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Managing Editor**

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**Global systemic risk: What's driving the
shadow banking system?**

ROBERT ENGLE, FARIBORZ MOSHIRIAN and
CHRISTOPHER S WONG

Driven by the tightening of banking regulations, the global shadow banking system continues to grow steadily in size and scope. This paper discusses issues related to the shadow banking system, focusing on Asia and China in particular. The paper highlights the increasing importance of the shadow banking industry in Asia and factors that will contribute to its expansion in the immediate future. The paper compares and contrasts shadow banking in the US and China. It also highlights the risks associated with shadow banking, including leverage risk, maturity and liquidity mismatch, and regulatory arbitrage.

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**Mutual funds and outperformance:
The difficulty of generating positive alpha**

BART FRIJNS F FIN

Many mutual funds claim that they are able to generate outperformance. This claim is at odds with much of the academic literature on fund performance. This paper presents three academic arguments on the difficulty of generating outperformance by mutual funds — mathematical, theoretical and empirical. It also offers some explanations which help reconcile the contrasting views of academia and the funds industry on this issue.

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**Financial planning and modelling an
individual's attitude to financial risk:
Is everybody on the same page?**

NEIL HARTNETT F FIN and ADRIAN MELIA

Understanding and suitably modelling an individual's attitude to financial risk remains a challenge for financial planners. We provide a snapshot of the issues involved and highlight the need for regulators, educators and practitioners to foster a far more professional treatment of client risk attitude through better guidance or mandates. We propose a clearer standardisation of industry terminology, understanding and regulatory direction.

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**Book-to-market ratio, default risk and return
implications: From a negative perspective**

BOB LI, PAUL LAJBCYGIER and CINDY CHEN

A paradox is created by the common practice in stock evaluation models of excluding stocks with a negative book equity (BE). If we interpret the book-to-market ratio as a proxy for distress risk, it makes no sense to exclude these negative BE stocks since they are, *prima facie*, most prone to distress risk. This paper reassesses the relationship between default risk, return and the book-to-market ratio by incorporating negative BE stocks into the study. We find that negative BE stocks carry higher default risks than their positive BE counterparts and that these risks are not totally offset by higher returns. This suggests that a default risk filter can be used in the investment universe selection process through which the portfolio return can be enhanced.

**PAPERS FROM:
THE MELBOURNE MONEY &
FINANCE CONFERENCE 2015**

Finsia acknowledges the contribution of the papers from the 20th Melbourne Money and Finance Conference to this issue of *JASSA*. The conference — The Australian Financial Sector and Global Integration — was held in July 2015 by the Australian Centre for Financial Studies.

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**International linkages of the Australian
banking system: Implications for
financial stability**

GRANT TURNER and JAMES NUGENT

This paper outlines the channels through which the Australian banking system is directly linked to international markets and the attendant financial stability implications. First, the large Australian-owned banks maintain a significant amount of international assets, including a large exposure to New Zealand and exposures within the Asian region that have grown rapidly over recent years. Second, Australian banks fund a portion of their domestic activities offshore, although post-crisis balance sheet adjustments should enhance banks' resilience to potential future global funding market disruptions. Third, despite their small share of the commercial banking market, foreign banks operating in Australia can still influence financial stability.

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Balancing safety, stability, efficiency and competition: Finding the balance for Australia's major banks

CHARLES LITTRELL

This paper provides insight into the way APRA thinks about capital requirements for Australia's major banks, in the context of its prudential mission.

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Innovation and reform in Australia's financial market infrastructure

OLIVER HARVEY, CALISSA ALDRIDGE and BEN COHN-URBACH

The global financial market infrastructure is in an unprecedented state of transition. Spurred by significant developments in technology and regulatory frameworks, market infrastructure across modern economies is becoming increasingly integrated, competitive, global and complex. The rapidly changing dynamics in global financial markets are being acutely felt in the Australian marketplace. To deliver most effectively for those they are designed to serve, markets need to reliably and effectively provide the infrastructure for companies to raise capital and for investors to invest and allocate risk. Using the example of recent developments in the over-the-counter (OTC) derivatives market, this paper highlights the challenges and opportunities in ensuring Australian financial markets continue to deliver these enduring benefits.