JOURNAL ARTICLE

Why Don't All Banks Practice Regulatory Arbitrage? Evidence from Usage of Trust-Preferred Securities

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The Review of Financial Studies, Volume 29, Issue 7, July 2016, Pages 1821–1859, https://doi.org/10.1093/rfs/hhw007

Published: 09 February 2016

Abstract

We investigate why only some banks use regulatory arbitrage. We predict that banks wanting to be riskier than allowed by capital regulations (constrained banks) use regulatory arbitrage, while others do not. We find support for this hypothesis using trust-preferred securities issuance, a form of regulatory arbitrage available to almost all U.S. banks from 1996 to Dodd-Frank. We also find support for predictions that constrained banks are riskier, perform worse during the crisis, and use multiple forms of regulatory arbitrage. We show that neither too-big-to-fail incentives nor misaligned managerial incentives are first-order determinants of this type of regulatory arbitrage.

Received November 27, 2014; accepted December 17, 2015 by Editor Philip Strahan.

JEL: G01 - Financial Crises, G21 - Banks; Depository Institutions; Micro Finance Institutions; Mortgages, G28 - Government Policy and Regulation

Issue Section: Articles