O ‘Jeito Brasileiro’ – the Brazilian way
Brazil’s engagement with standard setting bodies
and the implications for financial inclusion

A contribution from the Alliance for Financial Inclusion (AFI) network of developing country policymakers
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About this case study

This case study highlights the experience of Brazil in implementing international standards in the financial sector and the interaction, where relevant, with the topic of financial inclusion – a topic that is of particular relevance in Brazil. It draws on a questionnaire completed by the relevant regulatory authorities, coordinated by Banco Central do Brasil (BACEN), as well as meetings with each regulatory authority.

The case study aims to tell the story of Brazil’s engagement with each of the standard-setting bodies (SSBs) and to highlight areas where further engagement from the SSBs on the topic of financial inclusion will be welcomed. The Brazilian authorities recognize the important role played by each SSB and would like to contribute to the dialogue process as each SSB engages with the topic of financial inclusion. However, the case study does not present the official position of any of the supervisory authorities consulted and should not be construed as making demands on the SSBs. Rather, suggestions made illustrate potential needs at the country level for SSB dialogue, information and guidance.
1. Financial inclusion context

A continent in a country

Brazil is a large, complex and diverse country - in terms of its geography as well as demographic and economic realities. It includes large sprawling urban conurbations in the Southeast such as São Paulo and Rio de Janeiro, more remote and lightly populated areas such as the Amazon rainforest, and arid rural regions in the centre and northern parts of the country. Furthermore, Brazil’s income disparities between regions and population groups are well known.

Given this diversity, the country faces unique challenges in extending financial inclusion. It needs to offer a diverse product suite, from services for low-income consumers via the correspondent network, cooperatives and financial institutions, through to sophisticated internationally traded instruments on the stock exchange. A ‘one size fits all’ strategy for financial inclusion will not work. This calls for proportionality, a salient theme in this case study.

The financial sector is diverse and sophisticated

The Brazilian financial system or the Sistema Financeiro Nacional (SFN) represents the continuously evolving universe of regulated institutions in the Brazilian financial sector. Given the diversity of the Brazilian population, the SFN has to cater for a variety of needs. This explains the broad range of institutions, from credit cooperatives and savings and loans associations, to large international banks and exchange brokerages. The SFN forms the backdrop to the financial system regulatory framework and each of the standard setting spheres is relevant to a part of the SFN.

The National Monetary Council (CMN) is the overarching entity responsible for issuing regulations and guidelines for the proper functioning of the SFN, operationalized through four regulation and supervision entities:

- The Central Bank of Brazil (BACEN);
- The Securities and Exchange Commission (CVM);
- The Private Insurance Superintendence (SUSEP);
- The Complementary Pension Secretariat (SPC), recently renamed PREVIC).

These authorities regulate a diverse range of institutions across the following categories:

- Demand deposit-taking financial institutions;
- Other financial institutions (including microentrepreneur credit companies and development agencies);
- Financial intermediaries or auxiliaries;
- Insurance and pension entities;
- Portfolio management entities;
- Liquidation and clearing systems.

Appendix 1 provides a diagrammatic representation of all participants in the SFN.

There are a number of players outside the formal SFN

There are a number of entities that are significant for financial inclusion but are presently not actively supervised. For example, Civil Society Organizations of Public Interest (OSCIPs) are registered with the Ministry of Justice and the Ministry of Labor and Employment and participate in the National Program for Productive Oriented Microcredit, a multi-ministry governmental program, but are not prudentially supervised. The same is true for other entities outside the SFN, such as Fundos Públicos (public funds), NGOs involved in microcredit, and factoring companies.2

History determines policy and behavior

Brazil has had a complex economic history. The 1980s and early 90s were a tumultuous period characterized by stagnation, hyperinflation and crisis. Since the inception of the Plano Real in 1994, Brazil has been very cautious in its regulatory approach and places priority on adhering to or even exceeding international standards. The country has deliberately not followed a ‘test and learn’ pathway, preferring instead to proactively regulate anticipated market trends.

Financial institutions in Brazil are also conservative

Mainstream retail banks traditionally show the same risk aversion as the regulators. Given the historically high interest rates and traditionally attractive spreads on bonds, saving instruments have been most popular and commonplace, and mainstream financial institutions were less likely to diversify into new products. Instead, their sophistication lay in innovating to protect themselves against macroeconomic volatility. The combination of risk adversity and the relative newness of the need to

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1. Unless otherwise quoted, the source for all parts of the case study is the series of consultations with the relevant regulatory authorities in Brazil, as well as the questionnaire answers provided by them.
2. Factoring is a flexible form of loan, which advances money to a company as it issues new invoices. This is different to overdrafts or more formal loans, which are usually for a fixed amount.
3. The Plano Real, launched in 1994 was a program that strictly limited government spending, introduced a new currency (the Brazilian Real - BRL) in place of the Cruzeiro, and made other fiscal reforms. The program was initiated during an era of macroeconomic volatility, following a series of anti-inflationary programmes in the 1990s that were considered as only temporarily successful.
4. For example, the Basel Committee on Banking Supervision (BCBS) recommended before the financial crisis that financial institutions should have assets equivalent to at least 8 per cent of loans and other risks. In Brazil, the minimum set by BACEN was 11 per cent. In practice, banks were operating at a figure closer to 16 per cent.
innovate in terms of product diversity means that products aimed at financial inclusion may not be a natural progression for many of these institutions.

The financial inclusion story

Policy shifts to social inclusion

Along with the macroeconomic stabilization in the late 1990s, and the period of economic optimism that followed came a policy shift towards social inclusion. Innovative schemes such as Bolsa Familia\(^1\) epitomize that policy shift and have achieved remarkable success: to date, more than 30 million\(^2\) Brazilians have moved out of poverty. In June 2011, the new government launched an even more comprehensive program aimed at eliminating extreme poverty, *Brasil Sem Miseria*, as strategic priority.

Financial inclusion is also a social inclusion tool

The Brasil Sem Miseria scheme incorporates financial inclusion as an important tenet in its ‘productive inclusion’ pillar. There has also been a concerted effort to link financial inclusion to Bolsa Familia, with a simplified bank account created in 2003 with the initial aim of facilitating social cash transfer payments. More than 10 million such accounts were subsequently opened by Caixa Economica Federal alone, 7 million of which are active\(^3\). The Ministry of Social Development (MDS) is currently considering broader financial inclusion initiatives, including insurance, linked to the *Bolsa Familia* database.\(^9\)

The public banking sector has complemented the government push for financial inclusion

Brazil’s state-owned banking sector has a large market share.\(^10\) This includes state owned banks such as Caixa Economica Federal (henceforth Caixa), the public-private Banco do Brasil and development banks such as the Brazilian Development Bank (BNDES) and Banco do Nordeste. Government uses state-owned banks as tools to pursue financial inclusion. This is evidenced by the fact that the vast majority of simplified bank accounts are rolled out through Caixa’s large correspondent network\(^11\) and Banco do Brasil; private banks consider such accounts to be unprofitable\(^12\).

Existing infrastructure has been leveraged to reach previously unserved areas

More broadly, BACEN has committed itself to extend the reach of the financial sector. One of the core policy moves has been the creation of the banking correspondent space (Box 1).

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Box 1. Banking correspondents as a financial inclusion vehicle

The Brazilian banking correspondents are known internationally as a prime example of branchless banking. Originally introduced in the 1970s, the correspondent model really took off at the end of the 1990s when the Brazilian government wanted to create a framework to deliver financial services and facilitate cost-effective bill payments in remote areas.

From 2003, the government needed an effective distribution channel to disburse its social welfare payments and realized that banking correspondents would be a suitable means of expanding the banking sector footprint at low cost.\(^13\) It therefore implemented enabling regulation, which has led to the number of correspondents soaring to over 150,000. They are now responsible for BRL 394 billion in loan grants, roughly half the total quantity of loans in Brazil. It is estimated that 94 percent of the correspondent network is operated by Banco do Brasil, Bradesco and Caixa Economica Federal.\(^14\)

Today, virtually all of the more than 5,000 municipalities in Brazil are served by correspondents\(^15\), who provide a range of services, including account opening, deposits, withdrawals, loans and bill payments – with the latter accounting for most transactions.

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1. A social cash transfer scheme conditional upon education and health behaviour among recipients introduced under the Lula presidency in 2003.
2. “O País, enfim, reage à pobreza”, O Estado de Sao Paolo, 1 January 2011, Available at: http://www.estadao.com.br/noticias/impresso,o-pais-enfim-reage-a-pobreza,660687,0.htm
3. Brasil Sem Miseria (Brazil without poverty) is a social welfare scheme that aims to eliminate extreme poverty by 2014 through social transfers, health and education programs.
4. Kelly Oliveira, Agencia Brasil, ‘Caixa abriu 10,7 milhões de contas simplificadas em quase sete anos’ Agencia Brasil, 28 November 2010
6. Statistics from the Department of Financial System Surveillance and Information Management (DESIG) in BACEN reveal that over a third of both active and less active bank accounts in Brazil are found in the largest public banks, Caixa Economica Federal (public) and Banco do Brasil (public/private).
7. BACEN, data on correspondents, as at May 2011. Available at: http://www.bcb.gov.br/ICORPAIS
8. CGAP, 2010-3.
9. 80 per cent of Bolsa Familia payments are made by banking correspondents. Source: Lauro Gonzalez, Centro de Estudos em Microfinancas da (FGV), Seminar, “Bancos Comunitarios e Finanças Inclusivas”, FGV, São Paulo, 28 May 2010.

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2. Brazil’s engagement with standard setting bodies and the implications for financial inclusion
Government policy has sought to stimulate microfinance

In parallel, government has embarked on various policies to stimulate the microfinance sector, most notably:

- Mandated microfinance funding. In 2005, as part of the PNMPO (National Program of Productive Microcredit), BACEN and the Ministry of Labor and Employment enacted a credit policy that includes the requirement that commercial banks direct 2 percent of all demand deposits to microcredit.

- Strengthening credit cooperatives. Over the years, BACEN policies on credit cooperatives have grown and reformed the industry to a situation today where there are close to 1,500 cooperatives/credit unions, responsible for 5 percent of credit volume in Brazil and playing an important role in economic empowerment in rural areas.

- Broadening the reach of the SFN. BACEN has also implemented various initiatives to incorporate entities such as micro-entrepreneur credit companies (so-called SCMEPPs) into the SFN.

There is now a concerted effort to bring disparate financial inclusion programs into an overall framework

The road towards financial inclusion in Brazil therefore progressed organically. Various standalone initiatives within government and the financial sector gradually started to build up a broader financial inclusion focus, without an explicit policy direction or deliberate coordination across efforts.

The aim is now to consolidate the financial inclusion agenda in a multilateral framework for financial inclusion. BACEN has assumed the promotion of financial inclusion as a strategic objective and is leading the process of coordinating and consolidating financial inclusion efforts across various entities (including the National Development Bank, BNDES, the Ministry of Labor, of Finance, universities, credit associations and unions, and retail banks).

It is doing this through a series of Financial Inclusion Forums incorporating a broad range of stakeholders. The first Financial Inclusion Forum was held in November 2009 and a second in 2010, when BACEN published a comprehensive Financial Inclusion Report. The process will culminate in the third Financial Inclusion Forum in November 2011, when a National Partnership for Financial Inclusion will be launched to mirror, domestically, the coordination taking place internationally through the Global Partnership for Financial inclusion.

The Brazilian balancing act

Where caution meets a strong mandate for financial inclusion, interesting considerations emerge. Guidance, internationally, on how to effectively apply a risk-based/proportional approach to regulation that serves both goals is therefore much sought after. This theme will reverberate time and again in the SSB interaction stories in the sections to follow.

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14 Ibid. Banks can satisfy the directed lending requirement by originating microloans, transferring the amount to other institutions for the same purpose, or acquiring microcredit portfolios from other entities, including nongovernmental organizations. The amount that a bank fails to invest must be deposited in BACEN without remuneration. In addition the government has issued rules to enable banks to make payroll- consigned loans, the fastest growing line of business, which are channelled chiefly through non-bank agents.


2. Standard setting body membership

**Brazil has a full membership suite of the five SSBs**

Brazil is a member of all five international standard setting bodies. Its most long-standing engagement is with the International Association of Insurance Supervisors (IAIS), of which it has been a member since 1996. It is also a founding member of the International Association of Deposit Insurers (IADI). It gained Financial Action Task Force (FATF) membership in 2000 and joined the Basel Committee on Banking Supervision (BCBS) in 2009 as part of the BCBS’s post-global financial crisis wave of membership expansion. It likewise joined the CPSS (Committee for Payment and Settlement Systems) in 2009.

Each SSB is directly or indirectly relevant for financial inclusion in Brazil

**Brazil’s G20 engagement is also important for financial inclusion**

Brazil has engaged directly with IAIS on financial inclusion, and the broader issue of proportionality and adopting a risk-based approach is core to its engagement with FATF and the BCBS. In the payments sphere, various CPSS developments around retail payments and innovation inform discussions around financial inclusion and in the deposit insurance space, Brazil is closely engaged in the financial inclusion debate recently launched by IADI.

3. Key SSBs engagement stories

3.1. Basel Committee on Banking Supervision (BCBS)

**Core principles: ahead of the curve**

**Synopsis**

In its interpretation of the Basel Accords, Brazil is very conservative, a result of its aforementioned history. However, Basel III – the latest of the Accords and designed for the complexities of large international financial institutions – is considered too complex for the diverse challenges in the Brazilian domestic market.

Stability and efficiency in the financial system are the two pillars of BACEN’s regulatory approach. Financial inclusion is seen as complementary to those pillars. In considering stability and efficiency, BACEN is particularly concerned with the credit exposure of large systemically important institutions to smaller entities.

In constructing a framework that is calibrated towards the diverse requirements of entities in the Brazilian SFN, BACEN has designed a program of Simplified Prudential Regulation (SPR) for credit unions/ cooperatives. BACEN is confident that the SPR is in line with the Basel Core Principles. Implications for BCBS: Financial inclusion issues may benefit from additional guidance from BCBS on assessing different types of risk according to the size and complexity of financial institutions and their portfolios. This could include guidance on assessing liquidity risk as well as the issue of comparative exposure between different levels of the financial system. At present, the BCBS principles and guidance are drawn at the theoretical level. Supervisors would find more pragmatic guidance useful. Guidelines on partnerships between banks and non-bank entities are also required, highlighting the need for greater coordination between standard setting bodies such as the BCBS and the CPSS.

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19 For a comprehensive summary of Brazil’s engagement with the G20 Principles for Innovative Financial Inclusion, please see Table 2.3 in ‘Relatorio de Inclusao Financeira’, Banco Central do Brasil, 2010.

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4 Brazil’s engagement with standard setting bodies and the implications for financial inclusion
**Brazil’s engagement with Basel precedes its BCBS membership**

In line with Brazil’s commitment to international best practice, BACEN, under the guidance of the National Monetary Council, began implementing the Basel Accord of 1988 in 1994 – before the country became a member of BCBS. The Core Principles for Effective Banking Supervision also provide the general framework for Brazil’s banking supervisory approach.

BACEN started implementing Basel II in 2006 and Basel III, which was only published in December 2010, in 2011. Internationally, full Basel III implementation is expected by 2019. Brazil is one step ahead, planning to implement Basel III by 2017.

**BCBS membership entrenches commitment**

By prudently adhering to Basel principles, the Brazilian banking industry was largely protected against the global financial crisis – putting the Brazilian banks in a more comfortable position than most of their international counterparts regarding the adoption of stricter standards for Basel III. In fact, for the first years of transition to Basel III standards, Brazilian domestic financial institutions will already meet capital requirements above the international standard.\(^{20}\) It was a natural progression, then, for Brazil to become a member of the BCBS in 2009. BCBS membership gives Brazil, as a leading G20 nation, a greater voice on the topic of systemic stability, internationally.

**Progressions in Basel standards raise the bar**

Basel II is based on three “pillars”:

1. Minimum capital requirements (addressing credit, market and operational risk);
2. Risk management and supervision (systemic risk, pension risk, concentration risk, strategic risk, reputational risk, liquidity risk and legal risk);
3. Market discipline (leading to good corporate governance).

It is a significant progression from the original Basel Accord of 1988, which dealt with only parts of each of these pillars. Basel III, while it maintains the three pillars concept, enhances various aspects, adds a macroprudential overlay that includes capital buffers and calls for internal models for capital requirements. The progression across various Basel rounds reflects the growing complexity of the international financial system and the need for more and more capital to protect it against shocks.

**Increasing complexity calls for proportionality**

However, this increasing complexity presents a challenge to BACEN as banking supervisor: while it wants to assure stability, and is proud to be ahead of the curve in its prudential approach, it also has a strong mandate to pursue financial inclusion. Indeed, as stated in Box 1, BACEN regards financial inclusion and stability as two sides of the same coin. How, then, to strike a balance between meeting increasingly complex international standards aimed at large internationally active financial institutions and promoting financial inclusion?

Experience suggests that full compliance is costly and may not be viable for smaller institutions. There is therefore a need to “localize” the application of international standards so that regulatory systems and controls are appropriate to the size and characteristics of the organizations or operations regulated.

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**Box 2. Connecting the dots: the link between financial stability, efficiency and inclusion in Brazil**

International standards call for stability and efficiency. BACEN regards financial inclusion as complementary to both these goals:

- **Efficiency**: greater efficiency reduces costs, thereby promoting financial inclusion. The quest for financial inclusion, through the innovation it triggers, in turn can enhance efficiency.

- **Stability**: Financial inclusion is also consistent with financial stability. Though low-income targeted services and channels may not be systemically important on an individual scale, they expose systemically important financial institutions to increased risk – and a large number of tiny exposures can become systemically important. A more inclusive, broad-based system where a variety of entities are regulated in line with their respective risk exposures, combined with improved access to information, ensures a consistent funding stream for small entities that extend the boundaries of financial inclusion.

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Proportionality has been introduced for credit unions

BACEN took a decisive step towards proportionality when National Monetary Council Resolution 3897 of 2010 introduced Simplified Prudential Regulation (SPR) for credit unions. This was the outcome of in-depth studies by BACEN on the cost impact of Basel II implementation as well as the risk exposure of different entities. BACEN concluded that credit unions do not pose systemic risk and find the Basel II standards too complex and expensive to comply with. To encourage the credit unions to move into the regulated sphere, it developed the SPR, which sets eligibility criteria designed to limit risk (e.g. no foreign currency exposure, no investment in asset-backed securities, limits on total assets, etc). Eligible entities may choose whether to apply the SPR, which has standard, yet higher, capital requirements and simpler systems and compliance requirements, or the complete prudential regulation represented by the Basel standards.

The decision to implement the SPR also represented proportionality from a supervisory capacity point of view: although there is a degree of self-regulation through the so-called “central” or secondary cooperatives, the sheer number of credit cooperatives (close to 1,500) implies disproportionate supervisory costs relative to the low risks posed.

Alignment with BCBS strengthens position

The risk-based approach is ingrained in the Basel framework as well as the core principles. In implementing the SPR, BACEN carefully considered the Basel Core Principles and concluded that their approach “adequately meets the core principles” 22. The Microfinance Guidance issued by the BCBS has given them confidence that their chosen course of action is acceptable 21.

More clarity is required around proportionality

Proportionality is also required beyond credit cooperatives/unions. Ensuring the health of smaller institutions that operate closely to lower-income communities is important to foster financial inclusion. Given that microfinance providers and smaller niche banks do not have the same resources as the larger institutions, some Core Principles may represent a challenge to them: for example it will be difficult for them to introduce sufficient risk management processes, including for operational risks, as well as internal control and audit requirements. This, in BACEN’s view, calls for greater clarity on the risk-based approach to supervision at the institutional level. Going forward, more specific guidance internationally on how to apply proportionality in the developing country context will be important.

Proliferation of providers creates increased risk

An important aspect of the interplay between financial inclusion and stability and, hence, the need for a proportional approach, is that as players, products and channels proliferate, large institutions in the SFN incur risk exposures to smaller ones to which they lend. Such proliferation is part and parcel of financial inclusion, but small players may lack expertise, internal databases and sophisticated operational models, leading to information asymmetries that can, in turn, undermine their funding streams from larger institutions. Smaller entities may furthermore be calibrated to longer term funding and may incur difficulties if they have temporary short-term funding needs. This introduces liquidity risk, and may in turn affect the business models of the larger institutions.

This is an area where regulators would welcome BCBS guidance in particular around assessing liquidity risk and understanding the operational functionality of smaller institutions as it informs financial inclusion. Supervisors also need guidance in defining a regulatory pathway across a diversity of players, taking account of the relationships between them and the information asymmetries to be overcome. At present, the BCBS principles and guidance are drawn at the theoretical level. Supervisors will find more pragmatic guidance useful.

Furthermore, there are at present no specific guidelines on partnerships between banks and non-bank entities. This calls for greater coordination between standard setting bodies such as the BCBS and others – a topic that we’ll return to in Section 3.3 when we consider the core issues related to payment systems regulation.

21 “Simplified Prudential Regulation for Credit Unions in Brazil”, Banco Central do Brasil, Department of Supervision of Cooperatives and non-Banking Financial Institutions and the Department of Financial System Regulation.

22 “Simplified Prudential Regulation for Credit Unions in Brazil”, Banco Central do Brasil, Department of Supervision of Cooperatives and non-Banking Financial Institutions and the Department of Financial System Regulation.


Brazil’s engagement with standard setting bodies and the implications for financial inclusion
3.2. Financial Action Task Force

Applying a risk-based approach to anti-money laundering and combating the financing of terrorism

Synopsis

Financial inclusion is a relatively new topic in FATF and has not yet formally trickled down to the GAFISUD\(^{24}\) level. For Brazil, however, financial inclusion is a long-standing and fundamental objective.

The main concern with FATF’s approach to financial inclusion at the country level is the lack of clarity on the definition of low risk. This is most visible during the mutual evaluations. Though FATF endorses a risk-based approach and recognizes the importance of financial inclusion as complementary to AML/CFT objectives in theory, this is not translated into the mutual evaluation assessment criteria yet. Countries therefore risk being marked down on elements of their risk-based approach.

Implications for FATF? Brazil will find it helpful if FATF extends its guidance on the risk-based approach to define low risk more clearly, and for these considerations to be integrated into the mutual evaluation assessment criteria.

Brazil has been a FATF member since 2000 and it actively participates in FATF working groups such as the International Cooperation Review Group and the Evaluation and Implementation Working Group.

**Brazil has an established AML/CFT structure**

Brazil’s AML/CFT control structure derives from Law 9613/1998 (the “AML Law”) and consists of three components:

1. National AML and corruption strategy - The National Strategy Against Corruption and Money Laundering, ENCCLA, is a forum of 60 government and select private sector participants that sets the strategic priorities for AML/CFT in Brazil.

2. Financial intelligence unit - COAF, the Council for Financial Activities Control, was created by the AML Law. All supervised entities report suspicious transactions (STRs) and cash transactions (CTRs) directly to COAF. Its mandate is to receive reports, analyze them, keep client profiles and, where necessary, refer cases to the police or prosecutors\(^{25}\). COAF also acts as regulator for all AML/CFT accountable institutions that do not fall under the jurisdiction of any responsible supervisory authority.

3. Sector-specific AML/CFT supervisory authorities - The four supervisory authorities in the SFN (BACEN, CVM, SUSEP and PREVIC) are each tasked with implementing and supervising AML/CFT regulation in their respective spheres.

**How a risk-based approach has been adopted in Brazil**

Given the fact that Brazil is a large, diverse country with numerous porous borders, the government’s default policy is to exempt no transactions from identification. Even in instances where FATF recommendations allow a de minimis threshold (notably for wire transfers), Brazil does not make use of a threshold exemption. However, in such a diverse country a one-size-fits-all solution will also not be viable. Brazil has therefore implemented a risk-based approach in a number of instances, including:

- CMN Resolution 3,211/2004 created a simplified account aimed at the low-income market, which accepts alternative means of identification. Account opening can also proceed without customer due diligence (CDD) documentation, on the condition that all relevant CDD documents are then presented within six months of account opening. It therefore postpones rather than removes the need for verification of identity. There is a dedicated monitoring system and these simplified accounts are subject to a transaction limit of BRL 1,000 per month.

- BACEN Circular 3,461/2009 sets differentiated requirements for client identification, depending on the kind of business/transaction, with “eventual” or occasional clients subject to simplified procedures. The financial institution may develop internal procedures to identify occasional transactions that present low ML/FT risk. Furthermore, a risk-based approach may be applied in defining the criteria for updating client registration data.

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\(^{24}\) The FATF-style regional body in South America.

\(^{25}\) COAF operates a sophisticated, paperless system that uses artificial intelligence and parameters to filter and cross-analyse CTRs and STRs. Its database is connected to the criminal, tax, civil services, electoral and other databases. The national identity number, the CPF, is the common denominator. COAF’s artificial intelligence system daily filters approximately 2000 STRs and CTRs. Nevertheless, much is expected of COAF’s limited number of analysts and it lacks sufficient human resources for on-site inspections of all the institutions that it regulates.
Within the insurance sphere, CDD can be conducted at claims or cancellation stage for certain defined types of simple insurance products. Distinction is also made between products with benefits up to BRL 10,000 and those beyond. For “popular” capitalization contracts, CDD should be carried out when the amount is equal to or greater than BRL 2,000 (EUR 780/US$ 1,160) and when a benefit is paid. In addition to these AML/CFT measures put in place by private insurance supervisor SUSEP, the private health insurance supervisor ANS has also issued its own AML/CFT resolution.

The risk-based approach is also evident in the systems requirements for financial institutions. Every institution, of all sizes, must develop its own AML/CFT plan and submit it to its supervisory authority for approval. However, if approved in their plan, smaller entities (e.g. cooperatives) may implement simpler systems for identification, record keeping and monitoring/reporting of transactions to COAF, compared to the complex and costly IT systems implemented by large financial institutions.

Other instances of a risk-based approach include Brazil’s decision not to conduct on-site supervision of the Post Office’s money transfer service on the basis of the low level of activity and low risk presented.

AML/CFT not regarded as a primary barrier to inclusion

The regulators do not regard AML/CFT CDD measures as entailing a financial inclusion barrier per se. Brazil has had know your customer requirements under banking regulation for a long time, based on its history of instability and the risk of fraud. BACEN and COAF argue that, while some parties have approached them to request account opening and transfers without identification for certain low-risk cases, they have yet to see any evidence that this will have an actual impact on financial inclusion as the national tax number, the CPF, is very widespread and inexpensive to acquire. Furthermore, a large proportion of the population has electricity accounts that can be used for address verification. According to CGAP (2010), however, many low-income clients do not have a CPF or proof of address. CDD requirements were also raised by SUSEP as a potential cost-factor in the microinsurance space.

Institutions take a conservative approach to compliance

Financial inclusion barriers may also lie on the industry side. The AML/CFT authorities find financial institutions to be very observant and in some instances, this may even amount to overly conservative compliance. For example, in practice many banks do not apply the ‘relaxed’ customer identification procedures that are legally permitted to open simplified accounts, as they believe having to run two systems for client identification will increase costs and increase the risk of not promptly identifying fraud. Therefore most banks require a CPF to be presented, even for simplified accounts that allow alternative means of identification. Furthermore, though regulation does not specify that hard copy records of identification and verification must be kept, this is standard practice. Clearer guidelines on what will constitute an acceptable risk-based approach will be needed for firms to take up the flexibility allowed.

Mutual evaluation questions elements of Brazil’s risk-based approach

Brazil’s third round mutual evaluation was completed in 2010, and ENCCIA’s main priority for 2011 is addressing the deficiencies raised. Financial inclusion was not included as an independent topic, but is impacted indirectly through the ‘partially compliant’ ratings on a number of elements of the risk-based approach:

Recommendation 5: Customer Due Diligence. Brazil was rated partially compliant (PC) on this recommendation due to a number of issues, across supervisory authorities, that directly or indirectly relate to its risk-based approach. BACEN and COAF will reconsider the approach taken towards simplified CDD requirements as part of the preparations for the fourth round of mutual evaluations.

FATF recommendations and special recommendations require that some essential criteria related to CDD must be defined by law, and not in regulations or other enforceable means. This is a challenge. A risk-based approach calls for nimble regulation that can evaluate low and high risk on an ongoing basis as new scenarios arise. Legal provisions can

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26 ‘As defined in SUSEP Circular 380/2008’. These refer to closed group insurances where the premium is paid through credit card, and open-ended group insurances with a monthly premium not larger than BRL 50.
27 ‘Popular’ insurance is small value mass market policies, it is not specifically targeted at the low-income market.
24 As defined in SUSEP Circular 365/2008 art.1, Annex IV.
25 As defined in SUSEP Circular 380/2008 art.15, para.7.
Resolução Normativa ANS – RN 117/2005
21 Following the issues raised in the Mutual Evaluation (2010), Brazil has now decided to operate on-site supervision.
23 According to the 2007 BCG PNAD Survey, 98 per cent of Brazilian citizens have access to electricity.
22 ‘Update on Regulation of Branchless Banking in Brazil’, Consultative Group to Assist the Poor (CGAP), January 2010. Available at: http://www.cgap.org/gm/document-1.9.42396/Updated_Notes_On_Regulating_Branchless_Banking_Brazil.pdf
24 ‘Update on Regulation of Branchless Banking in Brazil’, Consultative Group to Assist the Poor (CGAP), January 2010. Available at: http://www.cgap.org/gm/document-1.9.42396/Updated_Notes_On_Regulating_Branchless_Banking_Brazil.pdf
25 Another important deficiency raised is on Special Recommendation II: Criminalize Terrorist Financing, as Brazil has not yet criminalized terrorist financing sufficiently, as a standalone offence, according to international standards. A bill to do so has been introduced into Congress, but it has not yet been enacted.
26 Mutual Evaluation Report, item 371

Brazil’s engagement with standard setting bodies and the implications for financial inclusion
Recommendation 23: Regulation, Supervision and Monitoring. Brazil received a PC rating on this recommendation partly due to the fact that there is no on-site supervision of the Post Office’s remittance service\(^{32}\). The decision not to do on-site supervision was taken consciously as part of a risk-based approach, given the limited scale of the Post Office’s money transfer activities and in light of the disproportionate resource demands that on-site supervision would make on COAF. What, in Brazil’s eyes, was a small issue with low risk to the system turned into a big issue in the mutual evaluation.

To address the identified deficiency, BACEN and COAF are developing a joint approach to on-site supervision of the Post Office, despite their earlier decision that this would not be warranted from a proportionality point of view. The experience is also likely to shape the country’s approach to AML/CFT more broadly: there is now increased hesitancy around anything that is internally regarded as a small issue, out of fear that it will become a big issue in the next evaluation round.

### 3.3. Committee on Payment and Settlement Systems (CPSS)

#### The payment system as backbone of the financial sector

**Synopsis**

Regulation of the payment system infrastructure, by promoting efficiency and building confidence, can promote financial inclusion. Retail payment instrument and channel innovation is also directly relevant in the quest to extend the reach of the formal financial sector.

Brazil does not yet have a regulatory framework for e-money. Nor is there any direct mandate for regulating non-financial institutions providing payment services. In navigating the very complex domestic retail payment system and thinking about the implications for regulation on payments-related innovations, BACEN is eager to learn from experience elsewhere, through the platform provided by the CPSS.

BACEN is an active member in the CPSS’s efforts to better understand the regulatory implications of innovations in retail payment systems, as well as other topics of relevance to financial inclusion. It is a two-way dialogue: through its active participation in CPSS working groups, Brazil is informing international discussions; at the same time, the outputs from the CPSS steer Brazil in considering new regulatory challenges in the payments space.

Implications for CPSS? Going forward, Brazil would appreciate CPSS guidance on a number of matters, most notably:

- **The legal mandate of regulators** in the face of payment system innovations, including the treatment of non-financial institutions (notably mobile operators) providing retail payments;
- **The merits of a bank-based model** and the role of banks, non-bank financial institutions and non-financial institutions respectively in such a model;

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\(^{32}\) Mutual Evaluation Report 2010, item 810
Proportionality in tailoring regulatory requirements to retail payment systems not regarded as systemically important.

Cooperation or dialogue between the CPSS and the BCBS on the nexus between payment system regulation and prudential supervision of payments providers will also be helpful.

BACEN’s Department of Banking Operations and Payments System (DEBAN) is the regulatory authority for Brazil’s multi-faceted payment and settlement system. Here we focus on the retail payment system. DEBAN’s 2004 Report on the Brazilian Retail Payment System (Diagnostico do Sistema de Pagamentos de Varejo) and its subsequent annual statistical updates 39, along with the 2006 report dedicated to the payment card industry 40, provide a comprehensive overview of the players, channels and instruments in the payment system, as well as the applicable regulatory framework.

There are two retail clearing houses: one for check payments (Centralizadora da Compensação de Cheques e Outros Papeis - COMPE); another (Câmara Interbancária de Pagamentos - CIP) for electronic instruments such as credit transfers, bill payments and credit and debit card payments. The retail payment system, as set out in the 2004 DEBAN report, comprises COMPE and CIP, the entire access channel infrastructure including ATMs and POS (point of sale) networks, as well as all payment instruments, including payment cards.

An efficient, safe payment system promotes financial inclusion

DEBAN has a legal mandate to mitigate risk and promote efficiency in the payment system. It regards this mandate as aligned with financial inclusion. Greater cost-efficiency implies that payment services will be more accessible to the low-income market. Risk mitigation enhances the credibility of the system in the public’s eye. This instills trust that can, in turn, enhance financial inclusion.

How should non-financial institutions such as mobile operators be treated?

DEBAN’s main challenge lies in the absence of a clear supervisory mandate for BACEN with regards to non-financial institutions, even if they offer payment services 41. Mobile network operators are a case in point, with some launching mobile payments initiatives 42. However, there is no official regulation for non-financial institutions for such initiatives. This creates regulatory risk for such companies that may discourage or delay investment in the growth of such models.

So far, there are few e-money and other payments innovations

Apart from the mobile operators, there are not many e-money initiatives in Brazil, partly because there is as yet no dedicated e-money regulation. Visa and MasterCard are starting to roll out pre-paid card initiatives, but they are still in the early stages. There are also embryonic developments in pre-paid e-wallet/card solutions such as the joint venture “Elo”, between Bradesco and Banco do Brasil 43.

However, BACEN has acted as an intermediary to encourage Febraban (Federação Brasileira de Bancos) to develop a business model for an e-money-based mobile platform for domestic use, suitable for the unbanked population. Up to now, these models have all involved a bank as a partner.

According to DEBAN, the best approach to accommodate such ventures would be a partnership between mobile operators or other players and banks (what is termed a “bank-based approach”). However, once again, BACEN does not have the legal mandate to regulate such partnerships.

There is a need for a comprehensive retail payments legal framework

To effectively regulate the industry, a legal framework is needed to give power to an authority to regulate and supervise any e-money, mobile financial services or other payment initiatives. This can only be done through an Act of Congress. DEBAN stresses that, in working towards such a legal framework, it is important to consider proportionality. Innovation in this space is crucial and legal interventions must guard against restricting innovation.

CPSS membership is key to resolving these challenges

Brazil regards its membership of the CPSS as very important in considering the various questions and challenges raised by retail payment system innovation. DEBAN has been a CPSS member since 2009 and actively participates in the CPSS working group structure. Initially, the CPSS focused solely on systemically important payment systems. Recently,

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39 Available at: http://www.bcb.gov.br/PAYMENTSYSTEM (English) and http://www.bcb.gov.br/75PB (Portuguese)
40 Produced jointly by DEBAN, the Ministry of Finance Secretariat for Economic Monitoring and the Ministry of Finance Secretariat for Economic Law. Available at: http://www.bcb.gov.br/Pom/Spb/Ing/Payment_Cards_Report.pdf
41 Payment services could technically be offered by non-financial institutions, as there is no legal mandate to oversee non-financial institutions.
42 For example the “cellular credit card” venture Oi Paggo rolled out by mobile network operator Oi
it has started to focus on retail payments through a number of initiatives, many of them in partnership with the World Bank. DEBAN has kept a close watch on all these developments.

**How the CPSS Core Principles could indirectly foster financial inclusion**

The CPSS does not yet have principles specifically for retail payment systems; the focus is rather on systemically important payment systems. DEBAN however sees the CPSS Core Principles as fostering financial inclusion indirectly in at least two ways:

- **Efficiency, safety and trust.** The Core Principles ensure that the pillars of efficiency, safety and trust are in place. As described above, this will promote public confidence and enhance accessibility. The challenge for the regulator is to strike the balance between security and confidence on the one hand, and efficiency on the other hand.

- **Proportionality.** Furthermore, the focus on systemically important payment systems allows for a proportional approach in those payment systems that are not regarded as systemically important and fall outside of the scope of the core principles. For example, BACEN does not classify CIP and COMPE as systemically important. Therefore they can tailor the risk requirements for these systems accordingly; this enhances efficiency.

In summary, Brazil’s engagement with CPSS has been mutually beneficial. Inputs and examples from Brazil are contributing to the CPSS’s work on retail payments. The resultant CPSS guidance on various topics then carries an “international stamp of approval” that helps BACEN in its domestic policy and regulatory process.

### Table 1. Brazil’s engagement in CPSS and World Bank retail payment system initiatives

<table>
<thead>
<tr>
<th>CPSS and World Bank retail payments initiative</th>
<th>Brazilian engagement</th>
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<tbody>
<tr>
<td>At the end of 2010, the CPSS launched a working group into innovation in retail payments and the implications for central banks. One of the working group’s initiatives will be to explore the link between retail payment systems and financial inclusion.</td>
<td>DEBAN participates in this working group. It is not clear yet whether the report will lead to any guidelines regarding implications for regulation of retail payment system innovations, but if so, DEBAN would find it very helpful.</td>
</tr>
<tr>
<td>The “International Advisory Group for Government Payments” is considering social cash transfers and is expected to publish a report and guidelines by the end of 2011. In disbursing grants, governments strive for payment system efficiency as any other enterprise; this can have a beneficial effect on financial inclusion.</td>
<td>Brazil’s experience with Bolsa Familia is an input into the working group, alongside other country examples.</td>
</tr>
<tr>
<td>The Global Remittances Working Group published General Principles for International Remittances in 2007.</td>
<td>The document was written with the cooperation of Brazil.</td>
</tr>
<tr>
<td>In 2007, CPSS issued a “General Guidance on National Payment System Development”.</td>
<td>Brazil was a member of the working group that developed the guidance.</td>
</tr>
<tr>
<td>World Bank Payment System Development Group.</td>
<td>Brazil was a participant.</td>
</tr>
</tbody>
</table>

*Source: DEBAN consultation, July 2011; desktop research on CPSS initiatives*
Where is further CPSS guidance needed?

Going forward, Brazil will continue to participate in and learn from the CPSS-World Bank work on retail payments and innovation. Specific areas where guidance will be welcomed include:

- **The legal mandate of regulators in the face of payment system innovation**, particularly as it pertains to the role of banks, non-bank financial institutions and non-financial institutions in the payment system. The work of the Innovation Working Group is an important first step in this regard.

- **Cooperation and dialogue between the CPSS and the BCBS** will also be helpful. Retail payment services bring together two areas: payment system regulation and prudential supervision of financial institutions. When issues such as provision of payment services by non-financial institutions are debated, it is therefore important to incorporate both the banking supervision and the payment system angle. Dialogue and perhaps even joint guidance from BCBS and CPSS would be helpful in thinking about such issues going forward.

### 3.4. International Association of Insurance Supervisors (IAIS)

**Distinct avenues of IAIS engagement**

Brazil is one of a few countries where two distinct supervisory authorities are members of the International Association of Insurance Supervisors (IAIS), namely the Superintendence for Private Insurance (SUSEP) and the National Agency for Supplementary Health Insurance (ANS). The two bodies each have a different mandate, distinct interaction with the IAIS and very different objectives with regard to access: SUSEP is interested in access to insurance as a financial service; ANS is primarily concerned with universal access to healthcare. Each therefore warrants a separate discussion.

**SUSEP has a long-standing IAIS membership**

As Brazil’s general insurance supervisor, SUSEP is an autonomous institution created by Decree-Law No.73/66, but with close ties to the Ministry of Finance. SUSEP has been a member of the IAIS since 1996. Over the years, its engagement has included participating in subcommittees and hosting the 2009 IAIS Annual Conference in Rio de Janeiro. Its IAIS interaction has two dimensions: its contributions to the IAIS-Microinsurance Network (MIN), Joint Working Group on Microinsurance (JWG) and its broader participation in the committees of the IAIS, particularly with relation to solvency issues.

**IAIS and SUSEP have a history of working together on financial inclusion**

Aligned with the Brazilian government’s social and financial inclusion policies, SUSEP has been pursuing simple and low-cost insurance products, adapted to the needs of the low-income population and formal and informal micro-entrepreneurs, since 2003. After two initial “popular insurance” circulars in 2004 failed to solicit the desired response from the market (though it kick-started industry and government engagement on the topic), SUSEP was alerted to the topic of microinsurance, internationally, during a panel discussion at the IAIS annual conference in 2005. SUSEP was keen to learn from international experience and apply it in its own approach to financial inclusion. When the first IAIS-Microinsurance Network10 Joint Working Group meeting was held at an IAIS triennial meeting in 2006, SUSEP attended. Afterwards, it decided to formally join the Joint Working Group and in 2007 it became the acting chair.

Since then, SUSEP has been an active participant in the main outputs of the Joint Working Group, including the publication of an Issues Paper on the regulation and supervision of microinsurance

### The SUSEP story

**Synopsis**

SUSEP has been a participant in the IAIS’s engagements on microinsurance over the past six years and currently chairs the IAIS-Microinsurance Network Joint Working Group on Microinsurance. The emerging international best practice on microinsurance policy, regulation and supervision has been shaping SUSEP’s approach to microinsurance regulation. SUSEP has also contributed to the IAIS discussions and emerging guidance alongside other countries through the JWG structures.

Beyond the topic of microinsurance, there is also a need within SUSEP for a proportional approach to prudential supervision. While the Insurance Core Principles are quite general and pose few challenges directly, the solvency framework is proving complex in the developing country context and further guidance on the application of a proportional approach would be useful.

Implications for IAIS? SUSEP’s experience illustrates how beneficial standard-setting body engagement on financial inclusion can be. The fact that the IAIS has set up a platform for dialogue between supervisors facilitates mutual learning. As a next step, financial inclusion and proportionality may also need to be incorporated more explicitly in the IAIS’s mainstream committee agenda.
in 2007, another issues paper on the treatment of mutuals and cooperatives in microinsurance in 2010 and, importantly, the Guidance Paper on Regulation and Supervision supporting Inclusive Insurance Markets now being drafted.

**SUSEP has developed domestic policy around microinsurance**

In parallel, SUSEP has been developing its own approach to microinsurance regulation. This was done through a Consultative Commission on Microinsurance, constituted under the aegis of the National Council of Private Insurance –(CNSP), incorporating a range of stakeholders. As input for this, SUSEP conducted a number of studies. The process fed into a Microinsurance Bill currently in Congress. SUSEP is also working towards a regulatory framework for microinsurance to be implemented in subordinate legislation.

**Interaction between IAIS and SUSEP has been mutually beneficial**

Throughout its domestic policy process, SUSEP took great care to align the process and content areas with the Insurance Core Principles (ICPs), as well as the emerging thinking on microinsurance in the 2007 Issues Paper. In this way, the work of the IAIS as a standard-setting body has directly shaped SUSEP’s approach to microinsurance regulation. At the same time, SUSEP’s participation in the Joint Working Group has provided it with the opportunity to share its own learning with peers and to input on the drafting of the various publications of the Joint Working Group.

SUSEP’s engagement with the IAIS and its principles, standards and guidance however extends much broader than the microinsurance topic. SUSEP is in the process of starting a new assessment program (pending the finalization of the revised ICPs). It is also developing a pilot on the new ICP 4 (licensing). The strongest need that has arisen in its broader interaction with the IAIS is for proportionality at the level of risk-based capital requirements and solvency rules, rather than at the level of the core principles, which are very general and hence not that difficult to implement.

**New solvency rules create challenges for industry**

In August 2010, SUSEP announced that it would be adopting IAIS guidelines in updating the insurance sector’s solvency regulation. In 2010, SUSEP introduced underwriting for risk capital and it is now in the process of introducing an additional layer for credit risk, to be followed by three further layers for legal, operational and market risk, respectively. In line with Brazil’s general tendency towards caution in financial sector regulation and, hence, proactive adherence to international standards and best practice, SUSEP is implementing the risk-based framework faster than the world norm. When designing its new risk-based approach to capital requirements, SUSEP did not explicitly take account of financial inclusion issues. Its work on microinsurance has in this sense been in parallel to its other work streams, rather than integrated across it.

Industry feedback on the first risk layer introduced is that it increased their capital requirements by up to 60 percent. Credit risk is expected to have an even bigger impact. Smaller insurers are complaining that this may drive them out of the market or lead to mergers. While internal models are allowed, the resource requirements are such that an internal model may not be viable for smaller insurers. Furthermore, whether or not an internal or standardized model is applied, the move towards risk-based solvency standards implies additional capital. The bottom line is: “capital costs money”.

**Proportionality is needed beyond microinsurance**

This highlights the need for proportionality beyond just microinsurance, to find a balance between regulation and market development. SUSEP has not yet formally started to consider this topic. However, it has indicated that further discussion and thought within the IAIS on the topic of proportionality, and the realities of solvency standards in the developing country context, will be of great value. The broader discussion around proportionality also points to the need for the IAIS committee structures to increasingly consider the implications for financial inclusion as part of the mainstream agenda, rather than just isolated in the work of the Joint Working Group.

**In the future, it will be important to translate guidance into assessment criteria**

Thus far, ICP observance has essentially been voluntary, tested through self-assessments and the periodic FSAP process. However, after the global financial crisis there is an increasing urgency to meet international standards across the financial sector (in the same vein as 9/11 increased the prominence of AML/CFT measures). Going forward, guidance on how to implement the ICPs and other standards proportionately without risking non-observance will become increasingly important.

In order to understand the ANS’s view of financial inclusion as embodied in the term micro health insurance, it is first necessary to understand its core mandate, which derives from the Brazilian constitution, the Consumer Code and the ANS’s history.

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41 At the time called the CGAP Working Group on Microinsurance
42 All reports available at: http://www.susep.gov.br/menuatendimento/microseguros.asp

A contribution from the Alliance for Financial Inclusion 13
The ANS story

Synopsis

The ANS has a constitutional mandate to provide universal access to healthcare and full coverage of health insurance needs. It was created as a vehicle for formalization and consolidation in the health insurance space and is positioned under the Ministry of Health rather than the Ministry of Finance. Therefore its mandate is in the first instance linked to access to healthcare rather than access to financial services.

As the ANS is still relatively young, its priority thus far has been set-up and formalization. IAIS membership and guidance has helped them in this task, notably in learning how to deal with solvency issues. Though financial inclusion falls outside its mandate, ANS realizes that the topic raises some pragmatic considerations for them.

Implications for IAIS? The ANS has expressed a need for more guidance regarding proportionality in the health insurance space, as well as a better understanding of health insurance-specific challenges inside the IAIS. This need is broader than financial inclusion: it relates to the challenge of formalizing and supervising small entities that lack compliance skills. This calls for pragmatic proportionality.

The ANS story highlights that it will be useful for the IAIS to address the special considerations for health microinsurance. This includes demarcation between health and other types of insurance, the interplay with health financing and public healthcare systems, as well as coordination between the insurance supervisor and the health authorities.

ANS was created to formalize and consolidate the health insurance sector

Up to the end of the 1990s, health insurance in Brazil was unregulated, outside of the health insurance activities provided by insurers regulated under SUSEP. A host of cooperatives, companies, health maintenance organizations and others operated outside of the insurance fold without any technical provisions, solvency rules or other functional regulation. As more and more consumer protection concerns came to the fore, the decision was made to formalize the provision of all health insurance activities under a new supervisory entity, namely ANS. This was done through Act 9,565 of 1998. ANS was created by Act 9,961 of 2001, but only acquired formal staff in 2005. In its start-up phase, the main emphasis was formalization of entities that hitherto had no conception of prudential regulation.

IAIS engagement has aided in the challenge of formalization

In dealing with the challenges of formalization, ANS realized that the IAIS Insurance Core Principles and other guidelines and tools for supervisors could be very helpful, specifically in terms of solvency requirements. For this reason, it became a member of the IAIS in 2007. Its main interaction with the IAIS subsequently has been through the solvency committee, which meets four times a year.

The ANS has a constitutional mandate for full coverage

ANS is housed under the Ministry of Health, as opposed to the Ministry of Finance link of SUSEP. This is a significant fact: it introduces a split between health insurance and other types of insurance and implies that ANS’s mandate derives from the Ministry of Health and its objectives, rather than the financial service-related objectives that steer SUSEP. Under the Brazilian constitution, there are two main mandates in the health sphere: (i) universal access to healthcare; and (ii) full coverage. The first is a horizontal concept, aimed at reaching all Brazilians. The second is a vertical concept requiring full coverage for each individual in the health insurance system. This can be represented as follows:

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4 Health insurance companies that were previously under SUSEP regulation (the so called “seguradoras especializadas em saúde”) migrated towards ANS and have to follow the CMN (National Monetary Council) guidelines when referring to assets that cover technical provisions. This was established in Act 10.185 of 2001.
Within the private health insurance space, the upshot of this constitutional mandate is that private health insurers are not allowed to impose any financial limits on the level of coverage provided on a policy. Each insurer must offer a full benefit package. Furthermore, no person may be denied access to private insurance based on health status. ANS recognizes that these features create cost barriers that go against the concept of financial inclusion, but it is a central pillar of their mandate that cannot be compromised on.

Health insurance has high penetration in Brazil. Despite the cost implications of regulation, health insurance inclusion in Brazil is remarkably high: according to the latest ANS data there are 60 million users of health and/or dental plans, amounting to 32 percent of the Brazilian population. Indications are that Brazilians prioritize health insurance, even if it is priced outside of what would be considered the microinsurance market.

Peripheral health insurance activities

Some potentially financial inclusion-relevant activities happen outside of the ANS mandate. There are a number of ‘prepaid card’ health plan schemes that operate much like a managed care system of discounted access to healthcare. Prepaid cards are not allowed for under the Private Health Insurance Act; hence providers of such services operate in grey area outside of formal supervision – a concern for the ANS.

Some life insurers are furthermore providing what is known as “eventual insurance”, namely life or other insurance for which the trigger may be health-related (e.g. hospitalization), but that provides a cash payout rather than indemnifying actual medical expenses. ANS does not regard these products as health insurance, but rather as a financial service regulated under SUSEP.

**There is scope for further IAIS guidance on the interplay between health and financial inclusion**

ANS recognizes that both these types of services appeal to the low-income market and may even fill a gap where full package private health insurance cannot reach. Yet their mandate does not cover such services, as it goes against the spirit of full coverage entrenched in their act. The ANS therefore acknowledges the broader financial inclusion topic, but cannot participate directly in this conversation.

In this regard, the ANS would find it helpful if the IAIS takes up the topic of financial inclusion in the health insurance space, the potential role for limited benefit health insurance packages, the contrasting objectives and particular considerations, as well as the interplay between different supervisors with different mandates, in a dedicated discussion. The helpfulness of such a dedicated discussion was confirmed in discussion with SUSEP.

**Broader IAIS guidance on health insurance would be welcomed**

Apart from the financial inclusion topic, ANS would also find dedicated IAIS consideration of health insurance and the specific supervisory challenges in the health insurance sphere helpful. The IAIS discussions are quite general and therefore do not always take into account the unique circumstances of health insurance vis-à-vis other types of insurance.

**There is a need for guidance on proportionality in health insurance beyond the issue of financial inclusion**

Specifically, they would welcome further guidance on the topic of proportional rules for small companies/cooperatives. ANS’s primary challenge lies in formalizing and consolidating the industry. In the process, it faces the supervisory challenge of dealing with small entities that have never had to adhere to solvency and other prudential rules and for whom the cost of full compliance is disproportionately high. The ANS therefore has a definite need for more guidance regarding a pragmatic approach to supervision in the application of solvency and other prudential requirements.

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*The number of entities has already come down from 2,500 pre-1998 to 1,620 currently.*
3.5. International Association of Deposit Insurers (IADI)

Setting an agenda for financial inclusion through deposit insurance

Synopsis

Deposit insurance is compulsory for all banks, consumer credit companies and savings and loans associations in Brazil, but not yet for credit unions. However, this is under consideration.

Brazil recognizes that several of the IADI principles are relevant for financial inclusion, but has thus far not explicitly considered deposit insurance through the financial inclusion lens and has not started to consider the broadening of deposit insurance to new products and channels such as e-money and m-payments. In starting to engage with these topics, information and guidance from IADI will be helpful.

Deposit insurance landscape

The National Monetary Council (CMN) is responsible for setting the policy direction for deposit insurance in Brazil. The national deposit insurance fund, Fundo Garantidor de Créditos (FGC), was created in 1995, with its statutory purpose to contribute to:

i Protection of small account holders;
ii Stability of the national financial system;
iii Prevention of a systemic banking crisis.

It is financed by ex ante contributions from at a rate of 0.0125 percent47 of insured deposits. Deposits of up to R$ 70,00048 per account holder are covered in the event of liquidation or institutional insolvency.

Deposit insurance’s role in financial inclusion

By its very mandate, deposit insurance is aimed at protecting those who are most vulnerable. In fulfilling this mandate, it builds trust in the financial sector, thereby contributing to financial inclusion. Furthermore, after the global financial crisis, Brazilian regulators realized that banks may be reluctant to provide funding to small and medium financial institutions due to the risk of insolvency. It therefore created a special guarantee for time deposits (called the DPGS) that is applicable to all investments up to a maximum of BRL 20 million. The DPGS amounts to deposit insurance at the institutional level and can play an important indirect role in financial inclusion by ensuring that smaller institutions (who in turn may have low-income customers as primary clients) have adequate funding. The DPGS will be phased out by 2016.

Membership is not yet extended to all deposit takers

Deposit insurance is currently compulsory for all supervised deposit-taking financial institutions. This includes all banks, consumer credit companies, mortgage companies and savings and loans associations, but excludes credit cooperatives. IADI Core Principle 8 requires compulsory membership of the deposit insurance scheme for all deposit-takers. This can be important from a financial inclusion point of view: on the positive side, it can include the most vulnerable small depositors in the safety net; on the negative side it can have cost implications that may discourage potential low-income depositors.

How Brazil interacts with IADI

Brazil, through FGC, is one of the forty member countries that established IADI and is part of IADI’s Board of Directors. After the global financial crisis, IADI gained more prominence internationally. In June 2009, IADI issued Core Principles for Effective Deposit Insurance Systems in cooperation with the BCBS (recognizing the relevance of prudential supervision for deposit insurance, as well as of deposit insurance for systemic stability in the banking sector). The Financial Stability Board (FSB) is currently heading a thematic peer review of deposit insurance systems benchmarked on the Core Principles. As a member of FSB, Brazil will participate in this initiative.

47 As per CMN Resolution 3.400/2006. Available at: http://www.fgc.org.br/lims/download_arquivo.php?cl_arquivo=19#per cent
There is scope for IADI guidance at the country level

IADI’s engagement on financial inclusion – a very recent phenomenon – has not yet spilled over into local discussions on the direction for deposit insurance and Brazil is not part of IADI’s newly established Financial Inclusion and Innovation Subgroup. However, as part of the upcoming peer review process, Brazil would like to better understand the challenges in implementing the deposit insurance core principles in a way that will foster inclusion. The following two examples illustrate this need:

● **Principle 2:** mitigating moral hazard. Preventing moral hazard is core to the management of a deposit insurance scheme. This is the reason why Brazil is considering a separate system for banks and new small players. It is also the reason for the limits that have been placed on the DPGS. Further guidance in this regard would be helpful.

● **Principle 8:** compulsory membership. In starting to think about expanding membership, BACEN has started to discuss whether to incorporate credit cooperatives as a first step. The discussion is still underway, but one potential solution is to create a separate system for deposit taking cooperatives, so as not to impact on the risk profile of the FGC. The FGC is focused primarily on the mainstream banking sector and there are some risks in providing deposit insurance to non-bank entities such as credit unions, particularly with respect to governance framework.

Brazil is also still in the process of considering the regulatory treatment for new products and channels such as e-wallets, pre-paid cards or mobile financial services: the question of deposit insurance for such new products and services has not arisen.

In both these instances, to name only two examples, there could be an important role for IADI in providing guidance, particularly in terms of financial inclusion. In this regard, Brazil intends to follow the work of the IADI Financial Inclusion and Innovation Sub-group.
4. Cross-cutting issues and conclusions

In the regulators’ stories above, a few words recur time and again, such as “proportionality”, “coordination”, or “caution”. Here we summarize the common threads in order to conclude on the implications and relevance of the standard setting bodies for Brazil.

Balancing caution and pragmatism

Due to Brazil’s turbulent past, all of the supervisors in one way or another display a high degree of caution. At the same time, there is a strong mandate for financial inclusion. Therefore they are faced with the challenge of striking a balance between caution and the need to facilitate technological and product innovation to support financial inclusion. The following examples illustrate the balancing act:

- BACEN is ahead of the curve in terms of its prudential supervision of financial institutions. At the same time, BACEN is conducting studies in order to evaluate possible impacts of Basel II and III standards on smaller institutions. The first step towards a balancing act was the implementation of Simplified Prudential Regulation (SPR) for credit unions in 2010. Yet even this move is tinged with caution: the SPR rules, although simplified, have maintained a more conservative level of capital than under Basel II.

- Private insurance supervisor SUSEP and health insurance supervisor ANS are eager to align with international best practice on solvency standards and actively engage with the IAIS standards and guidance in this regard. Both however recognize the need for pragmatic proportionality in some form: for SUSEP, this means balancing the need to meet more complex capital requirements implied by the implementation of a risk-based capital approach with the need to encourage a diverse provider landscape, while for ANS the focus is on setting appropriate solvency rules for small and cooperative entities in the wake of the formalization of the health insurance sector.

- In a country of the size, diversity and number of international borders of Brazil, the challenges of AML merit a cautionary approach whereby no exemptions are tolerated. Yet COAF and the supervisory authorities have implemented various simplified or delayed customer due diligence measures as part of a risk-based approach.

Proportionality is a broad issue for financial services - and not simply in terms of financial inclusion

The Brazilian case study highlights that financial inclusion is a subset of the broader issue of proportionality. While in some instances clearer guidance from the standard-setting bodies on financial inclusion will be helpful, the fundamental need is for more explicit guidance on proportionality/a risk-based approach more broadly. A financial-inclusion-facilitating approach will then flow naturally from that. This was highlighted in the case of ANS and SUSEP in relation to the IAIS, COAF in relation to the FATF recommendations, as well as on two fronts within BACEN: banking supervision and the Basel standards on the one hand, and non-systemically important payment systems on the other hand.

Formalization also requires proportionality

The formalization challenge requires supervisors to understand the landscapes that they are mandated to regulate, taking into account diversity and capacity constraints. Formalization is therefore intricately linked to the need for proportionality, as the following examples illustrate:

- Formalization requires an ability to address capacity and solvency issues in order to safeguard the key pillars of the BACEN mandate, namely stability and efficiency. This has successfully been done for the credit union sector, through the recently introduced simplified prudential regime, but is still a challenge in terms of new, unregulated entities in the payments space.

- The raison d’être for the supplementary health insurance regulator, ANS, is closely linked to formalization. It was created specifically to formalize and consolidate the health insurance sector. Before its creation, there were close to 2,500 unregulated health insurance providers in Brazil of various shapes and sizes. In incorporating them into the regulatory fold, the ANS has looked to the IAIS core principles and guidance on solvency.

Jurisdiction issues remain

Closely related to the formalization challenge is the issue of jurisdiction. Financial inclusion is a dynamic process: as the respective financial sector landscapes develop, supervisors face new challenges to respond to innovations in terms of new channels, instruments and players that may fall outside their jurisdiction. For example:

- As the first wave of formalization and consolidation comes to an end in the health insurance sector, a new formalization challenge looms: a number of “prepaid card” health insurance schemes have come to the ANS’s attention. The health insurance act does not allow for prepaid cards as a type of health insurance, meaning that these entities are effectively outside of the mandate of the ANS.
• The same scenario holds in the payments sphere, where BACEN’s payments division (DEBAN) does not have jurisdiction over non-financial payment providers.

• The jurisdiction challenge is also relevant for SUSEP. Under CNSP Resolution 102/2004, funeral assistance (cover provided by funeral homes) is classified as a pre-paid service and therefore does not qualify as insurance. As a consequence, funeral homes cover an estimated 20-25 million lives outside the jurisdiction of SUSEP.

International guidance on how to approach the issue of jurisdiction will therefore be helpful on more than one front in tackling the formalization challenge, as will be guidance on how to reconcile overlaps in the jurisdictions of different supervisors.

**The role of evaluations**

As long as the guidance from SSBs on what is regarded as low-risk is not specific, and as long as such guidance is not carried over into the assessment criteria for evaluations, caution is likely to trump proportionality in many situations. Brazil’s recent experience with the AML/CFT mutual evaluation is a case in point. Outside of the AML/CFT arena, the threat of international sanction has been less of an issue thus far, as observance of the standards is voluntary. The pressure is however likely to increase. Brazil’s next FSAP process will take place by the middle of 2012. As a member of the G20, Brazil has committed to publish the FSAP report and will want to showcase a high level of compliance in all spheres. This will reinforce the tendency towards caution, calling for more exact guidelines on proportionality for low-risk scenarios, to ensure that financial inclusion efforts do not suffer.

**Greater coordination is needed both domestically and between the SSBs**

As is evident from the discussion above, the cross-cutting themes themselves are not mutually exclusive, but are interrelated on a number of fronts:

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![Figure 2: The interrelatedness of the Brazilian cross-cutting themes](image)

*Source: authors' representation*

The innovations prompted by financial inclusion mean that it is increasingly difficult to separate different financial regulatory spheres into neat silos. For this reason, BACEN is bringing together a range of regulatory authorities in its National Partnership for Financial Inclusion. This mirrors the recognition of the need for coordination as embodied at the international level in the Global Partnership for Financial Inclusion.

Supervisors are looking towards international standard-setters for guidance not only in their own spheres of interest, but also in how to address cross-cutting issues and areas of overlap. Increased dialogue and coordination between SSBs will be helpful on issues such as payment models (including e-money) and new distribution channels (including banking correspondents) where there are both prudential (BCBS) and payment (CPSS) challenges at stake. The same goes for guidance on how to ensure stability and consumer protection across different spheres, while pursuing a coordinated financial inclusion agenda based on proportionality.

In this discussion, it is important that the SSBs “get down to business” in terms of practical guidance. Guidance at the theoretical level is a first step, but does not go far enough to meet supervisors’ day-to-day needs for guidance on how to tackle financial inclusion hands-on.
## Appendix: Participants in the Brazilian financial system (SFN)

### Participants in the Brazilian Financial System (SFN)

The financial system in Brazil is composed of various institutions and entities responsible for different aspects of regulation, supervision, and service provision. The chart below outlines the main participants categorized by their roles:

<table>
<thead>
<tr>
<th>Regulation and Supervision</th>
<th>Financial institutions that receive demand deposits</th>
<th>Other financial institutions</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>BCB</strong></td>
<td>Multiple or universal banks with a commercial bank portfolio</td>
<td>Multiple or universal banks without a commercial bank portfolio</td>
</tr>
<tr>
<td>Central Bank of Brazil</td>
<td>Commercial banks</td>
<td>Investment banks</td>
</tr>
<tr>
<td></td>
<td>Savings banks</td>
<td>Development banks</td>
</tr>
<tr>
<td></td>
<td>Credit cooperatives</td>
<td>Consumer finance companies</td>
</tr>
<tr>
<td><strong>CVM</strong></td>
<td></td>
<td>Savings and loan companies</td>
</tr>
<tr>
<td>Securities and Exchange Commission</td>
<td></td>
<td>Mortgage companies</td>
</tr>
<tr>
<td><strong>CMN</strong></td>
<td></td>
<td>Development agencies</td>
</tr>
<tr>
<td>National Monetary Council</td>
<td></td>
<td>Savings and loan associations</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Micro-entrepreneur Credit Company</td>
</tr>
<tr>
<td><strong>SUSEP</strong></td>
<td></td>
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<tr>
<td>Private Insurance Superintendency</td>
<td></td>
<td></td>
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<tr>
<td><strong>SPC</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Complementary Pension Secretariat</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### Other financial intermediaries or auxiliaries

- Commodity and futures exchanges
- Stock exchange
- Securities brokers
- Securities dealers
- Leasing companies
- Exchange brokerage companies
- Representatives of Foreign Institutions
- Independent agents for investments

### Insurance and pension entities

- Private closed pension funds
- Private open pension funds
- Insurance companies
- Capitalization companies
- Health insurance management companies

### Portfolio Management

- Mutual investment funds
- Investment clubs
- Foreign investors portfolios
- Consortium managers for self acquisition of durable consumer goods and services

### Liquidation and clearing systems

- Special system for liquidation and custody of government bond SELIC
- Center for the custody and financial liquidation of private issues CETIP
- Stock exchange clearing system
Global Partnership for Financial Inclusion
www.gpfi.org

The Global Partnership for Financial Inclusion (GPFI) is the main platform for implementation of the G20 Financial Inclusion Action Plan. The group engages partners from G20 and non-G20 countries, private sector, civil society, and others. It is chaired by the G20 troika countries, currently Korea, France, and Mexico. The GPFI is supported by three implementing partners: the Alliance for Financial Inclusion (AFI), the Consultative Group to Assist the Poor (CGAP), and the International Finance Corporation (IFC).

Alliance for Financial Inclusion (AFI)
www.afi-global.org

AFI is a global network of central banks and other financial inclusion policymaking bodies in developing countries. AFI has been given the mandate to foster the participation of non-G20 developing countries in the G20’s Global Partnership for Financial Inclusion as an implementing partner.

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