Discussion of: The Effects of Supervision on Bank Performance: Evidence from Discontinuous Examination Frequencies by Marcelo Rezende and Jason J. Wu

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Great paper: important question & nice identification strategy

- Are supervisory policies useful?
- Nice identification in the context of banking supervision: fuzzy regression discontinuity
 - examination frequencies jump at an asset threshold
 - threshold triggering high frequency varies over time

Supervision improves banks' ROE by reducing loan loss

Interpreting the results

frequent examinations \rightarrow reduce risk and increase ROE

- Implication: banks are *not* operating on a risk-return efficient frontier
- Question: Do regulators, at large, know how to run a private business better than private entities?
- Possible test: whether the result is more prominent for banks banks with poor governance and management incentives

How to bank examinations a ect bank performance?

This paper's story: Regulators provide information and guidance during examinations

 Alternative story: Enhanced incentives to perform in anticipation of examination

- an incentive disciplining device
- reduce agency cost
- \Rightarrow correct actions ex-post v.s. align incentives ex-ante

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Empirical design: measure examination intensity

- ► D_{t-1} : number of days between the two most recent examinations as of Dec 31 at year t-1
- Different effects of # days between two recent exams v.s. # days after the most recent exam
- Control the number of days after the most recent examination (as of Dec 31 at year t-1)

Empirical design

Choice of sample: safe and sound banks (that satisfy all criteria)

- Main target of bank supervision
- A valid (weaker) instrument for all banks
- bank-specific control variables: leverage, M/B ratio, PE ratio, Dividend-price, etc.
- macroeconomic control variables: interest rate, PPI, CPI, unemployment, etc.

Empirical design

- Loan loss measures involve reporting incentives
- Banks may deliberately choose asset levels
- Possible cyclicality in the effects of supervision

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