

MAIN FEATURES OF THE REGULATORY FRAMEWORK OF THE ARGENTINE FINANCIAL SYSTEM

April 2001

The objective of these notes is to describe the main features of the legal framework of the Argentine financial system. Some items have been simplified in order to facilitate understanding and interpretation. The paper should not be used as a substitute for the regulations issued by the Banco Central de la República Argentina.

This paper includes relevant regulations up to Comunicación "A" " 3243 (29/Mar/01).

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I. MONETARY REGIME AND EXCHANGE ARRANGEMENTS

A. OBJECTIVE

1. The primary and fundamental mission of the Central Bank of Argentina (BCRA) is to maintain the value of the Argentine peso, in accordance with the Convertibility Law (March 1991) and the Charter of the BCRA (September 1992).

B. MAIN ELEMENTS

1. The exchange rate is fixed with a conversion parity US\$1=\$1 established by the Convertibility Law.
2. The monetary base is fully backed by international reserves. Up to one third of this backing may consist of public bonds, denominated in US dollars and marked to market.
3. According to its Charter, the BCRA may not lend to national, provincial or local governments, nor to the non-financial private sector.
 - a. It may only finance the Treasury through the purchase of government bonds at market prices.
 - b. The growth in bond holdings of the BCRA must not exceed 10% per year.

C. FREE CAPITAL MOBILITY

1. There are no capital controls on financial nor on commercial operations between residents and nonresidents. Foreign currency flows in and out of the country are absolutely free from restrictions.
2. Financial institutions must report monthly on their exchange operations.
3. The BCRA has implemented measures to prevent money laundering operations from taking place.

D. LIQUIDITY MANAGEMENT OPERATIONS

1. Repurchase agreements: spot purchase and future sale of securities. The assets can be:
 - a. Government bonds:
 - i. Government bonds issued in domestic or foreign currency are purchased by the BCRA at market prices with a 10% haircut.
 - ii. The annual interest rate on repos. is changed periodically by the BCRA. Currently it is 9%.
 - b. CD's of financial trusts where the underlying assets are credits with Government collateral or bonds issued by SEDESA.
2. Reverse repurchase agreements: spot sale and future purchase of public bonds by the BCRA.

- a. Government bonds issued in domestic or foreign currency are sold by the BCRA at market prices with a 10% haircut.
 - b. The annual interest rate on reverse repos. is changed periodically by the BCRA. Currently it is 4.7% for operations with BCRA's assets and 4.9% for operations with CD's issued by foreign banks.
 - c. At the end of the business day, the deposits of financial institutions at the BCRA automatically become reverse repos. to the BCRA until the beginning of the next business day.
3. Overdraft and liquidity rediscount facilities
- a. The total credit in both kind of operations must not exceed the capital of the bank using the facility, as of the latest audited quarterly balance sheet.
 - b. Each operation may last up to 30 days and may be renewed after 45 days.
 - c. Overdraft facilities are subject to the provision of suitable collateral such as government bonds or preferred assets. Banks may rediscount loans granting to clients classified as 'normal'. The collateral for overdraft and rediscount facilities must amount to 125% of the total financing.
 - d. These operations have a fixed interest rate.
 - e. Financial institutions making use of overdraft or rediscount facilities are not allowed to purchase their own fixed term CD's nor their own corporate bonds, nor to cancel reverse repos. in advance nor provide financial assistance which uses those instruments as collateral.
 - f. In the case of a financial institution with liquidity problems, its rediscounts and overdrafts may be transferred to another institution, only if the latter purchases the former loan portfolio used as collateral for the rediscount or overdraft.
 - g. The BCRA may provide extraordinary liquidity assistance in the case of systemic liquidity problems, according to the Law 24,485 of April 1995.

E. CONTINGENT REPO. FACILITY

- 1. Purpose:
 - a. To provide the financial system with additional liquidity without restricting domestic credit, the BCRA has established a contingent financing facility with some of the major international banks.
 - b. This facility gives the BCRA the option to conduct repo. operations, by selling Argentine US dollar denominated Government bonds or mortgage backed securities and receiving the proceeds in US dollars.
 - c. On the maturity of the transaction, the BCRA will repurchase the Government securities.
- 2. Conditions:
 - a. Maturity: Minimum 2 years and maximum 5 years, according to each individual contract. There is an evergreen clause such that every three months the life of the Program is extended a further three months.

- b. Term: The term of the repo. operation is the decision of the BCRA up to a maximum of the maturity of the current program with the bank in question.
- c. Haircut: 20% of the market value for Government securities and 28% for mortgages bonds.
- d. Margin: If the market prices of the Government bonds fall by more than 5%, additional securities or US dollars must be delivered to reach the amount of 125% of transactions with Government securities or 140% of transactions with mortgages bonds. If the bond prices fall by more than the repurchase price, the BCRA must deliver US dollars as margin payments.

II. PRUDENTIAL REGULATION AND SUPERVISION

A. CAPITAL REQUIREMENTS

The BCRA has implemented a system of capital requirements based on the Basle Committee's recommendations. The capital requirement is defined as a function of the risk of the assets of the bank and is based on three types of risks: counterparty risk, interest rate risk and market risk. However, there is a minimum level of capital requirement fixed by the BCRA that banks have to comply with.

MINIMUM CAPITAL

1. The minimum level of capital is \$10 million for wholesale banks and \$15 million for the remain institutions.
2. The level of capital is \$5 million for financial institutions (except wholesale banks) created before October 1995 and whose capital requirements as of December 1998 were below \$5 million.

COUNTERPARTY RISK

1. The required 'capital to assets at risk' ratio is 11.5%, i.e., substantially higher than the 8% ratio recommended by the Basle Committee. In addition, public bond holdings in investment accounts and loans granted to the non-financial public sector have a ratio that ranges from 1% to 5% according to the modified duration of the asset.
2. The computation of the assets at risk involves three factors:
 - a. Each type of asset is weighted according to the level of risk assumed to be associated with it. The weights assigned to the different types of assets are, broadly:

Cash and Other Disposable Funds	0%
Government bonds	
With market risk requirements	0%
Investment Accounts	0%
Other domestic	
Central Government	0%
with Central Government collateral	0%
Provincial and Municipal Gov. w/o Central Gov. collateral	100%
of Public Companies w/o Central Government collateral	50%
OECD Central Government rated investment grade	20%
Loans	
to the private sector	
Preferred collateral	0%
Mortgages	50-200% (*)
With no preferred collateral	100%
Pledges granted up to 75% of the asset value	50%
Pledges granted for more than the 75% of the asset value	100%
With no preferred collateral	100%
to the non-financial public sector	0%
Central Government	0%

with Central Government collateral	0%
to the financial system	
Banco Nación	0%
public banks w/ Central Gov. collateral	0%
OECD foreign bank or endorsed by an OECD foreign bank rated A	0%
'investment grade' foreign bank or endorsed by an 'investment grade' foreign bank	20%
other	100%
Other credits from financial intermediation	
Futures, forwards and swaps	0%
Leasing (financing up to 75% of the asset value)	50%
Leasing (financing more than 75% of the asset value)	100%
Outstanding bonds	0%
Guarantees and contingent liabilities	
Non financial public sector	
Central Government	0%
with Central Government collateral	0%
Related to foreign trade	50%
Related to contractual agreements	100%
(*) Mortgages granted up to December 1997 for an amount less than 75% of the property price	
	50%
Mortgages granted up to December 1997 for an amount higher than 75% of the property price	
	100%
Mortgages granted as from December 1997 for an amount less than 75% of the property price and the evolution of its price (considering October 1997 as the base month) is:	
up to 1.5	50%
between 1.5 and 2	100%
higher than 2	200%
Mortgages granted up to as from December 1997 for an amount higher than 75% of the property price and the evolution of its price (considering October 1997 as the base month) is	
up to 2	100%
higher than 2	200%

- b. In addition to the Basle-style recommendations above, the interest rate charged for each loan is also taken into account to determine assets at risk. The higher the interest rate a loan has, the larger the weight used to compute assets at risk. The risk indicators (weights) range between 0.80 and 7.00. A 0.80 weight is applied to loans granted to clients with an international rating at least as high as that of Argentine bonds, and bearing an interest rate not higher than two percentage points above the prime rate published by the BCRA. In addition, personal loans, credit cards and overdrafts with annual interest rates up to 26% and other loans with annual interest rates up to 16% have an indicator of 1.00. These weights rise to a value of 7.00 for those loans with annual interest rates larger than 86% or 76%, respectively.
- c. The capital requirements also depend on the CAMELS rating that the Superintendency assigns to each institution. This rating abides by the international criteria related to a broad concept of the performance of banks. Banks have to adjust their capital requirement according to the following factors:

<u>CAMELS Rating</u>	<u>Factor</u>
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1	0,97
2	1,00
3	1,05
4	1,10
5	1,15

3. Assets at risk are therefore defined as:

$$\text{Assets at risk} = \sum \text{Asset}_i * \text{risk weight}_i * \text{interest rate weight}_i * \text{CAMELS factor}$$

and the capital requirement for counterparty risk is 11.5% of the assets at risk.

4. Those loans granted by a local branch or subsidiary of a foreign bank, on account of the head office, are not subject to capital requirements provided (i) the relevant foreign bank is rated 'A' or higher, (ii) it is subject to supervisory rules at a consolidated level and (iii) the loans are explicitly endorsed by the head office.

INTEREST RATE RISK

1. Financial institutions must comply with the capital requirements for interest rate risk. These requirements are added to those for counterparty risk and market risk.
2. These capital requirements capture the risks arising from the different sensitivity of assets and liabilities when interest rates change occurs. This is important because, in contrast with assets and liabilities in the trading book, where interest rate changes are immediately reflected through the change of the price of the assets, only the interest rate margin is affected in the banking book.
3. The regulation covers all the assets and liabilities no subject to market risk capital requirements (inclusive the securities accounted in investment accounts).
4. Capital requirements measure the value at risk (VaR) or maximum potential loss due to interest rate risk increases considering a 3 month horizon and with a confidence level of 99%. It is defined as:

$$VaR_R = \text{Max}\{(VAN_{rp}^p - VAN_{rp'}^p) * \sigma^p + (VAN_{rd}^d - VAN_{rd'}^d) * \sigma^d; 0\} * 100 * \frac{C}{VAN_{rp}^p + VAN_{rd}^d + \sum(A-P)}$$

where VAN represents the present value of the assets net of liabilities in domestic currency (p) and foreign currency (d) discounted at the interest rate r or r' (=r+100 b.p.); is σ a factor that measures the volatility of deposit rates as well as the correction for the 3-month horizon. The last factor is a correction that takes into account that not all assets and liabilities are included in the calculation. The function Max(.,0) is used because only risk arising from increases in interest rates command a capital requirement.

The value of σ is 0.018 for peso operations and 0.006 for dollar operations.

The computation assigns the flows of the bank's operations to different time bands taking into account their maturity. Banks with 1-3 CAMELS ratings may trend 50% of core deposits as long term maturities (in the case of banks with a 3 rating, the assigned maturity cannot exceed 3 years).

Contracts with variable interest rates referenced on a foreign interest rate are treated as if they had fixed interest rates due to the volatility of Argentine foreign interest rate spread.

Contracts with variable interest rates based on a domestic interest rate are treated as following:

- i. liability flows are assigned only up to the time band corresponding to the first repricing date,
- ii. 40% of asset flows (except Government debts) are taken as if there were at a fixed interest rate due to the fact that large shocks of the funding cost are not totally transferred to the clients, keeping part of the interest rate risk.

MARKET RISK

1. Capital requirements for market risks are added to those for counterparty risk and interest rate risk.
2. Capital requirements are computed as a function of the market risk of banks' portfolios, measured as their value at risk (VaR). The regulation covers only those assets traded routinely in open markets and which are not included in an investment account.
3. Five categories of assets are defined. Domestic assets are divided into equity and public bonds, and the latter are in turn classified into two zones according to their modified duration (less than or greater than 2.5 'years'). Foreign equity and foreign bonds are two other categories, the latter also comprising of two zones, equally defined. The fifth category is that of foreign exchange positions (other from US dollar), differentiating in accordance to the currency.
4. Overall capital requirement in relation to market risk is, then, the sum of the five amounts of capital necessary to cover the risks arising from each category.

The regulation allows for offsetting of positions of opposite sign in the same instrument (holdings, purchases and sales pending settlement, term operations, loans and deposits and options -their notional value weighted by their 'delta'-). Given the net position in an asset 'i', its inherent risk is assessed by calculating the Value at Risk (VaR) as follows:

$$VaR_i = V_i * k * \sigma_i * T^{1/2}$$

where V is the value of the net position, k is a constant depending on a confidence level chosen, σ is the daily volatility and T is the number of days in the holding period. The confidence level adopted is 99% and therefore k is set at 2.32. A minimum 5-day holding period is established.

The value at risk of a portfolio within a category of assets is calculated as:

$$VaR_p = \text{abs}(VaR_L - VaR_S) + \alpha * \min(VaR_L; VaR_S)$$

where VaR_L y VaR_S are the sum of the values at risk arising from long and short positions in different instruments, respectively. The first term of the expression considers the netting out of positions with opposite signs (to take into account that correlations are usually high within a category of assets). The second term is a 'disallowance' or additional charge which recognizes that the offsetting of positions cannot be full given that correlations, though probably high, are not perfect. The coefficient α was set at 1. Therefore, the formula reduces to:

$$VaR_p = \max(VaR_L; VaR_S)$$

The latter formulas apply to public bonds belonging to the same modified duration zone and no offsetting is permitted between zones.

The procedure regarding equities is similar to that of bonds. Full offsetting of long and short positions in the same asset is allowed, while partial offsetting (i.e., subject to a disallowance charge) is applied to positions in different stocks.

The treatment of options that has been adopted is in line with the so called 'delta plus' method proposed by the Basle Committee. The first step in calculating the risk stemming from options positions is to compute the notional values of the options, weighted by their 'delta' (the 'delta' of an option is the amount by which the value of an option changes given a one unit change in the price of the underlying asset). An option position is thus converted into a position in the underlying asset and incorporated into the calculation of the net positions in each of the assets. Additionally, the net 'gamma' and 'vega' risks should be calculated and a separate capital charge be levied. Gamma risks originate in the non-linear relationship between the value of an option and the change in the price of the underlying asset, while vega risk is a measure of the sensitivity of the value of an option to changes in the volatility of the price of the underlying asset. No offsetting is allowed between these additional option charges for different assets.

5. Market risk capital requirements must be computed on both individual and consolidated basis and must be met daily. Off-balance sheet, the computation of capital includes the daily change in the value of those national and foreign assets and derivatives covered by the requirements for market risk. Reporting to the BCRA is required on a monthly basis.

CAPITAL

1. The computable capital is divided into core and supplementary. The core capital includes permanent capital, non-equity contributions, net worth adjustments, disclosed reserves created by appropriations of retained earnings, and retained earnings (retained profits arising during the last fiscal year can be included only when they have been audited) and, in the case of consolidation, minority interests in permanent shareholder's equity.
2. The supplementary capital, which may not exceed the core capital, consists of 50% of the provisions on the loan portfolio classified as 'normal', retained earnings corresponding to the current fiscal year that have been audited and subordinated debt with a duration of at least 5 years at the moment of the issuance. The latter may not exceed 50% of the core capital.
3. The following items must be deducted from the calculated capital defined above: (i) sight deposits in foreign banks rated as non investment grade, (ii) securities that are not deposited in the authorized custodian, (iii) government bonds issued by a foreign government with a lower rating than that assigned to the Argentine bonds, (iv) share holdings of other financial institutions, (v) shareholders, (vi) good will, (vii) expenses in research and development, (viii) provisioning deficiency and (ix) others to be agreed on a case by case basis by the Superintendency.
4. Requirements must be complied on both an individual and a consolidated basis.

B. LIQUIDITY REQUIREMENTS

1. As from August 1995, the system of reserve requirements has been substituted by a system of liquidity requirements. The main features of the liquidity requirements are as follows:
 - a. Requirements are applied to the monthly average of deposits and other liabilities such as standby overdrafts facilities, repos., commercial paper and foreign credit lines (except those related to foreign trade).
 - b. The rates for the liquidity requirements are applied according to the residual time to maturity. Requirements are higher for shorter residual times to maturity:

Term of liability	Requirement (%)
up to 89 days (*)	20
between 90 and 179 days	15
between 180 and 365 days	10
beyond 365 days	0

(*) Requirements for remunerated current accounts must be equal to 80% when the interest rate exceed by more than 1 point the interest rate of savings account published by the BCRA. Requirements for mutual funds' sight deposits are 100%.

- c. The computation of the requirements for deposits is based on their maturity structure in the prior period, while the requirements for other liabilities are calculated taking into account their residual times to maturity in the period under consideration. The overall calculation is carried out on a monthly average of daily positions. There is a daily minimum requirement set at 75% of the prior month requirement.
- d. Requirements may be met with:
 - i. reverse repurchase operations (repos.) for BCRA;
 - ii. deposits in an international custodian (currently Deutsche Morgan Grenfell / C. J. Lawrence Inc. - New York);
 - iii. Argentine public or private bonds, as long as the local institution has the right to exercise a put option against an A-rated foreign bank on those bonds;
 - iv. Argentine mortgage loans granted according to the 'reciprocal model agreement' between 15/Oct/95 and 18/Jul/97 and the corresponding backed securities, as long as the bank possesses a 60-day put option against an A-rated (or above) foreign institution;
 - v. time deposit certificates issued by foreign banks rated 'AA' (long term), provided that the local bank:
 - (1) has the right to exercise a put option with regard to an 'AA' rated foreign bank;
 - (2) put-option certificates and contracts are deposited at the international custodian;
 - vi. securities issued by:
 - (1) 'A' rated OECD governments and its enterprises or agencies with an OECD Government collateral;

- (2) 'AA' rated international organizations;
 - (3) 'AA' rated OECD commercial banks;
 - (4) 'AA' rated OECD private firms; and
 - (5) mutual funds composed of OECD government bonds or OECD companies equities,
- as long as they are deposited at the international custodian and fulfill the BCRA liquidity requirements;
- vii. Unconditional standby letters of credit, issued in dollars, with a 360 day-maturity granted by foreign banks rated A or more. Only 83% of the amount of the letters of credit may be considered as complying with the liquidity requirement. If deposits decrease by an amount of 10% in a 120-day period, the funds have to be available at the domestic bank.
 - viii. Purchase of shares in BCRA's CD's.
2. There are limits to the use of these instruments.
 - a. Compliance may be fulfilled subject to the following limits:
 - i. Reverse repos.: up to 100%
 - ii. Standby letters of credit: up to 20%
 - iii. Other assets: up to 80%. Within this percentage there is a maximum of:
 - (1) 10% for domestic bonds;
 - (2) 5% for mortgage backed securities; and
 - (3) 30% for securities issued by OECD banks and companies.
 3. A carry-forward of 10% of the total requirement is admitted for a maximum period of 6 months.
 4. If the BCRA verifies an excessive concentration of liabilities (owners and/or terms) that implies a significant risk in relation to a bank's liquidity or to the whole financial system, it may set additional requirements on the banks' liabilities or take the necessary complementary measures.

C. INDIVIDUAL BANK LIQUIDITY POSITIONS

1. The BCRA is monitoring and evaluating the liquidity position of financial institutions, that is, the mismatch of maturities between short, medium, and long-term liabilities and assets.
2. The maturity mismatch must be considered under different scenarios as follows: (i) as stipulated in actual liability and asset contracts; (ii) a regular scenario (according to the previous three-month evolution of assets and liabilities); (iii) a scenario of individual illiquidity; and (iv) a global illiquidity position of the market.
3. 'Global mismatch' is defined as the sum of liquid assets plus the estimated flows generated by the recovery of the remaining assets, the maturity of liabilities, contingent commitments, expenses and other income.
4. 'Global mismatch' must be accumulated for each of the required periods as defined by BCRA, and it must have a positive sign in each of them.
5. Each one of the scenarios encompasses a different definition of liquid assets computable in the mismatch, which becomes more restrictive the larger the degree of illiquidity foreseen by the scenario.

D. CREDIT RISK DIVERSIFICATION AND GRADUATION

A minimum standard of diversification is established through regulation in order to limit risk without affecting average profitability in a substantial manner.

1. In order to establish a minimum standard of diversification, the regulation places limits on loans and other forms of financing taking into account both the borrower's capital and the net worth of the financial institution.
 - a. Limits that refer to the capital of the borrowers:
 - i. As a general rule, loans and other financings cannot exceed a client's own capital.
 - ii. This limit may be widened up to 200% when the additional credit does not exceed 2.5% of the capital of the bank, and there is approved by the board of the bank. This imposes a total limit equal to 300%.
 - b. Limits that refer to the net worth of the financial institutions:
 - i. The following limits are applied on loans as well as share holdings in other commercial firms.
 - (1) Banks are allowed to own companies which have a complementary activity to theirs; for example: pension funds or investment trust funds. They are also permitted to own commercial, industrial, agricultural, and other type of businesses with prior authorization from the BCRA.
 - ii. The limits as percentage of bank capital are:

LOANS	WITHOUT COLLATERAL	WITH COLLATERAL
Non-Affiliated Clients	15%	25%
Domestic Financial Institutions	25%	25%
Foreign Financial Institutions (Investment grade)	25%	25%
Foreign Financial Institutions (Others)	5%	5%
Association of companies (Soc. Gtía Recíproca - Law N° 24.467) authorized by BCRA		25%

- iii. Other limits are:

HOLDINGS IN OTHER COMPANIES	LIMIT ON BANK CAPITAL	LIMIT ON COMPANY'S NET WORTH
Non-complementary companies	(*)	12.5%
Complementary companies	(*)	100%
Total shares and stocks	50%	
Unlisted (**)	15%	

(*) See prior table.

(**) Include listed shares that are not subject to market risk capital requirements.

- iv. Those loans (except for interbank operations) that exceed 2.5% of the bank's capital will need previous approval by the board of the bank.
- v. Risk concentration, defined as the sum of loans that individually represent more than 10% of the bank's capital, may not exceed:
 - (1) three times the capital of the bank (without computing in the sum the loans to domestic financial institutions);
 - (2) five times the capital of the bank (computing in the sum the loans to domestic financial institutions);
 - (3) ten times the capital of a 'second tier bank' (computing the loans to domestic financial institutions).
- vi. Those loans granted by a local branch or subsidiary of a foreign bank, on account of the head office, are not subject to the rules of credit risk diversification and graduation provided (i) the relevant foreign bank is rated 'A' or higher, (ii) it is subject to supervisory rules at a consolidated level and (iii) the loans are explicitly endorsed by the head office.

E. DEBTORS CLASSIFICATION AND PROVISIONING

CLASSIFICATION

Regulation on debtors classification aims at establishing clear-cut standards to identify and classify loan quality and to assess potential or actual risk of capital losses and/or interest losses, in order to evaluate the adequacy of provisions.

1. Scope of the classification

- a. Classification includes all the bank debtors (domestic residents, belonging to both public and private sector and foreign residents) and it has to incorporate the total financings (loans, leasing, contingent liabilities, etc.).

- i. The exceptions to the rule are:

- (1) Debtors with loans fully collateralized by 'preferred A collateral'
 - (2) Those loans granted by a local branch or subsidiary of a foreign bank, on account of the head-office provided that (i) the foreign bank is rated 'A' or higher, (ii) it is subject to supervisory rules at a consolidated level and (iii) the loans are explicitly endorsed by the head office.

2. Methodology of classification

- a. Commercial loans: are classified based on the clients' payoff capacity and cash flows.

- b. Housing and consumption loans: are evaluated according to the fulfillment of debt payments.

- i. In order to promote loans to small and medium-sized companies, loans of up to \$200,000 may be considered as consumption loans.

3. Categories of classification

- a. Each debtor and all of its financings and guarantees have to be included in one of the following categories:

Commercial loans:

- i. *Category 1 (normal)*: the solvency of the debtor is enough to comply with all the financial commitments.

- (1) the cash flow project remains stable, while variables are modified;
 - (2) the borrower repays the funds on time;
 - (3) the borrower belongs to an economic sector with an acceptable future trend.

- ii. *Category 2 (potential risk)*: the borrower assumes all his financial commitments.

- (1) the cash flow project trends to weaken;
 - (2) moderate indebtedness;
 - (3) slight and occasional arrears in servicing the debt;
 - (4) the borrower belongs to an economic sector with some negative aspects on its future trend.

iii. *Category 3 (substandard)*: the borrower presents difficulties to assume his financial commitments which, if they are not corrected, it may produce capital loss to the bank.

- (1) the cash flow project indicates that the borrower cannot afford his total debt, but only the interests;
- (2) illiquid financial standing;
- (3) servicing in arrears between 90 and 180 days;
- (4) the borrower performs worse than the average of his sector, there are problems with his suppliers and clients.

iv. *Category 4 (doubtful)*: the borrower cannot afford all his financial commitments.

- (1) the cash flow project neither allows the payment of the debt nor its interests;
- (2) illiquid financial standing;
- (3) servicing in arrears between 180 and 360 days;
- (4) the borrower belongs to an economic sector with a low future trend, scarce profits;
- (5) the borrower has been claimed against the bank because of the non-payment, or asked bankruptcy proceedings, or executed out-of-court arrangements.

v. *Category 5 (loss)*: the borrower's debts are irrecoverable. Presents a poor financial standing, without payments, asks voluntary bankruptcy.

- (1) the cash flow project does not cover his production costs;
- (2) servicing in arrears for more than one year;
- (3) without capacity to compete in the market.

vi. *Category 6 (loss by technical decision)*: it includes loans to substandard debtors (180-day past due) of liquidated or revoked banks or of the remaining banks from privatizations.

Refinanced loans:

i. The classification of debtors subject to a process of refinancing must take into account the following aspects:

- (1) The payment agreements made with the group of creditors or with the bank. In the latter case, the following opinions are required:
 - (a) the external auditor, the rating agency and the Superintendency when the debt is larger than \$5.000.000;
 - (b) the external auditor and the rating agency when the debt is larger than \$1.000.000; and
 - (c) the external auditor when the debt is lower than \$1.000.000.
- (2) The percentage of the debt paid:
 - (a) to be classified as 'potential risk', the debtor has to have been paid, at least, 35% of the total debt (50% of this payment can be made granting additional collaterals no related with the debtor activity).

Housing and consumption loans:

- i. *Category 1 (normal)*: servicing with no more than 31-day arrears.
 - ii. *Category 2 (potential risk)*: occasional arrears, between 31 and 90 days.
 - iii. *Category 3 (substandard)*: difficulties to comply with the liabilities, over 90 to 180 days in arrears.
 - iv. *Category 4 (doubtful)*: borrowers in arrears over 180 days to one year, or under legal proceedings.
 - v. *Category 5 (loss)*: the borrower is insolvent, under legal proceedings or in bankruptcy. Scarce possibility of credit recover or in arrears over one year.
 - vi. *Category 6 (loss by technical decision)*: same treatment as commercial loans.
4. Classification and Provisioning Manual: banks must develop procedures for the analysis of their loan portfolios. These procedures have to assure:
 - a. an appropriate analysis of the financial and economic situation of any debtor;
 - b. a periodic review of the situation of any debtor.
 5. Large exposure: the classification of debtors whose debts exceed 2.5% of the capital of the bank or of related clients must be approved by the bank's highest authority.
 6. Classification review frequency:
 - a. The minimum classification period is one year.
 - i. A quarterly period is required for credits that amount to 5% or more of the capital of the bank.
 - ii. Half a year for credits that amount \$1.000.000 or range between 1% and 5% of the capital of the bank.
 1. Debtors reviewed biannually must represent, at least, 50% of total loans.
 - b. A bank has to review the rating assigned to a debtor when:
 - i. another financial institution reduces the debtor classification in the 'Credit Information Data Base' and the bank grants 10% or more of a debtor's total financing with the financial system,
 1. The BCRA only allows a discrepancy of one grade level on the information of debtors classification included in the 'Credit Information Data Base'.
 - ii. securities issued by the debtor are downgraded.

PROVISIONING

1. Provisioning must be carried out when loans are approved and must be adjusted periodically. Public sector loans are excluded.
2. Minimum provisioning levels are as follows:

	DEBTOR CATEGORY	WITH COLLATERAL	WITHOUT COLLATERAL
1	Normal (*)	1%	1%
2	Potential Risk	3%	5%
3	Substandard	12%	25%
4	Doubtful	25%	50%
5	Loss	50%	100%
6	Loss by Technical Decision	100%	100%

(*) Includes the loans with preferred "A" collateral.

3. Provisioning in excess of minimum requirements is permitted but if this percentage reaches the one assigned to a lower category, the debtor has to be classified in that category.
4. The Superintendency may require additional provisioning if it determines that the current level is inadequate.
5. When a loan with collateral is classified as 'doubtful' or 'loss' during 24 months, it starts to be treated as without collateral and its provisions must be according to the new classification.
 - a. Mortgages can be provisioned by less than 100% as long as they comply with certain requirements.
6. The interests accrued on credits classified as 'Substandard', 'Doubtful' or 'Loss' have to be fully provisioned. Banks can choose to interrupt the interest accrual on these credits.
7. As from August 1995 and following international accountancy practice, loans classified as 'loss' and fully provisioned must be charged off assets after the seventh month in which these conditions are verified, and transferred to off-balance sheet accounts.

COLLATERAL

1. Collateral is divided into the following types:
 - a. Preferred A: Guarantees that assure to the bank the fully repayment of the financing due to the existence of a solvent third party or secondary markets.
 - i. Include: cash, gold, CD's, automatic export reimbursements, Government bonds, letters of credit issued by an "A" rated foreign bank, national tax sharing funds, funds collateralized by an "A" rated OECD government, pledges, receivables discounted with assignor's liability when:
 - (1) the payment obligee is a 'significant' debtor:
 - (a) the debtor has a debt of at least \$5 million rated as 'normal in the 'Credit Information Data Base' assigned by 5 different banks or the debtor has outstanding bonds for \$15 million.
 - (b) the global limit for all the assignors with respect to one obligee is 5% of the bank's capital or 10% of the total debt of the obligee.

- (2) remainder obligees:
 - (a) global limit of this type of credits: 100% of the bank's capital;
 - (b) individual limit for each debtor: 5% of this type of credits;
 - (c) 85% of these credits has to be rated as 'normal' and the remainder 15% as 'potential risk'.
 - (d) the haircut of the receivables is determined considering the classification of the assignor and the obligee.
- ii. These operations may have less than 6 month maturity.
- b. Preferred B: Guarantees constituted by property rights that assure to the bank the repayment of the debt following the procedures for the execution of those rights.
 - i. Including: mortgages and pledges with more than 6 month maturities.
- c. Others.

F. OPERATIONS WITH RELATED CLIENTS

The regulations impose limits on the risks which may be present in transactions with persons or firms who are related to a financial institution.

1. The definition of 'relatedness' is based on the degree of control of the firm, measured by stock ownership, number of board members in common or actual or potential participation in governing bodies.
2. The concept of 'relatedness' is defined on the basis of the degree of control. Specifically, a person or a firm has control of a firm whenever:
 - a. a person or firm, directly or indirectly, has 25% or more of the total votes or any instrument that gives this right;
 - b. a person or firm, directly or indirectly, possess 50% or more of the votes necessary for the election of the board or of persons who have similar positions;
 - c. a person has the control of other institutions that can influence the decisions of the controlled firm;
 - d. the Central Bank, on behalf of the Superintendency, establishes that this person or firm has 'control influence' over the other.
3. The concept of financing include the holdings of shares and credits and warranties granted by a local bank, its foreign branches and other institutions controlled by the local bank as an economic group.
4. The following lending limits are determined in terms of the capital of the bank and its CAMELS rating as follows:
 - a. Banks with a CAMELS rating between 1 and 3:
 - i. For a related client:
 - (1) General:
 - (a) Loans with collateral: 10%.
 - (b) Loans without collateral: 5%.
 - (2) Domestic banks subject to consolidation:
 - (a) If the institution that received the funds has a CAMELS 1 rating: 100%
 - (b) If the institution that received the funds has a CAMELS 2 rating: 10% plus an additional margin equal to 90% of the capital as long as the loan has a less than 6 month maturity.
 - (3) Other domestic banks: 10%.
 - (4) Companies with complementary activities to those of the financial institution: 10%. This limit can reach 100% if company is one of factoring, leasing or credit cards.
 - (5) Foreign bank with an investment grade rating: 10%
 - ii. For the total of related clients: 20%.
 - iii. Total financing to related clients plus 'frozen assets': 90%

- (1) 'frozen assets' include: fixed assets, 'various goods', research and development expenses, good will, 'various credits', unlisted shares.
- b. Banks with a CAMELS rating between 4 and 5:
 - i. Are prohibited to finance related clients, except:
 - (1) if its foreign branches are subject to supervision on a consolidated base,
 - (2) to the controller foreign banks, or
 - (3) to companies which have a complementary activity to theirs.
- 5. The purchase of bonds traded on open markets are not included in these regulations, as long as holdings do not exceed 10% of the outstanding amount of the bonds (provided a 'BB' rating or above). Underwriting operations of under 180 days are also excluded from the regulation.
- 6. Banks cannot extend credit to related companies or individuals that do not have an adequate credit rating, i.e. rated less than 'BB' by a credit agency or classified as other than 'normal' by another bank.
- 7. A sworn statement concerning their relation (related or controlling) with the financial institution must be submitted by:
 - a. clients whose debt exceed 2.5% of the financial institution capital or \$1 million, whichever the lowest;
 - b. persons, directly or indirectly related with the bank, with 5% or more of the financial institution capital.

G. BASIC: BONDS, EXTERNAL AUDITING, SUPERVISION, INFORMATION AND RATING OF FINANCIAL INSTITUTIONS

The solvency and liquidity of the banks requires appropriate prudential standards together with a control system to verify compliance with them. In addition to a strict prudential framework, the Central Bank has designed a monitor system where the Superintendency shares the control function of financial institutions with the market. The market can supplement the Superintendency in monitoring and in ensuring financial institutions' discipline. The system is called BASIC, where each of the letters stands for an instrument used for banking supervision.

Given that information is a key element because no supervision is possible without it, the I component stands for the supply of information about banks' performance. Appropriate monitoring of an institution should be based on its thorough knowledge.

Component A refers to the importance given to the external audit function. External audit has a significant role to play in banking supervision, since it is through its work that figures submitted by banks in their reports are validated, and information quality is certified.

Component S refers to the supervisory function of the control agency. The supervisory policy is based on the belief that traditional supervision plays an extremely important role supplemented but not replaced by the market discipline.

Using information generated and validated within this system, components B and C allow the market to monitor and control financial institutions. Letter B refers to the banks obligation to issue bonds or other long term liabilities. To comply with this requirement, banks need to have a favorable opinion from domestic and international institutional investors, who put their capital at risk. This situation generates a new group of economic agents that monitor institutions.

Finally, component C refers to the role assigned to the rating of banks given by international credit rating agencies. Its main purpose is to provide depositors with information about the institutions' repayment ability.

1. B: BONDS

- a. The BCRA established that financial institutions (except branch offices of foreign banks with 'investment grade' rating and subject to consolidated basis supervision, and foreign-bank subsidiaries that, in addition to meeting the above conditions, have the explicit backing of their parent) must issue and place debt according to the following conditions:
 - i. Amount: 2% of total deposits held as of the last day of the second month prior to that of the debt issuance.
 - ii. Term: Annual.
 - iii. Issuance: The maturity may not be less than 360 days. Additionally, these instruments may not be redeemed in advance, unless the Superintendency, based on the market conditions, gives its express authorization.
 - iv. Instruments: There are several alternatives:
 - (1) outstanding bonds or other publicly-offered debt instruments, tradable in Argentine markets or in markets of OECD countries that have issued 'AAA' rated securities;

- (2) time deposit certificates held by a foreign bank with an 'A' rating or higher;
- (3) loans of foreign banks with an 'A' rating or higher;
- (4) loans of local institutions that have complied with the regulation through instruments (1) to (3);
- (5) shares as long as their holders (individuals or firms) have not been related to the financial institution for at least 360 days.
- v. Banks that do not satisfy the above issuance requirement attract:
 - (1) One percentage point higher liquidity requirements, and
 - (2) 5% higher capital requirements (for credit and interest rate risk).

2. **A: EXTERNAL AUDITING**

- a. External auditing is of fundamental importance and complementary to the supervisory activities of the Superintendency.
- b. According to the regulations, the financial institutions must appoint Certified Public Accountants (CPAs) for external auditing, who must register in the Registry of Auditors of the Superintendency.
- c. The name of the appointed CPA and the contract period must be reported to the BCRA. If he/she acts on behalf of a company this must also be reported.
- d. The regulation establishes auditor rotation every five years.
- e. The CPA must keep the working papers for a six-year period.
- f. The minimum procedures of external audit refer to the examination of fiscal year accounts as well as of quarterly accounts and are the following:
 - i. The procedures applied to the study of financial statements at the end of the fiscal cycle are:
 - (1) 'Inspection and Evaluation of Internal Controls' and
 - (2) 'Substantial Proofs' related to the holdings of bonds and other financial assets, debtors, monitoring of the documents and guarantees that back loans, monitoring of provisioning, review of the operation with derivatives, review of the consolidation of the balance sheet.
 - ii. The external auditor must report quarterly on:
 - (1) the main debtors of the financial institution: the report must contain the CPA's opinion on the situation of those debtors whose debts are equivalent to 1% of the capital of the financial institution or when the bank's credit to this debtor accounts for 70% or above of the total financial assistance the debtor is getting from the whole system. Also, this report must include the opinion on the appropriateness of the provisioning, and the reasons for an eventual discrepancy between the information submitted by the bank and that obtained by the Superintendency 'on-sight';

- (2) risk from operations with derivatives;
 - (3) those operations with foreign parties that are not subject to a regime of consolidated supervision.
- iii. The external auditor has to evaluate the organization of the internal auditing area, its working methodology and the fulfillment of the internal controls rules.

3. **S: SUPERINTENDENCY**

Supervision of financial institutions is an ongoing process including different stages: identifying risk; developing adequate supervision plans; keeping a close relationship with the institution to be aware of its strengths and weaknesses; performing on-site and off-site examinations and reviewing the information gathered; reporting examination results through reports and meetings with the bank's managers, and doing follow-up on any changes to be made by the institution to overcome its weaknesses or potential problems. This continuous cycle of supervision, may be summarized in four stages, the first three ones compose the inspection process: planning, examination, communication and follow-up (off-site supervision).

a. Consolidated supervision

- i. The concept of consolidated supervision has been adopted, according to which the financial institutions must present information on themselves and on their affiliates.
- ii. Domestic institutions are not allowed to participate in foreign institutions when the Superintendency considers that there is not enough data for the evaluation of the domestic bank.
- iii. If the bank is a branch of a foreign institution, the information required by the foreign supervisory authority from the bank's headquarters is considered to be fully reliable and comparable to those stipulated by the BCRA.

b. Inspections and evaluation

- i. This approach segregates examination of financial institutions (on-site supervision) from the technical analysis of the information supplied by institutions (off-site supervision). This segregation allows for refocusing the examination job, and puts technical analysis at the service of examination.
- ii. The usual output of an inspection is the 'Inspection Report'. This report is the base of the evaluation of the bank's situation.
- iii. After an inspection, the bank is classified according to the CAMELS rating system, which provides a summary measure for the soundness of the bank. The classification ranges between 1 and 5, where 1 corresponds to the highest rating.
- iv. The CAMELS method provides a general framework for the evaluation of a bank's solvency and for the application of the regulations. It includes qualitative as well as quantitative factors. Broadly, these include:

(1) *Capital:*

- (a) Adequacy for the institution's activities;

- (b) Volume of substandard assets;
 - (c) Past evolution, plans and outlook for the institution.
- (2) *Assets*:
- (a) Level, distribution and soundness of rated assets;
 - (b) Level and composition of non-interest (or low interest) bearing assets;
 - (c) Adequacy of provisions.
- (3) *Management*: Management performance must be evaluated regarding a number of aspects needed to run a financial institution, and against a background of usual banking practice
- (a) Technical skills, leadership and administrative ability;
 - (b) Adherence to the law and other regulations;
 - (c) Ability to plan and to respond to changing circumstances;
 - (d) Adequacy for and compliance with internal policies;
 - (e) The institution's profits from operations.
- (4) *Earnings*:
- (a) Ability to cover losses and available capital;
 - (b) Trend, volatility and structure of profits;
 - (c) Comparisons within homogeneous groups;
 - (d) Quality and breakdown of net income.
- (5) *Liquidity*:
- (a) Deposits' volatility;
 - (b) Stability, maturity structure and volume of loans;
 - (c) Availability of highly liquid assets;
 - (d) Access to money markets and other sources of immediate cash;
 - (e) Other.
- (6) *Sensibility*: It takes into account the following risks:
- (a) market risk;
 - (b) interest rate risk;
 - (c) price risk; and
 - (d) foreign exchange risk.

4. **I: INFORMATION**

- a. Financial institutions must comply with regulations on capital requirements, operations with related clients, credit risk diversification, debtor classification and individual bank liquidity positions both on individual basis and on a consolidated basis.
- b. Financial institutions have to submit to the BCRA the following information:
 - i. Monthly consolidated balance sheets. These balance sheets have to include information on 'significant subsidiaries' in the country.
 - (1) The BCRA defines 'significant subsidiary' as that which contributes at least 10% of the revenue of the institution or the assets of which represent 10% or more of the capital of the bank.
 - ii. Quarterly and annual balance sheets. These balance sheets must consolidate information of all the foreign and domestic subsidiaries and, when the Superintendency determines, the enterprises in which the bank has more than 12.5% of the capital.
- c. Domestic institutions must submit to the Superintendency information about enterprises or banks:
 - i. affiliated to stockholders with 5% or more of the capital/votes of the financial institution;
 - ii. affiliated to its directors.
- d. When individual or aggregate transfers considered during a consecutive six-month period represent 5% or more of the capital and/or votes of the financial institution, they must be reported to the BCRA. In addition, when buyers acquire 2% of the capital stock of the financial institution through public offerings or through domestic and international stock exchanges, it must also be reported to the BCRA.
- e. Financial institutions must request to their controlling stockholders to prepare consolidated semiannual financial statements of their economic groups, unless the controlling institution is required to prepare consolidated financial statements in its country.

5. **C: CREDIT RATING**

- a. Financial institutions must be classified by one of the rating agencies approved by the BCRA. It is required that the agency operate in at least 10 different countries of which at least 5 must be Latin-American.
 - i. The local branches of foreign banks and those institutions with explicit collateral on deposits by a foreign bank may have an alternative rating regime. These institutions must submit to the Superintendency at least two international ratings which take Argentine risk into account.
- b. Ratings must reflect the payment capacity of the medium and long term claims.
- c. Reports on ratings must be quarterly and presented to the Superintendency.
- d. Rating ranges between 'AAA' (minimum probability of failure) to 'T' (failure). If the rating assigned is 'CCC' or below, the rating agency must give its opinion about the amount of the possible capital loss.
- e. The evaluation has to include three basic elements:

- i. Financial institution position.
 - ii. Financial institution main characteristics: capitalization, assets, management, earnings, liquidity, liability structure, etc.
 - iii. Possible financial institution behavior according to different scenarios for the Argentine economy.
- f. The ratings obtained by financial institutions must be publicly available.

H. INTERNAL AUDITING

The internal auditing is a process carrying out by the board, the management and other members of a financial institution in order to get a reasonable level of certainty and efficiency of their operations, reliance in their accountability and the fulfillment of the legal requirements.

1. The process of the internal auditing is composed of an environment of control, evaluation of the risk, monitoring activities, disclosure and communication and surveillance.
2. Financial institutions have to constitute an 'Auditing Committee' composed by at least two members of the board (or same-level authorities) and the head of the internal auditing area.
3. Auditing Committee members have to rotate every 2 or 3 years.
4. The Auditing Committee has to:
 - a. exercise surveillance on the internal auditing systems;
 - b. take notice about the suggestions made by the external auditing or the Superintendency.
5. The personal data of the Auditing Committee members have to be submitted to the Superintendency.
6. Financial institutions have to develop and document their administrative and accounting procedures in order to get an adequate control of the operations.
7. Internal auditing must assure:
 - a. the existence, adequacy and integrity of the accounts;
 - b. their appropriate valuation;
 - c. the fulfillment of the BCRA regulations.

III. AUTHORIZATION OF FINANCIAL INSTITUTIONS

A. ESTABLISHMENT OF NEW FINANCIAL INSTITUTIONS

1. There is free entry to the financial system subject to:
 - a. Approval by the BCRA.
 - i. The aspects that the BCRA assesses when a license is issued:
 - (1) the suitability of major shareholders and the transparency of ownership,
 - (2) the skill and experience of the proposed directors and the senior management;
 - (3) the operating plan and the financial projections, and
 - (4) the operational structure.
 - b. Minimum capital of \$10 million for wholesale banks and \$15 million for other classifications of financial institutions.
 - i. Initial disbursement have must be effected with cash.

B. MERGERS AND ACQUISITIONS OF FINANCIAL INSTITUTIONS

1. Mergers and acquisitions are subject to the approval by the BCRA.
2. The regulations facilitate on mergers and acquisitions of financial institutions.

C. FINANCIAL INSTITUTION CLASS CHANGES

1. Financial institutions may change their class subject to:
 - a. Approval by the BCRA;
 - b. The fulfillment of the capital requirement, other prudential rules and the information requests of the BCRA;
 - c. Their not presenting any liquidity, solvency or profitability problems.

D. ESTABLISHMENT OF AFFILIATES IN THE COUNTRY OR ABROAD

1. The establishment of affiliates in the country or abroad are subject to:
 - a. The BCRA's decision on the convenience and benefits of the project.
 - b. The fulfillment of the capital requirement, other prudential rules and a CAMELS classification of 1 to 3.
2. The requests for opening a new branch office will be approved automatically 90 days after the verification of the established conditions, provided that the Superintendency has no objections. This 90-day period may be extended if necessary.

E. ESTABLISHMENT OF REPRESENTATIVE OFFICES ABROAD AND PARTICIPATION IN FINANCIAL INSTITUTIONS ABROAD

1. These are subject to:
 - a. Approval by the BCRA.
 - b. The fulfillment of the capital requirement, other prudential rules and the information requests of the BCRA.
 - c. The representation offices may only perform non-operative activities.
 - d. To participate in foreign subsidiaries, the responsibility of the domestic institution must be specified to be limited by the capital allowance; the institution may not take on additional responsibility nor commitments for operations of the foreign institution.
 - e. Participation in foreign financial institutions, whose financial statements must be consolidated with the local institution's, may not be held if the Superintendency does not receive all the necessary information to analyze the consolidated institution.

F. MODIFICATION OF THE SHARE COMPOSITION OF FINANCIAL INSTITUTIONS

1. The BCRA has the right to approve and authorize the transfer of share packages capable of producing changes in the classification of the institutions or alter the structure of the respective share groups.
2. There must be adherence to the regime for public offering in stock exchanges of the country or abroad.
3. Financial institutions must report to the BCRA when individual or aggregate transfers undertaken during a consecutive six-month period represent 5% or more of the capital and/or votes of the financial institution. In addition, when buyers acquire 2% of the capital stock through public offerings or through domestic and international stock exchanges, it must also be reported to the BCRA.

G. REPRESENTATIONS OF FOREIGN FINANCIAL INSTITUTIONS NOT AUTHORIZED TO OPERATE IN THE COUNTRY

1. The possibility of opening representations is subject to:
 - a. Authorization by the Superintendency.
 - b. Provision of diverse information about the bank represented.
 - c. Conforming to the completion of due reports.
 - d. The supervisory regime of the home country must be on a consolidated basis, except in the case of bordering countries.

- e. The operation of representatives is limited to consulting and technical assistance. Any operations involving financial intermediation and/or exchange are prohibited.

IV. LIABILITY MANAGEMENT

A. DEPOSIT INSURANCE

1. Deposits are not covered by any insurance from the BCRA. The Financial Institutions Law establishes that depositors have special privilege in that they have first claim to the funds held as liquidity requirements, in the following order:

- i. up to \$5,000 per deposit;
- ii. total deposits of 90 days and beyond;
- iii. the remainder of deposits pro-rata.

Depositors also have first claim to the institution's remaining assets, with the exception of creditors of preferred mortgages and pledges. In terms of the seniority of claimant, the BCRA follows depositors and precedes the remaining creditors, with the exception of those with employment contracts from the institutions.

2. In May 1995, the Deposit Insurance System was created. The system is fully-funded and obligatory for the financial institutions, and provides limited deposit insurance to depositors.

Each institution must join the Deposit Insurance Fund and pay a monthly installment, which is a function of its total deposits. The Deposit Insurance Fund is managed by 'Seguro de Depósitos S.A.' (SEDESA), whose partners are the Argentine government and a trust set up by the financial institutions.

The monthly installment ranges from a minimum of \$1.5 per \$10,000 to a maximum of \$3 per \$10,000 of deposits, according to the assessed risk level of the bank. The risk level depends on the quality of the loan portfolio, the 'assets at risk to assets' ratio, the CAMELS factor, and the excess capital requirement ratio.

The insurance is limited in nature. It covers up to \$30,000. The total amount of deposits that each person claims will be computed to determine the amount covered. However, there is no coverage in the case where the deposit account was constituted through endorsement or by schemes that offer additional incentives to the interest rate.

The funds of Deposit Insurance Fund can be used not only to return the insured deposits in case of an institution bankruptcy, but also in the following ways:

- i. To lend funds to financial institutions that are under a 'regularization and reorganization plan'.
- ii. To lend to financial institutions that are buying assets and paying the deposits of another institution which is under a 'regularization and reorganization plan'.
- iii. To make agreements with institutions which participate in the restructuring of another one, giving the former banks the option of buying assets of the bank with problems.
- iv. To buy deposits of suspended institutions.

B. DEPOSITS

1. Time deposits
 - a. US Dollar and peso fixed time deposits are allowed. The BCRA can authorize deposits in other currencies.
 - b. Public and private deposits in securities are allowed. Those securities have to be traded routinely in open markets.
 - c. Deposits are remunerated according to the interest rates that the parties freely agree on.
 - d. Dollar and peso fixed time deposits of less than 30 days are not allowed. Deposits of security deposits do not have minimum term.
 - e. CD's can be traded in secondary markets after 30 days of their issue.
2. Deposits with variable return: There are different types of indexes that can be used for the reference rates. The minimum term of these deposits is 90 days.

C. ENDORSEMENT OF THIRD PARTY OPERATIONS

1. Acceptances: Banks and other financial institutions may endorse debt operations between persons that belong to the non-financial sector.
 - a. Minimum term: 30 days
 - b. Margin: freely agree-on between the parties
 - c. These operations may be renegotiated as long as there are at least 30 days between the transfer.
2. Operations with securities: Financial institutions can endorse loans and repos. with securities.
 - a. Minimum term: freely agree-on if the securities are traded routinely in open markets, otherwise the term is 30 days.
3. Bonds issued by enterprises: Financial institutions can endorse the issuance of these bonds as long as:
 - a. Bonds are issued with authorization of the CNV ("National Securities Commission"), the term is not less than 30 days and the amount is larger than \$100.000.
 - b. Financial institutions can renegotiate these bonds after 30 days of their issuance.

D. CUSTODIAN AND REGISTER AGENT FUNCTIONS

1. To classify as custodian of Pension Funds assets or register agents for mortgages bonds, banks should:
 - a. be rated CAMELS 1 or 2 by the Superintendency;
 - b. have a minimum capital of \$50 million or 5% of the Pension assets;
 - c. have capital in excess of 0.25% of the Pension Funds assets. This amount of capital has to be invested according to the BCRA specifications.

V. ASSET MANAGEMENT

A. PERMISSIBLE LOANS

1. The allocation of funds has been deregulated.
2. Credit policy must be oriented to finance investment, production, trade, and consumption of goods and services as required by domestic and foreign demand.
3. Collateral may be provided, following the same conditions as for the granting of loans.
4. In addition, there are two regimes of fund absorption with specific allocation:
 - a. Foreign currency deposits ('Argendollars', Law 23,758): The objective is mainly to finance foreign trade operations and productive activities, and purchase of government and corporate bonds.
 - b. Outstanding corporate bonds: The objective is to finance investments in capital equipment, building of working capital, and liability refinancing for domestically-based companies and for personal loans or mortgages, housing construction and government bonds.

LOANS TO THE PUBLIC SECTOR

1. Financing to the non-financial public sector is prohibited, except:
 - a. Purchase of public bonds;
 - b. Other financings when:
 - i. are approved by the Ministry of Economy;
 - ii. are collateralized by royalties or federal share taxes;
 - iii. it is permitted the direct transfer of the funds between the collecting agency and the bank.

B. INTEREST RATES

1. Interest rates are set by bank according to market conditions.
2. There is a disclosure requirement, by which 'Total Financing Cost' must be specified, which includes the different charges associated with the operation. In addition, the BCRA publishes monthly the average of market rates.
3. Indexation of the principal is prohibited by the Convertibility Law (March 1991).
4. Fees or other additional charges to the agreed-on interest in the credit operations are prohibited if they are not related to an actual service or to the reimbursement of expenses.

C. SECURITIES HOLDINGS

1. Holdings of domestic public and private securities can be held in investment accounts.
 - a. The accounting valuation is that of the cost of the asset adjusted for the accrued interest of the coupon.

- i. if the security was held by the bank in trading accounts, the accounting valuation has to consider the market price of the previous day to the transfer to investment accounts.
- b. The valuation of the holdings in investment accounts has to be adjusted if the market price decreases more than 20% of the cost registered in the book value.
- c. Repo. operations with these holdings are permitted as long as the counterparty was another financial institution, a foreign bank rated 'A' or above, or the BCRA.

D. MUTUAL FUND HOLDINGS

- 1. Holdings of quotas of mutual funds are prohibited, except:
 - a. Those admitted for the complying of the liquidity requirements;
 - b. During the first 120 days of the issuance of a new mutual fund with public offered and when the bank act as intermediary. The limit for these holdings is 2% of liquidity requirements or \$2.000.000, the higher.
- 2. Financial institutions can act as intermediaries, they cannot operate on their own risk.

E. REPOS., FORWARDS, FUTURES AND OPTIONS

- 1. Repos. forwards and futures: can be conducted on public and private securities as long they are traded routinely in open markets.
 - a. Minimum term: freely agree-on between the parties, but in same occasions in required a 30-day minimum term.
 - b. Premium: freely agree-on between the parties.
 - c. Margin: freely agree-on between the parties, but it has to take into account the rules for the collateralization of bank's assets.
 - d. Operations must be performed through a centralized clearing system.
- 2. Options:
 - a. The sale of option contracts can only be performed by a financial institutions rated 'A' or above.
 - b. The purchase of option contracts can only be performed if there is a secondary market for these contracts or if the seller is a foreign bank with an investment grade rating.

F. COLLATERALIZATION OF BANK'S ASSETS

- 1. Collateral may not be used for funding operations between institutions, except in those situations especially approved by the BCRA.
- 2. The exceptions are:
 - a. Foreign lines of credit related to the settlement of operations in Euroclear and Cedel of banks rated 'A' or greater.

- b. Derivatives provided that these transactions are conducted in domestic institutional or OECD markets.
 - c. Guarantees of 'over-the-counter' transactions when:
 - i. counterparties are foreign banks with an 'A' or higher rating;
 - ii. the collateral does not exceed 20% of the amount of the transaction;
 - iii. domestic institutions must have an 'AA' or higher rating and branch offices or subsidiaries of foreign banks must have an 'AA' or higher rating, are subjected to consolidated supervision and have an explicit guarantee for the liabilities from their headquarters.
 - d. Banks can collateralize reverse repo. of bonds, currencies and loans as long as:
 - i. Both domestic borrowing and lending institutions are rated as 'AA' or higher. Foreign lending institutions that be rated as 'investment grade' or higher;
 - ii. They have the approval of the Superintendency when the haircut exceeds 50% of the financing.
 - e. In the case of standby letters of credit admitted for complying with the liquidity requirements.
 - i. haircut can not exceed 125%;
 - ii. banks can use mortgages, pledges and other assets as collateral for these credits;
 - iii. all banks are permitted to collateralize these credits.
 - f. Guarantees related to the clearing and settlement of payments.
 - i. banks can use the assets admitted for complying with the liquidity requirements.
3. The limits are:
- a. The total assets offered as collateral for foreign lines of credit and operations with derivatives cannot exceed 5% of the capital of the bank.
 - b. The total haircut for reverse repos. cannot exceed 100% of the capital of the bank .