De-limiting Arbitrage: Evidence from the Term Asset-Backed Securities Loan Facility

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Discussion: Martin Goetz

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Disclaimer: The views expressed are my own and do not represent the views of the Deutsche Bundesbank

This paper: Deep-dive into Term Asset Securities Lending Facility (TALF)

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TALF 2.0 "On March 23, 2020, the Federal Reserve established the Term Asset-Backed Securities Loan Facility (TALF) to support the flow of credit to consumers and businesses by re-enabling the issuance of ABS."
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- Understand what role arbitrageurs (and limits to arbitrage) played
  - Exploit two (surprise) decisions by FED
    - October 2009: unexpected CMBS rejections
    - April 2020: some CMBS not eligbile in TALF 2.0
  - Use information on rejected collateral and investor type(s)

Findings

1. TALF2.0: TALF-eligible CMBS decreased more than non-eligible ones
   consistent with theories stressing limits to arbitrage
2. TALF1.0: Price of longer WAL CMBS decrease after potential rating downgrade;
   TALF2.0: Price of longer WAL CMBS increase more after FED's (April) surprise announcement
   consistent with dynamic limits to arbitrage models
3. TALF1.0 + TALF2.0 Pledged CMBS of Hedge Funds and Mututal funds have short WAL
   interpretation: arbitrageurs took less risk
4. TALF1.0: Reduction of Hedge funds and mREITs after surprise rejections in October 2009
   interpretation: arbitrageurs leave market after increased risk of rejection
5. TALF1.0: WAL of arbitrageur-submitted CMBS increased in early 2010
   interpretation: arbitrageurs increase risk-taking as outside (repo) fuinding became available again
6. TALF1.0: Spreads of rejected CMBS increase; increase larger in earlier program period
   interpretation: arbitrageurs demand less compensation for trades that consume more capital

- Very nice paper, highly recommend to read it
  - Interpreting empirical findings through the lens of theory
  - TALF Tour de force

TALF: now and then

- How comparable are TALF1.0 and TALF2.0?
  - 2009: GFC = financial shock $\Rightarrow$ Investors/Intermediaries $\Rightarrow$ Real economy
  - 2020: Covid = real shock $\Rightarrow$ Real economy $\Rightarrow$ Investors/Intermediaries

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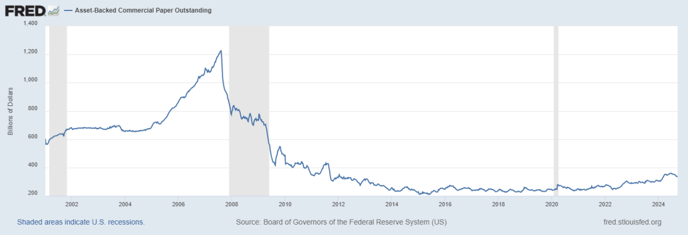

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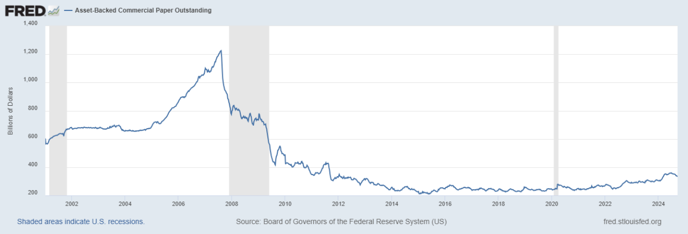

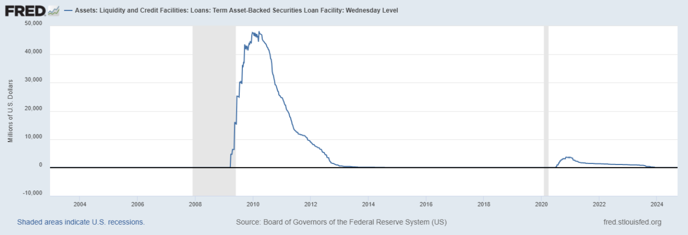

Interpretation and Definitions

- Indirect evidence hard to link to limits to arbitrage...
  - Especially for (differential) price effects of securities
    - (Other) investor types; market frictions
    - Different markets disruptions in 2009 and 2020
    - Possible to link it closer to limits to arbitrage?
      Heterogeneity across investor types/market segments, etc.
  - Dependent on classification of investors
    - Why are long-term investors not also arbitrageurs?

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  - Why should a limit to arbitrage only apply to arbitrageurs?
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- Possible to focus more on investor structure and behavior during period?
  - E.g. focus on TALF-only funds
    - Aren't they textbook arbitrageurs?
    - Important investor class (about a third of all loan requests 10/2009)

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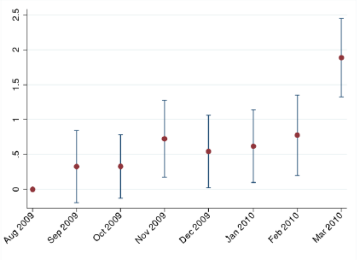
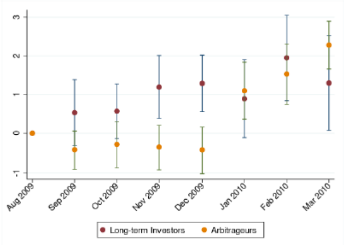
  - Also: Investor composition changed $\rightarrow$ counterfactual different. How would same investor behave?



a) All Borrowers



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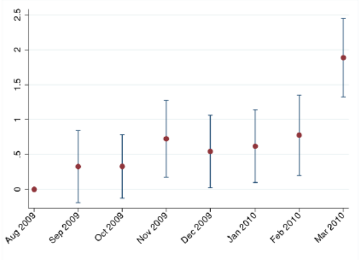
- Evidence (Figure 6(b)): Increase in 10/2009 more pronounced for long-term investors
  - But shouldn't arbitrageurs respond more?



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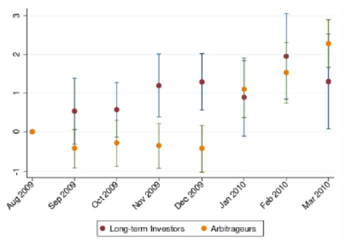

TALF 1.0: Unexpected CMBS rejections in October

- October 5th 2009: FED announces changes to TALF-program
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  1. Expand list of Nationally Recognized Statistical Rating Organizations (NRSROs) whose ratings are accepted for determining the eligibility of ABS to be pledged as collateral at the TALF

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  Rejection risk $\uparrow$ after 10/5/2009
  (There is always a referee 2 out there)
- Can you exploit pre-announcement heterogeneity in ratings?

Summary

- Nice paper!
  - Forces reader to think about economics behind programs, and how to interpret findings through lense of theory, to learn from effects.

- Good luck with the paper