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Discussion of "Private Debt versus Bank Debt in Corporate Borrowing" (Haque, Mayer, Stefanescu)

Viral V Acharya, NYU Stern School of Business, CEPR, ECGI, and NBER

Inquiry and its importance

- Private debt growing fast (in the grand scheme of things, still small, but rapid growth)
- No longer just leveraged buyout financing, but more direct lending and debt refinancings
- “Lending down the quality curve” to smaller, illiquid (private), riskier firms
- Unlike growth of “shadow banks” prior to GFC, well-capitalized, stable (?)

- What has led to this growth? Just the post-2022 banking stress or a secular trend?
- What is the purpose of banks and bank lending if non-banks can make such loans
- Why do firms rely on both banks and private credit (and/or bonds)?
- Answering these questions seems a worthy undertaking! Authors deserve much credit…

Key Findings and My Take

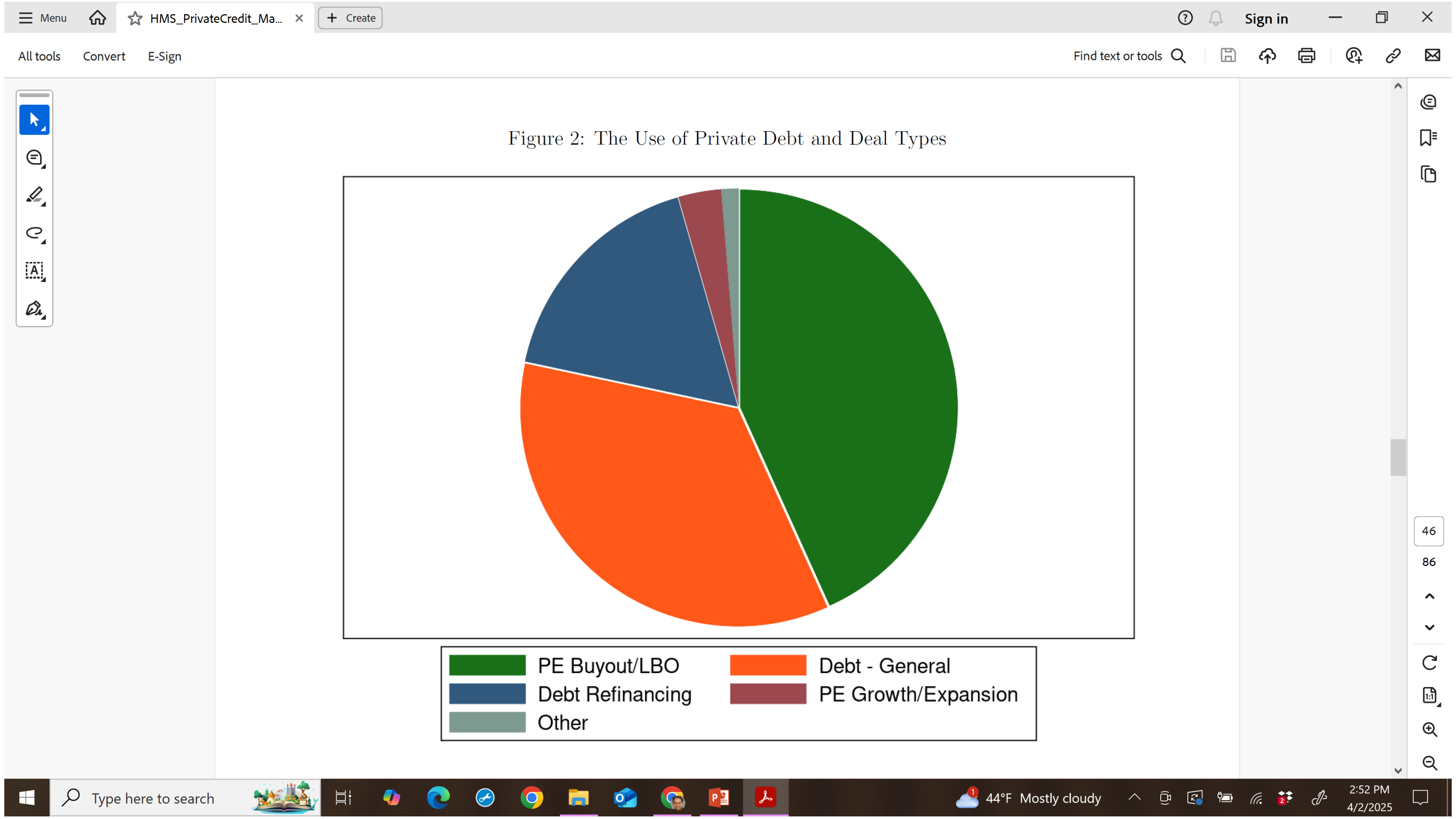
What I agree with

1. Firms borrowing from private debt lenders also borrow from banks
2. "Dual borrowers" are larger, with more intangible assets, riskier, more leveraged
3. Private debt provides "subordination" in the form of a junior tranche to bank loans
4. During periods of stress, dual borrowers draw down significantly on bank credit lines

Where I have doubts or concerns

5. Firms accessing private debt obtain additional bank debt, mainly through credit lines (causal interpretation of complementarity?)
6. Private debt serves as a substitute for riskier, long-term bank loans

Primary Concern: Data driven by LBOs/expansion



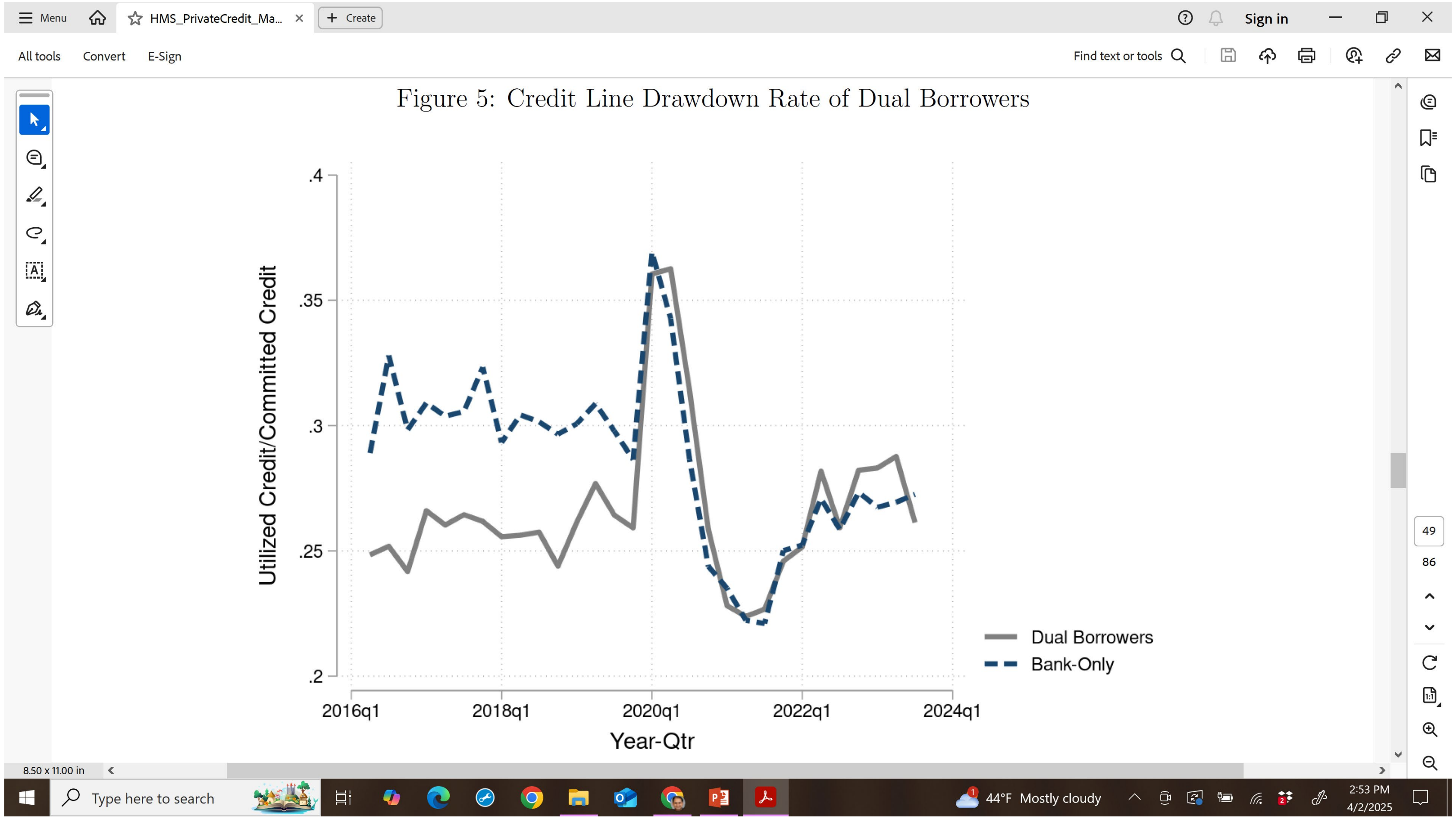
1. **Close to 45% of the deals are buyouts/LBOs**
2. **Another approx. 5% is for growth/expansion**
3. **What are "Debt – General" deals?**

Issue w/ the presence of LBO/expansion deals

- Leveraged buyouts are meant to alter the underlying firm significantly
  - Increase leverage; Reprioritize units: sell or liquidate inefficient ones, grow the more efficient ones

  OR Simply follow a growth strategy on the back of cheap leverage and M&As
  - Typically, increase risks, both credit (solvency) and operational (liquidity) risks
- Agree with authors that banks have a unique advantage in provision of credit lines (Kashyap, Rajan and Stein, 2002)
- However, the evidence authors present is unlikely an evidence of complementarity or causal effect of private credit and the reputation of private creditors on bank credit
- If LBOs/growth strategies cause firms to grow larger and liquidity-risky, it is given that bank credit lines will be needed and/or grow in size too
- Authors should drop LBOs, Growth/Expansion strategies… Focus only on debt refinancing

A minor concern / query (even minor: Y-14 match)



Change in drawdown rate of dual vs bank-only borrowers post COVID…

Pre-COVID, bank-only borrowers had approx. 5% higher utilization rate, but post-COVID almost identical

Why so? Economic behavior or a "quirk" of the data?

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Where Do Banks End and NBFIs Begin?

(with Nicola Cetorelli and Bruce Tuckman)

The views expressed in this paper are those of the authors and do not necessarily represent those of the Federal Reserve Bank of New York, the Federal Reserve System, or any of their staff.

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Transformation View of Bank **and** NBFI Sectors

Transformation View

Intermediation trans-forms endogenously

i) to loosen regulatory constraints/ to reduce regulatory costs;

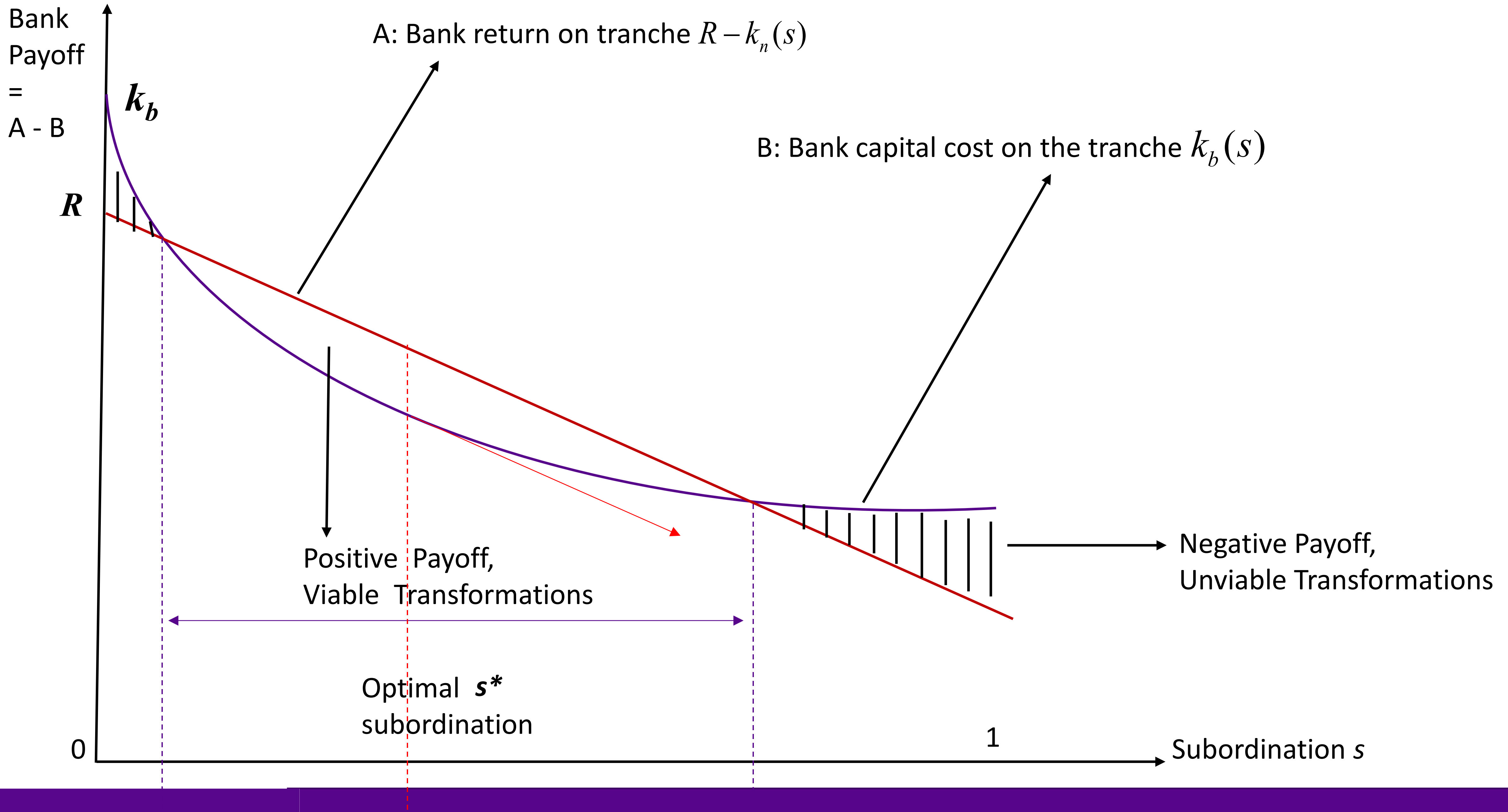
ii) to harness the funding and liquidity advantages of bank deposit franchises and access to safety nets.

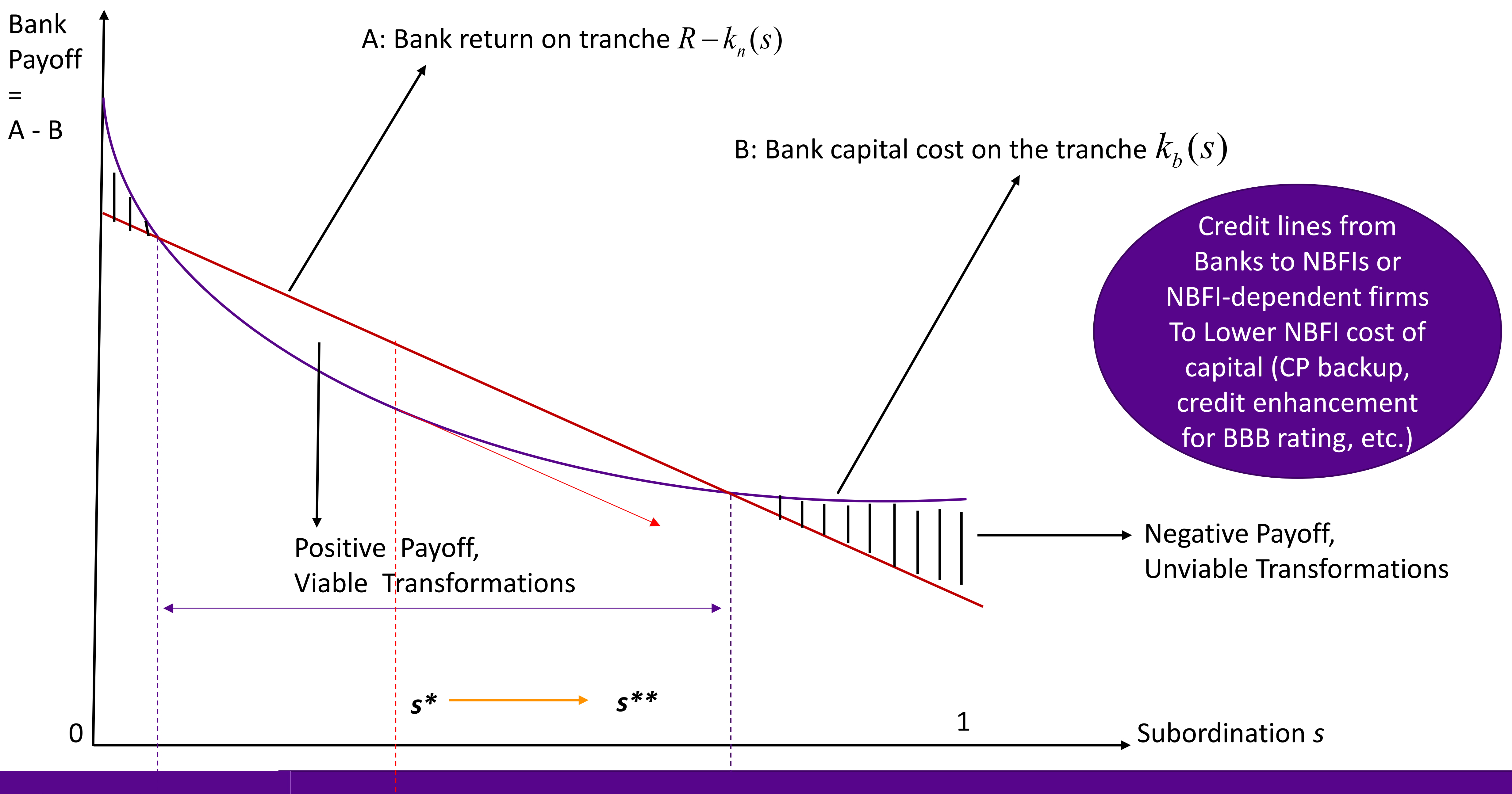
Transformation	Historically Within Banking	Spread Across Banks and NBFIs
Loans and Mortgages **Loans shift from being made and held by banks to being made by NBFIs with collateralized or senior financing provided by banks.**	• Corporate loans • Mortgage loans	• Banks make senior loans to private credit companies. • Banks make collateralized loans to mortgage REITs. • Banks hold senior tranches of MBS and CLOs.
Activities Using Short-Term Funding **Activities that require short-term funding transform from being conducted and funded by banks to being conducted by nonbanks and funded by banks.**	• Mortgage, CLO, and other ABS origination • Acquisition/LBO financing • Mortgage servicing	• Banks offer warehouse financing to nonbank mortgage, CLO, and other ABS originators. • Banks make short-term loans to private equity companies, including subscription finance loans. • Banks sponsor CP or directly lend to nonbank mortgage servicers.
Contingent Funding **While the footprint of NBFIs has grown relative to that of banks, banks retain responsibility for providing contingent funding in the form of credit lines to the NBFI sector.**	• Credit lines to nonfinancial businesses • OTC bilateral derivatives	• Banks provide credit lines to NBFIs to be drawn down during periods of stress. • Banks bear mutualized counterparty risk as derivative clearinghouse members and provide credit lines to NBFIs to meet margin requirements.

Bank	
Tranche (1-*s*) Yielding $R - k_n(s)$	Bank Deposits 1 – s – w(s) Costing $[1 - s - w(s)](\beta r_f - y)$
	Bank Equity w(s) Costing $w(s)(r_f + \pi_b)$

↔

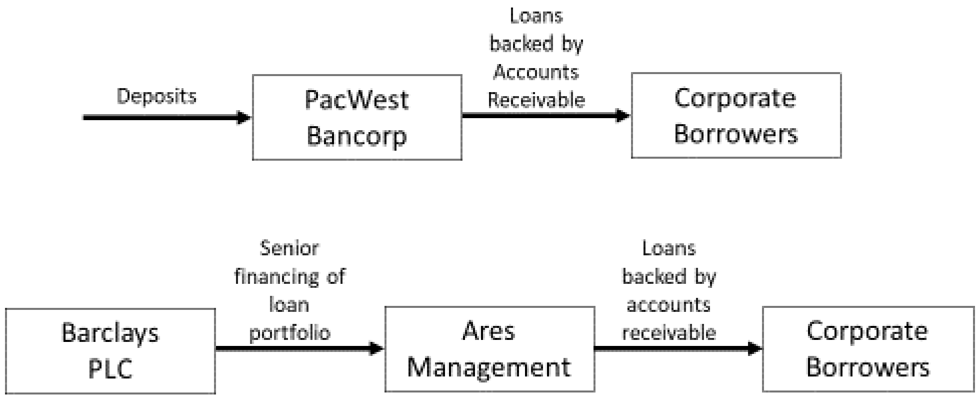
NBFI	
Assets Yielding R	Tranche *1 – s* Costing $R - k_n(s)$
	NBFI Equity *s* Costing $k_n(s) = (r_f + \pi_n)s$


Bank
Payoff
=
A - B
k_b
R
A: Bank return on tranche $R - k_n(s)$
B: Bank capital cost on the tranche $k_b(s)$
Positive Payoff,
Viable Transformations
Negative Payoff,
Unviable Transformations
Optimal s^*
subordination
0
1
Subordination s


Bank
Payoff
=
A - B
A: Bank return on tranche $R - k_n(s)$
B: Bank capital cost on the tranche $k_b(s)$
Credit lines from
Banks to NBFIs or
NBFI-dependent firms
To Lower NBFI cost of
capital (CP backup,
credit enhancement
for BBB rating, etc.)
Positive Payoff,
Viable Transformations
Negative Payoff,
Unviable Transformations
s^*
s^{**}
0
1
Subordination s

Two Examples of Transformations w/ Private Credit: Banks Provide Lines to Private Credit Providers

Private Credit



- **Blackstone Private Credit Fund**
  - more than $50 billion of assets
  - one of the largest private credit funds
  - committed facilities for $23.5 billion, almost all provided by 13 banks

Summary

- Important inquiry + Unique administrative data
- Highly recommend reading the paper as it is full of interesting and intriguing facts
- Concerned that some results are mechanical due to the presence of LBO deals
  - A better benchmark for private-credit funded LBOs is bond-funded LBOs
- That private credit provides riskier/junior tranche and takes over some term loan risk from banks makes good sense
- Whether private credit leads to origination of bank credit lines is unclear in the setting as demand and supply effects are not identified well (see Appendix starting next page)

THANK YOU! ☺

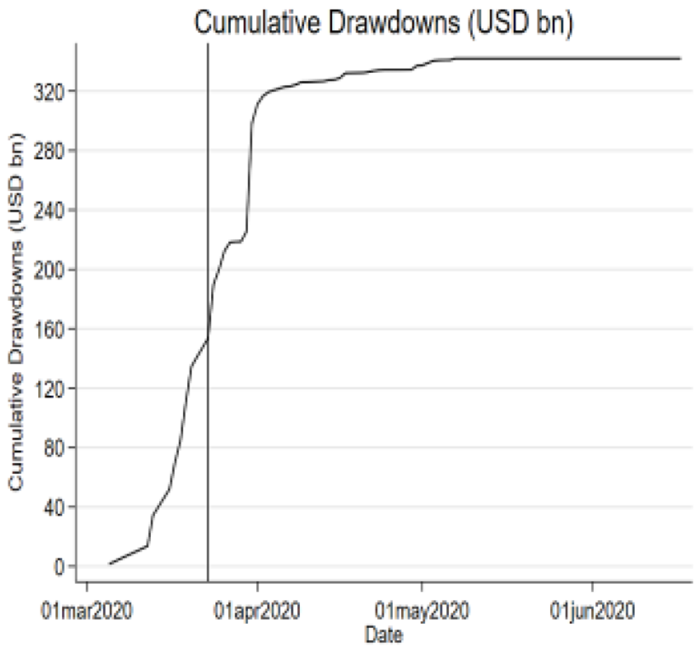
Bank provision of liquidity to firms dependent on non-banks for loans

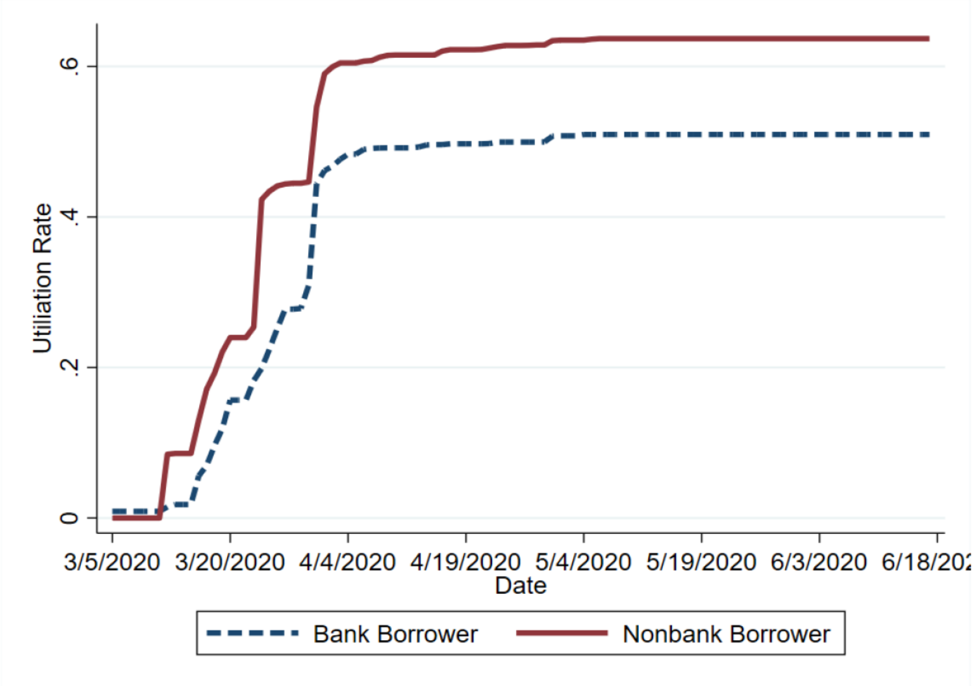
Fragile Financing? How Corporate Reliance on Shadow Banking Affects Bank Provision of Liquidity

Viral Acharya[1] Manasa Gopal[2] Sascha Steffen[3]

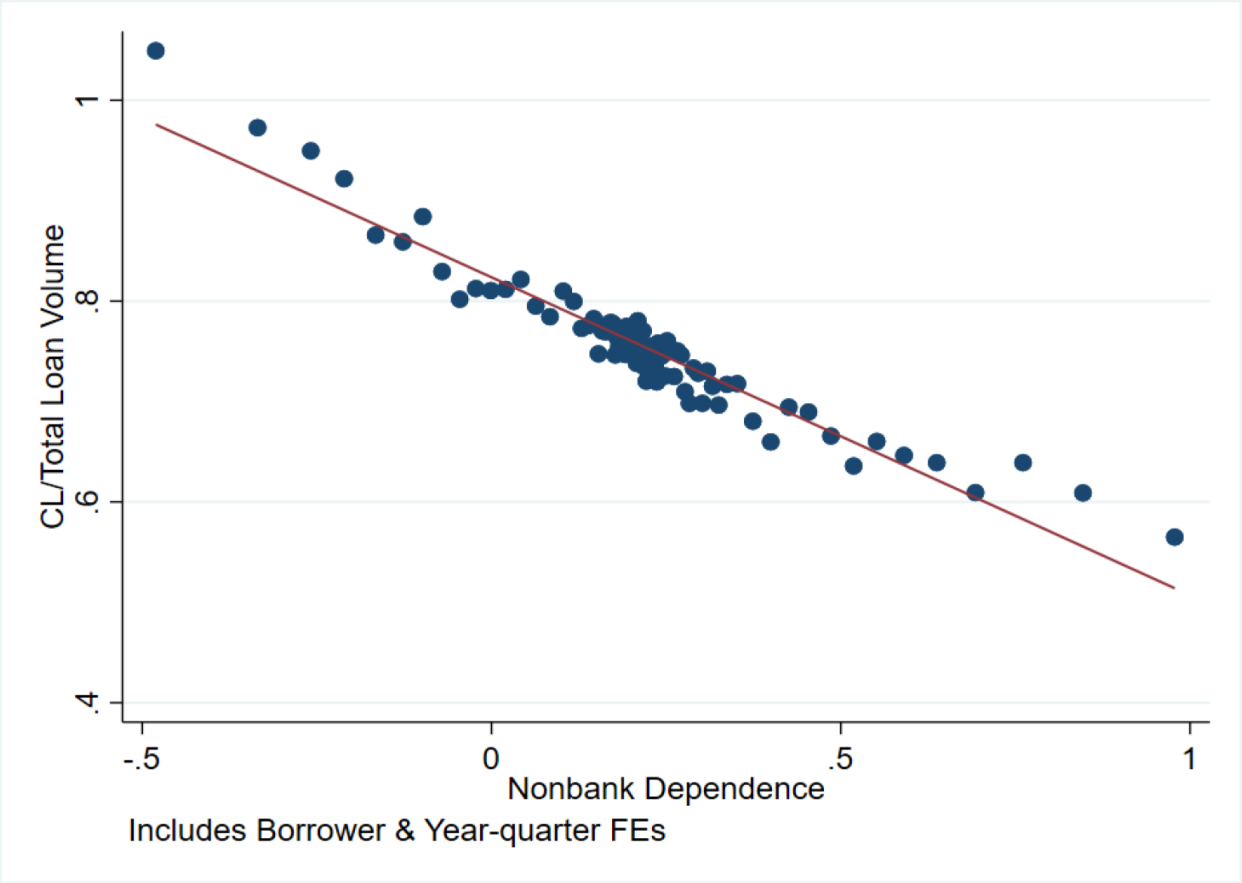
Motivation: COVID-19

- Firms drew down heavily on credit lines (Acharya and Steffen, 2020) - $320 billion drawndown within weeks
- Nonbank borrowers drew down more - Capital markets shut down early in the COVID-19 pandemic - Shadow banking funding more fragile



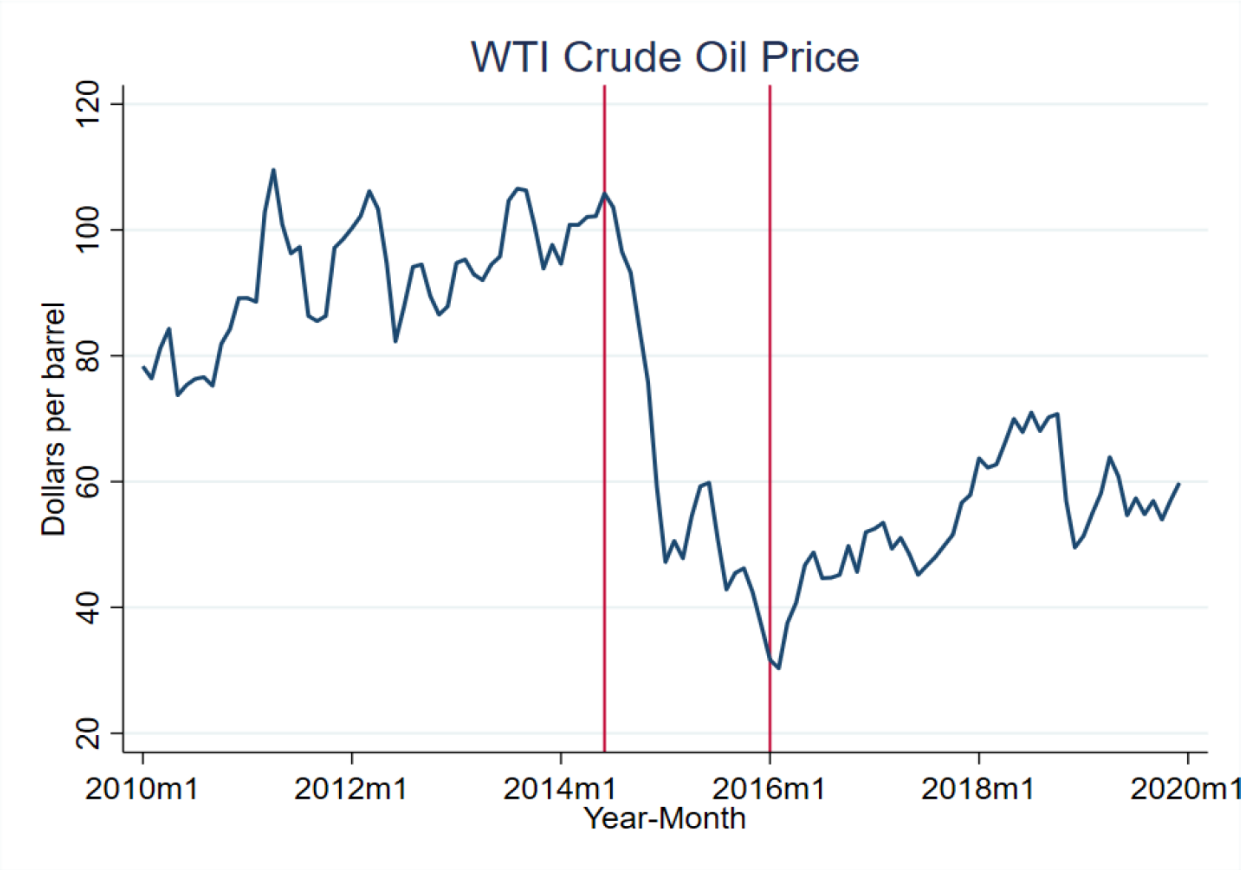


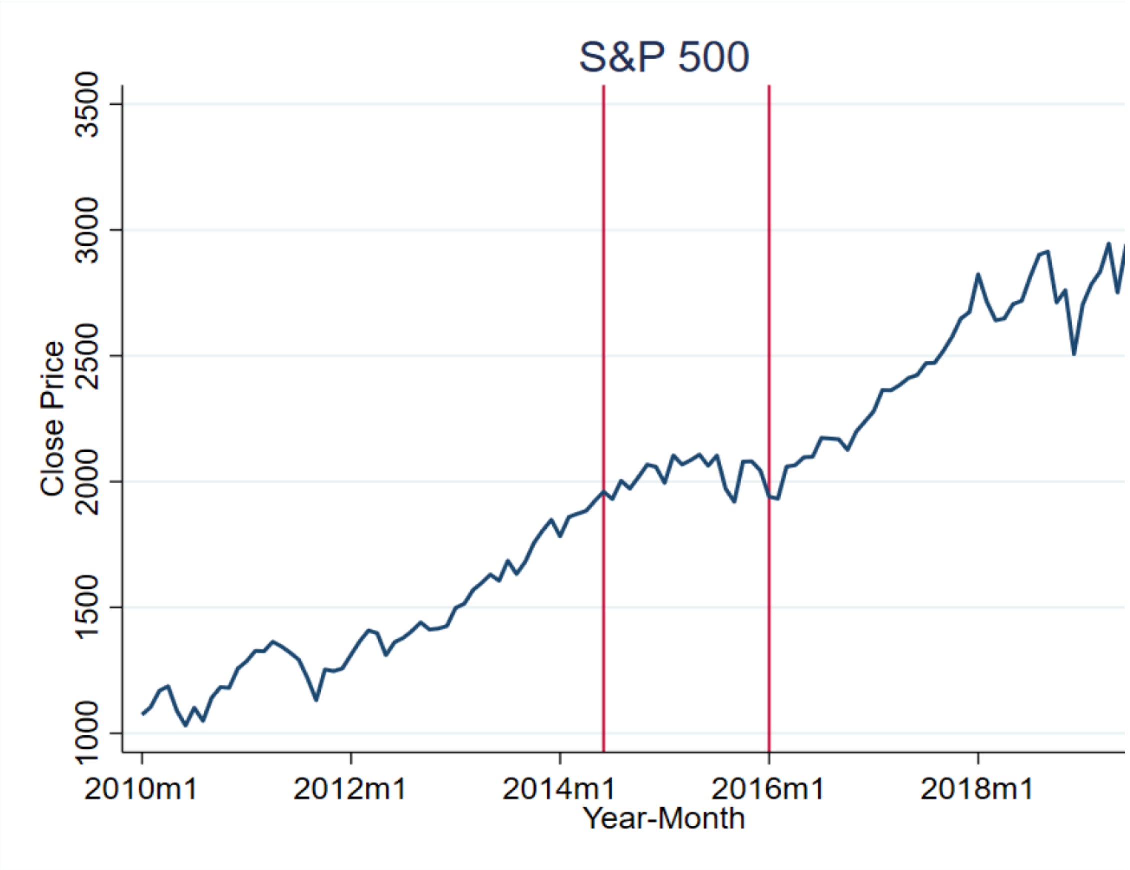
Access to Credit Lines for Nonbank Borrowers



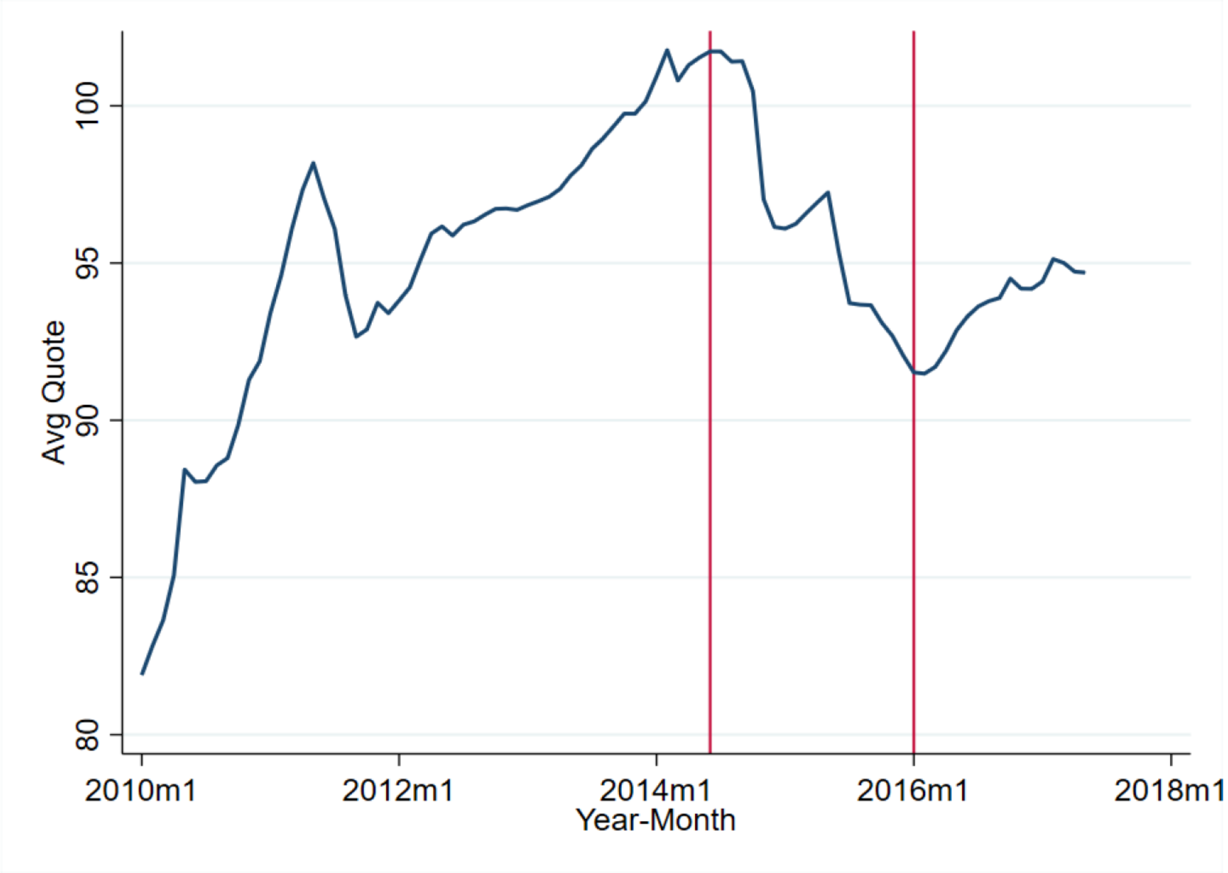
- Firms that have a higher nonbank dependence receive lower levels of credit lines

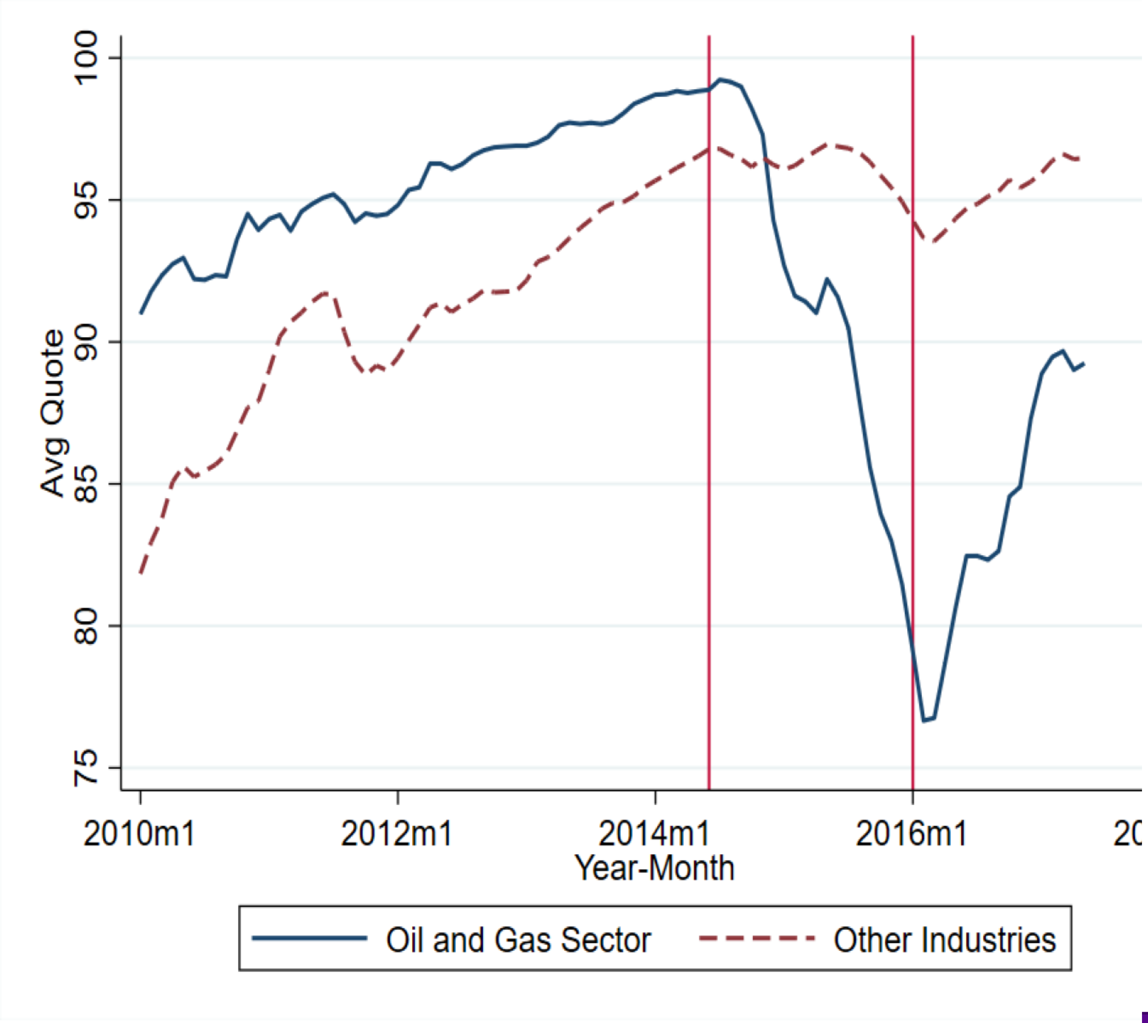
Oil price shock - (No) Stock market response



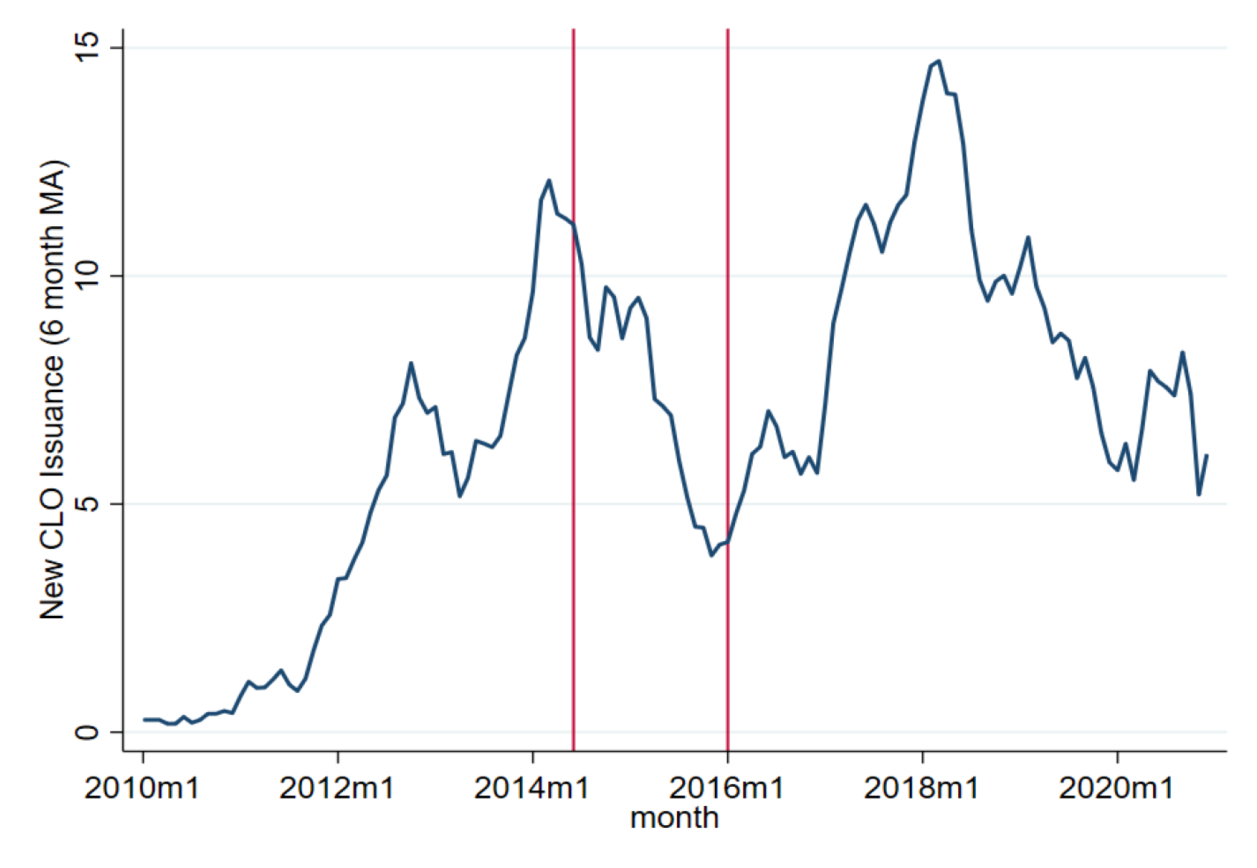


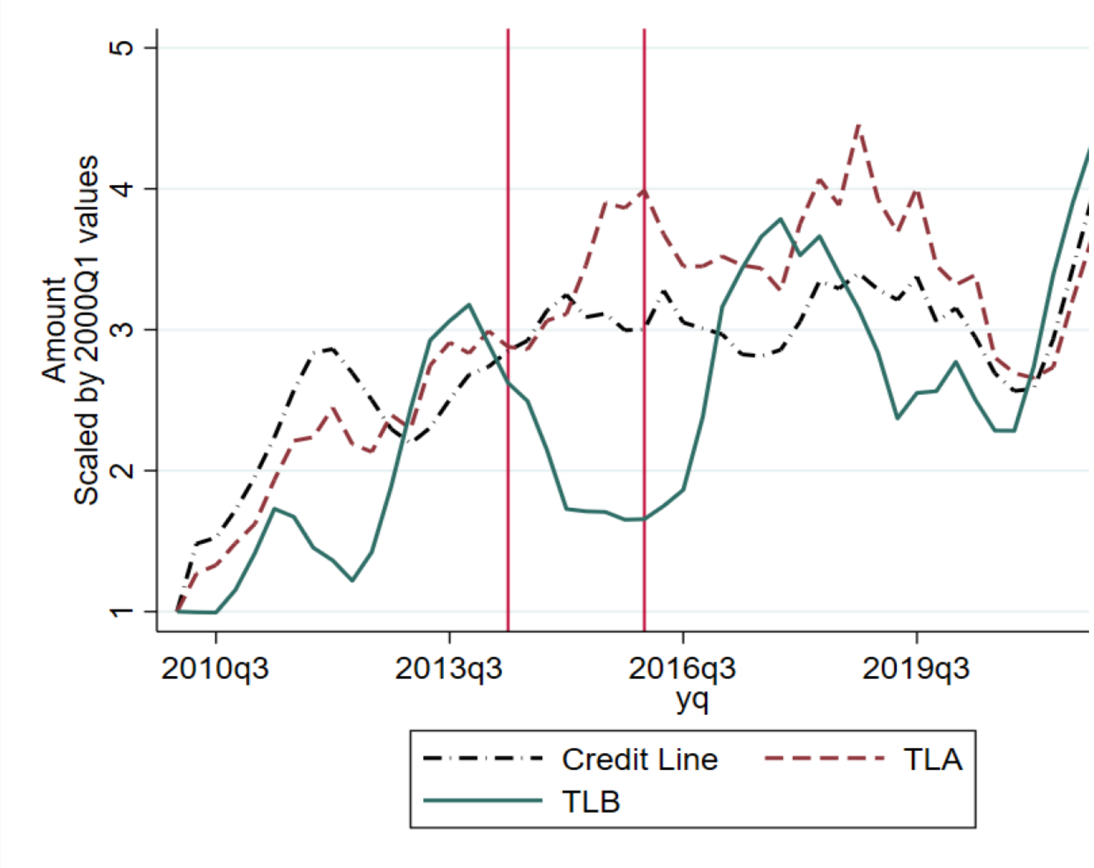
Oil price shock - Loan market response



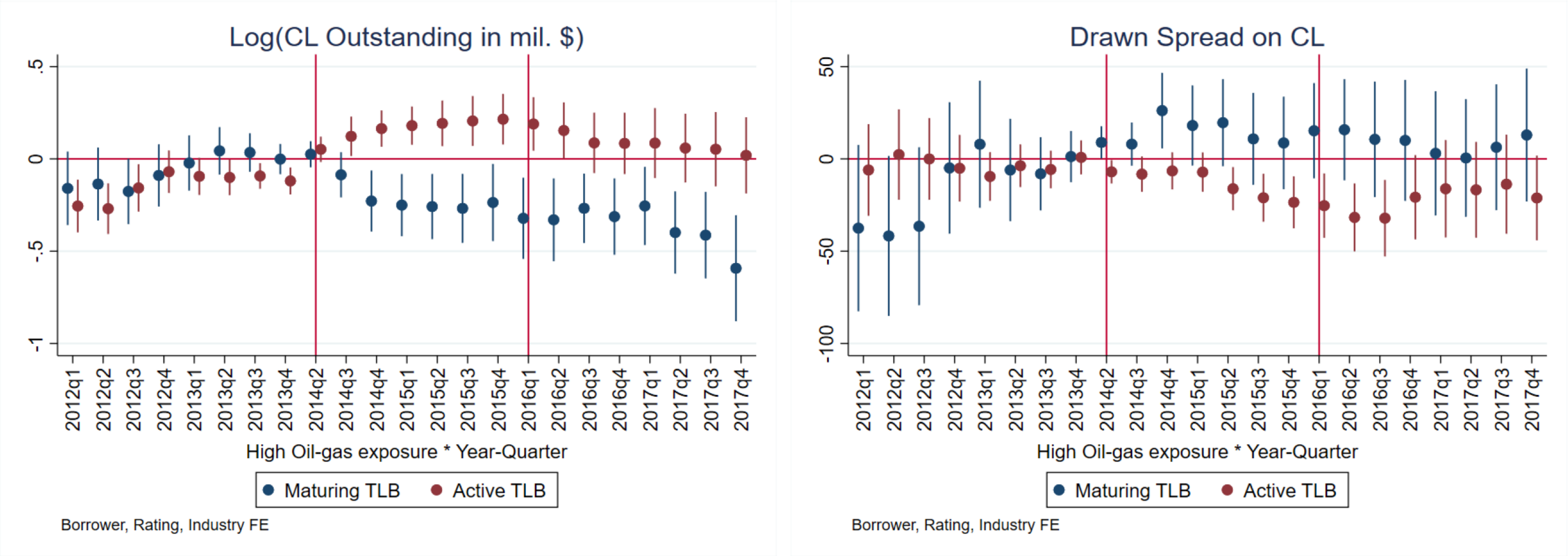


Oil price shock - Loan Issuance





Oil Price Shock - Impact on Credit Lines



- Supply of credit lines increases for borrowers with no rollover risk but exogenous reduction in nonbank reliance while it falls for borrowers facing rollover risk