Summary of the Discussion of the Paper by G. Sheldon

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Replying to the comment by SPREMANN, SHELDON accepted the point that his calculated probabilities of bank default apply only to a point in time rather than to the course of time. Contrary to SPREMANN, SHELDON did not find the mean-variance-approach to be appropriate for analyzing the effect of leverage restrictions on the risk-taking of banks because it assumes away default from the start (i.e., does not allow for the truncated distribution of returns for a limited-liability bank).

GUMERLOCK opened the discussion by pointing to the especially high default threshold of Swiss banks (see Table 3) and asked whether this was a cause for complacency or brought the Swiss banks in an uncompetitive position in an increasingly globalized environment? SHELDON referred to the appendix of his paper and attributed the high threshold to the unrepresentative composition of the Swiss banks in the sample (i.e., dominance of cantonal banks). Referring to the Swiss banks, ZUBERBÜHLER remarked that the guidelines of the Basle Accord were less stringent than the capital requirements already in force in Switzerland prior to the Accord.

BOOT doubted the representativity of the Dutch banks in the sample as they exhibited an above-average capital to assets ratio (CAR). SHELDON admitted a possible selection bias in the sample but asserted that this effect, being constant, should subtract out in an intertemporal comparison. BOOT questioned the use of actual CARs in determining whether the introduction of the guidelines represented a binding constraint and suggested that the degree of prior fulfillment would be more informative. SHELDON concurred but pointed to the limitations of his data. Moreover, he indicated that a similar study from FURLONG (1988), in which the degree of prior fulfillment was observed, achieved comparable results.

GOODHART raised a question relating to the measurement of the variance of return on assets. He found that the return variance of a single bank should be corrected for changes in market variance. SHELDON agreed and added that this is what he meant in the conclusions to this paper where he points out that aggregate market forces may be covering up the effects of CAR changes. SPREMANN closed the discussion by noting that with respect to the issue of bank failure, it is not a question of whether the bank defaults with respect to the market index as a whole, but whether it defaults at all (i.e., in absolute terms).