Comments on

Bank Lending Standards Abroad: Does Home-Country Regulation and Supervision Matter?

by S. Ongena, A. Popov, and G. Udell

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Outline

- My view/summary of the paper
  - Research Question
  - Empirical Challenges
- Discussion

Paper focus

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- More broadly, what is the impact of (exogenous?) changes in the domestic banking system on a foreign country credit market?
- Theoretically, the sign of this effect is unclear. Ultimately an empirical question.

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- Ex-ante riskiness of firms may be related to the bank quality – clientele effects
- Presence of banks in a given country (and locality) is not random – endogeneity bias

This paper – Methodology

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  - Instrument bank's entry choice (regulation/supervision in that country)

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- Business lending in host country IS affected by regulation and supervision in home country
- Tighter restrictions on bank activities at home $=>$ looser lending abroad
- Increase bank competition at home $=>$ decreased and laxer lending abroad
- Poor supervision in home-country amplifies these effects
- Results consistent with theories that underlie the risk-shifting behavior abroad following restrictions on bank activities domestically

Nice paper!

- Very well executed: intriguing question, careful econometrics, interesting results
- Focus on SME helps identification
- Policy implications arising from causality
- Very timely: how should banks be regulated? What is the broad effect of these changes?

Comment I – regulatory stringency

- This variable measures the extent to which government intervenes in the banking sector
- We know government guarantee may act to amplify moral hazard and risk-taking incentives
- 2007-2008 in this respect is a crucial period
- This may explain why the positive sign in Table 5: government guarantee determines a risk-shifting behavior via a relaxation of credit standards

Comment II – capital stringency

- Under Basel II (III) capital requirements apply at the consolidated level. How much of the yield-seeking activity can be fruitfully exploited within these margins?
- Is there a different effect based on the proportion of participation on the foreign banks, or are they entirely controlled by western European banks?
- Perhaps this explains why this variable doesn't turn out significant in the analysis

Comment III – competing story

- The 2007 has marked the beginning of the subprime crisis which later became banking crisis (and now sovereign crisis)
- Degree of heterogeneity in equity performance of banks in the sample
  - Alpha Bank +20%, Raiffeisen Bank +26%, Nordea Bank +11%, PKO Bank +39%
  - ING Groep -8%, Unicredit -5%, Societe Generale -4%, Bankas Snoras -1%

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- ... and one year later
  - Alpha Bank -46%, Raiffeisen Bank -55%, Nordea Bank -12%, PKO Bank -17%
  - ING Groep -50%, Unicredit -54%, Societe Generale -52%, Bankas Snoras -76%

Comment III – competing story (cont'd)

- An alternative explanation a la Merton (1973) is as follows:
  - losses on subprime provided signal of increased riskiness of equity
  - banks shifted toward more risky investments – asset substitution effect
  - regulatory/supervisory changes *responded* to this behavior
- In this scenario, there is not a direct causality link
- Control for performance of equity?

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- In this scenario, there is not a direct causality link
- Control for performance of equity?
- More generally, can causality also go the other way around? Regulators may condition their activity based on the perceived expansion of domestic banking activity abroad.

Comment V – measuring risk

- Measure of ex-ante risk is whether the firm has its accounts audited by an external auditor
- Is this picking up firm's dimension? If auditing is voluntary, then small (# employees, volume of sales, total assets) firms may not find it worthwhile to undertake this fixed cost.
- Why not measuring economic risk with some indicator of profitability?

Comment VI – Policy implications we may think of

- Higher restrictions on banking activity & increase in bank competition (more government intervention) at home $\Rightarrow$ lower lending and looser standards abroad
- That looks like a negative externality for EM
  - How are the terms of the loans (yields)?
  - Are domestic banks exporting risk in EM?

Further comments

- You report cross-sectional stats for Bank regulation and supervision for the 2002–2005 period (T3), but not for 2008. Is your identification exploiting cross-sectional variation in countries or time-series variation?
- IV regression for banks entry include bank proximity: isn't it what we want to abstract from? How good are the instruments?
- Use clustered standard errors at some level (city) – see Petersen (RFS, 2009)