

This PDF is a selection from a published volume from the National Bureau of Economic Research

Volume Title: The Risks of Financial Institutions

Volume Author/Editor: Mark Carey and René M. Stulz, editors

Volume Publisher: University of Chicago Press

Volume ISBN: 0-226-09285-2

Volume URL: <http://www.nber.org/books/care06-1>

Conference Date: October 22-23, 2004

Publication Date: January 2007

Title: Front matter, The Risks of Financial Institutions

Author: Mark Carey, Rene M. Stulz

URL: <http://www.nber.org/chapters/c9602>



National
Bureau of
Economic
Research

The Risks of Financial Institutions

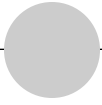


EDITED BY MARK CAREY
AND RENÉ M. STULZ

The Risks of Financial Institutions



**A National Bureau
of Economic Research
Conference Report**



The Risks of Financial Institutions

Edited by

**Mark Carey and
René M. Stulz**

The University of Chicago Press

Chicago and London

MARK CAREY is finance project manager in the Division of International Finance at the Federal Reserve Board and codirector of the National Bureau of Economic Research (NBER) Working Group on Risks of Financial Institutions. RENÉ M. STULZ is the Everett D. Reese Chair of Banking and Monetary Economics at Ohio State University, codirector of the NBER Working Group on Risks of Financial Institutions, and a research associate of the NBER.

The University of Chicago Press, Chicago 60637
The University of Chicago Press, Ltd., London
© 2006 by the National Bureau of Economic Research
All rights reserved. Published 2006
Printed in the United States of America

15 14 13 12 11 10 09 08 07 06 1 2 3 4 5
ISBN-13: 978-0-226-09285-0 (cloth)
ISBN-10: 0-226-09285-2 (cloth)

Library of Congress Cataloging-in-Publication Data

The risks of financial institutions / edited by Mark Carey and René M. Stulz.

p. cm. — (NBER conference report)

Papers presented at a conference held in Woodstock, Vt., on Oct. 22–23, 2004.

Includes bibliographical references and index.

ISBN-13: 978-0-226-09285-0 (cloth : alk. paper)

ISBN: 10: 0-226-09285-2 (cloth : alk. paper)

1. Financial institutions—Congresses. 2. Risk—Congresses.
3. Financial crises—Congresses. I. Carey, Mark S. (Mark Steven) II. Stulz, René M. III. Series.

HG173 .R562 2006

332.1068'1—dc22

2006044550

© The paper used in this publication meets the minimum requirements of the American National Standard for Information Sciences—Permanence of Paper for Printed Library Materials, ANSI Z39.48-1992.

National Bureau of Economic Research

Officers

Elizabeth E. Bailey, *chairman*
John S. Clarkeson, *vice-chairman*
Martin Feldstein, *president and chief executive officer*
Susan Colligan, *vice president for administration and budget and corporate secretary*

Robert Mednick, *treasurer*
Kelly Horak, *controller and assistant corporate secretary*
Gerardine Johnson, *assistant corporate secretary*

Directors at Large

Peter C. Aldrich
Elizabeth E. Bailey
John H. Biggs
Andrew Brimmer
John S. Clarkeson
Don R. Conlan
Kathleen B. Cooper
George C. Eads

Jessica P. Einhorn
Martin Feldstein
Jacob A. Frenkel
Judith M. Gueron
Robert S. Hamada
Karen N. Horn
Judy C. Lewent
John Lipsky

Laurence H. Meyer
Michael H. Moskow
Alicia H. Munnell
Rudolph A. Oswald
Robert T. Parry
Richard N. Rosett
Marina v. N. Whitman
Martin B. Zimmerman

Directors by University Appointment

George Akerlof, *California, Berkeley*
Jagdish Bhagwati, *Columbia*
Ray C. Fair, *Yale*
Michael J. Brennan, *California, Los Angeles*
Glen G. Cain, *Wisconsin*
Franklin Fisher, *Massachusetts Institute of Technology*
Saul H. Hymans, *Michigan*
Marjorie B. McElroy, *Duke*

Joel Mokyr, *Northwestern*
Andrew Postlewaite, *Pennsylvania*
Uwe E. Reinhardt, *Princeton*
Nathan Rosenberg, *Stanford*
Craig Swan, *Minnesota*
David B. Yoffie, *Harvard*
Arnold Zellner (Director Emeritus),
Chicago

Directors by Appointment of Other Organizations

Richard B. Berner, *National Association for Business Economics*
Gail D. Fosler, *The Conference Board*
Martin Gruber, *American Finance Association*
Arthur B. Kennickell, *American Statistical Association*
Thea Lee, *American Federation of Labor and Congress of Industrial Organizations*
William W. Lewis, *Committee for Economic Development*

Robert Mednick, *American Institute of Certified Public Accountants*
Angelo Melino, *Canadian Economics Association*
Jeffrey M. Perloff, *American Agricultural Economics Association*
John J. Siegfried, *American Economic Association*
Gavin Wright, *Economic History Association*

Directors Emeriti

Carl F. Christ
George Hatsopoulos
Lawrence R. Klein

Franklin A. Lindsay
Paul W. McCracken
Peter G. Peterson

Eli Shapiro
Arnold Zellner

Relation of the Directors to the Work and Publications of the National Bureau of Economic Research

1. The object of the NBER is to ascertain and present to the economics profession, and to the public more generally, important economic facts and their interpretation in a scientific manner without policy recommendations. The Board of Directors is charged with the responsibility of ensuring that the work of the NBER is carried on in strict conformity with this object.

2. The President shall establish an internal review process to ensure that book manuscripts proposed for publication DO NOT contain policy recommendations. This shall apply both to the proceedings of conferences and to manuscripts by a single author or by one or more co-authors but shall not apply to authors of comments at NBER conferences who are not NBER affiliates.

3. No book manuscript reporting research shall be published by the NBER until the President has sent to each member of the Board a notice that a manuscript is recommended for publication and that in the President's opinion it is suitable for publication in accordance with the above principles of the NBER. Such notification will include a table of contents and an abstract or summary of the manuscript's content, a list of contributors if applicable, and a response form for use by Directors who desire a copy of the manuscript for review. Each manuscript shall contain a summary drawing attention to the nature and treatment of the problem studied and the main conclusions reached.

4. No volume shall be published until forty-five days have elapsed from the above notification of intention to publish it. During this period a copy shall be sent to any Director requesting it, and if any Director objects to publication on the grounds that the manuscript contains policy recommendations, the objection will be presented to the author(s) or editor(s). In case of dispute, all members of the Board shall be notified, and the President shall appoint an ad hoc committee of the Board to decide the matter; thirty days additional shall be granted for this purpose.

5. The President shall present annually to the Board a report describing the internal manuscript review process, any objections made by Directors before publication or by anyone after publication, any disputes about such matters, and how they were handled.

6. Publications of the NBER issued for informational purposes concerning the work of the Bureau, or issued to inform the public of the activities at the Bureau, including but not limited to the NBER Digest and Reporter, shall be consistent with the object stated in paragraph 1. They shall contain a specific disclaimer noting that they have not passed through the review procedures required in this resolution. The Executive Committee of the Board is charged with the review of all such publications from time to time.

7. NBER working papers and manuscripts distributed on the Bureau's web site are not deemed to be publications for the purpose of this resolution, but they shall be consistent with the object stated in paragraph 1. Working papers shall contain a specific disclaimer noting that they have not passed through the review procedures required in this resolution. The NBER's web site shall contain a similar disclaimer. The President shall establish an internal review process to ensure that the working papers and the web site do not contain policy recommendations, and shall report annually to the Board on this process and any concerns raised in connection with it.

8. Unless otherwise determined by the Board or exempted by the terms of paragraphs 6 and 7, a copy of this resolution shall be printed in each NBER publication as described in paragraph 2 above.

Contents

Acknowledgments	xi
Introduction	1
Mark Carey and René M. Stulz	
I. MARKET RISK, RISK MODELING, AND FINANCIAL SYSTEM STABILITY	
1. Bank Trading Risk and Systemic Risk	29
Philippe Jorion	
2. Estimating Bank Trading Risk: A Factor Model Approach	59
James O'Brien and Jeremy Berkowitz	
<i>Comments on chapters 1 and 2:</i>	
Kenneth C. Abbott	
Paul Kupiec	
<i>Discussion Summary</i>	
II. SYSTEMIC RISK	
3. How Do Banks Manage Liquidity Risk? Evidence from the Equity and Deposit Markets in the Fall of 1998	105
Evan Gatev, Til Schuermann, and Philip E. Strahan	
<i>Comment:</i> Mark Carey	
<i>Discussion Summary</i>	

- 4. Banking System Stability:
A Cross-Atlantic Perspective** 133
Philipp Hartmann, Stefan Straetmans, and
Casper G. de Vries
Comment: Anthony Saunders
Discussion Summary
- 5. Bank Concentration and Fragility:
Impact and Mechanics** 193
Thorsten Beck, Asli Demirgüç-Kunt, and
Ross Levine
Comment: René M. Stulz
Discussion Summary
- 6. Systemic Risk and Hedge Funds** 235
Nicholas Chan, Mila Getmansky,
Shane M. Haas, and Andrew W. Lo
Comment: David M. Modest
Discussion Summary

III. REGULATION

- 7. Systemic Risk and Regulation** 341
Franklin Allen and Douglas Gale
Comment: Charles W. Calomiris
Discussion Summary
- 8. Pillar 1 versus Pillar 2 under Risk Management** 377
Loriana Pelizzon and Stephen Schaefer
Comment: Marc Saidenberg
Discussion Summary

IV. NEW FRONTIERS IN RISK MEASUREMENT

- 9. Global Business Cycles and Credit Risk** 419
M. Hashem Pesaran, Til Schuermann, and
Björn-Jakob Treutler
Comment: Richard Cantor
Discussion Summary
- 10. Implications of Alternative Operational Risk
Modeling Techniques** 475
Patrick de Fontnouvelle, Eric S. Rosengren,
and John S. Jordan
Comment: Andrew Kuritzkes
Discussion Summary

11. Practical Volatility and Correlation Modeling for Financial Market Risk Management	513
Torben G. Andersen, Tim Bollerslev, Peter F. Christoffersen, and Francis X. Diebold	
<i>Comment: Pedro Santa-Clara</i>	
<i>Discussion Summary</i>	
12. Special Purpose Vehicles and Securitization	549
Gary B. Gorton and Nicholas S. Souleles	
<i>Comment: Peter Tufano</i>	
<i>Discussion Summary</i>	
13. Default Risk Sharing between Banks and Markets: The Contribution of Collateralized Debt Obligations	603
Günter Franke and Jan Pieter Krahenen	
<i>Comment: Patricia Jackson</i>	
<i>Discussion Summary</i>	
Biographies	635
Contributors	639
Author Index	643
Subject Index	651

Acknowledgments

This volume contains papers and comments presented at a conference held in Woodstock, Vermont, 22–23 October 2004. We thank Martin Feldstein, president of the National Bureau of Economic Research (NBER), for his advice and support over the course of this project and for his ongoing support of work on risk management and financial institutions risk. Those who have supported this NBER project over the course of many meetings are too numerous to name. We thank them all, but especially NBER research associates Charles Calomiris, Frank Diebold, Darrell Duffie, and Andrew Lo. We thank Carl Beck and Denis Healy of the NBER Conference Department for efficient support of the conference, and Robyn Scholl of Ohio State and Helena Fitz-Patrick of the NBER Publication Department for excellent assistance with the publication process.

