Superintendencia de Bancos e Instituciones Financieras Chile

FINANCIAL STABILITY AND MACROPRUDENTIAL POLICY IN CHILE, A COUNTRY WITH LARGE FOREIGN BANKS

Raphael Bergoeing
Superintendente de Bancos e Instituciones Financieras de Chile

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Agenda

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- Foreign banks in Chile do matter
- Pros and cons of foreign banks, in theory
- Doing the homework: sound policies in Chile
- Foreign banks in Chile: should we care?
- Two policy implications

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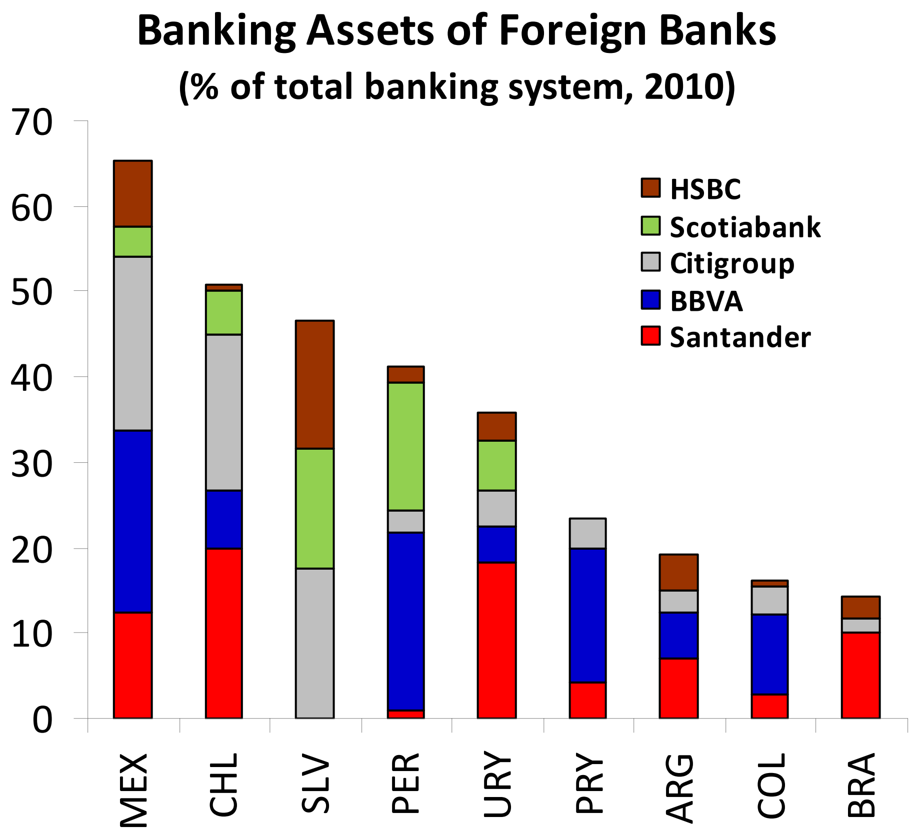
Foreign banks in Chile do matter

Foreign banks hold > 40% of assets



Source: Kamil, Herman et al (2010).

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Pros and cons of foreign banks, in theory

Pros of cross-border banking

- It has the potential to improve financial stability:
  - Improvement in the overall quality of the loan portfolio.
  - Contribution to a less volatile lending over the local business cycle.

- Outside competition can potentially mitigate anti-competitive behaviors in a concentrated industry.

- Transfers and spillovers of knowledge and know-how.

Cons of cross-border banking

- The globalization of financial markets can create strong contagion effects across markets.

- It can be difficult to deal with distressed banks in a cross-border setting, since there are many stakeholders involved and the resolution of failing institutions is more poorly defined at the international level than at the national level.

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Doing the homework: sound policies in Chile

Sound macro and financial policies

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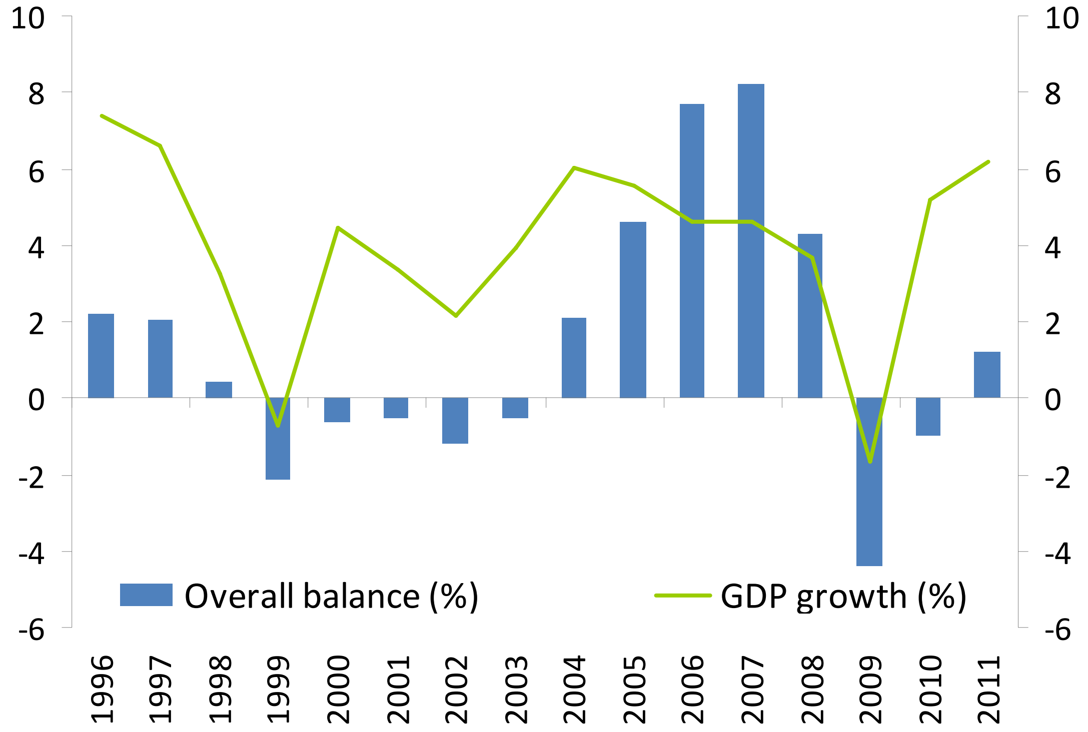
- A responsible and predictable fiscal policy rule (2001).
- An autonomous Central Bank (1989) with an explicit mandate (inflation and the payment system).
- A floating exchange rate regime (1999).
- Commercial and financial integration with foreign markets.
- A solid banking system, well regulated and supervised.
- Foreign and local banks face the same regulation.
- A financial stability committee (2010).

Countercyclical fiscal policy



Source: Data from the Central Bank of Chile and the Budget Office of Chile.

High marks

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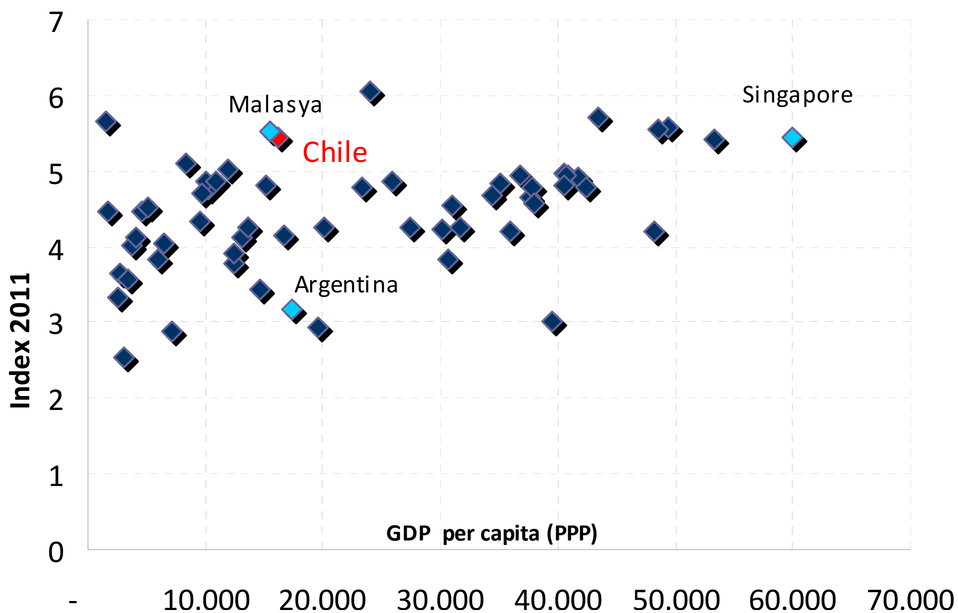
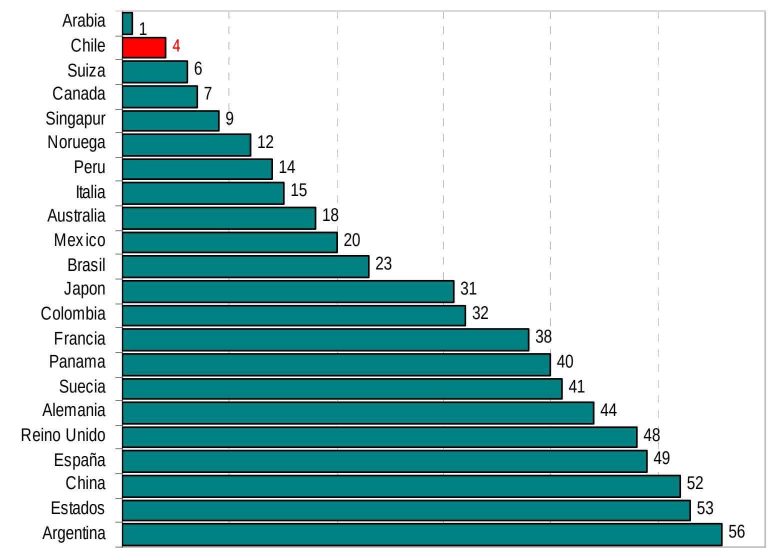
Financial stability ranking
(selected countries)



Banking stability ranking
(selected countries, 2011)



Source: World Economic Forum and IMF.

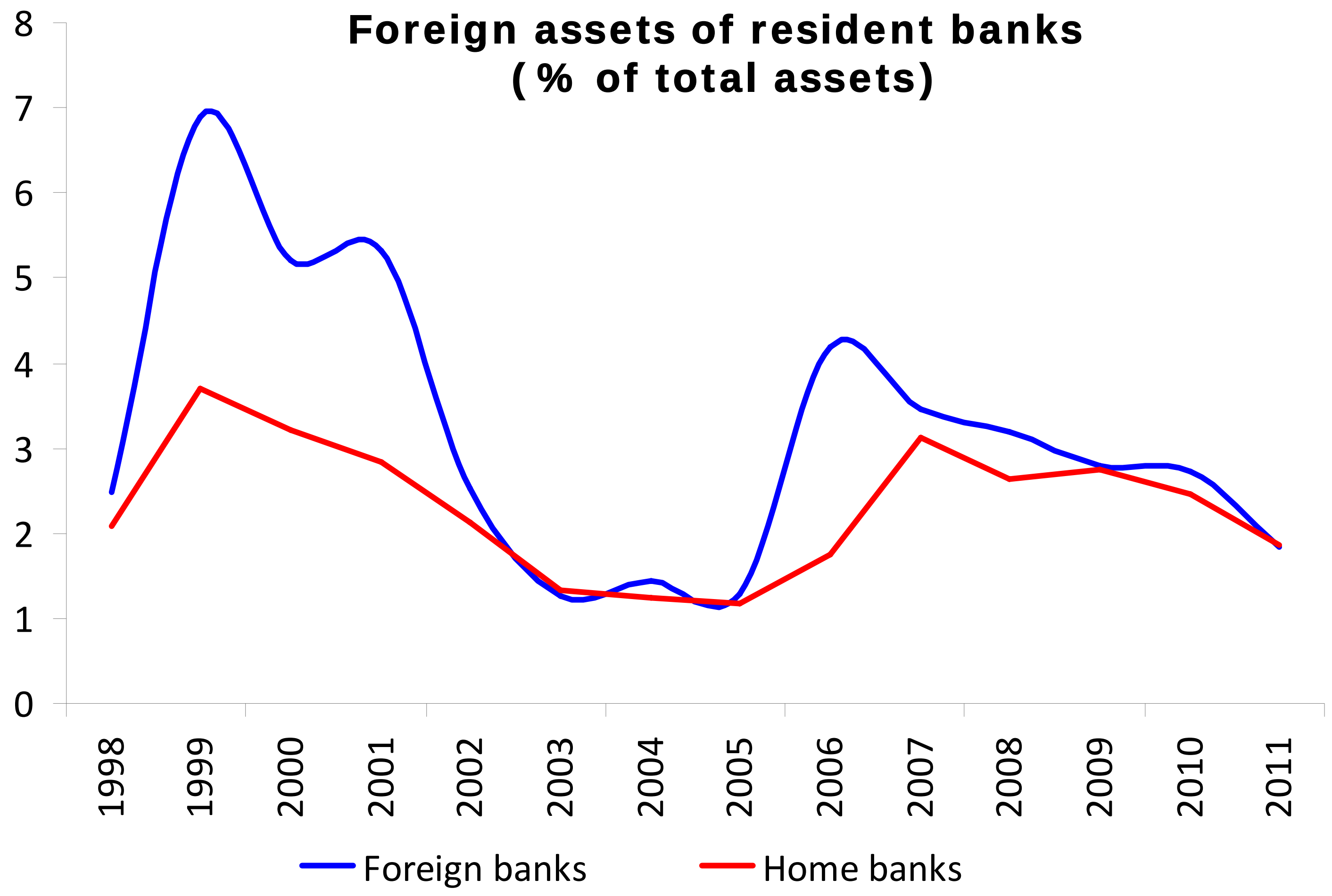
And even though we still are in Basel I...

	Basel I	Basel II	Basel III
Local banks	100%	100%	83%
Foreign banks			
-Subsidiaries	100%	100%	86%
-Branches	100%	100%	100%

Source: SBIF.

Foreign banks in Chile: should we care?

Foreign and local banks



Source: SBIF.

Foreign banks in Chile during this crisis

- Supply of cross-border bank lending and deleveraging remained relatively stable:
  - Subsidiaries of foreign banks in Chile have an asset composition and reliance on external funding similar to locally owned banks.

- No evidence that market penalized subsidiaries, in domestic or foreign funding costs.

- Financing to parents through selling shares, not reducing credits (Santander sold 7.8% of its shares in Santander Chile in November 2011).

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Two policy implications

Policy implications (1/2)

- A sound economic (macro and financial) environment attenuates the differences in behavior among local and foreign banks. **Still, cross-border banking supervision not trivial.**
  - o Cross-border funding is highly volatile.
  - o Information (for instance, respect to funding with parent and other foreign subsidiaries or branches).
  - o Regulation:
    - - Limits to sight (and overnight) deposits overseas.
    - - Corporate governance: the board defining an explicit and publicly known policy with respect to financial operations with parent institution.

Policy implications (2/2)

- Macroprudential (and macro) policy greatly influences financial supervision.
  - Need for explicit coordination among local economic authorities.
  - Countercyclical capital buffers (and macroprudential triggers in general) are just a backing tool.
  - It is important to have certain requirements through norms (not through laws).
  - Risk-based financial supervision has a discretionary component (qualitative analysis).

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