Discussion of

# Does Uniqueness in Banking Matter?

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# Summary

- *Motivation*: Engaging in low-substitutability bank activities may result in better or poorer returns, risk, and systemic risk (competing views)
- *Method*: Uniqueness Scores for activities and banks
- *Finding #1*: "Unique" → more profitable, less risky
- *Finding #2*: Low and high uniqueness banks have lower systemic risk (inverse-U relation b/w uniqueness & systemic risk)

# Uniqueness Score and Variation in Activities

Act-ty *a* Uniqueness Score $ActUnq_{a,t}$ = % of banks not engaging in *a* in *t*

Bank *i* Uniqueness Score $BankUnq_{i,t} = \Sigma a\ ActUnq_{a,t} * (Vol_{a,i,t} / TA_{i,t})$

Return/Risk/SystRisk = f (BankUnq, controls)

- Novel, beyond divers-n and specialization… Kudos to the authors!
- (an aside: Is it Uniqueness or Specialness?)
- Picks up changes in industry's activity mix (advent and fading of activities)
    - Time-series variation in $ActUnq_a$ (activity's life cycle)?
    - # of *a*'s changing from year to year? Activities' births and deaths
    - There m.b. a difference between being an early entrant vs. a laggard in an activity (both would have high Uniqueness Scores)
    - Do early entrants lose or maintain advantage as the activity propagates?
- **Suggestion**: Think of ways to distinguish b/w early entrants and laggards (in general, b/w "good" and "bad" uniqueness)

# Choice of Specific Activities

- Non-banking activities (insurance, VC, invest. banking) have plenty of non-bank providers – no lack of substitutability
  - BUT, selling these to banking customers (or in hopes of getting new banking clients, e.g., by lending to VC-backed start-ups)…
  - m.b. lucrative (rel-ps, soft info, sticky deposits, extra income per customer – benefits from synergies/scope/integration)
- Some important *a*'s not on list (e.g., bankers' acceptances, syndicated loans, trading specific assets, servicing mortgages, currency exchange), limited to items on Y9-C
- Securities classified as Held-to-maturity vs. Avail-for-sale
  - **Suggestion**: Use securities classes instead (Agency & non-agency MBS, ABS; Muni, Corps., Treas bonds, etc.)

# Size-Related Issues

- $ActUnq_{a,t}$ not weighted. If large BHC's that control 80%+ of TA perform activities smaller BHC's do not, does it make these activities or large BHC's more unique/special?
  - As ρ(BankUnq, Size) = 0.31**, ρ(BankUnq, NonIntInc) = 0.25**, *BankUnq* may pick up size and/or TBTF/SIFI status
  - Small BHCs do not report some items on Y-9C
  - Concern addressed to some extent with IV regressions
- **Suggestion**: Est. separately for BHC's w/TA < $1bln and > $10bln (base ActUnq only on activities these BHC's engage in) or consider $ActUnq_{a,t}$ weighted by industry's TA
- **Suggestion**: Controls for post-Reagal-Neal (1994), post-GLB (1999), post-Lehman (2008) – changing environments

# Derivatives

- Being a dealer in some OTC derivatives may indeed have low substitutability
- BUT, for most banks derivatives are supplementary – should be used for hedging. If hedging, a bank is likely less risky. But is it more unique? In what sense?
- Were derivatives reported in all years since 1986? By all BHC's or only large ones?
- Measured @ notional, capped at 100% – distorts estimation?
- **Suggestion**: Consider net gains or losses (revenues in case of trading accts) from derivatives instead of notional
- **Suggestion**: Separate hedging w/ders. from trading them

# Bank Uniqueness: Different Standpoints

**Standpoints/Keys**

- Bank's: A & L, Rev & Expense mixes
- Regulator's: Size, Systemic risk, Resolution cost, Primary dealer
- Customer's: Services I can obtain at the Bank, Employee expertise, Customer service
- Investor's: Risk & Return, Diversification potential

**Possible Measures**

- Your measure or similar scores for revenues & expenses (scaled, e.g., by Tot Rev) **– try at least this!**
- E.g., systemic risk measures
- Average or median Services per customer, Length of relationships, Cust satisfaction
- α, β, even ε and id.vol. from reg-n of bank's ROA on ROA of Industry/PeerGr/SizeQuant

# Minor Comments

- Data sources for ΔCoVaR and MES?
  - How is it estimated? For non-publicly traded banks? What period and frequency?
  - Isn't CoVaR negligible for small banks, even with high UnqSc (unless it's scaled by the bank's TA)?
- Most large BHCs received CPP funds even if they were safe & sound.
- Loan commitments' and Fiduciary activities' UnqSc of 0.978 and 0.999 in A1 look too high (one would suspect more banks engage in them).