Press points for Chapter 3: *Globalization of Financial Institutions: Financial Stability Implications*

Global Financial Stability Report (GFSR), April 2007

Key points

- **Globalization of financial institutions appears to have generally improved financial stability from the perspective of individual institutions and in the face of relatively small shocks.**

- **But increased international linkages within and across large institutions may make severe crises more broad-ranging and complicated to deal with.**

- **Policy makers need to make sure that ongoing oversight of internationalized financial institutions is effectively coordinated cross-border, and that crisis management arrangements are sound.**

The trend toward greater globalization of financial institutions is closely intertwined with other structural changes in the financial sector, including the growth of conglomerates combining a range of different financial sector activities; the large number of mergers and acquisitions; ongoing securitization and the expansion of derivatives; and improved risk management capacities within institutions on the back of rapid technological progress. These trends have created larger institutions with a greater international scope (large, complex, financial institutions, or LCFIs), often relying increasingly on funding from international markets rather than domestic sources. They have also brought a surge in internationalization of somewhat smaller banks, often with a regional focus, and sometimes also of banks based in emerging or developing countries.

Table 3.1. Financial Industry Mergers and Acquisitions, 1996–2006

	1996	2001	2006
		(In billions of U.S. dollars)	
By regions			
Developed Countries[1]	76.4	306.0	778.5
Cross-border	0.3	79.6	273.8
Rest of the world	2.7	70.2	124.1
Cross-border	0.0	29.5	85.6
Total	79.1	376.1	902.5
Cross-border	0.3	109.1	359.5
		(In percent of total)	
Cross-border M&A			
Developed Countries[1]	0.3	21.2	30.3
Rest of the world	0.0	7.8	9.5
Total	0.3	29.0	39.8

Source: Bloomberg L.P.

Note: Includes only deals where both the target and the acquirer are classified as a financial institution.
[1]Australia, Canada, Japan, New Zealand, the United States, and Western Europe.

Of all types of financial institutions, banks have been the most active in pursuing an international presence. The increase in foreign ownership has been particularly rapid in Eastern Europe and in Latin America.

For individual institutions, cross-border diversification appears to yield benefits in terms of profitability and market valuation, and in terms of soundness indicators. But it remains a question whether cross-border diversification has led to a decline in the systemic risk of these institutions as a group, especially in the face of severe adverse events. When banks as a group diversify internationally, systems may become more vulnerable to large common shocks and to spillover effects. For example, trading and other linkages between large globalized institutions appear to have increased. And major local and international banking markets are more concentrated, with a relatively small number of large international institutions having a central role in a number of them. Such effects may raise potential systemic risks in financial systems and internationally.

For host countries, the presence of strong foreign banks seems to have made their banking systems more resistant to traditional domestic banking crises. However, foreign-owned banks may have also become channels through which other vulnerabilities could build up. Financial systems with substantial foreign bank presence are more vulnerable to foreign shocks that affect the parent banks, for example. Those shocks may, in some cases, be larger and more difficult for the local authorities to deal with, or to even see coming.

To maximize the benefits of financial globalization while containing the potential risks, policy makers need to ensure effectively coordinated oversight of internationalized financial institutions to help prevent crises. They also need to put in place cross-border crisis management and resolution arrangements that are sufficiently robust to handle a severe shock and minimize spillovers. Progress is being made in these areas, but more needs to be done, in a wider range of countries.