Recent Loan Market Changes

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Outline

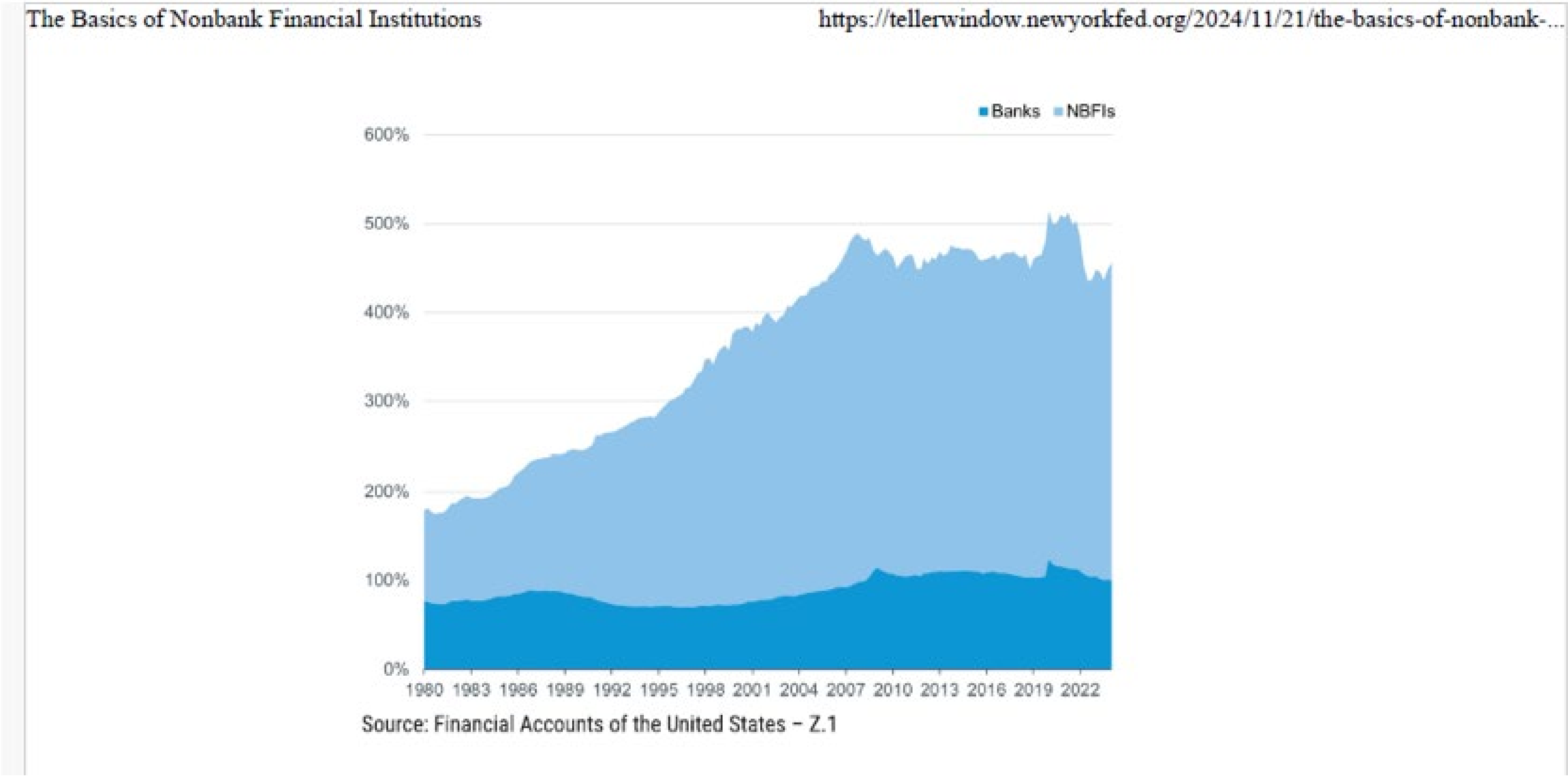
- Banks and nonbanks have shifted their relative importance in loan balance financing.
  - Financing
  - Originating

- Nonbank lenders are a very heterogeneous group.

- We don’t know very much about nonbank lenders’ stressed behaviors.

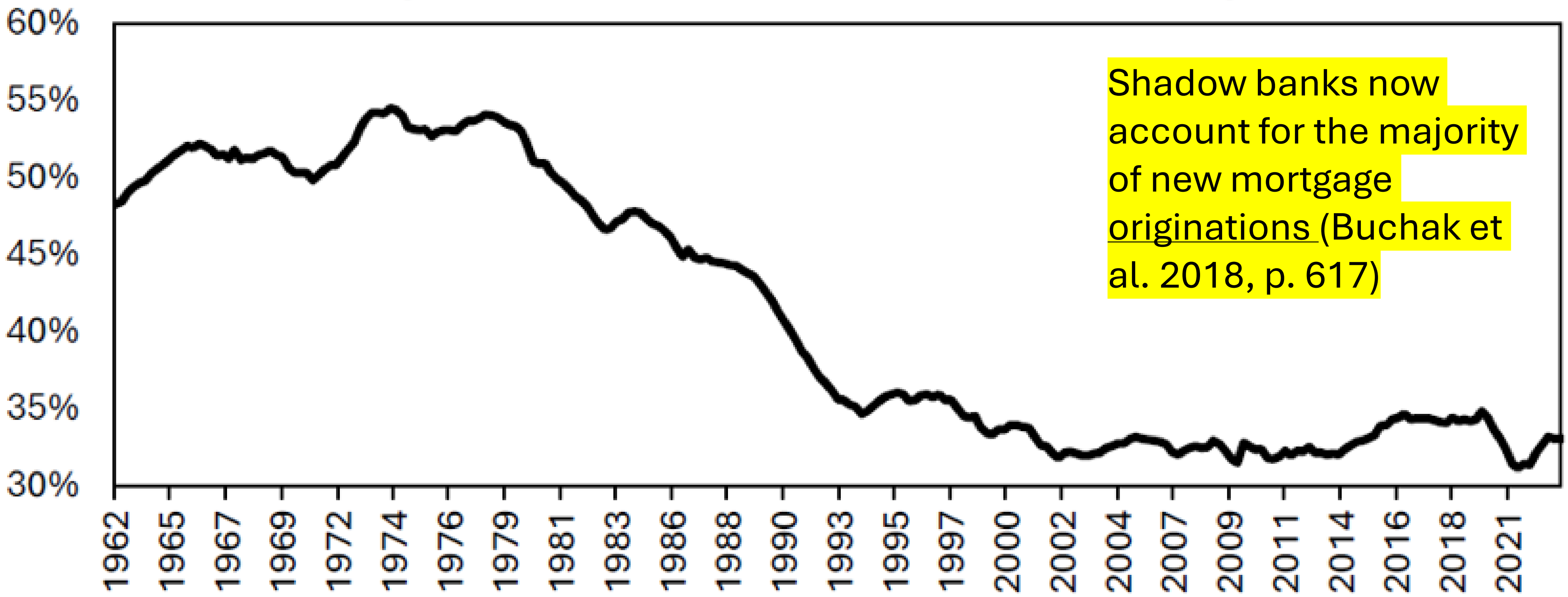
- Therefore, changes to the regulatory environment is a big risk (uncertainty) for the near term.

NBFIs' Assets have expanded relative to banks'



Banks finance a declining share of mortgage loans – particularly those that are not suitable for securitization.

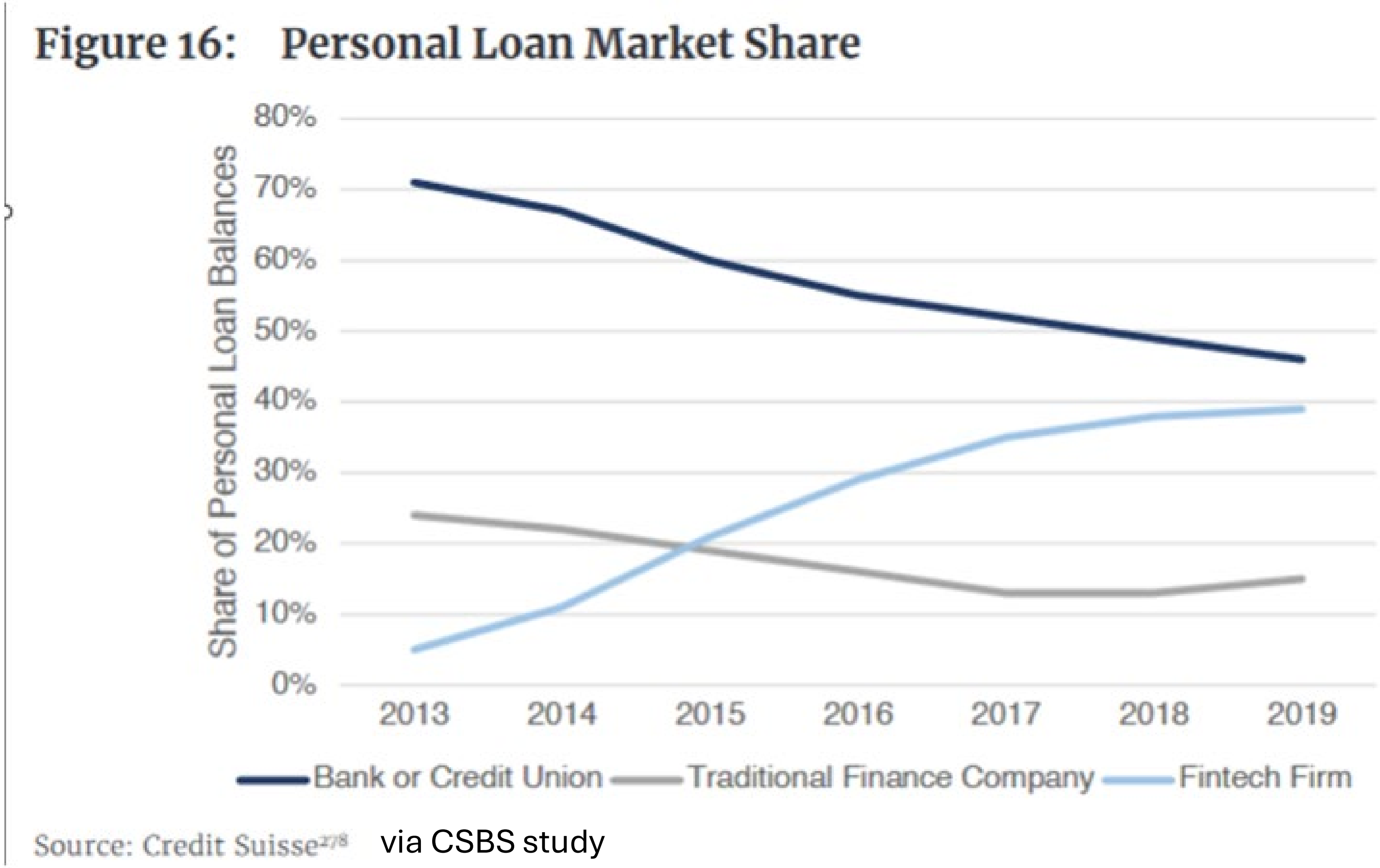
Figure 2: Main Facts on the Secular Decline of Bank Balance Sheet Lending



Shadow banks now account for the majority of new mortgage originations (Buchak et al. 2018, p. 617)

(a) Informationally sensitive lending share

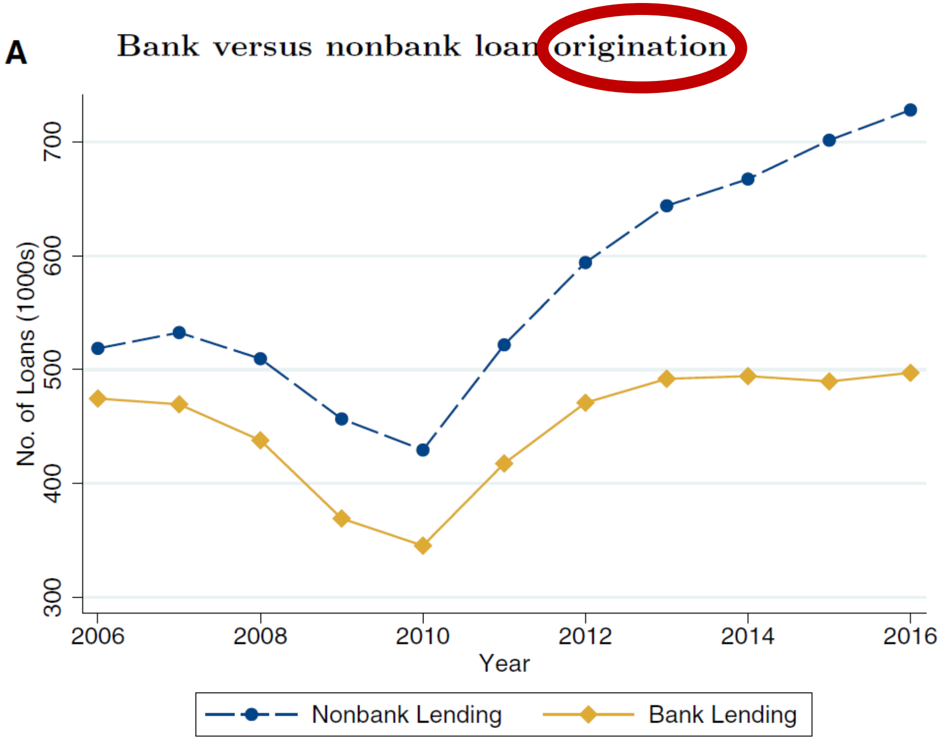
Similar story in personal loans

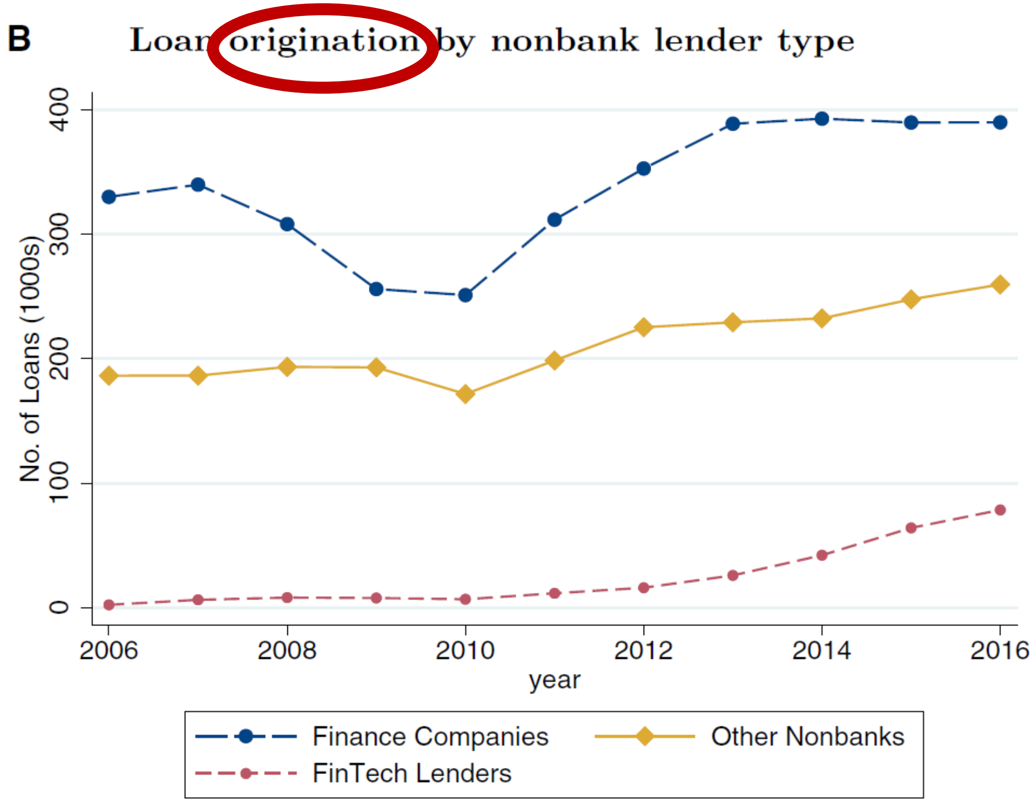


via CSBS study

Early growth of Fintech lenders in small business lending

- "By 2016, nonbank lenders had a market share of close to 60% in small business lending." Gopal and Schnabl, RFS (2022)





Fintech firms: prominent lenders, uncertain behaviors

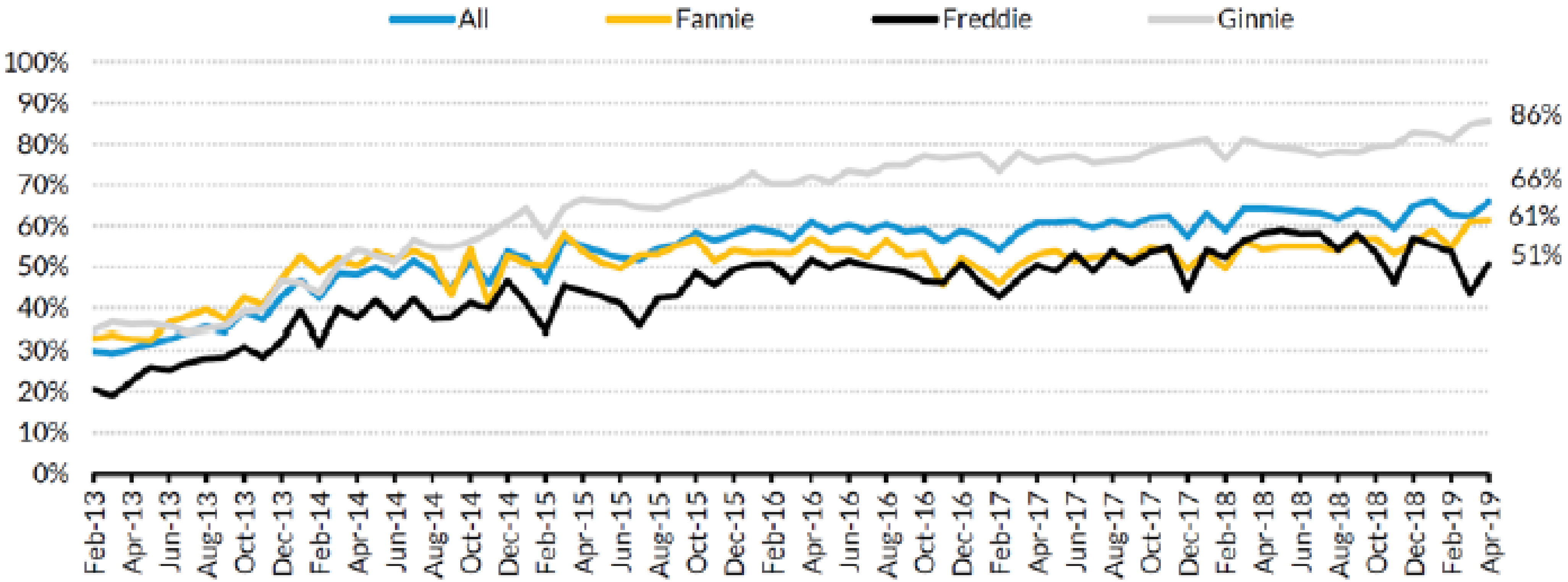
- “Evolution of Debt Financing Toward Less Regulated Financial Intermediaries” Isil Erel and Eduard Inozemtsev, JFQA 2024

“Overall, FinTech credit has become an important source of loans for small businesses and makes loans accessible to companies that otherwise would not be able to receive bank credit.” (p. 1240)

- “fruitful topics for further research:”
  - “the short-term funding constraints of nonbank lenders operating under different regulatory regimes”
  - “and their interconnections”
  - “how they would behave when their typical high-yield borrower is in distress” (p. 1266)

Mortgage

Nonbank Origination Share: All Loans



Sources: *eMBS and Urban Institute.*

Summary of these mortgage origination trends

In the mortgage market, banks lend less and originate fewer loans.

- “While still major players in the mortgage market, large banks currently have a smaller footprint of origination activity than nonbanks.” (CSBS, pp. 11-12)

- “nonbank financial services companies are now the primary source of mortgage originations (two-thirds market share) and they represent a growing source of mortgage servicing as well.” (CSBS page 3)

Causes of bank lending changes?

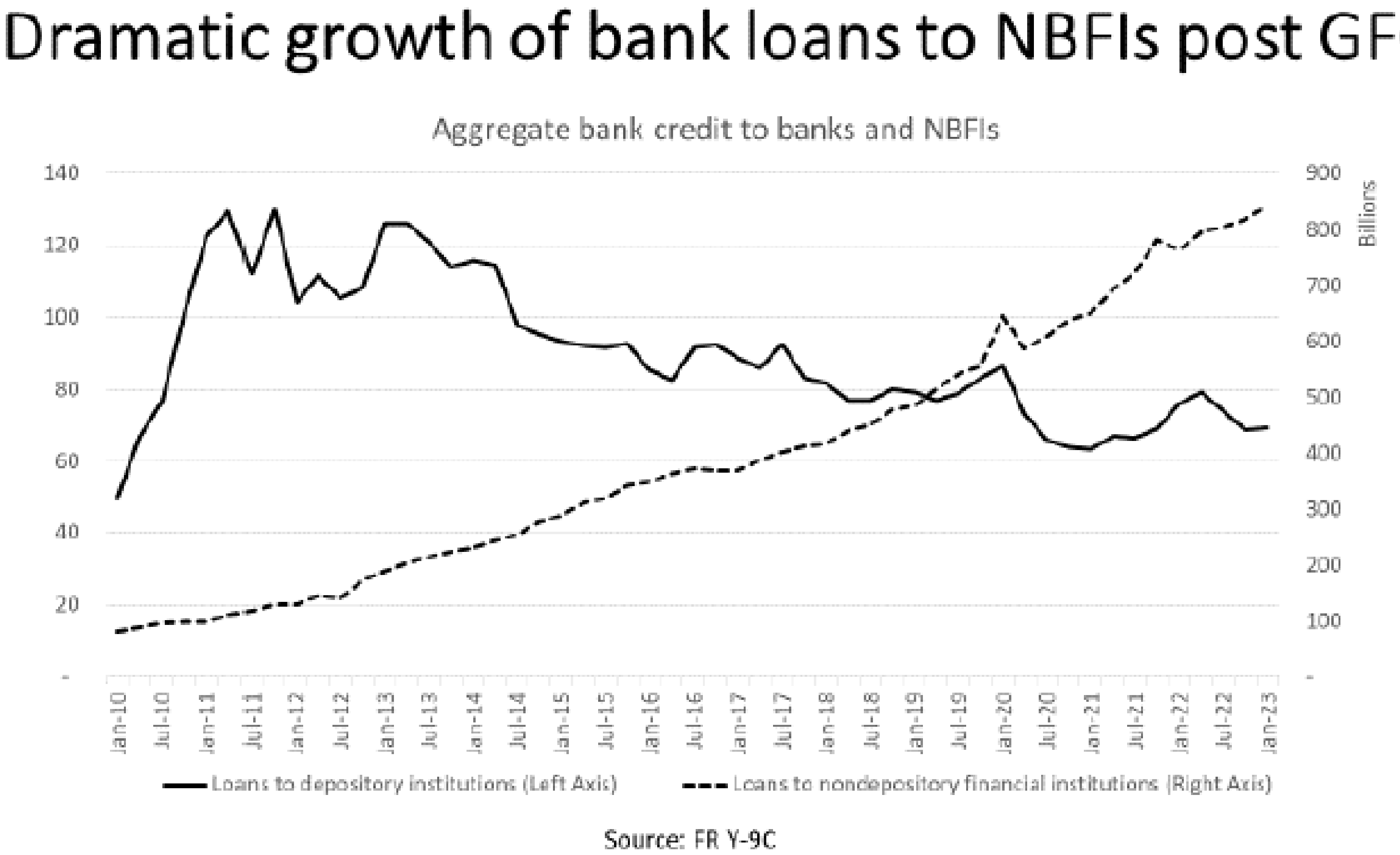
- Decline in banks' balance sheet lending share <u>may</u> simply reflect new entry by less regulated institutions as bank capital requirements have risen.

- But originations and underwriting should not be much affected by capital requirements.
  - These causes are more important to understand.
  - E.g. Erel and Inozemtsev (2024)

- Now shift to a microfinance perspective ...

From Acharya, Cetorelli and Tuckman

Figure 3a. Bank credit to NBFIs has surged post GFC



Because NBFIs are a heterogeneous, regulatory reform must be multi-facetted.

- Insurance companies
- Pension funds
- Mutual funds
- Finance companies
- Certain mortgage companies
- PE/VC firms
- Microfinance institutions
- REITs
- Securitization vehicles
- Money market funds
- Broker-dealers

“Multi-facetted” implies long planning time … Will financial markets misbehave during that interval?

Main threats

- As emphasized by Achaya et al.: funding risks for NBFI actually reside on bank balance sheets.
  - Stress test recognize this?
- Early view about “shadow banks” was that they could/should be regulated like commercial banks.
- But, with many types of NBFI, reforming their regulation (or deciding no reform is required) will be a long and heterogeneous process.

And another thing …

- GENIUS Act and stablecoins’ effects on traditional bank balance sheets
  - Quantities are yet to be determined
  - Enthusiasts predict that shift to stablecoins could be very large.
  - Stablecoins require 100% backing by HQLA.
  - What are the implications for the availability and cost of private credit?