Implicit Guarantees and Market Discipline: Has Anything Changed Over The Financial Crisis?

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The paper in two slides

- Very interesting paper.
- Clear contribution to the literature on implicit guarantees.

- The objectives of the paper:
  - 1. To study the impact of support rating (likelihood to have extraordinary support) and of viability rating (likelihood that the bank will survive) on CDS spreads.
  - 2. The impact of support rating informs on the influence of implicit guarantees.
  - The impact of viability rating informs on the influence of market discipline.
  - 3. Objective to analyze the evolution of these impacts with the financial crisis.

The paper in two slides

- Two key results:
  - 1. Before the crisis, no impact of support rating. Negative impact as expected of viability rating.
  - 2. During AND after the crisis, negative impact of support rating, negative impact of viability rating, positive impact of the interaction term.
- Two main conclusions:
  - 1. Since the crisis, support rating matters.
  - The crisis has been a wake-up call.
  - 2. Since the crisis, viability rating matters but less for banks with support rating (positive interaction term).
  - => market discipline plays a lower influence because of “too systematic to fail”

Identification strategy

- **1. Reverse causality**
- (I know, it is an easy one)

- What about the impact of CDS spreads on viability rating?

- Is it possible that CDS spreads influence the perception of persons in rating agencies?

Identification strategy

- **2. What about omitted variables?**

- You have bank fixed effects so you control for constant bank characteristics.
- You have time fixed effects.

- Endogeneity and omitted variables could be tested with GMM estimations (you have data for that).
- At least as a robustness check.

Identification strategy

- **3. Event study**
- What about considering the impact of a change in rating on change in CDS spreads?
- Event study methodology is great to isolate the specific impact of the change in ratings.

- I agree that it does not help to investigate the combined effect of Support Rating and of Viability Rating.
- But it can be a nice additional estimation to confirm your findings on the separate results for both types of ratings.
- See Norden and Weber (2004) and Norden (2014) for the influence of rating announcements on CDS spreads.

Robustness checks

- **1. Why not using ratings from another agency?**
- One robustness check with an alternative rating from Fitch (Support rating floor).

- Maybe investors do not care much about Fitch…
- Maybe Fitch ratings are not as good as those provided by the others…

- An additional thought: with Support Rating, do you test implicit guarantees or do you test the perception of implicit guarantees?

Robustness checks

- **2. Why not considering an alternative measure than CDS spreads?**
- You mention that you investigate the impact of ratings on refinancing costs.
- OK, CDS spreads are likely to influence refinancing costs of banks.
- But then it also means that (for robustness check) you can find an alternative measure for refinancing costs.

Robustness checks

- **3. Why not performing estimations only for the US?**
- Maybe all results are driven by the US.

Robustness checks

- **4. In the robustness check with the balanced sample, the results change:** no significant impact of Support Rating for all sub-periods.

- So you have a robustness check providing different results than the main ones… but no comment on this difference.

References

- When a question is a very important one, there are plenty of references to cite and the main difficult task is to be parsimonious.
- You have 14 references but only 3 published papers in journals (all others are discussion papers from various institutions).
- Why?
- Journals do not care? You should check more publications.

Introduction / Motivation

- Two key elements of the introduction of the paper look absent:

- **1. The objectives of the paper:**
- You stress the importance of the topic (antagonism between implicit guarantees and market discipline).
- And then you only mention that “this paper provides some contradictory evidence on this point”, then moving to the presentation of the findings.
- You should stress explicitly the objectives of the paper.

Introduction / Motivation

- **2. The reasons for the choice of the technique to quantify the value of structural subsidies for financial institutions.**
- You mention in a detailed way two alternative techniques.
- You explain their drawbacks… and then you explain you use the ratings-based approach, but you cite the drawbacks of this approach without providing totally convincing reasons to prefer it:
- (1) “[the approach] seems to be superior to the two other methods, as has been shown by Noss and Sowerbutts (2012)”. Just mentioning a reference is not enough.
- (2) “Moreover, the correct assessment of default risk by rating agencies is not too much of importance for our question at hand.” Really? More should be said why.

Minor remark: you are European

- **You have a too European perspective in the introduction:**
- “In case of a systemic crisis event, the ‘constructive ambiguity’ might convert to a principle of ‘almost certainty’ [about the probability of external support in case of a bank’s default] as the most recent financial crisis has demonstrated as a real-life example.”
- What about Lehman Brothers?
- “Even small banks have received bailout subsidies which yield to a decrease in market discipline”.
- I’m not sure it is true in the US: 465 failed banks between 2008 and 2012 (source: FDIC).