

Remarks on “Financial Regulation” Papers

Mark Carey

Federal Reserve Board

May 7, 2014

Remarks and slides are Carey’s opinions, not those of the Federal Reserve.

Overall

- Three nice interesting papers
- Examine the impact of financial regulation (or changes in regulation) on loans, lender profits, or real economy activity
- Considerable attention to identification

Gilje, Loutskina and Strahan

The story

- Nice natural experiment investigating the impact of deposit shocks on soft-information lending.
 - Shale-oil boom causes deposit inflows at some bank branches, which reduces cost of deposits...
 - ...which reduces the cost of funding soft-information loans at non-shale branches (other loans are securitized) and increases their volume
- Conclusions:
 - Within-bank capital allocation fosters integration and efficiency (prior literature)
 - Deregulation that reduces (inefficient) liquidity constraints is good (prior literature)
 - Securitization and wholesale funding don't fully integrate markets

Gilje, Loutskina and Strahan

Suggestion

- The average shale-exposed bank experiences a 2.5 percentage point higher growth in deposits...
- And a 14 percentage point increase in retained mortgages in non-shale counties.
- Please help the reader understand why a 7 bps fall in the cost of deposits and a 2.5 percentage point increase in their growth has such a large impact on lending.
 - Seems unlikely that relief of funding constraints is the whole story.

Rezende and Wu

The Story

- Banks that are supervised more intensively are more profitable!
 - More frequent examinations reduce loan losses...
 - ...but do not reduce net interest margins
 - ROE impact is +1.68 percent...substantial
 - Use regression discontinuity method based on legal differences in minimum exam frequency
- Implies banks should welcome supervision, as it reduces inefficient risk

Rezende and Wu

Suggestion

- Results of prior literature may have been influenced by endogeneity of condition and supervisory intensity
 - But prior literature mostly used larger samples, in particular including banks in conditions equivalent to CAMELS 3, 4, 5
 - The paper only examines 1 or 1-or-2 rated banks
 - Maybe they are well-run enough to get the good juice out of examiners
- What if supervision harms profitability at 3, 4 or 5 rated banks?
 - Might still be positive for welfare, given the conflicts of interest
- The jury is still out for overall welfare impact. Can the authors expand their analysis?

Demir, Michalski and Ors

The Story

- What's the impact of Basel 2 capital requirements *on the real economy*?
- Export flows from Turkey supported by a particular form of trade financing changed around the time that risk weights on that form of financing changed: Reductions in risk weights associated with higher exports, increases with lower exports.
 - Authors have volumes of exports by quarter, industry and destination country
 - Compares exports in two annual cross sections right around the regulatory change, slicing each cross section many ways with control variables.

Demir, Michalski and Ors

The Change

- In Turkey, before 7/1/12, commercial letters of credit (CLC) had either a 20% or a 50% Credit Conversion Factor (CCF) and a 20% or 100% risk weight
- After 7/1/12, the CCF stayed the same but the risk weight could be any of 20, 50 or 100%
- Suppose 20% CCF and risk weight increase from 20 to 50%
 - Formula for cost impact on Turkish banks is $CCF * (50-20) * (\text{equity capital requirement, assume } 8\%) * (\text{incremental cost of equity, assume } 10 \text{ pct pts}) = 0.2 * 0.3 * 0.08 * 0.1 = 4.8 \text{ basis points.}$
 - Pretty small

Demir, Michalski and Ors

Suggestions

- The measured impact seems too large given the small change in cost, and the note that costs were not always passed on to exporters.
- More argument that the difference-in-differences is immune to confounding factors would be helpful. Particularly for the OECD nations, do we really believe nothing else changed from one year to the next, given industry concentration of CLCs and the European crisis?
- Introduction makes it sound like Basel 2 harmed exports. But going by statistical significance, it looks like it helped exports. Can you clarify?