GLI GLOBAL LEGAL INSIGHTS

Banking Regulation

2022

Ninth Edition

Contributing Editors: **Peter Ch. Hsu & Daniel Flühmann**

glg global legal group

CONTENTS

Chile

Diego Peralta, Fernando Noriega & Alejandro Toro
Carey

Introduction

Three years have passed since the most pivotal reform to the Chilean Banking Law came into force in January 2019. Although the implementation of said reform was delayed because of the financial crisis caused by the COVID-19 pandemic, the progressive changes laid out in both the law and the adjusted schedule established by the Financial Market Commission (*Comisión para el Mercado Financiero*, or "**CMF**") are steadily being implemented and considered by relevant banks. An example of such adjustments is Law No. 21,384, approved in October of last year, through which the continued capitalisation of Banco del Estado de Chile, a systemic, state-owned bank, was approved in order to fulfil increasing capital requirements scheduled until December 2025, to comply with Basel III requirements. In a general sense, the main purpose of the now three-year-old law was to update Chile's Banking Law and relevant regulation to be on a par with newly developed protocols, regulations and financial standards set forth by global financial participants. The three key purposes of this law include: (i) consolidating all financial regulatory functions in a single entity, the previously mentioned CMF, in order to enhance corporate governance as well as its regulatory authority and oversight; (ii) bolstering the capital requirements of the banking system by adapting the existing regulations to the Basel III standards; and (iii) improving the mechanisms to prevent insolvency scenarios and to deal with institutions facing financial problems. These changes, along with some recent legislation, should improve the Chilean banking system and serve as a pillar to maintain the country's status as one of the best and more reliable investment destinations in the region. In addition, given the progressive and delayed nature of these changes, the impact on the general operation and functioning of the market and its members should be minor.

Regulatory architecture: Overview of banking regulators and key regulations

Regulators and key regulations

The Central Bank of Chile ("**Central Bank**") is an autonomous entity, whose main purpose is to safeguard currency stability and proper functioning of internal and external payments. In the exercise of its constitutional mandate, it is vested broad regulatory powers regarding foreign exchange transactions, and monetary, lending and financing matters.

Furthermore, working closely with the Central Bank and supervising proper fulfilment of some of its regulations, the CMF is the main regulator of the banking industry.

The CMF was incorporated on February 23, 2017 by Law No. 21,000, and on June 1, 2019 it replaced and assumed, among others, the authorities of the former banking regulator: the Superintendence of Banks and Financial Institutions.

The CMF's main mission (which is the basis for its regulations) is to supervise proper operation, development and stability of the Chilean financial market (including banks), and to ensure that entities under its supervision comply with the laws, rules, bylaws and applicable regulations.

The Central Bank's main mission is to oversee the currency's stability and proper operation of internal and external payments.

The Chilean banking system is based on the General Banking Act of 1997. The General Banking Act was materially amended in January 2019, introducing several innovations on supervision, and adjusting banks' capital requirements and other obligations to the standards set out in Basel III.

Since banks must be incorporated as special corporations, Law No. 18,046 (the Corporations Act) also applies to banks (with certain exceptions), mainly regarding corporate governance.

In addition to the above, both regulators have enacted several regulations, of which the most important are:

- CMF: Updated Compilation of Rules (*Recopilación Actualizada de Normas*), mainly issued by its predecessor (i.e. the Superintendence of Banks and Financial Institutions).
- Central Bank: Compendium of Financial Regulations and Compendium of Foreign Exchange Regulations.

Restrictions on the activities of banks

Only entities authorised under the General Banking Act can perform core banking activities in Chile. Financial activities that are not regarded as core banking activities are permitted without a banking licence (for example, lending, financial advice (not intermediation) and derivative transactions). However, financial advice has been increasingly regulated, as per Law No. 21,314, later referenced.

Banking services are understood generally as receiving, in a customary manner, money or funds from the public, to use it to grant loans, discount documents, make investments and perform financial intermediation, while obtaining revenue out of this money and performing related activities permitted by law.

Article 69 of the General Banking Act lists the operations that banks can engage in, which include (among others):

1. Deposit-taking and accepting other repayable funds from the public.
2. Issuing bonds or debentures.
3. Lending (in its various forms).
4. Money brokerage, intermediation or brokerage of trading and debt instruments.
5. Issuing letters of credit and performance bonds.
6. Entering into derivative transactions, money collection, payment and transmission services.
7. Trading money market instruments, foreign exchange, financial futures and options, exchange and interest instruments.
8. Acquisition, sale and trading of debt or fixed-income instruments, and providing underwriting services related to the issue and placement of such securities, and acting as a placement agent and underwriter relating to offerings of newly issued shares of the stock of public corporations.

Under Article 70 *et seq*. of the General Banking Act, banks are authorised to incorporate subsidiaries to perform the following operations or activities:

- Stockbrokerage, broker-dealers, management of mutual funds, investment funds or foreign capital investment funds, securitisation, and insurance brokerage.

- Leasing, factoring, financial advice, custody and transport of securities services, credit collection services and other financial services that the CMF, by a general ruling, deems ancillary to the banking business. Banks are also authorised to set up subsidiaries in the real estate business and managers of housing funds.

Additionally, banks are allowed, with prior CMF authorisation, to be shareholders or participate in banking support companies (*sociedades de apoyo al giro bancario*). These are companies whose sole objective is to provide services to facilitate compliance with bank purposes, and/or carry out banking activity other than raising money. Once the CMF has granted authorisation to a bank to incorporate or participate in a banking support company, the CMF cannot deny the same authorisation to another bank.

Recent regulatory themes and key regulatory developments

In line with the progressive implementation of Basel III standards and criteria, one of the most important landmarks of the year occurred in March, when the CMF appointed all banks considered to be Systemically Important Banks in Chile, according to the benchmarks defined in said legislation, based on the bank's size, interconnection, substitution of financial services and complexity of business model or structure. The included banks are the following: Banco de Chile; Banco de Crédito e Inversiones; Banco del Estado de Chile; Banco Santander-Chile; Itaú Corpbanca; and Scotiabank Chile. Each one of these banks will have to meet the increased capital requirements, which will be incremented 25% yearly up to their limit in December 2025. Steps to meet these requirements have already been taken, as highlighted previously in the case of state-owned bank, Banco del Estado de Chile.

Furthermore, during 2021, having already made some adjustments and taken measures to adapt to the COVID-19 situation during the previous year, legislative and regulatory efforts focused on the following: (i) changes meant to enable certain financial transactions and make them easy to execute; (ii) furthering requirements for public securities issuers and public incorporated companies; (iii) strengthening consumer protection in financial and credit operations; and (iv) proposed legislation to regulate and give an overall structure to Fintech platforms and services.

i. Regarding financial operations and certain contracts, two key changes are worth focusing on. Firstly, the amendments made by the CMF to Chapter 2-2 of its Updated Regulations Compendium, allowing banks to offer checkless checking accounts to the general public. These amendments allow for accounts to be opened via remote contracting, identity checks and authentication, as well as allowing the opening of checking accounts for individuals and entities with no Chilean domicile or residence, requiring the registration of a domicile abroad, or the appointment of an attorney in Chile, instead of a local domicile. Finally, to open said accounts, no local tax identification number is needed.

   Additionally, through Law No. 21,299, some changes were made to mortgage loans, allowing banks and other lenders to grant postponement credits to the borrowers. These credits can be repaid after or during the mortgage loans with interest rates capped at the mortgage loan interest. Together with these credits, lenders can offer the execution of a postponement mandate, through which the lender arranges the payment of the pending quotas, with the credit money, to facilitate the operation.

ii. On the topic of public securities issuers, transparency and accountability, Law No. 21,314 established new disclosure requirements for public securities issuers, such as public notices at least 30 days prior to the publishing of financial reports, together with a prohibition to related parties to execute any transaction over the issued securities, as

well as the obligation to publish corporate policies designed to impede inside trading. Other measures include the strengthening of certain criminal sentences in cases of market manipulation and disclosure of false information. On a corporate level, the prerogative for the CMF to more precisely define the conditions for board directors to be considered independent was introduced, in addition to rules to avoid conflicts of interest on boards.

Also, following the implementation of the CMF's General Rule No. 461, the content requirements for annual reports of certain companies were modified. The Social Responsibility and Sustainable Development section was eliminated, and in exchange companies must report on Environment, Sustainability and Governance factors in all sections of their annual reports, starting in fiscal year 2022, in addition to an index indicating the international reporting standards taken as a reference.

iii. Other changes implemented by Law No. 21,314 relate to consumer rights and clarity regarding interest rates and fees in Law No. 18,010, the Credit Operations Law. Article 9 of the bill prohibits the capitalisation of moratory interests, as well as establishing more clearly that interest accrues only on outstanding principal and not on repaid principal. Lastly, the bill authorises the CMF to issue a general rule establishing the requirements, rules and conditions that fees charged by Supervised Entities in money credit operations must fulfil in order to not be considered interest.

iv. Finally, legislation is currently being discussed in order to provide a certain basic framework for Fintech companies, such as minimum capital, disclosure requirements, minimal contractual conditions, etc. (more information is available at https://www.carey.cl/en/chilean-executive-presents-fintech-law-bill/).

Bank governance and internal controls

Governance and risk management

Banks in Chile must be incorporated as corporations, following the specific requirements in the General Banking Act and the Corporations Act. Every bank in Chile must be a special corporation (*sociedad anónima especial*) under the specific requirements of the General Banking Act.

Under the General Banking Act, the main body is the board of directors, entrusted with the direction of the bank and proper risk management. Directors cannot be both directors and employees of the bank.

The internal organisation of banks is mostly carried out by the board of directors, which must provide necessary governance of the banking entity through the senior management, committees and policies.

All directors must fulfil several honourability and solvency requirements to be appointed as such. These requirements include: not being convicted of serious crimes described in the General Banking Act; not being sanctioned by infringements to market regulations; and not being involved in serious conduct that may risk the bank's stability or the safety of its depositors. It is forbidden by law to set special requirements based on nationality or profession in order to be appointed as bank director, and notwithstanding the fulfilment of the abovementioned conditions, there are neither specific approvals from regulators nor certifications required in this regard.

The board must adopt necessary measures to remain informed of the management and general situation of the bank. The board must have at least five members and a maximum of 11 and must always be composed of an odd number of directors. The directors remain in office for three years and can be re-elected. The board must meet once a month.

Sound internal governance is measured in accordance with the CMF's Guide to the Banking Supervision Process. Pursuant to this Guide, the main objective of banking supervision is assessing the quality of risk management used by banks. This approach, according to the CMF, corresponds to the Supervision Based on Risks ("**SBR**") approach, which reflects the maturity of the banking industry in Chile.

According to the Guide to the Banking Supervision Process, the SBR approach is based on the following pillars that set standards for choosing persons with control functions, based on the levels of technical knowledge required:

- Government and supervision. The board of directors and the banks' committees must strongly promote the risk policy, requiring and receiving information to correctly assess the risks and apply agreements reached.
- Risk management framework. A clear demarcation of the policies and procedures decided by the board, which must be consistent with the bank's volume of business.
- Measurement and continuous monitoring of risk. This in turn includes:
  - risk quantification: review and evaluation of the bank's risk assessment methodologies, to determine whether these are duly documented, updated and consistent with the business depth and volume;
  - timely follow-up of risk: early warnings (constantly reviewed under established protocols) for risk detection and boundaries that limit the risks, with necessary analysis and bases for it;
  - risk information system: involving a management report structure, this must address the needs of the bank's different levels; and
  - independent review: internal independent and qualified auditing, with adequate depth and coverage. Its analysis approach should consider risk, compliance with internal policies and regulations, obtaining a recognised and validated opinion by different levels of the bank, and appropriate technological tools for developing their work.

Internal control

Chapter 1-13 of the Updated Compilation of Rules of the CMF defines corporate governance as a set of institutional instances, guidelines and practices that influence the bank's decision-making process, contributing, among other things, to the sustainable creation of value, within a framework of transparency and adequate management and control of risk. It classifies the banks according to their organisational rules as level A, B or C, with A being the most compliant with management proceedings.

The following aspects, among others, are considered by the CMF as inherent to good corporate governance and criteria for evaluating a bank's management:

i. Establishing strategic objectives, corporate values, lines of responsibility, monitoring and accountability.
ii. Verifying the performance of senior management and compliance with policies established by the board of directors.
iii. Promoting sound internal controls and effective audit.
iv. Establishing proper disclosure mechanisms.

Outsourcing of functions

Banks in Chile are allowed to outsource certain functions, provided the requirements set forth by the CMF are complied with. Chapter 20-7 of the Updated Compilation of Rules of the CMF contains the rules applicable to outsourcing of functions. Certain activities of banks may under no circumstances be outsourced, such as: those related to raising funds from third parties outside the bank's offices; the opening of bank accounts; and functions related to internal controls of the banks.

Banks are required to assess all the risks associated with outsourcing functions and establish an outsourcing policy that appropriately addresses those risks, including a proper governance structure, a sound framework of applicable regulations and procedures, and an environment that allows the identification, control, mitigation, monitoring and reporting of such risks.

Any outsourcing policy should consider, in general, the following elements: (i) general conditions approved by the board of directors regulating the activities or functions that may be outsourced; (ii) continuity of business; (iii) safety of the bank's own information and its clients; (iv) observance of banking secrecy; and (v) the political risk (*riesgo país*) of the country where the service provider is located (with banks not being allowed, except under certain exceptions, to outsource services to companies located in a country that does not have investment grade).

The abovementioned Chapter 20-7 also sets additional regulatory requirements applicable to the outsourcing of data processing services, and reinforced due diligence obligations when contracting cloud computing services.

Bank capital requirements

Following the recommendations of Basel III, the current regulations on capital requirements were updated by Law No. 21,130, which increased such requirements from both a quantitative and qualitative point of view to address the risks currently associated with banking activity. Main innovations in this regard can be summarised as follows:

1. **Capital requirement**. The minimum required level of effective equity is 8% of risk-weighted assets. The Tier 1 minimum capital requirement, corresponding to the composition of assets with the best loss-absorbing capacity, was increased 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. Additional Tier 1 capital can be made up of preferred shares or bonds with no maturity (perpetual).
2. **Conservation buffer**. A conservation buffer of 2.5% of risk-weighted assets above the established minimum must be set, which must be made up of basic capital.
3. **Additional basic capital**. Supplementing this conservation buffer, the law incorporates an additional basic capital requirement of a countercyclical nature, which will be generally applicable to all banking companies incorporated or authorised to operate in the country, by means of which it seeks to mitigate the development of systemic risks. The Central Bank, depending on the phase of the economic cycle, can set this reserve at up to 2.5% of risk-weighted assets, subject to the consent of the CMF.
4. **CMF authorities**. Additionally, the CMF is granted the authority to require basic capital or additional effective equity for up to 4% of risk-weighted assets in those cases in which the legal requirements are not sufficient to cover the specific risks faced by a determined entity.

Banking liquidity requirements

Article 35 No. 6 of Law No. 18,840, the organic constitutional law of the Central Bank, empowers it to enact regulations and set restrictions applicable to the relationships between active and passive banking activities.

Based on the above, the Central Bank enacted Chapter III.B.2.1 of its Compendium of Financial Regulations, which sets rules on management and measuring of banks' liquidity positions. Even though local banks solidly endured the global financial crisis, the Central Bank introduced this rule to prevent future liquidity shocks.

In this regulation, the Central Bank has established minimum standards and requirements that shall be observed by banks, with the purpose of maintaining an adequate liquidity position, in both local and foreign currency, and that allow banks to properly fulfil their payment obligations in both regular conditions and in exceptional stress scenarios whose occurrence can be considered plausible.

Chapter III.B.2.1 states that the board of directors is responsible for setting the bank's liquidity risk tolerance, understood as the liquidity risk level that the relevant bank is willing to assume as a result of both the risk/return assessment of its global policies, and the manner as to which such risks are managed. For these purposes, the board of directors must adopt, lead and oversee the implementation of a liquidity management policy (*Política de Administración de Liquidez*, or "**PAL**"). The bank's senior management is responsible for proposing to the board the PAL compatible with the nature, scale and complexity of the business and risk tolerance of the bank, and for enforcing and updating the PAL.

The PAL must contain stress tests, which must be performed at least quarterly, considering the structure of the bank's assets and liabilities, the scale and complexity of its operations, and possible effects on its cash flow and liquidity position. The PAL must also establish a formal contingency plan, setting the strategies to be adopted when facing a liquidity deficit in stress scenarios.

Under Chapter III.B.2.1 of the Central Bank's Compendium of Financial Regulations, the liquidity position is measured through the difference between expenses and income flows in and out of the balance sheet for a given period. This difference is called a term mismatch.

Banks must observe the following limits regarding term mismatches:

- The sum of all term mismatches for up to 30 days cannot exceed the basic capital.
- The same requirement must be met considering only flows in foreign currency.
- The sum of the term mismatches of up to 90 days cannot exceed twice the basic capital.
- Therefore, projected net cash outflows in 30 days cannot be higher than the equity capital of the bank, and projected net outflows in 90 days cannot surpass twice that amount.

The PAL shall be available at all times for CMF review and term mismatches, if any, must be reported by the bank to the CMF.

Note that due to the adverse effects caused by the COVID-19 pandemic, in 2020, the Central Bank's council introduced an amendment to these rules, by means of which it will be entitled to suspend or increase flexibility on the abovementioned limits, to the extent the term mismatches occurred during a national emergency or due to other serious exceptional cases.

Rules governing banks' relationships with their customers and other third parties

In their relationship with clients, the general rules applicable to each type of banking activity will apply. Therefore, banks need to follow the rules contained in Law No. 18,010 (the Money Lending Operations Act), which governs the lending business in Chile, setting out what is understood as a money-lending transaction, the rules governing accrual of interests and other matters (including a maximum interest rate (*interés máximo convencional*)), the Consumer Protection Act (Law No. 19,496), and the Data Protection Act. Regarding the maximum interest rate, it is important to highlight its connection with Law No. 21,314, previously examined, and the CMF's pending criteria for fees, as excluded fees would count towards the interest rate limit.

In addition, there are specific rules that govern the relationships of banks with their customers. Most of these specific rules are contained in sectorial regulations enacted by the

CMF, such as those regarding bank hours, bank accounts, leasing and factoring operations, other banking operations, issuance of subordinated loans, etc. Banks are also required to observe lending limit regulations when dealing with customers.

Anti-money laundering regulations are also applicable in the relationship between banks and their customers. In fact, banks need to follow Law No. 19,913 (the Anti-Money Laundering Act), which sets forth the general framework on anti-money laundering. In particular, banks are required to report to the Financial Analysis Unit (*Unidad de Análisis Financiero*):

1. "Suspicious transactions" they are aware of.
2. Cash transactions exceeding US$10,000, on a semi-annual basis.
3. Documents and antecedents required to examine a previously reported suspicious transaction, or one it has detected.

Law No. 20,393 extends to legal entities liability for criminal wrongdoings related to money laundering, financing of terrorism and bribery of civil servants (if such crimes are committed directly and immediately, in the legal entity's interest or for its benefit, by its owners or controllers).

The CMF requires banks, in addition to following the rules set forth in Law No. 19,913, to have specific anti-money laundering systems in place, which are based on the "know-your-customer" system. Chapter 1-14 of the Updated Compilation of Rules of the CMF lists the main features that every bank's "know-your-customer" system should contain.

Diego Peralta
Tel: +56 2 2928 2216 / Email: dperalta@carey.cl

Diego Peralta is a partner at Carey and co-head of the firm's Banking and Finance Group. His practice focuses on the creation and structuring of financial products and business financing, both from the lender and the borrower's perspective, on the purchases and sales of companies, on the issuance and placement of debt and equity securities in Chile or elsewhere, as well as on financial regulatory matters.

Mr. Peralta has been recognised as a leading lawyer by several prestigious international publications.

He is counsel and member of the Executive Committee of IABA, member of the Council of the Chilean Bar Association and of the Advisory Committee on Capital Markets to the Finance Minister. During 2015, he was also a member of the New Commerce Codification Commission for Chile and part of a working group that analysed a new General Banking Law in Chile.

He graduated from Universidad de Chile.

Fernando Noriega
Tel: +56 2 2928 2216 / Email: fnoriega@carey.cl

Fernando Noriega is a partner at Carey and is a member of the firm's Banking and Finance and Capital Markets Groups. His practice is focused on banking law, lending transactions, project financing, as well as issuance of debt instruments, capital markets and foreign investment.

He has been recognised in Banking and Finance by prestigious international publications such as *Chambers Latin America*, *The Legal 500* and *Leading Lawyers*.

During 2015–2016, he worked as a foreign associate at White & Case in New York.

He graduated *summa cum laude* from Universidad de Chile and holds an LL.M. in Banking Law and Financial Regulation from the London School of Economics and Political Science.

Alejandro Toro
Tel: +56 2 2928 2216 / Email: atoro@carey.cl

Alejandro Toro has been an associate at Carey since 2021 and is a member of the Banking and Finance Group. His practice is focused mainly on commercial, corporate, banking and financial law and advising local and foreign banks and financial institutions on local and foreign project financing.

He graduated from Pontificia Universidad Católica de Chile.

Carey

Isidora Goyenechea 2800, 43rd floor, Las Condes, Santiago, Chile
Tel: +56 2 2928 2200 / URL: www.carey.cl

www.globallegalinsights.com

Other titles in the **Global Legal Insights** series include:

AI, Machine Learning & Big Data
Blockchain & Cryptocurrency
Bribery & Corruption
Cartels
Corporate Tax
Employment & Labour Law
Energy
Fintech
Fund Finance
Initial Public Offerings
International Arbitration
Litigation & Dispute Resolution
Merger Control
Mergers & Acquisitions
Pricing & Reimbursement

GLI GLOBAL LEGAL INSIGHTS