



## Research Working Papers

# Competition and Bank Fragility

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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.

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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

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### 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



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