

The Fed Put and Bank Risk-Taking: Evidence from the Loan Book

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Summary

- The paper studies whether monetary policy affects bank risk-taking
- Conceptually, one would like to estimate:

$$\text{Bank risk-taking} = f(\text{monetary policy shock})$$

- But monetary policy is endogenous and affects both credit supply and borrower demand
- The authors therefore focus on a transmission variable:

$$\text{FOMC announcement} \rightarrow \gamma \rightarrow \text{loan risk-taking}$$

- Here, γ is the bank-specific option-implied tail-risk measure
- The key test is whether banks with larger FOMC-induced declines in γ subsequently originate riskier loans

Key Findings

- Banks with larger FOMC-induced declines in γ subsequently originate riskier loans
- The timing supports the interpretation:
 - No meaningful pre-trend before FOMC announcements
 - The effect appears only after the announcement
 - Non-FOMC-day γ does not predict lending
- The effect is stronger when banks face:
 - Short-term compensation incentives
 - Earnings pressure
 - Stronger lending-market competition
- Main takeaway: monetary policy affects the **risk composition** of bank credit, not only credit quantities

Comment 1: What Does γ Capture?

- The option-based measure is a powerful proxy for FOMC-induced changes in bank equity tail risk
- But the key mechanism requires an additional step: the measure should capture banks' own risk tolerance or constraints, not only market-implied downside risk
- Table A.1 is helpful, but:
 - Columns 1–3: realized credit-policy changes, not perceived risk
 - Column 4: uses banks' reported reasons for tightening standards, which is closer to the mechanism, but only among banks that already tightened
- Suggestion:
 - If possible, validate the tail-risk measure using a more direct proxy for banks' internal risk tolerance or constraints
 - Among banks that tighten standards, test whether the tail-risk measure predicts “reduced risk tolerance” more strongly than other reported reasons for tightening

Comment 2: Other Responses?

- Is the documented effect specific to loan-book risk-taking, or is it part of a broader balance-sheet adjustment?
- Asset-side responses:
 - Larger loan volumes or credit line commitments
 - Looser loan terms: lower spreads, longer maturities, weaker covenants
 - More risk-taking in securities portfolios or lower liquidity holdings
- Liability/capital-side responses:
 - More debt or wholesale funding
 - Higher leverage or higher payouts
 - Changes in funding maturity or deposit reliance

Comment 3: Which Banks Respond More to MP Shocks?

- The first arrow is also crucial:

FOMC announcement $\rightarrow \gamma \rightarrow$ loan risk-taking

- Section 2.2 shows that monetary policy shocks affect γ more for banks closer to distress:
 - higher pre-announcement CDS spreads
 - weaker stress-test capital positions
- This alternative is worth highlighting:

pre-existing fragility / risk appetite $\rightarrow$ large γ response and riskier lending

- The paper addresses related concerns using fixed effects, timing tests, and non-FOMC-day placebo tests
- Suggestion: further clarify how much of the result reflects FOMC-induced changes in γ , versus pre-existing bank fragility or risk appetite

Conclusion

- Excellent paper: impressive in scope, data, and empirical execution
- Advances our understanding of how monetary policy affects the **risk composition** of bank credit
- My comments:
 - Sharpen the interpretation of the mechanism
 - Explore broader asset- and liability-side responses
 - Clarify heterogeneity in banks' responses to FOMC announcements
- I learned a lot from reading this paper and highly recommend it!