RCAP jurisdictional assessments: self-reporting monitoring template for RCAP follow-up actions

Jurisdiction: Brazil

Status as of: 31 December 2016

With reference to RCAP report(s): RCAP Assessment of Basel III regulations – Brazil (December 2013)

Part A[1]

Post-RCAP follow up: Changes applied to local regulations of the Basel Framework relating to risk-based capital standards (RCAP-Capital)

Table A

(1) Issue and/or relevant Basel paragraph number(s)	(2) Detailed description of finding (please indicate as precisely as possible the finding as identified in the relevant RCAP assessment report)	(3) Detailed reference to the domestic legislation/regulation that addresses the finding	(4) Summary description of amendment or rectification made
Basel II, paragraphs 53–56: Claims on Sovereigns	The BCB does not depend on credit ratings from ECAIs or risk scores assigned by ECAs. The Brazilian regulations instead use the national discretion and alternative methodologies for the risk-weighting of exposures to sovereigns. The exposures to other sovereigns and Brazil not denominated and funded in local currency are assigned a risk weight of 20% if none of the four listed credit events have been witnessed in the last five years (suspension of payment with respect to external obligations, unilateral	Circular BCB 3,644/13, arts.19, 21 and 25	Circular BCB 3,714/14 refined article 19 of Circular BCB 3,644/13, establishing the conditions that shall be observed in order to apply the 0% FPR to exposures to central governments of foreign countries and their central banks. Specifically, the 0% FPR applies only to transactions with investment grade central governments and to those involving issues rated AA or equivalent. Ratings must be issued by a rating agency recognised by the Securities and Exchange Commission of Brazil (CVM). When using a 0% FPR: (i) exposures must be denominated in the local currency adopted by the central government to whom the

[1] To be completed only for those findings where action has been initiated/taken. Any plans for addressing other findings may be indicated in Part B.

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	alteration of the contractual term, moratorium or any other modality of rejection to accept the term of the external obligation, anticipation because of contract clause, or change in expiry date of obligation). For exposures to sovereigns that have witnessed any of the credit events, a 100% risk weight is assigned. Out of total exposures to sovereigns that are not denominated and funded in domestic currency, 74.68% of them would require a higher risk weight than 20% (ranging from 50% to 150%) if applying the external ratings of those sovereigns under the Basel approach. However, the exposures to such claims are not currently material. Also, in view of the unlikeliness of a significant increase in total exposures to sovereign that are not denominated and funded in the domestic currency in the three-year period, the Assessment Team considered the deviation as not material.		bank is exposed; and (ii) the bank must have sufficient funding resources referenced in the same currency as the exposure. When two or more ratings are available, the less favourable must be considered. Issues' ratings (by a CRA recognised by CVM) must be used when available, instead of any issuer ratings that may exist.
Basel II, paragraph 145	Basel paragraph 145 provides the details of collateral instruments that are eligible for recognition in the simple approach. The simple approach is followed under the Brazilian regulations. As per their regulations, agreements for the clearing and settlement of obligations in the scope of the National Financial system are included under eligible financial	Circular BCB 3,809/16, arts. 8 and 9	The comprehensive approach has been introduced in the local CRM implementation in August, 2016.

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	collateral although they do not fall under any of the six categories defined in the Basel paragraph. As per the data provided by the BCB, the netting agreements in Brazil are immaterial, covering only 0.17% of the entire financial system exposures.		
Basel II, paragraphs 182–187	Basel Paragraph 182 read with Annex 11 requires that collateral must be marked to market or revalued with a minimum frequency of six months. The Brazilian regulations are silent on this issue.	Circular BCB 3,809/16, art. 4, paragraph 1	All financial collateral must be marked to market, after the reform of the CRM techniques in August, 2016.
Basel II, paragraphs 207–210	There are no requirements on CRM techniques relating to first-to-default and second-to-default credit derivatives in the Brazilian regulations. As per the data provided by the BCB, the amount of credit derivatives traded in the financial system (bought credit derivatives: BRL 2.2 billion -> 0.05% of total assets; sold credit derivatives: BRL 9.8 billion -> 0.21% of total assets) is presently very limited and thus not material. Looking at the overall trend of the derivative market in Brazil, the deviation is not considered likely to be become material in near future.	Circular BCB 3,809/16, art. 2, paragraph 2, II	Second-to-default index derivatives are not an eligible instrument for credit risk mitigation, as Circular 3,809, in its art. 2, paragraph 2, II, mandates that any default within the pool of exposure triggers the execution of the guarantee.
Basel II, paragraph 812	According to the Basel framework, where disclosure, ie transparency, is a qualifying criterion under Pillar 1 to obtain lower risk weightings and/or to apply specific methodologies, there would be a direct sanction	Circular BCB 3,648/13, arts. 2 and 168 to 172	Circular BCB 3,648, published in 2013, in its articles 168-172, establishes transparency requirements towards the public, as required by the Basel framework for banks using IRB.

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	in the sense that a bank would not be allowed to apply the lower weighting or the specific methodology. Disclosure is a qualifying criterion for using AMA and internal models for market risk. For using IRB, the Brazilian regulations regarding transparency refer to transparency towards the BCB and not the public as the Basel framework requires.		According to Article 2, paragraph 1, the supervisor may cancel IRB authorisation if any of the IRB minimum requirements are not met at any time, including Pillar 3 provisions stated in articles 168 to 172.
Basel III, paragraphs 130–131	Resolution CMN 4,193/13 does not specify the treatment that applies to the repurchase of own shares and to the reduction of equity when a bank enters the capital conservation buffer. The BCB explained that this was not specified considering that banks are not allowed to repurchase their own shares or reduce their equity when their capital levels fall into the conservation capital range.	Resolution CMN 4,193/13, art. 9, IV. V, paragraphs 4 and 5	Resolution CMN 4,193, published in 2013, established in its article 9 that: "a shortfall in meeting the assigned ACP entails restrictions: IV – to the repurchase of own shares in any amount; and V – to the reduction of equity, when legally possible". Paragraphs 4 and 5 of this article, which refer to the same numerical restrictions as paragraph 131 of Basel III, establish that these restrictions apply to: "I – the payment of variable compensation to managers and members of the board of directors, in the case of joint stock companies, and to administrators of non-joint stock companies; II – the payment of dividends and interest on capital; III – the payment of the surplus and the net annual earnings to quota-shares of capital, as well as the redemption of quota-shares, in the case of credit unions;"

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			So, on this matter, when a financial institution does not meet its assigned ACP, repurchase of its own shares, in any amount, and reduction of equity, when legally possible, are not allowed under any circumstance, from 2013 onwards.
Basel III, paragraph 132(d)	The Brazilian regulations do not include the Basel requirement for banks in normal times to not operate within the buffer range for competitive reasons.	Resolution CMN 4,193/2013 art. 9 § 9	Aa amendment to Resolution CMN 4,193/2013 specified that the BCB might set individualised maximum lapses of time during which it is admissible not to comply with the conservation and the countercyclical capital buffers.
Basel III, paragraphs 139–140	Domestic regulations should include a provision equivalent to paragraph 139 that requires the relevant national authority to consider putting in place a countercyclical buffer when it judges a period of excess credit growth to be leading to the build-up of system-wide risk.	Circular BCB 3,827/17, Annex, art. 4, VI, § 1	Circular BCB 3,827, issued in January 2017, states that the credit growth pattern, the credit market conditions, the pricing of assets and other financial stability risk factors should be considered in order to put in place a countercyclical capital buffer ($CCyB_{Brazil}$). As a general remark, the BCB implemented recommendations from the "Guidance for national authorities operating the countercyclical capital buffer". In that sense, Circular 3,827/17 promoted enhancements to the governance framework related to the analysis, the decisions and the communication of the $CCyB_{Brazil}$. Henceforth, analysis and decisions will be taken by the Financial Stability Committee (Comef), which is comprised by the BCB's Board of Governors and was specifically created to promote financial stability and systemic risk discussions. All decisions involving $CCyB_{Brazil}$ will be disclosed just after Comef meetings, which occur quarterly. Policy Statement 30,371/2017 disclosed the $CCyB_{Brazil}$ operationalisation.

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Basel III, paragraph 141	The Basel reference that allows the national authority to reduce the buffer immediately was missing in the domestic regulations.	Circular BCB 3,769/15, art. 2, § 7.	If any jurisdiction reduces the countercyclical capital buffer, the new rate should come into force immediately.
Basel III, paragraphs 142–145	The Brazilian regulations do not indicate how to deal with cross-jurisdictional exposures.	Circular BCB 3,769/15, art. 2, II, IV V, §§ 1, 3, 5, 6, 7.	Cross-jurisdictional reciprocity is included in Brazil's countercyclical capital buffer framework by Circular BCB 3,769/15. It includes the geographic breakdown of the private sector credit exposures and the calculation of the bank's specific buffer requirement as a weighted average of the buffers applied by jurisdictions where the exposures are located.
Composition of capital disclosure requirements, paragraph 5	In paragraph 5, the Basel capital disclosure standards require banks to disclose the reconsolidation between their financial statements and their regulatory capital with the same frequency as the publication of the financial statements, whether these are audited or not. However, in paragraph 91, the Basel III text itself only requires the disclosure of this reconciliation to audited financial statements. In the case of Brazil, the BCB explained that audited financial statements of banks are published on a semi-annual basis, while two banks also publish unaudited financial statements on a quarterly basis. Based on paragraph 91 of the Basel III standards, the BCB only requires the disclosure of the reconciliation to audited financial statements on a semi-annual basis.	Circular BCB 3,678/13, art. 3	Even though Brazilian banks started publishing some Pillar 3 requirements with some delay (from 30 June 2014 on), this gap has been resolved, as banks started to publicise all information according to Basel recommendations.

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	Given that the inconsistency regarding the frequency of disclosure rests in the Basel standards themselves, the Assessment Team regards the frequency of the disclosure to be in line with the Basel provisions. Paragraph 5 of the disclosure regulations also requires banks to disclose their capital position based on these regulations with respect to any balance sheet on or after 30 June 2013. The Basel III regulations in Brazil only apply from 1 October 2013 onwards. The disclosure requirements in Brazil will enter into force on 30 June 2014, thus becoming effective in financial statements as of the same date.		

Part B

The Central Bank of Brazil (BCB) is constantly scrutinising, revising, and monitoring the current financial regulation and when appropriate, Brazilian authorities will modify it accordingly so that it can correspond even more closely to the Basel Committee's recommendations.

The issues expected to be addressed in 2017/2018 are:

(i) treatment of banks' investments in commercial entities along with a revision of the limit on fixed assets, a Brazilian-specific limit (Basel II, paragraphs 35–36);

(ii) revision of current capital requirements for bank exposures to central counterparties (paragraphs 126–127);

(iii) implementation of the standardised approach for counterparty credit risk framework (SA-CCR) to address:

- (a) the effective notional amounts issue for the current exposure method (CEM) (Basel II – Annex 4, paragraph 92(ii));
- (b) consideration of OTC derivatives bilateral netting (Annex 4, paragraphs 96(i)–96 (vi)).

(iv) full revision of the securitisation framework according to the new BCBS standard published in December 2014 to address the following issues pointed out in the RCAP report:

- (a) definition of which exposures can be classified as securitisation or re-securitisation ones (Basel II, paragraphs 538–552 (as amended by Basel 2.5));
- (b) application of the six operational criteria concerning the use of external credit assessments (Basel II, paragraph 565: (as amended by Basel III));
- (c) definition of the criteria to qualify off-balance sheet securitisation exposures (Basel II, paragraphs 577–582 (as amended by Basel 2.5));
- (d) definition of eligible guarantors in the standardised models (Basel II, paragraph 586);
- (e) definition of capital requirement for early amortisation provisions and determination of CCFs for both controlled and non-controlled early amortisation features (Basel II, paragraphs 590–605);
- (f) definition of the relation of external ratings to the Ratings-Based Approach (RBA) (Basel II, paragraphs 611–618: (as amended by Basel 2.5 and Basel III));
- (g) definition of the relation of external ratings to the Internal Assessment Approach (IAA) (Basel II, paragraphs 619–622).

(v) revision of current Pillar 3 regulation in order to comply with BCBS "Revised Pillar 3 disclosure requirements", of January 2015, and to address gaps related to this issue (Basel II, tables 4, 8 and 9). It is worth mentioning that the Central Bank of Brazil is planning to combine phases 1 and 2 of the BCBS review of the Pillar 3 framework.

Gaps related to market risk may not be identified in future assessments, taking into consideration the implementation of new Basel recommendations, such as the trading book/banking book boundary and the new Resolution on Market Risk Valuation Framework.

Gaps related to operational risk may not be applicable, considering the revision of the standardised approach to operational risk, which is underway by the BCBS.