



## Regulation in consultation on the Basel III standards

# CMF sets criteria for determining additional asset requirements as a result of the supervisory process

- *The regulation establishes a general framework for assessing capital adequacy of banks and the possibility of determining additional capital requirements (Tier 2) as a result of the supervisory review process.*

**May 15, 2020** – The Financial Market Commission (CMF) has published for consultation a regulation on implementation of additional capital requirements as a result of the supervisory review process, known as Tier 2. The consultation process will be open until July 22, 2020 for comments from the market and general public.

The regulation is based on the principles of the latest Basel Committee Accord, published in December 2017, and existing international experience. This also complies with the provisions of Articles 59 to 62 and 66 quinquies of the General Banking Act (LGB, for its Spanish acronym), allowing the Chilean banking system to adopt the best international practices.

When the CMF announced in March the extension of the deadlines for implementing Basel III in Chile — with the aim of giving banks greater flexibility to help their customers deal with the financial impact of Covid-19 — it reported that Tier 2 would regardless come into force in the fourth quarter of 2020. This is in consideration of the fact that the new rules expand the Commission's powers to impose additional capital charges on specific entities, should their conditions warrant it under any economic circumstances. Prior to the amendment to the LGB in 2019, and although the legislation included the concept of management and solvency assessment, the CMF was not empowered to impose higher capital requirements on banking companies with insufficient capital or management levels according to its supervisory assessment.

## Modifications

The new regulation corrects this gap by virtue of the powers granted by the LGB to the CMF. To this end, it amends Chapter 1-13 of the Updated Compilation of Rules for Banks (RAN, for its Spanish acronym), on management and solvency assessment,

with some consistency adjustments and additional management principles. In addition, it adds a new Chapter to the RAN, 21-13, which distinguishes 2 processes:

1. The capital self-assessment process, in which banks themselves determine their internal effective equity target required to cover their risks over a three-year timeframe.
2. The CMF's assessment of the adequacy of banks' effective capital to support their risk profile, as determined in the annual supervisory review process.

## Internal Capital Target

Unlike other regulations, where it is possible to make a quantitative analysis of the impact of any proposed guidelines, the component of sound judgement in Tier 2 — by both the bank's board of directors and the supervising entity — is inherent to the process. This complicates an estimation.

The Regulatory Report included in the consultation outlines the core elements of the approach that banks should take to identify their internal capital target.

Therefore, if the deficiencies found during the supervisory review process are significant, an "action plan" will be required from the board to correct them. The plan must be mutually agreed with the Commission and include, among other measures:

- Improvements to corporate governance.
- Risk management and control.
- Modification of the level of effective equity up to a maximum of 4 percent of risk-weighted assets minus the required provisions. This measure requires a favorable vote by at least four CMF Commissioners.

## Validity

The regulation will be in force immediately after its publication, which will be no later than December 1, 2020. In any case, all issues will be evaluated as from the supervisory cycle starting in January 2023. Prior to that date, the Effective Equity Self-Assessment Report will be based exclusively on the entity's risk and stress testing framework. It will also be required on a case-by-case basis by the Commission within its annual supervisory review process.

To access the details of the regulatory proposal, you can visit the [Draft Rules and Norms](#) section of the CMF website. In addition, the Commission also makes available to interested parties a Regulatory Report evaluating the impact of the proposed regulation, a Frequently Asked Questions document, and a Presentation. These documents summarize the core elements of this public consultation.

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