Review: costly state verification

- Developed by Townsend (1979), used in Diamond (1984), Bernanke-Gertler-Gilchrist (1999)
- Time 0: principal provides funding I to agent
- Time 1: agent's profit $y \sim F[0, y^*]$ is his private information but principal can verify y at cost
- Optimal contract (with deterministic verification) is debt with face value d: agent reports y truthfully and pays d if $y \geq d$, triggers default and pays y if $y < d$
- In our context: intermediary can cause losses (reduce v_t for private benefit); debtholders verify if v_t falls below d_t