Superintendencia de Bancos e Instituciones Financieras Chile

Regulatory Reform Agenda: **Did 2009 foresee 2017?**

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Agenda

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Is Basel III enough for EMDEs financial stability?

Basel III for EMDEs

Final thoughts

What do we know about systemic banking crises

Banking crises outcomes, 1970-2011
(2012) Laeven & Valencia, IMF WP/12/163

Country	Output loss	Increase in debt	Monetary expansion	Fiscal cost	Fiscal cost	Duration	Peak liquidity	Liquidity support	Peak NPLs
	Medians								
	In percent of GDP				In percent of financial system	In years	In percent of deposits and foreign liabilities		In percent of total loans
All	23.0	12.1	1.7	6.8	12.7	2.0	20.1	9.6	25.0
Advanced	32.9	21.4	8.3	3.8	2.1	3.0	11.5	5.7	4.0
Emerging	26.0	9.1	1.3	10.0	21.4	2.0	22.3	11.1	30.0
Developing	1.6	10.9	1.2	10.0	18.3	1.0	22.6	12.3	37.5

Emerging markets have been particularly hard hit by global financial crises

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Full-fledged Basel III requires a minimum prudential framework in place

Some EMDEs priorities

·Loan loss reserves regulation and supervision

·Consolidated supervision

·Risk mitigation of partially dollarized economies

·Risk-based supervision

·Limits to risk concentration (currency and economics groups)

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Full-fledged Basel III requires a minimum prudential framework in place

In addition, Basel III alone would not have prevented the 2008 crisis

- Strong corporate governance in banks
- Effective rating agencies and external auditors role
- Intrusive supervision
- Key role of multilaterals monitoring

In addition, EMDEs have idiosyncratic factors which pose unique financial stability risks

Macroeconomic Risks

Increased vulnerability due to:

- Political risk
- Higher social needs

Foreign exchange risks

- Some markets offer limited hedging of currency mismatches

Markets

- Relatively smaller, more concentrated markets; less developed capital markets/greater dependency on banks
- Informal economy (shadow banking)

Institutions

- Less developed legal/institutional frameworks
- Limited resources for regulatory supervision

Microeconomic Risks

Firm Level Risks:

- Family-owned conglomerates with bank and real economy companies (lack of consolidated supervision)
- Less infrastructure development (including IT/cybersecurity infrastructure)

G20 solution for the last subprime crises: Basel III standards. However, Basel III designed considering averages across BCBS member countries, with EMDEs playing only a minor role

EMDEs must be aware of their financial systems' features and limitations. Basel III is only one of many issues that need to be addressed

New Standard Approach (SA) models are not adequate for most EMDEs

Emerging markets have a different size scale → Risk factors do not adequately categorize assets → SA Models do not lead to increased risk sensitivity for EMDE markets

SA Credit Risk: EMDE corporates adversely impacted as companies are smaller and fewer have external classifications → RW generally higher for SMEs* and unrated companies

SA Operational Risk: for example: 80% of Chilean Banks would be in the lowest bucket

Basel III is also significantly complex in comparison to Basel I standards→ implementation/infrastructure and monitoring may not be viable in the short term for EMDEs due to lack of resources

*less than 50 million euros in annual sales

Basel III liquidity standards assume conditions hard to reach in some EMDEs

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In some markets there are structural limitations

- It may be impossible for some banks to raise significant funding via retail deposits, as retail market may be saturated and too small

High Quality Liquid Assets (HQLA) may have a limited offer or EMDE local markets may not be deep enough

Sovereign bond issuances and primary spreads, by region

Region	Spread (bps)		Size of issuance (%GDP)		#issuances	
	Mean	St.Dev.	Mean	St. Dev.	Sample	Overall
Asia and Pacific	341.5	91.0	3.05	4.20	10	12
Europe and Central Asia	255.4	181.9	2.41	1.83	106	121
Latin America and Caribean	343.6	177.9	2.20	2.62	85	98
Middle East and North Africa	192.0	102.7	1.37	0.81	11	13
Sub-Sahara Africa	458.3	107.3	3.76	2.65	20	22
Whole sample	305.9	180.7	2.43	2.36	232	267

Notes: Data refer to annual data for 105 emerging markets and developing countries over the period 1995-2014
Source: http://www.sciencedirect.com/science/article/pii/S1879933716300483

EMDEs face an important dilemma

Basel III compliance allows full integration into international financial community

However, Basel III does not fit to every EMDEs

The Chilean Case

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WEF Financial Market Development Index Chile's Ranking out of 138	
Financial Market Development Index	23
Soundness of Banks	9
Financing through local equity	23
Regulation of Securities Exchanges	14

Chile is still in Basel I

But we have been leveraging on:

- Enhancing intrusive supervision
- Supervising banks' risk management
- Designing comprehensive prudential regulations
- Strengthening corporate governance of banks

Final thoughts

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Basel III is not enough for financial stability in EMDEs... nor in developed economies
→ Progress is needed in other areas as well

Basel III standards could lead to an over estimation of risk weightings in EMDEs
→ transfer cost to real economy
→ impacting competiveness of EMDEs and long term development

Basel III compliance in EMDEs should consider idiosyncratic features

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