The Information in Systemic Risk Rankings☆

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Abstract

We propose to pool alternative systemic risk rankings for financial institutions using the method of principal components. The resulting overall ranking is less affected by estimation uncertainty and model risk. We apply our methodology to disentangle the common signal and the idiosyncratic components from a selection of key systemic risk rankings that are recently proposed. We use a sample of 113 listed financial sector firms in the European Union over the period 2002-2013. The implied ranking from the principal components is less volatile than most individual risk rankings and leads to less turnover among the top ranked institutions. We also find that price-based rankings and fundamentals based rankings deviated substantially and for a prolonged time in the period leading up to the financial crisis. We test the adequacy of our newly pooled systemic risk ranking by relating it to credit default swap premia.

Keywords: systemic risk contribution, risk rankings, forecast combination, financial regulation, banking supervision.

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