The Run for Safety:
Financial Fragility and Deposit Insurance

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Abstract

We examine the liquidity shocks to banks that can arise during a crisis due to concerns about safety by uninsured depositors. The analysis exploits exogenous changes in the deposit insurance threshold and a unique dataset with detailed information on balances and depositor characteristics for every bank account in Denmark. Our key result is that lowering the deposit insurance threshold during a crisis causes deposit mass in the ranges that become uninsured to decrease by almost 50% in non-systemic banks whereas the decrease is much smaller in systemic banks. While the money stays within the banking system in the aggregate, the reallocation imposes significant funding shocks for banks and affects their lending. We also find heterogeneity in bank liquidity risk arising due to differences in depositor characteristics.

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