



FEDERAL  
RESERVE  
BANK  
*of* ATLANTA

***"Shocked by Bank Funding  
Shocks: Evidence from 500 Million  
Consumer Credit Cards"***

Sudheer Chava, Rohan Ganduri, Nikhil Paradkar,  
and Linghang Zeng,

and

***"The Impact of Skin in the Game on  
Bank Behavior in the Securitization  
Market"***

Martin Hibbeln, and Werner Osterkamp

**Comments by Larry D. Wall  
Federal Reserve Bank of Atlanta**

The views expressed here are mine alone and not necessarily  
those of the Federal Reserve Bank of Atlanta, or the Federal  
Reserve System.

Two papers on retail funding that seem appropriate for Halloween

1. Chava et al. summarizes the horror felt by many credit card customers when their credit lines were “**Shocked**”
2. Hibbeln and Osterkamp focusing on what sounds like the title of a horror movie: “**Skin in the Game**”
  - Papers important for future financial system because nobody wants to see a remake of the 2007-09 horror scenes we saw in the “**Nightmare on Main Street**”

- Post-crisis changes to financial system
  - Stricter regulation to prevent systemic crisis
  - FinTech firms using technology to more efficiently serve customers
- Post-crisis implementation of stricter regulation across the board
  - Stress test of capital with goal that banks should not create or amplify impact of shocks to real economy
  - Explicit minimum liquidity requirements so that banks could meet liquidity stress scenario without having to borrow from the central bank
- FinTech firms providing retail lending
  - Initially most focused on new funding approach: peer-to-peer
  - Now, reliance on wholesale funding using loan sales similar to securitization but with no skin in the game

# RETAIL LOAN FUNDING

Questions for the future raised by these studies



1. Should we be worried about future liquidity shocks affecting banks ability to lend?
  - If yes, note new liquidity regulation will not necessarily protect this
    - Stress tests of capital have explicit goal of not just surviving but being able to continue funding good loans but
    - New liquidity regs only require that banks be able to meet a liquidity stress scenario without having to borrow from the central bank
  
2. Is skin in the game helpful in sustaining markets by reducing adverse selection and moral hazard?
  - If yes, should we be concerned about the FinTech lending model?

# ***Shocked by Bank Funding Shocks***

## Summary



- Paper uses credit card level data to study changes in credit lines and borrowing from prior to the crisis to after the crisis
  - The paper's baseline analysis is from customers with credit cards from more than one bank
- Results
  - Banks that relied more on wholesale funding were more likely to cut lines
  - The cuts in the lines were larger for lower credit quality customers
  - Cardholders whose lines were cut reduced their borrowing as they were not able to fully offset the reduction in lines
  - This reduction led to a decline in their consumption financed through credit cards

# ***Shocked by Bank Funding Shocks***

Comments: Shock may have come from capital

- There were a lot of moving parts during the crisis
- Many of the largest banks were among the largest card issuers and they were reliant on wholesale funding
  - But they faced a variety of other issues, including in many cases, concerns about their capital adequacy
- The paper includes regulatory risk-based capital ratios as an explanatory variable
  - Regulatory capital uses accounting measures of capital which were widely criticized for loss reserves being “too little, to late”

# ***Shocked by Bank Funding Shocks***

Comments: Shock may have come from capital



- Better measures of potentially binding capital constraints
  1. Participation in the Supervisory Capital Assessment Program (SCAP or the stress tests) which sought to identify under-reserved loans
  2. Participation in TARP's capital assistance programs
    - No participation – smaller banks signaling strong capital position
    - Participated but repaid at earliest opportunity – Largest banks required to participate and some small banks did so voluntarily
      - Early repayment incented after rules were changed to limit executive comp and dividends until capital was redeemed
    - Participated but were only allowed to repay with a delay

1. How exactly is “wholesale funding defined”?
  - Does it include reliance on securitization to fund credit card portfolios?
  - If not, how should we think about the role of securitization?
  
2. Table 1 discussion in the text (pages 15-16)
  - Discussion of Panel A correctly observes that many of the balance sheet differences between high and low exposure banks are not statistically significant
  - Discussion of Panel B points to many differences between the customers of high and low exposure banks, but in many cases fails to note the differences are not statistically significant (such as credit scores and income)
  
3. Proofread p. 13. Duplicate text (“We group ...”)

# THE IMPACT OF **SKIN IN THE GAME** ON BANK BEHAVIOR

## Overview: Model results

- Concerns about securitization
  - Adverse selection on the part of originators
  - Moral hazard on the part of loan servicers
- Europe provides an opportunity to test given two post-crisis initiatives
  - Mandatory risk retention rules for ABS marketed to European investors adopted in 2011 but not required for non-European investors
  - ECB loan level database initiative
- Methodology
  - Analyze RMBS deals from banks that issued deals with and w/o retention
  - Compare loan characteristics and time to securitize for adverse selection
  - Compare monitoring and restructuring for moral hazard
- Results suggest evidence of greater adverse selection and moral hazard for loans with no retention

1. Consider shrinking the sample period
  - Paper includes 2009 a year zero “Retention Deals”
  - Paper also includes 2015-2017 with zero “No-Retention Deals”
  - Probably can’t drop all of 2009 but otherwise do a robustness test dropping years with zero deals in one of the categories
  
2. Cannot use variables observable at time of securitization as measures of adverse selection
  - Paper uses observable variables: time to securitize, interest rate, loan to value, ...
  - But adverse selection arises when the seller has private information that the loan is worth less than would be expected based on public information

### 3. Increased monitoring may be due in part to the stress tests

- Europe has also had a series of stress tests and asset quality reviews since the crisis
- These reviews and tests may force regrading of assets that are on the bank's balance sheet

### 4. Provide more discussion of institutional details

- Where all loans from each bank originated in only one country?
  - Countries differ in bankruptcy laws and enforcement
- Does the originator always service the loans in Europe?
- Are these all private, commercial banks? Or are some state-owned or coops?
- Does the sample include any covered bonds?

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