International Banking

Ata Bertay
GFDR Lead, Research Department

Miriam Bruhn
Senior Economist, Research Department

http://www.worldbank.org/financialdevelopment
A Brief Historical Perspective on International Banking

- Early banks from the 15th century Italian city-states and their “foreign” branch networks

- Emergence of German merchant banks in the 16th century financing trade, industry and foreign sovereigns by raising funds from the money markets in Antwerp

- Dutch banks and early examples of syndicated loans and securities underwriting in the 17th and 18th centuries

- The first wave of globalization (late 19th century) and the rise of modern global banks in the 20th century
Definitions for Understanding International Banking

- International vs. Foreign banks
- Home vs. Host countries
- Global vs. Regional banks
- Subsidiaries vs. Branches
A Conceptual Framework: Basics

• Banks provide many important functions that facilitate economic activity (Levine, 1997)
  • Resource allocation
  • Diversification of risks
  • Mobilizing and pooling savings
  • Exerting corporate governance
  • Facilitating the exchange of goods and services

• Banks expand their activities into other countries to further diversify risk, to realize higher profit margins, and to achieve economies of scale (Cull and Martinez Peria, 2010)

• International banking flows interact with other types of flows (e.g. FDI, deepening local capital markets)
A Conceptual Framework: Bank business models

• In a multi-country setting some degree of financial integration is beneficial – despite information or regulation related costs

• Important differences compared to other types of capital flows, such as debt and equity investments, due to unique bank business model
  • Reduce information asymmetries through screening and monitoring
  • Heavily regulated mainly at national level – limited cross-border coordination
  • Supported by financial safety net (e.g. deposit insurance, lender of last resort)

• Home/host country and bank characteristics affecting costs and benefits of cross-border banking (especially economic growth-stability trade-off)
International Banking and Economic Development

• Entry by foreign banks => additional (human) capital, technologies etc. => increased competition in the banking industry, more efficient resource allocation, and better access to finance

• Institutional environment is critical
  • Poor information infrastructure and contract enforcement => cherry picking => lower access to finance
  • Lax regulation/supervision => high risk taking => banking crisis

• Recent empirical evidence on foreign bank presence on economic growth, entrepreneurship and inequality
International Banking and Financial Stability

• International banking as a risk-sharing scheme

• Ideally, stabilizing the local credit supply in a local crisis

• But if host country financial systems are not capable of handling such flows => fuel credit booms ending up in busts

• The global financial crisis revealed a number of country and bank characteristics affecting shifts in international banking
  • Cultural and institutional distance
  • Legal and regulatory framework
  • Cross-border vs. brick and mortar
  • Mode of entry (e.g. greenfield vs. M&A)
  • Funding structures
What Data Can Be Used?

• **Aggregate data on international banking flows:**
  - BIS Banking Statistics – collecting data from national authorities from BIS reporting countries
  - Bank-level data not publicly available (except G-SIBs assessment forms)

• **Bank-level data on ownership:**
  - Bankscope, SNL, Fitch etc.
  - Claessens and van Horen (2015)

• **Loan-level data:**
  - SDC Platinum and Dealogic
  - Global Bonds and Syndicated Loans Databases (FinDebt) for quarterly volume of syndicated loans
What Constitutes a Foreign Bank Claim?

- A financial claim extended to a nonresident counterparty
- For example, loans and deposits in other banks, debt securities, and other residual claims
- Counterparties and risk transfer
- Consolidated Banking Statistics vs. Locational Banking Statistics
Foreign Claims by Banks in Counterparty Economies

Source: Consolidated Banking Statistics (Immediate Risk Basis), Bank for International Settlements (BIS)

Notes: Foreign claims = outstanding cross-border loans + local loans by foreign-owned banks; breakdown into developing and high income is by host country.
Lending by foreign banks remains an important source of credit

Source: Consolidated Banking Statistics (Ultimate Risk Basis), BIS, and International Financial Statistics, International Monetary Fund

Notes: Foreign claims on nonbank private sector as a percentage of private credit (country-level average by region)
Foreign claims mostly fund the nonbank private sector

Source: Consolidated Banking Statistics (Ultimate Risk Basis), BIS, and International Financial Statistics, International Monetary Fund
Notes: Foreign claims as a percentage of GDP by counterparty sectors (country-level average by income level)
Cross-border lending is sizeable compared to bond issuances

Source: Global Syndicated Loan and Bond Database, World Bank
Notes: New volume issued each year in developing countries (for cross-border syndicated loans and foreign bonds)
Cross-Border vs Local Claims by Counterparty Economies

**Source:** Consolidated Bank Statistics (Ultimate Risk Basis), BIS

**Notes:** Breakdown into developing and high income is by host country
Cross-Border Claims by Host Regions

Source: Consolidated Bank Statistics (Ultimate Risk Basis), BIS
Source: Consolidated Bank Statistics (Ultimate Risk Basis), BIS
Introduction

Foreign Bank Presence through Subsidiaries (% of Banks)

Data

Stylized Facts

Conclusions

Source: Claessens and Van Horen (2015)
Notes: Percentage of banks that is majority foreign owned
The Rise of South-South Banking (Bank Ownership)

Source: Claessens and Van Horen (2015)
Notes: Percentage of banks that is majority owned by domestic vs foreign entities
The Rise of South-South Banking (Foreign Claims)

Source: Consolidated Bank Statistics (Immediate Risk Basis), BIS
Notes: Breakdown into developing and high income is by home country
Some international banks have become very large.

**Assets of top five banks relative to GDP**

*Source: Bankscope and World Development Indicators*
Restrictions on foreign bank entry have increased

Percentage of countries with restrictions on foreign bank entry through...

a. High-income countries

b. Developing countries

Source: Barth, Caprio, and Levine (2013)
New Developments in Global Finance

• Fintech = technology-enabled financial innovation facilitating new products, services, and business models
  • Currently still small in size, but has growth potential
    • Crowdfunding microloans (kiva.org)
    • Peer-to-peer money transfer services (TransferWise)

• International Microfinance Institutions (MFIs)
  • Greenfield MFIs with international holding company
    • Access, Advans, BRAC, FINCA, and ProCredit
  • Relative to other African microfinance providers, greenfield MFIs tend to grow faster, improve profitability, and increase lending to women (Cull et al. 2015)
Conclusions and Policy Implications

• International banking remains important after the global financial crisis
  • Competition and improved the efficiency of the financial system
  • Risk-sharing to smooth downturns in home and host countries

• A country’s experience with international banks depends on its institutional and regulatory environment

• New developments pose additional challenges to regulators
  • Rise of south-south banking
  • Increase in bank size
  • New technologies
Foreign Bank Presence through Subsidiaries (% of Assets)

Source: Claessens and Van Horen (2015)
### Example Transactions

<table>
<thead>
<tr>
<th>Transactions</th>
<th>Lending Banks</th>
<th>Borrowing Counterparties</th>
</tr>
</thead>
<tbody>
<tr>
<td>[1]</td>
<td>Bank #1 headquarter in Country A</td>
<td>Bank #1 subsidiary in Country B</td>
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### Reported Foreign Claims

<table>
<thead>
<tr>
<th>Transactions</th>
<th>LBS/R</th>
<th>LBS/N</th>
<th>CBS/IC</th>
<th>CBS/UR</th>
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