

Post-RCAP follow-up report: Brazil

Reference RCAP report: Assessment of Basel III capital regulations in Brazil, December 2013

Status as of: 31 December 2015

This follow-up report provides an overview of where the jurisdiction has taken, or plans to take, further actions to address findings raised in the RCAP assessment report. The report is based on self-reporting and the reported actions have not been reviewed by the Basel Committee.

Part A¹

Post-RCAP follow up: Changes applied to local regulations of the Basel Framework relating to risk-based capital standards (RCAP-Capital)			
(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 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. 9º § 9º	Amendment to Resolution CMN 4,193/2013 specified that the BCB might set a time during which it is admissible not to comply with the conservation and the countercyclical capital buffers.
53–56: Claims on Sovereigns 53–56: Claims on Sovereigns	The BCB does not depend on credit ratings from ECAIs or risk scores assigned by ECAIs. The Brazilian regulations instead use the national discretion and alternative methodologies for the risk-weighting of exposures to sovereigns.	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 operations with central governments of foreign countries and their central banks, as well as to financial transactions involving securities issued by those parties.

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.

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

(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
	<p>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 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 unlikelihood 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.</p>		<p>Specifically, the 0% FPR applies only to operations involving central governments with a rating of at least AA grade or equivalent, or an investment grade, attributed by a rating agency recognised by the Securities and Exchange Commission of Brazil (CVM). When a central government has an investment grade, the 0% FPR can only be used if (i) the operations or the securities issued by the central government are referenced in local currency; and (ii) the resources raised by the financial institution are referenced in local currency.</p> <p>In case of two or more ratings being available for the central government, the less favourable one should be considered. However, when the operations or transacted securities are rated by a rating agency recognised by CVM, this rating should be used for classifying them (instead of using the rating attributed to the central government involved).</p>
<p>Basel III, paragraphs 130–131</p>	<p>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</p>	<p>Resolution CMN 4193/13, art. 9, IV and V.</p>	<p>Resolution CMN 4,193, published in 2013, established in its article 9 that “a shortfall in meeting the assigned ACP entails restrictions: IV – to repurchase own shares in any amount; and V – to reduce equity when legally possible”. Paragraphs 4 and 5 of this article, which refer to the same numerical</p>

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

(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
	<p>repurchase their own shares or reduce their equity when their capital levels fall into the conservation capital range.</p>		<p>restrictions as paragraph 131 of Basel III, establish that these restrictions apply to: "I – the payment of discretionary 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;"</p> <p>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, have not been allowed under any circumstances, since 2013.</p>
<p>Basel III, paragraph 141</p>	<p>The Basel reference that allows the national authority to reduce the buffer immediately was missing in the domestic regulations.</p>	<p>Circular BCB 3,769/15, art. 2, § 7º.</p>	<p>If any jurisdiction reduces the countercyclical capital buffer, the new rate should come into force immediately.</p>
<p>Basel III, paragraphs 142–145</p>	<p>The Brazilian regulations do not indicate how to deal with cross-jurisdictional exposures.</p>	<p>Circular BCB 3,769/15, art. 2º, II, IV V, §§ 1, 3, 5, 6, 7.</p>	<p>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 that are being applied in jurisdictions to which the bank has an exposure.</p>
<p>Basel II, paragraph 812</p>	<p>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</p>	<p>Circular BCB 3,648/13, arts.168 to 172</p>	<p>Circular BCB 3,648, published in 2013, in its articles 168-172, establishes transparency towards the public, as the Basel framework requires for banks using IRB.</p>

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

(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
	<p>methodologies, there would be a direct sanction 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.</p>		
<p>Composition of capital disclosure requirements, paragraph 5</p> <p>Composition of capital disclosure requirements, paragraph 5</p>	<p>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.</p> <p>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. 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.</p>	<p>Circular BCB 3,678/13, art.3º</p>	<p>Even though Brazilian banks started publishing some Pillar 3 requirements with some delay, starting only on 30 June 2014, this gap was resolved because nowadays they are publishing the required information according to Basel recommendations.</p>

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

(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
	<p>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.</p>		

Part B

The Central Bank of Brazil (BCB) is constantly scrutinising, revising, and monitoring the current financial regulation and if it is considered 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 2016 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 the credit risk mitigation framework to address the following issues pointed out in the RCAP report:
 - (a) eligibility of collateral and its revaluation (Basel II, paragraph 145-146/182–187);
 - (b) requirements on CRM techniques relating to first-to-default and second-to-default credit derivatives (Basel II, paragraphs 207–210);
- (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 the internal ratings-based approach to address haircuts depending upon the issue rating for debt securities and residual maturity (Basel II, paragraphs 134, 141, 157, 176, 294 and 296);
- (vi) revision of current Pillar 3 regulation in order to comply with BCBS document "Revised Pillar 3 disclosure requirements", of January 2015 and to address gaps related to this issue (Basel II, tables 4, 8 and 9).
- (vii) revision of current capital requirements for bank exposures to central counterparties (paragraphs 126–127)