



Comments on “The Dark Side of Bank Wholesale Funding”

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Overview

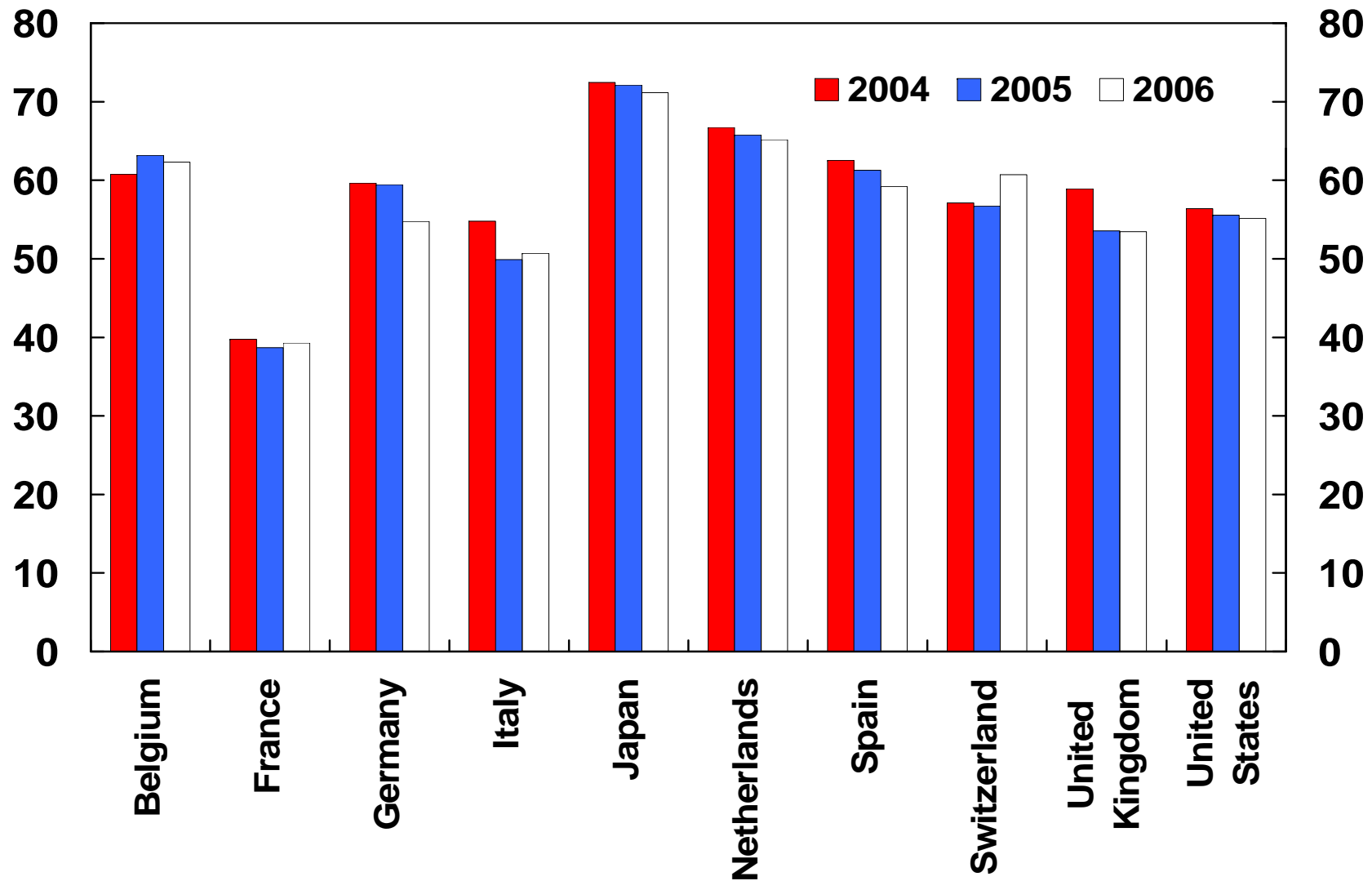
- **Wholesale funding**
- **The model's features**
- **The model's implications**
- **Policies**
- **Extensions**

Bank Wholesale Funding

- Disintermediation of retail deposits
- Middle layer of liabilities for banks
 - Interbank borrowing
 - Commercial Paper (CP)
 - Money market mutual funds
 - Large certificates of deposit
 - Repurchase agreements
 - Swapped foreign exchange liabilities

Commercial Banks: Deposit-to-Asset Ratios

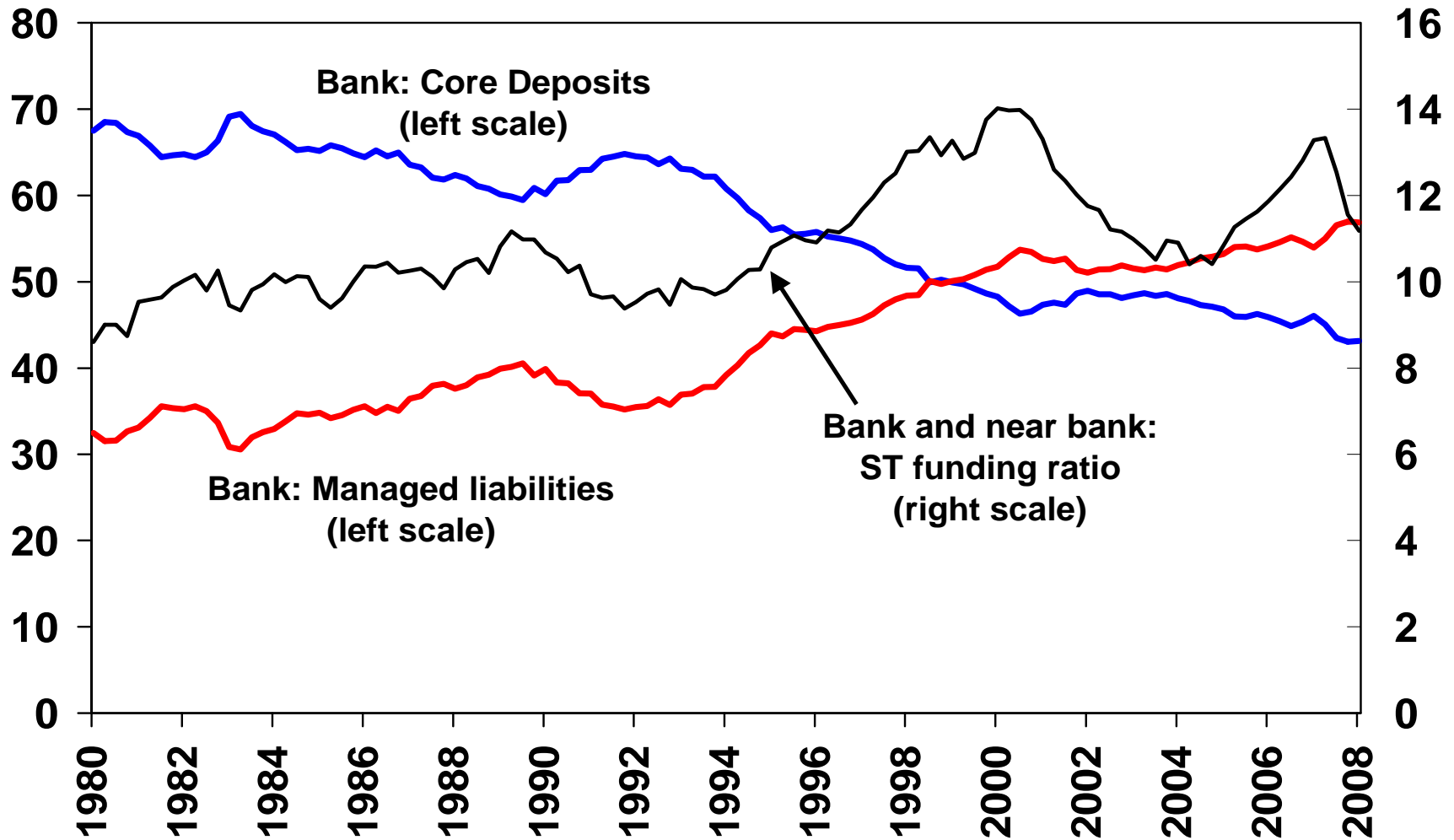
(In percent)



Note: Ratios of banks with at least \$200bn of assets in 2006.

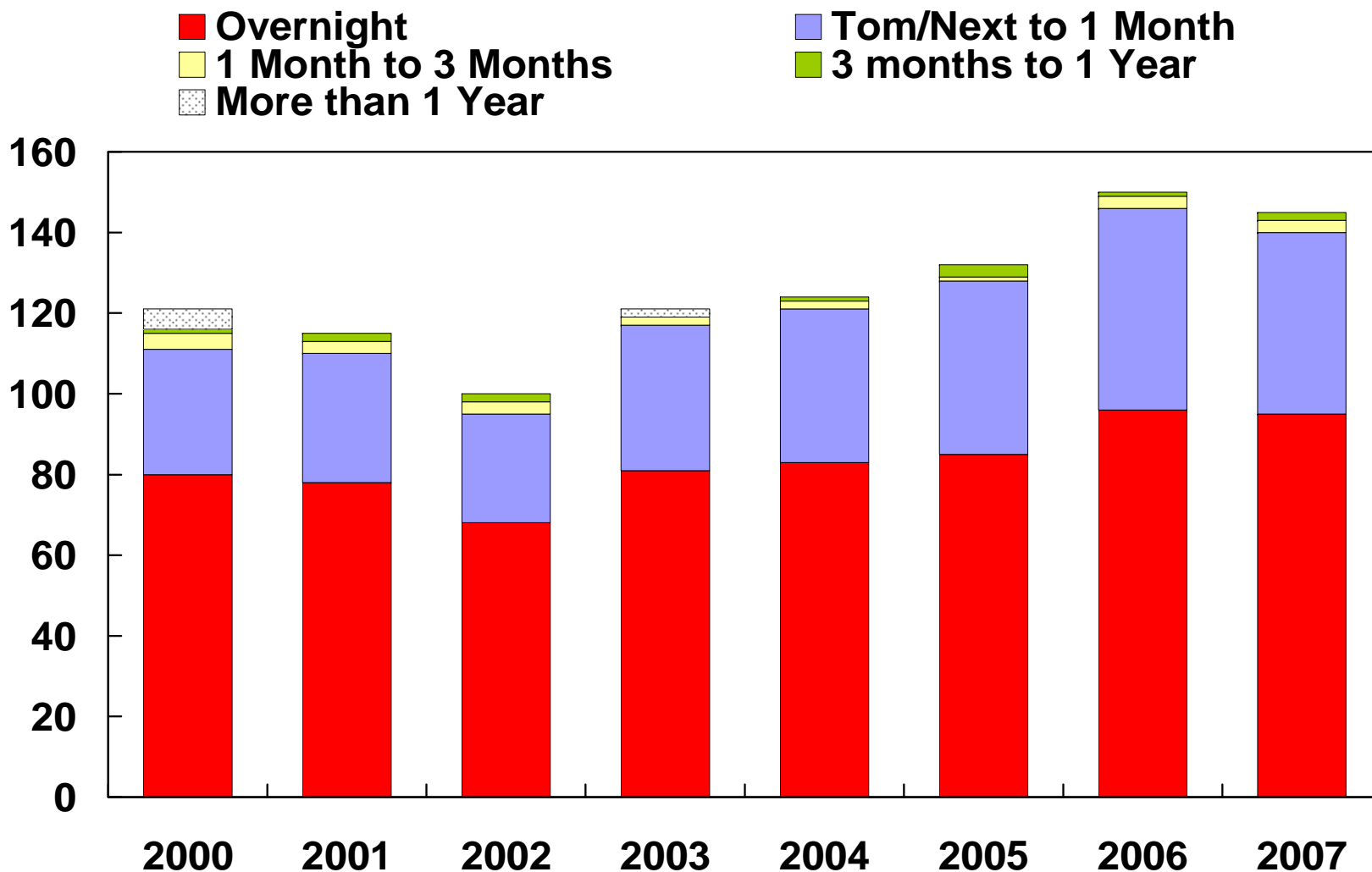
United States: Structural Changes in Financial Sector Liabilities

(In percent of total liabilities)



Unsecured European Bank Borrowing Volume

(In euros; indexed to 2002Q2 = 100)



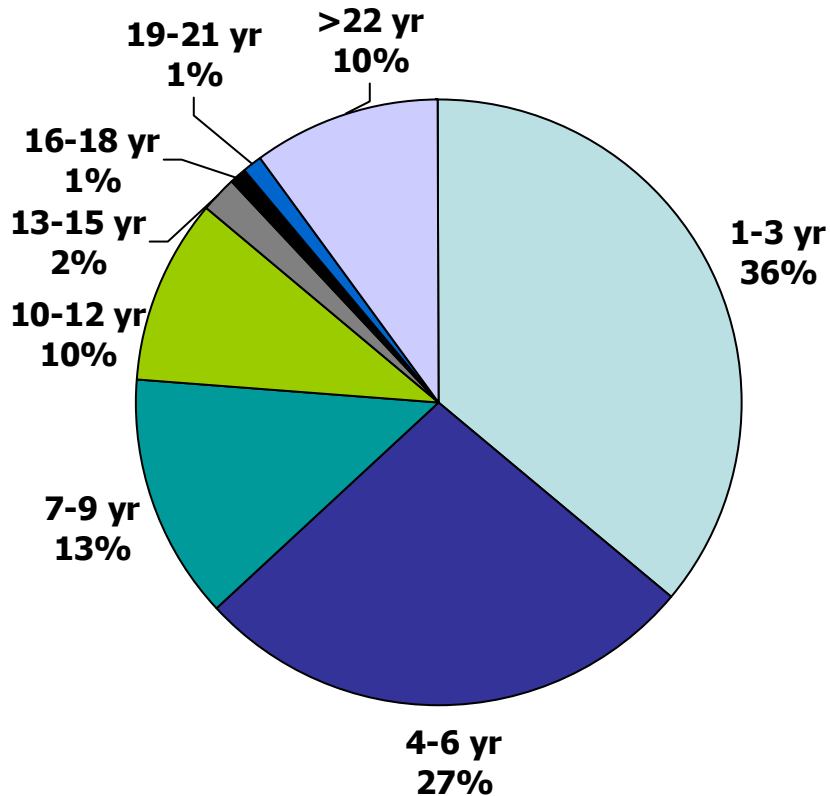
Model's features

- Key assumption: wholesale deposit providers receive a noisy (public) signal about banks' assets (in addition to own monitoring).
- Key result: causes wholesale depositors to force early, inefficient liquidation of bank in some circumstances.
- Key insight: “good” use of wholesale deposits (more investment) doesn't always hold.

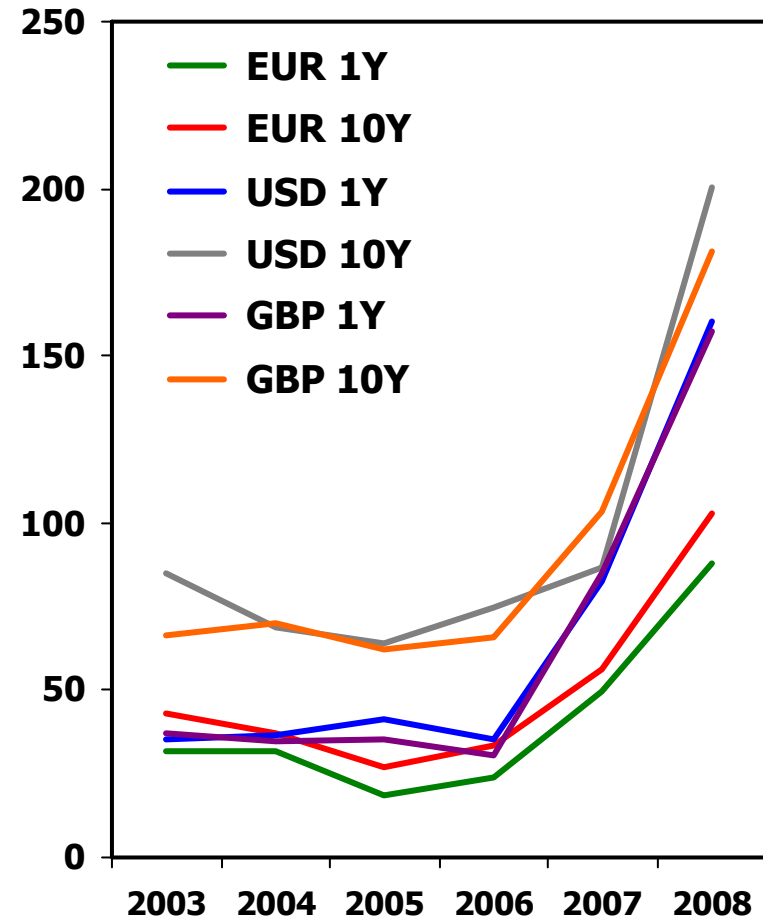
The model's implications

- Relates to current situation whereby wholesale deposit runs cause failures (e.g. Northern Rock, IKB) or rising funding costs.
- Intuition of model applicable to non-deposit takers (e.g. Bear Stearns) with “fragile” liability structures.
- Uncertainty about assets (project payouts) is the crux of the issue.

Average Syndicated Bank Loan and Debt Maturity Profile (July 2008)



AA Rated Bank Bond Index Spreads Relative to Governments (basis points)



Policies

- **Author's suggestions:**
 - Impose lower seniority for short-term wholesale financiers.
 - Assess taxes or higher deposit insurance covering all deposits.
 - Ban/restrictions on use of short-term wholesale funds.
 - Banks should have more “relationship-based assets” and reduce seniority of wholesale funds.

Policies

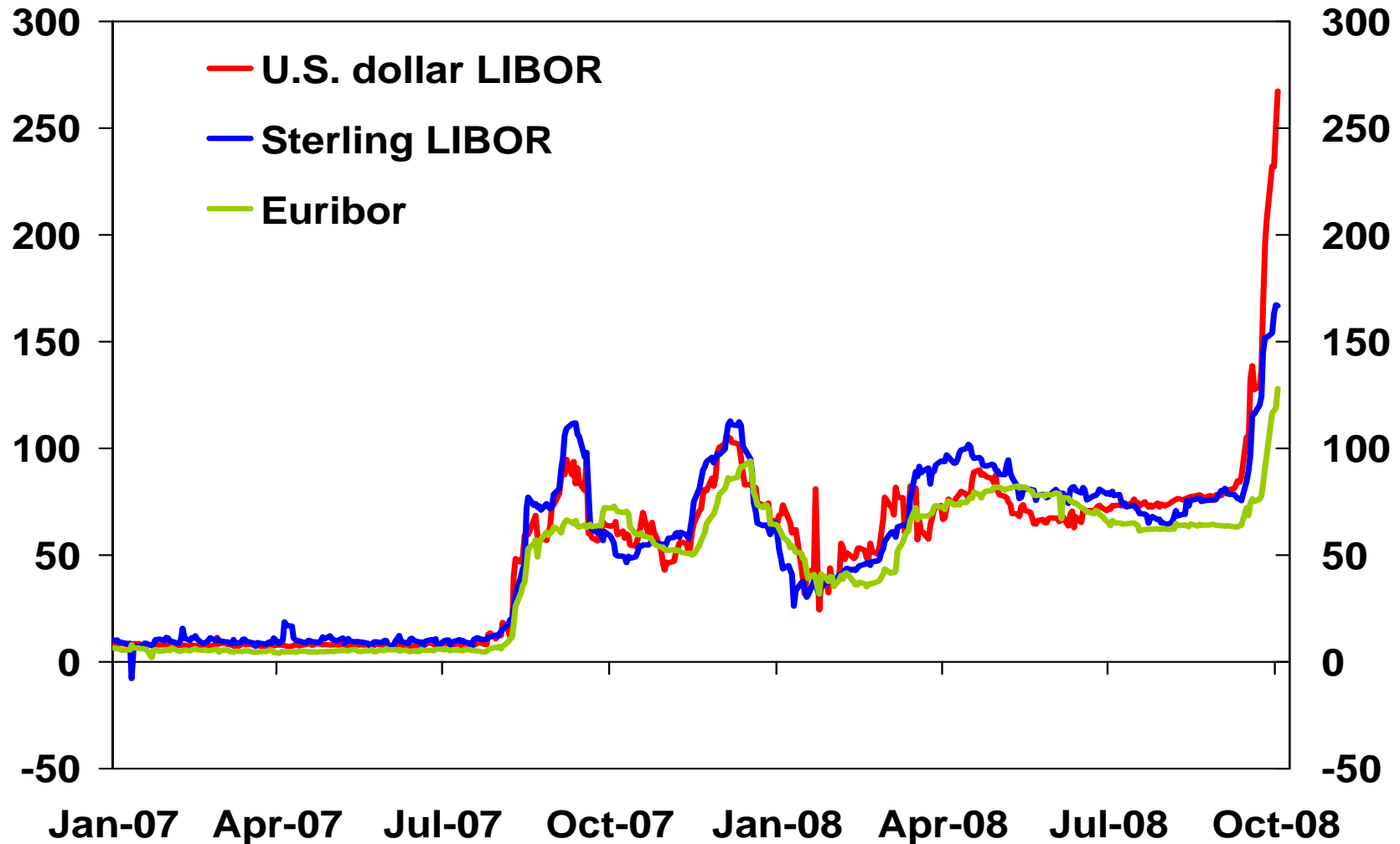
- **Other suggestions:**
 - Information on bank's assets (reduce the noisiness of the signal).
 - Information about banks' liability structures and funding liquidity risk management.
 - Backstops against wholesale runs ("insurance" provided by others or central bank).

Extensions

- Current liquidity difficulties are systemic (not just one wholesale run) and global – introduce interactions, not just one signal.
- Retail deposits are starting to look like “cheap” sources of funding – returns to retail deposits are bounded in model, what if not?
- What if retail depositors are not so “dumb” as in the model?

Spread between 3-month Uncollateralized Interbank Rates and OIS

(In basis points)





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