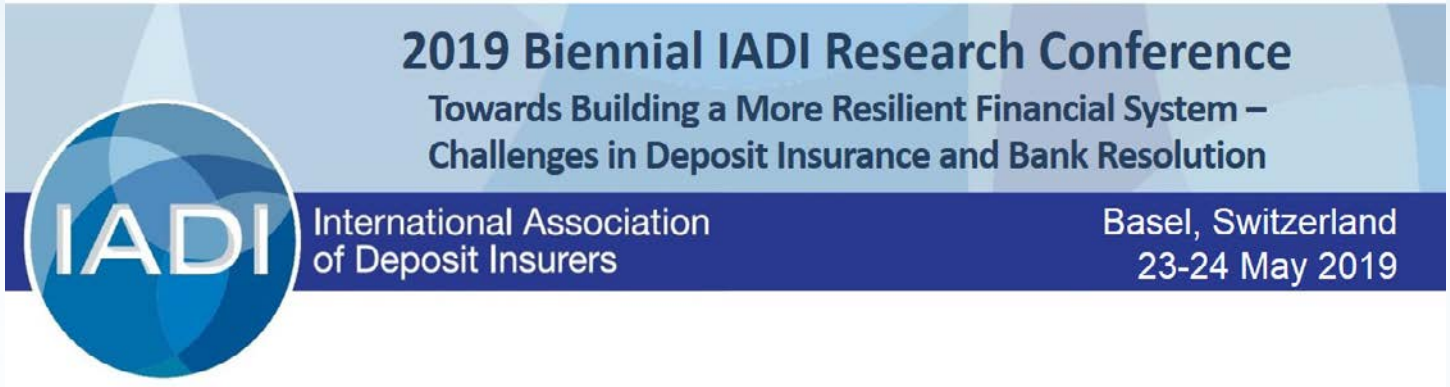

Private Deposit Insurance, Deposit Flows and Bank Lending

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- 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 Massachussetts 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

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