



Financial Development and Inclusive Growth in Chile

*ChileDay – Mansion House, London
30 June 2017*

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Financial development and inclusive growth in Chile

- As a country matures, the factors that fostered growth in early stages lose strength
- The search for new sources of productivity and growth is largely a concern of leaders and policymakers in Chile
- Finance makes an important difference for development
 - Intermediation of savings
 - Resource allocation and economic efficiency
 - Inclusiveness and protection against contingencies
 - Macroeconomic stability
- There is a substantial gap in financial development between advanced and emerging countries
- Can finance be one of such factors that may foster growth in Chile in the near future?
Which reforms can be most effective?

Agenda

1. Chile and its financial market in perspective
2. Recent financial policy developments
3. Future challenges



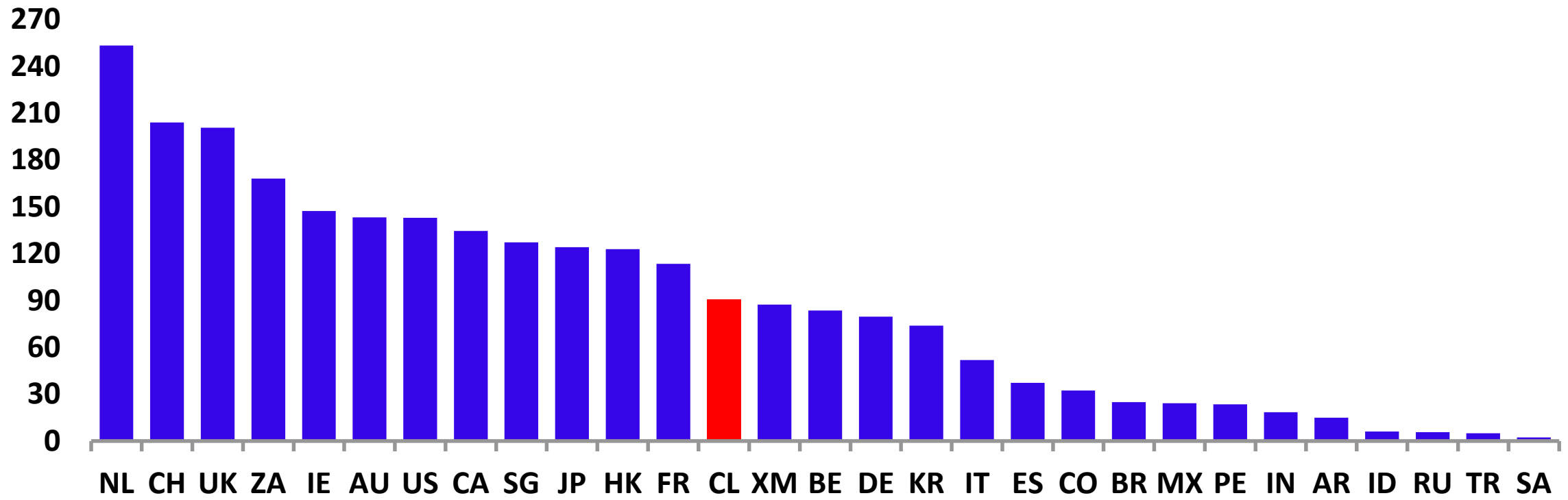
Chile and its financial market in perspective

Financial market in perspective: Chile



Institutional investors

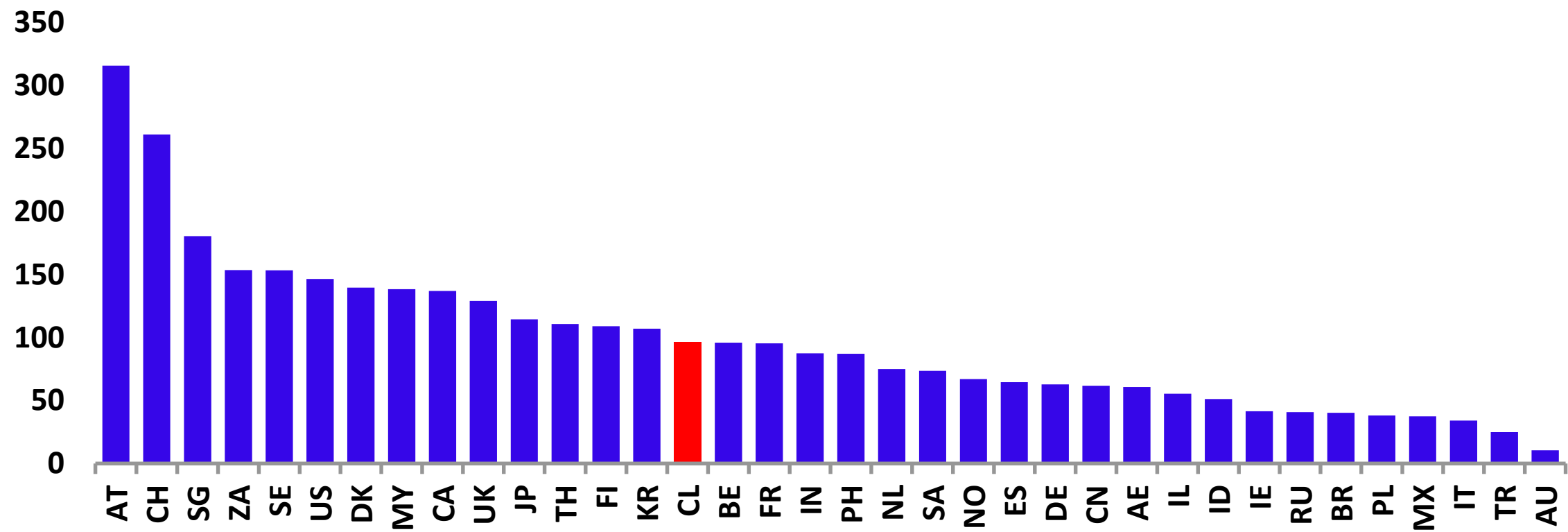
Pension funds and insurance companies (percent of GDP, 2015)



Sources: National Sector Balance Sheet and other data, IMF World Economic Outlook, and FSB calculations.

Stock market

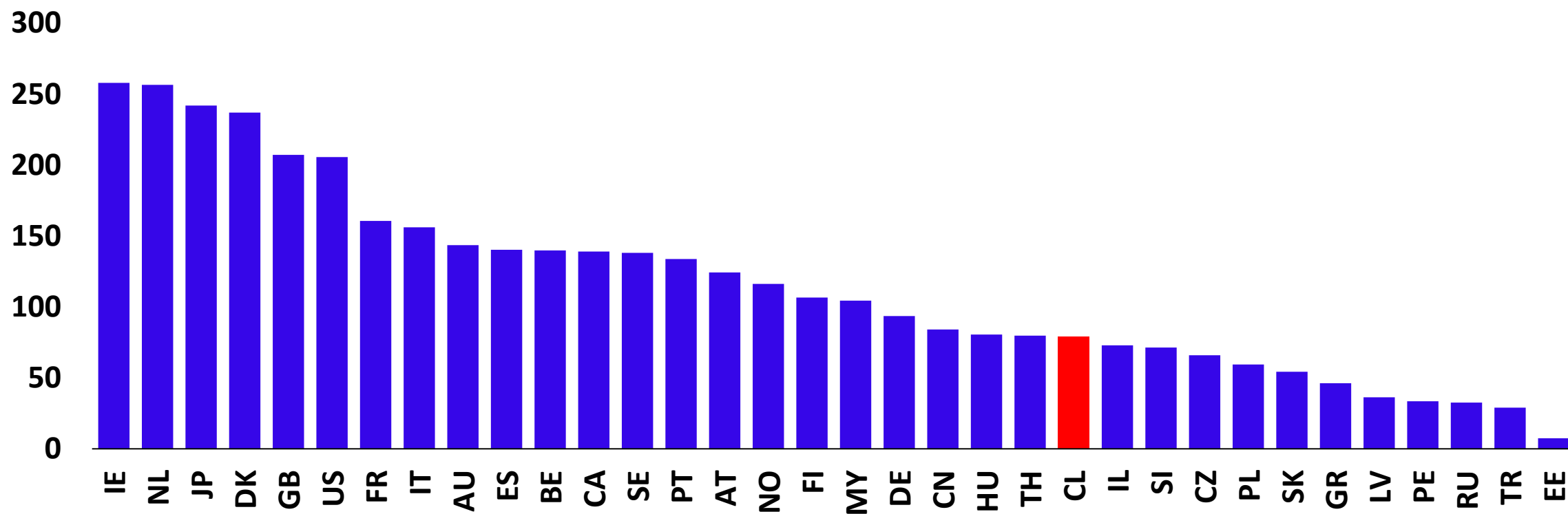
Market capitalization
(USD billion , June 2017)



Source: Bloomberg.

Corporate securities

Debt securities market depth (percent of GDP, December 2016)

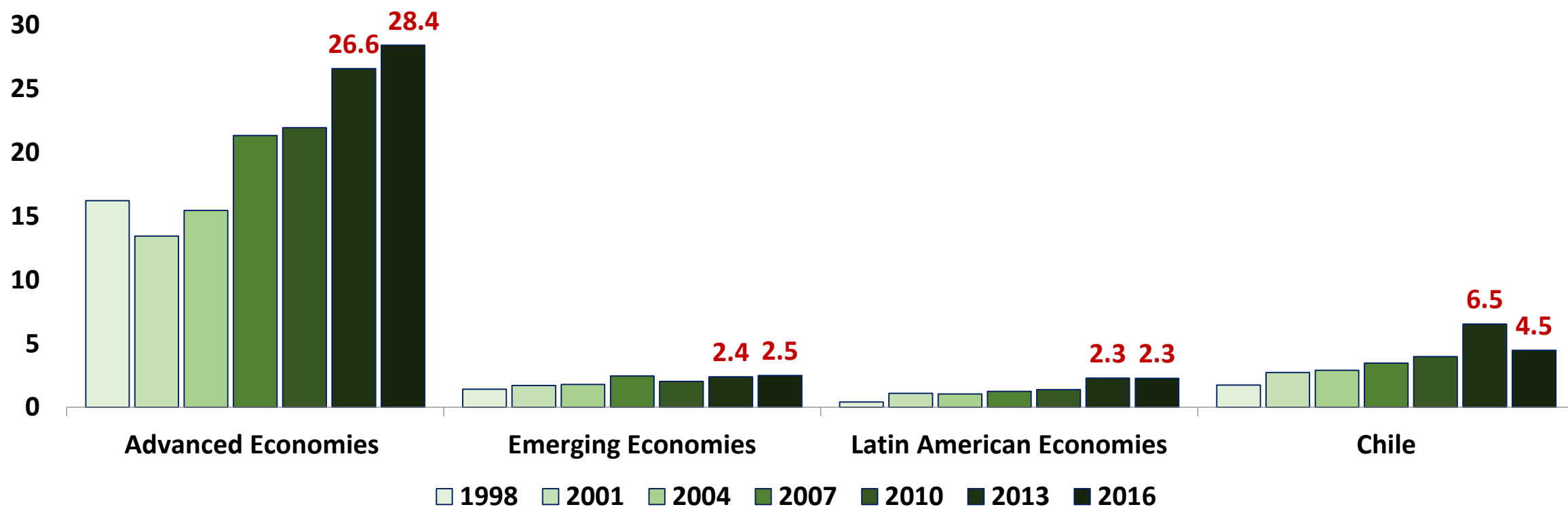


Debt securities: Total debt securities outstanding by residence of issuer. Source: BIS Debt securities statistics database, Central Bank of Chile and Ministry of Finance of Chile.

FX derivatives

FX derivatives market depth, 1998-2016

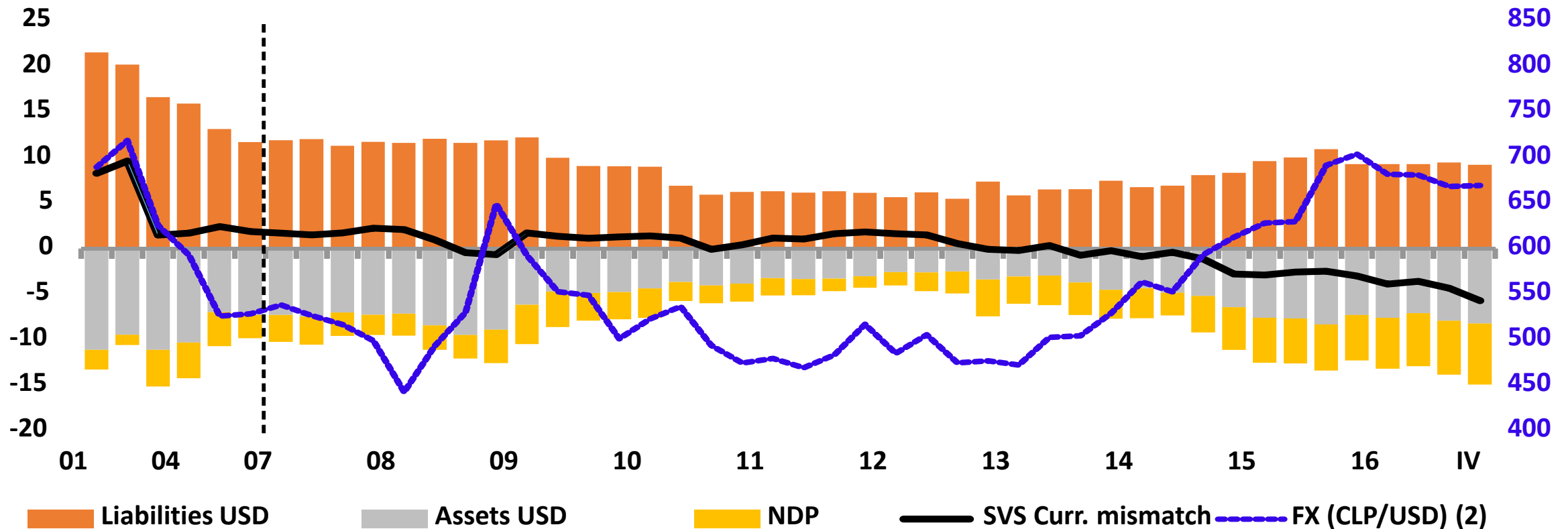
(annual amounts as percent of GDP)



Sources: Salinas, J. M. and J. M. Villena (2014), *"Mercado Cambiario Chileno, Una Comparación Internacional: 1998 a 2013,"* Studies in Economic Statistics 104, Central Bank of Chile, Bank of International Settlements, and IMF.

Currency mismatches in the corporate sector

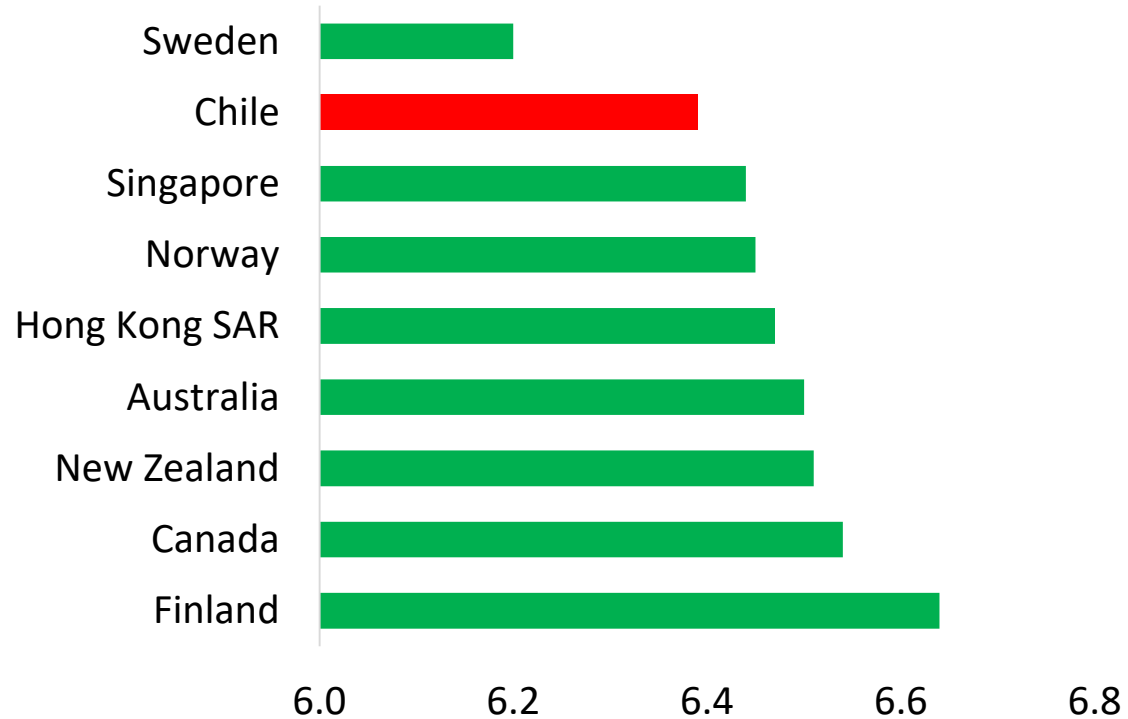
Composition of corporate currency mismatches (1)
(percent of total assets)



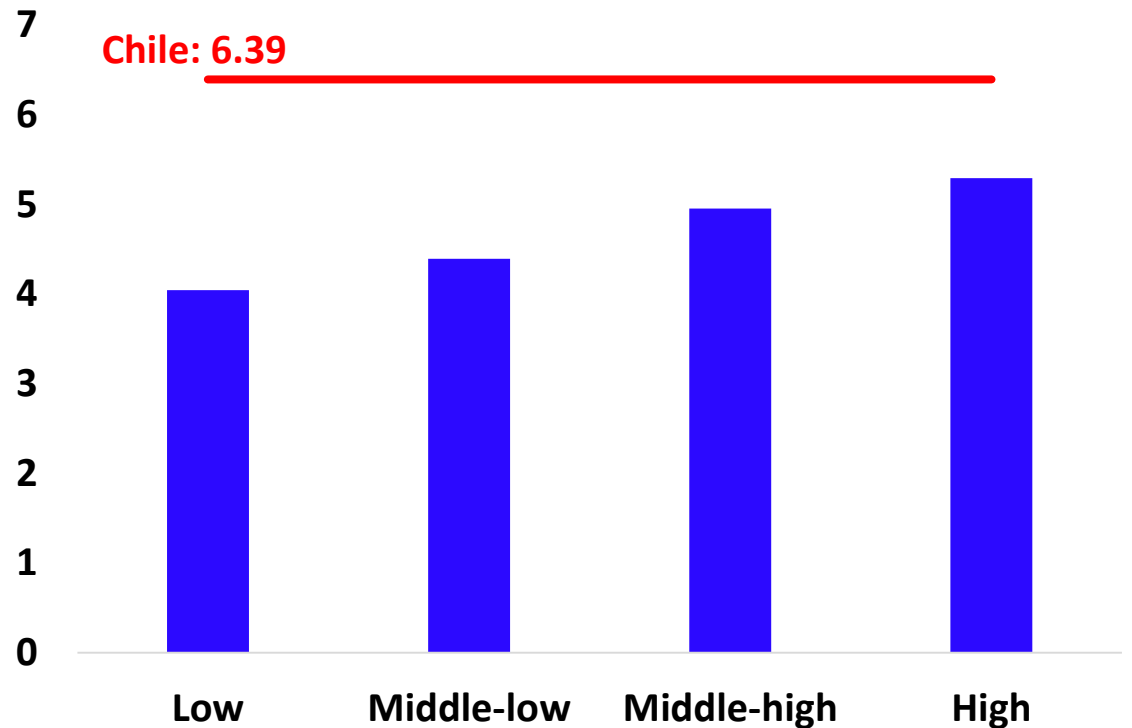
(1) The mismatch is calculated as liabilities in USD minus assets in USD, minus net derivatives position, over total assets. Individual information companies reporting their balance sheets in Chilean pesos. Annual data up to 2006, quarterly data onwards. Does not consider state-run, mining or financial firms. (2) Average exchange rate of the last month of the quarter (or year) on right axis. Source: Central Bank of Chile using SVS information.

Banking

WEF Banking Strength Index, 2016
(index; points)

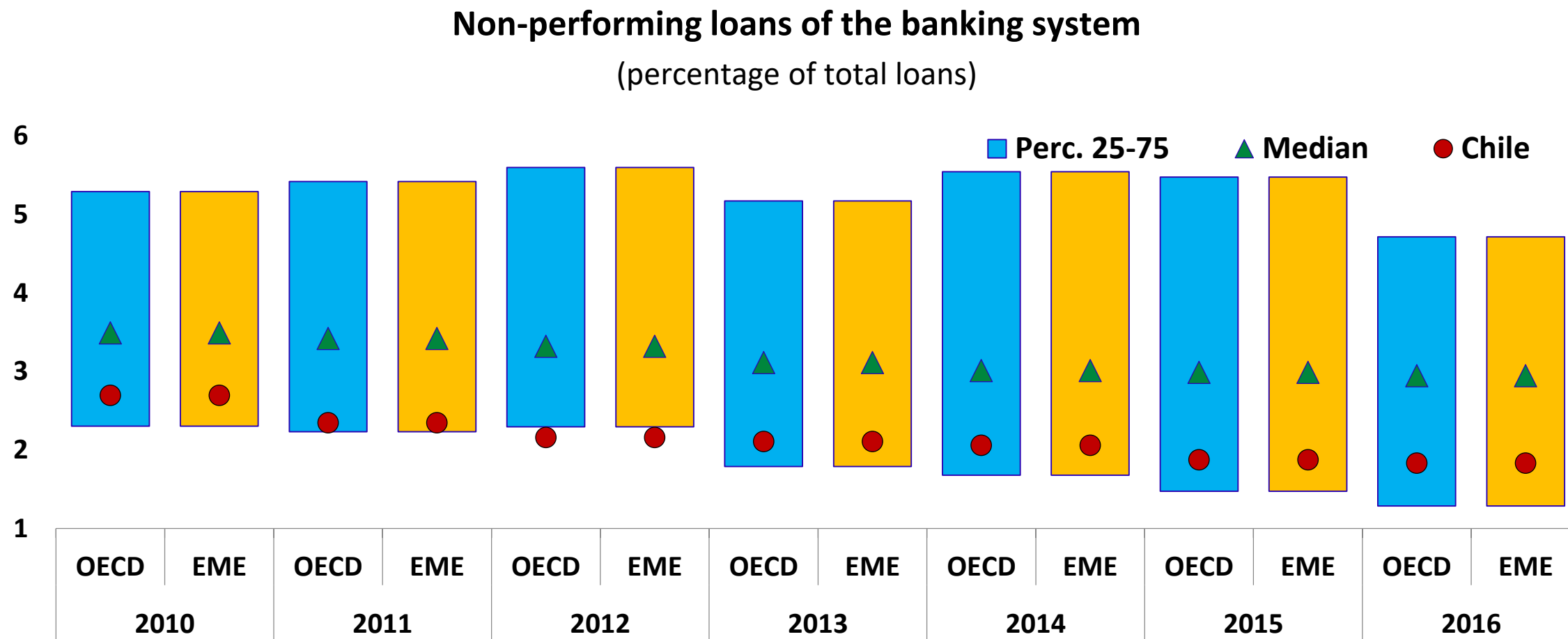


**WEF Banking Strength Index comparison
by income, 2016**
(index; points)



Source: The Global Competitiveness Index (World Economic Forum).

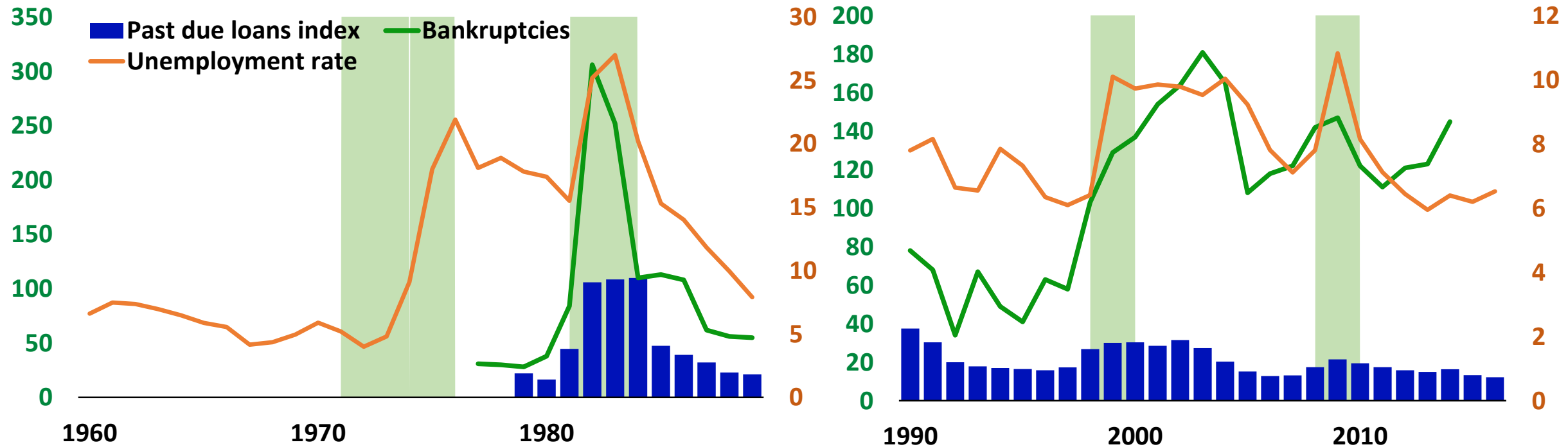
Banks' exposure to credit risk



Data of Luxembourg available until 2013, Korea until 2014, and Germany until 2015. Source: Financial Soundness Indicators, IMF, and SBIF.

Bankruptcies and past due loans in the business cycle

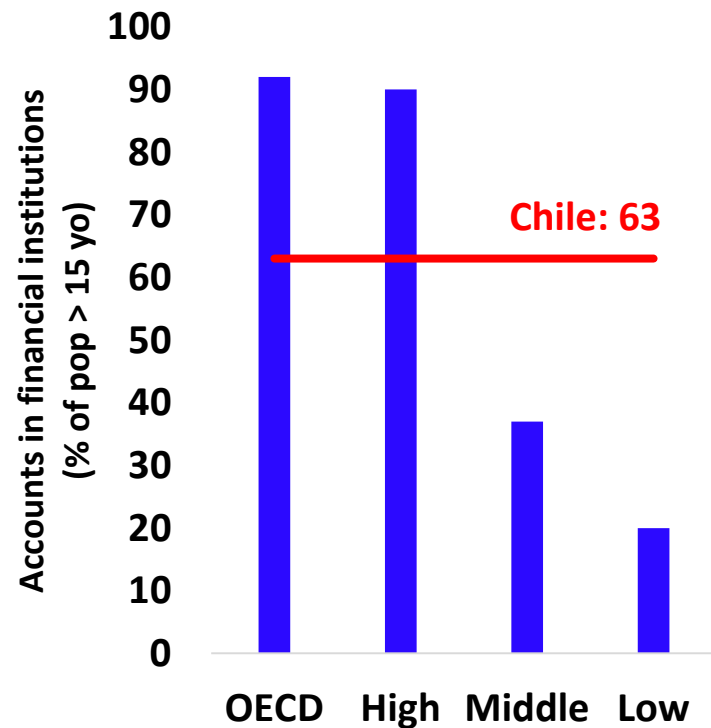
Bankruptcy, unemployment, and non-payment
(number of firms; percent; percent of total placement)



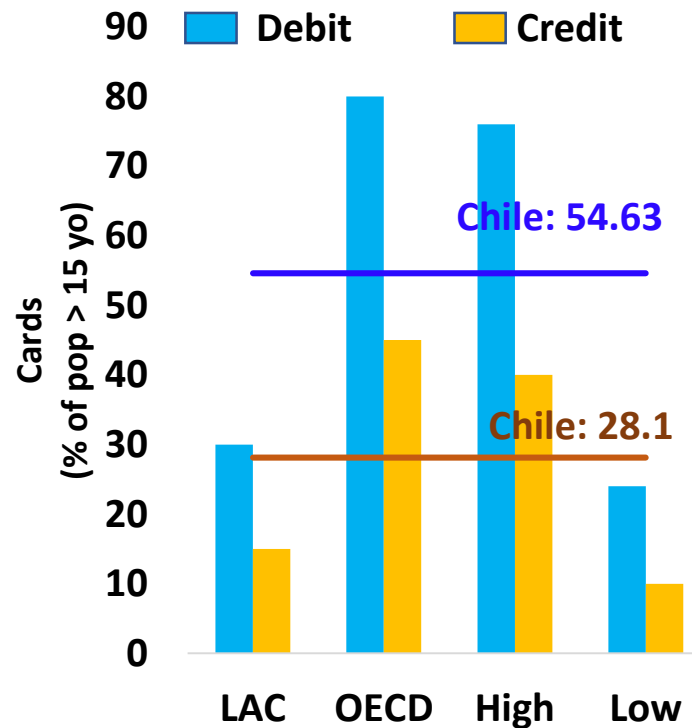
(*) Sources: Díaz, Lüders, and Wagner (2016), Martínez, Matus, and Oda (2017), and Superintendency of Insolvency and Entrepreneurship.

Banking coverage

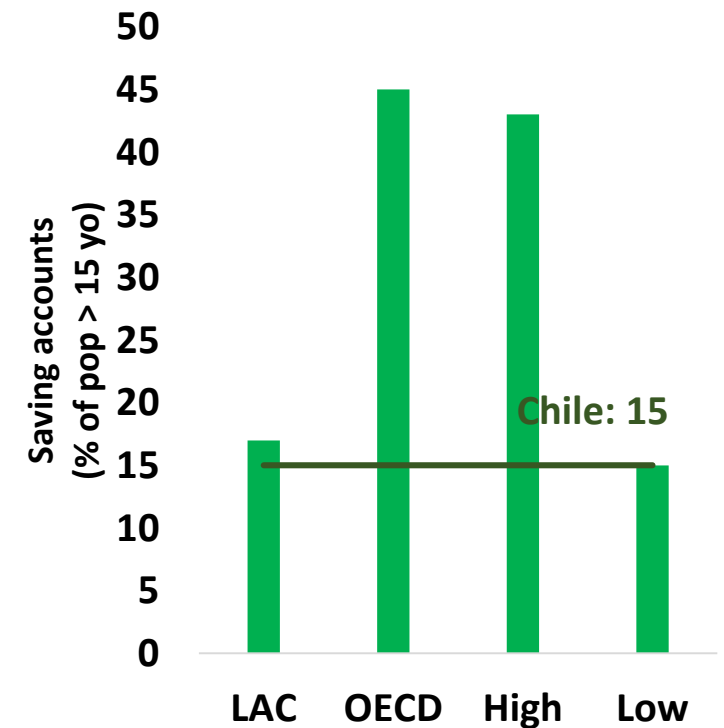
Adult population with any type of account in a financial institution
(percent, 2014)



Adult population with debit or credit card
(percent, 2014)



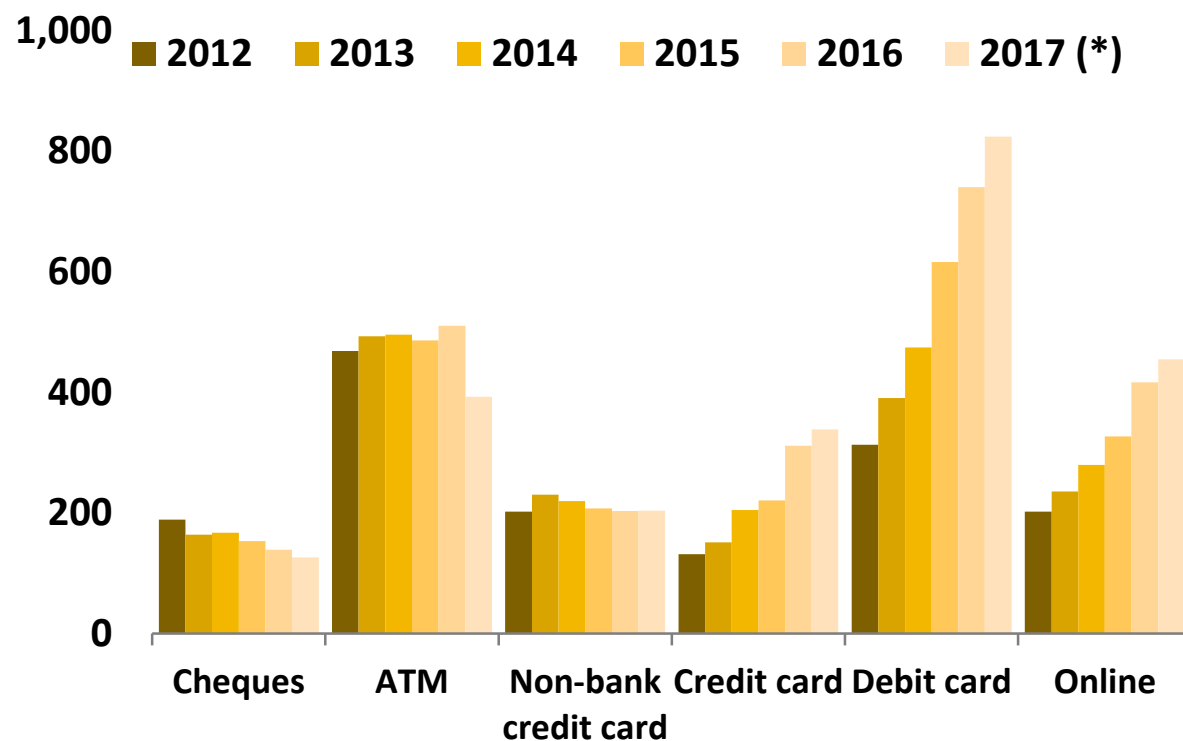
Adult population with savings in financial institutions
(percent, 2014)



Banks and payment methods

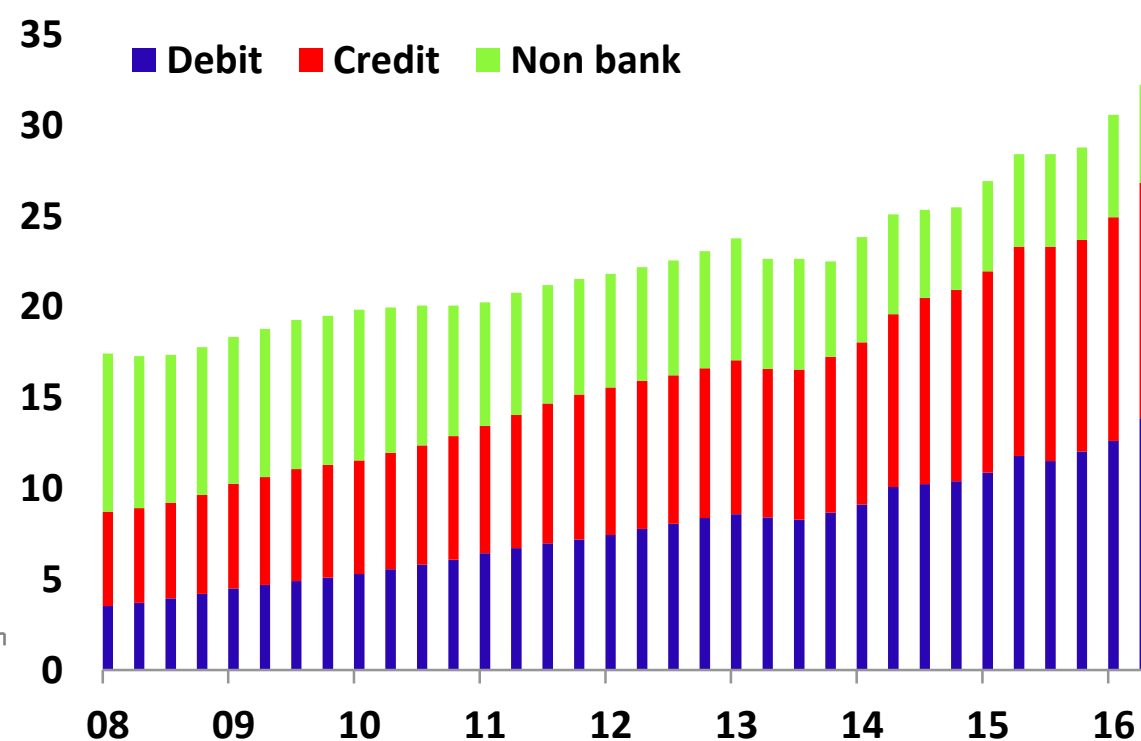
Payment methods

(million of transactions)



Total spending using cards

(percent of households consumption)

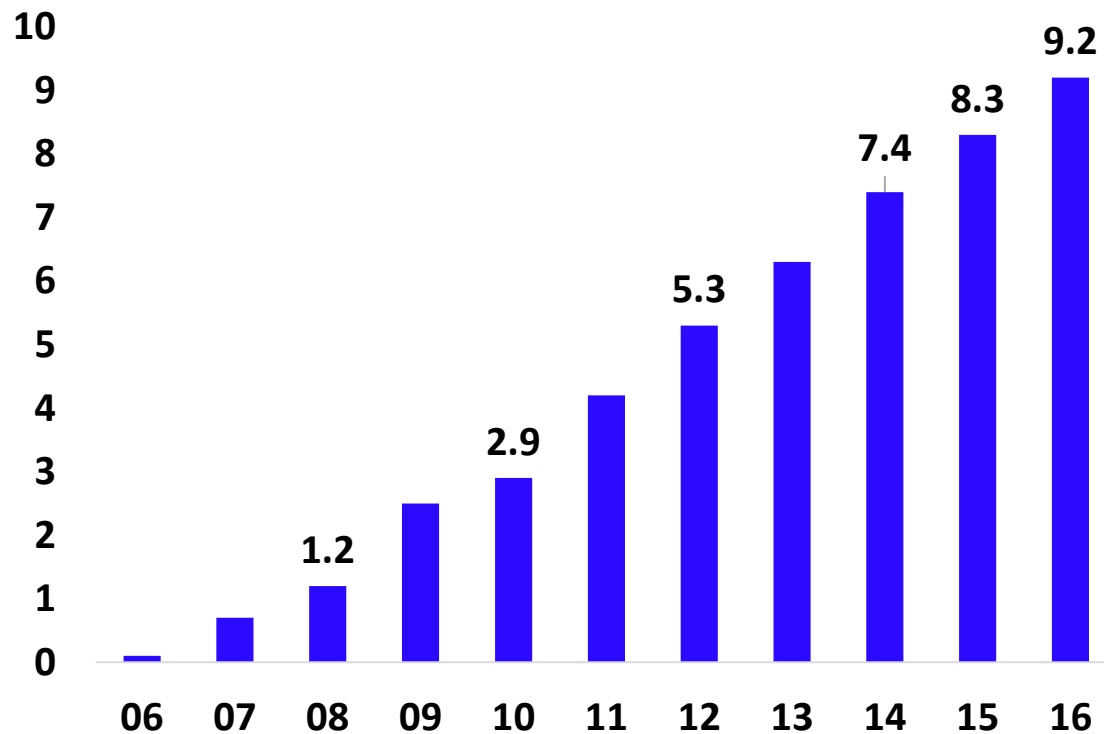


(*) Annualized. Source: Central Bank of Chile based on SBIF data.

State-owned-bank based financial inclusion has grown fast since 2006

“Cuenta RUT”

(million of active accounts)



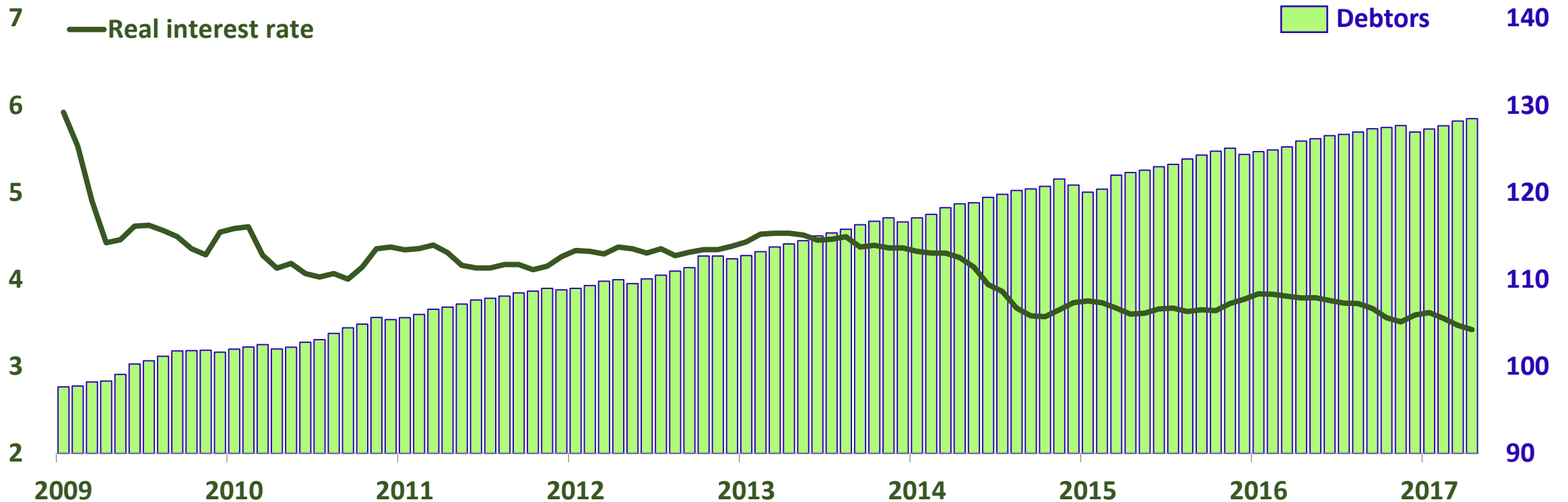
As of 2016:

- 900,000 new accounts opened in 2016.
- 52% are female owners.
- 32% live in rural or remote areas.
- 75% earned CLP\$400,000 per month (less than two times the minimum wage) or no income.
- 300,000 are owned by immigrants (69% of total immigrant population).
- 60% of accounts have no past due payments.

Mortgage loans have been accessible for households under favorable and stable financial conditions

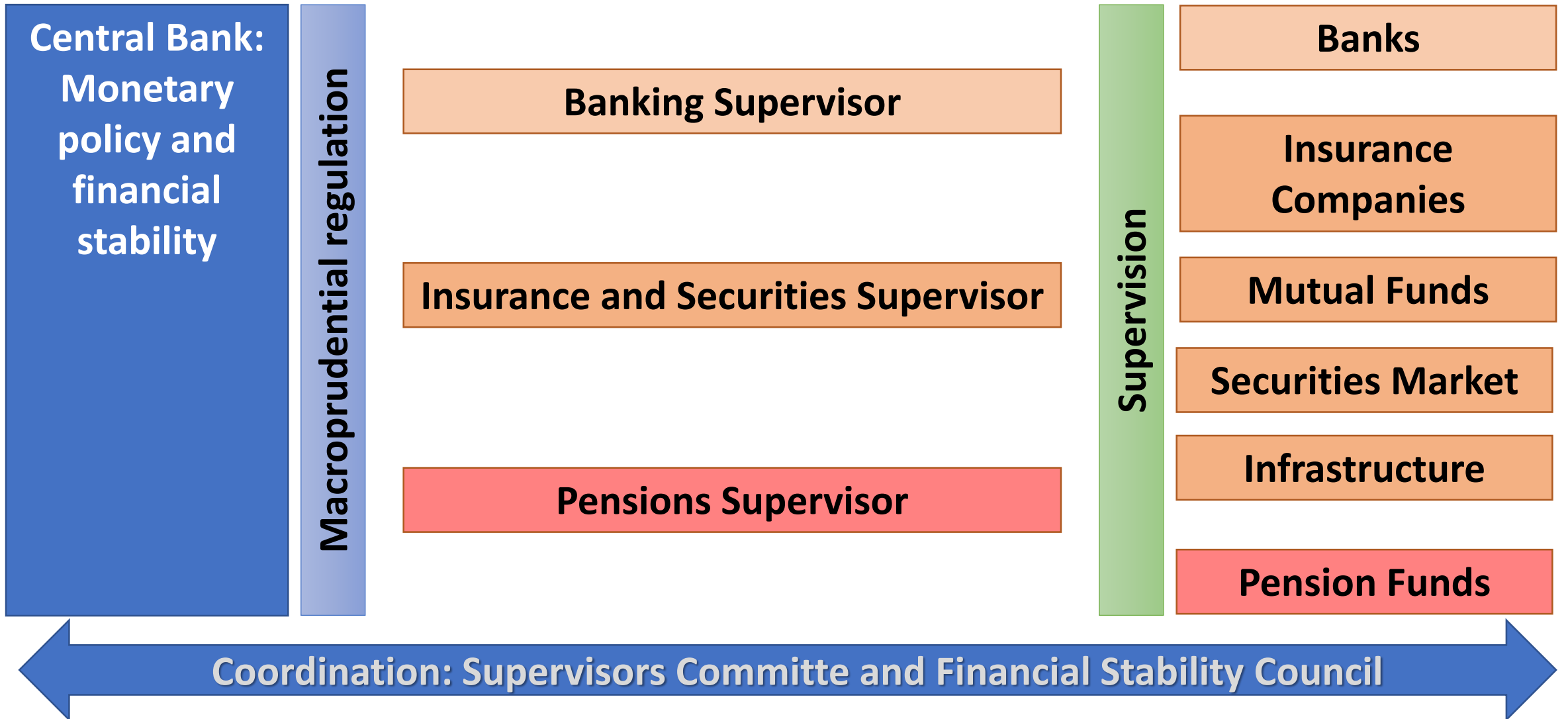
Banking mortgage market

(percentage; index 2009=100)



Source: Central Bank of Chile based on SBIF data.

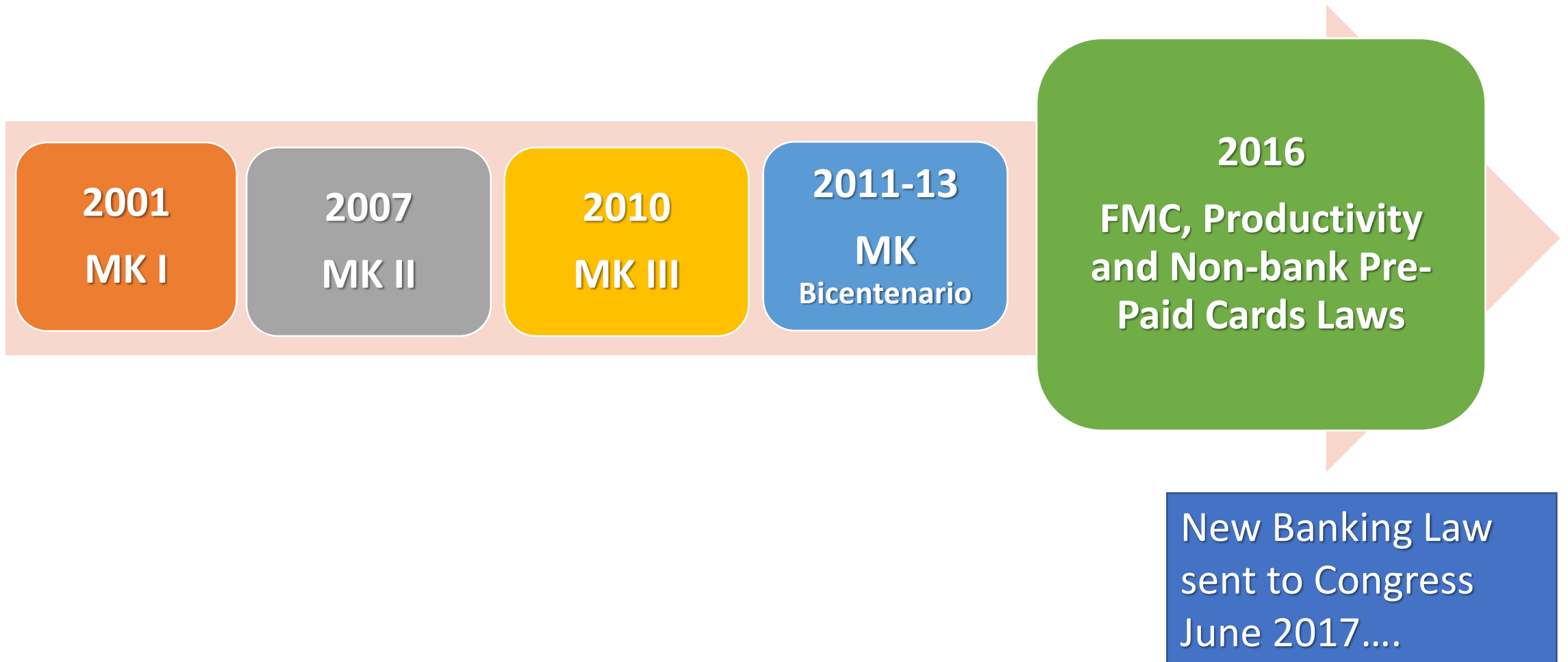
Institutional map for financial sector regulation





Recent financial policy developments

Legislative efforts to improve the financial regulation framework are sustained



The consolidation of supervisory agencies follows previous steps to coordinate financial policy

■ Policy Coordination

- Capital Markets Committee (1990s): informal instance.
- Committee of Superintendents (2001): sectoral supervisors.

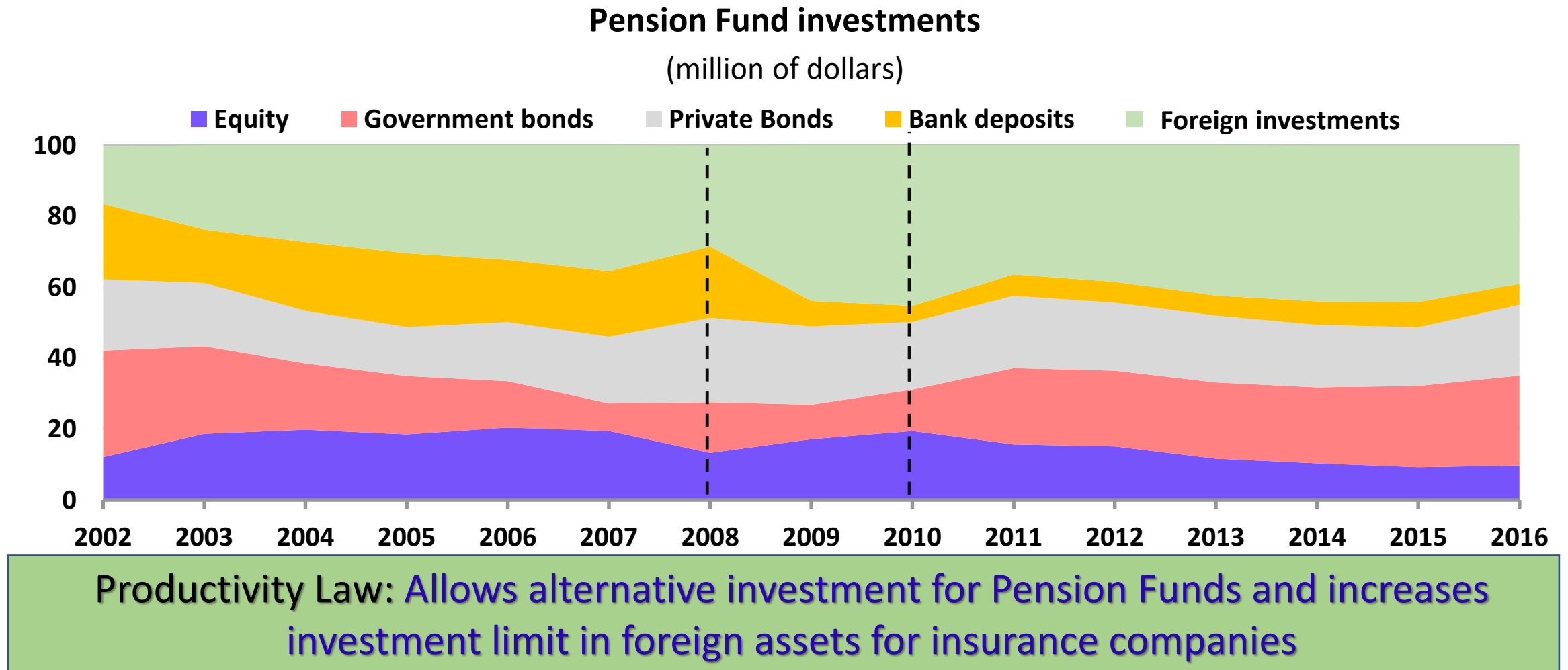
■ Financial Stability Council

- Formal instance since 2011.
- Policy coordination and identification of systemic risks.

■ Financial Market Commission

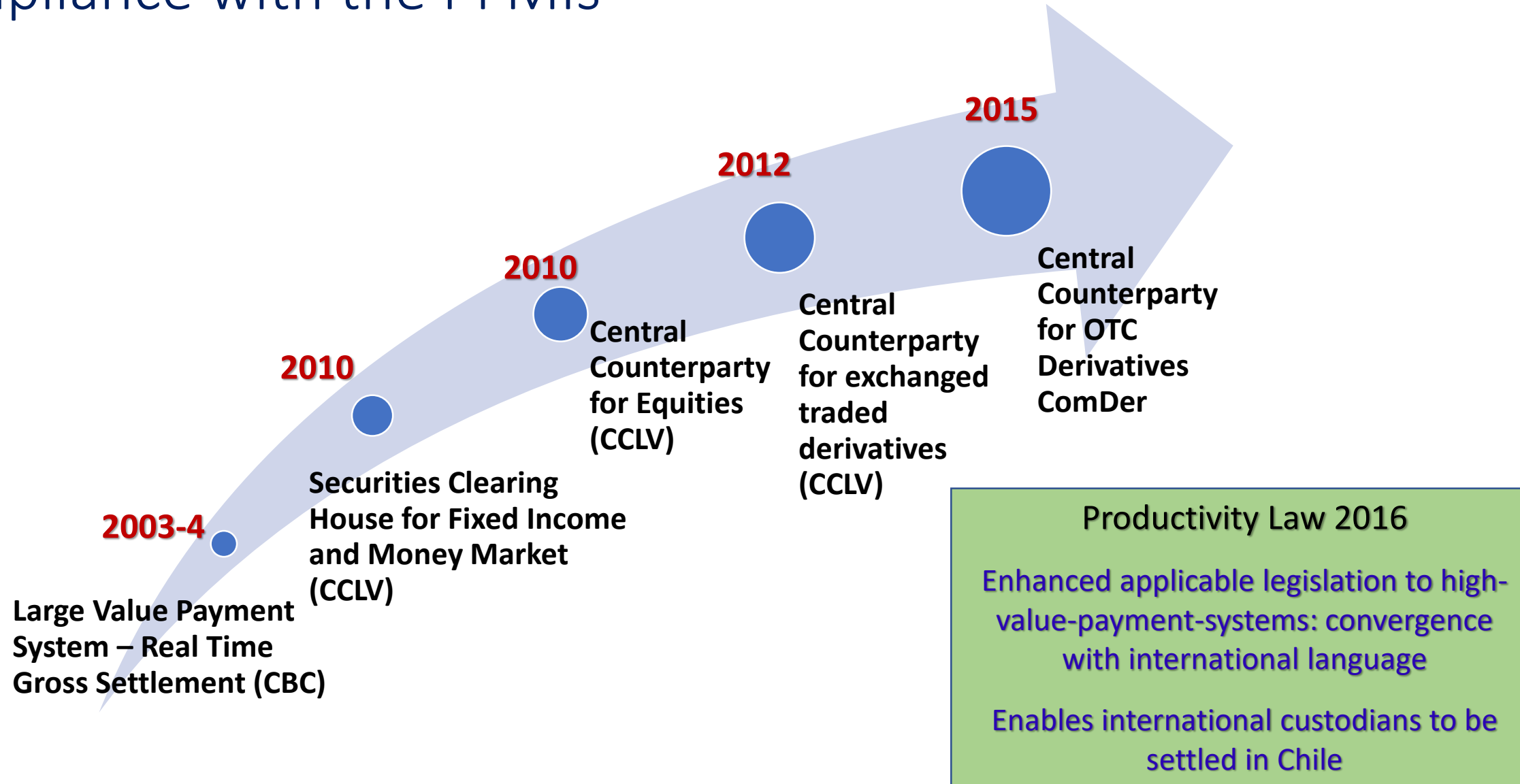
- Replaces Insurance and Securities Supervisors. Banking Supervisor will join the commission later
- Governance: board of directors.

Pension Funds have diversified portfolio in line with changes in regulation and market conditions



Dotted line represents an increase in the foreign investment limit. Source: Central Bank of Chile based on SBIF data.

Financial Market Infrastructure have high level of compliance with the PFMI



Banking regulation has evolved gradually adopting proven international standards and best practices

General Banking Act (1986) 1986

Major amendments followed the crisis of 1982

- Loan loss provisions and capital requirements
- Limits to cross related lending
- Risk-Based supervision

Basel I adopted in 1997

- Capital requirements for credit risk were introduced following the Basel I standards
- More flexibility for banks going abroad

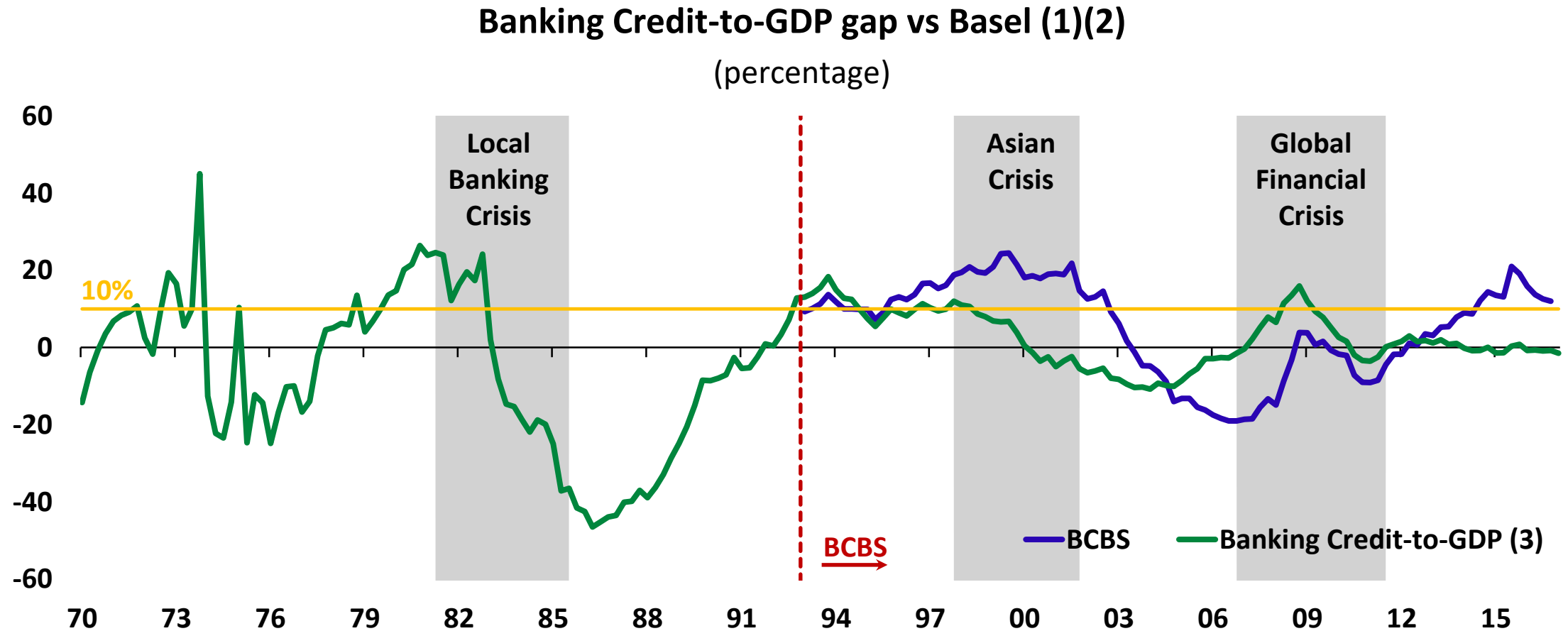
Basel III proposed in 2017

- More focus on equity capital
- Adds conservation and counter cyclical buffers
- D- SIB surcharge.
- Include Market and Operational risks in capital requirements

The recent banking reform bill proposes the most important changes to this legislation since 1997

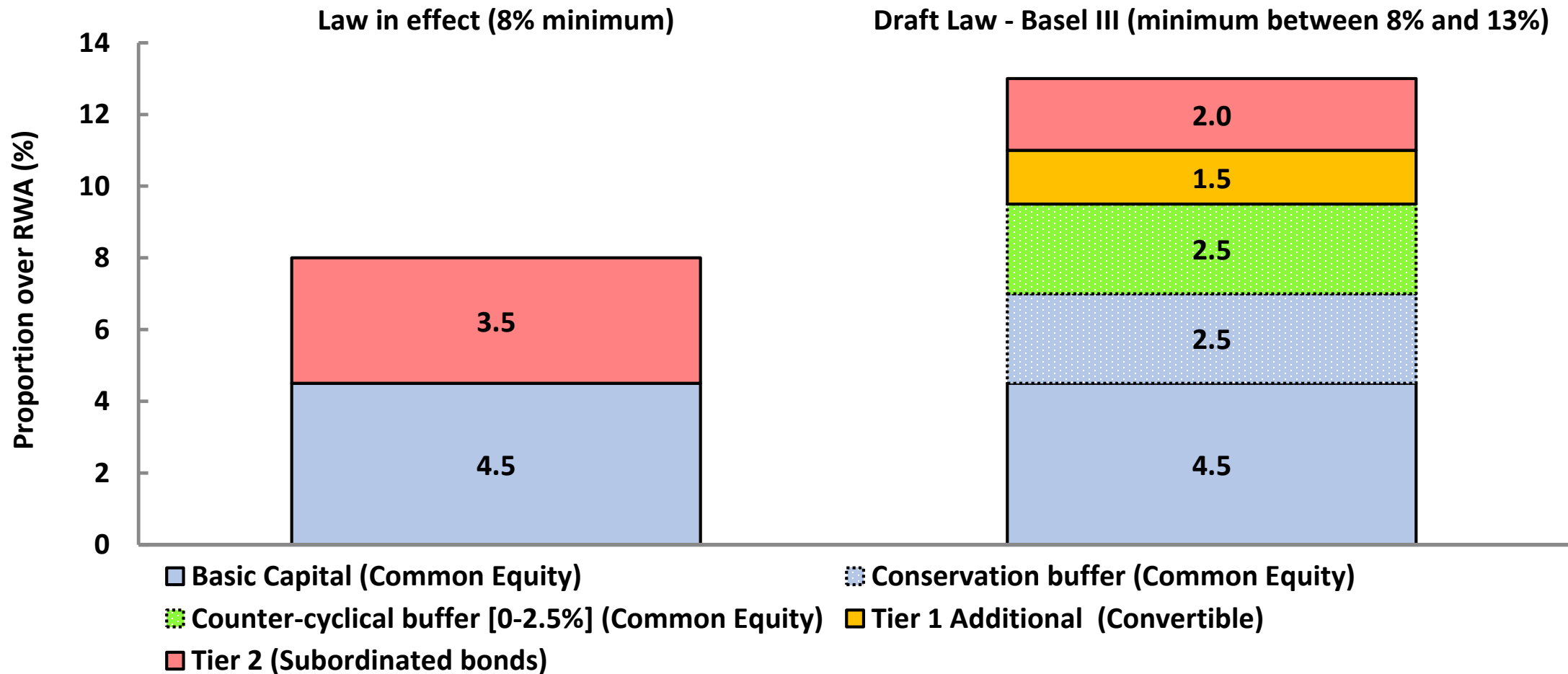
General Banking Act	Objectives	Improvements	Details
	Convergence to international standards	Boosts solvency and capital quality	Builds buffers: conservation, counter-cyclical and D-SIBs buffers
	Modernize the banking business	Enhances supervisory institutional framework	Incorporates Banking Supervision to financial markets commission (FMC) and procedures to preventive intervention
	Provides stability and sustainability	Flexibility to deal with critical situations	Limited capital gaps and gradual implementation
		Social benefits out weight costs	Smoother financial cycles: stable access to credit and financial inclusion
			Contributes to country's reputation and access to international markets

Experiences in Chile and elsewhere show financial crises following exceptionally expansionary credit cycles...



(1) Based on Hodrick-Prescott filter with lambda equal to 400,000. The BCBS uses the total private credit to GDP and the proposal only the banking component. (2) The gray areas represent periods of financial fragility delimited according to Martínez et al. (2017). (3) The proposal also considers a 10 year rolling window for the calculation of the cyclical component. Source: Central Bank of Chile.

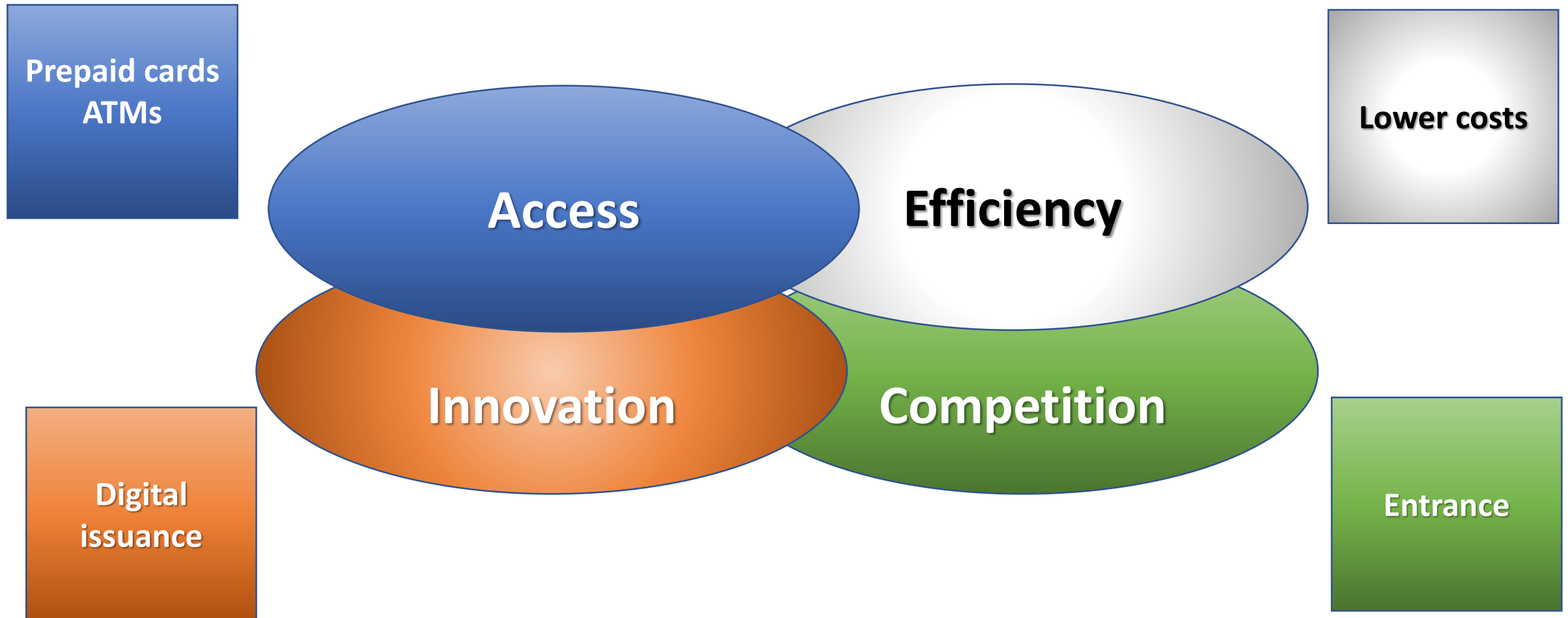
The bill proposes raising the quality and quantity of capital to build a comprehensive risk management framework for banks





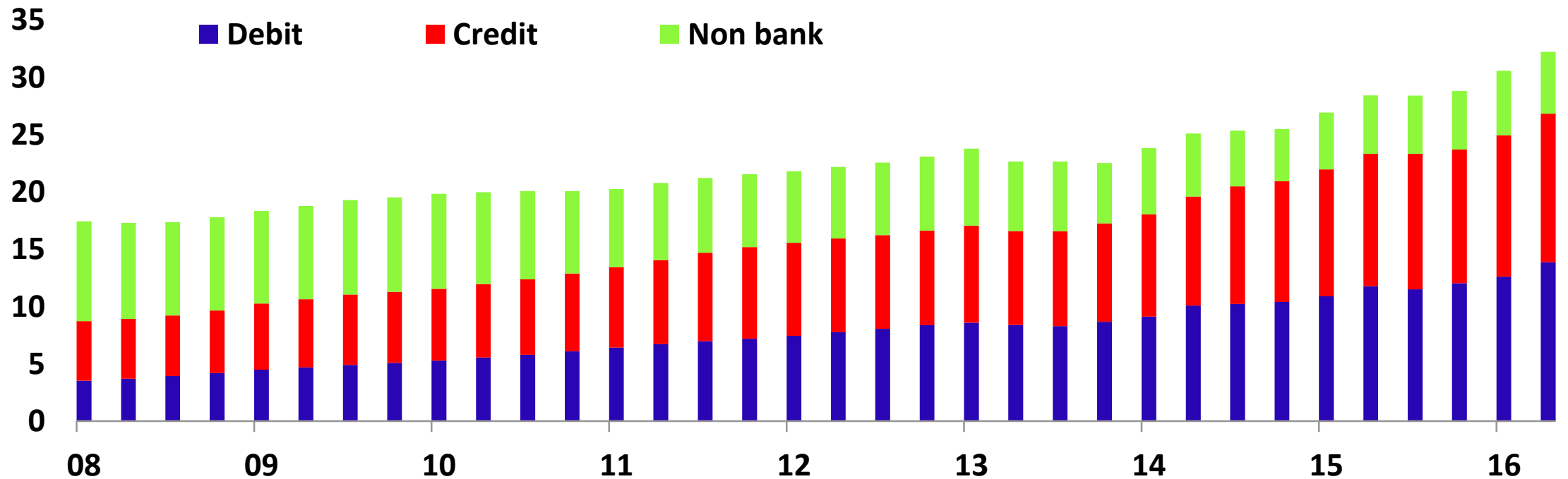
Financial inclusion is expected to increase

Legal and regulatory improves several dimensions while preserving payment systems continuity



Retail payments in Chile can be improved

Total spending using cards
(percent of households consumption)



Approximately 30% of consumption is paid with electronic means

Recent legal and regulatory changes could allow more people to benefit from electronic payment services

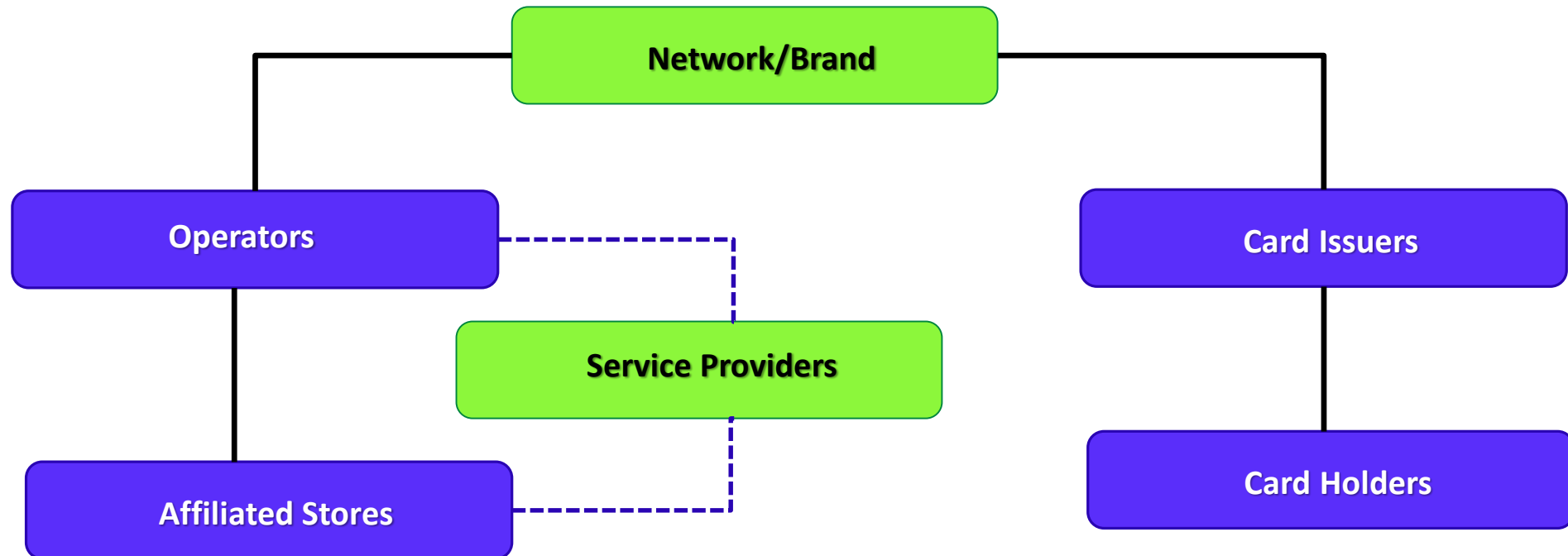
The new law seeks to enhance inclusion and competition

Central Bank New Regulation

Overhauling the whole retail payment regulation	Narrow down the scope of regulated entities dealing with the processing of transactions, reduce capital requirements for new acquirers, and allow for a “four-party model”, which was previously limited	Explicitly consider the possibility of non-physical cards as well as remote purchase and acquiring	Contribute to foster innovation and facilitate the participation of Fintech companies in this market
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One important amendment is the explicit recognition of a “four part model”

- Facilitates the entry of new purchasers who will not require an agreement with the issuers
- Both Issuers and operators (purchasers) adhere to a system with security conditions and various safeguards



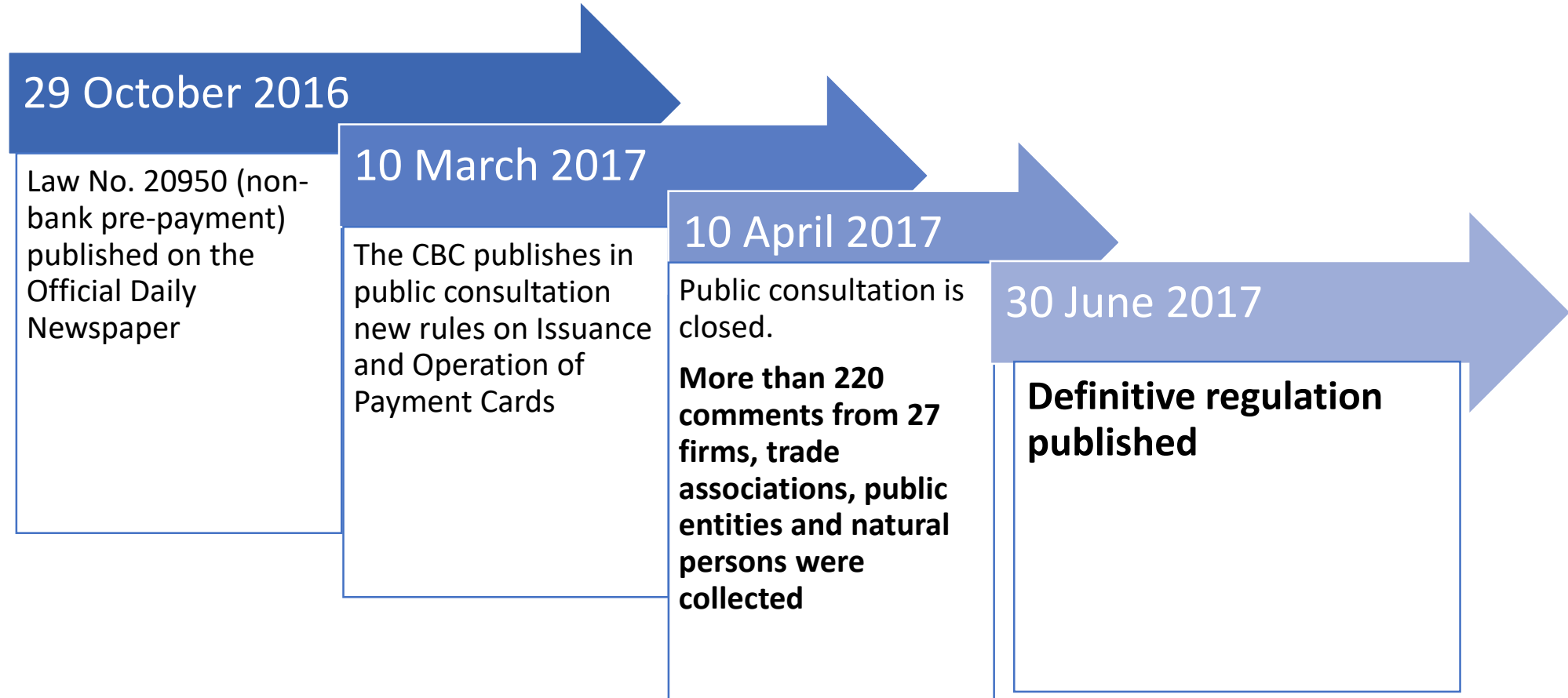
The new regulation seeks not to hinder innovation...

- **Regulation focuses in principles and not the physical platform or payment device**
 - Virtual or digital services for Issuance and Operation/Acquiring can be developed.
 - No reference to specific security standards (technologically neutral), but general principles instead.
 - A single instrument may have more than one payment means (digital wallet, debit and credit card).

...and also fostering massification of prepaid cards

- Prepaid cards may be used to make electronic transfers of funds and ATM withdrawals
- Issuance and acquiring can be performed by technological means or any appropriate alternative, in accordance with the law
- Milder authorization and identification requirements are proposed for prepaid cards issued for the payment of social benefits, allowances or subsidies

The process of regulatory review is coming to a close, and in the coming months the new framework will be in full operation



Throughout the process, the SBIF's opinion has been considered (publication requires prior report by SBIF), which must now issue its own body of regulation on the matter.



Challenges ahead

Summing up

- There is a substantial financial reform agenda currently under way in Chile
- These reforms are aimed at diversifying portfolios, broadening the supply of financial services, improve risk management, and integrate supervision
- This will contribute to deepening and consolidating a solid, efficient and stable financial sector, capable of contributing to inclusive, sustainable growth
- The responsible parties—MoF, SBIF, CBC—are working together to further advance this agenda

Some challenges ahead

- Derivatives market regulation can be improved
- Transactions Repository would improve the infrastructure for this market
- Technological breakthroughs and massive availability of information facilitate developing and adopting new financial business models
- FinTech innovations can be a source of opportunities for the financial system...
 - Increased access to financial services, improved efficiency and competition, among other
- ...but can also be a source of threats for financial stability
 - Increased risk due to “poorly calibrated” access to financial services, higher operational risks and greater importance of cybersecurity, among other



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