INCONSISTENT REGULATORS: EVIDENCE FROM BANKING*

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We find that regulators can implement identical rules inconsistently due to differences in their institutional design and incentives, and this behavior may adversely impact the effectiveness with which regulation is implemented. We study supervisory decisions of U.S. banking regulators and exploit a legally determined rotation policy that assigns federal and state supervisors to the same bank at exogenously set time intervals. Comparing federal and state regulator supervisory ratings within the same bank, we find that federal regulators are systematically tougher, downgrading supervisory ratings almost twice as frequently as do state supervisors. State regulators counteract these downgrades to some degree by upgrading more frequently. Under federal regulators, banks report worse asset quality, higher regulatory capital ratios, and lower return on assets. Leniency of state regulators relative to their federal counterparts is related to costly outcomes, such as higher failure rates and lower repayment rates of government assistance funds. The discrepancy in regulator behavior is related to different weights given by regulators to local economic conditions and, to some extent, differences in regulatory resources. We find no support for regulator self-interest, which includes "revolving doors" as a reason for leniency of state regulators. *JEL* Codes: G21, G28.

*The authors thank Larry Katz, Randy Kroszner, Ross Levine, Jesse Shapiro, Andrei Shleifer, Robert Vishny, and four anonymous referees for detailed comments. We also thank Alberto Alesina, Adam Ashcraft, Gadi Barlevy, Paul Beaudry, Matilde Bombardini, John Cochrane, Richard Crump, Josh Coval, Peter DeMarzo, Doug Diamond, Gene Fama, Mark Flannery, Gary Gorton, Bev Hirtle, Anil Kashyap, Cathy Lemieux, Thomas Lemieux, Christian Leuz, Jamie McAndrews, Evran Ors, Anna Paulson, Sam Peltzman, Gordon Phillips, Tomasz Piskorski, Raghuram Rajan, Uday Rajan, Rich Rosen, Philipp Schnabl, and Luigi Zingales; anonymous referees; seminar participants at Arizona, Arizona State, Bank of Canada, Berkeley, Brown, Chicago Booth (Finance and Applied Micro), the Chicago Fed, Columbia GSB, Darden, ECB, HBS, Harvard, Insead, Minneapolis Fed, Northwestern, NY Fed, Oregon, Princeton, SFU, UCLA, USC, UBC; and conference participants at AFA, Bocconi CAREFIN, CEPR Summer Symposium, NBER Political Economy, NBER Monetary Economics, Red Rock Conference, and JAR/NY Fed Conference for useful discussions. We are also grateful to Conference of State Bank Supervisors for useful discussions and feedback. Tanya Mann, Jonas Mishara-Blomberger, Justin McPhee, and especially Caitlin Kearns and Allen Zheng provided outstanding research assistance. The views expressed in this paper are those of the authors and do not necessarily reflect the views of the Federal Reserve Bank of New York or the Federal Reserve System.

The Quarterly Journal of Economics (2014), 889–938. doi:10.1093/qje/qju003.
Advance Access publication on March 7, 2014.