Mimicking Regulatory Peers
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Summary
Bank regulators’ disclosure and use of peer information through the Uniform Bank Performance Report (UBPR) affect banks’ decisions regarding regulatory capital.
- Banks’ regulatory capital ratios become more sensitive to the peer group average in the UBPR regime.
- Banks use either loan loss provisions (LLPs) or risk-weighted assets (RWAs) to manage their regulatory capital ratios depending on their capital levels relative to the peer group average.
- Bank lending decisions become sensitive to their regulatory capital ratio rankings in the peer group.
- The recognition of expected losses is delayed.

Uniform Bank Performance Report (UBPR)
- To facilitate the evaluation of bank conditions, the Federal Financial Institutions Examination Council (FFIEC) introduced the UBPR in 2004.
- The FFIEC defined bank peer groups and made the peer information publicly available.
- Bank examiners should compare a bank’s capital ratio with the UBPR peer group averages.
- Peer group averages are not considered supervisory targets, but intended to provide insight into performance of similar banks.
- However, it may affect banks’ decisions regarding regulatory capital ratios.
- Banks may consider the UBPR peer group average as a primer for stricter capital requirements, since most banks hold capital well above the regulatory minimum.

Why do banks mimic peers?
I predict and find that banks mimic the UBPR peer group average regulatory capital ratio to shape market participants’ (e.g., bank regulators, depositors) perceptions of their stability.
- Tier 1 capital ratio rankings in the UBPR peer group have predictive power for the likelihood that a bank will receive severe regulatory enforcement actions.
- Tier 1 capital ratio rankings become more important determinants of deposit flows in the UBPR regime.

Banks’ responses to UBPR
- Well-capitalized banks (Maintain their rankings)
  - Increasing Tier 1 targeting the peer group avg. by mimicking peers’ LLPs
- Under-capitalized banks (Move closer to the Avg.)
  - Being sensitive to the peer group avg. by mimicking peers’ LLPs

Main Results
- Tier 1 capital ratios of DeNovo banks become more sensitive to their cohorts’ average tier 1 capital ratio in the post-UBPR period relative to control banks.

Identification
- Estimating peer effects is challenging because of the reflection problem – if a bank’s capital ratio is a function of the capital ratios of peer banks, then vice versa is also true.
- The UBPR setting mitigates the reflection problem by permitting a difference-in-differences (DID) methodology.
- Control: Existing banks – grouped based on size
- Treatment: De novo banks – grouped with cohorts for the first 5 years, then moved to sized based groups

Mechanism
- Well-capitalized banks mimic their cohorts’ average LLPs to maintain their tier 1 capital ratio rankings.
- Under-capitalized banks reduce RWAs to increase tier 1 capital ratios.
- Under-capitalized banks adjust their loan composition by decreasing the proportion of commercial and industrial (C&I) loans and increasing the proportion of real estate loans.

Consequences
- DeNovo banks’ lending decisions become more sensitive to their tier 1 capital ratio rankings in the UBPR regime compared to control banks.

Main Results

<table>
<thead>
<tr>
<th>Dependent:</th>
<th>Tier1t,t−1</th>
<th>Tier1 peer,t−1 × DeNovo × Post</th>
<th>Tier1 peer,t−1 × DeNovo</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tier1t,t−1</td>
<td>(1)</td>
<td>(2)</td>
<td>(3)</td>
</tr>
<tr>
<td>(1.1)</td>
<td>0.382***</td>
<td>0.345***</td>
<td>0.390***</td>
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<td>(3.33)</td>
<td>(5.77)</td>
<td>(4.73)</td>
<td>(10.10)</td>
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<tr>
<td>Observations</td>
<td>245,748</td>
<td>243,129</td>
<td>243,129</td>
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<tr>
<td>Adjusted $R^2$</td>
<td>0.871</td>
<td>0.880</td>
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<tr>
<td>Peer Avg Characteristics</td>
<td>N</td>
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</tr>
<tr>
<td>Controls</td>
<td>N</td>
<td>Y</td>
<td>Y</td>
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<tr>
<td>Time FE, Bank FE</td>
<td>Y</td>
<td>Y</td>
<td>Y</td>
</tr>
</tbody>
</table>

Parallel trends for Tier 1 Capital Ratios (Tier 1 peer,t−1 × DeNovo × Year dummies)

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