Crisis Interventions in Corporate Insolvency

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Discussion by Rustam Jamilov

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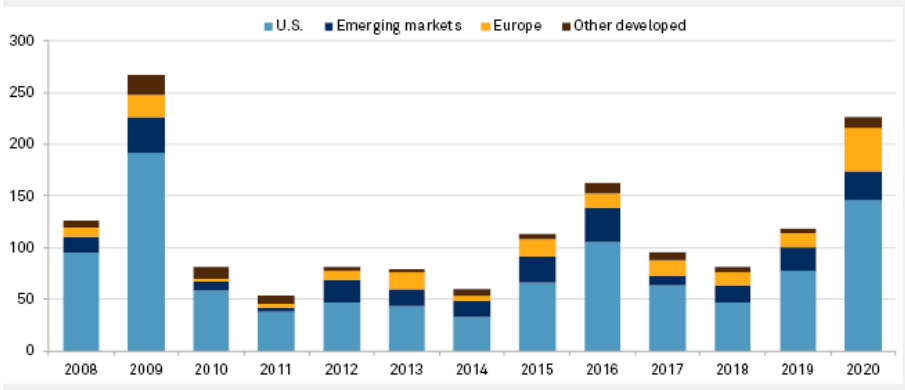
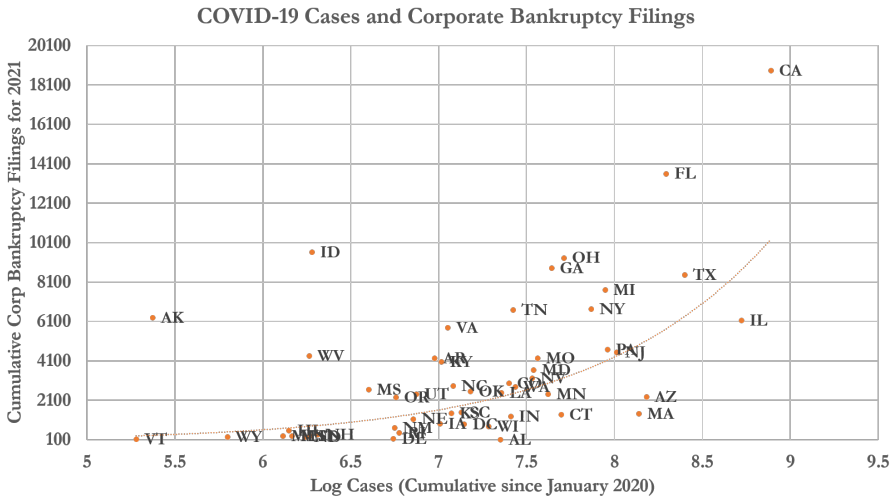
Global Corporate Bankruptcy Surge



Data as of Jan. 6, 2021.
Other developed region includes Australia, Canada, Japan and New Zealand.
Sources: S&P Global Ratings Research; S&P Global Market Intelligence's CreditPro

Lasting Impact of the COVID-19 Pandemic



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- An elegant, important, and timely paper
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- Social planner internalizes externalities, cleanses low-value firms to promote solvency of high-value borrowers
- Extension to bank heterogeneity offers novel insights on optimal seniority structuring and credit (re-)allocation

Comment 1: Relationship Lending

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- **Testable prediction**: banks with a higher propensity to form long-lasting credit relations are less likely to allow borrowers to liquidate?

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- Corollary 1 offers guidance: planner elects to liquidate more firms if three conditions are met:
  1. Loan demand of bankrupt firms > demand of solvent firms
  2. High price and quantity elasticity of liquidations
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- Points (1) and (3) seem reasonable
- Point (2) is contentious but can be tested, see next slide

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- **Testable prediction**: do liquidations lead to higher book or market values of lending? Literature surely has tested the opposite, i.e. the *determinants* of liquidations, but what of the *consequences*?

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- Similar findings in Greenwald et al. (2020)

Comment 5: Bank Market Power

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- In a constrained-efficient sense, the planner may prefer a more continuation-friendly rule since the aggregate benefit of liquidations is permanently lower
- **Testable prediction**: financial concentration (market power) yields more reorganizations, ceteris paribus; can test in the cross-section or time-series

Comment 6: Bank Heterogeneity

- Results on optimal seniority structure are consistent with recent quantitative normative analysis (Jamilov, 2021)
  - Optimal regulation reallocates credit towards more efficient intermediaries, which are also large because marginal costs fall with size
  - Collateral constraint tightness falls with bank size, leading to concentration of the marginal propensity to lend in the right tail

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1. The policy increases concentration in the banking sector, which is already countercyclical organically. Concerns for effects on competition, especially if markups and deposit franchise capital increase with bank size
2. The policy may be fueling the "too-big-to-fail" externality down the line

Minor Comments

- Operationalizing the model quantitatively with a simple calibration exercise would be very instructive both for intuition and policy prescriptions
- Social planner's implementations resemble traditional "bail-outs" of banks; but those interventions are not internalized by the banks themselves, which is an assumption. If banks know about the transfer, what would they prefer to do?
- Exogeneity of q is a strong assumption. Does this implicitly assume some form of deposit insurance? This is a binding friction in itself
- Are arbitrageurs just un-skilled households? If yes, then why do they receive a zero weight from the planner? If no, then who owns all firms and banks and what are the arbitrageurs exactly?
- A natural follow-up would be to extend the framework to infinite horizon. But, keeping the assumption that viability states v are either known or not may be too extreme. One alternative is to allow firms to (optimally) learn about their persistent types. The speed of Bayesian resolution of type uncertainty would then matter explicitly for the optimal liquidation rule, further enriching the framework

Summary

- Very elegant model and well-written paper
- Exemplary theoretical work - lots of testable predictions that can be easily take to the data
- Helps organize thoughts on core issues in micro-macro-finance
- Theory-driven pandemic-related proposals and ideas are welcome and needed

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