



## Basel III Standards

# CMF publishes for consultation regulation on the calculation of regulatory capital

**The regulation in consultation establishes guidelines for measuring effective equity, cleaning up items whose value is low or uncertain when facing a liquidation scenario, and implementing prudential concentration rules in accordance with rules and regulations in force.**

**November 19, 2019**

The Financial Market Commission (CMF) reports that it has published for public consultation the regulation for the calculation of effective equity that banks will have to use to comply with the legal limits established in the General Banking Act (LGB, for its Spanish acronym). Said regulation implements the modifications made to the LGB in accordance with the latest agreement of the Basel Committee on Banking Supervision (Basel III), incorporating the best international practices into Chile's banking system. The consultation process will end on January 17, 2020.

The new regulation will allow banks to have more robust capital to cope with a scenario of unexpected losses, thereby giving greater stability to the functioning of the banking system.

Prior to the amendment of the LGB, the effective equity calculation methodology followed the provisions of Basel I. These guidelines are described in the current Chapter 12-1 of the Updated Compilation of Rules for Banks (RAN, for its Spanish acronym).

The proposal considers the definition of three capital levels using the terminology of the Basel Committee on Banking Supervision, i.e. Common Equity Tier 1 (CET1), Additional Tier 1 Capital (AT1), and Tier 2 Capital (T2).

## Prudential adjustments

Prudential adjustments are introduced to determine the available amount of the different capital levels, isolating components that are of low or uncertain economic value, or of difficult liquidation under conditions of financial stress.

Key parts of the regulatory change include the total deduction of intangible assets and hybrid instrument issues by foreign subsidiaries, the partial deduction of deferred tax assets, and certain reserve or profit items. Likewise, it establishes prudential rules of concentration and the amount by which the non-controlling interest of entities that consolidate with the

bank is recognized, conditioned by the regulatory requirement of the subsidiaries. Finally, hybrid instruments issued by subsidiaries will no longer be recognized in consolidated effective equity.

The basic capital of a bank will correspond to the CET1 post deductions. In turn, effective capital is understood to be the sum of the three components, after deductions, for the purposes of applying the LGB's provisions. The limits of Article 66 of the LGB must be met on a local consolidated basis (the bank plus its subsidiaries in Chile) and on a global consolidated basis (the bank plus its subsidiaries in Chile and abroad).

It is preliminarily estimated that the new calculation methodology will generate a decrease of around 8 percent in the effective equity of the local banking system, equivalent to about USD 3 billion with information available as of December 31, 2018. This impact refers only to the numerator of the capital requirement, so it does not necessarily translate into higher demands for Chilean banks. The final impact will depend on the methodologies used to calculate risk-weighted assets.

The regulation will enter into force on December 1, 2020, regardless of any temporary provisions contained therein. The first adjustment, corresponding to 25 percent of the discounts, must be made on December 1, 2021. This amount will increase to 50 percent on December 1, 2022 and 75 percent on December 1, 2023, until full implementation is achieved on December 1, 2024. In the case of instruments issued by subsidiaries, they will no longer be recognized at an annual rate of 10 percent, thus reaching zero percent over a 10-year period.

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

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