Discussion of

Are International Banks Different?

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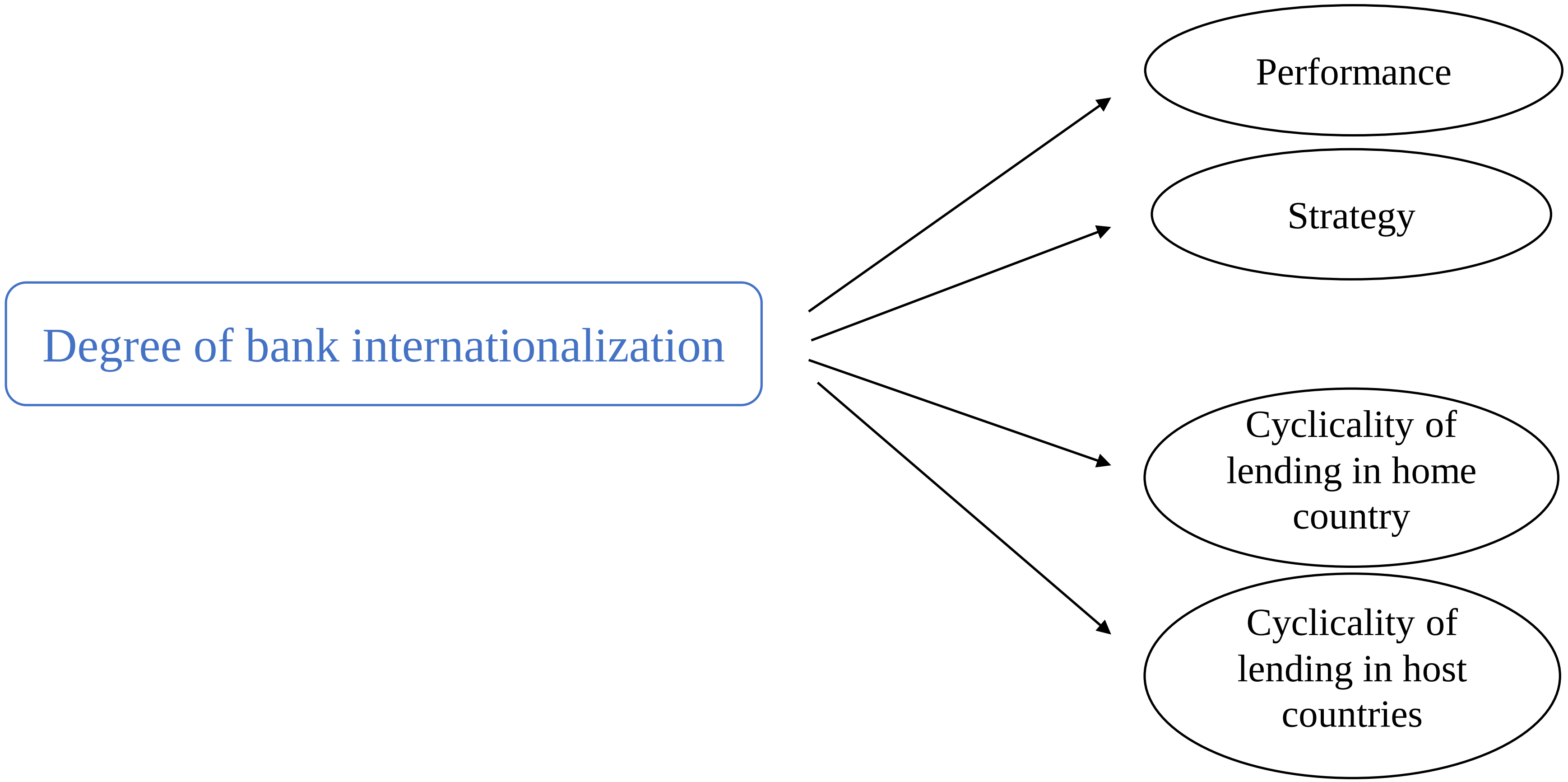
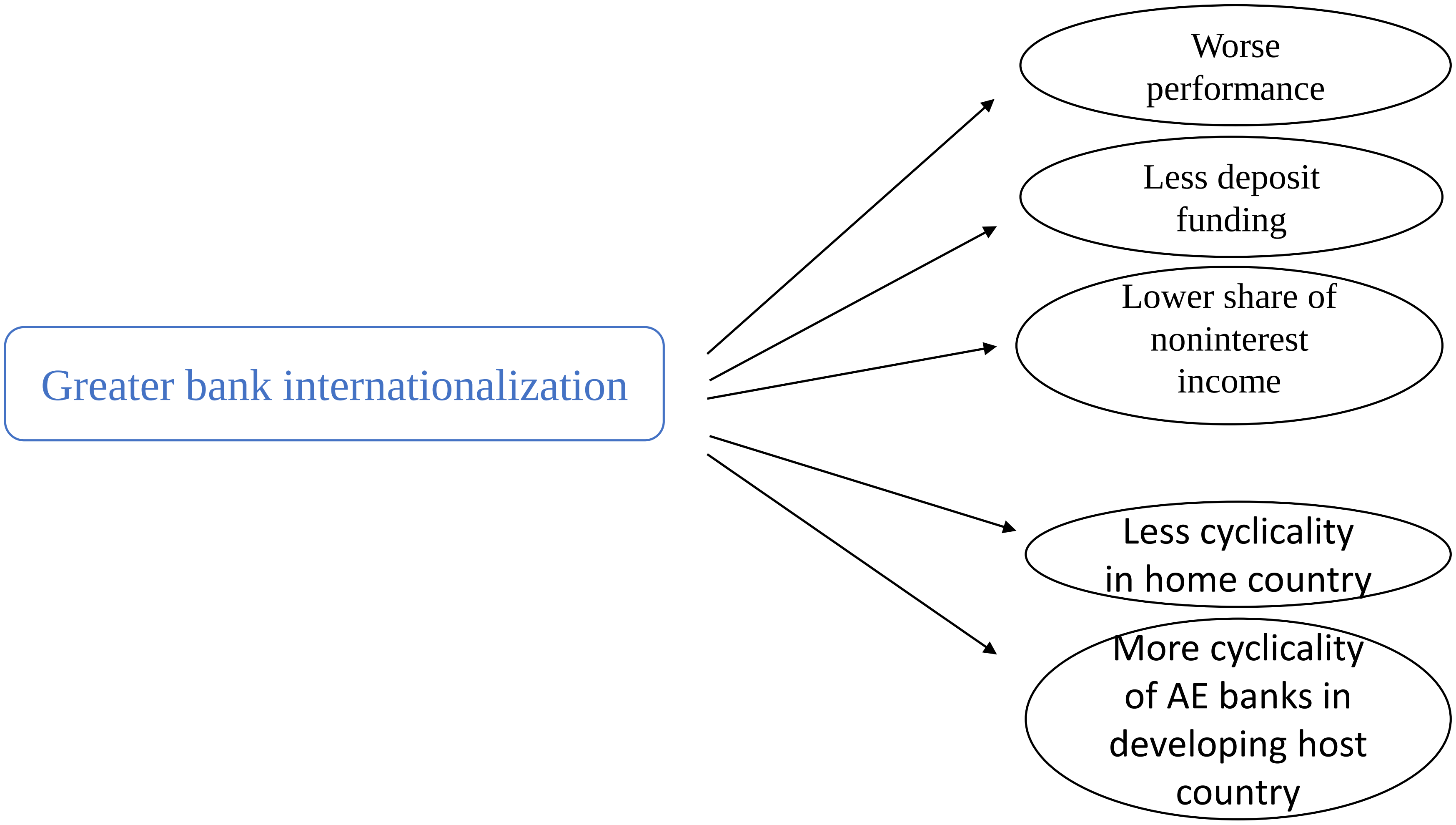
BIS ANNUAL CONFERENCE – JUNE 2018

What is the paper about?



Some key findings



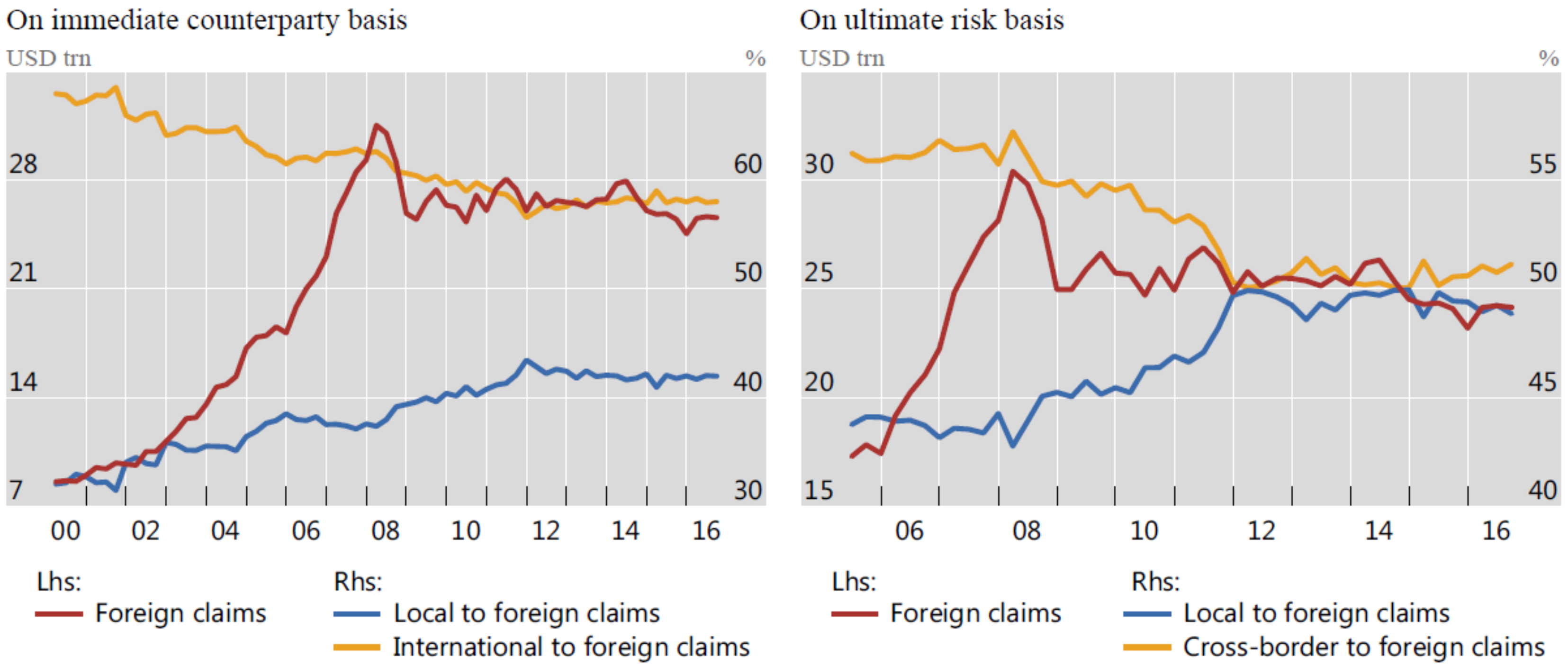
Comments

- Cross-border banking versus local banking via subsidiaries
- A few stylized facts on G-SIBs’ degree / mode of foreign presence
  - Role of relative profitability at home / abroad
  - Role of funding model
  - Role of line of business
- Regulation on “international” banking in home / host countries
  - Could help strengthen identification
  - Current regulatory issues

Cross-border banking remains larger than local banking

Local claims as a share of foreign claims

By lending banking system, all reporting countries

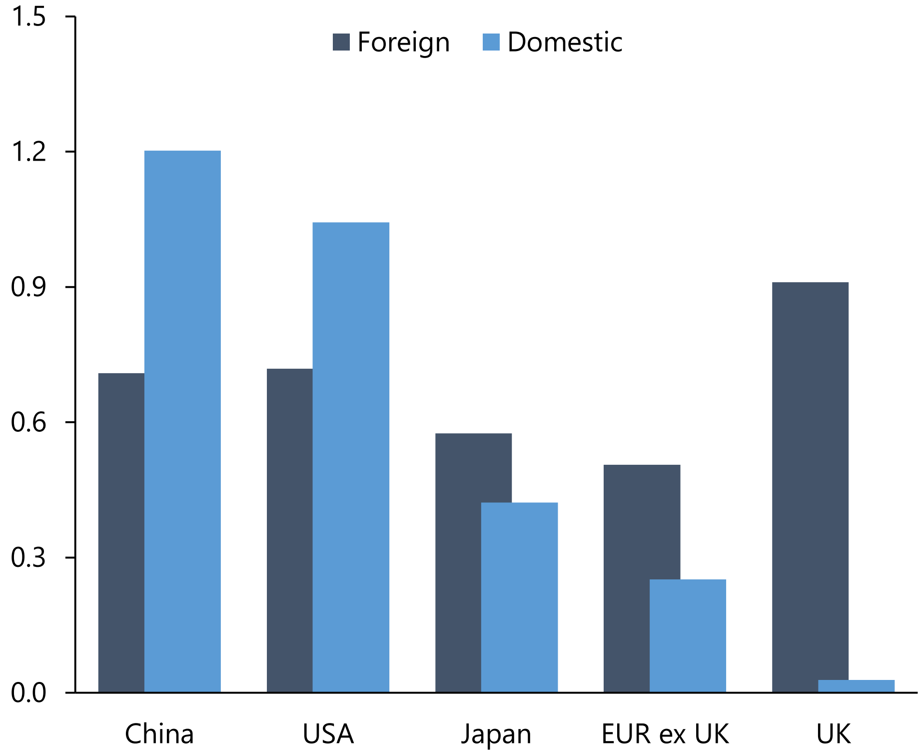


Source: BIS consolidated banking statistics (CBS).

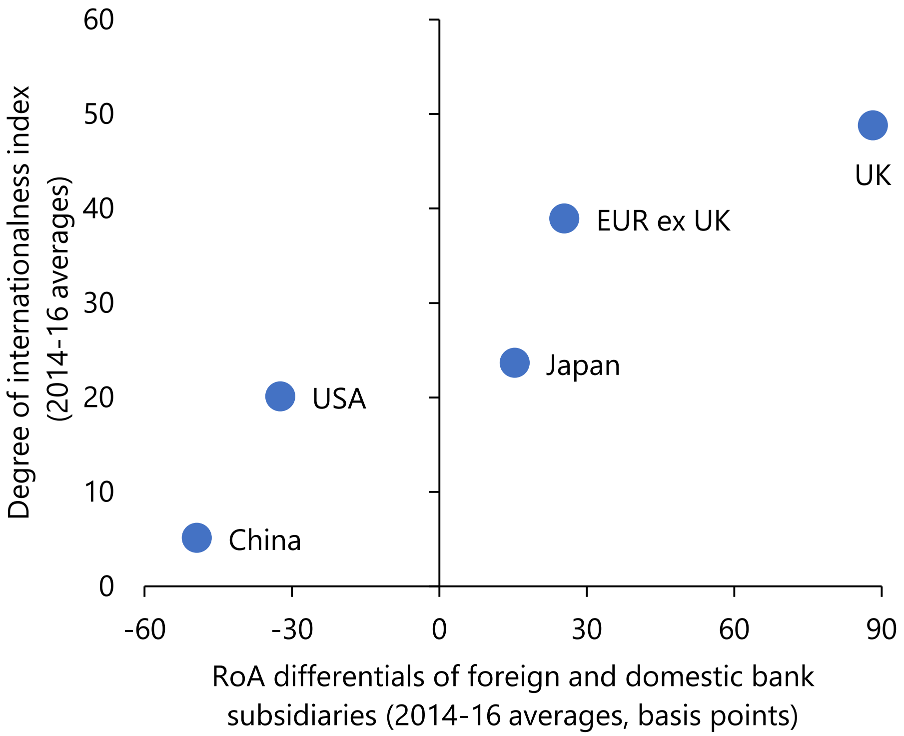
Source: Avdjiev, Aysun, and Hepp (2017)

G-SIBs' relative profitability across locations is a key driver of foreign expansion

G-SIBs ROA: Foreign Subsidiaries vs Home Subsidiaries
2014-16 Average, Percent



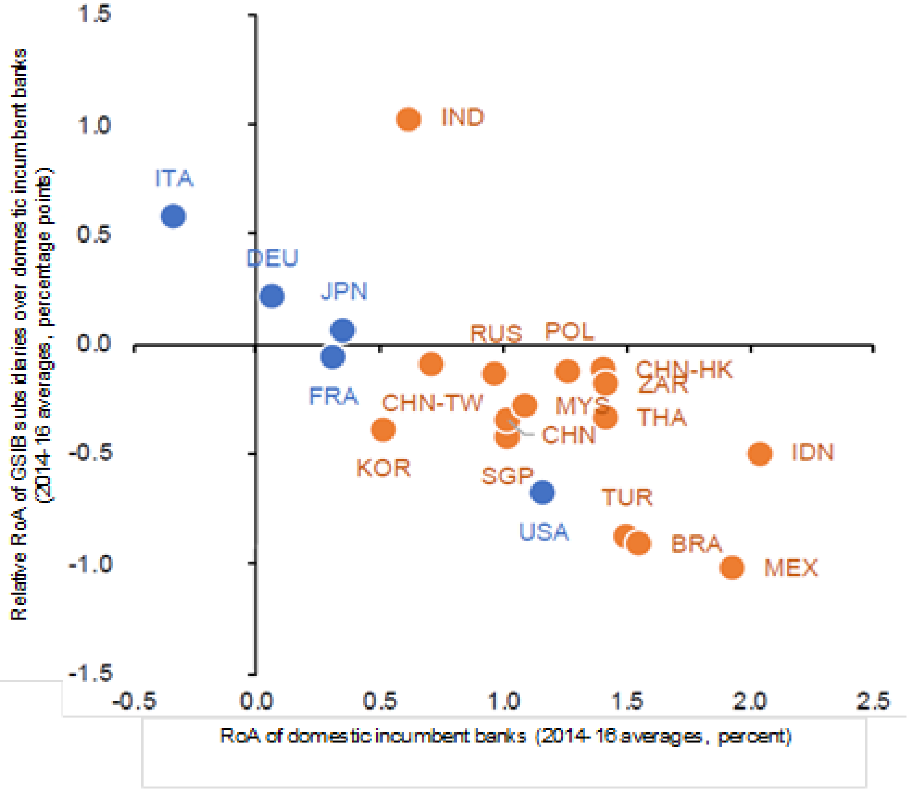
G-SIBs ROA Differential and Internationalness Index
2014-16 Average, Percent



Source: Caparusso, Chen, Dattels, Goel, and Hiebert (forthcoming IMF WP)

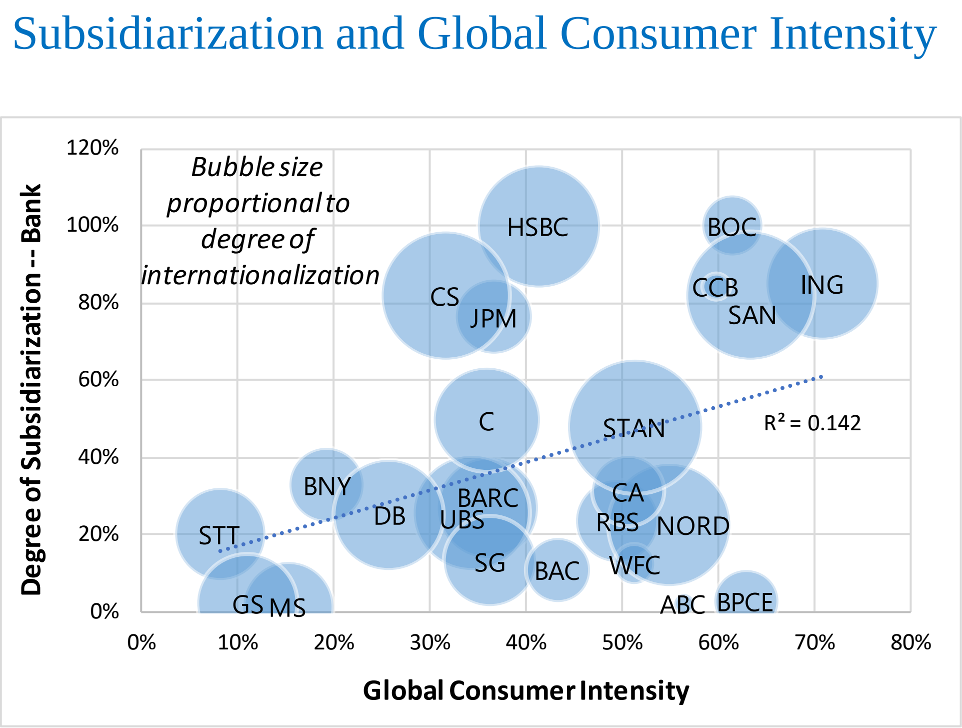
G-SIBs have a profitability gap in emerging markets

ROA: G-SIB's Foreign Subsidiaries vs Domestic Incumbents
(2014-2016 average)



Source: Caparusso, Chen, Dattels, Goel, and Hiebert (forthcoming IMF WP)

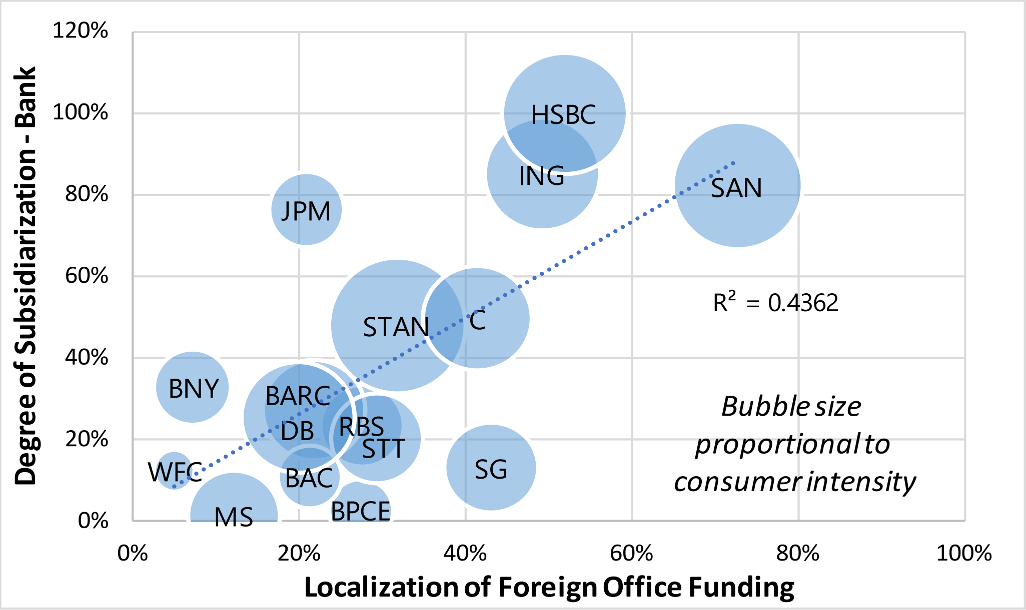
Greater multinationalization<-> Larger consumer business



Source: Caparusso, Chen, Dattels, Goel, and Hiebert (forthcoming IMF WP)

Greater multinationalization<-> Greater local funding

Subsidiarization and Overseas Office Funding Localization

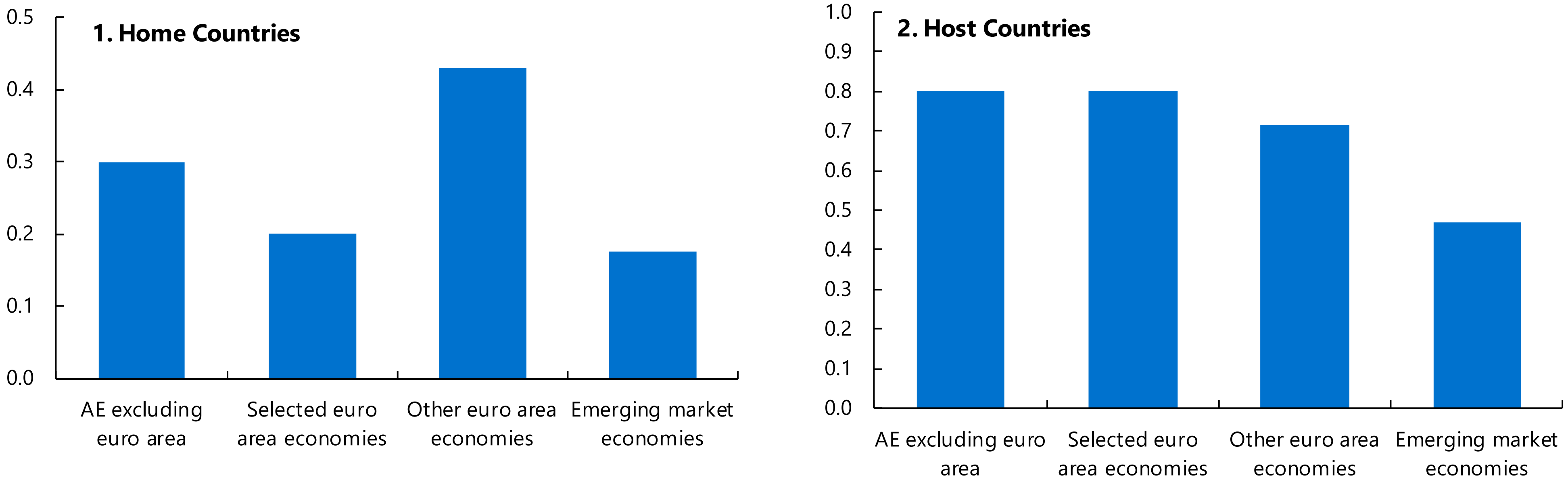


Source: Caparusso, Chen, Dattels, Goel, and Hiebert (forthcoming IMF WP)

Use changes in regulation on "international" banking operations (in foreign countries) as a source of exogenous variation ?

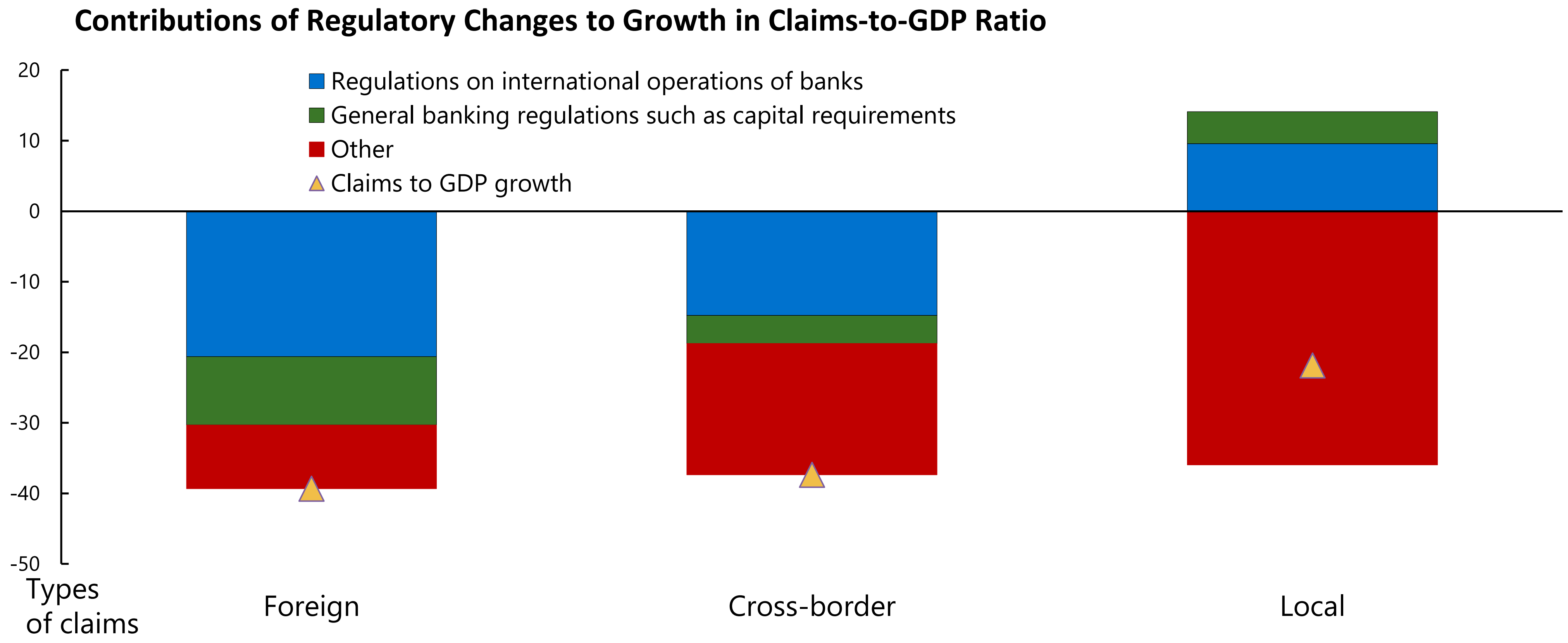
Share of Countries that Tightened Regulations on International Banking Operations between 2006 and 2014, by Region

(Percent)



Source: April 2015 GFSR

Effect of regulation on foreign banking

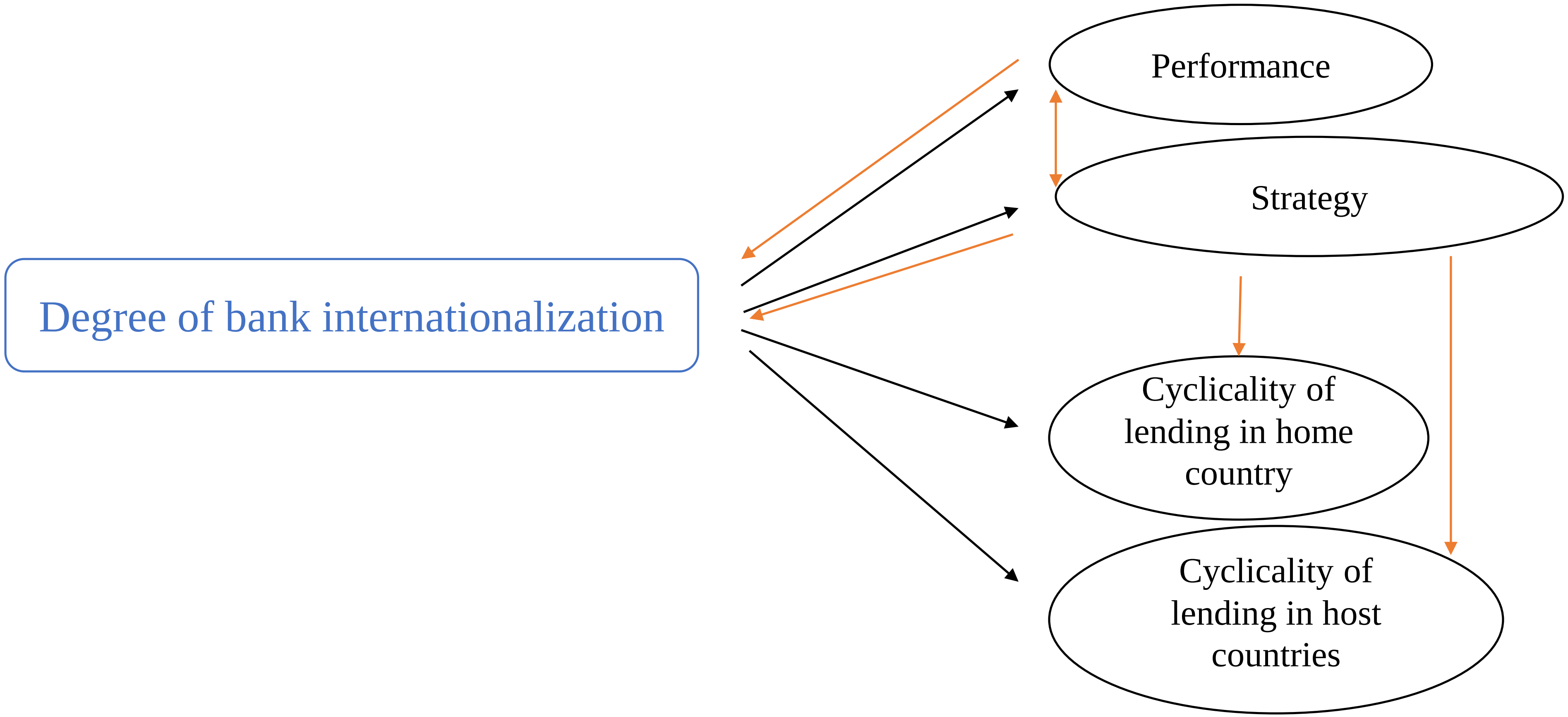


Source: April 2015 GFSR

Comments on selected regulatory issues

- Ring-fencing
- Specificities of a banking union
- Internationalization of EM / LIC banks
- Correspondent banking relationships

Conclusion: in search of identification



Additional Background

Subsidiary or Branch Model?

- Host authorities try to minimize financial stability risks by ensuring that foreign banks' affiliates maintain sufficient capital and liquidity buffers → easier under a subsidiary model
- One size doesn't fit all:
  - diversity of business models,
  - differences in regulatory and tax regimes,
  - varying stages of financial development in host countries
- From a financial stability viewpoint, neither model outperforms the other in reducing both probability and cost of a banking group failure
- Mechanisms to ensure effective oversight and orderly resolution are a more effective route to resolving the efficiency-financial stability trade-off

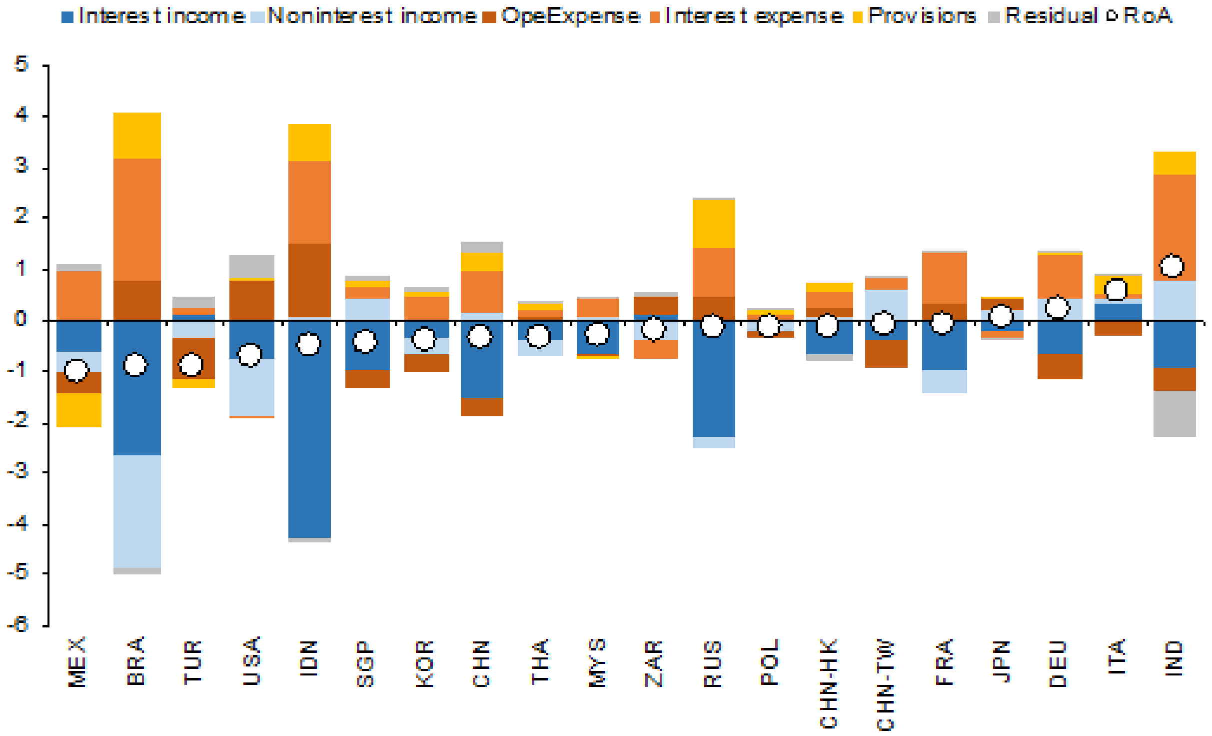
Diversity of business models

		International wholesale model	International retail model
	Line of business focus	Investment bank Corporate bank Transaction bank Wealth manager	Consumer (or commercial/SME) bank
		← Universal bank →	
Funding model	Funding products/ franchise	Wholesale and market-based instruments: interbank, commercial paper, repo, swaps	Large stable deposit franchises, often mass-market retail sourced through local branch network
Funding model	Funding operations	Centrally coordinated; extensive intra-group cross-border transfers.	Decentrally managed; local funding/little cross-border
Funding model	Currency focus	Focused on dollar and other international currencies.	Predominately domestic currencies.
Entity structure	Legal entity structure	Predominately operates through international branches	Extensive use of locally incorporated subsidiaries.
Entity structure	Primary regulatory interface	Home regulator is primary supervisor of branch operation	Country subsidiaries supervised by host authority

Source: Caparusso, Chen, Dattels, Goel, and Hiebert (forthcoming IMF WP)

G-SIBs have a different business model than domestic incumbents in EMs

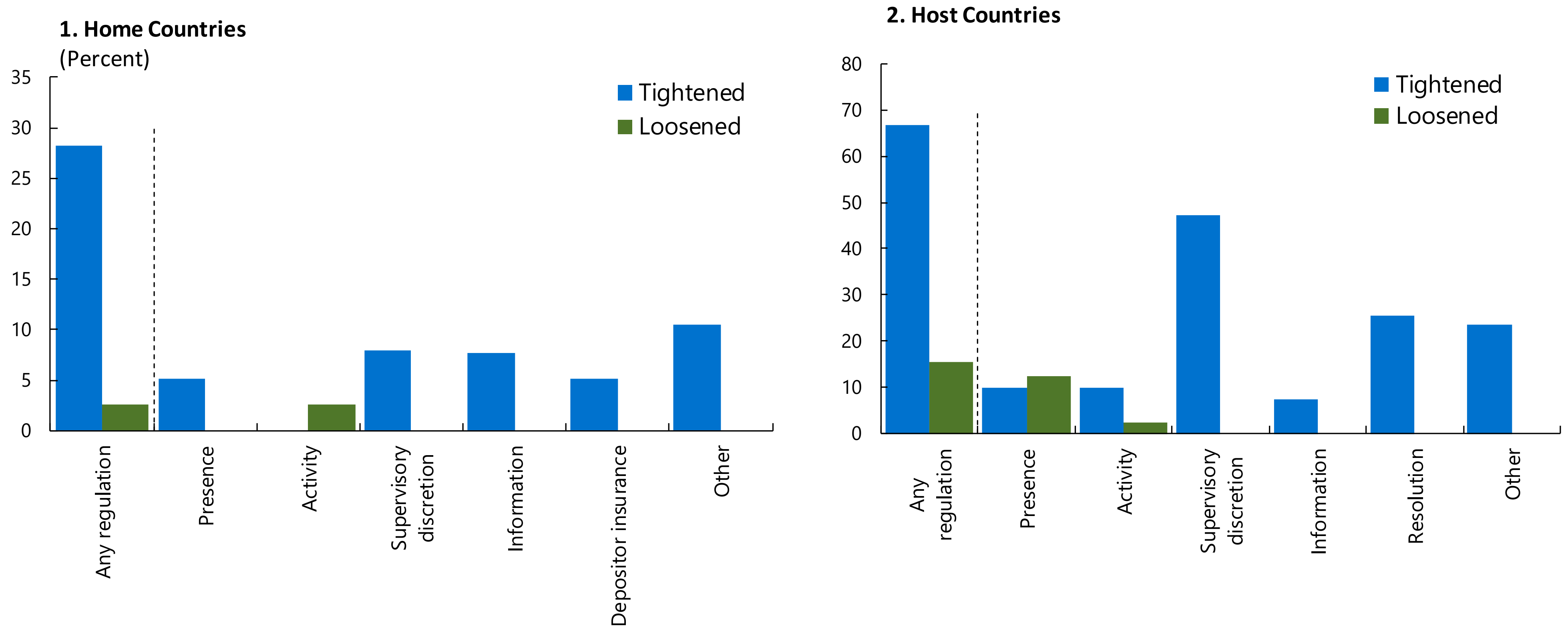
Decomposition of ROA difference
(2014-16 average)



Source: Caparusso, Chen, Dattels, Goel, and Hiebert (forthcoming IMF WP)

Changes in regulation on "international" banking by type

Share of Countries that Changed Regulations on International Banking Operations between 2006 and 2014



Source: April 2015 GFSR

Ring-fencing

- What is needed to prevent ring-fencing:
  - Better information sharing between home and host authorities
  - Supervisory colleges → joint risk assessments
  - Crisis management groups → group and firm-specific resolution plans
- Until sufficient progress is made in these directions, “ex-ante subsidiarization” remains an understandable ‘temptation’ and, in the end, a preferable option than discretionary ring-fencing during a crisis

International banking in a banking union

- Even in highly integrated areas, the incentive to ring-fence remains strong, without a completely common safety net → e.g. in the Euro Area, the banking union needs to be completed with common deposit insurance and public backstop…
- … but financial integration requires more than no-ring fencing:
  - less fragmentation/further harmonization: e.g. reduce fragmentation in bank insolvency laws that allow national authorities to avoid a substantial application of BRRD/bail-in
  - coordinate/harmonize ELA and eventually centralize
  - greater centralization of supervision including 3rd country branches, investment firms
  - more convergence in supervisory practices (esp. on-site)

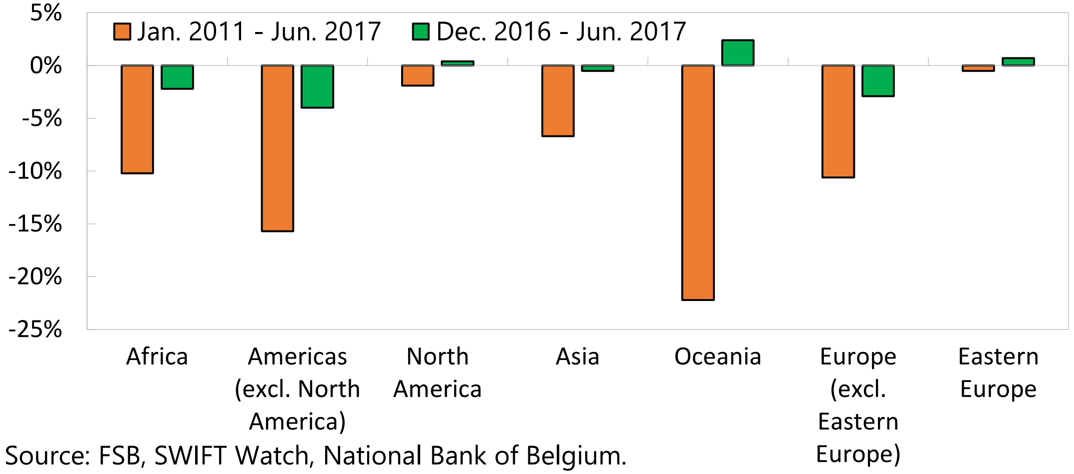
“International” banks headquartered in EMs / LICs

- “International” banks from EMs / LICs (e.g. pan-African banks):
  - facilitate economic and financial integration;
  - promote transfer of knowledge and technology;
  - foster competition, contributing to financial innovation;
  - enhance financial inclusion;
  - and support the financing of local infrastructure.
- But risks stemming from cross-border banking are also high: as these groups expand, new channels for transmission of macro-financial risks and spillovers across home and host countries may emerge
- Enhanced cross-border cooperation on regulation, supervision and crisis management is needed, in particular to support effective supervision on a consolidated basis and cross-border resolution

Correspondent banking relationships

- **The decline in CBRs continues**: overall concentration of correspondents has decreased since 2015
- While it seems to have stabilized in some areas (e.g. Caribbean), **financial fragilities remain in some countries**
- **Drivers of CBR pressures remain the same** (e.g. lack of clarity over regulatory expectations; weaknesses in regulatory and supervisory frameworks, including for AML/CFT); but also some **financial integrity issues** (e.g. corruption, transparency, sanctions)
- Potential negative impact on **financial inclusion** and **remittances** requires continued attention

Number of active counterparty countries by region
(average percent change across region)



Source: FSB, SWIFT Watch, National Bank of Belgium.

- **IMF multipronged approach**:
  - Monitor risks
  - Assess macro-criticality of this issue
  - Provide targeted technical assistance & training
  - Facilitate dialogue
  - Collaborate with other stakeholders