

# Review of Recent Trends and Issues in Financial Sector Globalization

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*The views in this presentation are those of the author and do not necessarily reflect the position of the Federal Reserve Bank of New York or the Federal Reserve System*

## Presentation outline

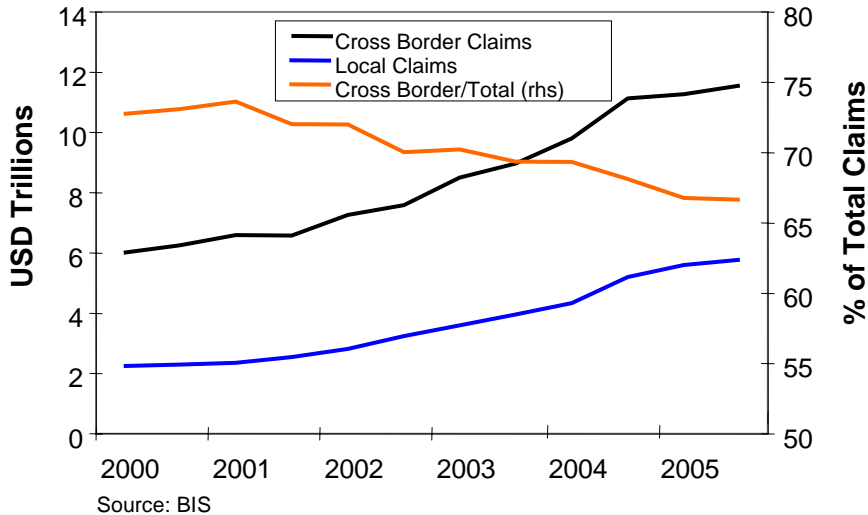
- Brief review of global trends in cross-border and financial sector FDI (FSFDI) activity
- Discussion of benefits, risks, and policy issues of FSFDI in emerging markets
  - Summary and update of 2004/2005 Committee on the Global Financial System reports

## Financial sector globalization is being driven by many factors...

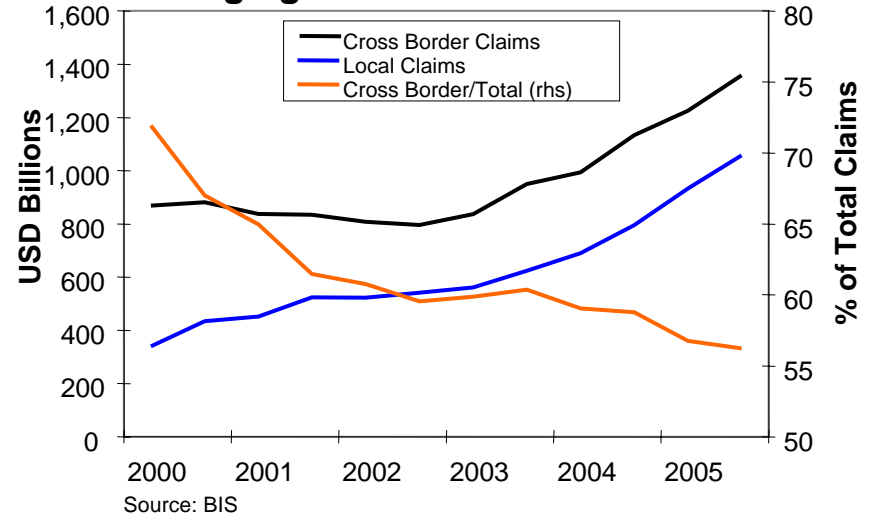
- Post-crisis recapitalization efforts in EM countries
- Broader globalization of product, services, labor and financial markets
- Ongoing liberalization, privatization, and consolidation
- Ongoing technological, communications and risk management advances
- Increased competitive pressures driving search for revenue diversification and operating scale efficiencies

...is evident in increased international bank lending,

**BIS Reporting Bank Claims on Industrialized Countries**

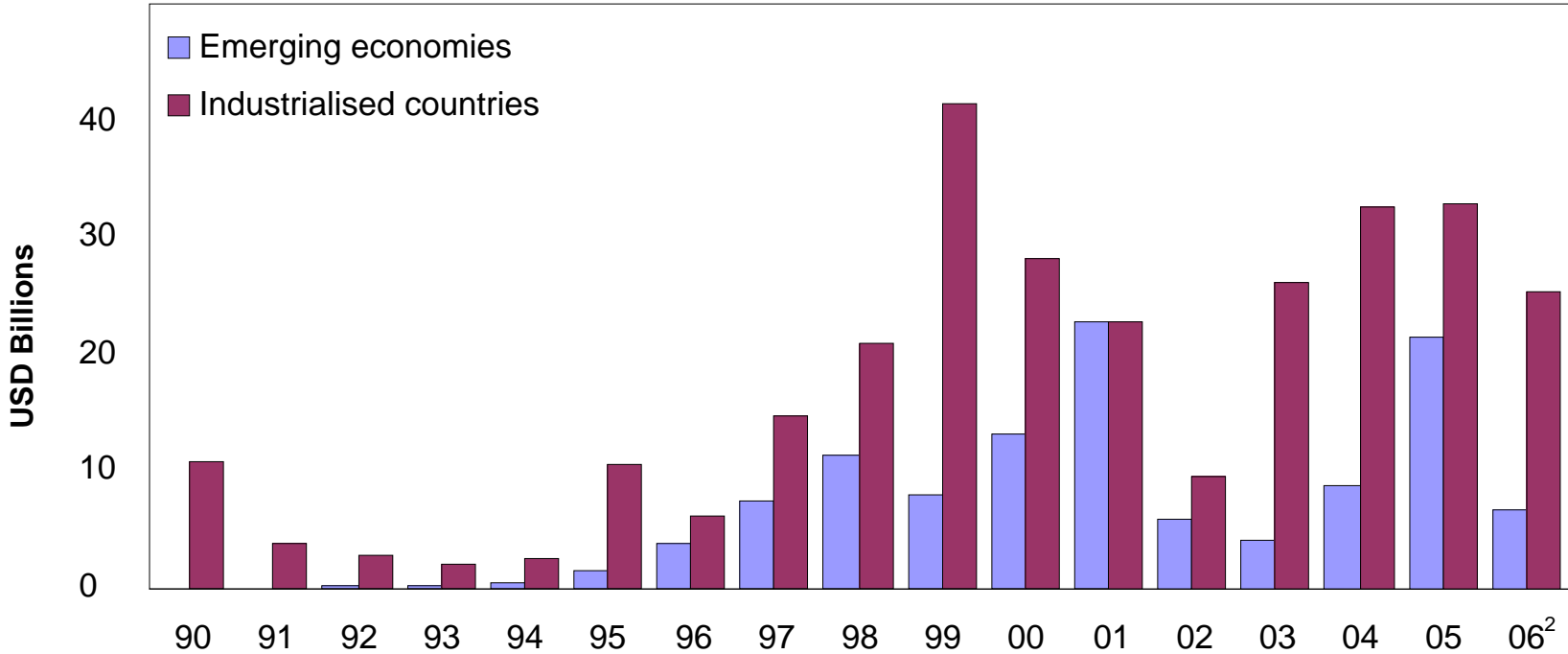


**BIS Reporting Bank Claims on Emerging Market Countries**



# ...cross-border mergers and acquisitions,

**Cross-border M&A deals in the financial sector<sup>1</sup>**



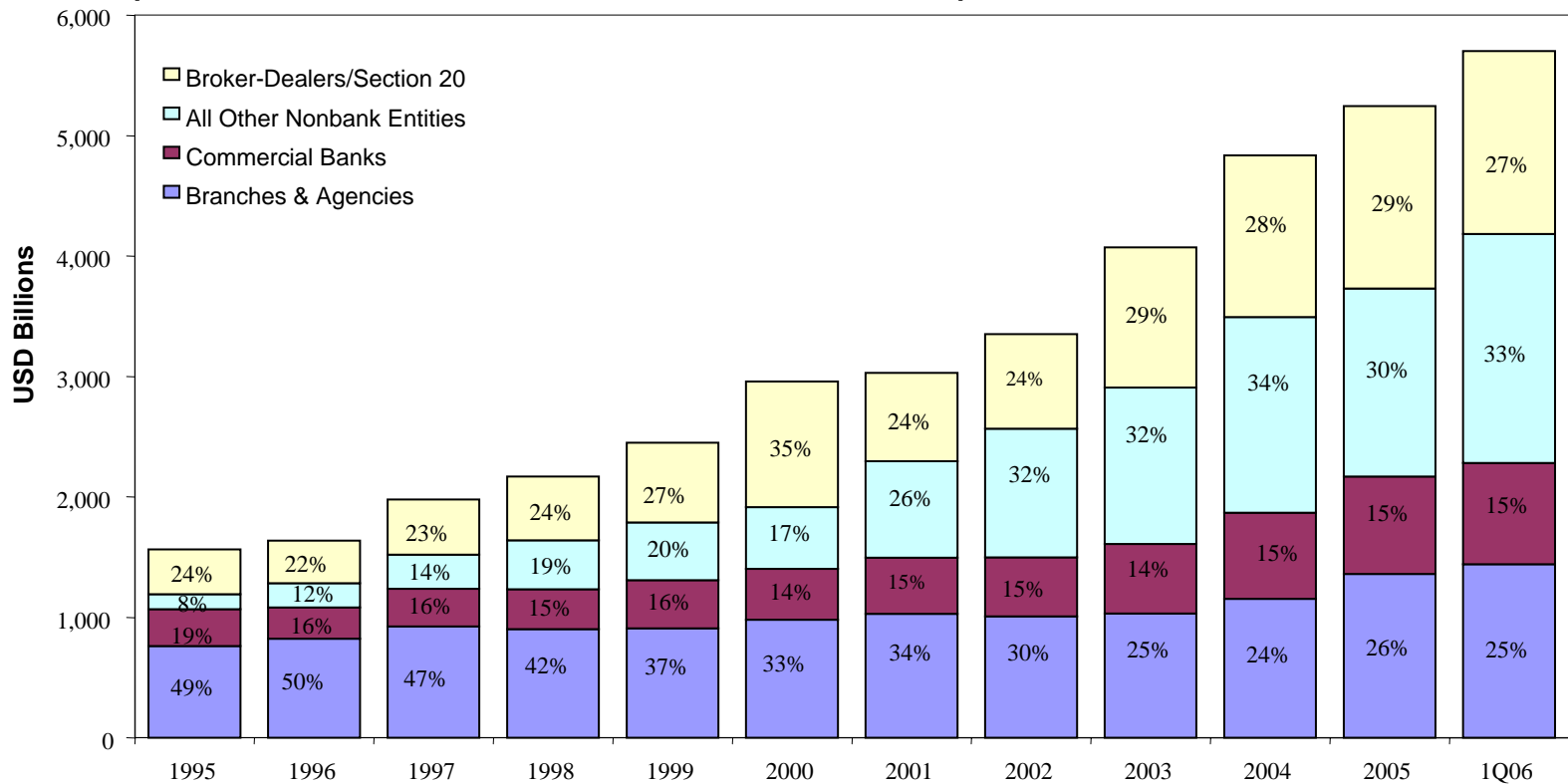
1 Value of completed M&A deals.

2 Data covers January - 5 June, 2006.

Source: Thomson Financial

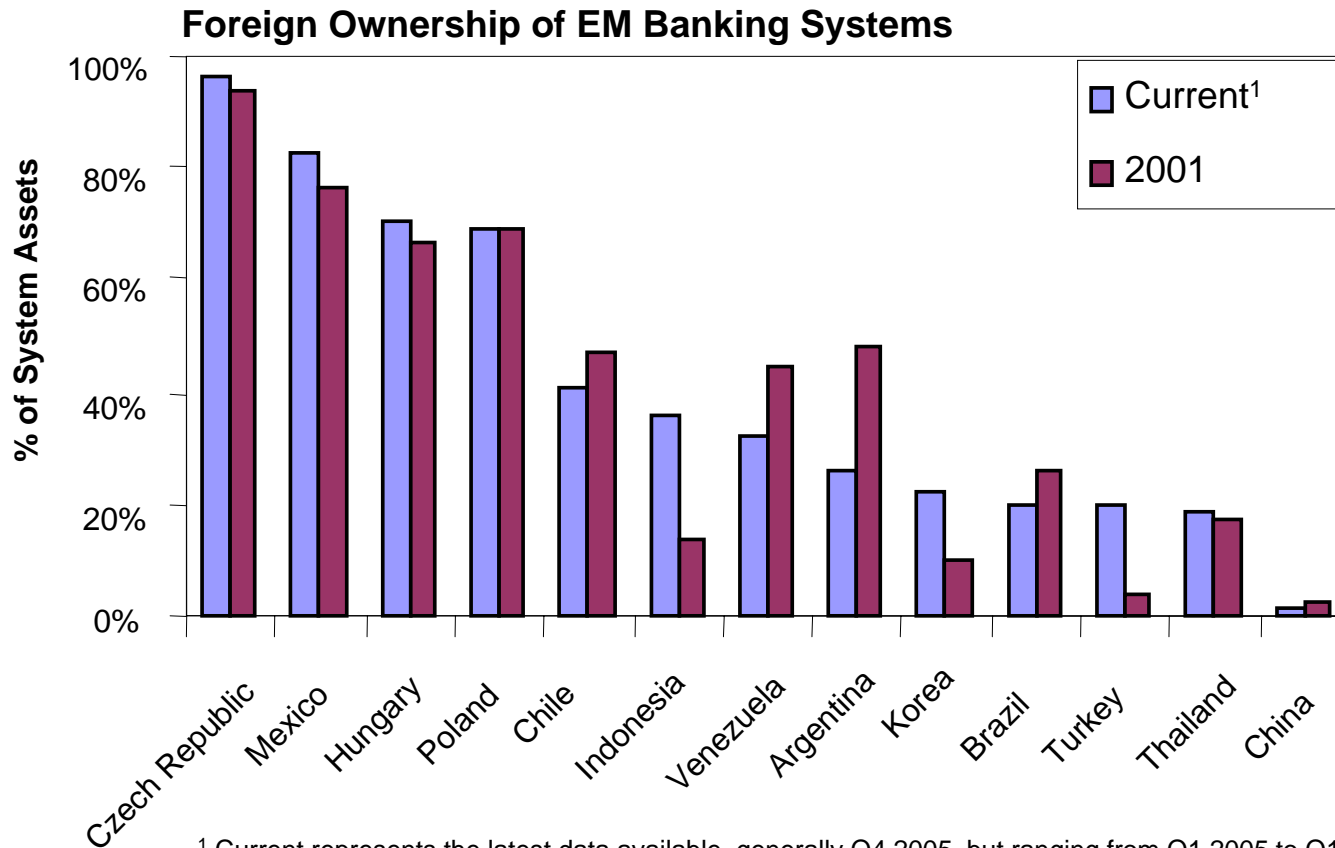
...and significant foreign bank presence in industrialized countries...

**Foreign US BHC Assets by Type**  
 (\$ Billions and as Percent of Total, 1995 – 1Q06)



Source: U.S. Regulatory Reports

...as well as in emerging market countries



<sup>1</sup> Current represents the latest data available, generally Q4 2005, but ranging from Q1 2005 to Q1 2006.  
Source: National Central Banks and Bank Superintendents

## The globalization of banking is likely to continue

- Increased large scale cross-border acquisitions in Europe
- Wave of strategic minority stakes in Chinese banks
- Prospective further opening of individual banking markets under global or bilateral free trade agreements



Growth of global banking creates clear benefits, as well as challenges.

## Benefits of global banking for EM countries (2004/05 CGFS findings)

- Foreign bank entry leads to greater efficiency in local banking markets
  - Improved credit and risk allocation
  - Competition fosters development of local markets
- Knowledge transfer helps spread global best practice
- Acquired banks gain access to global capital markets

## Challenges associated with global banking (CGFS 2004/2005 Reports)

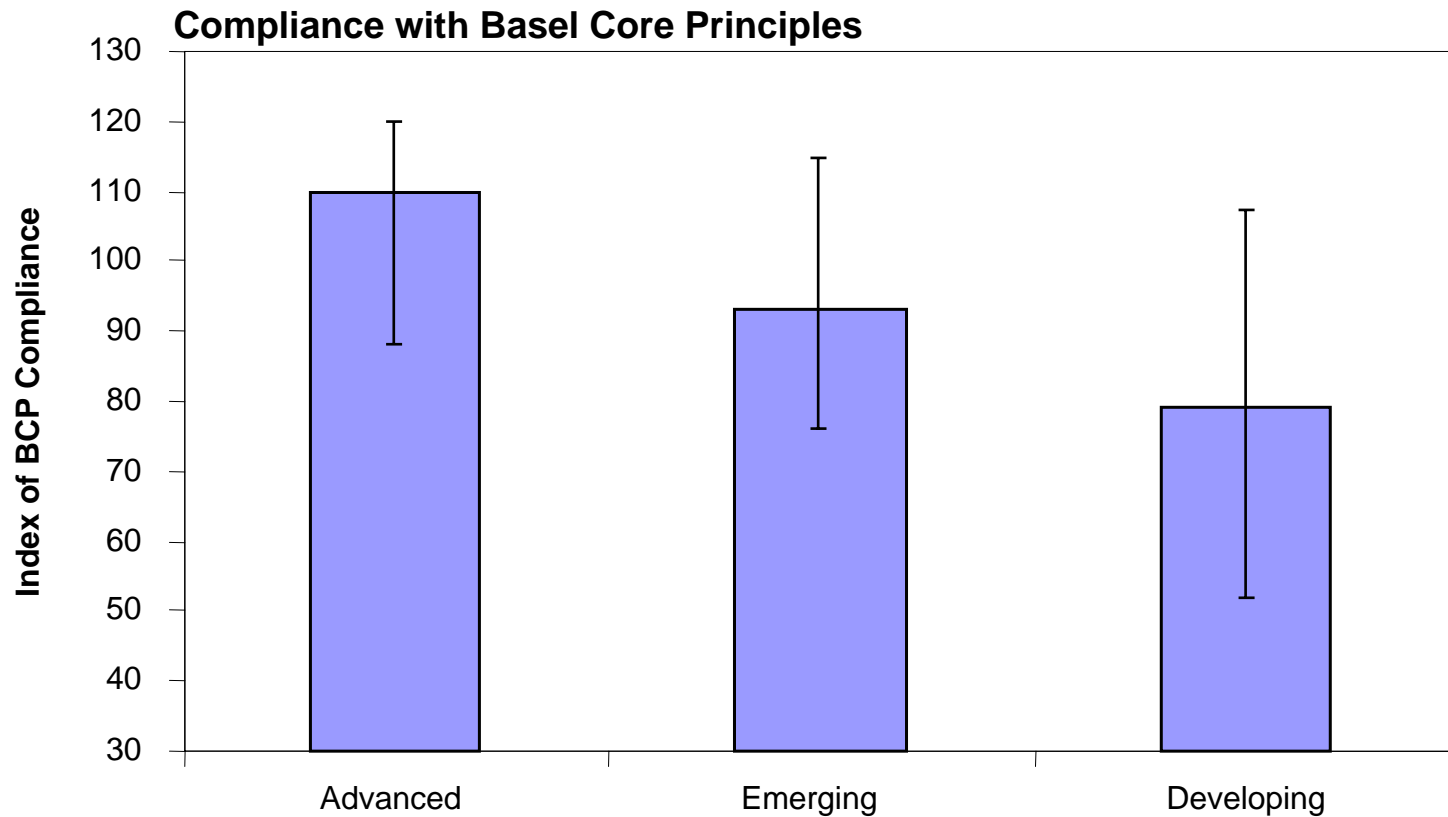
- Managing political sensitivities to heightened foreign participation
  - Can show up in nonregulatory barriers to entry, reflecting desires to maintain local control of banking systems and build national champions
- Achieving home/host supervisory coordination
- Dealing with local impact of decisions made on the basis of global risk/return considerations

## Potential challenges to local financial systems

- Risk management and capital allocation decisions by a foreign parent of a local subsidiary bank can affect the level of capital devoted to local markets
- Signals from key asset markets may no longer be available for acquired financial institutions
  - Delisting of largest institutions may greatly alter local market for some instruments
  - Acquisition of local bank by a foreign parent may reduce local analyst coverage and remove information from the price discovery process

- ## Financial sector supervision may become more challenging for local authorities
- Entry of increasingly complex and diverse banking organizations creates a need to enhance the know-how of local banking supervisors
    - Must develop knowledge of foreign legal, accounting and regulatory frameworks
    - Financial and technical skills of supervisors must be enhanced
  - Creates need for more and better cross-border information-sharing among supervisors

# The baseline: strengthening bank supervision



Error bars denote maximum and minimum observations.

Source: IMF, 2004

## Supervisory information-sharing is essential

- Substantial work by Basel Committee, Joint Forum on information-sharing principles
- Information flows host to home should be largely unimpeded; home to host should be as forthright as possible
- Active dialogue and coordination is under way between G-10 and non-G10 supervisors on Basel II home/host issues

## Mechanisms needed to promote financial stability

- Stronger institutions are key, regardless of ownership of banks
- Robust legal, accounting and supervisory frameworks are critical
- Standards such as FSAPs and ROSCs provide independent view on vulnerabilities and development challenges, and can enhance market transparency
- Regional compacts such as EU, NAFTA can foster development of supporting legal, market, and regulatory infrastructure



## Questions for panel discussion

- What are the main factors behind recent sensitivity to foreign bank investment in some countries?
  - Lessons for policymakers?
- What are the appropriate goals and behaviors of foreign banks in host markets?
  - Balancing local and parent interests
  - What mechanisms can be most effective in achieving local representation in foreign bank governance?

## Questions for panel discussion (continued)

- What role can market discipline play in ensuring the interests of all stakeholders are considered by the management of global banking institutions?
  - What mechanisms are most effective in ensuring market discipline's influence?
- What implications are seen for supervisory policy?
  - Frequency and quality of disclosure (Basel II)
  - Improvements in accounting infrastructure
  - Roles of home vs. host country authorities
  - Other?