

## **Fitch Comment: Venezuelan Government Seizes 4 Midsized Banks Due to Weak Financial Profile**

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Fitch Ratings-New York-4 December 2009: On Nov. 20, 2009, the Venezuelan government made the decision to seize four midsized banks on the grounds that they were in breach of a series of regulatory requirements. The government alleged the intervention was to safeguard the stability of the financial system. The banks seized were Banco Canarias, BanPro, Bolivar Banco and Banco Confederado, all property of the same shareholder. According to publicly available data, the banks had been out of compliance for some time with several regulatory rules such as minimum capitalization levels, related parties lending, and other rules; no reason was given for the timing of the regulatory action. According to data from the Banking Superintendence, the banks together managed roughly 5.46% of total system deposits as of September 2009, and all of them presented significant concentrations on their funding sources, especially of deposits from government controlled entities (28% of total deposits according to figures provided by the local Banking Superintendency).

The action initially contemplated the transfer of the administration of the banks to the government, and keeping them open to the public while the government offered to cover 100% of the deposits. On Nov. 30 the government decided to close the banks in light of their fragile financial profile, while the full guarantee of the banks' deposits offered by the government was replaced by the regular deposit guarantee fund guarantee (Fondo de Garantia de Depositos - FOGADE - the local deposit guarantee fund), which covers deposits up to VEB10,000 per depositor per bank (approximately USD4,651 at the current official exchange rate). Given the relatively low insured amount and the reported deposit concentrations in the affected banks, deposits losses can be expected among the largest depositors of the banks. Per regulatory information, around 92% of retail deposits (measured by accounts and not by total deposit amount) will be covered by FOGADE. At the moment, the payment process has begun using a government-owned bank as a platform to perform such payments, as the payment process has been prioritized by type of customer and is expected to be completed in 21 days.

In the past, similar government actions have set off episodes of deposit concentration and/or capital flight. The latter has been significantly muted by the exchange controls in place since early 2003, although some flight to quality deposit movements cannot be ruled out within the financial system. Currently, the local monetary market is unsettled and likely will remain so for at least the near future, while market indicators such as the interbank funds market and the trend on the implicit rate of the USD in the parallel market do not accurately represent the situation given the controls imposed on interest rates and the fixed exchange rate system in place since 2003.

Earlier in 2009 a government-owned bank also experienced an intervention but remained open to the public while conducting regular activities. The reasons for the action were also related to the weak financial profile of the entity (Banco Industrial de Venezuela), and this action had little effect on other banks' deposits. Since the recent intervention into these banks, and also during previous situations of liquidity shortages, the Central Bank has been proactive in providing short-term liquidity with an aim toward averting liquidity pressures in the wake of such actions. The recent announcement of a reduction of the cash reserve requirements is along these lines. Despite the liquidity shortage, the closing of the aforementioned banks and the possibility of some losses among depositors who held funds in excess of the current maximum amount of deposits insured by FOGADE could result in further flight to quality movements of deposits among the system.

As Fitch has outlined consistently in its reviews of the Venezuelan banking system, increasing government intervention in the form of directed lending and interest controls, among other risks, has increasingly limited the private banks' freedom to manage their own balance sheets, and has led to a gradual debilitation of once adequate balance sheets. Fitch's bank ratings have long reflected the risks inherent in this "creeping nationalization", even before the debilitation of bank balance sheets over recent years. The current low ratings and the Negative Outlook assigned to the majority of Venezuelan banks incorporate such facts. Nevertheless, possible negative effects of extended liquidity pressures in the system and/or specific situations of individual banks could result in further review of Venezuelan banks' ratings.

During the last two weeks, President Hugo Chavez has significantly escalated his public threats toward privately owned banks, threatening nationalization if bank's continued to fall short of his expectations as to their "proper role" of fostering economic development and social inclusion; while the situation of implicit regulatory forbearance could change in the future. For a number of years the Venezuelan government has increased the size of public sector banks, being that the recent nationalization of Banco de Venezuela resulted in a significant expansion of the footprint of the government in the Venezuelan financial system (around 21% of total assets considering all the banks owned by the government).

The complex array of controls that outline bank operations in Venezuela (compulsory lending rules, interest rates and fee controls, among others) results in a very challenging operating environment for the system as a whole, and could result in further government action in order to force banks to comply with such rules. The experience gained by most of the banks operating on a similar environment for a long period of time and the conservative position of a group of banks should allow them to maneuver the current situation. Nevertheless, government intervention into the private sector activities and the intrinsic situation of some banks remains as a challenge for the system.



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