

Two Papers on Bank Funding Decisions

Discussion

by

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16th Annual FDIC / JFSR Bank Research Conference
8 September 2016

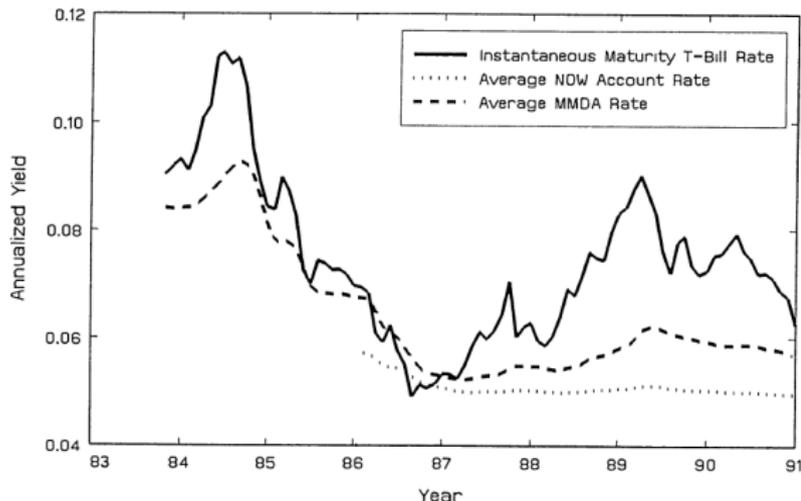
The Effect of Monetary Policy on Bank Wholesale Funding

by Dong Beom Choi and Hyun-Soo Choi

- ▶ The paper focuses on how changes in banks' wholesale funding (WSF) - retail deposit (RD) composition react to federal funds rate (FFR) changes:
 1. RDs decline with a rise in the FFR.
 2. Relative to small banks (SBs), large banks (LBs) use more WSFs to replace RDs and maintain lending as the FFR rises.
 3. The increase in WSF and lending following a rise in the FFR is greater in "Young" MSAs.
 4. Since LBs have smaller liquidity ratios, a binding LCR may constrain their future lending.
- ▶ The paper presents a clear model and extensive empirical tests that support these findings.

Comment: Changes in Retail Deposits

- ▶ Paper's model assumes banks pay zero interest on RDs.
- ▶ A literature documents sticky, asymmetric RD rate changes.¹



- ▶ The WSF - RD rate spread and disintermediation increase as the FFR rises.
- ▶ Legislation affecting RDs: 1999 Gramm-Leach-Bliley Act (GLBA); 1980 & 2008 deposit insurance increases.

¹Figure from Hutchison and Pennacchi (1996) *JFQA*.

Comment: Small versus Large Bank Access to WSF

- ▶ RD-dependent SBs set higher RD rates than LBs when market rates (LIBOR) rise.²

Year	SB MMDA	LB MMDA	SB-LB Spread	LIBOR
1998	2.83	2.22	0.61	5.66
1999	2.57	1.73	0.83	5.23
2000	2.75	1.86	0.87	6.64
2001	2.36	1.42	0.99	3.86
2002	1.26	0.81	0.44	1.83
2003	0.78	0.42	0.38	1.12
2004	0.79	0.50	0.37	1.36

- ▶ Though WSF rates often exceed average RD rates, SBs' *marginal* cost of issuing additional RDs is likely to be higher than LBs' marginal cost of issuing additional WSFs.

²Data from Park and Pennacchi (2009) *RFS*.

Comment: Old versus Young MSAs

- ▶ The paper finds support for its hypothesis that the young are more likely switch from RDs to WSFs as the FFR rises.
 - ▶ There is a bigger relative increase in WSF following a FFR rise in young MSAs (Table 6).
- ▶ The result is also consistent with Young MSAs having:
 - ▶ greater retail lending demand relative to RDs (Loan Rich, Deposit Poor).³
 - ▶ with relatively few RDs, banks use WSFs at the margin.
 - ▶ adjustment to FFR \uparrow implies RD \downarrow and WSF \uparrow .
- ▶ In contrast, Old MSAs have
 - ▶ greater RDs relative to retail lending demand (Loan Poor, Deposit Rich).
 - ▶ with many RDs, banks invest in securities at the margin.
 - ▶ adjustment to FFR \uparrow implies RD \downarrow and securities \downarrow .

³See Pennacchi (2016) "Banks, Taxes, and Nonbank Competition," [mimeo.](#)

Comment: Old versus Young MSAs (continued)

- ▶ Thus, the balance sheet adjustments of typical banks following a FFR rise are:

Bank in Young MSA

Assets
Many Retail Loans

Liabilities
Equity
Few RDs ↓
WSF (marginal funding) ↑

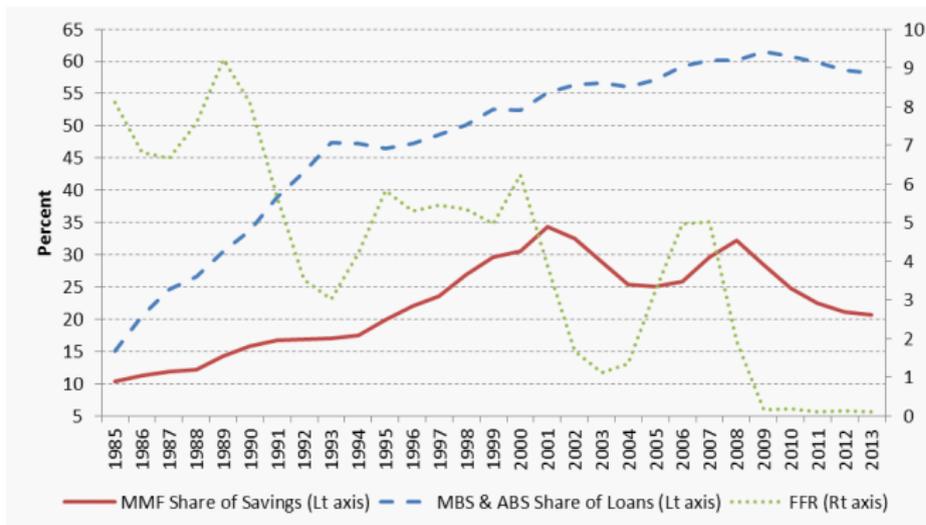
Bank in Old MSA

Assets
Few Retail Loans
Securities (marginal investment) ↓

Liabilities
Equity
Many RDs ↓

Comment: LB Liquidity Ratios and the LCR

- ▶ Since LBs have lower liquidity ratios, will a binding LCR limit their WSF and lending as the FFR rises?
- ▶ Securitization is an alternative funding source.



- ▶ MMF flows and securitization respond to the FFR with a lag.

Why Hire Your Rival? The Case of Debt Underwriting by David Becher, Rachel Gordon, and Jennifer Juergens

- ▶ Interesting and insightful paper exploring why an issuing bank hires a rival bank to underwrite its debt.
- ▶ Rivals are more likely to be hired when the issuer:
 1. lacks international expertise.
 2. lacks proprietary trading or derivatives activities.
 3. lacks asset management activities.
 4. has used other rivals in recent past.
 5. experienced a recent decline in underwriting ranking.
 6. is top 10 ranked but at underwriting capacity.
- ▶ Rivals are more likely to be hired when the debt issue:
 1. is a public, rather than private, deal.
 2. is an international deal.
 3. is relatively small.
 4. has a long maturity.

Comment: Purpose of Debt Issue

- ▶ If the data is available, it would be interesting and potentially important to know more about the type and purpose of the debt issue:
 1. issued by a parent or commercial bank or nonbank subsidiary?
 2. qualifies as regulatory capital?
 3. secured or unsecured?
- ▶ Figure 1 indicates that from 2005 to 2007, the proportion of financial to total debt offered exceeded 60%.
 - ▶ Partly may reflect shorter maturity and more frequent issuance of financial debt.
 - ▶ But might some of this debt be ABS and MBS issued from securitization vehicle subsidiaries of bank holding companies?
 - ▶ If so, factors affecting rival choice may differ compared to debt issued by a bank subsidiary.

Comment: Before and After 1999 GLBA

- ▶ Constraints facing commercial banks (CBs) were radically different prior to the GLBA:
 - ▶ Restrictions made underwriter ranking or financial debt capacity irrelevant for CBs.
 - ▶ Figure 4 shows changing regulatory limits on corporate debt underwriting revenue could require choosing a rival.
- ▶ So, show whether the major empirical results hold using a subsample starting after the GLBA.
- ▶ Quibble: Besides separating commercial banking from investment banking, the Glass-Steagall Act created the Federal Deposit Insurance Corporation.
- ▶ So if the GLBA “repealed Glass-Steagall,” this conference would not have been possible!

Conclusions

- ▶ This session's papers are valuable contributions for understanding banks' debt funding decisions:
 - ▶ Monetary policy, bank size, and market structure affect banks' choice of retail versus wholesale funding.
 - ▶ Underwriter expertise, reputation, and proprietary information affect banks' choice of debt underwriter.

- ▶ Further research on these topics could be fruitful.