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The effect of the participation of financial companies in non-financial companies in Brazil

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Abstract

This article shows the main results of the master's research, whose objective was to analyze the effect of direct or indirect participations of banks in non-financial companies in Brazil, the regulatory environment in which these participations are inserted, drawing a parallel with the North American regulatory environment, as one of the most developed financial markets in the world, with the largest stock exchange traded in the world and the pioneer country in the creation of the most sophisticated financial instruments in the world, specific regulatory treatment in relation to these holdings. To do so, I adopted exploratory research as a methodology, having as sources: books, articles, websites, Brazilian and North American laws, information on the shareholders of investment funds and shareholdings of banks and companies related to them, extracted from used software by professionals of investment banks, among others. As a result, it was possible to detect two large non-financial companies, with significant holdings and influences of banks, direct and indirect, and to point out the effects of these holdings. With this in mind, I intend to contribute to the management research by pointing out the current flaws in the regulatory model and proposing a general and holistic review that corrects the supposedly pernicious interventions of the financial market in the real economy, without avoiding the correct interactions that help in the development of certain sectors that not interested in private initiative.

Keywords: Banking Holdings. Participating companies. Banks. Regulatory standard of banks. Partner participation.

O efeito das participações de empresas financeiras em não-financeiras no Brasil

Resumo

Este artigo mostra os principais resultados da pesquisa de mestrado, cujo objetivo foi o de analisar o efeito das participações, diretas ou indiretas, de bancos em empresas não-financeiras, no Brasil, o ambiente regulatório em que estas participações estão inseridas, traçando um paralelo com o ambiente regulatório norte-americano, por ser um dos mercados financeiros mais desenvolvidos no mundo, com a bolsa de valores de maior volume negociado no mundo e o país pioneiro nas criações dos instrumentos financeiros mais sofisticados do mundo, e ainda, ter historicamente o tratamento regulatório específico em relação a estas participações. Para tanto, adotei como metodologia a pesquisa exploratória, tendo como fontes: livros, artigos, websites, leis brasileiras e norte-americanas, informações sobre os acionistas de fundos de investimentos e participações acionárias de bancos e empresas ligadas a eles, extraídas de softwares usados pelos profissionais de bancos de investimentos, entre outros. Como resultado, foi possível detectar duas grandes empresas não-financeiras, com participações e influências significativas de bancos, diretas e indiretas, e apontar os efeitos destas participações. Com isso, pretendo contribuir para a pesquisa em administração apontando as atuais falhas no modelo regulatório e propondo uma revisão geral e holística que corrija as intervenções perniciosas do mercado financeiro na economia real, sem evitar as corretas interações, que ajudam no desenvolvimento de determinados setores que não interessam à iniciativa privada.

Palavras-chave: Holdings bancárias. Empresas de participações. Bancos influência significativa. Partes relacionadas em IFRS. Padrão regulatório de bancos. Mercado de capitais. Bolsa de valores.

El efecto de las participaciones de empresas financieras en no financieras en Brasil

Resumen

Este artículo muestra los principales resultados de la investigación de maestría, cuyo objetivo fue el de analizar el efecto de las participaciones, directas o indirectas, de bancos en empresas no financieras, en Brasil, el ambiente regulatorio en que estas participaciones están insertadas, trazando un paralelo con el entorno regulatorio norteamericano, por ser uno de los mercados financieros más desarrollados en el mundo, con la bolsa de valores de mayor volumen negociado en el mundo y el país pionero en las creaciones de los instrumentos financieros más sofisticados del mundo, y aún, históricamente, tratamiento regulatorio específico en relación con estas participaciones. Para ello, adopta como metodología la investigación exploratoria, teniendo como fuentes: libros, artículos, websites, leyes brasileñas y norteamericanas, informaciones sobre los accionistas de fondos de inversiones y participaciones accionarias de bancos y empresas ligadas a ellos, extraídas de software usado por los profesionales de bancos de inversiones, entre otros. Como resultado, fue posible detectar dos grandes empresas no financieras, con participaciones e influencias significativas de bancos, directas e indirectas, y señalar los efectos de estas participaciones. Con ello, pretendo contribuir a la investigación en administración apuntando a las actuales fallas en el modelo regulatorio y proponiendo una revisión general y holística que corrija las intervenciones supuestamente perniciosas del mercado financiero en la economía real, sin evitar las correctas interacciones, que ayudan en el desarrollo de determinados sectores que, no interesan a la iniciativa privada.

Palabras clave: Holdings bancarios. Empresas de participación. Los bancos. Estándar regulatorio de asientos. Participación accionaria.

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INTRODUCTION

As Kasznar (2017) explains, in the course of his work, for the real economy to grow, there must be reinvestment, meaning that a significant part of the results of each year be reinvested in research and development, that the industry continues in its continuous growth, expanding its performance, strengthening the market segment in which it operates, through competition with its peers and thereby generate a chain of benefits, such as: payments of larger amounts of taxes, creation of more jobs, infrastructure development around the factories and on the roads that will flow production, among others, that will help in the growth of the economy of the country in general. In a way, there is a view that by paying less dividends the company discourages the investor, who will not be interested in investing in the company, but in fact, as the company grows by reinvesting in its business, it generates bring ever more robust and sustainable profits, and provide ever greater dividends, beneficial to the long-term investor. In order for adequate prosperity to occur, it is important that companies within each segment of the economy have a strategy that is completely geared to their specific business, in a holistic view, that considers the international environment, but also the specific characteristics of the internal market, adapting Cyrino (2004) to this context, it is a matter of "reconfiguring" the company to the requirements of this market segment and not being out of business.

When a financial company has significant influence through ownership interests in a nonfinancial company, it may distort the company's strategy and focus on short-term goals, which will avoid reinvestment over growing dividends, above the market average, in order to satisfy the immediate interests of short-term investors and speculators.

The primary objective of this article is to check whether the financial market holds significant ownership interests in nonfinancial companies, and, in case they do, whether they promote the growth in the domestic economy, helping to develop certain economy sectors, for example, or if they are harmful to such economy, generating concentration in these markets. The research hypotheses were traced, observing an array of positive and negative points that corporate holdings of this nature can bring, namely.

Box 1

Holding of ownership interests in nonfinancial companies by financial companies

Pros	Cons
Greater professional specialization or specialized professional advice;	Greater concentration of wealth and economic power in a sectoral group only (banks);
Greater access to facilitated credit and lower interest rates (subsidy);	Lower sensitivity of the buyer sector to the needs of the segments: industrial, commercial, agricultural and others;
Greater capitalization capacity, with internationalization possibilities;	Greater possibility of first making the banking system's interests feasible at the expense of the real production system;
Greater possibility of realizing new investments;	Large banks can generate such a concentration of interests and rules, potentially bringing injury to minority shareholders;
Generation of greater flow of dividend payments to shareholders;	Reduced reinvestment and a tendency to reduce innovation;
Gain of scale in concentration (the larger the size of the company, the greater the bargaining power with suppliers and the Government).	With concentration, reduction in jobs and lower amounts of taxes payment;
	With the concentration, apathy of the sector, lack of competition and increase of prices for the final consumer.

Source: Elaborated by the authors.

The hypotheses of this research are as follows:

H1 Due to the large volume and high margins of financial companies, their holding of ownership interests in nonfinancial companies would represent a super concentration of market power: the production of real goods would be dominated by the financial industry, leading to monopoly over the segment, which is potentially a strategic danger to domestic development;

H2 The holding of ownership interests by financial companies in nonfinancial companies affects the strategy that the latter would devise to compete in their market segments, aiming instead at short-term returns to satisfy shareholders who want quick returns. It may cause damage to the market segments in which they operate, as once a successful competitor makes decisions that will negatively affect the market in the long term as a result of aiming at short-term results, its competitors may follow it, thus compromising the health of the segment, and, consequently, the country's economy;

H3 Nonfinancial companies whose ownership interests are held by financial companies invest less in research and development (R&D) and in production maintenance and development, such as machinery maintenance and update, and innovation, and thereby undermine the company's growth in the medium and long terms.

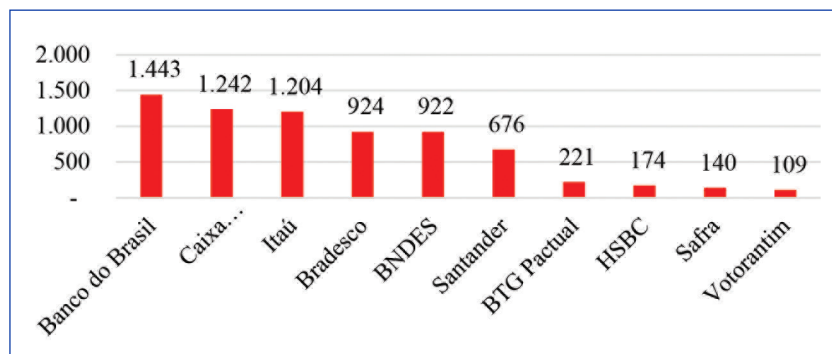
The research aims not only to study the dynamics of these holdings of ownership interests, but also to find whether there are actual negative aspects arising from it and reveal them, if any. The secondary objective is to understand how the Brazilian legislation deals with this issue and draw a parallel with the US law, which has always focused on this type of corporate operations and is nowadays criticized for the flexibilization of its laws in 1999, as mentioned by Goodwin (2013), precisely in relation to the holding of ownership interests by financial companies in the real economy. Finally, the research seeks to collaborate by providing an in-depth view on these issues, with the purpose of contributing to the improvement in the corporate relations between the financial market and the real economy, and to business management studies in Brazil.

METHODOLOGY

This is an exploratory research of documentary nature, in which the corporate structures of all the financial conglomerates of the five largest Brazilian banks were analyzed, according to the ranking of the Central Bank of Brazil (BACEN) of 2016, according to the following figure, extracted from the website of the Central Bank of Brazil. The website of the Brazilian Securities and Exchange Commission (CVM), in the "Reference Form", was also searched to verify corporate holdings formally declared by corporations. The purpose of this analysis was to understand the composition of the structure of industrial conglomerates, mainly and to find corporate holdings of banks in these conglomerates, in non-financial companies, that come from the real economy.

Figure 1

Ten largest banks in assets 2016 – R\$ bilion



Source: Banco Central do Brasil (BACEN)

It also included the analyses of the companies that make up the São Paulo Stock Exchange (IBOVESPA) index, B³, on the last business day of 2016. They represent 42.433% of the IBOVESPA on such date. Of these companies, the ten most significant companies were selected, excluding the stock market itself, repeated ticker symbols (PETR4 and PETR3, for example) and financial companies. The top ten nonfinancial Brazilian companies are highlighted below.” por “Of these companies, the ten most significant companies were selected, excluding the stock market itself, repeated ticker symbols (PETR4 and PETR3, for example) and financial companies, with only the top 10 non-financial Brazilian companies, indeed.

Figure 2

Index of the São Paulo Stock Exchange (IBOVESPA) on 12/28/2016

IBOVESPA	Ticker symbol	Type	Company	Segment	Ownership interest %	Reason for exclusion
1	ITUB4	PN EJ N1	ITAUBANCO	FINANCIAL	10.640	Financial
2	BBDC4	PN EJ N1	BRADESCO	FINANCIAL	7.666	
3	ABEV3	ON EJ	AMBEV	CONSUMER GOODS	7.156	
4	PETR4	PN	PETROBRÁS	ENERGY	6.012	
5	VALE5	PNA N1	VALE	MINING	4.665	
6	PETR3	ON	PETROBRÁS	ENERGY	4.634	Repeated
7	VALE3	ON N1	VALE	MINING	3.950	Repeated
8	BRFS3	ON NM	BRF	CONSUMER GOODS	3.701	Financial
9	BBAS3	ON NM	BANCO DO BRASIL	FINANCIAL	3.420	
10	ITSA4	PN EJ N1	ITAUSA	FINANCIAL	3.094	
11	BVMF3	ON EJ NM	BMFBOVESPA	SERVICES	2.961	
						The Stock Exchange Company
12	UGPA3	ON NM	ULTRAPAR	WHOLESALE / PETROCHEMICAL	2.762	Financial
13	CIEL3	ON NM	CIELO	SERVICES	2.579	
14	BBSE3	ON NM	BBSEGURIDADE	FINANCIAL	1.894	
15	KROT3	ON NM	KROTON	SERVICES	1.877	
16	VIVT4	PN	TELEFÔNICA BRASIL	TELECOMMUNICATIONS	1.813	
17	JBSS3	ON NM	JBS	CONSUMER GOODS	1.796	Financial
18	BBDC3	ON EJ N1	BRADESCO	FINANCIAL	1.650	
19	LREN3	ON NM	LOJAS RENNER	RETAIL	1.488	

Source: IBOVESPA (2016).

This survey covered a five-year period between 2012 and 2016, and the compositions of 100% of the funds belonging to the five largest Brazilian banks were obtained for such period and the total indirect holding of ownership interests by these banks through investment funds in the ten largest companies of IBOVESPA were analyzed (BNDES was excluded because it did not offer investment funds). For this purpose, the QUANTUM system of Paramita Tecnologia Consultoria Financeira was used.

In addition, the ownership interests of the aforementioned ten largest companies were analyzed to find the direct or indirect holding of ownership interests by the five largest banks. For this purpose, it was used the information obtained from the Bloomberg system of E & N Broadcast of *Jornal Estadão*.

The “Maiores e Melhores – As 1000 maiores empresas do Brasil” edition of Revista Exame released in August 2017, which ranks the 1000 largest and best companies in Brazil, was used as the main source of the analysis of the market segments in which nonfinancial companies operate, which ownership interests held by financial companies was significant. The financial statements of these companies for the five-year period were used, as well as their “Economic and Financial Data”, obtained on the CVM website. These data were used to study and understand the effects of the holding of ownership interests by financial companies in these nonfinancial companies.

Finally, a study was conducted on the regulations in force in Brazil, which allows the management of ownership interest by financial companies in nonfinancial companies, in addition to a review of the analogous regulation in the United States, which is one of the most developed financial markets in the world and, therefore, a reference to be analyzed.

Figure 3

**Studies on corporate structures and holdings of ownership interests
by financial companies in nonfinancial companies**



Source: Elaborated by the authors.

Through this study, a set of questions was answered along the lines that follow. Among them, if the degree of influence of bank ownership on other large Brazilian companies was supposed to be as high as usually assumed by “market consensus”; if this implies changes in the decision-making patterns of the companies traded on the Stock Exchange and whether the banks would be acting decisively in sectors that do not originate with them.

LEGISLATION

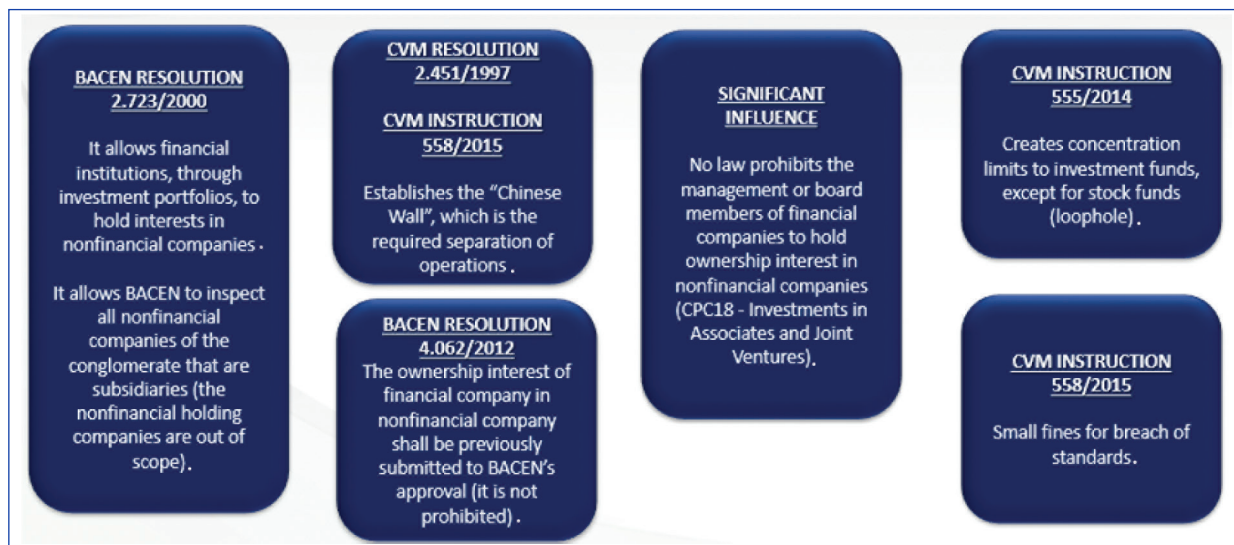
Kasznar (1990, p. 75) states that the end of World War II is the zero mark of the National Financial System. The emergence of the World Bank and the International Monetary Fund gave the United States the opportunity to develop its banking ecosystem ahead of other countries because of its deeper involvement. From this statement, we study the legal framework in the United States, as benchmarking, and Brazil, trying to understand how they affect the relations of participation between financial and non-financial companies.

Brazil

The study revealed that Brazil is advanced in some regulatory aspects, in relation to the financial market, as it was detecting that even before the United States, Brazil already adopted the prudential concepts established by the Basel Committee, that Pinheiro, Savóia e Securato (2015, p. 3) explains: “The core principle of the Basel Accord consists of making the capital of institutions compatible with the risks incurred.” Figure 4 shows a summary of such standards and their proposals:

Figure 4

Brazilian regulatory environment



Source: Elaborated by the authors.

In addition to the macro environment shown above, CVM Instruction 578/2016, which determines, in the case of Private Equity Investment Funds, the FIPs, the following:

Article 6 The participation of the fund in the decision-making process of the investee may occur: I - by the holding of shares that are part of the respective controlling stake; II - by entering into shareholders' agreement; or III - by entering into any contract, agreement, legal arrangement, or adopting another procedure that **assures the effective fund influence in the formulation of its strategic policy and its management, including by appointment of members to the board of directors** (COMISSÃO DE VALORES MOBILIÁRIOS, 2014, emphasis added).

For some experts who are sympathetic to capital markets, such as economists and investment market analysts, some concerns of this nature are not pertinent, such as that the executives of a financial holding company participate in the management of nonfinancial subsidiaries in which the holding has the controlling stake, which is the case of the FIPs, as mentioned by Cardoso, Visentini, Miguita et al. (2017), the managers must comply with the rules on abuse of voting power and abuse of control powers provided for in the Brazilian Corporate Law. However, who should decide whether the short-term or the long-term policy is the most beneficial to the company and its shareholders? It would certainly be the duty of the Administrative Council for Economic Defense (CADE), the Brazilian Antitrust Authority, but would this Council conduct its activities maintaining an adequate strict level or would it, as occurred in the United States before the enactment of the Gramm-Leach-Bliley Act, be softer, enabling an even greater concentration in the Brazilian banking market? Would the solution for avoiding concentration in the banking industry could be authorizing and easing the entry of foreign banks in the domestic market, thus diluting the power of current domestic banks? The US lesson should not be ignored. Every day we read in the newspaper about legal disputes with CADE, such as those of CIELO and VALE, being that of CIELO in 2018 to maintain its hegemonies in the cases of "card machines" and VALE, referring to FERTECO, in 2007.

Brazilian legislation has been developing in an unstructured way. An example is Lago (2012) comments on the regulatory advance with the enactment of BACEN Resolution 4,062 / 2012, which allows the participation of financial institutions in non-financial institutions with the prior authorization of this regulator, which was not possible until then. As a matter of fact, this same provision grants exception and broad freedom to the typical equity holdings of investment portfolios held by financial companies, made exclusively for the purpose of strengthening the free participation and management of funds in non-financial corporations, which is a contradiction, worse both acts in the same standard.

Pursuing profit from the perspective of a short-term investor, who in this case would be a financial institution, would cause an “agency problem”, which is one of the villains in this scenario (FONTES FILHO, 2004), because financial institutions decide to invest in nonfinancial institutions and act in their administrations because they see potential to leverage the results of such institutions, increase their share prices and subsequently sell them, earning considerable profits (SHLEIFER and VISHNY, 2003; VILARINS, 2016). The problem is that to accomplish it they have to act in the administration of these institutions serving the interests of financial institutions, which are often contrary to the medium and long-term strategies that would be better for the operating segment and would cause damage to the economy.

There are also cases involving inside information. There is concern that a financial conglomerate benefits from information. The so-called insider trading, according to Müssnich (2015, p. 10), is that “[...] the market participant negotiates on the basis of information not yet disclosed to the market, with the intention of obtaining for himself or for third parties an advantage improper “. As a result, compliance has been gaining increasing importance in the Brazilian corporate agenda. There is also talk of the chinese wall, which is defined as:

[...] a preventive mechanism through which activities are segregated (for example, a bank’s financial activities from those of a fund managed by the bank itself), in order to avoid “contamination”, minimizing situations of conflict of interests and even broad access to information not disclosed to the market (MÜSSNICH, 2015, p. 11).

Müssnich (2015, p. 11) adds that “[...] in practice, however, what is observed and often is the “beyond-walls” questioning of several transactions, that is, when the institution also has, “on the other side of the wall”, insider information. The Chinese wall originated in the US market and was quickly adopted worldwide. In Brazil, CMN Resolution 2451/1997 and CVM Instruction 558/2015, further amended by Instructions 593/2017 and 597/2018 deal with this issue. However, there are doubts about compliance with the law in Brazil or there would be no need for qualified and well-justified research such as Müssnich’s to study the impact of the illicit insider trading in Brazil. It is emphasized that such laws count, even, with timid inhibitors, almost null. The focus of this study is solely and exclusively associated with the regulatory view of the CVM.

The previously mentioned rules, including those that created the Chinese Wall in Brazil, are known to be generic, that is, they do not specify the situations in which the segregation of duties is essential and which procedures are considered appropriate when building an effective barrier. What it is possible to extract from the rules is that aspects such as physical separation of conflicting departments, restriction on access to files and computers applicable to the employees of an operation in relation to those of other operation (which may be different companies), employee training in awareness of the civil and criminal consequences of using confidential information, internal punishment, creation and dissemination of pro-secrecy culture, among others. Another important aspect of Brazilian legislation, which appears to be disconnected from the rest of the set of standards, is Article 9 of BACEN Resolution No. 2,723 / 2000, which establishes that, in Brazil, equity interests in companies subject to consolidation imply that (financial institutions and other institutions authorized to operate by BACEN) - full and unrestricted BACEN access to information, data, documents and verifications necessary for the evaluation of active and passive operations and risks assumed subsidiaries, regardless of their operational activity. Note that with this standard BACEN extends the regulatory scope not only to financial institutions and the like, but also to any other type of company, whether regulated or not by BACEN. The standard fails when it completes the text pointing out that it only covers “investees”, meaning that the scope is limited to companies that are below the parent company regulated by BACEN in the corporate structure, without reaching any companies that are above hierarchy of financial companies.

The simple withdrawal of the word “investee” from the standard would make it clear that, in order to be “necessary to evaluate the active and passive operations” of the companies, the transactions between the companies regulated by BACEN and its non-financial controllers should also be evaluated, the regulation would reach the corporate extension horizontally and vertically, reaching its full societal scope.

The CVM Instruction 555/2014 determines limits of concentration for the assets that make up the investment funds, but not for the shares, that is, there is free permission in relation to the concentration of this financial instrument. Of course, there are some requirements that the law makes, such as that the fund manager should make it clear in the documentation that will follow the shareholder that the fund has free exposure to stocks and may have limits concentrated in certain companies, for example, but nothing is made by the legislation, to avoid concentration on the equity participation of investment funds in non-financial corporations. On the contrary, the Brazilian legislation seems to allow and common practices, at least of the five

largest Brazilian banks, reject this facility and are prized by the zeal in relation to the risk that concentration brings, operating with dilution of participations. As a result, these banks do not have, at least in relation to the ten largest IBOVESPA companies, relevant holdings in these companies, which, as it is not prohibited, is the application of the best global risk management practices, by repelling concentration.

Finally, the current situation of Brazilian legislation in relation to the participation of financial companies in non-financial corporations needs to be reviewed jointly with the objective of repealing these existing laws and creating a regulatory framework, with a holistic view of the entire system. It makes sense to have Participation Investment Funds with unrestricted limits on corporate participation in non-financial companies by development banks, which is, for example, the focus of action of the National Bank for Economic and Social Development (BNDES) as defined by Paiva (2012), among others. The entry of these investments into segments that do not develop, can be a way to make this market viable, as was done by Petrobrás many years ago, in Getúlio Vargas' Government, with the creation of the state oil company to start exploration in Brazil. However, it is necessary to pre-establish rules that define the exact moment when the financial market must leave this segment, because it is already mature enough and no longer need this support that will become pernicious, maintaining a certain concentration in the segment, which will prevent its development, as is the case of the company VALE SA, very positive for the company, which is a giant, but negative for its competitors, who have no chance in this unequal dispute.

United States

After the stock market crash in 1929, also known as a “crash” on the New York Stock Exchange, the American society understood that it was important to create a law that would prevent recurrence of the facts that in that episode led the country to the crisis. For that society, one of the worst problems among those that caused the crisis was the participation of banks in non-financial companies, as Irwin (2015) states. Having established this, the creation of a law was studied, and the Glass-Steagall law was published in 1933, which segmented the financial market between the commercial and investment part, brought a strong state regulation, but with federal centralization, and prohibited the participation of bank advisers in non-financial corporations. However, with the passage of time it was possible to perceive that this law left loopholes that allowed the creation of participation companies, the so-called banking holdings, outside the regulatory arm. In 1956, a new law, the Banking Holdings, was published, which prohibited the existence of holdings that had shareholdings in more than two banks at the same time. However, over the years, society realized that the breaches of this law were again being exploited and that the existing bans brought problems to the competitiveness of the United States in the global economy, since in other countries it was possible to create of financial conglomerates that had the participation of commercial banks, investments, insurance companies, credit card companies and other financial companies, as Mahon (2013a) states. The society then called for changes in legislation so that the United States could become more competitive on the world stage. In 1999, the Gramm-Leach-Bliley law was enacted, repealing the two previous ones and allowing the creation of financial conglomerates, determining a size limit for financial subsidiaries in these conglomerates, and restricting cross-marketing between financial and non-financial firms of the same group (HAMILTON, 2015). In 2008, in view of the global financial crisis, experts started to blame it on the flexibilization of the Act enacted in 1999, an opinion with which White (2009) disagrees, as he believes that it was provoked by a combination of events, not an isolated fact. The crucial point is that even before the enactment of the aforementioned Act, Citibank had merged with the insurer Travelers, forming the first financial conglomerate, the Citigroup. What the Gramm-Leach-Bliley Act did was to legalize inevitable market changes so that the government would not lose power, says Mahon (2013b) and Sherman (2009).

In fact, the Congress started a debate with the society in search of answers to the crisis and in 2010 the Dodd-Frank Act was passed as a response, conferring even more regulatory powers to the FED, and providing for the Basel Committee's prudential standards, which are adopted by the central banks of the group of the countries with the 20 biggest economies in the world, the G20, and its third version is as follows:

The Basel III framework is a central element of the Basel Committee's response to the global financial crisis. It addresses a number of shortcomings in the pre-crisis regulatory framework and provides a foundation for a resilient banking system that will help avoid the build-up of systemic vulnerabilities. The framework will allow the banking system to support the real economy through the economic cycle (BANK FOR INTERNATIONAL SETTLEMENTS, 2010, p. 1).

The US adopted this version by adjusting the rules, making them stricter, where it became known as “US BASEL III” (PUTNIS, 2016, p. 618). The Act also set out stricter rules for the big villain of the crisis, the derivatives, with the establishment of a clearing organization. It established the Financial Stability Oversight Council and required banks to formulate a bankruptcy plan, which they would be forced to implement in certain cases, when banks were moving towards intervention, so that the transition would be milder and would affect less economy, as explained by Goodwin (2013).

The creation of financial conglomerates under the Gramm-Leach-Bliley Act aggravated the problem related to the “Too big to fail” companies, as defined by Mcmillan (2018, p. 106). They are the companies that, due to their enormous size, receive special attention of the government because in case of bankruptcy the effect in the US economy would be devastating. In the case of these companies, experts argue that the government has a differentiated treatment and ends up granting subsidized loans to avoid bankruptcy, which is unfair to the rest of the market.

In Brazil, from 2003 to 2016, a similar concept was introduced, from the BNDES support to “leading companies by sector, sales champions”. With cheap money these organizations would be better capitalized, they would depend less on market-based loans that are extremely high in the country and would grow faster, driving the productive sectors to a greater and faster growth of the Gross Domestic Product (GDP).

What has unfortunately been frequently found is the misappropriation of funds, which was emblemized by contractors involved in the scandals in Lava-Jato and the JBS Group of meats, financed by part of the political class.

For these reasons, the dominance of financial and banking groups on agricultural, industrial, commercial and service groups must be understood and correctly raised so as to avoid any misconduct and to adopt prudential and calibration measures in economic domains.

In this internal and external context, it was possible to observe the movements made by the United States over the years, to reinforce the regulation of its market, with its mistakes and correctness. Box 2 summarizes this picture well:

Box 2

US Regulatory Environment

Glass-Steagall Act 1933		Bank Holding Company Act 1956	
Pros	Cons	Pros	Cons
<ul style="list-style-type: none"> Segmented the financial market (Commercial and Investment) 	<ul style="list-style-type: none"> Increased bargaining power of banks with the Government (to save them from crises) 	<ul style="list-style-type: none"> Increased the regulatory powers of the FED 	<ul style="list-style-type: none"> Failed to follow the developments in the international financial market where financial conglomerates operated
<ul style="list-style-type: none"> Strict state regulation with federal centralization 	<ul style="list-style-type: none"> The loopholes allowed the creation of nonfinancial holdings out of the scope of regulation 	<ul style="list-style-type: none"> Improved the previous law 	<ul style="list-style-type: none"> The loophole allowed a holding company that had ownership interest in only one bank to have financial companies
<ul style="list-style-type: none"> Prohibited the board members of financial companies from holding ownership interest in nonfinancial companies 		<ul style="list-style-type: none"> Established the bank holding company and prohibited the holding company of more than two banks from having ownership interest in a nonfinancial company 	

Continuation

Gramm-Leach-Bliley Act 1999		Dodd-Frank Act 2010	
Pros	Cons	Pros	Cons
<ul style="list-style-type: none"> It allowed the creation of financial conglomerates (increased the competitiveness of the US financial market) 	<ul style="list-style-type: none"> It allowed the creation of financial conglomerates that have heavy concentration in the segment 	<ul style="list-style-type: none"> Conferred more regulatory powers to the FED 	<ul style="list-style-type: none"> Act currently in effect and without strong negative points pointed out by experts, except that its rule-based framework contrasts with the conceptual framework of Basel III
<ul style="list-style-type: none"> Created a size limit for the financial subsidiaries of conglomerates 	<ul style="list-style-type: none"> It allowed the creation of huge companies that are "too big to fail" 	<ul style="list-style-type: none"> Established stringent prudential standards (US BASEL III) 	
<ul style="list-style-type: none"> Restricted cross marketing between financial and nonfinancial companies of the same group 	<ul style="list-style-type: none"> US financial market experts accuse the Act of being the trigger for the 2009 global crisis as it repealed important parts of previous Acts 	<ul style="list-style-type: none"> Introduced stricter rules for derivatives (clearing organization) 	
		<ul style="list-style-type: none"> Creation of the Financial Stability Oversight Council 	
		<ul style="list-style-type: none"> It required banks to create a bankruptcy plan (precautionary planning) 	

Source: Elaborated by the authors.

CASE STUDY

The analysis of the participation of the five largest banks in the ten largest companies focused on three pillars: the indirect participation of financial companies in non-financial companies through investment funds, the direct participation of financial companies in non-financial companies and the direct participation of financial companies through a holding company.

Indirect holding of ownership interest through investment funds

In this study, it was verified that none of the five largest banks (except the BNDES, because it did not have any marketable investment funds) had a relevant stake, above five percent, in one of the ten largest Brazilian non-financial companies. Although there is no law prohibiting such participation, the largest banks practice risk management and diversification rules in their portfolios, diluting the risk that concentration on a holding can bring, as Ross, Jordan and Westerfield (2013, pp. 436). As the study focused on these companies, it is not possible to know whether the entire financial market practices the same techniques, so an additional study to understand whether, for example, smaller banks practice diversification to dilute risk would be important for studies in administration.

In fact, the first myth that large banks use investment funds to manipulate large non-financial corporations has been eliminated. The following tables will be presented for each year (2012 to 2016), with the equity holdings of the financial conglomerates in the ten largest non-financial companies, through the sum of the participations of the funds linked to these banks, in these companies (total percentage of ownership interest in the capital of companies):

Table 1

**Ownership interests held by the investment funds of the five largest banks
in the ten largest nonfinancial companies in Brazil**

2016					
COMPANY / BANK	ITAÚ	BRADESCO	BANCO DO BRASIL	SANTANDER	CAIXA ECONÔMICA
AMBEV	0.00%	0.08%	0.06%	0.02%	0.02%
PETROBRÁS	0.07%	0.34%	0.43%	0.14%	0.76%
VALE	0.00%	0.63%	0.58%	0.29%	0.87%
BRF	0.00%	2.24%	0.20%	0.10%	0.07%
ULTRAPAR	0.00%	0.19%	0.13%	0.06%	0.05%
CIELO	0.00%	0.13%	0.25%	0.03%	0.02%
KROTON	0.00%	0.21%	0.15%	0.09%	0.07%
TELEFÔNICA	0.00%	0.13%	0.13%	0.03%	0.03%
JBS	0.00%	0.15%	0.10%	0.05%	0.04%
RENNER	0.00%	0.26%	0.16%	0.12%	0.07%
2015					
COMPANY / BANK	ITAÚ	BRADESCO	BANCO DO BRASIL	SANTANDER	CAIXA ECONÔMICA
AMBEV	0.11%	0.10%	0.06%	0.02%	0.02%
PETROBRÁS	0.32%	0.34%	0.45%	0.12%	0.65%
VALE	0.61%	0.57%	0.75%	0.35%	0.91%
BRF	0.32%	2.31%	0.27%	0.16%	0.07%
ULTRAPAR	0.23%	0.36%	0.21%	0.09%	0.05%
CIELO	0.17%	0.20%	0.33%	0.08%	0.03%
KROTON	0.41%	0.41%	0.22%	0.09%	0.08%
TELEFÔNICA	0.13%	0.15%	0.12%	0.04%	0.04%
JBS	0.36%	0.20%	0.15%	0.05%	0.08%
RENNER	0.44%	0.42%	0.32%	0.22%	0.09%
2014					
COMPANY / BANK	ITAÚ	BRADESCO	BANCO DO BRASIL	SANTANDER	CAIXA ECONÔMICA
AMBEV	0.12%	0.15%	0.09%	0.04%	0.02%
PETROBRÁS	0.43%	0.55%	0.47%	0.15%	0.82%
VALE	0.78%	0.85%	0.82%	0.37%	1.05%
BRF	0.42%	2.32%	0.31%	0.23%	0.08%
ULTRAPAR	0.34%	0.43%	0.30%	0.14%	0.05%
CIELO	0.18%	0.46%	0.57%	0.17%	0.04%
KROTON	0.79%	0.51%	0.42%	0.17%	0.09%
TELEFÔNICA	0.18%	0.22%	0.20%	0.04%	0.04%
JBS	0.17%	0.29%	0.18%	0.07%	0.07%
RENNER	0.47%	0.45%	0.29%	0.35%	0.07%

Continuation

2013					
COMPANY / BANK	ITAÚ	BRADESCO	BANCO DO BRASIL	SANTANDER	CAIXA ECONÔMICA
AMBEV	0.09%	0.12%	0.07%	0.04%	0.01%
PETROBRÁS	0.46%	0.58%	0.44%	0.20%	0.85%
VALE	0.91%	1.01%	0.84%	0.46%	1.08%
BRF	0.44%	2.92%	0.28%	0.20%	0.07%
ULTRAPAR	0.27%	0.79%	0.25%	0.40%	0.05%
CIELO	0.25%	0.50%	0.01%	0.10%	0.05%
KROTON	0.80%	0.51%	0.25%	0.03%	0.08%
TELEFÔNICA	0.14%	0.14%	0.25%	0.05%	0.02%
JBS	0.19%	0.29%	0.18%	0.02%	0.07%
RENNER	0.47%	0.64%	0.33%	0.73%	0.12%
2012					
COMPANY / BANK	ITAÚ	BRADESCO	BANCO DO BRASIL	SANTANDER	CAIXA ECONÔMICA
AMBEV	0.02%	0.03%	0.01%	0.01%	0.00%
PETROBRÁS	0.58%	0.66%	0.49%	0.26%	0.90%
VALE	1.03%	1.12%	0.83%	0.56%	1.16%
BRF	0.41%	0.63%	0.25%	0.19%	0.06%
ULTRAPAR	0.28%	0.56%	0.20%	0.20%	0.04%
CIELO	0.21%	0.41%	0.01%	0.06%	0.03%
KROTON	0.05%	0.24%	0.21%	0.17%	0.01%
TELEFÔNICA	0.28%	0.15%	0.33%	0.07%	0.02%
JBS	0.30%	0.39%	0.23%	0.10%	0.05%
RENNER	0.63%	1.41%	0.48%	0.25%	0.18%

Source: Quantum System of Paramita Tecnologia Consultoria Financeira.

Direct holding of ownership interests

After analyzing the holdings of the financial companies in the ten largest non-financial companies, B.B. Banco de Investimentos S.A., of Banco do Brasil, was detected in CIELO S.A., a non-financial company in the electronic payment market segment. This financial company held 28.65% of the equity interest in CIELO from 2012 to 2016. There was also the participation of Columbus Holding S.A. in an identical percentage, in the same period. Columbus Holding S.A. is a non-financial holding company owned by the Bradesco group, which is outside the regulatory arm of BACEN and is not a publicly-held company. It is also outside the CVM's regulatory arm. As main characteristics of the pernicious effect of the participation of the financial company in the non-financial, the study of the financial statements and the dynamics of the market segment that CIELO is inserted presented:

1. The electronic payment market is a duopoly formed by CIELO and REDE, the latter being controlled by the Itaú Group. The concentration in the hands of few companies prevents new entrants and restricts competitiveness. In addition, there is less tax collection and less jobs directly and indirectly created by such company's suppliers, given the small number of competitors;
2. CIELO, instead of pursuing a long-term investment policy focused on long-term reinvestment and growth, pays dividends well above the average, which is the minimum required by the Brazilian Corporation Law, of 25% of net income. CIELO paid 50% of dividends from 2012 to 2015 and 30% in 2016. In addition, it paid additional dividends in significant amounts from 2012 to 2015 (not paid in 2016) between R\$ 284 million and R\$ 500 million, at an average of R\$ 394 million per year;

3. Some former executives from both banks participate in the administration of CIELO, as shown below in Box 3:

Box 3

**Participation of executives and former executives of controlling financial
companies in the management of nonfinancial subsidiaries**

Bank	Executive	Note	Election date
Bradesco	Milton Almicar Vargas	Former executive of Banco Bradesco (not informed on CIELO's reference form)	04.08.2016
Bradesco	Herculano Anibal Alves	Former executive of the Bradesco Group (Bradesco Asset Management- BRAM)	04.12.2017
Brasil	Francisco Augusto da Costa e Silva	Former executive at Banco do Brasil (not informed on CIELO's reference form)	04.08.2016
Brasil	Alberto Monteiro de Queiroz Netto	Executive of Banco do Brasil	03.10.2017

Source: CIELO Reference Form dated 12.31.2016, option 12 – Stockholders' meeting and administration, sub option 12.5 / 6 - Composition and prof. of adm. and CF; Bloomberg Research and Banco do Brasil website.

In the explanatory notes to CIELO, specifically in the Related Parties note, there was no mention of the fact that executives and former controlling executives are part of CIELO's current management, as determined by the International Accounting Standard (IFRS), regarding significant influence.

4. In Revista Exame (2017, p. 350), the company's reported adjusted net income amounted to US\$ 1,156.5 million in 2016, whereas REDE's (Redecard) amounted to US\$ 960.5 million in the same year. The annual ROI stood at 35.8% in the year in which the CDI stood at 14%;
5. In the financial statements as of December 31, 2016, the company reported a balance of advance on receivables amounting to R\$ 574,604 thousand, which paid interests of 101.96% of the interbank deposit rate. It is worth mentioning that such transaction is made with the majority stockholders and pays unequal remuneration to stockholders, as non-controlling interest holders are not entitled to such remuneration. To make matters worse, after analyzing the company's cash flow statement, the total cash inflow from operating activities amounted to R\$ 5,129,403 thousand in 2016, the total cash amounting to R\$ 1,409,432 thousand, causing the above-mentioned advance on receivables, with interests above the CDI, to be a transaction that seems unnecessary for the company's operations, given its cash inflow from operating activities.

"[...] a competitive market is much better and more efficient than a duopoly. Rooted in a status-quo that causes damages to creative competition and fair play, a duopoly owning a clearing house in which it knows all acquirer and facilitator transactions is an appeal and invitation to insider information, banned and condemned by the Law, CADE and the CVM. It calls for immediate and agile action by the monetary authority so that market conditions are established to provide equal opportunities to all stakeholders of supply chain" (KASZNAR, 2017, p. 125).

From the above points, it can be understood that the participation of financial companies in this non-financial company is not only detrimental to the management of the company and jeopardizes its continuity in the long term, as it brings bad effects to the duopolized market segment, which creates barriers to new entrants, and also to the economy of the country, as it avoids the generation of jobs and more taxes paid, among others.

However, the counterpoint is understood: it is a business right to own and control another company. Thus, sectoral concentration is a characteristic of the liberal, competitive and capitalist market. The supposedly pernicious aspect can be solved in part that is with better and greater regulation and market orientation, by the State, as long as it is probó, ethical and fair for the whole society.

Direct holding of ownership interests through group holding company

In this analysis, besides the aforementioned holding of ownership interests by Columbus Holding SA, owned by the Bradesco Group, in CIELO, it was found the holding of ownership interests by BRADESPAR, the holding company of Bradesco Group that is, as in the case of Columbus Holding, out of the scope of BACEN's regulation, but under the CVM's regulation, as it is a publicly-held company. It was not found any other significant ownership interests held by other financial groups in the ten companies.

BRADESPAR holds a 6.5% interest in the capital of VALEPAR SA, which in turn has a 33.12% stake in the capital of VALE S.A. In this case, we found that VALE has the monopoly on the Brazilian mining segment, reporting net sales of US\$ 14,551.1 million in 2016, according to EXAME (2017, p. 334), whereas Salobo, ranked second, reported US\$ 1,112.5 in the same period. VALE's market share is 72.2% while Salobo's is only 5.5%.

In relation to the participation of management members of the parent company in the subsidiary, it can be verified in Box 4, which was noted:

Box 4

Participation of current and former executives of parent financial companies in the management of nonfinancial subsidiaries

Bank	Executive	Note	Election date
Bradesco	Moacir Nachbar Júnior	CRO (Chief Risk Officer) of Banco Bradesco S.A.	04.20.2017
Bradesco	Denise Pauli Pavarina	Former Executive Officer of Banco Bradesco BBI S.A. between 2015 and 2017	04.20.2017
Bradesco	Fernando Jorge Buso Gomes	Corporate Officer of Banco Bradesco between 2003 and 2006	04.20.2017

Source: VALE Reference Form of 12.31.2016, option 12 - Assembly and administration, sub option 12.5 / 6 - Composition and prof. of adm. and CF; Bloomberg Research and Banco do Brasil website.

CONCLUSIONS

This article aimed to discuss the effect of the direct and indirect holding of ownership interests by the five largest Brazilian banks in the ten largest nonfinancial companies that make up the Brazilian Stock Exchange Index (IBOVESPA).

In the analysis of the US regulation and drawing a parallel with the Brazilian regulation, it was possible to stress the aspects in which Brazil shows advances, such as the adoption of the techniques established by the Basel Committee before the United States, as well as other aspects in which it is behind, such as the fact that bank holding companies are out of the scope of the regulation.

It is advisable to undertake a comprehensive study on the laws that deal with the holding of ownership interests by financial companies in nonfinancial companies, with a holistic and integrated view, the repeal of the current laws and the enactment of a rule-based regulatory framework that clarifies the specific cases in which financial companies may hold relevant ownership interests in nonfinancial companies.

These should be cases with specific purposes, such as giving liquidity to a market in formation or another that is seriously shaken and still with chances of recovery. It is necessary to define the rules of time of permanence of a majority controller whose goal is exclusively the control of supply chains and the maximization of bank returns.

The analyzes carried out in the financial conglomerates of the five largest banks show that, unlike the other conglomerates, Santander and Banco do Brasil do not have non-financial companies outside the regulatory body.

It was verified the direct participation of a financial company of Banco do Brasil in CIELO in partnership with a non-financial holding company of the Bradesco Group, in which each held 28.65% of equity interest. In addition, the participation of another non-financial holding company of the Bradesco group, BRADESPAR, was detected in VALE. These two findings were studied.

Several indications of practices that benefited the short-term investor, the speculator, were observed instead of the traditional investor, without taking into account the dynamics favorable to the market segment in which the companies were inserted or to the effect in the national economy, such as participation of executives and former executives in the management of these companies and the lack of transparency in disclosure, imposed by International Financial Reporting Standards (IFRS). These standards were not necessarily fulfilled in full in relation to the significant influence of one organization on the other or the payment of dividends - since it occurred at levels much higher than the market average - and the low investment in research and development when compared to competitors. Both companies operate in exclusive markets, that is, VALE in a market in which it manages a monopoly and CIELO in a duopolistic market, dividing the leadership with the REDE, of the Itaú group.

It can be argued that the domination and control of one organization over another is part of the processes of political, institutional, productive and financial market relations. It is natural and valid that banks want to expand. However, one has to ask whether there are no limits to conglomeration processes. What benefits a group of shareholders can potentially harm members of a society, a community and, therefore, citizens.

Rules of the game and regulations well designed and implemented, promote good production practices and can generate a win-win result.

For the research in Administration, the conclusions of the study attest to the existence of significant participations of financial companies in non-financial and show the need to improve the regulatory process, so that it is possible to give more fairness to the competitive and productive treatment of the segments in which there is the shareholding of financial companies in non-financial corporations.

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