

Discussion of Abboud et al and Gambacorta et al

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BANK CAPITAL: NEVER ENOUGH, OFTEN TOO MUCH

- Post GFC saw massive push by regulators towards (much) more self-insurance against shocks
 - More (and better) capital
 - More (and better) liquidity
 - More investment in risk management, controls, data & IT infrastructure
- Banks needed more capital exactly when they could deploy it less productively
 - Safer....
 - but less profitable
- In European economies, which were slower to recover, returns to bank capital were lower
- If returns to capital (or equity → ROE) are low, return the capital to shareholders
 - Basic corporate finance
 - Pressure on bank management
- But: need some min amount of capital to operate safely – and provide needed intermediation role
 - Else economy can't recover, and neither can ROEs
- Both papers teach us a lot about these core issues – in light of the real life COVID-19 stress test

SUMMARY OF ABBOUD et al

- Diana and her co-authors provide thorough documentation of how banks have fared through 2020
 - Capital and liquidity
 - Comparison to GFC
 - Cross-Atlantic comparison
- Highlights
 - Banks entered COVID crisis with more capital & liquidity than going into GFC
 - Banks did just fine, some businesses even thrived (capital markets) ...
 - ... but have been reluctant to deploy their buffers
 - Helpful to have positive CCyB going in so one can quickly lower (even to zero) without adverse signal
- Market metrics (equity prices, betas, CDS spread) broadly confirm regulatory metrics ...
 - ... but formal analysis points to weak ability of, say, capital and liquidity metrics to explain CDS spreads
- Overall, banks were part of the solution not the problem, as was the case in GFC

SUMMARY OF GAMBACORTA et al.

- What drives dividend payouts?
- Cast a wide net: non-financials and financials, then split out banks
 - 3,638 listed companies (271 banks)
 - Across 35 countries
 - 2005-'19
- Fraction of dividend payers higher in financial than non-financials, and even higher for banks
- What, then, drives high dividend payouts for banks?
 - When P/B is below 1
 - And even more when below 0.7
- Why? Perhaps signalling motive: the future is rosier than the past – so can “afford” to pay dividend
- Distressing from prudential perspective (micro and macro)
 - Authors conduct counterfactual to examine would-be impact on output had banks not paid out dividends → impact would have been substantial!

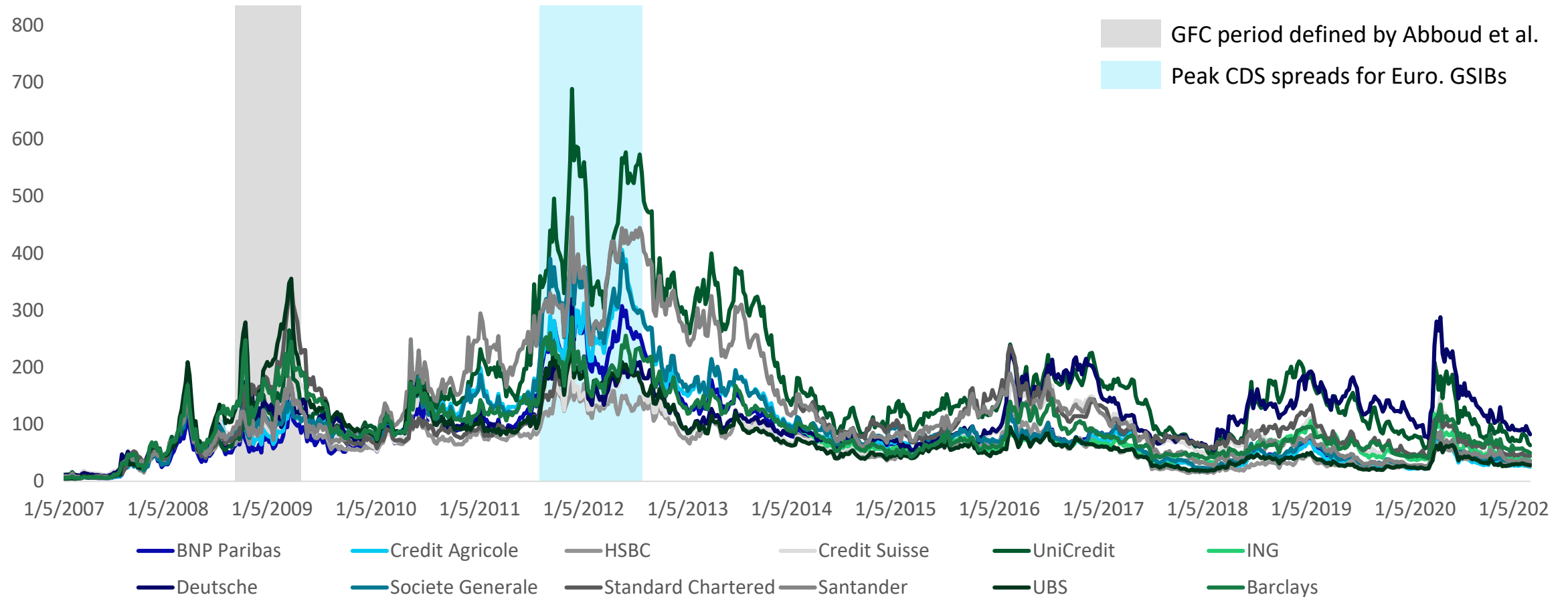
COMMENTS ON ABBOUD et al.

- Credit demand is glossed over – critical for any counterfactual
- Odd choice of GFC dates – US centric, less relevant for European banking experience [e.g. CDS spreads]
- Little discussion of deposit inflows and contribution to picture
 - Banks as lenders of second to last resort (Kashyap, Rajan, Stein (2002))
 - Banks really were quite effective shock absorbers and acted as automatic stabilizers since loan commitments are, well, committed
 - Works if there is sufficiently healthy capital base to allow temporary ballooning of balance sheet
- Important documentation of positive effect of high market volatility on trading revenue
 - In their intermediation role, banks (with significant capital markets business) do well when volatility (e.g. VIX) is high and thus trading demand is high
 - Use Volcker data to show – clever use of this regulatory data source
 - Other uses: CCAR modeling of trading revenue which at present is quite clunky and coarse as MTM and flow revenue not separated (and they move in opposite direction!)

THE GFC DEFINITION IN ABBOUD et al. IS VERY US-CENTRIC AND DOESN'T CAPTURE LATER STRESS PERIODS RELEVANT FOR EUROPEAN GSIBs

CDS spreads of European GSIBs (bps)

Dec 2007 – Feb 2021

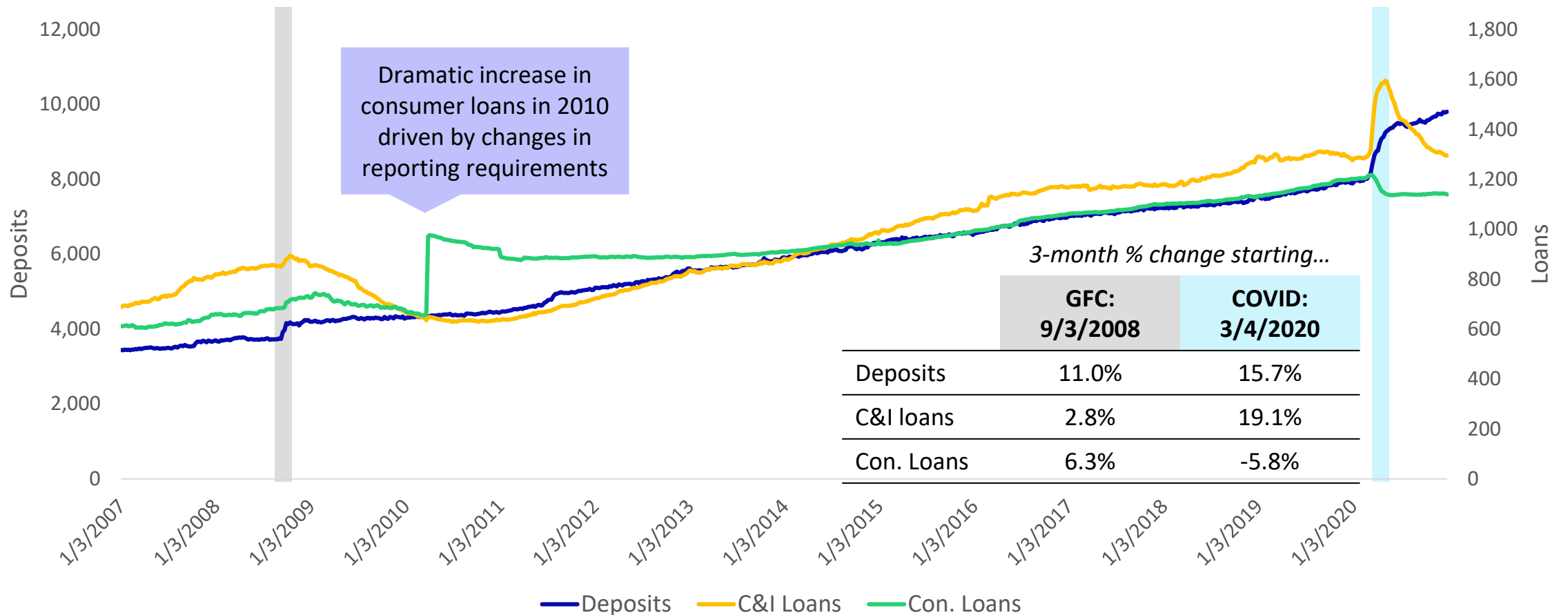


Source: Bloomberg

US BANKS HAD A HEALTHIER CAPITAL BASE GOING INTO COVID THAN GFC ALLOWING FOR TEMPORARY BALLOONING OF THE BALANCE SHEET

Deposits and loans of large US commercial banks (\$BN)

Jan 2007 – Dec 2020



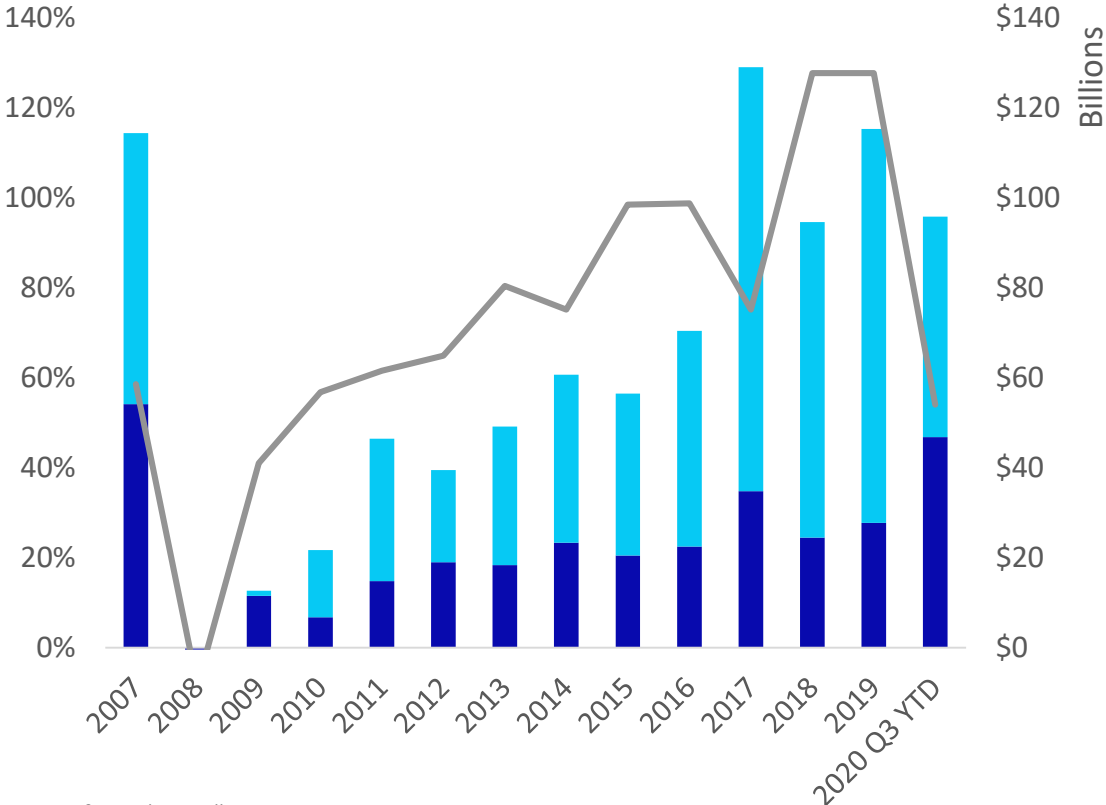
COMMENTS ON GAMBACORTA et al.

- Nonlinear relationship of dividend to P/B: very interesting!
- 2 ways to return capital: dividends and share repurchases
 - Banks recapitalized post crisis
 - Quickly in US
 - More slowly in Europe, hampered also by sovereign crisis
 - US banks have been able to return more capital than European banks, and mostly via share repurchases
 - Kohn & Liang (2019) document that US GSIBs used share repurchases as main channel
- Why use a linear probability model instead of logit or probit?
- The dividend retention and impact on GDP counterfactual is a stretch
 - Assume that “extra” capital fully deployed to credit formation (like lending)
 - Ignores credit demand (and note SLOOS reporting lower credit demand in Abboud et al.) – though commitment draws indicate plenty of precautionary demand
 - Very hard to believe these partial equilibrium analyses when general equilibrium claims are made, especially across such a long time frame (2008-'20), and especially of such magnitude (11-15% of GDP!!)

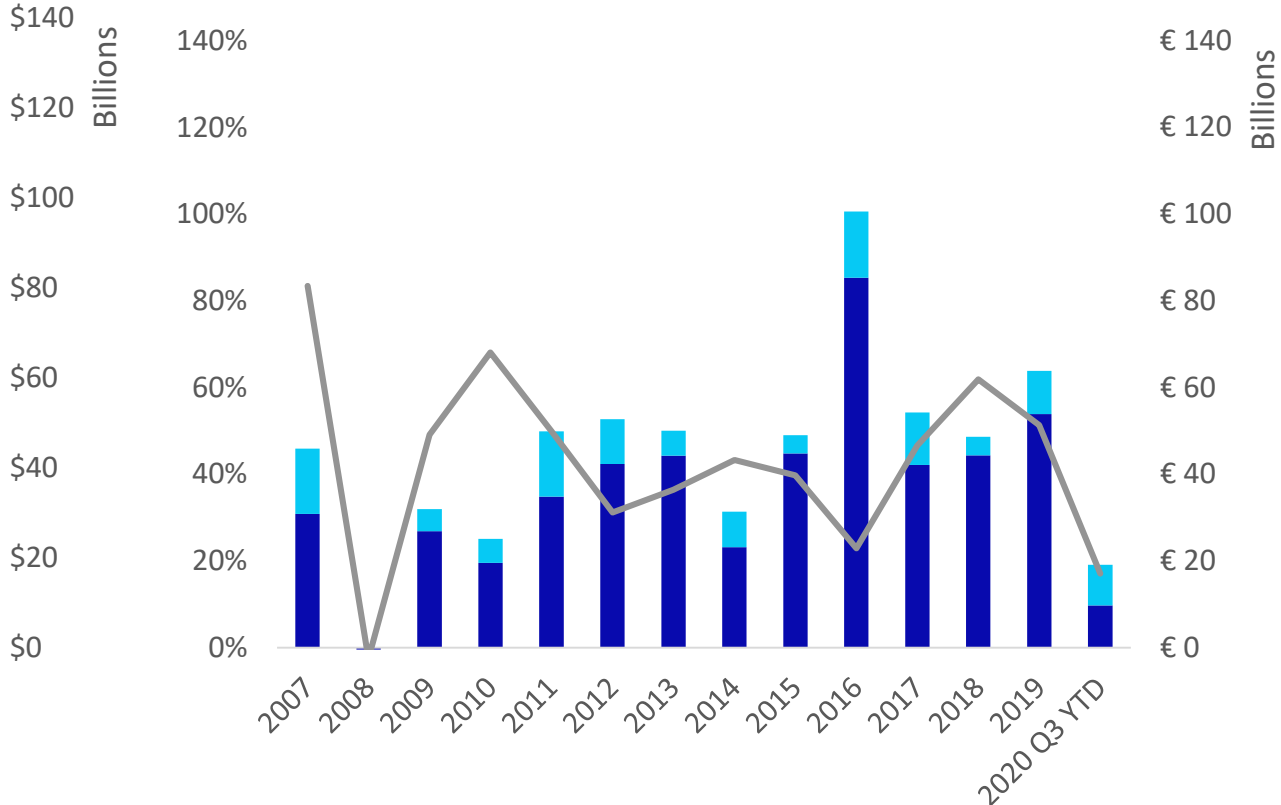
US GSIBs RETURN A LARGER PORTION TO SHAREHOLDERS IN THE FORM OF REPURCHASES THAN EUROPEAN GSIBs

Return to common shareholders (% of net income)
2007 – 2020

US GSIBs¹



European GSIBs²



Source: S&P Market Intelligence

1. Bank of America, Bank of New York Mellon, Citigroup, Goldman Sachs, JPMorgan Chase, Morgan Stanley, State Street, Wells Fargo
 2. Banco Santander, Barclays, BNP Paribas, Credit Agricole, Credit Suisse, Deutsche Bank, HSBC, ING, Societe Generale, Standard Chartered, UBS, UniCredit
 3. Reporting requirements for repurchase disclosures differ across European banks; graph reflects best estimate based on available information

CONCLUDING REMARKS

- Abboud et al. will be an important reference paper, documenting bank experience (so far) in this crisis
 - Capital
 - Liquidity
 - Revenue, especially trading revenue
- Gambacorta et al. present important result on bank dividend behavior
 - Banks are already highly levered, so their results present a cautionary tale
 - But their counterfactual on GDP growth is a stretch...

APPENDIX

STRESS TESTS REMAIN DOMINANT TOOL TO ASSESS BANK RESILIENCE TO SHOCKS

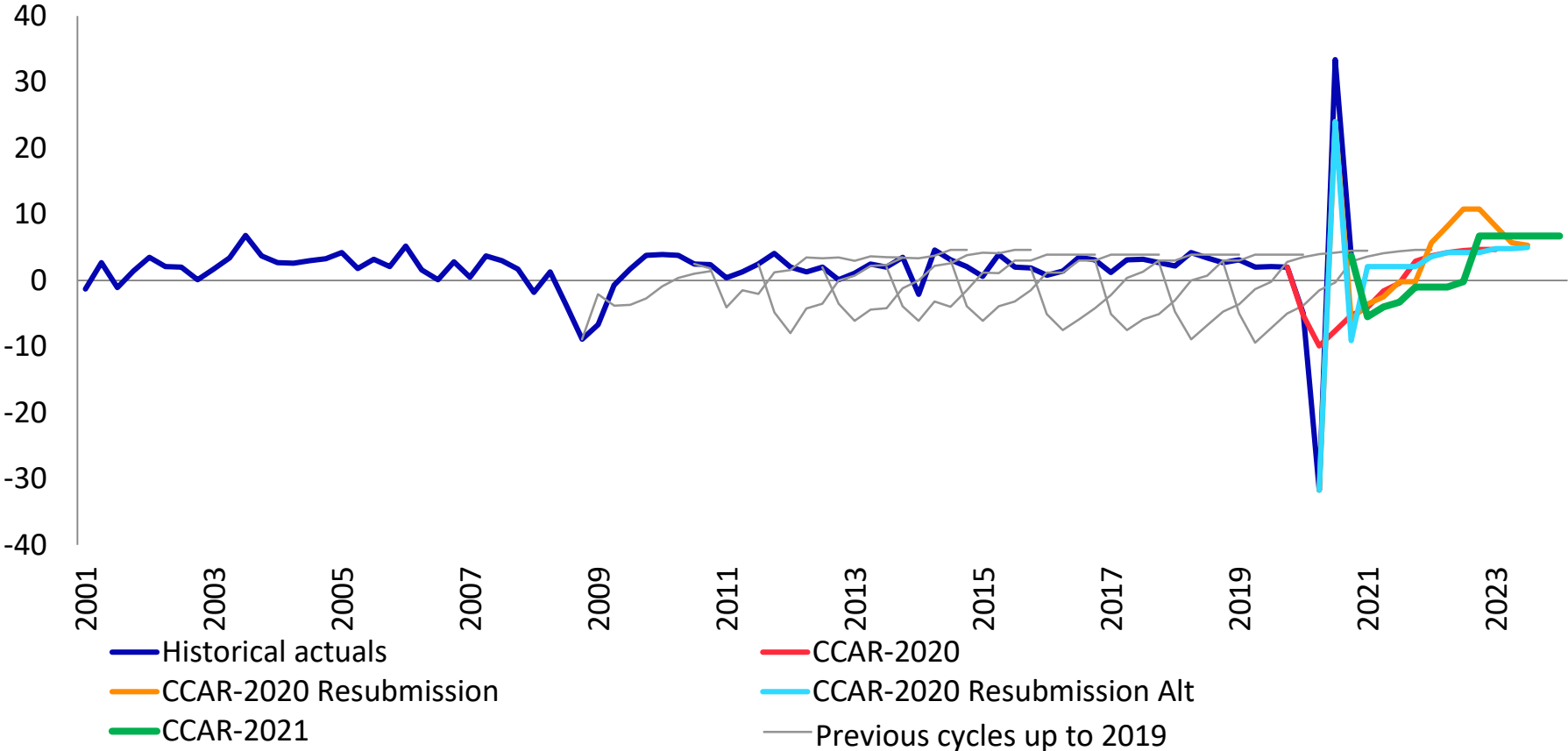
- Fed conducted two stress tests in 2020
 - CCAR-2020 with 1 stress scenario and 3 “sensitivity” scenarios
 - CCAR-2020 resubmission with 2 stress scenarios scenarios
- EBA and BoE-PRA cancelled their 2020 stress test exercises

- 2021 will see stress testing on both sides of the Atlantic
 - BoE-PRA is also conducting their bi-annual exploratory scenario with climate risk

CCAR SCENARIOS: REAL GROSS DOMESTIC PRODUCT GROWTH

Real GDP Growth (%)

Severely Adverse scenarios vs. historical observations

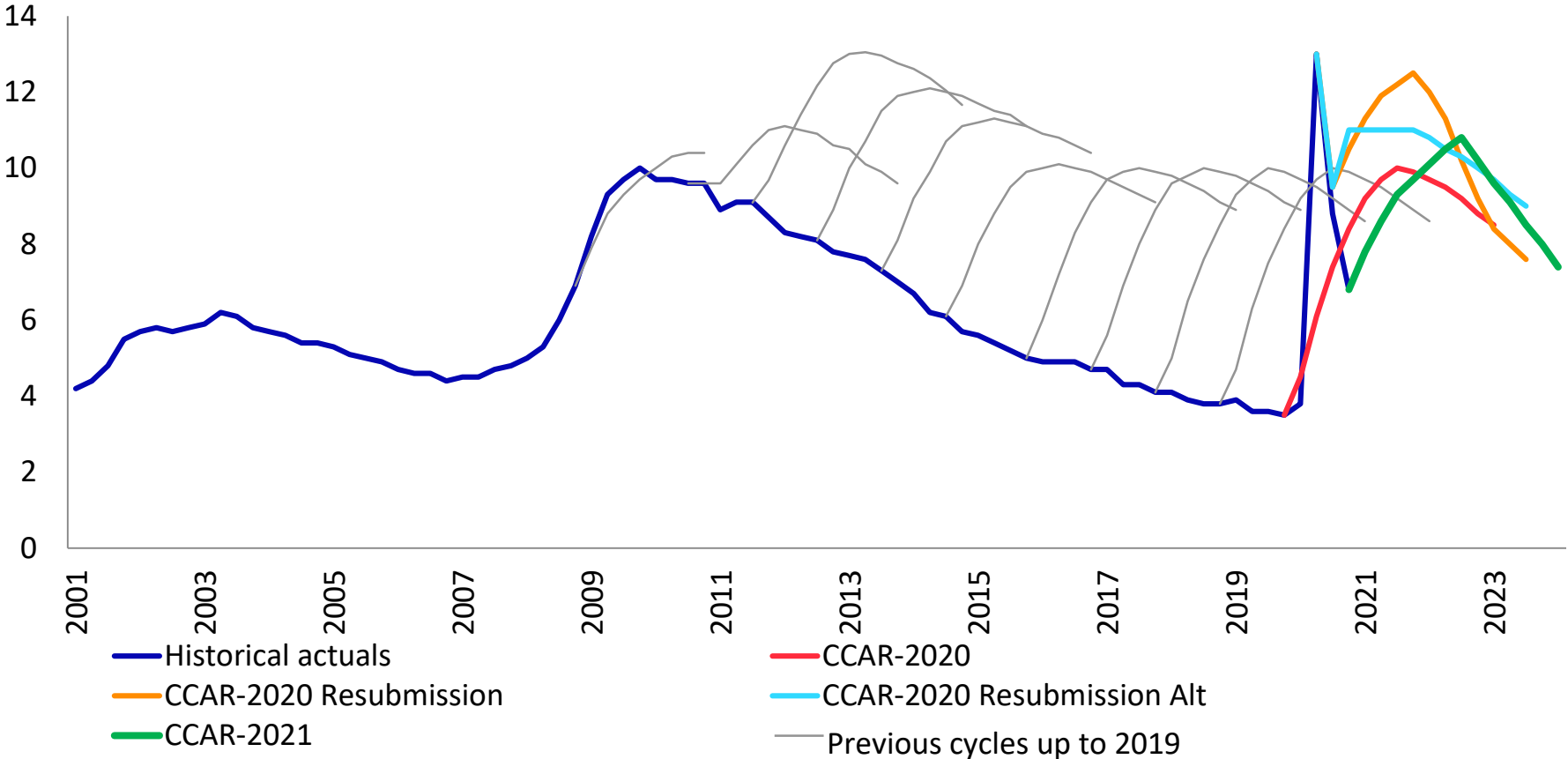


Source: Fed SCAP and CCAR-2011-2021 scenario disclosures
Note: For SCAP-2009, CCAR-2011 and CCAR-2012, only baseline and adverse scenarios were released. Therefore, adverse scenario data for these years is shown for comparison to severely adverse scenario data for CCAR-2013-2021. Historical data does not include restatements to preserve the jump-off point for historical CCAR scenarios. Fully restated historical data is available on the FRB website (<https://www.federalreserve.gov/supervisionreg/ccar-2021.htm>)

CCAR SCENARIOS: UNEMPLOYMENT RATE

Unemployment Rate (%)

Severely Adverse scenarios vs. historical observations

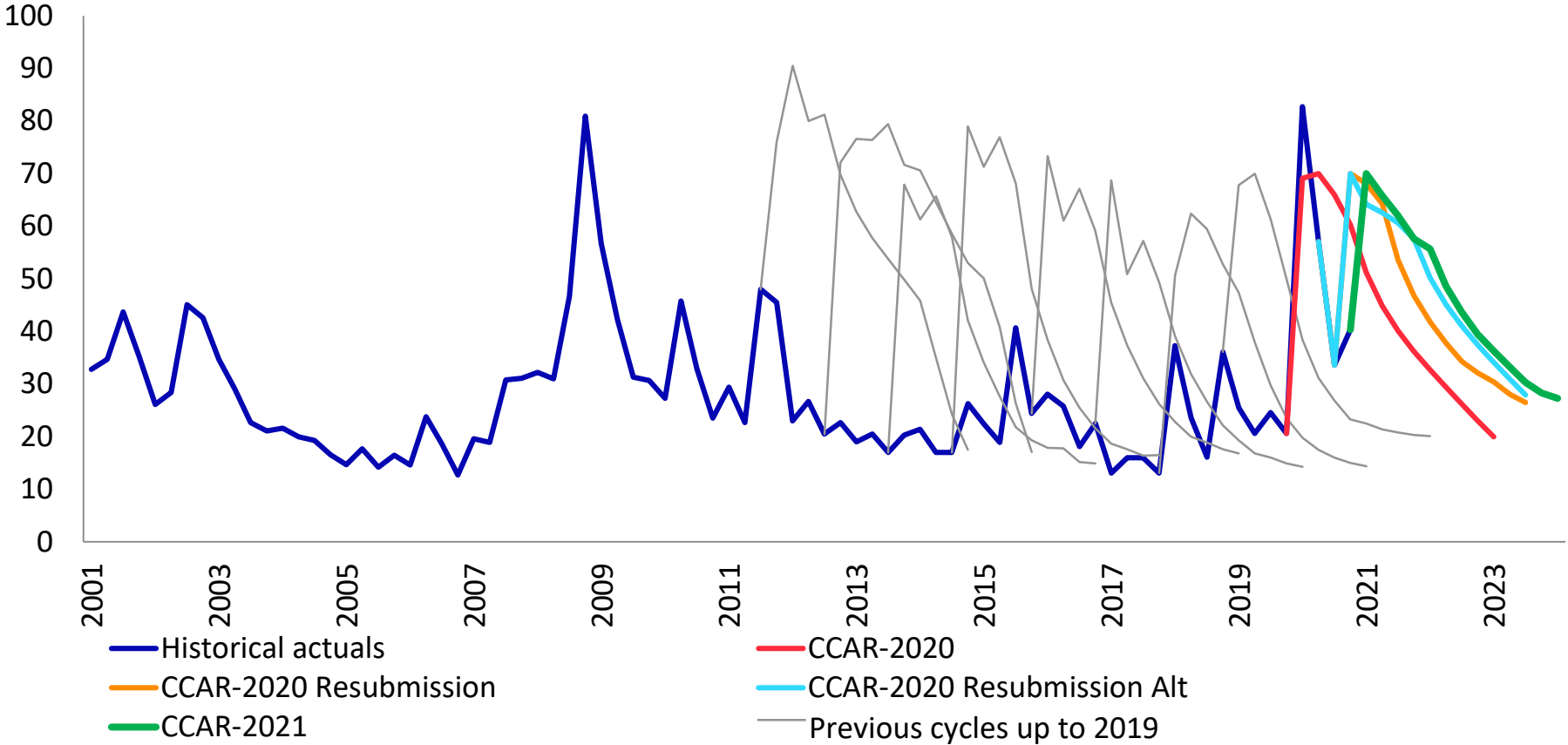


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CCAR SCENARIOS: MARKET VOLATILITY INDEX

Market Volatility Index (% Level)

Severely Adverse scenarios vs. historical observations

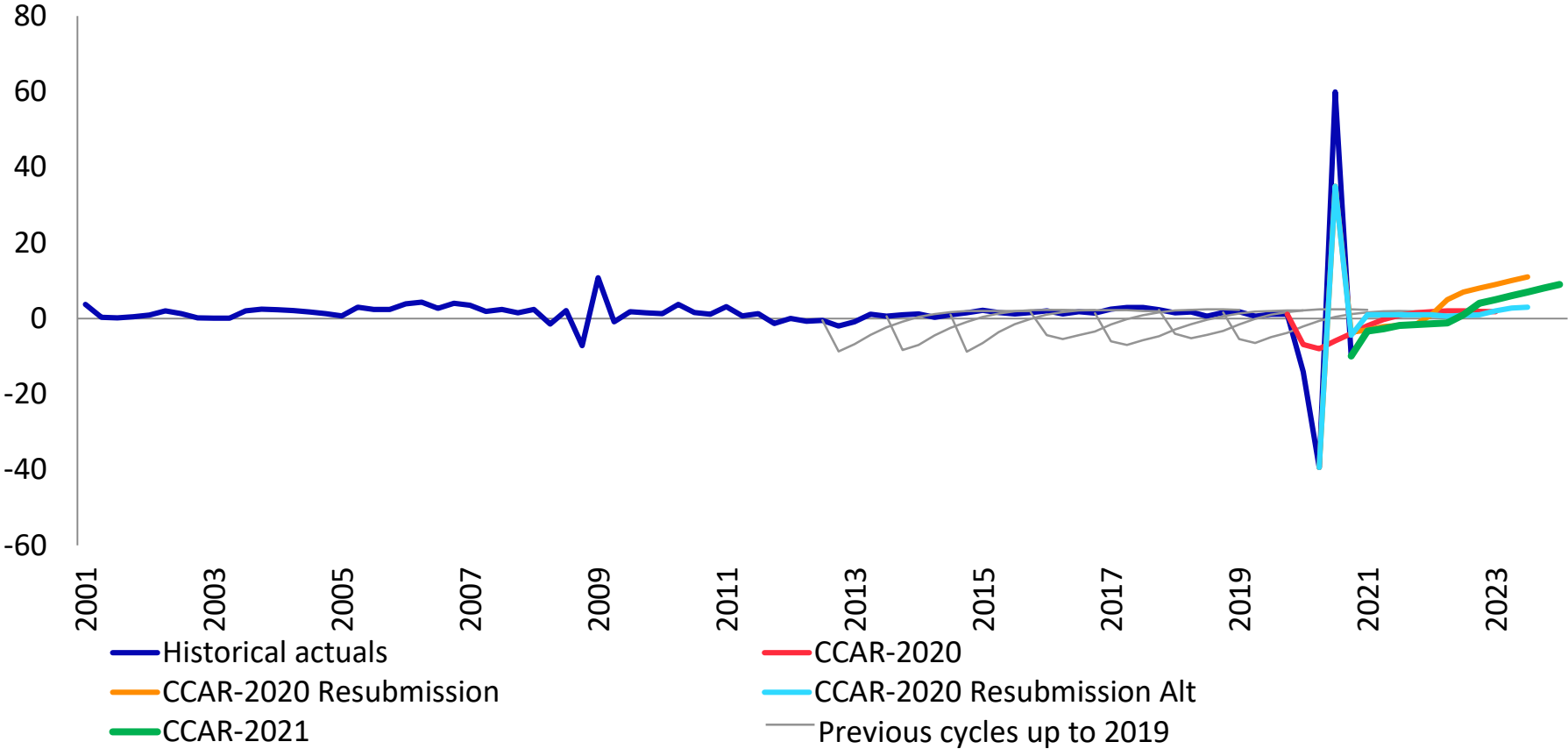


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CCAR SCENARIOS: EURO AREA REAL GDP GROWTH

Euro area real GDP growth (%)

Severely Adverse scenarios vs. historical observations



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