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Supervision of Financial Conglomerates: The Case of Chile

by

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Abstract: This paper describes the presence of financial conglomerates and assesses the extent to which the risks they introduce to the Chilean financial system are mitigated by existing oversight arrangements (and at what cost). In particular, the paper questions whether the current silo-based supervisory framework, which has served the system fairly well until now, can continue unchanged given growing inter-linkages in the financial system. A high-level short- and medium-term supervisory reform agenda is proposed, which addresses identified vulnerabilities relating to financial conglomerates and continues the migration from a rules-oriented to a risk-based supervisory approach that has gradually been taking place in Chile in recent years.

JEL Classification Code:

Keywords: consolidated supervision, risk-based supervision, financial groups, financial conglomerates, risk management, Chile

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Supervision of Financial Conglomerates: The Case of Chile

1. Introduction

The objectives of this paper, which is drawn from the recently completed Financial Sector Assessment Program (FSAP) work in Chile undertaken by a joint World Bank-IMF mission, are threefold:

- to describe the presence and characteristics of financial conglomerates in Chile (Section 2)
- to assess the extent to which the vulnerabilities they introduce to the financial system are mitigated by existing oversight arrangements, and at what cost (Section 3)
- to propose appropriate high-level modifications to the regulatory framework[1] that the Chilean authorities might want to consider in light of the findings (Section 4).

Chile represents an interesting case study because it already has a relatively strong supervisory framework, as well as ample publicly available information that can be used for analytical purposes. In common with other developing countries, however, its financial system lacks an integrated supervisory agency or a lead regulator that could (at least theoretically) better respond to the challenges arising from financial conglomerates.

The analysis and recommendations will take the current supervisory structure as given and will not consider other possible institutional set-ups[2]. Given the tight time constraints and breadth of this exercise, an in-depth analysis of each vulnerability has not been attempted – where appropriate, future avenues of exploration in the form of a research agenda are mentioned. The paper does not cover the historical rationale and evolution of financial conglomerates, the theoretical arguments for and against their existence, or any current regulatory problems in individual financial sectors that are not

[1] As traditionally defined, regulation refers to the set of rules and standards that govern the operation of financial institutions, while supervision refers to the oversight/monitoring of the application of those rules and standards. For the purposes of this paper, the two terminologies are used interchangeably.
[2] Please see De Luna Martinez J. and Rose T. A. (July 2003), Organization for Economic Co-operation and Development (2002), and Abrams R. K. and Taylor M. W. (2000) for a review of alternative institutional arrangements and the experience of integrated financial sector supervision.

directly related to financial conglomerates. Finally, it is important to clarify that international best practice in consolidated supervision[3] will only be discussed (and prescribed) to the extent that it is deemed an appropriate response to identified problems.

2. Overview of Financial Conglomerates in Chile

A. Definitions

The definition of financial conglomerates is by now well established in international regulatory circles. The Joint Forum[4] defines such entities as "*any group of companies under common control whose exclusive or predominant activities consist of providing significant services in at least two different financial sectors (banking, securities, insurance)*". By contrast, the EU's Financial Groups Directive, scheduled to take effect in 2005, defines a group as a financial conglomerate if at least 40% of its business is financial and at least 10% or EUR 6 billion of its financial business is in each of the insurance and the combined banking/investment sectors.

In view of the characteristics of the Chilean financial system, two major expansions to the Joint Forum definition have been made in this paper:

- given the importance of pension funds or AFPs (assets of US$49 billion, or 62% of GDP at end-2003), pensions are included here as an additional financial sector[5]
- given the prevalence of mixed-activity conglomerates (see below), the above definition has been modified to include the financial sub-groups of such conglomerates, as long as they have an important financial sector presence.

The revised definition that is used in this paper is therefore: "*any group of companies under common control whose activities include the provision of significant services in at*

[3] Interested readers should consult Basel Committee on Banking Supervision (July and November 2001).
[4] The Joint Forum was established in 1996 under the aegis of the Basel Committee on Banking Supervision, the International Organization of Securities Commissions (IOSCO) and the International Association of Insurance Supervisors (IAIS), in order to take forward the work of the Tripartite Group on a range of issues relating to the supervision of financial conglomerates.
[5] A distinction needs to be made between compulsory pensions (handled exclusively by AFPs) and voluntary pensions that can be offered by other market participants as well. Since AFPs also account for much of the latter (tiny in size) business, it is assumed here that the pensions sector consists solely of AFPs.

least two different financial sectors (banking, securities[6]*, insurance, pensions)*". Moreover, in order to ensure the maximum possible coverage for analytical purposes, a broad definition of what constitutes "*significant*" was adopted: most groups present in more than one financial sector were therefore categorized as financial conglomerates[7].

Chile does not currently have a legally embedded definition of financial conglomerates, while its legal characterization of related parties is not sufficiently comprehensive. The Securities and Insurance Superintendency (SVS) defines an 'economic group' in Securities Market Law 18.045 as *"…a group of entities that display the kind of links in their ownership, administration, or credit liability that lead to a presumption that the economic and financial action of the members thereof is guided by the group's common interest or is subordinate thereto, or that there are common financial risks in the credits granted to them, or in the acquisition of securities issued by them*". Articles 96-102 of the same law specify the characteristics and describe the obligations of such groups in greater detail. Using this definition, there were 92 'economic groups' as of March 2004, up from 12 in 1988. Even though the definition is sufficiently broad to be considered comprehensive, it excludes two important types of companies:

- non-registered (closed or foreign-listed) companies that could be part of a group – for example, Antofagasta is an important holding company of the Luksic group, but it is domiciled abroad and is therefore excluded from the SVS classification of the Luksic 'economic group'
- companies where more than one controller has major shareholdings – for example, since AFP Habitat is controlled by an investment company jointly

[6] Securities activities typically include the provision of securities brokerage and fund management services, as well as own account trading. For the purposes of this paper and given the relatively small size of the mutual fund segment (US 6 billion as of end-2003), securities brokerage is used as the proxy for activities in this financial sector. It should be noted that: (1) the majority of securities market players belong to banks and are therefore already included in any consolidated banking group statistics; (2) there is substantial over-the-counter (OTC) securities activity that is directly handled by the banks themselves.

[7] The precise meaning of "*significant*" (i.e. both the choice of proxy – assets, equity, income or capital – and threshold percentage) has been purposefully kept vague at this stage, given the need for additional analysis in order to be able to come up with an appropriate working definition for Chile. Given the presence of mixed-activity conglomerates, it is likely that such a definition would include similar criteria to the EU.

owned by Citibank and the Chilean Chamber of Construction, it is not included in either of the two ‘economic groups’.

The absence of a comprehensive legal definition of related parties has not hindered financial sector regulators in their application of prudential norms. Both the SVS and Pensions Superintendency (SAFP) use the ‘economic group’ definition in their application of related investment limits for their respective supervised entities. Because those entities are obliged to invest primarily in listed securities[8], the limitations of the definition that are mentioned above do not generally arise. By contrast, the Bank and Financial Institutions Superintendency (SBIF) uses its own, more encompassing operational definition for connected lending limits and in its analysis of important bank groups, major shareholder changes, and/or proposed change of ownership deals. This is because article 84 of the General Banking Law gives the SBIF great leeway in determining what constitutes a connected party.

B. Presence in the Chilean Financial System

Financial conglomerates are dominant in Chile and are consequently significant for its financial system. In that respect, Chile is not different from its Latin American neighbors in the extent to which conglomerates dominate the financial, and indeed the non-financial, system[9, 10]. In fact, the concentration in the financial sector partly reflects the structure of the Chilean corporate sector[11], although the presence of foreign financial institutions has helped to partly ameliorate domestic concentration. As can be seen in Tables 1 and 2, the insurance sector constitutes the only exception with regard to the penetration of financial conglomerates. Appendix II provides a more detailed breakdown of the incidence of financial conglomeration by financial sector for 2003.

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[8] Exceptions include operationes de libre disponibilidad (for AFPs) and mutuos hipotecarios (for insurance companies).

[9] The substantial presence of mixed-activity conglomerates in the financial system is a characteristic that often sets apart the financial systems of many emerging markets from those of developed countries.

[10] For a general description of the presence and characteristics of economic groups in Chile, see Agosin M. R. and Pasten E. H. (May 2003), Lefort F. and Walker E. (October 1999/April 2000a and b), and Majluf N., Abarca N., Rodriguez D. and Fuentes L. A. (April 1998).

[11] In addition to financial conglomerates and a few domestic ‘monolines’, many of the remaining financial institutions actually belong to a mixed-activity conglomerate – for example, Cruz del Sur (Angelini group), Larrain Vial (Larrain group), and Banco Falabella (Solari and Del Rio group).

Table 1: Presence of Financial Conglomerates in Chilean Financial System (2003)

As proportion (%) of each sector*	Banking	Securities	Insurance (life and non-life)	Pensions**
Belonging to a financial conglomerate***	98%	91%	40%	97%
Belonging to foreign financial conglomerate	41%	47%	13%	80%
Belonging to domestic 'pure' financial conglomerate	34%	23%	9%	1%
Belonging to domestic conglomerate with mixed activities****	23%	21%	18%	16%

Source: Own analysis based on data provided by SBIF, SVS and SAFP

** Percentages are based on bank assets (banking), securities turnover by stock brokerage companies/corredores de bolsa (securities), direct premiums (insurance) and AFP assets under management (pensions) for 2003.*

*** AFP Habitat is assumed to be controlled by Citibank even though it is jointly owned with the Chilean Chamber of Construction.*

**** Large foreign and domestic groups that are primarily active in one Chilean financial sector (e.g. AIG, Cruz del Sur/Angelini, Zurich Financial Services) are not considered financial conglomerates.*

***** Only conglomerates with non-negligible mixed activities are included, e.g. the Yarur and Security groups are excluded because their non-financial activities are very small in comparison to the total.*

Table 2: Five Largest Firms by Financial Sector in Chile (2003)

Ranking by Size**	Banking	Securities****	Insurance (life and non-life)	Pensions
1	Santander (ffc*)	Citibank (ffc)	ING (ffc)	Provida/BBVA (ffc)
2	Banco de Chile/Luksic (dmc*)	BBVA (ffc)	Chilena Consolidada/Zurich (foreign-owned)	Habitat*** (ffc)
3	Estado (state-owned, dfc*)	Santander Santiago (ffc)	Consorcio Financiero (dmc)	Cuprum/Penta (dmc)
4	BCI/Yarur (dfc)	Bice/Matte (dmc)	AIG (foreign-owned)	Santa Maria/ING (ffc)
5	BBVA (ffc)	Banchile/Luksic (dmc)	Cruz del Sur/Angelini (domestic-owned)	Summa Bansander (ffc)

Source: Own analysis based on data provided by SBIF, SVS and SAFP

** ffc: foreign financial conglomerate; dfc: domestic 'pure' financial conglomerate; dmc: domestic mixed-activity conglomerate*

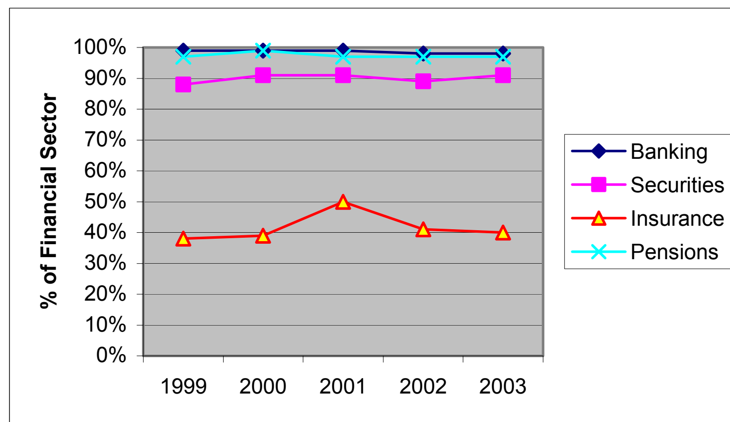
*** Ranking is based on bank assets (banking), securities turnover by stock brokerage companies/corredores de bolsa (securities), direct premiums (insurance) and AFP assets under management (pensions) for 2003.*

**** AFP Habitat is assumed to be controlled by Citibank even though it is jointly owned with the Chilean Chamber of Construction.*

***** There is some overlap between the banking and securities sectors, since consolidated results for the former include securities operations (only for bank holding companies).In addition, there is substantial OTC debt trading activity that is directly conducted by the banks themselves.*

The importance of financial conglomerates in the Chilean financial system has remained remarkably stable over the last 5 years. As can be seen in Diagram 1, following the increasing inroads into Chile by foreign financial institutions in the 1990's, a very high and stable level of financial conglomeration has prevailed in the last few years[12]. Pure 'monoline' players are rare, and are mostly concentrated in specialized activities like insurance (e.g. Chilena Consolidada/Zurich Financial Services, Allianz, MetLife) or investment banking and brokerage (e.g. Larrain Vial, IM Trust). Appendix III provides a more detailed breakdown of conglomeration by financial sector for 1990-2003.

Diagram 1: Market Shares of Financial Conglomerates by Sector (1999-2003)



Source: Own analysis based on data provided by SBIF, SVS and SAFP
Note: Each company's market share is based on bank assets (banking), securities turnover by stock brokerage companies/corredores de bolsa (securities), direct premiums (insurance) and AFP assets under management (pensions).

C. Typical Structure

Chilean financial conglomerates can be categorized along three important dimensions for policy purposes:

- ownership (domestic vs. foreign)
- activities (mixed vs. 'pure' financial)
- banking presence (include bank or not)

[12] The only noteworthy fluctuation involved the insurance sector and can be attributed primarily to merger-and-acquisition activity (exit of AXA and Santander, purchase of Aetna by ING, entry and subsequent collapse of Inverlink etc.).

As can be seen in Table 3, domestic financial conglomerates are either mixed[13] or purely financial in nature, while foreign ones are purely financial[14]. With a few exceptions, most financial conglomerates also have a banking presence, which typically represents their dominant activity in the financial sector. Geographical expansion (domestic vs. international), which forms another potential dimension, is not worth categorizing separately because of their limited foreign presence[15].

Table 3: Classification of Major Financial Conglomerates in Chile (2003)

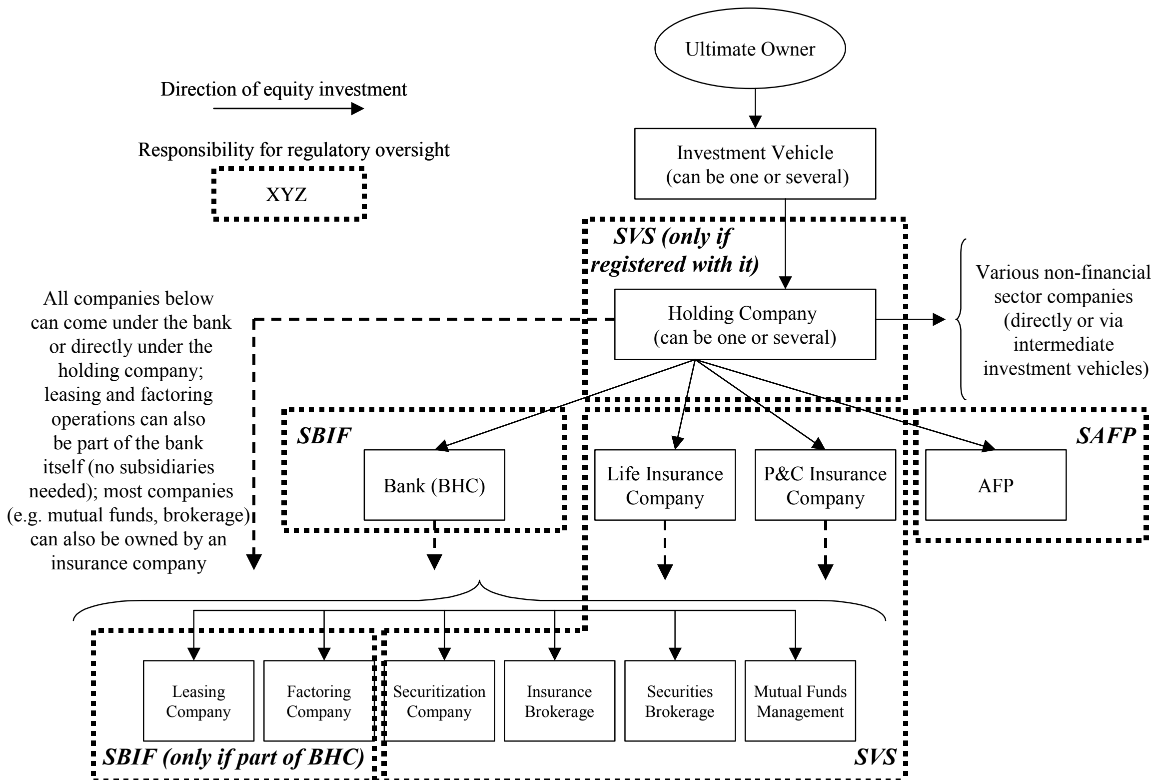
Name of Ultimate Controller	Banking*	Securities*	Insurance (life and non-life)*	Pensions*	Non-Financial Activities
Luksic (Banco de Chile)	17%	9%	1%		Mining, transport, food, manufacturing
Yarur (BCI)	11%	4%	2%		Negligible (viticulture)
Matte (Banco Bice)	3%	9%	3%		Forestry, electricity and real estate
Saieh (Corpbanca)	6%	4%	4%		
Garces, Leon and Vicuna (Consorcio Financiero)		2%	8%		Real estate, mining, bottling
Delano and Lavin (Penta)	(just granted banking license)	(investment and mutual funds but no stock broker)	6%	16%	Real estate, health
Grupo Security (various individuals)	2%	8%	2%		Negligible (travel, real estate)
Banco del Estado (state-owned)	16%	7%			
Santander	22%	12%	(small life insurance company)	11%	
BBVA	7%	14%	1%	32%	
Citibank	3%	14%		24%**	
ING			9%	13%	Health insurance

[13] In the sense of belonging to a larger group that includes significant non-financial activities.
[14] Minor exceptions apply in both cases: the Yarur and Security groups have some limited non-financial activities, while ING also offers health insurance. Since these activities are relatively minor when compared to the groups' overall size, they have all been classified as 'pure' financial conglomerates.
[15] The most significant foreign financial sector presence of Chilean financial institutions currently involves equity participation in foreign pension funds (Mexico, Peru, Colombia, Ecuador and El Salvador) by AFPs Provida and Santa Maria. In addition, a few Chilean banks have branches and/or rep. offices in the United States (New York or Miami), although they are primarily used to serve Chilean clients.

Source: Own analysis based on data provided by SBIF, SVS, SAFP and Feller Rate
** Percentages are market shares of each entity by financial sector. They are based on bank assets (banking), securities turnover by stock brokerage companies/corredores de bolsa (securities), direct premiums (insurance) and AFP investments (pensions) for 2003.*
*** AFP Habitat is assumed to be controlled by Citibank even though it is jointly owned with the Chilean Chamber of Construction.*

In the case of domestic financial conglomerates, the corporate structures used typically include holding companies, controlled via investment vehicles by the ultimate owner (individual and/or family). If the conglomerate owns a bank, activities such as mutual funds management, stock and insurance brokerage, factoring and leasing tend to come under it[16], otherwise they typically come directly under the holding company or (more rarely) under the insurance company. Foreign financial conglomerates follow the organizational structure of their parent companies, although they still need to comply with Chilean prudential regulations, i.e. the local subsidiary of the foreign bank cannot own an insurance company or an AFP.

Diagram 2: Stylized Structure of Domestic Mixed-Activity Conglomerate



[16] Over the last few years, factoring and leasing operations are increasingly being subsumed into the bank.

Given the pyramidal and fairly transparent (at least on the financial sector side) corporate structure of most domestic financial conglomerates, both control and cash flow rights are typically exercised via large shareholdings. This is also reflected in the composition of the Board of Directors: a comparison of Board members across the holding company and its major financial sector subsidiaries indicates the presence of the same one or two individual(s) from the controlling family.

D. Current Supervisory Arrangements

Regulation and supervision of the financial system take place on a sector-specific basis. SBIF is responsible for bank supervision; SVS covers insurance companies and brokers, securities markets entities (stock brokers, mutual/investment fund managers) and all registered 'open' companies; SAFP only covers AFPs.

Only the Bank Holding Company (BHC) structure is explicitly recognized under Chilean law (Ley General de Bancos) for consolidated supervision purposes. In that case, the bank forms the parent entity and the SBIF becomes responsible for consolidated prudential requirements, although supervisory authority for securities subsidiaries remains with the SVS. As can be seen in the previous diagram, permissible subsidiaries and affiliates under a BHC structure are essentially restricted to the banking and securities sectors, the only exception being insurance brokerage.

By contrast, there are no prudential requirements for holding companies that control firms from different financial sectors (including banks/BHCs). To the extent that such entities are publicly registered and form part of an 'economic group', they are subject to standard SVS oversight with a few additional reporting (but virtually no prudential) requirements. SBIF also requires submission of audited information of the financial statements by all shareholders owning more than 10% of the bank's equity. In addition, it collects, via the bank itself, information about the ultimate shareholders, although it is questionable whether that information by itself is sufficient for an adequate assessment (see next section). Moreover, SBIF (as well as SVS and SAFP) has no on-site inspection

authority and cannot impose any supplementary reporting or prudential requirements to firms that are parallel to or above its regulated entity.

In the case of foreign-owned/controlled financial conglomerates, responsibility for consolidated supervision rests with the relevant home supervisor. Reciprocal arrangements for information exchange take the form of a Memorandum of Understanding (MOU). On the banking side, Chile has already signed formal MOUs with the USA, Spain and Argentina; on the securities side, Chile has signed MOUs with 22 countries covering cooperation, technical assistance, exchange of information and consultation between regulatory bodies of different jurisdictions. There are no MOUs with foreign regulatory (as opposed to social security) authorities on the pensions side.

Cooperation between the domestic supervisors has historically been informal and narrow in scope, but this is slowly changing. The Superintendents have cooperated on an informal basis for several years in drafting prudential regulations that are of common interest (e.g. voluntary pensions rules), while they are also participating in the Capital Markets Committee[17] (together with the Central Bank) and the Risk Rating Commission[18] (together with AFP representatives). An informal Comité de Superintendentes (SBIF, SVS and SAFP) was set up in 2001 with the objective of improving regulatory coordination, and will become official under the proposed Capital Markets II legislative reform. The Superintendents have used this forum to voluntarily exchange information and experiences, discuss topics of common interest and analyze the impact of the introduction of new sector-specific regulations. Some elements of cooperation at an operational level have also recently been undertaken:

- joint on-site inspections by SBIF and SVS of some brokers where there is an overlap in jurisdiction because they belong to a BHC
- creation of ad hoc working groups to study issues of common interest, such as external auditors and mutual fund management fees charged to AFPs.

[17] The Capital Markets Committee is an informal body that was established in the early 1990's in order to coordinate financial policy issues and facilitate the introduction of new financial legislation, such as the proposed Capital Markets II legislative reform.
[18] The Risk Rating Commission was established in order to classify risk and approve instruments for purchase by AFPs.

The Comité has no permanent staff; the Technical and Executive Secretaries come from the ranks of SBIF, while the Superintendent of banks acts as the coordinator of its activities. A few high-level individuals from each Superintendency are the designated contact persons for each working group.

Strict firewalls exist between related companies in the banking/securities, insurance and pensions sectors. As can be seen in Table 4, firewalls (broadly defined) take the form of prudential limits on permissible activities, ownership of other companies, connected lending/investments and prohibitions on shared infrastructures/client bases. In the case of banks, since most limits are currently applied on a consolidated BHC basis, they do not apply for their subsidiaries that are mostly securities entities – so the two sectors are generally much more integrated with each other. A major effect of the imposition of these firewalls in the 1980's has been to reduce banks' importance for domestic mixed-activity conglomerates both organizationally (i.e. banks moved from the center to the edges of the group structure) and as a source of funding.

Table 4: Summary of Major Firewalls by Financial Sector

Firewall Type	Banking	Securities*	Insurance	Pensions
Permissible activities	Only those defined under article 69 of LGB	Those related to securities intermediation, buying and selling securities for trading and other activities authorized by SVS (article 27 LMV 18.045).	Only allowed to offer insurance products. Allowed to purchase consumer loans and mortgages in the context of their investment operations.	Management of pension funds, and the granting and administration of the benefits established in DL 3,500
Ownership limits	Global limit for equity participations (subsidiaries) and fixed assets of 100% of capital. Banks can only form subsidiaries for activities defined in article 70 of LGB, subject to meeting minimum capital adequacy, and management and financial strength rating requirements. Operation of subsidiaries to be supervised either by SBIF or by SVS. The subsidiaries cannot invest in other companies without the prior approval of the SBIF and the investment cannot exceed 5% of paid-in capital.	Forbidden to participate in other activities besides article 27 of LMV, because their activity is limited to securities.	No explicit legal prohibition other than the requirement that any additional activities be "complementary" to the core insurance business (article 4, DFL 251). In practice, the SVS has authorized subsidiaries in regulated financial businesses such as mutual and investment fund management, stock and insurance brokerage, and credit cards.	Can launch subsidiaries, with the prior permission of SAFP, to offer services related to social security abroad (e.g. AFP management, custody, collection of contributions, benefits management and payment etc.). Can also launch subsidiaries with the sole purpose of managing the social security resources of their own or of other domestic AFPs. Authorized to invest in up to 7% of the subscribed shares of a securities deposit company.

Firewall Type	Banking	Securities*	Insurance	Pensions
Connected exposure limits	Under article 84 of LGB, all on- and off-Balance Sheet credits to a party (irrespective of whether it is related to the bank) cannot exceed 5% of capital, which can be raised to 30% depending on the type of guarantee specified in the law. The sum of all credits to different related parties cannot exceed the bank's capital on a consolidated basis. All credits to related parties must be at arm's length. Great discretion given to SBIF to determine related parties, defined as owning at least 1% and 5% of bank equity for individuals and firms respectively. Bank Directors' interests in other companies are presumed to constitute related lending by association. Lending to bank employees limited to 1.5% of capital (except mortgages).	Brokers must comply with minimum capital requirements. For that purpose, the calculation of net capital excludes intangible assets owed by affiliated parties (Norma de Carácter General N°18 SVS). In case brokers are organized as corporations, any transaction with affiliated parties must be done at arm's length. (Article 89 LSA)	Definition of related party is that of 'economic group' (article 96 of SML 18.045). Limit on fixed income and shares issued or guaranteed by companies in an 'economic group': 7.5% of technical provisions and solvency margin. Limit on fixed income and shares issued or guaranteed by a related company and its subsidiaries: 5% of technical provisions and solvency margin. Limit on fixed income and shares issued by a related company abroad: 2.5% of technical provisions and solvency margin.	Definition of related party is that of 'economic group'(article 96 of SML 18.045). Debt securities: Global limit of 3% of the assets of a related company and 5% of the issue. All securities of a related company: 1% of a fund's value. All securities of all related companies (including direct and indirect investment): 5% of a fund's value. Investment fund shares and amount of committed payments (related fund administrator): 5% of shares issued and subscribed. Mutual fund shares (related fund administrator): 5% of issued shares. Shares of related open/banking and financial/real estate companies: 2%/0.5%/5% of company's subscribed shares respectively.
Board of Directors	Only non-executive Directors allowed (article 49 of LGB)	According to article 27 of LMV, if brokers are organized as corporations, their directors must accomplish certain qualification standards established by Article 26 of LMV. Directors cannot also be in the Board of a "sociedad administradora de fondos de terceros" (article 169 LMV) or an anonymous society or its related companies. (article 36 LSA). Article 44 of Law 18.046: The company cannot make a contract or negotiation when there is a director's interest involved without the pre-approval of the board. A director's interest is presumed when one of the parties is a corporation where he is also the director.	Specific integrity requirements included in insurance law, in addition to general rules for incorporated companies (ley de sociedades anónimas).	'Executives' (managers, deputy managers, and all other individuals with the ability to represent the firm or take important relevant decisions) in other financial companies cannot also be AFP Directors (article 156 of DL 3,500). No legal restriction for an AFP Director to be a Director in other related companies as well.

Firewall Type	Banking	Securities*	Insurance	Pensions
Other comments	According to article 16 of LGB, entities or individuals that control the bank (based on the Securities Market Law) and also own more than 10% of its shares, must provide information to SBIF on their financial situation, although that information cannot be more than what SVS requires for anonymous open societies. Prohibition on sharing distribution network (unless via normal market contract) and client database (law on sharing of private information) with related companies outside the bank holding company structure.	Joint SVS – SBIF Circular N° 960 regulates banks activity, stock, securities and money exchange. In Chile, physical persons or legal persons can be brokers without distinctions.	There is no explicit law/regulation on outsourcing or sharing of functions and systems – in practice, some back office activities are currently allowed to be shared. General law on sharing of private information also applies.	Risk Rating Commission established to classify risk and approve instruments for purchase by AFPs. Pricing vector for valuation purposes determined by SAFP itself. Prohibition on sharing client database and infrastructure with related financial companies.

Source: SBIF, SVS and SAFP
** Firewalls for the securities sector refer solely to stock brokerage companies.*

The existence of regulatory firewalls combined with historically high profitability in most financial sectors has contributed to the management of major financial entities within each conglomerate typically on a stand-alone basis. This means that management control is exercised at the level of each entity, subject to an overall group direction dictated by the main controller(s) principally via participation in the relevant Board of Directors. On the basis of interviews with executives from such entities, the major group-level synergies that have been identified are limited to common branding, certain elements of risk management (only by foreign entities) and strategic outlook. Holding company involvement is typically minimal – given that such companies are often non-operational in nature, they mostly act as a coordination and reporting mechanism. The only exception involves entities that form part of a BHC, where common management structures and sharing of infrastructure (distribution networks, information technology systems) and client databases are allowed between the bank and its banking/securities subsidiaries.

In conclusion, there is no comprehensive consolidated supervision framework for financial conglomerates in Chile. Different parts of the same group are supervised by different regulators, whose level of cooperation, coordination and information-sharing (though improving) is still informal and limited in scope. The silo-based nature of current

supervisory arrangements is reflected in the non-compliant status of the criteria underlying Principle 20 (see Appendix I) of the recent Basel Core Principles (BCP) assessment[19]. In that respect, Chile does not appear to be different than most other countries, since only 35% of them (based on a sample of 60 countries that had until recently participated in an FSAP) are actually partly or fully compliant with best practice in this area.

3. Assessment of Vulnerabilities and Costs of Regulation

A. Typology of Vulnerabilities Introduced by Financial Conglomerates

Five types of vulnerabilities, created by the presence of financial conglomerates, have been identified and are assessed in this section. Some of these reflect new types of prudential risks introduced by financial conglomerates (e.g. contagion), while others merely exacerbate pre-existing ones (e.g. inconsistent regulatory treatment). Although some of these practically overlap or tend to occur in tandem, it would be useful to treat them as conceptually distinct in order to determine the extent to which they are relevant for Chile. Moreover, given the limited presence abroad of Chilean financial conglomerates, the impact of the identified vulnerabilities as they apply across national jurisdictions is not examined.

Table 5: Typology of Financial Conglomerate Vulnerabilities

Type of Vulnerability	Description
Risk aggregation, complexity and transparency	Complexity and non-transparency of financial conglomerates creates potential for excessive concentration of exposures (intra-group or external), inadequate capitalization (excessive leverage or multiple gearing) and financial contagion to the bank stemming from problems in other parts of the group
Inconsistent regulatory treatment and insufficient coordination	Different regulatory regimes and lack of supervisory coordination create opportunities for regulatory arbitrage (e.g. in minimum capital requirements), reduce the effectiveness of overall supervision and raise costs of the failure resolution process of a conglomerate

[19] For a detailed description of the BCP framework, see Basel Committee on Banking Supervision (September 1997 and October 1999)

Incomplete coverage	Incomplete regulatory coverage of financial conglomerate entities or markets can result in arbitrage opportunities and imprudent concentration of exposures
Contagion	Psychological contagion (e.g. a run on a group bank) can originate from problems in other parts of a group that are perceived by the market to involve the bank by association (e.g. via common branding)
Distorted competition and consumer protection	A financial conglomerate can use informational advantages, cross-subsidies and/or off-market price transactions to undercut competitors in specific financial market segments and to exploit clients (conflicts of interest)

It is important to clarify up-front that, due to systemic concerns, greater weight is placed on those vulnerabilities that affect the banking sector as opposed to those that affect other financial sectors (e.g. securities[20], insurance). The reason is that the banking sector has traditionally been exposed to problems whose consequences have led to significantly greater social costs than problems in other sectors. This is also reflected by the different regulatory philosophies and practices[21]:

- banking regulation is primarily based on the avoidance of systemic risk
- securities and investment regulation is generally based on investor protection and enhancing the efficiency of markets via maximum transparency and disclosure
- insurance regulation focuses on the solvency of individual companies and protection of policyholders, although generally without any systemic dimensions.

As a result, the severity of the problems generated by any identified vulnerabilities, as well as the necessity for remedial measures, is greater for the banking sector. This also has implications for the regulation of financial conglomerates with a banking presence vis-à-vis those without it.

B. Risk Aggregation, Complexity and Transparency

There is little prima facie evidence to support the existence of excessive (when compared to the limits) intra-group exposures between financial sector entities of the

[20] To the extent that securities firms and mutual funds already come under a BHC structure, this distinction is not relevant for them.
[21] In addition to secondary goals such as investor protection, efficiency enhancement and broader social objectives. See Basel Committee on Banking Supervision (November 2001), Allen F. and Herring R. (2001), and van Lelyveld I. and Schilder A. (November 2002).

same Chilean conglomerate. As can be seen in Table 6, the strict firewalls previously mentioned have reduced the possibility of intra-group financial contagion originating from the group bank/BHC[22], which (given its size) typically dominates all other financial sector entities as far as financial conglomerate controllers are concerned.

Table 6: Intra-Group Exposures for Banking and Securities Sectors (2003)

Financial Conglomerate	Intra-group Exposure*
Luksic	12.5%
Yarur	9.2%
Matte	5.4%
Saieh	20.2%
Consorcio Financiero	N/A
Penta	N/A
Grupo Security	31.4%
Santander	19.4%
BBVA	7.7%
Scotia	6.8%
Citibank	1.8%
ING	N/A
SYSTEM AVERAGE	**12.4%**

Source: SBIF.

** Percentages represent related party (i.e. intra-group) exposure as a function of capital on a consolidated basis for the group bank (banking and securities) for 2003.*

Note: Banking and securities are put together because the limits apply on a consolidated BHC level, i.e. they include both the bank and its securities subsidiaries (if any).

In addition, the possibility of systemic problems stemming from excessive exposures within the financial part of a conglomerate is reduced by the fact that:

- domestic consolidated supervision already takes place for BHCs, which typically comprise both the banking and securities sectors in most financial conglomerates

[22] The equivalent (publicly unavailable) numbers for the insurance and pensions sectors are also low, although care should be taken with the different definition of related parties used for these sectors. For example, average system-wide intra-group exposure consisted of 0.4% of combined total assets and 0.5% of total investments for insurance companies and AFPs respectively.

- foreign financial conglomerates (which constitute around 40% of the Chilean banking system) are already supervised on a consolidated basis by their respective home-country supervisors
- domestic financial conglomerates that are dominant in the banking and securities sectors (e.g. Luksic, Yarur, Saieh) do not have a significant presence in the insurance and AFP sectors, and vice versa (e.g. Concorcio Financiero, Penta).

Of course, an important implicit assumption of this line of argument is that there is an appropriate level of supervision in each financial sector[23], as well as adequate coordination and cooperation between the different supervisors (see below).

There are, however, potential risks above the BHC level that are not adequately monitored or protected under current supervisory arrangements. These stem primarily from the non-regulated, non-financial part of a domestic conglomerate – for example, it is impossible currently to accurately assess:

- true group-level solvency beyond simple accounting measures – to prevent the incidence of excessive leverage[24]
- group-level concentration of external exposures (direct and indirect) by company/sector – to prevent significant weakening of the 'source of strength' (and thereby inability to inject more capital in the bank) because of problems in specific group counterparties/sectors
- dependence of bank funding (liabilities) on the rest of the group – to prevent a funding crunch in the bank because of withdrawals from other group members.

SBIF's solution to this problem has been to piece together and monitor the major conglomerates' structure and related equity positions via the collection of information from the bank itself and from its major direct shareholders, as well as from reporting of relevant credit exposures by all banks in the 'Central de Riesgos' (risk database).

[23] For example, as the Inverlink case has shown, in the absence of immediate and effective intervention by the supervisors, it is extremely difficult to stop a desperate group from raiding available funds from its financial sector entities.

[24] Excessive leverage can occur when a parent issues debt (or other instruments not acceptable as regulatory capital in the downstream entity) and downstreams the proceeds to a dependent in the form of equity or other elements of regulatory capital.

However, this is only a second-best option since it relies primarily on backwards-looking accounting statements and indirect sources[25], does not capture companies without domestic bank lending and has limited enforcement capabilities. In the case of financial conglomerates that have no banking presence, even this instrument is unavailable for SVS and SAFP. The situation is aggravated by the absence of two other factors:

- the concept of a financial holding company (FHC), which would allow the separation of financial and non-financial activities within a conglomerate, as well as the better protection/isolation of the former from the latter
- proper consolidation of financial statements, given the different accounting conventions that make it impossible to properly consolidate a bank at holding company level. Since only the equity method (i.e. one line item under the heading "investment in affiliates/associates" for the amount corresponding to the share of equity controlled) is used to consolidate its subsidiaries, the holding company's overall gearing ratio could be distorted.

Finally, the counter-argument that financial conglomerates are actually 'safer' because of diversification is not supported empirically. In a recent study[26] of risks within financial conglomerates, it was shown that diversification effects are greatest within a single risk factor, decrease at the business unit level, and are smallest (incremental benefits as low as 5%-10%) across financial sectors, depending on the business mix. This would imply that most of the diversification benefits are derived at the level of the individual bank/BHC, given that it is already exposed to most types of risks[27]. Even in the case of financial conglomerates that belong to groups with mixed activities, the relatively high concentration of the Chilean economy (given its size and structure) and its corporate sector imply that there must be few benefits from diversification. In addition, a

[25] For example, in the case of the Luksic conglomerate, the cash flow and solvency position of Quinenco (holding company of Banco de Chile) worsened in 2002, but the performance of Antofagasta (the other major – and parallel to Quinenco – holding company) improved. However, the issue of whether one holding company would provide support to the other, as well as whether any adjustments need to be made to the accounting statements in order to better reflect economic reality, cannot be addressed properly.
[26] See Kuritzkes A., Schuermann T. and Weiner S. (November 2002).
[27] A related issue, which is not discussed here, is whether those diversification benefits are adequately captured by the existing minimum regulatory capital requirements – and whether the bank is therefore appropriately capitalized. However, the point to emphasize here is that risks are not necessarily diversified away when reaching up to higher levels in the conglomerate structure.

conglomerate is also subject to contagion risk, which was not considered in the above study (see below).

C. Inconsistent Regulatory Treatment and Insufficient Coordination

There appear to be relatively few opportunities and no evidence of significant regulatory capital arbitrage within a financial conglomerate. Such opportunities currently stem primarily from the following two factors:

- certain credit activities (e.g. leasing, factoring and credit cards) can actually sit under/within or next to a BHC, so one potential incentive for financial conglomerates to choose the latter option would be to avoid regulatory capital requirements. Given the relatively small size (when compared to the bank) of such institutions, however, such opportunities are currently limited[28].
- loan sales/securitizations from the bank to group entities with less penalizing capital requirements (e.g. insurance company) is another possibility. However, such transactions are currently non-existent apart from mortgage securitizations[29]. A primary reason could be that banks currently have a sufficient level of capital in excess of minimum regulatory requirements, which does not force them to securitize their loans in order to improve their capital adequacy position.

Incidents of accounting and valuation arbitrage also do not appear to be taking place. In theory, the different accounting and valuation rules in different financial sectors[30] allow for the possibility of arbitrage opportunities. In practice, however, the existing firewalls on the type (arm's length pricing) and extent of related party transactions, as well as the fact that group companies are run on a stand-alone basis, have helped to mitigate this possibility – although it remains a concern.

[28] In addition, there are other factors that discourage such companies from operating next to the bank as opposed to under/within it – for example, the difficulty of easily sharing costs/distribution channels in such situations, and of obtaining funding (group bank funding would be subject to the related lending limits). Moreover, the return to the shareholders might be different because of the distinct tax treatment of profits in different entities – see Australian Prudential Regulation Authority (1998).

[29] The broader issue of credit risk transfer from the banking to the insurance and AFP sectors is not considered here.

[30] The SBIF, SVS and SAFP issue their own rules for their respective regulated entities, which complement and often supersede the generic accounting rules established by the College of Accountants in Chile.

However, the current implicit assumption by the Chilean regulators that financial conglomerates can be treated as a loose collection of independently-managed entities may not hold going forward. The functional supervision that has characterized the Chilean financial system is increasingly becoming more institution-oriented as a result of the 'blurring of boundaries' between financial sector participants. This refers to the increasing incidence of overlapping activities, risks and products that has been happening both internationally[31] and in Chile – for example:

- insurance companies are currently allowed to directly originate consumer loans and mortgages, and to launch mutual fund and credit card subsidiaries
- voluntary pensions are provided by banks, insurance companies and AFPs
- annuities will be allowed to be sold by banks (in addition to insurance companies) under the proposed Capital Markets II legislation
- all types of financial institutions participate in the growing securities and OTC derivatives markets.

As a result, the incentives for regulatory arbitrage could increase in the future. Anecdotal evidence suggests that controllers of Chilean financial conglomerates have historically viewed each financial sector in its own right, both because of the firewalls and because they were generally profitable stand-alone businesses. As the ability to maintain high profitability (particularly for banks) erodes due to intensified competition[32], controllers will increasingly be motivated to identify and leverage synergies among their group entities. Those synergies, which include the ability to arbitrage across regulatory domains, will be maximized if there is insufficient regulatory cooperation and coordination. Examples would include:

- moving assets to entities with lower regulatory capital charge or preferred accounting and valuation rules

[31] It is worth noting that the overlap at the level of financial products is usually greater than what is implied by simply comparing the presence of financial institutions in different financial sectors. This is because new hybrid products are constantly evolving, potentially combining banking, securities and insurance components – see van der Zwet A. (2003).

[32] Causal factors include the on-going relaxation of regulatory restrictions, as well as market developments such as increasing internationalization, product innovation and technological advancements.

- using non-regulated entities to bypass exposure restrictions
- taking excessive leverage within the conglomerate in order to maintain the group's equity participation in growing financial sector businesses.

Even though the level of cross-border supervisory cooperation appears satisfactory, coordination among domestic regulators is still informal and potentially insufficient. On the cross-border front, several formal Memoranda of Understanding (MOUs) have been signed by SBIF and SVS with foreign supervisors. On the domestic front, although the proposed Capital Markets Reform law will formalize the Comité de Superintendentes, there is currently no MOU or even informal agreement that clearly describes/assigns the roles and responsibilities of each supervisor[33]. This is a potentially problematic arrangement in normal but especially in emergency situations, where there is an obvious need to act in a coordinated and prompt manner. In addition, the supervisory framework lacks the concept of a 'lead regulator', whose main objective would be to monitor the behavior and assess the solvency of a financial conglomerate in its entirety (to the extent allowed by existing prudential arrangements). The apparent lack of sufficient regulatory coordination was noted in the case of Inverlink (see box below), where at least one commentator[34] states that better information sharing among supervisors could have prevented some of the worst abuses that took place and detected the problems earlier.

Box 1: The Inverlink Case

Founded in the early 1990's, Inverlink grew rapidly from a stock brokerage firm into a full-fledged financial conglomerate with pension fund (AFP Magister), life insurance (Le Mans) and other non-financial concerns. After being accused of share price manipulation in 2001, the group was encouraged by the SBIF to retract its banking license application, while the Central Bank refused it authorization to deal on the foreign exchange market.

At the beginning of February 2003, Inverlink's brokerage arm was revealed to have been buying market-sensitive information from the personal secretary of the Central Bank president. Faced with a run on its mutual funds caused by the accusations, the group resorted to selling certificates of deposit (CDs) worth

[33] Although a "*Joint Resolution*" was signed by Comité participants upon its establishment in 2001 (and augmented by a "*Protocol of Activities*" in 2003), it is neither comprehensive nor sufficiently detailed.
[34] See Larrain C. (spring 2003).

around US$100 million from CORFO that it illegally held. It appears that Inverlink had been using them (in addition to client assets) as collateral for short-term trading for several years. It also borrowed substantially from its insurance subsidiary, resulting in the latter's subsequent insolvency and collapse.

After being alerted to it, CORFO reported the theft in March – by that time, the CDs had changed hands and were held mostly by local mutual funds. This triggered a dispute as to their ownership, with the holders maintaining that they had acquired the CDs in good faith and the government (at least initially) insisting that CORFO would not lose any money. Over the course of the next three days, the mutual fund industry lost over US$1.5 billion (around 27% of its assets) as nervous investors unloaded positions; this led to knock-on effects on the prices of other secondary market securities.

Faced with a paralyzed market and mounting fears of a broader liquidity run, the government subsequently agreed to lift the stop payment on the CDs until the courts determine their legal ownership – a process that is still on-going. In addition, it reached an agreement with SVS and the banks (owners of most mutual funds) so that the latter would guarantee the immediate repayment of the stolen instruments and would take any court-mandated loss. This stabilized the financial markets, which have since returned to normalcy.

The scandal led to the resignation of the CORFO Executive Vice President, Central Bank President and SVS Superintendent, as well as to the arrest and trial of Inverlink senior management. It was also Chile's first (albeit limited) market confidence crisis since the early 1980's, raising questions about cross-sector contagion, inadequacies in market infrastructure, insufficient internal controls and ineffective surveillance.

Finally, as the Inverlink case has shown, the failure resolution process for a financial conglomerate is complex and problematic. Not only are current intervention and insolvency rules different for each financial sector, but they ignore the complex reality of conglomerate failures, such as:

- the resolution of intra-group exposures
- time needed to implement bankruptcy procedures, which can adversely affect the going concern value of certain financial sector entities
- priority for 'pecking order' of creditors at different group entities and levels
- treatment of the same types of contracts (e.g. derivatives) by counterparties of group companies in different financial sectors, which might have potentially different valuation, accounting and investor protection rules

- the spillover/impact from unwinding of (potentially large) positions on markets with participants from different financial sectors

The patchwork of bankruptcy laws and procedures that are currently in place is therefore unlikely to lead to an efficient resolution of a bankrupt conglomerate.

D. Incomplete Coverage

Given the current supervisory set-up, incomplete coverage is primarily a concern for two types of entities: unregulated financial companies and non-financial affiliates of mixed-activity conglomerates. In the context of Chile, the former primarily involves the credit card activities of department stores that have recently obtained a banking license (e.g. Falabella, Almacenes Paris and Ripley), which dominate the credit card industry[35]. These activities remain outside the scope of SBIF oversight, but now become relevant because of the bank presence. To the extent that the credit card company funds itself from the rest of the group (as opposed to non-group bank lending and securitization of receivables), then concerns arise for financial contagion propagating through the group.

In addition, the 'silo'-type regulation and relatively little coordination among supervisors may lead to incomplete surveillance in certain markets. The participants in these markets (primarily securities and derivatives) cut across those silos, so the need for even closer coordination is essential in order to ensure adequate monitoring (e.g. via sufficient data collection and sharing) and to minimize the incidence of regulatory arbitrage (e.g. via valuation and accounting arrangements). For example, there is anecdotal evidence to suggest that the level of information sharing and surveillance in OTC derivatives is still lacking, impeding the development of an adequate, holistic view of this market segment.

[35] It is estimated that as many as 15.5 million credit cards (out of a total of 17.8 million in Chile) in 2003 were issued by non-banks and did not therefore carry the Visa, Mastercard or American Express logos. Of these, the largest three issuers were Falabella (3 million), Almacenes Paris (2.7 million) and Ripley (2.2 million).

E. Contagion

Psychological contagion (as opposed to financial contagion) exists independently of any firewalls. As mentioned earlier, the existence of firewalls in Chile essentially implies that group financial sector entities (bank, insurance company or AFP) would essentially 'die within their walls', so that financial contagion does not spread from one to the other. However, empirical evidence from other countries suggests that the mere association (or common branding[36]) of a bank with a conglomerate and its controller is sufficient to create the perception in the market that their fortunes are linked[37]. Moreover, financial problems or reputation scandals in the non-financial parts of the conglomerate (e.g. fraud as in Parmalat's case) could result in a run on the group bank by depositors[38], even if it appears to be sufficiently protected by the firewalls[39]. This is one reason for the empirically frequent support of ailing group entities by their related bank, even if the latter is under no legal obligation to back them. Contagion therefore places a great onus on banking regulators to monitor (to the extent possible) the financial health of the entire group/controller, while avoiding to give the perception that they have become responsible for it (moral hazard).

In addition, contagion is exacerbated by capital market illiquidity and (potentially) by the existing firewalls in Chile. On the capital markets side, the inability to off-load positions in listed companies by conglomerate controllers would preclude fast injections

[36] In general, Chilean conglomerates have tended to brand their financial sector companies differently than their non-financial ones. Given that it is not currently an obligation under the law or regulatory norms, there are some exceptions to this trend – for example, Grupo Security (same name for real estate, travel agency and financial sector companies) and Falabella/Paris/Ripley (same name for bank and department store).
[37] Of course, as has been noted to us by some market participants, the other side of this coin is that clients are attracted by the stability projected by the presence of a large controller 'backing' a financial institution.
[38] Given the large proportion of 'risk-sensitive' depositors (i.e. firms and institutional investors) in the banking system, this type of liquidity risk is even greater in Chile than in other countries. It is exacerbated by the legal obligation of AFPs to withdraw their funds from any bank whose solvency drops below 10%.
[39] Two instruments that could be used to mitigate the damage to the banking system in such an eventuality are the BCCh's lender of last resort (LOLR) facility and its legal obligation to provide a 1000% guarantee on all sight deposits. The former would allow the BCCh (with the previous opinion of the SBIF) to grant emergency credit for up to 90 days to banks facing transitory liquidity problems, while the latter would ensure that all sight deposit account holders are repaid in the event of bank liquidation. However, both instruments are primarily mitigating (as opposed to preventive) in nature – the issue here is how to best ensure from a regulatory perspective that instances of contagion are minimized.

of liquidity[40]. International experience also suggests that regulatory firewalls might actually worsen the situation by preventing the sharing of available resources across the group[41].

F. Distorted Competition and Consumer Protection

The incidence of conflicts of interest and distorted competition has not been investigated in sufficient detail to assess its importance. It is extremely difficult to attribute any perceived lack of competition or 'excess' concentration to financial conglomerates per se, primarily because such groups have always played an important role in Chile's financial system. Anecdotal evidence of limited intra-group exposures[42], monitoring of intra-group transactions and stand-alone management of group companies, appears to suggest that such occurrences might be limited. Future research on this topic could focus on the following behavioral indicators:

- complaints stemming from securities underwriting, investment research and distribution channels (bank, mutual fund etc.) within the same conglomerate
- solicitations to clients of one financial company (e.g. insurance company) from other conglomerate companies (e.g. bank), indicating the sharing of confidential client information
- evidence of off-market price transactions or other contracts (e.g. services)
- significant overlaps in participation of Directors and senior managers of financial conglomerate companies in other group entities
- conglomerate predatory behavior (e.g. via under-pricing and cross-subsidies) in specific financial sectors, deliberately aimed at eliminating competitors

[40] For example, in the case of the Luksic conglomerate, Quinenco controlled a minority position of around 5.7% in a telecoms company (Entel) that could presumably be sold in the Santiago stock market to cover any short-term liquidity shortfalls. However, the market impact costs of such a transaction would be huge, given that Luksic's US$70 million position at the time was much greater than the average daily turnover of Entel (around US$2-3 million during 2003).

[41] "*Firewalls between the regulated subsidiaries and the rest of Drexel Burnham Lambert Group [DBLG] did not persuade the market that the regulated subsidiaries would not be brought down by problems in their affiliates and parent; but the firewalls did exacerbate DBLG's liquidity problem by limiting the group's access to the resources of the regulated subsidiaries*"; taken from Allen F. and Herring R. (2001).

[42] At least between financial sector companies and between financial and non-financial companies within a conglomerate. The extent of intra-group exposures between non-financial companies themselves has not been investigated.

- ‘cornering’ of the market for specific security issues due to large (intentional or unintentional) purchases by a financial conglomerate via its bank, mutual fund, stock broker, insurance company and AFP.

G. Costs of Current Regulatory Arrangements

In order to properly evaluate the effectiveness of the current regulatory regime with respect to financial conglomerates, its risk mitigation capacity (described above) needs to be weighed against its costs. Those costs come in two different forms: costs to financial conglomerates and societal costs at-large. The former refers to inefficiencies in the operations of conglomerates as a result of the existence of strict firewalls, while the latter refers to broader costs incurred by society as a whole. Since (to our knowledge) neither of these costs has been studied or quantified to-date, a few suitable topics for investigation are highlighted below that could form part of a broader research agenda on the pros and cons of existing regulation.

Inefficiencies to financial conglomerates created by regulatory firewalls come in the form of opportunity and operating costs, and manifest themselves in either reduced revenue or increased costs. Opportunity costs arise when a regulation prevents a financial institution from (directly or indirectly) engaging in profitable activities – for example, various types of economies of scale and scope that cannot be leveraged between group financial companies, such as shared infrastructure, functions, products, distribution networks and client databases. Operating costs arise from requirements that financial institutions perform certain functions, such as reporting to regulators, providing disclosure to customers and meeting certain operating standards. The duplication of some of these functions (e.g. reporting) increases such costs significantly. On the other hand, it should be noted that some of these activities would have been performed even in the absence of regulations, so the relevant measure is the incremental costs brought about by the existence of such regulations[43]. Both opportunity and operating costs are currently obscured because of historically good margins in most financial sectors. One potential

[43] See Elliehausen G. (April 1998).

way to estimate some of these costs in the case of banking would be to look at the experience of the removal/relaxation of certain firewalls by the General Banking Act of 1997, in terms of the organizational response of financial conglomerates (e.g. many banks decided to 'absorb' their leasing and factoring operations) and the associated impact on their revenues and costs.

Discouragement of innovation and risk-taking in financial services could represent the main societal costs of the firewalls. The dependence of bank profitability on traditional lending, as well as the relative absence of well-developed capital market instruments (e.g. structured securities, derivatives) and non-bank financial institutions (e.g. commercial finance companies) for a country with Chile's economic track record and credit rating, could be considered as partial evidence of the detrimental effect of firewalls on financial system innovation. However, additional investigation would be required to substantiate such anecdotal claims.

4. Conclusion and Policy Implications

A. Summary of Findings

The analysis of the previous section suggests that there do not currently appear to be significant weaknesses in the Chilean financial system stemming from the presence of financial conglomerates. This is primarily due to the influence of three factors:

- strict firewalls, forcing a conglomerate's financial sector entities to be managed on a stand-alone basis
- high profitability across most financial sectors (particularly for banks), obviating the need for controllers to identify and leverage potential synergies among their group entities
- major presence of foreign players in all financial sectors, which are subject to consolidated supervision by their home-country supervisors.

The risk mitigation capacity of existing regulatory firewalls has implied some costs that have not yet been quantified. Those costs come in two different forms: inefficiencies

in the operations of financial conglomerates due to the inability to leverage synergies, and broader societal costs. The former have been obscured to-date because of historically good margins in most financial sectors, while the latter are difficult to discern empirically; both of them merit further research and quantification.

However, a number of vulnerabilities stemming from the presence of financial conglomerates have been identified and could potentially be important going forward:

- risks above/parallel to the BHC level stemming primarily from the non-regulated, non-financial part of a conglomerate are not adequately monitored or protected against under current supervisory arrangements
- regulatory cooperation via the Comité is still at an early stage (evidenced by the absence of an MOU or other formal arrangements) and incomplete in scope
- the failure resolution process in individual financial sectors does not take into consideration the possibility of a financial conglomerate collapse, which can potentially greatly increase the costs involved
- the group bank (particularly in the case of domestic mixed-activity conglomerates) remains exposed to psychological contagion because of the market perception of association with the conglomerate/controller.

Although the existing framework has served the system fairly well until now, it is questionable whether this can continue unchanged. As the ability to maintain high profitability (particularly for banks) erodes due to intensified competition, controllers of financial conglomerates will increasingly be motivated to leverage synergies from their presence across financial sectors.

In addition, growing inter-linkages in the financial system that go beyond the issue of financial conglomerates motivate the need for closer supervisory coordination. There are two main causal factors for this phenomenon:

- structural characteristics of the system – in particular, the inter-dependencies between large institutional investors and banks, as well as the dominant presence of financial conglomerates

- blurring of boundaries between sectors, driven by the on-going relaxation of regulatory restrictions[44] and market developments (competition and technological innovation).

Both of these factors raise important cooperation issues not previously addressed (see Diagram below), which must now be dealt with appropriately by the supervisors.

Diagram 3: Issues Requiring Cross-Sector Supervisory Cooperation

More Systemic (arrow pointing upward, from bottom row to top row)

ISSUE	EXAMPLE(S)
Surveillance of macro-financial issues	‘Wiring’ of system (inter-sector linkages via common instruments and markets)
Crisis management arrangements	‘Fire drill’ (contingency planning) Resolution of conflicts of competence in event of failure of a financial conglomerate
Avoiding supervisory gaps and overlaps	Responsibility for monitoring and disclosing activities in securities and derivatives markets ‘Hybrid’ products
Monitoring of financial conglomerates	Analysis of risk profile of financial conglomerates
Competition within and across financial sectors	Stimulating competition in AFP sector by (potentially) opening it to other sectors
Level playing field	Consistency and integrity of valuation in different entities for same financial instruments Consistency of capital adequacy treatment for same instrument in different sector entities

B. Policy Implications

The analysis and identification of potentially important vulnerabilities from the presence of financial conglomerates strongly indicate that the current silo-based approach would need to migrate toward a more consolidated supervisory framework. This would involve closer regulatory coordination, better surveillance mechanisms and improved control policies for financial conglomerate risks. At the same time, the on-going process of selective relaxation of existing firewalls could continue, albeit focusing on those

[44] For example, the General Banking Act of 1997 removed previously existing limitations on banks (e.g. the right to carry out factoring, custody, foreign fund management, securitization, and insurance brokerage via subsidiaries) that were imposed by the 1986 Banking Law. Moreover, investment limits for AFPs have been progressively relaxed by the SAFP since the late 1980’s.

specific measures that are shown to be more efficiency- and competition-enhancing in relation to any potential risks that they introduce. These objectives underlie the reform agenda (described below) that Chile might want to consider in light of its situation.

A broad agenda for reform consisting of three types of measures could be undertaken:

- 'horizontal' measures – to improve regulatory coordination and cooperation
- 'vertical' measures – to improve consolidated risk monitoring and control of financial conglomerates
- selective relaxation of firewalls within financial conglomerates – to increase conglomerate efficiencies, in parallel with the introduction of 'vertical' measures.

This series of measures reinforces the rationale for a move from a rules-oriented to a risk-based supervisory approach that has been gradually taking place in Chile, particularly in banking. By necessity, detail on the measures has been kept at a minimum – specific fine-tuning and timing considerations merit further investigation necessitating the involvement of a working group comprised of all relevant parties.

Proposed 'horizontal' measures do not aim to expand the scope of existing regulation, but simply to improve regulatory coordination and information exchange. Because they generally do not depend on changes to existing legislation, they could be relatively easier to implement within a shorter time framework:

- Strengthen the mandate of the Comité de Superintendentes via the creation of a formal MOU that clearly outlines the roles and responsibilities of each supervisor. These could include:
    - information gathering and exchange
    - consultation and mutual assistance on policy changes
    - monitoring of markets and entities
    - problem resolution, including a definition of procedures during normal and emergency situations
    - conflict resolution process that specifies the ultimate arbiter in case of disputes between members.

Examples of MOUs can be found from a number of other countries and can serve as a useful starting point. In general, such MOUs contain broad, commonly shared principles (as opposed to detailed arrangements), which allows for greater flexibility and reduces the need for constant modifications. However, the potential limitations of MOUs in a civil code country like Chile are worth investigating.

- Agree on the selection criteria and responsibilities of a chairman among the supervisors to oversee coordination during emergency and non-emergency situations. The Joint Forum[45] provides a useful starting catalogue of possible coordination elements. For example, a separate coordinator can be appointed for each specific financial conglomerate, or an overall coordinator can be selected on a permanent or rotating basis among participating supervisors.
- Establish a dedicated small but competent secretariat in order to provide supporting analytical firepower, which could be drawn from the ranks of the participating supervisory agencies for a period of time.
- Set up working groups to investigate topics of common interest such as: the potential for harmonizing certain rules (e.g. fit and proper tests and valuation), monitoring and minimizing regulatory arbitrage or other distortions across financial sectors, and collecting and sharing data for surveillance of markets in which there are participants from various sectors (e.g. derivatives, securities).
- Establish an exchange program between staff in different regulatory agencies
- Set up a clear process for the resolution of conflicts of competence in the failure of a financial conglomerate with presence in different financial sectors
- Permit consultation and exchange of information/views between regulators in 'fit and proper' assessments concerning new license applications or change of ownership situations
- Develop 'what if' contagion scenarios involving the collapse of a financial conglomerate for assessing policy implications, setting priorities and deriving appropriate and well-coordinated contingency plans.

[45] See Basel Committee on Banking Supervision (July 2001).

Proposed 'vertical' measures rely on changes to the existing legislation, and aim to improve consolidated risk monitoring and control of financial conglomerates. They could be thought of as longer-term policies that will need to be carefully studied before being implemented[46], and are the following:

- Embed the concept of a 'financial conglomerate' in legislation, clearly defining its characteristics. Determining such a concept should involve the participation of all relevant financial sector oversight agencies as well as the tax and accounting authorities, and would be based on an assessment of the need for a more comprehensive supervision of complex and systemically important groups[47].
- For those groups that fall under the financial conglomerates definition, mandate the creation of an explicit, domestically-incorporated financial holding company (FHC) that would control all of their financial sector activities[48]. This would, on the one hand, clearly separate the financial part of a mixed-activity conglomerate and, on the other hand, provide a common parent entity for all financial sector regulators to focus on. In practice, this measure would not generally imply large adjustments to the existing corporate structures of most financial conglomerates, since many of them are already organized in a similar fashion[49].
- Establish a 'lead regulator' for FHCs with a clear responsibility and accountability mandate, who can be selected based on criteria such as the relative importance of the group's participation in different financial sector segments and on systemic concerns. This structure would supplement the existing sector-specific supervisory arrangements, which would not change.

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[46] In addition to the Joint Forum documents mentioned previously, the EU's Financial Groups Directive could also serve as a useful reference point and benchmark for such measures – see Financial Services Authority (October 2003). A recent comparison of alternative supervisory approaches can be found in Half C. (April 2002).
[47] As an example, see DeFerrari L. M. and Palmer D. (February 2001) for an overview of the US supervision framework for Large Complex Banking Organizations.
[48] Financial sector activities would be those defined by current legislation, i.e. those that come under the supervision of SBIF, SVS or SAFP. It should also be noted that the FHC can be defined (if deemed necessary) as an operating or a non-operating company.
[49] Foreign financial conglomerates are already generally structured in such a way for management (if not for legal) purposes. In addition, some of the most important domestic mixed-activity conglomerates (e.g. Luksic, Saieh and Matte) already have holding companies that could, with relatively few adjustments, serve the FHC purpose (i.e. LQ Inversiones Financieras, Corp Group Banking and Bicecorp respectively).

- Strengthen the ring-fencing of the financial conglomerate from the rest of the group – for example, by prohibiting common branding between the financial and non-financial parts of a group, and by requiring different Board Directors.
- Introduce appropriate consolidation rules for FHCs, including the treatment of subsidiaries and equity participations[50].
- Mandate the adoption of a single auditing firm for the entire financial conglomerate in order to strengthen the external auditor's capacity to review the financial operations in their entirety.
- Introduce supplementary reporting and disclosure requirements at FHC level (e.g. solvency and liquidity positions) and enable the 'lead regulator' to directly request information from the ultimate controller(s).
- Introduce prudential regulations for FHCs, such as supplementary licensing (fit and proper standards), reporting requirements and prudential standards (e.g. consolidated solvency standards[51] and large exposures rules).

Finally, the introduction of the above measures (particularly the 'vertical' ones) could be complemented by the review and possible relaxation of existing firewalls within financial conglomerates. To the extent that financial conglomerates are deemed to be adequately supervised, the regulators could evaluate the pros and cons of existing intra-conglomerate firewalls and determine whether it would be appropriate to simplify and/or remove some of them in order to improve efficiencies, while ensuring that competition within specific sectors is not negatively impacted. There are significant differences in strategy and operations between running a financial conglomerate and running a collection of stand-alone financial entities. Allowing a move from the latter toward the former (which might, in any case, be forced on regulators by market developments) would permit the realization of potentially significant efficiencies and could foster competition across financial sectors. Examples of selective relaxation measures would be to:

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[50] Several alternative consolidation techniques exist – see, for example, the Basel Committee on Banking Supervision (July 2001) and McDonald R. (1998).

[51] This is, incidentally, also a requirement under Basel II, i.e. the application of minimum capital adequacy standards at a consolidated level that reaches up to the financial holding company of a banking group.

- permit certain financial sector companies within an FHC to offer services (perhaps initially via subsidiaries/affiliates) traditionally provided by different financial sectors, e.g. allow a bank to offer AFP-type compulsory pensions
- remove restrictions on shared functions and infrastructure between different financial sector companies, e.g. allow a Group Treasury at the FHC level.

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Appendix I: BCP – Criteria for Assessing Consolidated Supervision

Principle 20: An essential element of banking supervision is the ability of the supervisors to supervise the banking group on a consolidated basis[52].

Essential Criteria

1. The supervisor is aware of the overall structure of banking organizations (i.e. the bank and its subsidiaries) or groups and has an understanding of the activities of all material parts of these groups, including those that are supervised directly by other agencies.
2. The supervisor has a supervisory framework that evaluates the risks that non-banking activities conducted by a bank or banking group may pose to the bank or banking group.
3. The supervisor has the legal authority to review the overall activities of a bank, whether the activities are conducted directly (including those conducted at overseas offices), or indirectly, through subsidiaries or affiliates of the bank.
4. There are no impediments to the direct or indirect supervision of all affiliates and subsidiaries of a banking organization.
5. Laws or regulations establish, or the supervisor has the authority to impose, prudential standards on a consolidated basis for the banking organization. The supervisor uses its authority to establish prudential standards on a consolidated basis to cover such areas as capital adequacy, large exposures and lending limits.
6. The supervisor collects consolidated financial information for each banking organization.
7. The supervisor has arrangements with functional regulators or individual business vehicles within the banking organization group, if material, to receive information on the financial condition and adequacy of risk management and controls of such business vehicles.

[52] Supervision of the banking group on a consolidated basis goes beyond accounting consolidation. It implies that there is a group-wide approach to supervision whereby all risks run by a banking group are taken into account, wherever they are booked. It is important to note that both accounting consolidation and consolidated supervision are key aspects of the supervision of banking groups.

8. The supervisor has the authority to limit or circumscribe the range of activities the consolidated banking group may conduct and the overseas locations in which activities can be conducted; the supervisor uses this authority to determine that the activities are properly supervised and that the safety and soundness of the banking organization is not compromised.

Additional Criteria

1. For those countries that allow corporate ownership of banking companies:
   - the supervisor has the authority to review the activities of parent companies and of companies affiliated with the parent companies, and utilizes the authority in practice to determine the safety and soundness of the bank;
   - the supervisor has the authority to take remedial actions, including ring-fencing, regarding parent companies and non-bank affiliates concerning matters that could impact the safety and soundness of the bank; and
   - the supervisor has the authority to establish and enforce fit and proper standards for owners and senior management of parent companies.

Appendix II: Financial Conglomeration by Sector (2003)

Table 7: Financial Conglomeration of Banking Sector (2003)

MARKET SHARE - BY ASSETS*	TOTAL ASSETS* (CLP MILLION)	BANK	ULTIMATE OWNER(S) / MAIN SHAREHOLDER(S)	FINANCIAL CONGLOMERATE (FC)	FOREIGN FC	DOMESTIC FC MAINLY MIXED-ACTIVITY
22%	10,429,646	Banco Santander-Chile	Santander	X	X	
17%	8,228,465	Banco de Chile	Luksic	X		X
16%	7,340,685	Banco del Estado	State-owned	X		
11%	5,107,461	BCI	Yarur	X		
7%	3,181,676	BBVA	BBVA	X	X	
6%	2,703,286	Corpbanca	Saieh	X		
3%	1,499,362	Banco del Desarrollo	Norte Sur (Catholic Church)	X		X
3%	1,524,416	Scotiabank Sud Americano	Bank of Nova Scotia	X	X	
2%	1,145,299	Banco Security	Several (no single controller)	X		
3%	1,203,593	BICE	Matte	X		X
3%	1,500,710	Citibank N.A.	Citigroup	X	X	
2%	1,071,272	BankBoston N.A.	Fleet	X	X	
1%	430,936	ABN AMRO Chile	ABN AMRO	X	X	
0%	230,446	Falabella	Solari - Del Rio			
1%	255,403	Dresdner	Dresdner	X	X	
0%	214,834	Conosur	Del Rio			
0%	168,063	Banco Internacional	Furman			
0%	224,446	HSBC Chile	HSBC	X	X	
0%	95,648	HNS Banco	Ergas			
0%	55,668	Ripley	Calderon			
1%	351,751	Deutsche Bank Chile	Deutsche	X	X	
0%	210,401	JP Morgan Chase	JP Morgan Chase	X	X	
0%	34,464	Do Brasil S.A.	Banco do Brasil			
0%	34,026	Bank of Tokyo-Mitsubishi	BTM			
0%	15,976	Banco de la Nacion	Banco de La Nacion			
0%	15,753	Monex	Ergas Benmayor			
100%	**47,273,686**					

Source: Own analysis based on data provided by SBIF
Note: Assets are defined as "activo contable total menos: las cuentas de ajuste y control del pasivo, operaciones a futuro del pasivo y el canje", while profit is defined as "utilidad del ejercicio".

Table 8: Financial Conglomeration of Securities Sector (2003)

TOTAL TURNOVER (CLP MILLION)	MARKET SHARE	STOCK BROKER	MAIN SHAREHOLDER	FINANCIAL CONGLOMERATE (FC)	FOREIGN FC	DOMESTIC FC MAINLY MIXED ACTIVITY
25,459,469	14%	CITIGROUP	Citigroup	X	X	
25,239,597	14%	BBVA	BBVA	X	X	
17,385,753	9%	BICE	Matte	X		X
16,180,186	9%	BANCHILE	Luksic	X		X
14,940,739	8%	SECURITY	Grupo Security	X		
13,285,847	7%	BANESTADO	State-owned	X		
12,900,981	7%	SANTIAGO	Santander	X	X	
10,632,398	6%	SUD AMER	Bank of Nova Scotia	X	X	
9,223,432	5%	SANTANDER	Santander	X	X	
7,864,480	4%	BCI	Yarur	X		
6,628,531	4%	CORP	Saieh	X		
4,575,343	2%	CONSORCIO	Consorcio	X		X
3,955,172	2%	LARRA				
3,663,873	2%	DEUTSCHE	Deutsche Bank	X	X	
2,764,213	1%	TANNER				
2,101,508	1%	NEVASA				
2,072,732	1%	IM TRUST				
1,818,107	1%	CELFIN				
870,703	0%	ALFA				
698,946	0%	MOLINA				
596,293	0%	INVERLINK	Inverlink	X		
562,882	0%	EUROAMER				
547,666	0%	CONTRERAS				
523,639	0%	COVA				
340,391	0%	URETA				
174,222	0%	FINANZAS				
166,259	0%	UGARTE				
83,583	0%	CERDA				
53,275	0%	SERRANO				
53,221	0%	MUNITA				
29,223	0%	VALENZUELA				
26,972	0%	LARRAGAR				
25,821	0%	LIRA				
11,282	0%	YRAVY				
7,317	0%	ETCHEGARAY				
185,464,056	**100%**					

Source: Own analysis based on data provided by SVS
Note1: Market share is defined as proportion of securities turnover by stock brokerage companies ('corredores de bolsa') both on and off the Santiago stock exchange – other securities market players ('agencias de valores', mutual and investment funds, and bank trading desks) are not considered.

Table 9: Financial Conglomeration of Life Insurance Sub-Sector (2003)

MARKET SHARE - BY PREMIUMS	TOTAL PREMIUMS (CLP MILLION)	MARKET SHARE - BY AUM	TOTAL AUM (CLP MILLION)	LIFE INSURANCE COMPANY	ULTIMATE OWNER(S)	FINANCIAL CONGLOMERATE (FC)	FOREIGN FC	DOMESTIC FC MAINLY MIXED-ACTIVITY
0%	3,586,607	0%	2,821,316	ABN AMRO	ABN AMRO	X	X	
2%	30,304,400	0%	13,289,017	ALTAVIDA	Santander	X	X	
1%	12,835,604	0%	11,422,390	BANCHILE	Luksic	X		X
8%	109,493,112	8%	807,831,535	PRINCIPAL	Principal			
1%	17,967,485	0%	19,630,461	BBVA	BBVA	X	X	
1%	15,385,706	0%	38,107,720	BCI	Yarur	X		
5%	68,689,127	4%	376,044,131	BICE VIDA	Matte	X		X
0%	0	1%	56,772,751	CAJA REASEGURADORA	Mapfre			
1%	19,532,593	0%		CARDIF	BNP Paribas			
6%	77,853,600	6%	541,464,520	CHILENA CONSOLIDADA	Zurich			
1%	13,318,449	1%	106,096,134	CIGNA VIDA	Cigna			
11%	148,430,805	16%	1,531,660,145	CONSORCIO NACIONAL	Consorcio	X		X
7%	101,506,446	8%	801,057,137	CONSTRUCCION	Chilean Chamber of Construction			
0%	570,096	3%	310,528,777	CN Life	Consorcio	X		X
3%	36,686,649	3%	264,805,067	CRUZ DEL SUR VIDA	Angelini			
4%	56,521,463	3%	315,288,298	EUROAMERICA VIDA	Clarke			
0%	1,439,789	0%	5,896,096	HUELEN	CAEP			
4%	61,000,775	4%	386,016,041	INTER RENTAS	AIG			
3%	40,103,163	1%	138,592,841	INTERAMERICANA VID.	AIG			
12%	160,714,718	12%	1,148,179,567	ING VIDA	ING	X	X	
1%	14,169,420	0%	13,264,340	MAPFRE VIDA	Mapfre			
10%	135,214,633	9%	896,605,702	METLIFE	Metlife			
0%	6,850,669	1%	99,749,678	MUT DE CARABINEROS	Mutual			
1%	8,145,532	0%	47,013,148	MUT. EJERC. Y AVIAC.	Mutual			
1%	11,408,249	1%	65,639,271	MUTUAL DE SEGUROS	Mutual			
3%	39,084,912	3%	246,715,484	OHIO NATIONAL	Ohio National			
6%	77,714,089	5%	460,232,105	PENTA	Penta	X		X
1%	17,122,253	1%	52,151,496	PREVISION VID.	Security	X		
1%	20,201,694	3%	259,457,144	RENTA NACIONAL VID.	Errazuriz			
6%	80,516,796	8%	736,252,657	VIDA CORP	Corp Group & Mass Mutual	X		
0%	9,072	0%	42,152,253	VITALIS	Consorcio	X		X
100%	**1,386,377,906**	**100%**	**9,794,737,222**					

Source: Own analysis based on data provided by SVS

Table 10: Financial Conglomeration of Non-Life Insurance Sub-Sector (2003)

MARKET SHARE - BY PREMIUMS	TOTAL PREMIUMS (CLP MILLION)	MARKET SHARE - BY AUM	TOTAL AUM (CLP MILLION)	NON-LIFE INSURANCE COMPANY	ULTIMATE OWNER(S)	FINANCIAL CONGLOMERATE (FC)	FOREIGN FC	DOMESTIC FC MAINLY MIXED ACTIVITY
3%	18,355,799	1%	3,463,212	ABN AMRO	ABN AMRO	X	X	
3%	16,544,013	5%	11,576,630	ACE	Cigna			
6%	41,095,178	6%	13,676,458	AGF ALLIANZ	Allianz	X	X	
4%	23,459,241	6%	14,587,694	BCI	Yarur	X		
14%	91,652,092	10%	23,467,823	CHILENA CONSOLIDADA	Zurich			
1%	6,723,458	2%	5,591,630	CHUBB DE CHILE	Chubb			
2%	9,793,994	2%	4,889,387	CONSORCIO NACIONAL	Consorcio	X		X
1%	6,223,624	2%	4,222,729	CREDITO CONTINENTAL	Swiss Re and Deutsche Bank			
17%	109,622,838	8%	18,100,174	CRUZ DEL SUR	Angelini			
0%	421,150	1%	2,410,044	HUELEN	CAEP			
3%	22,642,121	4%	8,625,501	ING	ING	X		
9%	57,449,347	12%	27,681,124	LA INTERAMERICANA	AIG			
6%	40,953,973	6%	13,925,034	LAS AMERICAS	Penta	X		X
1%	9,299,204	2%	5,010,300	LE MANS-ISE	Various families			
5%	34,840,258	4%	9,901,763	MAGALLANES	Various families			
1%	3,500,951	2%	4,090,933	MAPFRE GARANTIA Y CREDITO	Mapfre			
10%	62,181,863	4%	9,201,527	MAPFRE SEGUROS GRALES	Mapfre			
0%	758,060	2%	4,535,901	MUTUALIDAD DE CARABINEROS	Mutual			
1%	6,162,946	2%	4,346,552	RENTA NACIONAL	Errazuriz			
7%	46,124,560	7%	16,011,663	ROYAL & SUNALLIANCE	Royal and SunAlliance			
3%	17,368,729	2%	4,198,407	SECURITY PREVISION	Security	X		
0%	2,379,166	2%	5,317,919	SEGUROS DE CREDITO COFACE	Coface			
3%	21,772,379	9%	22,283,263	SEGUROS GRALES CARDIF	BNP Paribas			
100%	**649,324,944**	**100%**	**237,115,668**					

Source: Own analysis based on data provided by SVS

Table 11: Financial Conglomeration of Pension Fund Sector (2003)

MARKET SHARE - BY AUM	TOTAL AUM (CLP MILLION)	AFP	ULTIMATE OWNER(S) / MAIN SHAREHOLDER(S)	FINANCIAL CONGLOMERATE (FC)	FOREIGN FC	DOMESTIC FC MAINLY MIXED-ACTIVITY
32%	9,351,446	Provida	BBVA Pensiones Chile S.A.	X	X	
24%	7,099,202	Habitat	Citibank & Chilean Chamber of Construction	X	X	
16%	4,702,050	Cuprum	Empresas Penta S.A	X		X
13%	3,725,907	Santa Maria	ING S.A.	X	X	
11%	3,352,198	Summa Bansander	Santander Chile Holding S.A.	X	X	
3%	785,005	Planvital	Inversiones y Asesorias Los Olmos S.A. (BSI)			
2%	490,144	Magister	Inverlink Holding de Inversiones S.A.	X		
100%	**29,505,951**					

Source: Own analysis based on data provided by SAFP
Note: AFP Habitat, in which Citibank and the Chilean Chamber of Construction have equal shareholdings, is assumed to be controlled by the former.

Appendix III: Market Shares of Financial Conglomerates by Sector (1990-2003)[53]

Diagram 4: Share of Foreign Financial Conglomerates by Sector (1999-2003)

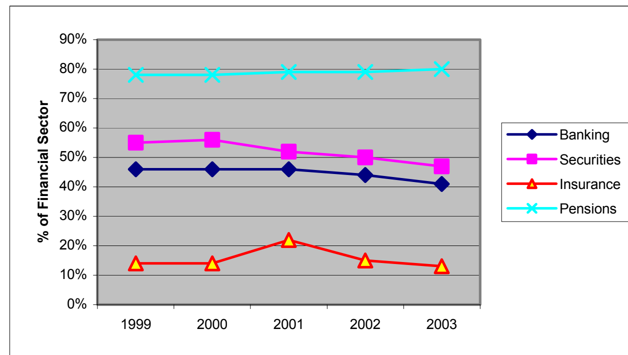


Diagram 5: Share of Domestic 'Pure' Financial Conglomerates by Sector (1999-2003)

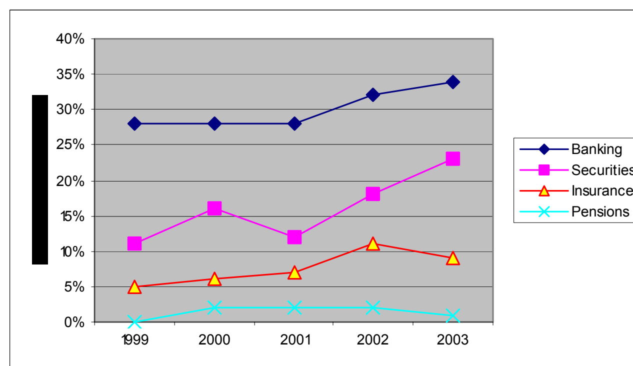
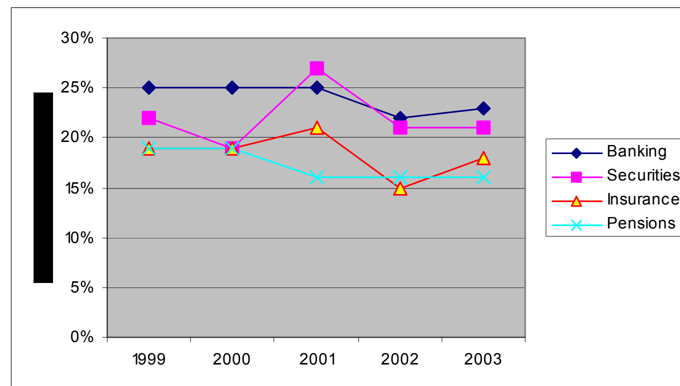


Diagram 6: Share of Domestic Financial Conglomerates Belonging to Mixed-Activity Groups by Sector (1999-2003)



[53] *Source: Own analysis based on data provided by SBIF, SVS and SAFP. Each company's market share is based on bank assets (banking), securities turnover by stock brokerage companies/corredores de bolsa (securities), direct premiums (insurance) and AFP assets under management (pensions). AFP Habitat is assumed to be controlled by Citibank even though it is jointly owned with the Chilean Chamber of Construction.*