International Banking and Cross-border Effects of Regulation: Lessons from Hong Kong

Kelvin Ho
Hong Kong Monetary Authority

and

Eric Wong
Hong Kong Monetary Authority

and

Edward Tan
Hong Kong Monetary Authority

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Summary

Using a confidential dataset of foreign bank affiliates (FBA) in Hong Kong, this study finds evidence of an international transmission of prudential policies through banks' balance sheets from a host country perspective. Specifically, in response to a tightening of capital requirements in the home country, parent banks with a higher Tier 1 capital ratio tend to sustain higher loan growth by their FBAs in Hong Kong than their peers. When a tighter liquidity requirement is considered, differences in parent banks' core deposit shares and reliance on net intragroup funding are found to significantly affect the loan response of FBAs in Hong Kong.

One implication is that from a host supervisor's perspective, understanding the balance sheet structure of a FBA's parent bank is important in assessing the international transmission of

prudential policies. Regarding the impact on the loan supply of the Hong Kong banking sector, our findings show that the size of the spillover effects for the overall capital and reserve requirements are larger than those for sector-specific prudential measures. The relatively smaller spillover effects for sector-specific prudential measures can be partly explained by a significant portfolio rebalancing effect both across and within affiliates of international banks, making the net impact on the host country less clear.