

## DISCUSSION:

“How do banks react to increased asset risks? Evidence from Hurricane Katrina” by C. Lambert, F. Noth, and U. Schüwer

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# Summary

- Question investigated: How do banks adjust capital ratios after exogenous shock to risky assets?
- Important analysis because banks' capital ratio is key factor in banking regulation;
- Problem: Endogeneity of risky assets in causal analysis;
- Authors use natural experiment (Hurricane Katrina) to identify effect of risky assets on banks' capital ratio using a DiD approach;
- Authors find that (relatively highly capitalized) banks act cautiously by themselves irrespective of regulatory requirements.

# Paper's Strengths

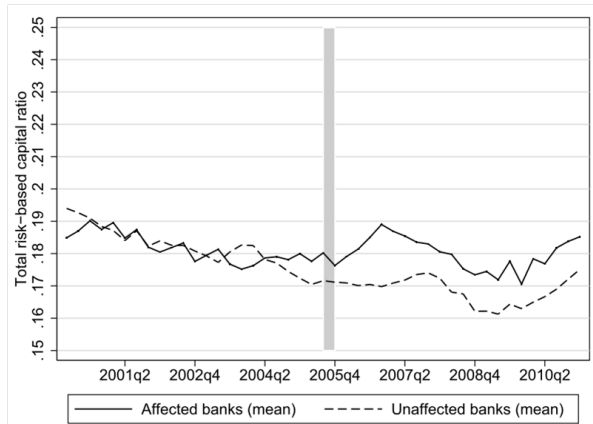
- Clear and convincing paper;
- Analysis highly relevant for regulators and supervisors;
- Innovative approach offers good identification strategy;
- Extensive set of robustness checks;
- Convincing results, in line with theory and previous research.

## Potential Points to Address: Baseline Equation

$$Cap_{it} = \beta_0 + \beta_1 Event_t + \beta_3(Event_t \cdot Affected_i) + \tau_\gamma + v_i + \epsilon_{it}$$

- Omitting variable '*Affected<sub>i</sub>*' independently from interaction term is controlled for by FE;
- However, robustness check (pooled panel model) including variable '*Affected<sub>i</sub>*' might rather be carried out in RE model (using Chamberlain approach).

# Potential Points to Address: Parallel Trend Assumption



Treatment effect (i) emerges earlier and, (ii), persists (no convergence).  
→ Something seems to have happened before, has been amplified by Katrina, and then persists.

## Potential Points to Address: Subsample Investigation

To make characteristics in subsamples (high/low capitalized banks) fit, authors omit '6 largest low capitalized banks'

- Akin to data mining;
- Provide further details why the sample is adjusted in this way (why not 6 smallest banks?);
- Alternatively (or robustness check), does splitting the sample in another way (e.g. at mean) help?

- Innovative approach offers valuable insights into banks' risk taking behavior;
- Results also of great interest for related areas, e.g. macro-finance: accounting for banks' risk taking behavior in agent based setup will allow for more realistic models.