

**Argentina: Detailed Assessment of Compliance of Basel Core Principles for Effective
Banking Supervision**

This paper was prepared based on the information available at the time it was completed in October 2011. The views expressed in this document are those of the staff team and do not necessarily reflect the views of the government of Argentina or the Executive Board of the IMF.

The policy of publication of staff reports and other documents by the IMF allows for the deletion of market-sensitive information.

Copies of this report are available to the public from

International Monetary Fund • Publication Services
700 19th Street, N.W. • Washington, D.C. 20431
Telephone: (202) 623-7430 • Telefax: (202) 623-7201
E-mail: publications@imf.org • Internet: <http://www.imf.org>

**International Monetary Fund
Washington, D.C.**

ARGENTINA

BASEL CORE PRINCIPLES FOR EFFECTIVE BANKING SUPERVISION
**DETAILED ASSESSMENT OF
COMPLIANCE**

OCTOBER 2011

INTERNATIONAL MONETARY FUND
MONETARY AND CAPITAL MARKETS
DEPARTMENT

THE WORLD BANK
FINANCIAL AND PRIVATE SECTOR
DEVELOPMENT VICE PRESIDENCY
LATIN AMERICA AND CARIBBEAN REGIONAL
VICE PRESIDENCY

Glossary

AML/CFT	Anti-Money Laundering/Counter Financing of Terrorism
BCBS	Basle Committee on Banking Supervision
BCPs	Basel Core Principles
BCRA	Central Bank of Argentina
CAR	Capital Adequacy Ratio
CNV	National Securities Commission
CPs	Core Principles
FIU	Fraud Investigation Unit
FSAP	Financial Sector Assessment Program
GAFISUD	Grupo de Acción Financiera de Sudamérica
IFRS	International Financial Reporting Standards
KYC	Know Your Client
MECON	Ministry of Economy and Public Finance
MoU	Memorandum of Understanding
NBFI	Non Bank Financial Institution
NPLs	Non-Performing Loans
RoE	Return on Average Equity
ROSC	Report on the Observance of Standards and Codes
SEFyC	Superintendence of Financial Entities
SSN	Superintendence of Insurance

Table of Contents	Page
I. Introduction, Context, and Pre-Conditions	4
Introduction.....	4
Information and methodology used for assessment.....	4
Institutional and macroeconomic setting and market structure—overview	5
Preconditions for effective banking supervision.....	11
II. ROSC, Main Findings, Summary, and Recommendations	18
Main Findings	18
Summary Compliance with the Basel Core Principles	24
Recommended action plan	29
III. Detailed Assessment	32
Detailed Assessment of Compliance with the Basel Core Principles.....	33
IV. Authorities’s responses.....	98
Part I. Introduction.....	98
Part II. Detailed response to the principles adherence assessment	103

I. INTRODUCTION, CONTEXT, AND PRE-CONDITIONS

1. The BCRA and the SEFyC are to be commended on their thorough supervision, their implementation of risk-based supervision, and their thorough examination process. Since the 2001-02 crisis, financial sector indicators have improved significantly and the banking system weathered well the impact of the global financial crisis, with high capital levels, the introduction of a capital buffer, and low NPLs. Nevertheless, shortcomings on the regulatory and supervisory framework still remain, in particular regarding independence, legal protection to supervisors, loan provisioning, and consolidated supervision warrant enhancements. The effective implementation of the new risk management regulation will be an important tool for improving bank management and in some cases oversight of the major risks in the banking system, in particular country and transfer risk, market risk, and interest rate risk in the banking book.

Introduction

2. This assessment of the state of compliance with the BCPs in Argentina has been undertaken as part of a World Bank Observance of Standards and Codes (ROSC) mission.¹ The assessment was conducted from May 11 to 26, 2011. It reflects the banking supervision practices of the Central Bank of Argentina (BCRA) as of the end of April 2011.

Information and methodology used for assessment

3. **The assessment is based on the following sources:** (i) a complete self-assessment prepared by the BCRA; (ii) detailed interviews with the BCRA staff; (iii) review of laws, regulations, and other documentation on the supervisory framework and on the structure and development of the Argentine banking sector; and (iv) meetings with individual banks, the banking associations, the Ministry of Economy and Public Finance (MECON), external auditors, and financial think tanks.

4. **The assessment was performed in accordance with the guidelines set out in the Core Principles (CPs) Methodology.**² It assessed compliance with the “essential” criteria only. The Methodology requires that the assessment be based on the legal and other documentary evidence, combined with a review of the work of the supervisory authority as well as its implementation in the banking sector. The assessment of compliance with the CPs is not, and is not intended to be, an exact science. Banking systems differ from one country to the next, as do their domestic

¹ The mission was led by Ms. Sophie Sirtaine (World Bank). The assessment was conducted by Ms. Valeria Salomao Garcia (World Bank) and Ms. Socorro Heysen (expert consultant). Ms. Maria Laura Patino (World Bank) provided valuable inputs on legal issues.

² Issued by the Basel Committee on Banking Supervision, October 2006.

circumstances. Furthermore, banking activities are changing rapidly around the world, and theories, policies, and best practices of supervision are swiftly evolving. Nevertheless, it is internationally acknowledged that the CPs set minimum standards.

5. **This assessment is based solely on the laws, supervisory requirements, and practices that were in place at the time it was conducted.** However, where applicable the assessors made note of regulatory and supervisory initiatives which have yet to be completed or implemented. In particular, regulations on risk management and corporate governance were recently issued, to be implemented by 2012.

6. **The assessment team enjoyed excellent cooperation with its counterparts and, within the time available to perform their work, reviewed all the information provided.** The team extends its thanks to the management and staff of the BCRA for their openness and participation in the process. The authorities are invited to provide comments on this draft version of the assessment, which will be reflected in the final assessment.

Institutional and macroeconomic setting and market structure—overview

7. **The financial sector in Argentina is dominated by the banking sector, with assets representing about 34 percent of GDP as of December 2010** (Table 2). The insurance sector's assets represent less than 5 percent of GDP and mutual fund assets are less than 2 percent of GDP. With the exception of Banco Credicoop, savings and cooperative banks are small. Private banks held about 56 percent of total banking sector assets and public banks 54 percent. The sector is moderately concentrated with the three largest banks representing 42 percent of banking assets.

Table 1: Structure of Argentina's Financial System, December 2010

Type of Institution	Assets (in bn pesos)	% of total assets in system	Assets as % of GDP	Number of Institutions
Banking sector				
Commercial banks	502.4	86%	35%	64
of which are private	280	48%	19%	52
of which are public	222.4	38%	15%	12
Other financial entities	7.8	1%	0.5%	16
Insurance companies*	61	10%	4%	181
of which are life				38
of which are property and casualty				100
Brokerage houses	na	Na	na	na
Mutual Funds	16.2	3%	1%	38
Total Financial System	587.4	100%	40%	

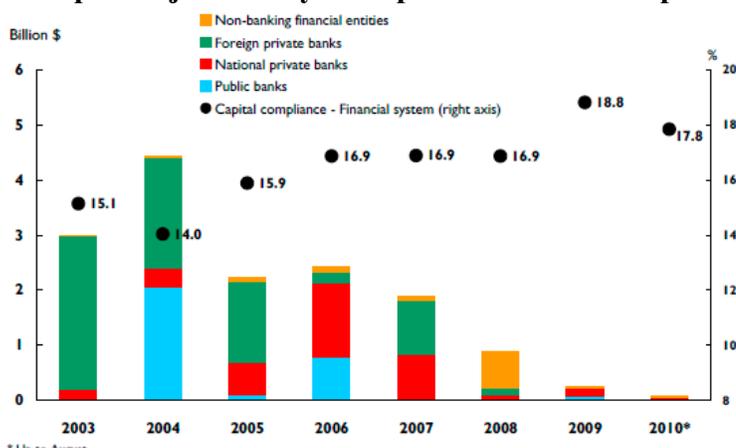
Source: BCRA, SSN

**The remainder of insurance companies includes retirement insurance, disability and public transport insurance*

8. **The degree of conglomeration is high.** Financial conglomerates manage almost 85% of banking assets, 78% of investment funds and 32% of the insurance business. Financial system assets are distributed between public sector conglomerates (27 percent), foreign conglomerates (28 percent), local private conglomerates (24 percent) and stand alone institutions (21 percent).³ Argentina is a host of international banks that belong to financial conglomerates whose parent companies are in Brazil, France, Germany, Great Britain, Italy, Japan, South Africa, Spain, Uruguay and the U.S. In turn, operations abroad of Argentine banks are considered small, and most of them correspond to the foreign branches of public banks. In addition to these, a couple of private local banks have small foreign operations in the Bahamas, the Cayman Islands, and Uruguay. Two of the conglomerates have parallel banks abroad. The large local conglomerates participate in the banking, insurance, and capital markets, but their main operations and risk exposures are generally in the banking sector.

9. **The banking sector has restructured significantly following the banking and currency crisis of 2001-02** during which a run on bank deposits occurred, the government defaulted on its debt, and the peso was devalued. Four foreign banks have withdrawn following the crisis, but they still represented 33 percent of private sector deposits as of December 2010⁴. Between 2002 and 2007, 23 banks disappeared in the local market as a result of mergers and market exits. The financial system received more than US16.2 billion in new capital injections between 2002 and April 2011, which led to a significant improvement in the financial system's soundness (Figure 3). The banking sector is supervised by the Central Bank of Argentina (*Banco Central de la República Argentina* -BCRA).

Figure 3: Capital injections by Groups of Banks and Capital Compliance



Source: BCRA, *Argentina Self-Assessment – Core Principles for Effective Banking Supervision*

³ BCRA, Financial stability report, 2nd Semester 2010.

⁴ The main foreign banks are Santander, BBVA, and HSBC. Bank of Nova Scotia, Credit Agricole, Lyods Bank, and Societe Generale exited the market in the aftermath of the 2002 financial crisis.

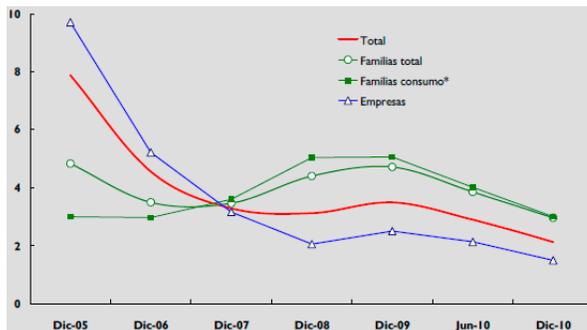
10. Since the 2001-02 crisis, official financial sector indicators have improved significantly, and deposits and credit to the private sector have recovered partially. Banks are well capitalized with a capital adequacy ratio (CAR) for the system averaging 17.7 percent in December 2010,⁵ and overly liquid. Non-performing loans to the private sector (90 days past dues) stood at 2.1 percent of total loans in 2010 and with the highest provision coverage in 10 years at 166 percent (Figures 4 and 5). Since 2005, profitability has been positive and improving, the return on average assets (RoA) reached 2.8 percent in 2010, and the return on equity more than 24 percent (Figure 3 bis). Banking assets and deposits have consistently risen since 2003 and represent respectively 35 and 26 percent of GDP. However, this remains significantly lower than before the crisis, as in 2000 they represented 58 and 30 percent of GDP respectively. Domestic credit to the private sector also remains low at 13 percent of GDP in 2010 (2 points denominated in foreign currency) compared to 22 percent in 2000 (14 points of foreign currency loans) (Figure 6bis), although growth has accelerated in 2010 and 2011 (Figure 6 bis).

Figure 3bis: Net income of financial sector (million pesos), and RoE



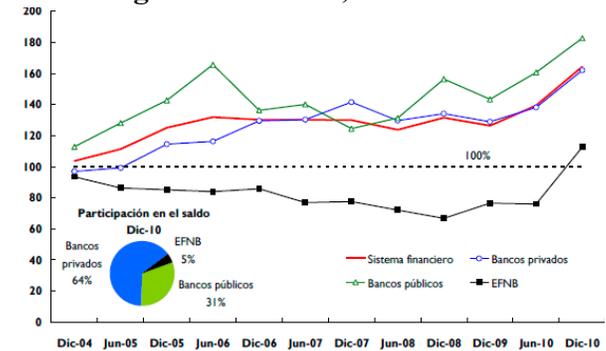
Fuente: CML&A en base a BCRA

Fig. 4: NPLs by type of borrower, % total loans



Source: BCRA, Financial Stability Report 1st Semester 2011 Semester 2011

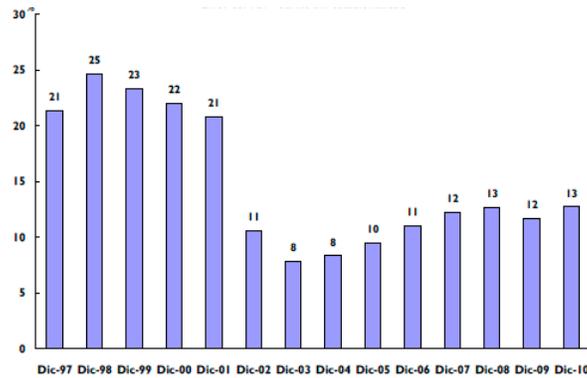
Fig. 5: Provisions, % of NPLS



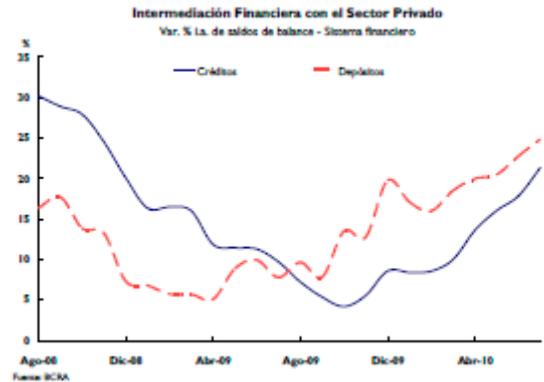
Source: BCRA, Financial Stability Report 1st Semester 2011

⁵ Capital adequacy of public banks is lower than for private banks (CAR of 14.9% versus 20.4% as of end 2010).

Figure 6: Private Sector Credit, % GDP **Figure 6bis: Private Sector Credit, yoy % growth**



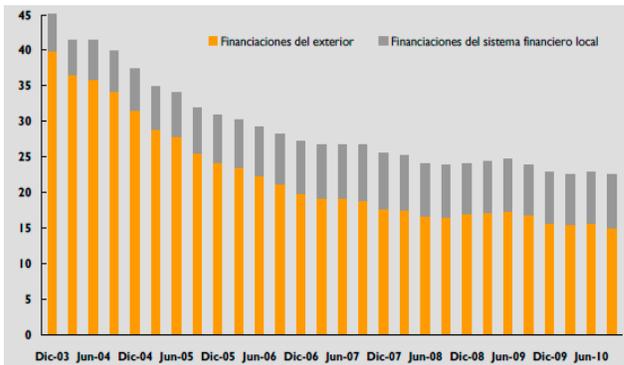
Source: BCRA, Financial Stability Report, 1st Semester 2011



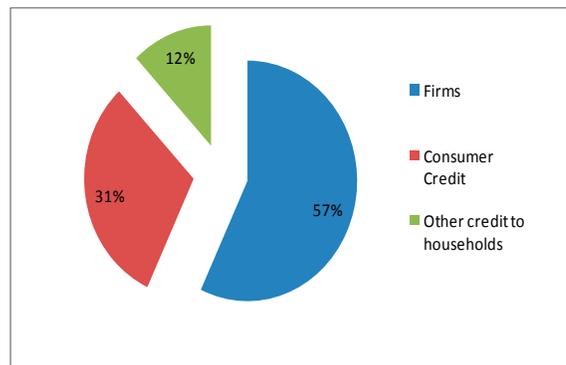
Source: BCRA, Report on Banks, August 2010

11. **Credit is mostly focused on short term working capital loans and consumer loans.** As of December 2010, 57 percent of the financial system’s private sector credit was extended to corporate borrowers, and 31 percent was made of consumer loans (Figure 8). Loans are mostly short term, with an average maturity of less than two years. Thus, Argentine large firms (mainly multinationals) finance themselves mostly outside the local financial system: as of June 2010, corporate external financing was about twice as high as local financing in percentage of GDP, although local financing has been slightly on the rise in the past years (Figure 7).

Figure 7: Corporate Credit, % of average GDP **Figure 8: Breakdown of Private Sector Credit**



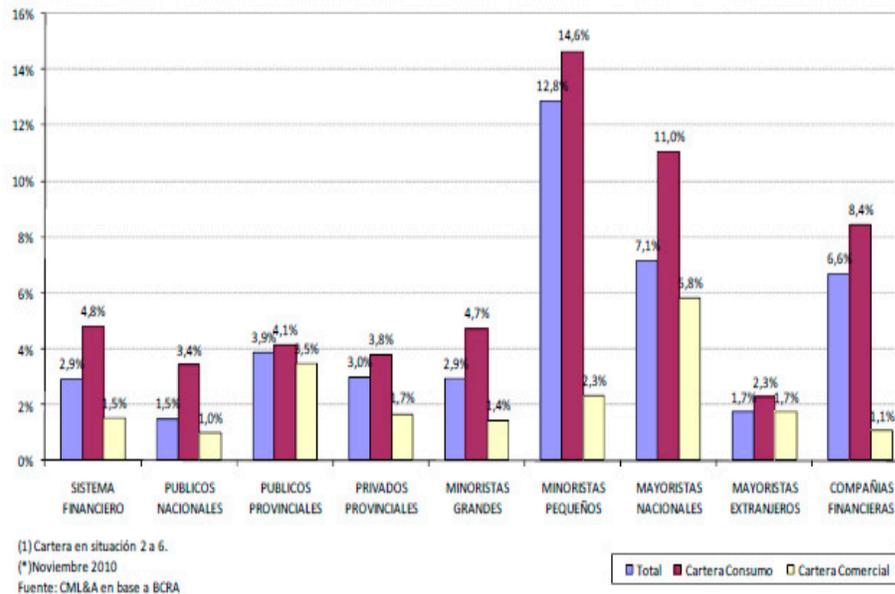
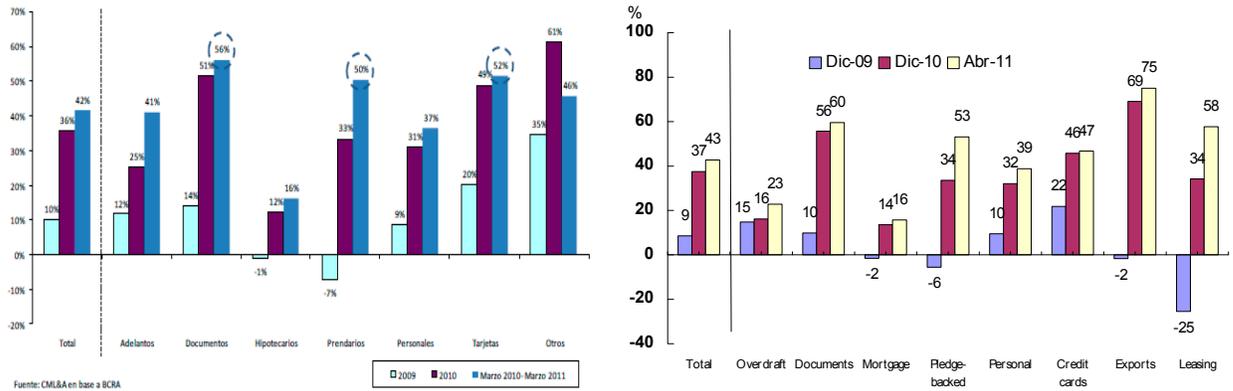
Source: BCRA, Financial Stability Report, December 2010



12. **The rapid growth in credit over the last 2 years, combined with higher levels of NPLs in private domestic banks and in smaller banks, need continued monitoring.** Credit to the private sector grew overall by 37.5 percent in 2010 and by another 42.8 percent (yoy) over the first 4 months of 2011 (Figure 9). Growth has been particularly strong for working capital loans, consumer loans, and credit card advances. As sustained credit growth is often associated with delayed increases in NPLs, this trend needs close monitoring. NPLs overall are low at 1.3 percent

at the end of March 2011 for corporate loans, and 2.7 percent for loans to individuals. NPLs are the lowest for large public banks and foreign-owned banks, and the highest for private domestic banks and smaller banks (Figure 9bis).

Figure 9: Private sector credit, % annual growth **Figure 9bis: Classified loans in % of total loans**



13. **Deposits remain short-term with a large public sector base, although term deposits have been growing quite steadily over the last 2 years.** Since mid-2009, term deposits have displayed a sustained growing trend (Figure 11). However, as of December 2010, short term deposits still represented about half of total private sector deposits (Figure 10). In addition, public sector deposits account for 30 percent of the total deposit base, about twice as much as the level

observed before the 2001-02 crisis (Figure 10 bis). Foreign currency deposits amounted to about 18 percent of private sector deposits, far less than the 65 percent observed in 2000.

Figure 10: Composition of private deposits

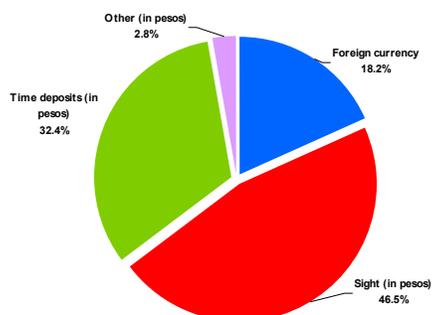
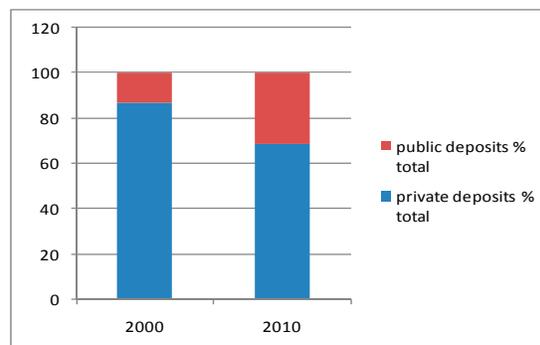


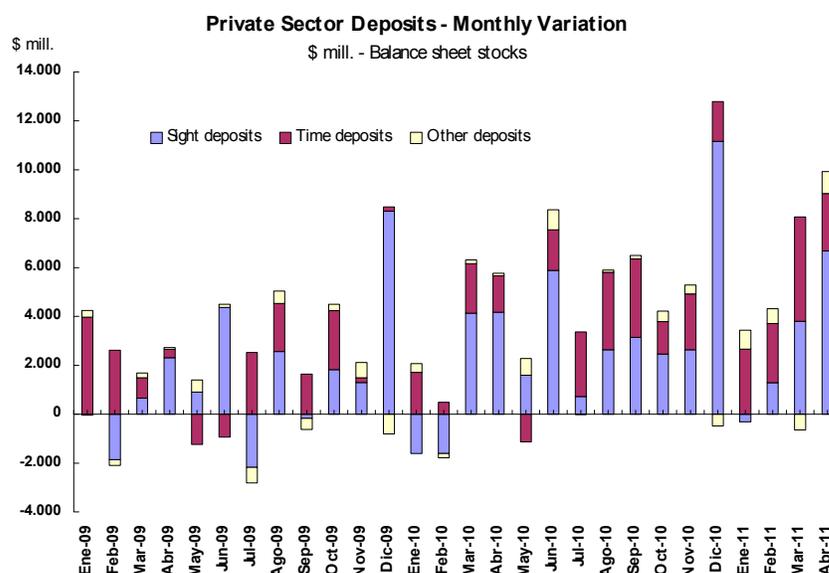
Figure 10bis: Public versus Private Deposits



Source: BCRA, Financial Stability Report, December 2010

Source: BCRA, statistical bulletins

Figure 11: Monthly variation of private deposits, in \$ million



14. **Banks' exposure to the public sector has decreased substantially in recent years, although less so for public banks.** The exposure of banks to the public sector (loans and investments), which had nearly reached 50 percent in 2002 decreased to 12 percent of assets in 2010 for the system as a whole and to about 22 percent for public banks. Public banks continue to rely significantly on public sector deposits for funding (45 percent of total liabilities versus 15 percent for national private banks as of end 2010).

Preconditions for effective banking supervision

15. **The BCPs recognize that a number of preconditions are necessary to enable the development of a stable banking sector capable of supporting economic growth through sound intermediation.** The BCP methodology sets out the necessary foundations of a sound banking supervisory system as including: i) sound and sustainable macroeconomic policies, ii) a well developed public infrastructure, iii) effective market discipline, and iv) mechanisms for providing an appropriate level of systemic protection (or public safety nets). For each of these preconditions, the BCPs describe desired elements. Preliminary findings with regards to these preconditions in Argentina are summarized below. Further analysis of these pre-conditions will be carried out in the context of the planned FSAP.

Sound and sustainable macro-economic policies

16. **After a sharp slowdown in the wake of the global crisis, the Argentine economy has returned to a strong growth path.** After growing by 0.9 percent in 2009, real GDP expanded 9.2 percent during 2010, supported by high commodity prices and strong domestic demand. Economic growth is expected to moderate somewhat in 2011 due to capacity constraints and some erosion in external competitiveness. The average official inflation rate based on Consumer Price Index for Greater Buenos Aires (CPI-GBA) was 10.5 percent in 2010, while inflation as measured by the provinces exceeded 20 percent on average. The official inflation rate has remained just below 10 percent in recent months, while inflation continues to exceed 20 percent in many provinces, amid mounting evidence that the economy is running close to full capacity.

17. **The banking system in Argentina weathered well the impact of the global financial crisis.** There was no bank failure during the crisis, and asset quality and capital adequacy have remained solid. Capital adequacy ratio increased from 16.9 percent in 2008 to 18.8 percent in 2009, but decreased to 17.7 percent in 2010. Non-performing loans increased slightly from 3.1 percent of gross loans in 2008 to 3.5 percent in 2009, but decreased to 2.1 percent in 2010. However, both deposit growth and private credit expansion slowed significantly. Deposit growth declined from an average of nearly 23 percent in 2006-07 to 15 percent in 2008, but steadily rose to 39 percent in 2010. Growth of credit extended to the private sector dropped from an average of nearly 38 percent in 2006-07 to 20 percent in 2008, but rose to 36 percent in 2010. Rapid credit growth over the last two years requires continued monitoring. A full assessment of the condition of the financial system will be carried out under the Financial Sector Assessment Program which the authorities have requested for 2012.

18. **The presence of well functioning elements of public financial infrastructure has supported financial sector growth in Argentina,** including an adequate credit registry managed by the BCRA, a system of collateral and pledge registration and execution considered effective by market players, rapidly improving corporate accounting and auditing regulations, flexible and well tested safety nets (including an effective deposit insurance and bank resolution framework), and an efficient national payment system. Nevertheless, continued progress is desirable, especially with regards to the oversight of the payment systems, and corporate and financial institutions

accounting, financial disclosure, and governance. A detailed description of these issues is provided in the BCP Detailed Assessment.

19. **Nonetheless, the capacity of the financial sector to further support the growth of the Argentine economy remains constrained.** While credit to the private sector and deposits have consistently risen since 2003 and represent respectively 13 and 26 percent of GDP, they remain significantly lower than before the crisis (in 2000, they represented 22 and 30 percent of GDP respectively),⁶ and substantially lower than in other emerging economies.⁷ Despite efforts by the authorities to expand access to banking services across the country, it remains particularly limited in some regions.⁸ Similarly, Argentina's capital market and insurance sectors are small compared to similar economies, with total market capitalization of 17.5 percent of GDP⁹ in the first quarter of 2011 and insurance premium accounting in 2010 to 2.7 percent of GDP. In addition to being limited in volumes intermediated and invested, Argentina's financial system is mostly short term, with a scarcity of investment and housing finance products. The deposit base and use of capital markets instruments remain indeed largely transactional and short term, as, in view of Argentina's historical macro-economic volatility, individuals remain wary of placing longer term savings in the domestic financial sector. With mostly short term liabilities and uncertainty regarding the inflation index,¹⁰ banks are unable to extend long term loans to finance productive investments and housing needs. The November 2008 nationalization of the private pension funds, and the ensuing refocusing of the investment policy in favor of large public investment projects, have further affected banks' and corporate ability to tap domestic long term capital market resources. This has further constrained banks' ability to lend long term. As private pension funds were major users of the domestic capital markets, this development has also affected the depth and liquidity of the stock exchanges. The government may want to review whether the existing regulatory controls on foreign exchange, prices, and trade further affect banks' intermediation capacity.¹¹

⁶ The crisis of 2001 and the ensuing measures (e.g. asymmetric pesification) decreased trust in the financial system.

⁷ The average level of credit to the private sector reached 55 percent of GDP at end 2010 for the following 12 emerging economies: China, Korea, Chile, South Africa, Brazil, Russia, Bolivia, Colombia, Peru, Venezuela, Uruguay and Mexico. At 13 percent, Argentina has the lowest credit penetration of this sample.

⁸ The mission recommends that issues of access to finance be included for analysis in the planned FSAP.

⁹ This is substantially less than Brazil, Chile, Colombia and Peru and in the lower range of OECD countries. Note that the figure only measures activity on the Buenos Aires stock exchange and may be understated.

¹⁰ Based on official data, inflation reached 9.7 percent in March 2011. Provincial indices show however higher levels of price increases (for instance the CPI of the Santa Fe and Saint Luis Provinces show a price increase of 21.7 percent in March 2011 year on year). Thus, private sector estimates suggest that inflation may be underestimated. To address these concerns, the Government is working with the IMF to elaborate a new index.

¹¹ Since 2005, inflows of foreign portfolio funds have been subject to minimum stay and reserve requirements. Portfolio inflows must remain in Argentina for at least one year and 30% of the investment amount must be kept in no-interest bearing US dollar denominated accounts for at least one year.

20. Government efforts to enhance macroeconomic and financial sector policy predictability and certainty would go a long way in further encouraging the development of long-term financial intermediation and investment instruments to support economic growth.

Most important of all is the necessity to continue building depositor and investor confidence in the domestic financial sector, through the maintenance of stable macroeconomic conditions and of strong financial sector regulation and supervision by independent authorities. The government's ongoing work to remove uncertainty on inflation levels and bring the inflation level to single digit is also critical to enable banks to develop adequate instruments to support long term lending and to enable the pricing of long term securities. The government could also consider adopting a medium term Financial Sector Development Strategy to demonstrate its long term commitment to financial sector growth and stability.

A well developed public infrastructure

21. The BCPs state that a well developed public infrastructure supporting sound financial intermediation needs to comprise six elements related to the legal, accounting, auditing, financial and payment system oversight frameworks. These elements include: a) a system of business laws (including corporate, bankruptcy, contract, consumer protection, and private property laws) which is consistently enforced and provides a mechanism for the fair resolution of disputes, b) comprehensive and well defined accounting principles and rules that command wide international acceptance, c) a system of independent audits for companies of significant size, to ensure that users of financial statements, including banks, have independent assurance that the accounts provide a true and fair view of the financial position of the company and are prepared according to established accounting principles, with auditors held accountable for their work, d) an efficient and independent judiciary, and well regulated accounting, auditing and legal professions, e) well defined rules governing, and adequate supervision of, other financial markets and, where appropriate, their participants, and f) a secure and efficient payment and clearing system for the settlement of financial transactions where counterparty risks are controlled. Key findings regarding the presence of these key elements of a well developed public infrastructure to support sound financial sector development and supervision are summarized below.

22. The presence of well functioning elements of public infrastructure has also supported financial sector growth in Argentina, including an adequate credit registry managed by the BCRA, a system of collateral and pledge registration and execution considered effective by market players, rapidly improving corporate accounting and auditing regulations, flexible and well tested safety nets (including an effective deposit insurance and bank resolution framework), and an efficient national payment system. Nevertheless, continued progress is desirable, especially with regards to the oversight of the payment systems, and corporate and financial institutions accounting, financial disclosure, and governance. A detailed description of these issues is provided in the BCP Detailed Assessment.

Accounting and Auditing

23. **Significant strengthening of Argentina's auditing and accounting framework is underway.** A 2009 ROSC on Auditing and Accounting concluded that Argentina's statutory framework for accounting and auditing was reasonably sound although it is fragmented and at times unduly complex, with many laws setting different requirements for particular sectors and/or jurisdictions. With regard to financial reporting and auditing standards, the ROSC recommended efforts to adopt portions of the International Financial Reporting and Standards (IFRS) as Argentine standards are still less demanding than their international counterparts, strengthening the auditing function, enhancing compliance with existing laws, regulations and standards, and achieving a greater level of integration within the accounting and auditing profession and collaboration among regulatory agencies. Government efforts to remedy these issues have culminated with the mandatory adoption of IFRS for all listed companies (except banks) as of January 1st 2012.¹² The BCRA is working on a proposal to require the use of IFRS standards for banks' financial statements as of 2014. Another positive development has been the Central Bank's project to set up a central repository of corporate financial statements. In addition, the securities supervisor (*Comision Nacional de Valores, CNV*) has submitted a new structure to the Ministry of Finance which includes a specific department and additional resources to oversee accountants and auditors.¹³ The CNV is also working with the accounting profession on the adoption of the International Auditing Standards (IAS) within the next two years.

Supervision of non bank financial markets

24. The supervision of non bank financial markets is strong overall, although further progress can be achieved in insurance and capital market supervision, and monitoring of NBFIs may need to be strengthened as these institutions grow in significance. Securities markets are supervised by the *Comision Nacional de Valores (CNV)* established by Law in 1968. Insurance companies are supervised by the *Superintendencia de Seguros de la Nacion (SSN)*, established by Decree in 1937 and further enshrined in the 1973 Insurance Law. A detailed assessment of the work of these institutions has been carried out as part of parallel reports reviewing their compliance with IOSCO and IAIS principles. Their conclusions point to strong supervision overall, but indicate opportunities for further strengthening (see reports). Credit mutuales and cooperatives are monitored by INAES, the National Institute for Associations and the Social Economy. As these entities grow in size and client base, consideration may need to be given to enhancing their regulation and supervision.

¹² FACPCE Technical Resolution 26, March 2009

¹³ The CNV is responsible for the oversight of accountants and auditors as per Decree 677 of 2001.

Payment system

25. **The Argentine economy is largely cash-based, but the use of non-cash payment instruments is increasing.** The macro and financial instability of the early 2000s led individuals to prefer short term liquid financial instruments or to place money abroad.¹⁴ Thus, since 2010, the government has implemented measures to encourage a transition towards non-cash transactions and an increase in bank use, including through the offering of cost-free peso-denominated savings accounts and debit cards, and the reduction in commissions on electronic banking transactions. Newly introduced bank settlement checks are intended to be used instead of cash in real estate deals. In addition, financial institutions in Argentina have developed state-of-the-art networks and are able to supply efficient cash-management services. As a result, over the last years, the number of current and savings accounts has risen, as has the number of debit and credit cards in circulation.¹⁵

26. **The BCRA has played an active role in the development of an efficient national payment system.** Among its major achievements is the implementation, more than a decade ago, of a Real Time Gross Settlement (RTGS) system. The BCRA has complemented the legal framework for payment systems, with a comprehensive regulatory framework for the operation of payment systems through *Comunicaciones*, although further provisions for the protection of payment systems, including BCRA's oversight function, are still needed.

27. BCRA provides liquidity to the banking system through its open market operations in the form of repos with BCRA paper. Since 2005 the BCRA also deals in overnight repos and reverse repos.

Effective market discipline

28. **The corporate governance and information disclosure of listed companies is improving rapidly.** Listed companies in Argentina with the exception of banks will be required to use International Financial Reporting Standards (IFRSs) as of January 1st 2012. The BCRA is working on harmonizing Argentine GAAP with IFRS for banks with an expected adoption of IFRS in 2014. All listed companies have to comply with strict transparency and financial reporting

¹⁴ The BCRA estimated that all undeclared financial assets totaled US\$170bn at end-2008.

¹⁵ According to CGAP Financial Access 2010, Argentina had 906 bank accounts per 1,000 adults, slightly below Colombia and Brazil but ahead of other countries in South America.

requirements¹⁶, and have to have an audit committee, composed of a majority of non-executive directors, independent from the company and the controlling shareholders.¹⁷

Mechanisms for providing an appropriate level of systemic protection (or public safety net)

29. **Argentina has a privately managed deposit insurance scheme.** Deposits are protected by a deposit insurance fund, managed by a private company, SEDESA, created by law in 1995¹⁸. All financial institutions authorized to operate by the BCRA must subscribe to the deposit insurance fund. The monthly contribution is determined by the BCRA and cannot be less than 0.015% and more than 0.06% of average outstanding deposits in local and foreign currency. To this amount, the BCRA can require another monthly contribution based on the risk of the entity, which cannot exceed 0.015% of average outstanding deposits. Deposits are guaranteed up to 120,000 pesos (about US\$ 30,000) per person. Deposits remunerated above a reference rate determined by the BCRA are excluded. As of March 31, 2011 the deposit insurance fund amounted to about 5 billion pesos (US\$ 1.25 billion), or 1.3% of total deposits, which is on the low side by international standards.

30. **The bank resolution framework is flexible and well tested, although a formal contingency planning framework would be useful.** Article 35 bis of the Law of Financial Entities established a bank resolution framework based on the Good Bank/Bad Bank model. This scheme enables the transfer of the deposits of the failed bank, with matching assets from the deposit insurance fund, to a sound bank. Since its creation, the deposit insurance fund has been used 28 times for bank resolutions, mainly between 1997 and 2003. There has been no resolution since the end of 2007.¹⁹ Argentina's strong and flexible legal framework for bank resolution and the BCRA's extensive expertise in this matter would be further reinforced by the establishment of a clear framework for contingency planning, and the formalization in manuals of the process of banking resolutions carried out over the past 15 years.

¹⁶ Including quarterly and annual reporting of the financial statements and management's discussion, immediate information to the CNV of material event, information of any shareholding above 5%.

¹⁷ Corporate governance of non-government listed companies has however recently become a source of debate after the appointment in April 2011 of National Security Scheme (ANSES) representatives to the Board of companies in which the private pensions funds (AFJP) had invested. When the AFJP were nationalized in November 2008, their holdings in private firms were consolidated into ANSES, which ended up with stakes above 25% in some companies. In April 2011, a presidential decree abolished the clause of the pension fund Law which prevented pension funds from holding more than 5% of the voting rights in an investee company, and ANSES appointed new directors at the Board of some companies. Some argue that these firms may have chosen not to list if they had known that the government could become one of their main shareholders.

¹⁸ The shareholders of SEDESA are 22 commercial banks.

¹⁹ Note that in 2010 a bill was introduced to Congress to transfer the deposit guarantee fund to the National Treasury and the management of the deposit insurance scheme to the BCRA. Such transfer would undermine the strong role that the deposit insurance scheme has played in the past in bank resolution.

31. **Work is also needed to establish an adequate framework for systemic oversight.** The monitoring of macroeconomic and financial system trends and risks conducted by the supervisory authorities should be deepened and expanded to cover all sectors, including the unregulated Non Bank Financial Institutions (NBFIs) and key economic sectors. In addition to monitoring risks, the systemic oversight framework should include a system of early warnings and mechanisms to take actions to mitigate the risks. To this end, the government should re-establish a high level systemic oversight body to oversee overall financial stability in the entire financial sector and coordinate essential macro-prudential and systemic crisis management policies.²⁰ To achieve these objectives, adequate exchange of information between the financial supervisors will be essential. The SSN will also need greater access to foreign supervisors, in line with those enjoyed by the BCRA and CNV

²⁰ A high level crisis committee was set up during the crisis of 2001-02 but was later dismantled.

II. ROSC, MAIN FINDINGS, SUMMARY, AND RECOMMENDATIONS

Main Findings

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

32. **The political and financial independence of the BCRA and the SEFyC should be strengthened.** While the BCRA is an autonomous institution, the degree of its effective political and financial independence is not always sufficient. Of particular relevance are the needs to strengthen the rules to nominate and remove members of the BCRA board and the Superintendent, to strengthen financial autonomy, with a budget which should not depend on the approval of the Ministry of Finance, as well as eliminate the ability of the Minister of Finance to potentially overrule BCRA's and SEFyC's decisions.

33. **The BCRA counts with a suitable legal framework for banking supervision, as well as with a reasonable set of powers to enforce compliance with laws and regulations.** The current framework (as well as moral suasion) has enabled the BCRA supervision teams to exercise a significant amount of power thus far in enforcing compliance, but an amendment to the law should be considered to enable supervisors to impose sanctions or to require an institution to take remedial measures when an institution is likely to be engaged in unsafe or unsound banking practices in general. Currently the legal framework does not make explicit reference to safety and soundness concerns and the BCRA's "cease or desist" power does not apply to practices that do not relate to bank products.

34. **Legal protection for supervisors is limited.** The Central Bank Law does not include protection for staff of the BCRA against lawsuits related to decisions made during the exercise of supervisory due diligence conducted in good faith. It should be amended to include protection provisions. Nonetheless, a regulation allows the BCRA to advance funds for the legal defense of supervisors in the event of criminal actions related to their professional activities conducted in good faith. For civil actions, where the BCRA establishes that the action was taken in good faith and no laws were infringed, supervisors can ask to be defended by the legal department of the BCRA.

35. **The new bilateral agreements signed by the SEFyC provide a good opportunity to continue enhancing cross-agency coordination.** Although informal exchanges of information between the supervisory agencies are frequent, they rely mostly on personal relations and had not been formalized until the SEFyC signed in May 2011 two separate Memoranda of Understanding (MoUs) with the CNV and the SSN respectively, to facilitate cross-agency cooperation. While this is a welcome step forward, these memoranda should be complemented by operational guidelines and rules on cooperation and information sharing.

Licensing and structure (CPs 2–5)

36. **Permissible activities in Argentina are defined in the Financial Institutions law, encompassing all activities related to financial intermediation.** The law expressly defines commercial, investment and mortgage banks, as well as finance companies, savings and loans and credit cooperatives. In addition, it enables the BCRA to consider other entities as financial institutions based on the nature and volume of their operations and other considerations.

37. **The BCRA has a detailed process for licensing, transfer of ownership, and major acquisitions, but the scope of the assessment should encompass a broader assessment of shareholders.** The licensing process encompasses fit and proper criteria, as well as business plans and financial projections assessments, among others. Transfers of ownership, as well as major acquisitions are subject to prior approval. There is a general prohibition for banks to own non-financial institutions with the exception of activities considered to be complementary to the financial business, where only notification is necessary. The current processes seem to be robust but would benefit from a broader assessment of not only financial soundness but also the full set of business activities developed by potential banks' shareholders.

Prudential regulation and requirements (CPs 6–18);

38. **Banks seem adequately capitalized overall but regulation would benefit from a review toward a more risk sensitive framework.** Capital requirements are broadly in line with Basel I with some exceptions. On the upside, there are capital charges for interest rate risk in the banking book; a capital conservation buffer of 30% of the total capital requirement is required for a bank to be allowed to distribute dividends; and capital requirements for credit risk are sensitive to the CAMEL BIG rating through a multiplying factor (0.97 to 1.15). On the down side, some risk weights are lower than Basle I (e.g. interbank exposures and some collateralized loans) and there is no capital requirement for operational risk. Looking forward, the SEFyC plans to progressively implement Basel II. In this context, it is important to ensure supervisors have powers to require additional capital for other risks along the lines of the pillar 2 of Basel II and to require banks to have a more forward-looking approach to capital management. Under Pillar 2 Banks and the SEFyC would need to adopt a more active role in assessing capital levels relative to banks risk-profiles.

39. **It is advisable to move toward more forward looking provisioning rules before the next downturn.** The current level of provisions appears to be adequate but, under the current backward looking regulation, it is likely to fall behind in the next downturn with growing credit risks, and increases in the share of non-performing and refinanced loans. The review should consider: (i) increasing the granularity of the classification of normal loans, (ii) moving forward the buildup of provisions for consumer loans as they deteriorate; (iii) establishing more stringent standards for the provisioning of refinanced loans; and (iv) removing the exception for the provisioning of exposures with the public sector.

40. **Exposures to related parties are not fully captured under the regulatory and supervisory framework.** The definition of related parties definition encompasses the financial conglomerate, major shareholders, board members, high management and their relatives but fails to encompass other direct and indirect interests of close family members. Supervisory procedures encompass the financial conglomerate up to the shareholders and their close relatives but do not go beyond that. Regulations and supervisory procedures should be enhanced, minimizing the risk of unintended exposures that could potentially undermine banks soundness.

41. **The recent issuance of two regulations that will be effective from 2012 are important steps toward the modernization of standards for bank governance and risk management.** The norm on corporate governance sets high standards for the organization, responsibilities, transparency, and control requirements in banks. The norm on risk management, issued during the mission, provides a comprehensive framework for banks' risk management policies and processes, as well as specific minimum standards for credit, liquidity, market, interest rate, and operational risks. The development of the necessary capabilities, organization, and processes to fulfill the expectations set by these norms will require significant efforts from banks and supervisors.

42. **The supervision of the most significant risks is already strong (credit liquidity and operational risks), but more needs to be done to achieve a more effective assessment of the management of these risks and to strengthen the supervision of other risks (market, interest rate, country, and transfer risks).** Specific regulations have been in place for several years for the management of liquidity and operational risks, including information technology risks. As per these regulations banks are required to identify, measure, monitor, and control their risks. Supervisors conduct an onsite evaluation of compliance with these regulations. While there are no specific standards in effect for market and interest rate risks, supervisors also review banks policies and procedures during onsite exams. However, the assessment of the adequacy of risk management policies needs to be further strengthened. The BCRA has been working on this by implementing a comprehensive supervisory training program.

43. **Supervisory procedures enable the SEFyC to have a reasonable assessment of the credit risk management process of banks but would benefit from further enhancements.** Assessment of credit risk management is performed mostly through review of policies, samples of loans as well as origination procedures and techniques in the case of retail portfolios. Going forward, additional focus on strategies and a more pronounced bias toward policies and procedures risk assessment will enable supervision to better assess credit risk management in banks. Supervision of credit risk is also aided by the detailed off-site evaluation of the large borrowers by a dedicated area within the SEFyC, albeit with an opportunity to significantly improve the current methodology by adopting a more granular approach to risk valuation, anticipating trends regarding particular borrowers or sectors. In addition, the BCRA regulations provide a solid set of limits on large exposures although it might benefit from specific requirements regarding procedures and controls for concentration risk management.

44. **The regulation of AML/CFT has been recently revamped.** Since late 2010, the Unidad de Información Financiera(UIF) has enhanced powers for the regulation, supervision, and enforcement of AML/CFT. By Decree 1396/2010, of December 14, 2010, the UIF has been appointed as the sole coordinator for all aspects pertaining to AML/CFT and has been granted adequate powers to conduct onsite examinations and gain access to information. The decree also establishes that the regulations issued by the UIF cannot be modified or broadened by other regulatory agencies, strengthens the Know Your Customer requirements and the framework for the assessment of suspicious transactions, and stipulates that those institutions that have the double role of supervisors and subjects obliged to report suspicious transactions, such as the BCRA and the CNV, must cooperate with the UIF. As a result, the BCRA and the UIF have agreed to unify the overlapping regulations issued by both bodies by August 2011. In the meantime, the UIF has given the regulations issued by the BCRA the status of complementary regulations.

45. **The supervision of AML/CFT is undergoing a transition.** In spite of not having explicit powers, the BCRA had issued regulation on AML/CFT for its supervised institutions and, for several years, has supervised compliance with these regulations. The BCRA supervision is thorough and aims at ensuring 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. In 2010, the UIF initiated its duties as supervisor by conducting onsite examinations, which have resulted in several enforcement actions and in a significant increase of suspicious transactions reports. In this context, the UIF and the BCRA have agreed on a new division of tasks. Starting in August 2011 the UIF will take the full responsibility for the supervision of compliance with AML/CFT regulation; the BCRA will only supervise the risks of ML/FT. The strengthening of the regulation and supervision addresses the weaknesses pointed out in the joint FATF/GAFISUD report,²¹ but the new division of responsibilities between the BCRA and the UIF should be monitored, particularly during the transition, to ensure that supervisory and enforcement gaps are not created with the new division of work between the two entities.

Methods of ongoing banking supervision (CPs 19–21)

46. **The BCRA has embraced the international trend toward the implementation of risk-based financial supervision, while maintaining a strong compliance framework.** The allocation of resources and the planning of supervisory strategies and follow-up are effective and

²¹ Grupo de Acción Financiera de Sudamérica and Financial Action Task Force, “Mutual Evaluation Report, AML/CFT, Argentina”, published in December 2010.

based on risks. The rating system for banking institutions, known as CAMELBIG,²² is based on qualitative as well as quantitative analysis, and gives a high weight to the assessment of management and controls. The intensity and intrusiveness of the follow up plan are calibrated on the basis of the seriousness of the weaknesses and the CAMELBIG rating of the institution. The review of compliance with laws and regulations is also an important goal during onsite examinations, and the framework for this is effective. Nevertheless, the risk-based orientation of the supervisory approach could be enhanced by strengthening the supervisory processes and capabilities to assess risks and risk management, thereby completing the move to a full risk based approach.

47. **There is an appropriate balance between onsite and off-site supervision and frequent contact with management.** The SEFyC is organized in four departments: Supervision, Analysis and Audit, Information Regime, and Control and Compliance. The Supervision Department is in charge of the overall supervisory process, which encompasses both on-site and off-site supervision activities. The three remaining departments provide support for the supervisory process. The Analysis and Audit department includes a team of risk specialists responsible for monitoring banking system trends, conducting bottom-up stress tests on various risks (market, liquidity and interest rate risks) and providing specialized support for on-site inspections of market risks. This area issues reports on liquidity, foreign exchange and interest rate risks, as well as reports on fixed income instruments and derivatives. Nonetheless, the results and alerts stemming from the analyses and stress tests on various risks could be more closely integrated into supervisory strategies and decisions. To this end, a two way feedback between these two departments is necessary to: (i) improve the depth and quality of the risk analyses and stress tests carried out by the Analysis area; and (ii) use the improved risk analyses and stress tests as an input for the supervisory decision process and strategies. This also requires continuing to develop supervisory capabilities with regards to risk assessment and risk management.

Accounting and disclosure (CP 22)

48. **BCRA accounting rules are generally prudent, but differ in some aspects with international standards.** Supervisors verify that bank records are drawn up in accordance to BCRA accounting rules, and have implemented a strong process to closely monitor external auditors. The BCRA accounting rules are generally prudent, with the exception of the valuation of some government securities and the amortization of legal contingencies (*Amparos*) arising from the 2001-02 banking crisis. Other relevant differences with International Financial Reporting Standards (IFRS) include: loan loss provisions, linear amortization of intangible assets, linear

²² CAMELBIG is a supervision tool focusing on reviewing a bank's Capital, Assets, Market Risks, Earnings, Liquidity, Business, Internal Controls, and Management (*Gerencia*). In Argentina, all the components include qualitative elements beside the usual quantitative elements.

accrual of derivatives and a more prudent treatment for deferred taxes. Nonetheless, notes to the financial statements disclose and value the differences between the BCRA accounting standards and IFRS. The BCRA has established an interdisciplinary committee to coordinate the transition toward IFRS.

Corrective and remedial powers of supervisors (CP 23)

49. **The SEFyC has a well structured system for early corrective actions.** The system is grounded on an effective escalation of the intensity, frequency and intrusiveness of supervisory actions coupled with the use of moral suasion and regulatory incentives and costs. For instance, banks with a poor CAMELBIG rating are limited in their activities and capacity to expand and pay higher premiums for deposit insurance. Sanctioning powers are adequate and used, although the slow sanctioning processes, especially when an appeal is presented, could sometimes hinder their effectiveness. The superintendent can issue cease and desist orders, but a legal amendment is recommended to widen their scope beyond credit activities. Further efforts are needed to improve the effectiveness of the few regularization processes that have lasted for several years without sufficient improvement.

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

50. **The SEFyC supervises banking groups on a consolidated basis, from the bank down.** While financial information is also collected on the immediate parent companies, the unregulated parent companies do not fall within the supervision of the BCRA. To have an effective framework for consolidated supervision, it is recommended that unregulated parent companies be effectively brought under the purview of BCRA and that the LEF should provide SEFyC with explicit powers to regulate and to inspect them, including extending to them a set of prudential standards on capital, risk limits, and risk management and governance standards. The participation of local banking groups in insurance and capital markets also requires an adequate oversight framework for the risks these activities represent for the overall banking group. To this end, it is advisable that the role of lead supervisor of a financial conglomerate be established (supervisor of the local entity with the highest risks), and that its responsibilities with respect to consolidated supervision, as well as the responsibilities of the other domestic supervisors, are clearly defined.

Summary Compliance with the Basel Core Principles

Summary Compliance with the Basel Core Principles—ROSCs

Core Principle	Compliance	Comments
1.1 Responsibilities and objectives	C	The BCRA Charter and the Financial Institutions Law establishes responsibilities and objectives for banking supervisions. Regulatory framework is comprehensive but may benefit from streamlining.
1.2 Independence, accountability and transparency	MNC	The political, operational and financial independence of the BCRA and the SEFyC need to be strengthened including confirmation of nomination of board members, reasoning for replacing Superintendents and effective financial autonomy. Minister of Finance should not have the power to overrule administrative supervisory decisions.
1.3 Legal framework	C	Legal framework is adequate. Need for regular consultations with the industry on prudential regulations to be issued. Amend the law to better state powers to set prudential rules in a more general way.
1.4 Legal powers	LC	Adequate range of powers in place but need for general power regarding safety and soundness. Cease or desist power should also be expanded.
1.5 Legal protection	MNC	Legal protection is limited.
1.6 Cooperation	LC	Arrangements for cooperation in place. Need for operational guidelines.
2. Permissible activities	C	Permissible activities are defined and the law allows for the supervision to encompass other entities as needed.
3. Licensing criteria	LC	Procedures include the assessment of the ultimate beneficiary, business plans and financial projections. Broaden the assessment to encompass all business activities of shareholders.

4. Transfer of significant ownership	LC	Adequate power regarding transfer of significant ownership Amend of regulations is needed to (i) to expand requirements of information from local acquirers (ii) receive immediate information that may affect suitability of major shareholders (iii) to better state the consequences of changes in control without the necessary approval.
5. Major acquisitions	C	Major acquisitions seem to be well managed in Argentina. Amend regulation to formally require the set of information and criteria for assessment of major acquisitions equivalent to licensing.
6. Capital adequacy	LC	Better align capital requirements to Basel. Move forward with the planned implementation of Basel II and III including operational risk and aligning capital requirements for interbank exposures and collateralized exposures and definition of capital.
7. Risk management process	MNC	Regulation to be implemented in 2012 is an important step towards compliance. Effective implementation is needed, as well as to address the management of risks not captured by capital requirements and to expand the reference to the internal process to assess capital adequacy to explicitly incorporate judgmental elements.
8. Credit risk	LC	Reasonable assessment of credit risk management processes in banks. Effective implementation of credit risk section of new risk management regulation is needed. Strengthen the off-site monitoring of large exposures incorporating a more granular assessment of risk is beneficial.
9. Problem assets, provisions, and reserves	MNC	Provisions rules need to be enhanced. Move toward more forward looking provisioning rules before the next downturn.
10. Large exposure limits	LC	Solid set of limits in place for large exposures. Issuance of regulation and implementation of procedures for concentration risk management is needed.

11. Exposure to related parties	LC	Monitoring of related parties does not encompass direct and indirect interests of shareholders and their close relatives. Definition of related parties does not encompass direct and indirect interests of close relatives of shareholders and high management.
12. Country and transfer risks	MNC	Prudential requirements limit this risk, but the SEFyC does not confirm that banks have systems to monitor and control this risk. The new regulation on risk management effective in 2012, requires banks to manage this risk.
13. Market risks	MNC	There are limits on the net foreign open position. A specialized market risk team conducts off-site analysis and stress tests; and may assist onsite examiners. The new risk management regulation effective in 2012, includes specific requirements for the management of market risks, such as setting internal limits, performing scenario analysis, stress testing and contingency planning, as appropriate, and periodic validation of the systems used to measure market risks.
14. Liquidity risk	LC	There are prudent minimum liquidity and risk management requirements, including scenario analysis and contingency planning. Supervisors monitor liquidity risks and examine liquidity policies and practices. The new regulation on risk management effective from 2012 includes more specific criteria for judging the adequacy of liquidity risk management.
15. Operational risk	LC	Supervisors verify that banks have risk management policies and processes for the various types of operational risk, as required by specific regulations, in the context of the review of internal controls. The SEFyC has initiated the development of off-site tools based on an events database.

16. Interest rate risk in the banking book	MNC	Capital is required for interest rate risk in the banking book. The new regulation on risk management effective in 2012, includes specific requirements on the management of interest rate risk in the banking book. Supervisory processes to analyze the adequacy of banks risk management frameworks would need to be further developed.
17. Internal control and audit	LC	Supervision of internal controls includes verification of proper delegation of authority and separation of functions, reconciliation of accounts, compliance with laws and regulations and independence of internal audit. A recent regulation effective in 2012 spells out precisely the minimum criteria defining the responsibility of the Board in relation to corporate governance, business strategy and risk management.
18. Abuse of financial services	LC	The UIF is responsible for the regulation, supervision and enforcement of AML/CFT, and since late 2010 has enhanced powers and resources and is conducting onsite evaluations and enforcement actions. The BCRA has also issued regulation on KYC and professional standards to prevent ML/FT and the SEFyC has supervised these norms. The SEFyC supervision seeks to ensure that banks have adequate policies and procedures, including strict “know-your-customer” rules, which promote high ethical and professional and prevent the bank from being used for criminal activities. In August 2011, the BCRA will unify its regulation with the UIF; and the UIF will take the full responsibility for the supervision of compliance with AML/CFT regulation; the BCRA will only supervise the risks of ML/FT.
19. Supervisory approach	C	Supervision is risk based with a strong compliance complement. Supervisors focus on safety and soundness and understand the operations of banks and of the banking system as a whole.

20. Supervisory techniques	LC	There is a balance between onsite and off-site supervision and frequent contact with management. Effectiveness could improve by better integrating the analysis and stress tests of specialized groups into the supervisory strategies.
21. Supervisory reporting	LC	Supervisors collect, review and analyze an adequate range of information on a solo and consolidated basis, and accuracy of information is effectively verified by onsite supervisors and external auditors. Accounting rules differ in some aspects from international standards.
22. Accounting and disclosure	MNC	Supervisors verify that bank records are drawn up in accordance to BCRA accounting rules, and closely monitor external auditors. BCRA accounting rules are generally prudent, but differ in some aspects with international standards, particularly with regards to government securities issued during the 2001-02 crisis.
23. Corrective and remedial powers of supervisors	LC	Argentina has a well structured system for early corrective actions and bank resolution. The scope of cease and desist orders and the causes for regularization and restructuring are rather limited. Also a few regularization processes have lasted more than five years.
24. Consolidated supervision	MNC	The SEFyC supervises the banking group on a consolidated basis, from the bank down. The unregulated parent companies do not fall within the supervision of the BCRA.
25. Home-host relationships	LC	The SEFyC has signed MOUs and cooperates with home and host banking supervisors providing access to information requested.

Compliant (C), Largely Compliant (LC), Materially Non-Compliant (MNC), Non-Compliant (NC), Not Applicable (N/A)

Recommended action plan

**Table 2. Recommended Action Plan to Improve Compliance with the Basel Core Principles
– main recommendations**

Reference Principle	Recommended Action
1(1) Responsibilities and objectives	Streamline regulation.
1(2) Independence, accountability and transparency	Strengthen the political, operational, and financial independence of the BCRA including confirmation of nomination of board members, reasoning for replacing Superintendents and effective financial autonomy. Minister of Finance should not have the power to overrule administrative supervisory decisions.
1(3) Legal framework	Amend the law to better state powers to set prudential rules in a more general way. Establish process for regular consultations to the industry on prudential regulations to be issued.
1(4) Legal powers	Amend the law to explicitly provide powers regarding safety and soundness concerns. Extend the scope of the “cease and desist” power.
1(5) Legal protection	Amend the laws to fully protect supervisors for actions taken in good faith.
1(6) Cooperations	Establish operational procedures for cooperation with the insurance and securities supervisors. Continue updating MOUs to increase information exchange.
2. Permissible activities	Monitor overall exposures of depositors to non-authorized entities.
3. Licensing criteria	Broaden the assessment to encompass all business activities of shareholders.
4. Transfer of significant ownership	Amend regulations (i) to expand requirements of information from local acquirers (ii) receive immediate information that may affect suitability of major shareholders (iii) to better state the consequences of changes in control without the necessary approval.
5. Major acquisitions	Amend regulation to formally require the set of information and criteria for assessment of major acquisitions equivalent to licensing.

Reference Principle	Recommended Action
6. Capital Adequacy	Move forward with the planned implementation of Basel II including operational risk and aligning capital requirements for interbank exposures and collateralized exposures. Review the definitions of capital in light of Basel III.
7. Risk Management Process	Effective implementation of new risk management regulation; address the management of risks not captured by capital requirements; expand the reference to the internal process to assess capital adequacy to explicitly incorporate judgmental elements.
8. Credit risk	Effective implementation of credit risk section of new risk management regulation. Strengthen the off-site monitoring of large exposures incorporating a more granular assessment of risk.
9. Problem assets, provisions and reserves	Revise classification criteria and establish requirements for provisions for past due loans irrespective of the counterparty. Move toward more forward looking provisioning rules before the next downturn.
10. Large exposure limits	Issuance of regulation and implementation of procedures for concentration risk management.
11. Exposures to related parties	Broaden the definition and monitoring of related parties.
12. Country and transfer risks	Regularly monitor the materiality of country and counterparty risks; and confirm that banks have risk management systems to control this risks.
13. Market risks	Effective implementation of market risk section of new risk management regulation
14. Liquidity risk	Effective implementation of liquidity risk section of new risk management regulation
15. Operational risk	Continue improving the operational risk events database and developing off-site tools for the measurement of operational risk. Further develop supervisory procedures for the on-site monitoring of operational risks, in particular those associated with out-sourced activities.
16. Interest rate risk in the banking book	Effective implementation of interest rate risk section of new risk management regulation

Reference Principle	Recommended Action
17. Internal control and audit	Effective implementation of corporate governance regulation to strengthen board responsibilities regarding governance, strategy and risk management.
18. Abuse of financial services	Continue strengthening the UIF supervisory capabilities and actions to ensure effective implementation of the new AML/CFT regulation. Closely monitor the implementation of this framework and the new division of responsibilities between the BCRA and the UIF, particularly during the transition, to ensure that supervisory and enforcement gaps are not created with the new division of work between the two entities.
19. Supervisory approach	Complete the move to the risk based approach by strengthening processes and capabilities to assess risk management
20. Supervisory techniques	Better integrate stress tests into supervisory decisions
21. Supervisory reporting	Step up convergence toward international standards, particularly with regards to valuation of government securities issued during the 2001-02 crisis
22. Accounting and disclosure	Effective implementation of corporate governance regulation to improve disclosure and step up convergence toward international accounting standards.
23. Corrective and remedial powers of supervisors	Step up efforts to improve the effectiveness of the few regularization processes that have lasted for several years without sufficient improvement; and consider amending the law to: broaden the scope of the cease and desist orders to cover more than credit related operations; and to allow for a regularization and restructuring for reasons other than liquidity and capital insufficiency (e.g. ML/TF).
24. Consolidated supervision	Legal amendment to broaden the scope of consolidated supervision above the bank, bring unregulated parent companies under the purview of the SEFyC and introduce the concept of lead supervisor.
25. Home-host relationships	Establish a more proactive cooperation with foreign supervisors, providing regularly information on material events and concerns.

III. DETAILED ASSESSMENT

Detailed Assessment of Compliance with the Basel Core Principles

Principle 1.	<p>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.</p>
Principle 1(1).	<p>Responsibilities and objectives. An effective system of banking supervision will have clear responsibilities and objectives for each authority involved in the supervision of banks.</p>
Description	<p>In Argentina the core legal framework regarding banking activities and its supervision is systematized in the Financial Institutions Law (Law 21,526), which provides a basic set of rules regarding the functioning of financial institutions, and in the BCRA Charter (Law 24,144), which specifies the missions, objectives and functioning of the BCRA.</p> <p>Law 24,144, Art. 3 lays down BCRA objectives, establishing that the BCRA shall primarily and essentially preserve the value of the currency, which should involve the regulation of the amount of money and lending within the economic system and the formulation of monetary, financial and exchange rules. Art 4 establishes BCRA functions, and states, among other objectives, that the BCRA shall oversee the performance of the financial market and enforce the Financial Institutions Law and its derived regulations.</p> <p>Law 24,144 Art. 43 establishes that the BCRA shall oversee financial and exchange activities through the Superintendence of Financial and Exchange Entities (SEFyC). SEFyC is a decentralized entity of the BCRA, depending on the BCRA for its budget and subject to such audits as the BCRA may order (Arts. 43, 44 and 45). Art. 46 defines SEFyC responsibilities, which encompass (a) to rate financial entities in accordance with the Financial Institutions Law; (b) to revoke licenses to conduct foreign exchange transactions; (c) to approve reorganization and or/rehabilitation programs of financial entities (d) to implement and enforce the regulations derived from Law 21.526, lay down by the BCRA; and (e) to establish requirements to be complied with by financial</p>

	<p>and foreign exchange institutions' auditors.</p> <p>In addition to the general provisions established through law 21,526, the BCRA issues regulatory instructions ("Comunicaciones") establishing prudential regulations, technical ratios and other requirements to be complied with by the institutions subject to its control. All regulations are published on the BCRA website. In addition, the BCRA compiles most of its regulations by topic, and these texts are also publicly available on the BCRA website. Laws and regulations currently in place provide a comprehensive framework of minimum standards that banks must meet, which comprises a broad range of requirements encompassing licensing, capital adequacy, corporate governance, loan classification and provisioning, limits, liquidity, and internal controls, among others. BCRA's regulations are frequently updated and adjusted to the financial system situation and to the development of applicable international standards.</p> <p>Detailed information on the financial strength and performance of the industry under its jurisdiction is publicly available at the BCRA website.</p> <p>The SEFyC take into account the risk profile of individual banks to decide on the supervisory approach to be used.</p>
Assessment	Compliant
Comments	<p>The regulatory framework is comprehensive but may benefit from streamlining. The current system comprises an overly extensive set of communications with numerous amendments and cross-references that are not always consolidated or adequately clear. This creates risks of misinterpretation from both banks and supervisor and adds an unnecessary burden to the process of supervision. The risks are somewhat mitigated by a private service that publishes an unofficial compilation of the regulations. However, a formal compilation would add legal certainty.</p>
Principle 1(2).	<p>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.</p>
Description	<p>The BCRA is a national autarchic entity. Although there is no explicit reference on the BCRA Charter regarding banking supervision, Art. 3 establishes that in the formulation and execution of the monetary and financial policy, the BCRA is not subject to orders, indications or instructions from the National Executive Branch.</p> <p>The BCRA is governed by a Board (BCRA Charter Art.6) comprised of a president, a vice-president and eight directors. Art. 7 establishes that all members of the Board are to be appointed by the Executive Branch with the Senate's approval for a term of six years (or less, if to replace another board member that did not fulfill its full mandate), and may be reappointed. Art. 7 also states that appointments can be made on an interim basis until the Senate approval. Board members which are appointed and approved by the Senate can</p>

be removed by the same authority following failure to comply with the provisions of the Charter, misconduct or failure to comply with civil servants duties. The Charter does not explicitly require the reasons for removing board members or the Superintendent to be made public. Interim board members (i.e. board members that are waiting for approval from the congress) can be replaced without justification or the Senate involvement.

The BCRA Charter also establishes (Art. 45) that the superintendent of supervision (head of supervision) and the deputy superintendent are to be appointed by the Executive Branch from among the members of the board, for a period of three years (or until the conclusion of their mandates as directors, if this were to be sooner). There are no criteria in the law regarding reasons for removal of the superintendent or the deputy superintendent. There is also no requirement for the reasons to be made public.

In practice, currently, the Board is composed by a president, two vice-presidents and five directors. The president, the first vice-president and two directors (one of which is the head of supervision) were appointed on an interim basis in September 2010. Since 2000 there have been seven Superintendents, with only two of them serving the full term (3 years).

Board members must possess demonstrated credentials in monetary, banking or legal fields in relation to the financial area, and enjoy recognized moral solvency (Law 24,144 Art. 6). Management of the BCRA is performed by the deputy general managers, who advise the President and the Board, and must meet the same suitability requirements as the Directors. They report to the President of the BCRA, or to the person appointed by the President as General Manager (Law 24.144 Art. 16). Management of the SEFyC is the responsibility of the Superintendent, the Deputy Superintendent, and its deputy general managers (Art. 44). For both the SEFyC and the BCRA there is a Functional Organic Manual (for internal purposes only) that describes the functional positions in each area.

The decisions taken by the BCRA are subject to a control of legitimacy exercised by the National Executive Branch through the Ministry of Economy and Public Finance, by means of the appeals (“recurso de alzada”) that natural or legal persons may file against resolutions issued by the highest BCRA authorities (as per Section 94 and thereafter of Decree 1759/72 regulating Law 19,549 on administrative procedures), which has happened on several occasions. In the case of administrative inquests on financial and exchange matters (which result in sanctions and/or fines) recourse to the administrative appeals system is not applicable. In those cases the Judiciary intervenes directly, either by setting the corresponding penalties for exchange violations, or by reviewing them in the case of financial violations at the request of those affected. In every case, as a result of the direct application of constitutional guarantees, decisions taken by the BCRA and the SEFyC or, as part of the appeals process by the National Executive Branch – through the Ministry of

	<p>Economy and Public Finance – are subject to review by the courts at the instance of those who consider that their rights have been affected.</p> <p>Regarding the disclosure of the BCRA’s actions, the President is required to submit an annual report on the Bank’s operations to Congress, and must appear before its Committees or Chambers to provide explanations on the scope of monetary, exchange and financial current policies, at least once a year, or at their requirement (BCRA Charter, Art. 10(i)).</p> <p>There is no formal publication of the supervision objectives but the BCRA website provides a description of activities for each of the units that compose the Superintendence. Supervision is accountable for the discharge of its duties through the issuance of the BCRA annual report, which is presented to the Congress every year and is available at the BCRA website.</p> <p>Supervision staff seems skilled and knowledgeable. Market participants interviewed by the assessors confirmed the existence of a strong technical and professional culture.</p> <p>Prior to September 30th of each year the Board prepares and submits for approval its annual expenditure budget (BCRA Charter Art.15 (e), a calculation of resources and the personnel salaries for the BCRA and the SEFyC. The budget is submitted to the Executive Branch for approval (Law 11.672 (art. 6)) although the BCRA Charter states that the budget is to be submitted to the Executive Branch for information only and approval by the congress. Authorities report that the budget, which is funded by BCRA income has been adequate to enable the performance of BCRA’s and SEFyC’s supervisory role, including as to number of staff, salary scales, training, equipment and travel, reporting also that for the last 10 years the budget has represented on average 13.5% of the BCRA income. There is no contracting of outside experts to conduct supervisory tasks but the authorities understand that staff can perform all necessary activities in a satisfactory manner.</p> <p>The Board establishes the bank staffing regulations, setting the conditions for hiring personnel, their technical training and their termination. The President has the power to appoint, promote and terminate BCRA personnel, and the Superintendent possesses the same powers in relation to SEFyC personnel (Law 24.144 Art. 10(g) and Art. 48(b)). As of December 31st, 2010 the BCRA had a staff of 1827 (63 of which working on regulation matters), and the SEFyC had 678 employees (286 of which directly working on supervisory matters). The average age of the staff of the two institutions is 46.</p>
Assessment	Materially non-compliant
Comments	The legal framework pertaining to the BCRA and the SEFyC allows for the members of the Board that are yet to be confirmed by the Congress to be removed from office during their term without reason. Current procedures also allow for board members to remain in their positions without confirmation for

	<p>an indefinite period of time, waiting for congressional approval. In addition, the law does not provide reasons for removing the superintendent. In both cases there is no requirement for the reasons to be made public.</p> <p>In addition, any decision taken by the BCRA and the SEFyC that does not relate to violations can be (and have been) challenged through an administrative appeal where the Ministry of Economy will have the final say on the matter, supported by information from the BCRA.</p> <p>Finally, although not evidenced at present, the legal framework regarding budget can potentially hinder BCRA's independence on setting its own budget.</p> <p>Laws should be amended in order to:</p> <ul style="list-style-type: none"> • Establish a maximum period for the appointed board members to be confirmed by congress. • Establish criteria for removal of the superintendent; • Extend the superintendent mandate to the same period as the members of the board; • Establish that each board member to be appointed and confirmed by the congress to serve a six years mandate; • Suppress the possibility of appeal through the Ministry of Economy of decisions taken by the BCRA in cases not related to violations; • Effectively ensure independence of BCRA budget through approval solely from the congress.
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.
Description	<p>Law 24,144 Art 14 grants to the BCRA board the power to grant and withdraw licenses. Law 21,526 Art. 7 states that financial institutions cannot commence activities without prior BCRA approval, while Art. 15 states that licenses can be revoked when fundamental changes have been made to an institution's basic conditions according to which the license had originally been granted.</p> <p>Law 21,526 (Art. 4) grants the BCRA regulatory powers to ensure compliance with such law, which encompass licensing; permissible, interbank and restricted activities; liquidity and solvency; information, accounting and controls; sanctions and appeals; resolution. Law 24,144 (Art. 14(d)) specifically states that the BCRA board shall set liquidity and solvency ratios for financial institutions. In addition, law 24,144 (Art.47) grants the Superintendent the power to lay down the information and accounting regime to which financial institutions are subject. Regulations are kept up-to-date, and many regulatory changes arise as a result of proposals by parties within and outside the BCRA, as well as from the development of the financial system and international standards. Consultations are not a regular procedure but have occurred in a</p>

	<p>couple of occasions, including the recently issued regulation on risk management. On those occasions consultations were conducted through banks' associations.</p> <p>Law 24.144 (Art. 47) grants the superintendent power to establish financial institutions' information regime and other information deemed necessary to the assessment of the financial system. Law 21,526 (Art. 36) establishes that preparation and presentation of balance sheets, profit and loss statement, documentation related to financial institutions economic and financial situation, as well as any other information requested by the SEFyC shall be provided in accordance with regulation to be issued by the SEFyC in that regard.</p>
Assessment	Compliant
Comments	<p>The BCRA should consider amending the laws to better state its powers to set prudential rules in a more general way. The current framework grants power to set liquidity and solvency ratios (through the BCRA Charter) and to ensure compliance with the Financial Institutions law. There is no clear statement regarding its powers towards financial stability or safety and sound practices.</p> <p>The BCRA should also establish procedures to conduct regular consultations with the industry regarding prudential regulations to be issued. Such process should be public, including, for instance, the publication of the proposals on its website.</p>
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.
Description	<p>The BCRA Chart (Art. 46 (d) grants to the superintendent the power to implement and enforce the regulation of the Financial Institutions Law. Art. 46(c) grants the superintendent the specific power to approve reorganization and/or rehabilitation programs submitted by banks. Art. 47(c) of the Charter also grants the superintendent power to order banks to cease or desist from loan policies or financial instruments that might place their solvency at risk, while Art.47(f) grants the superintendent the power to apply sanctions as established by the Financial Institutions Law.</p> <p>SEFyC's power to access banks records, as well as to seize all documents and related to infractions of regulations is spelled in the BCRA Chart (Arts. 50 and 51). Art. 54 states that in case the SEFyC encounter obstacles or resistance to carrying out its supervisory duties, the SEFyC may call on the assistance from law enforcement forces and obtain the necessary warrants from the courts. The Financial Institutions Law (Art. 37) establishes that banks shall grant access to their accounting records, books, correspondence, documentation and papers. Regulations do not provide for ensuring full access to bank's Board, management and staff but in practice authorities report (and banks confirmed) to have full access to all necessary personnel, including the Board and senior</p>

	<p>management of financial institutions.</p> <p>The Financial Institutions Law, Art. 34 establish that banks failing to comply with laws and regulations are required to provide the necessary clarifications within a timeframe to be established. In addition, banks must present a remedial action plan in accordance with guidelines and timeframe (maximum of 30 days) provided by the BCRA and the SEFyC, in cases where banks' liquidity or solvency are deemed to be compromised; cash reserves are deficient; recurrent non-compliance with limits or ratios; capital levels fall below the minimum. The SEFyC may also appoint an overseer (which decisions can be appealed through the President of the BCRA). Other measures include the request for collateral and restrictions on dividend payouts. Depending on the seriousness of the difficulties, the supervisor may order the restructuring of an institution in crisis to protect credit and its depositors, before revoking the institution's operating license (Art. 35 bis). As part of this latter process, it may: a) order the reduction, increase, or disposal of its capital; b) order the separation of privileged assets and liabilities and their transfer to a sound institution or a financial trust; or c) apply for court intervention of the institution, with the removal of the statutory governing authorities.</p> <p>The Financial Institutions Law (VI) rules on sanctions and appeals. Art. 41 establishes that infractions of the law, as well as resolutions and regulations issued by the BCRA or the SEFyC are subject to sanctions, which vary according to the seriousness of the violation, providing a range of measures, including warnings, fines, temporary and/or total and/or partial suspensions and withdraw of license. As indicated in CPI(2) this power is subject to judicial control and banks are entitled to appeal the SEFyC and BCRA decisions.</p>
Assessment	Largely Compliant
Comments	<p>The legal framework currently in place in Argentina provides for a reasonable set of powers to address compliance with laws and regulations governing financial intermediation. Nevertheless, general safety and soundness issues are currently not fully addressed by the legal framework. There are no general provisions in the law in that regard although in practice the current framework and moral suasion have enabled supervisors to exercise a significant amount of power. In addition, the "cease or desist" clause in the law is too narrow and does not provide for other practices that do not relate specifically to banks products.</p> <p>The BCRA should also consider amending the law in order to explicitly have access to the board, management and staff.</p>
Principle 1(5).	Legal protection. A suitable legal framework for banking supervision is also necessary, including legal protection for supervisors.
Description	The Financial Institutions Law (Art. 35 ter) establishes that actions taken by the BCRA or the SEFyC in the exercise of competencies and duties are only subject to review by the courts in the event of arbitrariness or when they are manifestly

	<p>unreasonable and it is for the court to establish if the case has merit.</p> <p>BCRA personnel bylaws (Board Resolution 413/2002), establish that in the case of staff becoming subject to criminal proceedings due to facts derived from the exercise of their duties, the BCRA may advance sums to fully or partially cover the necessary legal assistance. This has been extended to members of the Board and the Syndics of the BCRA, always on the grounds that by defending the actions of the officer a defense is also being made of the administrative measure emanating from the BCRA itself. In the case of civil lawsuits, where the BCRA established that the action was taken in good faith and no laws were infringed, BCRA staff can count on free assistance from the BCRA's legal department.</p>
Assessment	Materially non-compliant
Comments	<p>The law currently does not protect the supervisory authority and its staff for actions taken and/or omissions made while discharging their duties in good faith. Banks can take legal action (civil and criminal) against BCRA staff and have done so in several occasions.</p> <p>The law should be amended to in order to fully protect supervisors while discharging their duties in good faith.</p>
Principle 1(6).	Cooperation. Arrangements for sharing information between supervisors and protecting the confidentiality of such information should be in place.
Description	<p>Decree 1,759/72 (14) establishes that national public administration bodies are obliged to provide data or information necessary to fulfill the obligations of each body. A Cooperation and Information Exchange Agreement has been signed by the SEFyC and the National Securities Commission (Comisión CNV) and by the SEFyC and the Superintendence of Insurance (SSN) covering the sharing of information in relation to the sphere of action of each body. Nevertheless, information is only shared as long as it does not violate the secrecy rules protecting each regime (in particular, financial secrecy and stock exchange secrecy).</p> <p>On the matter of the Memoranda of Understanding (MOUs) already signed with foreign financial supervision bodies (Chile, Spain, Brazil, United States, United Kingdom, Mexico, Germany, Italy, Uruguay, South Africa, Cayman Islands, Paraguay and the Bahamas), in most cases signing parties agree to share information as long as it does not violate any domestic legislation. In addition, addenda have been made to the MOU with the United States to incorporate other supervisory bodies in that country and update its provisions. Some MOUs detail the treatment to be given to information of a confidential nature, or that for which publication should be restricted.</p> <p>The SEFyC does not have procedures in place for conducting on-site inspections outside Argentina. Nevertheless, recently several Argentine supervisors visited Uruguay to exchange information on supervision matters</p>

	<p>with officials in that country, while others took part in supervisory colleges (in Spain and Brazil) on certain international financial institutions that operate in Argentina.</p> <p>The BCRA charter (Art. 53) establishes the confidentiality of information that the SEFyC obtains in the exercise of its inspection duties. This information may be made public only with the approval of authorized officials, which enables supervisors to provide confidential information to other domestic or foreign financial sector supervisors. On the other hand, the Financial Institutions Law (Art 40) stipulates that information obtained by the SEFyC in the exercise of its duties which relates to liabilities are strictly confidential with the result that it cannot be shared with local or foreign supervisors. Third parties are subject to the same confidentiality rules as the BCRA or the SEFyC in cases where information is disclosed.</p> <p>The Financial Institutions Law (Art 39) states that banks cannot release confidential information on liabilities unless requests are made by the courts, legislature, the Financial Information Unit (UIF) or the Federal Public Revenue Agency (Administración Federal de Ingresos Públicos –AFIP–), a provision which is also followed by the SEFyC. In the case of any other type of information (Art. 53 of the BCRA charter, which refers to information obtained by the SEFyC during the performance of its duties), powers are discretionary; in other words, refusal is valid as long as it is justified and is not arbitrary.</p> <p>Various areas within the BCRA have worked with the CNV and the AFIP to coordinate actions for the supervision of foreign transactions as well as on legal aspects to facilitate information exchange between agencies.</p>
Assessment	Largely compliant
Comments	<p>The BCRA currently has reasonable arrangements for sharing information between supervisors and protecting the confidentiality of such information. Nevertheless, the BCRA is recommended to:</p> <ul style="list-style-type: none"> • Establish operational procedures and guidelines with the CNV and the SSN based on the agreements signed in order to ensure the regular exchange of information; • Continue updating the MOUs with foreign banking regulators to increase information exchange (including with respect to the prevention of money laundering and financing of terrorism).
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.
Description	Laws and regulations do provide a definition for the term “bank” through the Financial Institutions Law (Arts. 1 and 2) that expressly defines commercial, investment and mortgage banks, as well as finance companies, savings and

	<p>loans and credit cooperatives as financial intermediation institutions.</p> <p>The financial institutions law (Art. 21 to 29) establishes the activities that entities listed under Art. 2 can perform, as well as those that are forbidden or restricted. Art. 20 states that the BCRA has the power to authorize other operations (not comprised under Arts. 21 to 29), as long as they are considered compatible with financial institution activity. Art. 19 establish that the denominations comprised under the law can only be utilized by authorized entities. Art. 19 also forbids the use of names or expressions which are similar to those comprised by the law that might lead to confusion or mistaken interpretation, or that can raise doubts as to an institution’s nature or identity.</p> <p>There is no clear prohibition for unauthorized institutions to take deposits but the Financial Institutions Law (Art. 1) establishes that all entities that perform financial intermediation shall be under its rules. The Financial Institutions law describes the permissible activities to be exercised by each type of financial intermediation institution (Arts. 21 to 26), and stipulates that sight deposits can be taken by commercial banks, mortgage banks, savings and loans societies and credit cooperatives. As of March 2011, from the total sight deposits in the banking system, 99% was held by commercial banks (0.1% by non-banking financial institutions). There was no information available on deposits take by non-authorized deposit taking entities supervised by the INAES (“mutuales” and cooperatives).</p> <p>Every six months, as at June 30th and December 31st, the BCRA publishes a list of all the institutions authorized to operate. This information is also available at the BCRA webpage.</p>
Assessment	Compliant
Comments	<p>Banks permissible activities are described in the law and the use of the word “bank” in names is controlled. All entities that perform intermediation are under the law’s umbrella, and all entities not explicitly covered by the law can be considered as such based on the volume of its operations, as well as other monetary and credit policy considerations. As some non-authorized entities are deposit-taking institutions (e.g. “mutuales”), the BCRA should consider monitoring overall exposures of depositors to those institutions.</p>
Principle 3.	<p>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.</p>

Description	<p>The BCRA Charter (Art. 14(ñ)) establishes that the duties of the BCRA include the granting of authorizations to set up of new financial institutions. The Financial Institutions law (Art. 7) establishes that entities that intend to engage in financial intermediation cannot initiate activities without prior authorization from the BCRA.</p> <p>The legal framework grants the licensing authority the power to set criteria for licensing banks. Art. 4 of the Financial Institutions Law grants the BCRA the power to issue all necessary regulation to ensure compliance with the law. Chapter III rules on licensing of financial institutions, provides general criteria to be followed by the BCRA in assessing proposals. Additional regulations are in place (CREFI2 Chapter 1) for the authorization of new financial institutions and the minimum guidelines that must be contemplated. The regulations that have been issued to this end (CREFI2, Chapter 1) among other matters call for compliance with certain requirements and the submission of information and documentation to: determine the structure of the future institution, evaluate the background, experience and economic and financial capacity of the applicants and their shareholding structure, confirm the origin of the funds that will make up its capital, and evaluate the credentials, suitability and prior experience in the financial sector of directors, board members and managers.</p> <p>Criteria for issuing licenses appear to be consistent with those applied in ongoing supervision. Business plans and other information are sent to various areas within supervision for comments. Documents made available to the assessors indicate that such assessment follow the general criteria applied in ongoing supervision.</p> <p>Art. 8 of the Financial Institutions Law states that licensing of financial institutions will be based on convenience, the characteristics of the project, general and particular conditions of the market, as well suitable criteria to be applied to shareholders. The rejection of an application can be based on the insufficiency of the information provided by the applicant or on the verification that any of the criteria laid down have not been met.</p> <p>In cases where shareholders include legal persons, they are also required to submit among other elements a list of the shareholders of legal persons, indicating their name or corporate identity, address, nationality, number of shares or quotas held, the nominal value of the shareholding and voting rights corresponding to each person (CREFI2 Chapter 1 and 5). This set of information is to be provided for the entire chain of significant shareholders until the ultimate beneficiary. In case proposed shareholders are foreign supervised financial institutions there is no request for information up to the ultimate beneficiary.</p> <p>The authorization process includes fit and proper criteria for directors and senior management, which includes skills and experience, as well as other adverse regulatory judgments, including criminal activities (Financial</p>
-------------	--

	<p>Institutions law, Art. 10 and CREFI2, Chapter 5).</p> <p>In practice the BCRA has denied authorization due to the proposed ownership structure of the bank. In that particular case, although the group owned financial institutions elsewhere, the proposed ownership structure for Argentina was linked to a non-financial entity which was considered inappropriate by BCRA.</p> <p>A minimum initial capital amount is stipulated for all banks, based on its location, ranging from 10 to 25 million pesos (according to regulation on minimum capital). In practice capital needs are also assessed taking into consideration the business plan and forecasts, in order to ensure that new entrants will be able to comply with the minimum capital requirements.</p> <p>Analysis of an application for the authorization to set up a new financial institution includes confirmation of the adequacy of the internal control procedures of the future institution.</p> <p>The economic and financial feasibility of the project is analyzed by the supervision unit that routinely analyses business plans and projections that banks have to submit every year to the SEFyC. A licensing process made available to the assessors also showed that an external audit opinion was requested regarding the feasibility of the forecasts presented.</p> <p>In the case of the opening of a branch in Argentina, it is necessary to obtain a favorable determination from the home supervisors (CREFI2 1.6.2.4) regarding the timing and advisability of its setting up. Although this requirement is not specifically outlined in the case of the setting up of a subsidiary of a foreign institution, in practice compliance is required.</p> <p>All licensing requirements should also be satisfied by those institutions that are already in existence, non-compliance being considered as a justification for revoking of the operating license (Financial Institutions Law, Art. 15).</p> <p>Proposed board members are assessed through a special commission formed within the BCRA board, which includes the vice-chairman of the board and two board members, one of which is the superintendent, based on information provided by the technical team. At least 80% of board members must have experience in financial sector activities.</p>
Assessment	Largely Compliant
Comments	<p>Current procedures include the assessment of the ultimate beneficiary shareholders but do not extend the analysis to the direct and indirect interests that the ultimate beneficiary might have. The BCRA should consider incorporating on its analysis the assessment of all business activities that the proposed shareholders are involved with. In addition, procedures should be reviewed in light of the comments provided by the FATF/GAFISUD report.</p>

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.
Description	<p>The Financial Institutions Law (Art. 15) establishes that institutions must advise without delay any transfer of ownership or other circumstances that may lead to a change in the status of the institution or alter the shareholding group structure, which in practice implies control. Communication A450 establishes that those transactions will be subject to BCRA approval.</p> <p>In addition, regulations (CREFI-2, Capitulo V, Section 1) lay down that all transactions exceeding 5% of the capital and/or votes over a period of six months must be notified to the BCRA. These provisions cover the effect resulting from share syndication contracts or other such agreements designed to cede voting rights.</p> <p>The Financial Institutions Law (Art. 15) empowers the BCRA to reject proposals for changes to financial institution ownerships structure. Rules (CREFI2, Chapters 1 and 5) expressly state that it shall not be possible to pay price balances, deliver shares, record transfers in the shareholders' register or record capitalization of irrevocable contributions unless the BCRA has ruled on the timeliness and advisability of the transactions. Analysis shall be performed on the basis of criteria similar to those used for the authorization of new institutions in case of proposals by foreign-owned institutions. Although there is no clear requirement for an actual full assessment regarding business plans and other considerations in case of local investors, the BCRA states that it does perform such assessments.</p> <p>Banks are also requested to inform on a monthly basis (A2668 3.1.2.1) the composition of their capital, identifying all those shareholders holding 2% or more of the capital and/or voting rights. If the shareholders so identified are non-financial companies that have been established locally or abroad, the same procedure should be performed in relation to them until the ultimate beneficiary.</p> <p>The terms of the Financial Institutions Law (Art. 15) grant the BCRA powers to require transactions to be reversed or to revoke the operating license if the basic conditions for approval significantly change, which can also be used in case changes of control take place without the necessary notification.</p>
Assessment	Largely Compliant
Comments	<p>The legal framework provides the BCRA with adequate powers regarding transfer of significant ownership but the BCRA should consider:</p> <ul style="list-style-type: none"> • amending regulations in order to expand the requirements (that must be equivalent to authorizations) in case of transfer/significant changes of control, which currently is only requested in case acquiring company is located abroad . Such procedures will enable the SEFyC to

	<p>automatically receive information regarding potential consequences for management and strategies resulting from transfer of significant ownership and to ensure that those consequences are properly addressed;</p> <ul style="list-style-type: none"> • amending regulations in order to require any material information which may negatively affect the suitability of a major shareholder to be immediately informed to the SEFyC; • amending regulations and in order to better state the consequences (sanctions and or corrective actions) of changes in control that take place without the necessary notification to or approval from the supervisor.
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.
Description	<p>The Financial Institutions law (Art. 29) establishes that shareholdings in financial institutions require approval from the BCRA. Art. 28(a) establish a general prohibition for banks to run non-financial institutions, unless they expressly allowed by the BCRA on a general basis, which include investments in the capital of companies in the country or abroad which activities are considered to complement the financial business. Art. 29 grants exception to shareholdings in public service companies (e.g. electricity) where such holdings are required. The regulation on complementary activities list those activities that require prior approval (Section 2.3) stating in Section 2.4 that any other complementary activity not listed should be notified (i.e. would not need pre-approval). This applies to participations in excess of 12.5% of the capital stock or total votes, or lower percentages if they are sufficient to direct the corporate will (Section 2.1). Some other participations not related to complementary services in excess of 12.5% are also permitted (regulation on credit adjustments (“graduacion”), Section 3.2.2) but require prior authorization.</p> <p>In those cases for which regulations require prior authorization, this will be subject to compliance with certain requirements and the evaluation made in each instance.</p> <p>Although regulations identify the types of investment allowed, they do not establish maximum values based on the investor’s capital. This aspect is contemplated indirectly in the requirements for compliance with technical ratios in case of unconsolidated investments.</p> <p>Investment in foreign financial institutions in excess of 5% of the voting shares of the latter require prior approval (CREFI2, Chapter 4). The institution wishing to make such an investment must be in compliance with technical regulations in relation to capital, liquidity and solvency, should not be subject to</p>

	<p>regularization or stabilization programs, or show signs of organizational difficulties, and such organizational difficulties should not appear likely as a consequence of the proposed investment.</p> <p>For investments in financial institutions abroad regulations are intended to confirm that the local institution will not be exposed to significant risk, and to ensure adequate consolidated supervision (regulation on consolidated supervision, 1.3). In the case of the opening of branches abroad, an analysis is made regarding the regulatory regime of the financial system in the country that is the destination of the investment, and the plan of action proposed for the branch (CREFI2, Chapter 2, Section 1). Authorized investments in subsidiaries may not be granted or may be revoked if satisfactory consolidated supervision is not possible (according to regulations on consolidated supervision).</p> <p>There are no explicit criteria to be used in case of major acquisitions. Nevertheless, the BCRA reports that in practice criteria encompass a full assessment of business plans and forecasts in case of acquisition of financial institutions. The complementary activities permitted are assessed based on information requested which includes the amount to be invested, the nature of the business, the benefits expected from such business, as well as any other necessary information to assess the effects of such investment on the solvency and management of banks.</p> <p>The BCRA is aware of the risks that non-banking activities can pose to a banking group to the extent that regulates and limit non-banking activities to be performed by banks.</p>
Assessment	Compliant
Comments	The processes for approval of major acquisitions seem to be well established in practice in Argentina. Nevertheless, specific formal criteria should be established regarding information to be used on the assessment of major acquisitions of financial institutions.
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.
Description	<p>The Financial Institutions Law (Art. 32) establishes that banks must maintain minimum capital levels as established by regulation. BCRA regulations on minimum capital lay down minimum capital requirements to for credit risk, interest rate risk in the banking book, and market risk for all banks.</p> <p>BCRA regulations on minimum capital clearly define those instruments admitted for inclusion in Tier I and Tier II capital. Currently regulatory capital consists primarily of Tier I capital (as of March 2011 Tier I accounted for 87%</p>

and Tier II accounted for 13% of regulatory capital, on average). Tier I is comprised of common equity, “ajustes al patrimonio” (which includes revaluation reserves (from 20 years ago) and inflation adjustments conducted up to 1995, which together represent 17.2% of Tier I capital), retained earnings, general reserves and long term debt instruments (up to 20% of Tier I until end 2012 and up to 15% as of January 2013), as well as minority interests. In exceptional cases, the SEFyC may approve other instruments as Tier I capital, such as federal government bonds, BCRA bonds, deposits and other financial intermediation instruments, used for capitalization purposes. Currently Tier I is mostly composed by common equity and the share of long term debt instruments in Tier I is insignificant (just one institution in the financial system has issued such instruments, for a very low proportion of its total capital (2.93%)). Tier II is comprised of retained earnings (current year or unaudited), general provisions and provisions over fully collateralized loans (with preferred collaterals), subordinated, long term debt instruments that exceed the limit for Tier I or with residual maturity of less than 10 years or that are cumulative (all instruments up to 50% of Tier I).

Deductions are applied to both Tier I and Tier II and include goodwill and reorganization expenditures except for those clearly established as non-deductible (those exceptions amounted 97.1 million pesos for the entire system as of March 2011), foreign sovereign bonds with ratings lower than Argentina, demand deposits abroad with not connected non-investment grade banks, share holdings in other financial institutions and a few other items.

In the case of credit risk, financial institutions must maintain a required capital of at least 8% of risk-weighted assets (RWA). The risk-weighting system considers both on and off balance sheet assets and is in broadly in line with Basel I with some exceptions. Exceptions include, among others, fully collateralized exposures. Examples include exposures to the private sector fully collateralized by cash (including pesos, US dollars, Swiss francs, Pounds, Yens and Euros) or CDs issued by the bank itself with a 0% risk-weight; exposures fully collateralized by government bonds (at 75% of its market value) with a 20% risk-weight; collateralized by provincial (state) funds backed by funds from federal taxes require a 50% risk-weight; loans fully collateralized by agricultural machinery and automobiles (75% of market value) and industrial machinery (60% of market value) risk-weighted at 50%. In all those cases, the exposure exceeding the market value is risk-weighted at 100%.

The capital requirement for interest rate risk in the banking book is calculated using a standardized value-at-risk formula that calculates the impact of changes in interest rates (for both local and foreign currency). This requirement is added to the credit risk requirement.

The market risk requirement (regulation on minimum capital, section 6) is calculated on the basis of standardized value at risk formulas to give consideration to the market risk of the trading accounts. There are five asset

categories (foreign currencies, bonds in domestic and foreign currency, and equities in local and foreign currency). The market risk requirement for each bank is calculated on a daily basis (individual) or on a monthly basis (consolidated)

As of December 2010 the total capital requirement is equivalent to 9.4% of risk-weighted assets. The credit risk requirement represented approximately 84% of the total capital requirement, followed by the interest rate risk requirement with 12%, and finally the market risk requirement with 4%.

The overall risk profile of each institution is taken into account into the required capital ratio. The credit risk requirement is multiplied by a factor (ranging from 0.97 to 1.15) based on the CAMELBIG (refer to CP19) rating assigned by the supervisor to the institution.

The BCRA sets requirements (regulation on minimum capital, section 3) at a higher level than those suggested by international standards for some items: the capital requirement increases in line with noncompliance with regulatory limits; 8% capital requirement for government bonds in the banking book; 10% for fixed assets; capital requirements for interest rate risk in the banking book. In addition, the BCRA has established (regulation on distribution of dividends, section 2) that institutions wanting to distribute dividends must, among other requirements, maintain a capital conservation buffer of 30% of the total capital requirement, which in practice is reported by the BCRA to be equivalent to a buffer of somewhat more than 2.5% of RWA, in line with the standards recently agreed at international level.

Furthermore, the BCRA has performed quantitative impact studies to determine the potential impact on the Argentine financial system as a consequence of the introduction of the new bundle of measures known as Basel III, including also the simplified standardized approach for credit risk and operational risk under Basel II. The SEFyC reported that results indicate that most of the institutions within the banking system would not experience significant consequences as a result of such measures. The BCRA reported its intention to moving towards Basel II. The targeted timeframe includes capital charges for operational risk as of January 2012, Pillar 3 as of July 2012, capital charges for credit risk (without securitizations) as of October 2012, implementation of Pilar II as of 2013 and capital requirements for securitization as of April 2013. It was also reported that the financial system operates with very low leverage levels in relation to the parameters that have been approved internationally.

The Financial Institutions Law (Art. 34 and 35 bis) establishes that institutions that fail to comply with minimum capital requirements must correct the situation or submit a regularization proposal within a peremptory term. Failure to submit such a plan, its rejection, or its non-fulfillment, empowers the BCRA to apply corrective measures and resolution mechanisms laid down in law,

	<p>including the revoking of the institution's operating license.</p> <p>Up to now banks are not allowed to use internal assessment of risk as inputs to the calculation of regulatory capital.</p>
Assessment	Largely Compliant
Comments	<p>Capital requirements are broadly in line with Basel I with some exceptions. Materiality of those exceptions would require a more in depth assessment than the one conducted on this mission. Authorities should consider preparing an analysis of the materiality of the exceptions vis-à-vis Basel I. The forthcoming FSAP mission might consider conducting a more in depth assessment of those differences.</p> <p>Looking forward, the SEFyC plans to progressively implement Basel II, with mid-term plans for implementing the standardized approaches for credit and operational risk. In this context, it is important to ensure supervisors have powers to require additional capital for other risks along the lines of the pillar 2 of Basel II and also to require banks to have a more forward-looking approach to capital management. Banks and supervisors would need to adopt a more active role in assessing capital levels relative to banks risk-profiles.</p> <p>Current regulations in Argentina do capture, to some extent, the peculiarities of the local environment. Conservative approaches include the capital requirement for public sector enterprises and some deductions from capital. Nevertheless, the BCRA is recommended to:</p> <ul style="list-style-type: none"> • Move forward with its plans regarding capital charges for operational risk; • Move forward with a progressive approach toward the implementation of Basel II. • Review its definition of capital (e.g. to take into account only general provisions as Tier II capital, deduct goodwill from Tier I) ; • Review its definition of Tier I capital regarding capital injections not capitalized (aportes no capitalizados) and other instruments that can be counted as Tier I capital upon SEFyC approval; • Align capital requirements to Basel regarding collateralized exposures; • Clarify the regulation regarding capital requirements for interbank exposures.: <p style="text-align: center;">○</p>
Principle 7.	<p>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</p>

	commensurate with the size and complexity of the institution.
Description	<p>A regulation requiring banks to have in place comprehensive risk management policies and processes to identify, evaluate, monitor and control or mitigate material risks was issued in May 23rd 2011 and should be implemented as of 2012. The regulation encompass high standards (best practices) for the risk management process, as well as specific criteria for credit, liquidity, market, interest rate in the banking book, operational risk, as well as a requirement for the performance of stress tests, taking into account the size, nature and complexity of activities undertaken by banks.</p> <p>More specifically, the regulation requires banks' Boards to approve risk management strategies; internal processes for the assessment of capital levels relative to the risk profile; adequate information systems for risk assessment; measurement and reporting on size, composition and quality of exposures; policies and procedures that ensure new products and risk management procedures are approved by the Board; at least one unit (segregated from the origination) responsible for the identification, assessment, follow up, control and mitigation of risks, according to its size and complexity of its operations; periodic independent review by internal audit of the risk management unit; stress testing; contingency planning.</p> <p>At present, banks are required to present business plans (and projections) on an annual basis, which must encompass the identification of the risks deemed as significant by the Board, mechanisms of measurement, mitigation and monitoring of those risks adopted by management, as well as the information systems established to monitor those risks in order to achieve the objectives established by the business plans. In addition, the SEFyC hold meetings with banks to further discuss business plans and projections in order to assess their reasonableness.</p> <p>As part of its on-site inspections, the SEFyC verifies compliance with the policies, procedures, limits and the treatment of exceptions relative to banks internal policies. In particular, checks are performed to determine whether such exceptions are reviewed promptly by management and Board. It also determines whether the roles of evaluation, follow-up and control of risks are kept separate from the risk-assuming functions. In recent years, great importance has been assigned by the SEFyC rating committees to evaluation of the component concerning compliance with BCRA regulations and those of the financial institutions themselves relating to risk management.</p> <p>On the matter of the relationship between the level of risk assumed by a bank and its capital conservation, in addition to the SEFyC assessment of the Capital component of the CAMELBIG (see CP 19), it also considers, to some extent, the institution's policies and the approach of the Board and senior management in relation to the need to maintain reserves in excess of regulatory capital. In recent years, market risk specialists have been added to the supervision team to perform a methodological analysis of the systems and models developed by</p>

	<p>some of the institutions themselves. In addition, meetings and seminars have been held for the most senior financial institution authorities on stress tests, with the aim of promoting, spreading and deepening the adoption of such practices.</p> <p>To communicate the importance risk management and train financial institution officers and SEFyC staff, various technical documents have been published, and courses have been arranged both internally through a regular training programs and externally (e.g.ASBA).</p>
Assessment	Materially non-compliant
Comments	<p>The issuance of the risk management regulation that will be effective in 2012 is an important step towards compliance with this principle. Additional steps should include the adaptation of supervisory procedures and manuals, in particular for on-site examinations and training, as well as actual implementation by banks. Although some banks (foreign owned in particular) might already comply with most of the requirements, implementation might be a considerable challenge for smaller banks. In addition, even for banks that have already a more developed risk management framework, further customization might be needed in order to be able to fully comply with the new regulation. Authorities are advised to require institutions to deliver gap analyses to the SEFyC, supplemented by credible implementation plans in order to ensure an effective and rapid implementation process in banks.</p> <p>In addition, the BCRA should consider to:</p> <ul style="list-style-type: none"> - Incorporate on the regulation explicit reference to the management of risks not captured by capital requirements, such as reputation and strategic risk, as well as concentration risk (to the extent not covered by specific risks) - Expand the reference to the internal process to assess capital adequacy relative to the risk profile. Although the regulation makes clear reference to stress testing, assessment of capital should include judgmental elements as well.
Principle 8.	<p>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.</p>
Description	<p>The assessment of credit risk management is made through an evaluation of policies, samples of loans (commercial and consumer), as well as evaluation of origination procedures and techniques.</p> <p>There are no requirements in place for banks Boards to approve and periodically review the credit risk management strategy and significant policies</p>

and processes for assuming, identifying, measuring, controlling and reporting on credit risk (including counterparty risk) or that senior management implements the credit risk strategy approved by the Board and develops the aforementioned policies and processes. However, the risk management regulation issued by the BCRA in May 2011 and to be applied as of 2012 does require such a framework to be in place.

Currently the only explicit regulations regarding banks' Board requirements regarding credit risk refers to large exposures. The granting of loans in excess of 2.5% of regulatory capital requires an opinion from senior management and approval by a majority of the directors, unless with the exception of exposures to related parties is involved, when approval by at least two-thirds of directors is needed (regulation on minimum provisioning, section 3.1). The SEFyC carries out on-site inspections to verify that these requirements have been observed. In addition, it receives an annual report from the institutions with a proposed business plan, definition of the strategy adopted by the bank, and forecasts of the targets and objectives set for their achievement. Plans must provide information on business lines, risk management (credit risk in particular) and internal controls.

There are no requirements regarding banks' policies and processes on establishing an appropriate and properly controlled credit risk environment with the exception of the asset classification and provisioning regulations described in CP9. Regulation on asset classification (regulations on borrower classification), nevertheless, establish detailed criteria for managing certain aspects of credit risk, including: (a) renewing and refinancing existing exposures (based on the classification level); the appropriate approval authorities for large exposures; (c) periodicity of analysis of a borrower's ability to repay under the terms of the debt; (d) required documentation, including on collateral; (e) lending limits. On site examinations include the verification of the existence (and implementation) of updated credit policies and procedures, as well as risk concentration. Procedures also include a general assessment (which should encompass credit risk) on information available to senior management, quantity and quality of staff, limits and authorizations.

The SEFyC receives monthly information from financial institutions on all system debtors, with identification of the debtor, amount and type of debt, collateral, rating classification and provisions. This also means that banks have permanently updated information on their risk exposure and their doubtful assets. To provide the SEFyC with the required information, banks must classify their portfolios into the following two (optionally three) categories (Classification of Borrowers, Section 5): commercial portfolio (loans to companies), consumer and housing loans (loans to individuals), and optionally, the commercial portfolio classified as consumption or housing loans (loans to companies for amounts of up to \$750,000). While commercial portfolio loans are assessed mainly on the basis of the expected cash flow to be generated by the debtor's business, consumer and housing portfolio loans (and optionally

loans to companies up to \$750,000) are classified according to repayment performance. As a result of this assessment, loans in the two/three categories must be grouped into six classification levels in declining order of loan quality. The top level corresponds to debtors complying and expected to comply with their obligations normally, while the last two are for loans considered to be virtually unrecoverable.

The SEFyC Supervision Manual establishes criteria for monitoring and assessing (on-site and off-site) the ASSETS component, including the adequacy of policies, procedures and internal controls relative to a bank risk profile. Procedures encompass regulatory compliance, assets trends, loans assessments, other assets and credit risk mitigation. A report made available to the assessors by the authorities indicates that procedures are focused on compliance with regulations and internal policies procedures, as well as information provided to the board. Current credit risk management assessment procedures are in great part based on the assessment of internal controls.

Off-site monitoring includes the review of a monthly report on the banking system and peer groups' credit performance. Supervision of credit risk is also aided by detailed and continuous off-site evaluation of large borrowers (currently around 800 companies) by a dedicated area within the SEFyC. In practice, although such procedures result in adequate ongoing monitoring of the largest borrowers, there are no tools available (e.g. a more granular risk classification system) to differentiate risks of companies and indicate trends.

Off-site supervision has also made progress with the performing of stress tests that incorporate two macro scenarios and two sensitivity scenarios. Analysis is complemented by an evaluation of the business risk and the projection of expenditures and results. In addition, There is another area within the SEFyC dedicated specifically to analysis of the financial system that prepares a quarterly report on credit risk. This report includes indicators and estimates of losses under certain assumptions.

There are no requirements that credit decisions be made free of conflicts of interest and on an arm's length basis except for related party lending. On-site verifications encompass the assessment of a series of information on selected loans including the manager in charge of the loan, which can identify the existence of conflicts of interest in non-related party lending and mitigate the risk of occurrence.

Legal provisions (BCRA Charter, Section 50, and Financial Institutions Law, Section 37) ensure the BCRA unrestricted access to banks information and documentation during inspections or through an administrative request. There are no provisions in the law ensuring access to bank officers involved in assuming, managing, controlling and reporting on credit risk. SEFyC reported that it has full access to personnel, as deemed necessary, which was confirmed

	by banks.
Assessment	Largely Compliant
Comments	Current supervisory procedures enables the SEFyC to make a reasonable assessment of the credit risk management process of banks regarding prudent policies and processes to identify, measure, monitor and control credit risk but would benefit from further enhancements. Going forward, additional focus on strategies and a more pronounced bias toward policies and procedures risk assessment will enable supervision to better assess credit risk management in banks. Oversight of the management of credit risk of large borrowers would benefit from the adoption of a more granular approach to risk valuation, anticipating trends regarding particular borrowers or sectors. The implementation by banks and supervisors of the new regulation on risk management by both banks and supervisors will enable the SEFyC to better assess credit risk management relative to banks' risk profiles, including Boards' active involvement, as well as more focus on credit risk strategies.
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.
Description	<p>BCRA regulations contain rules on debtor classification, recognition of collateral and minimum provisions for credit risk (regulations on minimum allowances, borrowers' classification, credit management and collaterals and guarantees).</p> <p>Regulations on borrowers classification (3 and 5) establishes that banks must classify a borrower according to its ability to pay its commitment. It also determines that banks should develop procedures to ensure an adequate evaluation of the economic and financial situation of debtors and a regular review (based on objective and subjective criteria) of the situation as regards the status of all the risks assumed. Banks must also develop a "Classification and Provisioning Manual" describing the procedures for the analysis of the loan portfolios. Internal criteria for identifying impaired assets and making provisions cannot be less demanding than the guidelines set by the BCRA. Banks must segment their loans portfolio into commercial loans and consumer or housing loans. Commercial exposures up to 750,000 pesos may be considered, for classification purposes, as consumer loans, at the bank's discretion. Consumer and housing exposures can be classified and provisioned based on arrears only. Exposures in excess of 750,000 pesos must be classified and provisioned on an individual basis. Regulation set minimum guidelines for risk classification including the assessment of debtor repayment capacity and rules for approval of new exposures, rolling over and refinancing exposure depending on the classification.</p> <p>Banks must review all loans classifications at least once a year. Semi-annual reviews are required for exposures over 2 million pesos or ranging between 1%</p>

and 5% of regulatory capital. Quarterly reviews are required for exposures that amount to 5% or more of regulatory capital. Banks are also required to take into account information from the credit registry and in most cases only a one-level discrepancy is allowed in relation to the information submitted by other banks with relevant exposures, as well as to carry a file for each debtor (regulation on classification of borrowers, section 3).

The adequacy of the procedures for rating assets and setting up provisions as well as the effective use by banks of such procedures are assessed during the course of on-site inspections periodically carried out by the SEFyC. In addition, external auditors must assess the classification of credit exposures upon each examination of the quarterly financial statements as well as provide the SEFyC with a special report on the largest debtors of the banks they audit (regulation on external auditors).

According to the regulation on borrowers classification (section 2) classification encompasses both balance sheet accounts (loans, leasing and derivatives) and off balance sheet accounts (guarantees granted, derivatives, loans agreed and subject to drawdown). Regulation on minimum provisioning (section 1) establish that all exposures encompassed by the regulation on borrowers classification should be provisioned, with the exception of credits to the public sector, government owned banks (where there is a government (any level) guarantee, short-term (up to 30 days) interbank loans, guarantees (including trade finance) for clients classified as normal, loans and advances to the deposit insurance fund, as well as overdraft limits.

The SEFyC has no procedures in place to determine that banks have appropriate policies and processes to ensure that provisions and write-offs reflect realistic repayment and recovery expectations. On-site examinations include the review of the largest exposures and others (based on sampling techniques) commercial loans, which can result in reclassification or requirement of additional provisioning. Provisions for consumer loans are based on arrears and banks are not required to take into account any other techniques (including their scoring models or equivalent) for establishing provisioning criteria.

SEFyC on-site examinations procedures comprise the assessment of banks policies and processes, as well as organizational resources for identification of deteriorating assets (as defined by the regulation on borrowers' classification) for commercial loans. Consumer loans are required to be provisioned and classified based solely on arrears. There are no procedures in place for the assessment of the appropriateness of procedures regarding oversight of problem assets and collecting on past due obligations. Regulation recently issued on risk management and to be implemented as of 2012 explicitly requires banks to have in place adequate procedures for the oversight of problem assets and collections.

The SEFyC receives monthly information on all financial system debtors

including amount and type of debt, collateral, classification and provisions.

The SEFyC has the power (and uses it) to require banks to increase its levels of provisions (regulation on minimum provisioning section 2.6) if provisions are deemed to be insufficient. Section 2.8 establishes that failure to comply with such requirement is considered a severe violation and results in fines (minimum 1% of the additional required provisions) and other sanctions, with immediate effect.

There are no requirements for banks to have appropriate mechanisms in place for periodically assessing the value of risk mitigants, including guarantees and collateral.

Loans are to be grouped into 6 levels, in declining credit quality order. The basic criterion for commercial portfolio rating is the repayment capacity on the basis of the financial flows expected from the debtor's business. Liquidation of collateral received and debtor assets should be considered only in second place, as loans should be granted with repayment terms in accordance with customer repayment possibilities. According to regulation on minimum provisioning (Section 1), analysis should place special emphasis on the currency of the loans and the funds generated by debtors. In addition to analyzing payment capacity and the quality of collateral received, financial institutions must set up provisions for certain minimum percentages of loans based on the arrears on contract terms and other debtor conditions (deficiencies in corporate governance, inadequate information, technology difficulties, problems in the economic sector or with competition and creditor protection or bankruptcy). These percentages, set for each of the 6 rating levels, range from 1% (generic provisioning for "pass" loans) to 100% of the credit exposure. Loans classified as "unrecoverable" and fully provisioned should be written off from assets as from the seventh month subsequent to such circumstances having been identified. Exceptions to this rule encompass loans covered by "A" type collateral (which includes cash, gold, CDs, guarantees from top tier banks, warrants, receivables from government-owned companies, credit card receivables (subject to certain criteria) and others) are subject to provision through the generic provision (1%). Loans guaranteed by "B" category collaterals (mortgages, other fixed assets).

The table below summarizes the criteria for provisions. Each category, apart from the number of days past due, comprises an assessment of the borrower (with the exception of exposures up to 750,000 pesos, which can be classified solely based on arrears).

Category	Days past due	Collateralized ("B category")	Uncollateralized
1.Pass	Up to 31	1%	1%

	2 a) Watch/Low risk	Up to 90	3%	5%
	b) Restructured loans (and loans being restructured)	(initiated up to 60 days past due)	6%	12%
	3. Problem loans – median risk	Up to 180	12%	25%
	4. High risk	Up to one year	25%	50%
	5. Irrecoverable	Over on year	50%	100%
	6. Technically irrecoverable		100%	100%
	<p>There are no currently regulations in place requiring the board to receive and review information on the condition of the bank’s asset portfolio, including the classification of credits and the level of provisioning. Nevertheless the BCRA reviews the information received by the board during its on-site examinations. In addition, the new regulation on risk management to be implemented as of 2012 require a more active role of the board regarding credit risk management</p> <p>BCRA regulations on provisioning requirements (section 3.1) establish that debtor classification and the setting up of provisions for loans in excess of 2.5% of the institution’s regulatory capital should be approved by a simple majority vote by the Board, except in the case of related parties, in which case approval by two thirds of the Board members will be required. In addition, SEFyC continuously evaluates the credit risk of those debtors considered to be of systemic significance and the configuration of economic groups. It also continuously evaluates the development of financial institutions based on the latest on-site inspection, asset risk levels, suitability of provisions and the impact of potential adjustments on regulatory capital. When deviations in rating and provisioning exceed certain limits, a written procedure is initiated so that the financial institution can justify its position, increasing the level of its provisions if necessary (regulation on classification of borrowers, 3.5).</p>			
Assessment	Materially Non-Compliant			
Comments	<p>Regulation on asset classification and provision does not provide for adequate provisioning, in particular for certain collateralized exposures, consumer portfolios, restructured loans, as well as loans to the public sector. Although it might be argued that currently provisions are adequate, taking into account the size of the credit market in Argentina, as well as the economic cycle, provisions are likely not to pace up with deterioration of loan portfolios on a downturn of the cycle.</p> <p>As an indication that current provisioning requirements for consumer loans in</p>			

	<p>particular do not provide for an adequate level of conservatism. As a reflection of that, most large banks provision 100% of consumer loans past due over 180 days, although regulation requires full provisioning only after 360 days. In addition, criteria for reclassification of restructured loans allows for levels of provision that might not accurately reflect the actual levels of risks of such operations. Loans to the public sector (including federal, state and municipal loans, as well as loans to state-controlled banks) do not require provisioning.</p> <p>In addition, some of the criteria of this CP, including the requirement for banks to establish specific policies and processes for identifying and managing problem assets, for periodic review of problem assets, assessment of the value of risk mitigants, the assessment of the adequacy of organizational resources for identification, the oversight and collection of problem assets, as well as the timely and appropriate information to the board of the condition of the asset portfolio will be formally required only as of 2012, with the implementation of the new regulation on risk management.</p> <p>The BCRA is advised to:</p> <ul style="list-style-type: none"> • Revise the provisioning regulation in order to provide a more conservative approach to provisioning of past due collateralized loans; • Revise supervisory procedures and train staff regarding credit risk management in line with the new regulation; • Conduct an active discussion with stakeholders on its expectations regarding implementation of the new regulation; • Establish more stringent and forward-looking rules on provisioning for consumer loans; • Revise classification criteria of restructured loans, adopting a more conservative approach and ensuring levels of provisioning and classification reflect actual recovery expectations; • Require provisions for past due loans irrespectively of the counterparty (e.g. encompassing public sector and interbank exposures) • Adopt a more risk-sensitive approach for asset classification regarding normal loans. The BCRA is aware of the need to reformulate the minimum regulatory classification rules and incorporate more risk classification levels, particularly in the segment of normally-performing debtors, to achieve evaluations that are more sensitive to credit risk.
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.
Description	<p>The definition of economic group provided by BCRA regulations (A2140, Annex I(1) and Annex II (3.7) encompasses any party that is controlled or exerts control over another company, as well as companies that share the majority of board members. Control is defined by ownership (25% or more), exercise of voting rights (50% or more), influence (“para formar la voluntad social en las asambleas de accionistas”) and management (member of the board), Furthermore, at the proposal of the Superintendent, the Board of the BCRA may determine that a company or person directly or indirectly exercises controlling influence on the management and/or policies of another company for purposes of defining the existence of a link between them.</p> <p>BCRA regulations (A2140, Annex II) establish that on and off balance sheet exposures to individual customers in the private sector should not exceed 15% of financial institution regulatory capital; this limit is increased to 25% when loans are covered by certain types of collateral. For the purpose of calculating these limits, economic groups are considered as single customers. These rules also set limits on the total exposure to large exposures (which are defined as exposure equivalent to 10% or more of regulatory capital) which cannot exceed 3 times regulatory capital in the case of non-financial sector customers or 5 times if large exposures with the financial sector are included. These limits must be met on an individual and consolidated basis (regulations on consolidated supervision Section 5.2). Globally, exposures to the public sector cannot exceed 35% of total assets (A4546) or 75% of financial institution regulatory capital (A4230(2)).</p> <p>The SEFyC receives a quarterly report from the external auditors on the quality of the information banks submit in compliance with the quarterly information requirements (which encompass connected counterparties), with details of any differences between the data submitted by the bank and that obtained by the audit.</p> <p>BCRA regulations require that the granting of loans in excess of 2.5% of regulatory capital require approval by a majority of the directors. By means of both on-site inspections and the quarterly information regime, the SEFyC verifies that these limits have been observed, and that they have not been exceeded either individually or on a consolidated basis.</p> <p>Monthly, banks must submit to the SEFyC information on exposures according to economic sector (credit registry information comprises economic sector), and provide a quarterly breakdown according to currency and according to geographical area. Law 24,144 Art. 47(c) grants the SEFyC power to require banks to cease or desist of certain credit policies that can jeopardize banks’ solvency.</p>
Assessment	Largely Compliant
Comments	The BCRA regulations provide a solid set of limits on large exposures to

	<p>connected counterparties. Nevertheless, regulations do not encompass requirement for risk management policies and processes regarding interconnected parties or other material concentrations.</p> <p>The BCRA should consider developing regulation requiring banks to establish procedures and controls for concentration risk management, including issues regarding credit concentration within a specific industry, geographic region or business lines.</p>
Principle 11.	<p>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.</p>
Description	<p>The definition of related parties (A49 and A2140) encompasses any party that directly or indirectly exerts control over the bank as well as any party that the bank directly or indirectly exerts control over; board members, directors and senior management, companies they control or exert significant influence, as well as close family members; companies where the majority of board members comprise also the majority of the bank's board or of the bank's holding company board. It can also encompass any party that the BCRA rules that certain indicators constitute proof of existence of controlling influence, as well as, on exceptional cases, any party that the BCRA rules which relationship with the bank could undermine its solvency.</p> <p>The Financial Institutions Law (Art. 28 (d)) forbids banks to transact with their directors and managers and related persons and companies in conditions more favorable than those granted to their customers.</p> <p>BCRA regulations (TO Credit Management 1.5) establish that loans to related parties in excess of 2.5% of regulatory capital and their classification and provisioning must be approved by two-thirds of the members of the Board. The Corporations Law (19.550 art. 272) lays down that when a director has a conflict of interest in relation to his or her company, the Board and syndics must be informed, and the director should abstain from taking part in discussions. Overdrafts or short-term loans can be approved until 30 days after disbursement. Limits (up to one year) can be granted without approval of the board. Downgrades must be submitted to the board for approval, which includes write-offs. The SEFyC confirms during its on-site inspections that banks comply with these laws and regulations, as well as their own policies and procedures regarding loan granting procedures.</p> <p>There are no explicit requirements for banks to have policies and processes in place to prevent persons benefiting from the exposure and/or persons related to</p>

	<p>such a person from being part of the process of granting and managing the exposure except for board members.</p> <p>Regulations A2140 and A3129 rule on limits to related party lending. On and off-balance sheet exposures to each individual related party customer in the private sector must not exceed 5% of financial institution regulatory capital; this limit rises to 10% when loans are secured by certain forms of collateral; globally, assistance to related customers cannot exceed 20% of financial institution regulatory capital. In addition, the total amount of the assistance to these customers is calculated together with other assets such as property, as an immobilization that in total cannot exceed 100% of regulatory capital. Exceptions to those limits include personal loans (up to 50,000 pesos) and primary residence mortgages as well as other exposures that the SEFyC may allow under exceptional circumstances. Over the last few years there has been two cases, both with justifiable circumstances. In any case, the total exposure to related parties, taking into account the exclusions, cannot exceed 15% of financial institutions regulatory capital or 25% if secured by certain forms of collateral.</p> <p>There is no explicit requirement for banks to have policies and processes to identify individual exposures to related parties as well as the total amount of such exposures. Nevertheless, BCRA regulations (TO Credit Management (1.4)) require credit applications to be accompanied by customer affidavits on their relationship with the financial institution, its shareholders and directors, for total exposures that exceed 2.5% of equity or 2 million pesos. Once a month the general manager should submit a written report to the bank's directors and syndics on loans granted to related customers. There is also no requirement for banks to monitor and report on related party lending through an independent credit review process, although external auditors (TO external auditors) are required to annually assess related parties lending, which must comprise an assessment of the adequacy of the procedures adopted by banks to identify exposures to related parties.</p> <p>The SEFyC verifies procedures adopted by banks to identify exposure to related companies and their calculation. The procedures and criteria guidelines for assessing risks contained in the Supervision Manual indicate the way in which the ASSETS component is to be evaluated for purposes of the rating assigned to banks and the related internal controls, with special emphasis on monthly compliance with rules referred to the limits applicable to credit assistance to persons and companies in the non-financial private sector that are related to the bank.</p> <p>Banks are required to submit to the BCRA on monthly basis information on borrowers to the credit registry, where credits to related parties must be marked as such. The SEFyC obtains and reviews information on exposures to related parties as defined by regulation.</p>
--	--

Assessment	Largely Compliant
Comments	<p>The definition of related parties provided by regulation does not encompass direct or indirect interests of close relatives of related parties. In addition supervisors' understanding and application of the regulation comprises the financial group and its main shareholders but does not take into account other direct and indirect interests of major shareholders as well as their close family members' direct and indirect interests. Reports reviewed by the assessors presented evidence of monitoring related parties within the financial conglomerate and up to its holding but not beyond that. Supervisory procedures should be amended to encompass a broader definition of related parties. This shortcoming on the regulatory framework and its supervisory consequences is further discussed and has been reflected in the grading of CP 24.</p> <p>The authorities should consider amending the regulation in order to:</p> <ul style="list-style-type: none"> • broaden the definition of related parties (and enhancing the supervisory process accordingly); • establish explicit requirements for banks to 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 exposures; • establish explicit requirement for banks to have policies and processes to identify individual exposures to related parties as well as the total amount of such exposures.
Principle 12.	<p>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.</p>
Description	<p>Country risk and transfer risk are minimal in the Argentine financial system. Exposure to residents abroad derives almost exclusively from deposits at correspondent banks, financing of foreign trade, and to a lesser extent, from the setting up of branches. As of March 2011, only 1.6 percent of assets and 2.6 percent of liabilities are subject to country risk. Given their low materiality and the mitigating elements in existing regulations, the regulatory treatment of these risks has not been considered a priority and inspectors do not regularly cover these risks in their onsite examinations.</p> <p>Rules on credit policy require credit to be directed towards financing investment, production, sales and consumption required by domestic demand and the country's exports (Regulations on credit policies, Section 1, 1.1 and Section 5, 5.3).</p>

	<p>There are several restrictions that tend to limit country and transfer risks. Provisioning rules establish that exposures to non residents must be fully provisioned, unless the borrowers are investment grade, or financial institutions forming part of the economic group of the banks acting in the country or participate in reciprocal payments and credits agreements. There are strict limits on exposures to financial institutions abroad (unless it is with the parent company): 25% of regulatory capital for unrelated investment grade correspondents, 10% for related investment-grade correspondents, and 5% for all remaining correspondents (BCRA Communications “A” 2140, Annex II, 3.6, “A” 3129 and “A” 5193).</p> <p>In addition, minimum standards for internal controls establish that banks should have policies and procedures to evaluate and control the main risks from external and internal sources, albeit it does not explicitly mention country and transfer risks. Additionally, the new risk management regulation requires banks that have exposures with non residents have adequate policies, procedures and practices to identify, assess, monitor and mitigate country and transfer risks from these operations (article 2.1.2.3).</p> <p>The Supervision Manual establishes that supervisors must understand the business and the situation of the financial intermediaries and must use their judgment to select the procedures and reviews to be carried out to meet these objectives. It also has a short mention to country and transfer risks, as one of the macroeconomic factors, but does not set specific procedures to assess this risk and the adequacy of its management (Supervision Manual, form 5 on risk management).</p>
Assessment	Materially non Compliant
Comments	<p>While country and transfer risks do not appear to be material and the regulatory restrictions contribute to limit these risks, this may change over time, so it is recommended that the BCRA: (i) implement a system to monitor regularly the materiality of country and counterparty risks; (ii) incorporate in its supervisory manuals specific procedures to assess the adequacy of banks' policies and procedures regarding this risk; and (iii) effectively confirm that banks have information systems, risk management systems and internal control systems that accurately monitor and control country exposures.</p>
Principle 13.	<p>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.</p>
Description	<p>Exposures to market risk in Argentina are associated mainly with foreign exchange risk and relatively small trading portfolios of Argentinean government securities. Some banks have large exposures to government securities, but these are not generally traded, and are maintained in the banking book. Most banks do not have active trading desks. There is no trading in equity</p>

and commodities markets. Outstanding derivative contracts as of December 2010 amounted to 84.5 billion pesos, but 83 percent of these were for third parties. Operations with derivatives are limited mainly to forwards (60 percent, of which 87 percent correspond to foreign currency forwards), repos (19 percent, mainly of government securities) and futures (12 percent, mainly foreign currency). The remaining derivatives correspond to swaps and options.

The few banks that have active trading desks have established policies for the management of market risk. BCRA regulations require that banks that trade in options or that, at any time, hold assets that are marked to market for more than 25% of their regulatory capital, must define responsibilities for the management of market risks and the correct estimation of their capital charges for market risks (Minimum capital regulation, Section 6.7). This implies appointing persons to be responsible for the correct application of the calculation methodology and taking the necessary measures to ensure positions are covered by the required capital, as well as regularizing any capital shortfalls exceeding 3% of the requirement. They are also responsible for providing the SEFyC with the required information.

The BCRA also lays down the minimum capital to be held by financial institutions on the basis of the value at risk of asset portfolios exposed to market risk. The regulation defines the method and parameters for the calculation of the capital requirements. Regulations also detail the measures and sanctions in the case of non-compliance with these requirements (see CP 6).

The BCRA has set a regulatory limit on the overall net short foreign currency position, which cannot exceed 15% of bank regulatory capital (regulation on the foreign open position). There is no regulatory limit on the long foreign exchange position. Most banks tend to have significant long foreign currency positions (67 percent for large public banks and 19 percent for large private retail banks).

Market risk is one of the components of the SEFyC CAMELBIG rating system. The rating of this component is based on both onsite and offsite analysis. Onsite analysis covers a general review of policies and procedures regarding market risk management. The onsite Supervision Manual also contains detailed processes for the examination of the registration, accounting and reporting of investments, derivatives, money-market and foreign currency operations.

The offsite analysis is mainly conducted by a specific area responsible for market risk. The analysis of market risks, based on the banks reports to the SEFyC, includes a monthly review of exposures to market risks; and annual sensitivity and stress tests on foreign exchange risk and on market risks for the trading portfolio. Monthly reports are prepared on exposures to foreign currency, fixed income securities and operations with derivatives. The market risk specialists also assist onsite supervisors on the analysis of complex topics

	<p>associated with their area of expertise, particularly when a bank has significant exposure to market risk. As a result of this analysis the market risk specialists issue a rating that is used as an input for the rating of the M component of the CAMELBIG.</p> <p>The assessors had access to samples of the reports prepared by the market risk area on: foreign exchange risk and fixed income securities (monthly); and derivatives (quarterly). The report on foreign exchange risk reviews the compliance with the limit on the net foreign exchange open position and presents a VAR analysis for groups of banks. The report on fixed income includes a bank by bank VAR analysis. In turn, the report on derivatives focuses on analyzing derivative markets, but not individual bank exposures.</p> <p>During the course of this assessment, the BCRA issued a regulation on risk management (Risk Management Manual), which includes a specific section on market risk management. The Manual requires banks to have a market risk management framework, with policies, procedures and structures needed for the management of this risk. The framework should take into account the size and complexity of the financial institution. The Manual defines the responsibilities of the Board and senior management, sets limits and lays down sound valuation practice, among other aspects. There are also explicit requirements for banks to: develop internal models to estimate this risk, establish internal limits, apply a prudent valuation of financial instruments, perform stress tests and plan for contingencies.</p> <p>While the implementation of the new regulation by banks and supervisors will take some time, some steps have been taken by both, prior to the issuance of the regulation. Foreign and large banks already have some market risk management tools in place. The BCRA has held seminars on stress testing for senior banking officials to promote, spread and deepen the use of such tools. The area responsible for this risk within the SEFyC is already qualified to analyze market risk. The biggest challenge within the SEFyC is to deepen the capacity to assess the adequacy of risk management and to better integrate the analysis conducted by the specialized market risk area into the main supervisory processes. The biggest challenge with regards to banks is to ensure an adequate implementation of this framework in smaller banks, that is commensurate to the risks they take, and to adequately monitor the risks taken by the most sophisticated institutions, to ensure that these are adequately controlled and covered.</p>
Assessment	Materially non Compliant
Comments	To achieve full compliance with this principle, the BCRA would need to adapt the supervision procedures to ensure effective implementation by all banks of the market risk section of the risk management regulation. Supervisory processes to analyze the adequacy of banks' risk management frameworks would need to be strengthened; and supervisors would need to effectively confirm that banks have set internal limits, perform scenario analysis, stress

	testing and contingency planning, as appropriate, and periodic validation of the systems used to measure market risks. This would imply also further development of supervisory capabilities to analyze banks systems to identify and measure market risks and to assess the adequacy of banks policies (including the internal limits) in this regard.
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.
Description	<p>The Financial Institutions Law (article 31) establishes that banks must hold cash reserves as laid down by the BCRA, based on deposits and other obligations and financial liabilities. The law states that banks must observe the regulations issued by the BCRA in this regard (article 34). The BCRA has established two types of liquidity rules. The BCRA rules on "liquidity position" (A 5067) establish liquidity management guidelines, analysis of various liquidity scenarios and include limits on maturity mismatches. The scenarios as well as the limits on mismatches consider off-balance sheet items. The BCRA minimum cash rules (A 5197) establish the minimum liquidity ratios that banks must hold at all times.</p> <p>BCRA rules on "Liquidity Position" (A5067) indicate that banks should adopt management and control policies to ensure availability of reasonable liquidity levels to efficiently attend to their deposits and other financial commitments in different scenarios. Policies should contemplate procedures to evaluate market liquidity conditions in advance, face new scenarios and establish measures to prudently support longer-term assets. Consideration should be given to the level of concentration of assets and liabilities by customer, the economic and market situation and its development, and the possibility of obtaining alternative liquidity sources.</p> <p>In addition, banks are required to ensure that the structure of their organization includes an area and a person responsible from the highest management level to perform daily monitoring of liquidity conditions (A 5067, Section I, art. 1.2). A director should be appointed who should be informed at least weekly, or as frequently as circumstances require, about changes in liquidity conditions when these justify a definition of a new course of action. The officers and directors designated to handle liquidity policy should also adopt the necessary measures to ensure compliance with regulations on minimum cash levels.</p> <p>The regulation (A5067) includes scenario analysis of funding needs (at a minimum) on the basis of contractual flows of funds for domestic and foreign currency, adjusted as prescribed in the three scenarios considered in the regulation: normal, signs of idiosyncratic liquidity strains and signs of systemic liquidity stress.</p>

BCRA minimum cash rules (A 5197) set minimum liquidity requirements for sight and term liabilities. These are calculated on the monthly average of daily balances for deposits and other liabilities from financial intermediation at sight and at term, in pesos and foreign currency. Liquidity requirements are conservative and in accordance with the local environment. For example, savings and current account deposits in local currency carry a requirement of 19%. Time deposits in local currency carry a requirement of between 14% and 0%, depending on their residual term, while in the case of time deposits in foreign currency the requirement is set at between 20% and 0%, also depending on their residual term. Securities deposits are also subject to a requirement that varies depending on the currency in which they are denominated and their residual term.

Regulations adopt a conservative definition for the liquid assets qualifying for compliance with the liquidity requirements: these include cash, balances deposited in accounts at the BCRA and in special collateral accounts. Requirements must be complied with, separately for liabilities in local and foreign currency, so as to avoid currency mismatching.

Financial institutions record a sound liquidity position. Liquid assets currently represent 29.5% of total deposits. This value rises to 45.6% if bank holdings of BCRA debt instruments (Lebac and Nobac) are considered.

There is a system of monthly reports to the BCRA on minimum cash positions. In addition, banks are requested to make forecasts over a three-year period as part of the information regime entitled “Business Plan and Forecasts.” Figures for domestic and foreign currency are presented separately.

The Supervision Manual establishes the criteria for monitoring and evaluating the LIQUIDITY component of the bank rating system (CAMEL BIG). To this end, in addition to verifying compliance with the regulations, supervisors conduct an evaluation of the level and quality of liabilities, the diversification of funding sources, liquidity policies, liquidity management information systems and contingency plans. Onsite reports reviewed by the assessors present a description of all of these, an opinion with regard to the sufficiency of available funds relative to funding needs and the diversification of funds; an opinion on the adequacy of liquidity policies and controls; and a rating of the LIQUIDITY component. Some of these conclusions are not fully supported in the report (albeit they may be supported in the working papers that were not reviewed).

In addition, to assess the MANAGEMENT component, the Manual requires analysis of the participation by directors and management in the evaluation of risks associated with bank operations, including awareness of the bank’s liquidity conditions, and the policies adopted to handle it.

	<p>The SEFyC carries out stress test exercises on liquidity risk that include scenarios of deposit runs and analysis of contagion. In addition, the SEFyC prepares a monthly report on Liquidity Risk that includes an analysis of liquidity indicators, including funding rates, and cash flow estimates for 12 months under various assumptions.</p> <p>The recently issued regulation, “Risk Management Manual” (May 2011), includes a specific section for liquidity risk management, so as to order and update the existing rules and formalize supervisory requirements. The section on liquidity risk management is comprehensive and includes detailed requirements on the liquidity risk framework, including specific requirements for: liquidity strategy, board responsibilities and oversight, liquidity risk management, stress testing, and contingency planning, all of which should take into account the bank's corporate structure and the key business lines and products. Liquidity risk management should include the following processes: (i) the management of flows of funds (income and expenses) for the various maturity buckets; (ii) the periodic analysis of deposit structure; (iii) the measurement and monitoring of the net funding needs under various scenarios, including stress scenarios; (iv) monitoring of liquidity ratios; (v) the management of access to markets; and (vi) contingency planning. The responsibilities of the board include the establishment of the strategy, the risk tolerance levels and policies. The board must understand the key relationships between liquidity funding risks and liquidity market risks, as well as the impact of other risks.</p>
Assessment	Largely Compliant
Comments	<p>Prior to the issuance of the risk management regulation, the SEFyC already had an effective framework for the supervision of liquidity risk. The new regulation provides a specific benchmark to assess risk management. For this to be an effective tool, supervision procedures will need to be adapted to ensure effective implementation by banks of the liquidity section of this regulation. This will require further strengthening the capabilities of supervisors to analyze banks systems to identify and measure liquidity risks and the adequacy of banks policies in this regard.</p>
Principle 15.	<p>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.</p>
Description	<p>The BCRA has issued a specific regulation on operational risk management by financial institutions (A 4854). According to this regulation, banks must have an operational risk management framework containing policies, procedures and structures needed to identify, assess, monitor and mitigate this risk (article 1.2). Policies and procedures should be in proportion to the size and complexity of the financial institution. The regulation adopts the definition of operational risk</p>

used by the Basel Committee, which includes legal risk and excludes strategic and reputational risk (article 1.1).

The regulation requires bank Boards to approve the operational risk management framework, which should be reviewed annually, or when relevant events take place, and these events should in turn be notified to the SEFyC (article 2.1). The breadth and scope of the board responsibilities are spelled out in this article. The Board should have clear awareness of the procedures carried out to manage operational risk, and their degree of compliance. It should receive, at least every six months, information enabling it to analyze the bank's operational risk profile and determine the strategic implications for its business. The Board is also responsible for: (i) ensuring that the operational risk management system is subject to an internal audit process; (ii) approving policies for the communication of the operational risk management system and training; (iii) establishing policies for the management of operational risks arising from outsourced activities and services provided by suppliers; (iv) approving a policy for the communication of information to the public regarding the operational risk management system; (v) ensuring that the bank has qualified personnel and the necessary resources for risk management; and (vi) verifying that those responsible for the risk management do not perform other tasks that could give rise to a conflict of interest with that role.

The regulation also clearly defines the responsibilities of senior management (article 2.2), management areas (article 2.3), and the Operational Risk Unit or the officer responsible for that risk (article 2.4). General management is responsible for the implementation, reporting and control of processes and procedures for the putting into practice and operation of the operational risk management system. This system should be applied consistently throughout the bank, and all levels of the organization should understand their responsibilities in relation to the administration of this risk.

The regulation requires that general management: (i) is responsible for ensuring that there are processes and procedures for the management of operational risk in the case of the products, activities, processes and systems, in each of the material business units of the financial institution; (ii) should establish clear lines of authority, responsibility and communication with the various levels of management to encourage and maintain the responsibilities assumed; (iii) should ensure the availability of resources for efficient administration of operational risk; (iv) should ensure that the process of management oversight is adapted to the risks inherent to the policies of each business unit; (v) should receive information with the results of the execution of operational risk management processes; and (vi) should inform the Board at least every six months of the principal aspects in relation to the management of operational risk.

Regulations also establish that banks must have contingency and business

continuity plans in accordance with the size and complexity of their operations to ensure the continuity of their operating capacity and reduce losses in the event of business interruption (article 3.3). To do so, they must identify their most critical processes –including those dependent on third parties– and alternative mechanisms to be able to restart service in the event of its disruption. Banks must routinely verify the effectiveness of their recovery and business continuity plans, testing them and confirming that they are in accordance with business operations and strategy.

The BCRA has also created a comprehensive regulatory framework for the management of technology risks (A 4609). Since 2006, banks are required to possess policies, rules and procedures for the control of information technology and information systems, and the Board and management are assigned responsibility for achieving effectiveness and efficiency objectives. This responsibility includes adequate operational risk coverage for these items. The SEFyC has a team of 30 specialists on information technology, which is responsible for the evaluation of IT management, including the management of IT risks. Onsite exams of technology risks is thorough and includes an evaluation of IT security, continuity and contingency plans, outsourced systems, service providers and the management of risks stemming from the implementation of new IT systems and processes.

In 2010 the BCRA introduced an information regime entitled “Operational Risk Event Database” for banks to gather together data details of losses and operational risk events following uniform guidelines. The information requirements for the database covered, not only current events, but also all the past events that are currently (partly or fully) provisioned in the banks' balance sheets. The database is structured along the lines of the business and events classification proposed by the BCBS. This database must be used by the banks themselves to manage their operational risks. To unify the criteria and clarify doubts, the BCRA has set up a frequently asked questions section on its website in relation to the operational risk event database. In the future, the BCRA is considering to allow banks to use the general database of all Argentinean banks as a benchmark for the assessment of their operational risks. Work is also being carried out on the definition of tools for off-site monitoring on the basis of this data base, and on the development of procedures for the on-site review of the generation of the data base.

The supervision manual covers operational risk as a specific risk, in accordance with the guidelines of the regulations issued by the BCRA. The manual also considers specifically two types of legal risks: regulatory risks (risks of not complying with laws and regulations) and fiduciary risks (the risk of not meeting contractual obligations).

The onsite analysis of operational risk management aims at verifying that banks have an effectively functioning framework to manage their operational risks.

	<p>This is done in the context of the evaluation of internal controls. It stresses the evaluation of banks' policies and systems to manage operational risk and reviews the controls embedded in key banking processes, such as credit origination, constitution of collateral, record keeping and project development. The review also covers compliance with regulations and, more recently, examines the generation and maintenance of the Operational Risk Events Database.</p> <p>The evaluation of controls on out-sourced activities is conducted during onsite examinations. Internal and external auditors are also required to examine the out-sourced activities, when these are carried out in foreign countries. However, this is an area that needs improvement. Many institutions have not identified their critical service providers and the processes to evaluate these providers need formalization (this observation applies only to the service providers not related with IT systems).</p> <p>The new risk management regulation issued during the course of this assessment also includes a specific section on operational risk, which essentially compiles previously issued regulation.</p>
Assessment	Largely Compliant
Comments	Continue improving the operational risk events database and developing off-site tools for the measurement of operational risk. Further develop supervisory procedures for the on-site monitoring of operational risks and the management of these risks, particularly those associated with out-sourced activities.
Principle 16.	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..
Description	<p>Since March 1999 the BCRA requires all banks to hold capital to cover the interest rate risk on their banking book. This capital requirement is determined using a standardized value at risk formula that calculates the loss of economic value to the financial institution as a consequence of a change in rates, in both local currency and foreign currency. To make this calculation, banks must classify their expected cash flows (on and off-balance sheet assets and liabilities and certain income and expenditure) into time bands according to maturity or interest rate adjustment date, and according to whether they are denominated in <i>pesos</i> or foreign currency, or whether or not they are adjusted for inflation. They must also determine the present value of such flows and the net worth impact of changes in the discount rate, weighted by the estimated volatility of the market rates for each currency.</p> <p>The new risk management regulation includes specific regulatory requirements</p>

	<p>on the management of interest rate risk in the banking book, albeit it has not been implemented yet. However, for some time the SEFyC has taken a positive view of banks that adopt a prudent approach to the management of this risk. The Supervision Manual contemplates that when it is considered that a bank shows significant market and interest rate risk, assistance may be requested from personnel from the Market Risk Area of SEFyC to carry out an on-site evaluation of the risks, a mechanism that is implemented in practice.</p> <p>In recent years progress has been made with the performance of stress tests carried out by the SEFyC incorporating two macro scenarios and two sensitivity scenarios. The SEFyC also prepares a quarterly Interest Rate Risk Report, which includes banking book positions by currency, the mismatching for various classes of rates and currencies, and indicators providing an approximation of the interest rate risk situation to which banks are exposed. In addition, seminars have been held for the most senior financial institution authorities on stress tests, with the aim of promoting, spreading and deepening the adoption of such practices.</p> <p>The section on interest rate risk management in the new risk management regulation requires banks to have an interest rate risk management framework, which must include strategies, policies, information systems, procedures and structures needed for the management of this risk. The framework should be in proportion to the size and complexity of the financial institution. The policies must cover the establishment of internal limits reflecting the risk tolerance of the institution, the evaluation of interest rate risk prior to launching a new product or acquiring a new business unit, the relationship between interest rate and liquidity risks. The strategy must take into account the corporate structure, including the foreign subsidiaries and branches. The Manual clearly defines the responsibilities of the Board and senior management, sets limits and calls for banks to perform stress tests.</p>
Assessment	Materially non Compliant
Comments	<p>While the capital requirements for interest rate risk in the banking book may mitigate exposure to this risk, a comprehensive framework for the management of this risk needs to be implemented. To this end, it is recommended that the SEFyC adapt supervision procedures to ensure effective implementation by banks of the section on interest rate risk of the recently issued regulation on Risk management Manual. Supervisory processes to analyze the adequacy or banks' risk management frameworks would need to be further developed. This would imply also further strengthening of supervisory capabilities to analyze banks systems to identify and measure interest rate risks and the adequacy of banks policies (including the internal limits) in this regard.</p>
Principle 17.	<p>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</p>

	<p>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.</p>
Description	<p>BCRA regulation A 5042 establishes that the Board of Directors of a financial institution is ultimately responsible for the internal control environment (Annex I, section I, art. 2). It is responsible for approving the policies and procedures in relation to the control environment. In turn, management is responsible for the implementation, management and follow-up of the internal control norms and policies.</p> <p>The same regulation establishes the three main objectives of the internal controls of banking institutions and defines five interrelated components internal control systems. The three objectives are: effectiveness and efficiency of operations, reliability of accounting information and compliance with laws and regulations. The five components of internal control systems are: control environment (including an appropriate organization and integrity and values), risk evaluation, control activities, information and communication and monitoring. (A 5042, Annex I, section I, art. 1).</p> <p>It is therefore the Board that is responsible for aspects related to the structure of the organization, accounting processes, adherence to applicable laws and regulations, and the systems for the control and protection of assets. Additionally, risk specific regulations establish board responsibilities regarding the management of various risks, such as operational risk (A 4854) and liquidity risk (A 5067).</p> <p>Notwithstanding the fact that these regulations lay down the responsibilities of the Board and senior management regarding internal control and aspects of risk management of financial institutions, the recently issued regulation on corporate governance (A5201), which will be in effect in 2012, establishes a higher standard as regards organization structure, transparency, duties and obligations, and control systems. This regulation also includes guidance on director and senior management compensation in line with the international standards issued by the Financial Stability Board (FSB). Article 4.2.4 of this regulation also establishes an Ethics and Compliance Committee to promote compliance with internal and external regulations, in which board members should participate.</p> <p>By means of its on-site inspections, the SEFyC verifies that banks possess internal controls in accordance with the nature and scale of their business. The regulation includes minimum standards on internal controls and a methodology for evaluation of internal control, and basic guidelines for carrying out tests and for internal audit reports (A 5042, Annex II).</p> <p>BCRA authorization is required to become a director of a financial institution.</p>

Decisions are taken by a BCRA Committee for the Evaluation of Suitability and Experience, which must issue a ruling both upon initial appointment and when a mandate is renewed. The authorization and monitoring process is based not only on the assessment of the credentials of the applicant but also of the composition of the Board and the quality of the administration and the internal controls of the financial institution. In the case of serious instances of non-compliance, directors and senior management can be removed following an administrative proceeding.

BCRA regulations require bank Boards to appoint persons to be responsible for internal audit and evaluation of compliance with minimum internal control standards. The persons responsible for those activities must report to an Audit Committee formed by at least two members of the Board and the person responsible for the bank's internal audit function. If the person responsible for internal audit is not a director, the position should be filled by an officer independent from the remaining areas making up the structure of the organization. Banks must inform the SEFyC of the composition of the Audit Committee and the credentials of the person responsible for the internal audit function.

By means of the work of a specific area of the SEFyC responsible for evaluating the quality of internal and external audits, confirmation is obtained that the audit function is independent, and has sufficient resources as well as trained personnel who perform their tasks in accordance with the minimum standards established by the BCRA. The conclusions of this specialized area serve as background for the work of the supervisors responsible for assessing the Internal Control component as part of the overall CAMELBIG system evaluation process (see CP 19). The evaluation of internal control is thorough and takes into account aspects such as the procedures established by financial institutions for delegating authority and responsibility, segregation of duties, and the implementation of controls to ensure the effectiveness and efficiency of operations, reliability of information, and compliance with laws and regulations.

The BCRA has laid down that in the larger and more complex banks there should be a strict separation of executive and supervisory Board functions. In the case of banks of intermediate complexity, the Committee for the Evaluation of Suitability and Experience decides whether to authorize overlapping functions when evaluating the application of each candidate. Directors of small banks can exercise executive functions, as it is left to the criteria of such institutions to decide on the composition of their Boards based on the business and operating activities they perform. Larger and more complex banks must include on the audit committee at least one director not performing any executive function.

While BCRA rules do not require financial institutions to possess a specific

	compliance function, the supervision process evaluates whether banks have procedures in place to verify compliance with laws and regulations. The new corporate governance regulation, to be effective in 2012
Assessment	Largely Compliant
Comments	<p>Argentina's regulatory and supervisory framework stresses the importance of an adequate internal control environment and the board's responsibility in this regard. However, the new regulation on corporate governance that will be in effect in 2012 spells out more precisely the minimum elements defining the responsibility of the Board in relation to corporate governance, business strategy and risk management. For instance, this regulation stresses the need for Boards to be actively involved in determining financial institution long-term objectives and strategies, the supervision of senior management, and the maintaining of adequate lines of responsibility and a transparent organizational structure, supported by independent control and risk management functions.</p> <p>The regulation on internal audit is very prescriptive regarding the scope of the audit, and leaves little room for audit to independently (and responsibly) develop a risk based plan. A less prescriptive norm in which audit is required to implement a methodology that identifies the material risks faced by the bank and develops an audit plan based on its own risk assessment is likely to be more effective. Authorities indicated that they are working on a revised audit regulation along those lines.</p>
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.
Description	<p>Law 25246 of April 2000 established the Financial Information Unit (<i>Unidad de Información Financiera –UIF–</i>), which reports to the Ministry of Justice, Security and Human Rights, and is responsible for the analysis, processing and submission of the information for the prevention of money laundering, associated with criminal activities. The financing of Terrorism has been defined in Law 26.268 of June 2007. These laws are regulated by Decree 290/2007, which was recently modified by Decree 1396/2010 of December 14 2010. Once fully implemented, this latter decree would significantly strengthen the framework for the prevention of ML/TF. Specifically, the decree has:</p> <ul style="list-style-type: none"> - established the role of the UIF as the sole government coordinator for all aspects pertaining to AML/CFT; - broadened the powers of the UIF with regards to the supervision and regulation of these matters by establishing that: the UIF is to implement a system to control all parties that are required to report suspicious transactions;

	<p>to this end, the UIF is to establish supervisory and onsite inspection procedures and is to be granted access to all necessary information; and the UIF regulations on these matters cannot be modified or broadened by other regulations issued by other regulatory agencies;</p> <ul style="list-style-type: none"> - expanded the Know-Your-Customer(KYC) requirements; - established a new framework for the assessment of suspicious transactions; <p>and</p> <ul style="list-style-type: none"> - stipulated that those institutions that have the double role as supervisors and subjects obliged to report suspicious transactions, such as the BCRA and the CNV, must cooperate with the UIF. <p>The AML laws do not assign the BCRA the responsibility for the regulation and supervision of AML/CFT in the banking system. However, on the basis of the general powers of the Central bank law, to issue regulations and supervise financial institutions, the BCRA had interpreted that it had responsibility for issuing regulations on AML/CFT as well as to supervise their compliance. In fact, the BCRA issued several regulations on these matters, which are the basis for the BCRA supervision of AML/CFT, including some issued as early as 1987, years before the creation of the UIF and the issuance of the anti-money laundering laws.</p> <p>The BCRA regulations overlap with those issued by the UIF. The most important of the UIF regulations is Res UIF 228 of 2007. This regulation requires that banks establish adequate internal controls to prevent money laundering and financing of terrorism, requires that they appoint a compliance officer responsible for overseeing the observance and implementation of the necessary procedures and controls for to prevent ML and TF. This regulation also establishes general requirements for identifying clients, reporting requirements of suspicious transactions and the requirement to conserve documentation. It also requires that banks have periodic independent audits of their AML/CFT systems and that their personnel be trained on AML/CFT</p> <p>On December 23 2010, the BCRA compiled its regulations on AML/CFT in two texts, namely: Prevention of Money Laundering and Other illicit activities; and Prevention of Terrorism Finance. The BCRA revised regulations introduced additional requirements aiming at adopting the recommendation of the December 2010 GAFISUD mutual evaluation report. According to these regulations banks must:</p> <ul style="list-style-type: none"> • have a Committee for the prevention of ML/TF, which must include at a minimum one board member, the compliance officer and one high level officer from an area responsible for financial intermediation. This committee is responsible for the planning, coordination, and oversight of compliance with the policies approved by the Board in these matters. • have internal control policies and procedures to ensure compliance with
--	--

the basic KYC principle, with a risk orientation. The regulation is very specific with respect to the minimum elements of these policies and procedures; and includes additional safeties for customers. As recommended by GAFISUD, art. 1.3.4.2 of this regulation explicitly requires that financial institutions must in all cases apply procedures to determine the ultimate beneficiary – a natural person – for each transaction.

- submit to the BCRA on a monthly basis the information required concerning suspicious transactions notified to the Financial Information Unit (*Unidad de Información Financiera –UIF–*). This information is used for both specific on-site inspections on the prevention of money laundering and the financing of terrorism, and for statistics on the types of activities reported by all financial and exchange institutions;
- perform reinforced monitoring for large exposure customers, in particular politically-exposed persons (PEPs) and correspondent accounts, avoiding operation with shell banks.

In January and February 2011, the UIF issued 22 new regulations (prepared in late 2010). Three of these pertain to financial institutions (UIF 11/2011 strengthens the treatment of politically exposed persons, 12/2011 clarifies and broadens the requirements on the reporting of suspicious transactions; and 37/2011 on procedures to be observed by financial institutions with regards to criminal acts pertaining to money laundering and terrorism financing).

As part of the recent cooperation of the BCRA and the UIF, both institutions have agreed to harmonize their regulations pertaining to AML/CFT in financial institutions by August 15 2011 (Resolution UIF 60/2011). In the meantime, the UIF has declared that the BCRA regulation is complementary to its own (article 37 of UIF Resolution N° 37/11).

The regulation on correspondent accounts (A 5133), establishes that to open a correspondent account with a foreign bank, the domestic bank must verify that the correspondent institution: (i) has AML/CFT manual consistent with international standards and that it has appointed an officer in charge of overseeing its implementation; (ii) conducts its business in the jurisdiction where it is licensed and that it is not a shell bank; and (iii) is subject to consolidated supervision by an authority that adheres to the BCP. This regulation was recently modified, by A5162, to establish that banks are required to close correspondent accounts with foreign banks that do not provide all the information on foreign transfer operations required in the foreign exchange regulation. They cannot reestablish the relationship for at least two years.

The SEFyC periodically verifies whether banks are complying with current regulations on “Prevention of Money Laundering and Other Illicit Acts” and “Prevention of the Financing of Terrorism.” During the preliminary inspection (see principle 20) supervisors establish the risk profile of the institution with

regards to ML, on the basis of their review the KYC policies and practices, the internal controls established for the prevention of ML, the size and type of business conducted by the institution and the evaluation of compliance with laws and regulations. Later on, during the actual inspection, supervisors examine a sample of "risky costumers" to determine whether: the controls and procedures for AML/CFT were followed; the early warning signs were properly analyzed and acted upon; and the decision process to determine if an operation is reported or not is adequate. The sample of risky costumers is larger for institutions with a higher risk profile. On the basis of this evaluation, the SFyC determines the adequacy of the AML/CFT systems and controls.

In addition, banks' internal audit are required to consider in their planning the evaluation of the program for the prevention of money laundering and terrorism finance implemented by the bank, and the internal controls with regards to this matter, including aspects regarding its subsidiaries and affiliates that consolidate financial statements. (A 5042, Annex II, art. 1)

In the context of its new strengthened powers, the UIF has established an area responsible for the supervision of AML/CFT matters, and established its supervisory procedures and has started conducting onsite examinations on various types of institutions, including banks. As of end 2010, the UIF had a staff of 109 agents. According to the UIF annual report, suspicious transaction reports by financial institutions increased from 1444 in 2009 to 2546 in 2010.

The BCRA can apply a broad range of sanctions when an institution fails to comply with the laws and the regulations issued by the BCRA. However, the BCRA does not have powers to enforce the regulations issued by the UIF. In turn, the UIF has enforcement powers according to the AML/CFT legal framework. As a result of its supervisory actions, since 2010 the UIF has imposed sanctions to 4 banks for violations to the AML/CFT framework, including for failing to report suspicious transactions.

The BCRA and the UIF have also agreed to establish a new and clear division of their supervisory responsibilities. Under this division of responsibilities, the UIF will supervise and enforce the compliance with the legal and regulatory framework, while the BCRA will supervise and enforce the management of the risks associated with ML/FT. The new division of responsibilities will be effective once the regulations have been harmonized, after august 15, 2011. In the meantime, however, the BCRA continues to supervise these matters, as the UIF fully implements its supervisory framework.

Article 18 of the AML Law explicitly states that the reporting of suspicious transactions in good faith does not originate responsibilities of any kind, including civil, commercial, work, criminal, and administrative.

The BCRA is required to notify suspicious transactions to the UIF detected

	<p>when performing the tasks for which it is responsible, in accordance with the Asset Laundering Law (Law 25,246, Section 20, clause 15).</p> <p>The BCRA has been working toward amending its MOUs with local foreign supervisors to include cooperation with regards to AML/CFT supervisory matters. Specific aspects associated with the investigation of suspicious transactions are not covered by these MOU. These are instead processed by the UIF through Egmont.</p>
Assessment	Largely Compliant
Comments	<p>The legal and regulatory framework for AML/CFT has recently been revamped and the powers of the UIF have been strengthened, with a view to establish an effective framework for the prevention of ML/FT. The current assessment was conducted during the transition period, when the new UIF has established its supervisory framework and has initiated supervisory actions, but full implementation of this framework will take some time. The authorities expect that the effective implementation of the new framework will correct the weaknesses detected in the recent Financial Action Task Force (FATF) and the South American FATF (GAFISUD) Mutual Evaluation.</p> <p>The BCRA and the UIF intend to unify the overlapping regulations issued by both entities by August 2011 and to establish a clear division of their supervisory responsibilities. Under the new division of responsibilities, which will be effective since August 2011, the UIF will supervise and enforce the compliance with the legal and regulatory framework, while the BCRA will supervise and enforce the management of the risks associated with ML/FT. While potentially the enhanced supervision by the UIF would address the weaknesses in the reporting of suspicious transactions and compliance with the legal and regulatory framework, care should be taken, particularly during the transition, that supervisory and enforcement gaps are not created with the new division of work between the two entities. This is particularly important because the envisaged division seems overly conceptual, as one cannot really separate a sound understanding of (compliance with) the legal and regulatory framework from proper risk management.</p> <p>Currently the UIF has validated the complementary character of the BCRA regulation and the BCRA continued its role as supervisor for AML/CFT in the financial system. The SEFyC supervision is thorough and aims at ensuring that banks have adequate policies and processes in place, including strict KYC 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.</p>
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.						
Description	<p>The law states that the main objective of bank supervision is the control of bank solvency and liquidity. Bank supervision consists of the monitoring, inspection and rating of banks, by applying a series of procedures (defined in the Supervision Manual). The importance of the rating of banks is stressed in the BCRA Charter (article 46.a) by explicitly stipulating that the Superintendent is responsible for the rating of financial institutions.</p> <p>Bank supervision is a continuous process that is divided in 18 month cycles which concludes with the rating of the institution. To be able to grade banks, supervisors must obtain an understanding of the risk profile of each institution and its economic group. To this end, the Supervision Manual sets on-site and off-site procedures, as well as the criteria to be used for their rating. The manual also includes procedures to confirm adherence to prudential regulations and other legal requirements; and procedures to reconcile the recording and valuation of transactions with the chart of accounts and the reports submitted to the BCRA.</p> <p>The bank rating system is known as CAMELBIG and is based on the rating of eight basic components: Capital (C), Assets (A), Market (M), Earnings (E), Liquidity (L), Business (B), Internal Controls (I) and Management (G). For each of these components, the inspector will provide a summary of the strengths, the weaknesses and comments supporting his rating. The end objective is to obtain a composite evaluation that measures a bank's exposure to solvency and liquidity risk. The components are designed to evaluate business risks (Earnings, Assets, Market, Liquidity and Capital) on the one hand, and management risks (Internal Controls and Management) on the other. The rating methodology stresses the importance of management and controls, by assigning this two elements a cumulative weight of 50 percent. All the categories include an in-depth review of key qualitative elements, besides the analysis of financial indicators. Thus the assessment of capital is not limited to the capital adequacy ratios, but addresses also the quality of capital and the capacity of the shareholders to provide support to the institution in times of need. The analysis of management is also comprehensive and includes an evaluation of the business plans, policies and board oversight.</p> <p>A five level rating is defined, according to the following criteria:</p> <table border="1" data-bbox="511 1627 1468 1885"> <thead> <tr> <th data-bbox="511 1627 683 1665">Rating</th> <th data-bbox="683 1627 1468 1665">Criteria</th> </tr> </thead> <tbody> <tr> <td data-bbox="511 1665 683 1780">1: satisfactory</td> <td data-bbox="683 1665 1468 1780">The bank is solvent in all aspects. The observed weaknesses are not material and can be managed by the Board and management.</td> </tr> <tr> <td data-bbox="511 1780 683 1885">2: Adequate</td> <td data-bbox="683 1780 1468 1885">The bank is essentially sound. It has a few moderate weaknesses, which can be corrected with appropriate capacity and willingness of the board and management.</td> </tr> </tbody> </table>	Rating	Criteria	1: satisfactory	The bank is solvent in all aspects. The observed weaknesses are not material and can be managed by the Board and management.	2: Adequate	The bank is essentially sound. It has a few moderate weaknesses, which can be corrected with appropriate capacity and willingness of the board and management.
Rating	Criteria						
1: satisfactory	The bank is solvent in all aspects. The observed weaknesses are not material and can be managed by the Board and management.						
2: Adequate	The bank is essentially sound. It has a few moderate weaknesses, which can be corrected with appropriate capacity and willingness of the board and management.						

3: Needs improvement	The bank reveals a combination of moderate to serious weaknesses in one or more areas. The bank is generally less resilient to economic fluctuations and external events.
4: Deficient	The bank evidences unsound practices or conditions. There are serious financial or management weaknesses which render unsatisfactory results. It is not resilient to economic fluctuations.
5: Severely deficient	The bank evidences seriously unsound and insolvent practices or conditions, which render seriously deficient results.

The BCRA has embraced the international trend toward the implementation of risk-based financial supervision, while maintaining a strong compliance framework. The allocation of resources and the planning of supervisory strategies and follow-up are effective and based on risks. The supervisory manual distinguishes clearly the basic procedures that are applied to all institutions, from substantive tests, broader in scope and depth, which are applied for areas and institutions where there are specific concerns. In short, a basic review is applied if the internal risk management processes are adequate, or when risks are considered to be minimal. The intensity and intrusiveness of the follow up plan are also calibrated on the basis of the seriousness of the weaknesses and the CAMELBIG rating of the institution. Nevertheless, the effectiveness and risk-based orientation of the supervisory approach could be enhanced by strengthening the supervisory processes and capabilities to assess risks and risk management, thereby completing the move to a risk based approach.

From the review of regulations, supervisory manual and selected reports, the assessors have the impression that the review of compliance with laws and regulations is a very important goal during onsite examinations, and the framework for this is very effective. This approach has been essentially the same since 1996, since the banking crisis, albeit the SEFyC has enhanced many of its supervisory processes to prevent or mitigate the vulnerabilities evidenced during that period.

The SEFyC has a staff of 674 employees that are responsible for the supervision of 83 financial institutions, 92 foreign exchange institutions, 124 credit card issuers and 193 non bank credit intermediaries. The SEFyC is organized in four departments: Supervision, Analysis and Audit, Information Regime and Control and Compliance. The Supervision Department is in charge of the overall supervisory process, which encompasses both on-site and off-site supervision activities. The three remaining departments provide support for the supervisory process on the following subjects:

- *Credit Analysis*: Assessment of large borrowers and economic groups with systemic significance (see core principle 8).

	<p>- <i>System Analysis</i>: Monitoring of system trends, conducting bottom-up stress tests on various risks (market, liquidity and interest rate risks) and providing specialized support for on-site inspections on market risks. This area is also responsible for issuing special reports on liquidity, foreign exchange and interest rate risks, as well as reports on fixed income instruments and derivatives (see core principles 13, 14 and 16).</p> <p>- <i>Information Technology Audit</i>: Assists the Supervision Department in verifying the integrity of the information of financial institutions and in auditing the adequacy of internal controls and security of the information systems (see core principle 15).</p> <p>- <i>Auditor Control</i>: Controls the work of internal and external bank auditors and ensure that they comply with the regulations issued by the BCRA on the matter (see core principle 22).</p> <p>- <i>Information Regime</i>: Drafts the Information and Accounting Rules on the basis of current BCRA regulations and the needs of the supervision and analysis of financial institutions.</p> <p>- <i>Authorizations</i>: Handles requests for authorizations and revoking of licences, ownership transfers, mergers, acquisitions and appointment of directors (see core principles 3,4 and 5).</p> <p>One essential part of the off-site review consists of the monitoring of information that is submitted monthly by banks to the SEFyC. This task involves a basic or in-depth analysis, the scope and frequency of which depends on the risk profile defined for each bank. This analysis is summarized in a monthly report on each of the financial institutions. The report contains a set of prudential indicators, including levels and trends and a comparison with peers groups.</p> <p>The BCRA is also responsible for the oversight of the proper operation of financial markets. In this regard, the BCRA prepares and publishes reports analyzing the overall situation of the financial system to monitor the current and potential risks of the financial system. These include a monthly Report on Banks and a semi-annual Financial Stability Report.</p> <p>The SEFyC information system ADS contains all the information submitted by financial institutions, including financial statements, with notes to the financial statements, and a broad range of reports on various risks. It also includes general information on the financial institution, such as: its shareholders, managers and related parties, business plans, as well as the past supervisory reports. The information system is flexible and user friendly and allows supervisors to extract and define a broad range of reports. Supervisors also have access to a borrowers database, which includes information on outstanding balances, performance and classification of all the borrowers of financial institutions.</p>
Assessment	Compliant
Comments	The supervisory approach is risk based, albeit its effectiveness and risk-based

	orientation could be enhanced by strengthening the supervisory processes and capabilities to assess risks and risk management, thereby completing the move to a risk based approach.
Principle 20.	Supervisory techniques. An effective banking supervisory system should consist of on-site and off-site supervision and regular contacts with bank management.
Description	<p>The assessors had access to the supervision manual; and to onsite and offsite supervision reports, selected memoranda and responses from the bank, all of them associated to a full supervision cycle for one banking institution.</p> <p>The Supervision Manual contains detailed processes and procedures for the supervision of banks, establishing a mix of on-site and off-site activities. The supervision cycle lasts approximately 18 months.</p> <p>An onsite supervisory calendar is prepared, allocating the resources of the supervision department according to the priorities and risks. This calendar is shared with the support departments within the SEFYC so that they can time their reviews to coincide with the supervision calendar and provide their inputs (assessments of information systems and the external and internal audit functions) to the rating system at an appropriate time. The support departments will then prepare their supervisory calendars on the basis of their own objectives but also of the general supervision plan. The Superintendent will approve these plans.</p> <p>The onsite evaluation is comprehensive and clearly defined in the supervisory manual. The on-site work is divided in two phases:</p> <ul style="list-style-type: none"> ▪ The preliminary inspection, which has three goals: understanding the business and risk profile of the institution, assessing the control environment and preparing a plan for the actual inspection. The preliminary inspection can last up to two months in a large bank and may take about one month in a smaller less complex institution. The conclusion of this stage will define the scope and depth of the actual inspection. ▪ The actual inspection: A more in depth inspection with a comprehensive selection of substantive tests will be carried out for higher risk institutions/business/areas. This phase will include, for instance: a series of information audit tests to determine the reliability of the bank information and reports and a review of the loan portfolio. The support of specialists on market risks may be required if necessary. <p>During the course of the onsite inspection, the inspector communicates frequently with bank management, and all material inspection findings are discussed and communicated through memoranda on a timely fashion. The responses of the bank to each of the memoranda are reviewed and considered by the inspection team.</p>

At the end of the onsite process the inspector will issue a report, which includes the proposed CAMELBIG rating and a proposed follow-up strategy. This report is submitted to the CAMELBIG committee of the SEFYC. This committee is integrated by five rotating members, all of which are chiefs of supervisory groups. One of the five is always the inspector in charge of the bank being rated. The committee discusses and approves the final rating and follow-up plan.

The follow up plan includes a definition of three elements for each of the weaknesses: the goal of the follow up, the procedures for the follow up, and the frequency of the monitoring to be used. The procedures and approach to follow up depend on the rating of the relevant component and the rating of the institution. Closer and more intrusive follow up procedures are applied for more serious weaknesses and for entities with lower ratings. These procedures are clearly defined in the supervisory manual. A monthly report on follow-up is prepared for institutions with a CAMELBIG rating of 3 or below; and a quarterly follow-up report is prepared for institutions rated 1 and 2, except for large systemic institutions which could have more frequent reports.

Once the rating and follow-up strategy are approved, a summary report, containing the final rating is submitted to the bank. This report must be examined by the Board, who must in turn take appropriate actions to address the weaknesses identified by the SEFYC. In addition to this report, banks receive additional reports on: Information Technology External Audit and Control of internal and external Audit.

The off-site work comprises the follow up of the on-site findings and the regular analysis of the financial condition of the institution on the basis of the reports submitted to the BCRA. Off-site analysis enables the identification of situations that may require special monitoring or that must be taken into account during the next on-site inspection. In addition, observations arising from off-site tasks are generally communicated by means of memorandums and/or notes.

There are no coordination problems between the on-site and off-site roles, as they are both the responsibility of a single person: the inspector responsible for the supervision of the financial institution. The inspector also receives the input of specialized evaluations conducted by the support department, in areas such as internal audit, information systems and market risk.

In addition to the work carried out by the inspector in the Supervision Department, supervisors in the System Analysis Department also carry out some off-site activities, particularly related to the analysis and stress testing of specific risks (see core principle 19). These reports are submitted to the Supervision Department, but they are not fully integrated into the definition of supervision strategies. The risks and alerts stemming from these analyses are not always reviewed and considered by the supervision department.

	<p>Inspectors hold meetings with the banks' Board members and management (with a frequency based on their risk profile) to enable understanding and appraisal of business strategy, structure and performance, as well as other matters in relation to the institutions supervised. In addition, the Audit Control area also holds regular meetings with the Audit Committees.</p> <p>The Audit Control area assesses the work of banks' internal and external auditors and determines the adequacy of their work. This input is used later by the Supervision Department to define the strategy and scope of the inspection. Subsequently, the Audit Control area grades the work of the internal auditor, the Audit Committee, and the external auditor, issuing a report that is used by the supervision area when evaluating the CAMELBIG Internal Controls component.</p> <p>The consistency of the supervisory processes is reviewed by the coordination area within the SEFYC. The BCRA also has a comprehensive supervisory training program that all new supervisors must follow. The training program includes special modules on the laws, regulations, supervisory manuals and systems as well as practical case studies.</p>
Assessment	L argely Compliant
Comments	<p>The risks and alerts stemming from the stress tests and analyses conducted by the System Analysis Department are not always reviewed and considered in the supervisory decision process. It is recommended to integrate better these inputs into the definition of supervisory strategies. A two-way feedback between Supervision and System Analysis is necessary to improve integration of the analysis of these two areas, and achieve a more effective supervision by:</p> <p>(i) improving the quality of the risk analysis and stress tests carried out by the System Analysis area; and (ii) using the improved stress tests as an effective input for the supervisory decision process and strategies. This will also require to continue developing supervisory capabilities with regards to risk assessment and risk management.</p>
Principle 21.	<p>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.</p>
Description	<p>The BCRA Charter empowers the Superintendent to establish information and accounting requirements for financial and exchange institutions (LBCRA art. 47.a and LEF art. 36). The BCRA has therefore set up various mandatory prudential information and accounting information requirements covering most of the aspects required by the Principle, such as: detailed financial statements, including on- and off-balance sheet assets and liabilities, profit and loss, capital adequacy, liquidity, detailed information on all borrowers, asset concentrations (including by economic sector, geography and currency), asset quality, loan loss provisioning, interest rate risk, investments and foreign exchange risk</p>

(Information Regime regulation). Information on related party exposures is also collected, albeit there are some gaps (see principle 11).

The BCRA has issued accounting rules for use by financial institutions in preparing their reports (Chart and manual of accounts). The valuation norms issued by the BCRA are consistent, realistic and generally prudent. They do however show some differences with the International Financial Reporting Standards (IFRS) specified in Core Principle 22.

Information requirements are daily, monthly, quarterly, half-yearly or annual, depending on need and the type of information, and must be submitted on both an individual and a consolidated basis. Information requirements make no distinction between institutions of differing size and complexity, which means there are no simplified requirements for smaller structures. Nevertheless, the areas concerned with data analysis consider the risk profile of institutions when determining the scope and frequency of their tasks.

Submission of information is carried out according to the rules established for each type of information requirement. Once received by the BCRA it is subjected to validation controls and is then made available to BCRA and the SEFyC officers on the internal network, in accordance with the corresponding levels of authorization. The relevant areas then use this material to prepare financial institution situation reports individually and for the financial system as a whole.

The SEFyC has the power to request and receive any relevant information from banks, their related parties and the members of the financial group. Besides the periodic information requirements, supervisors gather additional information to gain an adequate understanding of the risks to which each financial institution is exposed, such as: (i) financial information on the non financial companies that belong to a group and (ii) qualitative information of the main risks and the controls defined for them.

The LEF lays down that banks must grant access to their accounting records, correspondence, documents and papers to BCRA officials, and the BCRA Charter empowers the Superintendent to determine the applicable information rules. BCRA regulations establish that the information submitted is in the nature of a sworn affidavit, and that directors, the general manager, the senior officer responsible for the accounting area and the person responsible for the generation and compliance with information rules at the bank are all responsible for coincidence between the data submitted to the BCRA and the records of the financial institution (“A” 2910 (1.4), “A” 3070 (1.3) and “A” 4657). Should it be determined that the information does not coincide, those persons responsible could be made subject to the penalties laid down in section 41 of the LEF.

	<p>In addition to the independent verification of the reliability of information conducted during onsite examinations, the SEFyC receives quarterly reports from external auditors covering a broad range of subjects pertaining to the condition, risks and controls of financial institutions. The regulations on external audit establish the minimum requirements for the scope of external audit, the audit procedures and the contents of the audit reports. Audit reports include year-end and quarterly reports on financial statements and on consolidated financial statements, and verification of the information contained in the reports on debtors, related companies and institutions and compliance with rules on the prevention of money laundering.</p> <p>External auditors must submit to the SEFyC a memorandum on bank internal control systems describing, at a minimum, the deficiencies observed during the course of their examination and their recommendations to address them. This memorandum should be sent as often as the external auditors consider it to be necessary, and at least once a year prior to the end of the fiscal year. The Board of the institution is responsible for analyzing the memorandum and implementing an improvement plan, with the participation of those responsible for internal audit.</p>
Assessment	Largely Compliant
Comments	The valuation norms issued by the BCRA are consistent, realistic and generally prudent. However the valuation of some government securities issued during the 2001-02 crisis is still considered materially different from International Accounting Standards.
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.
Description	<p>The Financial Institutions Law establishes that both the accounting and the preparation and presentation of bank balance sheets must observe the regulations issued by the BCRA (LFI art. 36 and 41). In addition, the BCRA Charter empowers the Superintendent to determine the information and accounting rules for financial institutions (LBCRA art. 47, a and b).</p> <p>BCRA accounting rules require banks to adapt their accounts to a basic mandatory Plan and Manual of Accounts that contains a definition and valuation rules for each of the accounts (RI Plan y manual de cuentas). Additionally, regulation defines any action that distorts or hides records as a serious violation (TO Veracidad de las registraciones contables).</p> <p>Quarterly/Annual Information Requirements regulate the presentation format for quarterly and year-end financial statements. Banks must submit their</p>

financial statements to the BCRA, and in the case of the year-end accounts, must publish them in the Official Gazette. The documents to be submitted to the BCRA on both an individual and a consolidated basis are the Balance Sheet, Statement of Income, Statement of Changes in Shareholders' Equity, Statement of Cash Flows, Exhibits and Notes, the Annual Report from the Board approved by the Ordinary Shareholders' Meeting and the Report of Independent Accountants.

BCRA rules require that the documentation submitted to the BCRA must be signed by the following financial institution authorities: President of the Board, General Manager, Senior Officer responsible for Accounting, the Syndics and the External Auditor. Responsibilities of the Board and Syndics are laid down in the Law on Corporations, and those of the External Auditor in the laws governing the profession (Law 20,488); notwithstanding the provisions of the BCRA establishing additional requirements (BCRA A 5042, regulation on external audit).

Accounting rules for banking institutions, issued by the BCRA differ from IFRS in several aspects. The most significant differences are associated with the temporary measures adopted during the crisis in 2001-2002. These are:

- *Valuation of government securities*: Certain government securities (such as BODEN, Compensation Bonds issued 2002 in accordance with Decree 905/02 and Law 25,769) are registered at their par value for their entire duration, and others (Discount Bonds issued in accordance with Decree 1,735/04) are valued on the basis of the sum of their cash flows (BCRA Communications "A" 5180 and Chart of Accounts - "A" 5185).

- Amortization of legal contingencies (*Amparos*) associated with the pesification of deposits: gradual amortization (most banks have adopted an accelerated amortization, and the residual for the few banks that adopted the gradual amortization schedule will be fully amortized by 2012).

Other relevant differences are: loan loss provisions, linear amortization of intangible assets (goodwill), linear accrual of derivatives and the prudent treatment of deferred taxes and investment in other companies.

Notes to the financial statements disclose and value the differences of the BCRA accounting standards Banks with respect to IAS.

It should be noted that at the end of 2009 the Superintendent formed a working group with the aim of analyzing the possible impact of the adoption of the IFRS by Argentine financial institutions and drawing up a comprehensive proposal to be submitted to the Board of the BCRA for evaluation.

In May 2010 the SEFyC signed a cooperation agreement with the Argentine Federation of Professional Councils in Economic Sciences (Federación

Argentina de Consejos Profesionales en Ciencias Económicas –FACPCE–), the entity that represents the accounting profession in Argentina. Among other tasks, training and exchange activities have taken place, surveys have been carried out among financial and exchange institutions and the auditors registered with the BCRA, and comparisons have been made between current accounting standards and the IFRS.

The regulation on external audit (BCRA A 5042) establishes minimum standards for external audit and regulates the scope and procedures to be performed by external auditors. It also lays down the qualifications and independence requirements for the registration and maintenance of certified public accountants on the Register of External Auditors for Financial Institutions. The Superintendent may exclude an auditor from the register if there is any change in the circumstances taken into account when authorizing registration. In the case of rule violations, the external auditor may receive sanctions in the form of warnings or fines, and may even be liable to criminal proceedings.

BCRA rules on minimum standards for external audits establish that auditors cannot perform their role for more than one financial institution at a time, nor can they hold their appointment for more than five consecutive fiscal years. To be re-appointed, a term at least equal to that of their performance as auditors must have transpired.

Minimum standards for external audits establish that engagement contracts must contain clauses in which the external auditors declare their awareness and acceptance of the obligations laid down in the regulations, and that the institutions authorize, and the external auditors in turn agree, that they shall attend to the enquiries of the SEFyC and shall grant access to their working papers.

The external audit plan must be based on an analysis of the main risk areas of the bank and on audit procedures must aim to achieve the most effective assessment of the controls of these risks. Nevertheless, the minimum scope of external audit is prescribed in the external audit regulation. For instance, the evaluation of the loan portfolio includes such aspects as: loan classification and provisioning, non-performing and refinanced assets, valuation of collateral, and an assessment of related party lending and the procedures used to identify related parties. The evaluation of the internal control environment includes an assessment of the organization, physical security of assets, budget planning, security of transactions, validation of accounting, internal audit function, among others. External audit also covers an assessment of the accounting procedures and of the information to be submitted to the BCRA.

Company law and BCRA regulations require the publication of annual financial statements (BCRA RI Contable para publicación trimestral/anual).

	<p>The BCRA also publishes ample aggregate and bank-by-bank information on financial statements and key prudential indicators on its website and in its “Information on Financial Institutions” report.</p> <p>Additionally, the recently issued regulation on corporate governance, effective from 2012, sets quantitative and qualitative requirements for information to be published, including information on risk management, performance, and sound governance practices (A 5201 Section 7).</p> <p>SEFyC supervisors meet regularly with external auditors. A dedicated area within the SEFyC is responsible for evaluating audit reports. The evaluation is thorough and includes a review of compliance with the external audit regulation and an assessment of the adequacy of audit work and reports. To this end, the SEFyC can examine audit reports and working papers and documentation.</p>
Assessment	Materially non Compliant
Comments	<p>The valuation norms issued by the BCRA are consistent, realistic and generally prudent. However the some government securities issued during the 2001–02 crisis have valuations that are considered materially different from International Accounting Standards. It is recommended that the BCRA formulate a proposed course of action for the implementation of IFRS; this should consider, among others, a revision of the valuation of government securities.</p> <p>The regulation on corporate governance that will be fully effective in 2012 is an important step toward meeting the criteria on the disclosure of qualitative and quantitative information by banks.</p> <p>The regulation on external audit indicates that external audit must be carried out taking into account the main risks, but it also prescribes very detailed lists of activities and procedures to be followed. The risk of overly prescriptive regulation is that it may incentivize auditors to follow the prescribed lists, without much consideration to their independent risk assessment. The authorities indicated that they are working on revised audit regulations that would be less prescriptive.</p>
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.
Description	The SEFyC has a well structured framework for the implementation of early supervisory actions. The supervisory strategy and the follow up plan are calibrated on the basis of the seriousness of the weaknesses and their focus is to correct them as early as possible through the regular supervisory process. This process is clearly delineated in the supervisory manual (see principle 20). The escalation of supervisory actions occurs using the following instruments for

serious weaknesses or for failure to make the necessary amendments: notes and memorandums, moral suasion, more frequent and intrusive onsite reviews and contacts with management, contacts at a higher level (the board of directors) and regulatory restrictions and fines.

Some regulatory restrictions and fines are linked directly to the institution's ratings. For instance, banks with a CAMELBIG rating of 4 or below are prohibited from lending to related parties and those that are 3 and below have significant restrictions to do so (A 2140 and amendments, as issued in A2829, art. 2.3); banks with CAMELBIG rating below 4 cannot expand their business through branches, purchases, acquisitions or any other action that requires authorization from the BCRA (A 3178 art. 2 y 3); banks with CAMELBIG rating 3 and below cannot retain risk with regards non performing loans in securitized portfolios (TO portfolio transfers, art. 1.3) and have to pay higher premiums for the deposit insurance.

The LBCRA also empowers the Superintendent to issue cease and desist orders, but only with regards to credit or investment policies that can endanger the solvency of the institution (article 47 c). One such order has been issued during the past five years.

By the LBCRA (art 47f) the Superintendent is empowered to apply sanctions for violations to the LEF and the regulations issued by the BCRA. The sanctions include: warnings, citations, fines, temporary or permanent barring to serve as manager, director, auditor or shareholder of financial institutions and revocation of the authorization. All sanctions are subject to appeal. Appeals for warnings and citations are addressed to the President of the BCRA. Appeals for all other sanctions are processed by an Appeals Court. The laws and regulations establish the procedure for the issuance of sanctions and the appeals process, including maximum time frames for each stage (A 3579, issued in 2002). Nevertheless, when sanctions are appealed, the process can be lengthy.

Sanctions take into account the level of the infraction, the damage to others and gain to the entity/person committing the infraction, and the size (capital) of the institution. The fines can be applied to the institution or to individuals. A higher scale of fines was issued by the BCRA in April 2010 (Resolution No 84 of 2010 updating Annex II of the sanctions regulation). In the past six years the BCRA has issued: 163 citations, 61 warnings, 1558 fines and 610 cases where persons have been barred from serving or participating in the financial system. The fines applied in the same period amounted to \$452 million pesos.

While the SEFyC can only require a change of management of directors when a serious legal violation has been committed, it can also signal the need for management change through the CAMELBIG rating system. In particular, a poor rating of the management component (G) is used as a strong signal that a management change is needed and institutions do take the hint.

The LBCRA, the LEF, the Law on Deposit Insurance (Law 24,485 on the operation of the deposit insurance company, Seguro de Depósitos S.A.– SEDESA–) and Decree 540/95, as well as the regulations issued in that regard, provide the framework for dealing with banks showing liquidity and/or solvency problems.

Institutions in violation to the solvency or liquidity requirements are required to present a regularization plan to the BCRA (article 34 of LEF). In this context, the BCRA can appoint "overseers" who would have veto power over board decisions. The decisions of the overseers can only be appealed to the President of the BCRA. The BCRA can also require the constitution of guarantees and limit the distribution of dividends. Failure to present in the specified timeframe, to obtain BCRA approval for this plan or to comply with an approved plan is cause for revocation of the bank's license.

In the context of a regularization, restructuring merger or acquisition, the BCRA can temporarily authorize exceptions to the compliance with some prudential limits or requirements.

There are no new regularization processes since the past banking crisis, but some institutions have been subject to regularization for over five years. The SEFyC staff reported that the institutions under prolonged regularization had taken corrective actions, including capital injections, according to their regularization plans. However, in view of the SEFyC, their degree of improvement or its sustainability had not been sufficient to justify lifting the regularization. The SEFyC informed that currently only a couple of public banks remain under this regime, and that these have explicit government guarantees.

If the liquidity or solvency problems of an institution cannot be solved in the context of a regularization plan, the BCRA can revoke its license (art. 44 of the LEF). In this context, the law provides a broad range of bank restructuring and resolution options (LEF, articles 35 bis), aiming at protecting depositors and minimum cost resolution. These actions can only be revised in judicial courts when they have been obviously arbitrary or unreasonable (LEF, article 35 ter).

Under restructuring, the BCRA can take any of the following measures (or a combination of them) (article 35 bis):

- a. Charge against the bank's capital the additional provisions and other losses determined by the BCRA, establish a deadline to inject additional capital, revoke the authorization of all or some of the shareholders to continue as such, and dispose the sale of the capital and right to inject capital of an institution.
- b. Carve out assets and liabilities and dispose the their transfer to another institution;

	<p>c. Request a judiciary intervention of the banks, thereby replacing the bank's statutory authorities by court trustees so that the restructuring measures can be adopted.;</p> <p>d. Temporary suspension of the institution, according to art. 49 of the LBCRA, so that no judiciary claims or executions proceed against the bank;</p> <p>e. The transfers of excluded assets or liabilities, approved by the BCRA under the LEF cannot be subject to judiciary claims or forced execution.</p> <p>In addition, the law establishes an order of precedence in the payment of the restructured bank's liabilities that protects depositors and the financial system as a whole.</p> <p>In the context of the above, in the last fifteen years 28 financial institutions have been restructured. As part of these processes, depositors recovered 98% of their deposits, and the spread to the system of individual crises was prevented. In the last five years there have been no restructurings requiring the BCRA intervention</p>
Assessment	Largely Compliant
Comments	<p>Laws and regulations and the supervisory framework provide a well structured system for early corrective actions and a broad range of bank restructuring and resolution tools. There is ample evidence of the effective use of the corrective actions and resolution framework by the BCRA. Nonetheless, the following improvements are recommended: (i) step up efforts to improve the effectiveness of the few regularization processes that have lasted for several years without sufficient improvement; (ii) consider amending the law to: broaden the scope of the cease and desist orders to cover more than credit related operations; and to allow for a regularization and restructuring for reasons other than liquidity and capital insufficiency (e.g. ML/TF).</p>
Principle 24.	<p>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.</p>
Description	<p>Financial conglomerates manage almost 85% of banking assets, 78% of investment funds and 32% of the insurance business. The assets in the financial system are distributed between public sector conglomerates (27 percent), foreign conglomerates (28 percent), local private conglomerates (24 percent) and stand alone institutions (21 percent) (BCRA, Financial stability report, 2nd semester 2010). The large local conglomerates participate in the banking, insurance and capital markets, but their main operations are risks are generally in the banking sector.</p> <p>The SEFyC collects information on the overall structure of the financial conglomerates to which its supervised institutions belong, and has powers to examine all the activities of the group's institutions that carry out financial intermediation (banks, finance companies and credit cooperatives), including the</p>

cross-border activities of these institutions. The activities and risks of group members that operate in the financial system, but are not directly subject to BCRA supervision (such as stock market companies, or the foreign controlling group), may also be included within the supervisor's evaluation, when they are consolidated with the bank, as financial institutions must submit their financial statements and other information on a consolidated basis.

The scope for consolidation is defined from the bank down, so unregulated parent companies and their affiliates do not fall within the scope of consolidation (TO Consolidated Supervision). Generally, the large local conglomerates that operate in banking and insurance, tend to have their banking and insurance companies below unregulated holdings, so the insurance business does not generally fall within the scope of consolidated supervision of the banking group. Two conglomerates also have parallel cross-border operations established by the shareholders (natural persons) some time ago.

To authorize local banks to set up branches and subsidiaries abroad, the BCRA requires information on the supervision and regulations in force in the host country. In addition, banks must commit to submit all the information that might be required by the SEFyC (CREFI2 Chapter II). When making its information requests, the SEFyC takes into account the legislation in the country where the subsidiary is located, and any agreements signed with the local supervisory body. BCRA regulations establish that banks cannot hold significant interests in banks or companies abroad if the SEFyC cannot obtain the information necessary to evaluate the situation of the consolidated group (TO Consolidated Supervision, article 1.3).

Monthly, banks must submit their financial statements and other information consolidating information from significant branches and subsidiaries abroad. Quarterly, they must consolidate the data for the remaining subsidiaries. Similarly, local branches and subsidiaries of foreign banks must submit the consolidated financial statements that their parent companies file with the banking supervision bodies in their countries of origin (TO consolidated supervision, Art. 3).

Capital requirements as well as large exposure and related party limits have been established for banking groups (within the scope of consolidation). Loan classification and provisioning requirements also apply at the group level.

Annually, banks must submit their business plan to the SEFyC with detailed information on the activities of their foreign and local subsidiaries, their strategy and principal lines of business, comments on risk management and internal controls, and an evaluation of the complementation of activities and businesses within their economic group. The SEFyC analyses the information received and evaluates deviations in relation to the forecasts made on a consolidated basis (Regulation RI on Business Plan and Projections).

	<p>In addition, minimum standards on internal controls establish that branches and subsidiaries must be examined with a frequency based on their importance and complexity and the risks involved, but at least annually. The result of this examination should be submitted to the Audit Committee, and once approved, to the Board, together with recommendations to overcome deficiencies (Internal controls Regulation, Annex III).</p> <p>To facilitate knowledge and monitoring of the financial system and its related risks, all the institutions forming a single economic group have been placed within the responsibility of the same SEFyC supervisory group. Supervisors regularly examine the consolidated financial statements from the bank down and verify compliance with consolidated capital requirements and prudential limits. The SEFyC also conducts onsite inspections to bank subsidiaries.</p> <p>SEFyC supervisors have participated as host supervisors in the supervisory colleges of the international financial institutions, for Brazilian and Spanish banks. Also foreign supervisors have conducted onsite examinations of banks affiliated with foreign conglomerates and the SEFyC has received the conclusions of these examinations. As a home supervisor, the SEFyC supervisory team has conducted onsite inspections on cross-border operations of local banks in Uruguay and once to a branch of a local bank in the US.</p>
Assessment	Materially non Compliant
Comments	<p>The scope of consolidated supervision covers from the bank down. While financial information is also collected on the immediate parent companies, the unregulated parent companies and their non-bank affiliates do not fall within the supervision of the BCRA. To have an effective framework for consolidated supervision, it is recommended that unregulated parent companies be effectively brought under the purview of BCRA and that the LEF should provide SEFyC with explicit powers to regulate and to inspect them, including extending to them a set of prudential standards on capital, risk limits, and risk management and governance standards. The participation of local banking groups in insurance and capital markets also requires an adequate oversight framework of the risks of these activities for the overall banking group. To this end, it is advisable that the role of lead supervisor of a financial conglomerate be established (supervisor of the local entity with the highest risks); that its responsibilities with respect to consolidated supervision, as well as the responsibilities of the other domestic supervisors, are clearly defined.</p>
Principle 25.	<p>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.</p>

Description	<p>Argentina is a host of international banks that belong to financial conglomerates whose parent companies are in Brazil, France, Germany, Great Britain, Italy, Japan, South Africa, Spain, Uruguay and the U.S. The most significant of these are operations from Spain, Brazil, Great Britain, South Africa and the US. In turn, operations abroad of Argentinean banks are considered small, and most of them correspond to the foreign branches of public banks. In addition to these, a couple of private local banks have small foreign operations in Bahamas, Cayman Islands and Uruguay. Two of the conglomerates have parallel banks abroad.</p> <p>Through the SEFyC, the BCRA has signed cooperation agreements with banking supervision entities abroad (see principle 1.6), including seven of the countries where local Argentinean banks have cross border operations and the two countries where the parallel banks related to local private conglomerates operate. There are no MOUs with Paraguay and Bolivia, where a local public bank has small branches.</p> <p>The exchange of information also takes place in practice with countries with which no MOU has been signed, and there is no impediment to supervisors from other jurisdictions carrying out their tasks in Argentina, as long as there is a commitment to observe regulations in relation to bank secrecy. Requirements by home supervisors are to be considered as if made by the BCRA, and this aspect is laid down in the rules on financial secrecy.</p> <p>The agreements that were signed several years ago, do not contemplate aspects in relation to risk management and AML/CFT. In addition, agreements refer only to financial institutions and not to other components of the group. However, the BCRA has been actively working to update these older agreements to include missing aspects. Updated agreements have been signed with Mexico and the United States, and formal discussions are underway with Germany, Brazil, and Italy.</p> <p>Before granting a new license, the SEFyC always reviews the supervisory framework of the country of origin or the country of destination of the investment. No licenses have been granted to shell banks. Prudential, reporting and supervision regulations do not make any distinction according to the origin of a bank's capital.</p> <p>Assessors were informed that the BCRA in its capacity as home supervisor has provided all the information requested from it. However, assessors were informed that some problems have arisen when seeking information in certain jurisdictions (where there is less experience in the matter of information exchanges with other foreign supervision bodies) and there is no habit of making routine on-site inspections abroad.</p> <p>Assessors were informed that, in its capacity as host supervisor, the BCRA has received all the information it has requested and has cooperated actively with the</p>
-------------	---

	<p>home supervisor, enabling on-site tasks in Argentina and accompanying them when required.</p> <p>In their capacity as home supervisors, representatives of the SEFyC groups have participated on exchange visits on supervision topics in host supervision countries. Furthermore, in the case of some foreign capital banks, the head of the SEFyC group has participated with peers abroad on foreign supervisory colleges.</p>
Assessment	Largely Compliant
Comments	<p>The SEFyC has signed MOUs with all the relevant foreign supervisors and cooperates with home and host banking supervisors providing access to information requested. A more proactive approach to cooperation should be adopted, by which information on material events and concerns is provided regularly to home and host supervisors. Also, it is recommended to continue with the progress on the updating of MOUs with foreign regulators and those of other financial services to increase the exchange of information (for example, on examinations in relation to Prevention of Money Laundering and the Financing of Terrorism, and on representatives of foreign financial institutions.)</p>

IV. AUTHORITIES'S RESPONSES

Part I. Introduction

51. **It has been almost eleven years since Argentina's last engagement with International Organizations took place regarding a financial sector assessment.** The FSAP conducted in 2001 was interrupted and suspended once the crisis entered in its worst stage and was never resumed. The world is currently witnessing a new phase of the systemic crisis that erupted in 2007 in advanced economies, which so far, has shown many phases and which consequences are being felt in every part of the globe.

52. The policy response to this crisis in central countries and the persistent uncertainty around future developments in the euro zone, has led to massive swings in capital flows, which have made it necessary to implement measures that attenuate their impact on the exchange rate and domestic monetary conditions.

53. In addition, Argentina's authorities found worrisome that the current strategies adopted by most countries in distress is being centered on fiscal consolidation and labor flexibility, instead of focusing in growth oriented policies, like the ones Argentina imposed after experiencing its worst crisis in decades. Furthermore, we are concerned about the fact that international organizations are recommending countries the same policy programs that were applied before in our country. If we have learnt something from the 2001/2002 crash is that, without programs aimed at promoting growth in aggregate demand, job creation and economic growth, debts become unsustainable and difficult to pay.

54. The authorities acknowledge that important challenges remain, and the assessments were noteworthy to identify many of them. The reinforcement of the supervision powers in accordance to international standards represents an immediate task. The effective identification, regulation and supervision of financial groups and/or conglomerates is presented transversally throughout the three assessments, and is a key challenge.

55. The report takes many elements under consideration while assessing the preconditions that each market should have so as to develop. Nevertheless, the mission arrives at some conclusions that need a more objective approach. In this line, the Authorities believe that the views regarding the pension system reform should be revised. Moreover, some points ought to be remarked and some processes further described in order not to fall under subjectivism, particularly regarding the facts and consequences of the State's recovery of the pension system management.

56. The 2001/2 crash left deep wounds, not only in an economic sense but also in the social and political spheres. The country's economy had been driven to unsustainability after years of, overall, current account and fiscal deficits and an increasing dependence on external financing of both the public and the private sectors. The lack of competitiveness, coupled with overindebtedness and an extremely rigid macroeconomic framework finally led to a financial debacle and to a dramatic unemployment rate of 21.5% in May 2002. The financial system collapsed and government institutions suffered a sharp down on credibility. Social instability impacts and consequences didn't take long to come out.

57. The economic policy framework applied during the decade before the crash, which was acclaimed and praised by International organizations, led the country to a point of no return, which no one (neither the Government, nor the International Organizations, and Credit Rating Agencies or consultants) could predict until the crunch became present, and with all type of warnings and downgradings nothing but procyclicality emerged.

58. Argentina started to recover when the Government put in place the backbone of a new macroeconomic architecture, characterized by abandoning convertibility and by implementing a flexible exchange rate regime, measures which, significantly, made it possible to recover the central bank's capacity to implement monetary policy and the institution's role as a lender of last resort. In parallel, getting primary and current account surpluses, tackling unsustainable public debt levels and composition (cancelling with the IMF and international creditors who were defaulted), and strongly underpinning social safety nets, made it possible to reacquire competitiveness and to reach a sustainable path of growth.

59. Figures from 2003 onwards show that Argentina's recovery was overarching, reflected by GDP growing hand in hand with job creation. This process has been achieved without any assistance from International organizations (in fact net disbursements were negative) and by, crucially, not heeding these institutions policy advise, which with the benefit of hindsight were definitely wrong. Needless to say, the sovereign debt restructuring was fundamental for Argentina's recovery and growth.

60. The inclusive growth path that Argentina started to transit would not have been possible to continue without recovering the administration of pension funds.

61. As mentioned before, the report arrives at certain conclusions that not only are influenced by a subjective or even dogmatic view, but also are simply wrong. In particular, the assertion that links the creation of the public countercyclical pension fund (*Fondo de Garantía de Sustentabilidad -FGS-*), with the lack of availability of long term financial resources for banks and other players, or with the low liquidity and depth of the capital markets needs to be reconsidered under the light of empirical data.

62. By analyzing the involvement of the Fund and the World Bank in the adoption and implementation of the flawed 1994 social security reform one can hint this involvement as being at the inception of one of the drivers of the ROSC characterization of the 2008 reversal, recovering the administration of the pension funds. In effect, the 1994 reform not only was continuously praised by the Fund and the World Bank, but also its adoption constituted a structural performance criterion for the program supported by the extended arrangement approved by the Fund in March 1992.

63. In this regard findings of the Independent Evaluation Office' Report on the Evaluation of the Role of the IMF in Argentina 1991-2001 (Chapter 2 Surveillance and Program Design) are telling²³.

23 "... The fiscal imbalance created by the social security reform was significant. From 1994 on, government revenues from social security payroll taxes gradually declined, with the revenue gap in 2001 estimated at 2.9 percent of GDP.

(continued)

64. One of the main unfulfilled promises of the 1994 reform was that the private administrators (AFJPs) would contribute to the stock markets development. Between June 2000 and June 2007, before the onset of the global financial crisis, the balance managed by the AFJPs was multiplied five-fold, from \$18,714 to \$95,871 million and the ratio Balance of the Retirement Fund/GDP rose 1.8 times, from 6.4% to 11.5%. However, in the same period the domestic market capitalization was multiplied only 3.5-times, from \$51,979 to \$179,771 million, and in terms of GDP it increased only by 1.3 times, from 17% to 22%. Figures from December 2011, show that financing through the local capital market grew by 3.6% y/y. In comparison to 2009 and 2008, was 108% and 92% above them respectively²⁴.

65. What's more, it's important to analyze the effect that administration fees and insurance premiums which the AFJPs charged their affiliated have over the development of the markets. Those fees as well as premiums for insurance accounted, in average, 35% of the contribution made by the affiliated workers per month. This fact was provoking significant asymmetries between nominal gross profits presented in the AFJP's balance sheets and what was actually reflected in the workers capitalization accounts. Between 1994 and 2008 the AFJP's gross notional revenue average reached 8.27% while the income after fees and premiums was 2.4%. As an immediate consequence, the pension funds had less availability of liquidity to invest, affecting the individual workers account. Since the pension system returned completely to public management, no fee or premium is collected, allowing the FGS to have more resources available to invest and a more rapid growth of capital. In fact, AFJP's funds presented a growing trend since 1994 (when they were created) accounting 13% of GDP in June of 2007. Between 2008 and 2011 the FGS' capital went from \$ARS 98.000 to \$ARS 199.490, reaching 10.2% of GDP, figures that reflect a more rapid growth than the AFJPs could get in a period of 13 years since their creation in 1994.

Of this, 1.5 percent was due to the transfer of workers' contributions from the social security system to individual accounts in the new private pension funds, a direct effect of the reform, and the remaining 1.4 percent resulted from the reductions in payroll tax rates. On top of this, the federal assumption of the liabilities of the provincial systems added another 0.9 percent of GDP annually to expenditures by 2001. Against this, there were offsetting reductions in social security expenditures as a result of the reform; an estimate by Rofman (2002), which may be optimistic, is that annual expenditures were smaller by 1.1 percent of GDP in 2001. Taken together, the reform and accompanying policy changes worsened the annual overall fiscal balance of the federal government by at least 2.7 percent of GDP.

The role of the IMF: The social security reform was initiated and in large part designed by the Argentine authorities, with the World Bank providing some technical assistance. In retrospect, most observers (the IMF, the World Bank, local commentators, and the administrators of the new private funds) overemphasized the potential benefits of the new system and failed fully to anticipate its severe fiscal consequences. Part of the problem was that it overestimated the self-financing component of the reform, without recognizing the imperfections of capital markets that would create an immediate burden on the government's borrowing requirements. The increase in fiscal deficits arising from the reform was considered simply as an explicit recognition of already existing implicit debt, which the markets should be willing to finance..."

²⁴ See the chart in CNV's DAR.

Effective Profit for Affiliated Workers, 1994 - 2008*

Profits from incomes after management fee

AFJP	Annual Rate of Return	
	Nominal	Effective
Arauca Bit	8,28%	2,41%
Consolidar	9,25%	3,33%
Futura	7,92%	2,07%
Máxima	8,58%	2,69%
Met**	8,93%	3,02%
Nación	10,97%	4,95%
Orígenes	7,98%	2,12%
Previsol	8,89%	2,98%
Profesión + Auge	8,09%	2,23%
Unidos	7,55%	1,72%
AVERAGE	8,27%	2,40%

Assumption: A worker that start into the system in 1994, with a salary of \$1.000, adjusted since 2001. This calculation was made in October 2008, near the half of the 30 years old worker's horizon. The attribution of the AFJP's fee as a % of the total worker contribution decreases during the time

66. In addition, since the FGS was born, the resources previously managed by private pension funds started to be invested in a vast kind of infrastructure projects, including roads, energy and social housing, mainly through the capital market. By November 2008, the private pension system had invested just 0.63% of their assets in project financing. Those investments were allocated **only in two projects**, one of which represented 96% of the total. Today, under the investment policies described, the FGS enhanced the previous scheme of investment in relation with longer terms and a more effective impact on the real economy, taking the infrastructure and developing share of the Fund portfolio up to 13.9%²⁵ by December 2011, given, since 2008, a context of global crisis where confidence in financial markets is at stake.

67. Regarding the availability of funding for the banking sector, we must note that the FGS augmented its share of term deposits in banks from 9.1% at its inception to an average of 11% in the period December 2011 - April 2012, maintaining at the same time a significant degree of diversification. In addition, the FGS launched open auctions to allocate its deposits, where the best bank offer would result in the cheapest financing to small and medium enterprises productive projects.

68. In conclusion, with respect to the depth of the domestic capital market, we must say that the Argentine stock market has historically been small in relation to GDP. Moreover, it has always

²⁵ We should highlight that investments in public instruments (including debt issued by public entities) remain at similar levels in relation with the holdings managed by the AFJPs; in average, all AFJPs had a share of 54.4% of their portfolio invested in public instruments by November 2008, while the FGS held by December 2011 public assets which represented 58.2% of its investments.

had a limited degree of diversification across sectors and a low number of listed companies. In addition, the exceptional macroeconomic instability suffered by the country after WWII has generated a pattern of behavior on the part of economic agents that has for a long time been part of our "culture", a factor which exacerbates the domestic repercussion of any negative external development. Consequently, to blame the creation and operation of the FGS for the adverse evolution of the local stock market in 2008/2009 is a mistake. The evolution of the depth and liquidity of the local stock market has been affected by structural and hystorical factors; nothing has to do with the creation of the FGS in 2008. On the contrary, investment policies taken by the FGS were aimed at boosting long term financing through the banking sector and the stock exchange market, by supporting the developing of both. Penetration in relation to GDP has never been over 20%, being particularly affected by the 2001/2002 collapse, which has had a profound impact on the collective memory of economic agents.

69. Concerning statistics, the Authorities want to remark that the institutions involved in the ROSC processes use only data provided by the National Institute of Statistics and Censuses (INDEC), an institution which has elaborated and published statistics in Argentina since 1968; no province or private agency has the ability or the resources to publish a representative CPI index. Notwithstanding, the Government is currently in the process of developing an enhanced CPI index with the technical assistance of the IMF. This new indicator will have, for the first time a national coverage and will collect data from all over the country, in contrast to the current index, which is constructed based on data from the city of Buenos Aires and the Greater Buenos Aires area.

Part II. Detailed response to the principles adherence assessment.

**BASEL CORE PRINCIPLES
BANCO CENTRAL DE LA REPÚBLICA ARGENTINA**

70. **The authorities and staff of the BCRA would like to thank the team in charge of the assessment of the Basel Core Principles (BCP) for their openness and comprehension and for the quality of their professional support.** Their assessments and suggestions were truly helpful to diagnose and prioritize the work Argentina has to do to adapt its banking regulation to international standards.

1. Basel Core Principles

71. **We agree with most of the descriptions, assessments and recommendations in the ROSC. Notwithstanding, it is necessary to state our discrepancy as regards four important principles in which regard the mission found that the BCRA supervision is materially non-compliant.** To better state our point, we show in the following chart those ROSC ratings compared to our own assessment and a 2001 FSAP that, though not completed nor published, was a reference for the BCRA on the view of the International Financial Institutions (IFIs) about our supervisory regime:

Principle	Description	FSAP 2001	Self-assessment 2010	ROSC 2011
1.2	Independence, accountability and transparency	LC	C	MNC
9	Problem assets, provisions and reserves	C	LC	MNC
22	Accounting and disclosure	C	LC	MNC
24	Consolidated supervision	C	LC	MNC

72. Although legislation and supervisory practices can always be improved, the rates given in the last ROSC do not seem to correspond to our current degree of compliance with international standards. Particularly if consideration is given not only to regulatory texts but also to the effective implementation of the rules, the overall context of the financial system, and the results of policies and practices in the area of supervision over the past 10 years. In conclusion, the assessment of the degree of compliance with these four principles is not only distant from the self-assessment but also reflects a considerably more negative outlook than the FSAP report in 2001, which was crafted very shortly before the general collapse of our Financial System.

73. We recognize that financial reporting standards have improved considerably since 2001 but we believe that our rules-though with a format somewhat dated- are reliable and appropriate for assessing the financial risks of a markedly transactional financial system. In any case, supervision has always been prudent. A fair evaluation of the merits and weaknesses of our reporting standards should not render it as mostly non-compliant with CPs 9 and 22.

74. Since 2001 there have been no major changes in the wording of CPs 1.2 and 24 nor in the Argentine legislation. In spite of that, after 10 years of an efficient and conservative supervisory practice, the assessment has gone from no observations to substantially non-compliant. In our October 2010 assessment we took particular account of the changes in both the international scenario and the supervisory practices, and concluded that these principles had been largely complied with. The following facts support our assessment:

Principle 1.2

75. The 2001 FSAP report stated: “The legislation grants independence to the members of the BCRA’s board coupled with a long tenure (6 years), and with a relative guarantee of permanence [...] during their tenure the directors can only be removed on grounds of misconduct or lack of compliance with their obligations by the President of the Republic. In each case, Congress is required to issue a nonbinding recommendation. The superintendent and the deputy superintendent are appointed for 3-year terms. The law does not limit their possible removal. It is understood that they could be removed following a similar procedure as used in their appointment.”

76. The BCRA has the widest independence that can be assigned to a public entity according to Argentine law. It is a self-administered institution separate from the National Government. The BCRA has an important degree of independence to elaborate and to execute its budget. In exercising its role and powers, the BCRA is not subject to orders, directions, or instructions from the National Executive Branch.

77. Its authorities are appointed and removed according to special procedures established in the BCRA Charter. The National Executive Branch appoints the president, the vice-president and the other members of BCRA’s board of directors with the approval of the Senate and after a public hearing. These BCRA authorities can only be removed by the President of the Republic due to misconduct or non-compliance with their public duties and after consultation with a Congressional committee. The decision to remove the president, the vice-president or a member of the BCRA’s board of directors may be reviewed by the National Judicial Branch.

78. The Executive Branch may appoint the president, the vice-president or a board member of the BCRA on an interim basis (“en comisión”) until the Senate approves such appointment. This institutional mechanism fosters the BCRA working capacities since it allows the Central Bank to avoid being paralyzed while the Senate discusses an appointment. If the Senate rejects the appointment proposed by the President of the Republic, the public officer appointed en comisión automatically ceases in his or her functions.

79. The superintendent and the vice-superintendent are members of BCRA’s board of directors and they are appointed by the President of the Republic after a proposal made by the BCRA president.

80. Regarding Argentina's legal framework, in mid-2011, the United States Court of Appeals for the Second Circuit has stated that "[...] by some calculations, the independence ranking that plaintiffs introduced into the record [...] renders BCRA more independent than the Federal Reserve System, the central bank of the United States, and more independent than the Bank of England, the central bank of the United Kingdom"²⁶

81. The BCRA Charter has recently been amended by Law No. 26.739. However, none of the strengths of Argentina's legal framework regarding this issue have been modified.

Principle 9

82. We agree with the assessors that a more granular debtor classification and a more stringent and counter-cyclical provisioning would constitute great steps forward in our regulation and we are consequently committed to following the advice. We stress the point, nevertheless, that our current system largely complies with the objectives of CP 9 in that problem assets are duly identified and our supervision is satisfied that financial institutions' provisions and write-offs reflect realistic repayment and recovery expectations. The consumer portfolio is provisioned at the end of each month on the basis of debtors' payments and legal status: loans backed by preferred collateral are subject to provisions of 3%, 12%, 25% or 50% as from their becoming 31, 90, 180 or 365 days in arrears. These provisioning percentages are doubled in the case of unsecured loans. The guidelines for refinanced loans are meant to make their upgrading more stringent: to prevent banks from concealing the potential uncollectibility of their portfolio by means of postponements, forbearances, stays, instalment reductions, renewals or restructurings, specific additional guidelines have been laid down on top of the days in arrears, which establish that the classification of debtors benefitting from such measures can only be improved when a given number of instalments or percentage of principal due have been repaid. All of these are minimum provisions (which constitute a floor for the supervisor) and do not prevent banks from booking larger amounts, calculated according to more rigorous criteria.

83. Exposure to the public sector is not exempted from impairment. If recorded in the trading book they are marked to market. If recorded in the banking book, impairment is dealt with over the duration of the exposure by comparing the book value of exposures with their future cash-flows discounted at the internal rate of return (IRR). The objective of the BCRA accounting rule is to limit the volatility of assets measurement. Transparency is guaranteed since, as explained in the description of BCP 22, financial institutions have to disclose in notes to their financial statements the differences between market prices and valuation according to our regulatory accounting standards.

²⁶ United States Court of Appeals for the Second Circuit, "NML Capital, Ltd and EM Ltd. v. Banco Central de la República Argentina and the Republic of Argentina", 5 July 2011. The Tribunal concluded that the Foreign Sovereign Immunities Act (FSIA) immunizes property of a foreign central bank or monetary authority held for its own account without regard to whether the bank or authority is independent from its parent state. Therefore, it did not reach the question of whether the Republic's control of BCRA was sufficient to disregard the presumption of juridical separateness.

84. The BCRA is attentive to the discussion at international level on loss provisioning and to the efforts to develop a converged standard on impairment of amortised cost financial instruments. The subtleties and implications of these questions have caused the postponement of both the completion and the effective date of IFRS 9. We are convinced that changing our time-tested regulatory accounting standards to incorporate more forward-looking measurement criteria before these issues have been settled could lead to a more uncertain and, consequently, less effective regulatory framework.

Principle 22

85. Notwithstanding the fact that the BCRA is still evaluating the long-term effects of migrating to the IFRS, the quality of our current accounting standards ensure that supervisors and other interested parties can correctly evaluate the financial position of banks and companies. As explained, the impairment of exposure to the public sector is dealt with over the period to maturity. We believe, and the successive postponements of international projects on financial instruments measurement support our belief, that subjecting exposure to the public sector to up-front, over-the-cycle provisioning is impracticable since it would imply estimating the uncollectibility of a National State, while the definition of State implies presumptions of its continuity and the fulfilment of its commitments. Besides, the assumptions necessary to make the estimation are difficult, if not impossible, to contrast and compare; they include the risk-free interest rate and the applicable risk and liquidity premiums. Once again, it should be noted that exposure to the public sector recorded in the trading book is always booked at market value.

86. On another note, we know from experience that risk associated with the public sector is related to repayment capacity, fiscal position and the ratio between GDP and debt held by private holders, not to “market discounts”.

Principle 24

87. Our rules explicitly state that the solvency of financial institutions and compliance with technical ratios are assessed on both an individual and a consolidated basis. The consolidation of balance sheets only covers financial institutions and companies providing complementing services for the financial activity because, in Argentina, individuals and commercial companies can be controlling shareholders of financial institutions. While it is evident that it is not possible to extend prudential regulations to them, it is also clear that such holders do not pose any material risk to the financial system, other than those derived from unsound governance or reputation. Our supervision is well aware of reputational risks affecting individuals and commercial companies related to financial institutions and monitors governance issues through tools evaluated under other BCPs. The structure of our financial system, the powers granted to the BCRA to license institutions, shareholders and senior managers and the absence of precedents to the contrary are conclusive proof that there are no ultimate beneficiaries unknown to the BCRA who could affect the safety and soundness of a bank.

2. General comments

Inflation

88. The texts make several references to concern over the “uncertainty” on price levels and “discrepancies between national figures and other available price indexes available” in Argentina. The BCRA uses only official indexes. According to the latest information available, year-on-year changes in official indexes show increases in consumer prices²⁷ of 9.7% for the first 3 months of 2012 compared with the same period of the previous year, and 9.8% for the year-on-year variation at March last; at the same time, the year-on-year variation in the index for implicit prices in GDP for the fourth quarter of 2011 was 15.6%²⁸.

Recovery of administration of the Pension System

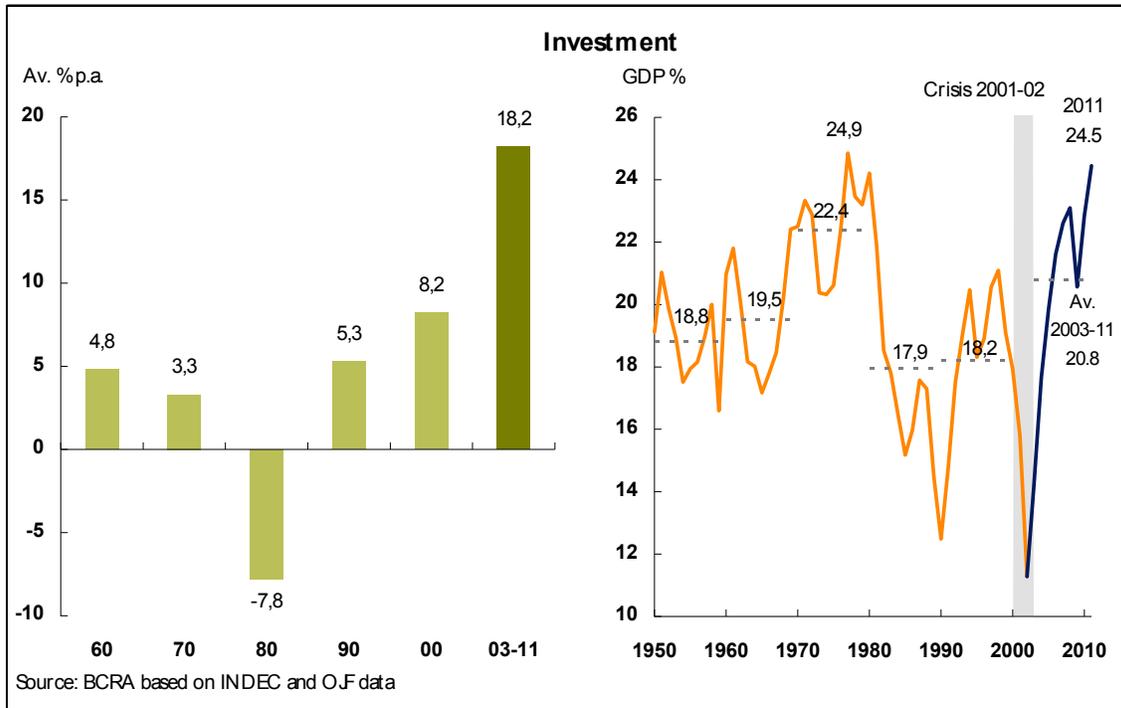
89. In the last quarter of 2008 the Integrated Pension and Retirement System (Law 24.241) was unified in a public social security system known as the Integrated Argentine Social Security System (SIPA). This did away with the private capitalization system that existed until then, at the same time as the resources making up the individual capitalization accounts of the members and beneficiaries (administered by the Pension funds - AFJPs) were transferred to the National Social Security Administration (ANSES) and became the Sustainability Guarantee Fund²⁹ (FGS), the end purpose of which is to constitute an anti-cyclical reserve fund, carrying out suitable investment of social security financial surpluses.

90. The mission’s texts maintain that the recovery and redirecting of the administration of the social security funds has had a negative impact on investment. Figures demonstrate quite the opposite. In recent years investment rates have been the highest in Argentina’s history.

²⁷ See: http://www.indec.gov.ar/nuevaweb/cuadros/10/ipc_04_12.pdf

²⁸ See: http://www.indec.gov.ar/nuevaweb/cuadros/17/pib_cua_03_12.xls Table 5.2.

²⁹ See: <http://www.anses.gob.ar/FGS/>



91. Since its inception, investment policies adopted by the FGS were designed to boost long term financing through the banking sector and the stock market, allowing the developing of both, and to directly foster productive projects and infrastructure.

92. Furthermore, since the ANSES took over responsibility for managing worker contributions, the stability and average duration of term deposits has increased, favoring the granting of medium-term credit. In effect, since the recovery of administration of the pension funds, social security term deposits have become less volatile, at the same time as they increased their participation in the portfolio of the new vehicle (FGS). As a result, term deposits went from having an average weighting of almost 4% in AFJP portfolios between 2003 and 2008 to levels of above 10% in the portfolio of the FGS in 2011 (11.7% in December, according to the latest available data).

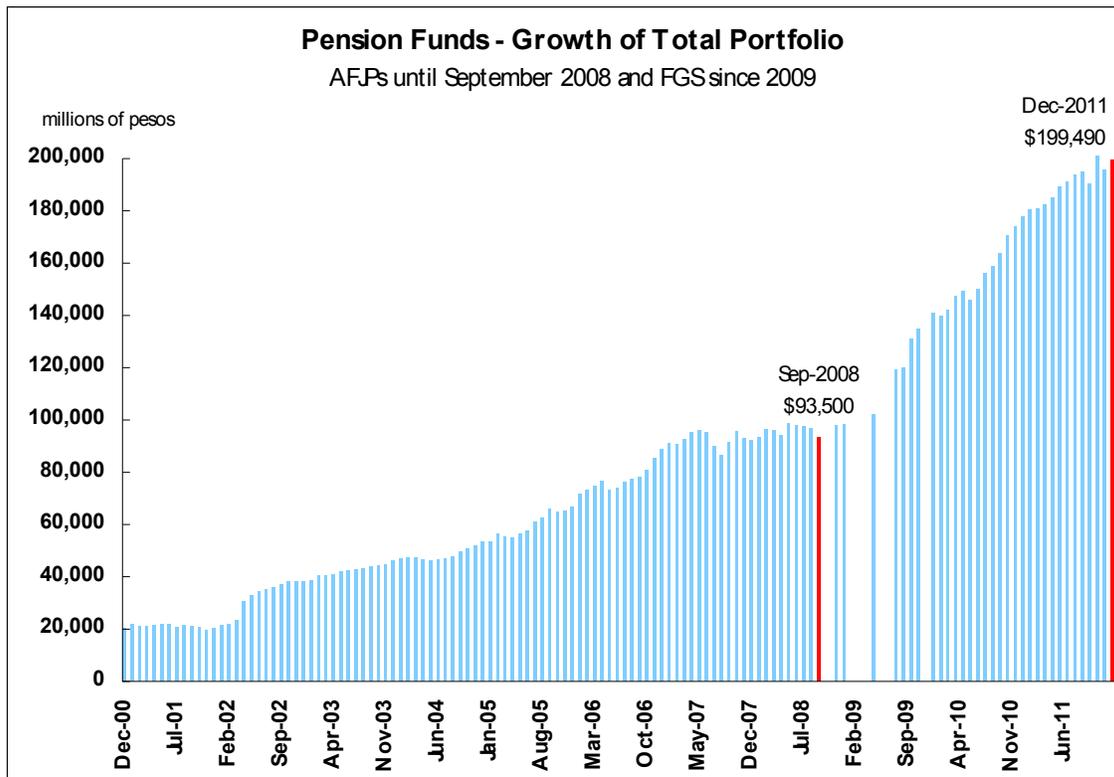
93. In addition, investments in productive projects and infrastructure account for 13.9% of the portfolio of the FGS to December 2011, and are intended to promote job-creating investments that contribute to enhance labor market development and economic activity. Under these investment policies, the Fund enhanced the previous scheme of investment in relation to longer terms and a more effective impact on the real economy, given a context of global crisis (2008/2009) where confidence in financial markets was at stake.

94. The creation of the FGS did not affect market debt placement. Once the international crisis in 2008-2009 was overcome, in 2010 issues of corporate bonds (ONs) by Argentine companies reached close to \$10 billion, similar to the level in 2007 and well above levels recorded in 2005-2006 (between \$2.0 and \$5.0 billion annually, net of debt restructuring transactions). Despite the volatility generated by the debt crisis in Europe, in 2011 to date placements have been made for over \$8.0 billion. It should be noted that more than 60% of debt placements in 2011 was by banks

and financial institutions. In the specific instance of banks, in the year to date they have placed debt on the market for over \$2.5 billion, for average terms of over 4 years. In addition, it is important to bear in mind that in the first half of 2009 the FGS played an anti-cyclical role, positioning itself as an investor in corporate debt placement transactions in a context that had been affected by the international crisis (taking between 33% and 70% of the amounts issued in several transactions).

95. Argentina's stock market has been historically small, with a very low penetration in relation to GDP, as well as in terms of enterprises listed and economic sector representation. With this in mind, the underdevelopment of the local stock market could not be associated with the birth of the FGS in 2008 under any circumstances. Nonetheless, this fact implies an important concern for the Authorities who recognize it as a big challenge that needs to be addressed.

96. It is important to highlight that one of the main unfulfilled promises of the 1994 Reform was that the private administrators (AFJPs) would contribute to the development of stock markets. Between June 2000 and June 2007, before the onset of the global financial crisis, the balance managed by the AFJPs was multiplied five-fold, from \$18,714 to \$93,871 million and the ratio Balance of the Retirement Fund/GDP rose 1.8 times, from 6.4% to 11.5%. However, in the same period domestic market capitalization was multiplied only 3.5-times, from \$51,979 to \$179,771 million, and in terms of GDP it increased only by 1.3 times, from 17% to 22%.



Similarly, it can be seen that the FGS portfolio has recorded greater rates of growth than had been recorded by the AFJP funds³⁰.

Naming of Directors to represent shareholdings in the hands of the National Government

97. The documents also criticize the appointment by the State of directors in those companies in which it has a shareholding. The exercise of shareholders' rights —criticized in the documents submitted by the World Bank mission— is in line with the OECD's Principles of Corporate Governance³¹. Specifically, those principles indicate that “for institutions acting in a fiduciary capacity, such as pension funds, collective investment schemes and some activities of insurance companies, the right to vote can be considered part of the value of the investment being undertaken on behalf of their clients. Failure to exercise the ownership rights could result in a loss to the investor who should therefore be made aware of the policy to be followed by the institutional investors.” Under the current system, in which the FGS is structurally designed to focus on the creation of registered employment, full defense of its shareholders' rights is much more important than it was in the past, as the AFJPs only marginally focused on the relative yields of securities when making investment decisions (as their earnings were based on commissions that did not even depend on the yields of the Funds being managed).

98. Last but not least, the mission's reports make no reference to the macro-prudential policies adopted by Argentina. On the contrary, the texts refer negatively on several occasions to the controls on the exchange market and commerce, among others. In this regard, we consider that these policies, discussed at length with the mission, should form part of the description of the strengths of the Argentine financial system and its regulations. In particular, we would like to highlight two main macro-prudential policies.

Currency mismatching

99. Historically, financial system currency mismatching has played a relevant role in the crises that have taken place, particularly in emerging economies. Such mismatching was a product of frequent periods of macroeconomic instability that contributed to a high level of financial dollarization (or indebtedness in other hard currencies) in these economies. As a result, the financial systems of these economies have shown greater vulnerability because of their exposure to sharp swings in exchange rates. Here it can be seen that one risk that has not been correctly considered is that arising from lending in foreign currency to debtors whose income is not linked to the currency in which the loan was granted.

³⁰ Further information on the FGS and its operation can be found in:

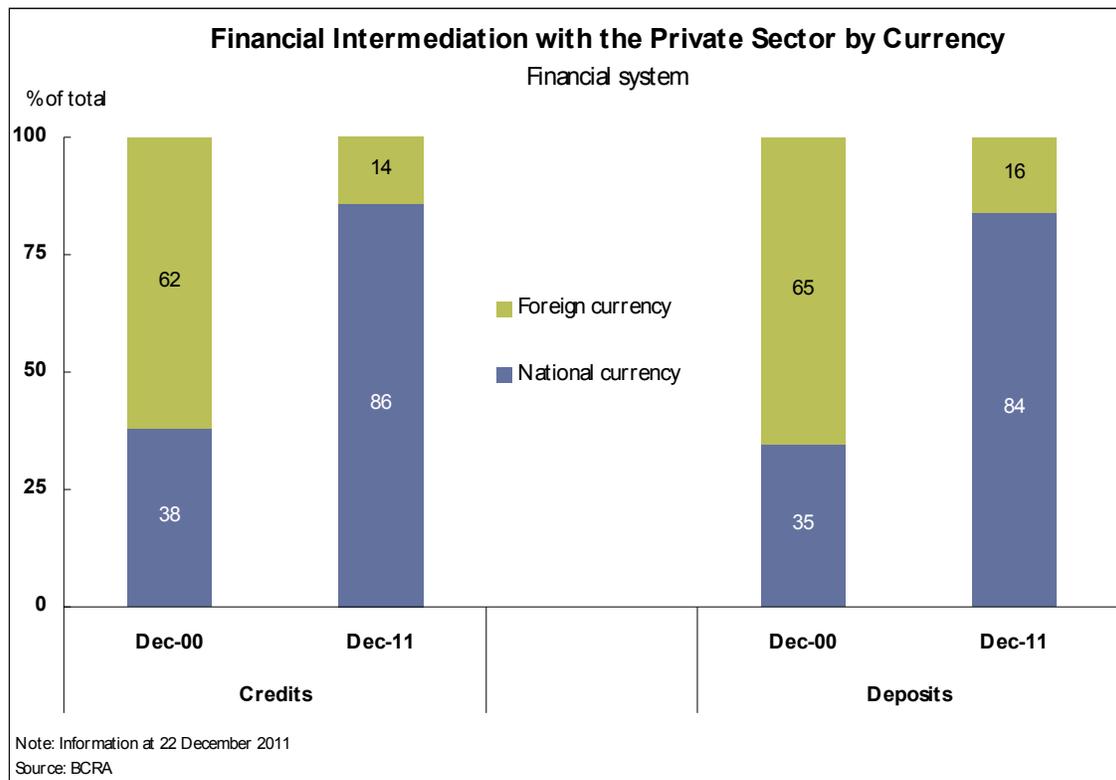
a) <http://www.anses.gob.ar/FGS/politicas-transparencia/informes-mensuales.php>, to access monthly reports with information on the portfolio of the FGS and

b) <http://www.anses.gob.ar/FGS/preguntas-frecuentes/faq.php> for a summary of the way in which it operates.

³¹ See: http://www.oecd.org/document/49/0,3746,en_2649_34813_31530865_1_1_1_1,00.html

100. In recognition of this situation and having learned from its own experience, we have developed a financial regulation framework to deal with this type of risk with both macro and micro-prudential aims. In conjunction with other measures (capital requirements, limits on foreign currency positions), Argentine regulations establish limits on bank use of foreign currency lending capacity, seeking to avoid solvency problems in individual banks as well as in the system as a whole, such as might originate from sudden changes in the peso-dollar exchange rate. Consequently, deposits in foreign currency can only be lent in foreign currency to companies with income in the same currency (or denominated in local currency but closely correlated with the development of the peso-dollar exchange rate). As a result of this macro-prudential measure, in Argentina foreign currency bank funding is channeled in its entirety to borrowers with income in the same currency.

101. In addition, prudential regulations issued by the BCRA include other elements to manage currency mismatches. In terms of market risk capital requirement, regulation considers in particular exchange rate volatility risk. It also sets a limit on financial institution negative net positions in foreign currency.



Controls on entry of short-term funds

102. Administration of capital flows by means of the implementation of policies with a macro-prudential focus is fundamental when it comes to restricting the volatility of the economy. A situation in which there are large inward and outward flows of capital as well as representing a

significant challenge for the execution of monetary and exchange rate policies, also has the potential to generate an adverse impact on the real economy and financial stability. While it is possible to associate capital inflows with future benefits (increased availability of funds, possibility of smoothing the volatility of spending, transfer of technology included in foreign direct investment, etc.), one also needs to bear in mind the existence of a series of adverse effects, including excessive growth in domestic demand and related inflationary pressures, the forming of bubbles (when flows end up financing speculative or low-quality investments), and excessive appreciation of the currency. Furthermore, the possibility of abrupt flow reversals - particularly in the case of short-term funds - carries with it considerable potential costs.

These matters have been widely discussed in economic literature³² and following the experience of the international crisis unleashed in 2007, even the IMF has recommended capital flow regulation.

From a macro-prudential perspective, in an effort to discourage short-term capital flows in 2005³³ Argentina introduced controls on these funds. Capital being brought in must remain in the country

³² There is prolific literature dedicated to this topic. We have selected just a few recent papers as examples of the broad recognition given to control of short-term capital as a macro-prudential tool.

Epstein, G. (2009) "Should Financial Flows Be Regulated? Yes", UN/DESA Working Paper No. 77, July.

Gallagher, K. (2011) "Regaining Control? Capital Controls and the Global Financial Crisis", PERI Working Paper No. 250, February.

Gallagher, K.; S. Griffith-Jones and J. A. Ocampo (2011) "Account Regulations for Stability and Development: A New Approach", Issues in Brief No. 22, The Frederick S. Pardee Center for the Study of the Longer-Range Future, November.

Gabel, I. (2011) "Not your Grandfather's IMF: Global Crisis, Productive Incoherence and Developmental Policy Space", PERI Working Paper No. 214, June.

Magud, N.; C. Reinhart and K. Rogoff (2011) "Capital Controls: Myth and Reality — A Portfolio Balance Approach", NBER Working Paper No. 16805, February.

Mohan, R. (2011) IMF Macro Conference "Macro and Growth Policies in the Wake of the Crisis", March 7-8, Washington, D.C.: International Monetary Fund.

Ostry, J.; A. Ghosh; K. Habermeier; M. Chamon; L. Laeven; M. Qureshi and A. Kokenyne (2011) "Managing Capital Inflows: What tools to use?", Staff Discussion Paper, Washington, D.C.: International Monetary Fund, April.

Co-Chairs' summary of Capital Flow Management Sub-Group Discussion on Coherent Conclusions for the Management of Capital Flows Drawing on Country Experiences. June 30, 2011.

"Managing Capital Inflows: What Tools to Use?" Prepared by Jonathan D. Ostry, Atish R. Ghosh, Karl Habermeier, Luc Laeven, Marcos Chamon, Mahvash S. Qureshi, and Annamaria Kokenyne . IMF Staff Discussion Note. April 5, 2011

"The Effectiveness of Capital Controls and Prudential Policies in Managing Large Inflows". Prepared by Karl Habermeier, Annamaria Kokenyne, and Chikako Baba. IMF Staff Discussion Note. August 5, 2011.

³³ National Executive Branch Decree 616/05.

for at least one year, and during the first year an unremunerated deposit in dollars must be set up for 30% of the amounts involved. These requirements apply to inflows involving indebtedness abroad by natural or legal persons in the private sector, portfolio investments by non-residents to establish positions in local currency, purchase assets or settle liabilities of the private sector, or to invest in securities issued by the public sector acquired on secondary markets, and income from the sale of foreign assets by residents in the private sector in excess of US\$2 million per month.³⁴

103. The reserve requirement does not apply to transactions for the financing of foreign trade, primary share issues, or public and private debt securities offered to the public and listed on self-regulated markets, foreign direct investment, inflows corresponding to borrowings from international agencies, loans to the private sector for terms of over 2 years for investment in non-financial assets and investments by non-residents for the purchase of real estate. In addition, the Ministry of Economy and Public Finance is empowered to modify the percentage and the terms established in the capital inflow requirements if changes take place in macro-economic conditions that make it necessary to lengthen or shorten them.

104. Last, it should be pointed out that the requirements on short-term capital inflows have been complemented by other macro-prudential policies in force in Argentina, including managed float of the exchange rate, reserve accumulation (and their strategic use as insurance against changes in the external context), and the establishing of the mentioned BCRA regulations to limit financial system currency mismatching.

³⁴ This latter point was introduced by Resolution 365/05.