



## Basel III Standards

# CMF moves forward with its Basel III implementation schedule and issues two new regulations

*The regulations set out the minimum requirements and conditions that hybrid instruments issued by banks must meet to be considered as part of effective equity.*

**November 24, 2020** – The Financial Market Commission (CMF) has issued two new regulations as part of the implementation process of Basel III standards in Chile. These are:

- Minimum requirements and conditions to be met by preferential shares and bonds without a fixed maturity date under Article 55 Bis of the General Banking Act ([Chapter 21-2](#) of the Updated Compilation of Rules for Banks, RAN).
- Minimum requirements and conditions to be met by subordinated bonds under Article 55 of the General Banking Act ([Chapter 21-3](#) of the RAN).

These regulations include the amendments made to the General Banking Act 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. They include feedback from the industry received during a public consultation process and, in the case of the regulation on preferred shares and bonds without fixed maturity, it has a prior favorable report from the Central Bank of Chile, as required by law.

## Hybrid Instruments

Regarding hybrid instruments for the constitution of effective equity, the requirements established for the issuance of preferred shares, bonds without fixed maturity (Additional Tier 1 Capital, T1), and subordinated bonds (Tier 2 Capital, T2). They seek to provide alternative modalities of regulatory capital to absorb losses when the capital of the issuing bank decreases under pre-established conditions and may facilitate the recovery of solvency levels or avoid the resolution of a bank.

Any issuance that does not meet the conditions established in these standards cannot be accounted for as effective equity by banks.

For subordinated bonds, Chapter 9-6 of the RAN is replaced by a new one which complements and adjusts the current requirements to align them with Basel III.

## Final Text of the Regulations

Comments received throughout the public consultation period focused on the Chapter on preferred shares and bonds without fixed maturity, while the Chapter on subordinated bonds remained unchanged since the only consultation received could not be resolved by changes to the regulations.

The main adjustments were to clarify the following:

- AT1 and T2 issuances made by foreign subsidiaries will not be part of the effective equity.
- Clarify the different loss absorption mechanisms, their characteristics, and the partiality of the conversion mechanism.
- Modify aspects related to the credit classification of AT1 instruments.
- Specify that the accounting aspects of such issues will be laid out in the Compendium of Accounting Standards for Banks.

## Impact

It is estimated that there would no need for banks to issue AT1 capital during the first year of implementation of the regulations. This is because most banks keep high levels of basic capital (CET1) and subordinated bonds (T2), and the latter can be used to compute as AT1 during the transitional period. Considering the full implementation of Basel III standards, it is estimated that five institutions could fill their capital gaps with AT1 instruments for an amount roughly equivalent to USD 1,468 million. For subordinated bonds, the major change corresponds to issuances by subsidiaries executed prior to the effective date of this regulation, which will no longer be recognized in consolidated effective equity as instructed in Chapter 21-1 of the RAN. These issuances must be phased out of the parent company's effective equity within 10 years.

Although the CMF announced the postponement of the beginning of the implementation of the Basel III requirements in Chile by a year, these regulations will be in force as of December 1, 2020, notwithstanding any transitional provisions established in the law and informed by the Commission.

To access the details of these two new regulations, interested parties can visit the [Rules and Norms section](#) of the CMF website. Additionally, the Commission makes available a [Frequently Asked Questions document](#) and a [Presentation](#) containing their core elements.

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