Global Banking: Trends and Policy Issues

A Host-Country Perspective

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Introduction

Banks are special:

- They are the central nervous system of the economy.
- They provide access to the payments systems.
- They are prone to systemic risks.
- They have access to the safety net: Deposit insurance, liquidity assistance.

Host-country authorities are responsible for locally incorporated banks: taxpayer money.
Impacts of foreign bank entry on:

I Efficiency and competition

II Subsidiaries’ ability to stand alone and market discipline

III Policy options
Global banks need depositor’s bases to reach the household sector.

- Their expansion overseas is taking place through the acquisition of existing retail banks.
- This situation leaves host-country market structures unchanged.

**Credit to households**
*(percentage of total credit to private sector)*

- **Mexico**: 
  - 1999: 35
  - 2004: 40
- **Poland**: 
  - 1999: 40
  - 2004: 45
- **Czech Rep.**: 
  - 1999: 25
  - 2004: 30
- **Hungary**: 
  - 1999: 10
  - 2004: 15

Source: BIS
Efficiency gains often result in higher profits and not in consumer benefits.

**Operating Expenses**
*(as a percentage of total assets)*

- Mexico: 1999 - 5%, 2004 - 4%
- Poland: 1999 - 4%, 2004 - 3%
- Czech Rep.: 1999 - 2%, 2004 - 1%
- Hungary: 1999 - 5%, 2004 - 4%

**ROE**
*(Profits after taxes as a percentage of equity)*

- Mexico: 1999 - 5%, 2005 - 15%
- Poland: 1999 - 10%, 2005 - 15%
- Czech Rep.: 1999 - 5%, 2005 - 25%
- Hungary: 1999 - 5%, 2005 - 5%

Source: BIS
Source: FMI, Global Financial Stability Report
Efficiency and Competition

Interest rate margins are often much higher in host countries

* Net interest margin (percentage of assets)

* Credit Cards APR* (Comparison between credit cards with similar characteristics)

Source: National central banks and supervisors.

* APR was calculated using the methodology of the U.K. Consumer Credit Act 1974. It includes Annual Fees.
Measures taken by Banco de México

- Require banks to publish annual interest rates (APR)
- Require banks to disclose fees and commissions
- Eliminate commissions on inter-bank transfers
- Central bank website provides a mortgage simulator allowing users to compare APRs among banks
- Efforts to reduce banks’ interchange and discount fees associated with credit and debit cards
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Ability to Stand Alone

“The formal legal distinctions and separation [between parent and subsidiary] are not matched by a similar economic separation”

Charles Goodhart

- Parent banks and subsidiaries are different legal entities.
- Subsidiaries are managed as branches, but legal responsibilities are limited to capital invested.
- The division is uneven between decision-making powers and responsibilities.
Parent banks maximize risk-adjusted returns on a global-portfolio basis.

They book operations where funding and regulatory costs are lower, and not where business is originated.

Decisions that maximize parent-bank benefits are not necessarily positive for the subsidiary. These practices shift income away from subsidiaries.

Matrix reporting arrangements.

Weaken accountability of local CEO’s and boards.
Ability to Stand Alone

- The degree of control a parent bank has is related to the subsidiaries’ ownership structure.
- Widely held ownership structures are important for large banks.
- Subsidiaries do not reap the benefits of having widely held parent banks: they are different legal entities.
Subsidiaries are de-listed from local stock exchanges

Outstanding subordinated debt has declined rapidly

**Market Discipline**

### Mexican Banks

<table>
<thead>
<tr>
<th>Year</th>
<th>Listed (%)</th>
<th>Not Listed (%)</th>
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<tbody>
<tr>
<td>1998</td>
<td>73%</td>
<td>27%</td>
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<tr>
<td>2005</td>
<td>13%</td>
<td>87%</td>
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</tbody>
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Source: Banco de Mexico

### Subordinated debt

(billions of pesos)

Source: Banco de Mexico
Impacts of foreign bank entry on:

I  Efficiency and competition

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III Policy options
How can we put in place the right incentives to entice managers to put the subsidiaries’ interests first?

- Strengthen corporate governance
- Issuance of subordinated debt
- Widen subsidiaries’ ownership structure: minority shareholders
Conclusions

- Foreign bank entry brings many benefits, but also challenges.
- For host countries is important to put in place the right incentives to enhance market discipline and the stand-alone ability of foreign-owned large subsidiaries: minority shareholders.
- Speed up efforts for convergence of home countries (G-10) regulations.
- Establish close cooperation of central banks and supervisory authorities to deal with crisis situations.
- Create a CGFS working group on cross-border crisis management by central banks?