BOARD OF GOVERNORS *of the* FEDERAL RESERVE SYSTEM

Discussion of "Securities Portfolio Management in the Banking Sector" by Rosen and Zhong

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*Note: the views expressed are those of the speaker and not those of the Federal Reserve System.

Overview

- Nice paper!
- Good use of regulatory data on bank securities holdings
  - Long time series covering more than the recent episode of deposit market shocks

- Main results:
  - Banks are "net purchasers of securities", and more likely to sell safe securities than risky securities
  - Deposit flows are reliable predictors of securities portfolio adjustments
  - Asymmetry in bank response to deposit base shocks
    - Purchase 22 cents/$ of deposit inflows, sell 12 cents/$ of deposit outflows

Why is this research important?

- Many margins for banks to adjust to changing economic conditions
    - Buy/Sell securities (or assets more generally)
    - Re-optimize balance sheet risk composition

- Important to think about which incentives banks face and how that impacts their responses

- Securities account for about 20% of bank balance sheets, yet little is known about how banks manage these portfolios

Comment 1: care needed when identifying security sales

- Authors observe both Fair Value (FV) and Amortized Cost (AC) of security holdings

- Use changes in AC to identify changes in the stock of holdings (s_t) not due to market price changes

$$AC_t = (1 - s_t)AC_{t-1}.$$

- AC can change over time for reasons other than sales/purchases

  - Amortization/accretion of premia/discounts when bonds are not purchased at par

  - For "Advanced Approaches" banks over most of this time period, fair value hedge gains/losses are included in a basis adjustment to AC

$$Unrealized\ GainLoss \equiv FV - AC.$$

Comment 2: not all funding shocks are deposit outflows

- Paper documents empirical relationship between deposit outflows and securities sales

- Deposit outflow ≠ funding shock

- Credit line drawdowns during the pandemic represented a large bank funding shock
  - Unrelated to deposit franchise

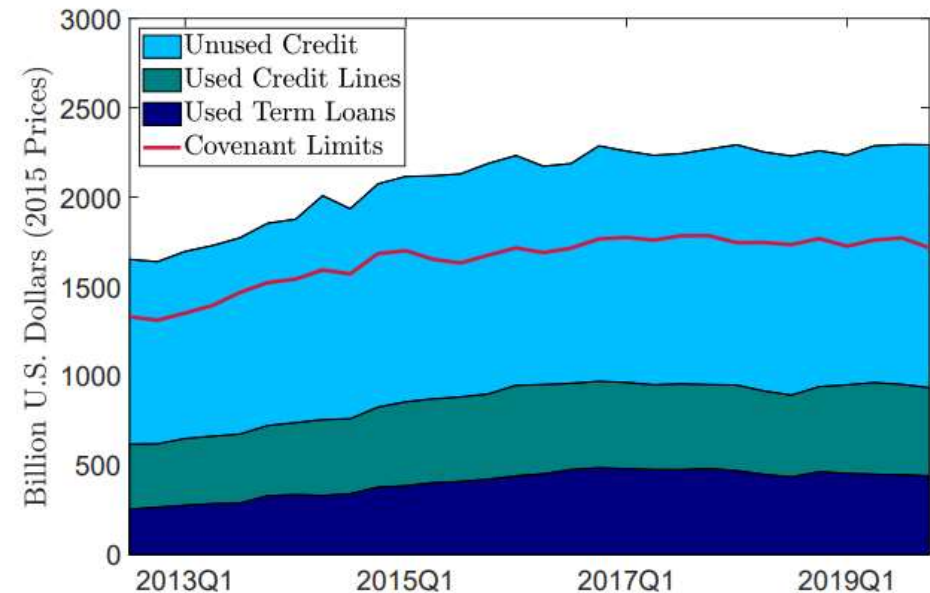- Many firms re-deposited credit lines drawdowns with their bank

Figure 3.1: Aggregate term loans and credit lines.

Notes: The figure shows the total amount of term loans and credit lines across all banks in billion U.S. dollars. Unused credit is the difference between committed and used credit of credit lines and term loans. The red line indicates covenant-adjusted undrawn borrowing capacity (see text and Appendix B.3 for details). Sample: 2012:Q3 - 2019:Q4.

Source: Greenwald, Krainer, and Paul (2023)

Comment 3: lots of regulatory changes over this time period

- Liquidity Coverage Ratio (2014) changed bank demand for liquid assets to absorb shocks to deposit franchise

- Securities portfolio choice related to:
    - Accounting treatment (Kim, Kim, and Ryan (2023))
    - Regulatory treatment of gains and losses (Greenwald, Krainer, and Paul (2023))
    - Time-variation in the regulatory pass-through of securities gains and losses (Fuster and Vickery (2018))

- Greater acknowledgment of the regulatory constraints faced by banks should help sharpen the empirical estimates

Comment 4: example, acknowledging bank constraints

- Greater acknowledgment of the economic and regulatory constraints faced by banks should help sharpen the empirical estimates

- For example, depending on health of balance sheet, banks typically choose to raise funding (at margin) through the Federal Home Loan Banks rather than selling securities