

# **Corporate governance and intra-group transactions in European bank holding companies during the crisis**

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## **Abstract**

In this paper we study the intra-group transactions between the parent bank and its foreign subsidiaries in European Union countries during the crisis. We use hand-collected data from annual statements on related party transaction and find that they may create a serious problem for the stability of the foreign banks' subsidiaries. Moreover, as some of those subsidiary banks were large by assets in some of the member states the related party transactions with the parent bank created a serious threat to host countries financial system stability. We attribute this transaction to weak governance in foreign subsidiaries. We suggest improvements in governance as well greater disclosure of related party transactions in bank holding companies in Europe.

**JEL classification:** G21, G28, G38

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## **1. Introduction**

The financial crisis put most multinational banks under severe funding stress. These banks were not only confronted with mounting losses in their home market but also faced disruption in their numerous foreign subsidiaries at the same time. Hence, as the financial losses increased and the crisis spread across markets cross-border banking activity declined sharply. It was therefore expected that this contraction might result in a considerable tightening of financial conditions in many host countries, which could exacerbate the economic downturn, especially in emerging markets (IMF, 2009). The recent studies, however, about foreign banks transmitting shocks to host countries are not conclusive, since most of the empirical research concentrated so far only on the loan channel (Allen et al., 2010; De Haas et al., 2010; Popov and Udell, 2010).

Most of these studies assume that the contraction of credit by foreign banks is the result of lower funds provided by the parent bank. The assumption was based on the findings of de Haas and Lelyveld (2010), who documented the existence of internal capital markets in multinational bank holding companies prior to the crisis. Using data for a large number of banks they showed that foreign subsidiaries with financially strong parent banks were able to expand their lending faster in the host countries. Consequently, it is not surprising that Popov and Udell (2010) found that foreign banks, whose parent banks had low equity ratios or severe losses in financial assets, tightened credit more in host countries during the global crisis.

Although the existence of internal capital markets in multinational banking has been well established in literature, little is known about how those internal capital markets work, especially during a financial crisis. Moreover, the existing empirical research used financial data for the parent bank and its subsidiaries without establishing directly the channels of the internal capital flows in multinational bank holding companies. We close the existing gap in the literature by providing an overview of the existing internal bank channels, which have been used to transfer assets and income from the parent bank to its subsidiaries and the other way around during the crisis in the period 2007-2009.

In order to present the different channels we hand-collected financial information from annual statements of multinational banks and their subsidiaries in the European

Union (EU). We focus mainly on the EU banking sector as in this region the integration process was especially visible in the recent years as the member states tried to establish a unified internal financial market by encouraging cross-border mergers and acquisitions in the financial industry. The pattern of financial integration in the EU, however, has been unbalanced. Large and concentrated foreign ownership has evolved in the banking sector in the new EU member states (NMS).

In these countries foreign ownership constituted between 30% in Slovenia to 99% in the Baltic countries (Allen et al, 2005). The foreign banks were often of small importance from the parent banks' perspective, but systemically important for the host countries. Furthermore, in the Central and Eastern Europe (CEE) member states multinational banks mainly come from Italy, Belgium or the Netherlands, with the exception of the Baltic States (Estonia, Latvia and Lithuania) where Swedish banks dominate so far. The concentrated and large exposure of the host countries increases their risk and vulnerability to fluctuations in home countries. The same conversely applies for home countries in the event of excessive concentration of their banks to a few countries as was the case for the Baltic States.

The exposures of the CEE countries to multinational banks and their dominant role in the banking sector make them important for these countries financial system stability, especially through the risk of intra-group asset transfers. In the past foreign banks and intra-group transfers were often associated with the stabilization of the financial systems in underdeveloped countries. De Haas and van Lelyveld (2005) documented that during crisis periods domestic banks contract their credit in CEE countries. In contrast, foreign banks played a stabilizing role by keeping their credit base stable. This study, however, concentrated only on crisis in the host countries and did not take into account potential liquidity problems of the parent banks, which surfaced during the current crisis.

Indeed, we report that during the crisis the intra-group asset transfers may involve substantial risk as they have been used to increase the liquidity of the parent bank and jeopardize the transferor's solvency in the host countries. As the foreign subsidiaries are relatively large those asset transfers may create a serious threat to the countries' banking sector stability. Those transfers were often disadvantageous to the subsidiaries as the

parent bank could exercise undue influence over its management. We argue therefore that the governance of foreign subsidiaries should take into account not only the interests of the parent banks, but also the stability of the host countries' financial systems.

In this study we documented intra-group asset transfers of multinational bank holding companies that were conducted during the crisis and created in our opinion a risk to the financial systems, often across several countries. Our assumptions are based on the theoretical models of Allen and Gale (2000) that showed that if a bank is hit by a shock, it tries to meet its liquidity need by drawing on its deposits at other banks before liquidating long-term assets. Upper and Worms (2004) expanded this model and presented empirical evidence showing that credit risk associated with interbank lending may lead to domino effects. In their work they documented that a failure of one bank might result in the failure of other banks not directly affected by the initial shock. Employing their findings to our study we argue that the failure of one subsidiary within a multinational bank holding company may have lead to the failure of multiple banks across the countries.

Consequently, we advocates for a greater disclosure and monitoring of intra-group transactions between parents and subsidiaries. Today only few banks provide detailed information on third party transactions in their financial statements. As a results outsiders are often not in the position to assess the risk related to this transactions. At the same time disclosure of information and risk is an important part of market discipline, which helps fulfill supervisory authorities their obligations.

Moreover, the study shows that those transactions often involve banks from different countries. We argue, therefore, that there is also a pressing need to regulate and supervise the multinational banks using transnational financial regulators. Only transnational authorities, with full access to information on third-party transaction within multinational banking holding company across different countries, will be able to monitor and assess the risk of those operations.

The analysis is presented in four parts. Part 2 presents the development of the EU banking sector with a focus on foreign banks. Part 3 discusses the problems of the governance of foreign banks. In Part 4 we present the data on intra-group asset transfers, and in Part 5 on intra-group income transfers. Finally, Part 6 concludes.

## **2. Overview of the banking sector in the EU-27**

The liberalization of international capital movements within the European internal market has significantly changed the banking systems of the member states. At the same time the integration process, which was encouraged through cross-border mergers, might have caused the banking system to be more vulnerable to financial instability. In this section, we present the development of the European banking sector and its integration process from both the legislative and institutional perspective, and describe the pressing cross-border banking issues.

### **2.1 Development of the financial system: legislation and institutions**

The development of the European financial system in the last thirty years was accompanied by an integration process. As a large literature has already pointed out, the European financial system is mainly bank-oriented, due to the dominant role of credit institutions (CIs) in most member states (Allen et al, 2005). Especially, in the CEE countries, domestic credit has undergone decade-long booms since the 1990s, which allowed solid economic growth and financial development. This has also been demonstrated by the narrowing gap of the income and financial deepening level between these countries and western European countries (Cottarelli et al, 2003). The problem is that the financial systems of the CEE countries are dominated by banks, most of which are foreign-owned institutions. That is to say, credit provision in these countries depends largely on the behavior of foreign-owned banks.

In this section, we first review the integration process of European banking system in last thirty years from the legislative perspective; then provide the empirical evidence of the consolidation process and multinational banking development, which resulted in the steeply increasing foreign banks' market share in CEE countries. We develop the evidence part from two aspects, first, the consolidation process and M&A activities and second, foreign ownership in European banking system. We leave the regulation problems associated with subsidiaries and foreign branches to the last part.

#### **2.2.1 The integration process of European banking: the legislative evolution**

One reason why cross-border banking is especially widespread in EU countries is due to the legislative efforts that have been made to achieve the long-term goal of creating a single market for financial services in EU. Since the First Banking Directive was published in 1977, which mainly coordinated the laws on credit institutions and removed obstacles to the establishment of credit institution branches across the borders of EU member states, the integration process of the European banking system has been accelerated. Several major advances followed in the 1980s and 1990s, including the 1985 white paper on *The Completion of the Internal Market* published by the European Commission, the 1986 *Single European Act*, the 1988 Directive on *Liberalization of Capital Flows*, the 1989 Second Banking Directive on single EU banking licenses, the 1992 *Treaty on European Union (TEU)*, which opened the way to political integration and started a new stage in European consolidation—the creation of Euro and the launch of Financial Services Action Plan (FSAP) in 1999, which built the legislative framework for the single market in the Euro Area. Then, from 2000 to 2004 there were also several directives on the European banking sector that were published, such as the consolidated banking directive, the directive on e-money, the directive on the reorganization and winding-up of credit institutions, the financial conglomerates directive, and the new EU takeover directive. Another important event in May 2004 was the entry of ten new member states, most of which are emerging countries from CEE.<sup>1</sup> Then in December 2005, the European Commission published a white Paper on financial service policies for the period from 2005 to 2010, which showed that the Commission would continue to advance the FSAP and eliminate the remaining barriers between the financial sectors of EU member states. Finally, the European Central Bank set up the objective to achieve a single Euro payment area (SEPA) by the end of 2010 and made the first SEPA products available from January 2008. Those products allowed the consumers to benefit from prompt and secure transfers between different bank accounts anywhere in the euro area.

## **2.2.2 The consolidation process and M&A activities**

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<sup>1</sup> In EU-10 countries which belong to the enlargement in 2004, five of them are from the CEE (Czech Republic, Hungary, Poland, Slovakia and Slovenia), three of them are from the Baltic States (Estonia, Latvia and Lithuania), and the remaining two are Cyprus and Malta. In 2007, the European Union was enlarged to 27 member states, when Bulgaria and Romania joined. In the preparations before accession, all these countries had undertaken political and economic reforms, which included the liberalization of their financial systems.

The level of the consolidation process in European banking has been high in the last twenty years. In the OMS the number of CIs fell from 12,256 in 1985 to 7,444 in 2003 (Demine, 2005). At the end of 2009 the number of CIs had further dropped to 6,360. This means that more than half of the CIs have disappeared in the last twenty years in the EU despite the fact that the internal market has expanded from 15 to 27 countries. Also, the total number of monetary financial institutions (MFI) has also decreased from 9,856 in 1998 to 8,076 in 2009 in the EU.<sup>2</sup> The decrease of the MFI reflects the ongoing consolidation process not only in the banking sector but in the whole financial industry in the EU.

Actually, the downward trend continued until November 2007, and after that the number of CIs grew for a short period until December 2008. Nevertheless, CIs still have a prominent role in the European banking system (see Table 1). In terms of a share to GDP, the total CIs' assets of the EU-27 increased from 275.9% in 2005 to 357.3% in 2009, while they were at 263.5% in 2000 for the EU-15 member states.

Among the EU member countries, changes of CIs' assets in the new EU-12 member states (NMS) have a totally different pattern from the old EU-15 member states (OMS). The data shows that before the 2007 financial crisis, the total assets of CIs measured relative to GDP in the OMS appear to decrease, but then increase after the crisis. In the NMS, the ratio rose before the crisis but declined after that. The difference in the ratios before the crisis was mainly due to the foreign banks' entry in the NMS.<sup>3</sup> In the literature some authors have pointed out that since foreign banks are not restrained by the conditions in the domestic market, there is a positive relationship between foreign bank market share and private sector credit growth (De Hass and Lelyveld, 2006; Clarke et al., 2003; Aydin, 2008).

M&A activities, especially the cross-border M&A deals, appeared to accelerate the consolidation process. Table 2 reveals that after the accession of the NMS in 2004, both the number and value of M&A transactions have increased significantly. Moreover, Figure 1 shows that even after the outbreak of the financial crisis in the second-half of

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<sup>2</sup> See the statistics of ECB at [http://www.ecb.int/stats/money/mfi/general/html/mfis\\_list\\_102.en.html](http://www.ecb.int/stats/money/mfi/general/html/mfis_list_102.en.html)

<sup>3</sup> According to the authors' calculation, in 2009, around 71.2% of the total assets of CEE banking assets were owned by foreign banks.

2007, the value of M&A transactions was still increasing in the years 2007-2008, in which the EU cross-border and outward transactions played a more and more important role. The year of 2009 saw the value of M&A deals dropping but this is probably only temporary. It is very likely that the cross-border M&A activity will pick up again once economic conditions improve, both within the EU and in particular in the emerging markets (ECB, 2010). With the number dropping and the total assets rising, especially when measured relative to GDP, the M&A activity and international strategy may partially give the reason why the size of CIs are getting larger in EU, which also enhances the bank concentration level in EU.

### **2.2.3 Foreign ownership in European banking**

The market share of foreign banks differs significantly between the OMS and NMS (Figures 2 and 3). This tendency is consistent with the evidence from other countries, where developed nations tend to have much lower foreign bank ownership shares than developing countries, as the government entry barriers are relatively more implicit and foreign banks always have net comparative disadvantages in developed countries, as Berger (2007) has pointed out.

On average the number of total foreign-controlled CIs in the OMS, including both subsidiaries and branches, was much higher than the number in the NMS. At the same time, the share of foreign-controlled assets to total assets of CIs was higher in most NMS during the past eight years than in the OMS. From 2001 to 2010, the average share of foreign to total banking assets in the NMS was 65.5%, while it was 25.8% in the OMS. During the 2007 financial crisis, the average number of foreign CIs increased in the NMS but dropped in the OMS. This may indicate that multinational banks were looking for opportunities in developing rather than developed countries during the crisis. This is consistent with the findings of Cardenas (2003), who showed that in emerging markets foreign banks used financial crisis as a reason to enter. In contrast, in mature economies foreign bank entry was more likely related to competitive pressure.

Table 3 shows that among the NMS, the highest percentage of foreign ownership in the banking sector is in Slovakia. In 2009, the foreign-controlled assets accounted for 96.1% of the total assets of CIs, while in 2005 and 2001, the ratio was 93.3% and 79.5%.

Estonia and Czech Republic rank second and third respectively, with foreign ownership shares of 94.9% and 89.7% in 2009. At the same time, the CR5 concentration ratio was 72.1% in Slovakia, 93.4% in Estonia, and 62.4% in Czech Republic. Due to the high concentrations in their banking systems, the CEE countries were found to be more prone to financial fragility, whereas capital regulations spur financial stability across whole Europe (Uhde and Heimeshoff, 2009).

The total number of foreign-controlled assets in the EU was €11.1 trillion in 2009, in which the share of NMS was less than 6.3%, showing that compared to the OMS, the banking sector in NMS is still highly undeveloped and dominated by a small number of foreign institutions. Further, among these subsidiaries or foreign branches, 93.5% are hosted by other EU countries, showing that most cross-border activities in these countries were still within EU area, which is line with the findings of Navaretti et al. (2010).

Among the OMS, France, the United Kingdom and Luxemburg have the highest number of total foreign-controlled CIs, including both subsidiaries and branches. In contrast, France has a quite a low market share of foreign-controlled assets of CIs, which was 10.8% in 2009. The average market share of foreign-controlled assets to total assets of CIs in the OMS was 25.8% in 2009, while in the NMS it was 65.5%. At the same time the average CR5 bank concentration ratio in the OMS was 54.9% and increased from 50.5% in 2000. The M&A activities, especially cross-border deals, mentioned above, were enhancing bank concentration in the recent years. Looking further into the foreign ownership in the OMS, the data shows that 69.9% of the foreign CIs were hosted by other EU countries, with the rest from other third countries. Hence, the data indicates that the banking system ownership in the OMS was much more diversified than the NMS. Ekholm (2010) documented that much of the development in EU cross-border banking was driven by large institutions in a few countries, notably the US, the UK, France, Germany and Netherland.

### **2.3 Subsidiaries vs foreign branches**

An important factor affecting regulation of cross-border banks is the choice of the form that foreign banks choose to operate abroad. The banks registered in the EU may use either the form of subsidiary or branch to operate in the other market. The differences

between the two forms can be described briefly as follows. Subsidiaries are independent companies governed by host authorities. In contrast, branches follow the single banking license scheme and are therefore regulated by their home countries. This difference provides different incentives for monitoring and supervising banks by the home and host countries' authorities.

Assuming a host country is riskier than the home country, the home country authority would prefer a subsidiary structure to insulate the parent bank from the host country's risk (Kahn and Winton, 2004). In addition when a branch experiences financial difficulties in the host country, it has to rely on a bailout from its home country. The home authority might, however, be reluctant to rescue the branch or its parent bank if it is not systemically important for the home country financial system. At the same time a branch may have a large share in the host country's assets and be systemically important to its financial system, which would then create conflicts of interests. Those problems arising from the dependence on the home country's regulation and bailout action have become evident in European banking system in the aftermath of the financial crisis that started in 2007. In particular, the problems of the Icelandic branches in the UK have exposed the described conflicts between home and host authorities.<sup>4</sup> Besides these, Navaretti et al. (2010) have also illustrated that different types of foreign bank entry might give rise to distinct liability structures between the bank's units within the group and hence different functioning of internal capital markets (ICMs).

As for the pros and cons of these two types of foreign institutions, subsidiaries could hold more advantages for the parent bank. The most important point is that branches might not address the internal incentive issues within the organization and its units as well as subsidiaries. As Navaretti et al. (2010) reported, subsidiaries can solve the risk-sharing problem and asymmetric information problem better, and hence reassure the shareholder, local management, public and government. Besides these, Dermine (2006) also pointed out several other factors that influence the multinational banks to choose subsidiaries as their preferred foreign organization form. First, it allows them to keep

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<sup>4</sup> The disagreement between Iceland, the UK and the Netherlands began in 2008 when Landsbanki failed. The Icelandic government declared that it would not compensate depositors in the UK and the Netherlands with Icesave accounts, which have been offered by Landsbanki through branches in those countries.

“business as usual” and does not require them to change the brand after a merger. Second, it provides a more flexible international corporate tax structure. Third, it creates an opportunity to get extra deposit insurance premia contributions made by the host countries. Fourth, it gives the flexibility to sell the business unit at any time. Cerutti et al. (2007) used the evidence of the world’s top 100 banks in Latin America and Eastern Europe to demonstrate that banks were more likely to operate as branches in countries which have higher taxes and lower regulatory restrictions on foreign bank entry. On the other hand, subsidiaries were preferred by banks seeking to establish large retail operations in host countries. Besides these factors, legal differences in parent banks’ responsibilities associated with subsidiaries and branches must also be considered.

The data in Table 3 shows that the banking sectors of the member states are experiencing some reversals in the choice of foreign entry modes in recent years, especially between the OMS and NMS, and the periods after and prior to the enlargement of the EU in 2004. In the OMS before the EU accession, foreign banks preferred to enter other European markets using branches, with 739 foreign banks having established branches in host EU-15 countries and 713 having established subsidiaries. Furthermore, the percentage of banking assets held by foreign branches is 13.6% in 2001, which far outstrips that of subsidiaries, 8.9%. But things seem to reverse after 2005, with the percentage of banking assets held by foreign branches declining from 14.4% to 11.9% and that of subsidiaries declining from 14.2% to 13.3% in the OMS.

In contrast, our data show that foreign banks preferred to enter other CEE countries using subsidiaries, as subsidiaries far outstripped foreign branches both in total numbers (143 to 43) as well as in percentage of banking assets controlled in each country (55.0% to 4.9%). But after the accession, the number of foreign branches increases dramatically, from 75 in 2005 to 128 in 2009, although the assets held by subsidiaries still dominates the banking sector in emerging countries.

Altmann (2006) mentioned the reasons why there exists some dissimilarity between these two regions on the form of foreign bank entry. The study stated that the abundance of branches as compared to subsidiaries can be partially explained as the EU-15 countries have been operating under the Second Banking Co-ordination Directive longer, which

permits banks that have a license in any EU country to open branches in another member state without further bureaucratic impediments. Additionally, in the NMS, the relatively small number of branches prior to the EU accession can be attributed to the unfavorable attitudes of host regulators toward branches (Cerutti et al., 2007). Before the accession, regulators in these countries often refused the applications from foreign banks to open branches based on a wider set of criteria than those used for banks seeking to use subsidiaries (Hryckiewicz and Kowalewski, 2010). Another reason explaining the subsidiary structure in the NMS is that many banks entered the CEE market via acquisition of privatized local banks and cross-border banking is thus the result of large scale M&A activity rather than organic growth, which is more the case in the OMS. After the NMS joined the EU in 2004, there were fewer potential targets left to acquire in the region, and thus, entries through branches gained in importance, which eventually declined during the global financial crisis.

### **3. Governance of foreign-owned banks**

According to the Basel Committee, the commonly used principle to govern and supervise foreign institutions is called “home country control”, which means the home country is responsible for the supervision of the consolidated entity, including the worldwide activities in the parent bank, foreign subsidiaries, branches and other operations, while host country is responsible for ensuring that foreign subsidiaries are well supervised within its borders (BCBS, 1997). But sometimes national differences in cross-border banking regulation may give rise to divergent incentives and mandates between the home supervisor and the host supervisor, which may cause an inconsistency or mismatch in the regulation of foreign institutions. In this part, we will elaborate the differences in the corporate governance of foreign subsidiaries and branches, in particular the agency problems and weak performance of independent non-executive board members in foreign subsidiaries. Today, many regulators attribute the governance of banks as one of the main causes of the global financial crisis (BCSB, 2010; European Committee, 2010b). As a result the Basel Committee made recommendations on the governance of financial institutions, while the European Commission may propose regulatory measures, in order to remedy any weakness in the corporate governance

system in the financial sector. The existing documents, however, show that the problems of governance of subsidiaries have largely been ignored. The Basel Committee (2010) principle stated only that boards of subsidiaries should adhere to the corporate values and governance principles espoused by its parent company. The European Commission (2010a) working documents did not discuss so far the problem of governance in foreign bank subsidiaries. We have presented evidence that foreign banks are often systemically important institutions in the member states' financial systems. Consequently, we advocate that any future recommendations or regulations should also consider foreign subsidiaries separately in more detail, and in particular its relationship to the parent bank.

### **3.1 Foreign bank subsidiaries**

Under the principle of “home country control”, for subsidiaries, the home country is a consolidated supervisor, while the host country supervises the local bank, with a local name, local management and internal culture (Goldberg et al., 2005). The foreign subsidiaries are separate corporations fully subject to the host country's jurisdiction. Therefore, it may cause significant agency problems between the parent bank and local bank managers. Another important issue in the governance of foreign subsidiaries exists in the independent non-executive board members, who have very low incentives to oversee the risk-taking activities by the executive board in the current regulatory system. In this part, we will first discuss the agency problem between home bank and local bank manager, and then show the severe problems with the current system of non-executive board members.

#### **3.1.1 Agency problems**

The first important issue for the governance of foreign subsidiaries is the agency problem between parent banks and their subsidiaries. The reason why a principal-agent structure is applied to explain this is that a parent bank and the host country share decision-making authority and responsibility for the foreign subsidiaries, so conflicts of interests may arise among the different parties: bank shareholders, bank managers, depositors, deposit insurers, and borrowers. The asymmetric information between these parties and the monitoring costs make it impossible to draw up a complete contract (Dermine, 2006). Sometimes, different subsidiaries will have different levels of agency

problems. Kim et al. (2005) have pointed out that the extent to which the principal could observe and verify the subsidiaries' activities depends on the strategic roles of the agents, which means various foreign subsidiaries may play different roles due to their strategic objectives and resources thus cast different levels of agency problems to the parent bank. Although we have mentioned that subsidiaries could solve the internal incentive issues better than branches, both of them have supervisory and legitimate worries as well.

First, the information sharing is quite asymmetric between host and home country. Since the home country is responsible for the consolidated supervision, it will have control over most key information about the consolidated bank, while the host supervisor will have greater access to information about the subsidiary operations and local economy. Normally, the host country should keep the home supervisor informed of all the risk-taking activities in the local bank, while the parent bank should disclose relevant information to its subsidiary. Thus, for its own financial stability, the host supervisor always hopes to get more information of the consolidated bank from the home supervisor, such as the overall risk characteristics as well as developments in the home country or other host countries that may affect the consolidated bank or the local subsidiary. On the other hand the home supervisor hopes to obtain more information about the local market since some of this may not be easily available (Krimminger, 2008). Normally the information sharing and disclosure should conform to the Memoranda of Understanding (MOU), but sometimes some special information may not be addressed in a timely and complete manner, especially some risk activities during the crisis. However, Pistor (2010) documented that the home supervisor is unlikely to monitor and respond to risk from activities of subsidiaries in host countries that are subject to their consolidated regulatory supervision. Moreover, she shows that the host regulator may supervise the subsidiary of the parent bank, yet it may rely on the home supervisor to exert regulatory control. As a result the existing framework favors home country regulators and leaves host country regulators without much power to adequately supervise foreign subsidiaries.

Moreover, we argue that in some cases, if the parent bank is large, and the subsidiary is not systemically important to the consolidated bank, it may not have enough incentives to exchange supervisory information with the host country, such as the overall bank's

operations or the intended actions by the home country, which leads to a very weak position for the host country. Therefore, communication and coordination is in particular critical for foreign subsidiaries.

Some papers have mentioned that a separate public listing of subsidiaries would solve the asymmetric information problems between uninformed investors, informed investors and the bank managers (Dermine, 2006). Furthermore, Francis et al. (2010) proposed that bank's regulators might rely on the information content in bank stock price to supervise banks and avoid financial volatility in the future. While, Habib et al. (1997) pointed out that the increase in the number of public traded securities could make the pricing system more informative and efficient. However, we are aware that the stock price information content might be biased by the governance problems of the subsidiaries, which we outline in detail later. Hence, in order to increase the information content in stock prices the governance problems in subsidiaries need to be resolved.

Deposit insurance is another issue besides information availability. The deposit insurance rules vary widely among different countries, existing on the types of accounts covered, the maximum limits to coverage, premium assessments, solvency, private or taxpayer involvement, and the government support for coverage (Eisenbeis and Kaufman, 2005). The inconsistent national deposit insurance rules of different countries may create disincentives for effective actions by home or host country and different coverage for depositors in the same country, as Krimminger (2008) has pointed out. For foreign subsidiaries, the EU directives stipulate that foreign subsidiaries in host countries should receive equal treatment with the domestically owned banks, so many of the conditions of prompt reopening are decided by host countries. But as the multinational banks are increasingly managed on a consolidated basis, management and facilities concerning deposit insurance may be held in the parent bank or other foreign subsidiaries, which leaves the host country still in a relatively passive position (Eisenbeis and Kaufman, 2005).

The third existing problem is the asymmetric risk sharing between home and host country. Kahn and Winton (2004) found that the problem of risk-sharing is particularly acute when two entities have different levels of risk. As for foreign subsidiaries, the

allocation of the responsibilities of supervision and resolution between parent banks and host-country supervisors is not very clear, which directly leads to a serious risk shifting problem between these two entities. To the parent bank, sometimes losses in one subsidiary may be offset by gains in another one, leaving the subsidiaries to bear the financial fluctuations. The parent bank would have low incentives to give obligations and guarantees to the subsidiaries. Cardenas et al. (2003) pointed out that when the subsidiary has financial difficulties the parent bank's decision about whether to support the subsidiary is totally dependent on the future profits and expenses including their legal and reputation costs. Specifically, if the financial turmoil is overwhelming, a parent bank may transfer losses to a host country's subsidiary or remove assets from the host country through intra-group transactions before the foreign subsidiary is approved for bankruptcy protection, which means the bailout or resolution costs will be shifted to the host country.<sup>5</sup> This has already become a huge problem among foreign subsidiaries in European countries during the financial crisis. We will show in the following sections a large quantity of asset transfers from 2007 to 2009, especially in those countries where the foreign bank assets account for a large share in the whole banking system.

Numerous papers discuss the blind spots of the principle of "home country control", especially for Central and Eastern European countries. Pistor (2010) argues that the home country may not monitor and regulate the risk which is unique to the host country; while the host country has very little regulatory power if the parent bank engages in direct lending practices or channels capital through entities that are not under similar regulations. This point of view is similar to Dermine (2005), who argues that the principle of "home country control", which is guiding the European cross-border banking system, is unlikely to be adequate in the future, as some small European countries may not be able to bail out a large international bank if there is any financial difficulty. Our data will also demonstrate this point below.

### **3.1.2. Independent non-executive board members (supervisory board members)**

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<sup>5</sup> According to the European Commission (2008), currently there's no regulation existing in the EU that expressly lays down a general prohibition on asset transferability between group's entities. The only prudential restriction is the largest exposures regime, which limits institutions' exposures to 20% of the respective institution's own funds. However, the current EU regulation allows member states an option to partially or fully exempt intra-group exposures, what has been done in most of the countries in our study.

A number of papers have discussed the relationship between bank governance and performance. This literature can be divided into two streams. The first stream is to study the relationship between board characteristics and bank performance, while the second discusses bank remuneration policy, which has already attracted considerable attention after 2007 financial crisis. Both streams have led to a range of regulatory proposals in many countries including the EU (European Committee, 2010a).

The impact of board features on bank performance is quite clear according to a number of papers. De Andres and Vallelado (2008) used cross-country evidence and demonstrate that bank performance has an inverted U relationship with board size and more outside directors will improve performance. The latter point has been confirmed by several other papers, like Pathan (2009), who also argued that more independent directors appear to lead to low risk-taking. Other papers discuss ownership concentration, risk taking and bank performance. Caprio et al. (2007) employed cross-country data and found evidence showing that concentrated ownership is consistent with good governance, while strong regulatory power may not improve the governance for a given level of ownership concentration. Also, Laeven and Levine (2008) found that more concentrated ownership will lead to higher risk-taking, which is exactly consistent with the agency theory.

Therefore, the common view among these papers is that non-executive independent directors are good for bank governance — they help control risk-taking and improve bank performance. Since the role of non-executive board members is in particular important when ownership is highly concentrated as it is in the case of subsidiaries, we inspect the performance and governance of independent directors more deeply, including the expertise and time commitment of those non-executive board members, their appointment, the board composition, and the board remuneration policy.

Analyzing the governance structure of listed foreign subsidiaries in the host countries we find that the proportion of independent non-executive board members with financial industry expertise was relatively low. Table 4 presets the characteristics of the independent non-executive board member in listed companies were we document that most of them have a degree in law or some other discipline and lacked any expertise in

the financial industry.<sup>6</sup> Moreover, we find that most of the risk or audit committees were dominated by non-executive board members, who also hold positions in the parent bank, which could cause severe agency problems.

For example in the BRE Bank, a listed company on the Warsaw Stock Exchange (WSE), where Commerzbank owns 75% of the equity, the supervisory board consisted of ten members at the end of 2010. Of the ten members five including the Chairman were independent according the definition of the governance code of the WSE. The function of Chairman was held since 2004 by a former Subsecretary of State at the Ministry of Infrastructure with 22 years work experience in the central state administration (degree in economics). This person was also the Chairman of the Supervisory Board in the years 1994-2001. The remaining four independent board members in the subsidiary were a CEO and co-owner of a Polish coffer producer (degree in economics), an adviser to the management of a logistics company (degree in engineering), a president of an economic think tank (degree in economics) and a law professor of the University of Warsaw. The remaining five members of the supervisory board were foreigners and senior managers at the parent bank. As a result we may assume that their loyalty to the subsidiary and host country was relatively low.

Moreover, the example shows that even in listed subsidiaries the supervisory boards are dominated by the parent bank board members, who are the only ones with the knowledge and access to information to monitor the bank's risk. In the case of the Commerzbank Polish subsidiary none of the independent board members had any industry experience. Furthermore, two of them did not even have permanent employment. This may make them more likely to follow the directions of the members representing the main shareholder. The performance of the non-executive board members, especially their challenges to the aggressive risk-taking activities of the dominant shareholder executed by the management, is extremely important to the subsidiaries. Erkens et al. (2010) found that during the crisis CEOs were more likely to be replaced following large losses if boards had more independent directors and firms were held more by institutional investors, but not when firms were controlled by inside blockholders. Hence, the

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<sup>6</sup> In the paper non-executive directors are equal to supervisory board members in banks with two-tier boards. Moreover, we discuss mostly issues related to listed subsidiaries of multinational banks in the host countries. In non-listed banks we found that in almost all the cases the non-executive directors were related to the parent bank.

composition of the board, where a low level of independent directors with financial expertise is present in subsidiaries, may leave the bank under poor supervision and regulation (Nestor Advisors, 2009).

Masulis et al. (2010) found that foreign directors are associated with a significantly poorer performance of the companies. Hence, a large presence of foreigners in the supervisory boards but also in the management may result in lower bank performance, especially in non-listed foreign bank subsidiaries. The size of the management and the supervisory board in foreign owned banks is shown in Table 5. We document that in the majority of the subsidiaries the non-executive board members are foreigners, who are often senior managers in the parent bank. For example, in Poland in the subsidiaries of Deutsche Bank or Raiffeisen Bank only one member of the supervisory board was Polish out of 6 and 5 members, respectively. Furthermore, all the supervisory members including the Polish were senior managers or former employees of the parent bank, who often own the parent bank's shares. Hence, those members will more likely safeguard the interests of the parent bank than the interests of other stakeholders of the subsidiary such as depositors.

For this reason, Cardenas et al. (2003) argued that the governance structures of the subsidiaries should be adequately designed to reflect the interests of both the parent company and the stakeholders of the subsidiary. Such regulations are clearly established in New Zealand and Australia. In those countries the regulation authorities require that banks have constitutions that explicitly prevent directors from damaging the subsidiary and its creditors while pursuing benefits for the holding company. In addition, foreign banks must include independent non-executive directors on their boards to make sure that the management is following the regulation and acting in the best interest of the local institution. In 12 of the member countries the law requires employee representation at board level, which may safeguard the interest of the subsidiary. On the other hand their leverage against the other board members and managers is weak.

Moreover, European Commission (2010c) recently reported the large majority of respondents to its public consultation on possible ways forward to improve corporate governance of financial institutions were not in favor of creating a specific duty of care to be established for the board of directors to take into account the interests of depositors

and other stakeholders during the decision-making procedure. Most of the respondents, where the majority were financial institution and investors from OMS, considered that the primary fiduciary duty of boards are their shareholders.

An existing and important problem of the governance presents also the remuneration policy of executive managers in the foreign bank subsidiaries. The inappropriate pay structures for directors, leading to excessive risk-taking and short-termism, were found to be one of the causes of the financial crisis. Again, however, most of the research and proposed regulations focus only on domestic banks, while ignoring the problem of subsidiaries and their remuneration policy for board members.

Our study shows that the remuneration policy of board member may be biased toward the interest of the parent bank and the expense of the host stakeholders. In Table 4, we list those subsidiaries where the management received in addition to its salaries the options for shares in the parent bank. Moreover, we find that managers of subsidiaries that are listed received bonuses in the form of the shares of the parent bank. For example, in 2009 the management of Citibank's subsidiary in Poland, which is also listed on the WSE, received as part of their remuneration Citigroup shares granted in the previous years and options on Citigroup common stock for which exercise rights were granted in 2009. Hence, all the managers of the subsidiary were Citigroup shareholders, while only one held a few shares of the subsidiary itself. In addition, the CEO of the subsidiary was also employed directly by Citigroup and held the position of Citigroup Country Officer as well was member of the Citigroup Management Committee. Consequently, we may assume that the remuneration policy in this foreign subsidiary was rather aimed at protecting the parent bank interest than that of the subsidiaries minority shareholders.

In our opinion the existing governance structure of subsidiaries may explain why the management of the foreign subsidiaries undertook transactions during the crisis, which were often to its disadvantage and moreover as we show later put it at risk.

### **3.2. Foreign bank branches**

As for foreign branches following the single banking license, it is the responsibility of the home country to regulate the institutions in the host country, as branches are an integral part of the bank and not separately incorporated into the host country's

jurisdiction, which is to say, the home country will have principal authority over the branch and all the relevant information. In this case, the host country is in an even weaker position in terms of information availability compared to the form of subsidiaries, so it may not assess the potential risks or externalities its financial system may be exposed to. This information problem is in particular acute in those European countries where foreign banks are significant in the financial system.

Another incentive issue of foreign branches is their resolution by their home countries when there is a financial turmoil. Since the decision of whether and when to bail out is also made by the home supervisor, the host country is totally at the mercy of the home country's willingness to provide the information or take timely actions. Numerous papers have shown that such a mismatch among supervisory control, information access and legal authority to intervene could cause significant problems during a financial crisis. If the branch is systemically important to the host country, while it only accounts for a small share of business in the consolidated bank, the home country will have low incentives to support the branch if there are financial difficulties (Cardenas et al., 2003; Goldberg et al., 2005; Krimminger, 2008; Ekholm, 2010). In this case, the host regulator is faced with a quite difficult dilemma: it lacks access to the key information about both the local branch and the consolidated bank, the supervisory authority to the institution in its own border, while it still has to bear the insolvency risk of the foreign branch and the potential impact to the whole economy, as shown by Krimminger (2008).

As for the deposit insurance scheme, when the bank is operated as a foreign branch in the host country, it is also the responsibility of the home bank to take on the deposit insurance. In this case, when a large number of foreign branches from different countries co-exist in the host country, the different deposit schemes may cause some confusion. Goldberg et al. (2005) has pointed out that normally the home country authorities would have incentives to charge higher deposit insurance premia to be able to cover the potential losses if the branch fails. Even so, when there's an insolvency situation, some countries follow a "separate-entity" doctrine, which means they will put their domestic depositors and creditors before those of other countries, such as Australia and the US. The other insolvency procedure followed by some countries is called "single-entity" doctrine, which considers the foreign depositors and creditors equal to domestic ones

(Cardenas et al., 2003).

#### **4. Asset transfers**

In this section we present our findings on the transfer of assets within cross-border banking groups in the EU. While, the intra-group transfer of assets is a common financial transaction between banking group members, we show that it may become sensitive in crisis situations.

In the crisis management techniques used by multinational banks may take different legal forms such as transfer of capital and collateral, interbank lending, guarantees and liquidity back-up facilities (European Commission, 2008). The aim of using these instruments is to provide financial support from one legal entity to another within the group. There are, however, some limits on how far the support can be granted. According to the European Commission (2008) the transfer of assets is possible as long as all institutions meet the respective prudential requirements. In other words, the asset transfer should not create any risk in the host or home country. On the other hand, there are no explicit regulations showing when the asset transfer may create a risk in the host or home country. Consequently, during the crisis assets were transferred from healthy subsidiaries in host countries to parent banks in financial difficulties. Hence, the results of this study reveal that the intra-group transfer of assets may have created a substantial risk for the host country financial system.

In some member states also particular types of transfers are prohibited or restricted. In Estonia, for example, a general loan restriction is embodied in the commercial code (European Commission, 2008). A subsidiary may grant a loan to its parent provided that this does not harm the financial status of the entity or the interests of the creditor. Also, in other countries regulations exist or have been introduced that should allow greater control of intra-group asset transfers. In Poland, for example, in 2009 the supervisory authority obligated foreign banks to reports daily on new exposures to foreign entities and warned against any transactions which might have consisted in ungrounded transfers of funds to parent entities.

This step shows that the supervisory authorities are aware of the possible assets transfers from subsidiaries to parent banks using the existing regulatory framework. Our

study, however, shows that despite the efforts of the authorities significant transactions between the subsidiaries and their parent banks took place during the crisis, which might have created a risk for financial system stability.

#### **4.1. Subsidiaries conversion to bank branches**

In the EU the Second Directive allows the conversion of foreign banks' subsidiaries to branches in host countries at any time. The main idea behind this regulation was to allow banks incorporated in one of the member states to conduct further activities using only branches across the unified single market.

The conversion of subsidiaries to branches is implemented in the form of a cross-border merger, and needs to be approved by both the host and home financial regulators. The need for approval by both agencies is related to the transfer of supervision over the bank assets and liabilities from host to home country regulators. Moreover, after the conversion the home country deposit insurance applies instead of the host country's. It creates a large regulatory problem, which was described in detail by Dermine (2005).

In the past, foreign banks preferred the structure of subsidiaries to branches in the NMS (Goldberg et al., 2005). According to Kahn and Winton (2004) a parent bank uses the subsidiary structure to protect itself if the host country is considered riskier than the home country. Moreover, Cerutti et al. (2007) found that host-country economic and political risk matters in the decision to establish a branch or subsidiaries. They found that branches are less common in countries with highly risky macroeconomic environments. Hence, the decision of multinational banks to operate in NMS using subsidiaries was not surprising.

Some multinational banks with banking licenses in one of the OMS also decided to operate branches in riskier NMS. The reason was that those foreign banks' branches were able to provide more loans than subsidiary banks as their loan limits were calculated using the parent banks' capital. Those new branches in the NMS, however, often only supplemented the activities of the subsidiaries. As a result branch operations were quite small in comparison to the subsidiary activities in the NMS.

At the same time multinational banks often owned subsidiaries in the NMS, which then operated in the region using branches. Unicredit, for example, has operated a fully

owned subsidiary in Latvia since 2007. It uses branches for its activities in Estonia and Lithuania. This structure allows the parent banks to protect their interest and reduce as well the capital funding needed to provide lending in the region. Similar bank structures for cross-border activity in the CEE countries have been adapted by other multinational banks as SEB, Citigroup and Société Général.

During the crisis, however, the multinational banks decided to convert subsidiaries to branches in host countries which were economically and politically riskier than the home country. In some of the cases the converted subsidiaries were merged not directly with the parent bank but with other subsidiaries in third countries, which had a more relaxed approach to their supervision. Moreover, this structure created a buffer, which protected the parent bank from any fallout coming from the branches. While, in the past the conversion of the subsidiaries to branches was found to create a risk for the parent bank it may have the opposite effect during a crisis.

As shown in Table 6 the converted subsidiaries were on average more profitable than their parent banks prior to the year of the conversion. Moreover, in most cases the subsidiaries' loan to deposits ratio was significantly lower than one. Hence, we may assume that the conversion improved the liquidity position of the parent bank. Therefore, the conversion of subsidiaries to branches may be seen as a substantial asset transfer from host to home country. It is important, as all the parent banks in our sample reported either declining earnings or losses in the year of the conversion. This means that most likely what was happening was that financially distressed parent banks were absorbing healthy subsidiaries

As a result, the situation of the parent bank may have been improved after the conversion, but it created a risk of financial instability in the host country. The risk may have been substantial because financial intermediaries such as Citigroup requested government help at the same time when they converted their subsidiaries to branches. Moreover, the share of the converted subsidiaries in the host countries was often substantial. The subsidiary of the Danske Bank before conversion represented more than 11% of the total banking assets in Estonia. Citigroup's subsidiaries share in total assets ranged from 1.3% in Romania to 3.5% in the Czech Republic prior to its conversion.

A failure of a converted branch due to the parent bank's losses could have resulted in the instability of the host banking system. Therefore, the conversions of subsidiaries to branches by Nordea and Danske Bank, two pan-Nordic financial groups whose Finnish subsidiaries were among the largest banks in the country, have raised concerns by the authorities (IMF, 2010). As a consequence the conversion of a subsidiary to a branch was put on hold as the host authority argued that it would significantly limit its supervisory effectiveness and power in Finland, including in a crisis situation.

The decision of the Finnish authority may indicate that the conversion of subsidiaries to branches should be limited or forbidden during financial crises or financial system instability. An argument for limiting the conversion of branches is that a healthy subsidiary may be absorbed by a failing bank, which may lead to instability in the host country.

On the other hand the conversion to branches may also create a risk for home regulators. In the short term a subsidiary conversion may improve parent banks' liquidity. Should the parent bank fail despite the conversion then the cost related to it including the deposit insurance will be covered by the home regulators. Those liquidation costs might be substantial when the multinational bank develops an extensive network of branches across European countries. Consequently, the conversion does not create a risk only to the host country but as well to the home country regulator.

#### **4.2. Intra-group deposits and loans**

Multinational banks use intra-group transactions to finance their subsidiaries and other operations across various countries. Haas and van Lelyveld (2010) have shown that multinational banks employ their internal capital market to allocate scarce capital to their subsidiaries. They found that foreign subsidiaries of stronger parent banks grow faster and that parent banks trade off lending across countries. Hence, the results suggested that the parent bank allocated the capital to subsidiaries in host countries with the greatest growth potential. The results are in line with an earlier finding that bank lending tends to be influenced by the home country business cycle (Martinez Peria et al., 2002; Morgan and Strahan, 2004).

Haas and van Lelyveld (2010) found that as a result of parental support subsidiaries do not typically rein in their lending during a financial crisis in the host country, while domestic banks were often forced to do so. Consequently, the results of their study confirmed that multinational banks may dampen host country financial shocks (Peek and Rosengren, 2000b; De Haas and Van Lelyveld, 2006). However, earlier studies also showed that lending by multinational banks tends to transmit home country financial shocks (Peek and Rosengren, 1997, 2000a; Van Rijckeghem and Weder, 2000, 2001). Nevertheless, none of the studies have shown that either host or home country financial shocks may result in financial instability in one of the countries.

A limitation of all these empirical studies is that they were not able to track the actual transactions within internal capital markets. Hence, they were not able to fully ascertain that the bank observed patterns are caused by equity flows between parent banks and their subsidiaries. Moreover, most of the studies assumed that those capital flows take either the form of equity, quasi-equity (subordinated loans) or intra group loans.

We may assume that equity and subordinated loans to subsidiaries cannot be easily withdrawn by the parent bank during a financial crisis. In contrast, intra-group loans to subsidiaries can be significantly reduced or even cancelled in a period of financial distress. Hence, in the literature it is often assumed that any reduction in foreign bank liquidity would be the result of reduced access to loans from the parent bank during the crisis, who suffered themselves from a lack of liquidity in the financial markets.

An explanation for this is that multinational banks have a tendency to centralize the funding of cross-board subsidiaries. Cardens et al. (2003) showed that multinational banks after acquiring a local bank usually close its foreign funding window to eliminate duplicity of operations. As a result they make the foreign owned subsidiary dependent on the willingness of its parent bank to provide foreign funding, which might turn out to be crucial during a period of financial distress. Furthermore, according to the authors subsidiaries are competing for funds among themselves as the parent company has the sole power to direct its resources anywhere.

Consequently, the tightness in liquidity and sharp revision of conditions has increased the likelihood of a sudden stop or reversal in foreign based lending to some emerging markets countries (Maechler and Ong, 2009). In the past, in many emerging markets, the

subsidiaries of multinational banks have been one of the major sources of finance for the catching-up process of these economies. Hence, it is not surprising that the bank lending ties have been identified as one of the main channels of transmission of the latest crisis from advanced economies to emerging markets (IMF, 2009). Indeed, recently Popov and Udell (2010) confirmed that the contraction of parent bank's balance sheet caused by losses on financial assets and deterioration of their equity position was transmitted through their subsidiaries to CEE countries. In contrast, Naveretti et al. (2010) reported that multinational banks have a stabilizing role across countries during the period of the recent financial distress.

One of the explanations for the different results is that the multinational banks behaved differently across countries during the crisis. A good example are the Baltic States, where the banking sector relies on Swedish banks. In the Baltic States three Swedish banks were active: SEB, Swedbank and Nordea. Nordea's operations were mainly done through branches, and its presence was relatively small in the region. In contrast, in 2009 Swedbank accounted for almost 45% of total lending in Estonia, while SEB accounted for 30% of lending in Lithuania. Jointly the Swedbank and SEB market shares represented 67% total lending in Estonia, 40% in Latvia and 51% in Lithuania (EC, 2009). The exposure of Swedish banks in the Baltic countries had significant benefits for them, in particular in terms of new revenue streams due to a credit boom in the region. Nevertheless, when the global crisis emerged, the credit losses started to increase dramatically as the Baltic States entered a severe recession in late 2008.

The uncertainty regarding potential losses of the Baltic subsidiaries and the economic situation in the region resulted in funding problems for the Swedish parent banks. As a consequence, their exposures to the region quickly become an issue for systemic stability in Sweden, where these banks were also dominating the banking sector. This situation prompted the Swedish authorities to introduce measures to support their national banking system and alleviate funding pressures on the affected multinational banks (CGFS, 2010).

Nevertheless, the lending of the Swedish Banks to the subsidiaries in the Baltic States still declined between the years 2008-2009. The lending pattern of Swedbank to its subsidiary in Latvia, which controls the banks in Estonia and Lithuania, is illustrated in Table 6. As can be seen the lending of the parent bank to its Baltic subsidiary dropped by

almost 20% in 2009, while the net exposures of the parent bank to its subsidiaries were down 30%.

While the Swedish exposure to the Baltic region created difficulties for both the home and host countries, it probably prevented greater reductions in the funding channel between the parent banks and their subsidiaries in the region. However, as the Table 1 shows, this was not the case in all the countries of the CEE region. In most of the countries, where the exposure of the multinational banks was relatively small compared to the parent banks' overall assets, the multinational banks dramatically reduced their lending and exposure.

As a result the situation in most of the CEE countries resembled the “nightmare scenario” described by Herring (2007). According to this scenario, multinational banks with a large share of the host market become systemically important, while at the same time, being so small relative to the parent group that it is not regarded as significant to the condition of the parent company. As a consequence, the home country regulator does not see a case for intervention as it is naturally concerned only with the stability of its' own financial system and not in countries where the multinational bank operates a subsidiary. The situation also explains why in most of the countries regulators introduced stability programs as they were forced to substitute for multinational banks.

However, those stability programs did not only stabilize the subsidiaries but also may have provided additional funding for the parent banks. Most of the existing studies on parent bank funding of subsidiaries have assumed the capital flow is either in the form of equity or more likely loans. The crisis, however, has revealed the intra-group deposits may be an important channel of cross-border asset transfers from foreign subsidiaries to parent bank.

Deposits and loans from the subsidiaries to its parent bank have the same function and provide liquidity, yet how they are regulated can differ substantially. In the EU the Directive relating to the taking up and pursuit of the business of credit institution provides limits on the exposure of the parent bank and/or subsidiaries to each other.<sup>7</sup> According to Article 111 Point 2 a credit institution or/and its subsidiaries may not incur

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<sup>7</sup> See Section 5 Large Exposures, Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institution, Official Journal L 177 , 30/06/2006.

an exposure to the parent undertaking and/or one or more its subsidiaries which exceeds the value of 20% of its capital. The exposure of the credit institution consists of any assets or off-balance sheet item listed in the Directive in Section 3 Subsection 1. The subsection lists in Article 79 the exposure classes, which are used to calculate the minimum capital required for credit risk in credit institutions. However, the Article 113 grants the member states a right to fully or partially exempt from the existing limits exposures incurred by the credit institution to its parent undertaking, to other subsidiaries of that parent undertaking or to its own subsidiaries, in so far as those undertakings are covered by the supervision on a consolidated basis to which the credit institution itself is subject. Moreover, this article also grants the member states a right to fully or partially exempt asset items constituting claims on and other exposures to institutions, with a maturity of one year or less, but not constituting such institutions' own funds.

Most member states implemented those two exceptions into their national banking laws as they assumed that they do not present a serious threat. It was assumed that the supervision on a consolidated basis would prevent any exposure, which would be deemed to be risky. The second exemption affected mainly bank transactions related to the interbank markets. In this case it was assumed that loans granted on the interbank markets, would nevertheless fall under further external or internal regulation on credit quality and concentration. On the other hand, bank deposits to institutions were not covered by any other regulations.

We assume that the implementation of these exceptions might have created a loophole in the national banking laws, which allowed parent banks and its subsidiaries to transfer assets without any significant restrictions. A confirmation could be the fact that in 2009 the Polish Financial Supervisory Authority decided to remove the exception for banks of claims on and other exposures to institutions, with a maturity of one year or less. It did it however gradually and so in 2009 only 50% of claims and other exposure was exempted, while by the end of 2010 no more exemptions in this regard were present anymore.

Nevertheless, we still assume that the risk inside the multinational bank may be substantial, what is the result of existing interconnections between the parent bank and its subsidiaries. An example of existing interconnections in a foreign bank subsidiary shows Figure 4. In this example, we use the subsidiary of UniCredit Bank in Czech Republic,

which was one of the few banks in our sample that disclosed in its financial statements detailed information who were their counter parts within the multinational banking holding company.

UniCredit Bank in Czech Republic is a subsidiary of UniCredit Bank Austria in Austria, which in turns is the subsidiary of the parent bank UniCredit in Italy. The Italian parent bank owns through UniCredit Bank Austria more than 20 subsidiaries in CEE countries, yet the Czech entity has links only to few banks within the bank holding company. In addition two banks, namely UniCredit Bank Austria and its subsidiary UniCredit CA IB, constitute together over 50% of all the subsidiaries claims. Those claims might signal an incomplete internal bank market structure, whereas Allen and Gale (2000) suggested that those structures are more fragile. Moreover, the subsidiaries significant exposure to only two banks shows that the risk of contagion inside bank holding companies can be much larger than in interbank markets.

Figure 4 shows the Czech subsidiary deposited funds or provided loans to the parent bank and other subsidiaries equal to 809 million euro. The Czech subsidiary as well many other banks in our sample do not report whether its assets are deposits or loans to other entities within the banking group. Therefore, we decided to present only the aggregate amount of claims of the subsidiaries to the parent bank group in the Table 7. In the Table the first three columns present the loans and advances of the subsidiary to the parent bank group for the years 2007-2009. We excluded here equity investments, which amounted to 32 million euro. Consequently, the reported exposures to the group might be biased downward in Table 7. Nevertheless, we found that the equity investments represent only a small proportion of subsidiaries assets in our sample.

The next three columns in the Table 7 present the amount of deposits and loans, which the subsidiaries received from the parent bank and other subsidiaries in the years 2007-2009. Again we decided to aggregate received deposits and loans as often the financial statements did not provide enough detailed information on the character of the liabilities of the subsidiary to related third-party. In case of the Czech subsidiary such an information was available. Based on it we know that the subsidiary received only deposits, which amounted to 281 million euro at the end of 2009.

Using the subsidiaries assets presented in the first column and liabilities showed in the next columns of the subsidiary we calculated its net position to the group. The difference between subsidiaries assets and liabilities for each year is presented in the following three columns. The Table 7 shows that the net position of the Czech subsidiary to the group amounted to 131 million euro in 2007 and then increased to 524 million euro in 2009. It means that during the crisis the Czech subsidiaries net claims to the parent bank group members increased by almost 400 million euro over the period 2007-2009. Finally, we decided to present the net position in relation to subsidiaries equity, what shows the last three columns. In 2007 the Czech subsidiary net position was equal to 17% of its capital and then it increased to 53% of its equity in 2009.

As a result the risk stemming from the exposure to the parent group has increased in the Czech subsidiaries during the risk. Indeed, we assume the risk might be much larger than shows the Table 7 as the market structure of the claims is incomplete. A good example are lending and borrowing relation between the Czech subsidiary and UniCredit CAIB, which is the investment bank in the UniCredit group. At the end of 2009 the Czech subsidiaries claims to UniCredit CAIB amounted to 55% of its equity, while the deposits of the UniCredit CAIB in the subsidiary were only equal to 2% of its equity. If UniCredit CAIB would fail over one quarter of the Czechs subsidiaries equity would be wiped out assuming a loss rate of 50% of the assets. This example clearly documents that the existing risk of contagion inside the multinational bank holding company. We advocate therefore for more disclosure of the counterparts as currently little information is provided by the subsidiaries about the actual structure of their bilateral exposure.

The data in Table 7 provides also information on different strategies of the parent groups towards their subsidiaries during the crisis. In Table 7 we documented that the Austrian Erste Bank Group changed its exposure, based on the net position, dramatically towards its subsidiaries in CEE in the period 2007-2009. Prior to the crisis the Erste Bank Group was financing the subsidiaries in our sample. In the year 2009 the situation changed and data shows that the subsidiaries in CEE were financing the parent group. Other banking groups as Swedbank or SEB, for example, reduced significantly their financing in the year 2009. Consequently, the data shows the most of the banking groups limited their financing or even have transferred assets out of CEE in the year 2009.

Most of the subsidiaries in our sample did not disclose whether the asset transfer to the parent group was a deposit or a loan. However, on the few banks that disclosed such information in their financial statements, we were able to establish that most of those transactions were deposits, whereas its terms were not reported.

Using deposits as a way of accessing funding has not been explored in the academic literature as it came to light in the banking industry over the course of the financial crisis. As a result, even new regulations, often do not cover deposits. For example, in Ireland a new Code that addresses the issues concerning related party lending applies to all loans, quasi-loans and credit transactions (including guarantees) between the parent bank and subsidiaries. Hence, those transactions need to be disclosed, while the level of disclosure relating to deposits is seriously lacking in certain instances. At the same time the scale and complexity of certain deposit arrangements between banks and their subsidiaries is large and may create a serious problem to the stability of many countries.

On the other hand, countries such as Poland as already mentioned have already introduced new regulations, which gradually remove the exemption provided by the national law and the directive. The data, however, suggest that only a few countries have decided to deal with this problem.

A good example illustrating this problem is the Irish subsidiary of Citibank called Citibank Europe. During the crisis the Irish holding bank converted four subsidiaries to branches in four different CEE countries. All those subsidiaries had high liquidity, which was reflected in a relatively low loan to deposit ratios. Hence, it is also not surprising that this Irish subsidiary used the newly gained funds in order to deposit it in other subsidiaries of the parent banks in other countries. Consequently, the Irish subsidiary currently has a very high exposure to the other operations of Citibank, which equaled on average 200% of equity in the years 2007-2009. The exposure of the Irish subsidiary may be much higher than presented in Table 7, when we take into account that not all the operation can be netted.

If the deposits were allocated to a Citibank operation that failed it would very likely trigger the failure of the Irish operation. The failure of this would mean a default of five banks (branches) in five different EU countries. Hence, the uncontrolled use of deposits

to finance parent banks underlying operations creates a serious problem not only to the stability of the host financial system but as well as to the whole EU financial system.

It is also very unlikely the Irish government would decide to bail out this Citibank operation as it includes mainly deposits and loans of the host countries. As a result it might not create directly a danger to the Irish financial system. Moreover, it might also be difficult to explain to the Irish voters why the government should try to safe deposits of CEE savers, when it cuts its social expenditures at the same time. On the other hand not saving this institution might as well be risky for the Irish financial system as we do not know all the counterparts of the Citigroup operations today. Hence, it may be that through a domino effect the other Irish Citibank subsidiary (with the deposits of the Irish savers) would be affected as well as a consequence of failure of Citibank Europe. Therefore, in our opinion, the regulators should not only monitor and collect information on the third-party transactions in their home country but should also be able to access to information from other host countries were the multinational banks operate.

#### **4.3. Off-balance sheet transactions**

An area that also lacks sufficient regulation guaranteeing extensive disclosure is derivatives transactions between the parent banks and subsidiaries. The disclosure of those transactions may be important as often they are only partially regulated by the existing law, which also turned out to be a major problem during the recent crisis. Moreover, often the transactions undertaken by the subsidiaries' management do not need the approval of the supervisory board as they are classified as usual business transactions. Hence, parent banks may easily force subsidiaries' management to engage in those types of transaction in order to transfer capital from the host country. Those transfers can take the form of provisions or subsidiaries' losses and are very difficult to trace.

Analyzing the financial statements of the subsidiaries across countries shows a significant increase in the volume of off-balance transactions between the parent bank and its subsidiaries during the crisis, as shown in Table 8. It is necessary, however, to be very careful in the interpretation of the financial data on related party off-balance transactions as most of the banks used different methods to present their exposure, which additionally varied across the time.

Currently, European accounting standards only require entities to determine and report in annual statements their overall off-balance sheet exposure and disclose fair value estimates. At the same time the existing accounting standards do not provide any information on how and to what extent the transactions between the subsidiary and parent bank should be disclosed. As a result the way they are presented varies a great deal and makes their assessment a very difficult task for outsiders. On the other hand given recent experience they may constitute a serious risk to the stability of banks as well as the financial system.

One of the propositions to the European Commission was that in the future the loan guarantees of the parent bank to its subsidiaries and vice-versa should also be supervised and disclosed (DBB Law, 2009). Including guarantees in the assessment process is important as they present an obligation. The data in the Table 8 shows that during the crisis the guarantees granted to the parent banks has increased significantly. In Poland, for example, the Deutsche Bank subsidiary had contingent assets and liabilities outstanding that increased considerably over the years 2007-2009 and were equal to 50% of equity in 2009. On the other hand, we may assume that most of the contingent assets are covered under the existing banking regulation as they constitute liabilities and are taken into account in the calculation of the capital adequacy of the bank.

Nevertheless, while subsidiaries disclosed to some extent the fair value of their contingent assets and liabilities related to parent bank transactions they seldom reported the valuation of the off-balance derivative instruments. In fact, those instruments seem to have a much higher value than the guarantees issued by the subsidiaries to the parent bank, or vice-versa. The Polish subsidiary of Citibank, for example, reported in 2009 that the balance sheet value in respect of the off-balance sheet derivative instruments amounted to 50.051 billion euro in 2008 and 23.129 billion euro in 2009, or 4.26 and 2.75 times the total asset value of the bank, respectively. Yet, the net balance sheet value of financial derivatives transaction was -2.75 and -1.27 billion euro at the end of the year 2008 and 2009, correspondingly.

According to Citibank's subsidiary's annual report these derivative transactions were opposite to derivatives transactions with the other parent bank entities to close current FX position of the Citigroup and its clients. Again the annual report of the Citibank's

subsidiary shows, however, that the FX positions constitute only 10% of the value of all the off-balance sheet liabilities in respect of derivative instruments. The remaining 90% represents mainly interest rate instruments, whereas interest rate swaps make up between 60%-70% of all the derivative instruments in the period 2008-2009. Thus, the large exposure of the subsidiary does not seem to be justified either by the scale of its operation in Poland or by the information provided in the annual statement.

Therefore, in our opinion, due to their large volume the off-balance sheet transactions between the parent bank and its subsidiaries may present a serious threat to the stability of the institution. Consequently, these transactions and instruments need to be disclosed in more detail. More important, however, a unified way of reporting them should be used, that would allow a comparison of the changes in exposure over the time and across institutions.

#### **4.4. Other financial instruments**

Our analysis of the annual reports revealed that the parent banks might also transfer other financial instruments to the subsidiaries and vice versa. Nevertheless, we found the value of the trading position between parent banks and its subsidiaries to be relatively small in comparison to the intra-group deposits and loans. On the other hand, we encountered problems in identifying the trading positions between the parent banks and subsidiaries as again the disclosure of these transactions in the annual reports was very limited. We advocate, therefore, that also the existing trading positions should be presented in more detail as they might also be used to transfer assets between a bank's entities.

#### **5. Income transfers**

In the previous section we have documented different methods used by parent banks to transfer assets from or to their subsidiaries during a crisis. We have shown that some of these transactions may create a risk for the stability of the financial system as the amount, which is transferred to the parent, can represent a significant proportion of subsidiaries' equity.

In this section we show how asset transfers determine the income and costs of the subsidiaries. Furthermore, we present evidences that those transactions might influence the profitability of the subsidiaries. However, in our opinion, income transfer does not present such a serious threat to the financial stability of the subsidiary as the volume of transactions was relatively small in comparison to asset transfers.

### **5.1. Dividends**

Dividend payments are the most important form of income flow from foreign subsidiaries to their parent companies so far. In non-financial companies the dividend payments account for approximately 50% of all remittances to US companies (Kim et al., 2005). It is therefore not surprising that dividend payments are often presented as the main way that the subsidiaries can support their parent banks during a crisis. In contrast to the majority of parent banks, the foreign subsidiaries, especially in emerging markets, were still very profitable in the years 2007-2008.

Table 9 shows the net incomes of parent banks and their foreign subsidiaries over the period 2007-2009. As can be seen most of the parent banks reported losses in the year 2008, which resulted in decisions to pay lower dividends in the same year. Moreover, many of the parent banks reported losses on subsidiaries in developed countries in the year 2008. Unicredit, for example, reported losses on its operation in Germany. Those losses have been offset by the profits of its Austrian bank holding company, which includes all the subsidiaries in the CEE countries without Poland. Consequently, overall Unicredit was still profitable in the year 2008. Nevertheless, its profitability declined quite rapidly as the effects of the crisis became felt in the CEE countries too. As a result the net profit fell more than 30% in the year 2008, and more than 50% in the year 2009.

As dividends are the easiest way to transfer capital from abroad but have a direct effect on subsidiaries' own funding level, most countries have some kinds of restrictions regarding the dividend payments of financial institutions. In Portugal, for example, the supervisory authority can introduce an embargo on the distribution of dividends when the bank fails to achieve minimum liquidity or solvency ratios. Similar regulations are also present in many other countries including the US (Eisenbeis and Kaufman, 2006). Moreover, in some of the countries such as Poland, for example, the supervisory

institution advised all the banks not to pay dividends during the crisis. This advice was not legally binding but was followed by most of the banks. As a matter of fact during the crisis subsidiaries delayed or significantly lowered the payments of the regular dividends despite their profitability and presented a reluctance to pay advanced dividends.

## **5.2. Income and expenses from related parties transactions**

Subsidiaries incurred costs and received income on transactions with the parent bank group during the crisis, which were mainly related to the asset transfers within bank holding company' different entities. The amount of income and expenses of the subsidiaries related to the parent bank transactions are shown in Table 10. The first column shows the income of the foreign subsidiaries in the years 2007-2009, where over 90% of it constitutes the interest income from deposits or loans provided to the parent bank group. Offsetting this, the next columns show the costs of the subsidiary incurred during related parties transactions in the years 2007-2009, where interest expenses associated with deposits or loans from parent bank group entities constituted again around 90% of all expenses. The last three columns shows the net income position of the subsidiaries to their parent bank groups for each of the years. We calculated the net income position as the difference between the expenses and income of the subsidiary that are related to the transactions with the parent group entities.

As deposit and loan transactions between the parent bank group and its subsidiaries were significant during the crisis, interest revenues and expenses related to them represent a substantial part of the income or losses of the subsidiaries. As an example, the SEB subsidiaries in the Baltic countries transferred income to the parent bank, which was related mainly to the loans received from it. The income transferred to the parent bank was equal to 1.5 and 2 of subsidiaries gross profits in the period 2007-2009. As a result the expenses related to the loans are significant and reflect also the magnitude of the transactions with the parent bank group, which were presented in Table 7.

In most of the countries the existing regulations limit the possibility to grant loans to a related party on more favorable terms. In contrast, there are no regulations that provide limits on loans to subsidiaries at disadvantageous terms. As the terms of the related party loans were not disclosed by the subsidiaries it is possible that some of them were given

by the parent bank on disadvantageous terms. Moreover, as deposit transactions are not covered by the current regulations their terms were also not reported in the annual statements. Again, the lack of regulation and disclosure might allow the parent banks to enforce less favorable terms on the deposits of subsidiaries. Hence, parent bank group members might have improved their profitability by receiving cheap deposits from some subsidiaries and lending capital at above market rates to other subsidiaries.

As the terms of all those transactions are not disclosed it is very hard to assess the profitability of related party transactions between the parent bank and its subsidiaries. However, Table 10 shows that in many subsidiaries those transactions constitute a significant proportion of its profit/loss. Therefore, in our opinion, these transactions and their terms need to be more in detailed to be disclosed in order to assess its relevance and economics justification. On the other hand the income flows to parent banks do not represent a significant proportion of subsidiaries equity. Hence, they do not present a serious threat to subsidiaries financial stability in the short term but may have a negative impact on its profitability in the long term.

One expense position, which was seldom disclosed separately in most annual statements of the subsidiaries, were the management fees for the administrative services that the parent bank provided to them. These fees are recorded as revenue on the parent bank's books and as fee expenses or overhead costs on the subsidiary's books. As the management fees are not disclosed separately across the subsidiaries it is difficult to assess their value and make any kind of comparison. The information that was provided, however, showed that the amounts charged by the parent banks were relatively small in comparison to the equity, yet could be a substantial cost. In 2009, for example, Citigroup received from its subsidiary in Poland over 41 million euro or 16% of the subsidiaries gross profit in fees for services related to maintenance of the information system and advisory support. In the year before, the parent bank charges were higher and amounted to over 64 euro million or 12% of the subsidiary's gross profit. As the amount fluctuated and no further explanations were provided those flows may also be transfers of income to parent banks from their subsidiaries.

These flows nevertheless do not constitute a serious threat to the stability of the subsidiary. In the case of the Citigroup subsidiaries the value of the transfers was equal to

5% of equity in 2008 and 4% in 2009. Should all the transfer be taken into account – dividends, income and expenses including the fees from services provided by the parent bank – the amounts transferred to the parent bank could be substantial. While, at the moment we are not able to differentiate those amounts and are not able to compare them across the subsidiaries and multinational banks, closer attention should be paid to them.

### **5.3. Acquisitions and disposals of assets**

Acquisitions and disposals of assets between bank holding companies allows asset transfers, but most importantly moves income from the parent bank to the subsidiary, or vice versa. Table 11 presents selected transactions between the parent banks and their subsidiaries during the crisis. In the table we show only those transactions where the acquired or disposed asset was another bank subsidiary. In this period, however, the entities sold also nonbanking businesses, especially insurance companies, leasing companies but also stakes in non-financial companies.

The acquisition or disposal of assets in bank holding companies might be used to create a more transparent financial organization. However, in a crisis those transactions may also have different goals. First, when one entity buys assets from another it increases the liquidity of the last. Increasing the liquidity of the subsidiaries may have been the main motive justifying the acquisition of the insurance and pension fund business by the Swedish parent banks from their Baltic subsidiaries in the years 2008-2009. Those operations were however often very profitable and hence the disposal will have a negative impact on the Baltic subsidiaries performance in the future.

As the divested operations were profitable, a second explanation could be that those transactions were not aimed at providing liquidity to the subsidiaries but to protect the interests of the parent banks in case of their failure. In this scenario the transactions would be not in the interests of the subsidiaries and the host regulators. Moreover, a remaining question is how the additional liquidity stemming from the sell-off will be used by the subsidiary. The Polish subsidiary of Commerzbank, for example, sold its pension business to a third-party investor, but later used the funds to acquire a branch in Poland from the parent bank.

A disposal of assets by the subsidiary may be in the interest of the parent bank and the subsidiary at the same time. In 2008, for example, the Swedbank subsidiary in Estonia sold its majority ownership in the Russian subsidiary to the parent bank. The subsidiary received €91 million for the Russian subsidiary and reported a loss on this transaction of €2.1 million euro. The transaction, however, allowed the Estonian subsidiary to limit its exposure to an unstable market during the crisis and therefore it was in its interests. At the same time the parent bank was more likely to be able to assist the Russian subsidiary should any additional funding be needed as the crisis further evolved. Consequently, we may assume that this transaction was in the interest of all the entities involved including the host regulator.

While, acquisitions and disposals were reported in the financial statements the information explaining the rationality of these transaction was lacking. Yet, it may be assumed that they do not provide any significant danger to the stability of the parent bank or its subsidiaries as these transactions are often monitored by different regulatory institutions. Furthermore, even as parent banks would try to protect their investments by acquiring assets from failing subsidiaries the interest of its debt holders were protected by law in most countries. In most of the countries regulations exist that would declare any unfavorable transfer of assets to parent bank from a failed subsidiary as not binding when they are found to be unfavorable for the creditors. Nevertheless, those transactions allow the parent banks to protect valuable assets from third-parties in case of failure, but it is unlikely they can be used to transfer assets prior to the failure of a subsidiary.

#### **5.4. Other methods of income transfer**

In a recent paper, Pistor (2010) presents a hypothetical scenario of a host-home regulation conflict, where she explains that multinational banks may have established prior to the crisis leasing companies and other vehicles that are not subject to the host's banking regulations. These financial institutions could have been founded in the period when the host regulator tried to slow the credit market expansion in the boom period by imposing ceilings on the permissible credit volume, especially in foreign currency. As the newly established institutions were not subject to the new regulation they were able to

provide further loans despite the measures of the host's regulators and contributed significantly to the credit boom, especially in the emerging CEE markets.

Till now very little has been revealed in the literature about the impact of these vehicles on the recent credit boom in foreign markets. It may be assumed, however, that these institutions were indeed used by the parent banks to transfer an uncontrolled amount of capital to the foreign markets in the form of loans in the past. As a consequence, it may also be assumed that the parent bank may easily change the direction of the flow of funds in those vehicles from the host market to the home market subsequently. Therefore, multinational banks may now contribute significantly to credit contraction in the foreign markets as they have to the credit booms in the past.

## **6. Conclusions**

In our paper we document that the existing European Union framework governing intra-group transactions of multinational banks does not sufficiently address the problems and risks countries face and that materialized in the global financial crisis. On one hand, domestic supervisors must safeguard the financial soundness of their banking system and therefore should prevent intra-group transactions that may jeopardize the solvency of foreign subsidiaries. On the other hand, we found that the existing regulations, including the disclosure requirements, are not able to identify and prevent those transactions.

As a result, during the crisis foreign bank subsidiaries engaged in transactions that might have jeopardized their own security. As the foreign bank subsidiaries have dominant positions in host countries banking sectors, especially in the NMS, they have created a serious risk to the soundness of the financial systems in those regions. Furthermore, we documented that the threats created by a single subsidiary might not only affect one country but also multiple several countries at the same time due to the network of its own subsidiaries.

Consequently, this paper seriously questions the soundness of the existing regulations and advocates for more detailed disclosure of all the transactions between the parent bank and its subsidiaries. Moreover, due to the gravity of the problems shown in the paper, in our opinion, not only new transnational regulations needed but in addition a transnational supervisory organization enforcing them. Furthermore, we also argue that the governance

of foreign subsidiaries should be changed as currently parent banks may easily instruct their subsidiaries to engage in certain transactions, which may be to their disadvantage and as a result make the host financial systems more vulnerable.

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Table 1 Number and total assets of credit institutions in euro and as a share of GDP

	Number of CIs					Total assets of CIs (EUR millions)					CIs assets as a share to GDP				
	2000	2005	2007	2008	2009	2000	2005	2007	2008	2009	2000	2005	2007	2008	2009
Austria	848	818	803	803	790	527,933	721,159	890,747	1,067,860	1,036,597	2.5545	2.9606	3.2747	3.7722	3.7788
Belgium	118	100	110	105	104	698,809	1,055,270	1,297,788	1,270,766	1,155,506	2.8201	3.4845	3.8746	3.6868	3.4259
Denmark	210	197	189	171	164	431,756	746,589	1,091,809	1,091,809	1,104,536	2.5163	3.6003	4.8092	4.7055	4.9555
Finland	341	363	360	357	349	127,999	234,519	383,908	383,908	387,630	0.9835	1.4908	2.1364	2.0791	2.2627
France	1099	854	808	728	712	3,502,581	5,073,388	6,682,335	7,225,140	7,155,460	2.4664	2.9393	3.5258	3.7080	3.7519
Germany	2742	2089	2026	1989	1948	6,063,568	6,826,564	7,562,432	7,875,401	7,423,967	2.9870	3.0446	3.1144	3.1555	3.0816
Greece	57	62	63	66	66	191,862	281,067	383,295	461,981	490,134	1.5581	1.4387	1.6927	1.9318	2.0638
Ireland	81	78	81	82	498	355,346	941,908	1,337,356	1,412,198	1,323,584	3.4552	5.8110	7.0480	7.7672	8.0932
Italy	861	792	821	818	801	1,771,126	2,509,436	3,331,829	3,634,559	3,691,965	1.5183	1.7555	2.1549	2.3182	2.4275
Luxemburg	202	155	156	152	147	647,896	792,417	915,446	931,563	797,460	30.4491	26.1679	24.4340	23.6750	21.1837
Netherlands	586	401	341	302	295	1,148,942	1,697,781	2,168,280	2,231,514	2,217,008	2.8560	3.3069	3.8129	3.7449	3.8881
Portugal	218	186	175	175	166	315,312	360,185	439,459	482,126	520,188	2.7288	2.3430	2.6044	2.8044	3.1031
Spain	368	348	357	362	352	1,124,944	2,152,833	3,005,274	3,381,187	3,433,283	1.8450	2.3689	2.8547	3.1063	3.2662
Sweden	211	200	201	182	180	434,669	659,286	854,947	907,536	934,534	1.6724	2.2098	2.5298	2.7153	3.1930
UK	491	394	396	391	389	5,227,636	5,897,712	10,094,508	8,840,240	9,420,998	3.3519	3.2158	4.9173	4.8695	6.0268
<b>OMS total</b>	<b>8433</b>	<b>7037</b>	<b>6887</b>	<b>6683</b>	<b>6961</b>	<b>22,570,379</b>	<b>29,950,114</b>	<b>40,439,413</b>	<b>41,197,788</b>	<b>41,092,850</b>	<b>5.9186</b>	<b>5.5251</b>	<b>5.9806</b>	<b>6.0301</b>	<b>6.2877</b>
Bulgaria	--	34	29	30	30	--	17,447	31,238	36,825	37,950	--	0.7973	1.0809	1.0793	1.1202
Cyprus	--	391	215	163	155	--	62,553	92,897	118,142	139,372	--	4.5796	5.8239	6.8496	8.2245
Czech Republic	--	56	56	54	56	--	100,902	140,168	155,005	160,219	--	1.0071	1.1008	1.0482	1.1674
Estonia	--	11	15	17	18	--	11,876	20,603	22,066	21,340	--	1.0621	1.3184	1.3729	1.5543
Hungary	--	214	206	197	190	--	78,289	108,504	124,672	126,160	--	0.8832	1.0734	1.1813	1.3553
Latvia	--	25	31	34	37	--	15,727	30,816	32,249	29,925	--	1.2087	1.4597	1.3999	1.6142
Lithuania	--	78	80	84	84	--	13,162	23,817	26,542	26,180	--	0.6307	0.8334	0.8242	0.9824
Malta	--	19	22	23	24	--	27,195	37,807	42,283	41,242	--	5.6846	6.9206	7.4468	7.2101
Poland	--	730	718	712	710	--	163,421	233,938	262,591	274,212	--	0.6686	0.7522	0.7246	0.8843
Romania	--	40	42	43	42	--	35,400	72,095	84,541	86,386	--	0.4436	0.5780	0.6049	0.7455
Slovakia	--	23	26	26	26	--	37,834	58,053	65,509	54,473	--	0.9837	1.0575	1.0113	0.8601
Slovenia	--	25	27	24	25	--	30,135	43,493	49,010	53,404	--	1.0479	1.2582	1.3198	1.5305
<b>NMS total</b>	<b>--</b>	<b>1646</b>	<b>1467</b>	<b>1407</b>	<b>1397</b>	<b>--</b>	<b>593,941</b>	<b>893,429</b>	<b>1,019,435</b>	<b>1,050,863</b>	<b>--</b>	<b>1.0901</b>	<b>1.2444</b>	<b>1.2077</b>	<b>1.1085</b>
<b>MU16 total</b>	<b>7521</b>	<b>6704</b>	<b>6391</b>	<b>6175</b>	<b>6458</b>	<b>16,476,318</b>	<b>22,804,244</b>	<b>28,534,207</b>	<b>30,633,483</b>	<b>29,921,272</b>	<b>2.5055</b>	<b>2.7978</b>	<b>3.1666</b>	<b>3.3261</b>	<b>3.3362</b>
<b>EU27 total</b>	<b>8433</b>	<b>8683</b>	<b>8354</b>	<b>8090</b>	<b>8358</b>	<b>22,570,379</b>	<b>30,544,055</b>	<b>41,123,104</b>	<b>42,217,558</b>	<b>42,143,710</b>	<b>2.6345</b>	<b>2.7591</b>	<b>3.3198</b>	<b>3.3745</b>	<b>3.5726</b>

Sources: ECB (2004, 2006, 2010)

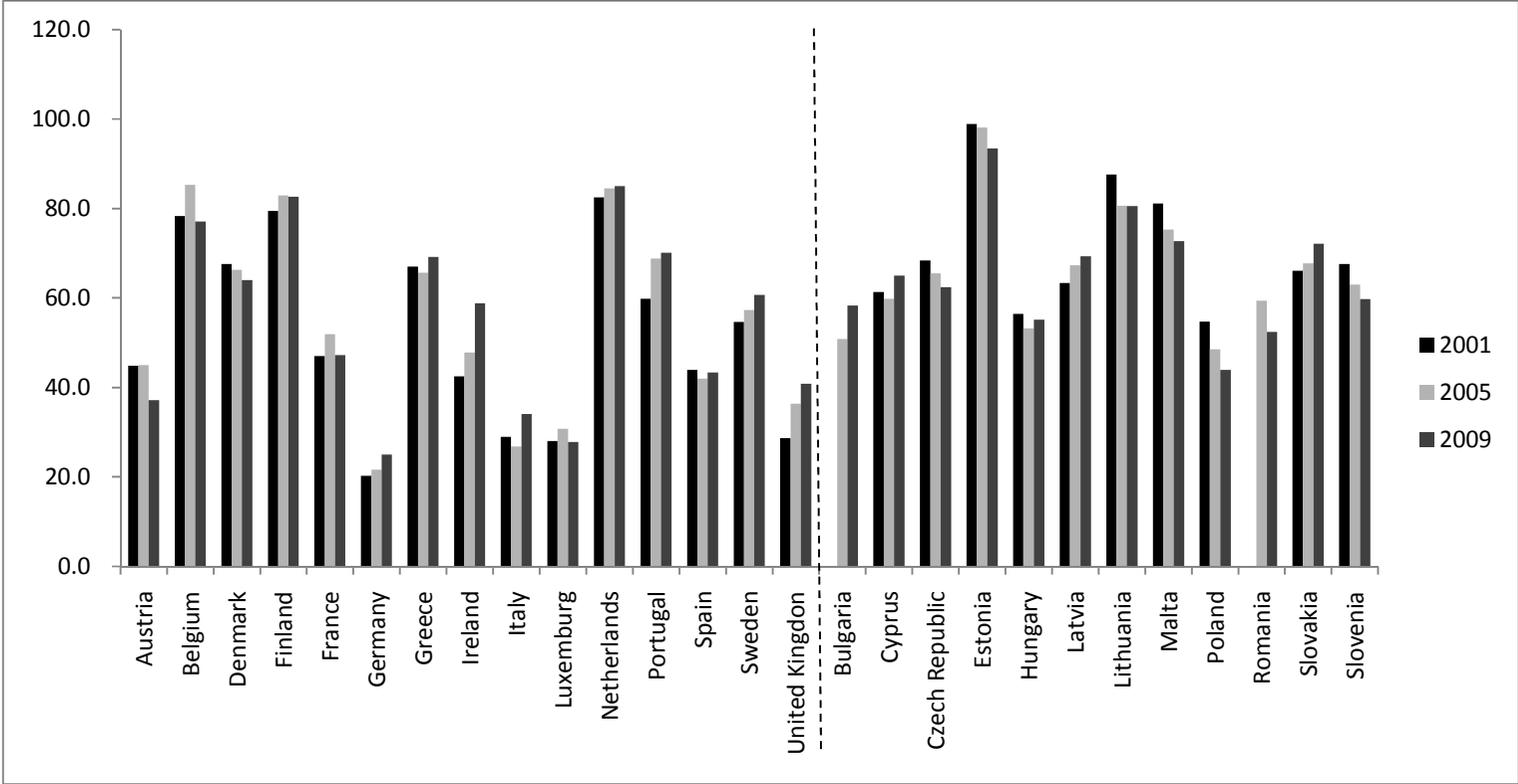
Table 2 Share of the five largest CIs assets in total assets (%)

	2001	2005	2007	2008	2009
Austria	44.9	45.0	42.8	39.0	37.2
Belgium	78.3	85.3	83.4	80.8	77.1
Denmark	67.6	66.3	64.2	66.0	64.0
Finland	79.5	82.9	82.3	82.8	82.6
France	47.0	51.9	51.8	51.2	47.2
Germany	20.2	21.6	22.0	22.7	25.0
Greece	67.0	65.6	67.7	69.5	69.2
Ireland	42.5	47.8	50.4	55.7	58.8
Italy	29.0	26.8	33.1	33.0	34.0
Luxemburg	28.0	30.7	27.9	27.3	27.8
Netherlands	82.5	84.5	86.3	86.8	85.0
Portugal	59.8	68.8	67.8	69.1	70.1
Spain	43.9	42.0	41.0	42.4	43.3
Sweden	54.6	57.3	61.0	61.9	60.7
United Kingdom	28.6	36.3	40.7	36.5	40.8
OMS average	51.6	54.2	54.8	55.0	54.9
Bulgaria	n.a.	50.8	56.7	57.3	58.3
Cyprus	61.3	59.8	64.9	63.9	65.0
Czech Republic	68.4	65.5	65.7	62.0	62.4
Estonia	98.9	98.1	95.7	94.8	93.4
Hungary	56.4	53.2	54.1	54.5	55.2
Latvia	63.4	67.3	67.2	70.2	69.3
Lithuania	87.6	80.6	80.9	81.2	80.5
Malta	81.1	75.3	70.2	72.8	72.7
Poland	54.7	48.5	46.6	44.2	43.9
Romania	n.a.	59.4	56.3	54.0	52.4
Slovakia	66.1	67.7	68.2	71.5	72.1
Slovenia	67.6	63.0	59.5	59.1	59.7
NMS average	70.6	65.8	65.5	65.5	65.4
MU16 average	51.9	56.7	56.7	57	57
EU27 average	59.1	59.3	59.5	59.6	59.5
MU16 average*	39.1	42.8	44.4	44.7	44.6
EU27 average*	37.8	42.6	41.5	45.2	44.3

Note: \* credit institutions assets weighted averages

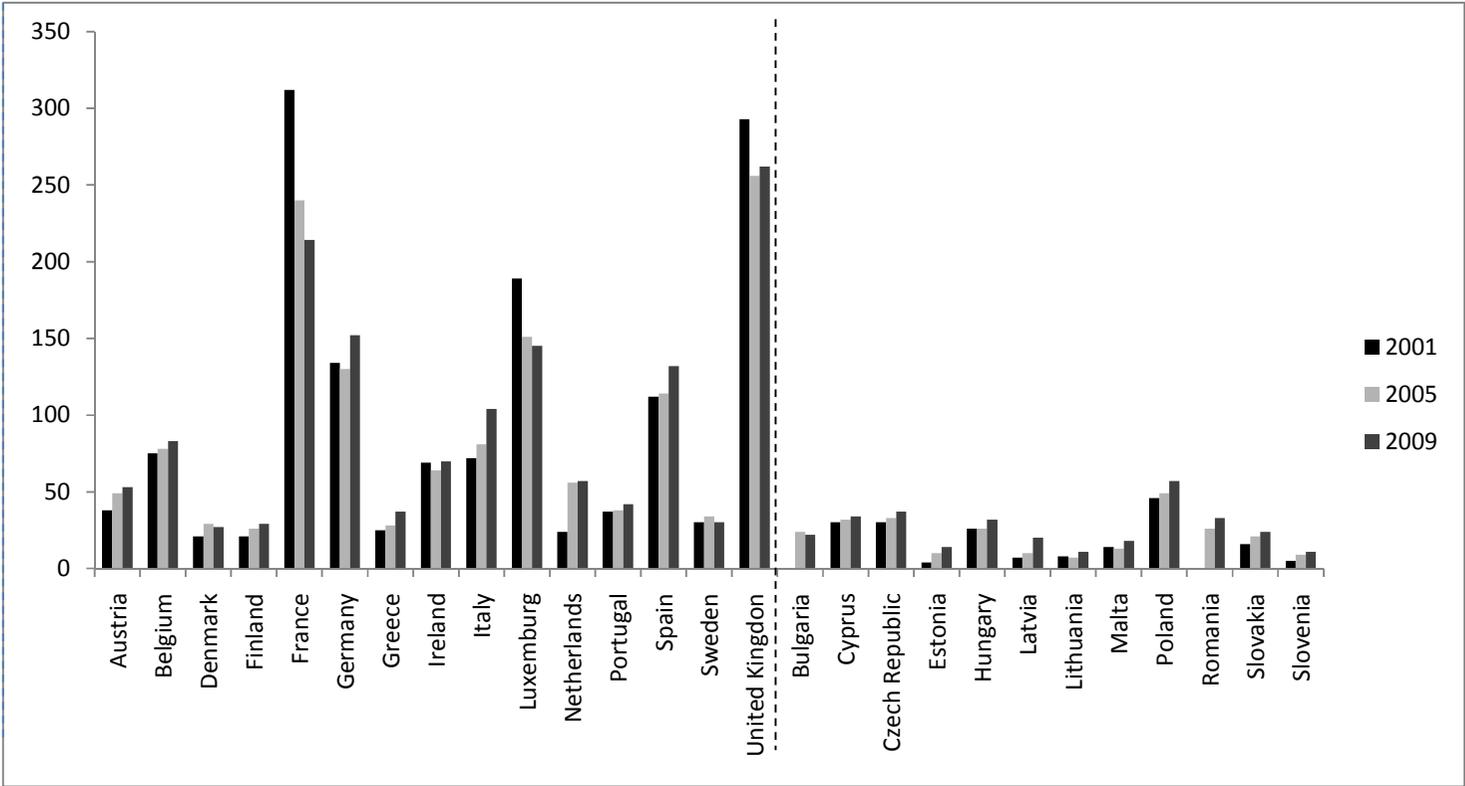
Sources: ECB (2004, 2006, 2010)

Figure 1 Share of the five largest CIs assets in total assets (%)



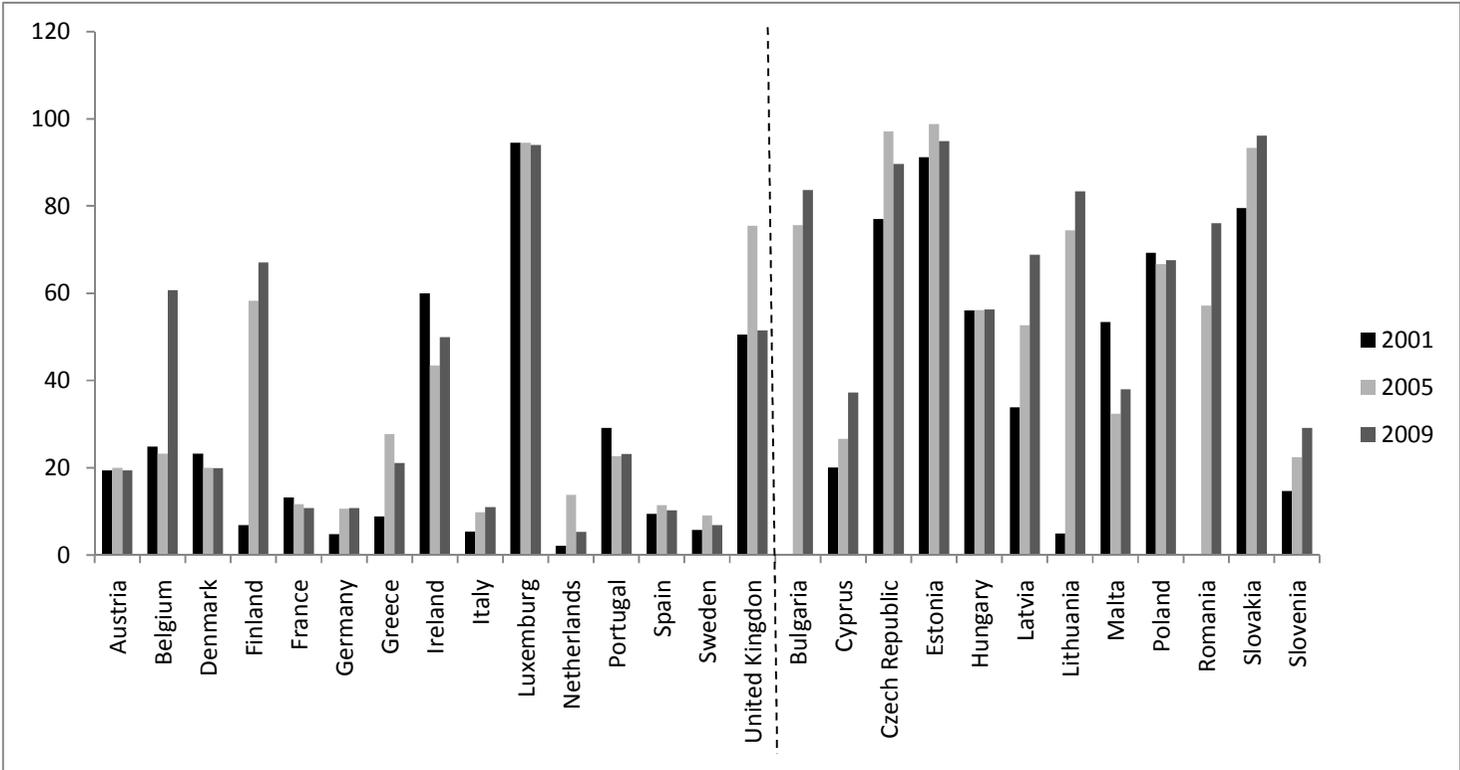
Sources: ECB (2004, 2006, 2010)

Figure 2 Number of foreign-controlled CIs: subsidiaries and branches



Sources: ECB (2004, 2006, 2010) and authors' calculations

Figure 3 Share of foreign-controlled assets to total assets of CIs (%)



Sources: ECB (2004, 2006, 2010) and authors' calculations

Table 3 Subsidiaries vs foreign branches: number and its share in total assets

	Number				CI's assets to total assets in %			
	Branches		Subsidiaries		Branches		Subsidiaries	
	2001	2009	2001	2009	2001	2009	2001	2009
Austria	15	26	23	23	0.78	1.05	18.64	18.35
Belgium	46	50	29	28	5.53	7.59	19.33	53.13
Denmark	11	19	10	10	4.37	3.57	18.81	16.36
Finland	18	20	3	6	6.37	4.36	0.44	62.74
France	83	81	229	159	3.73	2.04	9.49	8.73
Germany	80	89	54	41	2.07	2.45	2.68	8.30
Greece	21	23	4	5	8.80	7.81	0.00	13.29
Ireland	33	32	36	32	13.84	9.46	46.12	40.46
Italy	63	68	9	13	4.28	3.94	1.10	7.04
Luxemburg	63	44	126	107	19.14	14.58	75.42	79.43
Netherlands	5	28	19	28	0.73	2.85	1.33	2.48
Portugal	25	25	12	13	4.96	6.39	24.11	16.72
Spain	56	65	56	49	4.18	6.63	5.19	3.55
Sweden	20	20	10	14	5.41	6.39	0.35	0.47
United Kingdom	200	170	93	86	44.12	38.30	6.35	13.20
OMS total	739	760	713	614	13.64	11.92	8.86	13.32
Bulgaria	--	6	--	18	--	4.40	--	79.31
Cyprus	21	22	9	10	10.52	4.59	9.52	32.66
Czech Republic	10	12	20	21	12.76	11.71	64.24	77.97
Estonia	1	6	3	4	0.02	26.04	91.15	68.83
Hungary	0	3	26	23	0.00	6.19	56.04	50.12
Latvia	1	1	6	9	0.01	12.19	33.84	56.63
Lithuania	4	2	4	5	4.91	17.58	0.05	65.80
Malta	3	2	11	11	19.03	0.00	34.35	38.01
Poland	0	7	46	42	0.00	5.02	69.22	62.59
Romania	--	6	--	20	--	6.61	--	69.44
Slovakia	2	5	14	16	0.00	6.93	79.52	89.20
Slovenia	1	3	4	6	0.01	0.94	14.64	28.19
NMS total	43	75	143	185	4.85	6.87	54.96	59.34

Sources: ECB (2006, 2010) and authors' calculations

Table 4 Structure of supervisory boards and the characteristics of non-executive directors in listed foreign banks subsidiaries in 2010

No. of directors	Of which independent board members (non-executive directors)	Age	Education	Profession	other boards
<i>UniCredit (Poland)</i>					
9	1*	63	Ph.D. in engineering	Professor, Warsaw University of Technology	n/a
	2	64	Ph.D. in physics	Founder and President of the Business School WSB–NLU	n/a
	3	59	Ph.D. in economics	Professor, Gdansk University	3
	4	58	High school	CEO, Fiat Auto Poland	n/a
	5	55	M.A. in theater direction	CEO, Allianz Poland	1
<i>Citigroup (Poland)</i>					
12	1*	71	Ph.D. in law	Lawyer and Em. Professor, AM University	n/a
	2	63	Ph.D. in economics	Politician	8
	3	44	M.A. in economics and law	Founder and CEO, ICENTIS Corporate Solutions	2
	4	61	M.Sc. in engineering	CEO, ABB Poland	n/a
	5	62	Ph.D. in economics	Professor, Warsaw University	2
	6	61	M.Sc. in engineering	CEO, Can Pack Group	n/a
<i>Commerzbank (Poland)</i>					
10	1*	64	M.A. in economics	n/a	n/a
	2	58	M.A. in economics	Founder and CEO, MOKATE	n/a
	3	52	M.Sc. in engineering	Advisor to the Board of CTL Logistics	n/a
	4	59	Ph.D. in economics	President of the Gdańsk Institute for Market Economics	n/a
	5	46	Ph.D. in law	Lawyer and Professor, Warsaw University	5
<i>Erste Bank (Czech Republic)</i>					
9	0		no independent supervisory board members (non executive directors)		
<i>Erste Bank (Slovakia)</i>					
5	0		no independent supervisory board members (non executive directors)		
<i>KBC (Bulgaria)</i>					
3	0		no independent supervisory board members (non executive directors)		
<i>KBC (Poland)</i>					

7	1*	61	M.A. in law	Lawyer and CEO, PZMot	n/a
	2	66	Ph.D. in economics	Professor, Kozminski University	n/a
	3	57	M.Sc. in mathematics	Founder and CEO, Capital Strategy	n/a
<i>Société Générale Group (Romania)</i>					
11	1	70	n/a	Independent Financial Advisor	1
	2	46	M.A. in economics	Director, European Bank for Reconstruction and Development	6
	3	57	Ph.D. in economics	Professor, Technical University of Bucharest	n/a
	4	61	n/a	CEO, Romanian Loan Guarantee Fund for Private Entrepreneurs	n/a
<i>Société Générale Group (Czech Republic)</i>					
9	1	67	M.Sc. in engineering	n/a	n/a
	2	61	M.A. in economics	Retired	n/a
<i>ING (Poland)</i>					
8	1*	63	M.A. in economics	Professor, Technical University of Lodz	1
	2	59	Ph.D. in law	Lawyer and Professor, University of Silesia	0
	3	49	M.A. in economics	Auditor and CEO, PRO AUDIT	0
<i>Bank Millennium (Poland)</i>					
11	1*	70	M.A. in law	Lawyer	1
	2	85	M.Sc. in navigator engineer	n/a	1
	3	54	M.A. in law	Lawyer	1
	4	69	Ph.D. in economics	Rector and Professor, Kozminski University	2
	5	57	Ph.D. in economics	Politicians and Professor, Warsaw School of Economics	4
	6	64	Ph.D. in economics	Politicians and Professor, Warsaw School of Economics	n/a

Note: \*Chairman(woman) of the Supervisory Board

Sources: companies annual statements, ISI Emerging Markets, and Thomson ONE Banker

Table 5 Governance structure of parent banks and their subsidiaries

	Shares	Listed Stock Exchange	Management			of which foreigners			Board			of which foreigners			Option plans based on shares	
			2007	2008	2009	2007	2008	2009	2007	2008	2009	2007	2008	2009	P	S
<i>ING</i>	<i>Amsterdam, Brussels, NY</i>		9	7	3				12	11	11				Yes	
Poland	75%	Warsaw	7	7	7	3	1	2	8	8	8	4	4	4	Yes	Yes
<i>Unicredit</i>	<i>Milan, Frankfurt, Warsaw</i>		23	23	23											Yes
Bulgaria	92%	No	4	5	5	2	2	2	7	7	7	6	6	6	Yes	No
Poland	59%	Warsaw	9	9	7	3	4	3	9	9	9	5	5	5	Yes	Yes
Slovakia	99%	No	4	3	3	1	1	1	9	9	9	5	5	5	Yes	No
Czech Republic	100%	No	4	4	5	2	2	3	9	9	9	6	6	3	Yes	No
Hungary	100%	No	5	5	5	1	1	1	6	9	9	1	6	6	Yes	No
Romania	51%	No		6	5		2	2		9	7		8	5	Yes	No
<i>Commerzbank</i>	<i>Frankfurt</i>		10	8	9				21	21	21				Yes	
Poland	70%	Warsaw	7	7	7	4	3	4	9	9	10	4	4	5	Yes	Yes
<i>AIB</i>	<i>Irish, London, NY</i>		18	21	12										Yes	
Poland	71%	Warsaw	10	10	11	2	2	3		8	7	4	4	3	No	Yes
<i>Citigroup</i>	<i>NY, Tokyo, Mexico</i>		15	15	17											
Poland	75%	Warsaw	5	5	5	1	1	0	12	12	12	6	6	6	Yes	No
<i>KBC</i>	<i>Brussels</i>		26	25	22										Yes	
Poland	87%	Warsaw	5	5	5	2	1	1	10	9	10	4	4	5	No	No
Hungary	100%	no	4	3	3											No
Czech Republic	100%	no	5	6	5	2	2	1	9	9	9	5	5	5	No	No
Slovakia	100%	no	6	6		2	2		6	6		3	3		No	No

<i>Deutsche Bank</i>		<i>Frankfurt, NY</i>	4	4	8				20	20	20				Yes	
Poland	100%	No	3	3	4	0	0	0	6	6	5	5	5	4	No	No
<i>GE</i>		<i>NY</i>	16	16	16										Yes	
Poland	89%	Warsaw	2	8	8	0	4	4	11	12	13	4	6	4	Yes	No
Czech Republic	100%	No	3	3	4	3	3	4	3	3	3	2	1	1		No
<i>Raiffeisen Bank</i>		<i>Vienna</i>	7	6	6				7	6	7				Yes	
Czech Republic	51%	No	7	7	7	0	0	0	9	9	8	4	4	4	No	No
Poland	100%	No	5	5	5	0	0	0	5	5	5	4	4	4	No	No
Slovakia	100%	No	6	6	6	1	0	0	6	7	9	3	4	6	No	No

Note: Ownership structure of foreign banks and information on parent (P) or subsidiaries (S) option plans existing in foreign subsidiaries at the end of 2009. In one tier board companies the management shows the number of all directors.

Sources: companies annual statements

Table 6 Conversion from subsidiaries into branches in the EU during the crisis in the years 2007-2009 (in mln euro)

Parent Bank			Subsidiary converted to branch						as % of parent bank		
Year	Name	Gross Profit	Home country	Host country	Gross Profit	Loans	Deposits	Equity	Assets	Equity	Assets
2010	UniCredit Bank AG	1,957	Germany (Italy)	Austria	214	182.6	22,723.5	5,918.1	50,389.8	27.8%	17%
2010	Société Générale	512	Czech Republic (France)	Slovakia	-12.8	180.7	196.8	32	249.3	1.2%	0.9%
2009	AXA	-6.2	Belgium (France)	Hungary	8.4	936.7	1,035.3	32.7	1,090.0	4.0%	4.7%
2009	Citigroup	546.3	Ireland (USA)	Hungary	73.0	672.3	1,409.9	275.0	2,858.8	11.0%	22.2%
2009	Citigroup	546.3	Ireland (USA)	Slovakia	18.4	475.3	1,161.8	114.9	1,404.1	4.6%	10.9%
2009	Citigroup	546.3	Ireland (USA)	Romania	3.4	447.3	689.6	124.1	1,070.5	4.9%	8.3%
2008	Citigroup	374.9	Ireland (USA)	Czech	43.3	1,370.8	3,477.9	320.4	4,906.0	9.1%	71.8%
2008	Danske Bank	2,584.2	Denmark	Estonia	42.1	1,876.5	1,047.5	172.1	2,350.8	1.2%	0.5%

Note: In first column the year of the conversion, while the financial data for the parent bank and subsidiary is for the year prior to conversion. In the parentheses the home country of the ultimate owner of the parent bank is presented.

Sources: companies annual statements and Bankscope

Figure 4 Related parties transaction of UniCredit Bank Czech Republic as at 31 December 2009 (in mln euro)

CZ indicate transactions with the UniCredit Bank Czech Republic. The subsidiary conducted also transactions with UniCredit Leasing GmbH and Unicredit Business Partner s.r.o, which are not show here for brevity. The direct owner of the subsidiary and his share in equity is presented in italic.

UniCredit S.p.A Italy, listed			
Assets		Liabilities	
Receivables	221,287	Deposits	144,445
of which CZ	2		
Total	293,526	Total	173,052

Pioneer Asset Management Czech Republic, Pioneer Global Asset Management SPA (100%)			
Assets		Liabilities	
Receivables	na	Deposits	na
of which CZ	13		
Total	na	Total	na

UniCredit Bank Austria AG Austria, UniCredit S.p.A. (99.995%)			
Assets		Liabilities	
Receivables	10,664	Deposits	2,937
of which CZ	200	of which CZ	303
Equity	35	Other	
Other		Of which CZ	8
Total	10,872	Total	10,345

UniCredit CAIB AG <sup>a</sup> Austria, UniCredit Bank AG (100%)			
Assets		Liabilities	
Receivables	na	Deposits	na
of which CZ	9	of which CZ	286
Total	na	Total	na

UniCredit Bank AG Germany, UniCredit S.p.A. (100%)			
Assets		Liabilities	
Receivables	23,378	Deposits	11,587
of which CZ	15	of which CZ	13
Total	26,142	Total	15,142

UniCredit Bank Czech Republic, UniCredit Bank Austria AG (100%)			
Assets		Liabilities	
Receivables	809	Deposits	281
Equity	32		
Total	843	Total	281

UniCredit Jezalogbank Zrt <sup>b</sup> Hungary, UniCredit Bank Hungary (100%)			
Assets		Liabilities	
Receivables	205	Deposits	251
		of which CZ	24
Total	205	Total	251

UniCredit Bank Serbia Jsc Serbia, UniCredit Bank Austria AG (100%)			
Assets		Liabilities	
Receivables	3	Deposits	769
		of which CZ	8
Total	3	Total	771

Note: <sup>a</sup> in 2010 CAIB AG was merged with UniCredit Bank AG <sup>b</sup> data for UniCredit Jezalogbank Zrt (mortgage banks) as at 31 December 2008

Table 7 Subsidiaries transactions with the parent bank group (in mln euro)

	Loans and advance			Deposits and loans			Net position			to equity		
	2007	2008	2009	2007	2008	2009	2007	2008	2009	2007	2008	2009
<i>Swedbank (Sweden)</i>												
Estonia (Baltic)	371	497	1,314	10,161	10,520	8,541	-9,790	-10,024	-7,227	-5.20	-4.43	-4.04
<i>SEB (Sweden)</i>												
Estonia	330	37	8	2,386	2,028	2,412	-2,055	-1,991	-2,404	-3.98	-3.53	-5.04
Latvia	186	106	308	2,288	2,352	2,223	-2,102	-2,247	-1,915	-5.83	-5.75	-6.17
Lithuania	181	192	884	3,610	4,376	3,865	-3,428	-4,184	-2,980	-5.89	-6.44	-6.75
<i>ING (Netherlands)</i>												
Poland	1,493	2,252	143	126	1,464	831	1,367	788	-689	0.10	0.04	-0.05
<i>Unicredit (Italy)</i>												
Poland	420	311	627	160	1	2	260	310	625	0.01	0.01	0.02
Czech Republic	801	921	809	669	817	285	131	104	524	0.16	0.11	0.53
Bulgaria	433	753	1,005	435	1,469	1,516	-2	-715	-511	0.00	-1.02	-0.61
<i>Citigroup (USA)</i>												
Poland	896	408	285	633	1,001	401	264	-593	-116	0.03	-0.05	-0.01
Ireland	5,819	7,909	6,952	1,958	2,354	310	3,861	5,555	6,642	2.70	2.22	1.88
<i>Deutsche Bank (Germany)</i>												
Poland	1,009	257	158	319	62	28	690	196	130	0.41	0.11	0.13
<i>Erste Bank Group (Austria)</i>												
Slovakia	90	14	961	444	1,815	318	-354	-1,802	643	-0.48	-2.25	0.82
Czech Republic	165	1,068	755	431	409	314	-257	599	441	-0.12	0.24	0.18

<i>Raiffeisen (Austria)</i>												
Czech Republic	76	116	40	230	829	675	-150	-720	-635	-0.54	-1.62	-1.26
Slovakia	61	99	166	9	443	34	52	-343	132	0.09	-0.49	0.16
Hungary		30	213		950	952		-920	-739		-1.48	-1.43
Bulgaria	423	574	294	164	79	25	259	494	269	0.90	1.11	0.57
<i>GE Capital (USA)</i>												
Czech Republic	42	20	339	207	209	26	-163	-190	314	-0.21	-0.21	0.24
Poland		0	0		2	2		-2	-2		0.00	0.00
<i>Volksbank (Austria)</i>												
Czech Republic	2	11	3	62	47	34	-60	-37	-31	-0.38	-0.18	-0.15
Slovakia	15	15	4	2	44	86	13	-29	-82	0.10	-0.21	-0.64
<i>OPT Hungary</i>												
Slovakia	5	50	62	34	156	0	-29	-106	62	-0.28	-0.92	0.68

Note: When third-party transaction with parent banks were not listed in the annual statements we used instead the transaction with the parent group.

Sources: companies annual statements and Bankscope

Table 8 Subsidiaries off-balance sheet transactions with the parent bank group (in mln euro)

	Contingent assets and commitments			Contingent liabilities and commitments			Net position			to equity		
	2007	2008	2009	2007	2008	2009	2007	2008	2009	2007	2008	2009
<i>SEB (Sweden)</i>												
Estonia	140	42	0	118	0	0	21	42	0	0.02	0.03	0.00
Latvia	0	6	2	0	21	20	0	-15	-18	0.00	-0.04	-0.06
Lithuania	2	2	1	31	18	1	-29	-16	0	-0.05	-0.02	0.00
<i>Unicredit Italiano (Italy)</i>												
Poland	6	1	0	5	0	0	1	1	0	0.00	0.00	0.00
Bulgaria		80	53		0	0		-80	-53		-0.11	-0.06
<i>Commerzbank (Germany)</i>												
Poland	14	165	181	28	159	40	-14	7	141	-0.02	0.01	0.16
<i>AIB (Ireland)</i>												
Poland	132	47	2	132	7	9	0	40	-7	0.00	0.03	-0.01
<i>Millennium (Portugal)</i>												
Poland				124	89	37	-124	-89	-37	-0.23	-0.13	-0.06
Citibank												
Poland		82	52		65	4		17	48	0.00	0.01	0.03
<i>KBC (Belgium)</i>												
Poland	1	14	241	325	452	271	-325	-438	-30	-0.55	-0.60	-0.05
Hungary	58	6	12	57	53	39	-1	47	27	0.00	0.06	0.04
Czech Republic	16	38	29	3	3	2	-13	-35	-27	-1.07	-0.02	-0.01
<i>Deutsche Bank (Germany)</i>												
Poland	35	69	77	24	7	3	11	62	74	0.06	0.36	0.49

<i>Raiffeisen Bank (Austria)</i>												
Slovakia	15	36	20	23	26	36	8	-11	16	0.02	-0.02	0.02
Czech Republic	214	61	25	1	2	28	-213	-59	3	-0.81	-0.13	0.01
Hungary	0	15	36	0	0	0	0	-15	-36	0.00	-0.02	-0.07
<i>Volksbank (Austria)</i>												
Slovakia	13	15	10				13	15	10	-0.12	-0.10	0.01
Czech Republic	291	127	64	1	0	0	-290	-127	-64	-0.22	-0.07	-0.04
<i>Dexia (Belgium)</i>												
Slovakia	45	10	10	0	0	200	-45	-10	190	-0.50	-0.11	1.50
<i>Erste Bank Group (Austria)</i>												
Czech Republic	0	47	0	1	0	0	1	-47	0	0.00	-0.02	0.00
Romania					436	530		436	530		0.27	0.31
<i>Société Générale (France)</i>												
Bulgaria	85	282	48	44	149	133	-41	-133	85	-0.35	-0.94	0.48
Romania	40	49	96	0	0	0	-40	-49	-96	-0.04	-0.04	-0.07
<i>Eurobank EFG Group (Greece)</i>												
Bulgaria		0	1		0	2		0	1		0.00	0.00
<i>Intensa SanPaolo (Italy)</i>												
Hungary	0	0	0	0	0	0	0	0	0	0.00	0.00	0.00
<i>Bayerische Landesbank (Germany)</i>												
Hungary	4	8	8	0	0	0	-4	-8	-8	0.00	-0.01	-0.01
<i>OTP Bank (Hungary)</i>												
Bulgaria	27	27		3	6		-24	-22		-0.05	-0.03	

Sources: companies annual statements and Bankscope

Table 9 Parent bank's and its subsidiaries dividend payments (in millions of euro)

	Equity			Net income			Dividends		
	2007	2008	2009	2007	2008	2009	2007	2008	2009
<i>Citigroup</i>	77,167	103,487	107,576	2,457	-19,892	-1,049	7,291	4,347	25
Belgium	316	269	263	194	-47	-6			
Ireland	1,427	2,507	3,525	328	472	516			
Poland	1,563	1,365	1,510	230	146	123	173	0	120
United Kingdom	2,470	2,876	3,829	252	-94	-644	0	49	
<i>Unicredit</i>	62,465	58,240	62,892	6,678	4,529	2,035	3,431	0	550
Austria	15,334	14,237	14,388	2,364	1,284	1,153	808	808	0
Germany	23,638	23,024	23,998	5,866	-649	884	402	0	1,633
Poland	4,114	3,891	4,474	603	859	603	702	0	185
<i>Erste Bank Group</i>	11,403	11,095	14,943	1,550	1,039	977	295	309	347
Slovakia	733	802	782	138	142	31	53	65	
Czech Republic	2,150	2,428	2,398	465	586	447	171	576	172
Romania	1,346	1,611	1,561	258	516	205	102	94	192
Malta	140	138	134	13	11	7	12	13	7
<i>ING Bank</i>	27,195	24,121	31,217	3,701	703	543	1,300	4,250	
Belgium	8,776	9,480	10,554	1,161	905	1,241		348	
Poland	1,071	11,014	1,190	178	108	145	42	0	
<i>KBC</i>	18,487	15,376	17,177	3,403	-2,379	-2,547			
Hungary	815	740	777	144	99	37	115	112	27
Ireland	1,000	937	1,031	137	103	92	117		
Bulgaria	101	107	101	30	4	1			
Poland	635	642	630	109	79	8	39	0	0

<i>Raiffeisen Bank</i>	8,422	7,837	10,308	1,190	432	571			
Poland	477	611	686	94	88	36	42	38	47
Bulgaria	287	452	467	61	70	23		70	23
Romania	434	543	518	88	156	69		11	57
Slovenia	59	62	72	8	3	0			
Slovakia	592	663	808	114	131	95	63		
Hungary	599	599	536	110	56	-14	28	37	44
<i>SEB</i>	8,126	7,703	9,722	1,445	926	115	432	410	0
Lithuania	582	658	440	148	76	-412	0	0	0
Estonia	523	572	477	131	50	-88	0	0	0
Latvia	354	399	311	108	43	-183	0	0	0
Denmark	308	315	304	23	34	23			

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Sources: companies annual statements and Bankscope

Table 10 Subsidiaries income and expenses related to parent bank group transactions (in mln euro)

	Income			Expenses			Net parent bank			to profit/loss before taxes		
	2007	2008	2009	2007	2008	2009	2007	2008	2009	2007	2008	2009
<i>Swedbank (Sweden)</i>												
Estonia	48.8	61.7	5.2	402.9	583.2	314.1	354.1	521.5	308.9	0.661	1.234	(0.312)
<i>SEB (Sweden)</i>												
Estonia	7.4	11.3	10.3	96.1	114.3	68.8	88.7	103.1	58.5	0.680	1.898	(0.641)
Latvia	12.4	14.4	6.2	73.0	91.4	56.3	60.6	77.1	50.1	0.473	1.533	0.232
Lithuania	5.7	14.3	4.3	123.2	190.1	147.3	117.6	175.8	143.0	0.709	2.035	(0.288)
<i>ING Bank (Netherlands)</i>												
Poland	55.0	49.7	-2.5	27.3	17.4	15.3	-27.7	-32.3	17.8	(0.133)	(0.217)	0.091
<i>Unicredit (Italy)</i>												
Poland	3.3	7.5	1.1	3.6	5.8	4.5	0.2	-1.6	3.4	0.000	(0.001)	0.004
Slovakia	1.6	1.1	0.1	23.8	33.3	18.9	22.2	32.2	18.8	0.454	0.362	0.211
Czech Republic	24.6	38.5	20.5	25.8	26.0	6.6	1.1	-12.5	-13.9	0.007	(0.054)	(0.109)
Bulgaria	9.5	5.3	3.9	9.8	36.8	30.5	0.3	31.4	26.6	0.002	0.189	0.236
Romania	6.9	23.5	25.8	83.6	553.1	630.9	76.7	529.6	605.1	0.800	4.519	6.663
<i>Commerzbank (Germany)</i>												
Poland	6.8	10.2	3.4	65.0	145.2	123.3	58.2	135.1	119.9	0.231	0.511	2.166
<i>AIB (Ireland)</i>												
Poland	14.4	-82.6	20.1	10.4	26.0	16.6	-4.0	108.6	-3.5	(0.011)	0.339	(0.011)
<i>Millennium (Portugal)</i>												
Poland	0.0	0.9	14.0	1.2	0.2	13.2	1.2	-0.7	-0.7	0.007	(0.005)	(1.828)
<i>Citigroup (USA)</i>												
Poland	26.0	30.0	12.6	18.2	19.2	6.8	-7.8	-10.9	-5.7	(0.028)	(0.054)	(0.033)
Ireland	498.7	430.9	265.7	108.7	160.9	74.2	(390.0)	(270.0)	(191.4)	(1.040)	(0.491)	(0.318)

<i>KBC (Belgium)</i>												
Poland	3.1	2.0	9.5	27.0	46.9	28.7	66.1	94.0	61.5	0.498	0.845	4.987
Hungary	6.4	7.9	1.9	26.7	48.9	45.0	20.3	41.1	43.1	0.102	0.248	0.712
Czech Republic	5.1	23.7	31.0	90.2	69.4	20.2	85.1	45.7	-10.8	0.170	3.051	(0.014)
<i>Deutsche Bank</i>												
Poland	65.6	22.9	8.6	14.8	24.2	0.6	-50.8	50.5	-8.0	(1.532)	2.004	(0.221)
<i>Erste Bank Group (Austria)</i>												
Slovakia	1.2	4.9	14.5	7.7	27.9	5.8	7.1	27.5	-11.7	0.054	0.183	(0.228)
Czech Republic	61.4	-160.7	153.7	13.3	19.7	12.7	-48.2	180.4	-141.0	(0.086)	0.242	(0.246)
Romania	0.6	240.0	770.4	52.5	136.0	532.8	51.9	-104.0	-237.6	0.165	(0.165)	(0.779)
<i>Intensa SanPaolo (Italy)</i>												
Slovakia		6.7	8.1		19.1	20.7		8.8	9.7		1.415	0.060
Hungary				9.9	42.1	35.1	9.9	42.1	35.1	0.060	0.262	1.028
<i>Raiffeisen Bank (Austria)</i>												
Slovakia	2.0	3.5	5.6	1.5	7.7	2.2	1.4	-0.1	-3.4	0.011	(0.000)	(0.028)
Czech Republic	2.8	3.9	1.9	9.3	12.8	23.9	6.4	8.8	22.1	0.159	0.134	0.230
Hungary		8.2	2.2		59.7	31.7		50.9	27.7			
Bulgaria	11.4	17.0	5.8	10.4	12.8	7.9	-1.0	-4.2	2.0	(0.015)	(0.054)	0.080
<i>Dexia (Belgium)</i>												
Slovakia	6.2	4.4	8.3	11.9	17.8	14.8	5.8	13.4	6.6	0.383	(0.152)	(0.412)
<i>OPT (Hungary)</i>												
Slovakia	34.1	195.3	7.2	67.3	78.0	2.6	33.3	-117.3	-4.5	0.117	(0.322)	0.178
Bulgaria	15.1	2.3	3.0	13.2	22.6	8.1	-2.0	20.3	5.0	(0.018)	0.133	0.051

<i>Volksbank (Austria)</i>												
Slovakia	0.3	0.2	0.1	0.6	1.4	0.8	0.4	1.2	0.7	0.033	0.079	(0.096)
Czech Republic	0.4	0.8	0.2	3.3	3.4	1.9	3.0	2.6	1.7	0.179	0.158	0.160
Romania	0.0	0.0	0.0	46.7	117.4	65.0	46.7	117.4	65.0	7.826	2.992	1.271
<i>Société Générale (France)</i>												
Czech Republic	312.4	606.4	565.8	318.5	682.3	516.5	6.2	75.9	-49.4	0.012	0.117	(0.096)
Bulgaria	0.4	1.7	1.5	3.2	14.8	12.7	2.8	13.2	11.2	0.150	0.646	0.997
Romania	4.4	133.0	3.6	47.0	83.7	46.4	42.5	-49.3	42.7	0.117	(0.102)	0.125
<i>GE Capital (USA)</i>												
Czech Republic	10.9	13.0	26.0	24.6	40.5	30.6	13.7	27.5	4.6	0.123	0.198	0.044
<i>Eurobank EFG (Greece)</i>												
Bulgaria							0.8	15.9	1.9	0.014	0.230	0.061
Romania	-21.7	19.8		69.7	113.5		91.4	93.7		2.294	22.404	
<i>Bayerische Landesbank (Germany)</i>												
Hungary	0.6	0.6	2.6	13.7	88.4	8.3	13.1	87.8	5.8	0.157	2.648	0.267
<i>Piraeus (Greece)</i>												
Bulgaria	2.4	4.2		20.2	47.3		17.8	43.1		0.594	1.303	
<i>National Bank of Greece (Greece)</i>												
Bulgaria	0.0	0.0	0.0	6.3	57.7	45.5	6.3	57.7	45.5	0.060	0.513	0.997

Sources: companies annual statements and Bankscope

Table 11 Intra-group acquisitions of banks subsidiaries and branches in millions of euro

Year	Parent Bank	Acquirer	Vendor	Target	Shares	Deal Value
2010	OTP	Hungary		Romania	100%	
2010	ING	Poland		Poland		2.54
2010	Commerzbank	Poland	Germany	Poland	100%	2.54
2009	KBC	Belgium	Czech Republic	Slovakia		484
2009	Swedbank	Estonia		Lithuania	100%	
2008	Swedbank	Sweden	Estonia	Russia	85%	
2007	OTP	Hungary		Ukraine	100%	32.88
2007	Unicredit	Poland	Germany	Ukraine		84.28

Sources: companies annual statements and Zephyr database