BANKING IN THE MERCOSUR AREA:

LIBERALISATION AND INTEGRATION: A

POLICY RE-EVALUATION

REFLECTION

THESIS SUBMITTED BY

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ABSTRACT

This thesis studies MERCOSUR Agreements in the area of banking services. The core issue of this study is to examine whether the present and potential benefits arising from MERCOSUR Agreements - as they have been designed and implemented - are worth the risks and difficulties underscored of the liberalisation and integration processes.

For the proposed analysis, first of all a presentation is made of the context in which MERCOSUR integration is inserted (Chapter I). This means the trends towards globalisation, internationalisation and liberalisation present today in Latin America’s financial sector. In the second place (Chapter II), the Asuncion Treaty and MERCOSUR complementary Protocols are described. Thirdly (Chapter III), the regulations and structures generated in the MERCOSUR in relation to banking services are presented. Chapter IV describes countries financial legislation and regulation. Subsequently (Chapter V Section 1), the obstacles to liberalisation and integration present today in the instruments, bodies and specific provisions regarding the banking sector in the MERCOSUR and in the internal legislation of its Party States, are gone into in depth. Finally, (Chapter V Section 2), an explanation is given of the impact of the Brazilian and Argentine economic crises since 1999 on the MERCOSUR integration process, in macroeconomic and unilateral trade measures.

The author’s principal conclusion is that the MERCOSUR framework has a positive potential and may contribute to the economic growth and wellbeing of the countries and societies it involves. For the further development and enhancement of its positive effects, MERCOSUR should avoid or at least mitigate the risks and difficulties involved in the opening up processes. The author suggests some concrete strategies for future negotiations in the context of MERCOSUR, FTAA, GATS or other liberalisation agreements involving Latin American countries.
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ACRONYMS AND ABBREVIATIONS

ALALC. Asociación Latino Americana de Libre Comercio (Spanish, Latin American Free Trade Association)

ALADILAIA. Asociación Latino Americana de Integración (Spanish, Latin American Integration Association)

ALCA. Área de Libre Comercio de las Américas (Spanish, Free Trade Area of the Americas)

BASEL COMMITTEE- Basel Committee on Banking Supervision

BCRA. Banco Central de la República Argentina (Spanish, Argentinean Central Bank)

BCU. Banco Central del Uruguay (Spanish, Uruguayan Central Bank)

BID. Banco Interamericano de Desarrollo (Spanish, Inter-American Development Bank)

BIS. Bank of International Settlements

CARICOM. Caribbean Common Market.

CCM. Comisión de Comercio de MERCOSUR (Spanish, MERCOSUR Trade Commission).

CMC. Consejo Mercado Común. (Spanish, Common Market Council, highest MERCOSUR decision making body).

CMN. Conselho Monetario Nacional (Portuguese, National Monetary Council). Brazil.

EU. European Union.

FCES. Foro Consultivo Económico y Social (Spanish, Economic – Social Consultative Forum).

FTAA. Free Trade Area of the Americas.

GATS. General Agreement on Trade in Services (on WTO).

GDP. Gross Domestic Product.

GMC. Grupo Mercado Común (Spanish, Common Market Group, highest MERCOSUR executive body).

IOSCO. International Organization for Securities Commissioners

IAIS. International Association for Insurance Supervisors

IDB. Inter-American Development Bank

IMF. International Monetary Fund

LAIA – Latin American Integration Association

LACN - Latin American Community of Nations
MERCOSUR. Mercado Común del Sur (Spanish, Common Market of the Southern Cone)

NAFTA. North American Free Trade Agreement.

SAM. Secretaría Administrativa del MERCOSUR (Spanish, MERCOSUR Administrative Secretariat).

SIB. Superintendencia de Instituciones Bancarias (Spanish, Banking Institutions Supervisor). Paraguay.

SIIF. Superintendencia de Instituciones de Intermediación Financiera (Spanish, Financial Intermediation Institutions Supervisor). Uruguay.

USA. United States of America

WB. World Bank

WTO. World Trade Organization.
INTRODUCTION

The primary subject-matter of this volume is the MERCOSUR Agreements, their development and implementation in the area of banking and other financial services. The MERCOSUR Agreements are a framework for sub-regional economic integration presently being developed in the Southern Cone of Latin America, of which the States of Argentina, Brazil, Paraguay and Uruguay are full members. The core issue to be examined is whether the present and potential benefits arising from the MERCOSUR Agreements in the financial sector area - as they have been designed and implemented to date - are worth the risks and difficulties of and underscored by the attendant liberalisation and integration processes impacting the financial sector. The aim of such analyses - based on the concrete experience of MERCOSUR and the MERCOSUR countries- is to contribute to a better policy understanding of how a more successful and effective building-up of the MERCOSUR financial sector integration processes should be approached. Though the focus is on the MERCOSUR experience, it is hoped that lessons can also be learned with respect of other financial sector integration processes being undertaken or contemplated to be undertaken by other emerging economies.

The principal proposition presented and to be analytically developed by this volume is that, while the MERCOSUR framework in general terms has a positive potential and may contribute to the economic growth and well-being of the involved countries and societies, for the further viable and sustainable development and enhancement of its positive effects, MERCOSUR should avoid or at least mitigate the risks and difficulties involved in the opening-up processes as to the financial sector. For instance, it will be suggested that, in view of the economic and financial crises that has taken place first in Brazil (1999) and then in Argentina (2000 – 2002) and Uruguay (2002), it would be unwise to continue the opening-up process within the MERCOSUR framework until the macro-economic and institutional situation of all its member countries returns to more normal conditions: it is both impossible and untimely to advance in integration stages under economically unstable conditions. In setting forth and developing this proposition, this volume will suggest selective concrete strategies for future negotiations regarding integration and
liberalisation of financial services in the context of MERCOSUR, FTAA, LACN, GATS or other liberalisation agreements involving Latin American countries.

For the proposed analyses, an overview presentation in Chapter I is made of the context in which MERCOSUR integration is occurring: that is, the trends towards globalisation, internationalisation and liberalisation present today in Latin America's financial sector, as well as more generally in the Latin American and continental liberalisation processes. In Chapter II, the Asuncion Treaty and the MERCOSUR complementary Protocols are analysed, including a general and institutional appraisal of the Agreements relevant in the analysis of prospects for future development of regional integration, as well as in the process of financial integration. In Chapter III, the regulations and structures generated in the MERCOSUR region in relation to banking services are discussed, stressing basically their significance – or lack of it – as mechanisms for the removal of obstacles to their integration and liberalisation. Chapter IV considers the MERCOSUR countries' current state of financial legislation and regulation. Then in Chapter V, Section I, the possible obstacles to liberalisation and integration present today in the instruments, bodies and specific provisions regarding the banking sector in the MERCOSUR and in the internal legislation of its Party States are gone into in depth and an examination is made of the congruency between such possible obstacles and the evolution and present situation of banking integration in the MERCOSUR. Finally, in Chapter V Section II, an explanation is given of the impact of the Brazilian and Argentine economic crises since 1999 on the MERCOSUR integration process, in macroeconomic and unilateral trade measures. Unless otherwise indicated, this volume speaks as of June 2004.

Regarding MERCOSUR's positive potential and contributions, the progress achieved in the implementation of the first stages of trade in goods liberalisation, basically until 1998, is recognized. Additionally, this volume acknowledges the development of the MERCOSUR framework as an important economic and geopolitical factor – and its potential benefit for the Southern American countries - on international fora. These are assumed starting points for this study.

Nevertheless, as mentioned above, there are certain key, but diverse factors holding back MERCOSUR's success. On the one hand, an element –of a highly strategic nature and at political level– is linked to the need to
strengthen political will and State commitment in two different areas. First, regarding the insufficiency of macro-economic coordination and stability of the Member countries, which – as shown once more - seriously conspire against MERCOSUR’s viability. For this reason, it is essential to intensify commitments and consequences for Governments that do not comply with the macro-economic variables agreed on. Second, regarding liberalisation of financial service provision by financial institutions in the States Party, political will and commitment is needed to eliminate restrictions and prohibitions preventing access by those providing financial services from one State Party to another, as well as those limiting activities to be developed by financial institutions, thus distorting the conditions for competition among them in the four signatory countries. In this regard policy-makers should be careful not to confuse liberalisation policies implemented in varying degrees by some of the MERCOSUR countries during the 1990’s, with a result of MERCOSUR process: these policies were unilaterally decided on, for instance by Argentina, as a consequence of the influence of the worldwide liberalisation trend.

On the other hand and in this context, another – technical – element refers to the instruments used specifically for the integration of financial sectors and concerns the characteristics of the model adopted to advance in the financial integration of MERCOSUR. Such model clearly reflects the influence and solutions of the World Trade Organisation GATS Agreement. In the light of the results achieved, this strategy has not fulfilled the expectations of those promoting it and should therefore be reconsidered. Furthermore, the absence of an adequate coordination between the tasks and knowledge of the different MERCOSUR bodies – particularly between the Services Group and Technical Subgroup IV - has contributed to this meagre result. Additionally it should be remembered that the suitability of the liberalisation mechanism – or its lack of suitability – has a substantial repercussion on progress made in banking integration.

A clearer and more positive result has been achieved in another important aspect for the prospect of the liberalisation process involving the financial sector. By this, this study refers to the implementation of common policies to strengthen the prudential requisites for the banking industry (its soundness and solvency).
Finally, and with a broader approach to that of intra-MERCOSUR convergence, specifically pointing to the development of bank sectors in MERCOSUR Party States in the context of other liberalisation agreements, multi or bilateral, the author refers to MERCOSUR’s role as counterpart in trade liberalisation negotiations with other agreements or countries. Specifically addressing the banking sector it is essential – in order to maximize the benefits of said position - to establish a solid strategy before MERCOSUR submits or negotiates within international contexts or with developed country counterparts, free access by financial service markets in the region. In this regard, it is important to keep in mind that although all the countries have taken the path of opening up their financial sectors, beyond harmonisation in the context of MERCOSUR, this still shows very diverse levels in the four countries, implying that there is still ample room for liberalisation of bank services. Furthermore, potentially, conditions for competition in the sector may be very unequal. In view of this fact, when the time comes, negotiations should be addressed with a common strategy and not indiscriminately, in order to maximize the benefits for MERCOSUR countries and their banking sector and to avoid or mitigate some of the worst negative impacts of the opening up.
CHAPTER I

LATINAMERICA'S FINANCIAL INTEGRATION BACKGROUND AND NEW DEVELOPMENTS

This Chapter is aimed at placing the MERCOSUR and the banking sector of the Party States in a temporal and regional perspective. For this purpose, two sub-themes are differentiated and presented independently. Section I briefly describes other trade liberalisation Agreements existing in South America (including FTAA) whose formulation – and meagre results – except in the case of FTAA, explain the similarities and differences in approach used in the case of MERCOSUR regarding its background. Such Agreements, mostly signed during the 60’s and 70’s, are examples of the common trends in those decades with reference to free trade agreements. Thus, they strongly differ from the objectives and focus of the MERCOSUR Agreements signed during the 90’s. Section II refers exclusively to the South American financial–and banking–sector, particularly in the MERCOSUR countries, placing the significant factors, policies and influence of this activity in the context of world financial globalisation, internationalisation and liberalisation phenomena. This Chapter will apprise the present scenario of South America’s financial sector, showing the different movements that took place during the 1990’s and reflecting the worldwide trends towards internationalisation, liberalisation and globalisation in the banking industry. Establishing the context of the bank sector will enable a better analysis of integration Agreements and documents in the framework of MERCOSUR and of the evolution and prospects of this process.
I. FREE TRADE AND INTEGRATION AGREEMENTS: BACKGROUND AND NEW DEVELOPMENTS

A. BACKGROUND OF THE INTEGRATION PROCESS

The push for integration, especially in developing countries, derives from the fact that the limited size of national markets curbs the growth of national economies.1 Particularly in the last century, this situation has led to a proliferation of all types of cooperation, trade facilitation and integration agreements.

Without delving into the variations that time and space have implied in the forms of international rapprochement, we note that currently there has been a stepping up of sub regional and bilateral or trilateral agreements, with a comparative dropping off of new plurilateral or multilateral agreements, which had predominated in the past. One of the earliest manifestations of this regional approach was the MERCOSUR Asunción Treaty. In the Northern Hemisphere, we have also seen the same phenomenon, particularly the US movement toward bilateral negotiations and the generation of NAFTA, and the strengthening of the unified European Union market. During the same period, most of the developed world stepped up economic reforms geared to a market view. Additionally, these events occurred in a context of multilateral efforts in Geneva to liberalise trade in goods and services worldwide, which culminated in the Uruguay Round agreements of 1994, and the creation of the World Trade Organisation in 1995. In the mid-1990s, regional approaches to trade liberalisation spread around the globe, in Europe, the Americas and Asia.2


2 SERGIO ABREU BONILLA, MERCOSUR E INTEGRACION, (Montevideo, Nov. 1991); GUStAVO MAGARINOS, URUGUAY EN EL MERCOSUR, (Montevideo 1991).

Discussion has centred on scope and compatibility with other agreements to which the parties are members, including the WTO, as well as coordination with intra-regional agreements such as LAIA.4

This discussion must take into account an economic reality, insofar as many of the important effects of successful efforts toward regional integration involve complex relationships within a framework of long-term equilibrium.5 At the outset, and each time the agreement formally deepens its commitments, there are significant costs that must be assumed immediately, while the benefits may be felt much later. Many economists focus attention on analyzing whether the regional situation induces what Viner (1950) called trade creation or trade diversion.6 Starting with a static economic model of integration it is clear that there will be less diversion if the integration agreement involves countries whose economies are already competitive but potentially complementary.

Yet the static effects of regional integration agreements are only a small part of the history. The dynamic effects of integration are more important, since they are associated with increased competitive pressures associated with removal of trade barriers.

Trade integration refers to “dynamic” economic transformations that imply intensification of competition, reduction of economic rents, taking advantage of economies of scale, experience in marketing and exports, efficiency and professional management. Moreover, regional integration aims at non-traditional gains, such as commitments with investors, reform


6 Traditional regional integration theory is still influenced by Viner's and Meade's work in the 1950s on free trade areas and custom unions. Their ideas were further elaborated by Lipsey and Johnson. See JACOB VINER, THE CUSTOM’S UNION ISSUE, (Carnegie Endowment for International Peace, 1950); J.E. MEADE, THE THEORY OF CUSTOMS UNIONS, (Westport, Conn.: Greenwood Press); R. LIPSEY, THE THEORY OF CUSTOMS UNIONS: A GENERAL EQUILIBRUM ANALYSIS, (Weidenfeld and Nicolson, 1970). See also William Loehr, Notes on Lipsey's theory of custom unions, XIII (1 and 2). J. COMMON MKT. STUD. 97, 87-91
policies, strengthening of institutions and rules for procedures, synergy of economic policies among countries that integrate and their geopolitical objectives.7

When national economies involved in an integration process are relatively homogeneous, there is significant trade among them and their levels of income and technological development converge, and integration brings growing intra-industry trade. Adjustments occur fairly rapidly and with relatively few diversions. Instead, when integration involves very heterogeneous countries in terms of those parameters, the regional integration process initially is seen more in development of trade among the industries of the member countries, and with greater intensity in the gaps and difficulties of the process.8

Before entering into a specific analysis of MERCOSUR and its regulatory framework, it may be helpful to indicate briefly in chronological order the trade liberalisation schemes existing today in Latin America.9

1. Central American Common Market (CACM)

The experience of economic integration in Latin America started in Central America as the result of a network of bilateral agreements beginning in 1950, which consolidated a multilateral free trade area by 1958. At the same time, the creation of the Organisation of Central American States (OCAS) on October 14, 1951 by El Salvador, Nicaragua, Guatemala, Honduras and Costa Rica granted political support to the idea of gaining further integration.

9 See Abreu Bonilla and Magarifios, supra, note 2.
In 1960, OCAS country members, excepting Costa Rica which joined in 1962, signed the Managua Treaty or the General Treaty of Central American Economic Integration. This agreement was aimed at establishing a Central American Common Market (CACM).10

To that end, the Treaty created a set of institutions designed to implement the CACM11. Among them, an Economic Council (acting as the superior guiding body), an Executive Council and a Permanent General Secretariat (SIECA) were established. The Central American Monetary Council and the Central American Clearing House dealt with monetary matters while the Central American Bank for Economic Integration (CABEI) was in charge of promoting industrial development and guaranteeing balanced economic growth for signatory countries.

During its first years, due to the relatively small size in its member countries’ economies, their incipient industrial development and their notable monetary and exchange stability, CACM was a quite unique successful experience.12 Based on a policy of import-substitution advocated by the United Nation’s Economic Commission on Latin America (ECLA),13 it was able to create a common physical infrastructure in roads, electricity and telecommunications. However, policy concerns

11 GTCA60, supra note 10, arts. XX to XIV.
12 “In the area of trade, a Common Tariff Nomenclature (NAUCA) was prepared, and by 1965 there was a Common External Tariff in place that included 98% of the items. By that same year, intra-regional trade in 95 percent of the tariff captions had been freed, and special rules had been set up for certain selected agricultural and livestock products. By 1969, liberation of internal trade had reached 98%. The amounts traded among the member countries of the Central American Common Market grew rapidly from US$ 13 million in 1955 to US$ 66 million in 1963. The share in total trade went from 3% to 12% in those same years and industrial products represented 75% of that trade.” SELA, Guide to Latin American and Caribbean integration 2001, [hereinafter The Guide], at http://lainic.utexas.edu/~sela/AA2K1/ENG/docs/Integra/SPD15-01/SPD15-01-4.htm, last visited Apr. 13, 2004.
13 See O’KEEFE, supra note 10, at 1-2, 1-3. ECLA was the first name of the United Nations Economic Commission for Latin America. The United Nations Economic and Social Council through Resolution No. 106 (VI) of Feb. 25, 1948, originally established it. Later on, the Caribbean countries were included by Resolution No.1984/67 of 27 July 1984, changing its name to the “Economic Commission for Latin America and the Caribbean” (ECLAC). The Spanish acronym is CEPA. When considering not only the early stages but also the complete process of regional integration in Latin America, it is essential to refer to the comprehensive, influential, and in some cases criticised work of the ECLAC. For further information go to http://www.eclac.cl/acerca/default-l.asp, last visited May 13, 2003. See also Octavio Rodríguez, Prebisch: the continuing validity of his basic ideas, 75 CEPAL review 39, 39-65, 2001 available at http://www.eclac.cl/publicaciones/SecretariaEjecutiva/0/LEC2150PLtcg2150s_Rodriguez.pdf
among participants, external pressures and political events taking place within the sub-region, led the process into a crisis.

As for the policies, member countries could not agree on where to place the new factories that would produce the goods not already manufactured in the sub-region. At the same time, industrialist in the less-developed participants faced bankruptcy caused by the competition of more efficient sub-regional competitors. In addition, the revenue of the governments was affected by the losses in income result of the abolition of tariffs. The sub-region was also under external pressure due to the US dissatisfaction towards the inner-looking economic policies in place, cutting the investment needed to establish the new factories required. Moreover, El Salvador and Honduras entered into a war in 1969 following the eviction of thousands of Salvadoran illegal immigrants from Honduras. Internal instability affected some of the member countries (i.e., Nicaragua and El Salvador) generating with it further tensions among participant nations.

Economic factors such as the 1980s oil crisis, the external international debt crisis, local currency devaluations and civil wars, caused further disruptions leading the process into deep stagnation.

CACM was influential in the region as “it awoke great expectations regarding the potential of Latin American integration.” After long periods of decline, CACM managed to survive reviving through the creation of the Central American Integration System (SICA) in 1991. The Protocol of Tegucigalpa introduced a modern approach to the central American integration setting up a new institutional framework, giving to SICA juridical identity under international law and establishing the conditions for the creation of a Free Trade Area, a Customs Union and the promotion of further integration.

2. Latin American Free Trade Association (LAFTA)

Central America’s integrationist example later inspired the February 1960 execution of the Montevideo Treaty establishing the Latin American
Free Trade Association (LAFTA).\textsuperscript{18} The main purpose of the Treaty was set out in art. 1 so as to establish a free trade area within the following twelve years.\textsuperscript{19} Based on the further negotiation of positive lists,\textsuperscript{20} it was believed that the gradual elimination of inter-regional trade barriers would speed up the process of economic development of the countries involved.\textsuperscript{21} The establishment of concessions able to suit each member’s priorities would also link countries with divergent interests on the basis of effective benefit reciprocity.\textsuperscript{22} From the institutional standpoint, LAFTA’s structure comprised two central bodies: the Conference of Contracting Parties and the Standing Executive Committee, the first of which is the more relevant.

As the CACM, LAFTA was conducted within a framework of the import substitution industrialisation model.\textsuperscript{23} This policy was aimed at reducing the dependency of Latin American countries on industrialised economies. To that end, high tariffs were established to prevent the access of manufactured imports from non-members as well as participants were expected to develop their own industries. Production process would be divided across the region through production sharing arrangements. Soon local markets would become too small for the production. Therefore regional integration was required in order to allow economies of scale creating with it larger markets for regionally manufactured products.\textsuperscript{24}

However, LAFTA involved countries with diverse levels of development, size, and political interests. There were two groups of countries with dissimilar interests: on the one hand, the most industrialised countries within the area which had a clear interest in securing a wider market for their products.\textsuperscript{25} On the other, smaller and underdeveloped

\textsuperscript{18} This Treaty set up the Latin American Free Trade Association (LAFTA), signed by Argentina, Brazil, Chile, Mexico, Paraguay, Peru and Uruguay. Columbia (1961), Ecuador (1961), Venezuela (1966) and Bolivia (1967) joined in latter. See Sydney Dell, A Latin American common market?, 36 and 228, (London: Oxford University Press [for) Royal Institute of International Affairs, 1966).


\textsuperscript{20} Through the establishment of national and common list as determined in TM60, arts. 4 to 13.

\textsuperscript{21} TM60, supra, note 19, art. 3.

\textsuperscript{22} Id., arts. 10, 13.

\textsuperscript{23} See supra., note 13.


\textsuperscript{25} TM60 “was basically a mechanism for liberating trade between Argentina, Brazil and Mexico”. See also Rubens Antonio Barbosa, The Evolution of the Integration Process in South America. Introduction to MARTA HAINES FERRARI, THE MERCOSUR CODES, at xiv (BIICL 2000). See also Miguel S Wionczek, The rise and the decline of Latin America Economic Integration, IX, (1), J. COMMON MKT. STUD 49, 59 (1970).
countries focused on creating industrial development. As the promised benefits failed to reach all countries involved, the less industrialised countries of the region starting perceiving LAFTA as a disadvantageous agreement.

As result, some country members started taking actions aimed at overcoming their dissatisfaction beginning negotiations towards the conformation of sub-regional schemes which finally appeared in the late 1960s and early 1970s such as the Andean Pact, and the Caribbean Community and Common Market (CARICOM). As for the regional scheme, members adopted Resolution No. 370, which began a process of modification of the basic framework of the integration model that led to the signature of the Treaty for the creation of the Latin American Integration Association, which replaced LAFTA.

3. Latin American Integration Association (LAIA)

A new treaty was signed aimed at establishing a common market through the creation of an Area of Economic Preferences. Although it contains certain tariff and negotiation aspects, LAIA is an association not a trade regime as such. It comprises multilateral, sub-regional and bilateral systems under a single set of rules which provides a more open and flexible structure for regional integration than LAFTA. This can also be seen in the possibility it provides for non-Association members to participate partially in agreements executed with member countries.

LAIA was a reformulation of the LAFTA structure and involved different guidelines and criteria for integration. LAFTA’s legal status

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28 The Cartagena Agreement was signed in 1969 setting up the Andean Group or “Pacto Andino”, with the aim of creating a customs union. The Andean Community and the Andean Integration System started operating in 1997, when the Protocol of Trujillo (1996) started to apply. The Andean Community’s web site is http://www.comunidadandina.org, last visited July 24, 2003.

29 It is a customs union established in 1973 set up among Antigua and Bermuda, Bahamas, Barbados, Belize, Dominica, Grenada, Guyana, Haiti, Jamaica, Montserrat, St. Kitts and Nevis, Saint Lucia, St. Vincent and the Grenadines, Suriname, Trinidad and Tobago The CARICOM’s web site is http://www.cari.com, last visited Aug. 13, 2003.

30 See Abreu Bonilla and Magarifos, supra, note 2.


32 Barbosa, supra, note 25, at xv.
continues in. In terms of material changes, the instruments geared to the creation of a free trade zone were replaced by others that confer, with their different shades of intensity, regional tariff preferences, regional agreements, and partial agreements, all as possible alternatives to be applied by the signatory countries simultaneously and complementarily. This new agreement in turn emphasizes the promotion and regulation of reciprocal trade, economic complementation and co-operation, with a view to market expansion.34

LAIA also establishes differential treatment among the countries depending on their level of economic development35, foreseeing three different levels: lesser, intermediate and greater, relative development.36 Belonging to one or another level of development sets the degree of tariff preferences for the diverse products between countries.

One immediately visible highly transcendent element is that, unlike the provisions of the LAFTA Treaty, under this new structure the most-favoured-nation clause is residual, i.e., it is applied to benefits not provided for in the Treaty itself, in the Cartagena Agreement, or those deriving from cross-border traffic agreements executed by the member states.37

The same flexibility in the integration system can be seen in the mechanisms implementing trade liberalisation. To that end, member countries established an area of economic preferences, comprising a regional tariff preference, regional scope agreements, and partial scope agreements.38

As for the first of those mechanisms, regional tariff preferences constituted the multilateral tariff-reduction instrument par excellence in the framework, in a move toward global convergence of tariff barriers applicable to third-party countries. This mechanism was different from the measures previously provided for by LAFTA in the flexibility of the convergence schedule, since in no specific terms were set for this, and in the adaptability of the mechanisms for negotiation of tariff alignment, where lists of products excepted from convergence were accepted, as a

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33 See Abreu Bonilla and Magarifios, supra, note 2.
34 Id.
37 See MT80, supra, note 35, arts. 44, 45.
38 See MT80, supra, note 35, art. 4.
way of attenuating the impact of the process on more sensitive sectors. Different convergence regimes were also agreed on based on intermediate or lesser economic development of the countries in question. Nevertheless, despite all the means used to aid the gradual application of the tariff reduction, experience shows that its sphere of implementation has been very limited, the exceptions are numerous, and non-tariff barriers continue to be applied, so that the trade liberalisation attempted via this route has not been as successful as would have been desired.39

Regional scope agreements imply participation of all the signatory countries in principle to regulate trade areas, economic complementation, agriculture, trade, tourism, environment, etc.40

Partial scope agreements have been the most dynamic integration mechanisms. They include agreements signed by only some of the LAIA member countries, with the possibility of being extended to others who agree to adhere, with a view to intensifying trade relations among the signatories by reducing or eliminating tariff and non-tariff factors that hinder such relationships, reciprocally granting one another more favourable trade regimes, at least in relation to the products and/or for the quantities included. They involve an exceptional system within the LAIA framework insofar as the benefits the signatory countries grant one another are not automatically extended to the other LAIA members as they would be based on the most-favoured-nation clause that covers all LAIA members. This is in spite of the fact that their provisions fit precisely within the framework of the LAIA member countries. As regards their purpose, the partial agreements can involve economic complementation or trade or other accords, depending on the needs and interests of the parties. In principle, the possibilities are as broad as for regional agreements.41

LAIA's institutional organisation involves three bodies of a political nature called, respectively, Council of Ministers of Foreign Affairs, Evaluation and Convergence Conference, and Committee of Representatives and, together with them there is a technical body, which is the General Secretariat. The Council of Ministers is responsible for making general economic integration policy decisions, and is the most important

39 See Abreu Bonilla and Magariños, supra, note 2.
40 See MT80, supra, note 35, art. 6.
41 See MT80, supra, note 35, arts. 8 to 14.
body in LAIA’s institutional structure.  

4. **Caribbean Common Market (CARICOM)**

The hope of regional integration in the Caribbean dates back to 1958 with the establishment of the British West Indies Federation which comprised 10 islands. Even though it considered the creation of a Customs Union, during the four years of its existence the region remained economically the same. Among other achievements, the Federation promoted cooperation among the Caribbean islands through the creation of the University of the West Indies (1948) and the Regional Shipping Service (1962). At the end of the Federation in 1962, a Common Services Conference was called to decide about this process of inter-state cooperation. More importantly, in that year Jamaica and

5. Trinidad and Tobago attained their independence.

At the time, Jamaica suggested the creation of a Caribbean Community, encompassing the 10 islands of the Federation, the three Guianas and all islands of the Caribbean Sea, proposal which was discussed by several conferences of the Heads of the Governments of some of the Caribbean countries. In December 1965, Antigua, Barbados and British Guiana signed an Agreement at Dickenson Bay, Antigua to set up the Caribbean Free Trade Association (CARIFTA). Its beginning was delayed in order to allow the participation of other Commonwealth Countries and its purpose was enhanced towards the establishment of the Caribbean Common Market.

CARIFTA was aimed at uniting the economies of the Caribbean countries and at strengthening the presence of the member countries as a bloc on the international scene. The small size of its member countries, the lack of complementarity of their economies, and the limited development of their production systems were problems that the association had to confront. The agreement entered into effect in 1968 having by the end of

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42 See MT80, supra, note 35, Chapter VI, arts. 28-43.
that year Antigua, Barbados, Trinidad and Tobago and Guyana, Dominica, Grenada, St. Kitts/Nevis/Anguilla, Saint Lucia and St. Vincent, Jamaica and Montserrat as member countries. British Honduras (Belize) became a member in May 1971.\textsuperscript{46}

During 1972 and 1973, the Caribbean leaders discussed and decided to transform CARIFTA into a Common Market and to create the Caribbean Community,\textsuperscript{47} doing so by the Treaty of Chaguaramas in 1973\textsuperscript{48} which established the Caribbean Community and Common Market (CARICOM). Its objectives were defined as the promotion of trade among member countries in accordance with the rules of competition, encouragement of the balanced and progressive development of the economies of the signatory countries, implementation of trade liberalisation throughout the zone, and dismantling of pre-existing barriers.

The Treaty was signed by Barbados, Jamaica, Guyana and Trinidad & Tobago and other eight Caribbean territories which joined later on. The Bahamas became the 13th Member of the Community (1983), but not a member of the Common Market. Suriname became the 14th Member (1995). Associate Members of CARICOM are the British Virgin Islands and the Turks and Caicos (1991), Anguilla (1999), the Cayman Islands (2002), and Bermuda (2003).

\textit{S. The Andean Pact, the Andean Community and the Andean Integration System (AIS)}

The original Andean Pact was a step ahead from the regional integration efforts already in place in South America during the 1960s. The Presidents of Chile, Colombia and Venezuela, joined by representatives of the Presidents of Ecuador and Peru, met in 1966. They produced the "Declaration of Bogota" whose statements reflected the dissatisfaction of the Andean countries with LAFTA and proposed the creation of a sub-regional economic group comprising the signatory countries of that

\textsuperscript{46} See supra, note 43.
Declaration. \textsuperscript{49}

After its creation, the Andean Pact passed through different stages. An important boost in the early years, the inclusion of Venezuela in 1973 and the sudden abandonment of Chile in 1976 marked its first decade based on an inward-looking integration process proper of the import-substitution model. \textsuperscript{50} The member countries incapacity to reach agreements about policies and instruments required for the implementation of the referred model, as well as the recurrent non-compliance with the agreements already in place, rapidly affected confidence in the Pact at the end of the 1970s. \textsuperscript{51} Furthermore, unresolved political and territorial disputes among member countries (Peru-Ecuador 1977) added complexity to the already critical situation. \textsuperscript{52}

The Oil crises in the 1970s and the debt crisis in the 1980s with their consequent balance of payment problems induced a deep recession and a severe contraction in imports. \textsuperscript{53} Although the Andean Pact almost collapsed in terms of the decreasing rate of trade among member countries, important institutions such as the Andean Court of Justice and the Andean Parliament were created during this critical period, fostering the implementation of the rule of law within the sub-regional integration scheme. Certainly, the definition of the legal system of the agreement and the creation of the Court of Justice (1979) were extremely significant achievements in bringing into the process legal certainty and supranationality. The Andean Parliament (1979) was an attempt to give to the integration effort a forum for discussion of integration issues different from the other Andean bodies, which had strong governmental influence.

After a decade of stagnation the sub-regional scheme was re-launched by the Quito Protocol in 1987 establishing a new phase of the Andean Pact which would lay the foundations for advancing toward the formation of an Andean sub-regional community. Neo-liberal policies introduced in the

\textsuperscript{49} See Avery and Cochrane, supra, note 27, 88.
\textsuperscript{50} See supra, note 13.
\textsuperscript{52} See O'KEEFE, supra, note 10, at 1-10 and 1-9.
domestic context geared up to the opening of the Andean economies.\textsuperscript{54} It was also thought that the elimination of the "anti-exportation bias" inherent to the inward-oriented industrial development strategies was a means of taking the agreement to a successful end.\textsuperscript{55}

At the same time, due to the need of obtaining enough foreign reserves in order to pay back the external debt, gaining access to international markets was a crucial element, which would be guaranteed by joining multilateral agreements. In this sense, country members changed their policies toward open regionalism and started joining multilateral arrangements such as the WTO. During the 1990s all country members of the Cartagena Agreement joined the WTO and entered into an intensified integration process.\textsuperscript{56}

Between May 1989 and December 1991, the Presidents of the Andean countries convened on nine occasions\textsuperscript{57} to evaluate and try to revive the process. The impetus of the Presidents at that time ended up in the institutionalisation of the Andean Presidential Counsel, (Machu Picchu 1990).\textsuperscript{58} It was indeed one of the more important changes in the structure of Andean integration.\textsuperscript{59} This extraordinary process of about four years reached with concrete and pragmatic decisions what could not have been achieved in twenty years: a solid and efficient process toward the establishment of a Free Trade Area and the agreement on a Common External Tariff.

\textsuperscript{54} See Devlin & Estevadeordal, supra. See also ECLAC Publications, América Latina en el umbral de los años ochenta, 1979, 2a. ed., 1980. See also See O'KEEFE, supra, note 10, at 1-9.


\textsuperscript{57} See The Guide, supra, note 12.


A complete set of the documents issued in each one of the Andean Presidential summits can be found in Spanish at http://www.comunidadandina.org/cumbres/SC/Presidentes.pdf, last visited July 24, 2003.
However, the unity gained through political will and stability was altered as Peru's membership was suspended when its President, Alberto Fujimori, abrogated the Country's Constitution and closed the Courts and Congress in 1992. In addition, the political instability in Venezuela (President Carlos Andres Perez was forced to resign in 1993) affected the process. Notwithstanding these external political factors, the Andean Free Trade Area started fully operating for all countries, except from Peru, in 1993. All products were liberated. There were no lists of exceptions.

The Andean Presidents met at Trujillo Peru in March 1996 and approved the Trujillo Protocol by which introduced changes to the Cartagena Agreement. This Protocol created the Andean Community and established the Andean Integration System (AIS) in order to promote effective coordination between the different bodies and institutions (about 14) that comprise it.

The Protocol did not change the Andean Institutions already in place but constructed a single body comprising the following organs: The Andean Presidential Council (the highest-level body), the Andean Council of Ministers of Foreign Affairs, (the political leadership body), the Commission of the Andean Community (the main policy-making body), the General Secretariat of the Andean Community, (the executive body of the system), the Court of Justice of the Andean Community (the judicial body), the Andean Parliament (deliberative body), Advisory Institutions, Financial Institutions, Social Conventions and the

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64 See CA, supra, note 63, art. 7.
65 See CA, supra, note 63, Section A, arts. 11 to 14.
66 See CA, supra, note 63, section B, arts. 15 to 20.
67 See CA, supra, note 63, section C, arts. 21 to 28.
68 See CA, supra, note 63, section D, arts. 29 to 39.
69 See CA, supra, note 63, section E, arts. 40, 41.
70 See CA, supra, note 63, section F, arts. 42, 43.
71 See CA, supra, note 63, section G, art. 44.
72 See CA, supra, note 63, section H, arts. 45, 46.
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At their Eleventh meeting in Cartagena, May 1999, apart from pursuing the definition of a common foreign policy, the Andean Presidents committed to the core goal of establishing a Common Market by January 2005. Since then, the several bodies, organs and institutions of the AIS have been working to create the conditions for adding to the free circulation of goods, the unimpeded movement of services, capital, and people in the sub-region.

B. NEW DEVELOPMENTS

FTAA

I Overview

This proposed Agreement comprises all of the countries of the Americas, including the Caribbean, the US and Canada, and was an initiative by President Bush (senior) in 1994, as of the Miami Meeting of Heads of State in December 1994. It is intended to create a new economic relationship among the countries based on reciprocal treatment whose precise contents will largely depend on the results of the negotiations. The ultimate objective was to negotiate a hemispheric free trade agreement by 2005. The preparatory stage began in January 1995 and formal negotiations were launched in March-April 1998.

FTAA differs greatly from the US’s previous efforts in the hemisphere, which generally provided for a relationship where the US granted

76 See Granados, and Devlin & Estevadeordal & Garay, supra, note 5. See also Felix Arellano, “La relación entre el Multilateralismo y el Regionalismo: Algunas reflexiones sobre sus implicaciones para los países en desarrollo”, (The relationship between Multilateralism and Regionalism: Some reflections on their implications for developing countries) in Regional Meeting UNCTAD/PNUD/CEPAL with LATN assistance, Santiago de Chile, Nov. 1999.
concessions and assistance on a unilateral basis. FTAA is based on an opening up of national markets and the granting of concessions on the basis of reciprocal treatment.\textsuperscript{80}

In this context, the contents of the March 1998 joint declaration of San José, Costa Rica,\textsuperscript{81} are highly important. It clearly sets out the objectives of gradual trade liberalisation to permit fluid access to national markets, with specific mention of the areas of agriculture, rules of origin, investments, trade barriers, subsidies and antidumping measures, intellectual property rights, services, rules of competition, and dispute settlement. All of this is within the framework of the WTO rules and without prejudice to taking into account the situation of countries with very small economies.\textsuperscript{82}

2 Placement and perspectives.

FTAA is a good example of the new regionalism, in line with the foundation of a type of regional integration that diverse authors point to as generating social wellbeing (Ethier, 1998, Devlin, Estevadeordal, Garay, 1999). These common features consist of involving small countries linking much larger ones; of allowing the smallest countries to make significant reforms unilaterally; of allowing a modest degree of liberalisation under the agreement; that the objectives of the agreement are broad; and that the agreement is regional geographically.

Discussion has centred on scope and compatibility of FTAA with other agreements to which the parties are members, including the WTO, as well as coordination with intra-regional agreements such as CARICOM, NAFTA and MERCOSUR. This implies interpreting the Costa Rica declaration of March 1998, which provides that FTAA can coexist with bilateral and subregional agreements provided that the rights and obligations deriving from such agreements do not violate or go beyond the rights and obligations of FTAA.\textsuperscript{83}

FTAA is clearly an integration mechanism involving highly heterogeneous countries. This means, in view of the equality of all of its

\textsuperscript{82} See supra, note 81.
\textsuperscript{83} Id.
members, that the costs and benefits of integration can be relatively increased and their distribution may be uneven among the countries.\textsuperscript{84}

The US has pointed out FTAA's potentially positive effects for the liberalisation of hemispheric market access, especially in the market segments that go beyond the subregional agreements. We have to take into account that for most of the countries of Latin America this implies access to the US market, particularly for those items where the US has entry restrictions or quotas, and an improvement in the antidumping system. In turn, it is viewed as a mechanism for attracting direct foreign investment promoting technology transfer, modern corporate practices, and access to international export markets.

FTAA will also probably have, as all the countries involved admit, negative effects. Said effects include, on the one hand, business, sectoral and social adjustments that the national economies will experience. Although trade liberalisation will generate increased flows of trade and greater efficiency, in the process there will be microeconomic adjustments with intense social implications. Those adjustments are the consequence of the reallocation of resources. Considering the heterogeneity of the FTAA members, which include countries with very open economies, and the importance of trade as a percentage of product, it can be expected that the potential gains from the creation of a regional market will be significant, but it is also reasonable to foresee that the adjustments the opening process is likely to bring with it will also have major economic and social impacts. Another potentially negative element is the asymmetric distribution of the benefits of hemispheric trade liberalisation. Some studies suggest that trade liberalisation tends toward convergence of the richest and the poorest countries, but that even in the best of cases the process is very slow and uneven. Thus, everything else being equal, FTAA can imply the risk of some countries' reaping more of the benefits of opening their economies in the short and medium term. FTAA's potentially negative effects could also include deviation of investment and trade due to the existence of extra-zone common trade barriers, toward non-member countries. This effect, which is almost inevitable, is offset for member countries by intra-

zone trade growth, and for the rest of the world it is offset by generation of sustained economic growth. A final potential risk is that the progress on liberalisation among countries having internal structures and institutions with a very diverse degree of modernization may imply timing differences with the required internal reform processes. For example, in the financial sector, the liberalisation of financial services may imply, in countries whose financial systems are not very strong, that the reforms essential for improving regulation and oversight of those systems may be slowed down or not be as deep as necessary so that liberalisation of the sector does not produce liquidity or solvency risks for the entities operating in the country.

3. Progress

The US is currently promoting straightforward liberalisation with few exceptions. Other countries are more cautious. The US is also encouraging acceptance of concessions granted under intra-regional agreements only on aspects not included in FTAA. This position is not generally supported by the other countries. The Latin American countries will only be willing to make concessions to the extent that the US grants substantial concessions for entry of products now restricted from countries of South America, and agrees to correctly apply mechanisms to avoid trade diversion, particularly antidumping rules. These aspects are essential for the countries to obtain real benefits from accessing North American markets, and not only opening up their economies to trade flows from those markets. The process of negotiations will come to a successful end in 2005 only if and when the conflicting positions between the US and Brazil regarding highly controversial issues such as agricultural liberalisation, trade remedies, intellectual property rights, and labour and environmental standards are negotiated are lessened. As for the current negotiations status, it seems that the final outcome might present and scenario of low liberalisation where the mentioned main issues will not be included.


85 See supra, note 81.


87 See Jose Antonio Rivas-Campo & Rafael Tiago Juk Benke, "FTAA Negotiations: Short Overview", 6(3) JIEL 661-694, 2003.
II. FINANCIAL SECTOR IN LATIN AMERICA: INTERNATIONALISATION, GLOBALISATION, AND INTEGRATION

A. FINANCIAL INTERNATIONALISATION. ITS PROCESS. FACTORS.

Financial sector activities and their macroeconomic importance have grown dramatically over the last two decades. The banking industry, the sub-sector traditionally known and cared for because of its impact on national deficits, has internationalised and diversified its activities, becoming involved in capital market services, and in some cases even in insurance services. On the other hand, capital market transactions and services, of scant economic relevance in the 1970s, have become the rising star of financial sectors at the outset of the 2000s. International organisations look with the same concern at the solvency and soundness of the sector's major actors, investment and pension funds, as they do with multinational banks. Multinational corporations and conglomerates, with offices all over the world, engage in all of the financial activities and sub-sectors.\(^{33}\)

Regarding Latin American countries, this phenomenon took place mostly from 1985 onwards and during the 1990s, when most of the trends towards liberalisation were implemented. The economic environment in the region changed significantly during those years. Some of the changes have been the liberalisation of the economies, with freer and larger trade flows and fewer restrictions on capital flows, which grew enormously in volume, interest rate controls were eliminated or significantly reduced, and exchange controls were gradually dismantled. Simultaneously, the new technologies, especially in the fields of data processing and communications, enabled financial institutions to take faster action at lower cost on an international scale. All of that led to the need for new financial services to be provided in new ways, and to the adjustment in regulation of the industry. This new reality, in turn, led to deregulation, de-

monopolization, privatisation, increased competition, foreign investment and lesser entry barriers in the financial sector.\textsuperscript{89}

Furthermore, during the same period, the need to prevent financial crises also led to the development of new financial regulation and supervision following the Basle Cook rules, and lately the IOSCO and IAIS standards, with the involvement of other institutions such as the IMF and the World Bank. Most of the soundness and solvency standards set up for the financial industry by the Basle Cook Commission, IOSCO, and IAIS have been implemented in the above-mentioned countries.

In this general context, financial sector development in Latin American countries is important for different reasons. Internationally and regionally, the main concern is the solvency and soundness of each of the national financial systems, because of the systemic risk involved in financial crises. On the other hand, for each of the countries, the soundness of the financial system is crucial for macroeconomic stability. It is also important as part of the infrastructure for economic development as well as for participating in international markets. Finally, financial services have become a product in themselves, with increasing importance measured as part of the GDP.\textsuperscript{90}

National and regional policies and regulations in financial services are designed and influenced by different factors. They include some main trends - mostly coming from the international context - and actors such as domestic suppliers, national governments, multinational corporations, and international organisations (public and private). The links and connections between them are described in the following paragraphs.

1. Financial globalisation

The increase in the international activities of national financial institutions and the national markets greater interconnection - and partial integration - strengthened by technological advances and liberalisation measures taken by national regulatory authorities have converged since the mid 1980s to generate what is currently known as the globalisation of financial markets\textsuperscript{91}.

Central to this phenomenon is the flow of financial operations and

\textsuperscript{89} Id.
\textsuperscript{90} Id.
\textsuperscript{91} Id.
transactions instantly carried out between the institutions and with their clients throughout the global world, with no appreciable incidence of national, regional or continental borders.

The possibility of selling or buying securities in New York, London or any other market - whether central or peripheral - placing the order at any time or from any location the client may be in, exemplifies globalisation. And such an order may be placed by the interested party or a third party by any means of communication - be it on the telephone, the Internet or other -. The securities to be bought or sold may be issued in any market worldwide, and quotes and transactions may be made in any other market. The operation takes place according to the instructions and at the price established by the client. Another example of financial globalisation is the organisation and operation of international systems of compensation and payment among banking institutions from any market or the flow of international inter-bank placements.

There will be further enhancement of financial market expansion and interconnection over the next years. The possibilities of the globalisation phenomenon will be increased by the permanent technological developments as long as the other factors supporting it - such as market internationalisation, deregulation and integration - remain unchanged.

The globalisation of financial markets is also having an impact on South America’s and MERCOSUR’s banking activities and perspectives. On the one hand, globalisation brings benefits to consumers in any of MERCOSUR countries, clients of the different financial activity sectors, among others, easy access to the full range of banking, securities or insurance market products worldwide at an increasingly lower price, through rapid - almost instant – transactions.\footnote{\textit{Id. See also CARLOS JAVIER MOREIRO GONZALEZ, BANKING IN EUROPE AFTER 1992 (USA, 1993).}}

In the eyes of the financial entity offering the products in the South American continent, globalisation also has positive aspects as it allows greater competition, beyond national borders, accessing products and clients worldwide. The liberalisation of the circulation of goods, services and capitals may generate an increase in trade - and consequently in the product - increasing efficiency in resources and global capital allocation. With regards to the specific globalisation and interconnection of financial

\footnote{\textit{Id. supra, note 8893.}}
markets, it should be borne in mind that the possibility that many South-American countries have had to construct a modern industry was partly facilitated through better access to foreign capitals, yet it is necessary to acknowledge the need not to rely on very short-term money flows\(^93\).

On the other hand, financial globalisation also entails significant risks. First, as analysed above, globalisation deepens competition among national governments — for instance in the MERCOSUR context - that are pushed toward deregulation. Competition is geared to attracting private foreign resources for national investment and to offsetting loss of local capitals attracted by better investment opportunities abroad.

In addition and because of globalisation, the national regulations of MERCOSUR countries are no longer sufficient for each of the domestic financial systems to operate and evolve to meet the goals of national policies. Globalisation means that financial institutions (credits, sight or time deposits and investments) and their clients may opt for making transactions and operations either within or outside the national circuit. For example, it may be difficult to estimate the financial sector's contribution in terms of tax collection.\(^94\)

The interconnection of global financial markets also makes it difficult to isolate each of the MERCOSUR countries' financial system by means of national regulation to protect them against the negative impacts of the financial crises of other markets.

2. Multinational financial institutions

a. Overview

With financial globalisation and the expectation of growing integration, international financial institutions, particularly the European ones - Spanish, German and, to a lesser extent, French and Italian - as well as the US, have been developing different strategies for positioning in South America, particularly in the sphere of MERCOSUR and Mexico.\(^95\)

These corporations' penetration in Latin America has increased substantially over the last decade, bringing them to their current position\(^96\)

\(^93\) *Id.*

\(^94\) *Id.*

\(^95\) See Moreiro *supra*, note 936.

\(^96\) It improbable that said multinational banks will expand further their activities and positions in Latin America in the near future due to the political and economic turmoil going on in the continent, i.e. Venezuela, Colombia, Brazil and Argentina.
and as a natural development of their involvement in this Continent, they are increasingly playing an important role as pressure groups in connection with national regulations in financial activities.

The most easily identifiable aspect of the strategies these institutions are developing is the markets they have begun to approach as points of penetration. Another aspect, not as easy to see, is linked to the products they offer in those markets, basically choosing between personal banking or corporate or wholesale banking, capital market and or insurance services.

Of the possible approaches, the factor to be observed, first with the European banks and later with the American banks, is the generation of diverse linkages with other institutions. Generally speaking, we do not see new branches being established in a “green fields” system. We do find mergers and acquisitions, in which stronger institutions absorb smaller entities, or the allying of very powerful institutions that pool resources.97

b. Specific Instances:

i) German corporations

An interesting example is that of Deutsche Bank, which first extended throughout Europe, and later to diverse centres including, for the purposes of our analysis, a significant increase in its operating centres in South America. Deutsche Bank has a local presence, and in some cases even several branches, in Argentina, Brazil, Mexico and Uruguay.98

Another German bank that has been positioning itself strongly on this continent is the Dresdner Bank, which has opened branches in all the countries whose systems we have analysed in this paper.99 The Dresdner Bank has a significant presence in Brazil Argentina and Mexico, and has also set up business in Chile, Paraguay and Uruguay.

German banks, whose presence in Latin America goes back a good number of years, especially in Uruguay, Argentina and Chile, has strengthened its strategy of local establishment since the late 1980s. This trend coincided with the strengthening of the European Union and the fall of the Berlin wall, and the consequent liberalisation of Eastern Europe.

97 See supra, note 9388 and Moreiro, supra, note 938.
98 See supra, note 8893.
99 Id.
Over the last years, the German multinational financial institutions’ policy regarding their positioning in South America shifted somewhat, due to the capital needs arising from their new business opportunities in Eastern Europe countries. The German presence in the Southern Cone of South America was sufficiently significant at some point to justify local establishment, specifically in Buenos Aires, of an office of the Bundesbank (which was subsequently shut down in 2000).\textsuperscript{100}

ii)b. Spanish corporations

In recent years, especially in the last half of the past decade, Spanish banks have made major efforts to strengthen their positioning in South America\textsuperscript{101}. Banco Bilbao Vizcaya and Banco de Santander have been particularly keen on this strategy. Banco de Santander launched its penetration strategy first, with its presence in Chile and Uruguay, and later extended to Argentina and, finally, Brazil. It has also set up in Mexico. Banco Bilbao Vizcaya has developed its continental position somewhat later than Banco de Santander, and has set up in Argentina, Chile, Brazil and Mexico. In both cases, presence in Mexico (as a consequence of the 1995 crisis) and Brazil (only very recently) has been possible as of the national governments’ permitting foreign capital in local banking, as a way of aiding and strengthening it.\textsuperscript{102}

Obviously, some of these movements are a direct consequence of the alliances and business carried out between institutional headquarters.

iii)c. Other European institutions

The same is true in the case of ABN Amro and Banco Real, where part of their activities in South America is a result of the merger of the headquarters. ABN Amro is present in all of the countries we analysed, except Paraguay\textsuperscript{103}.

Other European banks with a clear presence in Latin America are HSBC Banco Roberts (English), and Lloyds Bank (English), which has not set up business in Mexico.

\textsuperscript{100} Id.
\textsuperscript{101} Id.
\textsuperscript{102} Id.
\textsuperscript{103} Id.
iv) d. American corporations

USA multinational corporations also are also well positioned in Latin America and were present in some cases even prior to the 1970s. Institutions like Citibank and Citicorp, Chase Manhattan Bank, Republic Bank, BankBoston, American Express Bank, or Bank of America have established themselves in several or all the countries under analysis. Citibank and lately Citicorp, for example, have a presence in all of the countries, in some cases with several branches in different cities, like in Brazil. It is also the only US bank established in Paraguay. BankBoston has branches in all the countries, except Paraguay. Interestingly, the largest number of US banks are concentrated in Mexico and then, to a lesser extent, Argentina, and less still in Brazil and, finally, in the rest of the countries. In Mexico, and somewhat in Argentina, we find the presence of US banks that generally do not cross borders, like Bank One or California Commerce Bank (only in Mexico), and even Credit Suisse First Boston.  

v) e. Others

Asian presence is more fragmented on this continent, and is primarily Japanese. It is clearly concentrated in Mexico and a bit less so in Brazil. There are some Oriental institutions in Chile. Examples are Dai-Ichi Kangyo Bank Limited, Japan Bank for International Cooperation, The Industrial Bank of Japan Ltd., The Sumitomo Bank Ltd., Tokai Bank and Tokai Bank of California, and the Bank of Tokyo-Mitsubishi Ltd.

3. International organisations

International organisations working in the area of Latin American financial services regulation seek to influence national governments in two major ways. On the one hand, they encourage the strengthening of the standards required for developing each of the sub-sectors’ activities: banking, capital markets and insurances. On the other hand, they foster the liberalisation and opening up to foreign investment and competition in these sectors. The relations and negotiations between international organisations such as the B.I.S., I.O.S.C.O. and I.A.I.S. or I.M.F., WB, and IDB, and national agencies are generally conducted directly at the level of

104 Id.
105 Id.
the regulatory agency (such as Banking Regulator, Central Bank, Insurance Supervisory Agency etc.), with some participation of the Ministry of Economy. Negotiations with other international forums, such as WTO, MERCOSUR, etc., are conducted mostly with participation of the Ministries of Foreign Affairs and the Ministries of Economy. Thus, the influence of national foreign policy issues is relative, allowing more room for achieving the trends promoted by the international organisations.\textsuperscript{106}

As the financial sector has become one of the central sectors and a target in the new internationalized and globalized economy, the strengthening of its solvency and, at the same time, its liberalisation have become the major trends in developed countries in the international context.

Many of the developed countries have repeatedly expressed their concern over the sector's soundness in the emerging economies, in view of the increasing risk of a systemic crisis due to the internationalisation and globalisation of the industry. But even so, liberalisation was seen as the main way to achieve access by multinational companies to the emerging markets, and to increase competition in the sector.

There are many international organisations involved in the regulation of each of the financial sub-sectors, such as the Basle Cook CommissionBasle Committee for the banking sector, or the International Organisation of Securities Commissions( IOSCO), COSRA (Latin American Securities Commissions), and FIABV (Federación Iberoamericana de Bolsas de Valores) for capital markets. For the insurance sector, the main organisation is the International Association of Insurance Supervisors (IAIS). Their recommendations and standards have increasingly been taken into account and followed by the international financial organisations that in turn, have strongly influenced their implementation all over South America.

Regarding the banking sector, the Basle Cook CommissionBasle Committee has achieved important results concerning the strengthening of the prudential rules for international entities over the past two decades, and has become a very influential organisation in this matter. This Committee was organized in 1975 under B.I.S support as a result of

\textsuperscript{106} Id.
the Herstatt bank crisis in Germany. Its members are the bank regulators for the G11 countries and Luxemburg. In operating terms, each G-10 member country has two representatives in the Committeeession, one of its Central Bank and another of the banking supervision authority. The representatives meet three or four times a year. The Committeeession is basically an advisory body whose recommendations require the unanimous agreement of all members.

Its goals are to foster cooperation through its members in banking supervision, to aid in the convergence of banking regulation, setting rules (soft law) for banking activities, particularly for international banks. Those rules refer to prudential standards, capital adequacy standards, bank supervision guidelines and responsibilities, supervision for financial conglomerates, accounting standards and transparency of information.

Over the decades, the rules established by the Basle-Cook Committeeession have become the main banking industry standards worldwide. They have been adopted as national regulations by all the developed countries and lately by many South American countries. In this latter case, they not only resulted from the evolution of national governments, but they have also been promoted by other international organisations such as the International Monetary Fund, the World Bank and the Inter-American Development Bank. Let us bear in mind that all the above international organisations, as well as the Basle-Cook Committeeession, carry out many training activities aimed at technicians in the Central Banks or banking and financial supervisory agencies in the developed countries and in South America in addition to their specific goals related to assistance to the different National States. Such seminars and lectures promote the adoption of standards and regulations governing banking activities in force in the most developed countries and those recommended by the Basle-Cook Committeeession. It is also interesting to point out that the guidelines and regulations recommended by all these organisations concerning financial areas are very similar, consequently the incidence of the

108 Id.
109 See supra, note 8893.
guidelines they promote for national regulation is clearly on the increase.\textsuperscript{110}

4. Domestic suppliers (private and public)

The composition of the financial systems in the countries studied has varied substantially in recent years, especially during the last half of the 1990s.\textsuperscript{111}

In the case of the banking industry, fundamental changes have consisted of a decrease in strictly domestic (private and public) banks in each of the countries, a trend toward concentration in the sector as a result of mergers and takeovers of small and more fragile entities, often of a special nature, such as the development institutions, or credit institutions geared to certain sectors (for example, farm loans) and greater relative participation of foreign banks.

Diverse factors account for these changes.\textsuperscript{112} First, the toughening of prudential and solvency requirements for the sector, as an expression of national polices geared to preventing systemic financial crises, which forced domestic private institutions lacking capital to satisfy these requirements by incorporating foreign capital, accepting dissolution, or acquisition or takeover by foreign entities.\textsuperscript{113}

Another factor that fostered these changes was the privatisation of government financial institutions by many governments as a way of obtaining resources and attracting foreign investment, improving the efficiency and solvency of institutions, and decreasing government participation in the economy. For the same purposes, in the case of public entities, policies were also implemented for mergers, reorganisation, closing down inefficient branches, etc., to improve public resource management.\textsuperscript{114}

The insurance industry went through fundamental changes over the 1990s, due to de-monopolization and privatisation of state-owned insurance companies. This phenomenon took place in almost all Latin

\textsuperscript{110} Id.
\textsuperscript{111} ANDIMA, SISTEMA FINANCEIRO NO MERCOSUL. RELATORIO ECONOMICO (Brazil, 1999); Robert Cull, The Effect of Foreign Entry on Argentina’s Domestic Banking Sector, for World Bank and WTO Conference “Liberalization and Internationalization of Financial Services”, May 10, 1999.
\textsuperscript{112} See supra, note 8893 and see also Eva Holz, The Impact of Financial Crises on Regional Integration Processes: The Case of the Crisis in the Brazilian Economy (1999-2000) and MERCOSUR (Mar, 27, 1999) (paper for the Sixth Annual Conference of the International Law Review Association of Southern Methodist University, unpublished).
\textsuperscript{113} Id.
\textsuperscript{114} Id.
American countries, accounting for the strong development of the insurance sector all over the continent.\textsuperscript{115}

Finally, changes in national policies regarding foreign investment in general, and particularly for the financial sector, consistent with the opening up of the economies of the region and the growing trends toward liberalisation and economic integration, contributed to the change in the composition of national financial systems.\textsuperscript{116}

5. National governments

Over recent decades, particularly the last one, changes have been taking place in the public policies of national governments in relation to their financial systems. They consist of a trend toward opening up to foreign investment in the sector, together with the establishment of stricter solvency and liquidity requirements, and more intense prudential supervision for all institutions, both public and private.\textsuperscript{117}

The results in terms of government companies were discussed earlier. These measures have been geared to strengthening liquidity and solvency of the remaining public institutions, avoiding their having to turn to the government for financial support, and ensuring their efficient management.\textsuperscript{118}

As regards private domestic banks, government action has often encouraged or led to mechanisms tending toward the disappearance of institutions in difficult situations. Generally, those processes have tended toward other institutions, generally more than one, acquiring or absorbing the bulk of the branches, assets and personnel of troubled institutions, along with their liabilities.\textsuperscript{119}

Finally, a relevant aspect in this analysis, also related to public policies, concerns strategies commonly adopted by governments in relation to the

\textsuperscript{115} Id.
\textsuperscript{116} Id.
\textsuperscript{118} Id.
\textsuperscript{119} Id.
admission of foreign investment in the sector.\textsuperscript{120}

An initial strategy in the banking industry, which continues to be applied, has consisted of demanding that the entry of new institutions be achieved by acquisition of troubled local institutions (Brazil, Mexico). Another way has been to authorize acquisition of share packages, sometimes only minority shares, of domestic entities, especially those in trouble or the weakest. This seeks to attract foreign capital to aid in strengthening weak domestic institutions, rather than having new highly competitive banks set up in the country and cause domestic institutions to fold.\textsuperscript{121}

The insurance sector privatisation was most frequently achieved through public bids for the state-owned companies. At the same time, competition in the sector was provided by de-monopolization and deregulation of the entry barriers to the industry.\textsuperscript{122}

Finally, in some cases countries maintain discretion in granting licenses, as a policy for controlling market entry of new foreign institutions. These policies are often based on the need to protect domestic entities from foreign competition, by ensuring a gradual opening up of the sector. Authorization is granted first to institutions whose range of activities generates lower costs and difficulties for adaptation by local institutions, or licenses are granted to entities operating in sectors where there are few or no local institutions providing services, etc.\textsuperscript{123}

6. Competition regulation

Most Latin American countries have introduced new competition regulation following the US or the European Union model. In many cases, the introduction of competition regulation was based not only on levelling the playing field but also on market transparency and consumer protection. Therefore, consumer protection regulation was approved almost simultaneously with new regulation on competition.\textsuperscript{124}

Even so, consumer protection in financial services has not been fully achieved in Latin American countries. The application of the pertinent regulations to financial sectors varies significantly from one country to the

\textsuperscript{120} Id.
\textsuperscript{121} Id.
\textsuperscript{122} Id.
\textsuperscript{123} Id.
\textsuperscript{124} See supra. note 117.
other. The Brazilian Consumer Protection Code and Mexican legislation may be the strongest regulations in this field, but they focus mainly on credit operations, minimum information to be provided to consumers, interest rate information, and prohibition of certain contractual provisions, in order to protect consumers. For insurance service consumers, general contract clause restrictions are applicable. There is no specific provision for consumer protection in other banking or capital market services in Brazil’s Code, when the consumer is the investor. In Mexico, Argentina and Uruguay, investor protection in capital markets is regulated by their respective Securities and Capital Market regulation. Argentina’s consumer protection regulation has been improved lately (1998-99).

The experience in South American countries, especially in regard to banking and insurance sectors, is that it is hard to bring those industries in line with a more competitive environment. In the banking sector, the privatised banks – which in many cases also developed monopolized activities such as mortgage banking, development banking, and others – have become very strong institutions. They usually keep some privileges at least for a period of time. All the state-owned companies and administrations continue to be their clients, and they have strong connections with regulators. All of these companies are very influential, and they try to keep their competitive advantage. Therefore, they normally play against the full application of the competition regulation. This explains why it might take longer than expected to have a fully competitive environment in the financial sector of Latin American countries.\textsuperscript{125}

7. Privatisation and competition in Latin American financial industries

Privatisation in the banking industry was frequently accompanied by the admittance of foreign investment in the sector. For instance, in Brazilian state-owned banks’ public bids, most of the consortia submitting bids consisted of multinational conglomerates. In Argentina, the privatisation of regional state-owned banks (only two main regional banks were not privatised: Banco de la Provincia de Buenos Aires and Banco de la Provincia de Córdoba) was achieved in many cases through the admittance of foreign ownership. Even so, privatisation of state-owned banks did not mean free admittance of foreign ownership. In many cases, there continue
to be strict restrictions on foreign investment in the banking industry, with Brazil being the most obvious case. In Brazil, there is a constitutional restriction on foreign investment in the banking sector, which exceptionally may be lifted by a presidential decision. This exceptional regime was applied for the acquisition of troubled local institutions by foreign investors. Brazil has already privatized 8 regional state-owned banks; and through different mechanisms it is expected that of the 35 regional state-owned banks only 11 are going to be left by the end of this year. Mexico and Argentina, instead, have gradually completely opened up to foreign investment in banking entities. Foreign ownership of banks is admitted up to 100%. In Chile there is only one state-owned bank left.

B. MERCOSUR COUNTRIES FINANCIAL INTEGRATION IN THE WTO

GENERAL AGREEMENT ON TRADE IN SERVICES (GATS)

1. Overview

This Agreement, under the WTO framework, is the first to establish legally enforceable rights in trade in services. Its outline came out of the 1994 Marrakech negotiations, at the end of the Uruguay Round. It was revised and improved in 1995 and 1997, and the final agreement was signed on December 12, 1997. It includes the commitment to engage in periodic negotiations to continue liberalizing services. 56 programs for commitments assumed by 70 member countries—South American countries are part of said programs—are included, as an attachment, in the 5th GATS Protocol, which was open for ratification until January 29, 1999. Ninety-six countries took on the commitments.

Under the agreement, services are not subject to the payment of duties or other general protection mechanisms.

GATS covers all private and public sector services, except those governments provide in exercising their authority. It includes the principle

of national treatment, i.e., non-discrimination in favour of national suppliers. It also incorporates the most-favoured-nation principle, which means no discrimination between and toward the members of the Agreement.\textsuperscript{128}

It establishes certain exceptions to these principles. For example, governments can choose the services for which they adopt market access and national treatment commitments; they can limit the degree of market access and national treatment; and they can establish exceptions to the most-favoured-nation obligation for up to ten years, or give some countries more favourable treatment than the rest.

GATS rules and approach for the liberalisation of services, specifically financial services, are of importance in our study as they have strongly influenced MERCOSUR’s own solutions regarding service integration in general, as well as banking services.\textsuperscript{129}

2. Financial services

a. Presentation and content

Financial services include banking, insurance and capital market services.

GATS establishes two large categories of services: insurance and related services, and banking and other financial services. Insurance services include reinsurance, insurance brokerage and intermediation, and insurance consultant services. Banking services cover traditional banking services like deposits and loans, payments, transfers, etc. Non-banking financial services include currency arbitration, transactions involving foreign exchange, securities, derivatives, pre-financing of issues, administration of assets and investments, and liquidation, payment, advisory and related services.\textsuperscript{130}

The objectives of financial services liberalisation are to improve the possibilities for companies to compete in different markets and enter new countries, and to provide more capital and financial infrastructure for developing countries.

\textsuperscript{128} See generally \textit{supra}, note 12631.
\textsuperscript{129} General Agreement in Services (Anex 1B). Financial Services Decision; see generally \textit{supra}, note 12631.
\textsuperscript{130} Id.
At the same time, this must be done without detriment to financial system stability, which continues to be a main concern for governments. Thus, governments can establish safeguard measures to avoid crises provoked by financial institution problems or failures.

A GATS Attachment takes into account specific features of financial services. It explains the need for governments to apply efficient monetary policies, provide prudential regulation, and protect investors and depositors, including as regards confidentiality. Governments can adopt precautionary measures regarding these aspects. Eighty-two countries, including the 12 European Union countries, included financial services on their lists or tables of commitments to open up services markets, in 1993 at the end of the Uruguay Round. Since the negotiations were not concluded, it was resolved to continue negotiating until June 30, 1995, to improve the commitments to open markets. Finally, the US reached the conclusion that many of its important trading partners' offers were insufficient, and it resolved not to apply the most-favoured-nation principle to those accessing the US market for the first time.

Finally, 29 participants (counting the EU as a single participant, and including all MERCOSUR countries) agreed to sign the Protocol and to submit revised tables of market access commitments. Some also submitted lists of commitments or most-favoured-nation exemptions.

In general, the commitments imply that a larger number of foreign banking, insurance and securities dealers will be allowed to undertake activities in other countries. Conditions can be established and the number of entities gaining market access can be limited. Moreover, in these three areas of activities, cross-border services are permitted, i.e., a company in one country can provide services to customers located in another country. Companies already established in a foreign country will be allowed to offer a broader gamut of services. In some instances the commitments imply increasing the number of new licenses for foreign institutions, or levels of foreign participation in the capital of banking, insurance or other financial companies; liberalisation of nationality or residence requirements for directors of financial concerns; and participation of foreign companies in asset management, payment and compensation services. Nevertheless, as

131 Id.
132 See supra, note 12631.
we will appreciate immediately, liberalisation offers and commitments undertaken by MERCOSUR countries were of scant relevance.

b. Liberalisation. Evolution and progress

B. LIBERALISATION. EVOLUTION AND PROGRESS.

From the economic standpoint, trade in financial services, like the rest of trade in goods and services, can have major positive effects on entry and growth on both sides of the business. Liberalisation can generate more efficiency and competitiveness, while simultaneously improving financial service management. It also helps to improve service quality, leads to transfers of technology and knowledge, and reduces the possibilities of systemic crises in small markets. It also improves allocation and placement of resources. Specifically, the GATS Agreement limits discrimination, insofar as most-favoured-nation treatment causes the most efficient supplier to win market share. It makes it possible to negotiate concessions in one area against liberalisation in other areas of foreign markets. It provides a neutral forum for dispute settlement and enforcement. It guarantees market access, thereby making liberalisation a reality. And finally, it provides a systematic mechanism for negotiating further liberalisation.

While the GATS rules are based on the same principles applied to trade in goods, some limitations make them weaker. The basic obligations deriving from the agreement are transparency and application of the most-favoured-nation principle. But national treatment is not automatic, and instead is a negotiable right, and the most-favoured-nation principle allows for reservations. Also exempted from the basic rules are measures adopted for prudential purposes. The degree of financial sector liberalisation depends on the extent and nature of the specific sectoral commitments assumed by the member countries individually. The main clauses refer to market access, national treatment, and other commitments. These provisions are applied only to sectors explicitly included in the timetable.

133 General Agreement in Services (Annex 1B). Financial Services Decision; See generally supra, note 12631.
134 See supra, note 12631.
135 General Agreement in Services (Annex 1B). Financial Services Decision; See generally supra, note 12631.
The agreement also allows for progressive liberalisation, reflecting the collective feeling that part of the liberalisation will be gradual.\textsuperscript{136} GATS establishes four different forms of market access liberalisation.\textsuperscript{137} The first is cross-border services, analogous to what is seen in trade in goods, implying that consumers in one country can acquire financial services from foreign banks or obtain insurance from firms established in another. The second refers to consumption abroad, whereby one country allows movement of consumers to the territory of the supplier. The third is the commercial presence of a service provider from one country in the territory of another. Finally, the fourth form is the supply of services through the physical presence of individuals from one country in the territory of another.

National treatment is defined as treatment no less favourable that that given to analogous domestic institutions. As opposed to the GATT approach, the member countries can establish limitations on national treatment in their programs and regarding any of the four forms of supply. GATS also allows member countries to negotiate additional commitments regarding qualifications, standards and requirements for licenses, among others.\textsuperscript{138}

In 1997, an in-depth WTO study based on information available prior to the final 1997 agreement found that member countries granted broader commitments in their financial sectors than in any other sector except tourism. Despite this, the number of limitations and restrictions maintained on market access or national treatment is higher than in other sectors, and the degree of commitments varies substantially according to the countries and the different financial sub-sectors. Nevertheless, in general, governments appear to prefer commercial presence over cross-border supply.

Basically, the WTO study concludes that developed countries have made more comprehensive commitments than the rest (except some cases in Africa). As in most of emerging economies, in the case of MERCOSUR countries restrictions were mainly focused in the banking sector and other financial services. And the real centre of the limitations was on installation

\textsuperscript{136} General Agreement in Services (Annex 1B). Financial Services Decision; See generally supra, note 12631.

\textsuperscript{137} General Agreement in Services (Annex 1B). Financial Services Decision.

\textsuperscript{138} General Agreement in Services (Annex 1B). Financial Services Decision; See generally supra, note 12631.
and presence of entities in WTO member countries other than that of their original authorization (form 3 of liberalisation). In contrast, fewer restrictions were placed on forms 1 and 2 of liberalisation, but at the same time, no commitments were made on same. As regards restrictions on the presence of entities in countries other than that of their original authorization, in MERCOSUR countries residency requirements are approximately equal to entity ownership requirements.

It is interesting that, in the case of MERCOSUR countries, the GATS had no impact on growth of competition through new entries to markets. However, it might have had some influence – as a means to resolve or avoid an economic or financial crisis - on authorization of entry of foreign participation in the share capital of existing financial institutions, while simultaneously protecting the position of the latter. In some cases, the option may have been politically guided to encourage entry of foreign capital as an injection for weakened domestic industry, rather than new competition.139

In MERCOSUR countries, in some cases (mostly concentrated in Brazil) there are high restrictions on participation in capital of financial entities, and in all of them there is discretionary granting of licenses for new institutions.

Domestic factors play a significant role in determining the commitments countries take on in the case of MERCOSUR countries. For example, macroeconomic policy elements have slowed down liberalisation, just as the need to protect domestic actors has implied strong limitations on commitments. Also, as regards the commercial presence in countries other than that of the original authorization, only Brazil maintains severe limits and requirements regarding admittance of foreign ownership of financial entities. Restrictions in the case of Brazil are explained by the fact that the country wants foreign capital mostly when it is needed to help strengthen weak domestic institutions, and does not allow the establishment of highly competitive new banks or insurance companies that could wipe out national institutions. Yet there are costs associated with direct foreign investments if competition is restricted, whereas if that investment sets up solely because the profitability of the investment is raised artificially by restrictions on competition, then the cost for the receiving country can

139 See generally supra, note 12631.
exceed the benefits. Other MERCOSUR countries, i.e. Argentina, opened up much more freely to foreign investment in the sector. In Argentina foreign participation has been viewed not only as a vehicle for transfer of technology and know-how, as well as management skills, but also as the best way - due to strong competition - to force major decisions on domestic institutions, obliging them to choose between obtaining new sources of capital and investment, or merging or getting out of business.

Discretionary granting of licenses, which were - and to some degree continue being - the common rule in MERCOSUR, have been highlighted as a way to avoid setting clear rules. This is possibly geared to protecting domestic entities from foreign competition. Yet the cost of these restrictions in the opportunity cost of lower foreign investment and in the lack of clarity in the rules and of efficiency on the domestic market, can be high.

31. Specific commitments of Argentina, Brazil, Chile, Paraguay, Uruguay and Mexico. 140

As I mentioned, each WTO member country must make a list of commitments, including the financial services for which market access and national treatment rules under GATS will be applied. They must also indicate any limitations.

Commitments can involve not including any limitation on forms of supply (that is, cross-border, consumption abroad, commercial presence, and physical presence of individuals), or not consolidating any commitment, which means that while the country does not limit the particular sector it does not commit to not doing so, or provide for limitations. 141

Commitments can be of two types, either horizontal, applicable to all sectors included on the list, or specific for certain services or activities.

In general countries divide financial services into insurance services, and banking and other financial services. Only Chile provides for a specific securities services sector.

Following the above general considerations, a comparative description is made of the specific commitments of the financial services sector.

140 WTO legal texts and agreements; GATS agreement and annexes, specific countries commitments.
141 Id.
undertaken by the MERCOSUR and some other Latin American countries based on the forms of supply:

a. Insurance services

2. **Insurance services**.

Cross-border supply and foreign consumption have not been consolidated by any of the countries.

Commercial presence is the only form of supply limited by all the countries. Brazil, Chile and Uruguay require insurance companies to be organized as corporations in the respective countries, and to be authorized by the competent authorities. Argentina has suspended authorizations for establishment of new entities. Mexico limits participation of foreign investment in institutions to a percentage ensuring control by Mexican investors.

The physical presence of individuals has not been consolidated in any of the countries, except as indicated in horizontal commitments, which in general define categories of executive employees.

b. Banking services and other financial services

3. **Banking services and other financial services**

Uruguay is the only country that does not limit cross-border supply. Brazil, Chile, Mexico and Argentina have not consolidated on this form of supply.

Uruguay is also the only country that does not limit foreign consumption. Brazil, Chile, Mexico and Argentina have not consolidated regarding this form of supply.

Argentina is the only country that does not limit commercial presence. In Uruguay, Brazil and Chile financial institutions seeking to set up business must be organized as corporations. Mexico limits foreign investment in order to maintain Mexican investor control. For companies established abroad to set up branches or agencies in Uruguay, their bylaws or regulations must not prohibit Uruguayan citizens from being part of their management, administration, board of directors or similar posts.
within Uruguayan territory. Additionally, Uruguay puts quantitative limits on commercial presence, insofar as the number of authorizations granted annually cannot exceed 10% of the institutions existing in the immediately preceding year.

Brazil only authorizes commercial presence based on reciprocal treatment in the country of origin of the institution or if the investment is of special interest to the Government of Brazil.

Chile requires foreign financial institutions to pay in the capital established by law. It also limits shareholdings, both for nationals and foreigners, to ten percent of the institution's capital. Larger participation requires authorization.

The physical presence of individuals has not been consolidated by any of the countries except as indicated in the horizontal commitments.
CHAPTER II

MERCOSUR. GENERAL

This chapter describes and analyses general aspects of MERCOSUR, as structured by the Asuncion Treaty and complementary Protocols. It includes, in Section I, a summary and commentary on general provisions regarding trade liberalisation and the circulation of services. It also contains a description on the dispute settlement system, on the MERCOSUR institutional structure, and on legal sources and legislative harmonisation by the Party States in view of facilitating the integration process. Section II evaluates the general solutions adopted for MERCOSUR regarding trade liberalisation and progress made in this field, the institutional solutions designed and implemented and their limitations, and the dispute settlement system and its difficulties. Both aspects, the general vision of MERCOSUR and the primary evaluation of mechanisms adopted for its operation, will enable us to locate and better appreciate provisions and instruments especially incorporated for the area of financial services.

I. MERCOSUR AGREEMENTS.

A. IN GENERAL

It is unquestionable that the signature of the Asuncion Treaty establishing MERCOSUR was preceded by a process of Argentine-Brazilian integration, and simultaneously by a tightening of the relationship between the two of them and Uruguay.142

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Following reestablishment of democracy in Argentina and Brazil a series of meetings began to be held and diverse declarations and conventions were signed between the two countries, marking a clear trend toward strengthening of the links between them.\textsuperscript{143} An example of this was the creation of the Joint (Argentine-Brazilian) High Level Commission for Integration on November 30, 1985; the Program for Economic Integration and Cooperation implemented in sectoral protocols; the Argentine-Brazilian Friendship Agreement of December 10, 1985; the Argentine-Brazilian Integration and Cooperation Treaty of November 29, 1988, etc.\textsuperscript{144}

As mentioned, simultaneously with this integration process the two countries stepped up their relationships with Uruguay. An example of this is Uruguay's incorporation, in the Alvorada pact of April 7, 1988, in the Protocol on ground transportation of the Argentine-Brazilian economic integration and cooperation program, as well as the Meeting of Ministers of Foreign Affairs and Economy held on August 1, 1990.

The parties' desire to establish MERCOSUR formally\textsuperscript{145} became a reality in the Asunción Treaty, signed by Argentina, Brazil, Uruguay and Paraguay on March 26, 1991, which provided for establishment of a common market that would be launched on December 31, 1994.\textsuperscript{146} The Asunción Treaty went into effect on November 29, 1991, and on that same day was filed with ALADILAIA as Partial Scope Economic Complementation Agreement No. 18.

This first agreement for formation of a common market was supplemented by a second document, the Brasilia Protocol, signed on December 17, 1991, and was followed by a third document, the Ouro Preto Additional Protocol signed on December 17, 1994 in compliance with section 18 of the Asunción Treaty. Subsequently the parties signed the Montevideo Protocol on integration of services – including financial ones – on December 15, 1997, which for the first time posed the need to move...
toward integration of services.

This common market involves, as reaffirmed in Chapter I of the Treaty, the free circulation of goods, services and capital. It provides for elimination of customs tariffs, non-tariff barriers, and any other measures having an equivalent effect of restricting circulation of goods; establishment of a common external tariff, and adoption of a common trade policy in relation to countries who are not signatories of the Treaty.147

In order to ensure the system of free competition among the signatory countries, the latter are to coordinate their respective macroeconomic and sectoral policies in the areas of foreign trade, agriculture, industry, tax and monetary regimes, exchange rates, and circulation of capital, services, customs, transportation, communications and others as necessary for such purposes.

Another medullar element148 for the establishment of the common market is the commitment taken on by the signatory countries to harmonize their internal legislations in the relevant areas with a view to strengthening the integration process.

As a general principle, the Treaty establishes that the common market shall be based on reciprocity of rights and obligations among the MERCOSUR member states.149

Several of the Treaty's provisions are devoted to explaining the system of trade relationships that the signatory countries must adopt following signature thereof.

On the one hand, the countries agree to ensure equal commercial terms in their relations with third party countries. For this purpose they will adopt the measures necessary so that their internal legislation restricts imports involving subsidies or dumping or any analogous trade practice. Simultaneously, the signatory countries will coordinate their respective internal policies in order to establish common rules on trade competition.150

The general system for relations with third party countries is built up by

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147 Id. art. 1.
148 Id. art. 1 (final paragraph).
149 Id. art. 2.
150 Id. art. 4.
several provisions of the Treaty. First, by the most-favoured-nation clause which states that the MERCOSUR signatories reciprocally grant one another, covering all advantages, favours, exceptions, immunities or privileges granted to products originating in or destined to third party countries who are not ALADILAIA members. Secondly, by the commitment of the MERCOSUR member countries to not affect the interests of the other signatory countries in any trade negotiation they may be involved in through December 31, 1994, or the interests of the said signatory countries by any other mechanism. Thirdly, to not cause prejudice to the purpose of the establishment of the common market in any agreement they may reach with other ALADILAIA member countries during the transition period which we shall refer to further on; and to consult with one another in relation to any negotiation relative to tariff reductions for the formation of free trade zones with other ALADILAIA member countries.

Goods originating in any of the signatory countries shall have, for the purposes of taxes, charges or other internal assessments, in each of the member countries into which such goods are imported, the same treatment as goods produced or manufactured domestically.

For the transition period (it should be remembered that the Asunción Treaty is primarily programmatic and geared to forming a common market) the Asunción Treaty establishes diverse elements: the trade liberalisation program consisting of progressive, linear and automatic tariff reductions, accompanied by elimination of non-tariff barriers, and reaching the end of the transition with zero tariff levels for the tariff universe (Schedule I) and without prejudice to differential treatment as to the pace of tariff reductions for Uruguay and Paraguay; the gradual and convergent coordination of macroeconomic policies with the aforesaid elimination of trade barriers, expressly including foreign trade, agriculture, industrial, tax, monetary, exchange and capital, services, customs, transportation, communications and other policies established to ensure appropriate conditions of competition between the States; adoption of a common external tariff that encourages foreign competitiveness of the MERCOSUR members; and adoption of sectoral agreements to improve efficient use of

151 Id. art. 8, point d) for most-favoured nation clause; points a) to d) for other clauses.
152 Id. art. 7.
production factors by application of economies of scale.\(^{153}\)

The organic structure for the transition period will be the responsibility of the Common Market Council and the Common Market Group.\(^{154}\) Both bodies are political rather than diplomatic-technical, and fields of competence are not differentiated in the text of the Treaty. They are, however, clearly distinguished in terms of hierarchy, since the Council is unquestionably the higher-ranking body and the Group is the executive body subordinated to the Council. There are no provisions for relationship between them.

In regard to services, as mentioned above, services integration was addressed specifically in the Montevideo Protocol, which was signed by the MERCOSUR countries the 15\(^{th}\) of December 1997 (DEC 13/97 of the CMC). This Protocol set up the general framework for the liberalisation of services circulation process, including financial services, in MERCOSUR countries. Later, the Council of the Common Market Decision No.9/98 (dated 23.7.98) approved the Sectoral Attachments to the Montevideo Protocol, including the attachment on financial services and the MERCOSUR countries initial lists of specific commitments.

**B. DISPUTE SETTLEMENT**

Under the Asunciòn Treaty\(^{155}\) the parties approved the Brasilia Protocol on December 17, 1991, which covered – as well as later the Olivos Protocol - which covers the regime applicable to disputes arising between MERCOSUR Party States as to interpretation and application of the provisions of the agreements constituting the integration framework, and any claims brought by individuals or legal entities as of implementation by any of the signatories of measures whose restrictive effects are in violation of the Asunciòn Treaty.\(^{156}\)

In six chapters, it provides for four instances, with dispute settlement procedures for each. In addition to the measures already provided in the

\(^{153}\) Id. arts. 1, 5.

\(^{154}\) Id. art. 9.

\(^{155}\) Id. art. 3 of Schedule III. It stipulated that within 120 days of effectiveness of the Treaty a transitory dispute settlement system could be established to replace the one provided for in the same Schedule III.

Asunción Treaty itself, such as direct negotiations of the parties involved and intervention of the Common Market group, the Protocol adds the possibility of arbitration (through an ad hoc tribunal, that is, established specifically for each conflict\textsuperscript{157}), as well as the possibility of using a fast track mechanism for claims brought by private parties. Thus, the Brasilia Protocol does not create a court of justice for MERCOSUR, but instead provides only for ad hoc arbitration tribunals. The parties, however, recognize the obligatory jurisdiction of the arbitration tribunal and agree to comply with its decisions. This solution, as will be observed shortly, can only be modified prior to definitive formation of the Common Market\textsuperscript{158}.

Before completion of the Common External Tariff convergence process the signatory States shall review the dispute settlement system in order to define and adopt the permanent system\textsuperscript{159}.

Subsequently, Chapter VI of the Ouro Preto Protocol signed on December 17, 1994 specifies that any controversies arising among the signatory countries as to interpretation, application or non-compliance with the provisions of the Asunción Treaty, agreements executed within its framework, Council Decisions, Group Resolutions and Trade Commission Directives shall be submitted to settlement procedures as established in the Brasilia Protocol.

The specific aspects of the dispute settlement procedure provided for in the Brasilia Protocol are regulated in Common Market Council Decision No. 17/98. It provides the mechanisms for initiating the dispute settlement procedures and distinguishes between cases where same are activated by a Party State or by a private party, computation of terms, involvement of experts when required, system and terms for appointment of arbitrators, and the declarations and obligations the arbitrators must take on upon accepting the assignment. It also provides rules for the proceedings of the arbitral tribunal and the contents of the arbitration award.\textsuperscript{160}

\textsuperscript{157} Id. art. 8.
\textsuperscript{159} Id. See also AT1991 supra, note 151 at Schedule III item 3. Also BP1991 supra, note 161 art. 34.
\textsuperscript{160} An additional comment should be made on the role that can be played by the Trade Commission regarding dispute settlement. In principle, art. 16 of the OPP1994 tasks the Commission with taking up claims submitted by the National Arts. of the Trade Commission originating in signatory countries or in claims by private parties relative to the situations referred to in arts. 1 and 25 of the BP1991 (conflicts between States and claims by private parties, respectively). That is to say, that the Trade Commission's functions include...
Finally, to conclude this introduction to the dispute settlement system under MERCOSUR, we must mention that in the year 2000, by Common Market Council Decision No. 25/00 on perfecting of the dispute settlement system of the Brasilia Protocol, the regime was subject to review for the first time. That Decision, within the framework of the set of Decisions for Re-launching of MERCOSUR, instructs the Common Market Group to analyse, among other issues, the perfecting of the stages of execution of awards; the criteria for drawing up lists and appointment of experts and arbitrators, and the stability of the latter; alternatives for uniform interpretation of the MERCOSUR rules, and facilitation of procedures. The results and proposals deriving from this analysis were expected to be submitted to the Common Market Group by December 2001 (Common Market Decision No. 7/01). This was the first approach in the search for a better permanent system within the framework of section 44 of the Ouro Preto Protocol. It is to be noted that on 5 July, 2002, the Protocolo de Olivos was signed, establishing a procedure for solving controversies between Party States regarding the interpretation, application or compliance with the Asuncion Treaty, the different Protocols, the Common Market Council Decisions, the Common Market Group Resolutions and the Directives of the MERCOSUR Trade Commission.

C. INSTITUTIONAL STRUCTURE OF MERCOSUR

MERCOSUR's organic structure has been generated in successive acts. The original acts creating the institutional structure of MERCOSUR are the Asunción Treaty and the Ouro Preto Protocol.

1. Transitory structure

Chapter II of the Asunción Treaty provides the organisation structure required for immediate implementation of the Treaty, only to be in force...
during the transition period.\textsuperscript{163}

For the purpose of the transition period, two bodies were created: the Common Market Council and the Common Market Group.

The Council is responsible for political conduction of the organisational structure of the Treaty to ensure fulfilling of the objectives of establishment of the common market and the temporary guidelines set out for such purpose.\textsuperscript{164} It is the Agreement’s maximum body, consisting of the Ministers of Foreign Affairs and economy of each of the signatory countries. The Council’s chair rotates among the members of MERCOSUR.

The Common Market Group is the executive body of the institutional structure, and is tasked with ensuring compliance with the Treaty, adopting the necessary measures for implementing Council decisions, proposing specific measures for application of the trade liberalisation program or coordination of macroeconomic policies, and setting out work programs to move toward formation of the common market. This body is coordinated by the Ministers of Foreign Affairs of the signatory countries and consists of four official and four alternate members for each country, in representation of their respective Ministries of Foreign Affairs, Ministry of Economy and Central Bank.\textsuperscript{165}

Attachment V, in connection with coordination of macroeconomic and sectoral policies, creates ten Working Groups under the aegis and supervision of the Common Market Group, to carry out studies and provide advice on specific subjects. Groups were created for technical areas, including analysis of trade issues, customs, land and ocean transportation, energy, industrial and technology policy, etc. One of the Working Groups (Subgroup 4) has been tasked with dealing with requirements for coordination and harmonisation of tax and monetary policy relative to trade, including the circulation of capital and services and related activities, which cover banking, capital market and financial activates in general.

During the transition period the decisions of the Council and the Common Market Group shall be made by consensus, with the presence of

\textsuperscript{163} It should be kept in mind that art. 18 provides that before Dec. 31, 1994 a special meeting was to be held among the signatories for the exclusive purpose of determining the final institutional structure of the common market organization and the respective faculties of the bodies created.

\textsuperscript{164} See AT 1991 supra, note 14651 arts.10, 11.

\textsuperscript{165} The Common Market Group has an administrative secretariat (art. 15) with headquarters in Montevideo.
all signatory countries.\textsuperscript{166}

2. \textit{Definitive Structure}

On December 17, 1994 the Asunción Treaty signatory countries signed the Additional Protocol on the Institutional Structure of MERCOSUR (called the Ouro Preto Protocol), which created the definitive institutional structure for MERCOSUR.

The Protocol provides that the bodies of the structure are the Common Market Council (CMC); the Common Market Group (GMC); the MERCOSUR Trade Commission (CCM); the Economic-Social Consultative Forum (FCES); and the MERCOSUR Administrative Secretariat (SAM).\textsuperscript{167}

The MERCOSUR organisation is exclusively as derived from the Ouro Preto Protocol.\textsuperscript{168} This Protocol\textsuperscript{169} also provides the express possibility for the bodies so created to issue rules that can involve the creation of new organic structures, arising from the acts of such bodies.

The Ouro Preto Protocol\textsuperscript{170} expressly grants legal capacity to MERCOSUR, whereby it unquestionably becomes an international organisation. It is an intergovernmental organisation (which implies that the signatory countries maintain intact their own decision-making powers) and is not supranational (which means that its bodies have autonomous decision-making powers and that decisions are obligatorily applied directly in all member countries even against the will of the countries). This aspect, which arises from the Asunción Treaty, was attenuated in the Brasilia Protocol, and is truly confirmed in section two of the Ouro Preto Protocol, which clearly indicates the inter-governmental nature of its decision-making bodies.

The functions of the Common Market Council, the senior body of MERCOSUR, as well as the membership and Chair of the Council, are identical to the structure for the transition period. It is an active, multi-

\begin{footnotesize}
\begin{enumerate}
\item See \textit{AT1991, supra}, note 14651, art. 16.
\item Legally, the \textit{OPP1994} also has a special significance insofar as its provisions, especially arts. 51 and 52, validate the acts performed prior to it that had structured bodies in an irregular way. Nevertheless, art. 51 of the Protocol repeals all the provisions that gave rise to pre-Protocol organic structure.
\item See \textit{OPP1994 supra}, note 15863 art. 1.
\item \textit{Id.} arts. 35, 36.
\end{enumerate}
\end{footnotesize}
personal, simple body (consisting of positions and not bodies) and its members are appointed as such because they are already members of other bodies.

The Council's duties comprise policy making and promotion of actions for formation of the common market, deciding on the proposals submitted to it by the Common Market Group, negotiating and signing agreements in representation of MERCOSUR with third party countries or groups of such countries. The Council rules by decisions, which are binding upon the parties. The decision in question must be adopted by consensus and with the presence of all the Party States.

The Common Market Group is the MERCOSUR executive body, whose functions, structure and composition are analogous to those applicable during the transition period. In turn, the Common Market Group is subordinate to the Council, but at the same time it holds hierarchy over the Trade Commission and the Administrative Secretariat. The Group has powers of delegation, as is proper to a body of greater hierarchy. It is an active, multi-personal, simple body and its members are appointed directly and not because they are members of other bodies. The decisions of the Common Market Group are adopted by consensus and with the presence of all signatory countries.

The MERCOSUR Trade Commission is the body that assists the Common Market Group in the analysis and application of trade policy instruments agreed on by the parties. It reports to the Common Market Group on the evolution and application of such instruments and on the decisions adopted in relation to requests submitted to it. It also makes proposals to the Common Market Group regarding adoption of rules necessary for the trade and customs integration process. It is hierarchically subordinate to the Common Market Group, decentralized, and could be called superior to the technical committees it may create. It is also an active, simple and multi-personal body.

The Commission's pronouncements are issued in the form of Directives.

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171 *Id.* arts. 8, 9.
172 *Id.* art. 37.
173 *Id.* art. 8.
174 *Id.* art. 37.
175 The Trade Commission, which as pointed out above was illegitimately created by Decision No. 9/94, was regularized by the *OPP1994* (art. 16 et seq.). Regarding its position towards the technical committees, *See* paragraph IX of art. 19.
or Proposals, the first of which are binding upon the signatory States. As mentioned, the decisions it adopts must be by consensus of its members with the presence of all the Party States.

The Trade Commission is coordinated by the Ministries of Foreign Affairs and consists of four official members and four alternates for each country.

The Joint Parliamentary Commission's purpose is to speed up internal procedures in each signatory country for the rapid entry into force of the rules issued by the MERCOSUR bodies and to aid in harmonisation of national legislations. It makes Recommendations to the Council through the Common Market Group. The Commission consists of a like number of parliamentarians from each signatory country, appointed by the respective Parliaments in line with their own national procedures.

It might be considered that the Parliamentary Commission is not in a relationship of institutional equilibrium with the Common Market Group, but that it is hierarchically subordinated to the Council through the Group. This is without prejudice to its fully recognized technical autonomy. Thus, it is a passive body (and is not part of the hierarchical line), simple, pluri-personal and its members are appointed as such because they are already members of other bodies (with the salvo that only certain legislators make up the Commission, i.e., members must be legislators, but this is not a sufficient condition).

The Economic-Social Consultative Forum is the body that represents the economic and social sectors and consists of a like number of representatives from each country. Its function is consultative and is performed through Recommendations to the Common Market Group. It is a simple, multi-personal body. It is also passive, and is subordinated to the Council through the Group, but with the necessary technical autonomy to fulfil its advisory functions.

The MERCOSUR Administrative Secretariat, the operating support body, has the task of providing of services to the other MERCOSUR

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177 Id. arts. 16, 17.
178 Id. arts. 25, 26.
179 The Joint Parliamentary Commission is a complex body to characterize. The AT1991 foresaw its existence in art. 24, but not as a member of the MERCOSUR Organization into which it is inserted based on the provisions of the OPP1994 (arts. 1, 2). Curiously, it lacks legislative functions and executive powers (Internal Regulation of functioning of the commission).
bodies (official archive, publication and dissemination of rules, translation of decisions adopted by MERCOSUR bodies, etc.). As such, it is a unipersonal, simple body, with permanent headquarters in Montevideo, without powers of administration or consultative functions.

An analysis of the organisation as structured by this Protocol shows that of all the bodies, the Common Market Council and Group, and the Trade Commission have decision-making powers.

As a whole, the structure does not constitute a tripartite separation of powers: there is no unitary, stable, permanent judicial body, as would be necessary for such purposes. The dispute-settlement body established first by the Brasilia Protocol and ratified with changes by the Ouro Preto Protocol, is based on ad hoc arbitral tribunals. There has likewise been no provision for a legislative or political control body.

D. LEGAL SOURCES

The Ouro Preto Protocol establishes the legal sources for MERCOSUR as the agreements executed within the framework of the Asunción Treaty and its Protocols; the Decisions of the Council, the Resolutions of the Group and the Directives of the Trade Commission, all of which are binding and if necessary are to be incorporated into the national legislations via the mechanisms foreseen in each legal system. All of them are acts of the law deriving from MERCOSUR. Even though the Protocol does not expressly say so, the original law consists of the provisions of the Asunción Treaty, the subsequent protocols, the supplementary instruments, and the agreements executed within the scope of those documents.

The MERCOSUR framework still does not have a mechanism for safeguarding alignment of the derived law with the original law, which in the European Union is provided by a recourse of nullity under the competence of the Court of Justice. This mechanism is necessary given that the original law is hierarchically superior to the derived law.

Beyond this, alignment of the original law is achieved by the principle

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181 It is headed up by a Director elected by the Common Market Group on a rotating basis among the signatory countries, and upon consultation with them the Director is appointed by the Common Market Council (OPP1994, arts. 31, 33). This body became more important as of OPP1994. Prior to that, under the AT1991, it was the Secretariat of the Council. It then became a body within the MERCOSUR structure.
that later rules, insofar as they are equal in rank and are issued by the same parties, derogate pre-existing rules. The Ouro Preto Protocol\textsuperscript{183} is no exception to this principle in its derogation of the provisions of the Asunción Treaty that were contrary to the Council Decisions issued during the transition period.

The hierarchy of derived rules depends on the institutional position of the bodies issuing them, which are ordered from greater to lesser hierarchy as follows: Council Decisions, Group Resolutions, and Trade Commission Directives. These are the only binding legal acts. Also legally binding are the agreements that may be executed by MERCOSUR with third Party States or international entities subsequent to effectiveness of the Ouro Preto Protocol, which grants MERCOSUR legal status.

Apparently, those derived obligatory rules are not immediately applicable.\textsuperscript{184}

This means that the Protocol authorizes each country to determine what procedures are required for application of derived obligatory rules. In some cases, incorporation will be immediate and direct, and in others an internal procedure will be required for effectiveness. Non-compliance by any State of the obligatory provisions will imply application of the consequences under International Law to the violator (U.N. Resolution No. 375, 1969 Vienna Convention on Treaty Law).

This Ouro Preto solution in relation to application of derived law was adopted with the agreement in principle of the delegations of Argentina, Brazil and Paraguay. The Uruguayan delegation advocated establishment of a rule providing in all cases for immediate application of the obligatory provisions in order to strengthen and facilitate the integration process. The other delegations’ refusal to go along with this may have been because of the fear that automatic incorporation of MERCOSUR rules, given their repealing affects on national law, would give rise to untimely distortions of national law.\textsuperscript{185} We should also take into account the impact of the terms or concepts of supra-nationality or community law in many spheres, as

\textsuperscript{182} OPP1994 supra, note 15863 Chapter V (arts. 41, 42). See also Gamio supra, note 147.
\textsuperscript{183} OPP1994 supra, note 15863 art. 53.
\textsuperscript{184} Id. arts. 38 to 40. In particular, art. 38 establishes as a general principle that the Party States agree to take the steps required so that in their respective countries the rules of MERCOSUR bodies are fulfilled. It should be clarified, however, that this decision does not establish the need for each derived act to be incorporated in internal law by confirmatory procedures. Only if that were necessary would the pertinent procedure provided by each legislation have to be used (art. 42).
\textsuperscript{185} See generally supra, note 1427.
well as commercial aspects in the countries involved. We point out that the share in regional trade of the economically larger members represents a much lower percentage than for the other two MERCOSUR members. Thus, the economically larger countries may have felt less of a need to adjust all of their trade regulations, or to harmonize policies and positive rights with the needs of the MERCOSUR integration process.\textsuperscript{186}

The biggest problem posed by this imprecision in the application of derived law remains a practical one, given how naturally slow the implementation of MERCOSUR decisions has been and continues to be in the different member countries, which likewise implies a slow pace for the integration process.

In any event, the Protocol itself provides the possibility for the Parties to establish an organic system and a different, definitive dispute settlement system at a later date, but prior to termination of the transition period, for convergence\textsuperscript{187}. This implies at least that if the difficulties in internal application of MERCOSUR decisions in the various countries are very serious, to the extent that they hinder the integration process, the possibility of correcting that situation does exist.

E. LEGISLATIVE HARMONISATION

1. Concept

By way of introduction, the definition of the concept and scope of harmonisation, differentiating it from legislative uniformity or coordination would seem appropriate.\textsuperscript{188}

In this sense, it should be noted that the existence of different legislative solutions in the various countries does not in itself imply the need to change them, insofar as such differences do not hinder integration. Harmonisation is necessary only as an effective tool for integration.

In this first context, the needs for harmonisation are found in areas of legal asymmetries that distort free competition from the economic standpoint. These asymmetries are generated when companies, in the light of the diverse legal and administrative regimes for their installation or operation in the different countries, choose one or the other country based

\textsuperscript{186} \textit{id.}

\textsuperscript{187} \textit{OPP1994 supra}, note 163, art. 44.
on those factors, which are discretionary, rather than reflecting substantive differences of competitiveness. Such are the legislative differences that must be smoothed out and later eliminated, if only gradually, in order to allow for real integration.

Moreover, legislative harmonisation cannot be dealt with simultaneously in all spheres in which it is required. It is essential to establish a timetable based on the priorities either according to the importance of the asymmetry, or to the subject of the regulation, within the integration setting.

Unlike harmonisation, legislative coordination merely implies balanced handling of differentiated national rules, without implying the need to make any modifications.

2. Regimes to be harmonized

Upon examining the overall characteristics of the national legislations of the four Asunción Treaty signatory countries we immediately see that they all belong to the Roman-Germanic family of law. In the era of major code-writing of the past century, the influences of their origins were felt to such an extent that Argentina and Paraguay had the same Civil Code drafted by Velez Sarsfield based on the work of Teixeira de Freitas.189

There are also no substantial differences in the commercial law of these same countries. The differences that can be found are the product of the subsequent different evolution in each case.

Some significant differences can be found at the level of Constitutional Law: for example, in Argentina there are still clear linkages between Church and State. And in the case of Brazil, its Constitution, in its various versions over time—in a process unlike that of the Constitutions of the other countries, which have not been changed much or often—has established limitations on the activities of non-Brazilian citizens.190

Despite the common background of the legislations191 there are many areas requiring harmonisation. They include, in addition to the specifically financial area, other related issues, for example corporate law or legal

188 ANA MA. M DE AGUINIS, EMPRESAS E INVERSIONES EN EL MERCOSUR 14 (Buenos Aires 1994).
189 See Holz supra, 8893 and 1127.
190 Id.
structure of entities and their activities outside the country of their original authorization, rules on capital and its investment and circulation, rules on circulation of services and persons, etc.

For example, Brazil, Argentina and Uruguay had signed a Treaty on conflicts of corporate law back in 1979, providing that applicable law is that of the place of organisation of the company. Nevertheless, continuing with the example, that treaty is insufficient in achieving legislative harmonisation insofar as the internal legislations of the countries signing the treaty confer differential and even protection benefits to their nationals - depending on the country and particularly in the case of Brazil -, using more liberal regimes than those in the other countries as a competitive advantage.192

This example underscores the need for legislative harmonisation, to be viewed as an on-going activity, a gradual process, analogically with the program for trade liberalisation and elimination of tariffs and preferences.

In the process of harmonisation, it must be borne in mind that additional difficulties caused by national idiosyncrasies in the region will have to be surmounted. This is seen in relation to communication among the MERCOSUR member countries, which is not always fluid, even among agencies and bodies of a single country. Inadverent modification of already harmonious solutions through other national solutions contrary to the trend or to the route agreed on for harmonisation should be avoided.

Along with the lack of communication, another characteristic typical of the zone is the proliferation of fora for analysis, action, cooperation and study in the different areas to be harmonized. This can and does lead to inconsistency among the solutions and proposals being studied and suggested, due to a lack of coordination among the different venues.193

3. Harmonisation in the Asunción Treaty

a. General

The Asunción Treaty refers to legislative harmonisation only to state that the signatory countries agree to harmonize their legislation in the areas indicated as relevant for the purposes of strengthening the integration

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192 See Holz supra, 8893 and 1172.
This generic formula makes it possible to include in the harmonisation process those issues and aspects that, according to the need for integration, and its urgencies and difficulties, are considered significant. This assessment may vary, while the diverse sectors are harmonized as the integration process moves forward.

In this light, some sectors of national regulations may be indicated early on as relevant for harmonisation. This is the case of rules on freedom of circulation of persons, services, etc.

Beyond the above general provisions of the Asunción Treaty, we must add that the Working Groups\textsuperscript{[195]} have constituted a useful mechanism in the essential process of harmonisation. Each working group in its area of competence, established as the most relevant for real implementation of the common market, constitutes a harmonisation factor. The working groups assess asymmetries in legal structures, evaluate their importance in the light of the common market, and propose measures for harmonisation as deemed necessary to the Common Market Group. In turn, the latter can prepare a formal project based on the working group's suggestions for approval by the Council or as the basis for a recommendation to the country in which the asymmetry is to be corrected.

b. Harmonisation of the regimes for circulation of services\textsuperscript{[196]}

In relation to free circulation, beyond the general principle on Harmonisation as a tool for integration, the Asunción Treaty establishes another mechanism\textsuperscript{[197]}, which is the adoption of sectoral agreements geared to optimizing use and mobility of the factors of production. Although this reference is somewhat ambiguous, given its breadth, it is aimed at the need to coordinate efforts of the signatory countries toward harmonisation of rules on circulation of capital and services. Specific provisions regarding services circulation are contained only in the Montevideo Protocol.\textsuperscript{[198]} This Protocol sets up the general framework for the liberalisation of services

\textsuperscript{[194]} AT1991, supra, note 14651, art. 1, final paragraph.
\textsuperscript{[195]} Reporting to the Common Market Group and established by technical area in Attachment V in accordance with the next to last paragraph of art. arts 13 of the Treaty.
\textsuperscript{[196]} Héctor Babace, La libre circulación de los trabajadores en el MERCOSUR, [The Free Circulation of Labour in MERCOSUR] in ESTUDIOS MULTIDISCIPLINARIOS SOBRE EL MERCOSUR, 105-133 (Montevideo, Ed. FCU 1995).
\textsuperscript{[197]} See general principle, AT1991, supra, note 151, art. 1 final paragraph; special provision for circulation of services, See also art. 5 (paragraph d).
circulation process, including financial services, in MERCOSUR. Subsequently, decision No. 9/98\(^\text{199}\) of the Common Market Council approved the Sectoral Attachments to the Montevideo Protocol, including the attachment on financial services and the MERCOSUR countries initial lists of specific commitments.

The internal provisions of each of the States,\(^\text{200}\) particularly as regards provision of services or performance of activities by foreigners, are very diverse. In all cases a distinction is made between tourists and residents, with the former being prohibited from carrying out any remunerated activity. In the case of residents, the most restrictive regime is the Brazilian one: foreigners must obtain a Foreigners identification card issued by the Registry of Foreigners, which provides access to the Employment and Social Security Card, which is necessary to engage in any type of remunerated activity.

Equal treatment for nationals and foreigners, promoting non-discrimination based on nationality, is a basic element of all the national Constitutions. The internal legislations respect this provision in principle, although there are differences in treatment in lower-ranking regulations. For example, minimum levels are established for companies for hiring nationals as employees, or inversely, maximums are set for hiring of foreigners.\(^\text{201}\)

We also find total reservations as to certain types of jobs or activities, which can be performed only by nationals.\(^\text{202}\) In Brazil, for example, this is true in the case of crews of aircraft or vessels of the merchant navy.

There can also be measures for positive discrimination in order to promote migration in a certain direction. For example, Argentina pays subsidies to migrant families when they stay in the country of origin.

Undoubtedly, under the regional integration framework, the disparity of regulations on the elements of free circulation of persons, including freedom to enter and remain in the MERCOSUR member countries—a necessary premise for the free circulation of services—must be the subject of greater legal harmonisation. That is the objective of the liberalisation

\(^{198}\) Which was signed by the MERCOSUR countries the 15\(^\text{th}\) of Dec. 1997 (DEC 13/97 of the CMC).
\(^{199}\) Dated July 7, 1998.
\(^{200}\) See Holz \textit{supra}, 9388 and 1127. See also Babace \textit{supra}, 201.
\(^{201}\) \textit{Id.}\n\(^{202}\) \textit{Id.}\n
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program and the lists of agreed on commitments under the Montevideo Protocol scheme. Since it is reasonable for reasons of security or public order to establish certain restrictions, harmonisation should not be unlimited. It should also be kept in mind that the process of liberalization of services circulation must necessarily be gradual, slow and flexible, in line with the difficulties implied by adjustment of the economy, in relation to the variable of national employment and to the situation of free circulation within the framework of the Common Market. The supply of labour and, in general, of services, increases and is displaced among the different countries, considering the respective competitive situations in the sectors of activity, the promotional regimes provided, and the level of employment and remuneration in each of them. It should be recalled that in the European Economic Community itself the process of regulatory harmonisation regarding free circulation of persons and services took 25 years, from the existence of preferences to nationals until the creation of the concept of a community worker.

At MERCOSUR level, the efforts toward convergence on the free circulation of services were initially being made, fundamentally in the sphere of Working Subgroup No. 11, as of 1992 called Labour, Employment and Social Security. The Montevideo Protocol changed this, as all negotiations in services were attributed to the Common Market Group, which created the Services Group with competence to define the criteria and instruments for negotiations in services, and to organize and implement the negotiation of liberalisation rounds.

III. ASSESSMENT OF THE GENERAL SOLUTIONS OF MERCOSUR

A. INTRODUCTION

The Treaty has adopted a pragmatic position, following the example of the previous attempts at integration by Argentina and Brazil. It is focused on the regulation of the mechanisms for progressive reduction through elimination of tariff barriers and outright annulment of non-tariff barriers of all types existing in the signatory countries.

The novelty incorporated by the Treaty is a linear, gradual and

\[203\] Created by Resolution No. 11/91 of the Common Market Group.
\[204\] Resolution CMG No. 31/98.
automatic process of tariff reduction, while at the same time setting the
goal of establishing a common external tariff and coordinating
macroeconomic policies\textsuperscript{205}.

Institutionally, that pragmatism can be seen in the transitory nature,
flexibility and simplicity of the structures created. This allows for a more
fluid adaptation to the existing structures in each of the signatory countries.

Based on prior, often unsuccessful integrationist experiences in Latin
America, the MERCOSUR member countries did not attempt at addressing
at this stage the potentially more conflictive aspects or areas for the
purpose of their structuring or harmonisation. This worked in favour of
pragmatism, since the most pressing objectives and the most urgent steps
toward a common market are in the trade area, in the facilitation of the
circulation of goods among the countries, and the reduction and
elimination of barriers or obstacles in that respect. Here we see the logic of
the Treaty provisions and in the omission of others that might have been
considered for inclusion\textsuperscript{206}.

One might ask what has been the degree of fulfilment of the goals
originally set out in the Asunción Treaty for the creation of a Common
Market on December 31, 1994. At the CMC meeting held on August 4 and
5, 1994, it was acknowledged that the goal would not be fulfilled as
planned, and a new period of convergence was agreed on, starting January
1, 1995. Those agreements were set forth in various CMC decisions.\textsuperscript{207}

Based on all these regulations it was expected in 1994 that the Free
Trade Zone, which is still not totally concluded, would be in full force as
of January 1, 2000, and that the Customs Union would be completed by
January 1, 2006. However, this schedule has been changed again—in fact,
implicitly—in the years 2000 and 2001, with the adoption of the Decisions
of the Common Market Council for Re-launching MERCOSUR. All these
decisions in different areas, including market access, perfecting of the
dispute settlement system, analysis of the structure of bodies reporting to

\textsuperscript{205} See Holz\textit{ supra}, 9388 and 1127.
\textsuperscript{206} \textit{id.}
\textsuperscript{207} CMC decisions (Nos. 3/94, 5/94, 6/94, 7/94, 8/94, 9/94 and 10/94), and subsequently the
CMC meeting in Ouro Preto on Dec. 17, 1994 adopted decision No. 22/94, for creation of
the Common External Tariff, lists of exceptions to the CET, and lists of convergence for the
capital goods, computer technology and telecommunications sectors; Decision 23/94 on the
Origin Regimen for products not included in the CET or with specific requirements, all of
which are subject to the Original Regimen set forth in Decision 6/94; Decision 24/94 on the
Regiment for Final Adjustment to the Customs Union; Decision 25/94 approving the

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the Common Market Group and the Trade Commission, or the Common External Tariff, etc.\textsuperscript{208} are geared to analyzing and solving difficulties detected in particular areas of MERCOSUR functioning. Later, Common Market Council Decision No. 7/01 extended to different times in the year 2001 the terms that the previous Decisions on Re-launching of MERCOSUR had set for the year 2000. These Council Decisions for Re-launching of MERCOSUR were a positive response to the critical situation faced by the Party States as of 1999, which posed serious difficulties for the operation of the MERCOSUR Agreement.

\section*{B. INSTITUTIONAL SOLUTION}

By way of introduction\textsuperscript{209} we note that in Latin America the concept of supra-nationality is equated with the aptitude of an international community body to adopt resolutions effectively \textit{erga omnes} that affect the foreign relations or internal affairs of the State without prior agreement thereto by the said State. Thus, supra-nationality involves first the competence of supranational bodies to issue decisions or resolutions and, second, the immediate applicability of such resolutions without it being necessary for the states to issue any legal act.

Supranational organisations (entities with legal status, unlike bodies or agencies) are different in doctrine from inter-governmental organisations because of the nature, membership and competence of their bodies. The decisions adopted by bodies of inter-governmental entities are only those that have been consented to by each of the States members of the organisation.

In the light of the foregoing concepts, it may be stated\textsuperscript{210} that the Asunción Treaty generated an inter-governmental organisation based on the principles of equality and resolution by consensus, clearly differentiated from a supranational structure. This configuration is maintained after the Ouro Preto Protocol. That Protocol seeks to correct the somewhat haphazard and perhaps excessive prior growth of the MERCOSUR structure.

\textsuperscript{209} See Esteva \textit{supra}, note 1427.
\textsuperscript{210} See Di Biase \textit{supra}, note 1472.
In line with its inter-governmental nature, decisions are adopted by inter-governmental and not supranational mechanisms. The only decisions that can be adopted by supranational bodies are those referring to Dispute Settlement, since they are made by an arbitral tribunal that is not inter-governmental, and its decisions can be imposed on the signatory countries even against their will. As of December 2004, nine arbitral tribunal awards were issued.

Given the inter-governmental nature of MERCOSUR decisions, they are not directly applicable within the signatory countries, which imply a certain degree of willingness in the process of internationalisation. The Ouro Preto Protocol attempted to improve this difficulty.

A secondary consequence of the inter-governmental nature of MERCOSUR decisions is that it is difficult to obtain uniformity in the implementation of the decisions at a national level, made more difficult by the absence of a Court of Justice that would might implicitly help to guide the application of the MERCOSUR legal order in a harmonious and uniform way. It should also be noted, perhaps marginally, that in addition to the difficulties mentioned, there is also a relative slowness, if compared to other alternatives, in the process of internationalisation of MERCOSUR decisions at national levels, which naturally leads to an analogous slowness of the integration process itself.

Observing the organisation as a whole, MERCOSUR can be seen as a centralized system. This affirmation applies only to the bodies mentioned in the Ouro Preto Protocol. In the view of part of the doctrine, the others, particularly the Working Subgroups or other Subgroups created by derivation based on sec. 52 of the Ouro Preto Protocol, will automatically be annulled upon effectiveness of the structure provided by the Protocol.

MERCOSUR's institutional organisation has turned out to be very primary, which may have been permissible at a first stage of integration, but will not adapt to the needs of subsequent stages in order to attain a common market. For example, the doctrine points out the imperious need for a court of Justice, and even for a legislative body, and those structures for political control of acts undertaken or order by MERCOSUR bodies have not been foreseen. The functions of the Joint Parliamentary

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211 See OPP1994 supra, note 15863 arts. 11, 17, 38.
212 See Durán supra, note 1427.
213 See Gamio supra, note 1472.
Commission do not have that goal, unlike the case of the European Parliament. However, it should be kept in mind that even the structure established by the Ouro Preto Protocol is transitory, which will make it possible, in the instances where the definitive structure must obligatorily be adopted, pursuant to the original law of MERCOSUR itself, to correct the imperfections noted.

Despite this, during the initial years of effectiveness of the agreement, the obstacles that arose were overcome without any major complications. This affirmation should probably be reassessed in the light of the difficulties faced since 1999 and to which we refer below.

It has been said that such effectiveness, significantly greater than what could objectively have been expected from the application of the regulations provided, was the consequence of political will: inter-governmental bodies consist of direct representatives of the States, members of the highest level of the respective national governments, and not diplomatic employees as had been customary. This phenomenon, which was entirely new, had made it possible - at the initial stages at least - to avoid a lack of coordination between the bodies of the integration process and the respective national governments and their political will. Thus, it was the will of the governments themselves, as members of the MERCOSUR bodies which, when faced with difficulties, had immediately addressed them and not put them off for resolution at a national political level.

The difference with the processes of integration under a supranational organisation lies in that in the latter, the effectiveness of the process is supported by the organic structures themselves, whereas in MERCOSUR it lies with the members of the bodies of the organisation who are simultaneously office holders in the governments of the member states.

Nevertheless, despite the relatively successful result of the organisation and regulation existing initially under MERCOSUR, it is necessary to remember that present - and the same will surely apply to future stages of integration - demands of the organisation are putting both aspects to the test. The dismantling of pre-existing barriers, a central procedure that involves construction of a free-trade zone, is not the same as the conceptual advance implied first by establishment of a customs union and then a

214 See Durán supra, note 1427.
common market. In the two latter cases the effort is a positive construction, of joint creation, which implies coordination of policies, regulatory harmonisation, all in diverse sectors and fields. All of this has already put the MERCOSUR integration process to arduous tests, and will continue to do in the future.

Effectively, now referring specifically to the difficulties experienced within MERCOSUR since the year 2000, and without losing sight of the fact that their causes were many and derive from the macroeconomic crises, first in Brazil and then in Argentina, one might ask to what extent the institutional structure may have been a factor in the intense repercussions of those crises on the functioning of MERCOSUR. Common Market Council Decision No. 26/00 instructing the Common Market Group to assess fulfilment of the goals of the Working Subgroups on the Specialized Meeting and Technical Committee, and to propose improvements for guidelines and terms, within the effort for the Re-launching of MERCOSUR, may be a first step toward critical analysis of the institutional structure of the Agreement. This evaluation could contribute to the building of an organisation more in line with the next stages of evolution of MERCOSUR.

C. DISPUTE SETTLEMENT REGIME

In the evaluation of this point, the main question we must ask is whether the dispute settlement system provided for in the sphere of MERCOSUR is appropriate for a Customs Union. Although the answer may be affirmative, we must also ask if that same system is appropriate for a Common Market.

The basic document, as indicated above, for dispute settlement is the Olivos Brasilia Protocol. To that, we should add some solutions relative to the Trade Commission, insofar as they complement the system provided for in the said Protocol.

The Olivos Brasilia Protocol is dual in scope. On the one hand, it involves the signatory countries, and not MERCOSUR, since claims by the countries are always with respect to the countries and not to MERCOSUR. Controversies between MERCOSUR and the Party States are not covered, or are regulatory controversies between the provisions of MERCOSUR in

\[215\] Id.
its original and derived elements and the internal regulations of each of the signatory states, or disputes between MERCOSUR employees and the bodies of MERCOSUR.  

Controversies between States are only included insofar as they refer to the application of the provisions of MERCOSUR itself, be they original or derived. In such case the solution envisaged is, as a last resort, arbitration. But such arbitration between States may be is a subsidiary solution: before reaching that venue, pursuant to the Olivos Brasilia Protocol the States must first go through diplomatic procedures such as direct negotiations, and only then can they either submit their claim to the Common Market Group or to an ad hoc Tribunal or to the Permanent Revision Court. Other procedures difficult to define, such as consideration, advice by experts (supposedly biding), and finally the recommendations customary under International Law involving declarations that are ultimately left to the discretion and interpretation of the parties or States affected themselves. Only after exhausting these mechanisms is it possible to turn to arbitration.

It is to be noted that on 5 July, 2002, the Protocol of Olivos was signed, establishing also an ad-hoc arbitral procedure (whose decision can be revised by a Permanent Revision Court created by this Protocol). The aim of these procedures is to solve controversies between Party States regarding the interpretation, application or compliance with the Asuncion Treaty, the different Protocols, the Common Market Counsel Decisions, the Common Market Group Resolutions and the Directives of the MERCOSUR Trade Commission. This procedure can be initiated by any State even without following previous conciliatory or diplomatic steps.

Another peculiarity of the arbitration system provided for derives from the fact that the tribunal is ad hoc (unless the parties agree to submit their claim to the Permanent Revision Court), which implies the impossibility that they themselves may harmoniously interpret and uniformly apply the provisions of MERCOSUR.

As a system, it is curious that conflicts between states are to be resolved by arbitration. Additionally, this solution is clearly different from that adopted by the European Union, which was always inclined toward the

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216 See Operti, supra, note 1427.
217 Id.
218 Id.
judicial system for such purposes. If we assign an equivalent rank to legislation and the rules contained in the Protocols, we find that controversies of rules equivalent to legislation are to be resolved by arbitration. This is a most extraordinary solution.

The situation described in the foregoing paragraph leads us to affirm that there is currently no venue to examine the legality of a rule of law, even of MERCOSUR itself: a controversy must first arise, and as a result, the act giving rise thereto may be annulled.

Yet since the current dispute settlement system implies participation of ad hoc tribunals, such annulment would only be for the specific case, without implying substitution or derogation of that act, or of the provision giving rise to it. Thus, again we have to conclude, there is no control of legality for Resolutions and Directives. Control can only be achieved in the case of a controversy, but in that event, only an arbitral award is obtained, which is not adequate as a legal controlling mechanism. This in general terms is connected with the scant supra-nationality incorporated by MERCOSUR in its structure, even recognizing that inter-governmental systems can have legal control mechanisms independent from the solution adopted on the question of institutional organisation.

The Protocol significantly restricts access by private parties to arbitration, insofar as procedurally the interested parties must first bring their claims before the Section in their own country, and then, if the Section supports the claim, they can take the route of arbitration.

This is a very serious affirmation: in the philosophically liberal legal world, private parties have been assured the unrestricted right to bring any claims they consider appropriate before judicial bodies. In the sphere of MERCOSUR, instead, obligatory intermediation in access to justice implies a limitation, a curbing of active legitimization. To this, we must add the materially restricted framework in terms of content of claims that can be brought to arbitration, which must refer to measures having a restrictive or discriminatory effect or giving rise to unfair competition. That is to say those private parties, within the MERCOSUR context, do not have the possibility of choosing an alternative or arbitral route other than as regulated by the Brasilia Protocol. The only possibility is to resolve the specific conflict by way of arbitration as indicated, or to take it outside

219 Id.
MERCOSUR.

This leads us to conclude that the MERCOSUR dispute settlement mechanism, as regards private parties, is clearly insufficient, and is even more limited than the system for dispute resolution between States, which, as we have already mentioned, is problematic.

These issues in connection with the MERCOSUR dispute settlement system underscore the relevance of Common Market Council Decision No. 25/00 on perfecting the Brasilia Protocol dispute settlement regime. As indicated earlier, that Decision, within the framework of the set of Decisions for Re-launching MERCOSUR, instructs the Common Market Group to analyse, among other issues, the perfecting of the stages of enforcement of awards; criteria for making lists and appointment of experts and arbitrators, and the stability of the latter; alternatives for uniform interpretation of MERCOSUR rules; and speeding up of procedures. The findings and the proposals deriving from this analysis, which must be submitted to the Common Market Group by December 2001 (Common Market Council Decision No. 7/01), will probably contribute to dissipating several points of the difficulties mentioned regarding the MERCOSUR dispute settlement regime.
CHAPTER III

MERCOSUR's BANKING SERVICES PROVISIONS

This chapter presents the regulations and structures generated in the MERCOSUR in relation to banking services, basically aimed at removing obstacles to their integration and liberalisation. For this purpose we have identified two areas of regulations and instruments provided for in the MERCOSUR which coexist and continue to be strengthened at the same time. On the one hand (Section I), the system established for the harmonisation of banking systems in the Party States, generated on the basis of the Asuncion Treaty. It should be noted that this harmonisation system—aimed at avoiding regulatory obstacles to liberalisation inherent in integration—was provided for and implemented although there was an absence of specific provisions regarding financial service integration. Secondly, (Section II), we will refer to provisions and instruments designed for the liberalisation and integration of banking systems, originating in the Montevideo Protocol, signed on December 15, 1997. Together with the description of its main provisions, we will also point out the peculiarities of this integration system. The parallel description—including their developments as of today—and analysis of both sets of mechanisms, will allow us to look in depth into their joint consistency and adequacy in view of the potential integration of the bank sector. This is one focus of Chapter IV.

I. REGULATORY HARMONISATION

A. GENERAL CONSIDERATIONS AND HARMONISATION MECHANISMS.

Setting up the MERCOSUR requires removal of obstacles preventing free circulation of production factors. This involves both material and legal obstacles. Material circulation implies the removal of tariffs, and

\footnote{See Xavier de Mello, supra, note 1427.}
legal circulation supposes different processes and mechanisms, basically eliminating regulatory asymmetries that distort the legal circulation of production factors. This is equally applicable to the circulation of services, including, financial services. Regulatory co-ordination in the banking area makes it possible to simplify business traffic considerably: suffice it to think in terms of the banking system as a mechanism for payment, by means of cheques, documentary credits, bills of exchange, etc. And a fluid payment system is essential in increasing trade flow among the signatory countries.

As pointed out earlier on in this paper, the Asuncion Treaty adopted a pragmatic position, continuing the example of previous Argentine-Brazilian attempts at integration, centred on regulation of mechanisms for progressive reduction until their elimination, of tariff barriers and the downright elimination of non-tariff barriers of any kind that may exist in the member countries.\(^{221}\) Priority was given to the implementation of the necessary instruments to facilitate the circulation of goods, leaving the regulation of other areas, possibly more difficult to harmonise, to a later date.

This strategy is reflected in the regulatory provisions of the Asuncion Treaty that only stipulate trade mechanisms for the integration process with a certain degree of detail. This is also reiterated in the field of financial activities, for which no specific provisions have been included.\(^{222}\)

Thus the Asuncion Treaty includes only one section referring directly, if not solely, to financial activities, establishing free circulation of services, without exception and providing for the co-ordination of the signatory countries policies, among others, regarding capital and services.\(^{223}\) In this way, financial activities are seen as a free supply of services and as circulation of capital insofar as they constitute a factor of production.

Furthermore, the establishment of working groups under the aegis of the Common Market Group specifically foresees that one of them, Subgroup 4 is aimed at analysing and co-ordinating fiscal and monetary policy linked to trade.\(^{224}\) This includes an analysis of the policies regarding capital and financial activities. Subgroup 4 activities in its field have a clearly potential role in the essential process of harmonisation. And basically in obtaining

\(^{221}\) See generally EVA HOLZ, supra, note 9788.
\(^{222}\) Id.
\(^{223}\) AT1991, supra, note 14651, art. 1, section 3.
detailed information on the Party Countries’ systems, in surveying asymmetries and competitive distortion in the regulatory structures, the evaluation of their importance in the light of the common market and in proposing to the Common Market Group the necessary harmonisation measures. In turn, this Group has various alternatives with which to design and implement a strategy to solve the identified restriction or distortion.

B. ACTIVITIES AND PROGRESS IN HARMONISATION

During its operations, Subgroup 4 set up four working Commissions to deal with the issues of this Group. Such Commissions are respectively, analysis of the Financial System, Capital Market, Insurance and Foreign Investments. Each of these Commissions comprises specialists from within the public sector of each of the MERCOSUR member countries. They all met repeatedly between 1992 and the end of 1994, four or five times a year to advance in the study of the countries’ regulations and their co-ordination.

In particular, the Financial System Commission started by surveying the system in force in each of the member countries in those points considered to be essential in getting to know the prevailing system. As will be seen in greater detail further on, the subjects surveyed in this way were the mechanisms for market access, requisites and authorisations for the installation of new bodies and branches and offices of those already existing, minimum capital and net worth, activities allowed to be carried out by these bodies, prohibited activities, prudential regulations, guarantees on deposits, banking secrecy, etc.

This first study implied an effort on the part of each of the signatory countries to clarify and systematise their own regulations in order to facilitate their understanding by the other MERCOSUR Party States.

From this point on, it was possible to make a comparison of the financial system regulations in each of the four MERCOSUR countries on the issues

224 Annex V, according to art. 13 of the AT1991, see supra, note 14651.
225 See Minutes of the Meetings from 1992 to 1994, subsequently continued by the following: Minutes No. 1995 - First Meeting, Oct. 1995; Minutes No. 296 - Second Meeting Apr. 8-10, 1996; Minutes of Extraordinary Meeting - Aug. 7-9, 1996 - (accounting plan); Report by Brazil on the Evolution of Financial Matters (Brasilia Oct., 1996); Minutes Third Meeting - Nov. 6-8, 1996; Minutes Fourth Meeting - Aug. 28-29, 1997; Minutes Fifth Meeting - Nov. 17-18, 1997; Minutes Sixth Meeting - First in 1998 - May, 4-6 1998; Minutes Seventh Meeting Paraguay -May 17-18,1999; Minutes Eighth Meeting Montevideo - 20 -21 Oct. 20-21, 1999; Minutes Ninth Meeting Montevideo -Oct. 20-22, 1999; Minutes
surveyed. Following the instructions of the Common Market Group, the Financial System Commission devoted itself to the work of trying to bring together and harmonise legal regulations in force on the points it had defined.226

It should be noted that at the end of each meeting of the Financial System Commission (as with each of the Working Commissions in the various Subgroups) Minutes were drawn up summarising the contents of the items addressed during the meeting, very often concluding with a recommendation or clarification to be submitted to the consideration and evaluation of the Common Market Group.227 In this way, work and progress has been made in harmonisation efforts.

Returning to the specific tasks of the Financial System Commission, these have been set out in the respective Minutes, reflecting the difficulties and progress in the various areas under consideration.

The Minutes concerning the meetings held during 1994 –when the original timetable foreseen for Subgroup work was still in force and in which progress and difficulties had to be brought to the attention of the Common Market Group at the end of 1994– show that, beyond the survey of regulations and systems mentioned earlier on, co-ordination and regulatory harmonisation efforts during this first stage were centred on regulations for access by new bodies to the financial system, minimum capital, credit risk ceilings, limits on credit concentration, classification of debtors, and provisions for bad debts, technical assistance, supervising systems (with special emphasis on consolidated supervising) and prevention and detection of illegal operations.228

Subsequently, at the first meeting of the Subgroup in 1995 a different working methodology was established on the basis of the preparation of two thematic agendas, a short term agenda to be revised every two years and another one to be addressed as from the year 2000.229 The subjects postponed for long term consideration were market access and establishment of entities offering banking, insurance and reinsurance services, co-operation regarding capital movement, study and follow-up of

226 Id.
227 Id.
228 Id.
The first short-term agenda, for the 1995 - 1996 biennium, included consolidated bank supervision for the financial sector, procedure for information exchange, reduction of asymmetries and harmonisation regarding a risk centre, the concept of liquid equity, forecasts, classification and assessment of debtors and operational limits, MERCOSUR’s external relations on financial matters, money laundering and operations with derivatives. In the area of insurance and reinsurance, the 1995 - 1996 biennium thematic agenda was centred on the harmonisation of insurance operations (minimum capital, solvency, provisions, organisation of the entity), development of agreements already reached on insurance, multimodal transport insurance, exchange of information and supervision experience and MERCOSUR’s external relations. In the capital market section, the 1995 - 1996 agenda covered operations with derivatives, follow-up of agreements already reached among the member countries, and MERCOSUR’s external relations.

Even so, difficulties arose in completing the short-term agenda. For example, at the third 1996 meeting of Subgroup 4, the commissions were given instructions on the need to finalise activities contained in the agenda in force within the established deadlines. At the first 1997 meeting held in August that year, the subgroups’ tasks were revised once again and it was agreed to promote negotiations in areas where there seemed to be more chances of progress to provide substantial compliance with the corresponding instructions. Subsequently, at the May 1998 meeting (the first one that year) the Subgroup decided through its co-ordinators, that the subjects being examined by the Subgroup which involved difficulties preventing progress to be made in the context of technical meetings, should be submitted by each central bank to their highest officials, to enable such subjects to be considered at the meetings of Central Bank Presidents. It was also considered necessary to define an action plan for the following years. For this purpose the co-ordinators met during the second semester of 1998. This action plan was approved by the Subgroup as a guideline for negotiation for the period 2000-2001, and submitted for adoption by the Common Market Group as Recommendation No. 6/99.
of this guideline, presently in force, the following are worth noting: participation in the rounds of negotiations on financial services, in the context of financial systems: consolidated global supervision and co-operation agreements among member countries, the improvement of transparency, soundness and efficiency of financial systems, adaptation of the regulation with a view to sector integration; regarding market papers, the implementation of cross-border trade for Investment Funds, operability of compensation and liquidation agreements, follow-up of regulatory asymmetries; regarding insurance, the implementation of an integrated access and implementation service on the market; regarding money laundering: signing of a Memorandum of Understanding, the development or modification of the role of Central Banks in the prevention and repression of money laundering.

Notwithstanding the difficulties shown in the summaries of the meetings and the Subgroup Minutes, activities performed up to 2000 have concentrated on the preparation of concrete, technical proposals to make progress in specific areas of financial harmonisation. A survey was prepared and carried out on the situation in each of the countries regarding compliance with international prudential regulations (25 principles), on new products, e-banking and consumer protection. The situation was surveyed and progress assessed in the reduction of asymmetries in some fundamental issues, such as minimum capital, classification of debtors and forecasts, risk ceilings and consolidated supervision. Progress was made in the harmonisation of accounting criteria used in the various countries, with convergence foreseen in five years time. Regarding the Capital Market, work has been carried out on the survey of the system in force in each country concerning Investment Funds. Various training and harmonisation activities were planned and carried out to avoid money-laundering operations. In this case, on the basis of the Subgroups' efforts regarding the prevention and struggle against legitimisation of assets from illegal activities, set out in Recommendation No. 01/00, the "Co-operation

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231 Id.
232 Id.
233 Id.
234 Id.
Agreement between the Central Banks of the MERCOSUR Party States was approved for the prevention and repression of manoeuvres aimed at legitimising assets from illegal activities. Furthermore, by Resolution of the Common Market Group it was arranged that the Party States should adopt the regulations of information transparency recommended by the Basle Committee regarding their financial systems, before 31 December 2005.

Although follow-up and evolution of progress in harmonisation will be gone into in greater depth further on, it can be anticipated that, having made the following analysis of achievements and difficulties in each of the areas addressed by Subgroup 4, in general the results, rated as changes in regulations helping towards harmonisation, as well as the criteria followed by said Subgroup have been uneven. Basically this circumstance reflects the difficulties existing in changing internal regulatory systems in areas as sensitive from the economic standpoint, as those concerning financial systems. This situation should therefore not surprise us. However, even with this exception, as will be seen later on, there are some aspects, particularly in the prudential area, where progress can be observed in regulatory harmonisation.

C. SPECIFIC HARMONISATION AREAS

Specific harmonisation areas

237 As an example we may quote the conclusions of the Financial System Commission in the Minutes of the Subgroup 4 Meeting in May 1998, where an assessment is made of progress in fulfilling the decisions of MERCOSUR authorities on minimum capital, classification of debtors, ceilings for credit risks and consolidated global supervision, concluding that differences subsisted on these issues among the MERCOSUR countries that were incompatible with the resolutions adopted, in particular “taking into account a vision of a full financial service integration at regional level.” Although two years later, regarding progress relating to minimum capital, classification and provisions for credit operations and ceilings for credit risk, this same Commission, at its meeting in Oct. 2000, pointed out that subsisting divergences were a product of the characteristics of each market and that at all events they observed the same concepts and objectives, therefore not involving significant asymmetries regarding prudential matters.
1. Access to the financial system

Regarding access to the financial system, that is to say to the possibility of entities already existing and operating in any of the member countries establishing themselves and operating in the other MERCOSUR States, the systems in the four countries have been - and continue being - examined, and asymmetries in regulations have been observed which are still valid as of today, as well the effective possibility of installation and operation and the necessary requisites for such purposes. Throughout the meetings of Subgroup 4, no progress has been seen in the necessary agreements regarding conditions that should apply to admit the installation in the MERCOSUR of financial entities from the member countries or even third party countries. This was one of the Subgroup's conclusions at the Porto Alegre meeting held in September 1994, still applicable, which ended by suggesting that at the next meeting of the Subgroup's commission on financial matters, this item should continue to be examined. In turn, at the November 1994 meeting, the Financial System Commission confirmed that regarding internal legislation in force in Brazil and Uruguay respectively, no progress had been made regarding the necessary agreement on conditions to be applied to admit the installation of financial bodies from each of the member countries and outside the zone, in the context of MERCOSUR. Those restrictive regulations are still in force.

Subsequently on the basis of Subgroup 4 Minutes No. 1/95 the examination of harmonisation difficulties in the systems for access by financial, insurance and reinsurance institutions to other Party States, was postponed at least until the year 2000. And so far, this item has not been addressed again on the agendas of the Subgroup Commissions.

2. Net worth requirements

Regarding standards for minimum capital as arising from the Basle Committee recommendations, already at the first meetings of the Commission agreement was reached by all the delegates regarding the advisability of bearing in mind the Basle Committee recommendations, proposing to the Common Market Group that they be adopted to establish minimum capital levels. On this basis the Common Market Group Council issued Decision Recommendation No. 10/93, providing that the Asunción

240 See supra, note 22530.
Treaty signatory States apply the Basle Committee guidelines. At the time of the beginning of the Commission's meetings, it was seen that regulatory requirements in Brazil, Paraguay and partially in Uruguay, did not coincide with the Basle Committee recommendations.

In view of Resolution No. 10/93, it was agreed on the need for harmonisation to be made in the sense of bringing the member states' positions as close as possible to the Basle Committee definitions, without prejudice to the need for adaptation that the financial systems of each of such countries might require specifically due to their own characteristics.

On this issue, progress was made between the start of the Subgroup meetings until their first finalisation in 1994. First of all, the asymmetries existing in this matter were surveyed. On this basis, Brazil issued Central Bank Resolution No. 2.099 adopting the Basle Committee's basic guidelines, and relinquishing former capital requirements, which were set in relation to the entity's indebtedness. Furthermore, on examining the mechanism foreseen in the individual legislation of the signatory countries, it was observed that the guidelines to determine minimum capital needs were already set on the basis of asset risks. However, in the form of integrating capital the distinction between basic and supplementary capital was not conceptually respected (only Argentina separated basic capital from supplementary capital for regulatory purposes). It was noted that, in the case of Paraguay, such harmonisation was only on the way of being adopted as it would be a result of the sanctioning of the new bank law, in process of legislative sanctioning.

The national delegates to Subgroup No. 4 concluded at their September 1994 meeting that the differences subsisting on the weights applied, methods of calculation, periodicity of demands and others, would not be conceptually significant once the new Paraguayan regulation had come into force.\(^{241}\)

As from 1995, progress continued to be made in the implementation of the Basle Committee Recommendations regarding minimum capital levels on the basis of risk weighted assets and periodically surveyed.\(^{242}\) In 1999,

\(^{241}\) See supra, note 22530; see also EVA HOLZ, supra, note 8893.

\(^{242}\) Thus for example, it may be mentioned that at the May 1998 meeting, the Financial System Commission stated that, in general each country determines the capital requirements of financial entities on the basis of assets weighted by risk, however that some departure from the recommendations of the Basle Committee subsisted in the areas of differentiation and components of basic and supplementary capital, capital requirements by market risk, criteria to assign weights in each risk category.
Subgroup 4 specifically assessed progress in the reduction of asymmetries regarding this issue and concluded that in general terms, each country was complying with the Common Market Council Resolution No. 10/93. 243 However, some exceptions were observed, such as the fact that only Argentina contemplates capital requisites on the basis of market risks, in Paraguay there is no differentiation between basic and supplementary capital (note that this situation is the exact opposite of that described four years before, when only Argentina made this differentiation), although all the capital components suggested by Basle are contemplated in its regulations. It was also noted that existing asymmetries regarding the weighting of assets had not been up-dated at that time.

At present, all the MERCOSUR countries have adopted guidelines for weighted capital by credit risk of at least 10% of the assets. Moreover, in 1999 the situation revealed that Argentina required a minimum of 11.5% weighted capital by credit risk (as detailed in Chapter IV Section I.E and Chapter V Section II.B, as of 2002, the minimum is 8%.) , Brazil demanded a minimum of 11%, while in Paraguay and Uruguay, and the minimum guideline was 10%.

3. Credit risk ceilings and limits on credit concentration

On starting its work, the Subgroup detected the asymmetries existing regarding credit risk ceilings and limits on credit concentration, a task that was fully completed. Such asymmetries still persisted in 1994, and therefore it was agreed to revise the provisions in each country on the matter in order to harmonise some specific aspects such as computing a collateral for the establishment of credit limits, the maximum ceilings for assistance, be it individual or global, definitions regarding operations with related clients, and concepts involving taking on credit risks.

At the September 1994 meeting of the Subgroup 4, the financial system Commission agreed on which asymmetries should be harmonised. According to the Commission guidelines, credit risk ceilings should be differentiated by whether the operations possessed or did not possess an effective collateral, fixing lower ceilings in the event that they did not have them. There should be ceilings on marketing and financing authorised to

243 Minutes corresponding to the May 1999 Meeting. See supra, note 22530.
local and foreign entities.\textsuperscript{244}

Subsequently, in May 1998, the Financial System Commission noted that considerable differences in this matter still persisted among the MERCOSUR countries.\textsuperscript{245} For example, in the individual quantitative ceilings, by economic groups and in relation to major credits. There were also differences in the definition of the base equity to determine the ceiling and in the computable collateral. The concept of operations covered and excluded from the risk ceiling had not been completely harmonised either. Said differences still persist as of today.

4. \textit{Classification of debtors and provisions}

The survey completed in relation to the classification of debtors and provision for bad debts identified a series of significant asymmetries to be harmonised. In turn, while working on this survey, at the successive meetings of the Subgroup 4 Financial System Commission the significance and main points of such harmonisation were defined.\textsuperscript{246}

In this respect, at the September 1994 meeting\textsuperscript{247} of the Subgroup, the Financial System Commission agreed on the significant asymmetries that should be harmonised, following international criteria and particularly recommending that the existence of various categories of debtors should be considered, according to the amounts and conditions influencing classification. For the classification of such debtors, their paying capacity and fulfilment of their obligations should be considered as well as the most relevant elements within the set of factors that were assessed in this respect: a revision of the regulations in force regarding interest and reclassification of debtors in the event of renegotiation of problematic debts; that in those cases where it did not exist, a risk centre should be established which would inform the financial system of the debt and classification of the debtor, and the level of minimum provisions for each category should be established.

\textsuperscript{244} The Argentine delegate stressed the need, following the international recommendations, for the other Central Bank delegates to analyse the feasibility of implementing global limits on concentration of major risks, similar to those in force in Argentina.


\textsuperscript{246} See supra, note 22530; see also EVA HOLZ, supra, note 8893.

\textsuperscript{247} Id.
Subsequently, Common Market Group Council Resolution No. 1/96 was issued, as already mentioned.

In compliance with this Resolution, in order to make an adequate assessment of the up-dated situation in the Party States, at the Subgroup 4 Meeting held in May 1998,\textsuperscript{248} it was decided to expand the information contained in the surveys on the regulations for each country. For this purpose, the definition of each risk category was to be widened in order to determine the criteria for including a debtor in one or the other category. The debtor classification criteria should also be set out more precisely, specifying if the preponderant factor in this classification was payment capacity, the objective delay in fulfilment, collateral, etc. The criteria for portfolio segmentation of portfolios into consumer, trade, mortgage, etc. categories, were also to be stated.

Regarding this item, the Financial System Commission at the April 2000 meeting of the Subgroup, concluded that Common Market Group Resolution No. 1/96 had been complied with in all the MERCOSUR countries regarding debtor classification, credit ceilings and related clients. This may be explained because Brazil, the country where the most divergence had been noted, as from 1999, also implemented the debtor classification methodology on the basis of paying capacity and other economic and financial factors affecting them.\textsuperscript{249}

5. \textit{Supervision systems. Consolidated supervision}

Regarding supervision systems, right from the first meetings of the Commission in 1992, the importance of eliminating restrictions limiting the inspection powers of the country of origin of the entity on its units installed in other member countries was pointed out. The need for exchange of information among supervisors was also emphasised.\textsuperscript{250}

In 1994, the delegates to the Commission from the four signatory countries of the Asuncion Treaty agreed on the need and advisability of implementing a consolidated supervision system, as a suggestion to be

\textsuperscript{248} See supra, note 2376.
\textsuperscript{250} See supra, note 22530; see also supra, note 8893.
submitted to the Common Market Group. Some limitations regarding the issue were pointed out due to the scope of banking secrecy in some of the member countries, restricting the possibility of the Central Bank of one of the member countries being able to supervise banking entities originally authorised to operate in its country in financial activities the entities carry out in countries others than that of its authorisation. Of course the difficulty noted was without prejudice to the supervising possibilities of the Central Bank in the country in which such entities were operating. Furthermore, and linked to this issue, the need for improving the information system among Central Banks was agreed on, accepting the context of banking secrecy and at all events, modifying legal and regulatory limitations in force in this respect.

Also and as a consequence, agreement was reached on the need to establish an organic system for exchange of information among the Central Banks, highlighting the Argentine example which considers requests for information from other Central Banks in an analogous way to that of requests for information made by the Argentine Central Bank itself, and which do not constitute a violation of banking secrecy.

Subsequently and continuing the work in relation to consolidated supervision and the application of the 25 Principles for Effective Bank Supervision recommended by the Basle Committee, an initial survey was made on the situation in each of the countries regarding their compliance with same. This survey is still in process, as the latest agenda of Subgroup

\[252\] Id.

\[252\] Additionally, the advisability of following the Brazilian and Argentine example regarding the concept of Consolidated Supervision was agreed on, using it not only for accounting purposes but also for the application of prudential regulations. As a result and to achieve the application of a method for consolidated supervision, at the Sept. 1994 Meeting, with the agreement of all the delegates to the Financial System Commission, the draft recommendations by the Working Subgroup 4 and the Common Market Group were attached to the Minutes of the Meeting. These recommendations were prepared on the basis of a preliminary version suggested by Brazil and also a draft decision of the Common Market Council for the Member States to adopt the necessary measures. Furthermore, the Brazilian delegate tabled draft terms of reference to be considered in the preparation of cooperation conventions among supervisors in the Party Countries, which was not part of the draft recommendations already mentioned. The draft was adopted and it was suggested that each Central Bank should consider the various proposals and make comments at the following Meeting. At the Nov. 1994 Meeting, the Brazilian delegation submitted a draft Convention – previously transmitted to the members of the Financial System Commission – to be signed between the Central Banks of the Asuncion Treaty signatory countries, dealing with the adoption, by national regulation and control bodies, of the General Principles for Consolidated Global Banking Supervision, designed following internationally accepted practices, principles, techniques and criteria. The representatives of the remaining countries there present agreed on the terms of the Convention and considered its concretion necessary and important, noting however that some clauses of the text produced at the Meeting should be examined technically and legally in greater depth before adoption by the national authorities of the Party States.
No. 4, formally adopted as a Negotiating Guideline by the Common Market Group by Resolution No. 84/99 that includes this as one of the activities to be carried out, is in force and being implemented.

Specifically referring to consolidated supervision, over the past years the country delegations have submitted various texts aimed at establishing agreements among supervisors. Such documents have been examined, but none has been approved by all the delegations. Technical (legal) difficulties subsist in ensuring compatibility of these agreements among supervisors and the regulations of domestic law setting out that certain information regarding financial transactions may only be provided to third parties under a court order.

At the October 2000 meeting, the Financial System Commission stated that at that date, only Paraguay was still not applying consolidated supervision. It was noted that Brazil and Argentina prevented financial institutions from effectively controlling non-financial enterprises. On its part, Uruguay prevented any type of participation by financial institutions, at any percentage, in undertakings not linked to financial activities. In some countries, such as in Uruguay, there were some limitations on carrying out inspections on units abroad, and in this case external auditing reports were used.

It was also noted that Brazil and Argentina had signed a co-operation agreement on consolidated global supervision, and Paraguay had shown itself to be well disposed to sign the same agreement with both countries.

Furthermore, the Common Market Group Resolution No. 20/01, set out that the Party States should adopt the rules on information transparency recommended by the Basle Committee in their financial systems before 31 December 2005.

6. Illegal operations

Regarding the prevention and detection of illegal operations, a survey was made of the regulations in force in each of the signatory countries.

Subsequently and with increasing force as from 1997, the Subgroup started placing emphasis on activities for the prevention and detection of asset laundering. On this basis, a sub-commission on money laundering was established within the Financial System Commission, specifically

\[253 \text{ See supra, note 2306.}\]
promoting the co-ordination and strengthening of measures to avoid the use of financial systems in asset laundering. This Sub-commission aimed its efforts at the exchange of information among the Party States' supervisors and towards the establishment of minimum guidelines for the prevention and struggle against money laundering. Following the task of regulatory harmonisation by the Subgroup regarding the prevention and struggle against legitimisation of assets from illegal activities, these came to fruition in the year 2000 in Recommendation No. 01/00, submitted to the Common Market Group, leading to the Common Market Council Decision adopting the "Co-operation Convention between Central Banks of the MERCOSUR Party States for the prevention and repression of strategies aimed at legitimising assets from illegal activities. No further regulations in this matter were issued after the above mentioned CMC Decision.

II. INTEGRATION. MECHANISMS

A. THE MONTEVIDEPROTOCOL AND ITS FINANCIAL SERVICES ATTACHMENT.

As stated before, the Asuncion Treaty focused on free trade, referring only tangentially to the integration of services.

It was only some years later, in fact in 1997, that the MERCOSUR addressed this area specifically, giving rise to the Montevideo Protocol for the integration of services – including financial services.254 This Protocol establishes the general framework for liberalising the supply of services in the Party States.255

Subsequently the Common Market Council adopted the Sectoral Attachments to the Montevideo Protocol on Trade in Services, including the Attachment on Financial Services and the Lists of Initial Specific Commitments of the Party States.256

The Protocol's purpose is to promote free trade in services in the MERCOSUR. It applies to measures adopted by the Member States that

254 Dec. 15, 1997, date on which the Montevideo Protocol was signed. See supra, note 198203.
affect trade in services in MERCOSUR, including supply of services, purchase, payment or use of services, access to services offered to the general public by prescription of the Member States and the use of same to provide a service and the presence, including commercial presence, of persons of a member State in the territory of another member State for the supply of a service.\footnote{257} According to the Protocol, the term “services” includes the supply of a service from the territory of a Party State to another Party State, or in the territory of a Party State to a consumer from any other Party State or by a provider of services of a Party State by means of a commercial presence in the territory of any other Party State or by a provider of a service from a Party State through the presence of physical persons from a Party State in the territory of any other Party State.\footnote{258} These modalities of providing services - in which the influence of the WTO General Agreement on Trade and Services is clear - in substance imply four different forms of freeing market access.\footnote{259} The first modality is the supply of cross-border services, similar to those seen in trade of goods, implying that the consumers of one country can acquire financial services from foreign banks or take on insurance with companies residing abroad. The second modality refers to consumption abroad, whereby a country allows movement of consumers to the supplying territory. The third form implies the commercial presence of a service provider from a given country in the territory of another country. Finally, the fourth modality covers supply of services through the presence of persons of a country in the territory of another country.

According to the Protocol, the term “services” includes all services in any sector, except services provided in the exercise of government powers.\footnote{260} The latter include services not provided under commercial conditions or in competition with one or various service providers. Under the Attachment, financial services include all insurance services and all banking and other financial services.\footnote{261} Notwithstanding the preceding definition, the Attachment goes on to state that the Party States will
harmonise the definitions of activities, using for this purpose paragraph 5 of the Annex on Financial Services of the World Trade Organisation’s General Agreement on Trade in Services. And, in principle, the services provided in the exercise of government powers are excluded from the context of the application of the Attachment, unless the Party State authorises its financial service providers to develop same, or with the guarantee of, or using the financial resources of the Party States, in competition with a public entity or with a provider of financial services. The Financial Service Attachment defines service providers as an individual or company desiring to supply financial services. The definition does not include public entities.

The basic obligations deriving from the agreement include application of the most-favoured nation principle, national treatment and transparency.

The most-favoured-nation principle is defined as no less favourable treatment than that given to similar services and providers of similar services of any other Party State or third-party country. The principle admits the exception that Party States may grant advantages to neighbouring countries, regardless of whether or not they are Party States, in order to facilitate trade in the border areas of services produced and consumed locally.

For its part, the national treatment principles require Party States to treat services and providers of services from any other Party State regarding all measures affecting the supply of services, no less favourably than they treat their own similar services or similar service providers. The requirement is fulfilled when the Party State grants services and service providers from the other Party States, a formally identical or formally different treatment to that granted to its own similar services and providers of similar services.

In terms of market access, and for each modality of service supply

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262 Id.
263 Services given in the exercise of governmental faculties are expressly defined, such as those activities carried out by a central bank or a monetary authority or other public entity in pursuance of monetary or exchange policies, the activities involved in a legal social security system or public retirement plans and other activities carried out by a public entity on behalf of or with the guarantee of with the use of the financial resources of the Party States.
264 These are defined as governments, central banks or monetary authorities, or bodies belonging to or controlled by a State, devoted to governmental functions or for government purposes, excluding those bodies that basically provide financial services under commercial conditions, or private entities carrying out functions normally fulfilled by central banks or by monetary authorities.
265 See Montevideo Protocol, Section III, supra, note 198203.
specified under section II, each Party State must grant services and service providers from other member States no less favourable treatment than that provided in its List of specific commitments.267

Specifically the Party countries are prohibited from maintaining or adopting measures regarding the number of service providers, the total value of assets or service transactions, the total number of service transactions, or the total volume of production of services, the total number of individuals who can be employed in a specific service sector or who a service provider can employ, the specific types of legal entities or joint ventures whereby a provider can supply a service and participation of foreign capital expressed as a maximum percentage of foreign shareholdings or as a total value of individual or aggregate foreign investment.268

The agreement allows Party States to negotiate commitments regarding measures affecting trade in services that do not appear on lists on the basis of sections IV and V. Such obligations are to be included in each Party State’s list of specific commitments.

Each State shall specify on a list of its specific commitments, the sectors and activities, indicating for each corresponding modality of supply, the terms, limitations and conditions regarding market access and national treatment.269 However, the most-favoured-nation principle and national treatment cannot be made more flexible within the commitments indicated by each country. That is to say that the specifications introduced cannot violate these principles as this is not allowed by the Financial Service Attachment. This is a substantial difference between the regulations governing financial integration in the MERCOSUR and those established for the liberalisation of financial services within the WTO. In fact, in the latter, the General Agreement on Trade and Services admits that the principle of national treatment can be restricted or made more flexible in negotiations carried out by each country for the formulation of its list of liberalisation commitments.

266 See Montevideo Protocol, Section V, supra, note 198203.
267 See Montevideo Protocol, Section IV, para. 1, supra, note 203 198. Furthermore they agree to allow cross-border movement of capital, an essential part of a market access obligation contained in their list of specific commitments regarding cross-border trade, and also to allow capital transfer to their territories when related to the commitment of market access entered into regarding commercial presence.
268 See Montevideo Protocol, Section IV, para. 2, supra, note 198203.
269 See Montevideo Protocol, Section VII, supra, note 198 203.
Returning to the provisions of the Montevideo Protocol, they set out that the principle of national treatment and market access prescriptions are not applicable to sectors, sub-sectors, activities or measures not expressly included on the List of Specific Commitments and to the measures enumerated in the country's List of Specific Commitments that are not in line with the said principles. This implies that the liberalisation system is based on the principle that any opening up must be expressly foreseen, indicating the sector, sub-sector and activity, the modality of supply referred to and for each modality, the limitations, terms and conditions imposed for market access and national treatment. In the defect of such specifications, the obligation for Party States to grant market access and national treatment does not arise.

Liberalisation of financial services agreed on by the countries, does not prevent such States from adopting or maintaining reasonable measures for prudential purposes to protect investors, depositors, policy-holders or individuals with whom a financial service provider has contracted a fiduciary obligation, or to guarantee the financial system's solvency and liquidity. Such measures, if in any way contrary to the Protocol, cannot be used as a means of eluding Protocol commitments taken on by the Party States. The Attachment also states that prudential measures adopted by one State may be recognised by another Party State.

In turn, following the guidelines of the Common Market Group, the commitment is established that the Party States will continue advancing in harmonisation, prudential regulations, consolidated supervision systems and the exchange of information on financial services. Under the transparency principle, each State must publish all generally applicable pertinent measures that refer to or affect trade in services prior to their effective date, except in situations of force majeure. Similarly each Party State must publish international agreements subscribed with any other country and that refer or affect trade in services. The States are exempt

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270 This is clear from Section VII of the Montevideo Protocol, see supra, note 198 203.  
271 Attachment to the Montevideo Protocol, Section 3. see supra, note 2549.  
272 This when applying its own measures, either unilaterally, through harmonisation or in another way, or based on an agreement or convention with the first Party State. In order to enable such recognition, the Party State that grants it will give the other Party States the opportunity to show the equivalence of prudential regulations and their application. When recognition is made by means of a convention, the State granting it will provide the other Party States with the opportunity of adhering to it or negotiating other similar agreements.  
273 Financial Service Attachment to the Montevideo Protocol, Section 4, see supra, note 2549.
from divulging confidential information.

Finally, the third part of the Protocol provides for a liberalisation programme based on an increase in the level of specific commitments to be completed in a maximum of ten years following entry into force of the Montevideo Protocol. For this purpose, annual rounds of negotiations will be held among the Party States, with the aim of progressively incorporating sectors, activities and modalities of supply in the Liberalisation Programme. During the implementation of this Programme, each Party State may modify or suspend specific commitments included on their lists.

The fourth part of the Protocol entrusts the Common Market Group with negotiation in services in the MERCOSUR and functions regarding calling and supervising negotiations. The MERCOSUR Trade Commission is also entrusted with the application of the Protocol, giving it the functions of reception of various information elements from the Party States and treatment of enquiries and claims submitted by the Party States regarding the application of the Protocol and commitments taken on in the Lists of Specific Commitments. Any dispute settlements that may arise will be governed by MERCOSUR general procedure.

During the year 2000, the Common Market Group Service Subgroup and the Common Market Council finalised the rounds of negotiations among the Party States, which respectively approved the Party States' Lists of Specific Commitments resulting from the First Round of Negotiations on Specific Commitments on the Subject of Services.

B. OFFERS AND SPECIFIC COMMITMENTS

As stated earlier on, in compliance with the provisions of the Protocol, the Common Market Council approved the Sectoral Attachments and the List of Initial Specific Commitments (Decision No. 9/98). This initial list was the object of the First and Second Round of Negotiations on Specific Commitments, which concluded with the approval of the Lists of Specific Commitments corresponding to each of the above mentioned Rounds.

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274 Montevideo Protocol, Section XIX, see supra, note 198 203.
275 Also of receiving notification and results of consultations on the modification or withdrawal of specific commitments, of receiving the recommendations referred to in Section XII, regarding certificates and to make a periodic evaluation of the evolution of trade in services in the MERCOSUR.
(GMC Resolution 13/02 decided to call for the IV Round of Specific Commitments in Services Negotiation to take place during 2002, concluded by CMC Decision No. 22/03, followed by the Fifth Round of Negotiations initiated by GMC Resolution No. 52/03).

The criteria for the preparation and submission of the lists of specific commitments are clearly inspired by those of the WTO General Agreement on Trade in Services. This influence, apparent in the analogies observed between the Montevideo Protocol and Attachment on Financial Services on the one hand and the General Agreement on Financial Services and its respective Financial Service Attachment, is clearly set out in the Financial Service Attachment to the Montevideo Protocol, referring to the definition contained in the WTO GATS regarding definitions of financial services.

In this context and similarly to the GATS, each MERCOSUR country must establish a list of commitments including those financial services that will be subject to the rules of market access and national treatment of the Montevideo Protocol. Furthermore, they must indicate the limitations in force for same. It should be remembered that, as already pointed out, contrary to the WTO General Agreement on Trade and Services, the Montevideo Protocol Financial Service Attachment does not admit, by means of limitations or restrictions, flexibilisation or mitigation of the national treatment principle.

Commitments may consist of not including any limitation in the modality of supply (cross-border supply, consumption abroad, trade presence, and presence of individuals), or of not consolidating any commitment, which means that although the country does not limit this sector, it has not engaged itself not to do so, or lastly, of foreseeing limitations. Common Market Council Decision No. 1101 defined the meanings for the terms “no limitation” and “not consolidated” to be utilized in the Sectoral Attachments by each country.

Commitments may be of two kinds: horizontal – applied to all the sectors foreseen on the list, such as for example in some cases the purchase of real estate by foreigners – and specific, for certain services or

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277 Attachment to the Montevideo Protocol, Section 5 a) second para. See supra, note 2549.
278 Decision 9/98, Sectoral Attachments. See supra, note 2549.
279 Id.
activities.280

Following the definition of financial services, the countries submit their lists of commitments, dividing these into insurance services and bank services.281 This latter category also includes other financial services.

Here below is a brief comparative analysis of the specific commitments of the financial services sector, on the basis of modalities of supply:

Regarding offer and commitments by the Party States, in general lines it may be observed that both Brazil and Argentina have major restrictions on insurance, while Paraguay and Uruguay have more openings and commitments. In turn, Argentina and Uruguay have many commitments and openings in bank services, whereas Brazil maintains significant restrictions and Paraguay is assuming some commitments.

Another aspect to be noted is the fact that the Party States’ commitments have not substantially varied throughout the Rounds of Negotiations on Specific Commitments.282 The countries’ levels of opening and commitment are practically identical to those established in the Lists of Initial Specific Commitments.283 For example, during the First Round of Negotiations,284 only Argentina included a mention of Financial Services – although it did not specify and commitment – while the other countries did not even mention such Services at that time. Similarly, the Third Round of Negotiations, whose results were submitted to the Common Market Group in December 2001,285 did not include new specific commitments in financial areas for any of the Party States.

Here below we will specifically examine the degree of opening and limitations on financial services that the countries reviewed committed themselves to for the different supply mechanisms. The specific offers and commitments in all the already finalised Rounds of Negotiation will be included.

280 Id.
281 Id.
282 Id.
283 Id.
286 Text of the result of the Third Round, as submitted to the CMG. and approved by CMC Decision No. 10/01.
I. Insurance services

A brief comment is made on each of the supply mechanisms for these services.\(^{286}\)

Argentina and Uruguay have not consolidated cross-border supply, except for ocean and air transportation insurance and for reinsurance, on which there is no limitation. Similarly, neither of the two countries has consolidated limitations on national treatment, except with regard to ocean and air transportation insurance and reinsurance on which no restrictions have been established.\(^{287}\)

Brazil has not consolidated this form of supply, except for transportation insurance, which is not limited in any way (except for imports of goods, which requires commercial presence for the supply of services), and for hull, engine and liability insurance for which market access by cross-border supply is limited to being authorised for vessels registered in the Special Brazilian Registry, depending on domestic conditions.\(^{288}\) Brazil also limits national treatment, for cross-border supply, in the case of transportation insurance linked to the import of goods. It does not foresee limitations on national treatment for cross-border supply of transport insurance nor for hull, engine and liability insurance that can be authorised for vessels registered in the Special Brazilian Registry. It has not consolidated limitations on national treatment for other kinds of insurance regarding cross-border supply. Paraguay has not consolidated this form of supply for any sector excepting reinsurance, which does not have limitations.\(^{289}\)

In relation to foreign consumption, Argentina and Uruguay have not consolidated this mode, except for air and ocean transportation insurance and reinsurance which is not limited in any way.\(^{290}\) Limitations on national treatment have not been consolidated either except for air and ocean transportation insurance and reinsurance which is not limited. Brazil has not consolidated this form of supply. Likewise, Paraguay has not consolidated this form except for reinsurance which is not limited in any


\(^{287}\) Id.

\(^{288}\) Id.

\(^{289}\) Id.

\(^{290}\) Id.
In terms of commercial presence, Argentina places no restrictions on market access or national treatment in any of the categories. However, at the time the lists of initial commitments were submitted, authorisation for the establishment of new entities had been suspended. This situation has changed and is thus set out in the first Round of Negotiations on Specific Commitments.

For access by new companies, Brazil, Paraguay and Uruguay require insurers to set up as corporations and to be authorised by the competent authority. It is interesting to note that in the case of Uruguay, at the beginning of its list of specific commitments for the financial sector, it established with a general nature that for insurance and bank services, the supply of services should be adjusted to the regulations of the respective supervisory bodies and competent authorities. And the establishment of financial service providers requires prior authorisation by the country’s competent authorities. Such authorisation may be denied for cautionary reasons, among which prevailing market conditions. In the case of Brazil, in addition to the establishment of a corporation and administrative authorisation, a presidential decree complementing incorporation according to Brazilian law is also required.

Paraguay admits, as another alternative, that commercial presence be instrumented in the form of branches of foreign corporations. Prior authorisation by the Insurance Supervision is required in all cases.

For this method of supply, Brazil, Paraguay and Uruguay do not establish any limitation to national treatment.

For its part, at the beginning of its list of specific commitments, Paraguay establishes its horizontal commitments (applicable to all sectors, among which financial activities) specifying that commercial presence is possible for legal entities established in accordance with Paraguayan Law with offices and representation in Paraguay, for the purposes of prerogatives and responsibilities.

For this service and for retrocession and commercial presence on the market for on the job accidents, Brazil has taken on the additional commitment of regulating such participation within a maximum delay of two years as from adoption by the National Congress of legislation governing these services. We should also mention some of the horizontal

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291 *Id.*
commitments taken on by Brazil, also regarding this form of supply. Foreign investments in Brazil must be registered with the Central Bank in order to obtain authorisation for future remittances which must be made in agreement with the Central Bank procedure for transfer of funds abroad. Moreover, it was established in general that foreign service providers seeking to operate as legal entities should be organised as provided under Brazilian law, requiring in all cases the registration of the contract or bylaws at the competent Public Registry, providing the minimum information specified.

None of the countries has consolidated the physical presence of individuals, except as indicated in the horizontal commitments. These define categories of senior personnel at companies in order to provide for measures as to entry and temporary stay of such individuals in some sectors.

The horizontal commitments of Argentina, Paraguay and Uruguay define senior personnel as managers, executives and specialists. No measures or sectors covering such personnel are specified. Brazil defines the same categories in order to limit work by such personnel to temporary contracts with entities established in Brazil. Furthermore, the companies must respect a proportion of two thirds Brazilian nationals employed over the total number of employees, in almost all service areas, unless foreign employees carry out specialised technical functions, having to prove the economic need for such services to the Ministry of Labour.

2. **Banking and other financial services**

In terms of its list of specific commitments, financial institutions are defined by Brazil as multiple banks, commercial banks, investment banks, real estate credit societies, commercial leasing societies, securities and distributor firms. Each one may only carry out the activities allowed by the National Monetary Council, the Central Bank of Brazil and/or the Securities Commission.

For its part, Argentina excludes financial operations carried out by the Government and State enterprises from the conditions on its list of specific

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292 Id.
293 Id.
294 Id.
295 Id.
296 Id.
commitments regarding banking services.\textsuperscript{297} These may be carried out in the entities that they designate. It also notes that it is necessary to be a member and shareholder in the Stock Exchange in order to participate in the stock market.

Cross-border supply has not been consolidated in Argentina, Brazil and Paraguay.\textsuperscript{298} Argentina and Paraguay have not consolidated either market access or limitations on national treatment, with the exception of certain bank activity advisory or auxiliary services.\textsuperscript{299} Regarding these, it is specified that there are no limitations to market access or national treatment under the form of cross-boundary supply.

For its part, Uruguay has no limits on provision of cross-boundary banking activities\textsuperscript{300} However, it has not consolidated this form of supply for securities market activities, foreign exchange brokering, asset management, payment and compensation services on financial assets, or for advisory services on financial matters.

Argentina does not limit foreign consumption in any way. Brazil and Paraguay have not consolidated this form of supply. For its part, Uruguay does not limit foreign consumption on banking services, however it has not consolidated this form of supply for stock exchange activities, nor for foreign exchange brokering, asset management, payment and compensation services on financial assets, or for advisory services on financial matters.\textsuperscript{301}

Regarding supply of services through commercial presence, Argentina does not limit any sector. Neither has it established limits on national treatment.\textsuperscript{302}

In Brazil market access in the form of commercial presence has various limitations.\textsuperscript{303} Thus, the establishment of agencies and subsidiaries of foreign financial institutions, as well as increases in the participation of foreign persons in the capital of Brazilian financial institutions are subject to authorisation by the Executive Branch on a case by case basis, granted by Presidential Decree. There are also limitations on the total number of agencies of a financial entity. Regarding services provided by non-
financial entities, there are limitations on the whole range of services regarding securities and derivatives, while market access requires that the supplier be organised as a legal Brazilian entity and, in the case of payment and compensation, the requirement is that the legal form be that of a corporation. However, there are no limitations for any of the sectors regarding national treatment for commercial presence.

Paraguay requires financial entities to be organised as registered-share corporations, except in the case of branches of foreign entities. All financial entities must be authorised by the Central Bank prior to launching their activities. There are no limitations on national treatment for supply under the form of commercial presence.

Under this form of supply, Uruguay also applies some limitations on market access, set out at the beginning of the list of the country’s specific commitments for the banking sector. These subject authorisation for establishment of branches or agencies of companies organised abroad to the requirement that their bylaws or regulations do not prohibit Uruguayan citizens from being part of their management, administrative board, board of directors, or any other senior post, job or position in the institution within the territory of Uruguay. It also limits the commercial presence of banks quantitatively, since the number of authorisations granted annually cannot exceed 10% of those existing during the preceding year. The rest of the financial institutions are not subject to this limit. Furthermore, banks must be organised as Uruguayan corporations with registered shares or as branches of foreign banks. Finally, for this form of supply, Uruguay specifies the range of activities admitted for each modality of financial entity, differentiating banks, financial co-operatives, financial concerns, off-shore funding institutions, firms administrating consortia and investment banks. Uruguay’s list of specific commitments for market access through commercial presence for all areas of banking services does not include any other limitation than those indicated above. National treatment for this kind of service provision has no limitations.

Supply of services through the presence of individuals has not been consolidated except in the horizontal commitments. That is to say, none of the countries has taken on commitments for this type of supply,
notwithstanding the fact that specifications are in force as foreseen by each Party State, in general for various service sectors, regarding the accomplishment of activities by foreign personnel in the sector's firms. As explained in the sector on insurance, in some sectors each country has defined categories of senior staff in companies within its horizontal commitments, in order to contemplate measures regarding entry and/or temporary residence of same.

Argentina, Paraguay and Uruguay define senior personnel in companies, distinguishing managers, executives and specialists. Measures of sectors that could be applied to the senior personnel thus defined have not been specified.

Brazil defines categories similar to those just mentioned, in order to limit the work of this type of personnel to temporary contracts with entities established in Brazil. Additionally, at least two-thirds of company personnel must be Brazilian nationals in almost all service areas, except for foreign employees carrying out specialised technical functions, proving to the Ministry of Labour the economic need for such services.

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307 Id.  
308 Id.
CHAPTER IV

BANKING LEGISLATION IN

THE VARIOUS MERCOSUR COUNTRIES

The present Chapter examines the standards of the banking system in each of the MERCOSUR member countries, classified by thematic units.

An analysis is made for each country, for example of the authorities authorizing, regulating and supervising the banking system; the requisites demanded from a financial institution for it to be able operate in the country; requirements regarding senior staff, directors and shareholders in a financial institution; which activities are allowed or prohibited to such institutions; and the initial and permanent net worth requirements for financial entities.

This thematic examination will make it possible to compare domestic Law standards in the MERCOSUR countries and to assess the existence of asymmetries in standards that should be solved to face the future integration of financial services in the context of MERCOSUR. This aspect will be dealt with in Chapter V.

I. THE ARGENTINE REPUBLIC

A. INTRODUCTION

The Argentine Constitution in force at the time of the signature of the Asuncion Treaty was the 1853 Constitution, which did not contain any provisions regarding integration. Subsequently, in 1994, a constitutional reform was sanctioned regulating this aspect under its article 74. This article foresees the majority necessary to approve integration treaties delegating competence and jurisdiction to supra-national organizations and establishes the legal rank of such treaties adopted by the Congress,
conferring on them a higher rating than that of laws.

The regulation regarding societies presently in force in the Argentine Republic, dates back to 1972. Subsequently and on several occasions, this legal text was the object of various modifications that were incorporated into the original regulation.

It should be noted that the previous regulation on societies, particularly regarding commercial societies, was contained in the Commercial Code, sanctioned in the nineteenth century and responded to the model of Napoleonic and European Commercial Codes of that time. It may be observed that Law No. 19,550 and its contents were not incorporated into the above-mentioned Commercial Code.

Law No. 19,950 regulates general principles regarding commercial societies. Among these principles, it establishes that the society is a subject of rights and duties with legal scope, it stipulates the invalidity regime, the relationship between partners, principles regarding administration and representation, etc., the system for its transformation, merging, division, dissolution and liquidation. It also regulates types of societies. We point out the classical personal and collective societies, limited partnership, and capital and industrial societies, limited liability societies and corporations.

Corporations are managed as capital societies where shares can be to the bearer, registered or book-entry stock. The organization of corporations responds to the classical model, that is, the shareholders meetings (regular and special) are held for the approval of management by the administrators and the corporation’s statements of accounts, or the modification of by-laws, mergers, divisions, or others, respectively. They are managed by a board of directors and audited by auditors (these are optional except for open corporations).

This classical organization may be complemented, subject to provisions in the bylaws, by the intervention of a Supervisory Board, comprising shareholders, with the function of supervising the Board of Directors’ management and possibly approving certain proceedings or contracts, as a prior requisite to drawing them up.

Law No. 19,550 regulates contracts for collaboration among

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309 See Esteva supra, note 147.
310 When Law No. 19,550, Apr. 25, 1972, was sanctioned.
311 Law No. 19,550 (Commercial Society Law), published as determined by Decree No. 841 of Mar. 20, 1984.
corporations, distinguishing the modalities of association for collaboration and the transitory union of companies. This latter modality may be constituted not only by corporations but also by individual businesspeople.

Regarding the foreign investment regime, article 20 of the Argentine Constitution sets out the principle of equal rights and treatment of foreigners and Argentines.

Also applicable as general principles on constitutional rating regarding foreign investment are articles 25 and 75, item 18, which establish instructions for the fostering and promotion of what today is known as foreign investment (these articles go back to 1853).

Finally, among the standards for constitutional rating, mention should be made of all the treaties subscribed by Argentina valid and in force, regarding Reciprocal Promotion and Protection of Investments, as the Argentine Constitution grants these a higher rating even than federal laws.

The text of the legal system for foreign investments in Argentina, which was reorganized on September 8, 1993, comprises Law No. 21,382 on Foreign Investments.\(^{312}\) This is a very liberal system aimed at implementing the constitutional principles mentioned above, bringing into line the rights of foreign investors and national investors in all fields, while completely liberalizing the entry and exit of capital. Legal and tax treatment is virtually the same for Argentine citizens and foreigners\(^{313}\).

Prior approval of the Executive Power is not required, neither is a record of the investment nor any other public office formality. In this way, foreign investment is framed in the context of private will, with complete freedom of both location and repatriation of capital and profits.

B. THE ARGENTINE BANKING SYSTEM

Regarding Argentina, first of all we have to take into account that even if the specific banking regulations and standards have not changed substantially since December 2001 – January 2002, the Argentine banking system has not been operating normally since the collapse of the economy which took place at that time and the subsequent new economic and financial rules issued by the Government (i.e. Law No. 25,561, dated

\(^{312}\) Law No. 21,382 of Aug. 13, 1976 (as amended in Sept. 8, 1993) [hereinafter Law No. 21,382].
January 7, 2002). For instance, on December 24 2001, the Argentine Government defaulted on its debt (141 billion US dollars); the convertibility currency rule was changed (1 peso equal to 1 US dollar) and shortly afterall of a sudden, a couple of days later (January 2002) the peso was worth one third of one US dollar; almost all deposits were frozen, meaning that depositors could not withdrawn their savings from the banking system ("corralito"). Also in January 2002; banks had to accept that many debts named in US dollars or other hard strong currencies could be cancelled by paying in the Argentine devaluated currency (peso) at the the previous exchange rate nominal parities (1 peso one dollar) when the peso at the time was worth one third of a US dollar, but depositors had to be maintained and finally paid back in the currency of the original deposit or at a a parity to be fixed by the Executive Power in order to preserve the value of the saving, which was called “pesificación asimétrica.” These rules meant the insolvency of all financial institutions. Even if the Argentine financial system gained international respect during the 90's regarding its solvency and - even more - its liquidity and strict compliance with high prudential standards, it could not absorb the negative shocks arising from the public debt default (all banks had strongly invested in Argentine debt, feature that was clearly induced by the Government itself), the “asymmetric pesification” and the change in the convertibility rule of the currency. There are estimates that during 2002, bank losses due to asset depreciation amounted to 20 billion US dollars. The above described situation was followed by some international banks deciding (i.e. New Scotia bank) to quit their operations in Argentina. The subsequent economic measures applied by the new Government during the year 2002 and the first part of 2003 were unsuccessful, especially regarding the “rebuilding” of the financial system. The IMF and other international financial organizations criticized the inconsistency of the Government’s economic measures. Public debt is still in default. Since the last months of 2002, the economy has begun its recovery, but still without the assistance of a local operating banking system: there is no domestic or international credit, and international trade is mostly financed by some international financial institutions.

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Decree 1.853 of Sept. 8, 1993, regulates the text of Law No. 21.382, and is wholly coherent with the basic Argentine policy regarding foreign investment, equal rights and liberalization of the applicable system.
1. The Financial Entity Law

The most substantial aspects of banking activity are regulated by Law No. 21,526 of 14 February 1977, the Financial Entity Law, in the drafting of the successive modifications to its original text.314

Law No. 21,526 begins by defining the context of its application, and includes all private or public persons or entities, and among the later, even mixed public entities of the Nation in any territorial circumscription where they may be found, which usually carry out intermediation between offer and demand of financial resources.315 It expressly includes commercial, investment and mortgage banks, financial companies, savings and loans societies, credit funds, not withstanding other figures that, due to their activities may come within the scope of this legal provision.316

Furthermore, the Law, may be applied to public and private persons and entities which are not expressly covered by it when, in the judgement of the Central Bank of the Argentine Republic, this is justified for monetary or credit reasons or if the volume of operations carried out by the entity warrants it.317

It should be noted that it is the Central Bank of the Argentine Republic's responsibility to apply the Law and its regulations, in addition to controlling institutions and persons coming under its legal provisions.318

Entities wishing to operate in the country require the prior authorization of the Central Bank of the Argentine Republic. Both this principle and its specific development are regulated under articles 7 to 17, Chapter III of the Law.

It should be noted in relation to the operation in the country of foreign financial entities, that article 3 of Decree No. 146/94319 is applicable, which provides that when they are incorporated as subsidiaries or branches of foreign capital entitiescompanies or as branches of entities abroad, they enjoy the same treatment as domestic local capital financial entities.
including matters referring to their modalities and conditions and requisites for the exercise of their activities.

The use by non-financial companies of terms such as “bank”, “banking”, “financial”, as part of their name is prohibited, as it is the use of names arising doubts about the activities carried out by the involved company or advertising made by non-authorized individuals or entities with the aim of attracting public savings. Regarding financial activity is regulated, in which use by non-authorized persons, the use of names that generate doubts or confusion and advertising that is made with the aim of attracting public savings by non-authorized persons, are prohibited.320

Merging and transmission of the commercial establishments of financial intermediation entities also require the prior authorization of the Central Bank of the Argentine Republic.321

Authorization to operate the entities may be revoked if fundamental changes have taken place in the basic conditions taken into consideration in order to grant this authorization.322

Financial entities are classified according to their activity into commercial, investment, mortgage and financial banks, savings and loans for housing societies, and credit funds.323

Commercial banks are authorized to fulfill all operations, including service operations, unless prohibited by Law No. 21,526 or by the Central Bank’s regulations.324 It is worth noting that no specific legal restrictions to commercial bank activities are to be observed in the legal text. The rest of banking is special, as will be seen further on.

Chapter 9 summarizes operations that are prohibited to financial entities, most of which are general, whatever the business of the entity, notwithstanding some specific restrictions according to the modality of the financial entity in question.

Title III of Law No. 21,526 regulates liquidity and solvency of entities, obliging these to adjust to the rules set out regarding all the parameters regulating these two elements.325

The aforesaid law envisages. Equally, mechanisms are foreseen for

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320 See Law No. 21,526, supra, note 3138, art. 19.
321 See id. art. 7.
322 See id. art. 15.
323 See id. Title II.
324 See id. art. 21.
325 See id. art. 30.
regularization and rehabilitation of financial entities that do not adjust comply with legal to all of the particulars required by the law or the Central Bank requirementsregulations regarding solvency and liquidity.

As pointed out earlier on, the Central Bank of the Argentine Republic is responsible for application of the Law and its regulations, in addition to the monitoring of institutions and persons covered by these legal provisions.326

2. Charter of the Central Bank

The Charter of the Central Bank of the Argentine Republic is contained in article 1 of Law No. 24,144 of 23 September 1992, Decree No. 1,860 of 13 October 1992, and Decree No. 1,887.327

Law No. 24,144defines the Central Bank as an autarchic State entity, setting out its purpose.329

The organization and functions of the various structures and bodies within the Central Bank are examined in detail further on.

However, it should be noted that the supervision of financial and currency exchange activities is carried out through the intermediary of the Superintendence of Financial Bodies, a decentralized body, reporting for its budget to the Central Bank.330

C. AUTHORITY REGULATING AND CONTROLLING BANKING ACTIVITIES

As stated above, the application of the Law and its regulations, as well as together with monitoring of individuals and institutions and people covered under the legal provisionssubject to same falls within the authority of the Central Bank of the Argentine Republic.

The Charter of the Central Bank of the Argentine Republic, prepared on the basis of article 1 of Law No. 24,144 of 23 September 1992, Decree No. 1,860 of 13 October 1992, and Decree No. 1,887 of 22 October 1992 defines it as an autarchic State entity, with the main task of preserving the value of the currency.332 Toward that end the Central Bank will regulate

326 See id. art. 4.
328 See Law No. 24,144, supra, note 3138.
329 See id. arts. 1, 3.
330 See id. art. 43.
331 See Law No. 21,526, supra, note 3138, art. 4.
332 See Law No. 24,144, supra, note 3138, art. 3, and Law No. 25,562, supra, note 331.
the amount of money and credit evolution, and will establish rules in monetary and financial areas according to the applicable legislation. The Central Bank is not subject to orders, indications or instructions from the Executive Power in the formulation and fulfilment of monetary and financial policies.

The Bank is governed by a Board of Directors, whose members must all be Argentine and have expertise in the subject. Its members are appointed by the Executive Power with the agreement of the Senate. It is the Board of Directors' responsibility, with regard to the financial system, to establish the technical relations for liquidity and solvency for financial entities; to establish general policies regarding the expansion of the financial system, (which must be respected by the Superintendence of Financial Entities); to revoke financial entities' authorization to operate; to authorize the opening of new foreign financial entities; and to approve the transmission financial entity shares.

The supervision of financial and foreign exchange activities operations is carried out by through the intermediary of the Superintendence of Financial and Foreign Exchange Entities, a decentralized body within reporting for its budget to the Central Bank, depending on same for its budget. The Superintendent is appointed by the Executive Power following a proposal by the President of the Bank, from among the members of the Board of Directors. The Superintendent is responsible for controlling financial bodies, qualifying them, approving their plans for rehabilitation, applying and implementing the regulations of the Financial Entity Law issued by the Bank, etc.

Regarding this same subject of supervision corresponding to the Central Bank, the Financial Entity Law establishes that the Bank may require from the various entities under its control the preparation and submission of all their accounting statements, different documents regarding their economic and financial situation, or other information they may have need of, under the form and within the deadlines it establishes.

Entities subject to supervision under Law No. 21,526 are obliged to give access permit to the officials of the Central Bank of the Argentine Republic to have access to their accounts and all their the totality of the

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333 See Law No. 24,144, supra, note 3138, arts. 6, 7.
334 See id. art. 14.
335 See id. art. 43.
This obligation also applies to credit users when checking or formalities are under way, and to unauthorized people who habitually usually carry out financial activities intermediation.  

D. LINES OF BUSINESS AUTHORIZED TO FINANCIAL ENTITIES.

UNIVERSAL, SPECIAL BANKING SOLUTIONS

Financial entities are classified according to their activity as commercial, investment and mortgage banks, financial companies, savings and loans for housing societies and credit funds.  

Commercial banks are authorized to carry out all the operations, including service operations that are not prohibited under Law No. 21,526 or by the Central Bank regulations. It is pertinent to note that no specific restrictions on commercial banking activities are to be observed in the legal text. The prohibitions included in article 28 are the only ones in force for these entities as in the case for the other financial entities, as will be explained here below.  

Investment banks may receive fixed-term deposits, issue bonds, debentures or other marketable securities related to the loans they grant, they may grant credit at least at medium term and only limitedly at short term, grant all types of guarantees and accept and place third party securities regarding operations in which they take part, invest in bearer securities related to the operations in which they take part, pre-finance and place them, act as trustees and depositories of common investment funds, manage bearer securities, rent out capital assets acquired for this purpose.  

For their part, mortgage banks may carry out all types of active and passive operations, even contingency operations, generally with real-estate guarantees relating to the acquisition, construction, extension, etc. of real estate.  

Financial companies may receive fixed-term deposits, issue bills of exchange and promissory notes, grant personal loans and grant advances on loans on sales or acquire them or manage them, etc. grant guarantees, invest in bearer securities and connected services, act as trustees and

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336 See Law No. 21,526, supra, note 3138, Title IV.  
337 See id, arts. 36, 37.  
338 See id, Title II.  
339 See id, art. 21.  
340 See id, art. 22.
depositories of common investment funds, manage portfolio securities.\textsuperscript{341}

Savings and loans for housing and other real estate societies are characterized by receiving deposits in which saving is a prior condition to granting a loan, granting loans for the acquisition or construction, etc. of housing and the substitution of encumbrance mortgages for the same purpose.

Credit Funds are characterized by granting short and medium-term loans to small enterprises, professionals, employees, workers and event to individuals.\textsuperscript{342}

The last three modalities are only authorized to receive fixed term deposits.

Chapter 9 summarizes operations that are prohibited to financial entities. In it, mention is made of general the prohibitions for all financial institutions, such as: the exploitation of non financial activities on behalf of non-financial companies, save by express authorization of the Central Bank, the establishment of encumbrances on their assets except when authorized by the Central Bank, the acceptance in guarantee of their own shares, the prohibition to carry out transactions with the members of boards of directors or persons individuals in managerial/administrative positions or with individuals physical or legal entities judicial persons linked to them, save under market conditions different from those of the market.\textsuperscript{343}

Regarding entities whose mode of activity is different from that of commercial banks, they are also prohibited from issuing remittances or transfers from one market to another.

The prohibitions and limitations on activities authorized to financial institutions were mitigated as from the sanction of Communication A 3086 of March 2000. This regulation defined “exploitation on their own behalf” characterizing as such and hence prohibiting, any non-financial activity carried out either directly or by a company in which the financial entity owns over 12.5% of the capital shares or votes in shareholding, or in the event of lesser shareholding, that equally give it the votes necessary to establish corporate willingness in the bodies of the company in question. In turn, the same regulation defined, independently from exploitation on its own behalf, the supplementary services of financial activity. For such

\textsuperscript{341} See id., art. 24.  
\textsuperscript{342} See id., art. 26.  
\textsuperscript{343} See id., art. 28.
development, the banks and financial companies may hold shares in the capital of companies whose exclusive objective is that supplementary activity, even though such shares exceed the percentages or the maximum intervention admitted in carrying out non-financial activities on their own behalf. Some of the cases of supplementary services foreseen in this regulation are intermediation activities in securities, exploitation of cashpoints, systems for the electronic transmission of transactions, management of pension and retirement funds, credit cards, leasing, factoring, management of invoice collection, data processing services, loan information services, advisory services in financial and investment areas, including mergers and acquisitions, or for the management of funds and trusts, etc. Some of the investments for carrying out supplementary activities require prior authorization by the Superintendence of Financial and Foreign Exchange Entities, (transitory acquisition of shares in companies to facilitate their development, for subsequent sale, credit cards, security intermediation), while others only need to be reported to the Superintendence prior to making the first payment.

D. ESTABLISHMENT OF BANKS IN ARGENTINA. REQUISITES, PROCEDURE. ESTABLISHMENT OF BANKS ABOARD

1. Establishment of banks. Requisites. Procedure

Entities included in the financial system may be public and private and the latter may be national, branches of foreign financial entities and representatives of financial entities abroad.

Entities wishing to operate in the country require the prior authorization of the Central Bank of the Argentine Republic. Both this principle and its specific development are regulated in Chapter 3 of the Law, articles 7 to 18.

In order to grant authorization to operate, the background and responsibility of those requesting operation are considered, together with their experience in financial activities, the elements of the project, the timeliness and advisability of the initiative, the list of members of the Board of Directors, management and supervisory boards and administrative and operating administration. The regulations do not permit people affected by inabilities disqualification and incompatibilities as
established under article 264 of the Commercial Society Law No. 19,550, those disqualified banned from holding public office exercising public positions, debtors in arrears, those disqualified forbidden from holding current accounts, or others sharing this nature or those who by decision of the competent authority have been declared responsible for irregularities in the government and administration of financial entities, to act as promoters, founders, directors, administrators, members of the supervisory boards, trustees, liquidators or managers of entities covered by the law, for a period of three years after such measures have ceased.

Private entities must be organized as corporations in order to obtain authorization to operate. This formal requisite is waived in the case of branches of institutions abroad (they must have a representation with sufficient powers), commercial banks (which may also adopt the form of a cooperative society), and credit funds (which may choose between the form of corporation, legally incorporated body or cooperative society).

For their part, the official entities of the Nation, the Provinces and the Municipalities are established according to their charters.

In all cases, the shares of entities set up as corporations must be registered. Any negotiation of shares or other circumstances that are likely to modify the qualification of entities or the groups of their shareholders or partners in the case of cooperative societies, must be reported to the Central Bank of the Argentine Republic, which may refuse to approve the change, and according to the regulations, they are also subject to adapting to the system of public offer on the commodity exchange in the country or abroad.344

Merging or transmission of commercial establishments of financial intermediation institutions also requires the prior authorization of the Central Bank of the Argentine Republic.345

2. Establishment of Foreign Entities

The Argentine system does not establish different requisites for branches of foreign entities346; therefore, their activities are conditioned to the prior authorization of the Central Bank of the Argentine Republic. Regarding capital, according to article 32, foreign entities must effectively and

344 See id. art. 15.
345 See id. art. 7.
346 See id. art. 13.
permanently maintain the corresponding capital in the country.

The activities of the representatives of foreign financial entities abroad are also subject to prior authorization of the Central Bank of the Argentine Republic, in accordance with the regulations that it duly stipulates. This text was changed in the sense indicated herein, by article 1 of Decree 146/94.347

It should be noted, regarding the operation in the country of foreign financial entities, that article 3 of Decree 146/94348 stipulates is applicable, stipulating that when they set up as subsidiaries or foreign capital companies or as branches of foreign entities abroad, they will enjoy the same treatment as local national capital financial entities, including their modalities and the conditions and requisites for undertaking their activities.

The opening of branches or other modalities of representation abroad, require the prior authorization of the Central Bank, which will decide in accordance with the regulations on this matter, requiring information on the operations to be carried out.

3. Requisites regarding senior staff

Applicants to the positions of directors, positions on the board of directors, or when renewing their mandates, must observe the general conditions of suitability and experience in financial activities, and those who are affected by disqualifications or incompatibilities established under article 264 of Law No. 19,550 may not be candidates or renew their mandates (those who cannot carry out trade, those convicted of fraudulent bankruptcy, up to ten years following their rehabilitation, those fortuitously bankrupt or who have declared bankruptcy or those insolvent up to five years following their rehabilitation, company directors or managers whose conduct is qualified as negligent or fraudulent up to ten years following their rehabilitation, those sentenced in the cases stipulated under Law No. 19,550, up to ten years after they have served their time, Public Administration officials whose activities are related with the purpose of the company, up to two years following their ceasing in their position), those disqualified from occupying public positions, debtors in arrears of financial entities, those disqualified from holding current accounts, and others sharing this nature, up to three years after the measure has ceased, those

347 See supra, note 3138.
348 Id.
disqualified by virtue of sanctions applied by the Central Bank, those who, by decision of the competent authority have been declared responsible for irregularities within the management and administration of financial entities.349

In order to demonstrate compliance with the general conditions of suitability, experience and lack of disqualification, financial entities may choose between the following procedures: either submit information justifying said conditions together with a Certificate of Judicial History to the Superintendence of Financial and Foreign Exchange Entities, at least 60 days before holding the regular shareholders or partners meeting considering the appointment of members of the board of directors; or appoint the director or manager and submit the above-mentioned documentation within ten days of holding the relevant shareholders or partners meeting.

Appointment of new general managers of financial entities or those carrying out these functions and the representatives responsible for branches of foreign financial institutions as well as renewal of the mandates of those already existing, will also be subject to prior assessment of their performance.

It has been established that in order to take up a position, the Board of Directors of the Central Bank must decide favourably on the issue and take into consideration the opinion of an Assessment Committee appointed by the President of the Central Bank.

Those appointed to such positions and those coming under the definition of the concept of “managers”, shall establish a performance bond if the Superintendence of Financial and Foreign Exchange Entities so requires. “Managers” are defined as being those administrative officials who, under this or any other name, have the authority to take decisions at the entity’s operational level and who are mainly responsible for their execution, according to the bylaws, the internal rules, the shareholder’s meeting or the governing body. Consequently, it covers officials who occupy the following positions or their equivalent, whatever the name they may adopt: general managers and deputy general managers, departmental managers in the central or main branch, managers and deputy managers of branches and agencies and other functional positions that come within the preceding

349 The system of disqualification and prohibition is foreseen under Law No. 21,526, supra.
The bond may consist of a surety deposit in the Central Bank, Deposit of Surety Bonds made out to the Central Bank and given as a pledge in favour of this Institution or a Guarantee from a Financial Entity other than the one where the position of this nature is being occupied. Non-establishment of bonds will give rise to the relative persons ceasing in their functions within 72 hours following expiry of the period set for the establishment of the bond.

For their part, the trustees (or members of supervisory boards) shall not incur in any of the disqualifications under article 10 of the Financial Entities Law No. 21,526, and their performance is generally governed by the stipulations of the Commercial Corporation Law No. 19,550.

Financial entities set up in the country must supply to the Superintendence of Financial and Foreign Exchange Entities on 30 June and 31 December each year, following a model established for this purpose as a sworn declaration, details of the companies or entities in the country or abroad linked to the directors – or equivalent authority – including the principle local responsible representative in the case of branches in the country of foreign financial entities, trustees or members of Supervisory Boards and persons fulfilling the functions of general manager or deputy general manager of the entity before they take up their positions.

Furthermore the entities must demand an annual submission of information on their family ties to their shareholders – having 5% or more capital stock or of the total votes – directors, trustees, or members of supervisory boards, general manager and external auditor, which shall be placed at the disposal of the supervisory board for the control that it makes periodically regarding operations with related clients.350

4. System for the protection of deposits

Law No. 24,485, modified by Law No. 25,089 of 11 May 1999, Decree No. 1,127/98 of 28 September 1998 and Decree No. 1,292/99 of 11 November 1999, created the System for Deposit Contingency Insurance, which is obligatory and costly, with the aim of covering risks on bank

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350 This system is regulated in Communications A Nos. 2.282, 2.573, 2.794 and 2.887. Communications are normative tools issued by the Central Bank of the Argentine Republic. Available at http://www.bcra.gov.ar/hm000000.asp (last visited Sept 23, 2004).
deposits.\textsuperscript{351}

In pursuance of the regulation Decree No. 540/95, modified by Decree No. 1,292/96, a “Contingency Fund on Deposits” (Fondo de Garantía de los Depósitos - FGD) was set up with the aim of covering bank deposits.\textsuperscript{352}

Likewise, the establishment of the “Deposits Society Corporation (Sociedad de Depósitos S.A. - SEDESA) was provided for, with the exclusive aim of carrying out the functions of trustee of the funds-in-trust contract that was drawn up between SEDESA and the National State, through the Central Bank of the Argentine Republic, to administrate the FGD.\textsuperscript{353}

Deposits in pesos and in foreign currency made in the participating entities under the form of current accounts, savings accounts, fixed-term deposits, or other modalities determined by the Central Bank of the Argentine Republic are covered by the system.\textsuperscript{354} The contingency covers the restitution of sight deposits or fixed-term deposits up to the amount of $30,000,00 pesos. The Central Bank of the Argentine Republic may arrange to have this amount changed.\textsuperscript{355}

The contingency is made in a subsidiary and complementary way to restitution of the deposits for application of privileges established by the financial entity law, within thirty working days counted as from the day following revocation of the authorization, provided the established requisites are complied with and the FDG has the sum available.\textsuperscript{356}

Regarding labour creditors, at the time the Central Bank of the Argentine Republic stipulates a financial entity’s total or partial suspension of operations or revocation of the authorization to operate, the Contingency System for Deposit Insurance shall stipulate the reimbursement to the owners of the sums deposited in the special accounts for the accrediting of remunerations, authorized by virtue of the provisions contained in Law No. 20,744,\textsuperscript{357} within no more than 5 working days from the date of suspension or revocation of the authorization to operate.\textsuperscript{358}

The financial entities authorized to operate in the Argentine Republic

\textsuperscript{351} See Law No. 24,485, \textit{supra}, note 32631, art. 1.
\textsuperscript{352} See Decree No. 540, Apr. 12, 1995, art. 1.
\textsuperscript{353} See id. art. 2.
\textsuperscript{354} See id. art. 11.
\textsuperscript{355} See id. art. 13, modified by Decree No. 1,127, Sept. 24, 1998.
\textsuperscript{356} See id. art. 17.
\textsuperscript{357} Law No. 20,744 of May 13, 1976.
\textsuperscript{358} Law No. 25,089 of Apr. 4, 1999, art. 1.
must pay FDG a monthly sum, determined by the Central Bank of the Argentine Republic ranging from a minimum of 0.015% and a maximum of 0.06% of the average daily balance of deposits in pesos and in foreign currency, established in the financial entities and with the additional contributions that the Central Bank of the Argentine Republic establishes for each entity in function of the risk indicators it considers appropriate.359

F. PRUDENTIAL REQUISITES

Title III of Law No. 21,526 regulates the entities' liquidity and solvency, obliging them to adjust to the regulations stipulated regarding credit expansion, granting of guarantees, positions of all kinds, terms, immobility of assets, technical relationships between their own resources and diverse asset resources, as well as technical relations to rate loans, guarantees and investments.360 They are required to maintain cash reserves, minimum capital and annually, the proportion of profits with a minimum of 10% and a maximum of 20% to be aimed at the legal reserve, in all cases following the stipulations of the regulations. Mechanisms for regulation and rehabilitation of financial entities that do not adjust to any of the items required by the law or the regulations of the Central Bank regarding solvency and liquidity are also foreseen.


Concerning new institutions, their minimum capital must amount to at least 10,000,000 pesos for wholesale banks and 15 million pesos for the other financial entities. The requirement of capital is 5 million pesos for financial entities (with the exception of wholesale banks) that were operating in October 1995, maintaining a requirement of less than 5 million pesos capital until the end of 1998.

However, the minimum financial liability demanded from the entities already in operation is the greater amount when comparing the basic requirement and what is calculated on the basis of risk-weighted assets.361

In the Argentine Republic, following the recommendations of the Basel Committee, computable financial liability required from financial

359 See Decree No. 540, supra, note 3516, art. 6.
360 See Law No. 21,526, supra, note 3138, art. 30.
institutions is equal to the basic net worth and supplementary net worth, deducting certain pre-established concepts. Supplementary net worth in turn, may not exceed 100% of the basic net worth. Additionally, the composition of basic net worth and supplementary net worth essentially follows the recommendations of the Basle Committee for modules in Tier I and Tier II of the capital. Thus, in basic net worth the following are accepted as computable items: share capital, non-capitalized contributions, adjustments to net worth, profit reserves, non-allocated profits, and in the case of consolidation, the participation of third parties. Supplementary net worth includes the result of the addition of subordinated bonds, in certain cases specified by the standards, one hundred percent of the results registered until the latest quarterly accounting statement audited in the latest closed exercise, that still has received no comments by the auditors, the totality of results of the ongoing exercise that have been registered at the closing of the last quarterly statement with a report by the auditor, half the proceeds or the totality of losses as from the latest quarterly or annual accounting statement that includes a report by the auditor, failures not considered in the accounting statements in certain assumptions, and contingencies to cover bad debts in the normal debtors portfolio, by 50% of the minimum amount required. From the net worth thus calculated, the balance in accounts of correspondent banks and other sight placements that are set out should be deducted, with the exception of placements at the head office, in financial institutions abroad, subject to merger supervision, provided they supervise the local entity set up as a corporation, other banks abroad authorized to take part in systems for reciprocal agreements, and payments and credits to which Argentina may have subscribed and some other situations which are explained; loan deeds that are physically not in the hands of the entity, unless custody or registry is the responsibility of certain institutions, such as the Caja de Valores S.A., Euroclear, Central Bank of the Argentine Republic, etc.; bonds issued by foreign governments having a weighted risk classification inferior to that of Argentina and that are not usually transacted on relevant markets, debt securities subject by contract to other liabilities issued by other financial entities, shares in other financial entities, net from provisions for risk of devaluation, save under

362 Communication A Nos. 2.470, 2.754, 2.970, 2.753, 2.774, 3.007, 3.022 and B No. 4.489. See supra, note 354.
certain circumstances; shares in financial entities abroad, net from provisions for risk of devaluation; shareholders; real estate provided accounting records are not properly covered; goodwill value of the business; organization and development expenses, save those expressly admitted, net from depreciation; items pending allocation; other deductions required by the Superintendence of Financial and Foreign Exchange Entities for registrations that do not reflect real operations; differences from insufficient bad debt provisions; finally, shares in companies aimed at leasing operations, pre-financing of capital issued on undertakings and advisory services to these undertakings.

In order to calculate the amount of minimum capital based on weighted risk and then to be able to compare it with the minimum capital as a basic initial requirement, a formula must be used considering the factor linked to the qualification assigned to the entity according to the assessment made by the Superintendence of Financial Entities, fixed assets weighted by 15% or 12.50% (according to whether they incorporated their net worth before or after the 1st of July 1993 respectively) and non fixed assets (considering loans, other credits from financial intermediation, other financing or assets), all of which shall have an 11.5% weighted risk. Furthermore, public bonds accounted for in investment accounts and loans to the public, non-financial sector have a requirement varying from 1% to 5% according to their modified duration. Lately, (Communication A 3959 of 29 May, 2003) as a way to get out of the general bank insolvency caused by the 2001 – 2002 Argentine collapse, a new rule was issued lowering to 8% the amount of minimum capital based on weighted risk, and establishing additional requirements to be complied in full on June 2004.

It is interesting to note that in loan risk weighting, for operations concerning financial intermediation and other ways of financing credit through financial intermediation and other financing, except in for operations among financial entities, the formula considers - in addition to the weight factor regarding risk assets risk - a risk indicator according to the for interest rate risk and another one an indicator for market risk.

From the preceding analysis of the regulations, it will be observed that in Argentina capital requisites are adapted to asset risk, following the Basel Committee guidelines. The percentage of capital required in this way, is higher than the standard issued by this Committee. In fact, to calculate the
amount of minimum capital on the basis of risk and then compare it to the
minimum capital as an initial basic requirement, a formula must be used
that considers the factor linked to the qualification assigned to the entity
according to the assessment made by the Superintendence of Financial
Entities, and various groups of assets that are risk weighted according to
the categories, between 11.5% and 15%. In the weighting of loans, other
credits through financial intermediation and other financing, save in
operations among financial entities, the formula considers, in addition to
the weight factor regarding risk assets, a risk indicator according to the
interest rate and an indicator for market risk. Summing up, the minimum
capital requirements based on asset risks required in the Argentine
Republic are relatively high, oscillating between a maximum of 15%
required for certain fixed assets and 11.5% necessary for non-fixed
assets. In spite of this general requirements, as explained before, lately,
(Communication A 3959 of 29 May, 2003) and in order to get out of the
general bank insolvency caused by the 2001–2002 Argentine collapse, a
new rule was issued lowering to 8% the amount of minimum capital
exigency based on weighted risk, and establishing additional standards to
be complied in full on June 2004.

In the case of new institutions requesting authorization to operate, net
worth must be paid-in in cash in national or foreign currency, in the
National Government’s public security bonds negotiated on stock
exchanges and markets, and it is required that one hundred percent of the
basic requirement be effectively paid-in prior to the initiation of authorized
operations. In the case of financial entities that are already operating in the country,
the requirement is that their accounting net worth should be equal to or
greater than the minimum capital requirements. The items listed below are
part of the concept of such computable net worth (CNW):

Outstanding stock in compliance with the regulations is divided into
basic and supplementary capital. Basic net worth is composed of equity,
non-capitalized contributions, adjustments to net worth, reserves of non-
distributed earnings and profits. The supplementary net worth (of which
the accounting amount to determine financial liability must not exceed
100% of the basic net worth), comprises non-distributed profits that have

363 See provisions of Communications A Nos. 2241, 2740 and 2970, supra, note 3514.
not yet been audited and those corresponding to the on-going period, 50% as a precaution corresponding to the normal portfolio and its subordinated debt, with a minimum term of 5 years. The latter may not exceed 50% of the basic net worth.

From the prior amount, sight balances placed in financial entities abroad that do not have an investment grade qualification, bonds whose physical holding is not registered in custody determined by the Central Bank of the Argentine Republic, bonds issued by foreign countries with a lower qualification than that of the National Government, shares in other financial entities, real estate whose ownership has not been registered, business goodwill, expenses and organization and development, differences due to insufficient provisions as determined by the Superintendence, should be deducted.

From the preceding concepts it will be observed that the Argentine Republic follows the Recommendations of the Basel Committee to the letter, in the conformation of capital, differentiating it into basic capital (corresponding to Tier I) and supplementary capital (Tier II) and in the items admitted in each of these categories and the proportion to be maintained by supplementary capital with relation to basic capital.

2. Technical relations

The concept of technical relations is broadly used by Central Bank regulators and technical staff to refer to certain relations between financial institutions assets, resources, deposits and obligations which financial institutions have to comply with for prudential purposes. Relation between total deposits and obligations and liquid assets, credit concentration ceilings, are some examples of technical relations, which sometimes are regulated by Central Bank rules within the so called technical relations, and sometimes separately.

Under Argentinean legislation (article 30, Law 21.526 Title III titled “Solvency and Liquidity” Chapter I titled “Regulations”), this concept refers to relations established by Central Bank regulations that financial institutions shall adjust to, between their own resources and all kinds of assets, all deposits and all kind of obligations; between all different kind of

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364 See Communication A Nos. 2241 and 2970, supra, note 34954.
365 The preceding information is taken from Communications A Nos. 3314, 3307, 3278, 3128, and 2970, see supra, note 34954.
assets and obligations; and to rank assets, guarantees and investments. It is to mention that the only technical relation established by Central Bank regulation until 2003, - which on the other hand is separately mentioned, as well as credit ceilings are, by Law 21.526 - is the one between fixed assets and computable net worth, as detailed below.

a. Fixed-asset ceiling

Fixed assets jointly with financing of related clients may not exceed 90% of the computable financial liability of the financial entity in the corresponding month. Assets to be deducted for the calculation of computable net worth are not considered in the establishment of fixed assets and other items. For their part, fixed assets and other items are computed net of the corresponding bad debt risk provisions and devaluation, without deducting 50% of the minimum amount required for bad debt risk provisions on the portfolio corresponding to debtors classified as being in a “normal situation” or “normal performers” and those covered by “A” preferred collaterals.\(^\text{366}\)

In particular, the holding of shares in the capital of companies not on the official list, and of equity securities on the official list and shares in common investment funds that do not give rise to the requirement of minimum capital for market risk contingencies, may not exceed 15% of the computable financial liability.\(^\text{367}\)

b. Ceiling to foreign currencies position and loaning

Investments of assets in the country

Since 2003 a new technical relation has been established for all financial institutions. By means of the new regulation, financial institutions global net foreign currencies position can not exceed 30% of their computable net worth. On the other hand, deposits or other obligations in foreign currencies shall be applied to loans granted to exporting companies, or to other financial institutions. Maintenance of foreign currencies liquid assets in excess of the institutions loaning capacity to the expressly named sectors arises the obligation to increase the financial institution capital, which shall only be paid-in cash.

\(^{366}\) See Communication A, No. 2781, supra, note 34954.

\(^{367}\) See Communication A, No. 2140 and 2461, supra, note 35449.
This parameter has not been used from the prudential standpoint, which means that no relationship has been established between net worth and the requirement to invest assets in the country.

3. **Credit risk: limits on credit concentration**

The Argentine Republic establishes various limitations on the concentration of credit in view of the risk this implies to the entities' solvency.

The regulations consider both the capital of credit applicants and the computable net worth of the financial entity.

Regulations in function of the credit applicant's capital, establish, as a general rule, that total financing may not exceed 100% of the clients computable net worth. This limit may be increased up to 300%, provided the additional support (200%) does not exceed 2.5% of the financial entity’s computable net worth and has the approval of the board of directors or equivalent authority.

Regarding regulations on the basis of the financial entity's computable net worth, limits are introduced both on credit exposure and on equity investment in other companies. It should be borne in mind that the financial entities may only exploit companies providing supplementary services to financial activities (common investment funds, pension fund administrations, etc.). The Central Bank must give its express authorization for an entity to be able to exploit commercial, industrial or agricultural companies, provided that it is applied to all the financial entities and does not affect the solvency of the entity involved (see above, lines of business authorized, item 5).

The ceiling established for credit risk by debtor or economic group (as a percentage of the financial entity's computable net worth) for un-related clients is 15% without guarantees and 25% with guarantees. For local and foreign entities, rated as the investment grade, the ceiling is established at 25%, with or without guarantee. Furthermore, for other foreign entities, the credit concentration ceiling has been established at 5%. Finally, for reciprocal guarantee corporations, this is established at 25% with guarantee.

Regarding the ceiling established on equity investment in other companies, this is set at 12.5% of the company's capital and at 100% of the...
company’s capital for supplementary activities.

Financing, with the exception of inter-financed operations exceeding 2.5% of the computable net worth of the loaning entity, must be endorsed by the opinion of the entity’s highest authority and the approval of the board of directors or competent authority.

The concept of risk concentration has been introduced as the sum of financing which individually exceeds 10% of the entity’s computable net worth. Risk concentration cannot exceed three times the entity’s computable net worth not including financing to local financial entities, or five times the entity’s computable net worth, computing financing to local financial entities, or ten times the computable net worth of a second grade bank when computing its operations with other financial entities.

Finally, financing granted by local branches or subsidiaries of foreign entities at the order of the head office and with funds from abroad are not subject to fractioning and credit grading regulations, provided the foreign entity is class “A” or higher; is subject to consolidated supervision and the operations involved are explicitly endorsed by the head office.  

4 Credit risk: classification of debtors and contingencies

Debtors are included in the classification on the basis of criteria set out here below and of the operations they carry out with the private sector, be they financial or otherwise. Debtors are automatically reclassified on the basis of the Risk Centre. This classification involves the main debtors of the financial system and is made known to the financial system.

The portfolio is segmented to define the applicable classification criteria, according to the amount of the debt, its collaterals and the origin of the resources justifying repayment capacity.

The general debtor classification criteria are based on arrears in payment, the quality of the collaterals, the information, or lack of information existing in the financial entity regarding the client, the client’s repayment capacity, the client’s juridical situation, the assessment made of the client’s business organization and the situation of such business in the corresponding sector of activity (administration, internal control, information system, etc.)

On the basis of all the above-mentioned parameters, six categories are
established in which commercial debtors are classified (consumer credit debtors comprising another category of debtors for the purposes of classification and contingency, are of a very scant individual amount and require simpler classification systems) consisting of normal risk debtors, potential risk debtors, problem debtors, debtors having a high risk of insolvency, bad debtors and finally, bad debtors due to technical provisions. The clients are included in a single category for the total of their debts for whatever purpose.

Clients in a normal situation are those whose cash flow shows that they can easily cover their financial commitments. This is assessed on their financial situation (level and structure of the debt, payment capacity on the basis of cash flow), punctual payment, appropriate board of directors, information system, sector of activity in which they operate and perform their business. Potentially risky debtors are those whose cash flow shows that they can cover all their commitments, but situation exist that if not corrected or controlled may compromise their future payment capacity. The parameters showing this possibility are the same as those qualifying clients in a normal situation. Clients with problems are those whose cash flow shows that they have difficulty in fulfilling their financial commitments normally. Such problems, if not corrected may result in a loss for the financial entity. The indicators may be lack of financial liquidity, progressive deterioration in the projection of cash flow, arrears amounting to over 90 days or up to 180 days, a doubtful board of directors, an information system that is not fully adequate, reiterated refinancing, etc. Debtors with a high insolvency risk are those whose cash flow shows that it is highly improbably that they will be able to fulfil all their financial commitments. The indicators are the same. As an example, high level of indebtedness, negative results from exploitation, arrears of over 180 days and up to 360 days, unsuitable board of directors, inadequate information system, etc. Clients in unrecoverable situation are those with bad debts. The indicators may be suspension of payments, legally declared bankruptcy or requested bankruptcy, arrears exceeding one year, refinancing, unsuitable board of directors, lacking internal auditing, poor information system, belonging to a dying out activity or one that is in a bad situation within their sector, etc. Bad debtors are those whose debts are

308 The preceding information is a summary of the main regulations of the Argentine
considered bad at the time of analysis. Among the indicators reflecting this situation, mention may be made of the clients showing a poor financial situation with suspension of payments, legally declared bankruptcy or requested bankruptcy, arrears exceeding 360 days, refinancing of capital and interests and financing of exploitation losses, unsuitable/dishonest board of directors, no internal auditing. Bad debtors due to technical provisions are those showing arrears of over 180 days in accordance with the list prepared for this purpose by the Central Bank.

Furthermore, to establish provisions regarding contingencies, in the Argentine Republic provisions are taken into account and required for debtors in all the categories, save those classified as normal and potential. To establish such provisions, guarantees provided by such debtors are computed. Provisions are made on the total owed by the clients. All the clients categorized are included in the provisions.

Taking all the elements addressed into consideration, percentages of minimum provisions are established that vary according to the category of the debtor and if the credit analyzed has or does not have guarantees. For category 1 (client in a normal situation), the percentage of provisions, with or without guarantees is 1%; for category 2 (potential risk situation), the percentage with guarantees is 3% and without guarantees is 5%; for category 3 (debtors with problems) the percentage with guarantees is 12% and without guarantees it is 25%; for category 4 (debtors with a high insolvency risk), the percentage of provision with guarantees is 25% and without guarantees is 50%; for category 5 (bad debtors) it is 50% and 100% respectively; and for category 6 (bad debtors due to technical provisions), for both situations it is 100%.

Provisions must be established, even regarding the financial sector (with other minimum levels) but are not applicable to the public, non-financial sector.\textsuperscript{369}

5. Accounting and external auditing standards

a. Argentina has adopted a system known as BASIC, where each one of the letters making up this word represents an instrument used in banking financial system, according to a Central Bank publication of Aug. 2001.

\textsuperscript{369} All the standards relating to the debtor classification and provisions for credits of difficult liquidation arise from Communications A 2.729, 2.840, 2.893, 2.935, 2.936, 2.937, 2.950.
supervision.

Because information is a key element and that the role of supervision cannot be carried out without it, the letter I refers to the supply of information on bank performance. Correct monitoring of an entity must be based on the full knowledge of this entity.

The letter A refers to the importance assigned to the task of external auditing. This plays a significant role in the banking supervision, as it is through external auditing that the figures submitted by the bank authorities in their reports are validated and the quality of the information is certified. Financial entities must appoint public accountants registered on the Superintendence’s “Registry of Auditors” for the task of external auditing.

The letter S refers to the supervisory function of the controlling body. Supervisory policy is based on the belief that traditional supervision plays an extremely important role, complemented but not substituted by market discipline.

Using the information generated and validated within this system, the letters B (whose application was suspended in June 2001) and C enable the market to monitor and control financial entities. Letter B refers to the banks’ obligation to issue bonds and other long-term liabilities. To fulfil this requisite, banks are subject to the need to have the favourable opinion of national and international institutional investors, who are placing their capital at risk. In this way a new group of economic agents is generated, which monitor the entities.

Finally, the letter C refers to the role assigned to qualification (in Spanish “calificación”) of banks by international risk qualifying firms. The main objective is to provide depositors with information on the entities’ repayment capacity.370

b. Regarding accounting, financial entities must submit their monthly balance sheets reflecting in a consolidated way the operations of the head office, branches in the country and abroad and significant subsidiaries in the country and abroad. For their part, local financial entities must submit quarterly and annual balance sheets, reflecting in a consolidated way the operations of the head office in the country or abroad, the subsidiaries, the

operations of entities or companies in which they possess or control over 12.5% of the votes in the cases in which the Superintendence of Financial and Foreign Exchange Entities thus stipulates by resolution and the entities and companies not subject to consolidated supervision, but that the entity chooses to include – prior authorization of the Superintendence of Financial and Foreign Exchange Entities.371

Furthermore, within 90 days of closing the period financial entities must publish the general balance sheet and profit and loss account, certified and substantiated by a professional accountant on the registry of public accountants.372

F. BANKING ACTIVITIES AND THE FINANCIAL MARKET

Regarding the financial market, Law No. 17,811,373 is in force, under the provisions of its present text.374

The Law regulates the whole stock market, covering public offer of securities, the organization and operation of stock-market institutions and the performance of stockbrokers and other persons undertaking trade in securities. A chapter is included on other stock exchanges or trade markets. Market brokers are the Stock Market and the Stock Exchange.

Furthermore, on the basis of Law No. 21,526, financial entities are classified by activity into commercial banks, investment banks, mortgage banks, financial companies, savings and loans for housing societies and credit funds.375

Commercial banks are authorized to carry out all loans and deposit transactions or even services that are not prohibited by the Law No. 21,526 or by the Central Bank’s regulations.376 The regulations authorize them to issue marketable bonds, make investments in bearer securities with limitations on their technical proportions and act as underwriters for issues. For their part, investment banks may carry out operations linked with other stock-market operations, such as issue bonds, securities or other marketable stock relative to the loans they grant, accept and place third-party stock relative to the operations they take part in, invest in bearer

371 See Communication A, No. 2989, supra, note 354.
372 See Law No. 21,526, supra, note 318, art. 36.
373 Law No. 17,811, July 16, 1968.
374 Changed on several occasions, the last being by Law No. 24,241, Oct. 13, 1993.
375 See Law No. 21,526, supra, note 318, Title II.
376 See id. art. 21.
securities relative to the transactions in which they participate, pre-finance and place them and act as trustees and depositories in common investment funds.

Furthermore, it should be noted that banking entities are authorized to integrate stock-market companies, taking part in the stock market as brokers.

To end this examination, although it will be seen that banking and financial markets would seem to constitute two separate contexts, in the sense that brokers and stock market companies of the financial market are not authorized by this sole circumstance to develop financial intermediation, and in turn, banking and other financial entities regulated by Law No. 21,526 do not seem to be authorized to develop financial market activities, commercial banks and investment banks do carry out stock exchange operations.

G. BANKING SECRECY

Title 5 of Law No. 21,526,\(^{377}\) in its text as modified by Law No. 24,144 regulates the scope of banking secrecy.\(^{378}\)

This text sets out that entities covered by Law 21,526 may not make known the deposits and all operations creating liabilities or loans payable they are involved in. Exceptions to the obligation of banking secrecy are requests for information by judges in court cases, the Central Bank of the Argentine Republic in fulfilment of its functions, tax-collecting bodies in general, provided the request refers to a precise person in relation to on-going checks, and this must be requested in advance in compliance with all the relevant formalities. If the request comes from the General Tax Office, only the last item must be fulfilled.

The people working as staff in these entities are also subject to the banking secrecy obligation.

In turn, it is specified that information reaching the Central Bank regarding deposits and all operations that create liabilities, in compliance with its functions, are covered by banking secrecy. Equally, the staff of the Central Bank of the Argentine Republic or of the external auditors this Bank may hire to carry out its tasks, are also under the obligation of

\(^{377}\) See Law No. 21,526, supra, note 318, arts. 39, 40.

\(^{378}\) See Law No. 24,144, art. 3, supra, note 318.
banking secrecy.

I. ILLEGAL OPERATIONS

Law 25.246 passed on April 13, 2000 and Decrees 169/01, 170/01, 1550/01 and 1547/01, respectively dated on February 13, 2001 (the two first ones), November 22, 2001 and November 28, 2001, modifies articles 277 and 278 of the Criminal Code. It defines as a criminal offense to assist the author of a crime to hide, acquire, receive the effects or money resulting from said crime, even if it is unintentional or if said assistance is not provided in order to obtain a profit. Another crime stated by the law is to transfer, manage, sell, or apply in any way money or goods resulting from a crime, when it is likely that as a consequence of any of these operations the original goods or effects will appear as of lawful origin. All these crimes are punished with imprisonment. The mentioned law also establishes an additional punishment - when these crimes are committed by public servants or professionals who require special authorization -, which is a special inability for carrying out said activities.

Law 25.246 creates the Financial Information Unit, as an autonomous body within the Ministry of Justice and Human Rights, whose objectives are to prevent and impede all money laundering operations coming from crimes related to drugs trade and traffic; arms smuggling; fraud committed against the Public Administration; minor’s prostitution or pornography. The Financial Information Unit will analyze all activities and operations which may involve money laundering; will cooperate with the judicial authorities to bring all money laundering cases to court. The Financial Information Unit can require all information relevant to its task to any public entity or body, as well as to individuals or legal corporations, be they public or private, who are obliged to provide said information. If legal secrecy provisions are invoked against the Financial Information Unit information request, the latter may require judicial authorization in order to get the required information. The Financial Information Unit is entitled to issue rules to be complied by all private or public individuals and legal entities regarding money laundering prevention,
The Financial Information Unit is integrated by five members: one Central Bank officer, one National Securities Commission officer, one expert on money laundering issues from the Drugs Secretariat within the Presidency of the Nation; two experts (i.e. financial experts or criminal lawyers or other professionals) in areas related to the scope of the law. The Financial Information Unit members shall be exclusively dedicated, and are prohibited to carry out any other activity. The term of their mandate is four years, which may be indefinitely renewed. They can be removed for physical or mental inability, for gross negligence, poor performance of their duties, or for the commission of any crime.

The Financial Information Unit will have links to the Ministry of Justice and Human Rights, the Ministry of Foreign Affairs, the Ministry of International Trade, the Drug Use Prevention Secretariat, the Central Bank of the Argentinean Republic, the Federal Administration of Public Income, the General Justice Inspection, the National Securities Commission and the Nation Insurance Superintendence in order to advise and coordinate their respective activities.

The Financial Information Unit shall not reveal the identity or source of the information it gets. The law states an extensive list of entities and individuals obliged to provide information to the Financial Information Unit, including in same all financial entities, all companies carrying out foreign exchange activities, all entities carrying out gambling activities, all individuals and entities carrying out capital market activities or intermediation, all enterprises carrying out post services and money transfers, insurance companies, all individuals or legal entities trading in numismatic or philatelic collections, art works, antiquities and jewelry. Said individuals and legal entities are obliged to keep records of their customers, clients and beneficial owners. They are also obliged to inform the Financial Information Unit all suspicious activity.
II. REPUBLIC OF PARAGUAY

A. INTRODUCTION

The Paraguayan Constitution in force at the time of signature of the Asuncion Treaty, was that sanctioned in 1967, which in the final sentence of its article 9 admits the possibility of the Paraguayan Republic incorporating international multinational systems, and in its article 103, stipulates that the State will favour the integration process of the countries of Latin America (but on the basis of the Republic’s interests and without prejudice to its sovereignty). The 1992 reform to the constitutional text, in its articles 137, item 1, 141 and 145, added standards specifically relating to our subject. It is recognized that Paraguay, as other countries, is able to admit supra-national juridical regulations and the incorporation of international treaties into Paraguayan Statutory Law is foreseen, together with the establishment of the order of priority of the regulations in internal law.

Paraguayan corporate law is presently fully regulated in the Civil Code, Chapter 9. This contemplates general principles on the matter, within which recognition of the corporate entity’s legal capacity, its operation and dissolution, regulation of the types of companies, including that of simple company (which among other things, does not carry out commercial activities) and even complex figures, such as corporations.

Within the different definitions, some classical forms of partnerships are set out, such as collective partnerships and limited partnerships, the intermediary formula of limited liability companies and capital societies par excellence, which are corporations.

The latter are organized in a classical scheme: the shareholders gathered at Shareholders’ Meetings annually determine on management, balance sheet and profits, and at special meetings decide on reformation of the bylaws, changing of the amount of paid-in capital, issuing of debt deeds and other decisions such as mergers, splits, etc. Their administration is entrusted to one or more directors appointed by the Shareholder’s Meeting and supervision corresponds to statutory auditors.

Regarding foreign investments, Law No. 60/90, Law No. 117/91 and

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379 See Esteva, supra, note 147.
Decree-law No. 19/89 are a sign of the evolution of Paraguayan opening up at that time. The standard previously in force regarding foreign investments, Law No. 551/75 was annulled, and substituted by a mechanism that was much more favourable to the promotion of foreign investment. The basic difference was the simplification of the formalities for the admission of such investment, the elimination of restrictions on foreign investment such as the systems for money remittance abroad, reimbursement of capital, approval of investment, concession of additional benefits to investment (promotional credits).

Furthermore, in their general system and structure, the new provisions are much more flexible than the previous ones regarding mechanisms for the ruling the promotion of investment.

As is usual, the benefits granted to investment or reinvestment of national or foreign capital in goods and services and technical assistance (including intangible assets and contracting of capital assets) are basically of a fiscal nature which frees them from taxes, levies or other similar charges.

The Investment Council, a body advising the Ministry of Industry and Trade and the Ministry of Finance, is responsible for the assessment and decision on investment projects, and for keeping a record of requests and background information on authorizations granted, etc.

B. THE PARAGUAYAN BANKING SYSTEM

The Paraguayan banking activity system at the start was outlined by Law No. 417 of 6 November 1973 and modified by Law No. 771 of 14 November 1979. It is also pertinent to quote the charter of the Central Bank of Paraguay, Decree-law No. 18 of 25 March 1952. Subsequently, Law No. 861 of 1996 was issued, fully annulling the above-mentioned Laws No. 417/73 and No. 771/79.

This last regulation, the General Bank, Financial Institution and other Credit Entities Law and the charter of the Central Bank of Paraguay, stipulate the entities and activities covered by banking regulations, the requisites that financial entities must fulfil in order to establish themselves and be authorized to carry out their activities, authorized and prohibited activities, organisms regulating and controlling banking activities, capital

and reserve requirements and other liquidity and solvency indicators, the accounting and information systems, the auditing mechanisms as well as the sanctions applicable to those breaching the regulations set out. All this is set out in various chapters, where details of each subject are given.

C. AUTHORITIES REGULATING AND CONTROLLING BANKING ACTIVITIES

The authority regulating and controlling banking affairs in Paraguay is the Central Bank of Paraguay, following the decision of the Banking Superintendence. Resolutions issued by the Superintendence are obligatory, notwithstanding the possibility of their being appealed before the Board of Directors of the Central Bank of Paraguay within ten days of notification.

Law No. 489 passed on June 20th, 1995, as previously Decree-law No. 18 of 25 March 1952 defines creating the Central Bank of Paraguay defined it as an autarchic State institution (art. 1), related to the Executive Power through the Ministry of Finance (art. 7). It is the Central Bank’s responsibility (article 4) to regulate monetary policies, to promote the banking system’s stability, liquidity and solvency and suitable distribution of credit in the economy, to collaborate in the coordination of the Government’s State’s economic, financial and fiscal policies, and to regulate and monitor the foreign exchange system and the international reserves, to accumulate international reserves as a mechanism to regulate monetary fluctuations, to intervene in the regulation of abnormal capital flow between the country and abroad.

The Central Bank of Paraguay is governed by a Board of Directors, appointed by the Executive Power with the Senate’s consent in agreement with the State Council, whose members should be individuals of recognized competence in economic or banking affairs from among persons of recognized competence in economic or banking affairs.

In turn, the Banking Superintendence is a technical body within the Central Bank reportings to the Board of Directors. The Banking Superintendence is responsible for, and supervising and ensuring the correct operation and compliance by financial entities with banking

\[381\] Id. arts. 4, 6, and 10.
\[382\] Law No. 489 Decree-Law No. 18 of 1995, arts. 11 and 129.
legislation, for inspecting banking institutions in the country and other entities under to its control, reporting the findings to the Board of Directors of the Bank and to the entities inspected. The Superintendence is directed by an is exercised by a Superintendent appointed by the Executive Power upon proposal of the Central Bank Board (art. 32).

Among other wider functions basically relating to internal control of the Central Bank of Paraguay, the Superintendent collaborates to ensure the correct operation and compliance with banking legislation, inspecting banking institutions in the country and other entities submitted to his/her control by law, promoting a system of accounting and banking reports with the banks, annually inspecting all the banks and entities subject to his/her control, reporting the findings to the Board of Directors of the Bank and to the entities inspected.

Within the regulatory powers of the Central Bank, Law No. 861/1996 specifically states that the Central Bank of Paraguay shall authorize operation of financial entities, issuing regulations applying to them (art. 4), it shall inspect and monitor, through the Banking Superintendence, all financial entities, (art. 102) it shall establish the accounting standards and regulations which it shall apply to them.\(^{383}\) These general provisions are developed for their concrete implementation by the law itself in diverse articles, as detailed in the following items.

D. AUTHORIZED LINE OF BUSINESS FOR FINANCIAL ENTITIES, SPECIAL OR UNIVERSAL BANKING

As will immediately be observed, the whole of Paraguayan banking may be classified as universal banking. Article 40 of Law No. 861, introduces a remarkable in a notorious change vis-à-vis the previous system in which the entire banking system was special, provides for a range of operations for banks. Said operations include acquisition, sition keeping and selling and conservation of shares and bonds issued by corporations in the country, to temporarily subscribe underwriting the first first issues of publicly bid offered securities, marketing and selling conserve shares of corporations that provide exclusive services to the entity, marketing and conserve selling shares in banks or other financial institutions operating on foreign stock exchanges, managing administrate pension funds and

\(^{383}\) Law No. 861, art. 103 and following. 144
investment funds, act as trustees, etc.

Paraguayan financial entities, according to the operations they are authorized to carry out, are classified into banks, financial entities, branches of foreign financial entities abroad and official banks.\textsuperscript{384} The possible objective of the banks is stated, while activities authorized to financial entities/investment banks is similar to that of banks, except that they are not allowed to have their customers open or operate through banking currency accounts operate through banking current account contracts, nor to issue or operate letters of credit. It is not mentioned whether they can purchase or hold conserve shares in banks or other entities abroad. Under both modalities, banks and financial entities investment banks may acquire and keepmaintain title-deeds of the Paraguayan public debt, Central Bank of Paraguay bonds, carry out operations and even hold precious metals, carry out foreign exchange operations for international exchange, etc. In turn, branches of foreign investment banks are authorized to carry out business following their established practice; however, they are subject to the provisions of Law No. 861/96 and other applicable Paraguayan legal standards. Official banks are regulated by their respective charters regarding their authorized activities on the financial market.

Chapter 3 of Title V of Law No. 861, in (articles 70, 75 and 76), establishes the list of activities prohibited to banks, applicable to financing financial entities, state banksby cross-reference to article 75 and branches of foreign entities under the regulations of article 76.

These are general prohibitions, applicable to all institutions developing financial intermediation activities. Thus they are not allowed to receive their own shares or shares from other financial entities as a guarantee for their operations, or to finance the paying-in of shares issued by the institution, grant loans without guarantees for amounts above certain individual and jointly considered maximum amounts of sums of money or grant personal guarantees to their employees, directors, administrators or auditors, grant warranty bonds or act as surety or secure third-party bonds for indeterminate amounts or periods, carry out operations with those occupying senior posts in the institution or with companies or individuals linked to them under more favourable conditions than those applied to

\textsuperscript{384} Id. arts. 40, 73, 76, and 77.
clients or grant loans in the established way to the benefit of employees, undertake operations outside their authorized line of business, acquire shares from corporations outside financial intermediation that are shareholders in the entity in question.

E. ESTABLISHMENT OF BANKS IN PARAGUAY. REQUISITES PROCEDURE.

ESTABLISHMENT OF FOREIGN BANKS.

1. Establishment. Requisites and Procedure

Article 5 of Law No. 861 indicates that no entity may carry out banking or financial activities on Paraguayan territory without the prior authorization of the Central Bank of Paraguay. Furthermore, only authorized entities may use the generic denominations distinguishing any of the classes of this activity, such as bank, banking, financial institution, or other similar denominations that may lead to confusion. In the denomination or name of the entities authorized, a specific reference to the activity they carry out must be made.

Financial entities developing any activity of such a nature must be organized as corporations with registered shares. Article 156 of the Law's temporary provisions establishes the schedule of adjustment to this requisite for the shares to be registered by financial entities existing at the time the law was sanctioned. This requisite does not apply to entities created by a specific law or to branches of foreign banks that develop activities on Paraguayan territory.

Another element required to enable operation of financial institutions is that they pay in and invest in cash the minimum capital stipulated under article 11 of this Law. This minimum capital is obligatory for all the entities operating in the country. The minimum amount for banks is G10,170,000,000.~, while for financial companies and societies in the Savings and Loans on Housing System, the minimum amount is G 5,085,000,000. These sums are up-dated annually based on the CPI, calculated by the Central Bank of Paraguay. Article 157 of the Law's temporary provisions, foresees a period of adjustment during which already authorized financial entities must adjust to the new requirements for minimum capital. As they increase their capital, they are able to

385 Id. art. 10.
operate according to the new range of authorized activities, discarding the restrictions previously in force regarding the line of business.

The appropriate authority for the registration of financial entities on the Record of legal persons and associations requires a copy of the authorization conferred by the Central Bank of Paraguay.

The requisites for the authorization to operate are set out in Chapters I and II of Title II of the Law under discussion, articles 11 to 14 inclusive.

The respective request for authorization shall be submitted by the promoter(s) who must be individuals of recognized moral and economic soundness, who should also be founding partners of the institution to be promoted.

Notwithstanding the Central Bank of Paraguay’s power to establish the requisites for the request for authorization, article 13 of the Law places emphasis on the full total identification of the shareholders and their respective participation amount of in the financial entity’s subscribed and paid-in capital stock by each one of them, identification and information regarding moral integrity and capital economic solvency of those individuals proposed for holding those occupying positions as members of the board of directors or as senior staff and administrative bodies. The request for authorization must also include a draft of the bylaws; the programme of activities the institution will be carrying out, the systems for internal control and auditing that will be implemented. The last clause of article 14 of the Law, specifies that the Central Bank of Paraguay will reject requests that do not comply with the established requisites and particularly those that do not guarantee a sound and prudent management of the entity or that do not justify it, to the satisfaction of the Bank, the suitability of the project, of its shareholders, its directors or administrators.

The request shall be published three times over a period of fifteen days, in two widely read newspapers, making public the details of the request. Following the last publication and for a term of thirty days, interested parties may object to the authorization for a new entity or its organizers. The objections must be well founded.

The Central Bank of Paraguay decides on the request for authorization of the relevant bank or other financial entity within three months from the submission of the request or from full submission of the required documentation. If the requesting body does not complete the required
elements within three months from them being requested, the request will automatically be refused (art. 14), and will not be re-submitted or a new one formulated within the subsequent two years.

In the event the Central Bank of Paraguay authorizes the project, the requesting party must start operating within one year as from the granting of the respective authorization. If not, the authorization will expire, unless the requesting party justifies the reason for this delay adequately in the opinion of the Central Bank.

Chapter IV of Title II of Law No. 861, articles 18 to 20, stipulates the necessary elements for the establishment of branches of banks and financial entities for the development of financial contracting operations and for performance as trustees in funds-in-trust according the Central Bank of Paraguay's regulations.

Financial entities are obliged to constitute subsidiaries to carry out activities. The constitution of such branches is obligatory in all cases in which the establishing institutions want to act as investment or pension funds administrators managers, as security traders or as a bonded warehouse.

The law clearly establishes clarifies that these activities may be also carried out by non other, different subjects from financial entities, but and in this case, they said institutions must comply adjust with the to the requirements for minimum capital requirements set forth by Law No.861 for financial entities necessary for this purpose.

Subsidiaries have to be incorporated as Branches will adopt the form of corporations, with registered. The bank or financial entity's participation in each of its subsidiaries stock shall not be less than shares having the right to vote for at least 51% of the voting capital stock and require the authorization of the Central Bank of Paraguay, following a report by the Bank Superintendent.

Each branch will only be authorized to carry out one operation in the range of operations described. Shares of the bank or financial entity in a branch shall be no less than 51% of the paid-in capital of the branch.

Prior authorization of the Central Bank of Paraguay is also required to authorize, close, transfer the head office, branch or agency, reduce its capital and reserves, change its statute or merge with another entity, be transformed, dissolve and liquidate its business or absorb another entity of
the financial system.

The Central Bank of Paraguay must issue its findings within thirty days of submission of the respective request.386

2. Foreign Entities

In the case of branches of foreign banks or financing entities desiring to operate in Paraguay under this modality, in all that is pertinent the requisites and conditions are those already mentioned for Paraguayan entities.

The request to open a branch must be accompanied by documentation justifying the authorizations corresponding in the country of origin, if so required, added to reports on the banking supervision service reports in the country of origin, specifying solvency, appraisal of assets, orderly management and transparency of the requesting entity. This must add elements making it possible to judge the type of supervision it is subject to in the country of origin, which should comply with international standards. Another element considered in granting authorizations is the reciprocity offered by the country of the requesting party.

In addition to the above-mentioned requisites – required by Law – Resolution No. 1, Record No. 192 of 6 October 1997 of the Central Bank, establishes that in order to authorize branches, the applying requesting entity must comply with the minimum net worth standards required for a series of minimum requirements. Thus, the institution must adjust to the margin of capital solvency demanded of banks, and it must be sound, solvent and shall not present any liquidity difficulties not be under localized supervision and if the entity submitted a Rehabilitation Plan due to liquidity problems, it will be subject to the approval of this Plan by the Board of Directors of the Central Bank. It is also required that the requesting entity be qualified as “A” or “B” during the quarter prior to the starting of its operations in Paraguay opening and that it is up-to-date with all the information required by the Banking Superintendence. In turn, the requesting entity it should justify its suitability and experience in the financial system. These last elements (integrity, suitability, etc.) are also required from the Manager (power of attorney) who must submit his curriculum vitae. Finally, it should be noted that the authorizing entity is

386 Id. art. 6.
the Banking Superintendence.

The minimum amount of capital that branches must maintain in Paraguay comprises permanent funds, of indefinite duration, located and registered in the country according to regulations in force. The minimum amount of capital is the same as that established for the creation of entities in the same class.

Carrying out of business at the branch, if not the responsibility of a board of Directors, shall be done through at least two representatives who effectively guide the entity and directly respond for its management. The requisites and responsibilities required from the representatives are the same as those regarding the members of the boards of directors of financial entities.

3. Requisites for senior staff

In Paraguay, the system for Direction and Administration is established in Law No. 861 (art. 34 and following). Said regulations foresee that financial entities shall have a Board of Directors comprising a President and no less than four directors, taking into consideration in particular, the size of the entity and its composition of shares.

The president, and the directors and general manager must have to be individuals, shall fulfilling the conditions of integrity, suitability and experience required by the law, and will be chosen by the Shareholders Meeting. Furthermore a series of prohibitions and disqualifications are in force regarding the position of director, manager or auditor. Those bans, these apply to: individuals those affected by inabilities and incompatibility set out in the Civil Code for the administration and representation of Corporations; to those occupying holding positions of of directors, managers, auditors or employees of other entities subject to supervision by the Banking Superintendence; to those occupying holding positions asin branches of the State officials, with the exception of teachers and consulting or technical advisors; to those bankrupt; to those who are insolvent or who are indebted with bad debts in the financial system when their debts are either with arrears or in process of process of legal collection procedures; to those convicted for common fraud crimes; and to the directors and officials of the Central Bank of Paraguay and the Banking Superintendence.
Any changes in the composition of the board of directors of a financial entity must be reported to the Banking Superintendence within a peremptory period of two working days.

The provisions of this law referring to directors are also applicable to general managers of financial entities as the case may be. A legal entity cannot be designated as the general manager of a credit entity.

4. *System for the protection of deposits*

The Paraguayan regime, through Law No. 861 first, and then through Law 2334 passed on December 12th, 2003, regulates a "system for the protection of deposits" in its articles 100 and 101, to face possible insolvency of the Financial System Entities.

It establishes that the protection of deposits from insolvency risks from possible insolvency of the private Financial System Entities will only take place within the limits of the law. The deposit subject to protection must be constituted by the set of monetary contributions that, under any modality, in national or foreign currency, are made by resident or non-resident individuals or legal companies, in financial entities up to the equivalent of ten 75 minimum wages.

No State entity, nor the Central Bank of Paraguay take on any obligation vis-à-vis investors in a entity of the financial system that may have become insolvent, except the only in the case in which the deposit protection scheme is applicable is in the case of liquidation of a financial entity whose resources are and insufficient to repay its depositors. cy of resources from the liquidation of the financial entity. In this hypothesis, the National Treasury Deposit Guarantee Fund shall provide the necessary funds to guarantee deposits up to an amount equivalent to ten 75 minimum wages.

The Ministry of Finance shall annually budget the necessary resources to set up Deposit Guarantee Fund is financed by the State (in an amount of U$50:000.000.-) and by mandatory contributions to be made by all financial entities.a special fund based on technical reports by the Banking Superintendence. These resources shall be invested in first line foreign financial entities by the Central Bank of Paraguay and the interest shall periodically be capitalized.

When necessary, the National Treasury shall issue and place marketable security bonds on the stock market in order to have the total amount of
resources required to comply with the provisions of the regulation.

F. PRUDENTIAL REQUISITES

1. Capital and financial liability. Application of the Basle Committee Guidelines

As stated earlier on, within the regulatory powers of the Central Bank, and specifically Law No. 861 (Title II) establishes the minimum capital that financial entities must maintain as a contingency. The minimum amount required for banks is G10,170,000,000, while for investment banks and companies in the Savings and Loans for Housing System, the minimum amount is G5,085,000,000. These amounts are updated annually based on the CPI calculated by the Paraguayan Central Bank.

Paid-in capital must be maintained at all times and shall be in cash.

The obligatory establishment of a legal reserve is also foreseen, which shall be the equivalent of 100% of its capital. The reserve is established by annually transferring at least 20% of the net profits from each financial period. In all cases, it is required that in the event of a reduction of the capital or legal reserve below the minimum amount, authorization must be obtained from the Banking Superintendence. This legal reserve is automatically used to cover losses over the period, and therefore over the subsequent periods, the totality of the profits must be allocated to the legal reserve until the minimum amount is again reached. The same Chapter, in article 29, refers to another reserve, that of revaluation of non-monetary assets, authorizing that the amounts accounted for there to be capitalized (the criteria for same uses the evolution of the Consumer Price Index), provided the minimum capital has been paid-in, in cash.

Chapter 4 of the same Title III regulates the allocation/distribution of profits. Such profits can only be allocated after publication of the balance sheet for the period and by virtue of a decision to allocate profits adopted by the shareholders’ meeting or the head office. Prior to allocation/distribution the opinion of the Banking Superintendence must be sought, and will be given within 120 days of the closure of the period. Once this period has elapsed without a verdict, the profits can be allocated.

\[387\] Id. arts. 25-31.
\[388\] Id. arts. 11 and 20.
\[389\] Id. Chapter 2 of Title III.
Provisional allocation/distribution on account of the period's profits is prohibited. The allocation/distribution of profits is not authorized until at least 20% of expenses have been paid off, including those for organization and all the commissions on the sale of shares, accumulated losses and other expenses not set out in tangible assets.

Furthermore, Chapter 2 of Title V (Banks) stipulates the limits on bank operations, applicable to other financial entities in accordance with article 75, based on their real net worth. In turn, their real net worth is the result of the sum of paid-in capital, the legal and optional reserve, the generic reserve for the portfolio, contingencies, the reserve for valuation of assets under the conditions established by the Central Bank, accumulated profits and from the audited period and the addition of the computable part of subordinate bonds if applicable, from all of which are subtracted shares in branches and investments in shares in banks aboard, accumulated losses and those of the period audited, and the deficit in provisions as determined by the Superintendence.

Subordinated bonds can only be computed as an item of the real net worth if their total term is of at least four years and cannot be paid in anticipation. In this case, their computation is accepted up to an amount equivalent to 50% of the paid-in capital and reserves, but instalments due to expire over the following 18 months cannot be taken into account.

As will be seen, regarding items included in the concept of real net worth, in the Paraguayan regulatory system, no difference is made between essential and supplementary net worth, contrasting with the recommendations of the Basle Committee Guidelines. Furthermore, the lines admitted in capital do not always comply with the Basle Committee guidelines. For example, in the integration of the minimum capital demanded, the accumulated profits and those of the on-going period that have been audited are computed. Subordinated bonds, in their accounting part if applicable, are also computed. Another computable line is that of generic reserves for portfolios, contingencies and optional reserves. Reserves for valuation of assets are admitted under conditions and regulations established by the Central Bank of Paraguay. Adjustments for inflation are partially computed. Irrevocable capital investment and profit reserves are fully computed. Provisions on the normal portfolio are not

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390 Id. art. 105 (Chapter 4 of Title III).
computed. From the computation of capital, balances with branches abroad, balances of shares in other local financial entities in each country, or shares in foreign banks are in no case subtracted from the capital computed.

The real net worth composed as we have just described, is the numerator of the division necessary to determine its proportion regarding the total sum of assets for prudential purposes, following the Basle Committee guidelines. Article 56 fixes at 8% - which must exist at all times - the minimum proportion between a financial entity’s real net worth and the total amount of assets and contingencies weighted for credit risk, including its branches in the country and abroad. The Central Bank of Paraguay may increase this ratio up to 12% and it is presently established at 10%. The Central Bank is also authorized to establish other general ceilings, within these proportions, regarding open positions in foreign currencies, interest rate risk, and structure of maturity or others that may be defined according to international practices.

With regard to entities in operation, maintenance of paid-in capital for at least the equivalent of the minimum in force is required. Any capital deficit must be covered over the semester following closure of the period (article 25).

2. Technical relations

Paraguayan regulations do not define this concept, broadly used by Central Bank technical staff to refer to certain relations between financial institutions assets, resources, deposits and obligations which financial institutions have to comply with for prudential purposes. Relation between total deposits and obligations and liquid assets, credit concentration ceilings, are some examples of technical relations, which sometimes are regulated by Central Bank rules within the so called “technical relations”, and sometimes separately.

a. Fixed-asset ceiling

Regarding technical relations demanded from Paraguayan financial entities, reference must be made to the ceiling for fixed assets.

This has been established according to the type of asset, in various

391 Id. art. 43.
proportions regarding real net worth (Law No. 861, art. 58). For holdings of precious metals, this ceiling is 20%; for share holding and bonds in corporations established in Paraguay, the maximum amount is 20% which may reach 30% for temporary underwriting of the first issues of government security bonds; for holdings of bonds and other securities issued by multilateral organisms, the ceiling is 20%; for investment in chattels and real estate, except those given under leasing, the maximum is 50% and the ceiling may be raised up to 100% in the case of chattels given in payment, and for the term established by the Central Bank; for loans, contingencies and leasing operations, the ceiling is four times the real net worth; up to 60% is the ceiling for the acquisition of shares in branch entities; for the acquisition of shares in banks abroad, the ceiling is 20%.

b. Time limits for maintenance of investments

All assets, including real estate received from a bank's debtor to cancel his obligation, or acquired by the bank during debt legal collection procedures, can be kept for a maximum period of time of one year. Before that period of time is over the bank is obliged to sell the mentioned assets. Failure to comply arise the obligation to constitute a prevision of an amount equivalent to the acquisition price.

Banks are allowed to invest and keep shares of non financial companies for not longer than a year. Before that period of time is over, they are obliged to sell – in public bids procedures - the above mentioned shares. Failure to comply arise the obligation to constitute a prevision of an amount equivalent to the publicly traded shares price.

23. Credit risk: ceilings on credit concentration

Regarding ceilings on credit risks, these are established at a maximum of 20% of the real net worth of the entity for credits and contingencies per individual or legal entity resident in the country. In certain operations, this ceiling may be raised to 30% based on its collateral, with the prior authorization of the Banking Superintendence of the Central Bank of Paraguay. If the credit is issued to a non-resident, the ceiling is 5% of said net worth, unless sufficient collaterals are submitted. The limit for

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392 Id. art. 58.
393 Id. arts. 58, 60-66.
commercial and financial leases granted to a same individual or legal entity is 20% of the entity’s real net worth. In turn, regarding operations with warrants, an entity may not receive as a guarantee warrants issued by a single bonded warehouse for over 40% of its real net worth. The ceilings for credits granted to a financial entity, the collaterals received from them and deposits established in the same institution, range from between 20% of the bank’s real net worth (foreign entities), to 30% of said real net worth (local entities). Regarding foreign entities, the ceiling may be raised to 50% of the real net worth of the loaning institution when the borrower is a first category entity. The ceiling may be raised to 70% of the lender’s real net worth provided, in operations with first category foreign banks, the excess is represented by letters of credit.

34. Credit Risk: Classification of Debtors and Provisions

Regarding classification of debtors and provisions for bad debts, in Paraguay by virtue of Resolution No. 8, according to Act No. 252 of 30.12.1996 of the Central Bank, operations covered for consideration as credit risks are those that link the financial entity with the private financial or non-financial sector and with the public sector (except for balances with the Central Bank). Included in this classification are all monetary and signatory credits: loans, accounts to be collected, bonds, and standing of security or other responsibilities in national and foreign currency. There is no segmentation of the portfolio to define the classification criteria to be applied.

The general classification criteria take into account various aspects regarding debtors, specifically, their arrears, the collaterals established, if they have provided the information required by the financial entity adequately or if they deliver it in arrears or if such information is non-existent, their capacity for repayment of the loan under the conditions and within the terms originally agreed on and the specific juridical situation of each client, changes in the net worth, economic and financial situation that may have taken place with each client since the time the credit was granted.

Based on these parameters, five categories of credit risk have been established: normal risk, potential risk, real risk, and high-risk credits and bad debts.

The normal risk category includes those clients who fulfil their
obligations regularly within the terms agreed on and whose behaviour is not expected to change, who provide up-dated information on all the elements required. Potential risk clients are those credits that although regularly complied with, possess a net worth endorsement, and up-dated information, are observed to have a repayment schedule which is not in conformity with the cash flow or their credit policies are not complied with, or have arrears of between 30 and 90 days. Real risk credits are those that, while showing regular compliance, do not have up-dated information or do not stipulate contractual payment requirements beyond 180 days; in this category are also included credits for which there exist reasonable doubts as to their payment under the conditions established because of a worsening of the client’s situation; likewise, those credits showing arrears of between 90 and 180 days. High-risk clients are those with credits showing relevant deficiencies in the client’s activities that make his business scantly viable, credits granted under unfavourable conditions for the credit entity; credits with arrears of between 180 and 360 days, and credits in which the borrower has been legally summonsed by creditors. Bad debts are those with over one year of arrears or in which the borrower’s activity makes recovery of the capital and its interests unfeasible.

In addition to these elements, criteria are considered for the establishment of contingency provisions. Furthermore, in establishing the corresponding credit provisions, the guarantees are computed in the credits being assessed for risk. There are minimum provisions that must be made, classified on the basis of the category of credit risk of each debtor. Thus, category 1 does not require provisions, category 2 requires 1%, category 3, 20%, category 4, 50% provision and category 5 requires 100%.

In all cases, provisions must be made on the balance of the debt, deducting the sales value of the real guarantees. On such balance, the percentage corresponding to the category is applied, resulting in the provision. Provisions are made regarding operations with the public non-financial sector and for the financial sector, however in the latter case, only when the credit classification places the debtor from the financial sector in risk categories 3 to 5.

4. Technical relations

Regarding technical relations demanded from Paraguayan financial
entities, reference must be made to the ceiling for fixed assets.

This has been established according to the type of asset, in various proportions regarding real net worth (Law No. 861, art. 58). For holdings of precious metals, this ceiling is 20%; for share holding and bonds in corporations established in Paraguay, the maximum amount is 20% which may reach 30% for temporary underwriting of the first issues of government security bonds; for holdings of bonds and other securities issued by multilateral organisms, the ceiling is 20%; for investment in chattels and real estate, except those given under leasing, the maximum is 50% and the ceiling may be raised up to 100% in the case of chattels given in payment, and for the term established by the Central Bank; for loans, contingencies and leasing operations, the ceiling is four times the real net worth; up to 60% is the ceiling for the acquisition of shares in branch entities; for the acquisition of shares in banks abroad, the ceiling is 20%.

5. Accounting and external auditing standards


a. The Banking Superintendence shall establish and change accounting standards and criteria for assessment applied to financial institutions, in addition to the models that they will use to adjust their balance sheet. It shall also establish the cases in which accounting information is to be consolidated, and for this purpose conclude on the existence of direct or indirect relationships among the entities.

Balance sheets must faithfully reflect the net worth and financial situation and the profits and losses of the financial entity’s activities. The Banking Superintendence may require these institutions to adjust the value of their assets, duly recognize their obligations, provisions, dubious transactions or eliminate balance sheet items that do not represent true values.
The annual duration of the accounting periods are established, and they are closed to coincide with the calendar year.

Such standards require the annual publication of the general balance sheet and the table of profits and losses, including a vouchered report made by a company of independent external auditors, within 120 days of closing the period. This publication must comply with a format given by the Banking Superintendence. Without detriment to this, the entities shall publish their balance sheets at least four times a year in order to inform their clients of the evolution of their economic and financial situation. Branches of foreign entities shall also submit at least once a year the balance sheets of the head office.

The Banking Superintendence shall publish at least every quarter, information disseminating the main indicators of the financial situation of the institutions monitored, together with a general qualification, by capital, by risk-weighted assets, profits and management.

b. External auditing is regulated by the Chapter just referred to, in which a registry of external auditors is established in order to examine the statements of financial entities. This registry shall be kept by the Banking Superintendence. It shall establish requisites as to their appointment, the context of balance sheets to be audited, technical standards to be used and additional reports to be submitted. Auditors are not covered by professional secrecy with the Banking Superintendence.

The auditors shall give their opinion on the justification of the balance sheets, their assessment of internal supervision and accounting system, results of the risk classification and shall make special reports on specific subjects required by the Banking Superintendence, at set intervals.

G. BANKING ACTIVITIES AND THE FINANCIAL MARKET

In order to examine the relationship between these fields of financial activity, in addition to the legal texts considered above, Law No. 1,284 of 1998, must also be considered. 395

Law No. 1,284 establishes that only stock-brokering firms are authorized to operate on the Stock Market and must be established for that

394 Id. art. 58.
sole purpose, and therefore, financial institutions may not operate directly on the Stock Market.\textsuperscript{396}

However, they may operate on the unlisted securities market through stock-brokering firms. In fact, banks or financial institutions may constitute or have shares in the capital of stock-brokering firms with the following limitations: a) no institution may have shares in more than one stock-brokering firm; b) stock-brokering firms in which some of such institutions have shares may not carry out transactions with shares issued by such related entities.\textsuperscript{397}

Furthermore, the whole of Paraguayan banking, as from sanctioning of Law No. 861, may be classified as universal banking. Article 40 of Law No. 861, in a notorious change vis-à-vis the previous regime, under which all banking was special, provides for a range of operations for banks, including acquiring and keeping shares and bonds issued by corporations in the country, temporary subscription of first issues of government securities, marketing and keeping shares of companies providing exclusive services to the entity, marketing and keeping shares in banks or financial institutions or institutions operating on foreign stock-markets, administrating pension funds and investment funds, acting as trustees, etc.

Activities authorized to investment banks are similar to those of banks except that they are not authorized to operate through banking current account contracts, they do not issue or operate with letters of credit, no mention is made of the possibility of them purchasing or keeping shares in banks or other entities abroad. Both modalities, banks and investment banks, may acquire and maintain Paraguayan government security bonds, Central Bank of Paraguay bonds, carry out operations and even keep precious metals, carry out international exchange operations, etc. In turn, the branches of foreign financial entities are authorized to carry out their business following their established practices, without prejudice to their being subject to the provisions of Law No. 861 or other Paraguayan legal standards that are applicable. Official banks are governed by their respective charters regarding the activities they are authorized to carry out on the financial market.

Furthermore, Chapter 3 of Title V of Law No. 861, under article 70, establishes the operations prohibited to banks, applicable to investment

\textsuperscript{396}Law No. 1,284 of 1998, arts. 104, 107.
banks under cross-reference to article 75 and to branches of foreign entities under the terms of article 76. These are general prohibitions, applicable to all institutions operating as financial intermediation entities. Thus, they are prohibited from receiving their own shares or shares from other financial entities as a collateral for their operations; from financing the consolidation of shares issued by their own institution, etc. The complete summary of prohibitions has been mentioned earlier on under the analysis of authorized lines of business. For the purpose of the present analysis, we would like to highlight, among other prohibitions, the prohibition for institutions to undertake operations outside their authorized purpose.

Summing up, it may be concluded that the relationship between the financial market and banking are close, even though banks and other financial entities may not operate directly on the financial market. They may only do this through brokers or sharing in the capital of a stock brokering firm and limiting themselves to operations on the unlisted securities market.

H. BANKING SECRECY

Chapter 2, of Title VII is intituled Duty of Secrecy (articles 84 to 89). This sets out the prohibition to all entities of the financial system, their directors, administrative boards and auditors and workers, from providing any information on operations with their clients unless they have their written consent or when dealing with exceptions expressly sent out in the above-mentioned articles. Prohibition does not apply in those cases in which revealing the amounts received from the various clients is needed for liquidating the banking or financial entities.

The obligation to maintain secrecy covers all the directors and officials of the Banking Superintendence, the Central Bank of Paraguay and the partners, representatives or workers of the auditing firms examining the financial entities balance sheets.

The obligation to maintain secrecy does not apply when the information is required by the Central Bank of Paraguay and the Banking Superintendence in the exercise of their legal responsibilities; or when dealing with the competent judicial authority by virtue of resolutions issued in court cases in which the affected body is a part, in which case

397 Id. art.110.
measures guaranteeing reserve shall be applied; the General Treasury of the Republic and the tax authorities in the framework of their sphere of competence and provided the hypothesis fulfils the circumstances referring to a specific responsible party, and that tax verification is in progress regarding this party and that the party has been formally and previously summoned.

The duty of secrecy covers all the institutions and persons excepting those referred to above, However, if in legal or administrative proceedings in which reserved information is used, the guilt of those benefiting from secrecy is established, such reserve shall automatically cease.

The duty of secrecy does not include consolidated information and qualification provided by the Central Bank of Paraguay and the Banking Superintendence, even regarding types of deposits, and not identifying specific clients.

I. ILLEGAL OPERATIONS

Law 1015 passed on December 3, 1996, and Central Bank Resolutions No. 2 dated May 2, 1997, No. 245 dated June 1, 1997, No. 1. dated November 15, 2001 and Nos. 001 and 240 respectively dated January 2 and June 24 2004, define (articles 3 and 4) as a criminal offense to hide, acquire, receive, transfer, manage, sell, or apply in any way money or goods resulting from certain crimes (i.e. drugs trade and traffic; smuggling). All these crimes are punished with imprisonment.

Law 1015 (article 26) creates the Money Laundering Prevention Secretariat as a body within the Presidency of Paraguay, whose objectives are to discipline, apply all non criminal measures, issue rules, receive and analyze information regarding money laundering operations, and order the investigation of suspicious transactions. The Money Laundering Prevention Secretariat can require all information relevant to its task to any public entity or body, as well as to individuals or legal corporations, be they public or private, who are obliged to provide said information. The Secretariat is chaired by the Minister of Industry, and is further integrated by one Central Bank's board member, one director of the Securities Commission, the Bank Superintendent, and the Commander of the National Police Office and the Executive Secretary of the SENAD.

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The Money Laundering Prevention Secretariat shall not reveal the identity or source of the information it gets. The law states an extensive list of entities and individuals obliged to provide information regarding suspicious transactions to the Money Laundering Prevention Secretariat, including all financial entities, all companies carrying out foreign exchange activities, all entities carrying out gambling activities, all individuals and entities carrying out capital market activities or intermediation, insurance companies and pension funds managers, all individuals or legal entities trading in art works, antiquities and jewelry. Said individuals and legal entities are obliged to keep records of their customers, clients and beneficial owners for at least five years, and to submit to the Money Laundering Prevention Secretariat all information and documents it might request regarding their customers and transactions. All legal entities and individuals subject to the previsions of the law are also obliged to inform the Money Laundering Prevention Secretariat all suspicious transactions their customers might be involved in.
III. FEDERATIVE REPUBLIC OF BRAZIL

A. INTRODUCTION

The Constitution of the Federative Republic of Brazil in force at the time the Asuncion Treaty was drawn up corresponds to the reformed text sanctioned on 5 October 1988.

This Constitution and for the purpose of analyzing the Brazilian situation when facing integration, is generally relevant in its Title 1 and in particular, article 4 which refers specifically to the integration of Latin America. This provision explains that the Federative Republic of Brazil shall seek economic, political, social and cultural integration of the countries of Latin America. Based on this provision, it may be inferred that Brazil is in a position to participate in supra-national organizations as a concession to Latin American integration.

Other Brazilian constitutional standards refer more precisely to economic aspects and others relating to the country's financial system and have an impact on the analysis of the integration of banking systems in the MERCOSUR countries, and therefore will be examined in this context.

Regulations regarding corporations in the Federative Republic of Brazil in force at present arise from various standards.

The basic regulations concerning corporations (commercial) were contained in the Trade Code, sanctioned in the nineteenth century and responded to the Napoleonic and European Trade Code of the time. Subsequently, Decree No. 3,708 of 1919 introduced the regulation on corporations, a system that has remained unchanged and sets out the main characteristics of this corporation model. Law No. 6,404 of 1976 consecrated the corporation system in force to day and originally contained in the Trade Code, which was abolished. Further, a New Civil Code was enacted in 2002. This New Civil Code revoked the old Trade Code and set up a whole set of rules and dispositions on Corporations (general principles) and other business entities. Corporations are still being

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399 The New Civil Code refers to general principles governing corporations, regulates general partnerships, limited partnerships, partnerships in which some partners put in money and
regulated under Law No. 6,404. However, the other business entities are entirely under the New Civil Code.

Law No. 6,404 regulates the general principles of corporations that are regulated like unit trust funds where shares must be registered (1990 change). The organization of corporations implies holding shareholders meetings (regular and special) that are aimed at approving management by the administrators and the balance sheets of the corporation, or reforms to the bylaws, mergers, splits or others, respectively. They are managed by a Board of Directors and audited by an optional Board of Auditors.

This classical organization may be complemented, in the case of open corporations where it is mandatory, by the intervention of a Supervisory Council comprising shareholders, whose function it is to establish major guidelines for the corporation’s business, elect and dismiss the directors, supervise management by the Board of Directors and eventually, authorize certain actions or contracts.

Regarding foreign investment, certain constitutional standards must be taken into account. For example, arts. 170, 172, 179, and 192 among others, bring constitutional provisions affecting financial services and integration.

According to article 172, the law shall regulate, in the interest of the nation, investments of foreign capital, reinvestments shall be encouraged and the remittance of profits shall be regulated.

At legislative level, the regime of foreign investment is foreseen in Investment Law No. 4,131. The regulation establishes that foreign capital invested in the country shall receive identical legal treatment to that granted to national capital, under equal conditions, and that any type of discrimination not foreseen legally, is forbidden. Therefore, the intention is that national and foreign companies compete under equal conditions. However, in conformity with Decree-law No. 5,452 (Consolidation of Labour Laws), two thirds of the employees must be Brazilian nationals; however, a greater percentage of foreigners are allowed when the number

other furnish services, partnerships limited by shares, the dissolution and liquidation of corporations.

400 Law No. 6,404, also recently modified by Law No. 10,303 of Feb. 22, 2001.
403 Decree-law No. 5,452 of May 1, 1943 (Consolidation of Labour Laws), art.354.

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of national specialists is insufficient.

All investments made in the country must be registered with the Central Bank of Brazil, in the Department of Foreign Capital (FIRCE) as a way of safeguarding the return of capital and dispatches of income.

B. THE BRAZILIAN BANKING SYSTEM

1. Constitutional regulations of relevance to integration and the Common Market.

First of all, the constitutional regulations set out in the text of the previously mentioned Constitution of the Federative Republic of Brazil, that directly or indirectly affect integration of banking system, will be analyzed.

Article 163 of the constitutional text establishes that the complementary law will stipulate on several issues, including public bonds, official credit institutions and internal and foreign public debt.

In turn, in Title 7, which addresses regarding the economic and financial order, contains regulations which may eventually concern the country’s banking system. In said Title, Chapter 1, in the item on the general principles of economic activities, various regulations may eventually concern the country’s banking system. Article 170, modified by Constitutional Amendment No. 6, and article 179 foresees envisage the economic order in which, among other principles, favourable treatment of Brazilian small companies with small-scale national capital will be applied observed.

Article 171 (repealed by Constitutional Amendment No. 6, in 1995) specified certain requisites to be fulfilled by companies in order to be considered as Brazilian ones. It also established that the law could provide Brazilian companies protection and special temporary benefits for the development of activities essential to the country’s development. Also under this article, the law could also establish whether a sector would be considered as essential for the technological development of the country, among other requisites.

According to article 172, the law shall regulate, in the interest of the nation, investments of foreign capital, reinvestments shall be encouraged

See supra, note 401399.
and the remittance of profits shall be regulated.

Then in Chapter 4 of the same Title (National Financial System), are added other provisions that are pertinent to our analysis. Thus, article 192 explains that the national financial system, structured to promote the balanced development of the country and serve the interests of the community, shall be governed by a supplementary law that will also stipulate authorization for the operation of foreign capital in financial institutions. Finally, article 52 (text resulting from Constitutional Amendment No. 40, 2003) of the temporary provisions of the Constitution establishes provides that until the conditions referred to in article 192 have been established, the installation in the country of new foreign financial institutions agencies domiciled abroad or the increase in the percentage of participation in the stock capital of domestic financial institutions with head offices in the country, of by foreign individuals or legal entities resident or domiciled abroad, are prohibited. The prohibition referred to in this article does not apply to authorizations resulting from international or reciprocal agreements or in the interest of the Brazilian government.

2. Legal standards and statutory provisions

Before launching on an examination of the specific provisions regarding the legal configuration of the Brazilian financial system, it should be noted that by Circular BCB N° 1.365 of 6 October 1988, issued immediately after promulgation of the Constitution of the Federative Republic of Brazil (the articles of which were analyzed above), it was confirmed that, until the complementary law referred to in article 192 of the Constitution regulating the financial system is issued, the provisions of laws governing the Brazilian financial system will remain in force. That is to say that the promulgation of the Constitution, subsequent in nearly all cases to the legal and regulative standards that we shall examine here below, does not alter their validity.

Following these introductory remarks, we are now in a position to analyze the legal and regulative provisions in detail.

In the first place, we must refer to Law No. 4,495405 that establishes the basic structure for regulation and supervision of the financial system. It also establishes the main guidelines for financial activities. This law has

405 Law No. 4,495 of Dec. 13, 1964. [hereinafter Law No. 4,495].
undergone several modifications, the last one being by Complementary Law No. 105.\textsuperscript{406} This law establishes that the financial system is constituted by the National Monetary Council, the Central Bank of Brazil, the Bank of Brazil, the National Bank for Economic and Social Development and other public and private financial institutions.\textsuperscript{407} Article 17 of the law defines financial institutions as public or private legal entities, having as main or accessory activity the collection, intermediation or application of their own or third party financial resources, and the custody of securities and other liquid assets the value of property of third parties. This legislation will apply to individuals or legal entities With regard to the respective legislation, such institutions rank with individuals who carry out the activities here described either permanently or occasionally.

Such institutions\textsuperscript{408} may only operate with prior authorization from the Central Bank and an Executive Power decree if they are foreign entities. Not only banks, credit, funding, and investment societies, economy funds, and credit cooperatives are subject to the same law, but also where applicable, the stock market, insurance companies or persons who on their own behalf or that of third parties, carry out activities related with the marketing of securities carrying out services or carry out services of a financial nature on financial or capital markets.

It is the National Monetary Council’s responsibility\textsuperscript{409} to govern means of payment, the value of money, to guide financial institutions’ application of resources, encourage the enhancement of financial institutions and instruments, to ensure liquidity and solvency of financial entities, coordinate monetary, credit, budgetary, tax and public debt policies in the way set out further on. It should be noted here that the Council decides on the technical and administrative structure of the Central Bank of Brazil, settles cases brought against it, approves the accounts and internal regulations, accounting and budget of the Central Bank. It may also resolve that the Central Bank deny new financial institutions authorization to operate, on the basis of advisability of a general nature.

In turn, the Central Bank of Brazil is an independent legal entity that the

\textsuperscript{407} Law No. 4,495, supra, note 4037, art. 1.
\textsuperscript{408} \textit{id.} art. 18.
\textsuperscript{409} \textit{id.} arts. 2-7.
law has set up on the basis of the then Superintendence of Money and Credit. The Bank is responsible for complying with and enforcing the provisions attributed to it by the law and the standards that Monetary Council entrusts to it.\textsuperscript{410} It is responsible for issuing paper currency and coins, catering to the services of money supply, carrying out loan and rediscount operations with financial entities, controlling credit, controlling foreign capital in conformity with the law, acting as a deposit for reserves, investigating financial institutions, authorizing financial institutions to operate, install or transfer their head offices - even abroad, transform themselves, reform themselves, merge, etc., and authorizing their operations.

In carrying out its duties, the Central Bank shall exercise permanent supervision of the financial and capital markets, of institutions that operate on these markets in any way and in relation to the modalities or operations they use. Article 37 adds that institutions subject to the present law are obliged to provide the Central Bank, under the form it requires, the data and reports it judges necessary to fulfil its commitments.

Regarding access by entities to financial activities, Law No. 4,728 of 14 July 1965,\textsuperscript{411} Section 4, stipulates that at times of imbalance in the balance of payments recognized by the National Monetary Council, the Central Bank, on adopting measure for the contention of credit, may limit access to the country's financial system, of those companies that have access to the international financial market, as will be explained further on. It is considered that the branches of foreign companies, companies with their head office in the country whose capital belongs totally to non-residents or persons with no domicile in Brazil, societies with their head office in the country, controlled by non-resident persons or persons with no domicile in the country (control means to have direct or indirect majority of capital with the right to vote) are considered to have access to the international financial market.

\section*{C. \textsc{Authorities Regulating and Supervising Banking Activities}}

The National Monetary Council is entrusted with governing means of payment, the value of currency, guiding the application of the resources of financial institutions, promoting enhancement of the financial institutions
and instruments, ensuring liquidity and solvency of financial entities, and coordinating monetary, credit, budgetary, tax and public debt policies. In fulfilling its duties, among other things it is its responsibility to discipline credit in all its modalities and operations, regulate the constitution, operation and supervision of those carrying out activities governed by this law, establish guidelines for credit risk taken on by the entities, establish technical requisites that these entities must comply with (encashment, net worth relations, etc.), issue general standards for accounting and statistics that must be observed by financial institutions, establish their minimum capital, etc. It also decides on the technical and administrative structure of the Central Bank of Brazil, resolving actions brought against it, approving internal accounts and regulations, accounting and budget of the Central Bank. It may decide that the Central Bank should refuse new financial institutions the authorization to operate, on the basis of advisability of a general nature. It applies to foreign banks operating in the country the same prohibitions or restrictions as those in force in the markets of their head offices applied to Brazilian banks installed in these countries or that will be established there. The members of the Monetary Council are the Minister of Finance, who is the chairman, the president of the Bank of Brazil, the president of the National Economic Development Bank, seven members appointed by the President of the Republic, and approved by the Senate, chosen among Brazilians of recognized repute in financial and economic affairs.

The Central Bank of Brazil is an independent legal entity that the law set up on the basis of the then Superintendence of Money and Credit. The Bank is entrusted with complying with and enforcing the provisions that the law assigns to it. It is responsible for issuing paper currency and coins, catering to the services of money supply, carrying out loan and rediscount operations with financial entities, controlling credit, controlling foreign capital in conformity with the law, acting as a deposit for reserves, investigating financial institutions, authorizing financial institutions to operate, install or transfer their head offices-even abroad-, transform themselves, reform themselves, merge, etc., and authorize their operations, operate on exchanges, sell government securities, shares, mortgage bills or

411 Law No. 4,728 of 14 July 1965, arts. 22 to 25. [hereinafter Law No. 4,728].
412 Law No. 4,495, supra, note 407, arts. 2 to 7.
413 Id. arts. 10, 11.
other credit deeds, postpone periods for operation, change their bylaws, transfer their control of shares, establish requisites to hold positions in the administration of private financial institutions.

In exercising its powers and on the basis of the regulations issued by the Monetary Council, the Central Bank shall examine requests put before it and resolve on granting or refusing the request. Foreign financial institutions depend on the authorization of the Executive Power, through a decree to be able to operate.

In fulfilling its duties, the Central Bank shall exercise permanent supervision of the financial and capital markets, of the institutions that in any way operate on these markets and of the modalities they use or the operations they undertake. Article 37 adds that the institutions subject to the present law are obliged to provide the Central Bank with the data and reports that it considers necessary to carry out its duties, under the form it may consider appropriate.

The Central Bank is managed by a board of directors comprising five members chosen by the Monetary Council from among its members.414

D. LINE OF BUSINESS OF FINANCIAL ENTITIES: UNIVERSAL AND SPECIAL BANKING

Entities are classified according to their activities into: Multiple Activity Banking (universal banking), Commercial Banks, Investment Banks, Development Banks Credit, Financing and Investment Societies, Economic Funds, Market Leasing Societies, Brokerage and Distributors of Deeds and Bearer Securities Societies, Consortia Administrators, Real Estate Credit Societies, Exchange Broker Societies, Mortgage Companies and Development Agencies.

Only multiple activity banks carry out all operations and provide services corresponding to the various portfolios they operate. The portfolios that they may operate are: a) commercial; b) investment and/or development (only public banks); c) real estate credit; d) credit, finance and investment; and e) commercial leasing. These institutions must hold at least two portfolios, one necessarily being a commercial or investment portfolio.415

414 Id. art. 14.
The remaining institutions, in pursuance of the Regulations annexed to Resolution No. 1.524 of 1994\textsuperscript{416} may carry out loan and deposit and accessory operations implemented through specific portfolios that shall be regulated: the commercial portfolio by the standards of commercial banks, the investment portfolio by the standards of investment banks, the development portfolio by the specific provisions for development banks, etc.

Direct exploitation of activities unrelated to financial activities is prohibited. However, through equity investment in a company exploiting activities unrelated to financial intermediation, a financial institution may indirectly exploit these activities, provided they are expressly authorized by the Central Bank and in conformity with the conditions established by the National Monetary Council. Investment companies are exempt from this condition, as they do not need the authorization of the Central Bank to participate in companies exploiting activities unrelated to financial intermediation (circular 126).

Concerning bans or limitations, generically the institutions are banned from granting loans or advance payments (Law No. 4,495, art. 34) to their directors or senior staff or to their family members, or to their shareholders holding more than 10% of the capital, save exceptions, or to companies in which the financial institutions have equity investments or to their directors, senior staff or family members in over 10% of the capital.

Furthermore they are forbidden (art. 35) from issuing debentures or beneficiary parts, save for exceptions authorized in each case by the Central Bank of Brazil for institutions that do not receive deposits from the public; acquisition of real estate that is not intended for their own use.

E. ESTABLISHMENT OF BANKS IN BRAZIL

REQUISITES. PROCEDURE. ESTABLISHMENT OF FOREIGN BANKS.

I. Establishment of Financial Entities

Article 17 of Law No. 4,495 defines financial institutions as public or private legal entities whose main or accessory activity is collection, intermediation or application of their own financial resources or those of third parties, and custody of the value of third party property. Individuals

\textsuperscript{416} Resolution No. 1.524 of 21 Sept. 1988, art.1.
carrying out the activities here described, either permanently or occasionally, are ranked with such institutions.

Not only banks, credit, financing and investment societies, economic funds and credit cooperatives are subject to this law, but also in what is applicable, the stock exchanges, insurance companies and individuals carrying out activities related with the marketing of deeds, carrying out services of a financial nature on the financial or capital market on their own account or for third parties. Such institutions (art. 18) may only operate with prior authorization by the Central Bank. In the case of foreign entities, an Executive Power decree is necessary for them to operate. Regarding public institutions, a Federal or State law is required, according to the case. Such authorizations are non-transferable and un-negotiable. They are conditioned to the applicants justifying an economic situation compatible with the activity to be carried out and the directors possessing technical expertise and a high degree of personal integrity. Transfer of financial control, be it direct or indirect, is also subject to the authorization of the Central Bank. In examining the application, the amount of investment of the new entity, the proportion such investment represents in the new worth of each of its members and compliance with the minim capital requirements according to the activity, are considered (Resolution No.BCB 2.099 of 17 August 1994 and Circular BCB No. 2.502 of 26 October 1994).

Regulations in Annex 1 to Resolution No.2.099 of 26 August 1994 set out more elements and formalities required to obtain authorization for the establishment of entities in Brazil. According to this regulation, authorization is conditioned to compliance with various requisites, such as proof of the economic and financial capacity of the managers is compatible with the undertaking, considering the net worth of the legal entities should be equivalent to at least 200% of the respective investment in the new institution, while that of individuals should be the equivalent of 120% of the investment, also whether the managers of the institution possess the requisites established by regulations in force regarding technical expertise and moral integrity; no registry restrictions on the administrators and managers; that paid-in capital should be no less than the minimum established by the National Monetary Council; membership of the mechanism for the protection of credit holders against financial institutions.
(Credit Guarantee Fund). There are also specific requisites for each type of institution which should be organized as corporations, with the exception of Brokerage and Distributors of Deeds and Bearer Securities Societies that may be organized as limited liability societies, credit cooperatives and consortia (art. 25), their capital stock should be represented by registered shares and stock trading implying control by the institutions requires authorization from the Central Bank.

Regulations also include other conditions that must be fulfilled by the financial institutions.

In fact, the shareholders controlling the institution must publish their intention of setting up a financial intermediation entity (Resolution No.2.099, Annex I, article 2). In this respect, Central Bank Resolution No. 2.112 of Nov 16, 1995, provides that the economic capacity of management of a financial institution must be analyzed on the basis of the situation of the controlling group and of the individuals who will effectively exercise the right to manage, and not simply of the entity directly controlling:

Furthermore, financial intermediation institutions may only participate in the capital of any corporation with the authorization of the Central Bank and under the conditions established by the Monetary Council (Law No. 4,495, art. 30).

Furthermore, they have a series of limitations, such as holding real estate, except for their own use. Real estate received as payment of a debt must be disposed of within a period of one year (Law No. 4,495, art. 35) also regarding loans to companies that have over 10% shares in the institution (art. 34.). Furthermore, the Central Bank may reject direct or indirect transfer of control, but not of shares that do not imply control (Resolution No. 2.999/94). For this reason, transfer of the control of shares in financial institutions requires the authorization of the Central Bank and must be included in the purchase-sales contract, fulfilling the requisites foreseen in the respective regulations for the establishment of financial entities. Changes in the share structure, previously notified to the Central Bank, must be communicated within 15 days of taking place.

It should be noted that foreign participation in the capital stock of financial institutions may not exceed the level they had at the time the Federal Constitution was sanctioned, without prejudice to the provisions of
article 52 of the temporary standards of the constitutional text (Resolution No. 2.099).

Regarding the minimum capital required for the granting of authorization to operate, the minimum amounts are established by the National Monetary Council. Furthermore, financial entities must pay-in at the time of subscribing the capital required, at least half of the total amount they are obliged to hold. This requirement of simultaneous paying-in is applicable both for the initial structure of the capital and for subsequent increases in same (art. 27). Private institutions must apply (art. 29), at least half of the deposits they received from the public in their respective Federative Unit or Territory.

Elections of the members of the Board of Directors and supervisory and consultative bodies, must be communicated to the Central Bank, which within a fixed period will accept the appointment or reject the name of those appointed who do not comply with the conditions of article 10 X of this Law (presently it would seem to be XI) which stipulates that it is the Central Bank’s responsibility to establish conditions for fulfilling managerial and other positions in private institutions.

In the case of Multiple Banks, the managers should be individuals residing in Brazil, in addition to complying with the requisites set out in the regulations in force on the matter.

2. Establishment of foreign banks

Law No. 4,495 in its article 39 includes in its scope foreign financial institutions operating in the country or wishing to operate in the country.

The National Monetary Council may refuse to authorize requests by foreign banks to operate for reasons of general advisability. It may apply the same restrictions or prohibitions to foreign banks, as those in force on the markets of their head offices applying to Brazilian banks installed or to be installed there. It should also be remembered, that the requirements for initial capital are doubled (infra No. 6, Prudential Requisites), to admit the installation of foreign banks in Brazil. In turn, the Central Bank of Brazil, on the basis of the guidelines established by the National Monetary Council, shall study requests and decide whether to grant them or to refuse them. It is also the Central Bank’s duty to control foreign capital stock in financial entities. The National Monetary Council may refuse or resolve that the Central Bank refuses any foreign financial entity establishment.
request. In all cases an Executive Power decree is needed authorizing the installation of the requesting entity.

Furthermore, Law No. 4,728 of 14 July 1965, Section 4, relative to the access of foreign capital companies to the national financial system stipulates (arts. 22 to 25) that during periods of imbalance in the payment balance recognized by the National Monetary Council, in adopting credit contention measures the Central Bank may limit access to the country's financial system by those companies that have access to the international financial market. Branches of foreign companies, companies with head offices in the country, whose capital is totally owned by persons non-resident or non-domiciled in Brazil, corporations with their head office in the country controlled by persons non-resident or non-domiciled in the country (control means to directly or indirectly hold the majority of the capital with right to vote) are considered for this purpose.

The law also establishes the minimum levels of access, under which the administrative ceiling cannot be established for access to the system (art. 23).

Access by an entity is the equivalent of its debtor balance in the financial system: this means the sum of all the loans of this system under any form, including opening of credit, discounts for commercial purposes, etc.

For the purpose of these limitations, the concept of national financial system means the capital market and all the public or private financial institutions with headquarters in the country, authorized to operate there. The limits foreseen here are not applied to financial institutions whose limits are established according to Law No. 4,495.

Once the authorization has been granted, the same treatment is in force for national and foreign financial institutions. Foreign investments in national financial institutions must be registered at the Central Bank (Law No. 4,131).411

3. Requisites for senior staff

Brazil has established a long list of basic conditions for those occupying positions in statutory organs of financial intermediation entities.418 Among

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411 See supra, note 405.
these should be noted: high moral integrity, residency in Brazil, no inability due to special laws or to being convicted on a series of criminal charges such as bankruptcy, tax evasion, fraud, corruption, extortion, speculation against the economy, public faith, property or against the SFN or criminal sentence that prevents, even temporarily, access to a public position; not declared unauthorized to occupy management positions in financial institutions; not to respond to any company where he is comptroller or manager, for outstanding issues relative to protesting titles, legal collections, bad cheques, delayed payment of obligations and other analogue situations; not bankrupt and not having participated in the management of an insolvent company or corporation.

In turn, to occupy the hold positions as of director and or managing-partner-manager, technical training conditions are established such as having acquired being a graduate of a higher education, having held - in the last five years -, course and having at least two years’ experience in managerial management positions in financial institutions in the last five or having held position for not less than four years, in the last five years in the financial area of other corporations with comparable net worth to that required for financial entities/entities of compatible size, or even having performed similar functions for over five years in the financial system, with the exception of credit cooperatives.

All elections and appointments of members of the statutory bodies must be communicated to the Central Bank within a maximum delay of 15 days. The Central Bank has the power to approve the appointment or to reject it. If the Central Bank finds any of such conditions missing, it may annul the decision to accept the appointment and launch the corresponding administrative process.

Finally, it should be noted that an obligation is established, promoting the separation of the administration of third party resources from the institution's other activities and in the event that this is promoted through the hiring of a company specialized in providing third-party resource management, or when it is done exclusively through the purchase on behalf of clients of investment fund instalments managed by other institutions, the appointment may be made of a director or partner-manager who is linked to activities other than the management of the institution's own resources. However, if the services of a financial institution or other institution
authorized to operate by the Central Bank are hired, the director or partner-
manger of the institution cannot be appointed as administrator, whatever
his link with the hiring entity.

4. System for the protection of deposits

Guarantee or insurance of deposits is regulated by resolutions 2.197 of
30.08.1995 and 2.211 of 20.11.1995 creating the Credit Guarantee Fund,
with the objective of providing a credit guarantee in the event the
participating institutions are intervened, in liquidation or their insolvency is
recognized by the Central Bank. The Fund is a civil private, non-profit
making association, whose objective is to manage credit protection
mechanisms concerning debt owed by financial institutions a procedural
law legal entity and burdensome on the participating financial institutions.
Its resources come from mandatory contributions made by all financial
entities, service tariffs, and income derived from financial resources
management and services provided regarding said resources. Participation
of financial institutions in this fund is a condition for them to be granted
authorization to operate.419

The insurance is limited to R$ 20 thousand for the total amount of
credits of each person against the same institution or against all the
institutions in the same financial conglomeration, for sight deposits,
savings accounts, fix-term deposits, bills of exchange, real estate bills and
mortgage bills. Credits from other SFN institutions, deposits, loans or
resources raised abroad, credits of persons linked to the institution
(administrators, members of statutory boards, comptrollers, controlled and
associated corporations) are exempt from coverage.

The Fund is constituted with regular contributions from its participants,
service rates from the issuing of bad cheques, recovery of credit rights
subrogated by the Fund, the profits from services rendered and returns
from the application of resources.

F. PRUDENTIAL REQUISITES

1. Capital and financial liability. Application of the Basel Committee
   Guidelines

Regarding capital, financial institutions must pay in at the time of
subscribing it, at least half the total subscribed capital that they are liable for. This requirement is applicable not only to starting capital but also in the hypothesis of an increase in capital (Law No. 4,495, art. 27). The non-paid in balance on constitution or formalizing the increase in capital must be paid in within one year from the date of its subscription. The amount of minimum capital is established by the National Monetary Fund.

Regarding net worth, Brazilian regulations make a distinction for the purpose of requisites, between new entities and those already operating on the market, and among the latter, according to the type of entity.

New entities must set up a minimum net worth, graduated according to the type of entity. Furthermore, such net worth will be increased on the basis of the number of agencies established, operations in foreign currency conducted and regarding the geographical location of the entities.

Thus, depending on the activity they develop, a minimum starting capital of between R$ 7,000,000 and R$ 17,500,000 for multiple banks (according to the definition and characterization made earlier on); commercial banks and cooperatives require between R$ 12,250,000 and R$ 17,500,000; investment banks require between R$ 8,750,000 and R$ 12,500,000 and housing credit societies require between R$ 4,900,000 and R$ 7,000,000; brokerage and distribution of deeds societies, etc. require between R$ 385,000 and R$ 550,000. All these minimum amounts are established in national currency. The dollar rate throughout 2001 oscillated between R$2,30 and R$2,80 per U.S. dollar and is periodically updated (Resolution No. 2.607 of 27 May 1999). The preceding amounts refer to national entities. In all cases, if the financial institution is foreign the minimum net worth requisites are doubled.

Capital components allowed are defined in the Federative Republic of Brazil in Resolution No. 2.543/98, which contemplates what it calls capital levels I and II or the Reference Net Worth. It should be noted that the standard includes the essential aspects of the Basle Committee guidelines. Level I includes liquid net worth to which the net balance of results of creditor accounts is added, minus the debtor ones, and the revaluation reserves, the contingency reserves and the special reserves of proceeds related to obligatory dividends that have not been distributed, are excluded. Also deducted are values of accumulative preference and recoverable

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Resolution No. 2,212 of Nov. 16, 1995.
shares. Level II capital may contain revaluation reserves, contingency reserves, and special reserves for proceeds relative to obligatory dividends that have not been allocated, accumulative preference shares, recoverable preference shares, subordinated debts and hybrid capital and debt instruments. Level II capital cannot exceed the value of level I.

There are also some limitations on certain items of capital components. For example, revaluation reserves computed may not exceed 25% of the Reference Net Worth; the amount of subordinated debts added to the value of preference and recoverable shares maturing in less than 10 years may not exceed the value of Level 1 Capital. In calculating capital, provisions on the normal portfolio are not computed, neither are the irrevocable contributions of capital, as this modality is not contemplated in Brazilian regulations. In computing the minimum amount of capital required shares in other financial entities located in Brazil itself are subtracted, as are shares in foreign banks, independently of the controlling situation that may link them. Balances with foreign branches are not subtracted, as the branches abroad are consolidated with the balance sheets in the country.

For entities in operation, net worth equal to the higher value resulting from comparing basic requirements and the liquid patrimony adjusted on the basis of the degree of risk of the asset structure and foreign exchange exposure in addition to the pre-established rate of interest. In the case of new entities, net worth must be paid-in in national currency or in Federal Government securities. The total of such net worth must be made effective prior to the granting of authorization to operate in the form of a deposit in favour of the Central Bank as a required guarantee.

Also following the Basel Committee guidelines in this aspect, in the case of entities in operation, liquid net worth adjusted by inflation must be equal or higher than the minimum capital required and the required liquid net worth (PLE) in terms of the risk, that is to say, of assets weighted by risk. The said net worth must be of at least 11% of the assets weighted by risk. This requisite is applicable to all the banks, independently from them carrying out international activities or not. The requisite of 11% minimum liquid capital calculated on weighted assets is applicable both

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421 Resolution No. 2.099, see supra, note 418.
422 The entire system regarding net worth is to be found in the Resolutions of the National Monetary Council Nos. 2.099, and 2.607 27 of May 1999.
to transactions recorded on the balance sheet, and those outside the balance sheet. To obtain this value, the weights of the institution’s credit operations by the risk attributed to them are considered. The scales of asset classification on the basis of credit risk are 0%, 20%, 50% and 100%. Recently, the requirement to reflect in the capital the risk of foreign exchange was implemented.\textsuperscript{423} The factor applicable to exposure to foreign exchange, when this exceeds 20% of the adjusted liquid net worth (PLA) is 33.3%. The requirement to compute additional capital on the basis of the interest rate risk (market risk) is also relatively new and has been required on the basis of Resolution No. 2.692/00 and Circular No. 2.972/00).

To comply with these requirements, shares in the capital stock of financial institutions and other institutions authorized to operate by the Central Bank, must be subtracted from the respective adjusted liquid net worth, together with the value of investments in the capital stock of financial institutions abroad.

2. \textit{Technical relations}.

Brazilian regulations do not define this concept, which is broadly used by Central Bank technical staff to refer to certain relations between financial institutions assets, resources, deposits and obligations, which financial institutions have to comply with for prudential purposes. Relation between total deposits and obligations and liquid assets, credit concentration ceilings, are some examples of technical relations, which sometimes are regulated by Central Bank rules within the so called technical relations, and sometimes separately.

a. Fixed-asset ceiling

Regarding technical relations required from Brazilian financial entities, reference must be made to the fixed assets ceiling (articles 35 and 36 Law 4.595, in which several prohibitions to financial entities activities are established).

Brazilian financial institutions shall not keep other real estate than that needed for their own use. Exception is made for those properties acquired during debtor’s legal collections procedures. The maximum amount of said real estate which may be held by financial intermediation entities shall not exceed 100% of their net worth.

\textsuperscript{423} Resolution No. 2.609 of May 27, 1999.
b. Investments maintenance time limit

All real estate not kept for the financial institution own use, including real estate received from its debtors to cancel their obligation with the bank or acquired by the bank during debt legal collection procedures, can be kept for a maximum period of time of one year. Before that period of time is over the bank is obliged to sell the mentioned assets. Failure to comply arise the obligation to constitute a prevision of an amount equivalent to the acquisition price.

32. Credit risk: limitations to credit concentration

In this item, Brazilian regulations limit credit concentration to 25% of the PLA (adjusted liquid net worth) per client in all financial institutions. This ceiling covers all credit or contingent operations including the granting of guarantees, futures and options, hiring credit and leasing operations and provision of guarantees, as well as regarding credits arising from operations with derivatives. They establish the same ceiling for credit concentration applies for underwriting operations for the resale and guarantee and underwriting of bearer securities and fromor investments in deeds and bearer securities issued by one same company, partner companies and controlling or controlled companies. Clients are considered as individuals or legal entities or groups of people, acting individually, jointly or representing common interests. In the public sector, the Union, State or Federal District or municipality are considered to be clients, each one jointly with its directly or indirectly linked entities (public companies, mixed economy societies, their subsidiary branches and other associated, autarchic companies and foundations, other bodies or entities.

Regarding inter-financial deposits, the risk concentration is limited to 30% of the PLA for the lender and is limited to two and a half times this amount for the borrower.

The same ceiling is in force for multiple banks, commercial banks, investment banks and other private institutions, regarding each issuer of credit securities when the financial entity underwrites them to subsequently resale them or guarantees the underwriting of such securities. This limit does not apply to investments in federal public security bonds.

424 The system set out here is contained in Resolution N° 2.474 of Mar. 27, 1998.
The same limit is applied to purchasing operations on the unlisted securities market or investments in bearer securities issued by a single entity. Economic groups are computed as a sole customer.

Investments made by financial entities in instalments in mutual investment funds are not subject to the ceiling on risk concentration.

43. Credit risk. Classification of debtors and provisions

a. Regarding debtor classification, in the first place it should be noted that operations covered by the present classification involve both the private sector – financial and non-financial – and the public sector.

Secondly, it should also be noted that there is no automatic reclassification in Brazil on the basis of a debtor centre.\(^425\)

Thirdly, in Brazil the portfolio is segmented to define the applicable criteria.

Fourthly, clients included in this classification are all those individuals and legal entities with obligations equal to or in excess of R$ 20,000,00.

Once the preceding clarifications have been made, we may observe that the general classification criteria involve parameters such as the category of the debtors, their arrears, the guarantees they may have given and their legal situation.

On the basis of these elements, debtors are placed in one of the nine possible categories: 1 AA (no arrears), 2 A (no arrears), 3 B (arrears of between 15 and 30 days), 4 C (arrears of between 31 and 60 days), 5 D (arrears of between 61 and 90 days), 6 E (arrears of between 91 and 120 days), 7 F (arrears of between 121 and 150 days), 8 G (arrears of between 151 and 180 days) and 9 H (arrears of over 180 days).

b. Based on the preceding classification,\(^426\) criteria are foreseen for establishing contingency provisions, computing for this purpose guarantees granted at the time.

Minimum provisions, in percentages, increase according to the risk of the category under consideration. Thus, category 1 AA, requires a minimum percentage provision of 0%, 2A a provision of 0.5 %, 3 B of 1%,

\(^425\) Resolution No. 2.724 of June 1, 2000, and Circular No. 2.977 of Apr. 6, 2000.

\(^426\) Regulations regarding debtor classification and provisions for bad debts are contained in Resolution Nos. 2.682 of Dec. 22, 1999; 2.724 of Sept. 30, 1996; and Circular No. 2.977 of Apr. 6, 2000.
Previsions are established both in the public non-financial sector and in the financial sector.

4. Standards for accounting and external auditing\textsuperscript{27}

a. In the first place, in relation to accounting provisions, it should be noted that it is obligatory for financial entities to use the accounting plan and manual. Balance sheets are published every six months and the general balance sheet and the income statement, notes and annexes together with the external auditor's report are published annually. The publication must appear in widely circulated newspapers and in the Official Gazette. Periods are annual.

b. Furthermore, regarding external auditing, this is obligatory and must take place every 20 days. A registry of professional auditors, from among which the selection must be made (which means that the auditor must already be registered for the entities to be able to select him/her from the roster) is kept by the Securities commission. The provisions regulating this matter are established by the National Monetary Council with the intervention of the Central Bank and the Securities Commission.

Regarding auditors' obligations, the submission of special reports on specific subjects has not been made obligatory. However, the auditors are obliged to allow the Central Bank to have free access to their working papers and other background documentation they may have used.

A regime for professional sanctions applicable to external auditors is foreseen, simultaneously applicable with the sanctions foreseen by the authorities of financial entities.

G. BANKING ACTIVITY AND THE FINANCIAL MARKET

In principle, direct exploitation of activities other than financial activities is prohibited. However, through equity investment in a company exploiting activities other than financial intermediation (financial institutions may invest in shares and other private securities of non-
financial companies), a financial institution may indirectly exploit these activities provided that it has the express authorization of the Central Bank and carries them out under the conditions stipulated by the National Monetary Fund.

Investment companies are waived from this regulation, and do not need authorization from the Central Bank to hold shares in companies exploiting activities other than financial intermediation.428

Notwithstanding the above, Law No. 6,385, in its Chapter III on the Allotment System, stipulates that the allotment system applies to financial institutions and other corporations whose purpose is to allot stock issue either as agents of the issuer or on their own behalf, underwriting or purchasing the issue to later market it; corporations whose purpose is to purchase stock in circulation to resell it on their own behalf; corporations and agents carrying out mediation in stock marketing, on stock markets or similar markets; and stock markets.429

For its part, it is the National Monetary Council's responsibility to define the types of financial institutions that may exercise activities on the securities market and the types of transactions and services that they may carry out; the specialization of transactions or services that market corporations must respect and the conditions under which services or transactions may be accumulated. Regarding financial institutions and other corporations authorized to exploit simultaneously operations or services on the bearer security market and on markets subject to Central Bank monitoring, the functions of the Securities Commission shall be limited to activities subject to the financial market law and without prejudice to the Central Bank being competent in all the rest. The Monetary Council shall regulate this provision, coordinating the activities of the Central Bank and the Securities Commission.

Summing up, there are financial institutions that are simultaneously authorized to carry out banking activities and activities on the securities market.

427 The system described is contained in Resolution No. 2.682 of Dec. 22, 1999 and Circular No. 1.273 of Dec., 1987, regarding accounting, and Resolution No 2.267 of Mar. 29, 1996; and Circular No. 2.676 of Apr. 11, 1996, regarding auditing.
428 Resolution 2.723 of June 1, 2000.
429 Law No. 6,385 of Dec. 7, 1976 (the law regulating the financial market and establishing the Securities Commission), art. 15.
H. BANKING SECRECY

Complementary Law No. 105,\textsuperscript{430} which revoked the previous rule on bank secrecy stated by article 38 of Law No. 4,495,\textsuperscript{431} establishes the financial institutions' obligation to maintain secrecy on loans and deposit operations and on services provided.

There are several cases which do not constitute the breaking of bank secrecy: some specific situations of sharing of information for statistic purposes following the rules stated by the Monetary Council or the Central Bank, information to be given to competent local or foreign authorities for criminal investigation purposes, information given with the consent of the legitimate parties.

Bank secrecy can be broken when an investigation is conducted regarding illicit activities, and especially regarding the commission of several crimes like terrorism, kidnapping for extortion purposes, money laundering, crimes against the financial system, and crimes against the public administrations.

Bank secrecy can also be broken when ordered by the Judicial Power, and in such cases the exhibition of ledgers or documents in court cases will be done in respect for the obligation for secrecy. Only the legitimate parties in the case may have access to this documentation and they may not be used for purposes other than the court case.

The Central Bank is obliged by bank secrecy, but financial institutions might not invoke bank secrecy to any inquiry, investigation or information request conducted or coming from the Central Bank.

All the institutions, and the Central Bank of Brazil, shall inform the Legislative Power upon a based request and in the exercise of its legal and constitutional competence. They shall also inform the Parliamentary Inquiry Commissions in exercise of its wide investigation powers. In these two latter cases, the request for information must be voted by special majority in the Chamber of Deputies and the Senate.

The Central Bank and the Security Commission are allowed to subscribe information sharing agreements for supervisory purposes or for illicit activities investigation purposes.

Tax agencies from the Ministry of Economy and of the States will

\textsuperscript{430} See supra, note 409.
\textsuperscript{431} See supra, note 408.
receive periodically general information regarding financial operations which shall only identify the person responsible for the operations and the total monthly amounts involved in same. The Executive Power will regulate the limits and periodicity of the information to be given to tax agencies. Tax agents may only examine documents, records, etc., if an action has been filed and these documents are considered essential by the competent authority.

Violation of the obligation to secrecy is a criminal offence punishable by 1 to 4 years imprisonment, without prejudice to other applicable sanctions as fines.

I. ILLEGAL OPERATIONS

Law 9.613 passed on March 3, 1998, modified several times, last one by Law 10.683 dated May 28, 2003) defines (articles 1 and 2) as a criminal offense to hide, acquire, receive, transfer, manage, sell, or apply in any way money or goods resulting from certain crimes (i.e. drugs trade and traffic; smuggling; fraud committed against the Public Administration; extortion by kidnapping; crimes against the financial system), when it is likely that as a consequence of any of these operations the original goods or effects will appear as of lawful origin. All these crimes are punished with imprisonment. The mentioned law also establishes, - as an additional punishment when crimes are committed by public servants or professionals who require special authorization -, a special inability for carrying out said activities for the same period of time as the imprisonment.

Law 9.613 (article 14) creates the Financial Activities Control Council (COAF) as a body within the Ministry of Economy, whose objectives are to discipline, apply all non criminal measures, receive and analyze information regarding money laundering operations coming from the crimes described in articles 1 and 2 of the law. The COAF can require all information relevant to its task to any public entity or body, as well as to individuals or legal corporations, be they public or private, who are obliged to provide said information.

The COAF is composed by noticeably skilled public servants, selected from among the Central Bank, the Securities Commission, the Private Insurance Superintendence, the Attorney General Office, the intelligence department of the Executive Branch. They are appointed by the Minister
of Economy. The President of the Council is appointed by the President of Brazil, upon proposal from the Minister of Economy.

The law states a list of legal entities and individuals obliged to provide information to the COAF, including in same all financial entities, all companies carrying out foreign exchange activities, all individuals and entities carrying out capital market activities or intermediation, all enterprises carrying out real estate trade and intermediation, insurance companies, all individuals or legal entities carrying out trade in art works and jewelry. Said individuals and legal entities are obliged to keep records of their customers, clients and beneficial owners. They have to keep all documents and records concerning all transactions described. They are also obliged to inform the COAF all suspicious activity.
IV. THE REPUBLIC OF URUGUAY

A. INTRODUCTION

The Uruguayan Constitution, promulgated in 1967, in its article 6, clause 2, promotes the integration of Latin American countries, but merely as a programmatic enunciation. Therefore, it is clear that integration is admitted but the difficulties involved in integration processes are not resolved.432

The Uruguayan entities regulation corporate system presently in force is covered by the Civil Code for civil corporations and by Law No. 16,060,433 sanctioned in 1989, comprising companies developing commercial activities as well as those carrying out mixed – commercial and civil – activities. encompassing commercial corporations and corporations with a mixed objective.

Law No. 16,060 and the regulations it stipulates substitute the regulations for commercial corporations foreseen in the ninetieth century Trade Code, of Napoleonic inspiration, that still in force only for other aspects of mercantile regulations in the country.

Law No. 16,060 regulates the main principles in corporate matters, within which it establishes that a corporation is a legal entity by the sole meeting of minds, it sets out the system of invalidity, relationships among partners, principles regarding administration and representation matters, etc., the system for transformation, merging, dividing, dissolution and liquidation of corporations. It also regulates the types of corporations. We would highlight classical partnerships such as general partnerships, limited partnerships, partnerships in which some partners put in money and others furnish services, limited partnerships, and corporations.

Corporations are regulated as capital corporations, where shares may be to the bearer, registered or book-entry stock. The organization of corporations responds to the classical model: shareholders meetings (regular and special) are aimed at approving administration by the management and the balance sheets of the corporation, or modifying the bylaws, mergers, divisions or others, respectively. They are managed by a

432 See Esteva, supra, note 147.
Board of Directors and supervised by auditors (this is optional except for open corporations).

Finally, Law No. 16,060 provides for two forms of association other than corporations: groups of economic interest and consortia. The former is a legal entity, while the latter is not as it is temporary. Both associations may comprise individuals or legal entities.

The system in force regarding foreign investment is covered by Decree-law No. 14,179 of 28 March 1974 and Law No. 16,906 of 7 January 1998 (Investment Law). The latter unifies in a legal body the regulations referring to guarantees to foreign investments and the tax incentives applicable to investments, thus providing investors with a clear and unified legal framework which they can refer to before taking decisions on investments.

The law sets out the principles of national treatment, exclusion from requisites of authorization or registration, free foreign exchange, guarantees on juridical stability and sets out the possibility for arbitration with the State to settle controversies that may arise over interpretation or application of the law. The benefits granted are in general of a tax nature.

B. THE URUGUAYAN BANKING SYSTEM

The collapse of the Argentine financial system first had an impact (January 2002) on those banks operating in both countries, Argentina and Uruguay, when the restrictions imposed on operations in Argentina forced Argentine bank clients to withdraw their deposits from the Uruguayan branches of the same institutions. This initial development was soon followed by a general run of most Argentine depositors from all Uruguayan financial institutions, even from international banks, due to their fear of having their deposits frozen in Uruguay as well, in the event similar measures to those imposed in Argentina should be adopted by the Uruguayan government. The Argentine crisis continued during 2002, and therefore its impact on Uruguayan economy worsened over the same period, causing continuation of the depositors' run. In July 2002, a bank holiday was declared, four private banks were suspended (not liquidated but closed), and deposits on two seriously illiquid state-owned banks where extended for two years, to be paid in the currency in which the deposit was established. Rules for solvent banks (international banks) were
not changed. There was no general freezing of deposits, or any change in the currency of deposits. From January 2002 up to July 2002, the system lost over 40% of its deposits. Finally, in December 2002, Law No. 17,613\textsuperscript{434} was passed, establishing a new procedure for the liquidation of the four suspended banks, and broadening Central Bank regulatory and controlling powers over private and public financial institutions as well as on private bank shareholders, directors and managers.

The Uruguayan financial legal system had no explicit system for the protection of deposits in the event of insolvency of financial institutions until 2002. Law No. 17,613 changed this situation, creating a Bank Deposit Guarantee Fund, to be administrated by a new Bank Savings Protection Superintendence. Said Fund will be mainly financed by the financial institutions and International Financial Organisations. The maximum amount to be paid to depositors by the Bank Deposit Guarantee Fund will be defined by the Executive Power, after a technical proposal to be made by the Central Bank. The Guarantee will be paid to depositors upon suspension or liquidation of a bank. According to Law 17.613 that the Central Bank will organize a deposit protection scheme will be regulated and controlled by the Central Bank itself. Up to now, the Central Bank has not implemented said legal provision. Before Law No.17,613 was issued, the Law expressly declared that the State did not guarantee any deposit save those with one of the two state owned banks.

1. Financial Intermediation Law

The central aspects of the banking system in Uruguay are contained in Decree-law No. 15,322,\textsuperscript{435} subsequently modified in Law No. 16,327,\textsuperscript{436} which in turn was reordered by Decree No. 614.\textsuperscript{437}

This regulation states that all public corporations financial entities, be they state corporations owned or not, as well as individuals private persons carrying out financial intermediation activities, are subject to the provisions of this Financial Intermediation System law, and to the regulations rules issued for this purpose by the Central Bank of Uruguay. Financial intermediation is defined as the usual and professional

\textsuperscript{434} Law No. 17.613 of Dec. 27, 2002.
\textsuperscript{435} Decree-law No. 15,322 of Sept. 17, 1982 (adopting the System for Financial Intermediation).
\textsuperscript{436} Law No. 16,327 of Nov. 11, 1992.
\textsuperscript{437} Decree No. 614 of Dec. 11, 1992.
performance accomplishment of negotiation or intermediation transactions between supply and demand of security bondsies, money or precious metals.\textsuperscript{438}

The use of names similar to those of «bank», «banking», etc. is prohibited to companies that are not authorized to carry out financial intermediation activities. The authorized entities must be so named to avoid that their designation might give rise to confusion regarding their nature or activity.

Entities carrying out financial intermediation activities must be organized as corporations.\textsuperscript{439} Branches of foreign corporations and financial intermediation cooperatives are exempt from this requirement. Article 43 of Decree-law No. 15,322 (with the addition of article 4 of Law No. 16,327) adds that financial entities set up as corporations, shall only have registered shares, and this should be established in their bylaws. The Central Bank of Uruguay keeps a record of the shareholders of such institutions and authorizes – prior to concretion – the transmission of shares from such entities. Requests for the transmission of shares must identify those acquiring them.\textsuperscript{440}

The establishment of financial intermediation entities is subject to prior authorization by the Executive Power\textsuperscript{441} and in order to grant this authorization, it must have the favourable opinion of the Central Bank of Uruguay. Furthermore, opening of a financial entity requires the Central Bank of Uruguay to allow it to start operating.\textsuperscript{442}

The establishment of new banks in the country will be authorized every year if the number does not exceed 10% of the banks existing the previous year.\textsuperscript{443}

Article 20 of Decree-law No. 15,322 in the text given in Law No. 16,327 stipulates that the Central Bank of Uruguay may arrange advise for the temporary or definitive revocation annulment of the authorization to operate. This measure shall be resolved by the Executive Power, either at the proposal of the Central Bank of Uruguay or with its consent.

Merges and transformations of entities authorized to carry out financial

\textsuperscript{438} See Decree-law 15,322, supra, note 4338, art. 1 (regulatory decree).
\textsuperscript{439} See Law No. 16,327, supra, note 4349, art. 17.
\textsuperscript{440} See Decree-law No. 15,322, supra, note 4338, art. 45.
\textsuperscript{441} Id. art. 6.
\textsuperscript{442} This part of the regulation arises from an amendment introduced by Law No. 16,327, see supra, note 4349, art. 1.
intermediation activities require prior authorization from the Executive Power together with the prior favourable opinion of the Central Bank of Uruguay.

Regarding modalities admitted by the law for financial institutions, these are to be found in the harmonization of various provisions. Article 17 of Decree-law No. 15,322, according to Law No. 16,327 refers to the activities banks and financial intermediation cooperatives are allowed to carry out. In turn, article 4 of Decree-law No. 15,322 and article 21 of Decree No. 614/92, regarding external financial intermediation companies, refers their regulation to Decree No. 381/89 with the changes of Decrees Nos. 521/90 of 14 November 1990, 540/90 of 30 November 1990 and 266/91 of 22 May 1991. Furthermore, articles 19 and 20 of Decree No. 614/92 include companies accrediting financial leasing contracts and companies that organize or manage purchase circles or consortia for the acquisition of goods or services, within the entities subject to the Central Bank of Uruguay's control. The former are only subject to the control regime, while the latter are covered by the definition of legal intermediation entities, which implies that they are also subject to authorization to operate.

Another modality for financial entities is that of investment banks. In this respect, article 22 of Decree No. 614/92 refers to Law No. 16,131 of 12 September 1990 and to Decree No. 189/92 of 8 May 1992 for the regulation of such investment banks.

2. Charter of the Central Bank

The entity regulating and controlling the financial system is the Central Bank of Uruguay. It is thus set out in article 1 of Decree-law No. 15,322 regarding general regulation and is reiterated in various provisions of the same Decree-law for specific situations. Furthermore, such functions are reconfirmed, this time in the context of insurance and re-insurance, by articles 3, 5, 6 and 7 of Law No. 16,426 of 14 October 1993; regarding Pension Savings Funds, by Law No. 16,713 of 11 September 1995, modified by Law No. 17,243 of 6 July 2000; and with respect to the securities market, by articles 20 to 24 of Law No. 16,749 of 30 May 1996.

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444 See Decree-law No. 15,322, supra, note 4338, art. 10.
445 See Decree-law No. 15,322, supra, notes 4383, art. 9, according to Law No. 16,327, supra, note 4349, art. 1.
and articles 24 to 27 of the Investment Funds law No. 16,774 of 17 September 1996, and finally, by articles 3, 4 and 6 of the Investment and Securitization of Assets No. 17,202 of 1 October 1999.

Furthermore, the Central Bank of Uruguay's Charter 446 defines it as an autonomous entity with technical, administrative and financial autonomy. Its aims, among others, 447 consist of promoting and maintaining the solidity, solvency, and adequate operation of the financial system. To perform its functions it will aim at coordinating with the economic policy orientation of the Executive Power. Regarding the financial system, the tasks of the Central Bank 448 will be set out further on.

Regarding supervision, article 15 of Decree-law No. 15,322 establishes the rule that financial intermediation entities are subject to supervision by the Central Bank, before, during and after their management. The Central Bank will supervise and guide private financial activities and compliance with the measures it considers advisable or efficient. This point will be taken up further on.

Supervision and inspection are carried out in conformity with article 15 of Decree-law No. 15,322 (intensified first by Law No. 16,327 and lately by Law No.17,613) with the widest faculties of supervision and investigation, and the authorized officials are invested with the same faculties as the inspectors of the General Tax Office.

C. AUTHORITIES REGULATING AND SUPERVISING BANKING ACTIVITIES

The entity regulating and supervising the financial system is the Central Bank of Uruguay. This is set out in article 1 of Decree-law No. 15,322 regarding general regulation and is reiterated in various provisions of the same Decree-law for specific situations 449 and in Law No. 16,426 regarding insurance and re-insurance. 450 It is also reiterated in Law No. 16,713 in the area of regulation and supervision of entities administrating Pensions Savings Funds, in Law No. 16,749 451 regarding regulation and supervision of the securities market and the Law for Investment Funds of

445 For example, Decree-law No. 15,322, supra, note 4338, arts. 4, 6, 9, 11, and 14.
447 Id. art. 3.
448 Id. art. 7.
449 See, e.g., Decree-law No. 15,322, supra, note 4338, arts. 4, 6, 9, 11 and 14.
regarding such Funds and their administrators and the Law for Investment and Securitization of Assets No. 17,202 of 1 October 1999.

The Charter of the Central Bank of Uruguay defines this as an Autonomous Entity with technical, administrative and financial autonomy. Its aims are to safeguard the stability of the national currency, ensure the normal operation of internal and external payments; maintain an adequate level of reserves; promote and maintain soundness, solvency and adequate operation of the financial system. To perform its functions it will aim at coordinating with the economic policy orientation of the Executive Power. Regarding the financial system, the attributions of the Central Bank imply that it will act as economic advisor, banker and financial representative of the Government and as banker to financial intermediation institutions. It is its task to regulate and supervise their execution by the members of the financial system, and may authorize or prohibit transactions, establish prudential or good administration standards, etc. The Bank is managed by a Board of Directors composed of three members appointed from among citizens of recognized prestige and expertise in financial matters.

Furthermore, regarding supervision, article 15 of Decree-law No. 15,322 establishes the rule that financial intermediation entities are subject to the supervision of the Central Bank, prior, during and after their operation. The Bank shall supervise and guide private financial activities and compliance with the regulations in force, using the means it considers advisable or effective.

Thus, it is up to the Central Bank to establish the minimum net worth of the entities, and may adjust it according to the speciality of the operations authorized to the entities’ modalities; establish minimum encashment, minimums on deposits, regulate methods for attracting resources; issue general standards and specific instructions promoting liquidity, solvency and limitation of risks that the entities may take on, and may require plans for adjustments if necessary.

452 Arts. 24-27.
453 Law No. 16,696, see supra, note 4459.
454 Id. art. 3.
455 Id. art. 7.
456 Id. arts. 36, 37 (for last resort loans and financial assistance advances).
457 Id. art. 14.
458 Law No. 16,327, see supra, note 4349, arts. 11, 16.
Law No. 16,696 in its articles 38 and 39 adds that supervision of financial intermediation institutions within the authority of the Central Bank is exercised through the Superintendence of Financial Intermediation Institutions, reporting to the Board of Directors but with technical and operational autonomy. It is responsible for issuing prudential standards and instructions for the conservation of the entities' stability and solvency; authorizes the installation of supervised institutions following authorization by the Executive Power; authorizes the opening up of branches; decides on projects for merges; approves plans for re-composition or net worth adjustments; requires information in the form and terms it considers advisable; arranges for the system of accounting information and its publication; continuously supervises each member of the financial system to verify their economic and financial situation and the legality of their transactions; etc.

Supervision and inspection faculties are enforced in conformity with article 15 of Decree-law No. 15,322\(^{459}\) with carte blanche regarding supervision and investigation. Its authorized officers have the same faculties as the tax officials of the General Tax Office.

D. LINE OF BUSINESS AUTHORIZED TO FINANCIAL ENTITIES. UNIVERSAL OR SPECIAL BANKING

Banking modalities and characteristics, regarding their activities and line of business have been set out in various provisions of differing legal rank.

article 17 of Decree-law No. 15,322, as modified by Law No. 16,327 stipulates in relation to activities authorized to banks and financial intermediation cooperatives, that that these are the only ones who can receive current account deposits and authorize withdrawal of such deposited funds through issuing of cheques; receive sight deposits, and receive fixed term deposits from residents. Art. 1 of the Compilation of Standards for Regulating and Supervising the Financial System clarifies that financial intermediation cooperatives are companies organized as cooperative corporations that operate exclusively with their members.\(^{460}\)

In turn, Law No. 16,327 adds to article 17 of Decree-law No. 15,322 that

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\(^{459}\) See supra, note 435433 (modified by Law No. 16,327, see supra, note 4349).

financial intermediation cooperatives may be authorized to transform themselves into cooperative banks, in which case the same tax and central bank regime applied to banks in general will be applied to them.

Article 4 of Decree-law No. 15,322 and article 21 of Decree No. 614/92, refer to external financial intermediation companies, referring their regulation to Decree No. 381/89 with the modifications of Decrees Nos. 521/90 of 14 November 1990, 540/90 of 30 November 1990 and 266/91 of 22 May 1991. From these regulations, it will be seen that the activities of such entities consist in carrying out financial intermediation or negotiation between supply and demand of securities, money or precious metals, located outside the Uruguayan territory. This objective is exclusive and must be limited to operations with non-residents in Uruguay.

In turn, articles 19 and 20 of Decree No. 614/92 include companies accrediting financial leasing contracts, ruled by Law No. 16,072 and modified by Law No. 16,205 respectively of 9 October 1989 and 6 September 1991; companies organizing purchase circles or consortia for the acquisition of goods or services within entities subject to Central Bank supervision. In the first case, they are only subject to the supervision system, while in the second case, they are comprised in the definition of legal intermediation entities, implying that they are also subject to authorization to operate.

Consortia managements, according to the provisions of the Compilation of Central Bank Standards 461 are those entities that organize or administrate groups, closed circles or consortia, whose members contribute funds to be applied reciprocally or jointly for the acquisition of specific goods or services. The performance of such activities is exclusive.

The activities of investment banks are regulated by Law No. 16,131 of 12 September 1990 and Decree No. 189/92 of 8 May 1992. This consists in the reception of deposits from non-residents for terms of over one year, the hiring abroad of credits for terms of over one year, the issuing of bearer securities, investing and operating in securities of any nature (shares, bonds, debentures, etc.), acquiring real estate or non-expendable goods to grant use of same against payment, granting long and medium-term loans, granting all types of personal collaterals, accepting and place securities, advising on investment matters, managing portfolios, managing,
reorganizing or acquiring companies, operating with precious metals and foreign currency.

Finally, financial offices are those entities authorized to carry out any type of financial intermediation operation except those reserved to banks and investment banks.462

Article 18 of Decree-law No. 15,322 lists the activities that in general are prohibited to all financial intermediation entities, including in this list operations of any nature unrelated to financial operations; the granting loans with guarantees from their capital or to pay it in or increase it; the granting credits or taking on guarantees for the obligations of their senior staff or entities in which such staff hold senior positions; the investment in shares or any security issued by private companies, unless acquisition is temporary in order to pre-finance the issue and except for the acquisition of shares or parts in the capital of foreign financial companies or foreign financial entities subject to the prior authorization of the Central Bank of Uruguay; the holding of real estate beyond the requirements of premises for the operation of the institution.463

E. ESTABLISHMENT OF BANKS IN URUGUAY. REQUISITES
PROCEDURE. ESTABLISHMENT OF BANKS ABROAD

1. Establishment of Entities

The establishment of financial intermediation entities is subject to the prior authorization of the Executive Power.464 In order to grant it, it must have the favourable opinion of the Central Bank of Uruguay. Furthermore, opening a financial entity requires entitlement that must also be conferred by the Central Bank of Uruguay.465 In granting this authorization and entitlement, legality, timeliness and advisability of the project submitted in the corresponding request must be considered, and an appreciation should be made of the solvency, soundness and suitability of the requesting company. Both the decision issued by the Executive Power and those issued by the Central Bank of Uruguay must be well founded.

462 Id.
463 Decree-law No. 15,322, see supra, note 4338, art. 4.
464 Id. art. 6.
Decree No. 614/92 specifies that the request for establishment must be submitted to the Ministry of Economy and Finance, indicating the capital involved, the background, the shareholders, directors and managers, the social contract, elements enabling an appreciation to be made of the efficiency of the applicant (an economic-financial feasibility study), elements making it possible to assess the financial significance for the national market implied by the applicant's operation.\(^{466}\) Only individuals can be directors or managers of financial intermediation entities.\(^{467}\)

With the submission of the request, the applicant must deposit 20% of the minimum net worth established by the Central Bank of Uruguay with the Central Bank.\(^{468}\) In order to start operations, the authorized entity must pay-in the total amount of the minimum net worth.\(^{469}\) At all events, paying-in\(^{470}\) shall be made in cash or in mortgage debentures. The minimum net worth must be held in the country and used for authorized activities. Authorized companies shall start operating within one hundred and eighty days following notification of the favourable resolution.\(^{471}\)

Annually the establishment of new banks in the country shall only be authorized if the number does not exceed 10% of the banks existing the previous year\(^{472}\).

The opening of branches of already authorized entities only requires prior authorization by the Central Bank of Uruguay.\(^{473}\)

Mergers and transformations of entities authorized to carry out financial intermediation activities require prior authorization by the Executive Power together with the prior favourable opinion of the Central Bank of Uruguay.\(^{474}\)

2. Establishment of entities and branches of foreign banks

The legislation makes no difference between national or foreign banks,
so the regulations are common for one and the other.

However, the installation of branches or agencies of foreign companies developing financial intermediation may only be authorized if their bylaws do not prohibit Uruguayan nationals from occupying senior positions or positions on the board of directors, or as employees on the national territory.475

3. **Requisites for senior staff**

According to Central Bank regulations, senior staff are considered to be those persons occupying positions as directors, auditors, supervisors or members of commissions delegated by the board of directors, managers or members of boards of directors or local administrative councils for entities with the head office abroad; included in this consideration are persons fulfilling tasks as general managers, deputy general manager, manager of a head office, manager of departments in agencies and branches, general accountant and head or foreign exchange operator, together with those having similar faculties to those just mentioned, and finally, university professionals, who either by holding positions or maintaining a permanent relationship with a financial entity, provide internal advisory services to the board of directors.476

The Central Bank studies the background of the directors and managers during the process for the authorization of each financial institution and in the event of new appointments. In turn, senior staff must declare to the financial intermediation company which they belong to, their links with companies in which they hold positions as directors, members of the board of directors, supervisors, companies in which they hold partnerships, senior managers of administrators, or internal advisors to the board of directors, either occupying positions or maintaining a permanent relationship with them.

Inability to occupy such positions may arise from the following causes: civil or commercial bankruptcy, inability to occupy public offices; having bad debts with financial intermediation companies; inability to hold a current account. Finally it should be noted that the Central Bank can request from bank shareholders the reorganization or substitution of their

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475 Decree-law No. 15,322, see *supra*, note 4338, art. 8.
476 Compilation of Central Bank Norms, see *supra*, note 45863, arts 38, 341-45.
representatives, directors, managers, administrators, and executives. The same officers, as well as trustees and comptrollers of private financial institutions who in performing their jobs approve or conduct action or get involved in omissions that may imply or imply the application of superior fines or sanctions, may be subject to fines or inability to occupy such positions, for a period of up to ten years, by decision of the Central Bank.

4. System for the protection of bank deposits

The Uruguayan financial legal system had no explicit system for the protection of deposits in the event of insolvency of financial institutions until 2002. Law No. 17,613 created a Banks Deposits Guaranty Fund to be administrated by a new Banks Savings Protection Superintendence, constituted as a new area inside the Central Bank. Said Fund will be mainly financed by contributions to be made by the financial institutions and International Financial Organisations. The maximum amount to be paid to depositors by the Banks Deposits Guaranty Fund will be defined by the Executive Power, following a Central Bank’s technical proposal. The guaranty will be paid to depositors upon the decision to suspend or liquidate a financial institution. Up to now, the Central Bank has not implemented the above mentioned Banks Deposits Guaranty Fund provision.

It is interesting to note that prior to Law No. 17,613, the Financial Entities Law expressly declared that the State did not answer for the deposits of private financial institutions. The case of State Banks was different (Mortgage Bank of Uruguay, Bank of the Oriental Republic of Uruguay) where by express provisions in the specific regulations the State’s guarantee was established for obligations taken on with investors.

However, on several occasions throughout the past decades, when difficulties have arisen in domestic banking institutions of a significant dimension, the deposits have received an implicit protection by means of the intervention of the entity in question by decision of the Central Bank of Uruguay and its maintenance with the support of public funds.

Prior to intervention, the law foresees certain mechanisms to face critical situations in financial institutions. In these cases and fundamentally to

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477 Decree-law No. 15,322, see supra, note 4338, art. 16, as modified by Law No. 17,613, see supra, note 4327.
478 Law No. 17,613, see supra, note 4327, art. 45.
cover temporary situations of illiquidity the Central Bank may act as a last resort lender, and as such under the terms and conditions that the Board of Directors establishes, may purchase, sell, discount and rediscount to financial intermediation institutions certain documents issued by the Uruguayan Government or the Central Bank or documents in which one of the parties is a financial institution and with maturities ranging from a maximum of between 180 and 365 days from the time of their acquisition by the Central Bank.\footnote{Id. art. 36.}

Likewise, and with equal functions, the Bank may grant advances to financial intermediation institutions for terms not exceeding ninety days, provided they are adequately guaranteed according to regulations.\footnote{Id. art. 37.}

Finally it should be noted that under the provisions of article 39 of Decree-law No. 15,322 and the RNRCSF a Plan for Net Worth Reorganization for financial entities in a situation of net worth insufficiency is foreseen.\footnote{Decree-law No. 15,322, see supra, note 4383, art. 16 (according to Law No. 17,613, see supra, note 4327, art. 335).} These entities must report on the cause of the situation and submit a plan that will enable them to set matters right in a reasonably short period. This information must be submitted to the Financial Institutions Superintendence. The Central Bank of Uruguay will determine whether it considers the plan submitted by the infringing company to be adequate, in which case it may suspend the application of fines foreseen for this eventuality. In the event that the plan for reorganization of net worth is not complied with, notwithstanding the adoption of the corresponding measures, the suspension of fines generated will be annulled. The Central Bank of Uruguay is the liquidator at the administrative offices of the companies integrating the financial intermediation system and their collaterals.\footnote{Decree-law No. 15,322, see supra, note 4338, art. 42.}

F. PRUDENTIAL REQUISITES


As pointed out earlier on, with the submission of the request to install a financial entity the applicant must deposit 20% of the minimum net worth
established by the Central Bank of Uruguay with said institutions. In order to start operating, the authorized entity must pay-in the total minimum net worth. In all cases, paying-in shall be made in cash or in Mortgage Bonds. The minimum net worth must be located in the country and used for the authorized activity. Companies authorized must start to operate within one hundred and eighty days following notification of authorization.

This minimum net worth, according to communication No. 2003/1847 of 30 March 2003 established for banks for investment banks, financial firms, and for financial intermediation cooperatives the amount of $Ur 190,000,000 (approximately equivalent to US $6,000,000); . In turn, for Foreign Financial Institutions, a deposit is required to be made at the Central Bank of Uruguay for US $4,500,000. All these minimum amounts are up-dated quarterly.

The parameter used is net worth, determined by the sum of essential net worth and supplementary net worth.

Uruguayan regulations, following the Basel Committee guidelines on this matter, make a distinction between essential net worth and supplementary net worth. The items accepted for the composition of one and the other also follow these international standards. The essential net worth includes integrated capital, non-capitalized contributions, net worth adjustments, reserves created against net proceeds after taxes and net results of previous exercises. The supplementary net worth may not exceed the essential net worth and includes subordinated bonds with a ceiling of 50% of the net essential worth, general contingencies on credits due to financial intermediation corresponding to estimates made by the company to cover future loss, net results of the last closed exercise that has not yet had a report from the external auditor, net results of the ongoing exercise, with the exception that net proceeds will be computed by 50% of the accumulated balance.

In turn, regarding the amount required, minimum net worth required from financial intermediation entities is the higher between the following

483 Decree-law No. 15,322, see supra, note 4338, art. 41.
484 Id. art. 7.
485 Id. art. 11.
486 Decree No. 614, see supra, 44035, art. 3.
487 Id. art. 7.
alternatives: the basic net worth; or 10% of the net risk weighted and contingency assets weighted in a scale ranging from 0 to 100% in six alternatives (0, 5, 10, 20, 50 and 100%, the latter figure being residual and applied to all assets that do not have a different rating) according to the level of risk, and 4% of the total assets and contingencies. Precisely, the use of the 10% of assets and weighted contingencies referred to is also based on the principles and standards recommended by the Basle Committee, imposing a requirement that is higher than the standard suggested by the Committee of 8% of the capital weighted by asset risk. In the case of foreign financial institutions, the minimum net worth requirement is the higher between the minimum capital of US$ 500,000 plus special investments, and 8% of weighted assets and contingencies plus special investments. 489

2. Technical relations

Uruguayan regulations do not define this concept, which is broadly used by Central Bank technical staff to refer to certain relations between financial institutions assets, resources, deposits and obligations, which financial institutions have to comply with for prudential purposes. Relation between total deposits and obligations and liquid assets, credit concentration ceilings, are some examples of technical relations, which sometimes are regulated by Central Bank rules within the so called technical relations, and sometimes separately.

a. Fixed Assets Ceiling

The maximum amount of immobilised assets for financial intermediation entities may not exceed 100% of the net worth. Included in the concept of immobilised assets are the balance—net of provisions—of credits registered in the accounts of the Group of "Credits in Arrears" with over two years arrears, investments, durable consumer goods and differed charges. 490

For Investment Banks, the amount of fixed assets may reach 50% of the net worth and consist solely of durable consumer goods and differed

489 The parameters and amounts mentioned here are found in the Compilation of Regulation and Control Standards for the Financial System, see id. arts. 12-14. It should be noted that the forms and value of the calculation of minimum net worth is contained in Circulars Nos. 1,613 of Dec. 31, 1998 and 1721 of Dec. 17, 1998.
charges. For Foreign Financial Institutions the percentage that fixed assets may amount to of the net worth also may reach 50%, and may consist exclusively of durable consumer goods.

b. Investments of assets in the country

The general system of asset location provides that it is obligatory to locate in the country assets for an amount of no less than 100 of the basic net worth.

As assets located in the country, material assets located on the national territory and rights demandable from persons residing on the national territory are accepted. It should be remembered that basic net worth is updated quarterly according to art. 15 of the Compilation of Central Bank Standards and, according to communication No. 2001/147 in force since 30 September 2001, it has been fixed at $Ur 75,800,000 (approximately the equivalent of U$ 5,414,286) for banks; for investment banks and financial firms at $Ur 45,700,000 (approximately the equivalent of U$ 3,264,286); and for financial intermediation cooperatives and prior savings groups at $Ur 3,800,000 (approximately U$ 271,428). For Foreign Financial Institutions, a deposit at the Central Bank of Uruguay of U$ 500,000 is required.

c. The ceiling for asset account balances in local and foreign currency for banks, financial firms and cooperatives, is the amount equivalent to 150% of accounting net worth, subtracting fixed assets.

The ceiling for the assets or liabilities balance in the item of «operations to be settled» in foreign currency, for banks, financial firms and cooperatives, amounts to 20% of the accounting net worth, less immobilised assets.

Under this item, forward contracts and floating of national public securities are liquidated.

Banks are not allowed to keep an open long term credit position (more

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490 Standards regarding fixed assets are contained in of the Compilation of Regulation and Control Standards for the Financial System, see supra, note 4746, arts. 52, 394 and 4327.
491 See supra, note 45863.
than three years), in excess of an amount equivalent to their net worth.

That means, the balance between all long term credits granted and long term deposits or obligations, both for periods over three years time can not exceed a sum equivalent to the bank's net worth.

Banks are obliged to constitute and maintain at all times a liquid assets portfolio in an amount equivalent to 30% of all its non residents deposits or obligations. The assets portfolio required can be constituted by cash, hard currencies, and precious metals, sight or maximum 30 day time deposits in highly rated banks, or public or private foreign debt highly rated by international rating agencies.


Limitations on credit concentration.

a. Identification and knowledge of the debtor are made by means of the debtor file.

The contents of this file are pre-established by the regulations. It must include the exact identification of the debtor, risk analysis information, including the general position of the owner with a report on the elements considered in granting the loan and the debtor classification. It should contain economic and financial information on the debtor, requiring the balance sheets with the compilation report. However, regarding foreign financial sector companies, audited balance sheets are required save for exceptional situations due to their notorious solvency, when this requisite is not necessary. For individuals, in certain cases, liability statements are required duly certified by a notary public, regarding the ownership of the assets declared, and complementary information is required in the cases when the debtor involves a certain amount of total credit risk in the overall financial system or requires medium or long term funding. Information is also required on guarantees, information on the correspondence exchanged with the borrower regarding credits granted, and copy of the resolutions regarding operations agreed on.

4. Credit concentration has been limited, and credit risk ceilings have been

The limit, by person, legal entity or economic group, is of 25% of the net worth requirement, as give on the last day of the one but last month, up-dated by the dollar exchange rate variation.

Operations for calculating the risk ceiling include direct or contingency credits, the holding of tradable bonds, in all cases net of provisions. Debit balances of operations to be settled and contingency rights on purchase-sales operations taken at 10% of their face value and guarantees in favour of international transport companies related with the ownership of goods imported under the cover of a documentary credit or endorsed collection are excluded from the contingencies.

The amount included in calculating the ceiling is the total amount due or bailed by the client.

Regarding Foreign Financial Institutions, the ceiling for the credit risk has been established at 40% of the net worth. In both cases, the form of calculation and the elements included in credit risk computation are the same as those set out for banks.

The ceiling can be increased, according to the case, up to an amount equivalent to 25%, 75% of the net worth of the institution, depending on the entity, when involving risks covered by a pledge on deposits, or by co-surety granted by banks and corporations organized abroad or by standby letters of credit or by pledging of deposits or letters of indemnity granted by departmental governments, the National Government, etc., when involving loans to finance exports that have already been completed and covered by payment instruments or draft bills of exchange endorsed by foreign banks or insurance on credits for exports hired by the State Insurance Bank.

5. Credit risk. Debtor classification and provision system

a. For the purpose of debtor classification, three categories have been established within the financial sector and five categories of differentiated debtors in the non-financial sector. In all cases, there are

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minimum, pre-established provisions, which are applied on capital and interest, less computable guarantees.\footnote{See Compilation of Central Bank Standards, \textit{supra}, note 45863, arts. 25.1-25.3, as contained in Circular No. 1.613 of Sept. 1999 (standards for classification of credit risks are contained in Specific Standard 3.8 amendment No. 43, for accounting standards and accounting plan for financial intermediation entities).}

The board of directors and administrators of financial entities are responsible for the accounts reflecting the true valuation of investments in non-credit risk assets and for the correct classification – exposition and valuation – of the total number of direct and contingent credit risks they take on, according to the regulations established in this respect by the Central Bank. Such entities must maintain appropriate records and control systems that make it possible for the assessments and classifications to be made available to the auditors and Central Bank officials.

Debtors of the financial sector are categorized in three possible stages: normal risk, high risk or unrecoverable credits. Normal risk debtors are financial institutions having valid operations provided there are no doubts about the recoverability of the credits in the agreed on form and term. High-risk debtors are financial entities with expired operations, and institutions of a similar nature showing deficiencies arising from situations affecting or likely to affect their capacity to repay under the agreed on conditions or for which up-dated information is lacking making it possible to assess their economic and financial situation. Unrecoverable credit debtors are those financial institutions that have been intervened or that are being liquidated or that show notorious deterioration of their solvency.

In the case of the non-financial sector, the categories are five. Normal risk debtors are those with valid operations or operations elapsed at least 30 days from the date of classification, provided there is no doubt, in the application of valid classification criteria, of their repayment capacity. To be included in this category, the debtor must be punctual in repayments, show appropriate profitability in his operations, and have indebtedness in accordance with the asset structure and level of income. The second category of potential risk debtors, involves those with valid operations or operations elapsing at least 90 days prior to the date of the monthly classification of the file, or with occasional arrears in payment, or showing some deficiencies arising from situations affecting or that might affect capacity for repayment in the agreed-on form and term. For example some
situations included in a risk of this category might be that the debtor has had a drop in sales and net profits, or that the board of directors or ownership of the company has been changed and this may be detrimental to its efficiency. The third category, real risk debtors, includes those whose operations must be accounted for in the category of expired loans. The situations and examples corresponding to this category are: arrears of between 60 and 180 days in the submission of information required by the financial entity, or accumulated negative results that do not significantly affect net worth. Inclusion in this category implies lesser risk significance within the categories supposing credits with terms and rates that are considerably different from those of the market. In turn, the high-risk debtor category covers those whose operations must be accounted for in the accounts of pending credits. For example, debtors with arrears of over 180 days in the submission of information required by financial entities or who have an embargo hindering the normal operation of business, or showing symptoms of deterioration in their solvency such as those arising from accumulated negative results significantly affecting their net worth. Finally, the category of unrecoverable credits involves those debtors whose operations are accounted for in the account of delinquent loans, and debtors who have taken flight, or who have bankruptcy or insolvency proceedings against them or who have legal actions pending with uncertain results, etc.

It should be borne in mind that the classifications made and the assessments submitted on debtors according to the existing categories may be revised by the Central Bank, which may also indicate changes to be made.

b. Furthermore, the neutralization of credit risks classified by the specific regulation 3.8 above is included in the corresponding provisions obliged by the Specific Regulation 3.12, according to revision No. 28. In fact, this Specific Regulation requires a minimum provision in each risk category, notwithstanding the fact that each entity may make a greater provision than indispensable.

Thus, for the financial sector, the prevision corresponding to normal risk debtors may not be less than 0%. The prevision applicable to high-risk debtors must be at least 50% and the necessary provision for unrecoverable credits must be at least 100%.
In the non-financial sector and for normal risk debtors, the provision varies between 0% and 0.5%, the lower provision corresponding to contingencies arising from the operation of consortia, and the higher one that corresponding to other normal risk credits. For potential risk debtors, the minimum provision is 5% and for real risk debtors this provision amounts to 20%, for high-risk debtors it is at least 50% and for unrecoverable credit debtors, a provision of 100% is required.

In order to determine the amount on which the provisions must be established, various elements must be borne in mind. Debit balances for operations to be liquidated and contingency rights in purchase-sales options are taken at 10% of their value. The balance of accounts for operations undertaken under the terms of agreements with automatic refund by the Central Bank are not computed, neither are accounts of losses entitled under operations to be liquidated of debtors for securities purchased or sold with a reverse future transaction, nor are contingency accounts for purchase contracts, nor accounts of guarantees given to international transportation companies on the ownership of certain personal estates.

Certain guarantees must be deducted from the amount on which the provisions should be made, set out in Specific Regulations 3.16 and 3.17.

Furthermore, regarding the consideration of guarantees, Specific Regulation 3.17 according to revision No. 47 stipulates that in establishing provisions for credit risks, only certain guarantees may be subtracted, always of a real nature but additionally, if established in the country, they must be made as pledges on cash or other equities, or credit rights on the State or, in some cases, foreign public bonds, or on goods that are easily sold or in some cases, mortgages on real estate, vessels or planes. A maximum period is established within which such guarantees may be computed following the expiry date of the respective transaction.

If the guarantees have been set up abroad, they will only be computed if they are pledges on deposits in cash or other equities described that are established in notoriously solvent financial entities or if they are mortgages on real estate abroad or on vessels or planes under certain conditions. The admission of real guarantees established abroad requires a legal study of the aspects set out, which must be up-dated quarterly.

In the calculation of credit risk provisions, the deduction of other
guarantees is also admitted, such as sureties given by foreign banks under certain conditions, those given by foreign companies of notorious solvency and fulfilling certain requisites, assignments on deposits in cash or other securities established in national financial entities or foreign banks of notorious solvency, letters of indemnity issued by the National Government or Departmental Governments, irrevocable letters of credit, bills of exchange and credit insurance covering loans to finance exports already shipped or services already supplied, fulfilling certain requisites, standby letters of credit issued by foreign banks of notorious solvency, real estate granted under leasing, assignments of warrants and certificates of deposit of certain goods issued by warehouse companies of notorious prestige and fulfilling certain requisites.

5. Accounting and external auditing standards

a. The drawing up of balance sheets following the standards and accounting plan stipulated by the Central Bank of Uruguay is obligatory. The closing date for accounting periods is necessarily the 31 December for all entities, without exception.

Balance sheets are published in the Official Gazette and in another national widely circulated newspaper in addition to the explanatory notes for such balance sheets.

Financial entities must supply the Central Bank monthly statements of net worth referring to the last day of each month, adjusted for inflation and the income statement.

c. Accounting information must be submitted to the Central Bank with the external auditor's report, drawn up according to the guidelines provided for this purpose by the Central Bank.

For this purpose, external auditors are considered as those who carry out an auditing examination referring to a financial intermediation company, even though they have not been hired by the company, and are independent from the company and the shareholders directly or indirectly exercising control.

Auditors must issue a statement regarding the balance sheet and income statement, including their opinion on whether they have been established according to Central Bank standards. Every four months they must report on their assessment of internal control, setting out significant deficiencies and omissions and formulating the corresponding recommendations.

The must report annually on the accounting system used and its adjustment to the Central Bank’s standards and accounting plan. Every six months they must issue a report on the results of the risk classification, expressing their opinion on quantification of provisions (annually for foreign financial institutions). They must also report on credits granted to entities belonging to the economic system and on compliance with the prohibition of granting loans to senior staff. They must supply reports that they have prepared on matters included in the preceding statements when they do not agree with the statements reported to the Central Bank. Furthermore, they must prepare an annual statement of the consolidated net worth abroad and assessment subsidiaries, to prevent financial institutions being used for the legitimization of assets derived from criminal activities.

A registry exists of auditors authorized to issue the reports that must accompany the balance sheet and income statement of financial entities. This registry is held by the Central Bank.

In their professional capacity, the auditors are obliged to adjust technically to the provisions established by the Central Bank regarding their assignments and what is not specifically set out in the Central Bank standards must comply with auditing standards generally accepted in the country. Furthermore they must keep the working papers regarding each of the examinations made for a period of five years; provide the Central Bank with all kinds of information regarding the work carried out and their conclusions; allow the Central Bank to consult the working papers directly; deliver to the Central Bank or to whomever the Bank designates, the documentation referring to work carried out in a financial entity if it is no longer authorized to continue carrying out its assignments by resolution of the Central Bank.

Furthermore, in their contracts the auditors must put on record that they do not maintain relations with the company nor do they have interests in it that might affect their professional independence; that they know and

\[498\] See Compilation of Central Bank Standards, supra, note 45863, art. 319.4, according to
accept the provisions of the Compilation of Central Bank Standards.\footnote{499}

Such declarations, involving firms of public accountants, are referred to all the professionals on their roster.

Breaches of the obligations described are described as slight or serious. Considered as serious breaches, in particular are the following: not carrying out hired auditing; issuing reports with contents contradicting evidence obtained in carrying out the job; non-compliance with the auditing standards resulting in significant economic damage; violation of professional independence; violation of professional secrecy.

The breaches that the auditors may commit in carrying out their assignment can be sanctioned with an observation, suspension from the registry for varying lengths of time and barring from the registry.

G. BANKING ACTIVITIES AND THE FINANCIAL MARKET

Regarding the financial market and its links with banking activities, provisions in force on this subject are the general standards for the banking area that have been mentioned.\footnote{500} The limits between both sectors of the financial market are contained in the coordination of Decree-law No. 15,322 as modified by Law No. 16,327 and the above-mentioned Laws No. 16,749, No. 16,774 and No. 17,202 that attenuate the rigid separation originally provided for in the first Law mentioned.

In fact, according to what we have seen earlier on, article 18 of Decree-law No. 15,322 lists the activities that in general are prohibited to all financial intermediation entities (save for investment banks), including on the list the performance of operations of any nature other than financial business; investment in shares or bonds issued by private companies, unless acquisition is temporary in order to pre-finance the issuing and also excepting acquisition of shares or parts in the capital of foreign financial companies or in foreign intermediation entities\footnote{501} with the prior authorization of the Central Bank of Uruguay, or holding real estate exceeding the premises required for operation of the institution.

This shows, and in particular until the sanctioning of Law No. 16,749,
that financial entities governed by Decree-Law No. 15,322 and its amendments, were expressly forbidden to participate on the stock market, thus marking the total separation existing between these two financial contexts.

This limitation has now been made more flexible by virtue of article 47 of Law No. 16,749 (Stock Market and Marketable Bonds Law) which authorizes financial entities to invest and maintain as assets marketable securities offered publicly, issued by non-financial companies (commercial, industrial, agricultural, etc.) and by article 5 of Law No. 16,774 (Investment Fund Law) which stipulates that financial entities, including banking entities may be shareholders in companies administrating Investment Funds.

The banking institutions can be stockholders of investment funds management agencies or pension funds management agencies. They can also be special partners of stock exchanges, operating for their customers.

Finally, the establishment of an electronic Stock market integrated by banks (it started operations on 5 September 1994), has implied that the banks have a framework in which to carry out inter-bank transactions of financial products. Furthermore, it should be noted that banks are special partners of stock exchanges (with no political rights), and operate purchasing and selling securities for their customers.

H. BANKING SECRECY

Secrecy regarding information on clients and their transactions with financial entities is presently contained in an express provision of Decree-law No.15,322 as amended by Law No. 16,327 and Decree No. 614/92.

From these standards it may be observed that financial entities, whether public or private may not facilitate or provide information of any kind regarding their customers' funds or securities held by the institution for any transaction they may be carrying out.

Nor may they make known any confidential information they receive from their clients or about them. Both transactions and the above-mentioned information are protected by professional secrecy, and may only be revealed by express and written authorization by the interested party or by a well-founded resolution of Criminal Justice or the competent Court of Justice when alimony is involved. At all events, revealing information
covered by professional reserve is subject to liability for prejudice arising from the lack of grounds for the request by resolution of the Law Court requiring it.

The duty of professional secrecy is not only applicable to financial entities but also to all the individuals who, because of the duties they carry out, related to the organization, operation or control of these entities, have access to transactions or information protected by the secrecy, independently from the nature of the link between such individuals and the owners of financial intermediation companies, including their external auditors.

It should be clarified that the knowledge that individuals referred to in the preceding paragraph necessarily acquire of protected transactions and information while fulfilling their assignments related with financial intermediation companies, does not break professional secrecy.

I. ILLEGAL OPERATIONS

Law 17.835 passed on September 29, 2004, establishes the obligation to report to the Financial Information Unit all suspicious transactions eventually related with money laundering crimes, as defined by article 54 of Decree Law 14.294 dated October 31, 1974 – incorporated by Law 17.016 (article 5) dated October 22, 1988 and modified by Law 17.343 passed on May 25, 2001. Money laundering crimes are defined by the above mentioned laws as the following actions: to hide, acquire, receive, transfer, manage, sell, or apply in any way money or goods resulting from certain crimes (i.e. drugs trade and traffic; smuggling; fraud committed against the Public Administration; extortion; kidnapping; weapons illicit traffic; human organs and medicines illicit traffic). All these crimes are punished with imprisonment.

Law 17.835 legally recognizes the existence of the Financial Information Unit (already established by Central Bank’s regulation), as a body within the Central Bank of Uruguay, whose objectives are to prevent money laundering operations.

The Financial Information Unit shall not reveal the identity or source of the information it gets. The law states an extensive list of entities and individuals obliged to provide information regarding suspicious transactions to the Financial Information Unit, including in same all
financial entities, all companies carrying out foreign exchange activities, all entities carrying out gambling activities, all individuals and entities carrying out capital market activities or intermediation, all enterprises carrying out post services and money transfers, insurance companies and pension funds managers, all individuals or legal entities carrying out trade activities regarding art works, antiques and jewelry. Said individuals and legal entities are obliged to keep records of their customers, clients and beneficial owners, and to submit to the Financial Information Unit all information and documents it might request regarding their customers and transactions. Bank or professional secrecy obligations shall not be invoked against the Financial Information Unit for withholding information or records it may require. All legal entities and individuals subject to the prevision of the law are also obliged to inform the Financial Information Unit all suspicious transactions their customers might be involved in. Failure to comply with the suspicious transactions report obligation may cause the Financial Information Unit to apply any of the administrative measures and civil punishments established by Decree Law 15.322. The compliance in good faith with the suspicious transactions report does not configure breaches of legal secrecy obligations.
CHAPTER V

EVOLUTION OF BANK INTEGRATION IN MERCOSUR

I. THE EVOLUTION ANALYSIS IS DONE FROM DIFFERENT PERSPECTIVES

The evolution analysis is done from different perspectives. Section I refers to the regulatory and instrumental evolution. On the one hand, Section I focuses on the evolution and modifications introduced in banking regulations since the signing of the Asuncion Treaty. This approach is originated in the internal legislation of the Party States detailed in Chapter IV (Sections I and II), and starts with a comparison of subject fields that are more relevant to the banking activity, in the light of liberalisation and integration.

On the other hand (Sections III and IV), a different approach is used to examine the results obtained in regulatory harmonisation activities undertaken by MERCOSUR itself by means of different mechanisms (Sub-group 4, Services Group); and in liberalisation and integration work also undertaken by MERCOSUR.

This evolutionary analysis, conducted from different angles simultaneously, allows us to examine the results obtained from instruments and procedures used, as well as to assess obstacles holding back integration. In particular, consistency—or lack of consistency—will be noticeable between the results of the openness and bank integration in MERCOSUR and the regulatory barriers of Internal Law. In this regard, it will be easy to recognize the parallelism between the lack of modification of Internal Law barriers preventing access by those providing financial services from one State Party to another, as well as those limiting activities to be developed by financial institutions, with the postponement of those same areas from the MERCOSUR agenda within the Sub-group 4.
discussion. There is also a parallel, regarding prudential standards, between the evolution in the Internal Law and regulations of MERCOSUR countries and the relative successful developments at the MERCOSUR instances. We will also be able to appreciate the difficulties raised up by the mechanism chosen for services -banking— integration as well as the impact on the integration process due to poor coordination between the tasks and objectives of some of MERCOSUR bodies.

Following the above-mentioned analysis, this Chapter includes, on further reflection, some elements – based in economic developments - resulting from the regional situation of recent years (Section II) and their impact on the MERCOSUR integration process. The Chapter particularly will point out how these inputs brought up different barriers to trade in the MERCOSUR context, even if they are thought of as transitory.

Finally, another feature underlined in both Sections in this Chapter, based on data and analysis, is the surge and potential of MERCOSUR’s facet as counterpart to other regional Agreements and countries in benefit of the sound development of the local and regional banking industry.

All the above will allow us to derive lessons and reflections vis-à-vis future phases of regional integration.
II. ASYMMETRIES TO BE HARMONISED. OFFERS AND COMMITMENTS IN THE MONTEVIDEO PROTOCOL. THEIR PROGRESS

A. BANKING REGULATION IN THE MERCOSUR COUNTRIES.

COMPARATIVE PRESENTATION.

1. Regulatory and control bodies

REGULATION

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<thead>
<tr>
<th>ARGENTINA</th>
<th>PARAGUAY</th>
<th>BRAZIL</th>
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<tr>
<td>(Law No. 21,526</td>
<td>(Law No. 861/1996 and</td>
<td>(Law No. 4,495)</td>
<td>(Decree-law No. 15,322 and Law No. 16,696)</td>
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<td>and its successive reforms)</td>
<td>Decree-law No. 18 dated 25.3.1952)</td>
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<tr>
<td>Central Bank of</td>
<td>Central Bank of Paraguay through the</td>
<td>National Monetary</td>
<td>Central Bank of Uruguay</td>
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<td>the Republic of</td>
<td>Superintendence of Banks</td>
<td>Council (CMN) and Central Bank of Brazil (BCB)</td>
<td>Autonomous entity with technical, administrative and financial autonomy</td>
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<tr>
<td>Argentina</td>
<td>An autarchic entity, body linked to the</td>
<td>CMN is the leading</td>
<td>Main task: preserve liquidity and solvency of institutions and enforce banking legislation. When performing its functions it will aim at coordinating with the economic policy orientation of the Executive Power.</td>
</tr>
<tr>
<td>Alndependent,</td>
<td>Executive Power through the Ministry of</td>
<td>regulatory entity for</td>
<td>Among its duties related to the financial system it works through the Superintendence of Financial Intermediation Institutions.</td>
</tr>
<tr>
<td>autarchic entity</td>
<td>Finance.</td>
<td>financial sector. body in financial issues, among others. It is chaired by the Minister of Finance. This body dDecides on the technical and administrative structure of the BCB, approves the latter’s budgets and settles any appeals against it. The BCB is an independent legal entity responsible for abiding by and enforcing legislation and standards stemming from the CMN.</td>
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<tr>
<td>of the Executive</td>
<td>It passes mandatory resolutions Main task; to preserve liquidity and solvency of institutions and enforce banking legislation. Grants authorization for the installation of new banking and financial entities.</td>
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<td>Power M. Its main task: is to preserve the value of the currency. It formulates rules on financial and monetary areas according to Law. It is rResponsible for the application of legal and regulatory standards in finance and controls the operation of the financial market.</td>
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<td>It is rResponsible for setting up liquidity and solvency standards, establishes policies relative to the scope of the financial system, Grants authorization for new financial entities, etc.</td>
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<td>ARGENTINA (Law No. 21,526 with its successive reforms until Law No. 24,144 and Decrees Nos. 1,860, 1,887 and 146 of 13.10.92, 15.10.92 and 21.2.94, respectively)</td>
<td>PARAGUAY (Law No.861/96 and Decree-law No.18 dated 25.3.1952)</td>
<td>BRAZIL (Law No. 4,495)</td>
<td>URUGUAY (Decree-law No. 15,322 and Law No. 16,696)</td>
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<td>The CMN regulates the constitution, operation and control of financial entities. It sets minimum capital of entities and credit risk guidelines, prudential standards, accounting standards, etc. The BCB authorizes the operation and installation of financial entities and establishes the requirements to hold management positions in private entities. It controls foreign capitals of financial entities.</td>
<td>Issues regulations for the financial system and monitors its execution. It authorizes or prohibits operations, issues prudential and good management standards, allows for the establishment of institutions authorized by the Executive Power, approves financial entities plans for net worth re-composition and decides on the accounting data regime and its dissemination.</td>
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<td>ARGENTINA (Law No.21,526 and its successive reforms until law No. 24,144 and Decrees No.1,860, 1,887 and 146 dated 13.10.92, 15.10.92 and 21.2.94, respectively)</td>
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<tr>
<td>Central Bank of Argentina through the Superintendence of Financial and Foreign Exchange Institutions Banks The BCRA It establishes the format and frequency requirements of accounting data on the economic and financial situation or of any other necessary information requested to the financial entities they control. It permanently monitors all entities and their performance, it rates them, it applies and implements regulations passed by the Bank, and it approves rationalization plans of the</td>
<td>Central Bank of Paraguay through the Superintendence of Banks. It verifies the correctness compliance of operations and compliance with standards; it inspects banking entities.; it promotes unified information systems and accounting; it compels to adjust the value of assets.</td>
<td>National Monetary Council through the BCB. It controls all entities, it permanently monitors them and their performance. It may request data and reports it deems necessary. It permanently controls all members of the financial system with broad capacity to investigate and act in the economic and financial field and legality of their operation.</td>
<td>Central Bank of Uruguay through the Superintendence of Financial Intermediation Institutions. It permanently monitors all entities and their performance with the broadest power to investigate in terms of economic and financial legality.</td>
</tr>
</tbody>
</table>
entities.
2. *Establishment of financial entities*

**AUTHORIZATION**

<table>
<thead>
<tr>
<th>ARGENTINA (Laws No. 21,526 and 24,144)</th>
<th>PARAGUAY (Law No. 861/96)</th>
<th>BRAZIL (Constitution of 5.10.1988, Title VII, arts. 172, 192 and 52 of transitory provisions; Law No. 4,495; BCB Resolutions Nos. 2,099 and 2,502)</th>
<th>URUGUAY (Decree-law No. 15,322 and Law No. 16,327 and Decree No. 614/92)</th>
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<tbody>
<tr>
<td>Yes. Responsibility of the Central Bank of Argentina.</td>
<td>Yes. Responsibility of the Central Bank of Paraguay.</td>
<td>Yes. For in the case of national entities, authorization is granted by the Central Bank of Brazil (BCB). In the case of foreign entities, the latter must be authorized to operate through an Executive Power decree. This decree, according to Constitutional standards, will be in accordance with regulations that determine the conditions for the participation of foreign capital in financial institutions, taking national interests into account.</td>
<td>Yes. It is the responsibility of the Executive Power. To grant it, the Executive Power must have the favourable opinion of the Central Bank of Uruguay. If authorization is granted, the entity must be allowed by the Central Bank of Uruguay to start operations.</td>
</tr>
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\[Id.\]
### REQUIREMENTS FOR AUTHORIZATION

| **ARGENTINA**  
(Laws No.21,526 and 24,144) | **PARAGUAY**  
(Law No. 861/96) | **BRAZIL**  
(Constitution dated 5.10.1988, Title VII, arts. 172, 192 and 52 of the transitory provisions; Law No. 4,495; BCB Resolutions Nos.2.099 and 2.502) | **URUGUAY**  
(Decree-law No.15,322 and Law No.16,327 and Decree No. 614/92) |
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<tr>
<td><strong>Provide evidence of background and responsibility of applicant, explain project it will develop in Argentina, identify stockholders, directors and trustees. The legal form required in principle (with exceptions) for private entities is that of a corporation with registered stock.</strong></td>
<td><strong>The Central Bank of Paraguay will determine this. Evidence must be provided as to by-laws project, activity programmes, internal control and auditing systems, stockholders ratio including their participation, information on moral and economic solvency of management and Board members.</strong></td>
<td><strong>Applicants must provide evidence of an economic situation that is compatible to the activity they will develop, technical solvency and high personal reputation on the part of its managers.</strong></td>
<td><strong>Each year, The establishment of new banks authorizations granted to new banks can not exceed in the country will be authorized every year if the number does not exceed 10% of the number of banks existing the previous year. The capital allocated to the entity must be indicated as well as information on Minimum capital requirements, depending on the activity will have to be met. The amount of the investment by the new entity will be analysed. Transfers of authorized entities also require the authorization of the Central Bank.</strong></td>
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<td>Minimum required capital must be paid in integrated. The resolution will consider background information and responsibility of applicants, their financial expertise, the project elements and the opportunity and advisability of the initiative.</td>
<td>Minimum capital requirements has to be paid in. The private entities must be corporations (S.A.) with registered stocks. The resolution considers the project, stockholders and managers, background and solvency of the applicant. Deadline for resolution is 3 months as from</td>
<td>Each year, The establishment of new banks authorizations granted to new banks can not exceed in the country will be authorized every year if the number does not exceed 10% of the number of banks existing the previous year. The capital allocated to the entity must be indicated as well as information on Minimum capital requirements, depending on the activity will have to be met. The amount of the investment by the new entity will be analysed. Transfers of authorized entities also require the authorization of the Central Bank.</td>
<td>Provide evidence of background and responsibility of applicant, its project, identify shareholders and directors. the people who will manage or direct it (they must be physical persons). Elements that help assess the efficiency of the applicant and the significance of their performance in the national financial market will be included.</td>
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<td>submittal of application.</td>
<td>The legal form will be that of a corporation with registered stocks, notwithstanding the establishment of foreign branches. To obtain authorization and permission to initiate operations, legality, opportunity and advisability of the project will be taken into account. Solvency, rectitude and ability of the applicant will be considered. Authorization and permission to operate must be justified.</td>
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**SUPPLEMENTARY REQUIREMENTS FOR FOREIGN ENTITIES**

| ARGENTINA  
(Laws No.21,526 and 24,144) | PARAGUAY  
(Law No. 861/96) | BRAZIL  
(Constitution dated 5.10.1988, Title VII, arts. 172, 192 and 52 of the transitory provisions; Law No. 4,495) | URUGUAY  
(Decree-law No.15,322 and Law No.16,327 and Decree No.614/92) |
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<td>Non additional requisites. Branches of foreign banks are subject to the same conditions and requirements as national entities. They must provide evidence that they are authorized in their own countries, and prove should this be required of them, and provide reports of banking monitor services of their country of origin, to reflect solvency, appraisal of their assets, management and transparency. The applicant will provide the elements to assess the kind of</td>
<td>Non additional requisites</td>
<td>The minimum required capitals required in the different modalities of financial intermediation entities are doubledy for foreign institutions. In the hypothesis that the said institution is foreign. The control of foreign participation in the capital of financial entities is the responsibility of the BCB.</td>
<td>Non additional requisites. The foreign institution establishment of branches or agencies of foreign financial intermediation entities will only be authorized if their by-laws or regulations shall do not prohibit Uruguayan citizens from integrating their directive echelons or from being employees throughout the national territory.</td>
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</table>
control conducted in the country of origin, which must adjust to international standards in the field.

Reciprocity conditions offered by the applicant banks’ countries will also be considered. The minimum legal capital will be that kept by the entity in Paraguay, its composition including permanent funds of undefined duration, located and registered in the country. The amount will be at least the minimum set for the creation of entities of this kind. The headquarters will respond without limitations and in solidarity for the operation of its branches in Paraguay, and this will be granted through the presentation of a resolution by the Board of Directors of the headquarters, stating they take on such responsibility.
3. **Conditions for directors and managers or other leading positions**

<table>
<thead>
<tr>
<th>Argentina (&quot;A&quot; Communications of the BCAR 2282, 2573, 2794 and 2887)</th>
<th>Paraguay (Law 861/96 sec. 34 and following)</th>
<th>Brazil (BCB Resolutions Nos. 2.451, 2.486, 2.536 and 2.645)</th>
<th>Uruguay (Articles 38, 344 and 345 of the Compilation of Regulation and Control Standards for the Financial System)</th>
</tr>
</thead>
<tbody>
<tr>
<td>People applying as directors or management advisers must comply with general conditions of Requirements for directors and managers: e) Expertise and experience in the financial activity. They cannot be affected by legal bans in a position where they are banned or not allowed to act according to legal standards: a) inability or incompatibility as established by corporate law No.19,550; b) unauthorized to occupy public positions; c) maintain debt with financial entities; d) inability to hold a current account; e) inability due to sanctions applied by the BCAR; f) found responsible for irregularities in the government.</td>
<td>Directors and managers The president and directors must be individuals physical persons that possess conditions of probity, suitability and expertise and are selected by the Stockholders Meeting. They can not be subject to Likewise, a series of prohibitions and liabilities are regulated in the functions of president, directors, managers or trustees: a) those affected by inabilities and incompatibilities; b) those occupying certain positions in other entities subject to the control of the Superintendence of Banks; c) those occupying offices in the branches of the State, with the exception of teachers and</td>
<td>The following basic conditions have been established to fill the positions within the statutory bodies of financial intermediation entities: Directors and managers have to: a) possessor of a good reputation; b) resident of Brazil; c) not in a position of inability due to special law or to being convicted on a series of criminal charges; d) not declared unauthorized to occupy management positions in financial institutions; e) not to respond to any company where he is comptroller or manager, for outstanding issues relative to protesting titles, legal collections, bad cheques, delayed payment of obligations and other analogue.</td>
<td>The Central Bank studies the background of directors and managers during the authorization process of each financial institution, as well as in the case of new appointments. In turn, top management must declare to the financial intermediation institution it is part of, their links to companies where they hold positions as directors, members of the board, trustees, partners in corporations, managers or top administrators or as internal advisers to company management, either by holding fixed positions of by maintaining permanent contact with them. Directors and managers shall be individuals who possess conditions</td>
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504 See supra, note 5005. See also, Argentina: “A” Communications of the BCAR Nos. 2.282, 2.573, 2.794 and 2.887; Uruguay: Compilation of Central Bank Standards, supra, note 45863, arts. 38, 344 and 345.

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| and management of financial entities. Provision of evidence of compliance with conditions must be submitted to the Superintendence of Financial and Exchange Entities. The appointment of the new general managers of the financial entities or whoever performs these functions and of the representatives responsible for foreign financial institutions' branches, as well as |
|———|———|
| consulting or technical advisers; d) those bankrupt; e) those insolvent or with bad debts in the financial system, either with unpaid debts or under legal collection procedures; f) those bankrupt and not having participated in the management of an insolvent company or corporation.; d) In turn, to occupy the positions of director and partner-manager technical training conditions are established such as being a graduate of a higher education course and having at least two years' experience in management positions in financial institutions in the last five or four years, in the last five years in the financial area of other entities of compatible size, or even having performed similar functions for over five years in the financial system, with the exception of credit cooperatives. All election and appointment acts for members of the statutory bodies must be communicated to the Central Bank. |
| situations; f) not bankrupt and not having participated in the management of an insolvent company or corporation.; d) In turn, to occupy the positions of director and partner-manager technical training conditions are established such as being a graduate of a higher education course and having at qualified experience. least two years' experience in management positions in financial institutions in the last five or four years, in the last five years in the financial area of other entities of compatible size, or even having performed similar functions for over five years in the financial system, with the exception of credit cooperatives. All election and appointment acts for members of the statutory bodies must be communicated to the Central Bank. |
| of probity, suitability and expertise. They shall not be The subject to legal bans or disabilities y to perform such positions may be due to the following causes: a) bankruptcy; b) inability to occupy public offices; c) having bad debts with financial intermediation companies; d) inability to hold a current account. Representatives, directors, managers, administrators, executives, trustees and comptrollers of private financial institutions who in performing their jobs approve or conduct action or get involved in omissions that may imply or imply the application of superior fines or sanctions, may be subject to fines or inability to occupy such positions, for a period of up to ten years, by decision of the Central Bank. |
| ——— | ——— |
| Same requisites apply to the renewal of mandates for the current managers, is also subject to prior evaluation of their backgrounds. Those appointed for such positions and those included in the definition of the “manager” concept must provide a shall have to submit a performance guarantee whenever the Superintendent of Financial and Exchange Entities requires so. |
4. Limitations to the activity of banking institutions

**RESTRrCTIONS IN THE BANKING ACTIVITY**

<table>
<thead>
<tr>
<th>ARGENTINA</th>
<th>PARAGUAY</th>
<th>BRAZIL</th>
<th>URUGUAY</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Laws No. 21,526 and 17,811)</td>
<td>(Law No. 861/96 and 94/91)</td>
<td>(Laws No. 4,495 and 6,385 and Resolutions Nos. 2.099 and 2.723)</td>
<td>(Decree-law No. 15,322 and Law No. 16,749)</td>
</tr>
</tbody>
</table>

Yes, there are. Banking is universal (sec. 40, law 861/96), and covers a wide range of activities. Apart from the normal activity of commercial banks, the latter develop activities as investment and promotion as well as financial activities. Their activity includes purchase and maintenance of stock from banks or other financial entities from entities companies traded operating in the stock market, stocks sold at the Stock Exchange, agreements for share in markets or sale of portfolios, acting as trustee in cases of trust fund agreements, provide services in financial advise, etc.

There are financial banks, branches of foreign financial entities and official banks. The latter abide by their own special laws.

Yes, there are. There are universal activity and special activity entities. Universal banking is called multiple activity banking.

There are also commercial banks, investment banks, development banks, housing credit entities and credit, financing and investment institutions that maintain their special type of activity.

Banking is universal. The broadest activity is that of commercial banks which have operational restrictions, for example activities allowed exclusively to investment banks that cannot be undertaken by the former.

Yes, there are.

**See supra, note 505. See also, Argentina: Law No. 17,811, see supra, note 3727, modified many times, last of all by Law No. 24,241, see supra, note 3738; Brazil: Laws Nos. 6,385, see supra, note 42732 (regulating Capital Markets and the Securities Commission); 6,404, see supra, notes 396401, 403 398 (regulating Corporate Law); 9,457 of May 5, 1997 (modifying Laws Nos. 6,385, and 6,404); Paraguay: Law No. 1,284 of Aug. 4, 1999; Uruguay: Law No. 16,749 of May 30, 1996.**
## PROHIBITIONS TO NON-FINANCIAL ACTIVITY

<table>
<thead>
<tr>
<th>COUNTRY</th>
<th>LEGISLATIVE SOURCES</th>
<th>DESCRIPTION</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>ARGENTINA</strong></td>
<td>(Law No. 21,526 and 17,811)</td>
<td>Yes. Unless by express authorization of the Central Bank, the exploitation of non-financial companies is prohibited. However, Communication A 3086, dated March 2000, admits that investment in companies that conduct non-financial activities is admitted, under certain percentages or that do not interfere in the participated company, conform situations that are not affected by the legal ban. Investment The same standard admits, even for relevant participations or participation that confers interference in participated companies, who the development of services supplementary to the financial activity is admitted.</td>
</tr>
<tr>
<td><strong>PARAGUAY</strong></td>
<td>(Law No. 861/96 and 94/91)</td>
<td>Do not exist. The financial entities can buy, keep and sell stocks issued by corporations established in the country, and buy, keep and sell stocks from corporations that provide exclusive services to that entity or its branches. The only prohibition has to do with undertaking operations different to those included in the corresponding authorization. The only limitation is to the purchase of stock from corporations different from the financial intermediation that, directly or indirectly are stockholders of the financial entity itself.</td>
</tr>
<tr>
<td><strong>BRAZIL</strong></td>
<td>(Laws No. 4,495 and 6,385 and BCB Circulars No. 1.524 and 1.364 dated 21.9.88 and 4.10.88, respectively)</td>
<td>Partial. It is prohibited to buy real estate that is not used by the institution and according to the cases, issue debentures or beneficiary parts.</td>
</tr>
<tr>
<td><strong>URUGUAY</strong></td>
<td>(Decree-law No. 15,322 and Law No. 16,749)</td>
<td>Yes. Operations of any sort in the field of commercial, industrial or services activities are prohibited. Investment in negotiable obligations issued by non-financial companies is an exception to the prohibition.</td>
</tr>
</tbody>
</table>

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## RESTRICTIONS IN THE DEVELOPMENT OF OTHER FINANCIAL ACTIVITIES: CAPITAL MARKET

<table>
<thead>
<tr>
<th>ARGENTINA</th>
<th>PARAGUAY</th>
<th>BRAZIL</th>
<th>URUGUAY</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Laws No. 21,526 and 17,811)</td>
<td>(Law No. 861/96 and 94/91)</td>
<td>(Laws No. 4,495 and 6,385 and BCB Circulars No.1.524 and 1364 dated 21.9.88 and 4.10.88, respectively)</td>
<td>(Decree-Law No. 15,322 and Law No. 16,749)</td>
</tr>
</tbody>
</table>

**ARGENTINA**

Yes.

Stock brokers and associations between them and third parties cannot be conformed by financial institutions.

Financial institutions The latter, in addition, are forbidden to exploit non-financial companies, unless they have express authorization from the Central Bank.

**PARAGUAY**

Yes there are.

Even as from approval of law No. 861/96, there seems to be a Banks are restricted to direct performance of the secondary market through stock agents or brokers (arts. 53 and 54 of law No. 94/91). They can participate in the capital of only one broker.

Banking entities can intermediate for others in the commercialization of securities and provide related services and invest in stocks and bonds of the investment banks.

**BRAZIL**

Partial.

It is admitted that financial institutions can simultaneously develop activities in the securities and banking markets, subject to the regulation of the Monetary Council to coordinate the action of the Securities Commission and the Brazilian Central Bank.

The multiple financial institutions can develop activities in the securities market directly by integrating the brokers' entity in the Stock Exchange, as subsidiary of the multiple institution.

**URUGUAY**

Yes.

Financial institutions are The prohibition to develop activities other than the core task includes prohibited to the prohibition to participate in the capital market as direct operators.

Nor can they not invest in stocks of non-financial entities. They may hold negotiable bonds issued by the said non-financial companies.

Banking institutions can be stockholders of investment funds and pension funds management agencies companies or pension funds management agencies. They can also be special partners of stock exchanges, operating for their customers.
5. **Capital and net worth requirements**

### MINIMUM STARTING CAPITAL

<table>
<thead>
<tr>
<th>Country</th>
<th>Legal Basis</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>ARGENTINA</strong></td>
<td>(Law B 21,526, Communications A 2470, 2754, 2970, 2753, 2774, 3007, 3022, 3959 and B 4489)</td>
<td>Wholesale commercial banks require minimum starting capital of $10,000,000; Aall other institutions, regardless of their modality, require a minimum starting capital of $15,000,000. It must be integrated in cash (national or foreign currency) or in national public securities by the national government for the total amount of the minimum capital previously required at the beginning of operations.</td>
</tr>
<tr>
<td><strong>PARAGUAY</strong></td>
<td>(Law No. 861/1996)</td>
<td>Banks, 10,170,000,000 guaranies. Financial institutions require 85,000,000,000 guaranies. They must be integrated in cash and in guaranies. Foreign bank branches will also comply with these minimum requirements.</td>
</tr>
<tr>
<td><strong>BRAZIL</strong></td>
<td>(Law No. 4,495 and BCB Resolutions Nos. 2.099 and 2.607)</td>
<td>Yes. The amount for the starting capital will be determined by the National Monetary Council (in reales and is upgraded as from December 1994). This amount will be increased according to branches or agencies established, operations conducted in foreign currency and the geographical location of the entities. Multiple banks require a minimum starting capital of between US$ 16,800,000 and US$ 42,000,000 (the amount will</td>
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<tr>
<td><strong>URUGUAY</strong></td>
<td>(Decree-law No.15,322, Law No. 16,327, Decree No. 614/92, Compilation of Standards for the Regulation and Control of the Financial System, sec. 13; Circulars No. 1613, 1847)</td>
<td>Banks, investment banks and banking cooperatives require a minimum capital (values presented are approximate as these are set and updated quarterly in Uruguayan pesos) of US$ 6,000,000. External financial entities (IFE) require US$ 4,500,000. The above amounts must be totally integrated before starting operations. Integration can be in cash or in mortgage bonds.</td>
</tr>
</tbody>
</table>

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506 See Argentina: Law No. 21,526, see supra, note 3138, and Communications “A” Nos. 2.470, 2.754, 2.970, 2.754, 2.970, 2.753, 2.774, 3.007, 3.022, 3.959 and “B” No. 4.489; Brazil: Law No. 4,495, see supra, note 4038, and Resolutions of BCB Nos. 2.099, 2.122, 2.312, 2.309, 2.606, and 2.607; Paraguay: Law No. 861, see supra, note 3847; Uruguay: Decree-law No. 15,322, see supra, note 438, Law No. 16,327, see supra, note 4397, and Decree No. 614, see supra, note 43540, Circulars Nos. 1.613, 1.721, and 1.847.

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vary depending on the portfolios to be developed).

Commercial banks require between US$ 29,400,000 and US$ 42,000,000.

Investment banks and housing credit entities require between US$ 21,000,000 and US$ 30,000,000. Half such amount is required of financial companies.

These amounts are doubled in all cases when the applicant is a foreign entity.
### Minimum Capital or Minimum Financial Liability During Operations

<table>
<thead>
<tr>
<th></th>
<th>Argentina</th>
<th>Paraguay</th>
<th>Brazil</th>
<th>Uruguay</th>
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<tbody>
<tr>
<td>(Law B° 21,526,</td>
<td>(Law No. 861/196)</td>
<td>(Law No. 4,495 and BCB Resolutions Nos. 2.099, 2.193, 2.543, 2.606, 2.692)</td>
<td>(Decree-law No.15,322, Law No. 16,327, Decree No. 614/92, CBU Communication No. 2001/147)</td>
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<td>Communications A</td>
<td>No 2470, 2754, 2970, 2753, 2774, 3007, 3022,3959 and B 4489)</td>
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<td>The net worth</td>
<td>All financial entities required by the higher requirement is the between entities in operation minimum capital or the minimum net the highest value between equivalent to the (computable net capital) or the real net worth. worth) equivalent to the integration or composition of the minimum capital (accountable minimum capital) and the one calculated in terms of risk assets. A formula is used in this calculation that allows an assessment to be made of the minimum capital in terms of the assets risk.</td>
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<td>of entities in</td>
<td>The net worth required must be the highest value between the minimum capital, or a 10% ratio between the total assets and the real net worth. The Central Bank of Paraguay may increase that percentage up to 12%. It is computed monthly and must be integrated in cash.</td>
<td>The minimum required is net worth requirement of banks is the highest between the basic (minimum capital); or 10% of the net risk weighted and contingency assets according to the level of risk, and 4% of the total assets and contingencies. In the case of investment banks, the above percentages are 15% and 10%, respectively.</td>
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<td>In the case of</td>
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<tr>
<td>external financial institutions, the minimum net worth requirement is the highest between the minimum capital of US$ 4,500,000 plus special investments, and 8% of weighted assets and contingencies plus special investments.</td>
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<tr>
<td>Country</td>
<td>Law/Decree Numbers</td>
<td>Composition of Capital</td>
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<tr>
<td>Argentina</td>
<td>Law B° 21,526, Communications A No. 2470, 2754, 2970, 2754, 2970, 2753, 2774, 3007, 3022 and B No. 4489</td>
<td>We can distinguish the net basic and the supplementary net worth. The net essential supplementary net worth, in turn, cannot exceed 100% of the amount of the basic net worth. In the basic net worth the following are accepted as computable items: share capital, non-capitalized contributions, and adjustments to net worth, reserve of proceeds, non-allocated results, and, in cases of consolidation, and the participation of third parties. Supplementary net worth: includes the result of the addition of subordinated bonds, 100% in certain cases specified by the standards, one hundred percent of</td>
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<tr>
<td>All failures not considered in the latest quarterly statements in accounting and asset risks:</td>
<td>Weighting of capital (net worth) in terms of assets weighted by risk. The said net worth must be at least 11% of the liquid net worth adjusted by inflation or equal to the minimum capital required and the required capital (PLE) in terms of assets weighted by risk.</td>
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<tr>
<td>Weighting of capital (net worth) in terms of assets weighted by risk.</td>
<td>Liquid net worth</td>
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</tbody>
</table>

Level II capital of the ongoing accounting period has not yet had a report by the external auditor, nor has the accumulated balance. The said net worth must be at least 1% of the net worth of the ongoing accounting period, with the exception that net worth cannot exceed 11% of the ongoing accounting period.

The exercise of the company to recover the deficit for contingencies determined by the accounting statement audited by the Superintendence includes a report by the auditors, the auditors, and the integrated capital calculation in anticipation of contingencies. The deficit for recoverable losses, estimated by the results of the last quarter and the last closed exercise, can be paid in the next four years and be registered until the expiry of the terms of the contingent-losses, and preferenceshares, and the results of the last quarter, forcing the calculation of the management of the ongoing accounting period. The exercise of the company to recover the deficit for contingencies determined by the accounting statement audited by the Superintendence includes a report by the auditors, the auditors, and the integrated capital calculation in anticipation of contingencies. The deficit for recoverable losses, estimated by the results of the last quarter and the last closed exercise, can be paid in the next four years and be registered until the expiry of the terms of the contingent-losses, and preferenceshares, and the results of the last quarter, forcing the calculation of the management of the ongoing accounting period.
assumptions, and contingencies to cover un-collectables in the normal debtors' portfolio by 50% of the minimum amount required. From the net worth thus calculated we must subtract certain items detailed by the standard.

II) Weighting of capital (net worth) in terms of assets risks.

The worth requirement is the highest between the minimum capital and the one resulting from weighting the capital in terms of assets risks.

It derives from a formula that takes into account the factor related to the rating of the entity (according to the Superintendence of Financial Entities), the fixed assets weighted by 15% or 12.5% (depending on the date of their incorporation to the net worth) and non-fixed assets, weighted with 11.5% of risk (in the case of some assets, apart from the weighting factor a risk indicator is considered, according to the

See previous section.

Liquid net worth adjusted by inflation must be equal or higher than the minimum capital required and the required liquid net worth (PLE) in terms of risk weighted assets. The said net worth must be at least 11% of the assets weighted by risk.

(Res. No. 2,099/94). The requirement for minimum capital of 11% calculated on weighted assets is applied to both operations registered in the balance sheet and those not registered there. To obtain said value the weighting of the institution’s active operations due to risk attached to them must be considered. The scales to classify assets according to credit risk are of 0%, 20%, 50% and 100%. The factor applicable to rate of exchange exposure, when exceeding 20% of the adjusted liquid net worth (PLA) is of 33.3%.

Additional capital in terms of the rate of interest risk (market risk) must be computed.

It is one of the alternatives by which the minimum net liability is determined. The required capital is 10% of assets and contingencies weighted according to a scale from 0% to 50%, in five possible levels according to the risk they represent.
Credit risk\textsuperscript{507}

\textsuperscript{507} See Argentina: Central Bank Communications No. A2.140 and Annexes, 2.410, A2.154, A2.573, A2.649; Brazil: Resolution No. 2.474 (MNI 2-1-2); Paraguay: Resolution Nos. 493 and 560 of SIB, and Resolution No. 8 and Minutes No. 252 of the Central Bank; Uruguay: Compilation of Central Bank Standards, supra, note 45863. Sec. 58.1, according to Circulars Nos. 1.687, 1.744; arts. 399.1 and 399.2 for IFE (External Financial Institutions.)
### 6. Credit Risk

**LIMITATIONS TO CREDIT CONCENTRATION**

<table>
<thead>
<tr>
<th>Country</th>
<th>Regulations and Notes</th>
<th>Limitation according to client:</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>ARGENTINA</strong></td>
<td>(Central Bank Communications No. A2140 and Annexes, 2410, A2154, A2573, A2649)</td>
<td>Limitation of credit concentration 15% of the computable net worth (customers in general) and 5% of such liability in the case of physical and legal entities that are related. With guarantees, the ceilings are increased up to 25% and 10%, respectively. The limit with the public sector is 25%.</td>
</tr>
<tr>
<td><strong>PARAGUAY</strong></td>
<td>(Resolution No. 493 and 560 of SIB and Resolution No. 8 and Proceedings No. 252 of the Central Bank)</td>
<td>Credit granted to another financial entity and deposits established in the same entity cannot exceed 30% of the real net worth of the bank. In the case of credit to foreign banks, the ceiling is 20%, and may reach 50% in the case of first-category banks. Credit ceilings in the case of foreign physical or legal entities are 5% of the effective net worth, and may reach up to 20%.</td>
</tr>
<tr>
<td><strong>BRAZIL</strong></td>
<td>(Resolutions Nos. 2.474; MNI 2-1-2)</td>
<td>The limit is 25% of the liquid net worth adjusted by client in the case of active operations and guarantees (even with the public sector). Economic groups are computed as a sole customer.</td>
</tr>
<tr>
<td><strong>URUGUAY</strong></td>
<td>(Sec. 58.1 of the Compilation of Standards for the Regulation and Control of the Financial System according to Circulars No. 1687, 1744; sec. 399.1 and 399.2 for IFE).</td>
<td>The limit, by person or economic group, is 25% of the net worth requirement. Operations included at the very top are direct or contingency credit, with the non-financial private sector. The amount computed to calculate the ceiling is the total due or bailed. The ceiling for IFEs is 40% and 50% for investment banks. The ceiling can be increased between 25% and 50% depending on the guarantees.</td>
</tr>
<tr>
<td>Limits with the financial sector: by customer 25% of computable liability (entities in the country or investment banks) or 5% (in all other cases). Limit on participation in the capital of complementary services companies: 10% of the computable worth requirement. Limit according to group of related companies: 20% of the computable net worth requirement for the risk of the whole group. Limit to risk concentration with individual risk customers over 10% of the computable net worth requirement of the entity: thrice the above-mentioned liability, if customers of the financial sector are not included, 5 times when the whole group of customers is considered, 10 times in the case of second-grade banks due to their operations with other financial entities. Only non-risk or self-</td>
<td>according to the guarantees that are established. Credit ceilings to residents in Paraguay are 20% of the bank's effective net worth, and it may reach 30% depending on the established guarantees. In the case of all ceilings, the related entities defined are computed as a sole person (unit of risk).</td>
<td>(of the net worth requirement). The ceiling can be increased between 25% and 50% depending on the guarantees covering the risk or if it is assumed to finance exports that have already been completed and covered by credit payment instruments or others.</td>
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</tbody>
</table>
liquidation operations are excluded.
# Classification of Debtors

<table>
<thead>
<tr>
<th>ARGENTINA</th>
<th>PARAGUAY</th>
<th>BRAZIL</th>
<th>URUGUAY</th>
</tr>
</thead>
<tbody>
<tr>
<td>Central Bank Communications No. A2729, 2840, 2893, 2935, 2936, 2937, 2950, 3028</td>
<td>Resolution No. 8 according to Proceedings No. 252 of the Central Bank</td>
<td>Resolutions Nos. 2.682 and 2.724; Circulars 2.977, MNI 2-1-6)</td>
<td>Sec. 25 of the Compilation of Standards for the Regulation and Control of the Financial System according to Circular N11661)</td>
</tr>
</tbody>
</table>

Appplies to It is classified by operations with the private, financial or non-financial sector.

The portfolio is segmented to define the classification criteria according to the amount of the debt and, its guarantees and origin of the resources for re-payment. The debtor is rated according to his delinquency in payment, quality of guarantees, information submitted (with delay, punctual, etc.), re-payment capacity, evaluation of his/her organization and situation in the field of activity and his/her juridical situation.

Based on the above, the categories are normal risk debtors, potential risk debtors, debtors with problems, high risk of insolvency, unrecoverable.

Applies to Operations analysed for the credit assessment are those conducted by the financial entity with the private (financial or non-financial) sector and with the public sector.

The portfolio is not segmented to determine the classification criterion.

In order to rate specific aspects are taken into account in the case of each debtor: outstanding payments, presentation of information required (in due time, with delay, etc.), capacity to pay back within the deadline and under given conditions, juridical situation.

There are five categories: normal, potential, real, high and unrecoverable risk.

Applies to Operations with the private sector are computed (financial or non-financial private sector) and with the public sector. Criteria are: arrears, guarantees and juridical situation.

With the above elements, nine categories are defined.

Brazil has no risk central.

In order to classify debtors, the emphasis is on the need to expose and assess correctly the credit risks (direct and contingent) and the non-credit risks. Valuation criteria are subjective and objective.

Risks are excluded in the case of headquarters and foreign branches. Risks with the public sector can be excluded.

Debtors of the financial sector are categorized in three possible stages: normal risk, high risk or unrecoverable credits.

For In the case of the non-financial sector, the categories are five, namely: normal risk, potential risk, real risk, high risk, and unrecoverable credits.
### 7. Illegal operations

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B. ASYMMETRIES AMONG THE BANKING SYSTEMS IN THE MERCOSUR COUNTRIES. THEIR RELEVANCE.

It is interesting to present the results arising from the analysis of financial regulations in the MERCOSUR countries, enabling us to appreciate normative convergence or divergence in some significant areas of the sector. In turn, this presentation makes it possible to better focalise the regulatory obstacles preventing or hindering progress in financial integration.

1 Regulation and Control

In all cases the formal solution adopted by the MERCOSUR countries, is that the regulation and control of the financial system is the responsibility of the Central Bank. In three cases, this responsibility is exercised through the Banking Supervision Authority (with the exception of Brazil). In two situations, Argentina and Uruguay, the Supervision Authority is technically autonomous, in the case of Paraguay, its functions are limited to collaborating with the Board of Directors in verifying and inspecting compliance with regulations. The differences are rather in the organisation and institutional composition of each of these Central Banks. For example, the Central Bank of Paraguay reports to the Executive Power through the Ministry of Finance. The Central Bank of Brazil is an independent body, but it must comply with and enforce the regulations set out by the National Monetary Council, chaired by the Ministry of Finance. The board of directors of the Central Bank is appointed from among members of the National Monetary Council. This body decides on the technical and administrative structure of the Central Bank and decides on resources to be deducted from it. It may resolve that the Central Bank deny authorisation for new financial bodies to operate on the basis of considerations of general interest.

The Central Banks of Argentina and Uruguay are autonomous bodies, whose resolutions are not subject to supervision or revision by any other body. Linked to this aspect, we should also consider the influence that the Government may have directly and organically, normally through the Executive Power, in the adoption of decisions regarding regulation and

\[508^* \text{See supra, note } 5005.\]
control of the financial system. This may be observed, at varying degrees, basically in relation to the most transcendental decisions, such as authorisation to install new financial institutions, particularly those with partial or total foreign capital, or in arrangements for ceasing of operations. This is what happens in the case of Uruguay, where authorisation is conferred by the Executive Power, in addition to the participation of the Central Bank mentioned above (in two instances: prior to authorisation for the operation of financial institutions in the country, their advice is mandatory, and following its authorisation by the Executive Power, the Central Bank is responsible for conferring authorisation, which it only does when all the requisites regarding organisation, structure, planning and systems it deems necessary are completed). Something similar happens in Brazil, where the installation of foreign bodies is authorised by the Executive Power and not the respective Central Bank (the Central Bank, following the guidelines established by the National Monetary Council, may recommend the installation, which may equally be objected to by the latter, but even without the opposition of the National Monetary Fund, authorisation for the operation of foreign entities is subject to a Presidential Decree being issued in this respect).

In another aspect concerning regulation and control, we should observe that for the time being there is no formulation for centralised regulation and control of the region’s financial systems in the MERCOSUR. For this reason, the different structures of the Central Banks may be of greater significance.

2. Establishment.511

The common features observed in comparing MERCOSUR country systems regarding the establishment of financial institutions are related to the competent body admitting or rejecting requests for installation and the nature of requirements for the authorisation of such installation.

509 Id.
510 Id.
511 See Argentina: Laws Nos. 21,526 and 24,144, see supra, note 3183; Brazil, Constitution of 10.5.1988, Title VII, arts. 171, 172, 192 and 52 of temporary provisions, Law No. 4,495, see supra, note 403398, BCB Resolutions Nos. 2.099 and 2.502; Paraguay: Law No. 861, see supra, note 37984; Uruguay: Decree-law No. 15,322, see supra, note 4338, and Law No. 16,327, see supra, note 4349, as well as Decree No. 614, see supra, note 44035. For requirements on directors and administrators see Argentina: Communications “A” of the BCAR Nos. 2.282, 2.573, 2.794, and 2.887; Brazil: Resolutions of BCB Nos. 2.451, 2.486, 2.536 and 2.645; Paraguay: Law No. 861, see supra, note 38479, arts. 34 and following; Uruguay: Compilation of Central Bank Norms, see supra, note 45863, arts. 38, 344 and 345.

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In general, the Central Banks in each of the above mentioned countries participate in the mechanism for granting or rejecting requests for installation. This, without prejudice to the fact that in the case of Uruguay, the authorisation is granted by the Executive Power, in addition to the participation of the Central Bank (on two occasions: prior to authorisation of operation of financial institutions in the country its advice is mandatory and, following authorisation by the Executive Power, the Central Bank confers entitlement, which it only grants when all the requisites regarding organisation, structure, planning and systems it considers necessary have been fulfilled); and in Brazil where the installation of foreign entities is authorised by the Executive Power and not by the respective Central Bank as indicated further on (the Central Bank, following the guidelines established by the National Monetary Council, may recommend installation, which equally may be objected to by the latter, but even without opposition of the National Monetary Council, the authorisation for foreign entities to operate is subject to a Presidential Decree being issued stipulating it).

In the four countries the elements that must be accredited for establishment of financial entities are aimed at moral solvency and net worth of the shareholders and members of the management and board of directors of the applicant, the composition of the net worth of the entity it proposes to operate, and the nature and advisability of the investment project involving the establishment.

Along these same lines, the four countries have established conditions for holding positions in the statutory organs of financial intermediation bodies. In fact, in all legislations it is required that individuals occupying such positions should not be included in the inhibitions and prohibitions established by the respective judicial systems for the exercise of trade, but there are also requirements regarding suitability, capacity and reputation. In general, the designation of corporations to occupy director positions is not permitted. Brazilian regulations do not admit non-resident individuals holding director-level positions in financial institutions. Furthermore, requisites for technical suitability are set out with more emphasis in Brazilian regulations than in those of the other countries, these address graduation from higher education and experience in director-level posts in

\[512\text{ Id.}\]
financial entities for a certain length of time. In the Argentine Republic, the Supervisory Authority for Financial and Foreign Exchange Entities may require the establishment of performance bonds by the individuals designated to fill director posts in financial institutions.

In general, the same requirements are established for managers and internal auditors. Compliance with these requirements is, in all cases, analysed by the Central Bank of the respective country, which must issue its findings prior to the post being taken up by the individual designated by the institution's officials.

In spite of the general coincidence that has been noted, there are some important asymmetries in the regulation, the effective possibility of installation and operation, and the requisites that must be fulfilled to enable entities existing and operating in any of the member countries to install themselves and operate in the other MERCOSUR States. Moreover, these asymmetries, already pointed out at the time of signing the Asuncion Treaty, still persist. We will refer to them here below.

3. Foreign Entities

The greatest asymmetries are to be found regarding the systems to admit installation of foreign entities in each of the four countries.514

Brazilian regulations are very restrictive, including at the level of constitutional provisions, for the establishment of new foreign entities or for increasing participation in the capital of entities already established by foreigners. In fact, the only exception admitted by the constitutional prohibition for the entry of foreign institutions into the Brazilian financial system and which operates on a case by case basis, is that, in addition to the recommendation of the Central Bank – following the guidelines of the National Monetary Council – and its non objection, is the issuing of an Executive Power Decree that expressly authorises operation of the entity in question. Additionally, capital requirements are doubled for foreign entities setting up in Brazil. The Paraguayan system has reporting requirements to evaluate solvency and oversight possibilities, net worth, and joint liability of the foreign headquarters for the operations of its branches in Paraguay. Argentine and Uruguayan rules do not have additional requirements for the

513 See supra, note 5005.
establishment of foreign institutions beyond those of investment of the minimum capital required. Uruguay does however limit the annual number of authorizations for operation of new banking institutions, without discriminating between local and foreign entities, to ten percent of the total number of banking institutions existing during the previous year.

It is significant to note that the regulatory barriers just been pointed out, have remained practically unchanged since signature of the Asuncion Treaty. In fact, on this subject, efforts at harmonisation have been unsuccessful. Throughout the meetings of the Common Market Group, Subgroup 4, no progress has been made in the necessary agreements regarding conditions that should be applied to admit installation in MERCOSUR of financial entities from other member countries, and even from third party countries. Thus at the November 1994 meeting, the Financial System Commission confirmed that, regarding internal legislation in force in Brazil and Uruguay respectively, no progress had be made regarding the necessary agreement on conditions to be applied to admit the installation of financial entities of each of the member countries or from outside the zone, in the context of MERCOSUR.

Later on, following Subgroup 4 Minutes No. 1/95, the analysis of difficulties in harmonising systems for access by financial, insurance and re-insurance entities was postponed at least until the year 2000. To date, this item has not been addressed on the agendas of the Subgroup Commission meetings.


Regarding the line of business of financial institutions in the MERCOSUR countries, in particular as regards the dichotomy between universal and special banking, the latter tend to predominate. This is the prevailing system in Argentina, with the exceptions implied by the opening up introduced by Central Bank regulations in 2000 mentioned earlier on, and in Brazil and Uruguay.

In a comparative analysis of the regulations regarding financial institution activities, we may appreciate a trend towards mitigating and

\textsuperscript{51}See supra, note 5005. See also Argentina: Central Bank Communications "A Nos. 2.282, 2.573, 2.794 and 2.887; Uruguay: Compilation of Central Bank Standards, supra, note 45863, arts. 38, 344 and 345.
making more flexible the restrictions in the legislation of the countries of
the region. As a whole, it may be stated that banking activities in such
countries are still compartmentalised and limited, however there are signs
of greater opening up. This comes from the gradual admission of universal
banking, and the incipient possibility of activities in capital markets and of
the development of non-financial activities as explained here below.

Openness in particular can be appreciated in the light of regulations
sanctioned over the past few years. The inclusion of banks with a universal
line of business in Brazil took place with the sanctioning of the Central
Bank Circulars Nos. 1.524 and 1.364, both in 1988. The new Paraguayan
law No. 861/96, in a much more radical change, eliminated special banking
and only regulates universal and financial banking. This means that only in
Argentina—to a lesser degree—and in Uruguay is the absolute speciality of
the banking line of business maintained.

Furthermore, solutions continue to be fairly strict\textsuperscript{516} regarding the
possibility of financial entities investing resources or developing non-
financial activities. Uruguay prohibits banking entities from investing or
developing any commercial, industrial or service activity, admitting some
very specific exceptions. Paraguay clearly and unrestrictedly admits that
banks may carry out non-financial activities as from the sanctioning of
Law No. 861/96. In the case of Brazil, admission of non-financial activities
is partial. In Argentina, prohibitions on activities and investment in non-
financial sectors were mitigated as from sanctioning of Communication A
3086 in March 2000. This regulation defined as implementation on its
own behalf, - and therefore only prohibited - non-financial activities
carried out directly or by a company in which the financial entity held
shares amounting to over 12.5% of the capital of stock or votes in which it
participates, or in the event of lesser participation, that they were likewise
granted the necessary votes to make up the social will in the bodies of the
company involved.

Finally, concerning participation of financial entities in capital markets,
Brazil is the country granting the most permissive solution, permitting
direct exercise of such activities by the financial institutions themselves.\textsuperscript{517}
Paraguay for its part, requires that such activity be exercised indirectly,

\textsuperscript{515}See supra, notes 5005, 508.
\textsuperscript{516}Id.
\textsuperscript{517}Id.
through participation of financial institutions in the capital of stock-market corporations. In turn, in Argentina, Communication A 3086 of March 2000 defined, independently from implementing on its own behalf, complementary services of financial activities, in which the banks and financial companies may have holdings in the company capital, with the exclusive aim of this complementary activity, even though such holdings exceed the percentages or maximum participation admitted in carrying out non-financial activities in the capital market. In turn, Uruguay, in a solution similar to the Paraguayan one, indirectly admits participation of banking institutions in the capital market, as it allows them to be special partners in the Stock Market, and to be shareholders in companies administrating investment and pension funds.

In the light of the evolution in regulations we have just noted, it may be stated that, regarding the line of business that banking entities are permitted to carry out, even before signature of the Asuncion Treaty, flexibility in the existing limitations on banking activities was to be observed (for example, the case of Brazil, which already admitted multiple banks in 1988). This trend was more marked after the entry into force of the MERCOSUR with clear regulatory modifications in Paraguay and the more timid Argentine and Uruguayan incorporations. Even so, it is evident that significant asymmetries are maintained regarding permitted or prohibited activities undertaken by banking entities in the MERCOSUR Party States. These have a direct effect on the conditions for competitiveness of banking institutions in these countries, and therefore should be examined and reconsidered in the light of possible future progress in the financial integration process.

5. Minimum Capital Requirements

In this matter, increasing coincidence in regulations stipulated by the MERCOSUR Party States is to be observed. This is an output of a conscious and prolonged effort by MERCOSUR's responsible bodies. However, some divergences still subsist. This area of regulation requires special care as the substance and compatibility of capital – as well as other prudential standards -requirements are relevant when seeking to establish a solid process of banking integration, which means to that end, to

518 See supra, note 5039.
strengthen the soundness and—through it—the stability of financial systems.

The four countries require minimum amounts of capital for the installation of new financial bodies. However, the amount required by each of them varies. Expressed in foreign currency, the amounts vary between US$ 20,000,000.- and $15,000,000.- required in Brazil (in some cases) or Argentina respectively, and a little under US$ 6,000,000.- required by Paraguay.⁵¹⁹

Regarding these efforts, already in 1993 the Common Market Council issued Decision No. 10/93 stipulating that the Asuncion Treaty Signatory States apply the guidelines of the Basle Committee. When the Commission started its meetings, it was seen that regulatory requirements in Brazil, Paraguay and partially in Uruguay, were not in line with the Basle Committee recommendations.

As from then, Brazil issued Central Bank Resolution No. 2.099 adopting the basic guidelines of the Basle Committee on this matter, setting aside the requirements for minimum capital amounts, on the basis of the entity’s liabilities. Also in Paraguay, through Law No. 861/96, prudential regulations were incorporated in accordance with the recommendations of said Committee.

Progress was made also in the adoption of the Basle Committee recommendations regarding permitted items for capital composition. At the beginning of the MERCOSUR integration process, the distinction between basic capital (Tier I) and supplementary capital (Tier II) was not conceptually respected (only in Argentina was basic capital separated from supplementary capital for regulatory purposes). Slowly, the countries moved their regulation in this direction and today, almost all of them (except Paraguay) admit the differences between basic and supplementary capital.

All the MERCOSUR countries presently maintain minimum net worth requirements during the operation of financial entities.⁵²⁰ In general, they require that at least the minimum initial capital be maintained or a certain minimum (at least 8%) relationship between the capital items or computable net worth and the credit risk-weighted assets (Basle Committee recommendations) be respected at all times. But the contents of such requirements are diverse and their comparative analysis is difficult. For

⁵¹⁹ Id.

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example, if we compare the application of the Basle Committee recommendations among the four countries, we will see that although they all apply them, the capital composition is not the same and asset weighting varies from country to country. Thus, Argentina requires now only a minimum proportion varying according to the assets under consideration, of 8% of the capital on the basis of risk-weighted assets. Brazil, Uruguay and Paraguay require 10%, although the Central Bank of this last country is authorised to raise this minimum proportion up to 12%. The differentiation between basic capital and supplementary capital (Tier 1 and 2 according to the Basle Committee regulations), is not included in the Paraguayan regulations and, furthermore, in the remaining MERCOSUR countries, the items admitted in each one and their consideration maintain certain differences. For example, in the calculation of inflation, in the re-valuing of assets, in the admission and treatment of subordinated debt, etc. Differences are also observed in the way each country weights its assets on the basis of risk, to apply capital requirements on these.

The last survey, carried out in 2000, shows the persistence of some exceptions in compliance with the Basle Committee recommendations regarding capital components\(^\text{521}\) and their weighting on the basis of their asset risks. For example, only Argentina considers capital requirements on the basis of market risk; in Paraguay basic capital and supplementary capital are not separated even though all the capital components suggested by Basle are contemplated in its regulations. It should also be noted that asymmetries existing in credit risk asset weighting have not been updated at the present time.

6. **Credit Risk**\(^\text{522}\)

The central concept reflected in this table, which is to limit financial entity exposure to debtor credit risks is reflected by the four countries. However, once again there are still differences to be noted in the implementation of credit ceilings.\(^\text{523}\) The maximum percentage of concentration per debtor or group of related companies, differs considerably from country to country. The classification criteria by debtor activity to establish the ceiling are also different. If we examine the items

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\(^{520}\) Id.

\(^{521}\) Id.

\(^{522}\) See supra, note 50410.

\(^{523}\) Id.
calculated in each country to establish the ceiling for exposure, we will also find differences.

a. Credit risk ceilings and limits on credit concentration.

At the beginning of the 90’s and even in 1994, asymmetries were found regarding credit risk ceilings and limits on concentration of credit. Since then, some advances can be appreciated in each country’s regulations regarding the harmonisation of some specific aspects such as the calculation of guarantees to establish credit limits; maximum ceilings for individual or global assistance; definitions in relation to operations with related clients; and concepts regarding the assumption of credit risks.

Even today, differences still exist in each country’s criteria for splitting up credit risks and operations with related companies, when compared with the principles established by the international financial community. For example, in the individual quantitative ceilings by economic groups and in relation to major credits. Also, differences still subsist in the definition of the base net worth to determine the ceiling and the computable guarantees. Neither has the concept of operations covered and those excluded from the risk ceiling been completely harmonised.

b. Classification of debtors and provisions

At the beginning of the MERCOSUR process there were significant differences in relation to debtor classification and bad debt provisions regulations. Some of those asymmetries were related to the existence of diverse categories of debtors, according to the amounts and conditions affecting the classification, and that for the classification of such debtors, paying capacity and fulfilment of obligations; others concerned interest and re-classification of debtors in the event of renegotiating problem debts.

Presently, some harmonisation has been achieved regarding debtor classification, credit ceilings and related clients in all the MERCOSUR countries.

7. Illegal operations

In all countries, the law defines money laundering crimes (Argentina Law 25.246 dated April 13, 2000, Paraguay Law 1015 dated December 3, 1996, Brazil Law 9.613 dated March 3, 1998; Uruguay, Law 17.835 dated September 29, 2004). The criminal offence is committed by hiding,
acquiring, receiving, transferring, managing, selling, or applying in any way money or goods resulting from certain crimes (i.e. drugs trade and traffic; smuggling; fraud committed against the Public Administration; extortion; weapons illicit traffic). All these crimes are punished with imprisonment.

Another common feature in all money laundering prevention legislation concern the creation of a special body, (Money Laundering Prevention Secretariat, COAF, Financial Information Unit), whose objectives are to discipline, issue rules, receive and analyze information regarding money laundering operations, and order the investigation of suspicious transactions. In Argentina, Paraguay and Brazil, the compliance body is created within the Executive Power. In the case of Uruguay, the Financial Information Unit is created within the Central Bank.

The law states an extensive list of entities and individuals obliged to provide information to the Compliance Body, including in same all financial entities, all companies carrying out foreign exchange activities, all entities carrying out gambling activities, all individuals and entities carrying out capital market activities or intermediation, all enterprises carrying out post services and money transfers, insurance companies, all individuals or legal entities trading in numismatic or philatelic collections, art works, antiquities and jewelry. Said individuals and legal entities are obliged to keep records of their customers, clients and beneficial owners. They are also obliged to inform the Financial Information Unit all suspicious activity.

C. HARMONISATION IN THE MERCOSUR INSTANCES AND BODIES. EVOLUTION. ANALYSIS.

It is interesting to reflect, several years after the initiation of harmonisation tasks within the Common Market Group, on the functioning of this operational experience, assessing it in the light of results obtained and the evolution in time of those asymmetries in national regulations that involved barriers to integration.

The starting point in this assessment is the MERCOSUR Action Programme until the year 2000, adopted by Decision of the Common
Market Council\textsuperscript{524} No. 9/95 that covered, in relation to Financial Affairs, two types of issues. On the one hand, those aspects on which it was possible and desirable to reach understanding in the short term, including the permanent exchange of information and experience on financial matters, or the definition of financial system areas, insurance, stock markets, promotion and protection of investments, and others. Furthermore, a second set of aspects was defined, that would only be considered in the medium or long term, including negotiations tending to broaden access to financial markets.

1. Liberalisation

In the light of the definitions of such a Programme, it is not surprising that direct results regarding regulation changes in the MERCOSUR countries towards more opening and market access to be attributed to the Subgroup’s policy setting harmonisation are scant. In particular, Brazilian restrictions are still in force on entry of foreign entities and individuals as new institutions or as shareholders in already existing financial companies, together with the Uruguayan limitation — for any financial institution, whatever its nationality — on the number of new banking licences to be authorised per year.

In this respect, already in 1994-5 and basically due to the difficulty for the Brazilian delegations to include the analysis of liberalisation into the working agendas of the Subgroup, or in its activity, possibly inconsistent with restrictions in force in that country for entry into the financial sector of foreign entities.\textsuperscript{525} However, the above-mentioned Programme of Action approved by Common Market Council Decision No. 9/95 stipulated market access aspects to be considered as from 2000. Overcoming this restriction has not been addressed since that date.


Conversely, another angle from which the Subgroup’s tasks should be valued is the co-ordination and harmonisation of regulations within the different countries. And in this respect, work has been positive, a major achievement, in the light of the MERCOSUR Action Programme.

On the one hand, strong links and communication channels have been

\textsuperscript{524} CMC Decision No. 9 of Dec 6, 1995.
established among the financial policy-makers. In turn, the exchange of information regarding regulations (with special emphasis on aspects related to the solvency of systems such as minimum capital, net worth, risk ceilings, auditing, accounting) has developed a better knowledge of financial systems and banking regulations by each policy-maker, making a relative comparison possible among those in force in the country with the others, and the appreciation of improvements that could be introduced in their system. For example, all this has led to changes in the prudential regulations of Brazil and Paraguay, which over the years have enhanced implementation of the Basle and MERCOSUR’s standards themselves.

From this standpoint, it should be remembered that all the MERCOSUR countries have adopted requirements for credit risk-weighted capital of at least 10% of the assets. Another valuable example is that, on the basis of the Subgroup’s policy harmonisation efforts regarding prevention and struggle against legitimisation of assets from illegal activities, set out in Recommendation No. 01/00 submitted to the Common Market Group, this body adopted Resolution No. 53/00 regarding “Minimum Regulation Standards to be adopted by Central Banks for the prevention and repression of money laundering.” In turn, this Resolution gave rise to Common Market Council Decision526 No. 40/00 adopting the “Cupertino Convention among Central Banks in the Party States to the MERCOSUR, for the prevention and repression of procedures aiming at the legitimisation of assets from illegal activities.” Also, by Common Market Group Resolution No. 20/01 it was stipulated that the Party States should adopt the information transparency rules recommended by the Basle Committee before December 31, 2005.

A sign of the complexity of the harmonisation process, even in areas unrelated to market access, can be observed in the conclusions of the Financial System Commission in the Minutes of the May 1998 Subgroup 4 meeting,527 assessing the rate of progress in fulfilling the decisions of MERCOSUR authorities on minimum capital, debtor classification, credit risk ceilings and consolidated global supervision, concluding that differences subsist in these issues among the MERCOSUR countries,

525 See supra, Chapter V, Section I, Subsection B, Nos. 2 and 3 (detailing Brazilian constitutional and legal restrictions).
527 Minutes Sixth Meeting – First in May 4 to 6, 1998.
incompatible with the resolutions adopted, in particular “taking into account a vision of full integration by the financial service on a regional level.” Although, shortly after, regarding progress on minimum capital, classification and provisions of credit operations and credit risk ceilings, at its October 2000 meeting, the same Commission pointed out that the divergences subsisting are a result of the features of each market and that at all events they observe the same concepts and objectives, and therefore do not constitute significant asymmetries in prudential affairs.328 These expressions basically reflect the difficulty existing in changing the internal policy systems in such sensitive areas, from the economic point of view, as those concerning financial systems.

3. The definition of areas to be harmonised by Subgroup 4: working agendas

In the light of the restrictions pointed out earlier on, Subgroup 4 turned to defining its priorities regarding harmonisation, concentrating on improvements and prudential co-ordination and criteria for preparing information and its transparency in the Member Countries.

These priorities were set out in Subgroup 4 working agendas, generally prepared every two years, although in some cases (between 1996 and 2000) they were only revised after a longer period. From the Agendas and Minutes of Meetings held during the first years of MERCOSUR, it may be seen that subjects in which efforts of co-ordination and policy harmonisation were centred were those of consolidated supervision, debtor classification and provisions for bad debts, policy regarding prevention and detection of illegal operations, credit risk ceilings, technical assistance, minimum capital, limits on credit risks, and assessment of the situation regarding access to the financial system. Later, and until 2000, efforts have been centred on the preparation of concrete, technical proposals, to advance in specific areas of financial integration. A survey was prepared and made on the situation in each of the countries regarding consolidated supervision, on compliance with international prudential standards (25 principles), on new products, e-banking and consumer protection. Progress was made in harmonisation of accounting criteria used in the various countries, foreseeing convergence in 5 years time. In relation to Capital

328 Minutes Eleventh Meeting (Recife, Brazil) – Oct 25 to 27, 2000.

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Markets, work has been carried out on a survey of the system in each of the countries regarding Investment Funds. It is foreseen to plan and carry out various training activities to avoid money-laundering operations.

The last Agenda was formally adopted as Subgroup Negotiating Standard for the period 2000/1 by Common Market Group Resolution No. 84/99. Specifically, over the past years information from each country regarding compliance with the 25 Basle Principles for Effective Banking Supervision has been analysed together with information regarding Consolidated Banking Supervision. The situation in each of the countries is being examined and recommendations adopted regarding prevention and repression of money-laundering. Periodically, a comparative table has been updated on policies in force in each of the countries for the banking sector on minimum capital, classification and risk ceilings, consolidated supervision, auditing and internal control. On the basis of international recommendations, some measures to ensure greater transparency of banking information have been examined and adopted.

A last aspect to be commented on in the methodology of the definition of areas to be harmonised in the context of Subgroup 4, refers to mechanisms for the determination of working Agendas. Formally, such Agendas were negotiated by the Subgroup co-ordinators, as part of the Common Market Group body, on the basis of instructions from their respective Governments. However, in practice it would seem to be different, without an apparently clear appreciation of the mechanisms used by the Subgroup co-ordinators to define these Agendas. Possibly not all the co-ordinators have given this task the same significance, or due to various circumstances, have not requested or obtained specific guidelines from their Governments. This can be noted in a greater influence some of the Party States’ strategies over the others when establishing the Agendas.

4. Alternative and complementary ways of defining the areas to be harmonised. Co-ordination in the Common Market Group

Another instance for the definition of Subgroup policies in a national context, is the creation of National Sections in each country, foreseen in the Ouro Preto Protocol (OPP1994). This mechanism facilitates co-ordination between Subgroup 4 or the other Technical Subgroups – and the
Service Group, providing the members of each country with formal opportunities to obtain and assess the information gathered and the objectives and achievements accomplished by the former in relation to all the MERCOSUR member countries. It should be remembered that in the context of MERCOSUR, by Resolution No. 31/98 the Service Group is formally responsible for the definition of criteria and instruments for negotiations and for the organisation and holding of Rounds of Negotiation on the offers and commitments in all the financial sectors. For this reason, the creation of National Sections enables greater fluidity in negotiations for the liberalisation of financial services. Such National Sections gather all the sectoral areas involved in each country for the establishment of policies, strategies and agendas for co-ordination and negotiation in the MERCOSUR. For example, in the case of Uruguay, the National Section comprises representatives of the Ministry of Economy and Finance, the Ministry of Foreign Affairs, the Foreign Trade Office of the Ministry of Economy and Finance, the Ministry of Industry, Energy and Mines, the Ministry of Animal Husbandry, Agriculture and Fisheries, the Planning Office, and the Central Bank of Uruguay. However, instrumentation and negotiation of strategies provided for by the National Section, correspond to the Ministry of Foreign Affairs.

Another – specific – modality of co-ordination is set out in the Common Market Group Resolution No. 5/01 instructing Subgroup 4, among other subgroups, to identify and eliminate restrictive measures on service trade, periodically reporting to the Service Group in order to advance in negotiations for the liberalisation of such trade. The adequate implementation of this Resolution could imply significant progress in the liberalisation process for financial services, facilitating identification of areas in which there are no problems in taking on commitments, distinguishing them from those in which difficulties are to be found, be these of a regulatory and/or political nature. In the latter case, information from Subgroup 4 will also facilitate a more precise knowledge of the nature of the problem, its extent and ways of solving it. Conversely, those aspects that can be liberalised may be included by the Service Group on the lists of specific commitments taken on by the Party States.

Last, but not least, a new way of co-ordination may be developing: it

531 CMG Resolution No. 31 of July 22, 1998.
should be noted that as a group, MERCOSUR is actively negotiating various trade openings with FTAA, the USA and the European Union. This circumstance, and even more, its success, would be very important as an external pressure to define and strengthen the liberalisation strategy of MERCOSUR services. This joint negotiation policy was already present in Common Market Council Decision No. 32/00 on MERCOSUR External Relations reaffirming the commitment of the Party States to jointly negotiate trade agreements with third party countries or extra-zone groups of countries granting tariff preferences, and defining in Decision No. 08/01 regarding Negotiations with Third Party Countries which resolved to accelerate bilateral negotiation processes in which MERCOSUR is participating - in particular the one being developed with the European Union. This Decision also gives a mandate to the MERCOSUR Pro-Tempore President to convene the Consultative Council foreseen in the Agreement signed among the Party States and the Government of the United States of America on June 19, 1991, to examine the possibility of initiating bilateral negotiations in a four plus one format. For this purpose, a Negotiating Group has been established, having as a first priority the definition in consensus of a common negotiation platform and the President of IDB, Dr. Enrique Iglesias was invited to be the Main Advisor to the Negotiating Group.

As said, this circumstance might be very helpful in achieving common strategies at the level of MERCOSUR. And it is necessary to add that it should be strongly advised to define said strategies before liberalisation negotiations with other countries or Agreements take place, in order to strengthen the development and soundness of the regional financial system. These institutions may require consistent governmental policies to overcome the barriers that prevent foreign institutions from operating in some countries. For instance, it would be recommendable to help local institutions to face the growing trend to concentrate around international financial conglomerates. It is true that the latter contribute investment, business expertise, technology and innovation. However, excessive concentration may lead —in case of a crisis of one or any of these international institutions—to dramatic consequences at the global level, especially in countries where their presence is more relevant. It may also

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532 CMG Resolution No. 5 of Apr. 25 2001.
contribute to make capital flows more volatile—and, in consequence, may cause restrictions in domestic credit—, insofar as multinational financial institutions move their resources from one region to another extremely quickly, following decisions of their headquarters in response to changing circumstances and better business opportunities.


1. Introduction

Another angle in the examination of the process towards financial integration is obtained by comparing regulatory restrictions existing in national systems, as analysed earlier on, with the commitments and offers made by each country in the context of the Montevideo Protocol. In fact, it is necessary to bear in mind that the Service Group, by Resolution No. 31/98 is formally responsible, in the context of MERCOSUR, for defining criteria and instruments for negotiations, and for organising and carrying out Negotiation Rounds on offers and commitments in all the service areas, including all financial sectors.\textsuperscript{534}

Furthermore, it should be borne in mind that the approach and concrete solutions for the integration of services set out in the Montevideo Protocol and its Financial Service Attachment—as analysed elsewhere—are very similar to the WTO General Agreement on Trade and Services and its respective Annex for Financial Services, with the exception that in the WTO documents, the most favoured nation clause has no limitations.\textsuperscript{535} And even following signature of these Agreements in MERCOSUR, the will to continue along the path of similarities with WTO instruments is manifest in the Common Market Group Decision No. 36/00 which adopts the World Trade Organisation GATS classification of services implemented through instructions given by the Common Market Group to Subgroups 1 and 4 in view of collaborating in the task of the Service Group in classifying ways of providing services. From which it may be seen that the MERCOSUR philosophy in approaching liberalisation of trade in services has been that of a trade agreement, with the objective, as

\textsuperscript{533} CMC Decision No 32/00 quoted, CMC Decision No. 08 of June 22, 2001.
\textsuperscript{534} See supra, note 52834.
\textsuperscript{535} CMC Decision No. 13/97, Montevideo Protocol CMC Decision 9/98, Financial Service and Initial List of Specific Commitments Annex, CMC Decision No.36/00 dated 30 June

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in the case of the WTO Trade and Service Agreement, of setting up a Free Trade Zone. This is a very different approach from that used by the European Union for the creation of a Common Market. The reasons for the MERCOSUR Party States adopting this approach, although not explicit, may be attributed to the optimism with which the mechanisms and solutions of the World Trade Organisation's General Agreement on Trade and Services were perceived. It should be borne in mind that the Montevideo Protocol was only drawn up a few months later than the finalisation of submission of lists of offers and commitments by the various countries in the context of the General Agreement on Trade and Services. Another element that differentiates the European Union solutions from those of MERCOSUR is the fact that in the latter were are not involved in a supranational organisation, nor does a Law Tribunal exist and therefore neither is there the possibility of the provisions of MERCOSUR bodies becoming immediately incorporated into domestic Law by means of Directives or sentences. In turn, practical reasons such as the fact that not all the service sectors have been surveyed in all the Party States (an element that does not directly affect the financial service sector, on which sufficient information exists), must also have been contemplated. This latter aspect would also have hindered the implementation of an inverse liberalisation path to that adopted, starting from opening up a universe of services and excluding negative lists. Finally, this was probably the only way that would simultaneously enable the achievement of some progress in the integration of services, implementing it with the care and in the time frames imposed by restrictions on access then in force, in addition to the political difficulties.

Since the signing of the Montevideo Protocol, the approach used in negotiations for opening up services has been the definition of areas of services, in which each country has prepared, individually and freely, its lists of offers and commitments. And this led to the fact that substantially, each country, in the context of MERCOSUR, submitted analogous offers and commitments to those it had already submitted to the WTO. In compliance with the provisions of the Montevideo Protocol, the Common Market Council approved Sectoral Attachments and the list of Initial Specific Commitments (Decision No. 9/98). This initial list was revised at

2000; WTO, complete text of the Final Agreement, Uruguay Round and of the General

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the First and Second Round of Negotiations on Specific Commitment that formally finalised, the first by Common Market Council Decision No. 1/00 of June 29, 2000; and the second by Common Market Council Decision No. 56/00 of December 14, 2000. The third round, initiated by Common Market Group Resolution No. 76/00 finalised at the end of 2000, its findings were approved by the Common Market Group and officially finalized by Common Market Council Decision No. 10/01 of December 2001. The content of these Decisions is the approval of the Lists of Specific Commitments corresponding to each one of the above mentioned rounds. Common Market Council Decision No. 11/01 defined the meanings for the terms “no limitation” and “not consolidated” to be utilized in the Sectoral Attachments by each country. Finally, Resolution 13/02 (GMC) decided to call for the IV Round of Specific Commitments in Services Negotiation to take place during 2002.

2. Offers and commitments

Regarding offers and commitments by the Party States, in general lines it may be seen that both Brazil and Argentina have important restrictions on insurance, while Paraguay and Uruguay have greater opening and more commitments. In turn, Argentina and Uruguay have a fair number of commitments and openings in banking services, while Brazil maintains significant restrictions and Paraguay has taken on some commitments.

Here below we will specifically examine the degree of openness and limitations on financial services that the countries reviewed committed themselves to for the various supply mechanisms.

Agreement on Trade and Services, see supra, note 1405, and accompanying text.

536 CMC Decision No. 9/98 (approving the Sectoral Annexes and the List of Initial Specific Commitments). This initial list was revised at the First and Second Round of Negotiations on Specific Commitments that formally finalised, the first by Common Market Council Decision No. 1 of June 29, 2000; and the second by Common Market Council Decision No. 56 of Dec 14, 2000 (in each case approving the countries' lists of specific commitments).

537 Id.
3. **Insurance services**

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In these three cases there are no limitations on offers. | **CROSS BORDER SUPPLY**
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<td>New authorisations subject to entities being set up as corporations or branches of foreign corporations. In all cases authorisation is granted by the Insurance Supervision Authority. No limitations on national treatment. Horizontal commitments are in force, implying that commercial presence requires legal entities to have offices and representation in Paraguay.</td>
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5. Evolution

So far progress in offers and negotiated commitment has been almost nil. The lists of offers and commitments submitted by each country in their initial commitments have been maintained almost integrally.\textsuperscript{538} And during the various rounds of negotiations, in some cases mention of the financial sector does not even appear on the lists of negotiated commitments.

It is true that signature of the Montevideo Protocol and the first rounds of negotiation on liberalising services took place in a context of general economic turbulence – the Asian and Russian crises – followed by regional difficulties – the Brazilian crisis, recessive economies – that did not generate a favourable environment for enhancing any aspect of integration.

This situation does not overlook the existence of other, intrinsic factors. These are not based on policy asymmetries, which although present, do not explain this phenomenon. At all events, the lack of progress in removing

\textsuperscript{538} See supra, note 5338.
them is symptomatic.

A factor that probably affects this result is that the negotiation strategy, based on the preparation of lists of financial service offers and commitments by each country, in a mechanism similar to that of the WTO, is possibly more compatible with the implementation of a Free Trade Zone than with the necessary efforts to set up a Customs Union. For example, in the case of the European Union, liberalisation of financial services is set out in a few Directives, that establish the general system and requisites for offering various financial service ranges in all the member countries. It is true that an antecedent of MERCOSUR approach to service liberalisation may be found in the strategy used for reductions in customs duties on goods during the transition period until the Common Market was set up. In that case the method followed was the negotiated preparation of a programme of progressive, lineal and automatic reductions in customs duties, until reaching the end of the transition with zero duties for the customs duties universe. And there the similarities end: the principle applied for the liberalisation of trade in goods has been the opposite of that imposed by the Montevideo Protocol for services.

In fact, the basis for the trade in goods rebate has been the general incorporation of all the goods in the programme, save for those that are expressly under exception. However, in the liberalisation of services the principle is that only services expressly included in the lists of specific commitments are liberalised. As we have already stated, it is probable that this strategy can be attributed to the optimism with which the mechanisms and solutions of the World Trade Organisation’s General Agreement on Trade in Services were seen. It is also true that there are many institutional and organisational differences between the European Union and the MERCOSUR hindering the adoption of solutions and instruments from the former by the latter. Finally, this path is probably the only one enabling the simultaneous achievement of some progress in the integration of services, while implementing it with the care and within the timeframes that the restrictions on access then in force, and the political difficulties, imposed.

On the basis of the preceding considerations, and even with the reservations mentioned above, it is reasonable to conclude that the system followed in the approach to liberalisation of services is a factor explaining the meagre progress made so far.
Another element that also refers to the mechanism used for liberalisation and that has certainly affected the scant progress made, is that systems defining the priority of sectors and negotiations in the first rounds do not seem to have been established.

In this context – as from Common Market Group Decision No. 36/00 – a first step in the definition of the strategy to be followed in negotiating liberalisation of services, is set by the adoption of the WTO Sectoral Service Classification. Also, as from this Resolution, service sectors in which negotiations are to be intensified can be selected, enabling such sectors to take on commitments entering in force immediately and/or differed in time but before the guideline of general entry into effect of the liberalisation of services. In this respect, it should be remembered that – in general – entry into effect of the negotiated commitments is foreseen to take place in the year 2010 (10 years after Common Market Group Resolution No.36/00). Subsequently, Resolution No.76/00 of the same MERCOSUR body marked the continuation of negotiations aimed at consolidating commitments by sectors, launched with Resolution No. 36/00. Following this, Common Market Group Resolution No.5/01\(^{539}\) instructing Subgroup 4, among other Subgroups, to identify and propose the elimination of restrictive measures on trade in services, periodically providing the Service Group (responsible for negotiation and liberalisation in all service areas) with the necessary information to enable progress to be made in negotiations for the liberalisation of such trade, may lead to significant progress in the liberalisation process of financial services. Said possible achievement may come from the task assigned to Subgroup 4, which is to facilitate the identification by the Service Group of areas in which there are no objections in taking on commitments, distinguishing them from those areas in which restrictions or difficulties of a policy and/or political nature exist.

In this way, the Service Group is slowly appearing as the centre in the definition of negotiation strategies in the field of financial services. In turn, it is extremely important that the Service Group is able to implement mechanisms to obtain information from Subgroup 4 regarding whether some of the MERCOSUR countries maintain greater restrictions than necessary in the light of their regulatory restrictions. For example, this is

\(^{539}\) CMG Resolutions Nos. 36/00, 76/00 and 5/01.
seen in the area of cross-border supply and foreign consumption of insurance and banking services, where none of the countries has consolidated its offer. Another case may be seen in Brazil’s horizontal commitments, applicable to insurance and banking services, regarding foreign investments or the limitation on employment of foreign personnel, exceeding the constitutional and legal restrictions in force. Based on this information the Service Group will be able to define, on a well founded and consistent basis, the strategies and the priorities on the liberalisation negotiations agenda.

Furthermore, this information from Subgroup 4 will enable the Service Group to exert pressure and carry out negotiations in the most suitable way to eliminate these excessive restrictions.

Throughout the first years of negotiations, it will be seen that there are few areas and methods of supply where the countries have foresseen unlimited access by institutions of the other Party States. It will also be seen that provision of most of the modalities has not been consolidated and that the limitations that the Party States established in the 1st Round of Negotiations have been maintained. This situation cannot be attributed solely to the regulatory asymmetries of National Laws.

The slow progress in negotiations to liberalise provision of financial services in the MERCOSUR, referred to above, together with some of the factors that may have led to such a situation and which we have pointed out, may reflect cautionary attitudes by the Party States’ governments in addressing this field of integration. This could be implicitly corroborated while the regulatory restrictions, basically the legal or constitutional ones (see 1.2., 1.3., 1.4 above) existing at the time the Montevideo Protocol was drawn up—and even at the time of the signature of the Asuncion Treaty—today remain unchanged.

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540 See supra, note 5338.
541 See supra, notes 14651, 2538.
II. STATE OF REGIONAL INTEGRATION AND THE MACRO-ECONOMIC SITUATION IN THE REGION. ITS THEIR RELATIONSHIP.

Entry into effect of the MERCOSUR gave rise to a rapid and intensive increase of trade flows among the member countries. For example, Argentine exports to Brazil rose from US$ 1.67 billion to US$ 7.7 billion in 1997.542

Brazil, with a GDP of approximately 500 billion dollars has a significant influence on MERCOSUR trade. Argentina represents approximately 40% of Brazilian production and the Uruguayan and Paraguayan product together do not reach 5% of Brazil, which fundament our statement. Additionally, this explains why Brazilian macro-economic stability is so relevant in the region.543 This has repercussions on the level of regional trade – which notoriously noticeable increases during periods of stability – as occurred since the implantation of the Real plan. However, in turn, it is clear that growth of trade in the region is also explained by a relatively higher level of prices in Brazil than in the rest of its trade partners and by a preferential rate of customs duties among them. All this enables us to understand that the increase of trade in the region, at least in part, took place at the expense of an increase in the Brazilian trade balance deficit. As an example, in 1993, the Brazilian trade surplus reached 13.3 billion dollars, while in 1998 the trade deficit was over 6 billion dollars. Over this same period, Uruguayan and Argentine exports to Brazil increased by 150% and 188% respectively (even considering goods that are hard to place on other markets and that are exported under MERCOSUR special regimes).544

In this context, the exchange rate started undergoing sustained pressure as from mid-1998, when the Russian crisis broke out. This pressure caused a significant loss of reserves, linked to the evolution of the increasing fiscal deficit and the level of Government indebtedness, to which political factors were added.545 Thus on January 15, 1999 the Central Bank of Brazil withdrew from the exchange market letting the real float. Devaluation of

543 Id.
544 See supra, notes 14651, 2538.
545 See Holz Eva, The impact of financial..., supra, note 1127.
the Real finally became stable at approximately 50% of its 1998 value, although during over the last months of 2000 (and throughout 2001), it again showed an upwards trend. Together with exchange measures, the Brazilian government adopted various substantial measures in order to reduce the fiscal deficit, making it possible for the economic and financial variables to become stable over during the year 2000. Thus, during 2000, industrial activities in Brazil grew approximately by 7%, export of goods grew 17% and imports 14.6%. Inflation during the same year was almost 6%. The economy stabilized and grew slightly during 2001 and 2002, inflation was kept under control, and the Real oscillated between 3 and 3.5 per US dollar (mostly due to political uncertainty prior to Brazilian elections which took place at the end of 2002).

A. REPERCUSSIONS IN THE REGION.

The Brazilian crisis eliminated overvaluation of the Real, involving among other things, the modification of trade flow within the MERCOSUR due to a drop in exports to Brazil and an increase in Brazilian exports to the other member countries of the Agreement.

These elements conjugated to lessen demand for goods and services in the countries of the region, leading to a drop in production. The prices of the various goods and services also tended to drop, with both aspects leading to the consequent recessive effect. Product fell in all the countries of the region (the most affected cases being that of Argentina and Uruguay with drops of 3.5% in the GDP), unemployment rose substantially (14.5% in Argentina, 6.3% in Brazil, 11.2% in Uruguay, 9.0% in Paraguay and 10% in Chile) and the rate of inflation in all the above mentioned countries also dropped.

It is evident that the significant variation in the economic situation of the various MERCOSUR member countries, which went hand in hand with the correction of many prices of goods and services traded intra-regionally had repercussions — in an ongoing process — on the evolution of integration. However, the final results will depend significantly on the type of mechanisms used to mitigate the impact of such price changes.

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546 Id.
547 Id.
548 Id.
B. THE IMPACT ON ARGENTINA. ITS CONSEQUENCES ON URUGUAY

As from the recessive adjustment of 1999, which among other consequences, led to a drop in the price of tradable goods, during the first half of 2000 an improvement in Brazilian the merchandise account was observed, turning the deficit into becoming a surplus. However, recession continued during in 2000. We should look now at Argentinian situation at the same time. It should also be remembered that since 1989 with the implantation of the convertibility plan, the exchange rate in Argentina was fixed, parity being established at one peso per US dollar. During 2000, unemployment rates continued to be close to 15%. Although exports showed an upwards trend, the GDP dropped slightly, public income continued to fall, and in spite of the successive attempts at containing public expenditure and at increasing collecting, the deficit in public accounts continued to rise. At the end of the year, this led the Government to request financial assistance ("shielding") from the international funding bodies (International Monetary Fund) for an amount of U$39,700,000, announced at the beginning of 2001. During 2001 the situation was further complicated by the closure of foreign capital markets and deterioration of fiscal accounts, already to be observed at the beginning of the year. During March 2001, the Minister of Economy was changed three times. The last one, Cavallo, promoted a plan to make the country's economy competitive once again, eluding more cuts in expenditure. Among the measures adopted, mention can be made of taxes on bank transactions, unilateral modification of MERCOSUR customs duties, sectoral reactivation plans with special tax treatment for sectors considered to be strategic, and the creation of a "trade dollar" which in fact involved a change in the convertibility exchange system. He also adopted measures to improve the external debt profile. Simultaneously, in order to obtain domestic credit, he reduced the reserves of financial institutions, and modified their composition, admitting National Government obligations for the purpose of constituting the reserve. In this way, the strength of the financial system was undermined, increasing its exposure to Government risk. Halfway through the year, when the bid for domestic obligations failed, Cavallo had to admit that he did not have domestic credit, and introduced a budgetary ruling of zero deficit, also applicable to the Provinces which were

549 Id. 278
temporarily authorised to finance their excess expenditure by issuing obligations with cancelling power (quasi-currencies such as the LECOP and the Patacones). The debt in the government's paying capacity and the antecedent of the 1989 Bonex Plan led to a persistent drain on the system's deposits. In this context, recession was worsened with drops in investment of over 20%, notoriously lessening domestic consumption, with the consequent reduction of GDP.

Finally the economy collapsed (December 2001) and new economic and financial rules were issued by the Government (i.e. Law 25,561 of jan. 7, 2002), which were focused on employment, on reasonable income for the population and toward that end on reducing its indebtedness with the financial system. But those rules at the same time meant the collapse of the paying system, the credit chain and the end undermining on the confidence in argentine financial system. Also, it destroyed argentine reputation in the international credit and financial markets. For instance, on December 24 2001, the Argentine Government defaulted on its debt (141 billion US dollars); the convertibility currency rule was changed (1 peso equal to 1 US dollar) and shortly after all of a sudden, a couple of days later (January 2002) the peso was worth one third of one US dollar; almost all deposits were frozen, meaning that depositors could not withdrawn their savings from the banking system ("corralito"). Also in January 2002; banks had to accept that many debts named in US dollars or other strong hard currencies could be cancelled by paying in the Argentine devaluated currency (peso) at the previous exchange rate nominal parities (1 peso one dollar) when the peso at the time was worth one third of a US dollar), but depositors had to be maintained and finally paid back in the currency of the original deposit or at a parity to be fixed by the Executive Power in order to preserve the value of the savings, which was called "pesificación asimétrica." These rules meant the insolvency of all financial institutions. There are estimates that during 2002, bank losses due to asset depreciation amounted to 20 billion US dollars. The above described situation was followed by some international banks deciding (i.e. New Scotia bank) to quitting their operations in Argentina. The subsequent economic measures applied by the new Government during the year 2002 and the first part of 2003 were unsuccessful, especially regarding the "rebuilding" of the financial system. It is important to stress out that since the financial system
crisis arose in 2001, prudential regulation ceased to be complied with by Argentinean banks. Additionally, in 2002, several Argentinean prudential standards required by Central Bank's regulation were softened and forbearances were allowed regarding some other prudential standards (which were mostly still maintained in 2004), E.g: Minimum computable worth amount has not been adjusted since 2001, relation between net worth and credit risk weighted assets has been reduced to 8%, requirements to obtain international ratings to mandatory issued debt has been suspended. The IMF and other international financial organizations criticized the inconsistency of the Government's economic measures. Public debt was is still in default until February 2005 when a debt swap (at an 80% loss) was accepted by 70% of the creditors. Since July 2002, the economy has begun its recovery, but still without the assistance of a local operating banking system: there is no domestic or international credit, and international trade is mostly financed by some international financial institutions.

The collapse of the Argentine financial system first had an impact (January 2002) on those banks operating in both countries, Argentina and Uruguay, when the restrictions imposed on operations in Argentina forced Argentine bank clients to withdraw their deposits from the Uruguayan branches of the same institutions. This initial development was soon followed by a general run of most Argentine depositors from all Uruguayan financial institutions, even from international banks, due to their fear of having their deposits frozen in Uruguay as well, in the event similar measures to those imposed in Argentina should be adopted by the Uruguayan government. As the Argentine crisis continued during 2002, its impact on Uruguayan economy worsened over the same period, causing continuation of the depositors' run. In the context of currency exchange, on June 2002 Uruguay abandoned its crawling peg system, allowing the Uruguayan peso to float. In July 2002, a bank holiday was declared, four private banks were suspended (not liquidated but closed), and deposits on two seriously illiquid state-owned banks where extended for two years, to be paid in the currency in which the deposit was established. Rules for solvent banks (international banks) were not changed. There was no general freezing of deposits, or any change in the currency of deposits. Prudential requisites and standards were not modified, but in fact were only fully complied with by international banks, From January 2002 up to
July 2002, Uruguayan financial system lost over 40% of its deposits. Finally, in December 2002 (dated December 27, 2002), law No. 17,613 was passed, establishing a new procedure for the liquidation of the four suspended banks, and broadening Central Bank regulatory and controlling powers over private and public financial institutions as well as on private bank shareholders, directors and managers. On the other hand, public debt was not defaulted, and in May 2003 a voluntary extension of same was agreed by international and local Uruguayan debt holders. Since the beginning of 2003, additional and higher prudential requisites were established, to be gradually applied by all financial institutions, national – public and private - or international,

C. REACTIONS IN THE NEIGHBOURING COUNTRIES TO BRAZILIAN CRISIS IN THE NEIGHBOURING COUNTRIES.

1. The Governments’ primary reaction

The immediate reaction to the Brazilian devaluation by the governments in the region was to defend their current exchange systems, ensuring that they would not be modified. This measure was a consequence of the concern stated by these countries’ economic agents and by organisations and investors from international contexts.550

In a way that was consistent with the exchange systems, and in order to improve product competitiveness in each of the countries, the Governments approved measures showing greater prudence and contention of public expenditure variables for the year. With this the States endeavoured first of all to preserve the countries of the region’s economic stability, and only in second place and in what was compatible with maintaining stability, to improve competitiveness of goods and services produced locally. By containing public expenditure, they avoided potential widening of the fiscal deficit that might have caused a retraction in economic activity and a consequent drop in collecting taxes. Indirectly, this measure also supported the capital flow in the balance of payments, as macro-economic stability is essential in maintaining the confidence of investors in these countries.551

550 See AT1991, supra, note 14651; Montevideo Protocol, supra, note 197 203.
551 Id.
2. Pressure. Subsequent measures.

However, as from mid-1999, the productive sectors in the countries started insisting that the measures adopted were insufficient to compensate for the lack of competitiveness of their products. And the spectrum of macro-economic measures and measures for the defence of local production they demanded from their respective governments were, what projected the greatest shadows over the future of MERCOSUR: The same suggestions were also received from some sectors of the region’s governments. For example, policies encouraging exports, refund of sales tax on MERCOSUR destinations, limitations on border trade, or specific, non-tariff “ad hoc” barriers to trade, all clearly violating the standards of the World Trade Organisation.\footnote{Id.}

D. FUTURE PROSPECTS FOR MERCOSUR. THE IMPACT OF THE CRISIS ON THE INTEGRATION PROCESS

1. In general

Undoubtedly, since 1999 MERCOSUR has been going through one of the hardest times since its establishment. The mechanisms used to correct the impact of the new price relationship among its member countries and to adjust main macroeconomic variables will be fundamental in defining the future of this integration agreement. And the Brazilian crisis launched a substantial variation process of the relative prices, which has still not concluded.

This explains the uncertain panorama following integration in the MERCOSUR framework. The bases for this uncertainty arise from two kinds of circumstances. The first reason is that it is very difficult and even inadvisable to continue with an integration process involving countries whose macro-economic policies are very unequal, particularly when the crisis and macro-economic instability is apparent in countries whose economies represent very significant parts of the total product of the countries belonging to MERCOSUR. The second element lies in the possibility that one or various signatories of the Asuncion Treaty unilaterally decide to apply sectoral defence mechanisms or non-tariff barriers incompatible with the MERCOSUR and the World Trade
It is unquestionable that the application of suitable macro-economic measures necessarily co-ordinated with the other governments of the MERCOSUR countries is one of the pillars for the validity and continuation of the implementation of this Integration Agreement.

In all the governments discipline is a key factor. Any adjustment of the magnitude of that which took place in Brazil, and is still on-going in Argentina and Uruguay, makes the transition mechanisms carefully studied for the most sensitive sectors of the economies of the four countries belonging to MERCOSUR hazy.\(^553\)

As measures aiming at the survival of MERCOSUR and the economic stability of its member countries – an essential requisite – it should be stressed that, on the one hand, Common Market Council Decision No. 6/99 entrusts the establishment of a High Level Working Group in the framework of the Meeting of Ministers of Economy and Central Bank Presidents, with the aim of co-ordinating the macro-economic policies of the Party States. The thematic areas to be addressed by the High Level Group cover economic policies with emphasis on inter-temporal sustainability of the countries’ public and external accounts, macro-economic co-ordination alternatives, and a proposal for a work programme for such a purpose, among others. In this same line, Common Market Council Decision No. 30/00 resolved advancing towards common objectives in macro-economic areas and financial services, entrusting this to the Ministers of Economy and Central Bank Presidents. For this purpose, harmonised statistics should be prepared, starting with tax statistics, based on a common methodology. Indicators on tax aspects should be published as from September 2000. The harmonised statistics were first published on October 31, 2001. In turn, the macro-economic convergence mechanisms were set out in the Minutes of the Meeting of MERCOSUR Ministers and Central Bank Presidents in December 2000, in Florianopolis.\(^554\) During 2002 and part of 2003, no substantial advances were achieved, reflecting mostly the economic turmoil in Argentina and the political adjustments to the new Brazilian and Argentine governments.

At prior meetings, particularly at the special Meeting of the Common Market Group held in May 1999, in Asuncion, the delegations had made

\(^{553}\textit{Id.}^{554}\)
various proposals to establish a context for the negotiation of macro-economic convergence, which finally were set out – on the basis of the Uruguayan proposal – in the above mentioned Decision No. 6/99.

c. Another relevant and auspicious detail, regarding MERCOSUR continuation, is seen in the fact that its bodies continued to operate regularly during the years 1999 - 2003, adopting Decisions and Resolutions in consistence with the continuity of the integration process, each one in the subject of their respective competence. In general, these Decisions and Resolutions did not address sensitive issues and did not concern trade in services, nor financial services areas in particular.

d. However, at the end of 2000 and coinciding with the Argentine situation becoming more serious, first in this country and then in the other member countries of MERCOSUR, some unilateral measures started to be implemented in violation of MERCOSUR and in general violating the continuity of the integration process of its member countries,

2. In particular

a. Some unilateral measures taken by members

The MERCOSUR Party States have instrumented various types of measures for local defence, of a para-tariff, tariff and currency exchange nature. We will describe them in this order. Of these, only the currency exchange measures specifically affect the financial service sector, but even so, all of them have repercussions on all levels and areas of the integration process.

Furthermore, it should be remembered that the Montevideo Protocol has only been in operation three years, practically coinciding with the period of regional macro-economic crisis, a circumstance that we must adequately weigh when assessing the state of progress in integration.

In Argentina, various para-tariff measures were announced and adopted such as the application of reference values (and the consequent need to establish guarantees) on exports of Uruguayan bicycles. Reference values were established in order to compare with the prices on entry of the merchandise. If both differ, the constitution of guarantees is required and the demonstration that these prices effectively correspond to market prices. Mention may also be made of the application of Provincial incentives to

production, mainly affecting Uruguayan exports of paper products. Another para-tariff measure is the establishment of explicit referential values in the constitution of guarantees.

In turn, Uruguay adopted anti-dumping measures for certain types of oil from Argentina and established an "automatic" licence for the import of shoes. It also increased VAT anticipated payment on imports from 5% to 10%.

Regarding tariff measures, Brazil changed the tariff position for the import of re-treaded tyres, prejudicing the Uruguayan trade current on the basis of Italian technology. It also adopted export taxes of 150% on exports of cigarette manufacturing inputs, destined to Uruguay and Paraguay. It also made a formal accusation regarding the dumping of Argentine and Uruguayan dairy products.

Also with respect to tariffs, Argentina, as from March 2001, announced a 35% increase in tariffs and dropped to zero capital goods, formalised in MERCOSUR under Common Market Council Decision 1/2001. In another complementary measure, Argentina unilaterally reduced tariffs on imports of capital goods, computer technology, oil and telecommunications from extra-MERCOSUR countries. This gave rise to the immediate reaction of Brazil, suspending trade negotiations with its partner, until the Argentine authorities revised their tariff preference measures. Also in regard to one of the specific sectors, Brazil brought down to zero tariffs on drugs.

For its part, Paraguay arranged for an increase in 10% of tariffs for 332 products until December 2002, and Uruguay reduced to zero tariffs on the import of capital goods.

In the context of currency exchange, on June 2002 Uruguay abandoned its crawling peg system, allowing the Uruguayan peso to float. Argentina first stipulated changes in the legal convertibility system of its currency, to include the Euro. The effect of this measure was to increase protection of Argentina vis-à-vis the MERCOSUR countries. And, on December 2002 the Argentinean peso was allowed to float.

Furthermore, Brazil, on the basis of the pure floating of the Real, has continued in its permanent revaluation process.

Finally it is interesting to note that during 2002 and 2003, the previous trend to adopt trade restrictive measures unilaterally, calmed down. No more measures were adopted.
b. Main MERCOSUR decisions

i) Both the Common Market Group and the Common Market Council have operated regularly throughout 2000, 2001 and 2002 and have adopted decisions on their respective areas of competence.

Within the most outstanding decision of the Common Market Council, we must refer to No.4/00 of the MERCOSUR Origin Regime, Nos. 22 and 52/2000 of access to markets, Nos. 25 and 65/2000 perfecting the conflict resolution system provided for in the Brasilia Protocol, No. 30/2000 for Macro-economic Co-ordination, the 1st and 2nd Rounds of Negotiations for Specific Service Commitments (Nos. 1 and 56/2000), No. 58/2000 on Agreements on Technical Barriers to WTO Trade, No. 64/2000 on Defence of Competition, Nos. 67 and 68/2000 on a Common External Tariff and No. 70/2000 on MERCOSUR Automotive Policy. Also, Decision 1/02 on institutional strengthening; Decision 13/02 adopting in the MERCOSUR the antidumping WTO Agreement; Decision 20/02 perfecting the system for the incorporation of MERCOSUR rules on member countries regulation; Decision 22/02 replacing the Decision 64/000 Annex on Defence of Competition; and Decision No.07/03 concerning the direct application to member countries of MERCOSUR rules.

Regarding the Resolutions of the Common Market Group, attention should be drawn to No. 3/2000 of Subgroup 12, Investment Group, Nos. 43 and 44/2000 establishing an Ad Hoc Group on Electronic Trade and Concessions, respectively, Nos. 36 and 76/2000 for Strengthening Service Liberalisation Commitments, Resolution13/02 which decided to call for the IV Round of Specific Commitments in Services Negotiation to take place during 2002, and many decisions regarding specific tariff issues.

The April and June 2001 Meetings of the Common Market Council were characterised by scant decisions, in which only exceptional tariff measures and those concerning automotive policy and re-launching of MERCOSUR are to be emphasised.

ii) Decisions regarding Re-launching of MERCOSUR are worth special mention.

In this respect, we would like to refer to Common Market Council
Decisions on Re-launching the MERCOSUR of the year 2000, which in some central issues, such as market access, dispute resolution, organic structure, and defence of competition, entrust the implementation of studies and proposals in order to overcome barriers detected in each one of such issues. In the external context, Decision No. 32/00 on Foreign Relations should be mentioned, reaffirming the Party States Commitment to jointly negotiate trade agreements with third party countries or with extra-zone groups of countries in which tariff preferences are agreed on.

Subsequently, Common Market Council Decision No. 07/01 postponed to different periods – between September and December 2001 – the deadlines within 2000 established by the Decision for Re-launching MERCOSUR.

On analysing the significance of Decisions regarding the Re-launching of MERCOSUR, it may be observed that they implicitly replace the calendar for Free Trade Zone and the Customs Union, which effectiveness was formally postponed respectively to the years 2000 and 2006.

It should be remembered that at the Common Market Commission Meeting of 4 and 5 August 1994, it was already admitted that such a goal would not be met according to the previous schedule. For this reason, it was agreed that a new period of convergence should be initiated as from 1st January 1995. Such agreements were set out in various Common Market Council decisions.

Another positive aspect is that all the Decisions and Resolutions regarding Re-launching of MERCOSUR implicitly underline the will to continue along the path of integration, beyond the setbacks, assumed to be a consequence of the current economic situation.

556 Id.
557 Decisions Nos. 3, and 5-10 of Aug. 5, 1994, and subsequently to the CMC meeting in Ouro Preto on Dec. 17, 1994: Decisions Nos. 22 (establishing the Common Foreign Tariff, lists of exceptions to same and the convergence lists of the capital goods, computer technology and telecommunication sector), 23 (referring to the system of origin for products not included in the Common Foreign Tariff or having specific requisites, were adopted). 24 (regarding the Regime of Final Adaptation to the Customs Union), 25 (which approved the Customs Code, a basic standard for customs regulation in the customs territory of the MERCOSUR, are applied to all of them) of Dec 17, 1994.
558 Likewise, Decision No. 67, of Dec. 14, 2000, extending until 1st Jan. 2003 Common Market Council Decision No.1597 regarding the Common Foreign Tariff, but reducing by 2.5 percent those foreseen in this latter Decision, and Common Market Group Resolution No. 25, of 13 June, 2001 (modifying the Common Foreign Tariff, in conformity with the provisions of Common Market Council Decision No. 67/00, mentioned above, should be interpreted in the same way).
Along this same line, it is relevant to quote Common Market Council Decision 5/01 creating High Level Groups with the aim of revising systematisation and rationality of MERCOSUR tariffs, analysing the respective production chains, which must make proposals to the Common Market Group before November 30, 2001. This tariff revision will be effective as from the year 2003, as the unilateral tariff measures adopted during 2001 by the MERCOSUR countries should be revoked in December of the year 2002 at the latest.\(^5\)\(^5\)\(^9\) As shown by CMC Decision 25/02 of 6 December 2002 and Decision 02/03 of 17 June, 2003, some of those measures were allowed to be extended until December 2003.

Even in the context of unilateral tariff measures such as those stipulated by Argentina, or the restrictive measures on trade stipulated during the year 2001 by the remaining Party States, an attempt has been made to frame them in the context of the MERCOSUR Agreements, emphasising them as exceptional and temporary.\(^5\)\(^6\)\(^0\) Thus, the 2\(^{nd}\) Special Meeting of the Common Market Council held in April 2001, concluded with Decision No. 01/01. Said Decision, under the name of exceptional measures in the field of tariffs, authorised the Argentine Republic to apply rates on import rights arising from resolutions Nos. 8/01 and 27/01 of the Argentine Ministry of Economy, exceptionally and temporarily until December 31, 2002 on imports from third party countries that are not members of MERCOSUR (this Decision was extended by Decision 02/03 of 17 June, 2003, until December 2003).

However, such measures should not imply restrictions on intra-zone trade nor distort the region’s competitiveness. It also entrusted the Common Market Group to carry out preparatory work on the analysis of the Impact of the Decision on MERCOSUR operations, commented on above.

iii) Finally, it should be noted, that as a group, MERCOSUR is actively

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\(^5\)\(^9\) This arises from the interpretation of CMC Decision No. 67 of Dec 14, 2000; CMG Resolutions Nos. 1 and 25 of Mar. 28, and June 12, 2001 respectively; and CMC Decision No. 01 of Apr. 7, 2001, that under the name of exceptional tariff measures, authorised Argentina to apply, exceptionally and temporarily, until Dec. 31, 2002, to imports from third party countries, non members of MERCOSUR, the duties on import rights arising from resolutions Nos. 8/01 and 27/01 of the Argentine Ministry of Economy).

\(^5\)\(^6\)\(^0\) This can be observed in Minutes No. 01/01 of the Common Market Council Special Meeting, aimed at reporting on tariff measures adopted by the Argentine Republic and their impact on the MERCOSUR, as well as other controversies and claims among the Party States, which were a background to the 2\(^{nd}\) Special Meeting of the Common Market Council (Minutes No.01/01 of the Common Market Group held on Mar. 28 and 29, 2001, in Asuncion).
negotiating various trade openings with FTAA, the USA and the European Union. This circumstance, and even more, its success, would be very important for the enhanced operation of the Regional Agreement. This joint negotiation policy was already present in Common Market Council Decision No. 32/00 on MERCOSUR External Relations reaffirming the commitment of the Party States to jointly negotiate trade agreements with third party countries or extra-zone groups of countries granting tariff preferences, and defining in CMC Decision No. 08/01 regarding Negotiations with Third Party Countries which resolved to accelerate bilateral negotiation processes in which MERCOSUR is participating, in particular the one being developed with the European Union. This Decision also gives a mandate to the MERCOSUR Pro-Tempore President to convene the Consultative Council foreseen in the Agreement signed among the Party States and the Government of the United States of America on June 19, 1991, to examine the possibility of initiating bilateral negotiations in a four plus one format. For this purpose, a Negotiating Group has been established, having as a first priority the definition in consensus of a common negotiation platform and the President of IDB, Dr. Enrique Iglesias was invited to be the Main Advisor to the Negotiating Group.

The importance of these negotiations, in addition to the opening up of traditionally closed markets or ones which apply major subsidies to products exportable from the MERCOSUR countries, in which the counterparts in the negotiations – all developed countries – will be obliged to maintain consistency in the establishment of tariffs and in macro-economic policies and co-ordination, as an essential requisite to achieve the objective of establishing trade liberalisation with such countries.

561 CMC Decision No. 32, see supra, note 5528, and No. 08 of June 22, 2001.
CHAPTER VI

REFLECTIONS AND CONCLUSIONS

At this point, the author will summarise the thoughts and conclusions developed by the previous analyses, focusing on the improvement of the financial integration of MERCOSUR and the banking industry in the context of, and beyond, the MERCOSUR. Such improvement may contribute—in a sustainable and progressive way—to maximize beneficial effects on the societies and economies of the countries in the region over the long run.

Prior to this, it should be underlined that in the current regional context, and up until the regularization of the macro-economic and institutional situation of all member countries, it is impossible—even unwise—to move ahead in terms of integration stages. As a consequence, the following comments will be presented in the understanding that they be applied under conditions of reasonable social and economic stability.

In the author's view, the MERCOSUR framework has a positive potential and may contribute to the economic growth and wellbeing of the countries and societies it involves. For the further development and enhancement of its positive effects, MERCOSUR should avoid or at least mitigate the risks and difficulties involved in the opening up processes. This general conclusion applies for the financial sector, as is further developed in this Chapter.

I. IN GENERAL. MERCOSUR. ITS RELEVANCE.

A. INTEGRATION. LIBERALISATION OF TRADE

The Asuncion Treaty and the subsequent Protocols adopt and generate pragmatic structures and mechanisms. They all centre round the regulation of instruments for the progressive reduction—until its total elimination—of tariff barriers and the outright annulment of any kind of non-tariff barriers
that could exist in the signatory countries.\textsuperscript{562}

However, there is an innovative component when compared to other previous integration schemes as it establishes a process of linear, gradual and automatic reduction of tariffs while at the same time it sets the objective to establish a common external tariff and the coordination of macro-economic policies.

In terms of the institutions and bodies, pragmatism is evident in the transitory, flexible and simple nature of the structures it creates to allow for a more fluid adaptation to existing regimes in each of the signatory countries.\textsuperscript{563}

As a result of the previous Latin American integrationist—and not always successful—experiences, the MERCOSUR Party States did not attempt, at an initial stage, to enter more deeply into potentially conflictive aspects or areas in terms of their structure or harmonisation. This is a logical attitude given the fact that, in any case, the most urgent steps relate to trade areas, the facilitation for the circulation of goods between countries, reduction and elimination of trade barriers.

Despite all this, the road to trade liberalisation has been paved with difficulties, which was only to be expected. It takes a long time, even among developed countries, to achieve some degree of economic convergence and simultaneously keep the path to the liberalisation of trade and services. Therefore, it has not been surprising that the goals set forth in the Asuncion Treaty to conform a Common Market on December 31, 1994,—clearly too ambitious—have been postponed formally in one instance and, in fact, once again. During the CMC meeting on August 4 and 5, 1994, it was acknowledged that the original goal would not be met according to plans. Accordingly, it was agreed to start a new convergence period as from January 1\textsuperscript{st}, 1995. Such agreements were reflected in a number of decisions made by the CMC (Numbers 3/94, 5/94, 6/94, 7/94, 8/94, 9/94, and 10/94) and later on in the Ouro Preto CMC meeting of December 17, 1994 and decisions adopted at such meeting. That is, in 1994 a new schedule was established and it foresaw that the Free Trade Area—not fully completed to date—would come into full force as from

\textsuperscript{562} See supra, Chapter II, Section II.

\textsuperscript{563} Id.
January 1st, 2000, and the Customs Union as from January 1st, 2006.\textsuperscript{564} However, this schedule has been modified again—in fact, implicitly—during 2000 and 2001 due to the Brazilian crisis and its impact on the region—with the adoption of Decisions of the MERCOSUR Re-launching Common Market Council. All these Decisions, cover a whole range of areas such as market access, improvement of the dispute settlement system, analysis of the structure of bodies depending on the Common Market Group and the Trade Committee, or that for the Common External Tariff, etc. (Nos. 22/00, 25/00, 26/00, 27/00, respectively) whose object is to analyse and solve difficulties related to the operation of MERCOSUR, encountered in their respective areas of competence. Later on, Common Market Council Decision Number 7/01 postponed to different periods throughout the year 2001 the terms that previous Decisions related to the Re-launching of MERCOSUR had set for the year 2000. It must be pointed out that such Decisions of the MERCOSUR Re-launching Council imply a relatively positive response in view of the critical situation facing the Member countries since 1999 that brought forth serious difficulties in the implementation of the MERCOSUR Agreement.\textsuperscript{565}

B. MERCOSUR. ITS NEGOTIATING CAPACITY IN TRADE AGREEMENTS

Regardless of the ups and downs in the economic integration process of MERCOSUR, the four Party States have undoubtedly conformed a somehow coherent group—especially in terms of consideration and negotiation with interlocutors and in terms of economic agreements at international fora. It is interesting to observe that in the different processes of economic and political analysis, regional circumstances are identified with those of MERCOSUR. In this sense, the expression is used as an equivalent of the Southern Cone area of South America. In addition, the fact that countries signing the Asuncion Treaty have sometimes joined efforts when making proposals to international interlocutors, has led to the perception of MERCOSUR as an economic and political unit. Hence, the

\textsuperscript{564} See CMC Decisions Nos. 3, 5-10, 22-25, supra, note 5502 and 554. Which includes: creation of the Common External Tariff, lists of exceptions to the CET, and lists of convergence for the capital goods, computer technology and telecommunications sectors; rule of origin regimen for products not included in the CET or with specific requirements, all of which are subject to the original regime set forth in Decision 6/94, regime for Final Adjustment to the Customs Union, and the Customs Code (the basic regulations for MERCOSUR customs territory).

\textsuperscript{565} See supra, Chapter II, Section II.
twofold effect of generating internal cohesion and a common front before the different external interlocutors.

Concrete institutional expressions of this nature and of joint international negotiation policies are already suggested in Decision Number 32/00 of the Common Market Council, vis-à-vis MERCOSUR Foreign Relations, which reaffirms the commitment of Party States to negotiate trade agreements jointly with third party countries or groups of countries outside the area, wherever tariff preferences are agreed. Later on, this trend is defined in Decision Number 08/01 of the same body, relative to Negotiations with Third Party Countries. In this Decision, it is resolved to accelerate bilateral negotiation processes MERCOSUR is part of, in particular the ongoing one with the European Union. The latter also includes the mandate to the Pro Tempore Presidency of MERCOSUR to convene the Consultative Council following the Agreement signed by the MERCOSUR Party States and the Government of the United States of America, on June 19, 1991, in order to study the possibility of initiating bilateral negotiations under the 4 + 1 format. To this effect, a Negotiation Group has been organized and its number one priority will be the consensual definition of a common negotiation platform. The President of IDB, Dr. Enrique Iglesias, has been invited to act as Senior Advisor of the Negotiation Group.566

One aspect of great relevance for the continuity and success of this new role of MERCOSUR lies upon each of its Party States policies—particularly Brazil and up to some extent Argentina, toward MERCOSUR and the region. By this, we refer to the importance they will attribute to MERCOSUR's best interests—as a whole—especially where those interests may clash with others on the national sphere.

It must be pointed out at this stage that the fact that MERCOSUR is negotiating necessarily as a block with FTAA, USA and the European Union, will constitute an element of alignment and consistency, necessary for the Regional Agreement. The joint policy of such negotiations, with developed countries as counterparts, will make it an imposition and an obligation to preserve consistent parameters that adjust to policies and macro-economic coordination and, in addition, are consistent in setting tariffs, as an essential requisite to successful progress.

566 See supra, Chapter V, Section II.
C. **FINANCIAL GLOBALISATION AND MACROECONOMIC STRENGTHENING**

In the light of the successive Asian, Russian and Brazilian crises, followed by the Turkish and, recently, the Argentine crises, it becomes imperative to question whether the benefits of globalisation and financial integration justify the absorption of their costs and risks—dramatically experienced by societies.

In fact, the liberalisation of the circulation of goods, services and capitals generates trade growth—and as result, product growth—, increasing efficiency in terms of the global location of resources and capitals, which are therefore, more efficiently used and contribute to the well-being and improvement in the standards of living of many societies subject to the integration framework. In the specific sense of financial globalisation, many countries in Asia and Latin America have had the possibility to modernize their industry and their economy, at least in part, due to the fact that they have had a freer access to available external savings, regardless of the need to recognize the advisability of protecting their dependency on very short-term capitals.

On the other hand, the growing perception of risks—relative to crises or to a higher probability of a crisis extension—and the resulting costs to societies in terms of the loss in wellbeing for the population, requires our profound study in order to avoid them or at least mitigate them.

Precisely, the increasing possibility of “contagion” due to financial globalisation, should not lead us to lose sight of factors inherent to each country that represent the underlying causes of their fragility in resisting external blows. This leads us inexorably to the need for macro-economic strengthening of each one of the countries themselves, beyond integration processes, as a true way to mitigate individually the impacts of financial globalisation.

Furthermore, globalisation may contribute to deepen crises due to the persistent application of imbalanced macro-economic policies. Under such circumstances, a trigger to spark off the crisis could be the investors' loss of confidence in the maintenance of policies in a given country, causing them to withdraw their investment and thus, close access to international credit.

What the Asian, Russian and Brazilian crises have had in common is that—despite the fact that they responded to partially different reasons—
they were generated and aggravated by persistent macro-economic inconsistencies, due to persistency of unsustainable structural deficits and significant external debt, mostly too short term, or any other similar deficit-financing mechanisms, without substantial corrections of the reasons generating them. It is essential that macro-economic policies of countries lead to sustainable values in terms of deficit, debt and product growth.

II. FINANCIAL LIBERALISATION. REFLECTIONS

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BA. MACROECONOMIC COORDINATION IN REGIONAL INTEGRATION

The need for consistent macro-economic policies is increased within the
framework of a regional integration process. In fact, a comparison of
experiences and of MERCOSUR itself reveals that macro-economic
coordination represents an unavoidable foundation to consolidate
integration agreements. In the case of this region, the situation over the
last few years reveals once again that the lack of close coordination among
the governments of the Parties in the definition and implementation of the
macro-economic variables that simultaneously affect each and every one of
them, is what has underlain all the difficulties that have been threatening
the continuity of MERCOSUR since 2000.567

Relevant monetary, currency, and inflation policies; the situation and
evolution of the balance of payments, and of balance of trade; close follow-
up of these and other relevant variables in the respective economies, are
some of the aspects affecting each the countries simultaneously. For this
reason, all stages of macro-economic policy implementation—from initial
definition to the necessary and permanent follow-up process to monitor

567 Id.
their evolution on a daily basis—require coordinated thought on the part of all governments in the countries undergoing integration processes.

The more the progress observed in the liberalisation of the flow of trade and services due to the implementation of the integration Agreement, the more the repercussion on the rest of the Party States of mal adjustments—at the level of each of the main economic variables—in any of the member countries. We can demonstrate the truth of this statement—even in the early stages of the opening-up process in MERCOSUR—by observing the adjustments that the radical change of the Brazilian foreign exchange criteria gave rise to and will still require, that led to an unforeseeable and unaligned fluctuation in the relative prices of goods and services at the level of the other MERCOSUR partners.\(^{568}\)

An essential element in the improvement of coordination to is to intensify the flow and quality of information that countries exchange, relative to both the public and private sectors. In addition, information transparency must be enhanced. For example, information in terms of international reserves, foreign debt—especially, short-term foreign debt—and capital flows from each one of the countries. This information together with its follow-up, will enable a more precise assessment of the situation and risks facing each of these countries and the region to be made. Enhanced-quality information will in turn, influence the adoption of more accurate and appropriate economic measures, as it facilitates analysis and discussion on the part of the other partner countries.

CB. POLITICAL COMMITMENTS IN THE IMPLEMENTATION OF COORDINATED MACRO-ECONOMIC POLICIES

The prevention of distortions in the macro-economic policies of the region calls for an intensification of coordination on the part of countries and for a high level of reciprocal, political commitment. Each one of the governments is responsible not only for the sound development of the variables in its own country but also for ensuring that their own policies are not obstacles in the development of economies in the other member countries of the integration agreement. From the very outset of MERCOSUR, this commitment was taken up by the four Party States—basically in an implicit and consensual way—in the understanding that none

\(^{568}\) *Id.*
of the signatory parties of the Asuncion Treaty would fail to comply.

However, over the last couple of years there has been enough evidence on the shortcomings of this commitment, which has not been complied with on more than one occasion since 1999. This leads us to confirm that the new integration stages within the scope of MERCOSUR will call for more formal and intense mechanisms to keep macro-economic coordination commitments among the countries. Any breach in coordination rules should involve pertinent and detrimental consequences for the offender.

The initial steps in that direction are first suggested in Decision Number 6/99 of the Common Market Council that calls for the creation of a Top Level Working Group in the sphere of the Meeting of Ministers of Economy and Presidents of Central Banks with the objective of coordinating macro-economic policies in the Member States. The fields covered are inter-temporal sustainability of the countries' public and external accounts; the alternatives for macro-economic coordination and a working program proposal to that end; the harmonisation of statistical macro-economic and financial information and the intensification of information relative to methodological criteria used by each State to prepare their respective economic indicators. Likewise, Decision Number 30/00 of the Common Market Council entrusts Ministers of Economy and Presidents of Central Banks with the preparation of harmonised statistic based on a common methodology in macro-economic and financial services areas. Harmonisation will start with the information included in the Nominal Fiscal Results and Primary Fiscal Government Result, the Governmental Net Debt and that of the Consolidated Public Sector and the level of prices. Indicators relative to fiscal aspects must be published as from September 2000. Harmonised statistics were first published on October 21, 2001.

This process must be expedited and deepened for the sake of regional economic wellbeing as well as for MERCOSUR's integration perspectives. Clear commitments must be made regarding macroeconomic variables and their convergence. Non-compliance with those commitments should cause diplomatic and/or economic penalties to the offender, which should be established according to their severity.

569 Id.
CD. CLEAR POLICIES IN BANK INTEGRATION

To date, MERCOSUR and its Party States have not addressed financial liberalisation in depth. Apart from the mechanism implemented so far—the preparation of lists of offers and commitments for service liberalisation—, the fact that from the time of the subscription of the Montevideo Protocol up until now, no progress has been made in the incorporation of financial services to such lists is remarkable. Moreover, restrictions and limitations to liberalisation expressed by the countries when the initial list of commitments was prepared in the framework of the Montevideo protocol have not been altered. Let us recall that that first list simply gathered the commitments that each country already presented as a list to the WTO, with no additional considerations, even in cases where they could have been feasible without having to introduce changes at the level of national legislation (at present, as from 2001, the work of the Services Group includes the detection and incorporation to the lists of the country’s commitments, non-restricted areas in terms of internal regulations and, despite this, not included in the specific commitments). We must also bear in mind that such lists of offers and commitments were created and presented under those conditions despite the fact that the information relative to the existing spaces for greater openings and liberalisations was then available, as a result of the work conducted by Sub-group.571

The lack of political will to start with the necessary liberalisation to harmonise and integrate financial sectors is reaffirmed by other means with the Brazilian decision expressed at the level of Sub-group IV and included in their Minutes 1/95 of Oct. 20, 1995, that postpones until the year 2000 consideration of attempting to harmonize in any aspect related to derogation of restrictions to access and invest in the financial sector, by companies from a MERCOSUR country in any of the other Party States.572

This situation clearly reflects the lack of commitment to move forward in financial integration and to reduce and finally eliminate restrictions to competition that are still present in some countries.573

At this point, it is relevant to stress that the opening up on the range of activities granted to bank institutions and investing regime, which took

570 Id.
571 See supra, Chapter V, Section II, Subsection D.3.
572 CMC Decision No. 9 of Dec 6, 1995.
573 See supra, Chapter V Section I, Subsection C.
place in the MERCOSUR countries during the 90's, was not a consequence of the Agreement. It was due to national policies of some of the Party States following international trends.

On the other hand, it is natural that at present, as the whole region and its Party States are immersed in macro-economic crises, it is neither timely nor advisable to address a financial liberalisation agenda. The macro-economic instability that conspires against commercial integration has a stronger negative incidence in the case of financial integration due to the possible systemic and contagious repercussions in the financial systems of each country. Only when the region reaches stability will it be able to reconsider its agenda and aim at a financial opening and integration within MERCOSUR.

In due course this process should undoubtedly, be approached carefully and gradually in order to avoid excesses in deregulations with prudential implications or with strong lack of protection of the weaker segments in the financial systems of each country. These elements, according to evidence, have neither been analysed nor coordinated.

**DE. OPPORTUNITIES FOR LIBERALISATION IN BANKING ACTIVITY**

An analysis of the financial system regulations in the countries of MERCOSUR reveals that there is still plenty of room to liberalise such services, increasing competition. This declaration is especially valid in an integration context as many of the restrictions that we have referred to have a particular impact on the supply of financial services that can be developed in any MERCOSUR country and in the foreign investment (from companies in other Party States) in each one of them.

The Member countries, in general, over the last decade— and consistently as is the trend observed in the rest of Latin America—, have expanded their range of activities granted to banking institutions, and have admitted in one way or another foreign investment in the sector. All this has been done regardless of the fact that, simultaneously, they have imposed stricter prudential rules to the whole of their banking system. As pointed out previously, the opening up in banking regulation and investing regime was not due to the Agreement. It was part of national policies of some of the Party States following international trends. On the contrary,

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574 See supra, Chapter I, Section II, Subsection A.
many aspects of the modifications and strengthening of prudential rules imposed in each of the Party States were due to a coordinated policy decided at MERCOSUR level.\textsuperscript{575}

Nevertheless, if we compare these advances with the general international trend we may conclude that there is still ample room for opening up in the banking industry. In addition, the levels of liberalisation admitted by each one of the Party States are diverse. This may potentially have repercussions in the sense of creating uneven conditions for competition in the sector. For example, in terms of the banking activity, the MERCOSUR countries, in general, do not admit universal banks, meaning that banking institutions cannot normally provide all the range of financial services, operate as securities agents, or render any other services related to the capital market. Neither can they perform activities related to insurance. On the other hand, there is some margin to make the investment scheme of banking institutions more flexible, enabling them to invest in the capital market sector and in non-financial institutions, allowing for the establishment of financial and insurance clusters, and by more freely accepting foreign investment in the sector.

Another parallel phenomenon is observed in the sense that there are also areas where liberalisation might be possible—as there are no regulatory obstacles preventing this—but, nevertheless, countries neither offer nor commit greater openings in the framework of negotiations of the Montevideo Protocol and the Financial Services Annex. For example, this is perceived in the areas of trans-boundary supply and foreign consumption of insurance and banking services, where none of the countries has consolidated their offers. Another example can be the horizontal commitments of Brazil, applicable to insurance and banking services, relative to foreign investment or to the limitation in the employment of foreign staff that exceed the existing constitutional and legal restrictions.\textsuperscript{576}

The above observations do not mean that countries should attempt the maximum level of opening that is possible in their financial services to achieve integration. However, they will duly require a common approach strategy, to move ahead with caution—but not indiscriminately—to attain liberalisation stages that are in themselves balanced in order to avoid competitive distortions among the integrated countries. This

\textsuperscript{575} See supra, Chapter V, Section I, Subsection B.

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harmonisation is essential so that, when the access of financial institutions to other MERCOSUR countries—that are not the country of origin—starts to be liberalised, the institutions' trend to establish themselves or to provide financial services from one country and not from others—caused by a difference in the schemes related to activities and investment allowed in the banking sector—can be avoided.

For example, Paraguay today is the only MERCOSUR country that completely and clearly allows universal banks. In full integration contexts where the rest of the countries do not admit this broad activity to their financial systems, we would probably observe that all banks in the region would settle in Paraguay in order to take advantage of greater business opportunities that the universal activity grants them. Additionally, from the Paraguayan subsidiary or branch they could offer such services to their customers throughout the region. Likewise, if Brazil maintains its present restrictive foreign investment scheme in the banking sector, in an integration context we would observe that international and regional banks would settle in any other MERCOSUR country to provide all banking services to their Brazilian customers through that branch and to request their being acknowledged as an institution installed within MERCOSUR to provide services to the Federative Republic of Brazil.

Along this road to liberalisation, and in order to mitigate the impact of the opening up and increased competition, it may be temporarily necessary for some of the Governments to protect certain key areas in banking services. For example, it may be temporarily wise not to dismantle the totality of benefits or protection to sectors such as the local banking or to certain institutions that have social objectives. These partial policies reduce the more potentially negative impacts of integration and can be appropriate instruments for the gradual opening of the markets.

The greater competition, resulting from the opening and a certain level of deregulation, may cause a trend to banking concentration and consolidation, at least in the short run, as part of the possible strategies of the financial institutions to reduce the effects of the growing presence of new competitors. In any case, facilitating market access that adds to the general phenomena of globalisation and internationalisation can alleviate the trend to concentration. On the other hand, a certain consolidation of

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556 See supra, Chapter V, Section I, Subsection D.

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the banking sector may constitute an institutional strengthening factor, a very necessary factor to preserve the solvency of the system in a more competitive and deregulated environment.

EF. LIBERALISATION MECHANISMS

Another aspect to be considered involves the instruments specifically used to integrate MERCOSUR financial sectors as it clearly conveys the influence and solutions of the GATS Agreement of the World Trade Organisation. In the light of results attained, this strategy so far has not been able to meet the expectations of its supporters.

As previously expressed, the approach and concrete solutions to integrate services as set out in the Montevideo Protocol are very similar to those of the General Agreement on Trade and Services of the WTO, with the exception that in the former the most-favoured nation clause has no limitations, while it does have limitations in the WTO Agreement. This analogy is once again observed in the Annex to Financial Services in the Montevideo Protocol, which includes the solutions of Annex to Financial Services of the General Agreement on Trade and Services of the WTO. Moreover: Decision Number 36/00 of the Common Market Council adopts the GATS services classification of the World Trade Organisation to classify services within the scope of MERCOSUR.

In short, the instrument used by MERCOSUR to approach liberalisation of trade in services has been that of a trade agreement with the aim, as is the case of the Agreement on Trade and Services of the WTO, of creating a Free Trade Area. This is a very different approach from the one used by the European Union towards the creation of a Common Market. We have explained at length the reasons why the MERCOSUR Member countries have adopted this approach instead of favouring solutions more similar to those adopted by the European Union.

Another element adding to the complexity of the mechanism under study lies in the fact that the liberalisation resulting from the preparation of banking service lists with a high degree of desegregation makes the opening and the negotiation of offers and commitments therein included very fragmented and complex. It is very difficult to compare offers by

577 Id.
analysing their equivalences.578

On the other hand, a different and necessary approach to the study of the process towards financial integration can be obtained by comparing the existing regulatory restrictions in the national schemes to the commitments and offers in each country within the framework of the Montevideo Protocol at the different negotiation rounds conducted by the Services Group. Since the signing of the Montevideo Protocol, the approach to the negotiation for the opening of services was the definition of the areas of service where each country prepared at a later stage, individually and freely, its own list of offers and commitments. Moreover, this led each country to propose offers and commitments at the MERCOSUR, analogous to those that it had previously presented at the WTO. This situation remains unchanged at present and in spite of the fact that there are areas where liberalisation would be possible—there being no regulatory obstacles to prevent it—the countries, notwithstanding, neither offer nor promise a greater opening within the framework of the Montevideo Protocol and the Annex to Financial Services. An example of this is perceived in the area of trans-boundary supply and foreign consumption of banking and insurance services, where none of the countries has consolidated its offer.579

Another aspect to be stressed up, linked to the latter, is the need to deepen and systematise the coordination between the MERCOSUR bodies in charge of the harmonisation process (Sub Group IV) and the liberalisation negotiations (Services Group). Better coordination would give the Services Group necessary tools—up to date information—to put adequate pressure on the representatives of the Member countries to improve their offers and deepen their commitments during the liberalisation negotiations.

Therefore, in view of the points raised, and the evolution that bank integration has achieved over the years, it may be said that it would be advisable to rethink whether this strategy is in fact the best one to address and implement the afore-mentioned integration process. We would suggest at least inverting the concept of the lists of offers and commitments and instead gradually liberalise the universe of services—in a similar way to goods liberalisation—with the exceptions stated by each country in the list corresponding to the nature of service involved.

578 Id.
In terms of prudential rules, the MERCOSUR countries have made efforts—even today—to harmonise and approach solutions. In addition, that coordination has been oriented towards increasing the requirements by adapting to, and in some cases exceeding, international recommendations.

Improvements in this area are notorious. Even so, the latest survey, conducted in 2000, reveals the persistence of some exceptions in compliance with the Recommendations of the Basle Committee in terms of capital components and their asset—risk weighting.580

The policy adopted at MERCOSUR level to strengthen prudential rules in each Member Country does not mean all difficulties and asymmetries have been solved. For example, all MERCOSUR countries maintain minimal net worth requisites during the operation of the financial institutions, whose amounts are calculated, in general, following the recommendations of the Basle Committee (relation between the capital or computable net worth items and risk-weighted assets). However, the content of such demand is diverse and its comparative analysis is difficult. Also, if we compare the application of the recommendations of the Basle Committee in the four countries, we can observe that even when all of them apply the recommendations, capital composition is not equal and asset weighting varies from country to country.581 Thus, Argentina requires a minimal proportion whose range depends on the goods under consideration, from 8 11. 5% and 150% capital in terms of the assets weighted by risk. Brazil, Uruguay and Paraguay require 10%, though the latter's Central Bank is entitled to increase that minimal proportion up to 12%. Furthermore, the differentiation between basic and supplementary capital (Tier 1 and 2 of the Basel Committee), is not present in the Paraguayan standards.582 Additionally, in the rest of MERCOSUR countries the items admitted in one or the other and their consideration, maintain certain differences. For instance, when computing inflation, when revaluating goods, in the admission and treatment of subordinate

579 Id.
580 See supra, Chapter V, Section I, Subsection C.
581 Id.
debt, etc. Differences are also noticeable in the way each country weights its assets against risk, to apply the requirements of capital on this. This leads us to consider whether in order to strengthen national financial systems and their integration potential, some of the remaining asymmetries become significant. So far, we can attest that beyond some difficulties when interpreting or comparing the requirements in each country, it is essential that all of them regulate and implement the Basle recommendations in full, in relation to the composition of capital and its amount, by weighting it in terms of the different risks the institution may have to face. As we have experienced over the recent crises, during those periods the application of prudential requisites and standards is at least partially suspended, and forbearances are allowed. That is one of the reasons it is important to set said prudential requirements at least at the same degree of exigencies as recommended by international standards or even at stringer ones.

Precisely, in view of a liberalisation and deregulation context—so characteristic of integration—it is even more necessary/inevitable than in others scenarios to set stringent requirements to preserve and to strengthen the soundness of banking systems for the sake of financial stability. In said context, there is ample possibility of banking system crises arising in one of the countries to spread to other or to the rest of the integrating countries. This contagion possibility has to be avoided or at least mitigated. No models exist that may be transplanted in terms of prudential regulations. Similarly, control must respond to the new and more deregulated framework and this requires training and experience, implying a certain amount of application time.

The special importance of domestic financial systems, which is intensified in a potential integration context, lies in its close impact on the macro-economic variables and in the ease with which the difficulties of this sector can be transmitted to the other countries of the region, and even to the rest of the world, through payment systems, and inter-banking credits and deposits.

Thus, it is necessary to balance the opening of the banking sector and the preservation of its soundness. There are no recipes to accomplish this. There are institutional factors, aspects related to pre-existing regulations

583 Id.
and even elements relative to the circumstantial situation of the banking sectors, that have a direct influence on the rhythm and degree of liberalisation and, therefore, on the subsequent cautionary adjustments.

Whereas deregulation can generate a certain idle capacity in the banking sector, this can be a transitory factor of financial fragility. The new context for greater openness, that enables new types of business and opportunities to financial stakeholders, simultaneously requires new rules that are clear and intense, which adjust the focus and objective of the standards to the new reality of the sector and the mobility of operators. It is necessary to give support to the development of a banking sector that is adequately capitalized, has good liquidity and management and that can correctly balance risk and profitability. This, in turn, also implies fluid and transparent information and a correct regulation and prudential control. This requires training and adjustments in control and regulations that help keep pace with economic agents. It also implies more emphasis on, for example, internal banking management systems, risk management, internal control, stronger implementation of international standards in terms of accounting, auditing, etc. It is important to develop sound commercial practices and, simultaneously, facilitate the differentiation between debtors, even before international credit markets which - as investors and lending institutions - will look closely at all improvements and modifications that may be introduced in this group of emerging countries. All of this should be done without completely drowning the benefits sought by liberalizing the banking sector — this may easily happen if the opening is either very sudden or excessive.

IV. GENERAL MERCOSUR STRATEGIES IN FINANCIAL AREAS

A. LOCATION

In the scope of negotiations related to trade liberalisation agreements, MERCOSUR as a political factor, could become very relevant if it established strategies oriented to strengthen and develop its activity sectors. Our comments will focus on the use of the political capacity of MERCOSUR in the stable and solid growth of banking institutions and
activities throughout the region. On the other hand and at the same time, the joint negotiation policy of such negotiations, with developed countries as counterparts, will benefit and help the implementation of MERCOSUR integration process. Negotiations with developed countries will make it an imposition and an obligation for MERCOSUR to preserve consistent parameters that adjust to the policies and macro-economic coordination and, in addition, to be consistent in setting tariffs, as an essential requisite to advance them successfully.

In this regard, and as a means to approach a feasible strategy, we must bear in mind that the trend of international organisations vis-à-vis the liberalisation of financial markets and the simultaneous strengthening of prudential standards will maintain its influence in the whole of Latin America and, within this hemisphere, in the MERCOSUR countries. Let us recall that, even when reforms introduced in the MERCOSUR countries in the nineties expanded the activities permitted to the banking institutions and made pre-existing restrictions for foreign investment in the sector more flexible, there are still significant margins for a possible liberalisation. Stricter prudential rules and standards must necessarily be implemented to accompany the liberalisation process, as was the case in the 90's.

On the other hand, in order to prepare a strategy to negotiate new trade agreements, especially those relative to accessing markets to supply financial services, some elements relative to the banking sector should be borne in mind:

In order to compete successfully in the context of global financial markets (electronic banking, merged capital markets) considerable investment must be made in technological development.

Competition in the globalise financial sector implies that smaller institutions will not be able to survive due to their more limited range of supply of services and proportionally higher fixed costs when compared to larger enterprises. Customers, even investors and consumers, will be attracted to lower prices in services rendered, easier access (via home computer or at the supermarket) to any financial service they want, that will be offered mostly by the largest institutions.

Some local Latin American financial institutions, mainly Chilean and
Brazilian ones, have started to develop strategies and to invest in order to position themselves in this new context. They are incorporating cutting-edge technology, they are undergoing reengineering, and they are acquiring smaller financial institutions both in their countries of origin as well as in third party countries. Their core assets are the know-how they develop, based on the best technology and their management models that enable them to offer a wide range of financial services in any market globally.

The MERCOSUR countries, with the exception of Brazil, so far have made their schemes more flexible to admit foreign investment unilaterally in the banking sector and this has not granted them returns in terms of accessing other markets. In addition, this could imply a specific difficulty to local financial clusters that might require the support of joint governmental policies to overcome the barriers that block their access to other countries when trying to render financial services. A similar analysis may be conducted in terms of the possibility of encouraging and strengthening regional financial clusters. The latter, on the other hand, may become a useful tool to mitigate the trend of financial concentration in the largest multinationals that have recently generated uncertainty as to the soundness of their policies when countries and regions where they have established get into critical situations.

B. CONTEXT AND STRATEGIES

MERCOSUR should focus their external negotiations in an attempt to neutralize or mitigate the trend to direct liberalisation spurred by international organisations and by the majority of countries in the developed world by granting the financial institutions of its Member States at least gradual concessions to allow their access–restricted today–to provide financial services in foreign markets.584

These aspects are essential so that MERCOSUR Party States may obtain greater benefits in such negotiations and the latter do not result in mere openings of economies to the trade flows coming from third countries. This bears special significance in the light of the potential growth of the banking sector in the MERCOSUR countries. The direction that negotiations take in the international arena, may define how and who will be able to develop this potential for expansion.

584 Id.
The General Agreement on Trade and Services of the World Trade Organisation and the Basle Committee are and will be factors of great influence on the banking regulations of MERCOSUR countries, and on Latin America in general. The first emphasizes liberalisation and the second the strengthening of prudential standards in the banking sector. Recently, recommendations of the World Bank, the International Monetary Fund and the Inter-American Development Bank have been contributing to both trends—greater opening and increased prudential requirements in the financial activity.

The four MERCOSUR countries have signed the General Agreement on Trade and Services of the World Trade Organisation that promotes competition in the financial sectors by avoiding anti-competitive practices in those institutions and a greater efficiency in the allocation of resources and services of the financial industry. These concepts are being implemented in different ways by each country: Argentina first and in greater depth and, recently, Brazil has privatised several federal banks. In addition, they have dismantled pre-existing monopolies in the banking activity. This has all been done without designing or foreseeing a common strategy in the framework of the World Trade Organisation. This should be corrected. Furthermore, the United States of America and some other countries such as the United Kingdom or Germany have been negotiating directly with some of the countries, mainly with Brazil and Argentina, to open financial markets. In the context of these bilateral negotiations, it is easy for any of the developed countries to preclude the access of MERCOSUR entities to their own market. For example, stating the exception to prudential standards accepted by the General Agreement on Trade and Services of the GATS. This circumstance would hardly take place during a joint negotiation by the block, due to the greater power of the group.

In terms of fundamental aspects, the MERCOSUR countries benefited from the adjustments they introduced to their financial systems between 1980 and the late 90's. Privatisation, mergers, readjustments and banking modernization have produced positive effects. This has contributed, for example, to mitigate the expansion of the macro-economic effects of the Asian and Brazilian crises that did not lead to banking crises in the region.

985 Id.
On the other hand, the lack of common strategies at the level of MERCOSUR, vis-à-vis an opening in foreign investment in the banking sector, may have a negative influence in the development of local financial institutions. These institutions may require consistent governmental policies to overcome the barriers that prevent foreign institutions from operating in some countries. It would be recommendable to help local institutions to face the growing trend towards concentration around international financial conglomerates. It is true that the latter contribute investment, business expertise, technology and innovation. However, excessive concentration may lead—in case of a crisis of one or any of these international institutions—to dramatic consequences at global level, especially in countries where their presence is more relevant. It may also contribute to make capital flows to be more volatile and, in consequence, may cause restrictions in domestic credit, insofar multinational financial institutions move their resources from one region to another extremely quickly, following decisions of their headquarters in response to changing circumstances and better business opportunities. Accordingly, we must point out and bear in mind that the new Basle capital rules—that will come into force in a couple of years—will probably bring about a reduction of investment on the part of international banks or financial conglomerates in the region. Therefore, the generation of strategies to strengthen and develop negotiation opportunities for regional entities—even including clusters—may represent an efficient way to really preserve competition in the local markets, avoiding—or at least, mitigating—an excessive concentration of financial oligopolies and, simultaneously, diminishing the risks of a potentially greater volatility of capital flows or of a potential crisis at the level of any financial institution operating in a highly concentrated market.
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PARAGUAY591

590 Laws, Decrees, Decree-laws available at www.planalto.gov.br or www.senado.gov.br; Central Bank and CMV Regulations and others available at http://www.bacen.gov.br/LEGISLACAO.

591 Issued by the Central Bank of Brazil (Executive Secretariat, Secre/Sucon), it is composed of twelve volumes, this publication contains the norms that govern the national financial system, its constitution, inspection and monitoring activities.
Banking regulation:
- Law No. 861 of July 12, 1996.
- Decree No. 18, of 1952.
- Law-Decree No. 18 of Mar. 25, 1952 which creates the Central Bank of Paraguay.

Capital markets:

Insurance:
- Insurance and Reinsurance Law No. 827 of Feb. 12, 1996.

URUGUAY

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Law No. 16,327 of Nov 11, 1992, which reforms the last.

Capital markets:
Law No. 16,749 of May 30, 1996.
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