FREE NETWORK POLICY BRIEF SERIES

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February 2017

Do Regional Ties Add to Depositor Trust during the Crisis? Evidence from Russia

The question of whether regional banks should be treated differently has recently become all the rage in the banking authorities' debates in Russia. We add to this discussion by analyzing bank regional ties in the flight-to-familiarity context, which implies that agents naturally feel more favorable about what they are comfortable or familiar with. We use the regional or local cues in the bank titles as the most evident source of familiarity for unsophisticated retail depositors. We argue that during the financial crisis of 2008-2009 depositors of "familiar" banks become less sensitive to bank risks. These banks therefore enjoy some additional protection against a bank run even if they are more risky.

Why should we care about bank regional ties?

The question of whether regional banks, working mostly within particular regions, should be treated differently and separately from large federal banks has recently become all the rage in the banking regulator's debates in Russia. They are usually smaller; their office networks are not vast; they may demonstrate higher risks. However, they may enjoy the advantage of additional trust by the local depositors, especially if the depositors clearly distinguish between the banks tied to the regions and all the rest. Giving those banks a special favor, the depositors may ignore their riskiness and avoid withdrawing their funds even in the period of financial crisis. This phenomenon can be explained in the flight to familiarity context. The familiarity hypothesis was first introduced by Huberman (2001). He suggested that agents naturally feel more favorable about and charitable toward what they are comfortable or familiar with.

Why should we – and banking authorities - care? Because the bank runs are not harmful for the economy if they are efficient, i.e. if more risky banks attract less deposits, resulting in lower deposit growth rates and/or lower market share (see Semenova (2007) and Karas, Pyle, and Schoors (2010, 2013) for Russian evidence). During the periods of financial turmoil this mechanism, also known as market discipline, is crucially important for the retail deposit markets, as it allows for efficient redistribution of funds from too risky banks to more reliable ones.

Market discipline can, however, be easily undermined, as the household depositors suffer from high monitoring costs and are usually unsophisticated and sensitive to non-risk related information available to them. Among other factors is the set of explicit guaranties provided by deposit insurance schemes. Peresetsky (2008) and Karas et al. (2013) show that the introduction of deposit insurance in Russia in 2004-2005 substantially reduced household depositors' sensitivity to bank risk, as most depositors were fully protected by the introduction of insurance. In the Russian context, there are two groups of banks that may be expected also to enjoy implicit guaranties, namely state banks that are controlled and protected by the state and foreign banks, which may provide external support to their Russian subsidiaries in case of financial difficulties. As these banks are considered to be under implicit protection of the state or foreign financial institutions, retail depositors perceive them as more reliable and feel no need to monitor their financial conditions (Semenova, 2007).

For the Russian market for personal deposits, which is regionally segmented with intense region-level competition, it is extremely important to consider the regional-level sources of depositors' confidence, undermining the market discipline. In Schoors, Semenova, and Zubanov, 2016, we hypothesize that depositors feel compelled to exert less discipline on familiar banks, measured as banks with local or regional references in their names – or in other words exhibit a flight to familiarity – especially in times of crisis.

Empirical strategy

We introduce a very simple proxy for the depositors' regional familiarity with the bank. If

the bank's name contains words related to its regional geographical position - the name of the region (e.g. Altay Bank), the name of the city (e.g. Bank of Moscow) or a place in the city (e.g. Okhotny Ryad) – we assume the household depositor perceives more familiarity with the bank. We go through the list of all Russian banks living from 2000 to 2010 and check if they are tied to the region and hence familiar in the eyes of depositors. Using quarterly data on the Russian banks' financial ratios provided by the Bank of Russia for 2001-2010, we check whether during and after 2008-2009 financial crisis the deposit growth at familiar banks is not sensitive to banks' risks, measured by capital adequacy, liquidity-to-assets ratio and the share of non-performing loans. We control for the banks' size and deposit insurance system inclusion, which stared in 2004-2005. We exclude all banks registered in Moscow to focus on pure regional evidence.

We also aim to determine the source of the lack of attention to familiar bank risks. There may be two possible explanations: high level of regional affinity (regionalism) – meaning that people feel more attached to the region and appreciate it so they trust it more to anything region-related – or high level of trust in regional governments (implicit guarantees) – implying that depositors expect the local authorities to help the banks or bail them out. We separate the regions into two groups by the regionalism index – to test the first hypothesis – and by the degree of reliance on local authorities – to test the second hypothesis. To construct the regionalism index we use data provided by Berkowitz, Hoekstra, and Schoors (2014) and choose components that may explain the current level of regional affinity based on the transition – or even Soviet – period history of the region. If the population was more stable, homogenous, less urbanized and prone to reforms, observed the substantial support the region got from the federal budget in the Soviet period (meaning that the region was favored), the regionalism is higher. We measure depositors' trust in regional and local authorities by the share of the region's population that supports the actions and policy of the regional government, calculated on data coming from the results of the Courier surveys, conducted regularly and nation-wide by the WCIOM and the Levada-center.

Results

Our results suggest that during the financial crisis the sensitivity to risks became weaker for all the Russian banks, which is in line with a cross-country study by Cubillas et al. (2012). But with respect to capital adequacy this effect is clearly more pronounced for familiar banks: in the post-crisis period, the capital sensitivity of familiar banks essentially falls to zero, while unfamiliar banks retain the level of market discipline they had before the crisis.

When looking for sources of additional trust, we confirm the importance of regional affinity. Indeed, during the crisis market, discipline is undermined only in regions with above median levels of regionalism. This effect is absent in the regions where the trust in local authorities is above the median level, though.

Conclusion

In Schoors, Semenova, and Zubanov, 2016, we provide some evidence of an alternative source of

depositors' confidence in bank reliability – namely, the regional ties providing familiarity. They make depositors more relaxed on bank riskiness in the period of the crisis, when the efficient redistribution of funds within the banking sector is especially important. This happens mostly in the regions with high levels of regionalism and regional affinity, i.e. where people believe more in region-centrism and the idea of power of the region. This result implies that banks in these regions may explore the additional benefits provided by the regionally tied names and pursuit riskier strategies when the financial world is unstable. The clear policy implication that can be suggested is that explicit distinguishing between regional and federal banks – as the policy debates suggest – should be accompanied by increased control of regional banks' risks. This control is justified and should indeed come from the regulator, as the market seems to be inefficient in this respect.

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