

Regulatory Responses to the Crisis in Brazil and Lessons Learned

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Agenda

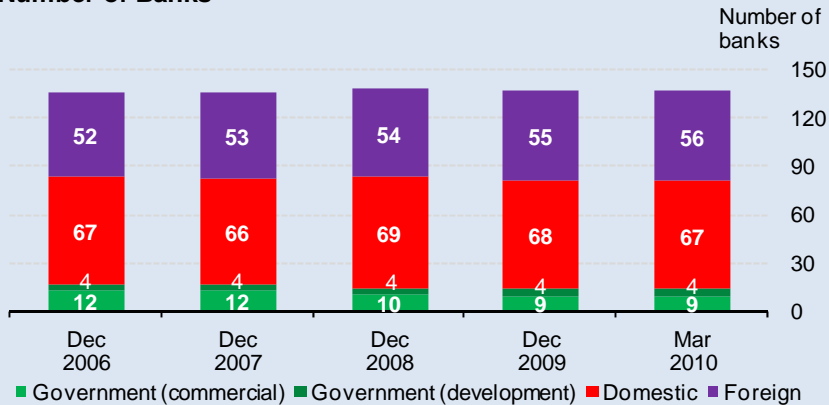
- Brazilian Financial System Overview
- Situation before the international crisis
- How Brazil was affected
- Current situation

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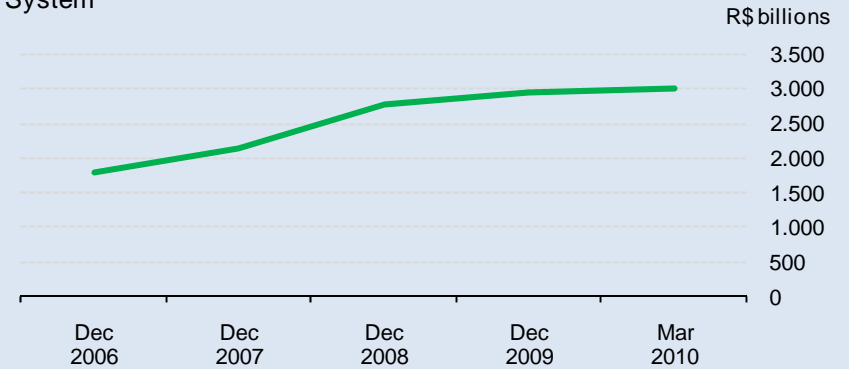
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Brazilian Financial System Overview

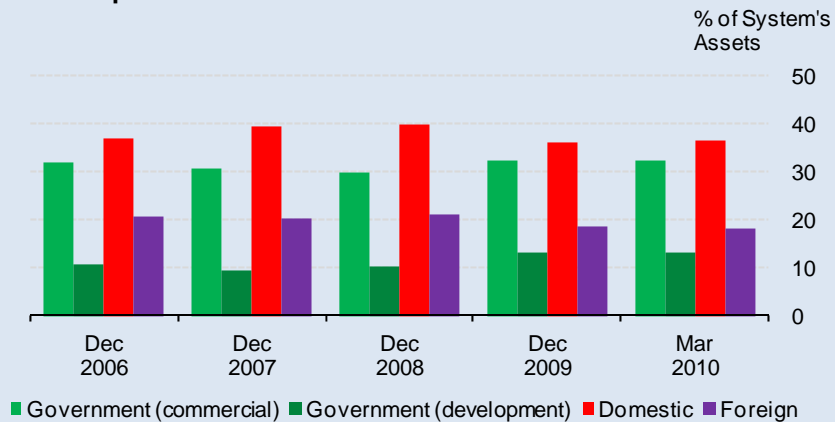
Number of Banks



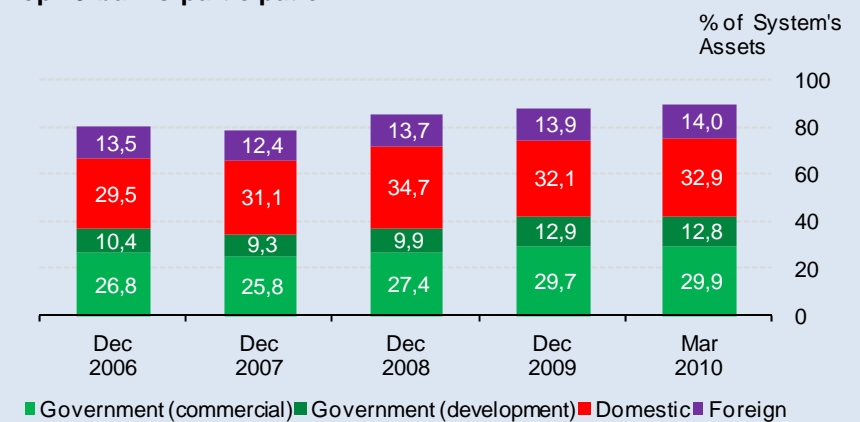
Total Assets System



Ownership



Top 10 banks participation



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Situation before the international crisis

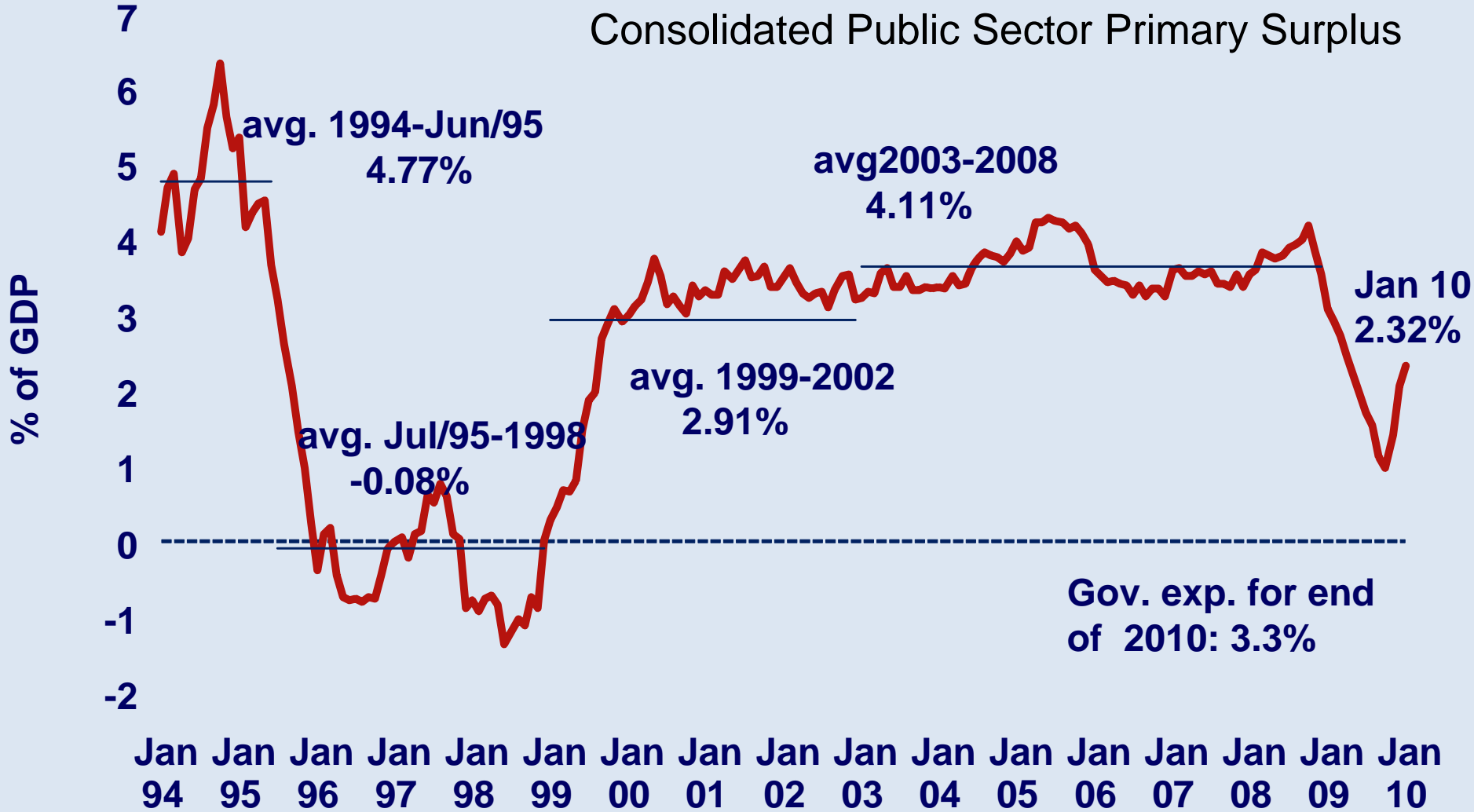
- In recent years, Brazil has successfully addressed historical vulnerabilities, giving room to a balanced economic growth:
 - Inflation Targeting
 - Floating Exchange Rate regime
 - Fiscal Responsibility
 - External Sector Equilibrium
 - Soundness of the Financial System

Inflation targeting

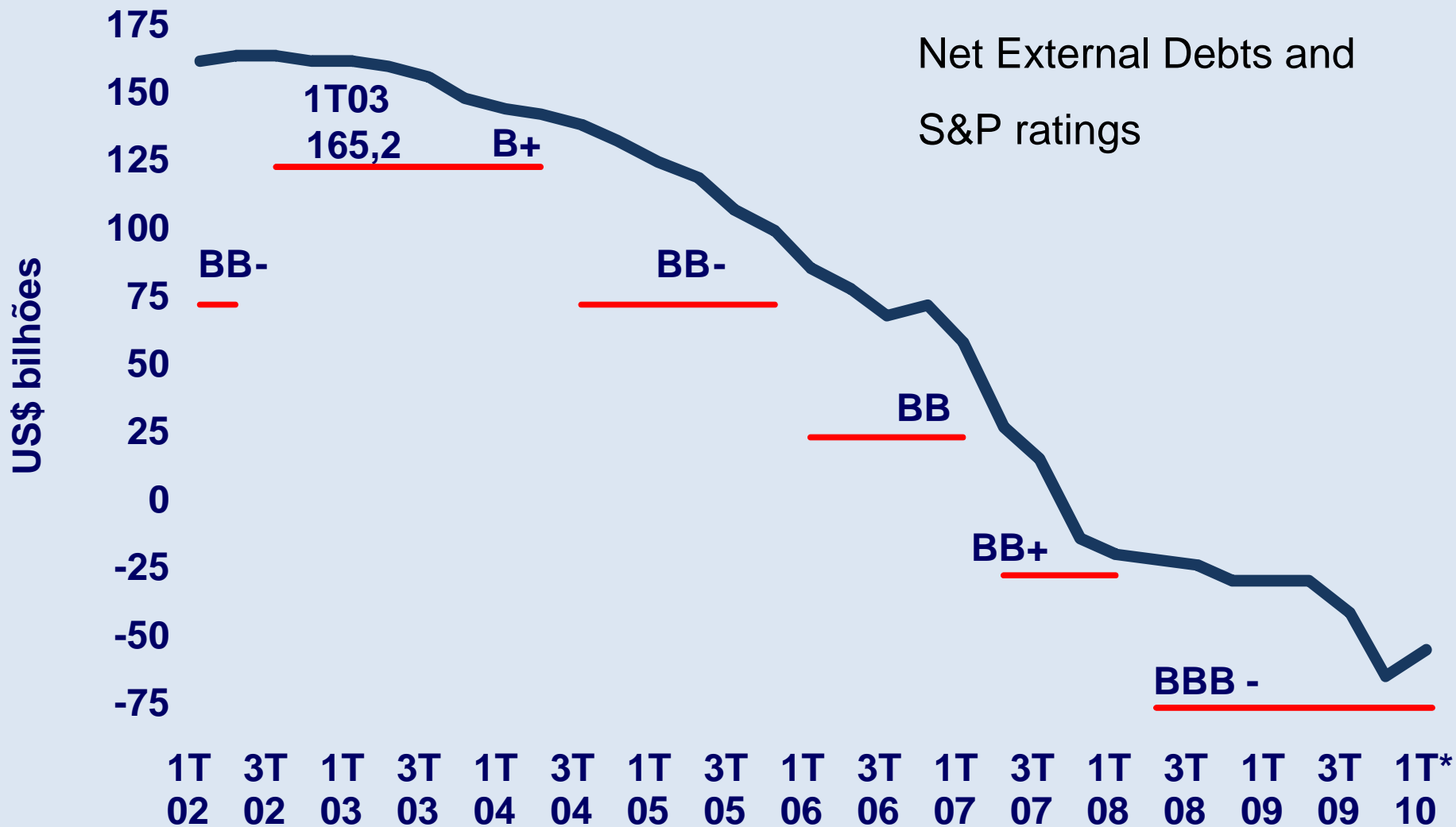
six consecutive years of inflation on target
with anchored expectations



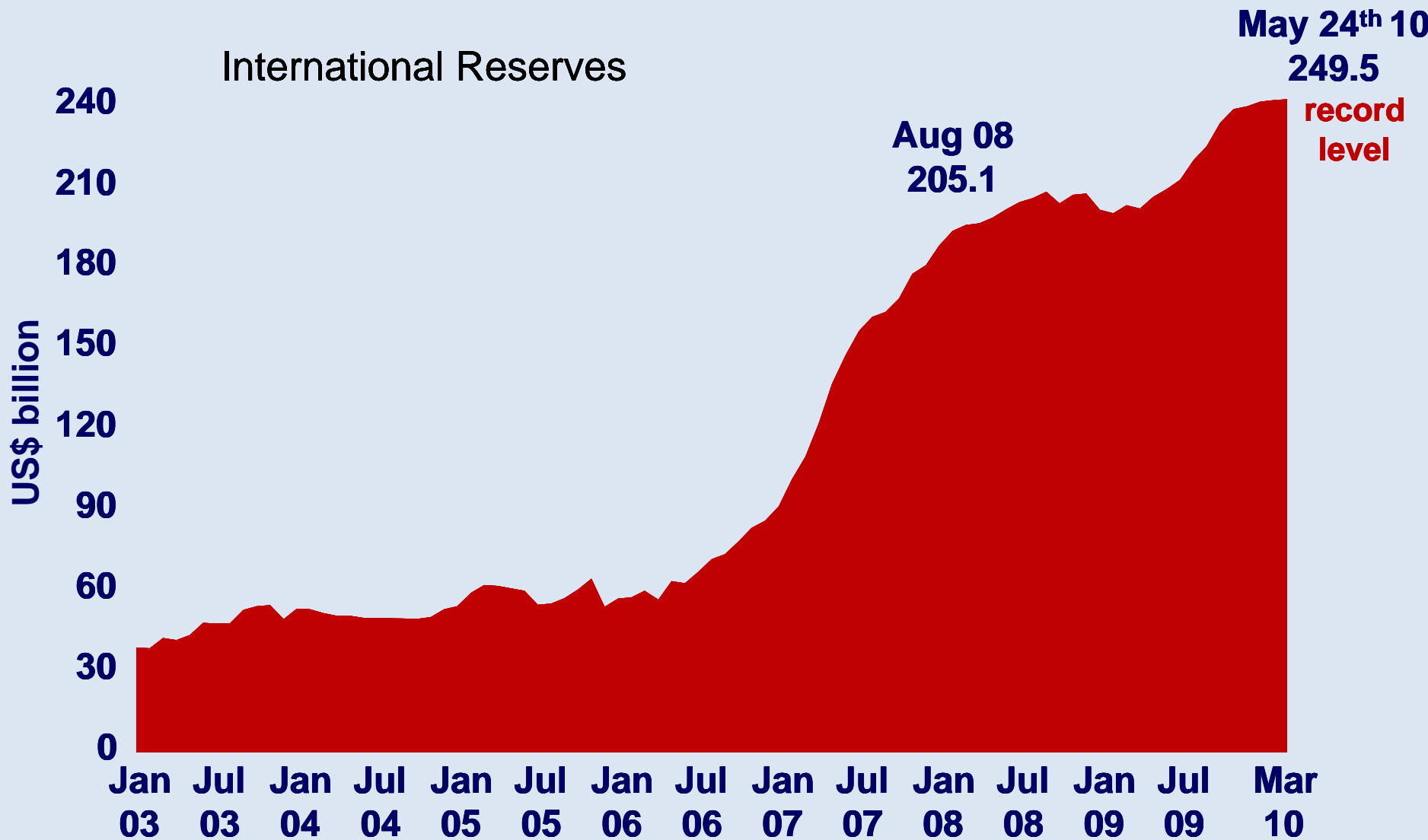
Fiscal Responsibility



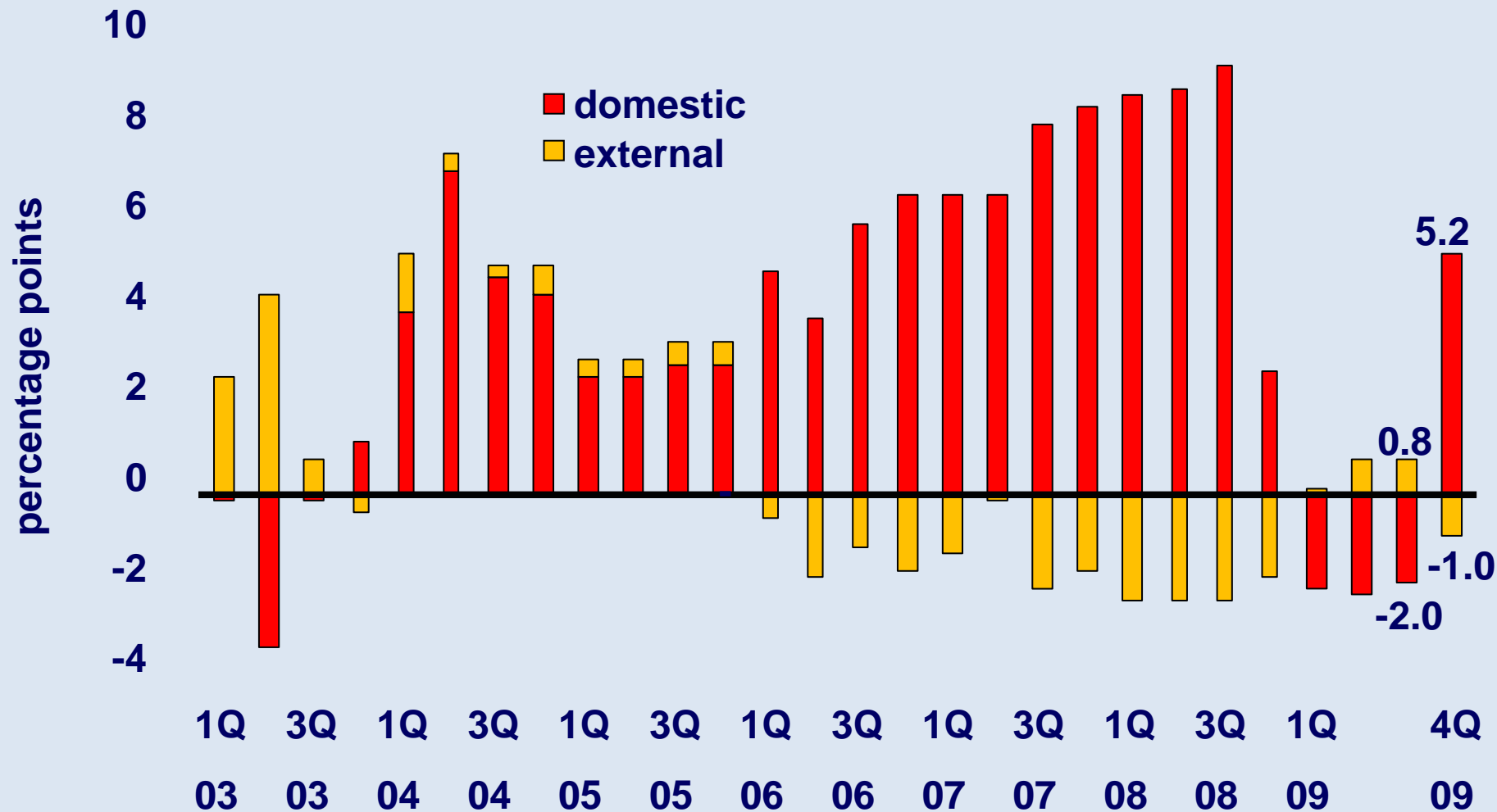
External Sector Equilibrium



External Sector Equilibrium



Contribution of Domestic and External Demands for GDP Growth



Soundness of the Financial System

- Brazilian authorities have embarked on the convergence process of international regulatory standards and best practices to improve the soundness of the Financial System (Basel and IRFS, Governance rules)
- But other reasons also contributed to the resilience of the system to cope with the international crisis:
 - Conservative regulation and strong supervision processes;
 - Banks well capitalized and with good liquidity;
 - Lower exposure to markets that triggered the international crisis

Specific Characteristics of the Financial System

- All financial institutions are subject to regulation and supervision, with little overlap in the financial sector supervisors' individual mandates;
- Managers' accountability: in the case of bankruptcy, the Brazilian law requires managers' personal wealth to be frozen until the end of the assessment of responsibilities;
- Financial Instruments - Bonds, Securities, Derivatives, including OTC, are mandatorily registered in a clearing house. The entries include identification of the final holder for each financial instrument.

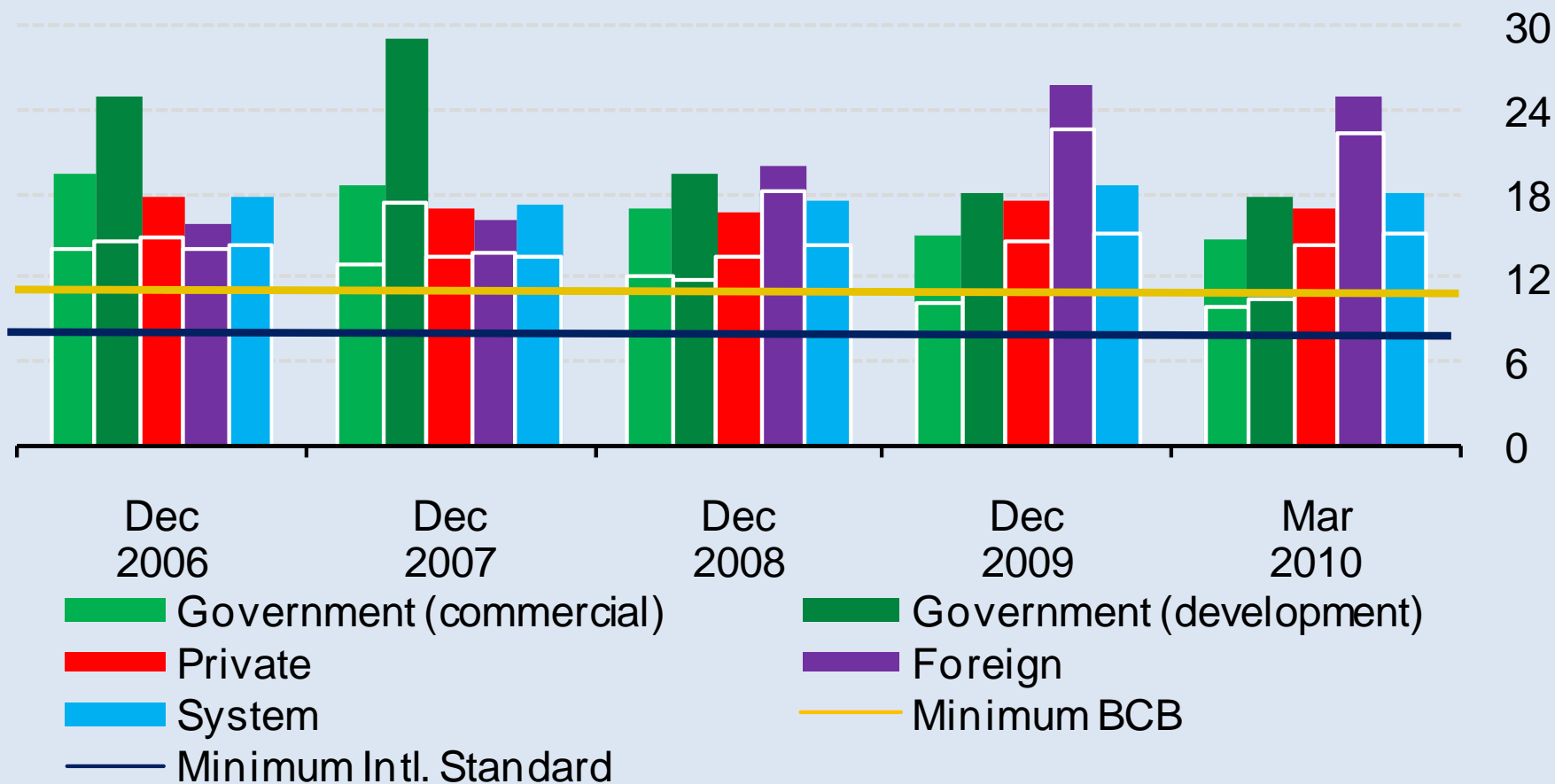
Specific Characteristics of the Financial System

- Wide umbrella of banking supervision: the supervision process also covers non-financial institutions under the control of financial companies (including those which are controlled by shareholders' agreement, those sharing the same managers, and those under the same name or brand);
- CAR is requested at both levels:
 - financial consolidation (only financial companies), and
 - economic consolidation (financial and non-financial companies)
- Forward-looking provision schemes, considering expected losses as well as past due credits.

Specific Characteristics of the Financial System

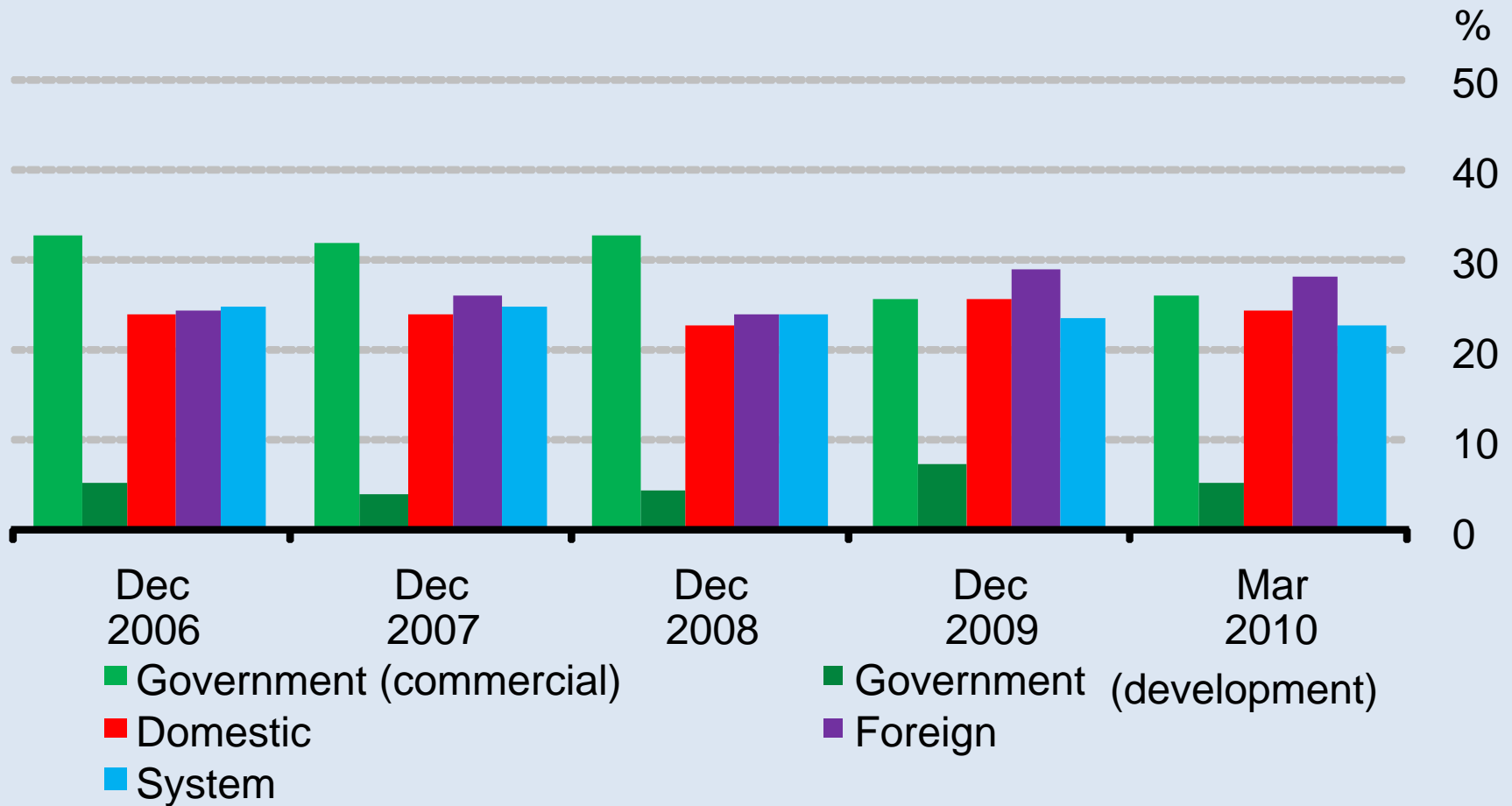
- Conservative capital requirement
 - Minimum capital ratio (CAR) of 11% (minimum Basel ratio is 8%)
 - Credit ratings are not used to determine credit risk weights under the standardized approach
 - It is requested one BRL on capital for each BRL on Net Foreign Exposure (short or long). NFE can not be more that 30% of Capital.
- Supervision process
 - Focus on risk – continuous on-site and off-site processes
 - Strong monitoring process – uses data from the Credit Risk Bureau and the Clearing Houses on a daily basis (not only financial statements)

Capital Adequacy Ratio



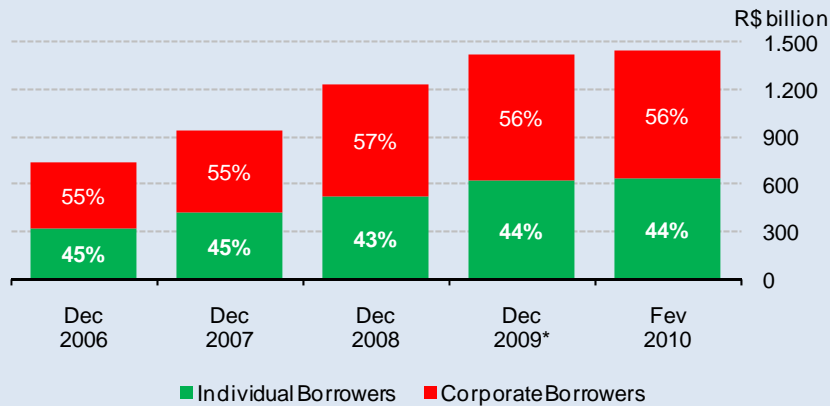
Liquidity.

Liquid Assets to Total Assets

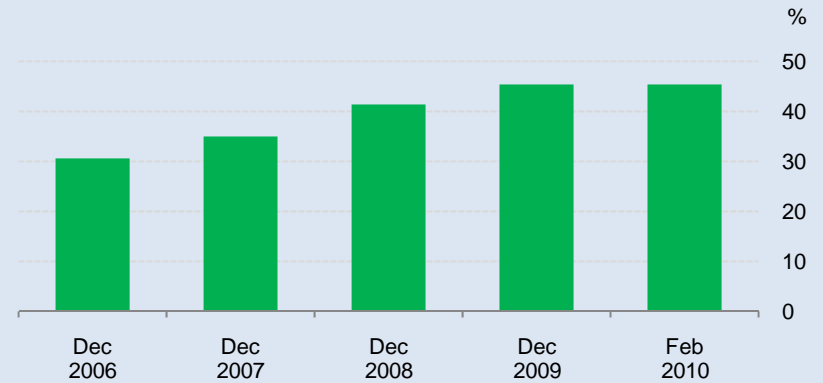


Credit evolution.

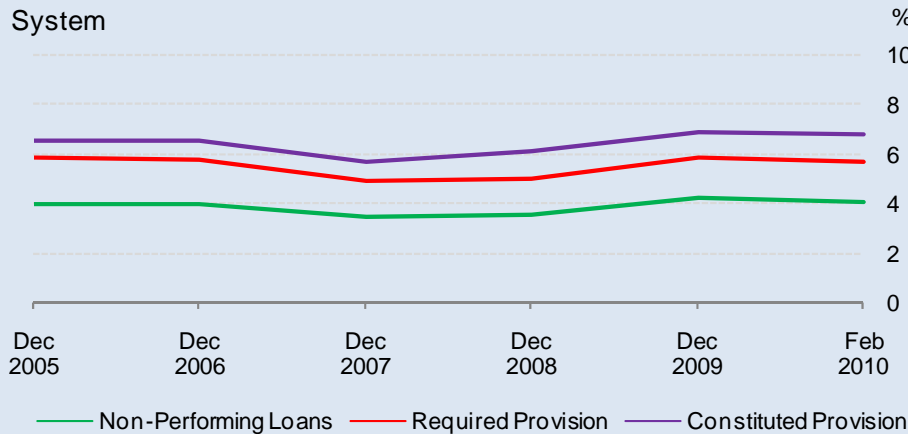
Loans



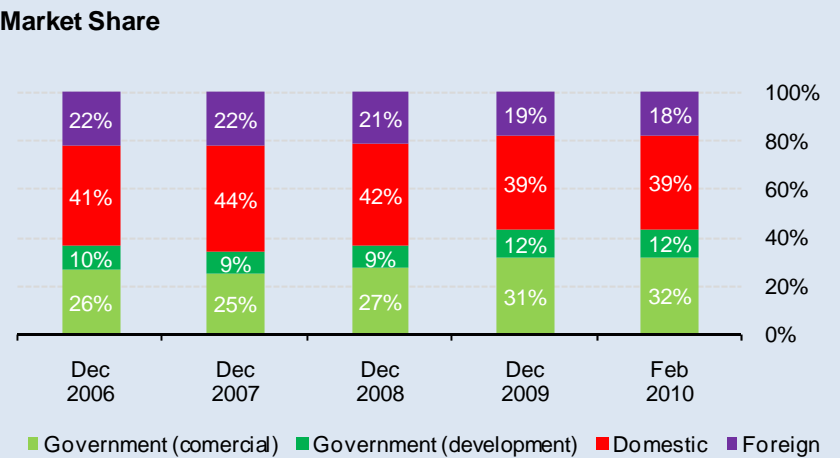
Domestic loans and leases / GDP



NPL and Provision to Total Loans ratios System

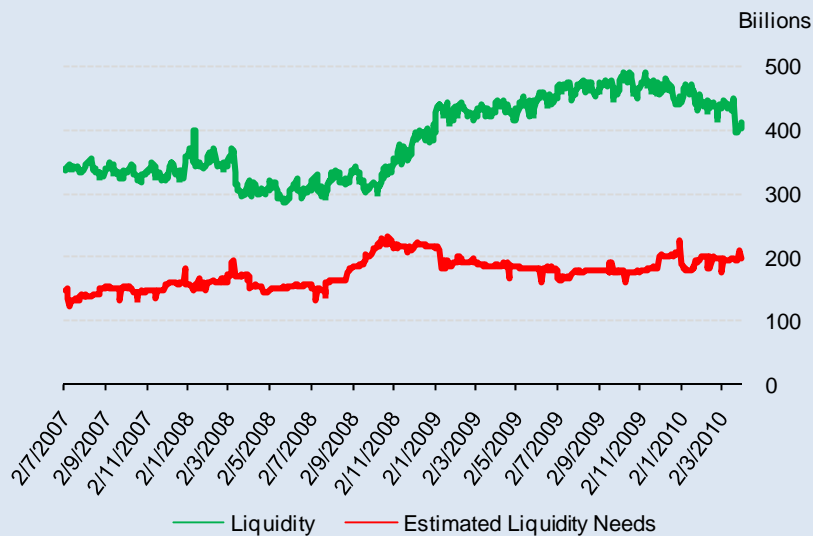


Market Share

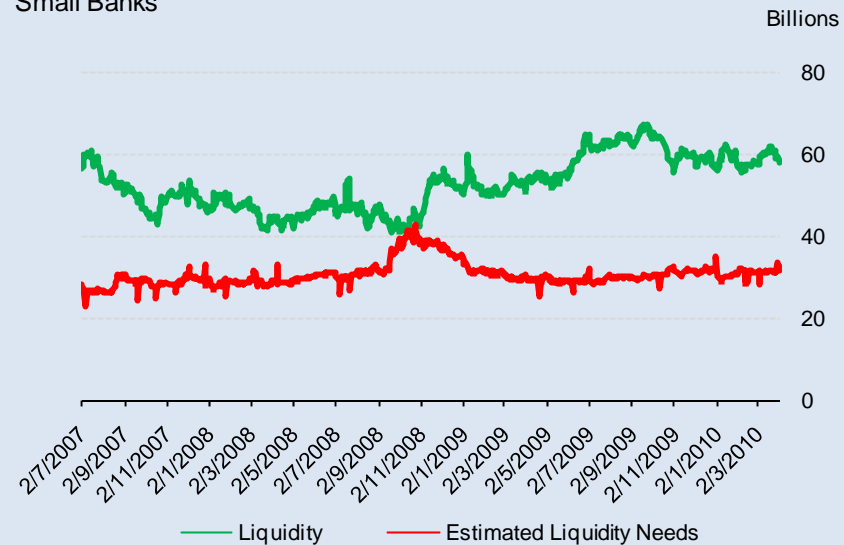


Current Liquidity *versus* Estimated Liquidity Needs on Stress Scenarios

Liquidity X Estimated Liquidity Needs



Liquidity X Estimated Liquidity Needs
Small Banks



Low impact from the triggers of the crisis in internal markets

- Although the Brazilian derivatives market is large, it is concentrated in interest rate and foreign currency risk related factors;
 - CDS volumes are irrelevant in the Brazilian derivatives market.
- Mortgages represent 6% of the Financial System's loans (despite the large growth in recent years).

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How Brazil was affected

- Until Lehman's bankruptcy, the impacts were insignificant
- After Lehman, risk aversion and short-term funding needs caused the dollar shortage in global markets resulting in a large and unexpected depreciation of the Real;
- There were some non-financial companies holding exotic derivatives negotiated abroad (in forex only). They did not adequately assess the risks involved in those positions and suffered heavy losses.

How Brazil was affected

- Hedge funds and other foreign investors started to repatriate capital; shortage in spot markets.
 - BCB sold US\$ 14.5 bi in spot auctions
- There was a lack of external funding, particularly for exporters; shortage in credit markets.
 - BCB lent US\$ 24.5 bi in repo auctions
- Exporters and other companies made hedge in the futures market, with a very short maturity structure; shortage in futures markets.
 - BCB sold forward US\$ 33.0 bi in swap auctions

How Brazil was affected

- Large banks with increased liquidity demand due to clients needing money to settle their exposure to foreign currency derivatives
- Some players needed money to cover daily adjustments and margins in the futures markets.
- Funding difficulties for small institutions, which faced risk aversion in the domestic market after the collapse in the external funding.
- Reserves requirements at R\$ 259 bi in Aug 09
 - BCB released R\$ 99.8 bi of reserve requirements
 - BCB earmarked R\$ 42.2 bi to small institutions
 - BCB authorized deposit insurance of up to R\$ 20 mi for smaller institutions; (the Insurer is a private company)

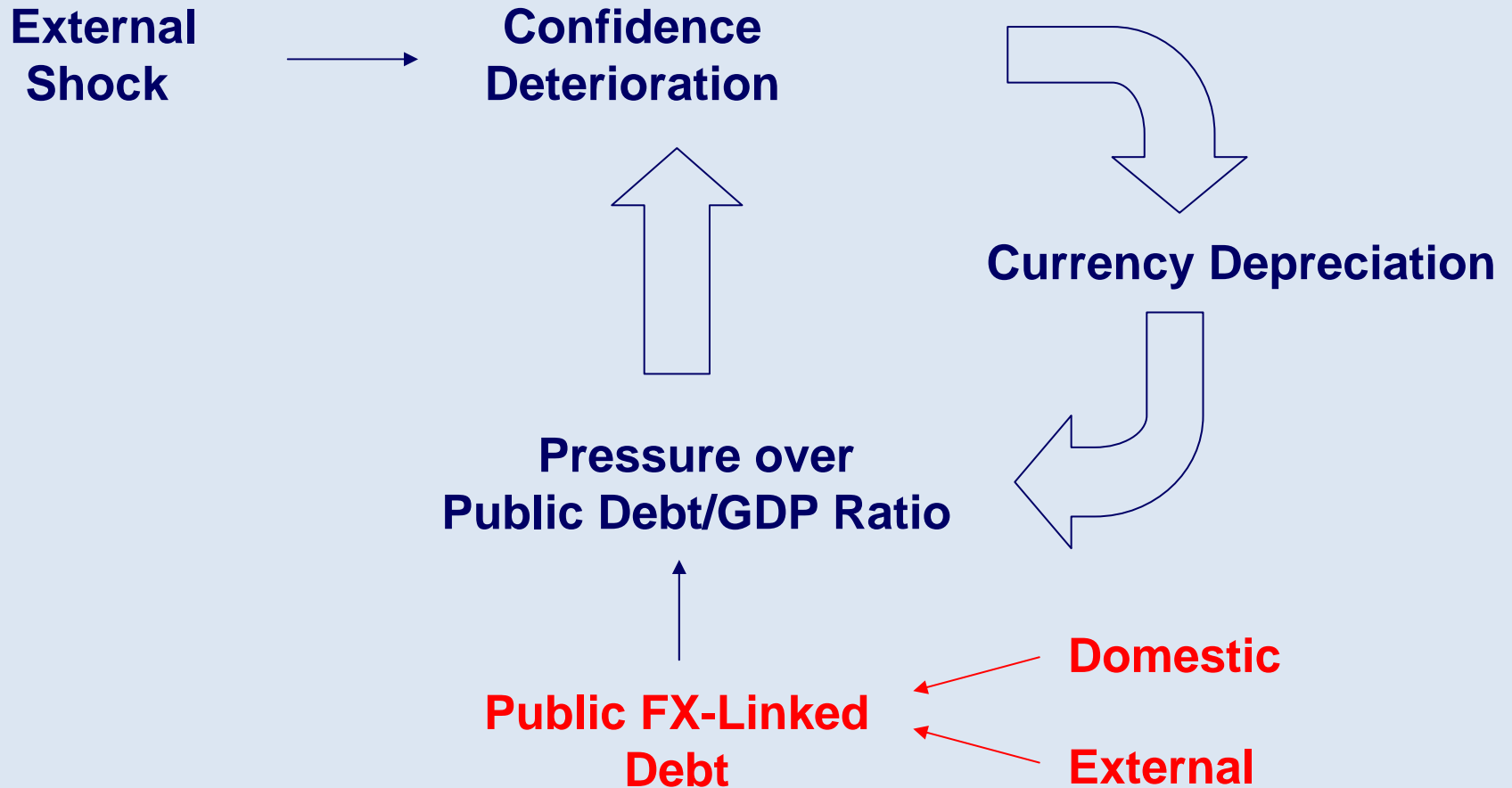
How Brazil was affected

- Other actions:
 - Tax relief for some industries with high-degree of interconnectivity throughout the economy
 - Stimulates the consumption
 - Government banks kept lines of credit open
 - Credit needs of export firms

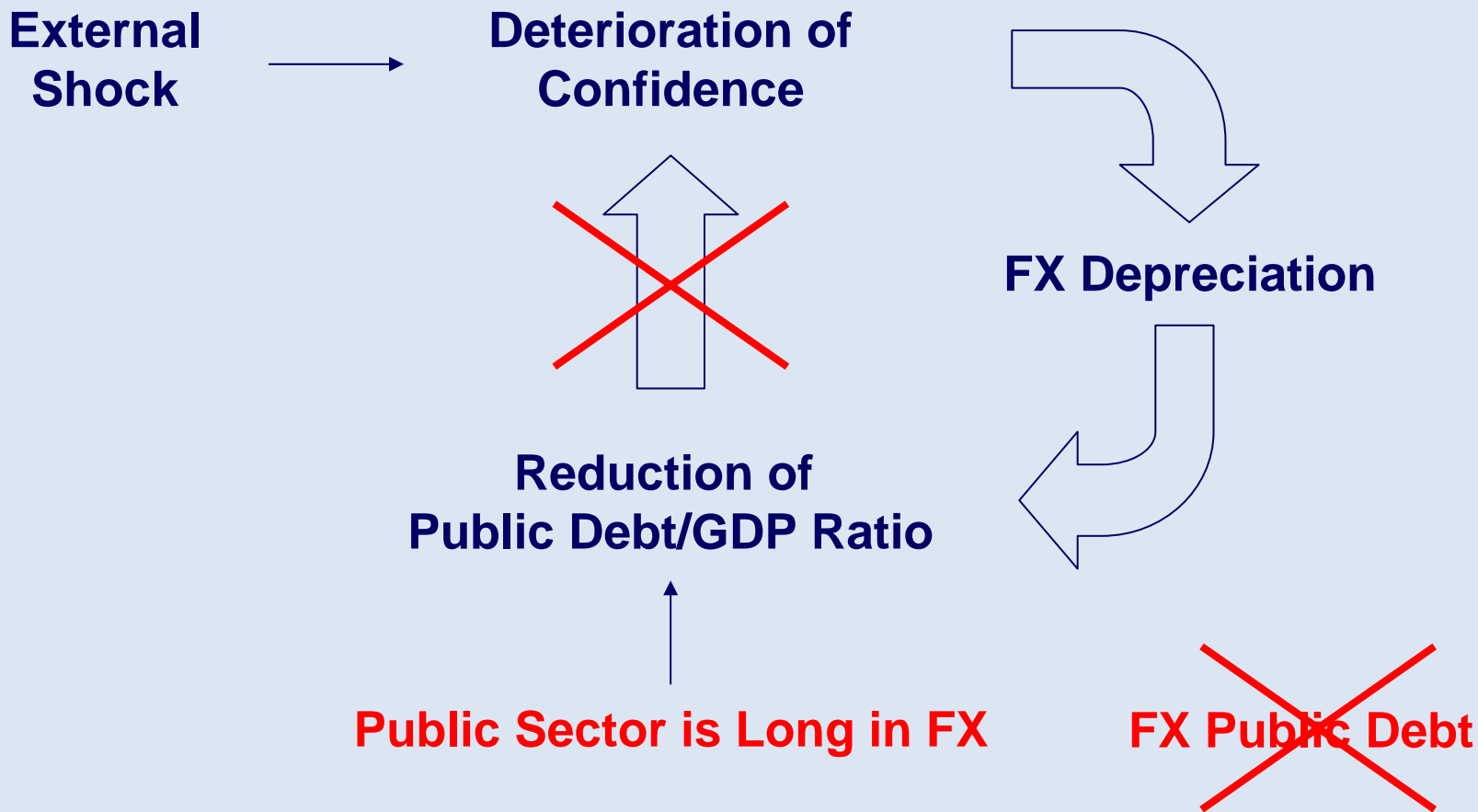
How Brazil was affected

- Summary of the conditions that lowered the impact on the Brazilian economy and its Financial System:
 - Successfully addressed historical vulnerabilities
 - Domestic demand-based growth
 - Sound Financial System
 - Low exposure to markets that triggered the international crisis
 - Quick and coordinated reaction from the Central Bank and the Ministry of Finance

Effects of Confidence Crises on the Brazilian Economy - Past



External Shock Feedback Loop: Now



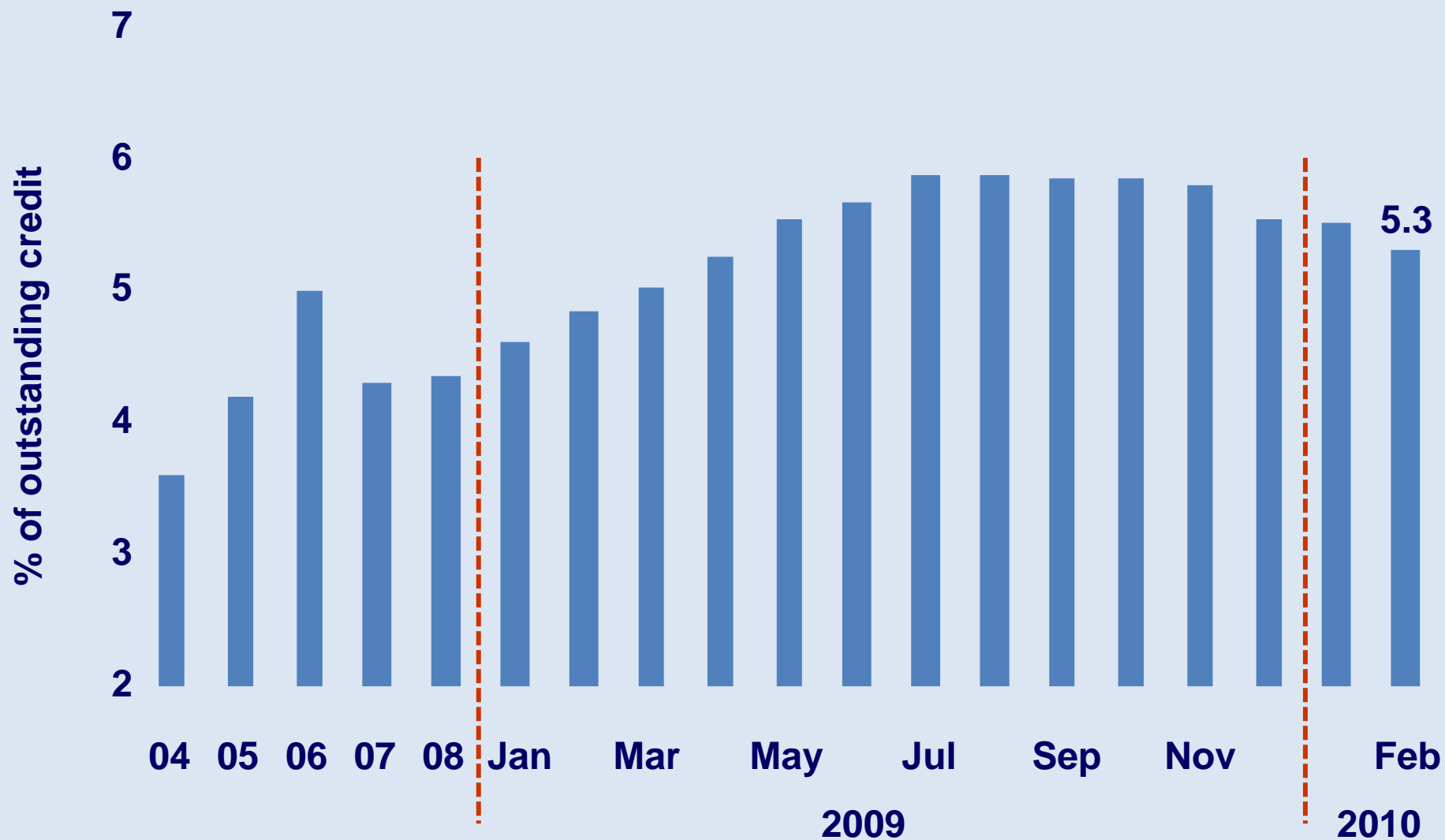
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Current situation

- Giving its macroeconomic fundamentals, Brazil has been able to reverse, without much distress, many of the anti-crisis policy measures:
 - Return of reserve requirements to pre-crisis levels;
 - Reversal of actions in the foreign exchange market;
 - Tax relief – phased out the tax cuts that had been adopted during the crisis.
 - The BCB increased the basic interest rate in the last monetary policy committee meeting and has given signs of further tightening.

Brazilian Banks: Delinquency

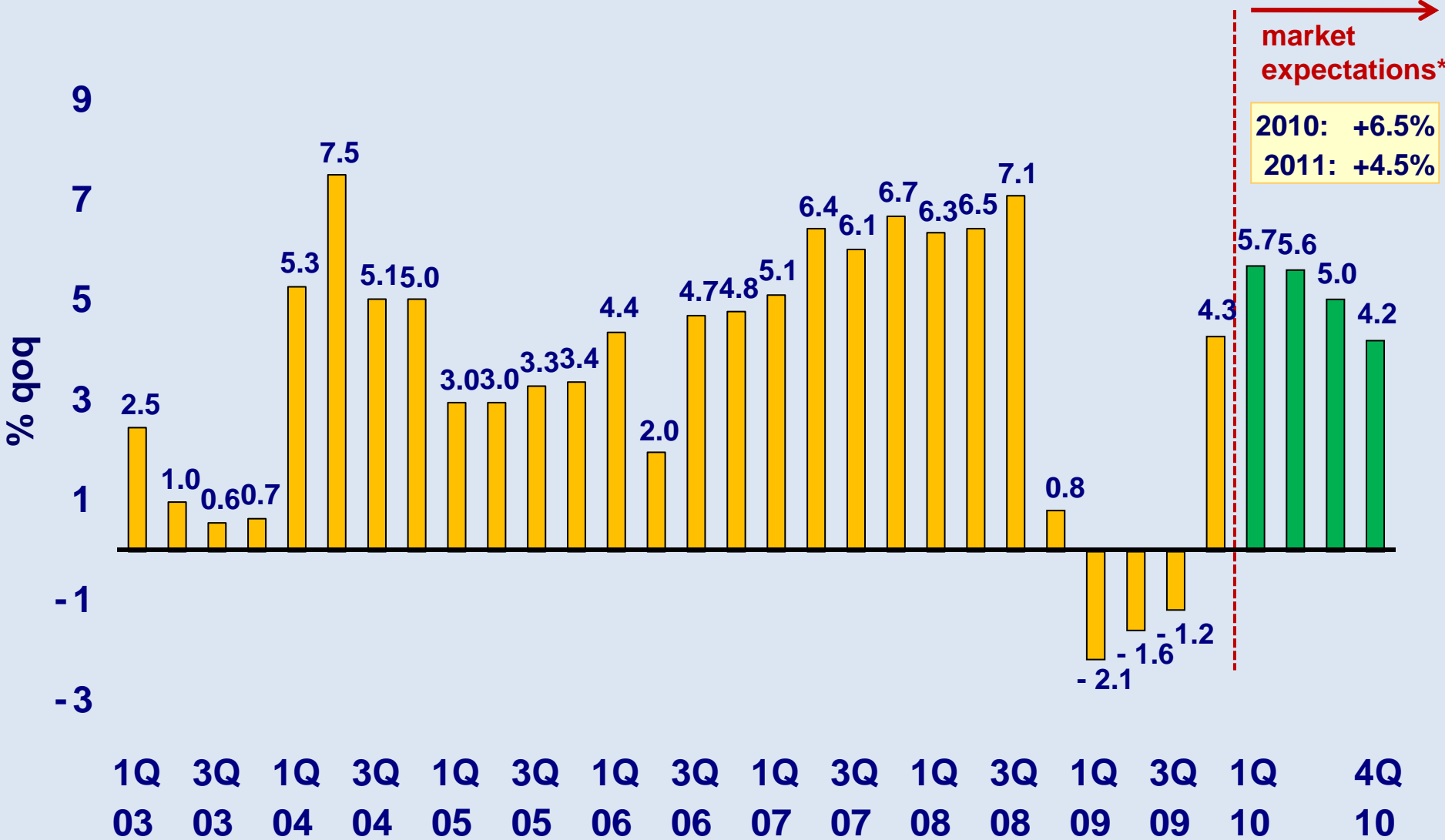


Unemployment

unemployment following a downward path



GDP Growth



Thanks!



Soccer World Cup



Olympic Games

See you in Brazil!

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