The Dynamic Convex Valuation Related To The Price Process In A Market With General Jumps *

Dewen Xiong†, Michael Kohlmann‡
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Abstract. We consider an incomplete market with general jumps in the given price process $S$ of a risky asset. We define the $S$-related dynamic convex valuation ($S$-related DCV) which is time-consistent. We discuss the representation for a given $S$-related DCV $C$ in terms of a ‘penalty functional’ $\alpha$ and give some characteristics of $\alpha$, which are the sufficient conditions for a given $C$ to be an $S$-related DCV. Finally, we give two special forms of $\alpha$ satisfying those conditions to describe the dynamics of the corresponding $S$-related DCV by a backward semimartingale equation.

Key words: backward semimartingale equation (BSE); dynamic convex valuation (DCV); dynamic convex risk measure; time-consistency

Mathematics Subject Classification (2000): 90A09, 60H30, 60G44

1 Introduction

One of the important problems in mathematical finance is the valuation of contingent claims in incomplete financial markets. Recently, many researchers have studied the utility indifference valuation method, see Klöppel and Schweizer(2007)[19], Mania and Schweizer (2005)[24], Rouge and El Karoui (2000)[26], and the references in there. In this paper, we continue our research on valuations in Xiong and Kohlmann (2008)[27] where a special utility indifference approach is described. In this paper we avoid the use of a utility function and propose a more direct model for valuations.

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†Department of Mathematics Shanghai Jiaotong University, Shanghai(200240), P.R.China. Email: xiongdewen@sjtu.edu.cn
‡Department of Mathematics and Statistics, University of Konstanz, D-78457, Konstanz, Germany. Email: michael.kohlmann@uni-konstanz.de, corresponding author
We consider a financial market similar to the one in Kohlmann and Xiong\cite{2007}. In the market, there is a risky asset whose discounted price process \( S = (S_t; t \in [0, T]) \) is a semimartingale with bounded jumps. We assume that all the purely discontinuous local martingales are driven by an integer-valued random measure \( \mu(\omega; du, dy) \) and the continuous martingale part of \( S \) is driven a continuous local martingale \( M \). Under some assumptions, the market is an incomplete market and we consider the \( S \)-related dynamic convex valuation of a contingent claim \( B \).

Mania and Schweizer (2005)\cite{2005} studied the dynamics of the exponential utility indifference value process \( C(B; \alpha) \) for a contingent claim \( B \) in a semimartingale model with a general continuous filtration. One can show even in our jump model that for fixed \( t \in [0, T] \) the exponential utility indifference valuation \( C_t(B; \alpha) \) satisfies the desirable properties of a valuation

(A) **Monotonicity:** \( C_t(B_1; \alpha) \leq C_t(B_2; \alpha) \) for all \( B_1, B_2 \in L^{\infty}(\mathcal{F}_T) \) with \( B_1 \leq B_2 \);

(B) **\( \mathcal{F}_t \)-convexity:** \( C_t(\lambda B_1 + (1-\lambda) B_2; \alpha) \leq \lambda C_t(B_1; \alpha) + (1-\lambda) C_t(B_2; \alpha) \) for all \( \lambda \in L^0(\mathcal{F}_t) \) with values in \([0, 1]\) and \( B_1, B_2 \in L^{\infty}(\mathcal{F}_T) \);

(C) **\( \mathcal{F}_t \)-translation invariance:** \( C_t(B + a_t; \alpha) = C_t(B; \alpha) + a_t \) for all \( B \in L^{\infty}(\mathcal{F}_T) \) and \( a_t \in L^{\infty}(\mathcal{F}_1) \);

(D) **\( \mathcal{F}_t \)-regularity:** \( C_t(B_1 I_A + B_2 I_{A^c}; \alpha) = C_t(B_1; \alpha) I_A + C_t(B_2; \alpha) I_{A^c} \) for all \( B_1, B_2 \in L^{\infty}(\mathcal{F}_T) \) and \( A \in \mathcal{F}_t \);

(E) **Time consistency:** for all \( B_1, B_2 \in L^{\infty}(\mathcal{F}_T) \) and all \( s \in [0, t] \)

\[
C_t(B_1; \alpha) = C_t(B_2; \alpha) \quad \text{implies that} \quad C_s(B_1; \alpha) = C_s(B_2; \alpha).
\]

Such properties are also found in the concept of coherent measures of risk (see Artzner et al.\cite{1999} or Delbaen\cite{2002}), in the concept of convex measures of risk (see Föllmer and Schied\cite{2002}), and in the concept of dynamic monetary concave utility functionals (DMCUF, see Klöppel and Schweizer\cite{2007}). Here -for the first time, to the best of our knowledge- we consider another interesting property

(F) **\( S \)-related property:** for all \( \pi \in \text{Adm} \) and \( x \in L^{\infty}(\mathcal{F}_0) \),

\[
C_t(x, \pi) = X_t^{x, \pi}, \quad \text{a.s.,}
\]

where \( X^{x, \pi} = x + \int \pi_u dS_u \) is the corresponding wealth process related to \( (x, \pi) \),

and a valuation \( C = \{ C(B) = (C_t(B))_{t \in [0, T]}; B \in L^{\infty}(\mathcal{F}_T) \} \) satisfying (A)~(F) will be called the **\( S \)-related dynamic convex valuation** (\( S \)-related DCV). In this way, we incorporate into the valuation the fact that the value at time \( t \leq T \) of an attainable wealth at time \( T \) should be the wealth itself at time \( t \). Similar to Theorem 3.13 of Klöppel and Schweizer\cite{2007}, we obtain a representation for the \( S \)-related DCV as the following
Theorem 1.1. If \( C = \{ C(B) = (C_t(B))_{t \in [0, T]}, B \in L^\infty(\mathcal{F}_T) \} \) is a dynamic convex valuation related to \( S \), which is continuous from above at time \( t \), then there exists a ”penalty functional” \( \alpha \) such that for all \( B \in L^\infty(\mathcal{F}_T) \)

\[
C_t(B) = \operatorname{ess} \sup_{Z \in \mathbb{Z}_e} \{ E \left[ Z_{t,T} B \mid \mathcal{F}_t \right] - \alpha_t(Z_{t,T}) \},
\]

where \( \mathbb{Z}_e \) is the family of the density processes of all equivalent martingale measure. Here, for each \( Z \in \mathbb{Z}_e \), \( Z_{t,T} := \frac{Z_T}{Z_t} \) and

\[
\alpha_t(Z_{t,T}) := \operatorname{ess} \sup_{B \in L^\infty(\mathcal{F}_T)} \left\{ E \left[ Z_{t,T} B \mid \mathcal{F}_t \right] - C_t(B) \right\}
\]

is the convex conjugate of \( C_t \).

Different from Klöppel and Schweizer (2007)\[19\], we here consider the family of the density processes of all equivalent martingale measures \( \mathbb{Z}_e \) in order to be able to treat the additionally introduced \( S \)-related property. Furthermore, we discuss the property of \( \alpha \) and try to give sufficient conditions for a given \( \alpha \) to be the penalty functional of an \( S \)-related DCV. Then we give two special versions of \( \alpha \) satisfying those conditions. This then allows to describe the dynamics of the corresponding \( S \)-related DCV by a backward semimartingale equation.

The paper is structured as follows. An incomplete market model with general jumps is established in section 2. We give the form of the density process of the equivalent martingale measure and give the definition of the \( S \)-related DCV. In section 3, we state a representation theorem for the \( S \)-related DCV by a ‘penalty functional’ \( \alpha \), and then we discuss some properties of \( \alpha \) which are the sufficient for \( \alpha \) to be the penalty functional of a \( S \)-related DCV. In section 4, we give two versions of \( \alpha \) satisfying the conditions derived in section 3 and describe the dynamics of the corresponding \( S \)-related DCV by a backward semimartingale equation.

2 The preliminaries

In this paper, we consider the dynamic convex valuation in a market similar to the one in Kohlmann and Xiong (2007)\[20\]. We begin with a finite time horizon \( T > 0 \) and a complete probability space \((\Omega, \mathcal{F}, P)\). Let \( \mathcal{F} = \{ \mathcal{F}_t, 0 \leq t \leq T \} \) be a filtration satisfying the usual conditions with \( \mathcal{F}_T = \mathcal{F} \). We assume that there exists a risky asset in the market, whose discounted price \( S = (S_t)_{0 \leq t \leq T} \) is described by a special semimartingale with bounded jumps. To describe the dynamics of \( S \), we need the following notations:

- \( A = (A_t)_{0 \leq t \leq T} \) is an \( \mathcal{F} \)-adapted continuous increasing process with \( A_0 = 0 \) and \( E A_T < \infty \);
- \( M = (M_t)_{0 \leq t \leq T} \) is a continuous local martingale with \((M,M)_t = A_t \);
- \( \mu = \{ \mu(\omega; dt, dx) : \omega \in \Omega \} \) is an integer-valued random measure on \( \mathbb{R}_+ \times \mathbb{R} \) with compensator \( \nu(\omega; dt, dx) = dA_t(\omega)K(\omega, t; dx) \), where \( K(\omega, t; dx) \) is a kernel from \((\Omega \times \mathbb{R}_+, \mathcal{P})\) into \((\mathbb{R}, \mathcal{B})\). Let \( \widetilde{N}(\omega; dt, dx) := \mu(\omega; dt, dx) - \nu(\omega; dt, dx) \).

Throughout the paper, we assume that all the jump martingales in the market are driven by the random measure \( \mu \), and that the following representation holds:
**Assumption 2.1.** Any purely discontinuous local \((P,F)\)-martingale \(m\) can be represented in the following form
\[
m_t = m_0 + \int_0^t \int_{\mathbb{R}} \psi(s,x) \tilde{N}(ds,dx).
\]

**Remark 2.2.**
1. Note that here we do not assume any representation property with respect to the continuous local martingale. Also the market model discussed in this paper is more general than the market considered in Kohlmann and Xiong (2007,a)\(^{[20]}\).
2. As \(A\) is a continuous process, \(a_t(\omega) := \nu(\omega, \{t\} \times \mathbb{R}) = 0\). Thus for all \(\tilde{P} := P \otimes B\)-measurable functions \(W(\omega,t,x)\), let
\[
\hat{W}_t(\omega) := \begin{cases} 
\int_{\mathbb{R}} W(\omega,t,x) \nu(\omega; \{t\} \times dx) & \text{if } \int_{\mathbb{R}} |W(\omega,t,x)| \nu(\omega; \{t\} \times dx) < \infty \\
+\infty & \text{otherwise},
\end{cases}
\]
then \(\hat{W} = 0\). Thus Assumption 2.1 implies that the filtration \(F\) is quasi-left continuous.
3. It is easy to see that there exists an \(F\)-optional process \(\beta = (\beta_t)_{0 \leq t \leq T}\) and a sequence of stopping times \((\hat{\tau}_n)\) such that for all positive \(\tilde{P}\)-measurable function \(W(\omega,t,x)\),
\[
W * \mu_t := \int_0^t \int_{\mathbb{R}} W(\omega,u,x) \mu(\omega; du,dx) = \sum_{(n)} W(\hat{\tau}_n, \beta_{\hat{\tau}_n}) I_{\{\hat{\tau}_n \leq t\}}.
\]
□

We now describe the market model. We assume that the dynamics of the discounted price process \(S\) are given by
\[
dS_t = S_0 + \int_0^t \gamma u dA_u + \int_0^t \sigma_1(u) dM_u + \int_0^t \int_{\mathbb{R}} \sigma_2(u,y) \tilde{N}(du,dy),
\]
where \(\gamma\) and \(\sigma_1\) are two predictable processes with \(\int_0^T \sigma_1(s)^2 dA_s < \infty\) a.s. and \(\sigma_2(t,y)\) is a bounded \(\overline{F}\)-measurable function. We assume that there exist two constants \(k\) and \(K\) such that
\[
\int_0^T \gamma^2_u dA_u \leq K < \infty \text{ and } \sigma_1(s) \geq k > 0. \tag{2.1}
\]

Just as in Kohlmann and Xiong(2007,a)\(^{[20]}\), let \(\delta_t = \frac{\gamma_t}{\sigma_1(t)}\) to introduce a new measure \(Q^0\) by
\[
\frac{dQ^0}{dF} |_{\mathcal{F}} := Z_t^0,
\]
where \(Z_t^0 = \mathcal{E}(\int_0^T \delta_u dM_u)\). From \(\int_0^T \delta^2_u dA_u \leq \frac{1}{K^2} \int_0^T \gamma^2_u dA_u \leq \frac{K}{k^2} < \infty\), \(Z^0\) is a continuous uniformly integrable martingale so that \(Z^0 S\) is a local martingale. Thus \(Q^0\) is an equivalent
martingale measure. If we let 
\[ \tilde{M}_t := M_t + \int_0^t \delta_u dA_u, \]
then it is easy to see that \( \tilde{M} \) is a continuous local \( Q^0 \)-martingale. Hence, under \( Q^0 \), the discounted price process \( S \) can be rewritten as
\[ S_t = S_0 + \int_0^t \sigma_1(u) d\tilde{M}_u + \int_0^t \int_{\mathbb{R}} \sigma_2(u, y) \tilde{N}(du, dy). \]

**Remark 2.3.** (1) It follows from Proposition 2.3 of Kohlmann and Xiong (2007) [21] that \( Q^0 \) satisfies the reverse Hölder inequality \( R_{LLOGL}(P) \), i.e., there exists a constant \( C \) such that for any stopping time \( \tau \)
\[ E \left\{ Z_{\tau, T}^0 \log Z_{\tau, T}^0 | \mathcal{F}_\tau \right\} \leq C < \infty, \tag{2.2} \]
where \( Z_{\tau, T}^0 = \frac{Z_0^0}{Z_T^0} \). Furthermore, for any \( B \in L^\infty(\mathcal{F}_T) \), we can define a measure \( P_B \) as in [9]:
\[ \frac{dP_B}{dP} |_{\mathcal{F}_T} := e^{\alpha B} \frac{E_{e^{\alpha B}}}{\mathcal{E}_{\alpha B}}. \]
So the density process of \( Q^0 \) with respect to \( P_B \) is given by \( Z_t^0, B \) which is defined as
\[ Z_t^0, B \tau, T := E_{P_B} \left\{ Z_T^0 e^{\alpha B} | \mathcal{F}_t \right\} = E \left\{ e^{\alpha B} \mathcal{E}^{\alpha B} | \mathcal{F}_t \right\}, \]
and since \( e^{\alpha B} \) is bounded, one sees that \( Q^0 \) satisfies the reverse Hölder inequality \( R_{LLOGL}(P_B) \), i.e.,
\[ E_{P_B} \left\{ Z_{\tau, T}^0, B \log Z_{\tau, T}^0, B | \mathcal{F}_\tau \right\} \leq C < \infty, \text{ a.s.} \]
holds for some constant \( C \) and all stopping time \( \tau \), where \( Z_{\tau, T}^0, B = \frac{Z_0^0, B}{Z_T^0} \).

(2) Note that the minimal entropy martingale measure, denoted by \( Q^E \), exists and is equivalent to \( P \) according to Frittelli (2000) [13]. \( \square \)

Let
\[ Z = \left\{ Z \right\} \quad Z \text{ is a nonnegative uniformly integrable martingale with } \quad \text{RCLL paths such that } ZS \text{ is a local martingale} \} \].
For any \( Z \in Z \), let \( \tau = \inf \{ t : Z_t = 0 \} \). From He, Wang and Yan (1992) \( \tau \) is a stopping time so that for all \( \omega \in \{ \tau < \infty \} \)
\[ Z_t(\omega) = 0, \quad t \geq \tau(\omega), \]
and for all \( \omega \in \{ \tau > 0 \} \) and \( t < \tau(\omega), \)
\[ Z_t(\omega) \neq 0 \text{ and } Z_{t-}(\omega) \neq 0. \]
Let \( Z_e = \{ Z \in Z; Z_t > 0, \text{a.s.}, \text{ for all } t \in [0, T] \} \), since \( Z^0 \in Z_e \), we have that \( Z_e \neq \emptyset \).
For all \( Z \in Z_e \), define \( Z_{t,T} := \frac{Z_T}{Z_t} \). We also introduce \( \tilde{Z}_t := \frac{Z_T}{Z_0} = E_{Q^0} \left( \frac{Z_T}{Z_0} | \mathcal{F}_t \right) \) and \( \tilde{Z}_e = \left\{ \tilde{Z} = \frac{Z_T}{Z_0}; Z \in Z_e \right\} \). With these notations we can state the following lemma.
Lemma 2.4. For any $Z \in \mathcal{Z}_e$, there exists a $\mathcal{F}_\tau$-measurable function $l(u, y)$ with $l(u, y) > 1$ and a continuous local martingale $L$ strongly orthogonal to $M$ with $L_0 = 0$ such that

$$Z_t = Z_0 \mathcal{E} \{- \int_0^t \{ \delta_u + \tilde{l}_u \} dM_u + \int_0^t \int \tilde{\sigma}_2(u, y) \tilde{N}(du, dy) + L \}_{t}$$

where $\tilde{l}_u := \int \frac{\sigma_2(u, y)}{\sigma_1(u)} l(u, y) K(u; dy)$.

Proof. Since $Z \in \mathcal{Z}_e$, $Z$ can be represented as

$$Z_t = Z_0 + \int_0^t Z_u \cdot dm_u$$

where $m$ is a local martingale with $m_0 = 0$. Since $M$ is a continuous local martingale, there exists a predictable process $\zeta$ and a continuous local martingale $L$ such that $m^c$, the continuous martingale part of $m$, can be represented as

$$m_c = \int \zeta_u dM_u + L_u.$$

Furthermore, by Assumption 2.1, $m^d$, the jump martingale part of $m$, can be written as

$$m_d^t = \int_0^t \int \tilde{l}(u, y) \tilde{N}(du, dy),$$

thus $Z$ is the solution of the following stochastic differential equation

$$Z_t = Z_0 + \int_0^t Z_u \cdot \zeta_u dM_u + \int_0^t \int \tilde{l}(u, y) \tilde{N}(du, dy) + \int_0^t Z_u \cdot dL_u.$$

By making use of Itô’s formula, we derive

$$Z_t S_t = Z_0 S_0 + Z_0 \cdot S_t + S_0 \cdot Z_t + [Z, S]_t$$

$$= Z_0 S_0 + \int_0^t Z_u \{ \gamma_u + \sigma_1(u) \zeta_u + \sigma_1(u) \tilde{l}_u \} dA_u$$

$$+ \int_0^t Z_u \{ \sigma_1(u) + S_u - \zeta_u \} dM_u + \int_0^t Z_u - S_u - dL_u$$

$$+ \int_0^t \int Z_u - \{ \sigma_2(u, y) + S_u - l(u, y) + \sigma_2(u, y) l(u, y) \} \tilde{N}(du, dy).$$

Since $ZS$ is a local martingale by the definition of $Z_e$, we finally get

$$\zeta_u = - \delta_u - \tilde{l}_u, \quad dA_u \times dP \text{-a.s.},$$

thus

$$Z_t = Z_0 \mathcal{E} \{- \int_0^t \{ \delta_u + \tilde{l}_u \} dM_u + \int_0^t \int \tilde{l}(u, y) \tilde{N}(du, dy) + L \}_{t}.$$
**Corollary 2.5.** For any \( \tilde{Z} \in \tilde{Z}_e \), there exists a \( \tilde{\mathcal{F}} \)-measurable function \( l(u, y) \) with \( l(u, y) > 0 \) and a continuous local \( Q^0 \)-martingale \( L \) strongly \( Q^0 \)-orthogonal to \( \tilde{M} \) (i.e., \( \tilde{L} \tilde{M} \) is a continuous local \( Q^0 \)-martingale) such that

\[
\tilde{Z}_t = Z_0 \mathcal{E} \left\{ - \int_0^t \tilde{l}_u d\tilde{M}_u + \int_0^t \int_{\mathbb{R}} l(u, y) \tilde{N}(du, dy) + L \right\}_t
\]

where \( \tilde{l}_u := \int_{\mathbb{R}} \frac{\sigma_2(u, y)}{\sigma_1(u)} l(u, y) K(u, dy) \).

We consider the following family of the admissible strategies

\[
Adm = \left\{ \pi \mid \pi = (\pi_u)_{u \in [0, T]} \text{ is a } S\text{-integrable predictable process such that } \sup_{t \in [0, T]} | \int_0^t \pi_u dS_u | \in L^\infty(\mathcal{F}_T) \right\},
\]

and for \( \pi \in Adm \) and \( x \in L^\infty(\mathcal{F}_0) \), let \( X_t^{x, \pi} := x + \int_0^t \pi_u dS_u \) be the corresponding wealth process. We now can give the definition of the dynamic convex valuation related to the price process \( S \):

**Definition.** An \( S \)-related dynamic convex valuation (\( S \)-related DCV) is defined to be the family

\[
\left\{ C(B) := \{ C_t(B) \}_{t \in [0, T]} ; \quad B \in L^\infty(\mathcal{F}_T) \right\}
\]

such that

(1) for given \( B \in L^\infty(\mathcal{F}_T) \), \( C(B) := \{ C_t(B) \}_{t \in [0, T]} \) is a bounded RCLL semimartingale;

(2) for every \( t \in [0, T] \), \( C_t(B) \) satisfies the following properties:

(A) **Monotonicity:** \( C_t(B_1) \leq C_t(B_2) \) for all \( B_1, B_2 \in L^\infty(\mathcal{F}_T) \) with \( B_1 \leq B_2 \);

(B) **\( \mathcal{F}_t \)-convexity:** \( C_t(\lambda B_1 + (1 - \lambda) B_2) \leq \lambda C_t(B_1) + (1 - \lambda) C_t(B_2) \) for all \( \lambda \in L^0(\mathcal{F}_t) \) with values in \([0, 1]\) and \( B_1, B_2 \in L^\infty(\mathcal{F}_T) \);

(C) **\( \mathcal{F}_t \)-translation invariance:** \( C_t(B + a_t) = C_t(B) + a_t \) for all \( B \in L^\infty(\mathcal{F}_T) \) and \( a_t \in L^\infty(\mathcal{F}_t) \);

(D) **\( \mathcal{F}_t \)-regularity:** \( C_t(B_1 I_A + B_2 I_{A^c}) = C_t(B_1) I_A + C_t(B_2) I_{A^c} \) for all \( B_1, B_2 \in L^\infty(\mathcal{F}_T) \) and \( A \in \mathcal{F}_t \);

(E) **Time consistency:** for all \( B_1, B_2 \in L^\infty(\mathcal{F}_T) \) and all \( s \in [0, t] \)

\[
C_t(B_1) = C_s(B_2) \quad \text{implies that} \quad C_s(B_1) = C_s(B_2) ;
\]

(F) **\( S \)-related property:** for all \( \pi \in Adm \) and \( x \in L^\infty(\mathcal{F}_0) \),

\[
C_t(X_t^{x, \pi}) = X_t^{\tilde{x}, \pi}, \quad \text{a.s.,}
\]

where \( X_t^{x, \pi} = x + \int_0^t \pi_u dS_u \) is the wealth process related to \((x, \pi)\).
Example. For a fixed positive constant $\alpha > 0$ and $B \in L^\infty(\mathcal{F}_T)$, introduce
\[
C_t(B; \alpha) := \frac{1}{\alpha} \log \inf_{\pi \in \text{Adm}} E_{Q_E} \left( e^{\alpha (B - X_{t,T}^{x,\pi})} \big| \mathcal{F}_t \right),
\]
where $X_{t,T}^{x,\pi} = X_T^{x,\pi} - X_t^{x,\pi} = \int_t^T \pi_u dS_u$. It easily follows from Mania and Schweizer (2005) that $C(B; \alpha)$ is an $S$-related DCV.

3 The representation theorem

We now derive the representation theorem for the $S$-related DCV of a contingent claim. We begin with the static case.

Definition. A mapping $\rho : L^\infty(\mathcal{F}_T) \rightarrow \mathbb{R}$ is called a static $S$-related convex valuation if it satisfies

(i) Monotonicity: $\rho(B_1) \leq \rho(B_2)$ for all $B_1, B_2 \in L^\infty(\mathcal{F}_T)$ with $B_1 \leq B_2$;

(ii) Convexity: $\rho(\lambda B_1 + (1 - \lambda) B_2) \leq \lambda \rho(B_1) + (1 - \lambda) \rho(B_2)$ for all constant $\lambda$ in $[0, 1]$ and $B_1, B_2 \in L^\infty(\mathcal{F}_T)$;

(iii) Translation invariance: $\rho(B + a) = \rho(B) + a$ for all $B \in L^\infty(\mathcal{F}_T)$ and constant $a$;

(iv) $S$-related property: $\rho(X_0^{x,\pi}) = 0$ for all $\pi \in \text{Adm}$.

As in [12], we let $\mathcal{A}_\rho = \{B \in L^\infty(\mathcal{F}_T) | \rho(B) \leq 0\}$, so that $\mathcal{A}_\rho$ is a convex set.

Lemma 3.1. Assume that $\rho : L^\infty(\mathcal{F}_T) \rightarrow \mathbb{R}$ is a static $S$-related convex valuation and $\mathcal{A}_\rho$ is $\sigma(L^\infty(Q^0), L^1(Q^0))$-closed, then there exists a ”penalty functional” $\hat{\alpha}$ such that for every $B \in L^\infty(\mathcal{F}_T)$
\[
\rho(B) = \sup_{Z \in \mathcal{Z}} \{ E[Z_0,T B] - \hat{\alpha}(Z) \},
\]
where $\hat{\alpha}$ is the convex conjugate of $\rho$, i.e.,
\[
\hat{\alpha}(Z) := \sup_{B \in L^\infty(\mathcal{F}_T)} \{ E[Z_0,T B] - \rho(B) \} .
\]

Proof. The idea is the same as in the proof of Theorem 5 of [12]. It is easy to see that
\[
\hat{\alpha}(Z) = \sup_{B \in \mathcal{A}_\rho} \{ E[Z_0,T B] \}
\]
and for any $B \in L^\infty(\mathcal{F}_T)$ and $Z \in \mathcal{Z}$,
\[
E[Z_0,T B] - \hat{\alpha}(Z) \leq E[Z_0,T B] - \{ E[Z_0,T B] - \rho(B) \} = \rho(B).
\]
Thus we must show that for any $m \in \mathbb{R}$ such that
\[
m > \sup_{Z \in \mathcal{Z}} \{ E[Z_0,T B] - \hat{\alpha}(Z) \},
\]
we have $m \geq \rho(B)$, i.e., $B - m \in \mathcal{A}_\rho$. Suppose that, on the contrary, $B - m \notin \mathcal{A}_\rho$. Since $\mathcal{A}_\rho$ is a $\sigma(L^\infty(Q^0), L^1(Q^0))$-closed convex set one can find a linear functional $\ell$ such that

$$\beta := \sup_{B \in \mathcal{A}_\rho} \ell(B) < \ell(B - m) =: \gamma < \infty.$$ 

We claim that

1. $\ell$ is a positive linear functional;
2. for any $\pi \in \text{Adm}$, $\ell(X^{0,\pi}_0, \pi T) = 0$.

In fact, for any $B \in L^\infty(\mathcal{F}_T)$ with $B \geq 0$, one can see that for all $\lambda \geq 0$, $\rho(-\lambda B) \leq \rho(0) = 0$, thus $-\lambda B \in \mathcal{A}_\rho$ and $\gamma > \ell(-\lambda B) = -\lambda \ell(B)$, it follows by taking $\lambda \uparrow \infty$ that $\ell(B) \geq 0$. Further more, if there exists a $\pi^* \in \text{Adm}$ such that $\ell(X^{0,\pi^*}_0) \neq 0$, let $c = \frac{2}{\ell(X^{0,\pi^*}_0)}$, then $\ell(cX^{0,\pi^*}_0) = \gamma$, which is a contradiction to $cX^{0,\pi^*}_0 \in \mathcal{A}_\rho$.

Therefore, there exists a $\xi \in L^1(Q^0, \mathcal{F}_T)$ with $\xi \geq 0$ such that $\ell(B) = E[\xi B]$, holds for all $B \in L^\infty(\mathcal{F}_T)$. Since $E[|Z_0^0\xi|] = E_{Q_0}(\xi) < \infty$, let

$$\tilde{Z}_t = E(Z_0^0\xi|\mathcal{F}_t),$$

one gets that $\tilde{Z}$ is a nonnegative uniformly integrable martingale which has an RCLL version, still denoted by $\tilde{Z}$. Since $S$ is a local bounded semimartingale, there exists a sequence of stopping times $(\tau_n)$ such that $S_{\tau_n}$ is bounded for each $n$. For any stopping time $\tau \leq T$

$$E[\tilde{Z}_{\tau \land \tau_n}S_{\tau \land \tau_n}] = E[\tilde{Z}_T S_{\tau \land \tau_n}] = \ell(\int_0^T I_{(0,\tau \land \tau_n]}(u)dS_u) = 0,$$

thus $\tilde{Z}_{\tau_n}S_{\tau_n}$ is a true martingale for each $n$ and $\tilde{Z}S$ is a local martingale under $P$. Thus $\tilde{Z} \in Z$ and

$$\check{\alpha}(\tilde{Z}) = \sup_{B \in \mathcal{A}_\rho} \left\{ E\left[\tilde{Z}_0 TB\right]\right\} = \frac{1}{\tilde{Z}_0} \sup_{B \in \mathcal{A}_\rho} \ell(B) = \frac{1}{\tilde{Z}_0} \beta ,$$

thus

$$\check{\alpha}(\tilde{Z}) < \frac{1}{\tilde{Z}_0} \ell(B - m) = \frac{1}{\tilde{Z}_0} E_{Q_0}[B\xi] - m = E[B\tilde{Z}_0,T] - m ,$$

which is a contradiction to the choice of $m$. Thus $B - m \in \mathcal{A}_\rho$ and thus $m \geq \rho(B)$.  

**Definition.** We call a dynamic convex valuation $C$ **continuous from above at time** $t$, if for any uniformly bounded sequence $(B_n)_{n \in \mathbb{N}} \subset L^\infty(\mathcal{F}_T)$ decreasing to some $B \in L^\infty(\mathcal{F}_T)$, we have

$$\lim_{n \to \infty} C_t(B_n) = C_t(B) .$$
By a similar argument as in Theorem 3.13 of Klöppel and Schweizer (2007)\textsuperscript{[19]}, we can state the following theorem

**Theorem 1.1.** If $C = \{C(B) = (C_t(B))_{t \in [0,T]}, B \in L^\infty(\mathcal{F}_T)\}$ is a dynamic convex valuation related to $S$, which is continuous from above at time $t$, there exists a "penalty functional" $\alpha$ such that for all $B \in L^\infty(\mathcal{F}_T)$

$$C_t(B) = \text{ess sup}_{Z \in Z_c} \{ E[Z_{t,T}B|\mathcal{F}_t] - \alpha_t(Z_{t,T}) \},$$

where $Z_{t,T} = \frac{Z_T}{Z_t}$ and

$$\alpha_t(Z_{t,T}) := \text{ess sup}_{B \in L^\infty(\mathcal{F}_T)} \{ E[Z_{t,T}B|\mathcal{F}_t] - C_t(B) \}$$

is the convex conjugate of $C_t$.

**Proof.** For every $Z \in Z_c$ and $B \in L^\infty(\mathcal{F}_T)$,

$$E[Z_{t,T}B|\mathcal{F}_t] - \alpha_t(Z_{t,T}) = E[Z_{t,T}B|\mathcal{F}_t] - \text{ess sup}_{B \in L^\infty(\mathcal{F}_T)} \{ E[Z_{t,T}B|\mathcal{F}_t] - C_t(B) \} \leq E[Z_{t,T}B|\mathcal{F}_t] - \{ E[Z_{t,T}B|\mathcal{F}_t] - C_t(B) \} = C_t(B),$$

thus

$$C_t(B) \geq \text{ess sup}_{Z \in Z_c} \{ E[Z_{t,T}B|\mathcal{F}_t] - \alpha_t(Z_{t,T}) \}.$$

We only need to prove that for all $B \in L^\infty(\mathcal{F}_T)$

$$E_{Q^0}[C_t(B)] \leq E_{Q^0} \left[ \text{ess sup}_{Z \in Z_c} \{ E[Z_{t,T}B|\mathcal{F}_t] - \alpha_t(Z_{t,T}) \} \right]. \quad (3.1)$$

Let $\rho_t(B) = E_{Q^0}[C_t(B)]$, then $\rho_t(B)$ is continuous from above and thus $A'_t := \{B; \rho_t(B) \leq 0\}$ is $\sigma(L^\infty(Q^0, \mathcal{F}_T), L^1(Q^0, \mathcal{F}_T))$-closed. Therefore, $\rho_t$ can be represented into the following form

$$\rho_t(B) = \sup_{Z \in \mathcal{Z}} \{ E[Z_{0,T}B] - \hat{\alpha}_t(Z) \},$$

where $\hat{\alpha}_t$ is given by

$$\hat{\alpha}_t(Z) = \sup_{B \in L^\infty(\mathcal{F}_T)} \{ E(Z_{0,T}B) - \rho_t(B) \}.$$

For $Z \in Z_c$ let

$$\hat{Z}_t = Z^0_t I_{s \leq t} + Z^0_t Z_{t,s} I_{s > t},$$

and $Z_t = \{ \hat{Z}; Z \in Z_c \}$. So $Z_t \subseteq Z_c \subset \mathcal{Z}$ and

$$\rho_t(B) \geq \sup_{Z \in Z_t} \{ E[Z_{0,T}B] - \hat{\alpha}_t(Z) \}. $$
3 THE REPRESENTATION THEOREM

For any \( Z \in \mathbb{Z} \) with \( Z \notin \mathbb{Z}_t \), there exists an \( \mathcal{F}_t \)-measurable set \( A \) such that \( E(Z_{0,t}I_A) \neq E(Z^0_{0,t}I_A) \). Thus for any constant \( \lambda \), \( \rho_{t}(\lambda I_A) = E_{Q^0}(C_t(\lambda I_A)) = \lambda E(Z^0_{0,t}I_A) \) and

\[
\hat{\rho}_t(Z) \geq \sup_{\lambda \in \mathbb{R}} \{ \lambda E(Z_{0,t}I_A) - \rho_t(\lambda I_A) \} = \sup_{\lambda \in \mathbb{R}} \{ \lambda (E(Z_{0,t}I_A) - E(Z^0_{0,t}I_A)) \} = \infty.
\]

Therefore,

\[
\rho_t(B) = \sup_{Z \in \mathbb{Z}_t} \{ E[Z_{0,t}B] - \hat{\rho}_t(Z) \}.
\] (3.2)

From the \( \mathcal{F}_t \)-regularity of \( C_t \), \( \{ E(Z_{t,T}B|\mathcal{F}_t) - C_t(B); B \in L^\infty(\mathcal{F}_T) \} \) is closed by \( \lor \), thus there exists a sequence \( (B_n)_{n \in \mathbb{N}} \subseteq L^\infty(\mathcal{F}_T) \) such that

\[
\alpha_t(Z_{t,T}) = \lim_{n \to \infty} \sup_{B \in L^\infty(\mathcal{F}_T)} \{ E(Z_{t,T}B_n|\mathcal{F}_t) - C_t(B_n) \}
\]

Since \( Z_{0,t} = Z^0_t \) for all \( Z \in \mathbb{Z}_t \), it follows from the monotone convergence theorem that

\[
E[Z^0_t \alpha_t(Z_{t,T})] = E[Z_{0,t} \alpha_t(Z_{t,T})]
\]

\[
\leq \sup_{B \in L^\infty(\mathcal{F}_T)} \{ E[Z_{0,t}B] - E_{Q^0}(C_t(B)) \}
\]

\[
= \hat{\rho}_t(Z).
\]

Combining with (3.2), one gets

\[
E_{Q^0}[C_t(B)] = \rho_t(B) = \sup_{Z \in \mathbb{Z}_t} \{ E[Z_{0,t}B] - \hat{\rho}_t(Z) \}
\]

\[
\leq \sup_{Z \in \mathbb{Z}_t} \{ E[Z^0_{0,t}Z_{t,T}B] - E[Z^0_{0,t}\alpha_t(Z_{t,T})] \}
\]

\[
= \sup_{Z \in \mathbb{Z}_t} \{ E_{Q^0} \left[ E(Z_{t,T}B|\mathcal{F}_t) - \alpha_t(Z_{t,T}) \right] \}
\]

\[
\leq E_{Q^0} \left[ \text{ess sup}_{Z \in \mathbb{Z}_t} \{ E(Z_{t,T}B|\mathcal{F}_t) - \alpha_t(Z_{t,T}) \} \right],
\]

and hence (3.1).

\[ \square \]

Remark 3.2.

1. Since for \( \pi \in \text{Adm} \), \( C_t(X^x_{-\pi}) = X^x_{\pi} \), so

\[
X^x_{\pi} = C_t(X^x_{-\pi})
\]

\[
= \text{ess sup}_{Z \in \mathbb{Z}_t} \{ E[Z_{t,T}X^x_{-\pi}|\mathcal{F}_t] - \alpha_t(Z_{t,T}) \}
\]

\[
= X^x_{\pi} - \text{ess inf}_{Z \in \mathbb{Z}_t} \{ \alpha_t(Z_{t,T}) \}.
\]

So

\[
\text{ess inf}_{Z \in \mathbb{Z}_t} \{ \alpha_t(Z_{t,T}) \} = 0.
\] (3.3)
3. From the proof of Theorem 1.1, one can see that for every \( Z \in \mathbb{Z}_e \), and there exists a sequence \((B^t_n)_{n \in \mathbb{N}} \subseteq L^\infty(\mathcal{F}_t)\), which may depend on \( t \), such that

\[
\alpha_t(Z_{t,T}) = \lim_{n \to \infty} E(Z_{t,T}B^t_n|\mathcal{F}_t) - C_t(B^t_n).
\]

(3.4)

3. Let \( \mathcal{A}_t := \{B; C_t(B) \leq 0\} \), then

\[
\alpha_t(Z_{t,T}) = \text{ess sup}_{B \in \mathcal{A}_t} \{ E[Z_{t,T}B|\mathcal{F}_t]\}.
\]

(3.5)

By the time-consistency of \( C \), \( \mathcal{A}_t \subseteq \mathcal{A}_s \) for all \( s \leq t \). As \( C_t(C_t(B)) = C_t(B) \), we have for all \( s \leq t \)

\[
C_s(C_t(B)) = C_s(B),
\]

and similar to [19], one can show that the time-consistency is equivalent to the following

\[
\mathcal{A}_s = \mathcal{A}_s(\mathcal{F}_t) + \mathcal{A}_t,
\]

(3.6)

where \( \mathcal{A}_s(\mathcal{F}_t) = \mathcal{A}_s \cap L^\infty(\mathcal{F}_\infty) \).

For any \( Z^i \in \mathbb{Z}_e \), \( i = 1, 2 \) and \( A \in \mathcal{F}_t \), let

\[
Z_s := Z^1_s I_{s<t} + \{Z^1_s I_A + Z^2_s Z^2_{t,s}I_{A^c}\}I_{s \geq t},
\]

one can see that \( Z \in \mathbb{Z}_e \) and \( Z_{t,T} = Z^1_{t,T} I_A + Z^2_{t,T} I_{A^c} \). We have the following Lemma

**Lemma 3.3.** Under the conditions of Theorem 1.1, for any \( Z^i \in \mathbb{Z}_e \), \( i = 1, 2 \) and \( A \in \mathcal{F}_t \), we have

\[
\alpha_t(Z^1_{t,T} I_A + Z^2_{t,T} I_{A^c}) = \alpha_t(Z^1_{t,T}) I_A + \alpha_t(Z^2_{t,T}) I_{A^c}.
\]

**Proof.** By direct calculation, one can see

\[
\alpha_t(Z^1_{t,T} I_A + Z^2_{t,T} I_{A^c}) = \text{ess sup}_{B \in L^\infty(\mathcal{F}_T)} \{ E[Z^1_{t,T} I_A + Z^2_{t,T} I_{A^c}]B|\mathcal{F}_t] - C_t(B)\}
\]

\[
= \text{ess sup}_{B \in L^\infty(\mathcal{F}_T)} \{ E[Z^1_{t,T} B|\mathcal{F}_t] - C_t(B)\} I_A + \text{ess sup}_{B \in L^\infty(\mathcal{F}_T)} \{ E[Z^2_{t,T} B|\mathcal{F}_t] - C_t(B)\} I_{A^c}
\]

\[
= \alpha_t(Z^1_{t,T} I_A) + \alpha_t(Z^2_{t,T} I_{A^c}).
\]

On the other hand, for any \( B^i \in L^\infty(\mathcal{F}_T) \), \( i = 1, 2 \), let \( B = B_1 I_A + B_2 I_{A^c} \), which also belongs to \( L^\infty(\mathcal{F}_T) \). It follows from the \( \mathcal{F}_T \)-regularity of \( C_t \) that

\[
\alpha_t(Z^1_{t,T} I_A + Z^2_{t,T} I_{A^c}) \geq E[(Z^1_{t,T} I_A + Z^2_{t,T} I_{A^c})B|\mathcal{F}_t] - C_t(B)
\]

\[
= \{E[Z^1_{t,T} B^1|\mathcal{F}_t] - C_t(B^1)\} I_A + \{E[Z^2_{t,T} B|\mathcal{F}_t] - C_t(B)\} I_{A^c},
\]

thus \( \alpha_t(Z^1_{t,T} I_A + Z^2_{t,T} I_{A^c}) \geq \alpha_t(Z^1_{t,T}) I_A + \alpha_t(Z^2_{t,T}) I_{A^c} \) and the proof is complete. \( \square \)
3  THE REPRESENTATION THEOREM

For any $Z^i \in Z_e$, $i = 1, 2$, let
\[
A = \left\{ E(Z_{i,T}^1 B|\mathcal{F}_t) - \alpha_t(Z_{i,T}^1) \geq E(Z_{i,T}^2 B|\mathcal{F}_t) - \alpha_t(Z_{i,T}^2) \right\},
\]
one can see that $A \in \mathcal{F}_t$ and
\[
Z_s := Z_s^1 I_{s<\tau} + \{ Z_s^1 I_A + Z_s^1 Z_s^2 I_{A^c} \} I_{s \geq \tau}
\]
also belongs to $Z_e$ and $Z_{t,T} = Z_{1,T}^1 I_A + Z_{1,T}^2 I_{A^c}$. It follows from Lemma 3.3 that $\alpha_t(Z_{t,T}) = \alpha_t(\{ Z_{1,T}^1 \} I_A + \alpha_t(\{ Z_{1,T}^2 \} I_{A^c})$ and thus
\[
E(Z_{t,T} B|\mathcal{F}_t) - \alpha_t(Z_{t,T}) = \left\{ E(Z_{t,T}^1 B|\mathcal{F}_t) - \alpha_t(Z_{t,T}^1) \right\} I_A + \left\{ E(Z_{t,T}^2 B|\mathcal{F}_t) - \alpha_t(Z_{t,T}^2) \right\} I_{A^c}
\]
\[
= \left\{ E(Z_{t,T} B|\mathcal{F}_t) - \alpha_t(Z_{t,T}) \right\} \vee \left\{ E(Z_{t,T}^2 B|\mathcal{F}_t) - \alpha_t(Z_{t,T}^2) \right\},
\]
from which one can see that the set $\{ E(Z_{t,T} B|\mathcal{F}_t) - \alpha_t(Z_{t,T}); Z \in Z_e \}$ is closed under $\vee$, thus we have the following corollary

**Corollary 3.4.** Under the conditions of Theorem 1.1, for every $B \in L^\infty(\mathcal{F}_T)$, there exists a sequence $(Z^n)_{n \in \mathbb{N}} \subseteq Z_e$ such that
\[
C_t(B) = \lim_{n \to \infty} E[Z_{t,T}^n B|\mathcal{F}_t] - \alpha_t(Z_{t,T}^n).
\]

**Lemma 3.5.** Under the conditions of Theorem 1.1, for all $Z \in Z_e$ and $s < t$, we have
\[
Z_s \alpha_s(Z_{s,T}) = E \left[ Z_t \alpha_t(Z_{t,T}) | \mathcal{F}_s \right] + \text{ess sup}_{B \in A_s(\mathcal{F}_t)} E \left[ Z_t B | \mathcal{F}_s \right], \tag{3.7}
\]
where $A_s(\mathcal{F}_t) = A_s \cap L^\infty(\mathcal{F}_t)$.

**Proof.** It follows from (3.6) that any $B \in A_s$ can be decomposed into the following
\[
B = B_1 + B_2,
\]
where $B_1 \in A_s(\mathcal{F}_t)$ and $B_2 \in A_t$. Therefore,
\[
E \left[ Z_T B | \mathcal{F}_s \right] = E \left[ Z_t B_1 | \mathcal{F}_s \right] + E \left[ E[Z_T B_2 | \mathcal{F}_t] | \mathcal{F}_s \right] \leq \text{ess sup}_{B \in A_s(\mathcal{F}_t)} E \left[ Z_t B | \mathcal{F}_s \right] + E \left[ \text{ess sup}_{B \in A_t} E[Z_T B | \mathcal{F}_t] | \mathcal{F}_s \right]
\]
\[
= \text{ess sup}_{B \in A_s(\mathcal{F}_t)} E \left[ Z_t B | \mathcal{F}_s \right] + E \left[ Z_t \alpha_t(Z_{t,T}) | \mathcal{F}_s \right],
\]
thus $Z_s \alpha_s(Z_{s,T}) \leq E \left[ Z_t \alpha_t(Z_{t,T}) | \mathcal{F}_s \right] + \text{ess sup}_{B \in A_s(\mathcal{F}_t)} E \left[ Z_t B | \mathcal{F}_s \right]$. On the other hand, there exists a sequence $B_n^t \in L^\infty$ such that
\[
\alpha_t(Z_{t,T}) = \lim_{n \to \infty} E[Z_{t,T} B_n^t | \mathcal{F}_t].
\]
We need to show that

$$E[Z_t\alpha_t(Z_{t,T})|\mathcal{F}_s] = \lim_{n \to \infty} E[Z_T B^t_n|\mathcal{F}_s].$$

(3.8)

It is easy to see that \(\{E[Z_T B^t_n|\mathcal{F}_s]: n \in \mathbb{N}\}\) is an increasing sequence and for each \(n\)

$$E[Z_T B^t_n|\mathcal{F}_s] \leq E[Z_t\alpha_t(Z_{t,T})|\mathcal{F}_s].$$

Since \(B^t_1 \in L^\infty(\mathcal{F}_T)\), there exists a constant \(c\) such that \(B^t_1 \geq c\), thus for each \(A \in \mathcal{F}_s\)

$$E[E[Z_T B^t_1|\mathcal{F}_s]I_A] = E[E[Z_T B^t_1|\mathcal{F}_s]I_A] \geq cE[Z_s I_A] > -\infty$$

From the monotone convergence theorem we get

$$E[Z_t\alpha_t(Z_{t,T})I_A] = \lim_{n \to \infty} E[E[Z_T B^t_n|\mathcal{F}_s]I_A]$$

$$= \lim_{n \to \infty} E[E[Z_T B^t_n|\mathcal{F}_s]I_A]$$

$$= E[\lim_{n \to \infty} E[Z_T B^t_n|\mathcal{F}_s]I_A]$$

holds for every \(A \in \mathcal{F}_s\), thus \(E[Z_t\alpha_t(Z_{t,T})|\mathcal{F}_s] = \lim_{n \to \infty} E[Z_T B^t_n|\mathcal{F}_s]\), which is (3.8). For each \(B_1 \in \mathcal{A}_s(\mathcal{F}_t)\), let \(B^n := B_1 + B^t_n \in \mathcal{A}_s\), thus

$$E[Z_t B_1|\mathcal{F}_s] + E[Z_t\alpha_t(Z_{t,T})|\mathcal{F}_s] = E[Z_T B_1|\mathcal{F}_s] + \lim_{n \to \infty} E[Z_T B^t_n|\mathcal{F}_s]$$

$$\leq \operatorname{ess} \sup_{B \in \mathcal{A}_s} E[Z_T B|\mathcal{F}_s]$$

$$= Z_s \alpha_s(Z_{s,T}).$$

The arbitrariness of \(B_1\) gives

$$E[Z_t\alpha_t(Z_{t,T})|\mathcal{F}_s] + \operatorname{ess} \sup_{B \in \mathcal{A}_s(\mathcal{F}_t)} E[Z_t B|\mathcal{F}_s] Z_s \leq \alpha_s(Z_{s,T})$$

and the proof is complete. \(\Box\)

**Corollary 3.6.** Under the conditions of Theorem 1.1, for every \(Z \in \mathbb{Z}_e\), \(\{Z_t \alpha_t(Z_{t,T})\}_{t \in [0,T]}\) is a nonnegative supermartingale with terminal value \(Z_T\alpha_T(Z_{T,T}) = 0\).

**Remark 3.7.** Under the conditions of Theorem 1.1, for all \(Z \in \mathbb{Z}_e\) and \(s,t \in [0,T]\) with \(s < t\), let \(\alpha_s(Z_{s,t}) := \operatorname{ess} \sup_{B \in \mathcal{A}_s(\mathcal{F}_s)} E[Z_s B|\mathcal{F}_s]Z_s\), then (3.7) can be rewritten as

$$Z_s \alpha_s(Z_{s,t}) = E[Z_t\alpha_t(Z_{t,T})|\mathcal{F}_s] + Z_s \alpha_s(Z_{s,t}).$$

We have the following theorem

**Theorem 3.8.** Given a family of convex nonnegative functionals

$$\alpha = \left\{ \alpha(Z) = (\alpha_s(Z_{s,t}))_{0 \leq s < t \leq T}: Z \in \mathbb{Z}_e \right\}$$

such that \(\alpha_{s,t}: \mathbb{Z}_e \to L^0(\mathcal{F}_s, [0, \infty))\) with \(E[Z_{s,t} \alpha_{s,t}(Z_{s,t})] < \infty\) for any \(Z \in \mathbb{Z}_e\) and \(0 \leq s < t \leq T\) satisfies
Remark 3.9. 1)\(\alpha_s(Z_{s,T}) = \alpha_s(Z_{s,t}) + E[Z_{s,t}\alpha_t(Z_{t,T})|\mathcal{F}_s],\) for each \(Z \in \mathcal{Z}_e\) and \(0 \leq s < t \leq T;\)

(ii) \(\text{ess inf}_{Z \in \mathcal{Z}_e} \{\alpha_t(Z_{t,T})\} = 0,\) for each \(t \in [0,T];\)

(iii) for any \(Z^i \in \mathcal{Z}_e, i = 1, 2\) and \(A \in \mathcal{F}_t,\) let \(Z_s = Z^1_s I_{s<t} + Z^1_t \{Z^1_{s,t} I_A + Z^2_{t,s} I_{A^c}\} I_{s \geq t},\) then \(\alpha_t(Z_{t,T}) = \alpha_t(Z^1_{t,T}) I_A + \alpha_t(Z^2_{t,T}) I_{A^c};\)

(iv) \(\lim_{h \downarrow 0} \alpha_t(Z_{t,t+h}) = 0,\) for \(Z \in \mathcal{Z}_e\) and \(t \in [0,T),\)

then \(C = \{C(B) = (C_t(B))t \in [0,T], B \in \mathcal{L}^\infty(\mathcal{F}_T)\}\) defined by
\[
C_t(B) = \text{ess sup}_{Z \in \mathcal{Z}_e} \{E[Z_{t,T}B|\mathcal{F}_t] - \alpha_t(Z_{t,T})\}
\]
is an \(S\)-related dynamic convex valuation.

**Remark 3.9. 2)** It follows from (iii) that for any \(Z^i \in \mathcal{Z}_e, i = 1, 2\) and \(\hat{Z}_u = Z^1_u I_{u<t} + Z^2_t Z^2_{t,u} I_{u \geq t},\) then
\[
\alpha_t(\hat{Z}_{t,T}) = \alpha_t(Z^2_{t,T}).
\]

From (i) and (ii), for any \(s < t\)
\[
0 = \text{ess inf}_{Z \in \mathcal{Z}_e} \{\alpha_s(Z_{s,T})\} \geq \text{ess inf}_{Z \in \mathcal{Z}_e} \{\alpha_s(Z_{s,t})\} + \text{ess inf}_{Z \in \mathcal{Z}_e} E[Z_{s,t}\alpha_t(Z_{t,T})|\mathcal{F}_s],
\]
which implies that
\[
\text{ess inf}_{Z \in \mathcal{Z}_e} \{\alpha_s(Z_{s,t})\} = 0 \quad \text{and} \quad \text{ess inf}_{Z \in \mathcal{Z}_e} E[Z_{s,t}\alpha_t(Z_{t,T})|\mathcal{F}_s] = 0.
\]

**3)** Since \(\{E[Z_{t,T}B|\mathcal{F}_t] - \alpha_t(Z_{t,T})\}; Z \in \mathcal{Z}_e\) is closed under \(\vee,\) there exists a sequence \((Z^n)_{n \in \mathbb{N}} \subset \mathcal{Z}_e\) such that
\[
C_t(B) = \vee_{n \to \infty} E[Z^n_{t,T}B|\mathcal{F}_t] - \alpha_t(Z^n_{t,T}).
\]

**4)** Under the conditions of Theorem 3.8, for any \(s < t\) and \(B \in \mathcal{L}^\infty(\mathcal{F}_t),\) we have
\[
C_s(B) = \text{ess sup}_{Z \in \mathcal{Z}_e} \{E[Z_{s,t}B|\mathcal{F}_s] - \alpha_s(Z_{s,t})\}. \tag{3.10}
\]

In fact,
\[
C_s(B) = \text{ess sup}_{Z \in \mathcal{Z}_e} \{E[Z_{s,t}B|\mathcal{F}_s] - \alpha_s(Z_{s,t})\}
\]
\[
\leq \text{ess sup}_{Z \in \mathcal{Z}_e} \{E[Z_{s,t}B|\mathcal{F}_s] - \alpha_s(Z_{s,t})\},
\]
since \(\alpha_s(Z_{s,T}) \geq \alpha_s(Z_{s,t}) \geq 0.\) On the other hand, for any \(Z^i \in \mathcal{Z}_e, i = 1, 2,\) let \(\hat{Z}_u = Z^1_u I_{u<t} + Z^2_t Z^2_{t,u} I_{u \geq t},\) it follows from (i) that
\[
C_s(B) \geq E(\hat{Z}_{s,T}B|\mathcal{F}_s) - \alpha_s(\hat{Z}_{s,T})
\]
\[
= E[\hat{Z}_{s,t}B|\mathcal{F}_s] - \alpha_s(\hat{Z}_{s,t}) - E[\hat{Z}_{s,t}\alpha_t(\hat{Z}_{t,T})|\mathcal{F}_s]
\]
\[
= E[Z^1_{s,t}B|\mathcal{F}_s] - \alpha_s(Z^1_{s,t}) - E[Z^1_{s,t}\alpha_t(Z^2_{t,T})|\mathcal{F}_s],
\]
3 THE REPRESENTATION THEOREM

holds for all \(Z^2 \in \mathbb{Z}_c\), thus
\[
C_s(B) \geq E\left(Z_{s,t}^1B|\mathcal{F}_s\right) - \alpha_s(Z_{s,t}) - E\left[Z_{s,t}1 \text{ ess inf}_{Z \in \mathbb{Z}_c} \alpha_t(Z_{t,T})|\mathcal{F}_s\right]
= E\left(Z_{s,t}^1B|\mathcal{F}_s\right) - \alpha_s(Z_{s,t}),
\]
therefore \(C_s(B) \geq \text{ess sup}_{Z \in \mathbb{Z}_c}\left\{E\left[Z_{s,t}B|\mathcal{F}_s\right] - \alpha_s(Z_{s,t})\right\}\), and (3.10) follows.

**Lemma 3.10.** Under the conditions of Theorem 3.8, for any \(B \in L^\infty(\mathcal{F}_T)\), \(C(B)\) defined by (3.9) is a bounded RCLL semimartingale such that \(\left\{\hat{Z}_t(C_t(B) + \alpha_t(\hat{Z}_{t,T})) : t \in [0,T]\right\}\) is a supermartingale for any \(\hat{Z} \in \mathbb{Z}_c\).

**Proof.** For any \(\hat{Z} \in \mathbb{Z}_c\), let
\[
Z_t(\hat{Z}) := \left\{Z \in \mathbb{Z}_c : ZI_{[0,t]} = \hat{Z}I_{[0,t]}\right\},
\]
so that \(Z_t(\hat{Z}) \subset \mathbb{Z}_s(\hat{Z})\) for every \(s < t\), and for every \(Z \in \mathbb{Z}_t(\hat{Z})\), \(Z\) can be rewritten as
\[
Z_u = \hat{Z}_u I_{u< t} + \hat{Z}_t Z_{t,T} I_{u \geq T}
\]
and thus \(\alpha_s(Z_{s,T}) = \alpha_s(\hat{Z}_{s,t}) + E\left[\hat{Z}_{s,t} \alpha_t(Z_{t,T})|\mathcal{F}_s\right]\). Therefore,
\[
\hat{Z}_s \left(C_s(B) + \alpha_s(\hat{Z}_{s,T})\right) = \hat{Z}_s \text{ ess sup}_{Z \in \mathbb{Z}_c}\left\{E\left[Z_{s,T}B|\mathcal{F}_s\right] - \alpha_s(Z_{s,T})\right\} + \hat{Z}_s \alpha_s(\hat{Z}_{s,T})
= \text{ess sup}_{Z \in \mathbb{Z}_c(\hat{Z})}\left\{E\left[Z_{s,T}B|\mathcal{F}_s\right] - \hat{Z}_s \alpha_s(Z_{s,T}) + \hat{Z}_s \alpha_s(\hat{Z}_{s,T})\right\}
\geq \text{ess sup}_{Z \in \mathbb{Z}_c(\hat{Z})}\left\{E\left[Z_{s,T}B|\mathcal{F}_s\right] - \hat{Z}_s \alpha_s(Z_{s,T}) + \hat{Z}_s \alpha_s(\hat{Z}_{s,T})\right\}
\geq \text{ess sup}_{Z \in \mathbb{Z}_c(\hat{Z})}\left\{E\left[Z_{s,T}B|\mathcal{F}_s\right] - \hat{Z}_s \alpha_s(\hat{Z}_{s,t}) - \hat{Z}_s E\left[\hat{Z}_{s,t} \alpha_t(Z_{t,T})|\mathcal{F}_s\right]
+ \hat{Z}_s \alpha_s(\hat{Z}_{s,t}) + \hat{Z}_s E\left[\hat{Z}_{s,t} \alpha_t(\hat{Z}_{t,T})|\mathcal{F}_s\right]\right\}
\geq \text{ess sup}_{Z \in \mathbb{Z}_c(\hat{Z})}\left\{E\left[Z_{s,T}B|\mathcal{F}_s\right] - E\left[\hat{Z}_t \alpha_t(Z_{t,T})|\mathcal{F}_s\right] + E\left[\hat{Z}_t \alpha_t(\hat{Z}_{t,T})|\mathcal{F}_s\right]\right\}.
\]
From Remark 3.9 3), one can choose a sequence \((Z^n)_{n \in \mathbb{N}} \subset \mathbb{Z}_d(\hat{Z})\) such that
\[
C_t(B) = \leftarrow \lim_{n \to \infty} E\left[Z^n_{t,T}B|\mathcal{F}_t\right] - \alpha_t(Z^n_{t,T}).
\]
It follows from the monotone convergence theorem that
\[
\hat{Z}_s \left(C_s(B) + \alpha_s(\hat{Z}_{s,T})\right) \geq \text{ess sup}_{Z \in \mathbb{Z}_c(\hat{Z})}\left\{E\left[Z_{s,T}B|\mathcal{F}_s\right] - E\left[\hat{Z}_t \alpha_t(Z_{t,T})|\mathcal{F}_s\right] + E\left[\hat{Z}_t \alpha_t(\hat{Z}_{t,T})|\mathcal{F}_s\right]\right\}
\geq \lim_{n \to \infty} E\left\{\hat{Z}_t \left\{E\left[Z^n_{t,T}B|\mathcal{F}_t\right] - \alpha_t(Z^n_{t,T})\right\}|\mathcal{F}_s\right\} + E\left[\hat{Z}_t \alpha_t(\hat{Z}_{t,T})|\mathcal{F}_s\right]
= E\left\{\hat{Z}_t \left\{C_t(B) + \alpha_t(\hat{Z}_{t,T})\right\}|\mathcal{F}_s\right\},
\]
thus $\{\hat{Z}_t(C(B) + \alpha_t(\hat{Z}_{t,T})); t \in [0,T]\}$ is a supermartingale. Similar to El Karoui and Quenez (1995)\cite{11} or Laurent and Pham (1999)\cite{22}, one can show that $\{\hat{Z}_t(C(B) + \alpha_t(\hat{Z}_{t,T})); t \in [0,T]\}$ has an RCLL version. As $\hat{Z}_t(\alpha) := \{\hat{Z}_t\alpha_t(\hat{Z}_{t,T}); t \in [0,T]\}$ is also an RCLL supermartingale, thus $C(B)$ has an RCLL version.

**Corollary 3.11.** Under the conditions of Theorem 3.8, if there exists $\hat{Z} \in \mathbb{Z}_c$ such that $\hat{Z}_t(C(B) + \alpha_t(\hat{Z}_{t,T}))$ is a uniformly integrable martingale, then for every $t \in [0,T]$

$$C_t(B) = E\left[\hat{Z}_{t,T}B|\mathcal{F}_t\right] - \alpha_t(\hat{Z}_{t,T}), \text{ a.s.}$$

**Proof of Theorem 3.8.** One can easily check that $C$ defined by (3.9) satisfies (A), (B) and (C) in the definition of the $S$-related DCV. For any $A \in \mathcal{F}_t$ and $B_i \in L^\infty(\mathcal{F}_t), i = 1, 2,$

$$E\left[Z_{t,T}(B_1 I_A + B_2 I_{A^c})|\mathcal{F}_t\right] - \alpha_t(Z_{t,T})$$

$$= \left\{ E\left[Z_{t,T}B_1|\mathcal{F}_t\right] - \alpha_t(Z_{t,T}) \right\} I_A + \left\{ E\left[Z_{t,T}B_2|\mathcal{F}_t\right] - \alpha_t(Z_{t,T}) \right\} I_{A^c}$$

$$\leq \text{ess sup}_{Z \in \mathbb{Z}_c} \left\{ E\left[Z_{t,T}B_1|\mathcal{F}_t\right] - \alpha_t(Z_{t,T}) \right\} I_A + \text{ess sup}_{Z \in \mathbb{Z}_c} \left\{ E\left[Z_{t,T}B_2|\mathcal{F}_t\right] - \alpha_t(Z_{t,T}) \right\} I_{A^c}$$

$$= C_t(B_1)I_A + C_t(B_2)I_{A^c},$$

thus $C_t(B_1 I_A + B_2 I_{A^c}) \leq C_t(B_1)I_A + C_t(B_2)I_{A^c}.$ On the other hand, for any $Z^i \in \mathbb{Z}_c, i = 1, 2,$ let $\hat{B} = B_1 I_A + B_2 I_{A^c}$ and $\hat{Z}_s = Z^1_{s,t}\{1_{s,t} I_A + \alpha_c \{Z^2_{s,t} I_A, \alpha_c \{Z^2_{s,t} I_{A^c}\}\}\}_{s \geq t},$ from (iii), one gets $\alpha_t(\hat{Z}_{t,T}) = \alpha_t(Z^1_{t,T})I_A + \alpha_t(Z^2_{t,T})I_{A^c}$ and $\hat{Z}_{t,T} = Z^1_{t,T}I_A + Z^2_{t,T}I_{A^c}.$ Therefore,

$$C_t(\hat{B}) = \text{ess sup}_{Z \in \mathbb{Z}_c} \left\{ E\left[Z_{t,T}B|\mathcal{F}_t\right] - \alpha_t(Z_{t,T}) \right\}$$

$$\geq E\left[\hat{Z}_{t,T}\hat{B}|\mathcal{F}_t\right] - \alpha_t(\hat{Z}_{t,T})$$

$$= \left\{ E\left[Z^1_{t,T}B_1|\mathcal{F}_t\right] - \alpha_t(Z^1_{t,T}) \right\} I_A + \left\{ E\left[Z^2_{t,T}B_2|\mathcal{F}_t\right] - \alpha_t(Z^2_{t,T}) \right\} I_{A^c},$$

thus $C_t(B_1 I_A + B_2 I_{A^c}) \geq C_t(B_1)I_A + C_t(B_2)I_{A^c},$ which implies that $C_t(B)$ satisfies (D), i.e., the $\mathcal{F}_t$-regularity. For any $\pi \in \text{Adm}$ and $t \in [0,T],$ it follows from (ii) that

$$C_t(X_{t,T}^{0,\pi}) = \text{ess sup}_{Z \in \mathbb{Z}_c} \left\{ E\left[Z_{t,T}X_{t,T}^{0,\pi}|\mathcal{F}_t\right] - \alpha_t(Z_{t,T}) \right\} = X_t^{0,\pi} - \text{ess inf}_{Z \in \mathbb{Z}_c} \alpha_t(Z_{t,T}) = X_t^{0,\pi},$$

and the $S$-related property of $C$ follows. We now show the time consistency of $C,$ i.e., for any $s < t$ and $B \in L^\infty(\mathcal{F}_t),$ it follows from (i) and (3.10) that

$$C_s(C_t(B)) = \text{ess sup}_{Z \in \mathbb{Z}_c} \left\{ E\left[Z_{s,t}C_t(B)|\mathcal{F}_s\right] - \alpha_s(Z_{s,t}) \right\}$$

$$\geq \text{ess sup}_{Z \in \mathbb{Z}_c} \left\{ E\left[Z_{s,t}E(Z_{t,T}B|\mathcal{F}_t) - Z_{s,t}\alpha_t(Z_{t,T})|\mathcal{F}_s\right] - \alpha_s(Z_{s,t}) \right\}$$

$$= \text{ess sup}_{Z \in \mathbb{Z}_c} \left\{ E\left[Z_{s,T}Z_{t,T}B|\mathcal{F}_s\right] - E\left[Z_{s,t}\alpha_t(Z_{t,T})|\mathcal{F}_s\right] - \alpha_s(Z_{s,t}) \right\}$$

$$= \text{ess sup}_{Z \in \mathbb{Z}_c} \left\{ E\left[Z_{s,T}B|\mathcal{F}_s\right] - \alpha_s(Z_{s,T}) \right\}$$

$$= C_s(B).$$
On the other hand, there exists a sequence \((Z^n)_{n \in \mathbb{N}} \subset \mathbb{Z}_e\) such that
\[
C_t(B) = \lim_{n \to \infty} E\left[ Z^n_{t,T} B \mid \mathcal{F}_t \right] - \alpha_t(Z^n_{t,T}),
\]
thus for any \(Z \in \mathbb{Z}_e\), let \(\hat{Z}^n_u = Z_u I_{u < t} + Z_t Z^n u \in \mathbb{I}_{t \geq t}\), then
\[
E \left[ Z_{s,t} \left\{ E(Z^n_{t,T} B \mid \mathcal{F}_t) - \alpha_t(Z^n_{t,T}) \right\} \mid \mathcal{F}_s \right] - \alpha_s(Z_{s,t})
= E[Z_{s,t} Z^n_{t,T} B \mid \mathcal{F}_t] - E[Z_{s,t} \alpha_t(Z^n_{t,T}) \mid \mathcal{F}_s] - \alpha_s(Z_{s,t})
= E[\hat{Z}^n_{s,t} B \mid \mathcal{F}_t] - E[\hat{Z}^n_{s,t} \alpha_t(\hat{Z}^n_{t,T}) \mid \mathcal{F}_s] - \alpha_s(\hat{Z}^n_{s,t})
= E[\hat{Z}^n_{s,t} B \mid \mathcal{F}_t] - \alpha_s(\hat{Z}^n_{s,t})
\leq \text{ess sup} \left\{ E[Z_{s,T} B \mid \mathcal{F}_t] - \alpha_s(Z_{s,T}) \right\}
= C_s(B). \tag{3.12}
\]
From an analogous argument as in the proof of Lemma 3.5, one can derive
\[
E \left[ Z_{s,t} C_t(B) \mid \mathcal{F}_s \right] - \alpha_s(Z_{s,t}) = \lim_{n \to \infty} E \left[ Z_{s,t} \left\{ E(Z^n_{t,T} B \mid \mathcal{F}_t) - \alpha_t(Z^n_{t,T}) \right\} \mid \mathcal{F}_s \right] - \alpha_s(Z_{s,t}) \leq C_s(B),
\]
thus
\[
C_s(C_t(B)) = \text{ess sup} \left\{ E \left[ Z_{s,t} C_t(B) \mid \mathcal{F}_s \right] - \alpha_s(Z_{s,t}) \right\} \leq C_s(B). \tag{3.12}
\]
From (3.11) and (3.12), we have
\[
C_s(C_t(B)) = C_s(B)
\]
and the time consistency follows. \(\square\)

4 Two \(S\)-related DCVs generated by \(\tilde{\alpha}\) and \(\hat{\alpha}\)

In this section we will consider two special penalty functionals \(\tilde{\alpha}\) and \(\hat{\alpha}\) satisfying the conditions of Theorem 3.8, and the corresponding \(S\)-related dynamic convex valuations generated by \(\tilde{\alpha}\) and \(\hat{\alpha}\) denoted by \(\tilde{C}\) and \(\hat{C}\) respectively. We then describe the dynamics of \(\tilde{C}\) and \(\hat{C}\) by two backward semimartingale equations.

For any \(Z \in \mathbb{Z}_e\), it follows from Corollary 2.5 that \(\tilde{Z}_t := \frac{Z_t}{\tilde{Z}_t}\) can be represented in the following form
\[
\tilde{Z}_t = Z_0 \mathcal{E} \left\{ - \int_0^t \tilde{l}_u \tilde{d}\tilde{M}_u + \int_0^t \int_\mathbb{R} l(u,y) \tilde{N}(du,dy) + L \right\},
\]
where \(l(u,y)\) is a \(\mathcal{F}\)-measurable function with \(l(u,y) > 1\) and \(L\) a continuous local \(Q^0\)-martingale strongly \(Q^0\)-orthogonal to \(\tilde{M}\) with \(L_0 = 0\). For any \(s < t\)
\[
\hat{Z}_{s,t} = 1 - \int_{[s,t]} \hat{Z}_{s,u} \hat{l}_u d\hat{M}_u + \int_{[s,t]} \int_\mathbb{R} \hat{Z}_{s,u-l(u,y)} \tilde{N}(du,dy) + \int_{[s,t]} \hat{Z}_{s,u} dL_u,
\]
Proof. One can easily check that $	ilde{Z}$ and $\tilde{Z}_u$ for $s < u$. Given two predictable processes $\xi$ and $\eta$ with $0 < c \leq \xi_u \leq C < \infty$ and $0 < c \leq \eta \leq C < \infty$ and a $\mathcal{F}$-measurable function $\xi(u, y)$ with $0 < c \leq \xi(u, y) \leq C < \infty$, where $c$ and $C$ are two positive constants, we define for each $\tilde{Z} \in \tilde{Z}_e$

\[
\hat{\alpha}_s(\tilde{Z}_{s,t}) := E_{Q^0}\left( \int_{[s,t]} \tilde{Z}_{u-} \xi_u dA + \int_{[s]} \tilde{Z}_{u} \eta d(L\mid \mathcal{F}_s) \right) \quad (4.1)
\]

and

\[
\hat{\alpha}_s(\tilde{Z}_{s,t}) := E_{Q^0}\left( \int_{[s,t]} \int_{\mathbb{R}} \tilde{Z}_{u-} \xi(u, y) dA + \int_{[s]} \tilde{Z}_{u} \eta d(L\mid \mathcal{F}_s) \right). \quad (4.2)
\]

4.1 The $S$-related DCV generated by $\hat{\alpha}$

To consider the $S$-related dynamic convex valuation generated by $\hat{\alpha}$, we introduce

\[
\mathcal{Z} := \left\{ \tilde{Z} \in \tilde{Z}_e; \hat{\alpha}_0(\tilde{Z}_{0,T}) < \infty \right\}
\]

Lemma 4.1. For any $\tilde{Z}^i \in \mathcal{Z}$, $i = 1, 2$ and an $\mathcal{F}_t$-measurable set $D$, let $\tilde{Z}_u = \tilde{Z}^1_u I_{u < t} + \tilde{Z}^2_u I_{u > t}$, then $\tilde{Z} \in \mathcal{Z}$.

Proof. One can easily see that $\tilde{Z} \in \tilde{Z}_e$. From

\[
E_{Q^0}[\hat{\alpha}_0(\tilde{Z}_{0,T})] \leq E_{Q^0}[\tilde{Z}^1_0] + E_{Q^0}[\tilde{Z}^2_0] < \infty,
\]

one can see that $\tilde{Z} \in \mathcal{Z}$.

It is easy to see that for each $\tilde{Z} \in \mathcal{Z}$ and $s < t$

\[
\text{ess inf}_{\tilde{Z} \in \mathcal{Z}} \left\{ \tilde{Z}_{s,t} \right\} = \hat{\alpha}_s(\tilde{Z}_{s,t}) = 0,
\]

and

\[
\hat{\alpha}_s(\tilde{Z}_{s,t}) = \hat{\alpha}_s(\tilde{Z}_{s,t}) + E_{Q^0}[\tilde{Z}_{s,t} \hat{\alpha}_t(\tilde{Z}_{t,T}) \mid \mathcal{F}_s], \text{ a.s.}
\]

One can easily check that

(iii') for any $\tilde{Z}^i \in \mathcal{Z}$, $i = 1, 2$ and a $\mathcal{F}_t$-measurable set $D$, let $\tilde{Z}_u = \tilde{Z}^1_u I_{u < t} + \tilde{Z}^2_u I_{u > t}$, then $\hat{\alpha}_t(\tilde{Z}_{t,T}) = \hat{\alpha}_t(\tilde{Z}^1_{t,T}) I_D + \hat{\alpha}_t(\tilde{Z}^2_{t,T}) I_{D^c}$.

(iv') $\lim_{h \to 0} \hat{\alpha}_t(\tilde{Z}_{t,t+h}) = 0$, for any $\tilde{Z} \in \mathcal{Z}$ and $t \in [0, T]$.

We have the following lemma

Lemma 4.2. For any $\tilde{Z}^i \in \mathcal{Z}$, $i = 1, 2$ and $\lambda \in [0, 1]$, we have

\[
\hat{\alpha}_s (\lambda \tilde{Z}^1_{s,t} + (1 - \lambda) \tilde{Z}^2_{s,t}) \leq \lambda \hat{\alpha}_s(\tilde{Z}^1_{s,t}) + (1 - \lambda) \hat{\alpha}_s(\tilde{Z}^2_{s,t}), \text{ a.s.}
\]
Proof. For any \( \tilde{Z}^i \in \mathcal{Z} \), \( i = 1, 2 \), there exist a \( \mathcal{F} \)-measurable function \( l^i(u, y) \) and a continuous local martingale \( L^i \) with \( L_0 = 0 \) and \( \langle L^i, \hat{M} \rangle = 0 \) such that

\[
\tilde{Z}^i_t = Z^i_0 e^{- \int_0^t \langle l^i(u, y) \rangle \, du} + \int_0^t \int l^i(u, y) \, \tilde{M}(du, dy) + L^i_t.
\]

For any \( \lambda \in [0, 1] \) and \( s < t \), one easily derives that \( \tilde{Z}_{s,t} := \lambda \tilde{Z}^1_{s,t} + (1 - \lambda) \tilde{Z}^2_{s,t} \) satisfies the following equality

\[
\tilde{Z}_{s,t} - 1 - \int_s^t \tilde{Z}_{s,u} - \{ \frac{\lambda \tilde{Z}^1_{s,u} - (1 - \lambda) \tilde{Z}^2_{s,u}}{\lambda \tilde{Z}^1_{s,u} - (1 - \lambda) \tilde{Z}^2_{s,u}} \} du + \left( \frac{1 - \lambda}{\lambda} \right) \tilde{Z}^2_{s,u} - (1 - \lambda) \tilde{Z}^2_{s,u} \}
\]

Thus

\[
\tilde{\alpha}_s(\lambda \tilde{Z}^1_{s,t} + (1 - \lambda) \tilde{Z}^2_{s,t})
\]

\[
= E_{Q^0} \left( \int_{s,t} \left( \frac{\lambda \tilde{Z}^1_{s,u} - (1 - \lambda) \tilde{Z}^2_{s,u}}{\lambda \tilde{Z}^1_{s,u} - (1 - \lambda) \tilde{Z}^2_{s,u}} \right) \right) du + \left( \frac{1 - \lambda}{\lambda} \right) \tilde{Z}^2_{s,u} - (1 - \lambda) \tilde{Z}^2_{s,u} \}
\]

Thus

\[
\tilde{\alpha}_s(\lambda \tilde{Z}^1_{s,t} + (1 - \lambda) \tilde{Z}^2_{s,t})
\]

\[
= E_{Q^0} \left( \int_{s,t} \left( \frac{\lambda \tilde{Z}^1_{s,u} - (1 - \lambda) \tilde{Z}^2_{s,u}}{\lambda \tilde{Z}^1_{s,u} - (1 - \lambda) \tilde{Z}^2_{s,u}} \right) \right) du + \left( \frac{1 - \lambda}{\lambda} \right) \tilde{Z}^2_{s,u} - (1 - \lambda) \tilde{Z}^2_{s,u} \}
\]

\[
= \tilde{\alpha}_s(\lambda \tilde{Z}^1_{s,t} + (1 - \lambda) \tilde{Z}^2_{s,t}).
\]

\[\square\]

Theorem 4.3. For \( \tilde{Z} \in \mathcal{Z} \), let \( \tilde{\alpha}_s(\tilde{Z}_{s,t}) \) be defined by (4.1), then \( \tilde{C} = \{ \tilde{C}(B) = (\tilde{C}(B))_{t \in [0, T]}, B \in L^\infty(\mathcal{F}_T) \} \) defined by

\[
\tilde{C}_t(B) = \text{ess sup}_{\tilde{Z} \in \mathcal{Z}} \left\{ E_{Q^0} \left[ \tilde{Z}_{t,T} B \mid \mathcal{F}_t \right] - \tilde{\alpha}_t(\tilde{Z}_{t,T}) \right\}
\]

is an \( S \)-related dynamic convex valuation.

Proof. Similar to Remark 3.9. 4) of Theorem 3.8, one can show that for any \( B \in L^\infty(\mathcal{F}_t) \) and \( s < t \),

\[
\tilde{\alpha}_s(\tilde{Z}_{s,t}) = \text{ess sup}_{\tilde{Z} \in \mathcal{Z}} \left\{ E_{Q^0} \left[ \tilde{Z}_{s,t} B \mid \mathcal{F}_s \right] - \tilde{\alpha}_s(\tilde{Z}_{s,t}) \right\}.
\]

Furthermore, from an argument as in the proof of Theorem 3.8, \( \tilde{C}_t(B) \) satisfies the \( \mathcal{F}_t \)-regularity, (i.e., for any \( \mathcal{F}_t \)-measurable set \( D \) and \( B_i \in L^\infty(\mathcal{F}_T), i = 1, 2 \), \( \tilde{C}_t(B_1I_D + B_2I_{D^c}) = \tilde{C}_t(B_1)I_D + \tilde{C}_t(B_2)I_{D^c} \).
\( \hat{C}_t(B_2) \mid D^e, \text{ a.s.} \) and the \( S \)-related property. As for the time-consistency of \( \hat{C} \), for any \( s < t \) and \( B \in L^\infty(\mathcal{F}_T) \)

\[
\hat{C}_s(\hat{C}_t(B)) = \text{ess sup}_{\tilde{Z} \in \mathcal{Z}} \left\{ E_{Q^0} \left[ \tilde{Z}_{s,t} \hat{C}_t(B) \mid \mathcal{F}_s \right] - \hat{\alpha}_s(\tilde{Z}_{s,t}) \right\} \\
\geq \text{ess sup}_{\tilde{Z} \in \mathcal{Z}} \left\{ E_{Q^0} \left[ \tilde{Z}_{s,t} \hat{Z}_{t,T} B \mid \mathcal{F}_s \right] - E_{Q^0} \left[ \tilde{Z}_{s,t} \hat{\alpha}_t(\tilde{Z}_{t,T}) \mid \mathcal{F}_s \right] - \hat{\alpha}_s(\tilde{Z}_{s,t}) \right\} \\
= \text{ess sup}_{\tilde{Z} \in \mathcal{Z}} \left\{ E \left[ Z_{s,T} B \mid \mathcal{F}_s \right] - \alpha_s(Z_{s,T}) \right\} \\
=: C_s(B).
\]

On the other hand, \( \left\{ E_{Q^0}[\hat{Z}_{t,T} B \mid \mathcal{F}_t] - \hat{\alpha}_t(\hat{Z}_{t,T}); Z \in \mathcal{Z} \right\} \) is closed under \( \vee \), thus there exists a sequence \( (\hat{Z}^n)_{n \in \mathbb{N}} \subset \mathcal{Z} \) such that

\[
\hat{C}_t(B) = \lim_{n \to \infty} E_{Q^0}[\hat{Z}^n_{t,T} B \mid \mathcal{F}_t] - \hat{\alpha}_t(\hat{Z}^n_{t,T}),
\]

thus for any \( \hat{Z} \in \mathcal{Z} \), let \( \hat{Z}^{a,n} = \hat{Z}_u I_{u < t} + \hat{Z}_t \hat{Z}^{a,n}_u I_{u \geq t} \), then

\[
E_{Q^0}[\hat{Z}_{s,t} \hat{C}_t(B) \mid \mathcal{F}_s] - \hat{\alpha}_s(\hat{Z}_{s,t}) \\
= \lim_{n \to \infty} E_{Q^0}[\hat{Z}_{s,t} \{ E_{Q^0}[\hat{Z}^n_{t,T} B \mid \mathcal{F}_t] - \hat{\alpha}_t(\hat{Z}^n_{t,T}) \}] \mid \mathcal{F}_s] - \hat{\alpha}_s(\hat{Z}_{s,t}) \\
= \lim_{n \to \infty} E_{Q^0}[\hat{Z}_{s,t} \hat{Z}^{a,n}_{t,T} B \mid \mathcal{F}_t] - E_{Q^0}[\hat{Z}_{s,t} \hat{\alpha}_t(\hat{Z}^{a,n}_{t,T}) \mid \mathcal{F}_s] - \hat{\alpha}_s(\hat{Z}_{s,t}) \\
= \lim_{n \to \infty} E_{Q^0}[\hat{Z}^{a,n}_{s,T} B \mid \mathcal{F}_t] - \hat{\alpha}_s(\hat{Z}^{a,n}_{s,T}) \\
\leq \text{ess sup}_{\tilde{Z} \in \mathcal{Z}} \{ E_{Q^0}[\hat{Z}_{s,T} B \mid \mathcal{F}_t] - \hat{\alpha}_s(\hat{Z}_{s,T}) \} \\
= \hat{C}_s(B).
\]

Therefore

\[
\hat{C}_s(\hat{C}_t(B)) = \text{ess sup}_{\tilde{Z} \in \mathcal{Z}} \{ E_{Q^0}[\hat{Z}_{s,t} \hat{C}_t(B) \mid \mathcal{F}_s] - \hat{\alpha}_s(\hat{Z}_{s,t}) \} \leq \hat{C}_s(B). \tag{4.7}
\]

From (4.6) and (4.7), we have

\[
\hat{C}_s(\hat{C}_t(B)) = \hat{C}_s(B)
\]

and the time consistency follows. \( \square \)

Similar to Lemma 3.10, we have the following lemma

**Lemma 4.4.** For any \( B \in L^\infty(\mathcal{F}_T) \), let \( \hat{C}(B) \) be the dynamic convex valuation (DCV) related to \( S \) defined by (4.5), then

1) \( \{ \hat{Z}_t(\hat{C}_t(B) + \hat{\alpha}_t(\hat{Z}_{t,T})); t \in [0, T] \} \) is an RCLL supermartingale under \( Q^0 \) for any \( \hat{Z} \in \mathcal{Z} \);

2) if there exists \( Z^* \in \mathcal{Z} \) such that \( \hat{Z}^*_t(\hat{C}_t(B) + \hat{\alpha}_t(Z^*_{t,T})) \) is a uniformly integrable martingale under \( Q^0 \), then for every \( t \in [0, T] \)

\[
\hat{C}_t(B) = E_{Q^0}[Z^*_{t,T} B \mid \mathcal{F}_t] - \hat{\alpha}_t(Z^*_{t,T}), \text{ a.s.}
\]

To obtain the dynamics of $\hat{C}(B)$, for any $\hat{Z}_t = Z_0 E \{- \int_0^t \hat{\xi}_u (\hat{\eta}_u)^2 dA_u + \int_0^t \theta(u) L_u \}$, we introduce

$$\Lambda_t(\hat{Z}) := \int_{[0,t]} \hat{Z}_u - \xi_u (\hat{\eta}_u)^2 dA_u + \int_{[0,t]} \hat{Z}_u - \eta_u d(L)_u.$$ 

$\Lambda(\hat{Z})$ is a continuous increasing process and the following equality holds

$$\tilde{\alpha}_s(\hat{Z}_{s,t}) = \frac{1}{Z_s} E^Q_0 \left[ \Lambda_t(\hat{Z}) - \Lambda_s(\hat{Z}) \right]^{[\mathcal{F}_s]}, \text{ a.s..} \quad (4.8)$$

Thus we have the following corollary

**Corollary 4.5.** For any $B \in L^\infty(\mathcal{F}_T)$, let $\hat{C}(B)$ be the $S$-related DCV related to $S$ defined by (3.9), then

1') $\left\{ \hat{Z}_t \hat{C}_t(B) - \Lambda_t(\hat{Z}); t \in [0,T] \right\}$ is an RCLL supermartingale under $Q^0$ for any $\hat{Z} \in \mathcal{Z}^*$;

2') if there exists $Z^* \in \mathcal{Z}^*$ such that $Z_t^* \hat{C}_t(B) - \Lambda_t(Z^*)$ is a uniformly integrable martingale under $Q^0$, then for every $t \in [0,T]

$$\hat{C}_t(B) = E^Q_0 \left[ Z_{t,T}^* B | \mathcal{F}_t \right] - \hat{\alpha}_t(Z_{t,T}^*), \text{ a.s.}$$

Proof. From (4.8), one easily derives

$$\hat{Z}_t \hat{C}_t(B) - \Lambda_t(\hat{Z}) = \hat{Z}_t (\hat{C}_t(B) + \hat{\alpha}_t(\hat{Z}_{t,T})) - E^Q_0 [\Lambda_T(\hat{Z}) | \mathcal{F}_t].$$

Since $\{E^Q_0[\Lambda_T(\hat{Z}) | \mathcal{F}_t]\}$ is a uniformly integrable martingale under $Q^0$, 1') and 2') follow from Lemma 4.4. \qed

For a given $B \in L^\infty(\mathcal{F}_T)$, we consider the following backward semimartingale equation (BSE)

$$\begin{cases}
Y_t = Y_0 - \int_0^t \frac{\xi_u}{2} (\varphi_u)^2 dA_u - \int_0^t \frac{1}{4 \eta_u} d(L)_u + \int_0^t \theta(u) dM_u + \hat{L}_t \\
Y_T = B.
\end{cases} \quad (4.9)$$

The solution of the BSE (4.9) is a 4-tuple $(Y, \theta, \varphi, \hat{L})$ satisfying (4.9) such that

1) $\theta$ is a predictable process such that $\theta \cdot \hat{M}$ is a BMO-martingale under $Q^0$. $\varphi$ is a $\mathcal{P}$-measurable function with $\varphi(u, y) > -1$ and $\varphi_u = \int_{\mathbb{R}} \varphi_1(u, y) \varphi(u, y) K(u; dy)$. Also $\int_0^t \varphi(u, y) \hat{N}(du, dy)$ is a BMO-martingale under $Q^0$ with $\int_0^T \int_{\mathbb{R}} \varphi(u, y)^2 K(u; dy) dA_u \leq c < \infty$, $Q^0$-a.s. for some $c \in \mathbb{R}$;

2) $\hat{L}$ is a BMO martingale under $Q^0$, i.e., $\hat{L} \in BMO(Q^0)$ with $\langle \hat{L} \rangle_T \leq c < \infty$, $Q^0$-a.s., which is strongly orthogonal to $\hat{M}$ under $Q^0$.
(3) $Y$ is a bounded RCLL semimartingale.

**Remark 4.6.**

1. If $S$ is a continuous semimartingale, i.e., $\sigma_2(u,y) = 0$, the BSE equation (4.9) is the same as (4.5) of Mania and Schweizer (2005) [24].

2. In general, the BSE (4.9) might not have a solution. However, in many cases, the BSE (4.9) has a solution. Especially, when $B = x + \int_0^T \pi_u dS_u$ for some $\pi \in \text{Adm}$,

$$
\begin{align*}
\theta(u) &= \sigma_1(u) \pi_u, \\
\varphi(u,y) &= 0, \\
\tilde{L}_t &= 0, \\
Y_t &= x + \int_0^t \pi_u dS_u,
\end{align*}
$$

is the solution of the BSE (4.9).

3. If BSE (4.9) has a solution given by $(Y, \theta, \varphi, \tilde{L})$, one can see that there exists a constant still denoted by $c$ such that

$$
\int_0^T \xi_u(\tilde{\varphi}_u)^2 dA_u + \int_0^T \eta_u d\langle \tilde{L} \rangle_u \leq c < \infty, \text{ } Q^0\text{-a.s.},
$$

(4.10)

since $\xi$ and $\eta$ are two bounded positive processes.

**Theorem 4.7.** If the BSE (4.9) has a solution denoted by $(Y, \theta, \varphi, \tilde{L})$, then for all $t \in [0, T]$

$$
\tilde{C}_t(B) = Y_t, \text{ } Q^0\text{-a.s.}
$$

**Proof.** For any $\tilde{Z} \in \mathcal{Z}$, there exist a continuous local $Q^0$-martingale $L$ with $L_0 = 0$ and $\langle L, M \rangle = 0$, and a functional $l \in \mathcal{P}$ such that

$$
\tilde{Z}_t = 1 - \int_0^t \tilde{Z}_{u-} \tilde{I}_u d\tilde{M}_u + \int_0^t \int_\mathbb{R} \tilde{Z}_{u-} l(u,y) \tilde{N}(du,dy) + \int_0^t \tilde{Z}_{u-} d\tilde{L}_u.
$$
If BSE (4.9) has a solution \((Y, \theta, \varphi, \tilde{L})\), from Itô’s formula we find that
\[
Y_t \tilde{Z}_t - \Lambda_t(\tilde{Z}) = Y_0 Z_0 - \int_0^t \int_\mathbb{R} Y_{u-} \tilde{Z}_u - \tilde{L}_u \tilde{d}M_u + \int_0^t \int_\mathbb{R} Y_{u-} \tilde{Z}_u - l(u, y) \tilde{N}(du, dy) + \int_0^t Y_{u-} \tilde{Z}_u - dL_u \\
- \int_0^t \tilde{Z}_u \frac{\xi(u) \varphi}{2} \tilde{d}A_u - \int_0^t \tilde{Z}_u - \frac{1}{4 \eta u} \tilde{d}L_u + \int_0^t \tilde{Z}_u - \theta(u) \tilde{d}M_u + \int_0^t \tilde{Z}_u - \tilde{d}L_u \\
+ \int_0^t \int_\mathbb{R} \tilde{Z}_u - \frac{\sigma_2(u, y)}{\sigma_1(u)} \{\theta(u) + \sqrt{2} \xi(u) \varphi_u\} \tilde{N}(du, dy) \\
- \int_0^t \tilde{Z}_u - \tilde{L}_u \tilde{d}A_u + \int_0^t \tilde{Z}_u - \tilde{d}L_u \\
+ \int_0^t \int_\mathbb{R} \tilde{Z}_u - l(u, y) \frac{\sigma_2(u, y)}{\sigma_1(u)} \{\theta(u) + \sqrt{2} \xi(u) \varphi_u\} \mu(du, dy) \\
- \int_0^t \tilde{Z}_u - \xi(u) \tilde{L}_u \tilde{d}A_u - \int_0^t \tilde{Z}_u - \eta u \tilde{d}L_u \\
= Y_0 Z_0 + \int_0^t \int_\mathbb{R} \tilde{Z}_u - \{\theta(u) - Y_0 \tilde{L}_u\} \tilde{d}M_u \\
+ \int_0^t \int_\mathbb{R} \tilde{Z}_u - \left\{Y_{u-} l(u, y) + \frac{\sigma_2(u, y)}{\sigma_1(u)} \{1 + l(u, y)\} \{\theta(u) + \sqrt{2} \xi(u) \varphi_u\}\right\} \tilde{N}(du, dy) \\
+ \int_0^t Y_u - \tilde{Z}_u - dL_u + \int_0^t \tilde{Z}_u - \tilde{d}L_u \\
- \int_0^t \tilde{Z}_u \frac{\xi(u)}{2} \left\{(\varphi_u)^2 - 2 \sqrt{2} \varphi_u \tilde{L}_u + 2 \tilde{L}_u)^2\right\} dA_u \\
- \int_0^t \tilde{Z}_u - \frac{1}{4 \eta u} \tilde{d}L_u + \int_0^t \tilde{Z}_u - \tilde{d}L_u - \int_0^t \tilde{Z}_u - \eta u \tilde{d}L_u.
\]

As \(\xi\) and \(\eta\) are positive, bounded and predictable processes, \(\{Y_t \tilde{Z}_t - \Lambda_t(\tilde{Z}); t \in [0, T]\}\) is a local \(Q^0\)-supermartingale. Furthermore, as \(Y\) is a bounded process, \(\tilde{Z}\) is a uniformly integrable \(Q^0\)-martingale and \(\Lambda_t(\tilde{Z}) \leq \Lambda_T(\tilde{Z})\) and \(E_{Q^0}[\Lambda_T(\tilde{Z})] = \bar{\alpha}_{0,T}(\tilde{Z}) < \infty\) for \(\tilde{Z} \in \mathcal{Z}\), so one sees that \(\{Y_t \tilde{Z}_t - \Lambda_t(\tilde{Z}); t \in [0, T]\}\) is uniformly integrable under \(Q^0\). Hence, \(\{Y_t \tilde{Z}_t - \Lambda_t(\tilde{Z}); t \in [0, T]\}\) is a true \(Q^0\)-supermartingale for any \(\tilde{Z} \in \mathcal{Z}\). Therefore, for any \(\tilde{Z} \in \mathcal{Z}\)

\[
Y_t \tilde{Z}_t - \Lambda_t(\tilde{Z}) \geq E_{Q^0}[B \tilde{Z}_T - \Lambda_T(\tilde{Z})|\mathcal{F}_t],
\]

thus

\[
Y_t \geq E_{Q^0}[\tilde{Z}_t B|\mathcal{F}_t] - \bar{\alpha}_t(\tilde{Z}_t,T)
\]

and hence

\[
Y_t \geq \text{ess sup}_{\tilde{Z} \in \mathcal{Z}}\left\{E_{Q^0}[\tilde{Z}_t B|\mathcal{F}_t] - \bar{\alpha}_t(\tilde{Z}_t,T)\right\} = \hat{C}_t(B), \quad \text{a.s.}
\]

Furthermore, if we let

\[
Z_t^* := \mathcal{E}\left\{-\int_0^T \frac{1}{\sqrt{2}} \tilde{\varphi}_u \tilde{d}M_u + \int_0^T \int_\mathbb{R} \frac{1}{\sqrt{2}} \tilde{\varphi}(u, y) \tilde{N}(du, dy) + \int_0^T \frac{1}{2 \eta u} \tilde{d}L_u\right\} t,
\]

it follows from (4.13) that

\[
\hat{\alpha}_0(\tilde{Z}_{0,T}) = E_{Q^0}[\int_0^T \tilde{Z}_{0,u} - \xi(u) \tilde{L}_u \tilde{d}A_u + \int_0^T \tilde{Z}_{0,u} - \eta u \tilde{d}L_u] \\
= E_{Q^0}[\tilde{Z}_{0,T} \{\int_0^T \xi(u) \tilde{L}_u \tilde{d}A_u + \int_0^T \eta u \tilde{d}L_u\}] \\
\leq c < \infty,
\]
for some constant $c > 0$, thus $Z^* \in \mathcal{Z}$ and \{\(Y_t Z^*_t - \Lambda_t(\check{Z}^*)\); \(t \in [0, T]\)\} is a uniformly integrable $Q^0$-martingale. Thus

\[
Y_t Z^*_t - \Lambda_t(Z^*) = E_{Q^0}^t \left[ Z^*_t B - \Lambda_T(Z^*) | \mathcal{F}_t \right],
\]

which implies

\[
Y_t = E_{Q^0}^t \left[ \check{Z}^*_t B | \mathcal{F}_t \right] - \check{\alpha}_t(\check{Z}^*_t) \\
\leq \text{ess sup}_{\check{Z} \in \mathcal{Z}} \left\{ E_{Q^0}^t \left[ \check{Z}^*_t B | \mathcal{F}_t \right] - \check{\alpha}_t(\check{Z}^*_t) \right\} \\
= \check{C}_t(B).
\]

So finally we get the desired result

\[
\check{C}_t(B) = Y_t \text{ a.s.}
\]

for all $t \in [0, T]$, which completes the proof.

\[\square\]

4.2 The $S$-related DCV generated by $\check{\alpha}$

We now consider the $S$-related dynamic convex valuation generated by $\check{\alpha}$. Let

\[
\hat{\mathcal{Z}} := \{ \check{Z} \in \check{\mathcal{Z}}; \check{\alpha}_0(\check{Z}_0) < \infty \}.
\]

By similar arguments as in the preceding case, one can show that for each $\check{Z} \in \hat{\mathcal{Z}}$ and for any $s < t$

\((i')\) \(\text{ess inf}_{\check{Z} \in \hat{\mathcal{Z}}} \{ \hat{\alpha}_s(\check{Z}_{s,t}) \} = 0;\)

\((ii')\) \(\hat{\alpha}_s(\check{Z}_{s,t}) = \check{\alpha}_s(\check{Z}_{s,t}) + E_{Q^0}^s(\check{Z}_{s,t} \check{\alpha}_t(\check{Z}^*_t) | \mathcal{F}_s), Q^0\text{-a.s.;}\)

\((iii')\) for any $\check{Z} \in \hat{\mathcal{Z}}, i = 1, 2$ and a $\mathcal{F}_t$-measurable set $D$, let $\check{Z}_a = \check{Z}_{a}^1 I_{u < t} + \check{Z}_{a}^2 I_{u \geq t}$, then $\hat{\alpha}_t(\check{Z}_{i,t}) = \check{\alpha}_t(\check{Z}_{i,t}) I_D + \check{\alpha}_t(\check{Z}_{i,t}) I_{D^c};$

\((iv')\) \(\lim_{h \to 0} \check{\alpha}_t(\check{Z}_{t,t+h}) = 0, Q^0\text{-a.s.}\)

Also for any $\check{Z} \in \hat{\mathcal{Z}}, i = 1, 2$ and $\lambda \in [0, 1],$

\[
\hat{\alpha}_s \left( \lambda \check{Z}_{s,t}^1 + (1 - \lambda) \check{Z}_{s,t}^2 \right) \leq \lambda \check{\alpha}_s(\check{Z}_{s,t}^1) + (1 - \lambda) \check{\alpha}_s(\check{Z}_{s,t}^2), \quad Q^0\text{-a.s.}
\]

Adapting the proof of Theorem 4.3, one directly derives

**Theorem 4.8.** For $\check{Z} \in \hat{\mathcal{Z}},$ let $\hat{\alpha}_s(\check{Z}_{s,t})$ be defined by (4.2), then $\hat{C} = \{ \hat{C}_t(B) = (\hat{C}_t(B))_{t \in [0, T]}, B \in L^\infty(\mathcal{F}_T) \}$ defined by

\[
\hat{C}_t(B) = \text{ess sup}_{\check{Z} \in \hat{\mathcal{Z}}} \left\{ E_{Q^0}^t \left[ \check{Z}_{t,t} B | \mathcal{F}_t \right] - \hat{\alpha}_t(\check{Z}_{t,t}) \right\}
\]

is an $S$-related dynamic convex valuation (DCV).
For any $\tilde{Z}_t = \mathcal{Z}_0 \mathcal{E} \{ - \int_0^t \tilde{\eta}_u d\tilde{M}_u + \int_0^t \mathcal{I}(u, y) \tilde{N}(du, dy) + L_t \} \in \hat{\mathcal{F}}$, we introduce

$$\hat{\Lambda}_t(\tilde{Z}) := \int_0^t \int_\mathcal{R} \tilde{Z}_y - \xi(u, y)(u, y_l)K(u, dy)dA_u + \int_{[0, t]} \tilde{Z}_{u-} - \eta_u d(L)_u.$$ 

Similar to Corollary 4.5, we have the following dynamic principle

**Corollary 4.9.** For any $B \in L^\infty(\mathcal{F}_T)$, let $\hat{C}(B)$ be the $\hat{S}$-related dynamic convex valuation defined by (4.11), then

1) $\{ \tilde{Z}_t \hat{C}_t(B) - \hat{\Lambda}_t(\tilde{Z}); \ t \in [0, T] \}$ is a RCLL supermartingale under $Q^0$ for any $\tilde{Z} \in \hat{\mathcal{F}}$;

2) if there exists $Z^* \in \hat{\mathcal{F}}$ such that $Z_t^* \hat{C}_t(B) - \hat{\Lambda}_t(Z^*)$ is a uniformly integrable martingale under $Q^0$, then for every $t \in [0, T]$

$$\hat{C}_t(B) = E_{Q^0} \left[ Z_t^* B \mid \mathcal{F}_t \right] - \hat{\alpha}_t(\hat{Z}^*_t), \ a.s.$$

We consider the following backward semimartingale equation

$$\begin{cases}
\hat{Y}_t = \hat{Y}_0 - \int_0^t \int_\mathcal{R} \xi(u, y)\varphi(u, y)^2K(u, dy)dA_u - \int_0^t \frac{1}{4\eta_u} d\langle \hat{L} \rangle_u \\
\quad + \int_0^t \theta(u) d\hat{M}_u + \int_0^t \int_\mathcal{R} \left\{ \frac{\sigma(u, y)}{\sigma(u)} \theta(u) + 2\xi(u, y)\varphi(u, y) \right\} \tilde{N}(du, dy) + \hat{L}_t, \quad (4.12)
\end{cases}$$

The solution of the BSE (4.12) is a 4-tuple $(\hat{Y}, \theta, \varphi, \hat{L})$ satisfying (4.9) such that

1) $\theta$ is a predictable process such that $\theta \cdot \hat{M}$ is a $\mathcal{BMO}$-martingale under $Q^0$. $\varphi$ is a $\mathcal{F}$-measurable function with $\varphi(u, y) > -1$ such that $\int_0^T \int_\mathcal{R} \varphi(u, y) \tilde{N}(du, dy)$ is a $\mathcal{BMO}$ under $Q^0$ with $\int_0^T \int_\mathcal{R} \varphi(u, y)^2K(u, dy)dA_u \leq c < \infty, \ Q^0$-a.s. for some $c \in \mathbb{R}$;

2) $\hat{L}$ is a $\mathcal{BMO}$ martingale under $Q^0$ (i.e., $\hat{L} \in BMO(Q^0)$ ) with $\langle \hat{L} \rangle_T \leq c < \infty, \ Q^0$-a.s., which is strongly orthogonal to $\hat{M}$ under $Q^0$;

3) $Y$ is a bounded RCLL semimartingale.

**Remark 4.10.**

1. Even if $S$ is a continuous semimartingale, i.e., $\sigma_2(u, y) = 0$, the BSE equation (4.12) is quite different from (4.5) or (4.9) of Mania and Schweizer (2005)[24], therefore the S-related DCV generated by $\alpha$ is totally different from the 'dynamic exponential utility indifference valuation' (see [24]). We think that the wealth related valuation is more realistic than the one related to a utility function and the more or less artificial corresponding indifference price.
2. In general, the BSE (4.12) may not have a solution. However, in many cases, the BSE (4.12) has a solution. Especially, when 

\[ B = x + \int_0^T \pi_u dS_u \] 

for some \( \pi \in \text{Adm}, \)

\[
\begin{align*}
\theta(u) &= \sigma_1(u)\pi_u, \\
\varphi(u, y) &= 0, \\
\tilde{L}_t &= 0, \\
\tilde{Y}_t &= x + \int_0^t \pi_u dS_u
\end{align*}
\]

is also the solution of the BSE (4.12).

3. If the BSE (4.12) has a solution given by \( (\tilde{Y}, \theta, \varphi, \tilde{L}) \), one can see that there exists a constant still denoted by \( c \) such that

\[
\int_0^T \int_\mathbb{R} \xi(u, y)\varphi(u, y)^2 K(u; dy) dA_u + \int_0^T \eta_u d(\tilde{L})_u \leq c < \infty, \ Q^0\text{-a.s.,}
\]

since \( \xi \) and \( \eta \) are two bounded positive process.

**Theorem 4.11.** If the BSE (4.9) has a solution denoted by \( (\hat{Y}, \theta, \varphi, \hat{L}) \), then for all \( t \in [0, T] \)

\[ \hat{C}_t(B) = \hat{Y}_t, \ Q^0\text{-a.s.} \]
Proof. Recall that \( \tilde{t}_u = \int_{\mathbb{R}} \frac{\sigma_2(u, y)}{\sigma_1(u)} l(u, y) K(u; dy) \), so it follows from Itô's formula that

\[
Y_t \tilde{Z}_t - \tilde{A}_t(\tilde{Z}) = Y_0 Z_0 + \int_0^t \tilde{Z}_{u-} \left\{ \theta(u) - Y_{u-} \tilde{t}_u \right\} d\tilde{M}_u
+ \int_0^t \int_{\mathbb{R}} \tilde{Z}_{u-} \left\{ Y_{u-} l(u, y) + \left\{ \frac{\sigma_2(u, y)}{\sigma(u)} \theta(u) + 2\xi(u, y) \varphi(u, y) \right\} \left\{ 1 + l(u, y) \right\} \right\} \tilde{N}(du, dy)
+ \int_0^t Y_{u-} \tilde{Z}_{u-} dL_u + \int_0^t \tilde{Z}_{u-} d\hat{L}_u
- \int_0^t \int_{\mathbb{R}} \tilde{Z}_{u-} \left\{ \frac{\sigma_2(u, y)}{\sigma(u)} \theta(u) + 2\xi(u, y) \varphi(u, y) \right\} l(u, y) \tilde{K}(u; dy) dA_u
\]

\[
- \int_0^t \int_{\mathbb{R}} \left\{ \tilde{Z}_{u-} l(u, y) \varphi(u, y) + 2K(u; dy) dA_u - \int_0^t \tilde{Z}_{u-} \tilde{t}_u \theta(u) dA_u \right\}
+ \int_0^t \int_{\mathbb{R}} \left\{ \tilde{Z}_{u-} \left\{ \frac{\theta(u)}{\sigma(u)} + 2\xi(u, y) \varphi(u, y) \right\} l(u, y) \tilde{K}(u; dy) dA_u \right\}
- \int_0^t \int_{\mathbb{R}} \left\{ \tilde{Z}_{u-} \left\{ \frac{\theta(u)}{\sigma(u)} + 2\xi(u, y) \varphi(u, y) \right\} l(u, y) \tilde{K}(u; dy) dA_u \right\}
- \int_0^t \tilde{Z}_{u-} l(u, y) \varphi(u, y) \right\} d\tilde{M}_u
+ \int_0^t \int_{\mathbb{R}} \tilde{Z}_{u-} \left\{ Y_{u-} l(u, y) + \left\{ \frac{\sigma_2(u, y)}{\sigma(u)} \theta(u) + 2\xi(u, y) \varphi(u, y) \right\} \left\{ 1 + l(u, y) \right\} \right\} \tilde{N}(du, dy)
+ \int_0^t \tilde{Z}_{u-} dL_u
- \int_0^t \int_{\mathbb{R}} \left\{ \tilde{Z}_{u-} \left\{ \frac{\theta(u)}{\sigma(u)} + 2\xi(u, y) \varphi(u, y) \right\} l(u, y) \tilde{K}(u; dy) dA_u \right\}
+ \int_0^t \tilde{Z}_{u-} d\hat{L}_u
\]

\[
= Y_0 Z_0 + \int_0^t \tilde{Z}_{u-} \left\{ \theta(u) - Y_{u-} \tilde{t}_u \right\} d\tilde{M}_u
+ \int_0^t \int_{\mathbb{R}} \tilde{Z}_{u-} \left\{ Y_{u-} l(u, y) + \left\{ \frac{\sigma_2(u, y)}{\sigma(u)} \theta(u) + 2\xi(u, y) \varphi(u, y) \right\} \left\{ 1 + l(u, y) \right\} \right\} \tilde{N}(du, dy)
+ \int_0^t Y_{u-} \tilde{Z}_{u-} dL_u + \int_0^t \tilde{Z}_{u-} d\hat{L}_u
- \int_0^t \int_{\mathbb{R}} \left\{ \tilde{Z}_{u-} l(u, y) \varphi(u, y) + 2K(u; dy) dA_u - \int_0^t \tilde{Z}_{u-} \tilde{t}_u \theta(u) dA_u \right\}
- \int_0^t \int_{\mathbb{R}} \left\{ \tilde{Z}_{u-} \left\{ \frac{\theta(u)}{\sigma(u)} + 2\xi(u, y) \varphi(u, y) \right\} l(u, y) \tilde{K}(u; dy) dA_u \right\}
- \int_0^t \int_{\mathbb{R}} \left\{ \tilde{Z}_{u-} \left\{ \frac{\theta(u)}{\sigma(u)} + 2\xi(u, y) \varphi(u, y) \right\} l(u, y) \tilde{K}(u; dy) dA_u \right\}
- \int_0^t \tilde{Z}_{u-} l(u, y) \varphi(u, y) \right\} d\tilde{M}_u
+ \int_0^t \int_{\mathbb{R}} \tilde{Z}_{u-} \left\{ Y_{u-} l(u, y) + \left\{ \frac{\sigma_2(u, y)}{\sigma(u)} \theta(u) + 2\xi(u, y) \varphi(u, y) \right\} \left\{ 1 + l(u, y) \right\} \right\} \tilde{N}(du, dy)
+ \int_0^t \tilde{Z}_{u-} dL_u
- \int_0^t \int_{\mathbb{R}} \left\{ \tilde{Z}_{u-} \left\{ \frac{\theta(u)}{\sigma(u)} + 2\xi(u, y) \varphi(u, y) \right\} l(u, y) \tilde{K}(u; dy) dA_u \right\}
+ \int_0^t \tilde{Z}_{u-} d\hat{L}_u
\]

The rest is the same as the proof of Theorem 4.7.

In the above results we present a to our knowledge new valuation which relates the value of general claims directly to accessible wealths. In this way we avoid to use controversially discussed pricing rules like e.g. utility indifference. This new valuation has all desirable properties and even holds in the general jump market given above. Accessibility of this valuation is guaranteed by the representation as BSE. It would be interesting to put different valuations to a benchmark test. This however goes far beyond the aim of this research and far beyond our numerical capabilities.

References

REFERENCES


