Discussion of
Prudential policies and their impact on credit in the US
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The views of the authors and not necessarily the views of the Federal Reserve Bank of New York or the Federal Reserve System

Paper objectives

- Investigate the effects of prudential policies on credit supply in the US
- The authors are interested in finding out the effect on credit supply of
  - (a) stress tests
  - (b) interagency guidance on leveraged lending

Paper methodology

- Stress tests investigation
  - Authors attempt to identify the impact on credit supply by looking at each CCAR bank's share of jumbo mortgage origination relative to all banks and nonbanks in a given state.
- Leveraged lending guidance investigation
  - The authors attempt to identify the impact on credit supply by looking at each financial institution's dollar share of speculative grade syndicated loan originations.

Paper key findings

- Stress tests had a negative impact on CCAR bank’s state share of jumbo mortgage originations.
- The authors find similar results by looking at mortgage approval rates
  - These effects are restricted to 2011 stress tests
  - On that year, effects more pronounced among banks with lower capital ratios
- Interagency guidance on leverage lending reduced the share of the bank’s term loan originations that were rated speculative grade
  - The effect is only evident after the answers to FAQ that regulators issued after their guidance
  - Limited evidence on nonbanks’ leveraged lending activites.

Comment 1: Design of the paper

- What is the rationale for combining in the same paper an investigation of two so distinct macroprudential policies?
- The authors say: "It is the first to assess the impact of instruments intended to curtail credit growth in the post crisis period in the US.'
  - The goal of leveraged lending guidance may have been to curtail the growth of leveraged loans, but that was not (and is not) the goal of stress tests.

Comment 2: Methodology – Stress tests investigation

- Why focus the investigation on the effects of stress tests on jumbo mortgages?
  - Is this the main place where we would expect a response by capital constrained banks?
- Why rely on the bank's capital ratio to identify capital constrained banks?
  - Why not use information on banks whose capital plans were not approved, or those that were only conditionally approved, or even information on relevant MRAs and MRIAs issued around the stress tests?

Comment 2: Methodology – Leveraged lending guidance investigation

- SNC has some limitations for an investigations of this nature
- Identification of leveraged lending based on banks' own loan ratings is susceptible to be influenced by banks
- Not comprehensive for loans arranged by nonbanks

Comment 2: Methodology (cont.)

- What is the rationale for the difference in the methodologies used in the two parts of the paper?
  - Stress test part: bank’s share of jumbo mortgage origination relative to all banks and nonbanks in a given state.
  - Guidance part: financial institution's dollar share of speculative grade syndicated loan originations

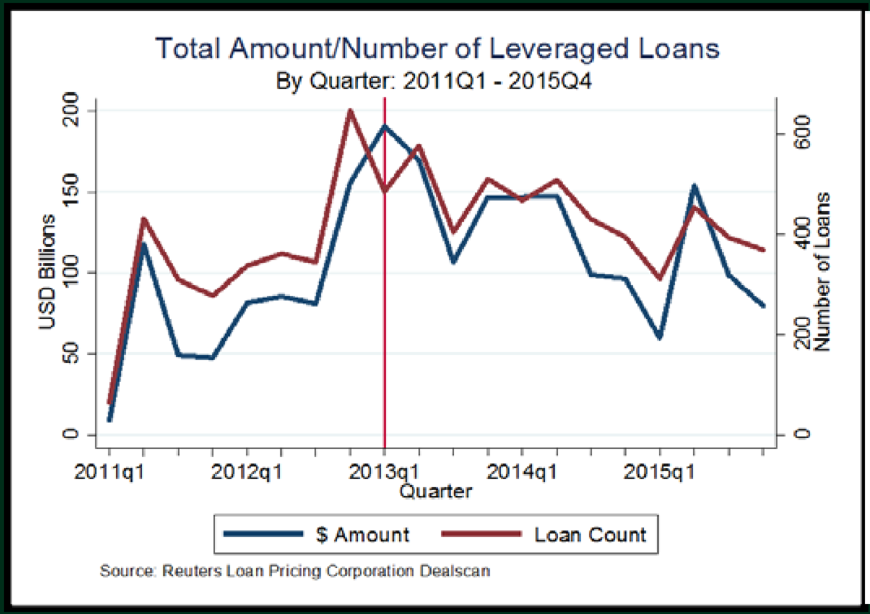
Comment 3: Results

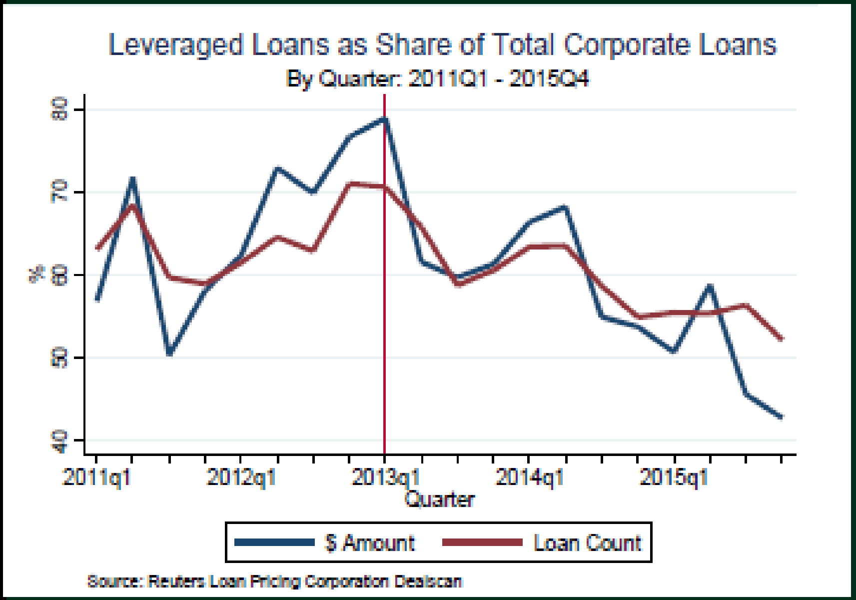
- The authors claim that only the 2011 stress tests had an effect.
  - But, in 2012 four banks “failed” the tests, in 2013 objections issued to the plans of two banks and in 2014 objections were issued to the plans of four banks.

Comment 3: Results (cont.)

- The authors claim the guidance:
  - did not have an effect on overall leveraged lending;
  - that banks cut on leveraged lending but only after the issuance of the answers to FAQ,
  - that nonbanks increased leveraged lending but only in the period after the issuance of the guidance.
  - Isn’t it puzzling that banks cut on leveraged loans and nonbanks do not take advantage of that decline in activity?

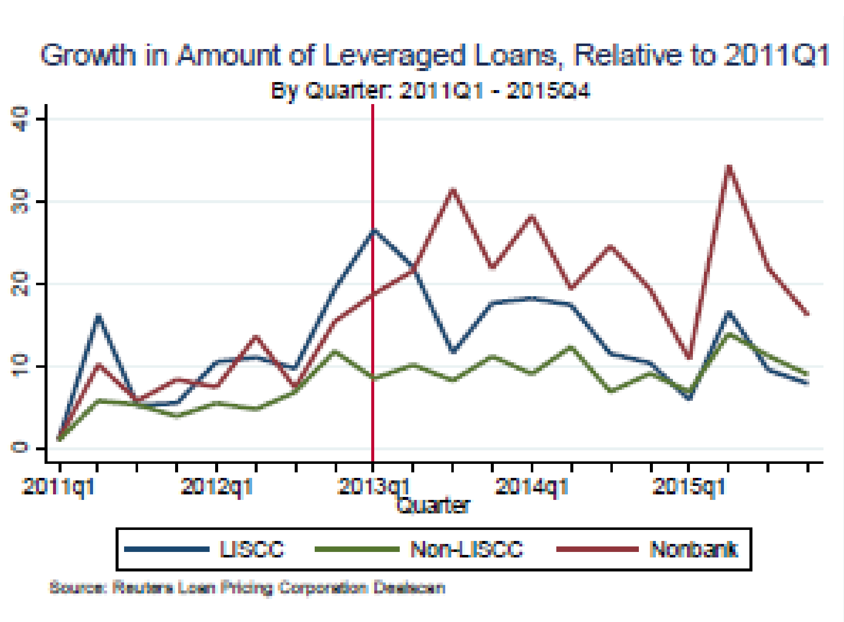
Did leveraged lending had an effect on lending?

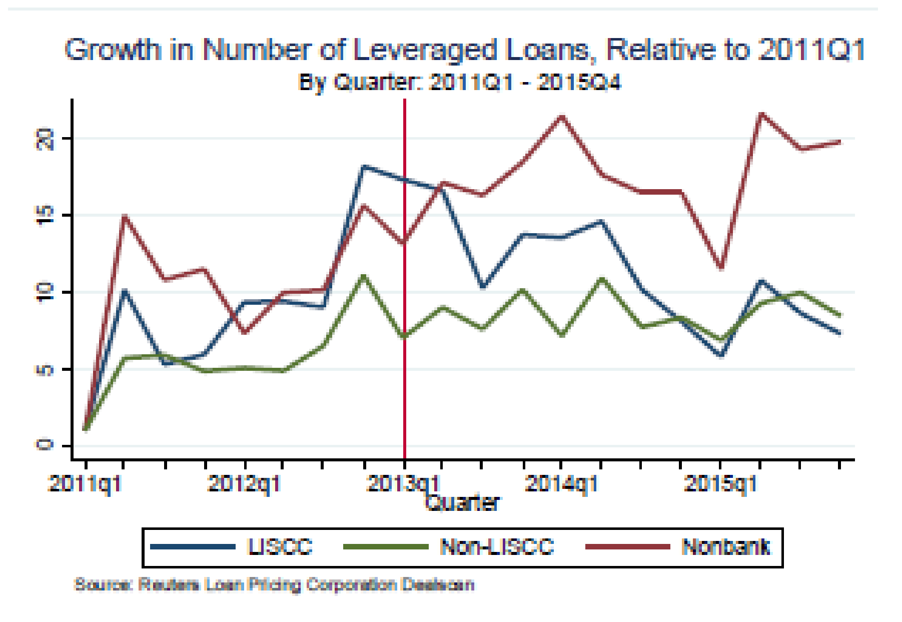




Source: Kim, Plosser and Santos (2016)

Have nonbanks benefited from the guidance?





Source: Kim, Plosser and Santos (2016)

- We also uncover evidence that borrowers switch from banks (in particular LISCC banks) to nonbank lenders after the issuance of the guidance

Did guidance trigger other effects?

- During the same time period that banks were cutting down on leveraged lending, nonbanks were increasing their borrowing from banks, probably to fund their additional leverage
- This evidence highlights an important challenge of macroprudential policies. Since their reach targets the entire banking system, they are more likely to trigger significant responses, some of which may have potentially unintended consequences.

Final remarks

- This paper adds to our understanding of the effects of macroprudential policies.
- The authors could further enrich their paper by
  - Providing supporting evidence to the suggestions they put forth to explain some of their “surprising results”.
  - Broadening their investigation into the potential effects of these policies, in particular the stress tests.