On a tight leash: does bank organizational structure matter for macroprudential spillovers?

Piotr Danisewicz, Dennis Reinhardt and Rhiannon Sowerbutts

Discussion from:

Silvia Bressan

Financial Institutions after the Crisis: Facing new Challenges and new Regulatory Frameworks

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Do cross-border spillovers of macroprudential regulation depend on the organizational structure of multinational groups?

- Parent – Branches *versus* Parent – Subsidiaries
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**Empirical design**

- Sample of foreign branches and subs operating in the UK
- Event study (diff-in-diff): Use changes in macroprudential regulations occurring in the parent country
- Impact from the macroprudential events on lending to UK customers

\[ \Delta y_{ijkt} = \alpha_i + \beta (\text{Regulation}_{kt} \times \text{Type}_{ijk}) + \text{Type}_i + BC_{ijkt} + \delta_{jkt} + \varepsilon_{ijkt} \]
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**Main Results**

<table>
<thead>
<tr>
<th></th>
<th>Non-bank lending</th>
<th></th>
<th>Interbank lending</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(1)</td>
<td>(2)</td>
<td>(3)</td>
<td>(4)</td>
</tr>
<tr>
<td>Capital regulation*Type</td>
<td>-0.059 (-0.62)</td>
<td>-0.065 (-0.66)</td>
<td>-0.063*** (-3.13)</td>
<td>-0.068*** (-4.13)</td>
</tr>
<tr>
<td>Lending standards*Type</td>
<td>0.034 (0.36)</td>
<td>0.037 (0.40)</td>
<td>0.020 (0.54)</td>
<td>0.024 (0.60)</td>
</tr>
<tr>
<td>Reserve requirements*Type</td>
<td>0.025 (0.27)</td>
<td>(0.28)</td>
<td>0.026 (1.07)</td>
<td>0.084 (1.08)</td>
</tr>
<tr>
<td>Type</td>
<td>0.030* (1.86)</td>
<td>0.031* (1.76)</td>
<td>0.030* (1.89)</td>
<td>0.042** (2.38)</td>
</tr>
<tr>
<td>Bank size (ln)</td>
<td>0.001 (0.18)</td>
<td>0.001 (0.20)</td>
<td>0.001 (0.19)</td>
<td>0.005 (1.56)</td>
</tr>
<tr>
<td>Wholesale</td>
<td>-0.101** (-2.18)</td>
<td>-0.101** (-2.24)</td>
<td>-0.101** (-2.19)</td>
<td>0.039 (1.03)</td>
</tr>
<tr>
<td>Observations</td>
<td>4,107</td>
<td>4,107</td>
<td>4,107</td>
<td>4,107</td>
</tr>
<tr>
<td>R-squared</td>
<td>0.529</td>
<td>0.529</td>
<td>0.529</td>
<td>0.515</td>
</tr>
</tbody>
</table>

*Type = 1 => Branch*
Main Results

- Do cross-border spillovers of macroprudential regulation depend on the organizational structure of multinational groups?

- With tighter capital rules in the parent country:
  - Foreign UK branches reduce their interbank lending more than foreign UK subsidiaries
  - The lending to non-banks does not change

- Tighter lending standards or reserve requirements do not induce changes in the lending policy
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Tighter lending standards or reserve requirements do not induce changes in the lending policy

=> With changing capital regulation it becomes easier and more flexible to adjusting the (interbank) lending of branches than of subs
Discussion

- Interesting paper!
- Contribute to the understanding on the lending policies of banking groups
- Insightful empirics
- Suggest that one driver for the choice of the group organizational structure might be the prevention of spill-over effects
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  - Suggest that one driver for the choice of the group organizational structure might be the prevention of spill-over effects

- Though, some more comments…
The main view is that branches can be more easily controlled than subs, so that parent firms can more quickly modify their lending.

- Does the argument rely only on corporate governance or the spillover channel is more articulated? Other arguments/channels:
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1) Segmentation in the foreign loans portfolio: Parent firms place riskier assets on subsidiaries, so to exploit the limited liability.

- Might be easier to shrink the safer assets of branches than the riskier loans of subs, which require more intensive evaluation and monitoring.
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=> Branches reduce lending more than subs
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- Check whether the FSA can impose conditions on the bank's deposit-taking permissions, e.g. restricting the ability to accept retail deposit as in the case for non-EEA branches
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- Make this result more appealing by:
  - Emphasis that, international parent – branches structures restore capital by cutting interbank rather than wholesale credit (is this a good side!?)
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  - Discussion/Test on effects from:
    - Increased counterparty risk in the UK interbank market
    - Tendency after the crisis in switching from wholesale to deposit funding models (Oura et al. (2013), IMF)
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Integrate Luciano & Wihlborg (2014, wp) in the debate around ring-fencing

=> the subsidiary structure is the desirable organizational structure from a social point of view

=> Operational ring-fencing would be optimal for financial conglomerates as well as for international banks
Although mentioned, **taxation issues** should be more deeply explored:

- A branch office is not considered a local tax resident
- Subsidiaries are taxed as local resident entities and are eligible for local tax benefits
- => A different allocation of profits (and loans) between subs and branches might result in different taxable income
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Controlling for the domestic and UK corporate tax rate

- Reinforces the argument that the spillover is due to tightening regulation and not tax rate differentials
- and/or would make the argument more articulated, e.g:
  - Spillover observed for subs where UK tax rate > domestic tax rate
- Disentangle the **affiliate-parent** lending
  - Is the spillover only on the affiliate "external" lending or also on the "intra-group" lending towards the parent?

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- Check **parental guarantee on affiliates’ debt**
  - The parent guarantee allows the affiliate to issue more external debt, ultimately expanding lending (*I do have work in progress on this*)
  - Hence, your pattern might be driven by the non-guaranteed branches
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- Expectation: The lending of fully owned subs should react more rapidly than partially owned subs

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• For the subs check cross sectional differences in the degree of control (partially vs fully owned subs)
  • Expectation: The lending of fully owned subs should react more rapidly than partially owned subs

• If the main argument is based on the more flexible control of branches, than the spillover effect should be noted also in the domestic country
  • But this maybe requires another database…
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End of Discussion