Crisis Transmission in the Global Banking Network

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March 30, 2014

Abstract

To shed light on the role of bank linkages in the transmission of financial shocks worldwide, we construct a global network of interbank exposures created through syndicated loans. We then study the impact of direct and indirect exposures to crises on bank profitability. We perform the analysis in a panel of over 2,000 banks from 88 countries spanning the 1997-2010 period. We find that larger direct exposures to banks in crisis countries reduce bank profitability. Larger indirect, higher-degree, exposures to banks in crisis countries have the same effect. We also find that a bank’s level of interconnectedness in the network – whether it is a “key intermediary” in that it borrows from and lends to many other banks – reduces its profitability during home country crises. Our results underscore the importance of bank linkages for the spread of financial contagion.

JEL classification: F34, F36

Keywords: contagion, financial networks, interbank loan syndication market, systemic banking crises

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1 Introduction

In the wake of the global financial crisis much attention has been devoted to the role of bank linkages in the transmission of financial sector shocks. Policy-makers argue that their complexity has grown significantly in recent years and has contributed to the severity of the global financial crisis (Dudley, 2012; Haldane, 2009; Tumpel-Gugerell, 2009). A related academic literature emphasizes the role of financial sector complexity in generating panics and deepening crises (Caballero & Simsek, 2009, 2013). We contribute to this literature by analyzing the transmission of financial crises through the global banking network. Our empirical approach, based on loan transaction data among banks in a large number of countries, allows us to examine the role of several channels of crisis transmission. These are direct and indirect exposures to financial institutions in crisis countries as well as banks’ degree of interconnectedness in the financial network.

The 2008-2009 crisis brought to the fore the challenges faced by economic agents, especially financial institutions, of operating in a complex macroeconomic environment. Following the bankruptcy of Lehman Brothers, a highly interconnected institution, financial markets shut down, triggering a credit crunch and recession. In the wake of the crisis there have been new efforts to strengthen regulation, in particular for those banks that are so interconnected that their failure may pose systemic risk. To better understand the nature and consequences of interconnectedness we identify several channels through which banking crises are transmitted internationally. We seek to determine whether direct exposure to borrowers in countries that experience a crisis, indirect connections with them, and the position of banks in the global banking network during crises and tranquil times explain bank profitability.

Our results suggest that the global banking network acts as a conduit for the spread of financial crises. We find that larger direct exposures to borrowers, especially banks, in crisis countries have a negative impact on bank returns. We also find that indirect (higher-degree) linkages to banks in crisis countries reduce bank profitability. We then test whether banks’ degree of interconnectedness
in the global banking network has an effect on their performance. In doing so, we focus on a particular type of centrality to identify important “intermediaries” in the network. These are banks that borrower from and lend to large numbers of banks, thus intermediating flows and connecting groups of banks in the network. Key intermediaries tend to connect global banks that are highly centric in the network with peripheral ones. We find that key intermediaries have similar returns to other banks during normal times, but fare significantly worse during periods of financial stress in their home countries.

To map international financial linkages and study the transmission of crises, we use loan-level data on loan syndications arranged by lenders in 88 countries to borrowers in 141 countries. These linkages refer to exposures created through syndicated lending to financial and non-financial firms, with the former as our main focus. The syndicated loan market is an important source of funding for corporates and sovereigns, as well as for financial institutions, especially banks. Total deal volume reached USD 4.3 billion at the peak of the market in 2007, of which about 10 percent represented lending to banks. In recent years, Turkish banks have notably tapped the international bank loan market to broaden their sources of funds. These loans have typically been oversubscribed, with many international banks eager to gain exposure to Turkish assets and build relationships with Turkish banks. Other major borrowers in this market include banks from the Japan, Hong Kong SAR, Thailand, and the UK.

Using data on interbank syndicated loan deals, we construct a bank-level financial network to which we refer as the “exposures global banking network” (EGBN). This is a standard counterparty network: edges represent interbank exposures (i.e., the stock of syndicated loan claims outstanding at a given point in time) and the nodes are banks. The EGBN is a directed network – in constructing loan exposures we focus on lending relationships, and in defining key intermediaries we look at banks that act both as borrowers and lenders. Based on the EGBN we construct measures of direct and indirect linkages among some 5,500 banks as well as bank-level indicators of interconnectedness.
An important step in our analysis is to link information on syndicated lending with banks’ financial data, which we are first to accomplish in a systematic fashion for a very large sample of banks.\(^1\) By combining measures of connectivity in the EGBN with bank financial data, we obtain a rich bank-level panel dataset spanning the 1997-2010 period. We then study the effect of direct and indirect linkages in the EGBN on bank profitability during crisis and tranquil years in the countries to which the banks are exposed. For the baseline regressions, our measure of bank profitability is return on assets (ROA). Crises are defined as systemic country-wide banking crises as in Laeven & Valencia (2012). We also examine whether a bank’s position in the EGBN as a key intermediary is important in explaining profitability during crises in the bank’s home country and abroad.

In theory, higher financial interconnectedness carries both benefits and risks. More interconnectedness improves risk sharing but can also facilitate contagion. A large body of work following the seminal study of Allen & Gale (2000) investigates the link between network topology (the pattern of relationships connecting economic agents) and the network’s resilience to shocks. Due to the complex nature of real-world network topologies, much of this literature has relied on simulations (see Upper (2011) for a review).\(^2\) Our contribution is to study channels of crisis transmission through the EGBN using observational data rather than simulations.

Our study contributes to a large literature on contagion in financial markets, especially contractual “knock-on” contagion (see Allen et al. (2009) for a survey). In the recent empirical literature there is no consensus regarding the effects of connectivity on macroeconomic performance during crises. Lee et al. (2011) examine the global trade network as a conduit for financial crises, and show that the connectivity of individual countries helps explain the spread of crises above and beyond their macroeconomic fundamentals. Chinazzi et al. (2013) find that countries with high connect-

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\(^1\)Giannetti & Laeven (2012) and de Haas & van Horen (2013) also conduct this match, but only for 256 banks and 117 banks, respectively, as opposed to over 2,000 banks in our sample.

\(^2\)See, for example, Battiston et al. (2009); Castiglionesi & Navarro (2010); Chan-Lau et al. (2009); Cocco et al. (2009); Craig & von Peter (2010); Gatti et al. (2010); Elliott et al. (2012); Garratt et al. (2011); Haldane (2009); Haldane & May (2011); Imai & Takarabe (2011); May & Arinaminpathy (2009); Nier et al. (2007); Sachs (2010); and von Peter (2007).
tivity in the global financial network – defined through cross-country debt and equity investments — experienced a smaller decline in output between 2008 and 2009, and there are nonlinear effects. Caballero et al. (2009) show that countries with banks that are more centric in the global syndicated loans network, such as France and Germany, had better stock market performance during 2007-2008 than countries with more peripheral banks, such as Iceland, Ireland, and Greece. Our findings add to this literature by focusing on banks and using the most granular data available to shed light on the role of financial linkages in the spread of banking crises internationally.

We also contribute to a growing body of work on systemic risk in empirical financial networks constructed from syndicated loan data. Recent studies construct global banking networks in which links arise when banks participate in the same lending syndicate. These “co-syndication” networks capture interconnectedness of banks through common asset exposures. Cai et al. (2012) show that global banks that are active underwriters of syndicated loans and are thus highly interconnected in the co-syndication network contribute more to systemic risk. Bo et al. (2013) show that syndicated loans arranged by highly centric banks in the same network tend to be made to more opaque borrowers. Our approach is different from these studies in that links in the EGBN arise when banks create exposures to borrowers through loan syndications. Therefore, ours is a standard network of interbank exposures that captures contractual interconnectedness rather than common exposures. The EGBN also differs from domestic interbank networks that have been commonly analyzed in the literature in that it has international coverage.

The remainder of the paper is organized as follows. In Section 2 we provide a short description of the interbank syndicated loan market. In Section 3 we present a simple mechanism for contagion in a financial network. Section 4 describes our data and empirical approach. In Section 4 we present our baseline results, a discussion of mechanisms, and robustness tests. Section 5 concludes.
2 A Primer on the Interbank Loan Syndication Market

Syndicated loans are an important source of funds for corporations, sovereigns, and banks worldwide. They are given out by financial institutions organized in lending syndicates, and take the form of credit lines (loan commitments) and term loans. Syndicated loans are larger, have longer maturity, and are more likely to be extended to safer borrowers (Cerutti et al., 2014). During 1997-2010 the largest lenders in the syndicated loan market were banks from the US, UK, Germany, Japan, and France. These countries also account for the largest deal volumes to banks. Over the same period, the largest borrowers in the interbank market were banks from the US, UK, Australia, Hong Kong (SAR), and France. Large emerging market borrowers included the Russian Federation, South Korea, Turkey, India, and South Africa.

Focusing on cross-border transactions only, Cerutti et al. (2014) show that syndicated loan exposures represented about one third of total loan claims in 2012. To estimate the size of the interbank segment of this market, we compare cross-border syndicated loan exposures to banks with BIS loan exposures to banks between 1995 and 2012. For syndicated loan exposures we construct three estimates: (i) an upper bound estimate, which comprises total credit lines and term loans; (ii) an intermediate estimate, which removes undrawn portions of the credit lines; and (iii) a lower bound estimate, which further removes term loans that are more likely to be extended by institutional investors rather than banks. According to these estimates, shown in Figure 1, syndicated loans to banks accounted on average for between 6.7 and 26.7 percent of total loan claims on banking systems during 1995-2012. The intermediate estimate for the period is 12.5 percent.

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3 The rest is accounted for by cross-border bilateral loans and internal capital markets transactions.
4 These are obtained using the methodology outlined in Cerutti et al. (2014).
3 Contagion Mechanism

In this section we describe a simple contagion mechanism in our interbank network. To distinguish exposures in the EGBN from exposures to non-bank borrowers (outside the EGBN), we refer to the former as “network exposures” and to the latter as “non-network exposures.” Assume that bank performance can be measured by $Y$, and let the exposure of bank $i$ to bank $j$ be denoted by $E_{ij}\delta^{(s)}$, where $E$ is either an indicator for the presence of an exposure, or a measure of its intensity, and $\delta^{(s)}$ is the decay factor that depends on the number of steps $s$ between banks $i$ and $j$ in the network. Denote as $C_i$ an indicator for a financial crisis in the country of bank $i$. Suppose bank $i$ has direct exposure $D_{ik}$ to non-bank (non-network) borrowers in country $k$. Omitting the time subscript for simplicity, a contagion mechanism in the banking network can be written as a spatial recursive equation as follows:

$$Y_i = \alpha_i + \beta_1 C_i + \beta_2 \sum_k D_{ik} + \beta_3 \sum_k D_{ik}C_k + \gamma \sum_j Y_j E_{ij}\delta^{(s)},$$  \hspace{1cm} (1)

where $\alpha_i$ reflects all other factors affecting the performance of bank $i$. Equation (1) can be expanded infinitely to obtain an expression for the effects of bank $i$ exposure to borrowers in crisis countries:

$$Y_i = \alpha_i + \beta_1 C_i + \beta_2 \sum_k D_{ik} + \beta_3 \sum_k D_{ik}C_k + \bar{\alpha}\gamma \sum_j E_{ij} + \beta_1\gamma \sum_j C_j E_{ij} + \frac{\bar{\alpha}\gamma^2}{1-\gamma} \sum_j P_{ij} + \frac{\beta_1\gamma^2}{1-\gamma} \sum_j C_j P_{ij}$$

$$+ \beta_2\gamma \sum_j \sum_k D_{jk}E_{ij} + \beta_3\gamma \sum_j \sum_k D_{jk}C_kE_{ij} + \frac{\beta_2\gamma^2}{1-\gamma} \sum_j \sum_k D_{jk}P_{ij} + \frac{\beta_3\gamma^2}{1-\gamma} \sum_j \sum_k D_{jk}C_kP_{ij},$$ \hspace{1cm} (2)

where we assume $\delta^{(1)} = 1$ and $\delta^{(s)} = 1/s$, and $P_{ij}$ is network proximity between banks $i$ and $j$ defined as inverse of the (binary or weighted) network distance between banks $i$ and $j$; $\bar{\alpha}$ is a weighted average of other characteristics that affect performance of banks other than bank $i$; and
Equation (2) shows how the performance of bank \( i \) depends on its direct and indirect exposures to borrowers in countries that are experiencing a crisis. In the empirical analysis we omit terms involving indirect exposures to non-bank (non-network) sectors and leaving us with our main specification:

\[
Y_i = \alpha_i + \beta_1 C_i + \beta_2 \sum_k D_{ik} + \beta_3 \sum_k D_{ik} C_k + \sum_j E_{ij} + \beta_1 \gamma \sum_j C_j E_{ij} + \frac{\alpha \gamma^2}{1 - \gamma} \sum_j P_{ij} + o(\text{indirect non-network exposures}).
\]  

(3)

We can expand equation (4) by explicitly allowing bank performance to be affected by its position in the global banking network – its global connectivity profile – which we denote \( N_i \), as follows:

\[
Y_i = \alpha_i + \beta_1 C_i + \beta_2 \sum_k D_{ik} + \beta_3 \sum_k D_{ik} C_k + \mu N_i + \nu N_i C_i + \gamma \sum_j Y_j E_{ij} \delta(s),
\]  

(4)

where we allow for a differential impact of the bank’s degree of interconnectedness during tranquil and crisis times. This equation, too, can be expanded infinitely with the same set of assumptions and definitions to obtain

\[
Y_i = \alpha_i + \beta_1 C_i + \beta_2 \sum_k D_{ik} + \beta_3 \sum_k D_{ik} C_k + \mu N_i + \nu N_i C_i + \bar{\alpha} \gamma \sum_j E_{ij} + \beta_1 \gamma \sum_j C_j E_{ij} + \frac{\bar{\alpha} \gamma^2}{1 - \gamma} \sum_j P_{ij} + \frac{\beta_1 \gamma^2}{1 - \gamma} \sum_j C_j P_{ij} + o(\text{indirect non-network exposures}).
\]  

(5)

When we estimate equation (5), we find that the network characteristics of other banks do not have statistically significant effects and we can therefore rewrite this equation in a simplified way

\[
C_j \text{ represents an indicator for financial crisis in the country of bank } j, \text{ to simplify notation.}
\]
as
\[
Y_i = \alpha_i + \beta_1 C_i + \beta_2 \sum_k D_{ik} + \beta_3 \sum_k D_{ik} C_k + \mu N_i + \nu N_i C_i + \bar{\alpha} \gamma E_{ij} + \beta_1 \gamma \sum_j C_j E_{ij} \\
+ \frac{\bar{\alpha} \gamma^2}{1 - \gamma} \sum_j P_{ij} + \frac{\beta_1 \gamma^2}{1 - \gamma} \sum_j C_j P_{ij} + \sigma (\text{indirect non-network exposures and other banks’ network chars}).
\]

(6)

We bring this equation to the data in the empirical analysis.

4 Empirical Strategy and Data

4.1 Data sources

We use two main data sources. The first is Dealogic’s Loan Analytics, a database that reports the universe of international syndicated bank loans issued since the early 1980s.\footnote{This implies that our network contains the universe of nodes (banks) that operate in this market during the period of analysis, and does not suffer from econometric problems associated with sampled networks (Chandrasekhar & Lewis 2011).} We obtain information for about 150,000 syndicated loan deals structured in one million tranches that were originated between 1990 and 2010. For each loan we download information on the identities of the borrower and all lending syndicate members, USD loan amount (expressed at constant prices using the US CPI), and loan origination and maturity dates. We then divide loan amounts equally among syndicate participants (for similar approaches, see Kapan & Minoiu (2013); Hale (2012); Giannetti & Laeven (2012)). Using these data we construct, for each year, the EGBN, a counterparty network of syndicated loan interbank exposures. An important caveat is that we only observe loans at origination and do not have data on actual drawdowns on credit lines, liquidation, prepayments, side-arrangements made by lenders to reduce these exposures on their balance sheets, or sales of syndicated credits on the secondary market. While this likely creates noise in our exposure
estimates, it also helps us avoid endogeneity problems we discuss later on. We end up with about 5,500 interconnected banks.

Bank balance sheet data come from Bankscope. We merge the interconnectedness data based on Loan Analytics with balance sheet information from Bankscope manually by bank name and country. To ensure consistency of the dataset, prior to the merge we carefully adjust lender names in Loan Analytics to account for name changes, mergers, and acquisitions. (See Appendix for details.) The final balanced panel dataset comprises 2,066 banks during the 1997-2010 period, although the regression sample contains fewer banks due to missing information on balance sheet variables.

4.2 Empirical specifications

We start with specifications that encompass two types of exposures a bank can form through syndicated lending: network exposures (through loans to other banks, captured in the EGBN) and non-network exposures (through loans to corporations and sovereigns). In this initial set of specifications we link bank performance to exposures vis-a-vis the bank and non-bank sectors in a given country during tranquil and crisis years in that country. Then we further examine the relationship between bank performance and network exposures by separating out direct from indirect linkages. As the former set of regressions are relatively straightforward, in this section we define the variables that enter the latter specifications with direct and indirect network exposures.

The main specification links a bank performance measure $Y_{iht}$ (bank $i$ in country $h$ in year $t$) to systemic banking crises in all countries $d$ ($\text{Crisis}_{d}^{t}$) in year $t$, including $d = h$, through direct exposures of bank $i$ to vis-a-vis banks in country $d$ at the end of period $t - 1$ ($E_{ihd t-1}$), indirect linkages of bank $i$ vis-a-vis banks in country $d$ at the end of period $t - 1$ ($R_{ihd t-1}$), and bank $i$’s individual network position, or degree of interconnectedness, $N_{iht-1}$, in the binary EGBN. These

6Note that our analysis is subject to survival bias, as some of the banks for which ROA is low in a period may fail in subsequent periods. In our setting, survival bias works against us finding results.
variables are formally defined in the next section.

For each bank we compute direct and indirect linkages in year $t - 1$ to borrowers in countries that are experiencing systemic banking crises at time $t$ and to countries that are not experiencing crises. We also interact bank’s overall network position measure with an indicator for banking crises in the bank’s home country and the total number of countries outside the bank’s home country. The most complete specification regressions are estimated using OLS as follows:

$$
Y_{iht} = \alpha_h + \alpha_t + \beta_1 \sum_{d=1}^{D} E_{ihtd-1}I(Crisis_{dt} = 0) + \beta_2 \sum_{d=1}^{D} E_{ihtd-1}I(Crisis_{dt} = 1) + \gamma_1 \sum_{d=1}^{D} R_{ihtd-1}I(Crisis_{dt} = 0) + \gamma_2 \sum_{d=1}^{D} R_{ihtd-1}I(Crisis_{dt} = 1) + \delta_1 N_{iht-1} + \delta_2 N_{iht-1}I(Crisis_{ht} = 1) + \lambda Z_{iht} + \epsilon_{iht},
$$

where $Z_{iht}$ are bank-specific control variables and we control for bank nationality fixed effects $\alpha_h$ and year fixed effects $\alpha_t$. Identification in these specifications thus comes from variation in connectivity across banks in a given country and within banks over time. We allow for the impact on bank performance of systemic banking crises to be instantaneous, but exposures and network measures are lagged one period to avoid direct reversed causality. In all regressions the standard errors are clustered at the bank level to exploit residual serial correlation in the errors.

An important econometric issue facing our specification is endogeneity. This can arise because banks may liquidate assets and reduce exposures in response to past or expected future performance-related shocks, leading to a problem of reversed causality. The imperfection of our data here plays in our favor. Our data refer solely to loan origination, not loan liquidation, actual drawdowns, nor prepayment. Thus, the only way in which endogeneity would affect our results is through changes in the pattern of new loan origination, but not through changes in the rest of the loan portfolio. Furthermore, the endogeneity problem is less of a concern when it comes to the network-based global connectivity indicator $N$ because it is determined not only by the actions of each bank $i$
but also by the actions of all the other banks in the network. Lagging the main covariates further reduces the possibility that the results are driven by the acquisitions of soon-to-fail assets.

4.3 Variable definitions

We consider the following outcome variables $Y$: ROA for the benchmark results and ROE for robustness tests. When we explore mechanisms we use loan net charge-off rates (NCO). Our control variables include measures of bank leverage (equity/assets), size (log-assets), indicators for the type of entity (controlled subsidiary, global ultimate owner, or other), and bank specialization (commercial banks, bank-holding companies, and other).

Direct and indirect linkages are based on syndicated loan exposures. For each loan we have the amount extended, the signing date, and the maturity date. We use loan amounts and maturity to construct bank-to-bank syndicated loan exposures. Direct exposures $E$, indirect exposures $R$, and the indicator of global connectivity $N$ are described below. We compute two types of direct exposures based respectively on the weighted and binary EGBN.

$E_{ihdt}$: Direct dollar exposures of bank $i$ vis-a-vis banks in country $d$ at the end of period $t$. This measure is also known as out-strength and reflects a bank’s local centrality measured by the intensity of its out-going connections.

$E_{ihdt}^{01}$: Direct “binary” exposures computed for each year $t$ as the number of banks in country $d$ to which bank $i$ has loans outstanding. This is also known as out-degree and reflects a bank’s local centrality measured by the number of its out-going connections.

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7 The “Other” category includes branch locations, independent companies, and single location banks.
8 The “Commercial banks” category includes cooperative banks, saving banks, real estate and mortgage banks, and other credit institutions. The “Other” category includes finance companies (credit card, factoring and leasing), investment and trust corporations, investment banks, securities firms, private banking and asset management companies, and group finance companies.
9 These are computed using the SGL Stata routine developed by Miura (2011).
\[ R_{ihdt} = \sum_{j \in d} 1/D_{ijdt} - E_{iht}^{01} \]: Indirect linkages of bank \( i \) vis-a-vis banks in country \( d \) at the end of period \( t \). This measure is computed for each bank \( i \) as the inverse of network distance \( D \) to all other banks in the network. (The inverse of network density is also called “network proximity.”) We define network distance between two nodes as the length of the shortest path between these two nodes in the binary EGBN. If two nodes are connected directly, the distance is 1. If there is no path connecting the two nodes, the distance is set to a large number exceeding network diameter (the longest distance between connected nodes). These are computed as the sum of network proximities of bank \( i \) to all banks in country \( d \) in the binary EGBN, excluding direct (or one step away) linkages. This measure reflects all indirect connections based on interbank exposures.

\( N_{ih,t} \): Bank \( i \)’s individual network position, or global connectivity profile \( N_{ih,t} \), in the binary EGBN in year \( t \). This refers to betweenness centrality, which is the number of bank pairs that are only related through a given bank \( i \). Formally, betweenness centrality is defined as the number of bank pairs that do not include bank \( i \), for which the shortest path (or one of the shortest paths) goes through bank \( i \), divided by the total number of bank pairs that do not include bank \( i \) in the EGBN. In the analysis we use an indicator variable for banks with positive betweenness centrality, to which we refer as key intermediaries because they tend to connect groups of banks in the EGBN.

### 4.4 Summary statistics

Summary statistics for all the variables used in the analysis are shown in Table 1. Our sample mainly comprises commercial banks (accounting for 78 percent of all banks), and 42 percent of all banks are controlled subsidiaries. Sample ROA is 0.86 on average and ranges between -6.57 and 8.26. As shown in Figure 2, both bank profitability and leverage (measured as the ratio of assets to equity) have trended upward before the global financial crisis and have experienced a sharp
correction during the crisis.

The middle portion of Table 1 summarizes our direct non-network exposures, and direct and indirect network exposures. Direct exposures refer to either the dollar amount of outstanding exposures (based on the weighted EGBN) at 2005 prices or the number of counterparties in the syndicated loan market (based on the binary EGBN). The average bank has USD 20.52 billion in total exposures vis-a-vis borrowers in non-crisis countries and US 3.22 billion vis-a-vis borrowers in crisis countries during 1997-2010. Of the USD 21 billion in total exposures to non-crisis countries, almost USD 17 billion are non-network exposures and the remaining 4 billion are network ones. Similarly, of the USD 3 billion worth of syndicated loan exposures vis-a-vis borrowers in crisis countries, USD 2.75 are vis-a-vis non-banks, and USD 500 million are vis-a-vis banks.

Focusing on bank linkages in the binary EGBN, the average creditor bank has network claims vis-a-vis 6 borrowing banks in crisis countries; the maximum out-degree is 240 for crisis countries and 105 for non-crisis countries. The distribution of the direct exposure measures, both weighted and binary, is heavily skewed — a common property of edge weight and degree distributions in empirical financial and trade networks (see Chinazzi et al. (2013) and Fagiolo et al. (2010)). For indirect exposures, a higher value indicates a lower distance, in network terms, to banks in crisis and non-crisis countries. Finally, we notice that 5 percent of the banks in the EGBN are key intermediaries.

Figure 3 depicts the loan origination volume and the total number of connections in the EGBN over the period of analysis. The total lending volume in the syndicated interbank market peaked at almost USD 400 billion in 2007 before collapsing by almost half by 2009. Network density ranges between 0.02 percent in 1997 and 0.14 percent in 2012, which makes for a relatively sparse network compared with a domestic interbank market. Gabrieli (2011) documents a density of 0.3 percent for the Italian interbank market, while Alter et al. (2014) find a density of 0.7 percent for the German interbank market. A visualization of the EGBN for the largest 100 banks is provided in Figure 4.
4.5 Preliminaries: Bank ROA during systemic banking crises

Before presenting our main empirical results, let us establish that bank profitability suffers during crises in a bank’s home country, as well during crises abroad.

In Table 2 (Panel A) we report results of panel regressions where bank ROA is regressed on an indicator for systemic banking crisis in the bank’s home country, with and without a comprehensive set of controls (these include bank country and year effects, interactions between the two to control for country-specific trends in bank ROA, and other bank-level controls such as size and equity-to-assets ratio.) The estimates indicate that bank ROA is lower by between 0.7 and 0.9 for banks in countries experiencing a crisis compared to banks in countries experiencing a tranquil period; this is a non-negligible half a standard deviation of ROA. We control for crises in banks’ home countries in all subsequent regressions.

What happens to bank ROA when there are crises outside the bank’s domestic market? In Panel B we repeat the same regressions but add the “number of crises elsewhere” as a second variable of interest. We find that bank profitability is lower the more crises occur outside the bank’s home country in any given year, which signals the possibility of contagion. In a given year in which 10 foreign countries experience crises, a bank’s ROA falls by a further 0.3-0.4, representing one quarter of a standard deviation. In a severely adverse scenario such as the global financial crisis, a bank that is located in a crisis country will have experienced a total decline in ROA of three quarters of a standard deviation if 10 other countries experience a crisis simultaneously.

5 Results

We now examine the effects of crises in foreign countries on banks’ returns to determine if contagion spreads through bank linkages. We begin by estimating a specification similar to equation (7) that links bank performance to total direct exposures vis-a-vis borrowers in crisis and non-crisis
countries, and then splits these exposures by sector: banks vs. non-banks. Since our goal is to study how systemic banking crises spread through the EGBN, we then separate network exposures into direct and indirect linkages. Finally, we turn to the performance of key intermediaries during financial crises.

5.1 Bank-level exposures to crisis countries

Table 3 shows regressions in which the covariates of interest are syndicated loan exposures in USD vis-a-vis all borrowers (columns 1-3) and by sector (columns 4-7). We also examine heterogeneity in the identified effects for banks with large interbank exposures vs. other banks. To do so, we split the same into some 500 “top” banks with above-median interbank exposures and the remaining “bottom” banks. (The sample correlation between the indicator for above-median interbank exposures and that for above-median total assets is 0.449.) Column 1 shows that direct linkages to borrowers in crisis countries negatively affect bank performance (column 1). This effect is driven by banks with smaller interbank exposures (column 3). An increase in total exposures from 0 to USD 35 billion (the maximum value observed in the sample – for Deutsche Bank in 2007), reduces bank ROA by 0.003*35=0.105. As expected, exposure to borrowers in non-crisis countries does not affect bank ROA.

In columns 4-7 we focus on the impact of network exposures. We find that on their own, interbank exposures reduce ROA when banks are exposed to countries experiencing systemic banking crises. This result holds when we also control for non-bank exposures (column 5). For the top banks, the coefficient on network linkages to crisis countries remains negative and statistically significant, while that on non-network linkages loses statistical significance. For the banks with below-median interbank exposures the coefficient of interest is still negative, but imprecisely estimated; in addition, non-bank exposures to crisis countries hurt ROA of “bottom” banks.

Taken together, these results suggest that despite being smaller in dollar value, interbank expo-
sures to counterparties experiencing systemic banking crises act as a more powerful channel of shock transmission than exposures to other sectors of the economy. This is not surprising as systemic banking crises take a while to transform into recessions, and even when they do, the intensity of the recessions can vary across countries.

In Table 4 we focus on crisis transmission solely through the EGBN. The question we ask is whether the number of connections to banks in crisis countries (out-degree) affects bank profitability once we control for the USD value of exposures (out-strength). To avoid problems of collinearity between out-strength and out-degree, especially for top banks, our control variable is given by total (rather than distinct bank and non-bank) exposures. We add to the specification direct exposures computed from the binary EGBN, representing the number of counterparties in crisis and non-crisis countries. The estimated coefficient on out-degree is negative and statistically significant – both in the full sample and for top banks (columns 1-2). The more direct linkages a bank has to banks in other countries, the worse its performance is when those countries experience a financial crisis.

To evaluate the magnitude of the effect in column (1), let us compare a bank that is not exposed to crisis countries to one that is exposed to 40 banks in crisis countries (as was ING in the latter years of our sample). Holding everything constant, the bank with no exposure will have an ROA that is higher by 0.017*40=0.68 than the bank with heavy exposure. Although this effect is less than half a standard deviation of ROA, it is large when we consider the size of losses it implies for a moderately-sized bank (the average bank in our dataset has total assets of USD 100 billion in 2010).

Several considerations should be kept in mind as we interpret these coefficient magnitudes. First, banks may recognize the contagion mechanism and create links to mitigate it, such that they create a network that is stable. This possibility would work against us finding an effect of financial linkages on bank profitability despite the existence of contagion risk. Second, banks do not always retain the originated loans on their balance sheets. Credit lines become on-balance sheet exposures only
to the extent that they are drawn. Furthermore, banks can reduce their exposures after origination through side-deals and sales in the secondary market (see next section for a discussion). Third, banks can hedge their exposures, for instance, by trading credit derivatives. All these factors are likely to reduce the magnitudes of our estimated coefficients.

To further understand how financial crises spread through the EGBN, in columns 4-6 of Table 4 we add to the direct exposure variables a measure of *indirect* connections to banks in crisis and non-crisis countries. The number of counterparties from crisis countries continues to have a negative effect on bank ROA despite the inclusion of this new variable (column 4). As expected, indirect, higher-degree, linkages to crisis countries also reduce bank performance – the coefficient is negative and statistically significant at the 10 percent level in the full sample, but loses significance for the top banks (column 5). This result suggests that shocks may travel along chains of banks to impact their profitability. Such shocks affect not only the financial performance of a bank’s immediate lenders, but also that of the lenders to that bank, the lenders to the lenders of that bank, etc.

To summarize, there are two main takeaways from the results in Tables 3-4. First, direct financial linkages to banks in crisis countries, captured by outstanding loan claims in USD terms, reduce bank profitability. Controlling for dollar exposures, the number of counterparties in crisis countries also reduce bank ROA, which suggests that diversification across financial partners turns into vulnerability when a large number of these partners are in turmoil. Second, crises spread through the global banking network through indirect linkages as well. Cascades of defaults could be generated through these linkages if banks that are exposed to crises become subject to runs and their home banking systems go into a systemic crisis. The magnitudes of the direct effects that we find are seemingly not very large, but are not trivial either given the size of bank balance sheets in modern financial systems.
5.2 Mechanisms

Our baseline findings suggest that there is crisis transmission through network exposures, in that loan exposures to crises, and hence potential losses, worsens bank performance. What are the mechanisms behind this result? The most obvious channel are losses incurred through borrower defaults, caused, for instance, by bankruptcies (in our case, bank failures). In exploring this channel, it is useful to note that syndicated loans differ from standalone loans in that they are more likely to be extended to relatively safer borrowers \cite{Cerutti2014}. As a consequence, the loan syndication market exhibits lower default rates (especially for financial institutions) and higher loan recovery rates than other segments of the credit market. Furthermore, defaults in this market typically trigger renegotiation that results in an amendment to extend the maturity of the loan. Outright default can lead the syndicate members to accelerate the loan and force the borrower into bankruptcy, but such instances are rare. At the height of the global financial crisis in 2009, the most popular practice were loan renegotiations.

With these caveat in mind, defaults caused by borrower bankruptcies are a potential mechanism explaining our results. (We are currently examining data on borrower bankruptcy filings to empirically document this mechanism.) To explore this channel, we replace the dependent variable with loan net charge-off rates representing the difference between gross charge-offs and recoveries on delinquent loans, expressed in percentage of total assets. The results, shown in Table 5, show that higher exposures to countries that are not experiencing a crisis are associated with lower charge-off rates. This evidence, however, is weak as coefficients on exposures to crisis countries are not statistically significant\footnote{During 2011-2012, loan default rates were 2 percent. Over five years, the default rate for firms rated AAA was 0.38 percent while that for firms rated B was 21.76 percent during 1981-2010. Loan recovery rates have been 71 percent compared to 43.5 percent for unsecured lending during 1989-2009, \cite{StandardPoor2011}.}

\footnote{In specifications not reported, we also examined the impact of syndicated loan exposures on non-performing loans and loan-loss reserves, but did not find strong results, likely because of the lack of comparability of these variables across banks and countries due to differences in accounting and reporting rules. Another channel we investigated, but did not find support for with aggregate data, were net interest margins, which may be squeezed when banks are}
A second potential mechanism are losses that banks may incur in their portfolio of securities. This occurs when banks place their syndicated credits in the securities book and hence mark them to market using secondary market pricing. This is more likely to happen for high-yield loans for which there is an active secondary market. To the extent that these loans are designated as “held for trading,” realized incomes and gains would affect net income and hence ROA. Aggregate balance sheet data are unfit for a test of this mechanism because variables such as the change in the USD value of trading securities, reported in Bankscope, are contaminated by exchange rate changes. (We are currently gathering data on the secondary market prices of high-yield syndicated loans to test this channel.)

One reason why it may turn out difficult to provide robust evidence of mechanisms using data from the loan syndication market may be that our loan exposures capture lines of business that go beyond this market. Such exposures would arise, for instance, from standalone lending and ancillary business such as cash management and advisory services. A high correlation between syndicated loan exposures and other exposures is possible because when banks decide to extend a loan, they not only consider the yield that comes from that loan, but that from the entire loan portfolio to that borrower as well as other sources of revenue from that relationship. Anecdotal evidence suggests that borrowers in the syndicated loan market often use the same underwriters for bond and equity issuances, and may conduct other fee generating business for banks from their lending syndicates (Standard & Poor’s 2011). This means that loss of income due to crisis risk could be related to banking services other than loan syndications.

5.3 Bank-level global network connectivity

We build on our previous findings to also study the effects on bank performance of global bank connectivity in the EGBN. The connectivity measure refers to betweenness centrality, a concept exposed to crises due to higher funding costs.
that helps us identify key intermediary banks in the EGBN. Key intermediaries are banks that tend to lie “at the crosroads” by linking groups of banks in the network to one another, or the more centric banks in the network to peripheral banks. There were 109 banks with positive betweenness centrality in the 2010 EGBN, roughly equally split between advanced economies and emerging market countries. Selected key intermediaries in the 2010 EGBN are listed, for the top countries, in Table 6. For illustration, two of them – Commonwealth Bank of Australia and Arab Bank Plc of Jordan – are shown in Figure 5 along with their borrowing and lending relationships. As seen from these two cases, key intermediaries tend to borrow from large global banks and lend to banks in domestic and regional markets.

In Table 7 we examine the effect of being a key intermediary on bank ROA during crisis and normal times. We control for direct and indirect linkages (as in column 4 of Table 4) and add an indicator for key intermediaries in the EGBN. We also include interactions between this variable and an indicator for systemic banking crises in the bank’s home country as well as the number of systemic banking crises in foreign countries.

Note first that the effects of direct exposures (in particular out-degree) from our benchmark regressions hold up in these richer specifications, although the coefficient estimates on indirect exposures have the expected sign, but are less precisely estimated. The estimates in column 1 indicate that key intermediaries have lower ROA compared to other banks. From columns 2-3 we see that this effect is driven by key intermediaries having significantly lower ROA (by 0.5 percentage points) than other banks during financial crises at home. This effect is almost double for banks with below-median interbank exposures, and still negative but statistically insignificant for banks with above-average interbank exposures (columns 4-5). In other words, there is a significant profitability sacrifice associated with being a key intermediary when the domestic market experiences a crisis, especially for banks with below-median interbank exposures, for which the estimated effect is 1 percentage point of ROA (p-value of equality with -1 is 0.814).
A possible mechanism behind this effect are creditors being unwilling to refinance the key intermediary’s loans coupled with large drawdowns by its borrowers during banking crises at home. The effect is stronger for banks with below-median interbank exposures, which tend to be smaller banks from emerging market countries. This is not surprising as emerging markets are more susceptible to sudden stops during financial crises. Sudden stops can increase the vulnerability of key intermediaries to funding shortages to the extent that these banks use syndicated loans as a significant source of funding.

5.4 Robustness

We subject our findings to several robustness tests in Table 8. In columns 1-3 we replicate the specification in column 4 of Table 4. The remaining columns refer to specification 3 in Table 7. For both specifications we perform three checks: (i) using ROE instead of ROA as the measure of bank performance; (ii) double-clustering the standard errors on bank and year (rather than on bank); and (iii) dropping all the banking entities in Citigroup, as they tend to be very active in the syndicated loan market and we want to make sure they are not driving our results. As seen in Table 8, our results are qualitatively robust, although the coefficients are sometimes less precisely estimated than in our baseline regressions. In particular, indirect exposures have a statistically significant coefficient in only 3 of 6 specifications.

6 Conclusions

In this paper we aim to better understand the role of bank linkages in the transmission of financial sector shocks worldwide. In particular, we examine how systemic banking crises spread through a counterparty network created by loan contracts in the interbank loan syndication market. We construct the network for the 1997-2010 period from granular information on syndicated loan deals.
We then link bank connectivity data from this network – in particular, direct and indirect exposures to borrowers in crisis and non-crisis countries – with bank balance sheet information to obtain a rich panel dataset for more than 2,000 banks from 88 countries. The data allow us to estimate the effect of network and non-network exposures to crises on bank performance.

In a first instance, we link bank performance to syndicated loan exposures vis-a-vis bank and non-bank borrowers, distinguishing between exposures to crisis and non-crisis countries. We find, not surprisingly, that outstanding loan claims on banks in countries that are experiencing a systemic banking crisis reduce bank profitability. We interpret this result as suggesting that international financial linkages, created through global interbank exposures, can enable the international transmission of shocks. We then distinguish direct from indirect exposures to banks in crisis countries, and find that higher such exposures are associated with lower bank profitability, while higher exposures to banks in non-crisis countries leave bank profitability unchanged.

Then, we assess banks’ interconnectedness in the syndicated loan network through the lens of betweenness centrality, a concept that allows us to identify key intermediaries in the network. Key intermediaries tend to borrow from global banks that are very active in the loan syndication market, and lend to banks in domestic and regional markets. We find that key intermediaries, especially smaller banks from emerging market countries, have markedly lower ROA during financial crises at home. This result suggests that a large and potentially diverse pool of creditors and debtors can lead key intermediaries to become vulnerable to funding shortages and increased demand for liquidity during financial crises at home, squeezing their profitability.

We also find tentative evidence on one mechanism behind our results, namely, net charge-offs. Specifically, we show that the net charge-off rate is lower when banks have higher exposures to borrowers in non-crisis years. We are currently assembling micro data to test two mechanisms – loan defaults triggered by borrower bankruptcies and losses on traded loans during financial crises.
References


Tables and figures

Figure 1: Syndicated loan exposures vs. BIS loan claims on banks (USD trillion), 1995–2012

Notes: The figure depicts syndicated loan exposures (SLE) and BIS loan claims by banks in 35 countries vis-a-vis banks in 197 countries during 1995–2012. “SLE-Upper bound” refers to exposures that comprise total credit lines (drawn and undrawn amounts) and term loans. “SLE-Intermediate” refers to on-balance sheet exposures that comprise drawn credit line resources and term loans. To compute on-balance sheet estimates of credit lines, we employ the time-varying credit line usage rates from Cerutti et al. (2014). “SLE-Lower” bound refers to exposures that are further adjusted in that term loans of type other than A are dropped because syndicate participants in such loans are often non-banks. All figures are expressed in USD trillion (at 2005 prices). Source: Authors’ calculations using BIS locational banking statistics and Loan Analytics based on Cerutti et al. (2014).
Figure 2: Bank performance and leverage, 1997-2010

Source: Authors’ calculations based on Bankscope.
Figure 3: Network connectivity and total bank-to-bank syndicated lending, 1997-2010

Source: Authors’ calculations based on Loan Analytics.
Notes: The figure depicts a visualization of the EGBN in 2007 for the largest 100 banks by assets. Blue nodes are banks in OECD countries and red nodes are banks in non-OECD countries. Edges width is proportional to syndicated loan exposures. Source: Authors' calculations based on Loan Analytics and Bankscope.
Figure 5: Examples of Key Intermediaries

A. Commonwealth Bank of Australia (Australia)

B. Arab Bank PLC (Jordan)

Notes: The figures depict visualizations of the incoming and outgoing connections of two key intermediaries in the 2010 EGBN: Arab Bank Plc (Jordan) and Commonwealth Bank of Australia (Australia). Key intermediaries are defined as banks with positive betweenness centrality. Red indicates borrowing relationships (incoming edges); blue indicates lending relationships (outgoing edges). For simplicity, 3 banks with which Arab Bank Plc had both lending and borrowing relationships in 2010 are not shown. Source: Authors’ calculations based on Loan Analytics and Bankscope.
Table 1: Summary statistics

<table>
<thead>
<tr>
<th>Variable</th>
<th>N</th>
<th>Mean</th>
<th>Median</th>
<th>St. Dev.</th>
<th>Min</th>
<th>Max</th>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<td>Return on assets</td>
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<td>1.68</td>
<td>-6.57</td>
<td>8.26</td>
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<td>Return on equity</td>
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<td>16.59</td>
<td>-78.09</td>
<td>55.25</td>
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<td>0.32</td>
<td>1.76</td>
<td>-2.10</td>
<td>10.66</td>
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<td><strong>Control variables</strong></td>
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<td>7.06</td>
<td>10.53</td>
<td>0.32</td>
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<td>Crisis in home country (Laeven and Valencia 2012)</td>
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<td>0.00</td>
<td>0.39</td>
<td>0.00</td>
<td>1.00</td>
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<td>No. of crises elsewhere (Laeven and Valencia 2012)</td>
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<td>0.00</td>
<td>12.00</td>
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<td></td>
<td></td>
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<td>Controlled subsidiary</td>
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<td>0.00</td>
<td>1.00</td>
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<td>Global ultimate owner</td>
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<td>0.00</td>
<td>0.41</td>
<td>0.00</td>
<td>1.00</td>
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<td>0.00</td>
<td>0.48</td>
<td>0.00</td>
<td>1.00</td>
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<td>Specialization, of which:</td>
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<td></td>
<td></td>
<td></td>
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<td>Commercial bank</td>
<td>23,310</td>
<td>0.78</td>
<td>1.00</td>
<td>0.42</td>
<td>0.00</td>
<td>1.00</td>
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<td>Bank holding company</td>
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<td>0.00</td>
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<td>0.00</td>
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<td>0.35</td>
<td>0.00</td>
<td>1.00</td>
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<td><strong>Direct and indirect exposures</strong></td>
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<td></td>
<td></td>
<td></td>
<td></td>
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<td>Direct US$ non-crisis exposure (total)</td>
<td>29,946</td>
<td>3.10</td>
<td>0.02</td>
<td>20.52</td>
<td>0.00</td>
<td>670.41</td>
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<td>Direct US$ crisis exposure (total)</td>
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<td>0.00</td>
<td>3.22</td>
<td>0.00</td>
<td>177.47</td>
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<td>Direct US$ non-crisis exposure (non-banks)</td>
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<td>0.00</td>
<td>3.78</td>
<td>0.00</td>
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<td>0.00</td>
<td>0.50</td>
<td>0.00</td>
<td>34.67</td>
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<td>Direct US$ non-crisis exposure (banks)</td>
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<td>2.58</td>
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<td>Direct US$ crisis exposure (banks)</td>
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<td>2.75</td>
<td>0.00</td>
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<td>Direct 0-1 non-crisis exposure (banks)</td>
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<td>105.00</td>
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<td>1.00</td>
<td>17.92</td>
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<td>240.00</td>
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<td>Indirect 0-1 non-crisis exposure (banks)</td>
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<td>0.04</td>
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<td>0.00</td>
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<td>Indirect 0-1 crisis exposure (banks)</td>
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<td>0.00</td>
<td>0.00</td>
<td>0.03</td>
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<td>0.87</td>
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<td><strong>Measures of network centrality</strong></td>
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<td>0.05</td>
<td>0.00</td>
<td>1.00</td>
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Notes: Summary statistics are shown for all bank-year observations with non-missing ROA. The variables ROA, ROE, equity/assets, and assets are winsorized at the 1st and 99th percentiles. Direct current exposures are expressed in constant (2005) billion USD. Sources: Authors’ calculations based on Loan Analytics, Bankscope, and Laeven and Valencia (2012).
Table 2: Effect of crises inside and outside home country on bank performance

<table>
<thead>
<tr>
<th>Panel A</th>
<th>(1)</th>
<th>(2)</th>
<th>(3)</th>
<th>(4)</th>
<th>(5)</th>
<th>(6)</th>
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<tr>
<td>Crisis in home country</td>
<td>-0.872***</td>
<td>-0.876***</td>
<td>-0.735***</td>
<td>-0.727***</td>
<td>-0.697***</td>
<td>-0.693***</td>
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<td>(0.047)</td>
<td>(0.056)</td>
<td>(0.060)</td>
<td>(0.053)</td>
<td>(0.070)</td>
<td>(0.065)</td>
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<td>yes</td>
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<td>Bank nationality FE</td>
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<td>yes</td>
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<tr>
<td>Bank nationality*Year FE</td>
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<td>14,955</td>
<td>11,374</td>
<td>14,955</td>
<td>11,374</td>
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<td>R-squared</td>
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<td>0.054</td>
<td>0.168</td>
<td>0.336</td>
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<table>
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<th>Panel B</th>
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<th>(3)</th>
<th>(4)</th>
<th>(5)</th>
<th>(6)</th>
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<tbody>
<tr>
<td>Crisis in home country</td>
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<td>-1.156***</td>
<td>-0.800***</td>
<td>-0.783***</td>
<td>-0.802***</td>
<td>-0.807***</td>
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<tr>
<td>(0.049)</td>
<td>(0.070)</td>
<td>(0.084)</td>
<td>(0.079)</td>
<td>(0.093)</td>
<td>(0.094)</td>
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<tr>
<td>No. of crises elsewhere</td>
<td>-0.085***</td>
<td>-0.102***</td>
<td>-0.022</td>
<td>-0.017</td>
<td>-0.040***</td>
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<td>(0.007)</td>
<td>(0.014)</td>
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<td>Other bank-level controls</td>
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<td>no</td>
<td>yes</td>
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<tr>
<td>Observations</td>
<td>14,763</td>
<td>14,763</td>
<td>14,763</td>
<td>11,326</td>
<td>14,763</td>
<td>11,326</td>
</tr>
<tr>
<td>R-squared</td>
<td>0.059</td>
<td>0.065</td>
<td>0.164</td>
<td>0.339</td>
<td>0.487</td>
<td>0.548</td>
</tr>
</tbody>
</table>

Notes: The dependent variable is ROA. The number of crises elsewhere refers to the number of systemic banking crises occurring each year outside the bank’s home country, according to the Laeven and Valencia (2012) dataset. Other bank-level controls refer to bank equity-to-assets ratio, size (log-total assets), and bank specialization and entity dummies. Standard errors are clustered on bank. Sources: Authors’ calculations based on Loan Analytics, Bankscope, and Laeven and Valencia (2012).
Table 3: Effect of direct exposures on bank performance

<table>
<thead>
<tr>
<th></th>
<th>(1)</th>
<th>(2)</th>
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<th>(6)</th>
<th>(7)</th>
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<tbody>
<tr>
<td></td>
<td>All</td>
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<td>Bottom</td>
<td>All</td>
<td>All</td>
<td>Top</td>
<td>Bottom</td>
</tr>
<tr>
<td>Direct US$ non-crisis exposure (total)</td>
<td>-0.000</td>
<td>-0.000</td>
<td>0.020</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(0.000)</td>
<td>(0.001)</td>
<td>(0.037)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Direct US$ crisis exposure (total)</td>
<td>-0.003***</td>
<td>-0.000</td>
<td>-0.694**</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(0.001)</td>
<td>(0.001)</td>
<td>(0.312)</td>
<td></td>
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<td></td>
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<tr>
<td>Direct US$ non-crisis exposure (banks)</td>
<td>-0.002</td>
<td>-0.003</td>
<td>-0.001</td>
<td>-0.163</td>
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<td></td>
</tr>
<tr>
<td></td>
<td>(0.002)</td>
<td>(0.004)</td>
<td>(0.004)</td>
<td>(0.279)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Direct US$ crisis exposure (banks)</td>
<td>-0.026***</td>
<td>-0.038**</td>
<td>-0.035*</td>
<td>-0.258</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(0.008)</td>
<td>(0.015)</td>
<td>(0.018)</td>
<td>(1.117)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Direct US$ non-crisis exposure (non-banks)</td>
<td>0.000</td>
<td>-0.000</td>
<td>0.030</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(0.001)</td>
<td>(0.001)</td>
<td>(0.041)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Direct US$ crisis exposure (non-banks)</td>
<td>0.002</td>
<td>0.005</td>
<td>-0.738*</td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td></td>
<td>(0.003)</td>
<td>(0.003)</td>
<td>(0.394)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Equity/Assets</td>
<td>0.089***</td>
<td>0.077***</td>
<td>0.103***</td>
<td>0.089***</td>
<td>0.089***</td>
<td>0.077***</td>
<td>0.103***</td>
</tr>
<tr>
<td></td>
<td>(0.010)</td>
<td>(0.021)</td>
<td>(0.010)</td>
<td>(0.010)</td>
<td>(0.010)</td>
<td>(0.021)</td>
<td>(0.010)</td>
</tr>
<tr>
<td>Log-assets</td>
<td>0.092***</td>
<td>0.078***</td>
<td>0.118***</td>
<td>0.092***</td>
<td>0.092***</td>
<td>0.078***</td>
<td>0.118***</td>
</tr>
<tr>
<td></td>
<td>(0.013)</td>
<td>(0.027)</td>
<td>(0.018)</td>
<td>(0.012)</td>
<td>(0.013)</td>
<td>(0.027)</td>
<td>(0.018)</td>
</tr>
<tr>
<td>Crisis in home country</td>
<td>-0.729***</td>
<td>-0.413***</td>
<td>-0.814***</td>
<td>-0.730***</td>
<td>-0.730***</td>
<td>-0.414***</td>
<td>-0.813***</td>
</tr>
<tr>
<td></td>
<td>(0.053)</td>
<td>(0.058)</td>
<td>(0.079)</td>
<td>(0.053)</td>
<td>(0.053)</td>
<td>(0.058)</td>
<td>(0.079)</td>
</tr>
<tr>
<td>Observations</td>
<td>11,374</td>
<td>3,321</td>
<td>6,811</td>
<td>11,374</td>
<td>11,374</td>
<td>3,321</td>
<td>6,811</td>
</tr>
<tr>
<td>R-squared</td>
<td>0.336</td>
<td>0.417</td>
<td>0.325</td>
<td>0.336</td>
<td>0.336</td>
<td>0.417</td>
<td>0.325</td>
</tr>
</tbody>
</table>

Notes: The dependent variable is ROA. Column heading “top” refers to top 500 banks by total banking exposures, and column heading “bottom” refers to the remaining banks. Exposures are lagged 1 year, crises are contemporaneous. Variables labeled “US$” are computed on the weighted EGBN. All specifications include bank entity and specialization dummies, bank nationality, and year fixed effects. Standard errors are clustered on bank. Sources: Authors’ calculations based on Loan Analytics, Bankscope, and Laeven and Valencia (2012).
Table 4: Effect of direct and indirect exposures on bank performance

<table>
<thead>
<tr>
<th></th>
<th>(1) All</th>
<th>(2) Top</th>
<th>(3) Bottom</th>
<th>(4) All</th>
<th>(5) Top</th>
<th>(6) Bottom</th>
</tr>
</thead>
<tbody>
<tr>
<td>Direct US$ non-crisis exposure (total)</td>
<td>-0.000</td>
<td>-0.001</td>
<td>0.020</td>
<td>-0.001</td>
<td>-0.001</td>
<td>0.018</td>
</tr>
<tr>
<td></td>
<td>(0.000)</td>
<td>(0.000)</td>
<td>(0.039)</td>
<td>(0.000)</td>
<td>(0.000)</td>
<td>(0.039)</td>
</tr>
<tr>
<td>Direct US$ crisis exposure (total)</td>
<td>0.002</td>
<td>0.003</td>
<td>-0.762**</td>
<td>0.002</td>
<td>0.003</td>
<td>-0.752**</td>
</tr>
<tr>
<td></td>
<td>(0.002)</td>
<td>(0.002)</td>
<td>(0.332)</td>
<td>(0.002)</td>
<td>(0.002)</td>
<td>(0.330)</td>
</tr>
<tr>
<td>Direct 0-1 non-crisis exposure (banks)</td>
<td>0.000</td>
<td>0.001</td>
<td>-0.006</td>
<td>-0.000</td>
<td>0.001</td>
<td>-0.003</td>
</tr>
<tr>
<td></td>
<td>(0.001)</td>
<td>(0.001)</td>
<td>(0.011)</td>
<td>(0.001)</td>
<td>(0.001)</td>
<td>(0.012)</td>
</tr>
<tr>
<td>Direct 0-1 crisis exposure (banks)</td>
<td>-0.019***</td>
<td>-0.014***</td>
<td>0.000</td>
<td>-0.016**</td>
<td>-0.013*</td>
<td>0.005</td>
</tr>
<tr>
<td></td>
<td>(0.006)</td>
<td>(0.007)</td>
<td>(0.016)</td>
<td>(0.006)</td>
<td>(0.007)</td>
<td>(0.016)</td>
</tr>
<tr>
<td>Indirect 0-1 non-crisis exposure (banks)</td>
<td>0.106</td>
<td>0.305</td>
<td>0.003</td>
<td>0.106</td>
<td>0.305</td>
<td>0.003</td>
</tr>
<tr>
<td></td>
<td>(0.171)</td>
<td>(0.203)</td>
<td>(0.462)</td>
<td>(0.171)</td>
<td>(0.203)</td>
<td>(0.462)</td>
</tr>
<tr>
<td>Indirect 0-1 crisis exposure (banks)</td>
<td>-0.820*</td>
<td>-0.489</td>
<td>-2.105***</td>
<td>-0.820*</td>
<td>-0.489</td>
<td>-2.105***</td>
</tr>
<tr>
<td></td>
<td>(0.469)</td>
<td>(0.595)</td>
<td>(0.547)</td>
<td>(0.469)</td>
<td>(0.595)</td>
<td>(0.547)</td>
</tr>
<tr>
<td>Equity/Assets</td>
<td>0.090***</td>
<td>0.079***</td>
<td>0.112***</td>
<td>0.089***</td>
<td>0.078***</td>
<td>0.111***</td>
</tr>
<tr>
<td></td>
<td>(0.012)</td>
<td>(0.021)</td>
<td>(0.012)</td>
<td>(0.013)</td>
<td>(0.021)</td>
<td>(0.013)</td>
</tr>
<tr>
<td>Log-assets</td>
<td>0.106***</td>
<td>0.082**</td>
<td>0.147***</td>
<td>0.108***</td>
<td>0.079***</td>
<td>0.156***</td>
</tr>
<tr>
<td></td>
<td>(0.015)</td>
<td>(0.029)</td>
<td>(0.021)</td>
<td>(0.016)</td>
<td>(0.029)</td>
<td>(0.022)</td>
</tr>
<tr>
<td>Crisis in home country</td>
<td>-0.763***</td>
<td>-0.442***</td>
<td>-0.841***</td>
<td>-0.767***</td>
<td>-0.453***</td>
<td>-0.844***</td>
</tr>
<tr>
<td></td>
<td>(0.060)</td>
<td>(0.065)</td>
<td>(0.090)</td>
<td>(0.061)</td>
<td>(0.066)</td>
<td>(0.093)</td>
</tr>
</tbody>
</table>

Notes: The dependent variable is ROA. Column heading “top” refers to top 500 banks by total banking exposures, and column heading “bottom” refers to the remaining banks. Exposures are lagged 1 year, crises are contemporaneous. Variables labeled “US$” are computed on the weighted EGBN and variables labeled “0-1” are computed on the binary EGBN. All specifications include bank entity and specialization dummies, bank nationality, and year fixed effects. Standard errors are clustered on bank. Sources: Authors’ calculations based on Loan Analytics, Bankscope, and Laeven and Valencia (2012).
Table 5: Effect of direct and indirect exposures on net charge-offs as potential mechanism

<table>
<thead>
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<th>(5)</th>
<th>(6)</th>
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</thead>
<tbody>
<tr>
<td>All</td>
<td>All</td>
<td>Top</td>
<td>Top</td>
<td>Bottom</td>
<td>Bottom</td>
</tr>
<tr>
<td>Direct US$ non-crisis exposure (total)</td>
<td>-0.000</td>
<td>0.000</td>
<td>0.001</td>
<td>0.001</td>
<td>-0.096*</td>
</tr>
<tr>
<td></td>
<td>(0.001)</td>
<td>(0.001)</td>
<td>(0.001)</td>
<td>(0.001)</td>
<td>(0.054)</td>
</tr>
<tr>
<td>Direct US$ crisis exposure (total)</td>
<td>-0.001</td>
<td>-0.001</td>
<td>-0.003</td>
<td>-0.002</td>
<td>0.590</td>
</tr>
<tr>
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<td>(0.002)</td>
<td>(0.003)</td>
<td>(0.002)</td>
<td>(0.003)</td>
<td>(0.412)</td>
</tr>
<tr>
<td>Direct 0-1 non-crisis exposure (banks)</td>
<td>-0.002</td>
<td>-0.003**</td>
<td>0.020</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(0.002)</td>
<td>(0.001)</td>
<td>(0.024)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Direct 0-1 crisis exposure (banks)</td>
<td>0.005</td>
<td>-0.000</td>
<td>0.019</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(0.007)</td>
<td>(0.005)</td>
<td>(0.024)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Indirect 0-1 non-crisis exposure (banks)</td>
<td>-0.402*</td>
<td>-0.136</td>
<td>-0.041</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(0.209)</td>
<td>(0.172)</td>
<td>(0.604)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Indirect 0-1 crisis exposure (banks)</td>
<td>-0.430</td>
<td>-0.400</td>
<td>-0.923</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(0.748)</td>
<td>(0.726)</td>
<td>(1.688)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Equity/Assets</td>
<td>0.026**</td>
<td>0.034**</td>
<td>0.019</td>
<td>0.039*</td>
<td>0.013</td>
</tr>
<tr>
<td></td>
<td>(0.012)</td>
<td>(0.014)</td>
<td>(0.019)</td>
<td>(0.023)</td>
<td>(0.014)</td>
</tr>
<tr>
<td>Log-assets</td>
<td>0.061***</td>
<td>0.075***</td>
<td>0.060</td>
<td>0.130***</td>
<td>0.120**</td>
</tr>
<tr>
<td></td>
<td>(0.022)</td>
<td>(0.025)</td>
<td>(0.039)</td>
<td>(0.030)</td>
<td>(0.048)</td>
</tr>
<tr>
<td>Crisis in home country</td>
<td>0.797***</td>
<td>0.913***</td>
<td>0.436***</td>
<td>0.508***</td>
<td>1.017***</td>
</tr>
<tr>
<td></td>
<td>(0.091)</td>
<td>(0.103)</td>
<td>(0.107)</td>
<td>(0.104)</td>
<td>(0.122)</td>
</tr>
</tbody>
</table>

Observations: 6,545 5,372 2,081 1,891 3,652 2,674
R-squared: 0.228 0.226 0.230 0.247 0.255 0.251

Notes: The dependent variable is net charge-offs (NCO). Column heading "top" refers to top 500 banks by total banking exposures, and column heading "bottom" refers to the remaining banks. Exposures are lagged 1 year, crises are contemporaneous. Variables labeled “US$” are computed on the weighted EGBN and variables labeled “0-1” are computed on the binary EGBN. All specifications include bank entity and specialization dummies, bank nationality, and year fixed effects. Standard errors are clustered on bank. Sources: Authors’ calculations based on Loan Analytics, Bankscope, and Laeven and Valencia (2012).
Table 6: Key intermediaries

<table>
<thead>
<tr>
<th>Rank</th>
<th>Country</th>
<th># banks</th>
<th>Selected examples</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td><strong>A. Advanced economies</strong></td>
</tr>
<tr>
<td>1</td>
<td>US</td>
<td>9</td>
<td>Bank of NY Mellon Corp, Citibank NA, HSBC Bank USA, Morgan Stanley, Citigroup Inc</td>
</tr>
<tr>
<td>2</td>
<td>Australia</td>
<td>6</td>
<td>National Australia Bank, ANZ, WestPac, Macquerie Bank Ltd, Commonwealth Bank of Australia</td>
</tr>
<tr>
<td>3</td>
<td>Hong Kong (SAR)</td>
<td>6</td>
<td>Bank of East Asia, Hongkong &amp; Shanghai Banking Corp, ICBC (Asia), Standard Chartered Bank (Hong Kong)</td>
</tr>
<tr>
<td>4</td>
<td>Japan</td>
<td>5</td>
<td>Daiwa Securities Capital Markets, Nomura Holdings, Mizuho Trust &amp; Banking, Sumitomo Trust &amp; Banking, Mizuho Securities</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td><strong>B. Emerging market economies</strong></td>
</tr>
<tr>
<td>1</td>
<td>China</td>
<td>7</td>
<td>Bank of China, Agricultural Bank of China, ICBC, China Development Bank, China Construction Bank</td>
</tr>
<tr>
<td>2</td>
<td>Turkey</td>
<td>6</td>
<td>Akbank, Garanti, Turk Econom Bankasi, Vakiflar Bankasi, Yapi ve Credi Bankasi</td>
</tr>
<tr>
<td>3</td>
<td>Russian Federation</td>
<td>5</td>
<td>VTB Bank, Sberbank, Alfa Bank, Bank of Moskow, Bank Uralsib</td>
</tr>
<tr>
<td>4</td>
<td>India</td>
<td>4</td>
<td>Axis Bank, ICICI Bank, Bank of Baroda, State Bank of India</td>
</tr>
<tr>
<td>5</td>
<td>Brazil</td>
<td>2</td>
<td>Itau Unibanco, Banco do Brasil</td>
</tr>
</tbody>
</table>

Notes: This table reports the top advanced economies and emerging market countries with key intermediaries in the 2010 EGBN. Sources: Authors’ calculations based on Loan Analytics.
Table 7: Effect of global connectivity profile on bank performance

<table>
<thead>
<tr>
<th></th>
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<th>(2)</th>
<th>(3)</th>
<th>(4)</th>
<th>(5)</th>
</tr>
</thead>
<tbody>
<tr>
<td>All</td>
<td>8,734</td>
<td>8,734</td>
<td>8,734</td>
<td>2,866</td>
<td>4,715</td>
</tr>
<tr>
<td>R-squared</td>
<td>0.341</td>
<td>0.344</td>
<td>0.344</td>
<td>0.418</td>
<td>0.342</td>
</tr>
</tbody>
</table>

Notes: The dependent variable is ROA. “Key intermediary” is an indicator for banks with positive betweenness centrality (see text for definition). Column heading “top” refers to top 500 banks by total banking exposures, and column heading “bottom” refers to the remaining banks. Exposures are lagged 1 year, crises are contemporaneous. Variables labeled “US$” are computed on the weighted EGBN and variables labeled “0-1” are computed on the binary EGBN. All specifications include bank entity and specialization dummies, bank nationality, and year fixed effects. Standard errors are clustered on bank. Sources: Authors’ calculations based on Loan Analytics, Bankscope, and Laeven and Valencia (2012).
<table>
<thead>
<tr>
<th>(1)</th>
<th>(2)</th>
<th>(3)</th>
<th>(4)</th>
<th>(5)</th>
<th>(6)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Direct US$ non-crisis exposure (total)</td>
<td>-0.008</td>
<td>-0.001</td>
<td>-0.000</td>
<td>-0.008</td>
<td>-0.001</td>
</tr>
<tr>
<td>Direct US$ crisis exposure (total)</td>
<td>0.053</td>
<td>0.002</td>
<td>0.002</td>
<td>0.052</td>
<td>0.001</td>
</tr>
<tr>
<td>Direct 0-1 non-crisis exposure (banks)</td>
<td>0.006</td>
<td>-0.000</td>
<td>-0.000</td>
<td>0.013</td>
<td>0.001</td>
</tr>
<tr>
<td>Direct 0-1 crisis exposure (banks)</td>
<td>-0.277**</td>
<td>-0.016**</td>
<td>-0.016**</td>
<td>-0.284**</td>
<td>-0.016**</td>
</tr>
<tr>
<td>Indirect 0-1 non-crisis exposure (banks)</td>
<td>0.095</td>
<td>0.106</td>
<td>0.099</td>
<td>-0.169</td>
<td>0.085</td>
</tr>
<tr>
<td>Indirect 0-1 crisis exposure (banks)</td>
<td>-3.955</td>
<td>-0.820***</td>
<td>-0.786*</td>
<td>-4.504</td>
<td>-0.806***</td>
</tr>
<tr>
<td>Equity/Assets</td>
<td>0.262***</td>
<td>0.089***</td>
<td>0.088***</td>
<td>0.251***</td>
<td>0.088***</td>
</tr>
<tr>
<td>Log-assets</td>
<td>1.186***</td>
<td>0.108***</td>
<td>0.105***</td>
<td>1.210***</td>
<td>0.112***</td>
</tr>
<tr>
<td>Crisis in home country</td>
<td>-10.110***</td>
<td>-0.767***</td>
<td>-0.764***</td>
<td>-9.768***</td>
<td>-0.739***</td>
</tr>
<tr>
<td>Observations</td>
<td>9,062</td>
<td>9,063</td>
<td>8,960</td>
<td>8,733</td>
<td>8,734</td>
</tr>
<tr>
<td>R-squared</td>
<td>0.205</td>
<td>0.339</td>
<td>0.340</td>
<td>0.205</td>
<td>0.344</td>
</tr>
</tbody>
</table>

Notes: The dependent variable is ROA in all columns except 1 and 5 where it is ROE. All specifications include bank entity and specialization dummies, bank nationality, and year fixed effects. In columns 2 and 5 std. errors are double clustered on bank and year (in all other columns they are clustered on bank). In columns 3 and 6 we drop all the entities of Citigroup. Regressions are run on the full sample. Sources: Authors’ calculations based on Loan Analytics, Bankscope, and Laeven and Valencia (2012).
Appendix. EGBN Construction

To construct our dataset we proceed as follows:

- **Step 1.** We download from Loan Analytics about 150,000 syndicated loan deals (structured in almost 1,000,000 loan tranches) signed between January 1990 and December 2010. To construct the EGBN we retain only the loans extended to financial institutions. We drop the deals for which the lender is recorded as “unknown” or “undisclosed [Asian, French, German, Japanese] bank”. We also drop the deals that involve non-bank borrowers. For lender country we use the variable “Lender nationality” as reported in Loan Analytics; for borrower country we use the variable “Deal nationality” after cross-checking that the information is correct by comparing banks that appear both as borrowers and lenders. We also retain the loan deals with multiple borrowers (representing less than 1 percent of the sample), for which we impute their nationality only if it cross-checks with information in Bankscope.

- **Step 2.** Given that some bank names are recorded in Loan Analytics with typos, refer to banks that have changed name, or have been acquired by or merged with other banks, we clean up the bank names as follows:
  - If a bank changed name during 1990-2010, we retain its Bankscope name (as of end-2010) throughout the entire sample period;
  - If two or more banks merged during the sample period to form a new bank, they are kept as distinct banks until the year of the merger and cease to exist after the merger; the bank resulting from the merger is kept subsequent to the merger;
  - If a bank was acquired by another bank, it appears as a distinct bank until the year of the acquisition;
  - Lending from multiple branches of the same bank in a foreign country is aggregated;
  - Lending from off-shore branches of a bank is aggregated.

The EGBN is constructed using the full set of about 5,500 banks that appear as lenders or borrowers in the loan syndication market during 1990-2010.

- **Step 3.** After cleaning the bank names, we match all banks – by name and country – with balance sheet data from Bankscope. We use various sources to learn the institutional history of banks and make appropriate matches. These include bank websites, the FDIC website[^12] and Bloomberg Businessweek[^13] Subsidiaries that report balance sheet information in Bankscope are treated as distinct entities and are not linked to their parent financials.

The merged sample of banks that participate in the loan syndication market and report to Bankscope contains about 2,000 distinct banks.

[^13]: http://investing.businessweek.com/research/company/overview/overview.asp