Comments by George G. Kaufman

on

"On The Independence of Assets and Liabilities: Evidence from U.S. Commercial Banks, 1990-2005"

by

Robert DeYoung and Chiwon Yom

Paper:

- "Assets and Liabilities" in title refers to on-balance sheet accounts
- Views "traditional" banking as focusing on maturity intermediation resulting in interest rate risk exposure and management of on-BS accounts
- Explores whether development of off-BS derivative instruments and deregulation have reduced need to manage IRR thru on-BS accounts (increased asset-liability independence).

Paper (cont.)

- Concludes that they have and maturity characteristics of two sides of on-BS now more independent of each other, particularly for larger banks, and bank markets more complete.
- Banks of all sizes now more similar in IRR management than before.

My Comments:

- Interesting paper with credible results.
- Main contribution is use of canonical correlation that permits vectors of variables to be considered rather than only individual variables.
- Seems reasonable approach, but I nor my colleagues knowledgeable in this technique so will assume used correctly.
- Have number of relatively minor comments that should improve paper.

Random Suggestions:

- Is Maturity intermediation traditional role of banking?
  - Only in Post-World War II era.
  - Before early 1900s, major source of funding short-term demand deposits and assets limited to short-term. Mortgages prohibited for national banks. Basic role was credit intermediation (real bills)
  - Maturity intermediation not limited to commercial banks; just more obvious and studied. Non-financial firms consider maturity of debt when financing inventories or plant.

Random Suggestions (cont.)

- Does development of ABS reduce banking intermediation?
  - Not obvious. Banks not only create ABS but buy them, particularly for MBS.
  - Permits banks greater liquidity and geographic diversification.
  - If banks buy ABSs, puts interest rate risk back on banks' books but give wider choice of managing risk.

Random Suggestions (cont.)

- Why smaller banks more asset-liability independent in earlier period? Greater emphasis on mortgage loans?
- Is non-interest income becoming more important?
  - Recently (since 1990) probably, but measured relative to interest or total income primarily reflects decline in interest rates.
  - Earlier? Non-interest income more important in 1930s.
- What is difference between demand and core deposits?

Random Suggestions (cont.)

- For purposes of interest rate risk, variable rate mortgages should be classified as short-term not long-term instrument.
- Relationship between short-and long-term interest rates not always upward so that long-term deposits not always costly. Yield curve at times flat and even downward sloping (1920s) and expectations theory says does not matter.