Private Equity Investment in U.S. Banks

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2018 Chicago Financial Institutions Conference

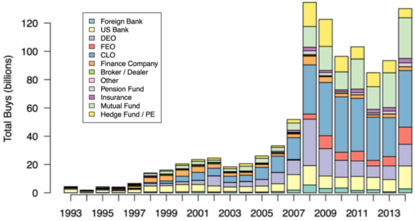
April 2018

Very interesting paper

- Fascinating question. Important context. Policy relevant.
- Detailed discussion of PE regulation
- My discussion:
  1. PE in other contexts
  2. Banking context
  3. What are the alternatives for FDIC?

Why is this interesting?

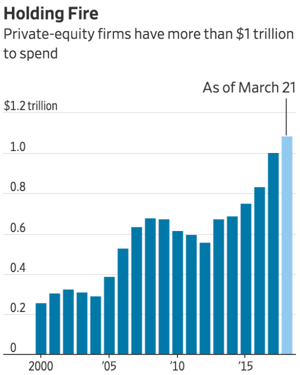
Bank assets on sale



- PE can acquire bank assets elsewhere (avoiding regulation)
- Suggests operating efficiency gains **not** liquidity provision

Why is this interesting?

Dry powder



- Policy Q: Should FDIC unshackle PE?

#1 Real outcomes of PE investments in industrial firms

- PE improves operations:
  1. Efficient resource allocation among U.S. manufacturing plants
  2. Fewer health code violations among Florida restaurants
  3. Improves workplace safety
  4. Increases product variety among retailers
  5. Investments in innovation
  6. Funding inflows during times of marketwide stress
  7. Better long-run worker outcomes due to IT investments

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  1. Not willing to "insure" obsolete workers
  2. Bad outcomes for communities (ex: Anchor-Hocking case)

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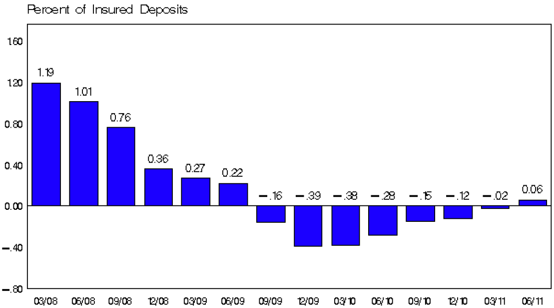
- **This paper:**
  - Aggressive risk culture at PE versus commercial banks

#2 U.S. banking context



- Deposit insurance fund in negative territory
- FDIC willing to accept private capital (from non-banks)

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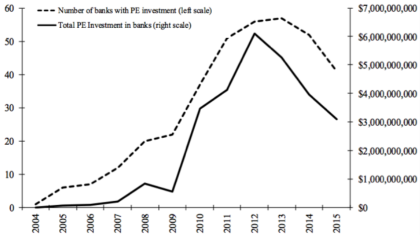

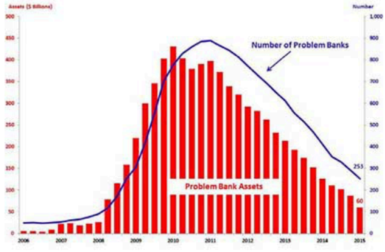

- Problem bank list $\Longrightarrow$ PE entry

#2 U.S. banking context

- PE "bottom-feeds" on **small, failing banks**. Why?
  1. Bigger banks can issue public equity
  2. FDIC auctions are too competitive
  3. WaMu disaster:
     - $7bn of PE finance in 2008
     - TPG capital lost $500m of $1.35bn investment

- Is the **magnitude of investment small**?
  - 2012 peak: $7bn on $1.5tn of bank equity (0.005%)
  - For comparison, PE peaks at 0.8% industrial employment in 2005
  - FDIC constraints appear to bind

#2 U.S. banking context

Open questions

1. Greater **systemic risk** seems implausible for small banks
   - What if FDIC lifts restrictions and PE goes big next time?
2. Is risk-taking "excessive" or not?
   - Why doesn't PE act efficiently for banks vs. industrials?
3. Might PE break implicit contracts in banking context?
   - Community-driven lending
   - Mortgages for underrepresented communities
   - Small business lending

   ... Sid Vij's **"Acquiring Failed Banks"** shows restructuring:
     - SME lending cut
     - Target branches closed
     - Acquiring banks capture **deposit franchise**

#3 What are the trade-offs for U.S. regulators?

1. FDIC must **safeguard DIF at all costs**
   - Absent PE, bank will fail $\implies$ DIF incurs loss
   - Accept PE despite excessive risk, bank fails later
   - Postponing DIF losses might be valuable

2. Duty to **protect customers and communities**
   - PE breaks implicit contracts imposing social externalities
   - Can this be assessed?
     - Look at HMDA and CRA loans post-PE
     - Branch closings in vulnerable neighborhoods
     - Are there real effects for firms and h

... Policy choice should weigh benefits and costs

Thank you!