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Beyond the Convergence-Divergence Divide: Comparing Banking Regulation in Latin America

PARA ALÉM DA DIVISÃO CONVERGÊNCIA-DIVERGÊNCIA: UMA COMPARAÇÃO DA REGULAÇÃO BANCÁRIA NA AMÉRICA LATINA

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Abstract
Over the last few decades, the rivalry between regulatory convergence and divergence has dominated scholarly debate. In accordance with this divide, countries tend to either converge toward Basel rules, becoming globally standardized players, or diverge from them, leaving their local institutions untouched, particularly within developmental States. Banking regulation in Argentina, Brazil, Chile, and Mexico, however, brings challenging evidence to that debate. Brazil, which, from among the group, has most converged toward Basel rules, relies on a sizeable developmental State. Argentina, which has also widely converged, relies on significant State intervention in the financial system. Conversely, Chile, a market-friendly country, has not adhered to international capital rules on the same level. Finally, Mexico has been in-between, reinforcing State-owned banks and adopting the new Basel standards, however, to a lesser degree, compared to Brazil. These findings support the claim that such countries combine global and local institutions more diversely than the convergence-divergence divide predictions would suggest.

Keywords
Banking regulation; Latin America; embeddedness; insulation; convergence-divergence.

Resumo
Nas últimas décadas, a rivalidade entre convergência regulatória e divergência teve largo predomínio no debate acadêmico. De acordo com essa divisão, os países tenderiam a convergir para as regras da Basileia, tornando-se atores globalmente padronizados, ou divergir delas, mantendo suas instituições locais em vigor, especialmente seus estados desenvolvimentistas. A regulação bancária na Argentina, no Brasil, no Chile e no México, no entanto, traz evidências que desafiam essa divisão. Os países que mais convergiram para as regras da Basileia, Argentina e Brasil, contam com ampla participação estatal no sistema financeiro. Por outro lado, o Chile, que é um país de mercado, não aderiu às regras de capital internacional da mesma forma. Por fim, o México figura em uma posição intermediária. O país reforçou seus bancos estatais e adotou os novos padrões da Basileia, mas em um ritmo inferior ao do Brasil ou da Argentina. Esses achados sustentam a afirmação de que os países combinam instituições globais e locais de maneira mais diversa do que as previsões da divisão convergência-divergência.

Palavras-chave
Regulação bancária; América Latina; embeddedness; insulamento; convergência-divergência.

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Introduction

A comparison of banking regulation in Argentina, Brazil, Chile, and Mexico, the four largest economies in Latin America, brings new evidence to the debate on regulatory convergence and divergence. In this group of cases, the most convergent countries are those that have combined global Basel rules with interventionist policies, such as in the cases of Argentina and Brazil. Mexico has adhered to capital rules while introducing legal changes that reinforced its State-owned banks to a certain degree. Strikingly, the most divergent country is Chile, which has the most market-friendly economy in the region. Such findings challenge the prevailing assumption of alignment between global convergence and market-based economies, or, on the other hand, between regulatory divergence and developmental States or interventive financial policies.

Since the 1990s, following the dramatic rise in economic globalization, the literature has split into two camps. While some authors have maintained a position of efficiency-driven convergence of institutions and best practices across the globe, others have highlighted the prevalence of local path-dependence factors and the persistence of regulatory divergence, mostly in developing countries. Empirical findings corroborate both standpoints. On the one hand, Basel standards have become a global framework, harmonizing more than one-hundred domestic rules toward a market-driven regulatory pattern. On the other hand, there have been several cases of mock compliance with Basel standards, particularly in economies with strong developmental States.

To this contention, the evidence from Latin America is far from trivial, as it combines conventional debate from both sides. Firstly, Argentina, Brazil, and potentially Mexico, reveal an unlikely juxtaposition of two different regulatory arrangements – Basel rules and developmental States or, at least, interventive financial policies. It is noteworthy that Brazil and Argentina, in particular, comply with Basel rules without significant exceptions, enforcing them even over State-owned and development banks. Secondly, the refusal of a middle-income liberal market economy, such as Chile, to adopt the most stringent Basel standards conflicts with recent trends in the developing world. Even low and lower-middle income countries, such as Rwanda, with smaller financial markets and more limited institutional capacity, have implemented the latest Basel agreements.

These four cases support the central claim of the article that banking regulation allows a variety of combinations among global and local settings, far beyond the strict divide between convergence and divergence. By shedding light on these regulatory diversities, this paper contributes directly to banking regulation scholarship, in particular, debates about convergence and divergence. It also dialogues with literature on the political economy of regulation, particularly that focused on the regulatory-State-building process in developing countries. Finally, this paper speaks to Law and Development literature, specifically to legal transplant scholarship, by bringing in cases that might augment the reference library on both successful and unsuccessful legal transplants.

The article is organized as follows: the next section outlines scholarly knowledge of convergence and divergence in banking regulation. The second section contains the analytical framework and the theoretical argument that guides the remaining analysis. The third section brings evidence from Argentina, Brazil, Chile, and Mexico regarding Basel implementation and combination with local developmental policies. Finally, findings and conclusions are presented.

1. **Reviewing the Literature:** Convergence and Divergence in Banking Regulation

Over the last few decades, the convergent vs. divergent rivalry has divided the scholarly debate on regulatory globalization. The banking sector has played a crucial role in this debate, given the interplay between Basel global standards and local rules. On the one hand, global capital rules have diffused massively around the world, laying down prudential obligations for the banking sector in more than one hundred jurisdictions, including developed, semi-peripheral, and peripheral countries (JONES, 2020). On the other hand, Basel standards have not deterred local malpractices or deep financial crises, nor triggered sweeping changes in domestic institutional arrangements. Particularly, in developing countries, one of the leading controversies mirroring the convergence and divergence divide resides in the interplay between the market-friendly nature of Basel standards and the persistence of financial activism by the State.

The Basel rules consist of soft law standards agreed on by the Basel Committee that are formally binding on the Committee's members, but also voluntarily adopted worldwide (JONES and ZATZ, 2017; JONES, 2020). The agreements aim to achieve stability in the global banking system, as well as to level the international playing field by preventing leveraged domestic banks from gaining market share abroad (BIS, 1988; TARULLO, 2008). The standards pursue such goals by requiring banks to reach a ratio of 8% between their capital (equity, earnings, etc.) and their risk-weighted assets (loans, mortgages, securities, etc.) – capital adequacy ratio (CAR). Supposedly, capitalized firms buffer their savers against default and disincentivizes shareholders from embracing risk-taking decisions (TARULLO, 2008; JONES, 2020). Also, Basel agreements aim for a level playing field by targeting lowly capitalized and highly leveraged banks, usually those that are State-sponsored.

In turn, the financial activism of the State involves broad interference by government in the financial system, particularly in the credit market. In this arrangement, policymakers craft regulatory devices to spur credit allocation according to policy preferences (THURBON, 2016). Rather than pursuing banking soundness, the main purpose of government officials is to use the credit market as development leverage (CHEY, 2014). Developmentalists accomplish their objectives by introducing underpriced banking savings as they direct those resources through subsidized earmarked credit policies. State ownership of

banks plays a central role in this governance by channeling cheap funding to selected businesses and segments.

In the contention between Basel standards and State financial activism, the convergent view sustains the prevalescence of the international harmonization process over domestic institutional arrangements (JORDANA and LEVI-FAUR, 2005; LEVI-FAUR, 2005, MAJONE, 2006). In this perspective, globalization has given rise to a convergent mode of regulatory capitalism, in which the "cox" State has become more suitable than the former "rower" State to govern the economy (LEVI-FAUR, 2005; MAJONE, 2006). Strictly speaking, with the rise of global codes, including Basel, the role of State activism in coordinating the local economy would have run out of steam (JAYARURYIA, 2005). In its place, transnational governance structures and local independent regulators have played a crucial role in conducting regulatory response worldwide (HELLEINER, 2015). Singer (2005) summarizes the core of the convergent view, emphasizing the inexorable nature of Basel rule globalization. He points out the leading role of political and market forces in fostering normative banking harmonization. In his terms, "for core harmonization of capital requirements, competitive pressures were a hindrance; but after G-10 countries harmonized, competitive pressures actually ensured peripheral harmonization."

In contrast, the divergent view emphasizes significant gaps between global rule-making and local enforcement. In this approach, the massive adoption of global capital rules has gone hand-in-hand with significant implementation failures, as reveal several cases of cosmetic Basel compliance (WALTER, 2006; 2008; TAMURA, 2005; CHEY, 2007; 2014). To a large extent, such a claim has drawn on Asian cases, such as Japan or Korea, in which preservation of developmental States undermined the substantive enforcement of global capital rules (TAMURA, 2005; WALTER, 2008; CHEY, 2014). Thus, instead of pointing out regulatory convergence, divergent scholars stress the persistence of local institutions in banking regulation (WALTER, 2008; MOSLEY, 2010).

Although rival outlooks, convergent and divergent views share the belief that Basel capital rules and financial activism by the State are at odds with each other. Both lineages presuppose an alignment between global codes and market-driven economies, or, by contrast, an overlap between regulatory divergence and interventive financial policies. In general, literature predicts such alignments due to interest-based reasons and institutionally-based explanations. Drezner (2007), for example, suggests that global regulatory regimes have a club-like nature, gathering a few powerful nations capable of imposing market-based rules on local policymakers who have no power or interest in resisting externally-driven financial reforms. Domestic policymakers accept regulatory convergence toward market-based arrangements. Also looking at the role of interests and incentives, Jones (2020) suggests that policymakers in developmental States have more significant incentives to run the banking system based on policy goals than merely by enforcing market-driven prudential discipline. Likewise, Walter (2008) and Chey (2014) argue that

implementing Basel rules can imply a high cost for concentrated interests, particularly in State-led economies, which resist market-oriented financial reforms. Institutionally-driven explanations reinforce the alignment between convergence and market-based arrangements. Mosley (2010), for instance, maintains that implementing global codes presupposes institutions and regulatory structures that typically shape market economies but are absent in State-led economies.

Thus, following the current division, peripheral nations would have one of two possibilities. They could either converge toward the global standard of capitalism, becoming globally-regulated and adapting local arrangements to global capitalism, or diverge from rule-harmonization, keeping their local discretion-based crony capitalism active.

Nevertheless, none of these views adequately describe recent developments in Latin America's banking sector. In this region, the most convergent countries are those that combine global rules with State financial activism. At the same time, the divergent case combines a liberal market economy with a gradual approach toward Basel rules. To classify these arrangements suitably, one requires a theoretical framework that goes beyond strict terms of convergence and divergence.

Recent literature dealing with regulation broadly, or the banking sector specifically, has leaned in the direction. Levi-Faur (2013) and Jayasuryia (2013), for example, outline conciliations between developmental and regulatory States. Jayasuryia (2013) describes how and why developing countries forge a regulatory State with dirigiste characteristics. Levi-Faur (2013) decouples developmental States from developing countries and sustains the polymorphic composition of the contemporaneous State, one that embodies regulatory and developmental functions. Both contributions are valuable as they conceive regulatory juxtapositions as a feasible outcome, instead of taking them as an institutional pathology. Their contribution, however, has not dealt with the specificities of the banking sector.

By working directly with banking systems, Knaack (2017 and 2020) and Naqvi (2019) describe cases of conciliation between global capital rules and developmental States. Knaack (2017) explains how two competing political factions in China have ensured a governmental balance between financial stability and economic growth, thus fostering a combination of the Basel rules with financial activism. Naqvi (2019) and Knaack (2020) also describe the case of Bolivia, where the government has been pulling in two directions, mixing capital rules with a rising ascendancy in the banking sector. In the same perspective, Jones and Zatz (2017), as well as a whole volume edited by Jones (2020), evidence that low and lower-middle-income countries have been selectively converging toward Basel rules while keeping their domestic arrangements at large. Differently from the Asian instances, however, a significant proportion of these cases have overlapped global and local policies without compromising prudential enforcement.

This article builds on this new set of literature that emphasizes regulatory coexistence and hybrid governance. It adds findings on Latin America's banking sector to a debate that usually

deals with the non-financial sector (JAYASURYIA, 2013; LEVI-FAUR, 2013) or explores the political economy of regulations through case studies, rather than cross-country comparative studies (KNAACK, 2017 and 2020; NAQVI, 2020).

2. Research Design and Analytical Framework

The present article has a taxonomic purpose as it intends to outline banking regulation prevailing in Argentina, Brazil, Mexico, and Chile. By classifying regulatory regimes, this article also engages in a comparative analysis of the countries' institutional arrangements, allowing a contrast of the different ways these economies have combined global and local financial rules. This paper, however, does not intend to advance causal explanations for the findings, as it concentrates on identifying the dependent variable, i.e., the varieties of banking regulation prevailing across the largest economies in Latin America.

While the first three countries are new members of the Basel Committee and, as such, must comply with the capital rules, they also have a long history of State intervention in the banking sector. Chile, in turn, offers a compelling contrast to this group, as it is one of the few market-based economies in Latin America that diverge from Basel rules. Moreover, Chile has been a relevant player in the global economy, as its membership in the OECD suggests. To adequately frame these puzzling combinations, this article detaches Basel rule compliance from the mode through which the State governs the domestic credit market.

The analysis of Basel compliance focuses on the three main building blocks shaping the most recent version of the agreement also known as Basel III. These core components embody revised rules on capital, liquidity, and leverage (YOUNG, 2014). Firstly, the agreement introduced new modalities of capital, such as the conservation buffer (up to 2.5%) and the countercyclical buffer (up to 2.5%), and increased the capital-adequacy ratio (CAR) from 8% to a range between 10.5% and 13%. It also defined a more demanding category of regulatory capital, requiring that 4.5% must be equity capital (common equity tier 1 – CET) out of the newly established CAR range (10.5% and 13%). Secondly, the revised agreement established two new obligations related to liquidity and leverage thresholds. The liquidity standards intend to ensure that even capitalized banks have liquid assets promptly convertible into cash in the event of both short- and long-term distress scenarios.

As for the short-run, the Liquid Coverage Ratio (LCR) determines that banks must have a rate no lower than 100% between their high-quality liquid assets and their total net cash outflow (BIS, 2013a). As for the long term, the Net Stable Funding Ratio (NSFR) determines that banks must have sources of funding available to avoid a financial mismatch between short-term liabilities and long-term assets over a one-year time frame. Additionally, the minimum NSFR threshold is also 100% (BIS, 2014). Lastly, Basel III also established leverage standards. Regardless of their risk-weighted capital and liquidity levels, banks are to also limit their leverage to a 3% ratio, which is a quotient between their capital

tier 1 and their assets. All these regulatory components should be gradually enforced, following Basel's schedule (Table 1).

TABLE 1 – **BASEL III – IMPLEMENTATION SCHEDULE**

INSTRUMENTS	2013	2014	2015	2016	2017	2018	2019
COMMON EQUITY TIER 1 (CET1)	3.5%	4.0%	4.5%	4.5%	4.5%	4.5%	4.5%
CAPITAL TIER 1	4.5%	5.5%	6.0%				
CAPITAL CONSERVATION BUFFER				0.625%	1.25%	1.875%	2.5%
CAPITAL COUNTERCYCLICAL BUFFER				0.625%	1.25%	1.875%	2.5%
LIQUIDITY – LCR			60%	70%	80%	90%	100%
LIQUIDITY – NSFR						100%	
LEVERAGE	DISCLOSURE					3%	

Source: BIS.

Governance of the credit market reflects the degree to which financial governance is embedded into or insulated from policy concerns. This article assumes that governments might play a narrow or broad role in governing the credit market. The embedded designs, which have a State-oriented nature, are those in which governmental authorities use banking regulation as a development leverage tool, i.e., a tool that enables intervention in credit allocation to achieve policy goals. Thus, the more embedded the banking regulation is, the more porous it is to government control over savings and credit allocations. Conversely, insulated arrangements are those that discipline the credit market on a market-oriented basis, i.e., detaching it from any other policy goals beyond financial soundness. In this case, the regulatory set deploys only market-friendly regulations to control private intermediation. Conversely, insulated arrangements steer clear of other regulatory purposes such as industrial competitiveness, employment, and national growth, which remain outside the banking regulator's radar.

In the following analytical framework, the horizontal axis describes the degree of convergence toward global capital rules, classifying countries around opposite poles of compliance and non-compliance with Basel III. The vertical axis mirrors the extent of State intervention in

the credit market, distributing domestic arrangements around the alternatives of insulation and embeddedness. That matrix gives rise to the following four ideal regulatory types: divergent embeddedness, convergent embeddedness, convergent insulation, and divergent insulation.

CHART 1 – **ANALYTICAL MODEL**

		DEGREE OF COMPLIANCE WITH BASEL RULES	
		(–)	(+)
DEGREE OF REGULATORY	(+)	DIVERGENT EMBEDDEDNESS	CONVERGENT EMBEDDEDNESS
EMBEDDEDNESS-INSULATION	(–)	DIVERGENT INSULATION	CONVERGENT INSULATION

Source: Author's own elaboration.

Divergent embeddedness, in the upper left position, represents a combination of embedded regulation with lowest compliance with international prudential rules. This type stresses the tension between State intervention in the credit market and substantive global market integration. Regulatory institutions are less committed to the international level playing field than they are to building comparative regulatory advantages to foster local players. This type includes both cases of outright rejection of Basel standards, like in the case of Ethiopia (WEIS, 2020) and cases of mock compliance, such as that of Japan in the 1990s (WALTER, 2008; CHEY, 2014) or more recently, the case of Angola (ENGEBRETSEN and OLIVEIRA, 2020). To sum up, it results in an irreconcilable trade-off between embeddedness and convergence, led by the former.

Divergent insulation, in the lower left quadrant, is the ideal type that combines the lowest compliance with global codes with the most moderate degree of State-led financing. It is a sort of arrangement that reveals a policy preference for a market order, albeit a local one. There is no interest-driven compulsion to adopt international standards, nor do policymakers refuse to devise domestic prudential rules. Banking regulation consists of gradual and selective regulatory choices. It is an unlikely combination, as it denies the two strongest regulatory orders, globaly-made capital rules and the State-driven credit market. In recent years, the rejection of the US and the EU in implementing Basel II and Basel III are examples of this type of double refusal (QUAGLIA, 2019).

Convergent insulation, in the lower right quadrant, represent the amalgam between a liberal market order and full compliance with Basel rules. The term "convergent" seeks to describe the predominance of interests and institutions aligned to the global market order

and committed to the international playing field. These policy purposes prevail over the creation of regulatory advantages that foster local business. The main goal of policymakers is to set the domestic economy as an international financial hub that hosts bank headquarters and the entire financial industry, profiting from fees. The UK is the most conspicuous example of such policy preferences, while Singapore has been striving to attain a similar state.

Ultimately, *convergent embeddedness,* in the upper right quadrant, represents the highest level of Basel compliance, along with the most significant degree of regulatory embeddedness. In this configuration, banking regulation integrates the purpose of converging toward the global market with government control over the financial system. Policymakers pursue a sort of developmental State, partially or fully curbed by global standards. Differently from cases of mock compliance, *convergent embeddedness* depicts arrangements in which both orders are substantially at stake.

3. Comparing Banking Regulation in Latin America

This section examines the regulatory arrangements that have emerged in the banking sector in Latin American case studies. The analysis draws on the previous analytical framework and compares the extent to which Argentina, Brazil, Chile, and Mexico comply with Basel rules and run interventionist developmental policies. The comparison highlights three different types of adjustment between global rules and local credit policies. It reveals Argentina and Brazil as following a convergent embeddedness mode, while Chile is in the oppositing position of divergent insulation. Finally, Mexico seems to be in transition toward the convergent embeddedness position (chart 2).

3.1. The Convergent Embeddedness of Argentina and Brazil

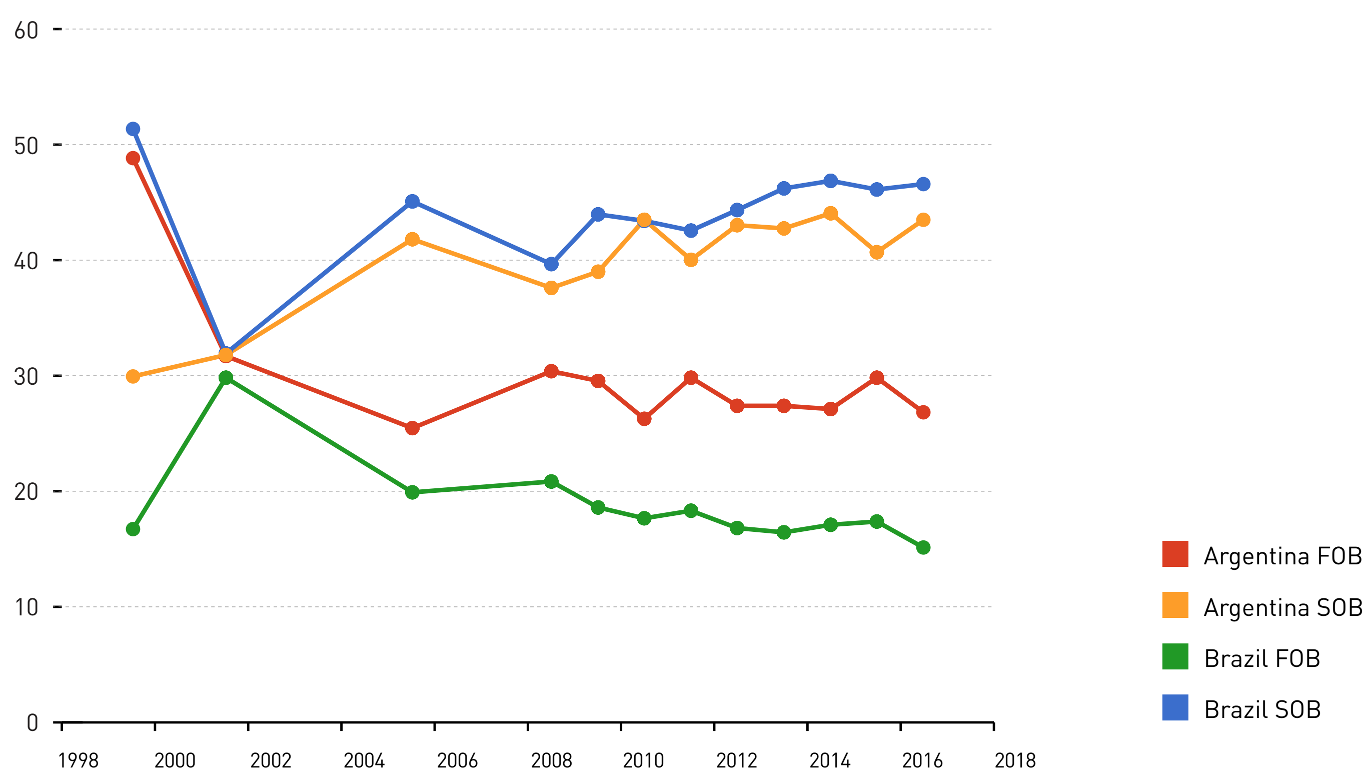
Argentina and Brazil have been pulling in two directions, combining embedded domestic regulation and substantive compliance with the third Basel agreement. Both countries have kept their interventionist State active while implementing the revised capital rules timely and materially.

The regulatory design in both countries has preserved or augmented the government's role in the economy, enabling policymakers to conduct interventionist policies in the banking sector. In Argentina, Act 26.739, enacted in 2012, enlarged the Central Bank's mandate, bestowing on it the task of pursuing "employment and economic development with social equality." From then on, in addition to overseeing monetary and financial stability (statute 24.114/1990), the Central Bank of Argentina (BCRA) must foment growth policies. Thereby, the legal reform of 2012 reinvigorated some institutional features typically displayed during 1970's developmentalism. At that time, officials ran central banks as governmental branches, orienting them toward economic development (JACOME, 2015).

Although Brazil has not reformed its regulatory apparatus like Argentina, it has kept the same legal design established in 1964. According to this, the National Monetary Council (CMN) detains rulemaking power, while the Central Bank of Brazil (BCB) performs supervisory functions. In its initial conception, the CMN was a corporatist council that combined political authorities, bureaucrats, and industry representatives. In the 1990's, administrative reforms eliminated the CMN's corporatist representation and introduced operational autonomy to the Central Bank (TAYLOR, 2009; FRANCO, 2017; SCHAPIRO and TAYLOR, 2020). Brazilian administrative reform, however, preserved the Executive branch's policy-making power. The BCB has become a de facto regulator and effectively disciplines the banking sector. Yet, in parallel with that, the Executive has preserved significant institutional leverages in the banking sector, particularly in relation to federal State-owned banks and earmarked credit policies (STALLINGS and STUDART, 2006; SCHAPIRO, forthcoming).

Despite the privatization process that occurred in Argentina and Brazil throughout the 1990's, State ownership of banks still plays a sizeable role in both economies. A comparison of bank ownership over the last two decades reveals a decline in the share of foreign-owned banks (FOB) and a steady increase in State-owned ones (Graph 1). The graph considers both financial assets in the hands of government and foreign players.

GRAPH 1 – **Foreign Ownership of Banks (FOB) versus State Ownership of Banks (SOB) in Argentina and Brazil**



Source: The World Bank (2001, 2005, 2007, 2011 and 2019).

In Argentina, Banco de La Nación plays a crucial role in the credit market. According to the IMF, Banco de La Nación accounted for 25% of loans and 30% of deposits in the whole banking sector (IMF, 2016). In its report, the IMF also stressed that State-owned banks have a different business model than private ones, "relying more on loans to small and medium enterprises at somewhat lower interest rates and longer maturities" (IMF, 2016, p. 12). Besides Banco de La Nación, it is also possible to evidence other State-owned banks under the control of local governments, such as in the case of Banco de la Provincia de Buenos Aires (BPBA), which plays a regional role.

Similarly to Argentina, the Brazilian banking sector also follows a dualistic configuration. While privately-owned institutions focus primarily on short-term lending, State-owned banks support long-term financing (STALLINGS and STUDART, 2006; MELLO and GARCIA, 2012). Brazil, however, has a larger and more specialized group of State-owned banks compared to Argentina. Such is the case of Banco do Brasil (BB), Caixa Econômica Federal (CEF), and BNDES. The central bank data indicates that BB, CEF, and BNDES have a disproportionate role in financing agriculture, housing, and manufacturing & infrastructure, respectively. BB accounted for around 50% of agriculture credit stock, while CEF accounted for almost 70% of housing credit stock. BNDES, in turn, accounted for roughly 20% of the total disbursed to companies, including short-term and long-term resources (BCB, 2018 and 2019).

Along with State ownership of banks, Argentina and Brazil have also been running directed-credit policies through which policymakers provide cheap funding for selected sectors. Throughout the 2010's, the Argentinean BCRA managed two main programs of directed credit: The Bicentenary Financial Plan and the Lines of Productive Investment (BCRA, 2011, 2012, 2013, 2014, 2015). The above-mentioned reforms in the Central Bank's statute, carried out in 2012, provided institutional support for these programs. Alongside the lengthening of the BCRA mandate, Act 26.739 also introduced article 17, "f," in the Central Bank charter, amplifying the regulatory possibilities for the BCRA to provide financial resources to banks (BCRA, 2012). Thus, in addition to the traditional role of lender of last resort, the BCRA can also extend collateralized financial resources to financial institutions "in order to promote mid-term and long-term lending for production investment."[1] In contrast, the BCRA has become a direct financier of governmental development plans.

The Bicentenary Financial Plan is aimed at directing credit toward classic developmental purposes, including import substitution policies (BCRA, 2011). It relies on an interest rate limited to 9.9% a year, as well as on a predefined five-year contractual term (BCRA, 2011). The "Lines of Productive Investment" plan consists of an even more intrusive program. All banks with a market share above 1% should lend a minimum volume equivalent

1 Ley 26.739, Art. 17, "f".

to 5% of their deposits. Moreover, half of this earmarked credit should favor small and medium companies (BCRA, 2012; BCRA, 2012b; GOLDSTEIN, 2014). Later, the BCRA raised the minimum disbursement threshold from 5% to 15% of deposits (BCRA, 2015). The program set a cap for interest rates, which ranged from 15% in 2012 to 19% in 2015.

In 2017, mirroring a shift in government, the BCRA changed its policy orientation. Following a market-friendly regulatory agenda, regulators announced the phasing out of directed credit policies (BCRA, 2017). Two years later, however, still during the Macri presidency, the Argentinean government launched a revised regulatory package designed to appease small and medium companies that, once again, included interest rate caps and extended contractual terms. Carrying on with the tradition, the new package relied mostly upon State-owned banks, which were to charge a lower interest rate (25%) compared to private players (29%).[2] The return of earmarked credit policies during a market-oriented government is a strong evidence that Argentinean regulatory embeddedness is far from being a partisan policy.

Comparatively, Brazil has run an even larger body of directed credit policies than Argentina. Operating under a legal framework enacted in 1964 (statute 4.595), which assigns ample leeway for policymaking, the monetary council (CMN) has established rules that favor agriculture, housing, and manufacturing. The central bank supervises the enforcement of these rules and punishes banks, private or State-owned, which do not observe the correspondent targets and caps. Between 2010 and 2020, directed credit accounted for almost half of all loans disbursed in Brazil (SCHAPIRO, 2021).

An example of this is the mandatory channeling of 34% of demand deposits to agriculture and the binding allocation of 65% of regulated savings to housing. For manufacturing, CMN defined a special interest rate, designated as TJLP, discretionarily. TJLP (now TLP) is the interest that BNDES pays to use its quasi-fiscal source of funding. Throughout the last few decades, the value of TJLP has always been lower than the basic interest-rate (SELIC), which indicates an implicit subsidy for BNDES lending. Oliveira (2019), for example, found that, between 2001 and 2010, the average real ex-post lending rate was around 35% a year, while the average lending rate ex-post TJLP was around 2.25%. Although BNDES adds operational costs and profit to TJLP, its final lending cost is considerably cheaper than the market average.

Meanwhile, regulators in both countries have implemented new rules on capital, according to the Basel schedule, which include conservation and countercyclical buffers, as well as dispositions on common equity capital and capital tier 1. Accordingly, both jurisdictions have required an increased amount of regulatory capital from their banks, one that has surpassed

2 Information available at: https://www.argentina.gob.ar/noticias/el-gobierno-lanzo-un-paquete-de-medidas-para-fortalecer-el-financiamiento-pyme-por-100000.

the former 8% capital adequacy ratio. In 2012, the BCRA issued Communications "A" 5272 and "A" 5369 (later amended), stating that both private and State-owned banks shall meet the revised capital requirements. In Brazil, the National Monetary Council (CMN) adopted the new capital rules in March 2013, establishing a threshold of 6% for common equity capital and 5.5% for capital tier 1.

In both countries, capital rules in the literature have also been translated into action, as Basel's peer-review reveals. According to the assessment teams, Argentina and Brazil have each deployed a complete and consistent regulatory set in which both were graded as compliant jurisdictions (BIS, 2013b and 2016a). It is no minor achievement, considering that seven out of the nineteen jurisdictions, including the European Union, were graded as not fully compliant.[3] In Argentina and Brazil, the figures of the largest banks indicate that both State-owned and private banks comfortably meet the requirements on regulatory capital. As previously described, with Basel III, regulatory capital thresholds increased from 8% (capital/assets) to a range between 10.5% (with a 2.5% conservation buffer) and 13% (with an additional countercyclical buffer). The largest figures among banks in both countries more than surpassed the minimum capital level.

TABLE 1 – **The Capital Adequacy Ratio of the Largest Private and State-Owned Banks – Argentina and Brazil**

PRIVATE BANKS

ARGENTINA	2018	2017	2016	2015	2014	2013	2012	2011
SANTANDER	14.21	N.D	12.58	12	15	14	N.D	N.D
GALICIA	15.14	10.69	15.04	13.38	15.91	14	N.D	N.D
BBVA	13.72	14.67	13.81	16.18	16.55	14.29	16.91	15.21
BRAZIL								
ITAU	18	18.8	19.1	17.8	16.9	16.6	18.1	16.4
BRADESCO	17.8	17.1	15.4	16.8	16.5	16.6	16.17	15.03
SANTANDER	15.06	15.8	16.3	15.7	17.5	19.2	20.8	24.8

(it continues)

3 Information available at: https://www.bis.org/bcbs/implementation/rcap_jurisdictional.htm.

STATE-OWNED BANKS

ARGENTINA	2018	2017	2016	2015	2014	2013	2012	2011
LA NACION[4]	17.89	34.05	43.06	30.15	25.57	21.76	N.D	N.D
BPBA	N.D	N.D	N.D	N.D	N.D	N.D	N.D	N.D
BRAZIL								
BB	18.86	19.64	18.48	16.13	16.11	14.53	14.83	13.98
CAIXA	19.6	17.65	13.5	14.43	16.07	15.13	12.99	13.34
BNDES	29.01	27.51	21.7	14.04	15.89	18.66	15.39	20.6

Source: Orbis Bank Focus (2023) and Banco de La Nación Argentina (2011, 2012, 2013, 2014, 2015, 2016, 2017 and 2018).

The same is true for liquidity rules, which is the second building block of Basel III. Argentineans and Brazilians have been enforcing both the short-term liquidity LCR and long-term (NSFR) liquidity. The Argentinean BCRA adopted the LCR in 2015, through Communications "A" 5693 and "A" 5724 (BIS, 2016b; BCRA, 2015). These rules target all internationally and regionally active banks, exceeding the Basel prescriptions that aim primarily at internationally active banks. Similarly, the BCRA also adopted NSFR extensively, making it mandatory for local banks. According to BCRA Communication "A" 6306, issued in January 2018, all banks with assets above 1% of total financial assets shall comply with local NSFR norms.

Brazil established liquidity regulation around the same time. CMN Resolution 4401, of February 2015, developed short-term liquidity rules applicable for all banks with total assets superior to R$100 billion. Later, CMN Resolution 4401/2017 developed mandatory LCR rules for all banks classified as part of segment 1, i.e., banks with assets superior to 10% of Brazilian GDP. From 2017 onwards, this same group of banks shall also meet the requirements for long-term liquidity (NSFR) (Resolution CMN 4.616/2017). The remaining banks are not formally obliged to follow the liquidity provisions. Still, the BCB monitors their performance through two Basel-like domestic indexes, the IL (liquid index) and the ILE (liquid structural index) (BCB, 2019).

4 All data refers to capital tier 1 – the only data regularly available in the bank report.

Peer-reviews also recorded Argentina and Brazil as compliant jurisdictions with liquidity standards (BIS, 2016b; 2017; 2019a; 2019b). The data corroborates such assessments. Argentinian and Brazilian figures more than outpaced the regulatory threshold of 100% liquidity between capital and assets, both for LCR and NSFR. The BCRA's financial stability report, in September 2019, indicates an average of 210% of LCR, and 160% of NSFR (BCRA, 2019). During the same period, the Brazilian Central Bank (BCB) recorded similar numbers, with the LCR achieving 228% and the NSFR reaching 121% (BCB, 2019). The Brazilian alternative indexes (IL and ILE), responsible for covering banks excluded from LCR and NSFR, also performed well. The banks examined under these alternative methodologies achieved indexes above 100% for both criteria (IL and ILE) (BCB, 2019).

Ultimately, Argentina and Brazil introduced leverage regulations in 2018. In Brazil, CMN issued resolution nº 4.615 in January 2018 and stipulated that all banks with assets exceeding 1% of Brazilian GDP should limit their leverage to 3%. Due to their growth, Brazilian banks have more than doubled such regulatory minimums, with numbers fluctuating between 7.2%, in June 2018, through 7.6%, in June 2019 (BCB, 2019, p. 33). Similarly, the BCRA established Communication "A" 6431, in March 2018, and stipulated prompt compliance with the leverage index. Compared to Brazilian banks, Argentinian banks easily exceeded the Basel standard and reached, on average, 8.5% in September 2018, and 9.1% in September 2019 (BCRA, 2019). Although it is still not possible to evidence Basel reports on leverage rules, country data suggests that Brazil and Argentina will grade as compliant jurisdictions again.

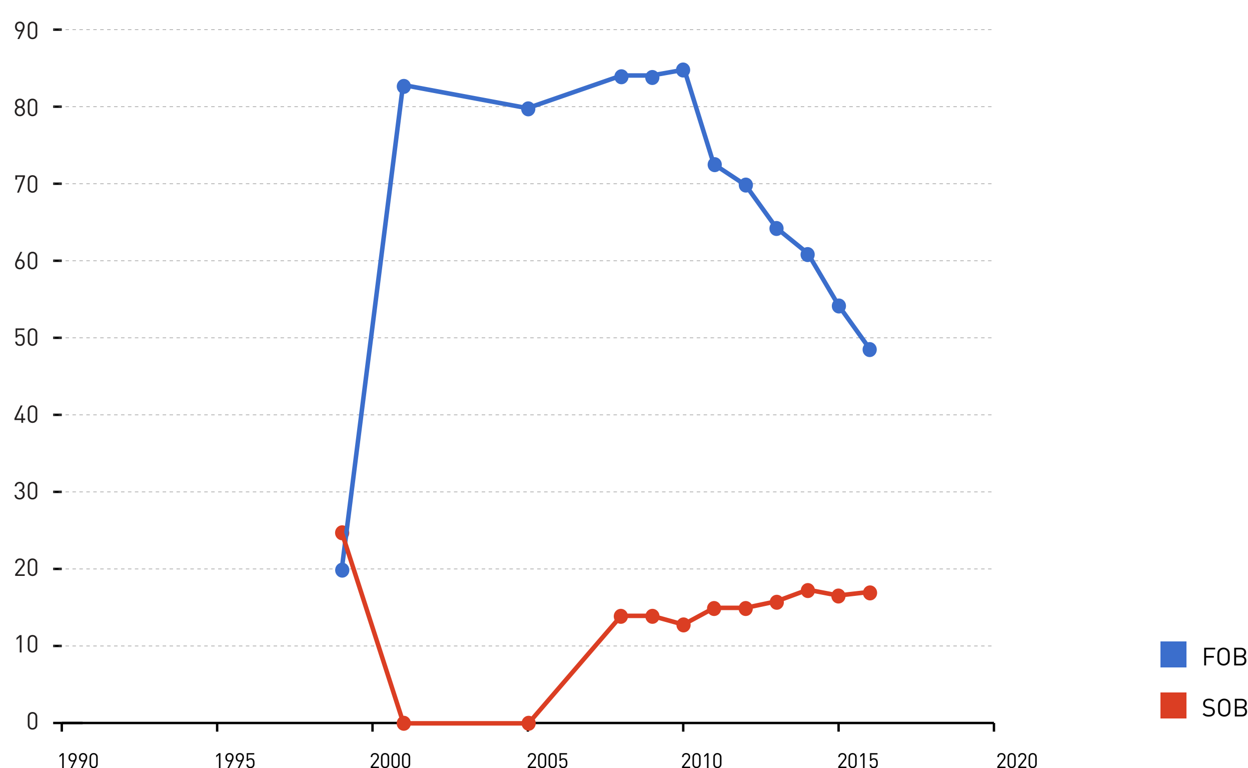
3.2. Mexico in Transition Toward Convergent Embeddedness

Mexico's banking regulation represents a transitional case toward a convergent embeddedness arrangement. The country seems poised to replicate the Brazilian and Argentinian combination of State intervention *cum* global prudential rules. So far, however, Mexico has achieved lower rates of Basel compliance and has a lesser degree of State intervention in the economy.

Such a transitional position is not unusual in Mexican banking regulation. Over the last few decades, its banking system has existed on a pendulum, in which State and market actors have played crucial roles interchangeably (CALOMIRIS and HABER, 2014). In the early 1980s, as a response to the infamous debt crisis affecting developing countries, the Mexican government nationalized the banking system, making it so that most of its banks became State-owned. Later on, in the early 1990s, in response to the spread of neoliberal reforms, officials privatized all those banks nationalized in the 1980s, selling their control to Mexican investors. Due to inconsistencies in its design, the privatization process failed, and the banking system faced a severe crisis in 1995, the so-called 'Tequila Crisis', which

triggered the need for banking reform (CALOMIRIS and HABER, 2014). Searching for a way out of the crisis, the government re-privatized banks, however, it ended up favoring foreign investors (STALLINGS and STUDART, 2006; MARTINEZ-DIAZ, 2009; CALOMIRIS and HABER, 2014). By the year 2000, the Mexican financial system had become the most privatized and foreign-controlled in Latin America, with around 80% of total banking assets under the control of foreign banks (FOB) (Graph 2).

GRAPH 2 – **FOREIGN OWNERSHIP OF BANKS (FOB) VERSUS STATE OWNERSHIP OF BANKS (SOB) – MEXICO**



Source: The World Bank (2001, 2005, 2007, 2011 and 2019).

Foreign investors recapitalized banks and stabilized the banking sector. However, that hardly solved the problem of credit shortage and lack of banking competition – both matters affecting the cost of funding. In such a scenario, policymakers devised a new banking reform in 2014, which aimed at both growing State-owned banks and bestowing legal powers upon the regulator to enforce Basel III.

State-owned banks, up until 2014, had played a limited role in the economy. In 1990, legal restrictions established in the Banking Act oriented such banks to perform indirect functions, such as provisioning guarantees for private loans or channeling resources through commercial banks, as second-tier institutions (Mexico, 2014). The scenario changed in 2014, when comprehensive banking reform altered 32 federal statutes and freed State-owned banks from legal

hindrances that curbed their economic role (NAVA and HERNANDEZ, 2016). Legal change ensured greater autonomy for State-owned banks to define their governance design, including earnings, human resources, and risk assessment policies (MEXICO, 2014). Moreover, the reform allowed State banks to fund private companies through equity investments, something they could not do before (MEXICO, 2014).

Policymakers achieved a significant portion of their desired outcomes (MEXICO, 2013). The share of Mexican State banks in total financial assets has gradually increased in recent years, reaching 17.2% in 2016. During the same period, foreign-owned banks have recorded an opposite trend, sharply declining in financial assets (Graph 2). Also, State-owned banks have augmented their participation in the credit market, reaching 29.5% of total credit in 2018, in addition to having adjusted their traditional role (BANXICO, 2019). In 2008, State-owned banks disbursed 44% of their credit directly, i.e., as first-tier institutions. This figure jumped to 65% in 2016 (IMF and THE WORLD BANK, 2017, p. 7-10).

In tandem with increasing the role of State-owned banks, the Mexican regulator, the National Banking and Securities Commission (CNBV), has enforced Basel III. CNBV implemented the higher regulatory plateaus of common equity capital (CET) (4.5%) and capital tier 1 (6%) immediately in 2013, foregoing the transitional period (BIS, 2015a). Both commercial and State-owned banks have constituted sizeable capital reserves, enabling them to outpace the regulatory minimum of 10.5% of capital ratio.

TABLE 2 – **THE CAPITAL ADEQUACY RATIO OF THE LARGEST PRIVATE AND STATE-OWNED BANKS – MEXICO**

PRIVATE BANKS	2018	2017	2016	2015	2014	2013	2012	2011
BBVA	12.44	12.29	13.73	14.92	15.22	15.9	N.D.	N.D.
BANORTE	17.17	17.23	N.D.	N.D.	N.D.	N.D.	N.D.	N.D
BANAMEX	13.75	14.07	14.36	13.96	15.5	13.71	15.04	15.28
SANTANDER	N.A.	15.74	15.61	16.17	15.91	14.78	14.83	N.D.
STATE-OWNED BANKS								
NAFINSA	14.52	14.46	13.26	13.57	14.62	14.32	16.35	15.14
BANOBRAS	18.51	16.99	21.07	13.98	N.D	N.D	N.D	N.D

(it continues)

STATE-OWNED BANKS								
BANCOMEX	18.79	18.08	19.03	12.63	13.08	13.72	14.47	12.37
SHF	14.52	14.21	14.04	17.45	14.53	18.65	17.42	13.73
BANSEFI	24.51	20.81	18.93	21.57	16.28	25.03	N.D	N.D
BANJERCITO	23.07	21.34	20.88	20.26	N.D	N.D	N.D	N.D

Source: Orbis Bank Focus (2023).

Nonetheless, Mexico has been less strict than Brazil or Argentina in implementing liquidity standards. Although the CNBV adopted short-term liquidity rules (LCR) in time and consistently (BIS, 2015b), it delayed the enforcement of long-term standards (NSFR). The Basel schedule stipulated the NSFR as due in the beginning of 2018, but CNBV did not adopt it until the end of 2019 (BANXICO, 2019, p. 121). Moreover, unlike in Brazil and Argentina, the LCR applies only to commercial banks, dispensing State-owned banks from the same liquidity obligations (BANXICO, 2019). Ultimately, although Mexican banks fully achieved the regulatory mark for leverage, the CNBV introduced the leverage standards in October 2018, i.e., with a delay vis-à-vis the Basel schedule (BANXICO, 2019).

3.3 The Divergent Insulation of Chile

Chile has been an outlier in Latin America, relying on a variant of capitalism that is less dependent on State intervention and mostly grounded in a liberal market economy. The financial system's institutional architecture has mirrored the broader political economy, embodying an insulated arrangement that favors market-based financial transactions over policy-induced credit. Moreover, private banks and capital market figures have been closer to those of developed countries, recording high scores of liquidity, capitalization, and lending volumes (STALLINGS and STUDART, 2006). In 2018, for example, the amount of credit loaned to the private sector reached the remarkable level of 116% of Chilean GDP, almost ten times the Argentinean proportion of 16% (THE WORLD BANK, 2019).

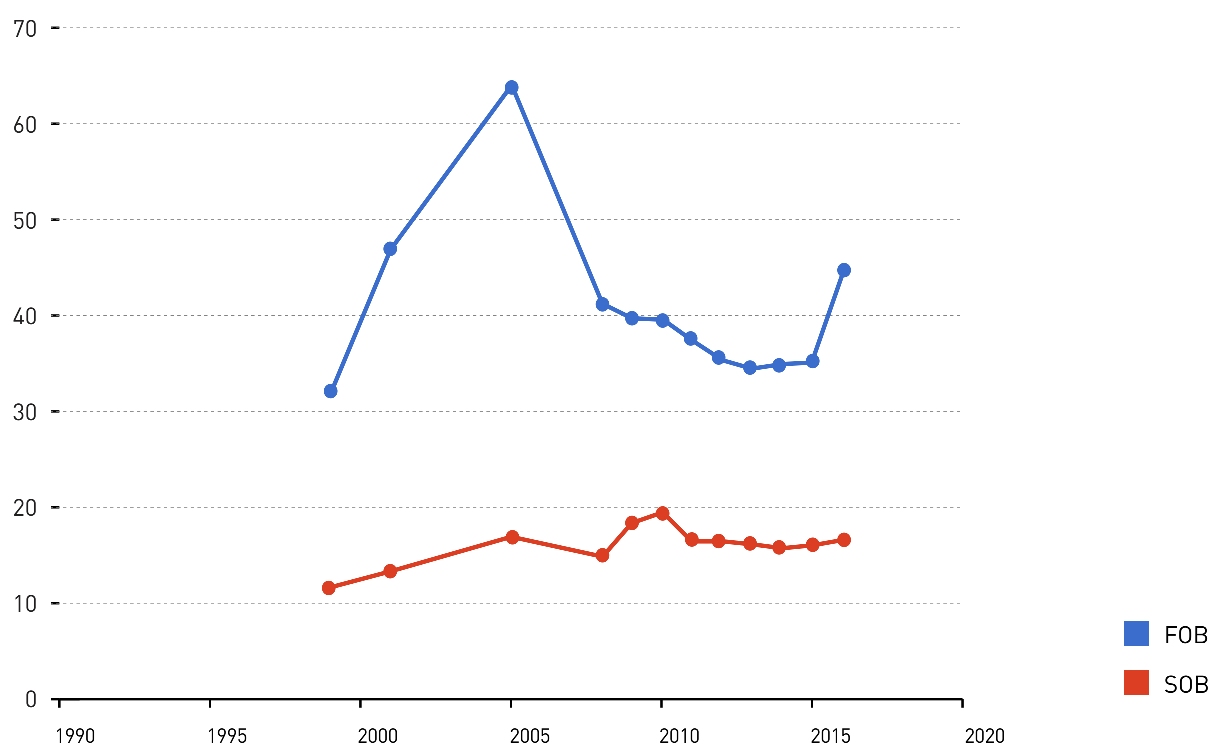
However, such insulated characteristics have not pushed Chilean regulators toward greater convergence with international capital rules. The country has been doubly separated from its local peers as it has not followed their embeddedness mode of regulation, nor has it adhered to Basel rules at a similar pace. In other words, Chile has built another variant of convergence-divergence policy options, giving rise to a divergent insulation alternative.

As for the insulation-embeddedness axis, the government discontinued policy-induced tools in the 1970s, during massive market-oriented reforms that led to sweeping transformations

across the financial system (HASTINGS, 1993). The liberal package halted previously sizeable earmarked credit policies and privatized State-owned banks significantly, leaving only Banco Estado under State control. The profound liberalization, however, caused regulatory disorganization and a financial crash in the early 1980s (DÍAZ-ALEJANDRO, 1984). The Chilean banking crisis was contemporaneous to the Mexican one, triggering an opposite policy response. Rather than nationalizing banks, the government kept the previous liberal orientation, favoring prudential regulatory standards over direct State intervention (STALLINGS and STUDART, 2006).

Banking regulation has since adopted an insulated feature, orienting State intervention towards disciplining market transactions. Instead of pursuing development-related regulatory goals, such as credit-induced growth or job creation, regulators have been mostly concentrating on financial soundness. Consequently, with such institutional choice, State ownership of banks has been kept at a moderate level, reaching around 15% of total financial assets (Graph 3). Foreign ownership, in turn, has grown since the 1990s, and a significant amount of local banking assets are under the control of foreign banks. Specifically, Chile's banking ownership trajectory has been markedly different from other countries in the region. While in Brazil, Argentina, and Mexico, governmental control over the banking sector remained high or increased in the 2010s, in Chile numbers reveal a new round of financial internationalization.

GRAPH 3 – **FOREIGN OWNERSHIP OF BANKS (FOB) VERSUS STATE OWNERSHIP OF BANKS (SOB) – CHILE**



Source: The World Bank (2001, 2005, 2007, 2011 and 2019).

Notwithstanding its market-oriented feature, Chile has pursued a more cautious strategy with Basel market-based standards. It is noteworthy that the Superintendence of Banks and Financial Institutions (SBFI), the former regulatory body,[5] implemented Basel I in the 1990s, however, it has never fully adopted Basel II (CHO, 2013).

Following a similar gradual strategy, Chilean policymakers postponed the implementation of Basel III until 2019, while Argentina, Brazil, and Mexico adopted it in early 2013. In fact, unlike its three Latin American contemporaries, Chile is not a member of the Basel Committee, and enforcing Basel regulations is not mandatory. In contrast, other economies, most of them smaller and less internationalized than Chile, have already adhered to Basel III. Among others, it is the case with Pakistan (NAQVI, 2020) and Uruguay (THE WORLD BANK, 2019).

Chilean convergence toward Basel III took place only after the enactment of a new banking act, Act 21.130 in 2018, that introduced the key concepts of the revised agreement into the local law. The statute also merged the SBIF with the former securities regulator and created the Financial Market Commission, which is now legally empowered to enforce prudential rules. The Presidential message that accompanied the bill in Congress recognized the Chilean delay in following recent updates to international capital rules. It argues that its legislative approval would be essential for levelling the Chilean banking regulation with recent trends in international regimes:

> As it is possible to recognize, the national legislation has not incorporated the advances that, since the issuance of Basel I, have been implemented in the international context, which generates an important gap that separates our current norms from both international standards and best practices in banking regulation. (CHILE, 2017)

Even with the enactment of the new act, regulators have gradually implemented Basel III. One example is that of the liquidity provisions, for which rule-makers devised a moderate transition to the full enforcement of short- and long-term requirements. Initially, regulators will primarily monitor the LCR and NSFR indexes, which will gradually become binding after 2019 (SBIF, 2018). However, such regulatory gradualism has not prevented Chilean banks from presenting sound regulatory numbers. The figures on regulatory capital mostly exceed the minimum threshold of 10.5% (Table 3). Yet, they are closer to the threshold, particularly in the case of Banco Estado, when compared to banks in Brazil and Argentina.

5 The statute 21.130/2018 merged the SBIF with the former securities regulator and created the Financial Market Commission, which is now legally empowered to enforce the prudential regulation.

TABLE 3 – **The Capital Adequacy Ratio of the Largest Private and State-Owned Banks – Chile**

PRIVATE BANKS	2018	2017	2016	2015	2014	2013	2012	2011
SANTCHILE	13.4	13.91	13.43	13.37	14	13.82	13.72	14.73
BANCCHILE	13.91	14.54	13.89	12.58	13.32	13.05	13.22	12.91
BANC CREDITO E INVERSIONES	12.76	13.2	13.41	11.98	13.78	13.44	13.6	13.92
ITAU CORP	14.62	14.67	14.02	8.42	12.39	13.22	11.05	14.47
STATE-OWNED BANK								
BANCO ESTADO	11.12	11.04	11.3	11.7	11.49	11.25	11.47	12.61

Source: Orbis Bank Focus.

Overall, the Chilean authorities have crafted a unique regulatory apparatus, particularly for the region. First, policymakers have preserved the financial liberalization drive that has shaped the local political economy since the 1970s. At the same time, however, regulators have avoided automatic convergence toward global prudential rules, without compromising financial soundness. Since the 1980s, the Chilean economy has not dealt with any banking crises and has enjoyed economic stability, despite several crises having hit the surrounding region and the economy worldwide.

Discussion & Conclusion

This article revisited the convergence and divergence debate, and grounded its analysis in the banking sector of Latin American countries. The countries of Argentina, Brazil, Chile, and Mexico, constitute a group of comparable global players that still display the attributes of developing nations. The selected sector – banking – has become globally regulated in the wake of an unprecedented diffusion of international capital rules. Such legal globalization has prompted two opposing views on the regulatory-building process. While some authors found substantive evidence of convergence toward global standards, others revealed an insurmountable gap between global rules and local enforcement, mostly in developing countries and developmental States.

As compelling as it is, this divide has struggled to keep up with ongoing legal globalization, particularly in the banking segment. The selected cases shed light on its limits.

Argentina, Brazil, Chile, and Mexico join a larger group of countries that also rely on hybrid arrangements and escape the challenges of the convergence-divergence divide. This group includes some African and South Asian countries that have adopted Basel rules while carrying out interventive developmental policies. It also considers developed jurisdictions, such as the US and the EU, that are global market-based economies, but resisted implementing Basel II and Basel III, respectively. To this collection, the Latin American case studies evidence two hybrid regulatory varieties, one that combines global rules *cum* interventive financial policies and another that diverges from global rules, but furthers a market-oriented arrangement.

Strikingly, there has not been a correlation between adherence to global standards and banking sector internationalization. Argentina, Brazil, and Mexico have recorded a decrease in foreign ownership of banks simultaneously with their entry onto the Basel Committee. Meanwhile, Chile is the only country that has registered an increase in foreign ownership of banks, despite its regulatory divergence. These cases bring bewildering evidence against the supposed clear-cut predictions of either convergence or divergence. After all, the countries that most closely follow Basel standards are those that combine them with a local banking system and more interventionist financial policies.

Such findings bring scholarly and policy implications. For the academic debate, the cases enable a rethinking of the building of economic regulation as an endogenous process rather than taking it as an externally-driven one. The convergence-divergence divide conceives of regulatory globalization as an external shock that affects nation-states, leading countries to either agree on international legal dominance or preserve their local order. Yet framing regulation as an outcome of the global-local overlooks the existence of domestic interests that support the adoption of global capital rules. Consistent with the new interdependence approach (FARREL and NEWMAN, 2016), one can speculate that as much as State-led economies, adherence to global capital rules also constitutes a local policy clientele that promotes their continuous implementation. The contrary is also true. Chile's non-developmental State and its initial, gradual adherence to Basel have given rise to a feedback loop between local elites and State regulation. It seems that Chilean elites prefer home-grown regulation to regulatory convergence, thus postponing the implementation of global codes. Therefore, it is more accurate to depict the regulatory building process as the result of domestic interests that advance their preferences by mobilizing different institutions, both within and outside the State.

Lastly, these findings might be of interest to policymakers. The examples of Argentina, Brazil, and potentially Mexico, suggest that financial activism and financial prudentialism might reinforce each other. On the one hand, prudential standards can protect State-owned banks against inconsistent political patronage. Developing countries are fraught with politicized State-owned banks that are poorly managed and financially vulnerable, so adopting capital rules might prevent some of these malaises. On the other hand, financial activism

can address the economic needs of strategic segments, enlarging domestic investment capacity, and diluting resistance to costly prudential norms. It is meaningful that Argentina, Brazil, and Mexico have not faced a banking crisis for almost two decades, while having increased their rates of domestic credit to the private sector (% of GDP). However, since their credit markets are still limited, it might be convenient to observe the Chilean case. Chile achieved financial soundness and credit elasticity, dispensing both full adherence to global capital rules and substantial State intervention in the banking market.

In conclusion, the case studies reveal that, between global convergence and local divergence, there might be a myriad of rule-based economic alliances conducting hybrid regulatory designs. Also, these cases open up a research agenda aimed at deeply investigating the interplay between global rules, local institutions, and interests in Latin America. Ultimately, they bring a substantial amount of material to enhance horizontal policy learning in the banking field.

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