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- Let $Y_1, Y_2, \ldots, Y_{N_u}$ be the exceedances. Determine $\hat{\beta}$ and $\hat{\gamma}$, such that the following holds:

$$\bar{F}_u(y) \approx \bar{G}_{\hat{\gamma},0,\widehat{\beta(u)}}(y),$$

  where $\bar{F}_u(y) = P(X - u > y | X > u)$.

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- Use N_u and $\bar{F}_u \approx \bar{G}_{\hat{\gamma}, 0, \widehat{\beta(u)}}$ to obtain estimators for the tail and the quantile of F

$$\widehat{\bar{F}(u+y)} = \frac{N_u}{n}\left(1 + \hat{\gamma}\frac{y}{\hat{\beta}}\right)^{-1/\hat{\gamma}} \quad \text{and} \quad \hat{q}_p = u + \frac{\hat{\beta}}{\hat{\gamma}}\left(\left(\frac{n}{N_u}(1-p)\right)^{-\hat{\gamma}} - 1\right)$$

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The justification :

- $e_F(u) = \int_0^\infty t dF_u(t) \approx \int_0^\infty t dG_{\gamma,0,\beta(u)}(t) = E(G_{\gamma,0,\beta(u)}) = \frac{\beta(u)}{1-\gamma}$, if $F_u(t) \approx G_{\gamma,0,\beta(u)}(t)$.

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- If $\bar{F}_u(x) \approx \bar{G}_{\gamma,0,\beta}(x)$ then $\forall v \geq u$ the approximation $\bar{F}_v(x) \approx \bar{G}_{\gamma,0,\beta+\gamma(v-u)}(x)$ holds.

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Definition: The empirical mean excess function:
Let $x_1, x_2, \ldots, x_n$ be a sample of i.i.d r.v. Let $N_u = |\{i\colon 1 \leq i \leq n, x_i > u\}|$ be the number of the sample points which exceed u. The empirical mean excess function $e_n(u)$ is defined as:

$$e_n(u) = \frac{1}{N_u}\sum_{i=1}^{n}(x_i - u)I_{\{x_i > u\}}.$$

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Consider the plot of the (interpolation of the) empirical mean excess function: $(x_{k,n}, e_n(x_{k,n}))$, $k = 1, 2, \ldots, n-1$. If this plot is approximately linear around some $x_{k,n}$, then $u := x_{k,n}$ might be a good choice for the threshold value.

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$$\ln L(\gamma, \beta, Y_1, \ldots, Y_{N_u}) = -N_u \ln \beta - \left(\frac{1}{\gamma} + 1\right) \sum_{i=1}^{N_u} \ln\left(1 + \frac{\gamma}{\beta} Y_i\right)$$

where $Y_i \geq 0$ for $\gamma > 0$ and $0 \leq Y_i \leq -\beta/\gamma$ for $\gamma < 0$.

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(see Daley, Veve-Jones (2003) and Coles (2001))

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The ML-estimators are in this case normally distributed:

$$(\hat{\gamma} - \gamma, \frac{\hat{\beta}}{\beta} - 1) \sim N(0, \Sigma^{-1}/N_u) \text{ where } \Sigma^{-1} = \begin{pmatrix} 1+\gamma & -1 \\ -1 & 2 \end{pmatrix}.$$

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There is an uncertainty related to the more or less arbitrary choice of the threshold u. It can be reduced by

- investigating the dependency of the ML-estimator $\hat{\gamma}$ on u.
- visualizing and inspecting the estimated tail distribution

$$\hat{\bar{F}}(u+y) = \frac{N_u}{n}\left(1 + \hat{\gamma}\frac{y}{\hat{\beta}}\right)^{-1/\hat{\gamma}}$$

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Let $x_1, x_2, \ldots, x_n$ be a sample of i.i.d. r.v. with an unknown distribution function F. From the POT method we get the following estimators for the tail distribution and the quantile $q_p = VaR_p(F)$ of F

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For $\hat{\gamma} \notin \{0,1\}$ we get the following estimator for CVaR:

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The proof is done in two steps:

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(1) Let X be a r.v. with $X \sim GPD_{\gamma,0,\beta}$ and $\gamma \notin \{0,1\}$. We show that

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The CVaR of the approximation $\tilde{F}$ is given as follows for $q_p > u$:

$$CVaR_p(\tilde{F}) = \hat{q}_p + \frac{\beta + \gamma(\hat{q}_p - u)}{1-\gamma}$$