“Bank Risk Taking and Liquidity Creation Following Regulatory Interventions and Capital Support”
by Berger, Bouwman, Kick and Schaeck

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The views expressed do not necessarily reflect those of the ECB or the Eurosystem.
Summary of the approach

- **Question**: How do regulatory interventions and capital support affect risk taking and liquidity creation of troubled banks?
- **Approach**: IV regressions to account for the non-randomness of regulatory interventions.

Instruments (Z)
- Vote share
- Distance
- Relative size

Explanatory variables (X)
- Interventions
- Capital support

Dependent variables (Y)
- Risk-taking
- Liquidity creation

\[ A \rightarrow C \rightarrow B \]

\[ t-1 \rightarrow t \]
Outline of the major comments

1. Specificities of the three-pillar German banking sector.
2. Challenge of measuring banks’ risk-taking (and liquidity creation).
3. Choice of the instrumental variables.
4. Other comments.
Specificities of the three-pillar German banking sector

- Savings banks and cooperative banks extend most of the loans in Germany (for corporate loans, private banks and Landesbanks have an important market share).
- Private banks and Landesbanks stand out in terms of size and the relatively small share of loans to total assets (liquidity creation in each banking sector (Figure A.1 page 37, middle panel)?)

<table>
<thead>
<tr>
<th>Bank type</th>
<th>Number</th>
<th>Total assets in bn EUR</th>
<th>Total loans in bn EUR</th>
<th>% of assets</th>
<th>NFC in bn EUR</th>
<th>HH House in bn EUR</th>
<th>HH Cons. in bn EUR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Public sector banks</td>
<td>432</td>
<td>2,369</td>
<td>894</td>
<td>38%</td>
<td>564</td>
<td>268</td>
<td>62</td>
</tr>
<tr>
<td>Landesbanks</td>
<td>9</td>
<td>1,264</td>
<td>256</td>
<td>20%</td>
<td>225</td>
<td>22</td>
<td>8</td>
</tr>
<tr>
<td>Savings banks</td>
<td>423</td>
<td>1,105</td>
<td>638</td>
<td>58%</td>
<td>339</td>
<td>246</td>
<td>54</td>
</tr>
<tr>
<td>Cooperative banks</td>
<td>1,104</td>
<td>1,038</td>
<td>456</td>
<td>44%</td>
<td>224</td>
<td>180</td>
<td>53</td>
</tr>
<tr>
<td>Private sector banks</td>
<td>273</td>
<td>3,221</td>
<td>281</td>
<td>9%</td>
<td>177</td>
<td>89</td>
<td>14</td>
</tr>
<tr>
<td>Other banks</td>
<td>58</td>
<td>1,688</td>
<td>677</td>
<td>40%</td>
<td>400</td>
<td>182</td>
<td>95</td>
</tr>
<tr>
<td>Total</td>
<td>1,867</td>
<td>8,315</td>
<td>2,309</td>
<td>28%</td>
<td>1,365</td>
<td>719</td>
<td>225</td>
</tr>
</tbody>
</table>

Source: Deutsche Bundesbank, German federal savings bank association. Data as of end-2012.
Specificities of the three-pillar German banking sector

- Public sector and cooperative banks are covered by a sector-specific protection scheme
  - Public sector banks are protected by the German Savings and Giro Association
  - Cooperative banks are protected by the Federal Association of Cooperative Banks
  - Private sector banks participate in the Deposit Guarantee Fund of the Federal Association of German Banks

- This protection scheme involves also supervision by the respective association, which may lead to a change in risk-taking and/or liquidity creation before any regulatory intervention.

- This may explain the negative coefficients in table II panel A and calls for – potentially – analysing the three sectors separately.

- Provide summary statistics by bank pillar in the paper.
Challenge of measuring banks’ risk-taking

- Given the on-going discussion about Basel II risk-weights, does the RWA/TA ratio reflect banks’ risk-taking accurately?

The Z-score is used as a robustness check, how is the relation to RWA/TA ratio? Did the Z-score predict bank distress prior to the crisis?

Source: Blundell-Wignall, Atkinson, Roulet (2013)
Note: Both figures show RWA according to Basel II, while the paper uses Basel I RWA.

Source: SNL; Data for European banks at end-2012
• **Hypothesis:** Pro-business parties favour regulatory interventions and capital support because that will help banks to survive.

• Important for IV approach: *Politics should not directly affect risk-taking and liquidity creation.* Is this justified?

• Englmaier and Stowasser (2013) find that German savings banks systematically adjust lending policies in response to local electoral cycles (as supervision functions are filled with county politicians).

• After public guarantees were removed in 2005, Landesbanks increased their risk-taking (Fischer et al. (2012); Pozsar et al. (2010): “[EU banks’] involvement in shadow banking was dominated by German Landesbanks”).

• Robustness: Split sample across bank pillars and explicitly compare public and cooperative banks.
Choice of the instrumental variables – distance between a bank and its association

- **Hypothesis:** Bankers associations are less likely to provide capital support when they have less information about the bank.

- Hau (2001) and Degryse and Ongena (2005) suggest that distance is a good proxy for information asymmetries.
- Berger et al. (2000) stress that only recent on-site inspections provide accurate information about the condition of a bank.
- In the US distance may matter, but in the Federal state of Germany? The hierarchical structure – at least of the public and cooperative pillar – with several associations at the state and regional level should in principle provide supervision. Could be interesting to test whether the private bank pillar stands out.
Other comments

- How much do the instruments vary over time (especially voting share and distance to bank association)?
- Page 12: Size is expected to be positively correlated with liquidity creation, but normalizing the information in figure A.1 appears to suggest the opposite (both Landesbanks and private banks were heavily invested in trading assets).
- Page 19-20: Can private bank associations force a merger, did this happen in the past?
- Table II, page 27: What is the rationale for the positive coefficient of cooperative banks (relative to private ones)? Have cooperative banks been subject to more regulatory interventions?
- Table VI, page 31: Why is the total effect of both interventions and capital support, when including the interaction term, rather small?

