Evergreen Lending in Times of Crisis
by Daniel Rabetti

Discussion by Amy Wang Huber

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Summary

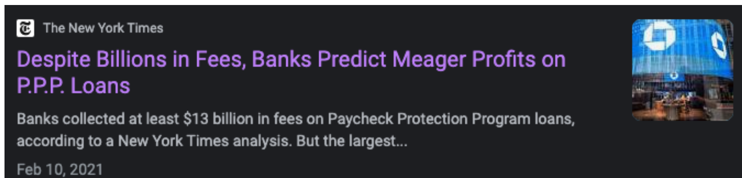
- Timely paper on an important question:
  - What is the role played by financial intermediaries in policy implementation?
- Findings:
  - Documents more lending by banks to relationship borrowers compared to transactional borrowers.
  - Argues that banks are motivated by a desire to subsidize existing loans.
- Discussion plan:
  - Revisit potential mechanisms and policy implications.

Mechanism – this paper

- Why did banks lend more to "relationship borrowers"?
- This paper: banks want to lower risk of default on pre-crisis debt.
  - Evidence 1: differential effect in deposit vs. lending accounts.
    - Deposit account provides limited insight into a firm's ability to pay debt.
    - If anything, this supports the view that asymmetric info plays a role.
  - Evidence 2: comparison between PPP and matched non-PPP firms.
    - PPP firms are selected into treatment, difficult to find a convincing match.
    - Irrespective, ex-post default reveals little about ex-ante decision.
- What could be helpful:
  - Within-bank, cross-sectional comparison based on cost of default.
  - Proxy 1: share of lending bank in firm's total debt.
  - Proxy 2: firm's distance to default.

Mechanism – alternatives?

- Possibility: extending loan to relationship firms is less costly.



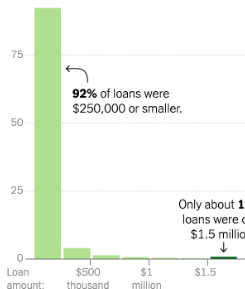
  - "... costs [banks] incurred to make the program work [include] all-nighters and rushed technology projects during four frenzied months of lockdowns and business closures."
  - Banks still need to do due diligence, especially because banks are wary that loan forgiveness may not materialize as payment from SBA is contingent on meeting stringent timeline requirements.

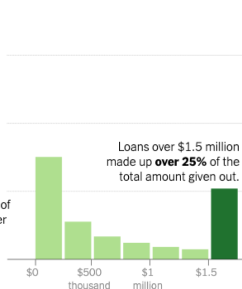
- Possible test: second round of funding became available end of April but amendment of loan forgiveness terms came at end of May – does relationship play a differential role before and after the amendment?

Policy implication

- Better / more clearly written policy solves the problem?
- What's the trade-off between larger loans vs. smaller loans is also central to the policy debate.
    - Cutoffs in the fee schedule could be useful for identification.

A tiny fraction of high-value loans made up a substantial portion of total P.P.P. money handed out





Note: The largest possible amount a business can be loaned via the Paycheck Protection Program is $10 million. • Source: Small Business Administration

Conclusion

- Important question!
- More analyses on the mechanism can shed better light on the economic trade-off.
- Good luck!