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How to evaluate financial regulation of Brazil

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Introduction

- Starting point: two Keynes´ ideas + one Minsky´s ideia

1. State as regulator of the field in which private agents make their portfolio decisions on the allocation of wealth => asset side

- However, as pointed out by Minsky, "*A decision to invest is always decision about a liability structure*".
- Then, the State should regulate both the asset and the liability side of agent´s portfolio decisions

2. The hierarchical and asymmetrical nature of the international monetary (and financial) system

Introduction

- Updating these three ideas to think over the financial regulation of peripheral/developing countries which adhered to the process of financial globalisation, becoming "emerging" economies
  - Their currencies are positioned at the lower levels of the currency hierarchy (non-liquid currencies)
    - let them specially vulnerable to the volatile and pro-cyclical nature of capital flows and to currency mismatch (Ocampo, 2012)
    - Retrench their economic policy autonomy
      - These countries face an "impossible duality" (Flassbeck, 2001)

Introduction

- Moreover, emerging countries with high degree of financial openness + sophistication of financial markets (such as Brazil) => cross-border flows and domestic financial markets deeply intertwined

- Traditional analytical division (domestic X external) no longer useful or even possible

Introduction

- Despite the differences in terms of typologies and policy recommendations, the recent literature on external financial regulation recognized that capital flows regulation need to encompass a variety of measures, such as capital controls and prudential regulation
- But, the same rationale applies to the domestic financial regulation: capital flows also affect domestic financial markets performance. Cyclical capital flows could cause credit and asset prices booms and bursts. Then, capital controls are also important to the regulation of domestic financial markets.

Introduction

- Think over financial regulation in a broader sense without separating the internal and external dimensions. Prudential financial regulation, capital controls and other regulatory measures should be seen as an essential part of the financial regulatory toolkit
- Back to my starting point:
- financial regulation in emerging countries with open capital account and sophisticated domestic markets should **regulate residents/non-residents and financial/non-financial agents their portfolio decisions (asset and liability structures) in foreign and domestic currency at the on-shore/off-shore and spot/derivative markets.**

Introduction

- The goals of financial regulation in emerging countries:
  - Managing the inherent instability (Minsky) = minimize the systemic risk (internal and external dimensions)
  - Contributing to the management of key-prices as a supporting tool of monetary and exchange rate policies => besides their stability, their level should stimulate the process of development/capital accumulation: competitive exchange rate and low interest rate
  - Supporting capital accumulation by fostering the development of finance and funding mechanisms (induce banks to provide finance and private agents to keep their wealth in non liquid assets)

2. What is the financial regulation in Brazil like?

- Regulatory framework in Brazil
  - Prudential regulation of the banking system
  - Capital market regulation
  - Derivatives markets regulation
  - Capital controls
- Mixing of approaches: institution, market, product, currency and residency based

2. What is the financial regulation in Brazil like?

Regulatory institutional structure (Normative)

Normative

National Monetary Council : Main financial regulator (banking system, securities and derivatives markets)
- Minister of Finance
- Minister of Planning and Budget
- Central Bank of Brazil

National Council of Private Insurance : guidelines and policy norms on private insurances

National Council of Complementary Private Pension: responsible for regulating the private pension scheme operated by pension funds

Supervisory

BCB

Securities and Exchange Commission (CVM)

Federal Revenue Office (Receita Federal)

Superintendence of Private Insurance

National Superintendence of Complementary Private Pension

Financial Regulation Dimensions

Types of Regulation

1 - Prudential Regulation
- Capital adequacy
- Reserve requirements
- Safety Net

2 - Capital Market Regulation

3 - Derivatives Regulations

4 - Capital Controls
- Portfolio Inflows
- Foreing Loans

Dimensions

1 – Agents
- Financial (banks and non-banks) X non –financial
- Resident X Non-resident

2 - Asset X liability

3 - Currency

4 – Market
- On-shore Xoff-shore
- Spot X derivatives (forward settlement)

3. Are all dimensions covered by financial regulation?

Regulation		Agents		Asset X liability	Currency (R$ and FX)	Market	
		Financial X non - financial	Resident X Non-resident			On-shore X off-shore	Spot X derivatives (forward settlement)
Prudential regulation	Capital adequacy	Banks	Resident	Asset	R$ & FX (liquidated & denominated)	On-shore & off-shore	Spot and derivatives (on-shore)
	RR	Banks	Resident	Liability	R$	On-shore	Spot
	Safety Net	Banks	Resident	Liability	R$	On-shore	Spot
Capital market regulation		Both	Both	Both	R$ & FX denominated	On-shore	Spot
Derivatives regulation		Both	Both	Both	R$ & FX denominated	On-shore (but indirect on off-shore)	Derivatives
Capital controls	Portfolio inflows	Both	Non-resident	Asset	R$ & FX denominated	On-shore	Spot
	Foreign Loans	Both	Resident	Liability	FX liquidated and denominated	Off-shore	Spot

4. Are the three aims of financial regulation achieved in Brazil?

- The first issue is the degree of financial openness
  - The hard critical view is that the financial openness should be reverted through changes in capital market regulation and derivatives markets regulation (finance is a domestic issue)
  - A more soft critical view is that if the open capital account environment is maintained, a broader regulation of capital flows and FX derivatives should be implemented (to mananging instability and, mainly, the exchange-rate)

Are the three aims of financial regulation achieve in Brazil?

- Support the process of capital accumulation by fostering the development of private finance and funding mechanisms (induce private agents to keep their wealth in non liquid assets)
  - There are no doubt that the initiatives (stimulus package of Dec. 2010 – securities market) are insufficient
  - Beyond prudential regulation, there is an other dimension that has to be taken into account. The regulatory framework should also aim at promoting development
    - Regulation need to foster private finance and funding mechanisms which should involve the banking system: regulation of the volume, term and cost (interest rate) of finance and funding

Thank You

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