

Discussion of:

Does a Larger Menu Increase Appetite? Collateral Eligibility and Bank Risk-Taking

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Summary

- ▶ Question:
 - How does central bank collateral policy affect credit supply?
- ▶ How:
 - European Central Bank starts accepting low quality RMBS
 - Use mortgage level data from Netherlands
 - Some banks are more affected than other banks (DiD)
- ▶ Results:
 - Increase share of newly accepted collateral in RMBS
 - Increase new mortgage supply
 - Reduce interest rates on mortgage originations
 - Newly issued mortgages perform worse

Empirical Setting

- ▶ ECB as a LOLR since 2008
 - Provides unlimited collateralized loans to eurozone banks
 - Accepts wide range of collateral (govt bonds, ABS, MBS)
 - Attractive haircuts and interest rate in eurozone periphery
 - RMBS rating is mapped to three classes: Class 1/2/3
- ▶ Mortgage supply in Netherlands
 - Class 2 becomes eligible in Dec11, Class 3 in Jun12
 - Since 2008 bank use retained RMBS to create liquidity
 - 2/3 of current issuance is retained
 - Banks have a technology to transform illiquid in liquid
- ▶ Data
 - Mortgage Data: Size, origination date, interest rate, LTV, location, borrower income/employment status
 - Bank-level variables
 - RMBS-level variables (rating, retained (Y/N))

1) Identification Strategy

- ▶ Rank banks according to their issuance of Class 2/3 RMBS
Affected banks: above median
Non-affected banks: below median

$$y_{ijklt} = \alpha_{lt} + \alpha_k + \beta \text{After}_t \times \text{Treatment}_k + \theta' X_{ijkt} + \epsilon_{ijklt}$$

y interest rate on new originations

i loans, j borrowers, k banks, l location, t month

- More how two groups differ along observables
- Why not using a continuous variable?
- Need to *interact* balance sheet characteristics with *After*

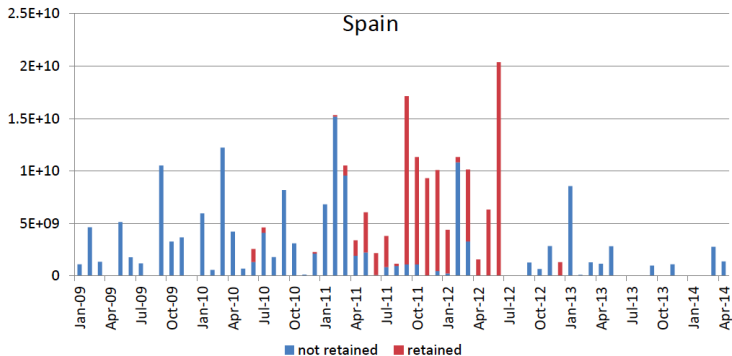
2) Two Shocks in December 2011

- ▶ Class 2 eligible in Dec 11, Class 3 eligible in Jun12
Before period: Jan10-Dec11
After period: Jan12-Dec13 (LTRO in Dec11!)
- 1) Laxer collateral eligibility requirement
Acceptance of Class 2/3 MBSs
- 2) ECB provision of long term liquidity
3-Year Long Term Refinancing Operation (Dec11-Feb12)

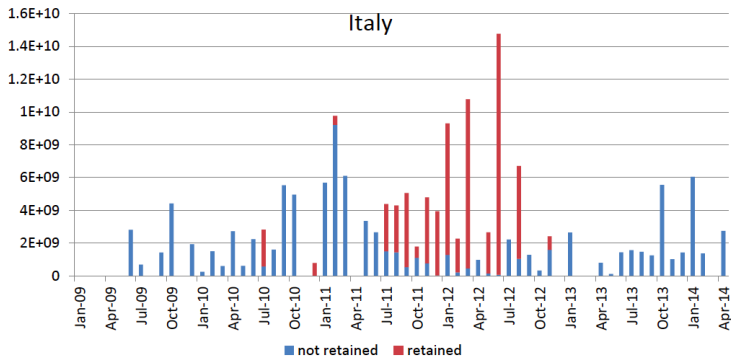
Which one is driving the results? LTRO data available:

- LTRO uptakes from Bloomberg
- Control for self-securitizations during LTRO allotment

Covered Bond Issuance in Spain



Covered Bond Issuance in Italy



3) Theory

- ECB as a LOLR
 - ▶ *Before*: accepts high quality and liquid collateral
 - ▶ *After*: accepts high/low quality and illiquid collateral
 - Bagehot: “collateral considered safe in normal times”
- If LOLR accepts liquid collateral
 - ▶ Effective in stopping Diamond-Dybvig runs
 - ▶ Does not free balance sheet capacity to fund projects
- If LOLR accepts low quality and illiquid collateral
 - ▶ Frees banks' balance sheet capacity to fund projects
 - ▶ At the cost of incentivizing reaching-for-yield?