

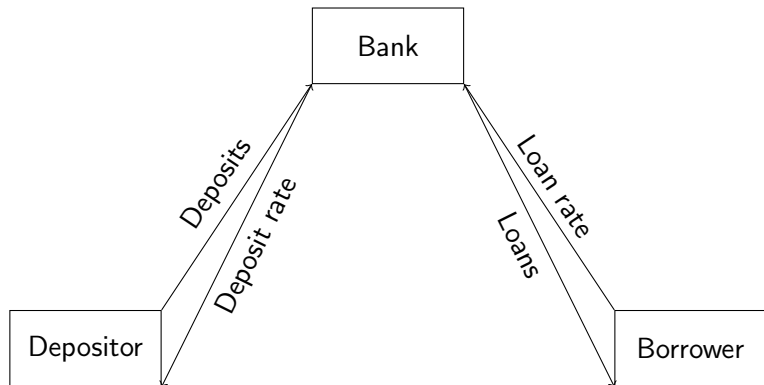
Lending by Servicing: Monetary Policy Transmission through Shadow Banks

Isha Agarwal, Malin Hu, Raluca Roman, and Keling Zheng

Discussed by Sergey Sarkisyan (OSU)

October 25, 2024

Traditional banks model

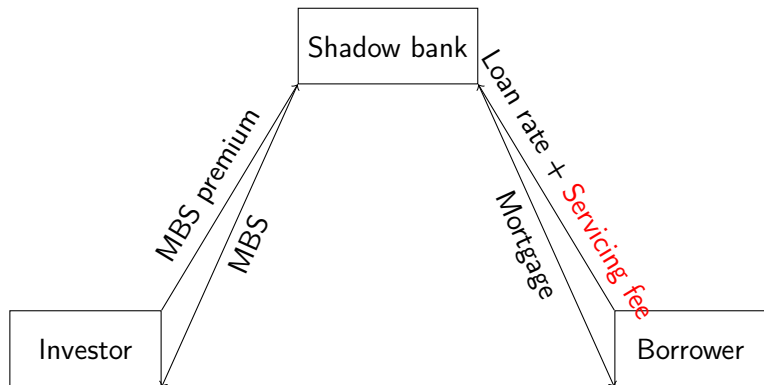


- Banks' profits: asset income - deposit spending

Rise in interest rates

- Decline in lending and securities, maturity mismatch:
 - Decline in asset income
- Little change in deposit rates:
 - Decline in deposit spending
- Banks' profits are **stable** over time

Shadow banks model



- Securitization creates another asset – **Mortgage Servicing Right**
- Shadow banks' profits: asset income - liability spending + **servicing fee**

Rise in interest rates (this paper)

- Decline in lending and securities, decline in equity, some maturity mismatch:
 - Decline in asset income and rise in liability spending
- Less prepayments, stable mortgage income:
 - Rise in income from mortgage servicing
- Shadow banks also hedge against interest rate risk

Channels

1. Collateral channel

- Borrowers prepay less when interest rates are high
- Servicing fees depend on outstanding volume – rise in MSR income

2. Cashflow channel

- Mortgage income is stable – predictable revenue stream

Implications

- MSR channel is less prevalent for traditional banks
 - They rely on deposit funding
- More shadow banks – weaker monetary transmission to **mortgage markets**

Overview of my comments

- Important paper because
 - documents how non-banks hedge (important for financial stability)
 - estimates how monetary policy is affected by the rise in shadow banks
- My comments:
 1. Macro implications
 2. Comparison between shadow and traditional banks
 3. Low interest rates

Comment 1: macro implications

- Imagine 2 separate worlds:
 1. World with traditional banks only – monetary transmission rate $x\%$
 2. World with shadow banks only – monetary transmission rate $y\%$

Comment 1: macro implications

- Imagine 2 separate worlds:
 1. World with traditional banks only – monetary transmission rate $x\%$
 2. World with shadow banks only – monetary transmission rate $y\%$
- Now merge 2 worlds into one. What happens to monetary transmission rate?

Comment 1: macro implications

- Imagine 2 separate worlds:
 1. World with traditional banks only – monetary transmission rate $x\%$
 2. World with shadow banks only – monetary transmission rate $y\%$
- Now merge 2 worlds into one. What happens to monetary transmission rate?
- Depends on the relation between x and y
- The results imply $x > y$ – weaker transmission with shadow banks

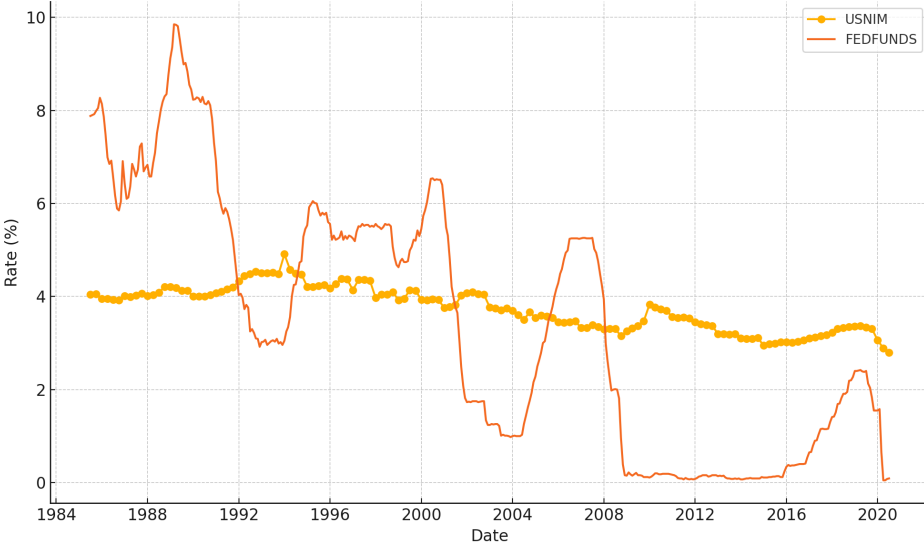
Suggestion

- The result is surprising – banks have lots of market power
- Also guarantees from the regulators (FDIC) benefit banks
- The authors have all data to compare x and y
- Doing it can make the results more convincing

Comment 2: shadow banks vs banks

- The paper can have even bigger implications if links more to banks
- Traditional banks' NIM is very stable due to hedging
- Show shadow banks' analog of NIM or their ROA
- This will also help with Comment 1

Banks' net interest margin



Comment 3: low interest rates

- Sarto and Wang (2023): rise in shadow banks happens with low interest rates
- Banks have less deposit franchise advantage with low rates
- **Suggestion:** look at periods with low rates
- Weakened transmission results might be driven by low rate periods!

Minor comments

- Are results dependent on FRM vs ARM mortgage composition?
- Show responses to unidentified changes to FFR
- Document how **total** transmission changes
- Try to consider only shadow banks that originated given mortgages

Conclusion

- Well-done and insightful paper
- Further convinces that interest risk is hedgeable even without deposit funding
- My comments: implication can be even bigger

Good luck!