

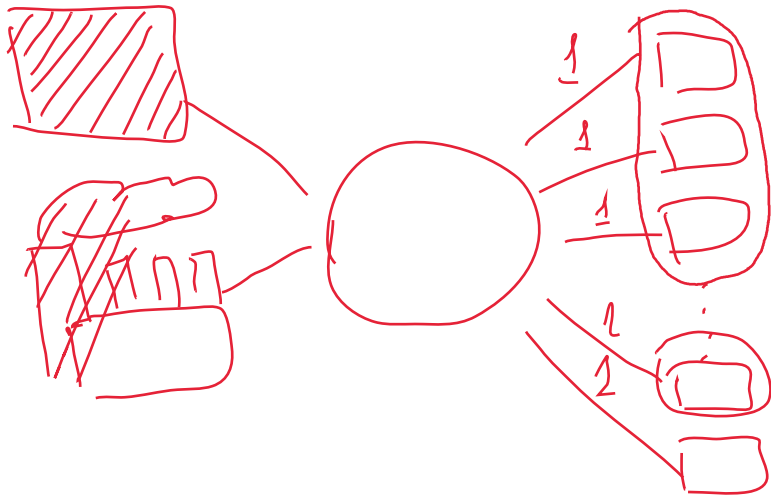
Bank Debt versus Mutual Fund Equity in Liquidity Provision

Yiming Ma, Kairong Xiao and Yao Zeng

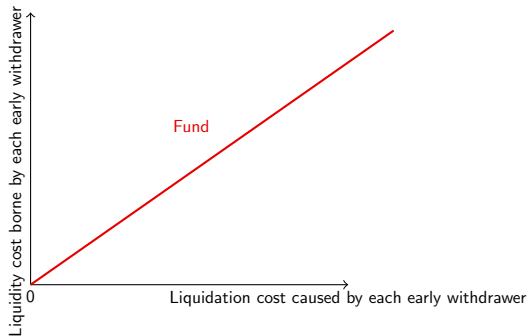
Discussion by Chaojun Wang
The Wharton School, University of Pennsylvania

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Liquidity Provision by Banks/Mutual Funds

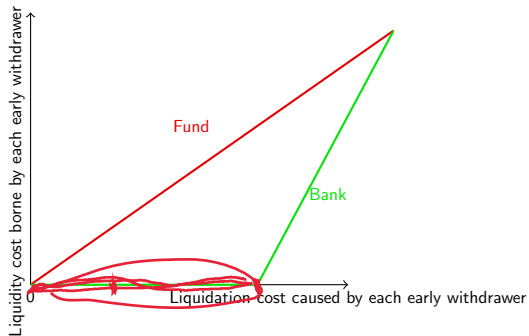


Distinction between a bank and a fund



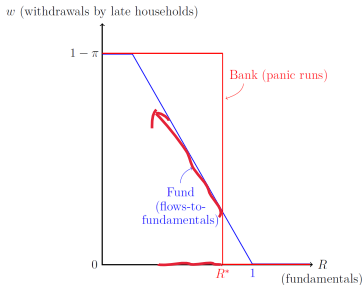
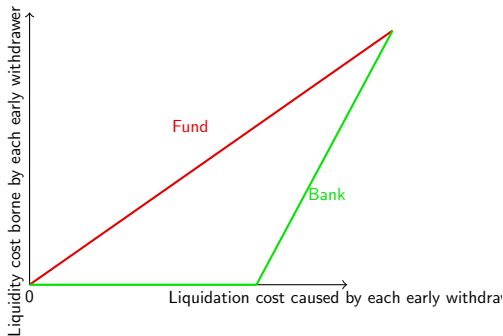
Distinction between a bank and a fund

Banks: early withdrawers bear much less cost of early liquidation



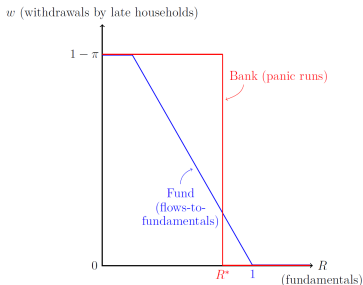
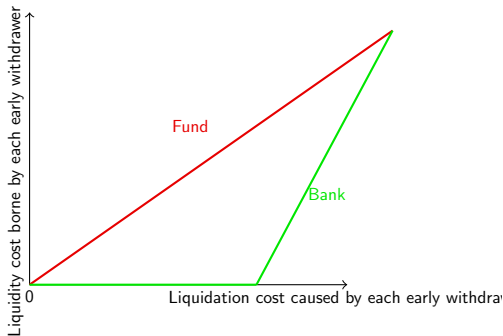
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Liquidity Provision Index

$$= E(\text{amount obtained through } \underline{\text{early withdrawal/redemption}}) - \text{Liquidation Value}$$

- ▶ Sources of frictions
- ▶ Equity/debt: Determinant of liquidity provision?
- ▶ Liquidity Provision Index: fully captures the essence of bank/fund function?

Sources of Frictions

- ▶ Bank: early withdrawers impose externality on late withdrawers
- ▶ Fund: early withdrawers swallow liquidation cost
- ▶ What is the source of friction with the fund?
- ▶ “Volatile flow-to-fundamental relationship”

Equity/debt: Determinant of Liquidity Provision?

Other distinctions between banks and mutual funds:

- ▶ Regulatory difference: banks better capitalized than funds
- ▶ Privileged access to Interbank markets
- ▶ Broader access to financial assets

LPI: Fully Captures the Essence of Bank/Fund Function?

- ▶ LPI doesn't include the utility of late withdrawers
- ▶ Banks: LPI doesn't account for liquidation cost imposed by early withdrawers on late withdrawers
- ▶ Role of financial intermediary: invest in long-term assets while preserving the ability to meet short-term liquidity demand
- ▶ Banks/funds maximize total utility of both early and late withdrawers