Comments on
"Bank Capital, Borrower Power, and Loan Rates"

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The big question

How important are supply side capital constraints in C&I lending? Why?

Theory: retained earnings are a nice alternative to costly external equity.

- Banks can exploit monopoly power over some borrowers.

Primary specification

$$Spread = \alpha + \lambda \cdot Capital + \delta \cdot Cashflow + \beta \cdot Capital \cdot Cashflow + \cdots$$

Capital = Capital / Assets

Cashflow = EBITDA / something

Results: $\boldsymbol{\lambda < 0}$, $\boldsymbol{\delta < 0}$, $\boldsymbol{\beta > 0}$

Comment 1: Is the effect big?

A 5pp change in capital (5% to 10%) is huge.

- IQR is 2.2pp and SD is 1.6pp.

According to my calculations, the impact of a 2 SD change in capital is:

- 9 bps on average
- 13 bps at 1st quartile of interest coverage
- 6 bps at 2nd quartile of interest coverage

Comment 2: capital proxy

Is capital/assets a good proxy for capital constraints?

- Particularly conditional on rating, size, profitability, and charge-offs

Suggestions:

- Drop additional bank controls
- Use bond or CDS spreads
- Just use rating

Comment 2: capital proxy

Bank rating	Estimated effect on loan spreads
AAA	-7 bps
AA	-3 bps
A	-6 bps
BBB	-5 bps
BB	23 bps
B	95 bps

Comment 2: capital proxy

During regular times (pre-2008), is there enough variation in capacity constraints?

- Theory suggests that the effect should show up for constrained banks.

Syndicated loan arranging is fairly concentrated among the big banks.

- Suggestion: use BHC-level

Loan arranger league table (2001)

Bank Holding Company	Market Share	LT Issuer Rating		Bank Holding Company	Market Share	LT Issuer Rating
1. J.P. Morgan	36%	**Aa3**		11. Wells Fargo	1%	**Aa2**
2. Bank of America	18%	**Aa2**		12. BNP Paribas	1%	**Aa3**
3. Citigroup	17%	**Aa2**		13. Barclays	1%	**Aa2**
4. BANK ONE	5%	**A1**		14. ABN AMRO	1%	**Aa2**
5. FleetBoston	3%	**A2**		15. SunTrust	1%	**A1**
6. Wachovia	2%	**Aa3**		16. Lehman	1%	**A1**
7. CSFB	2%	**Aa3**		17. G.E. Capital	1%	**Aaa**
8. Deutsche Banc	2%	**Aa3**		18. KeyBank	1%	**Aa3**
9. Bank of NY	1%	**Aa2**		19. Credit Lyonnais	1%	**A1**
10. Goldman Sachs	1%	**A1**		20. PNC Bank	1%	**A1**

Suggestion

Experiment with nonlinear effects and time series variation in effects.

- Develop a proxy for constrained banks.
- Just focus on post-2007 period.
- (Simon's paper finds time series variation.)

Comment 3: selection effects

Who are the banks rated below A and what kind of borrowers use them?

Borrower Characteristic	Capital<5%	Capital>10%
Age	17 yrs	20 yrs
Sales	$1.6B	$2.8B
Debt / Assets	0.36	0.28
Market / Book	1.5	1.8

Comment 4: bonds vs. loans

Nini's Hypothesis: Bonds and loans are not very close substitutes.

- Very different cash flows, non-price terms.
- Information and renegotiation issues.

The primary alternative to a loan is another loan from a different arranger.

- Bond market access may still proxy for this.