Atelier
« Mesure et contrôle du risque systémique »
26 au 28 septembre 2017

Workshop
"Measurement and Control of Systemic Risk"
September 26-28, 2017

Fire-Sale Spillovers Beyond Banks

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Since the financial crisis of 2008–9, there has been a shift of financial intermediation away from traditional banks towards non-bank institutions, in particular fixed-income mutual funds. The concurrent shift towards less liquid fund assets raises the prospect of run risk and financial stability concerns originating from mutual funds. We study the vulnerability of mutual funds to fire-sale spillovers by adapting the framework developed by Greenwood, Landier, and Thesmar (2015) for banks and implemented by Duarte and Eisenbach (2015) for banks and broker-dealers. We find that vulnerability of mutual funds to fire-sale spillovers has increased significantly since the early 2000s, both in absolute terms as well as relative to the vulnerability to initial losses. We find that three important factors are driving this increase: (1) The growth of mutual funds relative to the overall financial sector, (2) changing sensitivity of investor flows to fund returns, and (3) increasing cross-sectional correlation between fund size, asset illiquidity and investor sensitivity.

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