

Discussion of:
Strategic complementarity in banks’ funding liquidity choices and financial stability

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The views expressed in this presentation are those of the authors and are not necessarily reflective of views at the Federal Reserve Bank of New York or the Federal Reserve System.
Liquidity risk

• We have new regulation
  – Liquidity coverage ratio
  – Net stable funding ratio

• We have (some) good theory
  – Individual incentives to take liquidity risk
  – Joint incentives to take liquidity risk

• We don’t have (much) empirics
Strategic complementarities in risk

• Banks have incentives to take correlated risk
  – Relative performance evaluation → asset risk
  – Bailouts in liquidity crises → liquidity risk

• First-order importance for regulators
  – By definition inherently systemic risk
  – Coordination important for social planner

• Open questions:
  – Can complementarity be documented empirically
  – How big is the effect relative to idiosyncratic effects
This paper

• Look for peer effects in liquidity risk taking

• Peer effects:
  – Identification challenge due to “reflection problem”

• Liquidity risk:
  1. “Liquidity ratio”:
     liquid assets / total assets
     Net asset illiquidity minus net liability liquidity
     → increasing in illiquid assets and liquid liabilities

• Bottom line: strong peer effects with both measures

Very nice paper!
Liquidity risk

• Be more clear about mechanism
  – Funding liquidity vs. market liquidity
  – Maturity transformation vs. liquidity transformation

• Only use serious measures
  – Should include both asset and liability side
  – Berger-Bouwman GOOD; Liquidity Ratio BAD
  – Other candidates:
    • Liquidity mismatch index (Brunnermeier et al.)
    • Something based on LCR and NSFR
  – Systemic risk measures MES & SRISK
    • Quite similar in construction and interpretation
    • There are many other good measures
Liquidity risk measures

- Interesting reasons they don’t always comove?
- Bank level: Correlations? Trends?
Default risk measures

- Interesting reasons they don’t always comove?
- Bank level: Correlations? Trends?
Interpretation of peer effects

• How much variation is there to explain?
  – Within and across peer groups?

• What does $\beta = 0.5$ mean?

• Aggregate effect?
  – How much higher is liquidity risk because of peer effects?

• Moral hazard vs. information free riding
  – Small not affecting large seems consistent with MH...
Construction of peer groups

• Estimates depend strongly on group construction
• What is the intuition (economically or empirically)?
• Why is the main specification the right one?
• What’s the role of size in the LOLR peer effect?
Random comments

• Bank risk and systemic risk:
  – To assess impact of peer effects, control for liquidity risk or decompose into baseline and peer induced
• “Each bank constantly adjusts to other’s decisions”
  – Do analysis in changes instead of levels?
• Eurozone – lot’s of changes during sample period!
  – LOLR at national level?
  – All sovereign bonds equally liquid?
• Allowing $\beta$ to vary by bank and year
  – Does it change over time (in aggregate)?
• Placebo test:
  – Look for peer effects where we wouldn’t expect to find any