Systemic risk-taking at banks: Evidence from the pricing of syndicated loans*

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Abstract

Public guarantees in the event of joint bank failures can result in systemic risk-taking and distort financing decisions of banks. We argue that the pricing of syndicated loans provides an ideal laboratory to study such distortions. In the absence of systemic risk-taking, non-diversifiability of aggregate risk implies that the compensation required for taking on aggregate risk is higher than for idiosyncratic risk. However, in the presence of public guarantees, banks have higher benefits from taking on aggregate risk as this leads to higher correlation across banks. Consistent with the latter, we find that banks charge lower lending interest rates for aggregate risk than for idiosyncratic risk, controlling for firm, loan and bank specific factors. Importantly, there is no evidence for systemic risk-taking for the sample of non-bank lenders who do not benefit from public guarantees. We also find that effect is larger for smaller and less correlated banks, consistent with higher a priori benefits from systemic risk-taking for such banks. The evidence provided suggests that public bail-out policies have significant ex-ante costs by distorting financing decisions in the economy.

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