

Liquidity regulation and bank funding costs

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BCBS/CEPR Conference (BIS, May 21-22, 2026)

“Simplifying banking regulation and supervision without sacrificing safety”

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Overview & Main Findings

- **Research Question:** Does liquidity regulation (LCR) lower banks' wholesale funding costs?
- **Data & Method:** Granular instrument-level data on bank borrowing from Money Market Funds (Feb 2011–Dec 2015); exploits pre-determined variation in banks' LCR exposure
- **Key Results:**
 - Banks with larger LCR gaps saw 8% decline in wholesale funding rates (≈ 2.5 bps)
 - Effect twice as large for 31+ day vs. 1-day maturity instruments
 - Banks shifted toward longer-term borrowing and increased total MMF borrowing

An Important Paper on a Timely Topic

- **Liquidity regulation is at a critical juncture**

- Fed actively reconsidering design of LCR framework (Bowman, March 2026)
- Moving beyond compliance to question whether framework delivers actual resilience

- **Core issues driving reform discussions**

- Does framework work as intended?
- Liquidity hoarding problem
- Banks' pro-cyclical behavior
- Discount window stigma and fragmentation
- Fed balance sheet implications

- **This paper is relevant**

- provides causal evidence on how LCR affects wholesale funding markets
- Directly relevant to understanding costs/benefits of current framework

Comment 1: The Linear LCR Gap and Negative Treatments

- **Treatment construction (Section 2.2):**
 - $\text{LCR gap} = \text{Required LCR} - \text{Pre-regulation LCR}$ (applied linearly)
 - **Table 1a: Median gap = -0.03, minimum = -3.36**
 - Substantial variation from banks **already well above** compliance threshold
- **The issue:** Linear specification mixes responses of:
 - Genuinely constrained banks ($\text{gap} \approx 0$)
 - Over-compliant, high-liquidity banks ($\text{gap} \ll 0$)
- **Key question:** Is the effect concentrated among binding banks, or driven by “negative treatment” dynamics among institutions far above compliance?
- Table 7 provides capped gap specifications, but baseline leaves this question open

Comment 2: Policy Interpretations of Quantity Estimates

- **Recall the LCR formula:**

$$\text{LCR} = \frac{\text{Stock of HQLA}}{\text{Total net cash outflows over 30 days}} \geq 100\%$$

- **Paper's claim (Section 4.3):** Lower prices + higher quantities → “supply-side shift”
- **The challenge:** High-gap banks have **mechanical incentive** to demand >30-day funding
 - Longer-maturity borrowing (31+ days) **reduces the denominator** → increases LCR
 - Helps meet regulatory requirement without increasing HQLA
 - Aggregate borrowing can obscure reductions in penalized short-term funding
- **What's needed for policy conclusions:**
 - Decompose by maturity buckets (1-day — 2-30 — 31+) to separate mechanical from behavioral response
 - **Dollar calibration:** 2.5 bps savings on what volume? Compare to HQLA carry costs

Comment 3: Entity Alignment & Trapped Liquidity

- **The measurement mismatch:**
 - **Pricing:** Individual instrument level (CD, CP, repo) matched to RSSD IDs
 - **Treatment:** Consolidated BHC level (Call Report HQLA + net outflows)
- **The trapped liquidity issue:**
 - Liquidity at **subsidiary IDI** $\neq$ necessarily available to **holding company**
 - Legal and regulatory barriers to intra-organization transfers
 - Example: Subsidiary issues cheaper CP, but parent faces binding LCR constraint
- **Implication:** If liquidity is trapped, instrument-level pricing may not capture consolidated regulatory constraint—matters for interpreting magnitude and mechanism

Minor Comment: Table 11 Dependent Variable

- **Current interpretation:** “Banks...also **increased their overall borrowing** from MMFs”
- **What Table 11 estimates:** Dependent variable is **log difference** in borrowing (month t vs. $t - 1$)
 - Identifies: Higher post-treatment **borrowing growth**
 - Not: Higher borrowing **levels** directly
- **Fix:** Clarify link from growth rates to level quantities, or reframe around differential growth

- **This is an important paper on a crucial policy question**
 - Important evidence on LCR's effect on wholesale funding markets
 - Highly relevant for ongoing efforts to improve liquidity regulations
- **Three areas for strengthening:**
 - ① Treatment heterogeneity: Separate binding from non-binding banks
 - ② Quantity decomposition: Maturity buckets + dollar calibration
 - ③ Entity alignment: Address trapped liquidity concern
- Good luck to authors!