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IDENTIFYING DEPOSITS OUTFLOWS IN REAL-TIME

by Edoardo Rainone*

Abstract

We propose a method based on control charts to identify in real-time sudden deposits' outflows through payment systems. The performance of the methodology is assessed using both Monte Carlo simulations and real transaction-level TARGET2 data for a large sample of Italian banks. We identify a set of idiosyncratic bank stress episodes and show that deposits are generally shifted to other banks, mainly large and domestic ones, generating a size premium; only a limited amount migrates to foreign banks. Under the fixed-rate, full allotment regime, the liquidity drain is mostly offset through open market operations.

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1 Introduction[1]

When depositors withdraw their funds from a bank and move them to another one or convert them in cash, they leave digital footprints in the payment system. We propose a methodology that can be used by supervisory and resolution authorities (in a SupTech perspective),[2] commercial and central banks to monitor depositors' behavior in real-time and save relevant social and private costs. We are not aware of any study exploiting payment system data for this purpose.

Furthermore, the recent development of financial and payment services, the fintech revolution and the spread of smartphones, mobile devices and financial applications can drastically transform the speed with which changes in depositors' trust materialize and thus the stability of various funding sources, affecting the liquidity indexes under Basel III. Despite the importance of this measurement, evidence on the subject is scarce. We show how payment systems data can help us understand better the implications of these technological changes.

Along these lines, this paper's contribution is twofold.

First, we show how payment system data can be used to measure deposits' flows, construct a method based on control charts to track sudden changes in real-time, and test its performance using Monte Carlo experiments. The methodology proposed can be extended from deposits to other type of liabilities, like wholesale funding (Gertler et al., 2016; Martin et al., 2014), as long as these financial instruments are settled in payment systems or are visible in other financial market infrastructures, like central securities depositories, securities settlement systems or central counterparty clearing houses. Importantly for financial stability, our methodology can immediately provide information on potential contagion effects and on the degree of digitalization of the outflows.

Second, we apply our methodology to real data from TARGET2, the pan-European large value payment system owned and operated by the Eurosystem, on which European central banks, commercial banks and other financial market infrastructures can settle payments in central bank money.[3]

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[2]Suptech refers to the use of innovative technology by supervisory agencies to support supervision, reduce the burden on banks and allow for more proactive monitoring, better reporting, oversight and overall compliance on the regulator's side. The method proposed here can be used by supervisors to monitor banks' deposits stability in real-time and in a automated way, avoiding administrative and reporting burden for the banks.

[3]In Section 3.2 we provide a detailed description of TARGET2.

Analyzing the Italian banking system from August 2012 to August 2019, we identify and characterize a set of distress episodes. The estimated average length of such events is about four weeks. The liquidity drain from the distressed bank was significant and equal to about 3 percent of the bank's deposits on average, close to the run-off rate of stable deposits in the LCR (Basel III, 2013).

Thanks to the detailed information available in payments data, we can uncover the behavior of depositors as never done before. Deposits were almost entirely directed to other banks, leaving almost unchanged the deposit currency ratio. Contrary to the usual negative contagion effects found in the literature (see Goldsmith-Pinkham and Yorulmazer, 2010, for example), we provide evidence of positive spillovers (deposits inflows) to other banks.[4] Deposits from the distressed bank mainly shifted to large domestic banks, pointing at a *size premium* (Oliveira et al., 2014). A smaller portion of deposits moved across the border, mostly to Germany, Belgium, Great Britain and Luxembourg. About half of the transfers were done using real-time settlement (instead of the usual deferred settlement), putting an additional liquidity pressure on the stressed bank. The banks offset the liquidity drain even if the amount of excessive reserves was high in the period under analysis. Under the fixed-rate full allotment regime, banks chose to offset the liquidity outflow through open market operations and to a lower extent through repos and securities sales.

Our results point to limited systemic effects, as we do not find evidences of negative spillovers to other banks. This can be in part due to the fact that we restricted our sample to idiosyncratic shocks and unsecured interbank exposures were limited in the sample considered. In general, the external validity of this type of studies is limited as they depend on the specific sample analyzed. Nevertheless, we think that this paper adds important new evidence to the scant existent literature, which is mostly based on one single distress episode (see Goldsmith-Pinkham and Yorulmazer, 2010; Iyer and Puri, 2012; Iyer et al., 2016, for example), because it uncovers new features of distress episodes, only visible from payment systems. The methodology developed in this paper can also be used to monitor entire banking systems and detect systemic events in real-time.

The rest of the paper is organized as follows. Section 2 discusses related literature. Section 3 describes how to track deposits' flows with payment system data and the methodology proposed to identify distress episodes in real-time. Section 4 presents some Monte Carlo experiments to show the performance of the algorithm with simulated data. Section 5 applies the algorithm to TARGET2 data. Section 6 analyzes deposits' flows during the distress episodes identified and show how banks managed to offset the liquidity drain. Section 7 concludes.

[4] Goldsmith-Pinkham and Yorulmazer (2010) analyze the returns of stock prices for the rest of the U.K. banking system during the Northern Rock episode. They do not provide evidence on retail deposits.

2 Related Literature

Given its importance, depositors' trust has long been at the center of scholars and policy makers' debates. Our paper is related to a number of strands of the literature. Firstly, the micro empirical literature concerned with depositors' behavior; secondly, the macro literature focused on panic, depositors' trust and coordination failure; thirdly, the theoretical literature on policy tools designed to prevent distress episodes.

By studying deposits' outflows with payment system data, we complement the existing empirical micro literature in banking and finance which is concerned with depositors' behavior and perception.[5] Notable examples going in this direction are Iyer et al. (2016) and Iyer and Puri (2012). They look at micro data from depositors of one bank in India. They show how heterogeneity in depositors' responses to solvency risk and in bank-depositors relationships can generate different type of distress. Our study is somehow complementary as we look at payments instead of accounts and consider an environment in which the episodes are mainly digital instead of physical.[6] While the advantage of accounts data is that it is possible to observe heterogeneous behaviors across types of depositors, with payment data we can understand whether deposits are converted in cash or moved to another bank, and better assess contagion by observing transfers of clients of other banks. These aspects are particularly important to understand (i) if idiosyncratic shocks turn to systemic, (ii) what is the preferred option for depositors, (iii) whether distress episodes initiate and remain digital.

By showing the reactions of commercial banks to deposits' outflows, we relate to a large literature that looks at the interaction with financial and money markets. The coexistence of a central bank, which determines banks' reserve requirements, and an interbank market, which redistributes reserves, improves depositors' trust (Cañón and Margaretic, 2014). The occurrence of distress episodes can raise short-term interest rates (Waldo, 1985), preventing a smooth transmission of policy rates. Banks offer contracts preventing it, but they may accept some risk to achieve higher returns (Cooper and Ross, 1998; Ennis and Keister, 2006). An idiosyncratic episode may have significant effects on the rest of the banking system. One bank may trigger a panic-based episode that propagates to another bank (Brown et al., 2016). Banks that rely on funding from wholesale markets may be significantly affected by a crisis of another bank (Goldsmith-Pinkham and Yorulmazer, 2010). In such situations creditors begin a steady stream of withdrawals and become increasingly reluctant to roll-over short-term loans. As the market probability of distress increases, creditors withdraw some

[5]Understand depositors' actions timely is key, as they can change if the bank's fundamentals do not change (Chen and Hasan, 2006; Keister and Narasiman, 2016) and they can also influence each other perceptions (Kiss et al., 2014).

[6]The bank they analyze had no online banking or any automatic teller machines, while our episodes are almost entirely via these channels.

but not all of their funds (Gertler and Kiyotaki, 2015). In August 2007 a steady contraction of Asset Backed Commercial Paper (ABCP) market began, something akin to a slow distress. Such situations can anticipate a complete collapse of the banking system as depositors coordinate on a no rollover equilibrium, generating a crisis. As a result, banks liquidate all their assets leading to a sharp drop in asset prices and rise in spreads (Gertler et al., 2016). Indeed if the first wave of distress hitting the ABCP market had the features of a slow distress, the second, which led to the dissolution of the entire investment banking system had the features of a traditional fast crisis.

The macro effects and the systemic risk implications of distress episodes have also been at the center of the academic and policy debates on financial stability, especially after the recent financial crises. Macroeconomic models that consider depositors' trust include Gertler and Kiyotaki (2015) and Ferrante (2018). Even if retail markets remain relatively stable, wholesale funding markets may experience dry-ups. Distress of the shadow banking system were a salient feature of the financial crisis, culminating with the collapse in September 2008 of Lehman Brothers (Gertler et al., 2016). This aspect is well caught by the following phrase from a speech of the former FED President Ben Bernanke.

"The emergence of run-like phenomena in a variety of contexts helps explain the remarkably sharp and sudden intensification of the financial crisis, its rapid global spread, and the fact that standard market indicators largely failed to forecast the abrupt deterioration in financial conditions" (Bernanke, 2012).

Our results can also be informative for the large theoretical literature on policy tools to prevent distress episodes, as it provides new evidence on their characteristics. From a policy perspective, several tools have been proposed to incentivize depositors' trust. The government can provide deposit insurance and produce superior deposit contracts (Bryant, 1980; Dávila and Goldstein, 2020; Diamond and Dybvig, 1983). In addition, particular central bank liquidity provision policy can prevent bank panics without moral hazard problems (Martin, 2006). As an alternative, the commercial bank can suspend convertibility of deposits into cash (Engineer, 1989). In extreme cases, deposit freeze is also one of the most common policy response to a banking panic. Such freezes happened in the United States prior to 1933. More recently, Brazil, Ecuador, and Argentina have declared widespread deposit freezes to stop the outflow of deposits from the banking system. The anticipation of such an intervention can generate the conditions necessary for a self-fulfilling distress to occur (Ennis and Keister, 2009). There is also a large debate on the effects of bailing out or bailing in financial institutions (Gropp et al., 2010; Keister and Narasiman, 2016).

The idea behind this paper is simple: timely identification of distress episodes can be achieved using payment system information. Issues in depositors' trust involve the transfer of deposits that can be traced in payment systems. This is hard data, not survey data. It is consequently more timely and complete as it captures everything happens in real-time. This nice feature comes at a cost: the complexity of its structure.

3 Identifying Deposits' Outflows in Payment Systems

In this section we describe how to identify deposits' outflows using payment system data. Before getting into the details of our algorithm, we give a brief and simplified overview of payment systems and the related data.[7]

3.1 Deposits and Reserves

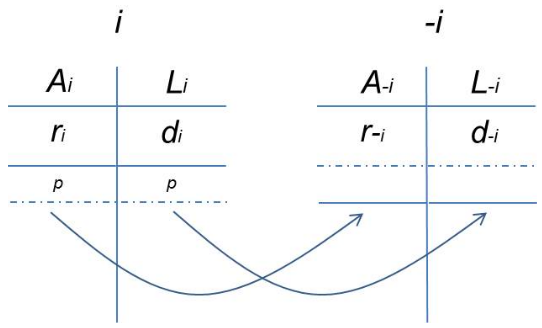
When deposits move from a bank to another one, the operation involves a change in both assets and liabilities for both banks. In Figure 1 a simple example is given. If a depositor of bank i transfers p to bank $-i$ (which can be thought as the rest of the banking sector), d_i decreases by p and d_{-i} increases by p on the liability side. On the assets side, the interbank transaction is settled using reserves held at the central bank, thus r_i decreases by p and r_{-i} increases by p. Also deposits converted in cash are traceable, in this case $-i$ is directly the central bank.

This mechanism is at the crux of banking intermediation in payments. The exchange of reserves guarantees that there is no counterparty risk left in the payment operation. Without access to and settlement in central bank money bank i and $-i$ should have bilateral accounts or use an asset not free from risk to clear the obligation. Both are undesirable from a systemic risk perspective and from the bank business perspective, as the latter is just selling a payment service and would avoid engaging in credit risk. See Directive 98/26/EC for more details on the obligations related to the settlement finality of payments in Europe.

Both deposits' outflows related to distrust and regular outgoing payments imply such movements of reserves; we describe in Section 3.3 how to identify the first cause. The settlement in reserves is operated in the real-time gross settlement (RTGS) system, where banks' reserve accounts are digitally managed and updated. It follows that if we can track p from the reserve leg of the transaction, we obtain information on the deposit leg as well.

[7] See Kokkola (2010) and Haldane et al. (2008) among others for a more detailed description of payment and settlement systems.

Figure 1: Deposits and Reserves



Notes. A simplified bank balance sheet is represented. A represents assets, L liabilities. i is a bank, $-i$ is the rest of the banking system. r_i are i's reserves, d_i are i's deposits.

3.2 How to Track Deposits' Flows in the RTGS

If a customer of a bank wants to withdraw her deposits, she has two options: (i) withdraw them in cash, (ii) transfer them to another bank.[8] When the deposits are transferred to another bank (liabilities decrease), they have to move from the reserve account of their bank to another one (assets decrease) at a certain point in time. In modern financial systems, interbank positions are settled in central bank money on the RTGS,[9] they can be settled directly or through a retail payment system (RPS).[10] The latter aggregates many single transactions, calculate interbank exposures and finally sends the position of each bank to the RTGS, netting the gross positions. It follows that a transaction reaches a final settlement in central bank money following different routes, depending on its nature and customers' preferences on the speed of settlement. If customers prefer a real-time settlement, they can buy this service from the debtor's bank and the payment is sent directly to the RTGS, otherwise the payment is settled through the RPS. Usually this process ends with a delay of one day w.r.t. a real-time settlement.

Nowadays, there is also the possibility of using 'instant payments', that are retail payments settled in few seconds. Since instant payments settle in real-time, banks have to dedicate part of

[8]Here we assume that the depositor does not want to convert the deposits into something different and potentially illiquid, like securities, gold or other financial activities different from cash or deposits, which can be used also for payments. Even in this case, if the account of the counterparty is in a different bank we will observe it anyway.

[9]Banks' reserve accounts are held in the RTGS. In this system, interbank transactions are settled in central bank money, intradaily or at the end of the day, to avoid the accumulation of interbank exposures and the implied counterparty risk. In this simplified discussion we assume there is only one RTGS for a currency. If the transaction is between customers of the same bank there is clearly no need to settle any position in the RTGS. Given that we are interested in distress episodes, this is not an issue because customers move their money outside their bank.

[10]Usually the RPS sends multilateral interbank positions that are computed with the information received from the automated clearing houses (ACHs), that in turn collect and aggregate customer payments. ACH is a computer-based clearing and settlement facility established to process the exchange of electronic transactions between participating depository institutions.

their reserves or some collateral to pre-fund them. These systems can settle basically the same type of transactions of classic RPSs plus mobile and peer-to-peer instant transfers, which can be increasingly used by customers. With a classic RPS it takes up to one business day for a payment in euro to reach the beneficiary. With instant payments, the funds are available immediately (in the order of seconds) for use by the recipient, 24/7/365. This feature is particularly appealing for depositors that want to move their deposits immediately because they think that the bank is going to fail. We may call this situation a sort of 'instant distress'.

Also an higher demand for paper cash is visible in the RTGS. Holding constant its inventory, if customers want to transform their deposits in cash, the bank has to get the banknotes from the central bank. The latter gives the cash to the bank and debits its reserve account in the RTGS in real-time.

Figure 2 gives a simplified view on how customers can move their deposits in a stylized payment system. The beige box represents a RTGS, where the reserve accounts of the banks are held. The smaller violet and orange circles represent respectively a RPS and an instant payment system (INST), which are called 'ancillary systems' of the RTGS. The red arrows represent possible ways a depositor of bank A has to move her money: (i) instantly, through INST; (ii) in real-time, ordering a direct transfer on the RTGS; (iii) with a deferred net settlement, through a RPS, to bank B; or (iv) converting the deposits into cash.

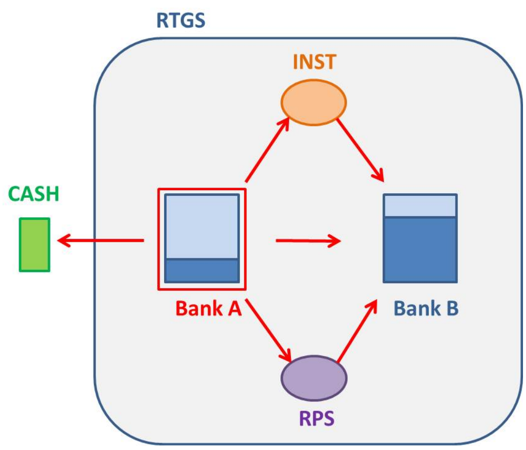
As a result, the RTGS represents an optimal perspective from which monitoring and studying customers' behavior.[11] If this information is promptly available, it can timely detect difficulties of a bank before the stability of the entire financial system is threatened.

In Section 5 we use data from TARGET2 to track deposits' outflows. TARGET2 is the RTGS system owned and operated by the Eurosystem. TARGET2 is based on an integrated central technical infrastructure, called the Single Shared Platform, it is operated by three national central banks: Bank of Italy, Banque de France and Deutsche Bundesbank. The implementation of TARGET2 was based on a decision of the ECB Council of autumn 2002. TARGET2 started operations on 19 November 2007, replacing TARGET. Central banks, commercial banks and other financial market infrastructures can submit payment in euro to TARGET2, where they are processed and settled in central bank money. European banks hold and manage their reserve accounts on TARGET2. More than 1,700 banks use TARGET2 to initiate transactions in euro, either on their own behalf or on behalf of their customers. Taking into account branches and subsidiaries, more than 55,000 banks

[11]Clearly this is not the case if customer payments are mixed with interbank payments or there are other types of noise. In this case it is impossible to identify properly ancillary systems or banking groups.

worldwide (and all their customers) can be reached via TARGET2. In the online appendix we detail the information on customer payments available in TARGET2.

Figure 2: A Simplified Schema of How Customers Can Move Deposits in Payment Systems



Notes. The big box is a stylized representation of a RTGS, where the central bank does its operations with commercial banks and where the latter have their reserve accounts (soft blue bins), all is settled in central bank money (dark blue in soft blue bins). The small violet circle represents a retail payment system (RPS). The small orange circle represents an instant payment system (INST). The red arrows represent outflows of central bank money from bank A reserve account, to bank B account via a RPS, INST, directly through the RTGS, or to banknotes.

3.3 Methodology

From a methodological perspective, the goal of our analysis is twofold. First, we want to identify distress episodes from payment system data. Second, we want to do it in real-time. The first problem consists in finding a structural break in depositors behavior with high frequency data. The second problem is more peculiar and close to a early warning method. On this topic, the economics and finance literatures have developed several methods mostly for banking, currency and balance of payments crises. A not fully exhaustive list of methods used in this context includes the minimization of the noise-to-signal ratio (Kaminsky and Reinhart, 1999), fully-parametric (Logit/Probit) models (Berg and Pattillo, 1999), semiparametric models (Arduini et al., 2012), classification trees and random forest (Alessi and Detken, 2017).

In all these approaches the econometrician (i) observes ex-post $W_{ct} = 1$ if a crisis occurred at time t in country c, (ii) chooses a set of covariates X_{ct} that should predict a specific type of crisis, (iii) specifies $f(X_{ct})$ as a valid function of the observables, (iv) selects a crisis threshold τ for f and (v) predicts a crisis if $f > \tau$. Observe that in this case it is also possible to assess the quality of the method and possibly type I and II errors.

Unfortunately, our problem is different from a classical early warning exercise. Usually the crisis is known and researchers try to use some information to predict the event, based on previous cases. For idiosyncratic distress episodes there may be no evidence for two reasons: (i) the deposits can fly away and get back in between two observations of supervisory data, (ii) the digital component does not allow to physically observe lines at the bank branches. See the online appendix for a discussion on the tempestivity of supervisory reports. In practice, episodes are not necessarily public knowledge. It means that we have to uncover them. In this sense, the exercise is substantially different. The coexistence of these two goals, identifying episodes and doing it in real-time, makes our task more difficult.

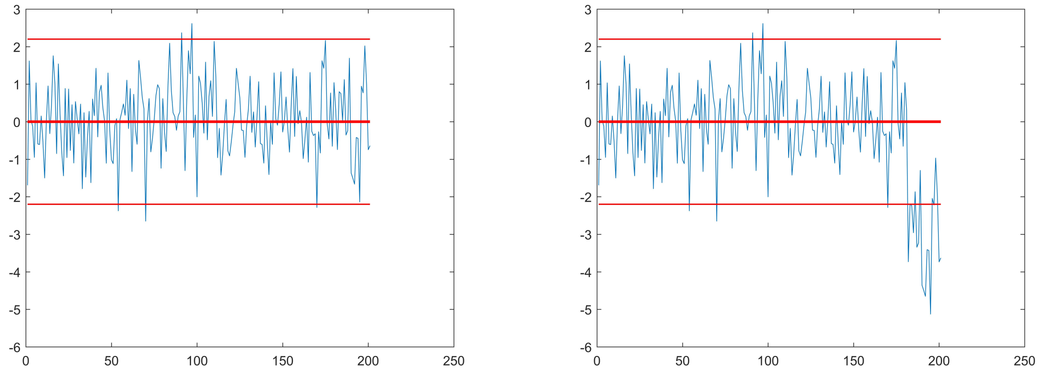
To achieve these goals, we propose to adapt a statistical tool that is very popular in industrial production: the control charts. The control chart was invented by Walter A. Shewhart while working for Bell Labs in the 1920s (Shewhart, 1926). Shewhart framed the problem in terms of common- and special-causes of variation. The control charts is now the most used tool to control industrial production processes. The tool was designed to monitor the quality of products in the continuum and to real-time detect anomalies in the production process. The aim was to minimize the cost of the production of wrong pieces. Here the logic is close, as we are interested in minimizing the social costs of a distress episode by identifying it as soon as possible.[12]

In practical terms, a basic control chart consists of points representing a statistic (y_t) that measures a characteristic of a sample taken from the production process over time. This statistic must be close to the 'desired value' (y^*), which is given by the industrial process and calculated as a mean of previous observations from a stable state. It constitutes the center line of the chart. The standard deviation of the statistic (σ_y) is also calculated from a stable state and used to determine upper and lower control limits (respectively UCL and LCL) that indicate the thresholds at which the process output is considered statistically unlikely and are drawn typically at 3 standard deviations from the center line, under normality assumption. By the way UCL and LCL are constructed, observations can exceed these limits in rare cases if the process is under control, for example $P(y^* - 3\sigma_y = LCL < y_t < ULC = y^* + 3\sigma_y) = 0.997$ of the observations occur within 3 standard deviations of the mean. This approach is also called the 'sigma approach'. In Figure 3 we show how simulated process under control (panel (a)) and not under control (panel (b)) look like. For some examples and a review see Lowry and Montgomery (1995).[13]

[12] An alternative to the Shewhart control chart would be the cumulative sum (CUSUM) control chart. The cumulative sum in this type of chart is the sum of deviations of individual sample results from the target. See Andreou and Ghysels (2009) for a review of this and other type of sequential tests used in financial time series. CUSUM charts are more sensitive to small and temporary shifts, which is less desirable in our context. Note that if there is a true shift in the process average, the Shewhart chart will pick it up eventually.

[13] See Montgomery (1980) and Lorenzen and Vance (1986) for a discussion on the economic design of control charts. See Scheffe (1947), Nelson (1989), Iacobini (1994), Nelson (1984), Lowry et al. (1992), Roberts (1959) among others

Figure 3: Processes Under and not Under Control



(a) Under Control

(b) Not Under Control

Notes. Time series of simulated data from a normal distribution. x-axis: days. y-axis: deposits net outflows. The DGP is from our pivotal simulation setting, as described in Section 4. The red bold line represents the expected value of the process, the red light lines track the UCL and LCL, here set equal to +/-2.2 σ. The last 20 observations of the series 'Not Under Control' are shocked with expected outflow equal to 3σ, where σ is the standard deviation of the simulated normal process.

For our problem, control charts have the following appealing features: (i) they are designed to be applied on real-time data (as in RTGS systems), without any ex-post and known definition of previous crises (W_{ct}); (ii) they allow us to detect timely 'special-causes' with high-frequency and firm-specific data; (iii) they do not provide a strictly binary indicator.

Nevertheless, they also have some undesired features: (i) they are ad hoc designed for controlled processes of a specific firm with very standardized outputs, so the 'desired value' (y^*) is given; (ii) they rely on quite strong distributional assumption (usually normality) and (iii) do not consider seasonality and other common and problematic features of financial time series.

These are substantial limitations in our context for the following reasons. Customer payments are not normally distributed and it is in general difficult to find realistic parametric assumptions. Banks have often structural unbalances generated by their clients' heterogeneity, some banks have more merchants than buyers among their clients or the other way around, thus they can have persistently or cyclically positive or negative net positions on customer payments. There are many technical features and intermediary chains that make these time series less predictable, banks may change their participation in RPS and RTGS or change the way they route their payments. There is high and specific seasonality and complex idiosyncratic time patterns in cash withdrawals (like holidays and weekends) and in payments related to taxes or fiscal dates. It follows that the 'desired value' (y^*) is not given and its UCL and LCL are more difficult to establish.

for interesting discussions, interpretations and extensions of control charts.

A way to see this problem could be in terms of an omitted unobserved treatment variable. Suppose that the deposits outflows are generated by the following model,

$$y_t = f(z_t) + \tilde{y}_t. \tag{1}$$

Deposit variation is fully explained by $f(z_t)$, that captures the observable component, and a unobservable component $\tilde{y}_t$. $f(z_t)$ can be seen as the term that captures seasonality, customers composition and any other systematic source of variation. This model differs from standard early warning models described at the beginning of this because we do not know ex ante which t is assigned to a distress period. If a shock occurs, but we can not observe it, a term adds to the random component in the unobserved term,

$$\tilde{y}_t = -d_t + \epsilon_t, \tag{2}$$

where d_t captures the additional net withdrawals if depositors do not trust their bank at time t and ϵ_t is a random component with a certain cumulative distribution function m_ϵ. When there is no shock $\tilde{y}_t = \epsilon_t$, thus we expect $P(\tilde{y}_t < \tau) = m_\epsilon(\tau)$, where τ is a threshold. If a shock occurs, i.e $d_t > 0$, then $\tilde{y}_t = -d_t + \epsilon_t$, thus we expect $P(\tilde{y}_t < \tau) = \rho > m_\epsilon(\tau)$. It follows that when a shock occurs, the probability of observing significant deposit withdrawals above the threshold τ increases. Our goal is to identify the time when the distress kicks in and d_t turns greater than zero. If the empirical frequency of $\tilde{y}_t < \tau$ increases in sequence, significantly exceeding $m_\epsilon(\tau)$ in a persistent way, we can interpret it as a shift generated by distress (d_t). The greater the intensity of the shock the higher the probability of detecting it. From this perspective it is also easy to see the importance of distributional assumptions. If ϵ is assumed to be normal, then we have $m_\epsilon(\tau) = F(\tau) = \frac{1}{\sigma_\epsilon\sqrt{2\pi}} \int_{-\infty}^{\tau} e^{\frac{-\epsilon^2}{2\sigma_\epsilon^2}} d\epsilon$. If this assumption is not correct, we can severely misspecify $P(\tilde{y}_t < \tau)$. What is particularly dangerous is if we overestimate $P(\tilde{y}_t < \tau)$ and set a potential critical value τ too low. In such situation we may have abnormal situations not detected. Given the high frequency of the data, we can use nonparametric methods to estimate the actual density m_ϵ when d_t is zero. In Figure A.1 in the online appendix, the blue lines report the empirical density of ϵ, which is estimated from our sample of pre-shock periods for the channels described above (more details are provided Section 5).[14] The orange lines depict instead the estimated normal distribution computed with the same sample mean and variance. While for cash withdrawals the density is very close to the normal, for digital transfers this is not the case. If we set a critical threshold to correspond with the fifth percentile of the normal distribution, we will not label as a warning a value largely below the real fifth percentile, thus not identifying timely any

[14]INST are not present in the sample, so it is missing in the plot.

episode. Such evidence highlights the importance of a nonparametric step. In the next section we use simulated data to show the benefits of a nonparametric approach. For these reasons we propose a method that preserves the nice features but tries to treat the drawbacks of the classic control chart method.

Regularized Nonparametric Shewhart Chart

To offset the undesired features of classic control charts, we introduce two important steps, one at the beginning and one at the end. The first consists in regularizing the input of the control chart (CC), the second uses nonparametric methods to identify anomalous situations in the CC framework. We name the method 'Regularized Nonparametric Shewhart Chart' (ReNoSCh).

In the first step we regularize the time series adding knowledge about the monetary phenomena under analysis:

$$\min_f \sum_T^{t=1} V(f(z_t), y_t) + \lambda R(f), \tag{3}$$

where V is an underlying loss function that describes the cost of predicting $f(z)$ when the label is y, such as the square loss or hinge loss; and λ is a parameter which controls the importance of the regularization term. $R(f)$ is typically chosen to impose a penalty on the complexity of f. Concrete notions of complexity used include restrictions for smoothness and bounds on the vector space norm. After this step the target variable becomes $\tilde{Y} = Y - f(Z)$. In our case the target vector is set $Y = RTST + INST + DNST + CASH$, the proxies for depositors behavior introduced in the online appendix. Z can be chosen in several ways. In our practical experience, when daily payment system time series are used, it is important to add (or let the method add) many day, week and month dummies in addition to the constant, the trend and cyclical effects. An additional difficulty associated with daily time series is that there are also non calendar-constant effects. For example, many transfers and cash withdrawals are made around Easter, whose date varies. It is important to include it to not have false alarms that are just holiday-implied abnormal reductions of deposits. In Section 5 we describe the set of controls included in our application when euro payments are modeled. A very simple specification of (3) would be a simple linear model with important dummies included in Z, thus having $f(z_t) = z_t\beta$, $\lambda = 0$ and $V(.)$ equal to the squared difference. After having chosen the model, the target variable becomes the residual, i.e. the difference between the observed and the predicted. In the linear case it is $\tilde{Y} = M_X Y = (I - X(X'X)^{-1}X')Y$. The resulting time series is similar to the classic CC input.

Now that we have a well-behaving series we need to define a way to assess timely when customer payments are not 'under control'. The issue here is that normality is far from reality in financial time series and especially in customer payments, as showed above. For this reason in the second step we derive nonparametrically critical thresholds and warnings, avoiding inadequate distributional assumptions. The idea is that if the monitored variable is not normal and its distribution is not known a-priori, we can nonparametrically estimate it and then assess whether the new observations are concentrating in unlikely regions. The high frequency of payment data allows us to do it. Given our interest in depositors' trust, we are worried only by a divergence towards the LCL, i.e. when the bank starts to have significant outflows of deposits. More formally, we propose the following procedure.

ReNoSCh algorithm

1. Regularize the target variable Y with model M on a big time support T_B, which ends at time t_c, and set the new target variable $\tilde{Y}$ equal to the obtained residuals;
2. Use a time interval $T_S \leq T_B$, which ends at time t_c, to estimate the distribution of $\tilde{Y}$ with a nonparametric method D;
3. Estimate a threshold ψ_p for a selected probability p such that $P(\tilde{Y} < \psi_p | M(T_B), D(T_S)) = p$;
4. Set s and k, with $s < k$, where s is the critical number of days in which the observations exceeded the critical threshold in the last k days. A warning at time $j > t_c$ is defined as a binary variable: $W_j^{k,p} = 1$ if $\sum_{t=j-k}^{j} I(\tilde{y}_t < \psi_p) > s$ and 0 otherwise;
5. A distress episodes occurs if U consecutive warnings are observed;
6. The episode ends when the bank fails or when we have E consecutive non-warnings days.

$\tilde{y}_t$ is the t^{th} element of the vector $\tilde{y}$, which contains all the observations of $\tilde{Y}$ sorted by their time index. Step 1 transforms the target in a stationary variable to be used in the CC environment. A visual and formal inspection is suggested before moving to step 2. We suggest to regularize the variable in the widest available interval T_B to capture as much as possible of its systematic component, and use eventually a smaller interval T_S in step 2, to capture potential small changes in the distribution of th random component occurred in the very last period when it is nonparametrically estimated in step 3. If opportune T_B and T_S can coincide. In step 4 the researcher has to decide p, the probability that determines the critical threshold. Here the trade-off is standard, the higher the threshold the more false positive, the lower the threshold the more false negative. In step 5 we propose a criterion for labeling a day as a warning day, which is observing s days below the threshold over the last k

days, if there are U warning days in a row (step 5) then we have an alert in place. Step 6 sets a similar criterion to establish the end of the episode. Such criteria can be changed and even made continuous, like using $W_j^{k,p} = \sum_{t=j-k}^{j} I(\tilde{y}_t < \psi_p)/k$, in this case U must be a continuous threshold, which does not represent the number of warning days anymore. The researcher may also avoid the consecutiveness of warning days and set U as a relative frequency in a reference period.

Observe that the number of choices involved is inevitably pretty big $C = (M, T, t, D, p, s, k, U, E)$, and there is not strictly preferable ones a priori. For this reason the practitioner has to fine tune these choices depending on the environment and constraints she faces. In the next section we provide some examples using Monte Carlo simulations. In Section 5 we give additional insights using real data. If we have multiple target variables, the algorithm can be used for each target time series separately, or they can be jointly considered using multivariate control charts (see Lowry and Montgomery, 1995). In the empirical application, we stick with the simplest set of choices, using a linear model in step 1 and sorting and counting in step 4. It is shown that even with such a not very sophisticated methodology the algorithm works pretty well in detecting distress episodes.[15]

The nature of this problem is similar to finding a structural break in the drift of $\tilde{y}_t$, given that when the distress kicks in its expected value becomes different from zero. As we are interested in estimating this point in time, the standard Chow test can not be used because it requires such a point as an input. A more suitable candidate would be the method proposed by Bai and Perron (1998), for example. This test is able to estimate where the breakpoint, if any, is located. Its constraint is that the researcher can use it only ex-post, it is not designed to provide an identification in real time. See Andreou and Ghysels (2009) for a view on historical and sequential tests. Nevertheless, both tests can be used ex-post to check whether ReNoSCh got a proper date. In Section 5.2 we show with real data that our algorithm is able to identify the break date with high precision.

3.4 Alternative Information

Given that there are many viewpoints from which the health status of a bank can be observed, it seems that we need at least to discuss why payment systems are better than other information sources to timely identify true distress.

If we restrict our comparison to central bank-internal information, we see at least two potential candidates for monitoring banks' deposits. If the central bank is also the supervisory authority, it is likely to receive reports from the commercial bank with a certain frequency. In addition, inspections and other forms of control can be implemented. The quality and the frequency of this information

[15]The MATLAB code for the construction of the control chart is available at the following link: ReNoSCh.m.

depends on many factors. Even if supervisory reports can give a deeper view on the balance sheet of the bank, they have two major drawbacks. First, the frequency is usually low, and thus it can happen that distress occurs (and even ends) in between two observations (see the online appendix). Second, the bank may temporarily misreport some items. As an alternative, the central bank can monitor other aggregates that are under its direct control at a high frequency. The reserve account is an example, given that it is recorded every day for every bank to manage the reserve requirements. Nevertheless, we show in Section 6 how the drain is offset immediately by the banks, making the balance of the reserve account flat and uninformative.

Alternatively, one can look at central bank-external data. A straight source of information is market data. One can follow several indexes computed for a bank for example on Thomson Reuters, Bloomberg and so on. The problem is that market data is by construction informative for marketable debt, it can tell us whether people is selling bank's bonds or other type liabilities, but it is uninformative about deposits. Another popular source of information is Google. Google trends has been used in several economic research papers to nowcast economic aggregates (see Choi and Varian, 2012; D'Amuri and Marcucci, 2017, for example). To test this possibility, we took the sample of episodes identified in the empirical application (see Section 5) and generated several time series combining the name of the bank with the words 'crisis', 'failure', 'distress' and summed them up. The indicator works pretty well in tracking these bad news episodes. Unfortunately, there is always an increase of these searches when bad news pop up, even without a drop of deposits, so the type I error is quite high. Probably people start to search these words even if they are not that bank's depositors and, even if they are, it is not automatic that they then withdraw their money.[16] It then seems a much more noisy measurement than the punctual outflows detected in payment systems.

4 Monte Carlo Study

In this section simulated data is used to study the properties of our algorithm. We set the numerical experiment parameters using some real world features, which are described in Section 6. We simulate deposits net outflows using the following model:

$$y_t = z_t\beta - d_t r_t + \epsilon_t, \ with \ \ t = 1, ..., T. \tag{4}$$

[16]Social networks, like twitter, also provide signals about depositors' sentiment (see Accornero and Moscatelli, 2018), but they may suffer from the same problem.

Where $T = 960 = 20 * 12 * 4$, a length close to the number of working days in 4 years, the average period in our empirical sample. ϵ_t is normally distributed with mean equal to zero and variance equal to σ. For simplicity let z_t be a $T \times k$ matrix capturing monthly seasonal effects and β be a $k \times 1$ vector, where $k = 12$, the number of months. Let $\beta_{1:11} = 0$ and $\beta_{12} = 3\sigma$, resembling higher customer payments outflows in December, during Christmas. r_t is an indicator function that switches to one when a distress episode triggers, d_t is the relative outflow. We generate 500 samples characterized by distress and other 500 generated without any. To mimic the features of real episodes observed, we set $r_t = 1$ if $t \in [T - 20, T]$ when a it occurs, so the episode is four weeks long in the last period of the sample. We set $d_t = 3\sigma$, which means that the expected daily net outflow during distress days is slightly below the first percentile of the distribution of customer payments.

Using this setting we play with our algorithm's parameters. To move along the different dimensions, we use a pivotal setting with $s = 3$, $k = 5$, $U = E = 5$, $M = linear$, $T_S = T_B$ and $p = 0.075$. We focus on four outcomes generated by the simulations. In order to understand the sensitivity of the efficacy and the fallacy of our algorithm to the main parameters we look at the frequency of true positive over the total number of real distress episodes generated and the frequency of false positive over the total number of no-distress episodes generated. To assess its reactivity under different specifications we compute the average distance from the beginning of an episode for the first day in which a warn is observed and for the day in which a sequence of warning days is labeled as a distress period.

First, we want to study the sensitivity of our method to the ratio between s and k, which is the number of days with an extreme value (s) over the last k observations. We set $k = 5$, the working days of a week and change $s = 1, 2, 3, 4, 5$. The first panel of Table 1 reports our results, where we can see that when s is very low we have a high number of false positives, equal to 74 percent when $s = 1$, while every true case is detected. The false positives dramatically decrease already when $s = 2$ to totally disappear when $s = 3$. When s increases further the algorithm is less able to intercept true cases, about 15 percent of them are not recognized when $s = 5$. This results is implied by the fact that a too strict sequence of observations below ψ_p is less likely to be observed, because some outflows may not be that negative and alternate with values above the critical threshold even if the bank is in distress. From the last two columns we can also see that the reactivity of the algorithm is higher for smaller s.

Another important parameter to set is p, the critical probability. Choosing it extremely low would not let the algorithm detecting critical episodes if the average outflows are not that extreme, while many false positive may appear if it is set too high. In the second panel of Table 1 we report the results of simulations with $p = 0.01, 0.025, 0.05, 0.075, 0.15$. When p is set equal to 0.01, about 12 percent of the true positive is not detected. The percentage of correctly recognized distress episodes sharply increase already at $p = 0.025$, to reach zero at $p = 0.075$. When this probability is set too high, in the table equal to 15 percent, some false positive cases start to appear. With an higher p the algorithm is faster in detecting the true distress episodes.[17]

In the third panel of Table 1 we study how the presence of systematic outflows, here represented by monthly effects, can bias the identification of distress episodes if not correctly treated. We first introduce the seasonal outflows in December and set them equal to $3/4\sigma$, a fourth of $E(d_t)$, and then double them. From the table we can see that the distortion is only on false positives, which move from zero to 74 percent. In other words, the algorithm signals a distress episode almost every time there are seasonal outflows, if they are comparable. In our practical experience, this is often the case. Especially during holidays the value of outflows can be even higher than those observed in distress episodes. In the fourth panel of the table we change U, the number of consecutive warning

Table 1: Simulation Study - Playing with ReNoSCh Parameters

	True positive	False positive	First warning day	First alert
s				
1	1.000	0.744	0.060	4.060
2	1.000	0.076	0.854	4.854
3	1.000	0.000	1.968	5.982
4	0.996	0.000	3.152	7.290
5	0.868	0.000	7.136	11.680
p				
0.010	0.884	0.000	6.610	10.854
0.025	0.992	0.000	2.626	6.738
0.050	0.997	0.000	2.262	6.288
0.075	1.000	0.000	1.968	5.982
0.150	1.000	0.020	1.582	5.590
β				
0	1.000	0.000	1.968	5.982
$3/4\sigma$	1.000	0.050	1.824	5.824
$3/2\sigma$	1.000	0.742	1.794	5.794
U				
1	1.000	0.042	1.944	4.000
3	1.000	0.014	1.944	4.140
5	1.000	0.000	1.968	5.982
7	0.000	0.000	30.000	30.000
9	0.000	0.000	30.000	30.000

Notes. Results based on 1000 replications, with 500 processes with distress episodes and 500 without. The column 'True positive' reports the percentage of detected true distress episodes over total true distress episodes. The column 'False positive' reports the percentage of no distress episodes erroneously labeled as distress episodes. The column 'First warning day' reports the average distance between the beginning of a distress episode and the first day in which a warn is observed, according to the algorithm's parameters. The column 'First alert' reports the average distance between the beginning of a distress episode and the day in which a sequence of warning days is labeled as a distress episodes, according to the algorithm's parameters. When no distress episode is recognized by the algorithm even if present, we set such distance to 30 days.

days. Given that we defined a warning day as a signal which may be induced by more than one day

[17] Such result depends on $E(d_t)$, the expected outflow during a distress episodes. Given that we set it equal to 3σ and we simulated ϵ with a normal distribution, the median of $\tilde{y}$ when the shock occurs is below its first percentile before the shock occurs. If $E(d_t)$ were higher we would have preferred to set p higher.

below ψ_p, we can see that even with low values of U the number of false positives is pretty small, but not negligible. The minima of both type I and type II errors are reached when it is equal to five. Increasing it further implies a sharp raise of type II error, with basically no true distress episode detected. This is again because the probability of observing very long sequences of warning days is low even when the expected outflow is high.

As a last exercise, it is shown how the nonparametric approach proposed performs with respect to the 'sigma approach' when the distribution of the random component is not normal. As the sigma approach uses a certain number of standard deviations (sigma) from the mean, it implicitly assumes normality, and it is thus expected to be less effective if data is not normal. This time ϵ is generated as a mixture of two different distributions:

$$\epsilon = I(\omega < \kappa)N(0,\sigma) + I(\omega \geq \kappa)P, \text{ with } \kappa \in [0,1], \omega \sim U(0,1),$$

and P equal to a not normal distribution. In practice κ observations have the same distribution of before and $1-\kappa$ have a different one. We set $P = \iota\chi^2_k$, where ι is a parameter and k are the degrees of freedom of the χ^2 distribution. We chose the χ^2 as its skewness and kurtosis are functions of k, respectively equal to $\sqrt{8/k}$ and $12/k$, so that it is easy to play only with the degrees of freedom to change these features of the resulting distribution of ϵ. Our pivotal setting is used to generate replications, the critical threshold ψ_p for the sigma approach is set such that $P(z < \psi_p) = 1 - F(z) = p$, with $z \sim N(\hat{\bar{y}}_t, \hat{\sigma}_{y_t})$, where $\hat{\bar{y}}_t$ and $\hat{\sigma}_{y_t}$ are the sample estimates of y_t mean and standard deviation in the pre-distress period. We set $\kappa = 0.6$, to have slightly more than the majority of observations being normal, and $d_t = \zeta$ such that $P(y_t < \zeta) = 0.13$, which has the same probability on its left of $d_t = 3\sigma$ when the random component has a standard normal distribution, as in our former experiments.

Given our interest in understanding whether a nonparametric approach detects distress episodes more effectively than the sigma approach, we focus on the power of these two procedures. In the second and third columns of Table 2 we report the frequency of true positives (on all true cases) detected respectively by the sigma and the nonparametric approach. The performance is explored along two dimensions. First, ι is increased from one to three to give more importance to non normality, secondly the number of degrees of freedom k is set to one, three and six to change skewness and kurtosis. On average the nonparametric outperforms the sigma approach by far with values always greater than 50 percent, while the sigma approach reaches higher values only when k and ι are low and it is always equal to zero when $k > 3$. It has to be noted that the power of both approaches decreases with k, this is because the fatter right tail of the random component makes more likely

Table 2: Simulation Study - Sigma vs Nonparametric

ι	k	Sigma approach	Nonparametric approach
1			
	1	1.000	0.964
	3	0.784	0.678
	6	0.000	0.548
2			
	1	0.846	0.908
	3	0.006	0.576
	6	0.000	0.572
3			
	1	0.082	0.860
	3	0.000	0.594
	6	0.000	0.546

Notes. Results based on 1000 replications, with 500 processes with distress episodes and 500 without. The column 'Sigma approach' reports the percentage of detected true distress episodes over total true distress episodes for the sigma approach. The column 'Nonparametric approach' the percentage of detected true distress episodes over total true distress episodes for the nonparametric approach.

to have some observations above the critical threshold, as witnessed in Figure A.2 in the online appendix, where the histograms for the nonparametric, sigma and observations are plotted for the cases in which $\iota = 1$.

In the practical implementation, we suggest to observe the distribution of the random component and compute the outcomes of the algorithm under different combinations and monitor them in parallel.

5 Empirical Application

After having described the source of information to keep track of deposits' outflows and the methodology to timely identify shocks, we move to the empirical part. We consider the Italian banking system operating in TARGET2 from August 2012 to August 2019. The period is particularly suited for the identification and the analysis of idiosyncratic episodes as the Italian banking system emerged from the financial crisis and the sovereign debt crisis with some vulnerabilities, and there were several changes of regulation related to banks' resolution. Some banks received aid under the applicable EU rules on resolution. The national insolvency proceedings facilitated the market exit of some banks. Other banks were precautionary recapitalized. Furthermore, many banks were often spotlighted for the high incidence of non-performing loans in their balance sheets.

5.1 Setting and Implementation

With respect to the subjective choices mentioned before, let us first detail our settings in what follows. We constructed bank i's net daily position on each of the channels listed in the online appendix by subtracting the total amount of outgoing payments to the total amount of ingoing payments related to the respective payment category.[18] Here we focus on the sum of the four relevant time series that proxy customer deposits' behavior, $RTST$, $INST$, $DNST$ and $CASH$, which are the net daily inflows respectively for real-time settlement, instant settlement, deferred net settlement and cash conversion transfers (see the online appendix for a detailed description).[19] We regularize payment data on a time support T_B between 2 and 7 years, depending on the length of the period the bank is operating on TARGET2. We included a constant, a trend, monthly and daily dummies, pre/post/during holiday periods fixed effects -namely Christmas, Easter and Summer-, start/middle/end of the month dummies, fiscal and tax payment dates dummies (around the 20th of each month some taxes are paid, generating significant payment burden for the banks). This setting gives up to about 1400 observations and less than 100 controls, which are by construction not linearly dependent, thus we can use simple OLS to regularize the data.[20] We then take a smaller time interval T_S of six months; we estimate the distribution of $\tilde{Y}$ by simple sorting and counting. Kernel density estimate does not provide superior results. We estimate a threshold such that $P(\tilde{y}_t < \psi_p) = p = 0.075$, which gives us more sensitivity (than 0.05) to departures from a stable state and does not capture too small deviations (like 0.15, see Table 1).

Based on our Monte Carlo study in Section 4, we set a warning as a sequence $s = 3$ of observations below the threshold on $k = 5$ consecutive days. Three over five days gives a good compromise if we think that a distress episode implies continuity of observations below the critical threshold (as shown below). Table A.1 in the online appendix reports some simple numerical examples that show that $s = 3$ outperforms $s = 2$ in terms of type II error and $s = 4$ in terms of type I error, when distress episodes last at least five consecutive days of outflows below the critical threshold. Finally, we have to set U, the number of consecutive warning days to trigger an alert. Our Monte Carlo study suggests that $U = 5$ minimize type I and II errors in the simulation settings explored, but with real data this is not guaranteed. Given that this is probably the most critical choice, we run the algorithm in parallel for $U = 0, 1, .., 7$.

[18] In principle deposits run-in (Martin et al., 2017) and asset side runs (Ippolito et al., 2016; Ivashina and Scharfstein, 2010) may be included in the net positions, but they should be a residual part compared to the deposit run-off.

[19] We also have considered each series separately. The algorithm performs worse because some banks are more active on some channels and not in others. $INST$ is missing in the time period considered.

[20] In case the degrees of freedom are too small other techniques like LASSO can be use to treat the dimensionality problem.

In the implementation, we did two exercises to study the performance of our algorithm. First, we ran the algorithm systematically for the whole banking system, keeping track of the warnings for each bank in each day.[21] Second, we identified bank-specific crisis episodes that involved banks in our sample. To define this set we used the following criteria. We took all the cases in which the supervisory authority started principal procedures, like special administration, liquidation and withdrawal of authorization. We added also cases in which 'many' newspapers started to diffuse 'bad news' about the same bank. With 'bad news' we mean information about the solidity of the bank, i.e. any information that put the solvency of the bank into question and may have impacted the risk associated with its deposits. With 'many' we mean all the major domestic newspapers, namely *Il Corriere della Sera, La Republica* and *il Sole 24 Ore*, and eventually some international newspaper like the *Financial Times* and *The Wall Street Journal*. In our sample period we did not observe any distress episode starting without the diffusion of bad news by the press. We can not exclude that it could happen, but if a rumor diffuse for example through social networks in a so widespread form to generate a distress episode, it is difficult to imagine that the press does not recognize it (especially given the participation of the press itself in the social networks). Following this procedure, we identified $k = 10$ cases, for which we tested whether there were digital distress episodes, as we know that there were not physical cash-based distress episodes.

For these cases, we first check whether the algorithm signals the existence of a distress episode and then check whether there was a real outpouring of reserves (see Section 5.2). In this case we take these episodes as true positives. In case the algorithm signals a warning outside these cases, we check for the existence of rumors or news regarding the bank and its balance sheet. If nothing is anomalous, we label it as a false positive. The exercise reveals the existence of $\bar{r} = 3$ cases, and that the algorithm is able to real-time detect them, with a very small portion of false alarms if an appropriate number of consecutive days of outflows is set. Table 3, shows type I and II errors when different numbers of consecutive warning days (U) are labeled as distress episodes.

For few consecutive warning days ($U < 5$), we can see that type I error is very big, while we always get properly the true distress episodes. When U is set to 5 days, a working week, the algorithm reaches its best, with type II error equal to zero and type I error equal to 0.1 percent. For values greater than 5, the type I error is still on its minimum but the type II error gets bigger. This is because we may have alternate warning/no warning days sequences. We think that setting $U = 5$ (a working week) is the best choice, as it shows a remarkably good performance with real and simulated

[21] We excluded the Sovereign debt crisis period from the sample, because we want to focus on idiosyncratic and not on systemic risk episodes.

Table 3: Empirical Type I and II Errors

U = 0	Warning	No warning
No distress	1.000	0.000
Distress	1.000	0.000

U=1	Warning	No warning
No distress	0.527	0.473
Distress	1.000	0.000

U=2	Warning	No warning
No distress	0.163	0.837
Distress	1.000	0.000

U=3	Warning	No warning
No distress	0.033	0.967
Distress	1.000	0.000

U=4	Warning	No warning
No distress	0.006	0.994
Distress	1.000	0.000

U=5	Warning	No warning
No distress	0.001	0.999
Distress	1.000	0.000

U=6	Warning	No warning
No distress	0.000	1.000
Distress	0.667	0.333

U=7	Warning	No warning
No distress	0.000	1.000
Distress	0.667	0.333

Notes. Warnings are generated with the ReNoSCh algorithm, described in Section 3.3. U is the number of consecutive warning days set by the researcher, according to the specifications in the empirical application. The other parameters of ReNoSCh are described in Section 5.1. A warning triggers when the number of consecutive warning days is greater or equal to U. A distress episode is defined as the event in which a significant outpouring of liquidity was observed ex-post as a reaction of bad news in many newspapers. For U = 6 and 7 in the distress cases, some non warning day appeared in between consecutive warning days.

data.[22] For E we set the same length, thus an episode ends after five consecutive non-warnings days. Under this specification, the time series of daily changes in net customer payments before the shock is stationary and similar to a white noise, passing the Dickey-Fuller test.

It is important to note that the high performance of the algorithm is also generated by the good quality of the information available. Given that we are able to identify exactly customer payments to other banks and cash withdrawals, if deposits are flying away, we see it. Clearly if the measurement is poor and, for instance we are not able to disentangle customer payments from interbank payments, or cash withdrawals are confounded with other operations of the bank with the central bank (like open market operations), these numbers may worsen dramatically and even invert. Indeed, in Section 6 we show how the liquidity drain is offset by open market operations and some interbank payments, if these flows were not separable from customer payments, we would just have had a flat line (the balance of the reserve account of the bank under distress).

5.2 Structural Break Tests

Our analysis is based on the ability of ReNoSCh to identify distress episodes. ReNoSCh works on real-time, when we are at time t it says to us whether a shock is occurring exactly at time t. This is not only a desirable feature, it is partly the scope of this work. In this section, we want assess the capacity of our algorithm to detect distress episodes formally.

[22] Alternatively, we can also allow for non consecutive days criteria, like observing average frequency of warning days non necessarily in a row, but this could increase the type II error.

A straight way to assess the quality of ReNoSCh's output is to backtest it. We can check whether structural break tests, which use a larger information set (having post-shock observations available) identify the beginning of distress at the same date. Clearly these methods are not substitutes of ReNoSCh, because they can not identify breaks in real-time, but they can tell whether they would ex-post spot a break at the date identified by ReNoSCh in real-time.

A classic methodology to test for structural breaks is the Chow test. As ReNoSCh works directly on residuals of a regularization step and we are not interested on any particular structural relationship of customer payments with other variables used in the regularization process, we can just test whether the average daily net position on customer payments changes its expected value exactly when ReNoSCh says. We took all the $\bar{r}$ distress episodes identified by ReNoSCh and average the net position of the bank separately for cash, real-time, deferred settlement payments and the sum of them across the episodes from 100 days before the first distress day and the following 20 days. We run the test giving the identified first day of distress as a candidate for the breakpoint. The test statistics are reported in the upper panel of Table 4, the p-values are always very small. There is significant evidence to reject the null hypothesis that the coefficients are stable after the ReNoSCh-break points occurred for all the time series considered.

The Chow test takes the breakpoint as given, thus the method is good for backtesting our model but is not fully comparable to it, as it does not estimate the break date. To check its sensitivity we can change the breakpoint around the one estimated by ReNoSCh and see how well the test performs. We took the 10 days before and the 10 days after the estimated day. In Figure A.3 in the online appendix we report the Chow test statistic in blue and its critical value in violet. We can see that the statistic reaches its maximum around the estimated break point, tracked by a black vertical line. Nevertheless, the blue line is above the violet in a small interval around the estimated break point, between 5 and 9 days wide. To get a more reliable assessment of the quality of our algorithm, we can consider a structural change test that provides also an estimate for the breakpoint. The test proposed by Bai and Perron (1998) is suited for this task and very popular among scholars doing this type of econometric exercises.[23] In their test there is no input regarding the breakpoint, and the method is free to estimate the optimal one. A useful feature of their estimator is also that it constructs confidence intervals for the break dates.

In the lower panel of Table 4, we report the expected break date estimated with the algorithm of Bai and Perron (2003) and the 95 percent confidence intervals.[24] All the days are expressed as

[23] See also Bai and Perron (2003) for a description af the relative algorithm and applications.

[24] We use the R function 'breakpoints' in the package 'strucchange' (Zeileis et al., 2001). We set the break points to be up to one.

their relative distance to the first day of distress estimated by ReNoSCh. The estimated break date for the aggregate time series of customer payments, in the first column, is the day after. For the deferred electronic transfers the estimated day is two days after, for the real-time transfers it is two days before, while for the cash withdrawals it is exactly the same day. The confidence intervals vary between 9 and 21 days and are narrower for DNST and the aggregate time series. Figure A.4 in the online appendix depicts the time series of the cumulated daily net position on customer payments, the ReNoSCh break date (the solid vertical line), the estimated endogenous break point (the dotted vertical line) and its confidence interval (the red segment). ReNoSCh break dates are always included in the confidence interval, and very close to the estimated expected date. As a whole it seems that the ReNoSCh provides a good outcome when compared with structural break methods. For the aggregate time series of customer payments, the beginning of distress is estimated even one day before. On average, it slightly anticipates the break date, which in our case is better than postpone it.

Table 4: Structural Break Tests - Exogenous and Endogenous Break Points

		All	DNST	RTST	Cash
Exogenous break point					
	Chow test statistic	22.559	14.780	8.345	10.982
	Critical value	3.076	3.076	3.076	3.076
	p-value	0.000	0.000	0.000	0.000
Endogenous break point					
	2.5% bound	-4 days	-4 days	-12 days	-4 days
	Expected	+1 day	+2 days	-2 days	0 days
	97.5% bound	+5 days	+6 days	+9 days	10 days

Notes. Dependent variable: daily change in the net position for each channel averaged across all the cases identified. The first column reports all the customer payments, the second reports the deferred net settlement transfers, the third reports the real-time settlement payments, the last reports the cash withdrawals. We considered 120 days, 100 before the distress starts. We use a standard Chow test for the exogenous break point. The test proposed by Bai and Perron (1998) and the algorithm in Bai and Perron (2003) are used to endogenously estimate the break date. 'Expected' reports the relative position of the estimated break point w.r.t. the estimated first day of distress. The bounds of the 95% confidence interval are also reported in terms of distance from the first estimated day of distress.

6 Evidence from Identified Distress Episodes

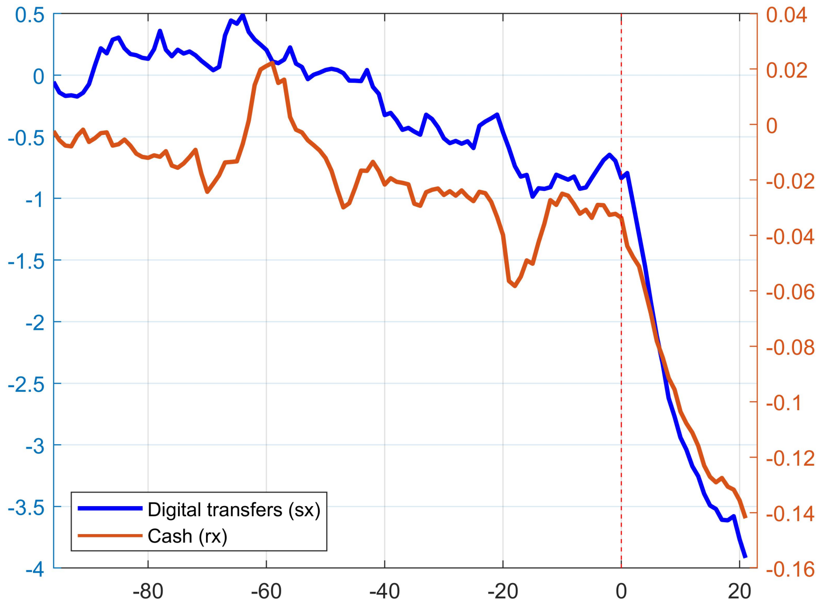
After having shown that our real-time identification scheme works with simulated and real data, let us move to the description of the features of the identified episodes. The first evidence is that not all of the k critical episodes considered turned into a real distress, but some did. In what follows, we use the sample of distress episodes identified by ReNoSCh (averaging the single cases). When not specified differently, we report the amount of outflows as a percentage of the banks' deposits before the shock. In these episodes, instant payments were not used by the banks.

Figure 4 provides an aggregate overview of the sudden decline of deposits when depositors' trust is undermined. In this plot, we average payments' net positions in digital transfers ($RTST + DNST$)

and banknotes ($CASH$) and cumulate them over time, starting from 100 days before the episode begins. The vertical line is the starting date estimated by ReNoSCh. We can see that it gets the break quite precisely, and more importantly in real-time. The drop in digital transfers (both real-time $RTST$ and net-deferred $DNST$) is pretty impressive as well as that for cash withdrawals ($CASH$). Nevertheless, the magnitude is different.

The distress episodes last on average four weeks, with an initial more intense phase of about two weeks. There is a following less intense period of other two weeks. The liquidity drain is significant and equal to about 3 percent of the deposits of the bank.

Figure 4: Visual Evidence from Identified Episodes



Notes. x-axis: days. 100 days before and 20 after the beginning of the episode. Day 0 is the first day of deposits' outflows estimated by ReNoSCh (red vertical line). y-axis: cumulated outflow expressed as a percentage of deposits. The cumulated outflow is computed as the net unexpected position for each channel averaged across all the episodes identified. Left axis: value for digital transfers, right axis: value for cash withdrawals.

In what follows we analyze in more detail the features of identified episodes. First, cash withdrawals and digital transfers to other banks are quantified and compared. Second, a closer look at both is provided, exploiting variation in banknotes denominations and characteristics of digital transfers, in particular destination and speed of settlement. Finally, we study how the banks manage to offset the liquidity drain.

Routes to Safety

Let us now explore in more detail the features of the identified episodes. After having identified these cases, we may be interested in understanding how they occurred and what are their most salient features. Thanks to the detailed information available in payments data, we can uncover the behavior of depositors as never done before. Figure A.5 in the online appendix depicts the potential routes to safety available to a depositor.

She can convert deposits into cash at the bank teller or at the ATM, alternatively she can move her deposits to another bank, domestic or foreign. She may prefer a big bank, if she believes in a too-big-to-fail policy (Oliveira et al., 2014) or she may even move the deposits abroad. The increasing development of financial services and financial integration in Europe makes nowadays very easy to open and transfer euro funds from one participating country to another. In addition the fast spread of new mobile and fintech products is eliminating many frictions. This is a particularly important aspect for the eurozone, as the entity ultimately backing money could change across countries.

In order to reduce the incentive to withdraw deposits from a bank the government can guarantee deposits (Bryant, 1980; Diamond and Dybvig, 1983). In Europe, every country has a fund that guarantees deposits up to a certain amount. Therefore, at least for eurozone countries, the institution guaranteeing banknotes (ECB) is different from the one guaranteeing deposits (depending on the country). This difference, together with the disutility represented by holding a credit with the fund instead of deposits (in case of default of the bank), produces a clear disparity between cash and deposits in the bank under distress, in same-country banks or in different-country banks. Here we want to investigate these aspects by studying the behavior of depositors. We excluded the possibility of converting deposits in assets, bitcoins, metal or gemstones, from our analysis because we can not observe it. Our analysis is limited to customers who do not want to change drastically the nature of their deposits. Perhaps, it would also be a quite credible assumption, as nowadays there are not strong barriers to easily and quickly open an account to a bank.

Digital Transfers vs Cash Withdrawals

A relevant advantage that payment system data offers to us is that we can not only timely detect deposits' distress, but we can also understand what they were more likely to be converted into. As mentioned before, both cash withdrawals and electronic transfers are visible in the RTGS. While an electronic transfer to a different bank keeps the deposit currency ratio unaltered, a conversion to cash modifies it. In addition disentangling these two different choices helps us understand the nature of depositors' fears. As banknotes are central bank money, depositors shall prefer it over deposits, especially if they trust less the entire banking system or they believe that there will be negative spillovers to other banks (Goldsmith-Pinkham and Yorulmazer, 2010).[25] On the other hand, if they do not trust only a specific bank anymore, they may prefer moving the deposits to other banks that they see as sounder. In this case their credits remain in commercial bank money and deposit currency ratio holds constant. Clearly, timely having information on these preferences is very helpful from a financial stability and a monetary policy perspective (Waldo, 1985).

Some empirical evidence for the episodes identified is reported here. We pool together all the identified episodes, $i = 1, ..., \bar{r}$, and estimate the following simple regression models,

$$y_{i,t} = \delta r_{i,t} + \alpha_i + u_{i,t},$$

where the dependent is the daily (t) net position (credits minus debits) of bank i for digital transfers ($y_{i,t} = RTST_{i,t} + DNST_{i,t}$) or cash operations ($y_{i,t} = CASH_{i,t}$). $r_{i,t}$ is a dummy that switches to one when distress triggers, α_i is a episode fixed effect and $u_{i,t}$ is the error term. The control period is 100 settlement days before the shock. The treatment period coincides with two weeks after the episode started. Table 5 reports the estimated coefficients with and without episode fixed effects (respectively in the second and in the first column). In the upper panel we use the raw daily net position of the bank. In the lower panel we consider the regularized time series used in ReNoSCh, $\tilde{y}_{i,t}$ instead of $y_{i,t}$, thus controlling also for the trend, monthly and daily dummies, pre/post/during holiday periods, start/middle/end of the month, fiscal and tax payment effects. It follows that the latter provides the cleanest effect of the shock on bank's cash flows. Let us focus on the bottom of the second column, where we compare distress days with non distress days controlling for the widest set of controls. As we can see, digital transfers are bigger in magnitude. The average daily drain is about 0.2 percent w.r.t. the 0.01 percent outflow generated by cash withdrawals. The relative outflows compared to normal times are comparable and respectively equal to about +900 percent and +700 percent.

Depositors seem to be worried about their bank's solidity, moving their funds mainly to other banks, and thus keeping the deposit currency ratio constant. This is good news for the financial stability of the system. Taking other financial intermediaries' perspective it can also be seen as a positive spillover. In ten days almost 2 percent of deposits were transferred to other banks. Such positive spillovers may alleviate negative ones, like those reported in Goldsmith-Pinkham and Yorulmazer (2010). While negative spillovers were explored in the literature, our evidence is new and brings

[25] They may also withdraw cash and then deposit it to another bank, but this hypothesis is quite unlikely as the direct transfer is much easier and cheaper (the transfer costs few euro).

Table 5: Digital Transfers vs Cash Withdrawals

	$\hat{\delta}$		% increase
	(1)	(2)	
Dependent: daily bank-specific net position in			
	Raw data		
Digital transfer	-0.0810 ***	-0.1676 ***	194 (s)
	(0.0316)	(0.0268)	
Cash withdrawals	0.0084 ***	-0.0053 ***	38 (s)
	(0.0032)	(0.0017)	
	Regularized data		
Digital transfer	-0.1930 ***	-0.1740 ***	942
	(0.0274)	(0.0282)	
Cash withdrawals	-0.0067 ***	-0.0059 ***	718
	(0.0013)	(0.0013)	
Episode FE	No	Yes	
Month Dummies	Yes	Yes	
Day Dummies	Yes	Yes	
Holiday FE	Yes	Yes	
Part of the month FE	Yes	Yes	
Trend	Yes	Yes	

Notes. * : $p < 0.10$; **: $p < 0.05$; ***: $p < 0.01$. OLS estimates of coefficients of a dummy switching from zero to one when the shock occurs. The dependent is the daily net position in euro respectively for digital transfers and cash withdrawals computed as the sum of credits minus the sum of debits for each bank hit by a shock. The coefficients are reported as a percentage of deposits. The control period is the 100 settlement days before the shock. The treatment period coincides with two weeks after the episode started, 11 day in total. We pooled together all the identified episodes. (s) means that the net flow changed sign.

relevant insights on retail funding during idiosyncratic distress episodes. Even though the whole sale funding of the rest of the banking system can shrink during an idiosyncratic distress episode, the retail funding can raise because of inflows from the stressed bank. Below we also shed lights on which intermediaries benefit the most.

These results provide useful thoughts for the policy makers. Central banks interested in offering central digital bank currency (CBDC) should take into consideration that in idiosyncratic episodes most of the funds are not converted in cash, instead they are transferred to other intermediaries. If this evidence is produced by the higher utility of having digital instead of physical money, the introduction of a CBDC can be disruptive and delete the positive spillovers to other intermediaries. For this reason, some kind of disincentive to convert deposits to CBDC could be envisaged.

Cash Withdrawals

Let us now focus on cash. Depositors can withdraw banknotes in two ways, via ATM and directly at the bank teller.

When we think about intense distress periods, the image of long lines at the bank tellers is the first to come into our minds. That is easily recognizable by everybody and translates in the ultimate form of panic. We showed that in terms of magnitude the identified distress episodes are mostly digital and thus invisible. Nevertheless, cash can still have an important role. So far, if a bank's client does not want to move her deposit to another bank, the only way she has to get central bank money instead of commercial bank money is withdrawing banknotes. Some central banks, like the

Riksbank, have recently expressed their interest in studying the possibility of adopting CBDC. As noted by Panetta (2018) and Weidmann (2018), it entails a risk in distress periods. The evidences collected in this section could provide some useful insights on the propensity to get central bank money during the identified episodes.

The advantage of the ATM is that it is faster to withdraw cash from almost everywhere and there is no face-to-face interaction. The latter is a desirable feature for depositors moving away their deposits. In some European jurisdictions, if a depositor withdraw a large amount of money in large denominations suddenly at the bank teller, the bank can ask a series of questions about the nature of the operation. This process is due to the prevention of money-laundering and terrorism financing which obliges banks to report 'suspect operations' to the financial intelligence unit (FIU). In this case the depositor has to declare that she is moving away her deposits or lie and risk to be filed by the bank.

Nevertheless, depositors can not withdraw large amounts of money at the ATM, there are pretty tight limits on daily operations, and only denominations up to 50 euro are often available in most of the euro countries, which are not the best to store big amounts of cash (especially because the ATM denomination is not known ex ante by the depositor).

Depending on the depositor's preferences, she may get a big amount of cash in large denominations at the bank teller, facing the risk of being filed, or repeatedly get smaller amounts at the ATM, taking the risk of not getting the last tranches because the bank is failed in the meanwhile. The smaller the deposits the fewer ATM operations needed.

Assuming a constant inventory of banknotes, if the depositors start to go to the bank teller, the bank will need large denomination banknotes. On the contrary, if the demand of cash is via ATMs it will need mostly small denominations ($\leq$ 50 euro). Given that we have granular data on which denomination is taken by each commercial bank on a daily basis, this information is used to get more insights about depositors' preferences. We pooled all the episodes and regressed the daily net position of banks on each denomination on a dummy taking value one when the shock kicks in and zero before, the control period is 100 days before the first day estimated by ReNoSCh. Our regression model takes the following form,

$$c_{i,t,d} = \delta_d r_{i,t} + \alpha_{i,d} + \rho_d w_t + v_{i,t,d},$$

where $c_{i,t,d}$ are the daily (t) net withdrawals (withdrawals minus deposits) in denomination d at day t in case i, $\alpha_{i,d}$ is the episode fixed effect for denomination d, w_t are time controls for month, day, holiday, part of the month effects and a trend, whose coefficients ρ_d are denomination-specific, $v_{i,t,d}$ is the error term. Table 6 reports our results. During distress days about 0.01 percent of deposits were withdrawn (or not deposited) in ATM denominations and almost a fifth of it in 100 euro banknotes, about 400 percent more than before the shock occurred for both. The largest denominations, 200 and 500 euro, show an increase but smaller in value and not significant. Interestingly both changed sign, meaning that the customers of the bank used to deposit these denominations before the shock, while they started to withdraw them after it. From our evidences we can see that even if deposits

Table 6: Cash Withdrawals - Demand for Different Denominations

	$\hat{\delta}$	% increase
Dependent: daily bank-specific withdrawals in		
ATM ($\leq$ 50)	0.0061 ***	355
	(0.0013)	
100	0.0005 ***	362
	(0.0002)	
200	0.0000	10(s)
	(0.0000)	
500	0.0003	20(s)
	(0.0002)	
Episode FE	Yes	
Month Dummies	Yes	
Day Dummies	Yes	
Holiday FE	Yes	
Part of the month FE	Yes	
Trend	Yes	

Notes. * : $p < 0.10$; **: $p < 0.05$; ***: $p < 0.01$. OLS Estimates of coefficients of a dummy switching from zero to one when a shock occurs. The dependent is the daily net position in euro for each banknote denomination and for each bank hit by a shock. The coefficients are reported as a percentage of deposits. The control period is the 100 settlement days before the shock. We pooled together all the identified episodes. (s) means that the net flow changed sign.

are moved mainly digitally, cash still plays a role. Surprisingly, smaller denominations are the most affected, signaling a higher incidence of preference towards withdrawing small amounts repeatedly instead of big amounts at the bank teller.[26] This is probably more rationale for small depositors, who may also not be aware of the deposit insurance (Bartiloro, 2011) or prefer to hold a small amount of cash instead of a credit issued from the deposit insurance. Big depositors may not want to store huge amount of money in banknotes, they probably have accounts with other financial institutions and prefer to use electronic transfers. This finding has significant implications for financial stability, since even some insured funds are likely to flee banks in response to stress, and can serve to inform banking theory models (Dávila and Goldstein, 2020).

[26]It is not possible to exclude that the bank also imposes the denomination to the customer, trying to disincentivize big withdrawals.

Positive Liquidity Spillovers

Another interesting aspect to investigate is which banks received the deposits. Being a cheap and relatively stable liability, they generate a positive spillover. Banks are not identical and depositors may have heterogeneous preferences. Furthermore, as a unique feature, the Eurosystem is composed by many nations having the same currency. With the integration of the European financial market and payment system, moving money from one country to another is increasingly easy. In addition, the diffusion of fintech products makes much cheaper and easier for customers to open foreign accounts and transfer money there.

When trying to address these curiosities we face a small constraint imposed by retail payment systems' netting mechanisms. Given that these systems send net multilateral positions in TARGET2, we do not have bilateral interbank flows, so we can not identify exactly the receiver of the funds. Nevertheless, this is possible for real-time bilateral transfers settled directly in TARGET2 on a gross basis. Even if this is a portion of all the digital transfers, it accounts for about a half of the total liquidity drain and can thus provide us with useful information.

To explore this aspect we focused on bilateral transfers settled in TARGET2, $RTST_{ij,t}$, where i is the distressed bank and j is another bank not hit at time t. We run simple pairwise regressions where the dependent is the variation of the net bilateral position of bank i versus bank j (credits minus debits). Such variation is computed as the difference of the daily average net position before and during the shock. The period before is 100 settlement days preceding the start of the episode. The treatment period coincides with two weeks after the episode started. We pooled together all the identified episodes, and use bank episode fixed effects. On the right hand side we put a dummy taking value equal to one if bank j has the same nationality of bank i. We also interacted this dummy with a proxy of the size of the bank, computed as the sum of payments sent in TARGET2 in the previous five years.[27] Our regression model takes the following form,

$$l_{ij} = \theta g_{ij} + \gamma g_{ij} * s_j + \alpha_i + w_{ij},$$

where $l_{ij} = \sum_{t<t_r} RTST_{ij,t} / \sum_{t<t_r} 1 - \sum_{t \geq t_r} RTST_{ij,t} / \sum_{t \geq t_r} 1$ is the increase in average net liquidity received by bank j from bank i after the shock occurs (at time t_r), g_{ij} is a dummy equal to one if bank i and j belong to the same country, s_j is the size of bank j and w_{ij} is the error term. Table 7 reports our results. In column (1) we take all the variations, in column (2) we restrict the sample to negative variations -i.e. when $l_{ij} < 0$-, the third column reports the ratio between the coefficients in

[27] The volume of payments is also used for the computation of the weight of the G-SIBs.

the second and first column. From the first row of the table we can see that the change in bilateral

Table 7: Bilateral Digital Transfers - Nationality and Size

Dependent: Δ pair-specific customer payments net position			
	All (1)	Negative (2)	% ratio
Domestic banks	-0.0009 ***	-0.0016 ***	1.9
	(289.706.97)	(0.0002)	
Size of domestic banks	-2.57E-09 ***	-5.57E-09 ***	2.2
	(6.77E-10)	(6.32E-10)	
Episode FE	Yes	Yes	

Notes. * : $p < 0.10$; **: $p < 0.05$; ***: $p < 0.01$. Estimated coefficients of a dummy switching from zero to one when the shock occurs. The dependent is the change in the daily net position in euro for each bank hit by a shock via-a-vis with other banks. The RTST are considered. We restrict this analysis to such transactions because for DNST the counterparty is not identifiable as ACH send multilateral positions to the RTGS. The coefficients for "Domestic banks" are reported as a percentage of deposits. The control period is the 100 settlement days before the shock. We pooled together all the identified episodes. in the 'All' column all the bilateral positions are taken, in the 'Negative' only positions with negative deltas are considered. The ratio is between all vs negative. If bilateral positions are missing before or after the shock the observation is dropped.

interbank flows to domestic banks was much bigger. These outflows were more likely to be directed to bigger banks, as witnessed by the second row. This evidence can also reconcile to a premium generated by the perception of depositors of a possible 'too-big-to-fail' policy (Oliveira et al., 2014). An alternative explanation could also be that big banks have more reach and visibility than small ones, and thus people willing to open a new account is more likely to be exposed to their advertising and marketing. For this reason we label it simply as a *size premium*.[28]

If outflows are mainly cross-border, the national deposit currency ratio changes, while the euro deposit currency ratio does not. Our evidence that a significant part of deposits remained in the national banking system is reassuring from a (national) financial stability perspective, because these banks are also most exposed to negative spillovers on other layers (for example on returns on the stock prices, as showed in Goldsmith-Pinkham and Yorulmazer, 2010). Furthermore, as we are able to identify this event in real-time, understanding whether depositors are moving deposits away from a single bank or from the entire banking system is clearly key.

Here we show that depositors who did not convert deposits in cash and moved them real-time to other banks mainly chose domestic big banks. These banks benefit the most from the positive spillover generated. It has to be noted that depositors using real-time settlement may be different from the other ones who chose deferred settlement. The latter could have smaller deposits or be less reactive to bad news. Then we can not claim any external validity to the whole population of depositors.

An additional interesting aspect to explore is about the destination of funds once they flew away

[28]The distressed banks in our sample are medium-big sized.

from the country. Table 8 reports the top four countries in terms of absolute cross-border outflows. The first column contain the country name, the second the number of bilateral bank-to-bank cross-border relationships involved, the third the difference in terms of net bilateral country-to-country position, the fourth and the fifth the pre and post-shock net positions, and the last the relative percentage change. The other top four countries are, in order of net change, Germany, Belgium, Great Britain and Luxembourg.[29] Even though we cannot exactly quantify the share of funds gone abroad because netting of DNST hides this information, we can say that the amount in the RTST (which represents about half of the value) is very small.

Table 8: Cross-border Digital Transfers - Country of Destination

Top five countries in terms of absolute outflows					
Country	# Pairs	Δ	Pre shock	Post shock	% change
DE	158	-13,940,832	20,080,077	6,139,245	-69%
BE	19	-8,686,221	2,969,934	-5,716,287	-292%
GB	25	-4,279,550	15,133,515	10,853,965	-28%
LU	18	-3,514,911	2,424,271	-1,090,640	-145%

Notes. Any RTST is included. We restrict this analysis to such transactions because for DNST the counterparty is not identifiable as ACH send multilateral positions to the RTGS. The control period is the 100 settlement days before the shock. We pooled together all the identified episodes. If bilateral positions are missing before or after the shock the observation is dropped. The country of destination is extracted from the BIC code which identifies the bank's account in TARGET2.

The Speed of Digital Transfers

As mentioned in the previous section, the time to settlement could be an important discriminant during distress periods. Advances in technologies used to transfer money create the possibility to move them from one account to another faster. Before the recent innovations, like ATMs, home-banking and so on, there were significant spatial and temporal frictions for people to take their deposits out of the bank. Today, with the rise of instant and mobile payments is even possible to have full disposal of funds in seconds from wherever there is an internet connection. In addition, online banking and fintechs allow customers to open accounts in a simpler and faster way.

It follows that there is a potential for faster and continuous outpouring of deposits and no moment of respite for bankers to manage the draining. Clearly, such possibility can be exploited by banks' clients, especially when the fear of loosing money kicks in suddenly. A series of important questions are related to this argument and connect to the potential risks of faster payments (Weyman, 2016). Can these technological innovations accelerate the speed and depth of distress? Can/Do banks shut

[29] Great Britain is a virtual partition in TARGET2 as it did not joined the euro, nevertheless British banks can have accounts in euro in National Central Banks books. The majority of British banks have accounts at the Deutsche Bundesbank. The upcoming Brexit may change this framework.

their digital doors down to prevent deposits from moving away?[30] Can it significantly increase the volatility of banks' reserves? What is the additional liquidity pressure created by the possibility of use real-time settlement?

Despite the prominent role of new technologies in payments there are not evidences on the effects of the speed of settlement because of the scarcity of critical episodes and data availability. Having the possibility to identify real-time and deferred settlement payments one by one with their timestamp offers us the possibility to play with these numbers and quantify the additional pressure generated by real-time settlement.

As a first step we are interested in quantifying the magnitude of real-time vs deferred settlement. The real-time settlement, anticipating the liquidity outpouring of about one day, puts additional pressure on the stressed bank. It is then important to quantify the incidence of real-time settlement on outflows.

We regress the daily net position of the bank for real-time and deferred transfers, pooling together all the identified episodes, $i = 1, ..., \bar{r}$, and estimating the following simple regression models,

$$y_{i,t} = \delta r_{i,t} + \alpha_i + u_{i,t},$$

where the dependent is the daily (t) net position (credits minus debits) of bank i for real-time transfers ($y_{i,t} = RTST_{i,t}$) or deferred transfers ($y_{i,t} = DNST_{i,t}$). $r_{i,t}$ is a dummy that switches to one when the shock triggers, α_i is a episode fixed effect and $u_{i,t}$ is the error term. The control period is 100 settlement days before the shock. The treatment period coincides with two weeks after the episode started. Estimated coefficients are reported in Table 9. In the first column we do not include episode fixed effects, in the second column we do. In the upper panel we use the raw daily net position of the bank. In the lower panel we consider the regularized time series used in ReNoSCh, $\tilde{y}_{i,t}$ instead of $y_{i,t}$, thus controlling also for the trend, monthly and daily dummies, pre/post/during holiday periods, start/middle/end of the month, fiscal and tax payment effects. If we look at the raw data without including episode fixed effects (the upper left panel) it seems that most of the additional outflows are generated by the deferred transfers, real-time payments are not even significant. When we control for regular pattern in payment data and include episode fixed effects, the effects are pretty comparable (the lower right panel). When the shock triggers banks experience an average outflow of 0.09 and 0.08 percent of deposits per day respectively for deferred and real time payments. The relative increase of outflows (in the last column of Table 9) is big, about a thousand more than the control period. In

[30] There were rumors on the possibility of such episodes during the "global stock market turmoil" on 6 February 2018 with the Dow's worst point drop ever.

Table 9: Speed of Digital Transfers - Time to Settlement

	$\hat{\delta}$		% increase
	(1)	(2)	
Dependent: daily bank-specific net position in			
	Raw data		
Real-time Settlement	-0.0086	-0.0774 ***	507 (s)
	(0.0244)	(0.0194)	
Deferred Net Settlement	-0.0723 ***	-0.0902 ***	113 (s)
	(0.0176)	(0.0181)	
	Regularized data		
Real-time Settlement	-0.0908 ***	-0.0809 ***	840
	(0.0206)	(0.0214)	
Deferred Net Settlement	-0.1022 ***	-0.0931 ***	1.054
	(0.0165)	(0.0170)	
Episode FE	No	Yes	
Month Dummies	Yes	Yes	
Day Dummies	Yes	Yes	
Holiday FE	Yes	Yes	
Part of the month FE	Yes	Yes	
Trend	Yes	Yes	

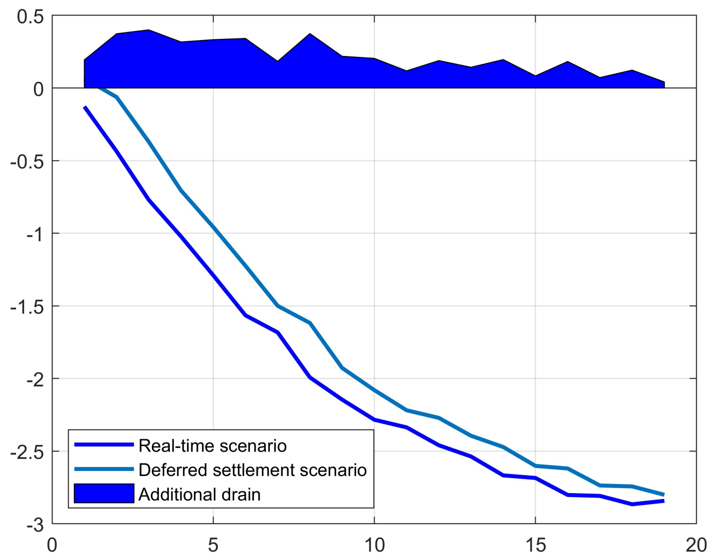
Notes. * : $p < 0.10$; **: $p < 0.05$; ***: $p < 0.01$. OLS estimates of coefficients of a dummy switching from zero to one when a shock occurs. The dependent is the daily net position in euro respectively for real-time settlement transfers and deferred net settlement transfers computed as the sum of credits minus the sum of debits for each bank hit by a shock. The coefficients are reported as a percentage of deposits. The control period is the 100 settlement days before the shock. We pooled together all the identified episodes. (s) means that the net flow changed sign.

our sample, the liquidity drain seems to be equally split between these two channels.

Subsequent natural questions would be: how much pressure is created by the possibility of choosing different settlement times? How much does real-time settlement accelerate the liquidity pressure? Given that we exactly know the time stamp of each transaction, we can change them to construct counterfactuals, averaging data across the episodes detected. To give a flavor from our sample, we depict in Figure 5 two counterfactuals.

The light blue line depicts the cumulated outflows generated in the first 20 days of a episode if all the payments were settled on a deferred basis. The blue line depicts the cumulated outflows generated in the same time span if all the payments were settled real-time. To construct the first (second) counterfactual we postpone (anticipate) the settlement time of all real-time (deferred) payments by one day, leaving unchanged the other category, average across all the episodes and cumulate over time. The difference between the cumulated outflows is represented by the dark blue area. Real-time settlement increases the immediate liquidity pressure by about 0.33 percent of deposits in the first 10 days, about 10 percent of the total average drain generated. To then decrease by about a half in the following 10 days. This is a significant magnitude, and if the bank has not excessive reserves to cover such outflows, it has to resort on the money market or on the central bank or on the liquidation of assets. In the first case, the costs can be quite high for the bank because, if the average depositor is already moving away, it is unlikely that other banks would lend money to the bank. It is also possible that the perceived risk is so high that the bank would not find any counterparty in the unsecured money market. In this case, it has to go to the secured with the implied need of collateral. In the next section we provide evidences on the liquidity sources used by banks in our sample.

Figure 5: Counterfactuals - Pure Real-time vs Deferred Settlement



Notes. x-axis: days. y-axis: cumulated outflow expressed as a percentage of deposits. Day 0 is the first day of deposits' outflows estimated by ReNoSCh. The lines represent the average (across episodes) cumulated net positions in two scenarios. The blue line depicts a scenario where everything is settled real-time. The light blue line depicts a scenario where everything is settled deferred. In the first scenario the observed DNST are shifted one day before, in the second the observed RTST are shifted one day after. The dark blue area is the difference between the two scenarios.

Offsetting the Liquidity Drain

In practical terms, deposits' distress implies a drain of bank's reserves. If the drain is significant, the bank can not ultimately be able to honor its obligations. Thus when a distress occurs the bank has to seek for liquidity. From a balance sheet perspective, the bank needs to substitute deposits with other liabilities or to shrink its assets, both implies injection of central bank money in its reserve account to compensate the drain. In our sample, the bank's reserves do not dramatically drop during the distress episode -and this is also why the level of reserves is not a good indicator to timely identify them-, meaning that banks did offset the liquidity drain immediately. Here we are interested in understanding how.

In principle, the bank has several options. Here we discuss three main ways: the unsecured money market, the use of collateral and operations with the central bank.

The unsecured money market used to be the most important channel to reallocate liquidity among banks. Even if the market was dramatically hit by the 2007-08 global financial crisis and the Sovereign debt crisis, it did not totally freeze (Afonso et al., 2011; Angelini et al., 2011; Rainone, 2017).[31] In TARGET2 we can identify precisely the unsecured money market operations of the e-MID. The information about the parties involved in a transaction allows us to reconstruct the trades done by the bank before and during the distress.

Another way to get liquidity is from securities. The bank can sell or pledge them to get a secured loan. The interest rate in the unsecured money market can be much higher or it would even be difficult to find a lender. Collateral can be a remedy. Indeed, we observed a shift from unsecured interbank market to central counterparty clearing (CCP) during the recent crises.[32] Since it is quite complex to disentangle securities selling from repo activity of banks on a daily basis,[33] and we yearn to use payment system data to easily follow up on ReNoSCh outputs, here we consider them jointly and proxy the liquidity obtained from securities (selling and pledging) using the cash leg of securities exchanges on central securities depositories in TARGET2.[34]

Alternatively, the commercial bank can go to the central bank and borrow funds. A core function of central banks is to act as a 'lender of last resort' to the banking system (Garcia-de Andoain et al., 2016). In the US, the Federal Reserve uses the Discount Window (DW) to fulfill this task, while the Eurosystem uses the Marginal Lending (ML) against collateral. Historically, both the DW and ML have been little used, even when banks faced acute liquidity shortages.[35] In October 2011, during the sovereign debt crisis, the Eurosystem adopted additional monetary policy measures in the form of a commitment to continue the fixed-rate full allotment policy initiated during the financial crisis of 2007-2008. [36] Under fixed-rate full allotment, counterparties have their bids fully satisfied, against adequate collateral, and on the condition of financial soundness. The Eurosystem's regular open market operations (OMO) consist of one-week liquidity-providing operations in euro

[31] Since the 2008 financial crisis the overall interest in the linkages between banks has risen (Ashcraft and Duffie, 2007; Cocco et al., 2009; Furfine, 2003; Hartmann et al., 2001; Iori et al., 2008; Rainone, 2019; Soramäki et al., 2007).

[32] See Mancini et al. (2015) and Piquard and Salakhova (2019) for an analysis of the determinants.

[33] A repurchase agreement (repo) is a form of short-term borrowing for dealers in securities. The dealer sells the securities to investors, usually on an overnight basis, and buys them back the following day.

[34] We could resort on other datasets but we would lose the high-frequency of our data and a coherent view on bank's liquidity. The central securities depository (CSD) provides services to support trading in financial instruments, like central safekeeping and administration services for shares and private-sector bonds. They offer pre-settlement, settlement, custody, asset servicing and collateral management services as well as issuer services to firms, banks, brokers, CCPs and stock exchanges. If a bank obtains reserves from securities selling or pledging, it involves the CSD. Before 2015 CSDs settled their transactions as ancillary systems in TARGET2, thus it is easy to identify their transactions using TARGET2 data. Since 2015 CSDs started to migrate to TARGET2-Securities (T2S), a technical platform offered to them for the settlement in central bank money of both domestic and cross-border securities transactions. Even if cash accounts in T2S are in central bank money and in the legal perimeter of TARGET2, no granular information is available on transactions settled in this platform. Nevertheless, given that commercial banks have to move money in their accounts in T2S at beginning of the day and get them back at the end, we can reconstruct daily bank-specific net positions from TARGET2 data.

[35] Although other explanations may exist, this lack of borrowing is commonly attributed to stigma (Armantier et al., 2015; Bernanke, 2009).

[36] This tool is significantly different from the term auction facility (TAF, see McAndrews et al., 2017; Taylor and Williams, 2009; Wu, 2011, for more details) implemented by the FED.

(main refinancing operations, or MROs) as well as three-month liquidity-providing operations in euro (longer-term refinancing operations, or LTROs).[37] The fixed-rate full allotment policy has proven a very efficient way of offsetting liquidity risk in the market by ensuring banks' continued access to liquidity. These operations are then much more attractive for a bank, especially because the rate is lower than the ML rate.[38] The only drawback is that MROs are done weekly, and not daily like the ML. This limit can be particularly problematic in the case of a sudden shock.

Usually all these operations are settled in the RTGS, as they involve large value payments that need to be settled in real-time on reserve accounts. From this standpoint, using payment system data offers a wide view on funding sources. Transactional data in TARGET2 allows us to identify payments related to these three liquidity channels.[39]

To understand which source was most used, we regress the net daily bank positions on these three channels. For the e-MID, we use the daily variation in the outstanding position of the bank as a borrower minus the position as a lender (UM). An increase means that the bank has borrowed more than lent. To capture the amount of liquidity got from the use of collateral, we used the daily net position of the bank in T2S (CO), including the transactions with the CCP.[40] If positive, it means that the bank sold securities or borrowed money through a repo. For the technical reasons outlined above, unfortunately we can not exactly disentangle repos from the trading part. The two operations are very different, but for what concerns this liquidity analysis it is informative enough to aggregate them. For monetary policy operations, we computed the daily change in the outstanding amount of net liquidity borrowed from the central bank (CB). We pool together all the identified episodes $i = 1, ..., \bar{r}$ again and regress daily positions on a dummy switching to one when the distress occurred using the following model,

$$h_{i,t} = \delta r_{i,t} + \alpha_i + a_{i,t},$$

where the dependent is the daily (t) net position of the bank in the unsecured interbank market ($h_{i,t} = UM_{i,t}$) or collateral operations ($h_{i,t} = CO_{i,t}$), or central bank operations ($h_{i,t} = CB_{i,t}$) or their sum. $r_{i,t}$ is a dummy that switches to one when the shock triggers, α_i is a episode fixed effect and $a_{i,t}$ is the error term. The control period is 100 settlement days before the distress. The

[37] MROs serve to steer short-term interest rates, to manage the liquidity situation and to signal the monetary policy stance in the euro area, while LTROs provide additional, longer-term refinancing to the financial sector.

[38] See `https://www.ecb.europa.eu/stats/policy_and_exchange_rates/key_ecb_interest_rates/html/index.en.html`.

[39] This is not always guaranteed. In practice the central bank has to have rich granular information on settled transaction and being able to label them properly. If for example OMO are not marked somehow, they are not distinguishable from other central bank operations. The practitioner should then rely on external data sources, which makes the analysis much more slow and laborious. The usability of TARGET2 granular data is appreciated.

[40] The CCP margins are excluded.

treatment period coincides with two weeks after the distress started. Table 10 reports our results. On average the bank got a daily liquidity inflow from all these channels equal to 0.33 percent of

Table 10: Offsetting the Liquidity Drain - Sources of Funding

	$\hat{\delta}$
Dependent: daily net position in	
All sources	0.3028 ***
	(0.0780)
OMO	0.2203 ***
	(0.0722)
Collateral	0.0792
	(0.0529)
Unsecured	0.0034
	(0.0079)
Episode FE	Yes

Notes. * : $p < 0.10$; **: $p < 0.05$; ***: $p < 0.01$. OLS estimates of coefficients of a dummy switching from zero to one when a shock occurs are reported. The coefficients are reported as a percentage of deposits. We pooled together all the identified episodes, all the specifications include episode fixed effects. Collateral is computed by taking the net cash position of each bank on transactions settled through the CSDs, it includes the the transactions with the CCPs. The net cash position in the unsecured channel is computed by using all the e-MID transactions settled by each bank.

deposits during distress days. More than 70 percent of this offsetting liquidity came from OMO. The rest was mainly taken using collateral, whose coefficient is not significant at all. The unsecured market played definitely a minor role, with a small magnitude and significance. This analysis showed that during the period under analysis the liquidity drain generated by deposits were mostly offset by OMO.

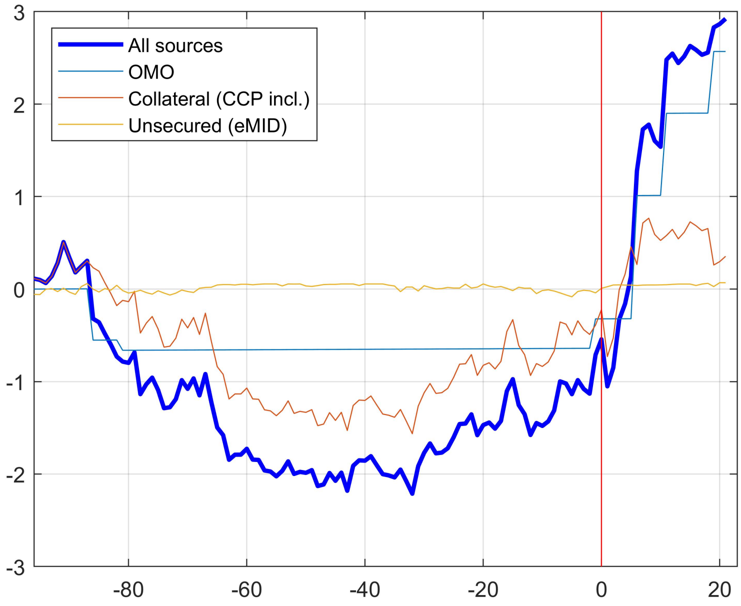
As mentioned before, this feature is clearly peculiar of that period. The fixed-rate full allotment represents a good option for a bank that is having liquidity problems. It could be almost impossible to get money in the unsecured money market, in that period was even difficult to find a counterparty. One could have expected a more prominent role played by the secured money market. At the end of the day, a repo has features similar to a OMO. The bank needs collateral for both operations, and the rate of general collateral (GC) repos has often been below the MRO rate. In addition if there is a stigma effect, it is better to get money from the market than from the central bank, especially if the counterparty are anonymous and the contract is secured.

Nevertheless, there are important differences between repo and OMO. The first is the potential length of the maturity. The second is the barrier to the market, a bank has to be a member of the CCP and have proper infrastructures to participate to the secured market. The third is the type of collateral. While the repo market is thick for GC, especially for government bonds, it is much more thin for less popular securities. In this sense, the rate for GC is not fully comparable with the MRO rate, because the GC is for specific securities, while for the MRO the bank can use a wider set of eligible assets. Another fundamental aspect is the computation of the liquidity cover ratio (LCR) within the Basel III framework. When the banks have to estimate the total net cash outflows over the next 30 calendar days, in the computation of the secured funding run-off, the amount to add to cash outflows for outstanding maturing secured funding transactions with the central bank is 0 percent (Basel III, 2013). The same amount is reachable only for secured funding backed by Level 1 assets, which may be scarce. Level 2A assets add 15 percent, while Level 2B add 50 percent. This feature reflects the different loan roll-over probability. While the secured market may suddenly dry-up, this does not hold for central bank liquidity.

To better get a sense of the timing of these operations, we leverage again the high frequency of our data. In Figure 6 we plot the average daily cumulated net position of banks for each channel. Day 0, tracked by a horizontal red line, is the first day in which ReNoSCh identified a shock. As before we considered 100 days before and 20 after. The yellow line reports the net position of the banks in the unsecured money market. The scale is not even comparable with the others. We can notice a slight increase after the red vertical line, but is even difficult to see it. The orange line is the collateral source, it was slightly increasing before the shock occurred, but we can see a clear jump after the red line that brought an amount of liquidity greater than 1 percent of deposits in the first five days of distress. The light blue line represent the outstanding position in the OMO. Also visually, it is clear that it played the major role in offsetting the liquidity drain. It looks as a step function because the auctions are not available everyday, as mentioned before. Interestingly, we can see that the banks were able to get the first tranche slightly before the shock on deposits triggered. That operations were particularly small, about 0.33 percent of deposits. The next week, when the shock kicked in, the amount borrowed was four times higher - about 1.3 percent of deposits-. The week after it was about the half of the previous week. In the last week it was slightly smaller.

This figure is somehow specular to Figure 6 and represents a sort of reassuring picture in terms of correct identification of timing and offsetting liquidity sources as the numbers roughly square: an amount of liquidity inflows equal to about 3 percent of deposits in 20 days to counterbalance a 3 percent of deposits flowing out in the same 20 days.

Figure 6: Offsetting the Liquidity Drain



Notes. x-axis: days. y-axis: cumulated flow expressed as a percentage of deposits. Day 0 (the red vertical line) is the first day of deposits' outflow estimated by ReNoSCh. Cumulated net positions for each channel averaged across all the cases identified. OMO stands for open market operations, the outstanding position is represented. 'Collateral' represents the net position for securities related settlements. It includes trades and repo contracts, CCP included. 'Unsecured' represents the net outstanding position in the unsecured money market in e-MID. The blue bold line is the sum of the all the sources.

7 Conclusion

This paper's contribution is twofold.

First, we propose a new methodology to identify distress episodes in real-time using payment system data. More specifically, we illustrated (i) how to measure deposits flows in RTGS systems; (ii) an algorithm that is able to identify distress episodes and quantify their severity in real-time; (iii) its good performance in numerical simulations and (iv) with real data from TARGET2.

Second, we show (i) the existence of distress episodes and their significance in terms of liquidity risk for banks; (ii) the major role played by digital transfers to other banks w.r.t. cash withdrawals; (iii) the positive liquidity spillovers to institutions not distressed and in particular to large domestic banks; (iv) the importance of real-time settlement in accelerating the speed of distress and finally; (v) how banks offset the liquidity drain mostly with open market operations instead of recurring to money markets or selling securities, under a fixed-rate full allotment regime.

The results are relevant from several policy standpoints.

Our estimates of deposits' outflows are informative for the calculation of 30 days potential outflows due to retail deposit run-off in the LCR (Basel III, 2013) and their potential evolution in an increasingly digital financial world.

The paper shows how monetary policy tools interact with bank idiosyncratic distress. Even if not specifically designed for this purpose, fixed-rate full allotment open market operations were effectively used to replenish the liquidity drain generated by deposits' outflows, avoiding penalizing fire sales. The weekly auctions proved to be a quite efficient parachute, even in the presence of fast deposit outpouring. Such evidence informs the debate on the role of 'automatic' lender-of-last resort (LOLR) that the central bank can play for example with the introduction of CBDC (Brunnermeier and Niepelt, 2019). Most pragmatically, the paper provides an operational tool to trigger a real-time LOLR, and highlights the idea that the introduction of CBDC is not the only method to observe deposits outflows in real-time.

Indeed, the proposed algorithm can be used to detect in real-time distress episodes and save significant social costs. This can allow supervisors to act promptly in case of idiosyncratic and systemic risk. If cloud computing and API (application programming interface) are available, such big payment data can be operational and become an effective SupTech tool (Broeders and Prenio, 2018).

We showed that real-time transfers have side effects, they are not only an important tool to mitigate credit risk in payments between banks (Kahn and Roberds, 1998), but they can also increase liquidity risk of banks during distress episodes by decreasing more quickly their reserves.

In this regard, the recent diffusion of instant payments, which offers the possibility to settle continuously, can be a structural break. While in an increasingly digital world banks can just shut their digital doors to prevent massive outflows, depositors may anticipate this reaction and withdraw deposits in advance. Regulators have to monitor these phenomena closely to mitigate new risks coming from the digitalization of financial services.

Another important innovation that has been intensively discussed recently is the implementation of CBDC. We showed that the majority of depositors preferred digital balances at other intermediaries to cash conversion. If such preference was mainly driven by the inconvenience of storing banknotes, the introduction of CBDC would constitute an appealing alternative to digital balances at other intermediaries, being backed by the central bank (Panetta, 2018; Weidmann, 2018). In such a case, deposits would shift to the central bank, removing the direct positive spillovers to big domestic intermediaries uncovered in this study. The central bank may then return the funds to the banking system (probably against collateral), changing the cost and the amount of retail funding for the other intermediaries.

As a final policy remark, the fact that depositors withdraw small denomination banknotes is surprising and should raise concerns, because most of the accounts of these depositors are likely to be covered by the deposit insurance. While this fact can be just due to unawareness of the deposit guarantee scheme, it may also point to distrust of the national banking system and the ability of the government to refund them in a short time. This is particularly possible in the Eurosystem where banknotes are guaranteed by a supranational authority, the Eurosystem, while deposits are not.

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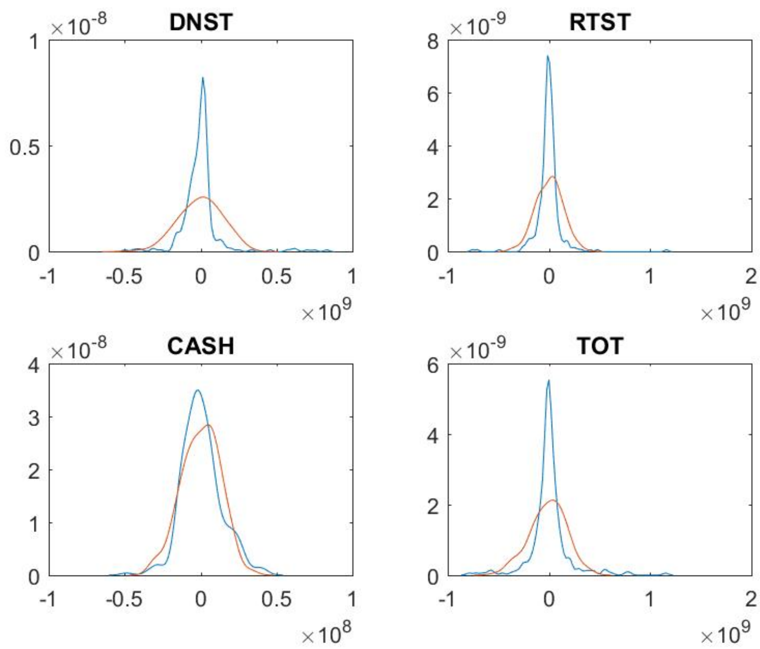
ONLINE APPENDIX

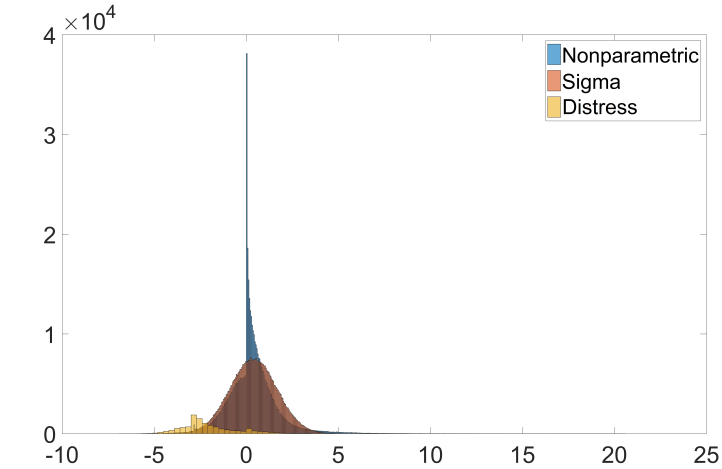
A Additional Figures and Tables

Figure A.1: Parametric vs Nonparametric Densities with Real Data

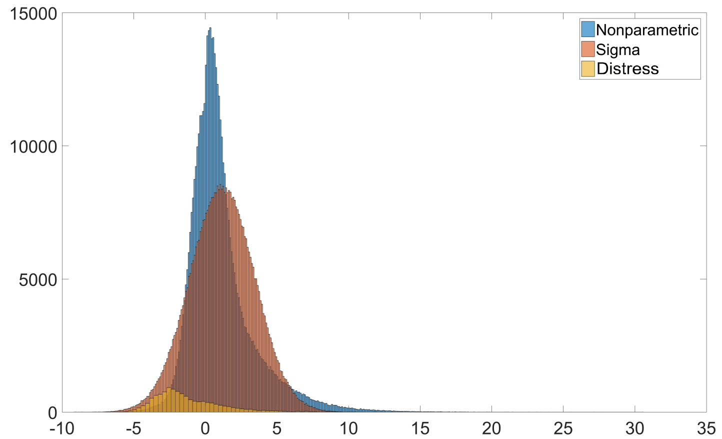


Notes. Empirical kernel densities in blue, theoretical normal distributions in orange.

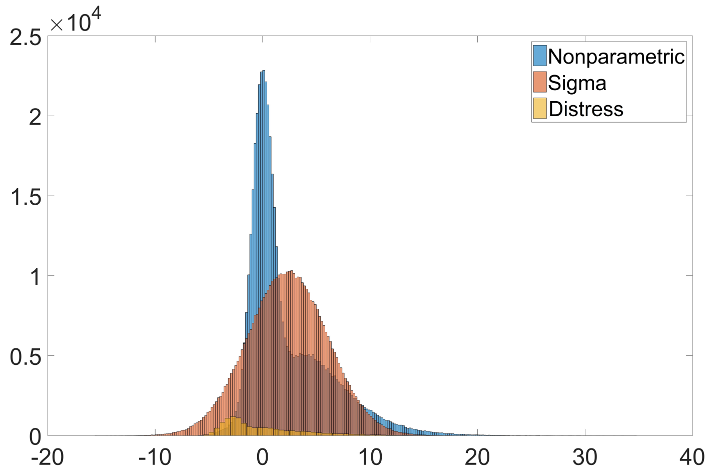
Figure A.2: Sigma vs Nonparametric Approach



(a) $k = 1$



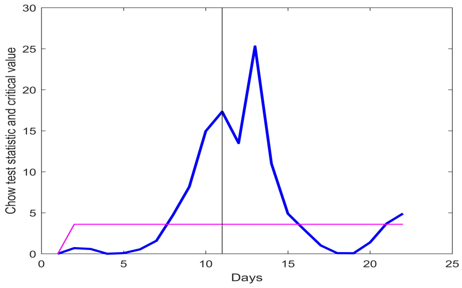
(b) $k = 2$



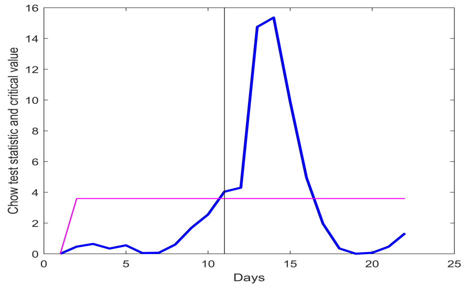
(c) $k = 3$

Notes. Histograms computed on data from 1000 replications, with 500 processes with distress episodes and 500 without. The red histogram reports the inferred distribution using the sigma approach. The blue histogram reports the distribution inferred with the nonparametric approach. The yellow histograms reports the distribution of observations under distress. The DGP is described in Section 4. k are the degrees of freedom, in all panels $\iota = 1$.

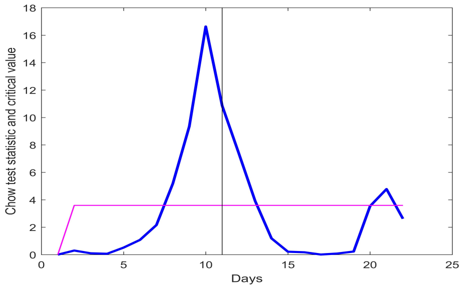
Figure A.3: Exogenous Break Points - Graphical Analysis.



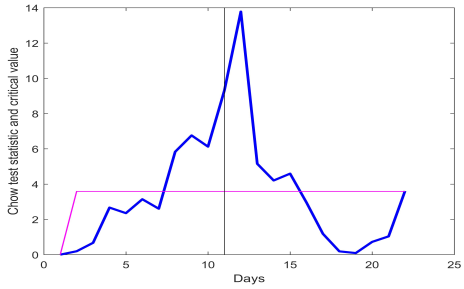
(a) All outflows



(b) Deferred



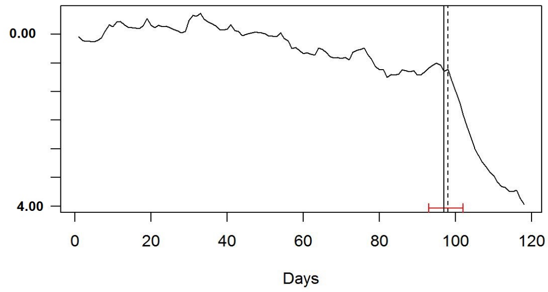
(c) Real-time



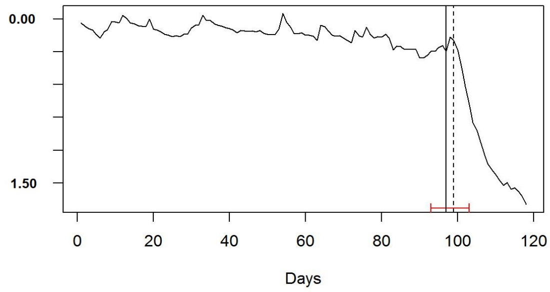
(d) Cash

Notes. Day 11 is the first estimated day of distress. Blue line: Chow test on every day on changes of net positions for each channel summed for all the cases considered. Time range for the test is 20 days around the pivotal day for which the test is computed. The position is centered to the estimated beginning (black vertical line). The violet line is the critical value.

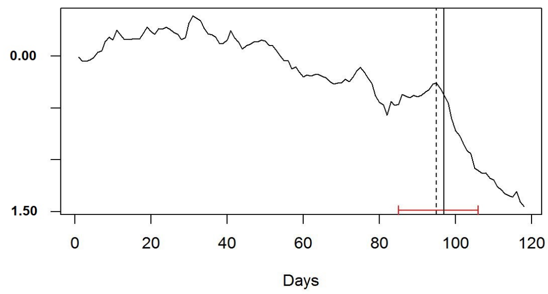
Figure A.4: Endogenous Break Points - Graphical Analysis.



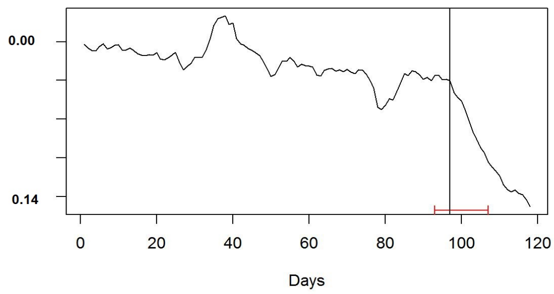
(a) All outflows



(b) Deferred



(c) Real-time



(d) Cash

Notes. Notes. x-axis: days. 100 days before and 20 after the beginning of the episode. y-axis: cumulated outflow expressed as a percentage of deposits. Day 100 is the first day of deposits' outflows estimated by ReNoSCh, a black vertical line keeps track of it. Black line: cumulated net positions in euro for each channel averaged across all the cases considered expressed as a percentage of deposits. The test proposed by Bai and Perron (2003) is used to endogenously estimate the break point on changes in the net positions. The endogenous break point estimate is represented with a vertical dotted line. Its 95% confidence interval is in red.

Figure A.5: Routes to Safety

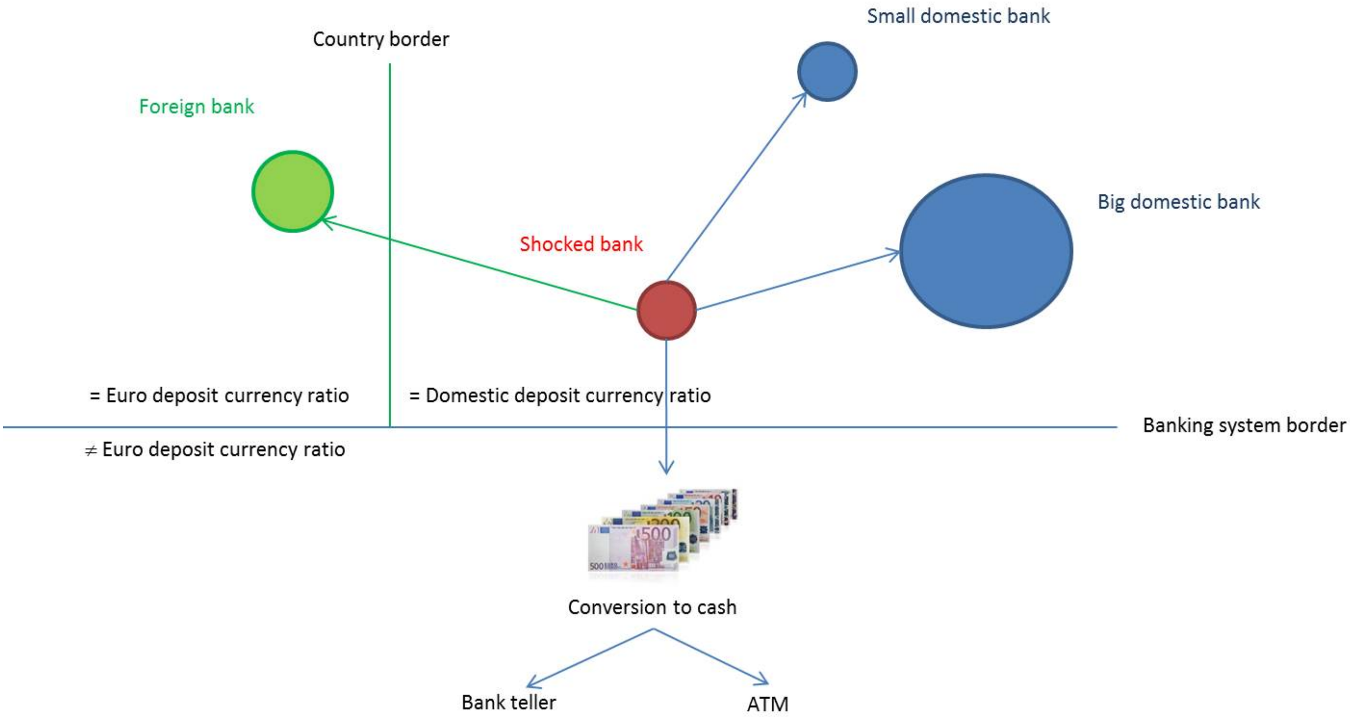


Table A.1: Number of Warning Days and Distress Detection

Number of warning days (s)	Sequence with distress																
	0	0	0	0	0	1	1	1	1	1	0	0	0	0	0		
2					N	N	W	W	W	W	W	W	W	N	N	DISTRESS	OK
3					N	N	N	W	W	W	W	W	N	N	N	DISTRESS	OK
4					N	N	N	N	W	W	W	N	N	N	N	NO DISTRESS	NOK
	0	1	0	1	0	1	1	1	1	1	0	0	0	0	0		
2					W	W	W	W	W	W	W	W	W	N	N	DISTRESS	OK
3					N	W	W	W	W	W	W	W	N	N	N	DISTRESS	OK
4					N	N	N	W	W	W	W	N	N	N	N	NO DISTRESS	NOK
	1	0	1	0	0	1	1	1	1	1	0	0	0	0	0		
2					W	W	W	W	W	W	W	W	W	N	N	DISTRESS	OK
3					N	N	W	W	W	W	W	W	N	N	N	DISTRESS	OK
4					N	N	N	N	W	W	W	N	N	N	N	NO DISTRESS	NOK
	Sequence without a distress																
	1	0	1	0	0	1	0	1	0	1	0	0	0	0	0		
2					W	W	W	W	W	W	W	W	N	N	N	DISTRESS	NOK
3					N	N	N	N	N	W	N	N	N	N	N	NO DISTRESS	OK
4					N	N	N	N	N	N	N	N	N	N	N	NO DISTRESS	OK
	1	0	0	1	0	0	1	0	0	1	0	0	0	0	0		
2					W	N	W	W	N	W	W	N	N	N	N	DISTRESS	NOK
3					N	N	N	N	N	N	N	N	N	N	N	NO DISTRESS	OK
4					N	N	N	N	N	N	N	N	N	N	N	NO DISTRESS	OK
	1	0	0	1	0	1	0	0	1	0	1	0	0	1	0		
2					W	W	W	W	W	W	W	W	W	W	W	DISTRESS	NOK
3					N	N	N	N	N	N	N	N	N	N	N	NO DISTRESS	OK
4					N	N	N	N	N	N	N	N	N	N	N	NO DISTRESS	OK

Notes. 0 is a day not below the LCL, 1 is a day below th LCL. In this numerical example 5 consecutive days constitute distress. The first three sequences are characterized by distress, the last three are not. The first column reports the number of warning days in the last 5 needed to have a warning day. N means that the number of warning days in the last 5 days does not exceed the threshold, W means that it does and thus that day is a warning day. If we have a sequence of 5 consecutive W the second to last column reports DISTRESS. If it is a true distress episode the last column reports OK.

B Source of Information in TARGET2

Here we describe in detail how to collect this type of data in TARGET2, the euro RTGS.[41] Configurations in other RTGS systems, like FEDWIRE for the dollar, BOJ-NET for the yen or CHAPS for the sterling are not extremely different. We take advantage of transaction-level data for each participating bank, which allows us to reconstruct the banks' customers behavior in a detailed way. More specifically, with TARGET2 granular data we can track bank i's customers transactions in four ways.

The first is the bank's multilateral position settled by domestic and international RPSs. Given its time lagged nature we call it *deferred net settlement transfer* channel ($DNST$). We consider the national RPSs and STEP2, an international RPS owned and managed by the EBA. STEP2 is a Pan-European ACH processing payments in euro. The platform is one of the key clearing and settlement mechanisms in the Single Euro Payments Area (SEPA).[42] Together the payments settled through these systems represent the vast majority of interbank retail transfers, including transactions to merchants, deposit transfers, card payments, and so on.

The second source of information is from the settlement process of instant payments. For euro payments, recently the European Banking Association (EBA) launched a service that uses pre-funding to settle these payments.[43] The Eurosystem recently launched TIPS, a new platform that allows the settlement of instant payments directly in central bank money.[44] Since instant payments settle in real-time, banks have to dedicate part of their reserves or some collateral to pre-fund them.[45] We label changes in these balances as instant settlement transfers ($INST$). These systems can settle basically the same type of transactions of classic RPSs plus mobile and peer-to-peer instant transfers, which can be increasingly used by customers. With a classic RPS it takes up to one business day for a payment in euro to reach the beneficiary. With instant payments, the funds are available immediately

[41]For more information about TARGET2 see `http://www.ecb.europa.eu/paym/t2/html/index.en.html`.

[42]STEP2 has been conceived from the outset as a Pan-European ACH for the single currency and eventually for a Single Euro Payments Area (SEPA), where banks from the different SEPA countries connect directly to exchange payment files and where appropriate routing tables enable reach to all other banks offering SEPA payments.For more information about STEP2 see `https://www.ebaclearing.eu/services/step2-t-platform/overview/`.

[43]See the RT1 webpage for more information `https://www.ebaclearing.eu/services/instant-payments/introduction/`.

[44]See the TIPS (TARGET instant payment settlement) webpage for more information `https://www.ecb.europa.eu/paym/intro/news/articles_2017/html/201706_article_tips.en.html`.

[45]In these sub-accounts payments can be settled in central bank money one by one, like in TIPS, or not, like in EBA RT1. The latter use pre-funding and settle in central bank money only after, while TIPS offers final and irrevocable settlement for instant payments in central bank money on a 24/7/365 basis. It allows participating banks to set aside part of their liquidity on a dedicated account opened with their central bank, from which instant payments could be settled around the clock. The balance on these accounts counts towards their required minimum reserve. These infrastructures process instant SEPA credit transfers and operate around the clock on any day of the year and support payment service providers in transferring euro transactions between payment accounts in less than 10 seconds end to end, with immediate availability of the payment amount to the beneficiary.

(in the order of seconds) for use by the recipient, 24/7/365.

Much before the introduction of instant payments TARGET2 offered real-time settlement in central bank money for customer payments to participating banks, this is the third source of information available. These are gross bilateral interbank money transfers settled directly in the RTGS on behalf of customers. They are more likely to be used for high value transactions and B2B transfers. Nevertheless, banks use these payments intensively also for small transactions, probably because instant payment solutions started to appear just by the end of 2017. We label this type of transfers as *real-time settlement transfers* channel ($RTST$). As bilateral gross interbank transfers, they also provide information on the counterparty -i.e. the bank that receives the funds-.

Finally, as both reserve accounts and banknotes are the only forms of central bank money (so far), cash operations by commercial banks have to be exchanged with funds in TARGET2 ($CASH$). If the payment message is rich enough, we also have data on the denomination of banknotes.

In practice, we can construct bank A's net position on each of these channels during a time interval t by subtracting the outgoing payments to the ingoing payments related to that specific payment category.[46] The first three variables capture deposits of customers flying from a bank to another one, leaving the deposit currency ratio unaltered, while the last captures the conversion from commercial to central bank money by depositors. A nice feature of payment system data is that it allows us to identify which of these cases materialize in real-time, if signals are properly extracted. There is no need to stress the salience of this information from a financial stability perspective. In the next section, we outline the method proposed to immediately extract signals from this data.

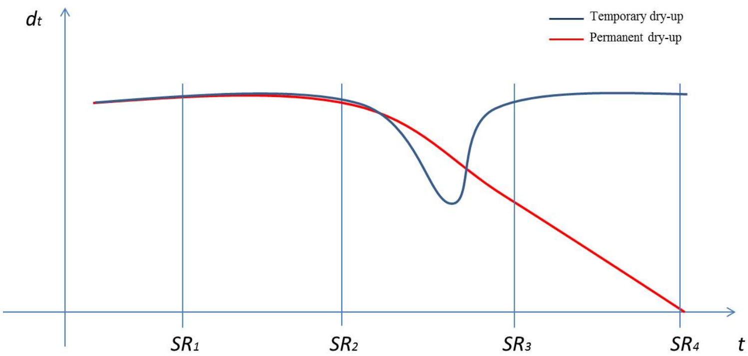
C Tempestivity w.r.t. Supervisory Reports

An important feature of payment data is that it can provide more timely signals of shocks to funding than supervisory reports, which have usually a low frequency. If some type of distress manifests in between two reports, it may be overlooked or captured with delay. Figure C.1 gives a simple graphical example. In the blue line, a temporary shock hits d_t in between supervisory reports SR_2 and SR_3. In this case, given that the shock is absorbed in the time interval and $d_{SR_2} \approxeq d_{SR_3}$ the event is not recognized. In the red line, a permanent shock hits d_t in between supervisory reports SR_2 and SR_3. In this case, the shock is recognized with delay. Both issues amplify with the interval $SR_t - SR_{t-1}$. Important social and private costs can be saved if the shock is recognized timely. The banks itself can reduce the cost of substituting the funds. The resolution authority has additional

[46] Other transformations of payments can be used, but the net position is the best proxy for daily variation of deposits.

time to collect an organize resources to manage the shock.

Figure C.1: RTGS vs Supervisory Reports



Notes. time (t) on the x-axis, deposits (d_t) on the y-axis. SR_t represents the time in which the supervisory report is delivered. The blue line represents a temporary shock, the red one a permanent shock.

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