

Winning Connections?

Special Interests and the Sale of Failed Banks

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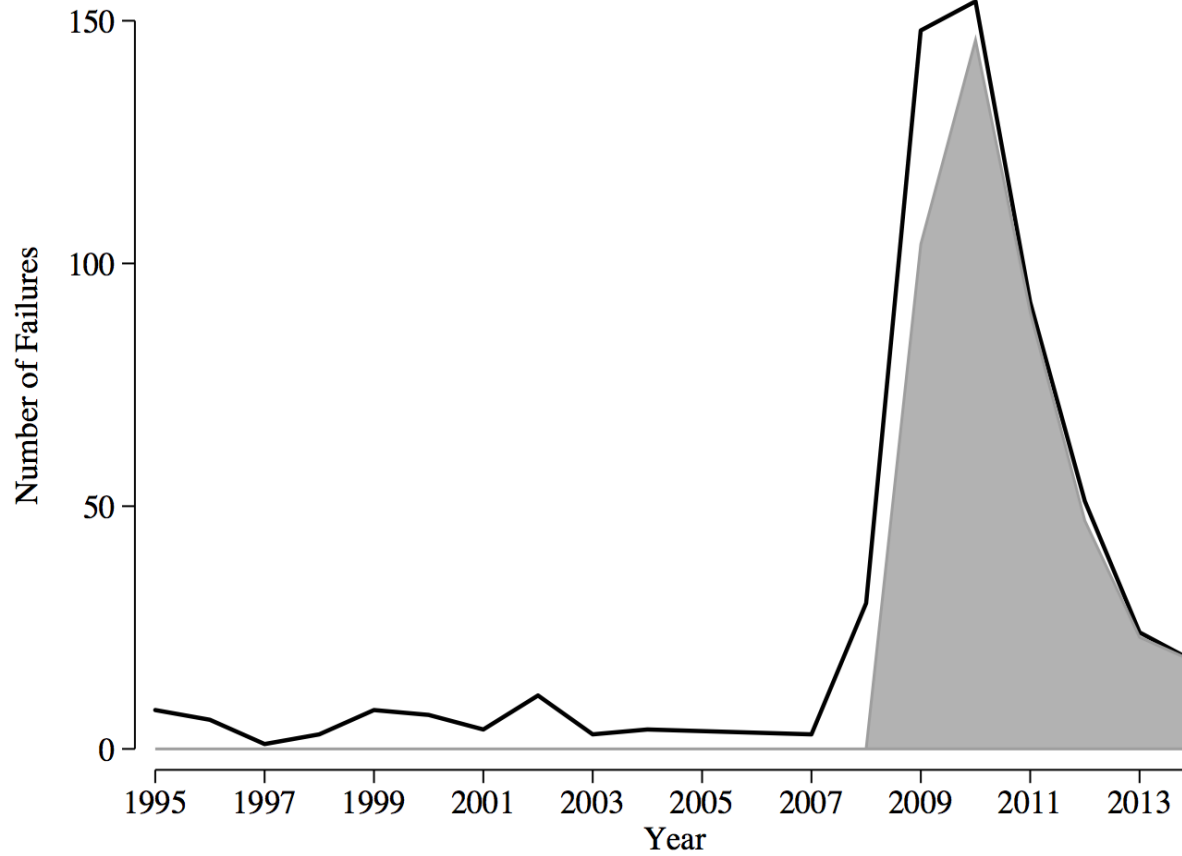
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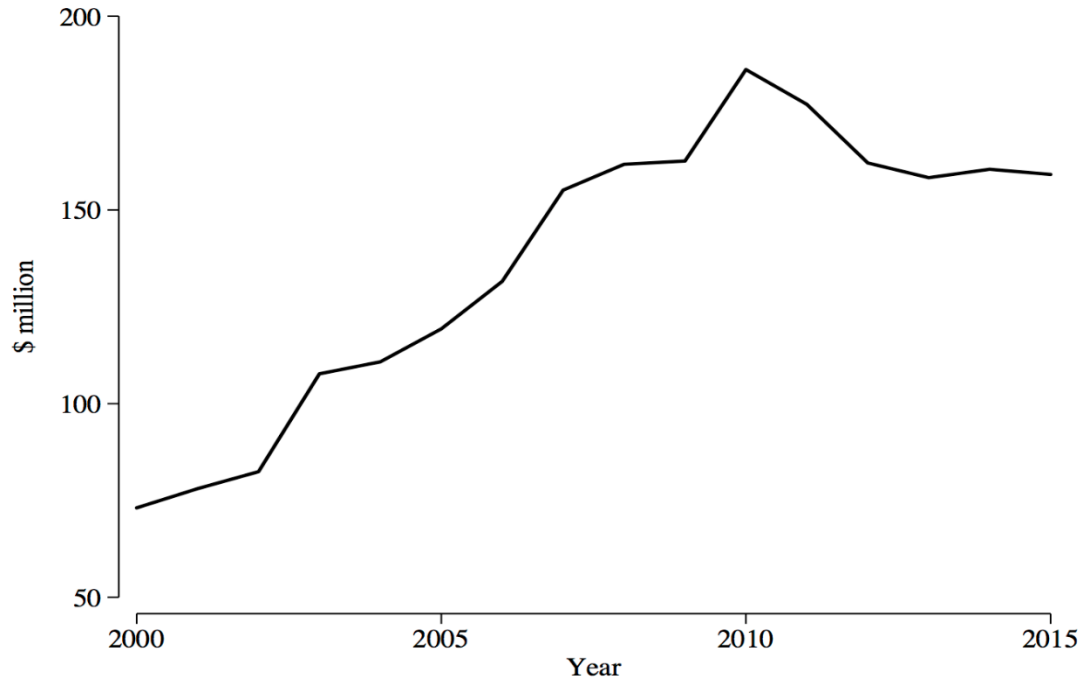
Bank Failures in the U.S.



The Sale of Failed Banks

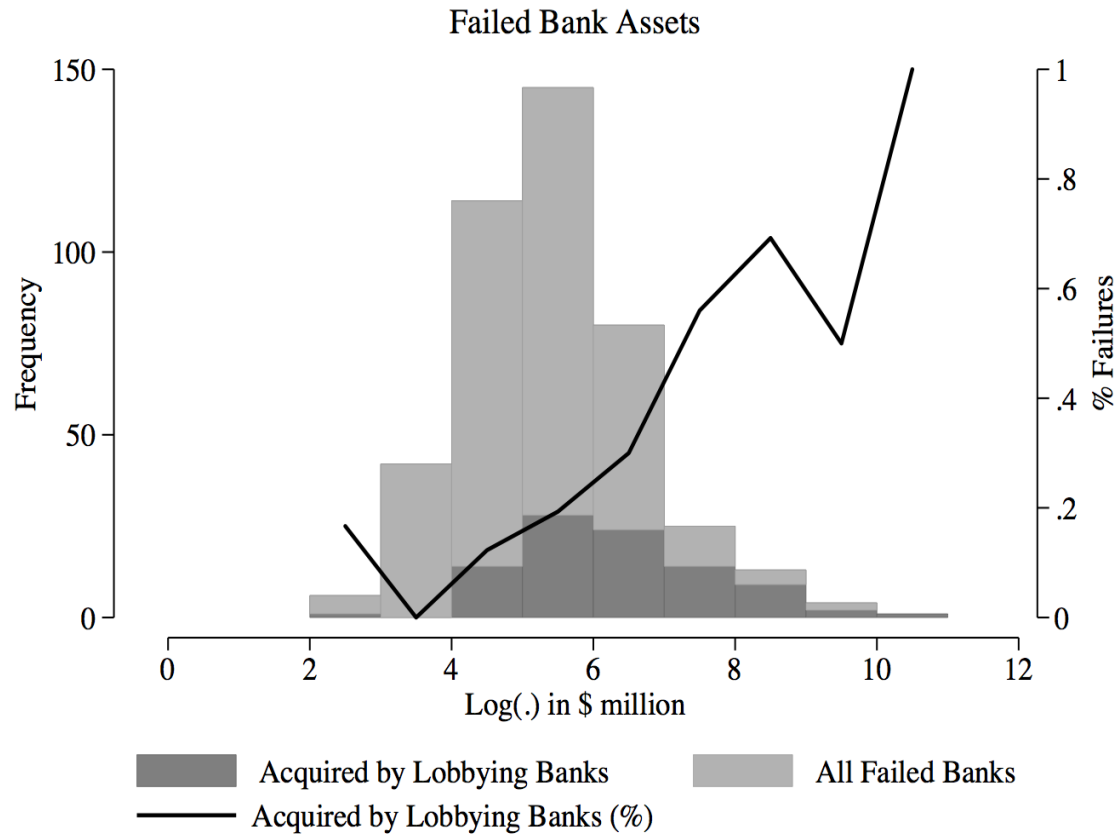
- The FDIC acts as the receiver, or the liquidating agent, for failed, federally insured depository institutions
- FDIC sold 470/509 banks in receiverships from 2007 to 2014 (~90%)
- These failures imposed substantial costs on the FDIC
 - The average cost of a sold failed bank in our sample is ~24% of the failed bank's assets
 - The resolution of bank failures led to Deposit Insurance Fund (DIF) costs of ~\$75 billion
- Also large recipients of government programs (e.g. TARP)

Lobbying by Prospective Bidders



FDIC criteria: (1) be a financial institution or in the process of applying for a bank charter; (2) be well-capitalized; (3) possess a CAMELS rating of 1 or 2; (4) have a satisfactory anti-money-laundering record; (5) have a satisfactory CRA rating; (6) be sufficiently large (i.e. twice the size of the failed institution if located in the same state, even larger otherwise).

Eventual Acquirers Engaged in Lobbying



This Paper

- Goals:

1. Empirical examination of the impact of bank lobbying on the auction process
2. Assessment of the economic consequences (cost to the seller and post-acquisition efficiency) associated with bank lobbying

- Findings:

1. Lobbying bidders are more likely to win the auction
 - Lobbying increases a bidder's probability of winning by 26.4pp
2. Lobbying bidders have to pay relatively less in order to win
 - The transfer to lobbying bidders is estimated at \$7.4 billion for the DIF (= 16.4% of the total resolution losses)
3. Lobbying distorts the efficient allocation of failed banks
 - Post-merger operating and stock market performance deteriorates at lobbying banks

Literature

- S&L crisis
 - James and Wier (JME 1987); Giliberto and Varaiya (JF 1989); James (JF 1991)
- Great Recession
 - Granja (JAR 2013): disclosure requirements
 - Cole and White (JBF 2017): costs of regulatory forbearance
 - Granja, Matvos and Seru (JF 2017): frictions due to acquirers' willingness and ability to pay
- Political economy of bank failures
 - Brown and Dinc (QJE 2005); Imai (JMCB 2009); Liu and Ngo (JFE 2014)
- Lobbying and the financial crisis
 - Duchin and Sosyura (JFE 2012); Igan, Mishra and Tressel (NBER 2012); Igan and Mishra (JLE 2014); Lambert (MS 2018)

The Resolution Process

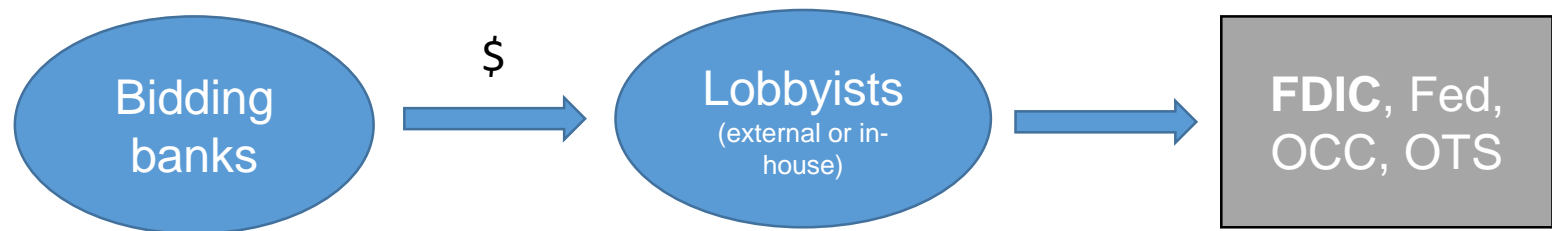
- Information gathered and failed bank marketed
 - E-mail inviting prospective buyer to secure data-room
 - Confidentiality agreements
 - Information about failed bank and P&A transaction
 - On-site due diligence (very limited and swift)
- Bidding and Selling
 - Mandate: limit losses to Deposit Insurance Fund
 - FDIC selects winning bidder using proprietary “least-cost” test
- FDIC’s discretion and power
 - The benefits are speed and clear expectations
 - The downside is a lack of transparency, including fairness, of the sale of failed banks

Auction Sample Construction

	Sample	Obs.	Aggregated Deposits	Aggregated Assets	Aggregated Resolution Cost
All failed banks, excluding 13 assistance transactions (2007-2014)		509	315,774	384,831	75,045
– Payoffs (no acquirer)		–26	13,888	15,901	4,467
– PIs (acquiring insured deposits only)		–13	27,673	40,341	15,284
– No auction disclosures		–39	37,517	49,682	10,226
– Two acquirers		–1	514	585	67
P&As with auction disclosures		430	236,167	278,306	44,992
1 bidder		147	59,017	66,082	15,939
2 bidders		81	59,076	73,229	10,805
3 bidders		79	40,514	47,809	8,294
4 bidders		58	37,688	45,206	5,457
>4 bidders		65	39,872	45,979	4,497

Bank Lobbying Activities in the U.S.

- Lobbying is pervasive in the U.S. democratic process (Drutman, 2015)
 - Lobbyists attempt to sway the influence of regulators and politicians on specific issues, using a combination of contacts, expertise, persuasion and public relation skills
- Lobbying Disclosure Act of 1995 imposes strict disclosure rules for every individual and firm lobbying the Congress and federal agencies
 - Lobbyists have to file **registration and periodic reports** indicating the amounts received by clients, the issue areas, and agencies lobbied
- In our context:



Bidding Banks: Descriptive Statistics

	Obs.	Mean	Std. Dev.	25 th Percentile	Median	75 th Percentile
<i>Financial Characteristics:</i>						
Total Assets (\$million)	1135	8840.63	33379.3	520.68	1466.58	3788.68
Liquidity Ratio	1051	25.12	11.32	17.06	23.1	31.73
CRE Loans (%)	1135	14.23	9.1	7.47	12.26	18.88
C&I Loans (%)	1135	24.99	15.54	14.68	22.51	30.99
Residential Loans (%)	1135	45.67	21.57	32.68	47.88	62.14
Tier 1 Capital Ratio	1088	15.78	6.96	11.83	13.88	17.09
NPL Ratio	1051	6.18	5.3	2.51	4.87	8.11
OREO Ratio	1135	1.04	1.13	0.21	0.65	1.43
Core Deposits (%)	1051	86.3	10.76	81.94	89.4	94.19
State Bank	1135	0.73	0.45	0	1	1
Estimated CAMELS Rating	1118	1.6	0.62	1	1.5	1.5
<i>Proximity to Failed Banks:</i>						
Eligible Bidder	1051	0.61	0.49	0	1	1
Distance	1134	5.42	1.34	4.4	5.48	6.52
Distance CRE Loans (%)	1083	23.16	19.23	8.39	17.72	33.45
Distance C&I Loans (%)	1083	8.9	8.14	2.83	6.54	12.43
Distance Residential Loans (%)	1083	14.87	13.63	5.18	11.54	19.75
Change in HHI	1156	1.75	9.27	0	0	0.07
<i>Lobbying Expenditures:</i>						
Lobbying Regulators > 0	1156	0.06	0.25	0	0	0
Lobbying Regulators (\$000)	1156	42.56	220.01	0	0	0
Lobbying Regulators (log)	1156	0.83	3.17	0	0	0
Active Lobbying	1156	0.18	0.39	0	0	0
Lobbying > 0	1156	0.12	0.32	0	0	0
Lobbying (\$000)	1156	86.72	338.77	0	0	0
Lobbying (log)	1156	1.46	4.05	0	0	0

Average targeted
lobbying on
regulators per
lobbying
bidder/year:
~\$710,000

Auction Winning Likelihood and Bidder Lobbying

	(1)	(2)	(3)	(4)
	Pr(Win)			
Lobbying Regulators > 0	0.1858*** (0.0648)	0.3425*** (0.0648)	0.2640*** (0.0680)	
Lobbying Regulators				0.0208*** (0.0051)
Quarter Fixed Effects	Yes	Yes	Yes	Yes
Failed Bank State Fixed Effects	Yes	No	No	No
Failed Bank Fixed Effects	No	Yes	Yes	Yes
Bidder Controls	No	No	Yes	Yes
Pseudo R-squared	0.059	0.074	0.101	0.101
Auctions	423	282	235	235
Observations	1149	1008	809	809

Economic Magnitudes

- Bidder lobbying status (Model 3):
 - Targeted lobbying on regulators increases a bidder's probability of winning by 26.4pp
- Bidder lobbying expenditures (Model 4):
 - A one SD increase in targeted lobbying expenditures on regulators increases a bidder's probability of winning by 6.6pp

Instrumental Variable Results

	(1)		(2)	
	2 nd Stage	1 st Stage	2 nd Stage	1 st Stage
	Pr(Win)	Lobbying Regulators > 0	Pr(Win)	Lobbying Regulators
Lobbying Regulators > 0	0.2183** (0.0949)			
Lobbying Non-Regulators > 0		0.5459*** (0.1032)		
Lobbying Regulators			0.0175** (0.0078)	
Lobbying Non-Regulators				0.6460*** (0.1108)
Quarter Fixed Effects	Yes	Yes	Yes	Yes
Failed Bank Fixed Effects	Yes	Yes	Yes	Yes
Bidder Controls	Yes	Yes	Yes	Yes
Wald Chi-squared	0.4161		0.2319	
Wald <i>p</i> -value	0.5189		0.6301	
Auctions	234		234	
Observations	803		803	

> Instrumented results mirror those from probit specifications

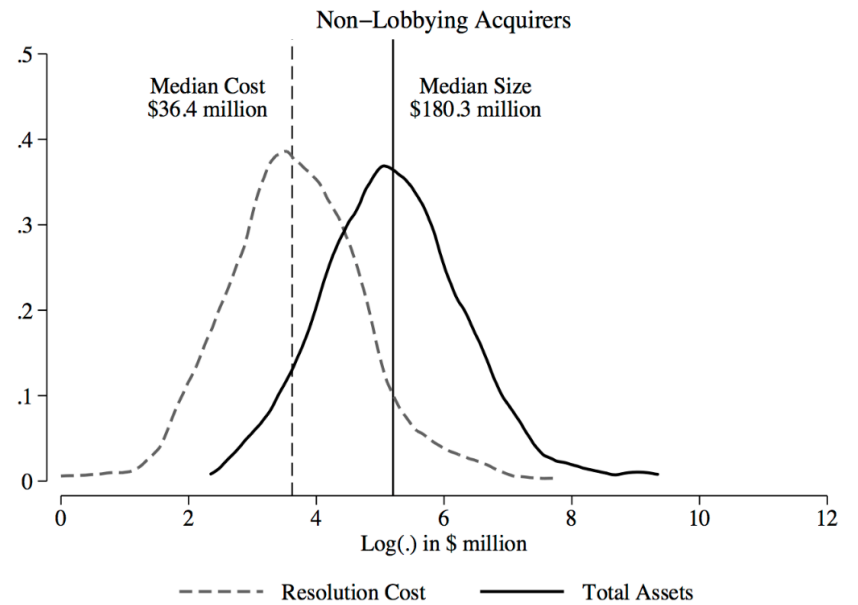
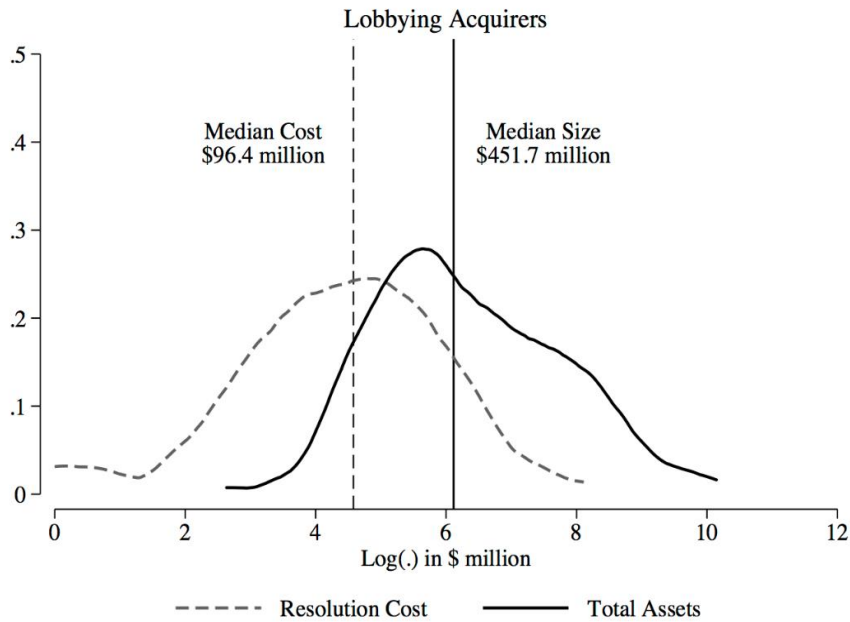
Alternative Lobbying Measures

	(1)	(2)	(3)	(4)	(5)	(6)
	Pr(Win)					
Lobbying through Revolving-Door Lobbyists > 0	0.5850*** (0.0767)					
Lobbying Regulators through Revolving-Door Lobbyists > 0		0.7047*** (0.1432)				
Lobbying Regulators Before > 0			0.3085*** (0.0703)			
Lobbying Regulators Before				0.0235*** (0.0053)		
Lobbying FDIC > 0					0.2477*** (0.0618)	
Lobbying FDIC						0.0198*** (0.0051)
Quarter Fixed Effects	Yes	Yes	Yes	Yes	Yes	Yes
Failed Bank Fixed Effects	Yes	Yes	Yes	Yes	Yes	Yes
Pseudo R-squared	0.121	0.121	0.107	0.108	0.098	0.098
Auctions	234	234	234	234	234	234
Observations	803	803	803	803	803	803

Competition within Auctions

	(1)	(2)	(3)	(4)
	Lobbying Regulators > 0		Lobbying Regulators	
	Pr(Win)			
Number of Bidders = 2	0.6799** (0.2919)		0.0544** (0.0222)	
Number of Bidders > 2	0.1786** (0.0714)		0.0142*** (0.0051)	
Number of Bidders = 2		0.6819** (0.2916)		0.0546** (0.0222)
Number of Bidders = 3		0.2748** (0.1363)		0.0205** (0.0102)
Number of Bidders = 4		0.2968** (0.1341)		0.0269*** (0.0083)
Number of Bidders > 4		0.0941 (0.1295)		0.0075 (0.0097)
Quarter Fixed Effects	Yes	Yes	Yes	Yes
Failed Bank Fixed Effects	Yes	Yes	Yes	Yes
Bidder Controls	Yes	Yes	Yes	Yes
Pseudo R-squared	0.108	0.108	0.109	0.110
Auctions	234	234	234	234
Observations	803	803	803	803

Resolution Costs



Do Lobbying Bidders Pay Less?

	(1)	(2)	(3)	(4)
	Net Discount Differential (%)			
Diff. Lobbying Regulators > 0	2.4037*** (1.0872)			
Lobbying Regulators > 0		2.6498** (1.2721)		
Cover Bidder Lobbying Regulators > 0		-1.6356 (1.3889)		
Diff. Lobbying Regulators			0.1776** (0.0821)	
Lobbying Regulators				0.1933* (0.0964)
Cover Bidder Lobbying Regulators				-0.1305 (0.1095)
Quarter Fixed Effects	Yes	Yes	Yes	Yes
Failed Bank State Fixed Effects	Yes	Yes	Yes	Yes
Failed Bank Controls	Yes	Yes	Yes	Yes
Bid Characteristic Controls	Yes	Yes	Yes	Yes
Number of Bidders Fixed Effects	Yes	Yes	Yes	Yes
Adjusted R-squared	0.452	0.449	0.451	0.448
Observations	247	247	247	247

> The transfer to lobbying bidders is estimated at **\$7.4 billion** for the DIF, or **16.4 percent** of the total resolution losses of \$45 billion

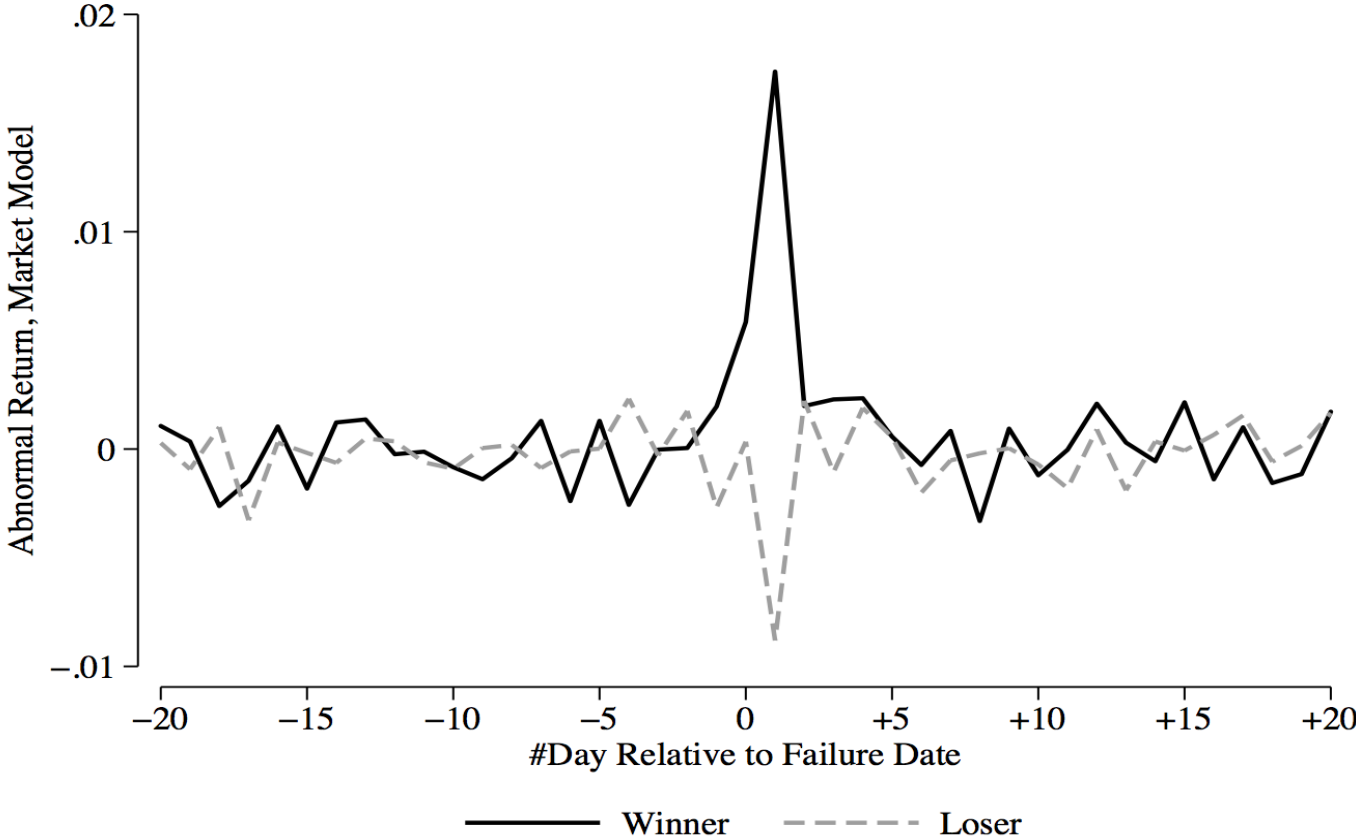
Do Lobbying Bidders Pay Less?

	(1)	(2)	(3)	(4)
	Pr(Acquirer Net Discount > Cover Bid)			
Diff. Lobbying Regulators > 0	0.3160*** (0.0656)			
Lobbying Regulators > 0		0.3220*** (0.0668)		
Cover Bidder Lobbying Regulators > 0		-0.1788 (0.1184)		
Diff. Lobbying Regulators			0.0227*** (0.0047)	
Lobbying Regulators				0.0234*** (0.0049)
Cover Bidder Lobbying Regulators				-0.0133 (0.0093)
Quarter Fixed Effects	Yes	Yes	Yes	Yes
Failed Bank State Fixed Effects	Yes	Yes	Yes	Yes
Failed Bank Controls	Yes	Yes	Yes	Yes
Bid Characteristic Controls	Yes	Yes	Yes	Yes
Number of Bidders Fixed Effects	Yes	Yes	Yes	Yes
Pseudo R-squared	0.535	0.535	0.529	0.530
Observations	202	202	202	202

Post-Acquisition Efficiency

	(1)	(2)	(3)	(4)
	ROA		Cost-to-Asset Ratio	
(Lobbying Regulators > 0) * Post-Acquisition	-0.1771*** (0.0272)		0.0473* (0.0266)	
Lobbying Regulators * Post-Acquisition		-0.0142*** (0.0021)		0.0038* (0.0021)
Post-Acquisition	0.0760*** (0.0258)	0.0761*** (0.0258)	-0.0107 (0.0197)	-0.0108 (0.0197)
Quarter Fixed Effects	Yes	Yes	Yes	Yes
Joint-Bank Fixed Effects	Yes	Yes	Yes	Yes
Bank Controls	Yes	Yes	Yes	Yes
Adjusted R-squared	0.343	0.343	0.615	0.615
Auctions	400	400	400	400
Observations	12935	12935	12935	12935

Stock Market Reaction



Stock Market Reaction

	(1)	(2)	(3)	(4)
	Acquirer CAR (-1,+1)			
Lobbying Regulators > 0	-0.0270**	-0.0091*		
	(0.0091)	(0.0034)		
Lobbying Regulators			-0.0020*	-0.0007**
			(0.0007)	(0.0002)
Controls	No	Yes	No	Yes
Quarter Fixed Effects	Yes	Yes	Yes	Yes
Failed Bank State Fixed Effects	Yes	Yes	Yes	Yes
Adjusted R-squared	0.026	0.251	0.025	0.251
Observations	201	198	201	198

Do Lobbying Bidders Engage in Rent Seeking?

- Two potential channels:
 1. **Information transmission** (Grossman and Helpman, 2001)
 - Lobbying resolves the information asymmetries inherent to the resolution process
 2. **Rent seeking** (Shleifer and Vishny, 1994)
 - Lobbying allows bidders of receiving a more favorable treatment by the FDIC
- Both channels explain why lobbying bidders are more likely to win auctions and they have to pay relatively less to win
- However, our findings on performance post-acquisition are only consistent with the rent-seeking story
- Further analyses inform us about the common agency issues prevalent in rent-seeking situations characterizing lobbying decisions

Takeaways

- Paper explores two key questions:
 1. Do bidders engaged in lobbying activities affect the auction process of failed banks?
 2. What are the consequences of acquirers' lobbying?
- Present evidence that bidders' lobbying efforts positively affect the probability of winning an auction
- Lobbying has economic consequences
 - Lobbying bidders pay less, resulting in important losses for the FDIC
 - Lobbying acquirers have lower operating and stock market performance than for other acquirers
- In the context of bank resolution, regulatory discretion may lead to undesirable effects by opening the door for outside influences through lobbying

Thank You!