PRESS RELEASE

CMF moves forward with its Basel III implementation schedule and issues regulation for calculation of regulatory capital

- *It is the fourth Basel III regulation issued by the Commission.*
- *The regulation establishes guidelines for measuring effective equity, purging items of low quality or whose value is uncertain in a liquidation scenario, and sets out prudential rules for concentration in accordance with the current legal framework.*

October 9, 2020 – The Financial Market Commission (CMF) has issued the regulation for calculation of the effective equity to be used by banks to comply with the legal limits established in the General Banking Act (LGB, for its Spanish acronym). Said regulation implements the amendments made to the LGB in line with the latest agreement of the Basel Committee on Banking Supervision (Basel III), allowing the incorporation of the best international practices into the Chilean banking system. This version of the regulation includes the feedback received from the industry during its public consultation process.

The new regulation will allow banks to have more robust capital to cope with a scenario of unexpected losses, providing greater stability to the operation of the banking system. This is the fourth regulation issued by the Commission for the implementation of Basel III standards in Chile.

Before the amendments to the LGB, the methodology for calculating effective equity followed the provisions of Basel I, whose guidelines are set out in the current Chapter 12-1 of the Updated Compilation of Rules for Banks (RAN, for its Spanish acronym).

The regulation considers the definition of 3 levels of capital under the terminology set by the Basel Committee: Common Equity Tier 1 (CET1), Additional Tier 1 (AT1), and Tier 2 Capital (T2).

Prudential Adjustments

The amendments introduce prudential adjustments to determine the amount available of the different levels of capital. It isolates components that are of low quality, uncertain economic value, or difficult to liquidate under conditions of financial stress. The total deduction of intangible assets, and the partial deduction of deferred tax assets and certain reserve or income items are noteworthy. Furthermore, it establishes prudential concentration rules and the amount by which the non-controlling interest of entities that consolidate with the bank is recognized, being conditioned to the regulatory requirement of its subsidiaries. Finally, hybrid instruments issued by foreign subsidiaries will no longer be recognized in consolidated effective equity.

The basic capital of banks will be CET1 after deductions. In turn, the sum of the three components after deductions shall be considered effective equity for the purposes of applying the provisions of the LGB.

The limits of Article 66 of the LGB must be complied with on a local consolidated basis (the bank plus its subsidiaries in Chile) and a global consolidated basis (the bank and its subsidiaries in Chile and abroad).

Impact

With information as of December 31, 2019, it is estimated that the new calculation methodology will generate a decrease in the effective equity of the Chilean banking system of around USD 2.3 billion, or 6.5 percent of the stock. Said impact refers only to the numerator of the capital requirement, so it does not necessarily translate into higher effective equity requirements for Chilean banks. The final impact will depend on the methodologies used for the calculation of risk-weighted assets.

The regulation will be in force from December 1, 2020, regardless of the transitional provisions it considers. The first adjustment must be made on December 1, 2022, corresponding to 15 percent of the discounts. This amount will increase to 30 percent on December 1, 2023, and to 65 percent on December 1, 2024. Full implementation will be achieved on December 1, 2025.

In the case of instruments issued by subsidiaries, they will be phased out of recognition at an annual rate of 10 percent from December 1, 2022. In addition, the requirement will be measured at the local consolidated level from this date onwards.

To access the details of this new regulation, interested parties can visit the Rules and Norms section of the CMF website. Additionally, the Commission makes available a Regulatory Report evaluating the impact of the regulation, a Frequently Asked Questions document, and a Presentation containing its core elements.

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