Argentina
Country Report

The Argentine Banking System and Prudential Regulations

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Related Research

- *Argentina (Research)*
- *Review and Outlook of the Argentine Financial System (June 2007)*

Summary Overview

The past four years have registered a significant improvement in the composition of balance sheets in Argentina's banking sector, leaving the effects of the 2001 crisis behind almost completely. This, in turn, has strengthened the stability of the sector over the short and medium term.

The improvement of the operating environment, with the economy growing by almost 9% per year in the past five years, has benefited the financial system considerably, leading to a sustained growth in lending and other financial services, a reduction in public sector exposure and a strengthening of solvency levels.

However, since the volatility in international markets in the second half of 2007 and, more recently, the worsening domestic political and economic environment, some uncertainty has been introduced in relation to the previously good prospects for the financial system and the economy as a whole. Rising inflation and a slowing of economic growth have put pressure on asset quality and, together with some liquidity pressures, have affected the profitability of the financial institutions, which is expected to become more volatile in the near future.

As the financial system continues to be in a process of rebalancing the balance sheets, exposure to the public sector has decreased sharply; at end-March 2008 the former accounted for 27.9% of the system's assets or 2.35x its equity, down from 50% and 3.55x, respectively, at end-2002

In addition to the growth of deposits, loan growth has been fuelled by measures to encourage private sector financing, namely the possibility of classifying SMEs borrowers according to their future cash flows rather than by credit history and more flexible capital requirements. At end-2007 private sector lending represented only 14.3% of GDP, well below the 2001 level (24%), which demonstrates that there is ample scope for further growth. Loan growth has led to a better asset mix, at end-2007 private sector financing accounted for almost 40% of the sector's assets, which is significantly above the level at end-2003 (17.8%) but still low.

Liquidity remains one of the system's strengths, based on the steady growth of deposits and the still limited proportion of assets devoted to lending; most of this is, however, invested in notes issued by the central bank.

Capital levels have improved significantly aided by rising profits and capital injections totalling ARS17bn since 2002, which has compensated for the strong growth in lending. Additionally, public sector assets are now almost fully marked to market, which also strengthens the system's balance sheets.

Prudential Regulations

Fitch views Argentina's prudential regulations as sound and relatively up to date when compared with international standards, and considers that the Superintendency of Financial Entities and Exchange Institutions (SEFyC) exercises a good supervisory role. However, the agency also recognizes that the central bank of Argentina (BCRA) is not fully independent from political pressures and that, in times of duress some regulations are softened in favour of financial institutions, which, although in some cases could potentially be negative, in a severe crisis is done to protect the sector from bigger damage.

Sovereign Overview

(Extracted from Fitch's Credit Analysis on the Argentine Republic published in February 2008. Please refer to www.fitchratings.com for further detailed research).

Rating Rationale

Argentina's current ratings are: Foreign Currency Issuer Default Rating (IDR) of 'RD' (Restricted Default), Local Currency IDR of 'B' and Country Ceiling of 'B+'.

Argentina's creditworthiness continues to be supported by high economic growth and twin surpluses. Current account surpluses combined with the policy of maintaining a "competitive peso" have resulted in an important accumulation of international reserves. Moreover, the 2005 debt restructuring and full repayment of IMF debt eased Argentine borrowing needs in the medium term, though needs remain high relative to similarly rated peers'.

The incoming administration headed by Christina Fernandez de Kirchner has the important task of adjusting the current economic model through the rationalization of fiscal expenditure, policies to address both inflationary pressures and transparency issues regarding official data, and the normalization of relations with external creditors to increase the availability of financing sources.

Fiscal accounts have become increasingly more dependent on taxes that have a strong cyclical component and/or distortionary effects on the economy. Additionally, spending flexibility has diminished due to the increase in pensions and politically important subsidies.

The current (and widespread) perception that inflation levels are significantly above those officially reported could not only affect medium-term growth prospects but also complicate the task of reigning in fiscal spending due to higher wage and pension demands. Although officials have vigorously defended the reliability of inflation data and the current anti-inflation policy, inflation expectations for 2008 are considerably higher than that anticipated by the government.

Key Rating Drivers

Holdouts

The normalization of relations with creditors continues to be a requirement for improvement in Argentina's creditworthiness. The ongoing default on non-tendered bonds hinders the credit standing of bonds being serviced because it limits the government's ability to access financing. Additionally, there is a risk that holders of defaulted bonds may be successful in securing legal judgments that could interrupt payments on performing bonds.

Economic Policy Framework

Even though still high commodity prices and intra-public sector financing should help Argentina meet its financing needs in the forecast period, tighter international capital market conditions could cause investors to discriminate against Argentine assets due to concerns about the sustainability of the current macroeconomic framework. The current pace of economic growth is being fuelled by an accommodative monetary policy and has encouraged short-term consumption. When combined with the prolonged use of price controls, export caps and cross-subsidies this not only detracts from the competitiveness of the Argentine economy, but also discourages or distorts private sector investment.

External Vulnerabilities

Downside risks to global growth could also affect Argentina indirectly through a greater-than-expected softening of commodity prices. Pure commodity exports account for 35% of total exports and contribute to about 10% of tax revenues. Nevertheless, Argentina's external position has improved significantly since the last global slowdown in 2001, which should allow the sovereign to weather deteriorating external conditions.

The Banking System

Background/History

The starting point underlying the structure of the present financial system in Argentina dates back to 1935 with the creation of the central bank. The central bank was modelled along the lines of the Bank of England. Until 1946 its main concern was the liquidity and solvency of a banking system badly affected by the crisis of the 1930s.

In 1946 all deposits in Argentina's financial system were "nationalized" and became part of the assets of the central bank, which in turn channelled these to the commercial banks for on-lending. In 1957 this process was reversed and the commercial banks were able to regain their independence but the period of "nationalization" or centralization left its marks on the financial system, with the central bank continuing to set important measures such as interest rate ceilings and a series of regulations regarding lending limits, and with several systemically important banks still in the hands of the public sector.

In 1969 new financial legislation was passed which spelled out the various roles to be played by different types of credit institution, namely the commercial banks, the mortgage institutions, investment houses, savings banks and consumer credit entities. At the same time, limits on the activities of foreign banks were introduced. Gradual liberalization was once more reversed with the imposition of a centralized system for deposits in 1974. In 1982, faced with a growing budget deficit, interest rates were once more strongly regulated and high cash reserve requirements on deposits were enforced. A period of hyper-inflation which discouraged the concept of savings and borrowing resulted in a weakened system by 1989.

The situation was worsened by the introduction of the "Plan Bonex" in December 1989. This plan was designed to withdraw liquidity from the banking system in an attempt to halt hyperinflation, and included a series of controls and restrictions on lending by public sector banks in order to allow for more funds to finance the public sector deficits. The Bonex Plan froze short-term, fixed-rate deposits and allowed account holders to withdraw only a minimal sum (the equivalent to some USD500), with the balance being converted into 10-year USD denominated "External Bonds" (Bonos Externos or Bonex). Bank deposits held with the central bank were converted into either Bonex or local-currency-denominated bonds known as "Bonos de Inversión y Crecimiento" or BICs. As a result many commercial banks faced a severe liquidity crisis and growth remained stunted. However, the Bonex Plan ultimately failed to reduce inflation, which once more spiralled in early 1990.

On 1st April 1991 the Convertibility Plan was introduced in Argentina. Under this plan a fixed exchange rate was established on a 1:1 basis with the USD, and the central bank was required to guarantee 100% of the monetary base with foreign currency and reserves. Renewed investor confidence resulted in significant capital inflows, banks were able to re-enter the international capital markets and raise capital at lower rates and interest rates demonstrated a sharp downward trend. A more stable economic climate also allowed the development of the domestic capital markets.

The Convertibility Plan underwent a very severe test following the Mexican devaluation of its currency in 1994. Argentina's banking system was particularly impacted by the Mexican crisis, suffering strong deposit outflows and a number of small banks were hit by liquidity problems. In the face of capital outflows and crisis of confidence, the Argentine government demonstrated its strong resolve to maintain the ARP/USD parity, implementing several measures to increase confidence in convertibility and assembling timely international financial support led by the International Monetary Fund. The results of the presidential elections in May 1995 had a positive impact in the markets and helped stabilize the banking crisis.

Five years later, in December 2001, a severe political crisis together with a deep economic recession and abandonment of the currency board led to probably the worst crisis in Argentina. The years that followed were marked by a high degree of uncertainty in which most banks adopted defensive strategies aimed at building and preserving liquidity, while traditional banking business remained at a standstill. With few exceptions, banks ceased lending activities, focused on loan collections and used deposit inflows to further boost liquidity cushions. In order to improve profitability, banks cut costs, primarily through staff and branch reductions. Revenue growth, however, was a more difficult task, most banks started to develop their transactional business, capitalizing on the increase in fee-based products that accompanied the cash restrictions as consumers were forced to use their debit and credit cards for purchases. At the same time, most banks in the sector had begun to restructure their international USD-denominated debt.

The financial sector was compensated by the government for losses that arose as a result of the unorthodox measures taken following the deposit freeze imposed in January 2002. Possibly the most controversial and costly measure was the asymmetric “pesofication” of the balance sheet, for which the government compensated banks by way of government bonds (Bodens). Under the asymmetric pesofication, USD denominated assets were converted to Argentine Pesos (ARP) at a rate of 1:1, while USD-denominated deposits and domestic obligations were converted at a rate of 1.4:1, creating significant losses on bank balance sheets, and effectively wiping out the system’s equity base. Cross-border foreign currency obligations were unaffected, and the peso devaluation inflated these liabilities significantly while the assets this funding supported were largely pesofied.

Many depositors brought legal actions (“amparos”) against the banks for the return of their deposits in dollars and courts returned unfavourable verdicts for the banks, ordering the return of such deposits in dollars, forcing banks to convert to dollars at then prevailing exchange rates, resulting in additional losses. Although the legal cases have yet to complete the legal appeal process to the final instance of the judicial process, banks were allowed to amortize those losses in up to five years.

The central bank granted significant liquidity assistance to the financial system, which totalled roughly ARP19bn. Banks were later permitted to pay back re-discount lines with holdings of government debt. As of end-2007, all the assisted banks had re-paid their obligations except for one public sector bank (Banco de la Provincia de Buenos Aires), which is paying back its debt in line with the original schedule.

Banks were also compensated for losses incurred due to the asymmetric application of inflation indexes. While deposits and certain loans were adjusted by the consumer price index (CER - Coeficiente de Estabilizacion de Referencia), which stood at 40.5% in 2002, consumer and mortgage loans were adjusted by the CVS, an index that measured the change in salaries that was substantially lower. Additionally, banks were required to adjust their liabilities by inflation a few months before their assets; inflation adjustment ceased in February 2003.

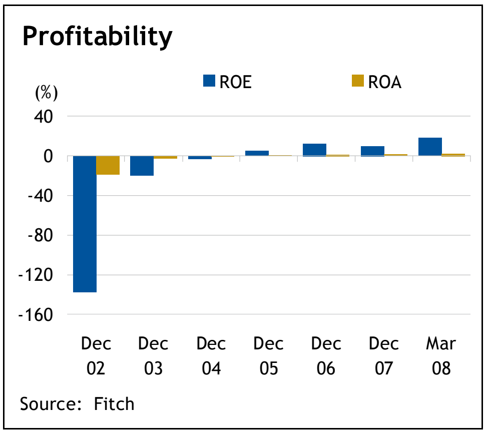
As a consequence of these various compensations being in the form of government bonds, balance sheets became even more heavily concentrated in government debt. At end-January 2003, public sector exposure amounted to ARS94.8bn or 47.6% of the banking system’s assets.

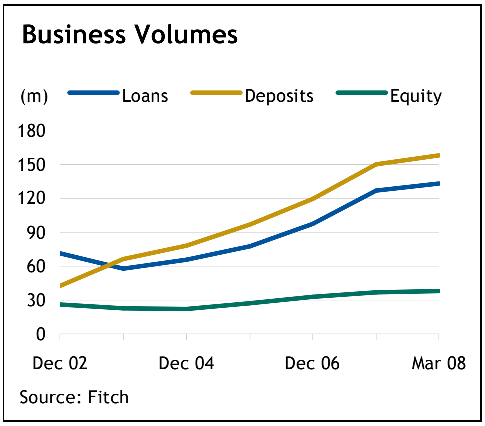
The loan contraction coupled with increasing loan loss provisions, the rise in non-productive assets, narrow and in some cases negative margins and the losses that arose from the measures discussed earlier resulted in a steep decline in profitability, with the sector posting hefty losses in 2002, the low point in the performance of the system through the Convertibility crisis.

Financial System's Current Performance and Trends

Profitability

The steady increase in traditional banking activities in the past four years has led to a sustained positive cycle and 2007 was the third consecutive year in which the system as a whole recorded net profits after the losses caused by the 2001 crisis. The improvement in profitability through the end of 2007 was been driven by higher operating revenues resulting from the increased business volumes as well as strong results from the banks' government bonds portfolios, which offset a steady rise in administrative expenses and in loan loss provisions due to loan growth.





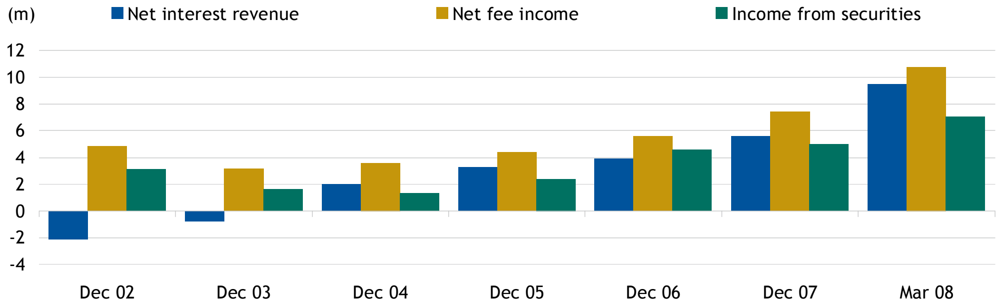
In 2007, the average ROE and ROA for the financial system were 9.9% and 1.2% respectively, down from the level of 2006 (12.5% and 1.6%). The decline in 2007 was mainly a consequence of lower results from the banks' securities portfolios due to the impact on the market value of Argentine government bonds of the volatility in the international financial markets; in spite of this decline, these are still a very important revenue source. However, in spite of the decline showed in Q307, the financial system's profitability is clearly rising and at end-March 2008 the system's ROE and ROA rose to 18.3% and 2.2%. Fitch expects to see more volatility in banks' earnings in the near future as the volatility of international capital markets is likely to continue and the local economy is likely to worsen. The latter will probably result in a deterioration of asset quality, a deceleration of loan growth and some liquidity pressures. On the positive side, the amortization of the judicial injunctions ("amparos") is almost finished and the absence of these hefty losses will strongly benefit banks' income statements in the future.

Benefiting from the strong growth in lending, which is increasing its share in banks' balance sheets, net interest income has risen steadily in the past few years; in 2007 this grew by 42.4%. This has supported the system's net interest margin, which in 2007 rose to 2.1%, up from 1.6% one year before; this ratio appears low by regional and international standards because the net interest revenue does not include securities gains and CER adjustment. Fitch expects this trend to continue in the next couple of years if the economic growth remains, although at a slower pace.

The increase in activity was also reflected by the rise in commission income, which grew by 32.2% in 2007 and 30.1% in 2006. At end-2007, net fee income represented a sound 50.1% of administrative expenses, a level that compares well internationally.

Administrative expenses have grown steadily since 2004 in line with increased business volumes, branch network and staff increases and growing inflation. In 2007 these rose by 27.9% and represented 5.0% of assets (4.5% in 2006). The cost to income ratio as of December-2007 was 69.8%, which, although it deteriorated somewhat due to the fall in income from financial transactions, has significantly improved since 2003 (167.4%). Fitch expects cost-efficiency levels to continue to improve as long as financial intermediation keeps on growing and operating revenue generation remains strong.

Operating Revenues



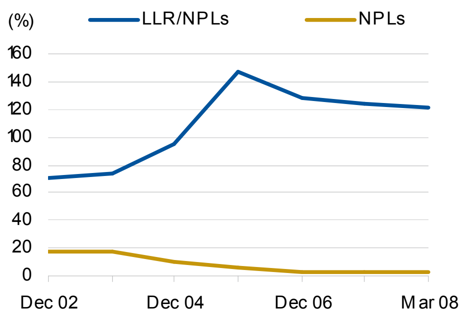
Source: Fitch

Credit Risk/Asset Quality

Between 2002 and March-2008, banks' public sector exposure declined notably — from almost 50% to 27.9% of assets. Among the main factors that led to this reduction were the scheduled amortization of loans, portfolio sales, valuation at market prices and the collections from the national government's pending compensations. Simultaneously, private sector lending grew from 17.8% of assets in 2003 to 35.9% at end-March 2008.

In 2007, credit to the private sector expanded by over 35%, the third year in a row of strong loan growth. Loan growth was mainly driven by consumer lending, including credit cards, which grew by approximately 57% during the year. Supported by some government initiatives to encourage credit to the private sector, mortgages experienced a strong surge (up 41.3%), albeit from a very low base. Commercial lending, mainly to SMEs, has also grown strongly (up 34% in 2007), with the increase well spread across the different economic sectors. At end-2007, the manufacturing sector accounted for 33% of total corporate lending, followed by the agricultural sector with 24%, services 23% the retail sector (14%) and construction and real estate (6%).

Asset Quality Ratios



Source: Fitch

Asset quality has improved significantly, reflecting the brisk expansion of credit and the benign economic environment, which has favored strong credit recoveries. Non-performing loans are at historically low levels: at end-March 2008 these represented only 2.7% of total loans, while before the 2001 crisis, the financial system's non-performing loans ratio was 11.8% at end-2000, reaching a high of 18% at end-2002. In addition, loan loss reserves covered a sound 124.2% of non-performing loans at end-Q108. However, this positive trend has probably come to an end, and during 2008 some deterioration in asset quality ratios has been seen due to the seasoning of loan portfolios, slower growth and a worsening environment.

Funding and Liquidity

Deposits are, by far, the system's main source of funding and represented 68.6% of total assets at end-March 2008. Deposits from the private sector have grown by over 20% per year since 2004. However, as a consequence of the deterioration of the economic and political situation, during May 2008 private sector deposits fell by 3.7%, with total deposits falling by 1.7%. During the two months that followed, most of these deposits returned to the system but deposit growth in 2008 is expected to be much lower than in previous years; in the first seven months of the year, deposits grew by 14.6%. The volatility of the deposit base has historically been a challenge for the Argentine banking system; lack of solid public trust in the system is the principal cause of the relatively short term nature of deposits in the system, and for the dominance of sight and savings funds, relative to time deposits, in the funding base. This is the inverse relative to most of the region's banking systems, and an impediment to long term growth of credit above low levels of GDP.

The improvement in banks' overall performance and balance sheets also allowed the financial system to continue reducing its debts with the central bank and the losses to be amortized caused by the judicial injunctions called "amparos". The latter are included in Intangible Assets and, at end-2007, accounted for only 0.5% of total assets (2.8% at end-2004) as roughly 87% of the original amount has already been amortized. Debt owed to the central bank due to liquidity assistance during the crisis has also decreased significantly, from 16.4% of the sector's total liabilities at end-2002 to 0.5% at the end of 2007, with only one bank (Banco de la Provincia de Buenos Aires) holding outstanding debt and paying it back according to the original schedule. Additionally, restructured time deposits, which consisted of fixed-term deposits frozen in January 2002 to prevent a run on banks, have been fully amortized.

Other funding sources include loans from local and foreign banks (2.8% of end-Q108 assets), senior debt issuance (2.1%) and subordinated debt (0.5%). Loan securitization, largely into local capital markets, has also been an important funding source for smaller banks and financial institutions that specialize in consumer lending.

In line with the growth in deposits, liquidity remains one of the system's strengths. At end-March 2008, liquid assets represented 41.8% of deposits. Liquidity could deteriorate in the near term due to market volatility, although this could be offset by the expected slowdown in loan growth. Liquid assets are, however, largely invested in notes issued by the central bank, which has historically proved a better creditor than the central and/or provincial government.

Capital

The system's capitalization has also improved significantly and is now considered adequate. At end-March 2008, the financial system's equity/assets ratio was 11.85%. This has been aided by the improvement in profitability and by capital contributions totaling ARS17bn (roughly USD 5,750m) since 2002. In addition, the solvency of the financial institutions has also been strengthened by the valuation of public sector assets at their market values, and the reduction of intangible assets (mainly "amparos"). However, capital levels are under pressure due to the system's significant growth over the past four years.

Depositor Preference

As a consequence of the various political, economic and banking crises in Argentina's history, the banking public is quick to lose confidence in the banks and, therefore, the country has a history of systemic runs on deposits, which have forced regulators to impose deposit freezes and restructurings several times in the last 50 years. The regulatory approach has been widely inconsistent, varying from comprehensive support of bank deposits to one where at times significant banks have been allowed to fail, with losses to creditors and depositors. Ironically, though bank deposits are given priority under local regulation governing liquidation proceedings, banks have defaulted on deposits more often than on other obligations, thanks to a history of deposit freezes which at times allowed banks to continue to service non-deposit obligations.

Structure of the System

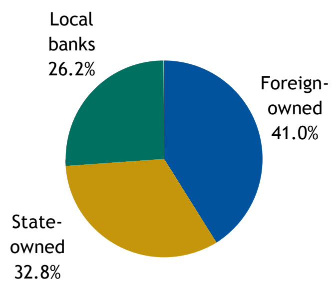
While during the prosperous years of the 1990s numerous foreign banks acquired local institutions, some of them decided to leave the country after the Tequila and the Argentine crises.

In this sense, while consolidation during the 1980s reduced the number of entities to just over 200, the 1995 Mexican crisis resulted in around 45 entities merged, acquired and liquidated. With the central bank's ability to act as a lender-of-last-resort limited by the Convertibility regime then in place, the regulator allowed banks to fail; incentive programs were put in place to encourage healthy banks to take over the liabilities of failed or ailing private and public sector banks.

The 2001-2002 crisis, which led to the asymmetrical devaluation of the peso and the deposit freeze called "corralito", resulted in the restructuring of the banks' deposit base, combined with extensive regulatory forbearance and significant liquidity assistance from the central bank. This effectively allowed most of the banks in a technically insolvent banking system to continue to operate. There were 15 foreign financial institutions that chose to exit their investments in Argentine banks in the years that followed, most of them as a consequence of the severity of the crisis, but due to other reasons as well. In this process there were some domestic banks that took advantage of the situation and acquired troubled banks or those disposed of by the foreign shareholders willing to leave, or some state-owned banks that were privatized. This resulted in these banks becoming much bigger players in the system, most notably the cases of Banco Macro and Banco Patagonia (formerly Banco de Río Negro S.A.), which increased their market shares from 0.7% and 0.3% of deposits at the beginning of 2001 to 6.5% and 2.2% at end-March 2008. There were also cases of foreign banks that disposed of part of their business but remained in the country, like ABN AMRO that sold its retail banking division to locally owned Banco Galicia, and some foreign banks that acquired some institutions to increase their business volumes, like HSBC Bank Argentina that acquired the local subsidiary of the Italian Banca Nazionale del Lavoro, and the case of South African Standard Bank that took over the assets and liabilities of the local branch of Bank Boston in 2006 (until then it only had a representative office in the country).

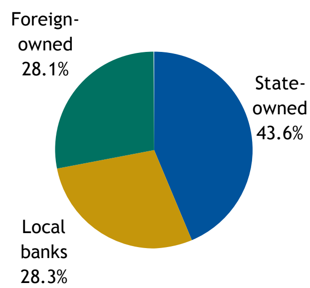
As of end-March 2008 Argentina's financial system is composed of a total of 85 financial entities: 12 state-owned banks, 41 domestic private sector institutions and 32 foreign entities (including branches and subsidiaries of foreign banks and finance companies); public sector banks account for a still high 43.6% of deposits. At December 2001 the system was composed of 107 institutions, of which 44 were foreign-owned, 13 owned by the state and the remaining 50 locally owned entities. Before the 1995 Tequila crisis there were over 200 financial institutions, of which 32 where state-owned.

Deposits (December 01)



Source: Fitch

Deposits (March 08)



Source: Fitch

Concerning market share according to deposit levels, at end-March 2008 public sector banks led with 43.6%, followed by domestic entities with 28.3% and foreign-owned institutions with 28.1%. At end-December 2001, foreign-owned bank share of total deposits was 41%, followed by state-owned entities with 32.8% and local institutions with 26.2%.

Prudential Regulations

Supervisory Role

According to Chapter 1 of the central bank of the Argentine Republic's (BCRA) Charter, the highest ranking monetary authority is the BCRA. Its functions are to monitor the appropriate operations of the financial market and implement the Financial Entities Law and other regulations, to act as the National Government's financial agent, to concentrate and manage its reserves in gold, foreign currencies and other foreign assets, to promote the development and strengthening of the local capital markets and to implement the country's foreign exchange policy.

In addition, the central bank develops and implements the prudential regulatory regime that is intended to provide the base for a stable financial system. This regulatory structure is supplemented by the surveillance of banking operations, in order to monitor prudential regulations compliance. In this sense, for purposes of supervision of the financial sector, and as dictated by Chapter 11 of the central bank's charter, this role falls under the jurisdiction of the Superintendency of Financial Entities and Exchange Institutions (SEFyC). Although the SEFyC is a decentralised agency, it operates under the central bank's organisational structure. Consequently, it reports directly to its chairman, its budget depends on the central bank and is subject to its audits. Its managers are appointed by the National Executive Power on the suggestion of the chairman of the central bank. Its main function is to control the creditworthiness and liquidity of financial entities and monitor the due fulfillment of prudential regulations issued by the central bank. As mentioned before, the agency considers that the central bank of Argentina (BCRA) is not fully independent from political pressures.

Prudential Regulations

In its supervisory role, the SEFyC has established steadfast parameters to examine risks inherent to the sector and bases its oversight on the CAMELS surveillance method, which stands for Capital, Assets, Management, Earnings, Liquidity and Sensitivity to market risk. In this sense, it is the aim of the SEFyC, through on- and off-site inspections, to rate the quality of a financial institution's financial condition, risk profile, and overall performance. In executing the particular rating, the five components of the surveillance method consists of capital adequacy, asset quality, management, earnings, liquidity, and sensitivity of market risks. The scale consists of a five-point schedule, with 1 being the strongest and 5 the weakest; these ratings are not public, but the rated entity is allowed to disclose them. These ratings are generally considered accurate. However, while they were in place before the recent crises, their accuracy in predicting most problematic banks has been relative when problems were caused by systemic crises. The regulator's ratings, in turn, determine the definition of some prudential requirements for the individual entities as further described below.

Minimum Capital Requirements

The minimum capital requirements are determined according to the risk of a financial institution's assets. These risks are broken down into credit risk, interest rate risk and market risk. Notwithstanding this, financial entities must maintain a minimum amount of basic capital defined by the BCRA according to the institution's core activities and geographic location (currently, this limit varies from ARS5m to ARS25m). A financial institution's capital must, at all times, be greater than the lower of the minimum amount of basic capital just mentioned and the sum of the requirements for credit and interest rate risk.

Financial institutions, including their subsidiaries in Argentina or abroad, must comply with minimum required capital regulations both on an individual and consolidated basis.

The capital requirement for credit risk, in terms of risk-weighted assets, is 10% for fixed assets and 8% for loans and other types of financing transactions as well as public sector assets (loans and bonds held in investment accounts).

This requirement is increased by any excess in limits regarding fixed assets (see below), credit risk diversification and rating, operations with related clients and in the general limit on the negative foreign currency net global position.

Argentina follows a risk-weighting procedure similar to those defined in Basel 1. Assets are categorized as follows:

Risk Weighted Assets

Asset	Risk weight (%)
Cash & equivalents	0
Government bonds	
With market risk capital requirements	0
Other domestic bonds with no explicit guarantee from the government	100
OECD Central Government bonds - rated AA or higher	20
Loans	
Private sector with preferred collateral in the form of	
Cash, time deposits in the same creditor	0
Guarantees by authorized reciprocal guarantee companies (or mutual credit guarantee consortia), export credit insurance, documentary credits	50
Mortgages	50-100
Pledges	50-100
Non-financial public sector	100
Financial sector	
Public sector financial institutions with the collection of federal taxes as collateral	50
Foreign financial institutions or financial institutions backed by them (rated AA or higher)	0-20
Other credits from financial intermediation	0-100
Guarantees and contingent liabilities	0-100

Source: BCRA

The risk weighting assigned to mortgages and pledges also ranges from 50% to 100% mainly depending on the loan-to-value ratio. Equally, other assets from financial intermediation, and guarantees and contingent liabilities, range in their weights from 0-100% according to their risk.

While the risk weights of the different asset types seem adequate, the 0% risk weight assigned to government debt and most collateralized loans raise concern as these are risky and potentially volatile assets in a country whose credit rating remains below investment grade and where foreclosing collateral usually entails, at least, a lengthy procedure.

Fixed assets should not exceed 100% of regulatory capital. Included are shares in domestic companies, receivables, property and equipment, sundry goods, expenses in organization and research, goodwill, and loans to related clients. These are calculated net of depreciation, accumulated amortization and loan loss reserves. Non-compliance with the limit produces an increase in the minimum capital requirement equal to 100% of the excess. Intangible assets generated by the differences arising from the fulfillment of court injunctions (“amparos”) ordering the repayment of deposits in their original foreign currency — (Law 25,561, Decree 214/02 and related regulations) will not be computed for this ratio up to 31 December 2008.

Loans issued by a domestic branch or subsidiary of a foreign financial institution, on behalf and by order of the head office, are not subject to a capital requirement, provided the relevant foreign financial institution is rated ‘A’ or higher, is subject

K Factor

Camels rating	K factor
1	0.97
2	1.00
3	1.05
4	1.10
5	1.15

Source: BCRA

to supervisory rules at a consolidated level and that the loans are explicitly guaranteed by the head office.

Finally, the capital requirement for credit risk also depends on the entity's CAMELS rating. The rating determines a factor by which the requirement is adjusted. This is the "K factor", which depends on the CAMELS rating and ranges from 1 (strongest) to 5 (weakest); the stronger the rating the less capital required and vice versa.

In the wake of the financial crisis of 2001 the regulators exercised forbearance of this norm and the K factor was set at 1 for all the financial institutions. This suspension was lifted in June of 2004.

The capital requirement for interest rate risk is complementary to those related to credit and market risks. The requirement is based on the risk that arises from the financial institution's balance sheet sensitivity or "duration". This effect is immediately reflected in the case of assets with a secondary market as changes in interest rates lead to variations in the price of those assets and, therefore, in the bank's balance sheet.

The capital requirement is calculated using a Value at Risk (VaR) model based on a 99% confidence level and a three-month horizon. In addition, since May 2003 it takes into consideration the CER (Coeficiente de Estabilizacion de Referencia – CPI linked index) to capture the real interest rate risk, i.e. the mismatch between the inflation rate movements and interest rate variations.

In the case of fixed-rate transactions, the cash flows transactions are assigned to different time bands taking into account their maturity.

The capital requirement for market risk is determined by the market risk of the financial institution's portfolio, measured by its VaR. This requirement must be met on a daily basis and reported to the central bank monthly. Assets kept in investment accounts (i.e. those held to maturity) are excluded as they are subject to credit and interest rate risk capital requirements.

The VaR methodology used to calculate this capital charge adopts a 99% confidence level and a five-day holding period. Additionally, the effect of all assets and liabilities denominated in dollars has been incorporated into the calculation as a foreign currency risk factor since 2003. Argentina's market risk VaR is similar in nature to others applied in other countries, however, a holding period of five days must be considered carefully as this sector is very susceptible to economic shocks and in times of duress disposing of certain assets could take more than five days. Argentina's financial institutions are expected to hold the assets in their portfolios for only five days; the typical holding period is one day, though 10 days are used in the European Union, in recognition of the more volatile and less liquid markets.

The portfolio is divided into five asset classes: domestic equities, domestic public sector bonds/central bank debt securities (the main category within the total), foreign equities, foreign debt instruments and foreign exchange positions. The VaR of the portfolio is calculated by summing the VaRs of the five asset classes.

The regulation allows for the netting of positions in the same instrument: holdings, buys and sells pending settlement, loans and deposits. Options are also covered based on Basel's "delta-plus" method — or their notional value weighted by their delta — and the risk arising from their net gamma risk must be also added.

The financial crisis of 2001 led to relatively extensive regulatory forbearance to support banks due to the severity of the crisis. In this sense, among other measures, the minimum capital requirements for non-financial public sector financing granted before May 31, 2003 and for interest rate risk were lowered temporarily via the "Alpha coefficients method". These coefficients gradually tend to 1, meaning that their effect ends up being neutral in 2007 for interest rate risk and in January 2009 for credit risk of this financing.

Regulatory capital of financial institutions comprises Basic Capital (Tier 1) and Complementary Capital (Tier 2). Tier 1 capital is largely composed of paid-in share capital plus retained earnings, equity reserves, and equity adjustments. Additionally, since October 2006 long-term debt with maturity of more than 30 years with non-cumulative and non-deferrable coupon payments qualifies as basic capital, up to a limit of 30% of this type of capital (this proportion will gradually converge to the international standard of 15% by 2013).

Tier 2 capital must not exceed basic capital and is composed of unaudited retained earnings, interim results, 50% of the reserves on the loan portfolio classified as ‘normal’ and subordinated debt with an average residual maturity of at least five years up to a limit of 50% of Tier 1 capital. Since October of 2006, Tier 2 is also composed of the portion of debt instruments that qualify as Tier 1 capital but exceed the above-mentioned limits, long-term debt instruments with residual time to maturity of less than 10 years and those with cumulative coupon payments, for which the limit is 50% of basic capital.

Financial institutions must deduct from regulatory capital sight deposits in speculative-grade foreign financial entities, securities whose physical custody is with custodians not registered with the BCRA, foreign sovereign bonds with a credit rating below that of Argentina, equity stakes in other financial institutions, unregistered real estate, goodwill and other intangible assets and deficit in loan loss reserves determined by the SEFyC.

Credit Risk Diversification and Rating

The aim of this regulation is to limit economic risk and achieve a minimum diversification level; consideration is therefore given to both the capital of the borrower and the financial entity’s total regulatory capital. Regulations establish the following:

- Total financing should not exceed 100% of clients’ capital. This limit could extend to 300% if the additional credit is not greater than 2.5% of the bank’s regulatory capital and is approved by the financial institution’s board of directors.
- While unsecured loans issued to individual borrowers cannot exceed 15% of the lending financial institution’s capital; collateralized loans can go up to a maximum of 25% of the bank’s regulatory capital.
- Collateralized and uncollateralized loans granted to domestic and investment grade foreign financial institutions face a limit of 25% of the lending entity’s regulatory capital. Speculative grade foreign financial institutions cannot exceed 5% of the entity’s capital, with or without collateral.
- Loans issued to reciprocal guarantee companies (or mutual credit guarantee consortia) authorized by the central bank cannot exceed 25% of the lending institution’s regulatory capital and must be issued with collateral.
- Total credit to the public sector (including the national government, the city of Buenos Aires and Provinces, and municipalities), with and without collateral, is not to exceed a maximum of 75% of the entity’s regulatory capital. Since July 2007, the monthly lending to the public sector may not exceed 35% of total assets of an institution. These limits do not apply to loans granted before 31 March 2003, or if they were originated as a result of the 2002 compensation for asymmetrical conversion into pesos. The same treatment applies to bonds issued in accordance with Decree 1735/04, which instituted the defaulted debt exchange proposal, that were received in the process of the sovereign debt restructuring, in exchange for bonds held at the banks as of 31 March 2003.

- Banks holding equity stakes in commercial companies also follow a limit schedule: if the holdings pertain to companies not carrying out complementary activities, the maximum stake allowed is 12.5%; while for entities that perform complementary activities the limit is 100%.
- Regulations also focus on the risk concentration mix. The sum of all loans that individually exceed 10% of the financial institution's regulatory capital may not exceed: three times the total regulatory capital (excluding loans to domestic financial institutions), five times the total regulatory capital (including loans issued to domestic financial institutions), and 10 times the total regulatory capital of a second-tier bank, considering its operations with other financial entities.
- Compensation bonds or notes received by institutions are excluded from the risk concentration ratio until December 2008 as dictated by Decree 905/02.

Debtor Classification, Provisioning and Collateral Guarantees

Classification rules aim at establishing clear-cut standards to classify loan quality in order to set minimum provisioning levels. In following these regulations, the financing portfolio is broken down into commercial loans and lending to individuals (both housing and consumer loans). Financing to the public sector is excluded and no provisioning is required, a measure that favors financing to this sector but is not considered conservative by Fitch, considering the relatively recent default of the sovereign/ the poor payment history of the government.

Every borrower is classified into one of six categories and this determines a minimum provisioning level, according to whether collateral has been committed; the categories range according to decreasing credit quality, with loans classified in categories 3-6 being considered non-performing ("cartera irregular" in local terms). Non-performing loans include the full financing, including the undue portion, and interest accrual must be either suspended or provided for.

In this manner, a borrower's classification is determined by analyzing its payoff capacity (and projected cash flows in the case of commercial borrowers) and its payment behavior for housing or consumer loans. To facilitate lending to SMEs, commercial loans of up to ARS500,000 may be considered as consumer loans for classification purposes, at the bank's discretion.

Minimum provisioning levels are as follows:

Borrower Classification

Debtor category (for both commercial and individual debtors)	Arrears (for consumer loans)	With collateral (%)	Without collateral (%)
1. Normal	Up to 31 days	1	1
2. a) Under observation	Up to 90 days	3	5
b) Under negotiation	Up to 60 days	6	12
3. Substandard	Up to 180 days	12	25
4. Doubtful	Up to 365 days	25	50
5. Loss	More than 365 days	50	100
6. Loss by technical decision[a]		100	100

[a] Loans more than 180 days past-due of liquidated financial institutions or of residual institutions after privatization or of trusts where SEDESA (deposit insurance company) is the beneficiary
Source: BCRA

In addition to this, the SEFyC can require additional loan loss provisions whenever it considers that those constituted by the bank are not sufficient to cover the expected losses.

New borrowers (new customers for the financial institutions) classified as non-performing by other institution face a limit on the financing available to them as prescribed by regulation. In essence, the new lender must classify the borrower based on its projected fund flows only; therefore, the total amount to be lent under these circumstances depends on the borrower's total outstanding debt and the worst rating assigned by any other financial institution. This norm is part of the relaxation of some regulations in order to promote lending to the private sector in the wake of the crisis, but many companies were still classified as non-performing due to heavy losses posted in those turbulent years.

Classification review is to be performed at least on an annual basis, but a quarterly review is required for loans that exceed 5% of the financial institution's regulatory capital and a semi-annual review for loans that amount to ARS1,000,000 or range between 1% and 5% of the financial entity's regulatory capital (the lower one applies). In addition, a financial institution has to review the rating assigned to a borrower when another financial institution that grants 10% or more of the borrower's total financing reduces its classification in the BCRA Credit Bureau. A review must also be carried out if the classification criteria is modified, or if there is a discrepancy of more than one degree between the classifications by the financial institution and that granted by at least two other institutions, if these are worse and the other banks' lending accounts for less than 40% of the borrower's debt in the financial system. If the latter percentage is above 40%, the financial institution must reclassify the debtor so that the discrepancy is not larger than one category, the largest discrepancy accepted.

All financing classified as 5 – Loss, and fully provided for, must be written off and kept off-balance-sheet after seven months in the rating category.

Financial institutions must constitute loan loss provisions of 1% (i.e. equal to debtors classified as 1 – Normal) to all financing fully covered with Preferred A guarantees.

Each financial institution must disclose to the BCRA on a monthly basis the classifications of all its debtors, which is published at the BCRA's credit bureau. The latter is a sound instrument for banks in Argentina as it is fairly comprehensive and up-to-date. However, the limitation it faces is that it does not include information on significant financing which is granted by finance companies that are not under the scope of the BCRA and do not disclose the classification of their clients. In some cases, these companies use other credit bureaux, which they build with their own data, usually together with other companies of their regions.

Guarantees

Loans can be backed by three types of collateral guarantees: Preferred A, Preferred B and others.

Preferred A guarantees consist of the cession of rights or pledge of bonds or documents in such a way that a financial institution may be assured of the full repayment of the debt due to the existence of a solvent third party or secondary markets available for the sale of the bonds or documents. The residual time to maturity of the credit transaction must not exceed six months, unless operations are backed by either cash collaterals, term deposits with the same financial institution, the assignment of tolls collection as collateral, or by guarantees and letters of credit issued by a 'AA' rated foreign financial institution, in which case the maximum residual time to maturity is one year. Preferred A guarantees are listed by the BCRA and, among others, include: cash, gold, time deposits in the same bank, Argentine government bonds, securities issued by the BCRA, guarantees and letters of credit issued by an 'A' rated foreign financial institution, credit card coupons, guarantees issued by OECD governments rated A or above, guarantees issued by reciprocal guarantee companies (or mutual credit guarantee consortia), etc.

Preferred B guarantees constitute property rights or third-party contingent liabilities that assure the financial institution the repayment of the debt following the procedures for the foreclosure of the collateral. These include first-grade mortgages and pledges, guarantees issued by reciprocal guarantee companies that do not qualify as Preferred A and other collaterals that meet all the requirements to qualify as Preferred A but the remaining time to maturity is more than six months. Guarantees are valued by independent specialists at the time the transaction is carried out, and are valid as long as there are no circumstances that negatively affect their quality as collateral, value or liquidity. However, the norm does not specify who is to judge the validity of the collateral, or how often it must be valued.

For other guaranteed transactions, the principal and interest will be considered taking into account the coverage margin established for each type of collateral.

In the event that a preferred A security serves as collateral to the loan and its value is equivalent to the amount of the loan, then this qualifies the loan as normal or non-delinquent and a 1% provision is required. If, however, the loan is backed by a Preferred B or other guarantee or with less than 100% in Preferred A guarantees then different provision levels are required based on its classification.

Related Clients' Transactions

Relationship between clients is based on the control of the company, as measured by the stock ownership or number of board members in common or actual or potential participation in governing bodies. The Argentine prudential regulation imposes lending limits to related clients based on the regulatory capital of the financial institution and its CAMELS rating. In general, the better the rating and the collateral, the higher the lending limit; however these cannot exceed 10% of regulatory capital for a single borrower and 20% for all related borrowers and a 100% limit for total financing to related clients plus total fixed assets.

For institutions with ratings between 1 and 3, the general limit is 10% for collateralized lending and 5% if it is not backed. For entities or companies that carry out complementary services and are subject to consolidation with the lending institution, the limit is 100% of the total regulatory capital if the borrower has a CAMELS 1 rating and this goes down to 10% plus an additional margin equal to 90% of the capital as long as loan maturity does exceed 180 days if the CAMELS rating is 2. Other domestic financial institutions and investment-grade foreign banks are bound by a 10% of regulatory capital borrowing limit.

Financial institutions with ratings weaker than 3 are barred from lending to related parties except in the case of foreign subsidiaries of the financial institution which are subject to supervision on a consolidated basis, foreign banks which are shareholders of the domestic institutions and companies dedicated to complementary activities to banking when subject to consolidated supervision.

The purchase of bonds traded in open markets are not included under these regulations as long as holdings do not exceed 10% of the outstanding amount of the bonds involved and provided they are rated 'BB' in the national rating scale or higher. Underwriting operations of less than 180 days are also excluded from the above-mentioned limitation.

Financial institutions cannot refinance credit to related companies or individuals classified as other than 'normal' by another financial institution or whose bonds are rated less than 'BB' by a rating agency. Finally, a written statement concerning their relationship (related or controlling) with the financial institution must be submitted by clients whose debt exceeds 2.5% of the financial institution's regulatory capital or ARS1m, whichever amount is lower; and persons, directly or indirectly related to the financial institution, holding 5% or more of the institution's voting rights.

Foreign Currency Net Global Positioning

All assets and liabilities in foreign currencies are included in the calculation of the net global position. Repo transactions under master agreements entered into domestic self-regulated markets are also included, with settlement of the net amount without delivery of the underlying asset. Assets deduced from regulatory capital are excluded from the calculation of this position.

Two ratios are considered:

Negative foreign currency net global position: starting January 2007, this position cannot exceed 15% of regulatory capital, however, it can be extended up to 15 percentage points (a maximum of 30%, which used to be the limit prior to January 2007) if the financial entity registers mid- and long-term (i.e. more than four years) financing in pesos to the non-financial private sector, for an amount equal to the incremental of the negative foreign currency net global position, and it registers an incremental on credit risk capital requirements equal to the general limit extension on the negative foreign currency net global position.

Positive net global position: this position cannot exceed the lower of 30% of the regulatory capital or the liquid capital (regulatory capital minus fixed assets). This norm is currently suspended.

Any excess is subject to a charge of twice the nominal interest rate of US dollar denominated LEBACs (short-term security issued by the central bank and denominated in either pesos or dollars) or twice the 30-day LIBOR for the last business day of the month, whichever is higher.

Foreign Currency Lending Capacity

Lending capacity of financial institutions stems from their foreign-currency deposits- including dollar term deposits to be settled in pesos- and must be allocated, indistinctively, to the following:

- pre-financing and financing of exports to be made directly or through principals, trustees or other brokers acting on behalf of the owner of the merchandise;
- financing of investment projects, working capital or purchase of any kind of goods that increase or are related to the production of goods to be exported;
- financing for manufacturers of goods to be exported by third-party purchasers, provided that such transactions are secured or collateralized in foreign currency by those purchasers;
- financing of commercial loans with the purpose of importing capital goods.
- debt or equity tranches of financial trusts whose underlying assets are loans granted with any of the above-mentioned purposes;
- interbank loans; and
- foreign currency debt or equity tranches of listed financial trusts, whose underlying assets are securities bought by the fiduciary and guaranteed by the reciprocal guarantee companies and whose target is to finance export transactions.

The lending financial institution must verify that borrowers have sufficient repayment capacity, considering at least two scenarios with considerable variations in the foreign exchange rate.

Lending capacity surpluses (exceeding the above-mentioned purposes) produce an additional cash requirement in the same currency to be held in cash or as deposits with the central bank.

Asset Valuation

The accounting standards are set by the Argentine Federation of Expert Councils on Economics through its technical body, the Special Committee on Accounting and

Auditing Standards (CENCyA). CENCyA in turn ensures that accounting (and auditing) standards in Argentina generally move in line with international developments and mandates that International Accounting Standards be the main source of accounting standards.

However, the 2001 financial crisis, led the central bank to establish temporary valuation rules concerning certain items in financial entities' balance sheets.

Specific valuation criteria include:

- Government bonds and debt securities issued by the BCRA. In August 2007, and mainly in order to reduce the effect of the volatility in the international markets on financial institutions' income statements, the BCRA introduced the option to register debt instruments issued by the central bank in investment accounts as long as the securities are included in the monthly volatility report published for information purposes by that institution. These securities must be held until maturity and valued at cost plus their monthly unrealized gains according to its internal rate of return. In its notes to the financial statements, financial institutions must disclose the valuation method used and the difference to the market value of the securities.
- In addition, with the same modification, financial institutions were allowed to register in available-for-sale accounts its holdings in government bonds and central bank debt instruments as long as they are included in the above-mentioned monthly volatility report. These securities must be marked to market, with variations against an equity reserve, and therefore, with no impact on the income statement.
- Guaranteed government loans, unlisted government bonds, promissory notes issued by the Trust Fund for Development of Provinces and other loans to the non-financial public sector are to be valued at the lower of its technical value or its present value calculated with the discount rates schedule below, which is published by the central bank and converges with the market interest rates (MR) for in June 2008.

Discount Rates For Selected Public Sector Assets

Year	Period	Nominal annual rate	Year	Period	Nominal annual rate	Year	Period	Nominal annual rate
2003	Mar-Dec	3.00%	2005	Oct	3.91%	2007	Mar	5%+0.13* (MR - 5%)
2004	Jan-Jun	3.25%	2005	Nov	3.96%	2007	Apr	5%+0.17* (MR - 5%)
2004	July	3.29%	2005	Dec	4.00%	2007	May	5%+0.21* (MR - 5%)
2004	Aug	3.33%	2006	Jan	4.08%	2007	Jun	5%+0.25* (MR - 5%)
2004	Sept	3.37%	2006	Feb	4.15%	2007	July	5%+0.29* (MR - 5%)
2004	Oct	3.41%	2006	Mar	4.23%	2007	Aug	5%+0.33* (MR - 5%)
2004	Nov	3.46%	2006	Apr	4.31%	2007	Sept	5%+0.38* (MR - 5%)
2004	Dec	3.50%	2006	May	4.39%	2007	Oct	5%+0.42* (MR - 5%)
2005	Jan	3.54%	2006	Jun	4.47%	2007	Nov	5%+0.46* (MR - 5%)
2005	Feb	3.58%	2006	July	4.56%	2007	Dec	5%+0.50* (MR - 5%)
2005	Mar	3.62%	2006	Aug	4.64%	2008	Jan	5%+0.58* (MR - 5%)
2005	Apr	3.66%	2006	Sept	4.73%	2008	Feb	5%+0.66* (MR - 5%)
2005	May	3.71%	2006	Oct	4.82%	2008	Mar	5%+0.75* (MR - 5%)
2005	Jun	3.75%	2006	Nov	4.91%	2008	Apr	5%+0.83* (MR - 5%)
2005	July	3.79%	2006	Dec	5.00%	2008	May	5%+0.92* (MR - 5%)
2005	Aug	3.83%	2007	Jan	5% +0.04 * (MR - 5%)	2008	Jun 08	
2005	Sept	3.87%	2007	Feb	5% +0.08 * (MR - 5%)	2008	onwards	Market rate

Source: BCRA

- Compensation BODEN bonds may be registered at their technical value.
- USD-denominated external bills of Argentina (also called "Patriotic Bonds") and other unpaid government bonds must be registered at the lower between their

book values as of 31 December 2003 and the amount resulting from reducing their face value by the lowest parity percentage resulting from calculating the net present value of all the other bonds valued using that methodology. In this manner, bonds currently in default are safeguarded from having a book value higher than performing public assets.

- Since August of 2005 non-listed LEBACs, NOBACs, corporate bonds, subordinated debt and debt securities issued by financial trusts have been valued by increasing their value according to their yield to maturity.
- In May 2005 the BCRA decided that financial institutions holding debt securities and other debt instruments of the national government, which, being eligible, were not exchanged in the sovereign debt exchange (Decree 1735/04), must set up provisions equal to 100% of their book value.
- Losses as a result of court injunctions due to the re-imbursement of foreign currency deposits may be recorded as intangible assets and amortized in 60 monthly installments. Furthermore, starting in December 2005, banks can extend the original term to reflect these losses, as long as they grant new commercial long-term loans with an average life greater than two years, up to a maximum of 10% of the institution's regulatory capital.

Liquidity Requirements

Minimum liquidity regulations are based on minimum cash requirements on demand and term liabilities. Requirements are determined based on the monthly average of daily balances of demand and time deposits and other liabilities arising from financial intermediation, both in Argentine pesos and foreign currency, and unused overdrafts facilities. Exemptions are assigned to obligations with the central bank, other local and foreign banks and repo transactions.

Peso-denominated checking and saving accounts have a cash reserve requirement of 19% or 30% if denominated in foreign currency. Certificates of deposits vary in severity of requirement based on their residual time to maturity; the rates range from the greater requirement of 14% for those peso-denominated deposits with the shortest residual time to maturity (up to 29 days) and 35% for those in foreign currency, to 0% for those with a residual time to maturity of more than 180 day in the case of local-currency deposits and more than 365 days for those in foreign currency.

Deposits of mutual funds have a cash reserve requirement of 19%, or 40% if denominated in foreign currency.

The total requirement is measured on the basis of the monthly average of daily balances of the liabilities as at the end of each day during the calendar month. In addition, the entities must keep a minimum cash position equal to 50% of the prior month requirement (or 70% if a shortfall is experienced in the previous month).

In the case of debt securities issued after January 1, 2002, the requirement varies according to the residual time to maturity and its currency. In the case of local currency issues, this goes from 2% if the residual time is between 90 and 179 days to 14% if it is less than 29 days. In the case of foreign currency securities, the requirements is 6% if the residual time is between 180 and 360 days and goes down progressively to 35 when it is less than 29 days.

In the event that the concentration of liabilities is excessive, either in creditors or maturities, the central bank can impose additional cash reserve requirements and/or other measures it considers adequate if the liquidity risk is significant.

If the financial institution fails to meet the minimum cash reserve and the daily minimum peso cash requirements, it will be subject to a charge twice the nominal interest rate for peso-denominated repos with the central bank. In the case of foreign currency, the charge is the higher of twice the nominal interest rate of USD-denominated LEBACs or twice the 30-day LIBOR on the last business day of the month.

Liquidity Assistance by the BCRA

Financial institutions are eligible for immediate assistance if their liquidity ratio, determined by the minimum cash reserve requirement on sight and time deposits, is lower than 25%; in which case the BCRA will lend the lower amount of: the amount requested by the entity, the amount needed to raise its liquidity ratio to 35%, the amount by which its deposits decreased during the last month, 20% of the total assistance to the financial system estimated by the Monetary Program, or the difference between the institution's equity and its outstanding debt with the BCRA. The assistance will be for a period of 90 days with the option to extend for the same period, and the soliciting entity is required to make payments in advance for amounts that will depend on its liquidity ratio.

Eligible collateral include publicly listed securities and mortgages on property owned by the borrowing financial institution in the case of temporary liquidity loans, and securities or loans to private sector clients classified as "Normal" in the case of re-discounts. In both cases, collateral should be worth at least 125% of the amount required.

As mentioned before, during the financial crisis of 2001 and 2002 the central bank acted as a lender of last resort and lent a total of ARS19,000m to the financial system. As of end-2007, all the assisted banks had re-paid their obligations except for one public sector bank, which is paying back its debt according to the original schedule.

Basel II

As with some other countries in the region, regulations regarding Basel II are somewhat delayed in Argentina. The target set by the central bank is to be fully compliant by 2010. With regards to Pillar I, the central bank decided to adopt the simplified standardized approach for credit risk. Its aim is that this approach does not result in significant variations in the current capital requirements. While the current requirements for market risk and interest rate risk will remain unchanged, the central bank has yet to decide which approach it will adopt for the capital requirement for operational risk.

In April 2008, the BCRA published its guidelines for operational risk management together with a schedule for their implementation by December 2009. Operational risk is defined as the risk of losses stemming from flaws in internal processes, from IT systems, from staff behavior or from external events. This definition includes legal risk but excludes strategic and reputational risk.

Financial institutions are required to establish an adequate framework for the management of operational risks which covers the institution's policies, proceedings and structure. In addition, responsibilities must be clearly defined and an operational risk unit, which could be only one person, must be created in accordance with the institution's size, nature and complexity of its business.

Additionally, the central bank plans to adopt the necessary measures for the implementation of Pillar II and III with enough time before 2010.

Anti- Money Laundering and Anti- Terrorism Financing

The central bank, based on the internationally accepted "know your client approach", has set the safety measures that financial institutions must adopt. These include identifying both new and existing customers and monitoring the activity of their accounts. In doing this, an affidavit must be submitted for individual transactions in excess of ARS30,000 to prove the origin and legitimacy of the funds and for transactions exceeding ARS200,000 documentation supporting the origin of the funds must be provided. Also, banks' staff must pay close attention to remote transactions, action on behalf of others i.e. trusts or special purpose vehicles, public officials or funds coming from another financial institution.

The central bank works together with national and international organisms to fight against the financing of terrorist activities. In this sense, financial institutions must block funds and other assets belonging to persons or entities included on the lists issued by certain national and international agencies, must immediately notify the Federal Court, notify the SEFyC in writing within 48 of the presence in the institution of any person included in these lists, comply with the anti-money laundering measures, identify and inform the Principal Management for Analysis and Control of Special Operations (GPAySOE) of any transactions suspected of being related to terrorism financing.

Distribution of Earnings

In October 2006 financial institutions were again allowed to distribute their earnings, which had been prohibited after the significant losses suffered by most banks in 2002 as a consequence of the crisis. To be authorized they must not be under a restructuring scheme, have outstanding financial assistance from the central bank, or be late in any information required by the central bank, and be in compliance with the minimum capital or liquidity requirements.

Distributable funds are composed of retained earnings minus the legal reserve (10% of the year-end profit up to a 20% of the share capital), the balance of court injunctions from the pesofication of deposits included in intangible assets, the difference between the book and market values of government and central bank bonds and the amount in equity reserves corresponding to available-for-sale securities, when negative.

Any earnings distribution must be approved by the SEFyC and the authorization request has to be submitted at least 30 days before the annual general meeting which will approve the dividend payment.

Regulations Relating to the Setting Up of Banks

The general rule is that complete freedom exists for the entrance or exit of financial entities to the market, as well as for their mergers and acquisitions. Furthermore, the same rules apply for domestic and foreign capital, as there are no limitations to the nationality of investors or the transactions to be carried out by the institutions in which foreign investors participate.

Under the Financial Entities Law, articles 7 and 8, the central bank has to approve new entities after an evaluation of the purpose, project goals, overall and sector market conditions, and past credit and financial expertise of the petitioner.

The BCRA also has to authorize the merger, absorption and transfer of a banking license after concluding that the resulting entity's financial structure will be sound enough to meet its business targets.

The Financial Entities Law also stipulates that financial institutions must disclose without delay any negotiation of its shares or any other circumstance which could lead to a change in its CAMELS rating, and the central bank has the right not to allow them. Finally, any change in the institutions shareholding structure involving 5% or more of its share capital must be informed even if the institution believes that it would not lead to a rating change.

Management

With regards to the management of financial institutions, the Financial Entities Law stipulates that the central bank must approve the appointment of members of the institutions' boards of directors. Directors must have appropriate skills for their functions, judged by the SEFyC based on their experience in financial services and/or similar areas. At least 80% of the entity's directors must have relevant experience. In addition, the law requires that the institution's management and administrative employees have the knowledge required to conduct activities on behalf of the entity.

The SEFyC also regulates internal and external auditors. External audits require approval from the central bank and have to adhere to the auditing framework set by the central bank. Internal audits must also adhere to the central bank's auditing framework.

Key Indicators for Argentina

Population (2006): 39.1m **Population growth rate (2001-2006):** 1.0% p.a.
GDP (2006): SD214.3bn **GDP per head at market exchange rates (2006):** USD5,476
GNI per head at purchasing power parity (2006): USD15,390 (=29% of USA level)
Modern sovereign rescheduling history: Numerous rescheduling with official and commercial bank creditors from 1983; Brady deal with commercial banks in April 1993 inflicted significant capital losses. 2001-present: in default on foreign currency bonds. 2005: 76% of default bonds tendered in distressed debt exchange

	2003	2004	2005	2006	2007f	2008f	2009f
Domestic economy and finance							
Real GDP growth (%)	8.8	9.0	9.2	8.5	8.7	5.8	3.8
Unemployment (% of labour force)	16.8	13.6	11.6	10.2	9.0	8.5	8.7
Consumer prices (annual average % change)	13.4	4.4	9.6	10.9	8.6	11.1	11.3
Gross domestic savings (% of GDP)	25.4	26.1	26.8	28.6	28.3	27.2	26.1
Gross domestic investment (% of GDP)	14.1	18.7	20.9	23.0	24.1	24.0	23.6
Short-term interest rate (%)[a]	3.7	2.0	4.1	7.2	8.4	7.1	7.1
Broad money (% change dec to dec)	29.6	21.4	21.5	20.3	19.0	18.0	15.5
ARS per USD (annual average)	2.90	2.92	2.90	3.05	3.11	3.24	3.35
REER (CPI, 2000=100)	47.7	46.0	45.9	45.2	44.9	46.1	47.3
REER: % change (+ = appreciation)	7.0	-3.7	-0.2	-1.4	-0.8	2.7	2.8
Public finances							
General government balance (% of GDP)	1.5	2.8	0.7	1.2	0.1	-0.5	-0.5
General government debt (% of GDP)	145.2	132.5	91.0	79.8	69.9	61.6	55.0
General government debt maturities (% of GDP)[b]	24.3	24.2	9.6	8.8	7.4	4.4	4.6
General government debt/revenue (%)	585.4	495.1	332.6	284.8	226.1	205.7	186.3
Interest payments/revenue (%)	9.4	6.1	8.3	7.4	7.8	7.7	7.6
Balance of payments							
Current account balance (USDbn)	8.1	3.2	5.7	8.1	5.9	4.3	3.5
Current account balance (% of GDP)	6.3	2.1	3.1	3.8	2.3	1.5	1.1
Current account balance plus net FDI (USDbn)	9.0	6.7	9.6	10.8	7.7	6.8	5.5
Current account balance plus net FDI (% of GDP)	7.0	4.4	5.3	5.0	3.0	2.3	1.7
Gross financing requirement (% of official reserves)[c]	146.0	110.7	63.4	54.4	23.0	14.1	12.2
Current external receipts CXR (USDbn)	38.5	44.7	52.4	60.9	70.9	76.7	81.5
Current external receipts CXR (Annual % Change)	16.6	16.1	17.1	16.4	16.4	8.2	6.1
Current external payments CXP (USDbn)	30.3	41.5	46.7	52.8	65.1	72.4	77.9
Current external payments CXP (annual % change)	25.2	36.7	12.5	13.2	23.2	11.3	7.6
External assets and liabilities							
Gross external debt (USDbn)	167.2	175.5	122.8	128.1	138.5	142.7	143.7
Gross external debt (% of GDP)	129.0	114.6	67.0	59.8	54.2	48.8	43.1
Gross external debt (% of CXR)	434.3	392.6	234.5	210.3	195.3	186.0	176.4
Net external debt (USDbn)	188.7	197.4	146.2	153.7	165.4	171.0	173.4
Net external debt (% of GDP)	145.6	128.9	79.8	71.7	64.7	58.4	52.0
Net external debt (% of CXR)	490.4	441.5	279.3	252.3	233.2	222.8	212.8
Public external debt (USDbn)	115.0	124.2	76.0	80.7	89.1	94.0	97.8
Public external debt (% of GDP)	88.7	81.1	41.5	37.7	34.8	32.1	29.3
Net public external debt (% of CXR)	261.9	233.8	91.5	79.9	60.5	49.3	45.4
Public FC denominated & FC indexed debt (USDbn)	107.1	114.2	72.8	78.6	81.4	82.7	84.0
Short-term external debt (% of gross external debt)	10.8	9.1	11.5	11.7	12.3	11.9	12.5
External debt service (% of CXR)	86.8	64.1	47.3	46.8	28.5	25.8	24.1
External interest service (% of CXR)	25.8	21.9	12.6	8.4	9.9	11.7	11.4
Liquidity ratio (%)[d]	29.8	35.5	53.3	68.3	91.9	124.0	149.3
Official international reserves including gold (USDbn)	14.2	19.7	28.1	32.0	46.2	56.1	60.8
Official international reserves in months of CXP Cover	5.6	5.7	7.2	7.3	8.5	9.3	9.4
Official international reserves (% of broad money)	36.3	42.3	50.7	48.5	61.6	65.5	63.5

[a] Central bank intervention rate (annual average)
[b] Maturities of medium and long-term debt during year plus short-term debt outstanding at the beginning of the year
[c] Current account balance plus amortization of medium and long-term debt, over official international reserves
[d] Official reserves incl. gold plus banks' foreign assets/ Debt service plus liquid external liabilities
Source: Fitch