VENEZUELA

BANKING

SUMMARY

The Venezuelan banking sector continues to recover from a serious financial crisis in 1994 and 1995, which affected more than 50 percent of the deposit base and is estimated to have cost the country between 15 percent and 18 percent of GDP. The crisis was the result of an economic recession, along with deregulation, lax bank supervision, directed lending, and poor credit practices. In response, the bank supervisory authorities have taken steps to stabilize the banking sector. For example, new banking legislation strengthened the supervisory authority of the Superintendency of Banks (SUDEBAN), although the Financial Emergency Law – passed during the collapse of the financial system – remains in effect and restricts SUDEBAN from acting as a fully independent entity. Significant foreign penetration into Venezuela is also credited with helping to restore confidence in the banking sector. However, the banking sector presently is under renewed pressure because of an economic slowdown in 1998, in large part due to depressed oil prices, coupled with soaring interest rates since the beginning of 1998. Although major banks are expected to weather the financial turmoil and economic contraction, banks' asset quality and earnings are exhibiting a deteriorating trend.

The market share of assets and deposits in the Venezuelan financial system is highly concentrated, with 39 commercial and universal banks accounting for 87.4 percent of financial sector assets as of March 31, 1998. The system remains segmented with specialized and legally distinct financial subsectors. A new banking law, which became effective in 1994, opened the banking sector to foreign investment. Until January 1994, other than representative offices, foreign banks were only allowed to establish through a joint venture, in which they could a hold a maximum of 20 percent ownership interest. The banking law also lifted onerous operating restrictions on established foreign banks that prevented them from expanding or offering a competitive range of services. Foreign banks control almost 50 percent of the banking system's assets (up from 3 percent in 1993), a reflection of the government's massive bank reprivatization effort in 1996-97.

Foreign banks perceive Venezuela as an attractive market because of the country's low banking penetration (gross loans represent only 14 percent of GDP) relative to other Latin economies of similar size, and the opportunities associated with the investments taking place in the oil and petrochemical sectors. Additionally, the relatively small size of the banking system is an impediment to locally incorporated banks as their lending capacity is insufficient to meet the needs of large industrial customers. The latter represents a business opportunity for most foreign banks.

Although foreign banks maintain an important presence in Venezuela, Citibank is the only U.S. bank with banking operations in Venezuela other than a representative office. At the end of March 1998, Citibank held 2.6 percent of universal and commercial bank total assets, and operated through seven

branches. Chase Manhattan and the Bank of America National Trust & Savings Association have received permission to open branches. There are no differences in the licensing requirements and permissible activities for locally-incorporated and foreign banks. However, the local capital of the branch rather than the consolidated capital of the parent bank is used to compute the branch's legal lending limit and other capital driven thresholds, in effect eliminating many of the benefits of establishing in branch form.

DESCRIPTION OF THE MARKET

The Venezuelan banking sector continues to recover from a serious financial crisis in 1994 and 1995, which affected more than 50 percent of the deposit base and is estimated to have cost the country between 15 percent and 18 percent of GDP. The crisis was the result of an economic recession, along with deregulation, lax bank supervision, directed lending, and poor credit practices. In response, the bank supervisory authorities have taken steps to stabilize the banking sector. For example, new banking legislation strengthened the supervisory authority of SUDEBAN. SUDEBAN can now require greater disclosure and higher levels of capitalization. In 1997, the requirement that banks offer farm loans at preferential rates was eliminated, as was the obligation of commercial banks to set aside a portion of their portfolio for agricultural loans. Significant foreign penetration into Venezuela is also credited for helping to restore confidence in the banking sector. However, the banking sector presently is under renewed pressure because of an economic slowdown in 1998, in large part due to depressed oil prices, coupled with soaring interest rates since the beginning of 1998.

Although major banks are expected to weather the financial turmoil and economic contraction, asset quality and earnings are deteriorating. Past due loans rose to 4 percent of total loans in September 1998, twice the level in 1997. Problem restructurings have increased and it is suspected that banks are easing terms on existing performing loans to preserve asset quality. Furthermore, rapid growth in 1997 may mask asset quality problems because these loans are still unseasoned. Total financial system assets increased by 49 percent from US$15.5 billion at the end of 1996 to US$23.1 billion at the end of 1997. Loan growth during this period was in excess of 100 percent.

The Venezuelan financial system, in theory, is highly segmented with specialized and legally distinct financial subsectors. These include universal and commercial banks, mortgage banks, investment banks, leasing companies, money market funds, capitalization companies, and the National System of Savings and Loan Associations. However, Venezuela's financial system is highly concentrated in terms of market share of banking sector assets. As shown in Table I, the universal and commercial banking sector comprised 39 institutions (compared to 47 commercial banks that existed in 1994), which accounted for 87.4 percent of financial sector assets as of March 31, 1998.

Table 1 – Principal Components of the Venezuelan Financial System
March 1998
(bolivars billions)

	Number	Assets	Percent of Total Assets
Universal Banks	11	6,523.1	53.8
Commercial Banks	28	4077	33.6
Savings & Loan Associations	21	872.8	7.2
Investment Banks	15	414.1	3.4
Leasing Companies	12	121.5	1
Mortgage Banks	5	91.0	0.8
Money Market Funds and Capitalization Companies	13	25.1	0.2
TOTAL	105	12124.6	100

The seven largest banks (Provincial, Mercantil, Banco de Venezuela, Union, Industrial de Venezuela, Corpbanca and Caribe) held 63.5 percent of universal and commercial bank assets as of December 31, 1997. Banco Provincial, the country's largest bank, held a 20 percent share. Foreign banks control almost 50 percent of the banking system's assets (up from 3 percent in 1993). Before 1994, the Banking Law did not allow the operation of foreign banks in Venezuela (with the grandfathered exceptions of Citibank, Extebandes, Tequendama Do Brasil and Ganadero). The new banking law, which became effective in 1994, opened the banking sector to foreign investment. The Venezuelan banking crisis (1994-95) entailed the intervention, closure, or nationalization of 19 banks which together held 55 percent of total banking system deposits at year-end 1993. Most of the state-owned banks that were nationalized in 1994-95 and privatized in 1996-97 were purchased by foreign banks. As a result, the sector moved from almost no foreign participation to almost 50 percent of the banking system's assets (Refer to Table II).

Table II – Percentage of Banking Sector Market Share Held by Foreign Banks

	Year-end 1993	Year-end 1997	March 31, 1998
Total Assets	1	41	46.5
Citibank (U.S.)	0.5	2.3	2.7
Total Loans	0.4	40.2	46.3
Citibank (U.S.)	0.3	3.4	3.2
Total Deposits	0.9	40.6	45.9
Citibank (U.S.)	0.5	2	2.5

Table III provides information on the major foreign bank presence in the Venezuelan banking system. As shown in Table III, Santander and BBV from Spain maintain the most important presence and account for 26.1 percent of banking sector assets. They conduct a full range of financial operations.

Table III – Major Foreign Bank Presence in the Venezuelan Banking System
March 31, 1998
(bolivars billions)

Bank	Owner	Ownership Stake	Assets
Banco Provincial	BBV (Spain)	49%	2,153.6
Banco de Venezuela	Santander (Spain)	95%	1,011.4
Corp Banca	Infisa (Chile)	94%	487.5
Banco del Caribe	Nova Scotia (Canada)	25%	382.5
Citibank	Citicorp (USA)	100%	279.0
Banco Fivenez	Banco Popular (Ecuador)	65%	222.2
Banco Republica	Da Vivienda (Colombia)	100%	119.4

The Venezuelan government owns Banco Industrial de Venezuela (BIV), which provides long-term developmental finance for projects that are high political priorities. The government also owns two regional institutions that play an inconsequential role in the market, and a new bank created in 1997

(Banco de Comercio Exterior - Bancoex) to finance and promote non-oil exports. These state-owned banks held only a combined 7.2 percent of universal and commercial bank total assets at the end of 1997.

Concentration of banking sector assets is likely to continue as additional consolidation in the number of banks takes place through closures and mergers. Some economic analysts expect that industry consolidation could reduce the number of universal and commercial banks in Venezuela by half due to large investments in technology and improvement of operating efficiency. In particular, many smaller domestic banks want to consolidate in order to obtain greater efficiency and the critical mass to compete with the larger foreign owned banks.

There is also a trend toward universal banking in Venezuela's banking sector. Such entities can perform all of the activities permitted to specialized financial entities. The conversion of many financial groups to universal banks reflected their desire to take advantage of economies of scale. Universal banks are also able to increase the size of their loan portfolio's based on the banks' larger consolidated assets. Banco Provincial was the first commercial bank authorized to operate as a universal bank on November 26, 1996. Since late 1996, eleven banks have received authorization to become universal banks, including five foreign financial institutions: Banco Provincial (BBV, Spain), Banco de Venezuela (Santander, Spain), Banco Fivenez (Ecuador), Banco Republica (Columbia), and Citibank (U.S.). ABN AMRO Bank, N.V., Venezuelan branch, received authorization to become a universal bank in August 1998, but has not yet started to operate as a universal bank. Previously, most large and medium-sized banks belonged to a financial group which controlled entities in all major financial subsectors. A typical financial group was comprised of a commercial bank, a leasing company, a mortgage bank, a credit card company, and offshore affiliates. Banco Venezolano de Credito did not choose to become a universal bank because it was not willing to consolidate with its financial group's liquid assets funds.

Foreign banks perceive Venezuela as an attractive market because of the country's low banking penetration (gross loans represent only 14 percent of GDP) relative to other Latin economies of similar size, and the opportunities associated with the investments taking place in the oil and petrochemical sectors. Additionally, the relative small size of the banking system is an impediment to locally incorporated banks as their lending capacity is insufficient to meet the needs of large industrial customers. The latter represents a business opportunity for most foreign banks. The foreign banks have injected new capital, instituted their own banking cultures, improved systems and internal controls, and introduced new technology to the banking sector. As a result, bank competition has increased significantly and banks have invested heavily to upgrade their systems.

Regulatory Structure

The 1994 banking law was supposed to have made SUDEBAN an independent agency and expanded its regulatory role to include other financial institutions besides banks. SUDEBAN's regulatory powers have been strengthened. For example, reporting requirements have been tightened to improve monitoring of offshore operations and activities within financial groups. Consolidated financial statements prepared for a banking group must include their locally-incorporated and overseas branches, subsidiaries and any related entities constituting a decision unit or activity. However, SUDEBAN must obtain prior approval from the central bank and the Superior Council of the Superintendency of Banks (comprised of the Minister of Finance, Bank Superintendent, central Bank President, and the President of the Deposit Insurance Agency) to intervene in or take over the operations of a troubled bank or financial institution. Moreover, SUDEBAN must obtain approval of the Financial Emergency Board (JEF) established by the Financial Emergency Law. The JEF is headed by the Minister of Finance and includes as members the President of the central bank, the President of the Deposit Guaranty Fund (FOGADE), and the Superintendent of Banks. The JEF has broad powers to take measures to address a financial crisis. For example, the JEF has the power to freeze and subsequently expropriate properties which back loans or investments of failing financial institutions. This ties SUDEBAN's hands to some extent, e.g., the ability to issue regulations or force more rapid industry consolidation. In the near term, it is unlikely that the Emergency Law will be repealed.

FOGADE gained responsibility for bank interventions and liquidations under the 1994 law. It provides deposit insurance up to a maximum of 4 million bolivars. To fund the insurance program, banks pay a fee at the end of each semester, currently set at 1 percent of total deposits. FOGADE also can provide monetary assistance to financial institutions to reestablish liquidity and solvency and can liquidate financial institutions. By early 1998, FOGADE had successfully privatized three banks (Consolidado, Republica and Venezuela) which had been intervened by the Venezuelan government during the 1994-95 financial crisis. FOGADE is funded through a variety of sources including government revenues, profits from its operations, bond issuances, and payments by financial institutions. In addition, the central bank can make loans directly to FOGADE.

Venezuelan banks are required to comply with the BIS risk based capital ratios. There are no significant differences in the calculation of these ratios from the BIS standards.

U.S. PRESENCE IN THE MARKET

Citibank Venezuela, founded in 1917, is still the only U.S. bank with a banking presence in Venezuela other than a representative office. At the end of March 1998, Citibank held 2.6 percent of universal and commercial bank total assets, and currently operates seven Venezuelan branches. Chase Manhattan received permission in April 1998 to open a commercial bank, but plans to maintain a single office and continue focusing on corporate customers. The Bank of America National Trust & Savings Association (San Francisco, California) received permission on August 4, 1998, to open a branch in Venezuela to operate as a commercial bank.

Non-U.S. foreign banks maintain an important presence in Venezuela. The foreign presence in the Venezuelan financial sector increased substantially in 1997, accounting for 48 percent of total banking sector assets at year-end. Five foreign financial institutions have universal bank licenses: Banco Provincial (BBV, Spain), Banco de Venezuela (Santander, Spain), Banco Fivenez (Ecuador), Banco Republica (Columbia), and Citibank (U.S.). ABN AMRO Bank, N.V., Venezuelan branch, received authorization to become a universal bank on August 11, 1998, but has not yet started to operate as a universal bank. As of June 1998, 73 foreign banks maintained representative offices in Venezuela; twelve were U.S. institutions and included Bank of America, Bankers Trust, J.P. Morgan, and Bank of New York. These banks provide a variety of financial services, including arranging medium and long-term dollar financing, clearing wire transfers, servicing corporate clients, and arranging debt-equity swaps.

TREATMENT OF U.S. FINANCIAL INSTITUTIONS

The 1994 Banking Law removed the entry barriers to foreign banks that provide reciprocal access to Venezuelan banks. Until January 1994, other than representative offices, foreign banks were only allowed to establish through a joint venture, in which they could a hold a maximum of 20 percent ownership interest. Foreign banks may now enter the Venezuelan market in one of three ways: acquisition of shares in existing commercial banks or other financial institutions, creation of a new bank or other financial institution wholly owned by foreign banks or investors, or establishment of a branch of a foreign bank or financial institution. Moreover, the country has lifted the onerous operating restrictions on established foreign banks, which prevented them from expanding or offering a competitive range of services.

There are no differences in the licensing requirements and permissible activities for locally-incorporated and foreign banks. In addition to retail and corporate banking, foreign banks can issue credit cards, participate in ATM networks, and engage in fund management and trading dollar-denominated public sector debt instruments with local and foreign clients.

There are no branching restrictions on foreign banks. They are not restricted from establishing ATMs. However, the local capital of the branch rather than the consolidated capital of the parent bank is used to compute the branch's legal lending limit and other capital driven thresholds, in effect eliminating many of the benefits of establishing in branch form.

Under the 1994 banking law, banks can engage in securities activities; in practice, however, foreign banks participate through separately established securities firms. Capital requirements are less onerous if an institution establishes a separate securities firm. Applications for entry into the Venezuelan financial system are submitted to SUDEBAN.

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Venezuela's current banking regime is reflected in its GATS offer for banking services. There are no measures in force which are more liberal than its commitments made in the GATS, and there are no planned liberalization measures that go beyond the GATS commitments. The only barrier with respect to "national treatment" and market access which remains to be addressed is a provision in the banking law by which the Venezuelan government can take into account "economic and financial conditions, general and local" and insist on reciprocity when deciding on an application for entry. However, the Venezuelan government has not used these powers to date against U.S. firms.