



CMF launches implementation of Basel III standards with issuance of regulation on additional equity requirements as a result of the supervisory process

- *The regulations to determine additional capital requirements establish the general framework for assessing the capital adequacy of banks as a result of the supervisory review process (Tier 2).*

September 14, 2020 – After the conclusion of a public consultation process, the Financial Market Commission (CMF) approved the issuance of the first regulation for the adoption of Basel III standards in Chile. Said regulation sets the criteria and general guidelines to determine additional capital requirements as a result of the supervisory process, known as Tier 2. Therefore, the Commission complies with the schedule established for the implementation process of Basel III standards pursuant to Law No. 21,130, which modernizes banking legislation.

Additional Equity Requirements

The regulations implementing the supervisory review process of banks' effective capital adequacy, called Tier 2, are based on the principles of the latest Basel Committee Accord, published in December 2017, and on available 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 incorporation of the best international practices into the Chilean banking system.

When the CMF announced in March of this year the extension of Basel III implementation deadlines in Chile, the aim was to give banks more flexibility to help their clients deal with the financial impact of the Covid19. It also stated that Tier 2 would come into force anyway in the fourth quarter of 2020. This is because these regulations extend the Commission's powers to establish additional equity charges on specific entities should their situation warrant it.

Before the amendment to the LGB in 2019, although said legislation included the concept of assessment by management and solvency, the Commission was not empowered to require greater equity requirements from banking companies with insufficient capital or management according to its supervisory assessment.

Amendments

The new regulation corrects this gap through the powers granted by the LGB to the CMF. To this end, Chapter 1-13 of the Updated Compilation of Rules for Banks (RAN, for its Spanish acronym), on management and solvency assessment, is amended with some consistency adjustments and additional management principles. It also introduces a new Chapter, 21-13, which differentiates two processes:

1. The process of equity self-assessment, in which banks themselves will determine their internal target effective equity, necessary to cover their risks over a timeframe of at least three years.
2. The assessment by the CMF of the adequacy of banks' effective equity to support their risk profile, as determined in its annual supervisory review process.

Impact

According to estimates as of December 2019, by using the regulatory proposals published in consultation and without considering the transition contemplated in the law, there would be positive requirements of effective equity equal to 0.75 percent of the system's risk-weighted assets (APR, for their Spanish acronym).

The results do not change substantially if it is considered that banks could set a somewhat higher internal target based on their historical equity or the benchmark capital adequacy ratio of peer banks (banks with similar characteristics such as size, market niche, etc.)

Validity

The regulation will enter into force immediately. The self-assessment report of effective equity to be presented by banks in 2021 will be based only on credit risk, and the 2022 report will incorporate market and operational risks. Both reports will have a simplified format. The full report with all its sections, considering all of the banks' material risks, including those for which there is no measurement standard, will be required from 2023 onwards.

To access the details of the regulation, interested parties may visit the [Rules and Norms section](#) of the CMF website. Additionally, the Commission makes available a [Regulatory Report](#) evaluating the impact of the regulation, a [Frequently Asked Questions document](#), and a [Presentation](#) with its core elements.

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