

"Do non-banks need access to the lender of last resort?
Evidence from fund runs"
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Motivation

- Central banks are concerned that runs on mutual funds could destabilize bond markets.
- This actually happened in March 2020 (Covid-19 crisis) .
- The Fed reacted by creating new facilities, providing LLR services to non-banks (funds).
- The ECB decided instead to use traditional tools: increasing the volume of Long-Term Refinancing Operations (Bridge LTROs) and expanding large-scale asset purchase programs (PEPP).
- Idea: the banks that receive liquidity assistance from the central bank would rechannel this liquidity to funds ("trickle-down theory").
- The main objective of the paper is to test this assumption.

What the paper does

- Studies the liquidity crisis of March 2020 and reactions by the ECB.
- There was a massive outflow from bond mutual funds, threatening the proper functioning of bond markets.
- The ECB reacted in two ways:
 - 1 expanding its asset purchases programs (APP and PEEP)
 - 2 providing additional liquidity assistance to banks (Bridge LTROs).

Main Results

- Funds with higher fractions of securities eligible to PEEP had higher returns and lower outflows.
- Banks that borrowed in LTROS passed on this liquidity to funds.
- Shows that the ECB managed to support indirectly the funds that were hit by runs, simply by providing additional liquidity to banks, so that banks could "recycle" this liquidity to funds.
- Suggests that there is no need to make LOLR accessible to NBFIs.
- My comments will focus on the justifications and modalities of LOLR interventions in the 21st century.

The original LOLR doctrine: Bagehot (1873)

- Based on the observation that illiquidity problems (e.g., runs) can force solvent banks into bankruptcy, imposing a stress on the financial system.
- This stress can be avoided if the central bank is ready to provide emergency liquidity assistance, based on Bagehot's "doctrine":
 - 1 adequate collateralization (to protect the central bank from credit risk)
 - 2 high interest rate (last resort) to limit moral hazard.
 - 3 potentially unlimited intervention (to reassure investors)
- Many central banks have adopted this doctrine, but also twisted it to sometimes bail out insolvent banks, increasing moral hazard.

"Enhanced" LOLR

- Moreover, since the GFC (2007-2009) central banks have widened their interventions:
 - 1 Wider sets of eligible collateral for lending to banks.
 - 2 Outright asset purchases, including private paper.
 - 3 The Fed has even created ad-hoc facilities for providing liquidity assistance to NBFIs.
- Three objectives:
 - 1 ensure financial stability
 - 2 safeguard monetary policy transmission
 - 3 support credit to the real economy

An important distinction that the paper could discuss

Central banks interventions on financial markets can be classified into two distinct categories:

- Ad hoc interventions after specific events such as a run on mutual funds or a market freeze (TARP in the US)
- Or recurrent interventions motivated by enhancing monetary policy transmission.

Conclusion

- This is an important paper, showing that central bank liquidity can "trickle down" to funds that suffer from outflows during crises.
- No need for the ECB to create special facilities to support illiquid NBFIs, as the Fed did, further complicating the US regulatory landscape.
- However, it is important to clarify the justifications for the tendency of central banks to intervene more and more in financial markets.
- Are these ad hoc interventions only motivated by financial stability considerations but that could increase moral hazard?
- Or are they permanent interventions, aimed at improving the effectiveness of monetary policy but that could distort price formation on financial markets?