

DISSERTATION PROPOSAL

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“Essays on Financial Intermediation: Public Line-of-credit, Bank Runs, Incentives and Disclosure”

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The discount window at the Federal Reserve helps to relieve liquidity constraints for banks by providing a reliable backup source of funding. In the first chapter, I study how the disclosure of discount window borrowings affects moral hazard problems faced by the banker and whether the release of this information could trigger bank runs. I propose a model in which banks suffer adverse shocks that require cash infusion in order to continue and assets are subject to moral hazard. The bank is financed by depositors who can withdraw at any time, introducing a collective action problem. I provide conditions that characterize whether disclosure or confidentiality of discount window borrowing is better if the policymaker maximizes the NPV of bank projects. The main result suggests that the benefits of disclosure outweigh the costs when moral hazard is serious relative to the size of the liquidity shock, because disclosure allows a contract that induces the banker to exert effort. The benefits of secrecy outweigh the costs when moral hazard is small relative to the liquidity shock, because a costly run is avoided.

In the second chapter, I study the interaction between incentive provision and inefficient rollover freezes for a bank financed with short-term debt. I propose a dynamic model where rollover freezes occur because of an intertemporal coordination problem and management has discretion over the riskiness of assets. The manager optimally chooses the project riskiness, which is a decreasing function of the rollover threshold. As is He and Xiong (2012), the rollover threshold is an increasing function of volatility. I characterize how changes in the fundamental's drift, debt maturity and liquidation costs change the equilibrium outcome of project riskiness and occurrence of runs, which in turn affects the value of the bank.

In the third chapter, I extend the incentive provision and inefficient rollover freezes analysis of the second chapter to an environment where information is released to creditors with a lag. I explicitly model the lag in disclosure for debtholders. Under a shorter lag, the equilibrium has runs that serve as a disciplining mechanism for management. However, runs are inefficient because of liquidation costs. As opacity increases with a longer lag, runs occur less frequently but moral hazard problems exacerbate, reducing the value of the bank. I provide conditions under which an interior lag maximizes the value of the bank.