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5th Annual Columbia SIPA/BPI Bank Regulation Conference: Lessons from Covid-19

The fifth annual Conference on Bank Regulation of the Bank Policy Institute & Columbia University School of International and Public Affairs took place over the four Fridays in February. Each year, the conference brings together academics, banking agency economists, and market participants to discuss the latest research on banking and bank regulation. This year's overarching theme was lessons learned from the Covid-19 crisis for banking and financial markets under stress.

Two research studies were presented in each of the first three sessions, while the fourth consisted of a panel discussion from the banking as well as academic perspective. Topics covered included small business lending during Covid-19; bank liquidity and its impact on credit provision; bank capital and liquidity outcomes under the Covid-19 event; and digitalization in banking.

The first session, on February 5th, focused on policy responses to support small business lending. Robert Bartlett (U.C. Berkeley) presented his paper "Small Firm Survival Capabilities and Policy Effectiveness: Evidence from Oakland," co-authored with Adair Morse (U.C. Berkeley). The paper uses survey data on Covid-19 financial impacts on small businesses in Oakland, CA and other information about the businesses, plus data on local foot traffic, to investigate resilience of small firms and effectiveness of support programs like the Paycheck Protection Program. The study finds that small business survival capabilities differ by size, and thus suggests that a one-size-fits-all policy like PPP is less than optimal. Because microbusinesses have less flexibility to cut employees, PPP was most effective for these businesses.

Filippo De Marco (Bocconi University) presented the second paper of the session, "Public Guarantees for Small Businesses during Covid-19," co-authored with Fabrizio Core (Erasmus University Rotterdam), assessing the effectiveness of Italy's support for small businesses during the pandemic. Specifically, this research examines expansion of a preexistent, government loan guarantee program for small businesses and banks' role in this expanded effort. The study finds that the earliest loans (April through May) disproportionately went to areas most affected by the pandemic, to non-essential businesses that were forced to close during the March lockdown, and to small firms with low cash reserves and higher leverage.

The topic for the second Friday of February was bank liquidity. Camelia Minoiu (Federal Reserve Board) presented her paper "Liquidity Insurance vs. Credit Provision: Evidence from the Covid-19 Crisis," co-authored with Tumer Kapan (International Monetary Fund). This research highlights how the onset of the Covid-19 downturn triggered a large volume of drawdowns from bank credit lines, as banks provided over $500 billion of financing. It also presents evidence from the syndicated loan market, Senior Loan Officer Opinion Survey and government programs (the PPP and the Main Street Lending Program) indicative of tightening of credit standards and reduced lending at banks with greater exposure to credit line drawdowns.

Sascha Steffen (Frankfurt School of Finance and Management) then presented his paper "Why Did Bank Stocks Crash during Covid-19," co-authored with Viral V. Acharya (New York University) and Robert F. Engle (New York University). This paper argues that aggregate drawdown risk is not well-captured in traditional measures of bank liquidity and develops an ex-ante measure of liquidity risk based partly on exposure to undrawn credit lines. The measure is then applied to explain underperformance of bank stock prices compared to non-financial corporates since the onset of the pandemic. The analysis suggests that higher ex-ante liquidity risk significantly impacts stock market returns.

Macroprudential policy was the primary focus of the third session. Diana Iercosan (Federal Reserve Board) presented ongoing research that offers a comprehensive look at how banks fared through the pandemic period. One important finding is that banks had enough capital and liquidity to withstand the Covid-19 shock, with average capital and liquidity ratios well above minimum requirements. However, a second quarter increase in excess capital indicates that they were reluctant to dip into capital buffers. Banks also continued to lend throughout the year, showing little evidence of an impact of regulatory capital constraints. Federal Reserve liquidity facilities helped to improve bank liquidity positions. Finally, increased volatility boosted trading revenues, which in turn offset significant increases in loan loss provisions.

Next, Tommaso Oliviero (University of Naples Federico II) presented his paper "Low Price-to-Book Ratios and Bank Dividend Payout Policies," co-authored with Leonardo Gambacorta (Bank for International Settlements) and Hyun Song Shin (Bank for International Settlements), which documents a negative relationship between price-to-book ratio and dividend payouts. The analysis indicates that declining profitability and price-to-book ratios during the pandemic could have induced larger dividend payouts than usual, eroding banks' capital base. This finding offers a justification for the regulatory decision to cap or suspend shareholder payouts in 2020.

The final session commenced with a keynote speech by Harit Talwar, Chairman of Consumer Business at Goldman Sachs. He highlighted the importance of keeping the customer at the center of decision-making through simple and transparent delivery of value-creating products. This requires a combination of technology, data, risk management and marketing, but also a strong balance sheet. Additionally, he noted the importance of a level regulatory and supervisory playing field to ensure fair competition and compliance best practice.

A discussion on Covid-19 and digitalization ensued, moderated by Julapa Jagtiani from the Federal Reserve Bank of Philadelphia. The conversation first highlighted the ways in which banks quickly adapted to the disruptions ensuing from Covid-19, both from the operational side and in their dealing with clients. The discussion then turned to the ongoing transformation of the banking sector, including adaptation to the low interest rate and deleveraging environment; increased regulation; and accelerating digitalization. In particular, banks face competitive threats from FinTech companies that have new data capabilities and strong net cash positions but are not burdened by legacy systems. Regulators are having to balance sometimes competing concerns regarding stability, efficiency, and data privacy.

Next, Vesa Pursiainen (University of St.Gallen) discussed new research showing how differences in bank digital capabilities determined their reaction to Covid-19. This research finds that banks ranked higher on IT capability had better performance outcomes, including reduction in branch visits, increased website traffic, quicker customer response times and greater deposit growth during the pandemic. Furthermore, SMEs in areas hit hardest by Covid-19 were more likely to switch to banks with better IT metrics.

Last, the discussion turned to legal and regulatory implications of digitalization of banking. These include increased supervision related to technology, including operational risk, contingency planning, scrutiny of third-party vendors and customer protection and fair lending. Increased regulatory scrutiny of FinTech firms and a heightened role for “reg tech” is also foreseen.

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