While changes to the conforming loan limit mechanically have a large impact on conforming loan volumes, interestingly the impact on loan retention is less direct. Decreasing the conforming loan limit by 25% raises the share of loans financed on balance sheet by 12 percentage points. This increase is driven largely by increased jumbo lending as a share of overall lending, which increases by 12 percentage points. Increasing the conforming loan limit has a muted effect on the share of balance sheet financing, which declines from 36% to 31%. While a substantially greater share of mortgage originations is conforming, banks continue to retain a significant share of these originations on balance sheet rather than selling them. They replace jumbo on-balance-sheet lending with conforming on-balance-sheet lending. That is, banks' response along the balance sheet retention margin is small even though their ability to sell loans increases. Increasing conforming loan limits does impact the distribution of profits between banks and shadow banks, with banks' profits decreasing and those of shadow banks' increasing as the latter now originate and distribute to a larger segment of the market where banks once dominated.

There is an interesting difference between the effects of lowering conforming loan limit (Table 11 and Figure 12) versus increasing capital requirements (Table 9 and Figure 10) on aggregate lending volumes. Both polices decrease aggregate lending volumes. However, in the case of increased capital requirements, both shadow bank migration and changes to bank balance sheet retention *alleviate* the adverse effect of policy on the aggregate lending volume. In other words, in the case of tighter capital requirements, solely focusing on bank balance sheet data would overstate the adverse effect of such policy on overall lending volume. On the other hand, in the case of lowering the conforming loan limit, the shadow banking sector *amplifies* the adverse impact on aggregate lending volume as this policy also causes a contraction of shadow bank lending.[22]

To summarize, the conforming loan limit has significant effects not only on overall lending volumes and lender market shares, but especially on the distribution of welfare and profits in the mortgage market. Extending conforming loan limits beyond their current level increases consumer surplus, but these gains are primarily felt in the highest-income areas, as is the impact of the current policy of having higher limits in high-cost MSAs. The consequences of this policy for the distribution of mortgage risk in the economy are relatively limited, with banks retaining substantial amounts of mortgages on their balance sheets.

V.D Summary from Counterfactuals.

Large Effect of Shadow Bank Migration Margin and the Balance Sheet Retention Margin

One overarching insight from the counterfactuals is that both adjustments on the shadow bank migration margin and the balance sheet retention margin are critical to understanding policy consequences. For example, we show that the tradeoff between bank stability and lending is much less severe than anticipated by models, which focus only on balance sheet lending. Figure 13A illustrates this visually by showing a change in the aggregate mortgage origination volume (in billions

[22] This observation may help explain why lowering the conforming loan limit has a much bigger adverse aggregate effect on lending volume compared to raising capital requirements: an almost $200 billion reduction due to a decline of conforming loan limit by 25% compared to about a $16 billion reduction in aggregate lending volume due to increasing capital ratios by 25% (from 6% to 7.5%).