

# Bank business models at zero interest rates\*

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## Abstract

We propose a novel observation-driven dynamic finite mixture model for the study of banking data. The model accommodates time-varying component means and covariance matrices, normal and Student's  $t$  distributed mixtures, and economic determinants of time-varying parameters. Monte Carlo experiments suggest that units of interest can be classified reliably into distinct components in a variety of settings. In an empirical study of 208 European banks between 2008Q1–2015Q4, we identify six business model components and discuss how these adjust to post-crisis financial developments. Specifically, bank business models adapt to changes in the yield curve.

**Keywords:** bank business models; clustering; finite mixture model; score-driven model; low interest rates.

**JEL classification:** G21, C33.

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# 1 Introduction

Banks are highly heterogeneous, differing widely in terms of size, complexity, organization, activities, funding choices, and geographical reach. Understanding this diversity is of key importance, for example, for the study of risks acting upon and originating from the financial sector, for impact assessments of unconventional monetary policies and financial regulations, as well as for the benchmarking of banks to appropriate peer groups for supervisory purposes.<sup>1</sup> While there is broad agreement that financial institutions suffer in an environment of extremely low interest rates, see e.g. Nouy (2016), it is less clear which type of banks (business models) are affected the most. A study of banks' business models at low interest rates provides insight into the overall diversity of business models, the strategies adopted by individual institutions, as well as to the question which types of banks are impacted the most by time variation in the yield curve.<sup>2</sup>

This paper proposes a novel observation-driven dynamic finite mixture model for the analysis of high-dimensional banking data. The dynamic framework allows us to robustly cluster banks into approximately homogeneous groups. We first present a simple baseline dynamic mixture model for normally distributed data with time-varying component means, and subsequently consider relevant extensions to time-varying covariance matrices, Student's  $t$  distributed mixture densities, and economic predictors of time-varying parameters. We apply our modeling framework to a multivariate panel of  $N = 208$  European banks between 2008Q1–2015Q4,  $T = 32$ , considering  $D = 13$  bank-level indicator variables for  $J = 6$  groups of similar banks. We thus track banking sector data through the 2008–2009 global financial

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<sup>1</sup>For example, the assessment of the viability and the sustainability of a bank's business model plays a pronounced role in the European Central Bank's new Supervisory Review and Examination Process (SREP) for Significant Institutions within its Single Supervisory Mechanism; see SSM (2016). Similar procedures exist in other jurisdictions.

<sup>2</sup>An improved understanding of the financial stability consequences of low-for-long interest rates is a top policy priority. For example, Fed Chair Yellen (2014) pointed to "... the potential for low interest rates to heighten the incentives of financial market participants to reach for yield and take on risk, and ... the limits of macroprudential measures to address these and other financial stability concerns." Similarly, ECB President Draghi (2016) explained that "One particular challenge has arisen across a large part of the world. That is the extremely low level of nominal interest rates. ... Very low levels are not innocuous. They put pressure on the business model[s] of financial institutions ... by squeezing net interest income. And this comes at a time when profitability is already weak, when the sector has to adjust to post-crisis deleveraging in the economy, and when rapid changes are taking place in regulation."

crisis, the 2010–2012 euro area sovereign debt crisis, as well as the relatively calmer but persistent low-interest rate environment of the post-crises period between 2013–2015. We identify six business model components and discuss how they adjust to post-crisis regulatory and financial developments, including changes in the yield curve.

In our dynamic finite mixture model, all time-varying parameters are driven by the score of the mixture predictive log-likelihood using the so-called Generalized Autoregressive Score (GAS) models developed by Creal, Koopman, and Lucas (2013); see also Harvey (2013). In this setting, the time-varying parameters are perfectly predictable one step ahead. This feature makes the model observation-driven in the terminology of Cox (1981). The likelihood is then known in closed-form through a standard prediction error decomposition, facilitating parameter estimation via likelihood-based expectation-maximization (EM) procedures. Our approach extends the standard score-driven approach of Creal, Koopman, and Lucas (2013) by using the scores of the EM-based criterion function rather than that of the usual predictive likelihood function.

Extensive Monte Carlo experiments suggest that our model is able to reliably classify units of interest into distinct mixture components, as well as to simultaneously infer the relevant component-specific time-varying parameters. In our simulations, the cluster classification is perfect for sufficiently large distances between the time-varying parameters and sufficiently informative signals relative to the variance of the noise terms.<sup>3</sup> This holds under correct model specification as well as under two forms of model misspecification. As the simulated data become less informative, and the time-varying parameters become less distant, the share of correct classifications decreases, but generally remains high. Estimation fit and the share of correct classifications decrease further if we incorrectly assume a thin-tailed mixture specification when the data are generated by a fat-tailed mixture distribution. As a result, robust models are appropriate if bank accounting ratios are fat-tailed, which is the case in our empirical sample.

We apply our model to classify European banks into distinct business model components. We distinguish A) large universal banks, including globally systemically important banks (G-

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<sup>3</sup>We use the terms ‘mixture component’ and ‘cluster’ interchangeably.

SIBs), B) corporate/wholesale-focused banks, C) fee-based banks/asset managers, D) small diversified lenders, E) domestic retail lenders, and F) mutual/cooperative-type banks. The similarities and differences between these components are discussed in detail in the main text. Based on our component mean estimates and business model classification, we confirm that the global financial crisis between 2008–2009 had a differential impact on banks with different business models, as also argued in, for example, Altunbas, Manganelli, and Marques-Ibanez (2011), Beltratti and Stulz (2012), and Chiorazzo et al. (2016). We also observe differences across business model components during the more recent euro area sovereign debt crisis between 2010–2012 for our sample of European banks. Throughout each crisis, domestic retail lenders and mutual/cooperative-type banks were affected the least.

In addition, we study how banks’ business models adapt to changes in yield curve factors, specifically the level and slope. The yield curve factors are extracted from AAA-rated euro area sovereign bonds based on a Svensson (1994) model. We find that, as long-term interest rates decrease, banks on average (across all business models) grow larger, hold more assets in trading portfolios to offset declines in loan demand, hold more sizeable derivative books, and, in some cases, increase leverage and decrease funding through customer deposits. Each of these effects – increased size, leverage, complexity, and a less stable funding base – are intuitive, but also potentially problematic from a financial stability perspective. This corroborates the unease expressed in Yellen (2014) and Draghi (2016); see footnote 2.

Finally, we find that banks’ income shares (composition) are not much affected by changes in the yield curve. This holds in particular for the share of net interest income, banks’ dominant source of revenue. Two opposing effects are likely to be at work. First, banks’ long-term loans and bond holdings are worth more at lower rates. Such one-off gains can be realized by selling such assets, e.g. to a central bank in the context of an asset purchase program; see Brunnermeier and Sannikov (2015). Second, banks funding cost also decrease, and typically do so faster than longer-duration loan rates, again initially supporting net interest income. On the other hand, low long-term interest rates squeeze net interest margins for *new* loans and bond holdings. Any short-term benefits from declining rates, therefore, likely come at the expense of the long-term viability of established bank business models;

see Nouy (2016).

The two papers that are most closely related to ours are Ayadi and Groen (2015) and Catania (2016). Ayadi and Groen (2015) use cluster analysis to identify bank business models. Conditional on the identified clusters, the authors discuss bank profitability trends over time, study banking sector risks and their mitigation, and consider changes in banks' business models in response to new regulation. Our statistical approach is different in that our components are not identified based on single (static) cross-sections of year-end data. Instead, we consider a dynamic framework for a multivariate panel of  $N$  banks with  $D$  variables each, over  $T > 1$ . Catania (2016) proposes a score-driven dynamic mixture model which is related to ours. His modeling framework is different in that the main focus is on the modeling of conditional asset return distributions over time, rather than on classifying a large cross-section. Parameter estimation in Catania (2016) is not based on an EM algorithm, but instead relies on score-driven updates for almost all parameters. The advantage of our approach is that it is more likely to work well if the time dimension is short. In addition, it remains tractable when many components are considered.

We proceed as follows. Section 2 presents a static and baseline dynamic finite mixture model. We then propose extensions to incorporate time-varying covariance matrices, as well as Student's  $t$  distributed mixture distributions. Section 3 discusses the outcomes of a variety of Monte Carlo simulation experiments. Section 4 applies the model to classify European financial institutions. Section 5 studies to which extent banks' business models adapt to an environment of exceptionally low interest rates. Section 6 concludes. A Web Appendix provides further technical and empirical results.

## 2 Statistical model

### 2.1 Static finite mixture model and EM estimation

We consider multivariate panel data  $\mathbf{y}_{it} \in \mathbb{R}^{D \times 1}$  for firms  $i = 1, \dots, N$  and times  $t = 1, \dots, T$ . We stack the observations  $\mathbf{y}_{it}$  into the matrix  $\mathbf{Y}_i = (\mathbf{y}_{i1} \cdots \mathbf{y}_{iT})' \in \mathbb{R}^{T \times D}$  and model the

data  $\mathbf{Y}_i$  as independent draws from a common  $J$ -component mixture density

$$f(\mathbf{Y}_i; \boldsymbol{\Theta}) = \sum_{j=1}^J \pi_j(\boldsymbol{\Theta}) f_j(\mathbf{Y}_i; \boldsymbol{\theta}_j(\boldsymbol{\Theta})), \quad (1)$$

with  $\boldsymbol{\Theta}$  containing the unique parameters characterizing the mixture density  $f(\cdot; \boldsymbol{\Theta})$ , and  $\pi_j(\cdot)$  and  $\boldsymbol{\theta}_j(\cdot)$  functions of  $\boldsymbol{\Theta}$  for  $j = 1, \dots, J$ , where  $0 \leq \pi_j(\boldsymbol{\Theta}) \leq 1$  and  $\pi_1(\boldsymbol{\Theta}) + \dots + \pi_J(\boldsymbol{\Theta}) = 1$  for all  $\boldsymbol{\Theta}$ . For example, in case of a mixture of normal distributions,  $\boldsymbol{\Theta}$  contains the mixture probabilities, the mixture means, and the unique mixture variances and covariances. If no confusion is caused, we write  $\pi_j$  and  $\boldsymbol{\theta}_j$  rather than  $\pi_j(\boldsymbol{\Theta})$  and  $\boldsymbol{\theta}_j(\boldsymbol{\Theta})$ .

We model the mixture in (1) over  $\mathbf{Y}_i$  rather than over  $\mathbf{y}_{it}$ , implying that an individual firm  $i$  is drawn from component  $j$  for all times  $t = 1, \dots, T$ . In the context of our empirical application, this implies we assume banks do not change their entire business model over time and switch cluster from for instance a corporate bank to a retail bank. As we see later, however, we do allow the business model characteristics themselves to change slowly over time by introducing time variation in the parameters  $\boldsymbol{\theta}_j(\boldsymbol{\Theta})$ . With this flexibility in mind, the assumption of a clustering over  $\mathbf{Y}_i$  rather than  $\mathbf{y}_{it}$  is empirically sensible.

A direct approach to estimating the unknown parameters  $\boldsymbol{\Theta}$  would be to maximize the log-likelihood function of the observed data, i.e.,

$$\log L(\boldsymbol{\Theta}) = \sum_{i=1}^N \log \left[ \sum_{j=1}^J \pi_j f_j(\mathbf{Y}_i; \boldsymbol{\theta}_j) \right]. \quad (2)$$

This is numerically infeasible in most empirically relevant settings. A common way around this problem is to look at the mixture distribution from an incomplete data perspective. We then approximate the likelihood function by an appropriately defined conditional expected likelihood function and use the expectation maximization (EM) algorithm to estimate the parameters; see Dempster, Laird, and Rubin (1977) and McLachlan and Peel (2000).

Let  $\mathbf{z}_i = (z_{i1}, \dots, z_{iJ})' \in \mathbb{R}^{J \times 1}$  be a mixture component selection vector, with the component indicator  $z_{ij}$  being 1 if firm  $i$  belongs to component  $j$ , and zero otherwise. The complete data for firm  $i$  now consists of the pair  $(\mathbf{Y}_i, \mathbf{z}_i)$ . If  $\mathbf{z}_i$  were known, the (complete

data) likelihood function would be given by

$$\log L_c(\boldsymbol{\Theta}) = \sum_{i=1}^N \sum_{j=1}^J z_{ij} [\log \pi_j + \log f_j(\mathbf{Y}_i; \boldsymbol{\theta}_j)]. \quad (3)$$

Because  $\mathbf{z}_i$  is unobserved, however, the complete data likelihood in (3) cannot be maximized. Following Dempster, Laird, and Rubin (1977), we instead maximize its conditional expectation over  $\mathbf{z}_i$  given the observed data  $\mathbf{Y} = (\mathbf{Y}_1, \dots, \mathbf{Y}_N)$  and some initial or previously determined value  $\boldsymbol{\Theta}^{(k-1)}$ , i.e., we maximize

$$\begin{aligned} Q(\boldsymbol{\Theta}; \boldsymbol{\Theta}^{(k-1)}) &= \mathbb{E} [\log L_c(\boldsymbol{\Theta}) \mid \mathbf{Y}; \boldsymbol{\Theta}^{(k-1)}] \\ &= \mathbb{E} \left[ \sum_{i=1}^N \sum_{j=1}^J z_{ij} [\log \pi_j + \log f_j(\mathbf{Y}_i; \boldsymbol{\theta}_j)] \mid \mathbf{Y}; \boldsymbol{\Theta}^{(k-1)} \right] \\ &= \sum_{i=1}^N \sum_{j=1}^J \mathbb{E} [z_{ij} \mid \mathbf{Y}; \boldsymbol{\Theta}^{(k-1)}] [\log \pi_j + \log f_j(\mathbf{Y}_i; \boldsymbol{\theta}_j)] \\ &= \sum_{i=1}^N \sum_{j=1}^J \mathbb{P} [z_{ij} = 1 \mid \mathbf{Y}; \boldsymbol{\Theta}^{(k-1)}] [\log \pi_j + \log f_j(\mathbf{Y}_i; \boldsymbol{\theta}_j)]. \end{aligned} \quad (4)$$

The conditionally expected likelihood (4) can be optimized iteratively by alternately updating the conditional expectation of the component indicators  $\mathbf{z}_i$  ('E-Step') and subsequently maximizing the remaining part of the function with respect to  $\boldsymbol{\Theta}$  ('M-Step').

## E-Step

The conditional component indicator probabilities are updated using

$$\tau_{ij}^{(k)} := \mathbb{P}[z_{ij} = 1 \mid \mathbf{Y}, \boldsymbol{\Theta}^{(k-1)}] = \frac{\pi_j^{(k-1)} f_j(\mathbf{Y}_i; \boldsymbol{\theta}_j^{(k-1)})}{f(\mathbf{Y}_i; \boldsymbol{\Theta}^{(k-1)})} = \frac{\pi_j^{(k-1)} f_j(\mathbf{Y}_i; \boldsymbol{\theta}_j^{(k-1)})}{\sum_{h=1}^J \pi_h^{(k-1)} f_h(\mathbf{Y}_i; \boldsymbol{\theta}_h^{(k-1)})}, \quad (5)$$

where, with a slight abuse of notation,  $f_j(\mathbf{Y}_i; \boldsymbol{\theta}_j^{(k-1)}) = \prod_{t=1}^T f_j(\mathbf{y}_{it}; \boldsymbol{\theta}_{jt}^{(k-1)})$ , with  $\boldsymbol{\theta}_{jt}$  denoting the parameters characterizing the  $j$ th component distribution  $f_j(\cdot; \boldsymbol{\theta}_{jt})$  of  $\mathbf{y}_{it}$  at time  $t$ . Once the  $\tau_{ij}^{(k)}$ s,  $i = 1, \dots, N$ ,  $j = 1, \dots, J$ , are updated, we move to the M-Step.

## M-Step

For given  $\tau_{ij}^{(k)}$ s, optimizing  $Q(\Theta; \Theta^{(k-1)})$  in (4) with respect to  $\pi_j$ , we obtain

$$\pi_j^{(k)} = \frac{1}{N} \sum_{i=1}^N \tau_{ij}^{(k)}, \quad j = 1, \dots, J. \quad (6)$$

The optimization of  $Q(\Theta; \Theta^{(k-1)})$  with respect to the remaining parameters in  $\Theta$  can sometimes be done analytically, for instance in the case of the normal finite mixture model. Otherwise, numerical maximization methods need to be used. The E-step and M-step are iterated until the difference  $L(\Theta^{(k+1)}) - L(\Theta^{(k)})$  has converged.

## 2.2 Dynamic normal mixture model with time-varying means

As a first extension to the standard static mixture model from Section 2.1, we consider a normal mixture model with dynamic means. We assume that each component density is a normal characterized by a static component covariance matrix  $\Omega_j \in \mathbb{R}^{D \times D}$  and a time-varying component mean  $\mu_{jt} \in \mathbb{R}^{D \times 1}$ ,  $j = 1, \dots, J$ . The component means are updated using the score dynamics of Creal, Koopman, and Lucas (2013); see also Harvey (2013) and Creal et al. (2014). For simplicity and parsimony, we consider the integrated score-driven dynamics as discussed in Lucas and Zhang (2015),

$$\mu_{j,t+1} = \mu_{jt} + A_1 s_{\mu_{jt}}, \quad (7)$$

where  $A_1 = A_1(\Theta)$  is a diagonal matrix that depends on the unknown parameter vector  $\Theta$ , and where  $s_{\mu_{jt}}$  is the (scaled) first derivative with respect to  $\mu_{jt}$  of the local objective



function at time  $t$ . The derivative of our EM-objective function is defined according to

$$\begin{aligned}
\nabla_{\mu_{jt}} &= \frac{\partial Q(\boldsymbol{\Theta}; \boldsymbol{\Theta}^{(k-1)})}{\partial \mu_{jt}} = \frac{\partial}{\partial \mu_{jt}} \left( \sum_{i=1}^N \sum_{j=1}^J \tau_{ij}^{(k)} \left[ \log \pi_j + \sum_{t=1}^T \log \phi(\mathbf{y}_{it}; \mu_{jt}, \Omega_j) \right] \right) \\
&= \frac{\partial}{\partial \mu_{jt}} \left( \sum_{i=1}^N \sum_{j=1}^J \tau_{ij}^{(k)} \left[ \log \pi_j - \frac{1}{2} T \log |2\pi\Omega_j| - \frac{1}{2} \sum_{t=1}^T (\mathbf{y}_{it} - \mu_{jt})' \Omega_j^{-1} (\mathbf{y}_{it} - \mu_{jt}) \right] \right) \\
&= \Omega_j^{-1} \sum_{i=1}^N \tau_{ij}^{(k)} (\mathbf{y}_{it} - \mu_{jt}), \tag{8}
\end{aligned}$$

where  $\phi(\cdot)$  denotes the multivariate normal density.

For location models, the inverse negative Hessian of the local objective function is an appropriate way to scale the score; see Creal et al. (2013). In our case, taking the derivative of (8) with respect to the transpose of  $\mu_{jt}$ , switching the sign, and taking the inverse, we obtain a scaling matrix  $\Omega_j / \sum_{i=1}^N \tau_{ij}^{(k)}$ . This yields a corresponding scaled score to update the time-varying component means

$$\mu_{j,t+1} = \mu_{jt} + A_1 \cdot \frac{\sum_{i=1}^N \tau_{ij} (\mathbf{y}_{it} - \mu_{jt})}{\sum_{i=1}^N \tau_{ij}}. \tag{9}$$

This updating mechanism is highly intuitive: the component means are updated by the prediction errors for that component, accounting for the posterior probabilities that the observation was drawn from the same component. For example, if the posterior probability that  $\mathbf{y}_{it}$  comes from component  $j$  is negligible,  $\mu_{j,t}$  is not updated.

All static parameters can now be estimated using the EM-algorithm. Starting from an initial  $\boldsymbol{\Theta}^{(k-1)}$  and an initial mean  $\mu_{j,1}^{(k-1)}$ , we compute  $\mu_{j,2}^{(k-1)}, \dots, \mu_{j,T}^{(k-1)}$  using the recursion (9). Next, we compute the posterior probabilities

$$\tau_{ij}^{(k)} = \frac{\pi_j^{(k-1)} \prod_{t=1}^T \phi(\mathbf{y}_{it}; \mu_{jt}^{(k-1)}, \Omega_j^{(k-1)})}{\sum_{h=1}^J \pi_h^{(k-1)} \prod_{t=1}^T \phi(\mathbf{y}_{it}; \mu_{ht}^{(k-1)}, \Omega_h^{(k-1)})}. \tag{10}$$

Next, the M-Step maximizes

$$\sum_{i=1}^N \sum_{t=1}^T \sum_{j=1}^D \tau_{ij}^{(k)} \left[ -\frac{1}{2} \log(|2\pi\Omega_j|) - \frac{1}{2}(\mathbf{y}_{it} - \mu_{jt})' \Omega_j^{-1} (\mathbf{y}_{it} - \mu_{jt}) \right], \quad (11)$$

with respect to  $\Omega_j$  for  $j = 1, \dots, J$ , and  $A_1$  and  $\mu_{j,1}$  for  $j = 1, \dots, J$ . Whereas the optimization with respect to  $\Omega_j$  can be done analytically, the optimization with respect to the remaining parameters has to be carried out numerically. Finally, the E-step and M-step are iterated until convergence.

## 2.3 Further extensions

### 2.3.1 Time-varying component covariance matrices

This section derives the scaled score updates for time-varying component covariance matrices  $\Omega_{jt}$ . If we also want to endow the time-varying covariance matrices with integrated score dynamics, we have

$$\Omega_{j,t+1} = \Omega_{jt} + A_2 s_{\Omega_{jt}}, \quad (12)$$

where  $s_{\Omega_{jt}}$  is again defined as the scaled first partial derivative of the expected likelihood function with respect to  $\Omega_{jt}$ . Following equation (8), the unscaled score with respect to  $\Omega_{jt}$  is

$$\nabla_{\Omega_{jt}} = \frac{\partial Q(\boldsymbol{\Theta}; \boldsymbol{\Theta}^{(k-1)})}{\partial \Omega_{jt}} = \frac{1}{2} \sum_{i=1}^N \tau_{ij}^{(k)} \Omega_{jt}^{-1} [(\mathbf{y}_{it} - \mu_{jt})(\mathbf{y}_{it} - \mu_{jt})' - \Omega_{jt}] \Omega_{jt}^{-1}. \quad (13)$$

Taking the total differential of this expression, and subsequently taking expectations  $E_j[\cdot]$  conditional on regime  $j$ , we obtain

$$\begin{aligned} \frac{1}{2} E_j \left[ \sum_{i=1}^N \tau_{ij}^{(k)} (d\Omega_{jt}^{-1} (\mathbf{y}_{it} - \mu_{jt})(\mathbf{y}_{it} - \mu_{jt})' \Omega_{jt}^{-1} + \Omega_{jt}^{-1} (\mathbf{y}_{it} - \mu_{jt})(\mathbf{y}_{it} - \mu_{jt})' d\Omega_{jt}^{-1} - d\Omega_{jt}^{-1}) \right] = \\ \frac{1}{2} \sum_{i=1}^N \tau_{ij}^{(k)} d\Omega_{jt}^{-1} = - \left( \sum_{i=1}^N \frac{1}{2} \tau_{ij}^{(k)} \right) \Omega_{jt}^{-1} d\Omega_{jt} \Omega_{jt}^{-1}. \end{aligned} \quad (14)$$

Vectorizing (14), we obtain  $-(\frac{1}{2} \sum_{i=1}^N \tau_{ij}^{(k)}) (\Omega_{jt} \otimes \Omega_{jt})^{-1} \text{vec}(\text{d}\Omega_{jt})$ , where  $\text{vec}(\cdot)$  concatenates the columns of a matrix into a column vector, and where the negative inverse of the matrix in front of  $\text{vec}(\text{d}\Omega_{jt})$  is our scaling matrix to correct for the curvature of the score. Multiplying the vectorized version of (13) by this scaling matrix, we obtain the scaled score

$$\begin{aligned} \text{vec}(s_{\Omega_{jt}}) &= \left( \frac{1}{2} \sum_{i=1}^N \tau_{ij}^{(k)} \right)^{-1} (\Omega_{jt} \otimes \Omega_{jt}) \cdot \text{vec}(\nabla_{\Omega_{jt}}) = \left( \sum_{i=1}^N \tau_{ij}^{(k)} \right)^{-1} \cdot \text{vec}(2\Omega_{jt} \nabla_{\Omega_{jt}} \Omega_{jt}) \Leftrightarrow \\ s_{\Omega_{jt}} &= \frac{\sum_{i=1}^N \tau_{ij}^{(k)} [(\mathbf{y}_{it} - \mu_{jt})(\mathbf{y}_{it} - \mu_{jt})' - \Omega_{jt}]}{\sum_{i=1}^N \tau_{ij}^{(k)}}. \end{aligned} \quad (15)$$

The estimation of the model can be carried out using the EM algorithm as above, replacing  $\Omega_j$  by  $\Omega_{jt}$  in equations (10)–(11).

### 2.3.2 Student's $t$ distributed mixture

This section robustifies the dynamic finite mixture model by considering panel data that are generated by mixtures of multivariate Student's  $t$  distributions.<sup>4</sup> Assuming a multivariate normal mixture is not always appropriate. For example, extreme tail observations can easily occur in the analysis of accounting ratios when the denominator is close to zero, implying pronounced changes from negative to positive values.

To use the EM-algorithm for mixtures of Student's  $t$  distributions, we use the densities

$$f_j(\mathbf{y}_{it}; \boldsymbol{\theta}_j) = \frac{\Gamma((\nu_j + D)/2)}{\Gamma(\nu_j/2) |\pi \nu_j \Omega_{jt}|^{1/2}} (1 + (\mathbf{y}_{it} - \mu_{jt})' (\nu_j \Omega_{jt})^{-1} (\mathbf{y}_{it} - \mu_{jt}))^{-(\nu_j + D)/2}. \quad (16)$$

Both the E-steps and the M-steps of the algorithm are unaffected save for the fact that we use Student's  $t$  rather than Gaussian densities. The main difference follows for the dynamic models, where the score steps now take a different form. Using (16), the scores for the

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<sup>4</sup>For a textbook treatment of the static finite mixture model of multivariate Student's  $t$  distributions; see McLachlan and Peel (2000) Chapter 7. For an EM algorithm for the estimation of models with time-varying volatilities and correlations for one-component elliptical distributions, see also McNeil, Frey, and Embrechts (2005) and Zhang, Creal, Koopman, and Lucas (2011).

location parameter  $\mu_{jt}$  and scale matrix  $\Omega_{jt}$  are

$$\nabla_{\mu_{jt}} = \Omega_{jt}^{-1} \sum_{i=1}^N \tau_{ij}^{(k)} w_{ijt} \cdot (\mathbf{y}_{it} - \mu_{jt}), \quad (17)$$

$$\nabla_{\Omega_{jt}} = \frac{1}{2} \sum_{i=1}^N \tau_{ij}^{(k)} \Omega_{jt}^{-1} [w_{ijt} \cdot (\mathbf{y}_{it} - \mu_{jt})(\mathbf{y}_{it} - \mu_{jt})' - \Omega_{jt}] \Omega_{jt}^{-1}, \quad (18)$$

$$w_{ijt} = (1 + \nu_j^{-1} D) / (1 + \nu_j^{-1} (\mathbf{y}_{it} - \mu_{jt})' \Omega_{jt}^{-1} (\mathbf{y}_{it} - \mu_{jt})). \quad (19)$$

The main difference between the scores of the Student's  $t$  and the Gaussian case is the presence of the weights  $w_{ijt}$ . These weights provide the model with a robustness feature: observations  $\mathbf{y}_{it}$  that are outlying given the fat-tailed nature of the Student's  $t$  density receive a reduced impact on the location and volatility dynamics by means of a lower value for  $w_{ijt}$ ; compare Creal, Koopman, and Lucas (2011, 2013), and Harvey (2013). We use the same scale matrices for the score as in Sections 2.2 and 2.3.1 and obtain the scaled scores

$$s_{\mu_{jt}} = \left( \sum_{i=1}^N \tau_{ij}^{(k)} w_{ijt} \cdot (\mathbf{y}_{it} - \mu_{jt}) \right) / \left( \sum_{i=1}^N \tau_{ij}^{(k)} \right), \quad (20)$$

$$s_{\Omega_{jt}} = \left( \sum_{i=1}^N \tau_{ij}^{(k)} \left( w_{ijt} \cdot (\mathbf{y}_{it} - \mu_{jt})(\mathbf{y}_{it} - \mu_{jt})' - \Omega_{jt} \right) \right) / \left( \sum_{i=1}^N \tau_{ij}^{(k)} \right). \quad (21)$$

The intuition is the same as for the Gaussian case, except for the fact that the scaled score steps for  $\mu_{jt}$  and  $\Omega_{jt}$  are re-descending to zero and bounded, respectively, if  $\mathbf{y}_{it}$  is extremely far from  $\mu_{jt}$ . Also note that for  $\nu_j \rightarrow \infty$  we see in (19) that  $w_{ijt} \rightarrow 1$ , such that we recover the expressions for the Gaussian mixture model.

### 2.3.3 Explanatory covariates

The score-driven dynamics for component-specific time-varying parameters can be extended further to include contemporaneous or lagged economic variables as additional conditioning variables. For example, a particularly low interest rate environment may push financial institutions, overall or in part, to grow larger and take riskier bets. Using additional yield curve-related conditioning variables allows us to incorporate and test for such effects. In the

case of a Student's  $t$  distributed mixture, the score-driven updating scheme with additional explanatory covariates evolves over time as

$$\tilde{\mu}_{j,t+1} = \tilde{\mu}_{jt} + A_1 \cdot \frac{\sum_{i=1}^N \tau_{ij}^{(k)} w_{ijt} (\mathbf{y}_{it} - \mu_{jt})}{\sum_{i=1}^N \tau_{ij}^{(k)}} = \tilde{\mu}_{jt} + A_1 \cdot \frac{\sum_{i=1}^N \tau_{ij}^{(k)} w_{ijt} (\mathbf{y}_{it} - B_j \cdot W_t - \tilde{\mu}_{jt})}{\sum_{i=1}^N \tau_{ij}^{(k)}}, \quad (22)$$

where  $E_{t-1}[\mathbf{y}_{it}] = \tilde{\mu}_{jt} + B_j W_t$ , with  $B_j = B_j(\boldsymbol{\Theta})$  a matrix of unknown coefficients that need to be estimated, and  $W_t$  containing the economic covariates of interest. Again, in the case of a Gaussian mixture,  $w_{ijt} = 1$ .

### 3 Simulation study

#### 3.1 Simulation design

This section investigates the ability of our score-driven dynamic mixture model to simultaneously *i*) correctly classify a data set into distinct components, and *ii*) recover the dynamic cluster means over time. In addition, we investigate the performance of several model selection criteria from the literature in detecting the correct model when the number of clusters is unknown. In all cases, we pay particular attention to the sensitivity of the EM algorithm to the distinctiveness of the clusters, the number of units per cluster, and the impact of model misspecification.

We simulate from a mixture of dynamic bivariate densities. These densities are composed of sinusoid mean functions and i.i.d. disturbance terms that are drawn from a bivariate Gaussian distribution or a bivariate Student's  $t$  distribution with five or three degrees of freedom. The covariance matrices are chosen to be time-invariant identity matrices. The smoothing parameter  $A_1$  is common to each cluster.

Visually, the simulated processes correspond to two data clouds moving in circles as determined by a component-specific time-varying mean; see for example Figure 1. To investigate the strengths and potential weaknesses of our method, we alter the characteristics of these circles.

The sample sizes are chosen to resemble typical sample sizes in studies of banking data.

We thus keep the number of time points small to moderate, considering  $T \in \{10, 30\}$ , and set the number of cross-sectional units equal to  $N = 100$  or to  $N = 400$ . The number of clusters used to generate the data is fixed at  $J = 2$  throughout. In our first set of simulation results in Section 3.2, we assume  $J = 2$  is known. In Section 3.3, we determine the number of clusters in the statistical model  $J$  using different model selection criteria. In total, we consider simulations from 96 different data generating processes.

In our baseline setting, visualized in Figure 1, we generate from two clusters located around means that move in two non-overlapping circles over time. Across our different simulation designs, the data have different signal-to-noise ratios in the sense that the radius of the circles is large or small relative to the variance of the error terms. In addition, we also consider two more challenging settings where the two circles overlap completely: the circles have the same center, but differ in the orientation of the time-varying mean component (clockwise vs. counterclockwise). Again, we consider circles with a large and small radius, respectively, while keeping the variance of the error terms fixed and thus changing the signal-to-noise ratio of the simulation set-up.

Finally, we investigate the impact of two types of model misspecification. First, we incorrectly assume a Gaussian mixture in the estimation process when the data are generated by a mixture of Student's  $t$  densities with five degrees of freedom ( $\nu = 5$ ). Alternatively, we simulate from a  $t(3)$ -mixture, but fix the degrees of freedom parameter to five in the estimation. In both cases, we check the effect of mis-specifying the tail behavior of the mixture distribution.

## 3.2 Simulation results regarding classification and tracking

Using the score-driven model set-up and EM estimation methodology from Section 2, we estimate the component parameters from the simulated data. Parameters to be estimated include the initial values for the component mean processes, the distinct entries of the covariance matrices, and the smoothing parameter  $A_1$ .

Figure 1 illustrates our simulation setup with two examples. The data generating processes are plotted as a solid black line. In each panel, the true process is compared to the

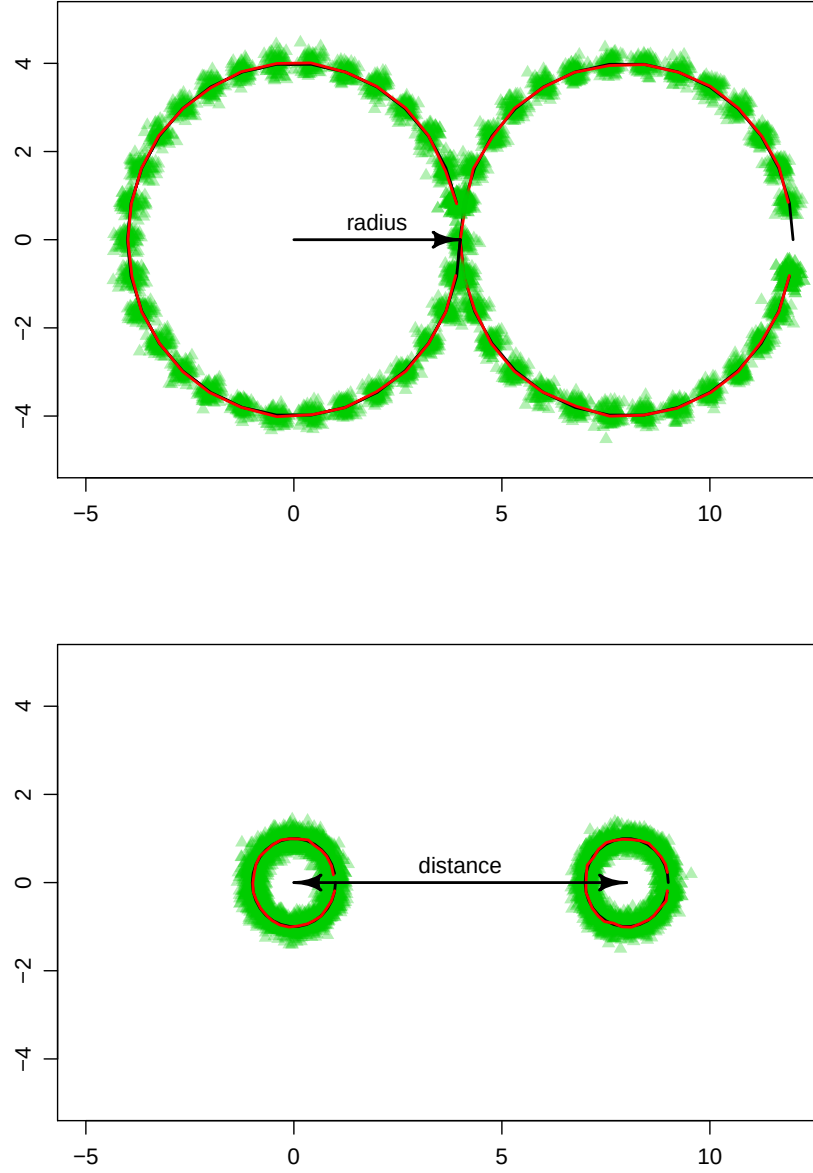


Figure 1: True mean processes (black) together with median filtered means over 100 simulation runs (red) and the filtered means (green triangles). Both panels correspond to simulation setups under correct specification with circle centers that are 8 units apart (distance=8). The upper panel corresponds to the simulation setup with radius 4, while the lower panel depicts the mean circles with radius 1.

pointwise median of the estimated paths over simulation runs (solid red line), as well as the filtered mean estimates across simulation runs (green triangles). The actual observations are dispersed much more widely around the black circles, as for each point on the circle they are drawn from the bivariate standard normal distribution, thus ranging from approximately  $\mu_{jt} - 2.5$  to  $\mu_{jt} + 2.5$  with 99% probability. Our methodology allocates each data point to its correct component, and in addition tracks the dynamic mean processes accurately.

Table 1 relies on mean squared error (MSE) statistics as our main measure of estimation fit. MSE statistics for time-varying component means are computed as the squared deviation of the estimated means from their true counterparts, averaged over time and simulation runs. The top panel of Table 1 contains MSE statistics for eight simulation settings. Each of these settings considers  $N_j = 100/2 = 50$  units per component. The bottom panel of Table 1 presents the same information for  $N_j = 400/2 = 200$  units per component. In each case, we also report the proportion of correctly classified data points, averaged across simulation runs.

Not surprisingly, the performance of our estimation methodology depends on the simulation settings. For a high signal to-noise ratio (i.e., a large circle radius) and a large distance between the unconditional means, the cluster classification is close to perfect, both under correct specification and model misspecification. Interestingly, the distance between circles is irrelevant for estimation fit and classification ability in the case of large radii (signal-to-noise ratios).

As the distance between means and the circle radii decrease, the shares of correct classifications decrease as well. Both estimation fit and share of correct classification decrease further if we assume a Gaussian mixture although the data are generated from a mixture of fat-tailed Student's  $t$  distributions. This indicates a sensitivity to outliers when assuming a Gaussian mixture in the case of fat-tailed data. Incorrectly assuming five degrees of freedom when the data are generated by a  $t(3)$ -mixture, on the other hand, leads to little bias. Consequently, a misspecified  $t$ -mixture model allows us to obtain more robust estimation and classification results than a Gaussian mixture model when the data are fat-tailed. This is due to the fact that also the  $t(5)$  based score-dynamics for  $\mu_{jt}$  already discount the impact



Table 1: Simulation outcomes

Mean squared error (MSE) and average percentage of correct classification for each cluster (% C1 and % C2) across simulation runs. Considered sample sizes are  $N = 100, 400$  and  $T = 10, 30$ . Radius (rad.) refers to the radius of the true mean circles and is a measure of the signal-to-noise ratio. Distance (dist.) is the distance between circle centers and measures the distinctness of clusters. Correct specification refers to the case of simulating from a normal mixture and estimating assuming a mixture of normal distributions. In the case of misspecification 1, data are simulated from a  $t$ -mixture with 5 degrees of freedom, but the model is estimated assuming normal mixtures. In the case of misspecification 2, a  $t(3)$ -mixture is used to simulate the data while in the estimation, a fixed value  $\nu = 5$  is assumed.

| $N = 100$             |       |      |       |       |      |       |       |  |
|-----------------------|-------|------|-------|-------|------|-------|-------|--|
| correct specification |       |      |       |       |      |       |       |  |
|                       |       |      | T=10  |       |      | T=30  |       |  |
| rad.                  | dist. | MSE  | % C1  | % C2  | MSE  | % C1  | % C2  |  |
| 4                     | 8     | 0.34 | 100   | 100   | 0.36 | 100   | 100   |  |
| 4                     | 0     | 0.34 | 100   | 100   | 0.36 | 100   | 100   |  |
| 1                     | 8     | 0.04 | 100   | 100   | 0.04 | 100   | 100   |  |
| 1                     | 0     | 0.04 | 99.18 | 99.28 | 0.04 | 100   | 99.99 |  |
| misspecification 1    |       |      |       |       |      |       |       |  |
|                       |       |      | T=10  |       |      | T=30  |       |  |
| rad.                  | dist. | MSE  | % C1  | % C2  | MSE  | % C1  | % C2  |  |
| 4                     | 8     | 0.34 | 100   | 100   | 0.37 | 100   | 100   |  |
| 4                     | 0     | 0.35 | 100   | 100   | 0.37 | 100   | 100   |  |
| 1                     | 8     | 0.05 | 100   | 99.98 | 0.05 | 100   | 100   |  |
| 1                     | 0     | 0.12 | 89.31 | 84.67 | 0.08 | 96.62 | 93.8  |  |
| misspecification 2    |       |      |       |       |      |       |       |  |
|                       |       |      | T=10  |       |      | T=30  |       |  |
| rad.                  | dist. | MSE  | % C1  | % C2  | MSE  | % C1  | % C2  |  |
| 4                     | 8     | 0.42 | 100   | 100   | 0.46 | 100   | 100   |  |
| 4                     | 0     | 0.42 | 100   | 100   | 0.46 | 100   | 100   |  |
| 1                     | 8     | 0.05 | 100   | 100   | 0.05 | 100   | 100   |  |
| 1                     | 0     | 0.07 | 94.14 | 93.78 | 0.05 | 99.7  | 99.62 |  |
| $N = 400$             |       |      |       |       |      |       |       |  |
| correct specification |       |      |       |       |      |       |       |  |
|                       |       |      | T=10  |       |      | T=30  |       |  |
| rad.                  | dist. | MSE  | % C1  | % C2  | MSE  | % C1  | % C2  |  |
| 4                     | 8     | 0.32 | 100   | 100   | 0.34 | 100   | 100   |  |
| 4                     | 0     | 0.32 | 100   | 100   | 0.34 | 100   | 100   |  |
| 1                     | 8     | 0.02 | 100   | 100   | 0.03 | 100   | 100   |  |
| 1                     | 0     | 0.04 | 98.38 | 98.31 | 0.03 | 99.98 | 99.99 |  |
| misspecification 1    |       |      |       |       |      |       |       |  |
|                       |       |      | T=10  |       |      | T=30  |       |  |
| rad.                  | dist. | MSE  | % C1  | % C2  | MSE  | % C1  | % C2  |  |
| 4                     | 8     | 0.32 | 100   | 100   | 0.35 | 100   | 100   |  |
| 4                     | 0     | 0.32 | 100   | 100   | 0.35 | 100   | 100   |  |
| 1                     | 8     | 0.03 | 100   | 100   | 0.03 | 100   | 100   |  |
| 1                     | 0     | 0.06 | 94.16 | 91.68 | 0.03 | 99.71 | 99.61 |  |
| misspecification 2    |       |      |       |       |      |       |       |  |
|                       |       |      | T=10  |       |      | T=30  |       |  |
| rad.                  | dist. | MSE  | % C1  | % C2  | MSE  | % C1  | % C2  |  |
| 4                     | 8     | 0.41 | 100   | 100   | 0.44 | 100   | 100   |  |
| 4                     | 0     | 0.41 | 100   | 100   | 0.44 | 100   | 100   |  |
| 1                     | 8     | 0.03 | 100   | 100   | 0.04 | 100   | 100   |  |
| 1                     | 0     | 0.05 | 95.03 | 95.18 | 0.06 | 97.74 | 97.78 |  |

of outlying observations, although not as strictly as the score-based dynamics of a Student's  $t(3)$  distribution.

### **3.3 Simulation results when the number of components is unknown**

In our empirical study of banking data, the number of clusters, i.e. bank business models, is unknown a priori. A number of model selection criteria and so-called cluster validation indices have been proposed in the literature, and comparative studies have not found a dominant criterion that performs best in all settings; see e.g. Milligan and Cooper (1985) and de Amorim and Hennig (2015a). We therefore run an additional simulation study to see which model selection criteria are suitable to choose the optimal number of components in our multivariate panel setting.

All criteria and definitions are listed in Web Appendix A.1. The simulation outcomes are reported in the Web Appendix A.2. Overall, we find that the standard likelihood-based information criteria such as AIC and BIC tend to systematically overestimate the number of clusters in a multivariate panel setting. Distance-based criteria corresponding to the within-cluster sum of squared errors perform better. The Davies-Bouldin index (DBI; see Davies and Bouldin (1979)) and the Calinski-Harabasz index (CHI; see Calinski and Harabasz (1974)) do well. In an empirical setting, therefore, we recommend looking at a variety of model selection criteria for a full picture, but to pay particular attention to DBI and CHI whenever the selection criteria disagree.

## **4 Bank business models**

### **4.1 Data**

The sample under study consists of  $N = 208$  European banks, for which we consider quarterly bank-level accounting data from SNL Financial between 2008Q1 – 2015Q4. This implies  $T = 32$ . Banks that were acquired or underwent distressed mergers, or ceased to operate for

other reasons, are excluded from the analysis. We assume that differences in the remaining banks' business models can be characterized along six dimensions: size, complexity, activities, geographical reach, funding strategies, and ownership structure. We select a parsimonious set of  $D = 13$  indicators from these six categories. Table 2 lists the respective indicators.

We augment the proprietary data from SNL Financial with confidential supervisory data from the European Central Bank. While the publicly-available data is generally of good quality, it occasionally has insufficient coverage for some bank-level variables given the purpose of this study. Specifically, we incorporate information from bank-level Finrep reports for euro area significant institutions when the respective information is missing from SNL Financial. This is most necessary for the bank-level breakdown between retail loans and commercial loans, and the share of domestic loans to total loans. The availability of detailed supervisory data also allows us to cross-check potentially influential data points in the SNL data.

Our augmented multivariate panel data is unbalanced in the time dimension. Missing values occur routinely because some banks are reporting at a quarterly frequency, while others report at an annual or semi-annual frequency. We remove such missing values by substituting the most recently available observation for that variable (backfilling). If variables are missing in the beginning of the sample, we use the most adjacent future value. In the cross-section, we require at least one entry for each variable and each bank.

We consider banks at their highest level of consolidation. In addition, we include large subsidiaries of bank holding groups in our analysis provided that a complete set of data is available in the cross-section. Most banks are located in the euro area (54%) and the European Union (E.U., 73%). European non-E.U. banks are located in Norway (12%), Switzerland (4%), and other countries (11%).

Table 2 also reports the data transformation used in the applied modeling. For example, some (but not all) ratios lie strictly within the unit interval. We transform such ratios into unbounded continuous variables by mapping them through an inverse Probit transform. We take natural logarithms of large numbers, such as total assets, CET1 capital, derivatives held for trading, etc. Finally, the 'ownership' variable combines information on

Table 2: Indicator variables

Bank-level panel data variables for the empirical analysis. We consider J=13 indicator variables covering six different categories. The third column explains which transformation is applied to each indicator before the statistical analysis.  $\Phi^{-1}(\cdot)$  denotes the inverse Probit transform.

| Category   | Variable                                 | Transformation                                                                          |
|------------|------------------------------------------|-----------------------------------------------------------------------------------------|
| Size       | 1. Total assets                          | $\ln(\text{Total Assets})$                                                              |
|            | 2. Leverage w.r.t. CET1 capital          | $\ln\left(\frac{\text{Total Assets}}{\text{CET1 capital}}\right)$                       |
| Complexity | 3. Net loans to assets                   | $\Phi^{-1}\left(\frac{\text{Loans}}{\text{Assets}}\right)$                              |
|            | 4. Risk mix                              | $\ln\left(\frac{\text{Market Risk}+\text{Operational Risk}}{\text{Credit Risk}}\right)$ |
|            | 5. Assets held for trading               | $\frac{\text{Assets in trading portfolios}}{\text{Total Assets}}$                       |
|            | 6. Derivatives held for trading          | $\frac{\text{Derivatives held for trading}}{\text{Total Assets}}$                       |
| Activities | 7. Share of net interest income          | $\frac{\text{Net interest income}}{\text{Operating revenue}}$                           |
|            | 8. Share of net fees & commission income | $\frac{\text{Net fees and commissions}}{\text{Operating income}}$                       |
|            | 9. Share of trading income               | $\frac{\text{Trading income}}{\text{Operating income}}$                                 |
|            | 10. Retail loans                         | $\frac{\text{Retail loans}}{\text{Retail and corporate loans}}$                         |
| Geography  | 11. Domestic loans ratio                 | $\Phi^{-1}\left(\frac{\text{Domestic loans}}{\text{Total loans}}\right)$                |
| Funding    | 12. Loan-to-deposits ratio               | $\frac{\text{Total loans}}{\text{Total deposits}}$                                      |
| Ownership  | 13. Ownership index                      | -                                                                                       |

**Note:** Total Assets are all assets owned by the company (SNL key field 131929). CET1 capital is Tier 1 regulatory capital as defined by the latest supervisory guidelines (220292). Net loans to assets are loans and finance leases, net of loan-loss reserves, as a percentage of all assets owned by the bank (226933). Risk mix is a function of Market Risk, Operational Risk, and Credit Risk (248881, 248882, and 248880, respectively), which are as reported by the company. Trading portfolio assets are assets acquired principally for the purpose of selling in the near term (224997). Derivatives held for trading are derivatives with positive replacement values not identified as hedging or embedded derivatives (224997). P&L variables are expressed as percentages of operating revenue (248959) or operating income (248961, 249289). Retail loans are expressed as a percent of retail and corporate loans (226957). Domestic loans are in percent of total loans by geography (226960). The loans-to-deposits ratio are loans held for investment, before reserves, as a percent of total deposits, the latter comprising both retail and commercial deposits (248919). Ownership combines information on ownership structure (131266) with information on whether a bank is listed at a stock exchange (255389). Ownership structure distinguishes stock corporations, mutual banks, co-op banks, and government ownership. Stock corporations can be listed or non-listed.

ownership/organizational structure with information on whether a bank is listed at a stock exchange. It distinguishes listed stock corporations, non-listed stock corporations, other limited liability companies, mutual/cooperative banks, and government-owned/state banks. We standardize the resulting categorical variable to zero mean and unit cross-sectional variance, and add standard-normally distributed error terms to make the variable ‘ownership index’ continuous.<sup>5</sup>

## 4.2 Model selection

This section motivates the model specification employed in our empirical analysis. We first discuss our choice of the number of clusters. We then determine the parametric distribution, pooling restrictions, and choice of covariance matrix dynamics.

Table 3 presents likelihood-based and distance-based information criteria, as well as different cluster validation indices for different values of  $J = 2, \dots, 10$ . Different criteria point towards different numbers of relevant components. Almost any choice of  $J \leq 9$  can be supported by some criterion or cluster validation index. Likelihood-based information criteria are sensitive to the specification of the penalty term, and either select the maximum number (AICc, BIC) or minimum number (AICk, BaiNg2) of components. Cluster validation indices such as the CHI and the DBI signal  $J \approx 6$  for both static and dynamic specifications of the component-specific covariance matrices  $\Omega_{jt}$ .

Additional considerations may also be relevant for the choice of  $J$ . First, the degree of homogeneity in the resulting peer groups may be more important than model parsimony if the model is used for supervisory benchmarking purposes rather than, for example, the out-of-sample forecasting of banking data or business model trends. This suggests that the sum over within-component sum of squared errors (SSE) should receive some weight. The minimal SSE is achieved at  $J = 9$  for the model with static covariance matrices, and  $J = 6$  for the model with dynamic covariance matrices.<sup>6</sup> With these considerations in mind, and

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<sup>5</sup>Doing so allows us to also consider information on ownership/organizational structure within our framework of normal and t-distributed mixtures. Omission of the ownership variable leads to small differences in cluster allocation among small banks. The choice of number of clusters is robust to the inclusion of the ownership variable.

<sup>6</sup>In practice, experts consider between five and up to more than ten different bank business models; see,

Table 3: Information criteria

We consider a subset of the likelihood- and distance-based information criteria, as well as cluster-validation indices we considered in the simulation study (section 3.3), for different values of  $J = 2, \dots, 10$ . The top panel refers to a specification with time-invariant  $\Omega_j$  with  $\nu$  estimated as a free parameter. The bottom panel refers to a model specification with dynamic component variance matrices  $\Omega_{jt}$ , and  $\nu$  fixed at five. Each statistic is the maximum (respectively minimum) obtained from 1,000 random starting values for the model parameters. loglik is the maximum value of the log-likelihood. AICc is the likelihood-based AIC criterion, corrected by a finite sample adjustment; see Hurvich and Tsai (1989). BIC is the standard Bayesian information criterion; see Schwarz (1978). AICk is a non-parametric AIC as suggested for k-means clustering; see Peel and McLachlan (2000). BaiNg2 is the second panel-IC as derived for approximate dynamic factor models; see Bai and Ng (2002). CHI and DBI refer to the Calinski-Harabasz index and Davies-Boulder index; see Peel and McLachlan (2000). SSE is the sum over within-component sum of squared errors. The top three suggested values are printed in bold, if applicable.

| $\Sigma_j$ static, estimated df. |                 |                  |                  |                |               |              |             |                |
|----------------------------------|-----------------|------------------|------------------|----------------|---------------|--------------|-------------|----------------|
| J                                | loglik          | AICc             | BIC              | AICk           | BaiNg2        | CHI          | DBI         | SSE            |
| 2                                | -5,874.8        | 12,189.7         | 13,624.7         | <b>2,451.3</b> | <b>-0.263</b> | <b>24.07</b> | 3.06        | 1,619.3        |
| 3                                | 1,661.9         | -2,655.8         | -524.4           | <b>2,687.9</b> | <b>-0.255</b> | 13.55        | 3.04        | 1,439.9        |
| 4                                | 5,561.9         | -10,220.2        | -7,400.0         | <b>2,980.5</b> | <b>-0.220</b> | <b>15.25</b> | 3.01        | 1,316.5        |
| 5                                | 8,098.2         | -15,049.3        | -11,548.3        | 3,450.3        | -0.055        | 9.66         | 3.00        | 1,370.3        |
| 6                                | 10,681.9        | -19,964.6        | -15,791.4        | 3,872.0        | 0.074         | <b>15.24</b> | <b>2.96</b> | 1,376.0        |
| 7                                | 12,058.4        | -22,456.5        | -17,620.1        | 4,214.4        | 0.144         | 12.49        | <b>2.68</b> | <b>1,302.4</b> |
| 8                                | <b>13,577.4</b> | <b>-25,223.8</b> | <b>-19,733.5</b> | 4,613.1        | 0.256         | 11.96        | <b>2.95</b> | <b>1,285.1</b> |
| 9                                | <b>15,702.9</b> | <b>-29,194.6</b> | <b>-23,060.4</b> | 4,971.8        | 0.335         | 6.72         | 2.99        | <b>1,227.8</b> |
| 10                               | <b>17,650.3</b> | <b>-32,798.7</b> | <b>-26,031.1</b> | 5,477.5        | 0.531         | 5.78         | 3.24        | 1,317.5        |

| $\Sigma_{jt}$ dynamic, $\nu = 5$ |                 |                  |                  |                |               |              |             |                |
|----------------------------------|-----------------|------------------|------------------|----------------|---------------|--------------|-------------|----------------|
| J                                | loglik          | AICc             | BIC              | AICk           | BaiNg2        | CHI          | DBI         | SSE            |
| 2                                | 1,114.9         | -1,791.9         | -363.6           | <b>2,411.3</b> | <b>-0.288</b> | 19.56        | 3.25        | 1,579.3        |
| 3                                | 9,057.1         | -17,448.6        | -15,323.7        | <b>2,696.6</b> | <b>-0.249</b> | 13.59        | <b>3.15</b> | 1,448.6        |
| 4                                | 13,542.2        | -26,183.0        | -23,369.3        | <b>3,126.3</b> | <b>-0.115</b> | 15.67        | 3.34        | 1,442.3        |
| 5                                | 16,014.2        | -30,883.7        | -27,389.2        | 3,493.0        | -0.024        | 15.89        | 3.33        | 1,413.0        |
| 6                                | 18,053.8        | -34,710.8        | -30,544.0        | 3,884.7        | 0.083         | <b>28.19</b> | 3.19        | <b>1,388.7</b> |
| 7                                | 20,431.7        | -39,205.6        | -34,375.4        | 4,308.2        | 0.214         | <b>33.50</b> | 3.28        | <b>1,396.2</b> |
| 8                                | <b>23,831.2</b> | <b>-45,734.2</b> | <b>-40,250.1</b> | 4,733.3        | 0.345         | 20.10        | 3.34        | <b>1,405.3</b> |
| 9                                | <b>23,772.0</b> | <b>-45,339.2</b> | <b>-39,211.0</b> | 5,177.0        | 0.490         | <b>24.88</b> | <b>2.86</b> | 1,433.0        |
| 10                               | <b>25,832.7</b> | <b>-49,165.9</b> | <b>-42,404.3</b> | 5,587.1        | 0.611         | 5.41         | <b>3.13</b> | 1,427.1        |

Table 4: Model specification

We report log-likelihoods and differences in log-likelihoods for a set of different model specifications. The estimates are based on  $J = 6$ , and are conditional on the same (optimal) allocation of banks to these components.

| Density  | $\nu$        | value    | $A_1$         | $\Omega_j; \Omega_{jt}$ | loglik          | $\Delta\text{loglik}$ |
|----------|--------------|----------|---------------|-------------------------|-----------------|-----------------------|
| N        | -            | $\infty$ | scalar        | static                  | 9,913.1         |                       |
| t        | fixed        | 5        | scalar        | static                  | 12,910.8        | 2,997.7               |
| t        | fixed        | 5        | vector        | static                  | 12,921.3        | 10.6                  |
| t        | est          | 8.5      | scalar        | static                  | 12,928.7        | 7.3                   |
| t        | est          | 8.5      | vector        | static                  | 12,939.0        | 10.3                  |
| N        | -            | $\infty$ | scalar        | dynamic                 | 13,411.0        | 472.0                 |
| t        | fixed        | 10       | scalar        | dynamic                 | 19,146.9        | 5,735.9               |
| <b>t</b> | <b>fixed</b> | <b>5</b> | <b>scalar</b> | <b>dynamic</b>          | <b>19,575.4</b> | <b>428.5</b>          |
| t        | est          | 5.1      | scalar        | dynamic                 | 19,575.6        | 0.2                   |

to be conservative, in line with Table 3 and our earlier simulation results, we choose  $J = 6$  components for our subsequent empirical analysis.

Table 4 motivates our additional empirical choices. Proceeding from the top to the bottom row, the log-likelihood improves significantly when we move from a Gaussian to a Student's  $t$  distributed finite mixture model, while keeping  $\Omega_j$  static. Specifically, the data favor a Student's  $t$  distributed model with low degrees of freedom, even after conditioning on component membership and time-varying parameters. Pooling the diagonal elements of  $A_1$  into a single parameter decreases the likelihood fit by approximately 10 points. We adopt this pooling restriction, saving eleven parameters to be estimated, even though the restriction is borderline significant at the 5% level. The adoption of dynamic covariance matrices  $\Omega_{jt}$  leads to large improvements in log-likelihood fit, by several thousand log-likelihood points, relative to the static specification.

In summary, we select a Student's  $t$  distributed dynamic finite mixture model, see Section 2.3.2, with dynamic component-specific covariance matrices  $\Omega_{jt}$ , as specified in Section 2.3.1. The autoregressive matrices are given by  $A_1 = a_1 \cdot I_D$ , and  $A_2 = a_2 \cdot I_D$ , where  $a_1, a_2$  are scalars to be estimated (in the M-step).

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for example, Ayadi, Arbak, and de Groen (2014) and Bankscope (2014, p. 299).

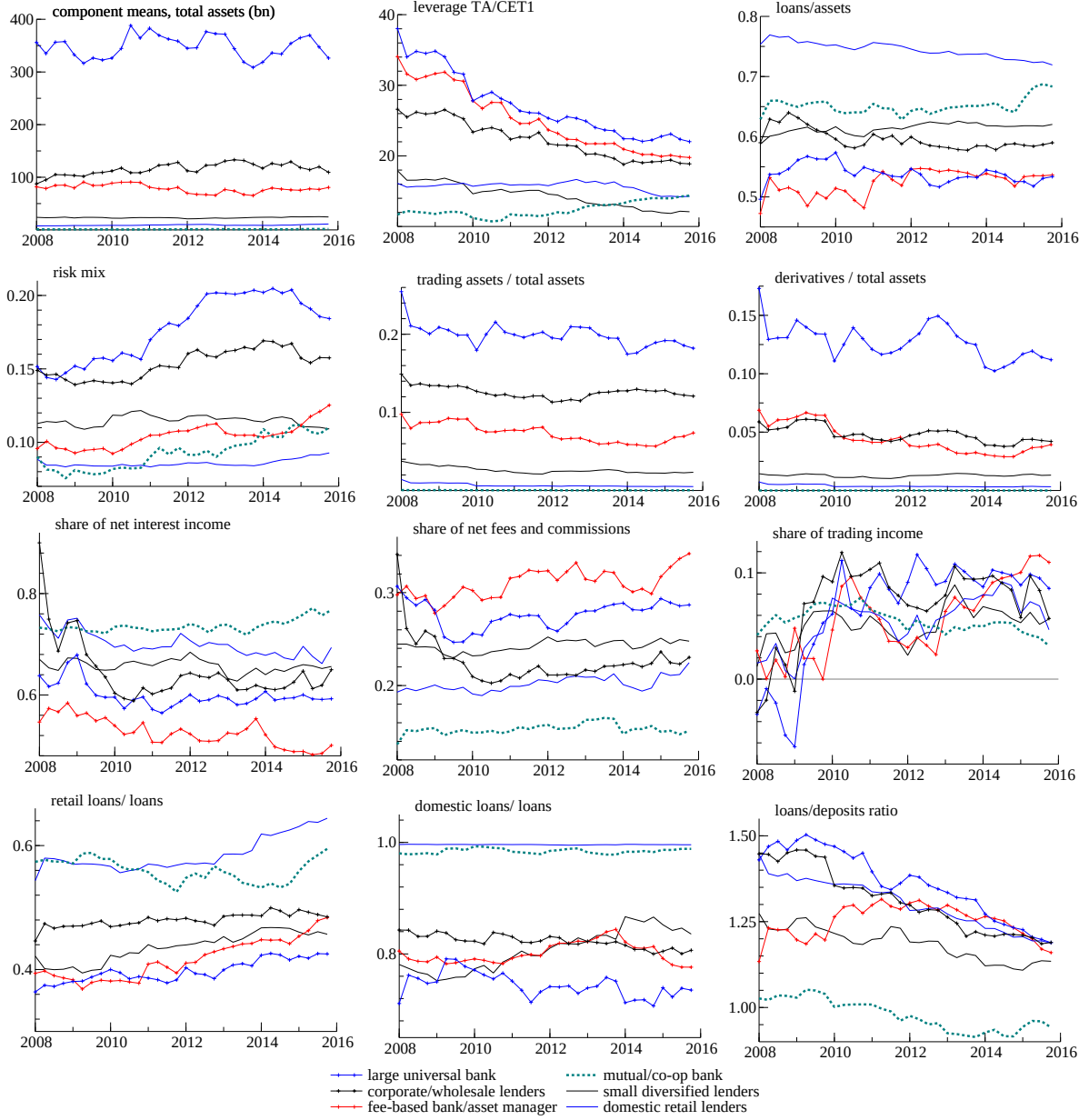


Figure 2: Time-varying component means

Filtered component means for twelve indicator variables; see Table 2. The ownership variable is omitted since it is time-invariant. Mean estimates are based on a t-mixture model with  $J = 6$  components and dynamic component covariance matrices  $\Omega_{jt}$ . We fixed  $\nu = 5$  to achieve outlier-robust results. We distinguish large universal banks (blue crossed line), corporate/wholesale-focused banks (black crossed line), mid-size diversified lenders (red crossed line), small diversified lenders (blue line), domestic retail lenders (black line), and mutual & co-operative banks (green dotted line).

### 4.3 Business model analysis

This section studies the different business models implied by the  $J = 6$  different component densities. Specifically, we assign labels to the identified components to guide intuition and





Figure 3: Box plots for indicator variables

We report box plots for twelve indicator variables; see Table 2 for the variable descriptions. For each variable, we consider the time series average over  $T = 32$  quarters. In each panel, we distinguish (from left to right): A: large universal banks; B: corporate/wholesale-focused banks; C: fee-based banks/asset managers; D: small diversified lenders; E: domestic retail lenders; and F: mutual/cooperative-type banks.

for ease of reference. These labels are chosen in line with Figures 2 and 3, as well as the identity of the firms in each component. Figure 2 plots the component mean estimates for each indicator variable and business model component (except ownership, which is time-invariant). Figure 3 reports box plots for time-averages of the indicator variables.

Our labeling is approximately in line with examples listed in SSM (2016, p.10).<sup>7</sup> Specifically, we distinguish

- (A) **Large universal banks, including G-SIBs** (10.6% of firms; comprising e.g. Barclays plc, Banco Santander SA, Deutsche Bank AG.)

<sup>7</sup>In addition, the Web Appendix B compares our cluster allocation against a 2016 supervisory ECB/SSM bank survey ('thematic review') that asked a subset of European banks in our sample which *other* banks they consider to follow a similar business model. We find that our classification outcomes for these banks approximately, but not perfectly, correspond to bank managements' own views.

- (B) **Corporate/wholesale-focused banks** (21.2% of firms; e.g. Bayerische Landesbank, HSH Nordbank, RBC Holdings plc.)
- (C) **Fee-focused bank/asset managers** (7.7% of firms; e.g. Julius Bär Group, DEKA Bank, Banco Comercial Portugues, Credit Lyonnais SA.)
- (D) **Small diversified lenders** (21.6 % of firms; e.g. Aareal Bank AG, Piraeus Bank SA.)
- (E) **Domestic retail lenders** (12.5% of firms; e.g. Newcastle Building Society, ProCredit Holding AG & Co. KGaA, Skandiabanken ASA.)
- (F) **Mutual/co-operative-type banks** (26.4% of firms; e.g. Berner Kantonalbank AG, Helgeland Sparebank.)

**Large universal banks, including G-SIBs** (blue line) stand out in Figures 2 and 3 as the largest institutions, with up to €2 trn in total assets per firm for globally significantly important banks; see Figure 3. Approximately 60% of total income tends to come from interest-bearing assets such as loans and securities holdings. This leaves net fees & commissions as well as trading income as significant other sources. Large universal banks are the most leveraged at any time between 2008Q1–2015Q4, even though leverage, i.e., total assets to CET1 capital, decreased by more than a third from pre-crisis levels, from approximately 38 to 24; see Figure 2. Large universal banks hold significant trading and derivative books, both in absolute terms and relative to total assets. Naturally, such large banks engage in significant cross-border activities, including lending (approximately 25% are cross-border loans).

**Corporate/wholesale-focused banks** (black line) are second in terms of firm size, with approximately €100 bn in total assets per firm. As the label suggests, such banks lend significantly to corporate customers, including other financial firms, with a share of retail loans of typically less than 50%. Such lenders also serve their corporate customers by trading securities and derivatives on their behalf, resulting in a significant trading book. Many corporate/wholesale-focused banks held substantial amounts of mortgage-related securities at the beginning of the 2008–2009 financial crisis. This exposure explains both the

high ratio of net interest income to total income in 2008Q1 for these banks, as well as the negative and zero contributions of trading income to total income between 2008–2009. Corporate/wholesale lenders tend to be non-deposit funded, as indicated by a relatively high loans-to-deposits ratio between 120 and 150%.

**Fee-focused banks/asset managers** (red line) are third in terms of size. Such institutions achieve most of their income from net fees and commissions (approximately half or more). This component contains asset managers as well as banks that offer fee-based commercial banking activities, including transaction banking services, trade finance, credit lines/overdraft fees, advisory services, and guarantees. By contrast, net interest income plays a less pronounced role, with a share of typically below 50%. Only approximately half of total assets are loans. These loans are granted to corporate rather than retail customers. Fee-focused banks tend to be active across borders, with a share of non-domestic loans of approximately 20%.

**Small diversified lenders** (black line) are characterized by less than €50 bn in total assets per firm. Lending is split, or diversified, approximately 50-50 between corporate and retail customers. Small diversified lenders tend to be well capitalized, as implied by a relatively low leverage ratio (typically less than 20), and are often government-owned (not reported). The share of non-domestic loans is approximately 20%, suggesting that bank lending is diversified as well across domestic and foreign loans. A low loans-to-deposits ratio points towards a substantial share of corporate and retail deposits.

Finally, **domestic retail lenders** and **mutual/cooperative-type banks** are the smallest firms, with typically less than €20 bn in total assets. While small, approximately 40% of banks in our sample are allocated to one of these two components. Consequently, such institutions are numerous, and therefore significant for financial stability outcomes, not in isolation but as a group; see Adrian and Brunnermeier (2015).

Domestic retail lenders and small mutual/cooperative banks have much in common. Most of their assets are comprised of loans. These loans are granted almost exclusively to domestic borrowers (no foreign loans), and are granted to retail rather than corporate customers. Most of their risk is credit risk, not market or operational risk (risk mix). Neither group holds

significant amounts of securities or derivatives in trading portfolios. Approximately two-thirds of their income comes from interest-bearing assets, making it the dominant source of income.

Domestic retail lenders differ from mutual/cooperative banks in two main ways: organizational structure and funding strategy. Domestic retail lenders tend to be set up as non-listed stock corporations (e.g., as a building society), while mutual and co-operative banks are set up as semi-public or partly customer-owned firms, respectively. Second, the loan-to-deposits ratio is particularly low for mutual and co-operative banks, at approximately 100%. This implies that approximately 70% of total assets are funded by customer deposits. If customer deposits are the dominant source of funding, and if negative short term interest rates cannot be passed through completely to retail customers, it is natural to expect that such banks suffer the most from low-for-long interest rates. We return to this issue in Section 5.

## 4.4 Heterogeneity during crises

Figure 2 suggests that the global financial crisis between 2008–2009 had a differential impact on banks with different business models. Large universal banks (A) and corporate/wholesale-focused banks (B) appear to be affected the most by the global financial crisis between 2008–2009. By contrast, domestic retail lenders (E) and mutual/cooperative-type banks (F) experienced less variability, particularly in the share of income sources. This is in line with, for example, earlier studies such as Altunbas, Manganelli, and Marques-Ibanez (2011), Beltratti and Stulz (2012), and Chiorazzo et al. (2016).<sup>8</sup>

In addition, we observe differences across banks’ business models also during the peak of the euro area sovereign debt crisis between 2010Q1–2012Q2; see ECB (2014). This time, fee-based banks/asset managers (C) and large universal banks (A) appear the most affected. For fee-based banks, total assets fell, the share of trading income decreased from approximately 10% to close to zero, and market risks rose (risk mix). Again, smaller retail lenders and

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<sup>8</sup>We refer to the Web Appendix C for plots of the filtered component-specific time-varying standard deviations  $\sqrt{\Omega_{jt}(d, d)}$  for variables  $d = 1, \dots, D - 1$ . In particular, the estimated cross-sectional standard deviations differ across components and tend to decrease over time from the high levels observed during the financial crisis between 2008–2009.

mutual/cooperative-type banks were relatively less affected.

## 4.5 Post-crisis banking sector trends

This section continues our discussion of Figure 2 with a focus on banking sector trends. For a more detailed discussion see ECB (2016).

The financial crisis of 2008–2009 and subsequent new regulatory requirements have had a profound impact on banks’ activities and business models. Pre-crisis profitability levels of many European banks were supported by high leverage ratios, reliance on relatively cheap wholesale (non-deposit) funding, as well as, in some cases, elevated risk-taking with concentration risks in securitization exposures and/or commercial real estate; see Ayadi et al. (2014) and ECB (2016). Changes in the post-crisis regulatory framework<sup>9</sup>, however, have rendered some of these previously profitable business strategies much less viable. In addition, adverse macroeconomic outcomes and financial market conditions during the euro area sovereign debt crisis between 2010–2012 weakened most European banks further.

Figure 2 suggests that banks adapt their respective business models to a changing financial and regulatory environment. We focus on three main developments. First, we observe a stark reduction in leverage (second panel in Figure 2) and wholesale funding (bottom right panel). Before the crisis, euro area banks were more highly leveraged, on average, than their global peers, according to the IMF (2009) and ECB (2016).<sup>10</sup> After the crisis, banks’ adjustment to higher capital requirements appear to have contributed to lower leverage ratios. The only exception is formed by mutual/co-op banks, whose leverage ratios have increased over time. Similarly, new regulatory requirements and the increased cost of wholesale funding seem to have pushed European banks to reduce their over-reliance on wholesale funding sources.

Second, changes in regulation made certain business lines more costly, in particular trad-

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<sup>9</sup>Examples include the Basel III rules, the Capital Requirements Directive (CRD) IV, the Bank Recovery and Resolution Directive, mandatory bail-in rules, and the move to single banking supervision (SSM) and a single resolution mechanism (SRM) in the euro area.

<sup>10</sup>Caveats apply. Relatively higher leverage ratios may have been related to different institutional practices, such as mortgage balance sheet retention. In addition, differences in accounting standards may have mattered, such as the different treatment of derivatives under IFRS and US GAAP.

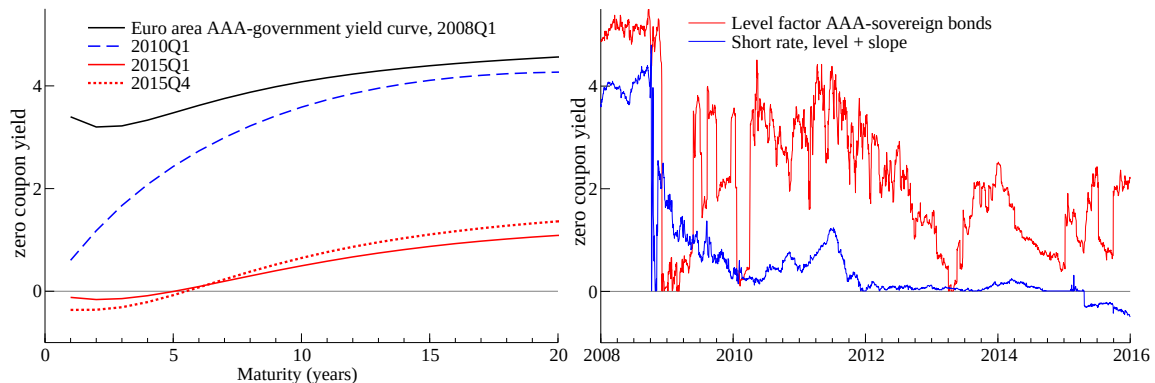


Figure 4: Yield curve and factor plots

All yield curve and factor plots refer to AAA-rated euro area government bonds, and are based on a Svensson (1994) four-factor model. Yield factor estimates are taken from the ECB. The left panel plots fitted Svensson yield curves on four dates – mid-2008Q1, mid-2010Q1, mid-2015Q1, and mid-2015Q4, for maturities between one and 20 years, and based on all yield curve factors. The right panel plots the level factor estimate, along with the model-implied short rate (given by the sum of the level and slope factor).

ing activities, thus providing banks with an incentive to scale down these activities.<sup>11</sup> Panels five and six of Figure 2 suggest that large universal banks substantially reduced their trading activities between 2012Q2–2015Q4. Derivatives held for trading declined from approximately 15% to approximately 10% of total assets on average for these banks. Assets held for trading declined from approximately 22% to 18% of total assets.

Third, there is some evidence of a shift towards retail business and away from investment banking and corporate/wholesale lending activities. Specifically, the share of retail loans to total loans is increasing for all banks, particularly in the low interest rate environment between 2012–2015.

## 5 Bank business models and the yield curve

### 5.1 Low interest rates

This section studies the extent to which banks adapt their business models to changes in the yield curve. We first discuss European interest rate developments before turning to parameter estimates.

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<sup>11</sup>For E.U. banks, the so-called Liikanen report recommended increased capital requirements for trading business lines, and a mandatory separation of proprietary trading and other high-risk trading from core activities. The Liikanen report was published in October 2012.

Figure 4 plots fitted zero-coupon yield curves for maturities between one and twenty years at different times during our sample (left panel). European government bond yields experienced a pronounced downward shift during our sample, ultimately reaching ultra-low and in part negative levels. The yield curve factors underlying the yield curve estimates pertain to a Svensson (1994) four-factor model and are extracted daily from market prices of AAA-rated sovereign bonds issued by euro area governments.<sup>12</sup>

Figure 4 (right panel) also plots the level factor, along with the implied short rate.<sup>13</sup> Long-term yields increased up to approximately 4% between 2009–2011 following an initial sharp drop during the global financial crisis. Between 2013–2015, nominal yields declined to historically low, even ultra-low, levels. In 2015, European 10 year rates are often below 1%.<sup>14</sup> Short-term rates become negative in 2015 following a cut of the ECB’s deposit facility rate to negative territory.

## 5.2 Fixed effects panel regression results

Table 5 presents fixed effects panel regression estimates of bank-level accounting variables  $\Delta_4 y_{it}(d)$ ,  $d = 1, \dots, 12$ , on a constant and contemporaneous as well as one-year lagged changes in two yield curve factors, level and slope. We consider annual differences since most banks report at an annual frequency. Table 5 pools bank data across business model components. Table 6 reports the regression coefficient for the one-year changes in the yield curve level, pooled as well as disaggregated across business model clusters.

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<sup>12</sup>The yield curve factors can be obtained from the ECB’s website. We take low-risk euro area yields as representative of low-risk E.U. yields more generally. European sovereign bond yields are highly correlated across borders, and also reflect global developments; see ECB (2013) and Lucas et al. (2014).

<sup>13</sup>The model-implied short rate is given by the sum of the level and slope factors at each time. Long-term yields are associated with the level factor. The slope factor fluctuates around a value of approximately -2 in our sample, and is not reported.

<sup>14</sup>Low long-term nominal interest rates do not only reflect unconventional monetary policies, such as the ECB’s Private Sector Purchase Programme (PSPP; occasionally referred to as “Quantitative Easing”). Decreasing inflation rates, inflation risk premia, demographic factors, and an imbalance between global saving and investment more generally play a role as well; see Draghi (2016).

Table 5: Factor sensitivity estimates

Fixed effects panel regression estimates for annual changes in bank-level accounting data  $\Delta_4 y_{it}(d)$ ,  $d = 1, \dots, 12$ , on a constant and contemporaneous and one-year lagged annual changes in yield curve factors level and slope. Specifically,  $\Delta_4 y_{it}(d) = b_1 \Delta_4 \text{level}_t + b_2 \Delta_4 \text{slope}_t + b_3 \Delta_4 \text{level}_{t-4} + b_4 \Delta_4 \text{slope}_{t-4} + \text{constant} + \text{fixed effects}_i + \epsilon_{it}$ . Dependent variables are as listed in Table 2. Standard errors are clustered at the bank level; stars denote significance at a 10%, 5%, and 1% level.

|                               | $\Delta_4 \ln(\text{TA}_t)$ | $\Delta_4 \ln(\text{Lev}_t)$ | $\Delta_4 (\text{TL}/\text{TA})_t$ | $\Delta_4 \ln(\text{RM}_t)$ | $\Delta_4 (\text{AHFT}/\text{TA})_t$ | $\Delta_4 (\text{DHFT}/\text{TA})_t$ |
|-------------------------------|-----------------------------|------------------------------|------------------------------------|-----------------------------|--------------------------------------|--------------------------------------|
| $\Delta_4 \text{level}_t$     | -0.0508***<br>(0.00942)     | -0.0260<br>(0.0162)          | 1.824***<br>(0.380)                | 0.00586<br>(0.0216)         | -0.00688***<br>(0.00246)             | -0.0111***<br>(0.00229)              |
| $\Delta_4 \text{slope}_t$     | -0.0514***<br>(0.00936)     | -0.0267*<br>(0.0160)         | 1.470***<br>(0.355)                | -0.00336<br>(0.0206)        | -0.00489*<br>(0.00252)               | -0.0105***<br>(0.00238)              |
| $\Delta_4 \text{level}_{t-4}$ | -0.0169***<br>(0.00367)     | 0.00685<br>(0.00688)         | 0.213<br>(0.148)                   | -0.00465<br>(0.00905)       | 0.000441<br>(0.00130)                | 0.00237***<br>(0.000796)             |
| $\Delta_4 \text{slope}_{t-4}$ | -0.0346***<br>(0.00487)     | -0.00777<br>(0.00734)        | 0.118<br>(0.169)                   | -0.00742<br>(0.0106)        | -0.000742<br>(0.00142)               | -0.000591<br>(0.000690)              |
| constant                      | 0.0104***<br>(0.00197)      | -0.0425***<br>(0.00364)      | 0.236**<br>(0.0959)                | 0.0201***<br>(0.00454)      | -0.00238***<br>(0.000698)            | -0.00107**<br>(0.000455)             |
| Observations                  | 3,064                       | 2,640                        | 2,902                              | 2,179                       | 2,285                                | 2,286                                |
| R-squared                     | 0.051                       | 0.008                        | 0.025                              | 0.002                       | 0.021                                | 0.066                                |

|                               | $\Delta_4 (\text{NII}/\text{OR})_t$ | $\Delta_4 (\text{NFC}/\text{OI})_t$ | $\Delta_4 (\text{TI}/\text{OI})_t$ | $\Delta_4 (\text{RL}/\text{TL})_t$ | $\Delta_4 (\text{DL}/\text{TL})_t$ | $\Delta_4 (\text{L}/\text{D})_t$ |
|-------------------------------|-------------------------------------|-------------------------------------|------------------------------------|------------------------------------|------------------------------------|----------------------------------|
| $\Delta_4 \text{level}_t$     | 1.931<br>(1.533)                    | 0.371<br>(1.064)                    | -0.0509<br>(1.260)                 | 0.00562<br>(0.00371)               | 1.225**<br>(0.535)                 | -0.230<br>(1.208)                |
| $\Delta_4 \text{slope}_t$     | 2.712*<br>(1.530)                   | 1.606*<br>(0.824)                   | 1.041<br>(1.263)                   | 0.00615*<br>(0.00333)              | 1.182**<br>(0.578)                 | -1.047<br>(1.274)                |
| $\Delta_4 \text{level}_{t-4}$ | -1.160*<br>(0.632)                  | -1.293***<br>(0.374)                | 0.686*<br>(0.397)                  | -0.00210*<br>(0.00126)             | -0.200<br>(0.188)                  | 0.277<br>(0.610)                 |
| $\Delta_4 \text{slope}_{t-4}$ | -2.191**<br>(0.896)                 | -1.335*<br>(0.678)                  | 1.243***<br>(0.449)                | 0.000269<br>(0.00221)              | -0.111<br>(0.224)                  | 0.0282<br>(0.659)                |
| constant                      | 0.118<br>(0.354)                    | -0.0291<br>(0.243)                  | -0.0375<br>(0.276)                 | 0.00728***<br>(0.000651)           | 0.362***<br>(0.0965)               | -1.973***<br>(0.287)             |
| Observations                  | 2,836                               | 2,827                               | 2,737                              | 1,895                              | 1,498                              | 2,417                            |
| R-squared                     | 0.003                               | 0.004                               | 0.007                              | 0.006                              | 0.006                              | 0.004                            |



Table 6: Sensitivities to changes in the term structure level ( $\Delta_4 l_t$ )

Yield level factor sensitivities for bank-level accounting data, controlling for changes in the slope factor and lagged changes in the yield curve. Factor sensitivity parameters are reported as pooled across all business models (column 2: All) as well as disaggregated across business model components A – F (columns 3 to 8). Estimates are obtained by fixed effects panel regression. Standard errors are clustered at the bank level.

| Dependent variable                   | All                      | A                       | B                       | C                      | D                     | E                       | F                       |
|--------------------------------------|--------------------------|-------------------------|-------------------------|------------------------|-----------------------|-------------------------|-------------------------|
| $\Delta_4 \ln(\text{TA})_t$          | -0.0508***<br>(0.00942)  | -0.0760**<br>(0.0326)   | -0.0834***<br>(0.0124)  | -0.0482<br>(0.0396)    | -0.00122<br>(0.0188)  | -0.0310<br>(0.0375)     | -0.0497**<br>(0.0203)   |
| $\Delta_4 \ln(\text{Lev})_t$         | -0.0260<br>(0.0162)      | -0.0318<br>(0.0395)     | -0.0229<br>(0.0236)     | -0.0619<br>(0.128)     | 0.00994<br>(0.0465)   | 0.0409<br>(0.0274)      | -0.0753***<br>(0.0271)  |
| $\Delta_4 (\text{TL}/\text{TA})_t$   | 1.824***<br>(0.380)      | 3.847**<br>(1.363)      | 2.702***<br>(0.501)     | 3.113*<br>(1.598)      | 0.453<br>(0.911)      | 1.328<br>(1.303)        | 0.766<br>(0.589)        |
| $\Delta_4 \ln(\text{RM})_t$          | 0.00586<br>(0.0216)      | -0.0616<br>(0.0581)     | 0.0407<br>(0.0513)      | -0.148**<br>(0.0641)   | -0.0107<br>(0.0397)   | 0.0858<br>(0.0780)      | 0.0288<br>(0.0307)      |
| $\Delta_4 (\text{AHFT}/\text{TA})_t$ | -0.00688***<br>(0.00246) | -0.0214**<br>(0.00823)  | -0.0138**<br>(0.00620)  | -0.00161<br>(0.00560)  | 0.00123<br>(0.00381)  | 0.000599<br>(0.000538)  | -0.000808<br>(0.000869) |
| $\Delta_4 (\text{DHFT}/\text{TA})_t$ | -0.0111***<br>(0.00229)  | -0.0371***<br>(0.00887) | -0.0210***<br>(0.00525) | -0.0129**<br>(0.00569) | -0.00170<br>(0.00206) | -1.95e-05<br>(2.04e-05) | 0.000209<br>(0.000841)  |
| $\Delta_4 (\text{NII}/\text{OR})_t$  | 1.931<br>(1.533)         | -1.253<br>(5.315)       | 5.763**<br>(2.645)      | -3.690<br>(7.723)      | 3.661<br>(4.309)      | 2.099<br>(2.141)        | -0.719<br>(2.665)       |
| $\Delta_4 (\text{NFC}/\text{OI})_t$  | 0.371<br>(1.064)         | 1.027<br>(1.573)        | 1.189<br>(0.830)        | 3.831<br>(3.979)       | 4.765*<br>(2.652)     | 0.805<br>(1.024)        | -4.510<br>(3.052)       |
| $\Delta_4 (\text{TI}/\text{OI})_t$   | -0.0509<br>(1.260)       | 0.579<br>(6.644)        | 2.727<br>(2.606)        | -2.229<br>(3.075)      | -3.477<br>(2.362)     | -0.143<br>(0.889)       | -0.566<br>(1.484)       |
| $\Delta_4 (\text{RL}/\text{TL})_t$   | 0.00562<br>(0.00371)     | 0.00168<br>(0.0137)     | 0.0114*<br>(0.00611)    | -0.0176<br>(0.0107)    | 0.00712<br>(0.00834)  | -0.00189<br>(0.00952)   | 0.0107<br>(0.00754)     |
| $\Delta_4 (\text{DL}/\text{TL})_t$   | 1.225**<br>(0.535)       | 3.843***<br>(1.214)     | 0.497<br>(0.794)        | -0.674<br>(1.284)      | 2.478<br>(1.886)      | 1.394<br>(2.619)        | 0.339<br>(0.317)        |
| $\Delta_4 (\text{L}/\text{D})_t$     | -0.230<br>(1.208)        | -2.828<br>(4.661)       | 1.665<br>(2.231)        | 0.264<br>(2.298)       | -0.356<br>(2.835)     | 2.485*<br>(1.451)       | -2.917<br>(2.462)       |

We focus on four main findings. First, as long-term interest rates decrease, banks on average grow larger in terms of total assets, by approximately 5% in response to a -100 bps drop in the level factor. According to Table 5, this effect on bank size is stronger if short-term rates decline as well, and also if yields have dropped in the previous year. This finding is in line with banks' incentive to extend the balance sheet to offset squeezed net interest margins for new loans and investments. In addition, and trivially, some bank assets are worth more at lower rates.

Second, the composition of bank assets is sensitive to the yield curve. The loans-to-assets ratio decreases by approximately 2% on average across business models in response to a -100 bps drop in long-term rates. Simultaneously, the sizes of banks' trading and derivative books increase in approximately corresponding amounts. This result is driven mostly by large banks (components A and B) and in part by fee-focused banks/asset managers (C). This change in balance sheet composition likely reflects a decreased demand for new loans from the private sector in an environment of strongly declining rates. In such an environment, large banks tend to invest in tradable securities such as government bonds instead of expanding their respective loan books; see Acharya and Steffen (2015) and Abbassi, Iyer, Peydro, and Tous (2016).

Third, there is remarkably little variation in the shares of income sources in response to changing yields. In particular, the share of net interest income is not significantly associated with contemporaneous changes in yields. Two opposing effects are likely at work. First, banks' long-term loans and bond holdings are worth more at lower rates. This may lead to mark-to-market gains, which can be realized, for example, when these assets are sold. Second, banks funding cost also decrease, and may do so at a faster rate than long-duration loan rates. On the other hand, low long term interest rates squeeze net interest margins for newly acquired loans and bonds. The former effect approximately balances the latter in our sample. Again, the short-term benefits of declining rates come at the expense of the long-term viability of established business models; see Nouy (2016).

Finally, the funding structure of banks is related to the slope factor for a subset of banks, particularly smaller mutual/cooperative-type banks. Such mutual/co-op banks rely heavily

Table 7: Factor sensitivity estimates: GAS-X model

We report parameter estimates associated with the extended GAS-X models. Term structure factors enter  $W_t$  in either levels (columns 2–3) or first differences (columns 4–5). Estimation sample is 2008Q1 – 2015Q4.

|         | GAS-X: levels        |                      | GAS-X: first differences |                    |
|---------|----------------------|----------------------|--------------------------|--------------------|
|         | $l_t$                | $s_t$                | $\Delta l_t$             | $\Delta s_t$       |
| ln(TA)  | -4.495***<br>(0.636) | -0.295***<br>(0.076) | -5.241***<br>(1.108)     | -0.330<br>(0.243)  |
| ln(Lev) | -1.299***<br>(0.243) | -0.033<br>(0.028)    | -0.792*<br>(0.453)       | -0.151*<br>(0.081) |
| TL/TA   | -0.049<br>(0.059)    | 0.007<br>(0.007)     | -0.257**<br>(0.108)      | 0.048**<br>(0.019) |
| AHFT/TA | -0.001<br>(0.002)    | (0.000)<br>(0.000)   | 0.001<br>(0.004)         | 0.001<br>(0.001)   |

on customer deposits for funding and are therefore particularly affected by low-or-negative short-term rates.<sup>15</sup> As the slope factor declines by -100 bps, such banks decrease their deposits-to-loans ratio by approximately 4%.

To conclude, banks' business models adjust markedly to changes in the yield curve. Wor-  
ringly, the effects of falling rates — increased size, increased leverage, increased complexity  
through larger trading and derivatives books, and possibly less stable funding sources — are  
potentially problematic and need to be assessed from a financial stability perspective.

### 5.3 Extended score-driven model

Term structure factors can be added to the econometric specification as discussed in Section  
2.3.3. Since we are modeling  $J$  component means (instead of  $N$  variables as in Tables 5 and  
6) and  $T = 32$  is moderate, we need to pool parameters across business model components.  
In addition, we use the yield curve factors to only drive a small subset of component means.  
We consider the component-specific means of four variables: log total assets, log leverage,  
and two indicators of asset composition – total loans to total assets, and assets held for  
trading to total assets.

Table 7 reports the respective parameter estimates. Term structure factors enter  $W_t$  in  
(22) in either levels or first differences. Overall, the loading coefficients on one-quarter lagged

<sup>15</sup>We refer to the Web Appendix D, Table D.4 for the respective slope coefficient estimate.

factors are in line with the panel regression estimates presented above. Specifically, declining long-term nominal interest rates predict growing bank size and leverage. The parameters indicating asset composition, however, are not significant in the level specification.

## 6 Conclusion

We proposed a novel score-driven dynamic finite mixture model for the study of banking data, accommodating time-varying component means and covariance matrices, normal and Student's  $t$  distributed mixtures, and term structure factors as economic determinants of time-varying parameters. In an empirical study of European banks, we classified more than 200 financial institutions into six distinct business model components. Our results suggest that the global financial crisis and the euro area sovereign debt crisis had a substantial yet different impact on banks with different business models. In addition, banks' business models adapt over time to changes in long-term interest rates.

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**Supplementary Appendices A – D to**  
**“Bank business models at zero interest rates”**

André Lucas, Julia Schaumburg, Bernd Schwaab



# Web Appendix A: Additional simulation results on information criteria and cluster validation indices

## A.1 Formulas

**Standard likelihood-based information criteria** As our framework is likelihood-based, we can apply standard information criteria such as AICc and BIC for model selection. However, these criteria might not give a large enough penalty when too many clusters are assumed. Therefore, we also consider a range of other criteria from the literature, that have been applied to select the number of components in different settings.

**Distance-based information criteria** The average within-cluster sum of squared errors simply measures the average deviation of an observation from its respective cluster mean. It does not take into account how well clusters are separated from each other. Therefore, we expect this criterion to overfit in some cases.

$$wSSE(J) = \frac{1}{T} \sum_{t=1}^T \sum_{j=1}^J \sum_{i \in C_j} \|\mathbf{y}_{it} - \mu_{j,t}\|^2 \quad (\text{A.1})$$

where  $\|x\|$  denotes the Euclidean norm of vector  $x$ .

The Akaike information criterion has been adapted to select the number of clusters when using the  $k$ -means algorithm (see Aggarwal and Reddy (2014), Chapter 4). It adds a penalty function to the within-cluster sum of squared errors:

$$AICk(J) = wSSE(J) + 2JD$$

with  $wSSE(J)$  as defined in (A.1). Bai and Ng (2002) provide criteria to optimally choose the number of factors in factor models for large panels. Their setting is similar to ours, so we also

include the three criteria suggested in their study:

$$\begin{aligned} IC_1(J) &= \frac{1}{ND} wSSE(J) + \frac{J(N+T)}{NT} \ln \left( \frac{NT}{N+T} \right) \\ IC_2(J) &= \frac{1}{ND} wSSE(J) + \frac{J(N+T)}{NT} \ln(c_{NT}^2) \\ IC_3(J) &= \frac{1}{ND} wSSE(J) + \frac{J \ln(c_{NT}^2)}{c_{NT}^2} \end{aligned}$$

with  $wSSE(J)$  from (A.1) and sequence  $c_{NT} = \min\{\sqrt{N}, \sqrt{T}\}$ .

**Calinski-Harabasz Index** The Calinski-Harabasz Index (CHI), which was introduced by Calinski and Harabasz (1974), has been successful in various comparative simulation studies, see, e.g., Milligan and Cooper (1985). We define a weighted version of the within-cluster sum of squared errors as

$$wSSE_M(J) = \frac{1}{T} \sum_{t=1}^T \sum_{j=1}^J \sum_{i \in C_j} d(\mathbf{y}_{it}, \mu_{j,t})$$

with  $d(x, y)$  denoting the Mahalanobis distance between two vectors  $x$  and  $y$ , i.e.  $d(\mathbf{y}_{it}, \mu_{j,t}) = (\mathbf{y}_{it} - \mu_{j,t})' \Omega^{-1} (\mathbf{y}_{it} - \mu_{j,t})$  where  $\Omega$  is the unconditional covariance matrix of the data. Similarly, we define the weighted between-cluster sum of squared errors as

$$bSSE_M(J) = \frac{1}{T} \sum_{t=1}^T \sum_{j=1}^J N_j d(\mathbf{y}_{it}, \bar{\mathbf{y}}_t)$$

with  $\bar{\mathbf{y}}_t = \frac{1}{N} \sum_{i=1}^N \mathbf{y}_{it}$  and  $N_j$  denoting the number of units contained in cluster  $j$ . Then, the CHI corresponding to  $J$  clusters is

$$CHI(J) = \frac{N - J}{J - 1} \cdot \frac{bSSE_M(J)}{wSSE_M(J)}.$$

$J$  is chosen such that  $CHI(J)$  is as large as possible.

**Davies-Bouldin index** The Davies-Bouldin index (DBI, see Davies and Bouldin (1979)) also utilizes the Mahalanobis distance. It relies on a similarity measure for each pair of clusters  $l$  and  $m$ , which is often defined as

$$R_{l,m} = \frac{s_l + s_m}{d_{l,m}}$$

where  $s_j = \frac{1}{T} \sum_{t=1}^T \frac{1}{N_j} d(\mathbf{y}_{jt}, \mu_{j,t})$ , measures the distance of a typical observation in cluster  $j$  to its mean, and  $d_{l,m} = \frac{1}{T} \sum_{t=1}^T d(\mu_{l,t}, \mu_{m,t})$  measures the distance between the centroids of clusters  $l$  and  $m$ .  $J$  is then chosen such that the maximum ratio of (weighted) within- and between cluster sums of squares is as small as possible:

$$DBI(J) = \frac{1}{J} \sum_{j=1}^J R_j$$

with

$$R_j = \max\{R_{jk}\}, \quad j \neq k.$$

**Average silhouette index** The silhouette index measures how well each observation fits into its respective cluster by comparing its within-cluster cohesion with its dissimilarity to the observations in the closest neighboring cluster. The silhouette value lies between -1 and 1, and the larger, the better is the fit. It was first introduced in Rousseeuw (1987) and its average over all observations has been shown to work well as a tool to determine the number of clusters in simulation studies, see, for instance, de Amorim and Hennig (2015b)

$$SI = \frac{1}{N} \sum_{i=1}^N \frac{b(\mathbf{Y}_i) - a(\mathbf{Y}_i)}{\max\{a(\mathbf{Y}_i), b(\mathbf{Y}_i)\}}$$

where  $a(\mathbf{Y}_i)$  is the average distance over time of  $\mathbf{Y}_i \in S_j$  to all other  $\mathbf{Y}_m \in S_j$  and  $b(\mathbf{Y}_i)$  is the average distance to all  $\mathbf{Y}_m \in S_l$ , where  $S_l$  is the closest cluster to  $S_j$ .

## A.2 Simulation tables: unknown number of clusters

We rely on the simulation settings as described in Section 3.1. This means we continue to simulate from bivariate mixtures consisting of two components, distinguishing between high and low signal-to-noise ratios, and overlapping and non-overlapping mean trajectories. As before, we consider the impact of two types of misspecification. By contrast, however, we do not assume that the number of clusters is equal to the true number (two) when estimating the model, but also estimate model parameters assuming one and three mixture components, respectively.

Tables A.1 and A.2 list the number of times each information criterion chooses 1, 2, or 3 as the number of clusters. Overall, we find that the standard likelihood-based information criteria AICc and BIC tend to systematically overestimate the number of clusters. As a result, these criteria do not work well. Distance-based criteria corresponding to the within-cluster sum of squared errors perform better, but almost all of them break down in one or more of the considered settings. The Davies-Bouldin index (DBI; see Davies and Bouldin (1979)) chooses the correct number of clusters in all cases reported here. Similarly, the Calinski-Harabasz index (CHI; see Calinski and Harabasz (1974)) often gives good indications as well. In our empirical application, we therefore report a variety of model selection criteria to get a full picture, but pay particular attention to these two validation indices whenever the criteria disagree.

Table A.1: Number of clusters

Chosen number of clusters by ten information criteria over 100 simulation runs. Correct specification refers to the case of simulating from a normal mixture and estimating assuming a mixture of normal distributions. In the case of misspecification 1, data are simulated from a  $t$ -mixture with 5 degrees of freedom, but the model is estimated assuming a Gaussian mixture distribution. In the case of misspecification 2, a  $t(3)$ -mixture is used to simulate the data, and a fixed value  $\nu = 5$  is assumed in the estimation.

| radius=4, distance=8 |               |     |    |            |     |    |            |     |    |
|----------------------|---------------|-----|----|------------|-----|----|------------|-----|----|
|                      | correct spec. |     |    | misspec. 1 |     |    | misspec. 2 |     |    |
| no. clusters         | 1             | 2   | 3  | 1          | 2   | 3  | 1          | 2   | 3  |
| AICc                 | 0             | 65  | 35 | 0          | 66  | 34 | 0          | 54  | 46 |
| BIC                  | 0             | 70  | 30 | 0          | 71  | 29 | 0          | 57  | 43 |
| SSE                  | 0             | 69  | 31 | 0          | 75  | 25 | 0          | 56  | 44 |
| AICk                 | 0             | 100 | 0  | 0          | 100 | 0  | 0          | 94  | 6  |
| BNG1                 | 0             | 100 | 0  | 0          | 100 | 0  | 0          | 85  | 15 |
| BNG2                 | 0             | 100 | 0  | 0          | 100 | 0  | 0          | 86  | 14 |
| BNG3                 | 0             | 100 | 0  | 0          | 99  | 1  | 0          | 84  | 16 |
| CHI                  | 0             | 100 | 0  | 0          | 100 | 0  | 0          | 100 | 0  |
| SI                   | 0             | 85  | 15 | 0          | 89  | 11 | 0          | 75  | 25 |
| DBI                  | 0             | 100 | 0  | 0          | 100 | 0  | 0          | 100 | 0  |

| radius=4, distance=0 |               |     |    |            |     |    |            |     |    |
|----------------------|---------------|-----|----|------------|-----|----|------------|-----|----|
|                      | correct spec. |     |    | misspec. 1 |     |    | misspec. 2 |     |    |
| no. clusters         | 1             | 2   | 3  | 1          | 2   | 3  | 1          | 2   | 3  |
| AICc                 | 0             | 53  | 47 | 0          | 55  | 45 | 0          | 54  | 46 |
| BIC                  | 0             | 55  | 45 | 0          | 58  | 42 | 0          | 58  | 42 |
| SSE                  | 0             | 70  | 30 | 0          | 71  | 29 | 0          | 56  | 44 |
| AICk                 | 0             | 100 | 0  | 0          | 100 | 0  | 0          | 98  | 2  |
| BNG1                 | 0             | 100 | 0  | 0          | 100 | 0  | 0          | 90  | 10 |
| BNG2                 | 0             | 100 | 0  | 0          | 100 | 0  | 0          | 91  | 9  |
| BNG3                 | 0             | 100 | 0  | 0          | 100 | 0  | 0          | 86  | 14 |
| CHK                  | 0             | 100 | 0  | 0          | 100 | 0  | 0          | 100 | 0  |
| SI                   | 0             | 96  | 4  | 0          | 99  | 1  | 0          | 79  | 21 |
| DBI                  | 0             | 100 | 0  | 0          | 100 | 0  | 0          | 100 | 0  |

Table A.2: Number of clusters, ctd.

Chosen number of clusters by ten information criteria over 100 simulation runs. Correct specification refers to the case of simulating from a normal mixture and estimating assuming a mixture of normal distributions. In the case of misspecification 1, data are simulated from a  $t$ -mixture with 5 degrees of freedom, but the model is estimated assuming normal mixtures. In the case of misspecification 2, a  $t(3)$ -mixture is used to simulate the data while in the estimation, a fixed value  $\nu = 5$  is assumed.

| radius=1, distance=8 |               |     |    |            |     |    |            |     |    |
|----------------------|---------------|-----|----|------------|-----|----|------------|-----|----|
| no. clusters         | correct spec. |     |    | misspec. 1 |     |    | misspec. 2 |     |    |
|                      | 1             | 2   | 3  | 1          | 2   | 3  | 1          | 2   | 3  |
| AICc                 | 0             | 55  | 45 | 0          | 64  | 36 | 0          | 60  | 40 |
| BIC                  | 0             | 63  | 37 | 0          | 67  | 33 | 0          | 60  | 40 |
| SSE                  | 0             | 68  | 32 | 0          | 68  | 32 | 0          | 55  | 45 |
| AICk                 | 0             | 100 | 0  | 0          | 100 | 0  | 0          | 96  | 4  |
| BNG1                 | 0             | 100 | 0  | 0          | 100 | 0  | 0          | 80  | 20 |
| BNG2                 | 0             | 100 | 0  | 0          | 100 | 0  | 0          | 81  | 19 |
| BNG3                 | 0             | 100 | 0  | 0          | 99  | 1  | 0          | 78  | 22 |
| CHK                  | 0             | 100 | 0  | 0          | 100 | 0  | 0          | 100 | 0  |
| Silhouette           | 0             | 99  | 1  | 0          | 98  | 2  | 0          | 93  | 7  |
| DBI                  | 0             | 100 | 0  | 0          | 100 | 0  | 0          | 100 | 0  |

| radius=1, distance=0 |               |     |    |            |     |    |            |     |    |
|----------------------|---------------|-----|----|------------|-----|----|------------|-----|----|
| no. clusters         | correct spec. |     |    | misspec. 1 |     |    | misspec. 2 |     |    |
|                      | 1             | 2   | 3  | 1          | 2   | 3  | 1          | 2   | 3  |
| AICc                 | 0             | 53  | 47 | 1          | 55  | 44 | 0          | 59  | 41 |
| BIC                  | 0             | 55  | 45 | 2          | 56  | 42 | 0          | 64  | 36 |
| SSE                  | 0             | 64  | 36 | 0          | 67  | 33 | 14         | 46  | 40 |
| AICk                 | 100           | 0   | 0  | 100        | 0   | 0  | 94         | 6   | 0  |
| BNG1                 | 1             | 99  | 0  | 61         | 39  | 0  | 67         | 28  | 5  |
| BNG2                 | 4             | 96  | 0  | 66         | 34  | 0  | 70         | 25  | 5  |
| BNG3                 | 0             | 100 | 0  | 45         | 55  | 0  | 58         | 35  | 7  |
| CHI                  | 0             | 100 | 0  | 0          | 98  | 2  | 0          | 100 | 0  |
| Silhouette           | 0             | 100 | 0  | 0          | 100 | 0  | 0          | 99  | 1  |
| DBI                  | 0             | 100 | 0  | 0          | 100 | 0  | 0          | 100 | 0  |

## Web Appendix B: Supervisory survey on banks’ peers

This section compares our classification results to a 2016 supervisory ECB/SSM bank survey (‘thematic review’).<sup>16</sup> The confidential survey asked SSM-supervised banks which *other* banks they considered to follow a similar business model. Of the banks that responded to the survey, 78 are in our sample (37.5%). Each bank could list up to ten peers.

The survey is not an ideal benchmark for our clustering outcomes, for several reasons. First, banks may have listed peers that are similar in only one aspect, such as a similar major business line, instead of peers at the consolidated level as the latter are considerably more difficult to determine (requiring, for example, a modeling framework as the one presented in the main text). Second, the survey responses may be biased towards larger and better-known banks. Third, country-effects may play a role: banks frequently reported peers that are located in the same jurisdiction. Country location, however, played no role in our classification analysis. Fourth, strategic reporting may have been present in some cases. Finally, the survey was undertaken at one point in time (2016), while our empirical results are based on earlier multivariate panel data (between 2008–2015).

Table B.1: Contingency table

For banks in each business model (column 1) we report the fraction of business model membership of the reported peers. The two highest entries in a row are printed in bold. We distinguish A: large universal banks, including G-SIBs; B: corporate/wholesale-focused banks; C: fee-based banks/asset managers; D: small diversified lenders; E: domestic retail lenders; and F: mutual/cooperative-type banks.

|       | A          | B          | C          | D          | E  | F          | Total |
|-------|------------|------------|------------|------------|----|------------|-------|
| A     | <b>41%</b> | <b>43%</b> | 0%         | 9%         | 0% | 7%         | 13    |
| B     | <b>49%</b> | <b>35%</b> | 6%         | 6%         | 0% | 4%         | 16    |
| C     | 13%        | <b>47%</b> | <b>20%</b> | <b>20%</b> | 0% | 0%         | 7     |
| D     | <b>30%</b> | 14%        | 5%         | <b>25%</b> | 0% | 25%        | 23    |
| E     | -          | -          | -          | -          | -  | -          | 0     |
| F     | <b>21%</b> | 5%         | 2%         | 18%        | 0% | <b>54%</b> | 19    |
| Total |            |            |            |            |    |            | 78    |

Despite these caveats, we may still expect to find most of the reported peers to come from the same, or at least an adjacent<sup>17</sup>, business model component as determined by our multivariate panel

<sup>16</sup>The clustering presented in the main text is not used for micro-prudential supervision. We thank the ECB MS I-IV team that assembled and conducted the thematic review.

<sup>17</sup>Components A–F are ordered in terms of declining average size (total assets), see Figure 2. In addition, the components are approximately ordered in terms of complexity, ranging from large universal banks, including G-SIBs (most complex), to traditional mutual/co-operative-type banks (least complex).

data methodology. This is the case. Table B.1 reports the respective fractions. The two highest entries in a row are printed in bold. Rows A–C have more than 80% of responses in the same and adjacent columns. No survey responses are available for domestic retail lenders (E). Smaller banks in rows D and F frequently list large universal (A) banks as their peers; these universal banks are probably comparable in only one business line, not at the consolidated level, see the caveats above. We conclude that our business model classification outcomes approximately corresponds to bank managements' own views.



## Web Appendix C: Component standard deviations

Figure C.1 plots the filtered component-specific time-varying standard deviations  $\text{std.dev}_{jt}(d) = \sqrt{\Omega_{jt}(d, d)}$  for variables  $d = 1, \dots, D-1$ . Allowing for time-varying component covariance matrices results in significant increases in log-likelihood; see Table 4. The off-diagonal elements of  $\Omega_{jt}$  are not reported. Overall, the standard deviations tend to decrease over time from the high levels observed during the financial crisis between 2008–2009. The variables (log) total assets and (the inverse Probit of) the share of domestic loans to total loans are particularly dispersed across units within a given component.

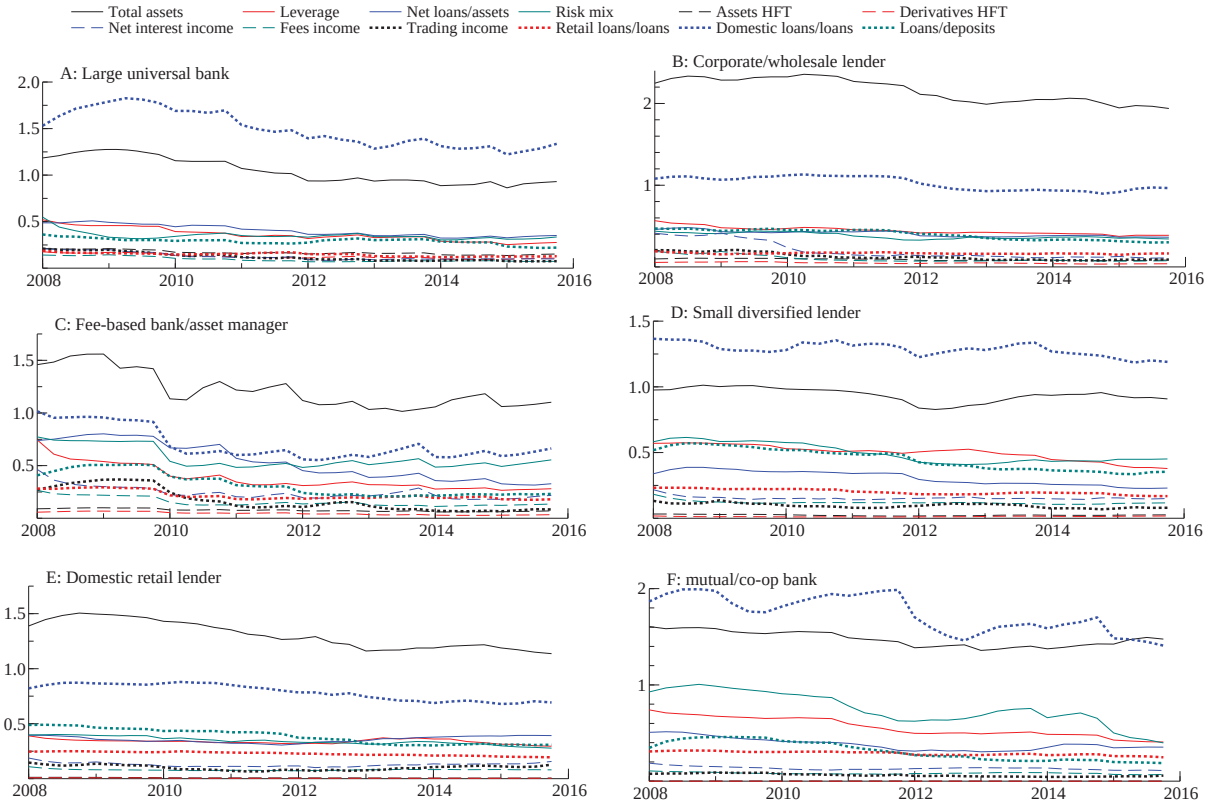


Figure C.1: Time-varying standard deviations

Filtered time-varying standard deviations around time-varying means as graphed in Figure 2. Each panel refers to a business model component and contains 12 standard deviation estimates over time (all variables in Table 2 except ownership, which is time-invariant). Mean and standard deviation estimates are based on a t-mixture model with six components and dynamic covariance matrices  $\Omega_{jt}$ . We fixed  $\nu = 5$  to achieve outlier-robust results.

## Web Appendix D: Term structure factor sensitivities

Tables D.1 – D.4 present factor sensitivity estimates obtained by least squares regression. Parameter estimates are either pooled across business models (column 2) and disaggregated across business models (columns 3 to 8). The pooled estimates are similar to the fixed effect panel regression estimates presented in the main text; see Table 5. Tables D.1 – D.4 report OLS standard error estimates. I.e., we do not cluster standard errors at the bank level owing to the lower number of banks within each business model component.

Table D.1: Disaggregated factor sensitivities

Yield factor sensitivities for bank-level accounting data. Factor sensitivity parameters are reported as pooled across business models (column 2) as well as disaggregated across business model components A – F (columns 3 to 8). Parameter estimates and standard errors are obtained by least squares regression.

| Dependent variable: $\Delta_4 \ln(\text{Total Assets})_t$ |                         |                         |                         |                      |                         |                       |                         |
|-----------------------------------------------------------|-------------------------|-------------------------|-------------------------|----------------------|-------------------------|-----------------------|-------------------------|
|                                                           | All                     | A                       | B                       | C                    | D                       | E                     | F                       |
| $\Delta_4 l_t$                                            | -0.0491***<br>(0.00803) | -0.0694***<br>(0.0181)  | -0.0811***<br>(0.0120)  | -0.0505<br>(0.0534)  | -0.00209<br>(0.0157)    | -0.0398<br>(0.0478)   | -0.0519***<br>(0.0148)  |
| $\Delta_4 s_t$                                            | -0.0487***<br>(0.00806) | -0.0834***<br>(0.0184)  | -0.0842***<br>(0.0121)  | -0.0471<br>(0.0533)  | 0.00507<br>(0.0158)     | -0.0263<br>(0.0474)   | -0.0543***<br>(0.0147)  |
| $\Delta_4 l_{t-4}$                                        | -0.0152***<br>(0.00332) | 0.00470<br>(0.00708)    | -0.00638<br>(0.00495)   | -0.0288<br>(0.0219)  | -0.0266***<br>(0.00647) | -0.0282<br>(0.0207)   | -0.0313***<br>(0.00640) |
| $\Delta_4 s_{t-4}$                                        | -0.0318***<br>(0.00399) | -0.0360***<br>(0.00870) | -0.0267***<br>(0.00599) | -0.0395<br>(0.0258)  | -0.0201***<br>(0.00775) | -0.0420*<br>(0.0240)  | -0.0544***<br>(0.00756) |
| const                                                     | 0.0113***<br>(0.00326)  | -0.0210***<br>(0.00780) | 0.00111<br>(0.00505)    | -0.00321<br>(0.0208) | 0.00733<br>(0.00638)    | 0.0658***<br>(0.0180) | 0.0216***<br>(0.00575)  |
| Obs                                                       | 3,064                   | 392                     | 802                     | 174                  | 627                     | 273                   | 796                     |
| R-squared                                                 | 0.030                   | 0.119                   | 0.078                   | 0.017                | 0.028                   | 0.016                 | 0.073                   |

| Dependent variable: $\Delta_4 \ln(\text{Leverage})_t$ |                         |                         |                         |                      |                        |                     |                         |
|-------------------------------------------------------|-------------------------|-------------------------|-------------------------|----------------------|------------------------|---------------------|-------------------------|
| $\Delta_4 l_t$                                        | -0.0252**<br>(0.0126)   | -0.0326<br>(0.0212)     | -0.0204<br>(0.0143)     | -0.0765<br>(0.139)   | 0.00748<br>(0.0294)    | 0.0472*<br>(0.0281) | -0.0726***<br>(0.0209)  |
| $\Delta_4 s_t$                                        | -0.0246*<br>(0.0126)    | -0.0279<br>(0.0212)     | -0.0252*<br>(0.0143)    | -0.0500<br>(0.138)   | -0.0219<br>(0.0293)    | 0.0541*<br>(0.0277) | -0.0569***<br>(0.0206)  |
| $\Delta_4 l_{t-4}$                                    | 0.00782<br>(0.00524)    | 0.0213**<br>(0.00875)   | 0.0214***<br>(0.00600)  | -0.00286<br>(0.0555) | 0.0147<br>(0.0115)     | 0.00171<br>(0.0124) | -0.0237***<br>(0.00892) |
| $\Delta_4 s_{t-4}$                                    | -0.00596<br>(0.00624)   | -0.00139<br>(0.0105)    | 0.0121*<br>(0.00718)    | 0.00852<br>(0.0658)  | -0.0148<br>(0.0137)    | 0.0103<br>(0.0142)  | -0.0400***<br>(0.0106)  |
| const                                                 | -0.0420***<br>(0.00505) | -0.0526***<br>(0.00896) | -0.0440***<br>(0.00594) | -0.109**<br>(0.0535) | -0.0329***<br>(0.0115) | 0.0130<br>(0.0106)  | -0.0477***<br>(0.00801) |
| Obs                                                   | 2,640                   | 359                     | 698                     | 171                  | 508                    | 225                 | 679                     |
| R-squared                                             | 0.006                   | 0.055                   | 0.023                   | 0.004                | 0.028                  | 0.020               | 0.043                   |

| Dependent variable: $\Delta_4 (\text{Loan-to-Assets ratio})_t$ |                     |                     |                     |                    |                    |                   |                      |
|----------------------------------------------------------------|---------------------|---------------------|---------------------|--------------------|--------------------|-------------------|----------------------|
| $\Delta_4 l_t$                                                 | 1.843***<br>(0.260) | 3.918***<br>(0.826) | 2.683***<br>(0.391) | 3.422**<br>(1.647) | 0.518<br>(0.490)   | 1.593<br>(1.399)  | 0.661<br>(0.478)     |
| $\Delta_4 s_t$                                                 | 1.461***<br>(0.260) | 3.327***<br>(0.832) | 2.349***<br>(0.394) | 2.666<br>(1.617)   | 0.386<br>(0.493)   | 1.402<br>(1.388)  | 0.164<br>(0.475)     |
| $\Delta_4 l_{t-4}$                                             | 0.228**<br>(0.107)  | 0.384<br>(0.320)    | 0.313*<br>(0.160)   | 0.654<br>(0.640)   | 0.381*<br>(0.202)  | -0.515<br>(0.607) | -0.112<br>(0.208)    |
| $\Delta_4 s_{t-4}$                                             | 0.132<br>(0.128)    | 0.752*<br>(0.390)   | 0.343*<br>(0.193)   | 0.768<br>(0.757)   | 0.0423<br>(0.241)  | -0.399<br>(0.701) | -0.383<br>(0.245)    |
| const                                                          | 0.243**<br>(0.105)  | 0.493<br>(0.341)    | 0.557***<br>(0.164) | 1.492**<br>(0.598) | 0.412**<br>(0.199) | 0.126<br>(0.527)  | -0.574***<br>(0.187) |
| Obs                                                            | 2,902               | 342                 | 722                 | 156                | 616                | 272               | 794                  |
| R-squared                                                      | 0.022               | 0.074               | 0.069               | 0.041              | 0.016              | 0.010             | 0.018                |

Table D.2: Disaggregated factor sensitivities, ctd.

Yield factor sensitivities for bank-level accounting data. Factor sensitivity parameters are reported as pooled across business models (column 2) as well as disaggregated across business model components A – F (columns 3 to 8). Parameter estimates and standard errors are obtained by least squares regression.

| Dependent variable: $\Delta_4 \ln(\text{Risk Mix})_t$ |                        |                       |                      |                       |                        |                     |                      |
|-------------------------------------------------------|------------------------|-----------------------|----------------------|-----------------------|------------------------|---------------------|----------------------|
| Cluster                                               | All                    | A                     | B                    | C                     | D                      | E                   | F                    |
| $\Delta_4 l_t$                                        | 0.00375<br>(0.0175)    | -0.0600<br>(0.0386)   | 0.0372<br>(0.0309)   | -0.136**<br>(0.0596)  | -0.0150<br>(0.0321)    | 0.121<br>(0.132)    | 0.0114<br>(0.0244)   |
| $\Delta_4 s_t$                                        | -0.00291<br>(0.0174)   | -0.0660*<br>(0.0386)  | 0.0239<br>(0.0310)   | -0.155***<br>(0.0591) | -0.00836<br>(0.0315)   | 0.104<br>(0.130)    | 0.00985<br>(0.0241)  |
| $\Delta_4 l_{t-4}$                                    | -0.00403<br>(0.00755)  | 0.00607<br>(0.0154)   | -0.00481<br>(0.0133) | 0.00205<br>(0.0240)   | -0.0198<br>(0.0138)    | 0.0165<br>(0.0599)  | 0.00250<br>(0.0114)  |
| $\Delta_4 s_{t-4}$                                    | -0.00623<br>(0.00891)  | -0.00375<br>(0.0188)  | -0.0159<br>(0.0157)  | -0.0193<br>(0.0279)   | -0.00347<br>(0.0162)   | 0.0470<br>(0.0689)  | -0.00441<br>(0.0132) |
| const                                                 | 0.0200***<br>(0.00691) | 0.0433***<br>(0.0162) | 0.0235*<br>(0.0126)  | 0.0349<br>(0.0227)    | -0.0397***<br>(0.0122) | 0.108**<br>(0.0494) | 0.0144<br>(0.00936)  |
| Obs                                                   | 2,179                  | 299                   | 565                  | 137                   | 394                    | 193                 | 591                  |
| R-squared                                             | 0.001                  | 0.010                 | 0.008                | 0.054                 | 0.011                  | 0.009               | 0.002                |

| Dependent variable: $\Delta_4 (\text{Assets held for trading}/\text{Total assets})_t$ |                           |                         |                          |                         |                         |                        |                         |
|---------------------------------------------------------------------------------------|---------------------------|-------------------------|--------------------------|-------------------------|-------------------------|------------------------|-------------------------|
| $\Delta_4 l_t$                                                                        | -0.00705***<br>(0.00164)  | -0.0232***<br>(0.00611) | -0.0131***<br>(0.00409)  | -0.00195<br>(0.00748)   | 0.00154<br>(0.00302)    | 0.000602<br>(0.000516) | -0.000519<br>(0.000853) |
| $\Delta_4 s_t$                                                                        | -0.00501***<br>(0.00162)  | -0.0195***<br>(0.00615) | -0.00858**<br>(0.00405)  | -0.00156<br>(0.00725)   | 0.00300<br>(0.00299)    | 0.000450<br>(0.000507) | -0.000502<br>(0.000827) |
| $\Delta_4 l_{t-4}$                                                                    | 0.000680<br>(0.000678)    | -0.000174<br>(0.00234)  | -0.00144<br>(0.00176)    | -0.00251<br>(0.00294)   | 0.00555***<br>(0.00125) | 0.000173<br>(0.000222) | 0.000627*<br>(0.000370) |
| $\Delta_4 s_{t-4}$                                                                    | -0.000313<br>(0.000805)   | -0.00706**<br>(0.00289) | 0.000287<br>(0.00209)    | -0.00816**<br>(0.00331) | 0.00430***<br>(0.00148) | 8.15e-05<br>(0.000259) | 0.000359<br>(0.000423)  |
| const                                                                                 | -0.00234***<br>(0.000633) | -0.00461*<br>(0.00261)  | -0.00578***<br>(0.00163) | -0.00212<br>(0.00256)   | -5.45e-05<br>(0.00116)  | 0.000137<br>(0.000192) | -0.000293<br>(0.000300) |
| Obs                                                                                   | 2,285                     | 334                     | 559                      | 118                     | 466                     | 234                    | 574                     |
| R-squared                                                                             | 0.018                     | 0.071                   | 0.033                    | 0.082                   | 0.068                   | 0.010                  | 0.009                   |

| Dependent variable: $\Delta_4 (\text{Derivatives held for trading}/\text{Total assets})_t$ |                           |                         |                          |                         |                         |                        |                         |
|--------------------------------------------------------------------------------------------|---------------------------|-------------------------|--------------------------|-------------------------|-------------------------|------------------------|-------------------------|
| $\Delta_4 l_t$                                                                             | -0.00705***<br>(0.00164)  | -0.0232***<br>(0.00611) | -0.0131***<br>(0.00409)  | -0.00195<br>(0.00748)   | 0.00154<br>(0.00302)    | 0.000602<br>(0.000516) | -0.000519<br>(0.000853) |
| $\Delta_4 s_t$                                                                             | -0.00501***<br>(0.00162)  | -0.0195***<br>(0.00615) | -0.00858**<br>(0.00405)  | -0.00156<br>(0.00725)   | 0.00300<br>(0.00299)    | 0.000450<br>(0.000507) | -0.000502<br>(0.000827) |
| $\Delta_4 l_{t-4}$                                                                         | 0.000680<br>(0.000678)    | -0.000174<br>(0.00234)  | -0.00144<br>(0.00176)    | -0.00251<br>(0.00294)   | 0.00555***<br>(0.00125) | 0.000173<br>(0.000222) | 0.000627*<br>(0.000370) |
| $\Delta_4 s_{t-4}$                                                                         | -0.000313<br>(0.000805)   | -0.00706**<br>(0.00289) | 0.000287<br>(0.00209)    | -0.00816**<br>(0.00331) | 0.00430***<br>(0.00148) | 8.15e-05<br>(0.000259) | 0.000359<br>(0.000423)  |
| const                                                                                      | -0.00234***<br>(0.000633) | -0.00461*<br>(0.00261)  | -0.00578***<br>(0.00163) | -0.00212<br>(0.00256)   | -5.45e-05<br>(0.00116)  | 0.000137<br>(0.000192) | -0.000293<br>(0.000300) |
| Obs                                                                                        | 2,285                     | 334                     | 559                      | 118                     | 466                     | 234                    | 574                     |
| R-squared                                                                                  | 0.018                     | 0.071                   | 0.033                    | 0.082                   | 0.068                   | 0.010                  | 0.009                   |

Table D.3: Disaggregated factor sensitivities, ctd.

Yield factor sensitivities for bank-level accounting data. Factor sensitivity parameters are reported as pooled across business models (column 2) as well as disaggregated across business model components A – F (columns 3 to 8). Parameter estimates and standard errors are obtained by least squares regression.

| Dependent variable: $\Delta_4$ (Net interest income/Operating revenue) $_t$ |                     |                   |                   |                   |                    |                     |                   |
|-----------------------------------------------------------------------------|---------------------|-------------------|-------------------|-------------------|--------------------|---------------------|-------------------|
| Cluster                                                                     | All                 | A                 | B                 | C                 | D                  | E                   | F                 |
| $\Delta_4 l_t$                                                              | 1.864<br>(2.145)    | -1.310<br>(3.127) | 5.815*<br>(3.233) | -4.646<br>(26.11) | 3.809<br>(4.802)   | 2.335<br>(2.276)    | -0.970<br>(3.640) |
| $\Delta_4 s_t$                                                              | 2.609<br>(2.150)    | -0.715<br>(3.158) | 5.549*<br>(3.258) | 9.556<br>(25.88)  | 1.083<br>(4.839)   | 2.425<br>(2.253)    | 0.747<br>(3.623)  |
| $\Delta_4 l_{t-4}$                                                          | -1.149<br>(0.870)   | -1.361<br>(1.188) | -0.620<br>(1.301) | -0.950<br>(10.08) | -0.709<br>(1.935)  | -1.923**<br>(0.970) | -1.159<br>(1.551) |
| $\Delta_4 s_{t-4}$                                                          | -2.181**<br>(1.048) | -1.999<br>(1.464) | -1.991<br>(1.579) | -10.94<br>(11.90) | 0.693<br>(2.330)   | -1.276<br>(1.148)   | -2.555<br>(1.843) |
| const                                                                       | 0.109<br>(0.863)    | -0.601<br>(1.297) | 1.391<br>(1.347)  | 1.403<br>(9.866)  | -0.0445<br>(1.944) | 0.0749<br>(0.871)   | -0.693<br>(1.419) |
| Obs                                                                         | 2,836               | 313               | 730               | 154               | 585                | 273                 | 781               |
| R-squared                                                                   | 0.003               | 0.007             | 0.009             | 0.049             | 0.010              | 0.023               | 0.007             |

| Dependent variable: $\Delta_4$ (Fee & commissions income/Operating income) $_t$ |                     |                      |                      |                   |                    |                     |                   |
|---------------------------------------------------------------------------------|---------------------|----------------------|----------------------|-------------------|--------------------|---------------------|-------------------|
| $\Delta_4 l_t$                                                                  | 0.326<br>(1.399)    | 0.856<br>(1.349)     | 1.144<br>(0.732)     | 3.889<br>(10.86)  | 4.791*<br>(2.884)  | 0.751<br>(1.202)    | -4.458<br>(4.154) |
| $\Delta_4 s_t$                                                                  | 1.545<br>(1.403)    | 1.375<br>(1.364)     | 1.744**<br>(0.738)   | 10.53<br>(10.75)  | 3.849<br>(2.906)   | 1.754<br>(1.190)    | -1.868<br>(4.137) |
| $\Delta_4 l_{t-4}$                                                              | -1.293**<br>(0.568) | -1.443***<br>(0.511) | -1.041***<br>(0.297) | -4.091<br>(4.188) | -0.0915<br>(1.162) | -1.066**<br>(0.513) | -1.813<br>(1.773) |
| $\Delta_4 s_{t-4}$                                                              | -1.333*<br>(0.685)  | -1.495**<br>(0.630)  | -1.019***<br>(0.360) | -3.414<br>(4.960) | 1.537<br>(1.399)   | -1.187*<br>(0.606)  | -3.065<br>(2.104) |
| const                                                                           | -0.0381<br>(0.563)  | 0.301<br>(0.563)     | 0.233<br>(0.305)     | -0.565<br>(4.099) | 0.741<br>(1.168)   | -0.155<br>(0.460)   | -0.736<br>(1.617) |
| Obs                                                                             | 2,827               | 302                  | 729                  | 157               | 585                | 273                 | 781               |
| R-squared                                                                       | 0.004               | 0.028                | 0.024                | 0.034             | 0.011              | 0.047               | 0.009             |

| Dependent variable: $\Delta_4$ (Trading income/Operating income) $_t$ |                     |                  |                    |                   |                   |                     |                   |
|-----------------------------------------------------------------------|---------------------|------------------|--------------------|-------------------|-------------------|---------------------|-------------------|
| $\Delta_4 l_t$                                                        | 0.0522<br>(0.983)   | 0.798<br>(2.894) | 2.577<br>(2.025)   | -1.187<br>(6.028) | -3.393<br>(2.068) | -0.00874<br>(1.945) | -0.465<br>(1.875) |
| $\Delta_4 s_t$                                                        | 1.130<br>(0.984)    | 1.780<br>(2.920) | 3.896*<br>(2.035)  | -0.242<br>(5.979) | -1.677<br>(2.083) | 0.176<br>(1.909)    | 0.277<br>(1.869)  |
| $\Delta_4 l_{t-4}$                                                    | 0.687*<br>(0.397)   | 1.425<br>(1.108) | 0.963<br>(0.808)   | -1.918<br>(2.322) | 0.655<br>(0.827)  | 1.669**<br>(0.834)  | 0.0900<br>(0.797) |
| $\Delta_4 s_{t-4}$                                                    | 1.264***<br>(0.478) | 1.269<br>(1.363) | 2.365**<br>(0.981) | 0.647<br>(2.763)  | -0.286<br>(0.997) | 1.399<br>(0.976)    | 1.151<br>(0.946)  |
| const                                                                 | -0.0220<br>(0.393)  | 0.529<br>(1.202) | 0.0836<br>(0.840)  | 0.170<br>(2.307)  | 0.0187<br>(0.835) | -0.0439<br>(0.713)  | -0.538<br>(0.729) |
| Obs                                                                   | 2,737               | 289              | 708                | 148               | 569               | 257                 | 766               |
| R-squared                                                             | 0.008               | 0.017            | 0.018              | 0.016             | 0.025             | 0.020               | 0.005             |

Table D.4: Disaggregated factor sensitivities, ctd.

Yield factor sensitivities for bank-level accounting data. Factor sensitivity parameters are reported as pooled across business models (column 2) as well as disaggregated across business model components A – F (columns 3 to 8). Parameter estimates and standard errors are obtained by least squares regression.

| Dependent variable: $\Delta_4$ (Retail loans/Retail and commercial loans) $_t$ |                         |                       |                          |                        |                        |                      |                        |
|--------------------------------------------------------------------------------|-------------------------|-----------------------|--------------------------|------------------------|------------------------|----------------------|------------------------|
| Cluster                                                                        | All                     | A                     | B                        | C                      | D                      | E                    | F                      |
| $\Delta_4 l_t$                                                                 | 0.00564<br>(0.00351)    | 0.00285<br>(0.00906)  | 0.0112**<br>(0.00523)    | -0.0172*<br>(0.00946)  | 0.00586<br>(0.00945)   | -0.0106<br>(0.0195)  | 0.0131*<br>(0.00695)   |
| $\Delta_4 s_t$                                                                 | 0.00628*<br>(0.00348)   | 0.00217<br>(0.00901)  | 0.0150***<br>(0.00517)   | -0.0199**<br>(0.00939) | 0.00857<br>(0.00940)   | -0.00759<br>(0.0182) | 0.0103<br>(0.00695)    |
| $\Delta_4 l_{t-4}$                                                             | -0.00220<br>(0.00146)   | -0.00237<br>(0.00375) | -0.00632***<br>(0.00212) | 0.00244<br>(0.00366)   | -0.00687*<br>(0.00373) | 0.00546<br>(0.00889) | 0.00316<br>(0.00306)   |
| $\Delta_4 s_{t-4}$                                                             | 0.000147<br>(0.00174)   | 0.000117<br>(0.00454) | -0.00290<br>(0.00255)    | 0.00248<br>(0.00441)   | -0.000477<br>(0.00452) | 0.00910<br>(0.00934) | 0.00253<br>(0.00361)   |
| const                                                                          | 0.00725***<br>(0.00139) | 0.00307<br>(0.00366)  | 0.00662***<br>(0.00208)  | 0.00466<br>(0.00365)   | 0.00134<br>(0.00375)   | 0.00385<br>(0.00640) | 0.0156***<br>(0.00280) |
| Obs                                                                            | 1,895                   | 213                   | 453                      | 121                    | 394                    | 180                  | 534                    |
| R-squared                                                                      | 0.004                   | 0.007                 | 0.039                    | 0.046                  | 0.017                  | 0.010                | 0.009                  |

| Dependent variable: $\Delta_4$ (Domestic loans/Total loans) $_t$ |                    |                     |                     |                    |                    |                  |                     |
|------------------------------------------------------------------|--------------------|---------------------|---------------------|--------------------|--------------------|------------------|---------------------|
| $\Delta_4 l_t$                                                   | 0.918*<br>(0.490)  | 3.494***<br>(0.936) | 0.166<br>(0.974)    | -1.162<br>(1.181)  | 1.813<br>(1.649)   | 1.410<br>(2.386) | 0.159<br>(0.447)    |
| $\Delta_4 s_t$                                                   | 0.917*<br>(0.482)  | 3.218***<br>(0.918) | 0.274<br>(0.964)    | -1.416<br>(1.166)  | 1.920<br>(1.638)   | 0.758<br>(2.305) | 0.418<br>(0.434)    |
| $\Delta_4 l_{t-4}$                                               | -0.367*<br>(0.203) | -0.298<br>(0.368)   | -1.013**<br>(0.413) | -0.909*<br>(0.511) | -0.136<br>(0.673)  | 1.034<br>(0.970) | -0.394**<br>(0.187) |
| $\Delta_4 s_{t-4}$                                               | -0.313<br>(0.239)  | -0.603<br>(0.442)   | -0.849*<br>(0.487)  | -0.970*<br>(0.564) | 0.110<br>(0.803)   | 0.822<br>(1.096) | -0.250<br>(0.219)   |
| const                                                            | 0.257<br>(0.183)   | 1.196***<br>(0.354) | -0.870**<br>(0.381) | -0.329<br>(0.414)  | 1.324**<br>(0.630) | 0.918<br>(0.826) | -0.0286<br>(0.163)  |
| Obs                                                              | 1,498              | 166                 | 337                 | 129                | 279                | 156              | 431                 |
| R-squared                                                        | 0.005              | 0.097               | 0.019               | 0.039              | 0.005              | 0.011            | 0.019               |

| Dependent variable: $\Delta_4$ (Loans-to-deposits ratio) $_t$ |                      |                      |                      |                   |                   |                   |                      |
|---------------------------------------------------------------|----------------------|----------------------|----------------------|-------------------|-------------------|-------------------|----------------------|
| $\Delta_4 l_t$                                                | -0.294<br>(0.904)    | -3.134<br>(2.128)    | 1.638<br>(1.974)     | 0.894<br>(4.000)  | -0.902<br>(2.102) | 2.894<br>(2.474)  | -2.747<br>(1.668)    |
| $\Delta_4 s_t$                                                | -1.087<br>(0.894)    | -2.738<br>(2.087)    | 1.305<br>(1.961)     | 0.502<br>(3.853)  | -2.773<br>(2.100) | 2.671<br>(2.436)  | -3.796**<br>(1.641)  |
| $\Delta_4 l_{t-4}$                                            | 0.280<br>(0.380)     | 0.879<br>(0.815)     | -0.352<br>(0.837)    | -1.421<br>(1.538) | 1.295<br>(0.884)  | 0.631<br>(1.086)  | -0.256<br>(0.729)    |
| $\Delta_4 s_{t-4}$                                            | 0.0352<br>(0.449)    | 2.067**<br>(1.003)   | -0.295<br>(0.998)    | -0.726<br>(1.815) | -0.680<br>(1.052) | 0.461<br>(1.237)  | -0.0321<br>(0.841)   |
| const                                                         | -1.981***<br>(0.351) | -4.499***<br>(0.843) | -2.542***<br>(0.794) | -1.787<br>(1.375) | 0.129<br>(0.846)  | -0.524<br>(0.914) | -3.007***<br>(0.621) |
| Obs                                                           | 2,417                | 267                  | 595                  | 136               | 520               | 243               | 656                  |
| R-squared                                                     | 0.004                | 0.027                | 0.002                | 0.014             | 0.023             | 0.006             | 0.017                |