



Bank Fragility and Resolution Costs by Allen, Clark, Hickman, and Richert

Discussion by
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Summary

- The Federal Deposit Insurance Corporation (FDIC) insures (in practice, all) deposits in Banks
- When a bank fails, the FDIC takes control and auctions the legal responsibility for the assets and liabilities of the failed bank in exchange of monetary compensation
- The paper studies those P&A auctions and the costs of bank failure
 - Size of FDIC is important question to avoid costs to the public

Summary II

- Main objective: predicting the auction outcome
- Difficult!
 - Prediction of a regression of actual auction result on failed firm observables has zero correlation with auction results out of sample
 - “Obvious” bc it’s an equilibrium outcome which needs to be modeled (strategic entry/bidding)
- Counterfactuals show importance of attracting more bidders
 - Paper shows that lowering participation constraints mean large gains
 - Other policies?
- Local banks have incentives to participate in auction
 - Paper warns increase in local markets concentration

Summary III

Model has two stages

1. Entry/ bidders selection: main contribution

- **Stage 0:** Eligible bidders become potential bidders signing NDA
 - Comment: This is random. In reality, Modeling implications?
- **Stage 1:** Potential bidders may pay entry costs (hiring big 4, asset valuation, etc.)
 - Comment: Do entry costs make sense? What do they capture?
 - Comment: What are the effects of lowering entry costs (eg, subsidy)? (this provides policy recommendation and benchmarks the contribution of the paper)

2. Bidding stage (Allen et al, RESTud 2024)

Comments I

- In addition to regression, what other benchmarks are possible?
- Correlation between model prediction and actual resolution cost is 53%. Yet, 100% correlation won't happen bc prediction has inherent noise. So, what is a good benchmark?
 - Confidence intervals of model prediction (Table 2)?
- From a policy perspective, precision of prediction outcomes is much more important for larger than smaller banks. How does the model perform in this dimension?

Results and Comments II

- Counterfactuals where size and financial health of potential bidders is changed
 - Removing size constraints altogether results in big increase in bidders
 - Comment: what if size constraint is only relaxed? (Not ideal that very small banks participate - maybe constraint is too tight)
- Local banks are interested bidders too
 - Comments:
 - What else can you say about local/non-local differences? Where do these come from?
 - Interesting policy trade-off between increase in local concentration and more bidders
- Additional counterfactual of a CRE crisis. For a non-finance person, not sure what the CRE crisis analysis adds. Maybe, lower emphasis in intro?

Minor comments

- How are FDIC premiums set?
- Make clear in Intro motivation and difference between two counterfactual scenarios
- Make clear in Intro that failed banks in 2023 were large, which explains big resolution costs
- Paper refers to columns of table with numbers. Yet no numbers in tables
- Make figures B&W printer friendly
- Table 2: include averages
- Explain more that FDIC pctile needs to be uniformly distributed in Table 2