cutoff and estimate the extent of the discontinuity at the conforming loan limit using the following regression discontinuity specification:

$$Bank_{ilt} = \beta \times Jumbo_i + X_i'\Gamma + \gamma_{lt} + \epsilon_{ilt}, \qquad (1)$$

where $Bank_{ilt}$ is a {0,1} indicator variable for whether the loan *i* in census tract *l* originated in year *t* is financed on the balance sheet or originated at a bank, respectively. $Jumbo_i$ is an indicator for whether the loan size is above the conforming loan limit in the time-county of origination, and the corresponding coefficient β is the object of interest. X_i' is a vector of loan-level controls including log loan size, log applicant income, and dummy variables for race, ethnicity, sex, loan type, loan purpose, occupancy, and property type. γ_{lt} is a census tract-origination year fixed effect, which absorbs any variation in local conditions over time, as well as regulatory differences. In other words, we examine the effect by comparing loans from the same census tract and year around the conforming limit, adjusting for observable borrower differences. For robustness, we also experiment with larger samples, those within 5%, 10%, and 25% of the conforming loan limit.

Table 2A shows that loans directly above the conforming loan limit experience about 50 pp increase in the share of loans financed on the balance sheet. Increasing the bandwidth above 1% produces similar results, as shown in columns 2–4. In 2015, the most recent year in our sample with complete data coverage, this association is even stronger: the share of loans financed on the balance sheet jumps by about 47 pp to 62 pp above the conforming loan limit (columns 5–8).

Table 2B shows that loans directly above the conforming loan limit are nearly 25 pp more likely to have been originated by a traditional bank, as opposed to a shadow bank. As above, when considering only loans originated in 2015, this difference grows to 38 pp. Increasing the bandwidth above 1% produces similar results, as shown in columns 2–4. The results around the discontinuity illustrate that traditional banks specialize in originating mortgages, which have to be retained on the balance sheet, and not simply mortgages, which are large.

III.B.2 Within-Bank Analysis: Balance Sheet Capacity and the Balance Sheet Retention Margin

In the previous section, we look at market segmentation between banks and shadow banks. In this section, we look within banks. We do so for two reasons. First, we use within-bank analysis to show that balance sheet capacity is driving banks' comparative advantage in the jumbo market, rather than other regulatory differences with shadow banks. Second, we provide microevidence for the balance sheet retention margin within banks.

Market Segmentation and Balance Sheet Capacity: Conforming Loan Limit Discontinuity

Our findings above are consistent with the idea that banks' ability to finance loans with their balance sheets generates a strong comparative advantage in the segment for difficult-to-sell loans—i.e., jumbo loans. However, balance sheet capacity is not the only differentiating factor between banks and shadow banks; for example, shadow banks are subject to a very different regulatory burden than traditional banks (see Buchak et al. (2018)). If low balance-sheet capacity is the source of market segmentation between banks and shadow banks, then we should observe similar segmentation between well-capitalized and poorly capitalized banks.