Welcome Speech

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Good morning everyone and welcome to Santiago, Chile. On behalf of the Superintendency of Banks and Financial Institutions of Chile, I would like to welcome you to the 19th International Conference for Banking Supervisors.

First of all, I would like to thank the staff of both the Superintendency and the Bank for International Settlements for organizing this event and I would also like to thank the Basel Committee on Banking Supervision, especially for the leadership and work of Chairman Stefan Ingves, Secretary General Bill Coen, and Deputy Secretary Karl Cordewener.

I also want to thank our local authorities, Mr. Rodrigo Vergara, the Governor of the Central Bank of Chile, Mr. Alejandro Micco, the Undersecretary of Finance, and all of the local and foreign banking authorities and banking supervisors attending today. We are extremely happy you were able to join us and thank you for traveling so far for this special occasion.

This week is a very important one for the Basel Committee and the international community of banking supervisors and central bankers. It represents the closing of a cycle of post crisis reforms that began after 2008 and led to the development of Basel III in 2010. This week the Basel Committee's goal was to make great progress on a number of outstanding issues related to Basel III, which were aimed in large part at reducing variability in risk-weighted assets without materially increasing capital requirements. The Committee addressed this issue by adapting the standard and internal ratings based approaches to credit risk, the operational risk framework, the leverage ratio framework, and an aggregate capital "output" floor. The commitment to finalizing these reforms by the end of this year was already communicated to the G20 countries and these reforms will be submitted to the Governors and Heads of Supervision in January 2017 for their approval.

At the same time, Chile is also pushing the agenda forward towards Basel III reforms. Together with the Ministry of Finance, we currently have drafted a new banking law that is ready to be sent to our Congress for approval, and one of the largest changes in this law is the adoption of Basel III requirements with some specific adaptations to local market characteristics. The reason is that currently Chile has an incomplete version of Basel I in place. That being said, we fortunately have not faced a banking crisis in the country since the beginning of the 1980s and were largely unscathed in the 2008-09 financial crisis. This was in part due to our focus on intrusive supervision and our generally conservative regulations. However, we view the inclusion of Basel III international capital norms as an important step for Chile to advance in banking stability and they are key to Chile's future as a player in the international financial arena.

While the finalizing of the post-crisis reforms is very important for global financial stability, past events have taught us that our work is by no means done and we cannot rest here. While this cycle is closing, surely a new cycle is beginning. Ever-varying economic conditions, new products and technologies, increased global financial interdependence, and growing pressure by consumers and investors mean that we need to be vigilant and pro-active.

Taking a step back, we can all remember the financial crisis of 2008-2009 vividly. The original good intention of increasing home ownership possibilities to a broader market of creditors led to: 1) lower lending requirements; 2) investors making overly daring or uninformed real estate purchases; 3) increased use of variable interest rate loans; and 4) banks began dealing in creative and largely unregulated derivative product markets related to the subprime mortgage boom. All the while, most banks appeared to be in compliance with capital requirements.

The rest of the story you know well: bank failures, large losses in economic output, slow recoveries, slowdown in investment, lower capital stock, lower worker productivity, sovereign debt crisis in some countries, increased unemployment, significant outlays of taxpayer money to rescue banks, etc., etc.

Just to give an idea of the magnitude of this crisis, according to a study by the IMF and I quote "world per capita output, which typically expands by about 2.2 percent annually, contracted by 1.8 percent in 2009, the largest contraction the global economy experienced since World War II". In the same study, conducted 5 years after the crisis, the IMF estimated that global unemployment increased by 30 million people due to the crisis.

The economic crisis of 2008-2009 was a failure by all means: a failure by the banks in taking excessive risk, a failure by banking supervisors in preventing excessive risk taking and a failure by rating agencies in accurately assessing risk. The last economic crisis was not averted by the capital accords and early warning signs were not detected.

The fallout of this crisis has not only been economic. Our fellow citizens have become distrustful of both the banking sector and their public institutions.

For instance, Edelman, a large global communications and marketing firm, conducts an annual survey called the Trust Barometer which surveys more than 33,000 people in 28 countries and assesses citizens' level of trust in different industries. Not too surprisingly, of all the industries mentioned, the respondents had the lowest trust in the financial services sector. Additionally, the survey showed that even lower than the trust respondents had in companies, was their trust in their governments. Governments were ranked last after non-profits, companies and the media.

Therefore, part of our work as central bankers and banking supervisors is not only trying to ensure the stability of the financial system, but also helping the public by strengthening the trust and credibility of regulatory forums and institutions.

In this regard, we have to understand the key areas that require additional effort in order to assure a resilient and sustainable banking system.

One of the first things we learned from the most recent crisis is that the problems may have been averted or lessened if more borrowers were aware of the risks of over-indebtedness and variable interest rate loans. For instance, reducing information asymmetries through active transparency and financial education is important for the consumer to make informed decisions.

Just to give you an idea, in a 2012 study by the OECD taken with survey data from 14 countries across 4 continents, the need for increased financial education was made evident. In 6 of the 14 countries surveyed less than half of their respondents had high levels of financial literacy and no country had more than 70% of its respondents with a high score. Financial behavior scores had even lower results. This low level of financial education represents an important risk that need to be addressed going forward and by addressing this risk, we will increase financial stability.

Second, we have learned about the importance of increasing transparency. This has been addressed in the modifications to pillar three of the Basel III accord, as banks will be required to explain how they calculate regulatory capital ratios and must disclose off-balance sheet exposures and securitizations. This information is vital for banking supervisors, rating agencies and investors in order to properly assess a bank's risk and in order to make informed decisions, making market discipline effective. We must continue to look for ways to increase transparency and hold banks accountable.

Additionally, we must focus our efforts on increasing the effectiveness of our banking supervision. Supervision should be intrusive and we should know the banks inside and out. We must understand their models, their processes, and the risks they are taking. We must also have sufficient resources and the necessary authority in order to carry out effective supervision and be empowered legally to act when necessary. We will need to improve our ability to perform consolidated analysis and to understand the risks that lay beyond the banks' balance sheets and how these risks could spill over. While Basel III addresses many of these issues, each country will have to work on the ground to make sure their supervisory body is effective and has the mandate, knowledge, and tools they require to perform their job.

In a 2010 report by the IMF, the results of the Financial Sector Assessment Program (FSAP) and the assessment of countries' compliance with Basel core principles of banking supervision are extremely relevant. In this assessments conducted in 24 countries, the biggest areas of weakness found were consolidated supervision, operational independence, powers to take corrective action and comprehensive risk management. These are areas where we will need to focus on an individual country level to improve the stability of our banking systems.

Finally, as part of the additional efforts we need to make going forward, we have to review the impacts of Basel III and continually adjust standards to minimize negative impacts or unintended consequences of these reforms. We need to be especially aware of the impact of these reforms on emerging market economies, as some additional adjustments may be necessary for these markets that take into account the unique characteristics of these economies and the need for economic growth and development in a stable and resilient banking environment.

Many of these issues have been discussed in the context of the Basel committee meetings and will also be discussed in the next two days as part of the International Conference of Banking Supervisors.

This week presents an opportunity to advance as an international community towards a stronger and more stable banking system, increasing consumer and investor confidence, and we need to remember that we cannot rest and must continue to work to improve banking supervision in our own countries, to understand the changing economic conditions in the international markets, and to be proactive in our approach as new threats will surely appear.

Our work in some ways has just begun…