Geographic Diversification in Banking and its Implications for Bank Portfolio Choice and Performance

Comments by Jaap Bos
(Netherlands Central Bank)
Overview

- Literature
- Methodology
- Data
- Recommendations
Literature

Bank Performance

- Literature

- Scale/Scope
  - 100M USD threshold
  - Insignificant

- X-efficiency
  - Managerial?
  - Significant

- Diversification
  - System Vs. Investor
  - Measurement?
• Scale/scope: not bank-specific

• X-efficiency: Berger and DeYoung (2001)

Methodology

- What is diversification?
  - Correlation
  - Distance
  - Inter-state Vs. Intra-State

- What is a BHC?
  - Organizational Vs Legal
  - Portfolio choice (abstract)
Data

- Riegle-Neal Interstate Banking and Branching Efficiency Act
  - Section 109

- Mergers/Takeovers
  - Loan portfolio quality (“for example, not all banks in Texas failed”)
Data (cont.)

- Riegle-Neal (& GLBA, section 106):
  “Section 109 prohibits any bank from establishing or acquiring a branch or branches outside of its home State under the Interstate Act primarily for the purpose of deposit production, and provides guidelines for determining whether such a bank is reasonably helping to meet the credit needs of the communities served by these branches”

[DOCID: fr06jn02, Fed. Register 67 (109)]
Data (cont.)

- Joint final rule:
  "beginning no earlier than one year after a bank establishes or acquires a covered interstate branch, the appropriate agency will determine whether the bank satisfies a loan-to-deposit ratio screen [...] that has been established by section 109. [idem]"
Data (Cont.)

Geographic diversification:

$$GEODIV_i = 1 - \sum_j \left( \frac{\text{market } j \text{ deposits}}{\text{total deposits}_i} \right)^2 = [0,1)$$

Screen (for bank i in market j with N banks):

$$L2D = \left( \frac{\text{loans}_i}{\text{deposits}_i} \right) \geq 0.5 \left( \sum_{n=1}^{N} \frac{\text{loans}_n}{\text{deposits}_n} \right) / N$$
Recommendations

- Be more specific w.r.t. your hypotheses
- Limit the number of tables
- Compare inter-state vs intra-state results
- Refine your diversification measure
- Formalize (and control for) the relationship between loans and deposits
- Control for loan loss reserves