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EXPANDING HORIZONS

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

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Discussion from:

Silvia Bressan

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

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The Paper in a Nutshell

- **Do cross-border spillovers of macroprudential regulation depend on the organizational structure of multinational groups?**
  - Parent – Branches *versus* Parent – Subsidiaries

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  - Parent – Branches *versus* Parent – Subsidiaries
- 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 macroprodential events on lending to UK customers

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Main Results

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Type = 1 => Branch

	Non-bank lending				Interbank lending			
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Capital regulation*Type	-0.059	-0.065			-0.063***	-0.068***		
	(-0.62)	(-0.66)			(-3.13)	(-4.13)		
Lending standards*Type	0.034		0.037		0.020		0.024	
	(0.36)		(0.40)		(0.54)		(0.60)	
Reserve requirements*Type	0.025			0.026	0.084			0.085
	(0.27)			(0.28)	(1.07)			(1.08)
Type	0.030*	0.031*	0.030*	0.030	-0.042**	-0.041**	-0.041**	-0.042**
	(1.86)	(1.76)	(1.89)	(1.70)	(-2.38)	(-2.30)	(-2.31)	(-2.40)
Bank size (ln)	0.001	0.001	0.001	0.001	0.005	0.005	0.005	0.005
	(0.18)	(0.20)	(0.19)	(0.19)	(1.56)	(1.58)	(1.59)	(1.57)
Wholesale	-0.101**	-0.101**	-0.101**	-0.101**	0.039	0.039	0.038	0.039
	(-2.18)	(-2.24)	(-2.19)	(-2.25)	(1.03)	(1.02)	(1.01)	(1.03)
Observations	4,107	4,107	4,107	4,107	4,107	4,107	4,107	4,107
R-squared	0.529	0.529	0.529	0.529	0.515	0.514	0.514	0.514

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

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- Though, some more comments…

On the Main Argument

The main view is that branches can be more easily controlled than subs, so that parent firms can more quickly modify their lending

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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

Taxation Issues

- Although mentioned, taxation issues shoudl be more deeply explored:
  - A branch office is not considered a local tax resident
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  - =>A different allocation of profits (and loans) between subs and branches might result in different taxable income
- 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*

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  - Is the spillover only on the affiliate "external" lending or also on the "intra-group" lending towards the parent?
- 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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- 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