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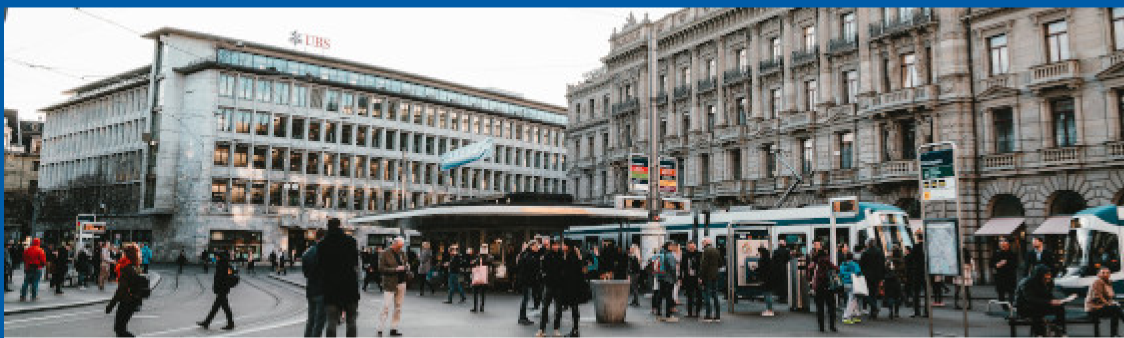
Leibniz Institute for Financial Research SAFE

Dear Marius Luta,

In this edition of the digital newsletter of the Leibniz Institute SAFE, we showcase new findings on the banking crisis of early 2023. We also consider how human interaction between banks and customers can prevent mortgage default.

We hope you enjoy reading about our research and welcome your feedback at newsletter@safe-frankfurt.de.

The bonanza of distressed bank takeovers



A SAFE research team reassesses acquisition gains of several banks in the spring of 2023, emphasizing that accounting figures are misleading and resolution authorities need to prepare for efficient auctions

In the wake of the spring 2023 banking turmoil, a team of economists and lawyers at SAFE at the request of the European Parliament's Committee on Economic and Monetary Affairs (ECON) examines windfall profits accruing at acquirers of failing banks. The in-depth analysis pursues a methodological rigorous approach by estimating market-based Cumulative Abnormal Returns (CAR). In contrast to the $44 billion in windfall profits reported in the financial press, the researchers find positive abnormal returns of about half that amount, shedding light on the complexity of valuing earnings in the banking sector.

In their analysis, Florian Heider, Jonas Schlegel, Tobias Tröger, and Mark Wahrenburg raise concerns about the misleading nature of using accounting figures to assess the economic value of acquiring a failed bank. The authors emphasize the importance of factors such as unrealized losses that are not fully reflected in accounting data. Their research carefully analyzes stock price reactions using the CAR methodology to provide a more accurate representation of economic value. The CAR-based figures, when quantified in dollar amounts, show significantly lower, albeit still meaningful gains for the acquirer compared to the accounting-based calculations in newspaper reports.

The researchers examined specific cases of bank acquisitions during the crisis – namely, UBS's acquisition of Credit Suisse, New York Community Bank's acquisition of Signature Bank, First Citizens' acquisition of SVB, and JPMorgan Chase's acquisition of First Republic – and highlight the challenges regulators faced in dealing with illiquidity-driven failures. The hasty sale of these banks resulted in massive losses for bank shareholders, bondholders, and the Federal Deposit Insurance Corporation (FDIC). The complexities of loss-sharing arrangements and the fate of assets not transferred to acquirers add additional layers of complexity to the valuation of the sale.

The study addresses potential shortcomings in the resolution process and offers comprehensive recommendations to mitigate windfall profits for acquiring banks. It emphasizes the importance of auctions with sufficient bidders, early and thorough auction preparation, and the need to pre-arrange for a sale of both significant and non-significant banks.

Ultimately, the researchers call for a reassessment of bank regulation and supervision strategies, arguing for auction-based resolution and enhanced sale preparation. As the financial landscape evolves, the findings of this study provide critical guidance to policymakers and industry stakeholders as they navigate the challenges of bank acquisitions in times of crisis.

Read SAFE White Paper No. 98 here

Notable Research: The value of personal contact in bank lending

Personal Communication in an Automated World: Evidence from Loan Repayments

By Christine Laudenbach, Director of SAFE's Household Finance Research Department, and Stephan Siegel, University of Washington.

In their paper "Personal Communication in an Automated World: Evidence from Loan Repayments," forthcoming in the *Journal of Finance*, the authors examine the changing dynamics between financial service providers and customers. Using data from a large German bank, their research analyzes the effects of personal, two-way communication versus impersonal, one-way communication on the payment behavior of delinquent borrowers.

Using a unique setup, the paper observes delinquent borrowers who receive a personalized phone call from a bank agent or a follow-up letter. The results reveal substantial differences: personal communication significantly increases the likelihood of timely repayment by 34.4 percentage points, while reducing default and loan termination by 23.8 and 12.4 percentage points, respectively. Importantly, these effects persist over time, suggesting a lasting impact on borrowers' payment behavior. Notably, the authors reject the idea that increased communication frequency is the primary driver of the observed effects. Interviews with call center agents and analysis of borrower responses suggest that it is the personal nature of the call, rather than its content, that significantly influences payment outcomes.

The study contributes to the understanding of the human element in bank lending, emphasizing the importance of the relationship between banks and customers. In contrast to past studies, the authors focus on non-contractual factors, revealing how communication acts as a crucial determinant of loan repayment behavior. Importantly, these effects persist beyond the initial delinquency, reducing the probability of future default and loan termination.

The paper's findings are also consistent with studies of the effectiveness of treatments and interventions in improving payment behavior. While advances in technology and communication formats are reshaping consumer finance, the authors suggest that maintaining or adding a human element to communication remains critical to borrowers' willingness to meet their financial obligations.

[Read the full paper here]

#SAFEHappenings




SAFE sends four candidates to the academic job market
The SAFE Ph.D. students Ruggero Jappelli, Errikos Melissinos, Christian Mücke, and Rachel Nam (shown above from left to right) are currently on the academic job market for economists. Find out about their job market papers, research interests, and research experience abroad here.

Leibniz Best Minds Grant
Nikolai Badenhoop, a legal scholar and postdoctoral researcher at SAFE, has been awarded a five-year grant as part of the 2024 Leibniz Best Minds Competition to lead a Leibniz Junior Research Group on "Sustainable Finance Law in Europe." The project will begin in January 2024.

Call for Applications – Ph.D. Programs in Finance and Economics
SAFE and the Graduate School of Economics, Finance, and Management (GSEFM) at Goethe University Frankfurt encourage outstanding students to apply to their full-time Ph.D. programs in Finance and Economics. The first application deadline is 31 January 2024, and the programs are scheduled to start in October 2024. SAFE will offer full scholarships to three outstanding applicants to the Ph.D. programs in Finance or Economics (given finance as one area of study in the latter case). Learn more about the Ph.D. in Finance at GSEFM in Frankfurt here.

Handpicked Literature

Peter Andre, Assistant Professor of Behavioral Finance at SAFE and Goethe University Frankfurt, recommends *The Financial Diaries: How American Families Cope in a World of Uncertainty* by Jonathan Morduch and Rachel Schneider:

“Case studies, statistics, and theory are all of vital importance for studying economic behavior. However, we can only fully understand the financial decisions made by households if we comprehend the day-to-day struggles that they endure. *The Financial Diaries* furnishes a unique window onto the economic life of the American family that cannot be conveyed by statistics alone. The reader is immersed in the lives of several American families, accompanying them over the course of a year while witnessing their victories and defeats. Jonathan Morduch and Rachel Schneider draw on detailed financial diaries and regularly recurring interviews to show how households save, spend, and cope with uncertainty. *The Financial Diaries* not only offers a trove of interesting data, but also a wealth of fascinating stories. Part economic study, and part human-interest story, the book showcases in a sympathetic fashion the economic realities faced by many Americans today.”

You can find the book here

Further Content

- **News:** Artificial intelligence GPT behaves more cooperatively than humans in decision-making situations
- **Video:** SAFE Policy Web Seminar – Vorstellung des Finanzstabilitätsberichts 2023 der Bundesbank
- **SAFE Finance Blog:** Hesse needs a financial education strategy (Christine Laudenbach and Vincent Lindner)
- All upcoming events and SAFE publications

About SAFE
The Leibniz Institute for Financial Research SAFE ("Sustainable Architecture for Finance in Europe") promotes interdisciplinary research and independent policy advice about the international financial system with a focus on Europe. The institute aims to contribute to a sustainable, crisis-proof financial architecture that stimulates innovation and serves economic and civil needs. Researchers from the fields of economics, law, and political science collaborate at SAFE on questions in the areas of Financial Intermediation, Financial Markets, Household Finance, Macro Finance, and Law & Finance.

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