

<p>Institution: 10007857 – Bangor University</p>
<p>Unit of Assessment: UoA 19</p>
<p>Title of case study: Competition, Governance and Bank Stability</p>
<p>1. Summary of the impact (indicative maximum 100 words)</p> <p>The risk of a systemic crisis and the inability of depositors to monitor how banks are governed are long-standing public policy concerns. Since joining Bangor University in 2008 Professor Klaus Schaeck and collaborators from central banks and international financial organisations have worked to inform the global policy debate on these issues. Specifically, how varying competitive conditions, corporate governance structures and regulatory innovations incentivise the development of safer and sounder banking systems. Notable impacts of Schaeck’s research since 2008 include: the use by central banks of his new methodology to gauge banking sector competition; priority change in the policy debate over the structure of bank boards and, in particular, the influence of female executives; and finally heightened policy awareness of the unintended consequences of regulations imposed on troubled or bailed-out banks.</p>
<p>2. Underpinning research (indicative maximum 500 words)</p> <p>Schaeck joined Bangor University in 2008 while teaming up with collaborators from central banks and international financial organisations to design a research agenda aimed at informing the global policy debate on banking regulation and supervision. Involving users in the design of the research maximised its impact on themes of high relevance for financial policy takers in Europe and North America. Schaeck’s research developed around three main themes while simultaneously he held several visiting positions and consulting contracts at the International Monetary Fund (IMF), the Deutsche Bundesbank, the European Central Bank (ECB), and the World Bank between 2008 and 2013. The three research strands are as follows:</p> <p>Theme 1: Banking competition Research in collaboration with the Lead Economist, World Bank and Deputy Division Chief at the IMF aimed to influence the policy debate around bank capital regulation. As part of the analysis, Schaeck introduced an important methodological innovation that involved developing a new competition indicator in the banking literature [detailed in a1 and a2]. This innovation gave rise to a new way to evaluate the competitiveness of local banking markets, while a specific finding of the research was that, contrary to conventional wisdom, banking competition encourages safe and sound banking systems and also incentivises banks to hold more capital.</p> <p>Theme 2: Corporate governance in banking Between 2009 and 2013, Schaeck was invited by the Deutsche Bundesbank to work in the Banking Supervision Department to research the effects of regulatory enforcement actions on bank risk-taking, explore corporate governance arrangements, and draft guidelines for a potential reform of bank governance in Germany.</p> <p>Empirical work dealt with the question of whether market discipline was effective and influenced the composition of banks’ governance arrangements (in terms of the board’s age, gender, and education composition) as well as the risk-taking incentives. Research with Deputy Head of the European Systemic Risk Board and an ECB Economist [a3], questioned conventional wisdom about the effectiveness of a banks’ board of directors to monitor and rein in risk-taking by executive managers. Meanwhile, research in collaboration with authors at the University of South Carolina/Senior Economist, Board of Governors of the Federal Reserve System and Division Chief at the Deutsche Bundesbank on the composition of banks’ board of directors, provided empirical evidence suggesting that boards with more female executives tend to operate riskier banks.</p> <p>Theme 3: Unintended consequences of bank regulation It is broadly accepted that regulatory enforcement actions on distressed banks and new regulations on the financial disclosure of interest rate risks have intended and unintended consequences. As a</p>

Impact case study (REF3b)

result of joint research with colleagues at the Bundesbank, Case Western Reserve University/MIT and the Federal Reserve, this research pointed out how new regulation on the disclosure of interest rate risks trigger banks to shift into less risky assets but, at the same time, have the effect of incentivising more aggressive hedging strategies. It led to a new understanding of troubled banks responses to regulatory intervention.

A second aspect of this research revolves around the links between bank bailouts and stability. Schaeck, in collaboration with a Senior Economist, World Bank [a4], provided empirical support to the view that bank bailouts and recapitalisations can increase competition, suggesting that the design of bailout strategies influences risk-taking through its effect on competition. This research challenged pre-established views on the role of government intervention in the financial sector.

3. References to the research (indicative maximum of six references)

Theme 1: Banking competition

[a1] Schaeck, K., and Cihak, M. (*forthcoming*) 'Competition, efficiency, and stability in banking', *Financial Management* (early online version - DOI: 10.1111/fima.12010) (published also as ECB Working Paper No. 932)

[a2] Schaeck, K., and Cihak, M. (2012) 'Banking competition and capital ratios', *European Financial Management*, 18: 836–866 (published also as IMF Working Paper No. 07/216). DOI: 10.1111/j.1468-036X.2010.00551.x

Theme 2: Corporate governance in banking

[a3] Schaeck, K., Cihak, M., Maechler, A., and Stolz, S. (2012) 'Who disciplines bank managers?', *Review of Finance*, 16: 197-243 (published also as IMF Working Paper No. 09/272). Submitted to REF 2014 (REF Identifier 1968). DOI: 10.1093/rof/rfr010

Theme 3: Banking regulation and economic stability

[a4] Calderon, C., and Schaeck, K. (2013) 'Bank bailouts, competition, and the disparate effects for borrower and depositor welfare', World Bank Policy Paper 6410. Available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2251716

4. Details of the impact (indicative maximum 750 words)

The pathways to impact of Schaeck's research involved user-groups from the outset and the findings were disseminated through presentations at central banks, by authoring publications of national and international financial organisations, and by engaging the general public through national and international media. In short, the research led to a transformation in the policy debate at several central banks and has received global media coverage.

Theme 1: Banking competition

To involve users from the design stage of the research, Schaeck held a visiting appointment at the International Monetary Fund (2008), Lamfalussy Fellowship at the European Central Bank (2008), and a consulting contract also at the European Central Bank (2011) [see b1].

Schaeck disseminated this research through presentations to, and discussions with, staff at central banks, namely: the Financial Stability Department of the Bank of England (2010), the Deutsche Bundesbank (2010 and 2011); and the U.S Federal Deposit Insurance Corporation (2011 and 2012). Early versions of this work led to Schaeck being invited to be a panellist in the G20 OECD Workshop "The New Financial Landscape" (Paris, 2011), presenting his work alongside IMF Deputy Director and ministers of finance and governors of central banks from several countries.

The key findings led to Schaeck and collaborators establishing a new indicator of competition for the banking industry [as detailed in a1 and a2], which is now used by among others the Deutsche Bundesbank and the European Central Bank, to gauge the level of competition in local banking markets [see b2]. The research results also featured prominently in discussions between the IMF and the Association of German Banks. Indeed, the Association used Schaeck's research to argue for policies to increase competition in the domestic banking market.

The substantial impact on policy debate is reflected in the findings of Schaeck's research being cited in several issues of the IMF's 'Global Financial Stability Report' [b3 and b7], as well as the OECD's 'Report on Competition: Issues in Banking' (2011). The ideas put forward by Schaeck also feature prominently in the UK's Independent Commission on Banking (the so-called Vickers Report on structural reform to the UK system, 2011), recommendations of which are being incorporated into the UK Banking Act 2013 [b4]. This evidence highlights the wide-ranging influence that Schaeck's work has had on policy formulation in the area of banking competition in central banks and various international financial organisations [b3, b6 and b10].

Theme 2: Corporate governance in banking

Schaeck's research on executive board composition *initiated an international debate* and heightened the general public's awareness of the potential destabilising influence of various policy proposals. This was particularly the case relating to reforms advocating female board quotas, a topic that has been discussed intensely in Europe and elsewhere. Indeed, the European Commission abandoned the idea of a mandatory board quota and Schaeck's research received significant attention in this debate, particularly in Germany, as illustrated by its use by the Minister for Labour and Social Affairs, the President and Vice-President of the Deutsche Bundesbank who debated the role of board quotas in April 2012 in response to the media attention triggered by Schaeck's research. This research also features in supplementary documents put forward by interest groups lobbying against the introduction of female board quotas to a German parliamentary enquiry on the introduction of mandatory board quotas in bank governance.

Global media attention over Schaeck's research dealing with role of female board members and the effectiveness of boards to control senior managers is evidenced in *Handelsblatt* (Front page, 28 January 2010), *Wirtschaftswoche* (28 January 2010), *Financial Times* (27 March 2012), *The Guardian* (27 March 2012), *The Telegraph*, *ITV News* (27 and 28 March 2012), *BBC News* (27 March 2012), *CNBC* (27 March 2012), *Forbes* (28 and 29 March 2012), *Financial Times Deutschland* (27 March 2012), *The Australian* (28 March 2012), *The Globe and Mail* (5 April 2012), and other newspapers in Spain, Switzerland, Poland, and in several countries in Latin America.

Theme 3: Banking regulation and economic stability

Between 2008 and 2013, Schaeck disseminated his work on the link between regulation and economic stability [a4], through presentations and discussions with staff at the European Central Bank (2009, 2010), the Bank of England (2009, 2010 and 2011), and the Deutsche Bundesbank (2010, 2011, 2012, and 2013) [b6 and b9]. The findings of this research were disseminated widely through citations within policy documents of central banks [b7], deposit insurance agencies and other regulatory bodies [b3, b4 and b5].

The discussions with bank supervisors and economists aimed to inform policymaking and operational work around the intervention of distressed financial institutions. In particular, the study on the regulation of interest rate risk was presented to the full Board of the Deutsche Bundesbank at its meeting of May 2013. The German central bank has used this research in its internal deliberations to evaluate and anticipate potentially unintended consequences of regulatory behaviour [b2]. The further impact of this research is evidenced by it having heightened the policy debate on the unintended consequences of regulatory enforcement actions in distressed banks, having stimulated discourse on the design of bank bailout packages, and having resulted in the better deployment of resources in the resolution of distressed banks [b3 and b6].

Other signs of impact include Schaeck being appointed as a consultant (2011 to 2012) for the design of the inaugural issue of the World Bank's Global Financial Development Report [b3]. His work on bank bailouts and the role of the state in financial systems influenced directly Chapter 4 of this new flagship publication. Research on the unintended effects of bank recapitalizations in the U.S., also had an impact on the general public's knowledge on these issues, as Schaeck was interviewed on this topic by the *Rolling Stone Magazine* in January 2013.

5. Sources to corroborate the impact (indicative maximum of 10 references)

References to the research can be found in the following publications:

- [b1] Letter of support: Principal Economist, Financial Research Division, European Central Bank (October, 2013)
- [b2] Letter of support: Head of Stress Testing, Department of Banking and Financial Supervision, Deutsche Bundesbank (July, 2013)
- [b3] Global Financial Development Report (2013) *The World Bank* (chap 3, pp. 91-93, 98, 100). <http://siteresources.worldbank.org/EXTGLOBALFINREPORT/Resources/8816096-1346865433023/8827078-1346865457422/Chapter-3.pdf>
- [b4] Independent Commission on Banking (2011) Interim Report. HM Treasury. Available at: <http://s3-eu-west-1.amazonaws.com/htcdn/Interim-Report-110411.pdf> (cited pp. 170 and 173)
- [b5] OECD (2011) Competition Issues in the Financial Sector - KEY FINDINGS. Available at: <http://www.oecd.org/regreform/sectors/47836843.pdf>
- [b6] International Monetary Fund, Financial Stability Board, Bank for International Settlements (2009) Guidance to Assess the Systemic Importance of Financial Institutions, Markets and Instruments: Initial Considerations—Background Paper. Available at: <http://www.imf.org/external/np/g20/pdf/100109a.pdf>, October 2009.
- [b7] Global Financial Stability Report, April 2009, International Monetary Fund (cited p. 114). Available at: <http://www.imf.org/External/Pubs/FT/GFSR/2009/01/pdf/text.pdf>
- [b8] International Monetary Fund (2009) 'Competition in the financial sector: Overview of competition policies', Working Paper 09/45, Washington DC: International Monetary Fund (cited p. 15). Available at: <http://www.imf.org/external/pubs/ft/wp/2009/wp0945.pdf>
- [b9] Federal Deposit Insurance Corporation (2009) 'The cost effectiveness of the private-sector reorganization of failed banks', *FDIC Center for Financial Research* WP 2009-11, Washington DC: Federal Deposit Insurance Corporation (cited p. 18). Available at: http://www.fdic.gov/bank/analytical/cfr/2009/wp2009/CFR_WP_2009_11.pdf
- [b10] Proceedings: G20 Workshop on competition in the financial sector (2008), *Bank of Mexico, Bank Indonesia* (cited p. 15). Available at: <http://www.banxico.org.mx/publicaciones-y-discursos/publicaciones/seminarios/%7B9FF34154-2399-AEA7-2F99-B8245F927173%7D.pdf>