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

**Raphael Bergoeing**

Superintendente de Bancos e Instituciones Financieras

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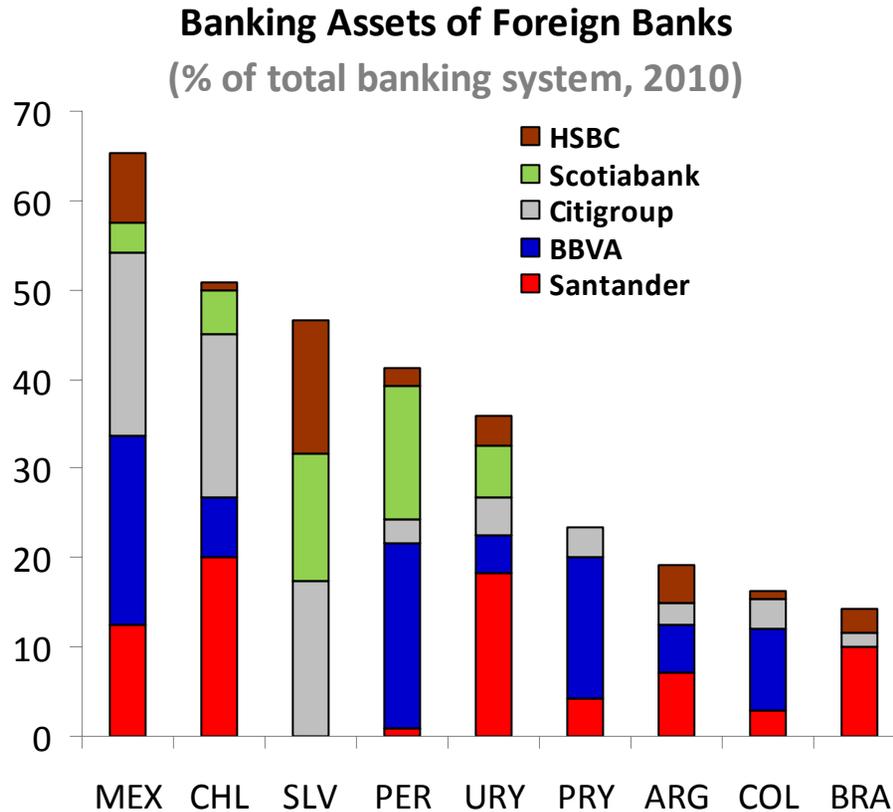
- Foreign banks in Chile matter
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- Doing the homework: sound policies in Chile
- Foreign banks in Chile: who cares?
- Some policy implications



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# Foreign banks in Chile 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

- o 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
- o Outside competition can potentially mitigate anti-competitive behaviors in a concentrated industry.
- o Transfers and spillovers of knowledge and know-how.

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

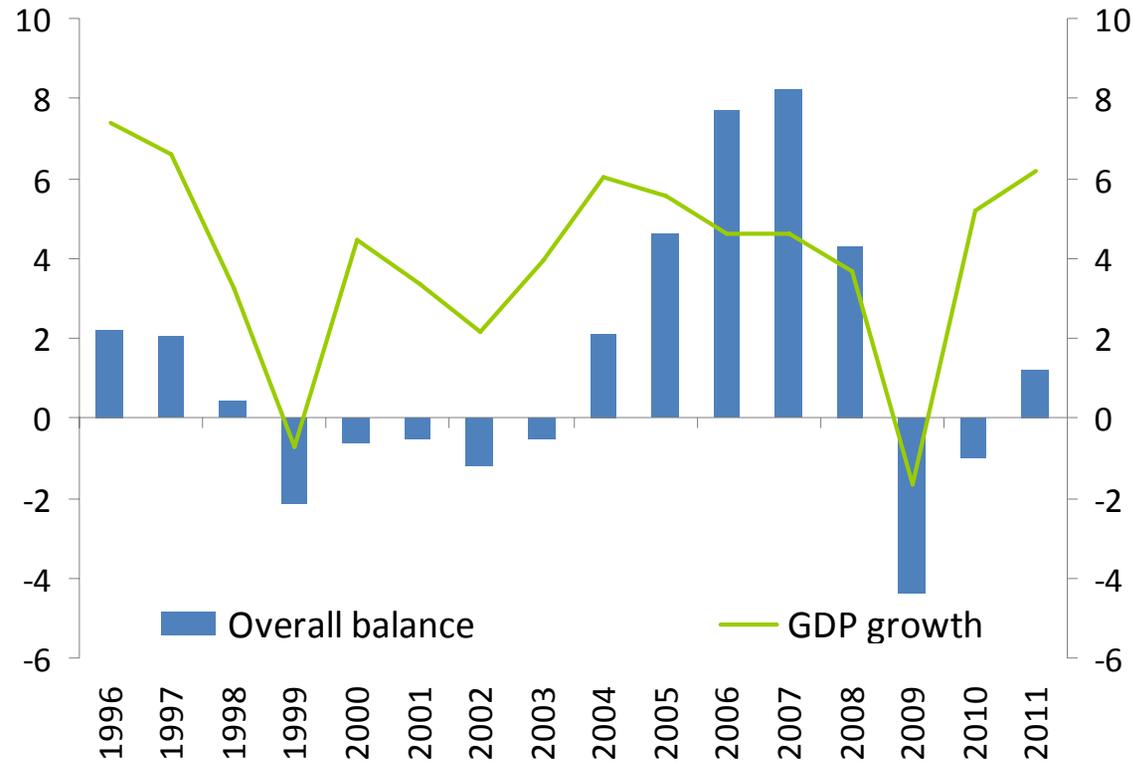


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# Doing the homework: sound policies in Chile

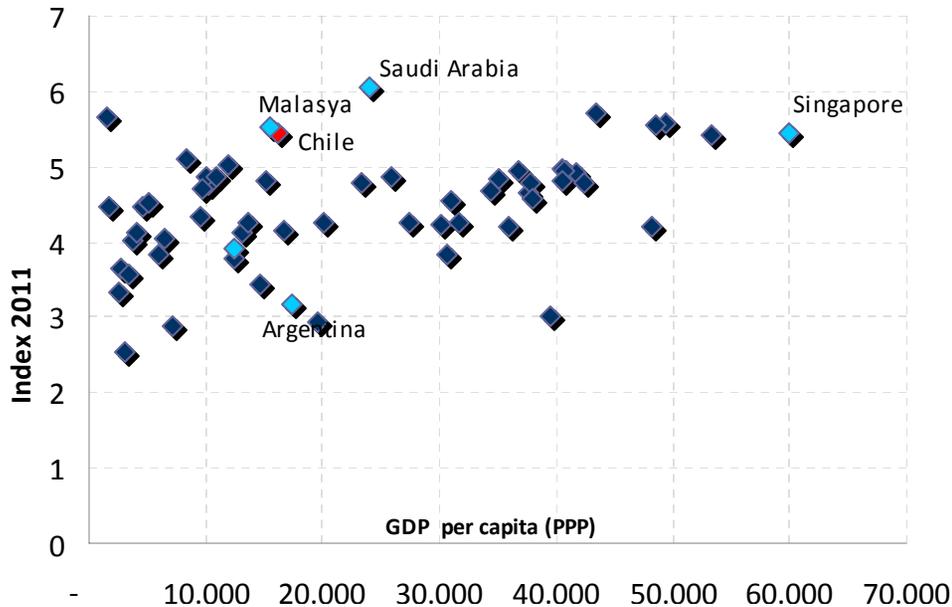
- A responsible and predictable fiscal (rule) policy (2001).
- An autonomous Central Bank (1989) with a explicit mandate (inflation and the payment system).
- A floating exchange rate regime (1999).
- Commercial and financial integration with foreign markets.
- A solid banking system, well regulated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

# Countercyclical fiscal policy

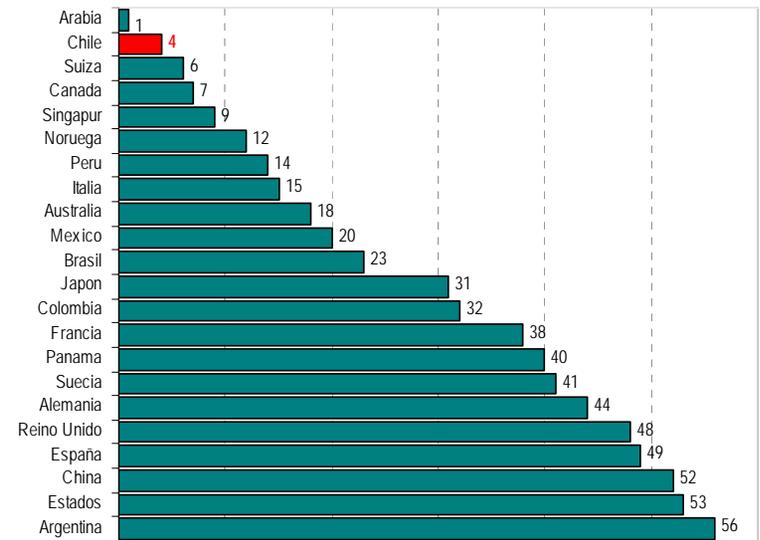


Source: From Central Bank of Chile and *Budget Office* data.

### Financial stability ranking (selected countries)



### Banking stability ranking (selected countries)



Source: World Economic Forum and IMF.

# And even though still in Basel I

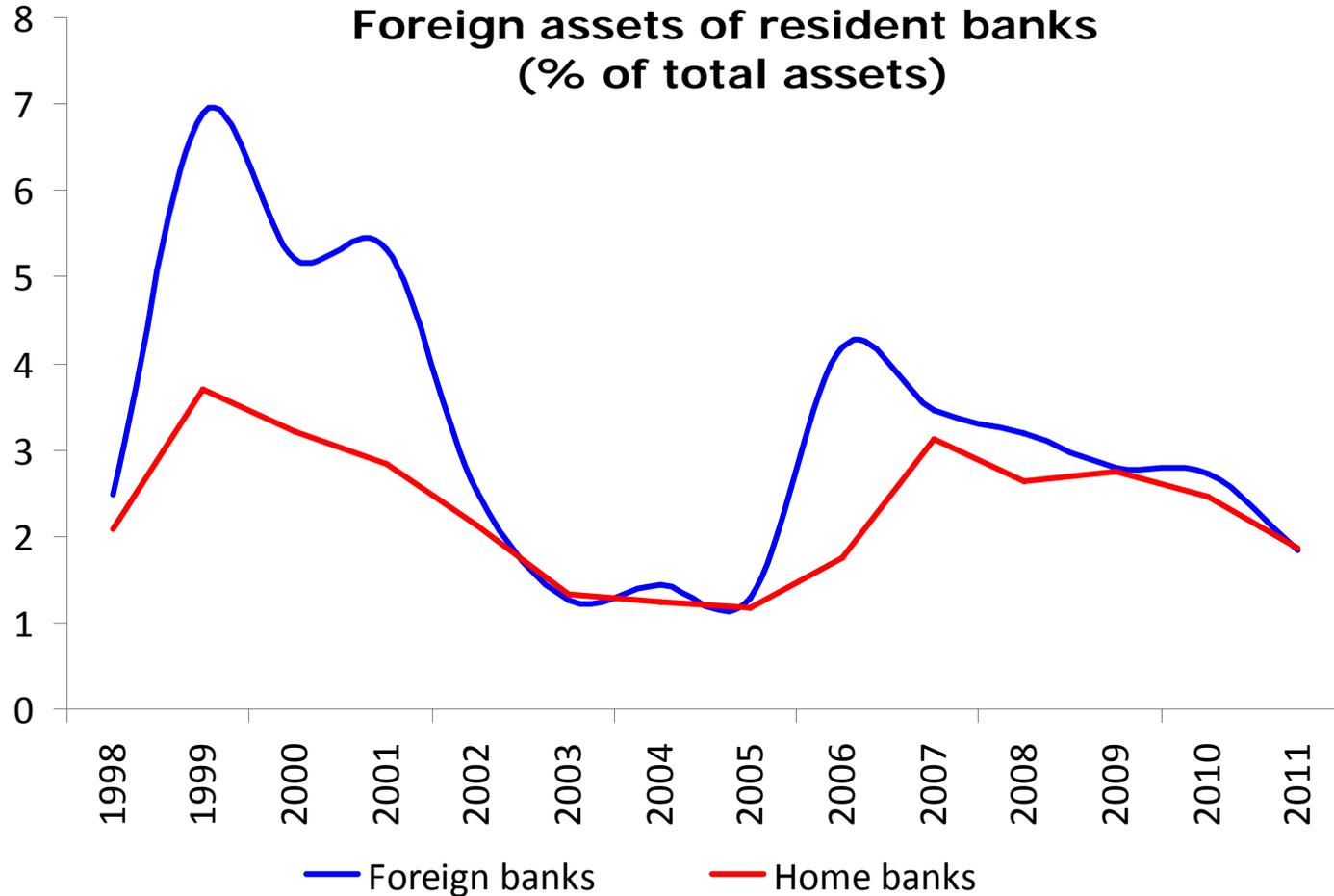
	<b>Basel I</b>	<b>Basel II</b>	<b>Basel III</b>
<b>Local banks</b>	100%	100%	83%
<b>Foreign banks</b>			
-Subsidiaries	100%	100%	86%
-Branches	100%	100%	100%

Source: SBIF.



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# Foreign banks in Chile: who cares?



Source: SBIF.

- o 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
- o No evidence that market penalized subsidiaries, in domestic or foreign funding costs.
- o 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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# Some policy implications

- A sound economic (macro and financial) environment attenuates the differences in behavior among local and foreign banks. **Still, cross-border banking supervision not trivial.**
  - Cross-border funding is highly volatile
  - Information (for instance, respect to funding with parent and other foreign subsidiaries or branches)
  - 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

- Macroprudential (and macro) policy greatly influences financial supervision.
  - Need for explicit coordination among economic authorities.
  - Minimum capital requirements (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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