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Title: Implicit Guarantees, Business Models and Banks' Risk-Taking through the Crisis: Global and European Perspectives

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Implicit Guarantees, Business Models and Banks' Risk-Taking through the Crisis: Global and European Perspectives

Abstract:

The objectives of this paper are, first, to analyze whether banks' risk-taking can be explained by factors contributing to implicit guarantees and by factors associated with banks' business models. Second, it analyzes how risk-taking associated with these factors has changed from a period before the financial crisis (2004-2006), through the crisis (2007-2009), to a period after the crisis (2010-2012). Third, it analyzes whether risk-taking behavior of banks in Europe differs from banks' risk-taking behavior in the US and globally. The empirical analysis covers 753 banks in a global sample of 45 countries including 86 European banks in 19 countries. Implicit insurance of banks' creditors is captured both by an expected U-shaped relationship between explicit deposit insurance coverage and banks' risk-taking, and by factors influencing the likelihood of bail-outs of individual banks. The main business model factors capture banks' reliance on wholesale funding and their involvement in derivatives markets. A comparison of the results of the cross-section analysis for each sub-period shows that the sources of implicit guarantees have become more pervasive in Europe as well as globally after the crisis. Business models are strongly associated with risk during and after the crisis globally. In Europe, banks relying on wholesale funding as well as those with large derivatives positions are relatively risky. Policy implications of these results are discussed.

JEL Classification: G21; G28; F43

Keywords: Implicit Guarantee; Financial Crisis; Globally Systemically Important Banks; Too-Big-To-Fail; Interbank Liabilities; Subordinated Debt; Market Discipline; Regulation and Supervision

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