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In reprieve, banks fail to get message



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INSIDE THE MARKETS

The idea that a brush with death will change the escapee's priorities apparently does not apply to bailed-out banks.

While you might be pulled from the wreckage of your car and decide to stop texting while driving, banks that got government injections of capital during the financial crisis concluded, it seems, that the problem was that they were not pressing the buttons fast enough.

A new study by the Bank for International Settlements, the so-called central banks' central bank, shows that bailed-out banks not only did not cut back on risk in their lending into the syndicated loan market after being defibrillated by their governments, they actually increased the practice, relative to the market and to banks that had not been rescued.

This is both astounding and totally predictable. Astounding because it was so clear that those risks were not just foolish but destructive. Predictable because, of course, the banks realized that they had not just been lucky but had been given a special exemption from death that will be very hard to revoke.

The study looked at the behavior in the syndicated loan market of 87 banks from industrial economies, accounting for about half of global banking assets, of which 40 took public capital. The syndicated loan market, in which banks originate and distribute loans, is a main source of company financing, used to pay for mergers, recapitalizations, investment or simply corporate need.

Predictably, the banks that got bailed out were those taking the biggest risks in the syndicated loan market before the crisis, according to the study, making more leveraged loans with high interest rates.

"During the crisis, rescued banks did not reduce the riskiness of their new syndicated lending compared to their nonrescued peers," wrote the authors of the study, Michael Brei and Blaise Gadanecz. "In fact, our results suggest that the relative riskiness of their lending increased."

Banks that did not take government coin cut their participation in the riskier leveraged market by about a quarter and made loans with an average margin of 0.36 percentage point less. Bailed-out banks, in contrast, increased their share of leveraged lending slightly. They also raised rates to bring pricing more in line with risk, but by so small an amount that it was not statistically significant.

It is possible, of course, that getting banks to continue making silly loans was the intention of the bailouts. After all, global financing markets reached a rate of near-shutdown, and the effect on the real economy was enormous and, much like the lending, indiscriminate.

Because capacity was being artificially supported, and because bankers get paid for doing deals rather than not driving their firms out of existence, it is natural that those at banks with hard proof that they would not be allowed to explode would continue lending.

You could argue that the truly toxic combination is too-big-to-fail status and zero interest rates. With rates at virtually nothing at the short end, and not much higher two, three or five years out, large banks can no longer count on the net interest margins that were their traditional lifeblood.

The market today is a big contrast to that of the late 1980s and early 1990s, when U.S. banks could heal and recapitalize, helped by a big spread between the rates at which they could borrow for short periods and at which they could lend for four or five years.

Loan demand also simply is not all that great, especially in the United States, though there is a huge supply/demand mismatch in the dicier parts of Europe. That has prompted banks to use their low-cost borrowing privilege and ample liquidity simply to speculate in the kind of proprietary activity that proved so costly for JPMorgan Chase.

With the U.S. Federal Reserve pouring fresh money into asset purchases, and with no sign that "too big to fail" will be dealt with effectively, risky banking seems to be more a feature than a bug in the financial system.

Not only did bailed-out banks not cut back on risky lending, they actually increased it.