Discussion by C Koch (BIS):

Diana Bonfim and Joao Santos:
“*The importance of deposit insurance credibility*”

2019 Biennial IADI Research Conference, May 23 2019

*The views expressed in this presentation are those of the discussant and not necessarily those of the Bank for International Settlements.*
How do depositors respond to changes in the perceived credibility of deposit insurance?

Two events in Portugal
I. Foreign subsidiaries become branches.
II. Announced change in the coverage of the Cypriote deposit insurance scheme.

Findings
I. Foreign branches see a deposit inflow.
II. Depositors withdraw more money from weaker banks (capitalization, profitability).

=> Depositors actively monitor banks.
My Overall Impression

- Very nice paper based on microdata!
- Fresh view on *deposit insurance*
  - stressing *credibility*
  - distinguish *household* (HH) and *corporate* deposits
- Highly policy relevant, inform policy discussions.

But, ...

- Some suggestions on the identification:
  - Other *events* with differential impact on banks? (PT bailout 2011, Draghi speech 2012).
  - You have great *data*, exploit the nuances. (foreign vs domestic banks)
- Some more *detail* would be helpful for the reader (sample, event...).
Events in Portugal and Europe
Timeline of events

Are there more differential effects that could support your identification?

Lehman

“Whatever it takes”

PT bailout

Cyprus

<= Branch conversion? =>
The first event that allows for a direct test of how this mechanism works is the decision of some foreign banks operating in Portugal to transform their subsidiaries into foreign branches during the global financial crisis. This legal change has crucial implications for depositors’ protection: after these changes, deposits were covered by the deposit insurance mechanisms of the home country of these banks, rather than by the Portuguese deposit guarantee scheme. If depositors are worried about the ability of the domestic scheme to cover their deposits amidst a sovereign debt crisis, we would expect to see more deposits flowing into these banks (and away from domestic banks in more acute distress, i.e., where the likelihood of involvement of the deposit guarantee scheme could be higher).

- **Transformation**
  - Who and when? “global financial crisis” or European crisis?
- **What is the *intention* of foreign banks?**
  - Gain market share?
  - Taxation?
Event II: Announced changes in Cyprus 2013

In March 16th \textit{2013,} the IMF and European authorities agreed on a bailout package for Cyprus, after a request for financial assistance. One of the conditions defined in the bailout package implied \textbf{losses on all bank deposits, including those that were insured by the deposit guarantee scheme} (Brown et al, 2016). More precisely, \textbf{deposits above 100,000€ would have a haircut of 9.9\%,} while \textbf{deposits below that threshold, which were in theory fully insured, would face a loss of 6.7\%.} This announcement directly affected the credibility of deposit insurance, not only in Cyprus, but also in other European countries under distress. Given the dramatic shock waves that this announcement created throughout Europe, the \textbf{decision was reversed on March 25th.} We test whether depositors in Portugal reacted to these events in Cyprus by moving their deposits out of weaker banks.

- Decision was reversed
  - March 16 and March 25
  - Monthly data $\Rightarrow$ net effect

$\Rightarrow$ \textbf{Consolidated data used for branches? ("less profitable, smaller banks")]
Can you exploit more differential effects as sources of identification?
- Among domestic banks?
- Among foreign parent banks?
The PT banking sector

Your Dataset

- March 2007-Dec 2013
- **44 banks** with 19 foreign branches/subsidiaries

European Banking Federation

As of 2011, the Portuguese banking system consists of **155 credit institutions**, of which
- 59 banks, 91 mutual agricultural credit banks and 5 savings banks.

As of 2017,
- 8 subsidiaries from (ES, FR)
- 25 branches (BR, CH, ES, FR, DE, UK, IE, NL)
  - => **8 different bank nationalities**.

=> Could you use more information (foreign vs domestic, mutual vs commercial...)?
=> Exploit the differential effect: crisis-hit vs non crisis-hit parents?

Source: European Banking Federation, 2012, 2018
Among domestic banks, there are differences...

In Portugal two deposit guarantee schemes are operating,
- one relative to **Cooperative** Banks included in the Mutual Agriculture Integrated System (PT2, Fundo de Garantia do Credito Agricola Mutuo);
- the second covering **other institutions** (PT1, Deposit Guarantee Fund).

“Economic Adjustment Programme”
- during the first semester of 2012 **two banks** issued € 4.500 million in hybrid instruments which were fully subscribed by the Portuguese State.
- The **stricter capital requirements** imposed on to Portuguese banks by Banco de Portugal include fulfilling a core Tier 1 ratio of 9% and 10% by the end of 2011 and 2012, respectively.
- Additionally, the **eight largest banking groups** ..... were also required to **reduce their Loan-to-Direct Deposit Ratio** to 120% by 2014.

=> Can you exploit these differences?

Source: European Banking Federation, 2012, European Commission, 2014
Among domestic banks, there are differences...

The downgrades of the Portuguese Republic ratings negatively affected the ratings of Portuguese banks.

**Evolution of the Portuguese Republic and Portuguese banks’ ratings by Moody’s, S&P and Fitch**

<table>
<thead>
<tr>
<th>Moody’s / S&amp;P / Fitch</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
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<th>2012</th>
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Source: Bloomberg
Among domestic banks, there are differences...

Restrictions of access to interbank financial markets led to an increase of Portuguese banks’ dependency on ECB.

<table>
<thead>
<tr>
<th>Date</th>
<th>M€</th>
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<tbody>
<tr>
<td>Dec. 08</td>
<td>10,210 M€</td>
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<td>Dec. 09</td>
<td>16,061 M€</td>
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<td>Dec. 10</td>
<td>40,899 M€</td>
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<td>May 11</td>
<td>47,204 M€</td>
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<td>Jun. 12</td>
<td>60,502 M€</td>
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<td>Mar. 14</td>
<td>45,047 M€</td>
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*Inventory management*
Exploit differences among foreign banks?

**Leverage** (2011) in home countries of foreign banks – better?

Source: [European Banking Federation, 2012](#)
Exploit differences among foreign banks?

*Profitability* (2011) in home countries of foreign banks – better?

Source: [European Banking Federation, 2012](http://example.com)
How to respond as a depositor?
How to respond as a depositor?

Portugal asked for financial assistance in 2011.

Change banks
  - Domestic
  - Foreign branches and subsidiaries

Options as a depositor
  - Move money outside of the country (Fig 1, explored)
  - Cash holdings?
  - Other safe investments, eg
    - Fx deposits (only possible with some banks)

=> Why not considering re-allocation effects?

*Depositors have more options....*
Deposits in PT: Depositors have options

During 2011, the growth in deposits from households coincided with the decrease of their ownership of units issued by investment funds.

Whereas bank deposits are stabilized since end-2012, Treasury savings certificates have gained popularity more recently in detriment of units issued by investment funds.

This trend exposes a substitution effect between investment and savings products with different risk profiles, revealing a larger preference for less risky assets after the financial crisis.
Minor Comments

Looking at logY or $\Delta \log Y$ (inconsistency between equations and tables) for the branch transformation.

HH versus corporate deposits

- **Micro firms** behave more like HH (split the sample)
- Larger SMEs, their cash management? (larger, more complex firms chose more sophisticated banks?)

Cyprus event

Table 5: ... includes *month fixed* effects? (should absorb *Cyprus dummy*?)

\[
y_{it} = \alpha_0 + \alpha_t + \beta_1 \text{Cyprus}_t + \delta \text{type}_t + \gamma X_{it-1} \\
\text{where } \text{Cyprus} \text{ is a binary variable that takes the value one in March and April 2013}
\]
Conclusions

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Thank you
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