

# **The Value of Contingent Liquidity from Banks to Nonbank Lenders**

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# Summary

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- **Question:** what effect does the use of credit lines from banks to fund nonbank lenders (NBLs) have on financial stability?
- **Approach:** describe nonbank-bank credit relationships empirically, then use a structural model to evaluate the impact via policy counterfactuals
- **Main Results:** use of credit lines is welfare improving compared to alternatives (cash, loans) but banks grant excessive credit line commitments
- **This discussion:** nice paper with sensible economics, some thoughts on additional mechanisms and policy questions
  - Additional motives to draw credit lines
  - Externality from credit line draws to credit at small firms
  - Revisiting the discontinuity in credit conversion factors (CCFs)

# Why do NBLs draw credit lines?

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- Paper correctly identifies **optionality** of credit lines as key characteristic
  - Borrower gets to observe conditions before deciding whether to draw
- In the model, this is used to respond to “investment shocks”
  - Additional loan demand arrives randomly across NBLs, can only be funded by credit lines (in the baseline experiment)
  - NBLs draw credit lines in the exact amount of these demand shocks, or their full credit line commitment, whichever is smaller
- This includes “optionality” in the sense that the bank can see the demand shock it has received prior to drawing the credit line
- However, it precludes that the NBL could choose to draw the credit line for any other reason, of which a number could be important

# Alternative drawdown motives

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## **Motive #1: incentives to draw when current spreads are high**

- Because credit lines have spreads that are fixed ex-ante, borrowers have incentives to draw them if current spreads (e.g., on commercial paper) rise
- This could occur either due to the financial conditions of the individual NBL, or due to aggregate conditions in financial markets
- Drawing because credit line spreads are too low ex-post is a major problem for lenders, and could reduce welfare gains from this instrument
- Could be particularly damaging if NBL financial conditions are deteriorating at the same time as their bank lenders

# Alternative drawdown motives

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## Motive #2: “runs” on credit lines

- In an environment of financial stress, borrowers with credit lines may be concerned that lenders may not be able to honor commitments in the future
- This incentivizes borrowers to draw credit lines heavily today.
- Just like with a run on deposits, this adds to the strain on lenders, potentially leading to self-fulfilling failures
- This mechanism could also increase the financial fragility associated with a system based on credit lines

# Alternative drawdown motives

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## **Motive #3: rollover risk from commercial paper**

- NBLs are also heavily reliant on commercial paper
- In order to receive a good credit rating on commercial paper, must be fully backstopped by an alternative facility, usually a credit line
- The model abstracts from rollover risk, but it could lead to some interesting complementarities between commercial paper and credit lines
- Alternatively, could see the credit lines drawn if NBLs are having rollover problems on the commercial paper, likely during times of financial stress

# Alternative externality via credit to firms

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- The paper mostly considers an externality from banks' choice of credit line limits to overall financial fragility via intermediary net worth
  - However, there is another important externality involving credit lines
- As the paper gets exactly right, the risk weight on a drawn credit line is higher than an undrawn one (via the CCF)
  - As credit lines are being drawn risk-weighted assets are increasing, and capital ratios are deteriorating
  - If banks face frictions on raising equity, they may instead improve their capital ratios by reducing credit supply
  - This can lead to large spillovers to smaller firms without credit lines, who then reduce overall debt and investment (“**regulatory capital channel**”)

# Alternative externality via credit to firms

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- Evidence from “The Credit Line Channel” (Greenwald, Krainer, Paul, 2025 JF)
- Regression of bank lending to firms without credit lines on bank credit line drawdowns during the COVID-19 pandemic
- Drawdowns reduce lending, but deposits do not meaningfully increase it
- Points to regulatory channel (CCFs) as primary mechanism

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	(1)	(2)	(3)	(4)	(5)	(6)	(7)
	2020:Q1	2020:Q1	2020:Q1	2020:Q2	2020:Q3	2020:Q4	2020:Q1
$\Delta$ Credit Line Usage	-1.96** (0.72)	-2.28*** (0.65)	-2.74*** (0.93)	-3.03** (1.14)	-3.63** (1.62)	-1.92 (3.41)	-1.83*** (0.63)
$\Delta$ Deposits							0.18 (0.21)

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# Alternative externality via credit to firms

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- Evidence from “Monetary Transmission Through Bank Securities Portfolios” (Greenwald, Krainer, Paul, 2025)
- Regresses change in bank term lending to firms on change in value of bank AFS securities + interaction with “AC” (if they count toward reg. capital)
- Result: strong transmission through regulatory capital channel

	(i)	(ii)	(iii)	(iv)	(v)	(vi)
$\Delta$ Value AFS	4.83** (2.14)	5.65** (2.37)	2.45 (2.48)	2.09 (2.59)	-2.08 (4.81)	-2.53 (4.92)
$\Delta$ Value AFS $\times$ AC	7.55** (3.50)	9.26*** (3.14)	10.86* (5.81)	14.03** (5.23)	12.95* (6.94)	15.18** (6.39)
$\Delta$ Value AFS $\times$ Size			-2.11 (1.87)	-3.08* (1.78)	-3.99 (3.45)	-4.71 (3.54)

# Suggestion: alternative policy experiment

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- The paper shows an extremely interesting empirical fact: NBLs have a large proportion (40%) of credit lines with **maturity exactly 364 days**
- Undrawn credit lines with maturity < one year have 20% the capital charge of a drawn credit line (CCF), but 50% if maturity is one year or longer
- While the paper already studies the impact of changing the CCF, I would recommend looking into changing the **difference** in the CCF by maturity
  - Jump at 1Y incentivizes taking on short-maturity credit lines
  - Could increase rollover risk, increasing financial instability
  - May also connect to Chodorow-Reich et al (2022 JFE) work showing that firms with shorter maturity credit lines drew less during COVID-19 pandemic
  - This seems like a very interesting policy to study carefully

# Final thought: maturity mismatch at NBLs

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- “Old view” of banks was that they were massively duration mismatched due to financing of long term loans with short term deposits
- Newer view (e.g., Drechsler, Savov, Schnabl) shows that deposit market power and inertia means that deposit franchise value has long duration
  - Banks are not nearly as mismatched as they might seem, stable NIM
- However, it seems like NBLs might really fit the old story
  - Longest maturity (sub-A) term loans, financed by commercial paper and short-term credit lines with floating rates
  - Are NBLs highly exposed to interest rate risk?
  - If so, how does this affect their use of bank credit lines?

# Conclusion

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- Very interesting paper taking the liability structure of NBLs seriously
  - Nice empirical evidence that NBLs are heavily reliant on bank credit lines
  - Model mechanisms are sensible
- I suspect there are other important mechanisms at play
  - Alternative motives for drawing credit lines (changes in spreads, runs, rollover risk on commercial paper)
  - Alternative externality (contraction in credit supply due to tightening of regulatory capital requirements when rates drawn)
- Exploring the implication of the jump in the CCF around 1-year maturity seems very interesting
  - Could be tilting NBLs into excessively short maturity credit lines