



**SYMPOSIUM ON BUILDING THE FINANCIAL SYSTEM OF THE 21ST CENTURY:
AN AGENDA FOR BRAZIL AND THE UNITED STATES**
RIO DE JANEIRO, BRAZIL • DECEMBER 7-9, 2012

AGENDA

FRIDAY, DECEMBER 7

6:30 p.m. COCKTAIL RECEPTION Javaé Foyer- JW Marriott

7:15 p.m. GREETINGS Javaé Ballroom - JW Marriott

- Sérgio Guerra, Vice Dean, Fundação Getúlio Vargas, Direito Rio
- Hal Scott, Director, Program on International Financial Systems, Harvard Law School

7:30 p.m. KEYNOTE ADDRESS Javaé Ballroom - JW Marriott

- Arminio Fraga, Founding Partner, Gávea Investimentos

8:15 p.m. - 9:45 p.m. DINNER Javaé Ballroom - JW Marriott

SATURDAY, DECEMBER 8

7:00-7:45 a.m. BREAKFAST Terraneo Restaurant - JW Marriott

8:10-8:25 a.m. WELCOME & OPENING REMARKS Auditorio Mota- 12th Floor - FGV

- Luiz Guilherme Schymura de Oliveira, Director, Instituto Brasileiro de Economia (IBRE), Fundação Getúlio Vargas, Direto Rio

8:25-8:45 a.m. PANEL SESSION Auditorio Mota- 12th Floor - FGV

Brazil and New York as Financial Centers

- Cristiana Pereira, Managing Director of Issuer Relationship, BM&F Bovespa
- Marcelo Cwerner, Senior Manager, Debt & Equity Advisory, KPMG LLP

8:50-10:15 a.m. SMALL GROUP SESSIONS

GROUP	ROOM	FACILITATORS	REPORTERS
1	Luis Schuartz Room-13 ^o floor	Laura Alfaro / Diego Serrano-Redonnet	William Grimes
2	Sala do Mestrado- 8 ^o floor	Steven Bipes/ Antônio M. Porto	Robert Ellison
3	Room 910- 9 ^o floor	Patrícia Sampaio/ Gordon Kingsley	Bruno Salama
4	Room 913- 9 ^o floor	Bruno Soter/ Andres Zenarruza	Dave Shuler

10:25-10:45 a.m. PANEL SESSION Auditorio Mota- 12th Floor - FGV

Inflation and exchange rates

- José Augusto Martins, Partner, Trench Rossi e Watanabe Advogados
- Richard P. Mattione, Partner, GMO

10:50-12:15 p.m. SMALL GROUP SESSIONS

GROUP	ROOM	FACILITATORS	REPORTERS
1	Luis Schuartz Room-13° floor	Hal Scott/Ed Morata	William Grimes
2	Sala do Mestrado- 8° floor	Melina Rocha Lukic/ Dave Shuler	Robert Ellison
3	Room 910- 9° floor	David Bunce/ Ary Oswaldo Mattos Filho	Bruno Salama
4	Room 913- 9° floor	Jorge Errázuriz/Juliana Mezdri	Will Evans

12:20-1:00p.m. LUNCH 12th Floor Reception- FGV

1:00-2:00 p.m. KEYNOTE PANEL Auditorio Mota- 12th Floor - FGV

Moderator: Hal Scott, Director, Program on International Financial Systems, Harvard Law School

- Commissioner Daniel M. Gallagher, U.S. Securities and Exchange Commission
- Commissioner Troy A. Paredes, U.S. Securities and Exchange Commission
- Commissioner Otavio Yazbek, Comissão de Valores Mobiliários

2:10-3:40 p.m. PANEL SESSION – PLENARY DISCUSSION ONLY

Auditorio Mota- 12th Floor - FGV

Development of Derivatives Markets and Risk Management in Brazil

- Moderator: Charles Carey, Vice Chairman, CME Group
- Ricardo Tatesuzi de Sousa, Executive Director, ABRANGE
- Robert Resnick, Chief Financial Officer, Cianport
- Henrique de Rezende Vergara, Chief Legal Counsel, BM&F BOVESPA

3:45 p.m. SHUTTLE BUS TO JW MARRIOTT

*Please meet outside of FGV for transportation back to the hotel

3:45-6:45 p.m. FREE TIME / REPORTERS MEETING

6:45-7:30 p.m. COCKTAIL RECEPTION Javaé Foyer - JW Marriott

7:30-8:30 p.m. KEYNOTE ADDRESSES Javaé Ballroom - JW Marriott

- Leonardo Pereira, Chairman, Comissão de Valores Mobiliários
- Ambassador Thomas A. Shannon, Jr., United States Ambassador to Brazil

8:30-10:00 p.m. DINNER Javaé Ballroom - JW Marriott

SUNDAY, DECEMBER 9

7:30-8:15 a.m. BREAKFAST Terraneo Restaurant - JW Marriott

8:30- 9:30 a.m. PRESENTATION & DISCUSSION Javaé Ballroom - JW Marriott

Extraterritoriality in post-crisis rules and their impact on financial markets

- Roberto Belchior, Latin America General Counsel and Chief Compliance Officer, Goldman Sachs
- Hal Scott, Nomura Professor, Director, Program on International Financial Systems, Harvard Law School

9:30-10:30 a.m. PRESENTATION & DISCUSSION Javaé Ballroom - JW Marriott

Brazil and New York as financial centers

- Helio Magalhães, Chief Country Officer Brazil, Citi
- David Gruppo, Head of Latin America Corporate and Investment Banking, Bank of Tokyo-Mitsubishi

10:30-10:45 a.m. REFRESHMENT BREAK

10:45-11:45 a.m. PRESENTATION & DISCUSSION Javaé Ballroom - JW Marriott

Inflation and exchange rates

- Antonio Porto Goncalves, Professor and Director of Business Studies, Fundação Getulio Vargas
- Alberto Kiraly, Head, Investment Banking, Banco Votorantim

2012 Symposium on Building the Financial System of the Twenty- First Century: An Agenda for Brazil and the United States

The first Brazil-U.S. Symposium was held in Rio de Janeiro, Brazil from December 7-9, 2012. Sessions discussed Brazil and New York as financial centers, inflation and exchange rates, development of derivatives markets and risk management in Brazil, and extraterritoriality in post-crisis rules and its impact on financial markets. There was considerable optimism about prospects for Brazil's economy and financial markets, despite some concerns about weakness of global demand and quantitative easing in the most developed economies.

Session 1: Brazil and New York as Financial Centers

Session 1 addressed prospects for the development of financial markets in Brazil and New York. Most of the discussion focused on Brazil, although concerns were raised by some participants about the effects of regulatory reform in the U.S. Participants exchanged views on the opportunities for the growth of Brazilian capital markets, why Brazilian capital markets were not severely affected by the global crisis and eurozone crisis, and what impediments remained to capital market development.

Goals for Brazil as a Market Center

Participants had a range of views about how they envisioned Brazil's financial market development. Some felt that there should be a goal of building a regional market center that would eventually service the financial needs not only of Brazil, but also of its South American neighbors. They felt that the sheer size of Brazil's economy and the quality of its financial regulation and macroeconomic management would make it a natural location for regional investors and users of funds. Others argued that the goal of becoming a regional market center was premature, and suggested that it should better be seen as a goal for the long-term. They pointed to several obstacles to Brazil taking on a regional role. A major obstacle cited by many participants was capital controls. Some pointed to other obstacles as well, including restrictive rules, overreliance on foreign investment, the Real's status as a non-reserve currency, and the political difficulties of regional cooperation.

There was considerably more discussion of how Brazil's financial markets could better serve the Brazilian economy. Participants noted that Brazil's economy suffered from a number of funding gaps, which they felt could be addressed through active capital markets. They expressed particular concern with the difficulty of obtaining long-term funding in Brazil's bank-based financial system. A number of participants attributed some of the weakness of market-based long-term financing to the continued dominant role of major publicly-owned specialized banks such as the Brazilian Development Bank (BNDES). They also pointed to the legacies of the hyperinflationary period, which made potential investors and creditors very nervous about providing long-term finance; some also felt that as a result, many family-owned corporations had gotten in the habit of self-financing and were suspicious of external financing.

Participants agreed that Brazil's equity markets were considerably more developed than its debt markets. They noted the successes of the CVM and BM&FBOVESPA in creating an efficient stock market with strong rules on transparency and disclosure. Many applauded the Novo Mercado in particular for its role in making Brazil's stock markets among the most attractive in South America, as evidenced by the participation of many foreign investors. However, a number of participants argued that representation on the exchanges was still too limited, especially among small and medium-sized enterprises (SMEs) that arguably were most in need of better access to long-term capital. The difficulty of SME listing was also seen as an obstacle to the development of venture

capital and private equity markets. A number of participants argued that it made exit difficult for venture capitalists and private equity firms, thus making it less attractive for them to invest even in promising firms and sectors; if listing became easier, it could be a boon for the growth of smaller companies in need of growth capital and management support.

Participants also expressed hope that Brazil's debt markets would expand significantly. They saw considerable need for debt funding that would not be provided by the banking system. While they expressed more satisfaction with government bond markets, they felt that Brazilian companies would benefit greatly from the development of liquid corporate debt markets. Much of the discussion of corporate debt markets focused on the potential benefits of bond financing for long-term projects, but participants also spoke about short-term markets such as commercial paper. A number of participants, noting that infrastructure development was an area in which Brazil was deficient, called for expanded debt financing of public infrastructure projects.

The other major role that participants hoped that Brazilian capital markets would fulfill was better investment opportunities for Brazilian savers and investors. They noted that Brazilian households were keeping much of their savings in low-yielding bank deposits and expressed the hope that deeper, more liquid capital markets would provide a better place for them to invest for longer-term goals. Similarly, they anticipated that domestic and international institutional investors with long time horizons would invest in Brazil's capital markets. For example, they felt that the insurance industry in particular would benefit from the development of long-term corporate and government bond markets.

Why Did Brazil Have a “Good Crisis”?

Many participants noted that Brazilian financial markets had navigated the global financial crisis and the eurozone crisis quite well. They expressed a range of views on the reasons for that success, including good regulation and macroeconomic policies, relative insulation from developed country markets, and good timing. There was no clear consensus as to the relative importance of each of these factors, but many participants felt that the resilience of Brazil's financial system in the face of global crises improved their confidence in its prospects going forward.

A number of participants emphasized the role of good policies in mitigating the impacts of financial troubles in the U.S. and Europe. They noted that Brazil had had strict capital adequacy standards in place that had been administered effectively by regulators. They also noted the regulators' conservative approach to approving new financial products that might be misused or misunderstood in the Brazilian context. They also pointed to other aspects of macroprudential regulation, arguing that the central bank had done a good job of watching out for systemic risks and providing guidance to banks on that basis. Many participants applauded the professionalism of BACEN and CVM, which they saw as sophisticated and consistent in their application of regulation. Participants also agreed that Brazil had benefited from its “twin peaks” model of regulation, in contrast to the regulatory fragmentation of the U.S. system, which they felt encouraged regulatory arbitrage and created problems of coordination.

Some participants also argued that Brazilian laws promoted responsible behavior and good alignment of interests of top management with those of society. In particular, some pointed to the “law of fiscal responsibility,” which created unlimited liability for control groups and senior management, as ensuring responsible behavior by financial institutions. This differed significantly from U.S. practice, where director’s insurance typically covered in full any personal liability arising from the behavior of a company. Not all participants thought that unlimited liability was a good idea; rather, they worried that it would lead to excessive conservatism, and argued that it was one of the reasons why Brazilian finance lacked innovation and why SMEs lacked access to formal financial markets.

Other participants emphasized Brazil’s good timing over good policies. They noted that when the crisis arrived in 2008, Brazil was in a good position to handle it, but argued that if the crisis had occurred a couple of years later it might have been much more severe. They pointed out that years of responsible fiscal and monetary policy had put the government and central bank in a position to stimulate the economy to counteract the effects of the slowdowns in the U.S. and Europe. Participants also pointed out that the credit-GDP ratio was still comparatively low in 2008. They noted that credit in the economy had risen dramatically from earlier in the decade, and argued that if the crisis had come later Brazil might have been in a much more precarious position. Several argued that Brazilian households had a high propensity to borrow if they were given the opportunity, and expressed relief that the relative underdevelopment of the mortgage market had prevented a housing bubble like that in the U.S. or Ireland.

Finally, a number of participants focused on the relative insulation of Brazil’s economy from events in the U.S. and Europe. One aspect of this was policy-driven, in the form of capital controls and continuing barriers to trade, particularly manufactured imports. Also, Brazil’s growth had become less dependent on U.S. and European demand. While some participants were suspicious of the idea of BRICS decoupling, many participants pointed to the positive effects of the global commodities boom and rapid growth in China, which buoyed Brazilian commodities producers and manufacturers despite the malaise of the most developed economies.

In looking back at the past five years, some participants asked what crises Brazil might have experienced if not for good policies, good timing, or Chinese demand. Several felt that among the major vulnerabilities for Brazil’s financial system were the burgeoning auto loan and consumer credit markets. Some pointed to major excesses in these markets, including the availability of 10-year car loans and the prevalence of store credit for buying other big-ticket items such as appliances. A number of participants also expressed concern over how Brazil would fare going forward, as Chinese growth and the global commodities boom cooled.

Opportunities for Capital Market Growth

Looking forward, participants generally expressed optimism about the growth prospects for Brazilian capital markets. They felt that Brazil’s economic fundamentals were strong

and that markets benefited from high-quality financial regulation and market infrastructure, including a real-time payments system. Many participants argued that Brazil's financial markets were the most attractive in South and Central America and would remain so into the future.

Participants saw Brazil's macroeconomic stability as a key attraction for the country as an investment destination for both domestic and international investors. Following the Real Plan in the 1990s, fiscal and monetary policy had proved to be remarkably consistent, leading to relatively low inflation, low and stable interest rates, relatively stable exchange rates, and confidence in the sustainability of government debt. Brazil's hard-won macroeconomic stability was seen as reducing the uncertainty of investors, and thus the perceived risks of making longer-term investments. The relative stability of exchange rates was also seen as particularly attractive to foreign investors. A number of participants also argued that the low nominal interest rate environment was beginning to make bank deposits look less attractive relative to financial securities for domestic investors, which could spur new sources of investment in Brazil's capital markets.

Participants also praised financial market infrastructure and regulation. They noted the sophistication and effectiveness of BM&FBOVESPA as an exchange. Many saw the Novo Mercado in particular as a turning point for introducing global standards of corporate governance and disclosure, which they saw as integral to investor confidence. Corporate governance was further reinforced by the best-practice guidelines of the Brazilian Institute for Corporate Governance. There was also considerable praise for the quality of regulation and supervision by CVM and BACEN. Many participants felt that Brazil's relatively smooth passage through the U.S. and European crises could be attributed in part to clear and well-enforced rules on capital adequacy and other prudential and macroprudential measures. Moreover, a number of participants saw the CVM's cautious approach to approving financial products as contributing to the stability of the Brazilian financial system, in contrast to the situation in the U.S. and other countries where unchecked financial innovation had contributed to bubbles and crises. They saw this as particularly important given that Brazil was an emerging economy and that most investors lacked experience and knowledge in making use of sophisticated financial products. The lack of investor sophistication was perceived by many participants as a significant gap in Brazil's financial infrastructure, and they called for much more investor education in order to ensure that financial markets fulfilled their appropriate role of intermediating funds in a way that benefits both suppliers and users of capital.

As evidence of the quality of Brazil's financial markets, many participants pointed to their attractiveness to foreign investors, who represented a large share of the investor base in equities and bonds and an even larger share of turnover in those markets. The willingness of foreign investors to bet on Brazilian markets was seen as a major advantage for Brazil compared to other emerging markets in South and Central America. However, some participants expressed concern that Brazilian capital markets might be overly dependent on foreign investment, which had proved fickle in many other times and places. There were also some concerns that, despite the recent successes in attracting

foreign capital, there remained significant costs of doing business in Brazil that might limit future foreign participation in its financial markets. Thus, a number of participants warned that authorities should pay attention to reducing the so-called “cost of Brazil” (including its complex tax system) in order to experience continued success in this regard. Overall, many participants felt that the development of a larger domestic investor base would be essential to the continued expansion of the country’s financial markets.

Impediments to Financial Market Development in Brazil

While most participants were optimistic about the prospects for financial market development, they noted a number of structural and policy obstacles. These reflected the relative immaturity of financial markets and Brazil’s status as an emerging economy with a history of hyperinflation.

Many participants pointed to the immaturity of the Brazilian financial markets as an impediment to fulfilling their potential role in the domestic and regional economies. One of the major weaknesses of the financial markets was the small number of issuers, of both equity and corporate debt. This was seen by a number of participants as a “chicken and egg” problem, in which limited issuance reduced the attractiveness of the markets to investors, which in turn made issuance less attractive. The problem was particularly acute for SMEs, which participants saw as key to the success of the markets. Another structural weakness that participants identified was the relatively small number of institutional investors, including insurance companies, pension funds, and mutual funds. Until a serious institutional investor base developed, some participants argued, there would not be enough demand to support a deep and liquid corporate bond market. Also, it was noted by a number of participants that retail lending markets such as mortgages were not well-developed, although auto loans and some forms of consumer credit had expanded greatly (too greatly, in the opinions of many) in the past decade

The immaturity of capital markets was largely attributed to three factors. One was the tradition of bank-based finance, and the enduring dominance of publicly-owned banks such as BNDES in project funding. Several participants tied the latter point more broadly to the legacies of an interventionist state. They also noted that there was a high level of concentration in the banking sector. A second factor was the predominance of government debt, which a number of participants saw as crowding out opportunities for corporate bonds. Third, the lack of development of long-term debt markets and institutional investors was linked by many participants to the long experience of high inflation, which had made many investors wary of committing funds to long-term private-sector activities.

Participants identified several regulatory gaps as disincentives to potential investors. In equity markets, while participants applauded the overall regime and improvements in the rights of minority shareholders (particularly since the recent revamp of corporation law), they expressed concern that control groups in many Brazilian firms held unfair advantages over other shareholders, thus making equity investment less attractive for households and institutional investors. And while participants generally gave positive assessments of rules on disclosure, transparency, and accounting for publicly-traded

firms, some expressed concern about the quality of disclosure for privately-held firms seeking to access corporate debt markets. In both of these cases, a number of participants pointed to a tradition of informality in lending and business decisions that they said reduced transparency.

A number of participants cited a conservative approach to prudential and legal regulation as an additional barrier to Brazil's financial market development. There was, however, some disagreement as to whether these policies were on balance appropriate for Brazil's economy. One important regulatory barrier was capital controls, especially the Financial Transaction Tax (FTT). Given the importance of foreign investors in Brazilian equity and debt markets, many participants saw capital controls as a significant obstacle to further development of financial markets. (Implications for inflation and exchange rates were discussed in Session 2.) Many participants also argued that strict preapproval requirements for new financial products unnecessarily restricted the introduction of useful hedging instruments and other financial instruments. Others felt that regulators were wise to restrict financial innovation that might destabilize markets or be misunderstood or misused by unsophisticated financial players. They argued that the cautious approach to financial innovation had helped to insulate the Brazilian financial system from the effects of the U.S. and European financial crises. All participants recognized that there were trade-offs between market development and protection of market players and stability. Similar questions were raised with regard to prudential rules for financial institutions, particularly as they concerned investments by pension funds and insurance firms. While recognizing that strict limitations on investments had been imposed in order to ensure the safety of pensions and insurance policies, many participants argued that they were outdated and had negative effects. The major concern from the point of view of market development was that the rules restricted the growth of a domestic institutional investor base. Several participants also worried that these funds were being forced into low-yielding investments, which they saw as problematic for policyholders. Some participants also expressed concerns about what they saw as regulatory uncertainty with regard to how the FTT would be applied, which financial products would be approved, etc. They saw this as a disincentive for some investors, particularly foreign ones, to enter the market.

A number of participants also noted places where they felt that regulation was insufficient, particularly with regard to consumer protection. One of these was the lack of attention to consumer credit for durable goods. They pointed out that there was little transparency about the actual rate of interest being charged or means of comparing financing options. There were also concerns about the economic rationality of auto loan products, where some lenders were providing ten-year loans even for used cars. These participants expressed concern that poorly regulated financial products could disadvantage households and contribute to excessive household leverage.

Finally, there was some discussion of whether optimizing market infrastructure and regulation would be sufficient for capital market development, or whether market development might require some sort of jumpstart. Several participants noted that there were few tax benefits for companies choosing to invest or access funds through capital

markets. Others countered that Brazil's tax system was properly balanced in its treatment of different forms of income and debt, and that this would support economically rational decision making rather than just tax avoidance strategies. Some compared Brazil's tax system favorably to that of the U.S. in that regard. Other participants suggested "regulatory discounts" as an alternative strategy for providing incentives for companies to access financial markets. They felt that smaller companies in particular would be more apt to list their shares on the exchange if the listing requirements were less onerous. There were, however, some concerns raised that lowering standards could work against the accomplishments of the Novo Mercado in raising standards of corporate governance and disclosure.

Session 2: Inflation and Exchange Rates

Session 2 dealt with the critically important issues of inflation and exchange rates, as well as their likely impact on financial market development in Brazil. There was also some discussion about macroeconomic policy in the U.S., including quantitative easing, the “fiscal cliff,” and implications for Brazil’s own macroeconomic choices.

Inflation and Politics

A major topic of conversation in the Symposium was the prospect for inflation in Brazil. Some participants questioned whether the Brazilian authorities’ commitment to anti-inflationary policy was waning. While they praised the quality of central bank personnel, statistics, and capabilities, they argued that growth was reemerging as a policy goal in addition to price stability, pointing to what they saw as a lack of response to overshooting of the official inflation target. They worried that, with memories of the hyperinflationary period receding, the political commitment to price stability even at the expense of growth might be waning. Several also pointed out that movement toward establishing formal central bank independence had stalled. With *de facto* independence dependent on the personality of the central bank governor and his or her relationship with the president, they worried that there were no institutional brakes on incremental movement away from price stability.

Most participants were less concerned. They felt that there would be enormous political costs to the resurgence of inflation and that no administration would be willing to take responsibility for undoing Brazil’s greatest economic policy achievement of the last two decades. They were also generally unconcerned about the lack of formal central bank independence, arguing that BACEN had accumulated considerable authority based on its proven successes in managing the Brazilian economy. With regard to the overshooting of the inflation target, several pointed out that fuel and soy were driving the overshoot; if Brazil were to follow the common developed country practice of concentrating on “core” inflation, they argued, the central bank would be well within its target range. Others felt that price rises were due to tight labor conditions rather than monetary policy. However, these points were not reassuring to participants who worried about a declining commitment to anti-inflationary policy, as they predicted that commodity prices and wages would have knock-on effects on other prices.

Inflation and Indexation

Participants spent considerable time addressing the issue of indexation in the Brazilian economy. They agreed that partial disindexation had been an important accomplishment in the fight against inflation, as strict and frequent indexation had contributed to embedding high inflation in the basic building blocks of wage and rent determination.

However, a number of participants expressed considerable frustration that the process of disindexation had not been completed. They noted that, unlike in some other countries such as Argentina, indexation had not been banned from labor and rent contracts. While practices such as monthly wage adjustments based on inflation had been outlawed,

participants stated that annual adjustments were pervasive in labor and rental contracts, as well as minimum wages. Many participants saw this as hardwiring inflation into the system and significantly reducing the ability of firms to adjust wages based on productivity, supply, and demand. Instead, they argued that labor contracts demanded a formula of “inflation-plus,” even if productivity did not keep pace with wage hikes. As a result, they expressed concern about declining competitiveness of Brazilian companies. Some participants worried less about contractual indexation, emphasizing instead what they saw as an indexation mindset. Either way, participants worried that indexation continued to complicate the task of monetary policymakers, as rising real wages threatened both price stability and full employment.

Exchange Rates

Another major concern for participants was exchange rates. Many participants worried that the Real was overvalued, which could have a negative impact on export competitiveness and growth. While there was a general sense among participants that the Real was overvalued, there was not a clear consensus either on where it should be or where the central bank thought it should be. Participants agreed that BACEN was managing the exchange rate through a dirty float, but with an ambiguous and undeclared range. Thus, while some participants felt that the exchange rate had gone well beyond an acceptable value, others felt that it was still within the central bank’s target range (albeit toward the top of the range). There was no clear consensus on how the authorities should respond to the overvaluation of the Real. Among the choices mentioned were more use of capital controls and foreign reserve accumulation, but both were seen as having costs attached in terms of either retarding financial market development or contributing to inflationary pressure.

There was considerable discussion of the impact on the economy of the strong Real. Participants highlighted two main concerns: effects on competitiveness and effects on inflation. The competitiveness issue attracted particular attention. Participants worried that currency appreciation exacerbated two trends that were already adversely affecting competitiveness. One was the relatively slow growth in productivity, which participants attributed to various causes including poor education, insufficient infrastructure, labor rigidity, and overregulation. Whatever the causes, weak productivity growth was seen by virtually all participants as a major concern for the Brazilian economy. The other worry was that Brazil’s trend rate of inflation was already higher than that of major trading partners and competitors. Given that these two trends might normally be expected to contribute to a weakening of the exchange rate, appreciation was seen by many participants as a major challenge for Brazil’s export competitiveness. At the same time, participants understood that depreciation would have significant inflationary effects. Thus, the central bank’s dirty float was expected to navigate between the shoals of losing competitiveness and accelerating inflation.

Some participants disagreed with the assumption that competitiveness needed to be maintained by keeping the Real from appreciating. Some argued that, while this might be effective in the short term in improving demand for Brazilian products abroad and depressing Brazilian demand for imports, in the long-run competitiveness could only be

achieved by addressing problems on the supply side. Thus, they advocated more aggressive investment in economic infrastructure and education to improve productivity of Brazilian companies and workers. Others pointed out that Brazilian producers faced a variety of costs other than exchange rates in the process of producing and marketing goods and services. They argued that tax and tariff reforms would do at least as much to address Brazil's competitiveness problems as focusing on the exchange rate and inflation. With regard to taxes, a number of participants pointed to the regressivity and inefficiency of the system. They also pointed out that high tariffs remained in place. This had the effect of reducing purchasing power for Brazilian residents, particularly for consumer durables such as automobiles. Some participants noted that some intermediate goods and components were also subject to relatively high tariffs, which reduced the international competitiveness of exporters who relied on imports in their supply chains. While there were a number of participants who supported the idea of structural tax and tariff reforms, several ruefully agreed that there was "zero political will" for it.

Intervening in Currency Markets

Much of the discussion of intervention in currency markets to limit the appreciation of the Real focused on capital controls, particularly the FTT. Participants expressed mixed opinions about the efficacy and wisdom of the controls. There were also questions about policy sustainability.

Participants recognized that capital controls would complicate the internationalization of Brazilian financial markets. The FTT directly contributed to the cost of moving money into Brazil, and controls also were seen as raising additional concerns among investors about their future ability to repatriate funds. Several participants also noted that the FTT was a variable tax that could be changed at the discretion of the Brazilian government, thus creating increased uncertainty among potential investors. In sum, there was a concern that active capital controls would reduce inward investment and increase incentives for Brazilian firms and households to move their money offshore.

Other participants defended capital controls, although they agreed that there were some costs in terms of investor confidence. Their defense rested on the importance of controlling hot money flows into the country. They saw hot money as a potentially seriously destabilizing force that would lead to currency appreciation, complicate inflation control, and contribute to asset price inflation. They therefore felt that capital controls were a better policy than just using monetary policy to mop up liquidity. Several participants also defended the FTT as a flexible and relatively market-conforming means of restricting inflows (which they saw as much wiser than restricting outflows). Some suggested that, given the importance that foreign investors attached to macroeconomic stability, effective use of capital controls might actually be reassuring to them.

Participants also debated whether capital controls were actually effective in controlling hot money. A number of participants expressed skepticism that they worked at all, arguing that most capital controls could easily be circumvented. Others felt that capital controls could be an effective policy tool in the short term, as many of the techniques for avoidance, such as transfer pricing strategies and disguising portfolio investment as direct

investment, could not be scaled up quickly. Two other concerns also arose regarding capital controls. One was microeconomic: that efforts to avoid controls would distort investment decisions, possibly creating asset bubbles in specific asset classes such as commercial real estate. On the macro front, several participants pointed out that, even if capital controls could be effective in reducing capital surges in the short run, they tended to be ineffective over the longer run. They saw this as a major challenge for Brazilian authorities, as they predicted that easy money and slow growth in the U.S. and Europe would continue indefinitely. Therefore, they argued that Brazil and other emerging markets would need to think about long-term strategies for dealing with hot money and imported inflation.

While much of the discussion of intervention in currency markets focused on the FTT, some participants argued that other forms of government intervention were equally important in affecting the effective rates. These included pricing for energy production concessions, the pricing policies of state-controlled firms, and investment activities of pension funds. The confusion over how policies were changing and their actual impacts on opportunities for foreign firms were seen as reducing the attractiveness to foreigners, or even restricting their access, to investing in some sectors.

Impacts of Capital Controls on Capital Markets

Participants offered a variety of perspectives on the impacts of capital controls on Brazilian financial market development. The most optimistic view was that capital controls would contribute to macroeconomic stability, thus supporting Brazil's signature economic accomplishment of the last two decades. Several participants argued that confidence in the stability of the Brazilian economy was the most important element for both international and domestic actors' decisions about investing in Brazil; thus, they felt that the negative impact of capital controls on financial market development would be limited.

Others disagreed. They focused on the increased costs and uncertainty for foreign investors. They saw the FTT in particular as penalizing financial transactions, and thus acting as a deterrent to participation in Brazilian financial markets. Several participants argued in addition that, although capital controls were designed to limit hot money flows, they could also negatively impact foreign direct investment. One reason was that foreign investors might fear that capital controls would eventually be extended to FDI. More directly, several participants pointed out that many foreigners engaged in FDI could potentially see much higher costs of hedging exchange rate or commodity price risks, thereby reducing their appetite for making the types of long-term investments the Brazilian economy most needed. Other participants doubted that FDI would be adversely affected, and even suggested that there would be additional incentives for foreign investors to engage in FDI rather than portfolio investment so that they could get in on Brazilian growth prospects. Since they felt that the Brazilian economy would benefit more from FDI than from portfolio investment, they considered the distortion of capital inflows to be a good thing.

Finally, some participants warned of other potential adverse effects or unintended consequences of capital controls. One major concern was that the active imposition of capital controls would kill Brazil's aspirations to become a regional financial market center, which they considered to be an important national goal. Some participants also argued that big foreign financial institutions would be better at evading controls than Brazilian firms or regional firms, thus disadvantaging smaller and local investors.

U.S. Policy

While much of the discussion of inflation and exchange rates focused on Brazil, participants also discussed U.S. macroeconomic policies. These were seen as important not only for understanding U.S. and global trends, but also for their effects on Brazil.

Most of the discussion about U.S. policy focused on monetary policy. Participants noted that, unlike BACEN, the ECB, and some other central banks, whose sole mandate was price stability (however defined), U.S. law stipulated that the Fed had a dual mandate. In other words, the Fed is explicitly required to take into consideration the effects of monetary policy on economic growth and employment, in addition to the effects on the price level. Under the current circumstances, many participants predicted that this would mean a greater emphasis on restoring growth rather than maintaining price stability, and thus to an extended period of easy money. There were some concerns raised that the aggressive expansion of the Fed's balance sheet under quantitative easing would lead to a future spike in inflation, but most participants appeared unconcerned about that possibility.

There was more concern over the effects on asset prices and on inflation in other countries, including Brazil. A number of participants asserted that there was already considerable evidence of asset bubbles in the U.S. They felt that the strength of U.S. equities did not reflect the actual, less rosy prospects of companies, and that other markets including bonds and possibly real estate were artificially inflated. The other concern was spillover effects on other countries, including Brazil. Participants worried that easy money in the U.S. would spill over to Brazil in the form of exchange rate appreciation, imported price inflation, or asset bubbles. Despite the potentially serious effects on Brazil and other countries, participants agreed that there was little likelihood that U.S. policies would be modified to address their needs, and that expansionary monetary policy would persist as long as the Fed deemed it necessary for the U.S. economy. While most participants rejected the accusation that U.S. monetary policies of near-zero interest rates plus quantitative easing amounted to a "currency war," they acknowledged that those policies would necessarily impact Brazil. For some, the situation called to mind former U.S. Treasury Secretary John Connally's famous statement to his European and Japanese counterparts that, "The dollar is our currency but it's your problem."

Participants also discussed the U.S. fiscal policy situation, particularly the so-called "fiscal cliff." They held a variety of views as to whether the outcome would be a grand compromise, a two-stage solution, or a debacle. Most appeared cautiously optimistic that some sort of compromise would be found in time to avert the automatic tax hikes and

spending cuts, but many remained nervous about the possibility for deadlock. A number of participants decried the situation as indicative of a broken political system. Several also offered the sobering thought that if a grand compromise were not reached, it was possible that there would be a replay of high-stakes bargaining over the debt ceiling later in 2013. Participants worried that an inability to come to an agreement would mean a severe contraction in U.S. demand, with global implications. They also noted that the stand-off added to global uncertainty at an already uncertain time. For Brazil, both were problematic from the standpoint of both exports and inward investment.

Session 3: Development of Derivatives Markets and Risk Management in Brazil and the U.S.

Session 3 addressed the development of derivatives markets in Brazil and the U.S. Participants discussed new global standards, changes in the U.S. regulatory regime, the current state and future prospects of Brazilian derivatives markets, and Brazil's lessons for the U.S. and other countries.

Global Standards

A starting place for discussion on derivatives markets in Brazil and the U.S. was changes in global standards in the wake of the global financial crisis. Participants noted the G20 commitment to moving away from bilateral trading and settlement of bespoke OTC derivatives toward central clearing and exchange-based trading, as well as the mandate for reporting all trades to trade repositories in order to improve transparency.

While the G20 had designated the end of 2012 as the deadline for countries to make those changes, participants observed that the major markets in the U.S. and Europe had not yet finalized all their rules. Participants noted that many of the new global standards mirrored policies that Brazil already had in place: banks faced high capital adequacy standards, most derivatives were already standardized and traded on exchanges, OTC trades were in general centrally cleared, and all derivatives trades were reported to one of two trade repositories, albeit that the OTC derivatives market was not nearly as developed as that of the U.S., particularly with respect to credit default swaps. The U.S., in contrast, required significant modifications of its regulatory regime in order to meet the new G20 standards, and therefore many of the rules and procedures were still not in place. A number of participants argued that Brazil's experience with rules in line with the new global standards would put it in a good position going forward.

U.S. Regulatory Regime

There was considerable discussion of the U.S. regulatory regime. One issue raised was the continuing delays in rulemaking and implementation. A number of participants expressed frustration with the delays, arguing that they created significant uncertainty for market participants and reducing the attractiveness and liquidity of derivatives markets. Others acknowledged the problems created by regulatory uncertainty, but argued that delays reflected the complexity of the mandates for change. They felt that missing deadlines was less problematic than putting in place rules that were inappropriate because they tried to fix the wrong problems, created bad incentives for market participants, or imposed excessive costs. Some participants also brought up the possibility that hastily-assembled rules could be challenged or even overturned in court, thus adding to (and extending the period of) uncertainty.

A particular concern of several participants was the lack of cost-benefit analysis in much of the rulemaking related to derivatives and other financial market regulation, despite the fact that many proposed rules involved potentially significant costs of compliance. The

SEC was given credit for making efforts to incorporate serious cost-benefit analysis into its rulemaking, for example in rules concerning security-based swap dealers, intermediate entities, and money market funds. In contrast, other regulatory bodies were seen as being much more reluctant to take seriously the costs of compliance, effects on liquidity, etc. that good cost-benefit analysis could help to avoid. It was noted that a federal court had already overturned commodity position limit rules emanating from Dodd-Frank, on the basis of inadequate attention to cost-benefit analysis; some participants predicted that this would be more and more common, and expressed hope that it would pressure more regulatory agencies to base their rulemaking on such analysis.

Two other points were made by a number of participants about the U.S. system of derivatives regulation, and of financial regulation more generally. One was that the Dodd-Frank Act mandated an extraordinary number of rules on a relatively tight schedule. Many of these rules would inevitably interact with each other and would affect broad swathes of the financial system. Thus, their effects would be at least somewhat unpredictable even with careful cost-benefit analysis, and would likely lead to a variety of unintended consequences. Moreover, the sheer number of required rules was overwhelming the capabilities of agencies and their personnel. Second, participants noted that the problems of regulatory fragmentation in the U.S. had not been ameliorated—and in fact had in some ways been exacerbated—by Dodd-Frank. In derivatives regulation, even though the bulk of derivatives were regulated by the CFTC, some derivatives trading remained under the jurisdiction of the SEC (and the Fed had input as well). This required separate rulemakings on nearly-identical issues by the two agencies, which raised problems of coordination and overlap. It would also further tax the capabilities of agencies' staff.

Derivatives Markets in Brazil

Many participants were highly complimentary of derivatives markets in Brazil. They felt that Brazil benefited from highly-competent regulators and exchanges, an effective division of labor among regulators, and a system that ensured confidence and transparency through clearing rules and trade reporting. They felt that Brazil was a model for emerging market derivatives regulation, and that the country also had valuable lessons to teach developed countries as well.

Trade reporting in particular was seen as a success of the Brazilian system. Participants noted that all derivative trades, whether exchange-traded or OTC, had to be reported to trade repositories. The repositories had developed detailed methodologies for classifying and tracking all trades, so that regulators and market participants would have access to high-quality and accurate information. They argued that trade repositories reduced risk in the system by making all information on trades, including net positions, available to supervisors in the CVM. BACEN also had access to much of that information, which contributed to macroprudential supervision. Further, aggregated data was released publicly to improve transparency for market participants.

There were, however, some concerns raised about Brazilian markets. A major one had to do with the preapproval process for financial products. Participants agreed that regulators

had been cautious about approving new products, out of concern for disruptions to the financial system. A number of participants felt that regulators had been wise to adopt such a cautious approach, given the level of development of Brazilian finance, the lack of sophistication of many potential users of derivatives, and the dangers that were exposed in the U.S. subprime crisis. Others felt that regulators were much too cautious, with the result that many potentially useful derivative products were either not available or were very costly due to lack of liquidity. This was seen particularly in the OTC markets, where innovation was seen as most likely to occur. These participants felt that the preference for security over innovation had gone too far, with detrimental effects on the development of Brazilian financial markets and on the availability of hedging instruments for commodities exporters and others.

The debate over the trade-off between stability and innovation was based partly on participants' understanding of the needs and sophistication of Brazilian end-users. While commodities firms seemed to many participants to be particularly likely to be able to benefit from a broader array of liquid derivative products, a number of participants expressed concerns about their ability to use such financial techniques in a way that reduced rather than increased their risk. Some participants also emphasized that agricultural producers could benefit more from investing in storage and transportation infrastructure than from purchasing derivative products. These issues also fed into questions about liquidity and cost. While some derivatives markets (particularly exchange-traded derivatives) were relatively liquid, others were not. One suggestion was that Brazilian derivatives markets could be made more liquid by further opening to foreign participants, including through cooperation between domestic and foreign exchanges. However, as with financial market development more broadly, a number of participants saw capital controls and taxes as serious impediments.

There was also a debate on the respective responsibilities of swap dealers, banks, and end-users. A number of participants argued that there should be significant suitability requirements to ensure that financial institutions did not sell inappropriate instruments to unsophisticated end-users. Some supporters of strict oversight on derivatives also pointed to problems that emerged in 2008 among some companies that had been deeply invested in exchange-rate derivatives, arguing that the end-users had not understood the dangers involved. This claim was strongly contested by other participants, who stated that the end-users had known precisely what they were getting into, and were just trying to shift responsibility onto banks.

Session 4: Extraterritoriality in Post-Crisis Rules and Its Impact on Financial Markets

Session 4 addressed problems created by extraterritoriality in post-crisis U.S. (and to a lesser extent, European) rules. Participants expressed concern about a variety of rules affecting banking, sovereign debt markets, and derivatives trading. They also discussed possibilities for lessening the issues created by lack of harmonization of rules, including mutual recognition.

Dimensions of U.S. Extraterritoriality

Participants raised a number of examples of extraterritorial impact of U.S. and European financial rules. These included Regulation K and the Volcker Rule for banks, entity and activity rules for derivatives dealers, and clearing and collateral rules for derivatives. The Volcker Rule and the CFTC's swap dealer regulations were seen as particularly relevant to Brazilian markets and financial institutions.

The Volcker Rule, which would outlaw proprietary trading activities of banks and limit banks' ownership of hedge funds and private equity, received considerable attention in Session 4. For U.S. banks, the Volcker Rule would apply not only to their activities in the U.S., but also to their global operations. Thus, a U.S. bank in Brazil could not engage in proprietary trading, even in Brazil. Foreign banks were worried about restrictions imposed on them in the United States. The Volcker Rule's carve-out for trading in U.S. government bonds was seen as a major problem—as written, a Brazilian bank doing business in the U.S. would be proscribed from trading anything but U.S. government bonds for its own accounts, *including* Brazilian government bonds.

Another major concern regarding Brazilian financial institutions and markets was the CFTC's swap dealer rules. As currently written, any foreign entity with gross notional positions in derivatives exceeding \$8 billion in the U.S. would be required to register as a swap dealer, and thus be subject to a variety of activity rules, including capital adequacy, segregation, etc. To make matters worse, foreign entities would be subject to all relevant U.S. rules on any swaps involving "U.S. persons," no matter where the transaction was done. One potential way out of this problem was that regulation by the CFTC could be waived if the foreign regulatory regime was deemed "equivalent" to that of the U.S. Participants expressed confidence that the Brazilian regime was in fact equivalent to that of the U.S., and hoped that it would be recognized as such.

Finally, U.S. law required the use of central counterparties for clearing cross-border derivatives transactions, and stipulated that U.S. entities must do business with CCPs that meet U.S. rules and are registered in the U.S. In principle, this was not seen as a problem, as a CCP could choose to meet the requirements of both the U.S. and its home jurisdiction by following the stricter standard in any given area. Some EU CCPs had already registered in the U.S. and were prepared to meet the higher of the EU (once they became effective) or U.S. standards. However, EU regulations (which were not yet in effect) provided that EU entities could only clear through CCPs with equivalent rules to

the EU. So, if a U.S. CCP sought to clear in the EU, it could not do so if there were significant differences between U.S. and EU rules, even if the U.S. CCP were prepared to meet the stricter rules. This would exclude U.S. clearinghouses from European markets, possibly leading to U.S. retaliation, with the effect of segmenting global markets. This was seen as less of a problem for Brazilian financial institutions than for U.S. ones.

Overall, it was agreed that there were a variety of regulations, particularly in the U.S. and EU, that have extraterritorial effects on the structure and operations of multinational financial institutions. These could lead to significant costs of regulatory compliance, regulatory arbitrage, and segmentation of markets. They could also lead to extensive ring-fencing, which in turn would prevent multinational financial institutions from managing operations, capital, and business strategies globally. In the extreme, some participants warned that international financial institutions would be unwilling to do business with U.S. persons or entities. And the open questions involving mutual recognition would exacerbate uncertainty in global finance.

Finally, some participants noted the problem of asynchrony of regulatory reform. For example, EU financial institutions would not face new regulations for at least half a year during which new U.S. regulations were already in effect. This was seen as giving them competitive advantages.

Effects on Brazil

Participants expressed concern about the potential effects of U.S. extraterritoriality on Brazilian financial institutions. With regard to derivatives, there was a strong hope that the quality of Brazil's financial regime would be recognized by the CFTC as a "comparable regime," so as to avoid "substituted compliance." However, while participants thought that would be appropriate, there remained uncertainty about whether that would happen. A major problem in achieving acceptable comparability could be Brazilian bank secrecy laws that prohibit transferring information about a client without the client's permission (including to U.S. regulators). These participants warned that if mutual recognition of regulatory regimes did not occur, the impact on liquidity of hedging instruments and on the ability to provide client facilitation in Brazil would be severe.

Participants raised a number of questions about the prospects for mutual recognition. Some expressed optimism, noting that the CVM had been working proactively with its U.S. counterparts to ensure that markets would not be disrupted. Some also pointed to Brazil's expanded global role as a member of the G20 and an active participant in FSB deliberations on global standards as helping to elevate perceptions of Brazilian financial regulation and ensuring that Brazilian standards were in fact in line with global standards. There were also questions regarding the U.S. politics of extraterritorial rulemaking. For example, one participant asked if policymakers might reconsider some of the post-crisis rules on the grounds that they would work to the advantage of bigger financial institutions and increase the likelihood that some would become too big to fail. While U.S. participants saw this as a potentially effective argument for small U.S. financial institutions, they felt that foreign financial institutions would not be able to advance such

an argument to politicians and regulators. With foreign financial institutions having few prospects of benefiting from the political process, participants pinned their hopes on international cooperation between regulators.

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