Navigating the Shifting Sands: The Future of Credit Intermediation for Banks and Nonbanks

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Bank intermediation

- The business of banking – using demandable deposits to fund illiquid loans – is inherently unstable.
- But because bank credit intermediation is socially valuable, society has provided a safety net to make banks more stable.
  - Deposit insurance and a lender of last resort.
  - Regulation and supervision
    - to control the resulting moral hazard caused by the deposit insurance and LOLR access and to take into account the externalities caused by a bank failure.

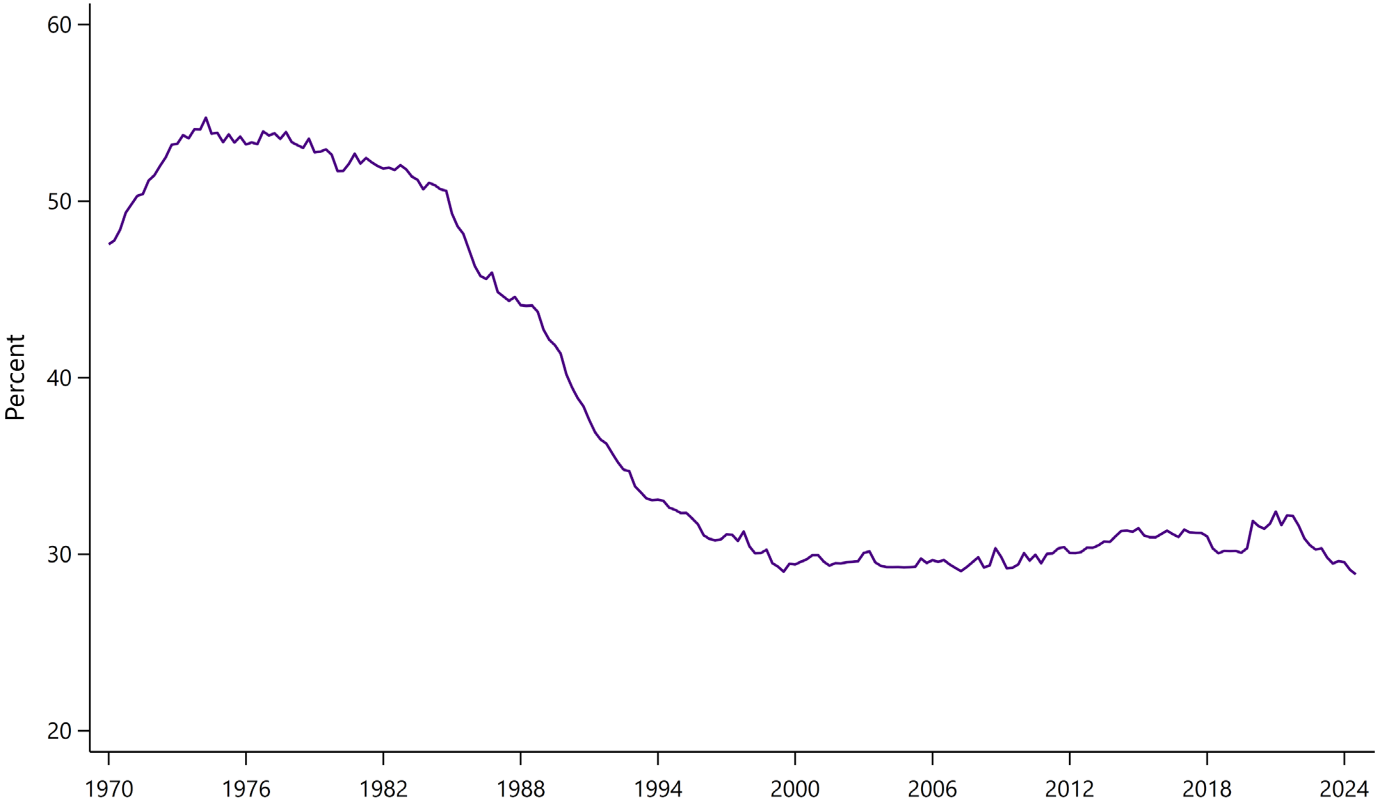
Why combine loan making and deposit taking?

- All interesting questions in banking economics boil down to: “Why combine loan making and deposit taking in the first place?”
- Historically, there were efficiencies associated with money changing and deposit taking, and once you have those deposits, it is profitable to make loans with them. Kashyap et al (2002).
- Economists have also provided some *ex post* rationalizations including:
  - **Strahan et al (2014): Banks receive deposit inflows in bad times that allow them to fund drawdowns of lines of credit.**
  - **In a few weeks in March and April 2020, before the government could provide meaningful support, U.S. commercial banks increased their lending by $700 billion. (By comparison, Fed lending went up $130 billion.)**

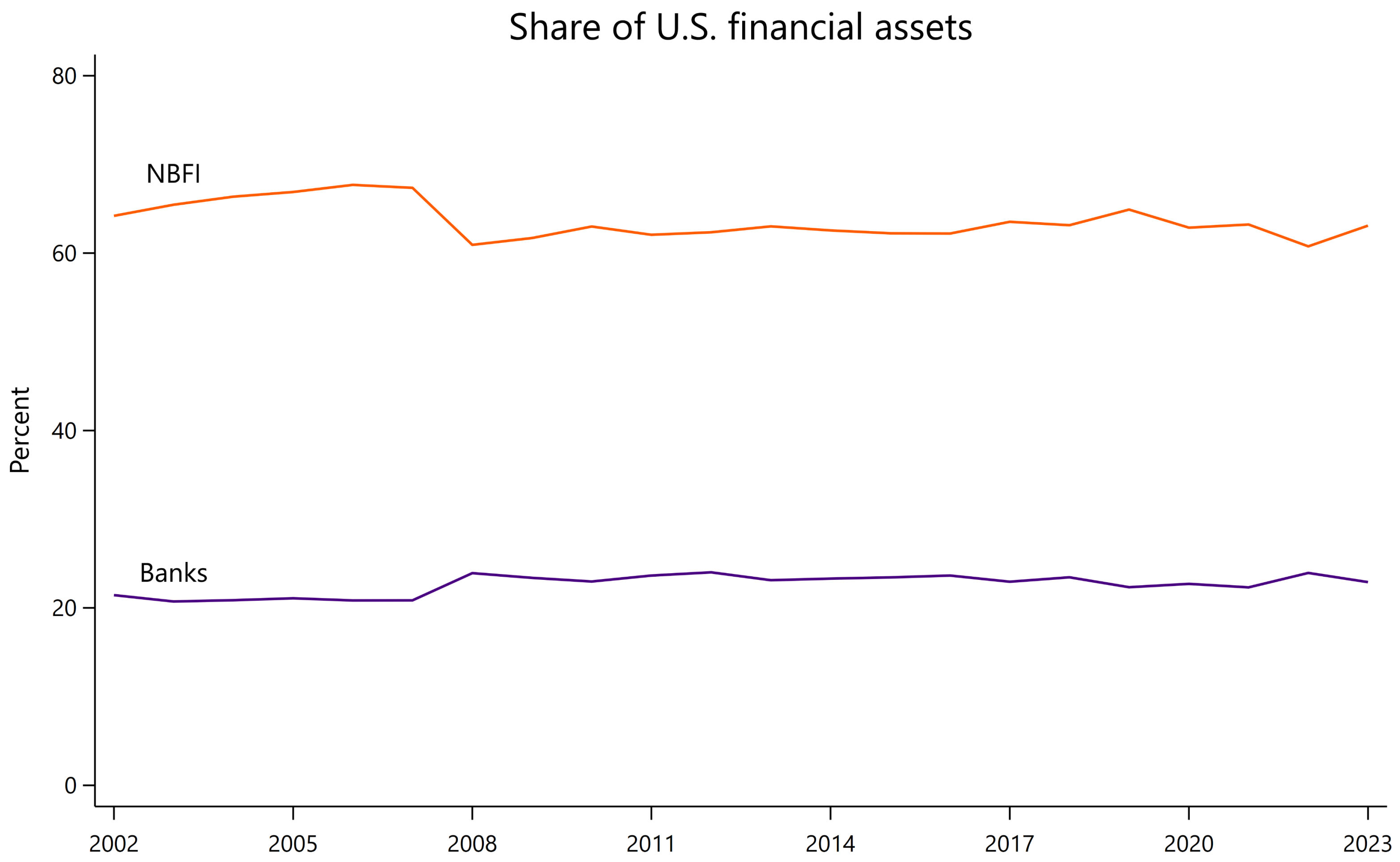
Disintermediation

- The replacement of bank intermediation with nonbank intermediation can be driven by financial innovation that allows unbundling.
    - The great disintermediation of the 70s, 80s, and 90s reflected the rise of money funds offering deposits that did not fund loans while securitization allowed loans to not be funded by deposits.
- Not nearly as much disintermediation since 2000.

Bank assets as a percentage of financial and nonfinancial debt



Source: Board of Governors of the Federal Reserve System.

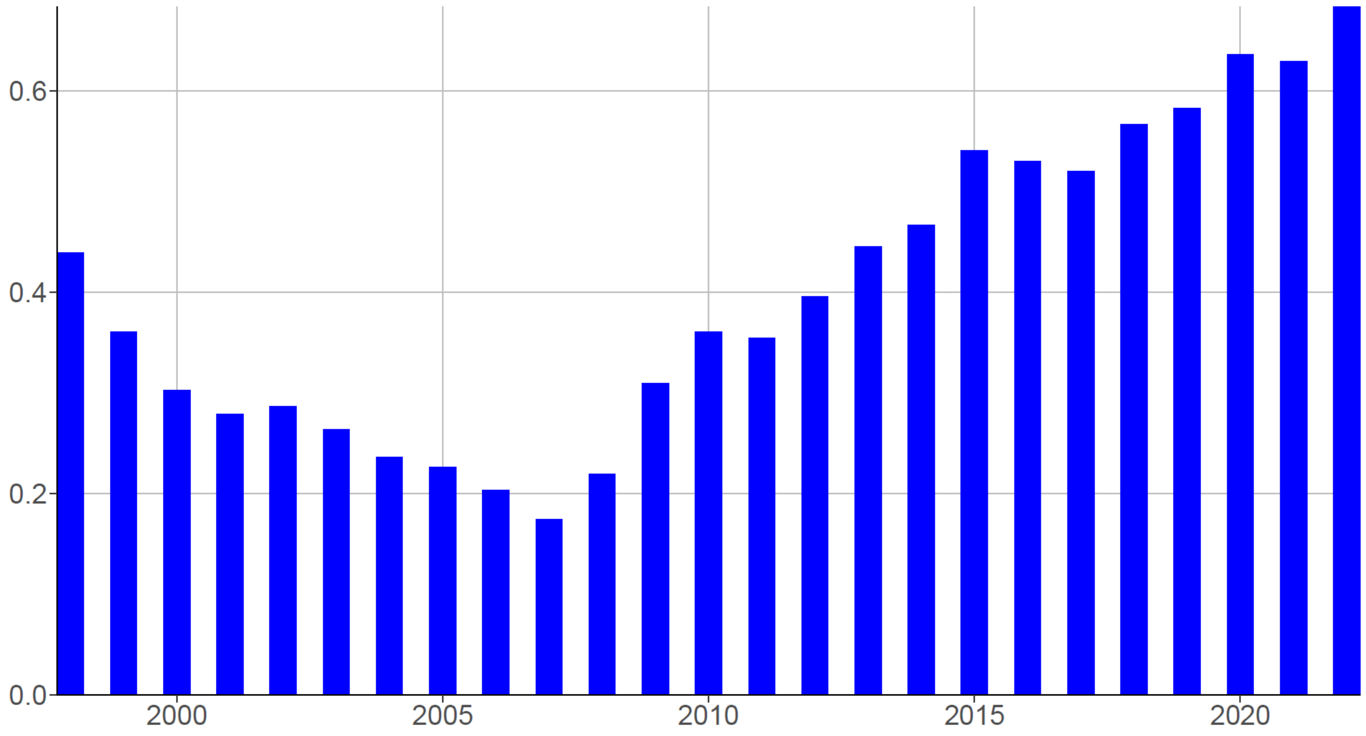


Source: Financial Stability Board.

Treasury market intermediation

- Regulation typically drives disintermediation by penalizing safe activities.
- Leverage ratio requirements and components of the GSIB surcharge have boosted the capital requirements associated with Treasury market intermediation.
- Primary dealer capacity has been about unchanged over the past 15 while treasury debt has nearly quadrupled.
- Treasury market intermediation is instead done in large part by high-frequency traders.

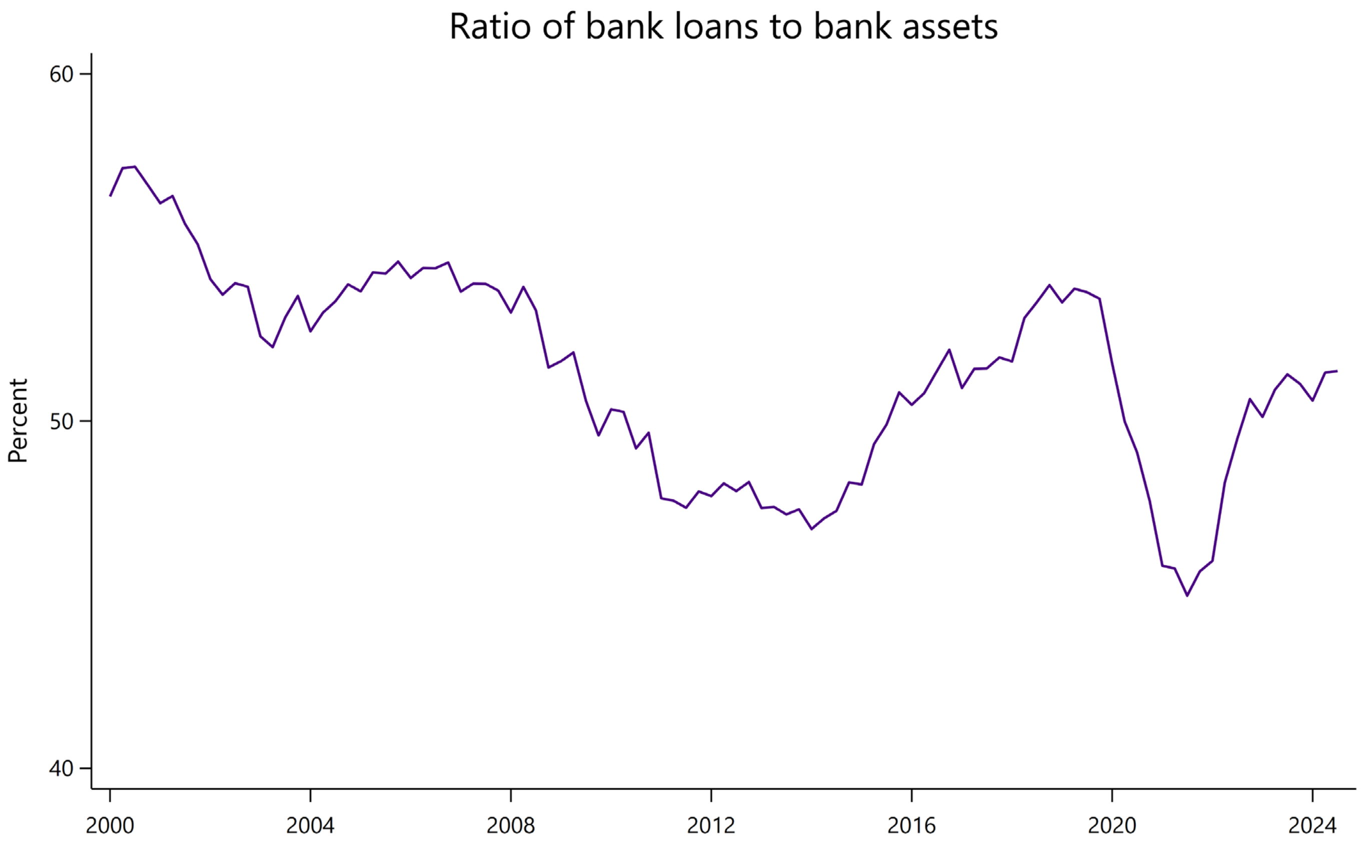
Ratio of Treasuries Outstanding to Total Primary Dealer Assets



Source: Darrell Duffie, *Fragmenting Markets: Post-Crisis Bank Regulations and Financial Market Liquidity*

Looking deeper, there has been some further bank disintermediation

- The stability of banks' share of total financial assets masks a reduction in loan share.
    - Banks' securities and reserve balances have risen because of QE, liquidity requirements, and to manage liquidity risk.
    - The decline in the loan share has been muted in part by increased bank lending to private credit originators.

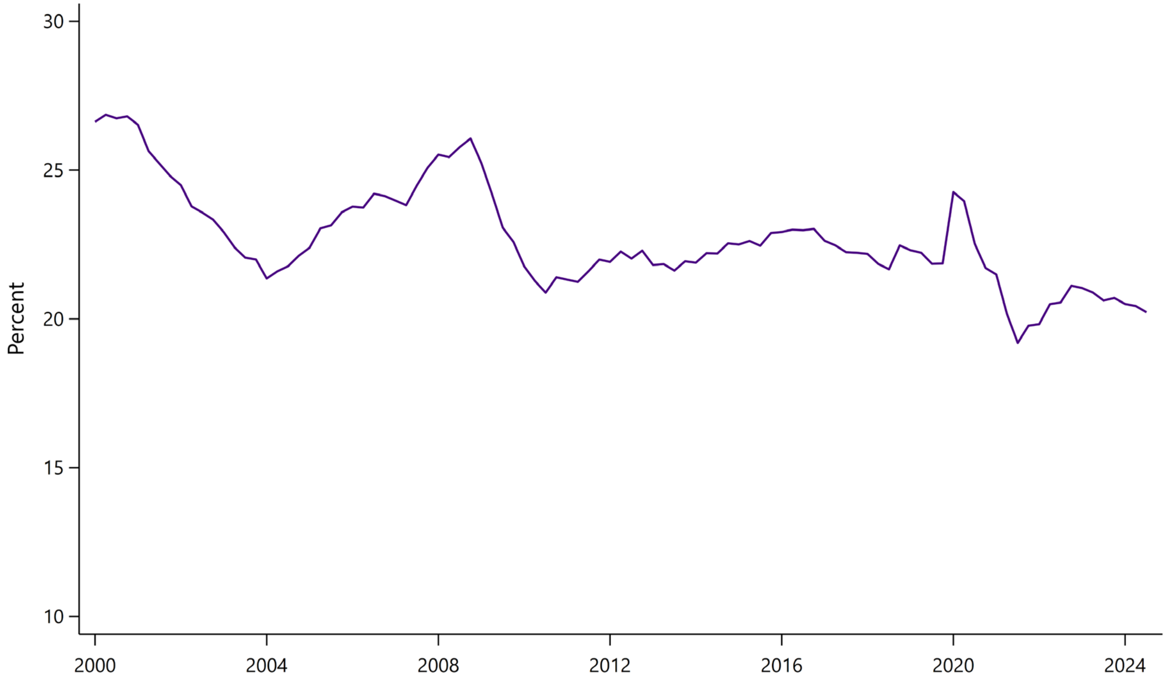


Source: Board of Governors of the Federal Reserve System.

Private credit

- A growing share of middle-market business loans are being provided by private credit lenders which are funded by equity investments from insurance companies and PE funds and by bank loans.
- Private credit has grown in part because of decoupling – illiquid loans funded with longer-term investments rather than deposits.
- In addition, the bank capital requirement for lending to private credit lenders is much lower than for lending directly to businesses.
- Still, because private credit lenders are not highly leveraged, the total amount of equity funding the loan is higher, not lower. A conundrum. See Chernenko, Ialenti, and Scharfstein 2025.

Bank loan share of business debt



Source: Federal Reserve Board, Financial Accounts of the United States.

Outlook

- Private credit seemed to be supercharged a few years ago by the prospect of sharply higher capital requirements. With those concerns abating, banks seem to be fighting back.
- In “Do we still need banks?” Scheider and Schuerman (2025) observe that the trend is toward replacing banks, which provide intermediation in normal times and stress times, with nonbanks, which only provide intermediate in normal times.
  - The result will likely be a need for more government intervention.
- Going forward there may be two countervailing developments:
  - Advances in payments and financial engineering will continue to decouple deposit-taking and loan-making.
  - Some sanity in bank regulation and (maybe) greater NBFI regulation will lessen the regulatory arbitrage motive for bank disintermediation.
- The financial system may run into trouble again. The money market mutual fund-securitization chain of intermediation did not hold up well in the GFC.
- In particular, Treasury market resilience is a huge concern.