Discussion:
Transparency in the Financial System: Rollover Risk and Crises
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What is this paper about?

When should the government release information about the banking sector?
- Heterogenous banks with rollover risk / inefficient runs
- Regulator decides when to disclose information about individual banks or aggregate state of the financial sector
- Role of commitment
Main results

- **Goal:** save as many banks as possible
- **Opacity vs transparency ↔ pooling vs separation**
  - Good states: pool all banks, "average" bank is safe, no run
  - Bad states: separate banks, run only on bad banks
- **Role of commitment:**
  - Commitment: can pool across states of the economy
  - No commitment: cannot do contingent policy
  - Partial commitment obtained through partially informed consumers
Outline

- Very interesting paper: “miracle” of US stress tests, mitigated results in Europe
- Nice piece of theory: clear-cut answers to the main questions
- Most interesting extensions are covered in the paper
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Discussion points:
- What do/can we learn from the results?
- What are stress tests about?
- More ingredients?
Model Setup

- Continuum of banks with long-term return:

\[ 1 + \mu + \underbrace{p}_\text{aggregate state} + \underbrace{\eta_i}_\text{idiosyncratic state} - \underbrace{cl_i}_\text{inefficient liquidation} \]

- **Inefficient** run iff:

\[ \mu + E_1[p + \eta_i] < c/2 \]

- Regulator affects \( E_1 \) through information policy
- Baseline: everybody knows \( p \), regulators know \( \{\eta_i\} \):
  - High \( p \): do not disclose, all banks survive
  - Low \( p \): disclose, only strong banks survive
Banks or financial institutions exposed to rollover risk

- Why these contracts? Are there more obvious solutions to the friction?
- Heterogenous “fundamentals” somehow irrelevant: mainly affect run probabilities

- Regulator can disclose more than banks can credibly do
Role of commitment

- **Full commitment:**
  - Same intuition: pool in good states, save what you can in bad states
  - Can pool across states: save all banks in medium-low states

- **No commitment:**
  - Temptation to pool: no $p$-contingent transparency policy
  - Always full separation equilibrium
  - Full pooling equilibrium if $\mu$ large enough

- **Partial commitment:**
  - If creditors know enough about the aggregate state, discipline regulators
  - Similar policy as full commitment
Stress tests

- Run and publicize a test: can financial institutions withstand large economic shocks?
- How much capital should be raised to survive large shocks? must be raised?
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- Are stress tests perfect?
  - In the paper: noisy idiosyncratic
  - Noisy aggregate?
- Does the regulator know the results of the stress tests in advance?
  - Information revealed to everybody only if choose transparency
  - Rig the tests?
  - When should the regulator learn more about banks?
Stress tests

- Creating certainty, coordinating role?
  - Reducing uncertainty helpful with risk averse creditors
  - Release information everybody knows, just not sure about common knowledge

- Actions after stress test?
  - Adjust market expectations about bailouts
  - Deal with risk-shifting inside banks
More ingredients

Model focused on exogenous rollover risk
More ingredients

Model focused on exogenous rollover risk

- Illiquidity vs insolvency
- Benefits of information if capital redeployable
- Bank responses: mergers, endogenous pooling, ...
Conclusion

- Very interesting paper: assess the incentives to disclose information about financial institutions
- Nonlinear run decision: precise information can help or hurt
- General message: transparency in bad times (save what can be save), opaqueness in good times (good “average”)
- Commitment issues: tendency to opacity
- Still a lot of key questions... more papers?