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COMPARATIVE ANALYSIS OF THE BRAZILIAN AND NORTH AMERICAN SURVEILLANCE OF FINANCIAL SYSTEM REGULATION: A STUDY OF THE CURRENT AND IDEAL SCENARIOS.

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Comparative Analysis of the Brazilian and North American Surveillance of Financial System Regulation: A study of the Current and Ideal Scenarios.

Summary

1. Context

The world is in the midst of the worst financial crisis in the past seventy-five years. Two questions arise: Is the current regulation of the Brazilian Financial System the best among the possible options? Is the Brazilian Court of Audit (TCU) able to assess this regulation?

TCU is the Brazilian federal agency that has the legal authority to conduct performance audits in the federal government. Its job is similar to that of the U.S. GAO (Government Accountability Office).

TCU has defined its works in recent years within a strategic vision (Strategic Plan for 2011-2015). Its objectives have taken into consideration internal and external aspects of short term and long term goals to achieve the level of performance that society desires.

The recent global financial crisis has forced governments around the world to make emergent action (using public resources) to prevent economic collapse. The crisis is so disturbing, as even the economies with solid experience in regulating were not able to prevent this situation from happening.

The last IBGE's official report (Brazilian Statistical Agency) disclosed that the Brazilian GDP was R$ 4.403 trillion (Brazilian currency) in January of 2013. The total balance of credit operations of the financial system reached R$ 2,367 billion (Brazilian currency) in January of 2013, according to information from the Brazilian Central Bank (BCB). The credit / GDP ratio was 53.2% at this time. Therefore, because of the volume of credit in Brazil, it is worth studying auditing tools in financial regulation.

The aim of this paper is to compare the North American and Brazilian scenarios in financial regulation in order to propose practical methods that might be applied in supervising the financial system regulation conducted by TCU authority. As a result, the basis for the assessment of the effectiveness of this system was created.

2. Overview of American and Brazilian financial system

2.1 American Financial System

Both the federal and state governments regulate banking within the United States. The Federal Reserve System is composed of five parts:

a) The presidentially appointed Board of Governors (or Federal Reserve Board), an independent federal government agency located in Washington, D.C.;

b) The Federal Open Market Committee (FOMC), composed of the seven members of the Federal Reserve Board and five of the twelve Federal Reserve Bank presidents, who oversee open market operations, which is the principal tool of U.S. monetary policy;

c) Twelve regional Federal Reserve Banks located in major cities throughout the nation, which divide the nation into twelve Federal Reserve districts. The Federal Reserve Banks act as fiscal agents for the U.S. Treasury, and each has its own nine-member board of directors;

d) Numerous other private U.S. member banks, which own required amounts of non-transferable stock in their regional Federal Reserve Banks;

e) Various advisory councils.

The division of the responsibilities of a central bank into several separate and independent parts (some private and some public) results in a structure that is considered unique among central banks. It is also unusual that an entity (the U.S. Department of the Treasury) outside of the central bank creates the currency used.

2.2 Brazilian Financial System

The National Financial System of Brazil is formed by a set of institutions (for both financial and non-financial entities) intended for the management of monetary policy of the federal Government. It consists of supervisory entities and operators that act on the national market and it is monitored by three regulatory agencies: the National Monetary

Council (CMN), the National Council of Private Insurance (CNSP) and the National Council of Complementary Security (CNPC).

According to article 192 of the Brazilian Constitution: "the national financial system is structured in such a way as to promote the balanced development of the country and serve the interests of the collectivity, in all its component parts, including credit unions, will be regulated by complementary laws that will regulates, including the participation of foreign capital."

3. Regulation of American and Brazilian Banking System

The global financial system has been streamlining due to rapid and constant change. The opening to competition in financial markets, advances in technology and communications, the demand for more and better financial services and concentration in the banking sector are some factors that cause profound changes in the business environment.

Sensitive to the impact of these changes and the recommendations of the Basel Committee on Banking Supervision and the Financial Action Task Force (FATF), the supervisory bodies of most nations have gradually modified their policies and procedures into a highly prescriptive model.

3.1 Regulation of American Financial System

Bank regulation in the United States is highly fragmented compared with other G10 countries. While most of these countries have only one bank regulator, in the U.S., banking is regulated at both the federal and state level. American banking regulation addresses privacy, disclosure, fraud prevention, anti-money laundering, anti-terrorism, anti-usury lending, and the promotion of lending to lower-income populations.

3.1.1 Federal Reserve System

The Federal Reserve System is the central bank of the United States. It was founded by Congress in 1913 to provide the nation with a safer, more flexible, and more stable monetary and financial system. Over the years, its role in banking and the economy has expanded.

Nowadays, the Federal Reserve's duties fall into four areas:

a) Conducting the nation's monetary policy by influencing the monetary and credit conditions in the economy in pursuit of maximum employment, stable prices, and moderate long-term interest rates;
b) Supervising and regulating banking institutions to ensure the safety and soundness of the nation's banking and financial system and to protect the credit right of consumers;
c) Maintaining the stability of the financial system and containing systemic risk that may arise in financial markets;
d) Providing financial services to depository institutions, the U.S. government, and foreign official institutions, including playing a major role in operating the nation's payments system.

3.2 Regulation of Brazilian Financial System

In Brazil, there is only one Financial Regulatory Agency, the Brazilian Central Bank - BCB. According BCB, the Supervisory keeps in pace with the evolution of financial markets, adapting its objectives, principles and policies aligned with the best practices accepted internationally. It changed from a prescriptive to a prudential viewpoint; it shifts from a reactive stance to proactive one.

Thus, the emphasis is on risk assessment and consolidating, integration and continuous controls, encompassing activities for planning and supervision for classification, monitoring and inspection of supervised institutions.

3.2.1 Brazilian Central Bank

The Brazilian Central Bank is a federal authority and member of the National Financial System, being linked to the Ministry of Finance of Brazil. Like other central banks in the world, the Brazilian bank is one of the main monetary authorities of the country. Today, the Brazilian Central Bank performs the following functions:

a) monopoly on currency issuance;

b) government's banker;

c) bank of banks;

d) supervisor of the financial system;

e) monetary policy enforcer;

f) exchange rate policy executor and depositary of international reserves.

The structure of the Brazilian Central Bank is constituted by a Board of Directors (the Governor and seven Deputy Governors) and by headquarters linked either to the Governor or to one of the Deputy Governors, besides a special unit and regional management offices. The area linked to the Deputy Governor for Supervision (Difis) is formed by seven headquarters, namely:

a) Department of Bank and Banking Conglomerates Supervision (Desup):

b) Department of Union and Non-Banking Supervision (Desuc);

c) Department of Financial System Monitoring and Information Management (Desig);

d) Department of Control and Analysis of Punitive Administrative Processes (Decap);

e) Department of Prevention against Financial Illicit and Financial System Information (Decic)

f) Department of Control and Management of Supervision Planning (Decop);

g) Chief-Executive Office of Fiscal Relations (Gefis)

The BCB has a Banking Supervision Manual (SUM). This manual aims to give transparency to the principles, in the form of expertise and supervision activities, based on the regulatory environment and the existing legal framework. In order that the supervisory procedures are performed in standardized way, the Manual also formalizes, in the form of a set of scripts, working papers and supporting tools. In this study, we showed some parts of SUM.

3.2.1.1 BCB's Supervision Manual - SUM

SUM Objectives

The supervision objectives seek to ensure the soundness of the National Financial System (SFN) and the regular functioning of institutions supervised by the BCB. This process involves activities carried out by different areas at BCB. However, the Supervision Manual (SUM) is restricted to activities within the competence of the Surveillance (Difis). The SUM is structured into six chapters, which dealt with the following subjects:

a) Title 1 - Introduction: objectives and organization of the manual;

b) Title 2 - Scope of Supervision: National Financial System (SFN), legal and prudential aspects and the Brazilian Central Bank (BCB);

c) Title 3 - Supervision Overview: model, objectives and principles;

d) Title 4 - SFN Supervision Process: planning, activities and coactive instruments;

e) Title 5 - External Demands: attending to requests by authorities, denunciations, complaints and request for information; and

f) Title 6 - Information Management Process: collection, treatment and availability of information.

Supervision's of the National Financial System (SFN)

Structure

The National Financial Systems (SFN) functional structure is formed of two subsystems:

a) the normative one, which congregates the normative and supervisory entities, and

b) the operative one, formed by financial institutions, consortium administrators, other institutions authorized to operate by the Brazilian Central Bank, subsidiary bodies and enterprises regulated and monitored by other supervisory authorities.

The normative subsystem is formed by:

a) normative entities, responsible for the establishment of policies and norms applicable to SFN; and

b) supervisory entities, responsible for the execution of policies and norms established by the normative entities, as well as for surveillance of the SFN participating institutions. The SFN normative entities are:

a) National Monetary Council (CMN): responsible for the establishment of the guidelines of the monetary, credit and exchange policies;

b) National Council of Private Insurance (CNSP): responsible for defining the guidelines and policy norms on private insurances; and

c) National Council of Complementary Private Pension (CNPC): responsible for regulating the private pension scheme operated by pension funds.

The operative subsystem comprises:

a) Banking financial institutions: banks, Federal Savings Bank (CEF) and credit unions;

b) Non-banking financial institutions: incentive agencies, savings and loans associations, mortgage companies, credit, financing and investment, real estate credit, and microentrepreneur credit and mercantile leasing companies.

c) Institutions operating in the capital market, including the securities and bonds, and stock, mercantile and futures exchange brokerage and distribution companies;

d) Institutions operating in the foreign exchange market, including the authorized FX brokerage houses, tourist agencies and means of accommodation and administrators of international coverage credit cards;

e) Insurance and capitalization companies and private social security entities, linked to the Social Security and Insurance Systems;

f) Entities administering third-party resources, such as those managing investment funds and consortium administrators; and

g) Entities providing regulated financial services, such as those of clearance and settlement and custody of bonds, in support of the financial markets.

Legal and Regulatory Competencies

The action by the Brazilian Central Bank with supervised institutions is a consequence of the strict compliance with the laws, which vest it with such competencies. The principal one, of conducting the National Financial System (SFN), is given by law 4,595, of December 31, 1964, which created the National Monetary Council (CMN) and the BCB.

Models of Supervision

Alert to the impact of changes and the recommendations of the Basel Committee on Banking Supervision and of the Group on Financial Action (FATF/GAFI), the supervisory entities of most countries gradually altered their policies.

In Brazil, according to BCB, Supervision migrated from a prescriptive perspective to another of prudential nature, transiting from a reactive to a proactive posture.

Objectives of Supervision

Introduction

In the exercise of its legal competence of the Brazilian Central Bank, the Supervision has as a mission to act with a view to ensuring the soundness of the National Financial System (SFN) and regulating the functioning of the supervised entities. For this goal, it aims:

a) to assess the supervised institutions as regards the risks assumed and their management capacity within the regulatory and prudential limits;

b) to verify the compliance with the specific norms of their competence, so that the supervised institutions act in conformity with the laws and regulation;

c) to stimulate the divulgation of information by the supervised institutions, with a view to improved practices of corporate governance in the aspects of transparency and equity in the relationship with the market stakeholders;

d) to prevent the utilization of the financial system for the transit of resources originating form the practice of financial illicit acts, money laundering and financing of terrorism;

e) to respond to denunciations, complaints and requests for information.

Principles of Supervision

Introduction

The Supervision Activities are based on the following principles:

a) supervision focused on risk;

b) continuous supervision; and

c) transparency.

Supervision Programming Elaboration

The planning of activities is done based on diverse sources, such as:

a) macroeconomic scenario;

b) guidelines and orientation by the director of Surveillance and the departments chiefs;

c) results of previous work of supervised institutions;

d) Risk Assessment and Control System SRC

e) monitoring; and

f) information from other areas of the Brazilian Central Bank (BCB), international supervision bodies, government entities, independent audit and the press. Once the activities are prioritized and adapted according to available resources, the planning of programming is concluded with its ratification by the chief of each department of Supervision and its communication to the Collegiate Board of BCB by the Surveillance director.

Supervision Programming Monitoring and Control

The monitoring and control of Supervision programming are conducted by means of the periodic elaboration of reports published on the Difis Portal or forwarded by e-mail to those responsible, dealing with the following situations:

a) non-ratified activities;

b) activities with delayed initiation;

c) ongoing activities with duration longer than foreseen;

d) designation of servants in activities;

e) modifications in planned activities;

f) servants designated to more than one activity;

g) servants with periods with designation in activities;

h) utilization of working days x men in activities and in absences.

Monitoring

The National Financial System (SFN) monitoring, for purposes of supervision of financial institutions and other institutions authorized to operate by the Brazilian Central Bank, consists of the monitoring of the accounting and of the market risks, liquidity, credit, image of the mentioned institutions and, above all, for studies and monitoring of the financial stability and systemic risk.

Monitoring of the Economic-Financial Situation of Banking and Non-Banking Institutions and Credit Unions

The monitoring of the economic-financial situation aims to follow-up systematically the available information, with the purpose of timely detecting situations or events which fall away from the expected standard behavior, both in terms of regulation and of risk assessment.

Operational Limits

The monitoring of operational limits aims to follow up on the compliance, by the financial institutions, by the other institutions authorized to operate by the Brazilian Central Bank and by consortium administrators, with the operational limits established in normative documents, ensuring the healthiness of the National Financial System (SFN), by means of :

a) the identification of tendencies for the system and for the institutions individually;

b) the verification of conformity with the prudential requisites or limits of individual debtors.

Monitoring of risks

The monitoring of risks inherent to the activities of financial institutions consist of the follow-up of risks incurred by the institutions, by their segments and by the financial system as a whole. It comprises the monitoring of risks of credit, liquidity, market and system risk.

Monitoring of Securities Market

The monitoring of stocks and operations occurred in the context of registration and financial settlement systems is conducted by means of own methodologies. The monitoring of stocks enable identifying inconsistencies between the information rendered by the financial institutions through their balance sheets and the independent information obtained from the registration systems, attesting to the quality of the data received. The monitoring of operations consist of the identification of businesses carried out in standards different from those observed on the market.

Monitoring of Foreign exchange market

The monitoring of the exchange market aims to provide information on the operations carried out in foreign currency or international transfers in *reais* by the institutions with a view to enabling the understanding of its functioning by the supervision and subsidizing studies for decision-making. Besides, it seeks to mitigate the risk of undue utilization of the financial system.

Entities liable to Surveillance Supervision

Inspection

The inspection is an essential element of the process of supervision to assess in objective and comprehensive manner the economic and financial situation, matters or relevant areas of the institution/conglomerate, and it can be undertaken both at the institution's own offices and at a distance, in the cases where the physical presence is not necessary.

The inspection aims to identify and assess the risks and controls inherent to each area or activity of the institution, as well as of the performance of the higher management in the maintenance of the soundness and the regular functioning of the entity.

In planning the inspection, the strategy of supervision must consider the characteristics of the institution (type, size, complexity, among others) and the objectives of the assessment, and decision may fall upon the carrying out of inspection based on the Risk and Control Assessment System (SRC) or on the Special Verification (VE).

Monitoring

Monitoring of the institutions, carried out in a segmented and individual manner, is a constituent activity in the process of supervision of the entities liable to surveillance.

The monitoring of segments is carried out by means of technical studies of general subjects applicable to the group of supervised institutions, the result of which is the dissemination of guidelines and criteria, as well as the proposal of specific supervisory actions.

The monitoring of segments must promote the development and dissemination of specialized knowledge, standardization of procedures and of uniform criteria.

The individualized monitoring of the institutions is carried out in a continuous way and complementary to inspection, with the aim of assessing the soundness of the entity, the compliance with norms, regulations and with operational limits, the risks associated to the activities developed by the institutions, the adoption of regulating and cleansing measures, as well as the identification of situations to be verified.

Public Attendance and monitoring of the attendance

The Brazilian Central Bank makes available to society the service of attendance to citizen's denunciations and complaints and information rendering. The registrations can be made personally at the Bank´s headquarters and at BCB´s regional representations or by a specific toll-free telephone line, by mail or through a form available on BCB´s page on the internet.

Disciplinary and Punitive Instruments

The Brazilian Central Bank have, at its disposal, disciplinary and punitive instruments to curb irregular practices, implement measures of an educative nature and confront situations which place the National Financial System (SFN) at risk. They are:

a) administrative punitive process (disciplinary action);

b) Injunction orders;

c) Commitment Letter;

d) Classification of supervised institutions as "in evidence".

Punitive Administrative Process (Disciplinary Action)

The Brazilian Central Bank is vested with legal power to file an administrative punitive process (lawsuit) upon verification of infringement to legal or regulatory norm on the part of:

a) supervised institutions;

b) auditing companies and independent auditors, as it comes to the auditing of the supervised institutions.

Provisional Remedies

The provisional remedies constitute limitations to the actions by the indicted during the verification of responsibilities.

Attendance Order

The Attendance Order is applied with the invitation of the legal representatives of the supervised institution and, in case deemed necessary, of its controllers, to inform about the measures, which they will adopt with a view to regulating the following situations:

a) noncompliance with the minimum capital standards, as well as inobservance of operational limits, according to prevailing regulatory provisions;

b) liquidity crisis which, by its seriousness, may place at risk the continuity of the supervised institution;

c) serious situation of internal controls, which compromise or may compromise the indispensable conditions for functioning of the institution;

d) serious deficiencies or procedures, the continuity of which compromises or may compromise the regular functioning of the supervised institution, in view of the risks of legal, operational, of reputation and of image nature.

“Recurring” Situation

The supervised institutions, which present the need for specific monitoring on the part of Supervision, are classified as ``Recurring´´ Situations. This is a consequence of observed situations, which compromise or may compromise of the indispensable conditions for regular functioning, such as the noncompliance of minimum standards of capital, serious situation of the internal controls, liquidity crises or other deficiencies of a serious nature.

Application of Penalties on Rendering of Information

The activity consists in the detection of irregularities observed in the process of information rendering to the Brazilian Central Bank (BCB) by the supervised institutions, in application of penalties, when due, and analysis of resources and in the managerial control of the activity.

Application of penalties

The application of penalties on the rendering of information to BCB derives, among other reasons, from not rendering the information and from the rendering of information or its substitution out of the established time periods.

Managerial control of penalties

The objective of the activity is the centralized managerial control of the penalties applied by the subcomponents of the Department of National Financial System Surveillance and Information Management (Desig) to the institutions supervised by BCB, in the rendering of information.

External Demands - Attendance to the Executive, Legislative, and Judiciary Branches

The Brazilian Central Bank receives demands from representatives of the legislative, executive and judiciary branches in the federal, state and municipal contexts.

The Supervision supplies information, answers questions, clarifies facts and takes measures, always observing the restrictions of secrecy of the information established by Complementary Law 105, January 10, 2001, consulting, as necessary, the Attorney-General of the Brazilian Central Bank.

Demands from the Judiciary Branch

The demands from the Judiciary regarding the blocking of value, unblocking and transfer of blocked value, as well as requests for information about the existence of accounts, financial investments, addresses, balances and movements of customers of commercial banks, multiple banks, investment banks and savings banks are attended mainly by Bacenjud 2.0 - System Support to the Judiciary.

The BacenJud is a computerized system, developed and released by the BCB in the international network of computers that allows the judge to forward its own determination or request information.

Demands from the Legislative Branch

The requests from the Parliamentary Inquiry Commissions (CPIs and CPMIs) directed to BCB are treated electronically with the financial institutions, which are responsible for providing the information directly to the requestor. Other demands are responded case by case, according to its object.

Information Management Process

The Brazilian Central Bank makes efforts to collaborate with the establishment of a scenario of equilibrium, stability, and transparency of the financial market.

In this sense, one searches the excellence in the information obtained so that it is internally available to supervision and other concerned areas, to the financial market and to the society in general.

In order for it to serve its intended purposes, the information must be submitted by the supervised entities in a standard format and in regular intervals, enabling thereby the analysis and control of quality.

The adequate treatment of information and of its disclosure in a systemic, reliable and timely manner, are fundamental inputs for the development of supervision tasks and, above all, subsidization of the decision making process and transparency for society.

Information Management

The information management of corporate interest to the Brazilian Central Bank comprises of the following: gathering of information, application of penalties, treatment or verification of the consistency of the databases, the disclosure of the information, granting of authorizations and credentials for access to the databases and the management of agreements for exchange of information with other bodies.

Authorizations and Credentials

For the receipt of some data and/or information, it is necessary to Grant authorization for the accrediting of users in the diverse transactions of the Central Bank Information System (Sisbacen).

Management of Agreements

In order to better monitor the development of financial market operations, the process of management of information entails the undertaking of information exchange agreements with other bodies of the public administration, such as the Brazilian Federal Revenue (RFB), the Securities and Exchange Commission (CVM), the Superintendence of Private Insurances (Susep), and the Secretariat of Complementary Social Security (SPC). These agreements also aim to propitiate the necessary conditions for joint measures on the surveillance of the financial system.

Consistency of databases and disclosure of information

The management of information related to the Brazilian Central Bank includes the treatment of information for quality verification. Referred verification comprises the crossing of information from different databases in order to check for data of the same nature, use of statistical models and other procedures which aim to ensure the quality of the whole of the bases managed by the Department of Financial System Surveillance and Information Management (Desig).

Synthetically, within the scope of this study, we showed activity of the FED and the BCB on banking supervision.

4. Principles, guidelines, and global trends in Banking regulatory systems

4.1 The Basel Agreement and the Brazilian Central Bank

Since its creation in 1930, the Bank for International Settlements (BIS) acts as a cooperation agent for the central banks, providing emergency financial allocation in case of crises which may threaten the international financial system as a whole.

In 1975 was established the Basel Committee on Banking Supervision (BCBS), linked to the BIS and formed by the central banks of the banks integrating the Group of the Ten (G10). Today, it is formed by representatives of supervision authorities and of the central banks of many countries.

In 1988, BCBS publicized the first Basel Capital Agreement, officially denominated International Convergence of Capital Measurement and Capital Standards, with the objective of establishing minimum requirements of capital for financial institutions, as a way of confronting credit risk.

In Brazil, the 1988 Agreement was implemented by means of Resolution 2,099, of August 17, 1994. It introduced in the country the minimum capital requirement for financial institutions, which vary according to the degree of risk of its active operations.

In 1996, the Committee published an amendment to the 1988 Agreement, incorporating to the capital requirement one installment for coverage of market risks (1996 Amendment).

4.2 The New Basel Capital Agreement and the BCB

In 2004, the BCBS publicized the revision of the Basel Capital Agreement, known as Basel II, with the objective of seeking for a more accurate measure of the various risks incurred by the internationally active banks.

The new agreement focuses on the large scale banks, internationally active, taking as the basis, besides the Essential Principles for Efficient Banking Supervision (Basel Principles), three mutually complementary pillars:

a) Pillar 1: capital requirements;

b) Pillar 2: revision by the supervision of the process of banking capital adequacy; and

c) Pillar 3: market discipline.

The implementation of the New Basel Capital Agreement in the country is being conducted in a gradual manner. The first formal manifestation of the Brazilian Central

Bank in the sense of its adoption took place by means of Communiqué 12,746, of December 9, 2004, through which was established a simplified schedule with the main phases to be followed by the adequate implementation of the new capital structure.

4.3 Basel III and the BCB

According to the Bank for International Settlements, “Basel III” is a comprehensive set of reform measures, developed by the Basel Committee on Banking Supervision, to strengthen the regulation, supervision and risk management of the banking sector. These measures aim to:

- improve the banking sector's ability to absorb shocks arising from financial and economic stress, whatever the source;

- improve risk management and governance;

- strengthen banks' transparency and disclosures.

The reforms target:

- bank-level, or microprudential, regulation, which will help raise the resilience of individual banking institutions to periods of stress;

- macroprudential, system wide risks that can build up across the banking sector as well as the procyclical amplification of these risks over time.

These two approaches to supervision are complementary as greater resilience at the individual bank level reduces the risk of system wide shocks.

According BCB, the Basel III rules related to the definition of capital and regulatory capital requirements were implemented through four national monetary Council resolutions (resolution nº 4,192/2013; nº 4,193/2013; nº 4,194/2013; and nº. 4,195/2013).

4.4 The BCB and agreements with organizations and institutions

For the improvement of the processes of supervision of financial institutions and conglomerates, whose businesses encompass subsidiary entities in other countries, various procedures are adopted, such as:

a) Elaboration of supervision agreements with foreign authorities;

b) Monitoring of activities of international organizations in matters related to supervision;

c) Exchange of information with foreign supervision authorities;

d) Coordination, support an follow-up of missions by foreign supervisors in the country;

e) Dissemination of the Brazilian supervision to the international context.

Pursuant to the recommendations of the Basel Supervision Committee, contained in the document The Supervision of Cross-Border Banking, of October 1996, the Brazilian Central Bank has struggled to carry out cooperation agreements with banking supervision bodies from other countries.

5. "Core Principles for Effective Banking Supervision" of Basel Committee on Banking Supervision

According to the Bank for International Settlements – BIS, the Basel Committee on Banking Supervision has completed its review of the October 2006 Core principles for effective banking supervision and the associated Core principles methodology. The revised Core Principles were endorsed by banking supervisors at the 17th International Conference of Banking Supervisors held in Istanbul, Turkey, on 13-14 September 2012.

Both the existing Core Principles and the associated assessment methodology have served their purpose well in terms of helping countries to assess their supervisory systems and identify areas for improvement. While conscious efforts were made to maintain continuity and comparability to the extent possible, the revised document combines the Core Principles and the assessment methodology into a single comprehensive document.

Important enhancements have been introduced into the individual Core Principles, particularly in those areas that are necessary to strengthen supervisory practices and risk management. As a result, certain "additional criteria" have been upgraded to “essential criteria", while new assessment criteria were warranted in other instances. Close attention was given to addressing many of the significant risk management weaknesses and other vulnerabilities highlighted in the financial crisis. In addition, the review has taken account of several key trends and developments that emerged during the last few years of market turmoil:

- the need for greater supervisory intensity and adequate resources to deal effectively with systemically important banks;
- the importance of applying a system-wide, macro perspective to the microprudential supervision of banks to assist in identifying, analyzing and taking pre-emptive action to address systemic risk; and
- the increasing focus on effective crisis management, recovery and resolution measures in reducing both the probability and impact of a bank failure.

The Committee has sought to give appropriate emphasis to these emerging issues by embedding them into the Core Principles, as appropriate, and including specific references under each relevant Principle.

In addition, sound corporate governance underpins effective risk management and public confidence in individual banks and the banking system. Given fundamental deficiencies in banks' corporate governance that were exposed during the crisis, a new Core Principle on corporate governance has been added by bringing together existing corporate governance criteria in the assessment methodology and giving greater emphasis to sound corporate governance practices.

Similarly, the Committee reiterated the key role of robust market discipline in fostering a safe and sound banking system by expanding an existing Core Principle into two new ones dedicated respectively to greater public disclosure and transparency, and enhanced financial reporting and external audit.

The Core Principles for Effective Banking Supervision (Core Principles) are the *de facto minimum* standard for sound prudential regulation and supervision of banks and banking systems. Originally issued by the Basel Committee on Banking Supervision (the Committee) in 1997, they are used by countries as a benchmark for assessing the quality of their supervisory systems and for identifying future work to achieve a baseline level of sound supervisory practices.

The Core Principles are also used by the International Monetary Fund (IMF) and the World Bank, in the context of the Financial Sector Assessment Programme (FSAP), to assess the effectiveness of countries' banking supervisory systems and practices.

Structure of Core Principles

The preceding versions of the Core Principles were accompanied by a separate assessment methodology that set out the criteria to be used to gauge compliance with the Core Principles. In the last revision, the assessment methodology has been merged into a single document with the Core Principles reflecting the essential interdependence of Core Principles and Assessment Criteria and their common usage.

The Core Principles have also been reorganized: Principles 1-13 address supervisory powers, responsibilities and functions, and Principles 14-29 cover supervisory expectations of banks, emphasizing the importance of good corporate governance and risk management, as well as compliance with supervisory standards. This re-ordering highlights the difference between what supervisors do themselves and what they expect banks to do.

Assessment of Core Principles

The Core Principles establish a level of sound supervisory practice that can be used as a benchmark by supervisors to assess the quality of their supervisory systems.

Essential criteria set out minimum baseline requirements for sound supervisory practices and are of universal applicability to all countries. An assessment of a country against the essential criteria must, however, recognize that its supervisory practices should be commensurate with the risk profile and systemic importance of the banks being supervised. In other words, the assessment must consider the context in which the supervisory practices are applied. The concept of proportionality underpins all assessment criteria even if it is not always directly referenced.

Effective banking supervisory practices are not static. They evolve over time as lessons are learned and banking business continues to develop and expand. Supervisors are often swift to encourage banks to adopt “best practice” and supervisors should demonstrably “practice what they preach” in terms of seeking to move continually towards the highest supervisory standards.

To reinforce this aspiration, the additional criteria in the Core Principles set out supervisory practices that exceed current baseline expectations but which will contribute to the robustness of individual supervisory frameworks. As supervisory practices evolve, it is expected that upon each revision of the Core Principles, a number of additional criteria will migrate to become essential criteria as expectations on baseline standards change. The use of essential criteria and additional criteria will, in this sense, contribute to the continuing relevance of the Core Principles over time.

It is important to bear in mind that some tasks, such as a correct assessment of the macroeconomic environment and the detection of the build-up of dangerous trends, do not lend themselves to a rigid compliant/non-compliant structure. Although these tasks may be difficult to assess, supervisors should make assessments that are as accurate as possible given the information available at the time and take reasonable actions to address and mitigate such risks.

While the publication of the assessments of jurisdictions affords transparency, an assessment of one jurisdiction will not be directly comparable to that of another. First, assessments will have to reflect proportionality. Thus, a jurisdiction that is home to many SIBs will naturally have a higher hurdle to obtain a “Compliant” grading versus a jurisdiction which only has small, non-complex deposit-taking institutions.

Second, with the last version of the Core Principles, jurisdictions can elect to be graded against essential criteria only or against both essential criteria and additional criteria. Third, assessments will inevitably be country-specific and time-dependent to varying degrees.

Therefore, the description provided for each Core Principle and the qualitative commentary accompanying the grading for each Core Principle should be reviewed in order to gain an understanding of a jurisdiction's approach to the specific aspect under consideration and the need for any improvements. Seeking to compare countries by a simple reference to the number of "Compliant" versus "Non-Compliant" grades they receive is unlikely to be informative.

From a broader perspective, effective banking supervision is dependent on a number of external elements, or preconditions, which may not be within the direct jurisdiction of supervisors. Thus, in respect of grading, the assessment of preconditions will remain qualitative and distinct from the assessment (and grading) of compliance with the Core Principles.

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

On April 2012, the paper that analyzed Brazil's Observance of Basel Core Principles for Effective Banking Supervision was completed. In this study, it will expose only key findings.

According to this paper, Brazil has a well-defined banking supervision process supported by a legal framework that grants the Brazilian Central Bank (BCB) broad enforcement powers for corrective action and weak bank resolution.

Although the BCB operates on an independent mode, there are amendments to Law 4595/1964 (Banking Law) that would aid in protecting the continuation of the operational independence.

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

This paper concluded: a) the Brazilian financial system is large, concentrated, and highly interconnected domestically; b) the banking system reports high levels of capitalization, liquidity and profitability; c) relative to peers, the Brazilian banking system is less globally integrated; d) Brazil has built a strong macroeconomic framework, increasing policy credibility and resilience to external shocks.

Regarding the preconditions for effective banking supervision: a) the Brazilian legal framework provides adequate support for banking supervision; b) the positive performance of the Brazilian economy, even after the worsening of the global crisis in the second semester of 2008 reflects the efforts of consolidating macroeconomic fundamentals; c) considerable improvements to the debt collection regulation have been implemented; d) the Federal Accounting Council (CFC) has the responsibility for publishing technical and professional accounting and auditing norms; e) auditors that provide services to institutions supervised by the BCB, are subject to stringent independence criteria; f) banks are required to disclose accounting, prudential and other types of information; g) in Brazil, deposit insurance is carried out by the Credit Guarantee Fund (FGC); h) the maximum value guaranteed by the FGC is R$ 70 thousand.

5.1.1 Main findings

The main recommendations of the 2002 FSAP with respect to banking supervision were largely addressed. A significant enhancement was made to the banking supervision planning process. Risk and Control Assessment System (SRC) involves a process that assigns an overall risk rating to each institution based on quantitative and qualitative measures.

About the objectives, independence, powers, transparency, and cooperation that paper listed these findings: a) formal aspects of independence, although operationally the BCB functions efficiently and without evidence of interference; b) hiring is based on civil service entry examinations for entry level positions, but the process could be modified to grant the BCB further flexibility.

Regarding the licensing and structure, the analyze found: a) the licensing process has been enhanced and recommendations of the 2002 BCP review implemented; b) although the Banking Law requires banks to obtain the prior approval of the BCB to invest in any company, in practice this has not been done.

About the prudential regulation and requirements: a) implementation of Basel II began in 2007; b) since June 2010 banks have been allowed to apply for the use of internal models for market risk; c) consultations are now underway for the gradual phase-in of Basel III; d) collection of country risk data has been expanded and cross-border exposures are not significant; e) a comprehensive legal framework and supervisory process is in place for anti- money laundering/combatting financial terrorism (AML/CFT); f) requirements for risk management oversight and structures are comprehensive, include conservative assumptions, and linked to capital adequacy determination; g) banks are required to implement adequate internal controls for their activities and must be in compliance with the relevant legal norms and regulations.

Regarding the Supervisory Process and Accounting and Disclosure: a) the BCB carries out rigorous, intrusive risk based supervision. Processes are well developed based on extensive information and analytically intensive; b) the supervisory process leverages its information systems to increase the efficiency of its supervisory staff; c) state-banks are systemically significant and are subject to the same supervisory process as private institutions; d) continuous monitoring leverages information from several sources including banks' regulatory reporting and data links with clearing houses and registrars; e) the onsite department is configured into teams responsible for designated institutions or groups of institutions as well as specific risks.

About the accounting and disclosure, banks are required to comply with BCB established regulatory accounting standards and to appoint a director specifically responsible for compliance with the required standards, basic accounting principles, and professional ethics and banking secrecy rules.

Regarding the corrective and remedial powers of supervisors: a) enforcement powers are broad and have been significantly enhanced with the issuance of Resolution 4019; b) a number of examples of enforcement cases were reviewed and the proactive nature of the BCB was evident; c) Brazilian corporate law requires companies to pay a minimum of 25 percent of profits as dividends for preferred shares.

About the consolidated and cross-border banking supervision: a) the BCB has broad authority to conduct consolidated supervision; b) consolidated supervision is primarily based on the information compiled at the parent bank level in order to manage the risks and controls across the group; c) through supervisory colleges and on a bilateral basis, the BCB collaborates with home-host supervisors.

5.2 United States: Publication of Financial Sector Assessment Program Documentation— Detailed Assessment of Observance of Basel Core Principles for Effective Banking Supervision

In this study, we showed only the main findings. It was based on the information available at the time it was completed in May 7, 2010.

The assessment of the United States against the Basel Core Principles (BCPs) was undertaken in the immediate aftermath of a period of extreme market stress and continued general economic downturn. At the time of the assessment, a wide-ranging set of legislative reform proposals had already been developed by the U.S. Treasury Department to address the weaknesses identified by the financial crisis; these reforms are designed to have a broader reach than the issues noted above.

The assessment of the current state of the U.S. implementation of the Basel Core Principles for Effective Banking Supervision has been completed as part of a Financial Sector Assessment Program undertaken by the International Monetary Fund during October–November 2009, and reflects the regulatory and supervisory framework in place as of the date of the completion of the assessment.

The U.S. financial structure is fundamentally different from some countries, in that it has advanced and well-developed capital markets, and diverse sources of credit; this means that the banking system in a traditional sense is a smaller part of the broader financial system. The approach taken by the assessors in assessing BCP compliance has been to examine whether the four Federal banking agencies (FBAs)—the Federal Reserve, the OCC, the OTS, and the FDIC—by themselves provide sufficiently effective supervision to meet the requirements of the BCPs. The use of holding company structures to own and operate banks is a fundamental component of the U.S. banking system, and this is recognized within the banking supervisory arrangements that have been established.

The U.S. financial system is large and highly diversified. At end-2007, total U.S. financial assets amounted to almost four and a half times the size of GDP. The crisis has radically changed the shape of the U.S. financial system in a short timeframe. After the crisis, asset quality has continued to deteriorate, despite an aggressive policy of loan loss provisioning. After a sharp contraction, the U.S. economy appears to have hit bottom in the second quarter of 2009 and is showing signs of recovery, although underlying economic activity remains weak. GDP declined by 6.4 percent in 2009 Q1 and 0.1 percent in Q2 at an annual rate. Looking ahead, the near-term outlook is for the gradual recovery to continue, albeit slower than the typical recovery in previous cycles, with growth returning to a lower trend only in mid-2010. Looking to the medium term, the post-crisis trend rate of U.S. growth is expected to be lower than the pre-crisis trend.

5.2.1 Main Findings

About the objectives, independence, powers, transparency, and cooperation: a) the multiplicity of agencies is a striking feature of the U.S. supervisory system; b) another striking feature of the U.S. system is the general absence of detailed, clearly stated objectives and mandates for each agency in the agency's original governing statutes, which are common features of laws in some other countries; c) in addition, the fundamental issue of interaction between the supervisory focus on the bank/thrift versus the holding company/group also needs to be addressed; d) federal banking agencies (FBAs) have a strong tradition of authority and accountability for supervisory matters being vested in those in charge of the supervision of individual banks and holding companies.

Regarding the licensing and structure, somewhat unusually, banks have some degree of choice over their regulator. This is largely due to the existence of a dual banking structure—involving state and Federal charters—and multiple federal regulators.

About the prudential regulation and requirements: a) the U.S. system is still on the Basel I risk-based capital framework, though the advanced approaches of Basel II have been enacted and will apply to the major banks over the next 2–3 years; b) severe shortcomings in bank risk management have been revealed in the recent crisis and supervisory oversight was not effective in identifying those weaknesses and having them remedied; c) these weaknesses resulted partly from the confluence of credit (including counterparty credit), market, and liquidity risk under extreme conditions; d) the FBAs have well-developed policies and processes to regulate and supervise traditional credit risk; e) linking monitoring to effective action will require a more comprehensive, shared, coordinated, and strategic approach to supervisory and regulatory enhancements than that presented to the assessors; f) the crisis has also revealed material weaknesses in market risk monitoring and management by financial institutions; g) FBA guidance on liquidity risk management and supervision is consistent with existing international standards and is likely to evolve in the near term due to pending interagency liquidity guidance and Basel liquidity standards; h) supervision of operational risk appears to be effective overall, although some greater focus and specialization might be beneficial, perhaps learning from Basel II experience; i) supervision of interest rate risk—an issue which is of increasing importance in the current environment—is broadly consistent across the FBAs in most material respects; j) banks maintain comprehensive programs, policies and procedures to reduce the risk of endangering the safety and soundness of the bank through abuse of its operations and services, including physical safety.

Regarding the methods of ongoing banking supervision: a) the FBAs collectively have broad, but not unlimited, legal authority to regulate and supervise banks and holding companies subject to their jurisdiction; b) individually, each of the FBAs employs standard supervisory techniques in a broadly consistent manner; c) the FBAs consider that the uniform CAMELS framework and their own separate supplementary risk rating systems serve two distinct purposes, and when combined, provide more complete information than either would provide individually about the condition and evolution of the industry; d) the recent market turmoil has highlighted important areas where regulatory oversight and coordination need to be strengthened.

About the accounting and disclosure: a) the U.S. agencies provide for extensive disclosure of financial information by regulated banks and holding companies; b) in discussions with supervisory staff, the decision to align regulatory reporting with U.S. GAAP, particularly with respect to the allowance for loan losses, was repeatedly criticized.

Regarding the corrective and remedial powers of supervisors: a) generally, the FBAs identify problems during on-site and off-site examinations; b) the FBAs have a range of supervisory options when a bank or holding company is not complying with laws, regulations or supervisory decisions, or is engaging in unsafe and unsound practices; c) a PCA regime applies to those instances in which a bank's capital falls below the prescribed minimum ratios/levels.

About the consolidated and cross-border banking supervision: a) the existing legislation for consolidated supervision needs to be strengthened; b) the FBAs have clear authority to share confidential supervisory information with foreign banking and other sector supervisors.

6. U.S. Government Accountability Office

The U.S. Government Accountability Office (GAO) is an independent, nonpartisan agency that works for Congress. Often called the "congressional watchdog," GAO investigates how the federal government spends taxpayer dollars.

Its mission is to support Congress in meeting its constitutional responsibilities and to help the performance and ensure government accountability. It provides Congress with timely information that is objective, fact-based, nonpartisan, nonideological, fair, and balanced.

Its core values are accountability, integrity, and reliability. It operates under strict professional standards of review and referencing; all facts and analyses in its work are thoroughly checked for accuracy.

Its work is done at the request of congressional committees or subcommittees or is mandated by public laws or committee reports. It also undertakes research under the authority of the Comptroller General. According to the GAO website, it supports congressional oversight by:

a) auditing agency operations to determine whether federal funds are being spent efficiently and effectively;

b) investigating allegations of illegal and improper activities;

c) reporting on how well government programs and policies are meeting their objectives;

d) performing policy analyses and outlining options for congressional consideration;

e) issuing legal decisions and opinions, such as bid protest rulings and reports on agency rules.

GAO advises Congress and the heads of executive agencies about ways to make government more efficient, effective, ethical, equitable and responsive.

The Federal Banking Agency Audit Act, enacted in 1978 as Public Law 95-320 and 31 U.S.C. section 714 establish that the Board of Governors of the Federal Reserve System and the Federal Reserve banks may be audited by the GAO.

The GAO has authority to audit check-processing, currency storage and shipments, and some regulatory and bank examination functions; however there are restrictions to what the GAO may audit. Audits of the Reserve Board and Federal Reserve banks may not include:

a) transactions for or with a foreign central bank or government, or nonprivate international financing organization;

b) deliberations, decisions, or actions on monetary policy matters;

c) transactions made under the direction of the Federal Open Market Committee; or

d) a part of a discussion or communication among or between members of the Board of Governors and officers and employees of the Federal Reserve System related to items (a), (b), or (c).

6.1 GAO's Auditing Methodology

The Yellow Book

The Generally Accepted Government Auditing Standards, also known as the Yellow Book, provide a framework for conducting high quality audits with competence, integrity, objectivity, and independence. The Yellow Book is for use by auditors of government entities, entities that receive government awards, and other audit organizations.

The Green Book

An organization employs internal control standards to ensure effective resource use in fulfilling its mission and strategic plan. GAO's Standards for Internal Control in the Federal Government, known as the Green Book, sets plans, methods, policies, and procedures for federal agencies.

GAO/PCIE Financial Audit Manual (FAM) – Volume 1, 2, and 3

In July 2001, the GAO and the President's Council on Integrity and Efficiency (PCIE) jointly issued the GAO/PCIE Financial Audit Manual (FAM). The FAM presents a methodology to perform financial statement audits of federal entities in accordance with professional standards. The last major revisions to the FAM were issued in July 2004. GAO and the PCIE have now updated the FAM for significant changes in auditing financial statements in the federal government since 2004.

To help the FAM continue to meet the needs of the federal audit community and the public it serves, GAO and the PCIE created a joint FAM Working Group. The Group is comprised of auditors from GAO and several Offices of the Inspectors General with experience conducting audits of federal entity financial statements. Through a collaborative effort, the FAM Working Group has prepared exposure drafts of a revised FAM that updates the audit methodology (Volume 1), provides audit tools (Volume 2), and presents new accounting, reporting, and disclosure checklists (Volume 3).

Volume 1 – Final GAO/PCIE Financial Audit Manual (July, 2008) GAO-08-585G

On October 5, 2007, that group issued an exposure draft of FAM Volume 1 (audit methodology) for a public comment period that ended January 31, 2008 (GAO-08-81G). The group considered public comments and issued this final version.

- Section 100 - Table of Contents, Introduction

- Section 200 - Planning
- Section 300 - Internal Control
- Section 400 - Testing
- Section 500 - Reporting
- Section Appendixes - Appendixes, Glossary, Abbreviations, Index

Volume 2 – Final GAO/PCIE Financial Audit Manual (July, 2008) GAO-08-586G

On October 5, 2007, that group issued an exposure draft of FAM Volume 2 (audit tools) for a public comment period that ended January 31, 2008 (GAO-08-82G). After the group considered public comments, it issued this final version.

- Section 600 - Planning and General
- Section 700 - Internal Control
- Section 800 - Compliance
- Section 900 - Substantive Testing
- Section 1000 - Reporting

Volume 3 - Final GAO/PCIE Financial Audit Manual (August 28, 2007) GAO-07-1173G

On June 29, 2007, the group issued an exposure draft of FAM Volume 3 (checklists) for a comment period that closed on July 30, 2007 (GAO-07-313G). The group then considered public comments before it issued this final version.

7. Brazilian Court of Audit - TCU

The Brazilian Court of Audit (TCU) audits the accounts of administrators and other persons responsible for federal public funds, assets, and other valuables. The Court also audits the accounts of any person who may cause loss, misapplication, or other irregularities that may cause losses to the public treasury. Such administrative and judicative authority, among others, is provisioned in art. 71 of the Brazilian Constitution.

The Court has a Secretariat that provides the necessary technical and administrative support in order for the Court to carry out its constitutionally and legally mandated attributions. The Secretariat is divided into several units.

7.1 Jurisdiction

Under the Brazilian Federal Constitution, the Court has jurisdiction over any individual or public or private legal entity that uses, raises, guards, manages, invests or administers federal public funds, assets and valuables or those which are under Union responsibility. Those who take on pecuniary obligations on behalf of the Union are likewise under its jurisdiction.

Also included are those who cause loss, misplacement or other forms of irregularity that result in losses to the public treasury.

7.2 Attributions

The TCU official attributions are established under some articles of the Brazilian Federal Constitution. The following is a summary of attributions related to this paper:

Art. 71, IV: To conduct inspections and audits on its own initiative or as requested by the National Congress.

Art. 74, § 2: To investigate accusations brought forth by any citizen, political party, association, or union regarding irregularities and illegalities.

7.3 Purpose

The Brazilian Federal Constitution mandates that public organizations and entities of Brazil are subject to the internal control of each Branch of Power, as well as to the external control exercised by the Brazilian National Congress. The Constitution allows the TCU to conduct accounting, financial, budgetary, operational and property audits and inspections to verify the legality, legitimacy, and sound business practices. It also verifies the application of aid, subsidies and revenue waivers.

Based on the principle of submission to internal and external controls, the Court oversees any individual or legal entity (public or private) who manages federal public funds under Union responsibility.

The internal control of each Branch of Power constitutes, in a way, an imposition of administrative de-centralization, allowing its directors an evaluation mechanism for activities performed outside its sphere.

External control is, in turn, exercised by the Legislative. At the federal level, the task is ascribed to the Brazilian National Congress through the joint action of the House of State Representatives and the Senate. To carry out this attribution of external control, the Brazilian National Congress engages the help of the TCU. As a result, the Court becomes the Union's operative body of external control par excellence.

The Brazilian State can use internal and external controls, along with the ever-present possibility of judgment by the Judiciary as instruments to promote and encourage transparency, probity, and efficiency in the administration of the public issues.

7.4 Functions

The core functions of the Brazilian Court of Audit are inspection, consultation, information, adjudication, sanction, correction, normative, and ombudsman.

7.5 Trends and the TCU

In last years, in addition to its inspecting duties, the TCU has been expanding its educational role and increasing its action in terms of the provision of guidelines for public managers, as well as the application of operational audits whose purpose, as mentioned before, is to assess the performance of bodies and entities, with respect to their efficiency and efficacy, in addition to the effectiveness of the governmental programs vis-à-vis the achievement of the purposes they are aimed at.

The TCU's action goes beyond the verification of compliance with legal directives of the accounting, financial, budgetary, fiduciary and administrative activities of organizations, and of the public bidding processes.

Through its operational audits, the Court evaluates the soundness, effectiveness, and efficiency of the performance of organizations and entities under its jurisdiction and of systems, actions and programs of the federal government.

The purpose of the operational audits is to seek the best means of attaining the objectives of governmental actions and programs, so as to contribute to the reduction of social inequalities and to the expansion of opportunities available to the population.

As mentioned, Brazilian Central Bank is in TCU`s jurisdiction. So, TCU has competence to evaluate effectiveness of BCB`s Banking Supervision and that is the reason of this paper. The TCU has some methodologies to analyze the performance of federal bodies. It will be showed above.

7.6 TCU’s auditing methodology

7.6.1 TCU’s Auditing Standards

The government audit activity exercised by the Brazilian Court of Audit is pronounced by a social character, requiring auditors to conduct their tasks according to technical standards and irreproachable behavior with an aim of improving public decisions and minimizing adversity in the interests of the Brazilian society.

According to these requirements, TCU’s Auditing Standards issued by the Brazilian Court of Audit (NAT), approved by Decree-TCU 280, of December 8, 2010. These requirements were made to ensure that the auditors are independent, upright, impartial, objective and competent in the development of audit work. If an auditor followed these requirements, his work would be considered flawless.

TCU’s Auditing Standards are complemented by specific rules, contained in manuals, standards, policies, and guidelines approved by the President or by the Secretary-General of External Control TCU.

7.6.1.1 Compliance Audit standards

The purpose of this document (Compliance Audit standards) is to define general planning, execution, preparation standards of the report, and quality control of compliance audits conducted by TCU.

7.6.1.2 Performance Audit Manual

The latest version of the Performance Audit Manual differs from the previous ones because it covers the entire cycle of this type of audit. Thus, in addition to updating chapters devoted to planning, implementation, and elaboration of the report, guidelines were included on the choice of the subject to be audited and the monitoring of the deliberations arising from the assessment of audit reports. Quality control was also the subject of a specific chapter.

The document reflects the evolution of methods and techniques employed by TCU as it gained experience in carrying out performance audits. The best international experiences on the subject were considered in the preparation of this manual, as well as contributions from professionals in this Court. The manual is aligned with the auditing standards adopted by the International Organization of Supreme Audit Institutions - INTOSAI.

The purpose of this document is to define principles and standards that guide the implementation and quality control of performance audits under the responsibility of technical units of the Court.

The Manual covers characteristics of Performance Audit: economy; efficiency; efficacy; effectiveness; equity; and other performance dimensions;.

The manual is structured to guide the auditor in the following phases: a) selection; b) planning; c) execution; d) the report; e) monitoring; f) quality control.

7.6.1.3 Survey’s Standards

The purpose of this document is to define general planning, execution, preparation standards of the report, and quality control. The purpose is to know the organization and functioning of bodies / entities of the federal public administration. It identifies objects and instruments for monitoring and evaluating the feasibility of conducting inspections.

The standards set forth herein shall be observed, as applicable, in surveys whose purpose is to know the organization and operation of systems, programs, projects, or activities of government.

Survey is a surveillance Instrument used by the TCU to:

a) understand the organization and functioning of the bodies and entities of the direct, indirect, or foundational powers of the Union, including funds and other institutions that may be jurisdictional as well as systems, programs, projects, and government activities in relation to financial aspects, budgetary, operational, and equity;

b) identify objects and instruments for monitoring and;

c) to evaluate the feasibility of conducting inspections.

7.6.1.4 Monitoring's Standards

Monitoring is the action of verifying the compliance of determinations and recommendations issued by the TCU.

The purpose of this document is to define general standards of planning, implementation, preparation of report, and quality control, for the monitoring conducted by the instrument of supervision provided for the Internal Rules of TCU and formalized by Monitoring Report process.

7.6.1.5 Auditing techniques applied at TCU

The TCU uses some auditing techniques such as: a) benchmarking; b) stakeholder analysis; c) SWOT analysis; d) Maps of products and Performance indicators; e) Process map; f) RECI Analysis; g) Logical Framework. For all of them, TCU has a guide to assist the auditor in his work.

8. Auditing methodology around the world

International Organization of Supreme Audit Institutions (INTOSAI)

The INTOSAI issued the International Standards of Supreme Audit Institutions (ISSAI). The ISSAI Executive Summaries are divided in these levels: Level (1) Founding Principles; Level (2) Prerequisites for the Functioning of Supreme Audit Institutions; Level (3) Fundamental Auditing Principles; Level (4) Auditing Guidelines; and INTOSAI Guidance for Good Governance (INTOSAI GOV).

Working Group on Financial Modernization and Regulatory Reform - INTOSAI

In the aftermath of the recent global financial crisis, governments have embarked on many efforts to modernize their financial regulatory systems, including consolidating or creating new regulatory bodies, and to reform their financial regulatory requirements, such as revising capital standards or subjecting products to greater regulation.

This working group aims to assist supreme audit institutions (SAIs) in addressing the challenges that exist in this area by developing tools and knowledge sharing opportunities for evaluating national reforms, along with sharing information on progress of reforms, and systematically tracking information of reforms at national and international levels.

The three draft strategic goals for the Working Group are to: first, develop tools and knowledge-sharing opportunities to enhance the capacity of supreme audit institutions (SAIs) to evaluate financial modernization and regulatory reforms on a national level.

Second, to establish mechanisms for sharing information on progress of financial modernization and regulatory reforms between SAIs and international organizations.

And, third, to develop a system to track and synthesize information on the nature, scope, and status of financial modernization and regulatory reforms at the national and international levels and identify gaps and areas where additional study by the Working Group is needed.

Incentive audit

A large body of evidence points to misaligned incentives as having a key role in the run-up to the global financial crisis. These include bank managers' incentives to boost short-term profits and create banks that are "too big to fail," regulators' incentives to forebear and withhold information from other regulators in stressful times, and credit rating agencies' incentives to keep issuing high ratings for subprime assets.

As part of the response to the crisis, policymakers and regulators also attempted to address some incentive issues, but various outside observers have criticized the response for being insufficient. Finance and Private Sector Development Team, Development Research Group proposes a pragmatic approach to re-orienting financial regulation to have at its core the objective of addressing incentives on an ongoing basis.

Specifically, that group proposes "incentive audits" as a tool that could help in identifying incentive misalignments in the financial sector. The group wrote a paper that illustrates how such audits could be implemented in practice, and what the implications would be for the design of policies and frameworks to mitigate systemic risks. This kind of audit is a part of a larger effort by the World Bank to provide open access to its research and make a contribution to development policy discussions around the world.

9. Organizations related to financial market

International Monetary Fund (IMF)

The IMF supports its membership by providing:

- policy advice to governments and central banks based on analysis of economic trends and cross-country experiences;
- research, statistics, forecasts, and analysis based on tracking of global, regional, and individual economies and markets;
- loans to help countries overcome economic difficulties;

- concessional loans to help fight poverty in developing countries; and
- technical assistance and training to help countries improve the management of their economies.

About the Technical assistance and training, the IMF provides it mainly in four areas:

- monetary and financial policies (monetary policy instruments, banking system supervision and restructuring, foreign management and operations, clearing settlement systems for payments, and structural development of central banks);
- fiscal policy and management (tax and customs policies and administration, budget formulation, expenditure management, design of social safety nets, and management of domestic and foreign debt);
- compilation, management, dissemination, and improvement of statistical data; and
- economic and financial legislation.

World Bank

The World Bank Group consists of five organizations:

a) The International Bank for Reconstruction and Development (IBRD) that lends to governments of middle-income and creditworthy low-income countries;
b) The International Development Association (IDA) that provides interest-free loans—called credits— and grants to governments of the poorest countries;
c) The International Finance Corporation (IFC) that is the largest global development institution focused exclusively on the private sector;
d) The Multilateral Investment Guarantee Agency (MIGA) that promotes foreign direct investment into developing countries to support economic growth, reduce poverty, and improve people's lives;

e) The International Centre for Settlement of Investment Disputes (ICSID) that provides international facilities for conciliation and arbitration of investment disputes.

The World Bank is a vital source of financial and technical assistance to developing countries around the world. It is not a bank in the ordinary sense but a unique partnership to reduce poverty and support development.

To ensure that countries can access the best global expertise and help generate cutting-edge knowledge, the Bank is constantly seeking to improve the way it shares its knowledge and engages with clients and the public at large. Key priorities include:

- Results: continuing to sharpen our focus on helping developing countries deliver measurable results.
- Reform: working to improve every aspect of the work: how projects are designed, how information is made available (Access to Information), and how to bring its operations closer to client governments and communities.
- Open Development: offering a growing range of free, easy-to-access tools, research and knowledge to help people address the world's development challenges. For example, the Open Data website offers free access to comprehensive, downloadable indicators about development in countries around the globe. It has also made World Bank Live—live discussions open to participants worldwide—a key part of our Spring and Annual Meetings with the International Monetary Fund.

There is the World Bank Institute (WBI) that is a global connector of knowledge, learning and innovation for poverty reduction. It connects practitioners and institutions to help them find suitable solutions to their development challenges. With a focus on the "how" of reform, it links knowledge from around the world and scale up innovations.

The World Bank Institute (WBI) supports the World Bank's operational work and its country clients in this rapidly changing landscape by forging new dynamic approaches to capacity development. WBI offers three areas of support to its developing-country clients:

- Open Knowledge: connecting them to global knowledge and learning on the "how" of reform,
- Collaborative Governance: helping them to mobilize for collective action, and
- Innovative Solutions: scanning and incubating innovations to tackle key development challenges.

Financial Stability Board (FSB)

The FSB has been established to coordinate at the international level the work of national financial authorities and international standard setting bodies and to develop and promote the implementation of effective regulatory, supervisory and other financial sector policies. It brings together national authorities responsible for financial stability in significant international financial centers, international financial institutions, sector-specific international groupings of regulators and supervisors, and committees of central bank experts.

The mandate of the FSB is to:

- assess vulnerabilities affecting the financial system and identify and oversee action needed to address them;
- promote co-ordination and information exchange among authorities responsible for financial stability;
- monitor and advise on market developments and their implications for regulatory policy;
- advise on and monitor best practice in meeting regulatory standards;

- undertake joint strategic reviews of the policy development work of the international standard setting bodies to ensure their work is timely, coordinated, focused on priorities, and addressing gaps;
- set guidelines for and support the establishment of supervisory colleges;
- manage contingency planning for cross-border crisis management, particularly with respect to systemically important firms; and
- collaborate with the IMF to conduct Early Warning Exercises.

As obligations of membership, members of the FSB commit to pursue the maintenance of financial stability, maintain the openness and transparency of the financial sector, implement international financial standards (including the 12 key International Standards and Codes), and agree to undergo periodic peer reviews, using among other evidence IMF/World Bank public Financial Sector Assessment Program reports.

The Bank for International Settlements (BIS)

The mission of the BIS is to serve central banks in their pursuit of monetary and financial stability, to foster international cooperation in those areas and to act as a bank for central banks.

In broad outline, the BIS pursues its mission by:

- promoting discussion and facilitating collaboration among central banks;
- supporting dialogue with other authorities that are responsible for promoting financial stability;
- conducting research on policy issues confronting central banks and financial supervisory authorities;
- acting as a prime counterparty for central banks in their financial transactions; and

- serving as an agent or trustee in connection with international financial operations.

The Basel Committee on Banking Supervision

The Basel Committee on Banking Supervision provides a forum for regular cooperation on banking supervisory matters. Its objective is to enhance understanding of key supervisory issues and improve the quality of banking supervision worldwide.

The Basel Committee is the primary global standard-setter for the prudential regulation of banks and provides a forum for cooperation on banking supervisory matters. Its mandate is to strengthen the regulation, supervision and practices of banks worldwide with the purpose of enhancing financial stability.

Inter-American Development Bank - IDB

The IDB is the main source of multilateral financing and expertise for sustainable economic, social and institutional development in Latin America and the Caribbean.

Partnering with clients, the IDB seeks to eliminate poverty and inequality, and promotes sustainable economic growth.

The Bank supports clients in the design of projects, and provides financing, technical assistance and knowledge services to support development interventions. The IDB focuses on empirical evidence for making decisions and measuring the impact of this projects to increase its development effectiveness.

Inside of IDB, there is the Office of Evaluation and Oversight (OVE) that is an independent body of the Inter-American Development Bank, responsible for externally evaluating IDB's projects and performance. The evaluations are aimed at promoting institutional learning and improving IDB's development effectiveness.

OVE was also mandated to conduct oversight reviews of corporate strategy, processes and instruments; provide normative guidance on evaluation issues; and contribute to evaluation capacity building in the region. In recent years, OVE has increased its efforts to improve evaluation training among regional governments.

About the OVE's methodology, in general, the basic evaluative questions address the issue of what results the IDB has achieved with its interventions in a given country, sector, thematic area or project. This entails first assessing the evaluability of the IDB's approach (i.e., strategy or project), then IDB's diagnosis of the problem, its intent with regard to possible solutions (expected results), the efficiency and effectiveness of IDB interventions, and the intended and unintended outcomes. In other words, did the IDB do the right thing? Did it do it efficiently and effectively? What happened as a result of the IDB's actions?

Because evaluation is a tool and all tools must be scrutinized constantly for improvement, the OVE continuously reviews its methodologies. The methodological working papers included here should be viewed along with the methodological statements in the different types of evaluation reports for a better understanding of the approaches OVE has taken.

Financial Action Task Force (FATF)

Financial Action Task Force is an inter-governmental policy body, comprised of over 30 countries, that has a ministerial mandate to establish international standards for combating money laundering and terrorist financing.

North American entities that work with financial market issues

- The Federal Financial Institutions Examination Council (FFIEC);
- The Financial Stability Oversight Council (FSOC);
- The Federal Deposit Insurance Corporation (FDIC);
- The National Credit Union Administration (NCUA);
- The Office of the Comptroller of the Currency (OCC);
- The Office of Thrift Supervision (OTS);
- The Consumer Financial Protection Bureau (CFPB);
- The Office of Inspector General (OIG-FED).

10. Conclusion

In recent history, the Brazilian financial system has undergone periods with the possibility of a systemic crisis. The difficulties presented by the financial institutions, triggered by the stabilization of the economy with the release of the *Real* Plan in July 1994, revealed some weaknesses of the Brazilian legislation in dealing with bank insolvencies. As a result, initial steps were taken to preserve the good order of the National Financial System. This situation led to the implementation of the Program of Incentives to the Restructuring and Strengthening of the National Financial System (PROER) by Law n. 9,710 of 1998. The cost of PROER reached billions of *reais* (Brazilian currency) using public resources.

Regarding the 2008 financial crisis, the Brazilian government enacted laws (n. 11.882 of 2008 and n. 11,908 of 2009) that allow the use of public resources in a possible financial crisis. During the presentation of the Chief of Staff to the Director of Financial System Organization, Maurício de Moura Costa at the International Seminar of the Brazilian Financial System, held on the 6th and 7th May 2013, he spoke of the possibility of using public resources if bank failures happen:

- Only as a last resort and always after bail-in;

- Just for systemically important institutions;

- Subject to the prior approval of the National Monetary Council (CMN);

- Regular reporting to the Brazilian Congress;

- Provision endorsed by the Credit Guarantee Fund (FGC);

- Recovery resources by institution or by system.

TCU's mission is to control the public administration to contribute to its improvement for the benefit of society. For this, the TCU has a jurisdiction to control the management of federal public resources. Therefore, if there are federal public funds, the TCU has competence to work there. However, TCU does not have specific methodologies for evaluating the Brazilian Banking Supervision.

The aim of this paper was to make a comparative analysis between the North American and Brazilian scenarios to use it to propose techniques that can be put into practice in the supervision of financial system regulation of TCU's competence. It also proposed techniques for creating bases for comparison, judgment and assessment of the lawfulness, effectiveness, economy, and legitimacy of that system.

Aiming to produce something practical and that could be implemented at TCU, we chose a deductive approach. Thus a study was conducted in these ways:

Initially, we exposed an overview of both financial systems. Furthermore, we explained, in a basic way, the regulation of these banking systems. Generally we explained the operation of the FED in USA, and banking regulation in Brazil. Regarding the Brazilian banking regulation, we exposed key aspects of Banking Supervision Manual (SUM) used by the BCB.

With the purpose to establish the criteria to be used in a performance evaluation, we used the "Core Principles for Effective Banking Supervision of Basel Committee on Banking Supervision". We showed main findings in last assessments made in the USA and in Brazil, called "Detailed Assessment of Observance of Basel Core Principles for Effective Banking Supervision".

We managed to contact the person who conducted the assessment in Brazil. It was Mrs. Laura A. Ard that is the Lead Financial Sector Specialist at the Corporate Governance Department in World Bank. The intention was to discuss the methodology used for assessment in Brazil.

Mrs. Ard explained how it worked, and gave me some documents of the Core Principles Methodology. Moreover, she said that the methodology used is just a baseline method to analyze the banking supervision. Each country may deepen the analysis to ensure stability of its financial system.

Another important fact is that the analysis was based on a self-assessment of BCB. The TCU is the Federal body that has jurisdiction to review the performance of the BCB, so it can execute a deeper and evidence-based analysis.

During the Minerva program, I had a meeting with Mr. Loren Yager who is the GAO's Managing Director of International Affairs and Trade. I explained to him the purpose of my work, and asked about the GAO's audit methodologies used, in addition to the Yellow Book, Green Book and FAM cited in this paper. He said that he could send me some documents of GAO. Also, I asked about the department that audits the FED that is the Financial Markets and Community Investment (FMCI). He said that he could get the contact of that department. We also exposed an overview of the TCU. We explained, in general, trends and methodologies currently used there.

As mentioned, the purpose of this paper was to pursue the development of methodologies to assess the banking regulation in Brazil, considering the U.S. experience in this matter. In this context, there was a visit in the United States Department of State at the Office of Monetary Affairs. There, one of the officers, Mr. Daniel Kachur indicated some of American agencies that manage matters related to the financial market. Therefore, we listed American agencies and international organizations (INTOSAI, IMF, World Bank, FSB, FATF, BIS, etc.) that work with these issues.

We also visited the Inter-American Development Bank (IDB). There, Mr. John P. Ferriter, the Office of External Relations, explained in general the work of the IDB. I asked about the IDB methodologies for performance evaluation. He indicated Mr. Jose Claudio Linhares Pires, the Lead Economist Specialist at the Office of Evaluation and Oversight who gave an overview of the activities and responsibilities at the IDB regarding the functions of the audit assessment. According that explanation, there are methodologies that can be useful for TCU. He said his department is available if there is interest from TCU.

It is important to note that TCU is participating in the INTOSAI Working Group on Financial Modernization and Regulatory Reform. The proposed work is aligned with the implementation of strategic objectives prioritized in the Strategic Plan of the TCU, such as:

1) Contribute to improving the management and performance of public administration;
2) Contribute to the transparency of public administration;
3) Prevent fraud and misappropriation of public resources;
4) Intensifying actions that promote the improvement of risk management and public administration controls;
5) Enhancing control actions aimed to improving the performance of public administration;
6) Intensify action controls to combat the waste of public resources;
7) Persuade the government to disclose information management;
8) Facilitate social control;
9) Select key areas;
10) Cooperate with the public administration and the control network;
11) Strengthen results-oriented culture;
12) Develop culture of innovation;
13) Promote improved governance in TCU.

In order to achieve the objectives listed above, this paper outlines steps for the following actions:

1) Expanding and improving the exchange of strategic information with other institutions;
2) Enhancing methodologies and action controls with a focus on performance evaluation of public administration;
3) Improving planning and monitoring of control activities;
4) Implementing methodologies, norms, and standards applied to control actions;

Note that activities to be developed and outcomes is highly complex and carries responsibility. Furthermore, it will develop a new methodology that will impact some departments in TCU.

Recently, the TCU has sought to improve its corporate governance structure. On October 7, 2013, TCU and the Organization for Economic Co-operation and Development (OECD) launched a study called Public Governance and External Control. The purpose of this study is to facilitate the contribution of supreme audit institutions (SAIs) in strengthening good governance and sound public management through its audit work and counseling.

For TCU, governance in the public sector essentially comprises the mechanisms of leadership, strategy and control put in place to evaluate, direct and monitor the performance of management. Governance also aims to implement public policies and services for society interest. Thus, the purpose of this study is to establish a proactive role in governance of one of the most sensitive sectors, financial regulation system.

Again, this paper is intended to lay the groundwork for a work proposal that aims to provide a relevant contribution to TCU, taking the opportunity to extract a high level of performance, knowledge and experience gained over the Minerva Program in monitoring banking regulation, in addition to developing works that can leverage the institutional outcome.

Visits and meetings with key members of organizations based in the United States created necessary conditions for the TCU to use their existing methodologies. This, combined with other international entities of recognized excellence, allows for the analysis of the Brazilian banking regulation.

Beyond that, the TCU is a member of *Rede de Controle da Gestão Pública* (The Brazilian Network of Control Public Management). This network is an inter-organizational decision center that aims to improve the effectiveness of the public management control. It brings together a number of Brazilian institutions whose goal is to develop actions aimed at monitoring public management, diagnosis and combating corruption, the encouragement and strengthening of social control, the sharing of information and documents, exchange of experience, and training of its staff.

Therefore, the various factors presented within this paper demonstrate the existence of prerequisites for achieving a methodology to audit the banking regulation in Brazil, and the broader significance of this banking regulation. In other words, the proposal work will develop mechanisms of control that standardize and systematize the assessment of regulation of the banking system, in order to prevent the occurrence of destabilization and fraud, thereby contributing to transparency and governance, and preventing the misuse of public resources.