The Economics of Bank Supervision

Thomas M. Eisenbach, David O. Lucca, and Robert M. Townsend*

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Abstract

We estimate a structural model of bank supervision on work hours of Federal Reserve staff supervising the consolidated universe of U.S. banks, with instrumental variables to account for the endogeneity of supervision to bank risk. Model estimates indicate that increased supervision lowers bank risk, but resources are only imperfectly reallocated to riskier banks. Needed supervisory resources grow less than proportionally with bank size and supervisors weight larger banks more than proportionally. We characterize times series variation in the aggregate shadow cost of resources, and show that it is not equalized across Federal Reserve districts.

Keywords: bank supervision, bank regulation, monitoring, time use
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*Eisenbach and Lucca: Federal Reserve Bank of New York, thomas.eisenbach@ny.frb.org and david.lucca@ny.frb.org; Townsend: Massachusetts Institute of Technology, rtownsend@mit.edu. The views expressed in this paper are those of the authors and are not necessarily reflective of views at the Federal Reserve Bank of New York or the Federal Reserve System. For valuable comments, we thank Doug Diamond, Richard Crump, Mark Flannery, Xavier Freixas, Paul Goldsmith-Pinkham, Daniel Lewis, and Gyongyi Loranth, as well as audience members at the New York Fed Conference on Supervising Large & Complex Financial Institutions, the Wharton Conference on Liquidity and Financial Crises, the BAFFI CAREFIN Annual International Banking Conference, the Jackson Hole Finance Conference, the Banco de España–CEMFI Conference on Financial Stability, the Western Finance Association Meeting, and the Chicago-Minnesota Theory Conference, as well as at Hong Kong University, Hong Kong University of Science and Technology, Singapore Management University, Nanyang Technological University, National University of Singapore, University of Mannheim, Bundesbank, Frankfurt School of Finance, and the European Central Bank. We thank Emily Eisner, Eilidh Geddes, Helene Hall, and Alice Liang for excellent research assistance. Any errors are our own.