

The role of CMF during the Pandemic

Presentación en Chile Day.

Marzo 2021

- Financial sector developments
- COVID-19 mitigation policies
- Financial risks and supervisory efforts
- 2020 Regulations and pending issues



Financial Sector Developments

Financial sector developments

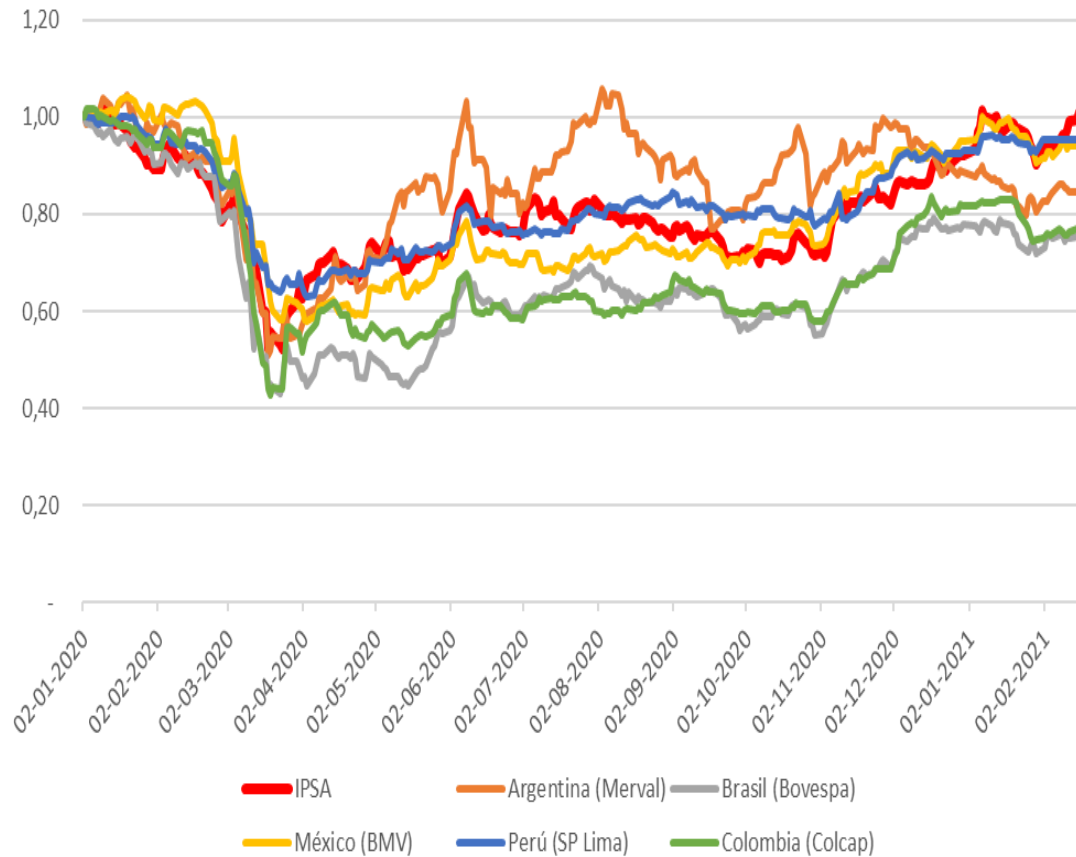
Vaccination progress gives hope for 2021

- **At the onset of the pandemic, local financial markets were hard hit.** Stock prices dropped significantly and the cost of financing for banks and companies increased.
- **Aggressive liquidity provision and several mitigation policies helped revert trend.** These measures have supported low funding costs, keeping bank and corporate bonds issuance flows active.
- **Regarding bank credit, commercial loans have performed countercyclically** during the pandemic, largely due to the FOGAPE-COVID program and the Conditional Financing Facility for Increased Loans (FCIC).
- **Consumer loans fell significantly during 2020.** Household income relief measures and the withdrawal of portions of savings from pension funds may have reduced the demand for loans.
- **Recently, positive news about the progress of vaccination in Chile has supported the expectations** of economic recovery. However, **uncertainty remains high.**

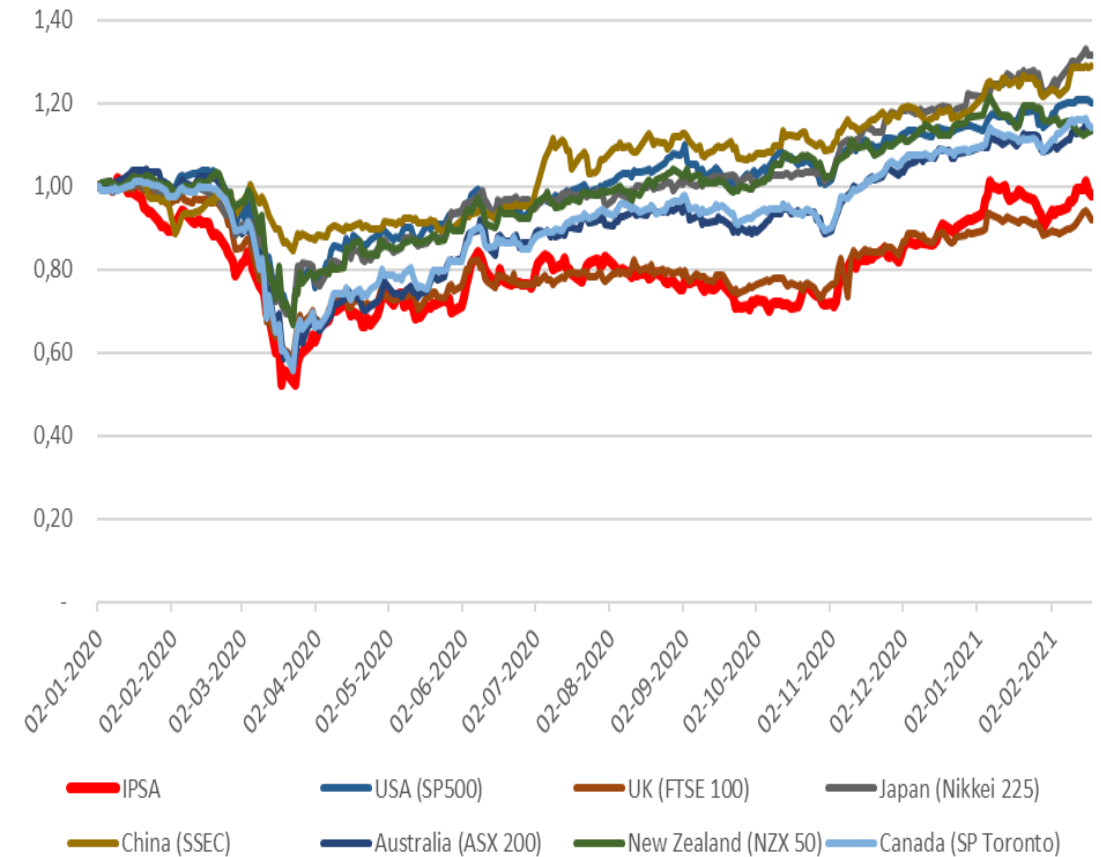
Stock market

Share prices rebound driven by better economic outlook

IPSA and Latam (index, USD)



IPSA and developed economies (index, USD)

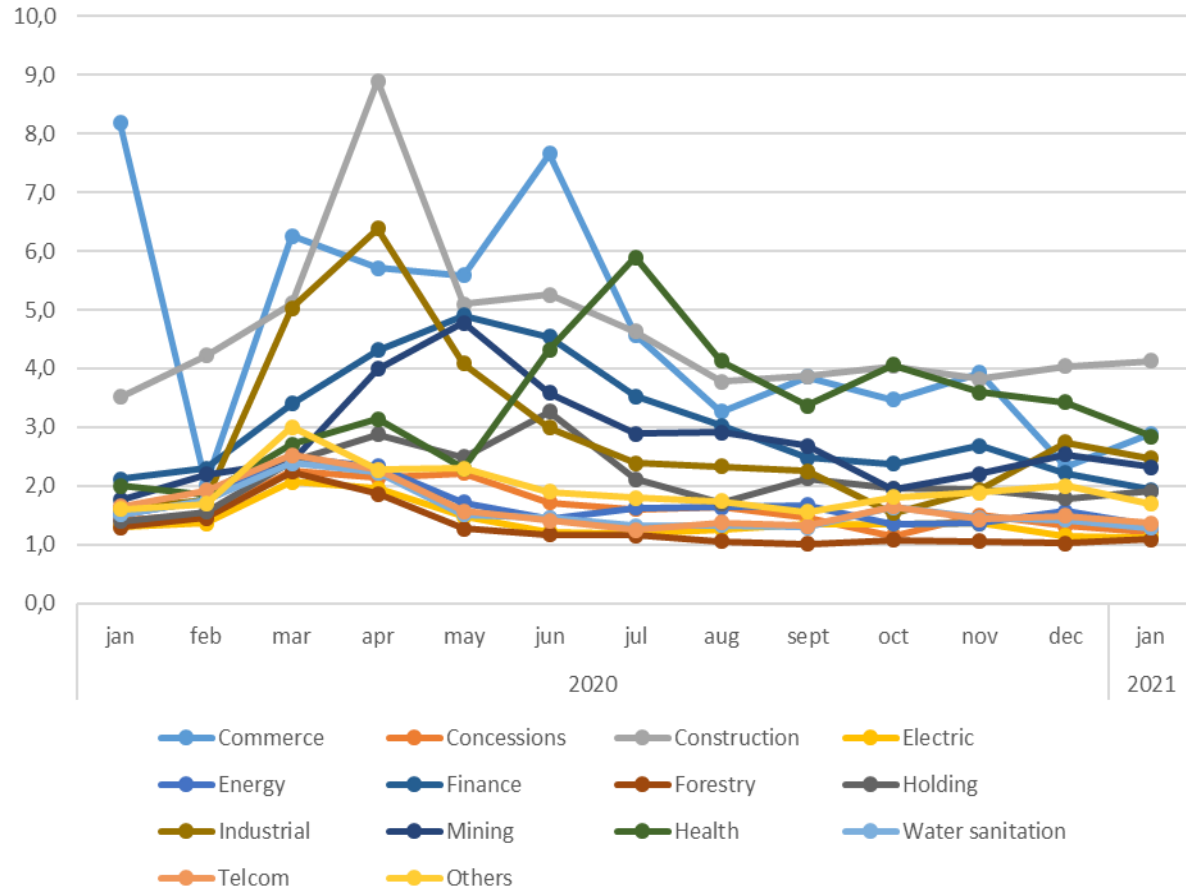


Source: Bloomberg

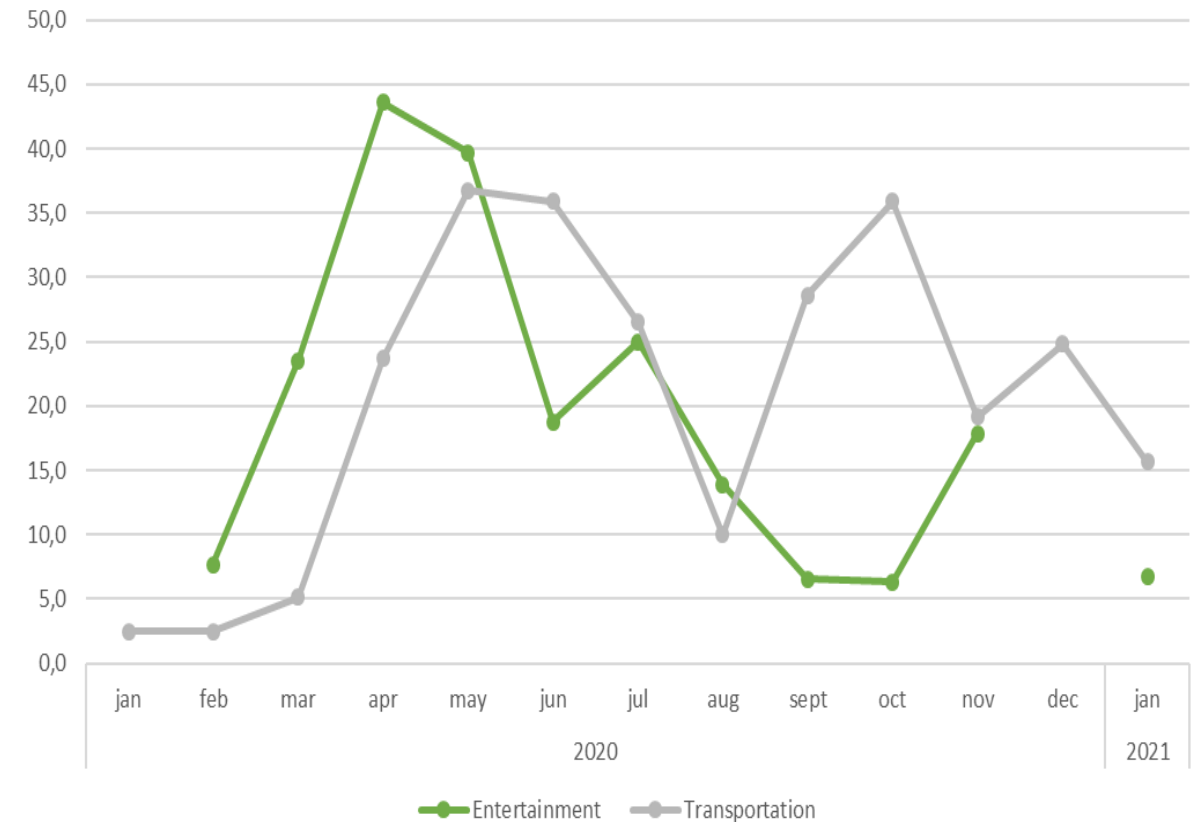
Corporate Bond Spreads

Spreads declined during the second half of the year

Monthly Spread by Sector (excl. Entertainment & Transportation)
(percentage point)



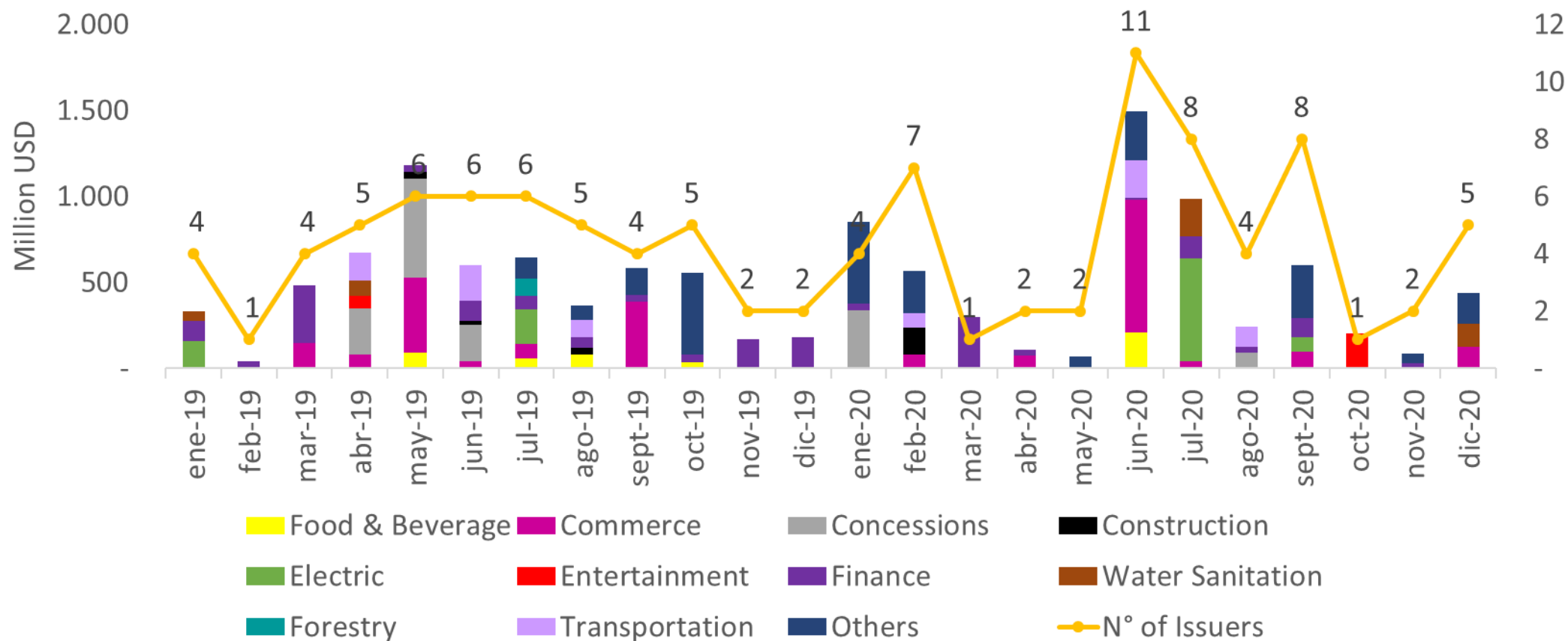
Monthly Spread by Sector (Entertainment & Transportation)
(percentage points)



Corporate Bond Issuance

Placements were affected at the beginning of the pandemic

Monthly Placements by Sector

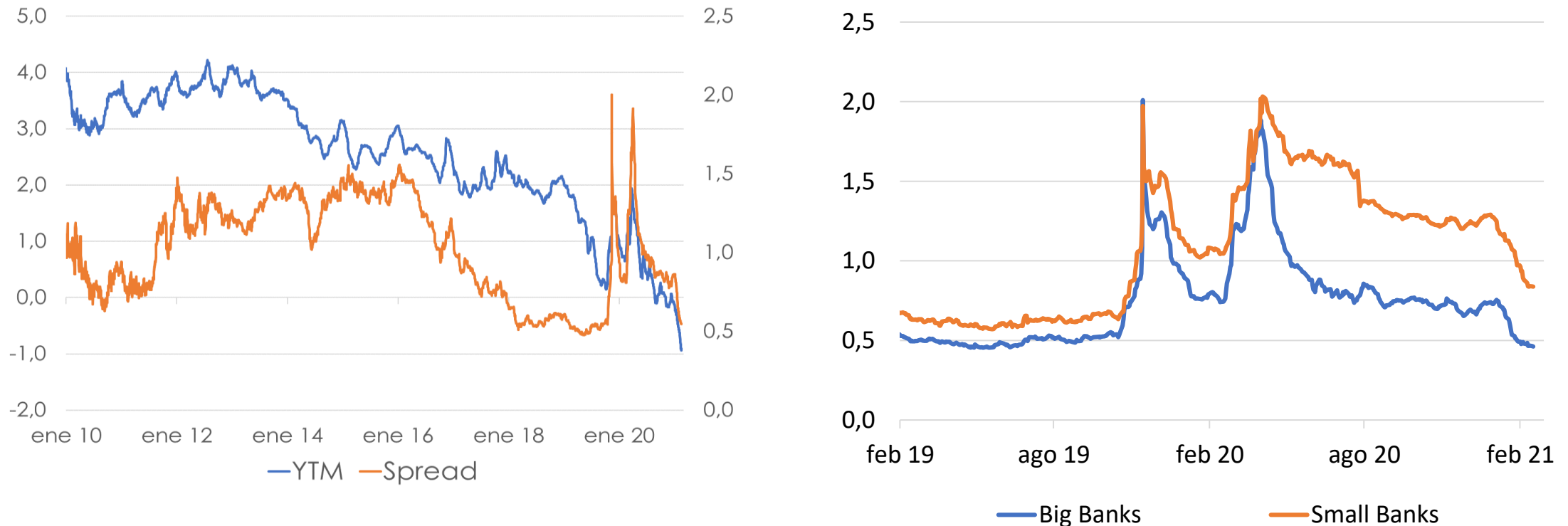


Banks: Medium-term financing cost in local currency

Bond yields fell after the March 2020 rally

- In March, the CBC cut interest rates twice from 1.75% to 0.5% and unveiled liquidity measures. The CBC expanded measures in June.

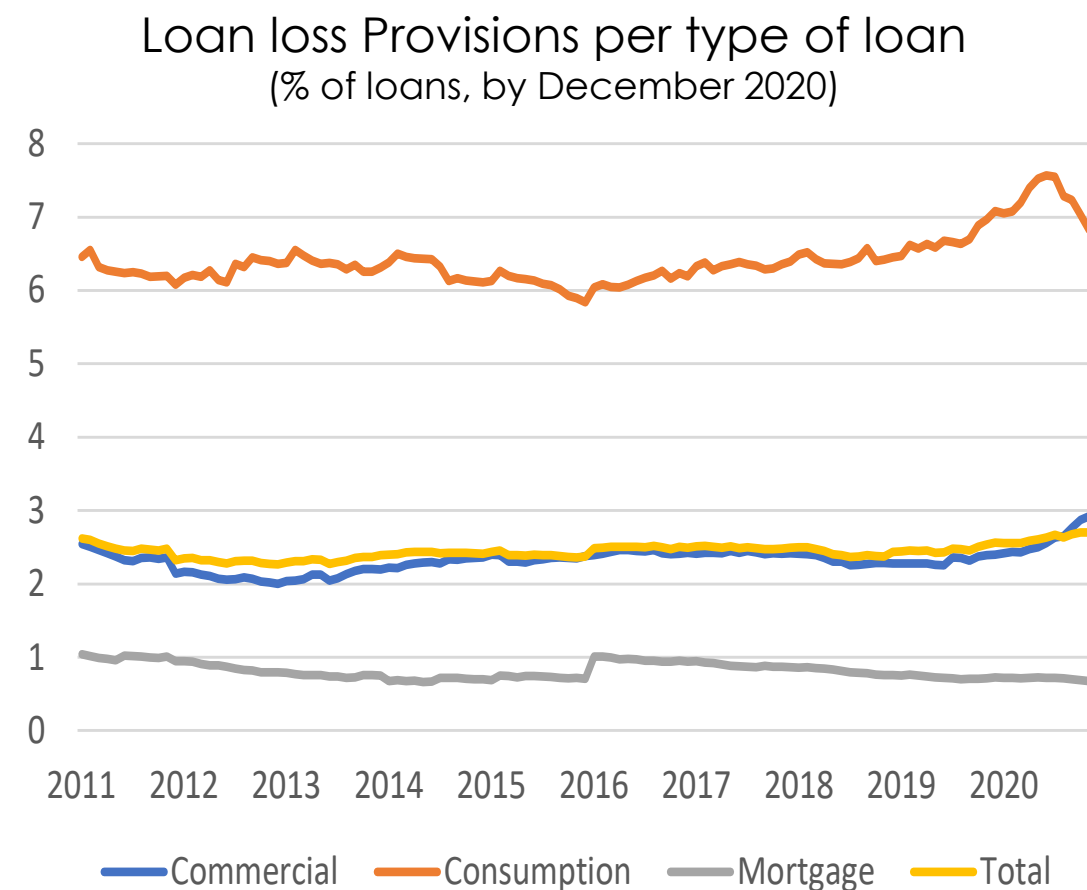
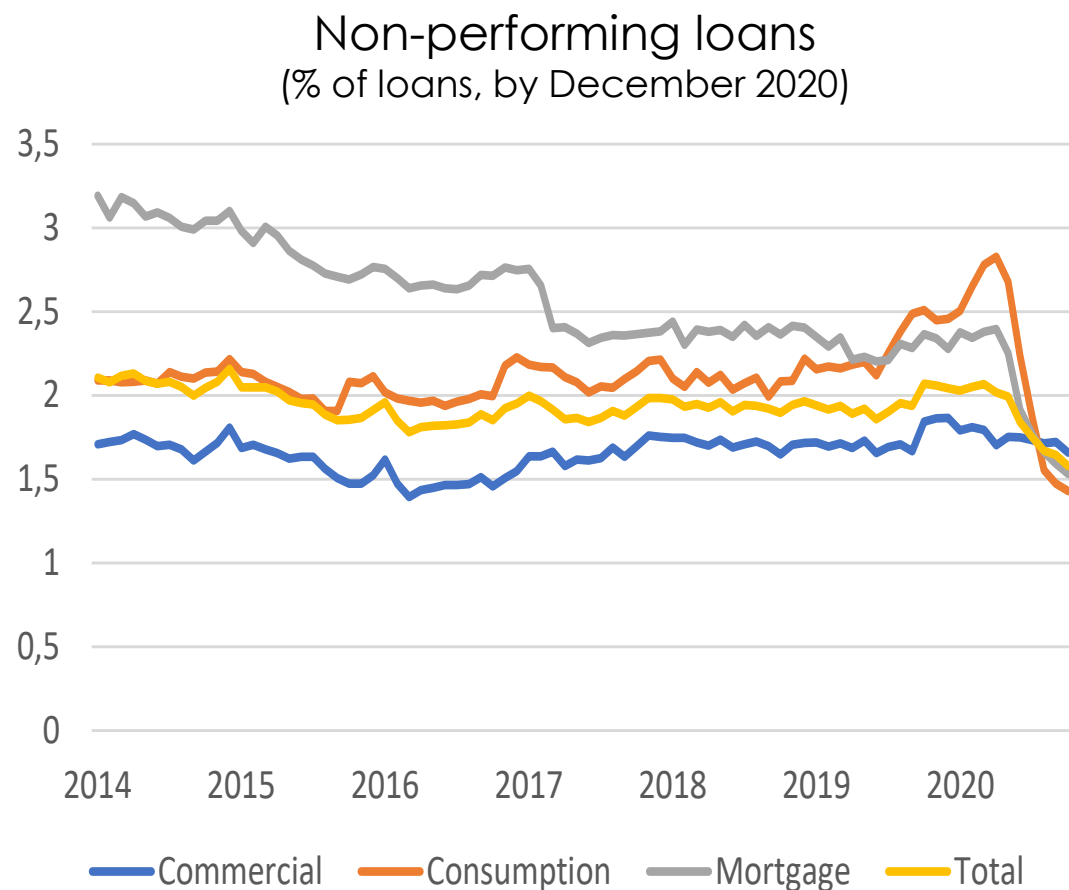
Bank Bonds: Yields and spreads
(by February 16, 2021)



- Compared to previous years, solvency ratios (capital adequacy) are higher. Part of this increase is due to regulatory changes, such as lower risk weighting for state guaranteed loans, but also precautionary policies adopted by banks.
- The system's liquidity position (Liquidity Coverage Ratio) continue to be above regulatory limits (70%). The smallest banks have increased their liquidity the most.

Banks: Non-performing loans

- NPLs decreased after August 2020 due to temporal relief measures for households and the withdrawal of a share of pension funds savings. Until February 19, 2021, the amount withdrawn from pension funds represented 12% GDP (MM US\$ 34,890).





COVID-19 Mitigation Policies

COVID-19 mitigation policies and supervisory actions

During the pandemic, the Ministry of Finance, the Central Bank of Chile (CBC), and the Financial Market Commission (CMF) adopted several measures in a coordinated way to mitigate its effects.

The purpose was to provide liquidity, facilitate access to credit, facilitate issuance and placement of securities, ensure continuity of financial institutions' operations, and closely monitor and assess risks.

- **Liquidity provision measures**

CBC: Inclusion of corporate bonds as collateral; Extension of foreign currency sale program; Longer maturities for peso and dollar liquidity programs; Temporary suspension (90 days) of maturity mismatch requirements; Extension of the relaxation of the LCR limit; Activation of Liquidity Credit Line (LCL); Special asset purchase program (BCP, BCU, bank bonds); Check Clearing House regulations incorporated a special protocol to implement actions in contingency situations; Special cash purchase/forward sale program (CCVP) for bank instruments.

Ministry of Finance: Tax deferral or suspension; subsidies to microbusiness (PAR IMPULSA); Labor income protection program.

- **Measure to facilitate access to credit**

CBC: Conditional Financing Facility for Increased Loans (FCIC1) and program extension (FCIC2).

Ministry of Finance: Credit line for working capital with state guarantee (FOGAPE) up to 3 months of sales; Reduction of deductible for FOGAPE guarantee and increase maximum financing for firms with sales under 1,000 UF.

CMF: Special treatment in the constitution of credit provisions (mortgage, commercial, and consumer); Use of excess mortgage collateral deferred to back loans to SMEs; Adjustments in the treatment of goods received in payment; Reduction of credit risk weighting for loans guaranteed by the Treasury of Chile, CORFO and FOGAPE (from 100% to 10%). This replaced the legal provision that allowed a share of these guarantees to be considered as part of voluntary provisions that make up regulatory capital; Postpone the implementation of Basel III requirements for one year.

Measures to mitigate the effects of the pandemic on the insurance industry (Law N°21.276 of October 2020 amended Insurance Law, DFL N°251):

- Distribution of dividends by insurance companies was restricted to fulfilling minimum solvency ratios.
- Allowed CMF flexibility to increase maximum financial leverage if evolution of the crisis made it necessary.
- Allowed CMF to reduce minimum credit ratings for insurance companies' investments in corporate bonds in the case of massive downgrades. The rationale is to avoid fire sales that could further damage insurance companies' solvency.
- Introduced flexibility in other investment limits such as sectoral diversification, noninvestment grade, etc when they are not responsibility of the company.

- **Measure to facilitate issuance and placement of securities**

The CMF implemented a series of initiatives that aim to facilitate access to capital markets; reduce financing costs, provide companies with greater tools to obtain resources, and strengthen market development.

Some of them include:

- General Rule No. 443: Temporarily exempts the presentation of certain documents in applications for registration of publicly offered securities. It also amends General Rule No. 30, facilitating the registration and placement of publicly offered securities.
- Law No. 21,276: Issued on October 19, 2020. One of its objectives was to speed the issuance of corporate bonds for already registered companies and so reducing liquidity problems. This Law also facilitated the issuance of convertible bonds. The CMF participated both in the design of the law and in discussions leading up to its approval.
- General Rule No. 451: Sets forth the characteristics or conditions to be met in to register securities under the automatic registration system.
- General Rule No. 452: Eases the conditions, requirements, and parameters currently governing securities offerings that do not require registration in its rolls.

- **Measures to facilitate operational continuity of firms:**
 - Remote participation in shareholders meetings (NCG 435 .March 2020)
 - Remote participation in Board meetings (NCG 450. November 2020)
 - Electronic signature for Board meetings minutes (NCG 434. February 2020)
 - Postponement of reporting of Financial Statements (Oficio Circular N° 1.142. March 2020)
 - Flexibility for certifiying competence for market agents (NCG 439. May 2020)



Financial Risk and Supervisory Efforts

- **Slower than expected recovery is a material risk.** Despite progress in vaccination , increases in COVID infections cannot be ruled out. The pandemic could last longer than expected or generate prolonged effects on some economic activities.
- **Jobless recovery could have lingering effects on credit risks .** In sectors that have been slower to bounce back, such as contact-intensive sectors (transportation , hospitality and leisure), it's likely some job losses persist for a long time.
- **Higher leverage makes firms and lenders more vulnerable** under more stressed scenarios. Although an increase in lending has been essential to face the immediate impact of the pandemic.
- **A complex and polarized political cycle** could add uncertainty and discourage investment.

○ Supervisory efforts

Risk-based supervision and coordination

○ **CMF increased remote supervision**

Focus on operational continuity and customer service; additional information requirements; supervisory plan 100% complete.

○ **CMF is increasing the use of stress testing for supervision**

- Banks: refinement of the top-down (TD) methodology, increase in the sample of bottom-up (BU) institutions in exercise, feedback for IAPE;
- Insurance : TD stress test and BU stress test exercise with a sample of companies

○ **Close CEF coordination and with Central Bank:** focus on effects partial withdrawals of pension funds and stress scenarios (MoU).

○ **Supervisory letters sent to banks and life insurance companies indicating the importance of limiting dividend distributions und the current uncertain scenario.**

○ **Coordinated effort with MoF to evaluate alternatives to complex parliamentary initiatives that could alter financial services.**

Supervisory efforts

Risk-based supervision and coordination

○ Pillar 2 as a microprudential tool.

- Annual exercise provides input to SREP process. Used for validating banks capital adequacy assessments (IAPE)
- Starting on April 2021, banks must submit yearly to the CMF their capital adequacy reports (IAPE: Informe de Autoevaluación de Capital). IAPE includes internal stress tests, considering at least the scenarios provided by CMF.
- The supervisor's stress test results will be used to challenge bank's internal results.
- As result of the SREP, the CMF could establish additional capital requirements for banks, up to 4% of RWA.



2020 Regulations and Pending Issues

Basel III regulations

- All Basel III regulations were published by Dec 2020. Gradual implementation.
- On March 2020 CMF decided to postpone the implementation of BIII requirements for one year.
- It is estimated that there will be no additional capital needs until December 2023. As of December 2025, additional capital needs are estimated in USD 2,3 billion.
- It also includes a framework for increased market transparency (pillar 3).

Risk-Based Supervision (RBS) for the insurance industry

- The bill entered the Congress in September 2011. In July 2019, the CMF sent to the Ministry of Finance indications to the project.
- Despite the lack of progress, the CMF considers very important to advance towards the implementation of this framework, including capital standards.

2020 Regulations and pending issues (cont.)

Cybersecurity regulation

- On Sept 2020, a systemic bank was affected by a cyber attack.
- The regulation for banks (Chapter 20-10) was published in December 2020, and it will be part of the operational risk's assessment of banks, according to international best practices.
- Regulation on operational risk management and cybersecurity for insurance companies is symmetrical to that of banks, and currently on public consultation.
- 2021 CMF's strategic initiatives considers issuing regulation on operational risk for all supervised entities.

Adoption of International Accounting Standards (IFRS)

- On December 2019 the CMF published modification to accounting standards of banks. Implementation starts on January 2022.
- On January 12, 2021, CMF published for consultation a regulation to implement the IFRS 17 accounting standards in the Chilean insurance market.

2020 Regulations and pending issues (cont.)

Bank resolution framework

- CMF 2021 Strategic initiative. The 2019 legal reform to the General Banking Law incorporated an early intervention regime, but our resolution framework is still weak.
- The CMF requested a Technical Assistance of the US Treasury's to develop a legal draft.

Financial conglomerate law

- CMF 2021 strategic initiative. The purpose is to generate a draft for the Financial Conglomerate Act, based on international experience.

2020 Regulations and pending issues (cont.)

Consolidated credit registry

- Recently, the government announced the imminent presentation of a legal initiative that creates a Consolidated Registry of Credit Obligations (RECOC), with three objectives:
 - Incorporate new reporters and add positive information
 - Empower the CMF to operate the system.
 - Improve on ownership information rights.
- Meanwhile the CMF has decided to generate a broader debt report, including non-bank supervised entities.

Fintech law

- In February 2021, the CMF published its proposal for a Fintech Law for the securities market, which was submitted to the Ministry of Finance in November 2020. The objective is to expand CMF's regulatory perimeter, protect shareholders, boost Fintech companies and increase competition in the financial market.

Responsibility of market agents

- Enhances anti market abuse regulatory framework: Increases fines and criminal sanctions, strengthen the board of directors' prevention's role
- New whistleblower protection framework
- Higher risk management standards for securities intermediaries, interconnection of securities stock exchanges is reinforced.
- New investment advice regulation (registration, disclosure and criminal liabilities).
- Pension advisors are only under the supervision of the Superintendence of Pensions.
- A new figure of Pension Financial Advisors or Pension Financial Advisory Entities (natural or legal persons that carry out pension advisory activities in a non-personalized way) is created, regulated and supervised by SP and CMF:
 - A registry will be created.
 - Advisors must present a bank guarantee or a guarantee insurance policy, to respond to the correct and complete fulfillment of all the obligations.

The role of CMF during the Pandemic

Presentación en Chile Day.

Marzo 2021