Regulatory impact on global banks

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The footprint of foreign banks internationally, which had grown considerably until the financial crisis, grounded to a halt and even declined slightly after 2008. Cross-border loans have also dropped off globally. However, there is a disparity between regions, with a sharper decline in flows into Eastern Europe, largely coming from funds whose parent companies are European banks, while in Latin America we see significant growth, after a slight drop at the onset of the crisis. What's behind the recent pullback by global banks? Why is there such a big difference between regions? Are there differences between types of banks too?

First, we must analyze why banks expand internationally and how said expansion is developed. The reasons are similar to those of other companies: they look for new business opportunities, diversify risks, improve efficiency through economies of scale, take advantage of the host country's incentives and assist customers in their international businesses. The bank internationalization process can be carried out without having operations in the host country through cross-border flows or through a physical presence abroad. If they choose the latter option, banks can expand through branch offices (which don't have their own legal status and they depend directly on the parent company) or through the subsidiaries (legally independent entities that are normally financed locally and subject to local supervision) with more or less autonomy according to a more or less decentralized business model. Whether Groups chose one or the other, or a combination of the two, depends on aspects such as regulations, the business strategy and the penetration in the host country; taxes on earnings, investment risk in the country and the development of new technologies and its impact on the physical presence of the banks. The first conclusion is that the business model and the legal status matters, given that there was greater pullback in regions with the most subsidiaries (Latin America). In that region, foreign banks with a decentralized business model, based on securing local deposits, with subsidiaries that enjoy a high level of autonomy in terms of managing capital and liquidity are predominant, which generates a firewall that prevents problems in the parent company from spreading to the subsidiaries and viceversa.

Second, the reasons that some banks gave for their pullback (both in terms of region and business lines) include, among others, efficiency and profitability, changes in the institutional scope and simplifying organizational structures. Nevertheless, the main reason was regulations. In this regard, the main factors are: (i) stricter capital and liquidity requirements, which forces banks to be more selective. One example is the leverage ratio, which makes some activities related to investment banking more attractive; (ii) the new resolution framework, with fresh loss absorption requirements, which could force banks to modify their structures to facilitate a hypothetical resolution; (iii) separating retail banking and wholesale/investment banking activities (which is currently obligatory in the US and the UK), which poses an operational challenge for banks; (iv) supervisors prefer certain legal structures, as we see in the U.S. for example. All the banks with over 50 billion dollars in assets are forced to form a holding company that groups together all the subsidiaries in that country and (v) the degree to which regulatory reforms have been implemented by the countries, which leads global banks to analyze whether its legal status is ideal or not and if it's worth it to do business in certain regions and/or business areas.

In conclusion, and considering that regulation plays a decisive role in this entire process, pushing ahead with efforts to achieve regulatory harmony globally is vital to producing an even playing field, depending on how developed the regulations are in the country of origin and the host country.