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

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.
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.
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.
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.
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).