Private Deposit Insurance, Deposit Flows and Bank Lending

Professor Andrew Campbell
School of Law, University of Leeds
According to the authors the paper sets out to do several things.

It raises two specific questions:

First, does a privately-funded and privately-organised deposit insurance fund provide its members better access to deposits during a financial crisis?

Second, does access to private deposit insurance allow banks to increase lending during financial crises?
It concentrates on the Depositors Insurance Fund of the US State of Massachusetts which is a private fund providing protection to those depositors who have balances in excess of the cover provided by the FDIC.

Starting point – depositors seek a safe haven for their wealth during crises.

This is what would be expected.
First question

It’s not clear why this would be the case and the paper doesn’t fully address this

As the DIF only covers deposits above $250,000 savers with less than that would not receive any benefit from it

Why would depositors with less than $250,000 even care about the protection provided by the DIF?

What is the level of deposits in Massachusetts in excess of $250,000
Second question

The paper considers whether there was an increase in deposits in DIF insured banks which was not replicated in non DIF insured banks

Will consider this question shortly
Level of public awareness?

Do depositors with less than the FDIC insured limit need to have any awareness of the DIF? Why should it matter to them?

Despite the claim by the authors that the article provides evidence for public awareness this is not actually the case.

A Wall Street Journal Article is cited.

What level of awareness is there of the FDIC insured limit?
Comparison between the DIF and the FDIC

‘Deposit insurance in the US has experienced turbulent times’ – this is true pre 1933 but since the creation of the FDIC under the Banking Act 1933 this can hardly be said to be the case

The FDIC is trusted by depositors in the US – many studies have demonstrated this over the years
‘We define a successful deposit insurance fund as one which completely protects the payment system without motivating risk-taking of banks, while failure is defined as a situation where a deposit insurance fund fails to protect the payment system or collapses due to design flaws.’

In most countries the deposit insurer is simply a paybox and is not capable of protecting the payment system

The member banks of the DIF are all savings banks so the relationship of the DIF and protecting the payments system is not clear
The FDIC is also a regulator and insolvency receiver and is only one part of the financial sector safety net.

The mandate of the FDIC is broader than for any other deposit insurer.

The DIF is quite different and has a much more limited role to play – has a narrow mandate.
The paper restricts itself primarily to Massachusetts so are the findings of the research too limited to actually demonstrate that having top-up private insurance affects the behaviour of depositors to any meaningful extent?

Further research would be helpful.

The authors look at several studies which highlight that investors allocate their wealth to banks during crises because of government-supported deposit guarantees.

So does the DIF top-up serve as a complement to government guarantees during a financial crisis?
Deposits and lending during the crisis

‘As privately insured banks expect fewer withdrawals during crises, they have greater incentives to transform liquid deposits into illiquid loans, such as loans with longer maturities.’

So what were the findings?

Shows a 7.6% increase in deposits of DIF member banks during the crisis but was this as a result of membership of the DIF?
Lending – the authors state that they find that DIF member banks increased total loans by 6.4% relative to non-DIF banks.

Was this because of the increased deposits and, if so, was this because of membership of the DIF?

Were they longer maturity loans?

This is something which could be developed further.
Only a small number of depositors need cover from the DIF, most do not

So do the others care about the private cover?

Are the many subsidising the few?

The poor are providing a subsidy to the wealthy?

Most US savers, on the basis of my own research and the research of others, have a high level of awareness of the FDIC and also a very high level of trust in that body

So only the relatively wealthy receive protection from the private scheme
- It would not be a surprise to find that those with savings in excess of the FDIC limits have a high level of awareness of the DIF cover

- An advantage for savers in DIF member banks is that they do not need to spread their savings around different banks to ensure that they are taking advantage of 100% protection

- The DIF does not appear to offer anything to those whose savings are under the FDIC limit

- So did the increase in deposits come from a number of very large deposits from wealthy savers?
Final point - what about moral hazard?

Always something which is raised by economists when the subject of unlimited cover is discussed

How is moral hazard being minimised here?

The authors raise a number of interesting issues and should be encouraged to do further research into this topic
THANK YOU
FOR YOUR ATTENTION

Professor Andrew Campbell
School of Law, University of Leeds