Discussion of:

Monetary Transmission through Bank Securities Portfolios

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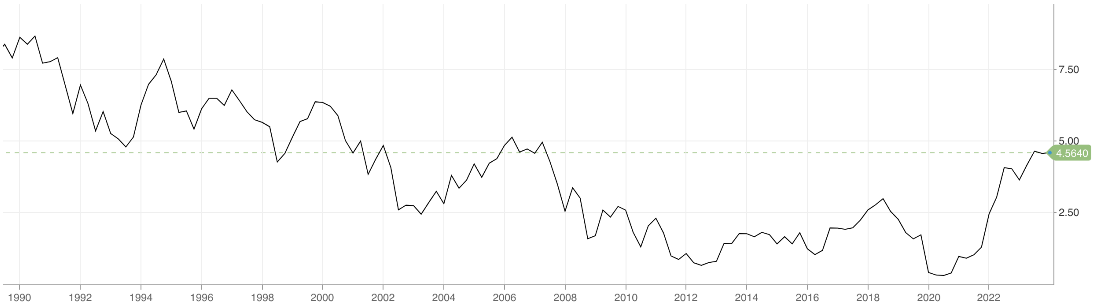
Deutsche Bundesbank

Premise

- Rapid hiking cycle caused a large drop in the price of various securities
- Banks hold around 20% of assets in Treasury and Agency MBS (as of 2021:Q4)
- Sudden "hit on balance sheet" because of loss of *economic* value (risk of runs too)
- Eventually, *but gradually*, higher NIM offsets the drop in the value of securities (DSS '21)



US 5Y Treasury Yields

HTM vs. AFS

- Banks can hold securities in their
  - **Trading book**: flows to the income statement ($< 1\%$ of assets)
  - Investment portfolio of the **banking book**: no income statement effect, (i) AFS or (ii) HTM

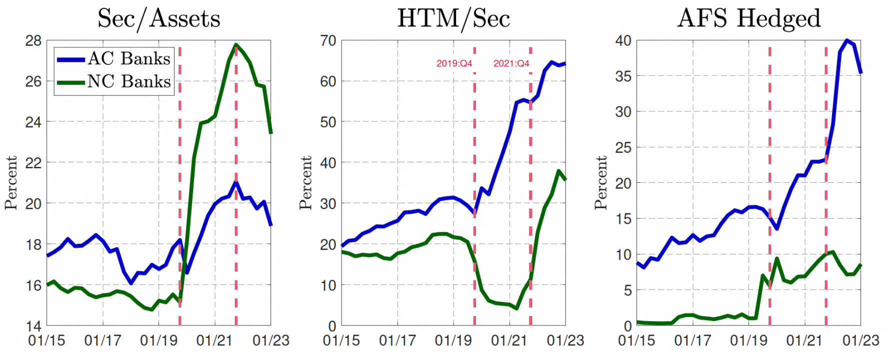
- **HTM holdings**
  - Does not influence the balance sheet at all
  - Around 4% of assets

- **AFS holdings**
  - Marked to market, can be hedged
  - Around 14% of assets
  - Affects book equity through the "accumulated other comprehensive income" (AOCI)
  - **AC banks** must include unrealized gains/losses in their *regulatory* capital. **NC banks** do not.

AC banks more conservative in their securities holdings

- You can’t really sell HTM that easily, risk of “tainting” the entire HTM portfolio
- Over the last two years, massive increase in securities and transfers from AFS to HTM

Figure 5.3: Evolution of Securities Portfolio.



AFS holdings and bank credit supply

- **Correlation across banks between drop in AFS securities value and bank credit supply**

- **AC banks drive the results $\rightarrow$ hit on *regulatory* capital**
  - AFS securities only, not HTM $\rightarrow$ hit on capital, not just drop in economic value
  - AC banks drive the results $\rightarrow$ hit on *regulatory* capital

- **AFS securities likely correlated with other bank characteristics**
  - Need to discuss this correlation in the cross-section of 10 AC banks and 19 NC banks
  - Correlation with uninsured depositors (96% of SVB's deposits were uninsured (FT))?
  - Correlation with strength of the deposit franchise (their hedge against hiking cycles)?

Sample banks

- **AC banks drive the results $\rightarrow$ hit on *regulatory* capital**
  - If this is the story, NC banks should serve as a placebo
  - But most regressions lump AC and NC banks together, using “AC-banks-time” fixed effects

- **The sample includes 10 AC BHCs and 19 NC BHCs**
  - Only around 1,200 firms across 27 banks with firm-time fixed effects
  - 12,000 firms across 28 banks without firm-time FE
  - Multiple relationships not common in the US and Y14 firm id not consistent across banks
  - Also, difficult to “control” in this sample for other AC bank characteristics

Banks *choose* their AFS holdings

- **Need to understand how banks choose their securities holdings**
  - Their maturity
  - Their hedging
  - Their AFS vs. HTM classification

  → Suppose inherently risky AC banks both (i) are weakly capitalized and (ii) hold a lot of unhedged long-term securities in their AFS portfolio

  - A model could give some structure, but the current version has an exogenous b^{LT}

- **Particularly important given the large inflow of deposits during the pandemic**
  - Also worth discussing to what extent this episode is “unique” (pandemic + rapid rise in rates)

"Hit-on-balance-sheet" channel

- **In this episode, the hit on (regulatory) capital is clearly driven by monetary policy**
- **But the mechanism is more general** $\rightarrow$ it applies to *any* large drop in securities value
- **Reminiscent of GIIPS banks' credit crunch during the eurozone crisis**
  - Unrealized losses on sovereign bonds triggered a slow run by US MMFs (De Marco, 2019)
  - This paper contributes with better data (e.g., hedging data) and interesting setting with regulatory differences (e.g., AC vs. NC banks)

Last two comments

- **Motivation using SVB**
  - SVB's securities mostly in HTM portfolio, but effects in this paper mostly from AFS holdings
  - The SVB episode triggered a run but this paper does not look at funding stability

- **Agency MBS vs. Treasuries**
  - Agency MBS are 54% of securities vs. 30% of Treasuries
  - Banks hedging focused mostly on Treasury interest rate risk (74% hedges for AC banks)
  - MBS are tough to hedge because of convexity coming from (lack of) prepayments

  → Is the credit contraction driven by Agency MBS?

Overall

- Impressive data work matching securities (and hedging) with corporate lending data
- Overlooked channel of monetary policy
- My suggestion is to discuss the many moving parts:
  - NIM
  - Regulatory capital vs. bank capital
  - Bank portfolio choice (hedging, maturity, AFS vs. HTM)
  - Potential role of bank fragile funding (e.g., deposit beta)