Liang et al (2018) Bank Liquidity Provision
Coen et al (2018) Taking Regulation Seriously

Discussion by Sergey Chernenko

Purdue University
Krannert School of Management

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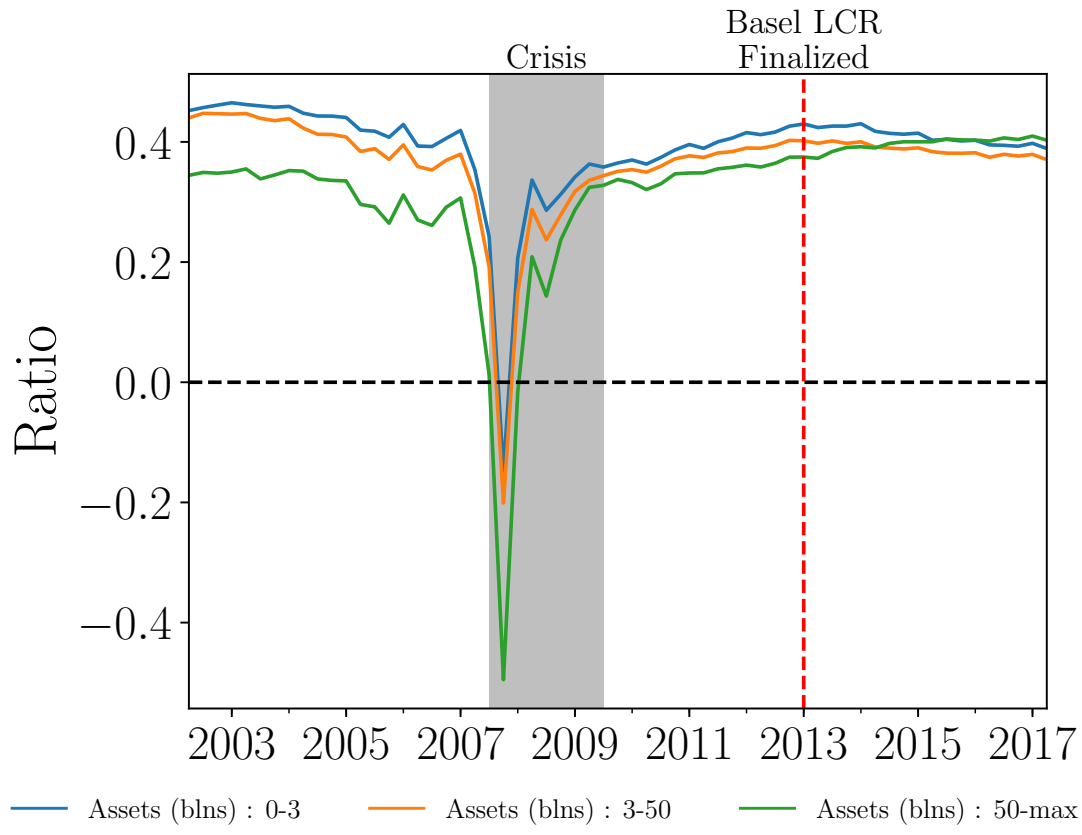
- **Question:** How has LCR affected liquidity creation by banks?
- Measure liquidity creation using Liquidity Mismatch Index (LMI) of Bai et al (forthcoming).
  - LMI = Asset Liquidity - Liability Liquidity
  - Smaller values of LMI indicate more liquidity creation



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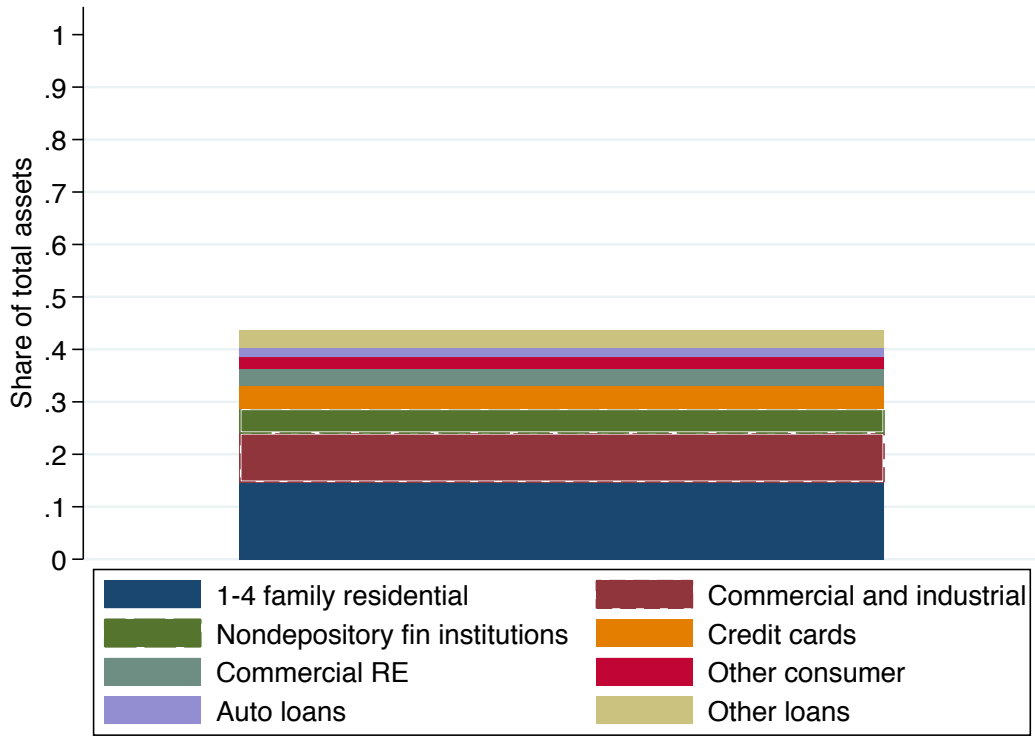
Changes in Loan Portfolios?

Different types of loans in the aggregate portfolio of the affected banks, 2012Q4



- LMI assigns same liquidity to all loans.
- Does not matter much in Bai et al: results driven by liabilities.
- Can you tell us more about changes in loan composition?

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- How should we think about non-constant returns to scale in liquidity creation and differential growth opportunities?
  - Parallel trends before treatment?
- Since liquidity creation is rewarded with higher multiples (Berger and Bouwman 2009, Egan et al 2016), can you look at the change in multiples for different banks?

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Questions

1. How do banks optimally liquidate their portfolios when forced to sell?
2. What is the role of different regulatory constraints?

Approach

- Model of bank balance sheets subject to regulatory constraints.
- Calibrate using detailed supervisory data on 7 UK banks.

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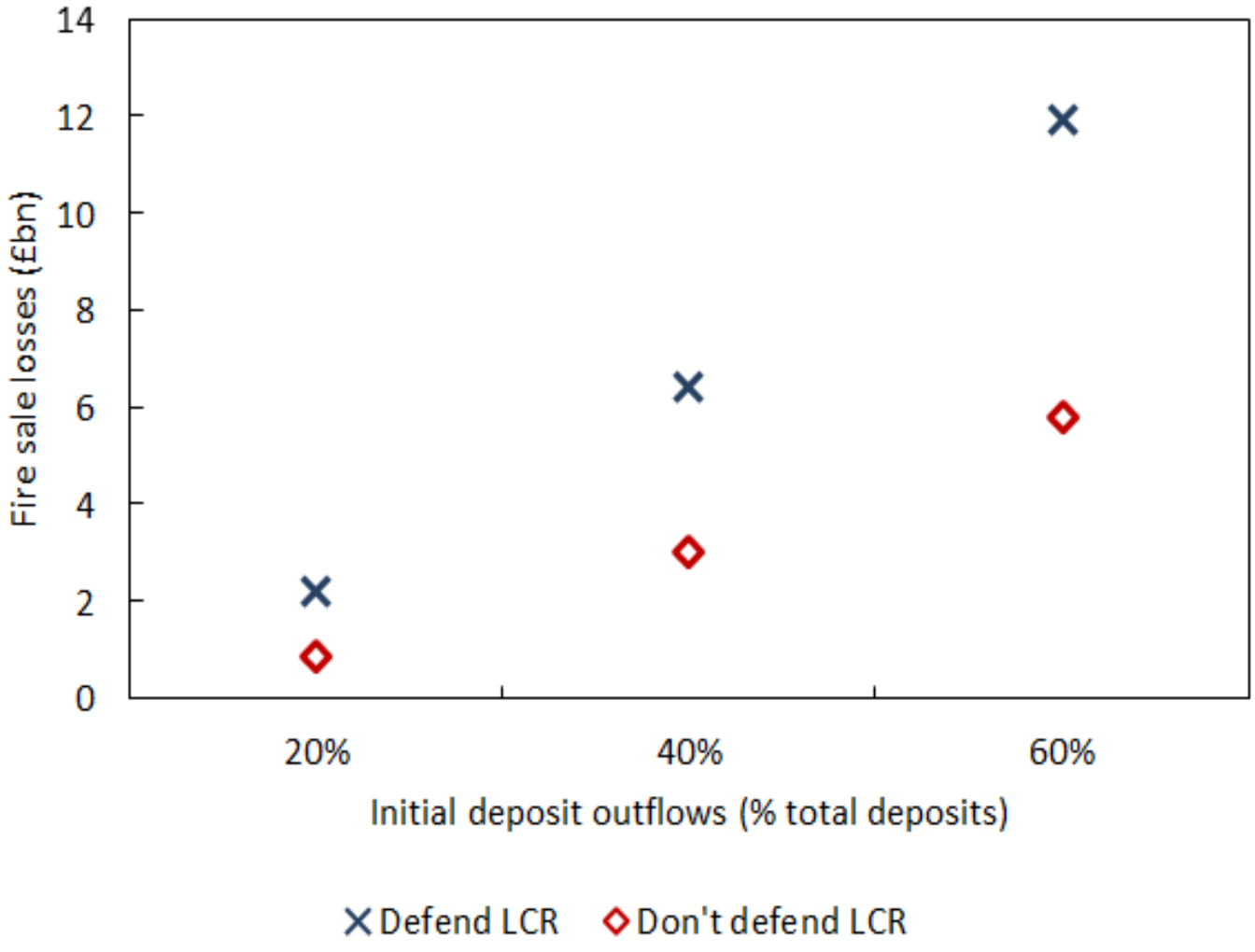
Lesson 1: Liquid Assets Must Be Usable Under Stress

Figure 6: fire-sale losses for deposit outflow scenarios



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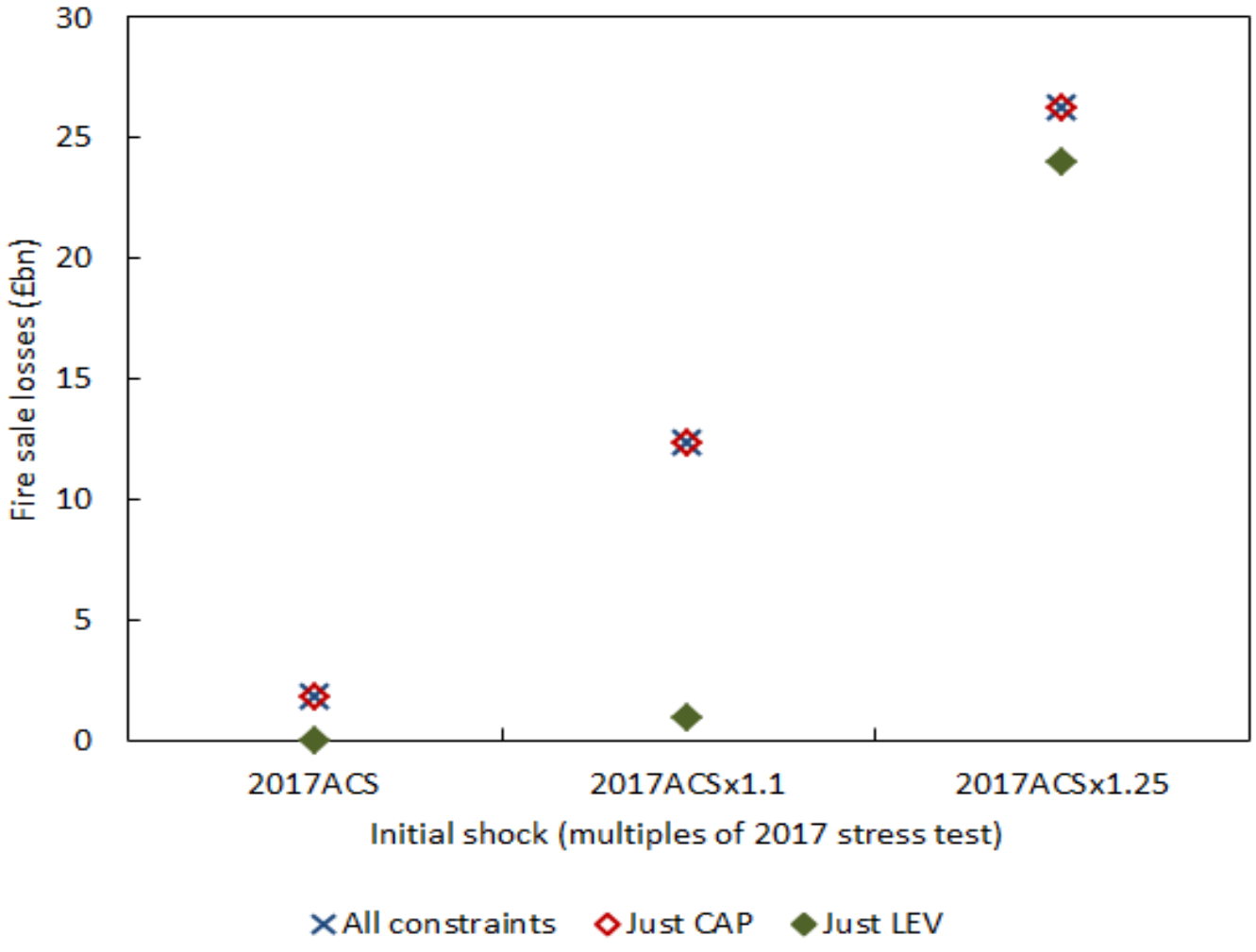
Lesson 2: Risk-Based Capital More Binding Than Leverage Ratio

Figure 3: Fire-sale losses for variants of 2017 stress test scenario



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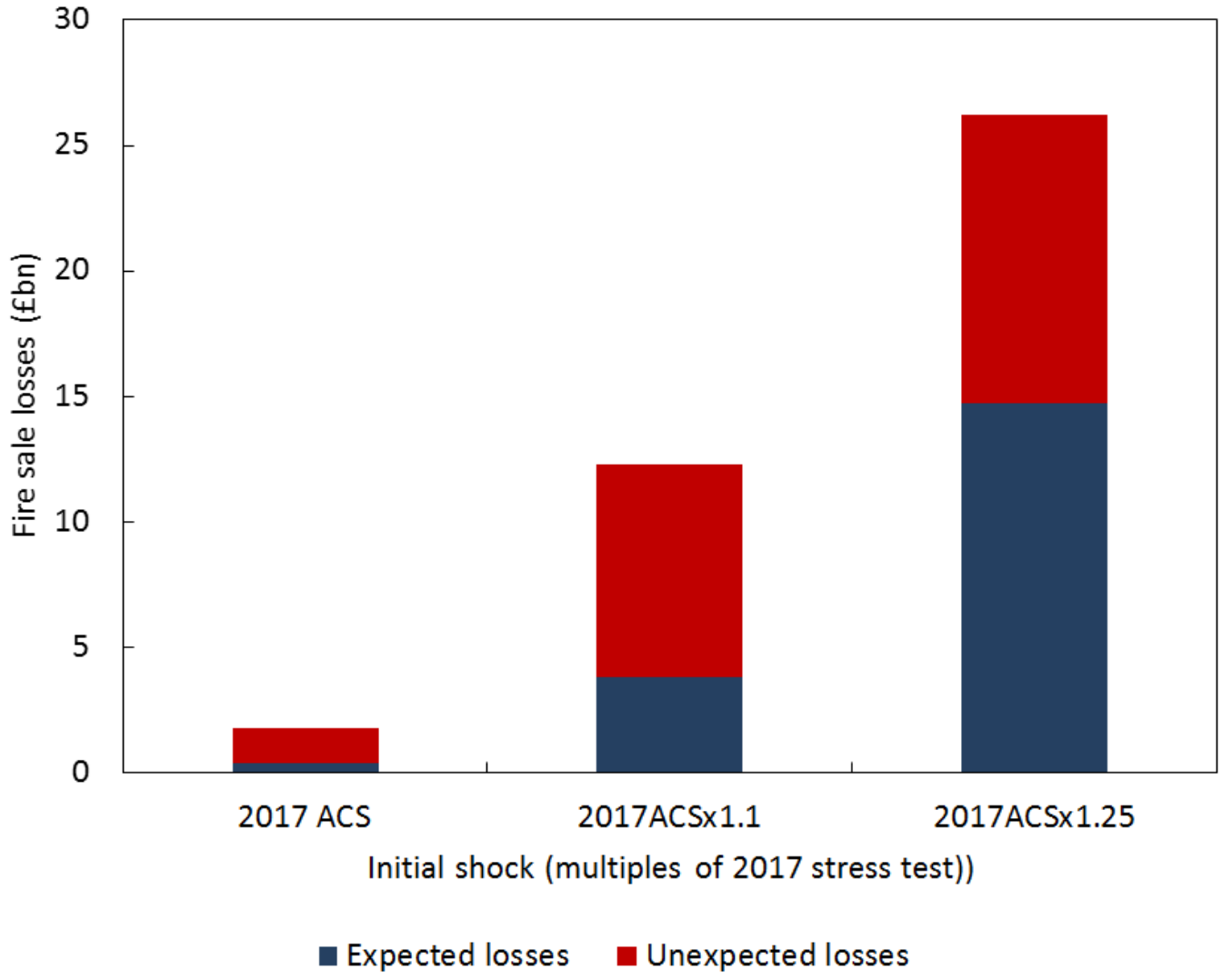
Lesson 3: Spillover Effects Are Large

Figure 4: Breakdown of fire-sale losses for 2017 stress test scenario



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Comments

1. Bank's objective function: minimize fire sale losses this period.
   - Trade-off between losses this period vs. positioning oneself to withstand shocks next period.
2. Anticipating vs. internalizing distressed sales by other banks.
   - In the model, banks completely fail to anticipate distressed sales by other banks.
   - Chernenko and Sunderam (2017): mutual funds that internalize more of the price impact of their trading hold more cash and use it more aggressively to accommodate fund flows.
   - What are the likely effects of greater transparency of bank holdings?
3. Securities holdings account for 7–28% of RWA of the 7 banks.
   - Irani et al (2018): banks sell syndicated loans in response to capital shocks.
4. Spillovers to US and other banks.