

Political Economy of Financial Regulation by R. Haselmann, A. Sarkar, S. Singla and V. Vig

Discussion by Michael Koetter^a

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BBK-HU Workshop on Financial Intermediation and Corporate Debt Markets

This paper asks an important and straightforward question

(Why) do regulators pursue national interests when crafting supra-national rules?

The paper hypothesizes that:

- H_0 : BCBS participants seek **global financial stability**
- H_A : “[they] are guided by some **alternate motivations** such as **national interests**.”
- ... like domestic fin stab, regulatory capture, revolving doors, lobbying, ...

Testing approach

- Outcome: opposition to or watering down of 30 issues j negotiated under Basel II & III by **national regulators (NR)** $i = 1, \dots, 6$ during 2009-2016
- Test variable: (Mis)aligned stance of **national champions (NC)** on these issues
- Defense against spurious correlations: $\alpha_t, \alpha_j, \alpha_i \dots$ (I guess?)
- Extracting NC stance: Categorization of consultation feedback tonality
- Extracting NR stance v1.0: Leakage to risk.net + Factiva & LexisNexis (WOW!)
- Extracting NR stance v2.0: Topic modelling of around 1,500 speeches (WOW!²)

Main take-away

The tail wags the dog: NR vote in the BCBS process on behalf of their NC

Let's visualize the setting and the game played

Each jurisdiction is populated by one NR, some NC, and small banks

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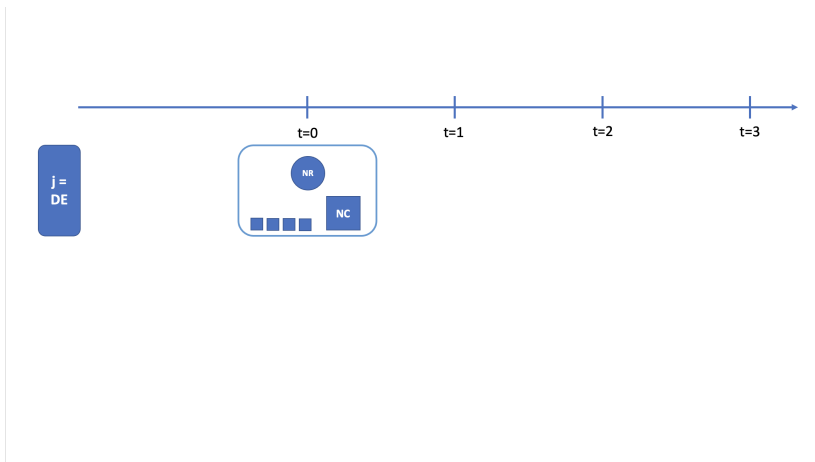
Priors

Measure-
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Up to six regulators on 30 Basel II & III issues craft a draft

These jurisdictions—DE,EU,FR,GB,JP,US—cover the majority of international banking markets

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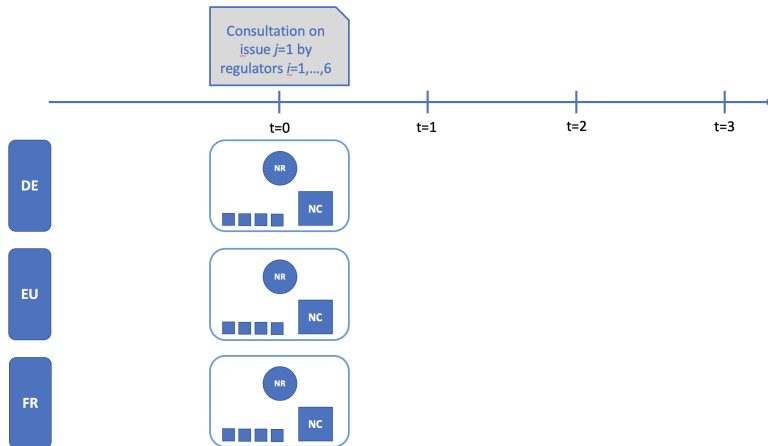
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Banks reveal their type: laudable text-mining effort of responses

Cool to observe banks' stances on issues — but which bank(s) are sampled and classified as NC?

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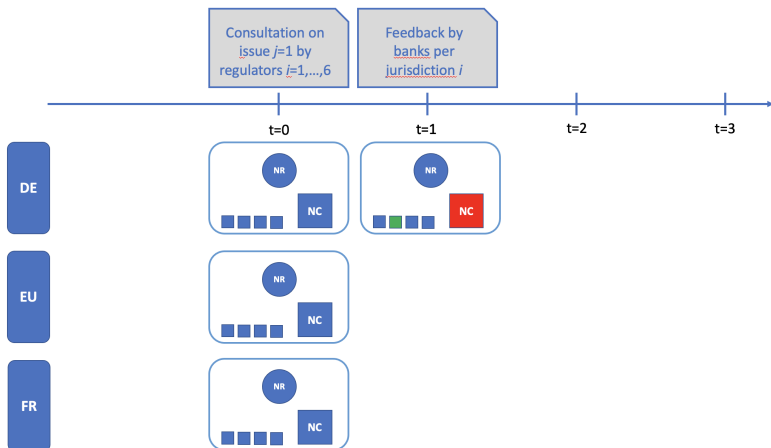
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And then a miracle occurs: national regulators reveal their type!

In $t = 2$, the stance of NR is extracted from a Sisyphean text analysis of NR speeches (plus leaks) . . .

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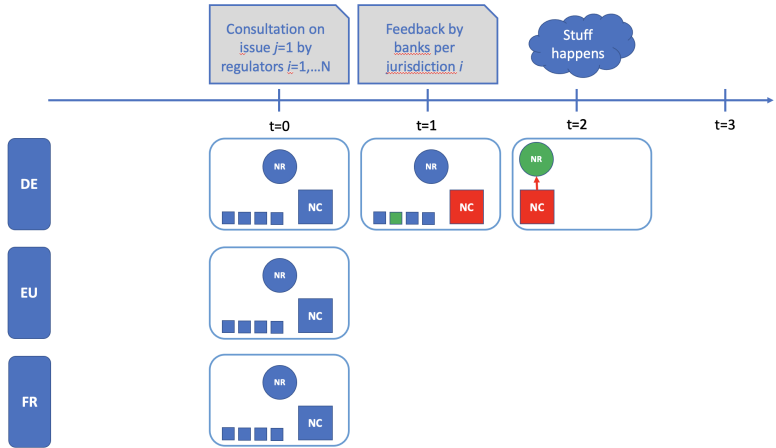
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And then a miracle occurs: national regulators reveal their type!

... with a narrative that NR are nudged by large banks via mechanisms that must not be named ...

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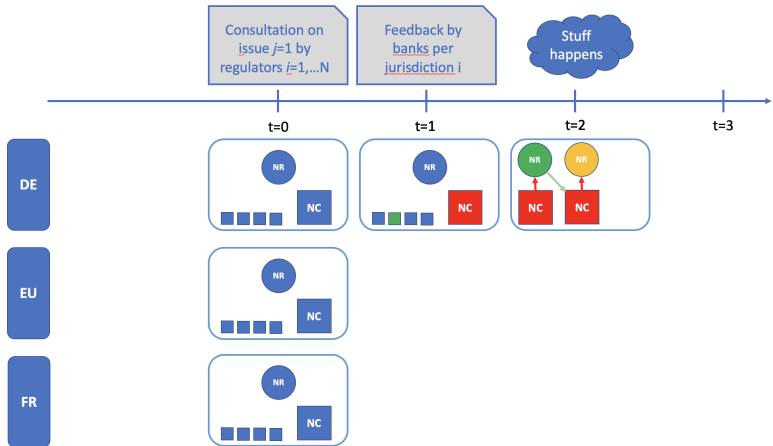
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And then a miracle occurs: national regulators reveal their type!

... like revolving doors capturing them, lobbying or sth else that makes them change their mind!

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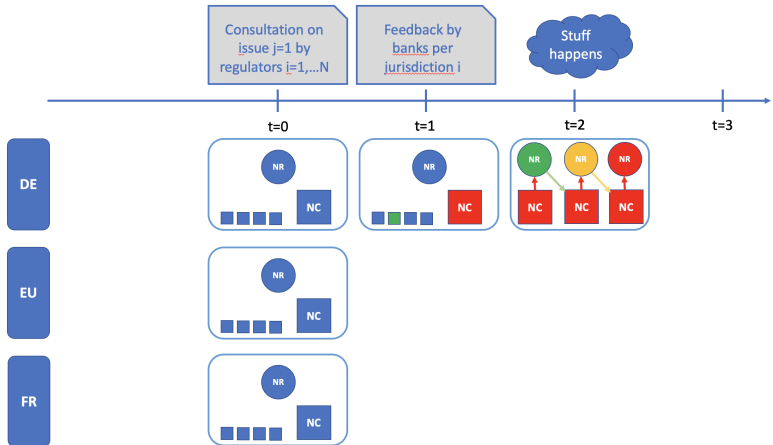
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The main test (to me): do opposing national champions. . .

. . . render it more likely that the BCBS representative opposes the issue. . .

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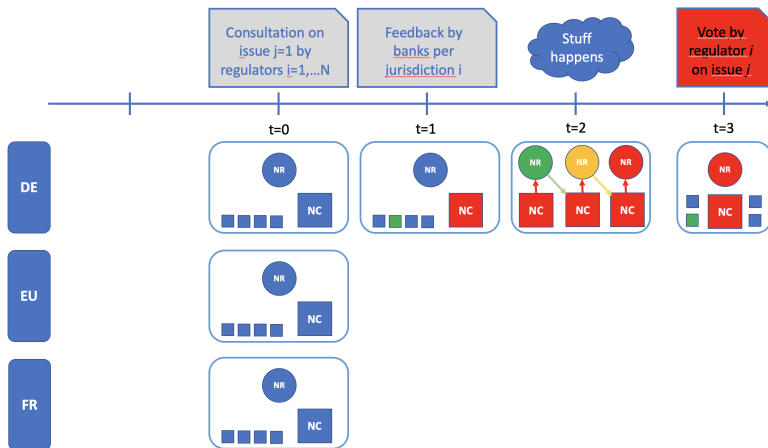
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The main test (to me): do opposing national champions. . .

... or at least water it down?!

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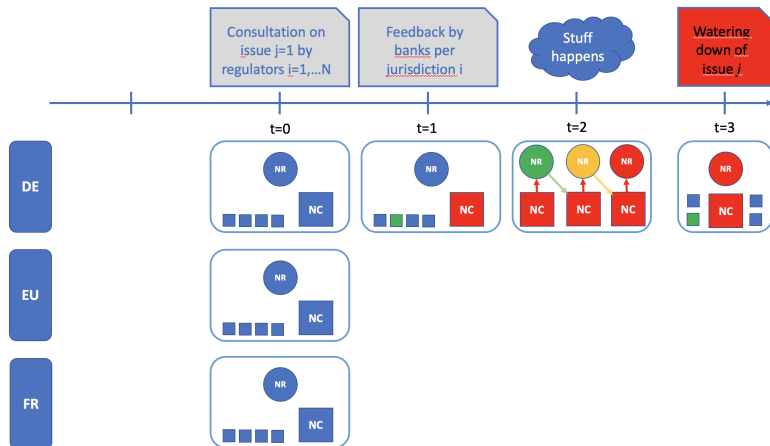
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Issue-regulator (T4) and speech-by-issue-(by time?) samples

No large bank ever favored regulation, thus the control are small favoring and neutral banks

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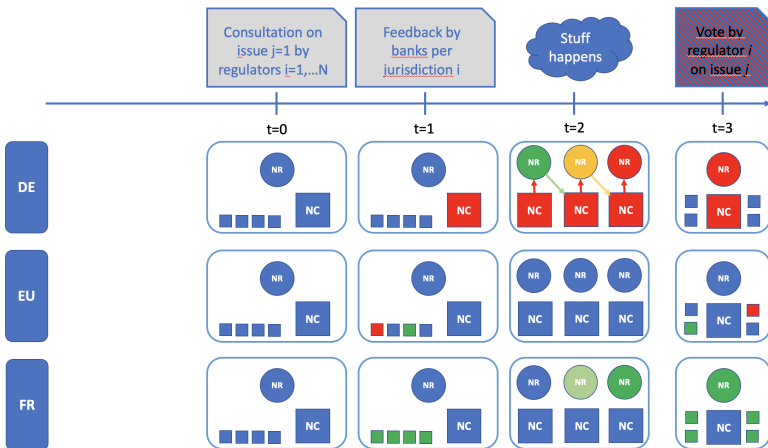
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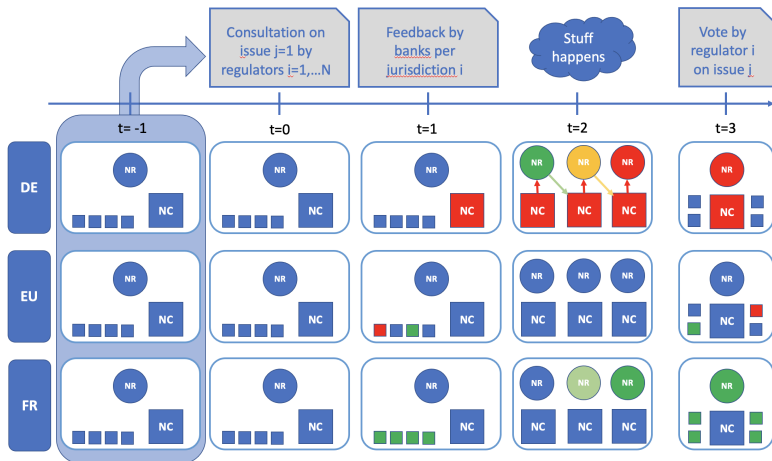
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#1: BCBS draft conditional on unobserved exchange in $t=-1$

Ain't the draft presented for consultation a reflection of intra- and inter-i talks?



#1: BCBS draft conditional on unobserved exchange in $t=-1$

Shouldn't the heterogeneity prior to the draft render it less. . .

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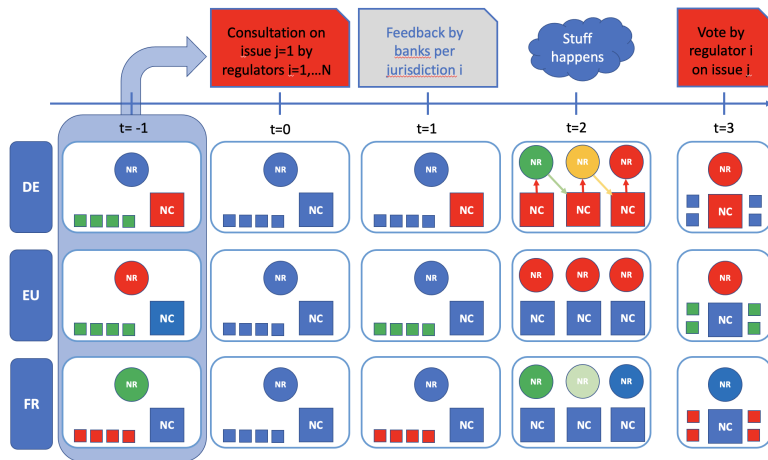
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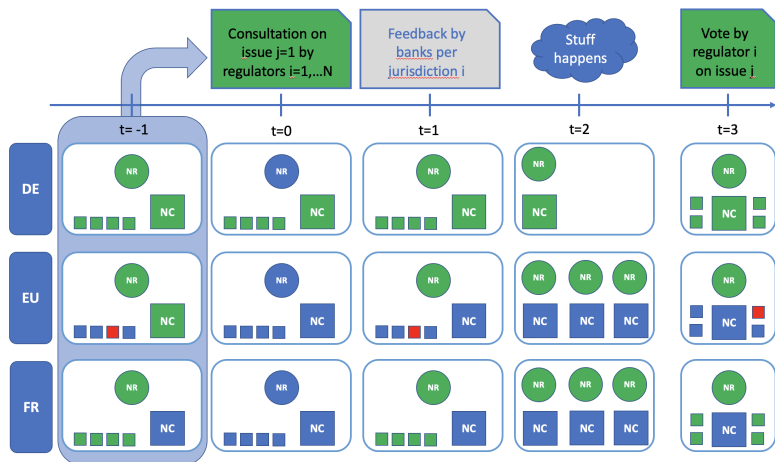
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#1: BCBS draft conditional on unobserved exchange in $t=-1$

... or more likely to reach an unanimous vote in the BCBS? Control for pre-draft stance!



#2: What if NR actually listen and learn from the consultation

Shouldn't supra-national regulation internalize what banks do not care about individually?

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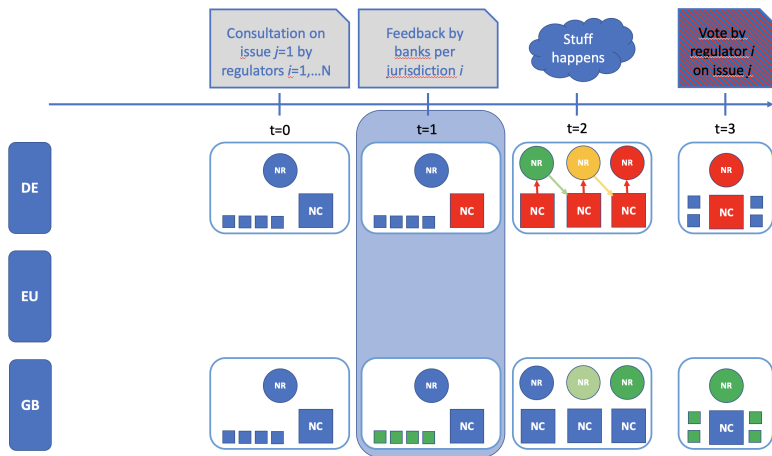
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#2: What if NR actually listen and learn from the consultation

Imagine higher capital ratios would "kill" continental banks' business models

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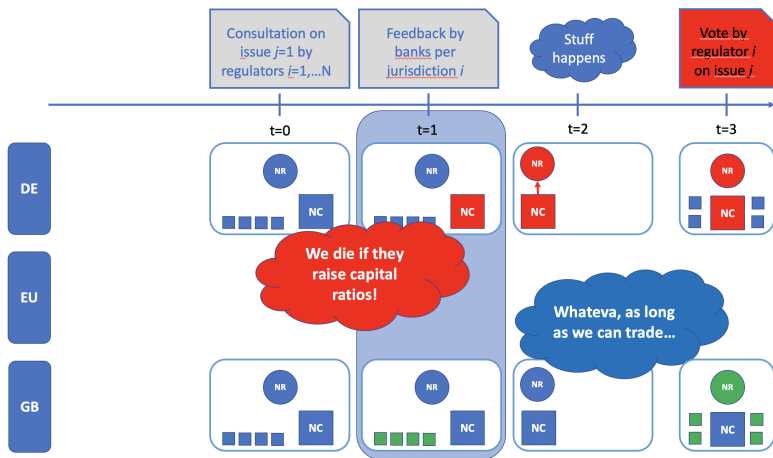
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#2: Whereas Anglo-Saxon banks' set-up is not directly affected

And accordingly their NR is not picking a fight – until that call from the continent

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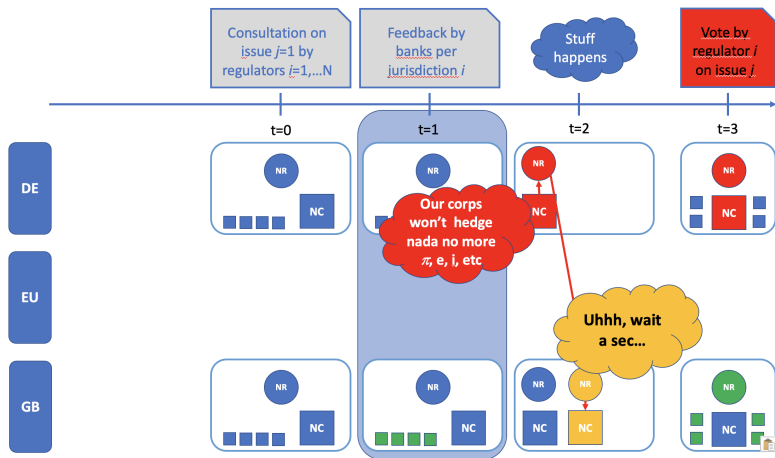
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#2: May regulators filter and enlarge the information set?

An overly romantic view? May NR/BCBS internalize system(at)ic threats to individual banks?

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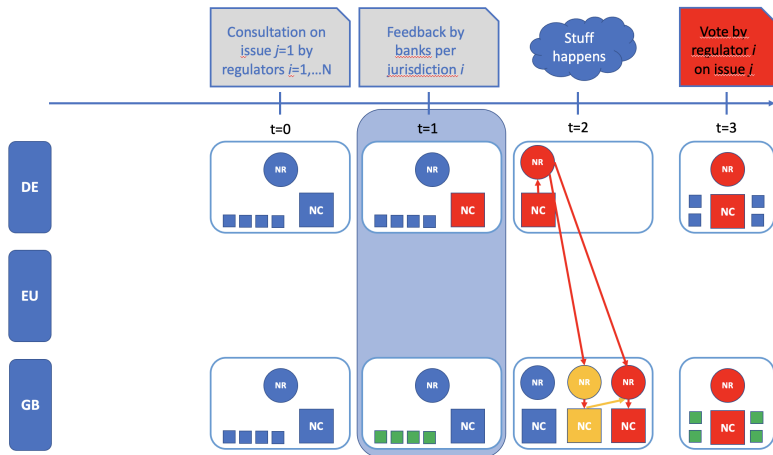
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#3: Do we omit important intra-jurisdiction players?

Identification is within-country assuming single NR. . .

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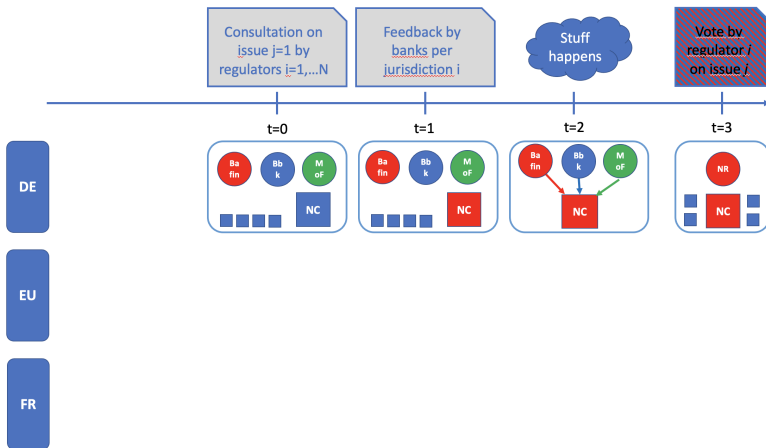
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#3: Do we omit important intra-jurisdiction players?

... and an unreported number of NC. There may be more! Not an innocuous descriptive stat!

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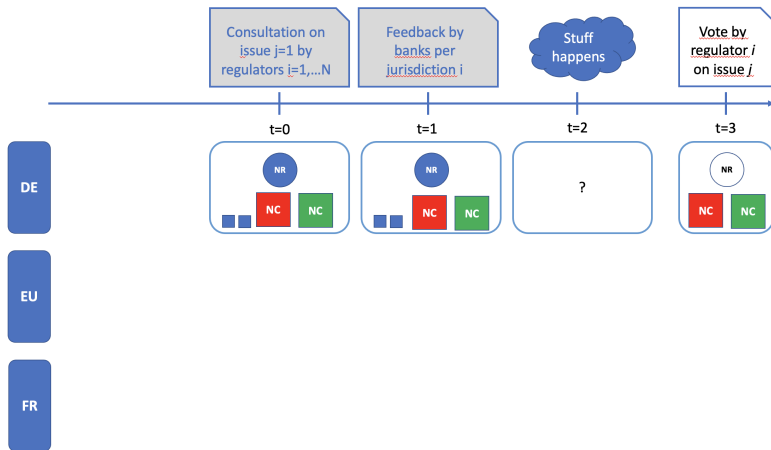
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#4: Interdependence of issues (and cross-sectional units)

The baseline (?) is on issues $j = 30$ by 5-6 regulators i (in year t)

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- Issue-regulator specification is: $Y_{ijt} = \beta_1 NC_{Support}_{jt} + \beta_i + \beta_j + \epsilon_{ijt}$ (N in T4: 172)
- Issues are negotiated within and across jurisdictions: account for dependence
- You specify within jurisdiction/within issue FE. . .
- . . . so it is important to understand how many small banks exist
- That is bc they are the source of variation—I did not find that in the paper?
- NB: you mention EU as one (of the few) i : so is BNP a NC in both FR and EU?
- Speech-regulator-country spec (3) – here the subscripts denote sth else?
- Useful to show how speaker frequency differ across jurisdictions
- Controversial issues may be spoken about systematically more often
- Could that actually reflect failed negotiations in $t - 1$. . .
- . . . or simply more officials being involved in the process?
- The timing of speeches remains a bit unclear
- Is it coded per calendar or per event year/time?

#5: Quite a few strong conclusions throughout

Related to the priors – can we rule out more benevolent explanations with this setting of 30 issues?

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- “Overall, our findings question whether the current international standard setting via the Basel agency really provide optimal outcomes.”
- I couldn’t judge that bc I do not firmly grasp the appropriate counterfactual
- “it is questionable whether those countries not participating in the Basel working groups should really adopt the Basel standards in their countries.”
- Isn’t it hard to say so if we have no data on these stakeholders stance reflected in unobserved speeches

A straightforward and crucial question indeed

And cudos for a novel and innovative approach to gather hard info on the matter!

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- Super novel evidence on regulators (changing) stance on Basel issues
- conditional on the revealed preferences of their subjects...this is great!
- Ingenious text analysis approach to achieve that is a great leap forward
- Possibly important to dig deeper into the crafting of the consultation draft
- Challenging metrics given the inherently small source of variation
- A great read and this paper will surely catch attention in many fora – be among the first to read it!

Bucket list of loose issues

Stuff that occurred to me while reading

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- Specification and results in section 3.1 refer to subsequent sections
- Tables and figures are hard to comprehend w/o any captions
- The fixed effect structure is unclear since text, specification, and tables mention different things, e.g. no α_t in T4 but in Sec. 3.1 vs. no α_j in specification (2) but T4.
- Which banks are covered and classified as NC vs. small?