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FREE TRANSLATION

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Central Bank of Brazil Full Board

Circular No. 3106 of April 10, 2002

Provides for the credit derivative transactions dealt with in Resolution No. 2933 of February 28, 2002

Pursuant to article 1 of Resolution No. 2933 of February 28, 2002, in a Full Board meeting held on April 10, 2002, the Central Bank of Brazil resolved as follows:

Article 1. - The institutions referred to in article 1 of Resolution No. 2933 of February 28, 2002 may transact in the following types of credit derivatives:

I. - credit swap, when the protection seller offers protection in exchange for a fee;

II. - total return swap, when the protection seller receives compensation on the basis of the flow of returns and payments received in relation to the underlying asset, dealt with in article 1, paragraph 3(II) of Resolution 2933/02.

Sole Paragraph - The following transactions are prohibited:

I. - trades in options linked to these types of credit derivatives;

II. - trades in credit derivatives between controlling, controlled or associated

individuals or legal entities, including the companies referred to in articles 3 and 18 of Resolution No. 2723 of May 31, 2000, as amended by Resolution No. 2743 of June 28, 2000;

III. - credit risks received from the persons referred to in item II; and

IV. - trades in credit derivatives, in which the flow of payments is not in the same currency or index as that of the underlying asset.

Article 2. - For the purposes of this Circular, the following definitions shall apply:

I. - swap transactions: the trades between a protection buyer and a protection seller for settlement on a future date, which result, upon the occurrence of one or more credit events, in full or partial recovery of the reference value set out in the contract by the protection buyer;

II. - credit events: the events defined between the parties in the contract and connected with the underlying asset or its obligors, and which, independently of any reason, cause the payment by the protection seller of the protection contracted by the protection buyer.

Article 3. - The transactions carried out under this Circular by the protection buyer-provided that the latter owns the underlying asset directly or indirectly through a credit derivative transaction-may, at the institution's discretion, be taken into consideration for the capital adequacy requirements (*Patrimônio Líquido Exigido - PLE*) dealt with in Resolution No. 2099 of August 17, 1994, as amended, vis-à-vis the level of transfer of the credit risk of the underlying asset.

Paragraph 1. - For the purposes of this article, transfer of the credit risk of the underlying asset is considered effective when:

I. - the contract establishes at least the following situations as credit events:

- (a) bankruptcy or civil insolvency of the obligors of the underlying asset;
- (b) petition for preventive debt rehabilitation (*concordata preventiva*) of the

obligors of the underlying asset;

- (c) judicial or extrajudicial liquidation of the obligors of the underlying asset;
- (d) restructuring of the obligors' debts, when this represents a loss or credit downgrade affecting the underlying asset;
- (e) change of control, consolidation or merger of the obligors, when this represents a loss or credit downgrade affecting the underlying asset;
- (f) moratorium of the obligors of the underlying asset;
- (g) default on the underlying asset;
- (h) compulsory advance payment of the underlying asset, in the event of contractual provision in this regard;
- (i) repudiation or challenging in court of the underlying asset;

II. - the underlying asset is legally transferable, if the credit derivative contract so stipulates upon the occurrence of a credit event;

III. - there is no co-obligation on the part of the protection buyer in relation to the portion of the underlying asset contemplated by the transaction;

IV. - there is no clause allowing for unilateral cancellation of the contract by the protection seller, except in the event of nonpayment by the protection buyer of the fee established in article 1(I) and (II);

V. - there is no clause allowing the protection seller to default on the obligation to make prompt payment of the amount due to the protection buyer upon the occurrence of a credit event.

Paragraph 2. - With a view to exercising the prerogative referred to in the main section, the percentage weighting factor to be applied to the protected amount of the underlying asset for the purpose of determining the PLE value shall be obtained

according to the following formula:

$FP > (PRP \times FPP)/PRA + [1 - (PRP/PRA)] \times FPA$, where:

FP > the percentage weighting factor applied to the protected amount of the underlying asset;

PRP > term to maturity of the credit derivative (business days);

FPP > percentage protection weighting factor equal to 50%.

PRA > term to maturity of the underlying asset (business days);

FPA > percentage weighting factor relating to the underlying asset, as per the Chart of Classification of Assets dealt with in article 2, paragraph 1 of the Regulations Annex IV to Resolution 2099/94, as amended.

Paragraph 3. - The risk exposure of an underlying asset exceeding the amount of protection shall be weighted by its original factor as per the Chart of Classification of Assets dealt with in article 2, paragraph 1 of Regulations Annex IV to Resolution 2099/94, as amended.

Paragraph 4. - When there is a clause stipulating the minimum amounts or percentages of loss of the underlying asset, so that total or partial recovery thereof may be effected, an additional PLE shall be set aside in an amount equivalent to the minimum amount or percentage stipulated.

Article 4. - Subject to the applicable rules on the limits of exposure for each client, the protection buyer shall:

I. - benefit from the credit derivative transaction ratably to the risk transferred, provided that it owns the underlying asset directly or indirectly under a credit derivative transaction, with due regard for the minimum requirements set forth in article 3, paragraph 1 relating to the obligors of the underlying asset;

II. - consider the credit derivative transaction ratably to the risk transferred, according to the limit of exposure relating to the protection seller.

Article 5. - The protection seller is exposed to the risk of the underlying asset ratably to the risk assumed, subject to the provisions of the Regulations Annex IV to Resolution 2099/94, as amended.

Sole Paragraph - As regards the risk exposure dealt with in the main section, the protection seller shall:

I. - observe the provisions of prevailing regulations on the limits of exposure for each client; and

II. - make specific provisioning to be determined in accordance with the same criteria set forth in Resolution No. 2682 of December 21, 1999.

Article 6. - In addition to the provisions of article 6 of Circular No. 3082 of January 30, 2002, information containing at least the following aspects of credit derivative transactions shall be disclosed in the notes to financial statements:

I. - the institution's policy, objectives and strategies;

II. - the credit risk received and transferred (book and market values), specifying the overall volume and during the respective period;

III. - effect (increase/reduction) on the PLE calculation;

IV. - amount and characteristics of the credit transactions transferred or received during the period as a result of the triggering events stipulated in the contract; and

V. - breakdown per type (credit swap and total return swap).

Article 7. - Institutions shall maintain, at the disposal of the Central Bank of Brazil, proper documents regarding their policy and procedures for credit derivative transactions, as well as the exposure limits established, irrespective of acting as

protection buyer or protection seller.

Article 8. - Signing of a credit derivative contract, when the amount accruing under transactions with one same counterparty is equal to or greater than ten percent (10%) of the Reference Equity (*Patrimônio de Referência* - PR) of any of the institutions acting as a counterparty to the contract, shall be notified to the Central Bank of Brazil.

Sole Paragraph - The notice referred to in this article shall be addressed within five (5) business days from the date of execution of the aforesaid contract to the division of the Financial System Information and Data Record Department (Decad) with jurisdiction over the institution falling within the condition referred to in the main section.

Article 9. - Pursuant to article 3 of Resolution 2933/02, the institution shall inform Decad of the name of its director in charge of credit derivative transactions.

Article 10. - This Circular shall come into force on the date of its publication.

SÉRGIO DARCY DA SILVA ALVES

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