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Deniz Anginer , Eugenio Cerutti , María Soledad Martínez Pería

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Foreign Bank Subsidiaries' Default Risk during the Global Crisis: What Factors Help Insulate Affiliates from their Parents?*

Deniz Anginer, Eugenio Cerutti, and María Soledad Martínez Pería†

Dr. Maria Soledad Martinez Peria, Macro-Financial Division Research Department International Monetary Fund
700 19th St. N.W., Washington DC, 20431, United States, Phone: 202-623-4918, Fax: not available, E-mail: mmartinezperia@imf.org

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Abstract

This paper examines the association between the default risk of foreign bank subsidiaries in developing countries and their parents during the global financial crisis, with the purpose of determining the size and sign of this correlation and, more importantly, understanding what factors can help insulate affiliates from their parents. We find evidence of a significant and robust positive correlation between parent banks' and foreign subsidiaries' default risk. This correlation is lower for subsidiaries that have a higher share of retail deposit funding and that are more independently managed from their parents. Host country bank regulations are also associated with the extent to which shocks to the parents affect the subsidiaries' default risk. In particular, the correlation between the default risk of subsidiaries and their parents is lower for subsidiaries operating in countries that impose higher capital, reserve, provisioning, and disclosure requirements, and tougher restrictions on bank activities.

JEL Classifications: F36, G11, G12, G15

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† Anginer, Virginia Tech and World Bank (on-leave), danginer@gmail.com, danginer@vt.edu; Cerutti, International Monetary Fund, ecerutti@imf.org; Martinez Peria, International Monetary Fund, mmartinezperia@imf.org.