Banking deregulation creates shareholder value, new study reveals

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Reduced regulation around banking activities creates shareholder value and positive stock returns, new research from Nyenrode Business University and Erasmus School of Economics reveals.

Dr. Michael Erkens, Professor of Corporate Reporting at Nyenrode and Erasmus School of Economics, and Prof. Dr. Ying Gan from Erasmus School of Economics studied the responses of US-based banks and shareholders to rollbacks of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.

The Act subjected the banking sector to greater federal oversight with an aim to ensure financial stability following the 2007-2008 global financial crisis.

According to the authors, deregulatory measures coincided with positive abnormal stock returns, improvements in capital strength and accounting performance, and an expansion in external financing and lending activity.

This is because steep compliance costs limited banks' business activities and disincentivised growth, the authors say. They suggest that banks slowed their asset growth to stay below the two thresholds ($10 billion and $50 billion) that determine the extent of regulations under Dodd-Frank.

The findings also suggest small banks (with assets under $10bn) and large banks (with assets over $50bn) are affected by and respond differently to deregulation. For small banks, rollbacks mainly included the repeal of stricter trading rules and an easing of mortgage underwriting standards. Large banks mainly received exemptions from capital requirements and stress tests. Thus, positive asset growth following the easing of restrictive measures was only noticed in small banks.

"Eased regulation for large banks likely makes small banks more willing to grow again and cross the $10 billion threshold. We find that shareholders of small banks react more favourably to deregulation. The difference in reaction suggests that investors of small banks expect stronger shareholder value creation through less restrictive financial oversight," Dr. Erkens says. Dr. Gan adds that "the positive firm outcomes for small banks demonstrate the potential practical relevance of a meaningful reduction in regulatory burden and compliance costs."

The research studied the reactions of US-based banks and shareholders to 25 events involved in rolling back parts of the Dodd-Frank Act between 2016 and 2018.

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For more information, a copy of the research paper, or to hear from Dr. Michael Erkens or Dr. Ying Gan, contact Kate Mowbray at BlueSky Education on kate@bluesky-pr.com, or call +44 (0)7710022871