Credit Disintermediation and Monetary Policy

Discussion by Victoria Ivashina

HARVARD | BUSINESS | SCHOOL

Copyright © President & Fellows of Harvard College

Theory

- At the core: choice between loans and bonds
- No asymmetric information, no controlled heterogeneity in risk, only in the initial endowment (*e*), and so the choice of loans vs. bonds is pinned down by
    - Loan cost: Banks charge intermediation spread $\gamma(r) > 0$
    - Loan benefit: Bank debt can be restructured (less capital is destroyed upon liquidation)

Theory

- Testable prediction (cross-sectional):
- Let's take monetary easing: for bank-dependent firms (banks with high level of bank debt vs. total debt)
  - Investment will expand more (this is not the exciting part)
  - In absence of bank-lending channel, bank share of debt will go down
    - because bank dependent firms have high liquidation probability and so they use their bank debt capacity to the max, and any adjustments happens primarily through the bond market
  - Bank-lending channel off-sets this effect (reverses it when it is strong)

Theory

- The choice of loans vs. bonds is pinned down by
  - Loan cost: Banks charge intermediation spread $\gamma(r) > 0$
  - Loan benefit: Bank debt can be restructured (less capital is destroyed upon liquidation)

- This set-up requires substantial abstract thinking
  - E.g., "bank specialness" is a pure cost, which is of course not how we think about it or how the firms experience it (bank debt is the cheapest form of debt at least in the direct sense)
  - The restructuring benefit of bank debt is independent of "bank specialness" in the model

Empirical Motivation

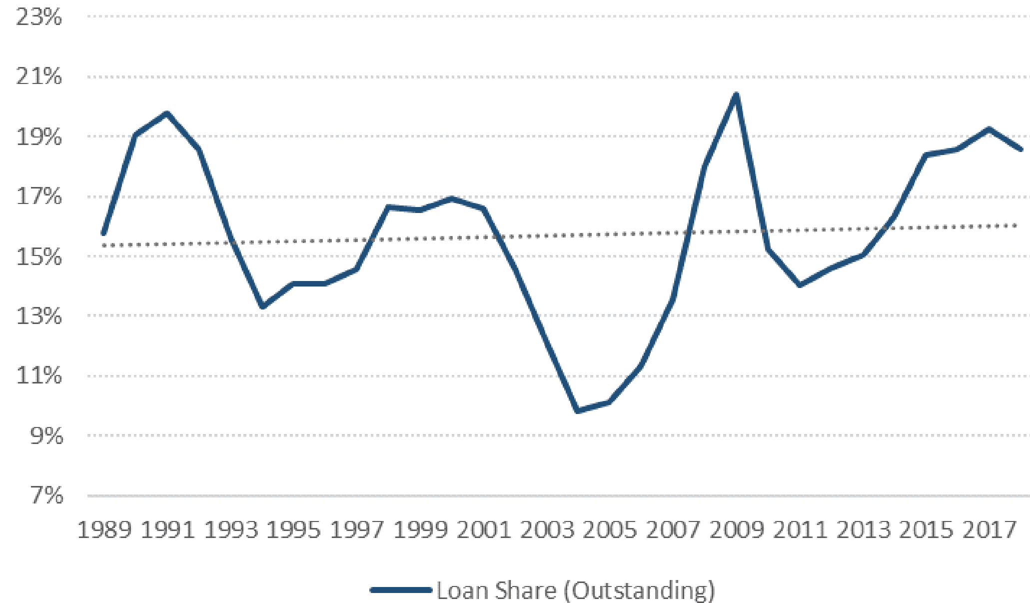
- The empirical motivation for disintermediation is built on “bonds” vs. “loans”
- There is a claim of a structural shift in the bond vs. loans following 1990-1991 recession
- This claim is novel, not fully convincing for purposes of this paper and ultimately unnecessary

Empirical Motivation

- To be clear, the patterns that we see in the Flow of Funds accounts are definitely there
- However, let's get closer to what we are talking about:
    - Bonds – SIFMA (Security Industry/Financial Market Association), Corporate Debt Outstanding
    - Loans – SNC (Shared National Credit) Program, Syndicated Credit ("Bank debt")
        - Syndicated credit picks up only large loans, but only large firms can issue bonds
        - Caveats: (i) SNC is the lower bound on syndication, (ii) both datasets are contaminated by "financials" – however, these should bias against my point

Fact Checking

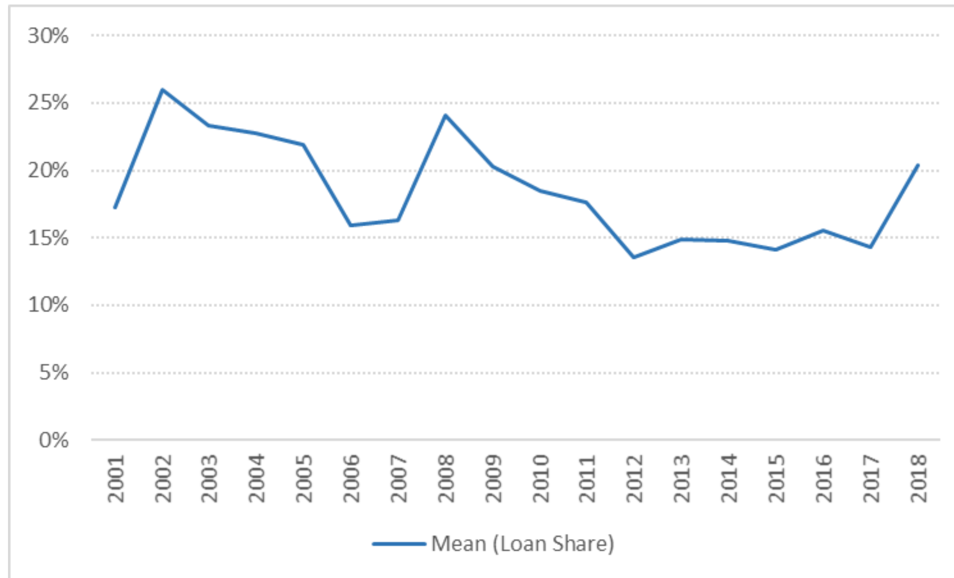
- For public-size firms (which is the sample used in the tests), there is no consistent decline in loan (vs. loan & bond) share following 1990-1991 recession



Fact Checking

- After 2001, Capital IQ gives loan vs. bond decomposition at the annual level

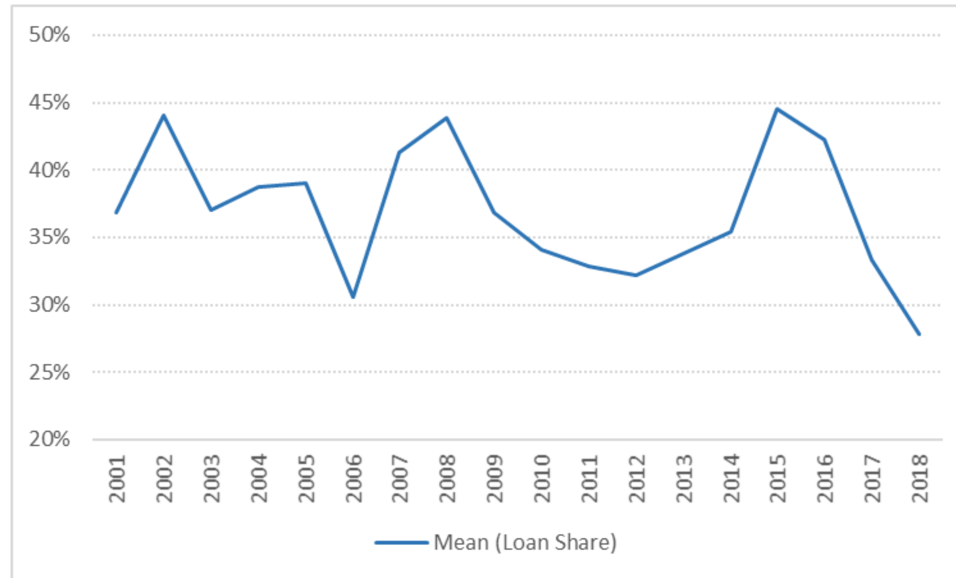
  20 random firms, S&P 500
  excluding Financials, and Utilities



Fact Checking

- After 2001, Capital IQ gives loan vs. bond decomposition at the annual level

  20 random firms, S&P 600 (small(er) cap)
  excluding Financials, and Utilities



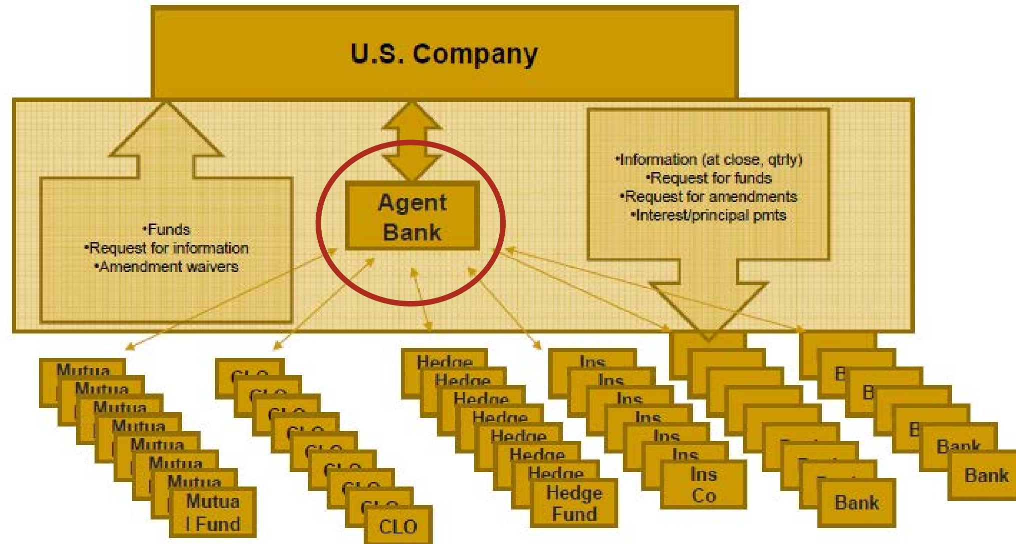
Empirical Motivation

- But it not clear that the paper needs to fight this battle:
  - Nothing in the tests or the model is about the time-series, this is purely motivational
  - **Leveraged Loan Market in the U.S. ~ $2 trillion outstanding from essentially zero in early 1990s**

    You would need to fine tune the execution though

    - Supporting empirical tests would need to zoom on the High Yield space
    - The Compustat proxy which relies in part on the short-term component wouldn’t be very good, as this debt mostly non-amortizable and rarely held to maturity
- But, this is “bank debt” that is no longer bank debt, it is been disintermediated

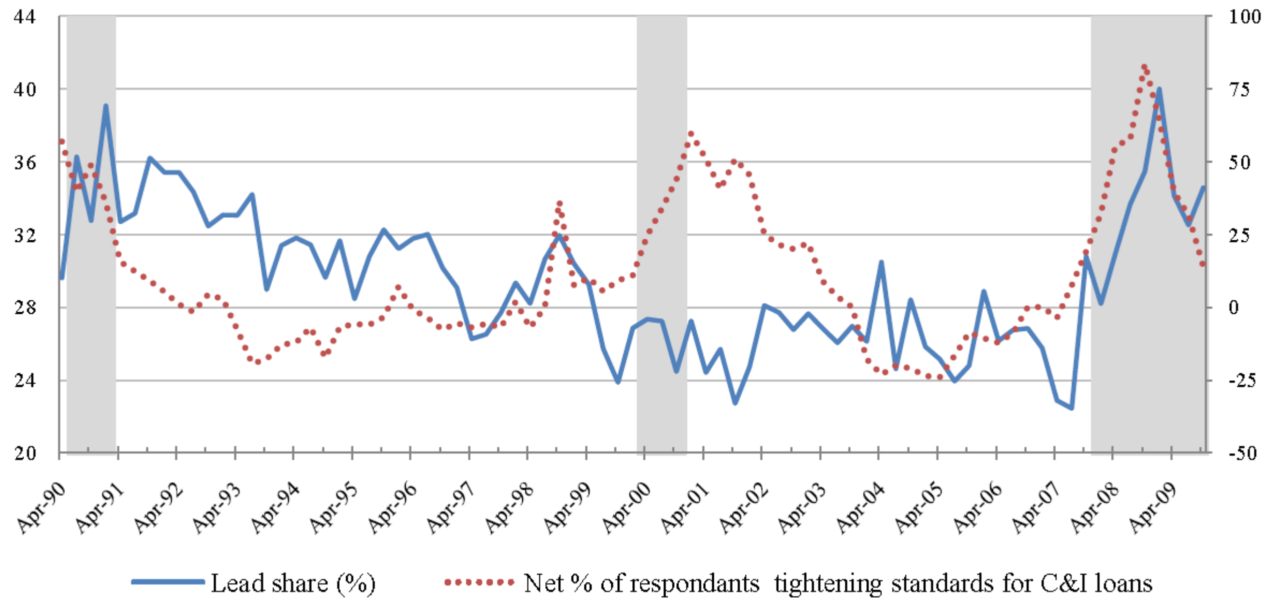
How a syndicated loan works
(Continual engagement between agents, borrowers and lenders)



LSTA

Note: It is still bank intermediated debt → A neat feature to think about, although completely outside of the current set-up

FIGURE 2—LOAN SHARE RETAINED BY THE ORIGINATING BANK AND CREDIT CYCLE



Ivashina and Scharfstein, 2010

In Sum

- A thoughtful approach to a clearly important subject (… in the making)
    - Creation and growth of leveraged lending is a better empirical grounding of this phenomenon
- Theory (that leads to testable predictions) is the central contribution