A sensitivities based CoVaR approach to assets commonality and its application to SSM banks

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Abstract

One important source of systemic risk can arise from asset commonality among ﬁnancial institutions. This indirect interconnection may occur when ﬁnancial institutions invest in similar or correlated assets and is also described as overlapping portfolios. In this work, we propose a methodology to quantify systemic risk derived from asset commonality and we apply it to assess the degree of indirect interconnection of banks due to their ﬁnancial holdings. Based on granular information of asset holdings of European signiﬁcant banks, we compute the sensitivity based ∆ CoVaR which captures the potential sources of systemic risk originating from asset commonality. The novel indicator proves to be consistent with other indicators of systemic importance, yet it has a more transparent foundation in terms of the source of systemic risk, which can contribute to eﬀective macroprudential supervision.

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