

EDITORIAL: Governance, risks, and rules at the beginning of the pandemic

Dear readers!

The editorial team is happy to present the second issue of the Journal “*Risk Governance and Control: Financial Markets and Institutions*” in 2020. This is the first issue after the COVID-19 affected our lives and economies. In this new scenario, research in the field of governance and regulation appears of extreme importance and should be encouraged.

A premise of this issue seems appropriate. The coronavirus epidemic has caused an abrupt economic and social disruption and markets are reacting accordingly. Many economies around the world could suffer from falling GDP, due to growing lockdown measures and the millions of people absent from work, the closure of schools and thousands of restaurants and other closed businesses. Therefore, financial markets are experiencing levels of extreme volatility, while investors are grappling with the various consequences that this virus could bring with it. In this regard, on March 11th, 2020 the European Securities and Market Authority (ESMA) published recommendations addressed to participants in the financial markets, precisely in consideration of the spread of COVID-19 and the related impacts on the European Union economy (ESMA, 2020). In particular, after examining the market situation and the emergency measures adopted by the various participants in the financial markets, ESMA made 4 recommendations on the following areas: 1) business continuity planning; 2) market disclosure; 3) financial reporting; 4) fund management.

In general, it should be noted that, in this context of emergency and uncertainty, companies are required to re-evaluate, *inter alia*, their need for liquidity as well as the methods for fulfilling their contractual and regulatory obligations in light of the specific level of business disruption and the new risks associated with the spread of COVID-19. The risk context and the associated interventions by the Authorities will hopefully open new research streams by the Scholars, of which the previous points are just some suggestions. We hope that the Journal could receive and accept in the future many contributions in the new fields suggested by the pandemic.

After this due premise, we are very pleased to present the current issue. It provides a careful analysis of some important and interesting fields of research in the governance and regulation streams. They concern, in particular, the relationship among capital, risk, and efficiency, the analysis of DFIs and the profitability under state ownership, the credit risk management in banks, the loan pricing policy, the exchange rate modelling in emerging markets, and the performance of credit intermediaries.

The first paper, by *Dimitra Loukia Kolia* and *Simeon Papadopoulos*, investigates the relationship between capital, risk, and efficiency in Eurozone and the U.S. banking institutions. It also assesses the determinants of bank capital, risk, and efficiency providing evidence of how the interrelationship and the managerial behaviors vary per type of bank (Fiordelisi, Marques-Ibanez, & Molyneux, 2010; Tan & Floros, 2013; Nguyen & Nghiem, 2015; Le, 2018). The Authors employed the input-oriented CCR model of data envelopment analysis developed by Charnes, Cooper, and Rhodes (1978) to estimate efficiency. They also applied the Z-score to calculate bank risk and the ratio of the value of total equity to total assets as an indicator of bank capital. Moreover, the relationship between capital, risk, and efficiency of banking institutions is investigated by employing the three-stage least squares (3SLS) model, developed by Zellner and Theil (1962). The study is innovative as it is the first to compare the capital risk and efficiency relationship between Eurozone and the U.S. banks by employing post-crisis data. Moreover, while the majority of studies investigate the European banking institutions, their paper focuses on a Eurozone bank sample. Lastly, the research fills in the gap from previous literature by examining separately three banking sectors, providing evidence of whether the links among risk, capital, and efficiency vary per type of bank. Their findings have important implications for regulators, bank managers, and shareholders. One of the main results is the confirmation of the necessity to consider bank efficiency when implementing measures of financial stability, since an increase in efficiency levels may precede a decrease in capital and risk.

The second contribution, by *Mbako Mbo*, concerns the issue of development finance by Development Finance Institutions (DFIs) (UNCTAD, 2019), their objectives and the possibility of making profits under state ownership (Pragash, 2016; Aharoni, 2000; Mbo & Adjasi, 2017; Shughart, 2008; Staikouras & Wood, 2004; Rachdi, 2013; Duraj & Moci, 2015). The paper highlights a theoretical framework for DFIs sustainable funding in the context of which the subject needs to be looked at, particularly with the state ownership dynamics in mind. The Author points out as state ownership introduces some uniqueness to the type of financial institutions DFIs are, with a direct bearing on their operational models, if sustainability is to be ensured. The cost of capital available to a DFI emerges as a fundamental determinant of how effectively a DFI becomes, measured from the perspective of the two-pronged nature of their objectives. According to the framework, three variables are crucial in the construction of investment pipelines for DFIs: the velocity of development impact, viability, as well as financial returns. The paper has a good foundation for future research on DFIs, as they are evolving at the same speed of capital markets. The framework provided by the paper offers a context within which future quantitative, and more interestingly, correlational studies can be conducted by Scholars.

Another very interesting research, by *Pasqualina Porretta*, *Aldo Letizia*, and *Fabrizio Santoboni*, analyzes the interdependencies and overlaps of IFRS 9 with the credit risk framework for financial intermediaries (also Basel 3). Through a case study, the purpose of this paper is to investigate the Expected Credit Loss (ECL)

and its main impacts on the coverage ratio of a loan's portfolio. As it is well known, under IFRS 9 and unlike IAS 39, the financial intermediary must immediately recognize, regardless of the presence or absence of a trigger event, future expected losses on its financial assets and must continuously adjust the estimate also in consideration of the credit risk for the counterpart (IASB, 2014; Bushman, 2016; Bushman & Williams, 2012; Cavallo & Majnoni, 2002; Laux, 2012). The new accounting standard confers new responsibilities and tasks, not just regarding credit risk modeling, to the bank's risk management. In this perspective, their paper is a relevant addition to the research on the relationship between the credit risk management framework and the accounting standard IFRS 9.

The contribution from *Federico Beltrame, Luca Grassetti, Maurizio Polato, and Giulio Velliscig* has some connections with the previous research. The research question that this paper seeks to answer is how this new approach is affecting the bank-firm relationship. The Authors focused on the effects of ECB's loan valuation metrics on third-party pricing policies and they assessed the impact of the debt service coverage ratio (DSCR) on the bank behavior about firm loan pricing conditions. They founded out that the DSCR becomes statistically significant in explaining the firm's cost of debt only after the introduction of this measure within the AQR exercise of 2014. The research contributes to the literature investigating third-party interdependencies with the interplay between lender-borrower relationship and loan pricing (Kim, Song, & Tsui, 2013; Byrne & Kelly, 2019; Gabbi, Giammarino, Matthias, Monferrà, & Sampagnaro, 2020). Their point of view is a novel perspective in the way it assesses the impact of debt service coverage metrics used in the AQR on the firm's cost of debt, thereby considering a measure of dynamic debt repayment and further extending the literature on such ratios beyond their mere default-prediction ability (Beaver, 1966; Houghton & Woodliff, 1987).

"Exchange rate modelling in the development community using the ARDL cointegration approach: The case of emerging markets" is the title of the interesting paper by *Abdulkader Aljandali and Christos Kallandranis*. They examined the monthly exchange rates of the country members of the Southern African Development Community (SADC) from 1990 to 2010 inclusive. This research is one of the first attempts in the literature to forecast exchange rates in SADC using the ARDL approach (Pesaran & Shin, 1995; Zerihun & Breitenbach, 2017; Redda, Muzindusti, & Grobler, 2017; Peters, 2010; Mair & Christian, 2001). The method offers good results for most exchange rates and shows that countries in the region reached a certain stage of development as changes in exchange rates seem to respond to changes in macroeconomic aggregates. The main novelty element of this research is the identification of a set of macroeconomic fundamentals that dictate changes of exchange rate movements both in the long- and short-run, even if most exchange rates that were examined are not freely floating and thus do not respond solely to the forces of the market.

The last contribution is the research by *Nicola Bianchi, Umberto Filotto, and Xenia Scimone*. The study is focused on a specific country - Italy. The Authors researched the effect of Italian regulation D.Lgs. No. 141/2010 (Law 141) on the performance of credit intermediaries. The study is significant as the Italian market is characterized by the low level of financial literacy, Law 141 is still the center of much debate and there is limited literature on the issue (Demyanyk & Loutskina, 2016; De Mynck & Bruloot, 2017; Ambrose & Conklin, 2014). The results, using a panel and difference-in-differences regression, show that, from 2009 to 2017, firm profitability was not driven by the increase in market entry requirements introduced by Law 141. Rather, it was influenced by firms' size, efficiency, and business model. The "no-effect" of regulation can mean two things: the 141-law did not influence one of the previous elements, or that the two effects on income and costs offset each other, with the ultimate consequence of no change in firms' profit. This work provides new empirical evidence on the literature linking regulation to intermediaries' profitability, filling an existing gap. Indeed, existing literature has not a clear result and mainly focuses on banking law (Pasiouras, Tanna, & Zopounidis, 2009; Wei, Gong, & Wu, 2017).

These research fields appear extremely interesting and provide important indications for scholars, investors, professionals, and regulators. We think that they will be very relevant for 2020 and beyond. Happy reading and stay safe!

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