

Essays on Banking Regulatory Reforms and Banking Industry Operation

Regulatory reforms in the U.S. banking industry since the 1990s have not only fundamentally modernized this age-old industry but have also provided us with some natural experiments on its operation and management strategies. My dissertation aims at empirically addressing some unanswered questions that have motivated much debate among banking practitioners, government lawmakers and economists.

In Chapter I, I study the impact of the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) on the "timeliness" and "effectiveness" of market discipline imposed by uninsured depositors. I sets up a theoretical framework of market discipline based on Jordan (2000) in which the market for deposits is described as an interaction between the supply side (both insured and uninsured depositors) and the demand side (banks) wherein market discipline is captured by an upward shifting marginal cost curve for uninsured deposits as bank default risk increases. I collect quarterly data for U.S. commercial banks for five years before the FDICIA (1984-1989) and five years after the FDICIA began to take effect (1992-1996), and construct the risk measures based on accounting data available from Call reports. Along with controlling for effects from the demand side, I employ two-way Granger-Causality tests with application of the generalized method of moments technique developed by Arellano and Bond (1991) for panel data to capture the "timeliness" (predictive power of changes in risk measures on changes in the interest rate spread) and "effectiveness" (predictive power of changes in interest rate spread on changes in risk measures) of market discipline imposed by uninsured depositors such as Jumbo-CD holders. I find clear-cut evidence that the improved regulatory environment provided by the FDICIA successfully revived incentives for uninsured depositors to monitor financial institutions' default risks, and has motivated financial institutions to be more responsive to market discipline by engaging in "self-corrective" actions.

In Chapter II, I examine the impact of the choice of interstate branching mode on entrant banks' branch performance in host markets. The theoretical foundation is based on theories and concepts from industrial organization and management strategy as well as monetary economics. Application of two-stage Heckman estimation corrects for endogeneity problems that are usually neglected in conventional studies measuring the impact of management strategy on performance. I also derive the entrant banks' counterfactual performance gains/losses associated with taking the alternative interstate branching mode to test whether bank managements made the right strategic decisions. The results indicate that under several well-defined circumstances, the de novo interstate branching mode is preferred to M&A, and entrant banks choosing interstate branching via M&A have absolute performance advantages over entrant banks setting up de novo branches. At the same time, both groups of banks categorized by their choice of interstate branching mode seem to have made the right decision. Therefore, free interstate de novo branching might encourage more small banks to enter the industry, which could prove beneficial to the development of small business within the host state without posing much threat to incumbent banks.

In Chapter III, I analyze the shareholder wealth effects of intracompany consolidations of multi-bank bank holding companies after the Riegle-Neal Act of 1994. The Riegle-Neal Act removed the interstate branching restrictions and thus authorized the interstate branching of MBHCS via intracompany consolidation of previous independently chartered subsidiaries in different states. This chapter investigates the wealth effects of intracompany consolidations with an event study methodology that studies the relation between the shareholders' expectation of long run benefits of intracompany consolidation and determinants such as financial and efficiency conditions, geographic and product scope, and the size and age of MBHCs before the consolidation.