Is there market discipline in the Swiss banking sector?
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1. Introduction
   - The New Capital Accord recognises the role of market discipline by stating that more transparency and disclosure by banks have the potential to reinforce capital regulation and other supervisory efforts to ensure the safety and soundness of the banking system. The increase in the level of disclosure will enhance the influence of market discipline in ensuring a sound banking system. In view of this fact the paper is most appropriate and it might be a good idea for countries to test their banking systems for market discipline.
   - This paper focuses particularly on the extent to which depositors monitor their banks and move their deposits in reaction to weak fundamentals and how changes in bank fundamentals affect individual bank deposits.
   - The paper makes a unique contribution in more than one way.

2. Literature
   - Existing studies are mostly based on US data and very little evidence exists from other countries. In this regard the paper makes a very important contribution and fills a gap in the existing literature.
   - In addition very few, if any existing research papers test for the presence of market discipline using information other than yield spreads. In this regard the paper also makes a unique contribution

3. Protection of depositors in Switzerland

- A comprehensive overview of the three different protection schemes for the deposits held at an insolvent bank is done.
- The reaction of depositors in Switzerland to changes in the Swiss non-official depositor protection scheme is tested.
- Although there is no official deposit insurance system in Switzerland, the protection schemes in place, especially the cantonal guarantee and the priority insurance, creates the impression of an implicit system providing enough protection to especially certain classes of depositors.
- Savings deposits only represent one quarter of all deposits in Switzerland, however, it still remains the most important and widely used type of bank account, and represents the investment instrument of small depositors (table 1).
- The structure of savings deposits (table 2) shows that after the priority insurance ceiling was revised upwards in Switzerland:
    - priority insurance savings increased to 57%
    - no-protection deposits decreased by 9,2%

4. Empirical methodology and model testing

- There are no serious concerns regarding the empirical methodology of the paper.
- The four hypotheses are clearly stated and well-explained.
- The dependent variable of the model represents the depositor's decision to withdraw deposits from a bank in reaction to weak fundamentals. The ratio of uninsured savings deposits to total savings deposits is used as the dependent variable. The obvious choice as dependant variable would be interest rate spreads but no regularly traded debt instruments issued by banks are available in Switzerland. Actually this is a positive for the paper seeing that the smaller banks could then be included in the analysis.
- The independent variable is the depositor's information set on which the decision is based. This represents an indicator of confidence in a bank. The question however remains whether the variables chosen are important and would be monitored by the holders of noninsured saving deposits. Previous research papers were used as an indicator in choosing the variables.

5. The data

- The data set is a panel of 250 Swiss banks. The bank specific data used was Swiss National Bank data.
- One problem with the data set is the existence of a substantial lag in the availability of the data used.

5. Empirical results

- The empirical results are particularly robust, especially for regional banks.
- In general the results indicate that the macroeconomic variables and bank-specific variables account partially for fluctuations in the share of uninsured saving deposits
    - *Firstly* the Swiss banking sector does exhibit a certain degree of market discipline, in the sense that depositors seem to monitor fundamentals of their bank and to respond in accordance with the developments.
    - *Secondly,* uninsured saving deposits are more sensitive to bank fundamentals in regional banks than in cantonal banks.
    - *Thirdly,* only in regional banks do higher insurance depositors hold fewer but larger savings deposits in response to the higher insurance limit.
    - *Fourthly*, none of the variables controlling for the imposition of a CHF 1 billion cap in 1993, are statistically significant for regional or cantonal banks; the cap has not significantly altered the behavior of depositors.

6. General comments

- The existence of market discipline in banking systems is very much a country specific issue. It will to a large extent be influenced by factors unique to the country concerned.
- The following issues may also be taken into account when the presence of market discipline in a banking sector is considered:
    - information on bank fundamentals are not always generally available while depositors are not always informed about changes in these

fundamentals and are generally not sophisticated enough to be informed,

- the level of the interest rate received on a specific deposit might play a role in the decision to move the deposit to another bank,
- informed and sophisticated depositors will exert a stronger market discipline on banks (especially true in developed countries),
- wholesale deposits will be more sensitive to changes in the fundamentals of banks than retail deposits,
- it might be that the effect of rumors of bank fragility could increase the movement of deposits between banks,
- banking is a service industry, therefor good service and historical links to a specific bank might reduce the movement of deposits,
- whether a deposit is taxable or not might also increase or decrease the likelihood of movement of deposits.

- It seems that there are a number of requirements for effective market discipline in banking:
  - a well developed and effective information system,
  - informed and educated investors who are able to evaluate bank fundamentals,
  - bank deposits should represent the main investment instrument of small depositors,
  - no implicit depositor protection perceptions and the absence of moral hazard.

7. Conclusion

- The overall finding of the paper is that in Switzerland the “quality” of a bank influences depositor’s willingness to hold their uninsured saving deposits in a particular bank, thus depositors seem to exert considerable market discipline.
- Depositors are aware of changes in the Swiss depositor protection systems:
  - Depositors at cantonal banks know their savings deposits are protected by a strong state guarantee (their behavior are less sensitive to marginal changes in system);

- Depositors at other banks adjust their holdings of uninsured savings deposits according to developments in bank-specific risk characteristics;
- Neither the cap on liquidity insurance (1993) nor the increase in priority insurance (1997) seems to alter fundamentally the behavior of depositors.