Comments by Rafael Repullo on

Did Good Cajas Extend Bad Loans?

Governance, Human Capital and Loan Portfolios

Vicente Cuñat and Luis Garicano

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Purpose of paper

Analyze effect of

- – Formal governance arrangements
- – Real governance characteristics
- – CEO’s characteristics

of Spanish savings banks on

- – Portfolio allocation in 2007
- – Ratings change over 2007-2009
- – Performance in 2009

Main results

- No significant effect of formal governance arrangements

  → Share of politically appointed seats in board

- No significant effect of real governance characteristics

  → Share of politically connected members of board

- Significant effect of CEO characteristics

  → Graduate studies (+)

  → Banking experience (+)

  → Previous public office (–)

Discussion

- Focus on CEO results
- Four comments
  - Performance in crisis vs. normal times
  - Performance measures
  - Possible effects of outliers
  - Correlation and causation

Comment 1: Crisis vs. normal times

- Paper focuses on effects on performance in crisis times

  → Effects of governance of a (really big) tail event

- This could be perspective of regulator

  → That mostly cares about bank failures

- But this is not perspective of social welfare maximizer

  → That also cares about surplus in normal times

- Why not also look at effects on performance in normal times?

Comment 2: Performance measures

- Four measures
  - Share of loans to real estate in 2007
  - Share of loans to individuals in 2007
  - Ratings change over 2007-2009
  - Non-performing loans ratio (NPL) in 2009

Comment 2: Performance measures

Comment 2.1

- Why is lending to real estate <u>necessarily</u> bad?
- Why is lending to individuals <u>necessarily</u> good?

Comment 2: Performance measures

Comment 2.2

"The key stylized fact we exploit is the causal relation between the portfolio allocation decisions during the 'bubble years' and the pain that the banks suffered later."

- This is not what the evidence shows

Corr (real estate, NPL) = 0.24 (p-value = 0.22)

Corr (real estate, delta rating) = – 0.19 (p-value = 0.34)

Comment 2: Performance measures

Comment 2.3

- NPL is <u>not</u> necessarily a signal of bad performance
- Trade-off between risk and return

  → Riskier portfolios may be very profitable

Comment 2: Performance measures

Comment 2.3

- Better performance measures

  → Return on assets (ROA)

  → Efficiency ratio (ER = Op. expenses ÷ Op. income)

  (NB: it should be called <u>in</u>efficiency ratio)

- Evidence for savings banks in 2006

  Corr (NPL, ROA) = – 0.11 (p-value = 0.50)

  Corr (NPL, ER) = 0.16 (p-value = 0.30)

Comment 2: Performance measures

Comment 2.4

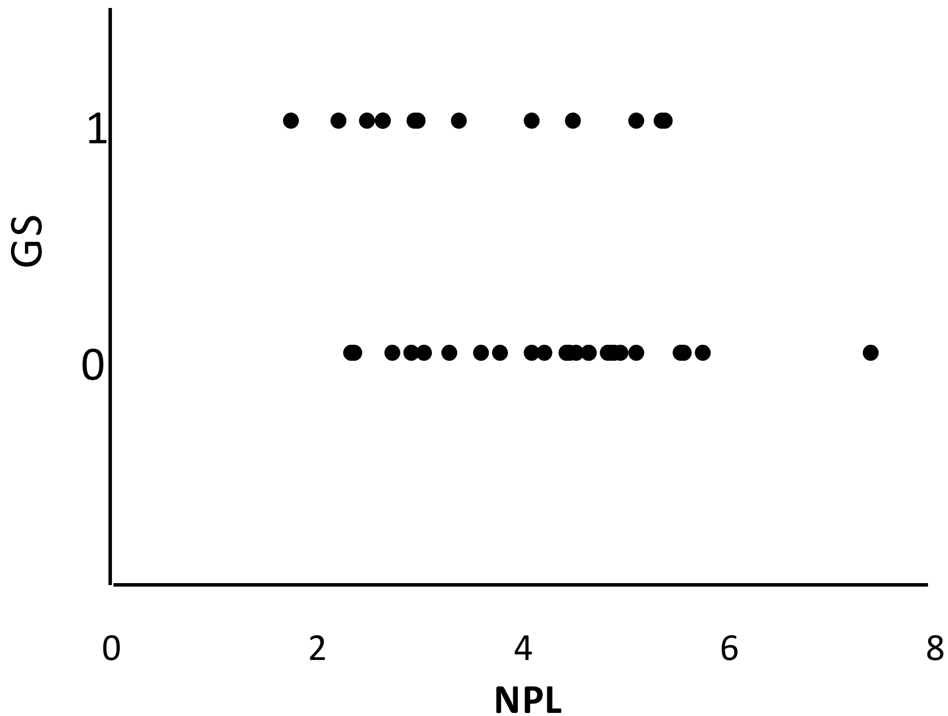
- Results change for better measures in normal times
- Regression results for 2006 (controlling for size)

	ROA	ER
Graduate studies (+)	0.067	– 0.314
Banking experience (+)	0.237**	– 2.507
Public office (–)	0.134	– 3.197

- Only one significant effect (and wrong sign of public office)

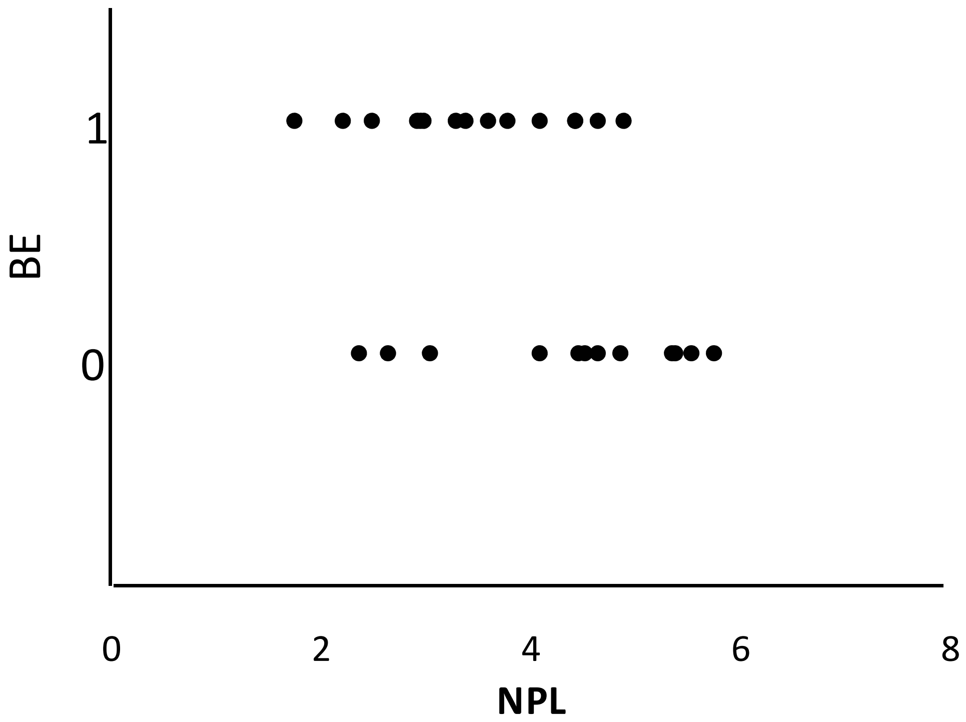
Comment 3: Possible outliers

- Look at raw data: NPL - Graduate studies (GS)



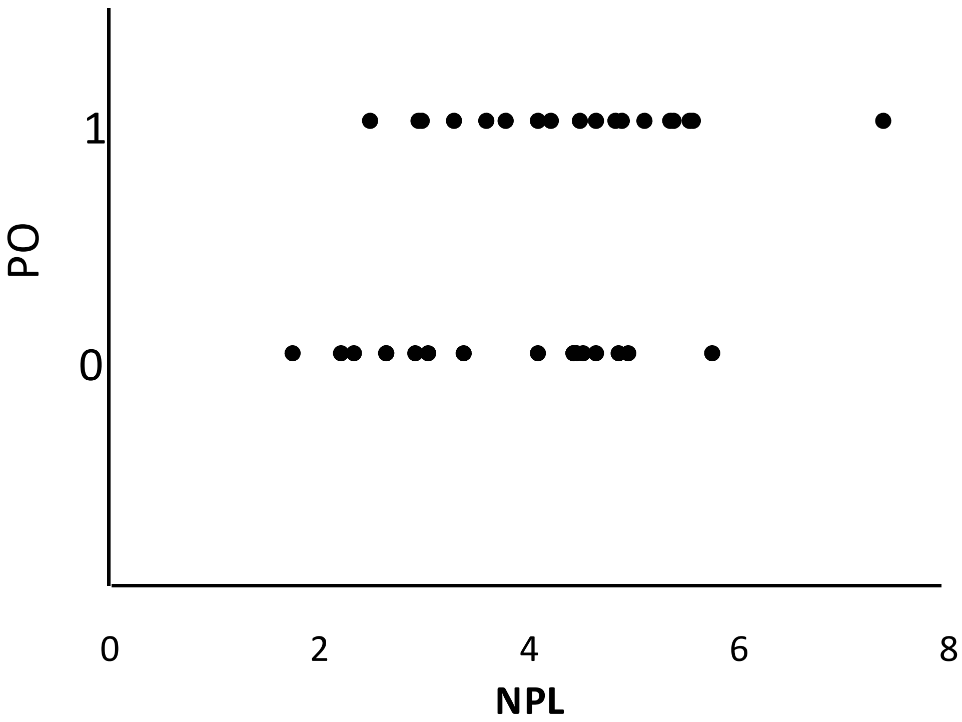
Comment 3: Possible outliers

• Look at raw data: NPL - Banking experience (BE)



Comment 3: Possible outliers

- Look at raw data: NPL - Public office (PO)



Comment 3: Possible outliers

Comment 3.1

- To avoid effect of outliers → run median regressions
- Regression results for NPL

	OLS	Median
Graduate studies	– 0.838*	– 1.500***
Banking experience	– 0.938**	– 1.140
Public office	0.764*	0.403

- No change in sign (but change in size and significance)

Comment 4: Correlation and causation

- Authors write in the introduction:

  "We cannot actually prove any causal connection"

- But they cannot resist the temptation to conclude:

  "The monetary cost of this lack of human capital
  for an average Caja (…) would add 556.4m euro
  of non performing loans."

Comment 4: Correlation and causation

Comment 4.1

- Could the relationship be the other way around?

  → Good banks appointing good CEOs

Comment 4: Correlation and causation

Comment 4.1

- Run inverse (logit) regressions

CEO characteristic = f(ROA, log assets)

	Graduate studies	Banking experience	Public office
ROA	0.933	3.565*	1.794
log assets	0.552*	0.375	– 0.092

- Coefficient of ROA is positive (and significant for BE)

Summing up

- Paper should also look at normal times
- Paper should look at better measures of performance (ROA)
- Given limited data, paper should correct for possible outliers
- Paper should avoid any causal statements

Concluding remark

- Paper looks at effect of governance on performance

    → Only for saving banks

    → No comparison with commercial banks

- Big puzzle: Why savings banks have done so well

    → Despite all these governance issues

    → In competition with some of the best banks of the world

Market shares