ARGENTINA

BANKING

SUMMARY

The Argentine banking sector has undergone a significant transformation in the past four years. Following the contagion effects of the Mexican financial crisis of late 1994, Argentina's banking system has been substantially strengthened by economic recovery, consolidation, enlarged foreign bank participation, and increased liquidity and capitalization. Mergers, privatization, acquisitions and liquidations reduced the number of financial institutions in Argentina from close to 300 in 1990 to 138 at the end of 1997. In late 1997, the Argentine government announced its intent to privatize Banco de la Nación – Argentina's largest commercial bank. However, the privatization of Banco de la Nación faces strong political opposition in the Argentine Congress (which must approve the privatization) and is unlikely to occur in 1998 or 1999. It is possible, however, that the bank will be "corporatized" (converted into a socieded anonima with private management) as a step toward incorporating private capital into the institution.

Thus far, adverse effects of the Asian crisis on the Argentine banking sector have been contained with deposits increasing somewhat during the crisis. Deposits in the Argentine banking system were over US$70 billion at the end of 1997 – 40 percent higher than in December 1994. Government-owned banks held 30 percent of total deposits in 1997 (down from 46 percent in 1993), and continue to have a virtual monopoly on public deposits. Total bank deposits represent only about 20 percent of Argentina's gross domestic product – a much lower ratio than in Chile, Mexico or Brazil. The 10 largest banks in Argentina controlled approximately 60 percent of banking sector loans and deposits at year-end 1997. Foreign banks controlled approximately 40 percent of banking sector deposits, up from 16.5 percent in 1994.

Two U.S. banks – Citibank and BankBoston – have extensive wholesale and retail operations. They are among the most prominent banks in Argentina. Six other U.S. banks – Chase Manhattan, Morgan Guaranty, Bank of America, Republic Bank of New York, Bank of New York, and American Express Bank – focus on wholesale and investment banking activities, and have played an important role in introducing new technology and better management techniques to the Argentine banking sector.

Eight U.S. banks operated in Argentina during the period 1994-98 through joint stock banks. Prudential limits for branches are still based on local capital of the branch rather than the consolidated parent, in effect removing the rationale for entry of the Argentine banking market through branches. Merger and acquisition opportunities have been available to U.S. banks on par with other institutions. In addition, and there are no restrictions on foreign banks establishing or expanding their presence in Argentina.

DESCRIPTION OF THE MARKET

Structure of the Market

The Argentine banking system is bimonetary. Under the April 1991 Convertibility Law, the Argentine peso is tied to the U.S. dollar at par value. Deposits and lending are in U.S. dollars and pesos. Total deposits were about US$70 billion in December 1997. In March 1998, peso deposits represented 47 percent of total deposits and U.S. dollar deposits were 53 percent. In terms of banking sector loans to the private sector, peso loans were 38 percent of total loans and U.S. dollar loans were 62 percent.

Structure of the Argentine Banking System
December 1997

	Assets	Deposits	Number of Banks
Private National Banks	53,953	28606	58
Public Banks	40,301	23,532	19
Cooperative Banks	4,100	2,666	6
All Foreign Banks	32,452	15,347	29
U.S. Banks	16,906	8,012	8
TOTAL	130,792	70,151	112

Source: Banco Central de la República Argentina, http://www.bcra.gov.ar

Argentine Banking Indicators
December 1997

	Deposits (US$ billions)	Banks	Offices	ATMs
U.S. Banks in Argentina	6.8	8	109	173
All Banks in Argentina	70.5	138	4165	2917

Source: Banco Central de la República Argentina, http://www.bcra.gov.ar

The financial system has been strengthened considerably since 1995 through mergers, acquisitions, and privatization. The number of financial institutions in Argentina dropped from close to 300 in 1990 to 138 at the end of 1997. In June 1998, there were 132 financial institutions in Argentina.

In spite of this consolidation, the Argentine banking sector remains one of the least concentrated in Latin America. The ten largest banks in Argentina held around 60 percent of total banking sector deposits and assets at year-end 1997. Public sector banks continue to have a monopoly on public sector deposit-taking and the administration of public sector funds. The Argentine federal, provincial and local governments, and some state enterprises, carry out financial operations using designated public banks.

Share of Total Deposits Controlled by the Ten Largest Argentine Banks
(percentage, end of year)

1994	50.2
1995	58.2
1996	59.2
1997	60.5

Source: Banco Central de la República Argentina, http://www.bcra.gov.ar

Privatization of the banking sector continues, with several foreign banks acquiring stakes in Argentine banks. Growing foreign participation in the Argentine banking system, particularly since 1996, has led to better management and efficiency. In 1995, with World Bank and Inter-American Development Bank assistance, the government of Argentina created a Trust Fund for Provincial Development to assist local governments to privatize their government-controlled banks. By year-end 1997, fifteen state-controlled institutions had been privatized. A few others are in advanced stages of the privatization process. Bank privatization has resulted in considerable expansion of credit to businesses in the interior of Argentina. Several foreign banks, including Banco Santander, Banco Bilbao Vizcaya, Scotiabank and Hong Kong and Shanghai Banking Corp. (HSBC), have made large investments in the Argentine banking system since 1994. The share of total deposits in foreign banks increased from 16.5 percent in 1994 to 40 percent at the end of 1997.

The central bank of Argentina (BCRA) also issued regulations to strengthen bank capitalization, liquidity requirements, and anti-money laundering efforts. All Argentine banks must meet a minimum total risk based capital ratio (calculated along BIS guidelines) of 11.5 percent. Central bank sources note that the actual capital held by the banks is higher than the minimum requirements.

Asset quality has improved considerably since the peak of the liquidity crisis in 1995, largely because of the growth in assets and improved credit risk evaluation by private banks. A reduction in the number of large corporate borrowers has improved the quality of borrowers. Still, increased retail lending to consumers and small and medium-sized firms may cause problems in the event of an economic downturn. The proportion of problem loans has decreased from 16 percent, on average, at the peak of the 1995 liquidity crisis to below 10 percent, on average, at the end of 1997. A few Argentine banks, however, still have very large irregular loan portfolios.

Bank minimum liquidity requirements, which replaced legal mandatory reserve requirements in 1995, have been increased gradually from 16 percent to 21 percent. In 1996, the BCRA negotiated a contingency repurchase agreement with a consortium of multinational banks to cover 10 percent of total deposits in the banking system in the event of a systemic run on deposits. This safety net, originally for US$6.1 billion, was increased to over US$7 billion in 1997. Under Argentina's currency board system which was implemented by the 1991 convertibility law, the BCRA uses its foreign currency reserves (about US$21 billion at the end of 1997) to back Argentina's monetary base.

The BCRA has also taken measures to strengthen the role of market discipline and promote transparency in the banking system. For example, the BCRA has eliminated all directed credit schemes, as well as restrictions on remittances by foreign banks. Detailed monthly financial information is now publicly available on each financial institution. Accountability over the adequacy of the work of external auditors has been substantially increased, and all Argentine banks are required to be rated publicly using international risk qualifications. The BCRA also requires Argentine banks to issue debt equivalent to at least 2 percent of their deposits.

Argentina's banking system profitability is still extremely low by international standards. During 1997, the Argentine banking system registered a return of only 5.98 percent on invested capital – up from 4.21 percent in 1996 and -0.2 percent in 1995. Nevertheless, some banks are much more profitable than the average. The ATM network in Argentina is expanding rapidly – at the end of 1997 Argentina had fewer than 1,900 ATMs, and at the end of 1997, the number of ATMs reached nearly 3,000.

Depositors have maintained confidence in the Argentine banking system since 1995. Unlike the dramatic outflow of deposits in the aftermath of Mexico's peso devaluation, Argentine deposits and lending have increased steadily despite the Asian financial crisis during the last quarter of 1997.

Regulatory Structure

The BCRA, created in 1935, has as its primary mission the preservation of the value of the Argentine peso. The BCRA issues currency, administers reserves, manages financial system liquidity, and acts as the government of Argentina's financial agent. It is prohibited from lending to the government or to individuals. The BCRA is governed by a board, composed of a President, a Vice President and eight directors, nominated for six-year terms by the Executive with the consent of the Senate. The central bank's Superintendency of Financial and Exchange institutions, headed by one of the Bank's directors, supervises the financial system. The Superintendency evaluates banks' capital, assets, management, earnings and liquidity (CAMEL) and enforces banking regulations.

The BCRA has strictly adhered to the requirement that it limit assistance to the banking sector by only offering assistance for temporary liquidity problems on a fully secured basis. With regard to deposit insurance, the GOA provided no explicit deposit insurance from 1991-95. The current limited system of deposit insurance was introduced in April 1995 in response to the Tequila effect (i.e., the backwash of Mexico's 1994-95 financial crisis that affected several neighboring countries). The BCRA implemented deposit insurance through establishment of a privately-managed deposit guarantee fund. The deposit guarantee fund is growing by about US$22 million per month. The deposit guarantee fund insures deposits of less than 90 days for amounts up to US$10,000, and deposits for longer than 90 days for amounts up to US$30,000. The amounts guaranteed are on a per person basis rather than per account. All types of accounts are covered, except those accounts on which the rate of interest paid exceeds a rate set by the central bank. The guarantee fund was recently used to cover two small bank failures, and its capitalization was US$130 million in June 1998. Local bankers consider it adequate to cover small bank failures, but it would be hard pressed to cover losses stemming from a large bank failure. In 1996, the BCRA negotiated a contingency repurchase agreement with a consortium of multinational banks to cover 10 percent of total deposits in the banking system in the event of a systemic run on deposits. This safety net, originally for US$6.1 billion, was increased to over US$7 billion in 1997.

Bank minimum liquidity requirements are calculated on the basis of all bank liabilities and apply equally to foreign and Argentine banks. The rate of the requirement varies according to the residual maturity of the liability (not according to the type of liability), with a higher rate applied to liabilities with maturities of less than 90 days. There are no requirements for liabilities with maturities of longer than 365 days. The shift from reserve requirements to minimum liquidity requirements started in 1995 and reflects the BCRA's explicit recognition that reserve requirements in Argentina are a prudential regulatory tool, not an instrument of monetary policy. The liquidity requirements are remunerated.

U.S. PRESENCE IN THE MARKET

At the end of 1997, the 27 foreign banks operating in Argentina held 45 percent of deposits (US$31.3 billion). The eight U.S. banks with Argentine operations held nearly 10 percent (US$6.8 billion) of bank deposits.

Two U.S. banks – Citibank and BankBoston – have extensive retail banking networks and are two of the most prominent banks in Argentina. The six other U.S. banks – Chase Manhattan, Morgan Guaranty, Bank of America, Republic Bank of New York, Bank of New York, and American Express Bank – have offices in Buenos Aires and do not have retail banking operations. These banks are involved in corporate finance activities and investment banking. In general, U.S. and other foreign banks do not fill a particular niche in the banking system. They have played an important role, however, in introducing new technology and better management techniques. They also have deeper financial pockets, thereby providing greater stability in the banking system.

The main foreign bank competitors of U.S. banks in Argentina are from Spain and Holland. U.S. bankers anticipate greater competition from Brazilian banks in the future.

TREATMENT OF U.S. FINANCIAL INSTITUTIONS

Foreign banks may establish in branch and subsidiary form in Argentina, or by acquiring shares in Argentine banks. In January 1994, the BCRA announced it was lifting the ban on the issuance of new banking licenses that had been in effect since 1984. In addition, a decree was promulgated in early 1994 to formally remove the legal distinction between foreign and locally-incorporated banks. The effect was to remove any legal constraints on the establishment of a foreign bank either as a branch or subsidiary bank. However, prudential lending limits for foreign bank branches in Argentina are based on local paid-in capital, not the parent bank's capital, effectively removing much of the rationale for establishing a branch. There are no additional restrictions on foreign banks establishing or expanding their presence in Argentina. Merger and acquisition opportunities have been available to U.S. banks on par with other financial institutions.

U.S. banking operations in Argentina have indicated that the rules and regulations governing banking activities are transparent, and there is sufficient opportunity for U.S. banks to comment on proposed changes to bank regulations and receive timely notification of impending changes.

As noted above, there are differences in treatment between state-owned banks and their private counterparts. In general, public sector banks continue to have a monopoly on public sector deposit-taking and the administration of public sector funds. Since January 1998, direct bank deposit of salaries has been mandatory for all Argentine companies with more than 100 employees. Foreign banks are allowed to participate in a nondiscriminatory fashion in the direct bank deposit of salaries (including public sector salaries), and many foreign banks do so.

Argentina imposes no market access restrictions or capital controls. There are no foreign investment registration requirements in Argentina. The central bank has eliminated restrictions on remittances by foreign banks. U.S. foreign direct investments in Argentina, including those in banking, are protected by the U.S.-Argentina bilateral investment treaty, which entered into force in 1994. With the exception of cross-border supply of services, Argentina's GATS schedule of commitments reflects current levels of openness. Argentina is currently discussing financial services liberalization within Mercosur with Brazil, Paraguay and Uruguay. It is unlikely, however, that any such regional commitments will exceed Argentina's GATS commitments.

There are no Mercosur regulations or laws affecting U.S. banks' operations. Financial services liberalization is on Mercosur agenda, but to date nothing has occurred. Central bank officials say that given Argentina's already open banking environment, the Mercosur discussions are unlikely to disadvantage U.S. or other foreign banks.