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The new regulatory environment: a global retail bank view

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Section 1

Profound regulatory reform as a response to the crisis

Numerous lines of reform with 4 main objectives

GLOBAL	EU
Basel III	CRD IV
Systemic risk (SIFIs)	CRD IV
Crisis management	BRRD
OTC Derivatives	EMIR
Financial instruments	MiFID II /MIFIR
Structural reforms	
Macroprudential policy	
Shadow Banking	
Credit rating agencies' regulation	

Objectives

- Strengthen banking solvency
- Mitigate systemic risk
- Minimize taxpayer cost
- Improve resolvability

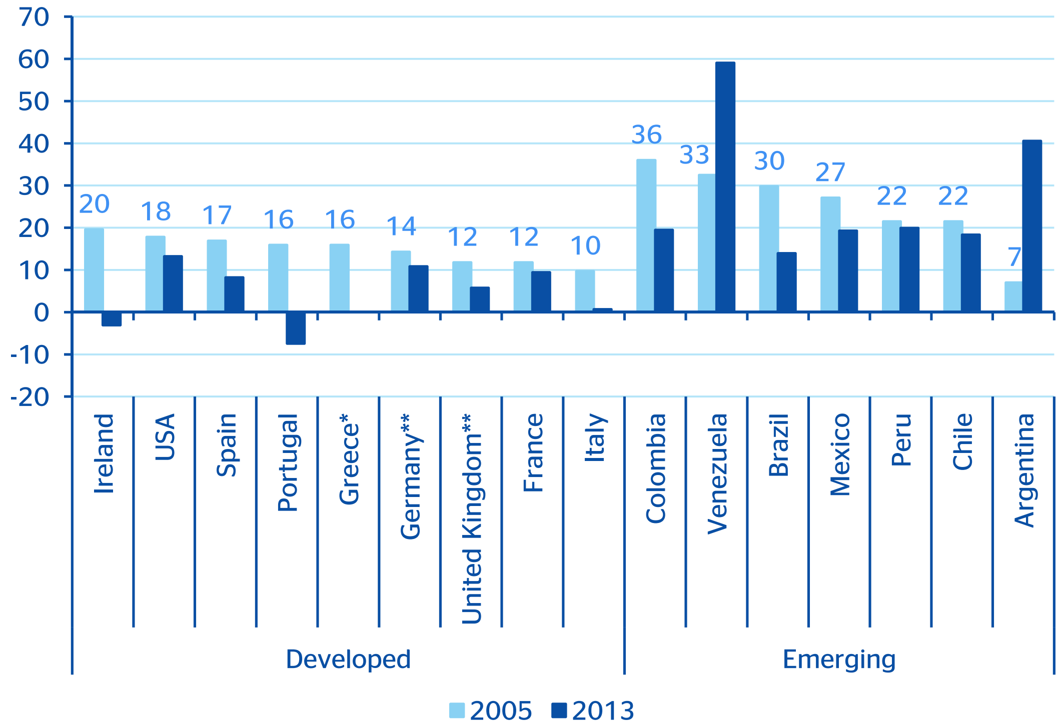
- It is difficult to assess the overall impact of all these measures
- Important to ensure the consistency of reforms in different jurisdictions
- Ring fencing trend challenging for global banks, less so for decentralized models

Section 1

The new environment of lower profitability

Return on Equity, RoE

Source: BBVA Research based on IMF



*n.a. data **2012 data

It will be difficult to regain pre-crisis levels of profitability, especially in terms of ROE (ROA maybe more)

Profitability of the banking business: challenging in developed countries; diversification to EMEs a strength

Greater dispersion between entities (end of public implicit subsidy)

Anticipate changes in the industry will be key to a successful business model: technology is crucial

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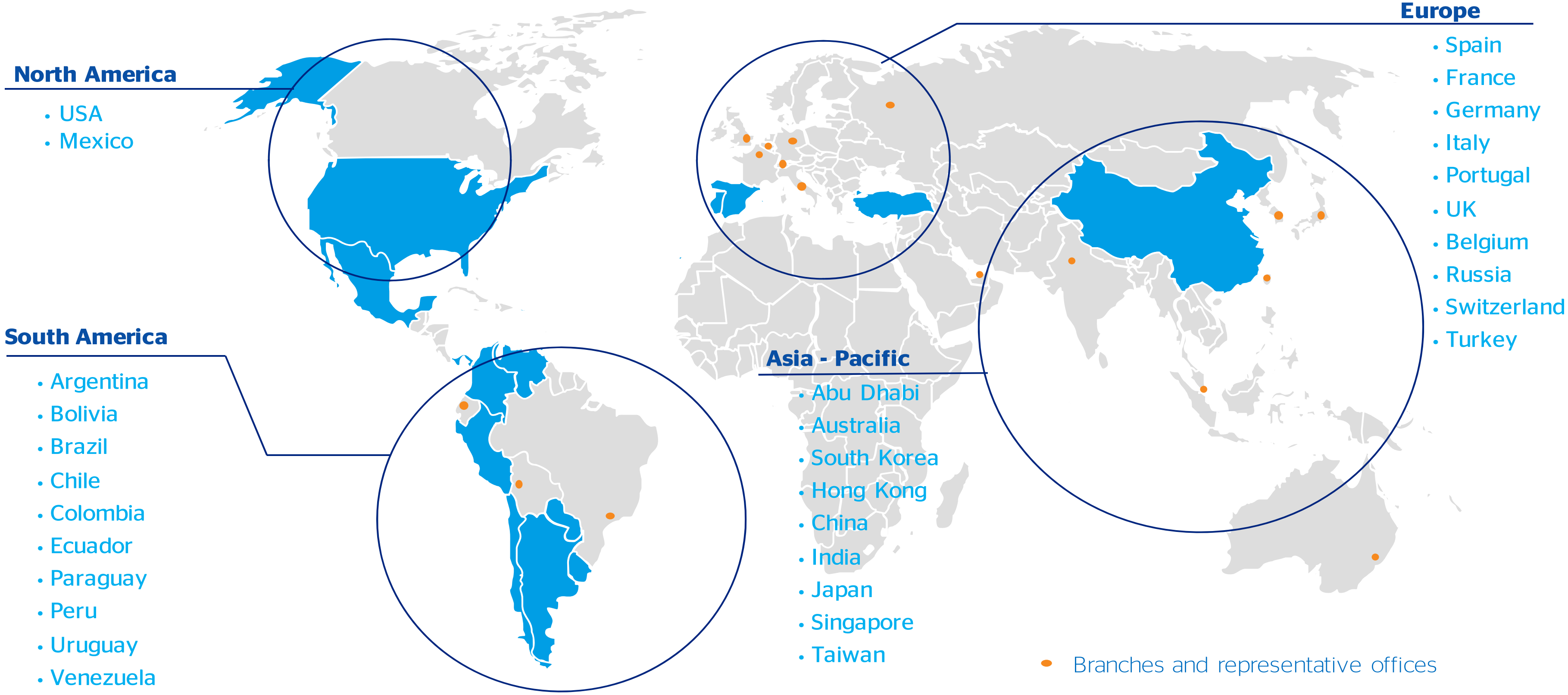
Section 2

BBVA is a global multinational group with strong presence in emerging markets



Section 2

The Decentralised Subsidiary Model

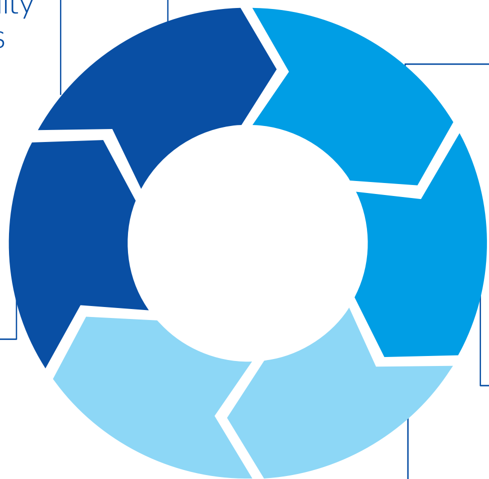
Parent sets

Definition of protocols, oversight activity, group's strategy of liquidity growth, funding policy guidelines

Locally incorporated subsidiaries in EME

Stand-alone entities with their own capital and liquidity management

Supervised by host, covered by local DGS



Credit risk managed independently

Subject to limits and tailored to specific host regulatory requirements

Consistent with Group common risk culture

Self sufficient in funding

Retail model, reliant on local currency deposits. Subsidiaries raise funds locally

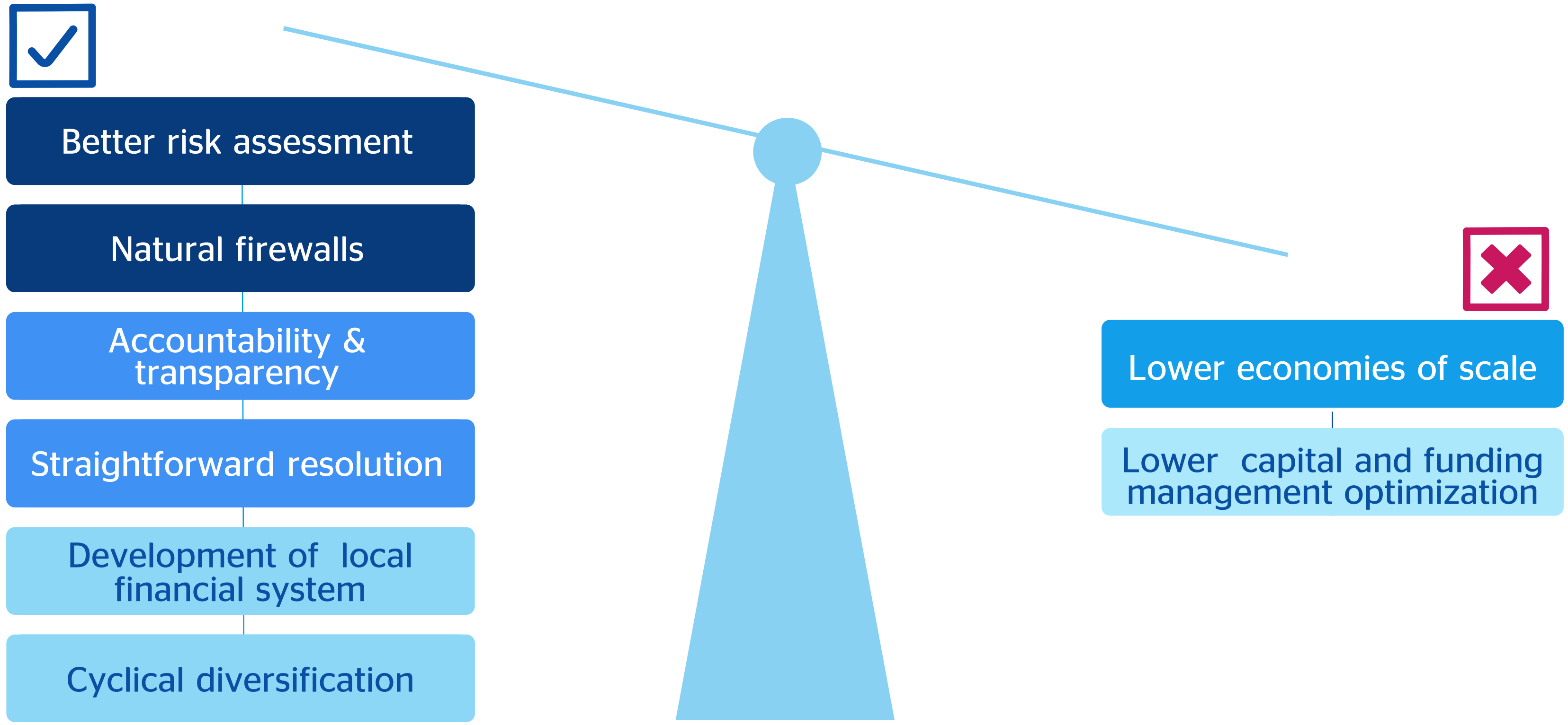
No systematic intragroup support. It is an option if needed, but at market prices

Multiple Point of Entry resolution

Independent governance

Section 2

Pros & Cons of Decentralised Subsidiary Model



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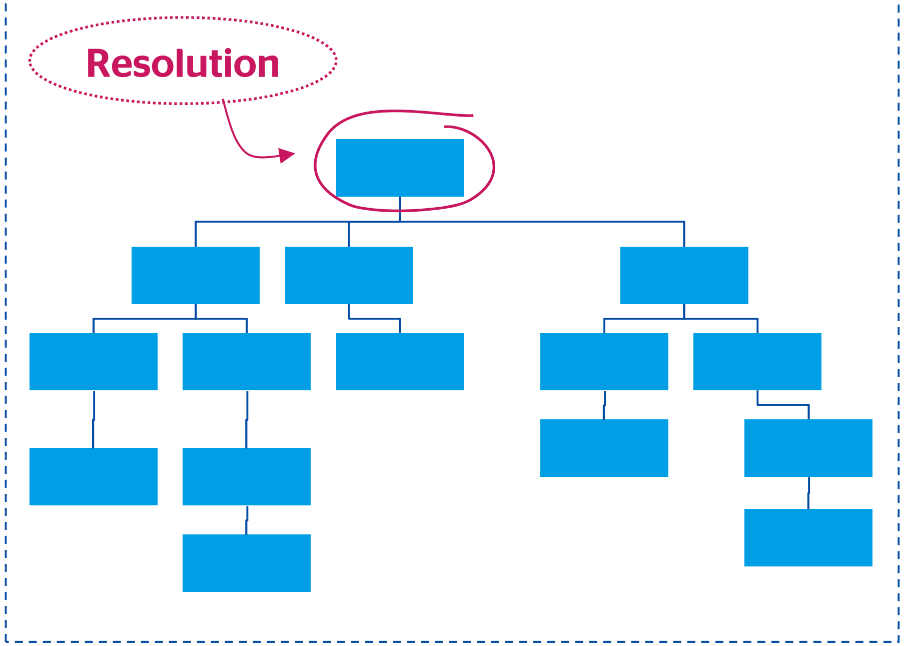
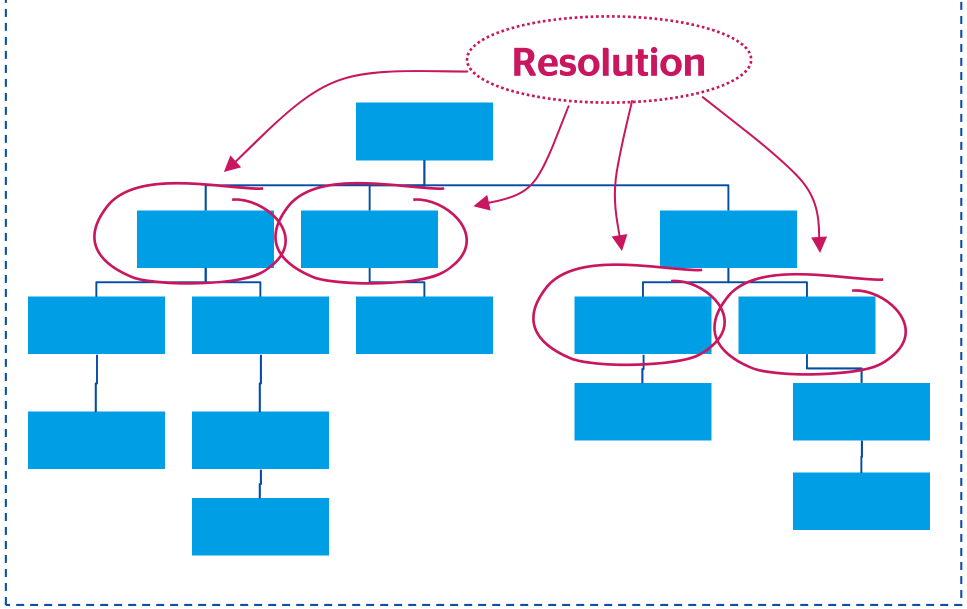
Section 2

Decentralised Model: consistent with MPE resolution

SPE resolution strategy



MPE resolution strategy



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Section 2

Strong resilience and less contagion

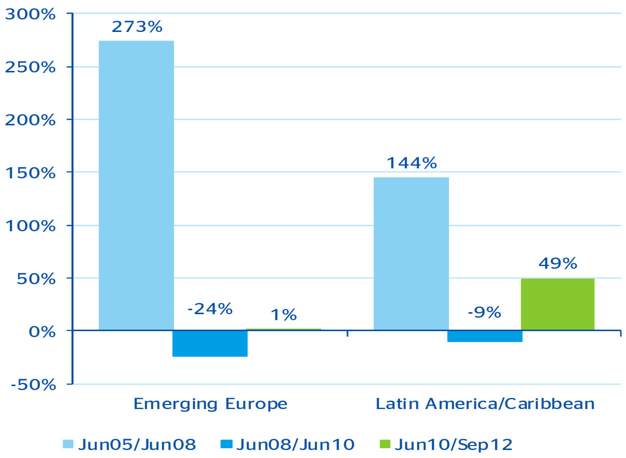
Experiences with crisis in host and home countries

Firewalls between different parts of the group work in both directions

Crisis in host country: Argentina 2001	Spanish banks stayed in Argentina, but had the option to leave without much contagion to parent or other subs
Crisis in home country: Eurozone crisis 2012-13	No evidence of contagion of liquidity problems in home to hosts

Changes in external loans of BIS-reporting banks to the bank sector

Source: BBVA Research based on BIS International Banking Statistics (Table 7)



**Latam*: Argentina, Brazil, Chile, Colombia, Mexico, Paraguay, Peru, Venezuela

***Emerging Europe*: Bulgaria, Croatia, Czech Republic, Hungary, Latvia, Lithuania, Poland, Romania

Latam: smaller bubble and bust than Emerging Europe. Stronger recovery

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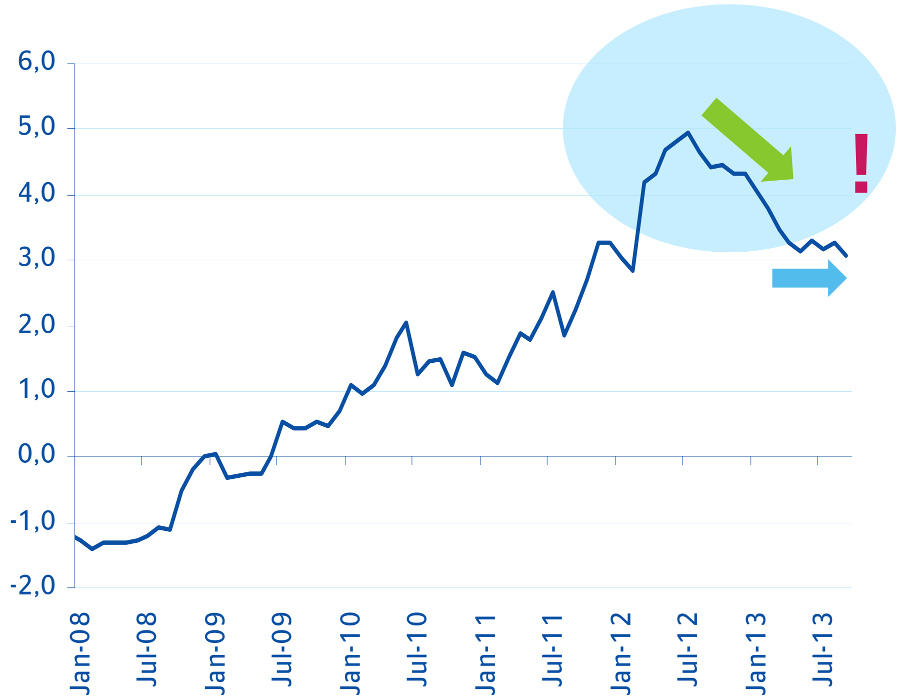
Section 3

Fragmentation is incompatible with the Euro

Composite measure of EZ financial fragmentation*
Source: BBVA Research and Bloomberg



A banking union is needed to:

Break the loop between sovereigns and banks

Strengthen the Monetary Union by reinforcing the institutional architecture

Restore the monetary policy transmission channel

Section 3

Banking union at a glance

Setting up a robust supranational framework

Pillar I

Common Rules

- **CRDIV/CRR**
- **BRRD**
- **DGSD**
- Start: **2014 - 2016**

Pillar II

Single Supervision

- **ECB as the ultimate responsible** for all Eurozone banks
- **ECB** to direct supervise **top 130 banks**.
- **National authorities** to directly supervise the **less significant entities**
- Start: **04/11/2014**

Pillar III

Single Resolution

- New **Single Resolution Authority** in cooperation with national resolution authorities,
- **Single Resolution Fund** funded with bank contributions
- **Pending issue:** Intergovernmental Agreement **(IGA)**
- Start: **2015 - 2016**

Pillar IV ?

Single Depo Guarantee Scheme

- Start: **unknown**

Section 3
Banking union

It will take time to break the vicious circle

Banking union has contained the fragmentation process…	…but further progress towards deeper economic, fiscal and political union is needed
Banking union is designed to solve the problems of the future…	… but finding a definitive solution to the legacy problems is a key prerequisite: AQR, ST
The SSM is a game changer for supervisory culture and practice in Europe…	… that needs to take into consideration the different business models of European banks
The agreement on a Single Resolution Fund is an important step forward…	…but the uncertainty on the common public backstop must be dispelled

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Section 4

Structural reforms

Activities separation is not a good idea

Design issues	• Risk of higher concentration of risky activities in fewer entities • Affects activities that are essential for well functioning of markets
New barriers to universal banking	• Increased costs for banks. Higher cost of capital and funding, reduced economies of scale • More difficult access and increased costs of financial services for clients • Exacerbate regulatory arbitrage (Shadow Banking)
Cross-border impacts	• Extraterritorial effects • Alters competition
Regulatory inconsistencies	• Fragmentation of the financial markets. • Business models more difficult to supervise and resolve by authorities • Cross-border activities more complicated for banks

Not the best solution. Little additional value in terms of financial stability but additional burdens on the financial industry with dampening effects on the real sector

Section 4

Banking future, digital banking

Bank must to learn to use the information to improve their profitability

New players

- There are already new competitors and not only in payments but also in the core banking business
- Important to maintain a level playing field between banks and new entrants
- Regulation should avoid fostering "shadow banking"

Technology: the key to the future financial system

- Customer should benefit from disruptive, low cost technology
- A lever for the necessary efficiency gains in banks
- Facilitates financial inclusion in emerging countries

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Final remarks

1. Banks are under the burden of increasingly heavy regulation. Ring fencing trend is worrying, especially for global banks

2. Profitability prospects are poor, especially in developed countries

3. Decentralized global banks are better adapted to a world of ring fencing

4. BBVA: decentralized globally, centralized in Europe

5. Banking Union: great progress has been made, further work is needed

6. Technology is key for the efficiency gains necessary to offset regulatory pressure

Thanks!

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