PRESS RELEASE

CMF publishes for consultation new version of standardized methodology to calculate consumer loan provisions

- *This new regulation would allow all loans granted by banks to have a standard provisions calculation methodology, wrapping up an effort that began over a decade ago.*

October 12, 2023 — The Financial Market Commission (CMF) published for consultation today a new version of the standardized methodology (SM) to calculate provisions for consumer loans and contingent credits granted by banking institutions established in Chile.

An early version of the regulation was in public consultation last year. Early in 2023, the Commission held technical worktables with industry representatives. As a result, the new SM under consultation includes and addresses the main concerns raised about its initial version.

Methodological Improvements

Provisions are the accounting record of expected losses (EL) of a bank's loan operations. They ensure banks have sufficient resources to mitigate possible losses related to loans they grant so they can carry out an adequate prudential risk management. The EL value is calculated as the product of a 12-month probability of default (PD) and the loss-given default (LGD).

The history of these methodologies begins in 2011 with the implementation of PD and LGD for provisioning individually assessed commercial portfolio exposures. This amendment repealed former Chapter 7-10 of the Updated Compilation of Rules for Banks (RAN) and was added to Chapter B-1 of the Compendium of Accounting Standards for Banks (CASB). A standard method for the housing portfolio was incorporated into Chapter B-1 of the CASB in 2014, and the standard allowance methodology for commercial loans under group analysis was created in 2018.

New Regulatory Proposal

The regulation under consultation today aims to introduce a SM for provisions related to consumer loans in Chapter B-1 of the CASB. As for the other portfolios, the regulation establishes matrices to determine the PD and LGD used to calculate the level of provisions. An earlier version was published for comments from interested parties between August and December 2022. Once the feedback period ended, the CMF participated in consulting tables with the Association of Banks and Financial Institutions and the Financial Retail Association, where they discussed and exchanged ideas on the most relevant issues regarding design and application of the SM under consultation.

Based on feedback obtained and the analysis conducted in the worktables, a new SM proposal was developed. In this new version, the determination of the PD is simpler and is based on three risk factors, which are also better aligned with the management of provisions made by the institutions. As for the LGD, openings are according to the type of product and considering the recovery particularities each of them might have.

Impact

Considering the size of the consumer portfolio as of March 2023 and if its behavior does not change significantly, the new SM would entail an increase of around USD 487 million in provisions. Said figure represents 18.1 percent of the available provisions stock at that date. Provisions calculated in the new regulation are lower than those of the starting proposal, which considered an approximate increase of 50 percent. The new proposal's reduced impact is due to a reduction in the LGD value.

Interested parties can access the **Draft Rules and Norms section** of the CMF website until November 16, 2023 to check the details of the proposed methodology and submit their feedback. The Commission also makes available the corresponding **Regulatory Report** assessing its impact.

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