

“Less or more risky”: The impact of regulations on bank failures

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Introduction and Literature

- Understanding how regulation impacts bank stability is crucial to preventing major failures. Period between the Civil War and the introduction of deposit full of insights, as possibility for controls exist.
- Literature does examine shareholder liability a bank risk taking and finds double liability is significantly associated with lower bank risk-taking (Grossman, 2001; Grossman 2007.)
- An expanded model may yield insights.
- Research questions: to what extent does regulations affect bank stability? What is the best set of regulations for bank stability?

Methods

Sample

- Aggregate, state-level aggregate data from 1865 to 1930 on asset and liabilities for both national and state banks, state laws, and bank failures. Alaska and Hawaii both excluded, as well as Rhode Island 1892, Nebraska 1893, Wisconsin 1893, Oregon 1892-1893, Illinois 1892, North Dakota 1893 due to duplicate values.

Measures

- Failure rates and assts at time of failure rates were found by dividing the number of failures by the number of banks and dividing assets at time of failure by aggregate assets, respectively.
- Multiple liability dummy constructed where 0=single liability and 1=multiple liability.
- Minimum share dummy constructed where 0=missing minimum director shores and 1=has minimum director share laws.

Empirical approach

- Multiple regressions fitted.
- Minimum capital requirement for states and minimum shares for director dummy included to control for risk.
- Fixed effects for time and year included to adjust for individual and time invariant effects.
- Final regression: fractionalized generalized linear model. Excludes failure rates greater than .5 as well to account for possible outliers.
- Final regressions done with state failure rates and asset failure rates.

Results

Univariate

- 74.88% of states had multiple liability across the entire sample. 24.15% had multiple liability across the entire sample. .29% changed from single liability to multiple liability. .67% changed from multiple liability to single.

Bivariate

- Average failure rates across single and multiple liability, branching and no branching, insured and uninsured, and minimum share and no minimum shares states did not appear to change over time.

Regressions

- National bank failure rate found to be significant for state bank failure rate. All other variables insignificant. Multiple liability and national bank asset failure rate significant for state asset failure rate.
- On average across the dataset, a 1 percent increase rise in the national bank asset failure rate is associated with a 11% increase in the state bank asset failure rate., ceteris paribus.
- On average across the dataset, states with multiple liability laws is associated with a .7% rise in state bank asset failure rates, ceteris paribus.

Discussion

- Results suggest multiple liability does to some extent drive asset failure rates.
- Limitations: very preliminary results. Robustness checks not performed and p values not adjusted. Possible simultaneity.
- Further research: examining the impact of reserve cities, understanding motivations, recessions v non recession, and impact of lagged multiple liability.

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