Smart Systemic-Risk Scores

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- Banks classified as SIFIs subject to higher capital requirements
- Classification of SIFIs: simple average of 5 systemic-risk categories
- Problem: volatile categories are *de facto* more important (Benoit et al. 2018)
    - Solution: standardization of the categories

This paper

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- Suggests a measure that equalize the contribution to variance of each category (*smart* indicator)
- Good properties of smart indicators: low variance without capping

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I would like to see:

- A better integration of the theoretical framework
- Some clarifications on your methodological choices
- More discussion of the objectives of the regulator

Theoretical axioms - 1/2

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- In the example above $\Delta(X_\theta) = \sum x_{i,\theta}$ and $\rho_0(Y) = E[Y]$
- Allows to characterize very simply a wide set of systemic risk measures

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First remark: no more risk here. Yet mention of *"risk of systemic risk indicator"*, *"smart betas"*.

- Risk $\rightarrow$ variance
- Not so much a question of measuring risk as a way to define an optimal indicator (Svensson and Woodford 2003)

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- But what if some banks are actually contributing to a large extent to systemic risk?
- Could you try to formalize the "symmetric treatment" constraint?

A quick technical remark

Not completely sure of your normalization choice

- In your paper you impose $\rho(1) = 0$
- Chen at al. (2013) impose $\rho(1) = F > 0$
- This normalization choice seems important to obtain the decomposition (Theorem 1)

Incentives

"By setting smaller weights for the most volatile categories, I create positive incentives for banks, especially non-SIFIs, to increase their risk taking in these categories without being heavily (and quickly) penalized by additional capital requirements. I argue that this pattern may increase financial stability since banks will become more substitutable by allowing some banks to increase their market shares in specialized activities, such as the custody services."

- To which extent can banks react to the indicators? Do changes in the ranking occur frequently?
- Is it desirable to have banks that are more similar?
- Shouldn't your weighting scheme change over time?

Good luck with the paper!