Finance Leases: A Hidden Channel of China's Shadow Banking System

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Overview

- This paper studies the role of finance leases in China's shadow banking system

- Finance leases serve as an important off-balance sheet lending channel of banks to substitute formal bank lending during tightening monetary policy

- Such finance leases mainly target low-risk lessees with better contract terms (e.g., lower leasing rates)

Overview

- Very nice paper with a very interesting idea
  - One of the most important research questions: shadow banking that plays important role in many countries across the globe (e.g., Ghosh et al. 2012; Rockoff, 2018). In China, the second largest economy worldwide, the shadow banking sector has been growing dramatically in the past decades, such as entrusted loans (e.g., Allen at el. 2019; Ruan 2021), weath management products (e.g., Chen et al. 2020; Archarya et al. 2017; Hachem and Song, 2017).
- Novel channel: finance leases.
- Solid empirical analyses, very well written!
- Comments on the interpretation of the results, narratives, and empirical exercise

Comment 1

- The main economic message of the paper is to show the substitutes between the bank-affiliated finance lease and the formal lending (e.g., bank loans).
  - It would be helpful to show the decreases in formal bank lending following the regulation shock on “overcapacity industries”
  - From the estimated coefficients in Table 4 column 2, treated firms increase the probability of having finance lease from 0.49% to 1.09%. The magnitude is not big. But the amount of finance lease increased by 174%.
  - Detailed summary stats. The current version shows only four variables in Table 8.
  - However, Figure 1 shows the leasing market in China reached to RMB 7 trillion in 2019.

Comment 2

- The authors also find that the increased finance leases are mainly from the bank-customer relationship
  - Table 5 shows that treated firms that have relationship with banks increase the probability of having finance lease from 0.19% to 0.59%.
  - At the level, 0.59%<1.09% so that many new finance leases actually target for non-relationship borrowers? If that is the case, then it is more than just substitution.
  - It would be great to understand the intensive vs. extensive extension of leases

Comment 3

- I am largely convinced by the empirical analysis of the paper, but I want to push the authors to show more evidence for the fundamental channels underlying the substitutions.
- For example, how do funds flow from the parent banks to the leasing firms.
  - The paper argues the implicit guarantee, bond issuance underwriter, etc.
  - It would be great to add direct evidence.
  - Compare the funding sources between bank-affiliated vs. non-bank-affiliated finance leases.

Comment 4

- Again, the authors did a good job in their DID analyses. Just a couple of assorted comments:
  - The regulation shock was in 2010, right after the famous 4-trillion program. How does that affect the interpretation of the results.
  - It is good to show parallel trends, the authors should include pre-trend dummies in all tables.
  - Maybe also show some unconditional patterns for parallel trends.
  - It seems that the non-bank-affiliated leases are not affected by the shock. This can be used as control group to estimate the economic consequences of increased finance lease (e.g., firm activities, stock prices, and so on).

A minor comment

China's $13tn shadow banking sector gets clearer definition

Top bank regulator lists criteria for determining threats to financial system

- As of the end of 2019, China's shadow banking sector as defined broadly shrank to 84.8 trillion yuan (US$13 trillion) from the peak of 100.4 trillion yuan in 2017

Broad definition of shadow banking

- interbank special purpose vehicles, entrusted loans, capital investment trusts, trust loans, bank asset management products, nonequity mutual funds, securities asset management products, insurance asset management products, asset securitization, nonequity private funds, online peer-to-peer lending, **financial leasing companies**, microfinance loans, commercial factoring companies, finance guarantee companies, consumer loans issued by unlicensed institutions, creditors' rights financing plans provided by local exchanges and structured finance products.

Narrow Definition

- investment by interbank special purpose vehicles, interbank asset management, entrusted loans, trust loans, online P2P lending and nonequity private funds

Conclusion

Very good paper!