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***NATIONAL FINANCIAL SYSTEM***  
***AND***  
***CENTRAL BANK PERFORMANCE***

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*“Although information technology by its very nature has lowered risk, it has also engendered a far more complex international financial system that will doubtless bedevil central bankers and other financial regulators for decades to come. I am sure that nostalgia for the relative automaticity of the gold standard will rise among those of us engaged to replace it.”*

**April, 2000      Alan Greenspan**

## ACRONYMS

ATM - Automated Teller Machine

BASA - Bank of Amazonia

BB - Bank of Brazil

BC - Central Bank of Brazil

BBC - Central Bank Bond

BM&F – Future and Commodity Exchanges

BNB - Northeastern Bank of Brazil

BNDES – Brazilian Development Bank

CEF - Federal Government Saving Bank

CETIP – Center for the Custody and of Financial Liquidation of Private Issues

CMN – National Monetary Council

CNSP – National Council of Private Insurance

COPOM – Central Bank Committee of Monetary Policy

CRSFN – Council of Funds of National Financial System

CVM – Securities and Exchange Commission

FED - Federal Reserve System

FGC – Credit Guarantee Fund

LBC – Central Bank Bond

MPAS – Public Social Insurance and Social Assistance Ministry

PROER – Program of Incentives for the Restructuring and Strengthening of the National Financial System

PROES – Program of Incentives for the Restructuring for the State Public Financial System

SELIC - Special system of Liquidation and of Custody

SFH – Housing Financial System

SISBACEN - Central Bank Information System

SPC – Complementary Pension Secretariat

SUMOC – Currency and Credit Superintendency

SUSEP – Private Insurance Superintendency

## ABSTRACT

The Brazilian economy went through major changes since the Bank Reform Law of 1964. The National Financial System, in order to follow up the process, went through several changes and evolutions. Financial intermediation is the core of economic development in a modern market economy. It must have an agile and adequate structure to make possible the activity of borrowers and savers of funds in many different situations. New products and services are created everyday by financial and non financial institutions in order to accomplish needs of the market.

Since the 1988 constitution, the National Congress is supposed to discuss and approve a regulation on financial system reform (art.192). The new supplementary act will regulate the Central Bank independence, foreign capital and official banks. It is reasonable to anticipate that new modifications in financial system structure might happen.

In the context of continuous evolution, this current work introduces in its first part, an analysis of the current structure of the financial system, one with which Brazil will step forward into 21st Century. Consequently, all regulation and supervision agencies of the system will be characterized, besides the several types of institutions of the operative system. The institutions of securities system and custody of securities and the institutions of the national system of insurance and supplemental social security will not be detailed in this work.

The second part of the work approaches the performance of Brazilian Central Bank in the National Financial System. It is an institution of major importance that performs broad and complex activities ranging from issuance and supply of currency to the banks through the system supervision activities.

Finally, it is important to point out that the ideas and opinions presented here are exclusive of the author and don't represent the official position of the Central Bank of Brazil.

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## 1 - BRIEFING OF NATIONAL FINANCIAL SYSTEM

The Bank of Brazil, the first bank of the country, was created in 1808 by prince D. João VI. At that time, the bank performed operations with deposits of precious metals, currency, emission of bank notes and exchange operation. As the only institution in the business, it had the privilege of selling the products traded by the crown. After the royal family returned to Portugal in 1821, the bank faced a serious crisis and in 1829 it was dissolved. The first private commercial bank was created in 1836. It lasted 3 years until the closing of its activities due to insolvency.

The new Bank of Brazil was created in 1853 thanks to Baron of Maua and a group of businessmen. The first foreign banks to settle in Brazil in 1860 were the "London & Brazilian Bank" and "The Brazilian and Portuguese Bank". In 1910 Brazil had 16 national banks and 5 foreign banks. A bill was introduced in 1918 by Congressman Sampaio Vidal, which proposed to transform Bank of Brazil into Central Bank of Emissions, but the project unfortunately did not succeed due to the absence of political support.

Brazil, contrary to many European nations that have structured their financial systems from a central bank, was beginning a long road of controversies and instabilities toward the creation of its Central Bank.

The General Supervisor of Banks was created in 1920 with the expansion of activities of financial brokerage, reporting to Financial Ministry. At that time, Bank of Brazil began to perform a number of activities of commercial bank and became a dubious institution, i.e. it operated both as a government institution and as a competitor in the commercial banks market. This was without a doubt one of the major aspects for the delay of almost 50 years of the creation process of a central bank in Brazil.

In the 1930's there were several attempts to create a central bank. With the market growth, the creation of an agency to control currency and credit was necessary. In 1945 it was created, by suggestion of Prof. Octávio Gouvêa de Bulhões, Currency and Credit Superintendency (SUMOC) reporting to the Financial Ministry. Since then, the financial system was controlled by three entities that together performed the activities of a central bank: SUMOC (with its Major Board), Bank of Brazil and National Treasury.

The National Financial System needed a reasonable structure that fit the needs of society as a



whole. The following 1964 speech of congressman Abel Rafael is just an example of the intense debate in the National Congress for the creation of a central bank in Brazil:

*"...at this moment, bringing to discussion the name of Bank of Brazil (BB), its development, the changes that it will have, to threaten the creation of a central bank, is a crime against Brazil. BB can not be a taboo against the financial progress of the country. We do not have a financial system, a bank system; we have banks, bank directors, bank agencies managers, but we do not have a financial system, because of lack of organization... Congressmen, the creation of a central bank is a necessity. Either we now create it and leave the sentimentalism to protect BB, that does not need protection for it will not suffer any loss in its activity and will even go on in a better situation after the organization of credit, currency and exchange or we will never fight inflation."*

Finally, on December 31, 1964, by Law 4595, the National Monetary Council and the Central Bank of Brazil were created. It took 50 years of discussions and successive postponements until the moment was finally reached.

Between 1964 and 1988, several laws and decrees were issued and they modified the structure and the operation of National Financial System:

- Law 4357/64 - Monetary Correction Law
- Law 4380/64 - National Housing Plan Law
- Law 4594/64 - Reform of National Financial System Law
- Law 4728/65 - Securities Law
- Law 6385/76 - Securities and Exchange Commission Law
- Law 6404/76 - Corporate Law
- 1986 Presidential Decree - end of Bank of Brazil's "movement account" that is no longer considered Monetary Authority.

Monetary authority duties are performed exclusively by Central Bank of Brazil. Non-typical activities so far performed by Central Bank, such as related to funding and management of public debt were transferred to National Treasury. In 1988, with the enactment of the new federal constitution, National Monetary Council lost many powers that were almost limitless. National Congress recovered directives pursuant to the ruling of the financial system. Central Bank president and directors appointed by the

country's President now must have their names approved by the Senate.

The issuance of Resolution 1524/88 allowed the creation of multiple banks, i.e. financial institutions might perform more operations, transforming bank agencies in diversified financial services offices. Thus, the north american model of specialized institutions was abandoned.

In 1994, with the official start of the Real Plan, banks lost their inflationary income and some of them failed to adjust themselves according to the rules of a new stable economic environment. After the bankruptcy of major banks, e.g. Econômico, Nacional and Bamerindus and to avoid the start of a systematic bank crisis, the federal government, through Central Bank, launched the "Program of Incentives for the Restructuring and Strengthening of the National Financial System - PROER", "Program of Incentives for the Restructuring for the State Public Financial System - PROES" and the Credit Guarantee Fund (FGC) as a way to assure the confidence of clients.

The great merit of PROER was to avoid the high cost of a system-wide crisis. About the costs of the program the balance sheet of Proer from its start-up in November 1995 to November 1997 shows that the amount released in the period totaled R\$21.0 billion. These resources have been used basically to finance the purchase by private institutions of part of the assets and liabilities of banks that were under intervention, including Econômico, Nacional and Bamerindus. Meanwhile, R\$1.2 billion has already been paid off and R\$ 13.2 billion transferred to the Central Bank of Brazil itself. Adding in the financial charges of the loans, R\$3.1 billion, Proer current balance, totals R\$9.7 billion.

Since then, SFN suffered significant alterations in its structure because a lot of control transfers, mergers, cancellations and liquidations took place and cause a reduction of existing institutions. As expected, private banks showed more flexibility to adapt themselves in a stable economy reducing costs, modifying technologies and creating new services.

It is worthwhile to mention the establishment of foreign banks in Brazil. In 1988, institutions with foreign control had 247 agencies countrywide. In 1998, this figure increased to 2,395 agencies, signifying a tremendous growth.

## INSTITUTIONS' PERCENTAGE PARTICIPATION IN THE BANKING AREA

	1993	1994	1995	1996	1997	1998	jun/99
Foreign control banks	7,28	9,57	13,08	10,29	14,29	21,86	25,91
Private banks	48,23	55,63	49,21	55,32	51,82	49,75	45,71
State-owned banks	15,02	11,06	12,41	12,40	11,49	11,35	11,26
CEF	4,04	5,27	12,04	8,85	9,09	5,42	5,30
BB	24,93	17,76	11,82	11,87	11,76	10,03	10,13
Credit cooperatives	0,50	0,71	1,44	1,27	1,55	1,59	1,69

By the end of 1999, Brazil had a very sophisticated financial system, precisely one of the most modern in the world, with around 200 banks and approximately 25,000 bank agencies.

## 2 - CURRENT STRUCTURE OF NATIONAL FINANCIAL SYSTEM

### Supervision Subsystem

National Monetary Council

Council of Funds of National Financial System - CRSFN

Central Bank of Brazil - BC

Securities and Exchange Commission - CVM

National Council of Private Insurance

Private Insurance Superintendency - SUSEP

Council of Complementary Pension

Complementary Pension Secretariat - SPC

### Operative Subsystem

Bank or Monetary Financial Institutions

Commercial Banks

Savings Banks

Credit Cooperatives

Cooperative Banks

Non bank or non monetary financial institutions

Investment banks

State Banks of Development

Leasing Companies

Consumer Finance Companies

Mortgage Companies

Institutions of Brazilian System of Savings and Loans

Real Estate Credit Companies

Savings and Loans Association

Multiple Banks

Special Agents

Bank of Brazil (BB)

Brazilian Development Bank (BNDES)

Bank of Northeast of Brazil (BNB)

Bank of Amazonia (BASA)

Federal Government Savings Bank (CEF)

Third Parties' Resources Management Institutions and Companies

Mutual Funds of Investment

Consortium Administrators

Investment Clubs

Securities Portfolio

Investment Companies - foreign capital

Institutions of Securities Delivering System

Securities Brokers

Exchange Brokerage Companies

Securities Dealers

Independent Agents for Investment

Commodities Brokers

Institutions of Securities Liquidations and Custody System

Stock Exchange

Over the Counter Brokers

Companies of Clearance and Liquidation of Operations

Commodities and Futures Exchanges - BM&F

Special System for Liquidation and Custody of Government Bonds - SELIC

Center for the Custody and Financial Liquidation of Privates Issues – CETIP

### Institutions of National System of Private Insurance and Supplemental Social Security

Private Open Pension Funds

Private Closed Pension Funds

Insurance Companies

Capitalization Companies

Health Insurance Management Companies

The following text items describe and detail the entire supervision subsystem. In relation to the operative subsystem, the bank as monetary institution to some of the third parties' funds management institutions will be explained. The focus of this paper is on Central Bank performance, therefore the other other institutions of the operative subsystem will not be analyzed, although they are related as components of financial system structure.

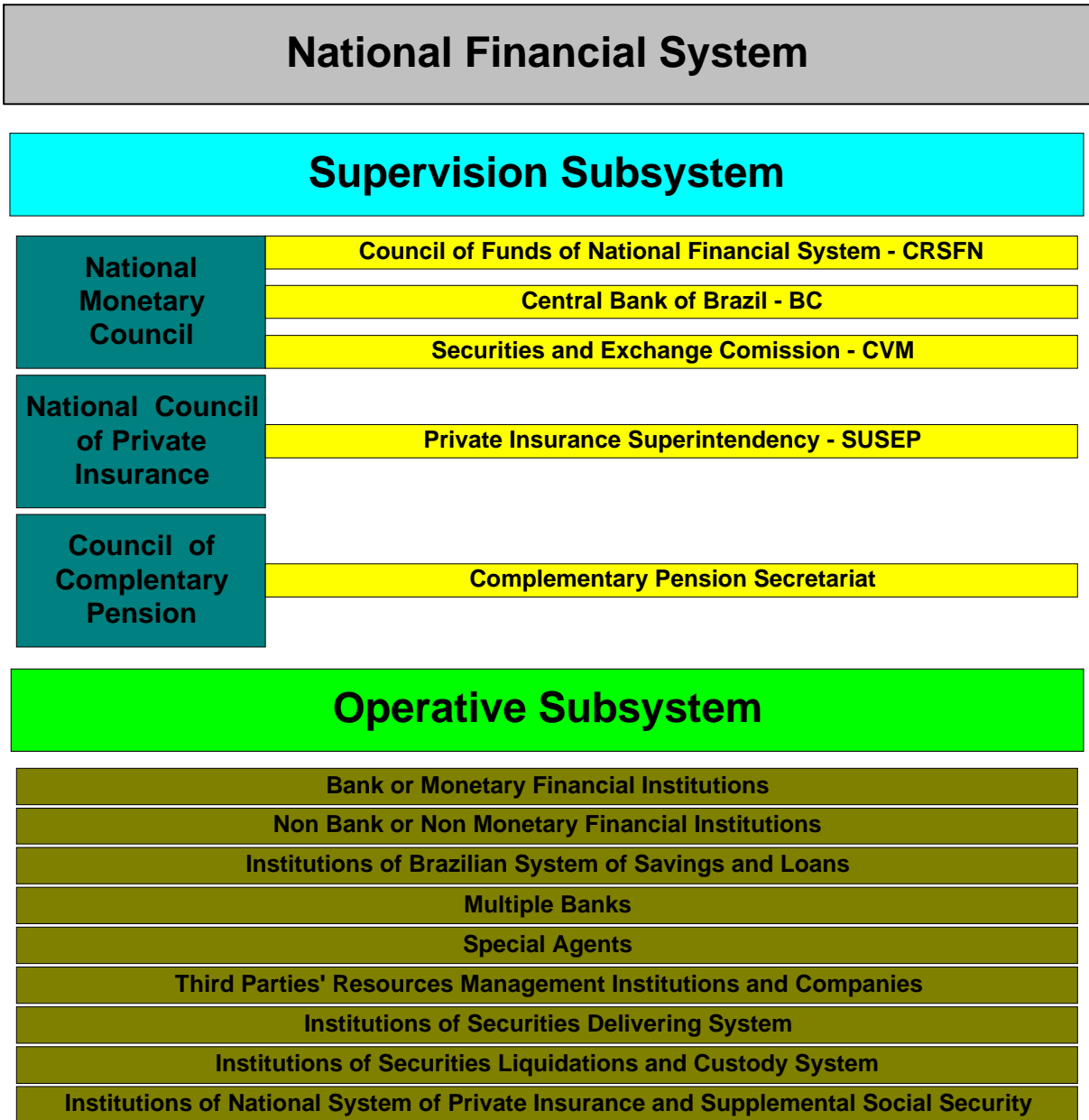


Exhibit 1 – Current Structure of National Financial System

### 3 - REGULATION AND SUPERVISION ENTITIES

#### 3.1- NATIONAL MONETARY COUNCIL

National Monetary Council (CMN) was created by Law 4595 and was inspired from the United States Federal Reserve Board. Council composition has been modified along the years and the current components, defined by Law 9069 of June 29, 1995 are: Financial Minister (Chairman), Planning Minister and Central Bank President.

It has the assessor agencies: Technical Commission of Currency and Credit, that deals with subjects related to monetary liquidity and consultive commissions on subjects specific and relevant to the financial system. The following charts respectively show the composition of the Technical Commission of Currency and Credit and the list of consultive commissions that were created:

<b><i>Composition of the Technical Commission of Currency and Credit</i></b>
President of Central bank of Brazil (Chairman); Four Directors of Central Bank of Brazil; President of Securities and Exchange Commission; Executive Secretary of Planning Ministry; Executive Secretary of Financial Ministry; Secretary of National Treasury of Financial Ministry; Secretary of Economic Policy of Financial Ministry.

<b><i>Consultive Commissions created to advise CMN</i></b>
Rules and Organization of Financial System; Securities and Futures Market; Rural Credit; Industrial Credit; Housing, Sanitation and Urban Infrastructure Credit; Public Endebtedness; Monetary and Exchange Policy; Administrative Processes.

CMN is the top organ of the financial system and deliberates through the issuance of resolutions, by majority voting, with the Chairman having the quality vote and the prerogative to deliberate "ad referendum" from the other members in case of urgency and relevance. The CMN Chairman may invite



other State Ministers, as well as state or private companies representatives to take part in meetings with no voting right. Central Bank of Brazil works as an executive secretary of the council that ordinarily meets once a month and, extraordinarily, always when called by the Chairman. CMN holds many and comprehensive attributions:

- adapt the volume of means of payment to the real needs of national economy and its development process;
- regulate the internal value of the currency;
- regulate the external value of the currency and the country's balance of payments;
- coordinate monetary, credit, budget, fiscal and internal and external debt policies;
- assure the liquidity and solvency of financial institutions;
- establish the directives and rules of exchange policy;
- discipline all modalities of credit;
- regulate the constitution, operation and fiscalization of financial institutions;
- determine the mandatory fees;
- regulate rediscount operations;
- regulate the activities of Stock Exchange, Brokers and other compounding institutions of distribution system.

### **3.2- COUNCIL OF FUNDS OF NATIONAL FINANCIAL SYSTEM**

The Council of Funds of National Financial System (CRSFN) was created on March 15, 1985, by decree 91152, as an integrant agency of Financial Ministry to rule out in first and last level the appellations set of decisions related to the application of administrative penalties from the Central Bank of Brazil and from the Securities Exchange Commission.

It is composed by eight counselors of reknown competence and skill of specialized knowledge in subjects related to financial and securities market. All those members and their respective replacements are appointed by the Finance Minister for a two-year term with only one extension.

The representative of Finance Minister is the Chairman and the VP is appointed by the Finance

Minister within four representatives of categories entities that are comprised by the Council. It is important to point out that an Attorney of Finance Ministry, appointed by the Finance Ministry General Attorney, works in the Council with the duty of assuring the faithful accomplishment of laws, decrees, rulings and other regulations.

<b><i>Composition of Council of Funds of National Financial System (CRSFN)</i></b>
A representative of Finance Ministry; A representative of Central Bank of Brazil; A representative of Federal Savings Bank; A representative of Securities and Exchange Commission; Four representatives of category entities, of financial and capital markets.

### **3.3- CENTRAL BANK OF BRAZIL**

Central bank of Brazil (BC) was created on December 31, 1964, by Law 4595, with the purpose of replacing the former Currency and Credit Superintendency (SUMOC) of Bank of Brazil and taking over the typical activities of a monetary authority. So far, Brazil had no one institution with the attributions related to a central bank. At the time, SUMOC, Bank of Brazil and the National Treasury altogether performed as a monetary authority.

Central Bank is a federal autarchy subordinate to Finance Ministry with headquarters in Brasilia and regional administrative offices in nine Brazilian states. It was created to perform as a central executive agency of financial system with the duty to accomplish and assure the accomplishment of the rules issued by CMN as well as all rules of the system. It is through it that the State directly supervises the financial system and, indirectly, the country's economy.

Central Bank is managed by a board of directors composed by the Governor and seven Deputy Governors, all appointed by the country's President and approved by the Senate. Exhibit 2 shows in details the current structure of BC.

The fundamental activities of Central bank (see annex 1 for a detailed table of BC attributions) are:

- the monopoly of currency issuance;
- act as the bank of banks;
- act as government's banker;

- perform the supervision of financial system;
- set and perform the monetary policy;
- set and perform the credit policy;
- set and perform the exchange policy;
- assessor federal government in business affairs.

Assets operations of the Central Bank are: purchase of foreign currencies, purchase of federal bonds (public or from the Treasury), the withdrawal of National treasury Account (tax expenses and redeems of National Treasury bonds), financial assistance in liquidity and the refund of mandatory on savings deposits.

Liabilities operations of the Central Bank are: issuance of currency (coins and bills), bank reserves, sell of federal bonds from its portfolio or from its issuance, sell foreign currencies, deposits in the account of National Treasury (taxes or bonds incomes from Treasury), the refund of financial assistance on liquidity and the collection of mandatory savings deposits.

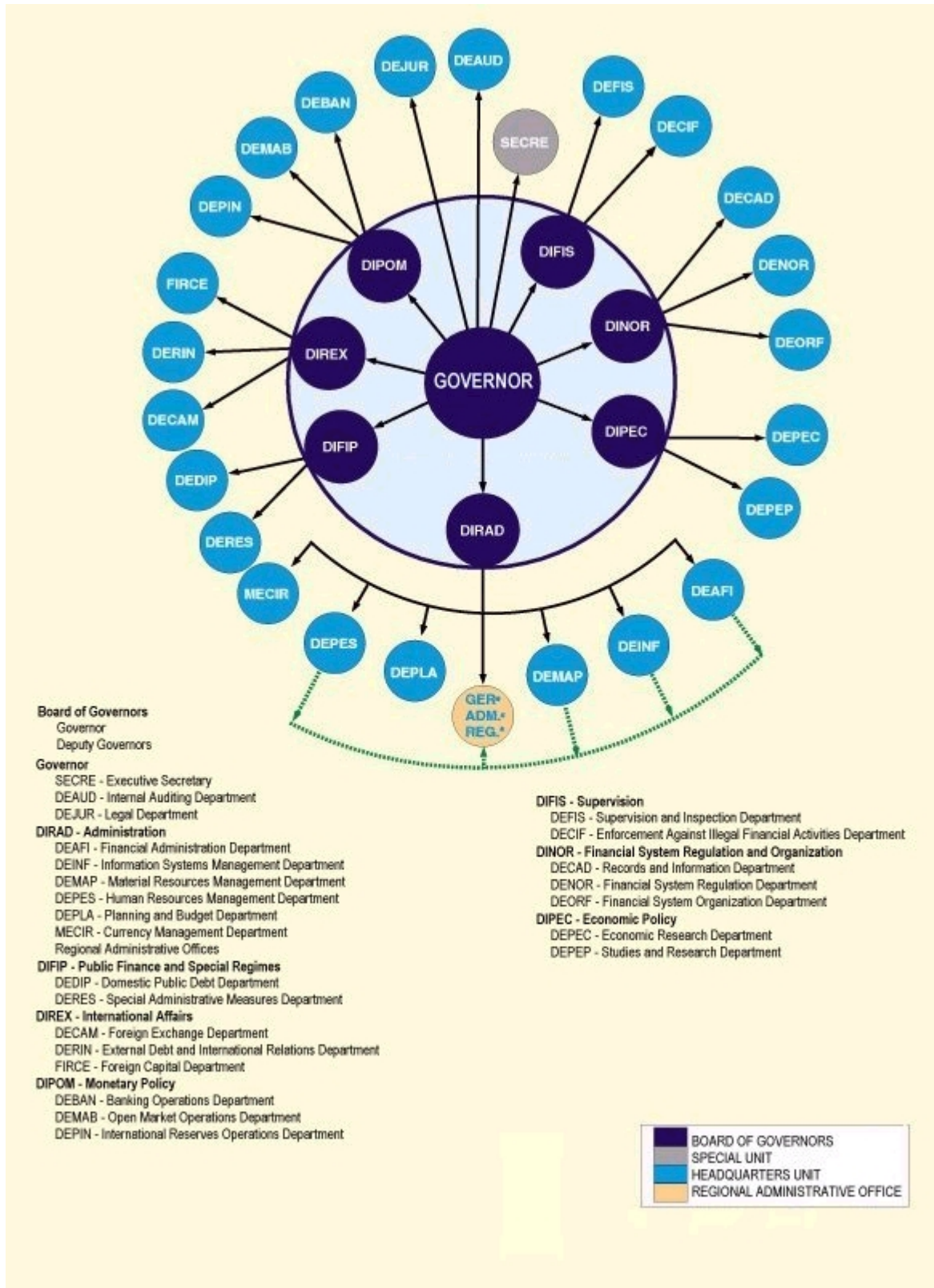


Exhibit 2 – Current Structure of Central Bank

**3.4- SECURITIES AND EXCHANGE COMMISSION**

Securities and Exchange Commission (CVM) is a federal autarchy reporting to the Finance Ministry, created by Law 6385 on December 7, 1976, which has the charge of regulating, controlling and supervising the issuance and distribution of securities, according to the guidance of National Monetary Council (CMN). Its fundamental goal is the offer of security and development conditions to securities market in order to assure it as an efficient and dynamic instrument of savings raising, corporation capitalization and dilution of income and property.

To accomplish this goal, CVM currently has the following executive structure:

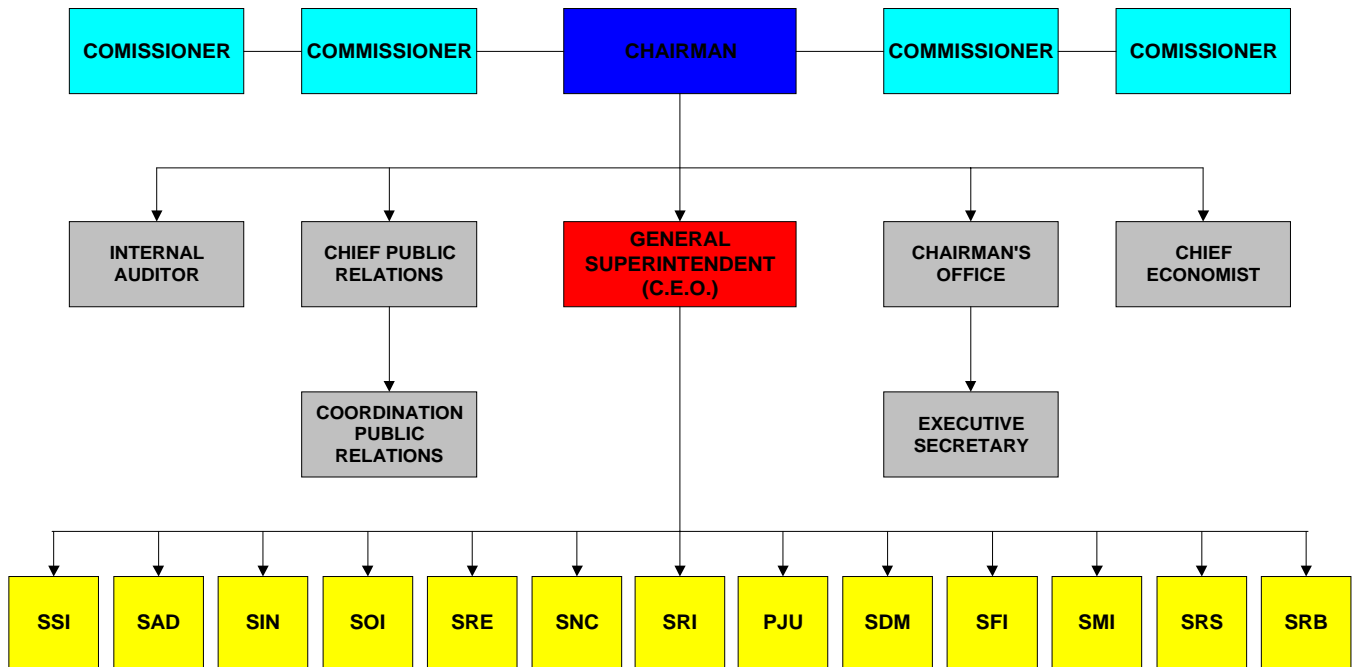


Exhibit 3 – Current Structure of CVM

Where:

SSI - Computer Supervisor

SAD - Administrative-Finance Supervisor

SIN - Investor Relations Supervisor

SOI - Supervisor of Guidance and Protection to Investors

SRE - Derivative Market Supervisor

SNC - Accounting Practices and Audit Supervisor

SRI - International Relations Supervisor

PJU - Legal Attorney

SDM - Market Development Supervisor

SFI - External Inspection Supervisor

SMI - Market Relations and Brokers Supervisor

SRS - São Paulo Regional Supervisor

SRB - Brasília Regional Supervisor

CVM attributions:

- assure the activity of stock and over the counter markets;
- inspect the issuance, record, distribution and trade of securities;
- encourage the application of savings in securities market;
- provide safety to securities bearers against irregular issuances and criminal acts of managers and stockholders;
- repress fraud or manipulations destined to create artificial conditions of demand, supply or price of securities traded on market;
- assure the access of the public to information on securities traded and companies that might have issued them;
- assure the accomplishment, in market, of conditions of credit utilization set by CMN.

### ***3.5- PRIVATE INSURANCE SUPERINTENDENCY***

Private Insurance Supervisor (SUSEP) was created by decree 73 on November 21, 1966, and is an autarchy reporting to the Finance Ministry. It is the institution responsible for the control and supervision

on insurance market, supplemental social security, capitalization and private plans of health care.

It is managed by a Directors' Board composed by the Supervisor and four Directors. A General Secretary and a General Attorney also take part in this board but with no voting right. Current structure of SUSEP is shown in the following table:

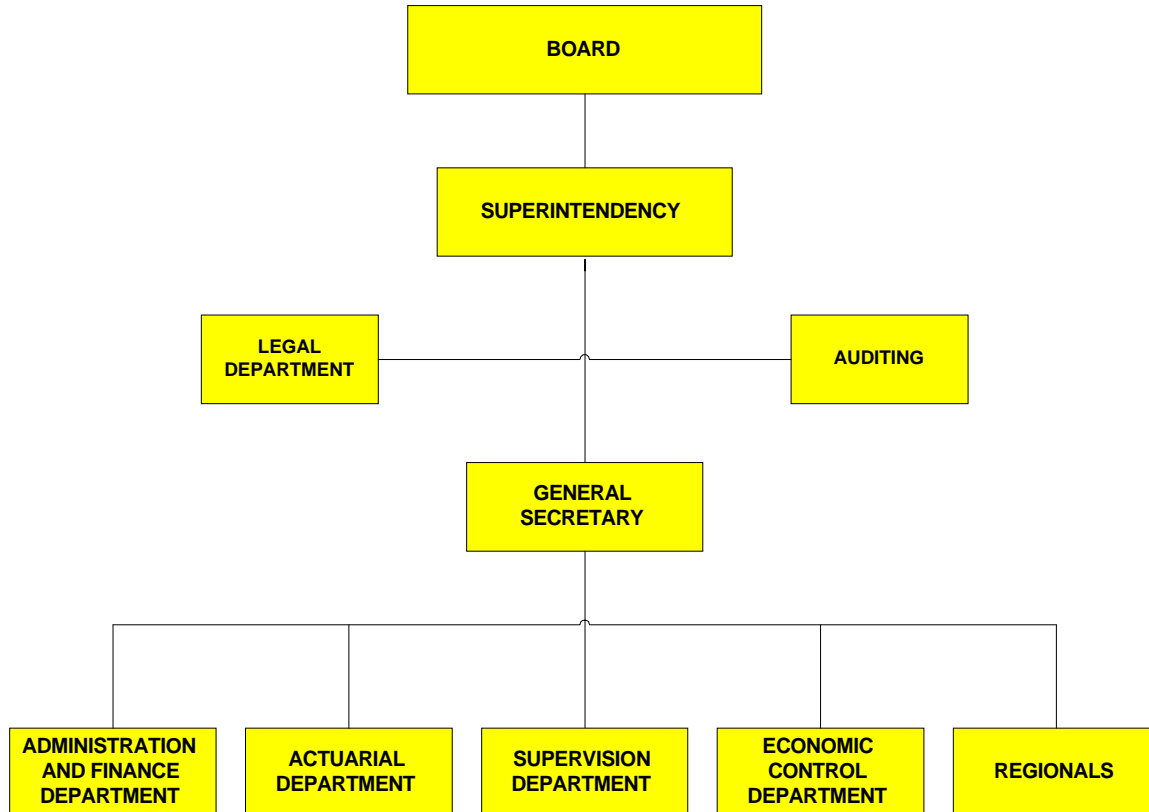


Exhibit 4– Current Structure of SUSEP

Main attributions of SUSEP are:

- Accomplish and assure the accomplishment of deliberations of Private Insurance National Council (CNSP) and perform activities that may be assigned by it;
- Inspect the constitution, organization, operation and activity of Insurance Companies, Capitalization Companies, Supplemental Social Security Companies and Private Plans of Health Care Agents responsible for the practice outlined by CNSP,
- Keep the liquidity and solvency of companies that take part in the market;

- Perform in a way to protect the raising of popular savings that are effective through operations of insurance, supplemental social security, capitalization and private plans of health care;
- Sponsor the improvement of institutions and operating instruments linked to it;
- Sponsor markets stability under its jurisdiction, assuring its expansion and the operation of its entities;
- Provide the services of Executive Secretariat of CNSP.

### **3.6- COMPLEMENTARY PENSION SECRETARIAT**

The Complementary Pension Secretariat (SPC) belongs to the Ministry of Public Social Insurance and Social Assistance (MPAS) and it is the competent organ to treat the referring subjects the private closed pension funds. It accomplishes the emanated orientations of the Management Council of Complementary Pension.

The complementary pension system was instituted in Brazil by the Law 6435 of July 15, 1977. In agreement with the Law, private pension funds are those that institute private plans of concession of savings or incomes, complementary benefits or assimilated to the public social insurance, by participants' contribution, of the respective employers or of both.

Those entities can be classified as closed or open. The difference among them is that the closed ones cannot have lucrative ends and they are accessible exclusively to the employees of only one company or of a group of companies. They are examples of the entity type of the great pension funds of public companies, such as Previ (of the employees of the Bank of Brazil), Petrus (of the employees of Petrobrás), and others. The closed entities are under the competence of Public Social Insurance and Social Assistance Ministry through SPC.

Complementary Pension Secretariat has the attributions:

- supervise, coordinate, guide and control activities related to closed-end complementary pension system (or pension funds system);
- analyse requests for authorization for creation, working, merger, acquisition, grouping, transferring of control and reform of bylaws of closed-end companies of private social security, submitting a technical evaluation to the state minister;



- inspect the activities of closed-end pension fund, pursuant to the accomplishment of effective legal rules and apply the suitable penalties;
- the liquidation of closed-end pension fund with working authorization cancelled or the ones that no longer have conditions to work;
- propose the basic directive for the complementary pension system;
- balance the activities of closed-end companies of complementary pension with practices of social and financial-economic development of government.

The following chart allows a better visualization of SPC positioning within the current structure of Public Social Insurance and Social Assistance Ministry.

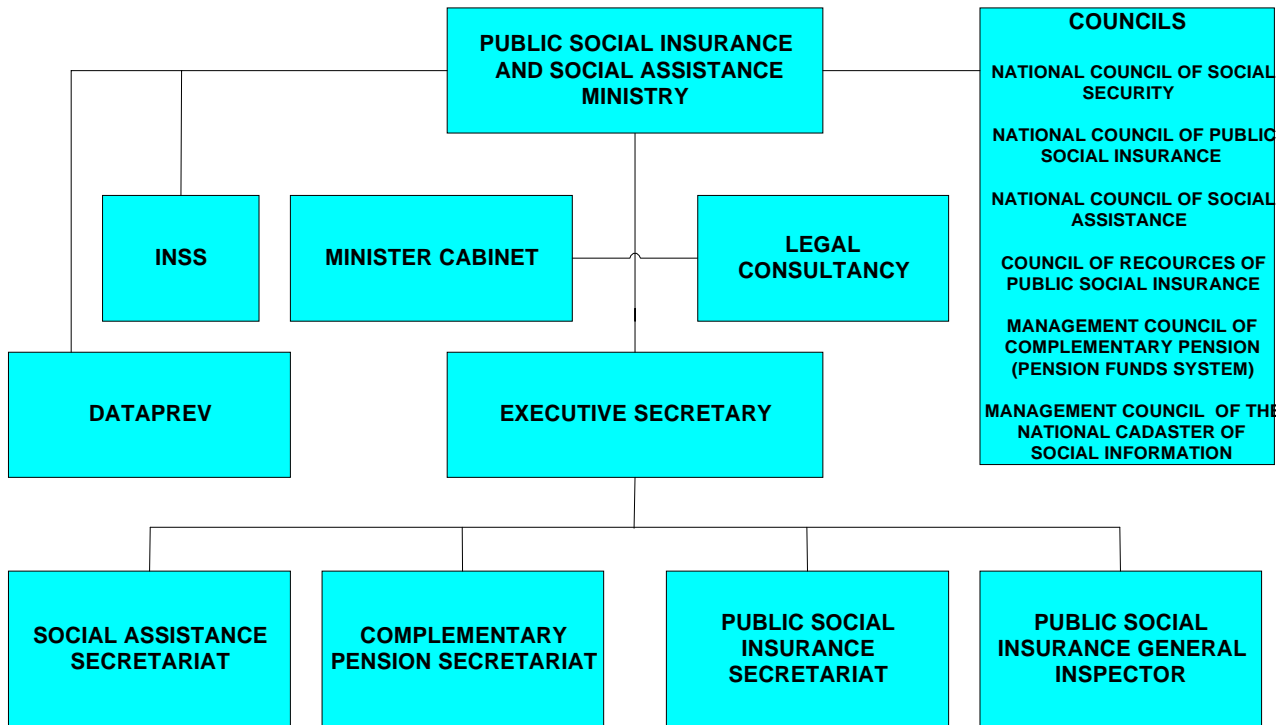


Exhibit 5– Current Structure of MPAS

## **4 - BANK OR MONETARY FINANCIAL INSTITUTIONS**

**Definition:** they are the institutions authorized to raise funds as a deposit and, for this, are able to create bookkeeping currency.

### **4.1- COMMERCIAL BANKS**

They are financial institutions which control stock can be close-end or open-end, that are formed as a stock company and specialize in short and medium term operations. They offer working capital for the commerce, industry, services, individuals and also for rural credit.

All commercial banks in Brazil are authorized by the Central Bank to work countrywide. Thus, they are under the jurisdiction of Central Bank all over the country. This system differs from the one adopted in the United States where a commercial bank can be authorized by a state government and, in this case, even choose to stay out of the FED system.

The operations set in which a commercial bank works is called the commercial portfolio. Basic loans, bonds discounts, working capital financing and rural credit are examples of asset operations. Among liabilities operations, there are short and long terms deposits.

Commercial banks perform a number of special operations such as exchange, gold, swap, custody of bonds and values and investment funds management. Among the operations called accessory, we have payment orders, collecting and cashing services and payment of third parties interests. Also, they render services of tax collection and billing of several services.

### **4.2- SAVINGS BANKS**

They are state financial institutions, formed like independent agencies that have the purpose of encouraging popular savings. The funds raised must be applied in credit operations that aim social promotion and welfare of population. These institutions are authorized by law to perform all operations done by Federal Government Savings Bank (CEF), except those exclusively performed or due to a monopoly. With privatizations that are taking place in the last years in financial setor, this kind of institution

is an endangered figure within SFN.

### **4.3- CREDIT COOPERATIVES**

Credit cooperatives are private institutions, specialized in providing credit and rendering services to their associates. They are formed from individuals. According to the purpose or nature of activities developed, the cooperatives can be classified as: economy and mutual credit, popular or Luzzati and rural credit.

Among assets operations we have bonds discounts, basic loan, rural credit, advances, transfers and financings. Liabilities operations are short term deposits, long term deposits and liabilities in the country and overseas. They also perform accessory operations like bill collection, payment receipt from associates as well as custody services.

### **4.4- COOPERATIVE BANKS**

Cooperative banks are commercial banks with exclusive participation of singular credit cooperatives, as well as of federation and confederations of credit cooperatives, constituted under the form of close-end corporations. According to the rule their operations are restricted to the states in which lie the headquarters of controlling companies. They mandatorily must have the expression "credit cooperative" on their record.

Credit unions are not allowed to take part in the capital of financial institutions and other institutions authorized to work by Central Bank or perform swaps through third parties.

## **5 - NON BANK OR NON MONETARY FINANCIAL INSTITUTIONS**

**Definition:** they are those institutions that are not authorized to raise funds as short term deposits.

### **5.1- INVESTMENT BANKS**

Private financial institutions formed like corporations, specialized in financial operations of medium and long terms. Its finality is to provide fixed capital and working capital to borrowers.

The investment portfolio is the set of operations that may be performed by an investment bank. Among the major assets operations we have the committed ones, interfinancial deposits, financings of fixed and working capital and rural credit. Liabilities operations are long term deposits, committed operations, interfinancial deposits and external deposits.

They also perform a number of special operations such as mutual investment funds management ruled by CVM, management of investment clubs and distribution, brokerage and deployment in securities market.

### ***5.2- STATE BANKS OF DEVELOPMENT***

Financial state institutions, formed as corporation with headquarters in the state capital that has its stock controlled. Specialized in credit operations of medium and long terms, it provides funds for projects and programs aiming economic and social development from the respective state.

The set of operations that may be performed by an investment bank is an investment portfolio. Those institutions have as major assets operations interfinancial deposits, fixed and working capital financings, external loans transfers, official funds and rural credit. As liabilities operations there are long term deposits, interfinancial deposits, external loans and from financial official institutions and credit operations or contributions of public sector.

### ***5.3- LEASING COMPANIES***

Companies formed as corporations, specialized in financial or operating lease operations. The set of operations that may be performed by a lease company is a lease portfolio. They have as assets operations financial or operating lease and the availabilities, when not in cash, they can be freely applied in the market. Main liabilities operations are interfinancial deposits, foreign loans, debentures, commercial papers and funds from official financial institutions, destined to transfers under certain programs.

### ***5.4- CONSUMER FINANCE COMPANIES***

Financial institutions formed as corporations which only goal is the performance of financing for acquisition of goods and services and financing the working capital.

Credit, financing and investment portfolio is the name given to the set of operations that may be performed by a consumer finance company. Within its asset operations there is financing of goods and services, financing of working capital and refinancing of lease operations. As liabilities operations we have debentures funded in financings, stockholders deposits, interfinancial deposits and funds from official financial institutions, destined to transfers in specific programs.

Those institutions also perform special operations of financial investment fund management and mutual investment funds management regulated by CVM.

### **5.5- MORTGAGE COMPANIES**

Financial Institutions formed as corporations according law 6404 of December 15, 1976, with the purpose of financing concessions destined to production, reform or trading real estate to which are not applied the rules of Financial System of Housing (SFH).

Asset operations are real estate financings, residential or business, the acquisition of mortgage credits, refinancings of mortgage credits and the transfer of funds to real state financings. As to liabilities operations there are mortgage notes, debentures, loans and financings in the country and abroad and the selling of mortgage credits.

As special operations those institutions perform in the management of mortgage credits of third parties and in the management of real estate investment funds.

## **6 - INSTITUTIONS OF THE BRAZILIAN SYSTEM OF SAVINGS AND LOANS**

**Definition:** institutions authorized to raise funds as deposits in savings accounts destined to housing financing.

### **6.1- REAL ESTATE CREDIT COMPANIES**

Financial institutions formed as a corporation destined to provide financial assistance to housing operations related to land acquisition, construction, selling or housing acquisition.

The set of operations that may be performed by a real estate credit company is called a real estate

credit portfolio. Its major assets operations are housing financings, credit concession to purchase or construction of real estate and operations of free range such as real estate financings non covered by SFH, the acquisition of public debt bonds and the financing of working capital for companies related to construction business. Major liabilities operations are performed with housing binds, mortgage bonds, savings deposits and refinancings from CEF. Housing Credit Companies also perform, as a special operation, the management of real estate investment funds.

## **6.2- SAVINGS AND LOANS ASSOCIATIONS**

Profitless companies with the purpose of providing funds for the acquisition of real estate to their associates besides raising and encourage savings.

As asset operations there are financings of real estate ventures both to associate and disassociate and operations considered free range such as real estate financings not covered by SFH, financing of working capital for companies in construction business, acquisition of bonds of public debt, mortgage loans and non residential real state financing. Within liabilities operations we have the ones performed with mortgage bonds, savings deposits and refinancing from CEF.

## **7 – MULTIPLE BANKS**

On September 21, 1988, the Resolution 1524 authorized the constitution of multiple banks. Those institutions have as characteristic the prerogative of possessing, in an only financial institution, from two to four of the following portfolios: commercial portfolio, investment portfolio, development portfolio, credit, financing and investment portfolio, and portfolio of real estate credit.. Besides, the Resolution 2099, on August 17, 1994, authorized the multiple banks the constitution of the lease portfolio. The multiple banks can accomplish all the operations allowed the financial institutions originally that created the multiple bank.

The creation of the multiple bank stimulated the bank concentration in Brazil. The multiple bank is a universal financial institution, that acts in several areas of the country and it accomplishes an enormous diversity of operations, in agreement with portifolios. This model of the universal bank possesses some

advantages and other disadvantages in relation to the segmented model, that in the institutions are specialized for products or for geographical area.

It is an undeniable advantage of the universal model the economical efficiency that means a smaller transaction cost due to the diversification of the assets portfolio, of the centralization and of the administrative flexibility. Another considerable factor is the answer capacity of those institutions to the demand incentives, the requirements of the market are more quickly assisted.

A more significant disadvantage of the universal bank, is the excessive concentration of the market in the hands of little and big institutions. A concentration of capital and political power significantly increases the chances of distortion in the decisions of economic policies in benefit of the elites of the financial sector.

## **8 – SPECIAL AGENTS**

**Definition:** they are the institutions that execute non-typical functions, depending on the group to which they belong.

### **8.1- BANK OF BRAZIL (BB)**

The Bank of Brazil (BB) is a commercial bank, constituted under the form of mixed corporation, with headquarters in Brasília. In practice, BB is the principal performer of the rural and industrial credit policy of the Government. In the last years, to adapt to a market more and more competitive, the Bank of Brazil went through a modernization process, that resulted in high reduction of operational costs, adaptation of the number of agencies, decrease of the effective number of employees and significant investments in bank automation.

Now, besides accomplishing all operations mentioned for the commercial banks, the Bank of Brazil executes other important attributions as financial agent of the Government, among them:

- accomplish the payments and necessary supplies for the execution of the General Budget of the Union (OGU);
- execute the policy of minimum prices of the agriculture-pastoral products;
- carry out agent payer and agent receiver functions abroad;

- execute the services of clearing checks and other papers (for delegation of BC);
- finance the rural and industrial activities;
- raise funds of savings toward the rural credit finance;
- carry out the functions of operator of the Fund of Investment Sectorial (fishing, forestation/afforestation and tourism);
- participate as financial middleman in the operations of debt renegotiation between States/Municipal Governments and the Federal Government;
- operate the Fund of Participation of the Program of Formation of the Patrimony of the Public Service (PASEP), in agreement with the determinations of PIS/PASEP's Managing Council Fund.

## **8.2- BRAZILIAN DEVELOPMENT BANK (BNDES)**

BNDES was created by the Law 1628 on June 20, 1952, and it is the main development agency of the country. It acts in the execution of the policies of investments and of credit of the federal government. The "BNDES System" is composed by the institution holding BNDES and two subsidiary entities: FINAME - special Agency of Industrial Financing and to BNDES-PAR - BNDES Participation.

BNDES has as main resources, the Worker's Assistance Fund (FAT), the Fund of the Merchant Marines (FMM) and the reception of resources in the coming of the recruiting of credit lines foreign market close to international financial organisms.

The operations of "BNDES System" are accomplished, also, through financial institutions that they operate in the authorized financial agents' quality, as the commercial banks, the investment banks or of development, the credit societies, financing and investment and the multiple banks.

Its basic objectives are to impel the economic and social development of the Country, to reduce the regional unbalances, besides promoting the growth and the diversification of the exports. For this, BNDES acts in several segments of the economic activity, among them: industry and commercialization of machines and equipments, infrastructure, agricultural development, trade and services (there included tourism), and the environment.



### **8.3- BANK OF NORTHEAST OF BRAZIL (BNB)**

BNB was created by the Law 1649 on July 19, 1952. It is a commercial bank, constituted under the form of a mixed capital company, with headquarters in Fortaleza. It acts as an auxiliary organ of the federal government in the execution of credit politics and they have as main purpose the attendance the located areas in the " polygon of the droughts " of the northeast area of Brazil.

The Bank of the Northeast, besides accomplishing operations of a commercial bank, offers resources for the development of the lacking areas of the Northeast. Those resources are addressed for enterprises as: the construction of dams, the financing of agricultural crops, the electric power production, the industrial and countless acquisition of machines.

In addition, the Bank of the Northeast is the financial agent of the Superintendency of Development of the Northeast (SUDENE) in the area, it is the operator of the Fund of Investment of the Northeast (FINOR) and of the Constitutional Fund of the Northeast (FNE).

### **8.4- BANK OF AMAZONIA (BASA)**

BASA had its origin in 1942 with the creation of the Bank of Rubber Credit. It was transformed in 1950 in the Bank of Credit of the Amazonia. On September 28, 1966, through Law 5122 the old bank was restructured and denominated Bank of Amazonia S.A.

It is a commercial bank constituted under the form of society of mixed economy, with headquarters in Belém, linked Finance Ministry. It also acts as auxiliary organ in the politics of credit of the federal government. It is the financial agent of the Superintendency of Development of the Amazonia (SUDAM), besides being the operator of the Fund of Investment of the Amazonia (FINAM) and of the Constitutional Fund of the North (FNO).

### **8.5- FEDERAL GOVERNMENT SAVINGS BANK (CEF)**

CEF was created on August 12, 1969, by the executive order 759. It is a public company, under the juridical form of private right, endowed with own patrimony and administrative and financial autonomy, with headquarters in Brasília and jurisdiction over the national territory.

CEF is considered a "social" bank that executes a series of attributions; among the principal they are:

- receive deposits with the purpose of motivating the habits of saving;
- render bank services of any nature;
- administer, with exclusiveness, the services of the federal lotteries;
- exercise the monopoly of the operations of civil pledge;
- act as agent operator and main collector of the Fund of Warranty for Time of Service (FGTS);
- administer the Fund of Habitational Attendance (FUNDHAB);
- administer the Fund of Compensation of Salary Variations (FCVS);
- be the agent exclusive payer of the safe-unemployment;
- operate the Fund of Participation of the Program of Social Integration (PIS) in agreement with the determinations of the Managing Council of PIS/PASEP;
- grant loans and financings of social nature, in consonance with the federal government's policy;
- operate in the habitational sector, as society of real estate credit, with the objective of facilitating the acquisition of the own house, mainly for the classes of smaller income.

## **9- ADMINISTRATORS OF THIRD PARTY FUNDS**

**Definition:** institutions that provide for the gathering of many investors or interested parties who have common objectives regarding the application of their funds.

### **9.1- MUTUAL INVESTMENT FUNDS**

Mutual investment funds are the communion of destined resources to application in diversified portfolio of financial assets, securities and exchange and other available operational modalities in the ambit of the financial market, constituted under the form of open condominium (when it admits the withdraw of the quotas) or closed (when it doesn't admit it), by simple communication in writing to the Central Bank of Brazil or authorization of Securities and Exchange Commission, with period certain or uncertain of duration, as it disposes a specific regulation or statute.

All administrating institutions should possess a regulation and should assist a group of attributions, as the registration of participants, the minute book of general assemblies, and the whole relative documentation of the operation's fund.

The ideal fractions of the Fund (quotas) should be nominative, untransferable and maintained in deposit account on behalf of title-holders, should be daily updated in function of the variation of the quotations of the bonds maintained in portfolio.

Countless investment funds exist, some regulated by BC, other for CVM, and other for BC and for CVM. The funds administered by BC are:

- Fund of Financial Investment;
- Fund of Financial Investment - Short Period;
- Fund of Application in Quotas of Fund of Financial Investment
- Fund of Financial Investment - State Debt and/or Municipal Debt;
- Fund of Fixed Income - Foreign Capital;
- Fund of Foreign Investment;
- Fund of Investment "Extramercado".

The funds administered by CVM are:

- Mutual Fund of Investment in Shares;
- Mutual Fund of Investment in Shares - open portfolio;
- Mutual Fund of Investment in Quotas of Mutual Fund of Investment in Shares;
- Sectorial Fund of Investment in Shares;
- Mutual Fund of Investment in Emergent Companies;
- Fund of Cultural and Artistic Investment;
- Fund of Privatization - Foreign Capital.

The funds administered together by the Central Bank and for Securities and Exchange Commission are:

- Fund of Investment - Foreign Capital;
- Mutual Fund of Investment in Shares of the Mining Sector;
- Mutual Fund of Incentive Shares;
- Fund of Real estate Investment;

- Mutual Fund of Privatization – Security Debt;
- Mutual Fund of Individual Retirement.

## **9.2- CONSORTIUM ADMINISTRATORS**

By definition the consortium administrators are classified in:

- profitless civil associations when not limited to the members of your social group;
- mercantile societies when destined for sale of goods of trade or production;
- civil societies with specific objective when they collect popular saving destined to propitiate acquisition of durable movable goods (of national or foreign production), of immobile goods that constitute residential units or of air line tickets financing.

The value of the monthly contribution for formation of the saving destined to the acquisition of the good it should be a fraction of the value of the same divided by the number of months foreseen for the duration of each group, added of a percentile as administration rate and other percentile in the quality of reserve fund. This reserve fund allows the administrator the acquisition of the same in case of non payment or increase of the price of the good.

The right to get the good of those associated occurs through draw or for bid. The bid is the offer of premature quittance of future installments, always counted of the end for the beginning. In that case, it wins the contemplation associated that to offer the largest number of installments they be premature.

Several durable goods (for instance, automobiles, household appliances, pieces of furniture), the immobile goods and air line tickets can be acquired through the consortium.

## AMOUNT OF COMPANIES IN OPERATION

TYPE	DEC/98	JUN/99
MULTIPLE BANKS	173	174
COMMERCIAL BANKS	28	26
DEVELOPMENT BANKS	6	5
INVESTMENT BANKS	22	20
CONSUMER FINANCE COMPANIES (CREDIT, FINANCE AND INVESTMENT COMPANIES)	42	43
SECURITIES BROKERS	192	195
EXCHANGE BROKERAGE COMPANIES	36	37
SECURITIES DEALERS	207	192
LEASING COMPANIES	80	82
GOVERNMENT SAVINGS BANKS	2	1
REAL ESTATE CREDIT COMPANIES/SAVINGS AND LOANS ASSOCIATIONS	21	20
MORTGAGE COMPANIES	4	4
SUB-TOTAL 1	813	799
CREDIT COOPERATIVES	1.088	1.135
SUB-TOTAL 2	1.901	1.934
INVESTMENT FUNDS	3.617	3.893
CONSORTIUM ADMINISTRATORS	422	414
INSTITUTIONS UNDER SPECIAL REGIMENT	89	96
TOTAL	6.029	6.337

## 10 – CENTRAL BANK PERFORMANCE

The Central Bank of Brazil has several functions in the National Financial System (SFN) and its functions are quite wide and complex. Among the main attributions are: the emission and the currency supply to the banks, the elaboration and execution of the monetary policy, the control of credit, the formulation and implementation of exchange policy, a foreign financial relationships and, finally, the supervision of SFN.

Before analyzing each one of those functions separately it is important to explain how the normative subject is in the system. The National Monetary Council (CMN) deliberates by the edition of resolutions that are implemented by the regulator entities to subordinates. The Central Bank, in the external scope, is used of the following normative acts at the market:

<b>DOCUMENT</b>	<b>CONTENT</b>	<b>SIGNATORY AUTHORITY</b>
CIRCULAR	Regulation of decisions of CMN or of the Board of BC, of general interest, of SFN or of part of it.	One or more members of the Board of BC.
CARTA-CIRCULAR	Instructions or explanations about deliberations of CMN or of the Board of BC, of interest of SFN or of part of it.	Head of Department(s) directly linked to the subject.
COMUNICADO	Popularization of several Explanations, of general interest.	Head of Department(s) directly linked to the subject.
COMUNICADO-CONJUNTO	Regulation, instruction or several Explanations about deliberations of the Board of BC, together with other institutions.	One or more members of the Board of BC and other(s) institution(s).

Those normative ones - the resolutions, the circular ones and the other documents - they are consolidated in manuals for use of the civil servants of BC and of the public in general. Examples of those manuals are the Norms and Instructions Manual (MNI), the Rural Credit Manual (MCR), the Consolidation of Foreign Exchange Regulations (CNC) and the Accounting Plan of the Institutions under the National Financial System (COSIF).

The Central Bank Information System (SISBACEN) exercises fundamental role in the popularization of those normative acts and, mainly, in the implementation of the contents of those measured through your systems of information. SISBACEN is an extensive network of communications

that links all the financial institutions of the country and several government organs to BC. In the last years, the great agility of BC in the implementation of the government's economical measures in the scope of SFN was no doubt due to the performance and efficiency of SISBACEN.

The Information Systems Management Department (DEINF) it is the unit entrusted of maintaining the computers, the network and the systems of information of the Central Bank. Over there they are developed and maintained, in partnership with the several Units of BC that demand information, the systems that implement the several functions executed by the Bank.

### **10.1- CURRENCY MANAGEMENT**

In order to execute the currency management function the Central Bank acts together with the Mint, developing bills and coins that will enter in circulation. The unit entrusted with that is the Currency Management Department (MECIR) that possesses offices in nine regional administrative managements dispersed for the country, besides the Federal Capital. The headquartes and the regional offices should have enough cash to supply money to geo-economical areas.

The Central Bank here exercises the function of " bank of the banks ", because it welcomes the constituent deposits of the bank reservations of the Country and it assists the withdrawal requested by the financial institutions. Besides, MECIR accomplishes a fundamental task in a country of continental dimensions like Brazil, that is the replacement of the currency, removal from circulation and destruction of the cash in bad situation. That task is made in a decentralized way with modern technology, that check agility to the process of maintenance of the quality of the Brazilian money.

The Currency Management Department regulates the stocks of money in circulation and in the vaults ones through specific system of information (called system of Administration of the Currency or Mecir), that allows the accomplishment of the several operations with the bank system as, for instance, withdrawal and cash deposit. In that way, to accomplish a withdrawal in BC the bank should register through SISBACEN, in an on-line specific application of the system Mecir, a withdrawal solicitation in one regional office. BC confirms through the system the accomplishment of the operation when the security van arrives to the vault to collect the money.

The system of information "Mecir" supplies the managers of the currency control a necessary knowledge of the amounts of bills and coins in circulation and in stock in each one of the several vaults of the Central Bank. Apart from that, the system has a specific module for controlling the falsified cash apprehended in the country.

## **10.2- EXECUTION OF MONETARY POLICY**

The Central Bank uses three basic instruments for the execution of the monetary policy: the reserve requirements, the operations of open market and the financial assistance for liquidity. Before detailing each one of those instruments it is important to explain what is the bank reserve account.

All commercial banks, multiple with commercial portfolio and savings banks maintains close to BC a checking account denominated bank reserve account, where the reservations are picked up in cash, free and compulsory. In that account they are registered for each bank, for instance, operations of withdrawals or deposits in BC, the net result of the checks settlement and other papers, the purchase and sale of reserves in the inter-bank market, the purchase and sale of federal bonds, the operations in the open market, the purchase and sale of foreign currency and the withdrawal of federal taxes.

The Banking Operations Department (DEBAN) it is the unit in charge of controlling the bank reserves accounts of the banks and it uses that, the system of information denominated Banking Reserves. That system supplies the reserve positions of all banks in full detail, as well as making it possible for the BC to determine the values of the reserve requirements on demand deposits and bank float.

The mechanism of the reserve requirement is a traditional instrument for the execution of the monetary policy. It impedes financial institutions that hold demand deposits can create book money indefinitely. To reduce that capacity " to multiply " the money of the institutions, the monetary authority it demands that certain portion of the deposits on demand deposits and of other accounting initials stay under custody. Those balances deposited in BC don't receive remuneration and this does with that the bank institutions try to maintain balances just inside of the certain limit for the legal demand.

The institutions are subject to keep at the BC up to 100% of their demand deposits and up to 60% of other accounting titles. Within these limits, BC can adopt different percentages in function of the geo-



economic region. The system of the reserve requirement divides the banks in two groups (A and B) in way to maintain a permanent liquidity in the market, and it has two different periods: the calculation period and the withdrawal period (or movement). As instrument of monetary policy, the monetary authority can periodically modify the percentile of withdrawal to adjust the stock or the currency flow in circulation.

The operations of open market consist of the purchase and sale of Treasury Bonds, of the portfolio of the Central Bank or of emission (BBC, LBC, etc.). It is a secondary market, that is, a market where negotiated bonds are already emitted. Those purchases and sales are of two types: committed operations and definitive operations. In the committed operations BC borrows or lends funds for a defined period, selling or buying bonds with the commitment to repurchase them or to resell them at previous date and price certain. In the definite operations the bond becomes part of the portfolio of the buyer institution. The purchase or definite sale of the bonds either is done through the informal or formal auctions. The first are accomplished by phone and they are restricted to the dealers. The seconds are accomplished for proposal sent in writing (by a specific electronic system) to BC.

In summary, BC adjusts the daily liquidity of the system through the definite operations, with several interventions in the market. If there is an excess of bank reserves, BC sells bonds and with that it removes money of the market; if there is a shortage of reserves BC buys bonds and with that it places money in the market. That adjustment is made with base in daily estimate accomplished by the Open Market Operations Department (DEMAB) with base in a group of factors as the withdrawal of taxes, the expenditures of National Treasury, operations with foreign exchange, redemptions or placements of public bonds, and others. DEMAB lies in the city of Rio de Janeiro and it executes all operations through the Special System of Clearance and Custody (SELIC), that is a data processing system destined to the registration of the operations of all the federal public bonds negotiated at the open market.

The third mechanism of monetary politics is that with the Central Bank acts as lender of last resort, through the concession of financial assistance to financial institutions with eventual problems of liquidity. Those loans are of incidental nature and of brief character. The Department of Bank Operations is responsible for that activity that has as its avoidance of eventual unbalances of a financial institution that can rebound in the remainder of the system. If in a certain day, for instance, a commercial bank doesn't

have enough balance in the bank reserve account to liquidate requirements, it should fall back upon BC. That loan is based on real warranties and it possesses the higher interest rates of the market.

On June 20, 1996 the Committee of Monetary Policy of the Central Bank of Brazil (COPOM) was instituted with the objective of establishing the guidelines of the monetary policy and defining the interest rate (Selic rate). COPOM is composed by the eight members of the Board of Governors of BC, with the right to vote, being presided by the President of BC, that has the quality vote. Other offices participate in the meeting, without the right to vote, the heads of the subordinate Departments to the Monetary Policy Deputy Governor (DIPOM) and of Economic Policy Deputy Governor (DIPEC). The creation of that committee looked to give larger transparency and appropriate ritual to the decision process to example of Federal Open Market Committee (FOMC) of the Federal Reserve and of German Central Bank Council.

The Central Bank of Brazil, through DEBAN, it will be executing during the year 2000 the project of reform of the brazilian payment system, the main objective of which is to reduce the risk of BC in the operations with the financial system. In that project, the complete reform of the current system of bank reserves and the creation of a specific module are included to make possible the transfer of great values in the system. It is a work of great mark, that involves changes in the Brazilian legislation and that it will involve the participation of BC, of CVM, of the financial institutions and clearing houses.

### **10.3- CONTROL OF THE CREDIT**

In that area, the Central Bank publishes all the decisions of the National Monetary Council, issuing complementary norms and executing the control and the fiscalization of the credit operations in all your modalities. The making of those norms is under the responsibility of the Financial System Regulation Department (DENOR) and the contention or not of the credit it depends on the objectives of the government's economic policy.

The monetary policy by itself has not been capable of containing consumption, for which credit policy has often been used, limiting credit operations and payment periods. BC also acts on the periods and forms of operation of the consortium administrators, on the credit cards and on the antedated checks, according to the habits of the Brazilian society.

In order to limit the credit of the public sector, the Central Bank acts through the monitorship of the execution of your debt limits with the financial system, the Domestic Public Debt Department (DEDIP) it has a specific information system that allows that control.

#### **10.4- EXECUTION OF THE EXCHANGE POLICY**

It refers the administration of the exchange rate basically and to the control of the exchange operations. The exchange rate represents the price in national currency of the foreign monetary unit. That price is formed by the supply and demand of the foreign currency. In that market, in the side of supply, are the exporters of goods and services, receivers of external investments, borrowers of loans and financing and foreign tourists. In the demand's side, are the importers of goods and services, companies that repatriate external investments or they pay profits and dividends on them, companies that amortize or they pay interests on loans and financings and Brazilian tourists.

The Foreign Exchange Department of BC uses the system "Câmbio", where on-line are registered all the exchange operations accomplished at the country. That system allows the bank and the government the daily accompaniment of all the exchange contracts made in Brazil.

The exchange market comprises two segments: the one of free rates (commercial) and the market of flotation rates, where the operations are accomplished with tourism, unilateral transfers, Brazilian investments in the exterior, international credit cards and operations with gold.

The performance of BC in the exchange market works through the purchase auctions or sale of foreign currency with the participation of the dealers, that are banks selected by BC among the banks that operate in exchange through the criterion of global movement with customers and in the interbank market. Those auctions are controlled by the International Reserves Operations Department (DEPIN). In that aspect, it is important to point out the relationship among the exchange and monetary policy, because whenever BC intervenes at the exchange market, buying or selling exchange value, he makes it to credit or debit in the reserve account of the institution that sold or it bought those exchange values. In the organization chart of BC, it can be observed that three units are subordinated to the Monetary Policy (DIPOM): the Banking Operations Department (DEBAN), the Open Market Operations Department (DEMAB) and the International Reserves Operations Department (DEPIN).

### **10.5- INTERNATIONAL FINANCIAL RELATIONS**

In the international area, besides the Foreign Exchange Department, BC owns the External Debt and International Relations Department (DERIN) and the Foreign Capital Department (FIRCE). The Brazilian Government's relationship with the international financial organisms as the IMF, World Bank and others are executed through the Central Bank, through DERIN, that acts as connection link. The participation of Brazil in the process of integration of Mercosur, that was created by the Agreement of Assumption on March 26, 1991, is another example of that performance.

In the scope of the foreign debt, with the Brazilian Plan of Financing implemented in 1992 the debt was changed by Republic bonds and the resources deposited in the Central Bank, relative to the external liability, were transferred for National Treasury. This way, the Union was close to responsible for the financial obligations the creditors and BC it was as agent entrusted with the implementation and administration of the contracts of restructuring of the foreign debt, with the execution of the payment schedule.

The accompaniment of the movements of foreign capital, which are goods or resources entering Brazil belonging to foreign residents, is accomplished by FIRCE. That capital is either as credit or as investments applied in Brazil. The latter represents actions of the social capital of companies installed in Brazil, that can be directly acquired in the stock exchange. The credits can be classified in loans or financings, depending on the means of entrance in the country, in other words, foreign currency or machines and equipments imported for payment in installments.

### **10.6- FINANCIAL SYSTEM SUPERVISION**

That is a quite sensitive area and it has been the object of several criticisms in past years, mainly, due to the financial problems of large banks after the Real Plan in 1994. There are proposals for the creation of an agency that would be exclusively responsible for the supervision, removing that attribution of BC. That model would have certain likeness with the north american model, where they coexist the Federal Reserves, Federal Deposit Insurance Corporation (FDIC) and Comptroller of the Currency. In the

second semester of 1999 the Central Bank went by a restructuring process it interns that also had as guideline the reinforcement of the supervision activity.

The supervision reaches the whole Brazilian territory and in the last twenty years, with the great growth of the number of institutions and also with the diversification of the operations, BC had to perfect its work methods in that area. The units of two managements of the Central Bank are directly linked to that function: the Financial System Regulation and Organization - DINOR and the Supervision - DIFIS (see organization chart of BC).

The Supervision and Inspection Department (DEFIS) is responsible for the coordination of the works of accompaniment of the institutions embraced by the supervision. The Records and Information Department (DECAD) accomplishes work of fundamental importance for the supervision, because it is responsible for the reception, control and distribution of all the information rendered by the financial institutions to BC. In that aspect, the Bank has wide access to the information of the financial institutions, and the data considered essential to the accompaniment of the market are demanded with periodicity even daily rate through SISBACEN. Those groups of information are contained in several documents as the half-yearly balance, the monthly balance sheet, central of credit risk, bank and other statistics. The systems of the Accounting Plan for Institutions under the National Financial System (Cosif) and the Financial Institutions Register (Cadinf) they are models of systems that supply data for the systems of the bank supervision as, for instance, the system "Super" that is used broadly by the inspectors in the inspection process.

The supervision activity is part of the prudential regulation and it tries to do with that the bank system is efficient and competitive. Its basic objectives are to promote safe and solid bank practices, protect the depositors and maintain the stability of the finance markets for the reduction of risks.

The supervision work is carried out in a direct or indirect way. In the first, the inspectors go to the institution to verify its solidity and the observance of the legal aspects of its operations, its registrations and controls. They are verified, for instance, credit operations, of exchange, of bonds of fixed income and of leasing, besides the audit accomplishment in the systems of the financial institution. All the important information is registered in a specific system of the supervision activity. In the second way, the supervision is made internally and in a systematic way with base in the information rendered by the institutions to BC.

The indirect accompaniment bases on accounting information rendered by the financial institutions that are stored in the databases of SISBACEN. That base possesses a historical of the information and it allows an analysis of the acting of the institutions individually or for segment of performance. A very important information system in that work is "Indcon", that calculates economic-financial indicators monthly for the financial institutions. Those indicators evaluate aspects such as capital, assets, results, liquidity, etc., that when compared to the patterns they identify the strong and weak points of the institution, making possible an optimization in the works of the supervision. In practice, the two supervision manners are complemented.

The Central Bank inspects multiple banks, commercial banks, savings banks, development banks and investment banks, consumer finance companies, securities brokers, securities dealers, leasing companies, real estate credit companies, savings and loans associations, mutual funds, credit cooperatives and consortium administrators. Translating this work in numbers, BC supervises 196 banks at the present time, 513 other financial institutions, 2,800 investment funds, 25,000 agencies, 1,200 cooperatives and about 400 consortium administrators. Also, the fiscalization accompanies operations of rural and industrial credit and of dozens of dependences of brazilian banks abroad. BC has a total picture today of approximately four thousand and five hundred active employees throughout Brazil and of that total one, about six hundred and fifty are in the Supervision and Inspection Department, divided among supervisors, inspectors and analysts.

The importance of the information in the supervision process is evident. For that, great effort has been made by the DEFIS and Information Systems Management Department (DEINF) to develop more modern and appropriate systems to the supervision activity. Those systems allow the supervision to access accounting data with the intention of diagnosing abnormality situations or of risk, besides accompanying, individually or in a comparative way, the behavior of the institutions with a base in economic-financial indicators.

## 11 – CONCLUSION

The basic function of the National Financial System (SFN) is to intermediate resources between savers and borrowers to promote the development, the modernization and the growth of the Brazilian economy. The operation depends fundamentally of the macroeconomic stabilization of the Country, that allows a reduction of the risk and, consequently, of the interest rates practiced at the market.

To recover the road of the economic growth inside of a picture of monetary and fiscal stability necessarily goes by a reduction of the size of the public sector and for the integration of Brazil in the international global context. Without forgetting that the Country cannot be dependent of the foreign savings for its development, the financial system should be agile, modern and possess operations that allow the growth of the internal savings and the financing of the productive activity. Only the economic stability will allow the market to leave a vision of short period for a vision of long period and, for that objective it is reached, to solve the subject of the unbalance of the public sector is fundamental condition.

Inside of a historical perspective, the National Financial System went by deep transformations from the creation of the first Bank of Brazil in 1808. In 1964, after a long maturation process and with relative delay in relation to the most developed countries of the world, the Central Bank of Brazil was created together with a new structure of the financial system. That structure was fundamental to foment the economical development of Brazil in the seventies. The economic problems of the eighties, with chronic inflation and macroeconomic unbalance in the Government's accounts promoted an incredible and strong development in Brazilian financial system. It is unimaginable for a citizen of a developed country and of stable economy, for instance, to understand as the financial Brazilian system could continue totally operating indexed with inflation rates superior to eighty percent a month.

The commercial opening begun by President Collor, the insertion of Brazil in the Common Market of the South (Mercosur) and the globalization phenomenon modified the panorama of the Brazilian economy. In the financial market it was not different. An earnest process of reduction of costs and search of competitiveness began, mainly in the private institutions, that took the one accentuated reduction in personnel staffs and to a huge investment in bank automation. The result is that today Brazil has, surely, one of the most modern and automated financial systems of the world. The products and services offered

by the banks and other institutions are more and more functional and close of the customers. Today the government collects taxes through the bank net and SISBACEN, and this money goes thru its account in the same day. The growth of home banking operations, the appearance of ATM machines more and more advanced, the development of electronic commerce, the reduction of the use of checks and of the money in cash for the accomplishment of payments are just some examples of the transformations that are happening in the world. That evolution pushes the regulator institutions, among them Central Bank of Brazil to a constant improvement in performance. The reform of the Brazilian payment system and the implementation of the great values transfer system, in order to reduce the risk of BC in the liquidation of the financial operations, are important examples of that modernization process.

The National Financial System is sustaining a natural process of reduction of the number of institutions and a larger competition among the same ones. The presence of the foreign banks went essential to stimulate this competition. Fundamental in the sector, the privatization of the state banks has been implemented inside than the political conditions allow, in a rhythm far away of what would be the ideal. Happily, it seems there is almost a consensus in the brazilian economists regarding the inconvenience of the existence of state-owned banks. The concept that a bank is a company, that basically buys and sells money, and in the which there is not space for political nominations or for the bad application of the resources, it seems more and more accepted and spread in the society.

Important step in that evolution certainly will be the independence of the Central Bank of Brazil in relation to the executive power in the execution of its constitutional mission that is to care for the power of purchase of the national currency. The concession of mandates to the members of the Board of Governors of BC, different from the presidential mandates, would provide to the Central Bank great condition to execute its functions free from political pressures.

Another important point is to define the role of BC clearly in the Financial System, the country wants a classic Central Bank, addressed basically to the execution of the monetary and exchange policy, or a Central Bank with a wide scope of tasks that includes, for instance, the control of the rural credit or the supervision of consortium administrators.

It is in the regulation of the article 192 of the Federal Constitution that the National Congress, will have once again the opportunity to adapt the structure of the National Financial System (SFN) to a more



liberal vision, a system that propitiates an adequate environment to lenders and borrowers, and allows the accomplishment of operations with safety and speed. The definition of the role, of the structure and of the competence of the regulator institutions, among them Central of Brazil, it constitutes important factor to the sustained and durable economic development of the country along the century twenty-first.

## ANNEX 1

### ***Major attributions of Central Bank of Brazil***

Issue bills and coins under the conditions and limits authorized by CMN;  
Perform the services of currency circulation;  
Set the percentage of mandatory payment;  
Receive mandatory payments and also voluntary deposits from financial institutions;  
Perform rediscount and loans operations to financial institutions;  
Perform the control of foreign capital;  
Depository of official reserves of gold and foreign currency and special rights of withdrawal;  
Supervise financial institutions and apply penalties;  
Grant authorization to financial institutions in order they can: work in the country, instal or transfer their headquarters of facilities and others;  
Establish conditions for any charge of management of private financial institution, as well as to any post in advisor, supervisor and similar agencies according to rules issued by CMN;  
Accept or refuse the voted ones for the charges of management of financial private institutions that do not satisfy the established conditions;  
Perform, as a tool of monetary policy, operations of selling and buying of federal public bonds;  
Contact, on the brazilian government's behalf foreign and international institutions;  
Sponsor, as federal government agent the deployment of internal and external loans with possible charge of those services;  
Sponsor the regular operation of exchange market aiming the relative stability of exchange rates and balance of payments;  
Issue bonds of own responsibility, according to conditions set by CMN;  
Regulate the execution of services of clearing of checks and other bond;  
Perform constant watch on financial and securities markets on companies that, directly or indirectly interfere in those markets in relation to many operating processes that they utilize;  
Provide services of secretariat of CMN;  
Operate exclusively with financial institutions, with prohibited bank operations of any nature with other companies, public or private, except the ones authorized by law;  
Perform and decree the interention or legal liquidation of private and non federal financial institutions, as well as credit unions and consortia managers;  
Decide on funds from interventor's decision unencumbered in one level;  
Decide on funds showed by the creditors notified of decisions from liquidators that do not seem favorable;  
Decree the regime of special temporary management in private and non federal public institutions;  
Set actions to assure the normality of public economy and the interests of depositors, investors and other creditors (e.g. the transfer of stock control);  
Regulate and supervise consortium managers;  
Approve standards of contracts to trade in commodities and futures stocks.

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