Superintendencia de Bancos e Instituciones Financieras Chile

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International Financial Conglomerates – Issues and Challenges.
The World Bank, IMF, United States Federal Reserve Board

FINANCIAL CONGLOMERATES AND BANK STABILITY: THE CHILEAN CASE

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STRUCTURE, SUPERVISON AND DEVELOPMENT OF THE CHILEAN FINANCIAL SYSTEM (1)

1. Chile's financial system is made up mainly by commercial banks, insurance companies, pension funds and securities market intermediaries.

2. Three specialized public sector agencies are responsible for financial supervision:
   - Superintendency of Banks (SBIF)
   - Superintendency of Securities and Insurance (SVS)
   - Superintendency of Pension Funds (SAFP).

3. Banks have become multi-purpose institutions and can set up two kinds of financial subsidiary:
   - those which complement their usual banking business and are supervised by the SBIF;
   - those related to securities business and insurance brokerage, which are supervised by the SVS.

STRUCTURE, SUPERVISON AND DEVELOPMENT OF THE CHILEAN FINANCIAL SYSTEM (2)

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4. The system's highly-segmented structure is being modified by rapid market and regulatory changes in the financial services sector.
   - International financial groups operate in different segments of the sector.
   - New regulations take account of increasing financial integration (i.e. voluntary pension savings schemes).

5. Nevertheless, a number of restrictions on integration remain in place and the system continues to be segmented.

4. An FSAP carried out by the IMF and the World Bank in 2004 concluded that:
   - the Chilean financial system is large, diversified and sound;
   - consolidated supervision of financial conglomerates was materially non-compliant.

SUPERVISION OF ECONOMIC GROUPS AND MIXED-ACTIVITY FINANCIAL CONGLOMERATES (1)

1. Economic groups play a very important role in the corporate sector in Chile, as in other developing countries.

2. They frequently engage in both financial and non-financial activities, forming mixed-activity financial conglomerates.

3. Key features of these conglomerates include:
   - boundaries usually not well defined;
   - concentrated ownership and control;
   - family connections.

SUPERVISION OF ECONOMIC GROUPS AND MIXED-ACTIVITY FINANCIAL CONGLOMERATES (2)

4. Issues as to where to draw lines for the purpose of consolidated supervision:
   - Which firms should be included for consolidation? Only financial institutions?
   - How many steps above the bank should we go in requiring disclosure of financial information? One step above, or all the way to the ultimate investment vehicle?

5. Other factors that introduce difficulties for consolidated supervision include:
   - differences in accounting standards within the country;
   - lack of a “lead” supervisor as regards the solvency of mixed-activity conglomerates.

PRESENCE OF MIXED-ACTIVITY FINANCIAL CONGLOMERATES IN THE BANKING INDUSTRY

Group of banks	Number of banks	Loan market share (%)
Banks which are part of mixed-activity domestic conglomerates	9	46.8
State-owned bank	1	13.2
Foreign banks	12	39.4
Banks with no relation with conglomerates	3	0.6
Total	25	100.0

PROTECTING THE SOLVENCY OF BANK HOLDING COMPANIES

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1. The main objective of consolidated supervision is to assess risks and capital adequacy for the financial conglomerate as a whole.

2. The second-best alternative is to protect the solvency of the bank or the bank holding company within the mixed-activity conglomerate.

REGULATION PROTECTING THE SOLVENCY OF BANK HOLDING COMPANIES THAT FORM PART OF A MIXED-ACTIVITY FINANCIAL CONGLOMERATE

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1. Consolidation of risks and capital at the level of the bank holding company.

2. Incorporation of capital into a new bank to avoid initial under-capitalization.

3. Solvency requirements for domestic controlling shareholders.

4. Strict limits on related-party lending and effective enforcement:
   - limit on unsecured lending to the conglomerate as a whole set at 5% of the bank's capital;
   - broad definition of a party related through ownership or management position;
   - permanent review of related firms and individuals;
   - SBIF credit register to verify lending limits.

RELATED-PARTY LENDING

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Year	% of total bank lending	% of total bank capital
1997	1.5	14.7
1998	1.4	11.8
1999	1.8	14.3
2000	2.0	16.4
2001	2.1	17.6
2002	1.4	10.4
2003	1.2	12.4
2004	1.7	13.0

Notes:

- Figures refer to the system as a whole.
- As from 2002, figures are measured in consolidated terms.

REGULATION PROTECTING THE SOLVENCY OF BANK HOLDING COMPANIES THAT FORM PART OF A MIXED-ACTIVITY FINANCIAL CONGLOMERATE

5. Consolidation of risks and capital at the level of the bank holding company.
6. Rules on establishing branches or subsidiaries and making investments in foreign countries that seek to ensure adequate consolidation at the bank level.
7. Presumptions on financial instability and recapitalization measures.
8. Stress testing for bank solvency.
9. Corporate governance standards to ensure sound banking practices.

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ISSUES UNDER DISCUSSION

1. Supervision of non-bank credit cards which have become an important component of the payment system.

2. Entry of banks and insurance companies into the pension fund industry.

3. Entry of banks into the insurance industry.

STEPS TOWARDS CONSOLIDATED FINANCIAL SUPERVISION

1. Setting up financial holding companies…

2. … and promoting financial transparency and market discipline at that level.

3. Adopting International Financial Reporting Standards (IFRS).

4. Giving legal status to the Committee of Superintendents of the Financial System and endowing it with a small staff.

5. Additional powers for the SBIF to request information from financial subsidiaries supervised by other agencies.

6. Joint on-sight supervision for subsidiaries overseen by the SVS.

CONCLUDING REMARKS (1)

1. Mixed-activity financial conglomerates have a significant presence in Chile, as in other developing countries.

2. They are subject to a segmented supervisory approach, supported by strong firewalls that protect the solvency of these financial institutions.

3. As regards banks, protection from risks originating in other entities of the same group has relied on strict regulations, which include solvency criteria for new entrants and strict limits on related lending.

CONCLUDING REMARKS (2)

4. The very nature of the mixed-activity financial conglomerates that control banks is the main difficulty for the implementation of comprehensive and consolidated supervision. This raises issues that are not easy to resolve.

5. Nevertheless, a number of intermediate steps must be taken to enhance and strengthen the current supervisory framework.

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Thank you for your attention.