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LABRYS FRONTIER SERIES

# Regulation and competition:

The case of the Brazilian  
fintech ecosystem

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# **Regulation and competition:**

The case of the Brazilian fintech ecosystem

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# Summary

Events such as the failure and rescue of Credit Suisse and the fallout of Silicon Valley Bank re-surfaces the old saying that prudential regulators should always favor banking concentration to improve financial stability, putting monetary authorities in opposition to competition authorities. In this paper, we want to switch gears and propose a framework to analyze monetary authorities' role in fostering competition. Then, we go through the case study of Brazil's financial system regulators and compare them with Brazil's competition authority's role and the importance of inter-agency cooperation.

# I. The role of regulation in crafting the perfect storm for competition and innovation in Brazil

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**F**or the past decade, Brazil's financial and payments market has been tightly regulated with masterful execution. Since 2013, the Brazilian Central Bank (BACEN) has opened up the market, expanding offers, improving quality, and reducing the cost of financial services and payments. As a result, the sector has witnessed [10 years of development](#) with increased financial inclusion and guaranteed financial stability, even in scenarios of significant turbulence and systemic stress. The population percentage holding an account grew by 50%, and those with access to digital payments increased by 54% in the last 5 years, according to [The World Bank's 2021 Findex](#).

Regulatory agencies acted on two main fronts to create the perfect environment for financial services development in Brazil: **(1) removing barriers to competition and (2) creating the necessary material conditions to compete.** In both cases, a notable factor is that regulators have been very open to industry contributions, including new entrants, as a source of local knowledge in creating and revising rules and standards.

## II. The archetype of financial system regulators in Brazil

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**B**razil's financial system regulatory agencies, BACEN and the National Monetary Council (CMN, in Brazilian Portuguese), primarily take ex-ante, general, and abstract actions. CMN is responsible for regulating the activity of the institutions participating in the National Financial System (SFN, in Brazilian Portuguese). At the same time, BACEN is in charge of regulating the institutions from the Brazilian Payment System. Due to this normative capacity, the performance of these agencies can take into account considerations of a systemic nature. Due to BACEN's inspection and supervision capacities, there is also **an ex-post facto** performance. Especially in cases of regulatory arbitrage, in which the regulator makes use of



the new circumstances of the market. However, even in these cases, the regulatory activity is predicated on previously issued norms or an effort to adjust old rules to new business models and use cases, which will ultimately be incorporated into new general and abstract norms.

Their regulatory perimeter is limited to the borders of the financial and payments market. However, in recent years, they have expanded their jurisdiction in two ways. The first was limiting the scope and defining boilerplate clauses in contracts between regulated entities and non-regulated companies. That way, BACEN can stipulate conditions for what institutions outside its jurisdiction can do in the frontiers of the financial system. This is the case of (i) open finance partnership contracts, (ii) relevant service provision contracts in the cybersecurity regulation, and (iii) bank correspondence contracts. BACEN and CMN's second strategy to expand their regulatory perimeter was to change the scope and definition of regulated activities. For example, they:

- (i) Created fintech licenses to encourage the transition of unregulated fintech to the regulated ecosystem; and
- (ii) Limited the scenarios in which payment institutions can operate before obtaining a license, especially in the case of digital account service providers, who are now required to obtain a pre-operational license in any case.

The general objectives of the Central Bank, that is, the premises that guide all of BACEN's regulatory activity, have also expanded over the last few years. Its mission, which originally was to “to ensure the stability of the currency

purchasing power, and foster a sound and efficient financial system”, was edited to add: “to ensure the stability of the currency purchasing power, to foster a sound, efficient and competitive financial system, and to promote the economic well-being of society”. However, BACEN's main objective continues to guarantee the financial system's stability and the conservation of the currency's value.

These agencies have become more open to market participation in editing and revising norms and standards, utilizing public consultations, working groups, and inspection activities. Over the past 10 years, BACEN held more than 50 public consultations. One notable success story is the Working Group on Instant Payments, which eventually became the Instant Payments Forum and evolved into the Pix Forum. Numerous institutions and associations have participated in this process, with numerous calls for contributions and 17 plenary meetings. The ultimate result of this collaboration process is the Pix, which stands as a testament to its success.

## **III. Brazil's financial systems regulators and their role in fostering competition**

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### **III.1. Removal of barriers to competition**

**T**he first front of action of the financial regulation mentioned above is the removal of barriers to competition, which is the most traditional form of competition protection. Over the last decade, this has been the highlight of BACEN's and CMN's regulatory activities, which have developed in two main ways.

Firstly, removing barriers on the regulation itself through what has been called proportional regulation. This worldwide trend in financial regulation reduces the regulatory burden for institutions that present a lesser

systemic risk to the market. The idea here is to adapt the rigor of regulatory requirements to the impact that an adverse event in that institution would have on the financial or payments system.

An example of regulatory innovation was the creation of regulation on Payment Institutions (IP, in Brazilian Portuguese). IPs are a simpler, lighter version of regulated financial institutions with lower prudential requirements for social capital and liquidity, among others. However, these institutions have some relevant limitations on the operations they can carry out. For example, credit services, leveraging deposits, and other services are excluded from the scope of IPs, which means they carry substantially less risk to the system. This regulatory change allowed institutions to start operating with simpler products and then expand their operations if and only if the company could thrive in this service. This was the case with Nubank, among many other fintech that came later.

Another example of proportional regulation is the risk-based approach, which is increasingly present in financial regulation in Brazil. This approach is more granular than grouping institutions according to license types and adapting regulatory rigor to each group. Instead, the norm defines the general result expected from institutions and requires each institution to determine how to guarantee this result through internal policies. These policies must be adequate to the complexity of the business model and the level of risk that the operation brings to the system. This ensures that new entrants can start their operations in a simplified way and increase their controls as necessary and

relevant to the objectives of the standard. This approach applies to regulating money-laundering prevention and cybersecurity in Brazil.

Secondly, BACEN has acted to punish anti-competitive market conduct, including cooperating with the Brazilian Competitions Authority, CADE. One example of such action was the ban on exclusivity clauses in payroll administration contracts that stated employees could only get payroll advancement loans from the employer's payroll bank. Another interesting example was the measures taken to prohibit discriminatory conduct banks employed against fintech in providing essential banking services. Another recent example is the regulation of payment schemes such as credit, debit, and prepaid card schemes. Changes to the regulation in recent years aimed to promote greater transparency about the schemes' rules, greater participation of scheme members in revising the rules, and greater interoperability between different schemes to reduce the cost of switching between them. For example, if an issuer leaves the Visa scheme to join Mastercard or vice versa.

### **III.2. Creating material conditions for competition**

In addition to the initiatives by BACEN and the CMN to reduce barriers to competition, their role in creating the material conditions for competition is worth mentioning. "Material conditions" refer to the processes and structures that open new frontiers to competition. In other words, they are substantial changes that combat the effects of a

highly concentrated market naturally closed by its own characteristics. Three examples stand out.

The first example pertains to the regulation of payroll account portability. For many years, BACEN has mandated the creation of a procedure for the portability of payroll accounts. However, the entire process was initially costly for the account holder, significantly reducing portability cases. The flow began with the payroll bank, which is the institution that offers payroll management services to the employer. The account holder had to fill out a portability request form, take it to a branch of the preferred institution to obtain another signature, and then return the form to the payroll bank. As a result, there were few requests for portability and slight effectiveness in promoting competition.

In 2018, the Central Bank simplified the portability procedure significantly. The process was reversed, and it was determined that the portability request must be initiated with the institution chosen to receive the portability. From that point on, the institutions are responsible for communicating with each other, and the account holder no longer needs to drive the process. However, the institution of origin may contact the account holder directly to verify the authenticity of the portability request. The institution may offer special deals to retain the customer's salary during this time.

The result was a significant increase in portability requests initiated and completed. This surge in demand demonstrates an unmet need for greater mobility between account providers. Customers wanted better quality or

pricing for financial and payment services. However, the current concentration of the market and its inherent characteristics make it extremely difficult for free competition to be effective. This circumstance is not unique to Brazil. Reports account that a British person is more likely to divorce than to change banks due to the inherent cost of this transition. This is where regulation comes into play, creating processes and infrastructures that open up new frontiers for competition.

This seemingly simple change had significant impacts on the competitive environment. Typically, new entrants do not have enough market positioning to secure payroll administration contracts. However, with the flow now simplified, these institutions can position themselves as their clients' primary account, ensuring a steady flow of monthly funds.

This recurring and automatic *inflow* of resources gives institutions a massive advantage in at least three relevant and market-changing ways:

- (i) It increases customer engagement with the institution's new app, resulting in marketing-related benefits such as brand recognition and opportunities for cross-selling and up-selling other products.
- (ii) It creates a potential revenue stream from payment services since the new institution is expected to become the primary channel for most of the account holder's payments.

(iii) It paves the way for facilitating credit to account holders. This is because being the center of wage deposits guarantees a reliable source of information on the client's actual income and increases the probability that the automatic debit mechanism in the account will fulfill the payment installments.

This is a clear example of regulators creating material conditions for competition.

Furthermore, BACEN's open finance initiative takes the concept of portability to another level to create material conditions for competition in a regulated and highly concentrated sector. Open finance is the operationalization of the concept of financial data portability by creating mandatory procedures and specific liabilities. This new policy is expected to result in an even more significant expansion of space for competition, especially in the credit market. Information asymmetry in the financial market is one of the biggest obstacles to expanding competition, as incumbent banks can draw on the vast financial history of their customers. At the same time, new entrants have much less information to make credit decisions. Open finance aims to break this asymmetry, allowing account holders to take their records to the institution that offers better quality service and/or a better price.

Finally, creating the Pix rail is the most successful and impactful example of BACEN's work creating material conditions for competition. Apart from developing the Pix payment scheme, the Brazilian Central Bank also built and operated its infrastructure. Pix has had unquestionable



impacts on the lives of all Brazilians. From a systemic point of view, one of the most critical impacts of Pix is creating a single network capable of connecting any two accounts to make payments.

Before Pix, the only way to create a payment service was to build a large enough network to generate sufficient interest from people who wanted to pay and those willing to receive payments through the new solution. It is a two-sided market that becomes more effective through a network effect. The larger the network, the more valuable the solution becomes for all its members. This applies to open schemes such as card brands and closed-loop schemes like Mercado Pago, WhatsApp Pay, RappiPay, iti, and other solutions that have emerged in recent years. In all these cases, the payer and receiver must be users of the same payment product for the transaction to occur. Therefore, creating a new payment solution that could compete with established networks was incredibly challenging for a new entrant. After the launch of Pix, any account can make payments to any other account, regardless of the payment service provider (PSP) used by the transaction counterparty. This means that a new entrant can offer a payment solution with the same reach as a large, established institution, regardless of its size or whether it chooses to provide services to consumers or retailers.

The size of the PSP network is no longer a competitive advantage. Instead, a single network accessible to all and that covers the entire Brazilian Payment System has replaced it. This change also shields competition in the payment system from prominent players outside the

market, such as big tech companies, which would otherwise have an inherent advantage in building payment services due to their extensive networks constructed through communication, information, media, smartphones, and marketplace products.

With the size of the PSP network no longer a competitive advantage, the risk of asymmetric competition from dominant big techs in their respective markets is also reduced.

## **IV. The archetype of the competition authority in Brazil**

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**C**ADE is Brazil's antitrust authority, meaning its regulatory activities are primarily conducted on a case-by-case basis after the fact. This allows the agency to act more flexibly to protect the economic system, even in the absence of previous specific regulations defining conduct to be followed or avoided. As a result, course corrections can be more targeted and specific to the needs of each case. Additionally, CADE may have a shorter feedback cycle between market interaction – filing an antitrust violation complaint, for instance – and action taken in defense of competition, allowing for a faster reaction to changes in the market.

CADE has not been as permeable to industry participation, though. The agency has only held two public hearings within its scope, both in 2020. Holding more public hearings may be relevant for the agency to gain more context from the market, which is a source of local knowledge that is constantly changing.

Another important feature that characterizes CADE's role is the greater scope of its scope of action in defense of competition. In fact, CADE has a constitutional mandate to protect the economic system from anti-competitive actions and therefore enjoys a lot of flexibility in defining the length of its jurisdiction.

This flexibility is relevant to competition in the fintech market because the boundaries of financial services are becoming increasingly blurred. Technology companies are starting to enter the payments and credit ecosystems, banks are offering non-financial services in a super app model, and startups are beginning to provide ancillary services to financial services without entering into a regulated operation. Phenomena such as decentralized finance (DEFI) and shadow banking have emerged as significant trends in this changing market. The result is that the space separating the financial and non-financial worlds has become smaller, and their intersections are more and more frequent.

As mentioned, BACEN and CMN have also worked to expand their jurisdiction in the face of these market changes. However, it is undeniable that CADE has considerably more margin to move across these borders

and ensure the health of the competitive ecosystem. A typical example of this is the case of Guia Bolso and Bradesco.

Guia Bolso, at the time of the facts, was a startup focused on personal financial management (PFM). Its application allowed users to access their bank transactions through the Guia Bolso infrastructure to have a centralized and facilitated view of their entire financial life. To this end, the startup offered an interface where users typed their bank passwords. Guia Bolso programmatically used the password to retrieve the requested data; a technique known as *screen scraping*. This access was exclusive for reading data, not allowing payment initiation.

In 2016, Bradesco filed a lawsuit against Guia Bolso, seeking to prevent the startup from accessing its customers' data. In 2018, however, the Brazilian government [submitted an amicus brief](#) supporting Guia Bolso's right to offer services to Bradesco customers. The case was then sent to CADE to investigate an anti-competitive infringement on the part of the bank. The Brazilian government argued that the bank could not subject its clients to an unnecessarily burdensome and repetitive experience to grant Guia Bolso access to their data. CADE agreed to hear the case. In 2020, Bradesco entered into a settlement in which it agreed to pay a fine of R\$23.8 million (USD 4.63 million) and create a dedicated interface to facilitate Guia Bolso's access to their customers' data. In 2021, Guia Bolso was acquired by the Brazilian fintech PicPay and today limits its services to the fintech's customers.

This case helps outline the main differences between the type of action of CADE and financial regulators in three aspects. The first is that CADE acted quickly in removing the barrier to accessing financial data, even before the Central Bank and the CMN issued the first regulations on open finance. Secondly, the autarky did so in a context involving a financial entity and an unregulated one, which is a terrain that financial regulation could not reach directly with open finance.

Finally, CADE's statements correctly highlighted the evidence of anti-competitive conduct in creating obstacles to accessing data through aggregators. However, the case-by-case aspect of the analysis and settlement's scope gave Guia Bolso, now PicPay, an unfair advantage against their competitors. After all, they continued without easy access to Bradesco data. At least five other financial data aggregators in the Brazilian market today operate similarly to Guia Bolso but continue to struggle to offer their customers the same service.

The case underscores the importance of two points. On the one hand, the need for CADE's collaboration with BACEN and CMN, which is institutionally well positioned to have a more systemic view of the market. On the other hand, the relevance of the institution being even more open to market participation, as would be the case with public hearings and other related instruments. More than that, the example suggests that CADE's case-by-case action may be more effective in removing barriers than in building material conditions to compete. After all, if the competition authority's decision was limited to prohibiting Bradesco

from blocking access to financial data by third parties (removing the barrier), all aggregators could benefit from the new policy. However, CADE created an imbalance in the market when it decided to go further ahead and mandated a dedicated interface (creating material conditions) available to a single company.

## V. A look into the future

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**T**he financial and payments markets are undergoing profound transformations and becoming increasingly complex, with intersections between the regulated and non-regulated world becoming increasingly frequent. If regulators want to succeed in adapting to these changes and promoting healthy competition, they must:

- (i) Be more receptive to industry participation, especially from new entrants; and
- (ii) Cooperate more with other regulatory agencies.

Another example of cooperation in the financial system could be with data protection authorities, especially



Brazil assign the role of regulating this right to the data protection authorities. But, considering the profound impacts on competition, nothing is more pertinent than the competition and the monetary authorities cooperating to guarantee the best result for the market and, ultimately, for consumers.

## VI. Conclusion

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**T**he role of regulation in protecting competition is changing. One should no longer speak only in defense of competition but in search of ways to encourage and develop competition, especially in regulated and/or highly concentrated markets. The stellar performance of financial regulation in the last decade demonstrates that removing barriers in the regulation itself and creating material conditions for competition, with the creation of procedures and structures, are productive ways to do so. Always open to cooperation between regulatory agencies and to market participation, regulation will be able to fulfill its role and continue to drive Brazil's economic development.

## About the authors



Mariana Cunha e Melo is an experienced lawyer with a background in strategic litigation, public policy, legal research, and regulated markets. She has worked with Supreme Court justices in Brazil, represented Google in high courts and strategic litigation cases, and built the internet law team at a top law firm. At Nubank, she helped structure the Public Policy team and led efforts to work with the Brazilian Central Bank on designing its Real-Time Payments rail. She has also worked in early-stage startups as a strategic projects owner and director of regulation and strategy. Mariana is also a writer and speaker on topics such as privacy, free speech online, and regulation of fintech companies, with numerous international events under her belt.

## About the authors



Jonas de Abreu is an experienced security engineer with a strong background in software engineering and security. He worked as an external consultant and instructor in the early stages of his career. Jonas spent almost a decade at Nubank, the leading fintech company in LATAM, where he made significant contributions as the Chief Information Security Officer and later as a Principal Engineer. He played a crucial role in shaping Nubank's infosec team and strategy and made a notable impact on the Brazilian Central Bank's decisions regarding the Pix rail. Jonas was responsible for Nubank's technical proposals during the Pix Forum, which were highly valued by industry experts and had a pivotal role in shaping the future of payment systems in Brazil.