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Ownership Concentration, Board Structure and Credit Risk: The Case of MENA Banks

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Daniel LABARONNE, LARE-efi, University of Montesquieu Bordeaux IV

This paper analyzes the impact of ownership concentration and board characteristics on MENA banks’ credit risk over the period 2004-2011. The sample includes 38 commercial banks belonging to ten countries of the MENA region. We use an econometric method that deals with the endogeneity problems that have arisen in the corporate governance literature. We show that ownership concentration is significant in explaining credit risk differences between MENA banks. Indeed, banks with highly concentrated ownership have a higher credit risk. However board size and CEO duality are not significant in explaining credit risk differences between MENA banks. In addition, the results highlight the fact that the independence of directors is not relevant to explaining risk-taking in MENA banks. We find that state directors exacerbate credit risk while institutional directors fulfill the functions of monitoring of the bank’s credit policy. Finally, our findings highlight the importance of the number of board committees in enhancing banks’ credit quality.

JEL Codes: G21; G30; G22; G33.
Keywords: Bank Governance; Ownership Concentration; Board of Directors; Credit Risk; MENA Banks.

Market Efficiency and Crises: Don’t Throw the Baby out with the Bathwater

Ariane SZAFARZ, Université Libre de Bruxelles (ULB), Solvay Brussels School of Economics and Management (SBS-EM), Centre Emile Bernheim

The essence of market efficiency is fair asset pricing, which is compatible with multiple price dynamics and speculative bubbles. However, many practitioners and financial academics criticize the efficient market hypothesis on the basis of highly volatile asset prices. I argue that the persistent confusion as to the nature of market efficiency is driven by the difficulty to grasp the financial interpretation of multiple solutions. Importantly, the confusion can mislead regulators when addressing volatility containment. Acknowledging the multiplicity of efficient price dynamics not only enriches the understanding of financial crises, but also helps designing appropriate regulations.

JEL Codes: G14; G12; G01; B41.
Keywords: Efficient Markets; Multiple Solutions; Rational Expectations; Speculative Bubbles; Volatility.

Mass Customization in Life-Cycle Investing Strategies with Income Risk

Romain DEGUEST, EDHEC-Risk Institute
Lionel MARTELLUNI, EDHEC Business School, EDHEC Risk Institute, ERI Scientific Beta
Vincent MILHAU, EDHEC-Risk Institute

Formal intertemporal portfolio selection models show that the utility-maximizing strategy for an individual investor depends on a number of subjective characteristics such as the investor’s horizon, risk aversion and non-financial income, in addition to depending on market conditions. These insights are vastly ignored by current forms of target date fund products, which most often propose a deterministic decrease in the equity allocation regardless of market conditions, and ignore the question of labor income risk. This paper shows that, in spite of a high degree of heterogeneity in individual investors’ income streams, grouping investors with similar income profiles, and implementing a unique investment strategy for all members of a given class, involves only a limited welfare cost with respect to an idealized fully customized strategy. Our results also suggest that these strategies consistent with mass-customization constraints strongly dominate allocation strategies that completely ignore the presence of income risk.

JEL Code: G11.
Keywords: Human Capital; Income Risk; Optimal Portfolio.

Focus on... Currency Turmoil in an Unbalanced World Economy

Michel AGLIETTA, University Paris Ouest-Nanterre, CEPII and France Stratégie
Virginie COUDERT, Financial Stability Directorate, Banque de France, University of Paris Ouest Nanterre

Like all asset prices, exchange rates are moved by a momentum created by alternating long phases of overvaluation and undervaluation with no stabilization at their equilibrium value. The dollar is particularly prone to these large fluctuations that regularly distort real exchange rates between major currencies. Misalignment in exchange rates is a repeated feature of dollar cycles, as much as unsustainable imbalances in the current accounts. Moreover, the appreciation phase of the dollar that has begun for several months is particularly disturbing for emerging countries that are heavily indebted in dollars. This paper studies the consequences of dollar cycles, as much as unsustainable imbalances in the current accounts. The prospect of a new dollar cycle is worrisome since most countries, far from deleveraging after the financial crisis, have massively increased their debt relative to GDP.

JEL Codes: F31; F33; F42.
Keywords: Dollar Cycle; High Indebtedness; International Liquidity; Exorbitant Privilege.
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Ownership Concentration, Board Structure and Credit Risk: The Case of MENA Banks

I. Introduction

The collapse of the global financial system, following the late 2000s financial crisis has exacerbated the debate about the vulnerability of a banking system considered, until this crisis, as powerful dynamic and innovative. These changes have raised the problem of the soundness of the banking system at the forefront of academic researchers and politicians. Indeed, banks play a major role in financial systems and they have an influence on economic activities. Recently, the Basel committee on Banking supervision (2014) underlined the pernicious of the corporate governance problem in the banking sector. From its point of view, effective corporate governance is critical to the proper functioning of the banking sector and economy as a whole.

The growing literature in corporate governance for the MENA banking sector is still threatened by a significant exposure using a sample of commercial banks from 12 MENA countries over the periods of 2002-2006. The aim of this study is twofold. First, we fill the gap of previous empirical research, which has been limited to bank governance in developed countries (Garcia-Marco and Robles-Fernandez, 2008; Pathan, 2009; Pathan and Skully, 2010). We seek to understand bank governance structure and board of directors (size and composition) in lieu of the Basel committee, internal control is major element in the bank governance (Maati and Maati-Mechna). These characteristics reinforce internal governance mechanisms. For the Basel committee, internal control is the responsibility of the bank governance mechanisms which are assigned to the shareholders and the board of directors. Thus, credit risk control and management are assigned to the shareholders and the board of directors. In this paper, we investigate the impact of internal governance mechanisms on credit risk of Middle East and North Africa (MENA) banks. The MENA region is worth studying for several reasons. The financial systems of the MENA countries remain excessively bank-based despite the reforms undertaken to establish a market-based financial sector and promote financial development. Moreover, the World Bank and the IMF report that the MENA banking sector is still threatened by a significant credit risk. MENA banks exhibit the highest rate of non-performing loans (NPLs) in the world with about 20% in 2007 (The World Bank, 2009). Over the period 2000-2009, Tunisia had the highest average NPLs ratio (19.7%) in the MENA region. The ratio reached 19.07% in Egypt, 13% in Morocco, 10.56% in Jordan, 9.53% in the United Arab Emirates and 7.58% in Kuwait (IMF, 2007, 2009; The World Bank data, 2010, 2001). The NPLs ratio is well beyond the international standards.

The aim of this study is twofold. First, we fill the gap of previous empirical research, which has been limited to bank governance in developed countries (Garcia-Marco and Robles-Fernandez, 2008; Pathan, 2009; Pathan and Skully, 2010). We seek to understand bank governance in the MENA region and address the possible impact of governance mechanisms on the credit risk. Our underlying idea is that several characteristics of the ownership structure and board of directors might affect the credit policy of MENA banks.

Indeed, our analysis is done within the context that urgent reforms of the banking sector in the MENA are required to improve the efficiency of credit policy. Understanding the governance of banks in this region will help to better guide the implementation of the reforms and recommendations proposed by the Basel Committee, which have been inspired by international standards and have not taken into account the specific features of the regions. Second, we simultaneously investigate the impact of ownership concentration and the characteristics of the board of directors on credit risk. Thus far, research has focused either on ownership concentration (Leaven, 1999; Iannotta et al., 2007; Leaven and Levine, 2009; Haw et al., 2010; Shehzad et al. 2010) or on the board of directors’ characteristics (Simpson and Gleason, 1999; Golambusen and Guerrione, 2000). To the best of our knowledge, this is the first paper that evaluates the impact of bank governance on credit risk in the MENA region. Recently, Istanbula et al. (2012) have considered the impact of the business and institutional environment on the credit risk exposure using a sample of commercial banks from 12 MENA countries over the periods of 2002-2006.
Focus on...

Currency Turmoil in an Unbalanced World Economy

I. Introduction

The world is once again under threat of currency turmoil ignited by a vigorous appreciation of the dollar against all other currencies. This is the harbinger of another long cycle which has been the pattern of exchange rates since the fall of the Bretton Woods system in 1971 (Figure 1). The dollar has soared against the yen since early 2013, and against the euro since mid-2014. Up to March 2015 the prospects looked fine. With the US economy being relatively buoyant with good employment statistics, and the euro area still in the doldrums, it seemed possible that the exchange rate mechanism might succeed, helped by market anticipations of diverging monetary policies, for example, incipient rise of Fed funds rate in the US, and massive quantitative easing (QE) cum zero to negative interest rates in the euro area.

As has happened before in similar circumstances, the US authorities were optimistic. Treasury secretary Jack Lew declared: “Let the exchange rate go where it needs to go”! However, no one, at any time, has been able to figure out where the exchange rate needs to go. Past experience does not support such an upbeat view beyond the short run. Since the beginning of the era of the floating exchange rate, the dollar has exhibited huge medium-term cycles with no hint of the existence of a fundamental value that might be a stabilizing attractor for the FX system.

Therefore, the questions that arise are: Is the dollar in the early phase of another momentous appreciation? What would be the consequences for the unbalanced world economy? Can US growth drive up growth in the rest of the world, or will distorted exchange rates reengineer the growth of global imbalances and reignite financial vulnerabilities?

In March 2015 exports rose less than 1% while imports grew 7.7% based on huge increases in imports of consumer goods, resulting in a jump in the trade deficit of 40% since February. New York Fed economists estimate that the dollar appreciation already achieved might reduce GDP growth by about 0.6% in 2015. Those estimates are not forecasts. US output might bounce back if consumer demand remains strong. However, what seems more likely than previously thought is a financial environment with higher volatility of exchange rates and asset prices, which may complicate monetary policy.

The rise in dollar debt is due to subpar income growth in the world economy which has precluded deleveraging of the already high level of debt reached in 2007 on the one hand, and to the status of the dollar as the de facto exclusive supplier of international liquidity on the other hand. Because US monetary policy is not bound by any international rules, it has supplied liquidity on its own terms, flooding the world with cheap money in order to revive domestic consumption in the US.

The catalyst for renewed dollar appreciation has been the divergence in monetary policy between the US on the one side, Japan until early 2013, and the euro area until late 2014 on the other. Monetary policies in these latter countries, working counter to the US before a recent change in course, have created deflation risks that the new trend of dollar appreciation compounded with the slump in the price of oil is expected to correct, spreading the recovery worldwide.

However, this is the benign scenario. History would suggest the possibility of a much more unpleasant outcome. Currently, the gap between US long term interest rates and similar rates in the euro area and Japan is large and expected to widen. Nevertheless, the market’s expectations of future short-term interest rates up to end-2017 are much lower than the Fed’s. If the market expectations are right, this means that the US recovery will be hurt by the dollar turning from being cheap to expensive.

This paper analyses the causes and consequences of the dollar appreciation for the world economy. Section 2 presents the various situations across countries in terms of debt ratios. Section 3 studies the impact of the previous dollar cycles on global imbalances. Section 4 discusses...
Les fonctions de risque, conformité et contrôle dans les établissements bancaires et financiers, les sociétés d’assurance, les mutuelles et les sociétés de gestion d’actifs ont subi une profonde mutation et convergé au fil du temps, sous l’impulsion des normes réglementaires, depuis l’émergence des premiers textes – au début des années 1990 – jusqu’aux plus récentes évolutions post-crise. Les exigences en matière de gouvernance des établissements ont, en outre, été structurellement modifiées grâce aux récentes directives européennes sur la solvabilité (Solvabilité 2 pour les assureurs et mutuelles ; CRD4, pour les établissements de crédit et entreprises d’investissement...). Dans l’Asset Management, les normes de contrôle des risques et rémunérations ont également évolué, avec notamment la directive AIFM.

Cet ouvrage présente les caractéristiques de ces fonctions clés qui constituent le socle des dispositifs de contrôle interne et de gestion des risques, ainsi que les nouvelles exigences pour les organes de gouvernance des établissements. Les fonctions successivement décrites sont :
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- La fonction de responsable des contrôles permanents.
- Le responsable LCB-FT – Le correspondant/déclarant TRACFIN.
- Le responsable du contrôle des services d’investissement RCSI et RCCI.
- La fonction risques.
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L’auteur analyse les interdépendances entre ces professions et explique comment optimiser leur organisation et leurs relations afin d’œuvrer pour une meilleure gouvernance, un contrôle efficace et une plus grande maîtrise des risques. Elle met en exergue les nouvelles exigences pour le conseil d’administration ou de surveillance en matière d’organisation (comités spécialisés du conseil), de rôle et responsabilité des administrateurs, de compétences et formation.

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