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Regulation and the change in banks’ business models

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I. Banking Models

I.1. Originate to hold (OtH) vs. Originate to distribute (OtD)

Spillover effects critical in OtD model

I.2. Commercial Banks vs. Investment Banking.

I.3. Multichannel Banking vs.Specialized Banks.

I.4. Stand-alone subsidiaries vs. Branching.

II. Regulation

- Very high capital requirement.

- Four ways to compute capital requirements:

    a. Basel III RWA

    b. Basel III Leverage

    c. Stress Test (adverse scenario)

    d. Resolution (TLAC / MREL)

- The binding constraint will be Resolution Capital.

- One size fits all; no discrimination of Banks' Business Models.

III. Are we pushing for a homogeneous banking sector?

- **If** regulation is designed for only one business model (OtD and universal banks without stand alone subsidiaries), **then**

- only one will survive (that subsector is the sole one that can cope with regulation), **but**
  - what about the other business models?
  - what about their clients?
  - what about financial stability?

IV. Discussions / Further considerations (1)

- Capital requirements must be aligned with risks:

  Not all business models have similar risks (neither idiosyncratic, nor systemic).

- Commercial banking:

  Low risk activities, P&L interest margin based (more stable), financing real economy (household, SMEs).

- Pilar II only adds requirements:

  Diversification, stand-alone subsidiaries model, sound corporate governance culture and strong risk management practices must be recognized in regulation.

IV. Discussions / Further considerations (2)

- The idea of profitability as “first line of defense” is missing

  Needed balance between safety and profitability

- What could be a prudent regulation for a certain business model, could also have unintended consecuences for other models.

IV. Discussions / Further considerations (3)

- In commercial banking, too much requirements could lead to less profitability, but not necessarily means higher safety nor more stability.

- In that case, there could be two undesirable options for banks' managers:
  a. Search for security: bonds vs. financing real economy, low ROE, weak and vulnerable shareholders base, real economy clients not served.
  b. Search for yield: riskier activities, regulatory arbitrage, higher PD, stronger intelinkages with financial system and potential spillover effects. Early intervention and resolution framework has not been tested for now.

V. Conclusions

Thank you very much