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Minister of Finance Leads Parliamentary Approval of the New Banking Law

After several years of discussion, Congress finally approved the New Banking Law yesterday. This landmark legislation is the most important adjustment to Chile's banking legislative framework over the past thirty years, aligning bank capital requirements with international Basel III standards, providing an enhanced new governance for the bank regulator, broadening the range of regulatory tools to deal with weak banks, and extending government guarantees for term deposits, among other important issues.

The bill's approval will contribute to further development of Chile's financial system, while at the same time build on its resilience. The major changes include:

- **A New Enhanced Governance for the Bank Regulator:** The current Securities and Insurance regulator, the Committee for Financial Markets (CMF), will also supervise and regulate the banking sector. This is the final step on a transition to an integrated model for supervision of the financial sector. As a result, the banking sector regulator will have a modern and independent governance structure, with explicit objectives including further financial market development and financial stability.
- **Adoption of Basel III Capital Requirements:** Chile's banking sector capital requirements are currently largely based on Basel I. Under the new legislation, the CMF will define the standard model for the definition of Risk Weighted Assets (RWA) and banks will be able to use internal models once they have been authorized by the CMF. In addition to the new capital requirements (Table 1), the CMF will be able to impose additional Pillar 2 capital requirements for banks that fail to mitigate risks with the minimum capital requirements.

Table 1: Capital Charges (as % of RWA)

Capital Requirements	Current	New
(1) Tier 1 Capital (2+3)	4,5	6
(2) CET1	*4,5*	*4,5*
(3) Additional Tier 1	-	*1,5*
(4) Tier 2	3,5	2
(5) Total Regulatory Capital (1+4)	**8**	**8**
(6) Capital Conservation Buffer	-	2,5
(8) Countercyclical Buffer	-	Up to 2,5
(9) Systemic Charges	Only for mergers.	From 1 to 3,5

- **New Tools for Dealing with Weak Banks:** The approved legislation extends the range of tools available for the regulator to deal with weak banks before they reach insolvency. The CMF will have to approve and supervise the application of private recovery plans proposed by banks that are facing problems. The CMF will also have the ability to restrict the range of operations that a bank can perform while implementing the recovery plan.
  The law also eliminates the “creditors proposal resolution tool” that involves a negotiation with creditors in the context of financial distress. This modification was justified on the terms of having limited practical use and had the potential of aggravating the problems of banks close to insolvency.

- **Extension of Government Guarantees for Term Deposits:** Term deposits will be 100% guaranteed by the government, up to a 200 UF limit for deposits on the same bank and 400 UF for deposits on all the system[1]. The current sight deposits guarantee scheme remains unchanged, meaning that these deposits remain covered up to a 100% with no maximum limit by the Central Bank of Chile.

There will be a transition period for the law’s implementation: The CMF will have up to one year to take on the regulation of banks and then, up to 1.5 years to issue the new capital requirements regulation. Once this regulation has been issued, new capital requirements will be gradually phased-in over a four-year period.

[1] Deposits were covered only up to 90% up to a limit of 120 UF.