Discussion: "The Economics of Network-Based Deposit Insurance" by Kim, Kundu, Purnanandam

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Summary of the Paper

How does enhanced deposit insurance access affect depositor behavior, bank risk-taking, and industry dynamics?

Empirical Strategy:

- Measure network participation by banks with positive reciprocal deposit balance
- Cross-sectional comparison of network vs. non-network banks during the 2023 banking crisis (SVB).
- Difference-in-differences using regulatory shock (2018 FDIC exemption) and "switcher" banks

Key Findings center around SVB crisis:

- Provides first causal evidence that reciprocal deposits helped draw in insured deposits
- Finds increase in riskier securities & loan delinquency rate
- Connects deposit insurance to banking market structure: smaller banks gained ground
- Estimates deposit supply elasticity: very large

Contribution to the Literature

- Very nice paper with interesting facts
- Several papers (e.g., Shaffer 2012) discussed stylized facts on reciprocal deposits and their effects on banks

Novel Empirical Setting:

- Leverages a regulatory shock (FDIC 2018 ruling) for causal inference in a modern banking context
- Studies bank behavior and market share holistically in recent US data

Key Insights:

- Expansion of government guarantees helped some banks grow and take on more risk

Discussion

1. Quantitative risk-measaure

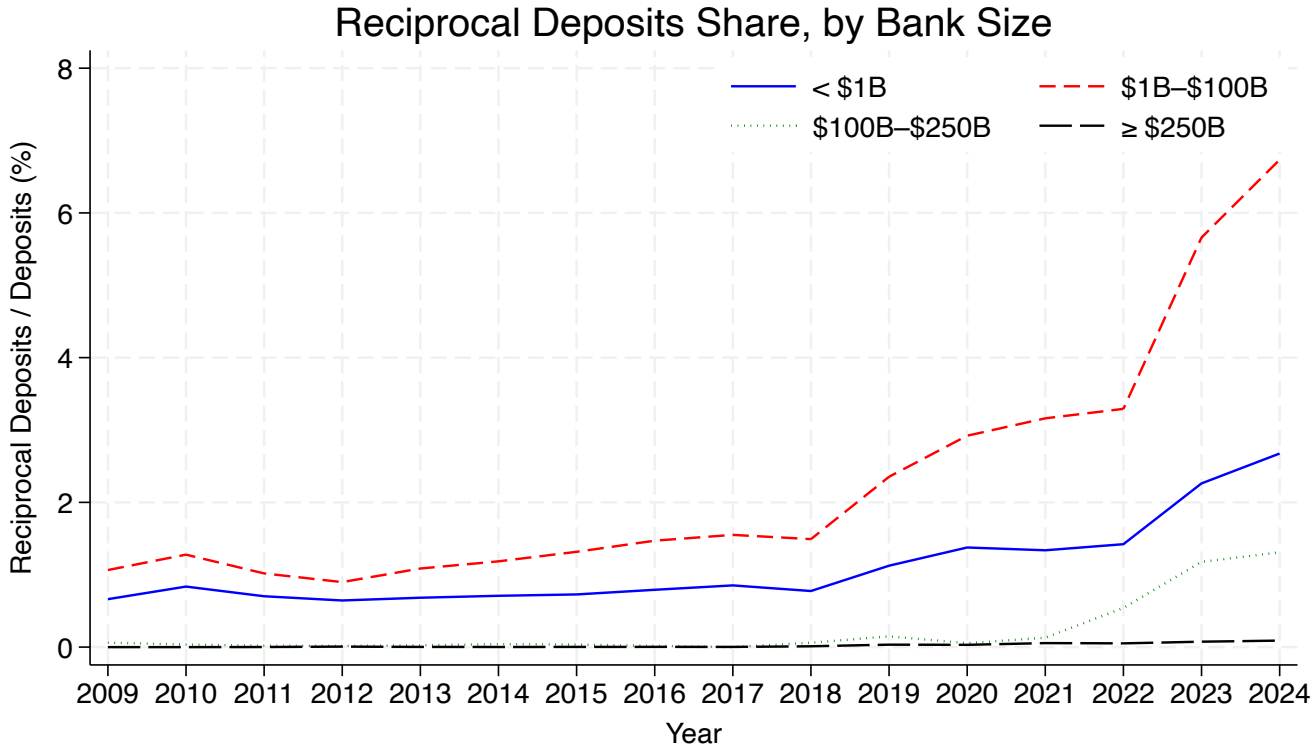
2 What we can learn about financial stability effects?

FDIC 2018 rule changes and "Switcher banks"

- Prior to 2018, reciprocal deposits were considered brokered deposits, which are subject to greater regulatory scrutiny and higher FDIC insurance premiums
- After the 2018 FDIC rule change, these deposits were exempted from being classified as brokered, up to a limit
- This reduced the regulatory cost of using reciprocal deposits, leading to a sharp increase in their usage
- Note: rule also accompanied by others: e.g., raised threshold for being counted as systemic:

  Significantly reduced regulatory scrutiny for banks with \$50–250 billion in assets, reclassifying many as "non-systemic"

Which banks use reciprocal deposits?



- Mid-sized banks are predominant users of reciprocal deposits
- Small banks likely do not have enough uninsured deposits demand
- Very large banks already enjoy government guarantees

What are the quantitative effects on banks' risk-taking

Did switcher banks choose higher *interest rate risk* exposure?

- Interest rate risk: banks' communication to investors enabled by regulatory guidance often confused cash flow risk with interest rate risk (duration risk) (e.g., Begenau-Stafford-2022, DeMarzo-Krishnamurthy-Nagel-2024)
- Security share, average maturity, maturity gap does not capture overall interest rate risk

What are the quantitative effects on banks' risk-taking

Did switcher banks choose higher *interest rate risk* exposure?

- Calculate exposure to interest rate risk for all balance sheet items + derivatives (Begenau-Piazzesi-Schneider-2025)
  - dollar position in 5-year swap as percentage of assets
  - Net balance sheet positions vs derivative positions

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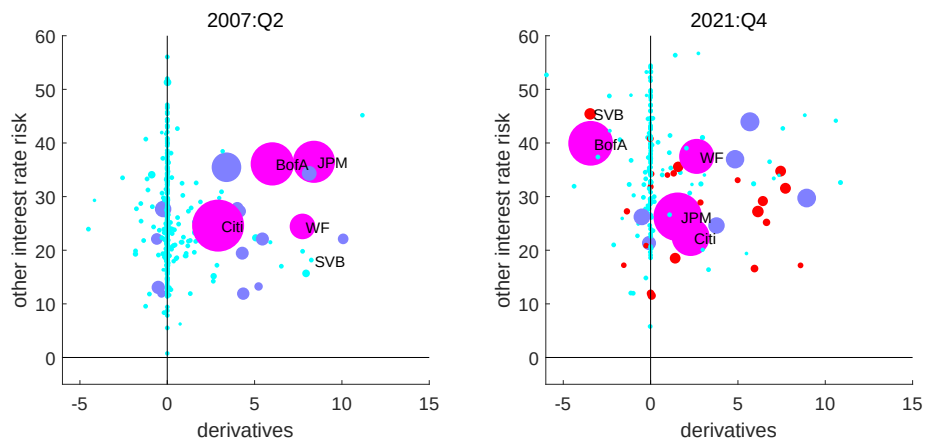
  - dollar position in 5-year swap as percentage of assets
  - Net balance sheet positions vs derivative positions
- Many mid-sized entered interest rate risk deriv mkt after GFC
- Mid-size banks increased interest rate risk exp w/ deriv

Figure 8: Interest-rate risk exposure from derivatives and other business

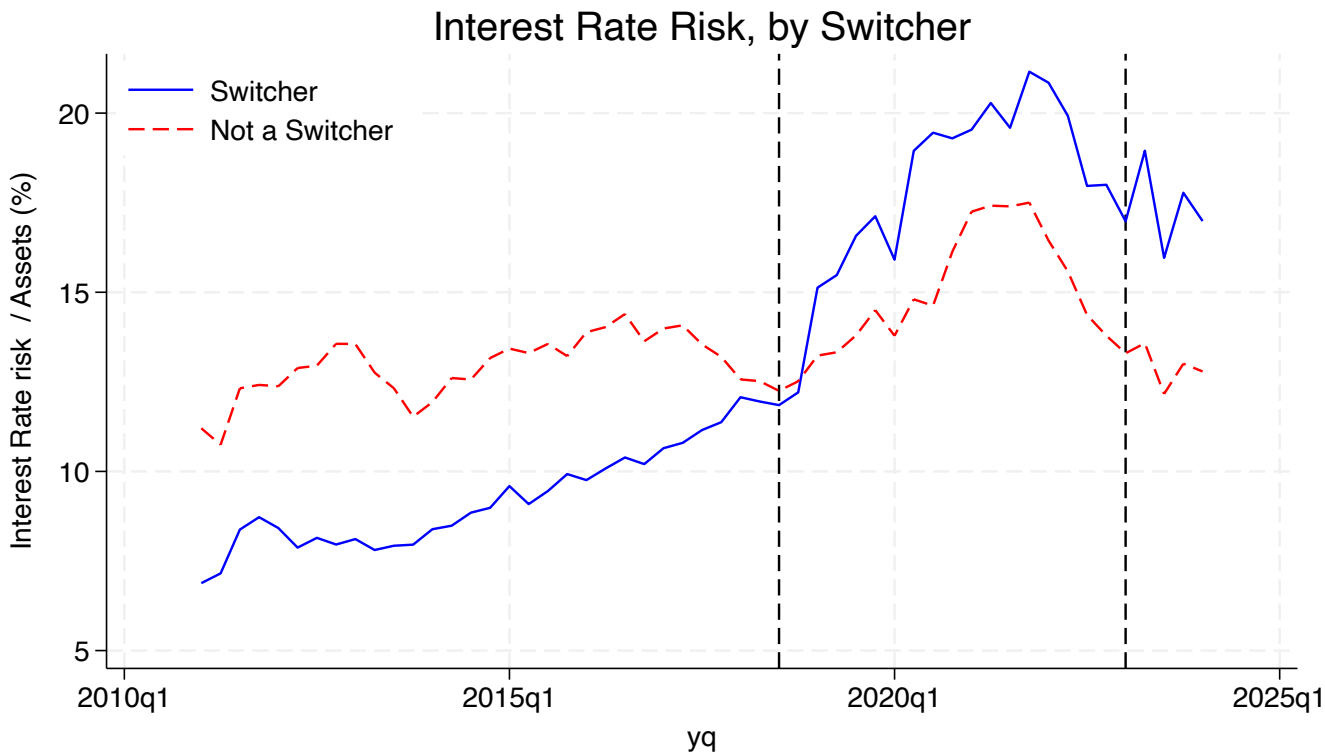


Notes: Scatter plots of interest-rate risk exposures due to interest-rate derivatives (horizontal axis) and other business (vertical axis) in 2007:Q2 (left panel) and 2021:Q4 (right panel) relative total assets. Dot size increases linearly with a bank's share in total bank assets if that share is larger than 20bp. Colors: pink for big 4, purple if assets > \$50bn, light blue for all others; in right panel, red indicates assets between \$50bn and \$250bn.

What are the quantitative effects on banks' risk-taking

Did switcher banks choose higher *interest rate risk* exposure?

- Mid-size banks turned most to reciprocal deposits
- (author definition of switchers: 2015- 2020q3)
- Take-away: indeed more interest rate risk



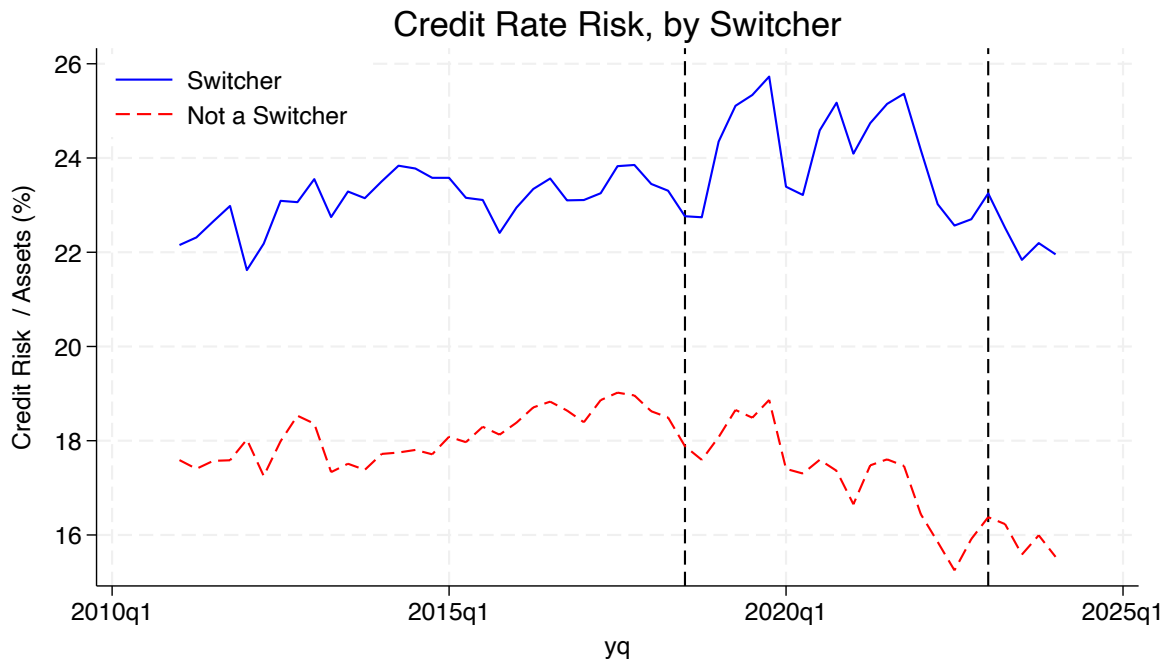
Did switcher banks choose higher *credit risk* exposure?

- Commercial real estate delinquency perhaps not representative of overall risk-taking

Did switcher banks choose higher *credit risk* exposure?

- Calculate exposure to credit risk factor comprehensively for all balance sheet + deriv. (Begenau-Piazzesi-Schneider-2025)

  exposure to credit-risk factor—-return on a leveraged portfolio that is long a five-year BBB-rated bond and short a five-year default-free bond— as percentage of assets



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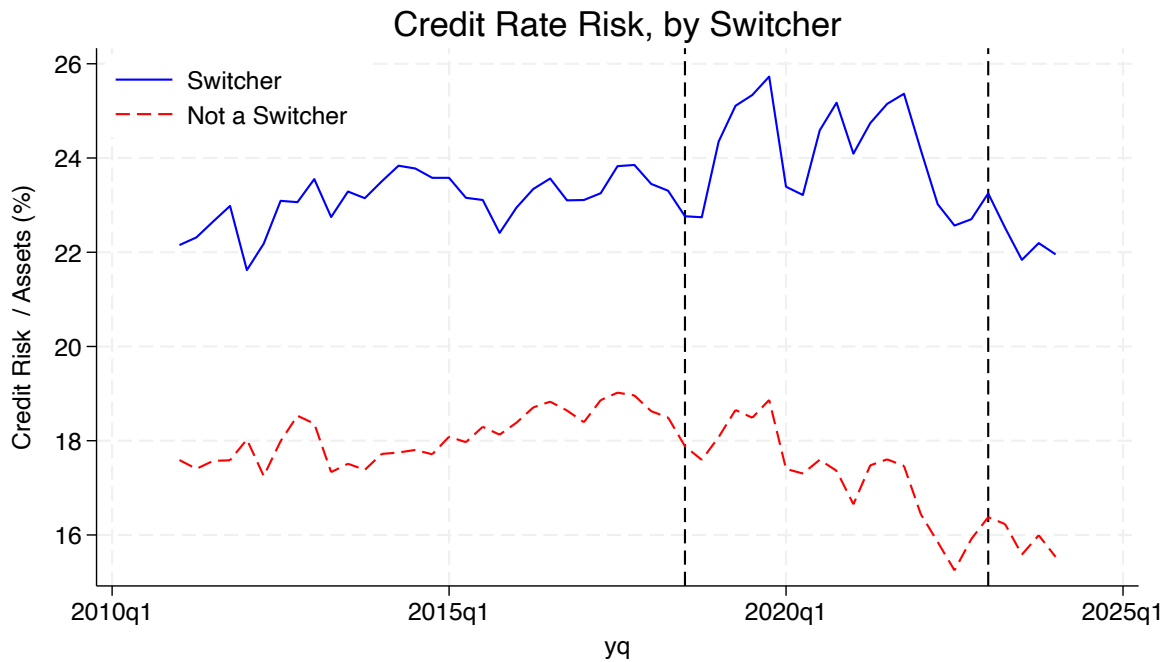
- Take-away: no discernible relative rise in credit risk



What do banks do with deposit inflows? Actively increasing interest rate risk?

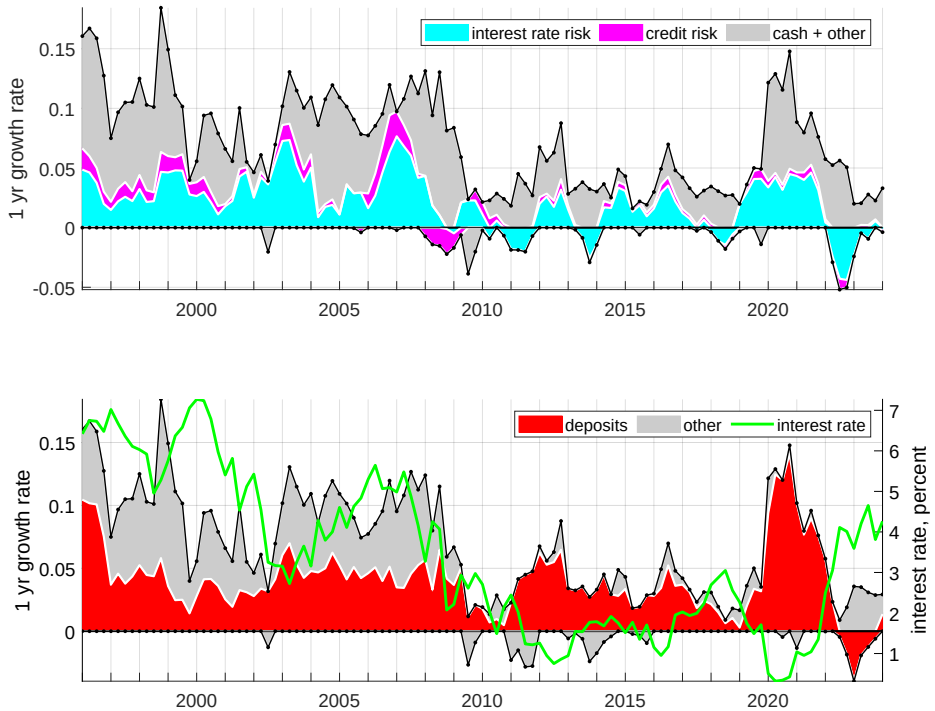
- Deposit view of banking:

  e.g., Hanson-Shleifer-Stein-Vishny-2015; Stulz et al-2022

What do banks do with deposit inflows? Actively increasing interest rate risk?

- Banks have no full controll over quantity of deposits coming in
- Not always profitable lending opportunities
- Deposits inflow often gets parked in interest rate sensitive securities

Figure A.16: Contributions of risk and deposits to asset growth



Notes: Decompositions of year-on-year percentage change in assets for all public banks into change in interest-rate risk over initial assets, change in credit risk over initial assets and all other assets (top panel) and into change in deposits over initial assets and all other liabilities (bottom panel). Bottom panel adds 5-year swap rate as green line (right axis).

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- Switcher banks that received larger deposit inflow may have no credit investment oppt, turning to interest rate risk as in other times

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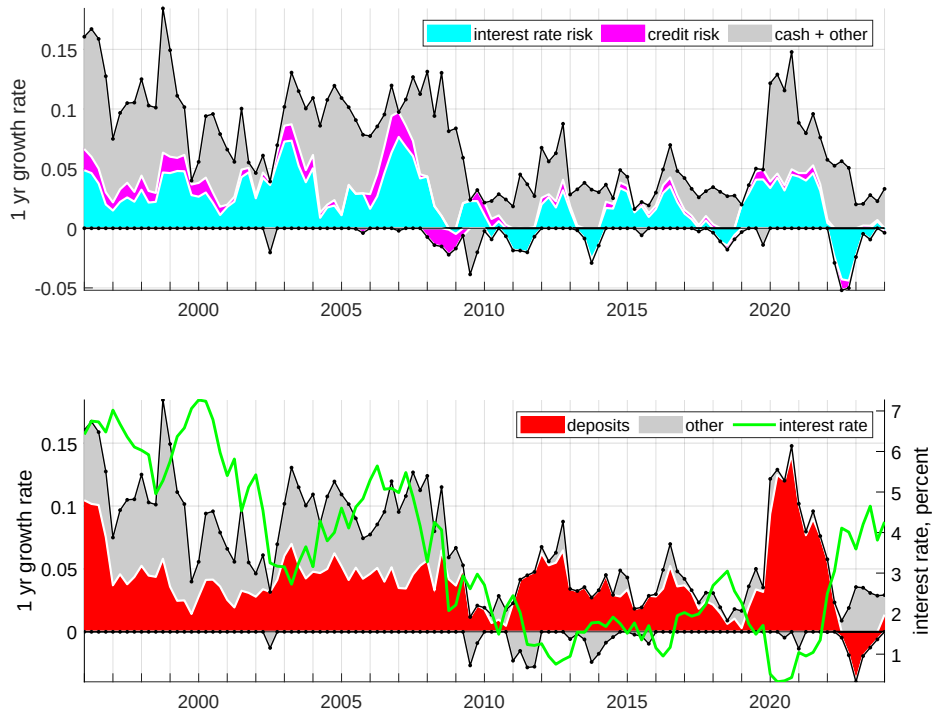

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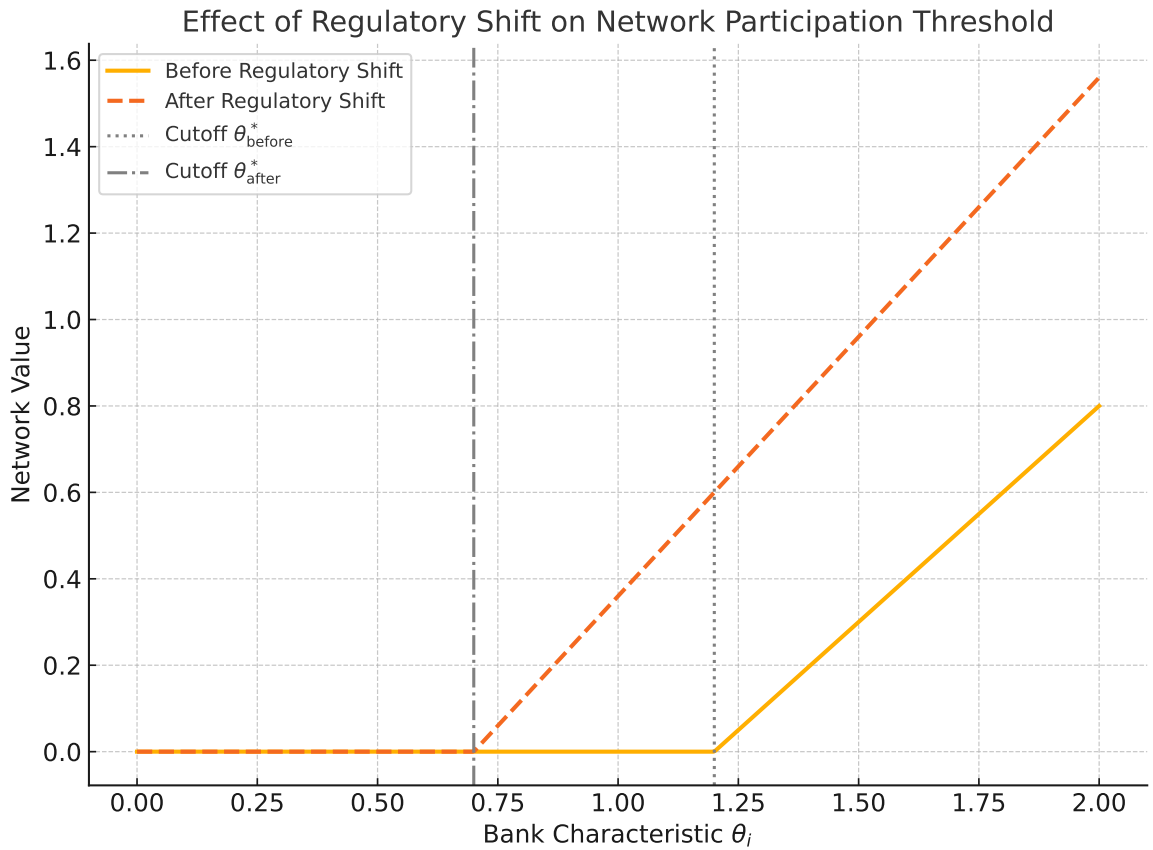
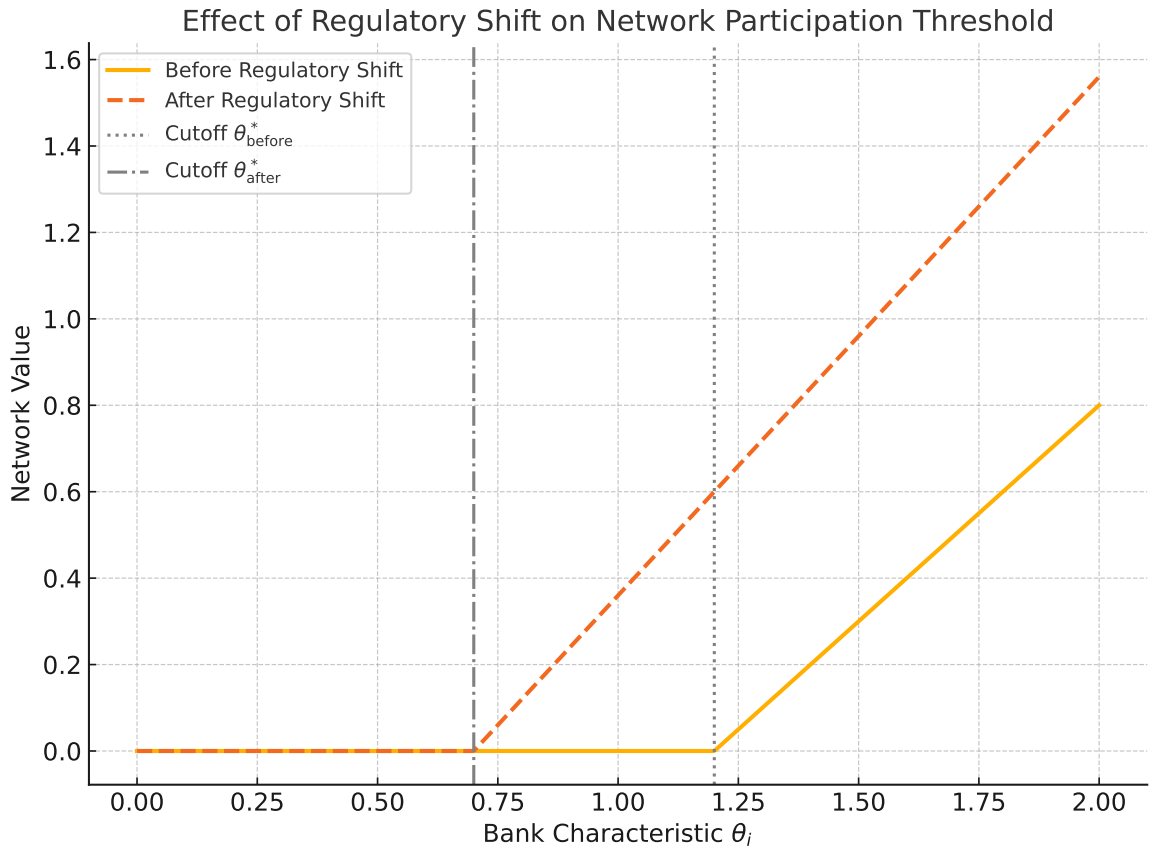
What we can learn about financial stability effects? (1)

- Carefully identified micro-moments critical inputs for policy analysis
- Identification discussion regarding selection
  - Historically (since 1982 Penn Square Bank failed), growth-oriented banks tap into brokered deposits, risky
  - Reciprocal deposits are preferable, but costly to join pre-2018
  - Graph illustrates selection into the network given bank type



What we can learn about financial stability effects? (1)

- Carefully identified micro-moments critical inputs for policy analysis
- Identification discussion regarding selection
  - Reduction in costs may select less but compared to non-switcher more growth oriented banks



What we can learn about financial stability effects? (2)

- Does the effect aggregate?
  - Reciprocal deposits grew a ton, yet remain negligible
  - How well do estimates map into systemically important banks?
  - Are uninsured deposits uninsured? (Ohlrogge 2025 argues they became de-facto insured)

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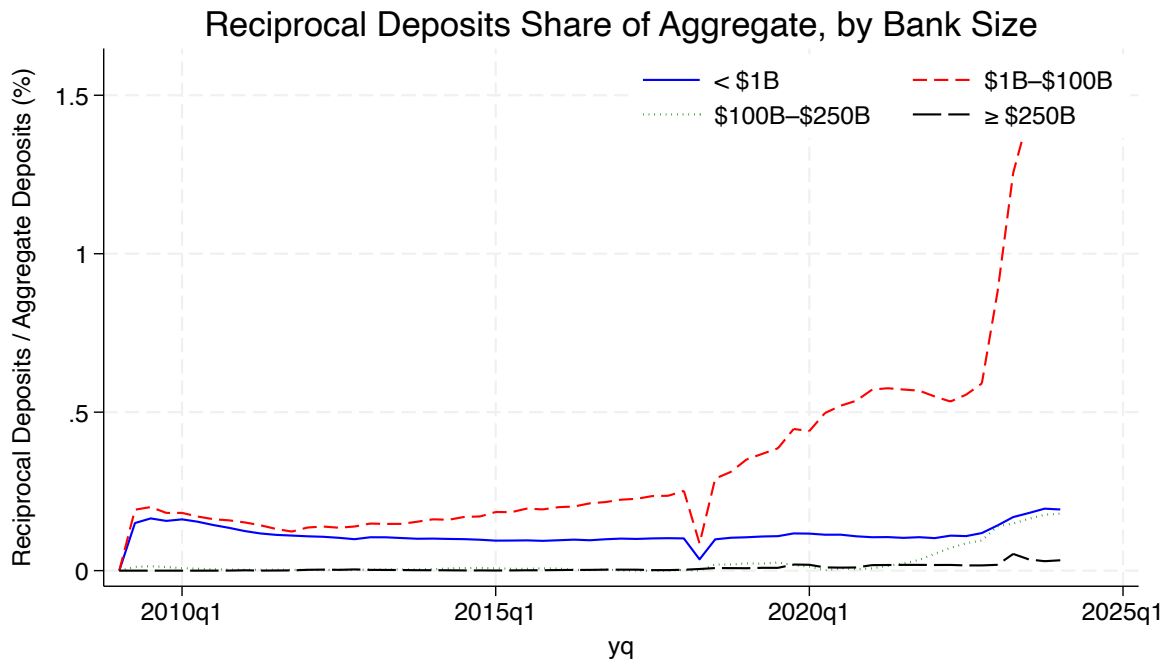


Why are not more at the regulatory max?

Table 2: Fraction of Banks for Which Reciprocal Deposits Are Near Their Nonbrokered Reciprocal Deposit Cap

	Percentage of banks	Percentage of industry reciprocal deposits in these banks
2022:Q1	1.7	11.4
2022:Q2	1.7	10.6
2022:Q3	1.5	9.9
2022:Q4	1.7	10.4
2023:Q1	3.0	28.6
2023:Q2	3.9	36.0
2023:Q3	4.1	41.5
2023:Q4	4.3	39.5
2024:Q1	4.8	41.9

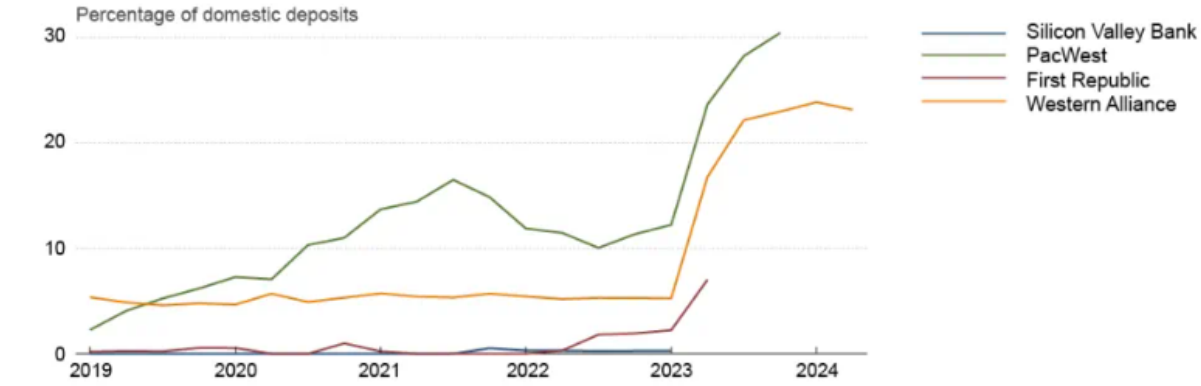
Source: Call Reports

Notes: Reports banks with reciprocal deposits of at least 90 percent of the lesser of $5 billion or 20 percent of their liabilities. No adjustment is made for banks subject to the special cap.

- Source Prescott-Rosenberger 2024
- Note that brokered deposits also split up deposits across banks
- Costs: Cap on 2018 rule, o/w treated as less favored brokered deposits
- Some banks really tapped into reciprocal deposits, but most did not
- Why are public entities overpresentative? Why are many companies not yet pressing banks to do more?

Why are not more at the regulatory max?

Figure 2: Reciprocal Deposits



Source: Call Reports

Notes: Reciprocal deposits as share of domestic deposits for selected banks affected by the banking turmoil in 2023. Silicon Valley Bank and First Republic ceased to exist by 2023:Q1 and 2023:Q2, respectively. PacWest merged with Banc of California in November 2023, so it is not reported past 2023:Q3.

- Source Prescott-Rosenberger 2024
- Note that brokered deposits also split up deposits across banks
- Costs: Cap on 2018 rule, o/w treated as less favored brokered deposits
- Some banks really tapped into reciprocal deposits, but most did not
- Why are public entities overpresentative? Why are many companies not yet pressing banks to do more?

Smaller comments

- would take the selection issue of "switcher banks" more seriously: show ratio of IV/OLS to argue it's reasonable, also show that switcher banks are similar based on observables
- curious that the delinquency rate increase is driven by 90+ days over such a short horizon. If the shock you studied had caused it (as supposed to something earlier), wouldn't we expect to see an increase in the less than 90 days first? Typically, it takes a few years for excessive risk to show up in delinquency rates (at least for GFC)
- discussion of Shaffer paper came up a bit short
- deposit supply elasticity parameter estimate interesting: show cross-section, connect to
- connection to macro-finance literature would be very useful: produce parameters that could be used as cost and benefit parameter targets for deposit insurance in these models
- useful to check whether magnitudes of estimates (e.g., (large?) deposit supply elasticity is reasonable and internally consistent

Take-Away

- Very nice paper with many useful facts
- Carefully identified study provides useful estimates of deposit supply elasticity, asset growth, portfolio, and funding changes in response to the SVB shock modulated by insurance access
- Exciting more work to be done for studying financial stability consequences and the nature of risk-taking of banks