

Discussion: Optimal Regulation of Credit Lines by J.E. Gutierrez

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¹Views are those of the author.

Setting

- 3 types of agents, firms, banks and investors, and 3 periods (0, 1, 2)
- Firms have profitable projects, which can require liquidity injections at $t = 1$
- Liquidity shocks depending on an aggregate state
- Without injection projects liquidated at value $Q(z)$, z number of firms liquidating
- \Rightarrow pecuniary externality
- Firms can try to avoid liquidations by setting credit lines with banks

Setting and Results

- Banks use pre-arranged junior funding ("equity", more expensive) as well as ex post funding
- Without sufficient liquidity a bank has to terminate the credit line ("liquidity risk")
- Junior pre-arranged funding lowers liquidity risk since it can be diluted
- More junior funding then leads to less terminations and project liquidations
- Laissez-faire equilibrium features too little junior funding
- Constrained efficiency attained e.g. by a minimal level of pre-arranged funding
- Akin to the Basel LCR ratio

Evaluation

- Interesting and well-executed paper!
- Some comments on how to improve policy relevance and clarify assumptions

Comment 1: Improve Policy Relevance

- Paper reads more like providing explanations for current policies
- Are there some new policy implications?
- The comparative statics exercise is interesting but underdeveloped
- Can you map the discussion here to some more concrete policy suggestions
- Also could explain more carefully why a minimal level on junior funding is akin to Basel LCR ratio
- Equivalence of different policies interesting but is it realistic?

Comment 2: Better Explain Some Assumptions

- A minimal level of such funding is not directly about regulating credit lines
- Also a Basel type LCR ratio could have resulted from other models as well
- Clarify the importance of credit lines
- Could also discuss the assumption of extra return on pre-arranged funding