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Shadow Banking, Insurance and Financial Sector Stability

Abstract

Motivated by the recent financial crisis and the near collapse of the insurance giant American International Group (AIG), we empirically study the link between the insurance sector, the size of the shadow system and financial stability across countries. Using the Z-score as a measure of financial stability and the ratio of insurance assets to GDP for 26 countries during the period 1998-2011, this paper shows that: (i) the insurance sector is negatively and significantly related to financial stability, and that (ii) using the shadow banking system as a channel, the insurance sector is detrimental to financial stability for countries with a high level of shadow banking assets.

KEYWORDS: Shadow banking, insurance, financial stability.

JEL: G01, G22, G23.

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