Abstract

We explore the practical relevance from a supervisor's perspective of a popular market-based indicator of the exposure of a financial institution to systemic risk, the marginal expected shortfall (MES). The MES of an institution can be defined as its expected equity loss when the market itself is in its left tail. We estimate the dynamic MES recently proposed by Brownlees and Engle (2011) for a panel of 65 large US banks over the last decade and a half. Running panel regressions of the MES on bank characteristics, we first find that the MES can be roughly rationalized in terms of standard balance sheet indicators of bank financial soundness and systemic importance. We then ask whether the cross section of the MES can help to identify *ex ante*, i.e. before a crisis unfolds, which institutions are the more likely to suffer the most severe losses *ex post*, i.e. once it has unfolded. Unfortunately, using the recent crisis as a natural experiment, we find that standard balance-sheet metrics like the tier one solvency ratio are better able than the MES to predict equity losses conditionally to a true crisis.

Keywords: MES, systemic risk, tail correlation, balance sheet ratios, panel.

JEL Classification: C5, E44, G2.