



# CHILE

## TECHNICAL ASSISTANCE REPORT—FORMING AN INTEGRATED SUPERVISORY AUTHORITY

February 2020

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# **INTERNATIONAL MONETARY FUND**

Legal and Monetary and Capital Markets Departments



## **Chile**

**FORMING AN INTEGRATED SUPERVISORY AUTHORITY**

**Dirk Jan Grolleman (MCM), Karla Vásquez (LEG), and  
John Laker and Jean-Pierre Deguée (IMF Short-Term Experts)**

**February 2020**



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**GLOSSARY**

BCCh	Banco Central de Chile (Central Bank of Chile)
CSF	Comité de Supervisión Financiera (Financial Sector Supervision Committee)
CEF	Consejo de Estabilidad Financiera (Financial Stability Council)
CMF	Comisión para el Mercado Financiero (Financial Markets Commission)
EGM	Executive General Manager
FSAP	Financial Stability Assessment Program
IMF	International Monetary Fund
MCM	Monetary and Capital Markets Department
MoF	Ministry of Finance
SBIF	Superintendencia de Bancos y Instituciones Financieras (Superintendence of Banks and Financial Institutions)
TA	Technical Assistance
SVS	Superintendencia de Valores y Seguros (Superintendence of Capital Markets and Insurance Companies)
UAF	Unidad de Análisis Financiero (Financial Integrity Unit)

## PREFACE

At the request of the securities markets and insurance supervision commission, the Comisión para el Mercado Financiero (CMF), a joint IMF Legal (LEG) and Monetary and Capital Markets (MCM) Department mission visited Santiago de Chile during September 27–October 10, 2018, to advise on the planned integration of the superintendency for banking supervision, Superintendencia de Bancos y Instituciones Financieras (SBIF), into the CMF.

In carrying out its work, the mission met with the President, Mr. Joaquin Cortez Huerta, the Board and other senior staff of the CMF as well as with the Superintendent, Mr. Mario Farren, and other senior staff of the SBIF. The mission also met the Superintendent of Pensions, Mr. Osvaldo Macías; the Director of the Financial Integrity Unit (Unidad de Analisis Financiero - UAF), Mr. Javier Cruz; the Capital Markets Coordinator of the Ministry of Finance, Ms. Catherine Tornel; and the Director of the Financial Policy Division of the Central Bank of Chile (BCCh), Ms. Solange Bernstein.

In its final meeting, the mission presented its main observations and recommendations to the Board of the CMF and the Superintendent and Deputy-Superintendents of the SBIF.

The mission would like to express its gratitude to the CMF and SBIF and its staff for the excellent arrangements made to facilitate its work and for their openness and cooperation.

## EXECUTIVE SUMMARY

**The CMF requested technical assistance (TA) on the proposed integration of the SBIF into the CMF.** In response to this request, the IMF fielded a joint LEG-MCM mission to Santiago de Chile during September 27–October 10, 2018. The mission advised on: (i) the internal governance structure of the new CMF (the CMF after integration of the SBIF); (ii) its internal organizational structure; (iii) the transition process towards the new CMF; and (iv) cooperation arrangements with the Central Bank and other relevant Chilean supervisory authorities. The mission also provided medium-term recommendations on the legal mandates and autonomy of the CMF to strengthen the institutional design of the supervisory agency. The Bills containing the amendments for integration of the SBIF into the CMF were approved on October 3, 2018.

**While the approved Bills contain important enhancements to the governance and regulatory framework, several legal aspects would benefit from further clarification.** These include aspects related to the mandate, objectives, powers, and governance of the CMF. In the short term, inconsistencies in and enhancements to the definition of the mandate of the CMF, the distribution of responsibilities between the CMF Board and its President, and the Board’s ability to delegate could be addressed in the short term by changes in the CMF’s charter, internal guidelines and operational procedures (e.g., explaining how the CMF will deal with conflicts of interest between its different mandates), a clearly communicated mission statement, and through provisions in an omnibus Bill to clarify the delegation framework for the CMF (a drafting proposal is contained in Annex I). In the medium to longer term, enhancements to the autonomy of the CMF would need to be incorporated in the respective financial sector laws at which point the definition of the mandate could also be further streamlined and aligned with the communicated mission statement. In addition, the mission notes that the main recommendations of the 2011 FSAP related to consolidated supervision and resolution still need to be addressed in the legal framework (Annexes II and III).

**Integration should achieve important synergies.** In addition to efficiencies in back-office and management functions, the new organization should deliver synergies in core regulatory and supervisory functions:

- Strengthening conglomerate supervision (e.g., internalizing coordination and data sharing).
- Broadening the base for developing and efficiently using specialized skills (e.g., cyber risk).
- Ensuring consistency of regulation across sectors (e.g., corporate governance regulations).
- Consolidating and strengthening the research function.
- Strengthening and harmonizing the approach to market conduct supervision across sectors.
- Building on developed sanctioning processes within the current CMF.
- Building on and harmonizing the well-established risk-based supervision process in the SBIF.

A proposed blueprint for the internal organization structure of the new CMF (an internal “twin peaks” model—see Section V and Annex IV) should help to drive these synergies.

**In the short term, however, the integration will pose significant challenges.** The recent changes to the CMF governance structure compound the challenges. The CMF and its collegial Board governance model were only established on January 1, 2018, and the organization and its Board are still settling into the new governance structure and decision-making process. At the same time, the integration does not foresee the inclusion of former senior SBIF staff on the Board, in either current or expanded size. In this context, it will be key that the CMF Board pays significant attention to developing relationships with SBIF staff, including understanding existing SBIF decision-making processes and how these would translate to the CMF, to ensure a seamless integration on “Day One” (the date when the integration is legally realized).

**An issue that will need to be considered carefully is the governance of the transition process.** While there are challenges common to any merger (human resources aspects, information and communication systems and technology, maintaining continuity in business-as-usual activities, mitigating uncertainty for staff through an effective communication strategy, etc.), the mission advises that a Steering Committee and taskforce be set-up, with CMF and SBIF involvement on an equal basis. While early communication on the blueprint for the organizational structure would be useful for managing expectations of staff, the first priority should be achieving an effective integration on Day One. Moving to the blueprint in a timely manner would then become the priority. The final organizational structure of the new CMF is, of course, a matter for the CMF Board.

**Though not an immediate priority, location of all staff in a single building will be essential for building “esprit de corps” and breaking down siloes in the new organization.** Options and the timetable for such a move should be established. At the same time, the CMF Board should consider establishing a clear ambition and supervisory strategy for the new organization to guide the staff and take regulation, prudential supervision, and market conduct supervision in Chile (e.g., conglomerate supervision) to the next level.

**The IMF stands ready to provide follow-up TA if needed.** The clarification of the mandate through internal and external statements and how to deal internally with possible conflicts of interest between different objectives is possibly an area in which IMF’s cross-country experience and advice could provide added value.

**Table 1. Chile: Key Recommendations—Forming an Integrated Supervisory Authority**

<b>Recommendations Relating to the Transition Process</b>		<b>Priority</b>
1	Establish a Steering Committee comprising the President of the CMF and the Superintendent of the SBIF to oversee the integration process. ¶54	ST
2	Establish a balanced (with equal representation) taskforce, to direct and coordinate working groups dealing with “back-office” and other integration issues. ¶53	ST
<b>Recommendations Relating to the Organizational Structure of the New CMF</b>		<b>Priority</b>
3	Consider an internal “twin peaks” organizational structure for the new CMF to promote the objectives of integration. ¶30	ST
4	Setup a consistent and robust delegation framework to address the need for effective and adequate supervision. ¶27, 28, 32–35	ST
5	The CMF President delegate to a CMF Commissioner the responsibility for developing bilateral relationships with the BCCh and the Superintendence of Pensions, respectively. ¶43, 44	ST
6	Establish an operational framework providing explicit criteria to manage potentially conflicting objectives. ¶16	ST/MT
7	Take the necessary decisions and actions at CMF Board level to achieve the agreed structure in a timely manner. ¶53	MT
8	Relocate all staff in a single building to build an “esprit de corps” and break down siloes in the new organization. ¶55	MT
<b>Recommendations for strengthening the mandate, objectives, and powers of the CMF under the current legal framework</b>		<b>Priority</b>
9	Provide a hierarchy of the objectives of the CMF through an internal statement to be made public. ¶15	ST
10	Create a CMF charter that outlines clearly the mandates, objectives, and powers of the CMF, and elaborates in detail the division of responsibilities between the Board members, the President, and other senior staff. ¶15, 16, 17	ST
11	Clarify the allocation of responsibilities of the decision-making bodies of the CMF through amendments made by an Omnibus Legislation. ¶27	ST
<b>Key Recommendations Needing Amendments to Financial Sector Laws</b>		<b>Priority</b>
12	Introduce amendments to the CMF Law to strengthen the institutional, budget, functional, and personal autonomy of the CMF. ¶19-22	MT-LT
13	Revisit the need for the BCCh’s involvement in the microprudential regulatory and supervisory tasks of the CMF. ¶21	MT-LT
14	Adopt the recommendations for strengthening the legal framework for consolidated supervision and the resolution regime of supervised entities. ¶41	MT-LT
15	Clarify the CMF legal mandates, pertaining to its different supervisory responsibilities, in Financial Sector Laws and provide a hierarchy between them. ¶14	MT-LT
ST = Short-Term (0 – 6 months); MT = Medium-Term (6 month – 2 years); LT = Long-Term (> 2 years).		

## I. INTRODUCTION

**1. The CMF requested technical assistance (TA) on the proposed integration of the SBIF into the CMF.** In response to this request, the IMF fielded a joint LEG-MCM mission to Santiago de Chile during September 27–October 10, 2018. The proposal for integration was contained in the Draft Law on Modernization of the Banking Legislation No. 63-365. In parallel, additional amendments were proposed to the CMF Law, aimed at further strengthening the collegial powers of the Board. The Bill of Law has been approved by Congress on October 3, 2018, and is now only awaiting promulgation.

**2. With the integration, the authorities expect to be able to realize several synergies in the new CMF.** Among the reasons for this important change, the new Law in its explanatory memorandum refers to: (i) the advantages of integration versus separation of functions in siloed supervisory agencies; (ii) better coordination for the supervision of capital ratios, a wider perspective over the financial market and the supervised institutions; and (iii) the introduction of a collective decision-making body to perform all functions, including those currently falling within the responsibility of a single person, viz. the Superintendent of Banks.

**3. The resulting institutional supervisory architecture is taken as a starting point for the TA.** In this context, the mission’s advice focused on: (i) the internal governance structure of the new CMF; (ii) its internal organizational structure; (iii) the transition process towards the new CMF; and (iv) cooperation arrangements with the central bank and other relevant Chilean supervisory authorities. The mission also provided medium-term recommendations on the legal mandates and autonomy of the CMF to strengthen the institutional design of the supervisory agency. While not in its main focus, the mission recognizes that further enhancements to the CMF and Banking Laws will be needed to follow-up on past recommendations regarding conglomerate supervision and the resolution framework. The mission’s observations in this regard are included in Annex II and III to this report.

**4. The mission held individual and joint meetings with CMF and SBIF staff.** The opening and closing meetings of the mission were held jointly with the CMF Board and the SBIF Superintendent and Deputy-Superintendents of both institutions. In conducting its work, the mission met with senior CMF and SBIF staff, and held joint roundtable discussions (involving CMF and SBIF staff) around four topics: conglomerate supervision, enforcement, conduct supervision, and financial stability. In addition, the mission met with representatives of the Superintendence of Pensions, the Financial Intelligence Unit (UAF), the Ministry of Finance, and the Central Bank of Chile (BCCh) to discuss their views on the integration.

**5. This report discusses the mission’s main observations and recommendations regarding the integration of the SBIF into the CMF.** After this introduction, Section II provides an overview of the existing supervisory architecture. Section III discusses the legal mandate, objectives, and powers of the new CMF, followed in Section IV by a discussion on the governance arrangements that existed prior to the integration and of the main changes brought in the Law recently approved. Section V discusses a possible blueprint for the organizational structure of the new CMF aimed at realizing the desired synergies in the supervision function and strengthening conglomerate supervision. Section VI discusses the recommendations regarding inter-institutional cooperation

arrangements and, finally, Section VII discusses the mission's recommendations regarding the transition process.

## II. EXISTING SUPERVISORY ARCHITECTURE

### **6. The existing supervisory architecture is organized following an institutional approach.**

The SBIF supervises banks, their subsidiaries, the larger credit cooperatives, and credit card issuers. The CMF supervises insurance companies; securities issuers; fund managers; brokers; and financial market infrastructures, among others; and the Superintendencia de Pensiones supervises pension and some social security benefits. The Ministry of Finance (MoF) is responsible for the preparation of financial sector laws, while the BCCh is responsible for monetary policy, and exercises financial stability functions.

**7. The financial sector supervisors cooperate and exchange information through the Financial Sector Supervisory Committee (Comité de Supervisión Financiera (CSF)).** The SBIF, CMF and the Superintendencia de Pensiones are permanent members of the CSF. In addition, the BCCh is invited to all meetings as an observer. The committee is used by the participating authorities as a platform for the exchange of information on regulatory and supervisory developments.

**8. The Financial Stability Council (Consejo de Estabilidad Financiera (CEF)) is the mechanism for financial stability and macroprudential policy cooperation and coordination.** The CEF is chaired by the Ministry of Finance and consists of the CMF, SBIF, and Superintendencia de Pensiones. The BCCh is not a formal member,<sup>1</sup> but is a permanent advisor to the CEF. The mission was advised that, in practice, the BCCh plays a lead role in the preparatory work and discussions of the CEF. While the CEF has powers to request information from its members and the BCCh necessary for the identification of financial stability risks, its policy recommendations are non-binding.

**9. The current governance model of the capital markets and insurance supervisor, with a collegial Board instead of a Superintendent, was only established recently.** The transition from a superintendencia (Superintendencia de Valores y Seguros (SVS) to a Commission (CMF) was only realized on January 15, 2018. This model is similar to the governance model of the BCCh, which is well-established, and is viewed favorably compared to a governance model in which all powers are concentrated in a Superintendent.

**10. To realize a governance model similar to the CMF, and to achieve various synergies and cost efficiencies, the proposal was made to integrate the SBIF into the CMF.** Combined, the SIBF (278) and CMF (346) will have in total about 624 staff, with a mandate for prudential supervision, market conduct, and surveillance of all the above-mentioned financial institutions, including banks; and for ensuring the functioning, development, and stability of the financial market.

**11. While the integration of an institution is challenging, the recent changes to the CMF's governance structure compound the challenges.** The CMF and its collegial Board governance model were only established on January 15, 2018, and the organization and its Board are still settling

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<sup>1</sup> The legal interpretation of the by law provided autonomy does apparently prevent the BCCh to be a member of the CEF. As a workaround, the BCCh is appointed as a permanent advisor to the CEF.

into the new governance structure and decision-making process. At the same time, the integration does not foresee any change in Board composition or size to include former senior SBIF staff.

### III. LEGAL MANDATE, OBJECTIVES, AND POWERS OF THE NEW CMF

#### A. Legal Mandate and Objectives

**12. A well-defined legal mandate is essential to support the supervisory authority's autonomy and accountability.** An adequate formulation of its legal mandates entails a clear definition of the objectives (i.e., the interests to be protected), tasks, and powers entrusted to the supervisory authority. Together, if explicit in the legislation, they create a solid legal underpinning that will serve: first, as guidance to the authority for the pursuit of its responsibilities, including when carrying out multiple objectives; second, as a yardstick to assess whether the authority's resources have been appropriately allocated for the discharge of its mandate; and third, to justify the level of autonomy needed vis-à-vis the political bodies and the financial sector industry, and the corresponding accountability. Finally, if the supervisory authority is granted with multiple legal mandates, their fulfilment may raise conflicts should they, at times, become mutually exclusive, in part or as a whole. The legislation would then need to provide an array of mechanisms to address this (i.e., prioritization and hierarchy of objectives, granting the authority ample discretion to determine relative priority at a given circumstance, and/or assigning different governance and decision-making structures to support each objective).

**13. CMF's legal mandates could be more clearly defined.** Two major shortcomings can be noted:

- *On one hand*, the organic law of the CMF recognizes as the objectives of the agency to: (i) ensure the proper functioning, development, and stability of the financial market, and (ii) facilitate the participation of the market agents and promote the public faith.<sup>2</sup> The law also requires that, the CMF, for achieving those objectives must maintain “*a general and systemic vision*” and consider “*the interests of investors, depositors, insured, and the public interest.*”<sup>3</sup> The following issues arise from the current wording:
  - (i) *first*, these provisions do not discriminate between the different legal mandates of the CMF particularly regarding its prudential mandate in its two key dimensions: micro- and macropudential aspects;
  - (ii) *second*, the recognition of the “*development of the financial market*” as one of the CMF's objectives raises questions as to the extent that this objective is appropriate for a supervisory authority and the conflicts that it may create with the other objectives; *and*
  - (iii) *finally*, a number of provisions opt to refer to the objectives in a more general manner without identifying to which legal mandate they correspond, suggesting that there is a confusion between the different legal mandates and the objectives to be pursued (e.g., the use of preventive and corrective measures is not linked to any specific objective

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<sup>2</sup> Article 1, second paragraph of the CMF Law (as amended).

<sup>3</sup> Also recognized in Article 5.30 of the CMF Law (as amended) which provides also the “*financial stability*” as a concern.

(e.g., prudential supervision) and is generally justified by the *protection of the shareholders, investors, depositors and insured, as well as the public interest and financial stability*).<sup>4</sup>

- *On the other hand*, the specialized laws that regulate the areas within the scope of supervision of the CMF, i.e., General Banking Law, Insurance Law,<sup>5</sup> and Securities Market Law<sup>6</sup> do not provide for clear objectives or purposes and nor are they coherently aligned with the general mandate provided under the organic CMF Law.

**14. While these weaknesses as a starting point can be addressed through internally and externally communicated statements, ultimately these are best addressed through legal reform.** It is advisable that in each law governing the specific mandate—i.e., the specialized laws regulating the banking, insurance and capital markets area, provides expressly its precise objective.<sup>7</sup> Also, the organic law of the CMF should be aligned with the corresponding provision of these specialized laws providing the different CMF’s legal mandates. It could also provide for its role in contributing to the stability of the financial system (see Section VI).<sup>8</sup> This is essential to support the legal certainty of the legal instruments to be used within the broad discretion bestowed on the supervisory authority. Pursuant to administrative law principles, an administrative act must be adopted in accordance with the objective of its respective legal mandate.

**15. Pending a legal reform, and to guide the new CMF in fulfilling its new legal mandates, its internal rules could clarify the objectives (i.e., the interests to be protected).** During this transition the CMF must have a clear view of its current and new mandates and how to achieve them in the formulation of policy and the day-to-day performance, particular in situations of conflict (see following paragraph on this issue). To this end, the CMF could elaborate a statement describing how it understands its mandates, the objectives for each mandate, and how it perceives an eventual ranking between these mandates in case of conflict. While this issue should be clarified in the law over the medium-term, in the interim, this statement could be communicated to the political authorities/bodies (i.e., Ministry of Finance and Parliament) and the stakeholders in the context of the CMF’s accountability framework.<sup>9</sup>

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<sup>4</sup> Article 5.30 of the CMF Law (as amended).

<sup>5</sup> Certain provisions suggest only some consumers protection dimensions. See for example Article 3, e) of the Insurance Law and Article 33, 6) of the CMF Law.

<sup>6</sup> While not explicitly stated, some objectives are reflected throughout the different provision of the Securities Market Law (e.g., see Article 39 on investors’ protection, good functioning, and fair; competitive, orderly, and transparent market)

<sup>7</sup> See in this respect drafting proposals in Annex I.

<sup>8</sup> In this respect, the CMF Law could provide a mandate in general terms, e.g., “In addition, the CMF’s mandate consists in contributing to the financial stability, in accordance with the legal framework established by...”

<sup>9</sup> See for example the Australian Prudential Regulation Authority Act 1998. The original formulation of that Act defined APRA’s purpose as: “In performing and exercising its functions and powers, APRA is to balance the objectives of financial safety and efficiency, competition, contestability and competitive neutrality.” To introduce a hierarchy of objectives the Act was amended in 2007 to give primacy to financial stability considerations. The Act now reads: “In performing and exercising its functions and powers, APRA is to balance the objectives of financial safety and efficiency, competition, contestability, and competitive neutrality and, in balancing these objectives, is to promote financial system stability in Australia.” In addition, the importance of a clearly defined mandate is also highlighted in the Technical Note ([https://www.imf.org/~media/Websites/IMF/imported-full-text-pdf/external/pubs/ft/scr/2011/\\_cr11230.ashx](https://www.imf.org/~media/Websites/IMF/imported-full-text-pdf/external/pubs/ft/scr/2011/_cr11230.ashx)) prepared in the context of the 2011 United Kingdom FSAP, which highlights in Section II that “*lack of clarity in mandates and*

**16. In addition to clarifying the legal mandates, an operational framework must be put in place to manage conflicting objectives.** Some supervisory decisions may have to deal with trade-offs regarding the compliance with different legal mandates. See for example the continuing tension with supervised entities subject to prudential supervision (banks, insurance undertakings) that are also listed on a financial market or that of banks needing public financing regarding its own funds requirement while a complete communication of their financial situation to the investors may cause the failure of the financing operation. These cases illustrate clearly the conflict between the mandate to safeguard the safety and soundness of supervised entities and in the end the financial stability and the one to preserve the investors and the trust in financial markets. Particularly when it is not the law itself that clearly prioritize the choice between different objectives, to address this conflict two key actions could be taken, on the basis of the existing mandates in the legal framework:

- *firstly*, adopt a framework of rules governing the manner to manage these situations<sup>10</sup> (e.g., internal rules for conflict of interest, rules for sharing of information between departments,<sup>11</sup> etc.); and
- *secondly*, design and implement an operational framework at the level of the staff and of the decision-making bodies (see Section V for recommendations on the internal organization of the CMF).

**17. The design of this latter operational framework should be in line with the internal organization of the CMF and follow a three-pronged approach.** As a first consideration, the internal organization of the CMF should be designed in way that allows the identification of cases in which more than one mandate/function will need to be considered and would likely cause a conflict of interest between them (see institutional design recommended in Section V of this report). As a second consideration, an operational framework could be designed to manage conflicting objectives. In this respect, a three-level approach can be designed: (i) the treatment of the case by each operational Department; (ii) the identification of the conflicting issues arising from the case; and (iii) the decision of the competent decision-making body based of its awareness of the conflicting situation and the prioritization of the objectives of the CMF’s legal mandates. Under the first level, a case must be handled and appreciated by the respective internal department in accordance with the sole objective of its mandate (e.g., conduct supervision), and this without self-censorship. In this respect, the communication of the factual information must be effective between each concerned department to the others in order to allow a treatment of the material facts under each legal mandate. At a second level, the internal organization must provide a framework to identify potential conflicts

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*expectations was a contributing factor to the regulatory failure leading up to the crisis.”* Similar comments on the importance of clarifying and defining the mandate can also be found in other Basel Core Principles Assessments or Technical Notes on Banking Supervision prepared in the context of FSAPs (e.g., Singapore 2013 and Sweden 2017). Finally, the issue is also observed in the Governance of Central Banks (BIS, Issues in Governance of Central Banks, May 2009), which may be charged with multiple mandates and objectives (e.g., price stability, financial stability, and prudential regulation and supervision). Chapter 2 of the BIS report covers amongst others the use of extra-statutory statements to clarify the prioritization and objectives of the assigned mandates.

<sup>10</sup> See Article 16.4 of the CMF Law.

<sup>11</sup> For instance, the sharing of information between the different Departments of the CMF (namely confidential information obtained in the context of one legal task to carry out other legal tasks) could be governed by rules establishing the modalities and limitations of such sharing under the “*need to know*” principle.

deriving of the respective treatments of the case. This could be achieved at the level of committees (as recommended in Section V) since their composition would reflect the different responsibilities of each department; this level would make a proposal of arbitrage to the decision-making body, namely the Board (the third level), which should assume the final arbitrage in accordance with the prioritization of objectives. In reconciling such conflicts, the overriding objective should be the maintenance of financial stability.

## B. Powers

**18. The necessary legal powers for banking supervision have been transferred to the CMF.** By replacing the SBIF with the CMF throughout the General Banking Law and in particular in Article 2, the CMF will benefit from all legal instruments given to the banking supervisory agency.<sup>12</sup> However, from a good legislative technique perspective, the list of “powers” provided by the CMF Law raises a number of observations: (i) the organic law of an integrated supervisory agency such as the CMF Law should include only general provisions governing broad and common powers, and tools that are used in the different legal mandates of the authority instead of listing the very specific ones related only to a particular mandate (e.g., Article 5 CMF Law); and (ii) specific powers and tools should be reserved to the specialized laws (see Articles 112 and following of the General Banking Law). This could be a consideration to take in future legal reforms.

## C. Autonomy

**19. A robust autonomy of a supervisory authority relies on four key elements:** *Institutional* (to which degree is the agency subject to instructions from political or public bodies), *personal* (do the key officials of the agency enjoy a sufficient degree of autonomy from political and private interests), *functional* (in executing its mandate, does the agency depend on actions of other public bodies), and *financial* (does the agency have sufficient financial resources to execute its mandate).

**20. While the autonomy of the CMF has been strengthened (compared to the previous set up of the SVS and the SBIF), some elements could be further strengthened.** Important improvements were achieved in the institutional and personal autonomy of the CMF at the time of its creation. However, some shortcomings as described below and detailed in Annex V remain:

- *Strengthen the institutional autonomy* by providing explicitly the autonomy of the CMF for the exercise of its functions and preventing instructions from political organs or other bodies other than those authorized by law.
- *Strengthen the personal autonomy* of the Board members by: (i) tightening the criteria for appointment to require appropriate knowledge and several years of experience on banking, securities, and insurance sectors for the Board members individually, and for the Board as a collective to have the required skills specific to the markets regulated under the CMF’s competence; (ii) extending the “double veto” appointment procedure to the President of the CMF; (iii) grant a six-year term of office to the President as it is the case for other Board members; (iv)

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<sup>12</sup> A new paragraph is also introduced in Article 2 of the General Banking Law: “*However, the Commission will maintain the powers conferred by Law No. 21,000, which creates the Commission for the Financial Market, with respect to the supervised entities.*”

provide the same due process safeguards for dismissal procedure to the President of the CMF as those recognized to other Board members; and (v) to restrict civil liability to the case of bad faith or gross misconduct found against the officials for actions or omissions in the exercise of their functions under the law.

- *Strengthen the financial autonomy* by providing the CMF the power to propose to Congress its own budget adequate to fulfil its mandate, commensurate to (if not benchmarked against) the industry fees, and not subject to any ceiling imposed by the Executive during budget preparation or if so, according to a multiyear planning prepared by the CMF.

Secondary legislation could strengthen the legal protection (personal autonomy) for CMF senior management and staff, providing for example insurance against liability.

**21. The continued involvement of the BCCh in the adoption of supervisory rules and decisions potentially hampers CMF's functional effectiveness.** Both the Banking Law and the Central Bank Law provide prerogatives to the BCCh regarding prudential supervision of banks by means of prior approval mechanisms or issuing regulations.<sup>13</sup> The mission was informed that this involvement responds historically to the need for a checks and balances mechanism vis-à-vis the SBIF's decision-making process (under the single Superintendent regime), its role of lender of last resort, and to the fact that currently the BCCh provides full guarantee over sight deposits. However, a number of considerations suggest that this approach could be reconsidered:

- The justification is weakened by the fact that the CMF's main decision-making body (Board) is collegial, providing an intrinsic checks and balances mechanism;
- External control regarding the CMF's actions is better dealt with a robust framework of accountability to its stakeholders;
- Opinion on regulations related to the BCCh's mandate with respect to macroprudential issues would be more transparently and adequately provided to the CMF through the CEF;
- The institutional arrangements for the financial safety net in Chile need to be reconsidered in line with best international practices. In this regard, the role of the BCCh to provide guarantee over sight deposits might be better addressed by the adoption of an effective resolution framework that reduces moral hazard and the creation of a deposit insurance scheme.<sup>14</sup>

**22. For banking supervision, the new arrangements appear to fall short of full compliance with the relevant *Core Principles for Effective Banking Supervision*.** Clarity of objectives, transparency, accountability, effective interagency coordination and adequate resourcing of banking supervision are essential elements of these *Principles*. In addition, it is yet unclear how the integration

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<sup>13</sup> See in particular in the Banking Law, Articles 35bis (rejection of merger, acquisition of entire assets, taking control of two or more banks), 55bis (secondary regulation fixing the requirement for issuing preferred shares), 66ter (additional capital requirement of countercyclical nature), 66quater (fixing the criteria qualifying a bank as systemically important), 67 (fixing the risk-weighted assets), 76 (investment in shares of bank established abroad), 83 (general rules relating to capital requirements, provisions, risks concentration), 117 and following (appointment of an interim administrator, revocation of the authorization), and 130 (revocation of the authorization). Also, the Central Bank Law provides that the central bank is entitled to issue the norms and limitations regarding the relationships that should exist between active operations and liabilities, i.e., ratio Assets/Liabilities (Article 35).

<sup>14</sup> A practical option (in terms of timing) would be to reconsider BCCh prerogatives regarding prudential supervision of banks when the financial safety net and crisis management framework updated in line with best international practices.

will affect the resources available for banking supervision. While the mission has no reason to assume that the new CMF will redirect existing bank supervision resources to its other mandates, it recognizes that the financial autonomy that the SBIF enjoyed—in the sense of being able to present and argue for its own budget—will be lost because the budget for banking supervision will no longer be determined on a stand-alone basis but within the broader mandate and priorities of the new CMF. Also, in this context, it will be important for the new CMF to clarify internally and externally how it interprets and prioritizes its mandates.

#### IV. GOVERNANCE STRUCTURE OF THE NEW CMF

**23. A good governance structure for a supervisory authority requires a clear and coherent allocation of responsibilities between its decision-making bodies.** A clear allocation of responsibilities entails defining: (i) who manages the agency on a day-to-day basis (*executive management*); (ii) who oversees the executive management (*oversight function*); (iii) who formulates policies entrusted to the agency (*policy formulation*); (iv) who adopts the normative instruments of general application (*regulatory function*); and (v) who adopts the supervisory decisions for individual application (*individual supervisory decision-making*). While the allocation of responsibilities between the decision-making bodies may differ from agency to agency, general principles should be followed to ensure a coherent framework. These are: that each responsibility must be allocated one of the decision-making bodies including residual powers (*no gaps*)<sup>15</sup> but no more than one (*no overlaps*); that the allocation is *clear and avoids ambiguities*;<sup>16</sup> and that promotes *check and balances* between and within the bodies to avoid concentration of power. All of this is fundamental not only for coherence but also to enable accountability.

**24. In Chile, the allocation of responsibilities between the decision-making bodies of the CMF seems to put in place a two-tier structure.** The CMF (as established in its organic law)<sup>17</sup> has two main decision-making bodies:

- The *Board*, entrusted with the policy-making, oversight, and regulatory functions, and some strategic individual supervisory decision-making,<sup>18</sup> and
- A *President*, chairman of the Board, in charge of the day-to-day executive management of the CMF. The President is accountable to the Board for its executive management functions. See Annex VI for a detailed description of the allocation of responsibilities.

**25. However, some inconsistencies and ambiguities in the CMF Law regarding this allocation could be identified.** For example, in relation to:

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<sup>15</sup> All roles and responsibilities as understood independently by each decision-making body should represent the true and desirable breadth of functions needed. This includes the definition of the body that will enjoy the residual powers, i.e., the powers not explicitly allocated to a particular body.

<sup>16</sup> Overlap or ambiguity of responsibilities between the decision-making bodies may result either on (i) inaction or (ii) duplicative and potentially conflicting responses to the tasks. In both cases the authority of the agency vis-à-vis the supervised entities will inevitably deteriorate quickly.

<sup>17</sup> See Articles 20 and 21 of the CMF Law.

<sup>18</sup> Impose sanctions (Article 20 num. 4 CMF Law).

- *Residual competences and individual supervisory decision-making.* On one hand, the law explicitly states that the Board carries out the “superior direction” of the CMF and is responsible for exercising the powers and duties the law(s) entrust to the agency (Art. 8 p.1 CMF Law). This provision seems to indicate that the Board exercises the residual competence of the CMF, i.e., the powers that are not elsewhere explicitly reserved to any specific decision-making body. More importantly, this residual competence would apply to most of the individual supervisory decision-making that are currently not explicitly allocated to either the Board or the President. On the other hand, the law grants the President the status of “Chief of Service” that under general administrative law<sup>19</sup> is responsible for the adoption of all administrative acts required not only for internal management but also for the fulfilment of the legal mandate of the institution (including the individual supervisory decision-making).<sup>20</sup> These provisions are therefore in direct conflict, raising fundamental questions on which body has ultimately the residual powers for individual supervisory decision-making.
- *Very frequent regular Board meetings and dedicated function of Board members to office.* The law mandates that the Board meets as a minimum twice a week (while the amended provision provides once a week) and when needed in extraordinary meetings. Also, the law states that the Board members must perform their functions on an exclusive dedicated fashion to the CMF. These provisions indicate that the Board may have been contemplated as a unitary collegial executive management board.

**26. To address these issues the CMF adopted a de facto (rather than a de jure) structure that allows Board members to participate in the full spectrum of the decision-making process.**

Twice a week, the Board members meet individually with staff to analyze issues related to regulatory and some important supervisory decisions of individual application. Some of these issues are formally elevated to the Board for approval during a formal session. Others are meant to solely guide staff on supervisory approaches. In the latter case, it is the President of the CMF that formally adopts the particular administrative act.

**27. To formalize this approach important amendments were introduced in the new CMF law to broaden the powers of the Board.**

Notably with respect to (i) additional *individual supervisory decision-making* (e.g., appoint inspector, provisional administrator, or liquidator of a supervised entity; suspend the operations/activities of supervised persons/entities in serious and urgent cases; adopt all preventive and corrective measures, approve licensing, mergers and reorganizations of supervised entities);<sup>21</sup> and (ii) *residual competence* to the Board (by generally stating that the Board exercises the competences and functions that the law entrusts to the CMF).<sup>22</sup> The latter would need to be perfected with legal reform and secondary legislation to properly allow and set up a flexible delegation system. In this respect, since delegation could not deprive/relieve/divest the competent decision-making body of its competences, the delegation must remain partial and must exclude acts considered “essential” or “having serious consequences.” See

<sup>19</sup> Article 31 of the Law N° 18,575 regarding the Constitutional framework principles.

<sup>20</sup> Even when considering the application of the general principle *lex specialis*, to avoid ambiguity the CMF could have stayed away from the use of wording that could create conflict with the division of responsibilities envisaged by the legislator in the CMF Law.

<sup>21</sup> Article 20 num. 10, 12, and 13 of the new law.

<sup>22</sup> Article 20 num. 1 of the new law.

Annex I for drafting suggestions to improve the legal provisions in this respect and Annex VII (Box 3) on general delegation principles.

**28. Within the current framework, two options seem to be available to crystallize a robust and coherent internal organization within the CMF’s decision-making bodies:**

- Adopt a model closer to a *unitary board* whereby the Board members are essentially executive members. This is by establishing a Committee structure between the Board and the heads of intendancies, with each Committee headed by a Board member. The Board, as a whole, would retain the decision-making powers and the engagement of the Committees would be to prepare emerging important issues before a decision is taken by the Board;<sup>23</sup> or
- Adopt a model closer to a *two-tier system* whereby a layer of Executive General Managers would be created (which could also be organized as an Executive Committee) that are granted powers additional to those for individual supervisory decisions. The Board would act mostly as an oversight Board with policy-making and regulatory functions, and some strategic individual supervisory decision making (as established in Article 20 CMF Law as amended).

Between those two models the delegation mechanism offers a broad range of possibilities. Subsection V.B discusses the two main organizational decision-making/coordination mechanisms that could be developed based on these models.

## V. BLUEPRINT FOR THE ORGANIZATIONAL STRUCTURE

### A. Internal Twin Peaks

**29. There is no single “best practice” blueprint for an integrated supervisory authority like the CMF.** Nonetheless, lessons learned from the global financial crisis and elsewhere suggest the following high-level principles for designing the organizational structure of the new CMF:

- Clear separation of activities and accountabilities between **prudential supervision**—focused on the safety, soundness, and risk management of individual financial institutions—and **securities market surveillance**—focused on the fair, efficient, and transparent operation of markets and the conduct of market participants.
- A well-defined coordination framework for the supervision of financial conglomerates and for the assessment of financial stability issues.
- Integration of common procedures and activities (such as development of policy proposals, authorizations (routine or otherwise), research, statistics and financial analysis) to achieve economies of scale and scope. An integrated policy department, for example, would promote cross-fertilization of policy approaches and skills, and avoid fragmentation of the policy-making process in the CMF. An integrated financial analysis group would provide economies of scope in the analysis of industry and market-wide trends.;

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<sup>23</sup> In this model, consideration could be given to creating an Audit Committee with independent members (that do not exercise executive functions) that meets a few times a year to provide independent assurance to the Board on the CMF’s financial and performance reporting responsibilities, systems of internal control, and compliance with applicable laws and regulations. As this may require changes to the legal framework, an advisory audit committee could be set-up in the interim.

- Centralization of all “back office” functions (human resources, finance, IT, etc.) to pursue cost efficiencies.

In this structure, trade-offs between the CMF’s objectives would be the responsibility of the CMF Board. Experience suggests that conflicts of objectives can arise, for example, between prudential supervisors wishing to operate discreetly to resolve an emerging risk issue and securities markets supervisors wishing to promote maximum transparency in the interests of investors. In reconciling such conflicts, the overriding objective should be the maintenance of financial stability. As noted in Section III, however, this priority is not explicit in the mandate of the new CMF but could usefully be clarified in internal rules and a public mission statement (see paragraphs 13–17).

**30. Given the chosen institutional set-up, the main alternative to the existing sectoral approach would be an internal “twin peaks” model (see Annex IV).** Two variants of this model, which involve different roles for the Board in the running of the CMF, are considered below. The model is not a pure twin peaks model because the peaks are not fully self-contained; activities such as policy development, financial analysis, and authorizations would be common and the responsibility of other dedicated areas. Compared to a purely institutional approach, three main benefits from this model are the organization of activities by objective, allowing potential conflicts of interest and trade-offs to be assessed more explicitly at the highest level in the organization,<sup>24</sup> consistency in the application of conduct rules across sectors, and promotion of efficiencies in the use and development of specialized skills.

**31. The central feature of this model is the separation of the CMF’s activities into four distinct groups.** A prudential supervision group would include the front-line prudential supervision activities of the bank, insurance and securities markets intendancies, each staying as separate intendancies, as well as a specialist risk department that would provide detailed technical assessments and expertise on major risk types to each intendancy. A market surveillance group would include the oversight of market conduct and performance, and bring together the consumer protection activities currently located in separate intendancies. A policy and research group would draw together the regulation, research, financial analysis and statistics activities currently duplicated in separate intendancies. This group would also process applications for authorization to operate in the Chilean financial system, working in conjunction with relevant prudential supervisors. A fourth group would have general administrative responsibilities. Finally, a small number of specialized units (internal audit, legal, enforcement, cabinet) would report directly to the Board.

## **B. Internal Decision Making and Coordination**

**32. To ensure that decision-making processes are not unduly slowed within this structure, the current discretion to heads of departments within the SBIF and the CMF should be**

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<sup>24</sup> While different factors played a role, H.M. Treasury in its assessment of the United Kingdom FSA model concluded that “*the FSA, by contrast, has regulatory tools for delivering financial stability, but with such a wide mandate prior to the crisis—including consumer protection, public awareness, market confidence and the reduction of financial crime—was not sufficiently focused on stability issues,*” indicating that possible trade-offs between different elements of the mandate (e.g., consumer protection versus safety and soundness) did not give appropriate weight to financial stability. See H.M. Treasury, “A new approach to financial regulation: building a stronger system,” February 2011.

**preserved.** However, there will be a clear need for coordination within and between the separate groups to prevent the emergence of siloed views and to ensure a system-wide perspective on emerging risk, conduct and financial stability issues. Coordination will also be essential in any framework for supervision of financial conglomerates, discussed later.

**33. Coordination could be achieved through the establishment a Committee structure between the Board and the heads of intendancies, with each Committee headed by a Commissioner.** These Committees would serve as “sounding boards” on emerging issues (including resourcing issues) before full Board engagement is needed, and as a means of ensuring timely and relevant information sharing within the CMF. Each Committee would have a Charter and defined membership at intendancy head level, although other staff could be invited to participate as necessary; however, the Committees would not have decision-making authority. A Prudential Supervision Committee, for example, would include the heads of the four intendancies in that group, as well as the head of regulation and the Chair of the Policy and Research Committee. A Market Conduct Committee would include the heads of the two intendancies in that group as well as the heads of regulation and legal. The Chair of that Committee could attend the Prudential Supervision Committee if, for example, emerging conduct issues threatened reputational damage to particular institutions. A Policy and Research Committee would include the heads of the regulation and research intendancies; since this Committee would also be the focal point for the CMF’s financial stability responsibilities, it would also include the heads of the four prudential supervision intendancies and the Chair of the Prudential Supervision Committee. An Administration Committee would include the heads of the three intendancies in that area.

**34. A Committee structure with designated roles for Commissioners has several advantages.** It would enable the CMF to draw on the particular skills, background, and experience of Commissioners in allocating Committee chair roles. It would help to avoid duplication and mixed signals by Commissioners in operational matters, and it would free the Board to focus on high-level policy and strategic issues without the risk of being swamped by routine matters. On the other hand, by engaging Commissioners more fully in the day-to-day running of the organization, the Committee structure may be seen to detract from the Board’s broader responsibilities for oversight of the CMF, which call for a degree of distance and objectivity.

**35. An alternative that enshrines the oversight role of the Board would be to replace the Committee structure with a layer of Executive General Managers (EGMs).** The EGMs would be responsible for the performance of their respective groups but would also have clear obligations to cooperate with each other in the areas envisaged for the four Committees. An EGM layer would add an additional rung to the career ladder in the CMF, which could prove an effective incentive and retention device for senior staff whom the CMF might be loath to lose; however, it would be costly, and it would leave open the question of how to make the most effective use of the talents of executive Commissioners on a day-to-day basis.

### **C. Conglomerate Supervision**

**36. The establishment of the new CMF provides an essential foundation for a more effective framework for conglomerate supervision.** Integration of banking, insurance and securities markets supervision will, firstly, facilitate the formation of a group-wide view of individual conglomerates by

eliminating any “frictions” to the exchange of information previously held in the separate agencies. (Though restrictions on sharing information relevant for the supervision of financial institutions have been removed under guidelines developed by the CSF, the mission understands that information flows have not always been seamless.) Secondly, integration will enable the development of a consistent methodology for assessing risks in a conglomerate emanating from double gearing, contagion, and conflicts of interest; once the necessary legislative support is available, it will also enable the establishment of harmonized minimum prudential standards in areas such as corporate governance, liquidity, and risk management.

**37. There is no accepted “best practice” within integrated supervisory agencies for the organization of conglomerate supervision.** Some agencies have assigned the supervision of conglomerates—particularly those with material operations in more than one financial industry—to supervisory “teams,” which cut across industry lines and bring together supervisors from each relevant industry under a lead supervisor. Other agencies have recently moved from a supervisory teams approach to an arrangement in which the lead supervisor of the dominant member of a conglomerate “outsources” the supervision of smaller members to supervisors in the relevant industry department. In other agencies again, separate departments are responsible for the supervision of conglomerates.

**38. In the new CMF, a “lead supervisor” model based on the existing intendancies may be a pragmatic first step in establishing a framework for consolidated supervision.** In this model, for example, the supervisor of a bank that dominates a particular conglomerate group would be designated as “lead supervisor” for that group, and would be able to draw on relevant supervisors in the other intendancies in undertaking risk assessments of the group. Supervisors would remain in their industry intendancies to minimize organizational disruption as the new CMF settles; for this reason, however, coordination arrangements would need to be established at head of intendancy level, and the availability of relevant staff would need to be agreed as part of the annual supervisory planning cycle. Any disagreement over resourcing or priorities for supervision of the group, either in the planning stage or as new risks emerge, would be reconciled in the Prudential Supervision Committee or by the EGM, if either of these governance structures were to be adopted.

**39. There is precedent for the “lead supervisor” model in the case studies of conglomerates prepared under the auspices of the CFS.** These case studies, intended to gain a better understanding of the conglomerate’s structure, business model, and risks have been led by the supervisor in charge of the main financial activity of the conglomerate. The case study structure provides the basis for “deep dives” into the governance, solvency, and liquidity of conglomerates. Within the new CMF, however, such studies will presumably be replaced by ongoing and structured risk assessments for all significant conglomerates.

**40. Oversight of conglomerates has strengthened since the IMF’s TA report on conglomerate supervision in September 2015.**<sup>25</sup> The new CMF should be in a good position, building on the work done by its predecessors, to realize the objectives that the short-term recommendations of the provided TA aimed to achieve. Legislative changes that provided supervisors

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<sup>25</sup> IMF MCM technical assistance report prepared on request of the Ministry of Finance of Chile entitled *Conglomerate Supervision*, September 2015 (#5747045)

with the capacity to require financial information from the final owners of banks, insurance companies, and pension fund administrators have ensured a better mapping of conglomerate structures and enhanced the information base for risk assessments. To date, however, information requests have been largely confined to public (and hence audited) information on conglomerate members because of data quality concerns. Using the expanded data base, the SBIF has been developing a methodology to provide a risk rating for conglomerates on three main criteria—solvency, systemic importance, and corporate governance and risk management—taking into account both quantitative and qualitative assessments of the main risks facing each conglomerate. The methodology is being applied to 17 bank-dominated conglomerates.

**41. Nonetheless, the legal framework in Chile does not cover conglomerate supervision and this shortcoming was not addressed in the recent legislative reforms.** Hence, the significant gap between the Chilean framework and the Joint Forum’s *Principles for the supervision of financial conglomerates* (2012), highlighted in the IMF’s TA report (and mostly related to the medium-term recommendations of the TA), remain (see Annex III). The current legal framework does not provide supervisors with the necessary powers and authority to enable comprehensive group-wide supervision; supervision is authorized only for a financial institution and its subsidiary. Supervisors do not have the power to set minimum prudential standards for corporate governance, capital adequacy, liquidity, and risk management for a financial conglomerate. Nor do they have the authority to impose sanctions on or require corrective actions by a financial conglomerate.

**42. Notwithstanding the lack of legal powers at the conglomerate level, the new CMF needs to establish its “moral authority” in this area and be willing to draw on it.** As a start, the Board of the CMF together with senior supervisors should meet with the Board at the top of each significant conglomerate to outline the CMF’s supervisory expectations for risk management within the group and to emphasize a “no surprises” approach in the group’s dealings with the CMF; the CMF should also confirm its intention to actively pursue appropriate tools for conglomerate supervision making maximum use of its existing powers. Such meetings should then become part of the regular supervisory cycle. In the same spirit, supervisors should be encouraged to take a more assertive approach to pursuing improvements to data quality in key risk areas rather than what appears to be a cautious approach of accepting only public data.<sup>26</sup>

## VI. INTER-INSTITUTIONAL COOPERATION ARRANGEMENTS

### A. Microprudential and Conduct Cooperation Arrangements

**43. With the integration of the SBIF into the CMF, the CSF could effectively be replaced by bilateral relationships.** There seem to be limited areas of common interest shared by all three authorities (BCCh, the new CMF, and the Superintendence of Pensions). In the area of life and disability insurance regulation, the CMF and the Superintendence of Pensions have a clear common

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<sup>26</sup> The lack of powers for consolidated supervision and the absence of effective implementation of consolidated supervision (governance, risk management, capital, liquidity, etc.) potentially affect the compliance with Principle 1 and Principle 12 of the Basel Core Principles. Faced with similar legal limitations, some countries have been able to overcome these limitations partially through alternative measures and moral suasion. For example, Peru is faced with similar legal limitations to supervise conglomerates on a consolidated basis, however, it has adopted a de-facto intrusive approach (see IMF, Peru: Financial Stability Assessment, June 2018).

interest in coordination and information sharing on regulatory and supervisory developments, but this is not an obvious area of interest for the BCCh. Hence, to ensure continuity in the relationship with the Superintendence of Pensions, the CMF should consider assigning a specific Board member as first point of contact and the responsibility for maintaining the bilateral relationship (and regular meetings) with that Superintendence.

**44. A similar bilateral relationship is needed between the new CMF and the BCCh.** As indicated in Section III, there are several banking supervision issues, which are more microprudential in nature, for which the prior approval of the BCCh is required. The impact of BCCh's involvement on the effectiveness of the CMF has been questioned above. At this moment these issues are coordinated between the SBIF and BCCh. This liaison should continue under a bilateral relationship between the new CMF and the BCCh, with a CMF Board member assigned responsibility for coordinating this relationship. A seamless transition of this relationship from the SBIF to the new CMF will be key for realizing the issuance of the anticipated new Basel III regulatory framework. Given the importance and structural impact of these regulations, the CMF and the SBIF should set up a mechanism to involve the CMF in the interim period (before the integration) to guarantee the strategic continuity and alignment of the position of the SBIF on these matters with the post-integration position of the new CMF. The steering committee structure proposed in Section VII could be instrumental in this regard.

**45. The CMF should review and notify the counterparties of MoUs concluded under the SBIF's competence.** All domestic (e.g., the UAF and SERNAC) and foreign authorities that have concluded cooperation agreements with the SBIF should be notified of the legal transfer of competences from the SBIF to the CMF. Where both the SBIF and UAF had MoUs in place (e.g., with SERNAC), these will be need to be reviewed to incorporate the matters covered in a single MoU.

## **B. Financial Stability and Macroprudential Cooperation Arrangements**

**46. While the integration of the SBIF in the CMF should not fundamentally affect the current arrangements, the representation of banking supervision in the CEF will change.** In practice, integration means that bank supervision will no longer be represented separately in the CEF. However, the CEF Law allows representatives of its members to be accompanied by persons and in a manner as required by the internal rules of its members. To assure continuity in decision making and given the systemic importance of the banking sector, the new CMF should give consideration to involving the responsible intendent (or EGM) for Banking Supervision and/or Policy and Regulation in the CEF. It will also be important to maintain continuity of bank regulation and supervision staff in the CEF's working groups.

**47. The new CMF may be better placed to contribute to the analytical work of the CEF, given its anticipated ability to consolidate and strengthen its research function.** The new CFM will be able to draw on microprudential data from the banking, insurance, and securities markets, allowing the development of a more holistic bottom-up view of emerging risks to financial stability, complementing the traditionally more macroeconomic and top-down perspective of a central bank. To realize the consolidation and strengthening of the research function, consideration should be given to its position in the internal organization (see Section V), which should also be supported (and

clarified) by the priority assigned to this part of the mandate in the mission statement of the new CMF (see Section III). Discussions with key stakeholders indicated that there is significant scope to develop a research/financial stability function in the new CMF complementing the work of the BCCh.

## VII. TRANSITION

**48. Preparations for integration will have to start quickly now that the amendments have been adopted by Congress.** Respecting the parliamentary decision-making process, the CMF and the SBIF did not start joint discussions and preparations for the integration; however, to minimize uncertainty in the transition process, they will have to advance quickly now that Congress approved the amendments on October 3, 2018.

**49. As one of the first steps in the integration process, the mission organized four roundtable discussions involving staff from both the CMF and the SBIF.** The roundtable discussions were the first joint meetings between the CMF and the SBIF involving a wider range of staff. The roundtables provided a platform for the exchange of current practices and views on challenges and benefits of the integration, and were organized around four topics: conglomerate supervision; enforcement; market conduct; and financial stability. The meetings proceeded in a constructive atmosphere indicating a shared ambition to achieve a professional and well-established new CMF, building on the best practices of both institutions, while at the same time realizing synergies.

**50. During the roundtable discussions, participants identified several areas where synergies could be realized.** In addition to efficiencies in back-office functions, the discussions centered on core regulatory and supervisory functions and objectives. Participants identified the following potential synergies that could be realized in the new CMF:

- Strengthening of conglomerate supervision (e.g., internalizing coordination and data sharing);
- Broader base for developing and efficiently using specialized skills (e.g., cyber risk);
- Consistency of regulation across sectors (e.g., corporate governance regulations);
- Consolidation and strengthening of the research function;
- Strengthening and harmonizing the approach to market-conduct supervision across sectors;
- Building on developed sanctioning processes within the current CMF; and
- Building on and harmonizing the well-established risk-based supervision process in the SBIF.

The proposed blueprint for the organizational structure of the new CMF (see Section V) should help to realize these synergies.

**51. While integration should achieve important synergies over time, the short-term challenges of integrating the two authorities should not be underestimated, and downside risks will need to be carefully managed.** Particular complications are the fact that the CMF was only established on January 15, 2018 and is still settling into its governance structure, and that the Board of the new CMF does not contain any former SBIF staff to ensure continuity in decision making. The following challenges and risks will need to be considered carefully in the integration process:

- a) Timeliness of early supervisory intervention, because of increased timelines for decision making resulting from:
- Slower and more formal CMF decision-making processes;
  - Potential loss of continuity in bank supervision knowledge at the highest management level; and
  - Increase in issues that need CMF Board attention as a result of the integration.
- b) Quality of regulatory and supervision functions during the transition process:
- Attrition of key supervisory and general administration staff (indirectly affecting core functions) because of a lack of transparency and uncertainties surrounding the integration process;
  - A shift in the focus of staff to the integration process at the expense of attention to and support of core functions; and
  - Decreased authority and effectiveness of SBIF supervision if market participants turn their attention to the CMF Board during the transition process.
- c) Reputational risk as a result of an inadequately managed integration process or an incident at a supervised entity that generates negative publicity.

**52. To minimize uncertainty, it is key to define, and have transparent communications on, the transition process.** While it will be difficult to remove all the uncertainty facing staff, uncertainty could be minimize by clearly defining the transition process and the objectives of integration, and communicating this transparently to staff.

**53. A dedicated taskforce (ideally separate from business-as-usual processes) should be set up to identify all practical issues that need to be addressed.** To assure a well-managed and balanced transition process, the taskforce should have CMF and SBIF involvement on an equal basis. While the exact composition of the taskforce is a matter for CMF and SBIF discussion, the mission sees merit in having two CMF Commissioners and two senior SBIF staff closely and equally involved in the taskforce. As a first step, the taskforce should establish an inventory of all issues that need to be addressed, and realistic timelines for action, to achieve de facto integration of the SBIF within a short timeframe and with least disruption; these issues should be assigned to separate working groups (see Annex VIII). A particular priority will be harmonizing employment conditions for staff and integrating IT systems, and the mission welcomes the CMF's intention to use specialist consultancies in these areas. After establishing de facto integration, the taskforce should shift its attention towards a more fundamental restructuring of the organization in line with the blueprint suggested in Section V.

**54. A steering committee should be set up to guide the taskforce and, where it can, take the decisions necessary to facilitate a smooth transition process.** The mission proposes that, during the transition period, the taskforce report to a two-person steering committee, consisting of the President of the CMF and the Superintendent of the SBIF. This governance model would provide an interim coordination mechanism between the CMF and the SBIF, as well as ensure balanced decision making on integration matters.

**55. Though not an immediate priority, location of all staff in a single building will be essential for building “esprit de corps” and breaking down siloes in the new organization.**

Options and the timetable for such a move should be established. At the same time the CMF Board should consider establishing a clear ambition and supervisory strategy for the new organization to guide the staff and take regulation, prudential supervision and market conduct supervision in Chile (e.g., conglomerate supervision) to the next level.

## ANNEX I. DRAFTING SUGGESTION FOR LEGAL AMENDMENTS

This Annex provides some drafting suggestion for modification to the CMF Law, General Banking Law, and Insurance Law with respect to:

- ***In the medium-term***: clarification of the legal mandates of the CMF as an integrated supervisory authority regarding its different competences; and
- ***In the short-term***: technical amendments which could be adopted in an Omnibus Bill to clarify the CMF's allocations of responsibilities.

### ***I. Amendments for Legal Mandates of the CMF***

**CMF Law**, “In accordance of this Law and the particular Laws governing it, the CMF’s missions are the following:

- to ensure the supervision of banks, .....[indicate the entities under the supervision of the CMF by application the Banking Law];
- to ensure the supervision of the insurance companies;
- to ensure compliance with applicable rules having purpose to protect investors’ interests in transactions on financial instruments and to ensure the good functioning, the integrity and the transparency of financial markets;
- to contribute to the respect of rules having purpose to protect savers and investors against the illicit offer or provision of financial services or products.

In the performance of its duties, the CMF shall, according to this ranking of priorities, work to ensure the protection of the interests of investors, depositors, insured and more generally their trust and the public interest and beyond this, to ensure the proper functioning, development and stability of the financial market and ultimately the financial stability.”

**General Banking Law**, “This Law regulates the establishment, activity and the supervision of banks operating in Chile, [and their potential resolution,] to protect savers, investors and the robustness and proper functioning of the financial system;”

**Insurance Law**, “This Law regulates the establishment, activity and supervision of insurance companies operating in Chile, including certain methods and conditions specific for insurance policies and operations, in order to protect policyholders, insureds, and beneficiaries of insurance policies and operations and to safeguard the robustness and proper functioning of the financial system.”

**Securities Law**, “To promote honest and equitable treatment of financial consumers and the transparency of the financial markets and therefore to ensure that the financial system deserves the trust of its users, this law provides:

- a) the requirements:
  - so that information disseminated by listed companies is complete, gives a faithful image of the company and is made available in a timely manner, ensuring that all shareholders of a listed company are treated equally.
  - on information disclosed by unlisted companies when issuing securities to the public;
  - for the smooth functioning of the financial markets and market infrastructures;
- b) the conduct of business rules to be complied with by financial service providers acting on financial market and/or providing investment services;
- c) the supervision of the previous requirements by the CMF and its legal instruments in this respect.”

## ***II. Technical Amendments for an Omnibus Bill***

Given the possibility to introduce technical amendments through an omnibus Bill, this Annex suggests some modifications clarifying the CMF’s allocations of responsibilities between the Board and the President.

### **a) CMF Law:**

**Article 8.** The Board of Directors of the Financial Markets Commission shall manage the organization, being responsible for the exercising the powers and performing the duties that this and other laws entrust to it. **In this respect, the Board shall pronounce upon all matters which are not expressly reserved for another body by this law.**

**Article 20.** **In the performance of its responsibilities set forth in Article 8,** the Board shall:

.....

10. Appoint a delegate inspector, provisional administrator or liquidator, in accordance with the provisions, respectively, in articles 117 and 130 of the decree with force of law No. 3, of 1997, of the Ministry of Finance, which establishes the consolidated, systematized and coordinated by the General Banking Law and other legal bodies indicated, as appropriate.

11. **In particular, the Board shall:**

- a) prepare, within the first four-month period of each year, an annual public account detailing the work carried out by the Commission in the immediately preceding year, including, among other matters, a general evaluation of the behavior of the markets that are subject to its competence, the actions of the Commission in normative and regulatory matters, the number of sanctions imposed and their causes, the number of sanctioning procedures in progress, their participation in the design of public policies, the resources used, the level of compliance with the tax objectives and the performance indicators used, as well as the challenges and goals for the following year;
- b) ~~12.~~ temporarily suspend, in serious and urgent cases duly qualified, totally or partially, by reasoned resolution, the activities of a person or entity audited or the quotation or transaction of one or more

securities, and adopt, in general, any preventive measure or corrective provided by law, in cases where the necessary standards for the proper development of such activities or when required by the public interest, financial stability or the protection of investors, depositors and insured are not met.

However, in the case of entities whose activities are regulated by virtue of the decree with force of law N° 3, of 1997, of the Ministry of Finance, which establishes the consolidated, systematized and coordinated text of the General Law of Banks and of other legal bodies that are indicated, the power of provisional suspension of activities described in this numeral, will be exercised in accordance with the provisions of said law.

d) ~~13.~~ dictate the resolutions that are pronounced with respect to the authorization of existence, operation and mergers or reorganizations of the audited entities, as appropriate and, in general, to pronounce on any other authorization or registration that the Commission must grant within the scope of its powers.

The Board ~~alone shall exercise the powers to which items 1 to 12 of this article refer, and they may not be delegated to other employees or authorities of the Commisison. In any case, the Board~~ may delegate certain of its powers ~~other than its regulatory, policy of administration, authorization, registration and operation to~~ and ~~sanctioning powers~~ to the Chairman, other commissioners ~~other authorities~~ or officials of the Commission, in accordance with the provisions of its internal operating regulations. ~~These internal operating regulations will precise the cases subject to delegation and the conditions under which the use of delegated powers is subject to. The delegation granted in accordance to this framework will be published on the Commission's website.~~ Likewise, the Board may confer special powers to officials of the Commission for the execution of certain agreements.

**Article 21.** The President of the Commission, ~~as the department head,~~ shall be responsible for organizing and managing the Commission ~~in accordance with the policy framework established by the Board pursuant to Articles 8 and 21.1.~~ In addition,

....

9. In accordance with the internal operating regulations establishing the delegation framework foreseen in Article 20, the president may delegate ~~the some~~ duties or powers regarding Commission's internal management ~~as the department head of the Commision.~~

## ANNEX II. LEGAL REFORM ON BANKING RESOLUTION

1. **To ensure a robust bank resolution framework, the 2011 FSAP made a number of recommendations for the reform of the legal framework.** More specifically, the FSAP recommended that the legal framework should ensure that resolution of both systemic and non-systemic cases can take place in an orderly manner, do not incur in high fiscal costs, and that the confidence in the banking system be maintained while preserving the financial stability in Chile.
2. **To meet these objectives, it was recommended that a comprehensive legal reform be adopted, at a minimum, covering the following areas:**
  - (i) broadening the available resolution tools, including P&A transactions, bridge banks, recapitalization without preemptive right of shareholders, forced bank debt restructuring;
  - (ii) providing the SBIF with the powers to write down capital as part of a bank restructuring;
  - (iii) strengthening legal protection for officials in charge of resolution;
  - (iv) establishing a clear priority of claims and allow for carve-outs on this basis; and
  - (v) lifting legal restrictions for the use of public funds to facilitate cost effective resolution of systemic banks with the appropriate safeguards.
3. **Good efforts were made to incorporate in the new Law provisions to amend the current bank resolution legal framework.**<sup>1</sup> See Box 2 for a detailed description of the proposed framework.
4. **However, a number of fundamental shortcomings in these reforms may hamper the effectiveness of the resolution framework.** We will briefly refer to the main weaknesses in the following paragraphs:
  - *The regularization phase could be further clarified and strengthened.* This phase as established by the new Law appears to resemble more to the so-called early intervention phase where more intrusive measures of the supervisory authority are triggered by a significant deterioration of the financial situation of the bank or where serious infringements of laws, regulations or administrative irregularities are believed to put the bank at risk of failing. As a matter of fact, some of the triggers of the regularization phase are posed late in the stage of a bank's difficulty, and may be more pertinent to early intervention, or perhaps even to a resolution process. Looking forward, legal reform could make the following adjustments to strengthen the regularization phase:
    - (i) provide more clearly as triggers the lack of compliance of prudential requirements.
    - (ii) clarify the range of early intervention tools available to the CMF. In general, an indicative list of measures could be provided in the law to grant an ample flexibility to the CMF to address any type of weakness be it in the liquidity, capital, profitability, asset quality of the bank, governance arrangements, shareholder's composition, etc.

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<sup>1</sup> New Law, Title XIV, Articles 112 to 117 bis and Title XV, Articles 120, 121, 130 to 138, 141 to 144.

### Box 1. Description of the Proposed Bank Resolution Regime in Chile

The new Law provides for three distinct phases for dealing with failing banks: (i) regularization, (ii) appointment of an “inspector” or alternately a “provisional administrator,” and (ii) compulsory liquidation.

- **Regularization** is initiated upon determination that: (i) capital requirements mandated by law are breached; (ii) losses observed during the past two or more months permit to predict that the bank will breach the capital requirements; (iii) there have been repeated events of noncompliance with the law, regulations or other instruments issued by the CMF; (iv) noncompliance with liquidity requirements; (v) recurrent need of Banco Central de Chile’s (BCCh) emergency financing; (vi) it is foreseeable that the bank will not be able to meet its obligations in the next 30 days; (vii) losses that surpass 10 percent of the paid capital and reserves; (viii) excess concentration in related party lending or in favorable terms relative to comparable loans; (ix) objections of external auditors to its financial statements; (x) noncompliance with the development plan approved with the granting of the license; and (xi) any other event that could indicate that there is threat to the financial stability of the bank or poor management (Article 112 of the General Banking Law as modified by the new Law).

In such cases, the following procedure is followed:

- The failing bank must present to the CMF a “Regularization Plan,” approved by its Board of Directors, detailing the measures that will be taken to remedy the situation and return to the normal operations within the next six months (Article 113 of the General Banking Law as modified by the new Law).
- The CMF approves, rejects, or requests changes to the Plan presented by the bank.
- In case the Plan is rejected, or upon expiry of the maximum duration of the Plan and if the financial condition of the bank has not been restored, the second phase is triggered and the CMF appoints an “inspector” or a “provisional administrator.”
- **Appointment of an “inspector” or a “provisional administrator.”** Powers differ between these two figures: the inspector enjoys veto rights on Board of Director’s decisions, while the “provisional administrator” is granted with the same powers of the Board of Directors of the bank. The appointment of the provisional administrator requires prior consent of the BCCh’s Board. No further guidance is given in the new law to the CMF on the criteria to evaluate when deciding for one or another. The maximum duration of the appointment of the inspector is one year, renewable for an additional year. In case of the provisional administrator, his appointment is for one-year renewable for as many times as considered necessary by the CMF (Article 117 of the General Banking Law as modified by the new Law).
- **Compulsory liquidation** can be initiated by the CMF at any phase of the resolution process. Triggers for liquidation are insolvency of the bank. The new law provides for a list of cases where insolvency can be presumed and therefore compulsory liquidation can be triggered by the CMF (Article 30 of the General Banking Law as modified by the new Law). The CMF appoints a liquidator with the purpose of collecting and realizing the bank’s assets and distribute the proceeds to the creditors, in full or partial satisfaction of their claims, in accordance with the priority set in the General Banking Law.

- *The intervention over the bank by the authorities, as currently designed in the new Law, may not ensure an effective mechanism that permits an expeditious and orderly resolution of financial institutions.* The proposed framework for appointment of inspectors or provisional administrator does not provide the adequate triggers allowing a prompt public intervention, the necessary powers to assume absolute control of the failing bank, or a robust range of tools that permit an orderly closure and wind-down of all or parts of the bank in a manner that maintains financial stability and ensure continuity of critical financial services and functions, while minimizing the costs of resolution and avoiding unnecessary destruction of value. Looking forward, the authorities could consider the following areas for legal reform to improve the proposed resolution framework:
  - (i) **Provide a clear ladder of triggers for the public intervention.** The new Law provides for the opportunity to appoint an inspector or an administrator in the cases where the Regularization Plan is rejected by the CMF, or if, upon expiry of the maximum duration of the Plan, the financial condition of the bank is not been restored. An inspector or administrator can also be appointed in case of infringements or noncompliance with instructions of the CMF that put in question the financial condition of the entity. Liquidation and revocation of license is always an option for the supervisor when the solvency of the entity is in question. However, the legal frameworks lacks a clear ladder of specified triggers that provide increasingly more intrusive powers to the supervisor to deal with different cases. In some cases, in particular where financial stability of the system is at risk, triggers that enable the CMF to intervene promptly the financial institution are essential. In this light, it is recommended that specific triggers for resolution be provided in the law. The triggers can be of a qualitative and quantitative nature. Such a combination, while giving more legal certainty, will also provide the authorities enough flexibility to adjust their response to the different circumstances, including systemic risk. Likewise, it will prevent regulatory forbearance sending a strong signal to the banking system that may reduce legal challenges.
  - (ii) **Introducing robust resolution powers and tools.** Provisions should be included to provide for bank resolution tools, such as mandatory recapitalization, mergers, transfer of assets and liabilities (purchase and assumption transactions, bridge banks), or mandatory debt restructuring. These powers should not only provide with the administrative and operational control of the entity, but ensure that the authorities can assume all shareholder's rights (essential for the undertaking of these resolution measures.) The authorities could further explore any possible constitutional implications of the suspension of shareholder's rights during this phase.
  - (iii) Equally important, **supporting powers of the CMF would need to be strengthened** to achieve a prompt resolution that could mitigate systemic risk and preserve assets value. These are: power to impose a moratorium and stay of creditor actions; power to ensure continuity of services and functions in resolution; power to depart from the equal treatment of creditors of the same class if necessary to contain the potential systemic impact of a bank's failure or to maximize the value of the resolution for the benefit of all creditors as a whole; and power to stay temporarily early termination rights that may arise under financial contracts in the event that entry into resolution or the exercise of any

- resolution powers is considered an event of “default” and activates contractual set-off rights.<sup>2</sup>
- (iv) To safeguard the rights of creditors, in light of international standards, the **"no creditor worse off than in liquidation" (NCWOL) principle could be introduced** in the General Banking Law, in order to ensure that no creditor will incur losses greater than those that it would have suffered if the bank had been liquidated in application of the provisions governing liquidation. It guarantees that the creditors whose claims have not been transferred will receive satisfaction for their claims in an amount at least equal to what they would have received (with due regard to the ranking of their claims), had the bank been liquidated immediately in the context of a liquidation procedure.
  - (v) **Introducing limitations on judicial review of actions of the CMF during resolution.** To ensure effectiveness of the resolution regime, the scope of judicial review should be limited by law. The General Banking Law or CMF Law should expressly limit judicial remedies for resolution actions—whatever their nature—before a civil, commercial, or administrative court in relation to challenges aimed at obtaining nullity, modification, or revision of the measure. The only remedy available for affected parties should be monetary compensation. Authorities are encouraged to analyze the feasibility of establishing such limitations under the local constitutional and legal system. Suspension of administrative decisions of the CMF during appeal (or illegality claim) is already restricted, in line with international standards, in the amendments introduced to the General Banking Law.<sup>3</sup>
  - (vi) **Providing the legal basis for public funding mechanisms for the financing of resolution.** There may be systemic cases where financial stability is at risk and a temporary public-sector backstop is necessary to prevent destabilizing the financial system and/or jeopardizing the continuity of essential payment, clearing, and settlement functions. To limit the risk of moral hazard, public support should be subject to strict conditions and should be recovered from the industry. Appropriate mechanisms available in the Chilean legislation could be further discussed with the authorities in future legal reform opportunities, including the explicit guarantee of the central bank to sight deposits.

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<sup>2</sup> New Law, Article 117, fifth paragraph that usefully prohibits the application of acceleration contractual clauses. See also, for example, Article 135 of the Bill, where moratorium is established in the context of liquidation proceedings.

<sup>3</sup> See suspension in appeal process is already provided by Article 70 of the CMF Law and Article 5.30 that applies this standard for the case of corrective measures.

### ANNEX III. LEGAL REFORM ON CONSOLIDATED SUPERVISION

**1. To enhance the effectiveness of the consolidated supervision framework for banks several critical legal reforms were recommended in the 2011 FSAP.** These are to adopt:

- (i) an explicit definition of financial conglomerate (FC), common to all domestic supervisors;
- (ii) clear allocation of powers and responsibilities for consolidated supervision of the FC;
- (iii) access to information on the wider financial group on a consolidated and individual basis, as well as on all nonfinancial entities of the group;
- (iv) ability to identify a de facto FC for consolidated supervision purposes;
- (v) requirement for a prior authorization, necessary to establish abroad any financial institution part of the FC and to undertake investments or transfers of ownership that would affect the ability to conduct effective supervision or entail new material risks;
- (vi) requirement that the local FC with cross-border parallel operations or with structures not suitable for consolidated supervision take corrective action;
- (vii) capital adequacy, liquidity, corporate governance, risk management, disclosure requirements, limits on large and connected-party exposures, all at the level of the FC; and
- (viii) a corrective action framework to address compliance with the above framework.

**2. The recently approved Law addressed these recommendations partially.** Proposed provisions on consolidated supervision fall short of international standards and good practices.<sup>4</sup> Some provisions that facilitate consolidated supervision have been adopted in 2017 with the approval of the CMF Law and the Law for the Financial Stability Council (e.g., power to request information<sup>5</sup> and examine entities that are part of financial conglomerates).<sup>6</sup> However, the new law on the integration of the SBIF into the CMF did not provide any additional powers or tools to the CMF to implement a robust framework for consolidated supervision of financial conglomerates. Remaining legal reform in this area is detailed in Box 1.

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<sup>4</sup> Basel Committee on Banking Supervision. Joint Forum Principles for the supervision of financial conglomerates, at: <https://www.bis.org/publ/joint29.pdf>.

<sup>5</sup> See the amendments to Article 16 of the General Banking Law under Article 7 of the Law 20.789 by which the Financial Stability Council was created.

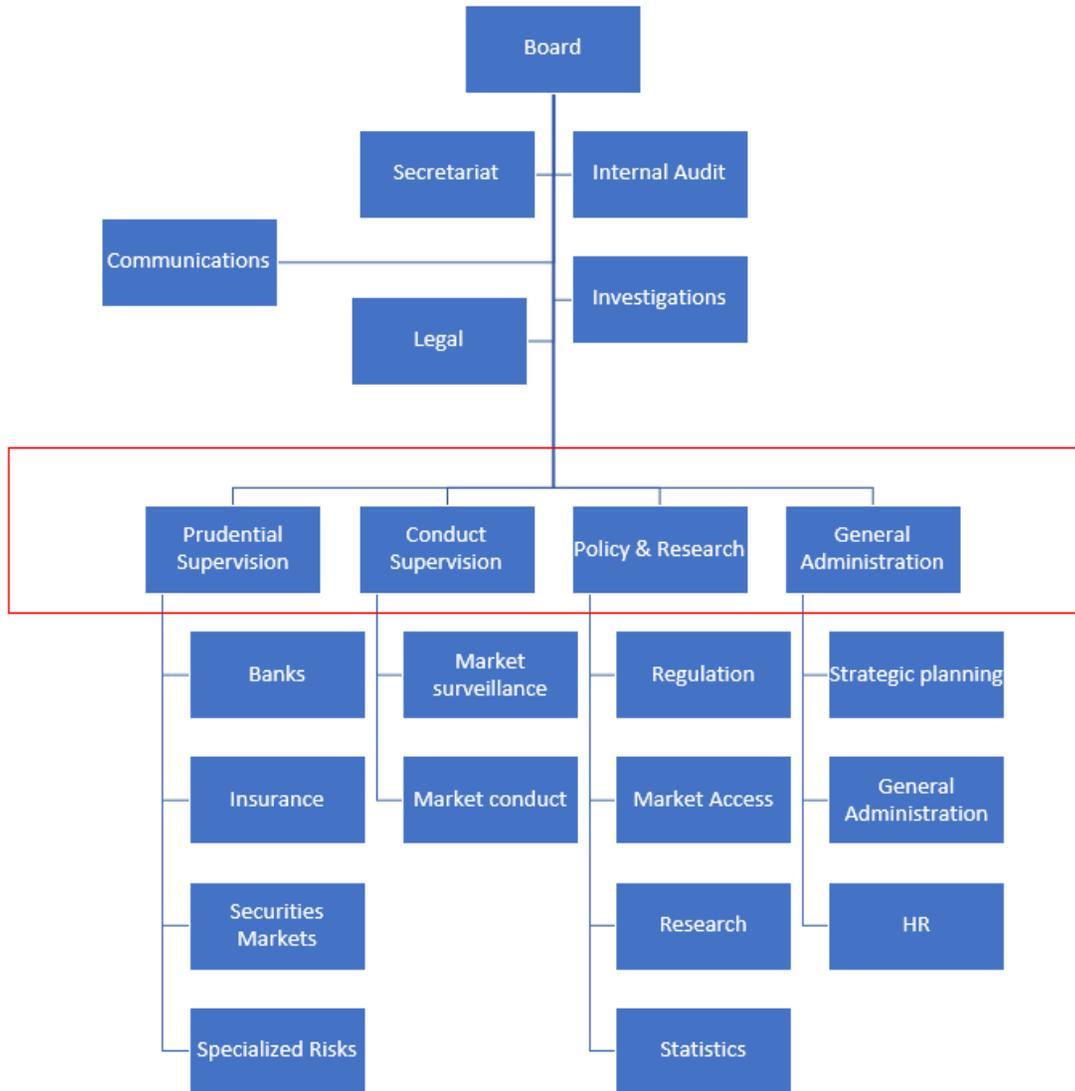
<sup>6</sup> CMF Law, Article 5(4).

### Box 2. Suggested Areas for an Effective Legal Framework for Consolidated Supervision

- ✓ **Scope of conglomerate supervision.** Defining the criteria to designate a group as a financial conglomerate and establishing the rules for assessing the “significance” of the regulated activities within the group and vis-à-vis the financial sector.
- ✓ **In case the Superintendence of Pensions has supervised entities belonging to financial groups, the designation and responsibilities of group-level supervisor will have to be established by law.**
- ✓ **Mechanisms for coordination and information sharing.** Extend the legal basis for the exchange of information domestically (inter-agency) and with foreign authorities for the specific purpose of consolidated supervision.
- ✓ **Scope of supplementary supervision of regulated entities.** Without prejudice to sectoral rules, establish requirements at the level of the financial conglomerate such as: (i) capital adequacy; (ii) liquidity risk, related-party exposures, related-party transactions, and intra group transactions; (iii) collecting and analyzing group structures, fit-and-proper status of shareholders and senior management of parent companies; (iv) assessing internal control mechanisms and risk management processes, etc.
- ✓ **Enforcement measures.** Enforcement measures pursuant to the sectoral rules should be applied to regulated entities in a financial conglomerate that do not comply with the supplementary requirements.

**The new Law does not contain “enabling provisions” that provide legal basis to conduct consolidated supervision.** To provide the maximum flexibility to the authorities for the implementation of different degrees of consolidated supervision, the law could have provided a general framework for: the scope of supervision, principles, powers and tools available for conducting consolidated supervision, coordination arrangements and decision-making procedures among the sectoral supervisors. Specific rules (e.g., for prudential and non-prudential requirements, assessment methodologies, etc.) could be developed at a later stage in secondary regulations.

## ANNEX IV. INTERNAL PEAKS MODEL



This level could be formed by a set of committees or by 4 different Executive Directors

## ANNEX V. STRENGTHENING THE AUTONOMY OF THE CMF

Dimensions of Autonomy	Current Framework	Inconsistencies and Weaknesses	Recommendations
<b>Institutional</b>	The law provides that the CMF is a decentralized public entity that will “relate” to the President of the Republic through the Ministry of Finance.	The autonomy of the CMF is not explicitly provided for. It is not fully clear if the sole nature of the CMF as a decentralized public service would prevent orders or instructions from the political bodies on policy grounds or for individual supervisory actions.	<i>By law:</i> Provide explicitly the autonomy of the CMF for the exercise of its functions preventing interference from political organs or other bodies, including the industry.
<b>Personal</b>	<b>Appointment criteria</b>		
	Board members are required to have recognized reputation, both professional and academic on financial related matters. Additionally, it is required that the Board, as a whole, has the experience and skills specific to the regulated markets under the CMF’s competence.	Too general and loosely worded.	<i>By law:</i> Tighten criteria to require appropriate knowledge and several years of experience on banking, securities, and insurance sectors
	<b>Appointment procedure</b>		
	<i>For the President of the CMF:</i> Appointed by the Executive. <i>For Board members:</i> Double veto procedure (Executive appoints prior approval of the Senate).	The appointment procedure for the President of the CMF does not allow a proper checks and balances mechanism and exposes the President to undue political pressures.	<i>By law:</i> Extend the “double veto” procedure to the President of the CMF.
	<b>Terms of office</b>		
	<i>For the President:</i> A 4-year term that follows the presidential cycle. <i>For the Board members:</i> a 6-year term, staggered.	Connection of the term of office of the President of the CMF with the political cycle hampers his/her personal autonomy exposing the function to undue political interference.	<i>By law:</i> grant a 6-year term to the President as the case of the other Board members.
	<b>Dismissal grounds</b>		
	Incapacity, performance of functions on non-profit entities, serious non-compliance with duties and responsibilities (defined by law), or any of the incompatibility grounds.	Overall sound.	
	<b>Dismissal procedure</b>		
The President of the CMF is dismissed by the President of the Republic by Executive Decree. Board members are dismissed following a due process procedure before the Supreme Court.	No due process safeguard for dismissal is granted to the President of the CMF.	<i>By law:</i> Recognize to the President of the CMF the same due process safeguards than the rest of the Board members.	
<b>Legal protection</b>			
Legal defence provided by the CMF in case of judicial actions.	Without protection from liability, the threat of litigation to CMF senior management and staff for undertaking their supervisory responsibilities may hamper their effective performance.	<i>By law:</i> Civil liability must be restricted solely to the case of bad faith or gross misconduct found against the officials for actions or omissions in the exercise of their functions under law. <i>As a transitional measure in secondary legislation or other legal instrument,</i> insurance against liability can be provided	

Dimensions of Autonomy	Current Framework	Inconsistencies and Weaknesses	Recommendations
<b>Functional</b>	As a decentralized public entity the CMF does not depend on the actions of other public bodies. (see Section III for details)	Adequate regarding internal management autonomy.	
<b>Financial</b>	The CMF collects fees and other forms of contribution from the supervised entities. This is also the case for the SBIF. The CMF does not have the competence to approve its own budget. Board proposes to the Executive the annual budget, within the ceiling determined by the latter earlier in the budgetary process. Then the budget is considered by the Executive and usually negotiations are taken to approve any deviation from the ceilings imposed by the Executive. The budget, along with all other budgets of public entities is sent to the Congress for approval.	The CMF does not have autonomy to establish its own budget according to the needs to fulfil its legal mandates. Even the preparation of the budget is already influenced by the ceilings imposed by the Executive. In addition, there were some cases where cuts in the public spending were applied equally to the CMF and SBIF during the budget execution. This could hamper effective supervision. In practice, the real contribution of the industry (insurance and capital markets) for the CMF budget is very low.	<i>By law:</i> Provide the CMF the power to propose its own budget adequate to fulfil its mandate, commensurate to (if not benchmarked against) the industry fees, and not subject to any ceiling imposed by the Executive during budget preparation or if so, according to a multiyear planning prepared by the CMF. Prohibit cuts in the State budgetare applicable to the CMF or provide that any such measure carefully takes into account the adequacy of the CMF resources, in line with the Basel Core Principles. Consideration must be given to increase the contribution of the supervised entities (for insurance and capital markets) to the CMF budget.

**ANNEX VI. ALLOCATION OF RESPONSIBILITIES BETWEEN THE BOARD  
AND THE PRESIDENT OF THE CMF**

FUNCTION	BOARD	Can delegate?	PRESIDENT	Can delegate?
<b>Regulatory</b>	Adopt regulations, circulars. (Art. 20.3)	NO		
<b>Policy-Making</b>	Approve: <i>internal operating rules</i> (Art. 8 ¶ 1), policies for planning, organization, direction, supervision, coordination and functioning of the CMF, acquisition and disposal of assets (Art. 20.2), and conflict of interests (Art. 16 ¶3). Approve (Art. 1 Int. Reg.): Strategic Plan of the CMF, Supervisory Policy, Sanctioning Regime Policy, Internal organization of the CMF, Administration Policy, Acquisition and disposal of assets Policy, HHRR Policy, Budget requiring to be approved by the MoF and Congress, and propose modification of laws and regulations to the Executive.	NO		
<b>Oversight</b>	Oversight of the executive management (Art. 20. 2 and Art. 21.3) [Obligation of the President to report to the Board <b>periodically</b> over the implementation of the policies and over the management of the CMF and <b>monthly</b> for the implementation of the decisions of the Board] Monitoring the achieving the CMF's global strategy, objectives and performance indicators, inspection plan, normative and sanctioning processes. Monitor of internal controls (Art 1 Int. Reg.)	NO		
<b>Executive Management</b>			"Chief of Service" <sup>1</sup> in charge of organizing and administrating the CMF (Art. 21) <b>within the internal organization framework approved by the Board (Article 18)</b> , supervise and control of staff (Art. 21 ¶ 1), execute the decisions of the Board (Art.21.1 and Art. 2 Int. Reg.), legally represent the CMF (Art. 21. 4), suspend the quotation and transaction of securities in the stock market in serious and urgent cases, establish regional offices ( <b>with the approval of the Board</b> ), determine the functions of each unit of the CMF (Art. 18).	YES Art.20.9
<b>Reserved Supervisory Powers</b>	Impose sanctions (Art. 4), <b>appoint inspector, provisional administrator or liquidator of a supervised entity, suspend the operations/activities of supervised persons/entities in serious and urgent cases, adopt all preventive and corrective measures, approve licensing, mergers and reorganizations of supervised entities (Art. 20. 10 and 12)</b> . Approve Results of the Evaluation, instruct corrective measures, resolve sanctioning procedures (Art. 1 Int. Reg.)	NO		
	<b>Authorize and approve registrations (Art. 20 num. 13)</b>	YES		
<b>Residual Supervisory Powers</b>	Art. 8 ¶ 1, Art. 20. 3 and Art. 1 Int. Reg.	YES Art. 20 ¶1 and 3	<i>As Chief of Service, [department head] shall be responsible for organizing and managing the Commission.</i>	YES Art.20.9

<sup>1</sup> It should be assessed the extent of the application of Art. 31 of the Law. 18.575 for the interpretation of the responsibilities allocated to the "Chief of Service" ("Jefe de Servicio").

**Text in black:** CMF Law, **Text in Red:** Recent Modifications New Law; **Text in Blue:** Internal Regulations CMF.

Dimensions of Autonomy	Current Framework	Inconsistencies and Weaknesses	Recommendations
<b>Functional</b>	As a decentralized public entity the CMF does not depend on the actions of other public bodies. Nevertheless, there are some prior approvals for regulatory and supervisory actions by the Central Bank (see Section III for details)	Adequate regarding internal management autonomy.	
<b>Financial</b>	The CMF collects fees and other forms of contribution from the supervised entities. This is also the case for the SBIF. The CMF does not have the competence to approve its own budget. Board proposes to the Executive the annual budget, within the ceiling determined by the latter earlier in the budgetary process. Then the budget is considered by the Executive and usually negotiations are taken to approve any deviation from the ceilings imposed by the Executive. The budget, along with all other budgets of public entities is sent to the Congress for approval.	The CMF does not have autonomy to establish its own budget according to the needs to fulfil its legal mandates. Even the preparation of the budget is already influenced by the ceilings imposed by the Executive. In addition, there were some cases where cuts in the public spending were applied equally to the CMF and SBIF during the budget execution. This could hamper effective supervision. In practice, the real contribution of the industry (insurance and capital markets) for the CMF budget is very low.	<i>By law:</i> Provide the CMF the power to propose its own budget adequate to fulfil its mandate, commensurate to (if not benchmarked against) the industry fees, and not subject to any ceiling imposed by the Executive during budget preparation or if so, according to a multiyear planning prepared by the CMF. Prohibit cuts in the State budgetare applicable to the CMF or provide that any such measure carefully takes into account the adequacy of the CMF resources, in line with the Basel Core Principles. Consideration must be given to increase the contribution of the supervised entities (for insurance and capital markets) to the CMF budget.

## ANNEX VII. IMPLEMENTING A SYSTEM OF DELEGATION

### Box 3. Implementing of a System of Delegation: General Administrative Law Principles

The delegation of powers is the act by which an authority (specifically, the competent body) - delegating - transfers (to delegate) the ability to adopt an administrative act, while retaining the overall responsibility for the relevant power.

**The process involves two acts:**

- a) **Authorization to delegate.** The competencies conferred on a decision-making body are powers of attribution that the body may not, in principle, transfer without authorization. This is why the delegation of powers requires, first of all, an authorization to delegate, which constitutes an authorization—in the organic law of the institution (in the case of the CMF, the CMF Law)—for the competent body to delegate a *portion* of its powers under the conditions and limitations specified by that authorization. This authorization to delegate must also designate the person or persons to whom powers may be delegated to. Usually, this is done through the functions identified within the institution. This authorization to delegate may nevertheless entrust the policy-making body to elaborate the delegation framework under which delegation could be granted.
- b) **Act of delegation.** Within the framework defined by the authorization to delegate, the competent body may agree to delegate one or more powers to one or more persons. These acts of delegation will identify:
  - the nature of the acts delegated (for example, in the areas that constitute execution of framework decisions, in emergency cases, for questions of detail, for aspects required by current management, etc.);
  - the beneficiary or beneficiaries of the delegation; and
  - the arrangements that accompany the delegation.

**Limitations to the delegation of powers.** It is universally accepted that a delegation of powers cannot affect the core responsibilities of the authority (the body) which delegates them. Thus, to avoid that a competent authority (decision-making body) could be deprived/relieved/divested of its competences, the delegation must remain *partial* and must exclude acts considered “essential,” or as “having serious consequences” (e.g., power to impose corrective measures, sanctioning, regulation powers, or major acts such as granting or withdrawal of license).

**Modalities.** In addition, a delegation system has a great deal of flexibility:

- a) **Sub-delegation.** Except where the act of delegation authorizes so, the delegate may not, in turn, sub-delegate the powers he has received by delegation. If desired, the delegating act should provide for it and designate the potential beneficiary of this sub-delegation.
- b) **Reporting.** A reporting requirement may be imposed to the delegates (reports, periodic communications, etc.).
- c) **Possibility of giving instructions to delegates.** The delegating authority may reserve the right of giving instructions to delegates in the exercise of delegated powers.
- d) **Adjustment of procedural conditions.** The delegating authority could also develop procedural requirements, such as the need for the delegate to make prior consultations (internal or external) before deciding.
- e) **Delegation versus divestiture.** By delegating powers, the competent body does not divest itself of its powers. The delegation therefore does not imply any alienation of power, so that the mandate entrusted to the delegate remains precarious.

**Revocation.** The delegating authority may always revoke the delegation granted or restrict its scope.

**ANNEX VIII. GOVERNANCE MODEL FOR THE TRANSITION PROCESS**

