Session 2: Countercyclical capital buffers

Discussion by
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1 This discussion does not reflect the views of the Federal Reserve Board or its staff.
Two related, yet different questions

- Does a reduction in capital requirements lead to increased lending by banks?
  - Applicable for thinking about countercyclical capital policy.
  - Findings may matter more broadly for capital regulation.

- Does distance to regulatory requirements impact bank lending?
  - Applicable for thinking about the design of regulatory capital buffers.
  - Not always easy to separate from effects of capital levels.
Useful, usable and used? Buffer usability during the Covid-19 crisis

- The authors study the effect of distance to regulatory requirements and the extent of capital relief from easing the CCyB on mortgage lending in the UK.

- The variation in capital relief stems from the dependence of the CCyB on domestic credit exposures.

- Using a difference-in-difference framework, the study finds that firms that stood to gain more from a lower CCyB and those further away from regulatory buffers lent more.
  - They also show an effect on the interest rate on such loans.

- These effects are stronger for riskier loans.
How to release capital requirements during a pandemic? Evidence from euro area banks

The authors study the effect of various regulatory capital relief on lending in the euro area.

They use three sources of variation in regulatory capital: A permanent reduction in CET1 requirements; release of the CCyB; and easing of guidance.

The study examines the effect on this on lending to businesses using credit registry data for firms with more than one lender.

The authors find that the more concrete capital relief are associated with higher lending while change in guidance seem to have little effect.

The effect is stronger for banks closer to regulatory buffers.
Both papers

- Overall, both papers find similar results in an important area of inquiry.
  - Regulatory capital relief supports lending.
  - Banks further away from buffers lend more.

- At the same time, the results are not very strong, consistent with somewhat mixed results in the literature.
  - In the first paper one finds no statistically significant effect when one aggregates to the bank level.
  - In the second paper, the results are driven more by the permanent regulatory relief than the temporary CCyB easing.

- Banks were constrained from paying dividends, which reduces the problems associated with dipping into buffers.

- I’ll next offer suggestions for further inquiry and refinement.
Comments on Mathur, Naylor and Rajan (2023)

- May benefit from a greater focus on the research questions.
  - Streamline the analysis of the changes in capital ratios.
  - Not clear that the incidence of Covid-19 represents higher risk.

- The use of binary classifications isn’t ideal. While this enables a diff-in-diff approach, one loses information in taking a continuous variable and turning it into a dummy.

- Saturate the model with double interactions when using triple interactions. Otherwise the interaction terms end up picking up direct effects.

- Why drop banks with the largest surpluses? It may be better to have a systematic identification of atypical banks—resulting in unusual capital ratios—and drop these from the sample.
Comments on Couaillier, Reghezza, d’Acri and Scopelliti (2023)

- The distinction between the two types of capital relief could be useful, as the change in P2R was permanent, whereas the CCyB decrease was temporary.

- Wonder the extent to which the time dimension matters, as the regulatory relief was all provided in March 2020.
  - What about trying some cross-sectional regressions of loan growth over 2020Q2 or from 2020Q2 to 2020Q4 on regulatory relief?

- Is the distance to P2G the right metric for understanding buffer usability constraints? As P2G is not directly tied to payout restrictions and these may not be known to market participants.

- What about using the predicted value of the P2G, as opposed to the residual? This would be a more typical instrumental variables approach.
The authors are tackling important questions that are of deep policy interest.

Best of luck!