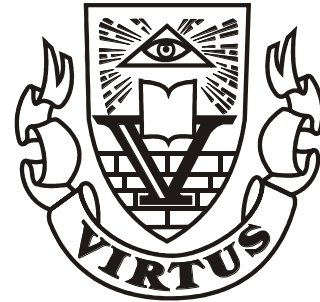


RISK GOVERNANCE & CONTROL: Financial markets and institutions

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Marco Guerrazzi

This paper aims at providing a critical assessment of the new 'Farmerian' economics, i.e. the recent Farmer's attempt to provide a new microfoundation of the General Theory grounded on modern search and business cycle theories. Specifically, I develop a theoretical model that summarizes the main arguments of the suggested approach by showing that a special importance has to be attached to the search mechanism, the choice of units and 'animal spirits' modelling. Thereafter, referring to self-made real-business-cycle experiments, I discuss the main empirical implications of the resulting framework. Finally, I consider its policy implications by stressing the problematic nature of demand management interventions and the advisability of extending the role of the central bank in preventing financial bubbles and crashes.

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Maria Carapeto, Scott Moeller, Anna Faelten, Valeriya Vitkova, Leonardo Bortolotto

This paper investigates distress classification measures in the banking sector. The power of ten different accounting measures is tested using media coverage as the benchmark for a sample of 1,175 banks which participated in merger and acquisitions or divestiture deals over the past 22 calendar years. According to the results of the study, a bank should be defined as distressed if the ratio of its non-performing loans to total loans is in the two highest deciles of the industry, using a three-year moving average. This measure is typically favored by practitioners, who maintain that other common measures, e.g., those involving provisions for loan losses, are not as accurate as they express only a managerial forecast. Interestingly, measures that capture capital adequacy too often depict the bank as healthy even if it is *de facto* distressed, while measures of asset quality, though highly correlated with each other, tend to overestimate the number of distressed banks.

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Seok Weon Lee

The purpose of this paper is to examine how the risk-taking behavior differed between Korean regional banks and national banks for the two different regulatory regimes; a very loose regulation period (1994-1997) and a very tightened regulation period (1998-2005). From the panel analysis over the period 1994-2005, we found that regional banks took riskier strategies than national banks when

banking regulations are loose. Moreover, their higher risk-taking contributed to higher profit under the period of loose regulation. However, after the banking regulations were tightened after financial crisis around the late 1990s, this phenomenon disappeared and the tendency of regional banks to take greater risk than national banks was not observed any more. Also, the positive relationship between risk-taking and profitability was not observed either after regulations were tightened. These empirical findings would have the following policy implications. When the economic conditions are good, and therefore, banking regulations are relatively loose, the greater risk-taking of regional banks could be profitable, because regional banks are in a better situation in terms of maintaining their market share based on the close ties with their regional clients, and can be protected from excessive competition with national banks. But, if the economic conditions get worse and financial crisis occurs, and therefore, banking regulations get tightened, regional banks are more adversely and sensitively affected by these shocks than national banks because their size is small and their assets are less diversified than national banks, especially being concentrated on loans to small and medium size business sector and real estate loans, which are very sensitive to the fluctuation of the economy. Furthermore, if these adverse economic and financial shocks continue long, the probability of regional banks to fail would be substantially higher and it can cause a serious damage to the regional economy. To avoid these adverse consequences in economic and financial crisis, regional banks need to diversify their asset portfolios and earnings structure, and improve the skill of more forward-looking risk management.

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José Vaz Ferreira

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Edmund R. Lizaraburu, Julio Quispe Salquero

Nowadays, the companies and financial institutions from emerging markets are looking forward for more space in the international market. They have found several alternatives and one of them is to implement process and procedures in order to be more efficient and offer better conditions to the local and foreign customers. One of these alternatives is to implement internal standards not only following corporate governance policies but also, implementing international standards such as ISO norms. This paper seeks to show the evolution of initial ISOs most frequently used in the financial emerging markets.

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