Discussion of "Should banks be worried about dividend restrictions?"

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Banking and Financial Stability Workshop - Santiago 2024

Research question and main results

- After GFC: new counter-cyclical capital requirements
  - goal is for banks to build up a capital buffer in good times...
  - and use it to absorb losses in bad times

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- Paper addresses this question, highlighting a time-inconsistency problem:
  - in a crisis, regulator would like to restrict dividends to ensure $\uparrow$ equity...
  - and keep capital requirements reduced to support lending activity.

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A: Without commitment, optimal capital regulation looks like single and fully releasable buffer

Model - key features

- Households:
  - supply labor inelastically, buy stocks and one-period bonds of banks
- Banks:
  - fund themselves with retained earnings (equity) and debt
  - extend loans to firms
  - frictions:
    - exogenous fraction of them exit each period $\Rightarrow \uparrow$ required return on equity
    - no-default constraint: requires some $\theta \times$lending $\leq$ discounted dividends
- Firms:
  - borrow from banks, produce final good, pay wages, repay loans, consume, exit
- Regulator:
  - seeks to achieve constrained efficiency...
  - under a time-consistency restriction ($\neq$ Schroth 2021)

Results

- Limited commitment cuts short length of time regulator can limit dividends
- Despite credibility concerns, regulator is able to avoid severe crises...
- but intermediate credit crunches are substantially more frequent
  - compared to decentralized equilibrium and full commitment case
- Main policy take-away: time-varying buffers are best
  - constant buffer $\Rightarrow$ dividend restrictions $\Rightarrow$ undermine credibility
  - actually optimal to allow banks to pay dividends even during crisis

Discussion

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  - speaks to different types of regulation seen in the real world
  - research can help guide policy changes and improve financial stability
- My discussion focuses on:
  1. nature of firms in the model and the welfare measure
  2. policy instruments and banks' endogenous response
  3. clarity of theoretical mechanisms
  4. some minor points

Comment 1: firms and the measure of welfare

- Measure of welfare in the paper: households' discounted utility
- In the paper, firms are like another type of (myopic) "household"
  - maximize one-period linear utility, eat their profits and exit
- Firms are not owned by households (only banks are)

Q: Why don't firms' profits count for welfare?

Q: Why not have households own shares of firms?

  - even if not tradable, to keep it simple
  - or add up household utility and firm profits with some Pareto weights

Comment 1: firms and the measure of welfare (cont.)

Why could this change in the welfare measure potentially matter?

- Firms receive loans from banks (k), who collect resources from households
- They face a profit non-negativity restriction for each productivity shock
  - so they probably get strictly positive profits sometimes
- Hence, they are "draining" resources from households that disappear with them and don't enter the welfare measure
- W_{CE} impacts time-consistency constraint of regulator, critical in the paper

Comment 2: the nature of regulation

- Regulator in the model lacks commitment, but in a sense is still very powerful
  - "central planner", chooses a path for all choice variables of relevance
  - although it must comply with an additional time-consistency constraint
- Instead, regulator could have a couple of policy instruments at hand (capital requirements, dividend restrictions)
- ...but banks could respond, maximizing their own profits in a decentralized equilibrium
- Studying implementation would strengthen the analysis

Comment 3: connecting equations and intuitions

- Paper could dig deeper into mechanisms using the model
- Could improve connection between explanations of mechanisms and equations

A few examples:

1. Pecuniary externality (tightening of market-based leverage constraints)
   - where in the model can we see this operating?
2. FOC of regulator's problem is left in terms of partial derivatives of W, W_{CE}
   - effects discussed under that FOC are hidden
   - this is the only theoretical result presented, and could be further explored (sharpen theoretical insights particular to the no-commitment setting)

Comment 4: calibration and robustness

Q: Are results sensitive to the calibration, in general?

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- Renders calibration and numerical computation very important
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Some specific concerns:

1. No capital accumulation; depreciation modeled in reduced form:

$$\text{Production function: } zk^{\alpha}n^{1-\alpha} + (1-\delta)\,k$$

   Q: Calibration sets δ to match replacement **investment**. Good mapping?

2. Part of analysis focuses on a particular realization of shocks

   Q: How general are the conclusions regarding dividend payments in crises?

3. i.i.d. productivity shocks buy tractability, but persistence might be important

Other minor points

- **Title:** perhaps not the most informative title for the paper?
  - Paper is really about optimal, time-consistent capital regulations
  - Concerns mostly what policymakers should be worried about, not banks
- **Exposition:** more accurate description of what is done at the introduction
  - model's key features, numerical results, etc
- **Data description:** very little detail given

Conclusion

- Credibility of regulatory bodies is an issue in many contexts
- Very pertinent question, great potential to shed further light on macroprudential regulation

Main comments:

- Paper could take better advantage of formal model to derive intuitions
- Would benefit from adjusting (or better defending) measure of welfare
- Studying implementation would broaden scope of paper and make it even more policy relevant

Looking forward to future iterations!