The Funding of Subsidiaries Equity, “Double Leverage,” and the Risk of BHCs

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[1] The views expressed hereafter are those of the authors and do not necessarily reflect the views of the ESM.

General appraisal

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- provides an extensive discussion on "double leverage"
- follows a rigorous econometric analysis based on a number of different specification/estimation strategies
- does not content itself with correlations but tries to uncover some degrees of causality (e.g. Granger causality, IV, etc.)

Key results

- A higher DLR $\frac{xE(S)}{E(HC)}$ is associated with/causes more volatile stock returns
- This relationship is non-linear, mostly driven by holding companies with a large $DLR \geq 100\%$
- Capital ratios and the global financial crisis could influence the market effect of DLR
- The type of subsidiaries matters: stock returns are more volatile when holding companies invest in bank subsidiaries

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  - The impact of regulatory capital and the crisis on the marginal effect of DLR: Capital dampens the marginal effect of DLR in OLS but reinforces it in the panel regression
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- Potential collinearity issue: DLR and size might be highly correlated
    - Useful to provide a correlation matrix of independent variables
- The impact of the crisis deserves further exploration
    - Potential reverse causality? Banks (double) leverage up in the upturn because
        - Risks were compressed
        - Capital requirements (based on a VaR calculation) allow more leverage
    - Is there a change of behaviour before and after the crisis?

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  - Are all BHCs in the sample publicly listed? What about unlisted companies?
- To what extent does double leverage differ from leverage?
  - Is DLR a proxy for leverage?

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- Basel III (and Basel II) requires BHC to deduct from their own equity significant holdings of other financial intermediaries
- Recent banking regulations (CRR) in Europe are even tougher
  - Articles 36 and 43-49
  - Double leverage *de facto* impossible

Minor comments

- Useful to provide additional information on the sample
    - How many BHCs? How many subsidiaries on average?
- Some suggestions on the structure of the paper (to make the main story/results more salient)
    - Section 2, which is useful for readers to understand the key concepts, is a bit too long
    - Focus on one baseline regression + one or two most relevant alternatives