# Thomas Rivera

## *Presentation Title*

## Adverse Selection in the Market for Bank Capital with Heterogeneous Risk Preferences

## *Abstract*

We study a model where banks are privately informed about the riskiness of their assets and the bank's shareholders and the external investors they tap for capital have different risk preferences. We show that when the bank's shareholders are less risk averse than outside investors, then no mechanism can resolve adverse selection in the market for bank capital, a stark contrast to the case with homogeneous risk preferences where full separation is possible. The implication of these results on the regulator's investment-stability tradeoff shows how when levels of risk aversion are low (high) than only the riskiest (riskiest and safest) banks will undertake new projects generating new insights for the optimal design of capital requirements.

## *Keywords*

Adverse Selection; Financial Stability; Bank Regulation; Heterogeneous Risk Preferences

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