RESEARCH

Whither global banks?

Workshop on “The future of the financial industry, FUNCAS, Madrid, 31st January 2012

Santiago Fernández de Lis | sfernandezdelis@bbva.com

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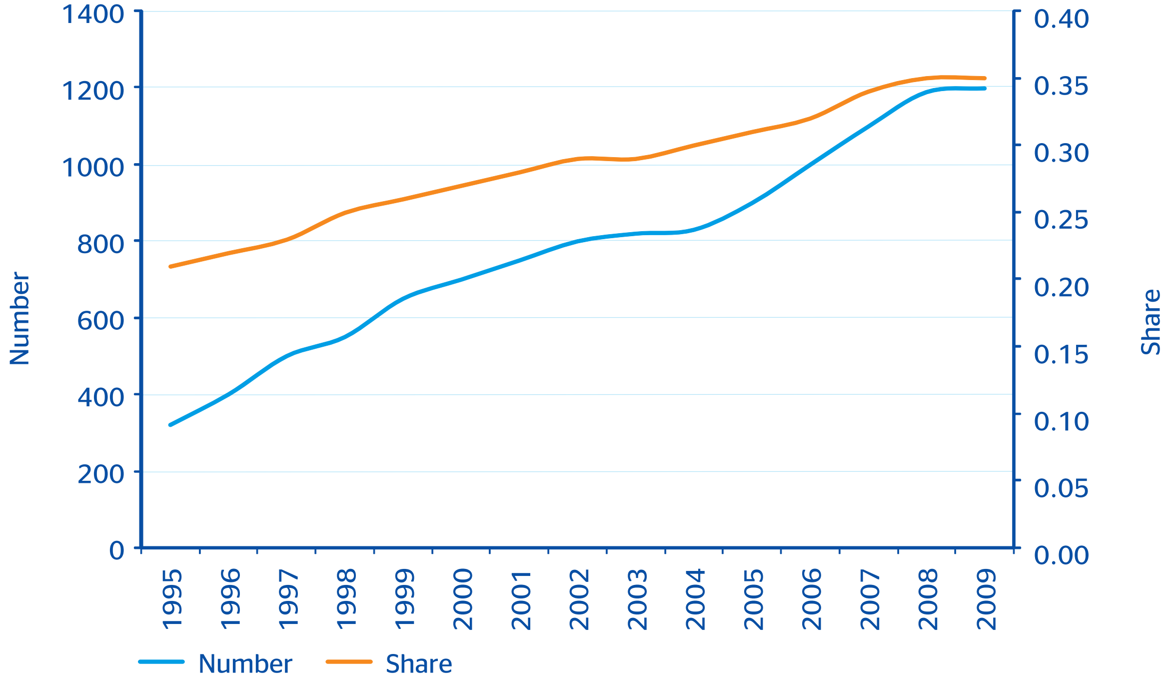
Trends in global banking

Substantial increase in the number and share of foreign banks over the last 15 years

Number and Share of Foreign Banks*
Source: IMF



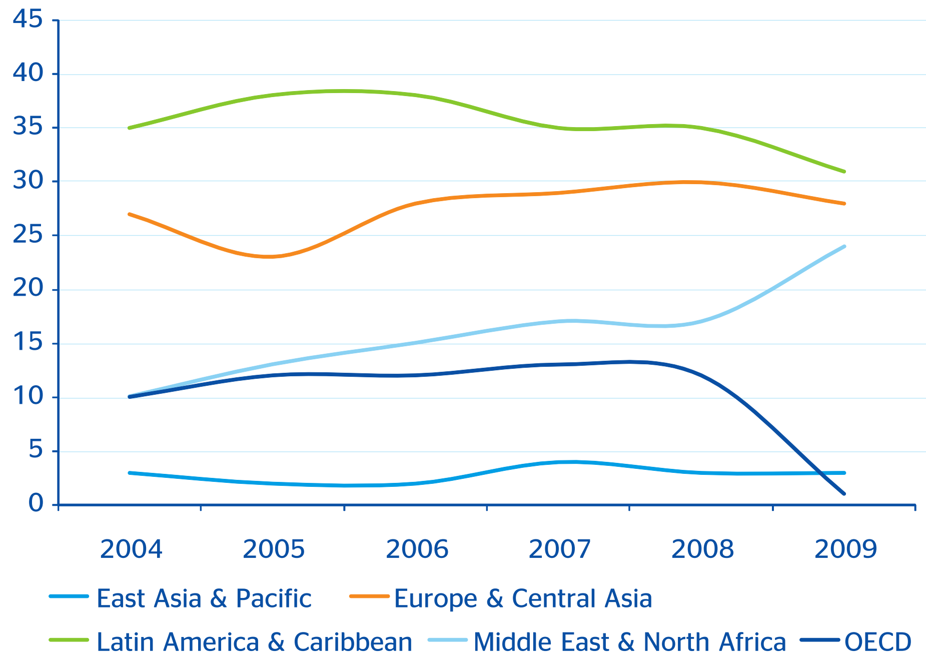
* Claessens, S. and van Horen, N. (2012), "Foreign Banks: Trends, Impact and Financial Stability", IMF Working Paper No.12/10

Trends in global banking

In terms of loans, deposits and profits, market shares of foreign banks average 20% in OECD countries and close to 50% in emerging and developing markets

Percentage of foreign bank assets over total bank assets*

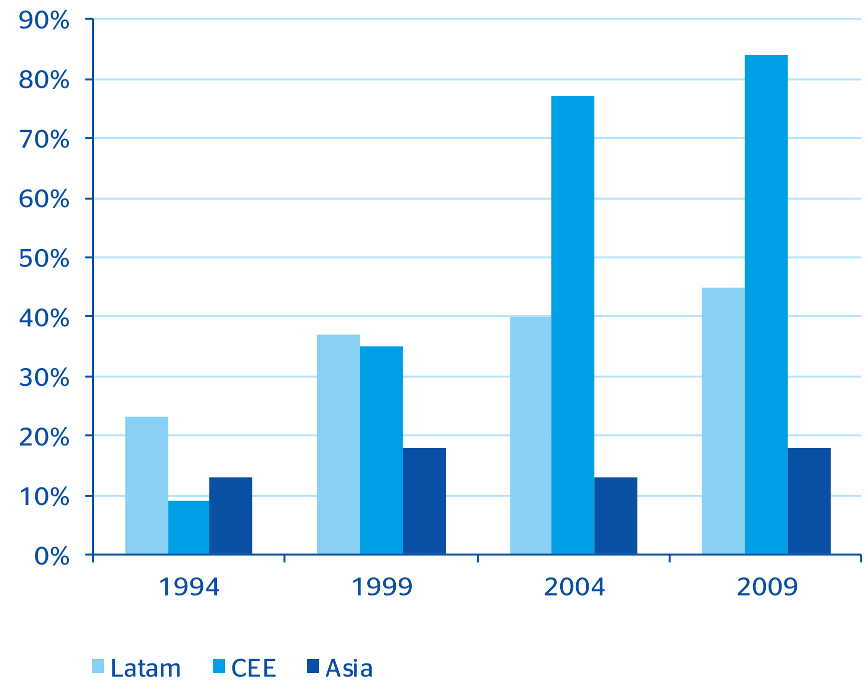
Source: IMF



Consolidated lending by foreign banks

(% of total bank lending to nonbanks)

Source: BIS



Trends in global banking

Is this crisis the start of a reversal in financial globalization?

Capital controls

(Capital Flow Management Measures)

Markets segmentation

Ring fencing

Uneven implementation of regulatory reform

"Globalization increases the costs of getting the policies wrong, just as it increases the benefits of getting them right"*.

* McMillan, M. and Rodrick, D. (2011), "Globalization, structural change, and productivity growth*", ILO-WTO Paper

The role of international banks is being questioned in this crisis

When taxpayers' money is used to rescue banks in some countries, there is a surge of nationalistic feelings…

Are international banks the source or the transmission channel of the crisis?

Not always and **Not all types of banks**

Shadow banking played an important role: SIVs, conduits

A series of recent IMF papers shed light on this:

Better results: **Retail** banks with **decentralized** model (stand alone **subsidiaries**)

Example: Latin America

Worse results: Banks more reliant on **wholesale** financing and depending on **parent bank funding (branches)**

Example: Central and Eastern Europe (CEE)

More resilient: subsidiaries, decentralized and retail

Subsidiaries

- Subsidiaries: local funding, local currency, host supervision, host deposit guarantee scheme. Better risk assessment and resolution, retail oriented
- However, some models depart from the theoretical structure of branches / subsidiaries: Some US branches are ring-fenced and some EU banks subsidiaries in CEE are dependent on home country funding

Decentralized funding

- Facilitates a decentralized management of capital and liquidity, lowers contagion (global systemic risk), reinforces local market discipline
- There may be losses of economies of scale in liquidity management and does not exploit the "too-big-to-fail" premium

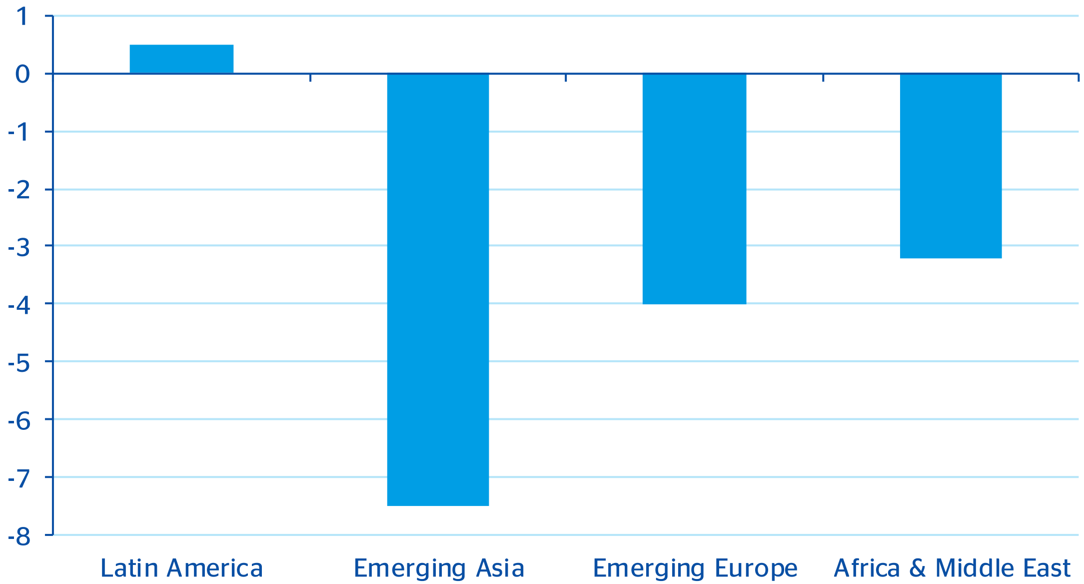
Retail

- Retail banks are usually covered by deposit guarantee funds. Wholesale banks are more exposed to funding problems (Northern Rock)

Case Study 1: Latam vs. CEE

The performance of their foreign banking models has been different:

Change in Foreign Banks' Total Outstanding Claims since Lehmann
(%, exchange rate adjusted, Sep 08-Jun 09)
Source: IMF



Case Study 1: Latam vs. CEE

The foreign banking models in both areas are very different*:

	Latam	CEE
Share of foreign bank lending through local affiliates, 2008	70%	50%
Deposits/Loans ratios in foreign-owned subsidiaries, 2007	105%	75%
Foreign banks cross-border lending to banking sector, 2008	<10%	15-65%
% Foreign banks' lending denominated in local currency, 2008	55%	30%
Change in foreign banks' claims since Lehman (Sep 08-June 09)	0.5%	- 4%

More resilient in this crisis

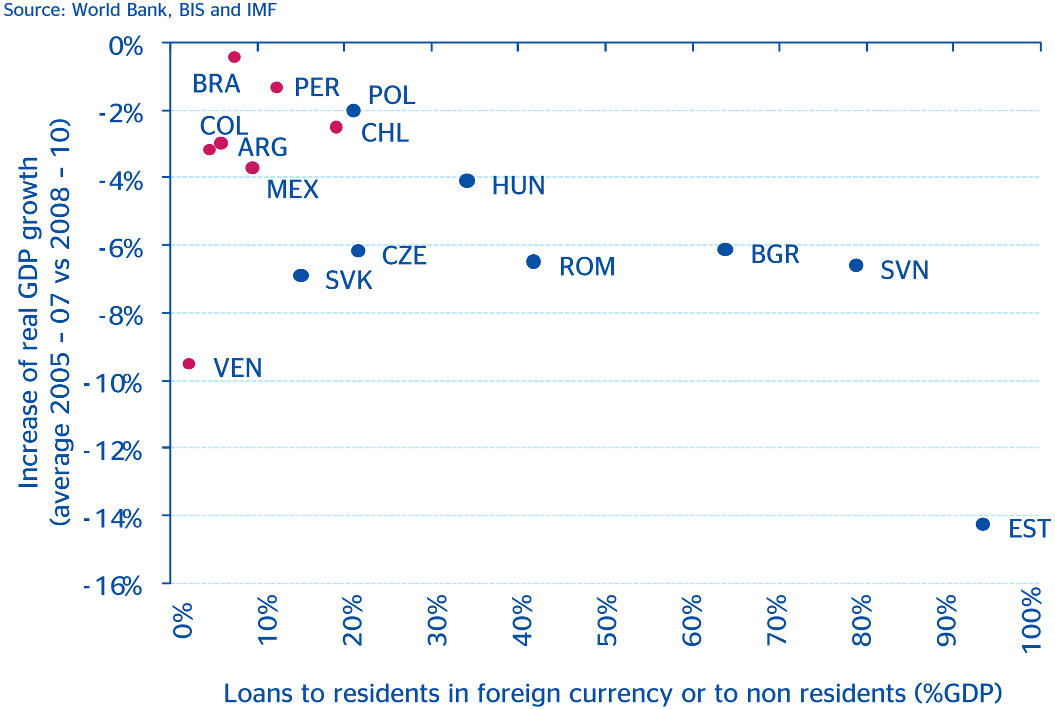
* Kamil, H. and Ray, K. (2010), "The Global Credit Crunch and Foreign Banks' Lending to Emerging Markets: Why Did Latin America Fare Better?", IMF Working Paper No.10/102

Case Study 1: Latam vs. CEE

Countries relying more on foreign currency lending and/or funding from the parent company did worse in this crisis

Foreign Banks' Weight and GDP Evolution (%)

Source: World Bank, BIS and IMF



Case Study 2: Spain, Belgium, Netherlands and Austria

Another recent IMF paper* studies the evolution of different international banks

"The large **Spanish banks,** which had **a locally funded** EM expansion strategy, **emerged stronger** from their EM business through the crisis **despite the difficulties in their home markets"**

"The **Austrian banks,** which developed a more **centrally funded** model, faced a **more severe test from their EM expansion** strategy and from **concentrated exposures in EM Europe.** The **external assistance** that the region received from the Fund, the EU, and other European institutions **played a significant role** in alleviating the strains felt by Austrian banks"

"The **Belgian and Dutch banks** which **expanded** their cross-border business **most rapidly** were **hard-hit.** They not only faced difficulties similar to the Austrian banks in EMs, but **also encountered difficulties with their AE exposures"**

Problems are different depending on whether they originate in home or in host countries...

...but the decentralized model is superior in both cases

* Seshadri, S. and Mühleisen, M. (2011), "Cross-Cutting Themes in Advanced Economies with Emerging Market Banking Links", IMF Report

Future:
Depends on regulation & resolution

The crisis has shown the importance of increasing coordination of:

Regulation

Higher harmonization of Basel standards

Supervision

Reinforcement of colleges of supervisors

FSB recommends the creation of Crisis Management Groups for SIFIs with a more limited size and more practical than colleges of supervisors

SIFis surcharges (Global & Domestic) may penalize subsidiries vs. branches

Future: Depends on regulation -- resolution

How to let banks fail without disrupting the whole economy is the single most important reform – Cross-border dimension complex – No burden-sharing agreement

Subsidiaries model: Key regulatory issues in resolution

Home- host relation

- **Ambiguities about home and host** authorities role and lack of cooperation

✗

- Enhanced international **cooperation** with home authorities leading role

✓

Need coordination home- host resolution plans

Intra-group support

- **Undermines the right to choose whether to support** or not in case of a crisis
- Runs **against the "stand alone subsidiaries"** model
- Facilitates **contagion to the whole group & the spread of crises**

- Ordinary **intra-group operations** (loans, guarantees, collaterals) should be executed at an **arm's length basis**
- **Intra-group support should remain a private and voluntary decision of the group** decided by the management of the entity, in accordance with the group business model

Is this different in the EU?

Recap: where do we stand?

- This crisis implies a reconsideration of the role of global banks:
  - Origin of the crisis? Partly, shadow banking also played a role
  - Spread of contagion? Partly:
    - Branches, centralized, wholesale funding created more systemic risk
    - Subsidiaries, decentralized and retail more resilient
    - Latam versus Central and Eastern Europe
- Resurgence of nationalistic and protectionist regulations. Segmentation of global financial system a risk
- Financial regulation key to:
  - Ensure level playing field
  - Avoid regulatory arbitrage
- Cross-border resolution challenging
- Objective: correct excesses while preserving pros of globalization & successful business models

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