Discussion of “The Evolution of Banking in the 21st Century: Evidence and Regulatory Implications”

Authors: Hanson, Ivashina, Nicolae, Stein, Sunderam, and Tarullo

Discussant: Raghuram Rajan
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Summary: Great paper, consistent with the all-star level of co-authors.

Main points
- Following SVB, need to rethink regulation
- Banks evolving, regulation has not

Policy proposals
- Large banks ==> bond mutual funds
  - Require pre-positioned collateral
- Require capital buffer against interest rate risk
- Allow mergers of mid-sized banks
Preamble

- What are the troubling facts about SVB?
  - It had uninsured demand deposits?
    - Deposit betas turned out higher than it thought?
  - It had no serious risk management?
  - It was insolvent on an MTM basis?
- Maybe it was appropriate it was run!
  - Bank runs as end games for those who mess up – no depositor monitoring needed
  - Is zero failure the goal?
- Were the externalities from failure large?
  - Fire sales, loss in informational and organizational capital, contagion through information/panic?
  - Massive ex post intervention
My remarks

- Is the focus on the right set of banks and on the right cause of vulnerability?
- Examine the regulatory proposals.
Figure 1: The Growth of Bank of Deposits

Figure 1A: Total deposits as a % of GDP and Uninsured deposits as % of domestic deposits
Household deposits to financial assets

HH Deposits to HH Fin Assets

Graph showing the trend of household deposits to financial assets from 1987 to 2023.
More domestic demand deposits and uninsured demand deposits after GFC

From Acharya, Chauhan, Rajan and Steffens (2023)
Insured/uninsured demand and time deposits vs reserves

From Acharya, Chauhan, Rajan and Steffens (2023)
Changes

- Time deposits down
- Demand deposits up
- Uninsured demand deposits up
- Undrawn lines of credit up
- Differences by bank size
Uninsured demand deposits/Assets by bank size

From Acharya, Chauhan, Rajan and Steffens (2023)
Uninsured demand deposits/(Reserves + Eligible Assets) by bank size

From Acharya, Chauhan, Rajan and Steffens (2023)
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In sum: Are we looking at the right places?

- Large banks write liquidity promises (on both sides of the balance sheet)
  - Hold liquid assets to pay contingent liquidity claims
  - LCR worked?
- Small banks – traditional lending, illiquid
  - But taking more liquidity risk throughout QE
  - Too many to fail?
- Why does QE get a free pass?
  - Where did uninsured demand deposits come from?
My remarks

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- Examine the regulatory proposals.
Proposal 1: Pre-position loans as collateral at the discount window

- Very sensible concept.
- Concerns about design
  - Will haircuts be appropriate (underpricing insurance)?
  - Dynamic haircuts (maybe make slow moving)
  - Flight-to-safety deposits and contingent loans (line of credit drawdowns)
- Dangers in creating asymmetric confidence
  - Exacerbate flight to safety plus hoarding
- Balloon effect ex ante
  - More uninsured demand deposits at small banks?
    - CRE loans
Proposal 2: Require capital buffer against interest rate risk/flow MTM losses to regulatory capital

- Very sensible
- Two way interest rate risk (DSS+W)?
Proposal 3: Allow mid-sized banks to consolidate

- Reasonable
- But did they not become mid-sized by buying up small banks?
- Technology offered modest scale economies while they lost local decision making (Stein (2002)).
- Prevent takeovers of small banks?
  - FDIC proposal
Bottom line

- Great paper on an interesting topic.
- Important policy recommendations, worth exploring in detail.
- Scope for future research!