

# Ownership diversity and the risk-taking channel of monetary transmission: Evidence from Europe

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## Executive summary

The financial crisis that erupted in 2007 has provided a vivid illustration of the potential for modern financial systems to exacerbate and spread financial distress on an international scale (Arinaminpathy et al., 2012). In the wake of the crisis, there is increasing recognition that the resilience of the financial system is affected not only by its aggregate exposure to risk, but also by the interconnections between individual institutions (Haldane and May, 2011). A number of studies have recently pointed to the role of diversity within the banking sector in promoting the stability of the financial system and its resilience to crises (e.g. Ayadi et al., 2010; Groeneveld, 2012; Michie, 2011). In making an interesting parallel between ‘financial ecosystems’ and ecology in the 1970s, Haldane and May (2011, p. 353) argue that “excessive homogeneity within a financial system—all the banks doing the same thing—can minimize risk for each individual bank, but maximize the probability of the entire system collapsing”. Despite the increasing appreciation of the need for a systemic approach to financial stability (May and Arinaminpathy, 2010), limited have hitherto been the attempts to examine how the interactions between banks with different forms of ownership impact on financial stability. This is at odds with insights from ecology, where the nature and intensity of the interacting relations (e.g. competition, predation and symbiosis) between individuals belonging to different species are known to have important effects on ecosystem stability (Jizhong et al., 1991).

Against this background, the aim of this paper is to shed new light on the link between diversity in banking and financial system stability. The question we address concerns the extent to which ownership diversity in the banking sector moderates monetary policy transmission through the risk-taking channel (Borio and Zhu, 2012; Ioannidou et al., 2015; Jiménez et al., 2014). Building on the work by Michie and Oughton (2013), we treat ownership types (i.e. commercial, cooperative and savings) as analogous to species

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in an ecosystem and construct indices of ownership diversity for the loan and deposit markets. Our results, based on a large panel of shareholder and stakeholder banks operating in Western Europe, suggest that ownership diversity buffers the impact of unexpected monetary policy shocks on bank risk. In addition, we find that—*ceteris paribus*—banks located in countries with greater diversity of ownership forms tend to be more stable than their counterparts from less diverse markets. These results hold across several econometric specifications and point to the stabilising role played by ownership diversity in modern financial systems. By providing novel insights into the implications of financial system architecture for systemic stability, our findings concur with the benefits to be gained from a critical mass of stakeholder banks operating alongside shareholder banks (Ayadi et al., 2010; Ferri et al., 2014; Michie, 2011).

The results of this paper have a number of implications for monetary authorities and other banking regulators. One of the major lessons from the empirical analysis is that ownership diversity emerges as an important factor accounting for differential effects of monetary policy on bank riskiness. For this reason, our evidence calls for a closer overseeing by central banks of the ownership composition characterising the banking system, as this is likely to moderate monetary transmission through the risk-taking channel. Moreover, the findings of this study are of interest to banking regulators, inasmuch as they feed into the current debate over how to design a more stable and resilient financial system (Casu and Gall, 2016; Meriläinen, 2016). In light of the positive link between ownership diversity and bank stability, regulators should ensure that the key attributes of stakeholder banks are not undermined by regulatory initiatives directed at and formulated for their shareholder counterparts. It follows that preserving (and, even more importantly, promoting) a multiplicity of ownership types in banking should be elevated as a major policy objective. For such an objective to be achieved, it is critical that competition between different ‘species’ of banks (rather than within banks of the same type) is encouraged and that the market shares on the loan and deposit sides of the market are distributed evenly across ownership forms.

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