

Constraining Bank Risk: International Evidence on the Role of Bank Capital and Charter Value

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Abstract : This paper examines the relevance of bank capital and charter value on bank insolvency and liquidity risks. Using an unbalanced panel of 2,111 unique local banks across 22 countries over 1998-2012, we find that both bank capital and charter value lower insolvency and liquidity risks, but this effect varies among conventional, Islamic, and Islamic-window banks. The risk constraining effect of bank capital becomes more prominent in the post 2007-2008 global financial crisis. Moreover, the relationships vary when conditioned upon other key bank-specific characteristics. For instance, the effect of capital on risk-reduction diminishes in the presence of high charter value for conventional-G7 and Islamic-window banks, during-GFC and pre-GFC period; respectively. Our findings have important policy implications related to bank safety. The results are robust to a range of robustness tests.

Keywords : bank capital, charter value, risk, financial crisis

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