Session 3:
More Lessons from 2023

Discussion by

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Bank Branch Density and Bank Runs

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Highlights

- Focus on **bank branch density** = # branches per $ billion in deposits
- Reduction in branch density since 2010, as branches declined while deposits continued to rise.
- Across banks, *low* branch density can be:
  - part of a business strategy that leverages digital banking and allows rapid scaling up; and
  - a vulnerability that increases the risk of deposit runs, as during the 2023 banking turmoil.
    - All three bank failures in March and May 2023 involved banks with low branch density
    - E.g., SVB had just 17 branches for $175 billion in deposits

Highlights

Systematic evidence on the role of branch density in 2023 turmoil:

- **Stock prices** (event studies around failures): banks with low branch density → higher declines, even when controlling for other bank characteristics

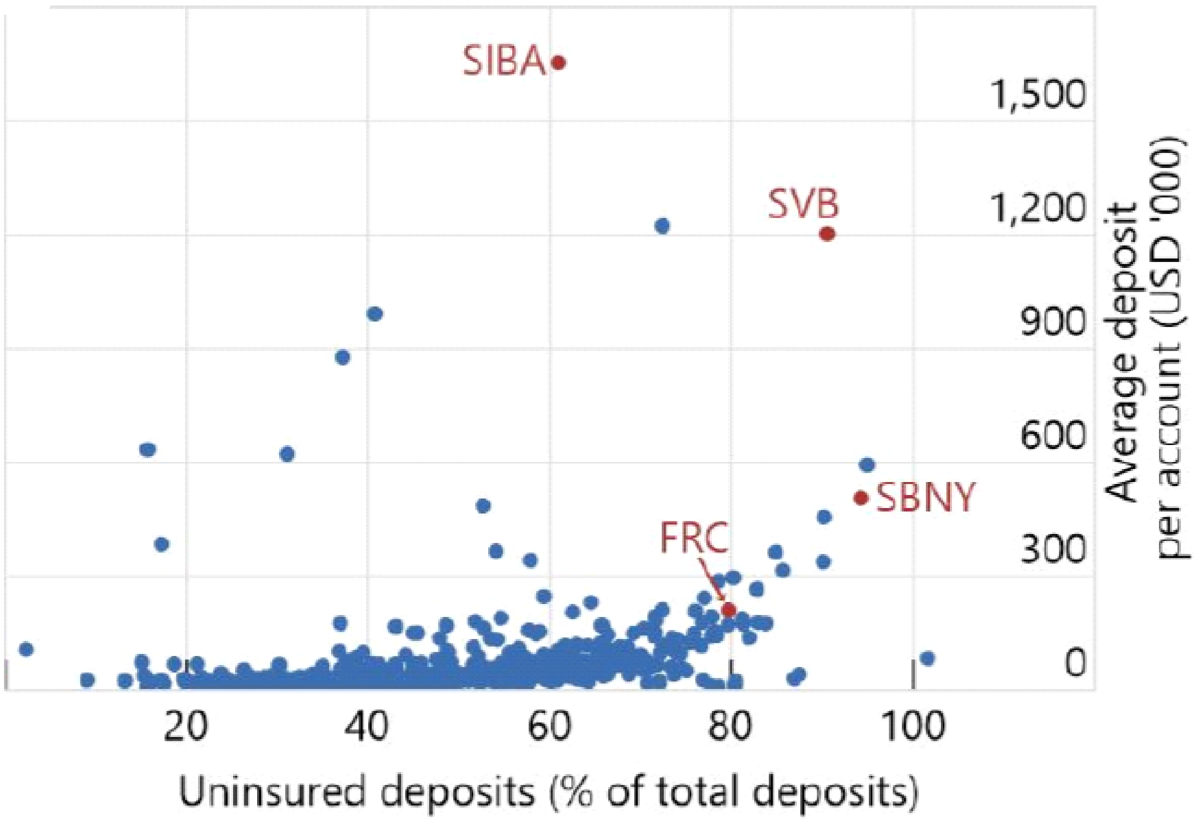
- **Deposit flows** (2023Q1-2022Q4): low branch density → greater outflows of uninsured deposits (and greater inflows of insured deposits)

- **Digital banking**: banks with low branch density in 2022 tended to have
  - larger increases in IT investment in preceding years
  - larger spikes in web traffic during the turmoil

Comments and questions

- The paper brilliantly highlights the role of branch density.
- How distinct is it from a few other funding characteristics that have been blamed in the 2023 bank failures?
  - Uninsured deposits: analysis controls for this and branch density remains significant. Still, it would be nice to know the correlation between density and uninsured ratio.
  - Concentrated deposit bases: no great data, could you proxy average deposit account size?
  - Rapid growth: pre-run deposit growth rate.
- This is not a criticism: the same business strategies could be leading to low density, rapid growth in good times, and/or concentrated deposit bases.

Deposit concentration and uninsured deposits[2]



Source: FSB (2024)

What Lessons?

- Should **supervisors** think more about bank branch density?
  - Evidence suggests it could be a useful metric to consider.

- Should **bankers** beware of business strategies with low branch density? There could a trade-off between
  - Rapid scale-up through digital banking / large accounts
  - Potentially less stable deposit base

Bank Underwater: Strategic Trading and Risk Management in Bank Securities Portfolios

Andreas Fuster
Teodora Paligorova
James Vickery

Highlights

- Did banks use their securities portfolios to manage their interest rate risk during 2022-23?
- This paper arrives at an answer that sounds like 'not much.'
- As rates rose, this extended the duration of MBS, but banks did not widely sell or hedge long-duration assets
- Accounting, financial, and regulatory frictions lead to 'sticky portfolios' and dearth of hedging.
  - Banks are reluctant to sell underwater securities.
    - Reluctance is stronger for banks that do not recognize unrealized losses in regulatory capital and for banks with low stock valuations.
  - Frictions in "qualified hedges" (fixed costs, hard to hedge prepayment)

Comments and questions

- Great paper with compelling evidence.
- Broader perspective would consider securities portfolios as one component of bank balance sheets, including liabilities.
- One reason banks may wish to hold long-duration assets is to hedge deposit franchise values, which are likely to rise with market rates (e.g., Drechsler, Savov, and Schnabl).
- However, even if asset and liability durations are matched, convexity may be mismatched.
  - Does MBS help or hurt from this perspective?
  - Deposit franchise values can be hard to measure and fragile: shifting betas, deposit outflows, runs.

Comments and questions

- Hedging frictions appear significant
  - Accounting rules are there for a reason
  - There is likely no perfect model, but important to get the balance right.