Combining deposit taking with credit line provision and the risk of concurrent runs by depositors and firms

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[Abstract] Combining deposit taking with credit line provision can afford banks some liquidity savings but it exposes them to a risk of concurrent runs on their assets and liabilities. If a bank’s financial condition deteriorates, depositors will have an incentive to withdraw their funds, and corporations will find it advantageous to accelerate the draw downs on their credit lines. We test this hypothesis of concurrent runs by investigating how US uninsured depositors and corporations with outstanding credit lines reacted over the last two decades to a deterioration in the performance of their bank. We find that during recessions, in particular the recent subprime crisis, banks that suffered larger losses experienced both a run by their uninsured depositors and an increase in the draw downs on the credit lines they had outstanding to corporations. These findings, which are robust to borrower, bank, and credit-line-specific controls as well as bank-fixed effects, show that banks provision of liquidity on demand to depositors and corporations exposes them to a risk of a concurrent run on their liabilities and assets. This finding is important because concurrent runs pose significant liquidity risks to banks.

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