On The Growth of Non-Bank Lending

Presentation by Victoria Ivashina

November 5, 2021
Agenda

1. Topology of the non-bank lenders
2. Drivers of their growth
3. Should we worry about it and why
4. Lessons from 2020
1. Non-bank lenders:
   • The non-bank credit market is clearly segmented
   • Is it helpful to think of these lenders as one big group: “non-banks”?
   • Let’s organize our thoughts:
1. Non-bank lenders:

- The non-bank credit market is clearly segmented
- Is it helpful to think of these lenders as one big group: “non-banks”?

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Firms

Large - Medium Firms  Medium - Small Firms  Very Small Firms  Personal Credit

People
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1. Non-bank lenders:

- The non-bank credit market is clearly segmented
- Is it helpful to think of these lenders as one big group: “non-banks”?

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<tr>
<th>Asset-based</th>
<th>Secured</th>
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Significantly different risk
1. Non-bank lenders:

- Alternative/non-banks credit segments that have experienced significant growth post 2008:

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<td>High-Yield Bonds</td>
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"On Non-Bank Lending" by Victoria Ivashina
2. Drivers of the growth:

- What is the role of regulation? Unclear; there are at least two other major forces at play

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Low interest rate environment

Data and analytics revolution

"On Non-Bank Lending" by Victoria Ivashina
Non-bank lenders in the corporate space:

This is what “private debt” is

Directly originated debt
- Traditional fund structure: (think PE-like structure & investors)
- Direct lending
- Mezzanine lending
- Special situation/Rescue financing
- Distress etc.

“BDC”
Business Development Companies (think REIT-like structure & investors)

Bank originated non-bank debt
- “CLO”
  Collateralized Loan Obligations (securitized structure/ABS)
- Loan Mutual Funds

- I.e., each of these broader segments has layers that have different mechanism at play, a point that is relevant to understand when thinking about financial fragility
3. What are the implications for financial fragility?

This paper highlights:

1. Funding Fragility:
   - Is the funding structure short-term or runnable?

2. Amplification mechanism:
   - Interconnection with banks (i.e., connection to potentially fragile institutions)
   - Dealer’s balance sheet constraints
3. What are the implications for financial fragility?

This paper highlights:

1. Funding Fragility:
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2. Amplification mechanism:
   - Interconnection with banks (i.e., connection to potentially fragile institutions)
   - Dealer’s balance sheet constraints
     - Borrower’s defaults—we are dealing with much higher leverage (e.g., Greenwood, Iverson and Thesmar, 2020; Group of Thirty, 2020; Ellias, Iverson and Roe (2021), Braeuning, Ivashina, Ozdagli, 2021)
     - How non-bank lenders behave beyond their liability structure (and firesale effect) -- are they “patient”? do they mark to market? can they renegotiate? are they in a position to deal with distress?— becomes crucial for understanding amplification
3. What are the implications for financial fragility?

- Separately, one has to look within broad market segments outlined earlier to understand fragility pressures.

**Directly originated debt**
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Don’t freeze, don’t run

Can freeze, don’t run
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**Don’t freeze, don’t run**

**Can freeze, don’t run**

- "BDC" Business Development Companies (think REIT-like structure & investors)

Can freeze, don’t run

Runnable → firesales

This is where much of the “2020” literature is sitting

- Current emphasis (here and in the literature) is on the March 2020 run, i.e., on the liability structure

*On Non-Bank Lending* by Victoria Ivashina
3. What are the implications for financial fragility?

3. Balance sheet constraints of non-bank structures (e.g., Harmon and Ivashina, 2020; Kundu, 2020)

- At least CLOs can precipitate financial distress
3. What are the implications for financial fragility?

- Can this come back to the balance sheet of the banks in a benign way? – I just don’t see how; this is not something a bank has “edge” in (on a significant scale) however you look at it, and there are many examples from 2008

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*Low interest rate environment*  
*Data and analytics revolution*
3. What are the implications for financial fragility?

- Can it come into the balance sheet of the banks in a *hidden* way? — With the information that we have, it is hard to rule out; more research on the backstop leverage provided by banks for securitization (for example) would be helpful.

- Relatedly, revolving lines can be another mechanism for indirect, hidden source of bank exposure (and 2020 gave us an insight on it).

- Who holds the risk is not fully clear either, for example, it appears that foreign global banks might be holding a significant fraction of top-rated CLO tranches.
4. 2020 Lessons (Missed?)

- Coming back to amplification mechanism: Borrower’s defaults—we are dealing with much higher leverage (e.g., Greenwood, Iverson and Thesmar, 2020; Group of Thirty, 2020; Ellias, Iverson and Roe (2021), Braeuning, Ivashina, Ozdagli, 2021)

- And credit market (and, relatedly, public market) frothiness has escalated farther since 2020

Open topics:
- As I already pointed out, micro studies of the non-bank lenders and structured way of thinking about non-bank lending growth is key
- To what degree did 2020 intervention inject moral hazard into already unhinged debt market?