

Bankers' Skin-in-the-game and
Bank Risk-taking: Evidence
from Security Issues

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What the Paper Does

- Question: Is bank-risk management improved when bankers have skin-in-the-game, or in other words, when bank executives ?
- Answer(s) : **YES**, but depends upon definition of "improve", and depends upon identifying assumptions
- Method
 - a. Amazing new data
 - b. Interesting by large D:
$$D_i = \beta Z_{i,d} + \Gamma' X_i + \eta_t + \zeta_b + \kappa_d + \tau_a + \epsilon_i \quad (1)$$
$$Y_i = \beta \hat{D}_{i,d} + \Gamma' X_i + \eta_t + \zeta_b + \kappa_d + \tau_g + \tilde{\epsilon}_i \quad (2)$$
 - c. Estimate 1st and 2nd stage - Subscription rate =

My Recommendations

- 1. Emphasize issues not identification**
- 2. Analyze prices and returns**
- 3. Explain "improve."** Clarify meaning and measure of the term and intuition underlying key claim
- 4. Focus on the feasible.** Perfect causal inference difficult in current setup, but you can still learn a lot from the data

Bank Risk and Compensation Schemes

Skin-in-the-game tied to individual decisions

- Common in investment banking - assets not held on balance sheet
- Bonus = f (your profits, your contribution to team, firm profits)
- Investment banks were partnerships before 1990s

Skin-in-the-game tied to collective outcomes

- Common for commercial and investment banks
- Double-liability for U.S. commercial banks is an example

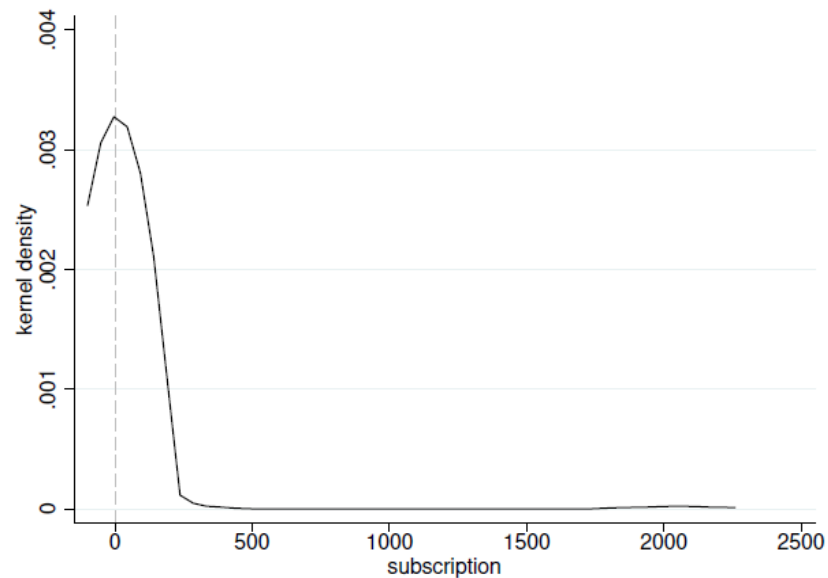
Security Issuance. How It Works

- Banker's role
 - i. Set parameters
 - ii. Guarantee funds raised by issuance
 - iii. If public offering does not raise guaranteed funds, then you buy the security yourself
- Stocks and bonds differ slightly
 - i. Stock - set price, number of shares, and total return
 - ii. Bond - set face, coupon, and number of shares. Price typically par

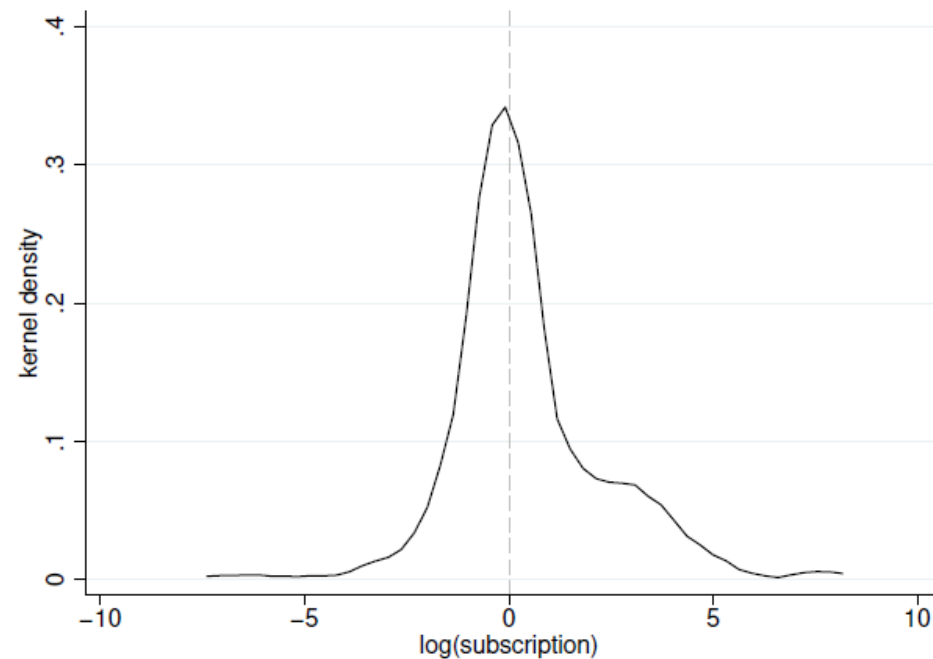
Subscription and Price

- Price excessive => sales insufficient => banker buys securities
- Price low => sale oversubscribed => issuer could have raised more

Figure 5: Distribution of subscription rate of issuance



(a) Times subscribed to issuance



(b) Log(subscription rate) of issuance

ent than

Issues with Estimation and Identification

$$D_i = \beta Z_{i,d} + \Gamma' X_i + \eta_t + \zeta_b + \kappa_d + \tau_g + \epsilon_i \quad (1)$$

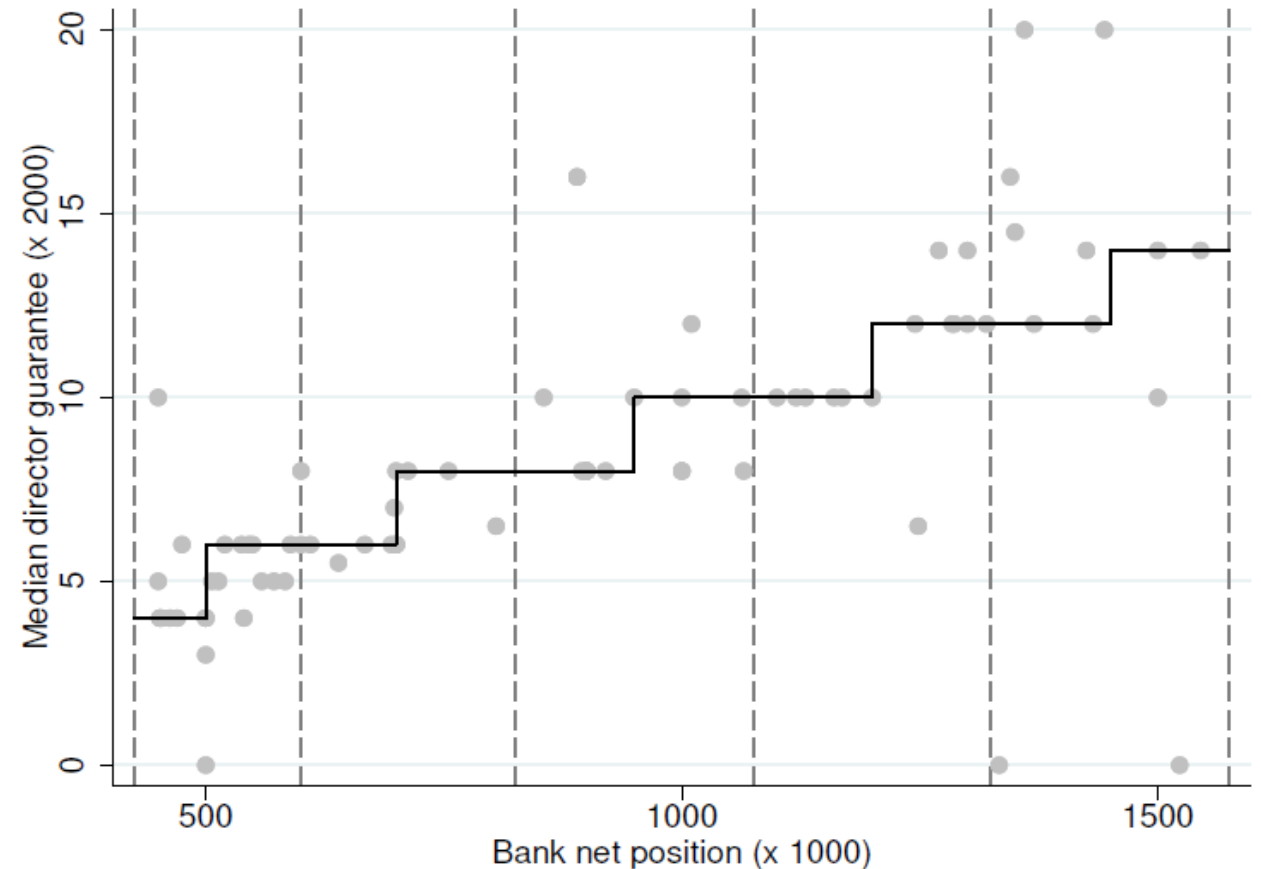
$$Y_i = \beta \hat{D}_{i,d} + \Gamma' X_i + \eta_t + \zeta_b + \kappa_d + \tau_g + \tilde{\epsilon}_i \quad (2)$$

- **Issue 1.** Outcome is log of subscription percentage => underpricing good and overpricing bad ... at the same rate. Why is this risk management?
 - Suggestion. Examine price (relative to optimum) and returns for bank, firm, investors directly
- **Issue 2.** Number of observations. ~240 security offerings.
 - # observations multiplied by ~6 by treating each executives guarantee as an independent offering

Issues with Identification & Instrument

- Discontinuities and instrument assumed. No independent evidence that instrument existed in reality.
- If instrument true, better estimation methods exist, e.g. RD
- Instrument doesn't work when #

Figure 4: Defining the bins



OLS
works
IV fails

Table A1: Subscription to issuance and median banker's guarantee

VARIABLES	(1)	(2)	(3)	(4)
	Log(subscription)	Log(subscription)	Log(subscription)	Log(subscription)
			OLS	
Actual director guarantee (x1000)	0.042*** (0.010)	0.045*** (0.011)		
Log(actual manager guarantee +1)			0.444*** (0.152)	0.451*** (0.158)
R^2	0.257	0.290	0.230	0.255
			RF	
Predicted director guarantee (x1000)	0.028 (0.020)	0.034* (0.020)		
Log(predicted manager guarantee + 1)			0.733 (0.565)	0.624 (0.572)
R^2	0.204	0.234	0.203	0.228
			IV 2nd stage	
Actual director guarantee (x1000)	0.027 (0.019)	0.033* (0.019)		
Log(actual manager guarantee +1)			0.682 (0.520)	0.594 (0.536)
R^2	0.066	0.111	0.030	0.069
			IV 1st stage	
	Actual manager underwriting guarantee	Log(actual manager guarantee + 1)		
Predicted director guarantee (x1000)	1.042*** (0.112)	1.030*** (0.113)		
Log(predicted manager guarantee + 1)			1.074*** (0.274)	1.050*** (0.282)
Observations	239	239	239	239
IV F-stat	87.24	83.33	18.66	18.16
Bin FE	Y	Y	Y	Y
Year FE	Y	Y	Y	Y
Industry FE	Y	Y	Y	Y
Controls	N	Y	N	Y

Note: This table presents estimates the effect of median director underwriting. The median director reflects the median guarantee of 3 or 4 directors of the sample. The dependent variable is the logarithm of the subscription to the security issuance. We only include the observations for which the bank is the lead underwriter and where the total bank guarantee does not exceed 5 million in the currency of issuance. The explanatory variables in columns (1) and (2) are the actual or predicted banker guarantee (in thousands of issued currency). For column (3) and (4), we take the logarithm of the actual and predicted banker guarantee to check whether very large guarantees are driving the results. We take the log(banker guarantee + 1) to preserve the observations where the bankers do not underwrite. The rows present the results for OLS, RF, and IV regression including the first stage. Column (1) and (3) include no controls. Column (2) and (4) includes a set of controls (bank share in syndicate, dummy for public, stocks, foreign, interlocked directorate, a main bank dummy and an IPO dummy. All columns include bin, year and industry fixed effects. Robust standard errors are in parentheses. ***, ** and * indicate significance at 1, 5 and 10% level, respectively.

Amazing Number of Interesting Issues to Examine With This Data

- Figure A2 => Prices lower (i.e. subscription rates higher) when bank is the lead or sole underwriter. Prices higher (subscription lower) when bank joins as partner in syndicate

Syndication structure and incentives influence revenues from IPO

- Do banks better price (i.e. subscription rate near 100%) IPOs for local or foreign entities or for one shot or repeat clients?
- Does better pricing lead to more clients?
- Do revenues earned (or money lost) by banks from investment activities impact portfolio choices (for liabilities or assets) of the