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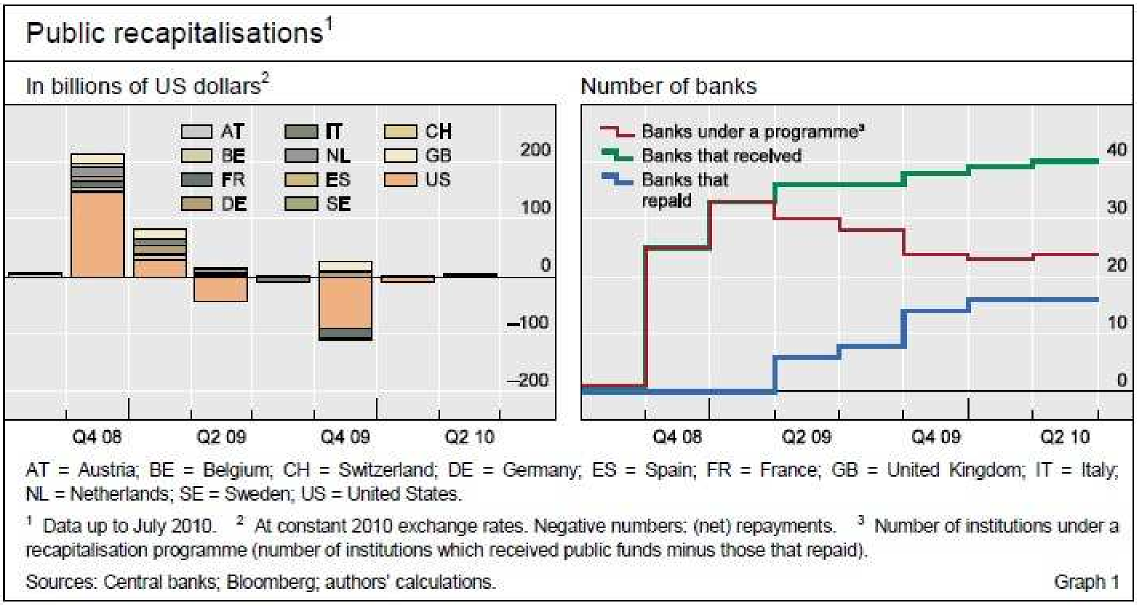
Do bailed-out banks remain bad, while good banks behave better?

Posted by **Masa Serdarevic** on Sep 18 16:08.

The trauma and cost of a public rescue must surely teach the bank management concerned to behave in a more prudent manner, right?

Wrong, according to a recent Bank of International Settlements paper.

Authors Michael Brei and Blaise Gadanecz have asked a simple enough question: what happens to a bank's lending profile, in terms of risk, following a bailout? To try and answer this, the authors looked at 87 bank holding companies in 14 countries, covering a cool $54 trillion of assets, representing some 52 per cent of the worldwide banking industry. They compared the syndicated loan book, as a proxy for willingness to take on risk, before and after a bailout. In short:



The conclusion is that a bailout made little difference to a bank's risk appetite (emphasis ours):

> *We find* ***no evidence that rescued banks reduced the riskiness of their new lending more than non-rescued banks in response to the crisis and the public rescues****. Even as lending volumes decreased across the board in 2009, rescued banks continued to write riskier syndicated loans, as reflected by their involvement in the leveraged loan segment and in the spreads charged on the facilities that they originated.* ***We also find, unsurprisingly, that the syndicated lending of banks that later received a bailout was riskier before the crisis than that of non-rescued institutions.***

While multiple factors are obviously at play when a bank gets bailed out (such as political pressure to keep corporate customers afloat), the research here suggests that when it comes to risk, bad banks largely carry on regardless.

Brei and Gadanecz also found that the rescued and the non-rescued groups varied in some important ways coming into the crisis. For example, before the crisis, rescued banks actually had a lower average loan-to-asset ratio than non-rescued banks, although rescued banks were typically more dependent on non-deposit funding, making them more vulnerable when liquidity begun to dry up. Following the crisis, rescued banks had a higher ratio of impaired to total loans "either because they were facing more impaired loans or because the rescues were associated with higher recognition of such loans", note the authors.

Rescued and non-rescued banks: overview[1]

	Rescued		Non-rescued	
Number of banks	**40**	**40**	**47**	**47**
Bank characteristics (year-end, USD trn)	**2007**	**2010**	**2007**	**2010**
Assets	31.29	30.38	21.82	24.01
Deposits	11.62	11.81	9.54	11.29
Loans	13.57	13.48	10.00	11.34
Syndicated loan signings	4.57	2.11	2.35	1.76
Net income	0.15	0.11	0.14	0.12
Balance sheet ratios (period averages, %)	Pre-crisis[2]	Δ crisis	Pre-crisis	Δ crisis
Total loans relative to total assets	45.6	–1.8	48.6	–1.3
Total deposits relative to total assets	39.6	–1.9	46.7	–1.8
Profitability (ROE)	12.4	–14.6***	9.8	–2.9***
Impaired loans over total lending	2.0	2.3***	2.8	–0.5*

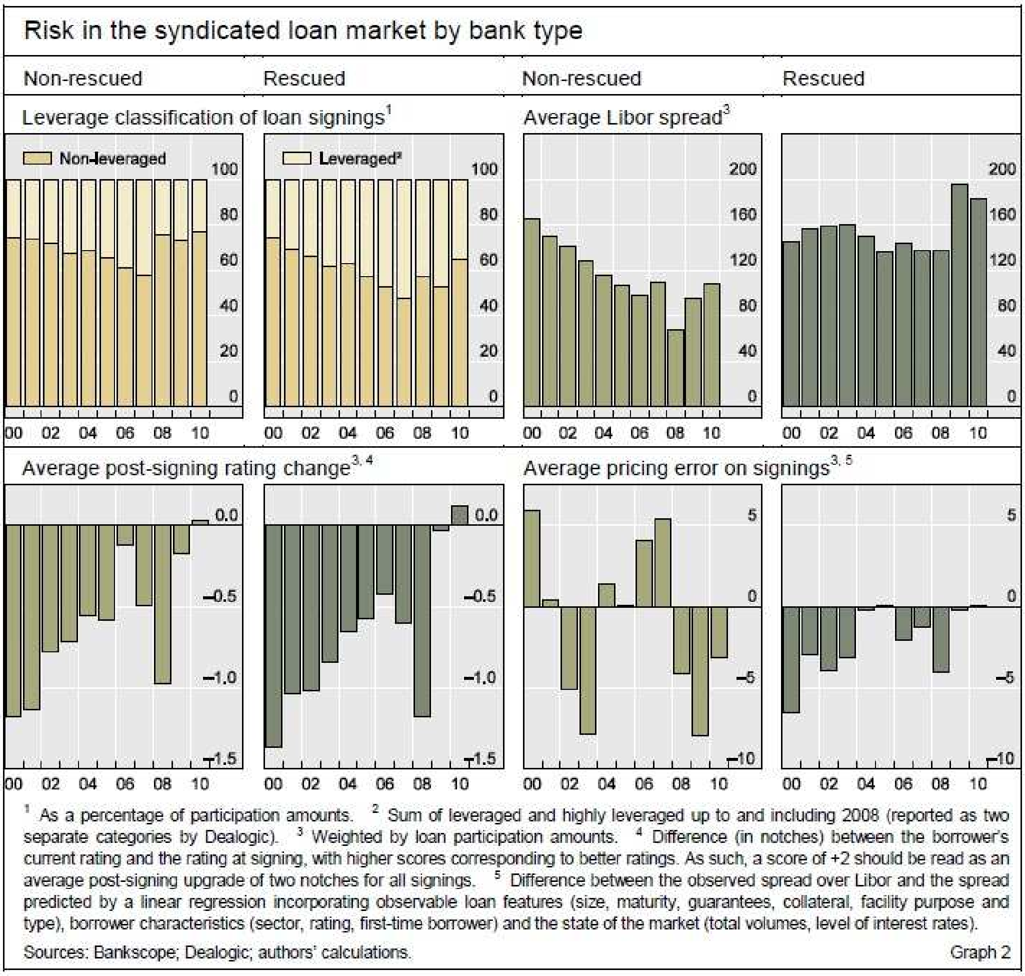
[1] The sample period is 2000–10 and includes 87 banks and 927 observations. "Rescued" denotes banks which received a public recapitalisation during 2008–10, while "non-rescued" indicates banks which did not receive such support. [2] "Pre-crisis" = 2000–07. "Δ crisis" is the value during the crisis (2008–10) minus the pre-crisis value (2000–07). ***, ** and * indicate that the differences are significant at the 1%, 5% and 10% levels, respectively, based on a weighted t-test.

Sources: Bankscope; Dealogic; authors' calculations. Table 1

Returning to the issue of the syndicated loans, why use them as a risk appetite proxy? Brei and Gadanecz:

> *With close to $7 trillion of new facilities signed in 2007, syndicated lending has been one of the largest sources of corporate funding. Syndicated loans also form a significant component of banks' total portfolio of commercial and industrial loans. Importantly, the available information on individual borrowers (like sector or nationality) and loan transaction terms (such as spreads, maturities or guarantees) makes the syndicated loan market a good laboratory for analysing bank risk.*

This is how those loans performed over time:



Risk in the syndicated loan market by bank type

[1] As a percentage of participation amounts. [2] Sum of leveraged and highly leveraged up to and including 2008 (reported as two separate categories by Dealogic). [3] Weighted by loan participation amounts. [4] Difference (in notches) between the borrower's current rating and the rating at signing, with higher scores corresponding to better ratings. As such, a score of +2 should be read as an average post-signing upgrade of two notches for all signings. [5] Difference between the observed spread over Libor and the spread predicted by a linear regression incorporating observable loan features (size, maturity, guarantees, collateral, facility purpose and type), borrower characteristics (sector, rating, first-time borrower) and the state of the market (total volumes, level of interest rates).

Sources: Bankscope; Dealogic; authors' calculations. Graph 2

As the charts above show, rescued banks issued more leveraged syndicated loans and the average Libor spreads at the rescued banks' new loans were much higher than at the non-rescued banks. The average maturity was also higher in the former group, and the loans they issued were downgraded to a greater degree than the loans issued by the non-rescued group. But the post 2007 data on syndicated loans suggests that the bailouts didn't result in rescued banks slashing their risk appetite:

> *During the crisis, rescued banks did not reduce the riskiness of their new syndicated lending compared to their non-rescued peers.* ***In fact, our results suggest that the relative riskiness of their lending increased. This is apparent when comparing how the two types of institutions changed their participation in leveraged facilities (relative to their total new signings), as well as the average Libor spread on those signings and the corresponding average maturities.***

… as you can see from this table:

Syndicated lending of rescued versus non-rescued banks[1]

	Rescued		Non-rescued		Rescued minus non-rescued		
	Pre-crisis	Δ crisis	Pre-crisis	Δ crisis	Pre-crisis	During crisis	Δ crisis
Syndicated loan signings relative to total assets (%)	12.1	–4.9***	8.1	–1.6***	4.0***	0.7	–3.3***
Share of leveraged loans in new signings (%)	38.5	3.3**	32.5	–7.7***	6.0***	17.0***	11.0*
Average Libor spread on new signings (bp)	148.8	23.1***	126.7	–36.4***	22.1***	81.6***	59.5***
Average rating change[2] (notches)	–0.8	0.4***	–0.7	0.3***	–0.1**	0.0	0.1
Average maturity of new signings (years)	4.5	1.2***	4.3	–0.2	0.2**	1.6**	1.4
Average pricing error[3] on new signings (bp)	–2.5	1.1	0.5	–5.6**	–3.0**	3.6	6.7

[1] See Table 1, footnotes 1 and 2. Averages are weighted either by total assets or syndicated loan participations. "During crisis" = 2008–10. [2] See Graph 2, footnote 4. [3] See Graph 2, footnote 5.

Sources: Bankscope; Dealogic; authors' calculations. Table 2

As the table shows, the non-rescued banks **did** reduce their risk. Good (or less-bad) banks behaved better. They made smaller leveraged loans (as a percentage of new signings) and the average Libor spread on new signings fell significantly.

Maybe this a natural and obvious outcome: it was a threat of state intervention (and management sackings) that encouraged banks that had avoided bailouts to stay out of trouble; meanwhile, bailed out banks were already in the mire, so the motivation to slash risk was just not there…

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This entry was posted by Masa Serdarevic on Tuesday, September 18th, 2012 at 16:08 and is filed under Uncategorised. Tagged with bank bailouts, bis, Risk, syndicated loans.

Comments

The banks were rescued cause they made bad bets; those bets didn't all miraculously end at the point of rescue, did they? Yes, getting out of the hole takes time. Thanks.

Bailouts bad. Didn't need more proof.

Makes perfect sense, Irish banks are loading up on dangerous loans again, recently giving a mortgage to a six month dead cat. Same with the Icelandic banks, Citigroup, RBS, Halifax. They are all going crazy again.

Actually most people's logic goes the other way, that moral hazard causes bailed-out banks to take more risk than banks that weren't bailed out.

Erm, isn't the point of syndicated loans that they get sold on to CLOs, smaller banks, pension funds etc rather than retained by original syndicate? Irrelevant input data = irrelevant conclusion. @ Wraithlin makes good point too. Shame on BIS for publishing this nonsense, they've got far more important tasks to spend their limited resources on.

This isn't really the best period to look at because governments have been pushing rescued banks to keep providing credit to the "real" economy.

Erm... couldn't the BIS afford to send an analyst team to Japan ? Am always amazed that the "here's one we made earlier" example just waiting to be looked at for a guide to our current situation gets so little attention.
