INTERVIEW

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Banking crisis: How to prevent a bank run and stabilize the system

Interview with Karolin Kirschenmann, EPoS Economic Research Center

- *"It is sensible for banks to invest in good client relationships"*

Bonn, Mannheim, 27.11.2023 – ***In times of a banking crisis, with swift and unagitated actions, governments, regulators and supervisors are able to calm down depositors and prevent larger fallouts. Close depositor-bank relationships help stabilize bank liquidity in crisis times. In general, the inherent fragility of banking systems requires crisp but calm supervision and regulation. These are findings of the discussion paper "Implicit and Explicit Deposit Insurance and Depositor Behavior" published by the EPoS Economic Research Center. Karolin Kirschenmann, one of the authors, explains the details.***

Ms Kirschenmann, what should governments do in times of a banking crisis?
Our main finding is that government interventions such as the increase in implicit deposit guarantees through capital injections, debt guarantees or the nationalization of banks in trouble and the increase in the explicit deposit insurance limit can be effective measures in calming down depositors and stabilizing the financial system.

Have these measures been implemented successfully?
Karolin Kirschenmann: During the financial crisis of 2008/2009 the Belgian government intervened early and quickly in the banking sector by both increasing explicit deposit insurance coverage and implementing implicit deposit insurance arrangements. The measures adopted were effective in calming down investors.

The results of our research also indicate that people are aware of and understand these interventions. Close depositor-bank relationships modulate the effects of such government interventions. Depositors with close bank relationships run less on their bank in the first place so that we conclude that close depositor-bank relationships help stabilize bank liquidity in crisis times.

Based on your findings, what are your recommendations to policy makers and bankers how to manage and prevent financial turbulence?
Karolin Kirschenmann: First of all, our findings indicate that government interventions can stabilize the banking system in crisis times. Secondly, our findings indicate that political trust seems to

generally boost the effectiveness of the studied government interventions. It is therefore important for governments to not squander political trust too easily, lest not to dent the effectiveness of two crucial stabilization policies in times of banking crises.

Third, for such interventions to work, depositors need to understand and be aware of the existing deposit insurance frameworks. As such, our results underpin the importance of financial education. It is therefore highly valuable that, for instance, the German Finance Ministry and the German Ministry for Education and Research have launched a joint initiative to improve financial literacy in Germany.

Our results are also important for bankers themselves because they confirm that strong depositor-bank relationships help stabilize bank liquidity in crisis times. It is therefore still sensible for banks to invest in good client relationships.

The presented discussion paper is a publication without peer review of the Collaborative Research Center Transregio 224 EPoS. Access the full discussion paper:
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