



Toward Better Banking

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The Implementation of Basel II in LA

- The impact of implementing Basel II in LA:
 - Going from Basel I to Basel II would not require significant increase in capital
 - Effect on the cost of capital are limited
 - Increase pro-cyclicality and volatility, but operational risks could help
- However, LA's capital markets remain under developed:
 - Low penetration of Rating Agencies
 - Lack of adequate information
 - Need to strengthen regulation
- In any case, costs of implementing Basel II may be small due to the high presence of foreign banking in a concentrated system.



The Role of Foreign Banking

- New capital (FDI)
- Increase bank competition
- Modernization and improvement of efficiency
 - Improvement of management expertise
 - Quality of financial risk management, through the introduction of technological innovations and risk management
- Increase credit pro-cyclicality and volatility



The Role of Foreign Banking:

Foreign and domestic banks in Chile

	Domestic				Foreign	
	Private		State-Owned			
	1990-99	2000-05	1990-99	2000-05	1990-99	2000-05
Net Interest Margin (% of total assets)	5.0	3.9	4.6	3.3	4.1	3.7
Overhead Cost (% of total assets)	3.2	2.6	3.2	2.9	3.0	2.6
Overhead Cost (% of net operational income)	55.2	52.8	62.3	65.8	62.0	51.5
Loan-loss provisions (% of total assets)	0.9	1.1	1.0	0.6	0.7	0.9
ROA	1.8	1.3	0.6	0.5	0.9	1.6
ROE	25.5	17.6	10.2	9.4	7.6	16.7
Capital adequacy ratio		12.2		12.2		16.0
Assets structure						
% Loans to total assets	72.8	76.1	58.2	62.5	60.3	68.3
% Household credit to total loans	17.8	20.7	36.5	45.5	16.4	27.0

Source: Superintendence of Banks and Financial Institutions



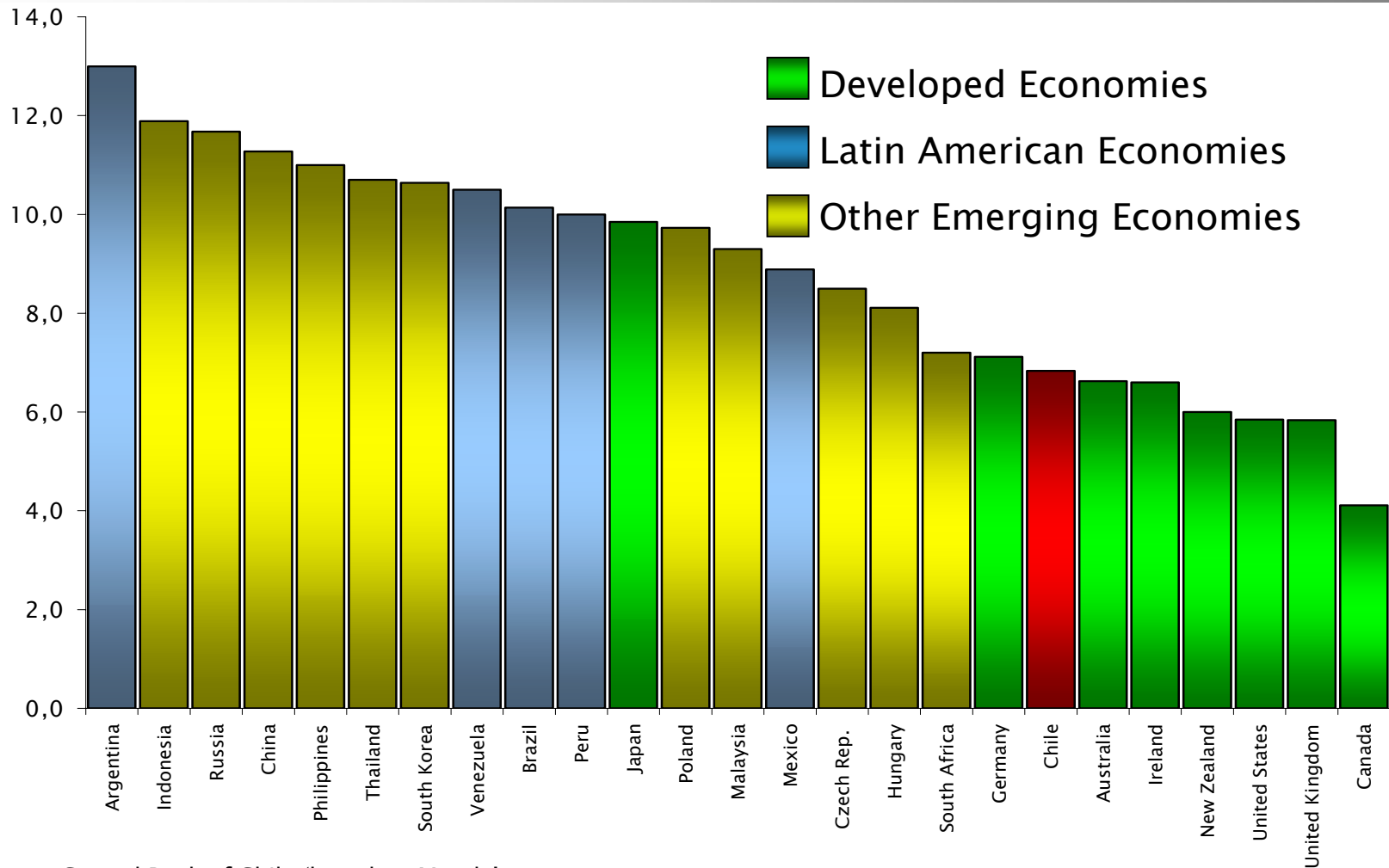
LA's Capital Markets: International Comparison

	Private Credit/GDP	Stock market capitalization/ GDP	Turnover ratio	Private Bond/GDP	Financial Strength Index
Argentina	12	62	6	10	0
Brazil	33	36	32	10	24
Chile	75	86	10	19	58
México	18	18	21	3	42
Colombia	23	15	3	0	24
USA	174	118	121	113	77
France	88	67	85	42	73
Germany	117	37	129	43	47
Spain	111	71	157	24	77
UK	110	120	100	39	83
Italy	83	37	121	44	63
Finland	61	96	11	22	73
Japan	105	60	87	44	21
Korea	120	48	235	50	18
Malaysia	132	141	34	53	35
Philippines	35	40	9	0	19
Czech Rep	30	18	52	7	41
Poland	28	15	27	n/a	31

Source: World Bank (2003), Moody's (Dec 2004)



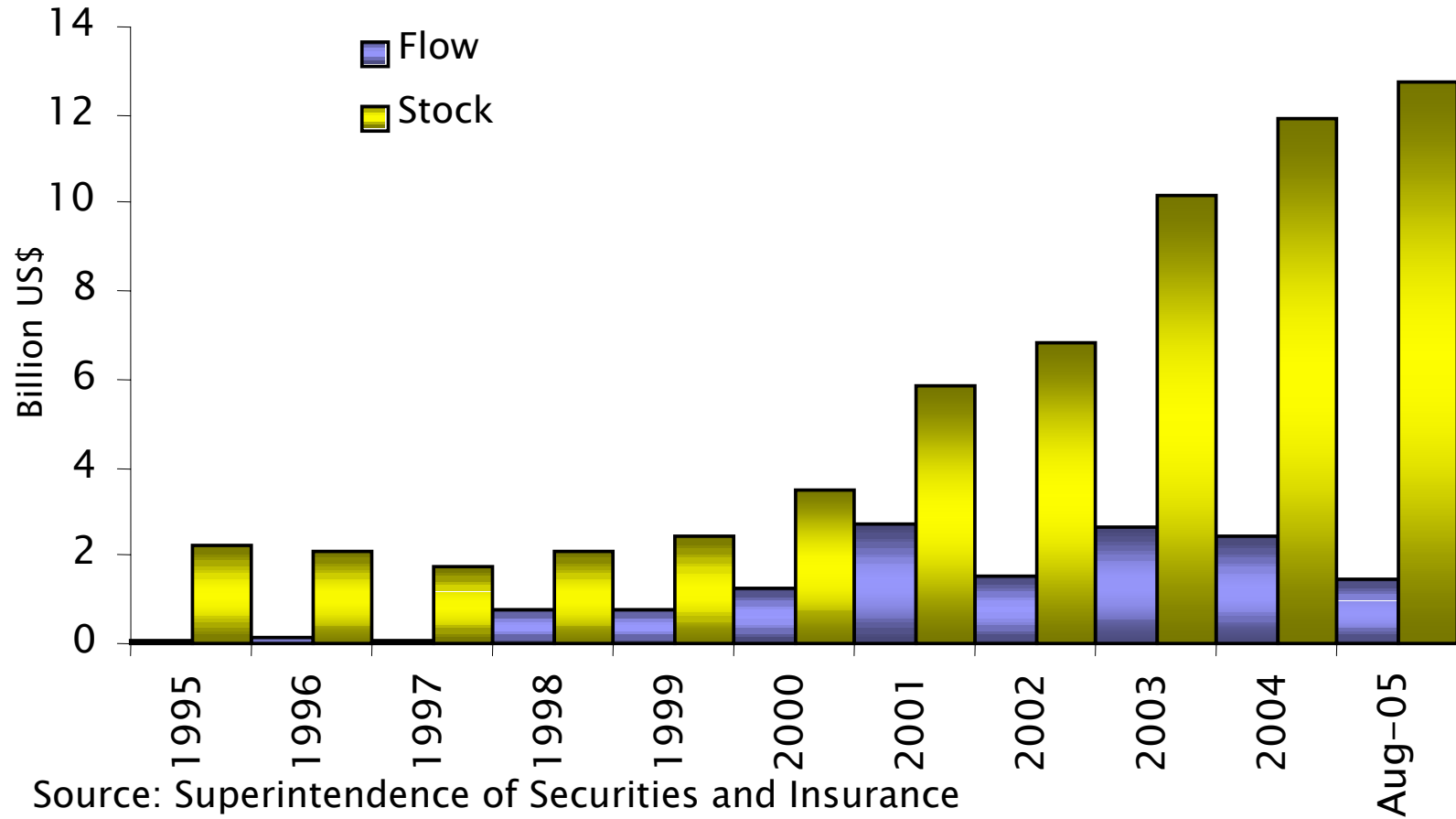
LA's Capital Markets: Banking Sector Strength Index



Source: Central Bank of Chile (based on Moody's Financial Strength Ranking, September 2005)

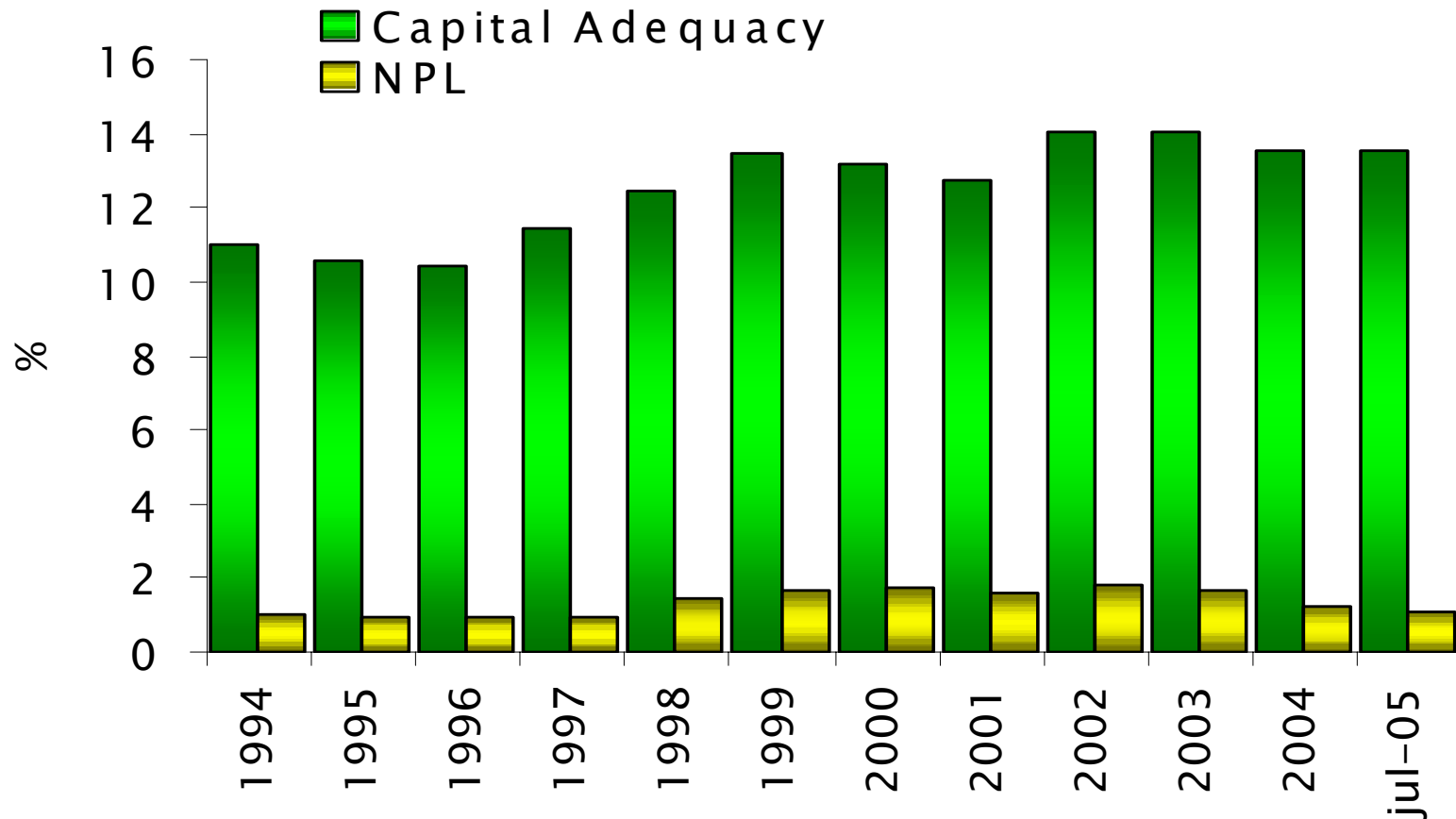


LA's Capital Markets: Chilean Corporate Bonds





LA's Capital Markets: Chilean Banking System Strength



Source: Superintendence of Banks and Financial Institutions



LA's Capital Markets: Rating Agencies

Country	Number of Agencies	% of total loans granted to rated firms
Argentina	4	24.4%
Bolivia	2	Non significant
Brazil	5	18%
Chile	4	18%
Paraguay	0	–
Peru	4	Non significant
Uruguay	3	Non significant

Source: Central Bank of Chile



Strengthening Banking Systems in LA

Limiting the extent of pro – cyclical

- But there is a need to balance business cycle stability and banks vulnerability

Prudential regulation

- Credibility issues and moral hazard are particularly important in small economies
- Liquidity and currency mismatch limits in the banking vs in the corporate sector

Corporate governance

- Working towards a consolidated supervision
- Strengthen role of bank's boards in terms of managing risks