High-order short-time expansions for ATM option prices of exponential Lévy models

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Abstract

The short-time asymptotic behavior of option prices for a variety of models with jumps has received much attention in recent years. In the present work, a novel second-order approximation for ATM option prices is derived for a large class of exponential Lévy models. Our method of proof is based on an integral representation of the option price involving the tail probability of the log-return process under the share measure and a suitable change of probability measure under which the pure-jump component of the log-return process becomes a $Y$-stable process. Our approach is sufficiently general to cover a wide class of Lévy processes which satisfy the latter property and whose Lévy densities can be closely approximated by a stable density near the origin. The results hereafter shed new light on the connection between both the volatility of the continuous component and the jump parameters and the behavior of ATM option prices near expiration. In the presence of an additional Brownian component, the second-order term, in time-$t$, is of the form $d_2 t^{(3-Y)/2}$, with the coefficient $d_2$ depending only on the overall jump intensity of the process and the tail-heaviness parameter $Y$. This extends the already known result that the leading term is $\sigma t^{1/2}/\sqrt{2\pi}$, where $\sigma$ is the volatility of the continuous component. In contrast, under such a pure-jump model, the dependence on the overall jump intensity and $Y$ is already reflected in the leading term, which is of the form $d_1 t^{1/Y}$. The information on the relative frequency of negative and positive jumps appears only in the second-order term, which is shown to be of the form $d_2 t$ and whose order of decay turns out to be independent of $Y$. The asymptotic behavior of the corresponding Black-Scholes implied volatilities is also addressed. Our numerical results show that first-order term typically exhibits rather poor performance and that the second-order term significantly improves the approximation’s accuracy.

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1 Introduction

It is generally recognized that the standard Black-Scholes option pricing model is inconsistent with options data, while remaining a widely used model in practice because of its simplicity. Exponential Lévy models generalize the classical Black-Scholes setup by allowing jumps in stock prices while preserving the independence and stationarity of returns. There are several reasons for introducing jumps in financial modeling. First of all, sudden sharp shifts in the price level of financial assets often occur in practice, and these “jumps” are hard to handled within continuous-paths models. Second, historical asset prices exhibit distributions with heavy tails and high kurtosis, which again are hard to replicate within purely-continuous frameworks. Finally, market prices of vanilla options exhibit skewed implied volatilities (relative to changes in the strikes), in contrast to the classical Black-Scholes model which predicts a flat
implied volatility smile. Moreover, the fact that the implied volatility smile and skewness phenomenon becomes much more pronounced for short maturities is a clear indication of the presence of jumps. We refer the reader to Cont and Tankov [11] for further motivations on the use of jump processes in financial modeling.

One of the first applications of jump processes in financial modeling is due to Mandelbrot [32], who suggested a pure-jump stable Lévy process to model power-like tails and self-similar behavior in cotton price returns. Merton [34] and Press [37] subsequently considered option pricing and hedging problems under an exponential compound Poisson process with Gaussian jumps and an additive independent non-zero Brownian component. A similar exponential compound Poisson jump-diffusion model was more recently studied in Kou [27], where the jump sizes are distributed according to an asymmetric Laplace law. For infinite activity exponential Lévy models, Barndorff-Nielsen [4] introduced the normal inverse Gaussian (NIG) model, while the extension to the generalized hyperbolic class was studied by Eberlein, Keller and Prause [13]. Madan and Seneta [31] introduced the symmetric variance gamma (VG) model while its asymmetric extension was later analyzed in Madan and Milne [30] and Madan, Carr and Chang [29]. Both models are built on Brownian subordination; the main difference being that the log-return process in the NIG model is an infinite variation process with Cauchy like behavior of small jumps, while in the VG model the log-price is of finite variation with infinite but relatively low activity of small jumps. 

The class of “truncated stable” processes was first introduced by Koponen [26]. It was advocated for financial modeling by Cont, Bouchaud and Potters [10] and Matacz [33], and further developed in the context of asset price modeling by Carr, Geman, Madan and Yor [8], who introduced the terminology CGMY. Nowadays, the CGMY model is considered to be a prototype of the general class of models with jumps and enjoys widespread applicability.

The CGMY model is a particular case of the more general KoBoL class of Boyarchenko and Levendorksii [7], which in turn is a subclass of the semi-parametric class of tempered stable processes (TSPs) introduced by Rosiński [41].

TSPs form a rich class with appealing features for financial modeling. One of their most interesting features lies in their short-time and long-time behaviors. Denoting by $Y$ a TSP, it follows that

$$\left( h^{-1}L_{th}\right)_{t\geq 0} \overset{D}{\longrightarrow} (Z_t)_{t\geq 0}, \quad (h \to 0), \quad (1.1)$$

where $Z := (Z_t)_{t\geq 0}$ is a strictly $Y$-stable Lévy process and $\overset{D}{\longrightarrow}$ denotes convergence in distribution. In fact, (1.1) holds when $Y \in (0, 1)$ provided $L$ is driftless, while it holds when $Y \in (1, 2)$ regardless of the mean of $L$. Roughly, (1.1) suggests that the short-time behavior of TSP is akin to that of a stable process, with its heavy-tailed distribution and self-similarity property which are desirable for financial modeling as emphasized, for example, by Mandelbrot [32]. In contrast,

$$\left( h^{-1}L_{ht}\right)_{t\geq 0} \overset{D}{\longrightarrow} (W_t)_{t\geq 0}, \quad (h \to \infty), \quad (1.2)$$

where $(W_t)_{t\geq 0}$ is a Brownian Motion, which suggests that in the long-horizon, the process is Brownian-like. In terms of increments, if we were to consider the consecutive “high-frequency” increments of the process $L$, say $\{L_{ht(i)} - L_{ht(i-1)}\}_{i\geq 1}$ with $h \ll 1$, these will exhibit statistical features consistent with those of a self-similar stable time series. But, low-frequency increments, say $\{L_{ht(i)} - L_{ht(i-1)}\}_{i\geq 1}$ with $h \gg h$, will have Gaussian like distributions.

Stemming in part from its importance for model calibration and testing, small-time asymptotics of option prices have received a lot of attention in recent years (see, e.g., [5], [6], [14], [15], [16], [19], [20], [21], [22], [23], [36], [38], [44]). We shall review here only the studies most closely related to ours, focusing in particular on the at-the-money (ATM) case. Carr and Wu [12] first analyzed, partially via heuristic arguments, the first order asymptotic behavior of an Itô semimartingale with jumps. Concretely, ATM option prices of pure-jump models of bounded variation decrease at the rate $O(t)$, while they are just $O(t^{1/2})$ under the presence of a Brownian component. By considering a stable pure-jump component, [12] also showed that, in general, the rate could be $O(t^\beta)$, for some $\beta \in (0, 1)$. Muhle-Karbe and Nutz [35] formally showed that, under the presence of a continuous-time component, the leading term of ATM option prices is of order $\sqrt{t}$, for a relatively general class of Itô models, while for a more general type of Itô processes with $\alpha$-stable-like small jumps, the leading term is $O(t^{1/\alpha})$ (see also [16, Proposition 4.2], [17, Theorem 3.7], and [44, Proposition 5]) for related results in exponential Lévy models). However, none of these papers have obtained higher order asymptotics for the ATM option prices.

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1 The terminology Tempered Stable is widely used in the literature, but unfortunately there is no uniform usage. It is worth noting that Rosiński’s class ((41)) is much more general than the “tempered stable” class introduced in several classical references of financial modeling with jumps (e.g. [2], [11], [28]).
In the present paper, we study the small-time behavior for at-the-money call (or equivalently, put) option prices

$$
\mathbb{E}(S_t - S_0)^+ = S_0 \mathbb{E}(e^{X_t} - 1)^+,
$$

under the exponential Lévy model

$$
S_t := S_0 e^{X_t},
$$

where $X := (X_t)_{t \geq 0}$ is the superposition of a tempered-stable-like process $L := (L_t)_{t \geq 0}$ and of an independent Brownian motion $(\sigma W_t)_{t \geq 0}$; i.e.,

$$
X_t := \sigma W_t + L_t,
$$

where $W := (W_t)_{t \geq 0}$ is a standard Brownian motion independent of $L$. The term “tempered stable” is understood here in a much more general sense than in several classical sources of financial mathematics (e.g., [2], [11], [28]) and even more general than in Rosiński [41]. Roughly (see Section 2 below for the explicit conditions), we consider Lévy processes whose Lévy measure admits a density $\mu$ such that, for some $Y \in (1,2)$, the function $q(x) := s(x)/|x|^{Y+1}$ satisfies the following fundamental property:

$$
\lim_{x \to 0^+} \frac{1}{x} (C_+ - q(x)) = \beta_+,
$$

$$
\lim_{x \to 0^-} \frac{1}{x} (C_- - q(x)) = -\beta_-,
$$

for some positive constants $C_+, C_-, \beta_+, \beta_- > 0$. Intuitively, (1.6) indicates that the small jumps of the process behave like those of a stable process. As it turns out (see [40, Proposition 1]), this class still exhibits the appealing short-time and long-time behaviors of Rosiński’s original tempered stable processes as described in (1.1)-(1.2) above.

Under the standing assumption (1.6) and other mild conditions, we show that the first order asymptotic behavior of (1.3) in short-time takes the form

$$
\lim_{t \to 0} t^{-1/Y} \mathbb{E}(S_t - S_0)^+ = S_0 \mathbb{E}(Z^+),
$$

where $Z$ is a centered $Y$-stable random variable under $\mathbb{P}$. When $\sigma \neq 0$, $Z \sim \mathcal{N}(0,\sigma^2)$ (i.e., $Y = 2$) and, thus, $\mathbb{E}(Z^+) = \sigma/\sqrt{2\pi}$, as already shown in [44] and [38]. When $\sigma = 0$ and $L$ is symmetric, the characteristic function of $Z$ is explicitly given by

$$
\mathbb{E}e^{iuZ} = e^{-2CT(-Y)}|\cos(\frac{Y}{2}u)|u|^Y,
$$

where $C$ is a measure of the overall jump-intensity of the process. In that case, (see (25.6) in [43]),

$$
d_1 := \mathbb{E}(Z^+) = \frac{1}{\pi} \Gamma \left(1 - \frac{1}{Y}\right) \left(2CT(-Y) \left|\cos \left(\frac{\pi Y}{2}\right)\right|\right)^{1/Y}.
$$

We refer the reader to Remark 3.5 below for the explicit expression of the leading term in the general case. Interestingly enough, under the presence of a continuous component ($\sigma \neq 0$), the first-order asymptotic term only reflects information on the continuous-time volatility, in sharp contrast with the pure-jump case where the leading term depends on the overall jump-intensity parameter $C$ and the index $Y$, which in turn controls the tail-heaviness of the distributions.

The asymptotic result (1.7) is in agreement with the result of Tankov [44] (see Theorem 5 therein), who showed that for a pure-jump Lévy process $(X_t)_{t \geq 0}$, whose characteristic function is of the form

$$
\mathbb{E}(e^{iuX_t}) = \exp \left(t \{iuy - |u|^Y f(u)\}\right),
$$

with $Y \in (1,2)$ and a function $f$ satisfying $\lim_{u \to \infty} f(u) = \tilde{c} \in (0,\infty)$ and $\lim_{u \to -\infty} f(u) = \tilde{c} \in (0,\infty)$, it follows that

$$
\lim_{t \to 0} t^{-1/Y} \mathbb{E}(S_t - S_0)^+ = S_0 \frac{1}{2\pi} \left(\tilde{c}_+^{1/Y} + \tilde{c}_-^{1/Y}\right).
$$

An expression similar to (1.7) is also obtained in [35] (see Theorem 4.4 therein) for a more general class of pure-jump martingales. Nevertheless, as previously mentioned, none of the these papers obtained second or higher order terms for the ATM option prices and the approaches therein do not seem amenable to study higher-order asymptotics.

The main result of the present paper establishes, for the Lévy model described above, a second order correction term to (1.7). To the best of our knowledge, this is the first second-order result in the literature of exponential Lévy
models. We show that the second-order asymptotic behavior of the ATM call option price (1.3) in short-time is of the form
\[ \frac{1}{S_0} \mathbb{E}(S_t - S_0)^+ = d_1 t^\frac{1}{2} + d_2 t + o(t), \quad (t \to 0), \]
in the pure-jump case (i.e., \( \sigma = 0 \) in (1.5)), while in the presence of a non-zero independent Brownian component (i.e., \( \sigma \neq 0 \)),
\[ \frac{1}{S_0} \mathbb{E}(S_t - S_0)^+ = d_1 t^\frac{1}{2} + d_2 t \frac{\sigma^2}{2} + o \left( t \frac{\sigma^2}{2} \right), \quad (t \to 0), \]
for different constants \( d_1 \) and \( d_2 \) that we will determine explicitly. To wit, we found that, under the presence of a nonzero Gaussian component, the second-order term depends only on the overall jump intensity parameter \( C \) and the tail-heaviness parameter \( Y \). However, for a pure-jump case, the tail features of the Lévy measure are already present in the second-order term. As a byproduct of our asymptotic results for option prices, we also give the asymptotic behavior of the corresponding Black-Scholes implied volatilities.

The derivation of our second-order approximation results is fully probabilistic and builds on two facts. First, we make use of the following representation of Carr and Madan [9]:
\[ \frac{1}{S_0} \mathbb{E}(S_t - S_0)^+ = \mathbb{P}^*(X_t > E) = \int_0^\infty e^{-x} \mathbb{P}^*(X_t > x) dx, \quad (1.11) \]
where \( \mathbb{P}^* \) is the martingale probability measure obtained when one takes the stock as the numéraire (i.e., \( \mathbb{P}^*(A) := \mathbb{E}(S_1 A) \)) and \( E \) is an independent mean-one exponential random variable under \( \mathbb{P}^* \). The measure \( \mathbb{P}^* \) is also called the share measure (see [9]). Second, we further change the probability measure \( \mathbb{P}^* \) to another probability measure, say \( \mathbb{P} \), under which the pure jump-component of \( X \) becomes a stable Lévy process, independent of the continuous component of \( X \). This change, in turn, enables us to exploit some key features of stable processes such as self-similarity and the behavior of their marginal densities tails.

The present article is organized as follows. Section 2 introduces the class of Lévy processes studied thereafter and some probability measures transformations, which will be needed throughout the paper. Section 3 establishes the second-order asymptotics of the call option price under the pure-jump model (\( \sigma = 0 \)). Section 4 establishes the second-order asymptotics of the call option price under an additional independent non-zero Brownian component (\( \sigma \neq 0 \)). Section 5 illustrates our second-order asymptotics for the important particular class of CGMY models, recovering our preliminary results first presented in [18]. Section 6 assesses the performance of the asymptotic expansions through a detailed numerical analysis for the CGMY model. The proofs of our main results are deferred to the Appendices.

### 2 A tempered-stable-like model

Let \( L := (L_t)_{t \geq 0} \) be a pure-jump Lévy process with triplet \( (0, b, \nu) \) and let \( W := (W_t)_{t \geq 0} \) be a Wiener process, independent of \( L \), defined on a complete filtered probability space \((\Omega, \mathcal{F}, (\mathcal{F}_t)_{t \geq 0}, \mathbb{P})\). We assume zero interest rate and that \( \mathbb{P} \) is a martingale measure for the exponential Lévy model
\[ S_t = S_0 e^{X_t}, \quad \text{with} \quad X_t := \sigma W_t + L_t, \]
where \((S_t)_{t \geq 0}\) represents the price process of a non-dividend paying risky asset. Equivalently, the Lévy triplet \( (\sigma^2, b, \nu) \) of \( X := (X_t)_{t \geq 0} \) is such that
\[ (i) \quad \int_1^\infty e^x \nu(dx) < \infty, \quad \text{and} \quad (ii) \quad \mathbb{E}(e^{X_t}) = \exp \left( b + \frac{\sigma^2}{2} + \int_{\mathbb{R}_0} (e^x - 1 - x 1_{\{|x| \leq 1\}}) \nu(dx) \right) = 1, \quad (2.1) \]
where hereafter \( \mathbb{R}_0 := \mathbb{R} \setminus \{0\} \) and the Lévy triplets are given relative to the truncation function \( 1_{\{|x| \leq 1\}} \) (see Section 8 in [43]). Without loss of generality, we also assume that \((X_t)_{t \geq 0}\) is the canonical process \( X_t(\omega) := \omega(t) \) defined on the canonical space \( \Omega = \mathbb{D}([0, \infty), \mathbb{R}) \) (the space of càdlàg functions \( \omega : [0, \infty) \to \mathbb{R} \)) equipped with the \( \sigma \)-field \( \mathcal{F} := \sigma(X_s : s \geq 0) \) and the right-continuous filtration \( \mathcal{F}_t := \cap_{s \geq t} \sigma(X_u : u \leq s) \).
As explained in the introduction, we consider a tempered-stable-like Lévy processes $L$ where the Lévy measure admits a density $s: \mathbb{R}_0 \to [0, \infty)$ of the form
\[ s(x) = |x|^{-Y-1}q(x), \]
for $Y \in (1, 2)$ and a bounded measurable function $q: \mathbb{R}_0 \to [0, \infty)$ such that
\[ \lim_{x \searrow 0} \frac{1}{x} (C_+ - q(x)) = \beta_+, \quad \lim_{x \nearrow 0} \frac{1}{x} (C_- - q(x)) = -\beta_-, \]
for some positive constants $C_+, C_-, \beta_+, \beta_-$. Throughout, we will also make use of the following assumptions:

**Assumption 2.1.** The function $q: \mathbb{R}_0 \to [0, \infty)$ is such that
\[ (i) \ q(x) \leq C_-, \quad \text{for all } x < 0; \quad (ii) \ q(x) \leq C_+ e^{-x}, \quad \text{for all } x > 0; \]
\[ (iii) \ \limsup_{|x| \to \infty} \frac{\ln q(x)}{|x|} < \infty; \quad (iv) \ \inf_{|x| < \delta} q(x) > 0, \quad \text{for any } \delta > 0. \]

A prototypical tempered-stable-like process, as understood here, is the CGMY process of widespread use in mathematical finance. For the CGMY process, let $X$ be a Brownian motion and $e^Y$ the exponential function. Following a density transformation construction as given in Sato [43] (see Definition 33.4 and Example 33.14 there)
\[ \nu(dx) = \left( \frac{C_+^M}{x^{1+Y}} 1_{\{x > 0\}} + \frac{C_+^G x}{|x|^{1+Y}} 1_{\{x < 0\}} \right) dx, \]
so that $C_+ = C_-, \beta_+ = C_+ M$, and $\beta_- = C_- G$. From this analogy, we choose to re-express the model in terms of the parameters $M := \beta_+/C_+$ and $G := \beta_-/C_-$, and the function
\[ \tilde{q}(x) := \frac{q(x)}{C_+} 1_{\{x > 0\}} + \frac{q(x)}{C_-} 1_{\{x < 0\}}. \]

In that case, (2.7) can equivalently be written as
\[ \lim_{x \searrow 0} \frac{1}{x} (1 - \tilde{q}(x)) = M, \quad \lim_{x \nearrow 0} \frac{1}{x} (1 - \tilde{q}(x)) = -G. \]

The following relations are direct consequences of (2.7) and are only stated here for future reference:
\[ (i) \ \lim_{\delta \searrow 0} \tilde{q}(\delta y) / \delta = e^{-y M} 1_{\{y > 0\}} + e^{-|y| G} 1_{\{y < 0\}}, \quad (ii) \ \lim_{\delta \nearrow 0} \frac{1}{\delta} \ln \tilde{q}(\delta y) = -y M 1_{\{y > 0\}} - |y| G 1_{\{y < 0\}}, \]
for any $y \in \mathbb{R}\setminus\{0\}$. Let us also note that (2.3-ii) implies the martingale condition (2.1-i) and also that $M > 1$.

**Remark 2.2.** The class of processes considered here is similar to the unifying class of Regular Lévy Processes of Exponential type (RLPE) as introduced in [7]. It also covers the class of proper Tempered Stable processes as defined in [41] as well as several parametric models typically used in mathematical finance, including the CGMY processes and the more general class of normal tempered stable processes (cf. [11, Section 4.4.3]). Let us also remark that the range of $Y$ considered (namely, $Y \in (1, 2)$) is the most relevant for financial applications in light of several recent econometric studies of high-frequency financial data suggesting that the Blumenthal-Getoor index is larger than 1 (cf. [1], [3], and references therein).

Following a density transformation construction as given in Sato [43] (see Definition 33.4 and Example 33.14 there) and using the martingale condition $\mathbb{E}e^{X_t} = 1$, we define a probability measure $\mathbb{P}^*$ on $(\Omega, \mathcal{F})$ via
\[ \frac{d\mathbb{P}^*|_{\mathcal{F}_t}}{d\mathbb{P}|_{\mathcal{F}_t}} = e^{X_t}, \quad (t \geq 0); \]
i.e., $\mathbb{P}^*(B) = \mathbb{E}(e^{X_t} 1_B)$, for any $B \in \mathcal{F}_t$ and $t \geq 0$. The measure $\mathbb{P}^*$, sometimes termed the share measure, can be interpreted as the martingale measure when using the stock price as the numéraire. Under this probability measure,
Let \((X_t)_{t \geq 0}\) has the representation \((\sigma W_t^* + L_t^*)_{t \geq 0}\) where, under \(\mathbb{P}^*\), \(W^* := (W_t^*)_{t \geq 0}\) is a Wiener process and \(L^* := (L_t^*)_{t \geq 0}\) is a Lévy process with triplet \((0, b^*, \nu^*)\) given by

\[
\nu^*(dx) := e^x \nu(dx) = e^x s(x) dx, \quad b^* := b + \int_{|x| \leq 1} x(e^x - 1) s(x) dx + \sigma^2,
\]

which is moreover independent of \(W^*\). Hereafter, we set

\[
q^*(x) = q(x)e^x, \quad s^*(x) = |x|^{-Y-1}q^*(x), \quad \bar{q}^*(x) := \bar{q}(x)e^x.
\]

The next relations follow immediately from (2.8):

\[
\begin{align*}
(i) \lim_{\delta \searrow 0} \bar{q}^*(\delta y)^{1/\delta} &= e^{-yM^*}1_{\{y>0\}} + e^{-|y|G^*}1_{\{y<0\}}, \\
(ii) \lim_{\delta \searrow 0} \frac{1}{\delta} \ln \bar{q}^*(\delta y) &= -yM^*1_{\{y>0\}} - |y|G^*1_{\{y<0\}}.
\end{align*}
\]  

where

\[
M^* := M - 1, \quad \text{and} \quad G^* := G + 1.
\]

An important tool thereafter is to change probability measures from \(\mathbb{P}^*\) to another probability measure, say \(\mathbb{P}\), under which \((L_t^*)_{t \geq 0}\) is a stable Lévy process and \((W_t^*)_{t \geq 0}\) is a Wiener process independent of \(L^*\). Concretely, let

\[
\bar{\nu}(dx) := |x|^{-Y-1} (C_+1_{\{x>0\}} + C_-1_{\{x<0\}}) dx, \quad \bar{b} = b^* + \int_{|x| \leq 1} x(\bar{\nu} - \nu^*)(dx).
\]

Note that \(\bar{\nu}\) is the Lévy measure of a \(Y\)-stable Lévy process which, in light of (2.4-iv), is equivalent to \(\nu^*\). Moreover,

\[
\bar{\nu}(dx) = e^{\bar{\varphi}(x)} \nu^*(dx), \quad \text{with} \quad \varphi(x) := -\ln \bar{q}^*(x) = -\ln \bar{q}(x) - x.
\]

By virtue of Theorem 33.1 in [43], there exists a probability measure \(\mathbb{P}\) locally equivalent\(^2\) to \(\mathbb{P}^*\) such that \((X_t)_{t \geq 0}\) is a Lévy process with Lévy triplet \((\sigma^2, \bar{b}, \bar{\nu})\) under \(\mathbb{P}\), provided that the following condition is satisfied:

\[
\int_{\mathbb{R}_0} \left( e^{\bar{\varphi}(x)/2} - 1 \right)^2 \nu^*(dx) = \int_{\mathbb{R}_0} \left( 1 - e^{-\varphi(x)/2} \right)^2 \bar{\nu}(dx) < \infty.
\]

To see that the previous condition holds under our assumptions, note that the integral therein can be expressed as

\[
C_+ \int_0^\infty \left( 1 - e^{\frac{1}{2} \ln \bar{q}^*(x)} \right)^2 |x|^{-Y-1} dx \quad \text{and, by (2.10-ii), the integrand in the first integral is such that}
\]

\[
\left( e^{\frac{1}{2} \ln \bar{q}^*(x)} - 1 \right)^2 \sim \frac{1}{4} (\ln \bar{q}^*(x))^2 \sim \frac{(M^*)^2}{4} x^2, \quad \text{as} \quad x \searrow 0.
\]

This shows that the first integral is finite on any interval \((0, \varepsilon)\). Outside any neighborhood of the origin, this integral is finite in view of (2.1-i). The second integral in (2.11) can be handled using again (2.10) and the fact that

\[
\varphi(x) = -\ln \bar{q}^*(x) \geq 0, \quad \text{for any} \quad x < 0,
\]

as seen from the assumption (2.3-i).

Now that we have established the existence of the probability measure \(\mathbb{P}\), let us state some properties and introduce some related terminology. Throughout, \(\mathbb{E}\) denotes expectation under \(\mathbb{P}\). Denoting \(\bar{\gamma} := \mathbb{E}X_1 = \mathbb{E}L_t^*\), we recall that the centered process \((Z_t)_{t \geq 0}\), defined by

\[
Z_t := L_t^* - t\bar{\gamma},
\]

\[\text{Equivalently, there exists a process \((U_t)_{t \geq 0}\) such that \(\mathbb{P}^*(B) = \mathbb{E}^*(e^{U_t}1_B)\), for } t \geq 0 \text{ and } B \in \mathcal{F}_t.\]
is a strictly $Y$-stable under $\tilde{P}$ and, thus, is also self-similar; i.e.,
\begin{equation}
(t^{-1/Y}Z_u)_{u \geq 0} \overset{\tilde{P}}{=} (Z_u)_{u \geq 0},
\end{equation}
for any $t > 0$. Let $p_Z$ denote the marginal density function of $Z_1$ under $\tilde{P}$. It is well known (see, e.g., (14.37) in [43] and references therein) that
\begin{equation}
p_Z(v) \sim C_{\pm}|v|^{-Y-1}, \quad \text{as } v \to \pm \infty, \quad \text{respectively.}
\end{equation}
In particular, for any $v > 0$, as $t \to 0$,
\begin{align*}
\tilde{P}(Z_t \geq v) &= \tilde{P}(Z_1 \geq t^{-1/Y}v) \sim t\tilde{v}([v, \infty)) = t \frac{C_{+}}{Y} v^{-Y}, \\
\tilde{P}(Z_t \leq -v) &= \tilde{P}(Z_1 \leq - t^{-1/Y}v) \sim t\tilde{v}((-\infty, -v]) = t \frac{C_{-}}{Y} v^{-Y}.
\end{align*}
The following tail estimate can also be deduced from (2.15) (see Appendix C for its proof):
\begin{equation}
\tilde{P}(|Z_t| \geq t^{-1/Y}v) = \tilde{P}(|Z_t| \geq v) \leq \kappa t|v|^{-Y},
\end{equation}
for all $v > 0$ and $0 < t \leq 1$ and some absolute constant $\kappa < \infty$.

Also, of use below, is the following representation of the log density process
\begin{equation}
U_t := \log \frac{d\tilde{P}|_{\mathcal{F}_t}}{d\tilde{P}} = \lim_{\epsilon \to 0} \left( \sum_{\varphi(\Delta X_s) - t \int_{|x| > \epsilon} \left( e^{\varphi(x)} - 1 \right) \nu^*(dx) \right); \tag{2.19}
\end{equation}
cf. Theorem 33.2 in [43]. The process $(U_t)_{t \geq 0}$ can be expressed in terms of the jump-measure $N(dt, dx) := \# \{(s, \Delta X_s) \in dt \times dx \}$ of the process $(X_t)_{t \geq 0}$ and its compensated measure $\bar{N}(dt, dx) := N(dt, dx) - \tilde{v}(dx) dt$ (under $\tilde{P}$). Indeed,
\begin{align*}
U_t &= \lim_{\epsilon \to 0} \left( \int_0^t \int_{|x| > \epsilon} \varphi(x)N(ds, dx) - t \int_{|x| > \epsilon} \left( e^{\varphi(x)} - 1 \right) e^{-\varphi(x)} \nu(dx) \right) \\
&= \lim_{\epsilon \to 0} \left( \int_0^t \int_{|x| > \epsilon} \varphi(x)N(ds, dx) + t \int_{|x| > \epsilon} \left( e^{-\varphi(x)} - 1 + \varphi(x) \right) \nu(dx) \right).
\end{align*}
Thus, from the definition of the Poisson integral under a compensated Poisson measure as in [25] (see Theorem 10.15 therein), we get
\begin{equation}
U_t = \tilde{U}_t + \eta t, \tag{2.20}
\end{equation}
with
\begin{equation}
\tilde{U}_t := \int_0^t \int_{\mathbb{R}} \varphi(x)\bar{N}(ds, dx), \quad \eta := \int_{\mathbb{R}} \left( e^{-\varphi(x)} - 1 + \varphi(x) \right) \nu(dx). \tag{2.21}
\end{equation}
In particular, from the definition of $(U_t)_{t \geq 0}$ in (2.19), the process $e^{-U_t}$ is a $\tilde{P}$-martingale and, thus,
\begin{equation}
\tilde{E} e^{-\tilde{U}_t} = e^{\eta t}. \tag{2.22}
\end{equation}

Remark 2.3. The constant $\eta$ above (and, therefore, also $\tilde{U}_t$) is well defined. Indeed, from (2.4-iv) and (2.10-ii),
\begin{align*}
\int_{|x| \leq 1} |e^{-\varphi(x)} - 1 + \varphi(x)| &|x|^{-Y-1} dx \leq C_1 \int_{|x| \leq 1} \varphi^2(x)|x|^{-Y-1} dx \leq C_2 \int_{|x| \leq 1} |x|^{-Y} dx < \infty,
\end{align*}
for some constants $C_1, C_2 < \infty$. Similarly, from (2.12) and both conditions in (2.4),
\begin{align*}
\int_{x < -1} |e^{-\varphi(x)} - 1 + \varphi(x)| &|x|^{-Y-1} dx \leq C_1 \int_{x < -1} |\varphi(x)||x|^{-Y-1} dx \leq C_2 \int_{x < -1} |x|^{-Y} dx < \infty.
\end{align*}
Finally, from (2.1-i) and (2.4), for some constant $C_1 < \infty$,
\begin{align*}
\int_{x > 1} |e^{-\varphi(x)} - 1 + \varphi(x)| &|x|^{-Y-1} dx \leq C_1 \int_{x > 1} e^{\ln \eta(x) + \varphi(x)}x^{-Y-1} dx + \int_{x > 1} |1 + \varphi(x)|x^{-Y-1} dx < \infty.
\end{align*}
The following decomposition of the process $X$ in terms of the compensated measure $\tilde{N}(dt, dx) := N(dt, dx) - \tilde{\nu}(dx)dt$
is also of use throughout:

$$X_t = \sigma W^*_t + Z_t + t\tilde{\gamma} = \sigma W^*_t + \int_0^t \int_{\mathbb{R}_0} x\tilde{N}(ds, dx) + t\tilde{\gamma}. \quad (2.23)$$

The representation (2.23) can be deduced from the Lévy-Itô decomposition of the process $(X_t)_{t \geq 0}$ (cf. Theorem 13.4 and Corollary 13.7 in [25] or Theorem 19.2 in [43]) with the stated Lévy triplet $(0, \tilde{b}, \tilde{\nu})$ of $X$ under $\tilde{P}$ and where, by construction, $\tilde{b}$ must be such that $\tilde{E}(X_t) = \gamma t$.

### 3 The pure-jump model

In this section, we find the second-order asymptotic behavior for the at-the-money call option prices (1.3) in the pure-jump model (i.e., $\sigma = 0$ and $X_t = L^*_t$). The proofs of all the results of this section are deferred to Appendix A. Before stating our first result, we need to rewrite the call option price (1.3) in a suitable form.

**Lemma 3.1.** With the probability measure $\tilde{P}$ defined in (2.19) and the parameter $\tilde{\gamma} := \tilde{E}X_1 = \tilde{E}L^*_1$,

$$t^{-\frac{1}{2}} \frac{1}{S_0} \tilde{E}(S_t - S_0)^+ = e^{-(\tilde{\gamma} + \eta)t} \int_{-\tilde{\gamma}t^{-1/Y}}^{\infty} e^{-t^{1/Y}v} \tilde{E}\left(e^{\tilde{U}_t}1_{(t^{-1/Y}Z_t \geq v)}\right) dv. \quad (3.1)$$

The next two lemmas are crucial to obtain the main result of the section:

**Lemma 3.2.** In the setting and under the assumptions of Section 2, for any $\xi \geq 0$,

1. $\lim_{t \to 0} \tilde{E}\left(e^{-t^{1/Y}(\tilde{U}_t + Z_t)}\right) = e^{\tilde{\eta}^Y}$,
2. $\lim_{t \to 0} \tilde{E}\left(e^{-t^{1/Y}\tilde{U}_t}\right) = e^{\tilde{\eta}^Y}$,

where $\eta := \Gamma(-Y)(C_+ M^Y + C_- G^Y)$ and $\eta^* = \Gamma(-Y)(C_+(M^*)^Y + C_- (G^*)^Y)$. In particular, both $t^{-1/Y}(\tilde{U}_t + Z_t)$ and $t^{-1/Y}\tilde{U}_t$ converge to a $Y$-stable distribution as $t \to 0$.

**Lemma 3.3.** In the setting and under the assumptions of Section 2, the following two assertions hold true:

1. For any $v > 0$,

$$\lim_{t \to 0} \frac{1}{t} \tilde{P}\left(Z^+_t + \tilde{U}_t \geq v\right) = \int_{\mathbb{R}_0} 1_{(x - \ln \tilde{q}(x) \geq v)} \tilde{\nu}(dx). \quad (3.3)$$

2. There exist constants $\tilde{\kappa} < \infty$ and $t_0 > 0$ such that

(i) $\frac{1}{t} \tilde{P}\left(\tilde{U}_t \geq v\right) \leq \tilde{\kappa} v^{-Y}$,
(ii) $\frac{1}{t} \tilde{P}\left(Z^+_t + \tilde{U}_t \geq v\right) \leq \tilde{\kappa} v^{-Y}$,

for any $0 < t \leq t_0$ and $v > 0$.

We are now in a position to establish the main result of this section. The following result gives the second-order asymptotic behavior of at-the-money call option prices under an exponential tempered stable Lévy model.

**Theorem 3.4.** Under the exponential Lévy model (1.4) without Brownian component ($\sigma = 0$),

$$\lim_{t \to 0} t^{\frac{1}{2}} \frac{1}{S_0} \tilde{E}(S_t - S_0)^+ - \tilde{E}(Z^*_t) = \tilde{\theta} + \tilde{\gamma} \tilde{P}(Z_1 \geq 0), \quad (3.5)$$

where, in terms of the function $\tilde{q}$ introduced in (2.6),

$$\tilde{\theta} := C_+ \int_0^\infty (e^{\tilde{q}(x)} - \tilde{q}(x) - x)^{-Y-1} dx, \quad (3.6)$$
$$\tilde{\gamma} := \tilde{E}L^*_1 = b + \frac{C_+ + C_-}{Y - 1} + C_+ \int_0^\infty x^{-Y}(1 - \tilde{q}(x)) dx + C_- \int_{-\infty}^0 |x|^{-Y}(1 - \tilde{q}(x)) dx. \quad (3.7)$$
Remark 3.5. The leading term $\bar{E}(Z_1^\pm)$ can be explicitly computed via the absolute first moment of $Z_1$ since $\bar{E}|Z_1| = 2\bar{E}(Z_1^+) - \bar{E}(Z_1) = 2\bar{E}(Z_1^+)$. It turns out that

$$\bar{E}(Z_1^+) = \frac{1}{2}\bar{E}|Z_1| = \frac{1}{\pi} \left( \bar{C}_+ + \bar{C}_- \right)^\frac{1}{2} \Gamma \left( 1 - \frac{1}{Y} \right) \left( 1 + \frac{\bar{C}_+ - \bar{C}_-}{\bar{C}_+ + \bar{C}_-} \right)^2 \tan^2 \left( \frac{Y\pi}{2} \right) \right)^\frac{1}{Y} \times \cos \left( \frac{1}{Y} \arctan \left( \frac{\bar{C}_+ - \bar{C}_-}{\bar{C}_+ + \bar{C}_-} \tan \left( \frac{Y\pi}{2} \right) \right) \right),$$

(3.8)

where $\bar{C}_\pm = C_\pm \Gamma(-Y)|\cos(\frac{1}{2}Y\pi)|$ (see the proof of (1.2.13) in [42]). In the symmetric case (i.e. $C_- = C_+ = C$), (3.8) simplifies to (1.8).

Remark 3.6. From (3.5), it follows that the short-time second-order asymptotic behavior of the ATM call option price (1.3) has the form:

$$\frac{1}{S_0} E(S_t - S_0) = d_1 t^\frac{1}{2} + d_2 t + o(t), \quad (t \to 0),$$

(3.9)

with $d_1 = \bar{E}(Z_1^+)$ given as in (3.8) and $d_2 = \bar{\vartheta} + \bar{\gamma}\bar{E}(Z_1 \geq 0)$. In words, the first-order term synthesizes only the information on the tail-heaviness index $Y$ and the overall jump-intensity parameter, while the second-order term also incorporates the information on the relative intensities of the negative and positive jumps as measured by $C_+$ and $C_-$. We now proceed to study the asymptotic behavior of the corresponding Black-Scholes implied volatilities. Throughout, let $\hat{\sigma}(t)$ denote the ATM Black-Scholes implied volatility at maturity $t$ with zero interest rates and dividend yield. The following result gives the asymptotic behavior of $\hat{\sigma}(t)$ as $t \to 0$.

Proposition 3.7. Under the exponential Lévy model (1.4) without Brownian component, the implied volatility $\hat{\sigma}$ has the following small-time behavior:

$$\hat{\sigma}(t) = \sigma_1 t^\frac{1}{2} - \frac{1}{2} + \sigma_2 t^\frac{1}{2} + o(t^\frac{1}{2}), \quad t \to 0,$$

(3.10)

where

$$\sigma_1 := \sqrt{2\pi\bar{E}(Z_1^+)} \quad \sigma_2 := \sqrt{2\pi} \left( \bar{\vartheta} + \bar{\gamma}\bar{E}(Z_1 \geq 0) \right),$$

(3.11)

and where $\bar{\vartheta}$ and $\bar{\gamma}$ are respectively given in (3.6) and (3.7).

4 Tempered-stable-like model with a non-zero Brownian component

In this part, we consider the case of a non-zero Brownian component. Concretely, throughout, $(X_t)_{t \geq 0}$ is a Lévy process with triplet $(\sigma^2, b, \nu)$ as introduced in Section 2 and $\sigma \neq 0$. The first order asymptotic behavior for the ATM European call options in this mixed model is obtained in [44] using Fourier methods. We give next the second-order correction term for the at-the-money European call option price. As before, we change the probability measure $\mathbb{P}$ to $\mathbb{P}^*$ so that $X_t = t\gamma + \sigma W_t^* + Z_t$, with $(Z_t)_{t \geq 0}$ a strictly $Y$-stable Lévy process under $\mathbb{P}$ (see (2.13)). Recall also that, under both $\mathbb{P}^*$ and $\mathbb{P}$, $W^*$ is still a standard Brownian motion, independent of $(Z_t)_{t \geq 0}$. We will also make use of the decompositions (2.20) and (2.23). The proof of the result below is presented in Appendix B.

Theorem 4.1. In the setting and under the conditions of Section 2, the ATM European call option price is such that

$$\lim_{t \to 0} t^\frac{1}{2} E(S_t - S_0)^\frac{1}{2} - \sigma E^*(W_1^*)^\frac{1}{2} = \frac{C_- + C_+}{2Y(Y-1)} \sigma^{1-Y} E^* \left( |W_1^*|^{1-Y} \right).$$

(4.1)

Remark 4.2. The $(1-Y)$-centered moment of a standard normal distribution is given by (see, e.g., (25.6) in [43]):

$$E^* \left( |W_1^*|^{1-Y} \right) = \frac{2^{1-Y}}{\sqrt{\pi}} \Gamma \left( 1 - \frac{Y}{2} \right).$$
Thus, the second-order asymptotic behavior of the ATM call option price (1.3) in short-time takes the form

\[ \frac{1}{S_0} \mathbb{E}(S_t - S_0)^+ = d_1 t^{\frac{1}{2}} + d_2 t^{\frac{3-Y}{2}} + o\left( t^{\frac{3-Y}{2}} \right), \quad t \to 0, \quad (4.2) \]

with

\[ d_1 = \frac{\sigma}{2\pi}, \quad d_2 = \frac{2^{1-Y}}{\sqrt{\pi}} \Gamma \left( 1 - \frac{Y}{2} \right) \frac{(C_- + C_+) \sigma^{1-Y}}{2Y(Y-1)}. \quad (4.3) \]

The first-order term only synthesizes the information about the continuous volatility parameter \( \sigma \). In fact, the first order term of the ATM call option price under the mixed tempered-stable-like model is the same as the one under the Black-Scholes model. The second-order term further incorporates the information on the tail index parameter \( Y \) and the overall jump-intensity, which is measured by the parameter \( C := C_- + C_+ \). However, these two-terms do not reflect the individual intensities of the negative or positive jumps as measured by the values of \( C_- \) and \( C_+ \). This fact suggests that it could be useful to consider a third-order approximation. For more information on the latter in the CGMY model, we refer the reader to [18].

The next proposition gives the small-time asymptotic behavior for the ATM Black-Scholes implied volatility under the tempered-stable-like model with non-zero Brownian component. Unlike the pure-jump case, we can only derive the first order asymptotics using Theorem 4.1. The second order term for the implied volatility requires third order asymptotics for the ATM call option price. The proof is deferred to Appendix B.

Proposition 4.3. Under the exponential Lévy model (1.4) with non-zero Brownian component, the implied volatility \( \hat{\sigma} \) has the following small-time behavior:

\[ \hat{\sigma}(t) = \sigma + \frac{(C_+ + C_-)2^{2-Y}\sigma^{1-Y}}{Y(Y-1)} t^{1-\frac{Y}{2}} + o\left( t^{1-\frac{Y}{2}} \right), \quad t \to 0. \quad (4.4) \]

### 5 Asymptotics for ATM option prices under a CGMY model

In this section, we specialize the second-order asymptotic expansions of the two previous sections to the CGMY model. The result presented here were first reported in [18]. Recall that under the CGMY model, the Lévy measure of the pure-jump component \((L_t)_{t \geq 0}\) is given by

\[ \nu(dx) = |x|^{-Y-1} q(x) dx = |x|^{-Y-1} \left( C e^{-Mx} 1_{\{x > 0\}} + C e^{Gx} 1_{\{x < 0\}} \right) dx, \quad (5.1) \]

with corresponding parameters \( C, G, M > 0 \) and \( Y \in (1, 2) \). Then, the characteristic function of the log-return process \( X_t = \sigma W_t + L_t \) takes the form

\[ \varphi_t(u) = \mathbb{E}(e^{iuX_t}) = \exp \left( t \left[ icu - \frac{\sigma^2 u^2}{2} + CT(-Y) \left( (M - iu)^Y + (G + iu)^Y - M^Y - G^Y \right) \right] \right), \quad (5.2) \]

for a constant \( c \in \mathbb{R} \). The martingale condition (2.1) implies that \( M > 1 \) and

\[ c = -CT(-Y) ((M - 1)^Y + (G + 1)^Y - M^Y - G^Y) - \frac{\sigma^2}{2}, \quad (5.3) \]

see, e.g., Proposition 4.2 in [44]. In particular, the center \( \gamma := \mathbb{E}X_1 = EL_1 \) of \( X \) and the parameter \( b \) of \( X \) (relative to the truncation function \( x 1_{\{|x| \leq 1\}} \)) are given by

\[ \gamma = c - CYT(-Y)(M^{Y-1} - G^{Y-1}), \quad b = c - \int_{|x| > 1} x \nu(dx) - CYT(-Y)(M^{Y-1} - G^{Y-1}). \]

Under the share measure \( \mathbb{P}^* \) introduced in Section 2, \((X_t)_{t \geq 0}\) has Lévy triplet \((b^*, (\sigma^*)^2, \nu^*)\) given by

\[ \sigma^* := \sigma, \quad b^* := c + \sigma^2 - \int_{|x| > 1} x \nu^*(dx) - CYT(-Y)((\sigma^*)^{Y-1} - (G^*)^{Y-1}), \quad \nu^*(dx) := e^x \nu(dx), \quad (5.4) \]
with $M^* = M - 1$ and $G^* = G + 1$. Under the probability measure $\mathbb{P}$, the centered process $(Z_t)_{t \geq 0}$ is symmetric, and its center $\tilde{\gamma} := \mathbb{E}X_1 = \mathbb{E}L_1^\gamma$ is given by (see [18] for the detailed computation)

$$\tilde{\gamma} = \tilde{b} + \int_{|x|>1} x\tilde{\nu}(dx) = b^* + \int_{|x|\leq 1} x(\tilde{\nu} - \nu^*)(dx) + \int_{|x|>1} x\tilde{\nu}(dx)$$

$$= -CT(-Y)\left((M - 1)^Y + (G + 1)^Y - M^Y - G^Y\right) + \frac{\sigma^2}{2}.$$

(5.5)

We also need the value of $\eta$ defined in (2.21), which, under the CGMY model, is now given by

$$\eta = C \int_0^\infty (e^{-M^*x} - 1 + M^*x)x^{-Y-1}dx + C \int_{-\infty}^0 (e^{G^*x} - 1 - G^*x)|x|^{-Y-1}dx = CT(-Y)\left((M^*)^Y + (G^*)^Y\right),$$

(5.6)

where, for the last equality above, we used the analytic continuation of (14.19) in [43].

We are ready to explicitly write the second-order expansions. First, let us compute the term $\vartheta$ of (3.6). To this end, it is convenient to use the representation given in (A.17) below noting that in the CGMY case $\bar{q}(x) := e^{-M^*x}\mathbb{1}_{\{x>0\}} + e^{G^*x}\mathbb{1}_{\{x<0\}}$. Hence,

$$\vartheta = C \int_0^\infty (e^{-v} - 1) \int_{\mathbb{R}_0} \mathbb{1}_{\{|x-\ln \bar{q}(x)\geq v\}} |x|^{-Y-1}dxdv$$

$$= C \int_0^\infty (e^{-v} - 1) \int_0^\infty \mathbb{1}_{\{Mx\geq v\}} x^{-Y-1}dxdv + C \int_0^\infty (e^{-v} - 1) \int_{-\infty}^\infty \mathbb{1}_{\{-Mx\geq v\}} (-v)^{-Y-1}dxdv$$

$$= \frac{C}{Y}(M^Y + (G + 1)^Y) \int_0^\infty (e^{-v} - 1)v^{-Y}dv$$

$$= -CT(-Y)\left((M^*)^Y + (G^*)^Y\right),$$

(5.7)

where in the last equality we used the identities $\int_0^\infty (e^{-v} - 1)v^{-Y}dv = \Gamma(1 - Y) = -\Gamma(-Y)$ (see p. 84 in [43]). Using (5.5)-(5.7) and recalling that $\bar{\vartheta} = \vartheta + \eta$ (see (A.18)), it follows that in the pure-jump CGMY model,

$$d_2 := \vartheta + \frac{\tilde{\gamma}}{2} = \frac{CT(-Y)}{2} \left((M - 1)^Y - M^Y - (G + 1)^Y + G^Y\right),$$

while in the general CGMY model with non-zero Brownian component, $C_+ = C_- = C$, and thus

$$d_2 := \frac{C\sigma^{1-Y}2^{1-Y}}{Y(Y-1)\sqrt{\pi}} \Gamma\left(1 - \frac{Y}{2}\right)$$

6 Numerical examples

In this part, we assess the performance of the previous approximations through a detailed numerical analysis for the CGMY model.

6.1 The numerical methods

Let us first select a suitable numerical scheme to compute the ATM option prices by considering two methods: Inverse Fourier Transform (IFT) and Monte Carlo (MC). Before introducing the IFT, let us set some notations. The characteristic function corresponding to the Black-Scholes model with volatility $\Sigma$ is given by

$$\phi^\text{BS,}\Sigma_t(u) = \exp\left(-\frac{\Sigma^2 t}{2} (u^2 + iu)\right).$$

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Here, we investigate the performance of the approximations for different settings of parameters.

6.2 Results for different parameter settings

We now introduce a Monte Carlo method based on the risk-neutral option price representation under the probability measure \( P \). Under this probability measure and using the notation (2.21) as well as the relations (2.20) and (2.23), we have:

\[
\mathbb{E}(e^{X_T} - 1)_+ = \mathbb{E}^*(e^{X_T} - 1)_+ = \tilde{\mathbb{E}}\left(e^{-M_T^* \eta_T^*} - e^{-X_T^*}\right)
\]

which can be easily computed by Monte Carlo method using that, under \( \tilde{\mathbb{P}} \), the variables \( U_T^* \) and \( -U_T^* \) are independent \( Y \)-stable random variables with scale, skewness, and location parameters \( TC|\cos(\pi Y/2)|\Gamma(-Y) \), 1, and 0, respectively. Standard simulation methods are available to generate stable random variables.

Next, we take the following set of parameters

\[
C = 0.5, \quad G = 2, \quad M = 3.6, \quad Y = 1.5.
\]

Figure 1 compares the first- and second-order approximations as given in Remarks 3.6 and 4.2 to the prices based on the Inverse Fourier Transform (IFT-based price) and the Monte Carlo method (MC-based price) under both the pure-jump case and the mixed CGMY case with \( \sigma = 0.4 \). For the MC-based price, we use 100,000 simulations, while for the IFT-based method, we use \( P = 2^{14} \) and \( Q = 800 \). As it can be seen, it is not easy to integrate numerically the characteristic function (6.2) since \( T \) is quite small and, therefore, the characteristic functions \( \phi_T \) and \( \phi_{BS,Y}^* \) are quite flat. The Monte Carlo method turns out to be much more accurate and faster. It is also interesting to note that the second-order approximation is in general much more accurate in the pure-jump model than in the mixed model with nonzero continuous component. This observation is consistent with the last comment of Remark 4.2.

6.2 Results for different parameter settings

Here, we investigate the performance of the approximations for different settings of parameters:
Figure 1: Comparisons of ATM call option prices for two methods (Inverse Fourier Transform and Monte-Carlo method) with the first- and second-order approximations. MC-based price is based on 100,000 simulations while the IFT-based method is based on the parameter values $P = 2^{14}$ and $Q = 800$. The parameter $\sigma$ in the mixed CGMY model is set to be 0.1.

1. Figure 2 compares the 1st- and 2nd-order approximations with the MC prices for different values of $C$, fixing the values of all the other parameters. In the pure-jump case, the 2nd order approximation is significantly better for moderately small values of $C$, but for larger values of $C$, this is not the case unless $T$ is extremely small. For a nonzero continuous component, the 1st order approximation is extremely poor as it only takes into account the parameter $\sigma$.

2. Figure 3 compares the 1st- and 2nd-order approximations with the MC prices for different values of $Y$, fixing the values of all the other parameters. In both cases, the 2nd order approximation is significantly better for values of $Y$ around 1.5, which is consistent with the observation that $|d_2| \to \infty$ as $Y \to 1$ or $Y \to 2$. For a nonzero continuous component, the 1st order approximation is again extremely poor when compared to the 2nd order approximation.

3. In the left panel of Figure 4, we analyze the effect of the relative intensities of the negative jumps compared to the positive jumps in the pure-jump CGMY case. That is, we fix the values $M$ to be 4 and consider different values for $G$. As expected, since the first order approximation does not take into account this information, the 2nd-order approximation performs significantly better.

4. In the right panel of Figure 4, we analyze the effect of the volatility of the continuous component in the mixed CGMY case. The 2nd order approximation is, in general, much better than the 1st-order approximation and, interestingly enough, the quality of the 2nd order approximations improves as the values of $\sigma$ increases. In fact, it seems that the 2nd-order approximation and the MC prices collapse to a steady curve as $\sigma$ increases.

A Proofs of Section 3: Pure-jump model

For simplicity, unless otherwise stated, throughout this section, we fix $S_0 = 1$.

Proof of Lemma 3.1.
From (1.11), we have
\[ t^{-1/Y} E(S_t - S_0)^+ = t^{-1/Y} \mathbb{P}^*(X_t \geq E) = t^{-1/Y} \int_0^\infty e^{-x} \mathbb{P}^*(X_t \geq x) dx = \int_0^\infty e^{-t^{-1/Y} u} \mathbb{P}^*(t^{-1/Y} X_t \geq u) du. \]  
(A.1)

Next, using the change of probability measure (2.19),
\[ \mathbb{P}^*(t^{-1/Y} X_t \geq u) = E^* \left( (1_{t^{-1/Y} X_t \geq u}) \right) = \tilde{E} \left( e^{-\tilde{U}_t} 1_{t^{-1/Y} X_t \geq u} \right), \]
and, moreover, (2.20) and (2.23),
\[ \mathbb{P}^*(t^{-1/Y} X_t \geq u) = e^{-\eta t} \tilde{E} \left( e^{-\tilde{U}_t} 1_{t^{-1/Y} Z_t \geq u - \tilde{\gamma} t^{-1/Y}} \right). \]
Then,
\[ t^{-1/Y} E(S_t - S_0)^+ = \int_0^\infty e^{-t^{-1/Y} u - \eta t} \tilde{E} \left( e^{-\tilde{U}_t} 1_{t^{-1/Y} Z_t \geq u - \tilde{\gamma} t^{-1/Y}} \right) du, \]  
(A.2)

and, changing variables \( v = u - \tilde{\gamma} t^{-1/Y} \), the result follows. \qed

**Proof of Lemma 3.2.**

Fix \( Q_t := \tilde{U}_t + Z_t \). From the usual moment generating formula for Poisson integrals, the change of variables \( y = t^{-1/Y} x \),
Figure 3: Comparisons of ATM call option prices with short-time approximations for different values of the tail-heaviness parameter $Y$.

Figure 4: Comparisons of ATM call option prices with short-time approximations for different values of $G$ or $M$ and different values of the volatility parameter $\sigma$. 
and recalling that \( \varphi(x) + x = -\ln \bar{q}(x) \),

\[
\mathbb{E} \left( e^{-\xi t^{-1/Y} Q_t} \right) = \mathbb{E} \left( \exp \left\{ -\xi t^{-1/Y} \int_0^t \int (\varphi(x) + x) \tilde{N}(ds, dx) \right\} \right) \\
= \exp \left\{ t \int \left( e^{\xi t^{-1/Y} \ln \bar{q}(x)} - 1 - \xi t^{-1/Y} \ln \bar{q}(x) \right) \bar{v}(dx) \right\} \\
= \exp \left\{ C_+ \int_0^\infty \left( e^{\xi t^{-1/Y} \ln \bar{q}(t^{1/Y})} - 1 - \xi t^{-1/Y} \ln \bar{q} \left( t^{1/Y} \right) \right) y^{-Y-1} dy + C_- \int_0^\infty \left( e^{\xi t^{-1/Y} \ln \bar{q}(t^{1/Y})} - 1 - \xi t^{-1/Y} \ln \bar{q} \left( t^{1/Y} \right) \right) |y|^{-Y-1} dy \right\}.
\]

(A.3)

Let \( \Xi(u) := e^u - 1 - u \) and \( B := \sup_u |\ln \bar{q}(u)|/|u| \), which is necessarily finite in light of of (2.4) and (2.8-ii). Now, using that \( \ln \bar{q}(u) \leq 0 \), for any \( u \in \mathbb{R}_0 \) (from both conditions in (2.3)), and that \( |\Xi(u)| \leq K (u^2 \wedge |u|) \), for \( u \leq 0 \) and some constant \( K < \infty \),

\[
\Xi \left( \xi t^{-\frac{\varphi}{Y}} \ln \bar{q} \left( t^{1/Y} \right) \right) |y|^{-Y-1} \leq K \left( \left( \xi t^{-\frac{\varphi}{Y}} \ln \bar{q} \left( t^{1/Y} \right) \right)^2 \wedge \left| \xi t^{-\frac{\varphi}{Y}} \ln \bar{q} \left( t^{1/Y} \right) \right| \right) |y|^{-Y-1} \\
\leq K \left( (\xi y B)^2 \wedge |\xi y B| \right) |y|^{-Y-1} \\
\leq K \left( (\xi B)^2 \wedge |\xi B| \right) (y^2 \wedge |y|) |y|^{-Y-1},
\]

which is integrable. Therefore, one can pass the limit inside the integrals in (A.3) and, using (2.8),

\[
\lim_{t \to 0} \mathbb{E} \left( e^{-\xi t^{-1/Y} Q_t} \right) = \exp \left\{ C_+ \int_0^\infty \left( e^{-uY} - 1 + uY \right) y^{-Y-1} dy + C_- \int_{-\infty}^0 \left( e^{-yG} - 1 + |y|G \right) |y|^{-Y-1} dy \right\} \\
= \exp \left\{ \left( C_+ \int_0^\infty \left( e^{-uM} - 1 + uM \right) u^{-Y-1} du + C_- \int_{-\infty}^0 \left( e^{-uG} - 1 + |u|G \right) |u|^{-Y-1} du \right) \xi Y \right\}.
\]

Finally, using the analytic continuation of the representation (14.19) in [43], we show that the last expression is of the form \( \exp(\eta^* \xi Y) \), with \( \eta^* \) given as in the statement of the Lemma.

For (3.2-ii), we proceed as above to get

\[
\mathbb{E} \left( e^{-\xi t^{-1/Y} \hat{E}_t} \right) = \exp \left\{ C_+ \int_0^\infty \Xi \left( \xi t^{-1/Y} \ln \bar{q}^* \left( t^{1/Y} \right) \right) y^{-Y-1} dy + C_- \int_{-\infty}^0 \Xi \left( \xi t^{-1/Y} \ln \bar{q}^* \left( t^{1/Y} \right) \right) |y|^{-Y-1} dy \right\}.
\]

(A.4)

Now, for all \( y \in \mathbb{R}_0 \),

\[
\xi t^{-1/Y} \ln \bar{q}^* \left( t^{1/Y} \right) = \xi t^{-1/Y} \ln \bar{q} \left( t^{1/Y} \right) + \xi \left( 1 - \frac{1}{\eta t^{1/Y}} \right) \ln \bar{q} \left( t^{1/Y} \right) + \xi \left( 1 - \frac{1}{\eta t^{1/Y}} \right) \ln \bar{q} \left( t^{1/Y} \right) + \xi \left( 1 - \frac{1}{\eta t^{1/Y}} \right) \ln \bar{q} \left( t^{1/Y} \right) + 1 \leq 0,
\]

(A.5)

from both conditions in (2.3). Using (A.5), we can then proceed as above to justify passing the limit into the integrals in (A.4). Next, using (2.10), we conclude that

\[
\lim_{t \to 0} \mathbb{E} \left( e^{-\xi t^{-1/Y} \hat{E}_t} \right) = \exp \left\{ C_+ \int_0^\infty \left( e^{-y\xi M^*} - 1 + y\xi M^* \right) y^{-Y-1} dy + C_- \int_{-\infty}^0 \left( e^{-y\xi G^*} - 1 + |y|\xi G^* \right) |y|^{-Y-1} dy \right\} \\
= \exp \left\{ \left( C_+ \int_0^\infty \left( e^{-uM^*} - 1 + uM^* \right) u^{-Y-1} du + C_- \int_{-\infty}^0 \left( e^{-uG^*} - 1 + |u|G^* \right) |u|^{-Y-1} du \right) \xi^Y \right\}.
\]

Finally, (3.2-ii) follows once more from the analytic continuation of (14.19) in [43].

\[\square\]

**Proof of Lemma 3.3.**
We use a small/large jump type decomposition. Concretely, fix $\varepsilon > 0$ and let

$$ Z^{(\varepsilon)}_t := \int_0^t \int_{|x| \geq \varepsilon} xN(ds, dx), \quad Z^{(\varepsilon)}_t := Z_t - Z^{(\varepsilon)}_t. \quad (A.6) $$

Denote respectively by $(N^{(\varepsilon)}_t)_{t \geq 0}$ and $(\xi^{(\varepsilon)}_t)_{t \geq 1}$ the counting process and sizes of the jumps of $(Z^{(\varepsilon)}_t)_{t \geq 0}$, so that $Z^{(\varepsilon)}_t = \sum_{i=1}^{N^{(\varepsilon)}_t} \xi^{(\varepsilon)}_t$. Next, defined the corresponding processes for $\tilde{U}$:

$$ \tilde{U}^{(\varepsilon)}_t := \int_0^t \int_{|x| \geq \varepsilon} \varphi(x)N(ds, dx) = - \sum_{i=1}^{N^{(\varepsilon)}_t} \ln \tilde{q}^* \left( \xi^{(\varepsilon)}_t \right), \quad \tilde{U}_t := \tilde{U}^{(\varepsilon)}_t - \tilde{U}^{(\varepsilon)}_t. \quad (A.7) $$

Let $\lambda_{\varepsilon} := \mathbb{E}N^{(\varepsilon)}_t$ be the jumps intensity of $Z^{(\varepsilon)}$. We prove the validity of the two assertions in two steps:

1. By conditioning on $N^{(\varepsilon)}_t$,

$$ t^{-1} \mathbb{P} \left( Z^{(\varepsilon)}_t + \tilde{U}_t \geq v \right) = t^{-1} \mathbb{P} \left( Z^{(\varepsilon)}_t + \tilde{U}^{(\varepsilon)}_t \geq v \right) e^{-\lambda_{\varepsilon} t} + e^{-\lambda_{\varepsilon} t} \lambda_{\varepsilon} \mathbb{P} \left( \left( Z^{(\varepsilon)}_t + \xi^{(\varepsilon)}_1 \right)^+ + \tilde{U}^{(\varepsilon)}_t - \ln \tilde{q}^* \left( \xi^{(\varepsilon)}_1 \right) \geq v \right) + O(t). $$

The first term above can be made $O(t)$ by taking $0 < \varepsilon < \varepsilon_0$, for some small enough $\varepsilon_0 > 0$ (see, e.g., [43, Section 26]). For the second term, first note that, from (2.7), there exists $\varepsilon_0 > 0$ such that, for all $0 < \varepsilon < \varepsilon_0$,

$$ a_0(v) := \lambda_{\varepsilon} \mathbb{P} \left( \left( \xi^{(\varepsilon)}_1 \right)^+ - \ln \tilde{q}^* \left( \xi^{(\varepsilon)}_1 \right) \geq v \right) $$

$$ = \int_{\mathbb{R}} 1_{\{x^+ - \ln \tilde{q}^*(x) \geq v\}} \bar{\nu}(dx) = \int_{\mathbb{R}} 1_{\{x - \ln \tilde{q}(x) \geq v\}} \bar{\nu}(dx) $$

$$ = C_+ \int_0^\infty 1_{\{-x - \ln \tilde{q}(x) \geq v\}} x^{-Y-1} dx + C_- \int_{-\infty}^0 1_{\{-x - \ln \tilde{q}(x) \geq v\}} |x|^{-Y-1} dx. $$

Also, since

$$ F_{v,v}(z, u) := \bar{F} \left( \left( z + \xi^{(\varepsilon)}_1 \right)^+ + u - \ln \tilde{q}^* \left( \xi^{(\varepsilon)}_1 \right) \geq v \right) $$

is continuous at $(z, u) = (0, 0)$, for any fixed $0 < \varepsilon < \varepsilon_0$, the function

$$ A_t(v) := t^{-1} \mathbb{P} \left( Z^{(\varepsilon)}_t + \tilde{U}_t \geq v \right) - a_0(v) $$

is such that

$$ \lim_{t \to 0} A_t(v) = \lambda_{\varepsilon} \lim_{t \to 0} \left( \bar{F} \left( \left( Z^{(\varepsilon)}_t + \xi^{(\varepsilon)}_1 \right)^+ + \tilde{U}^{(\varepsilon)}_t - \ln \tilde{q}^* \left( \xi^{(\varepsilon)}_1 \right) \geq v \right) - \lambda_{\varepsilon} \bar{F} \left( \left( \xi^{(\varepsilon)}_1 \right)^+ - \ln \tilde{q}^* \left( \xi^{(\varepsilon)}_1 \right) \geq v \right) \right) $$

$$ = \lambda_{\varepsilon} \lim_{t \to 0} \mathbb{E} \left( \lim_{t \to 0} F_{v,v} \left( Z^{(\varepsilon)}_t, \tilde{U}^{(\varepsilon)}_t \right) - F_{v,v}(0, 0) \right) $$

$$ = \lambda_{\varepsilon} \mathbb{E} \left( \lim_{t \to 0} F_{v,v} \left( Z^{(\varepsilon)}_t, \tilde{U}^{(\varepsilon)}_t \right) - F_{v,v}(0, 0) \right) $$

$$ = 0, $$

where we had used the dominated convergence theorem to obtain the last equality.

2. Throughout, $\tilde{k} > 0$ denotes a generic finite constant that may vary from line to line. First, note that (2.18) implies that

$$ \frac{1}{t} \mathbb{P} \left( Z^{(\varepsilon)}_t \geq v \right) \leq \tilde{k} v^{-Y}, \quad (A.8) $$

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for any $0 < t \leq 1$ and $v > 0$. So, it suffices to show the analog inequality for $\tilde{U}$. Let $\tilde{C} := C_+ + C_-$. Using the decompositions (A.6-A.7) with $\varepsilon = v/4$,

\[
\frac{1}{t} \mathbb{P}\left( \tilde{U}_t^{(c)} \geq v/2 \right) \leq \frac{1}{t} \mathbb{P}\left( N_t^{(c)} \neq 0 \right) = \frac{1}{t} \left( 1 - e^{-\lambda_* t} \right) \leq \lambda_0 \leq \tilde{C} \int_{|x| \geq v/4} |x|^{-Y-1} dx \leq \tilde{k} v^{-Y},
\]

for some $\tilde{k} < \infty$. Then,

\[
\tilde{E} \tilde{U}_t^{(c)} = t \int_{|x| > \varepsilon} \ln \tilde{q}^*(x) \tilde{v}(dx) = t \int_{|x| > \varepsilon} \ln \tilde{q}(x) \tilde{v}(dx) + tC_- \int_{x < -\varepsilon} x|x|^{-Y-1} dx + tC_+ \int_{x > \varepsilon} x|x|^{-Y-1} dx,
\]

and, since $\tilde{q}(x) \leq 1$ for all $x \in \mathbb{R}\setminus\{0\}$ (from (2.3)), $\tilde{E} \tilde{U}_t^{(c)} \leq tC_- \int_{x < -\varepsilon} x|x|^{-Y-1} dx = C_+(Y-1)^{-1}q_{Y}^{-1}v^{-1}Y$. Thus, whenever $t$ and $v$ are such that $C_+(Y-1)^{-1}q_{Y}^{-1}v^{-1}Y \leq v/4$, we have

\[
\mathbb{P}(\tilde{U}_t^{(c)} \geq v/2) \leq \mathbb{P}(\tilde{U}_t^{(c)} \geq v/2) + \mathbb{E}^{\tilde{U}_t^{(c)} = v/2} \leq \mathbb{P}(\tilde{U}_t^{(c)} \geq v/4).
\]

Next, using a concentration inequality for centered random variables (see, e.g., [24], Corollary 1),

\[
\mathbb{P}(\tilde{U}_t^{(c)} \geq v/4) \leq \mathbb{P}(\tilde{U}_t^{(c)} - \tilde{E} \tilde{U}_t^{(c)} \geq v/4) \leq e^{-\frac{v^2}{2}} t \leq \frac{16 e V^2_2}{v^2} t,
\]

where $V^2_2 := \text{Var}(\tilde{U}_t^{(c)})$ and in the last inequality, $\varepsilon = v/4$. Now,

\[
V^2_2 = \text{Var}\left( \tilde{U}_t^{(c)} \right) = \int_{|x| \leq v/4} \ln \tilde{q}^*(x) \tilde{v}(dx) \leq C \int_{|x| \leq v/4} x^2 |x|^{-Y-1} dx \leq \tilde{k} v^{-Y},
\]

for some $\tilde{k} < \infty$, where above, we set $C = \sup_{|x| > 0} |\ln \tilde{q}^*(x)| = |x|$, which is finite in view of both (2.4) and (2.10-ii). Therefore, whenever $C_+(Y-1)^{-1}q_{Y}^{-1}v^{-1}Y \leq v/4$ (or equivalently, $C_+(Y-1)^{-1}q_{Y}^{-1}v^{-1}Y \leq 1$),

\[
\frac{1}{t} \mathbb{P}(\tilde{U}_t^{(c)} \geq v/2) \leq \frac{e V^2_2}{v^2} \leq \tilde{k} v^{-Y},
\]

for some $\tilde{k} < \infty$. Moreover, for any $t > 0$ and $v > 0$,

\[
\frac{1}{t} \mathbb{P}(\tilde{U}_t^{(c)} \geq v/2) = \frac{1}{t} \mathbb{P}(\tilde{U}_t^{(c)} \geq v/2) 1_{\{C_+(Y-1)^{-1}q_{Y}^{-1}v^{-1}Y \leq 1\}} + \frac{1}{t} \mathbb{P}(\tilde{U}_t^{(c)} \geq v/2) 1_{\{C_+(Y-1)^{-1}q_{Y}^{-1}v^{-1}Y > 1\}} \leq \tilde{k} v^{-Y} + \frac{C}{t} (Y-1)^{-1}q_{Y}^{-1}v^{-1}Y \leq \tilde{k'} v^{-Y},
\]

for some constant $\tilde{k'}$. Combining the previous estimates, we finally have

\[
\frac{1}{t} \mathbb{P}(\tilde{U}_t^{(c)} \geq v/2) \leq \frac{e V^2_2}{v^2} \leq \tilde{k} v^{-Y},
\]

for all $v > 0$ and $t > 0$ and some constant $\tilde{k} < \infty$. \hfill \square

**Proof of Theorem 3.4.**

For simplicity, we first treat the case $\tilde{\gamma} = 0$ so that, in light of Lemma 3.1,

\[
t^{-1/Y} \mathbb{E}(S_t - S_0)^+ = e^{-\eta t} \int_0^\infty e^{-t^{1/Y} v} \mathbb{E}(e^{-\tilde{U}_t} 1_{t^{-1/Y} Z_t^* \geq v}) dv.
\]

The general case is resolved in Lemma A.1 below. Let

\[
D(t) := t^{-1/Y} \mathbb{E}(S_t - S_0)^+ - \mathbb{E}(Z_t^+),
\]

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which can be written as
\[
D(t) := \int_0^\infty e^{-\sqrt{t}}v \bar{E} \left( e^{-\bar{\nu}t}1_{\{ t-\sqrt{t} Z, Z \geq v \}} \right) dv - \bar{E}(Z^+_1)
+ (e^{-\eta t} - 1) \bar{E}(Z^+_1)
+ (e^{-\eta t} - 1) \left( \int_0^\infty e^{-\sqrt{t}}v \bar{E} \left( e^{-\bar{\nu}t}1_{\{ t-\sqrt{t} Z, Z \geq v \}} \right) dv - \bar{E}(Z^+_1) \right)
=: D_1(t) + D_2(t) + D_3(t).
\]

We will show that
\[
t^{1/Y-1} D_1(t) \to \vartheta =: \tilde{\vartheta}, \quad \text{as} \quad t \to 0,
\tag{A.12}
\]
for a certain constant \( \vartheta \), while it is clear that \( D_3(t) = o(D_1(t)) \) and that \( t^{1/Y-1} D_2(t) = o(1), \) as \( t \to 0 \). First, note that
\[
D_1(t) = \bar{E} \left( e^{-\bar{\nu}t} \int_0^{t^{1/Y} Z^+_1} e^{-\sqrt{t}}v dv \right) - \bar{E}(Z^+_1)
= t^{-1/Y} \left( \bar{E}(e^{-\bar{\nu}t}) - \bar{E}(e^{-(\bar{\nu}+Z^+_1)}) \right) - \bar{E}(Z^+_1)
= t^{-1/Y} \left( e^{\eta t} - \bar{E}(e^{-(\bar{\nu}+Z^+_1)}) \right) - \bar{E}(Z^+_1),
\tag{A.13}
\]
where to obtain the last equality we have used (2.22). Next, by the self-similarity of \( (Z_t)_{t \geq 0} \) under \( \bar{P} \) (see (2.14)), \( \bar{E}(Z^+_1) = t^{-1/Y} \bar{E}(Z^+_t) \) and, also using that \( \bar{E}(\tilde{U}_t) = 0 \),
\[
t^{1/Y-1} D_1(t) = t^{1/Y-1} \left( \frac{e^{\eta t} - 1}{t^{1/Y}} + \frac{1}{t} \bar{E} \left( \int_0^{Z^+_1+\tilde{U}_t} (e^{-v} - 1) dv 1_{\{ Z^+_1+\tilde{U}_t \geq 0 \}} \right) \right)
= \frac{e^{\eta t} - 1}{t} + \frac{1}{t} \bar{E} \left( \int_0^{Z^+_1+\tilde{U}_t} (e^{-v} - 1) dv 1_{\{ Z^+_1+\tilde{U}_t \geq 0 \}} \right)
\leq \frac{e^{\eta t} - 1}{t} \int_0^{Z^+_1+\tilde{U}_t} (e^{-v} - 1) dv - \frac{1}{t} \int_0^{Z^+_1+\tilde{U}_t} (e^{-v} - 1) dv \tag{A.14}
=: D_{11}(t) + D_{12}(t) + D_{13}(t).
\]
Clearly,
\[
D_{11}(t) \to \eta, \quad \text{as} \quad t \to 0.
\tag{A.15}
\]
Let \( Q_t := Z_t + \tilde{U}_t \) and note that \( Q_t \leq Z^+_1 + \tilde{U}_1 \). Then, for \( D_{13}(t) \), using that \( e^y - 1 \leq ye^y, y > 0 \), Markov’s inequality, and since \( Y < 2 \),
\[
0 \leq D_{1,3}(t) \leq t^{1/Y-1} \int_0^\infty \left( e^{1/Y u} - 1 \right) \bar{P} \left( t^{-1/Y} Q_t \leq -u \right) du
\leq t^{2/Y-1} \int_0^\infty e^{1/Y u} \bar{P} \left( t^{-1/Y} Q_t \leq -u \right) du
\leq t^{2/Y-1} \int_0^\infty e^{(1/Y-1)u} u \bar{E} \left( e^{-t^{-1/Y} Q_t} \right) \overset{t \to 0}{\longrightarrow} 0,
\tag{A.16}
\]
where in the last step we applied (3.2-i).

Let us now deal with \( D_{12} \). First, from (3.4-ii), one can apply dominated convergence and pass the limit inside the integrals so that
\[
\lim_{t \to 0} D_{12}(t) = \int_0^{Z^+_1+\tilde{U}_t \geq v} (e^{-v} - 1) \lim_{t \to 0} \left( t^{-1} \bar{P} \left( Z^+_1 + \tilde{U}_t \geq v \right) \right) dv.
\tag{A.16}
\]
From (3.3), we then have
\[
\lim_{t \to 0} D_{12}(t) = \int_0^\infty (e^{-v} - 1) \int_{\mathbb{R}_0} 1_{\{x - \ln \tilde{q}(x) \geq v\}} \nu(dx)dv =: \vartheta. \tag{A.17}
\]
Combining (A.14), (A.15), (A.16), and (A.17), it follows that
\[
\lim_{t \to 0} t^{1/Y - 1} \left( t^{-\frac{\gamma}{Y + 1}} E(S_t - S_0)^+ - \tilde{E}(Z_1^+) \right) = \lim_{t \to 0} t^{1/Y - 1} D_1(t) = \vartheta + \eta. \tag{A.18}
\]
Finally, to get the expression in (3.6), recall that \( \nu(dx) = |x|^{-Y - 1} \left( C_+ 1_{\{x > 0\}} + C_- 1_{\{x < 0\}} \right) dx \) and, thus, applying Fubini’s theorem to the right-hand side of (A.17) gives
\[
\vartheta = C_+ \int_0^\infty (e^{-v} - 1) \int_0^\infty 1_{\{x - \ln \tilde{q}(x) \geq v\}} x^{-Y - 1}dx dv + C_- \int_0^\infty (e^{-v} - 1) \int_0^\infty 1_{\{x - \ln \tilde{q}(x) \geq v\}} |x|^{-Y - 1}dx dv
\]
\[
= C_+ \int_0^\infty \int_0^\infty (e^{-v} - 1) dx x^{-Y - 1}dv + C_- \int_0^\infty \int_0^\infty (e^{-v} - 1) dx |x|^{-Y - 1}dv
\]
\[
= C_+ \int_0^\infty \left( 1 - e^{\ln \tilde{q}(x)} \right) \left( 1 - \ln \tilde{q}(x) - x \right) x^{-Y - 1}dx + C_- \int_0^\infty \left( 1 - e^{x + \ln \tilde{q}(x)} + x + \ln \tilde{q}(x) \right) |x|^{-Y - 1}dx.
\]
One can similarly show that the constant \( \eta \) defined in (2.21) can be written as:
\[
\eta = C_+ \int_0^\infty \left( e^{x + \ln \tilde{q}(x)} - 1 - \ln \tilde{q}(x) - x \right) x^{-Y - 1}dx + C_- \int_0^\infty \left( e^{x + \ln \tilde{q}(x)} - 1 - \ln \tilde{q}(x) - x \right) |x|^{-Y - 1}dx.
\]
Combining both expressions for \( \vartheta \) and \( \eta \) yields (3.6). The expression for \( \tilde{\gamma} \) in (3.7) follows from
\[
\tilde{\gamma} = \tilde{E}L_1^* = \tilde{b} + \int_{\{|x| > 1\}} x\nu(dx) = b^* + \int_{\{|x| < 1\}} x(\nu - \nu^*)(dx) + \int_{\{|x| > 1\}} x\nu(dx),
\]
and standard simplifications. This concludes the proof. \( \square \)

**Lemma A.1.** If \( \tilde{\gamma} \neq 0 \) in (3.1), then
\[
\lim_{t \to 0} t^{1/Y - 1} \left( t^{-\frac{\gamma}{Y + 1}} E(S_t - S_0)^+ - S_0 \tilde{E}(Z_1^+) \right) = \tilde{\vartheta} + \tilde{\gamma} \tilde{P}(Z_1 \geq 0). \tag{A.19}
\]

**Proof.** Without loss of generality, fix \( S_0 = 1 \) and also assume that \( \tilde{\gamma} > 0 \) (the case \( \tilde{\gamma} < 0 \) being similar). Using (3.1),
\[
t^{1/Y - 1} \left( t^{-\frac{\gamma}{Y + 1}} E(S_t - S_0)^+ - \tilde{E}(Z_1^+) \right) = t^{1/Y - 1} \left( e^{-(\tilde{\gamma} + \eta)t} \int_0^\infty e^{-t^{1/Y}vE} \left( e^{-\tilde{\vartheta}t} 1_{\{t^{1/Y}Z_t \geq v\}} \right) dv - \tilde{E}(Z_1^+) \right)
\]
\[
+ t^{1/Y - 1} e^{-(\tilde{\gamma} + \eta)t} \int_0^\infty \tilde{E} \left( e^{-\tilde{\vartheta}t} 1_{\{t^{1/Y}Z_t \geq v\}} \right) dv
\]
\[
=: \tilde{D}_{11}(t) + \tilde{D}_{12}(t).
\]
As in the proof of (A.12), it can be shown that
\[
\lim_{t \to 0} \tilde{D}_{11}(t) = \tilde{\vartheta}. \tag{A.20}
\]
For \( \tilde{D}_{12}(t) \), changing variables to \( u = t^{1/Y - 1}v \) and probability measure to \( P^\gamma \), we have
\[
\tilde{D}_{12}(t) = e^{-\tilde{\gamma}t} \int_{-\gamma}^0 e^{-tuP} \left( e^{-\tilde{\vartheta}t} 1_{\{Z_t \geq tu\}} \right) du = e^{-\tilde{\gamma}t} \int_{-\gamma}^0 e^{-tuP^\gamma} \left( t^{-1/Y}Z_t \geq t^{1/Y}u \right) du.
\]
Next, recall from Section 2 that, under $P^*$, $(L_t^*)_{t \geq 0}$ is a Lévy process with Lévy measure $\nu^*$ given by

$$\nu^*(dx) := e^x \nu(dx) = e^x s(x)dx = q^*(x)|x|^{-Y-1}dx.$$ 

In particular, $\lim_{x \to 0} q^*(x) = C_+$ and $\lim_{x \to \infty} q^*(x) = C_-$ and, since $1 < Y < 2$, the assumptions of Proposition 1 in [40] are satisfied. Therefore, we conclude that $t^{-1/Y} L_t'$ as well as $t^{-1/Y} Z_t$ converge in distribution to a $Y$-stable random variable $\tilde{Z}$ under $P^*$ with center (or mean) 0 and Lévy measure $|x|^{-Y-1}(C_+1_{\{x>0\}} + C_-1_{\{x<0\}})dx$. Hence, the distribution of $\tilde{Z}$ (under $P^*$) is the same as the distribution of $Z_1$ under $P$. Thus, Slutsky’s lemma implies that $t^{-1/Y} Z_t - t^{1-1/Y} u \xrightarrow{d} \tilde{Z}$ and, thus,

$$\lim_{t \to 0} P^* \left( t^{-1/Y} Z_t - t^{1-1/Y} u \geq 0 \right) = P^* \left( \tilde{Z} \geq 0 \right) = \tilde{P} (Z_1 \geq 0).$$

Finally, by the dominated convergence theorem,

$$\lim_{t \to 0} \tilde{D}_{12}(t) = \gamma \tilde{P} (Z_1 \geq 0).$$

Combining (A.21) with (A.20) leads to (A.19).

**Proof of Proposition 3.7.**

The small-time asymptotic behavior of the ATM call option price $C_{BS}(t, \sigma)$ at maturity $t$ under the Black-Scholes model with volatility $\sigma$ and zero interest rates is given by (e.g., see [21, Corollary 3.4] and also recall that $S_0 = 1$)

$$C_{BS}(t, \sigma) = \frac{\sigma}{\sqrt{2\pi}} t^{1/2} - \frac{\sigma^3}{24\sqrt{2\pi}} t^{3/2} + O(t^{5/2}), \quad t \to 0.$$  

(A.22)

To derive the small-time asymptotics for the implied volatility, we need a result analogous to (A.22) when $\sigma$ is replaced by $\hat{\sigma}(t)$. The following representation taken from [39, Lemma 3.1] will be useful,

$$C_{BS}(t, \hat{\sigma}(t)) = F(\sigma \sqrt{t}) \quad \text{with} \quad F(\theta) := \int_0^\theta \Phi' \left( \frac{v}{\sqrt{2}} \right) dv = \frac{1}{\sqrt{2\pi}} \int_0^\theta \exp \left( -\frac{v^2}{8} \right) dv,$$

together with the Taylor expansion for $F$ at $\theta = 0$ (see [39, Lemma 5.1]); i.e.,

$$F(\theta) = \frac{1}{\sqrt{2\pi}} \theta - \frac{1}{24\sqrt{2\pi}} \theta^3 + O(\theta^5), \quad \theta \to 0.$$

Then, since $\hat{\sigma}(t) \to 0$ as $t \to 0$ (see, e.g., [44, Proposition 5]), we conclude that

$$C_{BS}(t, \hat{\sigma}(t)) = \frac{\hat{\sigma}(t)}{\sqrt{2\pi}} t^{1/2} - \frac{\hat{\sigma}(t)^3}{24\sqrt{2\pi}} t^{3/2} + O \left( (\hat{\sigma}(t) t^{1/2})^5 \right), \quad t \to 0.$$  

(A.23)

Returning to the proof of Proposition 3.7, by equating (3.9) and (A.23) and comparing the first order terms,

$$\tilde{E}(Z_1^+)^{1/Y} \sim \frac{\hat{\sigma}(t)}{\sqrt{2\pi}} t^{1/2}, \quad t \to 0,$$

and, therefore,

$$\hat{\sigma}(t) \sim \sqrt{2\pi} \tilde{E}(Z_1^+) t^{1/Y} \sim \frac{\hat{\sigma}(t)}{\sqrt{2\pi}} t^{1/2}, \quad t \to 0.$$  

(A.24)

Next, set $\hat{\sigma}(t) = \hat{\sigma}(t) - \sigma_1 t^{1/Y}$. By comparing the first and second order terms in (3.9) with the first term in (A.23) (noting that the second order term in (A.23) is $o(t)$),

$$\left( \hat{\bar{\sigma}} + \gamma \tilde{P}(Z_1 \geq 0) \right) t \sim \frac{\hat{\sigma}(t)}{\sqrt{2\pi}} t^{1/2}, \quad t \to 0.$$

Hence, $\hat{\sigma}(t) \to 0$ as $t \to 0$, and moreover

$$\hat{\sigma}(t) \sim \sqrt{2\pi} \left( \hat{\bar{\sigma}} + \gamma \tilde{P}(Z_1 \geq 0) \right) t^{1/2}, \quad t \to 0.$$  

(A.25)

Combining (A.24) and (A.25) finishes the proof.
B Proofs of Section 4: pure-jump with a Brownian component

Proof of Theorem 4.1.

For simplicity, fix $S_0 = 1$. Recalling that $X_t = \sigma W_t^* + L_t^*$ under $\mathbb{P}^*$, and using (1.11), the self-similarity of $W^*$, and the change of variable $u = t^{-1/2}x$, we have

$$R_t := t^{-1/2} \mathbb{E}(S_t - S_0)_+ - \sigma \mathbb{E}^*(W_1^*)_+ = \int_0^\infty e^{-\sqrt{t}y} \mathbb{P}^* \left( \sigma W_1^* \geq u - t^{-1/2}L_t^* \right) du - \int_0^\infty \mathbb{P}^* (\sigma W_1^* \geq u) du.$$

Next, changing the probability measure to $\tilde{\mathbb{P}}$, using that $L_t^* = Z_t + \gamma t$, $U_t = \tilde{U}_t + \eta t$, and the change of variable $y = u - t^{1/2}\gamma$ in the first integral above, lead to

$$R_t = \int_0^\infty e^{-\sqrt{t}y-\gamma t} \tilde{\mathbb{E}} e^{-\tilde{U}_t - \eta t} 1_{\{\sigma W_t^* \geq y - t^{-1/2}Z_t\}} \, dy - \int_0^\infty \tilde{\mathbb{E}} e^{-\tilde{U}_t - \eta t} 1_{\{\sigma W_t^* \geq u\}} du$$

$$= -e^{-(\eta + \gamma)t} \int_0^\infty e^{-\sqrt{t}y} \left( \tilde{\mathbb{E}} e^{-\tilde{U}_t} 1_{\{\sigma W_t^* \geq y - t^{-1/2}Z_t\}} - \tilde{\mathbb{E}} e^{-\tilde{U}_t} 1_{\{\sigma W_t^* \geq y\}} \right) dy$$

$$+ e^{-(\eta + \gamma)t} \int_{-\sqrt{t}/\gamma}^0 e^{-\sqrt{t}y} \tilde{\mathbb{E}} e^{-\tilde{U}_t} 1_{\{\sigma W_t^* \geq y - t^{-1/2}Z_t\}} \, dy$$

$$+ \int_0^\infty \left( e^{-\gamma t - \sqrt{t}y} - 1 \right) \mathbb{P}^* (\sigma W_t^* \geq y) dy. \tag{B.1}$$

Above, the last term is clearly $O(t^{1/2})$ as $t \to 0$, while the second term can be shown to be asymptotically equivalent to a term that is $O(t^{1/2})$ by arguments analogous to those of (A.21). Thus, we only need to study the term in (B.1), which we hereafter denote by $A_t$. This term can further be expressed as:

$$A_t = e^{-\tilde{\eta}t} \tilde{\mathbb{E}} \left( -\tilde{\mathbb{E}} \int_0^\infty e^{-\sqrt{t}y} \left( 1_{\{\sigma W_t^* \geq y - t^{-1/2}Z_t\}} - 1_{\{\sigma W_t^* \geq y\}} \right) \, dy \right),$$

where we had set $\tilde{\eta} := \eta + \gamma$. To study the asymptotic behavior of $A_t$, decompose it into the following three parts:

$$A_t = e^{-\tilde{\eta}t} \tilde{\mathbb{E}} \left( -\tilde{\mathbb{E}} \int_{\sigma W_t^* \geq 0} e^{-\sqrt{t}y} 1_{\{\sigma W_t^* \geq y - t^{-1/2}Z_t\}} \, dy \right)$$

$$- e^{-\tilde{\eta}t} \tilde{\mathbb{E}} \left( -\tilde{\mathbb{E}} \int_{0 \leq \sigma W_t^* \leq -t^{-1/2}Z_t} e^{-\sqrt{t}y} \, dy \right)$$

$$+ e^{-\tilde{\eta}t} \tilde{\mathbb{E}} \left( -\tilde{\mathbb{E}} \int_{0 \leq -\sigma W_t^* \leq -t^{-1/2}Z_t} e^{-\sqrt{t}y} \, dy \right)$$

$$=: I_1(t) - I_2(t) + I_3(t). \tag{B.2}$$

We analyze each of these terms in the following three steps:

**Step 1.** Since $(Z_t)_{t \geq 0}$ and $(W_t^*)_{t \geq 0}$ are independent,

$$I_1(t) = e^{-\tilde{\eta}t} \tilde{\mathbb{E}} \left( -\tilde{\mathbb{E}} \int_{\sigma W_t^* \geq 0} e^{-\sqrt{t}y} 1_{\{\sigma W_t^* \geq y - t^{-1/2}Z_t\}} \, dy \right)$$

$$= e^{-\tilde{\eta}t} \int_0^\infty \tilde{\mathbb{E}} \left( e^{-\tilde{U}_t} \left( 1 - e^{-Z_t} \right) \right) \, dy$$

$$=: e^{-\tilde{\eta}t} \int_0^\infty J_1(t, y) e^{-\sqrt{2\pi\sigma^2}y} \, dy. \tag{B.3}$$
Using the self-similarity of \((Z_t)_{t \geq 0}\) and since \(\mathbb{E}Z_t = 0\), \(J_1(t, y)\) is then decomposed as:

\[
J_1(t, y) = \mathbb{E} \left( 1_{\{Z_t \geq -t^{\frac{1}{2}} y\}} \left( e^{-\tilde{U}_t} - e^{-((\tilde{U}_t + Z_t))} \right) - t^{-\frac{1}{2}} Z_t \right) + t^{\frac{1}{2}} - \mathbb{E} \left( (-Z_1) 1_{\{-Z_1 \geq t^{\frac{1}{2}} + y\}} \right)
\]

\[=: J_{11}(t, y) + J_{12}(t, y).\]  

(B.4)

Let us first consider \(J_{12}(t, y)\). From (2.15)-(2.17), there exists a constant \(\lambda > 0\) such that

\[
t^{\frac{Y}{2} - 1} J_{12}(t, y) \leq \lambda y^{1-Y},
\]

for any \(0 < t \leq 1\) and \(y > 0\) (see Appendix C for the verification of this claim). Moreover, for any fixed \(y > 0\),

\[
t^{\frac{Y}{2} - 1} J_{12}(t, y) = t^{\frac{Y}{2} + \frac{1}{2} - \frac{1}{2}} \int_{t^{\frac{1}{2}} + y}^{\infty} u_pZ(-u)du = t^{\frac{Y}{2} - \frac{1}{2} - \frac{1}{2}} \int_y^{\infty} wpZ(-t^{\frac{1}{2}} - \frac{1}{2} w)dw.
\]

Using (2.15), there exists \(0 < t_0 < 1\) such that

\[
t^{\frac{Y}{2} - \frac{1}{2} - \frac{1}{2}} wpZ(-t^{\frac{1}{2}} - \frac{1}{2} w) \leq 2(C_+ \vee C_-) w^{-Y},
\]

for any \(0 < t < t_0\) and \(w \geq y\). Therefore, by the dominated convergence theorem, and in light of (2.15), we get:

\[
\lim_{t \to 0} t^{\frac{Y}{2} - 1 - e^{-mt}} \int_0^{\infty} J_{12}(t, y)e^{-\sqrt{t}y} \frac{e^{-\frac{y^2}{2\sigma^2}}}{\sqrt{2\pi \sigma^2}} dy
\]

\[
= \int_0^{\infty} \left( t^{\frac{Y}{2} - 1} \lim_{t \to 0} J_{12}(t, y) \right) e^{-\frac{y^2}{2\sigma^2}} \frac{dy}{\sqrt{2\pi \sigma^2}}
\]

\[
= \int_0^{\infty} \left( \int_y^{\infty} \left( \lim_{t \to 0} t^{\frac{Y}{2} + \frac{1}{2} - \frac{1}{2}} wpZ(-u) du \right) \frac{e^{-\frac{y^2}{2\sigma^2}}}{\sqrt{2\pi \sigma^2}} dy \right)
\]

\[
= C_- \int_0^{\infty} \left( \int_y^{\infty} \frac{w^{-Y} dw}{\sqrt{2\pi \sigma^2}} \right) \frac{e^{-\frac{y^2}{2\sigma^2}}}{\sqrt{2\pi \sigma^2}} dy = \frac{C_-}{Y - 1} \int_0^{\infty} y^{1-Y} \frac{e^{-\frac{y^2}{2\sigma^2}}}{\sqrt{2\pi \sigma^2}} dy.
\]

(B.6)

For \(J_{11}(t, y)\),

\[
J_{11}(t, y) = t^{-\frac{1}{2}} \mathbb{E} \left( 1_{\{Z_t \geq 0\}} \int_{\tilde{U}_t}^{\tilde{U}_t + Z_t} \frac{e^{-x} - 1}{\sqrt{t}} dx \right) - t^{-\frac{1}{2}} \mathbb{E} \left( 1_{\{-\tilde{U}_t \geq Z_t \leq 0\}} \int_{\tilde{U}_t}^{\tilde{U}_t + Z_t} \frac{e^{-x} - 1}{\sqrt{t}} dx \right)
\]

\[
= t^{-\frac{1}{2}} \int_{\tilde{U}_t}^{\tilde{U}_t + Z_t} \left( e^{-x} - 1 \right) T_1(t, x, y) dx - t^{-\frac{1}{2}} \int_{\tilde{U}_t}^{\tilde{U}_t + Z_t} \left( e^{-x} - 1 \right) T_2(t, x, y) dx,
\]

(B.7)

where, for \(t > 0\) and \(y > 0\), we set

\[
T_1(t, x, y) := \tilde{F}(Z_t \geq 0, \tilde{U}_t \leq x \leq \tilde{U}_t + Z_t), \quad T_2(t, x, y) := \tilde{F}(Z_t \leq 0, \tilde{U}_t + Z_t \leq x \leq \tilde{U}_t).
\]

By (3.4-ii), there exists \(\kappa > 0\) such that, for any \(x > 0\) and \(0 < t \leq 1\),

\[
T_1(t, x, y) \leq \tilde{F}(x \leq \tilde{U}_t + Z_t) \leq \tilde{F}(x \leq \tilde{U}_t + Z_t) \leq \kappa t x^{-Y}.
\]

(B.8)

Hence,

\[
0 \leq e^{-\frac{t}{2} \frac{Y}{2} - 1} \int_0^{\infty} \int_0^{\infty} \frac{(1 - e^{-x})}{\sqrt{t}} T_1(t, x, y) dx \frac{e^{-\sqrt{t}y} e^{-\frac{y^2}{2\sigma^2}}}{\sqrt{2\pi \sigma^2}} dy
\]

\[
\leq e^{-\frac{t}{2} \kappa \frac{Y}{2} - 1} \int_0^{\infty} \int_0^{\infty} (1 - e^{-x}) x^{-Y} dx \frac{e^{-\frac{y^2}{2\sigma^2}}}{\sqrt{2\pi \sigma^2}} dy \to 0.
\]

(B.9)
as \( t \to 0 \), since \( Y > 1 \). Similarly, using (3.4-i), there exists a constant \( \tilde{k} < \infty \) such that

\[
T_2(t, x, y) \leq \tilde{P}(\tilde{U}_t \geq x) \leq \tilde{k}tx^{-Y},
\]

for any \( x > 0 \) and \( 0 < t \leq 1 \), and, thus, as in (B.9),

\[
\lim_{t \to 0} e^{-\tilde{\kappa}t} \int_0^\infty \int_0^\infty \frac{(1 - e^{-x})}{\sqrt{t}} T_2(t, x, y) dx \frac{e^{-\sqrt{t}y}e^{-\frac{y^2}{2\sigma^2}}}{\sqrt{2\pi \sigma^2}} dy = 0.
\]

(B.11)

For \( x < 0 \), using (3.2-ii) and Markov’s inequality, there exist \( 0 < t_0 < 1 \) and \( \tilde{k} < \infty \) such that

\[
T_1(t, x, y) \leq \tilde{P}(t^{-1/Y}\tilde{U}_t \leq t^{-\frac{1}{Y}}x) \leq \tilde{E}(e^{-t^{-1/Y}\tilde{U}_t})e^{t^{-1/Y}x} \leq \tilde{k}e^{t^{-1/Y}x},
\]

(B.12)

for any \( 0 < t \leq t_0 \). Therefore,

\[
0 \leq t^{\frac{Y-3}{2}} 0 \leq t^{-\frac{Y-3}{2}} \int_0^\infty (e^{-x} - 1)T_1(t, x, y) dx \leq \tilde{k}t^{\frac{Y-3}{2}} \int_0^\infty \left( (t^{\frac{1}{Y}} - 1)x - e^{t^{-1/Y}x} \right) dx = \tilde{k}t^{\frac{Y-3}{2}} \frac{t^{\frac{2}{Y}}}{1 - t^{\frac{1}{Y}}}
\]

Hence, by the dominated convergence theorem,

\[
0 \leq e^{-\tilde{\kappa}t^{\frac{Y-3}{2}}} \int_0^\infty \int_0^\infty e^{-\sqrt{t}y} \frac{e^{-\frac{y^2}{2\sigma^2}}}{\sqrt{2\pi \sigma^2}} dy \leq \tilde{k}t^{\frac{Y-3}{2}} \frac{t^{\frac{2}{Y}}}{1 - t^{\frac{1}{Y}}} \int_0^\infty \frac{e^{-\frac{y^2}{2\sigma^2}}}{\sqrt{2\pi \sigma^2}} dy \to 0,
\]

as \( t \to 0 \), since \( 2/Y > 1 > (3 - Y)/2 \), for \( 1 < Y < 2 \). Similarly, using (3.2-i), for \( x < 0 \),

\[
T_2(t, x, y) \leq \tilde{P}(\tilde{U}_t + Z_t \leq x) \leq \tilde{E} \left( e^{-t^{-1/Y}(\tilde{U}_t + Z_t)} \right) e^{t^{-1/Y}x} \leq \tilde{k}e^{t^{-1/Y}x},
\]

for any \( 0 < t \leq t_0 \) and some constant \( \tilde{k} \). Therefore, as in (B.13),

\[
\lim_{t \to 0} e^{-\tilde{\kappa}t^{\frac{Y-3}{2}}} \int_0^\infty \int_0^\infty \frac{(1 - e^{-x})}{\sqrt{t}} T_2(t, x, y) dx \frac{e^{-\sqrt{t}y}e^{-\frac{y^2}{2\sigma^2}}}{\sqrt{2\pi \sigma^2}} dy = 0.
\]

(B.14)

Combining (B.6), (B.9), (B.11), (B.13) and (B.14), we finally obtain

\[
\lim_{t \to 0} t^{\frac{Y-3}{2} - 1}I_1(t) = \frac{C_Y}{Y - 1} \int_0^\infty y^{1-Y} \frac{e^{-\frac{y^2}{2\sigma^2}}}{\sqrt{2\pi \sigma^2}} dy.
\]

(B.15)

**Step 2.** Next, we study the asymptotic behavior of \( I_2(t) \). Using the independence of \( (Z_t)_{t \geq 0} \) and \( (W_t^x)_{t \geq 0} \),

\[
I_2(t) = e^{-\tilde{\kappa}t} \tilde{E} \left( e^{-\tilde{U}_t} 1_{\{0 \leq \sigma W_t^x \leq -t^{-\frac{3}{2}} Z_t\}} \frac{1 - e^{-\sqrt{t}\sigma W_t^x}}{\sqrt{t}} \right)
\]

\[
= e^{-\tilde{\kappa}t} \int_0^\infty \tilde{E} \left( e^{-\tilde{U}_t} 1_{\{Z_t \leq -t^{-\frac{3}{2}} y\}} \right) \frac{1 - e^{-\sqrt{t}y} e^{-\frac{y^2}{2\sigma^2}}}{\sqrt{2\pi \sigma^2}} dy
\]

\[
= e^{-\tilde{\kappa}t} \int_0^\infty \tilde{E} \left( (e^{-\tilde{U}_t} - 1) 1_{\{Z_t \leq -t^{-\frac{3}{2}} y\}} \right) \frac{1 - e^{-\sqrt{t}y} e^{-\frac{y^2}{2\sigma^2}}}{\sqrt{2\pi \sigma^2}} dy
\]

\[
+ e^{-\tilde{\kappa}t} \int_0^\infty \tilde{P}(Z_t \leq -t^{-\frac{3}{2}} y) \frac{1 - e^{-\sqrt{t}y} e^{-\frac{y^2}{2\sigma^2}}}{\sqrt{2\pi \sigma^2}} dy.
\]

(B.16)

By (2.18) and the self-similarity of \( (Z_t)_{t \geq 0} \), for \( y > 0 \),

\[
\tilde{P}(Z_t \leq -t^{-\frac{3}{2}} y) \frac{1 - e^{-\sqrt{t}y}}{\sqrt{t}} = \tilde{P}(Z_1 \leq -t^{-\frac{3}{2}} y) \frac{1 - e^{-\sqrt{t}y}}{\sqrt{t}} \leq \kappa t^{\frac{1-Y}{2}} y^{1-Y} \leq \kappa y^{1-Y},
\]

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which, when multiplied by \( \exp(-y^2/2\sigma^2) \), becomes integrable on \([0, \infty)\). Hence, by (2.17) and the dominated convergence theorem,

\[
\lim_{t \to 0} t^{-1/2}e^{-\kappa t} \int_0^\infty \tilde{\mathbb{P}}(Z_t \leq -t^{1/2}y) \frac{1 - e^{-\sqrt{t}y} e^{-\frac{y^2}{2\sigma^2}}}{\sqrt{t}} dy = C_\gamma \int_0^\infty y^{1-Y} e^{-\frac{y^2}{2\sigma^2}} dy.
\]  

(B.17)

To find the asymptotic behavior of the first integral in (B.16), we decompose it as:

\[
\tilde{\mathbb{E}} \left( (e^{-\tilde{U}_t} - 1) \mathbf{1}_{\{Z_t \leq -t^{1/2}y\}} \right) = \tilde{\mathbb{E}} \left( \mathbf{1}_{\{Z_t \leq -t^{1/2}y, \tilde{U}_t < 0\}} \int_0^0 e^{-u} du \right) - \tilde{\mathbb{E}} \left( \mathbf{1}_{\{Z_t \leq -t^{1/2}y, \tilde{U}_t \geq 0\}} \int_0^0 e^{-u} du \right)
\]

= \(J_{21}(t, y) + J_{22}(t, y)\).  

(B.18)

For \(J_{21}(t, y)\), using Markov’s inequality and (3.2-ii), there exist \(\tilde{k} < \infty\) and \(0 < t_0 < 1\) such that

\[
J_{21}(t, y) = \int_{-\infty}^0 e^{-x} \tilde{\mathbb{P}}(Z_t \leq -t^{1/2}y, t^{1/2} \tilde{U}_t \leq t^{1/2}x) dx
\]

\[
\leq \tilde{\mathbb{E}}(e^{-t^{1/2}/Y} \tilde{U}_t) \int_{-\infty}^0 e^{-x} \exp(t^{1/2}x) dx \leq \tilde{k} t^{1/2} \frac{t^{1/2}}{1 - t^{1/2}},
\]

for any \(0 < t < t_0\) and \(y \geq 0\). Since \(1 - Y/2 < 1/2 < 1/Y\), for \(1 < Y < 2\), by the dominated convergence theorem,

\[
0 \leq t^{1/2} e^{-\kappa t} \int_0^\infty J_{21}(t, y) \frac{1 - e^{-\sqrt{t}y} e^{-\frac{y^2}{2\sigma^2}}}{\sqrt{t}} dy \leq \tilde{k} t^{1/2} \frac{t^{1/2}}{1 - t^{1/2}} \int_0^\infty y e^{-\frac{y^2}{2\sigma^2}} dy \to 0.
\]  

(B.19)

We further decompose the second term \(J_{22}(t, y)\) in (B.18) as:

\[
J_{22}(t, y) = \tilde{\mathbb{E}} \left( (e^{-\tilde{U}_t} - 1 + \tilde{U}_t) \mathbf{1}_{\{Z_t \leq -t^{1/2}y, \tilde{U}_t \geq 0\}} \right) - \tilde{\mathbb{E}} \left( \tilde{U}_t \mathbf{1}_{\{Z_t \leq -t^{1/2}y, \tilde{U}_t \geq 0\}} \right)
\]

= \(J_{22}^{(1)}(t, y) - J_{22}^{(2)}(t, y)\).  

(B.20)

Using (3.4-i) and the fact that \(1 - Y/2 < 1/2 < 1/Y\), for \(1 < Y < 2\),

\[
0 \leq J_{22}^{(2)}(t, y) \leq t^{1/2} \tilde{\mathbb{E}} \left( (t^{1/Y} \tilde{U}_t) e^{-t^{1/Y} \tilde{U}_t} \right)^+
\]

\[
= t^{1/Y} \int_0^\infty f \left( t^{1/Y} \tilde{U}_t \geq u \right) du
\]

\[
\leq t^{1/Y} \left( 1 + \int_1^\infty f \left( t^{1/Y} \tilde{U}_t \geq u \right) du \right)
\]

\[
\leq t^{1/Y} \left( 1 + \int_1^\infty \tilde{k} \tilde{t} (t^{1/Y} u)^{-Y} du \right),
\]  

(B.21)

which is clearly \(o(t^{1-\frac{Y}{2}})\). Moreover,

\[
J_{22}^{(1)}(t, y) = \tilde{\mathbb{E}} \left( \int_0^\infty (1 - e^{-w}) dw \mathbf{1}_{\{Z_t \leq -t^{1/2}y, \tilde{U}_t \geq 0\}} \right)
\]

\[
= \int_0^\infty (1 - e^{-w}) \tilde{\mathbb{P}} \left( \tilde{U}_t \geq w, Z_t \leq -t^{1/2}y \right) dw
\]

\[
\leq \int_0^\infty (1 - e^{-w}) \tilde{\mathbb{P}} \left( \tilde{U}_t \geq w \right) dw.
\]

Using (B.10), \((1 - e^{-\sqrt{t}y})/\sqrt{t} \leq y\), for \(y > 0\), and applying the dominated convergence theorem, we get

\[
0 \leq t^{1/2} e^{-\kappa t} \int_0^\infty J_{22}^{(1)}(t, y) \frac{1 - e^{-\sqrt{t}y} e^{-\frac{y^2}{2\sigma^2}}}{\sqrt{t}} dy \leq \tilde{k} \int_0^\infty (1 - e^{-w}) w^{-Y} dw \int_0^\infty y e^{-\frac{y^2}{2\sigma^2}} dy \to 0,
\]  

(B.22)
as $t \to 0$. Combining (B.17), (B.19), (B.21) and (B.22) lead to

$$\lim_{t \to 0} t^{\frac{31}{2}} I_2(t) = \frac{C_-}{Y} \int_{0}^{\infty} y^{1 - \gamma} e^{-\frac{y^2}{2\pi \sigma^2}} dy. \quad (B.23)$$

**Step 3.** We finally study the behavior of $I_3(t)$. Note that

$$I_3(t) = e^{-\bar{\eta}t} \int_{0}^{\infty} \mathbb{E} \left( e^{-\bar{\theta}t} 1_{\{Z_i \geq t^{\frac{31}{2}}y\}} \frac{1 - e^{\sqrt{t}y}}{\sqrt{t}} \right) e^{-\frac{y^2}{2\pi \sigma^2}} dy$$

$$= e^{-\bar{\eta}t} \int_{0}^{\infty} \mathbb{E} \left( e^{-\bar{\theta}t} 1_{\{Z_i \geq t^{\frac{31}{2}}y\}} \right) \frac{1 - e^{\sqrt{t}y}}{\sqrt{t}} e^{-\frac{y^2}{2\pi \sigma^2}} dy$$

$$+ e^{-\bar{\eta}t} \int_{0}^{\infty} \mathbb{E} \left( e^{-\bar{\theta}t} 1_{\{Z_i \geq t^{\frac{31}{2}}y\}} \right) e^{\sqrt{t}y} e^{-\frac{y^2}{2\pi \sigma^2}} dy. \quad (B.24)$$

We first investigate $J_{31}(t, y) := \mathbb{E} \left( e^{-\bar{\theta}t} 1_{\{Z_i \geq t^{\frac{31}{2}}y\}} \right)$ by decomposing it as:

$$J_{31}(t, y) = \mathbb{E} \left( e^{-\bar{\theta}t} - 1 \right) 1_{\{Z_i \geq t^{\frac{31}{2}}y\}} + \mathbb{P} \left( Z_i \geq t^{\frac{31}{2}}y \right)$$

$$=: J_{31}^{(1)}(t, y) + J_{31}^{(2)}(t, y). \quad (B.25)$$

By (2.18), it is easy to see that $J_{31}^{(2)}(t, y) \leq \kappa t^{1 - \gamma} y^{-\gamma}$, for any $0 < t \leq 1$ and $y \geq 0$. Hence, dominated convergence theorem together with (2.16) lead to

$$\lim_{t \to 0} e^{-\bar{\eta}t} t^{\frac{31}{2}} J_{31}^{(2)}(t, y) \int_{0}^{\infty} 1_{\{Z_i \geq t^{\frac{31}{2}}y, \bar{\theta}t \geq -u\}} du = - \frac{C_+}{Y} \int_{0}^{\infty} y^{1 - \gamma} e^{-\frac{y^2}{2\pi \sigma^2}} dy. \quad (B.26)$$

As before, $J_{31}^{(1)}(t, y)$ can be further decomposed as

$$J_{31}^{(1)}(t, y) = \mathbb{E} \left( \left( e^{-\bar{\theta}t} - 1 \right) 1_{\{Z_i \geq t^{\frac{31}{2}}y, \bar{\theta}t \geq -u\}} \right) + \int_{0}^{\infty} e^{\bar{\eta}t} \mathbb{P} \left( Z_i \geq t^{\frac{31}{2}}y, \bar{\theta}t \geq -u \right) du.$$

Now, for $u > 0$, $y > 0$ and $t > 0$, by Markov’s inequality and (3.2-ii), there exist $\bar{\kappa} < \infty$ and $0 < t_0 < 1$, such that

$$\mathbb{P} \left( Z_i \geq t^{\frac{31}{2}}y, \bar{\theta}t \geq -u \right) \leq \mathbb{P}(\bar{\theta}t \leq -u) \leq \mathbb{E} \left( e^{t^{1/Y}u} \right) \leq \tilde{\kappa} e^{-t^{1/Y}u}, \quad (B.27)$$

for all $0 < t < t_0$. Also, as we did in (B.21), there exist $K < \infty$ and $0 < t_0 < 1$ such that

$$0 \leq \mathbb{E} \left( \left( 1 - e^{-\bar{\theta}t} \right) 1_{\{Z_i \geq t^{\frac{31}{2}}y, \bar{\theta}t \geq -u\}} \right) \leq \mathbb{E} \left( \bar{\theta}t \right)^{\frac{\gamma}{Y}} \leq K t^{1/Y}, \quad (B.28)$$

for all $0 < t < t_0$. Hence, for any $y \geq 0$ and $0 < t < t_0 < 1$, and since $1 - Y/2 < 1/2 < 1/Y$, for $1 < Y < 2$,

$$t^{\frac{31}{2}} |J_{31}^{(1)}(t, y)| \leq \bar{\kappa} t^{\frac{31}{2}} \int_{0}^{\infty} e^{-u(t^{1/Y} - 1)} du + K t^{1/Y} t^{\frac{31}{2}} + \tilde{\kappa} t^{\frac{31}{2}} \to 0, \quad (B.29)$$

as $t \to 0$. Since both control functions in (B.27) and (B.28) are independent of $y$, combining (B.26) and (B.29), and by the dominated convergence theorem,

$$\lim_{t \to 0} e^{-\bar{\eta}t} t^{\frac{31}{2}} J_{31}(t, y) \frac{1 - e^{\sqrt{t}y}}{\sqrt{t}} e^{-\frac{y^2}{2\pi \sigma^2}} dy = - \frac{C_+}{Y} \int_{0}^{\infty} y^{1 - \gamma} e^{-\frac{y^2}{2\pi \sigma^2}} dy. \quad (B.30)$$
Next, by the self-similarity of \((Z_t)_{t \geq 0}\), we decompose the expression \(J_{32}(t, y) := \mathbb{E} \left( e^{-\tilde{U}_t} 1_{\{Z_t \geq \frac{t^2}{2} y\}} (1 - e^{-Z_t}) / \sqrt{t} \right)\) appearing in (B.24) as:

\[
J_{32}(t, y) = \mathbb{E} \left( 1_{\{Z_t \geq \frac{t^2}{2} y\}} \left( \frac{e^{-\tilde{U}_t} - e^{-(Z_t + \tilde{U}_t)}}{\sqrt{t}} - t^{-\frac{1}{2}} Z_t \right) \right) + \mathbb{E} \left( t^{1/2} Z_t 1_{\{Z_t \geq \frac{t^2}{2} + \frac{1}{4} y\}} \right).
\]  

(B.31)

Note that \(J_{32}^{(2)}(t, y)\) is quite similar to \(J_{12}(t, y)\) in (B.4) and, thus, the corresponding integral has an asymptotic behavior similar to (B.6). Concretely,

\[
\lim_{t \to 0} t^{1/2} e^{-\eta t} \int_0^\infty \mathbb{E} \left( t^{1/2} Z_t 1_{\{Z_t \geq \frac{t^2}{2} + \frac{1}{4} y\}} \right) e^{\sqrt{2} \eta Y} e^{-\frac{y^2}{2\sigma^2}} dy = \frac{C_+}{Y - 1} \int_0^\infty y^{1/2} e^{-\frac{y^2}{2\sigma^2}} dy.
\]  

(B.32)

Next, decompose \(J_{32}^{(1)}(t, y)\) as:

\[
J_{32}^{(1)}(t, y) = t^{-\frac{1}{2}} \mathbb{E} \left( 1_{\{Z_t \geq \frac{t^2}{2} y\}} \int_{\tilde{U}_t}^{Z_t + \tilde{U}_t} (e^{-x} - 1) dx \right)
\]

\[
= \frac{1}{t^{1/2}} \int_{-\infty}^0 (e^{-x} - 1) \mathbb{P} \left( Z_t \geq \frac{t^2}{2} y, \tilde{U}_t \leq x \leq Z_t + \tilde{U}_t \right) dx + \frac{1}{t^{1/2}} \int_0^\infty (e^{-x} - 1) \mathbb{P} \left( Z_t \geq \frac{t^2}{2} y, \tilde{U}_t \leq x \leq Z_t + \tilde{U}_t \right) dx.
\]

Note that for \(x > 0\),

\[
\mathbb{P} \left( Z_t \geq \frac{t^2}{2} y, \tilde{U}_t \leq x \leq Z_t + \tilde{U}_t \right) \leq \mathbb{P} \left( x \leq Z_t + \tilde{U}_t \right),
\]

while for \(x < 0\),

\[
\mathbb{P} \left( Z_t \geq \frac{t^2}{2} y, \tilde{U}_t \leq x \leq Z_t + \tilde{U}_t \right) \leq \mathbb{P} \left( \tilde{U}_t \leq x \right).
\]

Using the estimates (B.8) and (B.12), arguments as in getting (B.9) and (B.13) give

\[
\lim_{t \to 0} t^{1/2} e^{-\eta t} \int_0^\infty J_{32}^{(1)}(t, y) e^{\sqrt{2} \eta Y} e^{-\frac{y^2}{2\sigma^2}} dy = 0.
\]  

(B.33)

Combining (B.30), (B.32) and (B.33),

\[
\lim_{t \to 0} t^{1/2} e^{-\eta t} I_3(t) = \frac{C_+}{Y(Y - 1)} \int_0^\infty y^{1/2} e^{-\frac{y^2}{2\sigma^2}} dy.
\]  

(B.34)

Finally, from (B.2), (B.15), (B.23) and (B.34), and since \(1 - Y^2 / 2 < 1/2\), for \(1 < y < 2\), we obtain (4.1).

\[\square\]

**Proof of Proposition 4.3.**

When the diffusion component is nonzero, [44, Proposition 5] implies that \(\hat{\sigma}(t) \to \sigma\) as \(t \to 0\). In particular, \(\hat{\sigma} t^{1/2} \to 0\) as \(t \to 0\) and, thus, (A.23) above remains true. Let \(\tilde{\sigma}(t) := \hat{\sigma}_t - \sigma\), then \(\tilde{\sigma}(t) \to 0\) as \(t \to 0\), and (A.23) can be written as

\[
C_{BS}(t, \tilde{\sigma}(t)) = \frac{\sigma}{\sqrt{2\pi}} t^{1/2} + \frac{\hat{\sigma}(t)}{\sqrt{2\pi}} t^{1/2} - \frac{\hat{\sigma}(t)^3}{24\sqrt{2}\pi} t^{3/2} + O \left( (\hat{\sigma}(t) t^{1/2})^5 \right)
\]  

(B.35)

By comparing (4.2)-(4.3) and (B.35), we have

\[
\frac{(C_+ - C_-)^2}{Y(Y - 1) \sqrt{\pi}} \Gamma \left( 1 - \frac{Y}{2} \right) t^{3/2} \sim \frac{\sigma}{\sqrt{2\pi}} t^{1/2}, \quad t \to 0,
\]
and, therefore,
\[ \hat{\sigma}(t) \sim \frac{(C_+ + C_-)2^{\frac{1}{2}-Y} \sigma^{1-Y}}{Y(Y-1)} \Gamma \left( 1 - \frac{Y}{2} \right) t^{1-Y}, \quad t \to 0. \]

The proof is now complete.

\section*{C Additional proofs}

\textbf{Verification of (2.18).}

It suffices to show that, for some constant \( \kappa < \infty \) and any \( v > 0 \) and \( 0 < t \leq 1 \), \( \widetilde{P} \left( Z_1 \geq t^{-1}/v \right) \leq \kappa t|v|^{-Y} \). Indeed, using the same argument for \( -Z_1 \), one can show an analog bound for \( \widetilde{P} \left( Z_1 \leq t^{-1}/v \right) \), with \( v < 0 \), which in turn will imply (2.18). First, in light of (2.15), there exist \( 0 < R < \infty \) and \( H > 0 \), such that for any \( u \geq H \),
\[ p_Z(u) \leq Ru^{-Y-1}. \quad \text{(C.1)} \]

Thus, whenever \( t^{-1}/v \geq H \),
\[ \widetilde{P} \left( Z_1 \geq t^{-1}/v \right) \leq R \int_{t^{-1}/v}^{\infty} u^{-Y-1} du = \frac{R}{Y} \left( t^{-1}/v \right)^{-Y} = \frac{R}{Y} tv^{-Y}. \]

Since \( \widetilde{P} \left( Z_1 \geq t^{-1}/v \right) \leq 1 < H^Y tv^{-Y} \), when \( t^{-1}/v < H \), we deduce that
\[ \widetilde{P} \left( Z_1 \geq t^{-1}/v \right) \leq 1_{\{t^{-1}/v \geq H\}} \widetilde{P} \left( Z_1 \geq t^{-1}/v \right) + 1_{\{t^{-1}/v < H\}} \widetilde{P} \left( Z_1 \geq t^{-1}/v \right) \]
\[ \leq 1_{\{t^{-1}/v \geq H\}} \frac{R}{Y} tv^{-Y} + 1_{\{t^{-1}/v < H\}} H^Y tv^{-Y} \]
\[ \leq tv^{-Y} \left( \frac{R}{Y} + H^Y \right), \]

for all \( 0 < t \leq 1 \) and \( v > 0 \).

\textbf{Verification of (B.5).}

This is similar to the proof of (2.18). Using (C.1), for any \( t > 0 \) and \( y > 0 \),
\[ t^\frac{Y}{2} - 1 J_2(t, y) = t^\frac{Y}{2} - 1 t^\frac{1}{2} - \frac{1}{y} \int_{t^\frac{1}{2} - \frac{1}{y}}^{\infty} up_Z(u) du \]
\[ = t^\left( \frac{1}{2} - \frac{1}{y} \right)(1-Y) 1_{\{t^\frac{1}{2} - \frac{1}{y} \geq H\}} \int_{t^\frac{1}{2} - \frac{1}{y}}^{\infty} up_Z(u) du \]
\[ + t^\left( \frac{1}{2} - \frac{1}{y} \right)(1-Y) 1_{\{t^\frac{1}{2} - \frac{1}{y} \leq H\}} \left( \int_{H}^{\infty} up_Z(u) du + \int_{t^\frac{1}{2} - \frac{1}{y}}^{H} up_Z(u) du \right) \]
\[ \leq t^\left( \frac{1}{2} - \frac{1}{y} \right)(1-Y) 1_{\{t^\frac{1}{2} - \frac{1}{y} \geq H\}} \int_{t^\frac{1}{2} - \frac{1}{y}}^{\infty} Ru^{-Y} du \]
\[ + t^\left( \frac{1}{2} - \frac{1}{y} \right)(1-Y) 1_{\{t^\frac{1}{2} - \frac{1}{y} \leq H\}} \left( \int_{H}^{\infty} Ru^{-Y} du + H \widetilde{P} (Z_1 \geq t^\frac{1}{2} - \frac{1}{y}) \right). \]

Then, using (2.18),
\[ t^\frac{Y}{2} - 1 J_2(t, y) \leq t^\left( \frac{1}{2} - \frac{1}{y} \right)(1-Y) R(Y-1)^{-1} y^{-Y} t^\left( \frac{1}{2} - \frac{1}{y} \right)(1-Y) \]
\[ + t^\left( \frac{1}{2} - \frac{1}{y} \right)(1-Y) 1_{\{t^\frac{1}{2} - \frac{1}{y} \leq H\}} \left( RH^{1-Y} + H \left( \frac{H}{t^\frac{1}{2} - \frac{1}{y}} \right)^{-Y} \right) \]
\[ \leq R(Y-1)^{-1} y^{-Y} + t^\left( \frac{1}{2} - \frac{1}{y} \right)(1-Y) R \left( \frac{H}{t^\frac{1}{2} - \frac{1}{y}} \right)^{1-Y} y^{-Y} + H Y^{-1}, \]

and (B.5) follows with \( \lambda := RY/(Y-1) + H^Y \).
References


