as liabilities and market capitalization. Second, MES depends on the linear projection coefficient of the firm return onto the market return, i.e., the beta, whereas $\Delta \text{CoVaR}$ is based on the linear projection coefficient of the market return on the firm return. This difference is quite important. Indeed, MES and SRISK are fundamentally linked to the sensitivity of the firm return to the market return. In contrast, $\Delta \text{CoVaR}$ captures the sensitivity of the market return with respect to the firm returns. Although both measures aim to measure systemic-risk contribution, their conditioning approaches are completely different. In the next section, we analyze the consequences of these differences on systemic-risk rankings and on the identification of the SIFIs.

### 3.4 Comparing Systemic-Risk Rankings

The main objective of any systemic risk analysis is to rank firms according to their systemic risk contribution and, in turn, identify the SIFIs. The key question is then to determine whether the different systemic risk measures lead to the same conclusion. A natural way to answer this question is to analyze their ratio.

**Proposition 3** Under the A1 assumption and for a given financial institution, the ratio between $\Delta \text{CoVaR}$ and MES is:

$$
\frac{\Delta \text{CoVaR}_{it}(\alpha)}{MES_{it}(\alpha)} = \frac{\text{VaR}_{it}(\alpha)}{\sigma_{it}^2} \times \frac{\sigma_{mt}^2}{\text{ES}_{mt}(\alpha)},
$$

if the marginal distribution of the firm return is symmetric. If the distribution is not symmetric,
the term $VaR_{it} (\alpha)$ is replaced by $VaR_{it} (\alpha) - VaR_{it} (0.5)$.

The $\Delta CoVaR/MES$ ratio is the product of two terms. The first term is firm-specific, whereas the second is common to all firms. The fact that this ratio is firm-specific implies that the systemic risk rankings based on the two measures may not be the same. Consider two different financial institutions $i$ and $j$ such that $i$ is more systemically risky than $j$ according to $\Delta CoVaR$, $\Delta CoVaR_{it} < \Delta CoVaR_{jt}$. It is possible to observe a situation where $i$ is less risky than $j$ according to the MES measure, $MES_{it} > MES_{jt}$. In other words, the SIFIs identified by the MES and by the $\Delta CoVaR$ may not be the same. Note that this result can be extended to the SRISK since the latter directly depends on MES.

Another advantage of our theoretical framework is that it allows us to derive conditions under which both rankings are convergent, respectively divergent.

Proposition 4 A financial institution $i$ is more systemically risky than an institution $j$ according to the MES and the $\Delta CoVaR$ measures, $MES_{it} (\alpha) \leq MES_{jt} (\alpha)$ and $\Delta CoVaR_{it} (\alpha) \leq \Delta CoVaR_{jt} (\alpha)$, if:

$$\rho_{it} \geq \max \left( \rho_{jt}, \frac{\rho_{jt} \sigma_{jt}}{\sigma_{it}} \right),$$

if the conditional distributions of the two standardized returns $r_{it}/\sigma_{it}$ and $r_{jt}/\sigma_{jt}$ are identical and location-scale.

The proof of Proposition 4 is in the Appendix C. Then under A1 and mild assumptions, the SIFIs identified according to the MES correspond to the SIFIs identified with $\Delta CoVaR$, if the correlations of their returns with the market returns are larger than the correlations for the other financial institutions. The higher the correlation between the SIFI and the system returns, the more likely it is that both measures will lead to a convergent diagnostic. This result comes from the fact that correlation captures indifferently both the sensitivity of the system return with respect to the firm return ($\Delta CoVaR$ dimension) and the sensitivity of the firm return with respect to the system return (MES dimension).

The systemic risk rankings based on SRISK and $\Delta CoVaR$ can also be compared. In this case, the comparison depends on the liabilities and market capitalizations of the two firms. For simplicity, let us consider two financial institutions with the same level of liabilities.

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12 If we assume normality for the marginal distributions of $\varepsilon_{nt}$ and $\xi_{it}$, this ratio has a closed form:

$$\frac{\Delta CoVaR_{it} (\alpha)}{MES_{it} (\alpha)} = - \left( \frac{\sigma_{it}}{\sigma_{it}} \right) \Phi^{-1} (\alpha) \lambda (\Phi^{-1} (\alpha)).$$

13 If the conditional distributions are not identical and/or not location-scale, the corresponding condition has the same form and implies that the correlation $\rho_{it}$ exceeds a given threshold (see Appendix C).
Proposition 5 A financial institution \(i\) is more systemically risky than a financial institution \(j\) (with the same level of liabilities) according to the short-run SRISK and the \(\Delta\text{CoVaR}\) measures, \(SRISK_{it}(\alpha) \geq SRISK_{jt}(\alpha)\) and \(\Delta\text{CoVaR}_{it}(\alpha) \leq \Delta\text{CoVaR}_{jt}(\alpha)\), if

\[
\rho_{it} \geq \rho_{jt} \text{ and } W_{it} \leq W_{jt} \exp \left[ 18 \times ES_{mt}(\alpha) \times (\beta_{jt} - \beta_{it}) \right],
\]

where \(W_{it}\) and \(W_{jt}\) denote the market capitalizations of both firms.

The proof of Proposition 5 is in the Appendix D. \(\Delta\text{CoVaR}\) and SRISK provide a similar systemic risk ranking if and only if (i) the correlation of the riskiest firm with the system is higher than the correlation of the least risky institution and (ii) if the riskiest firm has the lowest market capitalization. Since both firms are assumed to have the same level of liabilities, this condition means that the rankings are similar if the riskiest financial institution has the highest leverage. In other words, if the SIFIs have a high leverage and are very correlated with the system, \(\Delta\text{CoVaR}\) and SRISK will lead to the same conclusion. As soon as one of these conditions is violated, the ranking of the financial institutions will differ.

4 An Empirical Comparison of Systemic Risk Measures

The five propositions in Section 3 have been derived under the assumption that the dependence between firm and market returns is fully captured by the time-varying conditional correlations. In practice, however, the linear correlation does not always fully capture the dependence between financial asset returns (e.g., tail dependencies). When we relax the A1 assumption, it is no longer possible to derive analytical expressions for the MES, SRISK, and \(\Delta\text{CoVaR}\). For this reason, we propose an empirical comparison based on a sample of large US financial institutions. Specifically, we use the same sample as in Acharya et al. (2010) and Brownlees and Engle (2011), which contains all U.S. financial firms with a market capitalization greater than $5 billion as of end of June 2007 (94 firms in total). For our sample period (January 3, 2000 - December 31, 2010), we extract daily firm stock returns, market value-weighted index returns, number of shares outstanding and daily closing prices from CRSP. Quarterly book value of total liabilities are from COMPUSTAT. Appendix E presents the list of all the sample firms.

4.1 SIFI or not SIFI?

The first step in our empirical analysis is to estimate the three systemic risk measures for all the financial institutions in our sample. The main finding from this preliminary analysis is that the different risk measures identify different SIFIs. For instance, Table 1 displays the tickers of the top 10 financial institutions according to their systemic risk contribution measured by the MES,
SRISK, and ΔCoVaR, respectively, for the last day of our sample period. On that day, there is not a single institution simultaneously identified as a SIFI by the three measures. Only two financial institutions (Bank of America and American International Group) are simultaneously identified by MES and SRISK, whereas ΔCoVaR identifies only three financial institutions (H&R Block, Marshall & Ilsley, and Janus Capital) in common with MES but none with SRISK. Furthermore, the SRISK-based top 10 list is clearly tilted towards the largest financial institutions (Bank of America, Citigroup, JP Morgan, etc.), whereas it is not necessarily the case for MES and ΔCoVaR. Indeed, these measures do not take into account the level of liabilities and the market capitalization of the financial institutions.

Table 1: Systemic Risk Rankings

<table>
<thead>
<tr>
<th>Rank</th>
<th>MES</th>
<th>SRISK</th>
<th>ΔCoVaR</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>MBI</td>
<td>BAC</td>
<td>HRB</td>
</tr>
<tr>
<td>2</td>
<td>AIG</td>
<td>C</td>
<td>MI</td>
</tr>
<tr>
<td>3</td>
<td>MI</td>
<td>JPM</td>
<td>BEN</td>
</tr>
<tr>
<td>4</td>
<td>CBG</td>
<td>MS</td>
<td>CIT</td>
</tr>
<tr>
<td>5</td>
<td>RF</td>
<td>AIG</td>
<td>WU</td>
</tr>
<tr>
<td>6</td>
<td>LM</td>
<td>MET</td>
<td>AIZ</td>
</tr>
<tr>
<td>7</td>
<td>JNS</td>
<td>PRU</td>
<td>AXP</td>
</tr>
<tr>
<td>8</td>
<td>HRB</td>
<td>HIG</td>
<td>JNS</td>
</tr>
<tr>
<td>9</td>
<td>BAC</td>
<td>SLM</td>
<td>NYB</td>
</tr>
<tr>
<td>10</td>
<td>UNM</td>
<td>LNC</td>
<td>MTB</td>
</tr>
</tbody>
</table>

Notes: The column labeled MES displays the ranking of the top 10 financial institutions based on MES, listed from most to least risky. The following two columns display the top 10 financial institutions based on SRISK and ΔCoVaR, respectively. The ranking is for December 31, 2010.

The findings about diverging rankings is not specific to any particular date. Indeed, out of 2,767 days in our sample, there are 1,263 days (45.7%) during which none of the 94 financial institution is jointly included in the top 10 ranking of the three risk measures. Figure 1 shows the daily percentage of concordant pairs between the top 10 SIFIs identified by the different risk measures. On average, the percentage of concordant pairs between MES and SRISK is 18.9%, which means that, only two SIFIs out of ten are common to both measures. Over our 11-year sample, this percentage ranges between 0% and 60%; the latter being at the peak of the crisis in October 2008. The figures are much lower for SRISK and ΔCoVaR, with on average 9.9% of concordant pairs. The highest level of similarity is obtained for MES and ΔCoVaR, with an average percentage of

14The ΔCoVaR is estimated with a quantile regression as proposed by Adrian and Brunnermeier (2011). See Appendix E for the full name of each financial institution.
concordant pairs of 43%.\textsuperscript{15}

Figure 1: These figures show the daily percentage of concordant pairs between the top 10 financial institutions according to the MES and SRISK (top figure), the SRISK and ΔCoVaR (middle figure), and the ΔCoVaR and MES (bottom figure), respectively. The estimation period is from 01/03/2000 to 12/31/2010.

Even if these systemic risk measures are divergent, they each deliver a consistent ranking for a given institution. Indeed, for each measure, we compute the Kendall rank-order correlation coefficient between the systemic risk ranking obtained at time $t$ and the one obtained at time $t-1$. The average correlations are 91.3% for MES, 97.7% for SRISK, and 93.4% for ΔCoVar, and are always statistically significant. This result indicates that the rankings produced by these measures are stable through time. This is a nice property to have since it would make little sense for a measure to regularly classify a bank as SIFI on one day, and as non-SIFI on the following day. Therefore, the divergence of the systemic risk rankings is not due to the instability of a particular measure but instead to their fundamental differences.

\textsuperscript{15}Differently, short-run and long-run SRISK provide very similar rankings. The percentage of concordance is generally higher than 50% and was particularly high during the 2007-2010 crisis period.
4.2 Main Forces Driving MES-Based Systemic Risk Rankings and Forecasts

Estimation

When the A1 assumption is relaxed, the MES can no longer be expressed as the product of the market ES and the time-varying beta of the institution. Indeed, the conditional tail expectation $E_{t-1}(\varepsilon_{mt} | \varepsilon_{mt} < C/\sigma_{mt})$ in the expression of the MES (Equation 10) can differ from zero. This term captures the tail-spillover effects from the financial system to the financial institution that are not captured by the correlation. Additionally, if both marginal distributions of the standardized returns are unknown, then the conditional expectation $E_{t-1}(\varepsilon_{mt} | \varepsilon_{mt} < C/\sigma_{mt})$ is also unknown. Consequently, both tail expectations must be estimated. To do so, we follow Brownlees and Engle (2011) and use a nonparametric kernel estimation method (Scaillet, 2005). We consider an unconditional threshold $C$ equal to the unconditional VaR of the system, denoted $VaR_m(\alpha)$.

Then, if the standardized innovations $\varepsilon_{mt}$ and $\xi_{it}$ are i.i.d., the nonparametric estimates of these tail expectations are given by:

$$\hat{E}_{t-1}(\varepsilon_{mt} | \varepsilon_{mt} < \kappa) = \frac{\sum_{t=1}^{T} K\left(\frac{\kappa - \varepsilon_{mt}}{h}\right) \varepsilon_{mt}}{\sum_{t=1}^{T} K\left(\frac{\kappa - \varepsilon_{mt}}{h}\right)} ,$$

$$\hat{E}_{t-1}(\xi_{it} | \varepsilon_{mt} < \kappa) = \frac{\sum_{t=1}^{T} K\left(\frac{\kappa - \varepsilon_{mt}}{h}\right) \xi_{it}}{\sum_{t=1}^{T} K\left(\frac{\kappa - \varepsilon_{mt}}{h}\right)} ,$$

where $\kappa = VaR_m(\alpha)/\sigma_{mt}$, $K(x) = \int_{-\infty}^{x/h} k(u) \, du$, $k(u)$ is a kernel function, and $h$ is a positive bandwidth parameter. Following Scaillet (2005), we fix the bandwidth at $T^{-1/5}$ and choose the standard normal probability distribution function as a kernel function, i.e., $k(u) = \phi(u)$. The final elements needed to compute the MES are the conditional variance and correlation estimates.

As in Brownlees and Engle (2011), we model the conditional variances $\sigma_{it}^2$ and $\sigma_{mt}^2$ according to a TGARCH specification (Rabemananjara and Zakoïan, 1993) and use a DCC model (Engle, 2002) for the time-varying correlations $\rho_{imt}$. The model is estimated in two steps using Quasi Maximum Likelihood.

We obtain daily MES estimates for all sample firms between January 3, 2000 and December 31, 2010. Using debt and equity data, we then compute the SRISK for each firm on each day. Based on these series, we conduct two types of analyses: (i) a cross-sectional analysis for all financial institutions, which allows us to rank systemic financial institutions and (ii) a time-series analysis, which allows us to forecast the systemic risk contribution of a given firm.

---

16 Results obtained with $C = VaR_{mt}(\alpha)$, where $VaR_{mt}(\alpha)$ denotes the conditional VaR, are similar and available upon request.
Cross-Sectional Analysis and Systemic Risk Ranking

Under A1, we show in Section 3 that the MES of a firm linearly depends on the firm beta. We now investigate whether this result holds true when we relax the A1 assumption. The scatter plot in Figure 2 compares the average MES, $\bar{MES}_i = \frac{1}{T} \sum_{t=1}^{T} \bar{MES}_{it}$, to the average beta, $\bar{\beta}_i = \frac{1}{T} \sum_{t=1}^{T} \beta_{it}$, for the 61 firms that have been continuously traded during our sample period.\(^\text{17}\) The coverage rate $\alpha$ is fixed at 5%, and the threshold $C$ is fixed to the unconditional market daily VaR at 5%, which is equal to 2% in our sample.

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{scatter_plot.png}
\caption{The scatter plot shows the strong cross-sectional link between the time-series average of the MES at 5% estimated for each institution (y-axis) and its beta (x-axis). The beta corresponds to the average of the time-varying beta $\beta_{it}$. Each point represents a financial institution and the solid line is the OLS regression line with no constant. The estimation period is from 01/03/2000 to 12/31/2010.}
\end{figure}

This scatter plot confirms the strong relationship between MES (y-axis) and firm beta (x-axis). Even when Proposition 1 is no longer valid, the OLS estimated slope coefficient (0.0248) is extremely close to the unconditional ES of the market at 5%, 0.0252 or 2.52% (see Equation 11).\(^\text{18}\) The main implication of this result is that systemic risk rankings of financial institutions based on their MES tend to mirror rankings obtained by sorting firms on betas. We illustrate this point in Table 2 in which we display the tickers of the top 10 financial institutions based on MES (second column) and betas (third column) on December 31, 2010. We see that seven out of the ten highest beta firms are also identified among the top 10 SIFIs according to their MES.

\(^{17}\) The data requirement allows us to estimate the average ES of the market return over the same period for all firms.

\(^{18}\) Similar results (not reported) are obtained when we consider unconditional (constant) betas rather than conditional betas, or when we consider the firm MES and beta at a given point in time rather than averages.
very high matching score is by no means specific to this date as shown in Figure 4 and remains pervasive during the entire sample period.\footnote{The beta measures the linear dependencies between the returns of the firms and of the financial system. Differences in rankings between MES and beta are due to differences observed in these dependencies among firms.}

### Table 2: Systemic Risk Rankings: MES, Beta and SRISK

<table>
<thead>
<tr>
<th>Rank</th>
<th>MES</th>
<th>β</th>
<th>SRISK</th>
<th>LVG</th>
<th>LTQ</th>
<th>MV</th>
</tr>
</thead>
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<tr>
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<td>MBI</td>
<td>MBI</td>
<td>BAC</td>
<td>SLM</td>
<td>BAC</td>
<td>JPM</td>
</tr>
<tr>
<td>2</td>
<td>AIG</td>
<td>LM</td>
<td>C</td>
<td>HIG</td>
<td>JPM</td>
<td>WFC</td>
</tr>
<tr>
<td>3</td>
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<td>LNC</td>
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<td>C</td>
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<tr>
<td>4</td>
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<td>MI</td>
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<td>MS</td>
<td>WFC</td>
<td>BAC</td>
</tr>
<tr>
<td>5</td>
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<td>AIG</td>
<td>PRU</td>
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</tr>
<tr>
<td>6</td>
<td>LM</td>
<td>AIG</td>
<td>MET</td>
<td>MET</td>
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<td>BRK</td>
</tr>
<tr>
<td>7</td>
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<td>BAC</td>
<td>AIG</td>
<td>AXP</td>
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<tr>
<td>9</td>
<td>BAC</td>
<td>BAC</td>
<td>SLM</td>
<td>AIG</td>
<td>PRU</td>
<td>MET</td>
</tr>
<tr>
<td>10</td>
<td>UNM</td>
<td>ATFC</td>
<td>LNC</td>
<td>RF</td>
<td>HIG</td>
<td>MS</td>
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</table>

<table>
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<th>Pairs</th>
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<th>LVG</th>
<th>LTQ</th>
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<tr>
<td>β</td>
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<td>–</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td>SRISK</td>
<td>2</td>
<td>2</td>
<td>7</td>
<td>6</td>
<td>–</td>
<td>7</td>
</tr>
<tr>
<td>LVG</td>
<td>3</td>
<td>2</td>
<td>8</td>
<td>5</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td>LTQ</td>
<td>2</td>
<td>2</td>
<td>6</td>
<td>2</td>
<td>–</td>
<td>7</td>
</tr>
<tr>
<td>MV</td>
<td>1</td>
<td>1</td>
<td>5</td>
<td>2</td>
<td>7</td>
<td>–</td>
</tr>
</tbody>
</table>

Notes: In the upper panel, the column labeled MES displays the ranking of the top 10 financial institutions based on MES, listed from most to least risky. The following five columns display the top 10 financial institutions based on conditional beta (β), SRISK, Leverage (LVG), Liabilities (LTQ), and Market Value (MV) of equity, respectively. In the lower panel, we report the number of concordant pairs between two risk measures. The ranking is for December 31, 2010.

Unlike with MES, systemic risk rankings based on SRISK reflect extra information over and above systematic risk. Table 2 shows that, as of December 31, 2010, only one high-beta bank (Bank of America) is identified as a SIFI by the SRISK measure. This result is due to the fact that the SRISK also reflects the leverage of the firm. The scatter plot in Figure 3 contrasts the average SRISK and beta for all sample firms. The relationship remains clearly positive, but largely less robust than the one obtained with MES (Figure 2).

Accounting for information about market capitalization and liabilities in the definition of the systemic risk measure leads to including some of the largest financial institutions in the SIFI list. This result is in line with the too-big-to-fail paradigm, whereas the MES tends to be naturally attracted by interconnected institutions (through the beta), which is more in line with the too-
Figure 3: The scatter plot displays the average SRISK estimated for each institution (y-axis) against its beta (x-axis). The beta corresponds to the average of the time-varying beta $\beta_t$. Each point represents an institution and the solid line is the OLS regression line with no constant. The estimation period is from 01/03/2000 to 12/31/2010.

interconnected-to-fail paradigm (Markose et al., 2010). However, we see in Table 2 that identifying SIFIs with SRISK is not equivalent to simply considering a threshold on the level of debt, firm size or leverage. In that sense, the SRISK is a nice compromise between the too-big-to-fail and too-interconnected-to-fail dimensions. We illustrate this property of SRISK in Figure 4.

The middle panel of Figure 4 displays the daily percentage of concordance between the top 10 financial institutions according to SRISK and beta, while the bottom panel displays a similar graph for SRISK and leverage. Unlike for MES-beta (top panel, 85.1% match), the matching is far from perfect for SRISK-beta, with an average percentage of concordant pairs of 23.3%. However, SRISK rankings are not mechanically determined by leverage (71.4% match on average); especially during the crisis both correlations and MES vary across firms. The minimum percentage of concordant pairs between SRISK and leverage during the 2008 crisis is equal to 20%: during this period only two top-leverage firms are identified as top SIFI by the SRISK.

**Time-Series Analysis and Systemic Risk Forecasting**

Another application of systemic risk modeling techniques is to study, and ideally forecast, the dynamics of the contribution of a particular financial institution to the risk of the system. In this section, we study the main forces driving MES and SRISK through time.

We have shown that under the A1 assumption, the MES is defined as the product of the market ES and the firm beta. Since the market ES is not constant through time, forecasting the conditional
Figure 4: These figures show the daily percentage of concordant pairs between the top 10 financial institutions according to the MES and beta (top figure), the SRISK and beta (middle figure), and the SRISK and leverage (bottom figure), respectively. The estimation period is from 01/03/2000 to 12/31/2010.

Beta may not be sufficient to forecast the MES. We consider as an example Bank of America, which is generally the top SIFI according to SRISK in our sample. The top panel in Figure 5 displays the in-sample time profile of its MES and of its conditional beta.\footnote{Similar results are obtained for out-of-sample forecasts.} We notice that the evolution of MES and beta can be very different at times. For instance, MES keeps increasing between 2007:Q4 and 2009:Q4 whereas the beta decreases after the 2008 crisis. So, during this period, measuring the systemic risk of Bank America by focusing solely on its beta would have been misleading. The next two panels plot the evolution of the SRISK with beta (middle panel) and leverage (lower panel). We see that, unlike beta and leverage, SRISK can be seen as a leading indicator of systemic risk.
Figure 5: The top figure displays the 5%-MES (blue solid line, left y-axis) and the conditional beta (red dashed line, right y-axis) of Bank of America. The middle figure shows its SRISK (blue solid line, left y-axis) and its conditional beta (red dashed line, right y-axis). The bottom figure displays its SRISK (blue solid line, left y-axis) and its leverage (red dashed line, right y-axis). The estimation period is from 01/03/2000 to 12/31/2010.

4.3 Main Forces Driving ΔCoVaR-Based Systemic Risk Rankings and Forecasts

Estimation

When we relax the A1 assumption, ΔCoVaR can no longer be expressed as a simple function of the correlation between returns. For any conditioning event $C(r_{it}) : r_{it} = c_t, \forall c_t \in \mathbb{R}$, the CoVaR satisfies:

$$\int_{-\infty}^{\text{CoVaR}_{R^m_{it}}(c_t)} f_{r_i, r_m}(x, c_t) \, dx = \alpha \int_{-\infty}^{\infty} f_{r_i, r_m}(x, c_t) \, dx,$$

where $f_{r_i, r_m}(x, y)$ denotes the joint distribution of $(r_{it}, r_{mt})$. There is no closed form for the CoVaR, but it can be estimated in various ways including a copula function, a time-varying second-order moments model, or by bootstrapping past returns. Adrian and Brunnermeier (2011) suggest to use a standard quantile regression (Koenker and Bassett, 1978) of the market return on a particular firm return for the $\alpha$-quantile:

$$r_{mt} = \mu_{\alpha}^i + \gamma_{\alpha}^i r_{it}.$$

For a conditioning event $C(r_{it}) : r_{it} = V aR_{it}(\alpha)$, where $V aR_{it}(\alpha)$ denotes the conditional
VaR of the $i^{th}$ financial institution is defined by:

$$\Pr \left( r_{it} \leq CovAR_{it}^{VaR_{it}^m(\alpha)} \, | \, r_{it} = VaR_{it}^m (\alpha) \right) = \alpha ,$$

is estimated by $CovAR_{it}^{VaR_{it}^m(\alpha)} = \tilde{\mu}_i^\alpha + \tilde{\gamma}_i^\alpha VaR_{it} (\alpha)$, where $\tilde{\mu}_i^\alpha$ and $\tilde{\gamma}_i^\alpha$ denote the estimated parameters of the quantile regression.\(^{21}\) A similar result is obtained for the CoVaR defined for the median state of the institution, $CovAR_{it}^{median(r_i)} = \tilde{\mu}_i + \tilde{\gamma}_i VaR_{it} (0.5)$. Then, by definition, the $\Delta$CoVaR is equal to:

$$\Delta CovAR_{it} (\alpha) = \tilde{\gamma}_i (VaR_{it} (\alpha) - VaR_{it} (0.5)).$$

As for MES and SRISK, we get an estimated $\Delta$CoVaR time-series for each of the 94 sample firms and we propose two types of analyses: (i) a cross-sectional analysis and (ii) a time-series analysis.

### Table 3: Systemic Risk Rankings: $\Delta$CoVaR and VaR

<table>
<thead>
<tr>
<th>Rank</th>
<th>$\Delta$CoVaR</th>
<th>DCC-$\Delta$CoVaR</th>
<th>VaR</th>
</tr>
</thead>
<tbody>
<tr>
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<td>TMK</td>
<td>MBI</td>
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<tr>
<td>2</td>
<td>MI</td>
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</tr>
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<td>BEN</td>
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<td>CIT</td>
<td>AFL</td>
<td>RF</td>
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<td>WU</td>
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<td>HRB</td>
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</tr>
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<td>DCC-$\Delta$CoVaR</td>
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<td>–</td>
<td>1</td>
</tr>
<tr>
<td>VaR</td>
<td>3</td>
<td>1</td>
<td>–</td>
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</tbody>
</table>

Notes: In the upper panel, the column labeled $\Delta$CoVaR displays the ranking of the top 10 financial institutions based on $\Delta$CoVaR estimated by quantile regression, listed from most to least risky. The following two columns display the top 10 financial institutions based on DCC-$\Delta$CoVaR estimated by GARCH-DCC model and VaR, respectively. The lower panel reports the number of concordant pairs between two systemic measures. The ranking is for December 31, 2010.

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\(^{21}\) The conditional VaR itself is not estimated through a quantile regression; rather, it is deduced from the QML estimated conditional variances issued from a TGARCH model. If we assume that the marginal distribution of the standardized firm returns is a location-scale distribution, the conditional VaR satisfies $VaR_{it} (\alpha) = F_i^{-1} (\alpha) \hat{\sigma}_{it}$, where $F_i(.)$ denotes the true distribution of the standardized returns $r_{it}/\sigma_{it}$ and $\hat{\sigma}_{it}^2$ is the estimated conditional variance. Because the quantile $F_i^{-1} (\alpha)$ is unknown, we estimate it by its empirical counterpart.
Cross-Sectional Analysis and Systemic Risk Ranking

Under A1, we have shown that $\Delta\text{CoVaR}$ is proportional to the VaR and that the proportionality coefficient is firm-specific. The main implication of this result is that the riskiest institution in terms of VaR is not necessarily the systemically riskiest institution. If we relax the A1 assumption and use a quantile regression to estimate the $\Delta\text{CoVaR}$ (Equation 23), we get a similar result: $\Delta\text{CoVaR}$ remains proportional to the VaR and the relationship between both risk measures is firm specific. The only difference is that the proportionality coefficient $\gamma^i$, issued from the quantile regression (Equation 21), is constant over time, whereas this was not the case in our time-varying second-order moment framework (see Proposition 2). However, the systemic risk ranking based on $\Delta\text{CoVaR}$ is not equivalent to a VaR-based ranking. Table 3 displays the tickers of the top 10 financial institutions according to their $\Delta\text{CoVaR}$ (second column) and VaR (fourth column) at 12/31/2010. Among the top 10 SIFIs identified by the $\Delta\text{CoVaR}$, only three of them belong to the top 10 VaR group: H&R Block, Marshall & Ilsley, and Janus Capital. In that sense, the Conditional VaR is not equivalent to the VaR as correctly pointed out by Adrian and Brunnermeier (2011).

![Figure 6](image_url)

Figure 6: The scatter plot shows the cross-sectional link between the time-series average of the $\Delta\text{CoVaR}$ estimated for each institution (y-axis) and its VaR at 5% (x-axis). Each point represents an institution and the solid line is the OLS regression line with no constant. The estimation period is from 01/03/2000 to 12/31/2010.

This result is robust to the choice of a particular date. Indeed, the average concordant pairs rate of the daily rankings based on VaR and $\Delta\text{CoVaR}$ is only equal to 45% for the period 2000-2010. It is also robust to the choice of the estimation method. For instance, Table 3 displays the ranking
based on the $\Delta \text{CoVaR}$ computed from the estimated time-varying second-order moments issued from the DCC model used in subsection 4.2, i.e., $\Delta \text{CoVaR}_it (\alpha) = \hat{\gamma}_it \left( \text{VaR}_it (\alpha) - \text{VaR}_it (0.5) \right)$, where $\hat{\gamma}_it = \hat{\rho}_it \hat{\sigma}_mt / \hat{\sigma}_it$.\footnote{This last estimate does not require any distributional assumption for the firm return because the DCC is estimated by QML, and we use the empirical quantile of the standardized returns to estimate the VaR.} Only one institution (Janus Capital) appears jointly in the top ten riskiest financial institutions according to both the DCC-$\Delta \text{CoVaR}$ and the VaR. Note that the difference between the rankings issued from quantile regression and the DCC model is due to the nature of the $\Delta \text{CoVaR}/\text{VaR}$ ratio: time-varying $\gamma_{it}$ in the DCC framework vs. constant $\gamma_{i}^t$ in the quantile regression.

Another way to illustrate the weak link between institution’s risk in isolation and institution’s contribution to systemic risk consists in comparing the averages $\Delta \text{CoVaR}_i = T^{-1} \sum_{t=1}^{T} \Delta \text{CoVaR}_it (\alpha)$ and $\text{VaR}_i = T^{-1} \sum_{t=1}^{T} \text{VaR}_it (\alpha)$ for the 94 sample firms. The scatter plot of Figure 6 shows the cross-sectional relationship that exists between the two measures. This figure, similar to that proposed by Adrian and Brunnermeier (Figure 1, page 4) with another sample, points out the great dispersion of both measures and confirms that $\Delta \text{CoVaR}$ is not $\text{VaR}$.

Figure 7: The top figure displays the $\Delta \text{CoVaR}$ (blue solid line, left $y$-axis) and the 5%-VaR (red dashed line, right $y$-axis) of Bank of America. The bottom figure displays the DCC-$\Delta \text{CoVaR}$ (blue solid line, $y$-axis) and the 5%-VaR (red dashed line, right $y$-axis). The estimation period is from 01/03/2000 to 12/31/2010.

**Time-Series Analysis and Systemic Risk Forecasting**

The $\Delta \text{CoVaR}$ is not $\text{VaR}$ conclusion is more questionable when it comes to forecasting systemic risk. Figure 7 compares the dynamics of the $\Delta \text{CoVaR}$ and VaR of Bank of America over the entire
sample period; the coverage rate $\alpha$ for both risk measures is set at 5%. We see that the two lines match almost perfectly and there is a theoretical reason for this. Indeed, with quantile regression, $\Delta \text{CoVaR}$ is strictly proportional to the VaR. So, for a given financial institution, $\Delta \text{CoVaR}$ is nothing else but VaR.\textsuperscript{23} This finding implies that, within the $\Delta \text{CoVaR}$ framework, forecasting the contribution of a firm to the risk of the system is completely equivalent to the tail risk of this firm.

This conclusion is robust to the estimation method used. When one considers the DCC-$\Delta \text{CoVaR}$ (bottom panel of Figure 7), the correlation between VaR and $\Delta \text{CoVaR}$ is less than one, but remains very high (0.73). The fact that the correlation is not equal to one is due to the time variability of the proportionality coefficient $\gamma_{it}$ in the DCC model. In that sense, a time-varying coefficient approach, based either on a multivariate GARCH model or Kalman filter, should be preferred to model the dependencies between firm and market returns.

5 Conclusion

In this paper, we have theoretically and empirically compared several popular systemic risk measures that can be estimated from public data: Marginal Expected Shortfall (MES), Systemic Risk Measure (SRISK), and Delta Conditional Value at Risk ($\Delta \text{CoVaR}$). We have derived these popular risk measures into a common framework in order to make the comparison easier and to identify the main forces driving each risk measure. For all systemic risk measures, we derive some analytical expressions that allow us to uncover the theoretical link between systemic risk and standard risks (systematic risk, tail risk, correlation, and beta), as well as firm characteristics (leverage and market capitalization). We show for a sample of large US financial institutions that our decomposition of systemic risk measures remains true in practice.

Which systemic risk measure should we use then? This paper demonstrates that it very much depends on the objective.

First, if the goal is to identify the most systematically important firms and to rank them, two measures should be preferred: SRISK and $\Delta \text{CoVaR}$. We have shown, both theoretically and empirically, that MES has a strong tendency to reproduce the ranking based on beta. Out of the two preferred measures, SRISK has one clear advantage: it explicitly depends on market capitalization and liabilities, which leads to systematically identify some of the biggest financial institutions as SIFIs.

Second, if the goal is to forecast the contribution of a particular firm to the global risk of the financial system, MES and SRISK are the favorite measures. Indeed, we have shown that the $\Delta \text{CoVaR}$ of a given firm is largely determined by its VaR. Thus, forecasting the contribution of

\textsuperscript{23} Adrian and Brunnermeier (2011) extend the quantile regression (21) by including other lagged state variables $M_{t-1}$, but conditionally to these variables, the result still holds.
a firm to the systemic risk is equivalent to forecasting the risk generated by its own activities, considered in isolation.

Our results also have some key implications in terms of capital procyclicality. Indeed, US and international banking regulators have recently called for adding some extra capital requirements for SIFIs (Financial Stability Board, 2011). Ideally, the increase in regulatory capital should take place during the run-up phase to the crisis and not at the outbreak of the crisis. Our investigations suggest that the MES, as it depends on beta and market tail risk, is unlikely to comply with this property. Indeed, during a crisis, both beta and market tail risk increase very quickly, and so would a MES-based capital charge. A similar evolution is to be expected with ∆CoVaR. The latter is tightly linked to the firm VaR and the correlation between firm and market returns, which both surge during a crisis. Differently, the main driving forces of SRISK are the six-month ahead MES and leverage. By construction, long-run simulated risk measures are less procyclical than their instantaneous counterparts and the leverage of large financial institutions tend to build up before a financial crisis (Kalemli-Ozcan, Sorensen and Yesiltas, 2011). As a result, SRISK is likely to act as a leading indicator of financial crises, rather than being triggered by them. This theoretical argument is consistent with the actual evolution of the SRISK prior to the 2008 crisis (see Figure 5 and the Stern-NYU’s V-Lab website).
References


Appendix A: Proof of Proposition 1 (MES)

Proof. Under assumption A1, for any conditioning event $C$, we have:

$$\text{MES}_{it}(C) = \sigma_{it} \rho_{imt} \mathbb{E}_{t-1} \left( \varepsilon_{mt} \mid \varepsilon_{mt} < \frac{C}{\sigma_{mt}} \right),$$

(A1)

or equivalently:

$$\text{MES}_{it}(C) = \sigma_{it} \rho_{imt} \mathbb{E}_{t-1} \left( \varepsilon_{mt} \mid r_{mt} < C \right).$$

(A2)

Let $\beta_{it} = \text{cov}(r_{it}, r_{mt}) / \text{var}(r_{mt}) = \rho_{imt} \sigma_{it} / \sigma_{mt}$ denote the time-varying beta of firm $i$. Combining $\beta_{it}$ with Equation (A2), we obtain:

$$\text{MES}_{it}(C) = \beta_{it} \sigma_{mt} \mathbb{E}_{t-1} \left( \varepsilon_{mt} \mid r_{mt} < C \right)$$

(A3)

The MES is expressed as the product between the time-varying beta and the truncated expectation of the market return for any given threshold $C$. By definition, the conditional expected shortfall of the market return $ES_{mt}(\alpha)$ corresponds to the truncated expectation of the market return for a given threshold equal to the conditional VaR (Jorion, 2007), $C = \text{VaR}_{mt}(\alpha)$:

$$ES_{mt}(\alpha) = \mathbb{E}_{t-1} \left( r_{mt} \mid r_{mt} < \text{VaR}_{mt}(\alpha) \right).$$

(A4)

Then, the MES defined for the specific event $C = \text{VaR}_{mt}(\alpha)$, denoted $\text{MES}_{it}(\alpha)$, is simply expressed as the product of time-varying firm beta and expected shortfall of the market return:

$$\text{MES}_{it}(\alpha) = \beta_{it} ES_{mt}(\alpha).$$

(A5)

Appendix B: Proof of Proposition 2 ($\Delta\text{CoVaR}$)

Proof. We consider two cases: a general case with $\rho_{it} \neq 0$ and a particular case with $\rho_{it} = 0$. Given Equations (5) and (6), if $\rho_{it} \neq 0$ then the market return can be expressed as:

$$r_{mt} = \frac{\sigma_{mt}}{\sigma_{it} \rho_{it}} r_{it} - \frac{\sigma_{mt} \sqrt{1 - \rho_{it}^2}}{\rho_{it}} \xi_{it}.$$  

(B1)

Under assumption A1, we have $\text{cov}(\xi_{it}, \varepsilon_{mt}) = 0$. For each conditioning event form $\mathbb{C}(r_{it}) : r_{it} = c$, CoVaR is defined as follows:

$$\text{Pr} \left( r_{mt} \leq \text{CoVaR}_{it}^{m|r_{it}=c} \mid r_{it} = c \right) = \alpha,$$

(B2)

or equivalently:

$$\text{Pr} \left( \xi_{it} \leq \frac{\rho_{it}}{\sigma_{mt} \sqrt{1 - \rho_{it}^2}} \left( \frac{\sigma_{mt}}{\sigma_{it} \rho_{it}} c - \text{CoVaR}_{it}^{m|r_{it}=c} \right) \mid r_{it} = c \right) = 1 - \alpha.$$  

(B3)

In the special case where the conditional mean function of $\xi_{it}$ is linear in $r_{it}$, the first two conditional moments of $\xi_{it}$ given $r_{it} = c$ can be expressed as:

$$\mathbb{E} \left( \xi_{it} \mid r_{it} = c \right) = \frac{\text{cov}(\xi_{it}, r_{it})}{\sigma_{it}^2} \times c = \frac{\sigma_{it} \sqrt{1 - \rho_{it}^2}}{\sigma_{it}^2} \times c = \frac{\sqrt{1 - \rho_{it}^2}}{\sigma_{it}} \times c.$$  

(B4)
\[
\begin{align*}
\n\mathbb{V}(\xi_{it} \mid r_{it}) &= \mathbb{V}(\xi_{it}) - \mathbb{V}_{r_{it}}[\mathbb{E}(\xi_{it} \mid r_{it})] \\
&= \mathbb{V}(\xi_{it}) \times \left[1 - \left(\frac{\text{cov}(\xi_{it}, r_{it})}{\sigma^{2}_{it}}\right)\right] \\
&= 1 - \left(\frac{\sigma_{it} \sqrt{1 - \rho^{2}_{it}}}{\sigma^{2}_{it}}\right)^{2} \\
&= \rho^{2}_{it}. \quad (B5)
\end{align*}
\]

Consider \( G(.) \) the conditional (location-scale) demeaned and standardized cdf of \( \xi_{it} \) such that:

\[
\begin{align*}
\mathbb{E}\left[\frac{1}{\rho_{it}} \left(\xi_{it} - \frac{\sqrt{1 - \rho^{2}_{it}}}{\sigma_{it}} \times c\right) \mid r_{it} = c\right] &= 0, \quad (B6) \\
\mathbb{V}\left[\frac{1}{\rho_{it}} \left(\xi_{it} - \frac{\sqrt{1 - \rho^{2}_{it}}}{\sigma_{it}} \times c\right) \mid r_{it} = c\right] &= 1. \quad (B7)
\end{align*}
\]

Thus, Equation (B3) is expressed as:

\[
\frac{1}{\rho_{it}} \left[\frac{\rho_{it}}{\sigma_{mt} \sqrt{1 - \rho^{2}_{it}}} \left(\frac{\sigma_{mt}}{\sigma_{it} \rho_{it}} \times c - \text{CoVaR}_{t}^{m|r_{it}=c}\right) - \frac{\sqrt{1 - \rho^{2}_{it}}}{\sigma_{it}} \times c\right] = G^{-1}(1 - \alpha).
\]

By rearranging these terms, we write the general expression of the CoVaR:

\[
\text{CoVaR}_{t}^{m|r_{it}=c} = -\sigma_{mt} \sqrt{1 - \rho^{2}_{it}} G^{-1}(1 - \alpha) + \frac{\rho_{it} \sigma_{mt}}{\sigma_{it}} c. \quad (B8)
\]

The CoVaR defined for the conditioning event \( \mathbb{C}(r_{it}) : r_{it} = \text{median}(r_{it}) \), has a similar expression:

\[
\text{CoVaR}_{t}^{m|r_{it}=\text{median}(r_{it})} = -\sigma_{mt} \sqrt{1 - \rho^{2}_{it}} G^{-1}(1 - \alpha) + \frac{\rho_{it} \sigma_{mt}}{\sigma_{it}} F^{-1}(0.5). \quad (B9)
\]

where \( F(.) \) denotes the marginal cdf of the firm return. Then, for each conditioning event form \( \mathbb{C}(r_{it}) : r_{it} = c \), the \( \Delta \text{CoVaR} \) is defined as:

\[
\begin{align*}
\Delta \text{CoVaR}_{t}^{c} &= \text{CoVaR}_{t}^{m|r_{it}=c} - \text{CoVaR}_{t}^{m|r_{it}=\text{median}(r_{it})} \\
&= \frac{\rho_{it} \sigma_{mt}}{\sigma_{it}} \times [c - \text{median}(r_{it})] \quad (B10) \\
&= \gamma_{it} \times [c - \text{median}(r_{it})], \quad (B11)
\end{align*}
\]

where \( \gamma_{it} = \rho_{it} \sigma_{mt} / \sigma_{it} \) denotes the time-varying linear projection coefficient of the market return on the firm return. If the marginal distribution of \( r_{it} \) is symmetric around zero, then \( F^{-1}(0.5) = 0 \), and we have:

\[
\Delta \text{CoVaR}_{t}^{c} = \frac{\rho_{it} \sigma_{mt}}{\sigma_{it}} \times c = \gamma_{it} \times c. \quad (B12)
\]

As in Adrian and Brunnermeier (2011) the \( \Delta \text{CoVaR} \), denoted \( \Delta \text{CoVaR}_{t}^{\alpha} \), defined for a conditioning event \( \mathbb{C}(r_{it}) : r_{it} = \text{VaR}_{t}^{\alpha} \) is:

\[
\Delta \text{CoVaR}_{t}^{\alpha} = \gamma_{it} \times [\text{VaR}_{t}^{\alpha} - \text{VaR}_{t}^{\alpha}(0.5)], \quad (B13)
\]

or

\[
\Delta \text{CoVaR}_{t}^{\alpha} = \gamma_{it} \times \text{VaR}_{t}^{\alpha}, \quad (B14)
\]

if the marginal distribution of the firm return is symmetric around zero.
Now, we consider the case where \( \rho_{it} = 0 \), the bivariate process becomes:

\[
\begin{align*}
\sigma_{mt} &= \sigma_{mt} \varepsilon_{mt}, \\
\sigma_{it} &= \sigma_{it} \xi_{it}, \\
(\varepsilon_{mt}, \xi_{it}) &= D,
\end{align*}
\]

where \( \varepsilon_t = (\varepsilon_{mt}, \xi_{it}) \) satisfies \( \mathbb{E}(\varepsilon_t) = 0 \) and \( \mathbb{E}(\varepsilon_{it} \varepsilon_{it}') = I_2 \), and \( D \) denotes the bivariate distribution of the standardized innovations. It is straightforward to show that:

\[
\mathbb{P}(r_{mt} \leq \text{CoV aR}_m) = \mathbb{P}(r_{it} = \text{VaR}_i) = \mathbb{P}(r_{mt} \leq \text{CoV aR}_m) = \mathbb{P}(r_{it} = \text{VaR}_i).
\]

Hence, we have \( \text{CoV aR}_i = \sigma_m F_{1m} \) and \( \text{CoV aR}_j = 0 \), where \( F_{1m} \) denotes the cdf of the marginal distribution of the standardized market return.

**Appendix C: Proof of Proposition 4 (Rankings MES-ΔCoVaR)**

**Proof.** First, given Equation (13), the inequality \( \Delta \text{CoVaR}_{it}(\alpha) \leq \Delta \text{CoVaR}_{jt}(\alpha) \) is then equivalent to:

\[
\frac{\rho_{it}}{\sigma_{it}} \times [\text{VaR}_{it}(\alpha) - \text{VaR}_{it}(0.5)] \leq \frac{\rho_{jt}}{\sigma_{jt}} \times [\text{VaR}_{jt}(\alpha) - \text{VaR}_{jt}(0.5)].
\]

(C1)

If we assume that the conditional distribution of the firm return is a location scale distribution, then \( \text{VaR}_{it}(\alpha) = \sigma_{it} F_{i}^{-1}(\alpha) \) where \( F_{i}^{-1}(\alpha) \) denotes the conditional \( \alpha \)-quantile of the standardized returns \( r_{it}/\sigma_{it} \). The inequality becomes:

\[
\rho_{it} \times [F_{i}^{-1}(\alpha) - F_{i}^{-1}(0.5)] \geq \rho_{jt} \times [F_{j}^{-1}(\alpha) - F_{j}^{-1}(0.5)].
\]

(C2)

For simplicity, we assume that the two conditional distributions for firms \( i \) and \( j \) are identical, i.e., \( F_{i}^{-1}(\cdot) = F_{j}^{-1}(\cdot) = F_{i}^{-1}(\cdot) \). The difference \( F_{i}^{-1}(\alpha) - F_{i}^{-1}(0.5) \) is typically a negative number, so the inequality \( \Delta \text{CoVaR}_{it}(\alpha) \leq \Delta \text{CoVaR}_{jt}(\alpha) \) can be reduced to the simple condition \( \rho_{it} \geq \rho_{jt} \).

\[
\Delta \text{CoVaR}_{it}(\alpha) \leq \Delta \text{CoVaR}_{jt}(\alpha) \iff \rho_{it} \geq \rho_{jt}.
\]

(C3)

Second, the inequality \( \text{MES}_{it}(\alpha) \leq \text{MES}_{jt}(\alpha) \), means that \( \beta_{it} \geq \beta_{jt} \) since the system’s ES is negative, \( ES_{mt} < 0 \). Given the definition of conditional beta, this inequality is equivalent to the condition \( \sigma_{it} \rho_{it} \geq \sigma_{jt} \rho_{jt} \).

\[
\text{MES}_{it}(\alpha) \leq \text{MES}_{jt}(\alpha) \iff \sigma_{it} \rho_{it} \geq \sigma_{jt} \rho_{jt}.
\]

(C4)

We have simultaneously \( \text{MES}_{it}(\alpha) \leq \text{MES}_{jt}(\alpha) \) and \( \Delta \text{CoVaR}_{it}(\alpha) \leq \Delta \text{CoVaR}_{jt}(\alpha) \) when conditions (C3) and (C4) are satisfied. Given the relative values of the volatilities, two cases can be studied separately.

Case a: \( \sigma_{it} \geq \sigma_{jt} \). The conditions (C3) and (C4) are satisfied if \( \rho_{it} \geq \rho_{jt} \).
Case b: $\sigma_{it} \leq \sigma_{jt}$. The conditions (C3) and (C4) are satisfied if $\rho_{it} \geq \rho_{jt} \sigma_{jt}/\sigma_{it}$.

Then, the systemic risk rankings (MES and $\Delta$CoVaR) of both financial institutions are identical when we have:

$$\rho_{it} \geq \max\left(\rho_{jt}, \frac{\rho_{jt} \sigma_{jt}}{\sigma_{it}}\right).$$ 

(C5)

If the two conditional distributions $F_i(.)$ and $F_j(.)$ are different, but location-scale, this condition becomes:

$$\rho_{it} \geq \max \left(\rho_{jt}, \rho_{jt} \frac{F_j^{-1}(0.5) - F_i^{-1}(0.5)}{F_i^{-1}(0.5) - F_i^{-1}(0.5)}\right),$$

(C6)

and if they are not location-scales it is:

$$\rho_{it} \geq \max \left(\rho_{jt}, \frac{\sigma_{it} [VaR_{jt}(\alpha) - VaR_{jt}(0.5)]}{\sigma_{jt} [VaR_{it}(\alpha) - VaR_{it}(0.5)]}\right).$$

(C7)

\[\text{Proof.}\]

A similar result can be obtained for short-run SRISK. Given the expression of the short-run SRISK, firm $i$ is riskier than firm $j$ if:

$$k D_{it} - (1-k) W_{it} \exp(18 \times \beta_{it} \times ES_{mt}(\alpha)) \geq k D_{jt} - (1-k) W_{jt} \exp(18 \times \beta_{jt} \times ES_{mt}(\alpha)).$$

(D4)

As shown in Appendix C, under some mild assumptions, we have:

$$\Delta \text{CoVaR}_{it}(\alpha) \leq \Delta \text{CoVaR}_{jt}(\alpha) \iff \rho_{it} \geq \rho_{jt}. \quad \text{(D2)}$$

The systemic risk ranking given by the SRISK and the $\Delta$CoVaR are convergent when conditions (D1) and (D2) are satisfied. These conditions can be expressed as constraints on both the correlation and the market value of the riskiest firm $i$:

$$\rho_{it} \geq \rho_{jt} \quad \text{and} \quad W_{it} \leq W_{jt} \exp[18 \times ES_{mt}(\alpha) \times (\beta_{jt} - \beta_{it})]. \quad \text{(D3)}$$
For simplicity, we consider two firms with the same level of liabilities, $D_{it} = D_{jt}$. Then, the inequality $\text{SRISK}^{SR}_{it}(\alpha) \geq \text{SRISK}^{SR}_{jt}(\alpha)$ is equivalent to

$$W_{it}/\beta_{it} \sigma_{it} \leq W_{jt}/\beta_{jt} \sigma_{mt}.$$  \hspace{1cm} (D5)

Since the ES of the market return is typically negative and is not firm-specific and since $\beta_{zt} = \rho_{zt} \sigma_{zt}/\sigma_{mt}$ for $z = \{i, j\}$, this condition can be expressed as:

$$\text{SRISK}^{SR}_{it}(\alpha) \geq \text{SRISK}^{SR}_{jt}(\alpha) \iff W_{it} \sigma_{it} \rho_{it} \geq W_{jt} \sigma_{jt} \rho_{jt}.$$  \hspace{1cm} (D6)

As shown in Appendix C, under some mild assumptions, we have:

$$\text{CoVaR}_{it}(\alpha) \leq \text{CoVaR}_{jt}(\alpha) \iff \rho_{it} \geq \rho_{jt}.$$  \hspace{1cm} (D7)

The systemic risk ranking given by the short-run SRISK and the $\text{CoVaR}$ are convergent when conditions (D6) and (D7) are satisfied. These conditions can be expressed as constraints on both the correlation and the market value of the riskiest firm $i$:

$$\rho_{it} \geq \rho_{jt} \quad \text{and} \quad W_{it} \geq W_{jt} \frac{\rho_{jt} \sigma_{jt}}{\rho_{it} \sigma_{it}},$$  \hspace{1cm} (D8)

or equivalently:

$$\rho_{it} \geq \rho_{jt} \quad \text{and} \quad W_{it} \geq W_{jt} \left(\beta_{jt} - \beta_{it}\right).$$  \hspace{1cm} (D9)

This result illustrates the difference between the short-run SRISK and the SRISK. The first measure is an increasing function of the market value, whereas the second is a decreasing one. Thus, the systemic ranking of the $\text{CoVaR}$ and the short-run SRISK will be similar if and only if the riskiest firm has the highest market capitalization, and consequently the lowest leverage.  \hspace{1cm} \blacksquare


Appendix E: Dataset

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<th>Insurance (32)</th>
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<td>Aetna Financial Group</td>
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