Research Working Papers

Competition and Bank Fragility

by: W. Blake Marsh and Rajdeep Sengupta

June 18, 2017

The buildup in commercial real estate loan concentration and the consequent fragility in small U.S. banks can be traced to an increase in large bank competition following interstate deregulation.

RWP 17-06, June 2017

We present empirical evidence documenting how increased competition can increase the fragility of banks using U.S. banking data from 1990 to 2005. In particular, we find that local banks belonging to community (CBOs) and regional banking organizations (RBOs) increased their share of commercial real estate (CRE) loans as competition from large banking organizations (LBOs) increased. The paper traces the buildup in CRE loan concentrations in such local banks before the financial crisis to the expansion of LBO activity into local banking markets. After instrumenting for LBO entry into new markets, we find a steady and continuous increase in CRE loan shares at local banks. CRE loan concentration was a principal cause of post-crisis bank failures, and this paper presents evidence showing how competition increases not just individual bank fragility, but the stability of the banking sector as a whole.

JEL Classification: E44, G21, G28

Article Citation

- Marsh, Blake, and Rajdeep Sengupta. 2017. "Competition and Bank Fragility." Federal Reserve Bank of Kansas City, Research Working Paper 17-06, June. Available at https://doi.org/10.18651/RWP2017-06

Related Research

- Bassett, William F. and W. Blake Marsh. Forthcoming. “Assessing Targeted Macroprudential Financial Regulation: The Case of the 2006 Commercial Real Estate Guidance for Banks. *Journal of Financial Stability*
- Regehr, Kristen, and Rajdeep Sengupta. 2016. “Sectoral Loan Concentration and Community Bank Performance.” Federal Reserve Bank of Kansas City, Research Working Paper 16-13, December. Available at

https://doi.org/10.18651/RWP2016-13

Authors

W. Blake Marsh

Senior Economist

Blake Marsh is a senior economist at the Federal Reserve Bank of Kansas City. He joined the Banking Research department in July 2016. His research areas are commercial bank regulation and financial intermediation. His current research examines commercial real estate lending, syndicated corporate lending, and financial innovation. Mr. Marsh holds a B.A. in economics from The George Washington University and M.A. and Ph.D. degrees from American University. He previously held positions at the Board of Governors of the Federal Reserve System and in the mortgage industry.

Rajdeep Sengupta

Senior Economist

Rajdeep Sengupta is a senior economist at the Federal Reserve Bank of Kansas City. He joined the Kansas City Fed in July 2013. His research areas are banking, financial intermediation and applied microeconomics. His most recent work focuses on lender competition and the subprime mortgage market. He received his Ph.D. from Vanderbilt University in 2006 and was an economist at the Federal Reserve Bank of St. Louis.