Do bank regulation and supervision stabilize the banking system? A cross-country systematic risk analysis

Chinpiao Liu, An-Sing Chen, Hsiaofeng Lin
E-mail: feng@mail.dyu.edu.tw

ABSTRACT

This paper conducts a cross-country empirical assessment of the impacts of national bank regulation and supervision on extreme and central (non-extreme) systematic risks of banking sectors. We examine the effects of five types of bank regulatory and supervisory policies, including official supervision, private sector monitoring, capital requirements, bank activity restriction and banking entry requirements. Extreme systematic risk is measured as the tail beta, which is the probability of a sharp decline in a banking sector index conditional on a crash in a world banking sector index. Central systematic risk is measured as the ordinary beta, which describes the sensitivity of a banking sector index to a world banking sector index during normal conditions. The results show that in normal time more private monitoring of banks significantly reduces both the tail beta and the ordinary beta of the banking sector. We also find that greater capital stringency reduces the ordinary beta of the banking sector, but increases the tail beta of the banking sector. As for the other bank regulatory and supervisory policies, we do not find significant impacts on the risks of the banking sectors during the normal time period. Finally, during the financial crises, only the restriction on the new entry of banks can significantly reduce the tail beta of the banking sectors.

Keywords: Bank regulation; Systematic risk; Banking system stability

REFERENCES

Boot, A.W.A., and A. V. Thakor, 1...