# Session 2: Countercyclical capital buffers

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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 od 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.

# Conclusion

- The authors are tackling important questions that are of deep policy interest.
- Best of luck!