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MONETARY UPDATING FACTORS AND INTEREST REFERENCE RATES

Chapter I – Monetary updating factors

National Treasury Bond (BTN)

Basic legislation: Laws 7,777, dated 6.19.1989 (instituted) and 8,177, dated 3.1.1991 (abolished); Minifaz Directive 169, dated 8.22.1989.

Objective: The BTN was created with the aim of providing the National Treasury with the resources required to preserve budget equilibrium or for credit operations based on anticipated revenues. Furthermore, BTN could be issued for voluntary exchange for Brazilian External Debt Bonds, which are papers reserved for exchange for public sector external debt registered at Banco Central do Brasil. Nominal updating of the BTN was effected monthly according to the IPC.

BTN had the following characteristics:
a) term: up to 25 years;
b) earnings: maximum interest of 12% per year, calculated on nominal value updated in monetary terms and paid every half-year;
c) nominal value: NCz$1,00 (one cruzado novo), in February 1989;
d) system of placement: public offer, on an auction basis;
e) modality: nominal-transferable.

National Treasury Bond – Fiscal (BTN-F)

Basic legislation: Laws 7,799, dated 7.10.1989 (instituted) and 8,177, dated 3.1.1991 (abolished).

Objective: The BTN-F was instituted as a reference for updating taxes and contributions under federal government jurisdiction. The daily value of the BTN-F was announced by the Secretariat of Federal Revenue, projecting growth in monthly inflation and reflecting the change in the value of the BTN in each month. On the first business day of each month, the value of the BTN-F corresponded to the value of the BTN updated to that month in monetary terms, based on article 5 of Law 7,777, dated 6.19.1989. Aside from being the tax and contribution indexing factor, the BTN-F could also be utilized as a reference for monetary updating of contracts or liabilities expressed in national currency and effective after the date on which Law 7,799, dated 7.10.1989, went into effect.

National Treasury Readjustable Bonds (ORTN)[18]

Basic legislation: Law 4,357, dated 7.16.1964 (instituted); Decree 54,252, dated 9.3.1964 (regulated); and Decree Law 2,284, dated 3.10.1986 (abolished).

Objective: Initially, ORTN were created with the objective of restoring the credibility of public securities since, up to that time, these papers contained no clauses calling for monetary updating of their value. As a result, payments of services were in arrears and the market value of these papers had been seriously corroded by inflation. Consequently, the first ORTN subscriptions were either compulsory or an alternative to federal tax payments. In the first case, these securities were issued obligatorily as matching funds for resources originating in the Worker Indemnity Fund and contained clauses that impeded their transfer, except in cases involving incorporation, merger or succession of the legal entity holding the papers. Another type of subscription was the obligation defined by the National Monetary Council as of 1966 in the sense that the technical reserves constituted by insurance companies would necessarily have to be placed in ORTN aside from other types of investments. A third system resulted from the levying of the income tax on the difference between the value of the goods representative of the immobilized assets of companies, indexed according to the change in the purchasing power of national currency, and the original acquisition value of such goods.

It was only in 1966 when Banco Central introduced the concept of compulsory reserves in securities that ORTN placements generated net revenues sufficient to cover the deficit or, at least, part of it. Between 1964 and 1968, this deficit exerted pressure on the Monetary Authority and resulted in issues of currency and sale of LTN directly to Banco Central which, in its turn, did not negotiate these papers on the market. Parallel to the compulsory reserves, the government began stimulating voluntary ORTN subscriptions through creation of various fiscal incentives granted to those holding these papers.

Insofar as the functioning of the financial market is concerned, the fact that operations were almost totally limited to the primary market made it more difficult to finance the internal securities debt, since the inexistence of an active secondary market generated a significant lack of liquidity. Aside from this, ORTN had longer maturities (between one and five years) and this contributed to increasing the deficit in the turnover of the debt. In practical terms, this fact meant that the volume of maturities was greater than that of new market placements.

18/ Text extracted from a magazine published by National Association of Open Market Operations (Andima): “Estudos Especiais – Selic” (December 1995).

National Treasure Obligations (OTN)

Basic legislation: Decree Law 2,284, dated 3.10.1986 (instituted) and Law 7,730, 1.31.1989 (abolished);

Comments: With issue of Decree Law 2,284/1986, the ORTN was altered to OTN, which was issued as of 3.3.1986. Its value was stipulated at Cz$106.40 (one hundred and six cruzados and forty centavos). The Decree Law determined that this value would remain unaltered up to 3.1.1987.

On 3.1.1987, the value of the OTN would be adjusted up or down in a percentage equal to growth in the IPC in the immediately previous period of twelve months. As of the date on which Decree Law 2,284/1986 went into effect, monetary indexing clauses in contracts with a period of less than one year were prohibited, subject to the penalty of voiding the contract in question.

Price Reference Unit (URP)

Basic legislation: Decree Law 2,335, dated 6.12.1987.

Objective: The URP was instituted with the objective of adjusting both prices and wages. On 6.15.1987, its value was set at 100 (one hundred) and it remained at that level as long as the simultaneous price freeze remained in effect (ninety days). Once prices were allowed to fluctuate, the following rules were to be applied:

a) the value of the URP would always be indexed at midnight of the first day of each month. The indexing factor was monthly average growth in the IPC in the immediately previous quarter;
b) in the first three months, the percentage change in the URP in each month would be equal to monthly average percentage growth of the IPC during the period of the price freeze.

Fiscal Reference Unit (Ufir)

Basic legislation: Laws 8,383, dated 12.30.1991, 8,981, dated 1.20.1995 and 9,430, dated 12.27.1996; Provisional Measures 542, dated 6.30.1994 (converted into Law 9,069, dated 6.29.1995) and 1,053, dated 6.30.1995 (converted into Law 10,192, dated 2.14.2001), and 1,973-67, dated 10.26.2000.

Objective: To serve as a measurement of value and parameter of monetary updating applicable to taxes and amounts expressed in terms of currency in federal tax legislation. When instituted by Law 8,383/1991, the monetary expression of the monthly Ufir was set in each calendar year and the daily Ufir was subject to the growth registered

each day, with the amount for the first day of the month being equal to the Ufir for that month. Provisional Measure 542/1994 (converted into Law 9,069, dated 6.29.1995) interrupted application of the Ufir in the period from 7.1.1994 to 12.31.1994, exclusively for purposes of updating the value of taxes, federal contributions and revenues on assets, provided that the respective credits were paid within the periods originally defined in legislation. This Provisional Measure abolished the daily Ufir as of 9.1.1994. In its turn, Law 8,981/1995 determined that, as of calendar year 1995, the monetary expression of the Ufir would be set for quarterly periods. Provisional Measure 1,053/1995 determined that, as of January 1, 1996, indexing of the Ufir would no longer be quarterly and would be half-yearly. Finally, Law 9,430/1996 determined that, as of January 1, 1997, the Ufir would be updated for annual periods (on January 1 of each year).

Real Unit of Value (URV)

Basic legislation: Provisional Measure 434, dated 2.27.1994, converted into Law 8,880, dated 5.27.1994.

Objective: The URV was created as a monetary standard that would temporarily be used parallel to the cruzeiro real in the Brazilian monetary system. Based on the arithmetic average of the changes in the three major price indices (Consumer Price Index (IPV), issued by Foundation Institute of Economic Research (Fipe); Broad National Consumer Price Index - Special (IPCA-E), published by IBGE; and the General Price Index - Market (IGP-M), which is elaborated by the Getulio Vargas Foundation (FGV), the URV has the role of achieving a higher degree of synchrony among prices, thus facilitating the transition to the new currency[19].

Transition to the URV was gradual in the financial market. In the first place, the National Monetary Council permitted negotiation of contracts on futures markets as well as operations involving the discounting of commercial invoices in URV. At the same time, financial institutions were permitted to contract lending operations in URV with the exception of rural credits and SFH operations, both of which follow their own specific rules. Following that, issues of private financial instruments in URV began, including CBD, debentures and short-term fixed income funds. In the case of commercial operations, the URV was adopted spontaneously.

The final stage of Real Plan implementation began on July 1, 1994, with conversion of prices and contracts expressed in URV into real at par. Prices and contracts still expressed in cruzeiros reais were converted on the basis of specific instructions for each type of contract at the rate of CR$2,750.00 = R$1.00.

19/ The first prices to be converted into URV in March 1994 were wages, social security benefits and contracts involving the public sector. There was no government intervention into the mechanisms involved in the formation of the prices of goods and services.

Chapter II – Interest reference rates

Interbank Deposit Certificate (CDI)

Concept: these are papers issued by financial institutions that are used as backing for interbank market operations. Though their characteristics are identical to those of Bank Deposit Certificates, operations with these papers are limited to the interbank market.

Objective: Transfers of resources from one financial institution to another. The major share of these operations is negotiated for one day only (CDI-over), reflecting expectations of the cost of banking reserves for the morning subsequent to closing of the transaction.

Overnight Operations

Objective: Exchange of banking reserves backed by federal public securities, the point at which the primary rate of interest of the economy is defined. This is the rate used as a reference for all other interest rates.

The open market is a secondary market or, in other words, a market in which securities issued previously are negotiated.

Open market operations are performed exclusively by financial institutions, since operations aimed at balancing currencies are effected through the use of banking reserves. Banco Central calibrates the cost of money through these operations and injects or withdraws resources as needed. Thus, financial institutions utilize the open market through overnight operations to purchase or sell securities and, in this way, close their daily cash flow result. Overnight operations are carried out at a rate that is predetermined by the parties involved.

The over-Selic rate is the median rate weighted by the volume of all operations with federal public securities.

Basic Financing Rate (TBF)

Basic legislation: Provisional Measure 1,053, dated 6.30.1995, CMN Resolutions 2,171 and 2,172, dated 6.30.1995, and 2,437, dated 10.30.1997; Banco Central Circulars 2,587, dated 6.30.1995, and 2,588, dated 7.5.1995.

Calculation system: based on the average monthly earnings of CDB/ RDB issued at preset market rates, with terms between 30 and 35

days. For purposes of calculating TBF, a sampling is drawn from the 30 largest financial system institutions, classified according to the volume of inflows of bank deposit certificates/receipts (CDB/RDB) among multiple banks with commercial or investment portfolios, commercial banks, investment banks and savings banks.

Objective: The Basic Financing Rate was instituted to be used exclusively as the basis of earnings of financial market operations, with duration terms equal to or greater than sixty days (art. 5 of Provisional Measure 1,053/1995).

Banco Central Basic Rate (TBC)

Basic legislation: CMN Resolution 2,288, dated 6.20.1996; Banco Central Circulars 2,780, dated 11.20.1997; 2,868, dated 3.4.1999, and 2,900, dated 6.24.1999; Banco Central Communiqué 6,629. dated 3.4.1999.

Objective: To be used as the parameter for discount window operations in the place of the over/Selic rate. This measure is aimed at facilitating financial institution access to these operations, particularly rediscount operations through interest rates closer to those practiced by the market. It is worth noting that rediscount operations were utilized normally up to 1986 when their costs were raised to punitive levels. This gave rise to the interbank deposit market as a source of financing to meet immediate liquidity needs. In this context, the institutions that resort to rediscount operations and accept the punitive rates imposed are evaluated negatively by the market, thus creating additional difficulties in their efforts to achieve financial equilibrium.

Circular 2,900 stated that the TBC would be preserved exclusively for contracts in effect on 3.4.1999 and Banco Central Communiqué 6,629 determined that, for the purposes of contracts in effect on that date, the TBC would be equal to the Selic rate.

Banco Central Assistance Rate (Tban)

Basic legislation: CMN Resolution 2,308, dated 8.28.1996; and Banco Central Circulars 2,711, dated 8.28.1996; 2,780, dated 12.12.1997; 2,868, dated 3.4.1999 and 2,900, dated 6.24.1999; Banco Central Communiqué 6,629, dated 3.4.1999.

Objective: Enhance the facility with which financial institutions are able to access discount window operations. The TBC and Tban were created to resolve the daily liquidity difficulties faced by financial institutions without having to pay the punitive rates that had become so common in liquidity financing operations. Those banks that possess

public securities and/or real guaranties but are undergoing passing liquidity difficulties are able to borrow funding through rediscount operations based on the TBC, complying with the criteria used to calculate the limits for each institution. Those institutions that require funding beyond the ceiling will have to bear the cost which is set in Tban, a rate higher than the TBC. In the context of the new rules, the period of these rediscount operations is up to 60 days for those guarantied by federal securities and up to 15 days for all others. These periods may be renewed at the request of the institution and at the exclusive discretion of Banco Central.

Circular 2,900 determined that the Tban would be maintained exclusively for contracts in effect on 3.4.1999 and Banco Central Communiqué stated that, for purposes of the contracts in effect on that date, the Tban would be equal to the Selic rate plus 2% per year.

Long-Term Interest Rate (TJLP)

Basic legislation: Law 10,183, dated 2.12.2001; Provisional Measure 684, dated 10.31.1994 (converted into Law 9,365, dated 12.16.1996) and 1,921, dated 9.30.1999 and CMN Resolutions 2,121, dated 11.30.1994; 2,161, dated 5.31.1995, 2,335, dated 11.13.1996, and 2,654, dated 9.30.1999.

Objective: The TJLP was created to be levied on financing granted by BNDES as of 1995. The objective is to offer longer term credit to companies for the purpose of stimulating investments. One should note that, on 8.12.1994, funding and lending operations on the financial market contracted with adjustment clauses based on a price index have been prohibited. The purpose of this measure was to stimulate the use of indices in these operations that reflect the cost of money as of a specified date, as occurs in the case of the TR, while eliminating those indices that reflect past inflation, such as the IGP-M.

As of October 1999, the TJLP will remain in effect for a calendar quarter and will be calculated according to the following parameters[20]:

a) inflation target calculated pro rata for the twelve months subsequent to and including the first month in which the rate is in effect, based on annual targets set by the National Monetary Council;
b) risk premium.

The TJLP is set by the National Monetary Council and released until the last working day of the quarter immediately prior to becoming effective.

20/ In the period from October 1 to December 31, 1999, the TJLP will be set at 12.5% per year, calculated on the basis of the pro rata inflation target for the coming months which is equivalent to 6.5% plus a risk premium of 6%. The TJLP will be set by the National Monetary Council and announced by the final business of the quarter immediately prior to that in which it will be applied.

Aside from the cases specified in current legislation, the TJLP may also be used in any operations carried out on financial markets or security markets under conditions defined by Banco Central do Brasil and, in the latter case, also by the Securities and Exchange Commission.

Reference Rate (TR)

Basic legislation: Law 8,177, dated 3.1.1991; CMN Resolutions 2,437, dated 10.30.1991 (replacing Resolution 2,097, dated 7.22.1995) and 2,604, dated 4.23.1999.

Objective: Created during the period of the Collor Plan II as a type of Brazilian Prime Rate, this is a basic interest reference rate to be used in the current month without mirroring inflation of the previous month. Though it was defined by the government as the indexing factor for contracts with terms of more than 90 days, the TR is used to index monthly savings account balances.

Calculation system: Based on the monthly earnings of CDB/RDB issued at preset market rates with terms specified at and including 30 and 35 days. For purposes of calculating the TR, a sampling is taken of the 30 largest financial institutions in the country classified according to the volume of bank deposit certificates and receipts contracted (CDB/RDB), encompassing multiple banks with commercial or investment portfolios, commercial banks, investment banks and savings banks.

This rate is nothing else but the TBF to which a reduction factor R is applied for the purpose of extracting the component that reflects the real rate of interest and the rate of taxation levied on bank deposits (certificates/receipts).

Daily Reference Rate (TRD)

Basic legislation: Law 8,177, dated 3.1.1991 (instituted) and Law 8,660, dated 5.28.1993.

Definition: allotment of the Reference Rate by the number of working days of the period to which the TR is concerned.

Objective: to be used as reference for the pro-rata amounts or those not related to the result of the full month.

Abolished as of 5.1.1993 by Provisional Measure 319, dated 4.30.1993, converted into Law 8,660, dated 5.28.1993.

Selic Rate

Basic legislation: CMN Resolution 1,693, dated 3.26.1990; Decree 2,701, dated 7.30.1998; Banco Central Circular 2,761, dated 6.18.1997, 2,868, dated 3.4.1999 and 2,900, dated 6.24.1999.

Concept: This is the rate calculated in terms of the Selic which, in turn, is obtained by calculating the average weighted and adjusted rate of one day financing operations, backed by federal public securities and processed within the system in the form of committed operations.

Committed operations are security sale operations with repurchase commitments assumed by the seller together with a resale commitment assumed by the buyer for purposes of liquidation on the following business day. The financial institutions that are apt to carrying out one business day committed operations are basically commercial banks, investment bank, security brokerage and distribution companies.

Comments: The Selic rate is based on effectively registered market rates. Basically, these rates reflect the money market liquidity conditions that exist at a given moment (funding supply versus demand). Since homogeneous backing is provided, these interest rates are not impacted by the risk of the borrower of financial resources in committed operations.

The Monetary Policy Committee (Copom) sets the Selic rate target and its bias, when one is adopted, as a monetary policy instrument aimed at ensuring compliance with the inflation target. The bias authorizes the Banco Central Governor to reduce or increase the rate without the necessity of convoking a meeting of the full Committee.

The period in which the Selic rate target remains in effect begins on the business day immediately subsequent to each Copom meeting and to each communiqué that notifies as to alteration of this rate up or down by the Governor of Banco Central depending on the bias in effect.

The period during which the bias remains in effect starts on the business day immediately subsequent to each Copom meeting.