Discussion of Bank Bold Holdings and Bail-in
Regulatory Changes

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The views expressed in this presentation are those of the author and do not necessarily reflect the views of Banco de Portugal or the Eurosystem.
Summary of the paper

How does the composition of bank bonds held by credit institutions change with MREL and TLAC?

Credit institutions increase the holdings of bank bonds eligible for MREL relative to the total holdings of bank bonds. The effect is stronger for self-holdings: Banks increase more their exposure to their own MREL eligible bonds than to other banks’ MREL eligible bonds.

Credit institutions also increase the holdings of TLAC-eligible instruments relative to non-eligible ones. The effect is stronger for cross-holdings.
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The paper’s question is new and important.

- The question is about the impact of bank liability policies beyond bank capital policies.
- The question can be informative about who bears the bail-in risk associated with MREL-eligible bonds.

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Results are about outcomes, not incentives.

The paper’s hypotheses and the interpretation of results are written around credit institutions’ incentives to hold bank bonds after MREL and TLAC.

The actual change in bank holdings of these exposures may have nothing to do with their incentives changing but with other market forces.

Supply or demand effect?

The authors argue that using issuer-quarter fixed effects controls for the supply effect.

Issuer-quarter fixed effects controls for the overall supply of bonds of a given issuer. It does not control for changes in the composition of that supply.

Control for each issuer’s change in the issuance of other liabilities that can also be used in bail-ins? Control for each issuer’s MREL shortfall?
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- Is May 2016 the key policy date for the demand side effect of MREL?
  - Expectation that certain liabilities will be used in a bail-in were shaped in June 2012 at the time of the Commission’s proposal.
  - Around June 2012 starts the sharp decrease in the weight of debt securities in euro area banks’ main liabilities.
  - Perhaps the policy change in May 2016 is mostly a supply side shock as banks become informed about their MREL shortfalls.

- Policy changes affect incentives to issue and hold different types of liabilities, not just bonds.
  - Having this in mind is critical for inferences about the implication of results.
  - For example, the inter-linkages across banks may have decreased despite the increase in the exposure to MREL-eligible bonds because the exposure of credit institutions to the equity of other banks decreased.
  - A similar comment applies to the point that banks’ risk exposure increased because they hold MREL-eligible bonds.
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Minor Comments

- Hard to generalize results to the banking sector (banks) when only 26 banking groups are observed – most of them G-SII.

- The number of observations stays constant across different specifications of each regression model.
  - This is unexpected. As issuer-quarter and holder-quarter fixed effects are added, I expect some observations to drop.

- In results related to the notional amounts there is a significant change in the magnitude of the coefficient on the post-policy dummy when issuer-quarter fixed effects are added.
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- **Nominal value vs market values.**
  - Nominal values are not directly comparable across different bonds. Terms and conditions are different.
  - MREL-eligible bonds may have a large nominal value but may also be sold at a significant discount such that banks’ exposure to MREL-eligible bonds may actually decrease after the policy.
  - A discount is likely if MREL-eligible bonds become riskier after the policy and no adjustment in other credit terms is made to compensate for the additional risk.

- Linear probability model. What is the underlying distribution of the error terms? Are you estimating a probit, a logit, or something else?
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Some descriptions overstretch results. Example:

- In section 3.3, p.25: '...MREL requirements contributes to increase the home bias in banks’ cross-holdings...'

- Table 7 results show that the introduction of MREL reduces the likelihood of holding bonds in the same country but less so if bonds are MREL-eligible.

- To look at the impact of MREL on same country holdings you need to look at both the post*same_country coefficient and the post*same_country_eligible and then you need to weight them according to the share of eligible bonds relative to total bonds.
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