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Uninsured deposits as a monitoring device: Their impact on bond yields of banks

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Abstract

We empirically analyze the impact of uninsured deposits on a bank's cost of public debt. Uninsured depositors can exert market discipline over a bank and potentially reduce its agency cost of debt through informed monitoring. We use a sample of public bond issues by U.S. bank holding companies from 1994 to 2013 and find statistically strong evidence that banks with more uninsured deposits relative to their assets issue bonds with a lower interest rate. Findings suggest a one standard deviation increase in uninsured deposits is associated with a 46 to 64 basis point decrease in bond yield. In addition, we find that bonds issued by banks with higher default risk or lower reputation benefit more from uninsured savers. Our paper contributes to the literature that explores market discipline and provides evidence that banks can benefit from it through a lower borrowing cost.

Keywords: Uninsured deposits, Market discipline, Bank cost of capital

JEL Classification: G1, G2, G21

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