

Fintechs and their regulation in Brazil

Like other countries, Brazil is experiencing the rise of new high technology-based financial services providers, which are known here also by the English neologism: Fintechs.

Some Fintechs challenge the traditional financial system by offering innovative, more user-friendly and cheaper services – at least until they become big enough to dominate the market and impose prices. In a highly regulated market as is the Brazilian financial sector, not all the above benefits will necessarily be present: either the Fintechs will offer ancillary, less value-added services, such as organization of personal expenses, or their revolutionary ideas will fall within any kind of regulated, state-supervised activity – exactly as the traditional institutions.

Fintechs that intend to offer full financial services need a license from the Central Bank of Brazil to operate as a bank, credit company, securities or foreign exchange broker, dealership house or payment institution, depending on the nature of the services. If the service involves securities, the Fintech also needs to obtain authorization from the Brazilian Securities and Exchange Commission (CVM) or be eligible to exemption.

The licensing process is typically time and cost expensive, in particular if the Fintech has foreign capital shareholders, no matter to what proportion. Brazilian Federal Constitution requires Presidential approval by Decree for any new foreign investment in the financial system.

For these reasons, some Fintechs operate in partnership with authorized financial institutions, whereby the latter are the actual service providers. Other Fintechs apply for their own licenses. In other words, behind a cool Fintech, where all can be done through a few touches in the smartphone screen, anywhere in the world and far from the bureaucracy and costs of the old banks, there is often a good old bank.

According to press reports, some intermediaries – apparently operating outside of the Brazilian territory – offer money transfer services through the internet without the high costs and taxes charged by banks. The intermediary basically matches transfer orders from country A to country B with transfer orders from country B to country A, and then settles the orders by transferring local currency among the parties that are in the same country.

That would be a real Columbus egg, if it were not for one detail: the exchange of Brazilian currency against foreign currency, or vice-versa, is defined by Brazilian legislation as foreign exchange transaction. And as such, it can only be carried out by institutions duly authorized by the Central Bank of Brazil. A more than eighty years-old piece of legislation (Decree No. 23,258, of October 19, 1933) sets forth a fine of up to twice the amount of the foreign exchange transaction that is not intermediated by an authorized institution.

In addition, the activity performed by the non-authorized intermediary is a crime under Article 16 of Law No. 7,492, of June 16, 1986 (White Collar Crimes Law). The fact that the website is operated abroad may render prosecution of the responsible individuals more difficult, but it does not exclude the crime. Brazilian law is applicable to crimes committed in the Brazilian territory. According to Article 6 of the Brazilian Criminal Code, a crime is considered as committed both in the place where the action or omission took place, totally or in part, and in the place where the result of the action or omission was produced or was expected to be produced. In the above described transaction, at least one part of the action (transfer of Brazilian currency) and of the result occurs in Brazil.

Even the transfer of funds in local currency, which does not involve foreign exchange, is reserved to the so-called payment institutions. The operation of such institutions is subject to authorization by the Central Bank of Brazil pursuant to Article 6, insert III, letter “f” of Law No. 12,865, of October 9, 2013.

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CVM recently published draft regulation on equity and investment-based crowdfunding, which is defined as the raising of funds by means of securities issued by small-sized entrepreneurs, offered through electronic platforms of co-investment. This kind of enterprise is hardly eligible to any of the registration exemptions currently available. CVM proposes the creation of new exemptions for both the issuer and the issuance, provided that the transaction matches certain requirements – one of them is that the search of investors is made only through digital means. Comments on the draft can be sent to CVM by November 6, 2016¹.

In parallel, CVM launched a research on the development and use of new financial technologies and their impact on the Brazilian capital market. Market players can participate in the research by answering a questionnaire available in the CVM website².

We believe that the discussion on licensing exemptions or simplifications should be extended to services that fall within the regulation and supervision of the Central Bank of Brazil, such as money lending and investment taking, with the aim of benefitting small sized new enterprises that represent very limited risks to the financial system. A great number of Fintechs should fall into that description.

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¹ http://www.cvm.gov.br/export/sites/cvm/audiencias_publicas/ap_sdm/anexos/2016/sdm0616edital.pdf

² <https://pt.surveymonkey.com/r/QFintechCVM>