FEBRABAN FEDERAÇÃO BRASILEIRA DE BANCOS

FB-0831/2023 São Paulo, October 06, 2023.

Basel Committee on Banking Supervision
Bank for International Settlements
Centralbahnplatz 2, CH-4002 Basel, Switzerland

Ref: *"Core principles for effective banking supervision ("Core Principles")* - consultative document"

The Brazilian Banks Federation (FEBRABAN) is grateful for the opportunity to comment on the Basel Committee's public consultation on revisions to the "*Core principles for effective banking supervision* ("Core Principles")". We would like to commend the Basel Committee for the very collaborative approach taken in developing the principles.

There is no doubt that initiatives aimed at adapting the regulatory and supervisory framework are always welcome and contribute to the resilience of the global financial system.

In that sense, FEBRABAN believes that considerations to the current proposal should be taken into account in order to preserve the intended purpose behind the revision of current framework and suggests the Committee to take into account the following points in the review.

I-) General Aspects:

Despite some comments on specific items in the document, which we will describe below, our main concerns involve two general aspects regarding the topics mentioned in the text of the public consultation, which are the time and form of implementing changes at a global level and in each location:

i) Extent of implementation of these principles

In general, according to the document content, we are addressing principles and not objective and prescriptive rules, or those that represent new definitive standards. On the one hand, such approach is positive as it avoids excessive prescription and guarantees a certain flexibility in the implementations and adaptations by banks of topics that may be comprehensive, complex or difficult to implement.

However, on the other hand, the subjectivity present in the principles creates great potential for different interpretations between the agents involved, be they banks, regulators and supervisors. At the limit, this can imply different forms of application in jurisdictions, whether in the form or in the deadline for adaptation.

It is worth mentioning the principles listed in the document related to climate, emerging and operational risks. Although such concepts are gradually being incorporated into the global and local regulatory framework, it is important considering, when defining the scope, granularity and extent of these regulatory requirements, the incipient nature of the related standards published and the level of maturity of the markets regarding methodological approaches to treatment and knowledge.

The issue of governance and the proposed adjustments to guarantee the independence, diversity, renewal and technical capacity of the Boards are also exemplified. We believe, given the recommendations and guidelines applied locally, that Brazilian banks already pursue these objectives and would comply with the established guidelines to some extent. However, there is potential subjectivity for each regulator and local supervisor’s interpretation of what would be an optimal composition that achieves the defined objectives, as well as the implementation speed. Moreover, the issue of revising or renewing the composition of the Board is quite subjective, which brings uncertainty and potential divergent interpretations.

Furthermore, although the importance of joint supervision with banks and other financial institutions was highlighted in the document, the importance of covering regulatory and supervisory powers for unauthorized controlling companies of entities authorized to operate in the financial system and the freedom for the regulatory and/or supervisory authority to expand the regulation and supervision perimeter for non-financial companies affiliated with an authorized entity must be addressed. This would be relevant for reducing asymmetries in jurisdictions with this growing scope.

Thus, the main concern lies in how to achieve an adequate degree of conceptual and interpretative alignment of such principles to guarantee a harmonious and symmetrical implementation and avoid excessive demands, whether in topics that may be considered not yet mature, and in interpretations and implementations in each jurisdiction.

ii) local implementation deadline and the adaptation of banks to the established principles.

As previously mentioned, the local regulatory framework in each jurisdiction has already gradually incorporated an important part of the embedded principles. However, this is a work in progress in some respects and it takes time to reach a level of effectiveness and compliance that is considered mature and sufficient by regulators and supervisors. Institutions are clearly making efforts to improve their analyzes and assessments of the risks mentioned. However, there is a learning curve that is not trivial and requires time to improve and mature.

The issue of social, environmental and climate risks is exemplified here. Such requirement, including the prospective view of scenarios and stress testing, has already been incorporated by the Central Bank of Brazil into the regulatory framework for risk management and into the risk policy of institutions, as well as in obtaining, analyzing and providing information to the regulator and the supervisor.

Similarly, the requirement for evaluating relevant third parties that provide core services to banks was also incorporated into the local regulatory framework. This topic has been the subject of several discussions for years in FEBRABAN risk forums, such as committees, working groups and congresses, including joint actions at FEBRABAN to evaluate and analyze relevant service providers.

Nevertheless, although these principles are incorporated into the regulatory framework and accessed by regulators and supervisors, their implementation is a work in progress carried out jointly by banks, regulators and supervisors until levels of maturity are reached that are minimally sufficient, stable and even harmonic among institutions and among jurisdictions.

In this sense, our concern is that the implementation of said principles be understood as a gradual, dynamic and continuous learning process.

II-) Specific Topics

Having explained the context described above and the inherent concerns, we list below the main specific topics that we believe are most sensitive to Brazilian banks, followed by some suggestions for changes to the text proposed in the public consultation:

Core Principle 1:

Our first highlight is present in Core Principle 1, which addresses Responsibilities, objectives and powers. The text presented by the Committee in the description of additional criteria (40.5) in item 5 defines the following:

(5) The supervisor has the power to:
(a) have full access to banks' and banking groups' boards,[3] management, staff and records (including records that are held by service providers and may be accessed either directly or through the supervised bank) ~~in order to review compliance with internal rules and limits as well as external laws and regulations;~~
(b) review the overall activities of a banking group (including activities performed by service providers), ~~both~~ whether domestic ~~and~~ or cross-border; and
(c) supervise the foreign activities of banks incorporated in its jurisdiction.

[3] For this purpose, "access" includes supervisory access in person to the bank's premises, and to senior executive staff and the board (both individual members and as a whole) as needed.

We understand that the Supervisor needs to have access to information from important/strategic service providers, but it is proposed that this activity be channeled through the supervised bank. This happens since the latter is in recurring contact with the Supervisor, and direct access to the service provider is not necessary.

Moreover, it is proposed that access to information relating to outsourced services only occurs within the scope of service providers that the financial institution considers relevant in its risk management policies, that is, providers that provide core and priority services to banks. Therefore, we suggest the following change to the proposed text, as described below:

5) The supervisor has the power to:
(a) have full access to banks' and banking groups' boards,[3] management, staff and records (including records that are held by **relevant** service providers and may be accessed through the supervised bank) ~~in order to review compliance with internal rules and limits as well as external laws and regulations;~~

The rationale behind this request is based on the experience acquired in our jurisdiction and aims to limit the scope of this analysis and avoid a high cost and unnecessary operational impact on banks.

The Brazilian regulatory framework currently already provides for the need to evaluate outsourced services in its rules, whether in risk management, in the contracting of data processing and storage and cloud computing services. However, banks are large users of services provided by third parties, many of them of an operational and specific nature and whose disruption or shutdown does not represent a relevant risk. For those

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that are critical, there is a requirement for operational continuity plans by institutions to ensure impacts are minimized.

In this sense, it is essential to reinforce the character of relevance and gradualism for implementation and adaptation, considering the breadth of the universe of service providers and the need for individual and specific assessments of each supplier, as well as studying possible impacts in case of compromising these services.

Core Principle 3:

It is worth highlighting at this point that information sharing (both between authorities and between authorities and banks) may have opportunities for improvement. We consider that, in some topics, macro prudential authorities and prudential supervisors coexist with a certain overlap between the demanded requirements, for example, in relation to countercyclical and systemic cushions, in addition to Pillar 2 analyses.

Core Principle 8:

Another concern is listed in Core Principle 8, which describes the Supervisory approach. According to this topic, the description of the core criteria (40.19) in item 1 establishes the following:

(1) The supervisor uses a well defined methodology and processes to for determine ~~determining~~ and assess ~~assessing~~ on an ongoing basis the nature, impact and scope of the risks: (a) which banks ~~or banking groups~~ are exposed to~~, including risks posed by entities in the wider group;~~ and (b) which banks ~~or banking groups~~ present to the safety and soundness of the banking system (including implications for and interlinkages with financial system stability).

The methodology and processes addresses, among other things, ~~the~~ banks' group structure (including risks posed by entities in the wider group); risks around banks' business model sustainability, including their ability to design and implement sound and forward-looking strategies to generate sustainable returns over time; banks' risk profile with a forward-looking view[15] , their internal control environment and ~~the~~ their resolvability ~~of banks. and~~ The methodology permits relevant comparisons between banks,~~.~~ and the nature, frequency and intensity of supervision of banks reflect the outcome of this analysis.

(2) The supervisor, in conjunction with relevant authorities where appropriate, uses a process to assess and identify which banks are systemically important in a domestic context. Supervisors should publicly disclose information that provides an outline of the process employed to assess and determine systemic importance. The supervisor should conduct these assessments sufficiently regularly to ensure they reflect the current state of the domestic financial system.

[15] The time horizon for establishing a forward-looking view should appropriately reflect climate-related financial risks and emerging risks as needed.

As previously mentioned, one of the industry's concerns is the timing of implementation and adaptation by banks to this established principle. This is due to the requirements established in the proposal regarding climate and emerging risk topics. Such risks are still being mapped, discussed and gradually implemented around the world.

Thus, as already adopted in jurisdictions such as Brazil and Europe, the proposal is that climate-related risks are risk factors to be considered together with other types of risk that banks manage (such as credit, market, operational, etc.).

On the other hand, from the perspective of emerging markets, there needs to be a standardization of the concept between jurisdictions in macro and local regulations, since most institutions currently follow the concept required by sustainability indices.

It is worth highlighting that the methodologies available for determining such risks are still incipient and exploratory, thus stressing the importance of delimiting the scope, granularity, as well as temporal and prospective analyzes of impacts on activities, business models, results and balances of banks.

The concern is that the adequacy and compliance with these principles is understood by regulators and supervisors as a quite gradual, dynamic and continuous learning process, which will involve qualitative and quantitative improvement in addressing these risks by everyone involved in the process, such as banks, regulators and supervisors.

Core Principle 14:

Core Principle 14 addresses corporate governance and specifically the topic of core criteria (40.32) in item 3, providing for the following:

(3) The supervisor determines that governance structures and processes for nominating and appointing board members are appropriate for the bank ~~and across the banking group~~. Board members should include a balance of knowledge, skills, diversity and experience. Board membership includes experienced non-executive members~~,~~ with sufficient independence to challenge management ~~where appropriate.~~ Boards regularly review their performance, and membership is regularly renewed to refresh skills and independence. Commensurate with the bank's risk profile and systemic importance, board structures include audit, risk oversight and remuneration committees with experienced, independent non-executive members.

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As previously highlighted, this matter raised concerns regarding the issue of governance and the adjustments made to guarantee the independence, diversity, renewal and technical capacity of the Boards.

Brazilian rules already pursue said objectives and, in a certain way, would already be in compliance with the guidelines established by the Committee. However, it is worth highlighting the issue of subjectivity in the interpretation of each local regulator and supervisor as to what would be an optimal composition that would achieve the aforementioned objectives, as well as what would be a period considered sufficient for renewing and revising the composition of the Boards. Subjectivities provide uncertainty and potential different interpretations regarding its adoption globally and locally and can lead to more restrictive and asymmetrical implementations.

Therefore, we propose that the text be amended to highlight that there would not be a need for complete independence of Board members, but rather a portion that is considered sufficient.

Moreover, it would be important to clarify what is intended by the need for periodic revision or renewal of Board members. Changes in composition occur over time, but it is not common for companies in the financial industry to have a high turnover of Board members, nor is there a specific period that limits the renewal of members or sets a definitive maximum length of stay.

Core Principle 16:

It is understood that further clarification would be important regarding the text described in Core Principle 6 (Capital adequacy) in the topic of additional criteria (40.38) in item 3, which provides for the following:

(3) Laws or regulations permit the supervisor or relevant authorities to require banks to maintain additional capital (which may include sectoral capital requirements) in a form that can be released when system-wide risk crystallises or dissipates.

It is believed that the rules applied in countries by local regulators and supervisors, at least the Basel signatories, must already provide for regulatory tools that allow the adoption of additional capital in some situations, whether on criteria based on supervisory risk assessment (add-on of structural capital or by reference), whether via the introduction of buffers and specific and temporary countercyclical macroprudential measures. However, the general way in which the topic is addressed does not qualitatively clarify the situation and scope of application of such requirements. Thus, some additional clarification in the text would be important to reference this possibility to the tools currently available in the Basel prudential regulation.

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Core Principle 19:

Another prominent topic is presented in Core Principle 19, which addresses Concentration risk and large exposure limits, in the topic of core criteria (40.44) in item 1, as described below:

(1) Laws, regulations or the supervisor require banks to have policies and processes that provide a comprehensive bank-wide view of significant sources of concentration risk.[51] Exposures (including counterparty credit risk exposure) arising from off-balance sheet as well as onbalance sheet items included in both the banking book and trading book are captured.

[51] Concentration risk may result from credit, market and other risk where a bank is overly exposed to particular asset classes, products, collateral, currencies or funding sources. Credit concentrations include exposures to: single counterparties (including collateral credit protection and other commitments provided); groups of connected counterparties; counterparties in the same industry, economic sector or geographic region; and counterparties whose financial performance is dependent on the same activity or commodity.

The topic provides the understanding that the Committee is establishing a command for all global banks. However, when the document highlights that credit exposures concentrated by geographic region should be observed, they propose that the bank's local operations should be considered.

In this regard, it is worth highlighting that Brazilian banks have their activities largely or fully concentrated in the local market, with international representation that is practically immaterial for the institution. Thus, it is believed that the application of this criterion should be optional and not mandatory or possibly consider some materiality criterion.

Core Principle 20:

It is also worth highlighting the criteria established in Core Principle 20, which addresses Transactions with related parties and the following command is established in the description of the principle, namely:

To prevent abuses arising in transactions with related parties[54] and to address the risk of conflicts of interest, the supervisor requires banks to: enter into any transactions with related parties on an arm's length basis;[55] ~~to~~ monitor these transactions; ~~to~~ take appropriate steps to control or mitigate the risks; and ~~to~~ write off exposures to related parties in accordance with standard policies and processes.

[53] Reference document: BCBS, Principles for the management of credit risk, September 2000.

[54] Related parties comprise ~~can include~~, among others ~~things~~, the bank's subsidiaries, affiliates~~,~~ and any party (including their subsidiaries, affiliates and special purpose entities) that the bank exerts control over or that exerts control over the bank; the bank's major shareholders up to the ultimate beneficial owner; and board members, senior management and key staff, their direct and related interests, and their close family members as well as corresponding persons in affiliated companies. It should also include parties that can exert significant influence on the board or senior management. Banks' exposure to banking entities within the banking group or wider group arising from transactions such as liquidity facilities, sale/purchase of foreign currencies or securities, letters of credit and guarantees may warrant a separate approach, particularly if the supervisor considers this to be appropriate to ensure sound group-wide risk management.

The principle observes that in the prescription of these rules, as they are very principled, they can lead to different interpretations. Brazil already has considerable regulatory maturity in the rules defined for loan operations with related counterparties, established by CMN Resolution 4693/2018. Therefore, we propose that the following criteria be adopted to clarify the Committee's evaluation objective regarding this type of operations:

The following are considered related parties of an institution:

I - its controlling shareholders, either individuals or legal entities;
II - its officers and members of statutory or contractual bodies;
III - the spouse, partner and relatives, by blood or related, up to the second degree, of the individuals mentioned in items I and II;
IV - individuals with qualified ownership interest in its capital; and
V - legal entities:
a) with qualified equity interest in its capital;
b) in whose capital, directly or indirectly, there is qualified equity interest;
c) in which there is effective operational control or preponderance in deliberations, regardless of equity interest; and
d) that have an officer or member of the board of directors in common.

For the purposes of the provisions of this principle, equity interest, either direct or indirect, held by individuals or legal entities in the capital of financial institutions or of these institutions in the capital of legal entities, equivalent to 15% or more of the respective representative shares or units.

Core Principle 25:

Another topic to be addressed herein concerns one of the major changes proposed by the Committee, present in principle 25 Operational risk and operational resilience.

In its description, the Committee defines what it expects from banks regarding operational risk and operational resilience and addresses the scope that must be considered in this principle in the footnotes. Although we understand the importance of mapping critical services/functions for the bank's operation, it is important emphasizing that such commands bring relevant impacts to the banks covered by this requirement. Therefore, we believe that the obligation to comply with such requirements should be restricted to banks in which the materiality of these critical services/functions is relevant, including observing their performance at the level of the local financial system, thus ensuring regulatory symmetry to banks that offer similar risks, but avoiding a disproportionate cost to less complex institutions.

Still regarding this principle, further clarification is suggested in the text prescribed in the core criteria (40.57) with regard to item 3. The proposed wording raised doubts regarding its applicability, notably in the term interconnectivity. As described, this item could be interpreted as relating to the risk of contagion, which does not seem to be aligned with the objective of the Committee. One way to avoid this interpretation would be to establish that interconnections are directly related to the risk arising from critical operations (i.e.: operational, intragroup, legal, shareholding agreements, etc.).

Finally, still based on said principle, the command present in the core criteria (40.57) in item 5 must be addressed, which provides for the following:

(5) The supervisor requires that banks conduct business continuity exercises under a range of severe but plausible scenarios to test their ability to deliver critical operations through disruption. The supervisor reviews the quality and comprehensiveness of the bank's business continuity and disaster recovery plans to assess their ability to deliver critical operations. In doing so, the supervisor determines that the bank can operate on an ongoing basis and minimise losses and interruptions to service provision in the event of a severe business disruption or failure (including but not limited to disruption at a service provider and disturbances in payment and settlement systems).

In the description above, our attention was drawn to the possible requirement for banks to carry out continuity exercises in cases of disruptions in payment and settlement systems. As in the previously mentioned item, performing tests individually considering a disruption of these services is extremely complex, considering that they are essential and systemic services. Therefore, some relevance and materiality should be foreseen for the imposition of this requirement, limiting its application to banks that pose greater risk to the system given their relevance to local payment and settlement systems. We emphasize that our concern is the performance of tests and not in the possible need to map and identify impacts resulting from scenarios of disruption of these services.

Once again, we appreciate the opportunity to comment on revisions to the "*Core principles for effective banking supervision* ("Core Principles")". Should you have any questions on the issues raised in this letter, please contact the undersigned com.gestao.riscos@febraban.org.br.

Very truly yours,

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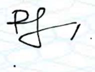

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