Comments on
The international expansion of Financial Conglomerates: Financial Stability implications

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* The comments and opinions expressed in this presentation do not necessarily reflect the views of Banco de la Republica or its Board of Directors

- Very interesting and complete presentation
- I will focus on the implications of some the issues raised for Colombian conglomerates operating abroad and the Colombian financial system

A Taxonomy on International banks activity

- Useful characterization of business models to assess risks to financial stability
- Foreign banks operate as local banks in Colombia (subsidiaries) ...
- ... and Colombian conglomerates seem to be similar to the Spanish ones (we should have the data):
  - They are "**multinational banks**" on the asset side, with large local operations in the host countries
  - They have a **decentralized** structure of funding, financing their operations in the host countries

- This is the business model to which international conglomerates have moved since 2007 ...

... And the research from BdE indicates this is the model that better allows reaping the benefits of international diversification

... Good news? ... Mostly so! ...

- Due to its documented Financial Stability Implications:
  - Potentially lower currency mismatches
  - Lower probability/effects of contagion
  - More control of local authorities on financial risk, credit supply and payment systems,...
  - ... Although diversity in regulation and supervision across jurisdictions makes financial stability monitoring costlier for the home country's authorities

- But also due to its Macroeconomic Implications:

  Lower influence of global financial conditions on domestic markets

  => More autonomy of monetary policy? (e.g. Rey, 2013)

  => Lower probability of Price/Financial stability trade-offs

- Question: From the point of view of the authorities, is there any reason why alternative business models could be better? (Economies of scale, etc)

Diversifying Abroad

- Clearly diversifying abroad may improve the resilience and performance of financial conglomerates,...

- ... With some caveats:

1. Diversification entails costs and risks for home and host supervisors and regulators

   - A supervisory and regulatory infrastructure must be in place to mitigate those risks

   - Colombia: Law of conglomerates, CB FX and FX maturity regulation, coordination with host country authorities

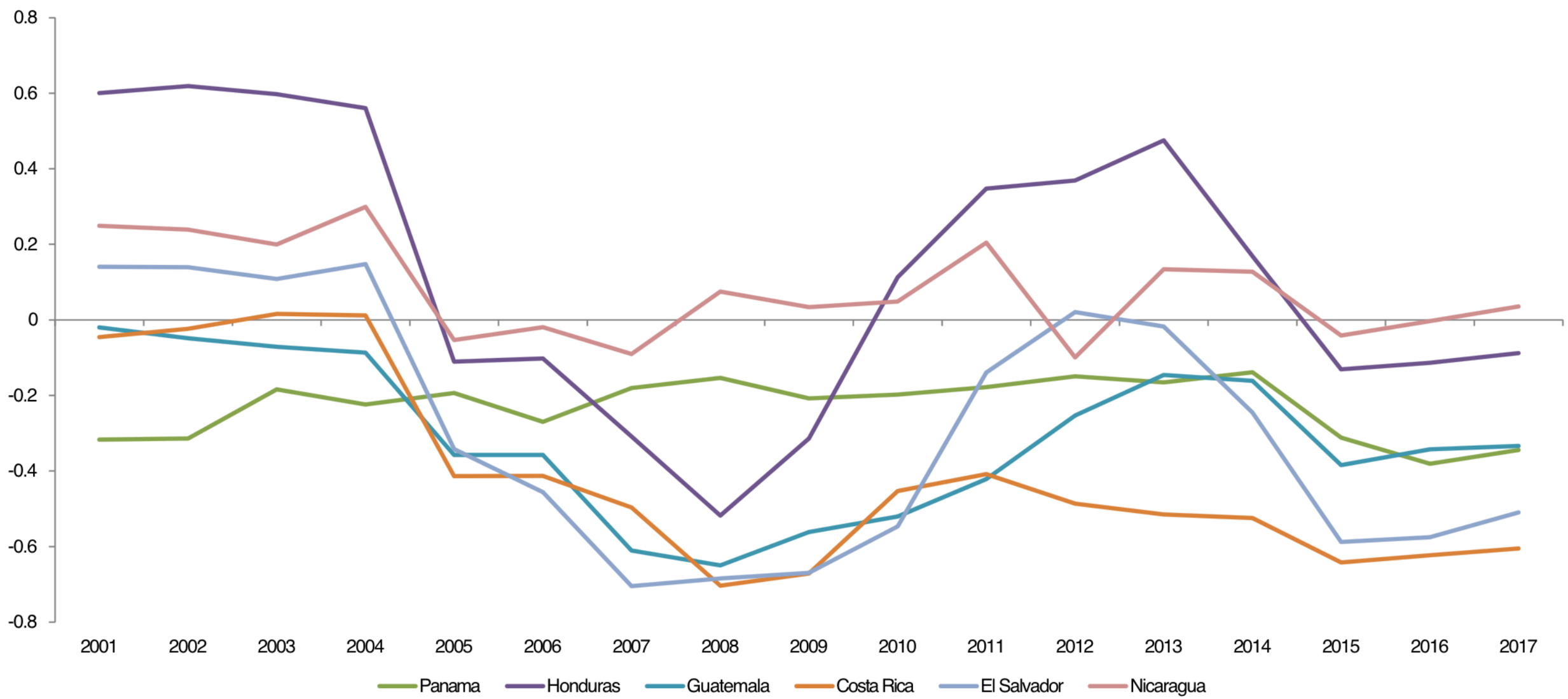
2. The benefits of diversification vary in time because they are shock-dependent

- This is obvious, but it is reminder that not too much faith must be placed on historical correlations...

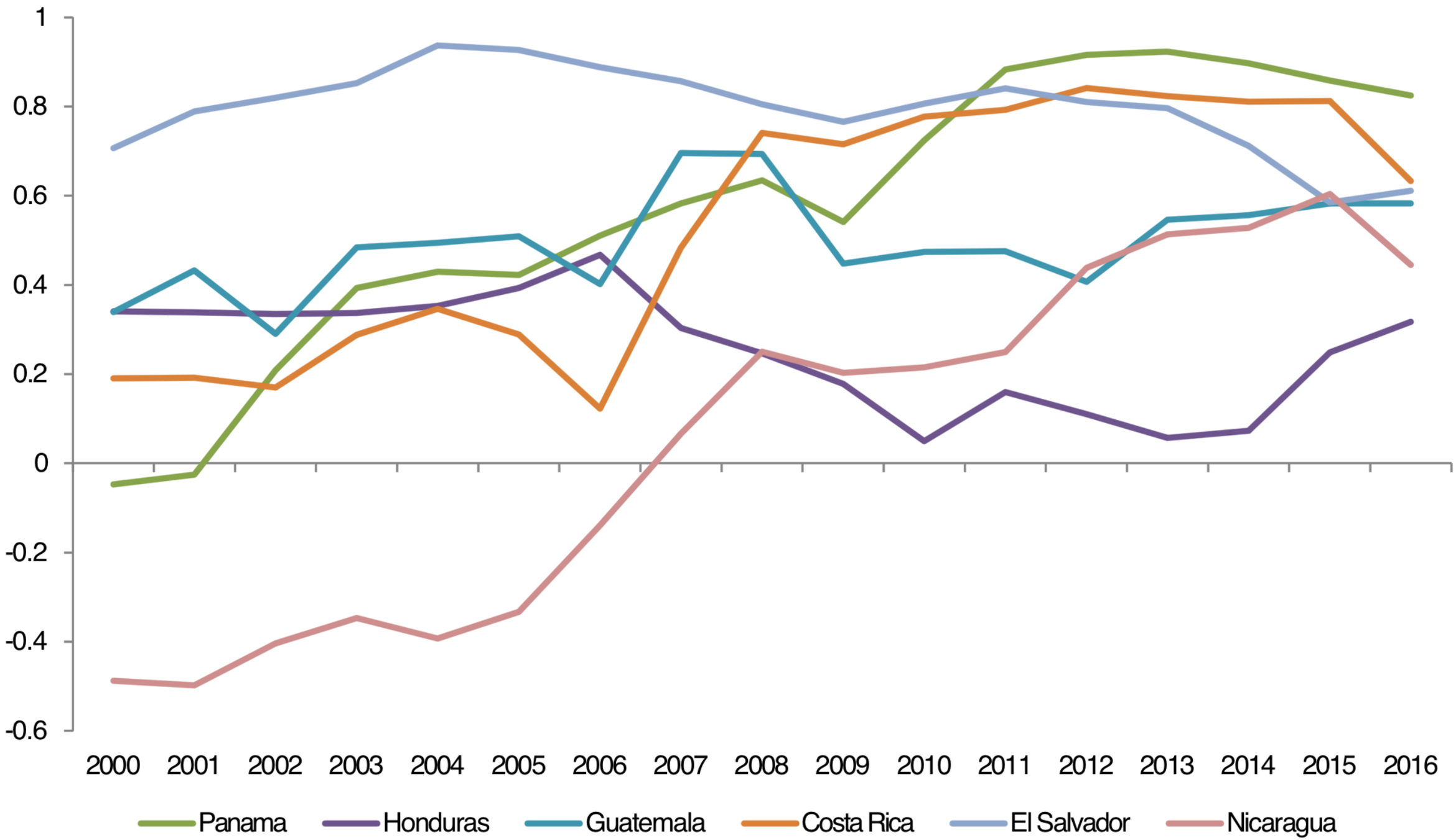
- ... rather, a careful analysis of vulnerabilities must be undertaken

=> Stress tests at the conglomerate level are necessary

Negative correlation between the (growth of) TOT of Colombia and host countries...

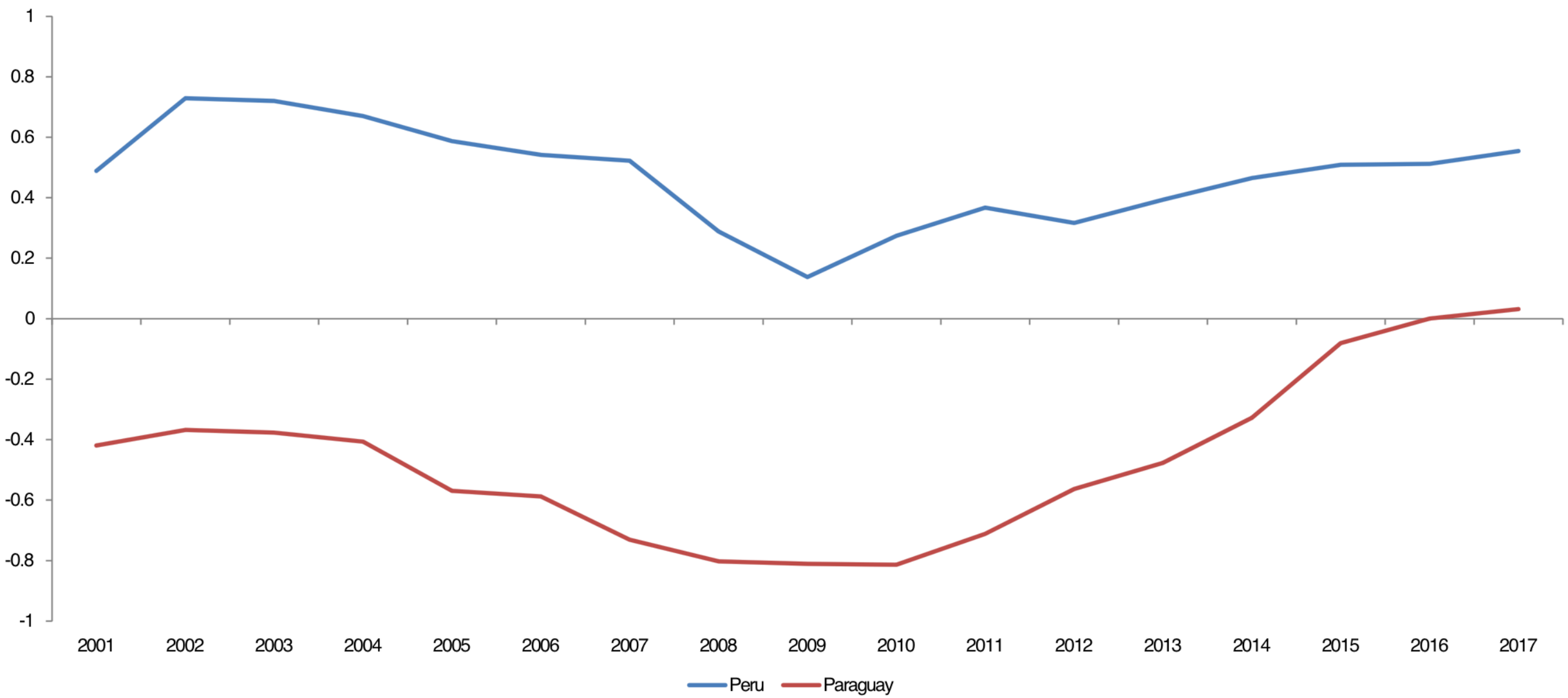


... But not necessarily negative correlations between their GDP cycles

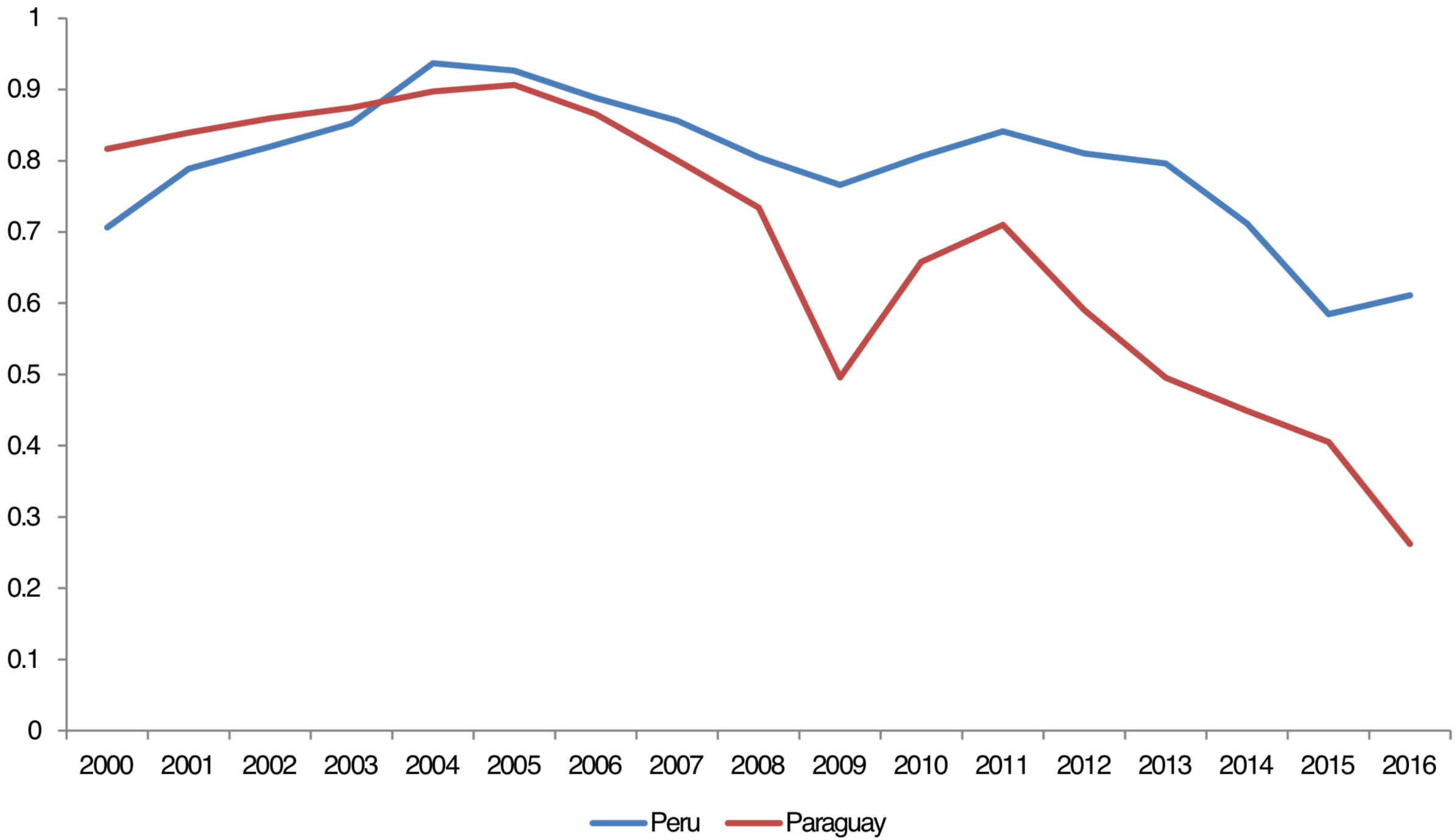


Similar story for Paraguay, not so much for Peru

Correlation between growth of TOT of Colombia and those countries



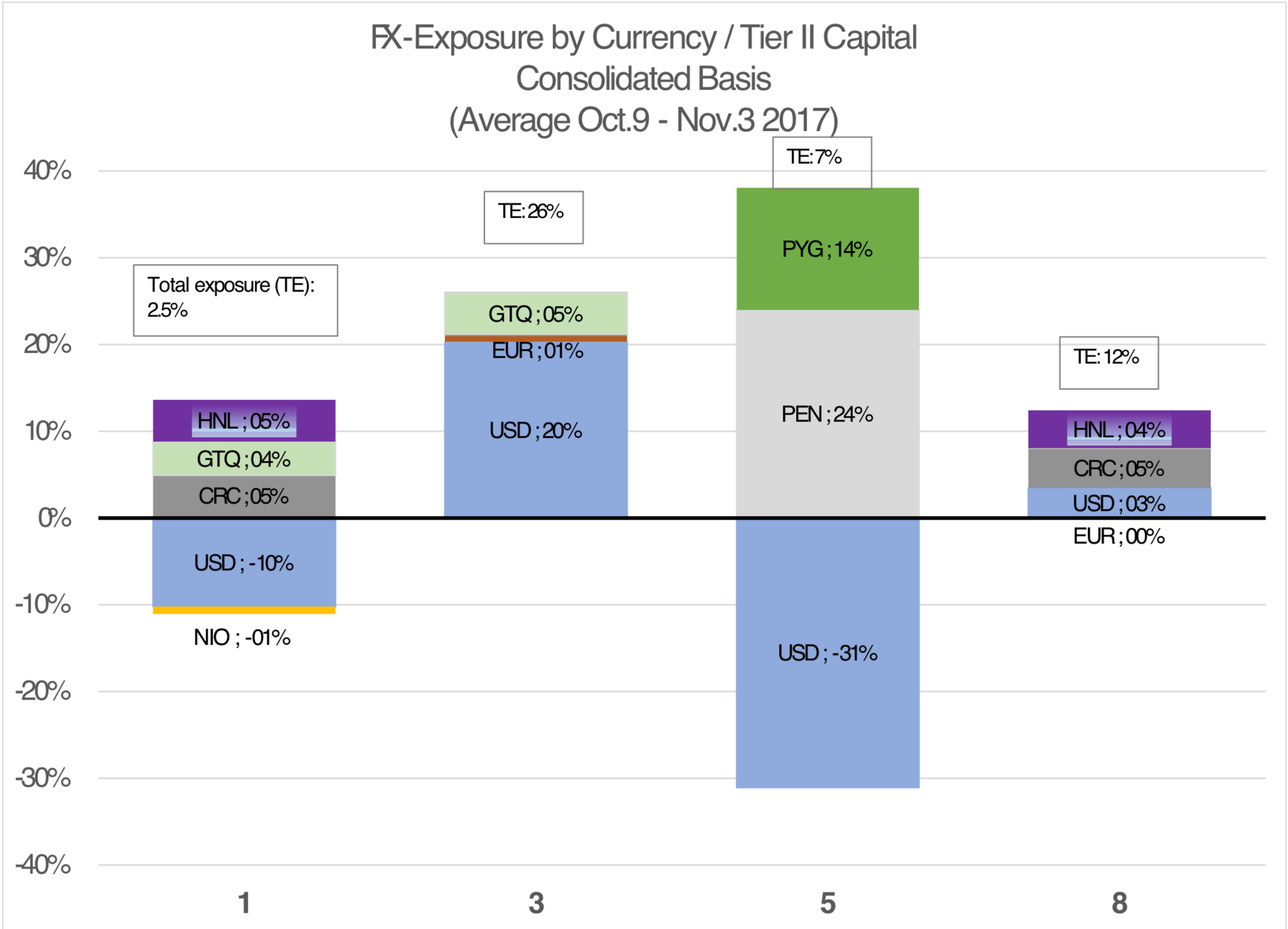
Correlation between cyclical components of GDP



Currency Mismatches

- Main issues for Colombian conglomerates:
  - Currency hedging markets not well developed in the host countries
  - Potential mismatches between several currencies...

    ... Hence, measuring only the COP/“USD” mismatches may be misleading


FX-Exposure by Currency / Tier II Capital
Consolidated Basis
(Average Oct.9 - Nov.3 2017)
40%
30%
20%
10%
0%
-10%
-20%
-30%
-40%
Total exposure (TE): 2.5%
HNL ; 05%
GTQ ; 04%
CRC ; 05%
USD ; -10%
NIO ; -01%
TE: 26%
GTQ ; 05%
EUR ; 01%
USD ; 20%
TE: 7%
PYG ; 14%
PEN ; 24%
USD ; -31%
TE: 12%
HNL ; 04%
CRC ; 05%
USD ; 03%
EUR ; 00%
1
3
5
8

- That is why Banco de la República introduced FX regulation that accounted for this diversity of currency exposures

- Correlations between currencies may help, depending on the sign of the exposures...

  ... But again, these correlations are variable and shock dependent

- An open question: How to regulate FX risk?

  Should limits of FX exposure be established (Colombia)?, ...

  ... or should it be included in capital regulation?

  If so, how and with which weights and time horizon?

- Another important aspect for Colombian conglomerates is liquidity risk in foreign currency,...

  ... especially for those banks operating in dollarized financial systems

- Even though dollarization does not preclude the existence of LOLR facilities,...

  ... they are ultimately bound by the fiscal willingness and capacity to timely provide the necessary FX liquidity

- In the case of some jurisdictions, there are two issues:
  - The existence of a cap on the funds available ex-ante reduces the effectiveness of the facilities (e.g. as measured by the probability of a run)
  - Weak fiscal positions reduce the credibility or scope of the facilities
- Host country authorities mitigate this risk through measures like higher RR on dollar liabilities
- Banco de la República introduced FX liquidity risk (“COP and FX LCR”)

Thank you