Sensitivity Analysis of Var and Expected Shortfall for Portfolios under Netting Agreements

FERMANIAN, Jean-David, SCAILLET, Olivier

Abstract

In this paper, we characterize explicitly the first derivative of the Value at Risk and the Expected Shortfall with respect to portfolio allocation when netting between positions exists. As a particular case, we examine a simple Gaussian example in order to illustrate the impact of netting agreements in credit risk management. We further provide nonparametric estimators for sensitivities and derive their asymptotic distributions. An empirical application on a typical banking portfolio is finally provided.

Reference

FERMANIAN, Jean-David, SCAILLET, Olivier. Sensitivity Analysis of Var and Expected Shortfall for Portfolios under Netting Agreements. 2003
SENSITIVITY ANALYSIS OF VAR AND EXPECTED SHORTFALL FOR PORTFOLIOS UNDER NETTING AGREEMENTS

Jean-David FERMANIAN
Olivier SCAILLET
SENSITIVITY ANALYSIS OF VAR AND EXPECTED SHORTFALL FOR PORTFOLIOS UNDER NETTING AGREEMENTS

Jean-David FERMANIAN\textsuperscript{a} and Olivier SCAILLET\textsuperscript{b} \textsuperscript{1}

\textsuperscript{a} CDC Ixis Capital Markets, 56 rue de Lille, 75007 Paris, and CREST, 15 bd Gabriel Péri, 92245 Malakoff cedex, France. jdfermanian@cdcixis-cm.com

\textsuperscript{b} HEC Genève and FAME, Université de Genève, 102 Bd Carl Vogt, CH - 1211 Genève 4, Suisse. scaillet@hec.unige.ch

First version: July 2003

Abstract

In this paper, we characterize explicitly the first derivative of the Value at Risk and the Expected Shortfall with respect to portfolio allocation when netting between positions exists. As a particular case, we examine a simple Gaussian example in order to illustrate the impact of netting agreements in credit risk management. We further provide nonparametric estimators for sensitivities and derive their asymptotic distributions. An empirical application on a typical banking portfolio is finally provided.

Key words: Value at Risk, Expected Shortfall, Sensitivity, Risk Management, Credit Risk, Netting.

JEL Classification: C14, D81, G10, G21, G22.

\textsuperscript{1}The second author receives support by the Swiss National Science Foundation through the National Center of Competence: Financial Valuation and Risk Management (NCCR FINRISK). Part of this research was done when he was visiting THEMA and IRES.

Downloadable at

1
1 Introduction

For risk management purposes, the evaluation of marginal impacts of current or new positions on risk measures and regulatory capital has been recognized as an important point (Garman (1996), Jorion (1997)). In practice, this evaluation can be made through explicit estimators of the first order derivatives of some standard risk measures, such as the Value at Risk (VaR) and the Expected Shortfall (ES), with respect to portfolio allocations (Gourieroux, Laurent and Scaillet (2000), hereafter GLS, and Scaillet (2000)). Knowledge of the sensitivity is helpful in reducing the amount of computational time needed to process large portfolios since it avoids the need to recompute risk measures each time the portfolio composition is slightly modified (Kurth and Tasche (2002), Martin, Thompson and Brown (2001), Martin and Wilde (2002)). Besides it allows decomposing global portfolio risk component by component, and identifying the largest risk contributions (Denault (2001), Garman (1997), Hallerbach (2003), Tasche (1999)). These derivatives are also of particular relevance in portfolio selection problem (see Markowitz (1952) for portfolio selection in a mean-variance framework). They help to characterize and evaluate efficient portfolio allocations when VaR and ES are substituted for variance as measure of risk (GLS (2000), Rockafellar and Uryasev (2000)). In fact, numerical constrained optimization algorithms for computations of optimal allocations usually require consistent estimates of first order derivatives in order to converge properly.

Unfortunately, the results available up to now have fallen short of taking the problem of netting. Clearly, this is an important omission since most financial positions with respect to one or several counterparties are netted in practice.

Generally speaking, when trading partners agree to offset their positions or obligations, we say that they are netting. By doing so, they reduce a large number of positions or obligations to a smaller number of positions or obligations, and it is on this netted position that the two trading partners settle their outstanding obligations.

In the financial community, positions are most of the time netted inside standardised

---

2A related topic is dynamic trading strategies under risk limits (Basak and Shapiro (2001), Cuoco, He, and Issaenko (2001), Leippold, Trojani, and Vanini (2002)).
juridical contracts. Streamlining of documentation has taken place as a result of joint efforts by regulators and financial industry organisations. In 1990, the Bank of International Settlements (BIS) issued minimum standards for the design and operation of netting schemes \(^3\), while in 1991, the Federal Deposit Insurance Corporation Improvement Act (FDICIA) provided support for netting contracts among banks and other financial institutions. In 1992, the International Swaps and Derivatives Dealers (ISDA) issued its first version of the well-known “ISDA Master Agreement” for over-the-counter (OTC) derivatives markets. Its amended versions are still in force between most market participants around the globe today.

As mentioned previously, the term netting is used to describe the process of offsetting mutual positions or obligations e.g. to offset an obligation owed by bank A to bank B with an obligation owed by bank B to bank A. There are three main techniques for netting:

- The netting by novation means that a single net amount is contractually substituted for previous individual gross sums owed between two counterparties, i.e. existing obligations are discharged by replacing them with a new obligation.

- The close-out netting \(^4\) is the right to close out transactions after the occurrence of a default or termination event \(^5\) and reduce the counterparty obligations to a single net payment obligation.

- The settlement netting is the process of settling all deals between two counterparties on a net cash basis.

Netting can be either bilateral or multilateral, monocurrency or multicurrency, monoproduct or multiproduct.

The use of netting techniques can bring significant benefits for balance-sheet purposes, capital usage, credit risk and operational efficiencies \(^6\). Indeed, beside reducing transaction

\(^3\)They are known as the Lamfalussy standards after the chairman of the Committee that wrote the report.

\(^4\)This is the current choice in the ISDA Master agreement.

\(^5\)An early termination date is designated as the result of the occurrence of an event of default or a decline in the credit quality of a party following the occurrence of merger-related events.

\(^6\)See also Duffie and Singleton (2003) for impact of netting in credit derivatives asset pricing.
costs and communication expenses, netting is important because it reduces credit and liquidity risks, and ultimately systemic risk. Taking an offsetting position subject to a netting agreement is thus related to credit risk mitigation. The tendency of the regulator is to allow wider range of credit risk mitigants in order to avoid the so-called ”domino effect” in the financial sector. In the new Basel Capital Accord (see the 2001 consultative document), on-balance sheet netting agreements of loans and deposits of banks to or from a counterparty will be permitted under some conditions. Note that, in 1995, the 1988 Basel Accord was modified to allow banks to reduce the credit exposures (“credit equivalent” in the Basel terminology) of their derivative positions by bilateral netting procedures (see Crouhy et al. (1998)).

The paper is organised as follows. In Sections 2 and 3 our aim is to extend the sensitivity analysis of VaR and ES to a setting in which netting is allowed, and to propose suitable estimators of the first order derivatives of VaR and ES in that context. In Section 2, we outline the framework and explain the differences arising from netting agreements in case of default of a given counterparty. The loss function associated with netted positions is no more a simple sum of exposures or mark-to-market valuations, but rather involves some nonlinearities. More precisely, it involves some terms like \((X_1 + \ldots + X_I)^+ = \max(X_1 + \ldots + X_I, 0)\), when the positions \(X_i, i = 1, \ldots, I\), belong to the same netting agreement at default. Section 2 contains the main result of the paper, namely the explicit characterization of the first order derivatives of VaR and ES for portfolios under netting agreements. The Gaussian case is briefly discussed. In particular we compare VaR and its sensitivity in the netted and unnetted cases. In Section 3, we derive estimators of sensitivities so that they can be used in practical risk management and portfolio selection procedures. These estimators are of a nonparametric nature and easy to implement. In Section 4 we provide an empirical illustration for a typical portfolio of a large bank. Section 5 contains some concluding remarks. Technical appendices gather proofs.
2 Main results

Let us consider a portfolio made of three components: \( a'Y \), \( a'_U Y_U \) and \( a'_N Y_N \). The first component \( a'Y \) is the part which is not sensitive to default risk on a given counterparty, while the two other parts can be affected by its default \(^7\). The second component \( a'_U Y_U \) gathers unnetted positions, i.e. positions which are outside the netting agreement signed with the counterparty and will not be pooled into a single position in case of counterparty default. The third component \( a'_N Y_N \) is the netted part governed by the master agreement with the given counterparty. At default, unnetted and netted positions should receive a different treatment when they exhibit positive value. Indeed recall that only contracts showing positive value at default need to be included in credit loss computations. The credit loss on unnetted positions corresponds to the sum on the positive part of each position, i.e. \( \sum_j (a_{j,U} Y_{j,U})^+ \), while the credit loss on netted positions corresponds to the positive part of the sum on each position, i.e. \( (a'_N Y_N)^+ \).

Let us now consider an additional single position \( a_Z Z \). This leads to a portfolio value at the initial date \( t_0 \) equal to:

\[
V(t_0) = a'Y(t_0) + a'_U Y_U(t_0) + a'_N Y_N(t_0) + a_Z Z(t_0).
\]

Hereafter the random variable \( D \) indicates default of the given counterparty at date \( t_1 \), and takes the value 1 (resp. 0) in case of default (resp. no default). More generally, \( D \) corresponds to a credit event that causes some losses, and is the starter of a netting agreement.

In the derivation of the portfolio value at date \( t_1 \) we need to distinguish three cases: i) the position is not subject to default risk on the counterparty; ii) the position is subject to default risk and cannot be netted in case of counterparty default; iii) the position is subject to default risk and falls under the umbrella of the master agreement signed with the counterparty. Then the values of the global portfolio at \( t_1 \) are obtained from the

\(^7\)Note that the identification of default to a given single counterparty is not a limitation of our analysis. The setting is sufficiently large to accommodate the practical situation of portfolios subject to multiple defaults.
contributions of each component under default and no default after taking into account potential netting. 

i) No default risk on $a_Z Z$

$$V(t_1) = a'Y(t_1) + a_Z Z(t_1) + (a'_U Y_U(t_1) + a'_N Y_N(t_1))$$

$$- \left( \sum_j (a_{j,U} Y_{j,U}(t_1))^+ + (a'_N Y_N(t_1))^+ \right) D.$$ 

ii) Default risk on unnetted $a_Z Z$

$$V(t_1) = a'Y(t_1) + (a'_U Y_U(t_1) + a_Z Z(t_1) + a'_N Y_N(t_1))$$

$$- \left( \sum_j (a_{j,U} Y_{j,U}(t_1))^+ + (a_Z Z(t_1))^+ + (a'_N Y_N(t_1))^+ \right) D.$$ 

iii) Default risk on netted $a_Z Z$

$$V(t_1) = a'Y(t_1) + (a'_U Y_U(t_1) + a'_N Y_N(t_1) + a_Z Z(t_1))$$

$$- \left( \sum_j (a_{j,U} Y_{j,U}(t_1))^+ + (a'_N Y_N(t_1) + a_Z Z(t_1))^+ \right) D.$$ 

In the following, we are interested in risk measures computed on the portfolio value at date $t_1$, namely VaR and ES (see Szego (2002) for a discussion about conditions for proper use of risk measures) defined by:

$$\alpha = P[V(t_1) < -VaR], \quad (1)$$

$$ES = -E[V(t_1) | V(t_1) < -VaR], \quad (2)$$

where $\alpha$ is a small loss probability level, say 1%. The dependence of VaR and ES with 

---

8In case of default it may happen that the asset $Z$ urgently needs to be replaced because of hedging demand. It is then sufficient to subtract the replacement value in case of default at date $t_1$, i.e. add the short position $-a_Z Z(t_1)D$. Stated results may be easily adapted to handle that case.

9These risk measures may also be computed on portfolio value changes:

$$\alpha = P[V(t_1) - V(t_0) < -\overline{VaR}],$$

$$\overline{ES} = -E[V(t_1) - V(t_0) | V(t_1) - V(t_0) < -\overline{VaR}].$$

Results obtained for $VaR$ and $ES$ can be immediately translated to $\overline{VaR}$ and $\overline{ES}$ using the two changes of variable $\overline{VaR} = VaR + V(t_0)$ and $\overline{ES} = ES + V(t_0)$. In particular, this will lead to

$$\frac{\partial \overline{VaR}}{\partial a_Z} = \frac{\partial VaR}{\partial a_Z} + \frac{\partial V(t_0)}{\partial a_Z}$$

and

$$\frac{\partial \overline{ES}}{\partial a_Z} = \frac{\partial ES}{\partial a_Z} + \frac{\partial V(t_0)}{\partial a_Z}$$

with $\frac{\partial V(t_0)}{\partial a_Z} = Z(t_0)$. 

---
respect to the loss probability level and portfolio allocations will be assumed implicit in the notations. Equations (1) and (2) may also be expressed in terms of losses using \( L = -V \):

\[
\alpha = P[L(t_1) > VaR],
\]

\[
ES = E[L(t_1) | L(t_1) > VaR].
\]

Note that our definition of “Expected Shortfall” does not correspond to the most general definition of this coherent measure of risk (see e.g. Acerbi and Tasche (2002), Rockafellar and Uryasev (2002)):

\[
\tilde{ES} = E[L(t_1) | L(t_1) > VaR] - (\alpha - P[L(t_1) > VaR]) \frac{1}{\alpha} VaR.
\]

Nonetheless, under our assumptions, loss functions will be absolutely continuous with respect to the Lebesgue measure. In this case, we know that \( ES \) and \( \tilde{ES} \) coincide.

As already mentioned, it is interesting to compute the contribution of each position to the risk of the whole portfolio and monitor the most risky ones for precautionary reasons. Since \( VaR \) and \( ES \) are homogeneous of degree one, we get by Euler Theorem:

\[
a' \frac{\partial VaR}{\partial a'} + a_Z \frac{\partial VaR}{\partial a'_Z} + a_U' \frac{\partial VaR}{\partial a'_U} + a_N' \frac{\partial VaR}{\partial a'_N} = VaR,
\]

and the same expression holds with \( ES \) substituted for \( VaR \). The contribution associated with \( a_Z Z \) to the global risk measured by \( VaR \) (resp. \( ES \)) is simply the sensitivity of \( VaR \) (resp. \( ES \)) with respect to \( a_Z \) multiplied by the allocation \( a_Z \), i.e. \( a_Z \partial VaR / \partial a_Z \), resp. \( a_Z \partial ES / \partial a_Z \).

The first order derivative of \( VaR \) and \( ES \) with respect to \( a_Z \) can be easily computed by applying the following proposition.

**Proposition 1.** Consider the loss functions

\[
L_1 = X - \varepsilon Z,
\]

\[
L_2 = X - \varepsilon Z + (\varepsilon Z)^+ D,
\]

\[
L_3 = X - \varepsilon Z + (Y + \varepsilon Z)^+ D,
\]
where $\varepsilon$ is a positive real number\textsuperscript{10}, and $(X,Y,Z)$ is a random vector admitting a continuous conditional density with respect to the Lebesgue measure, conditionally to the event $D = 1$ and $D = 0$. Then

**A. First derivative of Value at Risk.**

\[
\partial_\varepsilon \text{VaR}_1 = -E[Z|L_1 = \text{VaR}_1],
\]

\[
\partial_\varepsilon \text{VaR}_2 = -E[Z1\{Z < 0\}|L_2 = \text{VaR}_2, D = 1] \times P[D = 1|L_2 = \text{VaR}_2]
- E[Z|L_2 = \text{VaR}_2, D = 0] \times P[D = 0|L_2 = \text{VaR}_2],
\]

\[
\partial_\varepsilon \text{VaR}_3 = -E[Z1\{Y + \varepsilon Z < 0\}|L_3 = \text{VaR}_3, D = 1] \times P[D = 1|L_3 = \text{VaR}_3]
- E[Z|L_3 = \text{VaR}_3, D = 0] \times P[D = 0|L_3 = \text{VaR}_3].
\]

**B. First derivative of Expected Shortfall.**

\[
\partial_\varepsilon \text{ES}_1 = -E[Z|L_1 > \text{VaR}_1],
\]

\[
\partial_\varepsilon \text{ES}_2 = -E[Z1\{Z < 0\}|L_2 > \text{VaR}_2, D = 1] \times P[D = 1|L_2 > \text{VaR}_2]
- E[Z|L_2 > \text{VaR}_2, D = 0] \times P[D = 0|L_2 > \text{VaR}_2],
\]

\[
\partial_\varepsilon \text{ES}_3 = -E[Z1\{Y + \varepsilon Z < 0\}|L_3 > \text{VaR}_3, D = 1] \times P[D = 1|L_3 > \text{VaR}_3]
- E[Z|L_3 > \text{VaR}_3, D = 0] \times P[D = 0|L_3 > \text{VaR}_3].
\]

**Remark 1.** Note that we can rewrite

\[
\partial_\varepsilon \text{VaR}_2 = -E[Z1\{Z < 0, D = 1\}|L_2 = \text{VaR}_2] - E[Z1\{D = 0\}]|L_2 = \text{VaR}_2],
\]

\[
\partial_\varepsilon \text{VaR}_3 = -E[Z1\{Y + \varepsilon Z < 0, D = 1\}|L_3 = \text{VaR}_3] - E[Z1\{D = 0\}]|L_3 = \text{VaR}_3],
\]

and

\[
\partial_\varepsilon \text{ES}_2 = -E[Z1\{Z < 0, D = 1\}|L_2 > \text{VaR}_2] - E[Z1\{D = 0\}]|L_2 > \text{VaR}_2],
\]

\[
\partial_\varepsilon \text{ES}_3 = -E[Z1\{Y + \varepsilon Z < 0, D = 1\}|L_3 > \text{VaR}_3] - E[Z1\{D = 0\}]|L_3 > \text{VaR}_3].
\]

In the aforementioned loss functions we have implicitly assumed zero recovery rates.

This point of view, not necessarily unrealistic, could appear as too conservative in some

\textsuperscript{10}if $\varepsilon$ is negative, the results can be applied by simply changing $Z$ into $-Z$. 

8
cases. Similar formulas as the ones presented in Proposition 1 could be obtained with arbitrary fixed or random recovery rates. Unfortunately, these formulas are a lot more complicated.

Previous computations have been made in an “integrated” credit and market risk environment. Indeed, Var and ES computations have included impact of both market conditions and credit events on the portfolio value.

For credit analysis purposes, it is common to focus on credit risk solely. Practitioners and regulators are then concerned with so-called exposures to default. The exposure is a random variable related to positions with respect to a single counterparty, say \( i \), and corresponds to a specific amount potentially lost due to the default of that counterparty in the future. Lost amounts are often calculated by some calibrated pricing models. Formally, the exposure at \( t_1 \) to counterparty \( i \) can be written as

\[
Exp_{U,i}(t_1) = \left( \sum_j (a_{j,U} Y_{j,U}(t_1))^+ + (az(t_1))^+ + (aN_Y(t_1))^+ \right), \tag{11}
\]

in the unnetted case, and

\[
Exp_{N,i}(t_1) = \left( \sum_j (a_{j,U} Y_{j,U}(t_1))^+ + (aN_Y(t_1) + aZ(t_1))^+ \right), \tag{12}
\]

in the netted case.

Let us stress that positions are related to the same single counterparty \( i \). In the first case, \( Z \) is outside a netting agreement while, in the second case, it is not. Note further that exposures have nothing to do with default probabilities of the counterparty. The VaR associated with a single exposure is commonly called a potential exposure, and is a pure credit risk measure linked to positions with a single counterparty.

Moreover, to compute provisions to cover multiple credit losses, it is necessary to aggregate exposures and take into account the probability of default of several counterparties. Losses can be aggregated, for example, inside some portfolios, sections, or perimeters. The total credit loss of a portfolio \( P \) at \( t_1 \) is then equal to

\[
L(t_1) = \sum_{i \in P} Exp_i(t_1) D_i,
\]
denoting by $D_i$ the default of the $i$-th counterparty at date $t_1$. To study the marginal impact of a particular position $Z$ related to a given counterparty $i$ on the VaR and ES of the portfolio $P$ is approximately equivalent, depending on the status of $Z$ in terms of netting, to calculate the sensitivity to $a_Z$ of the VaR and ES of

$$L_U(t_1) = X + \left( \sum_j (a_{j,U}Y_{j,U}(t_1))^+ + (a_ZZ(t_1))^+ + (a_N^Y_NY_N(t_1))^+ \right) D_i,$$

and

$$L_N(t_1) = X + \left( \sum_j (a_{j,U}Y_{j,U}(t_1))^+ + (a_N^Y_NY_N(t_1) + a_ZZ(t_1))^+ \right) D_i,$$

for some random variable $X$.

These sensitivities can be calculated using the following result.

**Proposition 2.** Consider the loss functions

$$L_4 = X + (\varepsilon Z)^+ D,$$

$$L_5 = X + (Y + \varepsilon Z)^+ D,$$

where $\varepsilon$ is a positive real number, and $(X,Y,Z)$ is a random vector admitting a continuous conditional density with respect to the Lebesgue measure, conditionally to the event $D = 1$ and $D = 0$. Then

**A. First derivative of Value at Risk.**

$$\partial_\varepsilon \text{VaR}_4 = E[Z1\{Z \geq 0\}|L_4 = \text{VaR}_4, D = 1] \times P[D = 1|L_4 = \text{VaR}_4],$$

$$\partial_\varepsilon \text{VaR}_5 = E[Z1\{Y + \varepsilon Z \geq 0\}|L_5 = \text{VaR}_5, D = 1] \times P[D = 1|L_5 = \text{VaR}_5].$$

**B. First derivative of Expected Shortfall.**

$$\partial_\varepsilon \text{ES}_4 = E[Z1\{Z \geq 0\}|L_4 > \text{VaR}_4, D = 1]P[D = 1|L_4 > \text{VaR}_4],$$

$$\partial_\varepsilon \text{ES}_5 = E[Z1\{Y + \varepsilon Z \geq 0\}|L_5 > \text{VaR}_5, D = 1]P[D = 1|L_5 > \text{VaR}_5].$$

**Remark 2.** Note that we can rewrite

$$\partial_\varepsilon \text{VaR}_4 = E[Z1\{Z \geq 0, D = 1\}|L_4 = \text{VaR}_4],$$

$$\partial_\varepsilon \text{VaR}_5 = E[Z1\{Y + \varepsilon Z \geq 0, D = 1\}|L_5 = \text{VaR}_5],$$

10
and

\[ \partial_t ES_4 = E[Z 1 \{Z > 0, D = 1\} | L_4 > VaR_4], \]

\[ \partial_t ES_5 = E[Z 1 \{Y + \varepsilon Z > 0, D = 1\} | L_5 > VaR_5]. \]

Clearly sensitivities of potential exposures as defined in Equations (11) and (12) can be deduced from the previous formulas by forcing \( D = 1 \).

All aforementioned expressions are explicit. In principle they can be computed, at least numerically, once the distribution of the underlying random variables \((X,Y,Z)\) is known and independence with respect to the default event is assumed\(^{11}\). For instance, assume the joint law of \((X,Y,Z)\) is Gaussian \( \mathcal{N}(m, \Omega) \). Then it possible to get a closed form expression for \( \partial_t VaR_j \) and \( \partial_t ES_j, j = 1, \ldots, 5 \). Nevertheless, the formulas are tedious to obtain since the positive parts in the losses functions \( L_j \) require to evaluate some truncated distributions.

In the remaining of this section, we only study a simple portfolio example \( E_1 + \varepsilon E_2 \) where the vector of exposures \( E = (E_1, E_2)' \) is Gaussian with mean \( m = (m_1, m_2)' \) and covariance matrix

\[
\Omega = \begin{bmatrix}
\sigma_1^2 & \rho \sigma_1 \sigma_2 \\
\rho \sigma_1 \sigma_2 & \sigma_2^2
\end{bmatrix}.
\]

This simple example can be used to illustrate the impact of netting on VaR and their sensitivities.

Let us consider the credit losses when there is no netting agreement between \( E_1 \) and \( E_2 \):

\[ L_U = (E_1^+ + (\varepsilon E_2)^+)D, \]

and when all positions are netted:

\[ L_N = (E_1 + \varepsilon E_2)^+ D. \]

\(^{11}\) More generally, this is also true if the joint distribution of \((X,Y,Z,D)\) is known. Actually, some commonly used models are based on a dependence between credit events and the variations of some underlying market factors such as equities or spreads.
The credit VaR themselves do not admit explicit forms (even in this simple case) and need to be computed numerically. However, once they are known, they can be plugged in the explicit form of the sensitivities derived in appendix C.

Figure 1 shows the impact of netting as a function of $\rho$ for $m_1 = 10$, $m_2 = -1$, $\varepsilon = 1$ and $\sigma_1 = \sigma_2 = 1$. This portfolio can be viewed as made of a long aggregated position in one category of assets and a short position in another one with the same counterparty. In the first case the two positions cannot be netted while they can in the second case. VaR are estimated by computing empirical quantiles on 100,000 simulations delivered by an antithetic variate Monte Carlo procedure. The loss probability level $\alpha$ is equal to 1% (99% VaR) and the default probability $p$ is equal to 20%.

It can be observed that netting is valuable from a credit risk management point of view. Indeed, VaR are always lower in the netted case. Moreover, VaR sensitivities are larger in the netted case, for instance when $E_1$ and $E_2$ are independent. These results show that netting can be thought as sound credit risk mitigation practice and should be encouraged. This example also shows that the sensitivities can differ substantially between the two situations, and that netting agreements should be taken into account when computing VaR sensitivities. In the netted case we may observe that the VaR sensitivity becomes negative for highly negative correlations. The explanation is simple. If $E_1$ and $E_2$ are strongly negatively correlated, $E_2$ is usually very negative when $E_1$ is very positive. Hence increasing slightly the position in $E_2$ has a favourable effect on the VaR of the global netted position. On the contrary it is not possible to benefit from the offsetting effect in the unnetted case, and the VaR sensitivity stays positive always.

$^{12}$Note that if we increase the mean of $E_2$ in absolute terms, the benefits of netting increase since the probability of taking positive values diminishes.
3 Estimation

Since all sensitivities can be evaluated through conditional expectations, they are amenable to estimation by nonparametric techniques such as the well-known kernel method.

To be specific, assume the joint distribution of \((X, Y, Z, D)\) is known explicitly, or that we can get at least \(n\) random draws \((x_i, y_i, z_i, d_i)_{i=1,...,n}\) from the joint distribution of \((X, Y, Z, D)\). This is the usual situation because most of the risk models are parametric and/or simulation-based. This setting is large enough to host some dependence between “the market factors” \((X, Y, Z)\) and the default event 13.

Let us consider a consistent estimator \(\widehat{VaR}_4\) of \(VaR_4\). For instance, it can be deduced from computing an empirical quantile on the simulated losses \(l_{4,i}, i = 1,...,n\). Then, an estimate of \(\partial_\varepsilon VaR_4\) can be defined by the usual nonparametric kernel regression estimator:

\[
\partial_\varepsilon \widehat{VaR}_4 = \frac{\sum_{i=1}^n z_i 1\{z_i \geq 0, d_i = 1\} K_h(l_{4,i} - \widehat{VaR}_4)}{\sum_{i=1}^n K_h(l_{4,i} - \widehat{VaR}_4)}, \tag{17}
\]

where \(K : \mathbb{R} \to \mathbb{R}\) is a kernel (an integrable function whose integral is one), \(h = h(n)\) is a smoothing parameter, called the bandwidth (a sequence of positive real numbers which tends to 0 when \(n\) tends to the infinity) and \(K_h(u) = K(u/h)/h\) 14. Similarly,

\[
\partial_\varepsilon \widehat{VaR}_5 = \frac{\sum_{i=1}^n z_i 1\{y_i + \varepsilon z_i \geq 0, d_i = 1\} K_h(l_{5,i} - \widehat{VaR}_5)}{\sum_{i=1}^n K_h(l_{5,i} - \widehat{VaR}_5)}. \tag{18}
\]

Both estimators are easy to implement since they correspond to ratios of straight averages of known functions of the observed data points.

Denote the density of \(L_k\) by \(f_k, k = 4,5\), and set

\[
\mu_4(v) = E[Z^21\{Z > 0, D = 1\}|L_4 = v] - (\partial_\varepsilon VaR_4)^2, \\
\mu_5(v) = E[Z^21\{Y + \varepsilon Z > 0, D = 1\}|L_5 = v] - (\partial_\varepsilon VaR_5)^2.
\]

Then we prove the following asymptotic normality result in Appendix D.

**Proposition 3.** Assume for \(k = 4,5\),

13 For instance this dependence exists when equity prices and default probabilities are linked.

14 Obviously, direct differentiation of \(\widehat{VaR}_4\) through computation of finite difference has no meaning here since the empirical quantile is not differentiable w.r.t. \(\varepsilon\).
• $\sqrt{n}(\hat{V}aR_k - VaR_k) = O_P(1)$,

• $K$ is an even kernel function, $\int |t|^3|K|(t)dt < \infty$, $\lim_{|t|\to\infty} |t|^3K(t) = 0$. It is three times continuously differentiable, $K'$ and $K''$ are integrable and $K'''$ is bounded.

• $E[|Z|^p] < \infty$ for every integer $p$,

• $t \mapsto E[Z^4|L_k = t]$ is bounded in a neighborhood of $VaR_k$,

• $nh^5 \to 0$ and $nh^{7/2} \to \infty$,

• $r_k$ and $f_k$ are two times continuously differentiable,

• $f_k$ and $\mu_k$ are continuous and strictly positive in a neighborhood of $VaR_k$.

Then

$$\sqrt{nh} \left\{ \partial_x \hat{V}aR_k - \partial_x VaR_k \right\} \xrightarrow{law} n \to \infty \mathcal{N} \left( 0, \mu_k(VaR_k)/f_k(VaR_k) \int K^2 \right),$$

Similar kernel estimators of $\partial_x VaR_j$, $j = 1, 2, 3$ can be easily inferred. They are asymptotically normal under similar regularity conditions.

As usually these asymptotic normality results can be used to build confidence intervals around estimates. In particular the number $n$ of simulations can be chosen so that these intervals are sufficiently narrow to guarantee statistically precise sensitivity estimates.

We can also estimate the sensitivity of the expected shortfall by

$$\partial_x \hat{E}S_4 = \sum_{i=1}^{n} z_i \mathbf{1}\{z_i \geq 0, d_i = 1, l_{4,i} > \hat{V}aR_4\} \sum_{i=1}^{n} \mathbf{1}\{l_{4,i} > \hat{V}aR_4\},$$

(19)

and

$$\partial_x \hat{E}S_5 = \sum_{i=1}^{n} z_i \mathbf{1}\{y_i + \varepsilon z_i \geq 0, d_i = 1, l_{5,i} > \hat{V}aR_5\} \sum_{i=1}^{n} \mathbf{1}\{l_{5,i} > \hat{V}aR_5\}. \quad (20)$$

The strong consistency of the two latter estimators can be deduced from the strong uniform consistency of the empirical process (see Van der Vaart (1994)). Furthermore, their asymptotic normality can be established under some regularity conditions. However, the forms of their asymptotic normal distributions depend on the choice of the estimators $\hat{V}aR_k$, and are more complicated than in the VaR case.
4 Empirical application

In this empirical section, we wish to illustrate how the estimators of the previous section can be used in practice. We study a real life banking example and analyze the sensitivity w.r.t. an additional short position in a bond (borrowing) with a single AA- counterparty. The default probability is 2% at one year. We examine a short position to emphasize importance of netting in credit risk calculations, and aim to quantify what is the impact of this additional position on credit VaR and credit ES at a 1% loss probability level. 35 other positions are already standing with this counterparty. Each of these 35 positions corresponds to an aggregated position inside a netting agreement (some of them are in fact stand alone positions). Positions can be long or short, and include several categories of assets such as forward contracts, swaps and options in different currencies. Table 1 gives the current value of the 35 aggregated positions in Euros. The current value of the additional short position is equal to -1,150,000 Euros.

- Please insert Table 1 approximately here -

We compare the situation where the additional position can be incorporated inside one of the 35 existing netting agreements with the case where it is left outside any netting. The 35 netted cases are numbered from 1 to 35, and the unnetted case is called case 0. The number of simulations of default times is $n = 100,000$, and random future position values are computed from internal pricing models. The estimation procedure is based on a Gaussian kernel and a bandwidth selected according to the usual rule of thumb, namely $h = \hat{\sigma}n^{-1/5}$ where $\hat{\sigma}$ is the empirical standard deviation of the credit losses. Table 2 gives the one year credit VaR and one year credit ES together with their sensitivity for each case.

- Please insert Table 2 approximately here -

As already observed on the Gaussian numerical example, credit VaR and credit ES may differ substantially between netted and unnetted cases. Credit ES are much larger than

\footnote{Let us remark that this illustrative example may look a bit fictitious since one cannot usually choose the status of an additional position. We do so because this enlarges the number of studied cases.}
credit VaR revealing much of the danger of using the VaR concept in a credit environment (see Frey and McNeil (2002) for further elaboration). Besides if one enjoys the possibility to choose the agreement, which will host the additional position, then cases 17 and 27 seem to be more suitable from a credit risk management point of view since they minimize VaR and ES at one year. It can be further observed that a small VaR sensitivity can coexist with a large ES sensitivity (see for instance case 23 and 32). This can be explained by the fact that VaR only concerns a single point in the loss distribution, while ES is about an average of points.

5 Concluding remarks

Risk measures answer the need of quantifying the risk of potential losses on a portfolio of assets. This need may arise due to internal concerns (risk-reward tradeoff) or external constraints (prudential rules imposed by regulators). In this paper we have proposed estimation procedures allowing for a sensitivity analysis w.r.t. changes in portfolio allocation. The setting explicitly takes into account the possibility of netting. The estimation procedures are nonparametric, fast and easy to implement. They have also been shown to be of practical relevance in real life banking situations, and should help to achieve better credit risk management in the future.
Table 1: Current aggregated position values

<table>
<thead>
<tr>
<th></th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>9,100,000</td>
<td>510</td>
<td>752,076</td>
<td>556,260</td>
<td>-2,140,000</td>
</tr>
<tr>
<td>6</td>
<td>-2.510 10^9</td>
<td>-17,100,000</td>
<td>-22,500,000</td>
<td>3,990,000</td>
<td>-1,520,000</td>
</tr>
<tr>
<td>7</td>
<td>654,270</td>
<td>688,179</td>
<td>6,890,000</td>
<td>893,581</td>
<td>-28,000,000</td>
</tr>
<tr>
<td>8</td>
<td>-1,190,000</td>
<td>30,100,000</td>
<td>156,448</td>
<td>-1,680,000</td>
<td>0</td>
</tr>
<tr>
<td>9</td>
<td>26</td>
<td>27</td>
<td>28</td>
<td>29</td>
<td>30</td>
</tr>
<tr>
<td>10</td>
<td>-872,964</td>
<td>24,900,000</td>
<td>3,700,000</td>
<td>388,944</td>
<td>3,850,000</td>
</tr>
<tr>
<td>11</td>
<td>31</td>
<td>32</td>
<td>33</td>
<td>34</td>
<td>35</td>
</tr>
<tr>
<td>12</td>
<td>-346,792</td>
<td>294,316</td>
<td>-77,199</td>
<td>-1,620,000</td>
<td>3,340,000</td>
</tr>
</tbody>
</table>
Table 2: One year credit Var, one year credit ES and their sensitivity

<table>
<thead>
<tr>
<th>case</th>
<th>$Var$</th>
<th>$\partial_s Var$</th>
<th>$ES$</th>
<th>$\partial_s ES$</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td>70,331,367</td>
<td>0</td>
<td>8.380 $10^{12}$</td>
<td>0</td>
</tr>
<tr>
<td>1</td>
<td>69,377,844</td>
<td>-874,361</td>
<td>8.304 $10^{12}$</td>
<td>-9.341 $10^{10}$</td>
</tr>
<tr>
<td>2</td>
<td>70,330,857</td>
<td>0</td>
<td>8.379 $10^{12}$</td>
<td>0</td>
</tr>
<tr>
<td>3</td>
<td>69,540,685</td>
<td>-626,414</td>
<td>8.318 $10^{12}$</td>
<td>-6.072 $10^{10}$</td>
</tr>
<tr>
<td>4</td>
<td>70,073,963</td>
<td>-35,417</td>
<td>8.371 $10^{12}$</td>
<td>-2.109 $10^9$</td>
</tr>
<tr>
<td>5</td>
<td>70,331,367</td>
<td>0</td>
<td>8.380 $10^{12}$</td>
<td>0</td>
</tr>
<tr>
<td>6</td>
<td>70,331,367</td>
<td>0</td>
<td>8.380 $10^{12}$</td>
<td>0</td>
</tr>
<tr>
<td>7</td>
<td>70,331,367</td>
<td>0</td>
<td>8.380 $10^{12}$</td>
<td>0</td>
</tr>
<tr>
<td>8</td>
<td>70,331,367</td>
<td>0</td>
<td>8.380 $10^{12}$</td>
<td>0</td>
</tr>
<tr>
<td>9</td>
<td>69,815,558</td>
<td>0</td>
<td>8.329 $10^{12}$</td>
<td>0</td>
</tr>
<tr>
<td>10</td>
<td>70,015,777</td>
<td>-155,085</td>
<td>8.354 $10^{12}$</td>
<td>-2.390 $10^{10}$</td>
</tr>
<tr>
<td>11</td>
<td>70,198,039</td>
<td>0</td>
<td>8.365 $10^{12}$</td>
<td>0</td>
</tr>
<tr>
<td>12</td>
<td>70,191,493</td>
<td>-50,457</td>
<td>8.346 $10^{12}$</td>
<td>-1.384 $10^{10}$</td>
</tr>
<tr>
<td>13</td>
<td>69,415,329</td>
<td>-698,350</td>
<td>8.301 $10^{12}$</td>
<td>-8.310 $10^{10}$</td>
</tr>
<tr>
<td>14</td>
<td>70,015,777</td>
<td>-83,143</td>
<td>8.350 $10^{12}$</td>
<td>-1.860 $10^{10}$</td>
</tr>
<tr>
<td>15</td>
<td>70,331,367</td>
<td>-48,137</td>
<td>8.359 $10^{12}$</td>
<td>-1.986 $10^{10}$</td>
</tr>
<tr>
<td>16</td>
<td>69,757,868</td>
<td>0</td>
<td>8.332 $10^{12}$</td>
<td>0</td>
</tr>
<tr>
<td>17</td>
<td>69,281,888</td>
<td>-1,019,714</td>
<td>8.283 $10^{12}$</td>
<td>-1.030 $10^{11}$</td>
</tr>
<tr>
<td>18</td>
<td>70,171,780</td>
<td>0</td>
<td>8.364 $10^{12}$</td>
<td>0</td>
</tr>
<tr>
<td>19</td>
<td>70,331,367</td>
<td>0</td>
<td>8.380 $10^{12}$</td>
<td>0</td>
</tr>
<tr>
<td>20</td>
<td>70,331,367</td>
<td>0</td>
<td>8.380 $10^{12}$</td>
<td>0</td>
</tr>
<tr>
<td>21</td>
<td>70,331,367</td>
<td>0</td>
<td>8.380 $10^{12}$</td>
<td>0</td>
</tr>
<tr>
<td>22</td>
<td>70,331,367</td>
<td>0</td>
<td>8.380 $10^{12}$</td>
<td>0</td>
</tr>
<tr>
<td>23</td>
<td>70,291,539</td>
<td>-22,132</td>
<td>8.382 $10^{12}$</td>
<td>-3.316 $10^9$</td>
</tr>
<tr>
<td>24</td>
<td>69,620,844</td>
<td>-335,436</td>
<td>8.328 $10^{12}$</td>
<td>-3.862 $10^{10}$</td>
</tr>
<tr>
<td>25</td>
<td>70,331,367</td>
<td>0</td>
<td>8.380 $10^{12}$</td>
<td>0</td>
</tr>
<tr>
<td>26</td>
<td>69,283,062</td>
<td>-804,040</td>
<td>8.291 $10^{12}$</td>
<td>-8.780 $10^{10}$</td>
</tr>
<tr>
<td>27</td>
<td>69,281,888</td>
<td>-1,019,714</td>
<td>8.283 $10^{12}$</td>
<td>-1.030 $10^{11}$</td>
</tr>
<tr>
<td>28</td>
<td>69,315,574</td>
<td>-952,598</td>
<td>8.278 $10^{12}$</td>
<td>-9.605 $10^{10}$</td>
</tr>
<tr>
<td>29</td>
<td>70,079,282</td>
<td>0</td>
<td>8.351 $10^{12}$</td>
<td>0</td>
</tr>
<tr>
<td>30</td>
<td>69,281,888</td>
<td>-873,183</td>
<td>8.291 $10^{12}$</td>
<td>-8.611 $10^{10}$</td>
</tr>
<tr>
<td>31</td>
<td>69,926,891</td>
<td>0</td>
<td>8.338 $10^{12}$</td>
<td>0</td>
</tr>
<tr>
<td>32</td>
<td>69,724,979</td>
<td>-1,000</td>
<td>8.328 $10^{12}$</td>
<td>-2.077 $10^8$</td>
</tr>
<tr>
<td>33</td>
<td>69,994,493</td>
<td>0</td>
<td>8.346 $10^{12}$</td>
<td>0</td>
</tr>
<tr>
<td>34</td>
<td>70,331,367</td>
<td>0</td>
<td>8.379 $10^{12}$</td>
<td>0</td>
</tr>
<tr>
<td>35</td>
<td>69,281,888</td>
<td>-1,018,800</td>
<td>8.284 $10^{12}$</td>
<td>-1.021 $10^{11}$</td>
</tr>
</tbody>
</table>
A Proof of Proposition 1.

A.1 First derivative of Value at Risk.

We only provide derivation of $\partial_\varepsilon \text{VaR}_3$. The formula for $\partial_\varepsilon \text{VaR}_2$ can be obtained from $\partial_\varepsilon \text{VaR}_3$ by simply considering a sequence of random variables $(Y_n)$ which tends to zero almost surely and by applying a limit theorem (such as the theorem of dominated convergence). The expression for $\partial_\varepsilon \text{VaR}_1$ is a direct consequence of Property 1 in GLS (2000).

We may rewrite the equation defining $\text{VaR}_3$ as:

$$
\alpha = P[L_3 > \text{VaR}_3] = P[X - \varepsilon Z > \text{VaR}_3, D = 0] + P[X - \varepsilon Z > \text{VaR}_3, Y + \varepsilon Z \leq 0, D = 1] + P[X + Y > \text{VaR}_3, Y + \varepsilon Z > 0, D = 1] \equiv T_1 P[D = 0] + T_2 P[D = 1] + T_3 P[D = 1],
$$

where

$$
T_1 = \int \left[ \int \left\{ \int_{\text{VaR}_3 + \varepsilon z}^{+\infty} f_{(X,Y,Z)}|0(x,y,z) \, dx \right\} dy \right] dz,
$$

$$
T_2 = \int \left[ \int_{-\infty}^{-\varepsilon z} \left\{ \int_{\text{VaR}_3 + \varepsilon z}^{+\infty} f_{(X,Y,Z)}|1(x,y,z) \, dx \right\} dy \right] dz,
$$

$$
T_3 = \int \left[ \int_{-\varepsilon z}^{+\infty} \left\{ \int_{\text{VaR}_3 - y}^{+\infty} f_{(X,Y,Z)}|1(x,y,z) \, dx \right\} dy \right] dz,
$$

denoting by $f_{U|1}$, resp. $f_{U|0}$, the density of any random vector $U$ with respects to the Lebesgue measure, conditionally to $D = 1$, resp. $D = 0$. To ease reading, set $p = P[D = 1]$.

A simple calculation provides

$$
\frac{\partial T_1}{\partial \varepsilon} = -\int (\partial_\varepsilon \text{VaR}_3 + z) \left\{ \int_{\text{VaR}_3 + \varepsilon z}^{+\infty} f_{(X,Y,Z)}|0(x,y,z) \, dx \right\} dy \right] dz,
$$

$$
\frac{\partial T_2}{\partial \varepsilon} = -\int z \left\{ \int_{\text{VaR}_3 + \varepsilon z}^{+\infty} f_{(X,Y,Z)}|1(x,-\varepsilon z,z) \, dx \right\} dy \right] dz
$$

$$
- \int (\partial_\varepsilon \text{VaR}_3 + z) \left\{ \int_{-\infty}^{-\varepsilon z} f_{(X,Y,Z)}|1(\text{VaR}_3 + \varepsilon z,y,z) \, dy \right\} dz,
$$

$$
\frac{\partial T_3}{\partial \varepsilon} = \int z \left\{ \int_{\text{VaR}_3 - y}^{+\infty} f_{(X,Y,Z)}|1(x,-\varepsilon z,z) \, dx \right\} dy \right] dz
$$

$$
- \partial_\varepsilon \text{VaR}_3 \int \left\{ \int_{-\varepsilon z}^{+\infty} f_{(X,Y,Z)}|1(\text{VaR}_3 - y,y,z) \, dy \right\} dz.
$$
This yields

\[
0 = (1 - p) \frac{\partial T_1}{\partial \varepsilon} + p \cdot \frac{\partial T_2}{\partial \varepsilon} + p \cdot \frac{\partial T_3}{\partial \varepsilon}
\]

\[= - \partial_\varepsilon \text{VaR}_3 \]

\[\times \int \left\{ (1 - p) \int f_{(L_3, Y, Z)|0}(\text{VaR}_3 + \varepsilon z, y, z) \, dy \right. \]

\[+ p \int_{-\infty}^{-\varepsilon z} f_{(L_3, Y, Z)|1}(\text{VaR}_3 + \varepsilon z, y, z) \, dy \]

\[+ p \int_{-\varepsilon z}^{+\infty} f_{(L_3, Y, Z)|1}(\text{VaR}_3 - y, y, z) \, dy \right\} \, dz \]

\[+ \int z \left\{ -(1 - p) \int f_{(X, Y, Z)|0}(\text{VaR}_3 + \varepsilon z, y, z) \, dy \right. \]

\[- p \int_{-\infty}^{-\varepsilon z} f_{(X, Y, Z)}(\text{VaR}_3 + \varepsilon z, y, z) \, dy \right\} \, dz. \]

Clearly,

\[f_{(L_3, Z)|0}(l, z) = f_{(X, Z)|0}(l + \varepsilon z, z), \quad (21)\]

and

\[f_{(L_3, Y, Z)|1}(l, y, z) = f_{(X, Y, Z)|1}(l + \varepsilon z, y, z) \mathbf{1}\{y + \varepsilon z < 0\} + f_{(X, Y, Z)|1}(l - y, y, z) \mathbf{1}\{y + \varepsilon z \geq 0\}. \quad (22)\]

Thus, we deduce

\[0 = - \partial_\varepsilon \text{VaR}_3 \]

\[\times \int \left\{ (1 - p) \int f_{(L_3, Y, Z)|0}(\text{VaR}_3, y, z) \, dy \right. \]

\[+ p \int_{-\infty}^{-\varepsilon z} f_{(L_3, Y, Z)|1}(\text{VaR}_3, y, z) \, dy + p \int_{-\varepsilon z}^{+\infty} f_{(L_3, Y, Z)|1}(\text{VaR}_3, y, z) \, dy \right\} \, dz \]

\[+ \int z \left\{ -(1 - p) \int f_{(L_3, Y, Z)|0}(\text{VaR}_3, y, z) \, dy - p \int_{-\infty}^{-\varepsilon z} f_{(L_3, Y, Z)|1}(\text{VaR}_3, y, z) \, dy \right\} \, dz \]

\[= - \partial_\varepsilon \text{VaR}_3 \int f_{(L_3, Y, Z)}(\text{VaR}_3, y, z) \, dy \, dz + \int z \left\{ -(1 - p) \int f_{(L_3, Y, Z)|0}(\text{VaR}_3, y, z) \, dy \right. \]

\[- p \int_{-\infty}^{-\varepsilon z} f_{(L_3, Y, Z)|1}(\text{VaR}_3, y, z) \, dy \right\} \, dz \]

\[= - \partial_\varepsilon \text{VaR}_3 \cdot f_{L_3}(\text{VaR}_3) - (1 - p) \int \int z f_{(L_3, Y, Z)|0}(l, L_3 = \text{VaR}_3, \text{VaR}_3, y, z) \, dy \, dz \cdot f_{L_3|0}(\text{VaR}_3) \]

\[+ p \int_{-\infty}^{-\varepsilon z} z f_{(L_3, Y, Z)|1}(L_3 = \text{VaR}_3, \text{VaR}_3, y, z) \, dy \, dz \cdot f_{L_3|1}(\text{VaR}_3). \]
We get
\[
\partial_{\varepsilon} VaR_3 = \frac{(-p) f_{L_3|1}(VaR_3)}{f_{L_3}(VaR_3)} \int \int_{-\infty}^{-\varepsilon z} z f_{(L_3,Y,Z)|1,L_3=VaR_3}(VaR_3,y,z) \, dy \, dz \\
- \frac{(1-p) f_{L_3|0}(VaR_3)}{f_{L_3}(VaR_3)} \int \int z f_{(L_3,Y,Z)|0,L_3=VaR_3}(VaR_3,y,z) \, dy \, dz,
\]
and Bayes' rule gives the stated result. \(\Box\)

### A.2 First derivative of Expected Shortfall.

The expression for \(\partial_{\varepsilon} ES_1\) obtains directly from Proposition 1 in Scaillet (2000). Hence we only provide derivation of \(\partial_{\varepsilon} ES_3\) since \(\partial_{\varepsilon} ES_2\) can be deduced from \(\partial_{\varepsilon} ES_3\).

\[
ES_3 = E[L_3|L_3 > VaR_3] = \frac{1}{\alpha} E[L_3 1\{L_3 > VaR_3\}]
\]
\[
= \frac{(1-p)}{\alpha} E[L_3 1\{L_3 > VaR_3\}|D = 0] + \frac{p}{\alpha} E[L_3 1\{L_3 > VaR_3, Y + \varepsilon Z \geq 0\}|D = 1]
\]
\[
+ \frac{p}{\alpha} E[L_3 1\{L_3 > VaR_3, Y + \varepsilon Z < 0\}|D = 1]
\]
\[
\equiv \frac{(1-p)}{\alpha} \tilde{T}_1 + \frac{p}{\alpha} \tilde{T}_2 + \frac{p}{\alpha} \tilde{T}_3.
\]

By direct differentiation, we get
\[
\partial_{\varepsilon} \tilde{T}_1 = - \int z 1\{x - \varepsilon z > VaR_3\} f_{(X,Z)|0}(x,z) \, dx \, dz - VaR_3 \partial_{\varepsilon} VaR_3 \int f_{(X,Z)|0}(VaR_3 + \varepsilon z, z) \, dz
\]
\[
- VaR_3 \int z f_{(X,Z)|0}(VaR_3 + \varepsilon z, z) \, dz
\]
\[
= - \int z 1\{l > VaR_3\} f_{(L_3,Z)|0}(l,z) \, dl \, dz - VaR_3 \partial_{\varepsilon} VaR_3 \int f_{(L_3,Z)|0}(VaR_3, z) \, dz
\]
\[
- VaR_3 \int z f_{(L_3,Z)|0}(VaR_3, z) \, dz.
\]

Moreover,
\[
\partial_{\varepsilon} \tilde{T}_2 = -VaR_3 \partial_{\varepsilon} VaR_3 \int 1\{y + \varepsilon z > 0\} f_{(X,Y,Z)|1}(VaR_3 - y, y, z) \, dy \, dz
\]
\[
+ \int (x - \varepsilon z) 1\{x - \varepsilon z > VaR_3\} f_{(X,Y,Z)|1}(x, -\varepsilon z, z) \, dx \, dz,
\]
\[ \partial_\varepsilon \tilde{T}_2 = - \int z \{ x - \varepsilon z > VaR_3, y + \varepsilon z < 0 \} f_{(X,Y,Z)}(x, y, z) \, dx \, dy \, dz \]

\[- VaR_3 \int (\partial_\varepsilon VaR_3 + z) \{ y + \varepsilon z < 0 \} f_{(X,Y,Z)}(VaR_3 + \varepsilon z, y, z) \, dy \, dz \]

\[- \int (x - \varepsilon z) z \{ x - \varepsilon z > VaR_3 \} f_{(X,Y,Z)}(x, -\varepsilon z, z) \, dx \, dz. \]

Note that the last term of \( \partial_\varepsilon \tilde{T}_2 \) is the opposite of the last term of \( \partial_\varepsilon \tilde{T}_3 \). After summing all terms, we get

\[ \alpha \partial_\varepsilon ES_3 = -(1 - p) \int z \{ l > VaR_3 \} f_{(L_3,Z)}(l, z) \, dl \, dz \]

\[-(1 - p)VaR_3 \partial_\varepsilon VaR_3 \int f_{(L_3,Z)}(VaR_3, z) \, dz \]

\[-(1 - p)VaR_3 \int z f_{(L_3,Z)}(VaR_3, z) \, dz \]

\[-pVaR_3 \partial_\varepsilon VaR_3 \int 1 \{ y + \varepsilon z > 0 \} f_{(X,Y,Z)}(VaR_3 - y, y, z) \, dy \, dz \]

\[-p \int z \{ x - \varepsilon z > VaR_3, y + \varepsilon z < 0 \} f_{(X,Y,Z)}(x, y, z) \, dx \, dy \, dz \]

\[-pVaR_3 \partial_\varepsilon VaR_3 \int 1 \{ y + \varepsilon z < 0 \} f_{(X,Y,Z)}(VaR_3 + \varepsilon z, y, z) \, dy \, dz \]

\[-pVaR_3 \int z \{ y + \varepsilon z < 0 \} f_{(X,Y,Z)}(VaR_3 + \varepsilon z, y, z) \, dy \, dz \]

\[ \equiv S_1 + \ldots + S_7. \]

Note that we get by (22):

\[ S_2 + S_4 + S_6 = - VaR_3 \partial_\varepsilon VaR_3 f_{L_3}(VaR_3), \]

which simplifies with

\[ S_3 + S_7 = VaR_3 \partial_\varepsilon VaR_3 f_{L_3}(VaR_3), \]
because of (23). Thus

\[
\alpha \partial_\varepsilon ES_3 = -(1 - p) \int 1\{l > VaR_3\} z f_{\{L_3, Z\}|0}(l, z) dl \, dz \\
-p \int z 1\{l > VaR_3, y + \varepsilon z < 0\} f_{\{L_3, Y, Z\}|1}(l, y, z) dl \, dy \, dz \\
= -p E[Z 1\{L_3 > VaR_3, Y + \varepsilon Z < 0\}|1|Y + \varepsilon Z < 0]P[L_3 > VaR_3|D = 1] \\
-(1 - p) E[Z|D = 0, L_3 > VaR_3]P[L_3 > VaR_3|D = 0] \\
= -E[Z 1\{Y + \varepsilon Z < 0\}|D = 1, L_3 > VaR_3]P[D = 1|L_3 > VaR_3] \alpha \\
-E[Z|D = 0, L_3 > VaR_3]P[D = 0|L_3 > VaR_3] \alpha,
\]

proving the result. \(\square\)

**B** Proof of Proposition 2.

**B.1 First derivative of Value at Risk.**

Again we only need to explicit \(\partial_\varepsilon VaR_5\). We may rewrite the equation defining \(VaR_5\) as:

\[
\alpha = P[L_5 > VaR] \\
= (1 - p) P[X > VaR_5|D = 0] \\
+ p P[X > VaR_5, Y + \varepsilon Z < 0|D = 1] \\
+ p P[X + Y + \varepsilon Z > VaR_5, Y + \varepsilon Z > 0|D = 1] \\
\equiv (1 - p) T_1 + p T_2 + p T_3,
\]

where

\[
T_1 = \int 1\{x > VaR_5\} f_X|x|0(x) dx, \\
T_2 = \int 1\{x > VaR_5, y + \varepsilon z < 0\} f_{\{X, Y, Z\}|1}(x, y, z) dx \, dy \, dz, \\
T_3 = \int 1\{x + y + \varepsilon z > VaR_5, y + \varepsilon z > 0\} f_{\{X, Y, Z\}|1}(x, y, z) dx \, dy \, dz.
\]
A simple computation yields

\[ 0 = -(1 - p)f_{X|0}(VaR_5)\partial_\varepsilon VaR_5 - p\partial_\varepsilon VaR_5 \int 1\{y + \varepsilon z < 0\}f_{(X,Y,Z)|1}(VaR_5, y, z)\, dy\, dz \]

\[ -p \int z1\{x > VaR_5\}f_{(X,Y,Z)|1}(x, -\varepsilon z, z)\, dx\, dz \]

\[ -p \int (\partial_\varepsilon VaR_5 - z)1\{y + \varepsilon z > 0\}f_{(X,Y,Z)|1}(VaR_5 - y - \varepsilon z, y, z)\, dy\, dz \]

\[ +p \int z1\{x > VaR_5\}f_{(X,Y,Z)|1}(x, -\varepsilon z, z)\, dx\, dz. \]

Clearly, we have

\[ f_{(L_5,Y,Z)|0}(l, y, z) = f_{(X,Y,Z)|0}(l, y, z), \quad (24) \]

and

\[ f_{(L_5,Y,Z)|1}(l, y, z) = 1\{y + \varepsilon z > 0\}f_{(X,Y,Z)|1}(l - y - \varepsilon z, y, z) + 1\{y + \varepsilon z < 0\}f_{(X,Y,Z)|1}(l, y, z). \quad (25) \]

Thus, we can rewrite

\[ 0 = -\partial_\varepsilon VaR_5 f_{L_5}(VaR_5) \]

\[ +p \int z1\{y + \varepsilon z > 0\}f_{(L_5,Y,Z)|1}(VaR_5, y, z)\, dy\, dz. \quad (26) \]

We deduce

\[ \partial_\varepsilon VaR_5 \frac{f_{L_5}(VaR_5)}{f_{L_5}|1}(VaR_5) = P[D = 1|E[Z1\{Y + \varepsilon Z > 0\}|D = 1, L_5 = VaR_5], \]

and finally

\[ \partial_\varepsilon VaR_5 = P[D = 1|L_5 = VaR_5]E[Z1\{Y + \varepsilon Z > 0\}|D = 1, L_5 = VaR_5], \]

by Bayes’ rule. □
B.2 First derivative of Expected Shortfall.

We only provide derivation of $\partial_z ES_5$. As previously,

$$ES_5 = E[L_5 | L_5 > VaR_5] = \frac{1}{\alpha} E[L_5 1 \{L_5 > VaR_5\}]$$

$$= \frac{1 - p}{\alpha} E[L_5 1 \{L_5 > VaR_5\} | D = 0] + \frac{p}{\alpha} E[L_5 1 \{L_5 > VaR_5, Y + \varepsilon Z < 0\} | D = 1]$$

$$+ \frac{p}{\alpha} E[L_5 1 \{L_5 > VaR_5, Y + \varepsilon Z \geq 0\} | D = 1]$$

$$= \frac{1 - p}{\alpha} \int x 1 \{x \geq VaR_5\} f_{X|0}(x) \, dx$$

$$+ \frac{p}{\alpha} \int x 1 \{x \geq VaR_5, y + \varepsilon Z < 0\} f_{X,Y,Z}(x, y, z) \, dx \, dy \, dz$$

$$+ \frac{p}{\alpha} \int (x + y + \varepsilon z) 1 \{(x + y + \varepsilon z) \geq VaR_5, y + \varepsilon Z \geq 0\} f_{X,Y,Z}(x, y, z) \, dx \, dy \, dz$$

$$\equiv \frac{1 - p}{\alpha} \bar{T}_1 + \frac{p}{\alpha} \bar{T}_2 + \frac{p}{\alpha} \bar{T}_3.$$

Here,

$$\partial_z \bar{T}_1 = -VaR_5 \partial_z VaR_5 f_{X|0}(VaR_5),$$

$$\partial_z \bar{T}_2 = -VaR_5 \partial_z VaR_5 \int 1 \{y + \varepsilon Z < 0\} f_{X,Y,Z}(VaR_5, y, z) \, dy \, dz$$

$$- \int z x 1 \{x \geq VaR_5\} f_{X,Y,Z}(x, -\varepsilon Z, z) \, dx \, dz,$$

$$\partial_z \bar{T}_3 = \int z 1 \{x + y + \varepsilon Z \geq VaR_5, y + \varepsilon Z \geq 0\} f_{X,Y,Z}(x, y, z) \, dx \, dy \, dz$$

$$- \int (\partial_z VaR_5 - z) VaR_5 1 \{y + \varepsilon Z > 0\} f_{X,Y,Z}(VaR_5, y - \varepsilon Z, y, z) \, dy \, dz$$

$$+ \int z x 1 \{x > VaR_5\} f_{X,Y,Z}(x, -\varepsilon Z, z) \, dx \, dz.$$

We get by recalling Equation (26):

$$\alpha \partial_z ES_5 = -VaR_5 \partial_z VaR_5 f_{L_5}(VaR_5)$$

$$\quad + p \int z 1 \{l > VaR_5, y + \varepsilon Z > 0\} f_{L_5,Y,Z}(l, y, z) \, dl \, dy \, dz$$

$$\quad + p VaR_5 \int z 1 \{y + \varepsilon Z > 0\} f_{L_5,Y,Z}(VaR_5, y, z) \, dl \, dy \, dz$$

$$= p \int z 1 \{l > VaR_5, y + \varepsilon Z > 0\} f_{L_5,Y,Z}(l, y, z) \, dl \, dy \, dz.$$
Thus, by applying Bayes’ rule, we get
\[
\partial_\varepsilon ES_5 = \frac{P[D = 1]}{P[L_5 > VaR_5]} \int z \{l > VaR_5, y + \varepsilon z > 0\} f_{(L_5, Y, Z)}(l, y, z) \, dl \, dy \, dz
\]
\[
= P[D = 1|L_5 > VaR_5]E[Z \{Y + \varepsilon Z > 0\}|L_5 > VaR_5, D = 1],
\]
which proves the result. □

C Sensitivity of \(VaR\) and \(ES\) under the Gaussian assumption.

Let us first recall a useful lemma:

**Lemma 4.** The law of \(E_1\) conditionally to \(E_2 = e\) is Gaussian with mean
\[
m_{1|2}(e) = m_1 + \frac{\rho \sigma_1}{\sigma_2}(e - m_2),
\]
and variance
\[
\sigma_{1|2}^2 = \sigma_1^2(1 - \rho^2).
\]

Invoking (13), the sensitivity of \(L_U\)'s Value-At-Risk is
\[
\partial_\varepsilon VaR_U = E[E_2 \{E_2 > 0, D = 1\}|L_U = v],
\]
where \(v\) is the VaR level. First, let us calculate the density of \(L_U\). Actually, \(L_U\) equals 0 with the probability
\[
P(L_U = 0) = 1 - p + pP(E_1 < 0, E_2 < 0).
\]
Otherwise, \(L_U\) has a density with respects to the Lebesgue measure on \(\mathbb{R}^+\).

More specifically, consider a measurable real function \(\psi\). Then
\[
E[\psi(L_U)] = \psi(0)\{1 - p + pP(E_1 < 0, E_2 < 0)\}
+ p \int \psi(e) \{e > 0\} P(E_2 < 0|E_1 = e) f_{E_1}(e) \, de
+ p \int \psi(\varepsilon e) \{e > 0\} P(E_1 < 0|E_2 = e) f_{E_2}(e) \, de
+ p \int \psi(l) \{l > 0, e > 0\} f_{(L, E_2)}(l, e) \, de \, dl,
\]
26
where we have set \( \mathcal{L} = E_1 + \varepsilon E_2 \). By applying successively Lemma 4, we get

\[
P(E_2 < 0 | E_1 = e) = \Phi \left( - \left( m_2 + \frac{\rho \sigma_2}{\sigma_1} (e - m_1) \right) \frac{1}{\sigma_2 \sqrt{1 - \rho^2}} \right),
\]

\[
P(E_1 < 0 | E_2 = e) = \Phi \left( - \left( m_1 + \frac{\rho \sigma_1}{\sigma_2} (e - m_2) \right) \frac{1}{\sigma_1 \sqrt{1 - \rho^2}} \right).
\]

Moreover, the random vector \( (\mathcal{L}, E_2) \) is Gaussian with mean \( m = (m_1 + \varepsilon m_2, m_2)' \) and covariance matrix

\[
\Omega = \begin{bmatrix}
\tau^2 & \nu \tau \sigma_2 \\
\nu \tau \sigma_2 & \sigma_2^2
\end{bmatrix}.
\]

with

\[
\tau^2 = \sigma_1^2 + \varepsilon^2 \sigma_2^2 + 2 \varepsilon \rho \sigma_1 \sigma_2,
\]

\[
\nu \tau \sigma_2 = \rho \sigma_1 \sigma_2 + \varepsilon \sigma_2^2.
\]

Thus, by applying Lemma 4 and the symmetry of the Gaussian distribution, we get

\[
P(E_2 > 0 | \mathcal{L} = l) = \Phi \left( \frac{1}{\sigma_2 \sqrt{1 - \nu^2}} [m_2 + \frac{\nu \sigma_2}{\tau} (l - m_1 - \varepsilon m_2)] \right).
\]

The density of \( L_U \) at \( l > 0 \) is then

\[
f_{L_U}(l) = p \frac{P(E_2 < 0 | E_1 = l) \phi \left( \frac{(l - m_1)}{\sigma_1} \right)}{\sigma_1} + \frac{P(E_1 < 0 | E_2 = l/\varepsilon) \phi \left( \frac{(l - m_2 \varepsilon)}{\varepsilon \sigma_2} \right)}{\varepsilon \sigma_2}
\]

\[
+ \frac{P(E_2 > 0 | \mathcal{L} = l) \phi \left( \frac{(l - m_1 - \varepsilon m_2)}{\tau} \right)}{\tau}.
\]

Moreover, for every \( v > 0 \) such that \( f_{L_U}(v) > 0 \),

\[
\partial V a R_U = E[ E_2 \mathbf{1}\{E_2 > 0, D = 1\} | L_U = v]
\]

\[
= E[ E_2 \mathbf{1}\{E_1 > 0, E_2 > 0, D = 1\} | L_U = v] + E[ E_2 \mathbf{1}\{E_1 < 0, E_2 > 0, D = 1\} | L_U = v]
\]

\[
= E[ E_2 \mathbf{1}\{E_1 > 0, E_2 > 0, D = 1\} | L_U = v] + E[ \frac{L_U}{\varepsilon} \mathbf{1}\{E_1 < 0, L_U > 0, D = 1\} | L_U = v]
\]

\[
= \frac{p}{f_{L_U}(v)} \left[ \int \mathbf{1}\{v - \varepsilon e > 0, e > 0\} f_{(E_1, E_2)}(v - \varepsilon e, e) \, de \right]
\]

\[
+ \frac{\nu}{\varepsilon} \int \mathbf{1}\{e < 0\} f_{(E_1, E_2)}(e, \frac{v}{\varepsilon}) \, de.
\]
Moreover, let \( \tilde{v} = v - m_1 - \varepsilon m_2 \). Let us compute

\[
\int \mathbf{1}\{v - \varepsilon e > 0, e > 0\} f_{(E_1, E_2)}(v - \varepsilon e, e) \, de
\]

\[
= \int \mathbf{1}\{v - \varepsilon e > 0, e > 0\} \exp \left( \frac{-\sigma^2_2 \tilde{v}^2 + \sigma_1^2 \tilde{v}^2 - 2\rho \sigma_1 \sigma_2 \tilde{v} \varepsilon \tilde{e}}{2\sigma_1^2 \sigma_2^2 (1 - \rho^2)} \right) \frac{de}{2\pi \sigma_1 \sigma_2 \sqrt{1 - \rho^2}}
\]

\[
= \int \mathbf{1}\{v - \varepsilon e > 0, e > 0\} \exp \left( \frac{-\tau \tilde{e} - \nu \sigma_2 \tilde{v}}{2\sigma_1^2 \sigma_2^2 (1 - \rho^2)} \right) \frac{de}{2\pi \sigma_1 \sigma_2 \sqrt{1 - \rho^2}}
\]

\[
= \phi \left( \frac{\tilde{v} \sqrt{1 - \nu^2}}{\sigma_1 \sqrt{1 - \rho^2}} \right) \int \mathbf{1}\{v - \varepsilon e > 0, e > 0\} \phi \left( \frac{\tau \tilde{e} - \nu \sigma_2 \tilde{v}}{\sigma_1 \sigma_2 \sqrt{1 - \rho^2}} \right) \frac{de}{\sigma_1 \sigma_2 \sqrt{1 - \rho^2}}
\]

\[
= \frac{1}{\tau^2} \phi \left( \frac{\tilde{v} \sqrt{1 - \nu^2}}{\sigma_1 \sqrt{1 - \rho^2}} \right) \left[ \sigma_1 \sigma_2 \sqrt{1 - \rho^2} \int_c^d t \phi(t) dt + (m_2 \tau + \nu \sigma_2 \tilde{v}) \int_c^d \phi(t) dt \right]
\]

\[
= \frac{1}{\tau^2} \phi \left( \frac{\tilde{v} \sqrt{1 - \nu^2}}{\sigma_1 \sqrt{1 - \rho^2}} \right) \left[ \sigma_1 \sigma_2 \sqrt{1 - \rho^2} (\phi(c) - \phi(d)) + (m_2 \tau + \nu \sigma_2 \tilde{v}) (\Phi(d) - \Phi(c)) \right], \quad (29)
\]

by setting

\[
c = -\frac{m_2 \tau}{\sigma_1 \sigma_2 \sqrt{1 - \rho^2}} - \frac{\nu \tilde{v}}{\sigma_1 \sqrt{1 - \rho^2}}, \quad d = \left( \frac{v}{\varepsilon} - \frac{\nu \sigma_2 \tilde{v}}{\tau} - m_2 \right) \cdot \frac{\tau}{\sigma_1 \sigma_2 \sqrt{1 - \rho^2}}.
\]

and by denoting \( \phi \), resp. \( \Phi \), the pdf, resp. cdf of a standard Gaussian random variable.

Moreover,

\[
\int \mathbf{1}\{e < 0\} f_{(E_1, E_2)}(e, v, \tilde{v}) \, de
\]

\[
= \phi \left( \frac{v / \varepsilon - m_2}{\sigma_2} \right) \int \mathbf{1}\{e < 0\} \exp \left( -\frac{[\sigma_2 (e - m_1) - \rho \sigma_1 (v / \varepsilon - m_2)]^2}{2\sigma_1^2 \sigma_2^2 (1 - \rho^2)} \right) \frac{de}{\sqrt{2\pi \sigma_1 \sigma_2 \sqrt{1 - \rho^2}}}
\]

\[
= \frac{1}{\sigma_2} \phi \left( \frac{v - \varepsilon m_2}{\varepsilon \sigma_2} \right) \Phi \left( -\frac{m_1}{\sigma_1 \sqrt{1 - \rho^2}} - \frac{\rho (v - \varepsilon m_2)}{\varepsilon \sigma_2 \sqrt{1 - \rho^2}} \right).
\] \quad (30)

By taking together equations (28), (27), (29) and (30), we find \( \partial_\varepsilon \text{VaR}_U \).

Similar calculations provide \( \partial_\varepsilon \text{VaR}_N \) in the netted case. Here, the loss function equals zero with the probability \( 1 - p + pP(E_1 + \varepsilon E_2 < 0) \). This function has a density with respect to the Lebesgue measure at every positive point \( v \), and, with the previous notations,

\[
f_{L_N}(v) = \frac{p}{\tau} \cdot \phi \left( \frac{v - m_1 - \varepsilon m_2}{\tau} \right) \mathbf{1}\{v > 0\}.
\] \quad (31)
Moreover,

\[ \partial_v \text{VaR}_N = E[E_2 1 \{ D = 1 \}| L_N = v] \]

\[ = \frac{p}{f_{L_N}(v)} \int e f(t, E_2)(v, e) \, de \]

\[ = \frac{p}{f_{L_N}(v)} \int e \exp \left( -\frac{[\tau \hat{e} - \nu \sigma_2 \hat{v}]^2}{2 \sigma_2^2 \tau^2 (1 - \nu^2)} \right) \frac{de}{\sqrt{2\pi \sigma_2^2 \tau \sqrt{1 - \nu^2}}} \cdot \phi \left( \frac{\hat{v}}{\tau} \right) \]

\[ = \frac{p}{\tau^2 f_{L_N}(v)} \cdot \phi \left( \frac{\hat{v}}{\tau} \right) [\nu \sigma_2 \hat{v} + \tau m_2]. \quad (32) \]

Equations (31) and (32) provide the sensitivity of the VaR for \( L_N \).

Let us remark that the sensitivities of the expected shortfalls of \( L_N \) and \( L_U \) can be calculated in the same way. Unfortunately the formulas are more complicated. An extra integration with respect to \( v \) is in fact needed, and the sensitivities do not admit simple closed forms.

**D Asymptotic normality of VaR sensitivity estimators**

Let us consider an i.i.d. sample \((e_i, l_i)_{i=1,...,n}\) of a random vector \((e, l)\). The density of \( l \) is denoted by \( f \). Let \( \hat{v} \) be a statistic which tends to a constant \( v \) and \( n^{1/2}(\hat{v} - v) = O_P(1) \).

Set

\[ \hat{r}(v) = \frac{\sum_{i=1}^n e_i K_h(l_i - \hat{v})}{\sum_{i=1}^n K_h(l_i - \hat{v})}, \]

and denote the expectation of \( e_i \) conditionally to \( l_i = v \) by \( r(v) \), and its conditional variance by

\[ \mu(v) = E[e_i^2 | l_i = v] - r(v)^2. \]

**Lemma 5.** Assume

- \( K \) is an even kernel function, \( \int |t|^3 |K|(t) \, dt < \infty \), \( \lim_{|t| \to \infty} |t|^3 K(t) = 0 \). It is three times continuously differentiable, \( K' \) and \( K'' \) are integrable and \( K''' \) is bounded.

- \( E[|e|^p] < \infty \) for every integer \( p \),

29
• $t \mapsto E[e^4|l = t]$ is bounded in a neighborhood of $v$,

• $nh^5 \to 0$ and $nh^{7/2} \to \infty$,

• $r$ and $f$ are two times continuously differentiable,

• $f$ and $\mu$ are continuous and strictly positive in a neighborhood of $v$.

Then

$$\sqrt{nh}\{\hat{r}(v) - r(v)\} \xrightarrow{\text{law}} N\left(0, \int K^2 \cdot \mu(v)/f(v)\right).$$

Obviously the limiting behavior of $\partial_{\epsilon}VaR_k$, $k = 4, 5$ is a direct consequence of the previous lemma. For instance, set $e_i = z_i 1\{z_i > 0, D_i = 1\}$ to get the result for $\partial_{\epsilon}VaR_4$.

**Proof of Lemma 5**

The estimator $\hat{r}(v)$ can be decomposed into

$$\hat{r}(v) = \frac{\sum_{i=1}^n e_i K_h(l_i - v)}{\sum_{i=1}^n K_h(l_i - v)} + R_1(v) + \hat{r}(v)R_2(v),$$

with

$$R_1(v) = \frac{n^{-1} \sum_{i=1}^n e_i \{K_h(l_i - \hat{v}) - K_h(l_i - v)\}}{n^{-1} \sum_{i=1}^n K_h(l_i - v)},$$

and

$$R_2(v) = \frac{n^{-1} \sum_{i=1}^n \{K_h(l_i - v) - K_h(l_i - \hat{v})\}}{n^{-1} \sum_{i=1}^n K_h(l_i - v)}.$$

By applying Corollary IV.2 in Bosq and Lecoutre (1987), we get

$$\sqrt{nh}\left\{\sum_{i=1}^n e_i K_h(l_i - v) \right\} \sim N\left(0, \int K^2 \cdot \mu(v)/f(v)\right).$$

Moreover,

$$P\left(\sqrt{nh}|R_1(v)| > \epsilon\right) \leq P\left(\frac{\sqrt{nh}}{n} \left| \sum_{i=1}^n e_i \{K_h(l_i - \hat{v}) - K_h(l_i - v)\} \right| > \epsilon f(v)/2\right)$$

$$+ P\left(\left|n^{-1} \sum_{i=1}^n K_h(l_i - v) - f(v)\right| > f(v)/2\right) = P_1 + P_2.$$
The second term on the right hand side tends to zero (convergence in probability of the usual kernel estimator of the density function). By a three order expansion of $K_h$, we get

$$P_1 \leq P \left( \frac{\sqrt{nh}}{nh} \mid \sum_{i=1}^{n} e_i \left\{ (K')_h(l_i - v)(\hat{v} - v) \right\} \mid > \varepsilon f(v)/6 \right)$$

$$+ P \left( \frac{\sqrt{nh}}{n^2 h} \mid \sum_{i=1}^{n} e_i \left\{ (K'')_h(l_i - v)(\hat{v} - v)^2 \right\} \mid > \varepsilon f(v)/3 \right)$$

$$+ P \left( \frac{\sqrt{nh}}{nh^3} \mid \sum_{i=1}^{n} e_i \left\{ (K''')_h(l_i - v^*)(\hat{v} - v)^3 \right\} \mid > \varepsilon f(v) \right) \equiv P_{11} + P_{12} + P_{13},$$

where $|v^* - v| < |\hat{v} - v|$ a.e. Clearly, $P_{13}$ is zero for $n$ sufficiently large when $nh^{7/2} \rightarrow \infty$. Moreover, for every constant $\eta > 0$, there exists a constant $C > 0$ such that

$$P_{11} \leq P(n^{1/2}|\hat{v} - v| > C) + P \left( \frac{\sqrt{h}}{nh} \mid \sum_{i=1}^{n} e_i \left\{ (K')_h(l_i - v) \right\} \mid > \varepsilon f(v)/(6C) \right)$$

$$\leq \eta + \frac{E[e_i(K')_h(l_i - v)]}{\sqrt{Cst. h}}$$

$$\leq \eta + O(h^{1/2})$$

by an integration by parts. Thus, $P_{11}$ tends to zero when $n \rightarrow \infty$. Similar calculations provide the same result for $P_{12}$. Thus, we deduce

$$R_1(v) = o_P(1).$$

We can handle $R_2(v)$ similarly. Thus, we get the stated result by combining (33), (34) and (35). □
References


2002

2002.01 Jean-Emile DENIS
Taking International Marketing Decisions under WTO Rules

2002.02 Jean-Luc PRIGENT, Olivier SCAILLET
Weak Convergence of Hedging Strategies of Contingent Claims

2002.03 Séverine CAUCHIE, Martin HOESLI, Dušan ISAKOV
The Determinants of Stock Returns : an Analysis of Industrial Sector Indices

2002.04 Ana C. CEBRIAN, Michel DENUIT, Olivier SCAILLET
Testing for Concordance Ordering

2002.05 M. DENUIT, Olivier SCAILLET
Nonparametric Tests for Positive Quadrant Dependence

2002.06 Bernard DUBOIS, Sandor CZELLAR
Prestige Brands or Luxury Brands ? An Exploratory Inquiry on Consumer Perceptions

2002.07 John GUNSON, Jean-Paul DE BLASIS
Implementing ERP in Multinational Companies : their Effects on the Organization and Individuals at Work

2002.08 Michael GIBBERT, Gilbert J.B. PROBST
Anticipating and Managing Three Dilemmas in Knowledge Management : Insights from an In-Depth Case Study of a Major Diversified Firm

2002.09 Michael GIBBERT, Marius LEIBOLD, Gilbert J.B. PROBST
Five Styles of Customer Knowledge Management and how Smart Companies put them into Action

2002.10 Gilbert J.B. PROBST, Michael GIBBERT, Steffen RAUB
Wissensmanagement

2002.11 Claude TADONKI, Jean-Philippe VIAL
The Linear Separation Problem Revisited with ACCPM

2002.12 Philippe GAUD, Elion JANI
Déterminants et dynamique de la structure du capital des entreprises suisses : une étude empirique

2002.13 Foort HAMELINK, Martin HOESLI
What Factors Determine International Real Estate Security Returns ?

2002.14 Sandor CZELLAR
Consumer Attitude Towards Brand Extensions : an Integrative Model and Research Propositions
<table>
<thead>
<tr>
<th>Year</th>
<th>Authors</th>
<th>Title</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002.15</td>
<td>Michelle BERGADAA</td>
<td>Achats en ligne : un nouveau cadre temporel d'analyse de l'éthique dans la relation achat-vente</td>
</tr>
<tr>
<td>2002.16</td>
<td>Michelle BERGADAA</td>
<td>Comment les mutations mondiales sont-elles vécues par les grandes entreprises en Europe ?</td>
</tr>
<tr>
<td>2002.18</td>
<td>Michelle BERGADAA, Samad LAAROUSSI</td>
<td>Proposition d'une typologie d'interface entreprise-client induite d'une recherche qualitative par groupes de focus</td>
</tr>
<tr>
<td>2002.19</td>
<td>Michelle BERGADAA, Mohamed Jamil HEBALI</td>
<td>Les seniors utilisateurs d'Internet : typologie induite d'une recherche qualitative en-ligne</td>
</tr>
<tr>
<td>2002.20</td>
<td>Patricia GARCIA-PRIETO, Erwan BELLARD, Susan C. SCHNEIDER</td>
<td>Experiencing Diversity, Conflict and Emotions in Teams</td>
</tr>
<tr>
<td>2002.21</td>
<td>Natacha AYMARD-MARTINOT, Zofia HUBER SWINARSKI, Bernard MORARD</td>
<td>Balanced Scorecard : Evaluation de la performance dans un établissement médico-social</td>
</tr>
<tr>
<td>2002.22</td>
<td>Sandor CZELLAR</td>
<td>A Link between Self-monitoring and Prestige-related Consumer Knowledge? Preliminary Evidence from North America and Europe</td>
</tr>
<tr>
<td>2002.23</td>
<td>Olivier DU MERLE, Jean-Philippe VIAL</td>
<td>Proximal ACCPM, a Cutting Plane Method for Column Generation and Lagrangian Relaxation : Application to the P-Median Problem</td>
</tr>
<tr>
<td>2002.24</td>
<td>Michelle BERGADAA</td>
<td>L’utilisation de multi-cas d’entreprises dans un contexte de changement et de crise : compte-rendu d’expérience</td>
</tr>
<tr>
<td>2002.25</td>
<td>Stéphane GRABER, Sandor CZELLAR, Jean-Emile DENIS</td>
<td>Using Partial Least Squares Regression in Marketing Research</td>
</tr>
<tr>
<td>Year</td>
<td>Authors</td>
<td>Title</td>
</tr>
<tr>
<td>------</td>
<td>---------</td>
<td>-------</td>
</tr>
<tr>
<td>2003</td>
<td>Stéphane GRABER, Sandor CZELLAR, Jean-Emile DENIS</td>
<td>Premières évidences empiriques sur les antécédents de l’orientation vers le marché dans la gestion bancaire privée</td>
</tr>
<tr>
<td>2003</td>
<td>John GUNSON, Jean-Paul DE BLASIS</td>
<td>ERP implementation project management : an art as well as a science</td>
</tr>
<tr>
<td>2003</td>
<td>Paolo BATTOCCHIO, Francesco MENONCIN, Olivier SCAILLET</td>
<td>Optimal asset allocation for pension funds under mortality risk during the accumulation and decumulation phases</td>
</tr>
<tr>
<td>2003</td>
<td>Dušan ISAKOV, Frédéric SONNEY</td>
<td>Are practitioners right ? On the relative importance of industrial factors in international stock returns</td>
</tr>
<tr>
<td>2003</td>
<td>Martin HOESLI</td>
<td>Pourquoi les institutionnels investissent-ils si peu en immobilier ?</td>
</tr>
<tr>
<td>2003</td>
<td>Aharon BEN TAL, Boaz GOLANY, Arcadi NEMIROVSKI, Jean-Philippe VIAL</td>
<td>Supplier-Retailer Flexible Commitments Contracts : A Robust Optimization Approach</td>
</tr>
<tr>
<td>2003</td>
<td>Gaël VETTORI</td>
<td>Economies d’échelle – Les résultats de la recherche sur le secteur bancaire suisse</td>
</tr>
<tr>
<td>2003</td>
<td>César BELTRAN</td>
<td>The face simplex method in the cutting plane framework</td>
</tr>
<tr>
<td>2003</td>
<td>Philippe GAUD</td>
<td>Choix de financement des Firmes Européennes</td>
</tr>
<tr>
<td>2003</td>
<td>Olivier RENAUT, Olivier SCAILLET</td>
<td>On the Way to Recovery : A Nonparametric Bias Free Estimation of Recovery Rate Densities</td>
</tr>
<tr>
<td>2003</td>
<td>Jean-Emile DENIS, Stéphane GRABER, Sandor CZELLAR</td>
<td>Orientation vers le marché (OVM), qualité des services et satisfaction des clients dans le secteur du private banking (PB)</td>
</tr>
<tr>
<td>2003</td>
<td>Steven C. BOURASSA, Martin HOESLI, Vincent S. PENG</td>
<td>Do Housing Submarkets Really Matter ?</td>
</tr>
<tr>
<td>2003</td>
<td>Steven C. BOURASSA, Martin HOESLI, Jian SUN</td>
<td>What’s in a view ?</td>
</tr>
<tr>
<td>2003</td>
<td>Peter ENGLUND, Ake GUNNELIN, Martin HOESLI, Bo SÖDERBERG</td>
<td>Implicit Forward Rents as Predictors of Future Rents</td>
</tr>
<tr>
<td>Year</td>
<td>Authors</td>
<td>Title</td>
</tr>
<tr>
<td>------</td>
<td>----------------------------------</td>
<td>-----------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>2003.15</td>
<td>John GUNSON, Jean-Paul DE BLASIS, Mary NEARY</td>
<td>Leadership in Real Time: A Model of Five Levels of Attributes Needed by a Project Manager in ERP Implementations</td>
</tr>
<tr>
<td>2003.16</td>
<td>Kpate ADJAOUTE, Jean-Pierre DANTHINE, Dusan ISAKOV</td>
<td>Portfolio Diversification in Europe</td>
</tr>
<tr>
<td>2003.17</td>
<td>Elion JANI</td>
<td>Les déterminants des liquidités des entreprises suisses</td>
</tr>
<tr>
<td>2003.18</td>
<td>Jean-David FERMANIAN, Olivier SCAILLET</td>
<td>Sensitivity Analysis of Var and Expected Shortfall for Portfolios under Netting Agreements</td>
</tr>
</tbody>
</table>

La liste complète des cahiers de recherche se trouve sur notre site internet [http://www.hec.unige.ch/recherches_publications/recherche_publications.htm](http://www.hec.unige.ch/recherches_publications/recherche_publications.htm)

Pour commander des documents, veuillez vous adresser à :  
Caroline Sahlé – HEC Uni-Mail – 40 bd du Pont-d’Arve – 1211 Genève 4  
par tél. +41 22 705 81 09 ou par e-mail : caroline.sahle@hec.unige.ch