Discussion of "Evergreening" by Miguel Faria-e-Castro, Pascal Paul, and Juan M. Sanchez

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Summary

1. Studies the phenomenon of "evergreening" – i.e., extending loans on favorable terms to firms in distress – at U.S. banks
2. Shows banks with concentrated exposures give more credit at lower rates to firms close to default
3. What is the **friction**? The friction is **costly corporate insolvency** (Becker and Ivashina 2022) which makes restructuring less attractive to banks and more willing to sustain distressed firms to recover their investment
4. Build a dynamic heterogenous-firm model with this mechanisms to examine effects on aggregate outcomes: ↓rates, ↑ corporate debt, ↓ productivity, but ↑output.

Key takeaway: "Evergreening" is present even at large stress-tested U.S. banks and affects the real economy

General assessment

- An exciting paper (very well developed and mature)
  - **A clear contribution to the banking literature** – presents a theory of bank behavior ("evergreening") by which lenders have the incentive to keep distressed firms alive to recover their investment – doesn't require distorted incentives to delay loss recognition on bank balance sheets, informational asymmetries, gambling for resurrection, risk-shifting
  - Makes us think in new ways about lending practices at large U.S. banks
- Very topical in light of
  - Several evergreening practices across credit markets when borrowers experience shocks (CRE market, RRE market)
  - Concerns that ample liquidity and low interest rates since the GFC may have led to the breeding of zombie firms in the United States

Two broad sets of comments

- Evergreening or something else?
  1. Exploit the Y-14 data for insight into evergreening
  2. Model: Aggregate effects of evergreening - output goes up
  3. Model: Bank defaults?

- Relation to zombie lending
  - Reconciling studies on evergreening vs. zombie lending

Evergreening or something else?
#1 Exploit the richness of the Y-14 data

- Standard way of thinking about evergreening – the loan comes due, firm cannot repay, and the bank needs to recognize a loss unless it evergreens
- Exploit the richness of the Y14 data to look at loans falling due
  - Empirical evidence is about credit growth (rates) and the bank's decision to keep onlending (not about banks doing extend-and-pretend when loans come due)
  - We observe **maturity** → A test of evergreening is to look at loans that are coming due and examine the terms on which banks renew those loans to distressed firms
  - Do banks engage in temporary or permanent modifications, payment deferrals (forbearance), other types of loan restructurings

- **Post-evergreening**: Follow the loans over time
  - What are the post-evergreening loan-level outcomes? Do borrowers start cash-flowing again?
  - In the mortgage market, Fannie Mae's reperforming loans are highly successful: 90% are current or paid off

Evergreening or something else?
#2 TFP goes down, output goes up – good or bad?

Table 5.3: Impact of introducing concentrated lending.

	Δ % with const. entry	Δ % with const. labor
Firm level (Averages)		
Market Leverage	0.60	0.54
Interest rate	-1.24	-1.13
Size	2.34	1.99
Productivity	-0.04	-0.02
Exit rate	-0.70	-0.17
Aggregates		
Debt	3.13	1.04
Capital	3.13	1.04
Labor	2.14	0.00
Output	2.14	0.10
Wage	0.00	0.10
Measured TFP	-0.31	-0.23
Number of firms	0.77	-0.94

- Implications for concentrated lending vs dispersed lending
  - Evergreening (better lending terms) → less firm default (banks recover their investment) → firms borrow more (↑debt) and are a little larger but also less productive (↓TPF), yet output is not depressed (↑output)
- Evergreening a strong word?
  - Prudent or fwd looking restructuring?
  - Optimal restructuring response given market structure of lending?

Evergreening or something else?
#3 How about bank defaults?

- Model focuses on firm default
- An important dimension for analyzing welfare is bank default
  - How does the model incorporate **bank defaults**?
  - With evergreening, banks more likely to recoup investment, so bank default too less likely and output ↑ even more
- Is the welfare analysis in the model robust to introducing costs associated with bank defaults?
- The worry in the evergreening literature is that extend-and-pretend "saves the day" but eventually hurts the economy
  - By contrast, the model suggests evergreening is benign, good for the economy, possibly even more so with bank defaults

#4 Relation to zombie lending - Can evergreening and no-zombie lending coexist?

- Zombie lending a malign phenomenon by which distorted incentives among banks to recognize losses lead to evergreening to unviable firms, which weigh on productivity and economic growth
- Favara, Minoiu, and Perez-Orive (2022) find no evidence of zombie lending in the U.S.
  - Use the Y-14 data and show low-capital banks are no more likely to lend to zombie firms (either financially distressed firms with low prospects of recovery or weak firms that receive subsidized credit) than other banks
- Reconcile these findings with evergreening?
  - Some positive correlation of 0.2 between high PD (distressed) and zombie firms → differences across the two groups
    - High PD firms are not necessarily zombies (with no chance of recovery)
  - Evergreening here (benign, does not depress output) can coexist with lack of zombie lending

To sum up

- Insightful work on the lending behaviors of U.S. banks
  - Evergreening – on-lending on favorable terms to distressed firms - as banks wish to recover their investment
  - Friction: corporate insolvency/restructuring is costly

- Comments:
  - Questions of interpretation: Evergreening or fwd-looking restructuring?
  - Welfare analysis and implications for policy? Evergreening seems benign for output (probably even more so with bank defaults)

- Look forward to seeing the paper in print!