Complexity of Global Banks and the Implications for Bank Risk: Evidence from Foreign Banks in Hong Kong

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February 2021

Summary

The complex nature of an overall banking group could potentially affect the riskiness of their affiliates through various channels, such as agency costs and diversification gains. This paper empirically investigates the effects of bank complexity of the global banks (in terms of their business activities and geographical locations) on the riskiness of their affiliates, using a confidential data set of foreign bank affiliates based in Hong Kong (FBHKs). Our empirical findings based on a panel regression model suggest that the complexity of global banks has significant effects on the riskiness of their foreign bank affiliates, but the effects differ between the two complexity dimensions. Specifically, a FBHK from a more business complex banking group tend to have higher risks, and the effect is likely to be attributable to an intensified agency problem. For the geographical complexity, there is tentative evidence to support the presence of both diversification and agency problems. However, the average effect on the riskiness of FBHKs is found to be less clear-cut. To strengthen the identification, we further employ an alternative difference-in-difference (DID) estimation approach. This approach exploits the exogenous decline in bank complexity of the parent group arising from the introduction of GSIB regulatory framework. The DID results are consistent with the findings identified from the panel regression model.