Comments on “Deposit Insurance in Times of Crises: Safe Haven or Regulatory Arbitrage?"

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The views expressed here are those of my own. No responsibility for them should be attributed to the Bank of Canada.

Summary and Main Findings

- Does the presence of deposit insurance play a role in cross-border retail deposit flows?
  - Answer: Yes, especially during times of financial stress
- Are certain deposit insurance scheme characteristics important determinants of such cross-border deposit flows?
  - Answer: Mostly yes, and this suggests depositors taking advantage of regulatory arbitrage opportunities
- Did foreign depositors notice the expanding scope of deposit insurance in some countries and reallocate deposits accordingly?
  - Answer: Yes, and this points to the effectiveness of such efforts

Overall Impressions

- This paper looks at an important and under-studied topic
- Nice and comprehensive data set, which clearly required time and effort to assemble
- The paper has potential to appeal to a few different strands in the literature, but a wider scope and a slightly different focus may be needed
  - Most of my comments will be on this point
- There are a number of financial stability policy implications, which can be more prominent in the paper

Definition and Use of “Regulatory Arbitrage"

- Authors do not discuss why depositing funds within another DI scheme is “regulatory arbitrage"
- Retail deposit flows are different than the cross-border activities studied by Houston, *et al.* (2012) and Ongena, *et al.* (2013)
  - Aren't funds flowing into a “better" DI scheme in the first place?
  - Is there a situation where banks and/or depositors can avoid paying for DI? Does this cause the arbitrage?
  - Are there negative financial stability consequences?
    - Countries syphoning deposits off each other?
    - Inflows of foreign deposits tempting banks to take on more risk?
- Right now, the “regulatory arbitrage" analysis/discussion seems to be more about depositors choosing a preferred scheme

Approaching the Problem from a Depositor Perspective

- The two main hypotheses in the paper can be slightly re-stated:
  1. In countries *without* DI, some depositors may want coverage (i.e. "purchase insurance" or the "safe-haven hypothesis")
  2. In countries *with* DI, some depositors may want *different* coverage (i.e. "change insurance policies")
- These can be very different decisions from a depositor perspective
- The paper clearly establishes the safe-haven hypothesis
  - Many depositor countries seem to have explicit DI as well. Is the effect coming from only a few depositor countries?
  - Is Table 1 necessary? Neither main hypothesis involve "absolute" DI characteristics

Moving Between Two Explicit DI Schemes

- The paper seems to assert that depositors prefer as much deposit insurance as possible.
  - This is not always the case (Shy, *et al.* (2016), Damar, *et al.* (2016))
  - Makes this issue a bit more complicated
- Many different depositor choices. For example:
  - Switch to a lower limit scheme and increase return
  - Switch to a higher limit scheme and maximize coverage
  - Switch to an inferior scheme to get *some* FX deposit coverage
- Complex interactions between depositor preferences, bank failure risk, transaction costs, deposit rates and DI scheme characteristics
  - Conceptually similar to situations where one country has many different DI schemes (i.e. Canada)
  - Likely to matter more during non-crisis times

Moving Between Two DI Schemes: Suggestions

- Disaggregated data would help (probably not available)
- More interaction of DI characteristics, both *within* the bank country DI scheme and *between* bank vs. depositor country DI schemes
  - Deposit rate relative to coverage limit
  - FX deposit coverage
  - Coverage limit relative to moral hazard mitigation
  - Non-linear relationship between banking sector stability and deposit insurance coverage (Shy, *et al.* (2016))
  - Any possibility of capturing transaction and/or switching costs?
- The hypothesis development and results discussion in the paper can also be expanded

Conclusion

- Interesting paper with a very relevant research question
- Careful (and clearly labor-intensive) treatment of the data is worthy of praise
- Potential to contribute to a wider literature, with some adjustments
- Financial stability and regulatory policy implications are numerous. The authors can play these up much more
- Looking forward to seeing the next version!