ECB - Destabilisation of Bank Deposits across Destinations: Assessment and Policy Implications

**Highlights**

- The March 2023 demise of a number of US regional banks and of Credit Suisse suggests that contrary to expectations, the additional regulatory frameworks introduced after 2008, notably in the field of liquidity requirements, have not overcome the problem of bank runs and the need for central banks to act forcefully as lender of last resort.

- While the bank run literature rarely pays attention to where bank deposits can flow to, this ECB paper distinguishes the different destinations of bank deposit leakages as a starting point of the analysis. It explains the flow of funds mechanics across all possibilities and reviews for each the current (and prospective future) changes that may contribute to the recently observed increase of the speed and size of bank runs. The flow of funds mechanics in a closed system of financial accounts allows to understand and classify the different options for the migration of bank deposits within the financial system.

- Bank deposits do not simply disappear but are converted into a claim against a different entity or are absorbed when a bank issues debt or equity or does not renew a loan at maturity. ECB paper proposes the following list of five types of outflows of deposits from a commercial bank:
  - **Transfer of deposits to an account with another bank.** This is the classic modern electronic bank run out of one bank perceived to be a bad credit into another bank being perceived to be less credit-risky, as experienced in the cases of SVB and Credit Suisse;
  - **Investment into non-bank financial institutions that have no access to central bank liabilities, resulting in a shift of the deposits indirectly to another bank.** This would include investing in a money market fund, buying e-money or a stablecoin, or investing into (already issued) securities directly or indirectly (i.e. into a security fund);
  - **Investment into a non-bank financial institution which has access to central bank liabilities and indeed holds its inflows in this form.** Such a non-bank entity could be a money market fund, e-money issuer or stablecoin-issuing entity which is allowed to hold its fund with the central bank;
  - **Conversion of deposits directly into central bank money,** be it banknotes or hypothetical future retail central bank digital currency (CBDC). Moreover, some entities, like foreign central banks or sovereign wealth funds, can transfer their bank deposits directly to their account at the central bank;
  - **Deposit absorption through bank operations,** notably by issuing new bank debt (or equity) to a nonbank, by a borrower repaying a bank loan, or by a (central) bank selling assets to a non-bank.

- The ECB paper concludes that direct and indirect outflows of deposits to other banks will continue to play an important, and even further growing role in making bank deposit collection more competitive, expensive, and potentially less reliable. There are no convincing arguments to generally suppress competition for deposits across individual banks, and there would anyway be no good tools to do so.

- **New technology has made it easy** for everyone to open several bank accounts and to shift funds from one account to the other quickly and without cost or risks, and, moreover, banks can leverage their access to the central bank through BigTech and other innovative conduits (including e-money institutions or stablecoins who are constrained in their access to the central bank balance sheet), and, finally, social media have supported the dispersion of news leading to more correlated depositor behaviour.

- **At the same time, central banks can avoid becoming excessive destinations for commercial bank deposit outflows through the access of non-banks to their balance sheet.** Non-banks financial institutions (NBFIs like electronic money institutions, stablecoins, narrow banks or MMFs), governments, and sovereign wealth funds should not have unlimited and financially attractive access to central bank deposits. If they have access, the value of funds deposited by them should remain sufficiently limited, be it through eligibility criteria, quantitative limits, or incentives such as a sufficiently unattractive remuneration of the relevant positions in the central bank balance sheet. Payment institutions which anyway cannot build up large balance sheets through deposits with the central bank are not an issue from this perspective, while they may be able to contribute to competition and innovation to payments.

- **Finally, the relative role of banknotes as a destination of bank runs is likely to decrease further,** as the drawbacks of holding large amounts of banknotes at home remain, while alternative destinations of deposit outflows (and in particular into other banks) have become more and more easy and appealing in a digitalised society. As central banks have acknowledged that they will apply per-person limits (or other control instruments) to retail CBDC holdings, also this future form of direct access to the central bank balance sheet for all will not be amongst the major factors contributing to less stable bank deposits.