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The Spanish banks' decentralized business model

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Content

Spanish banks' expansion in LatAm

Started in the first half of the 1990s, driven by:

Push factors (EU/Spain)

1. Decreasing local returns (overcapacity and high efficiency levels)
2. Increased competition in the EU (financial liberalization/integration)
3. Euro → currency concentration of previously diversified risk

Pull factors (LatAm)

1. Crises, privatizations and deregulation. LatAm authorities seeked to attract foreign banks to foster financial development
2. Spanish firms FDI in Latam: follow the client
3. Diversification (negatively correlated cycles -- commodities). High potential returns (from efficiency gains)

- **Home supervisor: limit risks, keep corporate culture**
- **Host supervisors: keep control of domestic banking systems**
- **Banks: export retail banking model**

→ **CONSENSUS FOR STAND ALONE SUBSIDIARIES**

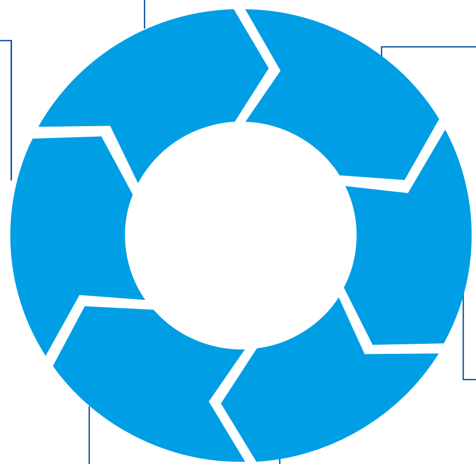
The Stand Alone Subsidiary (SAS) model

Locally incorporated subsidiaries

Stand-alone entities with their own capital and liquidity management

Parent sets

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



Self sufficient in funding

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

Intragroup support is an option if needed, but at market prices

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

Independent governance

Board of Directors appointed by parent bank

The Stand Alone Subsidiary (SAS) model

Decentralized capital and liquidity management

- More consistent with retail orientation and legal structure (subs)
- Natural firewalls in resolution // Limited contagion
- Helps development of local capital markets
- Subsidiaries are self-sufficient and sustainable

…but less potential for optimization of liquidity management, less economies of scale in funding activity

SAS – recent literature review

- ✓ **Fiechter et al (2011): no obvious structure (subsidiaries vs branches) is best suited for cross-border banking**. Depends on (i) quality of supervision, (ii) supervisory coordination, (iii) systemic importance of the affiliate, (iv) level of development and soundness of the host
- ✓ **Cull and Martinez Pería (2012): parent bank characteristics could be behind different patterns in CEE vs Latam**: higher lending growth (prior to the crisis) and steeper contraction (during the crisis)
- ✓ **Ongena, Peydro and van Horen (2012): lending contraction was lower for those subsidiaries in Emerging Europe that had a greater share of funding from local deposits**
- ✓ **IMF Policy Paper (2011): decentralised and diversified liquidity management offers advantages** in terms of lowering the build-up and transmission of vulnerabilities (mispricing risks)
- ✓ **Montoro and Rojas-Suarez (2012): financial soundness features of Latam banks**, such as capitalisation , liquidity and efficiency **played a role in explaining the dynamics of credit during the crisis**
- ✓ **CGFS Papers No 39 (2010): a more decentralised, less wholesale-oriented approach to funding could limit contagion, clarify lender of last resort responsibilities and improve resolvability**

The Stand Alone Subsidiary (SAS) model

Experience with crises in host and home countries

Crisis in host country: Argentina 2001	→	Spanish banks stayed in Argentina (long term orientation), but had the option to leave without much contagion to parent or other subs
Crisis in home country: Global financial crisis 2008 -	→	No evidence of contagion of liquidity problems in home to hosts

Firewalls between different parts of the group work in both directions

Decentralized global banks: is there a value added?

Centralised risk management & strategy

- **Risk management** operations in subsidiaries are an integral part of the global risk management. The Board sets group risk appetite and group-wide risk limits, while the global risk management sets delegated authorities & controls, monitors and mitigates liquidity and funding risks
- **Strategic decisions taken centrally at head office**

Intra-group support

- **Early identification of liquidity and funding risks**
- **Intragroup operations limited to exceptional circumstances** (to address a liquidity problem or promote expansion) and at market prices
- **Wholesale market access at subsidiaries supported by head office.** Opening the market in some countries (eg. Peru)

Export a successful business model

- **Retail banking business, with strong focus on efficiency. Human capital and technical skills**
- Group wide common IT platform. Group culture and information management
- **Local subs seen as long- term investments**
- **Adapted to local needs** (customer centric approach): each market is different

Development of local capital markets: the case of Peru

BBVA Continental: **pioneer issuing activity in local capital markets** generates **positive externalities** for the **local economy**

2005
Senior Notes First Local Issuance PEN 70m, 7y

2006
First A/B Loan IDB USD 100m

2007
Subordinated Notes Five Local Issuances PEN 145m, up to 25y USD 40m, up to 20y

2007
Mortgage-Backed Securities Pioneer transaction for a Peruvian bank USD 25m

2008
DPR First transaction USD 200m, 7y

2010
Subordinated Notes (*) First International Issuance USD 200m, up to 40y

2010
Senior Notes (*) First International Issuance USD 350m, 10y

2012
Senior Notes First plain International Issuance USD 500M, 10Y

BBVA Continental represents approximately 20% of the total senior issuances in the local debt capital markets. Only Peruvian bank issuing in the 15Y segment in the local market.

BBVA Continental represents approximately 24% of the total subordinated issuances in the local debt capital markets. The only Peruvian bank issuing in the 25Y segment in local currency, and 20Y in foreign currency.

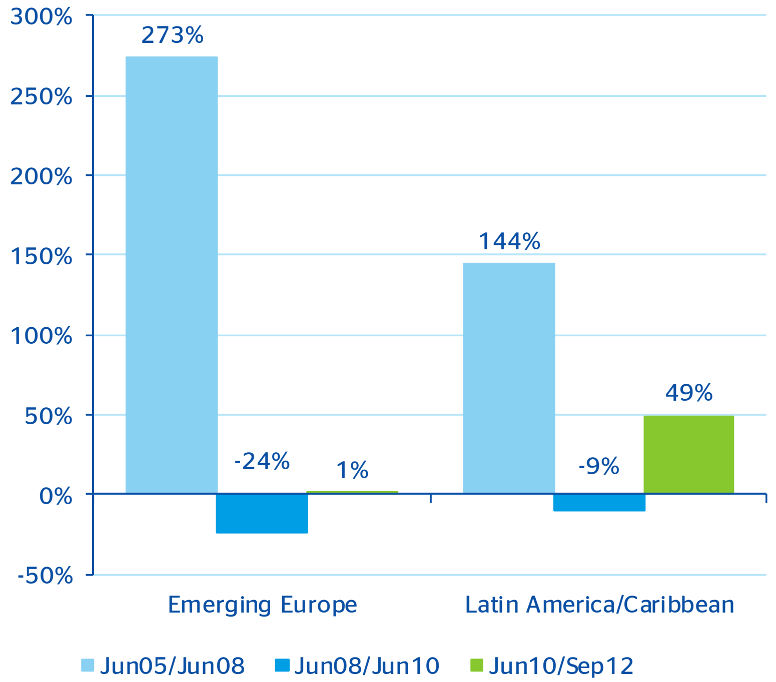
This was the only MBS issuance ever done by a Peruvian bank.

(*) Loan Participation Notes

Global financial crisis: CEE vs Latam

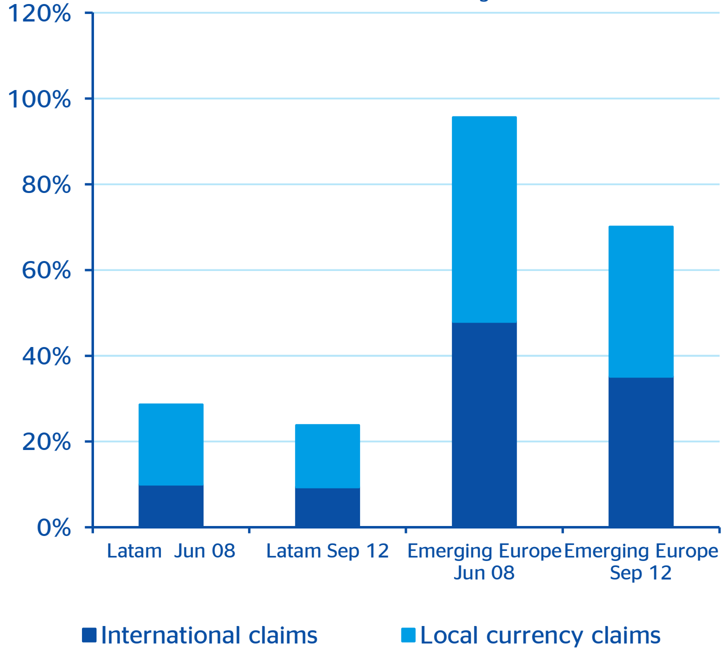
Changes in external loans of BIS-reporting banks to the bank sector

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



Total foreign claims of BIS-reporting banks as % Host Country GDP

Source: BBVA Research based on BIS International Banking Statistics (Table 9)



***Latam:** Argentina, Brazil, Chile, Colombia, Mexico, Paraguay, Peru, Venezuela
****Emerging Europe:** Bulgaria, Croatia, Czech Republic, Hungary, Latvia, Lithuania, Poland, Romania

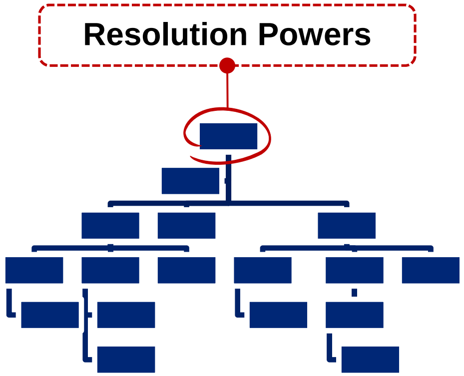
Pre-crisis growth matters. Lower contagion if affiliates rely on local funding rather than on parent. Despite funding problems, Spanish banks' exposure to Latam continues to increase

Resolution strategy: SPE vs MPE

G –SIFIs are required to develop RRP’s with 12 months of designation.

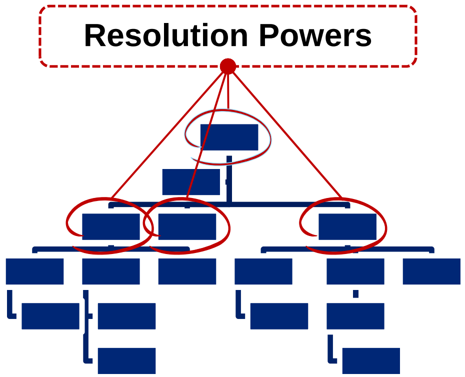
Business model is a **key driver** of the **resolution strategy**.

Single Point of Entry (SPE) Strategy



- **Resolution powers** at the top holding or **parent company** level
- **Single** resolution **authority** (of the parent company)
- **Significant interconnections** between subs/ branches within the group
- **Requires intragroup support** subordinated to external creditors of the subs

Multiple Point of Entry (MPE) Strategy



- Application of **resolution powers possible by resolution authorities in parent & subs**
- **The group** can be broken down into two or more **parts-** Important to **preserve essential** functions
- Requires **that the Group is independent** at the legal, financial, operational, informational and governance levels. Stand-alone rating
- Loss-absorption capacity in each Entry Point

Section 5

Main messages

- **There is no unique foreign bank business paradigm.** Different factors affect the choice of model
- For **Latin America, the SAS model has delivered good results** in the last crisis. Key was reliance on **local retail funding in local currency**.
- The **SAS business model contributed to global financial stability** preventing contagion from host to home countries and vice versa.
- Decentralized model **encourages self sufficiency and sustainability of subs**
- It can also deliver **significant benefits for host economies** in terms of local financial market development, financial inclusion, efficiency, risk culture
- **Resolution based on Multiple Point of Entry requirements**

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Thanks!

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