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

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

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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

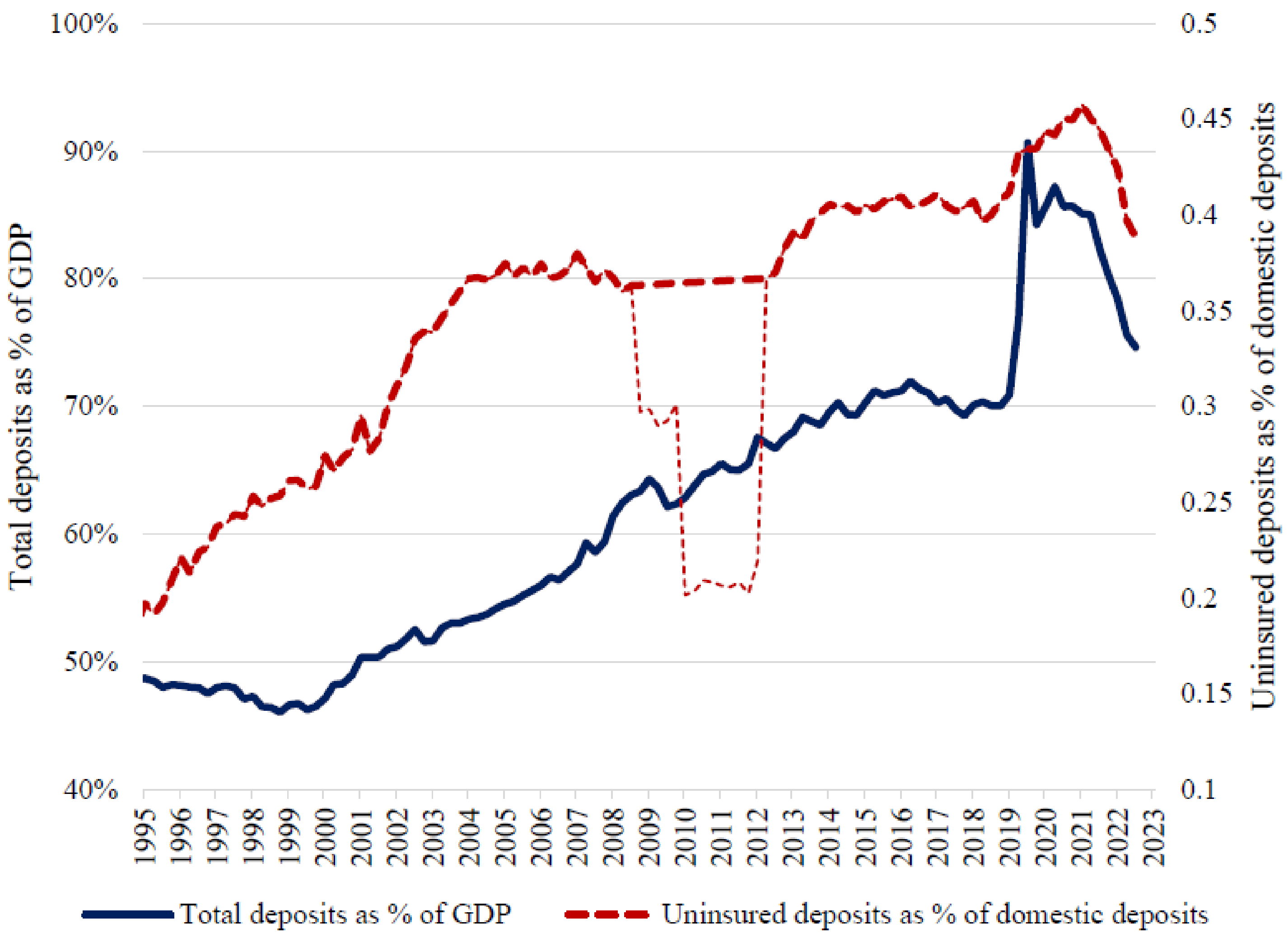
- What are the troubling facts about SVB?
  - It had uninsured demand deposits?
    - Deposit betas turned out higher than it thought?
  - It had no serious risk management?
  - It was insolvent on an MTM basis?
- Maybe it was appropriate it was run!
  - Bank runs as end games for those who mess up – 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

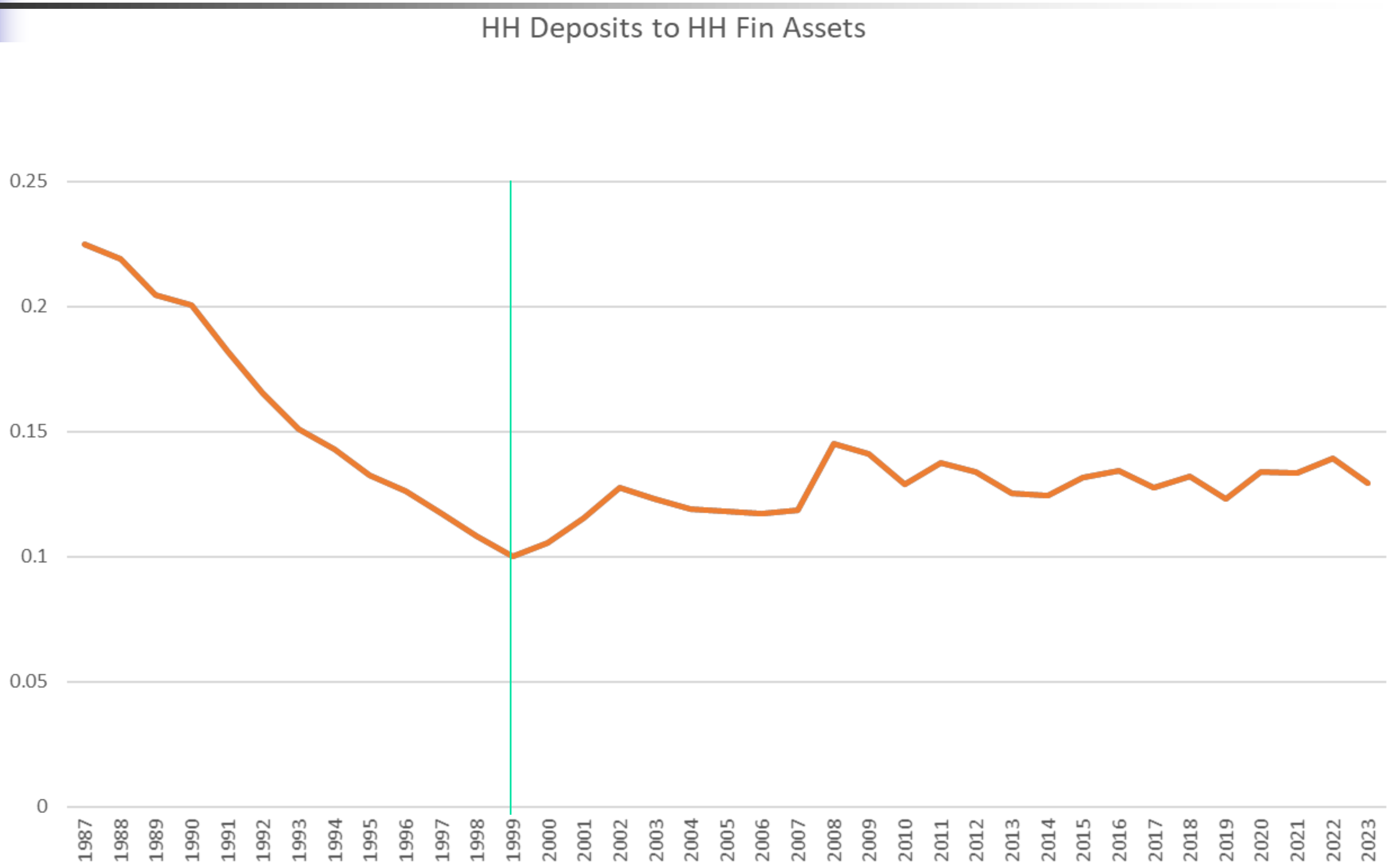
- Is the focus on the right set of banks and on the right cause of vulnerability?
- Examine the regulatory proposals.

Figure 1: The Growth of Bank of Deposits

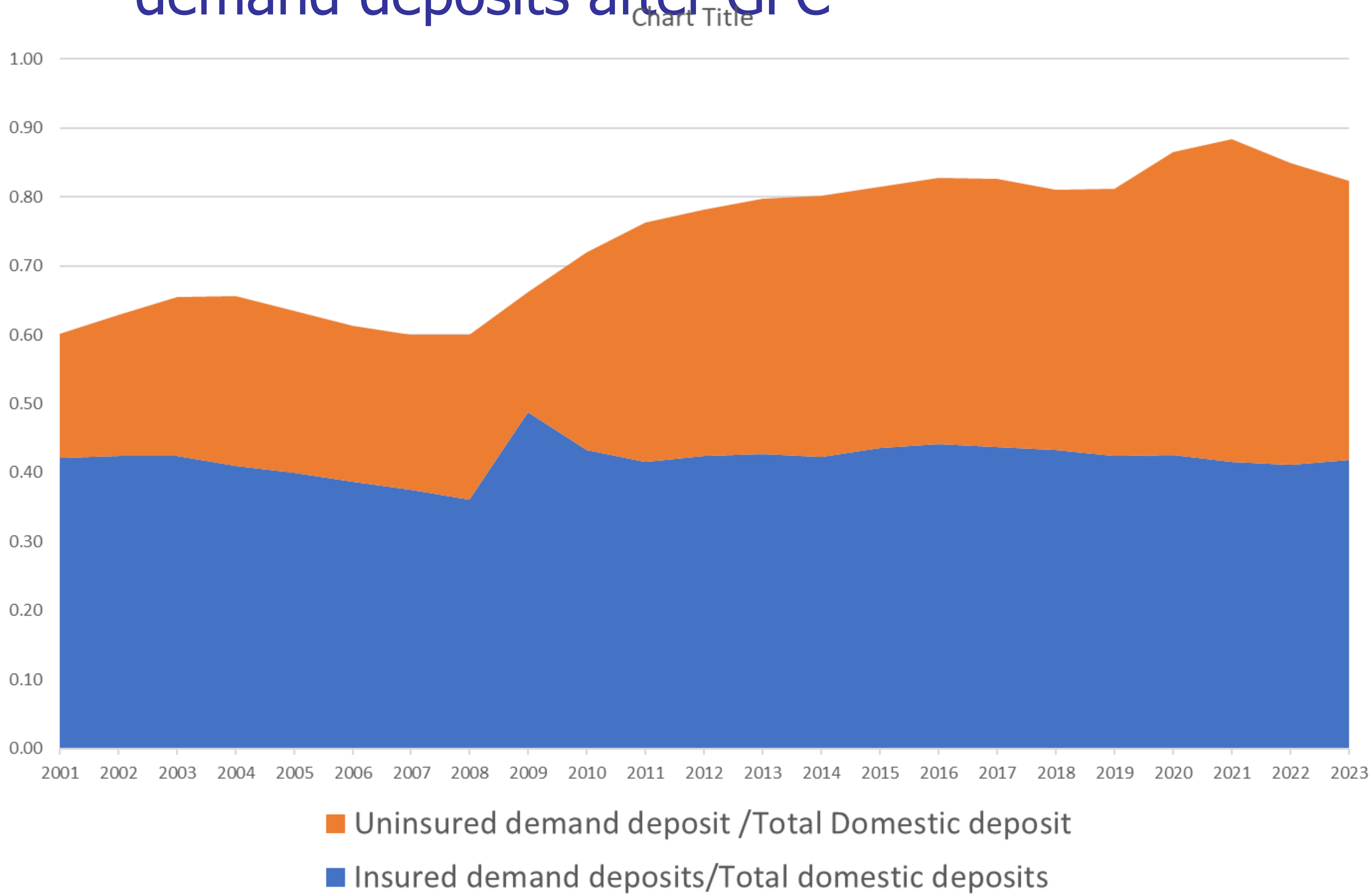
Figure 1A: Total deposits as a % of GDP and Uninsured deposits as % of domestic deposits



Household deposits to financial assets

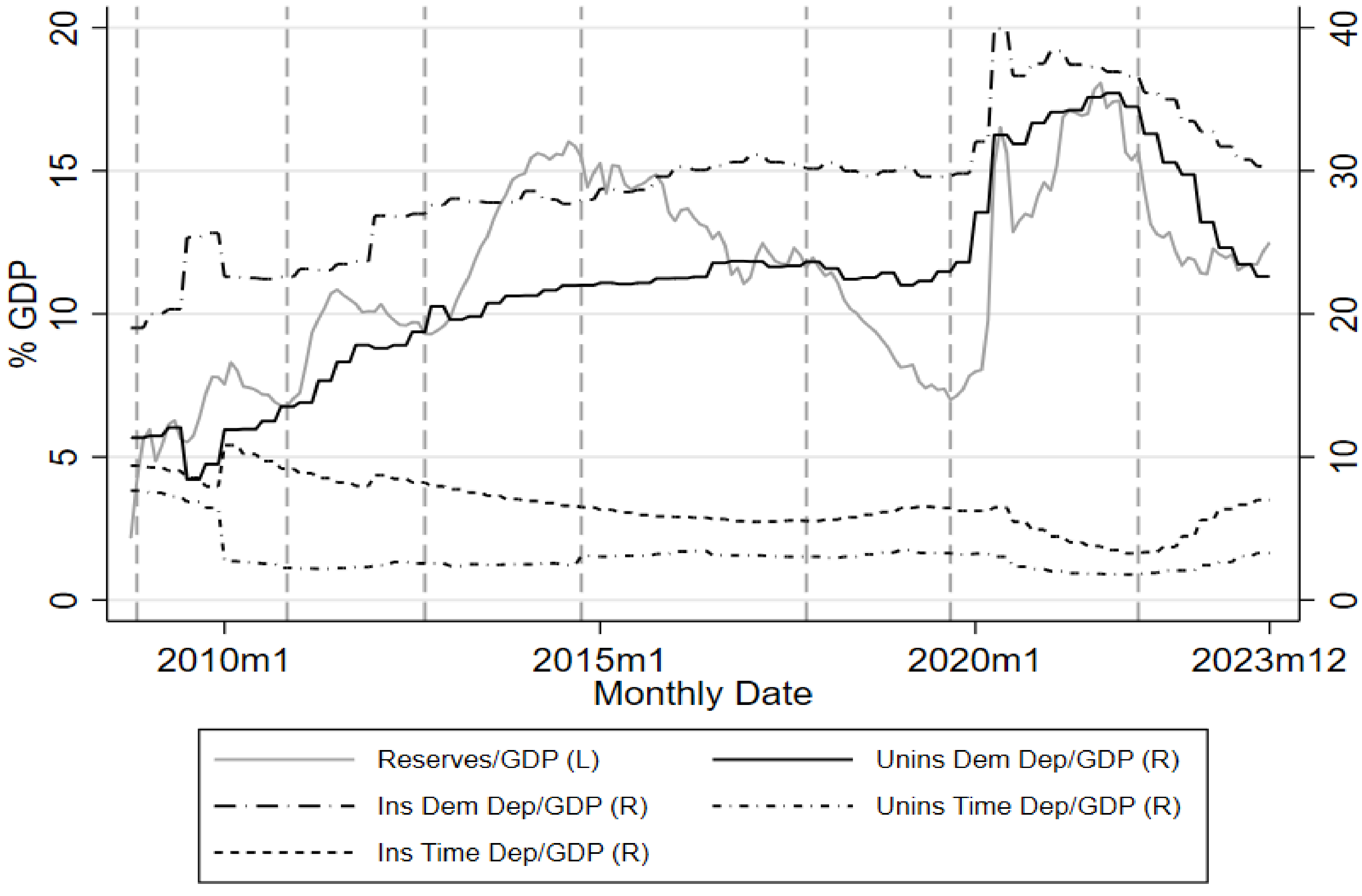


More domestic demand deposits <u>and</u> uninsured demand deposits after GFC



From Acharya, Chauhan, Rajan and Steffens (2023)

Insured/uninsured demand and time deposits vs reserves

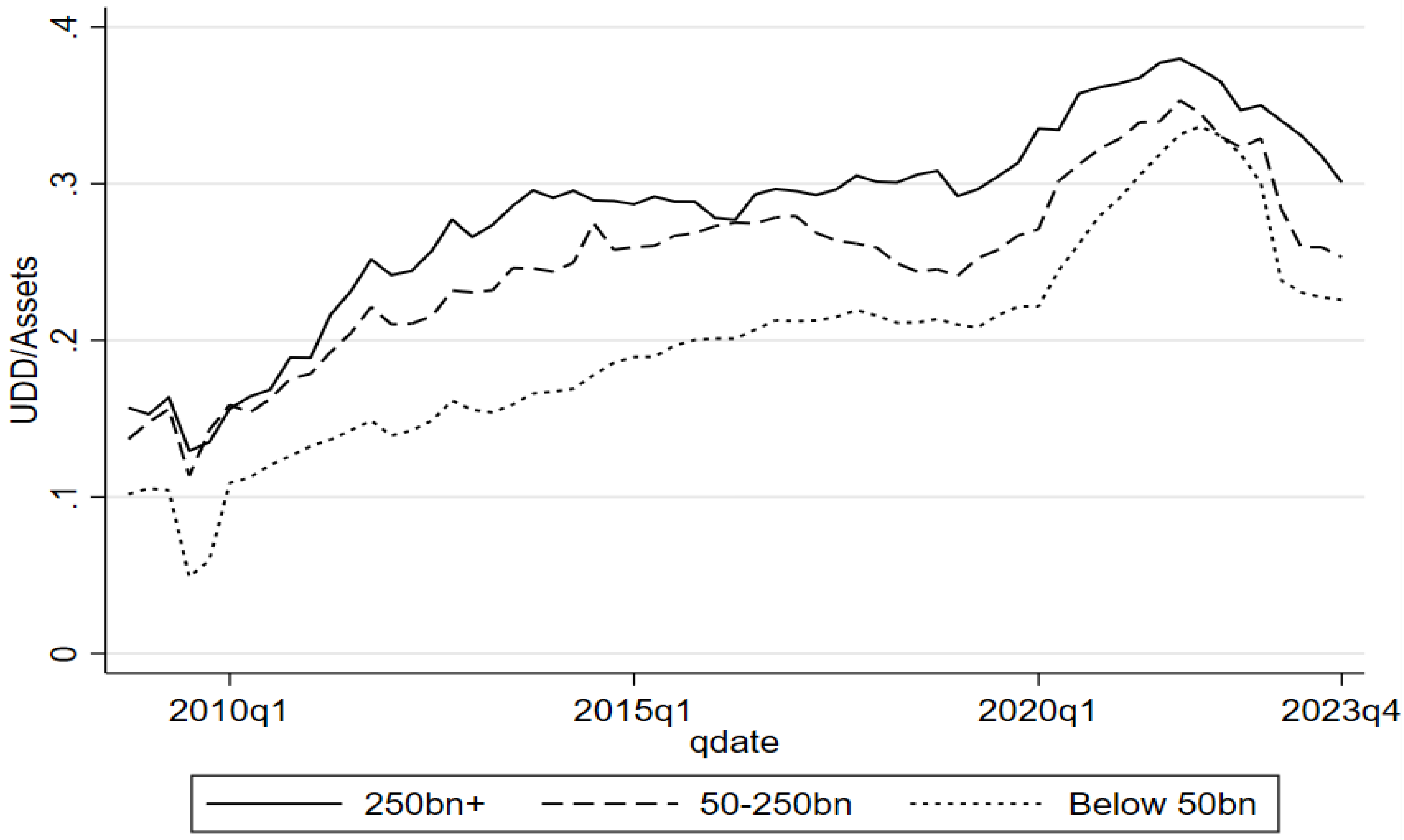


From Acharya, Chauhan, Rajan and Steffens (2023)

Changes

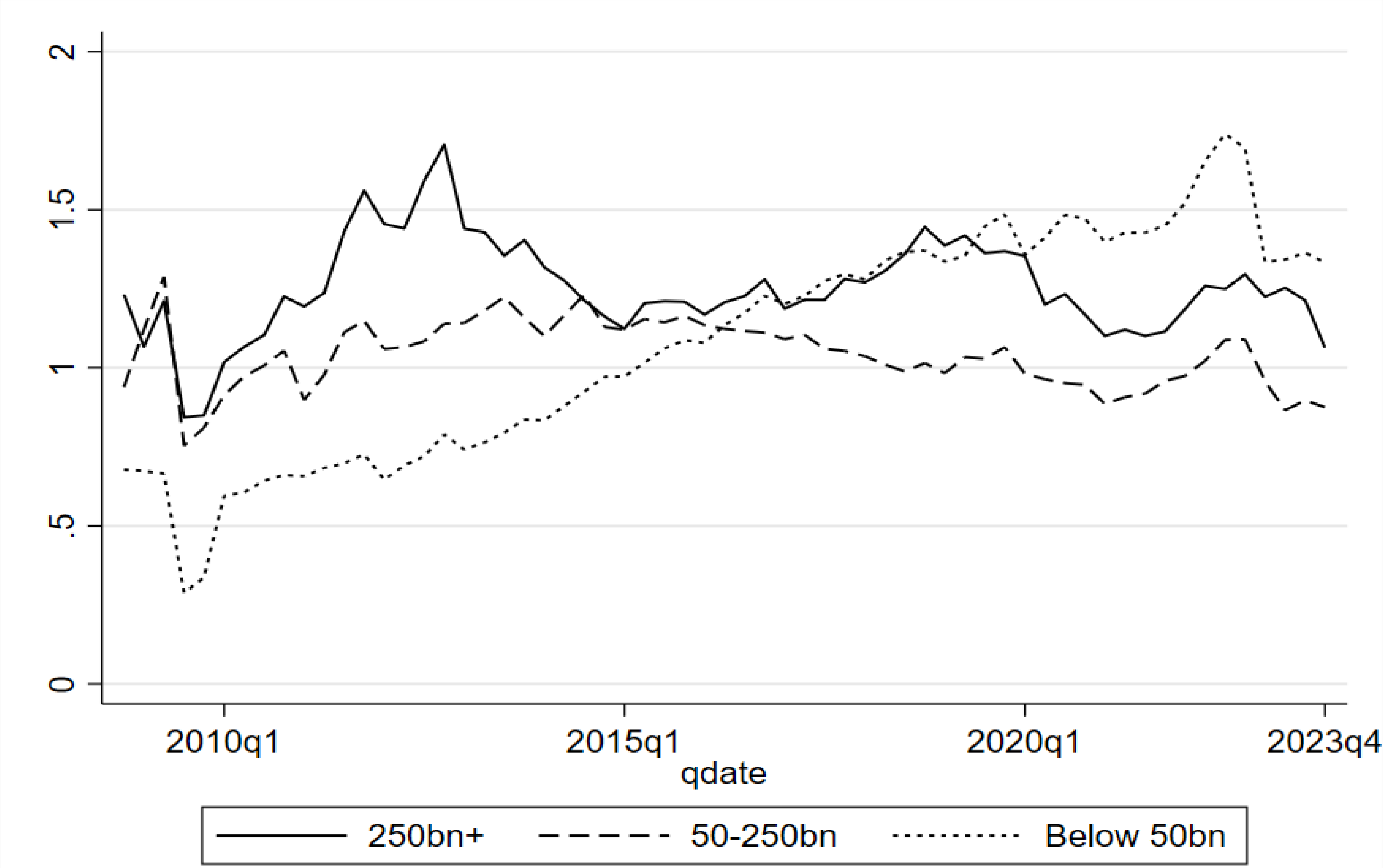
- Time deposits down
- Demand deposits up
- Uninsured demand deposits up
- Undrawn lines of credit up
- Differences by bank size

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)

Hanson et al. Table 1

>100 bn		C+S<3	S>3	C+S	(C+S<3)/ (C+S)
	2005	14	12	27	0.54
	2023	22	16	39	0.58
<100 bn	2005	15	14	29	0.52
	2023	12	15	28	0.44

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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Proposal 1: Pre-position loans as collateral at the discount window

- Very sensible concept.
- Concerns about design
  - Will hair cuts 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!