Discussion of:
The Effects of Supervision on Bank Performance: Evidence from Discontinuous Examination Frequencies

by

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Paper Overview

Great paper: important question & nice identification strategy

- Are supervisory policies useful?
- Nice identification in the context of banking supervision: fuzzy regression discontinuity
  - examination frequencies jump at an asset threshold
  - threshold triggering high frequency varies over time
- Supervision improves banks' ROE by reducing loan loss

Interpreting the results

frequent examinations $\rightarrow$ reduce risk and increase ROE

- Implication: banks are *not* operating on a risk-return efficient frontier
- Question: Do regulators, at large, know how to run a private business better than private entities?
- Possible test: whether the result is more prominent for banks banks with poor governance and management incentives

How to bank examinations affect bank performance?

- This paper's story:
  Regulators provide information and guidance during examinations
- Alternative story:
  Enhanced incentives to perform in anticipation of examination
  - an incentive disciplining device
  - reduce agency cost

$\Rightarrow$ correct actions ex-post v.s. align incentives ex-ante

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Empirical design: measure examination intensity

- D_{t-1} : number of days between the two most recent examinations as of Dec 31 at year t-1
- Different effects of # days between two recent exams v.s. # days after the most recent exam
- Control the number of days after the most recent examination (as of Dec 31 at year t-1)

Empirical design

- Choice of sample: safe and sound banks (that satisfy all criteria)
  - Main target of bank supervision
  - A valid (weaker) instrument for all banks
- bank-specific control variables:
  leverage, M/B ratio, PE ratio, Dividend-price, etc.
- macroeconomic control variables:
  interest rate, PPI, CPI, unemployment, etc.

Empirical design

- Loan loss measures involve reporting incentives
- Banks may deliberately choose asset levels
- Possible cyclicality in the effects of supervision

Conclusion

- Tackle an important question in a nice setting with a neat identification
- Applying the methodology to a broader set of banks can be important
- Pinpointing the channel is likely a future task