Bank Liquidity Management and Payout Policy under Peer Pressure

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We examine how peer effects in liquidity risk management spill over into payout policy and impact the trade-off that bank managers face when deciding whether to accumulate reserves or to pay shareholders. We show that under high peer pressure, banks reduce payouts and increase cash reserves, which reduces the probability of default and improves financial stability. Using data from the Federal Reserve's Y-9C report over the period 1987-2020, we find that a one standard deviation increase in peer pressure is associated with a 2%-12% increase in cash reserves and a 1%-17% decline in the dividend payout ratio, relative to their respective averages, leading to an improvement in banks' risk profiles.

In Special Session 61 on Recent Advances in Mathematical Finance and Related Fields at the Mathematical Congress of the Americas 2025.

MCA 2025 internal code: SS61-T08