USEFUL, USABLE, AND USED? BUFFER USABILITY DURING THE COVID-19 CRISIS

Aakriti Mathur, Matthew Naylor and Aniruddha Rajan

Discussion by **Diana Bonfim**

Fourth Conference on Financial Stability, BdE/CEMFI, June 29-30, 2023

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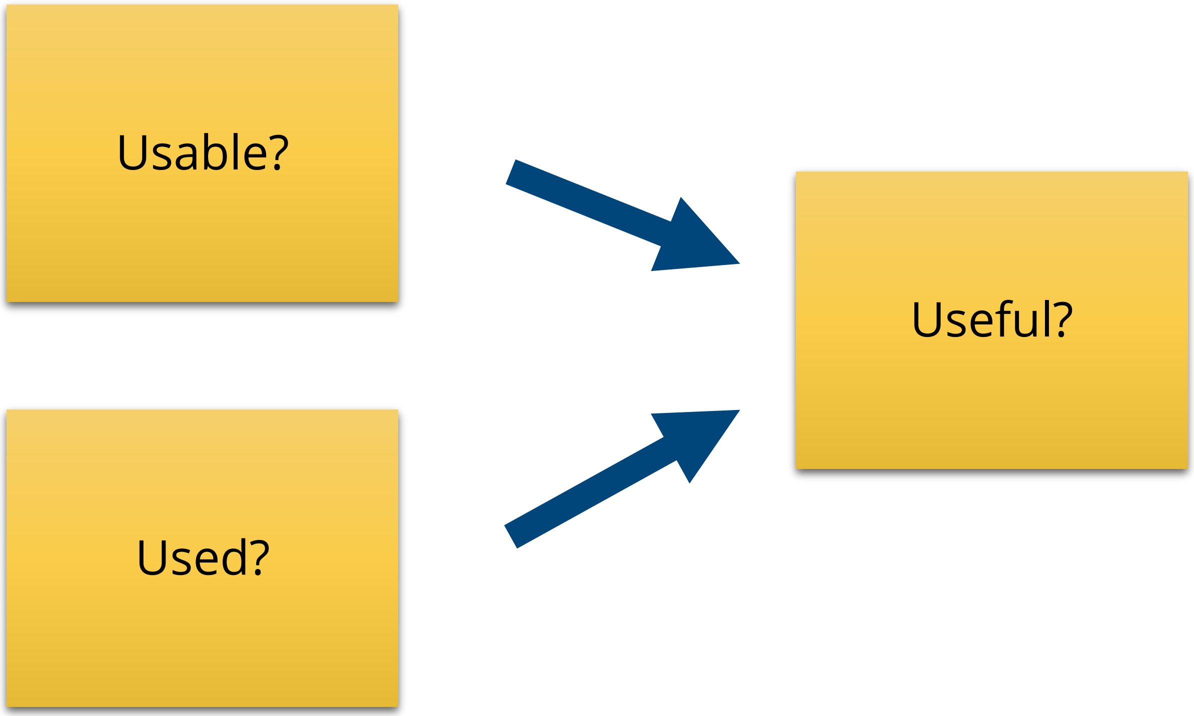
SUMMARY OF THE PAPER

Capital buffers



SUMMARY OF THE PAPER

Usable?

Basel III introduced several capital buffers to mitigate the procyclicality of bank behavior and regulation (Repullo and Suarez, 2013).

Big question: **are they usable?**

Several reasons to believe they may not be (Garcia Pascual and Abad, 2022, Couaillier et al., 2022, Berrospide et al., 2021).

SUMMARY OF THE PAPER

Used?

Are they used?

This refers more to buffer release. E.g. CCyB is designed to be released in downturns.

Goal: avoid a credit crunch.

SUMMARY OF THE PAPER

For capital buffers to be **useful** they need to be **usable** and **used/released**.

This paper:

- Explore COVID-19 as an episode to test buffers' **use** and **release** in the UK.

  Did banks make use of capital buffers or did they try to remain well capitalized?

  Did banks use their capital buffers to lend during a crisis and support the economy?

SUMMARY OF THE PAPER

Main findings:

- Banks with **less capital surplus** made an effort to actually improve their capital ratios during the pandemic, acting **procyclically**:
  - higher loan rates
  - smaller loan amounts
  - tighter terms on risky lending

- But, banks with a **greater capital relief** from the CCyB kept capital ratios stable and **did not act procyclically** (maybe not really countercylically).

MY COMMENTS

01

HOW DID BANKS ADJUST?

02

COVID AND EMPIRICAL DESIGN

03

IS THERE HOPE FOR COUNTERCYCLICAL REGULATION?

04

MINOR ISSUES

1. HOW DID BANKS ADJUST?

On the balance sheet	
Assets	**Liabilities**
Loans Mortgages Consumer loans Lending to companies Lending to governmental bodies	Equity Share capital Etc.
Liquid assets Shares, corporate bonds Government bonds Interbank debt claims Etc.	Borrowed capital Deposits > Customer deposits > Certificates of deposits Financial instruments > Bonds > Derivatives Interbank market funding
Other assets Real estate Derivatives Goodwill Etc.	
Balance sheet =	**Balance sheet**

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1. HOW DID BANKS ADJUST?

- What else happened?
  - Corporate loans?
  - Security holdings?
  - Funding structure (monetary policy)?

- How important are **mortgages** in shaping the adjustment?
  - Mortgages are among the assets with lower risk weights. If banks want to improve/stabilize capital ratios, they may prefer to grant mortgages, instead of going into riskier categories.
  - Does this mean this is a lower bound for the effects?

- How did **other support measures** affect banks (decisions)?

2. COVID AND EMPIRICAL DESIGN

- Is COVID the ideal setting to test the role of buffers?

(will there ever be one?)

- It is not easy to control for mortgage demand (as it is usually done for corporate loans – Khwaja and Mian, 2008).

- "*We test whether a* ***new loan issued to borrower*** *i in local area l by bank b in quarter t was* ***priced differently after the onset*** *of the pandemic by low surplus banks or by high CCyB pass-through rate banks*."

What is exactly being compared? Borrower characteristics (and their role) change during the pandemic.

2. COVID AND EMPIRICAL DESIGN

- Was the **heterogeneity** in the number of cases and local restrictions really important? Show supporting evidence.

- Many results are captured through double and triple **interactions**. It's not easy to understand the mechanisms at work.

- It also raises questions about the correlation between the two buffer measures.

- Why is 2019Q1 the reference period in the estimations?

3. IS THERE HOPE FOR COUNTERCYCLICAL REGULATION?

- Basel II was recognized as being (too) procyclical (Repullo and Suarez, 2013).

- The idea of countercyclical regulation has seeds in this building (Jiménez, Ongena, and Saurina, 2017).

- The results of the paper suggest that at best buffers can mitigate the procyclicality.

Suggestion: provide more descriptive insights. Did any bank actually use the buffers?

- BoE had a strategy of keeping the CCyB **structurally** above zero – do the results show that is important? Can we learn something from internationally active banks?

3. IS THERE HOPE FOR COUNTERCYCLICAL REGULATION?

- The BoE carried out **stress tests** early in the pandemic, showing banks that "the direct gains to banks of preserving capital by not lending were small. In contrast, they showed that the costs to the wider economy, and ultimately the banking system, from not lending could be very large."

Did this encourage banks to lend more?

Can the paper tell us anything about synergies/conflicts between micro and macro prudential policies?

4. MINOR ISSUES

- Structure of the paper: long methodological section; short results section. Integrate the analysis and focus more on results (and implications).

- The concept of CCyB pass-through rates is not easily grasped. Actually, the paper seems to be written primarily for a regulatory audience.

- Are the results consistent if the firm-specific PRA buffer is included (Pillar 2)?

- The extensive margin analysis is more about quantities. Maybe not needed.

- Interpret only statistically significant coefficients.

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