

ASBA/FSI  
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Implementation of Basel II and other Supervisory Topics  
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# DEVELOPMENTS AND REMAINING CHALLENGES RELATED TO BASEL II IMPLEMENTATION

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# Implementation of Basel II in Latin America and the Caribbean (LAC)

## Findings based on FSI survey conducted in eleven countries in 2004

### ■ Pillar 1 – Main findings

#### ■ Credit risk

- Banks controlling 50% of banking assets in LA would apply the foundation-IRB approach in 2007-09
- About half of foundation IRB banks would be moving to the advanced IRB approach after 2010
- Banks controlling a third of banking assets would implement the simplified standardised approach in 2007-09
- Banks starting to implement Basel II after 2010 would mainly apply the standardised approach

#### ■ Operational risk

- Banks controlling 60% of banking assets would adopt the alternative<sup>2</sup> standardised approach in 2007-09

## Implementation of Basel II in LAC

### ▪ **Pillar 2 – Main findings**

- A main challenge relates to the human and technical resources to supervise risk management and capital requirements
- Main concerns:
  - i) Implementation of the most sophisticated proposals, the IRB approaches and AMAs;
  - ii) Supervisory validation of more advanced approaches for credit and operational risk;
  - iii) Cross-border relationship between home and host supervisors

### ▪ **Pillar 3 – Main findings**

- Proper balance between transparency and proprietary and confidential information
- Cultural change following the disclosure of relevant and timely information
- Supervisory responsibility in assessing the information to be disclosed to the market

## Implementation of Basel II in LAC

- **Need of updating information as regards the risk approaches and the timing of Basel II implementation in LAC taking into account developments since 2004**
- **The use of banking assets as indicators in the 2004 survey tends to overestimate the implementation of Basel II in large countries**

## Chile: Pillar 1 Capital Requirements

Risk	Basel II First Stage Road Map Guidelines	Basel II Second Stage Not part of Road Map
Credit Risk	<ul style="list-style-type: none"> <li>▪ Upgrading provisioning scheme</li> <li>▪ Standardised approach</li> </ul>	Internal ratings-based approach (IRB)
Market Risk	<ul style="list-style-type: none"> <li>▪ Standardised approach</li> <li>▪ Internal VaR models</li> </ul>	_____
Operational Risk	<ul style="list-style-type: none"> <li>▪ Alternative Standardised approach</li> <li>▪ Standardised approach</li> </ul>	Advanced measurement approaches - AMAs

## Chile: Basel II First Stage

Year	Activities
2005	<ul style="list-style-type: none"> <li>▪ Quantitative Impact Study (QIS 5)</li> <li>▪ Standardised approach for market risk.</li> <li>▪ Capital limit* with credit and market risks*</li> </ul>
2006	<ul style="list-style-type: none"> <li>▪ Stress-test exercises of bank's capital adequacy</li> <li>▪ Banks can submit internal VaR models on market risk</li> </ul>
2007	<ul style="list-style-type: none"> <li>▪ Capital limit* with credit, market and operational risks</li> <li>▪ Stress-tests part of the appraisal of bank's capital adequacy</li> <li>▪ Disclosure of additional information on risks, provisions and capital</li> </ul>
2008	<ul style="list-style-type: none"> <li>▪ Banks can opt for the standardised approach of operational risk</li> </ul>

\* Capital limits will become capital requirements once market risk and Basel II become part of the General Banking Act

## Chile: Quantitative Impact Study – QIS 5

- Basel ratios  
Basel I: 12,2%  
Basel II: 12,0%
- Change in risk-weighted assets for credit risk: -8,8%
- Operational risk capital charge  
On minimum capital: 7,7%
- Rated corporate portfolio  
8,7% of corporate portfolio

## Chile: Basel II Workshop

- Working papers under discussion
  - 1. The Basel Ratio in the New Capital Framework**

Main issue: Capital adequacy in Pillar II taking into account unmeasured risks
  - 2. Assessment of banks according to risk management and capital adequacy**

Main issue: Adjusting the framework of bank appraisal of the General Banking Act
  - 3. Risk classification and external credit assessment institutions (ECAIs) in the standardised approach**

Main issue: Mapping of default percentages to risk categories



## Chile: Basel II Workshop

### **4. Provisions for credit risk**

Main issue: Upgrading the provisioning scheme in line with credit risk categories used in the standardised approach

### **5. Capital and provisions for contingent exposures**

Main issue: Credit conversion factors for contingent credit instruments used by banks established in Chile

### **6. Capital and provisions in the securitization framework**

Main issue: Basel II treatment of investments in junior bonds of securitized loans which do not have risk classification or investment grade appears to differ from the treatment of accounting standards

### **7. Credit risk mitigation techniques in the standardised approach**

Main issue: Inclusion of nonfinancial risk mitigants for provisioning purposes