Discussion of "The Option Value of Public Liquidity: Evidence from Regional Collateral Policies", by Chavaz and Dlugosz (2026)

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Research Question

Big picture

- Access to public liquidity is a key difference between banks and non-banks
- What are the consequences of this access for
  - Asset composition of banks and non-banks?
  - Funding model?
  - Financial stability?
  - The real economy?

Research Question

What is the effect of having access to public liquidity on loan supply?

Empirical approach

Ideal experiment:

- Some institutions, at random, receive access to public liquidity/ some loans become eligible

In this paper:

- Discrepancies in collateral policies across Federal Home Loan Banks (FHLBs)
  - Different (and better in some respects) from the Fed's discount window
  - Data: hand-collected eligibility criteria and HMDA data
- Granular fixed effects ensure that eligible and ineligible loans are observationally similar

Interesting paper and convincing approach:

- Important topic
- Causal relationship between pledgeability and loan supply convincingly established
- Refreshingly short

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This discussion

1. Conceptual framework
2. Quantifying the option value
3. Time contingency
4. Banks vs non-banks
5. Minor:
    1. Securitization
    2. Data quibbles

Comment 1: conceptual framework (i)

What wasn't obvious to me

- What are the important tests?
  - E.g., loan pricing seems important
- Which results should I expect?
  - E.g., given the results that eligible loans are more likely approved, I thought that higher risk-taking follows almost mechanically

Toy model that helped me:

- Loans pay R with prob. $1-p$ and 0 with prob. p
- Loan value: $V_j = (1-p)R_j - 1 + v_j$, where $j \in \{E, N\}$ and $v_E > v_N$

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Comment 1: conceptual framework (ii)

Prediction 1: Loan rates

$$R_E = \frac{1-v_E}{1-p} < \frac{1-v_N}{1-p} = R_N \qquad \text{(perfect competition)}$$

Prediction 2 and 3: Loan approval and risk-taking

Borrowers accept loan iff

$$R_j \leq \bar{R} \;\leftrightarrow\; \frac{1-v_j}{1-p} \leq \bar{R} \;\leftrightarrow\; p \leq 1 - \frac{1-v_j}{\bar{R}} := \bar{p}_j$$

- *Prediction 2*: eligible loans, but not ineligible loans, are accepted for $p \in (\bar{p}_N, \bar{p}_E]$
- *Prediction 3*: higher approval probability for eligible loans

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Prediction 4: Securitization

- Value of loan on balance sheet: $V_j = (1-p)R - 1 + v_j$
- Price of securitized loan: $V_j = (1-p)R - 1$

$\Rightarrow$ Comparative advantage of holding E loans on balance sheet

Prediction 5: Jumbo loans

If $v_E - v_N$ large, results for Predictions $1-4$ should be larger

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Comment 2: Quantifying the option value

Title: "The Option Value of Public Liquidity"

Abstract: "The value of this option [to pledge loans] is hard to quantify because liquidity usage is endogenous"

$\Rightarrow$ It would be interesting to quantify the option value:

$$v_E - v_N = (1-p)(R_N - R_E)$$

Measurable with

- Interest rate (only for originated loans)
- Credit score (confidential data)

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Comment 3: Time contingency

- Do the results capture a "funding cost" or a time contingent "option value"?
- Related: are the results applicable to the Fed's discount window? FHLB is routinely used during normal times, unlike the Fed's discount window
- In the toy model, let ν_j vary with the state of the economy and increase with market volatility
- Can test this by estimating the option value over the business cycle
- Did it spike during the GFC, September 2019 liquidity crisis, Covid, and the March 2023 SVB crisis?
- Aside: I didn't understand why only 2023 data is used. Then, for the market structure part, 2019-2024 data is used

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Comment 4: Banks vs non-banks

- Interesting and promising angle ("nonbanks" is the second word of the Abstract)
- In current paper, non-banks are mostly used to econometrically validate results (exception is market structure section)
- Given results on the option value, authors could do more:
  - What is the option value at the bank level? I.e., how much are non-banks disadvantaged compared to banks?
  - What about in crises?
  - What are the implications at the bank and non-bank level? E.g., liquid asset holdings, or loan specialization

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Minor (i)

Securitization

- Paper presents pledging and securitization as perfect substitutes
- Securitization gives liquidity, but also frees capital
- Why do banks choose one or the other?
- Does it vary with bank capital ratios? And are the baseline results stronger for well-capitalized banks? What about regulatory leverage ratios? Large fixed costs to securitizing?
- Seems important given that FHLB pledgeable loans (mortgages) are seemingly easy to securitize

Minor (ii)

Data Quibbles (decreasing in importance)

- Why not use the confidential data for the entire analysis?
- Risk-taking could be measured by credit score in addition to LTV ratio
- Product fixed effects halve the effects (column 6 in Tables 2 and 3). Why?
- "Borrower fixed effects" are actually fixed effects of borrower characteristics
- I don't understand column 4 of Table 5. Why does *"Eligible"* not have a coefficient?

Very interesting paper; good luck!