

EXPLANATORY MEMORANDUM N° 12 - CREATION OF THE SUBCOMMITTEE ON MONITORING THE FINANCIAL SYSTEM STABILITY

Dear members,

Under the Financial Stability Board (FSB), forum that includes Brazil that it is represented by the Brazilian Central Bank, the Brazilian Exchange Commission, and the Ministry of Finances, it was issued several recommendations to the member countries, of which we are going to mention two: i) present every five year the evaluation of each financial sector, according to the Financial Sector Assessment Program (FSAP), programs, that was jointly conducted, by the International Monetary Fund (IMF) and the World Bank, disclosing the outputs, e ii) establish mechanism of interaction and coordination among the financial sector responsible authorities.

2. The recommendation of increasing the coordination among the supervisory bodies was incorporated to principles and best practices recommended by some international organizations, that the institutions of this Committee are member: Basel Committee on Banking Supervision (BCBS) – Principles 1 and 19; International Association of Insurance Supervisors (IAIS) – Principle 5; International Organization of Securities Commissions (IOSCO) – Principle 12; International Organization of Pensions Supervisors (IOPS).

3. Brazil indicates the second semester of 2011, as the period to conclude the next FSAP. At this time, it will be considered, among others things, the adherence to international standards, issued by the international organizations mention above.

4. The understanding of the need of cooperation among the supervisors became clear during the evaluation of the causes of so-called subprime crises that happened in the United States, and its ramifications, especially at the European Community, which became evident coordination failures among the supervisors. Even in cases that the excesses in the mortgage market, derivatives and securitization was perceived by each supervisory body, the lack of institutional mechanisms of exchange information and coordination, had difficulty in recognizing the impacts and implications to financial stability, and react in a coordinated and timely way. .

5. In a way of reacting to the crises, the discussions about the creation of cooperation mechanisms among the supervisors, under relevant international forums that deal with financial stability issues was intensified.

6. In the United States (USA), for example, before problems noticed in the coordination among several authorities responsible for financial sector regulation, it was created, in 2009 July, a working party with representatives of the Institute Centre for Financial Market Integrity (CF) and the Council of Institutional Investors (CII), with the objective of analyzing the supervisory framework. This initiative results in a recommendation suggesting the creation of Systemic Risk Oversight Board (SROB). In addition, the American Congress, approved, recently, the financial system reform, presented by the government that foresees the creation of the Financial Services Oversight Council.

7. The debate on this issue, it is even more emphatic in the euro zone due to the European market dynamism, created by the adoption of a single currency in an environment of independent countries and by the operation of transnational financial institutions, which have supervisory systems in a national basis. Regarding this, in 2009 September, it was issued by the European Commission, a proposal to create the European Systemic Risk Board (ESBR) that aims, even without a formal authority, to make suggestions and influence the regulations and supervision policies of those countries financial sector.

8. In Brazil, the crises effects were mitigated by some factors, such as, the stricter banking regulation, low relationship of Brazilian financial system in the international context, incipient development stage of markets that were affected by the crisis, low relationship between credit and GDP and the vigorous macroeconomic situation of the country. Nevertheless, it should be mentioned that the situation related to the national companies exposure, mostly listed companies, in the exotic derivatives, that were hired in the international market, pushed the exchange market, resulting in concerns about the financial system stability and reflecting negatively the county's growth in 2009.

9. Moreover, it is also observed in other countries, that the companies and markets regulated by different supervisors are increasingly interconnected. In Brazil this trend it is confirmed: the largest investment funds managers are companies linked to banks; the insurance companies are part of financial conglomerates, among the biggest clients of the derivatives markets are the banking institutions, the investment funds and the pension funds are the biggest investors in commercial papers issued by the banks, in bonds and securities. Furthermore, the utilization of risk transfer tools among the financial institutions sector regulated by different authorities, it is becoming more and more relevant.

10. In the Brazilian case, the first step, that was taken before international recommendations, was taken in 2006, in the constitution of this Committee, that congregate the regulators and supervisors of Financial Market, Capital Markets, Insurance Markets and Private Pensions. The main goal of this Committee is to promote the coordination and the performance improvement of government entities that regulates and supervises the activities related to the population savings.

11. In addition, the item III of article 3° of Decree nº 5.685/2006, declare that it is responsibility of this Committee to facilitate and coordinate the information exchange among the member entities, even with international organizations and others countries.

12. In this context and to attend the international best practices and recommendations, especially regarding the need of a continuous supervision of the market and the celerity in the regulatory bodies' actions, we believe that it will be important to create, within

this Committee, a permanent forum that deals with this subject. The purpose of this forum will be the information exchange and the implementation of jointly actions to monitor the market and the specific areas regulated by the member entities, considering the assessment of National Financial System stability. It is also proposed that this forum should be composed of a subcommittee: the Subcommittee to Monitor the National Financial System Stability (Sumef).

13. This subcommittee will be created under sections; I, III and IV of article 3° of Decree n° 5685/2006, and will be responsible for:

I – To keep Coremec updated about the market evolution and its interconnections, especially in what regards to the relationship among its members and its functions, pointing out the risks to the National Financial System.

II – Inform about situations that due to the market integration, could endanger the National Financial System stability, requiring joint or coordinate actions of Coremec member entities.

14. To meet these goals, this subcommittee will:

I – execute, limited to the committee members, the exchange of information to help identifying events that could affect the National Financial System stability;

II – coordinate actions to attend the information requests on the National Financial System, especially those requested by the international organizations, as FSB, BIS, IMF, World Bank, or by programs conducted by this organizations, as the FSAP and the Financial Soundness Indicators (FSI); and

III – present action proposals to the Coremec to reduce the risk that the identified situations could cause stability to the National Financial System.

15. Regarding the operation and the representatives of this Subcommittee, it is proposed:

I – Should have two representatives of Coremec member entities and two alternate members, indicated by its respective bodies;

II – the subcommittee should establish a communication network to an effective exchange of information;

III – should have meetings, every two months, or in a shorter timeframe, if necessary;

IV – should send regular reports to Coremec, stating the activities that are being planned or developed and those ones that were concluded. It must have the subjects that were discussed and the conclusions.

V – Should operate as a collegiate body, supported by the Central Bank, that will be responsible for the agenda and the minutes of the meetings.

16. This Subcommittee can invite to attend the meetings, people who can contribute in the analysis of issues related to the financial stability.

17. Finally, to make possible the creation of this Subcommittee, it will be necessary to include on Coremec Internal Rules, the establishment of advisory bodies to the Committee, to ensure that it can better fulfill its mission. Regarding this, it is proposed to include on item VII, article 10, established by Coremec Resolution n° 1, June 30, 2006, as follows:

“VII – establish subcommittees, on a regular or non-regular basis, to assist Coremec to fulfill its purposes and duties, as provided in article 1° and 3° of Decree 5685, January 25, 2006”

18. This is what we bring to your attention, with our favorable opinion.