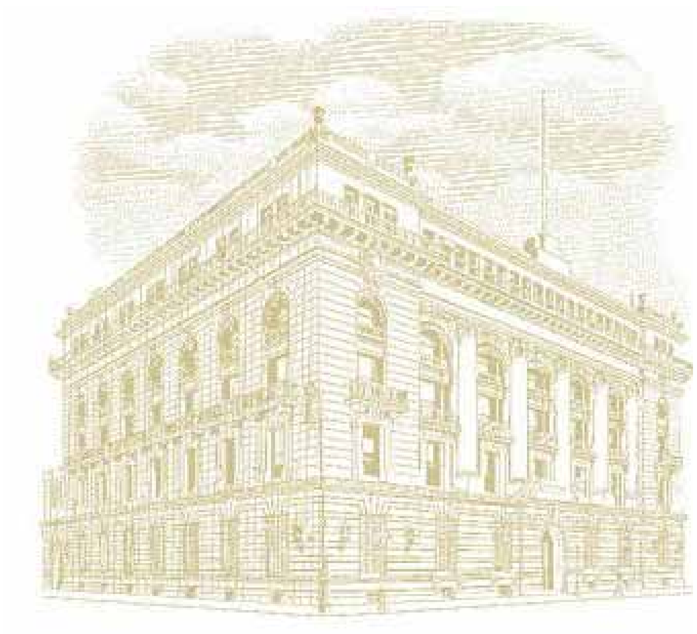
Global Banking: Trends and Policy issues



A Host-Country Perspective

Guillermo Ortiz

Fifth BIS Annual Conference
Brunnen, June 2006

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**.**

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Impacts of foreign bank entry on:

I Efficiency and competition

II Subsidiaries' ability to stand alone and market discipline

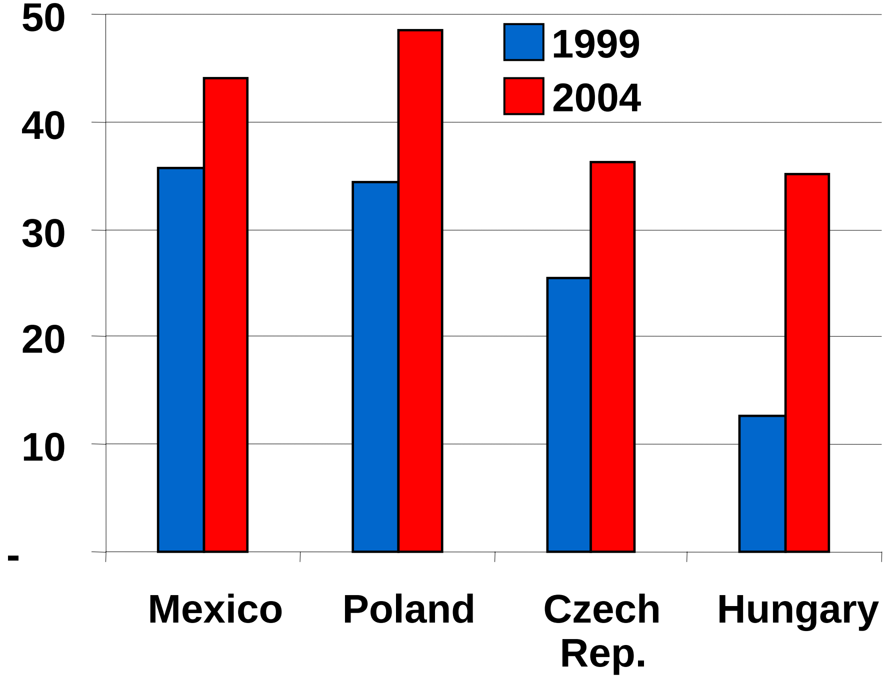
III Policy options

Efficiency and Competition

Global banks need depositor's bases to reach the household sector.

Credit to households

(percentage of total credit to private sector)



Source: BIS

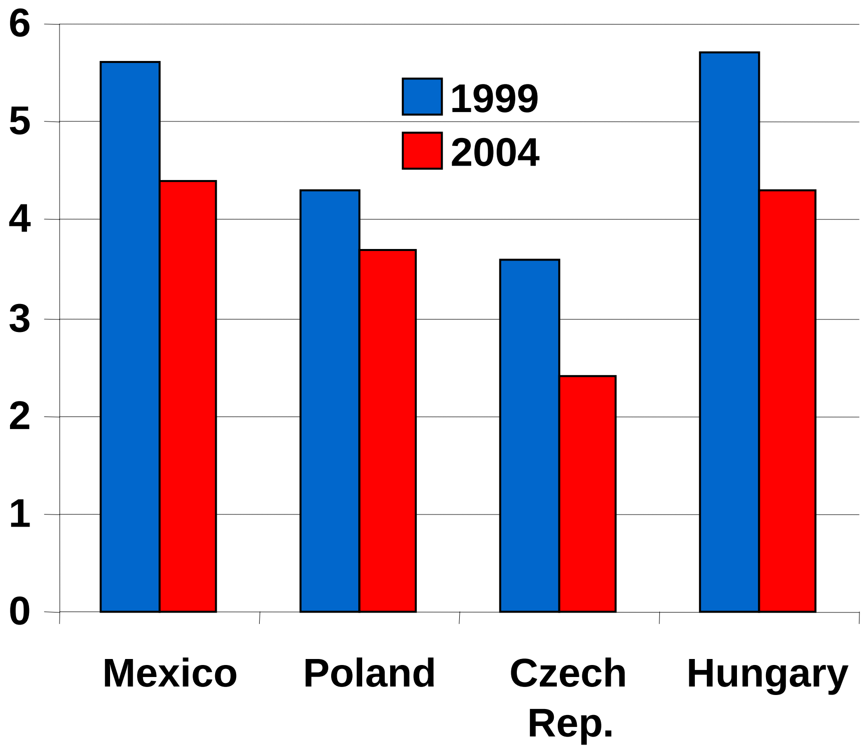
- **Their expansion overseas is taking place through the acquisition of existing retail banks**
- **This situation leaves host-country market structures unchanged.**

Efficiency and Competition

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

Operating Expenses

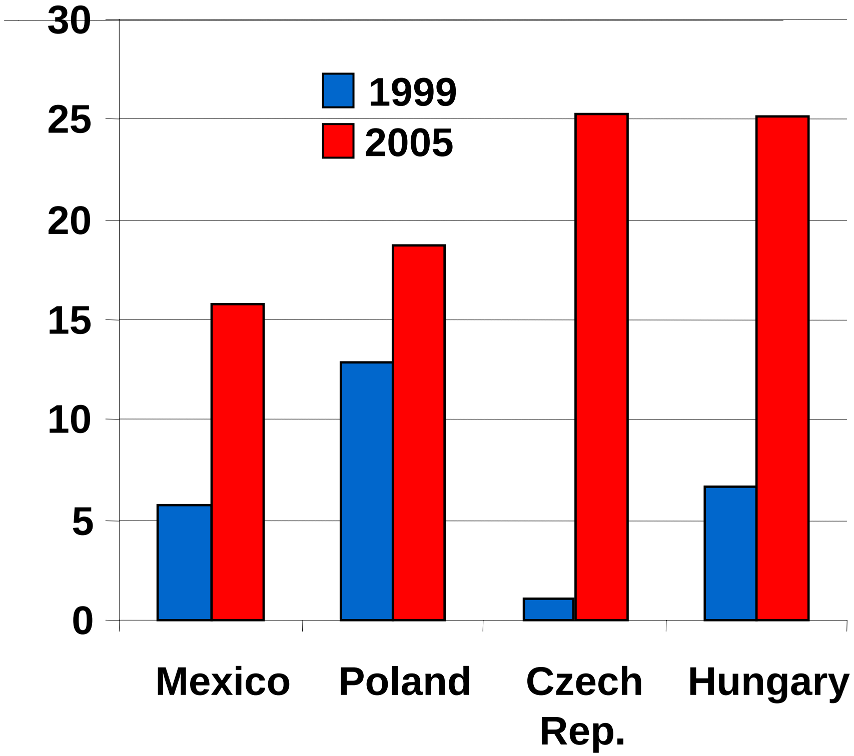
(as a percentage of total assets)



Source: BIS

ROE

(Profits after taxes as a percentage of equity)



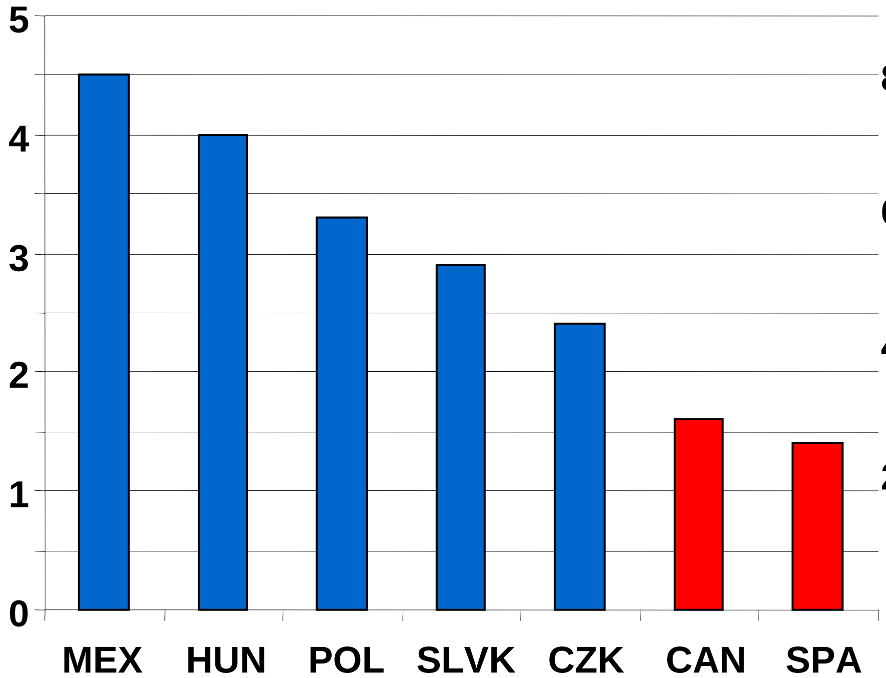
Source: FMI, *Global Financial Stability Report*

Efficiency and Competition

Interest rate margins are often much higher in host countries

Net interest margin

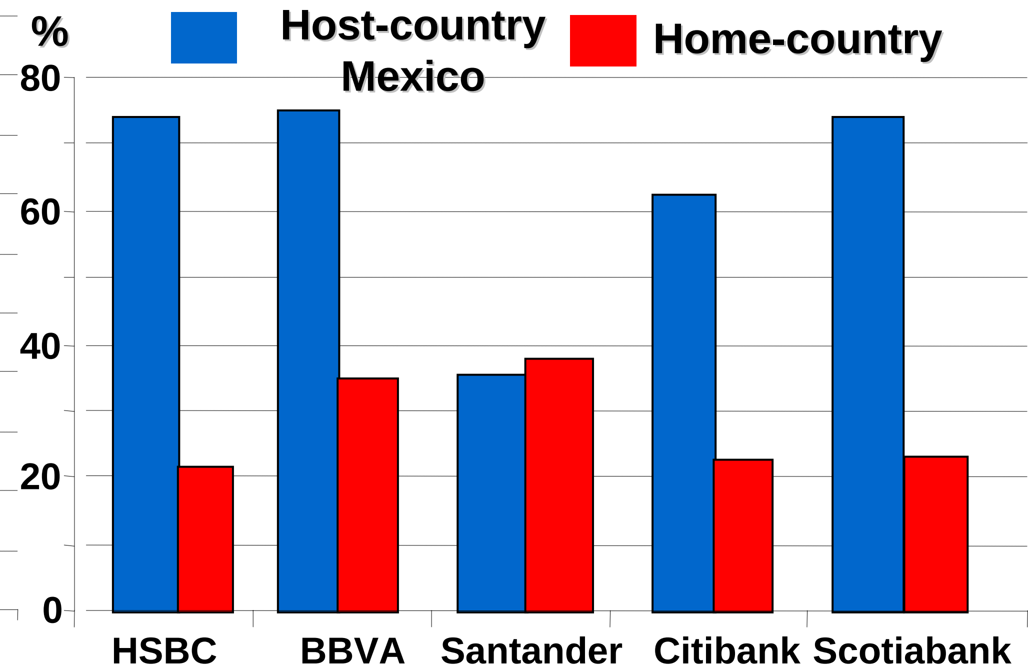
(percentage of assets)



Source: National central banks and supervisors.

Credit Cards APR*

(Comparison between credit cards with similar characteristics)



***** APR was calculated usig the methodology of the U.K. Consumer Credit Act 1974. It includes Annual Fees.

Efficiency and Competition

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.**

Ability to Stand Alone

- 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.

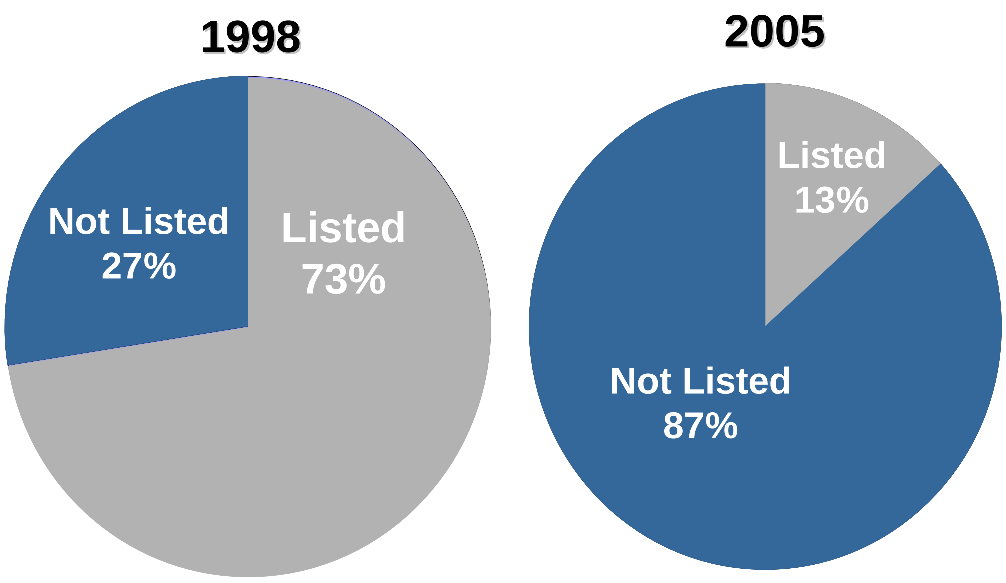
  Weaken accountability of local CEO's and boards.

Ability to Stand Alone

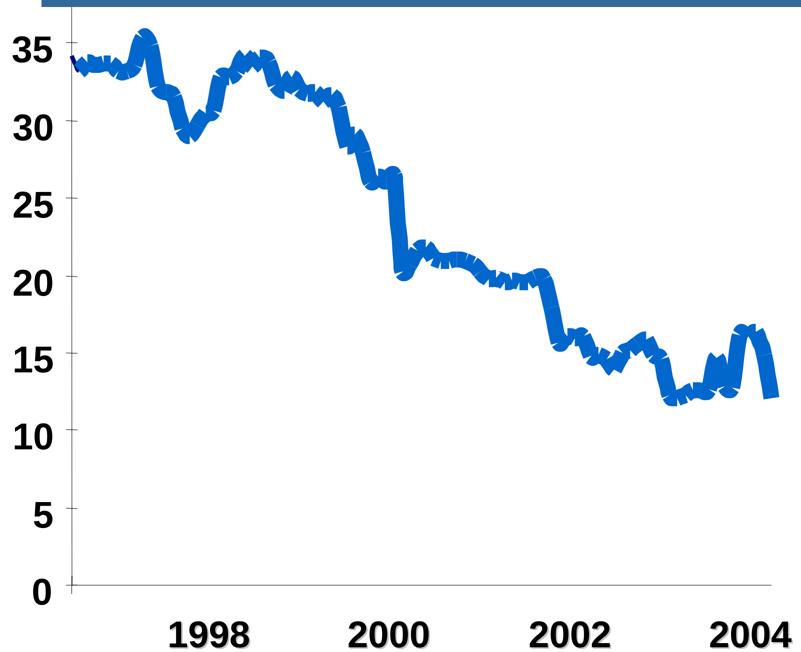
- The degree of control a parent bank has is related to the subsidiaries' ownership structure.
- Widely held ownership structures are important for large banks.
- Subsidiaries do not reap the benefits of having widely held parent banks: they are different legal entities.

- Subsidiaries are de-listed from local stock exchanges
- Outstanding subordinated debt has declined rapidly

Mexican Banks
(% of total assets)



Subordinated debt
(billions of pesos)



Source: Banco de Mexico

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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 <u>put in place the right incentives</u> 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 <u>central banks</u> and supervisory authorities to deal with crisis situations**
- **Create a CGFS working group on cross-border crisis management by central banks?**