

*Palgrave Macmillan Studies in Banking and Financial Institutions*

Series Editor: **Professor Philip Molyneux**

The Palgrave Macmillan Studies in Banking and Financial Institutions are international in orientation and include studies of banking within particular countries or regions, and studies of particular themes such as Corporate Banking, Risk Management, Mergers and Acquisitions, etc. The books' focus is on research and practice, and they include up-to-date and innovative studies on contemporary topics in banking that will have global impact and influence.

Titles include

Steffen E. Andersen

THE EVOLUTION OF NORDIC FINANCE

Seth Apati

THE NIGERIAN BANKING SECTOR REFORMS

Power and Politics

Roberto Bottiglia, Elisabetta Gualandri and Gian Nereo Mazzocco (*editors*)

CONSOLIDATION IN THE EUROPEAN FINANCIAL INDUSTRY

Dimitris N. Chorafas

BASEL III, THE DEVIL AND GLOBAL BANKING

Dimitris N. Chorafas

CAPITALISM WITHOUT CAPITAL

Dimitris N. Chorafas

SOVEREIGN DEBT CRISIS

The New Normal and the Newly Poor

Stefano Cosma and Elisabetta Gualandri (*editors*)

THE ITALIAN BANKING SYSTEM

Impact of the Crisis and Future Perspectives

Violaine Cousin

BANKING IN CHINA

Vincenzo D'Apice and Giovanni Ferri

FINANCIAL INSTABILITY

Toolkit for Interpreting Boom and Bust Cycles

Peter Falush and Robert L. Carter OBE

THE BRITISH INSURANCE INDUSTRY SINCE 1900

The Era of Transformation

José Manuel Pastor Monsálvez and Juan Fernández de Guevara Radoselovics (*editors*)

MODERN BANK BEHAVIOUR

Juan Fernández de Guevara Radoselovics and José Manuel Pastor Monsálvez (*editors*)

CRISIS, RISK AND STABILITY IN FINANCIAL MARKETS

Franco Fiordelisi and Ornella Ricci (*editors*)

BANCASSURANCE IN EUROPE

Past, Present and Future

Franco Fiordelisi, Philip Molyneux and Daniele Previati (*editors*)

NEW ISSUES IN FINANCIAL AND CREDIT MARKETS

Franco Fiordelisi, Philip Molyneux and Daniele Previati (*editors*)

NEW ISSUES IN FINANCIAL INSTITUTIONS MANAGEMENT

Kim Hawtrey

AFFORDABLE HOUSING FINANCE

Jill M. Hendrickson

REGULATION AND INSTABILITY IN U.S. COMMERCIAL BANKING

A History of Crises

Alexandros-Andreas Kyrtis (*editor*)

FINANCIAL MARKETS AND ORGANIZATIONAL TECHNOLOGIES

System Architectures, Practices and Risks in the Era of Deregulation

Paola Leone and Gianfranco A. Vento (*editors*)  
CREDIT GUARANTEE INSTITUTIONS AND SME FINANCE

Caterina Lucarelli and Gianni Brighetti (*editors*)  
RISK TOLERANCE IN FINANCIAL DECISION MAKING

Roman Matousek (*editor*)  
MONEY, BANKING AND FINANCIAL MARKETS IN CENTRAL AND EASTERN EUROPE  
20 Years of Transition

Philip Molyneux (*editor*)  
BANK PERFORMANCE, RISK AND FIRM FINANCING

Philip Molyneux (*editor*)  
BANK STRATEGY, GOVERNANCE AND RATINGS

Imad A. Moosa  
THE MYTH OF TOO BIG TO FAIL

Simon Mouatt and Carl Adams (*editors*)  
CORPORATE AND SOCIAL TRANSFORMATION OF MONEY AND BANKING  
Breaking the Serfdom

Victor Murinde (*editor*)  
BANK REGULATORY REFORMS IN AFRICA

Anders Ögren (*editor*)  
THE SWEDISH FINANCIAL REVOLUTION

Özlem Olgü  
EUROPEAN BANKING  
Enlargement, Structural Changes and Recent Developments

Fotios Pasiouras  
GREEK BANKING  
From the Pre-Euro Reforms to the Financial Crisis and Beyond

Daniela Pirvu  
CORPORATE INCOME TAX HARMONIZATION IN THE EUROPEAN UNION

Ramkishen S. Rajan  
EMERGING ASIA  
Essays on Crises, Capital Flows, FDI and Exchange Rate

Allesandro Roselli  
FINANCIAL STRUCTURES AND REGULATION: A COMPARISON OF CRISES IN THE UK, USA  
AND ITALY

Yasushi Suzuki  
JAPAN'S FINANCIAL SLUMP  
Collapse of the Monitoring System under Institutional and Transition Failures

Ruth Wandhöfer  
EU PAYMENTS INTEGRATION  
The Tale of SEPA, PSD and Other Milestones Along the Road

**The full list of titles available is on the website:**

[www.palgrave.com/finance/sbfi.asp](http://www.palgrave.com/finance/sbfi.asp)

---

### **Palgrave Macmillan Studies in Banking and Financial Institutions**

Series Standing Order ISBN 978-1-4039-4872-4

You can receive future titles in this series as they are published by placing a standing order. Please contact your bookseller or, in case of difficulty, write to us at the address below with your name and address, the title of the series and the ISBN quoted above.

Customer Services Department, Macmillan Distribution Ltd, Houndmills, Basingstoke, Hampshire RG21 6XS, England

---

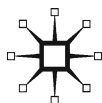
# Crisis, Risk and Stability in Financial Markets

Edited by

Juan Fernández de Guevara Radoselovics and  
José Manuel Pastor Monsálvez

*University of Valencia, Spain*

palgrave  
macmillan



Introduction, selection and editorial matter ©Juan Fernández de Guevara Radoselovics and José Manuel Pastor Monsálvez 2013

Individual chapters ©contributors 2013

Softcover reprint of the hardcover 1st edition 2013 978-1-137-00182-5

All rights reserved. No reproduction, copy or transmission of this publication may be made without written permission. No portion of this publication may be reproduced, copied or transmitted save with written permission or in accordance with the provisions of the Copyright, Designs and Patents Act 1988, or under the terms of any licence permitting limited copying issued by the Copyright Licensing Agency, Saffron House, 6–10 Kirby Street, London EC1N 8TS.

Any person who does any unauthorized act in relation to this publication may be liable to criminal prosecution and civil claims for damages.

The authors have asserted their rights to be identified as the authors of this work in accordance with the Copyright, Designs and Patents Act 1988.

First published 2013 by  
PALGRAVE MACMILLAN

Palgrave Macmillan in the UK is an imprint of Macmillan Publishers Limited, registered in England, company number 785998, of Houndmills, Basingstoke, Hampshire RG21 6XS.

Palgrave Macmillan in the US is a division of St Martin's Press LLC, 175 Fifth Avenue, New York, NY 10010.

Palgrave Macmillan is the global academic imprint of the above companies and has companies and representatives throughout the world.

Palgrave® and Macmillan® are registered trademarks in the United States, the United Kingdom, Europe and other countries

ISBN 978-1-349-43367-4      ISBN 978-1-137-00183-2 (eBook)  
DOI 10.1057/9781137001832

This book is printed on paper suitable for recycling and made from fully managed and sustained forest sources. Logging, pulping and manufacturing processes are expected to conform to the environmental regulations of the country of origin.

A catalogue record for this book is available from the British Library.

A catalog record for this book is available from the Library of Congress.

10 9 8 7 6 5 4 3 2 1  
22 21 20 19 18 17 16 15 14 13

# Contents

<i>List of Illustrations</i>	vi
<i>Notes on Contributors</i>	ix
<b>Introduction</b>	<b>1</b>
<i>Juan Fernández de Guevara Radoselovics and José Manuel Pastor Monsálvez</i>	
<b>1 Financial Stability and Economic Growth</b>	<b>8</b>
<i>Santiago Carbó-Valverde and Luis Pedauga Sánchez</i>	
<b>2 Financial Crisis and EU Banks' Performance</b>	<b>24</b>
<i>Ted Lindblom and Magnus Willeson</i>	
<b>3 Diversification, Diversity and Systemic Risk in European Banking</b>	<b>49</b>
<i>Pierluigi Morelli, Giovanni B. Pittaluga and Elena Seghezza</i>	
<b>4 Basel III, Pillar 2: The Role of Banks' Internal Control Systems</b>	<b>71</b>
<i>Elisabetta Gualandri</i>	
<b>5 Shadow Banking and Systemic Risk: In Search of Regulatory Solutions</b>	<b>96</b>
<i>Gianfranco A. Vento and Pasquale La Ganga</i>	
<b>6 Social Lending in Europe: Structures, Regulation and Pricing Models</b>	<b>116</b>
<i>Mario La Torre and Fabiomassimo Mango</i>	
<b>7 Banks' Ratings, the Financial Crisis and Size of Entities</b>	<b>156</b>
<i>Carlos Salvador Muñoz, José Manuel Pastor Monsálvez and Juan Fernández de Guevara Radoselovics</i>	
<b>8 Stock Exchange Mergers in the Aftermath of the Crisis: New Insights</b>	<b>183</b>
<i>Maurizio Polato and Josanco Floreani</i>	
<b>9 Sustainability and Financial Inclusion in Microinsurance</b>	<b>203</b>
<i>Marta de la Cuesta González, Cristina Ruza y Paz-Curbera and Francisco Javier Garayoa Arruti</i>	
<i>Index</i>	<b>231</b>

# Illustrations

## Figures

1.1	Selected transition variables plotted against time	19
1.2	Effect of positive financial development shocks by initial state of economy	19
2.1	The development of short-term market rates (3 months) in the five regions	41
3.1	Return distribution at the system level	58
3.2	Correlations between banks' stock prices	63
3.3	Correlations between stock prices of banks with assets exceeding €300 billion	63
3.4	Cross-section variability of the ROE for large European banks	64
3.5	Cross-section variability of the ROE for large international banks	65
5.1	Shadow bank liabilities versus traditional bank liabilities	97
5.2	Prudential standards and supervisory oversight: degree of application	98
5.3	The shadow credit intermediation process	102
5.4	The two liquidity spirals: loss spiral and margin spiral	103
5.5	Phase-in timeline: graph	107
5.6	Phase-in timeline: table	108
6.1	Distribution of SL platforms active in the UE	119
6.2	Strongly Pure SL (direct model)	124
6.3	Pure or Pass-Through SL (direct model)	124
6.4	Hybrid SL (brokered model)	125
6.5	Distribution of pure platform in EU	132
6.6	Distribution of profit-based platforms in EU	132
6.7	Distribution of brokered platforms in EU	133
6.8	An operational model for social lending	142
7.1	Distribution of ratings by size: before versus after the outbreak of financial crisis	165
7.2	Change in the rating estimated before versus after financial crisis	175
9.1	The microinsurance market	210
9.2	The inclusive financial products circle	211
9.3	Microinsurance performance balance	214

9.4	Microinsurance delivery channels	218
9.5	Net income ratio	224
9.6	Incurred expense ratio	225
9.7	Incurred claims ratio	226

## Tables

1.1	Selected studies on the growth responsiveness finance hypothesis	12
1.2	Lagrange multiplier test for linearity	17
2.1	Number of banks (N), total assets (TA) and mean total assets (Million EUR) by year and by association form	30
2.2	Number of banks and countries included in the sample by region	31
2.3	The overall profitability of EU banks in different regions	33
2.4	The average profitability of EU banks in terms of ROIF and ROFL	36
2.5	Leverage spread before ( $LS_{bLL}$ ) and after ( $LS_{dLL}$ ) loan loss provisions	38
2.6	Interest margins (IM) and average interest expenses ( $k_D$ ) of the average EU bank	40
2.7	Capital risk exposure (D/E) for banks in general, commercial banks (CB) and savings banks (SB)	44
3.1	Number of credit institutions	52
3.2	Concentration measures of European banking	52
3.3	The biggest 15 banks in the world	53
3.4	Non-interest income share	54
3.5	Two banking systems	57
3.6	Risk–return at the system level	59
3.7	The bank sample	62
4.1	Core principles for effective banking supervision	86
4.2	The European Supervisory Authorities (ESA)	88
5.1	The steps, entities and funding techniques involved in shadow credit intermediation	101
6.1	A taxonomy of social lending platforms	123
6.2	Social lending platforms in Europe	130
6.3	Distribution of pricing formulas adopted by SL platform in Europe	147
6.4	Average interest rate applied by the platforms of the sample	148
6.5	Average interest rates and usurious rates in Italy	150
7.1	Descriptive statistics of ratings and the market share of CRAs	163

7.2	Descriptive statistics of ratings issued by Fitch depending of the size of banks	164
7.3	Descriptive statistics of the determinants of the banks evaluated by Fitch	170
7.4	Eqn (1)–(2): ordered probit model with random effects	172
7.5	CRI and its components	177
8.1	EV/EBITDA multiple in major exchanges	190
8.2	The economics of merger agreements	192
8.3	Estimated losses in value for 5 per cent decrease in revenues CAGR or 5 per cent increase in cost CAGR	197

## **Boxes**

4.1	Internal governance in banking	76
4.2	Internal control review (Pillar 2)	78

## **Annex**

9.1	Formal operators and institutions visited	229
9.2	Research programmes in Colombia, Peru and Brazil	229



# Contributors

**Santiago Carbó-Valverde** is Director of Financial Studies and Analysis at Banco Mare Nostrum and Full Professor of Economics at the University of Granada, and Director of Financial Studies at the Spanish Savings Banks Foundation (FUNCAS). He is also a research professor at the Instituto Valenciano de Investigaciones Económicas (IVIE). He has also been a researcher and consultant at the Federal Reserve Bank of Chicago since 2008. He has been a consultant for both public and private financial institutions. He obtained his PhD in Economics from the University of Wales, Bangor, UK. He has published more than 200 papers on financial systems in *European Economic Review*, *Review of Finance*, *Journal of Money, Credit and Banking*, *Journal of International Money and Finance* and *Journal of Banking and Finance*. He has participated in conferences and international forums, including the G-20.

**Marta de la Cuesta González** is a senior lecturer at the Department of Applied Economics, Universidad Nacional de Educación a Distancia (UNED), Spain. She was Vice-chancellor of Economic Affairs at UNED between 2005 and 2009. She has held the Telefónica Chair in Corporate Responsibility and Sustainability, is a member of the Spanish Corporate Social Responsibility Board (Ministerio de Trabajo), and has been an independent member of the Banca Cívica Board since June 2011. She has a PhD in Economics and Business Management. A teacher at undergraduate and postgraduate levels, she is responsible for delivering modules in the areas of banking, financial systems and sustainable finance. She is a founding member of the Economics without Frontiers NGO and has promoted the foundation of the Spanish CSR Watch. Her main research interests include banking and finance, corporate social responsibility and socially responsible investing. Her work has been published in books, conference proceedings and academic journals such as *Journal of Business Ethics*, *Business Ethics: A European Review*, *The Service Industry Journal*, *Corporate Social Responsibility and Environmental Management*.

**Juan Fernández de Guevara Radoselovics** is Assistant Professor at the University of Valencia and Associate Researcher at the Instituto Valenciano de Investigaciones Económicas (IVIE). Between 1997 and 2008 he was a member of the technical staff at IVIE. He has also been an associate researcher of several projects of the Spanish National R+D+I Plan.

He graduated in Economics in 1995 and received his PhD in 2005. His research interests include financial economics, banking, productivity and social capital. He has jointly published more than five books and several articles in Spanish and in international journals such as *Journal of Banking and Finance*, *Regional Studies*, *Journal of International Money and Finance*, *The Manchester School*, *Revista de Economía Aplicada* and *Revista de Economía Financiera*, among others. He has collaborated in more than 20 research projects for firms and institutions.

**Josanco Floreani** is a lecturer in Banking and Finance at the Faculty of Economics of the University of Udine, where he teaches banking operations. He graduated in Economics from the University of Udine and received a PhD in Business Sciences from the same university. His main research interests include economics and governance of the securities industry, and regulation of financial markets. He is the author of several articles dealing with issues related to stock exchange mergers and valuation of exchanges.

**Pasquale La Ganga** graduated summa cum laude in Financial Markets and Institutional Economics from the University of Milan. In 2006 he joined the Bank of Italy and was assigned to the Banking and Financial Supervision Department in Rome, where he was involved in empirical and theoretical research focusing on liquidity risk management. He was a member of BCBS's Working Group on Systemic Liquidity Risk.

**Francisco Javier Garayoa Arruti** has been Managing Director of the Spain Social Investment Forum, Spainsif, since March 2010. He is the coordinator of the microinsurance group in the CUMES network of MAPFRE Foundation. He has worked in finance companies such as BBVA and other representative companies such as the Spanish Telefónica group. He obtained his PhD in Insurance Sciences from the University of Salamanca. His main research interests include microinsurance. His articles have been published in the risk reports of the MAPFRE Foundation. He is a member of the International Microinsurance Conference – Experts and Feedback Group.

**Elisabetta Gualandri** is Full Professor in Banking and Finance at the Marco Biagi Department of Economics of the University of Modena and Reggio Emilia, where she is a director of CEFIN (Center for Studies in Banking and Finance). She is also a director of the European Association of University Teachers in Banking and Finance, a member of ADEIMF (Italian Association of Teachers in Banking and Finance),

of AIDEA (Italian Academy of Business Administration and Management), and of SUERF (the European Money and Finance Forum). She was appointed as an auditor of the Bank of Italy in 2007. Recent research topics include the regulation and supervision of financial intermediaries and markets, the impact of financial crisis and Basel III, the internal corporate governance in banks, the financing of innovative SMEs and public intervention programmes.

**Ted Lindblom** is Professor and board member of the PhD Research Committee of Business Administration at the University of Gothenburg, Sweden. His current research mainly concerns banking and corporate finance, with particular focus on corporate governance and financial structure decisions. In the banking sector he has for more than 20 years been studying banking strategies, pricing, profitability and risk management under different market conditions and regulatory frameworks. He has authored and co-authored several articles and books on these issues.

**Fabiomassimo Mango** is Senior Lecturer in Banking and Finance at La Sapienza University of Rome, where he obtained his PhD. He is leader of the modules in banking and finance and financial markets. His research interests include financial markets, risk management, sovereign risk, securitization and microfinance.

**Pierluigi Morelli** works at the Research Department of the Italian Bank Association (ABI), where he is responsible for the econometric model of the Italian economy and banking system. He graduated in Statistics and Economics at La Sapienza University of Rome in 1988. From 1988 to 2009 he worked at the Centro Europa Ricerche (CER). As Research Director of the CER Monetary and Banking sector, he was in charge of the econometric models of the Italian economy, of the banking sector, and of pension expenditure. He has published numerous articles on monetary economics, banking, social security and environment.

**José Manuel Pastor Monsálvez** is an associate professor at the Universitat de Valencia, where he received his PhD in 1996. He specializes in banking and regional economics. He has received scholarships from several institutions (Valencian Regional Government, Caja de Madrid Foundation and FIES), and was a visiting researcher in the Finance department at Florida State University (1996–1997) and an external consultant for the World Bank. He is co-author of 18 books and has published 41 articles in national and international academic journals, including *Annals of Regional Science*, *Applied Economic Letters*, *Applied Economics*, *Applied Financial Economics*, *Economics Letters*, *European Journal of Operational*

*Research, International Journal of Transport Economics, International Review of Applied Economics, Institutions and Money, Investigaciones Económicas, Journal of International Financial Markets, Journal of Productivity Analysis, Journal of Transport and Statistics, Manchester School, Regional Studies, Revista Española de Economía and Transportation.* He conducts research on various competitive projects, as well as projects with private firms and public administration.

**Luis Pedauga Sánchez** has been a doctoral student since 2009 in the Empirical Economics programme at the University of Granada under the supervision of Prof. Dr. Santiago Carbó-Valverde, investigating different aspects of financial consolidation, financial stability and market power in banking. He served at the Economic Research Department in the Central Bank of Venezuela from 2000 to 2008. From 2005 through the spring of 2008, he was also an Instructor Professor of Econometric and Applied Multivariate Methods at the Catholic University Andrés Bello, Venezuela.

**Giovanni B. Pittaluga** is Full Professor of Economics at Genoa University, Italy. Previously he was Associate Professor of Monetary Economics at Università Cattolica del Sacro Cuore (1991–1994) and Economist at the Research Department of the Bank of Italy (1983–1988). He has been responsible for the budget of Regione Liguria (2000–2002 and 2005–2010) and member of the Board of Directors of Finmeccanica (2003–2005). He is the author of books and articles in international journals in the area of monetary economics. His research interests include central banking, banking, inflation, international political economy and economic history.

**Maurizio Polato** is Full Professor in Banking and Finance at the Faculty of Economics of the University of Udine, where he teaches Securities Exchange Economics. He graduated in Economics from the Cà Foscari University of Venice and received a PhD in Business Economics from the same university. His main research interests relate to economics and governance of the securities industry, banking economics and risk management.

**Cristina Ruza y Paz-Curbera** is a senior lecturer at the Applied Economics Department, Universidad Nacional de Educación a Distancia (UNED), Spain. She teaches at both undergraduate and postgraduate levels in the areas of banking, financial systems, sustainable finance and corporate social responsibility. She is a member of the European

Association of Teachers in Banking and Finance and the Spanish Technological and Innovation Certification Agency. Her main research interests include financial institutions, markets and risk, microfinance and socially responsible investing. Her work has been published in books, conference proceedings and in national and international academic journals. She has participated in different funded research projects and has organized courses in financial risk management. She has also participated in several congresses at both national and international levels, and is a referee for a number of international journals.

**Carlos Salvador Muñoz** is a PhD student at the University of Valencia. He acquired a BA in Economics from the University of Valencia and an MA in Banking and Quantitative Finance from the University of Valencia and the Complutense University of Madrid. Before joining the doctoral programme, he served for one year as a collaborator at the Department of Economic Analysis at the University of Valencia and worked for three months in the Bank of Valencia as a risk manager. He has also gained practical experience through his internships at the Investment Department of the insurance company of Bancaja (ASEVAL) and the insurance division of the regional government in Valencia.

**Elena Seghezza** is Lecturer in Economics at Genoa University, Italy. She previously worked as an economist at the Department of Economic Affairs of the Italian Government and at the Organisation for Economic Cooperation and Development (OECD). She has a PhD in International Economics from the Graduate Institute of International Studies, Geneva. She has published several articles on political economy, interest groups, inflation and international trade.

**Mario La Torre** is Full Professor in Banking and Finance at La Sapienza University, Rome. His main research areas are financial innovation, ethical finance and microfinance, film and art financing. He is currently a member of the Board of the Italian National Committee for Microcredit. He has been a member of the Board of Directors of Cinecittà and Consultant for the Ministry of Cultural Affairs. He has been a member of the consultative group for the definition of the Italian Microcredit Law and was involved in drafting the Italian Tax Credit Law for the film industry.

**Gianfranco A. Vento** is Professor of Banking and Finance at Regent's College, London, and an associate professor at Guglielmo Marconi University in Rome. He is author of books and articles on financial topics and a member of the editorial advisory boards of several international

academic journals. Before his academic career, he worked for five years at the Bank of Italy.

**Magnus Willeson** lectures in banking, risk management and finance at Linnaeus University, Växjö, Sweden. His research interests include the governance of banks, risk management, efficiency and pricing, which has resulted in several international publications. Recent research emphasizes the effects of risk management on banking operation and strategy.