EFFICIENT OR SYSTEMIC BANKS: CAN REGULATION STRIKE A DEAL? BY TIRUPAM GOEL

Discussion by

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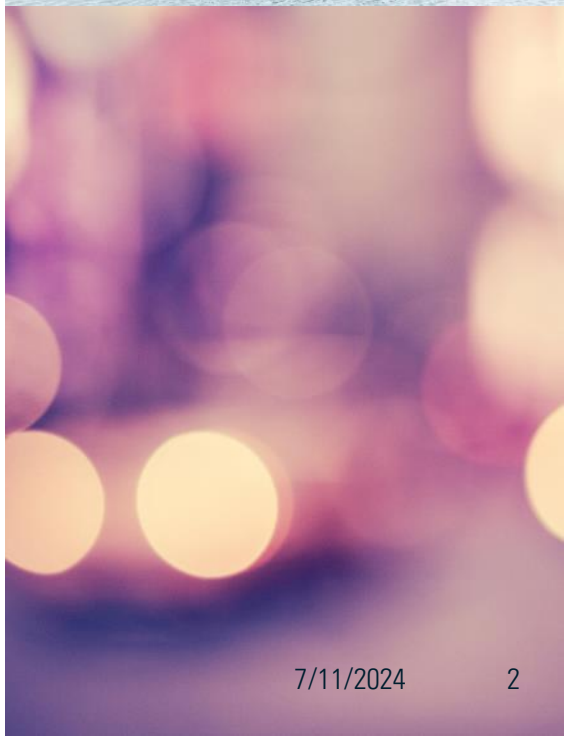
OUTLINE

Aims of the paper

Key results

Comments



AIMS OF THE PAPER

- Should the banking sector be organised as a few large or several small banks?
- What is the optimal capital requirement?
- The answer is complicated by a financial-stability versus efficiency trade-off. While large banks have scale economies, their failure can be systemic.
- The paper embeds this trade-off into a macroeconomic model to determine optimality.

KEY RESULTS

Optimal Regulation is Size-Dependent

- A capital requirement that is the same for all banks does not take any account of differences across banks

- A perfectly risk-sensitive requirement takes into account that large banks are more efficient and thus less likely to default (lower PD), but abstracts from how EAD and LGD depend on bank size.

- Equalising EL across banks implies looking only at one determinant of aggregate welfare in the economy, ignoring the benefits of financial intermediation in the economy

Stricter rules for larger banks can enhance financial resilience

- This regime allows smaller banks to assume higher leverage, which can help them grow faster and more rapidly benefit from economies of scale.

- But once banks become large and their defaults more costly, this regime limits the expected losses posed by them by lowering their default rate via higher capital requirements.

Optimal Size-Dependent Regulation for Banks

- Optimal regulation should be flexible

- The key is to balance efficiency and financial stability

- This can be done through size-dependent policies.

COMMENTS 1

- Great paper. Very important question and well written, if a bit long.
- Clear policy angle with usable results.
- The insights and intuition are clearly explained, and this cannot have been easy given the various opposing channels that make many of the results non-trivial.
- Numerous robustness checks have already been done.

COMMENTS 2

- Slight confusion between what is the **main aim of the paper**: the optimal number of banks or optimal capital regulation?
  - The introduction and abstract emphasise the discussion on the optimal number of banks, and the stylized model even shows how the optimal number of banks depend on the degree of diversification, but this is then later dropped through the rest of the paper.

- Key assumption to drive the results is the **systemic risk from costly default from larger banks**.
  - I agree with the assumption, but should we also think about how an orderly resolution of banks would affect this. Given its importance in the model, it would be nice to add more robustness and discussion around this point particularly given the TBTF and ordered resolution discussion.

- The paper to a degree omits **moral hazard,** assuming larger banks have an inherently more favourable risk-return profile.
  - Deposit insurance is mispriced in the model, but there is no ability to invest in assets of different riskiness. A discussion of the implications could at least be added. What if for example larger banks take on more risky assets because, e.g. they also have implicit government guarantees? Would this change the result given it is a driving assumption that larger banks are less risky due to higher efficiency?

COMMENTS 3

- The paper alludes to the differences between **minima and buffers** but is chiefly concerned for the minima. Given some of the results, could more be said to touch on this debate on optimal minima-buffer split. For example, the paper discusses how the size result justifies the logic behind the G-SIB buffer.

- Considering the impact of **cyclicality** on the results: the business cycle and the implications for optimal capital regulation are ignored.

- The paper has a lot to say concerning a **separate regime for smaller banks**, but this is not explored.

THANK YOU