Bayesian Approaches to Copula Modelling

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Abstract

Copula models have become one of the most widely used tools in the applied modelling of multivariate data. Similarly, Bayesian methods are increasingly used to obtain efficient likelihood-based inference. However, to date, there has been only limited use of Bayesian approaches in the formulation and estimation of copula models. This article aims to address this shortcoming in two ways. First, to introduce copula models and aspects of copula theory that are especially relevant for a Bayesian analysis. Second, to outline Bayesian approaches to formulating and estimating copula models, and their advantages over alternative methods. Copulas covered include Archimedean, copulas constructed by inversion, and vine copulas; along with their interpretation as transformations. A number of parameterisations of a correlation matrix of a Gaussian copula are considered, along with hierarchical priors that allow for Bayesian selection and model averaging for each parameterisation. Markov chain Monte Carlo sampling schemes for fitting Gaussian and D-vine copulas, with and without selection, are given in detail. The relationship between the prior for the parameters of a D-vine, and the prior for a correlation matrix of a Gaussian copula, is discussed. Last, it is shown how to compute Bayesian inference when the data are discrete-valued using data augmentation. This approach generalises popular Bayesian methods for the estimation of models for multivariate binary and other ordinal data to more general copula models. Bayesian data augmentation has substantial advantages over other methods of estimation for this class of models.
1 Introduction

Copula models are now used widely in the empirical analysis of multivariate data. For example, major areas of application include survival analysis, where much early work occurred (Clayton 1978; Oakes 1989), actuarial science (Frees and Valdez 1998), finance (Li 2000; Cherubini, Luciano and Vecchiato 2004; McNeil, Frey and Embrechts 2005), marketing (Danaher and Smith 2011), transport studies (Bhat and Eluru 2009; Smith and Kauermann 2011), medical statistics (Lambert and Vandenhende 2002; Nikoloulopoulos and Karlis 2008) and econometrics (Smith 2003; Cameron et al. 2004; Patton 2006). Copula models are popular because they are flexible tools for the modelling of complex relationships between variables in a simple manner. They allow for the marginal distributions of data to be modelled separately in an initial step, and then dependence between variables is captured using a copula function.

However, the development of estimation and statistical inferential methodology for copula models has been limited. Most research has either been focused on the development and properties of copula functions (see Joe 1997 and Nelsen 2006 for excellent overviews), or their use in solving applied problems. Less attention has been given to the question of how to estimate the increasing variety of copula models in an effective manner. To date, the most popular estimation methods are full or two-stage maximum likelihood estimation (Joe 2005) and method of moments style estimators in low dimensions (Genest and Rivest 1993). There has been only limited work on developing Bayesian approaches to formulate and estimate copula models. This is surprising, given that Bayesian methods have proven successful in both formulating and estimating multivariate models elsewhere. The aim of this article is two-fold: (i) to introduce contemporary copula modelling to Bayesian statisticians, and (ii) to outline the advantages of Bayesian inference when applied to copula models. Therefore, there are two intended audiences: (i) Bayesians who are unfamiliar with the advances and features of copula models, and (ii) users of copula models who are unfamiliar with the advantages and features of modern Bayesian inferential methods.

Previous Bayesian work on copula modelling includes that of Huard, Évin and Favre (2006), who suggest a method to select between different bivariate copulas, and Silva and Lopes (2008) who use Markov chain Monte Carlo (MCMC) methods to estimate low dimensional parametric copula functions. Pitt, Chan and Kohn (2006), Hoff (2007) and Danaher and Smith (2011) estimate Gaussian copula regression models using MCMC methods. Note that adopting a Gaussian copula does not mean the data are normally distributed. Smith, Gan and Kohn (2010b) extend the work of Pitt, Chan and Kohn (2006) to copulas derived by inversion from skew t distributions constructed by hidden conditioning. Smith et al. (2010)
and Min and Czado (2010; 2011) propose methods to estimate so called ‘vine’ copulas with continuous margins using MCMC. Pitt, Chan and Kohn (2006) show how Bayesian covariance selection approaches can be used in Gaussian copulas, while Smith et al. (2010) and Min and Czado (2011) also show how Bayesian selection ideas can be applied to determine whether, or not, the component ‘pair-copulas’ of a vine copula are equal to the bivariate independence copula. Smith et al. (2010) also show that the D-vine copula provides a natural decomposition for serial dependence. Ausin and Lopes (2010) consider Bayesian estimation of multivariate time series with copula-based time varying cross-sectional dependence. Last, Smith and Khaled (2011) suggest efficient Bayesian data augmentation methodology for the estimation of copula models for multivariate discrete data, or a combination of discrete and continuous data. Their approach is for general copula functions, not just Gaussian copulas, or copulas constructed by inversion.

This article is divided into three main sections. The first provides an introduction to copula modelling. There are a number excellent in-depth introductions to copulas and their properties; for example, see Joe (1997) and Nelsen (2006). The purpose of this section is not to replicate any of these, but to introduce aspects that are important in Bayesian copula modelling. This includes an outline of what makes copula models so useful, how copulas models can be viewed as transformations, what are copulas constructed by inversion and vine copulas, and why the D-vine copula is a natural model of serial dependence.

In the next two sections Bayesian approaches to formulating and estimating copula models are discussed separately for multivariate continuous and discrete data. This is because copula models, and associated methods, differ substantially in these two cases. In Section 3 the advantages of using Bayesian inference over maximum likelihood for case of continuous data are discussed. For the Gaussian copula, a sampling scheme that can be used to evaluate the joint posterior distribution of the copula and any marginal model parameters is outlined in detail. Different priors for the correlation matrix of the Gaussian copula are considered, including priors based on a Cholesky factorisation, the partial correlations as in Pitt, Chan and Kohn (2006), and the conditional correlations discussed in Joe (2005) and Daniels and Pourahmadi (2009). A new Bayesian selection approach using the latter is outlined, where the fitted copula model is a Bayesian model average over parsimonious representations of the dependence structure. Bayesian estimation and selection for D-vine copulas is also outlined. An interesting insight is that Bayesian selection of individual pair-copulas nests Bayesian selection of the conditional correlations for a Gaussian copula. Bayesian estimates of popular dependence metrics from the fitted copula are also discussed, where parameter uncertainty can be integrated out using the Monte Carlo iterates from the sampling scheme.

Demui and Lambert (2005) and Genest and Nešlehová (2007) point out that popular
method of moments style estimators based on ranks should not be used to estimate copula models for discrete data, making likelihood-based inference more important. However, the likelihood function differs substantially from that in the continuous case, and computational issues mean that maximum likelihood estimation is more difficult than in the continuous case. An effective solution is to employ Bayesian data augmentation, as outlined for a Gaussian copula in Section 4. The priors for the correlation matrix of the Gaussian copula, and also the Bayesian selection framework, are unaffected by whether the data is discrete or continuous. Last, it is discussed how measuring dependence in discrete data differs from that in the continuous case.

2 What Are Copula Models?

2.1 The basic idea

Consider initially the bivariate case with two random variables, \( Y_1 \) and \( Y_2 \), with marginal distribution functions \( F_1(y_1) \) and \( F_2(y_2) \), respectively. A copula model is a way of constructing the joint distribution of \( (Y_1, Y_2) \). Sklar (1959) shows that there always exists a bivariate function \( C : [0,1]^2 \rightarrow [0,1] \), such that

\[
F(y_1, y_2) = C(F_1(y_1), F_2(y_2)).
\]

The function \( C \) is itself a distribution function with uniform margins on \([0,1]\), and is labelled the ‘copula function’. It binds together the univariate margins \( F_1 \) and \( F_2 \) to produce bivariate distribution \( F \).

If both margins \( F_1 \) and \( F_2 \) are continuous distribution functions, then there is a unique copula function \( C \) for any given joint distribution function \( F \). If either \( F_1 \) or \( F_2 \) are discrete-valued, then \( C \) is not unique. However, the objective of copula modelling is not to find the copula function(s) \( C \) that satisfy Sklar’s representation, given knowledge of \( F_1, F_2 \) and \( F \). Instead, the objective is to construct a joint distribution \( F \) from a copula function \( C \) and marginal models for \( F_1 \) and \( F_2 \). In this way, copula models can be used equally for discrete or continuous data, or a combination of both.

It is important to notice that the copula function \( C \) does not determine the marginal distributions of \( F \), but accounts for dependence between \( Y_1 \) and \( Y_2 \). For example, in the case where \( Y_1 \) and \( Y_2 \) are independent, the copula function is \( C(u_1, u_2) = u_1 u_2 \), so that \( F(y_1, y_2) = F_1(y_1) F_2(y_2) \). This copula function is called the ‘independence copula’.

The copula model is easily generalised to \( m \) dimensions as follows. Let \( Y = (Y_1, \ldots, Y_m) \in \mathbb{R}^m \),
be a random vector with elements that have marginal distribution functions $F_1, \ldots, F_m$, then the joint distribution function of $Y$ is
\[ F(y_1, \ldots, y_m) = C(F_1(y_1), \ldots, F_m(y_m)). \] (2.1)

Again, the copula function $C : [0,1]^m \rightarrow [0,1]$ is itself a distribution function for random vector $U = (U_1, \ldots, U_m)'$ with uniform margins on $[0,1]$. As before, if all elements of $Y$ are continuous random variables, then there is a unique copula function $C$ for any given $F$, but this is not the case if one or more elements are discrete-valued. Nevertheless, Equation (2.1) can still be used to construct a well-defined joint distribution $F$, given $F_1, \ldots, F_m$ and $C$, just as in the bivariate case.

2.2 Why are copula models so useful?

A key feature of the copula representation of a joint distribution is that it allows for the margins to be modelled separately from the dependence structure. This promotes a ‘bottom-up’ modelling strategy, where models are first developed one-by-one for each univariate margin. Dependence is then introduced by an appropriate copula function $C$. Sklar’s theorem reassures that this is not an ad-hoc approach, and that there should be at least one copula function $C$ that correctly constructs the joint distribution $F$, as long as the marginal models $F_1, \ldots, F_m$ are accurate. Compare this to a more restrictive ‘top-down’ alternative, where the joint distribution function $F$ is selected first, which then determines the form of the marginals. For example, if $F$ is a multivariate $t$ distribution with $\nu$ degrees of freedom, then each $F_j$ is restricted to be univariate $t$ with a common degrees of freedom $\nu$.

For much applied multivariate modelling, the flexibility that the bottom-up approach allows is compelling. The marginal models can be of the same form, or completely different, including any of the following:

(i) **Parametric Distributions**: A parametric distribution $F_j(y_j; \theta_j)$, with parameters $\theta_j$. For example, $F_j$ may be a $t$ distribution with location $\mu_j$, scale $\sigma_j > 0$ and degrees of freedom $\nu_j > 0$, so that $\theta_j = \{\mu_j, \sigma_j, \nu_j\}$. A copula model with $t$ distributions for each margin is more flexible than a multivariate $t$ distribution because the level of kurtosis can differ in each dimension (Fang, Fang and Kotz 2002). For discrete data, $F_j$ may be a negative binomial distribution with stopping parameter $r_j > 0$ and success parameter $p_j \in (0,1)$, so that $\theta_j = \{r_j, p_j\}$. The negative binomial is a very popular model for count data that exhibit heterogeneity, and copula models provide flexible multivariate extensions (Lee 1999; Nikoloulopoulos and Karlis 2010; Danaher and Smith 2011).
(ii) Nonparametric Distributions: Approaches where each margin is modelled nonparametrically using the empirical distribution function (or a smoothed variant) have long been advocated in the copula literature; for example, see Genest, Ghoudi and Rivest (1995), Shih and Louis (1995) and Chen, Fan and Tsyrennikov (2006). Similarly, $F_j$ can be modelled using Bayesian nonparametric methods; see Hjort et al. (2010) for recent accounts of these. Alternatively, rank likelihoods can be used for each marginal model as outlined by Hoff (2007). In all cases, copula models provide simple multivariate extensions of existing nonparametric methods.

(iii) Regression Models: Univariate regression models can be used for each margin, in which case the resulting copula model is called a ‘copula regression model’ (Oakes & Ritz 2000; Song 2000). The regression coefficients $\beta_j$ can be pooled across margins $j = 1, \ldots, m$, so that $\beta_1 = \beta_2 = \ldots = \beta_m$, in which case the copula model is then an extension of the multivariate regression model. If the regression coefficients differ for each margin, then the copula model extends the ‘seemingly unrelated regression’ model popular in econometric analysis (Zellner 1962).

(iv) Time Series Models: When observations are made on a multivariate vector over time, the marginal models can be parametric time series models, and contemporaneous dependence captured via the copula function (Patton 2006; Chen and Fan 2006; Ausin and Lopes 2010). Popular choices are GARCH or stochastic volatility models for the margins. As with copula regression models, marginal parameters can either be pooled or allowed to vary across margin.

### 2.3 Copula functions and densities

Nelsen (2006, p.45) lists the three conditions that $C$ needs to meet to be an admissible copula function, which are:

(i) For every $u = (u_1, \ldots, u_m) \in [0,1]^m$, $C(u) = 0$ if at least one element $u_i = 0$.

(ii) If all elements of $u$ are equal to one, except $u_i$, then $C(u) = u_i$.

(iii) For each $a = (a_1, \ldots, a_m), b = (b_1, \ldots, b_m) \in [0,1]^m$, such that $a_i \leq b_i$ for all $i = 1, \ldots, m$,

$$\Delta^b_{a_m} \Delta^b_{a_{m-1}} \cdots \Delta^b_{a_1} C(v) \geq 0.$$
Here, $\Delta_{a_k}^b$ is a differencing notation defined as

$$
\Delta_{a_k}^b C(u_1, \ldots, u_{k-1}, v_k, u_{k+1}, \ldots, u_m) = C(u_1, \ldots, u_{k-1}, b_k, u_{k+1}, \ldots, u_m) - C(u_1, \ldots, u_{k-1}, a_k, u_{k+1}, \ldots, u_m),
$$

with $v_k$ a variable of differencing, and $v = (v_1, \ldots, v_m)$. Notice that if $c(u) = \partial^m C(u)/\partial u_1 \ldots \partial u_m$ exists, then property (iii) is equivalent to

$$
\int_{a_1}^{b_1} \cdots \int_{a_m}^{b_m} c(u) du \geq 0.
$$

Properties (i) and (iii) are satisfied if $C(u)$ is a distribution function on $[0, 1]^m$, while property (ii) is satisfied if $C$ also has uniform margins. The density function $c(u)$ is commonly referred to as the ‘copula density’.

In the vast majority of cases parametric copula functions $C(u; \phi)$, with parameters $\phi$, are used in applied analysis. There are a large number of choices for $C$, with Joe (1997) and Nelsen (2006) providing overviews of a wide range of copula functions and their properties. Particularly popular in the bivariate case are the family of Archimedean copulas; see Nelsen (2006; Chap. 4). Three of the most popular Archimedean copulas are the Frank, Clayton and Gumbel. These are listed in Table 1 along with their densities and measures of dependence.

### 2.4 Constructing copulas by inversion (of Sklar’s theorem)

Beyond the bivariate case, copulas that are constructed through inversion of Sklar’s theorem are popular; see Nelsen (2006, Sect. 3.1). To derive a copula function in this way, let $X = (X_1, \ldots, X_m) \in S_X$ have distribution function $G(x; \phi)$, with parameters $\phi$ and strictly monotonic univariate marginal distribution functions $G_1(x_1; \phi), \ldots, G_m(x_m; \phi)$. By Sklar’s theorem, there always exists a copula function $C$, such that

$$
G(x; \phi) = C(G_1(x_1; \phi), \ldots, G_m(x_m; \phi)).
$$

Denoting $u_j = G_j(x_j; \phi)$, then $x_j = G_j^{-1}(u_j; \phi)$, and substituting this into the equation above defines a copula function:

$$
C(u_1, \ldots, u_m; \phi) = G(G_1^{-1}(u_1; \phi), \ldots, G_m^{-1}(u_m; \phi); \phi).
$$

(2.2)
remains Clayton and Gumbel copulas. For the Frank copula, the copula function \( C \) parameters for copula function \( G \) it is important to notice that the multivariate distribution 1)d\( k \) distribution function of a therefore \( G \) (Song 2000) is the most popular of these, where resulting copula functions are collectively called ‘elliptical copulas’. The Gaussian copula \( \phi \) In this case, \( \text{variate normal with zero mean, correlation matrix } \Gamma \) and unit variances in each dimension. parameters \( \Gamma \) in the likelihood. \( u \) then is the Debye function; see Abramowitz and Stegun (1965; p.998).

\[
\tau_{1,2}(\phi) = 1 - \frac{1}{\phi} , \lambda_{1,2}^{\ell}(\phi) = 0 \text{ and } \lambda_{1,2}^{U}(\phi) = 2 - 2^{1/\phi}
\]

| Copula Function | \( \phi \in (-\infty, 0) \cup (0, \infty) \) |
|-----------------|------------------------------------------|
| Frank \( \phi \in (0, \infty) \) |
| \( C(u_1, u_2; \phi) = -\frac{1}{\phi} \log \left( 1 + \frac{\exp(-\phi u_1) - 2\exp(-\phi u_2)}{\exp(-\phi) - 1} \right) \) |
| \( c(u_1, u_2; \phi) = \phi (\exp(\phi(1 + u_1 + u_2))(\exp(\phi) - 1)) \times \left[ \exp(\phi) - \exp(\phi(1 + u_1)) - \exp(\phi(1 + u_2)) + \exp(\phi(u_1 + u_2)) \right]^{-2} \) |
| \( \tau_{1,2}(\phi) = 1 + \frac{1}{\phi}(D_1(\phi) - 1) \) |
| Clayton \( \phi \in (-\infty, \infty) \) |
| \( C(u_1, u_2; \phi) = \max \left\{ (u_1^{-\phi} + u_2^{-\phi} - \phi)_1, 0 \right\} \) |
| \( c(u_1, u_2; \phi) = \max \left\{ (1 + \phi)(u_1 u_2)^{-\phi} (u_1^{-\phi} + u_2^{-\phi} - 1)^{-1/\phi - 2}, 0 \right\} \) |
| \( \tau_{1,2}(\phi) = \phi/(\phi + 2) \) |
| Gumbel \( \phi \geq 1 \) |
| \( C(u_1, u_2; \phi) = \exp(-\tilde{u}_1^\phi + \tilde{u}_2^\phi) \), where \( \tilde{u}_j = -\log(u_j) \) |
| \( c(u_1, u_2; \phi) = C(u_1, u_2; \phi) (u_1 u_2)^{-\phi} (\tilde{u}_1^\phi + \tilde{u}_2^\phi)^{-2/\phi}(\tilde{u}_1 \tilde{u}_2)^{-\phi-1} \times \left[ 1 + (\phi - 1) \left( \tilde{u}_1^\phi + \tilde{u}_2^\phi \right)^{-1/\phi} \right] \) |
| \( \tau_{1,2}(\phi) = 1 - \phi^{-1} \) |

Table 1: Copula functions, density functions and measures of dependence for the Frank, Clayton and Gumbel copulas. For the Frank copula, the function \( D_1(\phi) = \frac{1}{\phi} \int_0^\phi t/(\exp(t) - 1) dt \) is the Debye function; see Abramowitz and Stegun (1965; p.998).

It is important to notice that the multivariate distribution \( G \) is only used to construct the copula function \( C \), and is not the distribution function of the random vector \( Y \), which remains \( F \) as given in Equation (2.1). The parameters \( \phi \) of the distribution of \( X \) are the parameters for copula function \( C \).

Elliptical distributions are common choices for \( G \) (Fang, Fang and Kotz 2002), and the resulting copula functions are collectively called ‘elliptical copulas’. The Gaussian copula (Song 2000) is the most popular of these, where \( G \) is the distribution function of a multivariate normal with zero mean, correlation matrix \( \Gamma \) and unit variances in each dimension. In this case, \( \phi = \Gamma \), \( G(x; \phi) = \Phi_m(x; \Gamma) \) and \( G_j(x_j; \phi) = \Phi_1(x_j, 1) \), with \( \Phi_k(\cdot; V) \) the distribution function of a \( k \)-dimensional \( N(0, V) \) distribution. The Gaussian copula function is therefore

\[
C(u_1, \ldots, u_m; \phi) = \Phi_m(\Phi_1^{-1}(u_1; 1), \ldots, \Phi_1^{-1}(u_m; 1); \Gamma).
\]

The restrictions on the first and second moments of \( X \) are necessary to identify the copula parameters \( \Gamma \) in the likelihood.

When each marginal distribution \( F_j \) is univariate normal with mean \( \mu_j \) and variance \( \sigma_j^2 \), then \( u_j = \Phi_1(y_j - \mu_j; \sigma_j^2) \). If a Gaussian copula is also assumed, then the copula model for \( Y \)
simplifies to a multivariate normal distribution with mean $\mu = (\mu_1, \ldots, \mu_m)$ and covariance matrix $D \Gamma D$, with $D = \text{diag}(\sigma_1, \ldots, \sigma_m)$.

Other choices for $G$ include a multivariate $t$ distribution, which results in the $t$ copula (Demarta and McNeil 2005), or a multivariate skew $t$ distribution (Smith, Gan and Kohn 2010b). When selecting $G$, care has to be taken to consider any restrictions on $\phi$ that may be necessary to identify the parameters in the likelihood.

### 2.5 Copula models as transformations

Copula modelling can be interpreted as a transformation from the domain of the data, to another domain where the dependence is easier to model. The transformation is depicted in Figure 1. If the elements of $Y$ are continuous-valued, the transformation $Y_j \mapsto U_j$ is one-to-one, as is the transformation $Y_j \mapsto X_j$ for inversion copulas.

The density of $Y$ is given by

$$f(y) = \frac{\partial}{\partial y} C(F_1(y_1), \ldots, F_m(y_m)) = c(u) \prod_{j=1}^{m} f_j(y_j), \quad (2.4)$$

with $u = (u_1, \ldots, u_m)$, $u_j = F_j(y_j)$, $f_j(y_j) = \frac{\partial}{\partial y_j} F_j(y_j)$ and $c(u) = \frac{\partial}{\partial u} C(u)$.

However, when the data are discrete-valued, the probability mass function is obtained by differencing the distribution function in Equation (2.1), so that

$$\text{pr}(Y = y) = \Delta_{a_{m-1}} \Delta_{a_{m-2}} \cdots \Delta_{a_1} C(v), \quad (2.5)$$

where $v = (v_1, \ldots, v_m)$ are indices of differencing. The upper bound $b_j = F_j(y_j)$ and lower bound $a_j = F_j(y_j^-)$ is the left-hand limit of $F_j$ at $y_j$, with $F_j(y_j^-) = F_j(y_j - 1)$ when $Y_j$ is ordinal-valued. In this case the transformations $Y_j \mapsto U_j$ and $Y_j \mapsto X_j$ are both one-to-many. This means that the elements $U_j | Y_j = y_j$ and $X_j | Y_j = y_j$ are only known up to bounds, with

$$F_j(y_j^-) \leq U_j < F_j(y_j) \quad \text{and},$$

$$G_j^{-1}(F_j(y_j^-)) \leq X_j < G_j^{-1}(F_j(y_j)),$$

for $j = 1, \ldots, m$. Nevertheless, $Y$, $U$ and $X$ still have distribution functions $F$, $C$ and $G$, respectively.

It is outlined later in Section 4 how interpreting a copula model as a transformation allows for the construction of Bayesian data augmentation schemes to evaluate the posterior distribution when one or more margins are discrete.
\[ U_j = F_j(Y_j) \quad \text{and} \quad X_j = G^{-1}_j(U_j) \]

| Variable  | \(Y\) | \(U\) | \(X\) |
|-----------|-------|-------|-------|
| Domain    | \(S_Y\) | \([0, 1]^m\) | \(S_X\) |
| Joint CDF | \(F(y)\) | \(C(u)\) | \(G(x)\) |
| Marginal CDFs | \(F_j(y_j)\) | Uniform | \(G_j(x_j)\) |

Figure 1: Depiction of the transformation underlying a copula model. The right hand column for variable \(X\) is for copulas constructed by inversion only. The transformations are given in the top row for \(Y\) continuous-valued.

### 2.6 Vine copulas

Much recent research in the copula literature has focused on building copulas in \(m > 2\) dimensions. One popular family of copulas are called ‘vines’, which are constructed from sequences of bivariate copulas. Joe (1996; 1997) was an early advocate of this approach, while Bedford and Cooke (2002) organise the different decompositions in a systematic way. Aas et al. (2009) called the bivariate copulas ‘pair-copulas’, and vines are also known as pair-copula constructions (PCCs). Recent overviews are given by Haff, Aas and Frigessi (2010) and Czado (2010).

Smith et al. (2010) point out that if the elements of \(Y\) are ordered in time, so that \(Y_t\) is observed before \(Y_{t+1}\), a vine labelled ‘decomposable’ by Bedford and Cooke (2002) (or D-vine for short) proves a natural way of characterising serial dependence; particularly Markovian serial dependence. This can be motivated by considering the following decomposition of the density of \(U\),

\[ c(u) = \prod_{t=2}^{m} f(u_t|u_{t-1}, \ldots, u_1), \]

where \(f(u_1) = 1\) because the marginal distribution of \(u_1\) is uniform on \([0, 1]\). The idea is to build a representation for each conditional distribution \(f(u_t|u_{t-1}, \ldots, u_1)\) as follows. For \(s < t\) there always exists a density \(c_{t,s}\) on \([0, 1]^2\) such that

\[
\begin{align*}
  f(u_t, u_s|u_{t-1}, \ldots, u_{s+1}) &= f(u_t|u_{t-1}, \ldots, u_{s+1}) f(u_s|u_{t-1}, \ldots, u_{s+1}) \\
  &\times c_{t,s}(F(u_t|u_{t-1}, \ldots, u_{s+1}), F(u_s|u_{t-1}, \ldots, u_{s+1}); u_{t-1}, \ldots, u_{s+1})
\end{align*}
\]

(2.6)

Here, \(F(u_t|u_{t-1}, \ldots, u_{s+1})\) and \(F(u_s|u_{t-1}, \ldots, u_{s+1})\) are conditional distribution functions of \(U_t\) and \(U_s\), respectively. This is the theorem of Sklar applied conditional on \(\{U_{t-1}, \ldots, U_{s+1}\}\). In a vine copula, \(c_{t,s}\) is the density of a bivariate ‘pair-copula’ and it is simplified by dropping dependence on \((u_{t-1}, \ldots, u_{s+1})\); see Haff, Aas and Frigessi (2010) for a discussion of why this
is often a good approximation. By setting $s = 1$, application of Equation \eqref{2.6} gives

$$f(u_t|u_{t-1}, \ldots, u_1) = c_{t,1}(F(u_t|u_{t-1}, \ldots, u_2), F(u_1|u_{t-1}, \ldots, u_2))f(u_t|u_{t-1}, \ldots, u_2).$$

Denoting $u_{t|j} = F(u_t|u_{t-1}, \ldots, u_j)$ and $u_{j|t} = F(u_j|u_t, \ldots, u_{j+1})$, for $j < t$, repeated application of the above with $s = 2, 3, \ldots, t - 1$ leads to the following:

$$f(u_t|u_{t-1}, \ldots, u_1) = \prod_{s=1}^{t-1} c_{t,s}(u_{t|s+1}, u_{s|t-1}),$$

where the notation $u_{t|t} = u_t$, for $t = 1, \ldots, m$. Therefore, the D-vine copula is given by

$$c(u) = \prod_{t=2}^{m} \left\{ \prod_{s=1}^{t-1} c_{t,s}(u_{t|s+1}, u_{s|t-1}) \right\}, \quad \text{(2.7)}$$

which is a product of $m(m-1)/2$ pair-copula densities, and $u = (u_{1|1}, \ldots, u_{m|m})$. If each pair-copula $c_{t,s}$ has copula parameter $\phi_{t,s}$, then the parameter vector of the D-vine is $\phi = \{\phi_{t,s}; t = 2, \ldots, m, s < t\}$. The hardest aspect of using the copula in Equation \eqref{2.7} is the evaluation of the arguments of the component pair-copulas. Aas et al. (2009), give an $O(m^2)$ recursive algorithm for the evaluation of these from $u$, based on the identity in Joe (1996, p.125); see also Algorithm 1 in Smith et al. (2010).\footnote{Smith et al. (2010) denote $u_{t|j} = F(y_t|y_{t-1}, \ldots, y_j)$ and $u_{j|t} = F(y_j|y_t, \ldots, y_{j+1})$ for $Y_1, \ldots, Y_m$ continuous random variables. However, this can be shown to be equivalent to the definition of $u_{t|j}$ and $u_{j|t}$ employed here.}

\underline{Algorithm: (Evaluation of the Arguments of a D-vine)}

For $k = 1, \ldots, m - 1$ and $i = k + 1, \ldots, m$:

Step 1: Compute $u_{i|i-k} = h_{i,i-k}(u_{i|i-k+1}|u_{i-k|i-1}; \phi_{i,i-k})$

Step 2: Compute $u_{i-k|i} = h_{i,i-k}(u_{i-k|i+1}|u_{i|i-k+1}; \phi_{i,i-k}).$

The functions $h_{t,s}(u_1|u_2; \phi_{t,s}) = \int_{0}^{u_1} c_{t,s}(v, u_2; \phi_{t,s})dv$ are the conditional distribution functions for the pair-copula with density $c_{t,s}$; see Aas et al. (2009) and Smith et al. (2010) for lists of these for some common bivariate copulas.

Because any combination of bivariate copula functions can be employed for the pair-copulas, the D-vine copula can be extremely flexible. Moreover, other vine copulas can be constructed using alternative sequences of pair-copulas; see Bedford and Cooke (2002) and Aas et al. (2009). However, the D-vine at Equation \eqref{2.7} is uniquely well-motivated when the elements of $U$ are time-ordered.\footnote{The algorithm here corrects a minor subscript typographical error in the algorithm in Smith et al. (2010).}
2.7 Measures of dependence

Nelsen (2006; Chap.5) and Joe (1997; Chap.2) discuss measures of dependence for copula models. In general, this is characterised by marginal pairwise dependencies between elements $Y_i$ and $Y_j$. Kendall’s tau and Spearman’s rho are the two most popular measures of pairwise concordance, and empirical analysts are often familiar with sample versions based on ranked data. However, when $Y_i$ and $Y_j$ are continuous-valued, and $Y$ follows the copula model at Equation (2.1), the population equivalents can be expressed as

\[
\tau_{i,j} = 4 \left( \int_0^1 \int_0^1 C_{i,j}^B(u_i, u_j) dC_{i,j}^B(u_i, u_j) \right) - 1 = 4E(C_{i,j}^B(U_i, U_j)) - 1, \text{ and}
\]
\[
\rho_{i,j}^S = 12 \int_0^1 \int_0^1 u_i u_j dC_{i,j}^B(u_i, u_j) - 3 = 12E(U_i U_j) - 3 . \tag{2.8}
\]

In the above expressions, $C_{i,j}^B$ is the distribution function of $(U_i, U_j)$ and is a bivariate margin of the $m$-dimensional copula function $C$. For some copulas $C_{i,j}^B$ can be computed in closed form, but for others this is not possible. Similarly, the expectations in the expressions for $\tau_{i,j}$ and $\rho_{i,j}^S$ can sometimes be computed in closed form, but for other choices of copulas they are computable only numerically, or by Monte Carlo simulation. Within a Bayesian MCMC framework the latter often proves straightforward; see Section 3.5.

In many situations high values of $Y_i$ and $Y_j$ exhibit different levels (or even directions) of dependence than low values of $Y_i$ and $Y_j$; something that is called ‘asymmetric (pairwise) dependence’. As noted by Nelsen (2006, Chap.4), when $Y_i$ and $Y_j$ are continuous-valued, then the dependence properties of the bivariate margin in these two variables is characterized by the dependence properties between $U_i$ and $U_j$. In this case, measures of asymmetric dependence are often based on the conditional probabilities

\[
\lambda_{i,j}^{up}(\alpha) = \Pr(U_i > \alpha | U_j > \alpha), \quad \lambda_{i,j}^{low}(\alpha) = \Pr(U_i < \alpha | U_j < \alpha),
\]

where $0 < \alpha < 1$. The limits of these are called the upper and lower tail dependencies (Joe 1997, p.33), and denoted as

\[
\lim_{\alpha \uparrow 1} \lambda_{i,j}^{up}(\alpha), \quad \text{and} \quad \lim_{\alpha \downarrow 0} \lambda_{i,j}^{low}(\alpha).
\]

For bivariate copula models there is only a single pairwise combination, $Y_1$ and $Y_2$, and for many bivariate copula functions dependence measures are available in closed form. For example, Table 1 gives expressions for measures of dependence for the Frank, Gumbel and
Clayton copulas; see Joe (1997), Nelsen (2006) and Huard, Évin and Favre (2006) for others. Pairwise dependence measures in multivariate \( m \)-dimensional elliptical copulas can also have closed form expressions. In particular, the Gaussian copula has zero tail dependence, with \( \lambda_{ij}^{up} = \lambda_{ij}^{low} = 0 \); whereas, the t copula has tail dependence that is non-zero, but is symmetric with \( \lambda_{ij}^{up} = \lambda_{ij}^{low} \). When employing a copula model it is important to ensure that the copula has dependence properties that are consistent with those exhibited by the data.

3 Bayesian Inference for Continuous Margins

When the data are continuous, the likelihood of \( n \) independent observations \( y = \{y_1, \ldots, y_n\} \), each distributed as Equation (2.1), is \( f(y|\Theta, \phi) = \prod_{i=1}^{n} f(y_i|\Theta, \phi) \), where \( y_i = (y_{i1}, \ldots, y_{im})' \) and

\[
f(y_i|\Theta, \phi) = c(u_i; \phi) \prod_{j=1}^{m} f_j(y_{ij}; \theta_j) .
\]  

(3.1)

Here, \( u_i = (u_{i1}, \ldots, u_{im})' \), \( u_{ij} = F_j(y_{ij}; \theta_j) \), \( \Theta = \{\theta_1, \ldots, \theta_m\} \) are any parameters of the marginal models, and \( f_j(y_{ij}; \theta_j) = \frac{\partial}{\partial y_{ij}} F_j(y_{ij}; \theta_j) \) is the marginal density of \( y_{ij} \). Initially, Equation (3.1) appears separable in \( \theta_1, \ldots, \theta_m \) and \( \phi \), but this is not the case because \( u_i \) depends on \( \Theta \). Most parametric copula functions have analytical expressions for the densities \( c(u; \phi) \), so that maximum likelihood estimation is often straightforward. However, there are a number of circumstances where a Bayesian analysis can be preferable:

(i) For more complex marginal models \( F_j(y_{ij}; \theta_j) \) and/or copula functions \( C(u; \phi) \), the likelihood can be hard to maximise directly. One solution is to use a two stage estimator, where the marginal model parameters \( \theta_j \) are estimated first, and then \( \phi \) estimated conditional on these. In the copula literature, this is called ‘inference for margins’; see Joe (2005) and references therein for a discussion. Another solution is to use an iterative scoring algorithm to maximise the likelihood, as suggested by Song, Fan and Kalbfleisch (2006). However, an attractive Bayesian alternative in this circumstance is to construct inference from the joint posterior \( f(\Theta, \phi|y) \) evaluated in a Monte Carlo manner, with \( \Theta \) and \( \phi \) generated separately in a Gibbs style sampling scheme; see Pitt, Chan and Kohn (2006), Silva and Lopes (2008) and Ausin and Lopes (2010) for discussions.

(ii) Bayesian hierarchical modelling has proven very successful for the modelling of multivariate data. This includes parsimonious modelling of covariance structures using Bayesian selection and model averaging; see Giudici and Green (1999), Smith and Kohn (2002), Wong, Carter and Kohn (2003) and Frühwirth-Schnatter & Tüchler (2008).
for examples. Bayesian selection can be extended to nonlinear dependence by considering priors with point mass components for \( \phi \). For example, Pitt, Chan and Kohn (2006) use a ‘spike and slab’ prior similar to Wong, Carter and Kohn (2003) for the off-diagonal elements of the concentration matrix \( \Gamma^{-1} \) of a Gaussian copula. Smith et al. (2010) use Bayesian selection ideas to mix over independent and dependent pair-copulas in a vine copula. Hierarchical models can also be employed for the margins \( F_j(y_j; \theta_j) \), and estimated jointly with the dependence structure captured by the copula function.

(iii) When estimating a copula model, the objective is often to construct inference on measures of dependence, quantiles and/or functionals of the random variable vector \( Y \) or parameters \( (\Theta, \phi) \). Evaluation of the posterior distribution of these quantities is often straightforward using MCMC methods.

### 3.1 The Gaussian copula model

To illustrate, Bayesian estimation of a Gaussian copula model for continuous margins is outlined as suggested by Pitt, Chan and Kohn (2006). Following Song (2000) and others, derivation of the copula density is straightforward by differentiation of Equation (2.3), so that

\[
c(u; \phi) = \frac{\partial}{\partial u} C(u; \phi) = |\Gamma|^{-1/2} \exp \left\{ -\frac{1}{2} x' (\Gamma^{-1} - I) x \right\},
\]

where \( x = (\Phi_1^{-1}(u_1; 1), \ldots, \Phi_1^{-1}(u_m; 1))' \). Thus, the likelihood at Equation (3.1) is a function of \( \Theta \) and \( \Gamma \), and can be written as

\[
f(y|\Theta, \Gamma) = |\Gamma|^{-n/2} \left( \prod_{i=1}^n \exp \left\{ -\frac{1}{2} x_i' (\Gamma^{-1} - I) x_i \right\} \right) \prod_{j=1}^m f_j(y_{ij}; \theta_j)
\]

where \( x_i = (x_{i1}, \ldots, x_{im})' \), \( x_{ij} = \Phi_1^{-1}(u_{ij}; 1) \) and \( u_{ij} = F_j(y_{ij}; \theta_j) \). Bayesian estimation can be undertaken using the following MCMC sampling scheme:

**Sampling Scheme:** *(Estimation of a Gaussian Copula)*

Step 1: Generate from \( f(\theta_j|\{\Theta \backslash \theta_j\}, \Gamma, y) \) for \( j = 1, \ldots, m \).

Step 2: Generate from \( f(\Gamma|\Theta, y) \).

Here, \( \{A \backslash B\} \) is notation for \( A \) with component \( B \) omitted. Steps 1 and 2 are repeated (in sequence) a large number of times, with each repeat usually called a ‘sweep’ in the Bayesian literature. The scheme requires an initial (feasible) state for the parameter values, which is denoted here as \( (\Theta^0, \phi^0) \). The iterates from the scheme form a Markov Chain,
which can be shown to converge to the joint posterior distribution \( f(\Theta, \phi|y) \), which is the (unique) invariant distribution of the chain. After an initial number of sweeps, the chain is assumed to have converged and subsequent iterates form a Monte Carlo sample from which the parameters are estimated, and other Bayesian inference obtained as outlined in Section 3.5. For introductions to MCMC methods for computing Bayesian posterior inference see Tanner (1996) and Robert and Casella (2006).

The posterior in Step 1 is given by

\[
f(\theta_j|\{\Theta\setminus\theta_j\}, \Gamma, y) \propto f(y|\Theta, \Gamma)\pi(\theta_j)
\]

\[
\propto |\Gamma|^{-n/2} \left( \prod_{i=1}^{n} \exp \left\{ -\frac{1}{2} x_i'(\Gamma^{-1} - I)x_i \right\} \right) f_j(y_{ij}; \theta_j) \pi(\theta_j),
\]

(3.4)

where \( \pi(\theta_j) \) is the marginal prior for \( \theta_j \). In general, the density is unrecognisable because \( x_{ij} \) is a function of \( \theta_j \), so Pitt, Chan and Kohn (2006) suggest using a Metropolis-Hastings (MH) step with a multivariate \( t \) distribution as a proposal to generate \( \theta_j \) in Step 1. The mean of the \( t \) distribution, \( \hat{\theta}_j \), is the mode of Equation (3.4), which is obtained via quasi-Newton-Raphson methods applied to the logarithm of the posterior density. The Hessian

\[
H = \frac{\partial^2 \log(f(\theta_j|\{\Theta\setminus\theta_j\}, \Gamma, y))}{\partial \theta_j \partial \theta_j'} \bigg|_{\theta_j = \hat{\theta}_j}
\]

is calculated numerically using finite difference methods. The scale matrix of the MH proposal is \( -H^{-1} \), and a low degrees of freedom, such as \( \nu = 5 \) or \( \nu = 7 \), is employed so that the proposal dominates the target density in the tails. If \( \theta_j \) has too many elements for \( H \) to be evaluated in a numerically stable and computationally feasible fashion, \( \theta_j \) can be partitioned and generated separately. Alternative MH steps are also possible, including those based on the widely employed random walk proposals.

The approach used to generate \( \Gamma \) in Step 2 varies depending on the prior and matrix parameterisation adopted, of which there are several alternatives. Pitt, Chan and Kohn (2006) consider a prior on the off-diagonal elements of \( \Gamma^{-1} \), which is equivalent to assuming a prior for the partial correlations \( \text{Corr}(X_t, X_s|X_j \setminus \{s, t\}) \) for \( t = 2, \ldots, m; \ s < t \). Hoff (2007) suggests using a prior for \( \Gamma \) in a Gaussian copula that results from an inverse Wishart prior for a covariance matrix. However, because \( \Gamma \) is just a correlation matrix (for \( X \)), any prior for a correlation matrix can also be used; for example, see those suggested by Barnard, McCulloch and Meng (2000), Liechty, Liechty and Müller (2004), Armstrong et al. (2009), Daniels and Pourahmadi (2009) and references therein.
3.1.1 Prior based on a Choelsky factor:

One such prior for a correlation matrix is based on a Cholesky factorisation, which is particularly suited to longitudinal data. This prior uses the decomposition

$$
\Gamma = \text{diag}(\Sigma)^{-1/2} \Sigma \text{diag}(\Sigma)^{-1/2},
$$

where \(\Sigma\) is a non-unique positive definite matrix, and \(\text{diag}(\Sigma)\) is a diagonal matrix comprised of the leading diagonal of \(\Sigma\). The matrix \(\Sigma^{-1} = R' R\), with \(R = \{r_{k,j}\}\) being an upper triangular Cholesky factor, and to ensure that the parameterisation is unique, \(r_{k,k} = 1\), for \(k = 1, \ldots, m\). Generation of \(\Gamma\) in Step 2 is undertaken by generating the elements \(\{r_{k,j}; j = 2, \ldots, m, k < j\}\) one at a time from the conditional posterior

$$
G(\Gamma | \{R \setminus r_{k,j}\}, \Theta, y) \propto |\Gamma|^{-n/2} \left( \prod_{i=1}^{n} \exp \left\{ -\frac{1}{2} x_i' (\Gamma^{-1} - I) x_i \right\} \right) \pi(r_{k,j}),
$$

using random walk MH; see Tanner (1996; p.177) for a discussion of this simulation tool. Once an iterate of \(R\) is obtained, the iterate of \(\Gamma\) can be computed using the relationship at Equation (3.5). Using a different prior, Hoff (2007) uses a similar approach to generate a correlation matrix for a Gaussian copula.

3.1.2 Prior based on partial correlations:

Daniels and Pourahmadi (2009) suggest parameterising a correlation matrix using the partial correlations

$$
\lambda_{t,s} = \text{Corr}(X_t, X_s | X_{t-1}, \ldots, X_{s+1}), \text{ for } s < t.
$$

This prior is based on the work of Joe (2006), who notes that these are unconstrained on \((-1, 1)\), and that \(\Lambda = \{\lambda_{t,s}; t = 2, \ldots, m, s < t\}\) provides a unique parameterisation of \(\Gamma\). Note that \(\lambda_{t,s}\) is sometimes called a ‘semi-partial’ correlation because it is not the correlation conditional on all other variables \(\text{Corr}(X_t, X_s | X_{j \notin \{t,s\}})\), which is the ‘full’ partial correlation considered by Pitt, Chan and Kohn (2006). One advantage is that the conditional distribution of \(\lambda_{t,s} | \{\Lambda \setminus \lambda_{t,s}\}\) is only bounded to \((-1, 1)\), whereas the conditional distribution of the full partial correlations have more complex bounds. Daniels and Pourahmadi (2009) suggest using either Beta or uniform priors for \(\lambda_{t,s}\), which can be employed and Step 2 undertaken by generating the elements of \(\Lambda\) one at a time, again using MH with a random walk proposal. Once an iterate of \(\Lambda\) is obtained, \(\Gamma\) can be computed using the identity at equation (2) of Daniels and Pourahmadi (2009).
There is an interesting link between the Gaussian copula parameterised by the partial correlations $\Lambda$, and the D-vine copula in Equation (2.7). When the pair-copulas in the D-vine are bivariate Gaussian copulas, with densities

$$c_{t,s}(u_1, u_2; \phi_{t,s}) = \frac{1}{\sqrt{1 - \phi_{t,s}^2}} \exp \left\{ - \frac{\phi_{t,s}^2 (x_1^2 + x_2^2) - 2\phi_{t,s} x_1 x_2}{2(1 - \phi_{t,s}^2)} \right\},$$

(3.7)

where $x_1 = \Phi^{-1}(u_1; 1)$ and $x_2 = \Phi^{-1}(u_2; 1)$, then the D-vine copula can be shown to be a Gaussian copula with copula density at Equation (3.2); see Aas et al. (2009) and Haff, Aas and Frigessi (2010). In this case, the individual pair-copula parameters $\phi_{t,s}$ above are the partial correlations $\lambda_{t,s}$.

### 3.2 Bayesian selection in a Gaussian copula

Bayesian selection approaches can be employed to allow for parsimonious modelling of $\Gamma$ in a Gaussian copula. It is well known that Bayesian selection can significantly improve estimates of a covariance matrix compared to maximum likelihood; see Yang and Berger (1994), Giudici and Green (1998), Smith and Kohn (2002), Wong, Carter and Kohn (2003), Frühwirth-Schnatter & Tüchler (2008) and others for extensive evidence to this effect. Pitt, Chan and Kohn (2006) show that this is also the case when estimating the dependence structure of $Y$ using a Gaussian copula model. They consider a selection prior with point mass probabilities on the off-diagonal elements of $\Gamma^{-1}$. In the Gaussian copula this is equivalent to identifying for which pairs $(t, s)$ the full partial correlation $\text{Corr}(X_t, X_s | X_{j\notin\{s,t\}}) = 0$. This also corresponds to conditional independence between $Y_t$ and $Y_s$, with the conditional density $f(y_t, y_s | y_{j\notin\{s,t\}}) = f(y_t | y_{j\notin\{s,t\}}) f(y_s | y_{j\notin\{s,t\}})$.

#### 3.2.1 Priors for selection:

Bayesian selection can also be undertaken for the semi-partial correlations $\Lambda$ defined in Equation (3.6). In the Gaussian copula this is equivalent to determining for which pairs $(t, s)$ there is conditional independence between elements of $Y$, with conditional density

$$f(y_t, y_s | y_{t-1}, \ldots, y_{s+1}) = f(y_t | y_{t-1}, \ldots, y_{s+1}) f(y_s | y_{t-1}, \ldots, y_{s+1}),$$

when $\lambda_{t,s} = 0$. To introduce a point mass probability for this value, binary indicator variables $\gamma = \{\gamma_{t,s}; t = 2, \ldots, m, s < t\}$ are introduced, such that

$$\lambda_{t,s} = 0 \text{ iff } \gamma_{t,s} = 0.$$
The non-zero partial correlations $\lambda_{t,s} | \gamma_{t,s} = 1$ are independently distributed with proper prior densities $\pi(\lambda_{t,s})$. Joe (2006) highlights that $\lambda_{t,s} | \{\Lambda \setminus \lambda_{t,s}\}$ are unconstrained on $(-1, 1)$, so that either independent uniform or Beta priors are simple choices for $\pi(\lambda_{t,s})$; see Daniels and Pourahmadi (2009). In comparison, each full partial correlation has bounds that are complex functions of the other full partial correlations and computationally demanding to evaluate. For this reason, Bayesian selection using the partial correlations $\Lambda$ is computationally less burdensome than using the full partial correlations.

The prior on the indicators $\gamma$ can be highly informative when the number of indicators $N = m(m-1)/2$ is large. For example, if $w_\gamma = \sum_{t,s} \gamma_{t,s}$ is the number of non-zero elements in $\Lambda$, then assuming flat marginal priors $\pi(\gamma_{t,s}) = 1/2$ puts high prior weight on values for $w_\gamma \approx N/2$. This problem has been noted widely in the variable selection literature; see Kohn, Smith and Chan (2001), Zhang, Dai and Jordan (2011) and Bottolo and Richardson (2010). One solution is to employ the conditional prior

$$
\pi(\gamma_{t,s} = 1 | \{\gamma \setminus \gamma_{t,s}\}) \propto B(N - w_\gamma + 1, w_\gamma + 1),
$$

where $B(\cdot, \cdot)$ is the beta function. This prior has been used effectively in the Bayesian selection literature, with early uses in Smith (2000) and Smith and Kohn (2002). It corresponds to assuming the joint mass function

$$
\pi(\gamma) = \frac{1}{N+1} \left( \frac{N}{w_\gamma} \right)^{-1}.
$$

The implied prior for the total number of non-zero elements of $\Lambda$ is uniform, with $\pi(w_\gamma) = 1/(1 + N)$, while the marginal priors $\pi(\gamma_{t,s})$ are all equal; see Scott and Berger (2010) for a discussion. This prior is also equivalent to the uniform volume-based prior suggested by Wong, Carter and Kohn (2003) and Cripps, Carter and Kohn (2005) on the model space.

### 3.2.2 MCMC sampling scheme:

To evaluate the joint posterior distribution of the indicator variables and the partial correlations $\Lambda$, latent variables $\tilde{\lambda}_{t,s}$, for $t = 2, \ldots, m, s < t$, are introduced such that $\lambda_{t,s} = \tilde{\lambda}_{t,s}$ if $\gamma_{t,s} = 1$. Notice that $\lambda_{t,s}$ is known exactly given the pair $(\tilde{\lambda}_{t,s}, \gamma_{t,s})$, so it is sufficient to implement a sampling scheme to evaluate the joint posterior $f(\tilde{\Lambda}, \gamma, \Theta | y)$, where $\tilde{\Lambda} = \{\tilde{\lambda}_{t,s}; t = 2, \ldots, m, s < t\}$, as below.

**Sampling Scheme:** *(Bayesian Selection for a Gaussian Copula)*)
Step 1: Generate from \( f(\theta_j|\{\Theta\\backslash\theta_j\}, \Gamma, y) \) for \( j = 1, \ldots, m \).

Step 2: Generate from \( f(\lambda_{t,s}, \gamma_{t,s}|\Theta, \{\Lambda\\backslash\lambda_{t,s}\}, \{\gamma\\backslash\gamma_{t,s}\}, y) \) for \( t = 2, \ldots, m, s < t \).

Step 3: Compute \( \Lambda \) from \((\tilde{\Lambda}, \gamma)\), and then \( \Gamma \) from \( \Lambda \).

Step 1 is unchanged from that in Section 3.1, while Step 2 consists of MH steps to generate each pair \((\tilde{\lambda}_{t,s}, \gamma_{t,s})\), conditional on the others. The MH proposal density is

\[
q(\tilde{\lambda}_{t,s}, \gamma_{t,s}) = q_1(\gamma_{t,s})q_2(\tilde{\lambda}_{t,s}).
\]

To generate from the proposal \( q \) above, an indicator is generated from \( q_1(\gamma_{t,s} = 0) = q_1(\gamma_{t,s} = 1) = 1/2 \), and \( \tilde{\lambda}_{t,s} \) from a symmetric random walk proposal \( q_2 \) constrained to \((-1, 1)\). For example, one such symmetric proposal for \( q_2 \) is to generate a new value of \( \tilde{\lambda}_{t,s} \) from a normal distribution with mean equal to the old value, standard deviation 0.01, and constrained to \((-1, 1)\).

Temporarily dropping the subscripts \((t, s)\) for convenience, a new iterate \((\tilde{\lambda}_{\text{new}}, \gamma_{\text{new}})\) generated from the proposal \( q \) is accepted over the old value \((\tilde{\lambda}_{\text{old}}, \gamma_{\text{old}})\) with probability

\[
\min \left(1, \alpha \frac{\pi(\tilde{\lambda}_{\text{new}})}{\pi(\tilde{\lambda}_{\text{old}})} \kappa \right), \tag{3.9}
\]

where \( \kappa \) is an adjustment due to the bounds \((-1, 1)\) on \( \lambda \). If the symmetric density \( q_2(\cdot) \) has distribution function \( Q_2(\cdot) \), then

\[
\kappa = \frac{Q_2(1 - \tilde{\lambda}_{\text{old}}) - Q_2(-1 - \tilde{\lambda}_{\text{old}})}{Q_2(1 - \tilde{\lambda}_{\text{new}}) - Q_2(-1 - \tilde{\lambda}_{\text{new}})}.
\]

If a uniform prior is adopted for \( \tilde{\lambda}_{t,s} \), as suggested in Daniels and Pourahmadi (2009), then the ratio \( \pi(\tilde{\lambda}_{\text{new}})/\pi(\tilde{\lambda}_{\text{old}}) = 1 \) in Equation (3.9). At each generation in Step 2, the likelihood in Equation (3.3) is a function of \((\tilde{\lambda}, \gamma)\), so it can be written here as \( L(\tilde{\lambda}, \gamma) \). Using this notation, the value \( \alpha \) in Equation (3.9) can be expressed separately for the four possible
configurations of \((\gamma^{\text{old}}, \gamma^{\text{new}})\) as:

\[
\begin{align*}
\alpha \left( (\tilde{\lambda}^{\text{old}}, \gamma^{\text{old}} = 0) \rightarrow (\tilde{\lambda}^{\text{new}}, \gamma^{\text{new}} = 0) \right) &= 1, \\
\alpha \left( (\tilde{\lambda}^{\text{old}}, \gamma^{\text{old}} = 0) \rightarrow (\tilde{\lambda}^{\text{new}}, \gamma^{\text{new}} = 1) \right) &= \frac{L(\tilde{\lambda}^{\text{new}}, \gamma^{\text{new}} = 1)\delta_1}{L(0, \gamma^{\text{old}} = 0)\delta_0}, \\
\alpha \left( (\tilde{\lambda}^{\text{old}}, \gamma^{\text{old}} = 1) \rightarrow (\tilde{\lambda}^{\text{new}}, \gamma^{\text{new}} = 0) \right) &= \frac{L(0, \gamma^{\text{new}} = 0)\delta_0}{L(\tilde{\lambda}^{\text{old}}, \gamma^{\text{old}} = 1)\delta_1}, \\
\alpha \left( (\tilde{\lambda}^{\text{old}}, \gamma^{\text{old}} = 1) \rightarrow (\tilde{\lambda}^{\text{new}}, \gamma^{\text{new}} = 1) \right) &= \frac{L(\tilde{\lambda}^{\text{new}}, \gamma^{\text{new}} = 1)}{L(\tilde{\lambda}^{\text{old}}, \gamma^{\text{old}} = 1)},
\end{align*}
\]

where \(\delta_0\) and \(\delta_1\) are the conditional probabilities from Equation (3.8) that \(\gamma_{t,s} = 0\) and 1, respectively. Notice that when \((\gamma^{\text{old}} = 0) \rightarrow (\gamma^{\text{new}} = 0)\) the likelihood does not need computing to evaluate the acceptance ratio at Equation (3.9). This case will occur frequently whenever there is a high degree of sparsity in the dependence structure, so that each sweep of Step 2 will be much faster than if no selection was considered.

Reintroducing subscripts, Step 3 of the sampling scheme is straightforward, with each partial correlation

\[
\lambda_{t,s} = \begin{cases} 
0 & \text{if } \gamma_{t,s} = 0 \\
\tilde{\lambda}_{t,s} & \text{if } \gamma_{t,s} = 1
\end{cases},
\]

and the correlation matrix \(\Gamma\) can be obtained directly from \(\Lambda\) using the relationship in Joe (2006) and Daniels and Pourahmadi (2009).

### 3.3 Bayesian estimation and selection for a D-vine

Bayesian estimation for vine copulas is discussed in Min and Czado (2010; 2011) and Smith et al. (2010). The latter authors consider Bayesian selection and model averaging via the introduction of indicator variables in the tradition of Bayesian variable selection. It is this approach that is outlined here, although readers are referred to Smith et al. (2010) for a full exposition.

The objective of Bayesian selection for a vine copula is to identify component pair-copulas that are equal to the bivariate independence copula. Recall that the bivariate independence copula has copula function \(C(u_1, u_2) = u_1u_2\), and corresponding copula density \(c(u_1, u_2) = \partial C(u_1, u_2)/\partial u_1\partial u_2 = 1\). This leads to a parsimonious representation because the independence copula is not a function of any parameters.

For the D-vine with copula density at Equation (2.7), Bayesian selection introduces
indicator variables $\gamma = \{\gamma_{t,s}; t = 2, \ldots, m, s < t\}$, where

$$
c_{t,s}(u_1, u_2) = \begin{cases} 
1 & \text{if } \gamma_{t,s} = 0 \\
\tilde{c}_{t,s}^*(u_1, u_2; \phi_{t,s}) & \text{if } \gamma_{t,s} = 1.
\end{cases}
$$

(3.10)

In the above, $c_{t,s}^*$ is a pre-specified bivariate copula density with parameter $\phi_{t,s}$. The copula type can vary with $(t, s)$, but for simplicity only the case where $c_{t,s}^*(u_1, u_2; \phi_{t,s}) = c^*(u_1, u_2; \phi_{t,s})$ is considered here. That is, each pair-copula $c_{t,s}$ is either an independence copula, or a bivariate copula of the same form for all pair-copulas, but with differing parameter values. From Equation (2.6) it follows that when $c_{t,s}(u_1, u_2) = 1$, $f(u_t, u_s|u_{t-1}, \ldots, u_{s+1}) = f(u_t|u_{t-1}, \ldots, u_{s+1}) \times f(u_s|u_{t-1}, \ldots, u_{s+1})$, so that there is conditional independence between $U_t$ and $U_s$.

The pre-specified bivariate copula can nest the independence copula, so that there exists a value $\phi^+$, such that $c^*(u_1, u_2; \phi^+) = 1$. In this case, the condition at Equation (3.10) can be rewritten as $c_{t,s}(u_1, u_2) = c^*(u_1, u_2; \phi_{t,s})$, with $\phi_{t,s} = \phi^+$ iff $\gamma_{t,s} = 0$. One example of such a copula is the Gumbel when $\phi^+ = 1$, which is easily seen by substituting the value into the copula density, as given in Table 1.

To estimate the joint posterior $f(\phi, \Theta|y)$, latent variables $\tilde{\phi}_{t,s}$, for $t = 2, \ldots, m, s < t$, are introduced such that $\phi_{t,s} = \tilde{\phi}_{t,s}$ if $\gamma_{t,s} = 1$. As with the partial correlations in the previous section, $\phi_{t,s}$ is known exactly given the pair $(\tilde{\phi}_{t,s}, \gamma_{t,s})$. Therefore, it is sufficient to implement a sampling scheme to evaluate the joint posterior $f(\tilde{\phi}, \gamma, \Theta|y)$, where $\tilde{\phi} = \{\tilde{\phi}_{t,s}; t = 2, \ldots, m, s < t\}$, as below.

**Sampling Scheme: (Bayesian Selection for a D-vine Copula)**

Step 1: Generate from $f(\theta_j|\Theta \setminus \theta_j, \phi, y)$ for $j = 1, \ldots, m$.

Step 2: Generate from $f(\tilde{\phi}_{t,s}, \gamma_{t,s}|\Theta, \{\tilde{\phi} \setminus \tilde{\phi}_{t,s}\}, \{\gamma \setminus \gamma_{t,s}\}, y)$ for $t = 2, \ldots, m, s < t$.

Step 3: Compute $\phi$ from $(\tilde{\phi}, \gamma)$.

Generating the marginal parameters $\theta_j$ in Step 1 is undertaken using the same MH step

\footnote{Note that this parameter is often a scalar, such as for an Archimedean or bivariate Gaussian copula. However, it can also be a vector, as in the case of a bivariate t copula where both the degrees of freedom and correlation are parameters.}
outlined in Section 3.1 but where the conditional posterior is now
\[ f(\theta_j | \{ \Theta \} \setminus \theta_j, \phi, y) \propto \left( \prod_{i=1}^{n} f(y_i | \Theta, \phi) \right) \pi(\theta_j) \]
\[ \propto \left( \prod_{i=1}^{n} c(u_i; \phi) f_j(y_{ij}; \theta_j) \right) \pi(\theta_j). \]

In the above, \( c(u_i; \phi) \) is the D-vine copula density at Equation (2.7), evaluated at observation \( u_i = (F_1(y_{i1}; \theta_1), \ldots, F_m(y_{im}; \theta_m)). \)

The algorithm in Section 2.6 is run separately for each observation \( u_i \) to evaluate the arguments of the component pair-copulas of \( c(u_i; \phi) \). Interestingly, selection can speed up this algorithm substantially because \( h_{t,s}(u_1|u_2; \phi_{t,s}) = u_1 \) if \( \gamma_{t,s} = 0. \)

Generating the pair \( (\tilde{\phi}_{t,s}, \gamma_{t,s}) \) follows the same MH step outlined in Section 3.2 for the partial correlations. The main difference is that whenever \( \tilde{\phi}_{t,s} \) is vector-valued, each element is generated separately in the same manner. Also, for many bivariate copulas (particularly the Archimedean ones) proper non-uniform priors for \( \tilde{\phi}_{t,s} \) are often preferred.

### 3.4 Equivalence of selection for Gaussian and D-vine copulas

It is worth highlighting here that the Bayesian selection approach for the D-vine nests that for the Gaussian copula, when the correlation matrix is parameterised by the semi-partial correlations \( \Lambda \). If the pair-copula \( c^* \) is the bivariate Gaussian copula with density at Equation (3.7), then \( \phi_{t,s} = \lambda_{t,s} \) and \( \phi = \Lambda \). In this case, the sampling schemes for Bayesian selection for D-vine and Gaussian copulas are identical.

### 3.5 Posterior inference

Estimation is based on the Monte Carlo iterates
\[ \{(\phi^{[1]}, \Theta^{[1]}), \ldots, (\phi^{[J]}, \Theta^{[J]})\}, \]
obtained from the sampling schemes after convergence to the joint posterior distribution, so that \( (\phi^{[j]}, \Theta^{[j]}) \sim f(\phi, \Theta | y). \) When Bayesian selection is undertaken, as in Sections 3.2 and 3.3 iterates \( \{\gamma^{[1]}, \ldots, \gamma^{[J]}\} \) are also obtained, with \( \gamma^{[j]} \sim f(\gamma | y). \) Monte Carlo estimates

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4In the copula literature the \( n \) observations \( \{u_1, \ldots, u_n\} \) are often called the ‘copula data’.
of the posterior means can be used as point estimates. For example, the posterior means

\[ E(\theta_k | y) \approx \frac{1}{J} \sum_{j=1}^{J} \theta_k^{[j]}, \quad \text{and} \quad E(\phi | y) \approx \frac{1}{J} \sum_{j=1}^{J} \phi^{[j]}, \]

are used as point estimates of the marginal model and copula parameters, respectively. Marginal 100(1 – α)% posterior probability intervals can be constructed for any scalar parameter by simply ranking the iterates, and then counting off the αJ/2 lowest values, and the same number of the highest values.

When undertaking Bayesian selection for a Gaussian copula, the estimates

\[ \text{pr}(\gamma_{t,s} = 1 | y) \approx \frac{1}{J} \sum_{j=1}^{J} \gamma_{t,s}^{[j]}, \quad \text{and} \quad E(\lambda_{t,s} | y) \approx \frac{1}{J} \sum_{j=1}^{J} \lambda_{t,s}^{[j]}, \]

can be computed. The former gives the posterior probability that the pair \(Y_t, Y_s\) are independent, conditional on \((Y_{s+1}, \ldots, Y_{t-1})\), for \(s < t\). The latter is the posterior mean of the semi-partial correlation. At each sweep of the sampling scheme, some elements of \(\Lambda^{[j]}\) will be exactly equal to zero, as determined by \(\gamma^{[j]}\). The estimate \(E(\Gamma | y) \approx \frac{1}{J} \sum_{j=1}^{J} \Gamma^{[j]}\) is therefore often called a ‘model average’ because it is computed by averaging over these configurations of zero and non-zero semi-partial correlations in \(\Lambda^{[j]}\).

Similar estimates can be computed when undertaking Bayesian selection for D-vine copulas. When the form of the component pair-copulas nests the independence copula, so that copula density \(c^*(u_1, u_2; \phi^+) = 1\), then it is possible to compute the posterior mean of the pair-copula parameters as \(E(\phi_{t,s} | y) \approx \frac{1}{J} \sum_{j=1}^{J} \phi_{t,s}^{[j]}\), because \(\phi_{t,s}^{[j]} = \phi^+\) when \(\gamma_{t,s}^{[j]} = 0\). However, when the pair-copulas do not nest the independence copula, \(\phi_{t,s}\) is undefined when \(\gamma_{t,s} = 0\).

If the measures of pairwise dependence discussed in Section 2.7 have a closed form expression (or an accurate numerical approximation), then Monte Carlo estimates are straightforward to compute. For example, the estimate of Kendall’s tau for continuous valued data is

\[ E(\tau_{i,k} | y) = \int \tau_{i,k}(\phi) f(\phi | y) d\phi \approx \frac{1}{J} \sum_{j=1}^{J} \tau_{i,k}(\phi^{[j]}). \]

Posterior probability intervals are constructed using the iterates \(\{\tau_{i,k}(\phi^{[1]}), \ldots, \tau_{i,k}(\phi^{[J]})\}\) in the same manner as for the model parameters. If the pairwise dependence measures are difficult to compute, then Kendall’s tau and Spearman’s rho can be obtained by evaluating the expectations at Equation (2.8) via simulation as follows. At the end of each sweep of
a sampling scheme, generate an iterate from the copula distribution \( U[j] \sim C(u; \phi[j]) \), and then compute

\[
E(C_{i,k}^B(U_i, U_k)) \approx \frac{1}{J} \sum_{j=1}^{J} C_{i,k}^B(U_i[j], U_k[j]), \quad \text{and} \quad E(U_i U_k) \approx \frac{1}{J} \sum_{j=1}^{J} U_i[j] U_k[j].
\]

Simulating from most copula distributions is straightforward and fast; see Cherubini, Luciano and Vecchiato (2004; Chap.6).

4 Bayesian Inference for Discrete Margins

Estimation of copula models with one or more discrete marginal distributions differs substantially from those with continuous margins; see Genest and Nešlehová (2007) for an extensive discussion on the differences. In this section, the case where all margins are discrete is considered, although extension to the case where some margins are discrete and others continuous is discussed in Smith and Khaled (2011).

The likelihood of \( n \) independent observations \( y = \{y_1, \ldots, y_n\} \), each distributed as Equation (2.1) and with probability mass function at Equation (2.5), is

\[
L(\Theta, \phi) = \prod_{i=1}^{n} \Delta_{a_{im}}^{b_{mj}} \Delta_{a_{im-1}}^{b_{m-1,j}} \ldots \Delta_{a_{1,m}}^{b_{1,j}} C(v; \phi). \quad (4.1)
\]

Here, \( v = (v_1, \ldots, v_m) \) are indices of differencing, each observation \( y_i = (y_{i1}, \ldots, y_{im}) \), the upper bound \( b_{ij} = F_j(y_{ij}; \theta_j) \), and the lower bound \( a_{ij} = F_j(y_{ij}^-; \theta_j) \) is the left-hand limit of \( F_j \) at \( y_{ij} \). In general, computing the likelihood involves \( O(n2^m) \) evaluations of \( C \), which is prohibitive for high \( m \). Moreover, even for low values of \( m \), it can be difficult to maximise the likelihood for some copula and/or marginal model choices.

An alternative is to augment the likelihood with latent variables, and integrate them out in a Monte Carlo fashion. From a Bayesian perspective this involves evaluating the augmented posterior distribution by MCMC methods; an approach that is called Bayesian data augmentation (Tanner and Wong 1987). Smith and Khaled (2011) discuss how this can be undertaken by augmenting the posterior distribution with latent variables distributed as \( U = (U_1, \ldots, U_m) \sim C(u; \phi) \). While their approach applies to all parametric copula functions, in the specific case of a copula constructed by inversion as at Equation (2.2), latent variables distributed as \( X \sim G(x; \phi) \), can also be used. Pitt, Chan and Kohn (2006) propose this to estimate Gaussian copula models, and Smith, Gan and Kohn (2010b) when \( G \) is the distribution function of the skew t of Sahu, Dey and Branco (2003).
4.1 The Gaussian copula model

For the Gaussian copula, latent variables \( x = \{ x_1, \ldots, x_n \} \) are introduced, where \( x_i = (x_{i1}, \ldots, x_{im}) \sim N(0, \Gamma) \). The augmented likelihood is \( L(\Theta, \Gamma, x) = \prod_{i=1}^{n} f(y_i, x_i|\Theta, \Gamma) \), with mixed joint density

\[
f(y_i, x_i|\Theta, \Gamma) = \text{pr}(Y = y_i|x_i, \Theta)f_N(x_i; 0, \Gamma)
\]

\[
= \left( \prod_{j=1}^{m} I(A_{ij} \leq x_{ij} < B_{ij}) \right) f_N(x_i; 0, \Gamma)
\]

Here, \( f_N(x; \mu, V) \) is the density of a \( N(\mu, V) \) distribution evaluated at \( x \), \( I(Z) \) is an indicator function equal to one if \( Z \) is true, and zero otherwise. The mass function

\[
\text{pr}(Y_j = y_{ij}|x_{ij}, \theta_j) = \begin{cases} 1 & \text{if } A_{ij} \leq x_{ij} < B_{ij} \\ 0 & \text{otherwise} \end{cases}
\]

where \( A_{ij} = \Phi^{-1}(a_{ij}; 1) \) and \( B_{ij} = \Phi^{-1}(b_{ij}; 1) \) as noted in Section 2.5, and \( \Phi_1(\cdot; 1) \) is the distribution function of a standard normal.

The likelihood of the copula model in Equation (4.1) is obtained by integrating over the latent variables, with \( L(\Theta, \Gamma) = \int L(\Theta, \Gamma, x)dx \). Let \( x_{(j)} = \{ x_{ij}, \ldots, x_{nj} \} \) be the latent variables corresponding to the \( j \)th margin, then the following sampling scheme can be used to evaluate the augmented posterior.

**Sampling Scheme:** (Data Augmentation for a Gaussian Copula)

Step 1: For \( j = 1, \ldots, m \):

1(a) Generate from \( f(\theta_j|\{\Theta \setminus \theta_j\}, \{x \setminus x_{(j)}\}, \Gamma, y) \)
1(b) Generate from \( f(x_{(j)}|\Theta, \{x \setminus x_{(j)}\}, \Gamma, y) \)

Step 2: Generate from \( f(\Gamma|\Theta, x) \).

Steps 1(a) and 1(b) together produce an iterate from the density \( f(\theta_j, x_{(j)}|\{\Theta \setminus \theta_j\}, \{x \setminus x_{(j)}\}, \Gamma, y) \). The conditional posterior at Step 1(b) can be derived as

\[
f(x_{(j)}|\Theta, \{x \setminus x_{(j)}\}, \Gamma, y) \propto L(\Theta, \Gamma, x)
\]

\[
\propto \left( \prod_{i=1}^{n} I(A_{ij} \leq x_{ij} < B_{ij}) f_N(x_{ij}; \mu_{ij}, \sigma_{ij}^2) \right)
\]

where \( \mu_{ij} \) and \( \sigma_{ij}^2 \) are the mean and variance of the conditional distribution of \( x_{ij}|\{x_i \setminus x_{ij}\} \) obtained from the joint distribution \( x_i \sim N(0, \Gamma) \). Thus, \( x_{(j)} \) can be generated element-by-
element from independent constrained normal densities. In Step 1(a), $\theta_j$ is generated using the same MH approach as in the continuous case, but where the conditional density is now

$$f(\theta_j|\{\Theta\setminus\theta_j\}, \{x\setminus x(j)\}, \Gamma, y) \propto \left(\prod_{i=1}^{n} \Phi_1\left(\frac{B_{ij} - \mu_{ij}}{\sigma_{ij}}; 1\right) - \Phi_1\left(\frac{A_{ij} - \mu_{ij}}{\sigma_{ij}}; 1\right)\right)\pi(\theta_j).$$

In Step 2 any of the existing methods for generating a correlation matrix $\Gamma$ from its posterior distribution for Gaussian distributed data $x$ can be used, as outlined in Section 3.1. Bayesian selection ideas can also be used as discussed in Section 3.2.

Pitt, Chan and Kohn (2006) demonstrate the efficiency of this sampling scheme empirically, and Danaher and Smith (2011) show it can be applied effectively to a problem with $m = 45$ dimensions. Smith and Khaled (2011) propose alternative sampling schemes that can be used with the Gaussian copula, or with other copula models.

### 4.2 Measuring dependence

For continuous multivariate data, dependence between elements of $Y$ is captured fully by the copula function $C$. In this case, the measures of dependence based on $C$ discussed in Section 2.7 are adequate summaries. But when one or more margins are discrete-valued, in general, measures of concordance involve the marginal distributions; see Denuit and Lambert (2005), and Nešlehová (2007). Nevertheless, the dependence structure of the latent vector $U$ (or the latent vector $X$ for copulas constructed by inversion) is still informative concerning the level and type of dependence in the data. Moreover, estimation using non-parametric rank-based estimators becomes inaccurate (Genest and Nešlehová 2007) and likelihood-based inference, such as that outlined here, preferable.

### 4.3 Link with multivariate probit and latent variable models

Last, it is not widely appreciated that the multivariate probit model is a special case of the Gaussian copula model with univariate probit margins (Song 2000). Data augmentation for a Gaussian copula therefore extends the approaches of Chib and Greenberg (1998), Edwards and Allenby (2003) and others for data augmentation for a multivariate probit model, to other Gaussian copula models. Similarly, the approach generalises a number of Gaussian latent variable models for ordinal data, such as that of Chib and Winkelmann (2001) and Kottas, Müller and Quintana (2005).
5 Discussion

The impact of copula modelling in multivariate analysis has been substantial in many fields. Yet, Bayesian inferential methods have been employed by only a few empirical analysts to date. Nevertheless, they show great potential for computing efficient likelihood-based inference in a number of contexts. One of these is in the modelling of multivariate discrete data, or data with a combination of discrete and continuous margins. Here, method of moments style estimators cannot be used effectively, and there can be computational difficulties in maximising the likelihood, so that Bayesian data augmentation becomes attractive; see Smith and Khaled (2011) for a full discussion. Another is in the use of hierarchical models, including varying parameter models (Ausin and Lopes 2010) or hierarchical models for Bayesian selection and model averaging, as discussed here. Last, while this article has focused on the Gaussian and D-vine copulas, the Bayesian methods and ideas discussed here are applicable to a wide range of other copula models, and it seems likely that their usage will increase in the near future.

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