

SUPERVISORY POLICY STIMULUS: EVIDENCE FROM THE EURO AREA DIVIDEND RECOMMENDATION

Ernest Dautović, Leonardo
Gambacorta, Alessio Reghezza

Discussion by Diana Bonfim

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SUMMARY OF THE PAPER

In a crisis, **supervisors** want to be sure that banks have **enough capital** to withstand shocks.

Asking for **higher capital ratios** can have pro-cyclical effects.

Solution: dividend restrictions.

At the onset of the pandemic, the ECB issued a recommendation, stating that, at least until October 2020, no "significant institution" should pay out dividends.

This paper: how did this recommendation affect banks' lending and risk-taking?



SUMMARY OF THE PAPER

Main findings:

- Dividend restrictions were **effective** in avoiding a credit crunch.
- Banks used non-distributed dividends to **lend more**, especially to **small and medium firms**, as well as to those in **sectors more affected** by the pandemic.
- There is **no evidence** of additional **risk-taking**.



MY COMMENTS

01

DIVIDEND BANS
AND BANK
PROFITABILITY

02

WHY FOLLOW THE
RECOMMENDATION
?

03

MAGNITUDES

04

OTHER POLICIES

05

MINOR ISSUES



1. DIVIDEND BANS AND BANK PROFITABILITY

Identification strategy:

- explore heterogeneity across banks on **planned but not distributed** dividends, as a % of RWA (as reported in a survey to the ECB).

Higher values can mean different things:

- **compliance** with the recommendation (interpretation in the paper)
- **risk preferences** of bank managers (they would retain dividends regardless of the recommendation; part of the solution this time). This is consistent with the sizeable increase in impairments early in the pandemic.
- higher **profitability** (pre-pandemic) – maybe more profitable banks were able to lend more?



2. WHY FOLLOW THE RECOMMENDATION?

- When bank managers decide to follow the recommendation, they can do two things:
 - act **countercyclically** and increase lending (this would be the goal of **macroprudential** authorities)
 - increase **loss absorbing capacity** (this would be the goal of **microprudential** authorities)

This paper shows that the decision of microprudential authorities had positive macroprudential effects. Great news, for macro-pru (and for the discussion on conflicts).

But what about the primary goals of supervisors??

(shown in a technical report by Dautovic et al. (2021) but not in this paper).



2. WHY FOLLOW THE RECOMMENDATION?

Empirical strategy:

Of the 110 banks in the sample:

- 35 banks were not planning to distribute dividends – **control group**
- 75 were planning dividend payments in 2020.
 - 53 did not pay dividends – **treatment group**
 - 11 had already distributed or approved it – **control group**
 - 1 distributed more than planned – **control group**
 - **what about the other 10?** Should they be treatment or control?

Needed: more discussion on control group and clearer evidence on parallel trends (e.g., dynamic DiD). **Compliance is choice...**

How do the results look like with a **discrete treatment** variable? Less affected by profitability.



3. MAGNITUDES

“In the absence of the ECB policy, lending growth would have been 2.1 p.p. lower.”

“The dividend recommendation sustains bank lending even in the absence of government guarantees (+1.5 to +1.9 p.p.).”

Does this mean that the dividend recommendation had **much stronger effects on bank lending than government guarantees?**

The results are much larger for firms with **multiple bank relationships**. How is this consistent with effects being larger for small and medium firms?



4. OTHER POLICIES

- The authors control for several monetary and fiscal policy measures.
- On **fiscal policy**, they control for government guarantees and moratoria on loans.

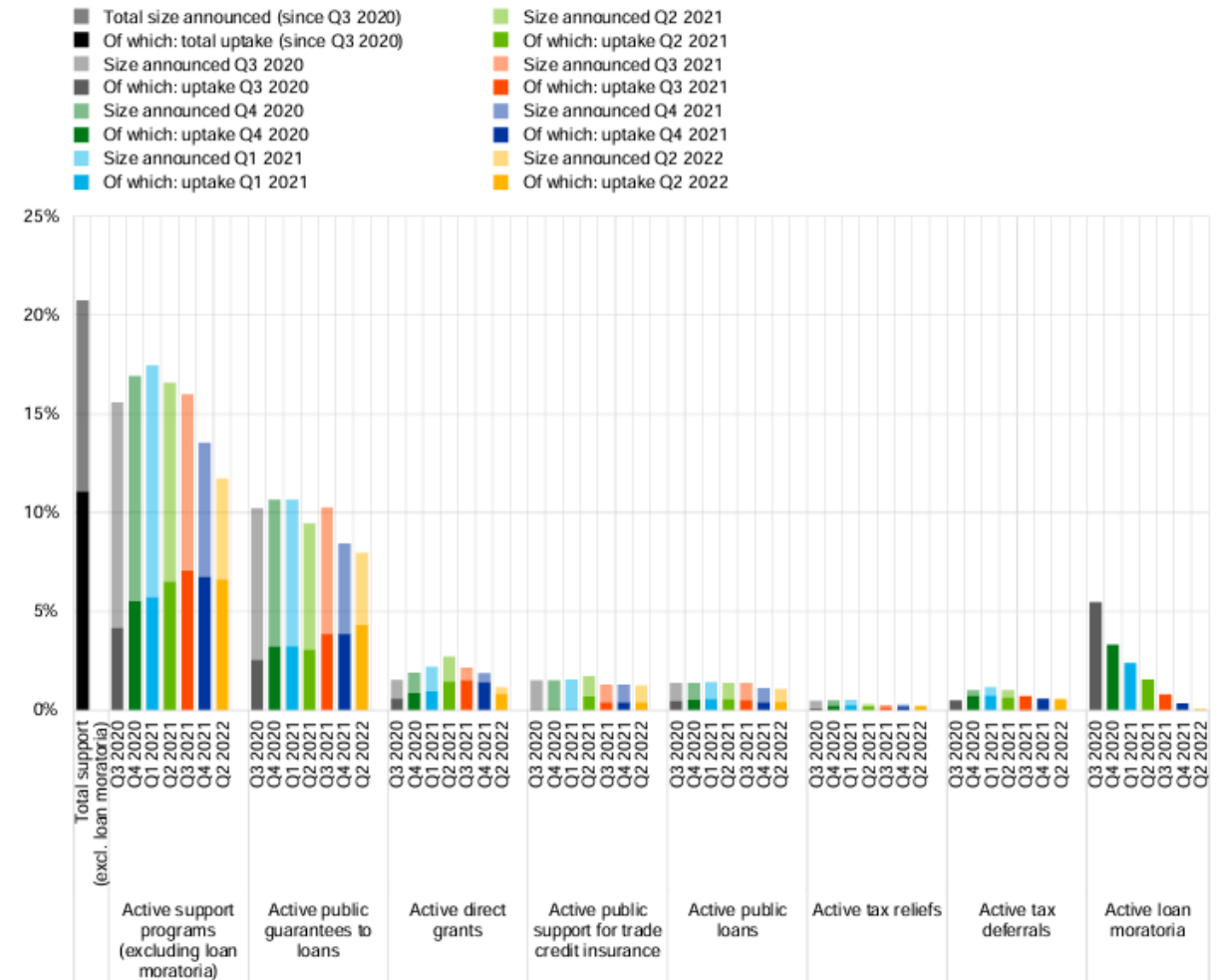
But this is not the full picture...

- **Monetary policy** is captured by uptake of TLTRO III and deposits at the central bank. Is it enough?
- What about **buffer releases**?

Chart 1

Announced size and uptake of moratoria and fiscal programmes (active and expired measures) as of 30 June 2022

(percentage of ESRB Member States' GDP for 2019)



Sources: Recommendation ESRB/2020/8 (reference date 30 June 2022) and ECB Statistical Data Warehouse (SDW).



5. MINOR ISSUES

- “To our knowledge, there is no historical precedent or regulation recommending banks not to distribute dividends”

The screenshot shows the top portion of a news article on The Wall Street Journal website. The page features the newspaper's masthead, navigation links, and a sidebar with social media sharing options. The main article title is "Portugal Asks Banks to Halt Dividends" by Patricia Kowalski, with the byline "By Patricia Kowalski" circled in yellow. The article text begins with "LISBON—Portugal's central bank has asked the country's banks to suspend paying dividends to conserve capital, as they prepare for tougher requirements under Basel III rules, a central-bank spokesman said." A "MOST POPULAR NEWS" section is visible on the right side of the page.

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Portugal Asks Banks to Halt Dividends

By Patricia Kowalski
Updated Jan. 27, 2011 7:45 pm ET

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LISBON—Portugal’s central bank has asked the country’s banks to suspend paying dividends to conserve capital, as they prepare for tougher requirements under Basel III rules, a central-bank spokesman said.

Banco BPI SA —the first of Portugal’s three largest lenders to report

MOST POPULAR NEWS

1. Epstein’s Private Calendar Reveals Prominent Names, Including CIA Chief, Goldman’s Top Lawyer
2. The Building Boom Is Prolonging Market Pain



5. MINOR ISSUES

- **Zombie firms** = firms with impaired loans above 95th percentile in a firm-bank relationship.

These are not zombies, these are gone-concern firms (banks are not hiding anything here). How do the results look like with a more standard zombie definition? (requires merging with Orbis)

- The analysis of firm **size** groups or **sectors** must consider that these groups have different **loan demand**.
- Credit line draw-downs: why not use Anacredit data, which allows for direct measurement?
- Martinez-Miera and Vegas (2021) also use the Khwaja-Mian (2008) approach and control for loans with government guarantees (unlike reference in page 6).

SUMMING UP

Recommending banks to restrict dividend distribution seems to be effective and non-distortionary.

Good news, but aren't there any drawbacks? Is this the silver bullet that solves all problems?



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