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SHORTER PAPERS, DISCUSSIONS, AND LETTER

Bank Capital: Lessons from the Financial Crisis

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Abstract

Using a multicountry panel of banks, we study whether better capitalized banks experienced higher stock returns during the financial crisis. We differentiate among various types of capital ratios: the Basel risk-adjusted ratio, the leverage ratio, the Tier 1 and Tier 2 ratios, and the tangible equity ratio. We find several results: (i) before the crisis, differences in capital did not have much impact on stock returns; (ii) during the crisis, a stronger capital position was associated with better stock market performance, most markedly for larger banks; (iii) the relationship between stock returns and capital is stronger when capital is measured by the leverage ratio rather than the risk-adjusted capital ratio; (iv) higher quality forms of capital, such as Tier 1 capital and tangible common equity, were more relevant.

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