Functions of the Central Bank of Brazil

Information up to October 2016

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BANCO CENTRAL DO BRASIL

Frequently Asked Questions Series

“Frequently Asked Questions” Series

Central Bank of Brazil

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Central Bank of Brazil Functions[1]

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General view

1. What is a central bank?

A central bank is the institution of a country which has been entrusted the task of regulating the volume of money and credit in the economy[2]. This assignment of central banks is usually associated with the goal of ensuring the stability of the purchasing power of the domestic currency. In addition, most central banks also have the task of promoting the efficiency and development of the financial system of a country.

2. What are the typical functions of a central bank?

A Central bank generally performs the following functions:

- monopoly of notes issuance;
- government's banker;
- bankers' bank;
- supervisor of the financial system;
- executor of the monetary policy; e
- executor of the exchange rate policy and holder of international reserves.

3. When did the first central banks emerge?

The central bank as an institution was setup relatively recently, having emerged in most industrialized countries in the late nineteenth century or the first half of the twentieth century. The origins of the first central banks, however, are more remote. Its development was gradual, as a response to the instability of the incipient European financial systems of the sixteenth,

[2] Source: Bank for International Settlements (BIS).

seventeenth and eighteenth centuries. In various European countries, the execution of some banking functions – basically the right of cash issuance - was concentrated over time in private institutions, which, in fact, began to take shape as central banks. These institutions were consolidated with the absorption of the functions of government's banker, depository of the reserves of other banks and lender of last resort to financial institutions (banker's bank).

The first state banks heard of were the Bank of Amsterdam, founded in 1609 by individuals, but with the guarantee of that municipality, and the Riksbank, founded in Sweden in 1656, which was characterized by functions of commercial nature. But it is the evolution of the Bank of England, founded in 1694, initially as a private institution, which enables us to perceive the process of formation of modern central banks, since it was the first institution to group more clearly the functions of a central bank.

4. How and when did the *Banco Central do Brasil* (BCB) was created?

The *Banco Central do Brasil* (BCB), federal authority and member of the National Financial System, was established in December 1964, with the promulgation of the Law No. 4,595. The Federal Constitution of 1988 established important guidelines for the operation of the BCB, such as the exclusive competence of the Union to issue currency and the requirement of prior approval by the Senate, in a secret ballot, after public hearing, for the governor and deputy governors of the institution, which are appointed by the President of Brazil.

The 1988 Constitution also envisages, in the article 192, the elaboration of the Complementary Law of the National Financial System, which will replace the Law 4,595/1964 and redefine the functions and structure of the BCB.

Click here to know more on BCB's history.

5. Before the creation of the BCB, which institutions were responsible for the typical functions of the central bank?

Before the creation of the BCB, the typical functions of monetary authority, since 1945, were performed jointly by the Superintendency of Money and Credit (Sumoc), by the Banco do Brasil (BB) and by the National Treasury.

The National Treasury was the issuing agency of paper currency. Sumoc was created with the purpose to exercise monetary control and prepare the organization of a central bank, having the responsibility of fixing the percentage of reserve requirements of commercial banks, the rediscount rates and the financial liquidity assistance and interest on bank deposits. In addition, it oversaw the activities of commercial banks, guided the foreign exchange policy and represented the country at international bodies.

BB, in turn, performed the functions of government's banker and of banker's bank, through the control of foreign trade operations, the receipt of compulsory and voluntary deposits of commercial banks and the foreign exchange operations conducted on behalf of public companies and the National Treasury, in accordance with the norms established by Sumoc and by the Bank of Agricultural, Commercial and Industrial Credit. Until 1986, the so called "movement" account was maintained. The account, created in 1965, guaranteed the transfer of resources from the BCB to the BB.

6. When did the monetary authority functions start to be implemented exclusively by the BCB?

Since the enactment of the Law 4,595/1964, the execution of the role of "banker's bank" by the BCB was supported by additional legal instruments. In addition, the BCB enjoys the monopoly of issuance, in compliance with the article 164 of the Constitution of the Federative Republic of Brazil, and the Law No. 4,595, which established the exclusive competence of the BCB to issue paper money and coins and to run the money supply services, the supervision of the National Financial System (SFN) and the execution of the monetary and exchange rate policies. The above mentioned Law, however, did not set clear boundaries separating the relationship between the BCB, BB and the Treasury, which hampered the performance of BCB in the conduct of monetary policy, as the monetary authority was even responsible for fiscal budget accounts, such as those related to debt.

In 1965, the "movement" account of BB started to be operated, recording the transactions carried out by the state-owned commercial bank as financial agent of BCB. This account started to be gradually used as source of automatic supply of funds to BB, enabling thus the realization of the official credit policy and other Federal Government operations, without prior provisioning of resources.

In 1985, with the objective of defining clearer lines of responsibility in the performance of the BCB, the separation of the accounts and functions of BCB, BB and National Treasury was implemented. In 1986 the "movement" account, which marked the relationship between BB and BCB, was extinguished, and the transfer of resources from BCB to BB became clearly identified in the budgets of the two institutions. Thus, the automatic supplies that hampered the monetary control by the BCB and contributed to the acceleration of inflation at the time were eliminated.

The financial government reordering process lasted until 1988 when the monetary authority functions were progressively transferred from the BB to the BCB, while atypical activities carried out by the latter, such as those related to the promotion and administration of federal debt, were transferred to the National Treasury.

Another major step in the definition of the exclusive performance of BCB as monetary authority was established by the 1988 Federal Constitution, which prohibited the BCB to grant loans directly or indirectly to the National Treasury. Subsequently, Article 34 of the Fiscal Responsibility Law (Complementary Law. 101/2000) prevented the issuance of government bonds by the BCB for monetary policy purposes, as of May 2002, further enhancing the separation between fiscal authority and monetary authority[3].

7. What is the relevance of the BCB performance for the Brazilian economy growth?

BCB's mission is to ensure the stability of the currency's purchasing power and a solid and efficient financial system. In the performance of its various functions, the BCB, for its autonomous work, for the quality of its products and services and for the skill of its employees, is an institution essential to the economic and financial stability, to the sustainable development and to a better income distribution in Brazil.

Monopoly of Note Issue Function

8. Who prints money in Brazil? What is the BCB role on this process?

The Brazil's Mint (CMB), which is a state-owned company, manufactures, with exclusivity, Brazilian money since 1969, as defined by law. The supply of banknotes and coins is ordered by the BCB to the CMB, as stipulated by a contract signed by both institutions.

When new banknotes, coins and commemorative coins are introduced, the project is developed in conjunction with the CMB, taking into account issues arising from the requirements for the money circulation, costs, securities against counterfeiting actions and semantic values, i.e. the amount of information of cultural nature that money can convey. Thus, thematic lines are adopted to give identity to national banknotes and coins. The project is submitted to the Board of BCB and to the National Monetary Council (CMN), whom is responsible for the final approval. The definition of security elements, which endow the money of the special features that will distinguish it as such, takes into account the analysis of existing forgery and attempted forgery, in order to identify weaknesses and ways to overcome them. It also considers the guidance of institutions such as Interpol, other central banks and other banknotes producers.

It is up to the Currency Management Department (Mecir) of BCB, headquartered in Rio de Janeiro, the scheduling of orders for cash, whose stock should be maintained at a level sufficient to meet the demand for banknotes and coins, due to the growth of the money supply, the replacement of notes worn out by use and the rebuilding of security inventories.

9. How does the BCB implement the function "Monopoly of Note Issue"?

The monopoly of note issuance encompasses the currency management activities related to money supply and is intended to meet the demand for money essential to the country's

[3] There are no more securities issued by the BCB on the market. The last batch - NBC-E - expired on 11/16/2006.

economic and financial activity. From an operational standpoint, the BCB meets the needs of cash by the banking system, and hence by the public, through issuance and collection mechanisms.

It is important to note that only the BCB can issue money (CMB only manufactures the cash according to the BCB's guidelines). The economic concepts of issuance and monetary gathering refer, respectively, to the placement/removal of money in circulation, thus increasing/decreasing the means of payment.

The issuance occurs when the BCB delivers paper-money to the commercial bank while debiting its Bank Reserves account, in order to meet the withdrawal's needs of the customers in their respective current accounts[4]. Thus, the issuance of paper-money by the BCB reflects the public's demand for paper-money.

On the other hand, sometimes individuals and companies place their surplus of paper money in their current accounts, bringing to the banking system excess cash, in relation to the needs of withdrawals. Thus, in a movement similar to that of the public, the banks deposit their cash surplus at BCB, which, in turn, credits the corresponding value in the Bank Reserves account of the institution in question.

The execution of the money supply services consists of: response to demand for money, cash replacement and destruction of worn out cash, unserviceable for circulation, studies, research, development and approval of projects of new banknotes and coins in order to improve them and minimize the risk of forgery.

The provision of money supply services was amended by CMN in 2005[5]. From these date on, the custody of cash of the BCB can be performed by financial banking institutions or by associations of financial institutions constituted for this purpose.

The provision of custody services is held in the premises of the custodian institutions under their administrative and operational control, whereas the BCB supervises the custodian institutions in regard to the compliance with the standards and procedures, and the quality of the services provided. The BCB also sets the maximum compensation to be paid by financial institutions to the custodians, taking into consideration, inclusively, the scale of costs incurred in providing the services.

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[4] Question 11 defines Bank Reserves account and Settlement Account.

[5] Resolution 3,322, of October 27th, 2005, regulated by Circular 3,298, of January 19th, 2006.

Banker's Bank Function

10. How does the BCB act as the "Bankers' Bank"?

In this role, the BCB receives the deposits (reserves) of banks. It also acts as lender of last resort; and it rules, monitors and provides systems for the funds transfer and for the settlement of obligations.

In its relationship with the financial institutions, BCB provides services and performs operations such as to:

- maintain accounts for the deposit of the voluntary and compulsory reserves of the financial system (the Banking Reserve account and the Settlement Account);
- provide credit to institutions with temporary liquidity needs;
- intervene, in case of major problems, as the lender of last resort; and
- act as the overseer of the Brazilian Payments System and the operator of the Reserves Transfer System (STR)[6].

11. What are Bank Reserves Account and Settlement Account?

Bank Reserves is an account maintained in the BCB to receive cash in local currency from SFN participants for the settlement of transactions with the monetary authority or other SFN institutions. Such account must be held by commercial banks, universal banks with commercial banking activity and savings banks, and it is optional for investment banks, foreign exchange banks, development banks and universal banks without commercial banking activity.

The Settlement Account must be held by clearing houses that operate systems considered as systemically important, and it is optional for the other clearing houses and non-banking institutions authorized to function by the BCB. In the case of clearing houses, the Settlement Account is used for liquidating results of their respective settlement systems; for the financial transfer of guarantees and custody; and for the settlement of financial obligations with the BCB. In the case of non-banking institutions, the Settlement Account has similar features to the Bank Reserves account.

[6] The STR is a system for transferring funds with real time gross settlement (RTGS), operated by BCB, that works based on credit orders, i.e., only the owner of the account to be debited may issue the order for transferring funds. The system is mainly important for the settlement of interbank operations held in monetary, foreign exchange and capital markets, including settlement of net results coming from clearing and settlement systems operated by third parties.

Table 1– Accounts Structure at BCB

	Banking Reserves Account	Settlement Account
Mandatory	Commercial banks; Universal banks with commercial banking activity; and Saving banks	Clearing houses/providers of clearing and settlement services systemically important.
Optional	Development banks; Investment banks; Foreign exchange banks; and Universal banks without commercial banking activity.	Clearing houses/providers of clearing and settlement services systemically important; and Non-banking institutions authorized to operate by the BCB.

Source: BCB.

The National Treasury also participates in the STR and controls directly the National Treasury Operating Account held at the BCB.

Since the SPB restructuring in 2002, the Bank Reserves account and the Settlement Account have been monitored in real time by the Department of Banking Operations and Payments System (Deban), and they must not have any negative balance. This provision aims to prevent the BCB from incurring losses due to the resolution of a financial institution whose reserve account has a negative balance.

12. Which operations do affect the balances of Bank Reserves and Settlement accounts?

The following operations affect clearinghouses' Settlement Account balance:

- the settlement of the clearinghouse settlement results;
- the financial transfers directly related to the mechanisms and safeguards adopted by the clearinghouses' settlement systems or linked to custody events referring to the settlement of issuer's obligations;
- the settlement of financial obligations between the BCB and account's holders.

For the remaining cases, i.e. Bank Reserves accounts and Settlement Account not held by clearinghouses, the following operations, among others, affect the balances:

- the result of purchases, sales and redemptions of government securities held at the Special System for Settlement and Custody (Selic)[7];
- the result of the exchange of checks in the "Checks Clearinghouse" (Compe), executed by *Banco do Brasil*;

[7] Selic is a computerized system that is designed for the custody of book entry securities issued by the National Treasury, as well as for the registration and settlement of transactions with these securities.

- the rediscount operations, considering the operations contracting, settlement, conversion and recontracting;
- deposits in and withdrawals from the Corresponding to Electronic Currency (*Conta Correspondente a Moeda Eletrônica* - CCME) held in BCB by a payment institution with regards to the resources corresponding to the balances of electronic currencies held in payment accounts;
- the transfers between reserves' holders, on their own behalf or on behalf of customers;
- the results of operations with private securities, stock exchanges, futures exchanges, purchase and sale of foreign currency, among other assets, carried out in various clearing and settlement houses;
- the result, in Brazilian *Reais*, of purchase and sale transactions of foreign currency by domestic agents, at the BM&FBOVESPA Foreign Exchange Clearinghouse;
- payments and revenues made by the BCB, as the depositary of the National Treasury Operating Account, including taxes, Guarantee Fund for Length of Service/Unemployment (FGTS), National Institute for Social Security (INSS) and the Social Integration Program (PIS);
- withdrawals and deposits of physical currency at BCB and Banco do Brasil, which acts as BCB's custodian of cash, as well as the movement of cash between financial institutions; and
- reserve requirements, fines and other financial costs imposed by the BCB.

13. What are the Reserve Requirements established by the BCB? What are their objectives?

The BCB is authorized by Law 4,595/1964, with the wording of Law 7,730/1989, to establish reserve requirements up to 100% on demand deposits and up to 60% on other financial institutions' accounting entries.

Observing the maximum limits established, the BCB Board can alter the reserve requirements' rates at any time. Financial institutions may be required to comply with the new rates immediately (when the goal of the BCB is to impact these institutions immediately) or with a time lag.

Currently, in Brazil there are the following types of reserve requirements, which apply to the different types of financial institutions' liabilities:

- reserve requirements on demand deposits;
- reserve requirements on deposits and guarantees resources;
- reserve requirements on savings deposits;
- reserve requirements on time deposits;
- additional requirement on deposits.

The reserve requirements are monetary policy instruments aiming at:

- influencing the monetary multiplier, and thus controlling the monetary aggregates expansion. Every time a loan is contracted, a financial institution creates means of payment that, when used by the credit borrower, generates a deposit at another financial institution. This institution then has the ability to lend to another customer, and so on. The repetition of this process shows the ability of the banking sector to multiply the money supply. Through establishing reserve requirements, the BCB reduces this ability, requiring that certain portion of the resources remain deposited at the Monetary Authority;
- creating a foreseeable demand for banking reserves, assuring BCB more efficiency when acting at the monetary market. According to pre-established parameters, the financial institutions hold a certain amount deposited at the BCB for a determined period. At the end of each period, this amount is recalculated and there may be the need for an additional deposit or a withdrawal of part of the deposited amount. This dynamics influences demand and supply for banking reserves, making markets more predictable;
- building up a financial system's liquidity cushion. When facing restricted liquidity, the BCB may reduce the reserve requirements in order to release resources for the financial institutions, as it was the case in the aftermath of the 2008 crisis[8].

Besides reserve requirements, there are other types of compulsory deposits held at the BCB. These deposits stem from the total or partial non-compliance with additional requirements applicable to the allocation of resources raised by financial institutions, such as:

- insufficient allocation to real estate financing of resources funded through savings deposits;
- insufficient allocation to credit operations aimed at low income borrowers and microcredit of resources funded through demand deposits;
- insufficient allocation to rural credit of resources funded through demand deposits or rural savings.

Further information can be seen at FAQ 12 – Reserves Requirements

14. What are BCB rediscount operations to the financial institutions?

Rediscount is one of the monetary policy classical tools, a mechanism through which a central bank provides liquidity, on its basic role of lender of last resort, to financial institutions that, due to unforeseen unbalances on their daily operations, their business dynamics or even unexpected cash flow mismatches, may need financial resources to perform their normal activities. This function, stemming from a central bank typical role of bank of the banks, is known in Brazil as BCB Rediscount, and is vital for the Financial System, since it allows keeping resources flowing as needed for its regular functioning.

[8] See also question 7 (How were the Reserve Requirements used to deal with the effects, in Brazil, of the 2008 international crisis (the Subprime Crisis)?) at FAQ 12 – Reserves Requirements.

Access to rediscount window is restricted to the financial institutions that are Bank Reserves account holders. The operations, at the request of the financial institution concerned, are operated as purchases with resale agreement or rediscount itself. In the first case, the BCB provides funds against the delivery, by the borrower (financial institution), of public securities at the amount equivalent to the operation. At this moment, the borrower sets a commitment to repurchase these securities from the BCB at the original value and the interest rate agreed. In the rediscount, originally considered in the Law 4,595/1964, the financial institutions used to offer customers' securities discounted by them as collateral for liquidity loans the BCB used to lend to them (currently, there are no records of these operations).

Regardless of the case, the following assets can be used as collateral in the BCB Rediscount operations: federal government bonds, other securities, loans and receivables, preferably with collateral, and other assets.

The BCB acts as a lender of last resort through two basic mechanisms: the first, also known in the financial market as Standing Facility, encompasses short-term liquidity assistance operations: intraday and one-business-day. These operations are different from traditional liquidity loans, being rather a feature of the Brazilian Payments System designed to ensure the smooth flow of payments in the new context inaugurated by the 2002 reform, when financial institutions were not allowed to keep negative balances in the Bank Reserves account, which meant "uncovered" withdrawals against the BCB. According to the purpose and the terms of the transactions, they can be:

- **Intraday operations**: These are repo operations with federal government securities, designed to meet liquidity needs throughout the day. The institution that needs reserves and holds government securities in its custody account in the Selic may sell them to BCB with the commitment to repurchase them later on the same day, at the same value, until the closing of Reserves Transfer System (STR). They are operations without any financial cost to the contracting institution, processed through automated systems based on electronic messages of request and payment. Any institution with Bank Reserves account or Settlement Account may use intraday rediscount with no limits other than the securities available at the contracting institution's portfolio, provided they have enough collateral (securities) in their custody account. The rediscount regulation allows that the intraday operations pending settlement at the end of working hours of the STR be automatically converted into one-business-day operations at the penalty rate (Selic rate + 1% p.a.), having as collateral the same securities used for the original intraday credit;
- **One-business-day operations**: These operations are also repo operations performed with federal government securities at the penalty rate (Selic rate + 1 % p.a.), aimed at meeting liquidity needs arising from the mismatch of short-term cash flow of the financial institution.

The second mechanism, known as rediscount itself, is designed for specific situations of a particular institution, where a menace to the systemic liquidity or a possible contagious to the other financial system participants be not necessarily configured. These operations are discretionary in the sense that they rely on prior consent of BCB – the transactions are authorized by the Deputy Governor for Monetary Policy - and are also conditional upon the presentation, by the requesting institution, of a detailed projection of the daily cash flow, demonstrating the needs of funds intended for the period of operation. Concerning the tenors, this mechanism has two possibilities:

- **Up to fifteen business days**: These operations are repo or rediscount operations (when they involve securities previously discounted) and may be rehired within 45 business days. They rely on the prior signing of a contract, and are used in case of mismatch of short-term cash flow, as long as it is not characterized as a problem of structural imbalance. The cost of this kind of operation is Selic + 2% p.a.;
- **Up to ninety calendar days**: These operations are repo or rediscount operations (when they involve securities previously discounted) and may be rehired provided the total period does not exceed 180 calendar days, to enable equity adjustment of the financial institution with structural imbalance. These operations depend on the signature of a contract and prior approval by the BCB Board for the hiring as well as the rehiring. The requesting financial institution must submit the claim to Deban, with the proper justification, accompanied by the statement of projected cash needs for the period of operation and the restructuring program aimed at the capitalization or sale of the share control, signed by the controlling shareholder, to be implemented during the operation. The cost of this kind of operation is also Selic + 2% p.a.

The financial movement relating to rediscount operations is accounted for in the Bank Reserves account or Settlement Account. Note that as long as the financial system operates under stable conditions, the short-term operations are predominant. Currently there are no records of these modalities I and II of the second mechanism.

It is important to say that, with the 2008 crisis, it was exceptionally adopted a third mechanism for providing liquidity: the Rediscount for Special Situations[9], aimed at preserving general liquidity of the National Financial System. Due to its systemic bias, this frame allowed the BCB to use special criteria and conditions to evaluate and accept assets, besides setting aside, temporarily, some fiscal regularity constraints needed to hire with public sector. A maximum tenure of up to 359 business days was set for operations under this new kind of rediscount.

[9] Law 11,882/2008, the Resolution 3,622/2008, and Circular 3,409/2008.

15. What is the difference between the BCB performance as lender of last resort and as monetary policy agent?

There is a distinction between the actions of the BCB as monetary policy agent and the role of lender of last resort. When BCB implements monetary policy, the focus of BCB's activities is the control of the banking system's liquidity (monetary aggregates) in order to affect interest rate. When acting in the role of lender of last resort, BCB's focus is to solve liquidity problems of specific institutions. In the latter case, the market may be liquid and the institution be illiquid or insolvent, without access to funding in the money market and thus resorting to the BCB Rediscount window. The Monetary Authority in this case acts as lender of last resort. Nowadays the tuning of banking system's liquidity is not implemented with rediscount but with open market operations, which allow more flexibility in the implementation of monetary policy.

16. How does the administration of the Brazilian Payments System (SPB) by the BCB relate to the "Bankers' Bank" function?

The BCB should promote the soundness, the normal operation and the continuous improvement of the payment system[10]. The BCB is the responsible for regulating, authorizing and supervising institutions related to the processing and settling of funds transfers, foreign exchange, financial assets and securities operations, collectively known as financial market infrastructure (FMI). The systems that settle securities transactions also depend on the authorization of the Brazilian Securities and Exchange Commission (CVM), being under BCB's responsibility the analysis of aspects related to the control of systemic risk.

The payment system itself comprises a set of procedures, rules, instruments and embedded operating systems used to transfer funds from payer to payee, and thereby terminate an obligation, interconnecting the real sector of the economy, financial institutions and the BCB.

Additionally, the BCB is also provider of settlement services, operating the Reserves Transfer System (STR) and the Special System for Settlement and Custody (Selic), respectively a funds transfer system and a system for the settlement of public securities operations.

Access FAQ 7 - Brazilian Payments System to know more.

17. What are the main guidelines for the functioning of the clearing and settlement service providers?

The clearing and settlement service providers, as part of the Financial Market Infrastructures of the SPB (see Communiqué n. 29,078/2016), are regulated by the Resolution 2,882/2001 and must observe general rules, which the BCB may apply, considering specificity of each system:

[10] Resolution 2882, of August 20th, 2001 of the National Monetary Council (CMN).

- the participants must have access to clear and objective information, that allow them to identify risks in the systems they may use;
- rules and procedures shall allow and stimulate the management and contention of liquidity and credit risks, as well as clearly establish, for these objectives, the obligations of the clearing and settlement houses, services providers and participants;
- the unconditional and irrevocable settlement obligation in an account held at the BCB shall occur in the earliest moment on the agreed day;
- the delivery of the negotiated asset and the associated payment shall be mutually conditioned;
- the clearing and settlement service providers shall ensure, at least, in the case a participant defaults, the prompt settlement of obligations, in an amount equivalent to the highest cleared debt position through them, taken into account the issuer's risk;
- the operational infrastructure of the clearing and settlement service providers shall have adequate safety and reliability levels, having contingence and recovering plans enable the processing in the settlement cycle;
- the means and procedures for settling obligations shall satisfy users' needs and be economically efficient;
- access criteria to the systems shall be public, objective and clear, allowing a wide participation, thus restrictions focused at risk contention are admitted;
- the administrative and organizational structure of the clearing and settlement service providers shall be effective and transparent such as to allow the assessment of managers performance and to reflect participants interests.

18. What is the Special System for Settlement and Custody (Selic), and what is the BCB role in its operation?

The Special System for Settlement and Custody (Selic), of the BCB, is the central depository of securities issued by the National Treasury and the BCB and is responsible for processing the issuance, redemption, interest payments and custody of these securities. All securities are book-entry, i.e., issued exclusively in electronic form. The Selic and its complementary modules administration is the exclusive competence of the Open Market Operations Department (Demab) of the BCB.

In the scope of the new SPB, the Selic is interconnected to the STR, observing the modality of delivery against payment for the transactions settlement. Because it is a real-time gross settlement system, the settlement of transactions is subject to the availability of the traded security in the custody account of the seller, registered in the Selic, and to the availability of resources by the buyer in the Bank Reserves account in the STR.

The system is managed by the BCB and operated in partnership with the National Association of Open Market Institutions (Andima)[11]. In addition to the National Treasury and the BCB, the participants of the system, as holders of custody account, include commercial banks, multiple banks, investment banks, savings banks, brokers and distributors of securities, entities providers of clearing and settlement services, investment funds and several other institutions members of the National Financial System.

Under the new SPB (Brazilian Payments System), the Selic remained as central custodian of the federal government securities, but shares with the securities settlement systems the settlement of transactions involving these securities. For this task, the clearing houses keep custody accounts in the Selic, where the securities that will be traded in these environments are held.

More information about the Brazilian Payments System can be obtained in the FAQ 7 - Brazilian Payments System.

Government's Banker Function

19. What is the "Government's Banker" function?

The origins of this function have close relationship with the right of issuance, which was granted by governments to the central banks against the obligation to provide them with loans whenever necessary. The central bank currently continues as the principal banker to the government as it holds its most important accounts, actively participates in the management of its cash flow, and is the holder and the investment manager of the country's international reserves.

The concentration of much of the government banking operations in the central bank is critical for the close relationship that exists between public budgets, its cash funds and the capital markets. The government is the economic agent with the highest revenues and expenditures; consequently the financial transactions with these funds generate seasonal movements that can significantly change the volume of available bank deposits and credit. Under these conditions, the management of the treasury accounts by the central bank is essential to regulate the credit and monetary aggregates.

In the past, before the development of the government debt securities market, the adjustment of the availability of government resources to meet its payment commitments was given through the concession of short-term credit by the central bank as anticipation of future taxes revenues. Nowadays this adjustment is done via placement of securities by the treasuries. Another institutional advance was the ban on treasuries' fiscal deficits financing by central

[11] In October 2009, Andima joined the National Association of Investment Banks (Anbid), creating the National Association of Financial Market and Capital Entities (Anbima).

banks, given their deleterious effects on monetary control, price stability and equilibrium of the balance of payments.

As depositary and administrator of international assets in the country, the central bank must ensure that the structure of the currencies and maturities, as well as the balance between income, risk and uncertainty is compatible with the nature of these resources. The concentration of foreign currency at the central bank enables it to buy and sell currencies in order to reduce volatility and speculation in the exchange market. This is especially important in highly indebted countries, where the transactions linked to the amortization service of the external debt can bring unbalances to the foreign exchange market. Moreover, in many countries, central banks manage, on behalf of the government, trade agreements by payments netting and exchange stabilization funds.

20. How does the BCB implement the "Government's Banker" function?

The process of reorganizing the accounts which linked BCB's, BB's and National Treasury's operations began in 1986. This led to:

- the end of the "movement" account that connected the BCB and BB, and
- the budget unification of typically fiscal accounts, with the creation of the National Treasury Secretariat (STN) and the transfer to the treasury of part of the foreign debt deposited in the BCB.

The accounting separation of the BCB and the National Treasury aimed primarily at highlighting in a clear manner the institutional differences between the conduct of monetary and exchange rate policies and the implementation of fiscal policy.

The Federal Constitution of 1988 gave support to reforms initiated in 1986, prohibiting loans, direct or indirect, from the BCB to the National Treasury or to any entity other than a financial institution. Thus, the BCB can no longer be used for inflationary financing of budget deficits or for providing loans typical of development banks in the context of fostering specific economic activities (indirect loans). However, it can keep in its portfolio public securities for monetary policy purposes. Besides, the BCB has the constitutional function to receive deposits related to the cash resources of the Union.

According to the Fiscal Responsibility Law, the BCB can only buy securities issued directly by the Union to refinance the federal securities debt that is maturing in its portfolio[12]. The same law forbade the National Treasury to acquire federal government bonds from the BCB portfolio, including transactions with rollback clause, except to reduce public securities debt. The BCB is also prohibited to buy in the secondary market securities issued on the same day by the National Treasury.

[12] Complementary Law No. 101, of May 4, 2000, Article 39 (in Portuguese).

Since the approval of the law, the BCB cannot issue securities any longer[13], so that only National Treasury securities circulating in the market can be used for monetary policy purposes through the open market operations.

Given the importance of the relationship between the BCB and the National Treasury, and the impact of the government actions on monetary policy, the BCB monitors in detail:

- the Federal Government's budgetary execution;
- the finances of states and municipalities;
- the finances of the indirect administration of the three government spheres;
- all borrowings by the public sector in the financial system, and
- the Financing Needs of the Public Sector (PSBR)

Also as the government's banker, the BCB is responsible for acting on behalf of the National Treasury in auctions of federal government securities, for managing the international reserves, representing the country at international organizations and receiving the Union cash resources as per paragraph 3 of Article 164 of the Federal Constitution, the so-called "Operating Account" maintained by the National Treasury, in which any debts or credits of its transactions with the society in general are accounted (the balance of the "single" account is remunerated by the BCB according to the intrinsic yield of the BCB portfolio).

Financial System Supervisor Function

21. What is the function of "Financial System Supervisor"?

The stability, the efficiency and the development of the financial system require a set of norms, appropriate procedures and its observance. In many cases, the supervision of financial institutions is a direct and exclusive responsibility of the central bank; in other cases, it is assigned to independent institutions. However, in no event the supervision is totally exogenous to the central bank, which is responsible for developing norms for the functioning of the financial system, and besides, it is the lender of last resort.

The regulation of the financial system begins, usually, by limiting the number of participants. The restrictions, in this sense, range from requirements regarding the quality of administration, go through minimum amounts of capital and then to the application of criteria of "necessity" or economic "convenience", with which it intends to avoid an excessive number of institutions or excessive concentration.

In addition to the minimum capital requirement for market entry, banks may be required to maintain certain ratios between capital, assets and liabilities. The most advanced methodologies for defining the coefficients of solvency or capital adequacy incorporate the quality of the portfolio, i.e., they are not based only on global accounting magnitudes, but also recognize the

[13] Complementary Law No. 101, of May 4, 2000, Article 34 (in Portuguese).

risk differentials between different asset classes by weighting. Undoubtedly, the assessment of asset quality is one of the most complex and important tasks of supervision of the financial system.

Another aspect of the regulation refers to the required liquidity of institutions, which is determined by coefficients designed to ensure an appropriate matching between the term-structures of assets and liabilities. The correspondence between structures for currency is also vital as well. It has gained growing importance, as the internationalization of financial activity deepens.

The restriction on the type of activity in which financial institutions can get involved is part of the regulation in many countries. In some cases, the financial activity is segmented, with specialized institutions involved in certain activities, such as commercial and investment banks. In others, banks are prohibited or limited to perform any extra-banking activity and, also, to keep companies' shares in their assets. In contrast, some regulatory schemes do not set restrictions on the type of activity that institutions may develop.

Regarding the restriction of concentration in the portfolio, practically all countries impose limits, for example, as a proportion between the capital, assets and a limit to the credit that may be granted to a single customer. These restrictions diversify the risks and reduced the possibilities of dishonest management of resources.

Finally, it should be highlighted the regulations related to the monetary and credit conditions in the economy, such as the reserve requirements, the global credit limits and the conformation of portfolio structure of banks, according to the activity of the borrower.

The type of supervision varies considerably from country to country. There are systems based on the direct inspection of banks, and those based on indirect inspection, based on the permanent contact with their managers and supplemented by the provision of periodic information. In recent years, the basic rules of supervision, in the various markets, have been defined by supranational institutions and adopted (via agreements signature) by the central banks of several countries. Adherence to these international precepts serves as additional assurance that the financial system of the signatory country is relatively solid, important factor in a context of increasing globalization of financial transactions.

22. Who makes the rules that regulate the national financial system?

In Brazil, the **National Monetary Council (CMN)** is the highest level entity to formulate public policies within the National Financial System (SFN). It is the CMN who sets the policies and the basic regulations for the functioning of the financial market and for the activities of financial institutions.

The CMN bases its decisions on the recommendations made by the BCB. It is comprised of three members:

- The Minister of Finance,

- The Minister of Planning, Development and Management, and
- The Governor of the BCB.

Council decisions are put into practice by means of resolutions, made public by the BCB and signed by its governor. The circulars, issued by the Board of BCB, regulate resolutions. Circular letters and communiqués are under the responsibility of BCB departments and regulate the operational aspects of the resolutions and circulars issued.

Table 2 shows the composition and the segments of the Brazilian Financial System.

Table 2 - Composition and segments of the Brazilian financial system

	Currency, Credit, capitals and exchange		Private insurance	Closed pension
Regulating entities	National Monetary Council (CMN)		National Council for Private Insurance (CNSP)	National Council for Complementary Pension (CNPC)
Supervision Entities	Central Bank of Brazil (BCB)	Securities and Exchange Commission (CVM)	Private Insurance Superintendency (SUSEP)	National Complementary Pension Superintendency (PREVIC)
Operators	• Banks and savings banks • Consortium managers • Credit unions • Security Brokers and Dealers [1] • Payment institutions [2] • Other non-banking institutions	• Commodities and futures exchanges • Stock exchanges	• Reinsurance Companies • Insurance companies • Capitalization companies • Entities operating private open pension funds	• Entities operating private closed pension funds

Source: BCB. [1] Some activities are also supervised by the CVM. [2] Payment Institutions are not part of the SFN but are regulated and monitored by the BCB, according to the guidelines established by the CMN.

Click here to know more about the National Monetary Council (CMN).

23. How does the BCB implement the "Financial System Supervisor" function?

Part of the mission of the BCB is to seek to ensure the soundness of the SFN and to regulate the functioning of banking and non-banking entities in Brazil. To fullfill this task, the BCB:

- authorizes entities to operate;
- regulates the functioning of these entities; and
- performs monitoring and supervision procedures of these entities.

In supervisory actions, the BCB follows the evolution pace of the financial market, adapting work processes to the best practices internationally recommended and adopted. The emphasis is on **assessing the risks incurred by the supervised entities** and the quality of the controls over these risks, consolidating an integrated and continuous process, encompassing activities related to the classification, monitoring and inspection of the supervised entities. Besides, the BCB checks the items of the financial statements and the compliance with laws and regulations.

In general, the supervision model applied by the BCB consists of three major processes:

- **robust, complex and intrusive monitoring**, consisting of a process of capturing data and information which are processed and used to generate information and analyses to support the supervision process. These data and information are obtained within the auditable universe and other external sources, notably clearing houses;
- **on-site supervision of financial institutions** (banks, credit unions and non-banking institutions), both in a prudential approach and in a conduct approach.
  - For this purpose, besides the information processed and made available by monitoring, in the supervision process additional information and data from the supervised entities are collected and its analysis produces specific supervisory actions;
  - In the case of banks and credit unions, the focus of prudential action is in solvency and liquidity of each entity of the auditable universe and, in the case of supervision of conduct, the focus is on the evaluation process of the supervised entities concerning the relationship with customers/users of financial products/services and the prevention of money laundering/financing of terrorism; and
- **strategic planning process, integration and support**, responsible for integrating the processes mentioned above, through planning and coordination actions, in order to ensure the highest possible efficiency to the model.

24. How many and which types of institutions are supervised by the BCB?

In October 2016, there were 1,812 institutions authorized to operate by the BCB, as shown in Table 3. The banking service counted this month, with 22,578 agencies and thousands of electronic service stations.

Supervision also keeps track, in thirty-three countries, of the dependencies of Brazilian banks abroad.

Table 3- Number of institutions authorized by type [1]

Type	Dec/2011	Dec/2015	Oct/2016
Multiple bank	139	132	133
Commercial bank [2]	21	21	21
Consumer Finance Company	60	53	53
Security Broker	100	87	79
Exchange Rate Broker	49	63	63
Security Dealer	127	102	101
Credit Union	1328	1113	1082
Consortium Manager	284	172	165
Others	132	120	115
Total	**2,240**	**1,863**	**1,812**

Source: BCB, Quantity of intitutions by type. [1] It has been considered institutions in the following situations: "no Authorized Activity"; "Authorized Active"; "On Temporary Special Administration"; "In Intervention" and "Paralyzed". [2] It includes Foreign Banks Full Branches.

Monetary Policy Agent Function

25. What is the function of "Monetary Policy Agent"?

This is the function that defines, in the broadest sense, a central bank, and ultimately encompasses the other functions.

Monetary policy influences the evolution of the money supply and controls the process of money and credit creation by the following classical instruments of central banks:

- reserve requirements [14];
- rediscount[15]; and
- open market operations.

The reserve requirements held by commercial banks at the central bank have inverse relationship with the banking system's ability to expand credit and the money supply. Higher reserve requirements imply lower ability of commercial banks to extend credit and multiply money, as part of the resources that would otherwise be used by banks to conduct active operations, i.e., loans or investments, is sterilized. Thus, by increasing the required reserves, the central bank reduces the potential of banks to expand credit.

Differently from other monetary policy tools, the reserve requirements must necessarily be observed by the financial institutions. Since they affect bank positions, this is not a flexible instrument, because abrupt changes in rates can cause mismatches in the term structure of assets and liabilities of the institutions to which these requirements apply. It is more often used when the monetary authority intends to implement a more structural change in the institutions' liquidity. Furthermore, the increase in the reserve requirements widens the differential between

[14] See Question 13 above.

[15] See Question 14 above.

the interest rates of assets and liabilities, but the magnitude of this effect is inversely proportional to the remuneration of requirements adopted by the central bank. Another aspect that must be considered in relation to the compulsory reserve requirement is the burden imposed to the banks, in comparison to other financial intermediaries not subject to this compliance.

The rediscount, in turn, although being much more related to the function of lender of last resort, is also considered a monetary policy instrument. When allocating the rediscount to support institutions with liquidity problems or to direct investments in priority activities, liquidity is injected into the banking system. It expands the reserve base of banks, holding credit levels otherwise inaccessible, with expansionary effects on the money supply. On the contrary, a decrease in the rediscount operations, either through contraction of the amounts or increase of the corresponding rates, implies monetary and credit restraint, while reducing liquidity in the banking system.

The open market operations have great flexibility, agility and scope for the regulation of the money supply, being of immediate and direct impact on the monetary aggregates, regulating, at the same time, the interest rate and the money supply. The open market operations are the instrument currently used by most central banks for monetary policy implementation.

These operations are carried out by the acquisitions and sales of short-term government securities in the secondary market, with competitive yields. By buying government bonds, the central bank delivers money (deposits) in exchange for the government's securities, increasing the bank reserves, the credit and the money supply, thus driving up the securities prices and dropping the interest rates. Conversely, when the central bank sells government securities, it collects, in contrast, currency from the banking system, reducing the liquidity in the economy, leading to a fall in the securities prices and increasing their yield.

26. How does the BCB implement the “Monetary Policy Agent” function?

The liquidity control occurs primarily through the use of traditional instruments of monetary policy, which are the reserve requirements, the rediscount operations (either as liquidity facility or longer term assistance), and the open market operations. Rediscount operations have been described in the item "the bankers’ bank"[16]. It is noteworthy that both reserve requirements and rediscount operations do not immediately affect the liquidity, given that financial institutions have a period to comply with changes in the reserve requirements, while rediscount operations as long term liquidity assistance depend on the occurrence of unusually higher liquidity needs. The open market operations, on the other hand, can be used to control financial system’s aggregate liquidity on a daily basis. These instruments are operated by the departments subordinated to the Deputy Governor for Monetary Policy: the rediscount and reserve requirements are implemented by the Department of Banking Operations and Payments

[16] See Questions 7 and 14 above.

System (Deban), and the open market operations, by the Open Market Operations Department (Demab).

The aim of the reserve requirements is to sterilize part of the funds raised by the financial institutions in order to control the aggregate liquidity and reduce the ability of money creation by financial institutions. When crediting a current account, a banking institution creates money that, when used by the borrower, can generate a deposit at another financial institution, which in turn is able to generate a new credit to another customer, and so on. The repetition of this mechanism generates the multiplication of money by the banking sector. In order to limit this process, BCB requires that certain portion of demand deposits, as well as the balances of other chosen accounting entries, remain deposited in the monetary authority.

The BCB is authorized by Law 4,595/1964, with the wording of Law 7,730/1989, to establish reserve requirements up to 100% on demand deposits and 60% of other accounting entries balances. Within those limits, the BCB can adopt differentiated percentages depending on the geo-economic regions, the priorities assigned to specific investments and the financial institutions nature.

As long as the aforementioned limits are observed, the BCB Board can alter the rates of reserve requirements at any time. Financial institutions may be required to comply with the new rates immediately (when the goal of the BCB is to impact these institutions immediately) or after some time.

The calculation of the requirements on demand deposits, considers the average of the daily balances of the accounts, subject to payment, in a two weeks period, while the movement or adjustment takes place, also, over a period of two weeks. The calculation period starts on a Monday and ends on Friday of the following week. The moving period begins on Wednesday of the first week following the end of the calculation period and ends on Tuesday of the second week thereafter.

Since overlaps occur between the period of calculation and the deposit at the BCB, institutions should estimate the values for the positions not yet known and may change them until the third working day after the end of the calculation period. Financial institutions are divided into two groups, "A" and "B", which have one-week gap between the respective periods of calculation and implementation in order to minimize possible market pressures on bank reserves.

There is a distinction between the roles of the BCB as monetary policy agent and the role of lender of last resort. When the BCB implements monetary policy, the focus of its activities is the control of the banking system's liquidity (monetary aggregates) and the focus is on the interest rate. When acting in the role of the lender of last resort, the focus is to solve liquidity problems of specific institutions. In the latter, the market can be liquid and the institution illiquid and insolvent, with no access to funding in the interbank market and thus resorting to the rediscount window at the BCB.

Article 10 of Law 4,595/1964 granted BCB the authority to make transactions for the purchase and sale of federal government securities, i.e., open market operations.

In the implementation of monetary policy, the sale of securities by the BCB to the banking system reduces the bank reserves, while the opposite occurs in the case of the purchase of securities. These interventions (purchases and sales of securities) held by Demab, are of two types: repo operations, with the aim of adjusting the liquidity, and outright operations, focused on shifting trends. In repo operations, the BCB borrows (or lends) resources for a specified timeframe, against the sale (or purchase) of securities with a commitment to repurchase them (or resell them) in a future agreed date at a specified price. In this type of operation, the BCB operates in the market through dealers, accredited periodically by BCB.

In outright operations, the security is incorporated into the portfolio of the acquiring institution. The outright purchase or sale carried out by BCB occurs through informal auctions, restricted to dealers, or through formal auctions (public offerings), in which all financial institutions with Selic account can participate. The BCB operates in formal auctions with the National Treasury securities that are part of their portfolio and, therefore, have already been issued in the past.

Note that, according to the Fiscal Responsibility Law, the BCB can buy securities directly from the National Treasury only when the purchase is intended to replace the securities maturing on its own portfolio, which is kept solely for monetary policy purposes. Moreover, to prevent the monetary transactions of BCB from having impacts on public debt, the BCB cannot issue own securities. Thus, the outstanding National Treasury securities are used for the purpose of open market operations.

The daily liquidity adjustment is accomplished through repo operations. The process can be briefly described as follows: before the market opens, the BCB estimates if there are excess or deficiencies reserves in the banking system. This estimate is obtained by collecting data on transactions that affect bank reserves. The most important factors that impact bank reserves are:

- currency issuance or withdrawal from the system;
- foreign exchange transactions;
- taxes payments;
- National Treasury expenditures;
- transfers of credit operations from the federal budget and from the General Federal Government Budget;
- financing taken or granted by the BCB, and their return;
- redemption and placements of government securities;
- extra market operations;
- payments or releases of reserve requirements in general, and
- withdrawals or deposits on the moving average of the reserve requirements.

For example, if the National Treasury executes payments, or if the BCB buys foreign currency it is necessary to compensate for the expansion of money supply, removing the excess resources from the system. This operation is materialized by the sale of securities that are repurchased at a later date. Likewise, when there is a shortage of reserves, caused by the collection of significant federal tax revenues or due to the sale of foreign exchange by the BCB, the open market trading desk conducts operations of securities purchase that are resold at a later date.

Considering, therefore, the estimates on reserves surpluses or shortages, as well as the Selic rate target set by the Monetary Policy Committee, interventions in the open market are carried out by the Open Market Operations Department, in order to maintain the effective Selic rate near the target. At the end of the day a fine adjustment of reserves (capping of banking liquidity) can be accomplished, in order to neutralize any imbalances still remaining[17].

More information on the open market operations in Brazil can be obtained at FAQ 6 – Monetary Policy, Open Market Operations and Foreign Exchange Swap.

Click here to know more about Copom, the decision making body of monetary policy.

27. What is the Inflation Targeting Regime?

Since July 1st,1999, the monetary policy in the BCB is conducted under the inflation targeting regime. This monetary regime is characterized by the commitment of the BCB to ensure that the observed inflation is in line with a pre-established goal, announced publicly.

More information about the inflation targeting regime in Brazil can be obtained from the FAQ 10 – Inflation Targeting Regime in Brazil.

Executor of the Foreign Exchange Policy Function

28. What does the function of "Executor of the Foreign Exchange Policy" consist of?

The foreign exchange market is where the exchange rate, i.e., the price of foreign currency, one of the basic economic prices, is determined. The exchange rate is formed from the conditions of supply and demand. The economic agents who acquire foreign currency to make payments to various agents domiciled abroad (imports of goods and services, trips abroad, etc.) require foreign currencies. On the other hand, the economic agents who export goods and

[17] The Selic rate may be defined as the adjusted weighted average rate of the one day financing operations, backed by federal public securities held through Selic system as repo operations. Selic is a computerized system aimed at keeping in custody securities issued by the National Treasury and the BCB (not anymore), as well at registering and settling operations with these securities. The Selic and its complementary modules are managed exclusively by Demab.

services in general, contract overseas loans, etc., and wish to internalize the resources in the country, offer foreign currencies.

It is usually under the responsibility of the monetary authority of a country to implement the foreign exchange policy, a function that requires the maintenance of foreign currency denominated assets and/or gold intervention in the currency markets, whenever necessary, in order to maintain the purchasing power of the national currency and to ensure the proper performance of international transactions, in accordance with the guidelines of economic policy.

To achieve these objectives, the central bank may adopt different exchange rate regimes, according to the circumstances of the economy. These can be grouped in a broad sense, into two groups:

- **fixed exchange rate**, when the monetary authority sets the international price of the national currency. To sustain the parity, the central bank commits itself to purchase or sell the currency at the rate established; and
- **flexible exchange rate**, in which the exchange rate is formed by the action of the market agents that demand and offer foreign currency, without interference (or with little interference) of the monetary authority. In this regime, the monetary authority does not have any commitment to sustain an international price for the domestic currency.

Given the close relationship between the monetary and exchange rate policies, the monetary policy effects depend mainly on the type of exchange rate regime used.

In a context of international mobility of capital, with fixed exchange rates, it reduces the ability of the central bank to influence the quantity of money. The monetary stock is determined by the foreign currency supply. Hence the money stock is not controllable by the central bank, but adjusting to variations in the amount of foreign currency. The base interest rate, set by the Monetary Authority, should ensure the equilibrium of the balance of payments, rather than pursue the goal of domestic price stability, which depends on the maintenance of the desired foreign exchange rate parity. That is, once the monetary authority does not control the money supply, monetary policy is regarded passive.

In a flexible exchange rate system with international capital mobility, it is the price of foreign currency that adjusts to variations in the quantity of money. Thus, the money stock is controllable by the Monetary Authority, thus the monetary policy is considered active. The base interest rate, in this framework, can be fixed in accordance with the primary objective of price stability.

29. How does the BCB implement the "Executor of the Foreign Exchange Policy" function?

The Brazilian Federal Constitution (section XIII, Article 48) establishes that it is up to the National Congress, with the sanction of the President of the Republic to decide on "financial matters, exchange and monetary, financial institutions and their operations". The CMN is responsible for the regulation of the operations of foreign exchange policy, international reserves and other attributions of the external financial area. The implementation of exchange rate policy is up to the BCB. For this purpose, the BCB maintains assets in gold, securities and foreign currencies for transactions in the exchange markets, which make up the country's international reserves, in order to contribute to the sustainability of the country's external accounts and to avoid excessive volatility of the currency, as defined by the economic policy guidelines.

The BCB competence to manage the foreign exchange reserves has legal basis in Law No. 4,595, Articles 10 and 11. Another aspect to be considered relates to the minimum level of the country's international reserves. The Senate, as was established in the Resolution 82 (December 18th 1990), fixed as minimum level the one that ensures sufficient resources to maintain the imports monthly average of the last 12 months, for a minimum period of four months.

The BCB is responsible for the smooth functioning of the foreign exchange market, the relative stability of exchange rates and the equilibrium of the balance of payments and may, for that purpose: a) buy and sell gold and foreign currency and carry out credit operations abroad; b) manage the country's foreign exchange reserves; b) promote, as a federal government agent, the contracting of loans; c) monitor and control the capital movements, including those related to agreements with international entities and the recovery of Brazilian governmental credit abroad; and, d) negotiate, on behalf of the Brazilian government, with financial institutions and foreign and international financial institutions.

In a free floating exchange regime as adopted by Brazil in January 1999, there is no level considered optimal for the exchange rate. The BCB performance, in this context, aims to ensure adequate conditions for the price formation, avoiding extreme situations of lack or excess of liquidity in the interbank market.

The purchase or sale of foreign currency by the Brazilian Monetary Authority occurs, as a rule, through the electronic auctions, in which the BCB receives offers to buy or sell U.S. dollars upon delivery or receipt of national currency, by financial institutions domiciled in the country. The actions of BCB in the foreign exchange market occur through the so called dealers, who are chosen by the criterion "global activity with customers", and turnover in the interbank foreign exchange market. Thus, the BCB interventions in the foreign exchange markets occur via auctions to buy or sell foreign currency, with the participation of dealers, whose main function is to provide liquidity to the interbank market as a whole and to the end customers of foreign exchange operations, being mandatory their participation in auctions whenever they are announced by BCB.