

Separating Retail and Investment Banking

Discussion

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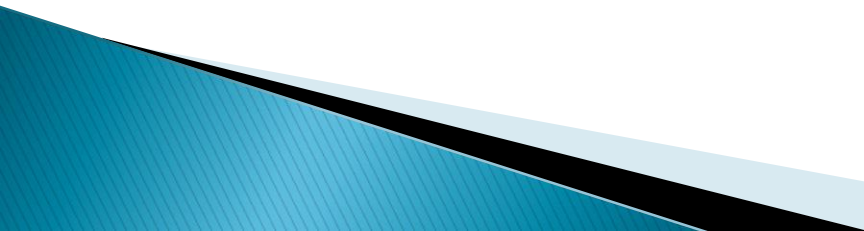
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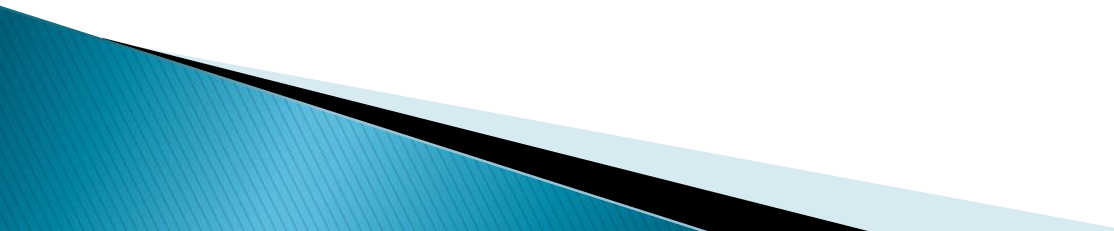
Summary

- Response of credit availability and standards to the ring fencing of retail banking from IB activities
- For identification, use of the variation in
 - loan terms issued by each bank depending on maturity
 - deposit funding available across banks that are differently involved in IB before the uk “Vickers reform“ (and IV equivalent)
- For measuring spillovers on smaller banks, use of
 - a regional indicator of their exposure to rfb

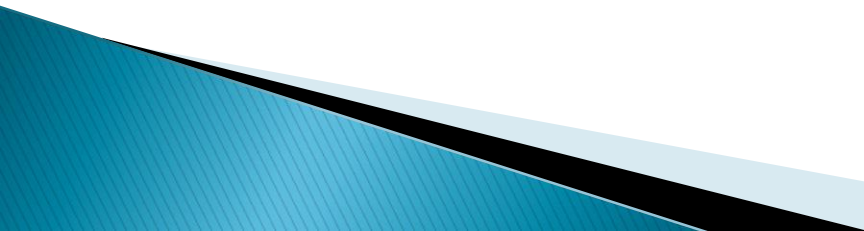
Results

- RFB mortgage spreads fall and their market share increases
 - smaller banks compete aggressively especially for high LTV mortgages
 - syndicated loans origination by the NRBF falls, especially for non UK borrowers
 - => mixed effects on credit availability and minor effects on credit standards for smaller banks only
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Discussion

- Separation versus conglomeration is a recurrent (policy) question
 - Very good data and careful analysis
 - Clearly identified contribution to banking (credit standards; synergies between loan supply and deposit taking...)
 - Striking result on the competitive spill-overs of ring fencing
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Discussion

- Economic channel
 - an internal capital market story => ring fencing eliminates internal competition for (deposit) funding
 - Questions on syndicated loans
 - Thoughts on the separation of retail and investment banking
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1. Internal Capital Market Channel

- Multimarket spillovers generated by the creation of an internal capital market (Cestone et al. (2005, 2013))
 - how internal resources are reallocated to affiliates in response to changes in actual or prospective markets
 - how this in turn affects affiliates' competitive behavior

Prediction 1. .. a market displays lower entry rates when incumbent affiliates have larger cash holdings

=> smaller competitors exit when the RFB activities rely on larger deposit funds, as IB no longer can claim them

2. Questions on Syndicated Loans

- Why did Syndicated Loans move to the NRFB when it was possible to keep them within the RFB?
 - prohibition for RFB to operate outside the EEA
 - synergies between IB and corporate lending
 - lower margins from synd. loans versus mortgages
 - moving synd. loans to NRFB as a Nash solution

AND/OR

- Is the larger reduction in the non-UK Synd. Loans only apparent?

2. More on Synd. Loans

- Cerutti and Zhou (2017, 2018) find
 - a reduction in global banking activities by core lenders (France, Germany, Japan, UK, US) due to macropru
 - an increase in local subsidiary lending that substitutes for direct foreign lending
- Can we rule out the increase of lending by foreign local subsidiaries?
 - Loan data are collected at the ultimate parent level, but balance sheets seem to refer to UK subsidiaries

3. Separating Retail and IB

- Vickers refers to resolution and bailouts
 - “easier to **resolve** banks that get into trouble; insulate .. retail banking services from external **financial shocks**; .. **reducing the expectation of bail-outs**”
- Models with endogenous bankruptcy may help inform this debate and inspire future empirical work

3. Separating Retail and IB

- Leland (2007): splitting a conglomerate into separate units insulates from shocks but prevents support
- Luciano et al (2014), Nicodano and Regis (2019)
 - creating separately-incorporated subsidiaries insulates from shocks while allowing for support among subsidiaries
 - at *the same level of debt*, joint default probability falls

Conclusion

- Very stimulating reading
 - Robust evidence that ring fencing retail banking is associated with a competitive externality
 - Consistent with internal capital market theory
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