Separating Retail and Investment Banking

Discussion

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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

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

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

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