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Comments on: "Bank Examiners' Information and Expertise…" by Calomiris and Carlson

David C. Wheelock

Federal Reserve Bank of St. Louis

Main Question and Results

- Did 19th century OCC bank examiners uncover information (hard or soft) that helps predict bank failures or other outcomes, or that enhanced market discipline?
- Main Results:
  - Exam info (hard and soft) helps explain expected (by examiner) losses;
  - Exam info (hard and soft) helps predict bank failures during the Panic of 1893;
  - Exams help explain growth of surplus and undiv profit, and change in OREO;
  - Recommendations to skip dividend helps explain actual skips and loan charge offs;
  - Skipping a dividend resulted in higher interest rates paid on borrowed funds, suggesting that examinations enhanced market discipline by revealing information about a bank’s condition to the market.

General Questions/Comments

- With only 41 examiners for 3800 banks, and given how examiners were compensated, it's remarkable that exams seem to have uncovered anything of value.
- Did exams result in fewer bank failures or losses to depositors?
  - Evidence that exam info *predicts* failures does not necessarily mean that examinations *reduced* number of failures or ultimate losses to depositors. Evidence that dividend omissions increased the cost of funds is certainly suggestive, but perhaps more could be done to quantify the impact on failures or losses.
- How fast did exam info decay? Cole and Gunther (1998) find that exam ratings help predict failures only over short horizons (< 6 months); call reports do better over longer horizons. (Of course, exams might help ensure the accuracy of call reports.)

Dividend Recommendations

Examiner recommendations help explain dividend omissions, but how many dividend payouts did examiner recommendations actually prevent?

- Anecdotal evidence indicates that banks were reluctant to skip a dividend, and paper finds that a recommendation increased the likelihood that a bank omitted its dividend by 23%.
- But sometimes omitting a dividend would be in the best interests of the bank – especially with double liability on bank shareholders, and presumably bankers had the same soft information that examiners had. Recommendation might be capturing info that a banker would have acted upon anyway.
- More evidence that examiner recommendations *caused* banks to omit dividends would be helpful, e.g., how many recommendations led to enforcement actions? In the sample, did banks ever skip dividends without an examiner recommendation? Or, not skip when recommended?

Regression Variables

- Regressions for failure, income, and ΔOREO include public call report items, e.g., capital/assets, OREO/assets, and due from banks/assets, but why not loans/assets, securities/assets, or due to banks/liabilities?
  - loans/assets, etc., commonly included in bank failure studies.
  - due to banks/liabilities: Depositors might be more likely to run on banks that are susceptible to interbank runs.
- Regressions also include environment variables, e.g., county population. Perhaps add %Δ pop (1880-90) to capture econ growth, and some measure of market structure, e.g., concentration ratio, banks/pop, or bank's market share.

Other Questions

- Did dividend omissions cause deposit outflows, as well as higher interest rate on borrowed funds? (Dang and Helwege 2018)
- Is the effect of a dividend omission on interest rates (or deposit flows) the same if not recommended by examiner? (Or were all skips recommended?)

Final Comments and Conclusion

Takeaway – Policy Implications?

- Supervision seems to have influenced dividends and charge offs, but did it make the system more stable?
- Can revealing information be destabilizing in a crisis, or is more info always better? (Dang and Helwege 2018)
- Would exams have been as beneficial in a system that was inherently more stable, e.g., a Canada-style system?

Very nice paper -- provides a lot of interesting information about how banking supervision can enhance the stability of an inherently unstable banking system.