We again study originations around the conforming loan limit. We define a bank to be well capitalized if its capital ratio is in the top 25% of bank capital ratios in the given year. Figure 4C plots the well-capitalized banks' share of overall bank lending by conforming loan limit percentile. Well-capitalized banks' market share jumps discontinuously by about 10 pp at the cutoff, suggesting that these banks possess a comparative advantage in jumbo mortgage lending. We formally test for the discontinuity in Table 3. First, within the sample of banks loans, the fraction of loans retained on the balance sheet significantly jumps above the conforming loan limit (Table 3A). Second, the fraction of loans originated by the well-capitalized banks substantially increases at the conforming loan limit (Table 3B). These results suggest that the balance sheet capacity of well-capitalized banks gives them a comparative advantage in the jumbo sector relative to both shadow banks and poorly capitalized traditional banks, leading to market segmentation.

Balance Sheet Retention Margin

In the aggregate data we document that banks' business models adjust to shocks in balance sheet capacity. They shift away from originating balance-sheet intensive loans (jumbo), and towards loans they can sell (conforming) when their capitalization declines. Here, we provide microevidence of the balance sheet retention margin.

Figure 5A shows a simple scatter plot of banks' shares of loans retained on the balance sheet as a function of their capital ratios. The plot illustrates a strong positive relationship between bank capitalization and the share of loans they choose to retain versus sell. Figure 5B shows that this is the case within banks as well. Banks that experience a decrease in balance sheet capacity are more likely to sell loans, rather than retain them on the balance sheet. In other words, banks change their business models with changes to their balance sheet capacity. As banks' balance sheet capacity declines, they shift towards the originate-to-distribute model and then move back towards portfolio lending as their balance sheet capacity improves.

We more formally investigate whether traditional banks are more likely to retain a larger share of originated mortgages on their balance sheet if they are better capitalized using the following specification:

$$Retain_{bt} = \beta CR_{bt} + \gamma_t + \gamma_b + X'_{bt}\Gamma + \epsilon_{bt} \qquad (2)$$

Where $Retain_{bt}$ is the percentage of loans retained on the balance sheet by bank b in year t; CR_{bt} is a bank's capital ratio; γ_b are bank fixed effects, controlling for differences in banks' propensities towards portfolio lending, as well other time invariant differences in business models; γ_t are time fixed effects, which absorb any aggregate changes that would affect the business model of banks, including aggregate demand or supply fluctuations that would affect the propensity to retain loans on the balance sheet; X_{bt} contains bank controls, including log number of originations, log bank assets, deposits to liabilities, log of the average loan size and applicant income of the bank's originations,