

**Brazil: Detailed Assessment of Observance of Basel Core Principles for Effective
Banking Supervision**

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FINANCIAL SECTOR ASSESSMENT PROGRAM

BRAZIL

BASEL CORE PRINCIPLES FOR EFFECTIVE BANKING SUPERVISION

DETAILED ASSESSMENT OF
OBSERVANCE

APRIL 2012

INTERNATIONAL MONETARY FUND
MONETARY AND CAPITAL MARKETS DEPARTMENT

THE WORLD BANK
FINANCIAL AND PRIVATE SECTOR
DEVELOPMENT VICE PRESIDENCY

Contents

Page

I. Summary, Key Findings, and Recommendations.....	3
Introduction.....	3
Information and methodology used for assessment.....	3
Institutional and macroeconomic setting and market structure—Overview.....	5
Preconditions for effective banking supervision.....	6
Main findings.....	7
Recommended action plan and authorities’ response.....	14
II. Detailed Assessment.....	16
Text Tables	
1. Summary Compliance with the Basel Core Principles—Detailed Assessments.....	13
2. Recommended Action Plan to Improve Compliance with the Basel Core Principles.....	14
3. Detailed Assessment of Compliance with the Basel Core Principles.....	16

GLOSSARY

AML/CFT	Anti-Money Laundering and Combating Terrorism Financing
BIS	Bank for International Settlements
BCP	Basel Core Principles for Effective Supervision
BCB	Banco Central do Brasil
BCBS	Basel Committee for Banking Supervision
BM&F	Commodities and Futures Exchange
BOVESPA	Sao Paulo Stock Exchange
CAER	Capital, Assets, Liabilities/Liquidity, Earnings
CFC	Federal Accounting Council
Cobit	Control Objectives for Information and Related Technology
Comef	Financial Stability Committee
Coremec	Committee on the Regulation and Inspection of Financial, Capital, Insurance, Pension Fund and Capitalization Markets
CMN	National Monetary Council
Cosif	Accounting Plan of National Financial System Institutions
COAF	Council of Financial Activities Control
CVM	Securities and Exchange Committee
DDR	Daily Monitoring of the Components of Capital Requirements
DRL	Statement of Liquidity Risk
DRM	Statement of Market Risk
FGC	Credit Guarantee Fund
FATF	Financial Action Task Force
FSAP	Financial Sector Assessment Program
IASB	International Accounting Standards Board
ICAAP	Internal Capital Adequacy Assessment Process
IFRS	International Financial Reporting Standards
ISA	International Standards on Auditing
MOU	Memorandum of Understanding
PAP	Punitive Administrative Process
PAS	Annual Program of Supervision
Previc	National Superintendence of Complementary Social Security
Raet	Temporary Administration Regime
Selic	Special System for Clearance and Custody
SFN	National Financial System
SIM	Integrated Monitoring System
SRC	Risk and Control Assessment System
Susep	Superintendence of Private Insurance
VAR	Value-at-Risk
VE	Special Verification

I. SUMMARY, KEY FINDINGS, AND RECOMMENDATIONS

1. **Brazil has a well-defined banking supervision process supported by a legal framework that grants the Banco Central do Brasil (BCB) broad enforcement powers for corrective action and weak bank resolution.** The supervisory process is risk-based and intrusive. The process is based on a supervisory cycle that includes a mix of onsite and offsite activities and concludes with a rating of the bank on a scale of one-to-four based on quantitative and qualitative factors. The timeliness of corrective action has been improved by the adoption of regulations (resolutions) that enable the BCB to impose corrective action based on judgmental factors, such as the adequacy of corporate governance. Prior to the implementation of the Pillar 2 style resolutions, the BCB enforcement was focused on corrective enforcement while now it takes on a more preventive approach that may correct unsafe and unsound practices before they impact the bank condition. *Currently banks are subject to corporate law in the area of dividend pay-out which establishes that a 25 percent minimum of profits must be paid to preferred stock shareholders. Although the BCB could mitigate the requirement by asking for additional capital to offset the dividend, the requirement hinders the ability of the BCB to preserve capital in a weak bank situation.*

2. **Although the BCB operates on an independent mode, there are amendments to Law 4595/1964 (Banking Law) that would aid in protecting the continuation of the operational independence.** The BCB has a tradition operating independently, however, as also recommended in the previous FSAP, the independence should be codified by: granting the BCB authority to directly issue resolutions without having to go through the National Monetary Council (CMN), establish in law the reasons for removal of the BCB Governor, and establishing a fix-term for the Governor.

Introduction

3. **This assessment of the Basel Core Principles for Effective Supervision (BCP) was conducted from February 27 through March 20, 2012.** As agreed with the authorities, the supervisory framework was assessed against the BCP methodology issued by the Basel Committee on Banking Supervision (BCBS) in October 2006. In their self-assessment the authorities addressed both essential and additional criteria and the assessors based their conclusions on compliance with both criteria. The BCB is the sole supervisor of the banking system and as such, the assessment covers only the BCB. The last BCP assessment was conducted in 2002, however, the grading is not comparable to this assessment as the principles and methodology were revised in 2006. The assessment was performed by Laura Ard (World Bank) and Jose Tuya (consultant).

Information and methodology used for assessment

4. **In conducting the assessment a number of information sources were reviewed and significant reliance was placed on the authorities' self-assessment.** The self-assessment was very thorough and facilitated the BCP review. In addition to reviewing the self-assessment, the

assessors also reviewed the responses to a questionnaire sent to the authorities as part of the information gathering process which requested more detailed information to support the self-assessment. The BCP assessment included meetings with BCB supervisory, legal and policy staff and meetings with commercial banks. Open access was provided to review inspection reports, licensing and change-in-control applications, enforcement documents, internal and bank-submitted reports and on-line presentations on the Risk and Control Assessment System (SRC) that encapsulates the BCB supervisory cycle.

5. **The assessment of compliance with each principle is made on a qualitative basis.** A four-grade assessment system is used: compliant; largely compliant; materially noncompliant; and noncompliant. To achieve a ‘compliant’ assessment with a principle, all essential criteria generally must be met without any significant deficiencies. A ‘largely compliant’ assessment is given if only minor shortcomings are observed, and these are not seen as sufficient to raise serious doubts about the authority’s ability to achieve the objective of that principle. A ‘materially noncompliant’ assessment is given when the shortcomings are sufficient to raise doubts about the authority’s ability to achieve compliance, but substantive progress has been made. A ‘noncompliant’ assessment is given when no substantive progress toward compliance has been achieved. In addition, a Principle will be considered not applicable when the Principle does not apply given particular circumstances as described in the 2006 Core Principles Methodology.

6. **The standards were evaluated in the context of the Brazilian financial system’s structure and complexity.** The Core Principles must be capable of application to a wide range of jurisdictions whose banking sectors will inevitably include a broad spectrum of banks. To accommodate this breadth of application, a proportionate approach is adopted within the Core Principles, both in terms of the expectations on supervisors for the discharge of their own functions and in terms of the standards that supervisors impose on banks. An assessment of a country against the essential criteria must, therefore, recognize that its supervisory practices should be commensurate with the complexity, interconnectedness, size, and risk profile and cross-border operation of the banks being supervised. In other words, the assessment must consider the context in which the supervisory practices are applied. The concept of proportionality underpins all assessment criteria. For these reasons, an assessment of one jurisdiction will not be directly comparable to that of another.

7. **The assessors appreciated the collaboration and hospitality of the BCB.** The staff always made themselves available to discuss the principles and provided detailed presentations that greatly facilitated the BCP assessment. Coordination of meetings, obtaining additional information and responding to ad hoc inquiries was managed in an extremely efficient and professional manner by Ricardo Franco Moura, Senior Advisor to the Board.

Institutional and macroeconomic setting and market structure—Overview

8. **The Brazilian financial system is large, concentrated, and highly interconnected domestically.** There are 1,475 deposit-taking financial institutions with assets exceeding 100 percent of GDP, including 137 banks, 4 development banks, and one savings bank as of November 2011. The five largest banks account for two-thirds of total assets and are typically part of larger financial conglomerates, which often include insurance and asset management operations.

Banks by ownership

Banks by control ^{1/}	Number	Net Worth (%)	Total assets (%)	Deposits (%)	Loans (%)
Public	13	33.48	43.26	45.86	41.90
Private	124	66.52	56.74	54.14	58.10
Domestic	67	39.60	39.07	38.02	40.15
Under foreign control	57	26.92	17.67	16.12	17.96
Total	137	100.00	100.00	100.00	100.00

As of September 2011

Public Includes BNDES and Federal Savings Banks (Caixa).

Multiple and commercial Banks under foreign control.

9. **The banking system reports high levels of capitalization, liquidity and profitability.** In September 2011, Brazilian banks, in general, were capitalized above regulatory minimum levels. The average Basel capital adequacy ratio was 17.17 percent, well above the 11 percent required in Brazil, and above the 8 percent required by the Basel I and Basel II methodologies. The leverage ratio (9.57) and liquidity ratio (around 1.08) were also prudentially adequate. The liquidity ratio is based on a liquidity buffer/stressed cash flow. The Return on Equity (RoE) of the banking system was 22.83 percent.

10. **Relative to peers, the Brazilian banking system is less globally integrated.** Foreign banks (mainly from Europe and the U.S.) control slightly less than 20 percent of total banking assets (down from close to 30 percent in 2002). Santander (fifth largest bank) has the more significant market share (9 percent of the system's assets), followed by HSBC (with 3 percent of the system's assets). This is lower than the foreign participation in other Latin American peers. Also, foreign banks' businesses are focused on the Brazilian market—international exposures account for only around 10 percent of their assets and 17 percent of their liabilities (as of March 2011)—while domestic banks have limited foreign lending and borrowing—only around 5-6 percent of their assets and liabilities.

11. **Brazil has built a strong macroeconomic framework, increasing policy credibility and resilience to external shocks.** Fiscal responsibility legislation, the inflation targeting regime, and a flexible exchange rate have facilitated declining debt-to-GDP ratios have yielded an impressive reduction in inflation during the last decade, and allowed the economy to adjust quickly to external shocks. Economic growth has been strong, and the economy is now estimated

to be the sixth largest (just ahead of the United Kingdom). The authorities took advantage of the favorable environment during the years prior to the crisis to accumulate a comfortable foreign reserves cushion while significantly reducing external public debt and improving the debt profile. As a result of its prudent macroeconomic policies, Brazil achieved an investment grade in 2008 and was recently upgraded further to BBB by Fitch and S&P, and Baa2 by Moody's, in part reflecting the strength of its financial sector.

Preconditions for effective banking supervision

12. The Brazilian legal framework provides adequate support for banking supervision.

The BCB operates independently and has the authority to impose sanctions, preventive corrective action and to resolve weak banks, including their liquidation.

13. The positive performance of the Brazilian economy, even after the worsening of the global crisis in the second semester of 2008 reflects the efforts of consolidating macroeconomic fundamentals. A consistent history of fiscal discipline, competent management of the foreign debt, the maintenance of high level of international reserves and significant entry of foreign direct investment, demonstrated the sustainability of Brazilian macroeconomic policy, contributing to the stability of the financial system.

14. Considerable improvements to the debt collection regulation have been implemented. The reform of the Bankruptcy and Judicial Recovery Law (Law 11101) was another step in the evolution of the credit market, since it establishes the priority of bank liabilities over tax liability. The result is a more efficient debt collection process, especially for home loans and vehicle financing. This, along with consigned credit, a form of personal credit where monthly instalments are billed directly to the payroll, are considered the most relevant factors for the increase of credit to individuals in terms of values and growth rates.

15. The Brazilian system of settlements and compensation has five main components: the BCB; the Interbank Chamber of Payments (clearing and payment); the check clearing system of Banco do Brasil (Compe); registry for swaps, municipal and state securities, corporate securities and options (Cetip) and BM&FBovespa, which maintains four clearinghouses for different markets: derivatives (including commodities, swaps and futures); securities; currency Exchange (interbank currency operations); and CBLC (shares, corporate securities and options). All Brazilian institutions are obliged to deposit available funds in reserve accounts at the BCB.

16. The Federal Accounting Council (CFC) has the responsibility for publishing technical and professional accounting and auditing norms. The CFC was created to advise, regulate and supervise the accounting profession. The Institute for Independent Auditors of Brazil) is an independent, non-governmental entity that convenes professionals of the auditing and accounting areas. It issues guidelines of a practical nature, which are commonly referred to by the CFC. BCB is responsible for issuing accounting norms for the banking sector. This legislative power derives from Law 4595/64 and Article 61 of Law 11941/2009. Regarding this

matter, CVM's regulations which do not conflict with those issued by BCB are also applicable to financial institutions that are listed, as established by Article 22, § 2 of Law 6385/1976.

17. **Auditors that provide services to institutions supervised by the BCB, are subject to stringent independence criteria;** having to go through a certification exam that covers specific knowledge of the financial system, as well the international norms edited by the International Federation of Accountants (IFAC). Brazil is adopting the international norms for auditing, issued by the IFAC, and for accounting, issued by the International Accounting Standards Board. The CFC already adopted the auditing norms and is in the process of adopting the accounting norms.

18. **Banks are required to disclose accounting, prudential and other types of information.** In addition to disclosing to the general public, financial institutions are required to send periodically individual and consolidated accounting statements to the BCB, in compliance with both the Banking Law and the Corporate Law. The accounting regime for banks is in the process of convergence with the International Financial Reporting Standards (IFRS) issued by IASB. Since December 31, 2010, listed banks must publish accounting statements in accordance with international standards.

19. **In Brazil, deposit insurance is carried out by the Credit Guarantee Fund (FGC).** The FGC is a private entity established by Resolution 2197 to manage a protection mechanism for financial institution creditors in case of a default. Investors and depositors of the following institutions are entitled to protection by the FGC: multiple banks, commercial banks, investment banks, development banks, Federal Savings Bank, credit, financing and investment companies, mortgage companies and savings and loan associations.

20. **The maximum value guaranteed by the FGC is Reals 70 thousand.** Funds for the guarantees provided by the FGC come from ordinary contribution from associated institutions, fees from the default of checks, credit rights subrogated by the FGC from associated institutions, as well as from the results of the services rendered by the FGC and the interest from investing its resources.

Main findings

21. **The main recommendations of the 2002 FSAP with respect to banking supervision were largely addressed.** The licensing process was tightened, the memorandum of understanding (MOU) between BCB and CVM has been fully implemented, and the improvement of capital quality by excluding goodwill and tax credits was (is) being addressed by the implementation of Basel II (and Basel III). However, the recommendation concerning the need to amend legislation to formally ensure the autonomy of the BCB remains unaddressed.

22. **A significant enhancement was made to the banking supervision planning process.** The BCB implemented the Annual Program of Supervision (PAS), which encompasses the planning of its activities, among which stands out the SRC. The SRC is a well-structured methodology for identifying and assessing the most relevant risks of institutions, as well as the

quality of internal controls and risk management systems. The SRC analysis provides a comprehensive understanding of the operations and risk profiles of the banks and aids in allocating resources in accordance to risk.

23. **The SRC involves a process that assigns an overall risk rating to each institution based on quantitative and qualitative measures.** The quantitative rating is based on indicators of asset quality, capital adequacy, liquidity and profitability. The qualitative rating is based on an analysis of: 1) Business risks and controls: credit, legal, operational, market, liquidity and contagion risks. 2) Corporate functions and controls: strategic, reputation, information technology, money laundering and operational risk. The contagion risk analysis includes the risks posed to the banking group from nonbanking affiliates, subsidiaries. The bank is assigned a qualitative, quantitative and an overall numerical rating ranging from 1–4 and the frequency and scope of the activities will reflect the risk of the institution.

Objectives, independence, powers, transparency, and cooperation (CP1)

24. **Formal aspects of independence, although operationally the BCB functions efficiently and without evidence of interference.** There is a long-standing tradition of independent operation and since the last FSAP the legal protection of the BCB governor and the BCB's enforcement powers have been strengthened. However, one of the main recommendations of the 2002 FSAP concerning the need for a fixed term for the BCB Board has not been addressed. Furthermore, the law should require specific reasons (“due cause”) to justify removal of the governor and allow the BCB authority to issue prudential regulations directly (without going through the CMN).

25. **Hiring is based on civil service entry examinations for entry level positions, but the process could be modified to grant the BCB further flexibility.** To protect the integrity of the civil service, the BCB is not permitted to hire specialized staff at other than entry level positions which may result in expertise having to be developed internally over time. Some experienced staff has been hired at the entry level but whether in adequate numbers to meet needs should be evaluated. While the supervisory staff is well trained and talented, it is recommended that the employment framework be reviewed to determine whether technical position staffing depth is adequate.

Licensing and structure (CPs 2–5)

26. **The licensing process has been enhanced and recommendations of the 2002 BCP review implemented.** The licensing process involves a thorough analysis of strategic plans, capital projections and fit-and-proper tests. Additionally, for the first three years of operation the new bank is closely monitored to determine its ability to achieve projections.

27. **Although the Banking Law requires banks to obtain the prior approval of the BCB to invest in any company, in practice this has not been done.** Article 30 of the Banking Law states that: “private credit institutions, with the exception of investment institutions, may

participate in the capital of any company only with prior authorization from the Central Bank of Brazil. However, Resolution 2723 failed to include this requirement. As a result, investments, other than where control of a financial institution is involved, were not subject to BCB approval, but required ex-post notification. After the mission concluded, Resolution 4062 was issued requiring prior BCB approval for acquisition of an interest in nonfinancial institutions.

Prudential regulation and requirements (CPs 6–18)

28. **Implementation of Basel II began in 2007.** All credit and market risk approaches regulations are currently in place and the regulation for the advanced approach for operational risk was issued for public comment in March 2012. The prudential framework governing loan securitization was strengthened in 2008 by requiring banks to report securitized loans in their balance sheets, unless a final and irrevocable transfer of risk is in place.
29. **Since June 2010 banks have been allowed to apply for the use of internal models for market risk.** After a lengthy consultation period, the regulation for IRB approval was issued. Starting in December 2012 banks can apply for approval to implement the IRB approach. Applications for market risk approaches started being filed in 2011. Approvals to implement IRB are expected in 2013 after the validation process. Banks will file the first internal capital adequacy assessment process (ICAAP) report in July 2013.
30. **Consultations are now underway for the gradual phase-in of Basel III.** A challenge for some banks will be deductions for deferred tax assets, which now account for about 20-25 percent of Tier 1 capital but which are not allowed under Basel III. Banks are expected to meet the new standard primarily through a mix of retained earnings and some stock issuances.
31. **Collection of country risk data has been expanded and cross-border exposures are not significant.** Banks cannot place abroad funds raised in Brazil and only funds raised directly by the facilities located abroad can be invested in foreign securities and corporates. The vast majority of transactions conducted by foreign branches are related to Brazilian bonds issued abroad or financing local clients or Brazilian companies. The total securities of the six largest Brazilian banks in December 2011 were R\$630 billion and foreign securities represented only 1.4 percent.
32. **A comprehensive legal framework and supervisory process is in place for anti-money laundering/combating financial terrorism (AML/CFT).** The BCB closely monitors compliance through a mix of offsite and onsite activities, including horizontal reviews by its specialized AML/CFT staff. The field work is supported by detailed inspection procedures and is included in the SRC.
33. **Requirements for risk management oversight and structures are comprehensive, include conservative assumptions, and linked to capital adequacy determination.** For purposes of supervisory oversight, risk is divided into eleven risk categories: credit, market, liquidity, corporate (level) operational, business area operational, contagion, legal, reputational,

strategic, information technology (IT) and money laundering. Risk monitoring is a key activity and substantive analysis of each risk group and the respective management process is conducted. Controls are expected to exist and be commensurate with the size and complexity of the operations of each institution. Risks are viewed on an institution level as well as on a consolidated level. Supervision examines the risk metrics used by banks to measure their risk, including the assumptions used in the stress tests. Supervision also runs stress tests on banks' positions which are pulled down from various data feeds and regulatory reporting. Capital calculations for each risk are prescribed and are consistent with or more conservative than those presented in Basel II. Risk ratings are assigned not only for banking and banking related activity but also for insurance and asset management in the relevant cases. Contagion risk is also rated within the context of the impact the given institution would have on the system if it experienced significant financial distress. The risk rating process is quite granular and is built upon layers of various risk considerations including assessment of corporate governance, management, AML specifically, as well as the direction and trend of the risk.

34. Banks are required to implement adequate internal controls for their activities and must be in compliance with the relevant legal norms and regulations. The Supervisor can direct additional controls if risk management deficiencies are found, and it can impose more restrictive operational limits when such deficiencies are not corrected on a timely basis. Recent regulation has provided the Supervisor with the basis to address risk management and control concerns on a proactive basis rather than waiting for identified concerns to embed themselves in the financial condition and performance of the institution.

Supervisory Process and Accounting and Disclosure (CP 19–21)

35. The BCB carries out rigorous, intrusive risk based supervision. Processes are well developed based on extensive information and analytically intensive. Supervision is tailored to each institution based on its risk profile and the size and complexity of its activities. Accordingly, each institution is on a 12 or 24-month supervisory cycle which is planned and guided by the plan set out by the SRC. The SRC is a well-structured methodology for identifying and assessing the most relevant risks of institutions, as well as the quality of internal controls and risk management systems. The supervisory plan consists of a combination of continuous monitoring and onsite activities. Systemic banks are considered as high priority due to their impact.

36. The supervisory process leverages its information systems to increase the efficiency of its supervisory staff. The information systems produce significant quantitative analysis, including the use of artificial intelligence to produce quantitative risk ratings for the banks. The supervisory staff focuses on providing the qualitative overview based on a detailed analysis of corporate governance, risk management and conglomerate risks, including the possible impact on the conglomerate from affiliates or nonbank subsidiaries. In discussions with the banks it became evident that frequent discussions occur to discuss the bank performance and that the level of the discussions reflect the risk profile of the bank. Turnover is low at the BCB and the

number of existing staff (over 700 direct supervisors) supports the number of activities planned in the annual supervisory plan.

37. **State-banks are systemically significant and are subject to the same supervisory process as private institutions.** A review of annual supervisory plans, reports of inspection and enforcement actions for the state-owned banks did not reveal any difference when compared with private banks. The inspection reports are detailed and highlight deficiencies concerning corporate governance, information systems and capital. A case reviewed highlighted internal control deficiencies and the follow-up action by the BCB was prompt, requiring correction plans and discussions with the bank's board.

38. **Continuous monitoring leverages information from several sources including banks' regulatory reporting and data links with clearing houses and registrars.** Virtually every financial instrument is registered in Brazil, and the supervisor is able to pull down transactional information for each and every bank with a one day lag. Subsequently, supervisory systems can monitor transaction based detail as well as reconstruct various bank positions such as liquidity positions, funds provider information, and market risk exposures. The BCB, based on its information flows is able to stress test certain positions and monitor extraordinary trends. Activity identified outside of normal parameters is flagged with further follow up conducted.

39. **The onsite department is configured into teams responsible for designated institutions or groups of institutions as well as specific risks.** Teams monitor information generated by continuous monitoring as well as conduct their own monitoring and oversight according to the supervisory plan and cycle established for the respective institution. The onsite department also houses teams specialized in topical risks including: (i) Credit, liquidity, and market and operational risks; (ii) Legal and fiscal issues; (iii) Validation (internal models); (iv) Basel II and III implementation; (v) Corporate governance and internal controls, and (vi) AML. Supervisory cycles begin and end with a full review of the given institution, evaluation of supervisory activities and results, and development of a subsequent supervisory plan. Such (SRC) reviews involve the inspector in charge of the institution as well as supervisory management.

Accounting and Disclosure (CP 22)

40. **Banks are required to comply with BCB established regulatory accounting standards and to appoint a director specifically responsible for compliance with the required standards, basic accounting principles, and professional ethics and banking secrecy rules.** Banks are required to publish semiannually audited statements according to the accounting plan of national financial system institutions (Cosif), and annually according to international financial reporting standards (IFRS) as applicable. All public listed banks and those required to appoint Audit Committees must produce annual IFRS statements. Furthermore, financial conglomerates are required to publish consolidated statements according to IFRS. All financial institutions must receive an external audit according to international audit standards. Since 2008, BCB has been conducting an Accounting Convergence Project for the purpose of

evaluating the differences between the local and IFRS, as separate financial statements are concerned. The goal of the project is to obtain a convergence of domestic rules applied to general purpose financial statements of banks to IFRS where feasible. In general, Cosif standards result in more conservative figures particularly regarding provisioning.

Corrective and remedial powers of supervisors (CP 23)

41. **Enforcement powers are broad and have been significantly enhanced with the issuance of Resolution 4019.** The resolution improved the ability of the BCB to require early correction of issues identified through its supervisory process by making it possible to require correction based on judgmental views on the adequacy of internal controls, corporate governance and not having to wait until the bank condition demonstrated quantitative indications of deterioration to be able to require corrective action.

42. **A number of examples of enforcement cases were reviewed and the proactive nature of the BCB was evident.** The BCB has taken enforcement action due to inadequate corporate governance and internal controls and has taken enforcement action for capital and asset quality issues. The actions are initiated by a letter of issues sent to the bank asking for resolution of the issues within a timeframe. The enforcement action escalates quickly after the timeframe expires without adequate bank response. The actions are closely tracked in the ongoing supervision process and, if needed, intervention of the bank takes place to protect the erosion of bank capital. The BCB meets with the Board and management to ensure it stresses the significance of its recommendations.

43. **Brazilian corporate law requires companies to pay a minimum of 25 percent of profits as dividends for preferred shares.** While the BCB could offset this requirement in a weak bank situation by increased provisioning or requiring additional capital, a permanent solution should be sought by exempting banks from the requirement.

Consolidated and cross-border banking supervision (CPs 24–25)

44. **The BCB has broad authority to conduct consolidated supervision.** The BCB is empowered to supervise banks on a solo and consolidated basis, including all the offices or entities within the group, irrespective of their location or legal structure.

45. **Consolidated supervision is primarily based on the information compiled at the parent bank level in order to manage the risks and controls across the group.** Parent banks are subject to mandatory detailed regular reporting to the BCB, which also covers internal global risk management and information on internal controls. Additionally, the BCB coordinates and exchanges information with domestic and foreign supervisors to accomplish a full view of risk.

46. **Through supervisory colleges and on a bilateral basis, the BCB collaborates with home-host supervisors.** As home supervisor, the BCB conducts supervisory colleges for Banco do Brasil and Itaú-Unibanco and participates as host in a number of others. Additionally, the BCB has signed MOUs with a number of countries.

Table 1. Summary Compliance with the Basel Core Principles—Detailed Assessments

Core Principle	Grading	Comments
1. Objectives, independence, powers, transparency, and cooperation		
1.1 Responsibilities and objectives	C	
1.2 Independence, accountability and transparency	LC	The BCB cannot issue prudential regulations directly. The Banking Law does not require “due cause” for the removal of the Governor.
1.3 Legal framework	C	
1.4 Legal powers	C	
1.5 Legal protection	C	
1.6 Cooperation	C	
2. Permissible activities	C	
3. Licensing criteria	C	
4. Transfer of significant ownership	C	
5. Major acquisitions	LC	The BCB is not in compliance with the banking law which requires that participation in the capital of any company requires prior authorization from the Central Bank of Brazil. (To address the deficiency, the BCB adopted Resolution 4062 on March 29, 2012.)
6. Capital adequacy	C	
7. Risk management process	C	
8. Credit risk	C	
9. Problem assets, provisions, and reserves	C	
10. Large exposure limits	C	
11. Exposure to related parties	C	
12. Country and transfer risks	C	
13. Market risks	C	
14. Liquidity risk	C	
15. Operational risk	C	
16. Interest rate risk in the banking book	C	
17. Internal control and audit	C	
18. Abuse of financial services	C	
19. Supervisory approach	C	

20. Supervisory techniques	C	
21. Supervisory reporting	C	
22. Accounting and disclosure	C	
23. Corrective and remedial powers of supervisors	C	Banks are subject to corporate which establishes a floor of 25 percent of net profits that must be paid as dividends. Banks should be exempt from this requirement to ensure capital preservation in a weak bank situation.
24. Consolidated supervision	C	
25. Home-host relationships	C	
<i>Aggregate:</i> Compliant (C) – 23, Largely compliant (LC) – 2, Materially noncompliant (MNC) – 0, Noncompliant (NC) – 0, Not applicable (N/A) – 0		

Recommended action plan and authorities' response

Recommended action plan

Table 2. Recommended Action Plan to Improve Compliance with the Basel Core Principles

Reference Principle	Recommended Action
1(2). Independence, accountability and transparency	<p>Codify the independence of the BCB by providing in the law that the governor and board of the BCB can only be removed for due cause that should be detailed in the law. Also consider establishing a fixed term.</p> <p>Grant the BCB authority to issue prudential regulations directly without having to work through the CMN.</p> <p>New staff must be hired at entry level salary. Inject limited flexibility to hire technical experts at other than entry level.</p>
5. Major acquisitions	<p>Amend existing regulation to implement the banking law requirement that investment in other companies by banks must receive the prior approval of the BCB. A di minimus level should be established to avoid excessive filings. Addressed the deficiency by the adoption of Resolution 4062 on March 29, 2012.</p>
23. Corrective and remedial powers of supervisors	<p>Exempt banks from the corporate law requirement that 25 percent of net profits must be paid as dividends to preferred shareholders.</p>

Authorities' response to the assessment

The authorities indicated their overall agreement with the assessment and offered additional inputs to clarify several of the points contained in the text. The term for bank directors (three years) was clarified as was the technical accuracy of the process of freezing bank administrators' assets in a liquidation scenario, etc. Clarifications were made to specific legal cites and legal language. To address the MNC rating on CP5, on March 29, 2012, the Board of the BCB approved Resolution 4062 requiring banks to seek the prior approval of the BCB to invest in the shares of other financial institutions or companies.

II. DETAILED ASSESSMENT

Table 3. Detailed Assessment of Compliance with the Basel Core Principles

Principle 1	Objectives, autonomy, powers, and resources. An effective system of banking supervision will have clear responsibilities and objectives for each authority involved in the supervision of banks. Each such authority should possess operational independence, transparent processes, sound governance and adequate resources, and be accountable for the discharge of its duties. A suitable legal framework for banking supervision is also necessary, including provisions relating to authorization of banking establishments and their ongoing supervision; powers to address compliance with laws as well as safety and soundness concerns; and legal protection for supervisors. Arrangements for sharing information between supervisors and protecting the confidentiality of such information should be in place.
Assessment	
Principle 1(1)	Responsibilities and objectives. An effective system of banking supervision will have clear responsibilities and objectives for each authority involved in the supervision of banks.
Essential criteria	
EC1	Laws are in place for banking, and for the authority (each of the authorities) involved in banking supervision. The responsibilities and objectives of each of the authorities are clearly defined and publicly disclosed.
Description and findings re EC1	<p>The national financial system (SFN) regulatory structure is established by Law Number 4595 of 1964 (Banking Law), which establishes the Central Bank of Brazil (BCB) as the banking system supervisor and the National Monetary Council (CMN) with responsibility (among other central banking responsibilities) to safeguard the liquidity and solvency of financial institutions. The CMN is authorized to establish prudential regulations (resolutions) and its members are the Minister of Finance (President), the Minister of Budget and Planning and the Governor of the BCB. The BCB serves as the Executive Secretariat of the CMN.</p> <p>Banking and financial laws are issued and amended by the National Congress, while CMN is authorized to establish resolutions that provide the BCB with legal power to act and issue circulars. CMN may present proposals to issue and to amend existing legislation to the National Congress.</p> <p>The regulations for financial issues that fall under the regulatory competence of the BCB are approved by its Board of Directors in the form of circulars.</p> <p>As supervisor of the financial system, the BCB is responsible for the supervision of: commercial banks, multiple banks, exchange banks, development banks, investment banks, the Federal Savings Bank and credit/finance investment societies. All these institutions take insured deposits but only the commercial and multiple banks may accept demand deposits and grant commercial loans. Other companies supervised by the BCB include: brokers and brokerage firms, credit cooperatives, leasing companies and micro credit companies.</p> <p>A commercial bank is defined as a financial institution making commercial loans and able to accept demand deposits. A multiple bank is defined as a financial institution that accepts demand deposits and offers commercial loans or investment products <u>and</u> has an additional financial portfolio (i.e., foreign exchange/securities brokerage). Conglomerates include a cross-border activity. A financial bank/conglomerate is only involved in financial activities as</p>

	<p>defined in the Banking Law. An economic bank/conglomerate would include insurance or pension fund activities, neither of which is defined as a financial activity in the Banking Law.</p> <p>Law 9613 assigns the BCB the authority to regulate and supervise the banking system regarding anti-money laundering and combating terrorism financing (AML/CFT).</p> <p>The Banking Law grants the BCB full authority to license banks and enact remedial actions and resolution of non-viable banks. Law 6024 grants the BCB the power to intervene and extra-judicially liquidate financial institutions.</p> <p>All laws and regulations are published in the Federal Official Gazette of Brazil.</p>
EC 2	The laws and supporting regulations provide a framework of minimum prudential standards that banks must meet.
Description and findings re EC2	<p>Brazil has a well-developed regulatory framework: Prudential requirements for market, operational, credit and liquidity risks are addressed in Resolutions 3464, 3380, 3721 and 2804. AML/CFT is addressed in Law 9613 and Circular 3461. Capital rules are covered in Resolutions 3444, and 3490 plus other attendant resolutions. There are also regulations on transparency, disclosure, external auditing and internal controls, to name a few.</p> <p>As evidenced during the BCP review, the BCB has substantial flexibility to issue resolutions (established by the CMN), circulars and circular letters on a timely basis to address prudential concerns.</p>
EC3	Banking laws and regulations are updated as necessary to ensure that they remain effective and relevant to changing industry and regulatory practices.
Description and findings re EC3	The banking law is broad and provides the framework permitting the issuance of regulations, including those to implement international standards without requiring legislative action. This flexible framework permits the BCB working with the CMN to ensure that prudential regulations are current and address current risks. (See EC1)
EC4	The supervisor confirms that information on the financial strength and performance of the industry under its jurisdiction is publicly available.
Description and findings re EC4	Banks are required to publish their financial statements in a local newspaper. In addition, through its financial stability reports and its website, the BCB provides information on the financial system.
Additional criteria	
AC1	In determining supervisory program and allocating resources, supervisors take into account the risks posed by individual banks and banking groups and the different approaches available to mitigate those risks.
Description and findings re AC1	The BCB rates the banks using a 1-4 ranking—which reflects both quantitative and qualitative analyses—to reflect the adequacy of capital, asset quality, liquidity and profits. The results are collected in a risk matrix and based on the risk level of each bank, plans for supervisory activities are developed and resources assigned reflecting the risk profile of the bank.
Assessment of Principle 1(1)	Compliant
Comments	
Principle 1(2).	Independence, accountability and transparency. Each such authority should possess operational independence, transparent processes, sound governance and adequate resources, and be accountable for the discharge of its duties.
Essential criteria	

EC1	The operational independence, accountability and governance structures of each supervisory authority are prescribed by law and publicly disclosed. There is, in practice, no evidence of government or industry interference which compromises the operational independence of each authority, or in each authority's ability to obtain and deploy the resources needed to carry out its mandate. The head(s) of the supervisory authority can be removed from office during his (their) term only for reasons specified in law. The reason(s) for removal should be publicly disclosed.
Description and findings re EC1	<p>Although the legal framework does not fully protect the independence of the BCB to conduct its supervisory activities, operationally the BCB functions efficiently and there is no evidence of interference from government or industry. Lack of legal protection for ensuring independence include:</p> <ul style="list-style-type: none"> • The Board of the BCB is appointed by the President and approved by the Senate and serves without a fixed-term mandate and can be dismissed "immediately and without discussion"; Decree 91961 (1985). The governor reports directly to the President. The current governor is a career member of the BCB and has been in office since January 2011 after having served for four years as Deputy Governor for Financial System Regulation (2006–2010). The prior governor served from 2003–2010. • Prudential regulation, in the form of resolutions, is established by the CMN over which the Minister of Finance presides. <p>The Banking Law, Law 6024 and Resolution 4019 establish the authority of the BCB to undertake enforcement action, apply penalties and intervene and resolve weak banks independently.</p>
EC2	The supervisor publishes objectives and is accountable through a transparent framework for the discharge of its duties in relation to those objectives.
Description and findings re EC2	The supervisory objectives and processes (supervisory manual) are available in the BCB website. The BCB finances, budget and operations are subject to the oversight of the Congress with the assistance of the Federal Audit Court. The Executive Branch exercises control by means of the Office of the Comptroller General of Brazil.
EC3	The supervisory authority and its staff have credibility based on their professionalism and integrity.
Description and findings re EC3	The BCB staff operates under high professional standards and is provided with extensive developmental opportunities to maintain and improve their technical abilities. In 2009 the BCB published its Code of Conduct in the BCB website. Internally, the BCB has an Internal Affairs unit to monitor compliance with the Code. Internationally, the BCB staff participates in international forums such as the Basel Committee, and the Association of Supervisors of the Americas.
EC4	<p>The supervisor is financed in a manner that does not undermine its autonomy or independence and permits it to conduct effective supervision and oversight. This includes:</p> <ul style="list-style-type: none"> • A budget that provides for staff in sufficient numbers and with skills commensurate with the size and complexity of the institutions supervised. • Salary scales that allow it to attract and retain qualified staff • The ability to commission outside experts with the necessary professional skills and independence and subject to necessary confidentiality restrictions to conduct supervisory tasks • A training budget and program that provides regular training opportunities for staff • A budget for computers and other equipment sufficient to equip its staff with the tools needed to review the banking industry and assess individual banks and banking groups;

	<p>and</p> <ul style="list-style-type: none"> • A travel budget that allows appropriate on-site work.
Description and findings re EC4	<p>The BCB operational budget is subject to the Fiscal Responsibility Law and included in the General Federal Government Budget. The BCB also depends on governmental authorization to carryout entrance examinations and hire new employees. The government's public competition hiring process prevents the BCB from hiring technical experts at higher than entry level salaries. The BCB is obliged to use the government's selection/testing process in its hiring. Successful candidates are hired at the beginning salary level. Although the BCB has a well-developed developmental program, it is a lengthy process to develop expertise in critical areas like modeling, interest rate and market risk. The BCB has qualified staff in these areas but not depth within the ranks.</p> <p>Although lacking full budgetary independence, the staffing levels, travel budgets are considered adequate. The turnover is low and in the past four years there have been no exits from the officer ranks.</p>
Additional criteria	
AC1	The head(s) of the supervisory authority is (are) appointed for a minimum term.
Description and findings re AC1	The head of the supervisory authority (BCB Governor and Deputy Governors) is not appointed for a minimum term.
Assessment of Principle 1(2)	Largely Compliant
Comments	<p>Although there is a long-standing tradition of independent operation by the BCB supervisory function, the institutionalization of that independence with legal safeguards would aid in its continuity. For example, in the areas of issuing resolutions, and establishing a "due cause" requirement for the removal of the Governor. Also considered should be a fixed term for the Governor.</p> <p>Alternatives or modifications to the hiring process should be considered. Hiring experienced staff from the market place would deepen the BCB's experience profile and introduce new thinking processes.</p>
Principle 1(3)	Legal framework. A suitable legal framework for banking supervision is also necessary, including provisions relating to authorization of banking establishments and their ongoing supervision.
Essential criteria	
EC1	The law identifies the authority (or authorities) responsible for granting and withdrawing banking licenses.
Description and findings re EC1	The Banking Law grants the BCB the authority to grant and revoke bank licenses. The BCB also approves changes-in-control, mergers, opening of branches and foreign establishments.
EC2	The law empowers the supervisor to set prudential rules (without changing laws). The supervisor consults publicly and in a timely way on proposed changes, as appropriate.
Description and findings re EC2	Prudential regulations are established by the CMN without the need to amend laws. Although the BCB is a member of the CMN, it lacks the power to independently issue regulations. However, the BCB drafts the regulations and provides the technical support. Regulations are issued timely and expediently and reflect international standards. The BCB can issue resolutions, circulars to further detail and implement the regulations. Significant proposed regulations are published for comment.
EC3	The law or regulations empower the supervisor to obtain information from the banks and

	banking groups in the form and frequency it deems necessary.
Description and findings re EC3	The Banking Law requires banks to provide the BCB with the reports necessary to implement its duties. Additional regulations expand on the information to include information on members of the conglomerate or economic group. Circular 3402 provides the BCB with authority to request information on an ad-hoc basis.
Assessment of Principle 1(3)	Compliant
Comments	The BCB has the capacity to issue regulations without amending laws after they have been established by the CMN.
Principle 1(4)	Legal powers. A suitable legal framework for banking supervision is also necessary, including powers to address compliance with laws as well as safety and soundness concerns.
Essential criteria	
EC1	The law and regulations enable the supervisor to address compliance with laws and the safety and soundness of the banks under its supervision. The law and regulations permit the supervisor to apply qualitative judgment in safeguarding the safety and soundness of the banks within its jurisdiction.
Description and findings re EC1	<p>The Banking Law provides the BCB with enforcement authority to ensure compliance with prudential requirements. Resolution 4019 adopted in 2011 establishes the broad capacity and wide range of supervisory tools of the BCB to effect corrective action and preventive action to implement Pillar 2.</p> <p>The issues over which the BCB can act range from capital deficiencies to inadequate risk management, insufficient internal control, strategies that do not match the bank's risk profile. The BCB uses both judgmental and quantitative factors to address and measure the risks and need for corrective action. The BCB regulations are largely based on international standards.</p>
EC2	The supervisor has full access to banks' board, management, staff and records in order to review compliance with internal rules and limits as well as external laws and regulations.
Description and findings re EC2	<p>BCB supervision is intrusive and there is direct access to bank records and frequent contact with bank management. Through review of Board of Directors and financial committee minutes the BCB monitors Board involvement in risk management. At a minimum, for high and medium priority banks, the supervisors meet annually with the Board. For the lower risk banks there is a meeting with the Board every other year.</p> <p>The Banking Law grants BCB unrestricted access to documents and bookkeeping records of supervised institutions. Refusal to comply is considered an obstruction of supervision and subject to penalties.</p>
EC3	<p>When, in a supervisor's judgment, a bank is not complying with laws or regulations or it is or is likely to be engaged in unsafe and unsound practices, the supervisor has the power to:</p> <ul style="list-style-type: none"> • take (and/or require a bank to take) prompt remedial action; and • Impose a range of sanctions (including the revocation of the banking license).
Description and findings re EC3	The BCB has the authority to adopt preventive and corrective action when banks do not follow regulations or reflect operating weaknesses. These actions include restricting operations, requiring additional capital, requiring plans to correct deficiencies and in critical situations, intervention, removal of management, liquidation and/or the imposition of fines. Under Resolution 4019 the BCB powers over enforcement were broadened in the areas of supervisory discretion and judgment in analyzing risks and demanding corrective action. (See EC23)

Assessment of Principle 1(4)	Compliant
Comments	
Principle 1(5)	Legal protection. A suitable legal framework for banking supervision is also necessary, including legal protection for supervisors.
Essential criteria	
EC1	The law provides protection to the supervisory authority and its staff against lawsuits for actions taken and/or omissions made while discharging their duties in good faith.
Description and findings re EC1	The Federal Civil Servants Law 8112/90 provides that civil servants shall incur civil, criminal, and administrative liability in the case of the improper exercise of their duties. Civil liability is incurred either through acts of omission or commission or willful or wrongful acts that cause harm to the public treasury or to third parties and employees have a right to be represented by the Federal Attorney's Office (Law 9028 of 1995).
EC2	The supervisory authority and its staff are adequately protected against the costs of defending their actions and/or omissions made while discharging their duties in good faith.
Description and findings re EC2	When suits are commenced against individual employees of the BCB, the General Counsel's Office makes an assessment as to whether the employee had acted in good faith and within its supervisory powers and thereafter makes a recommendation to the Board. The Board can authorize that the employee be defended by the General Counsel's Office, which is part of the Federal Attorney's Office. The General Counsel's Office has been successful in defending most cases and cases are often commenced against the BCB or the Governor, rather than against individual employees.
Assessment of Principle 1(5)	Compliant
Comments	
Principle 1(6)	Cooperation. Arrangements for sharing information between supervisors and protecting the confidentiality of such information should be in place.
Essential criteria	
EC1	Arrangements, formal or informal, are in place for cooperation and information sharing between all domestic authorities with responsibility for the soundness of the financial system, and there is evidence that these arrangements work in practice, where necessary.
Description and findings re EC1	<p>BCB established agreements with the following Brazilian authorities:</p> <ul style="list-style-type: none"> • Complementary Pension Secretariat (SPC), later replaced by National Complementary Pension Superintendency (PREVIC), signed on December, 2007 in order to exchange information and perform coordinated supervision actions; • Securities and Exchange Commission (CVM): agreement established since 2002 in order to exchange information and to communicate irregularities and corrective measures taken; • Secretariat of the Federal Revenue of Brazil (RFB): agreement established since 2002 to exchange information. • The Private Insurance Superintendence (SUSEP): signed on July, 2005, to exchange information to take coordinated supervision actions in the entities of the group. <p>In 2006, the Brazilian government created the Committee for Regulation and Supervision of Financial, Capital, Insurance, Pension Fund and Capitalization Markets (Coremec) to promote a broad, coordinated and enhanced action by the national financial system supervisors.</p>

EC2	Arrangements, formal or informal, are in place, where relevant, for cooperation and information sharing with foreign financial sector supervisors of banks and banking groups of material interest to the home or host supervisor, and there is evidence that these arrangements work in practice, where necessary.
Description and findings re EC2	There are formal and informal agreements established between BCB and other foreign supervisory authorities in order to exchange information regarding the Brazilian financial institutions located abroad and international financial institutions located in Brazil. These agreements include Argentina, Bahamas, Cayman Islands, Germany, Indonesia, Mexico, Panama, Paraguay, Portugal, Spain, United States (OCC, FDIC, FED, OTS and New York State Banking Department), and Uruguay. BCB hosts supervisory colleges for Itaú-Unibanco and Banco do Brasil and participates in colleges for Credit Suisse, Deutsche Bank, GMAC, HSBC, Rabobank and Santander.
EC3	The supervisory may provide confidential information to another domestic or foreign financial sector supervisor. The supervisor is required to take reasonable steps to ensure that any confidential information released to another supervisor will be used only for supervisory purposes and will be treated as confidential by the receiving party. The supervisor receiving confidential information from other supervisors is also required to take reasonable steps to ensure that the confidential information will be used only for supervisory purposes and will be treated as confidential.
Description and findings re EC3	In exchanging information and signing MOUs, the BCB ensures that protection of the information meets the privacy standards of Brazil in accordance with complementary Law 105.
EC4	The supervisor is able to deny any demand (other than a court order or mandate from a legislative body) for confidential information in its possession.
Description and findings re EC4	The BCB only provides information shielded by bank secrecy Laws in cases of submission of particular requests from Parliament/Justice (prescribed by Complementary Law 105/2001). Any request not covered by Complementary Law 105 is denied.
Assessment of principle 1(6)	Compliant
Comments	
Principle 2	Permissible activities. The permissible activities of institutions that are licensed and subject to supervision as banks must be clearly defined and the use of the word “bank” in names should be controlled as far as possible.
Essential criteria	
EC1	The term “bank” is clearly defined in laws or regulations.
Description and findings re EC1	The Banking Law defines financial institutions as “public or private legal entities, whose main or secondary activity is collection, intermediation or investment of their own or third party funds, in national or foreign currency, as well as the custody of third party property”. There is a wide variety of financial institutions that can accept deposits and that are licensed and supervised by the BCB and covered by the Credit Guarantee Fund (FGC). These institutions include the commercial banks, multiple banks, exchange banks, development banks, investment banks, the Federal Savings Bank (CEF) and credit unions. There are also a savings and loan association and credit cooperatives that can accept deposits. The BCB website identifies and describes the permissible activities for the various institutions.
EC2	The permissible activities of institutions that are licensed and subject to supervision as banks are clearly defined either by supervisors, or in laws or regulations.

Description and findings re EC2	The permissible activities are clearly defined and the BCB website contains a description of each financial system entity and its permissible activities. While not defined as financial, banks are permitted to establish subsidiaries for insurance and pension funds. The aggregate investment in commercial companies when aggregated with the bank's fixed assets/premises may not exceed 50 percent of capital.
EC3	The use of the word "bank" and any derivations such as "banking" in a name is limited to licensed and supervised institutions in all circumstances where the general public might otherwise be misled.
Description and findings re EC3	In practice The use of the word bank is limited to financial institutions chartered and supervised by the BCB. Only institutions licensed by the BCB may engage in deposit taking. Law 4595/1964 stipulates that individuals or legal entities that act as financial institutions, without being duly authorized by the BCB are subject also to one to two years of detention. The BCB website clearly defines and lists deposit taking institutions.
EC4	The taking of deposits from the public is generally reserved for institutions that are licensed and subject to supervision as banks.
Description and findings re EC4	Only institutions licensed and supervised by the BCB may engage in deposit taking. Commercial and multiple banks are the only ones, in the banking system, permitted to take demand deposits.
EC5	The supervisory or licensing authority publishes, and keeps current, a list of licensed banks and branches of foreign banks operating within its jurisdiction.
Description and findings re EC5	Available in the BCB website.
Assessment of Principle 2	Compliant
Comments	
Principle 3	Licensing criteria. The licensing authority must have the power to set criteria and reject applications for establishments that do not meet the standards set. The licensing process, at a minimum, should consist of an assessment of the ownership structure and governance of the bank and its wider group, including the fitness and propriety of Board members and senior management, its strategic and operating plan, internal controls and risk management, and its projected financial condition, including its capital base. Where the proposed owner or parent organization is a foreign bank, the prior consent of its home country supervisor should be obtained.
Essential criteria	
EC1	The licensing authority could be the banking supervisor or another competent authority. If the licensing authority and the supervisory authority are not the same, the supervisor has the right to have its views considered on each specific application. In addition, the licensing authority provides the supervisor with any information that may be material to the supervision of the licensed institution.
Description and findings re EC1	The Banking Law establishes the BCB as the sole licensing authority for financial institutions to: operate in the country; install or transfer their headquarters or offices abroad; be transformed, merged or incorporated; and transfer their equity control. With the enactment of the current Brazilian Constitution, of 1988, the inflow of foreign capital in the SFN became subordinate to the provisions in the Act of Transitory Provisions of the Constitution, that prevents the establishment, in the country, of new branches of foreign financial institutions and the increase in participation of foreign individuals or legal entities in

	<p>the equity of national financial institutions, until the conditions for the participation of foreign capital in these institutions is determined, by means of complementary Law. However, the same constitutional provision permits exceptions in case of authorizations resulting from international agreements, reciprocity, or of national interest. The manifestation of such interest is materialized by presidential decree, thus the BCB must submit for final approval applications of foreign banks for a license.</p> <p>Control of banks can only be held by: natural persons; financial institutions and other financial system members licensed by the BCB; and other legal entities whose exclusive business purpose is to invest in the equity of financial institutions and other institutions licensed by the BCB.</p>
EC2	The licensing authority has the power to set criteria for licensing banks. These may be based on criteria set in laws or regulations.
Description and findings re EC2	<p>Resolution 3040 establishes the requirements to obtain a license and can be amended by the BCB through the CMN. The requirements include publication of the purpose of the proposed institution to allow for public comment. Foundations, investment funds and private pensions cannot have a controlling share in a bank.</p> <p>The application should include:</p> <p>a) An economic and financial feasibility study;</p> <ol style="list-style-type: none"> 1. A business plan, that must describe, at least: details of the proposed organizational structure; specification of the internal control structure; establishment of strategic goals; definition of the main products and services to be offered, as well as the intended target audience; 2. The information technology infrastructure to be deployed to provide the specified products and services, as well as the estimated size of the service network; 3. Deadline to begin operations; 4. Description of the criteria used in the recruitment of upper management; <p>b) Definition of the standards for corporate governance;</p> <p>c) Indication of the composition of the institution's control group;</p> <p>d) Economic and financial capacity of the controlling shareholder or control group.</p> <p>A review of applications disclosed a thorough evaluation by BCB staff, and requests for additional information when needed. Also reviewed was a denied application. Both processes are well documented and the recommendations were well substantiated and addressed the criteria above.</p>
EC3	The criteria for issuing licenses are consistent with those applied in ongoing supervision.
Description and findings re EC3	The criteria for issuing a license are consistent with those for ongoing supervision as the criteria require adequate capital, fit-and-proper management and adequate corporate governance.
EC4	The licensing authority has the power to reject an application if the criteria are not fulfilled or if the information provided is inadequate.
Description and findings re EC4	There have been 37 applications filed in the past five years. Of these; 12 were approved, two denied, 8 withdrawn and 15 are pending (also see EC2).
EC5	The licensing authority determines that the proposed legal, managerial, operational and ownership structures of the bank and its wider group will not hinder effective supervision on both a solo and a consolidated basis.
Description and findings re EC5	The application must address, for BCB evaluation, the internal control systems, organizational structure, and identification of the control group. Where control is not evident, the applicant

	must provide a “controlling agreement” disclosing how control will be exercised.
EC6	The licensing authority identifies and determines the suitability of major shareholders, including the ultimate beneficial owners, and others that may exert significant influence. It also assesses the transparency of the ownership structure and the sources of initial capital.
Description and findings re EC6	Resolution 3040 requires that the application identify significant shareholders and control group. If the bank is to be widely-held, a list of shareholders must be provided. In reviewing the suitability of significant shareholders the BCB requires applicants to provide authorization for BCB to inquire into their backgrounds. The sources of capital are verified and transaction documentation required.
EC7	A minimum initial capital amount is stipulated for all banks.
Description and findings re EC7	Minimum capital is R\$17,500,000 for a commercial bank. An additional R\$6,500,000 is required to engage in foreign exchange operations.
EC8	The licensing authority, at authorization, evaluates proposed directors and senior management as to expertise and integrity (fit and proper test), and any potential for conflicts of interest. The fit and proper criteria include: (i) skills and experience in relevant financial operations commensurate with the intended activities of the bank; and (ii) no record of criminal activities or adverse regulatory judgments that make a person unfit to uphold important positions in a bank.
Description and findings re EC8	Resolution 3041 establishes the fit-and-proper requirements for senior managers. These include: unblemished reputation, be a Brazilian resident for directors, no prior violations, not having declared bankruptcy, not having been disqualified to serve on a Board previously and have the technical capacity for the position. The BCB also checks credit records, tax records and for foreign applicants checks Interpol and the home country supervisor.
EC9	The licensing authority reviews the proposed strategic and operating plans of the bank. This includes determining that an appropriate system of corporate governance, risk management and internal controls, including those related to the detection and prevention of criminal activities, as well as the oversight of proposed outsourced functions, will be in place. The operational structure is required to reflect the scope and degree of sophistication of the proposed activities of the bank
Description and findings re EC9	The information required by Resolution 3040 includes a description of proposed organizational structure, internal control structure, strategic goals, main products and services to be offered, information technology infrastructure, and definition of standards for corporate governance. (See EC2)
EC10	The licensing authority reviews pro forma financial statements and projections for the proposed bank. This includes an assessment of the adequacy of the financial strength to support the proposed strategic plan as well as financial information on the principal shareholder of the bank.
Description and findings re EC10	The proposal must include information to support the financial capacity of controlling shareholders to support the bank. The approval will depend on the evaluation of the financial capacity of the owner, the origin of the funds invested and estimates of the initial and future capital needs as indicated by the business plan and viability study. Proforma financial statements are provided and based on projected growth and capital needs a determination is made of the organizers ability to support future growth. An application reviewed during the assessment was denied due to the proposed shareholders lack of funds to support the bank’s projected growth.
EC11	In the case of foreign banks establishing a branch or subsidiary, before issuing a license, the host supervisor establishes that no objection (or a statement of no objection) from the home supervisor has been received. For purposes of the licensing process, as well as ongoing

	supervision of cross-border banking operations in its country, the host supervisor assesses whether the home supervisor practices global consolidated supervision.
Description and findings re EC11	Circular 3317 addresses the request of information from home supervisors to determine that the applicant is subject to consolidated supervision, has systems in place to manage cross-border operations, and that the home supervisor evaluates compliance with anti-money laundering requirements on a global basis.
EC12	If the licensing, or supervisory, authority determines that the license was based on false information, the license can be revoked.
Description and findings re EC12	The BCB has the authority to cancel a bank license.
EC13	The board, collectively, must have a sound knowledge of each of the types of activities the bank intends to pursue and the associated risks.
Description and findings re EC13	In its review process the BCB has the information required to match the experience of the proposed management and Board to manage the product lines and target market of the proposed institution. Board members serve for a three-year term and if re-elected must be approved by the BCB and their fit-and-proper re-assessed.
Additional criteria	
AC1	The assessment of the application includes the ability of the shareholder to supply additional financial support, if needed.
Description and findings re AC1	As part of the application process the BCB determines the capacity of shareholders to support the projected capital needs of the bank. An application was denied based on this assessment.
AC2	The licensing or supervisory authority has policies and processes in place to monitor the progress of new entrants in meeting their business and strategic goals, and to determine that supervisory requirements outlined in the license approval are being met.
Description and findings re AC2	New institutions must report for the first three years of operation on the alignment of accomplished operations with the objectives stated in its business plan. This information must be presented in the financial statements during the first three years of operation. If the BCB verifies, during that period, the non-adequacy of operations in relation to the strategic objectives, the institution must present substantial justification, which will be evaluated by the BCB, which may establish additional conditions, and a deadline to be met.
Assessment of Principle 3	Compliant
Comments	
Principle 4	Transfer of significant ownership. The supervisor has the power to review and reject any proposals to transfer significant ownership or controlling interests held directly or indirectly in existing banks to other parties.
Essential criteria	
EC1	Laws or regulations contain clear definitions of “significant” ownership and “controlling interest.”
Description and findings re EC1	Law 6404 defines control: “controlling shareholder is defined as the individual, legal entity, group of people joined by voting agreement or group of legal entities under common control, which: <ul style="list-style-type: none"> • Hold voting rights that assure in a permanent way, the majority of votes in the decisions of the general shareholders’ meeting and the power to appoint the company’s upper management; and

	<ul style="list-style-type: none"> • Use that power effectively to direct corporate activities.” <p>Resolution 3040 establishes a 5 percent shareholding as significant.</p>
EC2	There are requirements to obtain supervisory approval or provide immediate notification of proposed changes that would result in a change in ownership, including beneficial ownership, or the exercise of voting rights over a particular threshold or change in controlling interest.
Description and findings re EC2	<p>Resolution 3040 establishes that BCB authorization is required for the transfer of corporate control, and any change, direct or indirect, in the control group, that might imply change in the effective control of institutional business, as a consequence of:</p> <ul style="list-style-type: none"> • shareholders’ or quota holders’ agreement; • inheritance and statements of intent, e.g., donation and advance inheritance; • isolated or joint act, by any person, physical or legal entity, or group of persons representing common interest. <p>Still in the terms of the aforementioned resolution, the following acts of corporate restructuring, also depend on the BCB’s approval:</p> <ul style="list-style-type: none"> • change of business purpose; • creation or cancellation of an operational portfolio, by a universal bank; • merger, split or incorporation. <p>Circular 624 requires that the BCB be informed of: any change from the prior ownership map reported to BCB concerning 5 percent shareholders; any change in control; and/or any change in ownership relating to foreign ownership. The Authorizations Department (DEORF) analyzes the information and must approve any change in control through the application of a fit and proper test. DEORF uses a broad definition of control in these instances. Resolution 3040 provides that anyone with the power to influence through whatever means is to be considered a “controller” and is made subject to DEORF’s approval process.</p>
EC3	The supervisor has the power to reject any proposal for a change in significant ownership, including beneficial ownership, or controlling interest, or prevent the exercise of voting rights in respect of such investments, if they do not meet criteria comparable to those used for approving new banks.
Description and findings re EC3	The Banking Law establishes the need for BCB approval to effect changes of control; the BCB “will study the requests and decide to grant or deny”. In the past five years there have been 51 change-in-control applications, 28 were approved, 8 were withdrawn and 15 are pending.
EC4	The supervisor obtains from banks, through periodic reporting or on-site examinations, the names and holdings of all significant shareholders or those that exert controlling influence, including the identities of beneficial owners of shares being held by nominees, custodians and through vehicles which might be used to disguise ownership.
Description and findings re EC4	Circular 624 requires that all changes in the capital ownership must be reported when there is a change in any of the following group of shareholders: controlling shareholders, 5 percent shareholders, upper management, financial institutions, and foreign shareholders.
EC5	The supervisor has the power to take appropriate action to modify, reverse or otherwise address a change of control that has taken place without the necessary notification to or approval from the supervisor.
Description and findings re EC5	Changes in control that fail to comply with regulations may lead to: a resolution that the operation be reversed, prohibition from working in the institution or cancellation of the bank’s license.
Additional criteria	
AC1	Laws and regulations provide, or the supervisor ensures, that banks must notify the

	supervisor as soon as they become aware of any material information which may negatively affect the suitability of a major shareholder.
Description and findings re AC1	Through its ongoing monitoring and interactions with management, the BCB is made aware of major shareholder qualifications. Additionally, directors serve three-year terms and upon re-election, the bank must submit their names to the BCB for approval at which time the BCB updates their fit-and-proper qualifications.
Assessment of Principle 4	Compliant
Comments	
Principle 5	Major acquisitions. The supervisor has the power to review major acquisitions or investments by a bank, against prescribed criteria, including the establishment of cross-border operations, and confirming that corporate affiliations or structures do not expose the bank to undue risks or hinder effective supervision.
Essential criteria	
EC1	Laws or regulations clearly define what types and amounts (absolute and/or in relation to a bank's capital) of acquisitions and investments need prior supervisory approval.
Description and findings re EC1	<p>The Banking Law and Resolutions 2723, 2743 and 4062 provide guidance with respect to acquisitions and investments that require BCB notification. BCB has the exclusive authority to authorize the establishment and change of ownership of financial institutions, which includes the granting of authorization for one financial institution to acquire control of another. Requirements for capitalization fit and proper standards for managers and information on sources of the equity capital continue to apply.</p> <p>Article 30 of the Banking Law states that: "private credit institutions, with the exception of investment institutions, may participate in the capital of any company only with prior authorization from the Central Bank of Brazil, adequate reason being given in the application and authorization being granted expressly in each case, without prejudice to subscription guarantees under such general conditions as may be established by the National Monetary Council".</p> <p>Resolution 4062 states that "[...] The direct or indirect investment in the capital of any domestic or foreign companies by banks and other licensed entities is dependent on prior authorization by the BCB. Exceptions are granted for shareholding operations typical of investment portfolios held by investment and development banks, development agencies or universal banks with an investment or development portfolio [...]". Moreover, it states "[...] Authorization for investment shall be granted only in cases where the invested company's activities complement or support the investing entity's [...]"</p>
EC2	Laws or regulations provide criteria by which to judge individual proposals.
Description and findings re EC2	See EC1
EC3	Consistent with licensing requirements, among the objective criteria that the supervisor uses is that any new acquisitions and investments do not expose the bank to undue risks or hinder effective supervision. The supervisor can prohibit banks from making major acquisitions / investments (including the establishment of foreign branches or subsidiaries) in countries with secrecy laws or other regulations prohibiting information flows deemed necessary for adequate consolidated supervision
Description and findings re EC3	Resolution 2723 states that the BCB may only grant authorization in matters for which it has the information, data and documents required to evaluate the assets and liabilities of cross-border investments, in order to ensure a global consolidated supervision. Such regulation

	<p>applies to all cross-border, regardless of their location, including the so-called “tax heavens”.</p> <p>The applicant must present a declaration committing itself to provide the BCB, complete and unrestricted, all information, data, documents and verifications needed to evaluate their operations and the risks assumed affiliated institutions.</p> <p>Prior to the authorization for opening subsidiaries and agencies abroad, the BCB communicate with the host supervisor to ensure that consolidated supervision can be conducted. One of the points addressed, when consulting the foreign supervisory authority regarding the operation, refers to the type of supervision undertaken by such authority, if globally consolidated or not.</p>
EC4	The supervisor determines that the bank has, from the outset, adequate financial and organizational resources to handle the acquisition/investment.
Description and findings re EC4	For investments related to the acquisition of control in other banking institutions, the BCB performs the type of analysis performed for changes in control as described in CP4. In all other cases, the BCB requests, at least, “[...] the description of the invested company’s activities and business purpose, the expected synergies stemming from the investment and its alignment with the participating entity’s business strategy [...]”, according to Resolution 4062.
EC5	Laws and regulations clearly define for which cases notification after the acquisition or investment is sufficient. Such cases should primarily refer to activities closely related to banking and the investment being small relative to the bank’s capital.
Description and findings re EC5	There are no notification requirements for investments that do not require prior authorization by the BCB—i.e., investment banking activities such as underwriting, as well as investments held for trading purposes.
EC6	The supervisor is aware of the risks that non-banking activities can pose to a banking group, and has the means to take action to mitigate those risks.
Description and findings re EC6	The BCB (Circular 2981) requires banks to detail their direct or indirect investment in: all foreign companies, domestic companies that are subject to consolidation, companies where the bank investment exceeds 10 percent of the company’s shares and where the book value of the investment exceeds 10 percent of the net worth of the participant. The BCB includes these investments in the supervision of the bank and the regulations provide the BCB with the authority to require information needed for its supervisory purposes.
Additional criteria	
AC1	When a bank wishes to acquire a significant holding in a financial institution in another country, the supervisor should take into consideration the quality of supervision in that country and its own ability to exercise supervision on a consolidated basis.
Description and findings re AC1	See EC3
Assessment re Principle 5	Largely Compliant
Comments	Rated MNC during the mission but upgraded to LC as the end of March the BCB adopted Resolution 4062 requiring the prior approval of the BCB before making investment in other financial institutions or companies.
Principle 6	Capital adequacy. Supervisors must set prudent and appropriate minimum capital adequacy requirements for banks that reflect the risks that the bank undertakes, and must define the components of capital, bearing in mind its ability to absorb losses. At least for internationally active banks, these requirements must not be less than those established in the applicable Basel requirement.

Essential criteria	
EC1	Laws and regulations require all banks to calculate and consistently maintain a minimum capital adequacy ratio. Laws, regulations or the supervisor define the components of capital, ensuring that emphasis is given to those elements of capital available to absorb losses.
Description and findings re EC1	<p>The current definition of regulatory capital, as established by Resolution 3444, is compliant with Basel II criteria, including composition requisites and loss-absorbing characteristics. Banks are required to maintain an 11 percent minimum capital ratio. The current ratio for the industry is 16.2 percent and a leverage ratio of 10.3. In 2013 Brazilian banks will file their first ICAAP report. Qualifying banks will be authorized to implement IRB approaches in 2013.</p> <p>Through Communication 20615, published on February 17, 2012, the BCB posted for comments the proposed regulation to implement Basel III. The proposed resolution is more stringent in the beginning of the implementation calendar in terms of total capital requirements since today, Brazil holds a minimum of 11 percent total capital. At the end of the implementation period, the minimum capital requirements will converge at 10.5. Implementation of Basel III will result in a phase-out of deferred tax credits stemming from fiscal losses and deferred tax credits. In the latter, the credits can be used when they meet the criteria determined in the tax law, a process which takes up-to two years thus creating the deferred tax position.</p> <p>For banking groups and holding companies the minimum capital must be calculated on a consolidated basis and including off-balance sheet risks. In addition, conservative add-ons were made to the calculations proposed by the Basel Committee to reflect the characteristics of the Brazilian market.</p> <p>The basic approaches related to the estimation of credit, market and operational risks have been established by local rules. The introduction of internal models calculation for operational risk and credit risk follows the timeline provided in Communication 12746 and subsequent amendments.</p> <p>Circular 3478 establishes minimum requirements and procedures that internal models must comply with in order for the bank to be able to calculate market risk capital requirements. As set in article 1, the use of internal models by financial institutions requires prior authorization from the BCB. Communication 19028 sets the beginning of the authorization process for the use of basic and advanced internal ratings-based approaches to calculate capital requirements for credit risk.</p> <p>Financial institutions also have to allocate capital for interest-rate risk in the banking book. Stress tests to evaluate the impact of interest rate variations on the exposures of institutions are also demanded. Additionally, the BCB collects the information from the banks to compute the capital add-on for interest rate risk.</p> <p>Financial institutions deliver monthly information documenting their capital adequacy. To guarantee the reliability of the documents, the data is analysed and cross-checked with other sources of information, as well as submitted to on-site inspectors. The supervisor evaluates if the institution's capital is adequate to support the current and foreseen level of business activities, as well as the risks associated with it.</p> <p>Resolution 3490 establishes BCB authority to require that a bank increase its capital or decrease its risk exposure to address capital adequacy. This power is also established under Resolution 4019.</p>

EC2	At least for internationally active bank, the definition of capital, the method of calculation and the ratio required are not lower than those established in the applicable Basel requirement.				
Description and findings re EC2	Brazil assigns more conservative risk weights in many categories of assets:				
Exposure	Basel II		Brazil		
Sovereigns	AAA to AA-	0%	Countries not having undergone credit events over the last five years	50%	
	A+ to A-	20%		All others	100%
	BBB+ to BBB-	50%			
	BB+ to B-	100%			
	Below B-	150%			
	Unrated	100%			
PSEs	Same as banks, with some domestic PSEs eligible for treatment as sovereigns under certain conditions		Treasury and Central Bank	0%	
			Otherwise	100%	
MDBs	On the accord's eligibility list	0%	On the accord's eligibility list	0%	
	Otherwise	100%	Otherwise	100%	
Banks (option 2)	AAA to AA-	20%	Original maturity of three months or less	20%	
	A+ to A-	50%		Otherwise	50%
	BBB+ to BBB-	50%			
	BB+ to B-	100%			
	Below B-	150%			
	Unrated	50%			
Securities firms	Same as banks, when subject to same capital requirements		Same as banks: broker dealers in Brazil are subject to the same capital requirements as banks		
Corporates	AAA to AA-	20%	100%		
	A+ to A-	50%			
	BBB+ to BB-	100%			
	Below BB-	150%			
	Unrated	100%			
Retail	75%		75%		
RRE	35%		LTV < 50%	35%	
			50% < LTV < 80%	50%	
			LTV > 80% (retail)	75%	
			LTV > 80% (otherwise)	100%	
CRE	100%		100%		
Past Due Loans	Provisions less than 20%	150%	No specific risk weight. Domestic provisioning rules require that loans past due more than 90 days be provisioned at 30% of the outstanding amount.		
	Between 20% and 50%	100%			
	Provision greater than 50% of outstanding amount	100%, with supervisory discretion to reduce to 50%			
Recently risk-weights for longer term vehicle and personal financing were increased. Vehicle loans with maturities exceeding 60 months carry a weight of 150 percent and 300 percent for personal loans exceeding 60 months.					
An operational risk charge is also imposed as a percentage of gross income.					
EC3	The supervisor has the power to impose a specific capital charge and/or limits on all material risk exposures.				

Description and findings re EC3	Resolution 3490 requires banks to measure their exchange rate, commodities, price, market, interest, and credit risks and compute the capital required for each. Resolution 4019 provides authority to increase capital for individual institutions to reflect the risk profile. Additionally, the BCB is developing the methodology to assess additional capital charges based on the risk rating assigned to the institution by the supervisors.
EC4	The required capital ratio reflects the risk profile of individual banks. Both on-balance sheet and off-balance sheet risks are included.
Description and findings re EC4	The BCB has issued a compendium of regulations to ensure that a bank's capital level reflects its unique risks. Resolution 3490 establishes the requirement that banks compute specific charges for a number of risks (see EC3), additional guidance on how to measure each of the risks. Also through the supervisory process the BCB can require additional capital for areas of high risk.
EC5	Capital adequacy requirements take into account the conditions under which the banking system operates. Consequently, laws and regulations in a particular jurisdiction may set higher capital adequacy standards than the applicable Basel requirements.
Description and findings re EC5	The BCB has established a more conservative requirement in assigning risk-weights and minimum regulatory capital to reflect the characteristics of its financial system. The BCB applies a multiplier to the Basel II formulas for computing the capital charge for various risks.
EC6	Laws or regulations clearly give the supervisor authority to take measures should a bank fall below the minimum capital ratio.
Description and findings re EC6	Resolution 4019 provides the BCB authority to require additional capital without having to wait until capital drops below the minimum.
EC7	Where the supervisor permits banks to use internal assessments of risk as inputs to the calculation of regulatory capital, such assessments must adhere to rigorous qualifying standards and be subject to the approval of the supervisor. If banks do not continue to meet these qualifying standards on an ongoing basis, the supervisor may revoke its approval of the internal assessments.
Description and findings re EC7	At present there are no banks relying on IRB or market risk models to determine regulatory capital. Guidance issued by the BCB for the validation of models is conservative and requires that the standards be maintained on an ongoing basis.
Additional criteria	
AC1	For non-internationally active banks, the definition of capital, the method of calculation and the capital required are broadly consistent with the principles of applicable Basel requirements relevant to internationally active banks.
Description and findings re AC1	Capital requirements are the same for all banks.
AC2	For non-internationally active banks and their holding companies, capital adequacy ratios are calculated and applied in a manner generally consistent with the applicable Basel requirement, as set forth in the footnote to the Principle.
Description and findings re AC2	See AC1
AC3	The supervisor has the power to require banks to adopt a forward-looking approach to capital management and set capital levels in anticipation of possible events or changes in market conditions that could have an adverse effect.
Description and	Regulations implementing Pillar 2 are based on a forward looking approach.

findings re AC3	
AC4	The supervisor requires adequate distribution of capital within different entities of the banking group according to the allocation of risks.
Description and findings re AC4	While compliance with the regulatory capital requirements is done on a consolidated basis, as part of its supervisory process, the BCB reviews the activities and capital of all consolidated subsidiaries to ensure that they are adequately capitalized.
AC5	The supervisor may require an individual bank or banking group to maintain capital above the minimum to ensure that individual banks or banking groups are operating with the appropriate level of capital.
Description and findings re AC5	Brazilian banks operate with capital levels in excess of minimums.
Assessment re principle 6	Compliant
Comments	
Principle 7	Risk management process. Supervisors must be satisfied that banks and banking groups have in place a comprehensive risk management process (including Board and senior management oversight) to identify, evaluate, monitor and control or mitigate all material risks and to assess their overall capital adequacy in relation to their risk profile. These processes should be commensurate with the size and complexity of the institution.
Essential criteria	
EC1	Individual banks and banking groups are required to have in place comprehensive risk management policies and processes to identify, evaluate, monitor and control or mitigate material risks. The supervisor determines that these processes are adequate for the size and nature of the activities of the bank and the banking group and are periodically adjusted in the light of the changing risk profile of the bank or banking group and external market developments. If the supervisor determines that the risk management processes are inadequate, it has the power to require a bank or banking group to strengthen them.
Description and findings re EC1	<p>See also CPs 17, 8, 9, 13–16</p> <p>The requirements for institutions' risk management functions and activities are prescribed over several resolutions:</p> <p>The Banking Law grants the legal powers for CMN to establish rules on institutions' governance structures, subject to the general rules of corporate legislation (especially Law 6404. Relevant regulation includes:</p> <ul style="list-style-type: none"> • Resolution 2554 requires the establishment of a structure for internal controls, including financial information systems, operational and management systems, and compliance procedures. • Specific risk management regulation: operational risk (Resolution 3380), market risk (Resolution 3464) and credit risk (Resolution 3721); • Resolution 2804 establishes procedures for controlling liquidity risk; • Resolution 3198 requires an audit committee for financial institutions that meet specified characteristics; • Resolution 3041 establishes fit and proper requirements members in the key positions of the governance structure (including directors (executive management) in key risk positions); • Resolution 3988 requires a capital management structures;

	<ul style="list-style-type: none"> Resolution 4019 which provides the BCB the ability to require early correction of issues identified through its supervisory process based on judgemental (risk oriented) views on the adequacy of internal controls and corporate governance rather than waiting until a bank's condition demonstrably deteriorates from the given deficiency to be able to require corrective action. <p>The relevant regulations require systems and controls to be commensurate with the size and complexity of the given activity. The Supervisor possesses the authority to direct changes in institutions' processes and to require strengthening. (See CP 23)</p>
EC2	<p>The supervisor confirms that banks and banking groups have appropriate risk management strategies that have been approved by the board. The supervisor also confirms that the board ensures that policies and processes for risk-taking are developed, appropriate limits are established, and senior management takes steps necessary to monitor and control all material risks consistent with the approved strategies.</p>
Description and findings re EC2	<p>Risk management policies in financial institutions must be approved and reviewed, at least once a year, by the senior management and the board of directors. Supervision evaluates the following aspects, in order to guarantee that the financial institution adopts appropriate strategies for risk management: if the bank has established formal strategies/policies for credit risk, market risk and liquidity risk management duly approved by the senior management and the board of directors; if these strategies/policies are aligned with the institution's objectives and goals for its risk management and if the board communicates these strategies/policies within the institution; if there is an effective commitment of senior management related to sound practices in risk management; if there are institutional AML policies duly formalized and issued by the senior management or by the board of directors, and if there is concern in seeking improvements in the procedures related to AML.</p> <p>The Supervisor, through its various onsite events (SRC and VEs (targeted reviews)) and continuous monitoring, evaluates, validates, and monitors the risk management activities of the institutions.</p> <p>More specifically, the Supervision Manual defines eleven risk groups and their respective control groups (risk management) that must be evaluated by the Supervisor. The eleven risks are: credit risk, legal risk, market risk, liquidity risk, contagion risk, corporate operational risk, business area operational risk, reputational risk, strategic risk, information technology (IT) risk and money laundering risk. Risk monitoring is a key activity, especially for credit, liquidity, market, operational, legal, reputational and strategic risks. The analysis of each risk group and management process is conducted commensurate with the size and complexity of the operations of each institution. Risks are viewed on an institution level as well as on a consolidated level. Risk ratings are assigned not only for banking and banking related activity but also for insurance and asset management in the relevant cases. Contagion risk is also rated within the context of the impact the given institution would have on the system if it experienced significant financial distress.</p> <p>In accordance with Resolution no. 2554, financial institutions are required to implement adequate internal controls for their activities and must be in compliance with legal norms and regulations applied to them. The Supervisor can direct additional controls if risk management deficiencies are found, and it can impose more restrictive operational limits when such deficiencies are not corrected on time.</p>
EC3	<p>The supervisor determines that risk management strategies, policies, processes and limits are properly documented, reviewed and updated, communicated within the bank and banking group, and adhered to in practice. The supervisor determines that exceptions to established</p>

	<p>policies, processes and limits receive the prompt attention of and authorization by the appropriate level of management and the Board where necessary.</p>
Description and findings re EC3	<p>Risk management policies in financial institutions must be approved and reviewed, at least once a year, by the senior management and the board of directors. Supervision evaluates the following aspects to determine appropriate risk management strategies are in place:</p> <ul style="list-style-type: none"> • formal strategies/policies for credit risk, market risk and liquidity risk management duly approved by the senior management and the board of directors; • if strategies/policies are aligned with the institution's risk objectives and goals and if the board communicates these strategies/policies within the institution; • commitment of senior management to sound risk management; <p>Furthermore, the supervisor regularly evaluates development of strategic plans and the processes therein; data integrity within the risk management process; contingency plans for operational risk; how strategies and management policies for market and liquidity risks are developed, approved and disseminated; and credit policies and procedures. The Supervisor also examines the processes surrounding exceptions to policies and if procedures and parameters are provided for special approval of exceptions to policies, limits and authorizations.</p>
EC4	<p>The supervisor determines that senior management and the board understand the nature and level of risk being taken by the bank and how this risk relates to adequate capital levels. The supervisor also determines that senior management ensure that the risk management policies and processes are appropriate in the light of the bank's risk profile and business plan and that they are implemented effectively. This includes a requirement that senior management regularly reviews and understand the implications (and limitations) of the risk management information that it receives. The same requirement applies to the board in relation to risk management information presented to it in a format suitable for board oversight.</p>
Description and findings re EC4	<p>As a part of evaluating risk strategies, internal controls, and risk management processes, the Supervisor is continually assessing the awareness and understanding of relevant management. Furthermore, the level of understanding of management is assessed through interviews during the inspection and continuous monitoring process. The supervisor meets with the board of directors, in relevant cases, once a year or depending on the given risk profile of the institution. Through this and evaluation of information received by the board as well as review of board minutes, the Supervisor is able to assess the understanding and level of awareness of these parties.</p> <p>Inspections of specific risk and controls likewise involve evaluation of risk management policies and procedures</p>
EC5	<p>The supervisor determines that the banks have an internal process for assessing their overall capital adequacy in relation to their risk profile, and reviews and evaluates bank's internal capital adequacy assessments and strategies. The nature of the specific methodology used for this assessment will depend on the size, complexity and business strategy of a bank. Non-complex banks may opt for a more qualitative approach to capital planning.</p>
Description and findings re EC5	<p>Institutions must maintain adequate capital on a continuous basis, commensurate with the level and nature of their business risks, in accordance with Resolution no. 3444. In addition to Resolutions 3444 and 3490 that address the calculation of the regulatory capital, Resolution 3988 requires banks to establish a capital management framework commensurate with their risk profile. This includes planning, evaluation, monitoring and control of capital needs and,</p>

	<p>for the largest banks, an internal capital adequacy assessment process (ICAAP).</p> <p>Requirements for ICAAP were established by Circular 3547 and require a comprehensive assessment of capital adequacy over a one-year horizon. Banks must consider their strategic objectives and the risks to which they are exposed. Regulation requires the identification and measurement of existing and prospective risks in each of the following categories: (i) credit risk, (ii) market risk, (iii) operational risk, (iv) liquidity risk, (v) interest rate risk in the banking book, (vi) counterparty credit risk, and (vii) concentration risk.</p> <p>Other risks, such as liquidity risk, strategic risk, reputational risk and risk of environmental externalities affecting institutional activities, must also be assessed even if they cannot be effectively measured. Banks must also fulfill other requirements related to stress-testing and independent validation of models according to processes conducted on a regular basis (at least every three years or when significant model changes occur). ICAAP results must be reported on an annual basis and must be approved by the board of directors.</p> <p>The procedures established in Supervision Manual include the evaluation of the internal capital management process. Supervision verifies the existence and the quality of the capital plan presented, according to the size, complexity, risk profile and business strategy of the institution. The supervisor evaluates senior management knowledge about the nature and level of risk of the institution and how it is related to the bank's capital levels. Supervision also checks the existence of a policy to define the minimum amount of desired capital. This policy should describe the institution's risk appetite and should be aligned with its business strategy. The process and procedures for the amount of capital to be maintained, as defined in the capital plan, should encompass all material risks of the institution. In the case of interest-rate risk in the banking book, the institution must ensure that a sufficient amount of capital is measured and set apart to cover the risks.</p>
EC6	Where banks and banking groups use models to measure components of risk, the supervisor determines that banks perform periodic and independent validation and testing of the models and systems.
Description and findings re EC6	Circular 3478 outlines in detail the independent process that must be in place to validate and test models, including Board involvement. Banks are required to validate internal models every three years or when there are significant changes.
EC7	The supervisor determines that bank and banking groups have adequate information systems for measuring, assessing and reporting on the size, composition and quality of exposures. It is satisfied that these reports are provided on a timely basis to the board or senior management and reflect the bank's risk profile and capital needs.
Description and findings re EC7	The supervisory process (SRC, VEs, and continuous monitoring) assesses how information on corporate risk must be captured and reported to management and the board on a regular and timely basis. Management reports are expected to provide a comprehensive view (on a solo and consolidated basis) of the bank's risk profile and allow the identification, prevention and timely correction of risk control and management deficiencies. Resolution no. 2554 addresses the monitoring reports, and other resolutions explicitly state the need to issue reports to the senior management.
EC8	The supervisor determines that banks have policies and processes in place to ensure that new products and major risk management initiatives are approved by the board or a specific committee of the board.
Description and findings re EC8	The Supervisory Manual directs the evaluation of the new product procedures which is conducted during onsite activities and reviewed through the continuous monitoring process. Risk management policies in financial institutions must be approved and reviewed, at least once a year, by the senior management and the board of directors. Supervision evaluates the

	following aspects, in order to guarantee that the financial institution adopts appropriate strategies for risk management: if the bank has established formal strategies/policies for credit risk, market risk and liquidity risk management duly approved by the senior management and the board of directors; if these strategies/policies are aligned with the institution's objectives and goals for its risk management and if the board communicates these strategies/policies within the institution; if there is an effective commitment of senior management related to sound practices in risk management; if there are institutional AML policies duly formalized and issued by the senior management or by the board of directors, and if there is concern in seeking improvements in the procedures related to AML.
EC9	The supervisor determines that banks and banking groups have risk evaluation, monitoring and control or mitigation functions with duties clearly segregated from risk-taking functions in the bank, and which report on risk exposures directly to senior management and the board.
Description and findings re EC9	See EC 1 above. All regulation on risk management, namely Resolutions 3380, 3464 and 3721, require that the risk management functions are to be segregated from risk-taking functions, and that reports on risk exposures are to be sent directly to senior management and the board.
EC10	The supervisor issues standards related to, in particular, credit risk, market risk, liquidity risk, interest rate risk in the banking book and operational risk.
Description and findings re EC10	See CPs 8, 9, 13–16 and EC 1 above.
Additional criteria	
AC1	The supervisor requires larger and more complex banks to have a dedicated unit(s) responsible for risk evaluation, monitoring and control or mitigation for material risk areas. The supervisor confirms that this unit (these units) is (are) subject to periodic review by the internal audit function.
Description and findings re AC1	See also EC 1 above. The 3 Resolutions on operational, market, and credit risk require risk management activities be performed by a specific unit. Inherent in the risk based supervisory process such units are required to have the skills and sophistication commensurate with the nature of their institution's activities.
AC2	The supervisor requires banks to conduct rigorous, forward-looking testing that identifies possible events or changes in market conditions that could adversely impact on the bank.
Description and findings re AC2	See EC 6 regarding stress testing.
AC3	The supervisor requires banks and banking groups to have in place appropriate policies and processes for assessing other material risks not directly addressed in the subsequent CPs, such as reputational and strategic risks.
Description and findings re AC3	See also EC 5 above. Circular 3547 (ICAAP) and the SRC-Risk and Control Assessment System manuals specifically require the evaluation of reputational and strategic risks. Other risks, such as liquidity risk, strategic risk, reputational risk and risk of environmental externalities affecting institutional activities, must also be assessed relative to capital even if they cannot be effectively measured. The Supervisor captures and evaluates such risks through its monitoring and risk rating process.
Assessment of Principle 7	Compliant
Comments	

Principle 8	Credit risk. Supervisors must be satisfied that banks have a credit risk management process that takes into account the risk profile of the institution, with prudent policies and processes to identify, measure, monitor and control credit risk (including counterparty risk). This would include the granting of loans and making of investments, the evaluation of the quality of such loans and investments, and the ongoing management of the loan and investment portfolios.
Essential criteria	
EC1	The supervisor determines, and periodically confirms, that a bank's Board approves, and periodically reviews, the credit risk management strategy and significant policies and processes for assuming, identifying, measuring, controlling and reporting on credit risk (including counterparty risk). The supervisor also determines, and periodically confirms, that senior management implements the credit risk strategy approved by the Board and develops the aforementioned policies and processes.
Description and findings re EC1	<p>The Supervisor evaluates the credit processes of financial institutions through a combination of supervisory techniques including the SRC (comprehensive review process—see CP 20) of credit risk—which results in a risk rating for credit risk; ongoing monitoring; and periodic targeted onsite reviews (VE's).</p> <p>Examination procedures are described in the Supervisory Manual and guide the evaluation of the credit risk relative to the size and complexity of the institution and its credit related products as well as the extent of its credit risk exposures. The inspection process furthermore evaluates the institution's system of credit risk management and its ability to identify and measure risk and its effectiveness in establishing strategies to control and mitigate such risk. Evaluation of credit risk also entails the review of the institution's risk appetite and business strategy through a series of interviews with management, audit committees, and control functions. It also determines if the credit granting process and credit growth is commensurate with the policies, procedures, controls and risk appetite of the institution.</p> <p>More specifically, the supervisory assessment of credit risk and controls includes examination of, inter alia:</p> <ul style="list-style-type: none"> • credit risk management framework; • operating rules for credit committees • credit policies and lending strategies (including limits, large exposure management); • credit process (granting, monitoring, collecting, segregation of duties, client analysis, collection activity, exception monitoring, etc.); • methodology for rating each loan and for establishing the relevant loan loss provision; • credit portfolio management; • credit systems (IT); and • routines and procedures to identify, measure, manage and mitigate credit risk exposures. <p>Policies and strategies for credit risk management are required to be reviewed at least annually by the Board of Directors and senior management.</p>
EC2	<p>The supervisor requires, and periodically confirms, that such policies and processes establish an appropriate and properly controlled credit risk environment, including:</p> <ul style="list-style-type: none"> • a well documented strategy and sound policies and processes for assuming credit risk; • well defined criteria and policies and processes for approving new exposures as well as renewing and refinancing existing exposures, identifying the appropriate approval authority for the size and complexity of the exposures;

	<ul style="list-style-type: none"> • effective credit administration policies and processes, including continued analysis of a borrower's ability and willingness to repay under the terms of the debt, monitoring of documentation, legal covenants, contractual requirements and collateral, and a classification system that is consistent with the nature, size and complexity of the bank's activities or, at the least, with the asset grading system prescribed by the supervisor; • comprehensive policies and processes for reporting exposures on an ongoing basis; • comprehensive policies and processes for identifying problem assets; and • prudent lending controls and limits, including policies and processes for monitoring exposures in relation to limits, approvals and exceptions to limits.
Description and findings re EC2	<p>The main standards for measuring, monitoring and controlling credit risk are enumerated in Resolution 2554, Resolution 2682 and Resolution 3721. Resolution 3721 requires banks to implement a credit risk management structure responsible for: policies and strategies for credit risk management; validation of systems, models and procedures used in credit risk management; estimation of losses due to credit risk; adoption of procedures for credit recovery; use of credit risk mitigation tools; limits for risk appetite; classification of exposures according to the level of credit risk; assessment of credit risk associated to new products; stress testing of credit risk models; credit risk management reports and documentation.</p> <p>See EC 1 above which details the onsite process for determining the integrity, accuracy, and comprehensiveness of institutions' credit risk management processes and oversight.</p> <p>In addition, Supervisory staff conducts continuous (offsite) monitoring which includes obtaining and reviewing, inter alia:</p> <ul style="list-style-type: none"> • public reports concerning the credit risk management structure; • external audit reports regarding the review of the criteria adopted by the institution to classify operations in risk levels and the evaluation of correspondent provisions; • internal bank management reports and MIS; • information from Credit Risk Monitoring (MRC) which is a tool employed by the continuous monitoring department and • meetings with the teams responsible for credit risk management in the institution.
EC3	The supervisor requires, and periodically confirms, that banks make credit decisions free of conflicts of interest and on an arm's length basis.
Description and findings re EC3	<p>See also CP 11</p> <p>There is a ban on loans or advancements to related parties which mitigates the risk of conflict of interest. Such bans are defined in the Banking Law 4595 and Circular 30. Violations are defined as crimes against the SFN in Law no. 7492.</p> <p>Resolution 3721, of 2009, forbids both the staff and the director to accumulate activities that may offer conflicts of interest. There is a ban on cumulatively executing the activities of granting (and approving) loans, credit risk management and/or internal audit.</p> <p>In addition, Resolution 3859, of 2010, establishes principles of corporate governance to be observed by credit unions.</p>
EC4	The supervisor has full access to information in the credit and investment portfolios and to the bank officers involved in assuming, managing, controlling and reporting on credit risk.
Description and findings re EC4	The Banking Law guarantees access to all institutional data deemed necessary for supervisory duties. In addition, Complementary Law 105 establishes that the secrecy of financial institutions operations, including bank accounts and investments, will not be used to deny BCB scrutiny while carrying out supervision. All documentation relating to the implementation of the credit risk management structure and related policies and strategies must be kept in the institutions, available to the BCB (Resolution 3721). Institutions must send

	<p>information about credit operations to the BCB (Resolution no. 3658 and Circular 3567) as input for the ongoing credit risk supervision process.</p> <p>As fully described in CP 20, the information to which the Supervisor has access, both through on and offsite processes, is extensive and is used heavily in ongoing analysis of credit risk quality, trends, and management and board oversight.</p>
Additional criteria	
AC1	The supervisor requires that the credit policy prescribes that major credit risk exposures exceeding a certain amount or percentage of the bank's capital are to be decided by the bank's senior management. The same applies to credit risk exposures that are especially risky or otherwise not in line with the mainstream of the bank's activities.
Description and findings re AC1	The main provisions for credit risk management for institutions are enumerated in Resolution 3721 as indicated in EC 2 above. These provisions include that credit risk exposures are to be evaluated and decided according to their size and risk content, including large exposures.
AC2	<p>The supervisor determines that banks have in place policies and processes to identify, measure, monitor and control counterparty credit risk exposure, including potential future exposure sufficient to capture the material risks inherent in individual products or transactions. These processes should be commensurate with the size or complexity of the individual bank.</p> <p>In addition, when the institution sells its credit portfolio and still retaining the major risks, it must be kept on balance sheet (Resolution 3533).</p>
Description and findings re AC2	<p>See EC 2 above.</p> <p>The main provisions for credit risk management for institutions are enumerated in Resolution 3721. These provisions include that credit risk exposures are to be evaluated and decided according to their size and risk content, including counterparty risk in general and that stemming from derivative and complex financial instruments. In practice, the largest banks in the system manage credit risk through quite a developed management committee structure which assures a "more than four eyes" approach to credit analysis and approval. Boards receive comprehensive information on the same.</p>
AC3	The supervisor determines that banks have policies and processes to monitor the total indebtedness of entities to which they extend credit.
Description and findings re AC3	The main provisions for credit risk management for institutions are enumerated in Resolution 3721 as indicated in EC 2 above. These provisions include, inter alia, that systems, routines and procedures exist to identify, measure, monitor and mitigate exposure to credit risk and that limits to extension of credit be established, on the individual level as well as on the aggregate level concerning operations with similar characteristics. Also see CP 10 below.
Assessment of Principle 8	Compliant
Comments	
Principle 9	Problem assets, provisions and reserves. Supervisors must be satisfied that banks establish and adhere to adequate policies and processes for managing problem assets and evaluating the adequacy of provisions and reserves.
Essential criteria	
EC1	Laws, regulations or the supervisor require banks to formulate specific policies and processes for identifying and managing problem assets. In addition, laws, regulations or the supervisor require periodic review by banks of their problem assets (at an individual level or at a portfolio

	level for credits with homogenous characteristics) and asset classification, provisioning and write-offs.
Description and findings re EC1	<p>Resolutions 2682 and 2697 provide the regulatory framework for loan classification (including leasing and other extensions of credit) and provisioning standards for financial institutions. Financial institutions must grade their credits and assign one of nine categories (AA, A, B, C, D, E, F, G and H) according to increasing levels of risk. Regulation requires the financial institution to make a qualitative judgment about a borrower's ability to repay using criteria that are verifiable and consistently applied. Both past performance and future prospects must be considered. Where more than one credit to a customer or economic group is outstanding, the most severe classification of either credit is used for both (exceptions may apply according to specific loan characteristics such as the existence of highly liquid collateral).</p> <p>As directed by the Resolution, classification of credit must be based on "consistent and verifiable criteria and supported by inside and outside information. Past due credits must be automatically classified on a monthly basis according to the number of days past due. Credits rated "H" must be written-off after 6 months but continue to be accounted for off-balance sheet. Accrual of interest is required to stop after 59 days in arrears. Credits that are past due a minimum of 15 days must be rated at the "B" level, at a minimum, and the rating must progress according to the period in arrears until reaching the "H" level for a period greater than 180 days.</p> <p>Minimum provision amounts are dependent on the loan rating and range from zero for the best-rated loans (AA) to 100 percent for those with the highest risk (H). Notwithstanding the minimum provisioning requirements, it is the responsibility of the institution's management to ensure that the level of provisions is adequate.</p> <p>The Resolution also establishes rules for renegotiated credits, documentation supporting internal credit reviews, valuation of collateral, and disclosure of selected information in the financial statements. Reclassifications of renegotiated credits are allowed if and when significant amortization occurs or relevant new facts are presented, such as new collateral which is highly liquid and sufficient. Payments received on renegotiated credit are only recognized when installments are duly paid.</p> <p>Auditors must conduct a detailed review of the criteria for restructuring and verify that classifications and amounts of loan loss reserves are appropriate. In addition, supervisors may require changes in classifications and impose additional provisions as deemed necessary.</p> <p>Resolution 3721 requires that institutions must implement a framework for credit risk management that includes, inter alia, clearly defined criteria and procedures for detection and prevention of credit risk deterioration. In addition, institutions must periodically evaluate the quality of collateral.</p> <p>Resolution 2682 directs that classification of credit operations must be periodically reviewed: a) on a monthly basis, due to payment delay; b) each 6 months, in case of operations of a single client or group that represents 5 percent or more of the institution's capital base; or c) each 12 months for all other cases. Financial institutions are formally required to rate all loans where they retain credit risk—such as in the case of loans purchased. If loans are purchased with full recourse, the given institution must assess the creditworthiness of the selling institution.</p>
EC2	The supervisor confirms the adequacy of the classification and provisioning policies and processes of a bank and their implementation; the reviews supporting this opinion may be conducted by external experts.

Description and findings re EC2	<p>The determination of adequate classification and provisioning processes, consistent with Resolutions 2682, 2554, and 3721, is a key focal point of credit risk inspections. Key elements examined include, inter alia, the credit analysis, approval, and management process (consistent with policy and regulatory requirements). During an onsite inspection, tests are performed so as to ensure that the institution uses a minimum set of credit factors in the assignment and review of risk ratings.</p> <p>Borrower creditworthiness, portfolio condition, and risk management adequacy (including the accuracy of risk ratings and associated provisions) are determined by selecting and evaluating a sample of credit operations decided prior to the beginning of an inspection. Samples can be selected randomly or based on evidence found in the Credit Information System (SCR). For instance, selected samples may include borrowers who have delinquent loans in other financial institutions (and not in the financial institution under inspection) or when credit ratings are worse in other financial institutions than those observed in the financial institution under inspection.</p> <p>As a result of the inspection, the Supervisor may determine new ratings for credit operations deemed riskier than originally classified as well as additional provisioning according to Resolution 2682.</p>
EC3	The system for classification and provisioning takes into account off-balance sheet exposures
Description and findings re EC3	Resolution 3721 establishes that financial institutions must implement a specific framework for credit risk management which includes provisioning mechanisms for all exposures, including those off-balance sheet. The Supervisor classifies all credit obligations associated with the borrower including loans (funded and unfunded commitments), guarantees, and other relevant off balance sheet obligations.
EC4	The supervisor determines that banks have appropriate policies and processes to ensure that provisions and write-offs reflect realistic repayment and recovery expectations.
Description and findings re EC 4	<p>See also EC 2.</p> <p>According to Resolution no. 3721, the framework for credit risk management should include: a) well documented policies and strategies that establish operational limits, mechanisms to mitigate risks and procedures implemented to maintain the exposures under acceptable levels defined by senior management; b) estimation and provisioning of credit losses based on consistent and prudential criteria; c) procedures for loan recovery; and d) documentation on the loss/recovery of loans.</p> <p>The credit risk management framework (Resolution no. 3721) must include procedures that address credit information and documentation; periodic evaluation of collateral; identification and prevention of credit quality deterioration; and the handling of limit and credit exceptions. Credit risk management must be conducted by a specific unit apart from the business line.</p> <p>Resolution 3721 also prescribes stress tests and the use of the outcomes to define thresholds and policies. Since July 2010, banks seeking approval for the use of internal models to calculate the capital requirement for market risk have had their stress tests assessed by the supervision. In 2012, there will be on-site examinations regarding the IRB implementation process in large banks which will include the assessment of credit risk stress tests. Finally, in 2013, the scope of stress testing assessments will include all risks and the way each one affects the others, in the context of ICAAP.</p> <p>For selected banks that are implementing the Internal Ratings-Based (IRB) approach, the Supervisor will conduct a review of credit risk stress testing. This review started at the end of</p>

	2011. The Supervisor also intends to require large banks (that opt for an Internal Model Method—IMM) to perform reverse stress tests regarding counterparty credit risk.
EC5	The supervisor determines that banks have appropriate policies and processes, and organizational resources for the early identification of deteriorating assets, for ongoing oversight of problem assets, and for collecting on past due obligations.
Description and findings re EC5	See EC 1,2,4 above
EC6	The supervisor is informed on a periodic basis, and in relevant detail, or has access to information concerning the classification of credits and assets and provisioning.
Description and findings re EC6	<p>The Banking Law states that financial institutions must provide the information requested by the Supervisor necessary for it to carry out its duties.</p> <p>Institutions must document their policies and procedures for granting loans and classifying credit operations. That information must be provided to the Supervisor and to the external auditor and must indicate, at least, the type and levels of risk that the institution is willing to manage, besides the minimum requirements for granting loans and the process of authorization.</p> <p>In practice, ongoing monitoring of financial institutions is extensive (see CP 20). Also, the supervisor maintains an extensive database which includes information about credit risk operations updated monthly by financial institutions. Supervisor has the authority to request additional information as it deems necessary.</p>
EC7	The supervisor has the power to require a bank to increase its levels of provisions and reserves and/or overall financial strength if it deems the level of problem assets to be of concern.
Description and findings re EC7	<p>The Supervisor may determine the reclassification of credit operations and demand corrective actions including capital allocation for incorrectly classified operations (Resolution 2682).</p> <p>Similarly, if a classification or disclosure error or inconsistency is identified during an onsite inspection, Supervision may direct the necessary corrective actions and adjustments to the financial statements. In addition, according to Resolution no. 4019 the Supervisor may require, as a prudential measure, financial institutions to increase capital. This may be necessary when there is deterioration in the condition of the institution (for instance when a high level of classified assets is determined to potentially threaten the soundness of the bank), regardless of compliance with minimum capital requirements.</p>
EC8	The supervisor assesses whether the classification of the credits and assets and the provisioning is adequate for prudential purposes. If provisions are deemed to be inadequate, the supervisor has the power to require additional provisions or to impose other remedial measures.
Description and findings re EC8	<p>See EC 2 and EC 7</p> <p>Specialist credit inspection teams examine asset quality during the on-site inspection process in order to determine the quality of assets and the adequacy of loan loss reserves. Supervisors also validate the banks' own systems of internal loan review, review banks' classification and provisioning policies and practices, assess loan approval and credit administration activities, collection efforts and on-going oversight of problem credits, collateral valuation practices, and determine adherence to banks' established policies. All exposures are reviewed including loans and advances, off balance sheet items, due from banks, investments, acquired assets, and other assets.</p>
EC9	The supervisor requires banks to have appropriate mechanisms in place for periodically assessing the value of risk mitigants, including guarantees and collateral. The valuation of

	collateral is required to reflect the net realizable value.
Description and findings re EC9	Resolution 3721 specifically directs that risk mitigants, including guarantees, be considered in the classification process by the bank and through the supervisory credit review. These elements are considered during the onsite credit risk reviews by the supervisors.
EC10	Laws, regulations or the supervisor establish criteria for assets to be identified as impaired, e.g., loans are identified as impaired when there is reason to believe that all amounts due (including principal and interest) will not be collected in accordance with the contractual terms of the loan agreement.
Description and findings re EC10	See EC 1 above.
EC11	The supervisor determines that the Board receives timely and appropriate information on the condition of the bank's asset portfolio, including classification of credits, the level of provisioning and major problem assets.
Description and findings re EC11	During the onsite supervisory process, the Supervisor reviews all relevant information, including management MIS and Board information. During the continuous monitoring process the Supervisor likewise receives, in part, information circulated to the same parties.
EC12	The supervisor requires that valuation, classification and provisioning for large exposures are conducted on an individual item basis.
Description and findings re EC12	Resolution no. 2682, establishes a threshold of R\$50,000 as an exception, to classifying and provisioning by delinquency, but all credits require evaluation (classification) on individual basis. Additional provisioning, beyond the minimum required by classification, may also be based on models.
Additional criteria	
AC1	Loans are required to be classified when payments are contractually a minimum number of days in arrears (e.g., 30, 60, 90 days). Refinancing of loans that would otherwise fall into arrears does not lead to improved classification for such loans.
Description and findings re AC1	Minimum required provisions as a percentage of outstanding loan balances and according to risk classification are as follows: I - arrears up to 15 days - risk level A - minimum provision of 0,5 percent; II - arrears from 15 to 30 days - risk level B - minimum provision of 1 percent; III - arrears from 31 to 60 days - risk level C - minimum provision of 3 percent; IV - arrears from 61 to 90 days - risk level D - minimum provision of 10 percent; V - arrears from 91 to 120 days - risk level E - minimum provision of 30 percent; VI - arrears from 121 to 150 days - risk level F - minimum provision of 50 percent; VII - arrears from 151 to 180 days - risk level G - minimum provision of 70 percent; VIII - arrears over 180 days - risk level H - minimum provision of 100 percent.
Assessment of Principle 9	Compliant
Comments	The regulatory framework and supervisory process diligently address and continuously monitors credit risk in the banking sector. The Supervisor receives rich information, both on and off site, from which to monitor and detect adverse trends. Regulation requires that banks' credit risk management processes be conducted by a specific unit apart from the business line. In practice, while credit risk management departments are not embedded in the business line, in certain cases, they appear to have role in the analysis and vetting of certain, selected credits. Supervision may want to review this, on a case by case, basis to determine if a step back from this activity is warranted.

Principle 10	Large exposure limits. Supervisors must be satisfied that banks have policies and processes that enable management to identify and manage concentrations within the portfolio, and supervisors must set prudential limits to restrict bank exposures to single counterparties or groups of connected counterparties.
Essential criteria	
EC1	Laws or regulations explicitly define, or the supervisor has the power to define, a “group of connected counterparties” to reflect actual risk exposure. The supervisor may exercise discretion in applying this definition on a case by case basis.
Description and findings re EC1	<p>Resolution 2844 defines “client” as any person, natural or legal entity, including groups of people, acting alone or in concert, representing a common economic interest. The BCB has flexibility to interpret connectedness. Resolution 2844 sets a maximum exposure limit per client to be observed by the banks contracting credit and leasing operations and in the provision of guarantees, including off-balance sheet items and credit exposures linked to derivatives operations.</p> <p>The monitoring of risks and limits carried out by the BCB uses information from the financial institutions and the tax authorities to define “economic group.</p> <p>The concentration limit is set at 25 percent of capital per client and at 600 percent of capital for all large exposures added up. A large exposure is defined as the exposure per client or per security-issuing entity that represents 10 percent or more of the bank’s capital.</p> <p>Resolution 2827 limits to 45 percent of capital the amount of credit operations of banks with public sector entities. The BCB monitors the exposure of banking institutions to verify the compliance of operational limits.</p> <p>Operations with connected parties are treated jointly with others and all aspects related to risks are evaluated. Resolution 3721 establishes that the credit risk management structure must consider the risk exposure at the individual level as well as at the aggregated level, combining operations with similar characteristics.</p> <p>Circular 3398, establishes the reporting requirement corresponding to limits and minimum standards to the BCB, among them exposure per client and the sum of concentrated exposures.</p> <p>Resolution 2844 authorizes the BCB to adopt measures deemed necessary for financial institutions to comply with exposure concentration limits.</p> <p>The concentration of assets or liabilities is an indicator monitored by the BCB to identify areas of concern. Based on Resolution 4019 the BCB can carry out preventive prudential measures. Besides the operational limits regularly established, the credit risk supervisory monitoring also evaluates concentration risk under different approaches.</p>
EC2	Laws, regulations or the supervisor set prudent limits on large exposures to a single counterparty or a group of connected counterparties. “Exposures” include all claims and transactions, on-balance sheet as well as off-balance sheet. The supervisor confirms that senior management monitors these limits and that they are not exceeded on a solo or consolidated basis.
Description and findings re EC2	There is a 25 percent limit on exposures to a client/group. There is also a global limit of 600 percent of capital on significant exposures (those exceeding 10 percent of capital). There is also a 45 percent limit on exposures to a public entity. Through onsite supervision and offsite monitoring the BCB reviews compliance. The BCB credit registry provides information based on the banks’ reporting.
EC3	The supervisor determines that a bank’s management information systems identify and aggregate on a timely basis exposure to individual counterparties and groups of connected counterparties.
Description and findings re EC3	The BCB monitors the timeliness and accuracy of the bank’s systems by reviewing the credit registry and the bank’s internal reporting.

EC4	The supervisor confirms that a bank's risk management policies and processes establish thresholds for acceptable concentrations of credit and require that all material concentrations be reviewed and reported periodically to the Board.
Description and findings re EC4	Resolution 3721 requires that financial institutions define and document policies and strategies for the management of their credit risk and establish operational limits to maintain credit risk exposures at levels compatible with management risk controls. The limits must be reviewed annually.
EC5	The supervisor regularly obtains information that enables concentrations within a bank's portfolio, including sectoral, geographical and currency exposures, to be reviewed. The supervisor has the power to require banks to take remedial actions in cases where concentrations appear to present significant risks.
Description and findings re EC5	The BCB monitors concentrations through information in its credit registry. Resolution 2844 grants the BCB authority to require corrective action should the concentration level expose the bank to significant risks.
Additional criteria	
AC1	Banks are required to adhere to the following definitions: <ul style="list-style-type: none"> • 10 percent or more of a bank's capital is defined as a large exposure; and • 25 percent of a bank's capital is the limit for an individual large exposure to a private sector nonbank counterparty or a group of connected counterparties. Minor deviations from these limits may be acceptable, especially if explicitly temporary or related to very small or specialized banks.
Description and findings re AC1	Resolution 2844 establishes those thresholds. See EC2
Assessment of Principle 10	Compliant
Comments	
Principle 11	Exposures to related parties. In order to prevent abuses arising from exposures (both on balance sheet and off balance sheet) to related parties and to address conflict of interest, supervisors must have in place requirements that banks extend exposures to related companies and individuals on an arm's length basis; these exposures are effectively monitored; appropriate steps are taken to control or mitigate the risks; and write-offs of such exposures are made according to standard policies and processes.
Essential criteria	
EC 1	Laws or regulations explicitly provide, or the supervisor has the power to provide, a comprehensive definition of "related parties". This should consider the parties identified in the footnote to the Principle. The supervisor may exercise discretion in applying this definition on a case by case basis.
Description and findings re EC1	Article 34 of the Banking Law prohibits financial institutions from lending or advancing funds to, or guaranteeing the obligation of, or underwriting the securities of: (i) its directors, and executive officers, managers, members of its fiscal council, their respective spouses and certain other relatives of such person; (ii) any entity of which such financial institution holds more than 10 percent of the capital (except subject to prior approval of the BCB in certain circumstances); and (iii) any entity of which any of the persons mentioned in (i) above holds more than 10 percent of the total capital. Furthermore, violations are defined as crimes against the SFN in Law no. 7492.
EC2	Laws, regulations or the supervisor require that exposures to related parties may not be

	granted on more favorable terms (i.e., for credit assessment, tenor, interest rates, amortization schedules, requirement for collateral) than corresponding exposures to non-related counterparties.
Description and findings re EC2	Not Applicable
EC3	The supervisor requires that transactions with related parties and the write-off of related-party exposures exceeding specified amounts or otherwise posing special risks are subject to prior approval by the bank's Board. The supervisor requires that Board members with conflicts of interest are excluded from the approval process.
Description and findings re EC3	Not Applicable
EC4	The supervisor requires that banks have policies and processes in place to prevent persons benefiting from the exposure and/or persons related to such a person from being part of the process of granting and managing the exposure.
Description and findings re EC4	Not Applicable
EC5	Laws or regulations set, or the supervisor has the power to set on a general or case by case basis, limits for exposures to related parties, to deduct such exposures from capital when assessing capital adequacy, or to require collateralization of such exposures. When limits are set on aggregate exposures to related parties those are at least as strict as those for single counterparties, or groups of connected counterparties.
Description and findings re EC5	Not Applicable
EC6	The supervisor requires banks to have policies and processes to identify individual exposures to related parties as well as the total amount of such exposures, and to monitor and report on them through an independent credit review process. The supervisor confirms that exceptions to policies, processes and limits are reported to the appropriate level of senior management and, if necessary, to the Board, for timely action. The supervisor also confirms that senior management monitors related party transactions on an ongoing basis, and that the Board also provides oversight of these transactions.
Description and findings re EC6	Not Applicable
EC7	The supervisor obtains and reviews information on aggregate exposures to related parties.
Description and findings re EC7	Not Applicable
Assessment of Principle 11	Compliant
Comments	The BCB closely monitors compliance with this prohibition through its credit registry to ensure banks do not make arrangements to lend to each other's related parties. Cases of collusion have been uncovered and prosecuted.
Principle 12	Country and transfer risks. Supervisors must be satisfied that banks have adequate policies and processes for identifying, measuring, monitoring and controlling country risk and transfer risk in their international lending and investment activities, and for maintaining adequate provisions and reserves against such risks.
Essential criteria	
EC1	The supervisor determines that a bank's policies and processes give due regard to the

	identification, measurement, monitoring and control of country risk and transfer risk. Exposures are identified and monitored on an individual country basis (in addition to the end-borrower/end-counterparty basis). Banks are required to monitor and evaluate developments in country risk and in transfer risk and apply appropriate countermeasures.
Description and findings re EC1	Resolution 3721 requires banks to implement the systems to monitor credit risk. Included in the credit risk is country risk. From the credit registry, the BCB can pull the banks' foreign exposures.
EC2	The supervisor confirms that banks have information systems, risk management systems and internal control systems that accurately monitor and report country exposures and ensure adherence to established country exposure limits.
Description and findings re EC2	The BCB monitors bank exposure through reports submitted to the credit registry. Additionally, international exposure of Brazilian banks is limited as the bank cannot on-lend funds raised in Brazil on a cross-border basis.
EC3	There is supervisory oversight of the setting of appropriate provisions against country risk and transfer risk. There are different international practices which are all acceptable as long as they lead to risk-based results. These include: <ul style="list-style-type: none"> • The supervisor (or some other official authority) decides on appropriate minimum provisioning by setting fixed percentages for exposures to each country. • The supervisor (or some other official authority) sets percentage ranges for each country, and the banks may decide, within these ranges, which provisioning to apply for the individual exposures. • The bank itself (or some other body such as the national bankers' association) sets percentages or guidelines or even decides for each individual loan on the appropriate provisioning. The provisioning will then be judged by the external auditor and/or by the supervisor.
Description and findings re EC3	Resolution 3721 banks must implement a risk management framework to identify measure, control and mitigate credit risk of individual operations and also of a consolidated group of similar operations. That framework must include, at least, the relevant sources of credit risk, the identification of the borrower or the counterpart, the risk concentration and the way the operations are consolidated. Country risk and transfer risk are explicitly included in the credit risk concept. The risk management framework must include the evaluation of credit risk, taking into account market conditions, macroeconomic perspectives, changes in markets and products and the effects of sector and geographic concentration, among others.
EC4	The supervisor obtains and reviews sufficient information on a timely basis on the country risk and transfer risk of individual banks.
Description and findings re EC4	Banks must disclose the total amount of credit risk exposure and the average exposure in the quarter. That information must be segmented by countries and geographic regions with relevant exposures. On an ad hoc basis inspectors also collect information to monitor exposures. Given the limited amount of country risk, the monitoring is considered adequate.
Assessment of Principle 12	Compliant.
Comment	.
Principle 13	Market risk. Supervisors must be satisfied that banks have in place policies and processes that accurately identify, measure, monitor and control market risks; supervisors should have powers to impose specific limits and/or a specific capital charge on market risk exposures, if warranted.
Essential	

criteria	
EC1	The supervisor determines that a bank has suitable policies and processes that clearly articulate roles and responsibilities related to the identification, measuring, monitoring and control of market risk. The supervisor is satisfied that policies and processes are adhered to in practice and are subject to appropriate Board and senior management oversight.
Description and findings re EC1	<p>Policies and procedures for the identification, assessment, monitoring, and control of market risk are defined in Resolution 3464, amended by Resolution 3897, which regulates the implementation of the framework for managing market risk by financial institutions, establishes its responsibilities and requires its adequacy to the size, nature, complexity and risk of their operations.</p> <p>The activity of market risk management must be executed by a specific unit, segregated from the business and internal auditing units, and the director responsible for the market risk management is not allowed to execute functions related to asset management and treasury operations.</p> <p>Market risk management policies and strategies must be approved and revised, at least once a year, by the senior management and board of directors, if it exists. This includes establishing exposure limits that must be monitored on a daily basis by the market risk management structure.</p> <p>The market risk unit is responsible for the identification, assessment and control systems of all relevant sources of market risk, evaluation tests on such systems at least annually, and the performance of stress tests and scenario analysis.</p> <p>During on-site inspections of market risk, supervisory staff verify the adequacy of the given institution's market risk management structure. This includes review of:</p> <ul style="list-style-type: none"> • adequacy of policies and strategies and evaluation of how strategies and policies are approved, reviewed, documented and disseminated. Policies must reflect the risk appetite and clearly state: roles, list of authorized financial instruments, hedging strategies, risk measures, limits and report lines. • Role of senior management, communication of strategies, selection of competent personnel, nature of risk profile, risk reporting, and timely correction of deficiencies. • Risk identification and management systems commensurate with the complexity of activities and products, and the identification, development and approval of new products. • Mark-to-market process, including evaluation of the independence of personnel conducting the valuation(s), documentation and auditing. • Market risk limit structure including the review, approval, use, monitoring, and exception process therein. • Methodology and sophistication of the institution's stress testing process; if it is commensurate with institutional risk profile and if it addresses all relevant risk factors. The development and approval of scenarios (frequency, officers responsible, risk factors, and granularity) must be considered. • Independence, technical skills, and overall role of risk management. • Reporting by the risk management, if it is timely, reliable, and contains all the relevant information for decision-making. • Internal manuals and procedures and if they adequately address the limit structure, model assumptions, systems adequacy, mark-to-market formula and processes, security and

	<p>control procedures, contingency planning, and requirements for data.</p> <ul style="list-style-type: none"> • Flow of information to and from trading desks, risk management, and senior management functions. • Accuracy of the back testing process and how back testing results are applied to enhance risk models. <p>Internal and external audit is evaluated through interviews and documents, such as the audit plan, working papers, reports/letters to the bank, frequency of reviews in critical areas, their independence and the follow-up of their recommendations by the bank's management.</p> <p>In addition, Supervisory staff carries out extensive continuous monitoring activities. See CP 20.</p>
EC2	The supervisor determines that the bank has set market risk limits that are commensurate with the institution's size and complexity and that reflect all material market risks. Limits should be approved by the Board or senior management. The supervisor confirms that any limits (either internal or imposed by the supervisor) are adhered to.
Description and findings re EC2	See EC 1 above.
EC3	The supervisor is satisfied that there are systems and controls in place to ensure that all transactions are captured on a timely basis, and that the banks' marked to market positions are revalued frequently, using reliable and prudent market data (or, in the absence of market prices, internal or industry-accepted models). The supervisor requires banks to establish and maintain policies and processes for considering valuation adjustments/reserves for positions that otherwise cannot be prudently valued, including concentrated, less liquid, and stale positions.
Description and findings re EC3	<p>See EC 1 above.</p> <p>During the inspection process, the supervisor verifies that the bank has a process of mark-to-market that is verifiable and consistent. This process must be carried out by personnel not involved in trading activities, be properly documented and audited.</p> <p>During continuous monitoring, supervisory staff obtains institutional reports and gathers information from other sources (such as BOVESPA, CETIP, other financial instrument registrars, etc.) in order to assess important issues regarding the risk profile of the entity. The analyses include review and evaluation of market risk exposures and valuation methods for less liquid positions. If necessary, the supervisory staff require response and corrective action by the institution.</p> <p>Two features of Brazilian financial market minimize the problem of the valuation of less liquid positions: the compulsory registration of all financial instruments and the absence of a secondary market for private instruments. The first brings transparency to the market, on prices, volumes and counterparties. The second means that the great majority of traded instruments are liquid. Less liquid positions and/or instruments are evaluated on a case-by-case basis and institutions' methodology is checked.</p>
EC4	The supervisor determines that banks perform scenario analysis, stress testing and contingency planning, as appropriate, and periodic validation or testing of the systems used to measure market risk. The supervisor confirms that the approaches are integrated into risk management policies and processes, and results are taken into account in the bank's risk-taking strategy.
Description and findings re EC4	The institution must perform stress tests related to market risk, which must include a breakdown of key assumptions, and must consider their results when establishing and reviewing its policies and limits for market risk. Back testing of the results must also be performed. The Supervisor reviews the stress and back testing conducted by the institution

	both during onsite activities and through continuous monitoring. See EC 1 also.
Additional criteria	
AC1	The supervisor requires that market data used to value trading book positions are verified by a function independent of the lines of business. To the extent that the bank relies on modeling for the purposes of valuation, the bank is required to ensure that the model is independently tested.
Description and findings re AC1	See EC 3
Assessment of Principle 13	Compliant
Comments	
Principle 14	Liquidity risk. Supervisors must be satisfied that banks have a liquidity management strategy that takes into account the risk profile of the institution, with prudent policies and processes to identify, measure, monitor and control liquidity risk, and to manage liquidity on a day-to-day basis. Supervisors require banks to have contingency plans for handling liquidity problems.
Essential criteria	
EC1	The supervisor sets liquidity guidelines for banks. These guidelines take into consideration undrawn commitments and other off-balance sheet liabilities, as well as existing on-balance sheet liabilities.
Description and findings re EC1	Resolution 2804 requires banks to implement liquidity risk control systems in order to provide a daily assessment of their maturity and repricing gaps over a 90 day horizon. Institutions are required to establish a process for identifying, measuring, monitoring and controlling liquidity risk that ensures maintenance of liquidity sufficient to face distressed scenarios. The framework must be compatible with the operational profile and activities of the bank and must be periodically reassessed. Control systems must identify the risks on both a solo and consolidated basis within a conglomerate.
EC2	The supervisor confirms that banks have a liquidity management strategy, as well as policies and processes for managing liquidity risk, which have been approved by the Board. The supervisor also confirms that the Board has an oversight role in ensuring that policies and processes for risk-taking are developed to monitor, control and limit liquidity risk, and that management effectively implements such policies and processes.
Description and findings re EC2	Supervision evaluates if senior management formally establishes (and the Board approves) and communicates the bank's strategy and policies to the area responsible for the daily liquidity management, including the existence of specific guidelines for different currencies in different countries, and the process of reviewing their goals, policies, objectives and procedures. Resolution 2804/2000 requires that all relevant information on liquidity risk evaluation, monitoring and control must be part of a timely report to the board and senior management. Liquidity risk management regulation will be updated shortly and will put more emphasis on the responsibilities of the board and senior management.
EC3	The supervisor determines that a bank's senior management has defined (or established) appropriate policies and processes to monitor, control and limit liquidity risk; implements effectively such policies and processes; and understands the nature and level of liquidity risk

	being taken by the bank.
Description and findings re EC3	<p>Resolution 2804 establishes minimum standards for liquidity control and requires management systems that are commensurate with the risk profile of the institution. It requires continual monitoring of on and off balance sheet positions and the risk arising from the associated operations.</p> <p>Institutions must maintain documentation regarding overall liquidity control structure; the different scenario runs conducted on the institution(s) activities and the resulting potential impact(s) on cash flow; ongoing liquidity monitoring; contingency funding testing; periodic tests on control systems, including stress tests; the availability of information provided to and obtained from the relevant institutional departments; and contingency planning for managing liquidity crises as per Circular 3393.</p> <p>The Supervisor determines the adequacy and implementation of the above requirements through its regular inspection processes and through the continuous monitoring process. The Supervisor receives extensive information regarding the liquidity positions and prospective positions and risks on an ongoing basis, in part through regulatory reporting received directly from the institution and also through the BCB's interface with the various financial instrument registrars. Through these processes, the Supervisor is able to recreate and rigorously and proactively monitor the funding and liquidity positions of all institutions. It furthermore, conducts stress test of the positions to determine potential periods of stress and the nature of stress therein. The parameters set within the BCB's ongoing monitoring system, relative to the risk and profile of the given bank, generate exceptions on a transactional, position, and trend basis. Through this process, the supervisor is able to conduct effective and timely continuous monitoring of the funding and liquidity situation of all banks. See also CP 20.</p>
EC4	The supervisor requires banks to establish policies and processes for the ongoing measurement and monitoring of net funding requirements. The policies and processes include considering how other risks (e.g., credit, market and operational risk) may impact the bank's overall liquidity strategy, and require an analysis of funding requirements under alternative scenarios, diversification of funding sources, a review of concentration limits, stress testing, and a frequent review of underlying assumptions to determine that they continue to be valid.
Description and findings re EC4	See EC 2. Also, EC 3 highlights that the Supervisor determines that the department responsible for funding and liquidity management (treasury) must regularly interface with the other operational departments of the institution to provide and obtain relevant information for the management process.
EC5	The supervisor obtains sufficient information to identify those institutions carrying out significant foreign currency liquidity transformation. Where a bank or banking group's foreign currency business, either directly, or indirectly through lending in foreign exchange to domestic borrowers, is significant, or where a particular currency in which the bank has material exposure is experiencing problems, the supervisor requires the bank to undertake separate analysis of its strategy for each currency individually and, where appropriate, set and regularly review limits on the size of its cash flow mismatches for foreign currencies in aggregate and for each significant individual currency.
Description and findings re EC5	<p>Brazilian banks are not allowed to have, domestically, deposits and investments in foreign currency. Foreign currencies are kept in accounts in foreign banks, and BCB imposes limits on foreign exchange exposures. Nonetheless, financial instruments (loans, OTC derivatives, securities) may be indexed in foreign currency.</p> <p>The Department of Financial System Monitoring of BCB is capable of tracking several exposures in foreign currency (or indexed to), especially those related to trade finance,</p>

	<p>funding from abroad and government securities.</p> <p>Since most transactions are registered in registrars and the BCB interfaces with each registrar and obtains daily information, the BCB is able to identify institution specific and aggregate fluctuations in domestic and foreign currencies exposures.</p> <p>Resolution 2804/2000 requires that banks evaluate the liquidity risk for each material currency separately. The supervisor can have a very good idea of the foreign currency exposure through a market risk report that must be submitted daily to the Central Bank.</p>
EC6	The supervisor determines that banks have contingency plans in place for handling liquidity problems, including informing the supervisor.
Description and findings re EC6	See EC 3 above.
Additional criteria	
AC1	The supervisor determines that, where a bank conducts its business in multiple currencies, foreign currency liquidity strategy is separately stress-tested, and the results of such tests are a factor in determining the appropriateness of mismatches.
Description and findings re AC1	The Supervisor monitors IRR via gap reports of cash flows subject to four specific IRR factors, i.e., local interest rate yield curve, foreign interest rate yield curves (USD, EUR, JPY, GBP and CHF), local inflation indexed yield curves (IPC-A and IGP-M) and other local indexed yield curves (TR, TJLP). It is based on a parametric VaR approach, whose parameters are calculated and published by the BCB on a daily basis. This methodology corresponds to the BIS standardized approach, but differs in terms of complexity and precision. The instruments' cash flows are spread across twelve specific vertices according to their maturities: 1 bd (business day), 21 bd, 42 bd, 63 bd, 126 bd, 242 bd, 504 bd, 756 bd, 1008 bd, 1260 bd, 2520 bd, and over 2520 bd. When the maturity lies between two vertices, the cash flow is proportionally split between them.
AC2	The supervisor confirms that banks periodically review their efforts to establish and maintain relationships with liability holders, maintain the diversification of liabilities, and aim to ensure their capacity to sell assets.
Description and findings re AC2	See EC3
Assessment of Principle 14	Compliant
Comments	
Principle 15	Operational risk. Supervisors must be satisfied that banks have in place risk management policies and processes to identify, assess, monitor and control/mitigate operational risk. These policies and processes should be commensurate with the size and complexity of the bank.
Essential criteria	
EC1	The supervisor requires individual banks to have in place risk management policies and processes to identify, assess, monitor and mitigate operational risk. These policies and processes are adequate for the size and complexity of the bank's operations, and the supervisor confirms that they are periodically adjusted in the light of the bank's changing risk profile and external market developments.
Description and findings re EC1	Resolution 2554 and Resolution 3380 require the implementation of internal control and operational risk management frameworks, commensurate with the complexity and nature of

	<p>the operations conducted by financial institutions. The operational risk management framework must identify, evaluate, monitor, control and mitigate the operational risk.</p> <p>Operational risk is defined as, inter alia:</p> <ul style="list-style-type: none"> • Internal or external fraud • Employment practices and workplace safety • Poor practices concerning customers, products, and services • Damage to physical assets • Events that lead to the interruption of institutional activities • Gaps in information technology systems • Failure to meet deadlines and manage the activities of the institution <p>In order to evaluate (onsite) and verify the integrity and soundness of operational risk management, among other risks, the Supervisor has the following dedicated teams, inter alia: Operational Risk Team, Legal Risk and Tax Accounting Team, IT Team, and Corporate Governance Team.</p>
EC2	<p>The supervisor requires that banks' strategies, policies and processes for the management of operational risk have been approved and are periodically reviewed by the Board. The supervisor also requires that the Board oversees management in ensuring that these policies and processes are implemented effectively.</p>
Description and findings re EC2	<p>Resolution 3380 requires that senior management and the board of directors approve and periodically review operational risk management policies. It also requires the appointment of an operational risk management director and defines key elements in the structure of operational risk management. Resolution 2554, assigns to the board of directors the responsibility to implement an effective internal control framework. It also directs that internal controls must be effective and assigns to the senior management the responsibility to implement its framework.</p> <p>The engagement of the board of directors in the operational risk management is verified during the SRC review (see CP 20). The Supervisor evaluates the capacity of senior management to recognize operational risks arising from the institutions' objectives, as well as its knowledge about the main aspects of operational risk.</p>
EC3	<p>The supervisor is satisfied that the approved strategy and significant policies and processes for operational risk are implemented effectively by management.</p>
Description and findings re EC3	<p>Within SRC's procedures, Supervision evaluates the policies and the roll out of operational risk management. It also examines the responsibility and commitment of the senior management with the implementation of the approved operational risk management framework and also analyzes the effectiveness of the actions taken by the senior management for implementing and improving the internal control systems.</p> <p>In addition, the Supervisor can conduct specific examinations regarding operational risk (VE—Special Verification—Operational Risk Management). These procedures are contained in the Supervision Manual and include the assessment of the framework implemented by financial institutions in order to manage operational risk, including legal risk.</p> <p>The main goals for the VE—Operational Risk Management are: evaluation of internal corporate governance (oversight) arrangements and how they ensure that risk management policy and procedures are being applied on a day-to-day basis and the actual effectiveness of the internal audit function as the "third line of defense" in the organization.</p>

	<p>Other relevant and important elements of the (operational) VE procedures include:</p> <ul style="list-style-type: none"> • The board and senior management involvement in operational risk issues; • Internal processes established to identify, assess, monitor, control and mitigate operational risk and the frequency of reviews; • Documentation and quality of operational risk losses database and its use in the risk management; • Operational risk management reports submitted to the business units, steering committees and to the Board. • Quality of information provided to public regarding operational risk framework.
EC4	The supervisor reviews the quality and comprehensiveness of the bank's business resumption and contingency plans to satisfy itself that the bank is able to operate as a going concern and minimize losses, including those that may arise from disturbances to payment and settlement systems, in the event of severe business disruption.
Description and findings re EC4	<p>Resolution 3380 requires that the operational risk management framework include contingency plans to ensure business continuity and to limit extreme losses, including those derived from relevant outsourced services. Resolution 2554 establishes that internal controls must include periodic security tests on the institution's information systems. The Supervisor is required to evaluate the quality and reliability of contingency plans, including the development and consistency of regular testing.</p> <p>Furthermore, the Supervision Manual prescribes the use of the Control Objectives for Information and Related Technology (Cobit) methodology to assess the aspects related to the continuity of IT services.</p>
EC5	The supervisor determines that banks have established appropriate information technology policies and processes that address areas such as information security and system development, and have made investments in information technology commensurate with the size and complexity of operations.
Description and findings re EC5	<p>Resolution 2554 and Resolution 3380 do not specifically provide treatment for structuring of IT systems, such as definition of minimum requirements for policies and processes. However, Resolution 2554 directs banks to periodically conduct security tests, and Resolution 3380 considers IT system failures as operational risk events. The BCB is in the process of developing a new resolution on IT risk management.</p> <p>In practice, the Supervisor evaluates the adequacy of the relevant processes, people, systems, equipment and other resources employed in IT risk management relative to the size, complexity, risk level and dependence on technology of all operational, management and administrative activities of the institution. Recently, the inspection of credit quality has also included an evaluation of IT systems used in the relevant areas to ensure accuracy and integrity of the information generated. Also, most of the large banks have recently significantly upgraded, or are in the process of upgrading, their IT platforms and systems – in part, at the direction of Supervision.</p> <p>Specialized teams dedicated to specific banking risks are located within the onsite supervision department. There is a team in charge of IT issues, specializing in risk assessment and control of processes, resources and technological environments based on international best practices as the framework Cobit.</p> <p>The procedures contained in the Supervision Manual are based on the Cobit methodology and direct evaluation of the institution's strategic IT plan; the guidelines followed by the institution on technology infrastructure; the investment in technology and the communication of IT policies and guidelines.</p>

EC6	The supervisor requires that appropriate reporting mechanisms are in place to keep the supervisor apprised of developments affecting operational risk at banks in their jurisdictions.
Description and findings re EC6	<p>Resolution no. 3,198/2004, determines the preparation of assessment reports by an external auditor about the quality and adequacy of the internal control system focusing on risks that present potential impact on the institution's financial statements and operations. Resolution no. 3380/2006 requires that a description of the operational risk management framework must be released to the public at least annually.</p> <p>The Supervisor evaluates the operational risk related information submitted by the institution and that information released to the market and the adequacy therein. Institutions' internal audit departments are a main point of contact for the supervisor – for both onsite inspection planning and ongoing supervisory monitoring. As well, the Supervisor is also in periodic contact with the external auditor; both functions provide key inputs to operational risk monitoring.</p>
EC7	The supervisor confirms that legal risk is incorporated into the operational risk management processes of the bank.
Description and findings re EC7	<p>Resolution 3380 classifies legal risk as part of operational risk. Legal risk is defined as the possibility of loss from inadequate or deficient contracts signed by the institution, noncompliance with legal statements, or from compensation for damages to third parties caused by the institution's activities.</p> <p>During SRC procedures, Supervision verifies whether legal risk is included in the corporate definition of operational risk.</p>
EC8	<p>The supervisor determines that banks have established appropriate policies and processes to assess, manage and monitor outsourced activities. The outsourcing risk management programme should cover:</p> <ul style="list-style-type: none"> • conducting appropriate due diligence for selecting potential service providers; • structuring the outsourcing arrangement; • managing and monitoring the risks associated with the outsourcing arrangement; • ensuring an effective control environment; and • establishing viable contingency planning. <p>Outsourcing policies and processes should require the institution to have comprehensive contracts and/or service level agreements with a clear allocation of responsibilities between the outsourcing provider and the bank.</p>
Description and findings re EC8	<p>Resolution 3380 requires the management of the operational risk to also address outsourced activities. The operational risk management framework should identify and monitor the risk of outsourcing service providers and define their roles, responsibilities and their contingency plans.</p> <p>Consistent with the Supervisory Manual, during specific examinations regarding operational risk (VE—Special Verification—Operational Risk Management) the Supervisor verifies if policies include outsourcing practices. In addition, Supervision also assesses the quality of procedures and processes of operational risk management regarding outsourcing.</p>
Additional criteria	
AC1	The supervisor determines that the risk management policies and processes address the major aspects of operational risk, including an appropriate operational risk framework that is applied on a group-wide basis. The policies and processes should include additional risks prevalent in certain operationally intensive businesses, such as custody and correspondent banking, and should cover periods when operational risk could increase.

Description and findings re AC1	<p>Resolution 3380 requires that the operational risk management framework be capable of controlling risks on an individual institution basis as well as for the financial conglomerate inclusive of identifying and monitoring the operational risk of other companies within the conglomerate.</p> <p>The Supervision Manual directs the supervisor to evaluate the process of identifying operational risk inherent in relevant products, activities, processes and systems of the institution, of non-financial companies owned by the conglomerate, as well as the operational risks resulting from the merger, acquisition/incorporation, split or sale of companies within the conglomerate.</p>
Assessment of Principle 15	Compliant
Comments	
Principle 16	<p>Interest rate risk in the banking book. Supervisors must be satisfied that banks have effective systems in place to identify, measure, monitor and control interest rate risk in the banking book, including a well defined strategy that has been approved by the Board and implemented by senior management; these should be appropriate to the size and complexity of such risk.</p>
Essential criteria	
EC1	<p>The supervisor determines that a bank's Board approves, and periodically reviews, the interest rate risk strategy and policies and processes for the identification, measuring, monitoring and control of interest rate risk. The supervisor also determines that management ensures that the interest rate risk strategy, policies and processes are developed and implemented.</p>
Description and findings re EC1	<p>The structure of banks' balance sheets reflects the current term structure of the financial market which is, in part, a product of a historic high inflation environment. The periods of high inflation necessary kept maturities short, both on the asset and liability side. As a result, interest rate risk in the banking book was very short term, almost immediate and therefore, akin to market risk in the trading book. As such, the policies and oversight of the banking book was treated similarly. Following an extended economic stability, the term structure of instruments and banks' balance sheets has extended, albeit still relatively short with the majority of maturities within the three to five year range. Even then, many assets are floating rate as are liabilities, minimizing many aspects of interest rate risk in the banking book.</p> <p>The regulatory rules and guidance on interest rate risk continue to fall largely under the market risk resolutions with additional guidance, in the form of circulars, addressing interest rate specifically. Banks are required to establish management processes, risk measurement, analysis, control and stress testing in the banking book. Consistent with Basel II, banks are also required to specifically allocate capital against this risk.</p> <p>Resolution 3464 requires the elaboration of policies and strategies for the management of market risk and for the definition of operational limits. Policies and strategies must be approved and periodically reviewed (at least annually) by the senior management and the board of directors, if it exists. According to BCB Circular 3365, the evaluation and measurement of the interest rate risk of the operations classified in the banking book must be implemented through a system adequate to the nature of the institution's operations, the complexity of its products and to its exposure to interest rate risk.</p> <p>Supervisory procedures require evaluation of the bank's approval, review, documentation and disclosure of the strategies and policies. The ability and the level of involvement of the senior management with risk management are also evaluated. The role of senior management is</p>

	also verified in the activities of VE of Market Risk Management and in the activities of VE of Treasury Operations.
EC2	The supervisor determines that banks have in place comprehensive and appropriate interest rate risk measurement systems and that any models and assumptions are validated on a regular basis. It confirms that banks' limits reflect the risk strategy of the institution and are understood by and regularly communicated to relevant staff. The supervisor also confirms that exceptions to established policies, processes and limits should receive the prompt attention of senior management, and the Board where necessary.
Description and findings re EC2	<p>Circular 3365 more specifically establishes procedures for calculation of capital to cover interest rate risk (IRR) in the banking book. The guidance includes the following requirements:</p> <ul style="list-style-type: none"> • The management and measurement of IRR in the banking book must be commensurate with the nature of the institution's operations, the complexity of its products and its exposures; • The systems and processes which facilitate IRR management must: <ul style="list-style-type: none"> ○ incorporate all relevant instruments; ○ use generally accepted risk measurement techniques; ○ address the various characteristics and behaviors with regard to rates, maturities, pricing, embedded options and other details; ○ incorporate appropriate assumptions to transform positions into cash flows; ○ measure instruments' sensitivity to changes in the interest rate term structure; ○ be integrated into the daily risk management practices; ○ incorporate interest rate shocks (stress tests); and ○ measure the necessary regulatory capital for IRR in the banking book. • Stress tests must be performed at least quarterly and estimate the percentage of change in market value of banking operations against the regulatory capital. The stress test must also estimate the number of basis points of a parallel interest rate shock that would lead to a decline in market value of banking operations corresponding to 5 percent, 10 and 20 percent of regulatory capital. The stress test must be performed for each risk factor accounting for at least 5 percent of total exposures in the banking book, and jointly for the remaining operations. A report on the results of the assessment of the IRR in the banking book must be forwarded to the Supervisor; • The institution must prove that its measurement system adequately captures and assesses the IRR in banking book. <p>At the individual bank level, supervisors receive IRR reports that are used in the risk management processes. Each bank has particular reports and tools. Even though the level of complexity and sophistication can vary from bank to bank, the systemically important banks have tools that are able to simulate different behaviors for interest rate yield curves over time (scenario analysis) and to assess the impact of these behaviors on cash flows, earnings and balance sheets.</p> <p>The Supervisor uses the above compilation of information for two specific purposes: first, to determine the amount of required capital; and second, evaluation of the interest rate risk each bank carries. The GAP report information is provided within the context of DRM (Market Risk Statement) monitoring tool, and is used by supervisors at all levels (individual banks, banking groups and system).</p> <p>With regard to the supervisory procedures, the Supervisory Manual prescribes the evaluation</p>

	<p>of interest rate risk measurement systems in both trading and banking books, of the comprehensiveness of procedures for identifying market risk factors and for mapping new products. Furthermore, Supervision verifies the adequacy of the approved limit framework in relation to the size and complexity of the operations of the institution, and the ability and involvement of the senior management in supervising market risk management.</p> <p>The evaluation of the adequacy and comprehensiveness of the interest rate risk identification and measurement systems, as well as of the respective exposure limits, is also established in the procedures of the VE of Treasury Operations. Cases of exceeded limits as well as the involvement and capacity of the senior management in issues related to risk management are evaluated. Examinations are also carried out to verify if the control systems capture all significant sources of risk and if the premises and hypotheses used by the market risk management instruments are sufficient to highlight potential risks. There are specific references to the evaluation of capital components for the banking book, along with other portions of capital to cover market risk.</p> <p>Regarding the validation of the system, Resolutions 2554, and 3464 require periodic review, respectively, of internal controls (amended by Resolution 3056) and of the market risk management structure. Such aspect is also considered in Circular 3354 which deals specifically with the review of the policies for classifying operations in the trading or in the banking book.</p> <p>Regarding model validation, models are required to be validated every three years unless there is a significant change in the parameters surrounding the model or in the external environment.</p>
EC3	The supervisor requires that banks periodically perform appropriate stress tests to measure their vulnerability to loss under adverse interest rate movements.
Description and findings re EC3	<p>See also EC 2 above for more detailed presentation.</p> <p>Resolution 3464 requires the performance of stress testing, the results of which should be considered in establishing and reviewing policies and limits for capital adequacy. It also states that the systems used to manage market risk should cover all relevant sources of risk.</p> <p>Specifically for managing interest rate risk in the banking book, Circular 3365 directs stress testing, at least quarterly. This Circular also sets out a number of requirements to be incorporated in the testing process.</p> <p>In addition, for institutions that adopt internal models of market risk, the Circular 3478 establishes minimum requirements, among which is the performance of stress testing.</p> <p>Supervisory procedures of SRC and VE of Treasury Operations require supervisory review of stress tests executed in the market risk area, the adequacy of scenarios used and the comprehensiveness of risks considered. The analysis and actions taken in response to the results and the proper reporting to the senior management of the institution are also verified.</p>
Additional criteria	
AC1	The supervisor has the power to obtain from banks the results of their internal interest rate risk measurement systems, expressed in terms of the threat to economic value, including using a standardized interest rate shock on the banking book.
Description and findings re AC1	<p>See EC 2 and 3 above.</p> <p>The Banking Law establishes that it is mandatory for institutions to provide the BCB with data or information deemed necessary to the accomplishment of its assignments.</p> <p>In general, regulations require institutions maintain supervisory related information available</p>

	<p>for at least five years.</p> <p>The main information required is:</p> <ul style="list-style-type: none"> • Monitoring reports of the internal control system for a period of five years (Resolution 2554); • Reports showing the procedures used for the classification of operations in the trading or banking book (Circular 3354); • Reports detailing the results of the measurement of interest rate risk in the banking book (Circular 3365); • Details of the estimation of capital to cover the interest rate risk in the banking book (Circular Letter 3415). <p>Continuous monitoring collects and reviews various information flows from the institutions and from other sources in order to identify changes in institutional capital structure and risk profile.</p> <p>Under SRC activities, market risk management reports are requested and examined. In the procedures related to VE of Treasury Operations – Risk Management and to VE of Corporate Management, the management reports used by the institution are evaluated as well as the consistency of the data reported to the Supervisor specifically for the calculation of capital requirements.</p>
AC2	The supervisor assesses whether the internal capital measurement systems of banks adequately capture the interest rate risk in the banking book.
Description and findings re AC2	<p>Resolution 3490, determines the constitution of a portion of the regulatory capital to particularly support the interest rate risk in the banking book. In supervisory procedures, there are specific references for assessing the constitution of the portion of capital correspondent to the risk in the banking book.</p> <p>See also CP 6.</p>
AC3	The supervisor requires stress tests to be based on reasonable worst case scenarios and to capture all material sources of risk, including a breakdown of critical assumptions. Senior management is required to consider these results when establishing and reviewing a bank's policies, processes and limits for interest rate risk.
Description and findings re AC3	See EC3
AC4	The supervisor requires banks to assign responsibility for interest rate risk management to individuals independent of and with reporting lines separate from those responsible for trading and/or other risk-taking activities. In the absence of an independent risk management function that covers interest rate risk, the supervisor requires the bank to ensure that there is a mechanism in place to mitigate a possible conflict of interest for managers with both risk management and risk-taking responsibilities.
Description and findings re AC4	<p>According to Resolution 3464, risk management should be performed by a specific unit, segregated from the business and internal auditing units. The assignment of an officer responsible for managing the market risk is required, as well as the effective implementation of the structure as indicated in the schedule specified in the abovementioned Resolution.</p> <p>Resolution 2554, which regulates the implementation of the internal control system, determines that the activities of the institution should be segregated to avoid conflict of interest. Similarly, Resolution 3464 prevents the officer responsible for managing the market risk from performing functions related to the administration of third party or treasury funds.</p> <p>Within the activities of the SRC and VE of Market Risk Management and VE of Treasury</p>

	Operations, a number of issues related to conflict of interest are assessed.
Assessment of Principle 16	Compliant
Comments	
Principle 17	Internal control and audit. Supervisors must be satisfied that banks have in place internal controls that are adequate for the size and complexity of their business. These should include clear arrangements for delegating authority and responsibility; separation of the functions that involve committing the bank, paying away its funds, and accounting for its assets and liabilities; reconciliation of these processes; safeguarding the bank's assets; and appropriate independent internal audit and compliance functions to test adherence to these controls as well as applicable laws and regulations.
Essential criteria	
EC1	Laws, regulations or the supervisor establish the responsibilities of the Board and senior management with respect to corporate governance to ensure that there is effective control over a bank's entire business.
Description and findings re EC1	<p>See CP 15, Operational Risk for a discussion on internal controls.</p> <p>Most of the responsibilities rest with the management and the Board of Directors who are in fact those responsible for the administration of the company (Law 6404). The main responsibility for the implementation of internal controls is with the institution's management (Resolution 2554) which must provide high standards of ethics and integrity and an organizational culture that demonstrates and emphasizes to all employees the importance of internal controls and the role of each one in the process (Resolution 2554). The board is required to establish sound corporate governance practices including supervising the performance of the management. Activities related to the internal controls system must be reported at least twice a year, and the reports must be submitted to the board, the management and to the external auditor. Responsibilities in the institution must be well defined to avoid conflict of interests (Resolution 2554).</p> <p>Furthermore, in institutions that are required to have an audit committee, it must assess the effectiveness of external and internal auditors and the compliance with laws and regulations (Resolution 3198) and must formally communicate the existence or evidence of error or fraud to the Supervisor. The audit committee is directed to meet with the management of the institution at least once every three months as well as with the external audit and the internal audit.</p>
EC2	<p>The supervisor determines that banks have in place internal controls that are adequate for the nature and scale of their business. These controls are the responsibility of the Board and/or senior management and deal with organizational structure, accounting policies and processes, checks and balances, and the safeguarding of assets and investments. More specifically, these controls address:</p> <ul style="list-style-type: none"> • Organizational structure: definitions of duties and responsibilities, including clear delegation of authority (for example, clear loan approval limits), decision-making policies and processes, separation of critical functions (for example, business origination, payments, reconciliation, risk management, accounting, audit and compliance). • Accounting policies and processes: reconciliation of accounts, control lists, information for management. • Checks and balances (or "four eyes principle"): segregation of duties, cross-checking, dual control of assets, double signatures.

	<ul style="list-style-type: none"> • Safeguarding assets and investments: including physical control.
Description and findings re EC2	<p>See also EC 1 above and CP 15.</p> <p>Resolution 2554, assigns to the board of directors the responsibility to implement an effective internal control framework. It also directs that internal controls must be effective and assigns to the senior management the responsibility to implement its framework. Management must implement adequate internal controls in each entity of the financial conglomerate, consistent with complexity and risk of the operations they conduct.</p> <p>The procedures established for SRC, VEs (targeted inspections) and continuous monitoring activities are based on definitions established by the Bank for International Settlements (BIS) and the Committee of Sponsoring Organizations of the Treadway Commission (COSO). As such, an internal controls system approach is used that encompasses five components: Control Environment; Risk Assessment; Control Activities; Information and Communication; and Monitoring. The content of those procedures are set out in the Supervision Manual.</p> <p>The internal control verification is carried out in the context of corporate level and business units. Internal controls applied to specific activities are also verified and supervisory findings are also compared to internal audit findings and recommendations to validate and review that process as well.</p> <p>The Supervision Manual enumerates procedures to evaluate the adequacy of the internal controls system. Such procedures are established both at a more general level and for more specific activities, such as corporate governance, audit committee function, credit operation controls, treasury area, currency exchange operations, real estate loans, IT and application systems. The supervisor also assesses whether members of the institution—especially senior management—are committed to and qualified to implement effective internal controls.</p> <p>The Supervisor has the legal power to sanction institutions and must do so when infractions are identified and verified. In less serious cases, the Supervisor may report deficiencies through an inspection letter or summons communication as specified in the Supervision Manual.</p>
EC3	Laws, regulations or the supervisor place the responsibility for the control environment on the Board and senior management of the bank. The supervisor requires that the Board and senior management understand the underlying risks in their business and are committed to a strong control environment.
Description and findings re EC3	See EC 2
EC4	The supervisor has the power to require changes in the composition of the Board and senior management to address any prudential concerns related to the satisfaction of these criteria.
Description and findings re EC4	<p>See also CP 23.</p> <p>The qualifications of Board members are vetted by the BCB upon their appointment and renewal of their term (every three years). As well, the composition, qualification and experience of the Board members are evaluated in the SRC process and during on-site inspections. If a weakness in oversight, potential conflict of interest, or a lack of necessary independence is identified, the Supervisor can require relevant corrective action. The BCB can suspend directors (Article 44 of Banking Law) and/or can impose a Board on the bank, benching the bank's permanent Board until the issues are resolved and if not, then the BCB can move to liquidation.</p>
EC5	The supervisor determines that there is an appropriate balance in the skills and resources of the back office and control functions relative to the front office/business origination.

Description and findings re EC5	<p>The determination of the balance of skills in both the back office and control functions relative to front office activities is inherent in the requirement for and execution of comprehensive and sound internal controls, internal audit oversight, external audit processes, and Supervisory oversight. Also, this element is key to the evaluation of risk controls specified in the specific risk areas.</p> <p>See EC 2 above, CP 7 Risk Management Process, and CPs 13–16.</p>
EC6	<p>The supervisor determines that banks have a permanent compliance function that assists senior management in managing effectively the compliance risks faced by the bank. The compliance function must be independent of the business activities of the bank. The supervisor determines that the Board exercises oversight of the management of the compliance function.</p>
Description and findings re EC6	<p>Financial institutions are not required to have a segregated compliance function or to appoint a compliant officer. Nevertheless, the Internal Control System, including compliance function, as determined by Resolution 2554, is a responsibility of the Board of Directors as a whole.</p> <p>The majority of Brazilian banks have a compliance officer or unit. The large banks present separate compliance units apart from other control functions. However, other banks combine compliance activities with other functions such as internal control units. In practice, 95 percent of institutions assign an officer or a unit responsible for compliance activities.</p>
EC7	<p>The supervisor determines that banks have an independent, permanent and effective internal audit function charged with (i) ensuring that policies and processes are complied with and (ii) reviewing whether the existing policies, processes and controls remain sufficient and appropriate for the bank's business.</p>
Description and findings re EC7	<p>The Resolution 2554 requires that all financial institutions have a system of internal controls and that an internal audit function be established as a part of this system. The Resolution 3056 reinforces the requirement to establish an internal audit function.</p> <p>As a part of the ongoing supervisory process, the Supervisor interacts on a regular basis with internal audit functions. During onsite and continuous monitoring, the Supervisor elicits internal audit reports to (i) review the adequacy of audit in the relevant area and (ii) to supplement inspection procedures.</p>
EC8	<p>The supervisor determines that the internal audit function:</p> <ul style="list-style-type: none"> • has sufficient resources, and staff that are suitably trained and have relevant experience to understand and evaluate the business they are auditing; • has appropriate independence, including reporting lines to the Board and status within the bank to ensure that senior management reacts to and acts upon its recommendations; • has full access to and communication with any member of staff as well as full access to records, files or data of the bank and its affiliates, whenever relevant to the performance of its duties; • employs a methodology that identifies the material risks run by the bank; • prepares an audit plan based on its own risk assessment and allocates its resources accordingly; and • has the authority to assess any outsourced functions.
Description and findings re EC8	<p>As a part of the ongoing supervisory process, the Supervisor interacts on a regular basis with internal audit functions. During onsite and continuous monitoring, the Supervisor elicits internal audit reports to (i) review the adequacy of audit in the relevant area and (ii) to supplement inspection procedures.</p>
Additional criteria	

AC1	In those countries with a unicameral Board structure (as opposed to a bicameral structure with a Supervisory Board and a Management Board), the supervisor requires the Board to include a number of experienced non-executive directors.
Description and findings re AC1	There are no specific regulatory requirements in place for appointing independent and non-executive directors to the board (unless institutions are listed). However, the Supervisor encourages institutions to adopt the practice; the larger systemic institutions have begun implementation.
AC2	The supervisor requires the internal audit function to report to an audit committee, or an equivalent structure.
Description and findings re AC2	In cases where audit committees are required, they are requested to evaluate the effectiveness of the internal controls system and of the internal and external audit work. According to Resolution 2554, financial institutions should provide a biannual report on internal controls system.
AC3	In those countries with a unicameral Board structure, the supervisor requires the audit committee to include experienced non-executive directors.
Description and findings re AC3	In cases where an audit committee is required, the audit committee is required to be composed of 3 outside individuals, one with specific experience in the area of accounting and/or auditing.
AC4	Laws or regulations provide, or the supervisor ensures, that banks must notify the supervisor as soon as they become aware of any material information which may negatively affect the fitness and propriety of a Board member or a member of the senior management.
Description and findings re AC4	Resolution 3198 requires the external auditor and/or the audit committee to formally inform the BCB, within three working days, of becoming aware of a significant noncompliance situation, fraud, error or omission. In addition, if any board member or senior management becomes aware of material information which negatively affects their fitness, without taking corrective action, they can be penalized by BCB.
Assessment of Principle 17	Compliant
Comments	
Principle 18	Abuse of financial services. Supervisors must be satisfied that banks have adequate policies and processes in place, including strict “know-your-customer” rules, that promote high ethical and professional standards in the financial sector and prevent the bank from being used, intentionally or unintentionally, for criminal activities.
Essential criteria	
EC1	Laws or regulations clarify the duties, responsibilities and powers of the banking supervisor and other competent authorities, if any, related to the supervision of banks’ internal controls and enforcement of the relevant laws and regulations regarding criminal activities.
Description and findings re EC1	The Central Bank of Brazil (BCB) is responsible for issuing regulations, conducting onsite and offsite inspections, verifying compliance and applying administrative sanctions when appropriate. (Law 9613) The Council for Financial Activities Control (COAF), Brazil’s Financial Intelligence Unit, is responsible for receiving communications on suspicious transactions and cash operations, for analyzing these communications and for producing Financial Intelligence Reports that are sent to the competent authorities (General Attorney, Federal Police and others). BCB and COAF work in coordination and maintain permanent cooperation, ranging from the formulation of norms to information exchange and technical support. BCB has a seat in COAF’s Council, and has access to communications on suspicious

	<p>transactions and cash operations. The analysis of those communications is COAF's responsibility.</p>
EC2	<p>The supervisor must be satisfied that banks have in place adequate policies and processes that promote high ethical and professional standards and prevent the bank from being used, intentionally or unintentionally, for criminal activities. This includes the prevention and detection of criminal activity, and reporting of such suspected activities to the appropriate authorities.</p>
Description and findings re EC2	<p>The BCB has the authority, defined by the Banking Law, and Law 9613, to supervise financial institutions for AML/CFT compliance, as well as to apply the penalties specified in those laws.</p> <p>The BCB must notify the competent authorities of signs of crimes against the public order, as well as of evidence of irregularities or illegal administrative offenses that have been noticed in the exercise of its legal authority of supervisor (Complementary Law no. 105).</p> <p>Law 7492 describes the crimes against the banking system. Law 9613 describes the crime of laundering or concealment of assets, rights and values, sets forth procedures for the prevention of this criminal offense and establishes a financial intelligence unit in Brazil, the COAF. Law 9613 also states that communications made in good-faith to the COAF, as stated by Law, will not result in civil or administrative liability.</p> <p>The CMN and the BCB have enacted regulations establishing the procedures that banks must meet for the implementation of their internal control systems (Resolution 2554), as well as regulation defining the requirements of AML/CFT (Circular. 3461), highlighting the following aspects:</p> <p>I) Implementation of policies and internal control procedures to prevent the use of financial institutions for the crimes described by Law. 9613. Such policies must:</p> <ol style="list-style-type: none"> a) specify, in an internal document, the responsibilities of the members at each hierarchical level of the institution; b) encompass the timely collection and registration of information about customers, enabling the identification of risks associated to such persons; c) define the criteria and procedures for the selection, training, and monitoring of the financial and economic situation of employees; d) include the preliminary analysis of new products and services, as regards the prevention of those crimes; e) be approved by the board of directors; and f) appropriate and extensive internal disclosure. <p>The referred procedures must include explicit measures that determine the checking of the customer registry information and the identification of the final beneficiaries of operations, and include rules for the definition of politically exposed persons.</p> <p>Resolution 2554, also assigns to the board the obligation to foster high ethical standards of integrity and to promote an organizational culture that demonstrates and emphasizes, to all staff, the importance of internal controls and the role of each staff member in the process.</p> <p>II) Identification of all the customers: individuals, legal entities and their representatives, including the final beneficiaries. Also, it is necessary to maintain the customer's files updated, as well to store the files of all operations and transactions for 5 years.</p> <p>III) Monitoring of operations and transactions to identify unusual situations; special attention to the situations that pose higher risk and detection of suspicious situations.</p>

IV) Communication to the COAF of cash operations and transactions exceeding R\$ 100 thousand, as well as of those, irrespective of their value, that show signs of the crimes stated in Law 9613, to the financial intelligence unit. Complementary Law 105 provides that it does not constitute a breach of secrecy to communicate to the competent authorities, including to the COAF, the practice of administrative or criminal offenses, including the supply of information on transactions involving proceeds from any criminal practice.

V) Nomination of a director responsible for the implementation and compliance with the established measures, as well as for the communication of suspicious transactions to the COAF.

VI) Adoption of rigorous procedures for starting relationships with financial institutions, representatives or correspondent banks abroad, especially in countries, territories and places which do not adopt registration and control procedures similar to those defined by Circular 3461. These strengthened procedures also apply to the initial relationship with customers contacted via electronic means, through correspondent banks in the country or by any other indirect mean. Financial institutions should dedicate special attention to transactions with customers from countries that apply the recommendations of the Financial Action Task Force (FATF) in an unsatisfactory manner. Regarding cross-border relationships between correspondent banks and other similar relationships, they should: a) gather information on the correspondent institution about its reputation and the quality of its supervision, including if the institution has been subject to investigation or to any action related to AML/CFT; b) assess the controls adopted by the correspondent institution with respect to AML/CFT; c) obtain approval from the director responsible for the transactions in the foreign exchange market before establishing a new correspondent relationship; d) document the respective responsibilities of each institution regarding AML/CFT.

VII) Financial institutions should pay special attention to:

a) transactions or proposals whose characteristics, regarding involved parts, values, forms of implementation and instruments, or which, by lack of economic or legal grounds, raise suspicion of crimes described in Law 9613, or are related;

b) opening of accounts and/or beginning of transactions with politically exposed persons of Brazilian nationality and those coming from countries with which Brazil has a high number of financial and commercial transactions, common borders or ethnic, linguistic or political closeness;

c) evidence of fraud in the procedures of identification and registration set out in Circular 3461;

d) customers and operations where it is not possible to identify the final beneficiary; e) transactions with customers from countries that unsatisfactorily apply the FATF recommendations. In addition, the responsible officer of Brazilian banks with subsidiaries or branches located in those countries must communicate the BCB about the unsatisfactorily application;

f) situations where it is not possible to keep the information files of their customers updated. Special attention includes enhanced monitoring, analysis previous to reporting to the COAF, and the evaluation of senior management regarding the interest in the beginning and the maintenance of the relationship with the customer.

During the SRC, the risk of AML/CFT is evaluated, as well as its risk management and its capacity to mitigate risks. Measures of improvement may be required whenever failure in these controls is observed. The SRC findings may lead to the decision to carry out

	<p>examinations in the form of Special Verifications (VE), which differ from SRC for being restricted to the subject of AML/CFT, with more detailed procedures for assessment of policies and controls, as well as for monitoring action plans for improvements to be implemented.</p> <p>The evaluation of internal controls of the institution for compliance with regulations and good practice of AML/CFT include:</p> <ul style="list-style-type: none"> a) an evaluation of the organizational structure, including the Board of Directors' (or senior management) role in fostering AML/CFT practices over the institution; b) policies of Customer Due Diligence , "know-your-employee" and training, c) the examination of the work of the auditors. <p>The evaluation is focused on the compliance to internal rules and regulations related to AML/CFT and the checking of how senior management has implemented the improved procedures of AML/CFT, which may have been recommended by the audit (internal and external) and by the BCB. The tools of AML/CFT (management reports or IT systems) are also verified; the procedures for detection and selection of operations to be analyzed; the effectiveness of the process for detection and selection of atypical operations; and the management department of AML/CFT, verifies the appropriateness of the number of employees.</p> <p>The internal audit activity must be part of the internal controls system. When not performed by a specific unit of the institution or entity, it may be carried out by an external auditor. Circular 3467 requires that AML compliance be audited.</p> <p>Resolution 2025 and Circular 3.461 established the requirements for customer identification and for keeping customer identification data. The requirements address both individuals and corporates.</p> <p>Complementary Law 105 provides that the BCB may sign agreements with other supervisory authorities of financial institutions and with other central banks, aiming at supervising the branches and subsidiaries of foreign institutions in Brazil and branches and subsidiaries of Brazilian financial institutions abroad and promoting mutual cooperation and information exchange. Based on the mentioned Law, the BCB has signed agreements with central banks or supervisory bodies of other countries, based on the BCBS' model ("<i>Essential elements of a statement of cooperation between banking supervisors</i>").</p>
EC3	<p>In addition to reporting to the financial intelligence unit or other designated authorities, banks report to the banking supervisor suspicious activities and incidents of fraud when they are material to the safety, soundness or reputation of the bank.</p>
Description and findings re EC3	<p>Specialized staff of the BCB has access to suspicious transaction reports and incidents of fraud in accordance with the following norms:</p> <ul style="list-style-type: none"> 1) BCB Circular 3.461, dated 7/24/2009, art. 13: <p>“Art. 13. The institutions addressed by art. 1 must communicate to Coaf, in the manner determined by the Central Bank of Brazil:</p> <ul style="list-style-type: none"> I – the operations undertaken or services rendered, with value equal to or above R\$10,000.00 (ten thousand reais), and which, considering the parties involved, values, the means of execution, the instruments used or the lack of economic or legal grounding, may present evidence of the crimes foreseen in Law 9,613, of 1998.

II – the operations, which, by their frequency, value or form, are suspicious of trying to bypass identification, control and registration mechanisms.

III – the operations undertaken or services rendered, whichever the value, to persons who reportedly have perpetrated or tried to perpetrate terrorist acts or participated therein or facilitated their occurrence, as well as the existence of resources pertaining to or controlled by them directly or indirectly.

IV – acts suspicious acts of financing terrorism.

§1 The provisions of item III also apply to entities pertaining to or controlled, directly or indirectly, by the persons mentioned therein, as well as by persons and entities acting on their behalf or under their command.

§2 The communications of occurrences addressed by items III and IV must be done up to the first business day following that in which they were verified.

§3 Proposals for operations and the acts described in items I to IV must also be communicated to Coaf.”

2) **CMN Resolution 3.198**, dated 05/27/2004 (consolidates regulations concerning independent audit services):

"Art. 23 The independent auditor and audit committee, when existing, must, individually or in tandem, formally communicate to the Central Bank of Brazil, in up to three days from identification, the existence or evidence of error or fraud represented by:

I – non-compliance with legal and regulatory norms, putting at risk the continuity of the audited entity;

II – fraud of any value committed by the institution’s administration;

III – relevant fraud perpetrated by entity employees or third parties;

IV – errors that result in relevant inaccuracies in the entity’s accounting statements.

§ 1 – For the purposes of this regulation, must be observed the concepts of error and fraud established in CFC or Ibracon norms and regulations.

§ 2 – The independent auditor, internal audit and audit committee, when existing, must maintain, among themselves, immediate communication of the events foreseen by this article."

3) **BCB Circular 2.025**, dated 11/24/1993 (consolidates regulation concerning the opening, maintenance and use of deposit accounts):

"Article 13. The financial institution shall close a deposit account in which finds irregularities, judged of a serious nature, in the information provided, communicating the fact immediately to the Central Bank of Brazil."

4) **BCB Circular Letter 3.298**, dated 02/22/2008 (establishes the sending of ombudsman reports to the Central Bank—annexed table, themes 3 and 13—in accordance with BCB Circular 3.370, dated 10/23/2007, which was succeeded and updated by BCB Circular 3.503, dated 7/26/2010):

“3 – Checking accounts: Complaints involving the opening, maintenance and closing of checking and salary accounts, such as:

- Opening of a checking account without proper documentation;

	<ul style="list-style-type: none"> • Not offering the option of providing a magnetic debit card or checkbook; • Questions relative to the magnetic debit card; • Blocking of account; • Unauthorized debits or ones made due to operational errors by the institution; • Unidentified withdrawals; • Unrealized deposits; • Unauthorized transfers; • Inobservance of withdrawal, debit for payment (except of checks) or automatic debit orders; • Inobservance, incomplete or incorrect execution of DOC, TED or any other payment and transfer orders (except checks); • Inobservance, incomplete or incorrect execution of titles or other papers. <p>(...)</p> <p>13 – Other themes: Complaints unforeseen in previous themes, such as:</p> <ul style="list-style-type: none"> • Scams (e.g., credit offers, that are not fulfilled, by companies or natural persons who are not financial institutions, using the institution’s name without its knowledge); • Supply of counterfeit money; • Fraud committed by employees, representatives or third parties against customers or non-customers; • Complaints from the correspondent network in the country; • Bank secrecy.” <p>Additionally, the BCB in its ongoing monitoring has frequent communications with the banks.</p>
EC4	<p>The supervisor is satisfied that banks establish “know-your-customer” (KYC) policies and processes which are well documented and communicated to all relevant staff. Such policies and processes must also be integrated into the bank’s overall risk management. The KYC management program, on a group-wide basis, has as its essential elements:</p> <ul style="list-style-type: none"> • a customer acceptance policy that identifies business relationships that the bank will not accept; • a customer identification, verification and due diligence program; this encompasses verification of beneficial ownership and includes risk-based reviews to ensure that records are updated and relevant; • policies and processes to monitor and recognize unusual or potentially suspicious transactions, particularly of high-risk accounts; • escalation to the senior management level of decisions on entering into business relationships with high-risk accounts, such as those for politically exposed persons, or maintaining such relationships when an existing relationship becomes high-risk; and • clear rules on what records must be kept on consumer identification and individual transactions and their retention period. Such records should have at least a five year retention period.
Description and findings re EC4	<p>According to Circular 3461, banks are required to appoint a senior officer (normally a statutory director) responsible for compliance with anti-money laundering provisions and reporting procedures, including communications to COAF.</p> <p>Banks are required to implement policies, procedures and internal controls to combat money laundering and terrorist financing. Such controls include monitoring customers’ transactions by AML software developed in-house or provided by specialized firms. There are a wide variety of parameters used to select transactions to be analyzed by the banks’ specialized</p>

	<p>compliance unit. As part of the analysis, the banks' specialized units, as a best practice, demand from relationship managers an assessment of the customers' transactions.</p> <p>In case the specialized unit is convinced that the transaction is atypical, it files a report, which is referred to an AML Committee for final analysis. The AML Committee is usually comprised of senior managers; one of them is the money laundering reporting officer. Once the AML Committee decides to report the transaction as suspicious, a report must be made to COAF no more than 24 hours after the committee decision. All analyses of customers' transactions selected by the AML software or referred to the specialized unit by other means (no matter if they are related to suspicious activities or not) must be recorded for five years.</p> <p>During the BCB annual SRC evaluation, the BCB verifies whether Senior Management is committed to ensuring that business is conducted in conformity with high ethical standards, laws and regulations. Despite that, at any time, the team responsible for a bank can undertake an ad hoc action to check the soundness of governance and internal controls at corporate level.</p> <p>As a general rule, the compliance inspections are conducted in accordance with the Annual Supervision Plan, established in the last two months of each year. Basically, it reflects complaints addressed by customers, media exposure and denouncements from the police and public attorney against financial institutions but primarily it reflects the supervisors' assessment of the institution's AML risk. Other items that affect scope of AML inspections include the introduction of new products and changes in banks' AML systems. The supervision procedures work in three distinct, yet coordinated, ways: an off-site monitoring routine, Special Verifications, or targeted inspections and horizontal reviews. There were 65 inspections conducted in 2011.</p> <p>Anti-money laundering inspections include: a review of: financial institution anti-money laundering policies, organizational structure, procedures for identifying, analyzing and registering suspicious transactions, know-your-customer procedures, know-your-employee procedures, training policies and auditing. The supervisory manual, in conjunction with the detailed guidance provided by the BCB specialized unit on AML/CFT gives the inspector a thorough program for the inspection. In addition, the specialized unit also conducts inspections focusing on implementation of newly issued guidance, reviewing banks' AML monitoring systems, doing horizontal reviews on specific products and following-up on GAFI recommendations. The specialized unit and the inspector team for the bank work closely and consult regularly to coordinate AML activities.</p> <p>As part of the SRC, the bank risk for AML is rated on a scale of 1–4 to reflect the AML risk; factors covered are institutional policies, organizational structure, procedures and tools, and KYC. A review of inspection reports, follow-up letters to the banks on inspection report follow-up, scope letters sent to the bank requesting information to be made ready for the inspection confirms the active ongoing supervision of banks for AML risk.</p>
EC5	<p>The supervisor is satisfied that banks have enhanced due diligence policies and processes regarding correspondent banking. Such policies and processes encompass:</p> <ul style="list-style-type: none"> • gathering sufficient information about their respondent banks to understand fully the nature of their business and customer base, and how they are supervised; and • not establishing or continuing correspondent relationships with foreign banks that do not have adequate controls against criminal activities or that are not effectively supervised by the relevant authorities, or with those banks that are considered to be shell banks.
Description and findings re EC5	<p>See EC 2 and 4.</p> <p>In addition, current regulations provide criteria, to be followed by financial institutions authorized to operate and supervised by Central Bank, which ensure that relationships with shell banks are prevented.</p>

	<p>1) Title 1, Chapter 4, Section 3, item 7 of the International Capital and Foreign Exchange Market Regulation (RMCCI):</p> <p>“7. For the course of operations addressed by this section, the financial institutions and other institutions allowed to work by the Central Bank of Brazil, authorized to operate in the foreign exchange market, must adopt measures to know the AML procedures adopted by the foreign bank, counterparty in the operation, in order to comply with the recommendations of the Financial Action Task force (FATF) and make sure that it is not an institution that:</p> <p>a) does not have physical presence in the country in which is constituted and licensed; and</p> <p>b) is not affiliated to any financial services group that is subject to effective supervision.”</p> <p>2) Title 1, Chapter 13, Section 1, item 9A of the International Capital and Foreign Exchange Market Regulation (RMCCI):</p> <p>“9-A. Financial institutions, concerning cross-border relationships between corresponding banks and other similar relationships must:</p> <p>a) obtain sufficient information on the corresponding institution in order to fully understand the nature of its activity and know, from publicly available data, the reputation of the institution and the quality of its supervision, including if the institution was object of an investigation or action by supervisory authority related to money laundering or terrorism financing, and make sure that it is not an institution that:</p> <p style="padding-left: 40px;">I - does not have physical presence in the country in which is constituted and licensed; and</p> <p style="padding-left: 40px;">II - is not affiliated to any financial services group that is subject to effective supervision</p> <p>b) evaluate the AML/CFT controls adopted by the correspondent institution ;</p> <p>c) obtain the approval of the director in charge of operations related to the foreign exchange market before establishing new correspondent relationships;</p> <p>d) document the respective responsibilities of each institution as to combating money laundering and terrorism financing.”</p>
EC6	The supervisor periodically confirms that banks have sufficient controls and systems in place for preventing, identifying and reporting potential abuses of financial services, including money laundering.
Description and findings re EC6	See EC 2 and 4.
EC7	The supervisor has adequate enforcement powers (regulatory and/or criminal prosecution) to take action against a bank that does not comply with its obligations related to criminal activities.
Description and findings re EC7	As fully detailed in CP 23, the BCB has adequate enforcement authority to take supervisory action for violations of anti-money laundering regulations. In the past years there have been 13 sanctions (fines) applied.
EC8	<p>The supervisor must be satisfied that banks have:</p> <ul style="list-style-type: none"> • requirements for internal audit and/or external experts to independently evaluate the relevant risk management policies, processes and controls. The supervisor must have access to their reports; • established policies and processes to designate compliance officers at the management level, and appointed a relevant dedicated officer to whom potential abuses of the bank’s financial services (including suspicious transactions) shall be reported; • adequate screening policies and processes to ensure high ethical and professional

	<p>standards when hiring staff; and</p> <ul style="list-style-type: none"> ongoing training programs for their staff on KYC and methods to detect criminal and suspicious activities.
Description and findings re EC8	See EC 2 and 4.
EC9	<p>The supervisor determines that banks have clear policies and processes for staff to report any problems related to the abuse of the banks' financial services to either local management or the relevant dedicated officer or to both. The supervisor also confirms that banks have adequate management information systems to provide managers and the dedicated officers with timely information on such activities.</p> <p>Article 1 of BCB Circular 3461, Article 1 requires that banks must implement internal control policies and procedures designed to prevent the practice of crimes addressed in Law 9,613, of March 3, 1998. Among other things, the policies referred to in the head provision should define the criteria and procedures for selection, training and the monitoring of financial situation of the institution's employees.</p>
Description and findings re EC9	See EC 2 and 4.
EC10	Laws and regulations ensure that a member of a bank's staff who reports suspicious activity in good faith either internally or directly to the relevant authority cannot be held liable.
Description and findings re EC10	<p>Complementary Law 105 provides that it does not constitute a breach of secrecy to communicate to the competent authorities, including to the COAF, the practice of administrative or criminal offenses, including the supply of information on transactions involving proceeds from any criminal practice.</p> <p>Law 9613 provides that suspicious activity reports made in good faith to Coaf will not result in administrative and civil liability.</p>
EC11	The supervisor is able to inform the financial intelligence unit and, if applicable, other designated authority of any suspicious transactions. In addition, it is able, directly or indirectly, to share with relevant judicial authorities information related to suspected or actual criminal activities.
Description and findings re EC11	<p>The BCB must notify the competent authorities of signs of crimes against the public order, as well as of evidence of irregularities or illegal administrative offenses that have been noticed in the exercise of its legal authority of supervisor (Complementary Law 105).</p> <p>BCB must also send to Coaf information on customer identification data and value movements related to operations listed in Law 9.613,</p> <p>Moreover, Complementary Law 105, dated January 10, 2001, art. 1, §3, indent IV, states that it is not a violation of bank secrecy the communication to the competent authorities of criminal or administrative offenses including the purveyance of information concerning operations involving assets originating in any criminal practice.</p>
EC12	The supervisor is able, directly or indirectly, to cooperate with the relevant domestic and foreign financial sector supervisory authorities or share with them information related to suspected or actual criminal activities where this information is for supervisory purposes.
Description and findings re EC12	<p>The BCB must notify the competent authorities of signs of crimes against the public order, as well as of evidence of irregularities or illegal administrative offenses that have been noticed in the exercise of its legal authority of supervisor (Complementary Law 105).</p> <p>Complementary Law 105 also allows for the signing of agreements with:</p>

	<ul style="list-style-type: none"> • other domestic supervisory entities, in order to execute joint supervision works, and; • foreign central banks or supervisory entities for the following purposes: supervise branches and subsidiaries of foreign institutions in Brazil and of Brazilian institutions abroad, and mutual cooperation and information exchange for investigating activities or operations concerning the application, negotiation, hiding or transfer of financial assets and values related to illegal activities.
Additional criteria	
AC1	If not done by another authority, the supervisor has in-house resources with specialist expertise for addressing criminal activities.
Description and findings re AC1	Not applicable, criminal violations are addressed by COAF.
Assessment of Principle 18	Compliant
Comments	
Principle 19	Supervisory approach. An effective banking supervisory system requires that supervisors develop and maintain a thorough understanding of the operations of individual banks and banking groups, and also of the banking system as a whole, focusing on safety and soundness, and the stability of the banking system.
Essential criteria	
EC1	The supervisor has policies and processes in place to develop and maintain a thorough understanding of the risk profile of individual banks and banking groups.
Description and findings re EC1	<p>The BCB adheres to a risk based supervisory approach that is guided by a combination of the overarching SRC process (see below), onsite inspections and continuous monitoring. The approach employs the use of supervisory cycles (12 or 24 months) which are tailored to each institution based on its risk profile and accompanying quantitative ratings (CAER) and qualitative ratings. The approach is governed by a comprehensive Supervision Manual.</p> <p>The supervisory process is carried out mostly by DIFIS departments (those under the Deputy Governor for Supervision) except with licensing and authorizations which are under another Deputy Governor. In order to ensure full scope coverage of the banking system, Supervision uses the PAS to plan supervisory activities. Each of the supervisory departments participates in the planning process which includes programming oversight activities and budgeting.</p> <p>The planning and the prioritization of supervisory activities is based on a variety of factors: inputs and guidance from the Deputy Governor for Supervision and the Heads of Departments; macroeconomic scenarios; results of previous work in the institutions, SRC Committee - Corec; ongoing monitoring; and information from other areas of the BCB, international supervision bodies, government entities, and external auditors.</p> <p>The SRC is one of the key foundations of the supervisory process. SRC is a well-structured methodology for identifying and assessing the most relevant risks of an institution as well as the quality of internal controls and risk management systems. The SRC represents the beginning/end of an institution's supervisory cycle. The SRC, essentially a stocktaking exercise of the given bank, is an inspection and review process that accumulates all the information and targeted inspections which have occurred over the institution's supervisory cycle and completes the review of the institution by a full scope inspection that takes into consideration the events and results of the supervisory cycle that have gone before. The</p>

	<p>completion of the SRC triggers a comprehensive review, validation, and/or amendment of the given institution's supervisory results and forthcoming plan by the Corec. The result of the SRC feeds the planning and prioritization of oversight events over the course of the institution's next supervisory cycle thereby also maximizing the use of resources. Corec is composed of three to five members: Head of Department of Supervision of Banks and Banking Conglomerates, Deputy Head of the same, Head of Banking Division, Head of Division (Specialized and Dedicated Teams). Corec is also responsible for approving proposed inspections.</p> <p>In addition to the SRC, an institution will be subject to specified targeted inspections of various types which focus on trends, developments, specific risks, throughout the supervisory cycle. Supervision has in its portfolio of on-site procedures inspections to assess specific risks and to verify the compliance of institutions with laws and regulations. Supervision may also initiate inspections for examining specific situations in response to indications of possible noncompliance with laws or regulation; unfavorable trends identified during the continuous monitoring activity; or for following up on the implementation progress regarding corrective actions and inspection results. In addition to the planned supervisory events such as inspections, all institutions are subject to extensive and continuous ongoing monitoring.</p> <p>Supervision is organized in specialized teams: Credit, liquidity, market and operational risk; legal and fiscal issues; Validation (internal models); Basel II and III implementation; corporate governance and internal controls; IT; accounting; AML; foreign exchange; clients and users of financial institutions. Within the monitoring department there are divisions responsible for the ongoing monitoring also organized by specialization: credit risk; liquidity and market risks; securities markets; foreign exchange; systemic risk; financial stability; information quality and management.</p>
EC2	<p>The supervisor monitors and assesses trends, developments and risks for the banking system as a whole. The supervisor also takes into account developments in non-bank financial institutions through frequent contact with their regulators.</p>
Description and findings re EC2	<p>The monitoring of the financial system as a whole, targeted segments, conglomerates and institutions consists of a systematic and comprehensive monitoring of economic and financial information to detect situations or events outside expected patterns or parameters. Monitoring is conducted in the following ways: a) generation of information and analysis on the behavior of entities and segments by type of activity of the banking system; b) monitoring the trends of the banking system's aggregate balance sheet, results, and activities; c) early warning communications to supervision on relevant changes in the equity and financial structure of banking entities; and d) indication of shifting risks and potential changes in the operational strategy of institutions.</p> <p>Developments and concerns are exchanged amongst regulators through the vehicle Coremec, which coordinates, at a high level, the national regulators of the banking system, capital markets, and of pension and insurance. It is an advisory committee, comprising representatives of the BCB, CVM, Previc and Susep. The information-sharing agreements concluded between the BCB, CVM, Previc and Susep allow the BCB to have a regular exchange of specific supervisory information.</p>
EC3	<p>The supervisor uses a methodology for determining and assessing on an ongoing basis the nature, importance and scope of the risks to which individual banks or banking groups are exposed. The methodology should cover, inter alia, the business focus, the risk profile and the internal control environment, and should permit relevant comparisons between banks. Supervisory work is prioritized based on the results of these assessments.</p>
Description and	<p>An extensive continuous monitoring process (offsite) allows the Supervisor to track</p>

findings re EC3	information flows relating to banks or banking conglomerates from different sources such as regular reporting and information obtained directly from the institutions, data feeds from the various clearing entities or registrars, external information, etc. As well, the supervisor obtains institutional documents, reports, and other information obtained through regular contacts and meetings with senior management. This information flow allows Supervision to identify key changes in ownership structure, risk profile and positions, and strategies of institutions on a very current basis. The monitoring systems used allow manipulation of the data to graph and project results of an institution against those of another. These analyses are used in the decision making process related to supervisory responses and remedial actions. Also produced periodically, Score Monitoring Reports focus on the economic-financial situation of a bank and provide automated, updated inputs for the CAER ratings (Capital, Assets, Liabilities/Liquidity and Results) that are assigned by the offsite function.
EC4	The supervisor confirms banks' and banking groups' compliance with prudential regulations and other legal requirements.
Description and findings re EC4	Supervision also carries out the monitoring of regulatory operational limits (minimum Basel capital ratio, credit concentration limits, currency exposure) and trend analysis of operational limits and of credit, liquidity and market risks for the financial system and financial institutions. Any noncompliance or unusual trends are reported monthly by the Integrated Monitoring System (SIM) or by extraordinary communications as necessary. Such monitoring allows the detection of events and trends that signal the need for further monitoring or follow up by the supervisor(s).
EC5	The supervisor requires banks to notify it of any substantive changes in their activities, structure and overall condition, or as soon as they become aware of any material adverse developments, including breach of legal or prudential requirements.
Description and findings re EC5	Supervision is in regulator contact with banks and banking conglomerates through the regular supervisory process which sets out, through supervisory circular, regular contact requirements with management and boards based on risk profile and systemic importance of the institution. Furthermore, based on the supervisory cycle, the Supervisor regularly communicates inspection findings with management. Generation of early warning flags by the continuous monitoring system also trigger communication with the relevant party as necessary. Banks (management, Boards, and Audit Committees) are required to notify the Supervisor upon the occurrence of unusual events.
EC6	The supervisor has an adequate information system which facilitates the processing, monitoring and analysis of prudential information. The system aids the identification of areas requiring follow-up action.
Description and findings re EC6	<p>Indicated in EC 3, the BCB has very systematic and comprehensive offsite continuous monitoring system (called Variations) which is fed by (i) regulatory reporting from banks and (ii) by direct links to registration and settlement houses systems (BM&FBOVESPA and CETIP). Besides the registration and settlement services provided by these two companies, the SELIC system is run by BCB and exclusively registers and settles all transactions with Government bonds.</p> <p>All financial instruments are required to be registered in Brazil. Supervisory monitoring systems receive data feeds (next day) from these entities and monitor, on a bank by bank basis as well as by counterparty, the ongoing positions of the bank(s). This plus the regulatory reporting information combine to create a very comprehensive system which is monitored continuously.</p> <p>Various supervisory parameters, quite granular in nature, have been programmed into the systems which, in turn, trigger early warning signals upon exception. In addition, the onsite supervisory process also conducts regular monitoring. Depending on the nature of the early</p>

	<p>warning signal, the relevant staff or management is notified, which can go up to and include the BCB Board of Directors.</p> <p>In addition, Supervision has the Memory System and the Comment System. The Memory System allows supervisors to register, systematically and in a timely manner, the history of occurrences observed through supervisory work in institutions/conglomerates. The records remain available for consultation and support of the supervisory decision-making process. The Comment System provides relevant information about institutions/conglomerates under the supervision of BCB and provides input to the decision-making process.</p>
Additional criteria	
AC1	The supervisor employs a well defined methodology designed to establish a forward-looking view on the risk profile of banks, positioning the supervisor better to address proactively any serious threat to the stability of the banking system from any current or emerging risks.
Description and findings re AC1	The supervisory process for the banks, the SRC process, the continuous monitoring, the onsite monitoring and contact with the institutions, all combined, represent a comprehensive approach to monitoring the Brazilian banking system. The supervisors continually conduct surveillance of the institutions and discuss supervision results, planning, and strategy with management, boards, audit committees on a regular basis. This overall process provides the tools and the processes through which supervisors can detect developing risk and trends in the banking sector.
Assessment of Principle 19	Compliant
Comments	
Principle 20	Supervisory techniques. An effective banking supervisory system should consist of on-site and off-site supervision and regular contacts with bank management.
Essential criteria	
EC1	The supervisor employs an appropriate mix of on-site and off-site supervision to evaluate the condition of banks, their inherent risks, and the corrective measures necessary to address supervisory concerns. The specific mix may be determined by the particular conditions and circumstances of the country. The supervisor has policies and processes in place to assess the quality, effectiveness and integration of on-site and off-site functions, and to address any weaknesses that are identified.
Description and findings re EC1	<p>The BCB is in charge, with exclusivity, of the supervision of financial institutions. On-site and off-site supervision are run by the same entity, the BCB, but placed in different internal departments. Both teams share internal tools, for example, the SMM, which updates market and liquidity risk information on a daily basis and may be accessed by every on-site and off-site supervisor.</p> <p>The on-site and off-site supervisory and monitoring routines communicate with each other immediately after any suspicious situation is observed. The SIM is a tool designed to focus on the integration and information exchange between these two teams. Because of that, there is no particular frequency when information is communicated as it is a continuous process.</p> <p>Supervision is risk based and is conducted in an integrated and continuous manner, encompassing activities aimed at ensuring soundness and solvency. The onsite supervisory process is the primary point of supervision with the continuous monitoring system supporting the onsite process in addition to acting as a separate surveillance mechanism over the</p>

	institutions, conglomerates and the system as a whole.
EC2	The supervisor has in place a coherent process for planning and executing on-site and off-site activities. There are policies and processes in place to ensure that such activities are conducted on a thorough and consistent basis with clear responsibilities, objectives and outputs, and that there is effective coordination and information sharing between the on-site and off-site functions.
Description and findings re EC2	<p>The planning and implementation of on and off-site supervision are done according to the PAS. In the elaboration of PAS guidelines, strategies and goals for the supervisory area are established. At the end of the year, a communication is sent to the Board containing a summary of the planning. The PAS may be revised due to new and/or relevant developments raised from off-site monitoring and on-site examinations. The implementation of PAS is controlled by means of periodic reports. At the end of each year, a summary of what was performed, a type of “annual report,” is elaborated and published on the internal web portlet.</p> <p>Planning for institution specific onsite and offsite activities is a product of the SRC process, as mentioned above, a stocktaking process through which each institution is reviewed at the end of its supervisory review in a holistic manner by key constituents of the supervisory department(s). Risk rating reviews are conducted and plans for the subsequent supervisory cycle are discussed, amended, and/or agreed.</p>
EC3	<p>On-site work, conducted either by the supervisor’s own staff or through the work of external experts, is used as a tool to:</p> <ul style="list-style-type: none"> • provide independent verification that adequate corporate governance (including risk management and internal control systems) exists at individual banks; • determine that information provided by banks is reliable; • obtain additional information on the bank and its related companies needed for the assessment of the condition of the bank, the evaluation of material risks, and the identification of necessary remedial actions and supervisory actions, including enhanced off-site monitoring; and • monitor the bank’s follow-up on supervisory concerns.
Description and findings re EC3	<p>The Control and Risk Assessment System (SRC) is used to identify and assess most institutional risks as well as the quality of internal controls and risk management systems. Inherent in the SRC process as well as through the menu of different onsite inspections, oversight by boards, management and internal risk systems (i.e., governance) is continuously evaluated.</p> <p>Furthermore, the validation of information received by the supervisor is conducted through the continuous monitoring process (receipt, reconciliation, and monitoring of information and developing trends) as well as through the inspection process. Supervision may conduct targeted inspections in response to indications of possible noncompliance with laws or regulation, developing trends identified through the monitoring activity, or for following up on the implementation of corrective actions.</p> <p>The SRC and continuous monitoring process is specifically structured to ensure that risks are identified (by the supervisor and the bank) on a timely basis; that sufficient information is requested and analyzed to allow for timely risk identification; and that prompt follow up through the offsite or onsite process is conducted.</p>
EC4	<p>Off-site work is used as a tool to:</p> <ul style="list-style-type: none"> • regularly review and analyze the financial condition of individual banks using prudential reports, statistical returns and other appropriate information, including publicly available information;

	<ul style="list-style-type: none"> • follow up on matters requiring further attention, evaluate developing risks and help identify the priorities and scope of further work; and • help determine the priorities and scope of on-site work.
Description and findings re EC4	<p>The process of off-site supervision uses regulatory and managerial bank generated reports to continuously analyze the financial and capital positions and condition of the institutions as well as the nature and trends of risk exposures. In addition to the information produced by the institutions, Supervision also receives information from financial transactions registrars, clearing and custodial systems (including on derivatives). As indicated, virtually all financial instruments are registered in Brazil allowing the BCB to interface and pull transaction history and detail for specific products, by institution and counterparty. This allows the supervisor to monitor the cash flows of the institutions, evaluate key positions, and detect off-market or out-of-the-ordinary transactions and trends. Using this information, the Supervisor can recreate key positions of the banks and analyze selected events. In addition, this information can be manipulated and presented in a variety of ways—graphically, by peer group, etc. This information database and management system is front and center to the ability of supervision to understand and monitor the institutions on an ongoing basis and to generate early warning signals. This information is streamlined and automatically generated by the system and includes early warnings flagged according to embedded parameters (which adjust according to the risk factors of the institution). In addition, the dedicated onsite supervisors provided ongoing oversight using this systems information, bank specific reports, and ongoing contact with the bank and relevant parties. If any concerns arise as a result of either continuous monitoring by the system or ongoing surveillance by the supervisors, contact with the institution(s) occurs without delay.</p> <p>The monitoring of the correction plan by the supervisor is performed with the use of the SMF, which is the record of the history of occurrences of observed institutions, kept available for consultation and to aid in the decision-making process of the supervisor. All information generated as described, in addition to onsite supervisor events, is used in the supervisory planning process—for both the supervisory effort as a whole and for institution specific supervisory cycles.</p> <p>As a part of continuous monitoring activities, meetings between the Supervisor and the external auditors are held on a regular basis. The external auditor’s reports are also examined. In addition, according to Resolution 3198, the external auditor has a duty to inform the BCB, within three days, about the existence or evidence of errors, breached banking rules and laws or frauds that pose risks to the financial institution on an ongoing concern basis, and any fraud carried out by management/employees identified during the audit procedures which results in relevant errors in the financial statements.</p>
EC5	Based on the risk profile of individual banks, the supervisor maintains sufficiently frequent contacts as appropriate with the bank’s Board, non-executive directors, Audit Committee and senior and middle management (including heads of individual business units and control functions) to develop an understanding of and assess such matters as strategy, group structure, corporate governance, performance, capital adequacy, liquidity, asset quality and risk management systems.
Description and findings re EC5	The Supervisory Manual clearly enumerates the individuals (board members, audit committees, heads of risk management, internal audit, etc.) that must be met during the supervisory cycle or at least annually. The frequency of these meetings will depend on the priority assigned to each institution by Supervision and on the type of action to be performed, whether annually, semi-annually or quarterly. Event triggered communication (as a result of early warnings, ongoing surveillance, or inspections) is also conducted by supervision. The

	<p>higher the risk category of the bank, the more communication will intensify. The largest banks/conglomerates are, by definition, considered high risk and therefore received elevated supervisory attention on an ongoing basis.</p> <p>Whenever necessary, the unit responsible for off-site monitoring keeps contact with the person responsible, in the institutions, for the production and remittance of information to the BCB, and schedules meetings with market representatives to assess the situation and the perspectives of the financial system.</p>
EC6	On an ongoing basis during on-site and off-site supervisory activities, the supervisor considers the quality of the Board and management.
Description and findings re EC6	The performance of the Board of Directors, the Executive Board and the Audit Committee is evaluated through a number of on-site activities, including regular meetings. The AC includes an annual meeting with the executives and with the Board of Directors as well as meetings with executives of the areas of risk management, controls and business. Through its ongoing supervisory process, the BCB is regularly meeting with bank management; meetings with the Board are called in the case of exceptional issues which require elevated attention.
EC7	The supervisor evaluates the work of the bank's internal audit function, and determines whether, and to what extent, it may rely on the internal auditors' work to identify areas of potential risk.
Description and findings re EC7	<p>Resolution no. 2.554, of 1998, states that internal audit is part of the internal controls system. The performance of the internal audit is evaluated in the SRC assessment and in other VEs. In these assessments, the supervisor requests and takes in consideration the work of the internal audit and meets with their representatives to better understand the work carried out in the area under review and its conclusions. The opinion formed in this evaluation is applied to better focus the scope and the depth of on-site examinations.</p> <p>The AC allows the BCB to receive Internal and External Audit annual plans and the report of accompanying notes.</p>
EC8	The supervisor communicates to the bank the findings of its on- and off-site supervisory analyses by means of written reports or through discussions or meetings with management.
Description and findings re EC8	<p>The initial results of inspections are conveyed, at the end of the process, to management. Thereafter, final results are presented through an examination letter. At least once during the supervisory cycle, Supervision meets with the board of directors to communicate observations, concerns, plans, etc. During the supervisory cycle, periodic communication occurs regarding any issues that may arise from the continuous monitoring process. Depending on the nature or seriousness of the irregularities identified in process, the opening of punitive administrative procedures may be proposed.</p> <p>As a disciplinary instrument, there is the "term of attendance", which can be triggered by the results of an inspection, used to summon the legal representatives of the supervised institution, and in some cases, the controlling shareholders depending on the gravity of the situation (for instance, insufficient capital or unsafe and unsound operating condition). By means of the term of attendance a commitment is entered by the managers and controllers for corrective action.</p>
Additional criteria	
AC1	The supervisor meets periodically with senior management and the Board to discuss the results of supervisory examinations and the external audit. The supervisor should also meet separately with the independent Board members, as necessary.
Description and findings re AC1	As described above, the results of supervisory examinations and the overall supervisory process are conveyed to senior management on a regular basis. Formally scheduled

	meetings with the board, audit committees, and senior management are required at least annually. Meetings with independent members may be requested at any time, as necessary. As a practice, however, meetings with only independent board members do not occur frequently.
Assessment of Principle 20	Compliant
Comments	As indicated in AC 1 above, the Supervisor could consider incorporating into supervisory procedures—as a matter of practice - meeting with independent Board members to discuss results of supervision and issues of concern. In addition to possibly obtaining additional information of supervisory interest, this could help to elevate the stature of these members as well as to continue to convey and reinforce the Supervisor's view on the role and importance of the Board.
Principle 21	Supervisory reporting. Supervisors must have a means of collecting, reviewing and analyzing prudential reports and statistical returns from banks on both a solo and a consolidated basis, and a means of independent verification of these reports, through either on-site examinations or use of external experts.
Essential criteria	
EC1	The supervisor has the power to require banks to submit information, on both a solo and a consolidated basis, on their financial condition, performance, and risks, at regular intervals. These reports provide information on such matters as on- and off-balance sheet assets and liabilities, profit and loss, capital adequacy, liquidity, large exposures, asset concentrations (including by economic sector, geography and currency), asset quality, loan loss provisioning, related party transactions, interest rate risk and market risk.
Description and findings re EC1	<p>The Banking Law requires financial institutions to provide the data or reports deemed necessary by the BCB to perform its duties. Resolution 2723 requires banks to prepare their financial statements on a consolidated basis including their participation in companies located in the country and abroad. In order to assess the risk of an economic group on a consolidated basis, the Resolution requires reporting on all non-financial companies that are members of the financial conglomerate and/or economic group. Resolution 3490 requires the exposure of affiliates and of equity investment in financial institutions, domestically and abroad, to be in the calculation for minimum total capital. Circular 3402 empowers Supervision with the authority to request information as needed, on non-specified dates. As a result, the BCB can request and receive information whenever deemed necessary.</p> <p>The BCB collects information on concentration of assets by economic sector through the Financial and Economic Statistics (Estfin), by geographic sector through the Banking Statistics per Municipality (Estban) documents, and by currency through the IFT.</p> <p>Resolution 2723 provides the authority to the Supervisor to request information of non-financial companies (insurance, pension funds) from their financial controlling shareholder, and it is a practice of supervision to request such information.</p> <p>There is a specific procedure in the VE-Internal Control (targeted examination) in order to evaluate the institution's performance in providing regulatory reports and its compliance with other demands from the BCB.</p>
EC2	The supervisor provides report instructions that clearly describe the accounting standards to be used in preparing supervisory reports. Such standards are based on accounting principles and rules that are widely accepted internationally.
Description and findings re EC2	The BCB establishes the accounting standards to be followed by supervised institutions through the Accounting Plan of National Financial System Institutions (Cosif), Circular 1273.

	<p>This plan is in line with the Fundamental Principles and the accounting standards issued by the CFC, the Federal Accounting Council and is endorsed by CMN.</p> <p>Resolution 3786 determines that financial institutions listed as public companies or those required to implement an Audit Committee detail and annually disclose consolidated financial statements based on international accounting standards issued by the IASB as of December 31, 2010. The BCB is implementing a strategic project called Reduction of Asymmetries in order to harmonize the national accounting standards and IFRS, on a solo basis.</p> <p>Regarding regulatory reporting, Cosif is the basic mandatory chart of accounts. It was instituted in December, 1987 and is continuously updated. Other mandatory charts have been created as necessary. The rules, instructions and layouts for all of them are available on the Internet, as well as by means of communication with the Supervisory Team.</p>
EC3	<p>The supervisor requires banks to utilize valuation rules that are consistent, realistic and prudent, taking account of current values where relevant.</p>
Description and findings re EC3	<p>General rules of accounting evaluation are described in the Cosif. Specific regulations deal with the procedures of marking to market, such as Circular 3068 (securities) and Circular 3082 (derivatives).</p> <p>Supervision evaluates the procedures and criteria used by institutions to revalue assets using market prices and verifies the values reported by the institutions in the securities (marked to market) portfolio. The instructions for completing the documents accompanying the Statement of Daily Monitoring in the components of: DDR, DRM and DRL require that institutions report their positions on a marked to market basis.</p> <p>Relevant discrepancies between asset positions in certain instruments and the values reported in the financial statements are flagged for investigation with the institutions.</p> <p>There are several procedures enumerated in the Continuous Monitoring Manual to ensure that supervisors assess the quality of the accounting policies and pricing process of the assets. The Manual establishes the frequency with which to perform this activity according to supervision priority matrix and the sources of information to be used in the analysis.</p>
EC4	<p>The supervisor collects and analyses information from banks at a frequency (e.g., monthly, quarterly and annually) commensurate with the nature of the information requested, and the size, activities and risk profile of the individual bank.</p>
Description and findings re EC4	<p>Circular 3402 enumerates the requiring reporting and submissions and the deadlines therein. In general, reports are standardized but their periodicity and scope can be different depending on the type of institution and the amount of risk that it is exposed to, for example:</p> <p>DDR—daily monitoring report of capital components and requirements. Only banks and institutions with large exposures (more than 5 percent of capital or more than R\$3,000,000.00) are obligated to report;</p> <p>DLO—monthly report of compliance with operational limits. All institutions are required to report. However, smaller institutions (with total assets or credit provided below R\$100,000,000.00) report less detailed information.</p> <p>Information on exposure to market risk is collected daily and monthly. In addition, daily reports of transactions recorded in clearinghouses are collected and used for specific analyses of market risk and also in the monthly reconciliation of the information.</p> <p>Information related to liquidity risk is received every day from central custody and monthly from institutions as are balance sheets and the DRL.</p>

	<p>Credit transaction information is reported monthly by means of the SCR.</p> <p>Cosif: banks file reports monthly or quarterly, pursuant to Circular 3402. Reports are to be filed monthly when the total credit provided exceeds R\$100,000,000.00, otherwise, only quarterly.</p> <p>For institutions on the watch list, special monitoring can be required to supplement regular reporting.</p>
EC5	In order to make meaningful comparisons between banks and banking groups, the supervisor collects data from all banks and all relevant entities covered by consolidated supervision on a comparable basis and related to the same dates (stock data) and periods (flow data).
Description and findings re EC5	Comparisons between banks and banking groups (i.e. the financial conglomerate versus the economic conglomerate) are one element of the aforementioned continuous monitoring system. Through this process, the early warning system generates automatic Variations in accounting variables and ratios and automatic scores for each individual bank or bank conglomerate—comparing institutions with its peer group at a point in time or studying the evolution of the monitored entity through time. Each automatic warning signal must be addressed by an analyst who decides whether it should be sent as an early warning to the Supervision department.
EC6	The supervisor has the power to request and receive any relevant information from banks, as well as any of their related companies, irrespective of their activities, where the supervisor believes that it is material to the financial situation of the bank or banking group, or to the assessment of the risks of the bank or banking group. This includes internal management information.
Description and findings re EC6	<p>See EC 1 above.</p> <p>For those other related parties, which do not match the criteria for consolidation as established at Resolution no. 2723, there are disclosure requirements for transactions and outstanding balances with such parties, according to IAS 24 – Related Party Disclosures, incorporated to the local regulations by means of Resolution no. 3750.</p>
EC7	The supervisor has the power of full access to all bank records for the furtherance of supervisory work. The supervisor also has similar access to the bank's Board, management and staff, when required.
Description and findings re EC7	<p>See EC 1, 4, 6 above.</p> <p>Resolution no. 2901/ 2001 establishes that contracts signed between the institution(s) and boards, service providers, and external auditors have in the contract(s) specific language authorizing the BCB full access, at any time, to the work performed therein.</p>
EC8	The supervisor has a means of enforcing compliance with the requirement that the information be submitted on a timely and accurate basis. The supervisor determines that the appropriate level of senior management is responsible for the accuracy of supervisory returns, can impose penalties for misreporting and persistent errors, and can require that inaccurate information be amended.
Description and findings re EC8	<p>Failure to provide or providing incorrect information, in violation of the terms and conditions established by the laws and regulations, subjects the financial institutions as well as their administrators to penalties (Resolution 3883 and Resolution 1065). Failure to comply within the deadline given for clarification of information provided or for certain procedures is considered an incorrect supply of information or non-observance of procedures.</p> <p>Some norms determine the designation of a director responsible for supplying the information. In addition, there are remedial powers addressed in more detail in Principle 23.</p> <p>The BCB has regular contact with the institutions regarding questions and details about reports submitted and may apply remedial action in the relevant situations.</p>

EC9	The supervisor utilizes policies and processes to confirm the validity and integrity of supervisory information. This includes a programme for the periodic verification of supervisory returns by means either of the supervisor's own staff or of external experts.
Description and findings re EC9	The BCB has processes for the continuous verification of the validity and integrity of information provided by institutions. A large part of the validation is carried out at the moment of delivery, through internal consistency tests and validation rules. As a result, the institution may be requested to confirm data or even change the document. The Supervisor also validates the data received from supervisory field work.
EC10	The supervisor clearly defines and documents the roles and responsibilities of external experts, including the scope of the work, when they are appointed to conduct supervisory tasks and monitors the quality of the work. External experts may be utilized for routine validation or to examine specific aspects of banks' operations.
Description and findings re EC10	When performing supervision activities, BCB only uses experts that belong to its own staff. In certain situations, BCB requires the external auditor to perform additional procedures or assurance engagements. However, these engagements do not replace the legal obligations and responsibilities of the Supervisor.
EC11	The supervisor requires that external experts bring to its attention promptly any material shortcomings identified during the course of any work undertaken by them for supervisory purposes.
Description and findings re EC11	See EC10
Assessment of Principle 21	Compliant
Comments	
Principle 22	Accounting and disclosure. Supervisors must be satisfied that each bank maintains adequate records drawn up in accordance with accounting policies and practices that are widely accepted internationally, and publishes, on a regular basis, information that fairly reflects its financial condition and profitability.
Essential criteria	
EC1	The supervisor has the power to hold bank management and the bank's Board responsible for ensuring that financial record-keeping systems and the data they produce are reliable.
Description and findings re EC1	Resolution 3198 requires that financial institutions appoint a director who is technically qualified to be responsible for the monitoring, supervision and compliance with norms regarding accounting procedures and external audit adequacy. The appointed director is held responsible for the information provided and any fraud, negligence or malpractice in performing his or her duties. The director is also responsible for responding to the Supervisor on any matters regarding the same. The abovementioned resolution lists the responsibilities of the Audit Committee, among which is reviewing, before publication, the semiannual financial statements including explanatory notes, management reports and the external auditor's opinion. Circular 1273 which established the Cosif (financial institution accounting (regulatory) requirements), holds the director in charge of the accounting department responsible for compliance with the required standards, basic accounting principles, and professional ethics and banking secrecy rules.

	<p>The parent institution is responsible for the preparation and submission of consolidated financial statements to the BCB. The director in charge of the accounting department of the leading institution is, ultimately, held responsible for the reliability of the consolidated financial statements and also for the timeliness of its delivery to the BCB.</p> <p>Resolution 3198 also holds the managers of financial institutions responsible for hiring external auditors who do not meet the requirements provided in the regulation annex to Resolution 3198, which addresses primarily auditor independence.</p> <p>The Supervisor, by means of the SRC , evaluates:</p> <ul style="list-style-type: none"> i) The effectiveness of the Board of Directors actions regarding the disclosure of timely and precise information on the relevant issues related to the institution; ii) The performance of the Audit Committee, in the internal and external audits evaluation; and, iii) The performance of the Fiscal Council (high level council appointed by minority shareholders) regarding its legal responsibilities. <p>The Supervision Manual directs the execution of VEs of the Audit Committee and of Corporate Governance through which the responsibilities of Senior Management and Audit Committee in providing reliable financial statements are evaluated.</p>
EC2	The supervisor has the power to hold bank management and the bank's Board responsible for ensuring that the financial statements issued annually to the public receive proper external verification and bear an external auditor's opinion.
Description and findings re EC2	<p>All financial institutions are required to publish semiannual, audited financial statements.</p> <p>All financial institutions are obliged to publish financial statements under Cosif rules. Circular 2804 (annex 1) presents the procedures for such publications, including periodicity, channels of disclosure, templates and the requirement of an external auditor's opinion.</p> <p>Resolution 3198 (annex 3) obliges financial institutions to obtain an external auditor's opinion on the financial statements published under Cosif rules. This Resolution consolidates the rules relating to services provided by external auditors.</p> <p>Regarding the publication of IFRS statements, Resolution 3786 (annex 3) defines the institutions required to prepare and publish such statements (annual basis) and also sets out the requirements for an external auditor's opinion. This requirement is targeted to financial institutions listed as public companies or those required to implement an Audit Committee.</p>
EC3	The supervisor requires banks to utilize valuation rules that are consistent, realistic and prudent, taking account of current values where relevant, and to show profits net of appropriate provisions.
Description and findings re EC3	See CP 21, EC 3.
EC4	Laws or regulations set, or the supervisor has the power, in appropriate circumstances, to establish, the scope of external audits of individual banks and the standards to be followed in performing such audits.
Description and findings re EC4	<p>The norms that regulate the work of external auditors are established by resolutions issued by the CFC. The CFC approves the Brazilian Accounting Norms (NBC) which result from official translations of International Standards on Auditing (ISA) done by the Ibracon. External audits are required to be conducted consistent with ISA – International Standards for Auditing.</p> <p>Resolution 3198 (Annex) defines the responsibility of the external audit process which</p>

	encompasses audit of the accounting statements, including explanatory notes, and the IFT. Supervision reviews external audit activity semi-annually.
EC5	Supervisory guidelines or local auditing standards determine that audits cover such areas as the loan portfolio, loan loss reserves, non-performing assets, asset valuations, trading and other securities activities, derivatives, asset securitizations, and the adequacy of internal controls over financial reporting.
Description and findings re EC5	<p>External auditors must follow the standards set forth by ISA as endorsed by the CFC (Brazilian Accounting Council).</p> <p>The BCB has the power to determine specific services to be performed by external audit in the institutions. More specifically, Circular 3467 grants the BCB the power to direct of complementary examinations according to findings in the institutions.</p>
EC6	The supervisor has the power to reject and rescind the appointment of an external auditor that is deemed to have inadequate expertise or independence, or not to be subject to or not to follow established professional standards.
Description and findings re EC6	<p>The BCB has the power to direct a change of external auditors only during the processing of a PAP (remedial action (see CP 23)) according to Law 9447, Law 6024, and Decree-Law 2321 (temporary special administration regime). In such cases, once the PAP is initiated, the BCB may direct replacement of the existing audit firm or auditor.</p> <p>Circular 3467 grants the BCB, in specific cases, the power to demand the review of the work performed by an external auditor by another external auditor but does not grant the power of rejecting or substituting the auditors chosen by the institution.</p> <p>Since 2008, Supervision has set up four PAPs against audit firms. The reason for this was the lack of notes in the audit report which (should have) referred to significant deficiencies identified in the financial statements.</p>
EC7	The supervisor requires banks to produce annual audited financial statements based on accounting principles and rules that are widely accepted internationally and have been audited in accordance with internationally accepted auditing practices and standards.
Description and findings re EC7	<p>Resolution 3786 establishes that the financial institutions listed as public companies or which are required to establish an Audit Committee, must, from December 31, 2010, prepare and disclose annually consolidated financial statements using IFRS which have been audited by an external auditor. Regulatory reporting, on the other hand is presented according to Cosif which prescribes accounting standards for financial institutions. Since 2008, BCB has been conducting an Accounting Convergence Project for the purpose of evaluating the differences between the local and international accounting rules (IFRS), as separate financial statements are concerned. The goal of the project is to obtain a convergence of domestic rules applied to general purpose financial statements of banks (Cosif) to IFRS. Recently, some IFRS standards have been incorporated into Cosif:</p> <ul style="list-style-type: none"> • IAS 39: Derecognition of a Financial Asset (Resolution 3533) • IAS 37: Provisions, Contingent Liabilities and Contingent Assets (Resolution 3823) • IAS 36: Impairment of Assets (Resolution 3566) • IFRS 2: Share Based Payment (Resolution 3989) <p>In general, particularly regarding provisioning, Cosif standards result in more conservative figures.</p> <p>Supervision verifies compliance with the abovementioned norms in on-site examinations and in off-site monitoring.</p>

EC8	Laws, regulations or the supervisor require periodic public disclosures of information by banks that adequately reflect the bank's true financial condition. The requirements imposed should promote the comparability, relevance, reliability and timeliness of the information disclosed.
Description and findings re EC8	<p>Law no. 6404 determines that, at the end of each year, the Board of Directors must prepare financial statements that clearly detail the company's assets and liabilities and the variations in equity over the year. Such statements must be complemented by any additional information needed to clarify the statements. All banks licensed by the BCB are subject to this Law.</p> <p>Section 22 of the Cosif (Elaboration and Publication of Financial Statements of basic norms) consolidates the norms related to the periodic disclosure of information, such as Circular 2804 which establishes guidelines for the publication of financial statements.</p> <p>Circular 3477 requires that financial institutions disclose information concerning risk management, minimum capital requirement, and the adequacy of capital.</p>
EC9	The required disclosures include both qualitative and quantitative information on a bank's financial performance, financial position, risk management strategies and practices, risk exposures, transactions with related parties, accounting policies, and basic business, management and governance. The scope and content of information provided and the level of disaggregation and detail should be commensurate with the size and complexity of a bank's operations.
Description and findings re EC9	<p>Disclosure requirements are set forth in several Resolutions and Circulars:</p> <p>Circular 3.477 (annex 4) requires disclosure of risk management structures and functions, regulatory capital, minimum required capital by type of risk and exposures (market, credit, operational risks and IRR). Additionally, this Circular requires banks to have a disclosure policy with defined responsibilities. There are different frequencies of disclosures, some information must be disclosed quarterly (quantitative), others semiannually or annually;</p> <p>Resolution 3464 (annex 5) requires the implementation of a market risk management structure and also requires banks to publish (at least annually) information on the market risk structure together with the financial statement.</p> <p>Resolution 3380 (annex 6) requires the implementation of an operational risk management structure and requires banks to publish (at least annually) a description of such together with the financial statement.</p> <p>Resolution 3721 (annex 7) requires implementation of a credit risk management structure and banks to publish (at least annually) a description of such together with the financial statement.</p> <p>Resolution 3988 (annex 8) requires implementation of a capital management structure and also requires banks to disclose (at least annually) a description of its capital management structure.</p>
EC10	Laws, regulations or the supervisor provide effective review and enforcement mechanisms designed to confirm compliance with disclosure standards.
Description and findings re EC10	<p>Circular 2804 empowers the Supervisor to demand the republication of financial statements that were not made according to the established rules.</p> <p>Circular 3477 holds a (executive) director responsible for the information disclosed. The BCB has also adopted the IAS 8 – Accounting Policies, Changes in Accounting Estimates and Errors, effective from 1.1.2012, by Resolution 4007.</p> <p>If, in practice, the Supervisor determines that significant adjustments to the disclosed financial</p>

	are required, most likely through an onsite inspection, the bank is required to notify the public about such an event. In experience, such notifications have occurred through a note to the financial statement rather than through republication of the statement itself.
EC11	The supervisor or other relevant bodies publish aggregate information on the banking system to facilitate public understanding of the banking system and the exercise of market discipline. Such information includes aggregate data on balance sheet indicators and statistical parameters that reflect the principal aspects of banks' operations (balance sheet structure, capital ratios, income earning capacity, and risk profiles).
Description and findings re EC11	The BCB releases on its website analytical accounting information aggregated by type of institution. Another publication which presents aggregate data is the Financial Stability Report of the BCB. Besides the aggregate information, the BCB also publishes registry information and financial statements of individual institutions and financial conglomerates, on its website.
Additional criteria	
AC1	The supervisor meets periodically with external audit firms to discuss issues of common interest relating to bank operations.
Description and findings re AC1	The Supervisor meets with the external auditor during on-site examinations to examine the paperwork and understand the auditing procedure. During the continuous monitoring process, Supervision has periodic meetings with the external audit executives.
AC2	External auditors, whether or not utilized by the supervisor for supervisory purposes, have the duty to report to the supervisor matters of material significance, for example failure to comply with the licensing criteria or breaches of banking or other laws, or other matters which they believe are likely to be of material significance to the functions of the supervisor. Laws or regulations ensure that auditors who make any such reports in good faith cannot be held liable for breach of a duty of confidentiality.
Description and findings re AC2	Resolution 3198 (Annex) establishes that the external auditor and the Audit Committee must formally communicate to the Supervisor, within three working days of identification, evidence of error or fraud identified in specific situations. Supervision verifies such reporting.
AC3	Laws, regulations or the supervisor require banks to rotate their external auditors (either the firm or individuals within the firm) from time to time.
Description and findings re AC3	Resolution 3198 (Annex) amended by Resolution no. 3606/2008 and Circular-Letter 3367 requires financial institutions to replace the technical person in-charge(akin to auditor-in-charge),director, manager, supervisor and any other professional in a managing position involved in the relevant institution's external audit work after the issuance of five complete annual reports. The Supervision Manual directs that the Supervisor should verify the rotation of the staff.
AC4	The supervisor requires banks to have a formal disclosure policy.
Description and findings re AC4	Circular 3477 requires that institutions must have a formal policy for the disclosure of information approved by the Board. The disclosure policy must specify: the information to be disclosed, the internal controls system applied to the information release process, the establishment of a continuous assessment process of the reliability and adequacy of the information released, as well as describe the relevance criteria applied to the releasing information.
AC5	The supervisor has the power to access external auditors' working papers, where necessary.
Description and findings re AC5	Resolution 3198 states that contracts between financial institutions and the respective external auditors must have a specific clause granting access to the BCB, at any time, to external auditors' workpapers as well as to any other document that has been used in the course of issuing bank related reports. As a matter of practice, Supervision requests auditors' workpapers in order to assist in the

	scoping and review process of on and off-site analysis.
Assessment of Principle 22	Compliant
Comments	
Principle 23	Corrective and remedial powers of supervisors. Supervisors must have at their disposal an adequate range of supervisory tools to bring about timely corrective actions. This includes the ability, where appropriate, to revoke the banking license or to recommend its revocation.
Essential criteria	
EC1	The supervisor raises supervisory concerns with management or, where appropriate, the Board, at an early stage, and requires that these concerns are addressed in a timely manner. Where the supervisor requires the bank to take significant remedial actions, these are addressed in a written document to the Board. The supervisor requires the bank to submit regular written progress reports and checks that remedial actions are completed satisfactorily.
Description and findings re EC1	<p>The BCB has the following enforcement powers: corrective; prudential (preventive measures); sanctioning and intervention/resolution. Law 4595 establishes that the BCB is responsible for banking surveillance to identify and require corrective action for violations and unsafe and unsound banking practices, including inadequate risk management and internal control deficiencies.</p> <p>The prudential enforcement power of the BCB encompasses both preventive power and resolution/liquidation. Resolution 4019 establishes a set of preventive enforcement measures that may be undertaken by the BCB in order to preserve the soundness, the stability, as well as the regular functioning of the bank. Resolution 4019 greatly increased the ability of the BCB to require early correction of issues identified through its supervisory process by making it possible to require correction based on judgmental views on the adequacy of internal controls, corporate governance and not having to wait until the bank condition deteriorated to be able to require corrective action.</p> <p>Resolution power is based on the “temporary special administration regime”, “intervention” and “extrajudicial liquidation” prescribed in the following: Law 6024, Decree-Law 2321 and Law 9447.</p> <p>The sanctioning (punitive) process is initiated by the supervisory staff to be filed against institutions, their managers or their external auditors. Its application is initiated by a procedure, called “Punitive Administrative Process”, which is regulated by Law 9784. The penalties established by federal laws (Banking Law, Law 9613 and Law 4131) include: (i) warnings; (ii) fines; (iii) suspension of managers; (iv) temporary disqualification to hold executive positions and (v) cancellation of the license to operate.</p> <p>B) Supervisory Tools and Use</p> <p>Whenever the findings of the supervisory process only denote minor deficiencies, they are communicated and appropriate corrections required through an “inspection letter” sent to the financial institution.</p> <p>In more severe cases, the supervisory staff summons the managers and the majority shareholders of the financial institution, through an “attendance order”. The objective is to discuss the problems and the possible solutions, and also to define a deadline for the institution to present a corrective action plan. This plan and its timeline must be approved and followed-up by BCB. When carrying out its duties, the supervisory staff may directly contact any department or employee of the financial institution.</p> <p>In order to prevent the deterioration of the financial situation of the institutions and protect the</p>

	<p>regular functioning of the Brazilian financial system, BCB may determine the following preventive prudential measures: 1. Adoption of additional controls and procedures. 2. Reduction of the risk of exposures. 3. Increase of the minimum capital level. 4. More restrictive operational limits. 5. Increase of liquidity level. 6. Restriction to manager's income, as well as to payments to shareholders. <i>However, existing law requires that banks pay a minimum of 25 percent of their net profits as dividends.</i> The BCB cannot reduce that floor in a supervisory action. 8. Restriction to operations, acquisitions and opening new branches. 9. Sale of assets.</p> <p>It is important to point out that supervision tools may be applied independently of each other and do not have to be applied sequentially providing the BCB optimal flexibility. In choosing the most adequate administrative action, supervision staff must consider the nature, extent, severity, relevance and contumacy of the situation observed in the supervised institution. The decision is taken according to a discretionary assessment of the circumstances in each case. The authority to take such decisions varies according to the instrument. For example: attendance orders require, at least, the approval of the Head of Division responsible for the supervision of the institution, while the application of an administrative punitive process is decided by a committee composed by members of the BCB.</p> <p>Additionally, if severe and continuous breaches are verified, inconsistent information is submitted, or non-conformity to procedures related to foreign exchange operations are found, the BCB may impose the penalties established by the Banking Law and by Law 9613.</p> <p>In extreme cases, such as a severe impairment of assets or a continuous breach of regulations by the financial institution, BCB can adopt resolution tools and declare the "intervention", "extrajudicial liquidation" or "temporary special administration regime" (Law 6024, Decree-law 2321, and Law 9447).</p>
EC2	The supervisor participates in deciding when and how to effect the orderly resolution of a problem bank situation (which could include closure, or assisting in restructuring, or merger with a stronger institution).
Description and findings re EC2	The BCB is responsible for initiating resolution of an institution and coordinating the involvement of the FGC (see EC1).
EC3	The supervisor has available an appropriate range of supervisory tools for use when, in the supervisor's judgment, a bank is not complying with laws, regulations or supervisory decisions, or is engaged in unsafe or unsound practices, or when the interests of depositors are otherwise threatened. These tools include the ability to require a bank to take prompt remedial action and to impose penalties. In practice, the range of tools is applied in accordance with the gravity of a situation.
Description and findings re EC3	<p>A review of supervision files disclosed instances where the BCB employed the enforcement tools provided by Resolution 4019 acting in advance, imposing dividend restrictions and requiring managers to restore the institution's liquidity levels. The BCB places banks under enforcement or corrective action requirements on a watch list and are subject to increased monitoring. The main aspects of the monitoring are: the observance of the established corrective action deadlines, the implementation of a regularization plan, the monitoring carried out by the independent auditor and timely reporting.</p> <p>Eventually, if the bank is not able to overcome its deficiencies, resolution measures are implemented such as "intervention" or "extrajudicial liquidation" or the "temporary special administration regime".</p>
EC4	The supervisor has available a broad range of possible measures to address such scenarios as described in EC 3 above and provides clear prudential objectives or sets out the actions to be taken, which may include restricting the current activities of the bank, withholding approval of new activities or acquisitions, restricting or suspending payments to shareholders or share repurchases, restricting asset transfers, barring individuals from banking, replacing or

	restricting the powers of managers, Board directors or controlling owners, facilitating a takeover by or merger with a healthier institution, providing for the interim management of the bank, and revoking or recommending the revocation of the banking license.
Description and findings re EC4	<p>As mentioned above, according to Resolution 4019, BCB may require banks to adopt additional amounts of regulatory capital, to restrict current or new activities, acquisitions and payments to shareholders as preventive measures to situations that can put the bank's stability at risk, like the deterioration or the perspective of deterioration of its financial and economic situation. The BCB is also in the process of implementing capital premiums based on its risk rating system (CAER).</p> <p>In addition, the resolution measures below are decided by the BCB's Board of Directors and decreed by the BCB's Governor, based on the proposition of the Supervisory staff.</p> <ol style="list-style-type: none"> i. Actions that require appropriate measures to be taken by controlling shareholders in order to solve problems detected through the capitalization, the transferring of control, merger and other restructuring processes. ii. The temporary special administration regime, conducted on a "going concern" basis, carried out by a Directors Council appointed by the BCB. iii. The regime of Intervention, conducted on a "going concern" basis, carried out by an intervenor, appointed by the BCB. iv. The extrajudicial liquidation regime, conducted by a liquidator, appointed by the BCB. <p>After the special resolution measure is decreed, the Department of Bank Liquidation is responsible for conducting the subsequent process. In the past five years, one bank was closed and four were resolved through the merger and acquisition process.</p> <p>According to Resolution 4019, BCB may require banks to adopt additional amounts of regulatory capital as a preventive measure to situations that can put the bank's stability at risk, like the deterioration or the perspective of deterioration of its financial and economic situation. The BCB is also in the process of implementing capital premiums based on SRC.</p>
EC5	The supervisor has the power to take measures should a bank fall below the minimum capital ratio, and seeks to intervene at an early stage to prevent capital from falling below the minimum. The supervisor has a range of options to address such scenarios.
Description and findings re EC5	Regulations regarding regulatory capital establish the authority of the BCB to require that additional capital be injected to correct a deficiency. The BCB can also require a bank to hold capital above regulatory minimums.
EC6	The supervisor applies penalties and sanctions not only to the bank but, when and if necessary, also to management and/or the Board, or individuals therein.
Description and findings re EC6	Article 44 of the Banking Law extends penalties and sanctions to managers, directors and auditors. In a liquidation situation, assets of controlling owners, directors and management can be frozen. In addition to the assets that are frozen, the BCB may propose to the CMN to have the assets of the members of the audit committee frozen, among others (Article 36 of Law 6024). The seized property will make up the bankruptcy estate, after the due legal process, through authorization of the courts, for the payment of creditors (Articles 41 and 45 of Law 6024). Law 9613 sets administrative penalties for financial institutions and its managers related to money laundering violations. Law 4131 also sets administrative penalties and fines related to foreign exchange operations.
Additional criteria	
AC1	Laws or regulations guard against the supervisor unduly delaying appropriate corrective actions.

Description and findings re AC1	The emphasis on early remedial action that is emphasized in the enforcement regulations promotes the early action by the BCB. Criminal charges can be brought against a financial institution if intentional and undue delays are verified (Brazilian penal code).
AC2	The supervisor has the power to take remedial actions, including ring-fencing of the bank from the actions of parent companies, subsidiaries, parallel-owned banking structures and other related companies in matters that could impair the safety and soundness of the bank.
Description and findings re AC2	The BCB enforcement powers (Resolution 4019) are broad and flexible enabling responses to various situations, including contagious risk arising from related parties' activities.
AC3	When taking formal remedial action in relation to a bank, the supervisor ensures that the regulators of nonbank related financial entities are aware of its actions and, where appropriate, coordinates its actions with them.
Description and findings re AC3	Cooperation between BCB and other Brazilian supervisors is conducted through Coremec. The committee was established by Decree 5685 to coordinate supervisory actions. Additionally, the insurance, banking and security supervisors share information on a bilateral basis.
Assessment of Principle 23	Compliant
Comments	Banks are subject to corporate law which requires that companies payout a minimum of 25 percent of their profits as dividends. It is recommended that banks be exempted from this requirement as it will limit the BCB ability to preserve bank capital in a weak bank situation.
Principle 24	Consolidated supervision. An essential element of banking supervision is that supervisors supervise the banking group on a consolidated basis, adequately monitoring and, as appropriate, applying prudential norms to all aspects of the business conducted by the group worldwide.
Essential criteria	
EC1	The supervisor is familiar with the overall structure of banking groups and has an understanding of the activities of all material parts of these groups, domestic and cross-border.
Description and findings re EC1	The BCB maintains detailed information and organizational charts on all conglomerates, including cross-border operations. A demonstration and discussion of the data during the mission demonstrated the detailed information available and the supervisors' familiarity with operations and related companies. Monthly the bank files a report of all transactions between the members of the banking group. Cross-border activities are monitored and frequent communications with home/host supervisors is maintained, including cross-border inspections.
EC2	The supervisor has the power to review the overall activities of a banking group, both domestic and cross-border. The supervisor has the power to supervise the foreign activities of banks incorporated within its jurisdiction.
Description and findings re EC2	Regulations and supervisory procedures allow the supervisory staff to fully understand the structure of a banking conglomerate as well as its main activities, regarding the individual companies and the whole group. According to Resolutions 2804, 3380, 3464 and 3721, financial institutions must implement frameworks to manage liquidity, operational, market and credit risks. This framework must identify, assess, monitor and control the risks associated with each institution, individually, and to the banking group as a whole. It also must identify and monitor the risks related to the non-banking companies that are part of the conglomerate.

	<p>Banks must prepare their financial statements on a consolidated basis, including investments in companies in Brazil and cross-border. They must provide in the statements information about management centers and decision making trees, and identify operational and corporate control. Regulations establish that BCB must have total access to information, data, documents and verifications necessary for assessing the assets and liabilities, and the risks associated to the subsidiaries, regardless of their operational activities (Resolution 2723). Prudential regulations and supervisory requirements are applied on a consolidated basis to banks and their subsidiaries, and all members of the conglomerate.</p> <p>Resolution 3490, establishes that financial institutions that are part of a conglomerate must determine regulatory Capital and set the risk diversification on a consolidated basis. The determination of the Base Capital, or Tier I, must be conducted on a consolidated basis for institutions that are part of a financial conglomerate (Resolution 3444).</p>
EC3	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.
Description and findings re EC3	<p>The risks that the holding company or affiliates may pose to the financial condition of the bank are estimated in the formal "contagion risk" assessment performed by the BCB. Using this process, the BCB analyzes the bank's exposure to the risks associated to its conglomerate's activities that are not under the BCB's direct supervision (primarily insurance activities). The review relies on reviewing strategic plans, internal audit reports, reviewing management information systems and communicating with other supervisors involved. The communication with other supervisors includes having joint meetings with the bank's board of directors to discuss how the non-banking activity is monitored and strategic plans.</p> <p>The contagion risk assessment is divided into three parts:</p> <ol style="list-style-type: none"> 1. Economic/financial position. A review of capital invested and future capital needs. 2. Understanding of risks generated by activities. Business understanding by management of the non-banking business and technical expertise of management in those areas. 3. Specific reviews. Review the non-banking activities, the scope, the risk management and consult with other regulators.
EC4	The supervisor has the power to impose prudential standards on a consolidated basis for the banking group. The supervisor uses its power to establish prudential standards on a consolidated basis to cover such areas as capital adequacy, large exposures, exposures to related parties and lending limits. The supervisor collects consolidated financial information for each banking group.
Description and findings re EC4	<p>Under the Banking Law, BCB has the legal power to examine financial reports and documents from any person or company that exerts control over financial institutions. In addition, according to the Law 6024 (which regulates the intervention and the liquidation of financial institutions), the BCB may impose identical regimes to the corporates involved in integrated activities with those institutions, or attached to them by common interests and their managers. Integrated activities or common interests occur when the corporates are debtors of the entity under intervention or extra-judicial liquidation, or when their partners or shareholders participate in its capital with more than 10 percent, or when they are spouses or relatives up to the second degree, related by blood or akin, with the managers or with the members of the consultative, administrative or Audit Committee members.</p> <p>According to Resolution 4019, when a risky condition to the regular functioning of the SFN or to a supervised entity is identified, the BCB can determine prudential measures such as limiting or suspending distribution of dividends above the minimum legally established.</p>

	<p>The Banking Law and Circular 30 prohibit the granting of loans by the banks to specific related parties.</p> <p>Regarding the financial statements of the conglomerate, BCB has the ability to apply consolidation of any financial institution not directly controlled. This situation can be identified when there is a set of financial entities linked directly or not, for ownership or effective operational control, characterized by common management or performance in the market under the same brand or trade name.</p> <p>Supervisory powers of BCB extend to all subsidiaries that compose a conglomerate.</p> <p>Also see EC2.</p>
EC5	<p>The supervisor has arrangements with other relevant supervisors, domestic and cross-border, to receive information on the financial condition and adequacy of risk management and controls of the different entities of the banking group.</p>
Description and findings re EC5	<p>BCB has established cooperation with other supervisory agencies of the Brazilian Financial System through Committee on Regulation and Supervision of Financial Markets, Capital Markets, Insurance, Pension Plans and Savings Bonds (COREMEC). This committee was established by Decree 5685 in order to propose coordinated regulatory and supervisory actions, among other issues.</p> <p>Apart from COREMEC, there are also other specific cooperation agreements (MoUs) between BCB, the Securities Commission, the Superintendence of Private Insurance, the National Complementary Pension Superintendence and the Secretariat of the Federal Revenue of Brazil.</p> <p>The channels set by COREMEC and the MoUs allow the supervisory staff to address matters related to the other companies that are part of the banking conglomerates.</p> <p>The BCB has also established close working relationships with home/host supervisors of import to the Brazilian banks. The exchanges of information take place through participation in supervisory colleges, cross-border onsite reviews, participation in regional supervisory groups and through information requests based on agreed-to procedures in MOUs and through more informal channels. Additionally, in its annual development of the supervisory plans, the BCB works closely with the other domestic supervisors.</p>
EC6	<p>The supervisor has the power to limit the range of activities the consolidated group may conduct and the locations in which activities can be conducted; the supervisor uses this power to determine that the activities are properly supervised and that the safety and soundness of the bank are not compromised.</p>
Description and findings re EC6	<p>The BCB has the power to limit the conglomerate's activities concerning the applications for the approval of new activities. Resolution no. 4,019, of 2011, established that the BCB may determine prudential actions over the institutions in order to limit risk exposure. That power can be used upon national or foreign units and includes the restriction to the opening of new units or to new operations and the determination to sell assets, among other measures.</p>
EC7	<p>The supervisor determines that management is maintaining proper oversight of the bank's foreign operations, including branches, joint ventures and subsidiaries. The supervisor also determines that banks' policies and processes ensure that the local management of any cross-border operations has the necessary expertise to manage those operations in a safe and sound manner and in compliance with supervisory and regulatory requirements.</p>
Description and findings re EC7	<p>The BCB supervisory approach is company-wide and includes foreign operations. In its annual supervisory plan the inspector will highlight areas of risk and conduct activities throughout the year that include offsite and cross-border. The information available to BCB for the ongoing supervision includes bank internal reports, credit registry and onsite access. A demonstration provided to the assessors of the process detailed the actual supervisory</p>

	documents the comprehensiveness of the supervision.
EC8	<p>The supervisor determines that oversight of a bank's foreign operations by management (of the parent bank or head office and, where relevant, the holding company) includes: (i) information reporting on its foreign operations that is adequate in scope and frequency to manage their overall risk profile and is periodically verified; (ii) assessing in an appropriate manner compliance with internal controls; and (iii) ensuring effective local oversight of foreign operations.</p> <p>For the purposes of consolidated risk management and supervision, there should be no hindrance in host countries for the parent bank to have access to all the material information from their foreign branches and subsidiaries. Transmission of such information is on the understanding that the parent bank itself undertakes to maintain the confidentiality of the data submitted and to make them available only to the parent supervisory authority.</p>
Description and findings re EC8	The BCB ensures that cross-border activities are only approved in jurisdictions that will collaborate on consolidated supervision. The supervisory program includes analysis of the risk management process over cross-border activities to ensure that the cross-border activities are subject to same standards as domestic operations.
EC9	<p>The home supervisor has the power to require the closing of foreign offices, or to impose limitations on their activities, if:</p> <ul style="list-style-type: none"> • it determines that oversight by the bank and/or supervision by the host supervisor is not adequate relative to the risks the office presents; and/or • it cannot gain access to the information required for the exercise of supervision on a consolidated basis.
Description and findings re EC9	The BCB can take measures based on Resolution 4019, which establishes preventive prudential measures to arrest the deterioration of the financial situation of the institutions. Those measures are valid for the whole conglomerate. As an example, the enforcement of Resolution 4019 can result in restrictions to be followed by the head office, such as the reduction of risk exposures, or other restrictions on operations and acquisitions, even cross-border. Those restrictions may directly reflect in the cross-border operations.
EC10	The supervisor confirms that oversight of a bank's foreign operations by management (of the parent bank or head office and, where relevant, the holding company) is particularly close when the foreign activities have a higher risk profile or when the operations are conducted in jurisdictions or under supervisory regimes differing fundamentally from those of the bank's home country.
Description and findings re EC10	Cross-border activities of Brazilian banks must be approved by the BCB; they must be established in countries that conduct consolidated supervision and abide by international standards as determined by the BCB during the approval process. Additionally, international operations are an extension of domestic activities and do not include higher risk products.
Additional criteria	
AC1	<p>For those countries that allow corporate ownership of banking companies:</p> <ul style="list-style-type: none"> • the supervisor has the power to review the activities of parent companies and of companies affiliated with the parent companies, and uses the power in practice to determine the safety and soundness of the bank; and • the supervisor has the power to establish and enforce fit and proper standards for owners and senior management of parent companies.
Description and findings re AC1	Banks can only be owned by individuals and financial holding companies but not by non-financial corporations. Supervisory powers of BCB extend to all subsidiaries that compose a financial conglomerate and an economic and financial conglomerate.

AC2	The home supervisor assesses the quality of supervision conducted in the countries in which its banks have material operations.
Description and findings re AC2	Through internal bank reports, onsite visits and exchange of views with host supervisors.
AC3	The supervisor arranges to visit the foreign locations periodically, the frequency being determined by the size and risk profile of the foreign operation. The supervisor meets the host supervisors during these visits. The supervisor has a policy for assessing whether it needs to conduct on-site examinations of a bank's foreign operations, or require additional reporting, and has the power and resources to take those steps as and when appropriate.
Description and findings re AC3	The BCB conducts onsite inspections of significant operations on a regular basis. They have conducted inspections in offshore centers, Luxembourg, Spain and United States.
Assessment of Principle 24	Compliant
Comments	
Principle 25	Home-host relationships. Cross-border consolidated supervision requires cooperation and information exchange between home supervisors and the various other supervisors involved, primarily host banking supervisors. Banking supervisors must require the local operations of foreign banks to be conducted to the same standards as those required of domestic institutions.
Essential criteria	
EC1	Information to be exchanged by home and host supervisors should be adequate for their respective roles and responsibilities.
Description and findings re EC1	The BCB has frequent communications with home and host supervisors. All jurisdictions where the Brazilian banks have important operations are covered by MOUs with the host supervisor. As host supervisor the BCB has signed MOUs with home supervisors. A review of interaction by the assessors of exchanges with other supervisors documented that the contacts are frequent and substantive.
EC2	For material cross-border operations of its banks, the supervisor identifies all other relevant supervisors and establishes informal or formal arrangements (such as memoranda of understanding) for appropriate information sharing, on a confidential basis, on the financial condition and performance of such operations in the home or host country. Where formal cooperation arrangements are agreed, their existence should be communicated to the banks and banking groups affected.
Description and findings re EC2	MOUs have been signed with Argentina, Bahamas, Cayman Islands, Germany, Indonesia, Mexico, Panama, Paraguay, Portugal, Spain, USA, and Uruguay. Information exchanged includes reports of inspection, participation in joint examinations and in supervisory colleges sharing the BCB assessment of the bank. Information on the agreements is listed in the BCB website.
EC3	The home supervisor provides information to host supervisors, on a timely basis, concerning: <ul style="list-style-type: none"> • the overall framework of supervision in which the banking group operates; • the bank or banking group, to allow a proper perspective of the activities conducted within the host country's borders; • the specific operations in the host country; and • where possible and appropriate, significant problems arising in the head office or other parts of the banking group if these are likely to have a material effect on the safety and soundness of subsidiaries or branches in host countries.

	<p>A minimum level of information on the bank or banking group will be needed in most circumstances, but the overall frequency and scope of this information will vary depending on the materiality of a bank's or banking group's activities to the financial sector of the host country. In this context, the host supervisor will inform the home supervisor when a local operation is material to the financial sector of the host country.</p>
<p>Description and findings re EC3</p>	<p>Typically, the host supervisor requires from the BCB a large set of information during the authorization process. This set of information includes all relevant information about the regulatory framework, scope and role of Brazilian supervision, as well as information about the group that requests authorization.</p> <p>BCB routinely provides information to the host supervisor when there are on-site inspections on the subsidiaries of Brazilian banks abroad. Meetings with the host supervisor are held at the beginning and conclusion of inspections, in order to exchange information on the most relevant facts and on the situation of the group as a whole. A copy of the inspection report is provided to them.</p> <p>The scope and frequency of information exchange depends on the relevance of the foreign subsidiary to the Brazilian group, since, in most cases, the subsidiaries of Brazilian banks are not systemically important for the foreign markets where they operate.</p>
<p>EC4</p>	<p>The host supervisor provides information to home supervisors, on a timely basis, concerning:</p> <ul style="list-style-type: none"> • material or persistent non-compliance with relevant supervisory requirements, such as capital ratios or operational limits, specifically applied to a bank's operations in the host country; • adverse or potentially adverse developments in the local operations of a bank or banking group regulated by the home supervisor; • adverse assessments of such qualitative aspects of a bank's operations as risk management and controls at the offices in the host country; and • any material remedial action it takes regarding the operations of a bank regulated by the home supervisor. <p>A minimum level of information on the bank or banking group, including the overall supervisory framework in which they operate, will be needed in most circumstances, but the overall frequency and scope of this information will vary depending on the materiality of the cross-border operations to the bank or banking group and financial sector of the home country. In this context, the home supervisor will inform the host supervisor when the cross-border operation is material to the bank or banking group and financial sector of the home country.</p>
<p>Description and findings re EC4</p>	<p>The authorization process for financial institutions that maintain direct or indirect ties with foreign financial institutions to operate in the Brazilian Financial System requires information from the home supervisor about the regularity of the financial institution as well as on the intended investment. Once the foreign subsidiary starts operating, information is updated whenever there is a petition by the home supervisor or when relevant facts that may affect the situation of the subsidiary or the group as a whole occur.</p> <p>When significant problems that may endanger the safety or soundness in operations and/or structures of foreign institutions that operate in Brazil are verified, BCB informs the home supervisor on the situation and on the actions being taken in Brazil, so that the home supervisor can adopt, within its powers, the actions deemed appropriate to promote the solution of the detected problems.</p> <p>Information to home supervisors on the results of the supervision in the Brazilian subsidiaries,</p>

	<p>such as the results of the rating and other inspections/checks, if there are not more serious problems in these institutions, is provided eventually.</p> <p>Besides that, participation in supervisory colleges allows BCB to have a more comprehensive perspective of foreign banks that operate in Brazil. Exchange of information among supervisors about global strategy and risk controls permits a better understanding on how institutions run their business in different countries and their consequences to Brazilian market. This understanding helps BCB to plan its supervisory activities on these banks in a more consistent way.</p> <p>The information is shared observing the legislation of each country, especially with regards to laws concerning the obligation to maintain the confidentiality of information, which poses some difficulties to communication. However, the growing number of memoranda of understanding (MoUs) between supervisors of different countries has mitigated this circumstance. In general, documents and data are only disclosed to other college members after obtaining the consent in writing from the supervisor responsible for providing the information.</p> <p>With respect to the colleges in which BCB has been participating, BCB's representatives usually disclose at least the assessments made through the SRC. Further information on general issues as corporate governance, risk management and exposure, among others, is disclosed on demand.</p>
EC5	A host supervisor's national laws or regulations require that the cross-border operations of foreign banks are subject to prudential, inspection and regulatory reporting requirements similar to those for domestic banks.
Description and findings re EC5	All banks in Brazil are subject to the same regulatory and supervisory requirements.
EC6	Before issuing a license, the host supervisor establishes that no objection (or a statement of no objection) from the home supervisor has been received. For purposes of the licensing process, as well as ongoing supervision of cross-border banking operations in its country, the host supervisor assesses whether the home supervisor practices global consolidated supervision.
Description and findings re EC6	Circular 3317 addresses the request of information from home supervisors to determine that the applicant is subject to consolidated supervision, has systems in place to manage cross-border operations, and that the home supervisor evaluates compliance with anti-money laundering requirements on a global basis.
EC7	Home country supervisors are given on-site access to local offices and subsidiaries of a banking group in order to facilitate their assessment of the group's safety and soundness and compliance with KYC requirements. Home supervisors should inform host supervisors of intended visits to local offices and subsidiaries of banking groups.
Description and findings re EC7	Home supervisors are granted access to conduct onsite reviews; however, only one bank in Brazil is of significance in relation to global assets. That one bank is visited annually by the home supervisor.
EC8	The host supervisor supervises shell banks, where they still exist, and booking offices in a manner consistent with internationally agreed standards.
Description and findings re EC8	Not Applicable
EC9	A supervisor that takes consequential action on the basis of information received from another supervisor consults with that supervisor, to the extent possible, before taking such action.

Description and findings re EC9	Before taking action consultations would take place.
Additional criteria	
AC1	Where necessary, the home supervisor develops an agreed communication strategy with the relevant host supervisors. The scope and nature of the strategy should reflect the size and complexity of the cross-border operations of the bank or banking group.
Description and findings re AC1	In addition to the communication strategies set out in MoUs, the Supervision develops strategies of closer communication and frequent interaction with foreign supervisors responsible for the supervision of banks with a significant presence in Brazil or most significant subsidiaries of Brazilian banks abroad, in order to collect and provide information for supervisory purposes. These strategies, though unwritten, work in practice by exchanging letters, e-mails, and also by meetings with foreign authorities.
Assessment of Principle 25	Compliant
Comments	