Discussion of "The capital constraint channel of collateral eligibility: Evidence from a credit support exit policy"

IV CEMLA/Dallas Fed Financial Stability Workshop

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— *Discussion by Peter Karlström* —

The paper in a nutshell

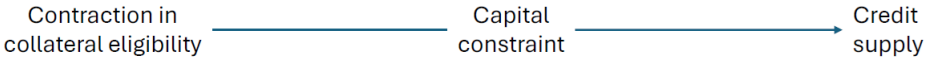
- Question:
  - Do bank capital constraints influence the effect of collateral policy changes on credit supply?

- Contribution:
  - Contributes to the literature on collateral eligibility policies and credit supply.
  - Sheds light on the interaction between liquidity and capital constraints.

- Results:
  - Banks with tighter capital constraints cut credit supply significantly more.
  - No aggregate credit contraction because of strong compositional shifts towards larger and less risky firms.

Mechanism - Capital constraints channel

- Capital constraints channel
  - Contraction in collateral eligibility leads to a balance sheet expansion (acquire more liquid assets).
  - Short-term costs of adjusting bank capital implies higher leverage and tighter capital constraints.
  - Larger reduction in credit supply for more capital-constrained banks.



Mechanism - What about funding costs?

- **The authors state in the introduction (page 2) that it's possible to isolate the effect on credit supply since there was no (other) policy change affecting funding costs.**

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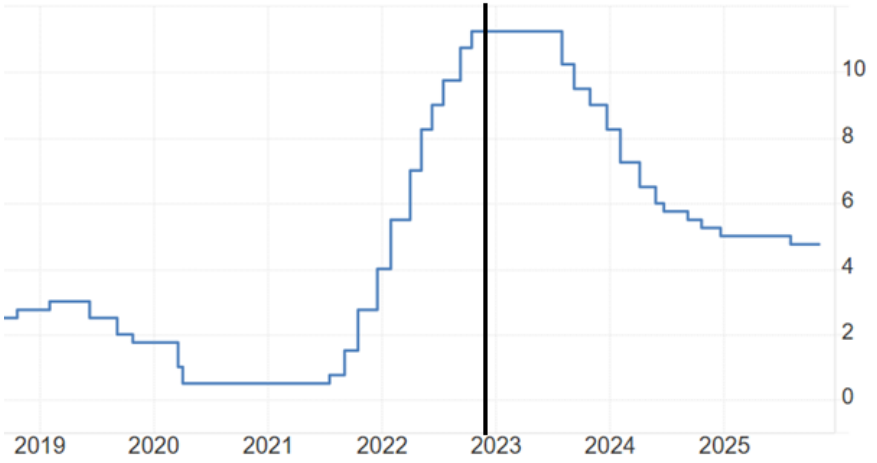

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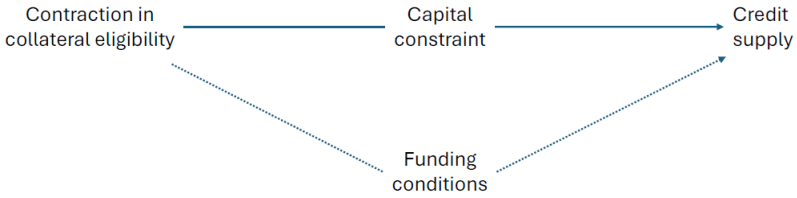
- **However, on page 4 the authors hypothesize that deposit rates are lower for better capitalized banks after the change in collateral eligibility.**

  "We find that better capitalized banks charged lower interest rates and offered larger maturities in new loans, which suggests that these banks faced lower rates in deposit markets after changes in collateral policy."

  - **The findings suggest that funding conditions adjusted to the contraction in collateral eligibility (and are also not constant across banks).**

Mechanism - What about funding costs?

- Changes in collateral eligibility are likely to impact funding conditions (see for example Lentner 2025).
- Funding conditions are a key determinant of banks' credit supply.
- The authors may consider to examine the impact of the contraction in collateral eligibility on deposit flows and interest rates, and shifts in deposit composition (e.g. retail/wholesale).
- It is crucial to account for banks' funding conditions when assessing the validity of the capital constraints channel.



Threshold effects and sequence of policy changes

- Presence of threshold effects
  - The study could benefit from exploring potential non-linear (thresholds) effects of capital constraints during liquidity stress on credit conditions.

- Sequence of policy changes and synergy effects
  - The authors may also consider discussing potential implications of the sequence of financial policy implementation. What can we learn about the optimal order financial policies should be implemented?
  - The paper could benefit from including a discussion about potential synergy effects between collateral eligibility policies and CCyB. For instance, Jude and Levieuge (2025) find synergy effects for banks lending rates in countries with CCyB release and monetary policy easing.

Additional comments

"Importantly, Table 2 also shows that the estimates in our main specification do not change significantly when we do not include predetermined bank-level controls, suggesting that the level of capital surplus is independent of other bank characteristics that could capture the effects of changes in collateral eligibility on credit supply through other channels, such as the liquidity channel. Thus, we are confident that we estimate the capital constraint channel separately from other channels."

- While the coefficients in Table 2 on η are stable for h=3 and h=6, they increase substantially and significantly for h=9, h=12, and h=18. This seems to contradict the conclusion that the capital surplus measure is independent of other bank characteristics, such as those related to the liquidity channel.
- Two banks with particularly high capital ratios were excluded. What was the justification for this?
- According the table notes, standard errors are clustered at the firm level. It may be better to cluster standard errors at the bank level (if this is not already the case).

Final remarks

- The paper presents a laudable exercise to assess the role of bank capital constraints in shaping the effects of collateral policy changes on credit supply.

- An important contribution to the literature on collateral eligibility, banks' capital surplus, and credit to firms.

References

- "Doubling down: The synergy of CCyB release and monetary policy easing" (Jude and Levieuge, 2025)
- "Collateral Haircuts and Bank Funding: Evidence from Sovereign Downgrades" (Philipp Lentner)