Welcome from the Conference Chair

Dear INFINITI Delegate

Welcome to Trinity College Dublin and the 8th INFINITI Conference on International Finance. The theme this year is one that we chose last year, in initial discussions, to be “International Credit and Financial Market Integration: After the Storm?” However, it should be noted that we added the question mark later! It has been a most interesting year, a transformative year for economies and financial markets.

Part of the role of conferences and academic gatherings is to address and question the events and issues of the day, and I am confident that this Conference will do that. We have again an exceptionally interesting set of papers, special and keynote speakers. Our first keynote is Bill Megginson, a man whose expertise in the financial aspects of privatisation has been known to us for many years, whose keynote talk examines who really got hurt when Lehman collapsed. The results are a great example of the way that unexpected fallout can be examined. The second is Ed Kane, of Boston College, a man whose personal fortunes would be transformed had he only had the foresight to copyright his coinage of the term “zombie banks” and to charge media for its use! His talk will be a provocative and challenging exploration of how the system reacted and reacts to crises.

Above and beyond that, over 160 papers on a vast array of international financial issues will be presented. We welcome back old friends and greet new ones. Special roundtable sessions on real estate finance, on investments in the post-crisis world, and on the structure of the emerging bond markets provide more in-depth opportunities for exploration.

We are also delighted to welcome back to INFINITI Professor Patrick Honohan, who for many years has presented as an author at this and other conferences but who has since gone on to become Governor of the Central Bank of Ireland and ex-officio a member of the Governing Council of the European Central Bank. Governor Honohan opens the Conference Monday at 8:30 a.m.

As previous years, a selected set of papers will be published in a Special Issue of the Journal of Banking and Finance, courtesy of Professor Ike Mathur, Editor. (See page 4 for further information.)

Many thanks to all the reviewers for their assistance in the paper selection, and to the local organising group: Jenny Berrill, Elaine Hutson, Colm Kearney and Aleksander Šević. Most of all thanks once again to Linda Soriton, the operational genius behind this Conference.

I hope that you have an enjoyable Conference.

Brian M Lucey, PhD, FTCD
Associate Professor of Finance, School of Business, &
Research Associate, Institute for International Integration Studies
Trinity College Dublin
What and Who are INFINITI?

INFINITI stands for International Financial Integration. The INFINITI Group is one of the research groupings within the Institute for International Integration Studies (IIIS).

INFINITI was constituted in the summer of 2003, and has three main activities:

- Running the annual INFINITI Conference on International Finance,
- Hosting short- and long-term visitors through the IIIS, and
- Maintaining an active research agenda. Our work is available from the IIIS, SSRN or REPEC.
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Special Issue of the *Journal of Banking and Finance*

The Journal of Banking and Finance (JBF) will publish a Special Issue, edited by Brian M Lucey, from papers presented at the 8th INFINITI Conference on International Finance. The theme for this Special Issue is “International Credit and Financial Market Integration: After the Storm?”

Authors of papers presented here are therefore invited to submit their papers to the JBF for consideration in this special issue. Papers submitted will go through the normal JBF submission and review process. Papers must be submitted online through EES at http://ees.elsevier.com/jbf/default.asp and authors should specify “INFINITI 2010” for “Paper Type” during the submission process.

The time period for submitting papers through EES for the special issue is **from 15 July 2010 through to 31 July 2010**. You are strongly encouraged to address your Discussant’s comments prior to submitting the paper.

Should you have any further questions regarding the submission of the paper for the Special Issue, please do not hesitate to contact Brian Lucey (blucey@tcd.ie).

### CFA Institute CE Qualified Activity

As a participant in the CFA Institute Approved-Provider Program, CFA Ireland has determined that this programme qualifies for 1 credit hour for each Plenary Session, 1.5 credit hours for each Special Session, and 1.5 credit hours for each Parallel Session attended. If you are a CFA Institute member, CE credit for your participation in this programme will be automatically recorded in your CE Diary. Please see the Conference Reception Desk for a copy of the form to be filled out and returned.
We would like to thank the many reviewers who volunteered their time to help out with our double blind peer review process:

Shyam Adhikari, Texas Tech University, USA
Betty Agnani, Universidad de Granada, Spain
Sam Agyei-Ampomah, University of Surrey, UK
Vincent Arago, Universitat Jaume I, Spain
Henry Aray, Universidad de Granada, Spain
Wolfgang Aussenegg, Vienna University of Technology, Austria
Madhu Bala, Indira Gandhi National Open University, India
Marina Balboa, Universidad de Alicante, Spain
Fabio Bertoni, Politecnico di Milano, Italy
Ansgar Belke, Universität Duisburg Essen, Germany
Dirk Baur, University of Technology, Sydney, Australia
Marina Balboa, Universidad de Alicante, Spain
Madhu Bala, Indira Gandhi National Open University, India
Jane Bogoev, Staffordshire University & National Bank of the Republic of Macedonia, UK & Macedonia
Nicola Borri, Libera Universita Internazionale degli Studi Sociali, Italy
Erik Devos, The University of Texas at El Paso, USA
Wolfgang Aussenegg, Vienna University of Technology, Austria
Henry Aray, Universidad de Granada, Spain
Vincent Arago, Universitat Jaume I, Spain
Betty Agnani, Universidad de Granada, Spain
Shyam Adhikari, Texas Tech University, USA
Francesco Guidi, University of Greenwich, UK
Manu Gupta, Virginia Commonwealth University, USA
Alexis Guyot, EUROMED Marseille Ecole de Management, France
Jens Hagendorff, University of Leeds, UK
Shan He, Louisiana State University, USA
Walid Hichri, Université de Lyon 2, France
Adora Holstein, Robert Morris University, USA
Sheue-Ching Hong, Tamkang University, Taiwan
Neeltje van Horen, De Nederlandsche Bank, The Netherlands
Elaine Hutson, University College Dublin, Ireland
Emma Iglesias, University of Essex, UK
Iuliana Ismailescu, Pace University, USA
Tariq Javed, Mohammad Ali Jinnah University, Pakistan
Juan-Angel Jimenez-Martín, Universidad Complutense de Madrid, Spain
Juha Junttila, University of Oulu, Finland
Sasidharan K, TKM Institute of Management, India
Petko Kalev, University of South Australia, Australia
Aleksander Karminsky, State University Higher School of Economics, Russian Federation
Stefanie Kleinemeier, Maastricht University, The Netherlands
Asta Klimavičienė, ISM University of Management and Economics, Lithuania
Tim Korkeamaki, Hanken School of Economics, Finland
Finn Kornner, Carl von Ossietzky Universität Oldenburg, Germany
Julia Kraus, Technical University Munich, Germany
Christopher Kubik, Colby-Sawyer College, USA
Scott Linn, The University of Oklahoma, USA
Horst Loechel, CEIBS China Europe International Business School, China
Félix López, Universidad de Valladolid, Spain
Bernhard Mahlberg, Vienna University of Economics and Business, Austria
Davinder Malhotra, Philadelphia University, USA
David Mares, Banking Institute - College of Banking, Czech Republic
Srdjan Marinkovic, University of Nis, Serbia
Juan Carlos Matallin-Saez, Universitat Jaume I, Spain
Ike Mathur, Southern Illinois University Carbondale, USA
Ana Paula Matias Gama, Universidade da Beira Interior, Spain
Petros Migiakos, Bank of Greece, Greece
Wasseem Mina, United Arab Emirates University, UAE
Andrea Monticini, Università Cattolica del Sacro Cuore, Italy
Lucia Morales, Dublin Institute of Technology, Ireland
Bruce Morley, University of Bath, UK
Christian Mueller-Kademann, Zurich University of Applied Sciences, Switzerland
Paramita Mukherjee, IBS (ICFAI Business School), India
Romita Mukherjee, Cornell University, USA
Maria Jesús Muñoz Torres, Universitat Jaume I, Spain
Ana Paula Matias Gama, Universidade da Beira Interior, Spain
Beloño Nieto, Universidad de Alicante, Spain
Sebastián Nieto-Parrà, OECD Organisation for Economic Co-operation and Development, France
Oghenovo Obrimah, Virginia Commonwealth University, USA
Sean O’Riordan, Mapflow, Ireland
Alexei Orlov, Radford University, USA
Francesca Pancotto, HEC Liège, Belgium
Georgios Papanastasopoulos, University of Piraeus, Greece
Aisyah Abdul Rahman, Universiti Kebangsaan Malaysia, Malaysia
Latha Ramchand, University of Houston, USA
Mary Tone Rodgers, Pace University and Merrill Lynch Pierce Fenner & Smith, USA
Elisabet Ruiz-Dotras, Universitat Oberta de Catalunya, Spain
Enrique Salvador, Universitat Jaume I, Spain
David Schmidt, Aston University, UK
Aleksandar Šević, Trinity College Dublin, Ireland
Moh Sherif, Heriot-Watt University, UK
Marcello Signorelli, Università degli Studi di Perugia, Italy
Aymen Smondel, Université Paris IX Dauphine, France
Carolyn Stumph, Indiana University-Purdue University Fort Wayne, USA
Nuria Suárez Suárez, Universidad de Oviedo, Spain
Cecilio Tamarit, Universitat de València, Spain
Olesia Verchenko, Kyiv School of Economics, Ukraine
Tina Viljoen, The University of Sydney, Australia
Svitlana Voronkova, ZEW Centre for European Economic Research, Germany
Ching-Chang Wang, Southern Taiwan University, Taiwan
David Wang, Chung Yuan Christian University, Taiwan
Berry Wilson, Pace University, USA
John Wilson, University of St Andrews, UK
Karen Ho-Yan Wong, The Open University of Hong Kong, Hong Kong
Rim Zaabar, SKEMA Business School, France
Guangfeng Zhang, University of Glasgow, UK
Chen Zhou, De Nederlandsche Bank, The Netherlands
Keynote Speakers

William Megginson

Bill Megginson is Professor and Rainbolt Chair in Finance at the University of Oklahoma’s Michael F. Price College of Business, and was recently named a George Lynn Cross Research Professor. From 2002 to 2007, he was a voting member of the Italian Ministry of Economics and Finance’s Global Advisory Committee on Privatization. During spring 2008, he was the Fulbright Tocqueville Distinguished Chair in American Studies and Visiting Professor at the Université Paris Dauphine. He has published refereed articles in several top academic journals, including the *Journal of Economic Literature*, the *Journal of Finance*, the *Journal of Financial Economics*, the *Journal of Financial and Quantitative Analysis*, and *Foreign Policy*. His co-authored study documenting significant performance improvements in recently privatized companies received one of two Smith Breeden Distinguished Paper Awards for outstanding research published in the *Journal of Finance* during 1994. Professor Megginson’s research has been frequently cited in academic and professional publications. His articles have been downloaded over 32,000 times from the Social Sciences Research Network, and his books and articles have been cited over 6,500 times (according to Google Scholar). His co-authored privatization survey article, published in the *Journal of Economic Literature* in 2001, is the eighth most widely cited finance article published since 2000, and the most widely cited article published in 2001. He is author or co-author of nine textbooks. Dr Megginson holds a PhD in finance from Florida State University. He has been a Visiting Professor at Duke University, Vanderbilt University, the University of Zurich, the University of Amsterdam, Bocconi University, and Université-Paris Dauphine. He has visited 71 countries and has served as a privatization consultant for the New York Stock Exchange, the OECD, the IMF, the World Federation of Exchanges, and the World Bank.

Edward J Kane

Edward J Kane is Professor of Finance at Boston College. From 1972 to 1992 he held the Everett D. Reese Chair of Banking and Monetary Economics at Ohio State University. A founding member of the Shadow Financial Regulatory Committee, Kane rejoined the organisation in 2005. He served for twelve years as a trustee and member of the finance committee of Teachers Insurance. Currently, he consults for the World Bank and is a senior fellow in the Federal Deposit Insurance Corporation’s Center for Financial Research. Previously, Kane has consulted for numerous agencies, including the IMF, components of the Federal Reserve System, and three foreign central banks. He consulted as well for the Congressional Budget Office, the Joint Economic Committee, and the Office of Technology Assessment of the U.S. Congress. He is a past president and fellow of the American Finance Association and a former Guggenheim fellow. He also served as president of the International Atlantic Economic Society and the North American Economics and Finance Association. Kane is a longtime research associate of the National Bureau of Economic Research. Besides authoring three books, he has published widely in professional journals and currently serves on six editorial boards. He received a BS from Georgetown University and a PhD from the Massachusetts Institute of Technology.
General Information regarding the Conference

Conference Reception Desk

We have a dedicated Conference Reception Desk located on the Upper Concourse of the Arts Building (Level 2). It will be open at the following times:

- Monday, 14 June 0800 to 1800 hrs
- Tuesday, 15 June 0800 to 1800 hrs

Messages may be left here for delegates.

Completion of Registration

All registration fees and other charges must be paid in full in order to complete your Registration. At this time, you will receive your Conference Programme & Book of Abstracts, as well as a Conference Badge. Please wear your badge at all times during the Conference, as only delegates with official Conference ID will be allowed into any of the Conference Sessions and functions.

Conference Location

The Conference will be held in the Arts Building. The best entrance to use would be the Nassau Street entrance (at the top of Dawson Street) as this leads directly into Level 2 of the Arts Building. All the rooms we are using are on Levels 2, 3, 4 and 6.

- Level 2
  - Conference Reception Desk
  - Synge Theatre
  - Ui Chadhain Theatre
  - Davis Theatre
Level 3  
Room 3071  
Room 3106  

Level 4  
Room 4047  
Room 4050A  
Room 4050B  

Level 6  
A6.009 Irish-Scottish Seminar Room  
C6.002 IIIS Seminar Room  

There are Conference Assistants to help guide you to the specific rooms on every level.

**Dress Code**

The dress code for the entire Conference, including the Conference Gala Dinner, is smart casual.

**Car Parking**

There is no car parking available on campus.

**Conference Programme**

The Conference officially begins at 0830 hrs on Monday, 14 June 2010, in the Synge Theatre on Level 2 of the Arts Building.

**Parallel Sessions**

All presenters may upload their presentations in either MS PowerPoint or pdf format. They are responsible for ensuring that that their presentations are uploaded onto the computer in the room in advance of the start of their Session. A Conference Assistant will be available to assist in the process – please note that the rooms are only available for the last 15 minutes of the break prior to the start of the Session. For example, upload anytime between 0815 and 0830 hrs for a Parallel Session 1 presentation. Presentations may of course be uploaded during any breaks prior to the allocated session, however only on the same day that they will be presented.

During the Parallel Sessions, each presenting Author will make a 15-20 minute presentation on their paper (depending on the number of papers in the Session). The allocated Discussant will then have 5 minutes to respond to the presentation.

The Session Chair is responsible for directing any Q&A and for ensuring that the Session ends on time. Any time left at the end of the each Session will be devoted to general Q&A on all papers presented during the Session. Presenting Authors are therefore asked to remain in their rooms until the end of the Session.

**Papers**

Full papers are only available directly from the Authors.

**Photocopying**

There are no photocopying facilities available to us in the Arts Building, but there are a few retail outlets on Nassau Street which can provide you with this service.
Catering

Tea, coffee and water will be served during the breaks, as indicated in the Conference Programme, on the Upper Concourse (next to the Conference Reception Desk area).

Delegates are reminded that they should make their own arrangements for lunch. On-campus, there is the Buttery Restaurant (beneath the Dining Hall), for those who prefer the economical option. Off-campus, there are many coffee shops, cafes, pubs and restaurants just beyond the Nassau Street entrance.

Social Events

On Monday evening, from 1930 hrs, you are invited to join us in Messrs Maguire on O’Connell Bridge, Burgh Quay, Dublin 2. Essentially, walk out the Front Arch entrance and head right towards O’Connell Bridge. Don’t cross the bridge, the bar is on your right-hand side. We have the top floor booked for INFINITi delegates.

The Conference Gala Dinner will be held in the Dining Hall on-campus at 1930 hrs. Registered delegates do not have to pay any additional charges to attend this event – it is included in the registration fee – however, if you did not indicate on your registration form that you would attend this event, please double check with the Conference Reception Desk no later than 1730 hrs on Monday, 14 June 2010, as spaces are now limited.
Programme

As a participant in the CFA Institute Approved-Provider Program, CFA Ireland has determined that this programme qualifies for 1 credit hour for each Plenary Session, 1.5 credit hours for each Special Session, and 1.5 credit hours for each Parallel Session attended. If you are a CFA Institute member, CE credit for your participation in this programme will be automatically recorded in your CE Diary. Please see the Conference Reception Desk for a copy of the form to be filled out and returned.

Sunday, 13 June 2010

1700-1900 Welcome Reception and Early Registration The Atrium

Monday, 14 June 2010

0800-1800 Registration Desk Open Upper Concourse, Level 2, Arts Building

0830-0900 Welcome Synge Theatre

Opening Remarks by Patrick Honohan, Governor of the Central Bank of Ireland

0900-1030 Parallel Sessions 1

1030-1100 Tea & Coffee Upper Concourse

1100-1200 Plenary Session Synge Theatre

Bill Megginson, Michael F Price College of Business, The University of Oklahoma, USA

“The Value of Investment Banking Relationships: Evidence from the Collapse of Lehman Brothers”

The sudden collapse of Lehman Brothers on September 14, 2008 offers a unique natural experiment to test whether existing investment banking relationships have value for the clients. We study the impact of the Lehman collapse on industrial firms that employed Lehman for (1) underwriting equity offerings; (2) underwriting debt offerings; (3) providing advice on mergers and acquisitions; (4) providing analyst research services; and (5) providing market-making services. Companies using Lehman as lead underwriter for equity offerings lost around 5% of their market value, on average, (amounting to approximately $23 billion in last market capitalization) in the seven days surrounding Lehman’s bankruptcy. We also examine how client losses were related to various client characteristics including the nature and strength of their relationship with Lehman. The losses were especially severe for companies that had undertaken a larger number of equity offerings in the past 10 years with Lehman as lead underwriter and those that were smaller, younger, and more financially constrained. No other client groups were adversely affected.

1200-1300 Lunch (delegates’ own arrangements)

1300-1430 Parallel Sessions 2

1430-1445 Tea & Coffee Upper Concourse
Special Session A

“Real Estate Finance”

A roundtable organised and moderated by Brian Lucey of Trinity College Dublin, featuring a number of commentators. The roundtable will examine the future for real estate as an investible asset, the effects of real estate crashes on financial systems, the particular case of Ireland and the recent crash and the long-term macroeconomic consequences of real estate booms and busts.

- Simon Stevenson, Director, Center for Real Estate Finance, City University London
- Derek Brawn, Investment Strategist, Globalreach Securities Ltd
- Peter Matthews, Banking Consultant
- Constantin Gurdgiev, Lecturer, Blogger, Commentator and Head of Macroeconomics, Global Centre for Economic Development, Institute for Business Value, IBM

Parallel Sessions 3

Informal Social Evening

Tuesday, 15 June 2010

Edward J Kane, Boston College, USA

“Post-Crisis Financial Reform as Denial and Coverup”

The securitization bubble can be traced to the ways that national safety nets subsidize leveraged risk-taking. Subsidies encourage firms both to take hard-to-monitor risks and to make themselves politically, administratively, and economically difficult for government officials to fail.

The presentation underscores the incentive conflicts that led creditors and internal and external supervisors to short-cut and outsource their due diligence. Unless proposed reforms adequately address these conflicts, safety nets will continue to expand and their expansion will undermine financial stability by generating large interim rewards for creative and aggressive risk-takers.

As a participant in the CFA Institute Approved-Provider Program, CFA Ireland has determined that this Plenary Session qualifies for 1 CE hour inclusive of 1 SER hour, in the content areas of Standards, Ethics, and Regulations. If you are a CFA Institute member, CE credit for your participation in this programme will be automatically recorded in your CE Diary. Please see the Conference Reception Desk for a copy of the form to be filled out and returned.

Lunch (delegates’ own arrangements)
1300-1430  **Parallel Sessions 5**

1430-1445  **Tea & Coffee**  Upper Concourse

1445-1615  **Special Session B**  Synge Theatre

**“Investments in the Post-Crisis World”**

A roundtable organised by CFA Ireland and moderated by Aleksandar Šević of Trinity College Dublin, featuring

- “An Update on Latest Trends in Fund Offerings” by David Hammond, CFA, Managing Director at Bridge Consulting
- “An Update on Current Issues in the EU Government Bond Market” by Catherine McLaughlin, CFA, Fixed Income Fund Manager at Irish Life Investment Managers
- “Role of the CFA Institute and CFA Ireland in the Changing World” by Oliver McClure, President of CFA Ireland

1445-1615  **Special Session C**  Davis Theatre

**“The Structure of the Emerging Bond Market”**

This invited session is organised by the OECD Development Centre in collaboration with the Pontifical Catholic University of Argentina Graduate Business School. It will bring together three recent papers on the microstructure and pricing of emerging bond markets from a historical perspective. A first paper will present fresh empirical evidence on primary bond market at the end of the 19th century and analyses the role of financial intermediaries as underwriters. A second paper estimates the determinants of two key issuance costs during the period 1993-2007 in the sovereign bond market: underwriting fees and yield spreads. The third paper revolves around the application of the sovereign ceiling rule in a sample of Latin American corporate bonds and the firm or bond-idiosyncratic determinants of the latter during the period 1996-2005.

- “Containing contagion without an IMF: Underwriters and volatility in 19th century sovereign debt markets” by Juan H Flores, University of Geneva and Figuerola Institute, Switzerland
- “Breaking down the cost of issuance: An analysis of the microstructure of emerging sovereign bond markets” by Sebastián Nieto-Parra, OECD Organisation for Economic Co-operation and Development, France
- “The Cost of Corporate Bond Finance in Latin America: Spreads and Ratings” by Martin Grandes, Ricardo Pasquini and Demian Panigo – presented by Martin Grandes, Pontifical Catholic University of Argentina, Argentina

1615-1630  **Tea & Coffee**  Upper Concourse

1630-1800  **Parallel Sessions 6**

1930  **Conference Gala Dinner**  The Dining Hall
As a participant in the CFA Institute Approved-Provider Program, CFA Ireland has determined that this programme qualifies for 1.5 credit hours for each Parallel Session attended. If you are a CFA Institute member, CE credit for your participation in this programme will be automatically recorded in your CE Diary. Please see the Conference Reception Desk for a copy of the form to be filled out and returned.

## Parallel Sessions at a Glance

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<td>The Banking Firm</td>
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<td>Banking Products</td>
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<td>Trading Risk, Return &amp; Expectations</td>
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<td>Investment Risk &amp; Liquidity</td>
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<td>Impact Determinants</td>
<td>Bond Markets Around the World</td>
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<td>Capital Structure</td>
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<td><strong>Dates</strong></td>
<td>Corrugation</td>
<td>Governance &amp; Crises</td>
<td>Market Crises</td>
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<td>Room 4050B, Level 4</td>
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<td>Trading &amp; Settlement I</td>
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<td>Irish-Scottish Seminar Room, Level 6</td>
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Parallel Sessions

*Where there are multiple authors, an asterisk indicates the presenting author.

As a participant in the CFA Institute Approved-Provider Program, CFA Ireland has determined that this programme qualifies for 1.5 credit hours for each Parallel Session attended. If you are a CFA Institute member, CE credit for your participation in this programme will be automatically recorded in your CE Diary. Please see the Conference Reception Desk for a copy of the form to be filled out and returned.

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Chair: Ralph de Haas, EBRD European Bank for Reconstruction and Development, UK

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Chair: Maggie Fu, University of Macau, China

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Chair: Stuart Hyde, The University of Manchester, UK

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*Simon Leader, University College Dublin, Ireland*  
Don Bredin, University College Dublin, Ireland  
Cal Muckley, University College Dublin, Ireland  
**Discussant:** George Filis, University of Portsmouth, UK

**Gold and Financial Assets: Are there any Safe Havens in Bear Markets?**  
Virginie Coudert, Banque de France, France  
*Hélène Raymond, Université Paris X Nanterre, France*  
**Discussant:** Simon Leader, University College Dublin, Ireland

**Stock market and oil prices: Dynamic correlation in oil-importing and oil-exporting countries**  
*George Filis, University of Portsmouth, UK*  
Stavros Degiannakis, University of Portsmouth, UK  
Christos Floros, University of Portsmouth, UK  
**Discussant:** Hélène Raymond, Université Paris X Nanterre, France

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### Session 3j: Exchange Rates

**Chair:** Frank McGroarty, University of Southampton, UK  
Assessing the Real Exchange Rate Misalignments: Is Real Undervaluation of the Currency Likely and Can It Be Sustained?  
Megumi Kubota, University of York, UK  
**Discussant:** Frank McGroarty, University of Southampton, UK

**Misery Loves Company, Beauty Contest Dynamics in Exchange Rates Expectations**  
*Francesca Pancotto, HEC Liège, Belgium*  
Aline Muller, HEC Liège, Belgium  
**Discussant:** Megumi Kubota, University of York, UK

**Artificial Neural Network and High Frequency Exchange Rate Prediction**  
*Frank McGroarty, University of Southampton, UK*  
Taufiq Choudhry, University of Southampton, UK  
**Discussant:** Francesca Pancotto, HEC Liège, Belgium
### Parallel Sessions 4: Tuesday, 15 June 2010  
**0900-1030**

**Session 4a: Bank Loans**  
Chair: Elena Cubillas, Universidad de Oviedo, Spain  

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<td>Are bank loans important for output growth? A panel analysis of the Euro area</td>
<td>Ulrike Rondorf, Freie Universität Berlin &amp; Commerzbank AG, Germany</td>
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<td>Effects of loan provisions on bank lending fluctuations: some international comparisons</td>
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<td><strong>Discussant:</strong> Ulrike Rondorf, Freie Universität Berlin &amp; Commerzbank AG, Germany</td>
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<td>The effect of information asymmetries among lenders on syndicated loan spreads</td>
<td>Blaise Gadanecz, Bank of International Settlements, Switzerland</td>
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<td>Philip Molyneux, University of Wales, Bangor, UK</td>
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<td><strong>Discussant:</strong> Vincent Bouvatier, Université de Paris Ouest, France</td>
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**Session 4b: Regulation**  
Chair: Gerhard Winkler, Vienna University of Economics and Business & Oesterreichische Nationalbank, Austria  

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<td>Orla McCullagh, University of Limerick, Ireland</td>
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<td><strong>Discussant:</strong> Sandra Dow, Monterey Institute of International Studies, USA</td>
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<td>Re-Mapping Credit Ratings</td>
<td>*Manuel Lingo, Vienna University of Economics and Business &amp; Oesterreichische Nationalbank, Austria</td>
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<td>Corporate Governance and Corporate Strategies for Climate Control and Environmental Mitigation</td>
<td>Raj Aggarwal, University of Akron, USA</td>
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<td><strong>Discussant:</strong> Manuel Lingo, Vienna University of Economics and Business &amp; Oesterreichische Nationalbank, Austria</td>
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**Session 4c: Rethinking the Euro**  
Chair: Gerald P Dwyer, Federal Reserve Bank of Atlanta, USA  

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<td><strong>Discussant:</strong> William Bryant, Macquarie University, Australia</td>
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<td><strong>Discussant:</strong> Séverine Menguy, Université Paris X Nanterre, France</td>
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<td>The superiority of a European stabilization mechanism over national budgetary stabilization policies</td>
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**Session 4d: Finance & Development in Emerging Markets**  
Chair: Sergey Gelman, Higher School of Economics, Moscow, Russia  

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<td>*Eduardo Cavallo, Inter-American Development Bank, USA</td>
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<td>Carlos Scartascini, Inter-American Development Bank, USA</td>
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<td>Thomas Lagoarde-Segot, EUROMED Marseille Ecole de Management, France</td>
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<td>Transactions Costs in an Emerging Stock Market: Berlin 1892-1913</td>
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<td>Carsten Burhop, Max Planck Institute for Research on Collective Goods, Germany</td>
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<td><strong>Discussant:</strong> Thomas Lagoarde-Segot, EUROMED Marseille Ecole de Management, France</td>
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### Session 4e: European Investment

**Chair:** Anna Naszodi, Magyar Nemzeti Bank (Central Bank of Hungary), Hungary

| The risk-return trade-off in Europe: A temporal and cross-sectional analysis |
| *Enrique Salvador, Universitat Jaume I, Spain |
| Vicent Aragó, Universitat Jaume I, Spain |
| Discussant: Anna Naszodi, Magyar Nemzeti Bank (Central Bank of Hungary), Hungary |

| Trade-throughs in European cross-traded equities after transaction costs – Empirical Evidence for the EURO STOXX 50 |
| Bartholomäus Ende, E-Finance Lab, Germany |
| Peter Gomber, Johann Wolfgang Goethe Universität Frankfurt am Main, Germany |
| *Marco Lutat, Johann Wolfgang Goethe Universität Frankfurt am Main, Germany |
| Discussant: Enrique Salvador, Universitat Jaume I, Spain |

| Beating the Random Walk in Central and Eastern Europe by Survey Forecasts |
| Anna Naszodi, Magyar Nemzeti Bank (Central Bank of Hungary), Hungary |
| Discussant: Marco Lutat, Johann Wolfgang Goethe Universität Frankfurt am Main, Germany |

### Session 4f: CDS Bond Spreads

**Chair:** Brian Lucey, Trinity College Dublin, Ireland

| A study of the causal relationships between sovereign CDS spreads, risk-free interest rates and exchange rates |
| *Yang Liu, University of Bath, UK |
| Bruce Morley, University of Bath, UK |
| John Hudson, University of Bath, UK |
| Discussant: Brian Lucey, Trinity College Dublin, Ireland |

| Exchange Rate Policy and Sovereign Spreads in Emerging Market Economies |
| Inci Gumus, Sabanci Universitesi, Turkey |
| Discussant: Yang Liu, University of Bath, UK |

| CDS Bond Spreads among the PIIGS 2006-2010 |
| *Brian Lucey, Trinity College Dublin, Ireland |
| Constantin Gurdgiev, IBM & Trinity College Dublin, Ireland |
| Jonathan Batten, Hong Kong University of Science & Technology, Hong Kong |
| Cetin Ciner, University of North Carolina at Wilmington, USA |
| Discussant: Inci Gumus, Sabanci Universitesi, Turkey |

### Session 4g: Corporate Ownership

**Chair:** Graham Partington, The University of Sydney, Australia

| Does Government Ownership Affect the Cost of Debt? Evidence from Privatization |
| Ginka Borisova, Iowa State University, USA |
| *William Megginson, The University of Oklahoma, USA |
| Discussant: Elaine Hutson, University College Dublin, Ireland |

| Empirical Evidence on Ownership Structure, Management Control and Agency Costs |
| Sindhar Gogineni, The University of Oklahoma, USA |
| *Scott Linn, The University of Oklahoma, USA |
| Pradeep Yadav, The University of Oklahoma, USA |
| Discussant: Graham Partington, The University of Sydney, Australia |

### Session 4h: Money & the Real Economy

**Chair:** Bernd Wilfling, Westfälische Wilhelms-Universität Münster, Germany

| Heterogeneous Expectations, Learning and Monetary Policy Rules in A Two-country Model |
| Qinwei Wang, University of Cambridge, UK |
| Discussant: Lars Oxelheim, Lund University, Sweden |

| Real Sector and Banking System: Real and Feedback Effects. A Non-Linear VAR Approach |
| Stefano Puddu, Université de Neuchâtel & Université de Lausanne, Switzerland |
| Discussant: Qinwei Wang, University of Cambridge, UK |

| Corporate Distress and Restructuring with Macroeconomic Fluctuations: The Cases of GM and Ford |
| *Lars Oxelheim, Lund University, Sweden |
| Claes Wilhberg, Chapman University, USA |
| Discussant: Stefano Puddu, Université de Neuchâtel & Université de Lausanne, Switzerland |
### Session 4i: Mergers & Acquisitions

**Chair:** Maria Nieto, Banco de España, Spain

#### Acquiring Shareholders’ Valuation in Cross-Border M&As: The Influence of the Legal and Institutional Environment

*Isabel Feito-Ruiz, Universidad de Oviedo, Spain*
*Susana Menéndez-Requejo, Universidad de Oviedo, Spain*

**Discussant:** Sheila O Donohoe, Waterford Institute of Technology, Ireland

#### Determination of Bidders’ Gains and the Choice of Earnout as Acquisition Payment Currency

*Leonidas Barbopoulos, University of St Andrews, UK*
*Sudi Sudarsanam, Cranfield University, UK*

**Discussant:** Isabel Feito-Ruiz, Universidad de Oviedo, Spain

#### What do Premiums Paid for Bank M&As Reflect? The Case of the European Union

*Jens Hagedornf, University of Leeds, UK*
*Ignacio Hernando, Banco de España, Spain*

*Maria Nieto, Banco de España, Spain*

**Discussant:** Leonidas Barbopoulos, University of St Andrews, UK

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### Session 4j: No Session

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### Parallel Sessions 5: Tuesday, 15 June 2010
**1300-1430**

| **a** | Session 5a: Cross-Border Banking  
| Chair: Harald Sander, Cologne University of Applied Sciences, Germany  
| How Institutional Differences between Home and Host Country Affect Bank Efficiency? International Comparison of Domestic versus Foreign Banks with Their Specifications and Regions  
*Sheng-Hung Chen, Nan Hua University, Taiwan  
Hsiang-Hsi Liu, National Taipei University, Taiwan  
Chuan-Yu Lin, Nan Hua University, Taiwan  
Discussant: Stefanie Kleimeier, Maastricht University, The Netherlands  
| Information sharing and cross-border entry in European banking  
*Caterina Giannetti, GSBC Jena, Germany  
Nicola Jentzsch, DIW German Institute for Economic Research, Germany  
Giancarlo Spagnolo, University of Tor Vergata, SITE Stockholm & EIEF, Italy  
Discussant: Sheng-Hung Chen, Nan Hua University, Taiwan  
| What Drives Cross-Border Depositing: Economics, Culture or Institutions? New Evidence from the Euro zone  
*Sylvia Heuchemer, Cologne University of Applied Sciences, Germany  
*Stefanie Kleimeier, Maastricht University, The Netherlands  
Harald Sander, Cologne University of Applied Sciences, Germany  
Discussant: Caterina Giannetti, GSBC Jena, Germany  |

| **b** | Session 5b: Behavioural  
| Chair: William Megginson, The University of Oklahoma, USA  
| A Tale of Two Strategies: Cash Flow, Accruals and the Role of Investor Sentiment  
Xavier Gerard, State Street Global Advisors Limited, UK  
*Ron Guido, Fidelity International, UK  
Christos Koutsopanis, State Street Global Advisors Limited, UK  
Discussant: William Megginson, The University of Oklahoma, USA  
| An examination of investor sentiment effect on G7 stock market returns  
*Deven Bathia, University College Dublin, Ireland  
Don Bredin, University College Dublin, Ireland  
Discussant: Ron Guido, Fidelity International, UK  
| One Half-Billion Shareholders and Counting: Determinants of Individual Share Ownership around the World  
Paul Grout, University of Bristol, UK  
*William Megginson, The University of Oklahoma, USA  
Anna Zalewska, University of Bath, UK  
Discussant: Deven Bathia, University College Dublin, Ireland  |

| **c** | Session 5c: FX  
| Chair: Aleksandar Šević, Trinity College Dublin, Ireland  
| Covered Interest Parity in the Yen Forward Market: New Insights from Threshold Non-Linear Dynamics  
*Jonathan Batten, Hong Kong University of Science & Technology, Hong Kong  
Wai-Sum Chan, Chinese University of Hong Kong, Hong Kong  
Hong-Lun Chan, The Hong Kong Polytechnic University, Hong Kong  
Peter Szilagyi, University of Cambridge, UK  
Discussant: Fang Cai, The Federal Reserve Board of Governors, USA  
| Is There a Risk-Return Tradeoff in the Foreign Exchange Market?  
*Gino Cenedese, The University of Warwick, UK  
Lucio Sarno, City University London, UK  
Discussant: Jonathan Batten, Hong Kong University of Science & Technology, Hong Kong  
| The Impact of Macroeconomic Announcements on Real Time Foreign Exchange Rates in Emerging Markets  
*Fang Cai, The Federal Reserve Board of Governors, USA  
Hyoosoo Joo, University of Maryland, USA  
Zhiwei Zhang, Hong Kong Monetary Authority, Hong Kong  
Discussant: Gino Cenedese, The University of Warwick, UK  |
### Session 5d: Emerging Markets & Financial Crises
Chair: Igor Masten, University of Ljubljana, Slovenia

**Political Crises and Stock Market Integration: Evidence from Emerging Markets**
*Bart Frijns, Auckland University of Technology, New Zealand
Ivan Indriawan, Auckland University of Technology, New Zealand
Alireza Tourani-Rad, Auckland University of Technology, New Zealand*
Discussant: Tuomas Peltonen, ECB European Central Bank, Germany

**Financial integration and financial development in transition economies: What happens during financial crises?**
*Arjana Brezigar-Masten, IMAD Institute for Macroeconomic Analysis and Development, Slovenia
Fabrizio Coricelli, Université Paris 1 Panthéon-Sorbonne, France
*Igor Masten, University of Ljubljana, Slovenia*
Discussant: Bart Frijns, Auckland University of Technology, New Zealand

**Credit Euroization in Central, Eastern and Southeastern Europe**
*Wolfgang Rainer, Vienna University of Economics and Business Administration, Austria
Peter Haiss, Vienna University of Economics and Business Administration, Austria*

**Asset Price Booms, Credit Bubbles and Future Financial Stress - A Focus on Emerging Markets**
*Tuomas Peltonen, ECB European Central Bank, Germany
Marco Lo Duca, ECB European Central Bank, Germany*
Discussant: Arjana Brezigar-Masten, IMAD Institute for Macroeconomic Analysis and Development, Slovenia

### Session 5e: Investment Risk & Liquidity
Chair: Tom Flavin, National University of Ireland, Maynooth, Ireland

**Legal regime, Size, and Liquidity factors in Asset Pricing**
*Bruce Hearne, University of Leicester, UK
Kate Phylaktis, City University London, UK
Jennifer Piese, King's College London, UK*
Discussant: Tom Flavin, National University of Ireland, Maynooth, Ireland

**Why do variance swaps exist?**
*Belén Nieto, Universidad de Alicante, Spain
Alfonso Novales, Universidad Complutense de Madrid, Spain
Gonzalo Rubio, Universidad CEU Cardenal Herrera, Spain*
Discussant: Bruce Hearne, University of Leicester, UK

**Credit and Liquidity Risk in Sub-prime Mortgage backed Assets**
*Mardi Dungey, University of Tasmania & University of Cambridge, Australia & UK
Gerald P Dwyer, Federal Reserve Bank of Atlanta, USA
*Igor Masten, University of Ljubljana, Slovenia*
Discussant: Belén Nieto, Universidad de Alicante, Spain

### Session 5f: Bond Pricing
Chair: Inci Gumus, Sabanci Universitesi, Turkey

**Liquidity Risk and the Pricing of Sovereign Bonds**
*Sakkapop Panyanukul, The University of Warwick, UK*
Discussant: Riccardo Pacini, Università degli Studi di Roma "Tor Vergata", Italy

**Auctioning Government Securities: The Puzzle of Overpricing**
*Riccardo Pacini, Università degli Studi di Roma "Tor Vergata", Italy*
Discussant: Sakkapop Panyanukul, The University of Warwick, UK

**Liquidity Risk and Pricing of Government Bonds around the World**
*Sakkapop Panyanukul, The University of Warwick, UK*
Discussant: Gerard Gannon, Deakin University, Australia
### Session 5g: Capital Structure

**Chair:** John Goodell, The University of Akron, USA

**Capital Structures in Europe, managerial insight and governance regimes.**
Charlie Reuter, ESCP-EAP & Université de Paris Ouest (CEROS), France
Discussant: John Goodell, The University of Akron, USA

**Capital Structure in European SME’s - The role of culture**
Ciarán mac an Bhaird, Dublin City University, Ireland
Discussant: Charlie Reuter, ESCP-EAP & Université de Paris Ouest (CEROS), France

**Determinants of capital structure and its choice in developing Central and Eastern European countries**
* Péter Hernádi, Budapest University of Technology and Economics, Hungary
Mihály Ormos, Budapest University of Technology and Economics, Hungary
Discussant: Ciarán mac an Bhaird, Dublin City University, Ireland

**Capital Structure in the G-7 Countries: Pecking Order Theory and Mean Reversion in Earnings**
Raj Aggarwal, The University of Akron, USA
*John Goodell, The University of Akron, USA
Sutthisit Jamdee, St Cloud State University, USA
Discussant: Mihály Ormos, Budapest University of Technology and Economics, Hungary

### Session 5h: The Macroeconomy & Finance

**Chair:** Rukmani Gounder, Massey University, New Zealand

**Monetary Policy, Global Liquidity and Commodity Prices**
*Ansgar Belke, Universität Duisburg Essen, Germany
Ingo G Bordon, Universität Duisburg Essen, Germany
Torben W Hendricks, Universität Duisburg Essen, Germany
Discussant: Sascha Becker, Freie Universität Berlin, Germany

**Inflation, Price Dispersion and the Role of Market Integration**
*Sascha Becker, Freie Universität Berlin, Germany
Dieter Nautz, Freie Universität Berlin, Germany
Discussant: Ansgar Belke, Universität Duisburg Essen, Germany

**Portfolio and short-term capital inflows to the new and potential EU countries: patterns and determinants**
*Mara Pirovano, Universiteit Antwerpen, Belgium
Jacques Vanneste, Universiteit Antwerpen, Belgium
André Van Poeck, Universiteit Antwerpen, Belgium
Discussant: Rukmani Gounder, Massey University, New Zealand

### Session 5i: Trading & Settlement I

**Chair:** Michael Schuppli, Westfälische Wilhelms-Universität Münster, Germany

**Crowded trades among hedge funds**
*Marcello Pericoli, Banca d’Italia, Italy
Massimo Sbracia, Banca d’Italia, Italy
Discussant: Michael Chlistalla, Johann Wolfgang Goethe Universität Frankfurt am Main, Germany

**The Future of European Post-Trading - Consequences for Risk Management in View of the Financial Crisis**
*Michael Chlistalla, Johann Wolfgang Goethe Universität Frankfurt am Main, Germany
Peter Gomber, Johann Wolfgang Goethe Universität Frankfurt am Main, Germany
Torbent Schaper, Johann Wolfgang Goethe Universität Frankfurt am Main, Germany
Discussant: Marie-Noëlle Cales, Université de Lyon 2, France

**Price Discovery and Investor Structure in Stock Index Futures**
*Christian Salm, Westfälische Wilhelms-Universität Münster, Germany
Michael Schuppli, Westfälische Wilhelms-Universität Münster, Germany
Discussant: Marcello Pericoli, Banca d’Italia, Italy

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<td>Market Liquidity and Ownership Structure with weak protection for minority shareholders: evidence from Brazil and Chile.</td>
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<td>Size and Liquidity Effects in Sub Saharan African stock markets</td>
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<td>Stock Exchange Consolidation and Financial Risk: The Case of Euronext</td>
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<td>Discussant: Faten Ben Slimane, Champagne School of Management, France</td>
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| Session 6j: No Session | Irish-Scottish Seminar Room, Level 6 |
Abstracts

Session 1a: Banks & Crises

The resolution of banking crises and market discipline: International evidence
*Elena Cubillas, Universidad de Oviedo, Spain
Ana Rosa Fonseca, Universidad de Oviedo, Spain
Francisco González, Universidad de Oviedo, Spain

This paper analyzes the effect of banking crises on market discipline in a sample of 101 banking crises over the 1989-2007 period. We control for unobservable bank, country, and time specific effects using an international panel data set of 3,254 banks from 87 countries. We also evaluate how bank regulation, supervision, institutions, and crisis management policies shape the effect of banking crises on market discipline. Our results suggest that on average market discipline diminishes after a banking crisis. The reduction of market discipline is, moreover, higher in countries where bank regulation, supervision, and institutions promote market discipline before the banking crisis, and where a more accommodating kind of intervention is used. Specifically, forbearance and recapitalizations are the two kinds of interventions that have the most negative effect on market discipline.

Keywords: Market discipline, banking crisis, crisis resolution, regulation, supervision, institutions.

The crisis as a wake-up call. Do banks tighten screening and monitoring during a financial crisis?
*Ralph de Haas, EBRD European Bank for Reconstruction and Development, UK
Neeltje van Horen, De Nederlandsche Bank, The Netherlands

We examine whether the sharp credit contraction during the global financial crisis was mainly caused by a liquidity shock or an intensification of banks’ screening and monitoring. By analyzing a large set of syndicated loans to private borrowers over the period 2005-2009 we find significant changes in syndicate structure during the crisis. In particular, we document a considerable increase in retention rates among syndicate arrangers which we cannot explain by reduced market liquidity. Furthermore, this increased ‘skin in the game’ is particularly pronounced when information asymmetries between borrower and lending syndicate or within the lending syndicate are high. Therefore, we conclude that the reduction in bank lending during the crisis was to a large extent caused by stricter bank screening and monitoring: a wake-up call.

Keywords: bank lending, financial crisis, loan retention, screening and monitoring, syndication

The Effectiveness of ‘Quantitative Easing’ and the Accountability of the Central Bank in Japan
*Richard Werner, University of Southampton, UK

In March 2000, the Bank of Japan adopted a policy called ‘Quantitative Easing’. This paper reconsiders the effectiveness of this policy in Japan, its country of origin, including implications for alternative transmission channels. It is found that the policy introduced by the Bank of Japan in March 2001 and maintained until March 2006 makes little empirical difference, while ‘quantitative easing’ in the original sense of the word (an expansion in credit creation) would. A stable relationship between a monetary aggregate (the disaggregated credit counterpart) and nominal GDP is found. The implications for the accountability of the Japanese central bank are discussed.

Keywords: accountability, central banking, credit creation, general-to-specific methodology, monetary policy, operating tools, qualitative easing, quantitative easing

How Bank Market Concentration, Regulation, and Institutions Shape the Real Effects of Banking Crises
*Nuria Suárez Suárez, Universidad de Oviedo, Spain
Ana I Fernandez Alvarez, Universidad de Oviedo, Spain
Francisco González Rodríguez, Universidad de Oviedo, Spain

This paper studies the influence of bank market concentration, regulation, and institutions on the real effects of 68 systemic banking crises in 54 countries over the 1980-2000 period. We find that less stringent restrictions on non-traditional bank activities and on the mixing of banking and commerce have a negative effect on economic growth during normal periods but mitigate the negative effects of banking crises on economic growth. This changing influence between crisis and non-crisis periods is reinforced by market concentration. We also find that explicit deposit insurance and better-quality accounting standards mitigate the negative real effects of systemic banking crises and interact positively with bank concentration to minimize the reduction of economic growth during crisis episodes. These results are evidence of the greater benefits that long-term relationships and the mixing of banking and commerce may provide during banking crises.

Keywords: banking crises, bank concentration, economic growth, institutions, regulation

Session 1b: Banking Products

Evidence of Microfinance Profitability
Peter Muriu, The University of Birmingham, UK

The establishment of microfinance institutions (MFIs) world-wide for the provision of collateral free loans has emerged as an important tool for improving financial access to the poor. But given their nature, MFIs can only meet a fraction of the demand for microcredit. Microfinance currently experiences a huge inflow of private investors who believe that financial institutions can profitably engage in microfinance on a massive scale. Commercial banks have begun to view the industry as a potentially profitable business with a huge unmet demand for micro credit. One of the main spheres of research in industrial economics is to evaluate factors that help explain firm profitability. Many MFIs in Sub-Sahara Africa (SSA) face major constraints in delivering microfinance services profitably. Such challenges imply that they have not been able to bridge the financial access gap. While MFIs in other regions have continuously reported positive profits, those operating in SSA continue to post negative profits. Why has this remained so? This paper specifically examines the impact of firm and industry specific effect, quality of institutions, and macroeconomic environment on the profitability of SSA microfinance institutions. Our analytical framework utilizes an unbalanced panel dataset comprising of 210 MFIs operating during 1997-2007 period. We test the robustness of the models with different specifications that confirm the general result. Our results show that, with the exception of MFI age and capital structure, all MFI-specific determinants significantly affect MFI profitability in the anticipated way. We find that higher microfinance profits are associated with well-capitalized MFIs and scale advantages, while credit risk and managerial inefficiency are associated with decreased profitability. A key result is that macroeconomic environment does not matter with regard to microfinance profitability. We also find that corruption impacts negatively on MFI profits, while profits are not persistent in SSA microfinance industry.

Keywords: Micro Finance Institutions; Sub-Sahara Africa; Profitability
Why do banks provide leasing?
*Dilek Bulbul, Johann Wolfgang Goethe Universität Frankfurt am Main, Germany
Felix Noth, Johann Wolfgang Goethe Universität Frankfurt am Main, Germany

Banks are engaging in leasing activities at an increasing rate which is shown by aggregated data for European as well as for US banking companies. However, little is known about leasing activities at the bank level. The contribution of this paper is to introduce the nexus of leasing in banking. Starting from an institutional base, it shows key features of bank’s leasing activities using the example of German regional banks. The banks in this sample can choose between different types of leasing contracts which provide them with certain leeway in conducting business with their clients. This should improve bank’s income and optimize its risk-return profile. Using a unique dataset we find a robust and significant positive impact from bank’s leasing volumes on its profitability, however, this effect cannot be observed for its competitiveness.

Keywords: Leasing, bank performance, competition.

Securitization and Bank Performance
*Barbara Casu, City University London, UK
Andrew Clare, City University London, UK
Anna Sarkisyan, City University London, UK

Using predominantly pre-crisis data, this paper employs a propensity score matching approach to analyze whether individual banks did improve their performance through securitization. Our results show that securitizing banks tend to be more profitable institutions, with higher credit risk exposure and higher cost of funding. However, our analysis does not provide evidence to suggest that securitization had a beneficial impact upon bank performance. Therefore the results presented in this paper show that, as well as leading to an increase in systemic risk, securitization seems not to have improved the performance of individual banks in the lead up to the crisis.

Keywords: Securitization, Bank Performance, Propensity Score Matching

Session 1c: Institutional & Fund Investment

Alexis Guyot, EUROMED Marseille Ecole de Management, France

The aim of this paper is to explore the link between institutional investors’ holdings in companies’ share capital and the liquidity of their stocks. We have established a classification of institutional investors according to their identity, their investment style, their activism and the turnover rate of their portfolios. We underline the fact that institutional investors are a diverse investor group, using a range of different investment styles. The results of our research qualify Barabanov and McNamara (2002) previous work: low sized firms truly benefit from institutional investment (except from pension funds) which narrow spreads and bring stock prices to be more resilient, but for larger firms, institutional investors could increase transaction costs. We also demonstrate that contrarian strategies add liquidity to the market, as do diversification strategies, whereas idiosyncratic strategies decrease stock liquidity. We support that institutional investor activism send a positive signal to the market and decreases transaction costs but causes imbalances in stock prices. Finally, we show that the length of time that institutional investors hold stocks in a portfolio has a twofold impact: on one hand, high portfolio turnover rate could increase liquidity by trading volume, but on the other, it could have an informational value for less liquid markets which leads up to increase the adverse selection component of the spread.

Keywords: Institutional Investment, Liquidity, Transaction Costs, Price Impact

The Impact of Foreign Government Investment: Sovereign Wealth Fund Investments in the US
*Elvira Sojli, Erasmus Universiteit Rotterdam, The Netherlands
Wing Wah Tham, Erasmus Universiteit Rotterdam, The Netherlands

We find that large, foreign, and politically connected investors, like Sovereign Wealth Funds (SWFs), open new markets for their target firms. In the short run, the market welcomes SWF investments in the expectation of potential monitoring and internationalization benefits. The degree of internationalization and Tobin’s q increase substantially in the years subsequent to an SWF investment. The long-run increase in Tobin’s q is directly related to the number of government-related contracts granted. The target companies contribute to the SWF markets by increasing their competitiveness, by providing certification to their domestic market, and by transferring technological know-how.

Keywords: Sovereign Wealth Funds; Monitoring; Large Shareholders; Internationalization; Political Connectedness.

The Influence of Buy-side Analysts on Mutual Fund Trading
*Stefan Frey, Eberhard Karls Universität Tübingen, Germany
Patrick Herbst, Johann Wolfgang Goethe Universität Frankfurt am Main, Germany

We present evidence of the impact of buy-side analysts on the behavior and performance of fund managers. Using data provided by a large global asset manager, we relate buy-side analysts’ recommendations to fund transactions on a daily basis. Our results show that buy-side analysts have a significant influence on trading decisions: fund managers almost certainly follow recent recommendations revisions in their trades. Fund flows and sell-side recommendations matter as well, but to a lesser extent. Positive abnormal returns to buy-side analysts’ revisions are also reflected in the performance of mutual fund trades: trades triggered by buy-side recommendations have higher returns than other trades.

Keywords: Buy-side analysts, analyst recommendations, mutual funds, investment decisions, investment performance

Session 1d: African Financial Integration

Integration of South Africa’s stock market with global and emerging markets
*Anmar Pretorius, Monash South Africa Ltd, South Africa
Jesse De Beer, University of the Free State, South Africa

The recent global financial crisis have once again emphasized the importance of understanding the nature and degree of capital market integration, as well as changes in capital market integration over time. In the literature, several implications of stock market integration are emphasized. This includes the impact on global diversification possibilities.

In the emerging market stock market integration literature, most studies focus on the regional stock markets of East Asia and Latin America. Similarly, in the case of the Johannesburg Securities Exchange (JSE), several studies empirically investigate stock market integration between the JSE and other stock market in Southern Africa. This study makes an important contribution by extending the existing empirical literature on emerging stock market integration. Most notably, our sample period include the current global financial crisis. We focus on the integration of the JSE, classified by FTSE as an “advanced emerging market” with major emerging and developed stock markets.

Empirical results confirm that the JSE is cointegrated with other emerging market countries. Integration with the BRICS countries is only present during the recent global crisis, while integration is confirmed with the advanced emerging markets during the whole period and the global crisis. With Brazil being present in both groups, it is perceived that the presence of a long run relationship is due to the resource intensiveness of Brazil, industry similarity and the similarity of the size of the South African and Brazilian markets.

Cointegration is also confirmed between the JSE and developed markets during the crisis free period of 1999 to 2007. The presence of Australia in this group can help to explain the integration. Australia is
also a resource rich country with an economic basis similar to that of South Africa. Integration with Germany can be explained by economic integration. Europe is traditionally South Africa’s main trading partner and Germany is the biggest economy in Europe. The JSE’s relative low risk indicators, similar to the developed markets, can also help to explain cointegration. Statistically significant slope dummys created for the crisis periods confirm the changing nature of the long run relationship with developed markets.

Keywords: market integration, emerging markets, South Africa

An empirical examination of the linkages between different African stock markets
Sam Agyei-Ampomah, University of Surrey, UK

This paper examines the nature and extent of linkages between African stock markets and the relationships between these markets and that of regional and global indices. We present evidence to show that African stock markets are still segmented from global markets. We also find evidence of time varying integration to the global market but the level of integration rather diminishes over time. In addition, we find that a large part of the total volatility of the domestic index appears largely country-specific which can be diversified away by cross-country diversification.

Keywords: Equity market integration, emerging markets, Africa

Determinants of international financial integration in Emerging and Frontier market economies in Sub Saharan Africa.
*William Gabriel Brau-Insaidoo, University of Cape Town, South Africa
Nicholas Biekpe, University of Cape Town, South Africa

The main goal of the study is to investigate the major determinants of international financial integration of emerging and frontier market economies in Sub Saharan Africa. To achieve this objective, a dynamic panel regression analysis is undertaken, using data on the Emerging and Frontier market economies in Sub Saharan Africa. The estimation results indicate that both pull and push factors are key determinants of the level of integration of emerging and frontier market economies in Sub Saharan Africa. External and domestic financial liberalization also profoundly affect the level of financial integration of these economies. The study recommends financially developing economies to pursue policies aimed at achieving macroeconomic stability, and a liberalized domestic and external financial sector for higher financial integration.

Keywords: international financial integration, foreign capital flows, debt creating flows, panel, emerging market economies

Systematic Risk, CDS Spread and Market Integration: An Empirical Investigation
*Maurice Peat, The University of Sydney, Australia
Jiri Svec, The University of Sydney, Australia

In this paper CDS spread data is used to investigate determinates of credit risk. The results of Granger Causality analysis show that changes in CDS spreads are “caused” by systematic risk factors, and that firm specific factors do not significantly influence changes in CDS spread. Further the analysis indicates that changes in the US VIX index are the primary determinant of changes in CDS spreads in Australia and Europe, indicating a high degree of integration of credit markets.

Keywords: Credit risk, structural models, credit spread, credit default swaps

Dealer Behavior and the Trading of Newly Issued Corporate Bonds
*Michael Goldstein, Babson College, USA
Edith Hotchkiss, Babson College, USA

This study examines dealer behavior and trading activity for a sample of 3,181 newly issued corporate bonds, focusing on underpricing at issuance and subsequent price dispersion. Unlike the equity market, the measured underpricing is the result of both an ex-ante pricing decision made by the bonds’ underwriters and significant price dispersion that occurs in the after-market for trading corporate bonds. For the full sample, underpricing averages 45 basis points (BP) for investment grade and 124 BP for high yield offerings. In the aftermarket, customers purchasing a bond on the same day from the same dealer frequently pay prices differing by over $2 (per $100 face amount). However, the introduction of transparency is associated with a reduction in underpricing and aftermarket price dispersion. Whether these gains are potentially passed on to issuing companies is less clear, as non-syndicate member dealers account for a significant proportion of after-market trading activity and price dispersion.

Finally, regardless of transparency regime, there is no evidence that dealers in newly issued bonds accumulate significant inventory positions, even when issues subsequently trade below the offering price.

Keywords: Corporate bond, underpricing, dealer behavior

Session 1f: Stops & Warnings

How to Evaluate an Early Warning System? Towards a Unified Statistical Framework to Assess Financial Crises Forecasting Methods
*Elena Dumitrescu, Université d’Orleans, France
Christophe Hurlin, Université d’Orleans, France
Bertrand Candelon, Maastricht University, The Netherlands

This paper proposes a new statistical framework inherited from the traditional credit-scoring literature, to evaluate currency crises Early Warning System (EWS). Applied so as to assess the predictive power of panel logit and Markov frameworks, it results that the panel logit is outperforming the Markov switching ones. Furthermore, the introduction of forward looking variables clearly improves the forecasting properties of the EWS. It thus confirms the adequacy of the second generation crisis models in explaining the occurrence of crises.

Keywords: currency crisis, Early Warning System, credit-scoring

When do the sudden stops really hurt?
*Mehmet Caner, North Carolina State University, USA
Fritzi Koehler-Geib, The World Bank, USA
Gallina Andonova Vinolette, The World Bank, USA

This paper analyzes the drivers and consequences of sudden stops of capital flows. It focuses on the impact of external vulnerability on the depth and length of sudden stop crises. The authors analyze 43 developing and developed countries between 1993 and 2006. They find evidence that external vulnerability not only significantly impacts the probability of a sudden stop crisis, but also prolongs the time it takes for growth to revert to its long-term trend once a sudden stop occurs. Interestingly, external vulnerability does not significantly impact the size of the instantaneous output effect in case of a sudden stop but prompts a cumulative output effect through significantly

Keywords: external vulnerability, sudden stops, global financial crisis
diminishing the speed of adjustment of output to its trend. This finding implies that countries financing a large part of their absorption externally do not suffer more ferocious output losses in a sudden stop crisis, but take longer to adapt afterward and are hence expected to suffer more protracted crises periods. Compared with previous literature, this paper makes three contributions: (i) it extends the country and time coverage relative to datasets that have previously been used to analyze related topics; (ii) it specifically accounts for time-series autocorrelation; and (iii) it provides an analysis of the adjustment path of economic growth after a sudden stop.

Session 1g: Corporate Finance

The Effects of Access to Public Debt Markets on Capital Structure
*Cesario Mateus, The University of Greenwich, UK
Amrit Judge, Middlesex University, UK

This paper investigates the role played by credit ratings in determining a firm’s capital structure choice. Until recently the primary focus of capital structure studies has been demand side determinants of firm leverage. Little thought has been given to supply side factors that might open up access to alternative sources of debt capital. In this paper we use a firm’s possession of a corporate credit rating as an indicator of access to the public bond markets. We find firms that have an S&P or Fitch long-term debt rating possess twice as much leverage compared to those without a rating. These results are robust to the use of alternative measures of leverage and methods of estimation. The debt access and leverage effects we find for rated firms have important value implications via a firm’s debt tax shield and the accompanying increase in interest deductions and facilitating investment in value enhancing projects that would otherwise be foregone because of bank lending constraints.

Keywords: Capital Structure, Credit Ratings, Bond Market Access.

Bookbuilding Information Production Revisited: Discount for Investor’s Disutility?
Taufique Samdani, Université Paris 1 Panthéon-Sorbonne & ESCP Europe, France

Discount for information production in bookbuilding Initial Public Offering (IPO) is often attributed to issuer preference for information production than for proceeds. Considering issuer preferences are not in conflict, the model in this paper shows that endogenous price revisions and price adjustments that distinguish US IPOs from most European IPOs generate first-best price outcome. This suggests that various bookbuilding conducts in the US and Europe share a common objective in information production. Price outcome in the model is conditional on investor’s utility for allocation of shares in relation to his disutility of effort for information production. The model has empirical implications regarding underpricing in bookbuilding IPOs.

Keywords: Bookbuilding IPO, underpricing, information production, bookbuilding price revision, first-best outcome.

The Relative Importance of Information Asymmetry, Litigation Risk, and Expropriation Risk: International Evidence from Seasoned Equity Offerings
Manu Gupta, Virginia Commonwealth University, USA
Oghenovo Obrimah, Virginia Commonwealth University, USA
*Nanda Rangan, Virginia Commonwealth University, USA

In this paper, we find no evidence that differences in the severity of information asymmetry problems between equity issuers and investors affect the cross-country variability in SEO underpricing. We find, however, that SEO underpricing decreases with the strength of ex post anti self dealing laws, indicating expropriation risk has a significant effect on the cross-country variability in SEO underpricing. With respect to litigation risk, we find SEO underpricing decreases with the strength of liability rights conferred on investors only in countries with strong ex post anti self dealing laws. Our findings indicate that legal protections that mitigate equity issue-specific information asymmetry problems or confer litigation rights on investors decrease investment risk only within the larger context of investor expropriation risk.

Keywords: Legal Risk, SEOs, Expropriation Risk, Litigation Risk, Information Asymmetry

Globalization of Corporate Governance: The American Influence on Dismissal Performance Sensitivity
*Trend Randoy, University of Agder, Norway
Lars Oxelheim, Lund University, Sweden
Jochen Jungelges, University of Agder, Norway

We examine how globalization of corporate governance practices influences the dismissal risk of European CEOs. It is hypothesized that the harsh monitoring of the American corporate governance system influences European CEOs’ dismissal performance sensitivity, indirectly and directly. The former materializes via European firms’ cross-listing on U.S. exchanges, the latter results from European firms hiring American independent board members. Both influences are hypothesized to result in increased dismissal performance sensitivity. Based on data from the 250 largest European publicly traded firms we find a significant increase in the dismissal sensitivity in poorly performing companies with American board membership.

Keywords: CEO dismissal, performance sensitivity, globalization, corporate governance, foreign board membership

Session 1h: Contagion

Crisis and Hedge Fund Risk
Mila Getmansky, University of Massachusetts – Amherst, USA
Monica Billio, Università “Ca’ Foscari”, Venezia, Italy
*Loriana Pelizzon, Università “Ca’ Foscari”, Venezia, Italy

We study the effects of financial crises on hedge fund risk and show that liquidity, credit, equity market, and volatility are common risk factors during crises for various hedge fund strategies. We also apply a novel methodology to identify the presence of a common latent (idiotsyncratic) risk factor exposure across all hedge fund strategies. If the latent risk factor is omitted in risk modeling, the resulting effect of financial crises on hedge fund risk is greatly underestimated. The common latent factor exposure across the whole hedge fund industry was present during the Long-Term Capital Management (LTCM) crisis of 1998 and the 2008 Global financial crisis. Other crises including the subprime mortgage crisis of 2007 affected the whole hedge fund industry only through classical systematic risk factors.

Keywords: Hedge Funds; Risk Management; Liquidity; Financial Crises

Financial Integration in European Countries: Some Panel Evidence
Candida Ferreira, Universidade Técnica de Lisboa, ISEG & UIECE, Portugal

This paper provides empirical evidence of the financial integration of some developed countries, mostly in the European Union, covering the period between 1961 and 2008.

The main contributions are to be found first, in the application of panel estimates and test statistics. Particularly of some recently developed tests like the Westerlund (2007) bootstrap cointegration tests and the Pesaran (2004) test of cross-sectional independence, using the available AMECO series of nominal and real long-term and short-term interest rates as well as the yield curve; secondly, in the comparison of the approximations between the countries’ series of rates and those of two chosen benchmarks: the German and US rates, for six panels of EU and some non-EU countries during three specific time intervals.

The obtained results allow us to draw conclusions not only on the quite high degree of approximation towards the benchmark rates, particularly those of Germany, but also on the differences in the patterns of this approximation before and after the implementation of the Single Market Program and of the EMU. Furthermore, we draw conclusions on some specific characteristics of the considered series of rates and, in particular, of the yield curves.
Comovements of international stock markets before and during the subprime mortgage crisis are examined using cross-spectral methodology. The paper performs a simple frequency-domain-based test for contagion that avoids biases of the correlation breakdown tests used in the extant literature. The most recent financial crisis is found to be manifest in greater comovements along high-frequency components. Calculated changes in the high-frequency portion of the covariance indicate a contagion for the majority of the pairs of countries in the sample.

Keywords: Stock Market Comovements, Subprime Mortgage Crisis, Cospectral Analysis.

Session 1: Commodities I

A Comparative Analysis on the Effects of the Asian and Global Financial Crisis on Precious Metals Markets
Lucia Morales, Dublin Institute of Technology, Ireland
Bernadette Andreoussos-G’Callaghan, University of Limerick, Ireland

The global financial crisis has vigorously struck major financial markets around the world, and especially developed markets have suffered the most. However, some commodities markets and in particular precious metals markets seem to be unscathed to this financial downturn. Thus, in this paper we investigate the nature of volatility spillovers between precious metals returns over the 1995-2009 period with our attention being focused in these markets behaviour during the Asian and the global financial crisis. We analysed daily closing values for precious metals data, using the US$/Troy ounce for gold, the London Free Market Platinum price in US$/Troy ounce, the London Free Market Palladium price in US$/Troy ounce, and the Zurich silver price in US$/kilogram. We divide our sample into a number of sub periods, prior to, during and after the Asian crisis, with the objective to provide a wide analysis of the behaviour of the precious metals markets during this time period. We also analyse the global financial crisis from August 2007 to December 2009 using GARCH and EGARCH modelling. The results show that there is clear evidence of volatility persistence between precious metals returns, characteristic that is shared with financial markets behaviour. However, in terms of volatility spillovers effects, the main findings show that there is weak evidence of volatility spillovers, with the exception of gold, that tend to generate effects in all the markets, but with little evidence in the case of the other precious metals influencing the gold market. Results, however, clearly suggesting a great level of independence among these markets what clearly evidence possibilities of diversification among them.

Keywords: Precious Metals Returns, GARCH and EGARCH modeling, Volatility Persistence, Volatility Spillovers and Asymmetric Spillovers

Incremental information and forecast horizon: Platinum versus Gold
Michael Chng, Deakin University, Australia

Studies on cross-market trading often document evidence of one market exerting short lag dynamics onto another, but is itself experiencing longer lag dynamics, or ‘feedback-effect’, from that same other market. If inherent two-way interaction between markets differ in terms of lag-dynamic, it is intuitive to expect incremental information, based on conditional return forecast, to be itself conditional on the chosen forecast horizon. By modeling price cointegration between TOCOM platinum (PL) and gold (GD) futures contracts, we confirm that incremental information from the VECM-based forecast over a buy-hold strategy and a naïve forecast, are both statistically and economically significant based on risk-adjusted returns net of transaction cost. For 1-step horizon, PL forecasts generate superior profits over GD. For 5-step horizon, while overall profit levels decline, it is the GD forecasts that produce incremental profit over PL. Subsequent analysis on realized net returns across a spectrum of k forecast horizons (k=1, 2, ...10) confirm that while PL forecast profitability declines rapidly as k increases, profit from the corresponding GD forecast actually increases gradually towards k=5, and decays at a slower rate thereafter.

Keywords: return, forecast horizon, cross-market, VECM, commodity futures.

Does Exchange Rate Volatility Impacts US Soybean Export: Evidences from a Multi-Country Analysis Framework
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Jaime E Malaga, Texas Tech University, USA
Eric J Belasco, Texas Tech University, USA

Exchange rate volatility has become more important as trade barriers are gradually eliminated. In the US, soybean exports contribute a significant portion of the total agricultural revenue. This study examines the case of three exporting countries; US, Brazil, and Argentina and three importing countries; Japan, China, and Mexico. An Exponential Generalized Autoregressive Conditional Heteroskedacticity (EGARCH) model is used to more appropriately estimate the characteristics commonly found in exchange rate volatility. A Panel VAR model was used to estimate the relationship between soybean export, exchange rate volatility, and the FOB export prices on soybean and soybean oil. Higher exchange rate volatility in China after 2005 may have caused the decrease of US exports to China. Similarly, when Japanese currency was highly volatile, the US soybean exports to China raised and they shrank both to Japan and Mexico. Trade diversion effects are also observed; when exchange rate volatility in one country is observed, more trade is diverted to other countries. The higher the FOB price, the more trade substitution was observed from other competing exporting countries. Cross-country effects of exchange rate volatility and prices do not have consistent impacts across importing countries. Under free trade regimes, exchange rate policy can be used to enhance or divert international agricultural trade flows.

Keywords: Exchange Rate Volatility, Soybean Trade

Session 1j: Volatility

Do trading volumes explain the persistence of GARCH effects?
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We examine the role of trading volumes in GARCH-based tests of the mixture of distributions hypothesis (MDH) on firm-level data for the 20 largest S&P 500 stocks. In doing so we provide a set of increasingly generalised nested models within which to examine the role of trading volumes, beginning with the AR1-GARCH(1,1) model with no trading volumes, progressing to the univariate AR1-GARCH(1,1)-X, the AR1-GARCH(1,1)-M and the AR1-GARCH(1,1)-M-X models, and culminating with the constant correlation bivariate AR(1)-GARCH(1,1)-M-X model. Amongst our main finding are that trading volumes are robustly significant and positively signed in the volatility of returns equations for most firms, acting to reduce persistence and to eliminate the need for GARCH terms. As we progress from the AR1-GARCH(1,1) to the AR1-GARCH(1,1)-X, AR1-GARCH(1,1)-M-X, and the bivariate AR(1)-GARCH(1,1)-M-X models, the persistence parameters decline from an average of 0.988 to 0.331, 0.213 and 0.314 respectively. Our results are very robust and consistent with the MDH in most cases, but not all due most likely to idiosyncratic risk differences among firms.

Key Words: Volume and volatility, mixture of distributions hypothesis, GARCH.
Explaining Asymmetric Volatility around the World
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Based on the APARCH model and two outlier detection methods, we compute reliable time series of volatility asymmetry for 49 countries with relatively few observations. Results show a steady increase in the asymmetry over the years for most countries. We find that economic development and market capitalization/GDP are the most important factors that increase volatility asymmetry. We also find that higher participation of private investors and coverage by financial analysts increases the asymmetry, suggesting investor sentiment as a driving force. Leverage and feasibility of short-selling increase volatility in falling market conditions, although only to a smaller extent.

Keywords: Volatility asymmetry, leverage effect, short-selling, APARCH model

Financial Development, Dependence on External Finance and Firm-Level Volatility in Manufacturing and Construction Sectors
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Theoretical and empirical literature so far has failed to establish a robust link between the financial development and output volatility at the firm level. In this paper I test the theoretical predictions of a general equilibrium model of financial development, risk-taking, risk-diversification and firm-level volatility. I find a significant positive effect of financial development on firm-level volatility confirming the relationship predicted by the model. This finding stands in sharp contrast to a number of recent studies reporting a negative relationship between the financial development and the volatility at the firm level. Furthermore, the effect is stronger for firms in industries that are relatively more dependent on external finance. These results imply that firms requiring more external funds due to technological characteristics of the industry would choose higher risk-taking strategies in countries that are more financially developed. The results are very robust to the choice of different estimation methods which control for potential outliers and alternative measures of financial development.

Keywords: Firm Volatility, Financial Development, External Finance

Extreme Asymmetric Volatility, Leverage, Feedback and Asset Prices
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Asymmetric volatility in equity markets has been widely documented in finance, where two competing explanations, as considered in Belkaert and Wu (2000), are the financial leverage and the volatility feedback hypothesis. We explicitly test for the role of both hypotheses in explaining extreme daily U.S. equity market movements during the period January 1990 to September 2008. To this aim, we examine asymmetric volatility based on a novel model of market returns, conditional market volatility and volatility of volatility. We then test for extreme asymmetry and the distinct predictions of both hypotheses. Our results document significant extreme asymmetric volatility. This effect is contemporaneous, consistent with both hypotheses, and it is important for large market declines. We further derive aggregate asset pricing implications under extreme volatility feedback. Given our results, asymmetric volatility, which includes the effect of volatility feedback at extreme levels, is shown to play an important role in explaining substantial equity market declines. As large market declines can in part be attributed to feedback they are not fully inconsistent with rational asset pricing behavior given the absence of information on changes in market fundamentals. Our findings also underline that means which are directed to a stabilization of extreme conditional market volatility are an important task for market regulators. We argue that extreme asymmetric volatility represents a component of systemic market risk.

Key Words: market volatility, asymmetric volatility, leverage effect, volatility feedback, VIX, market stress, systemic market risk

Session 2a: Banks & Risk

Are banks too big to fail?
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We consider three measures on the systemic importance of a financial institution within a interconnected financial system. Based on the measures, we study the relation between the size of a financial institution and its systemic importance. From both theoretical model and empirical analysis, we find that in analyzing the systemic risk posed by one financial institution to the system, size should not be considered as a proxy of systemic importance. In other words, the "too big to fail" argument is not always valid, and alternative measures on systemic importance should be considered.

We provide the estimation methodology of systemic importance measures under the multivariate Extreme Value Theory (EVT) framework.

Keywords: Too big to fail; systemic risk; systemic importance; multivariate extreme value theory.

Has the Basel II Accord Encouraged Risk Management During the 2008-09 Financial Crisis?
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*Juan-Angel Jimenez-Martín, Universidad Complutense de Madrid, Spain
Teodioso Perez-Amaral, Universidad Complutense de Madrid, Spain

The Basel II Accord requires that banks and other Authorized Deposit-taking Institutions (ADIs) communicate their daily risk forecasts to the appropriate monetary authorities at the beginning of each trading day, using one or more risk models to measure Value-at-Risk (VaR). The risk estimates of these models are used to determine capital requirements and associated capital costs of ADIs, depending in part on the number of previous violations, whereby realised losses exceed the estimated VaR. In this paper we define risk management in terms of choosing sensibly from a variety of risk models, and discuss the selection of optimal risk models. A new approach to model selection for predicting VaR is proposed, consisting of combining alternative risk models, and comparing conservative and aggressive strategies for choosing between VaR models. We then examine how different risk management strategies performed during the 2008-09 financial crisis. These issues are illustrated using Standard and Poor’s 500 Index, with an emphasis on how market risk management practices were encouraged by the Basel II Accord regulations during the financial crisis.

Keywords: Value-at-Risk (VaR), daily capital charges, exogenous and endogenous violations, violation penalties, optimizing strategy, risk forecasts, aggressive or conservative risk management strategies, Basel II Accord, global financial crisis.

Why do banks use sophisticated credit risk management instruments?
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*Claudia Lambert, Johann Wolfgang Goethe Universität Frankfurt am Main, Germany

The objective of our research is to investigate empirically the adoption of sophisticated credit risk management instruments across banks. Based on a unique dataset combined with survey data we analyse the economic fundamentals that make the use of sophisticated credit risk management instruments by banks more likely and examine the drivers affecting the depth of implementation and integration of credit risk management instruments. In particular, the adoption of credit derivatives and credit portfolio models is in the focus of our analysis. Setting a laboratory environment for our analysis we find that sector concentration is the main determinant for the usage of credit portfolio models as a risk management tool, while bank profit generation motives crucially influences a bank’s decision to use credit derivatives. Moreover, we find that it is foremost competition that affects the depth of implementation and integration of sophisticated instruments. Our results suggest that banks have developed specific knowledge of their local markets and that they utilize it for their business decisions. Our study sheds light on practices of the usage of credit risk management tools in the banking industry.
Acquisitions had less underpricing but we detected no such impact. However, the method of payment is important: firms returns are significantly lower for firms that engaged in pre-IPO acquisitions in the two years prior to their IPO. We find that first day sample, we identified 86 companies that made one or more acquisitions. We examine 425 firms in the computer software industry that went public in the US. We find that when stock was used the signal of firm quality is not credible. Those using stock were more likely to have been subsequently charged with underpricing and were also more likely to fail within three years following the IPO.

Keywords: IPO; Acquisitions; Signaling

Session 2c: Order Flow & Informational Impact

What does the market microstructure of the CBOT Grain Futures Markets Reveal About the Transmission of Common and Non-Common Knowledge Components of Information into Asset Prices?

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*Sandra Dow, Monterey Institute of International Studies, USA
*Sotiris Staikouras, City University London, UK

We show that the FX markets and CBOT grain futures share certain institutional features. In particular, that dealers in the FX market and a segment of Corporate Exchange Members have access to transaction information that is known only to the counterparties and not transparent to other market participants. We also show that for the CBOT grain markets the opening gap return can be used as a proxy for the arrival of common-knowledge (CK) news. This allows us to interpret the intra-day dependency of price discovery in the CBOT grain futures market in terms of CK and non-common-knowledge (NCK) news.

Keywords: order flow, market microstructure, CBOT, price discovery, corn, wheat, oats, soybeans, commodity futures, news, open

Cross-Industry Product Diversification: The case of Bank-Insurance Takeovers

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Elyas Elyasiani, Temple University, USA
*Panagiotis Dontis-Charitos, City University London, UK

We investigate the impact of domestic and international bank-insurance mergers on the risk-return profiles of the acquiring banks and those of the peer banks and peer insurers using a GARCH framework and the 1990-2006 data. Our contributions include the following. First, we examine the abnormal returns due to the bank-insurance acquisitions on the bidding firms, peer banks and peer insurers to determine the magnitude of the effects on the former, whether these effects spillover to the latter and whether these effects are of competitive or contagion nature. Second, we model the determinants of the abnormal returns of the bidder banks as functions of the bidder's characteristics and deal-specific factors. Third, we contrast the risks of the bidders, and those of the bank and insurer peers, in the pre- and post-announcement periods to determine whether risk is altered as a result of the merger for either of these groups of institutions. The findings indicate that acquiring and peer firms do experience positive and significant abnormal returns with the effect on insurer peers being larger in magnitude and slower to complete. These results establish the prevalence of intra- and inter-industry contagion. The magnitudes of the abnormal returns on the bidder firms vary with leverage, relative size of the deal, growth opportunities, medium of payment, and whether the bidder is located in the US. The overall risk (the sum of the market and idiosyncratic risks) of the bidders and bank/insurer peers is found to have declined following the bancassurance deals, countering the concerns about the systemic risk implications of combining bank-insurance enterprises. Implications for investors and financial institution managers are drawn.

Keywords: risk management, credit risk, credit derivatives, credit portfolio model

Session 2d: Banking & Corporate Strategy

And the walls came tumbling down ... Investment banks’ recommendations and underwriting fees in Latin American bond markets

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This paper examines whether banks’ recommendations to investors in emerging sovereign bonds are truly independent of these same banks’ underwriting activity in Latin American countries. The main findings are the following. First, after controlling for macroeconomic and financial variables, I find that investment banks tend to positively recommend sovereign bonds where they act as lead managers. Second, econometric analysis shows that this association is more important as the underwriting fee is higher. While most of this study is based on empirical analysis, I also show that my results are corroborated by interviews undertaken with the main institutional investors in sovereign bonds. Findings of this research suggest the existence of a conflict of interest between originators and the banks’ departments of investment banks in the Latin American bond market.

Keywords: Information, Investment Banks, Primary Emerging Bond Market, Moral Hazard

Cross-Industry Product Diversification: The case of Bank-Insurance Takeovers

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Elyas Elyasiani, Temple University, USA
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Keywords: risk management, credit risk, credit derivatives, credit portfolio model

Session 2d: Finance, Development & Flows

Bilateral Remittance Flows, Institutional Quality and Individual Happiness: Macro and Micro Level Analysis.

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Migrants sending money home are an important part of millions of people around the world where remittances play a direct role on the receiving households’ wellbeing. This paper explores the determinants of bilateral remittance flows that link institutional quality, individual happiness and cultural aspects at the macro- and micro-levels using both novel dataset published by Ratha and Shaw (2007) and German Socio-Economic Panel (GSOEP) data. The macro-level results indicate that various institutional quality measurements are highly significant. In particular, the quality of institutions of sending countries is found to be highly important in explaining the patterns of the remittance flows between high-income countries. In addition, life satisfaction and/or happiness levels of sending countries have a major impact on the bilateral remittance flows for all samples. Using GSOEP data the micro-level hypothesis of happiness, institutional quality and the level of remittance flows provide interesting results. The extent to which a society leads to a change in the behavioral nature of being a local or or has a sense of belonging, we find that immigrants send less money back home when they feel like German and are owners of dwelling. Also immigrants remit more
money when they are happy in the country of residence and they have more trust in the institutions of the country of origin. 

Keywords: Bilateral remittance flows, Institutional Quality, Happiness, Individual Level, Remittance data, Gravity equations

Financial Market Bubbles, the Funding of FDI and Future Crises
*David Schmidt, Aston University, UK
Nigel Driffield, Aston University, UK
James Love, Aston University, UK

This paper seeks to fill a significant gap in the literature, by bringing together the standard analysis of the motivation for FDI, with the multinational’s ability to finance it. We provide direct evidence that multinational firms engage in a particular form of arbitrage; raising funds in over-valued markets which they invest in foreign assets. This highlights the importance of the firm’s financing capacity in the FDI decision which may be driven by market bubbles. Using a large, firm-level data set of matching parents and subsidiaries within the OCED, we show the capital flows to FDI are linked with capital market values. This type of arbitrage-driven FDI may in turn lead to the partial decoupling of economic and financial motives for FDI in financial market bubbles. This suggests that internationalisation decisions that are taken by firms in response to over-valued equity markets, may well be rational in the short term, but are ultimately unsustainable.

Keywords: Foreign Direct Investment, Subsidiary Performance, Speculation and Arbitrage

Integrating an Emerging Market Economy into the Global Economy: Financial Services Foreign Direct Investment in Vietnam
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Banks have incentives to enter emerging market economies as do governments in allowing foreign banks entry to their market. As banking systems in these economies are generally underdeveloped, foreign banks would have an advantage over indigenous banks. In addition, opening an underdeveloped financial system to foreign competitors would lead to a decrease in the market share of local banks as domestic agents move their deposits to the better reputed, technologically superior, and more competitive foreign banks. Eventually foreign banks could control the banking system and could de facto control the money supply. However, Vietnam has implemented entry restrictions to guarantee a required level of cooperation. This is applied to the banking system in Vietnam, a member of the World Trade Organization, where five foreign banks have been awarded licenses to wholly incorporate. A model of the foreign bank, government and indigenous banking industry interactions is proposed.

Keywords: Banking; Vietnam; Economic integration of emerging market economies; Inward FDI to emerging market economies; Economic development and competitiveness in emerging market economies; Entry strategies in emerging markets; Knowledge creation and diffusion in emerging market economies.

Session 2e: Investment Style & Approaches

Efficiency and Dynamics of Islamic Investment: Evidence of Liquidity Costs and Political Effects on Dow Jones Islamic Indexes
Alexis Guyot, EUROMED Marseille Ecole de Management, France

In this article, we examine both the efficiency and the price dynamics of a sample group of Islamic indexes in comparison with conventional indexes. Several conclusions can be drawn. Firstly, efficient investment allocation is not compromised by application of Shari’ah criteria: the application of Wright’s multiple rank test (2000) demonstrates that Islamic indexes are as efficient as their unrestricted counterparts. However, although some indexes present degrees of liquidity that are similar to conventional indexes, others impose an additional liquidity cost on investors. Moreover, the absence of co-integration between pairs of indexes supports the idea that Islamic indexes may contribute to the international diversification of investors’ portfolios. Finally, we highlight the influence of the terrorist attacks of 11 September 2001, the invasion of Iraq in 2003 as well as the subprime crisis on the degree of index integration. Ultimately, investors whose investment decisions are guided by religious principles may have to bear an additional liquidity cost as well as accept that their portfolios are more sensitive to geopolitical events and financial crises.

Keywords: Dow Jones Islamic Indexes, Shari’ah, market efficiency, liquidity, cointegration

The Case for Intra-regional Style Analysis: Diversification or Rotation?
Hsiiao-Ying Chao, Nova Southeastern University, USA
Natcha Limthanakom, Nova Southeastern University, USA
*Charles Collier, Nova Southeastern University, USA

In contrast to some earlier studies, we document statistically significant within-country style effects in a majority of our Southeast Asian emerging market portfolios. Small capitalization and value stocks tend to outperform their style counterparts in the complete samples. While average return correlations among the zero cost style portfolios are low—emphasizing the value of an intra-regional diversification strategy—these correlations exhibit significant variation over time. Measures of integration for the style portfolios are also low on average but tend to vary over time. These results suggest that while diversification is helpful on average, there are some periods of time when a regional style rotation strategy is warranted and other times when country-specific rotation strategies are reasonable.

Keywords: Style rotation, emerging markets, integration, Southeast Asia

Session 2f: Impact Determinants

Does the influence of institutional investors depend on the institutional framework?
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Oscar Lopez de Foronda, Universidad de Burgos, Spain
Mauricio Jara, Universidad de Valladolid, Spain

This paper analyzes the effect of institutional ownership in alleviating or exacerbating the conflicts of interests among stakeholders in different legal and institutional frameworks. This analysis is carried out based on two characteristics: the concentration of power of institutional ownership and the identification of the main types of institutional investors. In common law countries, consistent with the convergence and entrenchment hypotheses, we find a U-shaped relation between ownership structure and firm performance. In civil law countries, consistent with the collusion and contest theories, we find an inverted U shape relation. We also find that when institutional investors are classified as pressure resistant and pressure sensitive according to the strength of their ties with managers, pressure-resistant investors, who operate more independently, are the most capable of improving the value of the firm.

Keywords: Corporate Control, Corporate Governance, Institutional Framework, Institutional Investors, Legal Framework

The Impact of Derivatives Markets on Financial Integration, Risk, and Economic Growth
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*Bernhard Sammer, Vienna University of Economics and Business Administration, Austria

During the last decade, derivatives markets became an asset class of their own and influenced the financial landscape strongly. While the financial sector contributes positively to overall economic growth in many studies up the mid nineties, a positive contribution of the financial sector to economic growth in mature market economies is less evident with more recent data. What has happened? Is the rapid growth of derivative markets a catalyst for changes in the financial sector? Are derivative influences capable of destabilizing the financial system? Drawing on the Merton and Bodie (1995) functional perspective, this paper tries to explain this change by discussing the
Sudden stops: Are global and local investors alike?  
*Cesar Calderon, The World Bank, USA  
Megumi Kubota, University of York, UK

Our main goal is to characterize the determinants of sudden stops caused by domestic vis-à-vis foreign residents. Are the decisions of domestic residents to invest abroad or of foreign residents to cut off funds from the domestic economy governed by the same set of determinants? Given the distribution of the different types of sudden stop events over time and its different macroeconomic consequences, we argue that their determinants may not be alike. Using an effective sample of 82 countries with annual information over the period 1970-2007, we find that global investors are less likely to stop bringing their capital whenever their economic is growing and world interest rates are lower. Local residents, on the other hand, are more willing to invest abroad when macroeconomic performance is poor (high inflation), the financial system is weak, and there are high external savings (current account surpluses). Rigorous financial openness makes the domestic country more vulnerable to sudden stops caused by either local or global investors. Finally, countries with higher shares of FDI are less prone to inflow-driven sudden stops whereas the opposite holds for outflow-driven sudden stops.

Keywords: Sudden stop, gross capital flows, Probit modeling

Session 2g: Corporate Risk Exposure

Corporate Performance, Corporate Risk-Taking, Earnings Management and Corporate Governance in International US Firms  
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Maria Angeles Fernandez Izquierdo, Universitat Jaume I, Spain  
Maria Jesus Muñoz Torres, Universitat Jaume I, Spain

The impact of corporate governance mechanisms on performance is one of the most explored relationships in the corporate governance literature. However, there are other variables that may also be influenced by corporate governance behaviour. This research contributes to the empirical literature through the examination of simultaneous and endogenous relationships between corporate performance, corporate risk-taking, earnings management, and corporate governance mechanisms at firms listed in the S&P 500 index. The results show that corporate performance, corporate risk-taking, earnings management and board of director effectiveness should be endogenously determined. Analyzing the relationship between any two of these variables we observe that corporate risk-taking is negatively influenced by corporate performance. The results also confirm that board of directors compensation is not a good proxy for board effectiveness. Finally, the results evidence managers use their control over the firm to make earnings management. This discretionary use of funds is also associated negatively with corporate performance.

Keywords: corporate performance, corporate governance, earnings management, simultaneous equations, endogeneity problem.

Explaining firms’ exchange rate exposure: the role of country factors  
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This paper provides new evidence on the measurement and determinants of exchange rate exposures of firms with an international orientation. We document the existence of significant foreign exchange rate exposures as well as substantial differences between firms originating from developed and emerging markets. We also propose new country-specific factors to explain the cross-sectional and time-series variation in exchange rate sensitivities. It appears that country specific factors account for about 30% of the variability of firms’ exposure after controlling for firm and industry level determinants. Among such country factors, high use of foreign currency derivatives, deeper financial markets, as well as small and balanced current accounts significantly decrease firms’ sensitivity with respect to exchange rate changes in both developed and emerging markets.

Keywords: exchange rate exposure, foreign currency derivatives, emerging markets

Exchange exposure and corporate governance in US firms  
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In this paper, we examine the relation between firm-level corporate governance quality and the firm’s foreign exchange exposure. Using a sample of 1479 US firms for the period 1999 to 2009, we find that 14 percent are exposed to exchange rate fluctuations, which is consistent with prior research. We then conduct a series of cross-sectional regressions, with the firms’ estimated exposure as the dependent variable, on 445 of these firms for which the entreprennual index (E-index) is available. For the subset of these that are significantly exposed, we find a positive relation between the firm’s E-index and its foreign exchange exposure. As higher values for the E-index indicate poorer corporate governance, this is consistent with the notion that firms with poor corporate governance are more exposed to exchange rate changes because managers are less likely to add value by hedging. This relation diminishes for highly internationalised firms, and is strongest for domestic firms and those with subsidiaries in only one or two regions of the world. We suggest that this is because, unlike genuinely multinational firms, domestic and regional firms are not naturally hedged. Managers of firms with little international reach must actively hedge to reduce their foreign exchange risk, and our results suggest that domestic and regional firms with poor corporate governance are not doing so effectively. Our findings point to the importance of a good corporate governance environment that provides incentives to managers to add value by hedging, particularly for firms that are not naturally hedged.

Keywords: foreign exchange exposure, firm-level, corporate governance, hedging, multinational firms

Session 2h: Governance & Crises

Exchange Rate Flexibility across Financial Crises  
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Cécile Couharde, Université de Versailles, France  
Valérie Mignon, Université Paris X Nanterre, France

This paper studies the impact of global financial turmoil on the exchange rate policies in emerging countries. Many emerging countries have loosened the link of their currencies to the US dollar since the bursting of the subprime crisis in July 2007, chiefly under the fire of market pressures. Spillovers from advanced financial markets to currencies in emerging countries stem from the same causes documented in the literature on contagion, such as the drying-up of investors’ liquidity, the rise in risk aversion, and the updating of their risk assessments. Consequently, interdependences across currencies are likely to be exacerbated during crisis periods. To test this hypothesis, we assess the exchange rate policies by their degree of flexibility, itself proxied by the exchange rate volatility, and investigate their relationship to a global financial stress indicator, measured by the volatility on stock markets of advanced countries. We introduce the possibility of non-linearities by running smooth transition regressions (STR) over a sample of 21 emerging countries from January 1994 to September 2009. The results confirm that exchange rate flexibility does increase more than proportionally with the global financial stress, for most countries in the sample. We also evidence regional contagion effects spreading from one emerging currency to other currencies in the neighboring area.

Keywords: financial crises, dollar pegs, contagion effects, nonlinearity
Are Stock Markets More Contagious During Periods of Crisis?
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Jochen Mierau, University of Groningen & NETSPAR, The Netherlands

We present a new method to examine shift-contagion between financial markets. Our measure of synchronicity between stock markets can be used to analyse non-normal and non-stationary market returns during longer crisis periods, without being disproportionately affected by potential pure-contagion on a handful of trading days. Moreover, the measure would perfectly coincide with the dynamic conditional correlation (DCC) coefficient if the latter were calculated using realised rather than forecasted market returns. When analysing the 1997 East Asian crisis and the Sub-prime mortgage crisis, we find no evidence that stock market returns are more contagious during periods of turmoil than during tranquil times.

Keywords: Contagion, Synchronicity, Sub-prime Crisis, East Asian Crisis

Corporate Governance, Internationalisation and the Division of Power between Managers and Shareholders
Jennifer Berrill, Trinity College Dublin, Ireland
Colin Kearney, Trinity College Dublin, Ireland
*Aleksandar Šević, Trinity College Dublin, Ireland

Session 2: Ratings & Rating Agencies

Rating Performance, Capital Incentives and Capital Adequacy for Securitizations
*Harald Scheule, The University of Melbourne, Australia
Daniel Roesch, Leibniz Universität Hannover, Germany

The paper analyzes the capital adequacy of financial institutions based on the current regulatory regime and impairment data for US asset portfolio securitizations. The paper finds that the regulatory capital for securitizations is insufficient to cover implied losses during economic downturns such as the Global Financial Crisis as well as selected asset portfolios, selected seniority levels and resecuritizations. In addition, the rating process of securitizations may further reduce regulatory capital requirements.


Adverse Borrower Selection in the Context of Rating Errors
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Theory of finance has acclaimed initial screening and ongoing monitoring as two essential functions of banks aimed at enabling these institutions to minimize the negative effects of adverse borrower selection. Against this background, this paper studies the impact of erroneous rating systems on the performance of banks. We employ a multi-bank, multi-period model to study the effects of adverse selection caused by erroneous rating systems on banks’ market shares and excess returns during changes in the economic environment. Our model is parametrized using a unique dataset on the Austrian banking market provided by the Austrian central bank. Applying a scenario technique which also accounts for differences in customer behavior, the results of our numerical analyses show that the effects of erroneous rating systems on performance can be substantial and are furthermore heavily dependent on customer behavior and economic conditions. The empirical findings are consistent with earlier theoretical works on adverse selection, help explain banks’ counter-cyclical lending standards, and may provide bank managers with useful insights on the determinants of the optimal accuracy of their rating systems.

Keywords: Rating accuracy, risk based lending, adverse selection, performance

Pitfalls and Remedies in Testing the Calibration Quality of Rating Systems
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Testing calibration quality by means of backtesting is an integral part in the validation of credit rating systems. Against this background this paper provides a comprehensive overview of existing testing procedures. We study their deficiencies theoretically and illustrate their impact empirically. Based on the insights gained thereof, we develop enhanced hybrid testing procedures which turn out to be superior to the commonly applied methods. We also propose computationally efficient algorithms for our calibration tests. Finally, we are able to demonstrate empirically that our method outperforms existing tests in a scenario analysis using rating data of Moody’s.

Keywords: Rating System, Validation, Calibration Quality

Session 3a: The Banking Firm

Changes in Capital and Risk: An Empirical Study of European Banks
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Laetitia Lepeit, Université de Limoges, France
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In this paper, we investigate the impact of changes in capital of European banks on their risk-taking behavior from 1992 to 2006. First, we assume that risk changes are different for 3 categories of banks (undercapitalized, adequately capitalized and highly capitalized). Second, we consider the impact of an increase in each component of regulatory capital (equity, subordinated debt, hybrid capital) on banks’ risk changes. We find that, for undercapitalized banks, an increase in capital is associated with a decline in risk. We obtain the opposite result for adequately and highly capitalized banks. Our findings also highlight that the decrease in risk for undercapitalized banks only holds when banks increase their equity capital. Conversely, an increase in subordinated debt or hybrid capital is associated with an increase in risk. On the whole, our conclusions support the policy recommendations for a narrow definition of regulatory capital with a closer focus on core capital than on other hybrid instruments.

Keywords: Risk, Bank Capital, Capital regulation, European banks

Exchange exposure in Chinese banks
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Bank Productivity Changes in two Asian Giants
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China and India have experienced rapid economic growth over the last two decades, and finance is central to growth. Banking is the dominant form of finance in both countries, so an interesting question is what are productivity advances, and the forces driving them, among Chinese and Indian banks? This study looks at the banking sectors’ trends in total factor productivity (TFP) changes between 2000 and 2007, and its components. We also consider the relationship between TFP growth and individual banks’ financial performance. We find TFP growth is largely driven by technical progress/innovation. It is somewhat faster in China than India and strongest among large banks. Foreign banks display slower growth than locally owned banks but the association between ownership or listings and TFP change is ambiguous. In China TFP growth continues to outpace India’s but there may be some deceleration with a shift in the underlying components. TFP advances are found to exert important influences on bank-specific equity prices.
**Session 3b: Bank Profitability & Earnings**

Does the stock market compensate banks for diversifying into the insurance business?

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Sotiris Staiokouras, City University London, UK
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This paper explores a wide range of corporate restructurings, all available deals from wire services, in the banking and insurance sectors that led to bancassurance ventures. An event study methodology is employed to calculate excess returns on and around these deals' announcement date. Using both univariate and multivariate analysis the paper finds bank driven mergers, deal's size and regional categorization all triggering positive and significant market reactions. Unlike the univariate framework, multivariate analysis shows that geographic focus and language are not significant factors. The results also indicate that markets are indifferent with respect to bank withdrawals from the bank-insurance operations. Finally, Canadian, U.S. and European bank-insurance deals produce positive results, while Australasian bidders offer statistically insignificant equity returns.

Keywords: Bank-insurance interface; Divestments; Financial conglomerates; Event study; Abnormal equity returns

On the Earnings Smoothing Hypothesis in the Banking Industry

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This study provides empirical evidence on the propensity of bank managers to smooth earnings through loan-loss provisions. The analysis on a sample of international banks using both pooled time-series cross-sectional and panel-data regressions leads to three main conclusions. First, bank managers actively use loan-loss provisions either to smooth high earnings or as an income-reducing tool when earnings are abnormally low. This result is consistent with Healey's (1985) compensation theory. Second, all other things being equal, banks following IFRSs or non-US local GAAPs have a greater discretion to smooth earnings. US GAAP exhibit the highest accounting quality, as remarked in Barth, Landsman, Lang and Williams (2006). Finally, we observe that in 2008, when the financial crisis hit its most critical stage, banks seemed to reduce the extent of earnings smoothing because they could have been below the minimum threshold for carrying out smoothing practices.

Keywords: Income smoothing, Earnings management, multi-way cluster

Substitution or complementarity between “soft” information and “hard” information: why and which effect on bank profitability?

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The Basel II committee set up directives encouraging banks to use internal scores in order to assess the risk of their customers. This new form of information competes with the existing ones. SMEs are most concerned by these new stakes, due to the lack of transparency. The aim of this paper is to understand the determinants of the choice between substitution and complementarity between the two types of information: “soft” and “hard”, to test a potential effect of this choice on the banking performance and to describe which variables are involved in the decision-making process. The originality of this work is to try to quantify the information costs and to use it as a variable which is affecting the adopted choice.

Keywords: Basel directives, “soft” information, “hard” information, credit decision-making process, bank performance, Bank-SMEs relationship

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**Session 3c: Equity Market Microstructure**

The effect on liquidity and spreads from the introduction of algorithmic trading

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Algorithmic trading leads to greater competition in liquidity provision, thereby improving liquidity. Is there a correlation between algorithmic trading and liquidity? The Australian Stock Exchange introduces initiatives to help facilitate algorithmic trading. These initiatives are the introduction of anonymity in the market and the reformed pricing structure that aims to attract global order flow and predominantly adopt value-based pricing. This paper examines the effect of market liquidity using high frequency data from a reconstructed limit order book. First we find evidence consistent with dynamic trading strategies. Similar to Hasbrouck (2008) we investigate the phenomenon of cancelled orders. We find an increase in fleeting orders and examine the behaviour of these fleeting orders across different regimes. Second, we examine the dynamic relationships between spread, depth and volatility. We define a proxy for liquidity that measure the time (duration) between orders within the autoregressive conditional duration (ACD) model framework. We analyse equity volatility of ten stocks traded on the Australian Stock Exchange (ASX) and show how intraday seasonal patterns of duration, as well as microstructure variables, impacts on conditional volatility. We find that spreads and market depth increase conditional volatility and further measure the impact of cancelled orders. The questions are whether these initiatives do causally improve algorithmic trading and consequently liquidity.

Tapping hidden liquidity: Flash Orders at the NASDAQ

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In this paper we investigate the impact of new liquidity enhancement functionalities on market quality. We use the introduction and subsequent removal of the flash order facility from Nasdaq to evaluate the impact of such new mechanisms on market quality. We investigate market quality by providing answers to the following three questions: (i) Do flash orders enhance market liquidity and price efficiency? (ii) At the intraday frequency, are flash orders more frequently used when market quality is low? (iii) Do flash orders attract volume from traders that are not willing to display their trading interest publicly? Answers to these questions can provide guidance for the current policy debate on the use of flash orders and for future adoptions of similar mechanisms.

Keywords: Flash orders; Market quality; Competition
High-Frequency Jump Filtering in a Microstructure Model
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We present a general microstructure model written as a state-space model which allows for jumps. Our microstructure model also incorporates short-term GARCH effects, daily, and intraday seasonality. Guided by outlier removal techniques, we adapt the Kalman filter to iteratively detect jumps. Simulations demonstrate good power properties for jump identification. We apply our methodology to an illiquid and a liquid stock traded at Euronext Paris over one month. We find that jumps and market microstructure noise cannot be considered in isolation. On average we detect one jump per day. Our methodology could be used to detect jumps in real time.

Keywords: microstructure, noise, volatility, jumps

Session 3d: Finance, Development & Institutions

Governance, Performance and Diversification: Evidence from African Microfinance Institutions
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In this paper, we analyze the relationship between the performance of microfinance institutions and their organizational, income and fund structure, which includes internal and external governance, and product and service diversification. We particularly investigate three aspects of performance: sustainability, outreach, and portfolio quality or risk. Using a panel of 281 microfinance institutions in 34 African countries from 1996-2008, we find that although non-government organizations perform better in terms of depth of outreach and profitability compared to the other institutions, they are not necessarily operationally more self-sufficient. Meanwhile, asset expansion attracts more clients but at the expense of lower depth of outreach. In addition, external governance leads to higher efficiency and productivity but does not necessarily improve portfolio quality. Interestingly, MFIs that focus on loans are found to be less operationally self-sufficient. Meanwhile, asset expansion attracts more clients but at the expense of lower depth of outreach. In addition, external governance leads to higher efficiency and productivity but does not necessarily improve portfolio quality. Interestingly, MFIs that focus on loans are found to be less operationally self-sufficient.

Keywords: Governance, Performance, Microfinance, African Economies, Diversification, Risk, Non Government Organizations

International Commodity Price Shocks, Democracy, and External Debt
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We examine the effects that international commodity price shocks have on external debt using panel data for a world sample of 93 countries spanning the period 1970-2007. Our main finding is that positive commodity price shocks lead to a statistically significant and quantitatively large increase in government consumption expenditures in autocracies. To explain this result, we show that positive commodity price shocks lead to a statistically significant and quantitatively large increase in government consumption expenditures in autocracies. In democracies on the other hand government consumption expenditures did not increase significantly. We also document that following positive windfalls from international commodity price shocks the risk of default on external debt decreased in democracies, but increased significantly in autocracies.

Keywords: Commodity Price Shocks; Debt Policy; Political Institutions

A closer look at financial development and inequalities
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This paper estimates the dynamic impact of financial development on income distribution using a panel Bayesian structural vector autoregressive model. Banking intermediaries and capital market development exert a non-linear impact on income inequalities, with distributional costs in the short run and benefits in the long run. Banks impact income distribution more than capital markets, and financial sector characteristics matter more than size. This implies that banking sector reforms should be prioritized over capital market reforms, and that governance reforms should be prioritized over financial deepening reforms. Short run redistributive policies may also have a role to play.

Keywords: Finance, inequality, SVAR

Session 3e: Studies on Investment

A non-price measure of cross-market price discovery: Theory and empirical application
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Within-market price discovery models differ in terms of the trading parameters being considered, including price, quantity and time-based measures. Paradoxically, cross-market price discovery models, primarily Gonzalo and Granger (1995) and Hasbrouck (1995), both focus only on price parameters. If the price discovery process in at least one of the markets is driven by non-price parameters, then using either of the two entrenched models will lead to false rankings. We have two objectives. First, we develop a cross-market joint trade direction model (JTDM) model from the Madhavan et al (1997) within-market model. Second, we estimate and test the JTDM against the Gonzalo and Granger (1995) VECM measure. This allows us to directly test the information content of trade direction versus quote revision in cross-market price discovery. Empirical application on 20 Chinese twin-board firms reveal i) VECM and JTDM generate consistent ranking in 4 out of 10 A-H firms and 2 out of 10 A-B firms, all of which provide strong evidence of price discovery by the H or B boards; ii) For the 6 A-H firms with conflicting rankings, the Wald and/or J-test rejects VECM in favor of JTDM in all cases; iii) Among the 8 A-B firms with conflicting rankings, the Wald and J-tests reject VECM (JTDM) in favor of JTDM (VEC) in 2(3) firms. For the remaining 3 A-B firms, neither model nor model selection tests can decide which board is more informative.

Keywords: price discovery, trade direction, cross-listings

Rights Issue Announcements Motives and Price Response
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The extent to which a rights issue is bad news may depend upon the motive for the issue. This proposition is examined in the context of an event study where abnormal returns consequent to the announcement of a rights issue are conditioned on the stated motives for the issue. Those motives that we characterize as negative (raising working capital, or debt reduction) generate larger negative abnormal returns than those motives that we characterize as positive (funding projects or acquisitions), and there is evidence that issues with positive motives have a negligible, or even a positive price impact. These results are robust to the inclusion of control variables which include both characteristics of the issue and characteristics of the issuer.

Keywords: Rights Issue, price discovery, announcement, motives
Dynamic Cross Hedging: A Multivariate Analysis of Hedged Portfolios
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This study compares the performances of different hedged portfolios constructed by different hedge types, risk models and mean models respectively. These multivariate dynamic futures hedging comparison is provided by examining 17 spot and 17 futures prices covering four different markets (currency, equity, bond and commodity). The variance-covariance matrix (optimal hedge ratio) of the hedged portfolio is captured by a variety of risk models (unconditional model, BEKK, CCC, DCC, EMA and EWMA). Two methods (MLE and MCMC) are used to estimate the parameters of the mean model. Different hedged portfolios are constructed according to hedge types (univariate hedging and multivariate hedging), risk models and mean models. We find that under MCMC estimation the DCC risk model constructed by the multivariate hedging and the CCC risk model constructed by the univariate hedging have lower real portfolio risk (VaR) but higher real portfolio return (CSR). The portfolio value increase smoothly year by year has no significant fluctuation. They perform better than other hedged portfolios which give the best hedging strategy for the hedge fund. The portfolio performance from multivariate hedging is better than univariate hedging except EMA.

Keywords: Hedge, Future Hedging, Cross Hedging, Multivariate GARCH, BEKK, CCC, DCC, EMA, EWMA, MLE, MCMC

Session 3f: Bond Markets Around the World

Regional Volatility Linkages of Latin American International Bonds
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This paper investigates the nature of volatility transmission of the US dollar denominated sovereign Eurobonds issued by major Latin American economies in international markets. We employ a multivariate GARCH framework to capture the cross-market volatility dynamics across key economies in the region. The study provides evidence on volatility sharing of international bonds issued by emerging markets. Systematically, the Brazilian volatility is significantly explained by the volatility of Chile, Colombia, Venezuela and Mexico. Such transmission channels are stronger particularly during the post-Argentine crisis window. Existence of these transmission channels provides insights into the nature of intraregional vulnerabilities in emerging market international bonds.

Keywords: Latin America; Volatility; Spill overs; Transmission

Investing in local currency bond markets
*Francis Warnock, University of Virginia, NBER & Trinity College Dublin, USA
John Burger, Loyola College in Maryland, USA
Veronica Warnock, University of Virginia, USA

This paper investigates the nature of volatility transmission of the US dollar denominated sovereign Eurobonds issued by major Latin American economies in international markets. We employ a multivariate GARCH framework to capture the cross-market volatility dynamics across key economies in the region. The study provides evidence on volatility sharing of international bonds issued by emerging markets. Systematically, the Brazilian volatility is significantly explained by the volatility of Chile, Colombia, Venezuela and Mexico. Such transmission channels are stronger particularly during the post-Argentine crisis window. Existence of these transmission channels provides insights into the nature of intraregional vulnerabilities in emerging market international bonds.

Keywords: Latin America; Volatility; Spill overs; Transmission

Regional Stochastic Dynamics and Market Integration of Emerging Market Sovereign Eurobonds
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This paper models the cross-market dynamics in an emerging market regional setting using US dollar denominated risky sovereign Eurobonds issued by major Latin American economies. We employ Johansen’s and a modified three step procedure, which can generate portfolio adjustment weights whilst accounting for common volatility effects across markets. The bonds are grouped by maturities across different markets in the Latin American region. The analysis uncovers evidence cross-market links – creating a sub-regional formation across the Latin American region.

Keywords: Common stochastic trend, Market integration, Latin America, Long-run dynamics, Sovereign bonds

Session 3g: Dividends & Corporate Payout

Debt, dividends and growth opportunities in East Asian firms: The role of institutional factors
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We analyze the impact of debt and dividends on firm value, conditional on growth opportunities, using data from 11 East Asian countries. Consistent with previous literature, our results show that debt and dividends play a dual role: First, they alleviate the problem of overinvestment when firms lack of growth opportunities, and, second, they exacerbate the problem of underinvestment when firms have growth opportunities. We also find that some institutional features such as the legal protection of investors, capital market activity, and the incentive to control shareholders from extracting private benefits potentially modify this relation.

Keywords: corporate debt, dividends, growth opportunities, institutional setting, ownership structure

Corporate Payout Policy in Japan alongside International Evidence
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Cal Muckley, University College Dublin, Ireland

We avail of a database of 3371 listed industrial corporations, during the period 1990 through to 2008, to examine the evolution of cash dividends and share repurchases in Japan, and by way of comparison we consider corporate payout policy in the United Kingdom and in the United States. The aggregate real US dollar value of payout has grown incessantly across Japan, the United Kingdom and the United States, as well as across methods of payout, i.e. dividends and share repurchases, except in the United Kingdom and the United States, in the period 2006 to 2008. Excluding the case of Japan, there has been a decline internationally in the percentage of listed firms involved in corporate cash dividend payout. In the same vein, the concentration of the total real US dollar value of cash dividend payout has increased markedly across Japan, the United Kingdom and the United States. However, while this trend, with regard to the total real US dollar value of cash dividend payout, is in line with altering firm characteristics in Japan, there is cogent evidence for unexplained disappearing and appearing cash dividends in the United Kingdom and the United States, respectively. Furthermore, while there has been moderate growth in the percentage of listed firms involved in share repurchase activity, in the United Kingdom and the United States, there has been a dramatic rise in the percentage of firms involved in share repurchase activity in Japan. In addition, the growth in share repurchases is inadequately explicated by altering firm characteristics, especially in Japan. Overall, agency cost-based life cycle theory provides the best explanation of corporate payout internationally, with some notable explanatory power attributed to signaling theory in respect to cash dividends in Japan. Catering theory contributes significantly, albeit in a second order capacity, to the explanatory power of our models, specifically in respect to share repurchases.

Keywords: Payout policy, dividends, share repurchases, international financial markets
**Session 3h: Market Crises**

**Causal Relationships among Real Estate Prices, Interest Rates and Stock Prices during the Period of Subprime Mortgage Crisis**

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This paper aims to investigate the causal relationships among real estate prices, interest rates and stock prices in the U.S. during the period of the Subprime Mortgage Crisis. The empirical results show that the three proxy variables—3 month Libor interest rates (LIBOR), S&P/Case-Shiller Home Price Index (SPCS20) and S&P 500 Stock Index (S&P500)—do not share a long-run common trend during the period from Jan. 2003 to Dec. 2008. However, for the short-run effect, a bi-directional causality was found in the preceding relationship between SPCS20 and LIBOR. Among other causal relations, it is found that LIBOR and SPCS20—Granger-causally—S&P500, but not in reverse order. This confirms that changes in real estate prices lead the changes in monetary policy (interest rates), and interest rates lead stock prices. The interest rates together with real estate prices play a leading role to the movements of stock prices. The nonlinear techniques are further used in this research. Firstly, from the applications of the threshold autoregressive (TART) and momentum threshold autoregressive (M-TART) models, respectively, the results show that there exist threshold cointegration relationships between LIBOR and SPCS20, also between S&P500 and LIBOR. Secondly, based on the result from the threshold error correction or momentum-threshold error correction models (TECM or M-TECM), the findings show that there exist asymmetric causal relationships between LIBOR and SPCS20, also between S&P500 and LIBOR, which are corresponding with the previous empirical evidences from the TART and M-TART models.

Key words: Subprime mortgage crisis, Asymmetric causal relationship, Threshold Autoregressive Model, (Momentum) Threshold Error Correction Model

**What explains stock markets’ vulnerability to the 2007-2008 crisis?**

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*Maria Soledad Martínez Pería, The World Bank, USA

This paper examines the determinants of stock markets’ vulnerability to the 2007-2008 crisis. Given that the US was the crisis epicenter, we analyze the factors driving the comovement between US returns and stock returns in 83 countries. We distinguish between the period before and after the collapse of Lehman Brothers. We find that the main channel of transmission was financial. We also find evidence of a “wake-up call” or “demonstration effect” in the first stage of the crisis, since countries with vulnerable banking and corporate sectors exhibited higher comovement with the US market. On the other hand, despite a collapse in trade across countries, we do not find support for this channel of transmission.

Key words: stock market correlations, financial crisis transmission

**Systemic Risk, Missing Gold Flows and the Panic of 1907**

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This paper investigates the liquidity crisis that occurred during the Panic of 1907, and the resulting systemic risks and failures, such as the suspension of convertibility of bank liabilities that occurred in the fall of 1907. In contrast to previous studies of the 1907 crisis, our analysis focuses on the U.S. capital markets during the banking crisis, and the bond and stock markets of the New York Stock Exchange, and the systematic risks that the bank suspension of convertibility posed. Our analysis will illustrate the mechanisms and influences that allowed the U.S. capital markets to remain not only open, but also relatively liquid, during the crisis, providing liquidity to the rest of the economy by minimizing a systemic spillover from the banking sector’s problems.

Key words: Panic of 1907, bearer bonds, gold clauses, securities cross listing

**Gold and Financial Assets: Are there any Safe Havens in Bear Markets?**

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We look into the role of gold as a safe haven against stocks during recessions and bear markets. We take stock of the studies by Baur and Lucey (2010) and Baur and Dermott (2009) and extend the results in several ways. First, we try to generalize their approach to more standard definitions of crises. Gorton and Rouwenhorst (2004) evidenced that commodity futures largely outperform stocks during recessions. We show that this result holds for gold futures, during recessions as well as in bear markets. Consequently, we rely on two exogenous methods for identifying crisis periods: the NBER recession dating procedure and the algorithm proposed by Pagan and Sossounov (2003) to define bear markets. Second, we use real returns to control for the role of inflation and to test for the “real” safe haven property of gold, that is, its ability to preserve real wealth during crises. Third, we allow for a time varying conditional covariance between gold and stocks real returns. We estimate bivariate ARMA-GARCH-X models on monthly data for several countries (France, Germany, UK, US) as well as groups of countries (G7, European countries) over the period 1976.1-2009.4. We then test for a decrease in the covariance during crises and find no...
significant change. Fourth, we show that gold is a hedge against stocks in the long run and test for a different speed of adjustment to long-term equilibrium during crises.

Keywords: gold, stock, safe haven, hedge, nonlinearity

Stock market and oil prices: Dynamic correlation in oil-importing and oil-exporting countries
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The paper investigates the time-varying correlation between stock market prices and oil prices for oil-importing and oil-exporting countries. A DCC-GARCH approach is employed to test the above hypothesis based on data from six countries; Oil-importing: Canada, Mexico, Brazil and Oil-importing: USA, Germany, Netherlands. The results suggest that time-varying correlation does not differ for oil-importing and oil-exporting economies. Furthermore, our findings show that the correlation increases significantly positively (negatively) in response to important demand-side (supply-side) oil price shocks, which are caused due to periods of world turmoil (i.e. wars) or world economic prospects.

Keywords: oil prices, stock market returns, DCC-GARCH, dynamic correlation

Session 3j: Exchange Rates

Assessing the Real Exchange Rate Misalignments: Is Real Undervaluation of the Currency Likely and Can It Be Sustained?
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There is a renewed debate on the role of exchange rate policies as industrial policy tools in both academia and policy circles. Policy practitioners usually examine real exchange rate (RER) misalignments to monitor the behavior of this key relative price and, if possible, exploit distortions in the traded and non-traded relative price to promote growth. Anecdotal evidence shows that some countries have pursued very active exchange rate policies to promote the export sector and enhance growth (e.g. China) by undervaluing their currencies. The main goal of this paper is to provide a systematic characterization of real exchange rate undervaluations. We first calculate fundamental RER misalignments based on the long run RER equation derived from the theoretical model developed by Kubota (2009). Then, we construct a dataset of real undervaluation episodes. Second, we present some basic evidence on the co-movement of RER undervaluation and (real and nominal) macroeconomic aggregates. We specifically assess the behavior of macro aggregates during undervaluations using an “event analysis” methodology. Finally, we evaluate whether (and if so, to what extent) economic policies can be used to either cause or sustain real undervaluations. In this context, we empirically model the likelihood and magnitude of sustaining RER undervaluations by examining their link to policy instruments (e.g. exchange rate regimes, capital controls, among other policies) using Probit and Tobit models, respectively.

Keywords: Misalignment, Undervaluation, Fundamentals and Open Macro Policy

Misery Loves Company. Beauty Contest Dynamics in Exchange Rates Expectations
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Traders taking positions in the market as well as forecasters who provide professional expectations on the future path of financial variables have an incentive to observe the forecasts (trades) that are publicly disclosed by their peers. Most likely they are particularly affected by the forecasts (or trades) of the market player that has obtained the best performance in previous periods of forecasting (or trading). These beauty contest dynamics where peculiarly relevant in the context of survey expectations, where reputation measures performance. In this paper we first characterize heterogeneity in survey exchange rate expectations and explore the presence of behavioral rules. We observe how forecasters compromise in order to minimize errors, follow the consensus view and mimic the prediction patterns of the forecaster who was the best performing in the immediate past. We show that the prediction of this previous best forecaster determines the consensus across time, and that the degree to which his prediction is followed by his peers is determined by his forecasting performance. We inspect the micro-dynamics of these phenomena and identify the role of a new ecology of behavioral rules in which the role of the previous best forecaster as a leader of the market for expectations is crucial.

Keywords: Exchange Rate Expectations, Beauty Contest, Heterogeneity, Survey Data

Artificial Neural Network and High Frequency Exchange Rate Prediction
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This paper shows that the Artificial Neural Network (ANN) model does a good job in predicting very high frequency return in the currency market. The previous bid and ask prices are significant factors in the predictions.

Keywords: ANN, Frequency, Bid and Ask prices, Forecasting

Session 4a: Bank Loans

Are bank loans important for output growth? A panel analysis of the Euro area
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This paper investigates whether changes in the volume of supplied bank loans have a significant effect on output growth in the euro area. This is only the case if firms depend on the financing by banks. Having established the significance of the bank lending channel, we now turn to loan-loss provisions on bank lending fluctuations. We therefore investigate the effects of loan loss provisions on bank lending fluctuations, making first a difference between non-discretionary loan loss provisions on bank lending fluctuations, making first a difference between non-discretionary and discretionary loan loss provisions. International comparisons are made between three panels of European, US and Japanese banks. In each panel, we find a negative and significant effect of non discretionary loan loss provisions on credit fluctuations. This common feature is necessary so that banking regulators reach a consensus concerning the beneficial aspects of a dynamic provisioning system.

Keywords: Bank lending channel, monetary policy transmission, credit view, cross-country analysis, euro area

Effects of loan provisions on bank lending fluctuations: some international comparisons
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Laetitia Lepetit, Université de Limoges, France

A dynamic provisioning system is one of the instruments that regulators could use for introducing counter-cyclicality into prudential regulation. The potential effectiveness of such instrument depends on how far actual provisioning practices exacerbate credit fluctuations. We therefore investigate the effects of loan loss provisions on bank lending fluctuations, making first a difference between non-discretionary and discretionary loan loss provisions. International comparisons are made between three panels of European, US and Japanese banks. In each panel, we find a negative and significant effect of non discretionary loan loss provisions on credit fluctuations. This common feature is necessary so that banking regulators reach a consensus concerning the beneficial aspects of a dynamic provisioning system.

Keywords: bank lending, loan loss provisions

The effect of information asymmetries among lenders on syndicated loan spreads
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We examine the effect information asymmetries among syndicate members on loan spreads. In particular we measure the past relationship of each participant and arrange with the borrower separately by using the previous number of borrowing/lending interactions and the duration of these interactions. Using a sample of
5,842 syndicated loan transactions, we find that when participant banks have an information inferiority in the syndicate they require higher spreads to compensate for this asymmetry. This is amplified when the borrowers are more opaque. On the contrary, the availability of borrower credit ratings significantly reduces information asymmetries and nullifies the impact of information set differences among arrangers and participants on loan spreads. We also provide evidence that the presence of reputable arrangers leads to lower spreads only for those borrowers with potentially fewer asymmetric information problems. For opaque borrowers, mandating a reputable arranger facilitates access to funds available in the syndicated loan market but does not lower loan spreads.

Keywords: syndicated loans, repetitive lending, arranger moral hazard, arranger reputation, opaque borrowers

Session 4b: Regulation

The integration of early warning signals with pricing and risk management models
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Much of the academic literature in the area of early warning signals (EWS) in finance and economics is domiciled in the review of distress in emerging markets and in particular debt and currency crises. The literature with respect to banking crises is rather more limited. The current global financial crisis has affected many mature economies prompting the need to revisit the positioning of EWS. Muted regulatory oversight and corporate governance coupled with a sustained period of low interest rates, “esoteric instruments, ... and skittish investors” [Reinhart and Rogoff, 2008] caused the financial markets’ Icarus to fly too close to the sun. Some argue that the current contagion has its roots in traditional banking crises; inflated asset valuations and inadequate risk management [Calice et al., 2009].

Re-Mapping Credit Ratings
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Alexander Esl, Vienna University of Economics and Business Administration, Austria
Hermann Elendner, Vienna Graduate School of Finance, Austria

Rating agencies report ordinal ratings in discrete classes. We question the market’s implicit assumption that agencies define their classes on identical scales. To this end, we develop a non-parametric method to estimate the relation of rating scales for pairs of raters. This scale relation identifies for every rating class of one rater the extent to which it corresponds to any rating class of another, and hence enables a rating-class specific re-mapping of one agency’s ratings to another’s scale. Our method is based purely on ordinal co-ratings to obviate error-prone estimation of PDS and disputable assumptions involved, and exploits structure in the joint estimation of all rating classes’ relations from a pair of raters. We find convincing evidence against the hypothesis of identical scales for the three major rating agencies Fitch, Moody’s and Standard & Poor’s, provide the relations of their rating classes and illustrate the importance of correcting for scale relations in benchmarking and pricing.

Keywords: credit rating; rating agencies; rating scales; comparison of ratings

Corporate Governance and Corporate Strategies for Climate Control and Environmental Mitigation
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Strategic corporate responses to climate change and environmental challenges do not seem to be the primary domain of corporate management. Such decisions are often not seen as profit maximizing in the short run and are generally not consistent with executive incentives. Nevertheless, as such responses may indeed be firm value maximizing, these decisions can be expected to reflect the nature of a firm’s corporate governance. Based on an analysis of 500 of the largest firms, we show empirically that this is indeed the case. Specifically, this study documents that institutional ownership and entrenchment seem to significantly influence environmental impact and green policies of large firms. More interestingly, governance measures such as inside and institutional ownership and entrenchment have a much stronger influence on environmental reputation of large firms.

Keywords: Corporate Governance, Climate Change, Environmental Impact, Strategic Decisions

Session 4c: Rethinking the Euro

How to limit the moral hazard related to a European Stabilization mechanism
Séverine Menguy, Université Paris X Nanterre, France

The paper studies the opportunity to introduce a centralized insurance mechanism in Europe. Indeed, in a monetary union, monetary policy can efficiently stabilize common shocks but it is much less usable in case of asymmetrical shocks and /or if the countries are structurally heterogeneous. Thus, the national and decentralized stabilization policies could be efficiently complemented by a global insurance mechanism. Indeed, introducing state dependent federal transfers is beneficial if the variance of demand or supply shocks is sufficiently high in comparison with the disinfective effect of these transfers on the national effort to reduce the variance of idiosyncratic shocks. Nevertheless, a state independent federal premium would then also be useful in order to avoid the moral hazard problem implied by a centralized insurance mechanism.

Keywords: Economic and Monetary Union, fiscal federalism, stabilization policy, insurance mechanism

Interest Rate Linkages between the US, UK and German Interest Rates: Should the UK join the European Monetary Union?
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Roselyne Joyeux, Macquarie University, Australia

In light of continuing mixed results in the literature, this paper re-examines the German Dominance Hypothesis (GDH) and considers whether the UK should join the Eurozone. For this purpose short term interest rates relationships between the UK, Germany, the Eurozone and the USA for the period January 1982 to June 2007 are studied. The policy implication of a loss of monetary autonomy for the UK in favour of Germany or the European Central Bank (ECB) would give support to the UK joining the EMU as an economic response. From the early 1980’s the Bundesbank’s responsibility was to use money growth targets to keep the average inflation rate down in the long run. This long run objective suggests that an inappropriate methodology for testing the GDH is to test whether the German stochastic trend is a driving stochastic trend. In other words we determine whether a permanent shock to the German interest rate has a permanent effect on the UK interest rate. To this end the structural shocks in a VECM are identified by imposing long-run restrictions of the type developed in King, Plosser, Stock & Watson (1991). We apply the same techniques to testing whether the UK has suffered a loss of monetary autonomy in favour of the ECB.

Keywords: Exchange Rate Mechanism, interest rates, vector error correction models.

The superiority of a European stabilization mechanism over national budgetary stabilization policies
Séverine Menguy, Université Paris X Nanterre, France

In the framework of the Economic and Monetary Union, theoretical arguments assume that a centralized insurance mechanism would be useful to compensate for the loss of the exchange rate autonomy, beyond the intertemporal stabilization provided by national policies. Indeed, some conditions must be verified to avoid the excesses of the transfers in large redistributive flows. However, a simple macroeconomic model underlines analytically the higher efficiency of a centralized mechanism over decentralized budgetary stabilization policies, especially for demand shocks. Indeed, such a mechanism can only be useful to stabilize supply shocks if the countries are heterogeneous, and even then, it is not beneficial simultaneously to all member countries of the monetary union.
Session 4d: Finance & Development in Emerging Markets

The Politics of Financial Development: The Role of Interest Groups and Government Capabilities

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*Eduardo Cavallo, Inter-American Development Bank, USA
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Financial development is good for long term growth. So why doesn’t every country pursue policies that render full financial development? In this paper we advance a political economy account of financial development that stresses the joint role of interest groups and government policymaking capabilities in decision making. Building on a profuse political economy literature, we build a theoretical model that shows that incumbent interest groups do not always oppose financial development. The intensity of opposition by incumbents depends on both their degree of credit dependency and the role of governments in credit markets. We provide empirical evidence based on cross country and panel data from a large sample of countries, that financial development is determined, at least partially, by the interaction of incumbent interest groups’ preferences and government policymaking capabilities. Moreover, improvements in government capabilities have a significant impact on credit market development only in those countries where credit dependency is high. We thus contribute to this rich literature by providing a unified account of credit market development that includes two of its main determinants, traditionally considered in isolation. The findings provide novel implications for the set of potential policy recommendations.

Keywords: financial development, interest groups, political economy, government capabilities

Firm level liquidity and the political economy of stock market development in Tunisia

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The question of whether or not increased stock market size allows for improved financing conditions for firms in emerging markets is an important one for policy-making. This paper seeks to investigate this issue by analyzing whether increases in market-level liquidity have indeed trickled down to individual firms over the last decade of stock market development in Tunisia, a fast-growing Mediterranean emerging market. We develop time varying liquidity scores for all firms listed in the Tunisian market over the 1997-2009 period and analyze the extent to which market development, firm-level characteristics and risk exposure affect the magnitude and the distribution of liquidity using a set of fixed effect panel regressions. Our results suggest that massive increases in value traded have created market congestion, thereby increasing the costs of trading, in a context of persistently low efficiency and increased international integration. The main implications of this process are (i) market-level development and international integration are not sufficient conditions to ease access to finance for local firms, (ii) further reforms in the Tunisian market should focus on diversifying corporate ownership and improving the disclosure of information, and (iii) international investors seeking diversification in Tunisia should be aware of a significant illiquidity risk.

Keywords: Economic Development, International Finance, Middle East and North Africa

Transactions Costs in an Emerging Stock Market: Berlin 1892-1913
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We estimate effective spreads at the Berlin Stock Exchange for the period 1892-1913 using daily stock market returns for a sample of 27 stocks. Our results show that transaction costs at the main stock exchange in a bank-based financial system at the turn of the 20th century were quite low and about comparable to effective spreads in modern markets. Nonetheless, effective spreads varied substantially over time and across securities. We find that this variance can be to a great extent explained by the size (market capitalization of the company or market) and the speed of information processing.

Keywords: Effective Spreads; Transaction Costs; Economic History; Germany

Session 4e: European Investment

The risk-return trade-off in Europe: A temporal and cross-sectional analysis

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Vincent Aragés, Universitat Jaume I, Spain

This paper analyzes the risk-return trade-off in European equities considering both temporal and crosssectional dimensions. In our analysis, we introduce not only the market portfolio but also 15 industry portfolios comprising the market. By obtaining the covariances between market and industry returns with a bivariate GARCH BEKK model, and constraining the risk-aversion coefficients to be the same for cross-sectional consistency, we obtain a positive and significant relationship between return and risk using European market data.

Keywords: Equity risk premium, multivariate GARCH, cross-sectional analysis, ICAPM, risk aversion

Trade-throughs in European cross-traded equities after transaction costs – Empirical Evidence for the EURO STOXX 50

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The new regulatory environment triggered by MiFID has resulted in a transformed competitive landscape and increased fragmentation among execution venues in Europe. One key component of MiFID is best execution, i.e. investment firms are obliged to achieve the best result for customer orders on a consistent basis. Specifically for retail transactions, the total consideration, i.e. price and explicit transaction costs, shall apply as a benchmark for the best result. In contrary to RegNMS, MiFID does not require to achieve the best result based on a real-time comparison of available prices. Therefore, after the introduction of MiFID the question on the extent of suboptimal order executions after transaction costs arises. Applying order book data for EURO STOXX 50 securities of ten European execution venues, this paper analyzes suboptimal order executions including transaction costs by simulating an optimal Smart Order Routing engine. The results show that after explicit transaction costs, specifically cross-system settlement costs, still an economically relevant number of suboptimal order executions prevails. The developed methodology and parameters enable for assessing and future tracking of the efficiency of order execution in European equity markets and the effectiveness of regulatory measures both on the trading level, e.g. MiFID, or on the post-trading level, e.g. the Code of Conduct for Clearing and Settlement.
A study of the causal relationships between sovereign spreads, risk-free interest rates and exchange rates
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Bruce Morley, University of Bath, UK  
John Hudson, University of Bath, UK

The aim of this study is to determine the causal relationships between credit default swap (CDS) spreads, risk-free interest rates and exchange rates, by using VAR and VECM econometric models. Although to date there is some literature on the causality between the risk-free interest rates and the sovereign CDS, as yet there is no literature on exchange rates and CDS spreads. The paper uses the data from 2005 to end-2009, covering the full period of the recent global financial crisis. Against this special background, there are different results for the two cases: France and USA. For France, there is bi-directional Granger causality between the CDS spreads and the exchange rate, and the long run equilibrium causes the risk-free interest rates. For USA, the causality between the CDS spreads and the exchange rate is unidirectional: the exchange rate Granger causes the CDS.

Keywords: Sovereign spreads, exchange rates, causality

Exchange Rate Policy and Sovereign Spreads in Emerging Market Economies
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The exchange rate policy of a country is closely related to the current and future macroeconomic performance of the economy. Therefore, it is expected that the risk perceptions about a country would be affected by its exchange rate policy. This paper empirically analyzes the relationship between exchange rate policy and sovereign risk premia in emerging market economies, considering both the actual exchange rate behavior and the officially declared regimes. The results show that countries that announce a fixed exchange rate regime face lower spreads than countries that announce a floating regime or intermediate flexibility. When the actual exchange rate behavior is considered, this relationship persists between intermediate flexibility and pegs but countries that allow their exchange rates to freely float do not face higher spreads in this case. The difference between the results is due to the fact that many countries deviate from their declared exchange rate policy. The empirical analysis also reveals that the countries that announce a floating regime do not face higher spreads than pegs when they actually allow a high degree of flexibility as they announced. However, intermediate flexibility leads to higher spreads independently of whether this is the announced policy or the actual behavior.

Keywords: Sovereign spreads; Exchange rate regimes; Default risk

Session 4f: CDS Bond Spreads

CDS Bond Spreads among the PIIGS 2006-2010
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Jonathan Batten, Hong Kong University of Science & Technology, Hong Kong  
Cetin Ciner, University of North Carolina at Wilmington, USA  
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We explore whether retained government ownership affects the cost of debt for fully and partially privatized companies. On average, a one percentage point decrease in government ownership is associated with an increase in the credit spread, used as a proxy for the cost of debt, by one-half of a basis point. However, fully privatized companies exhibit lower credit spreads than partially privatized firms, indicating the cost of a lengthy privatization process. Empirical evidence indicates these findings result from decreasing government guarantees, firm performance improvements, ownership uncertainty, and bondholder-shareholder conflicts.

Keywords: Government ownership, Government ownership, Bonds, Cost of Debt

Empirical Evidence on Ownership Structure, Management Control and Agency Costs
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We present new empirical evidence on the agency costs which emerge from the vertical (ownership versus control) and horizontal (majority versus minority) agency problems. Using a cross-section of 55,970 public and private firms, we document that agency costs increase as firms move from a single owner/single manager ownership structure to more complicated ownership structures. Within each ownership structure, agency costs are significantly higher when firms are not managed by owners. We find that bank monitoring has a significant positive impact on the performance of private firms. We also show that agency costs are lower in firms with shared control of ownership. Further, we find that horizontal agency costs are lower in firms where control is contestable.

Keywords: Agency problems; agency costs; ownership; control

Session 4h: Money & the Real Economy

Heterogeneous Expectations, Learning and Monetary Policy Rules in A Two-country Model
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By introducing heterogeneous expectations into a two-country dynamic general equilibrium model, this paper analyses how learnability of rational expectations equilibrium may be affected by monetary policy rules when agents in different countries face heterogeneity in expectations and learning. The results show that persistently heterogeneous expectations and learning may alter conditions for learnability relative to the corresponding average economy, while transiently heterogeneous learning does not. Therefore, policymakers should pay more attention to international heterogeneity in expectations and learning behavior.

Keywords: Monetary policy, learning, heterogeneity, expectation, exchange rate regime
Real Sector and Banking System: Real and Feedback Effects. A Non-Linear VAR Approach
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This paper studies the relationship between macro variables and banking sector. In particular, we are interested in quantitative and qualitative responses of the macro-economic variables and the banking quality indicator to shocks generated in the macroeconomic system and in the banking sector. In order to achieve this result, we estimate a non-linear VAR, based on four variables (output gap, interest rate, inflation rate and non-performing loans). Our study is based on country specific as well as pooled analyses. Impulse response functions are estimated using the local projections approach. The results show evidence for real and feedback effects, the effect going from the macro variables to the banking sector and vice versa. Specifically, the two effects work via the output gap and interest rate while the inflation rate plays a marginal role in the shock transmission. The results are robust to the datasets used, to the shock identification procedures chosen and to the period taken into account.

Keywords: Financial Stability, Non-Linear VAR, Local Projections Methods

Corporate Distress and Restructuring with Macroeconomic Fluctuations: The Cases of GM and Ford
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Traditional methods for evaluating corporate credit risk rarely consider the impact of the macroeconomy on corporate value and performance. We argue that lenders and management can obtain valuable information about the need for and approach to restructuring by decomposing default predictions into "intrinsic" and macroeconomic factors. The approach is modeled previously used for measuring macroeconomic exposures on default predictions in order to filter out macroeconomic factors. In this paper the method is applied on an analysis of the Z-scores for GM and Ford for the period 1992-2005. The macroeconomy was decomposed into different ways with implications formgagements’ and creditors’ approaches to restoring financial health.

Session 4i: Mergers & Acquisitions

Acquiring Shareholders’ Valuation in Cross-Border M&As: The Influence of the Legal and Institutional Environment
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Susana Menéndez-Requejo, Universidad de Oviedo, Spain

The aim of this paper is to analyze the influence of the legal and institutional environment on acquiring shareholders’ valuation around the announcement date of cross-border Mergers and Acquisitions (M&As) controlling for the possibility that a cross-border acquisition decision is an endogenous choice. The database includes 469 M&As of European (221 cross-border and 248 domestic) listed firms, with target firms being worldwide public or private firms (40 countries), over the 2002-2006 period. Shareholders of acquiring firms place greater value on cross-border M&A announcements than on domestic ones. The weaker the legal and institutional environment of the acquirer is in comparison with that of the target country, the more negative is the effect on acquiring-shareholders’ valuation of M&As. The legal and institutional environment is an important determinant factor in acquiring firm shareholders’ valuation when there are relevant differences between the acquirer and target countries. A stronger legal and institutional environment in the target country increases the transaction cost for cross-border deals, so the decision to acquire a firm in these countries is negatively valued by acquiring-firm shareholders.

Keywords: Mergers and Acquisitions (M&As), Cross-border deals, acquiring-firm abnormal return, legal environment, investor protection.

Determination of Bidders’ Gains and the Choice of Earnout as Acquisition Payment Currency
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Sudi Sudarsanam, Cranfield University, UK

Abstract: The paper examines the wealth effects of a comprehensive sample of UK bidders offering contingent payment or earnout as consideration for their acquisitions. Our evidence conveys that bids using earnout yield significantly higher announcement and post-merger gains to bidders’ shareholders, than bids involving non-earnout such as cash, stock exchange, or mixed payment. This is consistent with our hypothesis that earnout is an effective payment mechanism to reduce valuation risk to acquirers and also to enhance their value gains from acquisitions. The paper also shows that bidders offering earnout to targets operating in ‘relatively intangible rich’ industries enjoy significantly higher gains than bidders offering non-earnout in bids of similar assets, which is consistent with our model of optimal method of payment choice. Overall, the paper offers evidence that bidders using earnout mitigate valuation risk to acquirers and enhance shareholder wealth during the announcement and post-merger period.

Keywords: Earnout, bidder gains, intangible rich industries, abnormal returns, post-merger performance, method of payment

What do Premiums Paid for Bank M&As Reflect? The Case of the European Union
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Ignacio Hernando, Banco de España, Spain
*Maria Nieto, Banco de España, Spain
Larry Wall, Federal Reserve Bank of Atlanta, USA

We analyze the takeover premiums paid for a sample of European bank mergers between 1997 and 2007. We find that acquiring banks value profitable, high-growth and low risk targets. We also find that the strength of bank regulation and supervision as well as deposit insurance schemes lower the takeover premiums paid by acquiring banks. This result, presumably in anticipation of higher compliance cost, is mainly driven by domestic deals. Also, we find no conclusive evidence that bidders seek to extract benefits from regulators either by paying a premium for deals in less regulated regimes or by becoming ‘too big to fail’.

Session 5a: Cross-Border Banking

How Institutional Differences between Home and Host Country Affect Bank Efficiency? International Comparison of Domestic versus Foreign Banks with Their Specifications and Regions
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Hsiang-Hsi Liu, National Taipei University, Taiwan
Chuan-Yu Lin, Nan Hua University, Taiwan

Previous empirical evidences on efficiency analysis for foreign bank show mixed findings about whether foreign banks do perform better than domestic banks. Using comprehensive panel data on 70 countries for the period 1992 to 2006, this paper empirically investigates comparative performance of banking sector particularly in comparison with efficiency analysis for foreign versus domestic banks, and further identifies key determinants of bank efficiency associated with bank characteristics and cross-country differences in macroeconomic condition and institutional governance. Utilizing several combinations of input and output factors, various efficiency measures on banks are calculated by Data Envelopment Analysis (DEA) approach to evaluate comparative performance of foreign versus domestic banks. The empirical findings indicate that foreign banks show better efficiency than domestic banks according to efficiency scores from technology and scale. Banks with better performance are positive related to Cap funds to total assets, cap funds to liabilities, larger bank assets, liquid assets to total deposit & borrow, increasing off-balance sheet items over total assets, net loans to total deposit & borrow, net loans to deposit funding, net profits before taxes to equity, other operation income to average assets, and non operation items to net income, but negative associated with lower Equity to total assets, lower non-interest expenses to average assets, cost to income ratio, and falling GDP per capita. Specifically, cross-country differences or similarity in...
institutional quality between home country and host country for all banks are significantly positive with political instability. Interesting, foreign banks performing better are associated with closer distance in macroeconomic conditions and institutional governance between host and home country.

Keywords: Bank Efficiency, Foreign Banks, Data Envelop Analysis (DEA), Institutional Governance, Panel Tobit Model with Random-Effect

Information sharing and cross-border entry in European banking
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Information asymmetries can severely limit cross-border bank entry. When a bank enters a new market, it has incomplete information about potential new clients. Such asymmetries are reduced by credit registers, which distribute financial data on bank clients. We investigate the interaction of credit registers and bank entry modes (in form of branching and M&A) by using a new set of time series cross-section data for the EU-27 countries. We study how the presence of public and private credit registers and the type of information exchanged affects bank entry modes during the period 1990-2007. Our analysis shows that the existence of both types of registers increases the share of branching in the overall entries. Additionally, the establishment of public registers reduces concentration ratios, and some banking competition indicators (such as overhead costs/assets). The introduction of a private credit bureau, on the other hand, has no effect on concentration ratios, but positively contributes to competition (by decreasing interest rate margins). This suggests that credit registers facilitate direct entry through a reduction of information asymmetries, which in turn intensifies competition.

Keywords: credit registers, foreign entry, asymmetric information.

What Drives Cross-Border Depositing: Economics, Culture or Institutions? New Evidence from the Euro zone
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*Stefan Kleinmeier, Maastricht University, The Netherlands
Harald Sander, Cologne University of Applied Sciences, Germany

We investigate the role of cultural and institutional factors for banking market integration by employing a unique data set on Euro-zone cross-border depositing in an augmented and theoretically substantiated gravity model framework. We demonstrate that cultural factors such as trust and institutional factors such as legal system heritage militate against pure economic reasoning. We conclude that these factors can limit financial integration in general and in Euro zone banking markets in particular. Such natural barriers are difficult to overcome by integration policies.

Keywords: cross-border deposits, banking market integration, gravity model, culture, European single market

Session 5b: Behavioural

A Tale of Two Strategies: Cash Flow, Accruals and the Role of Investor Sentiment
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*Ron Guido, Fidelity International, UK
Christos Koutsouyannis, State Street Global Advisors Limited, UK

This study documents a subtle and counter-intuitive interaction between operating cash flow (OCF) and accruals, and their association with future stock returns. While the two strategies should by construction capture similar anomalies, we find evidence in two large stock markets that they appear distinct, and that returns to these strategies are strongly negatively correlated. We show that the presence and behaviour of financially distressed firms influences asymmetrically the performance of accruals and CFO strategies. Given their highly speculative nature, we find investor sentiment to be an important determinant of the performance of financially distressed firms. Because accruals and CFO based strategies load asymmetrically on financially distressed securities, strategies based on accruals (cash flow) perform particularly well (poorly) during high sentiment periods and particularly poorly (well) during low sentiment periods.

Keywords: Accruals, Cash Flow, Asset Pricing, Market Efficiency, Investor Sentiment

An examination of investor sentiment effect on G7 stock market returns
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This paper examines the relationship between investor sentiment and G7 stock market returns. Using a range of investor sentiment proxies including consumer confidence index and equity fund flow, we examine if investor sentiment has significant influence on aggregate stock market returns, value stock returns and growth stock returns. Using monthly data for the period January 1995 to December 2007, our results indicate that investor sentiment has significant influence on equity fund flow on value and growth stock returns is mixed for different countries.

Keywords: Investor Sentiment, Consumer Confidence, Mutual Funds

One Half-Billion Shareholders and Counting: Determinants of Individual Share Ownership around the World
Paul Groot, University of Bristol, UK
*William Megginson, The University of Oklahoma, USA
Anna Zalewska, University of Bath, UK

This study presents the first comprehensive compilation of the number of people around the world owning shares voluntarily. We document that at least 317 million people in 70 countries (24 developed and 46 emerging market nations) invest in equity of publically listed companies or mutual funds. Accounting for contributors of voluntary pension schemes investing in equity increases the number of shareholders to over 544 million. We also test for determinants of personal shareholdings and find that (i) the legal origin matters (common law countries have statistically significantly higher percentage of population investing in equity), (ii) GDP per capita also matters but its significance is driven by emerging markets (in particular those opened before 1985), and (iii) privatisation does not contribute to higher levels of shareholder participation in the medium- and long-run.

Keywords: Government policy and regulation; Capital and ownership structure; Legal origin; International finance; Emerging markets

Session 5c: FX

Covered Interest Parity in the Yen Forward Market: New Insights from Threshold Non-Linear Dynamics
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Wai-Sum Chan, Chinese University of Hong Kong, Hong Kong
Hong-Lun Chan, The Hong Kong Polytechnic University, Hong Kong
Peter Sillnay, University of Cambridge, UK

This paper studies the magnitude and time-variation of transaction cost bounds associated with covered interest parity. We employ a three regime Bivariate Threshold AutoRegressive (BTAR) model and provide economic intuition about the three states. When studying different maturities of the USD-JPY rates, one state represents times when USD borrowers have a comparative advantage, one state represents times when JPY borrowers have an advantage, and a third state represents white noise around the theoretical exchange rate. The profit associated with exploiting an arbitrage varies with maturity as well as state: the largest profit arises when USD borrowers have

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the advantage, while the largest variance in profit occurs when JPY borrowers have the advantage.

**Key Words:** Arbitrage; Covered Interest Parity; Yen Forward Market; Lead-lag Relationship; Threshold Autoregression (TAR); Non-linearity Test

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**Is There a Risk-Return Tradeoff in the Foreign Exchange Market?**

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Lucio Sarno, City University London, UK
Ilias Tsiakas, The University of Warwick, UK

This paper provides an empirical investigation of the risk-return relation for foreign exchange (FX) portfolios that exploit deviations from uncovered interest parity. Using a large cross-section of US nominal exchange rates, we follow Pollet and Wilson (2009) in decomposing the FX market variance into the average variance as a measure of idiosyncratic FX risk and average correlation as a measure of systematic FX risk. We then estimate a set of predictive regressions based on the Merton (1973) model for multiple horizons, and find two key results: (i) an investor will benefit from holding idiosyncratic FX risk over medium and long horizons regardless of the choice of numeraire currency, which indicates a positive risk-return tradeoff in the FX market; and (ii) the relation of systematic FX risk and return tends to be negative but the sign of this relation may change for numeraires other than the US dollar.

**Key Words:** Exchange Rates; Average Variance; Average Correlation; Idiosyncratic Risk; Systematic Risk; Carry Trade.

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**The Impact of Macroeconomic Announcements on Real Time Foreign Exchange Rates in Emerging Markets**

*Fang Cai, The Federal Reserve Board of Governors, USA
Hyunsoo Joo, University of Maryland, USA
Zhiwei Zhang, Hong Kong Monetary Authority, Hong Kong

This paper utilizes a unique high-frequency database to measure how exchange rates in nine emerging markets react to macroeconomic news from the U.S. and domestic economies. We find that major U.S. macroeconomic news have a strong impact on the returns and volatilities of emerging market exchange rates, but many domestic news do not. Emerging market currencies have become more sensitive to U.S. news in recent years. We also find that market sentiment could sway the impact of news on these currencies systematically, as good (bad) news seems to matter more when optimism (pessimism) prevails. Market uncertainty also interacts with macroeconomic news in a statistically significant way, but its role varies across currencies and news.

**Key Words:** exchange rate, emerging market, macroeconomic news, high-frequency data

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**Session 5d: Emerging Markets & Financial Crises**

**Political Crises and Stock Market Integration: Evidence from Emerging Markets**

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Ivan Indriawan, Auckland University of Technology, New Zealand
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This paper investigates the role of political crises in explaining the change in the degree of stock market integration for emerging markets over the period 1991-2006. Using the International Crisis Behavior database, which contains detailed information about political crises around the world, we assess whether political crises affect stock market integration for 19 emerging markets from Far East Asia, Latin America and Eastern Europe. We find that political crises and their characteristics significantly reduce the level of stock market integration for these regions. In particular, the start of a political crisis, its severity, US involvement in the conflict and the number of actors involved in the crisis all have a significant impact on the level of stock market integration for the emerging markets in each region.

**Key Words:** Stock Market Integration; International Crises; Emerging Markets

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**Financial integration and financial development in transition economies: What happens during financial crises?**

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This paper provides an empirical analysis of the role of financial development and financial integration in the growth dynamics of transition countries. We focus on the role of financial integration in determining the impact of financial development on growth, distinguishing "normal times" from periods of financial crises. In addition to confirming the significant positive effect on growth exerted by financial development and financial integration, our estimates show that a higher degree of financial openness tends to reduce the contractionary effect of financial crises, by cushioning the effect on the domestic supply of credit. Consequently, the high reliance on international capital flows by transition countries does not necessarily increase their financial fragility. This implies that financial protectionism is a self-defeating policy, at least for transition countries.

**Key Words:** transition economies, financial integration, financial crises, economic growth, threshold effects

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**Credit Euroization in Central, Eastern and Southeastern Europe**

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In recent years, an increasing share of private sector credit in Central, Eastern and Southeastern Europe (CESEE) has been denominated in foreign currency, a process also referred to as credit euroization. Despite warnings from researchers and central banks, the inherent risks associated with foreign currency (FX) lending have been underestimated or neglected by banks and borrowers. The global financial crisis induced a materialization of these risk factors. The weakening of CESEE currencies against the Euro and the Swiss franc led to a significant increase in the real cost of FX borrowing and consequently higher expected credit default risks for banks. The aim of this paper is to analyze the process of credit euroization in CESEE and investigate the motives of borrowers and lenders to engage in FX lending. Building on a comprehensive review of the existing literature, a model of credit euroization is developed and tested empirically on 13 CESEE countries over the time period 1999 to 2007. We find evidence that underpins the concept of the foreign funds channel, as developed theoretically in this paper. The results suggest that credit euroization is driven by foreign borrowings, but that it is irrelevant whether the funds are channelled into the system via subsidiaries of Western banks (foreign bank channel) or via domestic banks borrowing abroad. A second key finding is that banks appear to finance FX loans to households to a greater extent with FX deposits, whereas they finance FX loans to corporations to a higher degree with foreign borrowings.

**Key Words:** Credit euroization/dollarization, foreign currency lending, financial sector foreign direct investment, foreign banks, Central, Eastern and Southeastern Europe

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**Asset Price Booms, Credit Bubbles and Future Financial Stress - A Focus on Emerging Markets**

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Marco Lo Duca, ECB European Central Bank, Germany

The paper analyses the role of financial imbalances, in the form of rapid expansion of credit and run-up of asset prices, in predicting extreme events of financial stress using the signalling approach (Kaminsky et al., 1998) and discrete choice models for 28 key advanced and emerging economies for 1990-1-2009. In doing so, we construct a country-level Financial Stress Index (FSI) to capture broad set of tensions in a country’s financial markets. We then evaluate the usefulness of signals with the approach by Alessi and Detken (2009) to find the optimal thresholds for the indicators, depending on the preferences of the policy maker. Our results show that asset price and credit booms are useful indicators of financial imbalances that can be used in predicting extreme financial stress, with significant statistical gains. Finally, we assess the current evolution of asset prices and credit against the thresholds that we
found. Interestingly, the results show that despite many markets are distant from overheating, a few markets are already in "danger" areas.

Keywords: macroprudential analysis, financial stress, financial imbalances, emerging economies, asset boom, credit boom

Session 5e: Investment Risk & Liquidity

Legal regime, Size, and Liquidity factors in Asset Pricing
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Kate Phylaktis, City University London, UK
Jennifer Piese, King’s College London, UK

This study introduces a new legal regime factor into the international valuation literature which exploits the differences between civil and common law origin countries. This builds directly on the concept that institutions both build and shape culture and economic outcomes and takes account of the pervasive differences between civil and common law countries worldwide La Porta et al (1998, 2002). This study contrasts the abilities of three prominent liquidity constructs, namely Amihud (2002) price-impact, Liu (2006) trading speed and volume-based turnover, in explaining the total trading costs in a sample of 62 equity markets spanning developed and developing countries as well as aggregated worldwide civil and common law universes. The evidence reveals that differences in legal origin of markets exert a pervasive effect on the liquidity generating process that transcends institutions across markets. Furthermore, a world market universe is created from the constituent stocks of the top tier equity market indices from 60 countries worldwide leading to the construction of size and liquidity returns-based factors and a new legal regime factor. The results indicate that the four-factor legal regime CAPM outperform both other pricing models.

Keywords: Legal Origin, Asset pricing, International Financial Markets

Why do variance swaps exist?
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Alfonso Novales, Universidad Complutense de Madrid, Spain
Gonzalo Rubio, Universidad CEU Cardenal Herrera, Spain

This paper studies the determinants of the variance risk premium and concludes on the hedging possibilities offered by variance swaps. We start by showing that the variance risk premium responds to changes in higher order moments of the distribution of market returns. But the uncertainty that determines the variance risk premium—the fear by investors to deviations from Normality in returns—is also strongly related to a variety of risks: risk of default, employment growth risk, consumption growth risk, stock market risk and market illiquidity risk. Therefore, the variance risk premium could be interpreted as reflecting the market willingness to pay for hedging against financial and macroeconomic sources of risk. We provide additional evidence in support of that view.

Credit and Liquidity Risk in Sub-prime Mortgage backed Assets
Mardi Dungey, University of Tasmania & University of Cambridge, Australia & UK
Gerald P Dwyer, Federal Reserve Bank of Atlanta, USA
*Tom Flavin, National University of Ireland, Maynooth, Ireland

The mortgage backed securities market has dramatically declined during the credit crunch of 2007-2008. To understand the factors driving its demise we utilise a latent factor model representing common effects, asset rating effects, vintage of issuance effects and liquidity effects - extending the recent representation of CDO pricing in Longstaff and Rajan (2008). Common and liquidity effects are shown to have an increasing influence on the performance of the ABX-HE indices, with the role of vintage factors changing dramatically over the sample period of January 2006 to May 2008. Consistent with other evidence, risk from systemic factors has transferred risk to more highly rated tranches of these structured finance products.

Keywords: credit crunch, asset backed securities, factor models, Kalman filter

Session 5f: Bond Pricing

Liquidity Risk and the Pricing of Sovereign Bonds
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This paper examines the role of the liquidity in the pricing of sovereign U.S. dollar bonds in emerging markets. We extend Acharya and Pedersen’s (2005) liquidity-adjusted capital asset pricing model to the bond market and find that both liquidity level and multiple liquidity risks are priced factors for the expected excess return of U.S. dollar bonds issued by developing countries. The combined effects of liquidity risk and liquidity level can explain as much as 1% per annum extra yield spread for the countries that have higher liquidity betas. Countries which have a high correlation with the global market (or U.S. stock market) have higher required bond returns than low correlation countries. The liquidity factor helps explain the credit spread puzzle of high yields. Our empirical results also support a flight to liquidity across the studied countries and are robust to controlling for bond characteristics and the U.S. risk factors.

Keywords: liquidity, liquidity risk, asset pricing, bonds, emerging markets

Auctioning Government Securities: The Puzzle of Overpricing
Riccardo Pacini, Università degli Studi di Roma “Tor Vergata”, Italy

This paper explores if the overall institutional setups to place Government securities adopted by eurozone countries preserve a regular functioning of the market, principally looking at the primary market pricing performance with respect to the secondary market. However, I find that Government securities are always overpriced. The empirical analysis shows that this cannot be viewed as a success of the issuing technique or as the result of the discretion enjoyed by some Treasuries in the stop-out price setting procedure, but rather as a consequence of the Treasuries bundling the securities auctioned with a number of commodities, such as the syndication rights. Since the overpricing may harm the long-run competitiveness of Treasury auctions by driving the smaller primary dealers out of the primary market, I suggest discontinuing the bundling or exploring alternative auction mechanisms such as the clock auctions, and in particular those which put up different items simultaneously.

Keywords: Overpricing, Government Securities, Primary Dealers, Commodity Bundling, Multi-Unit Auctions

Liquidity Risk and Pricing of Government Bonds around the World
Sakkapop Panyanukul, The University of Warwick, UK

This paper finds that both liquidity level and liquidity risk are important in explaining the cross-section of domestic government bond returns in 39 countries (both emerging and developed) around the world. After controlling for other market factors and bond characteristics, liquidity and liquidity risk together can explain as much as 0.41% per annum of extra yield for the highest versus the lowest liquidity risk countries (China and Argentina respectively). There is also evidence of a liquidity spill-over from the U.S. stock market to domestic bond markets around the world. Employing a conditional model which allows both time-series and cross-sectional variation in liquidity betas, we find that the impact of liquidity risk is time varying across two different regimes: it increases in times of high uncertainty and is always larger in emerging than in developed countries. Nevertheless, the price of risk or premium required by investors for holding this time-varying risk is relatively stable.

Keywords: liquidity, liquidity risk, time-varying liquidity, asset pricing, bonds, international markets

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Keywords: liquidity, liquidity risk, time-varying liquidity, asset pricing, bonds, international markets
Session 5g: Capital Structure

Capital Structures in Europe, managerial insight and governance regimes.
Charlie Reuter, ESCP-EAP & Université de Paris Ouest (CEROS), France

We investigate the determinants of Capital Structure in Europe and we implement a novel approach focusing on the relevance of manager’s knowledge and behaviors for leverage ratios in aggregate. We show that this relevance is moderated by the governance structure of firms. Specifically we show that firms with concentrated-ownership exhibit a negative relation between managerial sentiment and both measures of leverage (market and book leverages) while firms with dispersed ownership exhibit a positive relation to market leverage only (no relation is obtained on medium-range firms). We further show that other dimensions relating to transparency, size & prominence moderate the relationship. Our contribution extends to debates on agency and corporate governance. We emphasize the practical importance between two dominant views of agency: managers vs. shareholders and control-holders vs. minority shareholders. While illustrating this relevance, we suggest that different governance structures, that is, different kinds of agency conflicts, lead to different managers’ behaviors in aggregate and different market valuation of these behaviors. An implication is that a normative assessment of managerial action may depend on the underlying governance regime.

Keywords: Agency Theory, International Capital Structure. Economic Sentiment. Corporate Governance. Dispersed & concentrated ownership

Capital Structure in European SME’s - The role of culture
Ciaraí mac an Bhaird, Dublin City University, Ireland

Determinants of capital structure and its choice in developing Central and Eastern European countries
*Peter Hernadi, Budapest University of Technology and Economics, Hungary
*Miklós Omos, Budapest University of Technology and Economics, Hungary

We analyze the determinants of capital structure and its choice of small and medium-sized enterprises in the developing Central and Eastern European countries form 2002 to 2007 using a firm-level dataset. We confirm the positive impact of size and tangibility of assets on the leverage, while reject the positive impact of profitability and effective tax rate, as well as, the expected negative impact of business risk and non-debt tax shields on corporate borrowing. Despite the undoubted relevance of country specific factors, we report that the SMEs behave homogeneously and also that the relevant capital structure determinants show remarkable steadiness. We argue that firms of the CEE countries converge their corporate financial decision making procedure to that of the developed countries. We state that companies respect a one-sided upper threshold rather than do converge to a fixed target on both sides. We find that companies are by far not indifferent to the hierarchy of financing alternatives.

Keywords: Capital structure; Emerging European countries; Static tradeoff theory; Pecking order theory; Agency theory

Capital Structure in the G-7 Countries: Pecking Order Theory and Mean Reversion in Earnings
Raj Aggarwal, The University of Akron, USA
*John Goodell, The University of Akron, USA
Sutthisit Jamdee, St Cloud State University, USA

This study assesses the level of leverage of the G-7 countries over a recent 11-year period and examines with panel analysis the partial determinants of capital structure. We find that the level of leverage seems to be very sticky in all G-7 countries. While balance sheet structures do differ across countries, debt ratio determinants are remarkably similar and debt ratios generally depend positively on tangibility of assets, and company size, and negatively on the market to book ratio, R&D expenses, and profitability. These findings extend the recent US work of Fama and French (2002) on testing the pecking order and trade-off theories and significantly support for the pecking order theory of capital structure in each of the seven countries. Our results are not sensitive firms with mean reversion in earnings exhibits a negative relationship between profitability and leverage.

Session 5h: The Macroeconomy & Finance

Monetary Policy, Global Liquidity and Commodity Prices
*Ansgar Belke, Universität Duisburg Essen, Germany
Ingo G Bonden, Universität Duisburg Essen, Germany
Torben W Hendricks, Universität Duisburg Essen, Germany

This paper examines the interactions between money, interest rates, goods and com-modity prices at a global level. For this purpose, we aggregate data for major OECD countries and follow the Johansen/Juselius cointegrated VAR approach. Our empirical model supports the view that, for controlling for interest rate changes and thus differ-ent monetary policy stances, money (defined as a global liquidity aggregate) is still a key factor to determine the long-run homogeneity of commodity prices and goods pric-es movements. The cointegrated VAR model fits with the data for the analyzed period from the 1970s until 2008 very well. Our empirical results appear to be overall robust since they pass inter alia a series of recursive tests and are stable for varying compositio-n of the commodity indices.

The empirical evidence is in line with theoretical considerations. The inclusion of com-modity prices helps to identify a significant monetary transmission process from global liquidity to other macro variables such as goods prices. We find further support of the conjecture that monetary aggregates convey useful information about variables such as commodity prices which matter for aggregate demand and thus inflation. Given this clear empirical pattern it appears justified to argue that global liquidity merits attention in the same way as the worldwide level of interest rates received in the recent debate about the world savings and liquidity glut as one of the main drivers of the current fi-nancial crisis, if not possibly more.

Keywords: Commodity prices, cointegration, CVAR analysis, global liquidity, inflation, international spillovers

Inflation, Price Dispersion and the Role of Market Integration
*Sascha Becker, Freie Universität Berlin, Germany
Dieter Nautz, Freie Universität Berlin, Germany

Recent monetary search models emphasize that the real effects of inflation via its impact on price dispersion depend on the level of search costs and, thus, on the level of market integration. For less integrated markets, the inflation-price dispersion nexus is predicted to be asymmetrical V-shaped which implies an optimal inflation rate above zero. For highly integrated markets, however, theory suggests that the impact of inflation on price dispersion disappears. Employing price data of the European Union member states, this paper is the first that empirically tests these implications of monetary search theory.

Keywords: Inflation; Relative price variability; Monetary search models; European market integration.

Portfolio and short-term capital inflows to the new and potential EU countries: patterns and determinants
*Mara Pirovano, Universiteit Antwerpen, Belgium
Jacques Vanneste, Universiteit Antwerpen, Belgium
André Van Pooie, Universiteit Antwerpen, Belgium

In this paper we estimate a dynamic panel model (Arellano-Bond GMM) explaining the volume of portfolio and short-term capital inflows (predominantly bank loans) in the new and potential EU member States as a function of a set of variables representing macroeconomic fundamentals (both domestic and foreign), macroeconomic policies and development of the financial sector. We find that while inflows of short-term bank loans are significantly explained by macroeconomic factors, exchange rate regime and liquidity of the banking sector, portfolio inflows seems to be meaningfully influenced only by the level of foreign GDP. We suggest two explanations for the latter result. First, the inability of aggregate data to capture the risk and expected profitability dimensions that typically underlie portfolio decisions. Second, portfolio capital in the form of bonds might react to interest rates other than the domestic
Crowded trades among hedge funds

*Marcello Pericoli, Banca d’Italia, Italy
Massimo Sbracia, Banca d’Italia, Italy

We analyze the correlation between “idiosyncratic” hedge fund returns over the period 1995-2008. Idiosyncratic returns are identified by regressing monthly hedge fund returns on a set of standard market factors and taking the residuals. Their correlation was very low and stable for about 12 years, but increased to unprecedented levels by 2007. To explain this rise, we add to the initial regression a set of non-standard factors: returns on leveraged loans, a proxy for returns on distressed debt and one for funding liquidity. After controlling for these factors, the rise in idiosyncratic return correlations during the crisis is strongly attenuated. These results are consistent with the narrative of “crowded trades”, i.e. of investment strategies that became more similar across hedge funds, which dived on few new markets and then exited with the emergence of financing difficulties.

Keywords: Trading strategies, correlation, contagion

The Future of European Post-Trading - Consequences for Risk Management in View of the Financial Crisis

*Michael Chlistalla, Johann Wolfgang Goethe Universität Frankfurt am Main, Germany
Peter Gomber, Johann Wolfgang Goethe Universität Frankfurt am Main, Germany
Torsten Schaper, Johann Wolfgang Goethe Universität Frankfurt am Main, Germany

The European post-trading landscape is recently changing fundamentally due to regulatory actions, the financial crisis, and the strong linkage of the global financial markets. The systemic importance of post-trading infrastructures underlines the industry’s significant dependence on safe and efficient risk management processes. Using the Delphi methodology in a study among a multitude of experts from different areas of post-trading, we developed a joint and coherent view of the most important issues relating to risk management the post-trading system has to cope with.

Keywords: Delphi Study, Post-Trading, Financial Crisis, Risk Management

Price Discovery and Investor Structure in Stock Index Futures

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*Christian Salm, Westfälische Wilhelms-Universität Münster, Germany
Michael Schuppel, Westfälische Wilhelms-Universität Münster, Germany

Previous literature on price discovery in stock index futures and spot markets neglects the role of different investor groups. This paper relates time-varying spotfutures linkages studied within a VECM-DCC-GARCH framework to changes in the investor structure of the futures market over time. Empirical results suggest that during the dominance of presumably unformatted private investors, the futures market does not contribute to price discovery. By contrast, there is evidence of information flows from futures to spot markets and a significant increase in conditional correlation between both markets as institutional investors’ share in trading volume increases. We derive implications for the design of emerging futures markets.

Keywords: Futures Markets, Price Discovery, Volatility Spillovers, Individual and Institutional Investors, VECM, Dynamic Conditional Correlation

Session 6a: Issues in Finance

Puzzle Solver
Christian Mueller-Kademann, Zurich University of Applied Sciences, Switzerland

This paper presents a model for asset markets with a subjectively rational solution for the price of the traded asset. Traders cannot act objectively rational and an increase in the number of traders does not enlarge the information set necessary for determining the “true” price. Consequently, many well-known “puzzles” vanish as there is no objective truth to which data could live up. An empirical test is suggested. It demonstrates the relevance of the argument.

Keywords: rational expectations, fundamental uncertainty, macro finance, financial crisis

Optimal Reserve Accumulation and Sovereign Debt: The Bright and the Dark Side of International Reserves

*Flavia Corneli, Banca d'Italia & European University Institute, Italy
Emanuele Tarantino, Tilburg University, The Netherlands

This paper establishes a theoretical relationship between sovereign debt price, reserves accumulation and the likelihood of liquidity shocks that provides a rational foundation to sovereign countries’ decision to face a liquidity crisis when that takes place. We analyze the effects of reserves on the contracting relationship between a lender and a country. We show that, at the prospect of liquidity shocks, reserves can lower sovereign debt price provided the likelihood of such a shock is big enough: this reinforces a precautionary motive for the accumulation of reserves that encourages the sovereign to insure itself against a liquidity crisis. However, we also show that a country may decide to deliberately default on the liquidity shock: if the opportunity cost of accumulating liquid assets is high enough, a limited liability effect dominates the precautionary motive and leads the country to lower the investment in international reserves.

Keywords: Sovereign Debt, International Reserves, Liquidity Shock, Strategic Default

Session 6b: Econometrics

Can VAR Models Capture Regime Shifts in Asset Returns? A Long-Horizon Strategic Asset Allocation Perspective
Massimo Guidolin, The University of Manchester, UK
*Stuart Hyde, The University of Manchester, UK

In the empirical portfolio choice literature it is often invoked that through the choice of predictors that may closely track business cycle conditions and market sentiment, simple Vector Autoregressive (VAR) models could produce optimal strategic portfolio allocations that hedge against the bull and bear dynamics typical of financial markets. However, a distinct literature exists that shows that non-linear econometric frameworks, such as Markov switching, are also natural tools to compute optimal portfolios arising from the existence of good and bad market states. In this paper we examine whether and how simple VARs can produce empirical portfolio rules similar to those obtained under a range of multivariate Markov switching models, by studying the effects of expanding both the order of the VAR and the number/selection of predictor variables included. In a typical stock-bond strategic asset allocation problem on US data, we compute the out-of-sample certainty equivalent returns for a wide range of VARs and compare these measures of performance with those typical of non-linear models that account for bull-bear dynamics and characterize the differences in the implied hedging demands for a long-horizon investor with constant relative risk aversion preferences. We conclude that most (if not all) VARs cannot produce portfolio rules, hedging demands, or out-of-sample performances that approximate those obtained from equally simple non-linear frameworks.
Session 6c: Derivatives

An exact pricing formula for European call options on zero-coupon bonds in the run-up to a currency union
Gerrit Reher, Westfälische Wilhelms-Universität Münster, Germany
*Bernd Will fing, Westfälische Wilhelms-Universität Münster, Germany

In this paper we analyze the dynamics of zero-coupon bond options in a situation in which two open economies plan to enter a currency union in the future. More precisely, we make use of recent theoretical work on the continuous-time dynamics of interest-rate differentials between the economies involved and derive a closed-form pricing formula for a European call option on zero-coupon bonds. In a Monte-Carlo simulation study we show that significant option-pricing errors can occur when the key features of interest-rate dynamics during the run-up to the currency union are ignored.

Keywords: Interest-rate dynamics; interest-rate option pricing; currency union

Session 6d: Emerging Market Finance

Currency crisis, foreign reserves target, and debt dynamics in transition economies
*Aleksandr Gevorkyan, New School University & Capco, USA
Willi Semmler, New School University, USA

This paper develops an extended monetary policy rules model with possibility of foreign exchange reserves targeting with dynamic effects on foreign currency denominated debt: external, domestic public, domestic corporate, domestic households’ currency demand, and financial institutions effective leverage. The model is calibrated for the transition economies of the Commonwealth of Independent States first without and then with explicit foreign exchange reserves targets. Choice of the right reserves target may help dampen the negative impacts of a crisis and thwart a potential currency run. Three possible scenarios, each with different currency depreciation, reserves, and sustainable debt levels are derived and reviewed. Categorizing between net exporters and net importers based on country-specific external positions, the paper derives specific country group results. Both country groups are susceptible to exchange rate risk and are vulnerable to a multitude of shocks due to their fragile financial system. Due to limited access to global capital markets, both groups are facing problems of currency depreciation, with net importers risking high inflation, while net exporters over-borrowing. This paper promotes extended research as new aspects of reserves accumulation, exchange rate dynamics, and foreign currency denominated debt appear.
Dynamic relationship between foreign, domestic factors and sovereign spread in Asian emerging economy
Zilong Wang, University of Essex, UK

This paper analyses the dynamic relations between external factors, domestic macroeconomic factors and sovereign spread in Asian emerging countries by using SVAR model. Term structure of US interest rate, dollar index and GRA are used as external factors, this work shows that variation of sovereign spreads in Asia is mainly driven by external shocks, sovereign spread increases response to all kinds of external shocks. Debt to GDP ratio shock shows remarkable explanatory power for the variation of sovereign spread. Variation of domestic macroeconomic variables are also driven by external shocks in Asia, especially Indonesia and China, their economies heavily rely on US economy. The longer the horizon, the more important US variables are for the unanticipated volatility of domestic macroeconomic variables and sovereign spread. Dollar index shock and GRA shock play the main role, whereas term structure is less important.

Session 6e: Asset Pricing

A Multifactor Consumption based Asset Pricing Model of the UK Stock Market: The US Stock Market as a Wealth Reference
*John Hunter, Brunel University, UK
Feng Wu, Santander, China

Here a multifactor model of UK stock returns is developed, replacing the conventional consumption habit reference by a relation that depends on US wealth. Two step Instrumental Variables and Generalized Method of Moments estimators are applied to reduce the impact of weak instruments. The standard errors are corrected for the generated regressor problem and the model is found to explain UK excess returns by UK consumption growth and expected US excess returns. Hence, controlling for nominal effects by subtracting a risk free rate and conditioning on real US excess returns provides a coherent explanation of the equity premium puzzle.

Keywords: Consumption-CAPM, Excess Returns, Generalized Regressor, GMM, Habits, Wealth Reference

Asset Parity and the Risk Premium
Atanu Ghoshray, University of Bath, UK
*Dandan Li, University of Bath, UK
Bruce Morley, University of Bath, UK

The aim of this study is to analyze the potential risk premium inherent in the asset parity condition. This is important because many studies have suggested the failure of the asset parity conditions are due to a time-varying risk premium. The GARCH-M and CGARCH-M models are used to measure the time-varying risk premium in asset parity conditions for both emerging and developed countries. The main finding of this study is that UIP still does not hold in most countries but the $\delta$ coefficient is significant in GARCH class models rather than OLS model. In general, emerging countries work better in terms of UIP than developed countries. This study also finds that the risk premium is significant in most countries and suggests that risk is an important part of modeling exchange rate movements. This needs to be considered in both empirical and theoretical models. In addition the interest rate differential is shown to be stationary when the asymmetric adjustment TAR and M-TAR unit root tests are used.

Keywords: currency crisis, foreign reserves, monetary policy rules, foreign currency denominated debt, transition economies

Strategic Asset Allocation with Heterogeneous Beliefs
Thiago Souza, Queen Mary, University of London, UK

We study how the presence of long term investors using different return forecasting strategies and switching them based on their past performance generates the price trends observed in financial markets. In the empirical section, we assume that investors choose how to allocate their portfolios among four major stock indices: Dow Jones, FTSE, Nikkei and Hang Seng. The exercise shows that a decrease in the proportion of fundamentalists is related to movements in prices that are subsequentially reverted. It also shows that traders tend to use similar strategies in some of these markets. In this paper, we bridge the literatures on intertemporal asset allocation and on heterogeneous beliefs. The interaction between two switching types of agents, e.g. fundamentalists and chartists, is responsible for endogenously generating the observed price trends.

Keywords: Risk premium; UIP; GARCH-in-mean; Component GARCH-M

Convergence of the Term Structure of Interest Rate and the Distortions Associated with the Financial Crisis
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Catalina Bolance-Losilla, Universitat de Barcelona, Spain
Hortensia Fontanals-Abiòl, Universitat de Barcelona, Spain

Since 1999, the European Central Bank monitors the monetary policy with a unique interest rate for all the EMU (European Monetary Union) countries. The creation of EMU raises the question whether the common monetary policy has the same impact in all member countries. We analyze the convergence of interest rate in four major EMU countries before and during the financial crisis. Instead of analysing the integration of the interest rates with the parity conditions, CAPM or econometric methodologies, we propose to test the convergence of the interest rate with the full term structure of interest rate or yield curve. We estimate the term structures of Germany, France, Spain and Italy - the four largest euro area countries- for the period 2003-2009. The adopted methodology is the 3-factor Nelson-Siegel model at daily intervals. We test the convergence of term structures with different interest rate levels and the shape of the term structure. We apply univariate inference and the Tukey’s multiple comparison test in order to identify the countries whose term structures are statistically equal. This paper presents our analysis about the convergence of the EMU term structures of interest rate before and after September 2008. The results show that before September 2008 full term structures are statistically equal in the four countries, except Italy in the long term. During the financial crisis, term structures are statistically equal for the very short term only. In conclusion, the results suggest that in stable periods, a unique monetary policy leads to a unique term structure of interest rate in the four major countries, mainly in the short and medium term. However, according to our analysis volatility in financial markets generates different distortions, and in different measure, in practically all interest rate levels of these countries. The monetary policy only guarantees an interest rate convergence in the very short term.

Keywords: convergence, term structure of interest rate, non-linear parametric model, financial crisis

Why does the Interest Rate Decline Over the Day?
*Angelo Bagliori, Università Cattolica del Sacro Cuore, Italy
Andrea Monticini, Università Cattolica del Sacro Cuore, Italy

We provide a simple model, able to explain why the overnight (ON) rate may follow a downward intraday pattern, implicitly creating a positive intraday interest rate. While this normally reflects only some frictions, a liquidity crisis introduces a new component: the chance of an upward jump of the ON rate, which must be compensated by an intraday decline of the ON rate. By analyzing real time data for the e-MID interbank market, we show that the intraday rate has increased from a negligible level to a significant one after the start of the liquidity crisis in August 2007, and even more so since September 2008. The intraday rate is strongly affected by the likelihood of a dry-up in the ON market, proxied by the 3M Euribor – Eonia swap spread. This evidence supports our model and it shows that a liquidity crisis
impairs the ability of central banks to curb the market price of intraday liquidity, even by providing free daylight overdrafts. Such results are relevant for the efficiency of the money market and of payment systems.

Keywords: interbank market, intraday interest rate, financial crisis, liquidity risk

Session 6g: Emerging Market Corporates

Market Liquidity and Ownership Structure with weak protection for minority shareholders: evidence from Brazil and Chile.
Diego Cueto, Universidad ESAN, Peru

This project focuses on the effects of ownership structures on the liquidity of the stock market in a context of low protection for minority shareholders and large ownership concentration. The ultimate defense strategy of an expropriated investor is to exit the position, provided that a market liquid enough exists. In principle, this should not be a problem for a stock in the local index. However, a run by blockholders may hurt minority shareholders more than the consumption of private benefits by dominant shareholders. Moreover, to the extent that blockholders such as local pension funds have few diversification opportunities and their funds increase overtime, they are themselves locked into their positions and they would prefer increasing their monitoring than exiting large positions. Large stakes by blockholders reduce the availability of floating shares. Therefore, the monitoring roles of institutional investors seem to have a high cost in terms of market liquidity. I show that a number of corporate governance mechanisms including ownership concentrations by dominant shareholders have stabilizing effects and converge to reduce asymmetric information and increase market transparency. Providers of liquidity are thus encouraged to post smaller spreads.

Keywords: Corporate Governance; Ownership Concentration, Liquidity; Emerging Markets.

Size and Liquidity Effects in Sub Saharan African stock markets
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This study contrasts the effectiveness of a Capital Asset Pricing Model (CAPM) augmented with size and recently developed Liu (2006) liquidity factors against the Fama and French (1993) size and book to market value factors. The application of time varying parameter techniques enables a greater understanding of the dynamics of liquidity within a unique sample of Sub-Saharan African stocks. The evidence suggests that with the exceptions of Ghanaian and Kenyan markets the Fama and French factors retain their explanatory power in explaining the cross section of stock returns. Time varying liquidity beta profiles indicate that the financial sectors of Namibia, Zambia and Mauritius have been affected by the 2008 global financial crisis, while Botswana and Kenya are unscathed.

Keywords: Liquidity, CAPM, Kalman filter, Emerging Financial Markets, Sub Saharan Africa

Session 6i: Trading & Settlement II

Compatibility Between European Securities Settlement Systems: A Spatial Competition Approach
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This paper studies the question of Securities Settlement System (SSS) compatibility in Europe through price competition in post-trading market. We study the incentives of CSD’s to migrate to TARGET 2 Securities when they are competitors in the market for depository services. In the spirit of Matutes and Padilla (1994), we construct a stylized model of CSD’s competition which emphasises the distinctive features of SSS compatibility. We investigate the consequences of the network effect in a setting, where rival CSD’s first agree on a compatibility regime and then compete in securities settlement and depository services. Therefore, we derive the implications for CSD compatibility of post-trading cost and CSD’s entry. Finally, we investigate the normative implications of our model and draw some policy conclusions.

Stock Exchange Consolidation and Financial Risk: The Case of Euronext
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Since the nineties, stock markets have been experiencing significant technological, legal and other kind of changes affecting their organization and structure. This has led to strategic moves in mergers and alliances at a national as well as at an international scale. The aim of this paper is to better understand this phenomenon and analyze its impact on the future of stock markets considered as any operational firm seeking to maximize its profits. To achieve this, we focus on the case of the merger of three out of four stock exchanges now forming Euronext. Our goal being to study that merger and its potential effect on Euronext’s market risk (measured by volatility). However, the results obtained are mixed. In terms of volatility, the merger is beneficial only for one of the three markets studied. This leads to the insight that the expected benefits in merging depend on the features of each market, its importance and its degree of integration with other financial places before its effective consolidation.

Keywords: volatility; Euronext Stock Exchange; merger; financial risk

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European equity trading takes place in electronic order-driven systems in which one group of traders makes liquidity while the other one takes liquidity. Liquidity is an important criterion for market quality. New trading venues apply maker-taker pricing, i.e. they prefer liquidity makers by their trading fees to attract liquidity and lure market share from incumbent exchanges. In return, SWX Europe and the London Stock Exchange (LSE) introduced maker-taker pricing, but the latter meanwhile abolished it. We address those events to investigate the impact of maker-taker pricing on an incumbent market’s liquidity. Maker-taker pricing at SWX Europe did not substantially affect spreads, but lead to an increase in the volumes quoted at the top of the order book. We do not find evidence of a negative liquidity effect, when the LSE abolished its maker-taker pricing. Our results suggest that maker-taker pricing lacks its attributed incentives for the provision of liquidity.
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