Reg News

BACEN Resolution 229 – A credit-risk fine tuning that aligns with BCBS and impacts Brazil's DLO reporting

Effective on January 1, 2023, BACEN's Resolution 229 poses challenging requirements that impact the way financial institutions currently calculate credit risk and how they report it. In March 2023, all banking segments must include its new requirements in their DLO submissions. Although all BACEN-regulated banks are affected, the most significant impact is on the largest banks (Segments 1-3).

Resolution 229 falls under DLO – Brazil's major umbrella risk reporting framework – the Demonstrativo de Limites Operacionais (Statement of Operational Limits). Its purpose is twofold: to fine-tune the credit-risk calculation methodology, and better align with the Basel Committee on Banking Supervision's (BCBS) recommendations. And its arrival comes as no surprise in the context of the ongoing global Basel III reform trend. Firms in scope are on an evolving Basel journey that is becoming more complex – in Brazil and globally.

The Resolution's outcomes can change a firm's bottom line, and for several, the change is anticipated to be positive.

Basel III-Driven Credit-Risk Fine Tuning – Bottom-Line Implications.

The Resolution's focus on credit risk directly impacts a firm's capital requirement. It establishes procedures for calculating the portion of risk-weighted assets (RWA) related to exposures to credit risk subject to the calculation of the capital requirement using the Standardized Approach (SA) – a global trend under Basel III reforms. Indeed, the new Resolution improves the standardized credit approach, enabling a potential reduction in credit RWA exposures and in the total amount of regulatory capital held by financial institutions. In short, the Resolution's outcomes can change a firm's bottom line, and for several, the change is anticipated to be positive.

So, it is important that firms gather the right data and execute the calculations precisely. Especially considering its direct impact on a firm's P&L, banks are strongly motivated to seek the most integrated and automated system to manage this Resolution's and DLO's overall complex data, calculation, and reporting requirements.

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The RWA Rule Changes – More Granular, More Data-Intensive.

BACEN made two primary changes. Namely it:

- **Created new, more granular classifications for counterparties**
- **Added new risk-weight rules**

To comply with the new credit RWA calculation rules, banks must classify counterparties according to new segments. To achieve this, the bank's processes must become more data and calculation intensive and accommodate more detailed downstream reporting. On the other hand, if such processes are effectively implemented, the Resolution creates an opportunity for banks to become more capital efficient via a more optimized approach to risk mitigation.

Globally, financial institutions are experiencing a common regulatory-driven push for more granular data reporting. With respect to Resolution 229, this challenge centers on the need to classify new segments (as shown in the following two examples) using more granular data that can be difficult for banks to capture and properly identify.

Prudential Conglomerates

Under the new classification, prudential conglomerates must be separated into three types indicating by how they are led as follows:

- **Financial institution**
- **Payment institution that doesn't have a financial institution as part of its operations**
- **Payment institution that has a financial institution as part of its operations**

Financial Institutions

This classification now comprises local and foreign qualified central counterparties (QCCP), non-QCCP, and entities operating financial market infrastructures, e.g., the Committee on Payments and Market Infrastructures (CPMI), and/or the International Organization of Securities Commissions (IOSCO). For Resolution 229 purposes, they are all categorized as financial institutions and classified into three risk categories.

- **An institution that meets minimum capital requirements (MCR) and additional principal capital (ACP)**
- **An institution that meets MCR but does not comply with ACP**
- **An institution which, in the absence of public-domain information relating to MCR and ACP, presents a high credit risk**

In sum, to comply with these examples and other Resolution 229 requirements, firms must execute more granular and automated segmentation, risk-weight assignment, and allocation processes. In turn, this increases the complexity of the RWA calculation, especially regarding the application and optimization of credit-risk mitigation.

The Pressure Is On – More Reforms Are Coming.

As jurisdictions and financial institutions progress on their Basel journeys worldwide, so does BACEN with its Basel III reform initiatives. For example, also impacting DLO reporting is the recently issued Resolution 5038, which amends CMN Resolution 4958. It provides minimum requirements for regulatory capital (PR), Tier I and principal capital, and ACP. Methodology updates impact multiple requirements including:

- **RWA CAM: Related to exposures in gold, foreign currency, and assets subject to exchange variation whose capital requirement is calculated by a standardized approach**
- **RWA DRC: Related to credit-risk exposures of financial instruments classified in the trading book**
- **RWA CVA: Related to exposures to the risk of variation in the value of derivative financial instruments due to the variation in the credit quality of the debtor**

The pressure is on, both from deadline and future-proofing perspectives. Brazil's Basel-driven regulatory landscape will continue to become more complex. To address BACEN's changing Resolutions and DLO reporting requirements, firms will need to marshal coherent, transparent, and integrated functional and technical capabilities. This will enable them to gather and manage granular data, perform new classifications and calculations, and submit a clean, timely DLO report.

Firms must strategically address the global regulatory trend toward more diverse data, more granular data, and more frequent, reconcilable, and auditable reporting. Likewise, it is important to consider additional applications of underlying risk data inputs and resulting outputs. For example, a strategic view would encompass the notion that the same reconcilable granular dataset should be utilized to run optimizations, stress testing, what-if analyses, and related reporting.

Talk to us about your approach to BACEN Resolution 229, upcoming Resolutions, and DLO reporting. Adenza's end-to-end risk and regulatory reporting solutions on a single platform will stand up to examination/audit, drive data usage, operational efficiency and TCO reduction.

Fine tune your credit risk.

In Brazil, the pressure is on to address BACEN's changing Resolutions and DLO reporting that require more granular data, new classifications and calculations, and impact the bottom line. This calls for firms to have transparent, integrated functional and technical capabilities to smoothly navigate the complex Basel journey.

Contact Adenza about our end-to-end global risk and regulatory reporting solutions on a single platform.

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