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LAW 21,130 TO MODERNIZE CHILEAN BANKING LEGISLATION IS ENACTED

Last Saturday, January 12, and after a year and a half of legislative discussion, the law that modernizes the banking legislation contained in the General Banking Law ("LGB"), was enacted as Law of the Republic, after the control of the Constitutional Court was fulfilled.

The Law incorporates new banking capital and reserves requirements, in accordance with the Basel III guidelines, in addition to modernizing the corporate governance and the powers of the banking regulator and the bank resolution mechanisms.

In this way, the Law consists of the following main axes:

Transfer of all faculties from the Superintendence of Banks and Financial Institutions ("SBIF") to the Commission for the Financial Market ("CMF")

All institutions currently supervised by the SBIF, namely, banks, issuers and operators of credit or payment cards with provision of funds, among others, will be subject to the supervision of the CMF, created in 2017 by Law 21,000. However, in order to avoid regulatory duplication, all the rules that enshrine the powers of SBIF will be repealed from LGB and contained in Law 21,000, as amended. With the incorporation of the CMF, the figure of a Superintendent is eliminated, being replaced by a Council, composed of 4 commissioners and a president.

New capital requirements

Following the recommendations of Basel III, the current regulations on capital requirements and risk management are updated, increasing the capital requirements from a quantitative and qualitative point of view, in order to be consistent with the risks currently associated with banking activity.

• Minimum capital requirements: First, the minimum required level of effective equity is maintained at 8% of risk-weighted assets. The Tier

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1 minimum capital requirement, corresponding to the composition of assets with the best loss-absorbency capacity, increases from 4.5% to 6% of risk-weighted assets. This increase is achieved by incorporating an additional Tier 1 capital requirement equivalent to 1.5% of risk-weighted assets. As for the additional Tier 1 capital, it is established that it may be made up of preferred shares or bonds with no maturity ("perpetual"). Second, the bill fills an important gap in current legislation, incorporating a conservation buffer of 2.5% of risk-weighted assets above the established minimum, which must be made up of basic capital. Likewise, progressive restrictions are established on the bank's profit distribution when this requirement is not met.

Complementing this conservation buffer, the bill incorporates an additional basic capital requirement of a countercyclical nature, which will be generally applicable to all banking companies incorporated or authorized to operate in the country, by means of which it seeks to mitigate the incubation of systemic risks. The Central Bank of Chile, in consideration of the phase of the economic cycle, may set such reserve at a percentage that may amount up to 2.5% of the risk-weighted assets, subject to the consent of the CMF.

Additionally, the CMF is granted the faculty to require basic capital or additional effective equity for up to 4% of the risk-weighted assets in those cases in which the legal requirements are not sufficient to cover the specific risks faced by a determined entity.

• Role of the regulator in the weighting of assets to determine the required capital: the CMF will have the faculty to determine the risk weighting of assets, through the implementation of standardized methodologies that must have the consent of the Board of the Central Bank of Chile. Banks can also implement their own methodologies for the determination of risk-weighted assets.
• Recognition of systemically important institutions: The concept of meaningful participation is abandoned and the concept of systemically important banks is explicitly incorporated. For that purpose, in addition to retaining the faculty to authorize or reject mergers or other forms of bank concentration operations, the CMF will establish the elements to be taken into consideration to determine the classification of an institution as systemically important, such as market participation and interconnection with other financial entities, among others.
• Distribution of dividends: Current legislation establishes limitations

to the distribution of dividends to the shareholders of a bank in those cases in which part of the capital has been lost, as long as it does not recover. The Law introduces additional limitations in the event that the different capital requirements are not met, seeking to protect the bank's capacity to absorb eventual losses, preventing its resources are no longer available for the payment of obligations with depositors and other creditors a result of a profits sharing.

Intervention mechanisms for troubled banks and crisis management

The Law considers the improvement of the available mechanisms to deal with troubled banks before they become insolvent, whose key objectives are the protection of depositors and taxpayers, the payment system and the financial stability.

• Incorporation of an early regularization plan: Obligation for banks to report to the CMF if they find themselves in a situation in which they could face financial problems or in aspects of their administration. Therefore, banks will be obliged to submit to the CMF a regularization plan containing measures designed both to stabilize them and to ensure their normal functioning. Additionally, the CMF will have the authority to impose certain prohibitions or limitations upon the respective bank, relating to the granting of credits, celebration of certain acts and agreements, etc.
• Capitalization by the financial system and preventive capitalization: Both tools become part of the regularization plan as specific measures that can be adopted to normalize the bank's situation. With regard to capitalization by the financial system, the minimum term for these loans is increased from two to three years. For its part, in relation to preventive capitalization, the period for holding the shareholders' meeting required for approval of the respective capital increase is shortened.
• Appointment of delegated inspector or provisional administrator: This figure is moved into Title XIV of the GBL, which contains the rules on the regularization of banks so that it acts as an intervention formula that allows the solution of a bank's financial problems, when these reach a state of progress greater than those that trigger the obligation to present the regularization plan. That is why this power of designation, when acting in the context of early regularization, can only be exercised once the respective plan has failed.
• Elimination of the creditors' agreement: This was an institution based on the general preventive insolvency tools contained in the old

bankruptcy law, and whose objective is to prevent the forced liquidation of the bank. The Law eliminates it and seeks to focus on other measures that allow to reduce, in a more efficient and effective way, the costs that the liquidation of a bank imposes on depositors and the State.

Other modifications

• The project eliminates the coverage limit of 90% of the obligations and increases from 120 to 200 Unidades de Fomento per year (@ US 8,200), the limit of the obligations in the same bank that will be covered by the guarantee for term deposits. Furthermore, the total amount of the benefit for the same person in the entire system is increased to 400 Unidades de Fomento per year.
• Greater requirements are imposed on bank directors, since persons who incur in serious conduct that would have affected the stability of the institution in which they worked, or the security of depositors, in the case of a bank, may not be elected as directors.
• The legal protection of CMF staff is extended to the interim administrator, the delegated inspector and the liquidator regulated in the LGB.
• The CMF was assigned the task of evaluating the effectiveness of the controls that banks implement in order to avoid the use of the financial system and other sectors of economic activity to commit crimes. In such cases, the CMF must inform the FAU accordingly and provide it with any background information that might be useful in initiating and carrying out an investigation into such situations.
• With regard to current accounts held in the name of a minor, it is established that the administration shall be of the person who signs the respective account opening, who may be an ascendant in a straight line up to the second degree of consanguinity or who has personal care of the child or adolescent, regardless of who has parental authority. The aim is to avoid the risk that the resources contained in the account may be withdrawn against the will and to the detriment of the depositor.
• Lastly, improvements were added to the remuneration of the CMF commissioners, to the operations to which savings and credit cooperatives are entitled, and to the risk ratings of banks.

In this way and with this new Law, the aim is to reduce the risks of a possible liability to the State in the event of future economic crises, given that the banks will have to have a greater capital base in order

to face situations of financial instability and to positioning Chile with the highest standards of international banking practices.

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