

Financial Integration, Specialization, and Systemic Risk

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- Very interesting theoretical paper on bank linkages
- 2 country, 2 + 1 asset model with multiple shocks
- Main findings, a la Ricardean trade theory:
 - Autarky: banks diversify dom.
 - Integrated: banks specialize dom., diversify int'l
 - Solution asymmetric information: unsecured deposits

Utility Function & Liquidation Value

- Other models: early liquidation at a penalty
- Here: liquidation value 0
- How important is this assumption?

$U = c_1 + c_2$ Simple to solve but:

- No risk aversion
- No discount factor
- No decreasing marginal utility for c_1, c_2

Types of agents

Two types of households 'q' and '1-q'

- How important is assumption $q > 0.5$
- Individually rational to invest in deposit scheme?
 - q EU at least 1 $\rightarrow X$ (else do not deposit)
 - 1-q EU at least S (else 'contest' bank to follow 'Safe' strategy)

Domestically undiversified portfolio

- \underline{S} needed for EU^U must be > 2 , not realistic case?
- If $S < \underline{S}$ does not hold, $EU^S > EU^A$ (At footnote 6)
- Range for S where:

$$EU^D < EU^U \text{ but } S < \underline{S} \text{ needed for } EU^U?$$

In this model risk of contagion seems small:

- Domestic diversification: same breakdown prob.
- Domestic safe: breakdown prob. 0 But:
 - Dom. div. most likely under autarky
 - Paper states focus on dom. div. vs. int'l div.
- Most interesting case: $EU^I > EU^S > EU^D$? \longrightarrow in paper d_I compared to d_S
- Asymmetric information : both banks cheat, as they are symmetric. thus both revert to autarkic strategy?

Conclusion and Correlations

- Main finding: Unsecured bank deposits?
- Mention of cross-country correlation:
 - cross-country correlation not specifically defined here
 - How to quantify (empirically) add'l benefits and risks not captured in normally?
- I like the link to cross-country correlations: Maybe more in-text info?