Discussion of:

Strategic complementarity in banks' funding liquidity choices and financial stability

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Liquidity risk

- We have new regulation
  - Liquidity coverage ratio
  - Net stable funding ratio
- We have (some) good theory
  - Individual incentives to take liquidity risk
  - Joint incentives to take liquidity risk
- We don’t have (much) empirics

Strategic complementarities in risk

- Banks have incentives to take correlated risk
  - Relative performance evaluation → asset risk
  - Bailouts in liquidity crises → liquidity risk
- First-order importance for regulators
  - By definition inherently systemic risk
  - Coordination important for social planner
- Open questions:
  - Can complementarity be documented empirically
  - How big is the effect relative to idiosyncratic effects

This paper

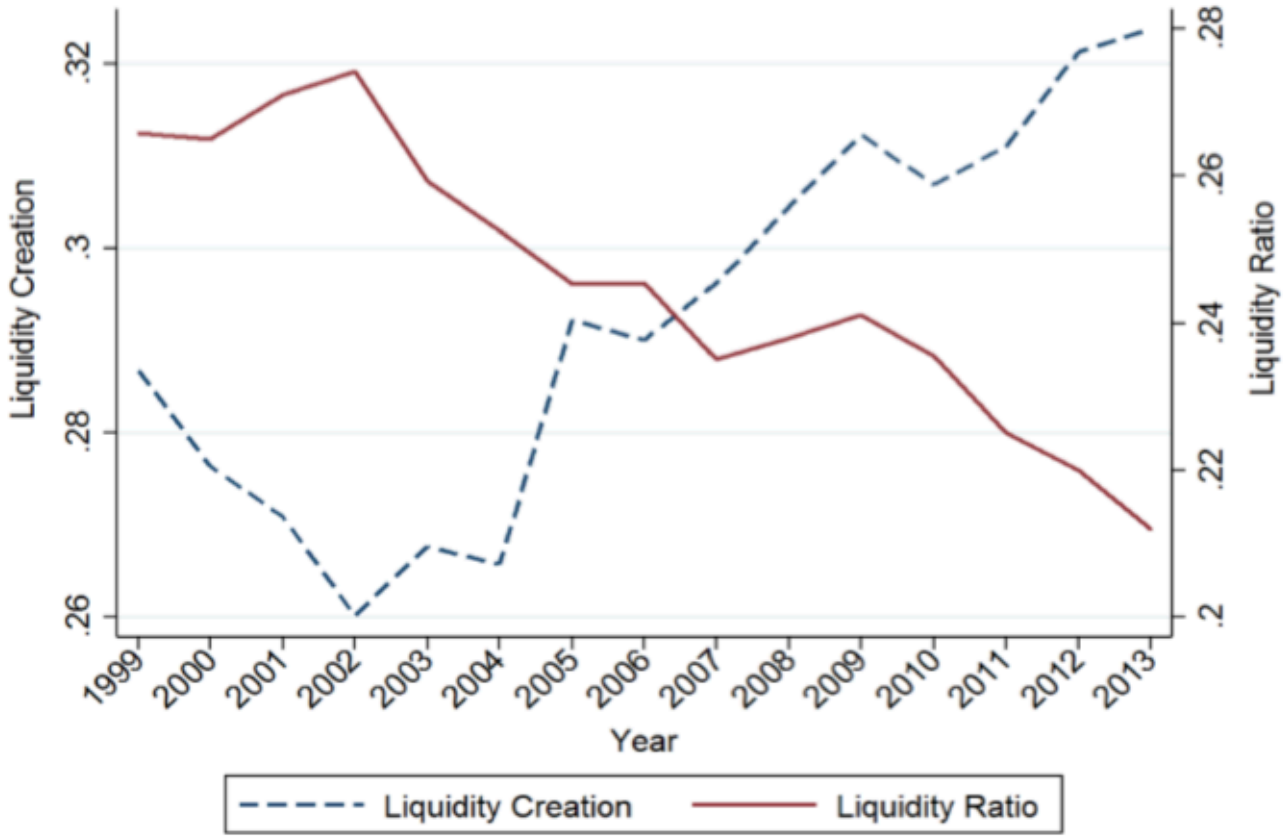
- Look for peer effects in liquidity risk taking
- Peer effects:
  - Identification challenge due to "reflection problem"
- Liquidity risk:
  1. "Liquidity ratio":
     liquid assets / total assets
  2. "Liquidity creation" from Berger & Bouwman (2009):
     Net asset illiquidity minus net liability liquidity
     → increasing in illiquid assets and liquid liabilities
- Bottom line: strong peer effects with both measures

Very nice paper!

Liquidity risk

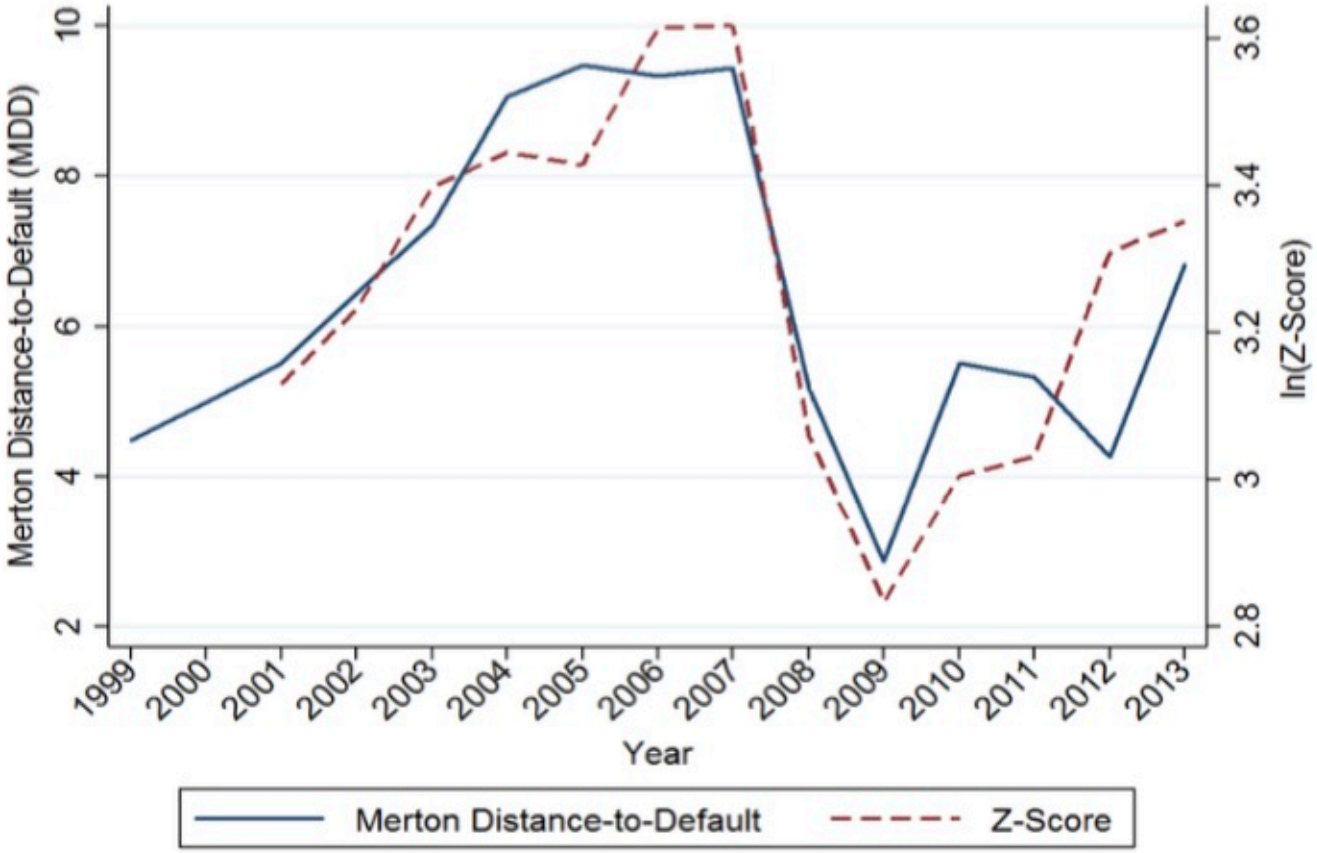
- Be more clear about mechanism
  - Funding liquidity vs. market liquidity
  - Maturity transformation vs. liquidity transformation
- Only use serious measures
  - Should include both asset and liability side
  - Berger-Bouwman GOOD; Liquidity Ratio BAD
  - Other candidates:
    - Liquidity mismatch index (Brunnermeier et al.)
    - Something based on LCR and NSFR
  - Systemic risk measures MES & SRISK
    - Quite similar in construction and interpretation
    - There are many other good measures

Liquidity risk measures



- Interesting reasons they don't always comove?
- Bank level: Correlations? Trends?

Default risk measures



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Interpretation of peer effects

- How much variation is there to explain?
  - Within and across peer groups?
- What does $\beta = 0.5$ mean?
- Aggregate effect?
  - How much higher is liquidity risk because of peer effects?
- Moral hazard vs. information free riding
  - Small not affecting large seems consistent with MH…

Construction of peer groups

- Estimates depend strongly on group construction
- What is the intuition (economically or empirically)?
- Why is the main specification the right one?
- What's the role of size in the LOLR peer effect?

Random comments

- Bank risk and systemic risk:
  - To assess impact of peer effects, control for liquidity risk or decompose into baseline and peer induced
- "Each bank constantly adjusts to other's decisions"
  - Do analysis in changes instead of levels?
- Eurozone – lot's of changes during sample period!
  - LOLR at national level?
  - All sovereign bonds equally liquid?
- Allowing β to vary by bank and year
  - Does it change over time (in aggregate)?
- Placebo test:
  - Look for peer effects where we wouldn't expect to find any