INTRAFI® RESEARCH BRIEF FOR BANK EXECUTIVES

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Academic research often shapes how banking risks and policies are understood. IntraFi's Research Briefs for Bank Executives distill relevant research studies into concise, accessible summaries focused on what the findings mean for bank leadership.

Key Findings

- A bank failure can raise funding costs and constrain lending at nearby surviving banks, according to an academic working paper examining U.S. bank failures from 2006-2018.[1]
- Bank failures make depositors more attentive and rate-sensitive, reshaping competition among surviving banks.

Following a local bank failure, the study finds that depositors become more rate-sensitive, prompting even financially sound institutions to pay more for funding.

The authors estimate that rates on one-year, $100,000 CDs rise by roughly 4 basis points at competing banks after a nearby failure. The effect appears immediately, persists for up to three years, and is strongest when there is heightened public attention.

The evidence suggest that the effect is driven by depositor attention and price sensitivity rather than concerns about the solvency of surviving banks. Better-capitalized banks raise rates more than weaker peers following a competitor's failure, and the increase in rates on uninsured deposits is only about half that for insured deposits, the opposite of what would be expected if depositors were demanding compensation for greater perceived risk. In short, depositors "wake up," becoming less sticky and less willing to accept below-market rates.

Higher deposit rates do not fully offset the impact. Deposit growth at surviving local banks falls by approximately 4.5 percentage points, increasing funding pressure and constraining credit supply. Small-business lending declines, mortgage lending shifts away from banks, and nonbank lenders partially fill the gap.

Public attention amplifies these effects. Failures that generate more Google search activity produce larger increases in competitors' deposit rates. This presents a policy tradeoff. The FDIC must publicize failures to protect and inform customers of failed banks, but that publicity may also increase rate sensitivity at otherwise healthy nearby institutions.

Considerations for Bank Management

- A competitor's failure should be viewed not only as an opportunity to attract displaced deposits, but also as a potential local funding shock.
- Local failures can increase deposit price sensitivity, weaken deposit retention, raise funding costs, and pressure loan growth.
- More broadly, depositor behavior can transmit banking stress beyond the failed institution, increasing the economic costs of isolated failures even when surviving banks remain financially sound.

[1] Lee, Brian Jonghwan and Walz, Stefan, When Banks Fail: Depositor Attention and the Cost of Funding for Survivors (October 31, 2024). Available at SSRN: http://dx.doi.org/10.2139/ssrn.5772924