Liquidity support and distress resilience in bank-affiliated mutual funds
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The story
- Open-ended mutual funds issue shares redeemable daily at their net asset value, backed by a portfolio of potentially illiquid assets ⇒ Large redemptions impose a cost on remaining investors ⇒ In a crisis, fund investors have the incentive to withdraw faster than the others ("run" the fund) ⇒ Mutual funds are particularly vulnerable to financial distress
- Bank-affiliated funds may be more resilient because banks may serve as an "investor of last resort" for funds which are seeing excessive outflows. Recent examples (US):

The story

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Empirical analysis and results
Do European banks support distressed affiliated funds by purchasing fund shares?

- Bank trade$_{ijt}$ = β$_{ij0}$ + Affiliated$_{ijt}$ + Fund controls$_{jt}$ -1 + γ$_{jt}$

Note: the plotted lines represent the function E(Bank trade | Fund flows, Outflow = 1) - E(Bank trade | Fund flows, Outflow = 0) for affiliated and unaffiliated funds.

Are bank-affiliated funds more resilient to distress? Does the presence of a parent bank change fund investors’ behavior after shocks?

- Compare bank-affiliated and unaffiliated funds, while controlling for investment style and other fund attributes.

Main takeaways
- European banks provide liquidity support to their affiliated mutual funds. As a consequence, bank-affiliated funds are less vulnerable to large redemptions and are better able to weather temporary financial distress. Our results are stronger for funds affiliated to financially solid banks (high capital and/or low CDS spread).
- By redistributing risks across business entities, bank holding companies mitigate fund runs and subsequent fire sales in a crisis, with potential wider benefits to financial stability.
- However, further results show that negative shocks at a parent bank spill over to its affiliated funds: interconnections facilitate financial contagion and the propagation of shocks across sectors.

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Note: This sample covers 97% of the EU mutual funds by assets reported by Lipper for Investment Management.

Note: This sample includes the proprietary holdings of mutual fund shares for the 26 largest euro-area banking groups.

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