Financial Conglomerates in Chile

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The views expressed are my own and do not necessarily reflect those of the Central Bank of Chile

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2. Regulation and Supervision of BHC
3. Approach beyond BHC
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Financial regulation and supervision in Chile is grounded on a sectorial approach, with integrated supervision in securities and insurance

SBIF Superintendencia de Bancos e Instituciones Financieras	**SVS** Superintendencia de Valores y Seguros	**SP** Superintendencia de Pensiones
Banks and their subsidiaries	Securities markets and issuers	Pension Fund managers
Credit card issuers	Financial market infrastructures	Unemployment insurance fund manager
Credit Unions	Insurance Companies	

Hence, achieving the final goals of conglomerate supervision*/ entails important challenges

- Lack of explicit legal framework for consolidated supervision.
- Limited legal powers of the supervisor to go “upstream” in the corporate structure.

* Principles for the supervision of financial conglomerates. Joint Forum. Basel Committee on Banking Supervision. BIS.

However, a robust and conservative regulatory framework allows us to face those challenges

- The Chilean banking crisis of 1982 was a major shock, with an estimated cost of 50% of GDP.
- The lessons were deeply incorporated in especially in the General Banking Act (1986 reform).
- That reform enacted the main firewalls, such as the related lending restrictions, and grounded the basic elements of a very judicious approach to banking.
- A highly empowered supervisor emerged, along with other important legal restrictions:
  - Banks may not invest in equities, neither directly nor through derivatives.
  - This excludes the possibility of a bank controlling an insurance company, for example.
  - Only banks are allowed to take deposits.

However a robust and conservative regulatory framework allows us to face those challenges

- A “second generation” reform was enacted in 1997, putting in place very important additional improvements:
  - Bank supervision took a decisively risk-based approach, maintaining a balance between intrusive supervisory powers and sound regulation.
  - BHC supervision powers were granted, and
  - A framework for internalization of Chilean banks was set up.

However a robust and conservative regulatory framework allows us to face those challenges

- Nowadays a “third generation” reform is in the congress:
  - SBIF and SVS will be integrated in a Financial Council Commission.
  - Basel III solvency toolkit.
  - Banking resolution framework improvements.

Additionally, the Central Bank of Chile is vested with supplementary regulatory authority

- The CBCh has legal responsibility for the well functioning of the payment system, which forms the basis of the Financial Stability objectives of the Bank, and provides a foundation for many of the banks regulatory powers.

- In discharging its authority, the Central Bank of Chile (CBCh) has enacted a conservative set of prudential regulation related with important financial functions of banking institutions:
  - Banks may not issue credit derivatives.
  - Only FX and interest rate derivatives are permitted, and then only based on a restricted set of currencies and rates.
  - A very demanding liquidity risk management regulation since 1998, including quantitative requirements.

Over the years, coordination mechanisms have been in place and progressively strengthened…

1990s

Capital Markets Committee

Created informally, as the main coordinating agent for the financial policy agenda.

2001

Committee of Superintendents

Enacted to allow a more effective regulatory coordination.

2011/2014

Financial Stability Council

Created as the coordination body at the highest level of authority. Chaired by the Ministry of Finance.

Strengthened by legal changes that explicitly allow for information sharing

2017/18

Financial Market Commission

The last step in this progression is the recently proposed consolidation of the banking and the securities/insurance supervisors. Currently in congress.

… which benefit from active CBCH engagement

- Given its broad financial stability mandate, the CBCh is actively involved in the supervisory coordination mechanisms, being a member of both the Committee of Superintendents (CCSS) and of the Financial Stability Council (CEF).
    - Monthly meetings with the CEF and the CCSS.

- This commitment is complimentary to the permanent monitoring of financial market conditions carried out by the CBCh, and continuously provides valuable inputs to the supervisors:
    - Financial Stability Report twice a year,
    - Permanent assessment of systemic risks and stress testing,
    - Etc.

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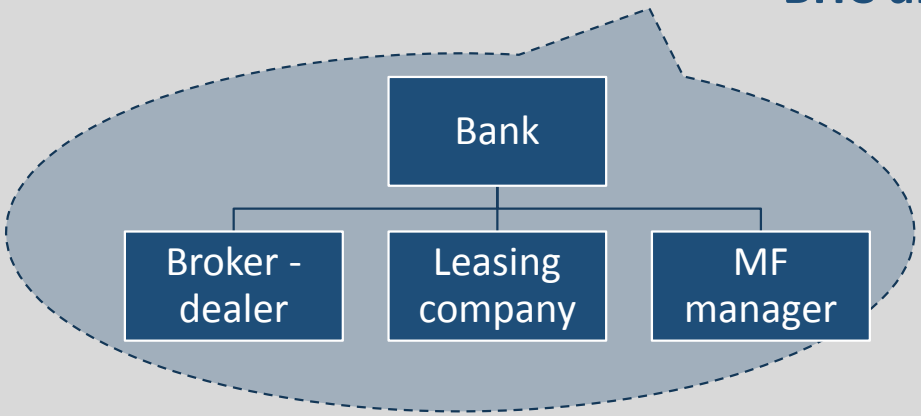
A strong point of the Chilean framework is the consolidated supervision of Bank Holding Companies

- SBIF supervises all business, at the bank or subsidiaries level, including on-site supervision.
- All financial information is collected on both a consolidated basis and at the level of the individual bank and subsidiaries.

BHC under SBIF supervision



The SBIF has the authority to put in place additional capital requirements on a consolidated basis

- The consolidated capital base data are permanently disclosed.
- A breach of minimum capital requirements on consolidated basis can trigger preventive actions by the supervisor and the resolution framework.
- The liquidity requirements are defined by the CBCh, and apply on a consolidated basis.
- These regulations apply also to international BHCs with the parent bank established in Chile.

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- The 1997 reform was thought as the foundations to promote the internationalization of Chilean banks.
- At the time, no Chilean banks had international presence.
- The SBIF and CBCh became in charge of authorizing interested banks to establish a branch or subsidiary abroad.
- In order to go abroad, banks are subject to various prudential conditions, most notably that the investment must not be higher that 40% of regulatory capital.

These regulations apply also to international BHCs with the parent bank established in Chile

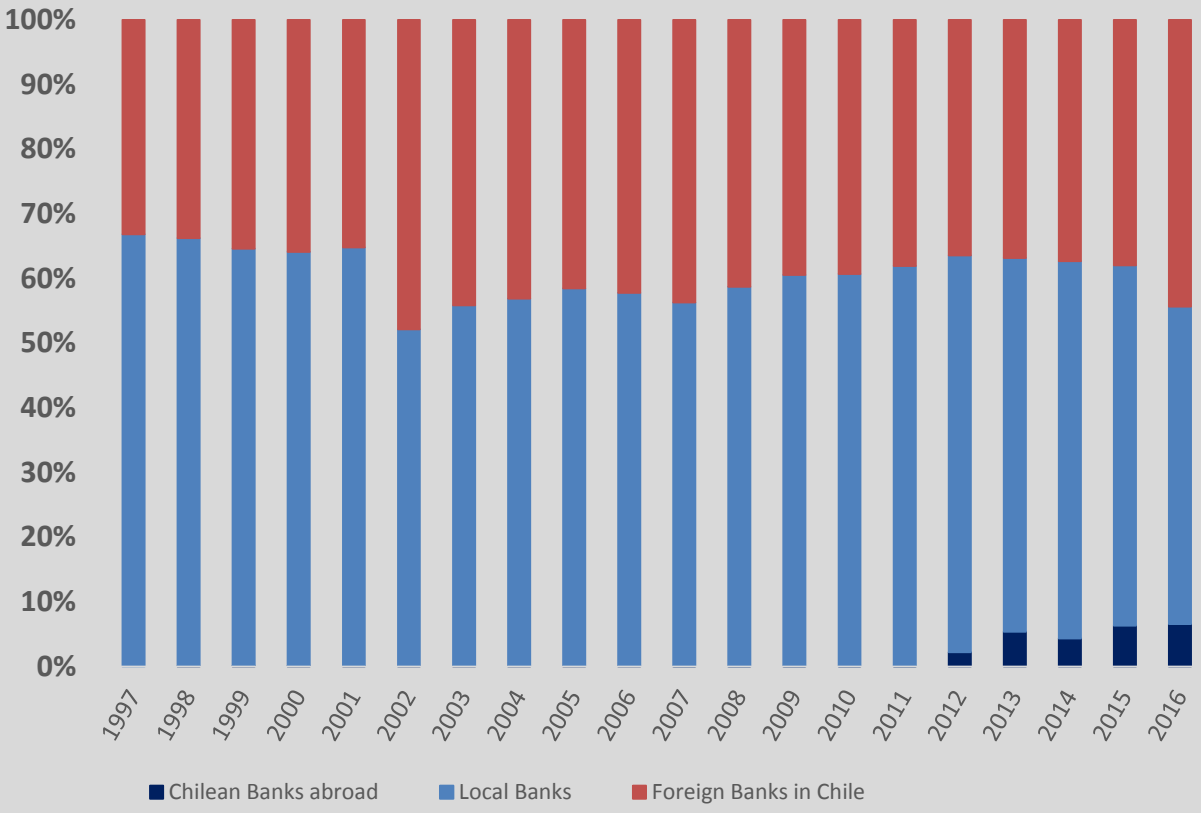
- …Only 3 banks opened branches abroad in 1998, 1999 and 2005. During that decade (1998-2007) this participation was stable around 0.08 % of assets.

- This landscape changed in 2012. This year, the first Chilean bank applied for authorization to buy a bank in a really great country … Colombia!

- Not much later, a second bank applied for authorization to buy a bank in Miami, Florida.

- In other words we had the possibility to test a legal framework 15 years after its was enacted .. and the results were very successful.

These regulations apply also to international BHCs with the parent bank established in Chile



These regulations apply also to international BHCs with the parent bank established in Chile

	Consolidated assets	Subsidiaries abroad		Branches abroad		Total assets abroad	
	USD MM	USD MM	%	USD MM	%	USD MM	**%**
Itau	43.644	10.904	25%	1.235	2,8%	12.139	**28%**
BCI	46.380	8.237	18%	1.855	4,0%	10092	**22%**

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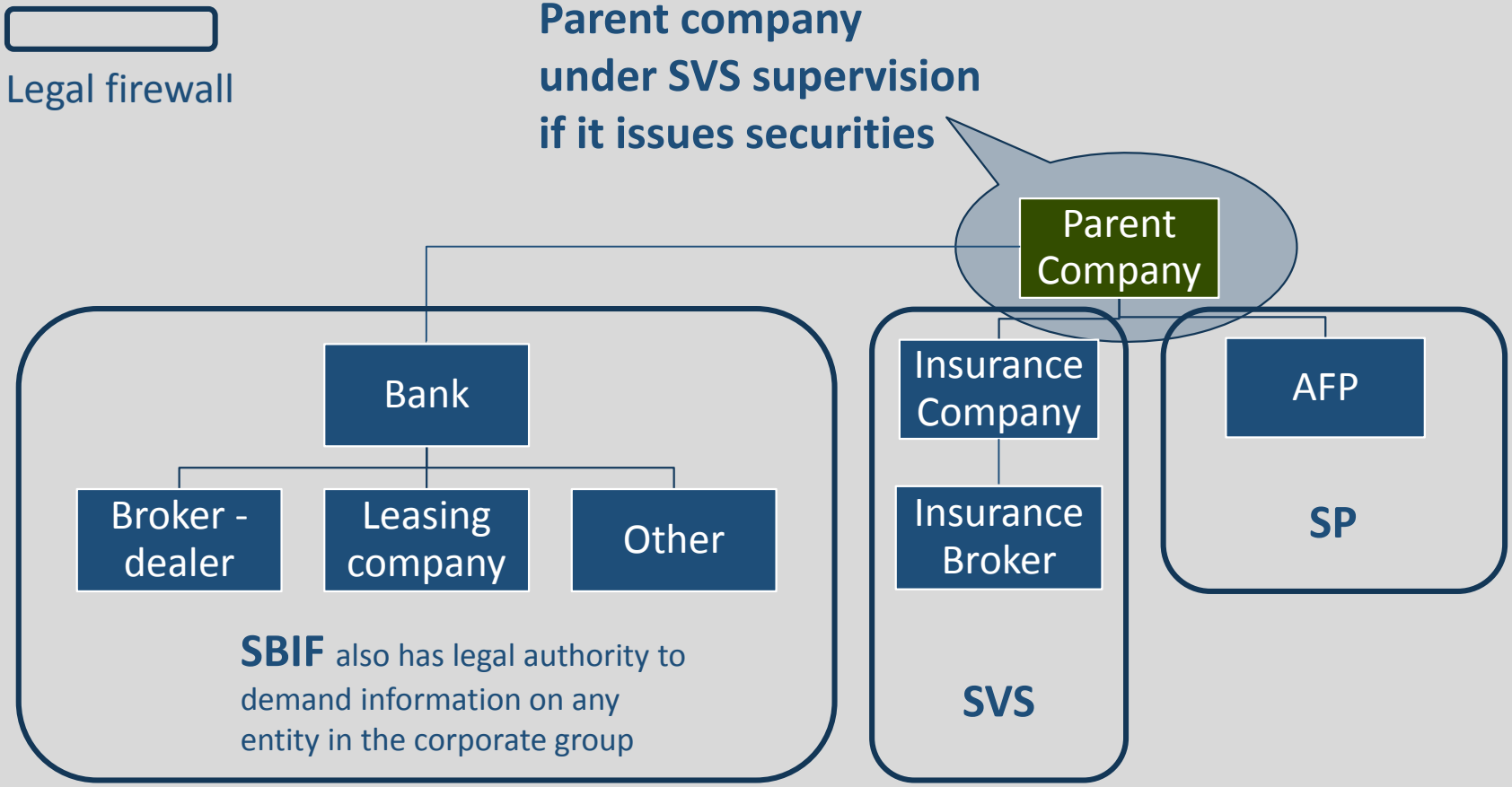
Stringent legal firewalls are in place, and not only for banks



The improvements in coordination have been a very powerful boost for the supervisory approach to conglomerates, beyond the BHC framework

- An amendment to the Financial Stability Council (CEF) act introduced the binding possibility for supervisors to require information from all companies related to their supervised entities.

- Furthermore, this information can be shared between supervisors through the Committee of Superintendents and the CEF.

- The CBCh, as participant of both the Committee of Superintendents and the CEF, can access this information (with minimal restrictions) and incorporates it in the ongoing financial stability analysis.

Given our legal framework, we focus our efforts in making supervisory coordination most effective

- **Our working definition of a financial conglomerate considers:**
  1. Companies under common control or significant influence,
  2. Which carry out business in at least two of the regulated financial industries in Chile:
     - Banking,
     - Insurance, and
     - Pension fund management.
- With these two criteria, we can identify **15 relevant financial conglomerates** operating in Chile as of September 2017.
- The total financial assets of these 15 FC are roughly 490 USD billion, approximately 200% of Chilean GDP.

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	Banco / SBIF	Insurance / SVS	Pension Fund / SP
1	99,0%	1,0%	0,0%
2	65,2%	34,8%	0,0%
3	86,5%	13,5%	0,0%
4	0,0%	0,2%	99,8%
5	35,9%	64,1%	0,0%
6	98,9%	1,1%	0,0%
7	99,7%	0,3%	0,0%
8	98,0%	2,0%	0,0%
9	99,6%	0,4%	0,0%
10	0,0%	14,6%	85,4%
11	0,0%	11,7%	88,3%
12	99,0%	1,0%	0,0%
13	71,0%	29,0%	0,0%
14	0,0%	0,2%	99,8%
15	0,0%	10,0%	90,0%

This framework was tested in 2013, when difficulties within a mixed conglomerate were successfully tackled

- A real sector enterprise of a mixed conglomerate faced severe financial stress due to a breach of fixed income covenants.
- The problems tainted the conglomerate's bank through reputational channels, as interest rates of exchange traded deposit certificates issued by the bank jumped and liquidity problems ensued.
- Moral suasion by the authorities was effective. The supervisors and the CBCh followed possible solutions directly with the controlling partner.
- Finally the situation was normalized by liquidating assets. The bank was no longer under pressure and markets returned to business as usual.

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The stability of the last 30 years suggest the system has been effective

- Overall culture of prudence regulation and supervision.
- Effective supervisory framework.
- Stringent legal firewalls
- Effective coordination mechanisms between authorities.
- BCCh involved trough its regulation and financial stability roles.

However, there is room for improvement

- Even if coordination has proved successful, supervision may benefit from a more integrated approach like the one proposed by the bill currently in congress.

- And can be further strengthened with the adoption of explicit authority for the supervisors to place constraints on the corporate structure of financial conglomerates, specially regarding limitations on ownership of non-financial entities.

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