Risks in U.S. Bank International Exposures

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Abstract

U.S. banks maintain international exposures, with Europe and the Americas as key counterparty markets. In this paper, we show the evolving scope of these exposures and the changes in the embodied risks taken through bank cross-border activity, local claims, and derivative positions. Conclusions differ across types of U.S. banks. Compared with other banks, money center banks tend to have higher shares of their assets in foreign exposures. Money center banks have a smaller share of their exposure as cross-border, with these exposures concentrated in lower risk countries. While money center local claims are increasingly in Latin American countries, these claims are at least partially matched by local liabilities, so that their contribution to bank transfer risk is reduced accordingly. As a share of total international exposures, money center banks tend to have significantly lower transfer risk than that contained in the average foreign exposures of other banks.

Keywords: Bank, Foreign exposure, claims, derivatives, business cycle, interest rates

JEL Classification: F3, G2

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I. Introduction

U.S. banks carry substantial exposures to foreign markets, occurring through cross-border activities, through the local activities of their subsidiaries or branches, and through positions they take in derivatives markets. The amounts and forms of these exposures have evolved dramatically over time, as have the associated risks. In this paper, we focus on this evolution and, of particular interest, on the differences in exposures across types of banks, specifically very large banks versus smaller ones. We contrast the risks in these exposures across respective types of U.S. banks and show how these risks and their capitalization have changed over time. Such differences are the result of the diverse strategies pursued (or perhaps simply attainable) by large and small banks in expanding their exposure in countries characterized by varying risk categories. This analysis allows us to obtain significant insights regarding the risk profile associated with banks' foreign exposure.

The paper narrowly looks at this set of risk issues, taking the perspective of the home country banks. Many studies on other home country and host country themes are explored elsewhere [BIS (2004), Hawkins and Mihaliek (2001), Goldberg (2005), and Litan et al. (2001)]. Riskiness of positions and associated bank capital reserves, the focus of our paper, has been established as centrally important for financial system stability in Basel II.

Our analysis begins with detailed data contained in quarterly reports filed by U.S. banks or bank holding companies as part of the bank supervisory process. Each reporting bank provides a country-by-country delineation of its foreign claims[1] and of the form of these claims, i.e. whether they are cross-border, extended by the local affiliates of U.S. banks, or valuations of derivative positions held. The report also contains some information on maturity composition and broad categories of recipients of U.S. claims by destination market, distinguishing borrowers among foreign banks, public entities or private sector ones.

Houpt (1999) and Palmer (2000) initially used these data to examine trends over the 1980 and early to mid 1990s. Houpt provided an especially clear comparison of different concepts of risk embedded in U.S. bank foreign exposures. Goldberg (2002, 2005) provided a perspective on key trends in this data and the underlying reporting banks. U.S. banks engaged in international lending have become more diverse since the 1980s, with fewer banks overall,

and the remaining banks increasingly polarized in terms of size and portfolio allocations. Starting from highs of 185 reporting banks in the mid 1980s, the number of US banks with foreign exposures declined to 140 by the mid 1990s and further declined to 71 banks in 2004. In the 1980s banks were broadly distributed across small, medium, and large asset ranges. By 2004 the distribution was more bimodal.

A few very large banks increasingly dominate overall external claims of U.S. banks. By the late 1990s, many of the other U.S. banks reporting foreign exposures were smaller banks with a strong focus on European and Latin American markets. Lending by the smaller banks, especially with respect to Latin American and Asian markets, was more volatile than the lending by larger banks, a pattern we also observe with the additional years of data reported in the present paper.[2]

In this paper, we extend this analysis, and highlight a number of important risk-related features of U.S. bank foreign exposures. First, despite consolidation in the number of reporting banks, overall exposure has continued to grow. The trend is driven by the growth in foreign exposures of a small number of Money Center Banks (MCBs).

The country composition of total foreign exposure has been fluctuating over time. Especially for MCBs, there has been a shift in recent years away from Asia and the Middle East and towards positions in "safer" countries, where degrees of safety or riskiness of countries are proxied by Fitch ratings, or towards less risky forms of exposure. Honing in on the geographical composition of exposure, we highlight the increasing importance of Latin America for MCBs, after significant withdrawals in the previous decade. Interestingly, the run up was achieved mainly as a result of a significant increase in local claims.

We present analysis of the distribution of transfer risk across investment grade and speculative grade countries over time, and differences across MCBs and non-MCBs. Exposure to the riskiest countries has been trending down for MCBs. This trend is not observable for the average non-MCB, which has a much larger relative transfer risk exposure in speculative grade countries than the average MCB.

When paired with an analysis of these positions relative to both bank-specific assets and capital, we show that while levels of foreign exposure are increasing, exposure as a share

[1] This process also informs the Federal Deposit Insurance Corporation and state banking regulators. The use of the term "U.S. banks" in this paper generally includes U.S. owned banks and U.S. subsidiaries of foreign banks.
[2] For details from the host-country perspective, see Crystal, Dages and Goldberg (2001).

of total bank assets has been declining recently for both MCBs and nonMCBs. With capital to asset ratios rising for average banks, the result is that foreign exposure as a fraction of banks' equity capital is less than 200 percent for non-MCBs, versus 600 percent for MCBs. On average, only MCBs have increased their foreign exposure's weight on banks' equity capital. Simultaneously, these banks have reduced the incidence of transfer risk and raised the share of investment grade countries in their international exposures.

The body of this paper is divided into three sections. Section II discusses the broad patterns in U.S. bank foreign exposure data, and shows the composition of these exposures by type, meaning cross-border or locally generated, and geography. Section III explores the risk features of these exposures, showing implied transfer risk and combining the exposures with measures of country risk. Section IV offers concluding remarks.

II. Broad patterns in U.S. Bank foreign exposures

A Federal Financial Institutions Examinations Council (FFIEC) report 009 must be filed by every U.S. chartered insured commercial bank in the 50 States of the United States, the District of Columbia, Puerto Rico, and US territories and possessions, provided that the bank has, on a fully consolidated bank basis, total outstanding claims on residents of foreign countries exceeding $30 million in aggregate. In these reports, bank claims are itemized by country, and separately encompass credit extended to foreign country banks, public entities, and other recipients including individuals and businesses. In addition to direct international flows, bank claims also include revaluation gains on interest rate, foreign exchange, equity, commodity and other off-balance sheet contracts. Banks provide some details on time remaining to maturity (one year and under, 1 to 5 years, and over five years). Other quarterly reports filed by banks contain information on bank total assets located in the United States and abroad. There have been changes over time in reporting conventions, but much of this confidential data is consistently available by bank, starting with reports from 1986 and continuing to the present time (2004). Aggregate data are published in the Country Exposure Lending Survey (E.16) statistical release (http://www.federalreserve.gov/releases/) and are made available to staff at the BIS for their statistical publications on the overall indebtedness of various countries throughout the world. Microdata are confidential.

We report statistics and trends for Money Center Banks (MCBs) and for all other banks. Each *Country Exposure Lending Survey* lists banks classified as MCBs. As of the end of 2004, five organizations comprised the group of Money Center Banks: Bank of America Corp., Fleet NA Bank, Taunus Corp., J.P. Morgan Chase & Co., and Citigroup.[3] Although MCBs are not always necessarily the largest U.S. banks by asset size, they do represent the majority of total foreign exposure of all U.S. banks. As indicated in Table 1, there were 9 banks classified as MCBs in 1990 controlling a total market share of about 75 percent. As a result of mergers, that number declined to 5, and their market share is above 80 percent. Table 1 provides these data, and a range of summary statistics for U.S bank foreign exposures at four different dates, starting from 1990 and extending to the end of 2004.

There are different ways of presenting and analyzing data of foreign exposure of banks. Publically available sources add up exposures across all banks and then report the total amounts of U.S. bank exposures in each country or in each type of claim. Such figures correspond to what we call "weighted averages" across the exposures of all U.S. banks. In some of our tables and charts we use this type of data. Alternatively, we can discuss the data in a way that reflects the average portfolio of a bank in either category, MCB or non-MCB without regard for the actual size of the bank. We present this type of analysis as "unweighted" averages of foreign exposures across banks.

[3] Another category, called Other Large Banks, includes data from: Bank of New York Co., Wachovia Corp., HSBC Holdings PLC, and State Street Corp. As of June 30, 2005 the capital and assets in these categories are reported, http://www.ffiec.gov/PDF/E16/E16_200506.pdf, as follows.

Banking Organization Category	Tier 1 Capital	Total Assets
All Reporting Banks	$ 417.5 billion*	$ 7,110.0 billion
Money Center Banks	$ 208.3 billion*	$ 4,138.2 billion
Other Large Banks	$ 61.2 billion	$ 1,062.4 billion
All Other Banks	$ 148.0 billion	$ 1,909.4 billion

Table 1 Summary Statistics on U.S. Bank Foreign Exposures

All Banks	**1990q4**	**1995q4**	**2000q4**	**2004q4**
number of reporting banks	163	137	99	71
		millions of US dollars*		
Total exposure	436509	496354	841141	1173770
Cross-border exposure	251711	287711	423324	587312
Local exposure	184798	208643	329979	476559
Derivative exposure	--	--	87838	109899
Transfer risk (=xborder + net local + derivative)	306773	350069	520891	727111
Composition of Total Exposure		percent		
Cross-border claims	94.8	93.3	90.2	83.8
Local claims	5.2	6.7	8.1	14.1
Derivatives	--	--	1.7	2.1
Composition of Cross-Border Claims		percent		
To public borrowers	19.5	14.6	11.9	6.4
To banks	59.8	51.0	45.7	42.5
To other private borrowers	20.7	34.4	42.4	51.1

All amounts are in millions of 2000 dollars.
All shares are weighted averages across banks in each category.

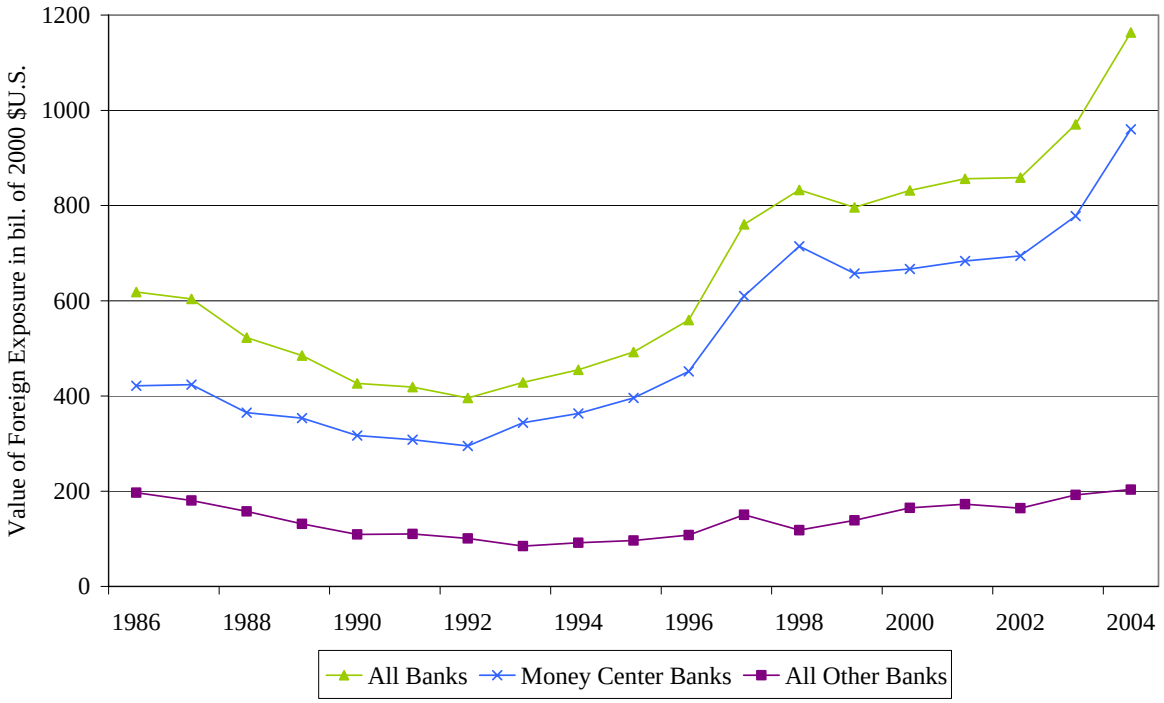
Money Center Banks	**1990q4**	**1995q4**	**2000q4**	**2004q4**
number of MCBs	9	7	5	5
	Percent of U.S. Total accounted for by MCBs			
Total exposure	74.4	80.4	80.2	82.6
Cross-border exposure	64.1	72.6	76.1	81.5
Local exposure	88.3	91.1	81.7	82.9
Derivative exposure	--	--	93.8	86.7
Transfer risk (=xborder + net local + derivative)	68.2	76.0	77.7	79.2
Composition of Total Exposure		percent		
Cross-border claims	62.4	62.1	60.0	53.9
Local claims	37.6	37.9	26.8	37.0
Derivatives	--	--	13.2	9.2
Composition of Cross-Border Claims		percent		
To public borrowers	34.2	27.5	22.3	16.3
To banks	33.9	30.0	34.1	26.2
To other private borrowers	31.9	42.5	43.7	57.5

*All amounts are in millions of 2000 dollars.
All shares are weighted averages across banks in each category.

Despite consolidation in the number of banks reporting foreign exposures, the overall foreign exposures of U.S. banks have continued to grow. As revealed in Charts 1 through 3, after declining over the late 1980s and into the early 1990s, the foreign exposures of U.S. banks continue to have a strong positive trend. The charts differentiate between the aggregate

over all banks, the amount accounted for by MCBs, and the amount from all other U.S. banks reporting foreign exposures. The amount of total exposure from all other banks has only recently recovered, in real terms, to levels last seen in the mid 1980s. In Chart 2, all of the growth in cross-border lending has been concentrated in money center banks, with flat (in real terms) cross-border claims from all other banks with foreign exposures. Chart 3 shows that MCBs dominate totals in local claims and local claims growth,[4] although other banks as a group have a low but increasing focus on this form of exposure.

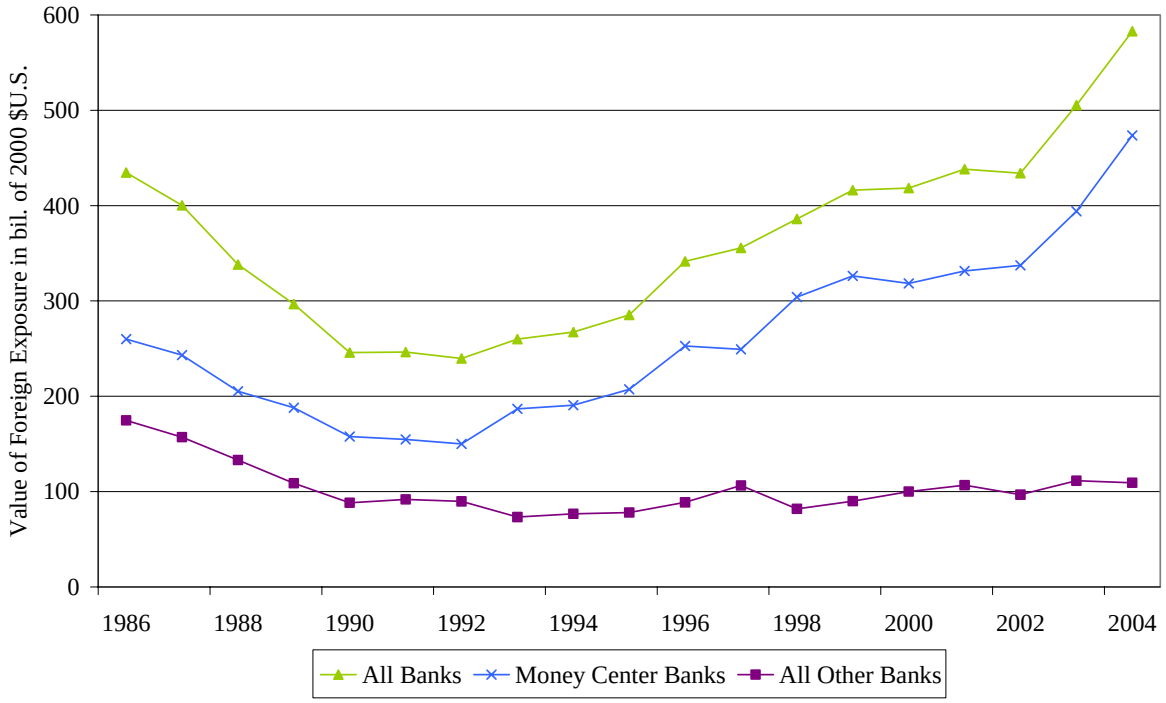
Chart 1: Total Foreign Exposure of U.S. Banks



Note: each year represented by q4 data

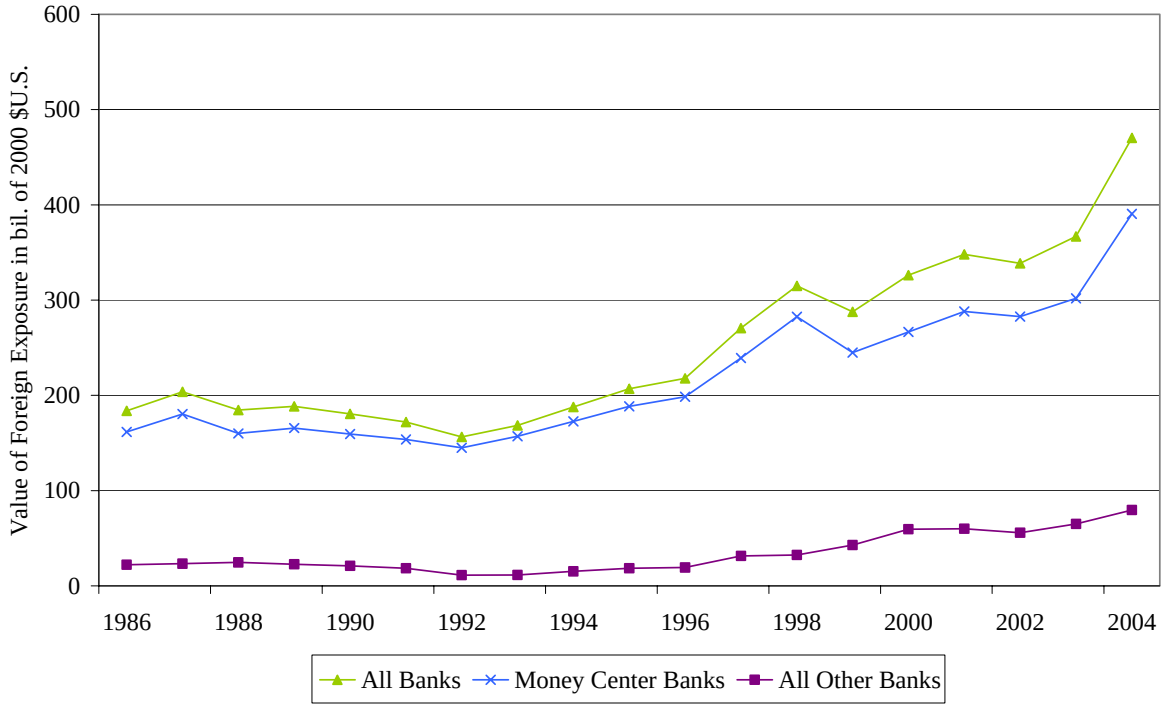
[4] Local claims are loans issued, in any currency, by a foreign branch of a U.S. bank to borrowers in the country where the branch is located.

Chart 2: Total Cross-Border Exposure of U.S. Banks



Note: each year represented by q4 data

Chart 3: Total Local Claims Exposure of U.S. Banks



Note: each year represented by q4 data

Geographic Distribution on U.S. Bank Foreign Exposures

The geographical distribution of foreign exposures of U.S. banks has evolved over time. Table 2 presents details of these exposures, looking at five year intervals since 1990, with distinctions made between money center banks and all other banks. Looking first at the unweighted averages in Table 2, the exposure shares for Europe are on the order of fifty percent for the MCBs, with non-MCBs averaging less than a third of their foreign exposures in Europe. The role of Latin America in the foreign portfolios has varied considerably over time over both types of banks. It fell dramatically for MCBs over the second half of the 1990s and then rose to record levels as these banks reestablished levels of cross border claims and expanded their local banking operations and local claims in the late 1990s and early 2000s. The share of Asia and the Middle East in the overall foreign portfolios of MCBs has declined accordingly, reaching 16.3 percent in 2004.

A different pattern emerges when we show the geographical breakdown of all banks summed together, instead of the average breakdown across individual banks. In this (weighted) approach, Latin America is a much smaller part of the total portfolios of both the MCB aggregate and the non-MCB aggregate. Thus, while the average banks in these categories may have increased their focus on the region, some large players have a smaller focus, substantially reducing the total presence of Latin America in U.S. bank foreign exposure.

Table 2: Geographical Breakdown of Exposures

Unweighted Averages across Banks	MCBs Only				non-MCBs			
Breakdown of Total Exposure (in percent)	**1990q4**	**1995q4**	**2000q4**	**2004q4**	**1990q4**	**1995q4**	**2000q4**	**2004q4**
to Industrialized Countries*	60.5	69.8	77.1	62.3	46.2	44.6	41.9	46.8
to Emerging Markets*	39.5	30.2	22.9	37.7	53.8	55.4	58.1	53.2
to Europe	45.8	44.5	57.2	48.9	34.2	29.9	26.4	30.7
to Latin America	22.0	17.4	11.5	28.1	42.9	46.6	47.1	38.6
to Asia and the Mid. East	21.3	29.4	21.2	16.3	12.1	11.6	16.8	21.8
to Other Regions	10.9	8.7	10.0	6.7	10.8	12.0	9.7	8.9
Breakdown of Cross Border Exposure								
to Europe	36.6	42.4	63.7	56.4	30.0	25.9	29.0	35.3
to Latin America	32.3	24.1	14.3	22.9	39.3	47.8	47.8	43.4
to Asia and the Mid. East	21.5	27.2	14.6	13.6	21.8	17.3	12.6	13.0
to Other Regions	9.6	6.3	7.3	7.0	9.0	9.0	10.6	8.4
Breakdown of Local Claims Exposure								
to Europe	62.4	49.9	41.2	37.5	55.0	40.9	47.6	36.8
to Latin America	5.8	8.4	14.0	37.7	7.4	25.6	15.0	19.4
to Asia and the Mid. East	20.3	30.1	29.1	19.6	29.5	17.3	11.0	12.3
to Other Regions	11.5	11.6	15.7	5.2	8.2	16.2	26.3	31.5

Note: all shares are unweighted averages across all banks or across only the top money center banks.

* Industrialized/emerging classification from IMF.

Table 2: Geographical Breakdown of Exposures (weighted averages across banks in each group)

Weighted Average across Banks	MCBs Only				non-MCBs			
Breakdown of Total Exposure (in percent)	**1990q4**	**1995q4**	**2000q4**	**2004q4**	**1990q4**	**1995q4**	**2000q4**	**2004q4**
to Industrialized Countries*	61.1	68.1	69.1	68.0	56.3	56.8	65.4	86.8
to Emerging Markets*	38.9	31.9	30.9	32.0	43.7	43.2	34.6	13.2
to Europe	47.3	41.8	50.8	54.8	37.2	30.5	44.6	58.3
to Latin America	19.2	18.4	15.1	13.8	24.4	41.0	27.9	8.6
to Asia and the Mid. East	21.1	30.1	24.8	23.4	28.8	19.7	8.5	7.2
to Other Regions	12.4	9.7	9.2	8.1	9.6	8.9	19.0	25.9
Breakdown of Cross Border Exposure								
to Europe	37.8	41.0	61.1	67.0	35.9	30.8	51.5	65.3
to Latin America	32.1	26.2	18.2	11.4	28.1	41.5	28.7	15.3
to Asia and the Mid. East	20.3	26.1	14.3	15.4	27.2	21.4	11.0	10.6
to Other Regions	9.8	6.7	6.3	6.2	8.8	6.3	8.8	8.8
Breakdown of Local Claims Exposure								
to Europe	56.8	42.6	34.4	34.2	42.5	28.9	30.7	46.3
to Latin America	6.5	9.8	13.7	18.7	9.1	39.0	28.9	0.8
to Asia and the Mid. East	21.8	34.6	40.1	37.3	35.4	12.5	3.9	3.1
to Other Regions	14.9	13.1	11.8	9.8	12.9	19.7	36.5	49.8

Note: all shares are weighted averages.

* Industrialized/emerging classification from IMF.

III. Risks in U.S. Bank Foreign Exposures

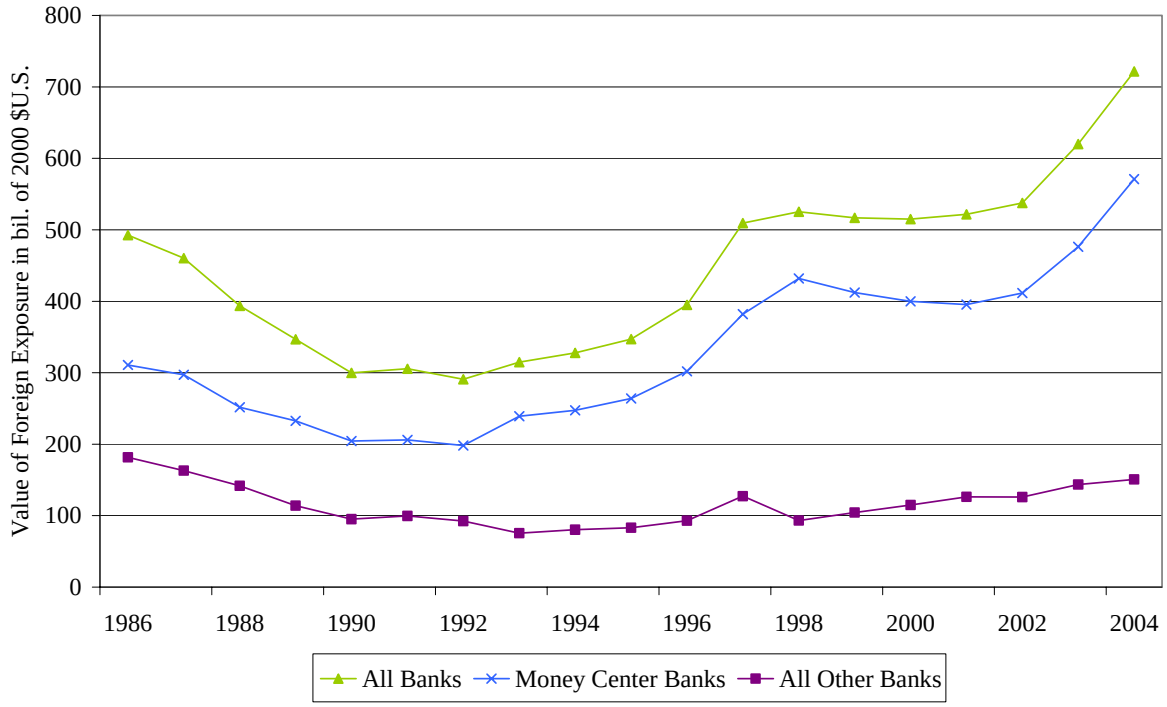
This section explores the risks in U.S. bank foreign exposures, beginning with the concept of transfer risk and then introducing country risk considerations. While aggregate and publically available reports provide numbers on total transfer risk and breakdowns across countries, we specifically use information on individual bank data to evaluate such risks for the average bank in each category. Through our bank-specific analysis we are able to relate these risks to other bank-specific information, like bank assets and bank capital, thus providing a clearer view of the risks in such U.S. bank foreign exposures, and the extent to which these risks appear to be capitalized.

Transfer Risk is defined as the portion of a bank's foreign exposure that is vulnerable to default because a country is unable to provide local borrowers with sufficient access to foreign currencies to meet their foreign obligations denominated in another currency, that is, any loan denominated in a currency other than the local currency of the borrower. Houpt (1999) states that "the supervisory measure of transfer risk has become the sum of cross-border claims, net local country claims, and claims resulting from revaluation gains [i.e., derivative claims]" (p. 9).[5]

As shown in Chart 4, transfer risk displays an increasing trend, as we also observed in Chart 1 on Total Foreign Exposure of U.S. Banks. Both measures increased by about 40 percent in the last five years. However, by taking a longer window on these series, we observe that transfer risk has been growing more slowly. Chart 5 shows the ratio of transfer risk to total exposure for all banks, money center banks, and all other banks. As unweighted averages across individual banks in each category, these figures capture the average increase in importance of local branches and subsidiaries of within types of U.S. banks and the increased importance of netting out with local liabilities the total volume of their local country claims. This pattern is especially relevant for MCBs, which were able to reduce total exposure by almost 40 percent in 2004 (making the ratio of transfer risk to total exposure about 60 percent). The chart indicates a much smaller reduction for all other banks.

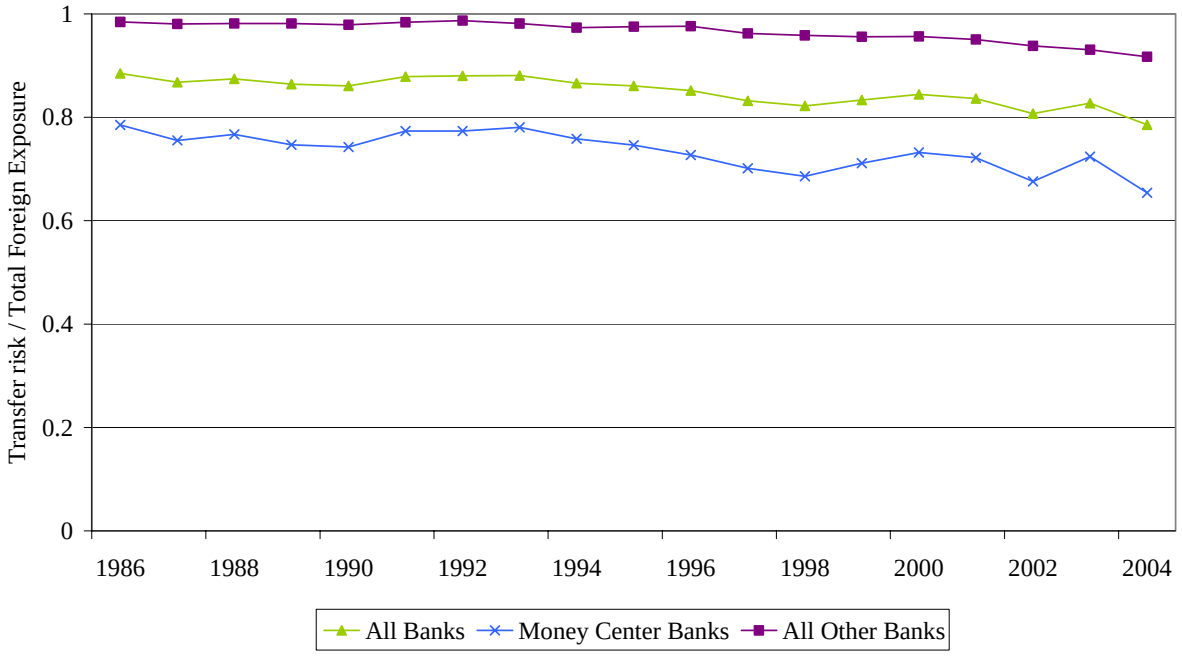
[5] In our analysis, provided below, we calculate a bank's transfer risk to a specific country as follows. First, construct net local claims (local claims – local liabilities). If net local claims are negative, set these at zero, following Houpt's definition, then sum cross-border, net local, and derivative claims.

Chart 4: Total Transfer Risk of U.S. Banks



Note: each year represented by q4 data

Chart 5: Ratio of Transfer Risk to Total Exposure for U.S. Banks



Note: Unweighted average across banks in each category

The relevance of this observation is also captured by the comparison of the ratios with total bank assets. Table 3 shows the capital ratios of MCBs and non-MCBs. The first row shows total foreign exposure relative to total equity capital, as unweighted averages across banks. The second row shows transfer risks relative to total equity capital. For MCBs, these ratios declined during the 1990s, but have reverted back in more recent years. The ratio of exposure or transfer risk to equity capital is far higher for MCBs than for non-MCBs, typically up to four times as high for exposure and at least three times as high for transfer risk. Part of this discrepancy across types of banks is explained by foreign exposure playing a larger role in bank assets among MCBs as compared with non-MCBs. As the third row of the table demonstrates, on average MCBs are more internationally active as measured by the share of total exposure in total assets. The fourth row of the table shows that the gap between bank types in transfer risk relative to assets is far less pronounced. MCBs have more exposure, relative to their assets, but the risks associated with every dollar of exposure are lower. The ratio of transfer risk to bank assets has become more similar across bank types in recent years.

Within this table we also provide standard deviations in each row at each date. The standard deviations are used to illustrate the extent to which bank specific information tends to differ from the mean data that we just discussed. There has been a dramatic rise in the differences across MCBs in their exposure and transfer risks relative to equity capital. The differences in exposure capitalization ratios are mainly driven by differences across banks in equity capital relative to overall assets.

Table 3: Capital Ratios of Exposed Banks (unweighted averages across banks)

	MCBs only				non-MCBs			
Mean	**1990q4**	**1995q4**	**2000q4**	**2004q4**	**1990q4**	**1995q4**	**2000q4**	**2004q4**
total exposure / total equity capital	7.50	5.91	4.63	6.05	1.50	1.65	2.11	1.42
standard deviation	*3.28*	*2.05*	*3.36*	*7.69*	*2.34*	*2.57*	*3.52*	*2.32*
transfer risk / total equity capital	5.25	4.23	3.39	5.09	1.44	1.61	2.02	1.33
standard deviation	*1.87*	*1.12*	*2.79*	*7.87*	*2.27*	*2.55*	*3.51*	*2.30*
total exposure as a share of total assets	0.35	0.37	0.28	0.23	0.10	0.13	0.16	0.12
standard deviation	*0.14*	*0.12*	*0.21*	*0.14*	*0.15*	*0.19*	*0.22*	*0.16*
transfer risk as a share of total assets	0.25	0.26	0.2	0.15	0.10	0.13	0.16	0.11
standard deviation	*0.08*	*0.04*	*0.16*	*0.11*	*0.15*	*0.19*	*0.22*	*0.15*
total equity capital / total assets	0.05	0.06	0.06	0.09	0.07	0.09	0.10	0.10
standard deviation	*0.01*	*0.01*	*0.01*	*0.07*	*0.03*	*0.05*	*0.07*	*0.05*

Note: all ratios and shares are unweighted averages across all banks or across money center banks.
Total Equity Capital = Common Equity + Preferred Equity + Retained Earnings + Treasury Stocks
Total Assets = Cash + Securities + Federal Funds Sold + Loans + Trading Assets + Fixed Assets & Real Estate + Intangibles
Data are from quarterly Call Reports (banks) and Y-9C filings (hank holding companies).
Definitions of equity and assets are identical for banks and bank holding companies.

Further insights into the composition and degree of risk involved in foreign exposures are gained when we add into our analysis country risk considerations. *Country Risk* ratings are intended to reflect each country's ability to pay back its international debt. Country risk includes assessments of liquidity constraints, sovereign default, political instability, the possibility that the government will confiscate foreign property or refuse to enforce foreign claims on local lenders, etc.[6] Since country risk covers a variety of features of a country it is generally reported as an index or letter grade. Most published classifications measure sovereign country risk, which is used as a proxy for overall country risk. Moody's, Standard and Poor's, Fitch and the OECD all publish well-regarded sovereign country risk ratings. In our analysis below we use the Fitch data, which has been published since 1994. Fitch's country coverage has expanded since 1994 and covered about 80 countries in 2004. The Fitch ratings are reported as A through D letter grades, with multiple letters denoting lower risk, so AAA is the best possible credit rating. Fitch groups its country rankings into investment grade, at BBB-rated and above, and speculative grade, at BB and below.[7]

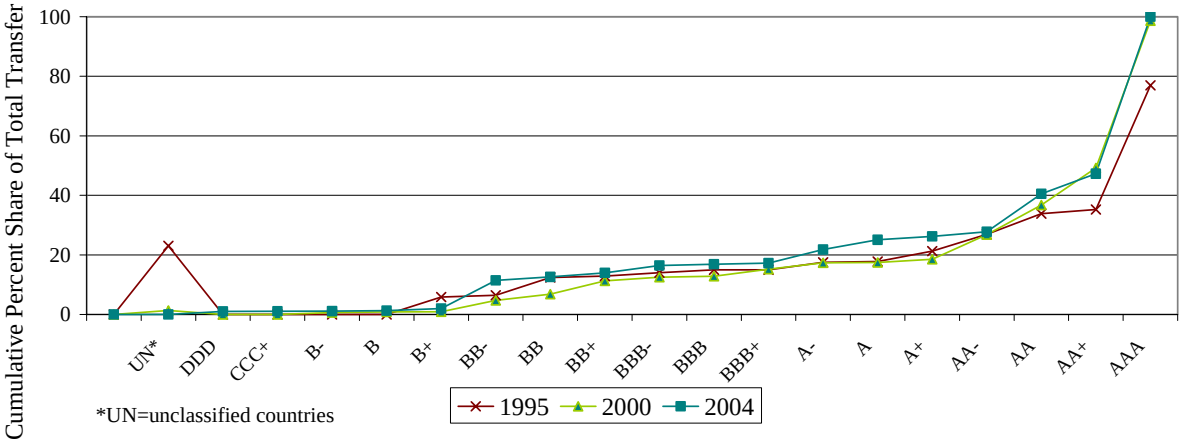
Charts 6 through 8 use the information on the exposures of each bank to specific countries, and presents constructed distributions of the risk in portfolios for different types of banks over three dates, 1995, 2000, and 2004. The risks for the average across MCBs are tracked in Chart 6, for average non-MCBs in Chart 7, and a comparison of relative risks of portfolios in 2005 for both types of banks in Chart 8. A distribution that is skewed more to the right means that a portfolio contains a higher share of exposures in safer countries.

As mentioned in introduction, U.S. banks have produced significant changes in the portfolio composition of total foreign exposure over time, both through changing the form of exposure – via cross-border versus via local claims, and through a change in the proportion of "safer" or "riskier" countries. As shown in Chart 6, MCBs had some changes in the distribution between 1995 and 2000, but the distribution of country risk is similar for 2000 and 2004. By contrast, Chart 7 shows that the average non-MCB had higher-risk countries in its portfolio in 2000 than in 1995, with this type of portfolio maintained in 2004. Chart 8 shows that in 2004, the non-MCBs had substantially more country risk in their transfer risk

[6] Houpt (1999) defines country risk as "all risks from economic, social, legal, and political conditions in a foreign country that may affect the status of loans to parties in that country" (p. 8)
[7] Further details on Fitch classification details can be found at < http://www.fitchratings.com/corporate/

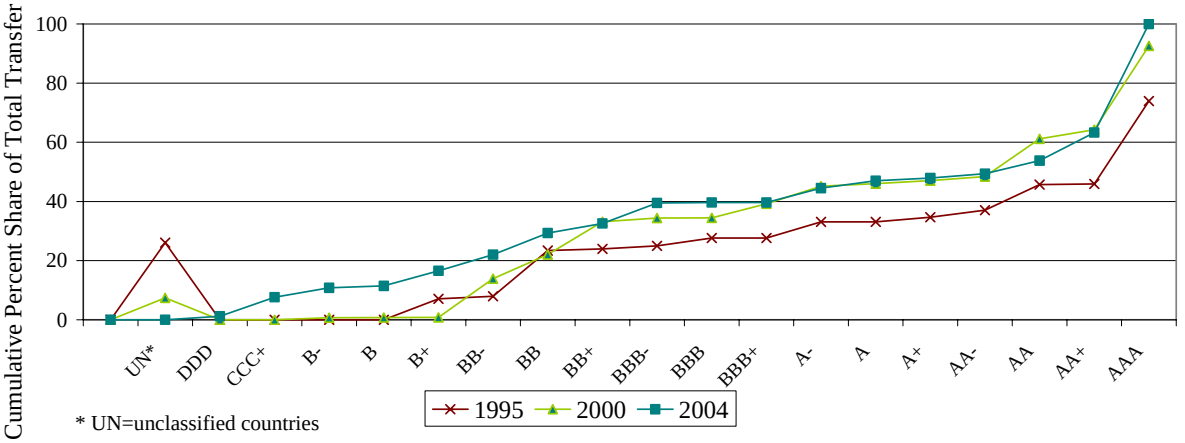
than non-MCBs. Not only is the form of the total international exposure more risky for non-MCBs, because of their higher share of cross-border claims, the country composition of the non-MCB exposures also is more risky.

Chart 6: Detailed Distribution of Country Risk for MCBs Over Time



Note: Shares are unweighted averages across all banks in each category.

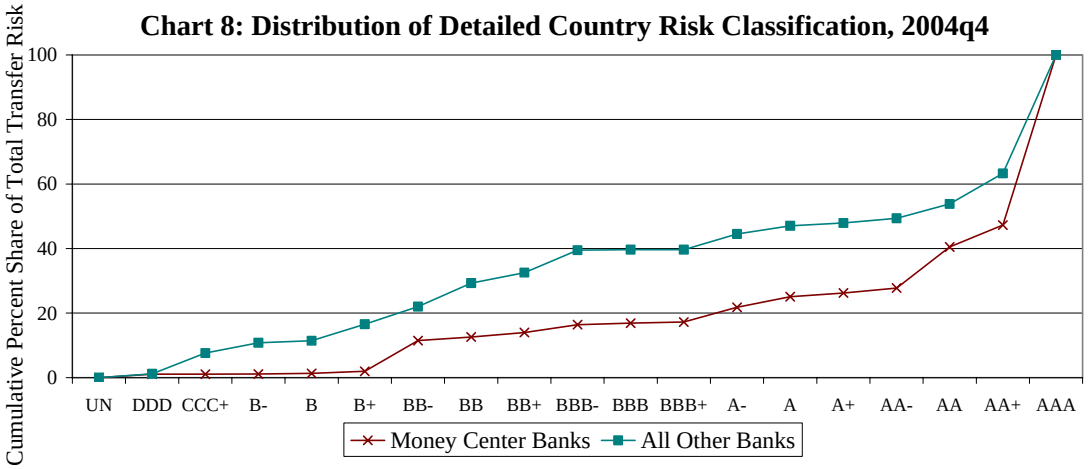
Chart 7: Detailed Distribution of Country Risk for non-MCBs Over Time



Note: Shares are unweighted averages across all banks in each category.

fitchResources.cfm?detail=1&rd_file=ltr>

Chart 8: Distribution of Detailed Country Risk Classification, 2004q4

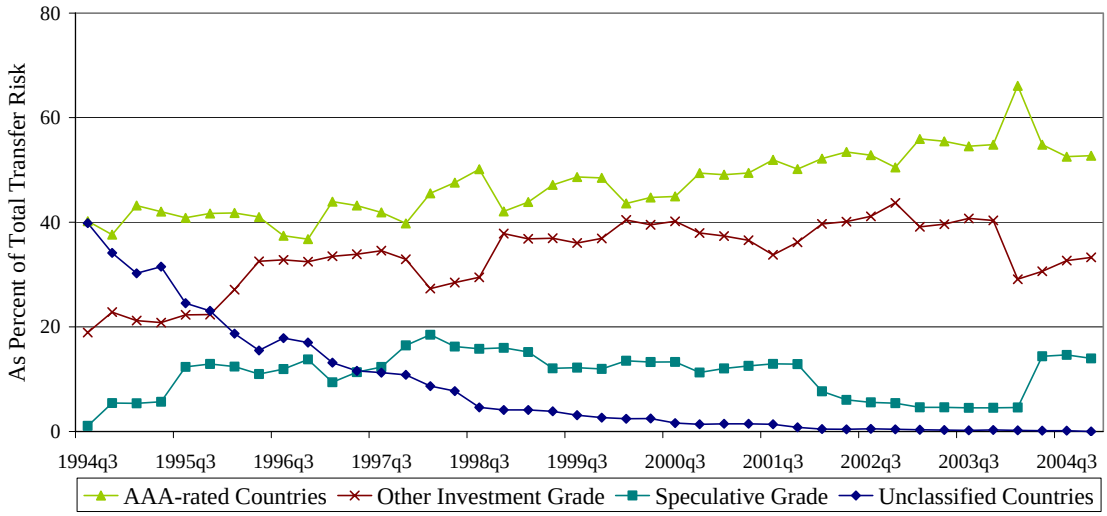


Note: Shares are unweighted averages across all banks in each category.

Another way of describing the riskiness of bank portfolios is by considering the shares within transfer risk of investment grade versus speculative grade countries. The shares over time for the average MCB banks and for the average non-MCB banks are presented in Charts 9 and 10. For MCBs, the share of AAA-rated countries has tended to rise over time, as has the share of other investment grade countries.[8] The share of speculative grade and other unclassified countries declined since the mid 1990s, and has stayed below 20 percent in the past decade. Non-MCBS, shown in Chart 10, continue to have much higher shares of their portfolio in speculative grade countries and otherwise unclassified countries. Table 4 highlights the same information, with specific numbers provided at each date. Observe that the mix of country risk for MCBs (on average) was about 50 percent since 2000, with total investment grade exceeding 80 percent of the foreign exposure. By contrast, the investment grade portion of the portfolio has been closer to 60 percent in the non-MCBs, with the speculative grade and unclassified part of the average non-MCB portfolio closer to 40 percent.

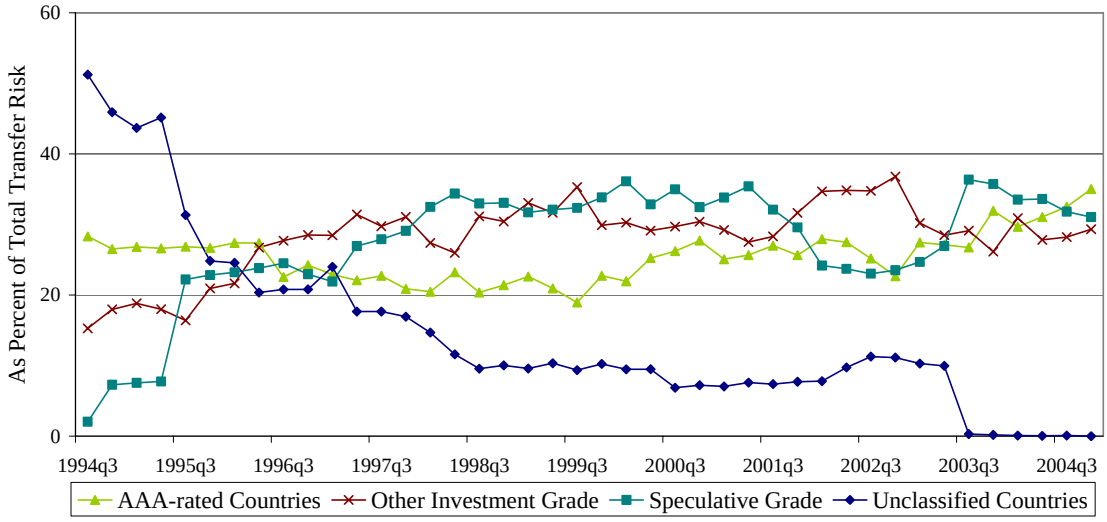
[8] These comments are conditional on the shares of foreign exposures that are in countries classified by Fitch. Unclassified counties are below 20 percent of the investments since the mid 1990s. These countries were traditionally more important for the international exposures of non-MCBs than for MCBs.

Chart 9: Country Risk within Transfer Risk for Money Center Banks



Note: Shares are unweighted averages across all money center banks.

Chart 10 Country Risk within Transfer Risk for non-MCB



Note: Shares are unweighted averages across all non-money center banks.

Table 4 Country Risk Distribution in Transfer Risk
(in percent)

Unweighted	MCBs only				non-MCBs			
	1990q4	1995q4	2000q4	2004q4	1990q4	1995q4	2000q4	2004q4
to AAA-rated Countries*	--	41.7%	49.0%	52.8%	--	28.0%	27.2%	36.7%
to Other Investment Grade Countries*	--	20.9%	37.8%	32.7%	--	18.4%	31.0%	30.5%
to Speculative Grade Countries*	--	10.0%	11.4%	14.4%	--	16.9%	33.2%	32.8%
to Unclassified Countries*	--	27.4%	1.8%	0.1%	--	36.6%	8.5%	0.0%

* Risk ratings as defined by Fitch. All figures are unweighted averages across banks.

Table 4. Country Risk Distribution in Transfer Risk (weighted averages across banks)
(in percent)

Weighted	MCBs only				non-MCBs			
	1990q4	1995q4	2000q4	2004q4	1990q4	1995q4	2000q4	2004q4
to AAA-rated Countries*	--	39.0%	44.5%	61.1%	--	34.7%	40.7%	65.7%
to Other Investment Grade Countries*	--	20.3%	39.3%	32.9%	--	18.3%	35.4%	28.0%
to Speculative Grade Countries*	--	11.2%	13.9%	5.8%	--	13.1%	22.0%	6.1%
to Unclassified Countries*	--	29.6%	2.3%	0.1%	--	33.9%	1.9%	0.1%

* Risk ratings as defined by Fitch. All figures are weighted averages across banks.

IV. Concluding Remarks

As the figures show, the total foreign exposures of U.S. banks, especially MCBs, have continued to grow over time. At the same time, the incidence of foreign exposure on banks total asset portfolio has actually diminished. Banks reporting foreign exposure have generally improved their overall capitalization, and as a result, on average, foreign exposure has not increased its weight on banks' equity capital for non-MCBs. On average across MCBs, exposure relative to equity capital has recently risen to levels last seen in the mid 1990s.

In addition to an overall better capitalization, U.S. MCBs have also increased their share of foreign exposure towards safer countries. The exposure of MCBs to riskier countries – especially Latin American countries – is now achieved mainly through the activities of local branches and subsidiaries that take on liabilities as well as assets. Hence, MCBs have maintained their exposure to riskier countries while reducing its relative impact on transfer risk. Despite higher shares of foreign exposure in portfolios of MCBs, the geographic

breakout of cross-border loans and the net positions on local claims make the risk implications of each dollar of exposure for MCB less than for smaller banks.

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Data Appendix.

Banking exposure data

U.S. FFIEC 009 and 009a reports are filed quarterly by all U.S. banks with significant exposures.

Background: The report was initiated in 1977 as the FR 2036 report and was used to collect data on the distribution, by country, of claims on foreigners held by U.S. banks and bank holding companies. The FDIC and OCC collected similar information from institutions under their supervision. In March 1984, the FR 2036 became a Federal Financial Institutions Examination Council (FFIEC) report and was renumbered FFIEC 009. It was revised in March 1986 to provide more detail on guaranteed claims. In 1995 (1997?), the report was revised to add an item for revaluation gains on off-balance-sheet items and an item for securities held in trading accounts, and several items were combined. Another revision which will, among other changes, make the FFIEC report more directly comparable to the BIS foreign exposure reports will be implemented starting with the 2006q1 report.

Respondent Panel: The panel consists of U.S. commercial banks and bank holding companies holding $30 million or more in claims on residents of foreign countries. Respondents file the FFIEC 009a if exposures to a country exceed 1 percent of total assets or 20 percent of capital of the reporting institution. FFIEC 009a respondents also furnish a list of countries in which exposures were between 3/4 of 1 percent and 1 percent of total assets or between 15 and 20 percent of capital. Participation is required.

Appendix Table: Country Risk Classifications in 2004q4

Countries Classified as AAA-rated	Countries Classified as other A-rated	Countries Classified as B-rated or below
Austria	Australia	Argentina
Denmark	Bahrain	Azerbaijan
Finland	Belgium	Bolivia
France	Bermuda	Brazil
Germany	Canada	Bulgaria
Ireland	Chile	Cameroon
Luxembourg	China	Colombia
Netherlands	Cyprus	Costa Rica
Norway	Czech Republic	Croatia
Singapore	Estonia	Dominican Republic
Spain	Greece	Ecuador
Sweden	Hong Kong	Egypt
Switzerland	Hungary	El Salvador
U.K.	Iceland	India
	Israel	Indonesia
	Italy	Iran
	Japan	Kazakhstan
	Korea	Lebanon
	Kuwait	Malawi
	Latvia	Mali
	Lithuania	Mexico
	Malaysia	Mozambique
	Malta	Panama
	New Zealand	Papua New Guinea
	Portugal	Peru
	Saudi Arabia	Philippines
	Slovakia	Poland
	Slovenia	Romania
	Taiwan	Russia
		Serbia
		South Africa
		Thailand
		Tunisia
		Turkey
		Uganda
		Ukraine
		Uruguay
		Venezuela
		Vietnam
Share of 2004q4 Countries that were similarly classified in 2000q4		
71.4	72.4	94.9
Share of 2004q4 Countries that were similarly classified in 1994q4		
50	58.6	89.7

Source data: Fitch