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The Effects of Shadow Banking on Banking Risk Based on Capital Adequacy Approach[1]

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Research Paper

INTRODUCTION

Many of the activities of unauthorized, or even authorized, financial institutions, and some exchange offices can be defined as shadow banking. Since traditional banks are obliged to adjust the interest paid to accounts based on the monetary laws of the country, depositors, to increase the interest received, tend to unauthorized financial institutions approved by the central bank. But when at a certain point in time, depositors' concerns about the performance of these institutions caused them not to reinvest/deposit or request the withdrawal of deposits in financial institutions, financial institutions that had invested short-term deposits in long-term

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assets (such as paying loans with maturity) remained in repaying public deposits. As a result, these institutions are forced to sell their assets and transfer assets to the lowest possible value to banks and other authorized financial institutions. Western researchers believe that shadow banking is a kind of financial, credit, and liquidity intermediary that attracts a lot of liquidity with little capital through strengthening financial leverage, which ultimately leads to a capital market crisis.

Nowadays, the laws and regulations governing capital requirements such as capital adequacy ratio (CAR) on the one hand and the laws and regulations of anti-money laundering (AML), customer identification (KYC), and so on from different aspects, have put the banks' activities and performance, especially in the brokerage relations sector, under various pressures. So much so that traditional banking is reluctant to enter many of the old and lucrative activities and its scope of extensive and dynamic activities has faced a significant operational gap that is filled by shadow banks.

Some researchers believe that shadow banking can reduce bank risk. The bank not only transfers part of the bank credit risk to foreign investors but also causes the risk existing in the whole capital market to be shared through asset securitization.

Some other researchers have pointed out that banks, by investing in the securities sector and other off-balance sheet activities, reduce the bank's capital adequacy ratios on the one hand and increase systemic risk on the other. There are two views on the relationship between shadow banking and bank risk, one view believes that shadow banking reduces bank risk and on the other hand, the other view believes that shadow banking increases bank risk. To clarify this conflict, this study aims to investigate the effects of shadow banking on bank risk with a focus on the capital adequacy approach in Iran.

MATERIALS AND METHODS

For this purpose, data from 23 investment funds, 23 insurance companies, and 19 banks and credit institutions have been used from 2013 to 2018. This research is of the applied type in terms of the objective. In addition, in terms of the way of inference about the hypotheses of the research, it is in the group of correlation research. Moreover, since we will conclude testing the existing data, our research will be in the group of confirmatory theories. To analyze the data, the ARDL method has been used.

RESULTS AND DISCUSSION

The findings of the research showed that the index of capital adequacy ratio had an impact on the risk-taking of banks in the presence of shadow banking. In this regard, it is argued that shadow banks are not obliged to maintain the required capital requirements are not supported by the central bank as the lender of last resort, and therefore do not have network security.

CONCLUSION

The findings of the research showed that the index related to shadow banking had significant effects on bank risk in Iran. Therefore, it is suggested that bank managers concentrate their activities and investments in the non-shadow banking sector and core banking activities to maintain their bank risk at an optimal and proportional level.

Therefore, the indices such as bank size, loan ratio, deposit ratio, and board independence had significant effects on bank risk in Iran. Therefore, it is suggested that bank managers adjust their bank risk at a level proportional to their volume of activities by controlling the banking criteria and indices such as bank size, volume of deposits received, and loan ratio.

In addition, it was observed that specific bank characteristics and macroeconomic indicators had an impact on bank risk.

Keywords: Shadow Banking, Bank Risk-Taking, Capital Adequacy.

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