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### **New Financial Regulations in Cuba: Less Autonomy for Monetary Policy and More Space for Foreign Capital and Microcredit**

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To date little attention has been paid to regulations that create a new regulatory framework for the Cuban banking system. On October 12, 2018, the *Gaceta Oficial de la República de Cuba* published two law-decrees, 361 and 362, designed to reorganize the functioning of the Cuban central bank, the commercial banks and the rest of the banking system. These new law decrees replace Decree-Law 172 and 173, which in 1997 gave rise to the Central Bank of Cuba, bringing the regulatory system closer to international standards and providing more autonomy to the monetary policy - although it never operated completely independently. These older two decrees created the legal framework for the banking reform of the 1990s.

The new regulations issued last year do not reveal an intention to promote a new structural banking reform, although they reflect new nuances and introduce novel concepts that could provide some insight into the management of monetary, credit and financial policies in the future. Perhaps the most interesting is the new space granted to foreign capital and microcredit within the financial system.

#### **New Regulatory Framework for the Central Bank**

**Decree-Law 361** establishes the mission, functions, and norms for the organization and operation of the Central Bank, as well as the responsibilities

of its president, vice president, superintendent, and its Board of Directors. The mission of the Central Bank has stayed relatively the same as that in 1997. Now it is worded as follows:

The Central Bank of Cuba has the mission to promote, according to its faculties, the stability of the purchasing power of the national currency and to contribute to the harmonious development of the economy; to exercise the regulation and supervision of financial institutions and representative offices of foreign financial institutions authorized to be established in the country.

That is, monetary stability is the main objective, but leaving open the possibility of influencing other aspects that contribute to the “harmonious development of the economy” and to supervise and regulate financial institutions, which is distinctive in the Cuban case, given that the banking superintendence is part of the Central Bank.

It is not a mission solely focused on the control of inflation, although it does appear as the first objective. The ambiguous inclusion of “harmonious development” means that the Central Bank can participate in policy decisions beyond the methods directly available to it—adjusting the money supply, setting interest rates and other instruments of monetary control, etc.

In the more specific wording of its functions and faculties, it now wrests from the institution autonomy for monetary policy, and emphasizes that policy must be made in harmony with fiscal policy and with the rest of the macroeconomic policies. For example, the first two specific functions are drafted as follows:

- a) To propose monetary, financial, credit and exchange rate policies, coordinating their designs and scope with the fiscal policy objectives and, once approved, to direct and execute their application.
- b) To regulate the amount of money, the interest rate and credit, according to monetary policy, directing credit to the prioritized sectors defined in the economic policy.

A chapter on macroeconomic coordination absent from previous regulations is now incorporated as follows:

ARTICLE 83.1. The macroeconomic coordination will be determined based on an annual policy agreement signed by the ministers of Economy and Planning and of Finance and Prices, as well as the president of the Central Bank of Cuba.

2. The annual agreement contributes to harmonizing the policies of the aforementioned organizations, and is aimed at achieving the macroeconomic objectives that are established. Among other aspects, it will contain the established ranges necessary to guarantee the growth of the economy, stabilize prices, fiscal and external balances and assessment of the social repercussions of the economic policies used to achieve the objectives.

This type of economic policy arrangement, with this scale and objectives, would be novel in the regulatory framework of the Central Bank. We do not know if the annual agreement will be made public and transparent, how it will be implemented and monitored, and its interplay with the annual plan of the Ministry of Economy and Planning. What is certain is that the new norms do not contemplate the design and exercise of an autonomous monetary policy, rather that process is made subject to macroeconomic coordination.

On the other hand, the new regulations try to limit the financing of the fiscal deficit, although without completely prohibiting it. Article 58 provides that:

The Central Bank of Cuba can grant credits to the State in the following cases:

- a) To meet temporary liquidity needs within the limits of the monetary program, through short-term advances or other credit modalities, payable before the last accounting day of each year; credits that will be granted at interest rates applied by financial institutions; and
- b) when determined by the Council of State in cases of national emergency.

Whereas Article 59 provides that:

The Central Bank of Cuba can act as a direct purchaser of State securities only for open market operations or for monetary policy reasons.

In other words, with these two new articles, the monetization of the fiscal deficit is limited, leaving the only exceptions for short-term financing (one year) and in cases of national emergency. The previous regulations provided that the Central Bank could only finance the fiscal deficit if it was approved by the Cuban Council of State, which in practice occurred every year in accordance with the National Budget approved by the National Assembly. Therefore, the new norms represents a step forward by limiting the issuance of money to finance public spending.

In practice in recent years the Cuban government has been issuing public bonds to finance fiscal imbalances. This method has allowed the expansion of the fiscal deficit in order to cushion the impact of the Venezuelan crisis on the Cuban economy, without this being reflected in higher inflation.

The new regulations, like the previous ones, also allows the Central Bank to borrow money from external sources on behalf of the State. The new regulation is worded as follows in Article 57: "The Central Bank of Cuba can borrow from external creditors to finance the Balance of Payments on behalf of the State, following a favorable report from the ministries of Economy and Planning and of Finance and Prices, and their cost and the exchange rate differential will be repaid with resources from the State Budget."

This article permits the Central Bank as an institution to actively participate in managing imbalances in the Balance of Payments and the ability to borrow abroad.

A final notable detail is that the new norms confirm that the monetary unit of the Republic of Cuba is the Cuban peso, and, unlike the prior regulations, does not allow the Central Bank to carry out operations in foreign currency. Therefore, the new regulatory framework for the Central Bank contemplates that the future monetary system will have the Cuban peso as the sole currency.

Other functions that remain within the Central Bank sphere are:

- To regulate credit levels and the interest rates.
- To execute, once approved, the monetary exchange regimen.
- To establish legal reserve requirements and act as a lender of last resort for financial institutions.
- To grant licenses for the creation of financial institutions.
- To approve the appointment of top-level managers of financial institutions.
- To dictate the rules, procedures and regulations to execute the supervision of financial institutions.
- To prevent the use of the banking and financial system for illicit activities, including money laundering and financing of terrorism.
- To exercise the regulation and surveillance of the country's payment systems.
- To represent the State before international banking, monetary and credit organizations.
- To compile and publish the country's Balance of Payments.
- To keep the statistical record of the country's external debt.

The rest of the new regulations on monetary policy and relations within the financial system do not reveal material changes. In general, the new regulations take the Central Bank's more than 20 years of operating experience and adjust the regulations to the practices developed in recent years within the Cuban banking system and the prevailing economic system. This differs from Decree-Law 172 of 1997, which was drafted with the regulations of the central banks in the region as the point of reference and required the adjustment of financial procedures and monetary analysis to serve an economy that was being decentralized and was opening to international markets.

With the rapprochement to Venezuela and the backpedaling on the reforms from the beginning of the century, many of those procedures were left unfinished or never fully applied. The new decree laws rather recognize that in an economy that remains centralized, with price controls and with state monopoly in most markets, the independence of the Central Bank is unrealizable and probably unnecessary. In the current system, coordinating the different policies can be more useful.

### **New Regulatory Framework for the Banking System**

On the other hand, **Decree-Law 362** establishes a new legal framework for the operation of the financial system. It adopts procedures to create new financial institutions, establishes the type of financial institutions that can operate and the type of services they can offer, defines the role of foreign investment in the financial system and establishes a framework for the management of accounting and the presentation of the financial statements. It also sets standards for the management of bank secrecy, for banking supervision and for the operation of the new Risk Information Center.

In the new regulations, what stands out is the different organization contemplated for the structure of the financial system. Previously, banking regulations provided for a variety of licenses, which defined the scope of services and the type of financial intermediation that institutions could carry out. By contrast, Decree-Law 362 of 2018 defines seven different types of financial institutions with separate functions. These are:

- Universal bank.
- Corporate bank.
- Second-tier bank.
- Investment bank.
- Non-banking financial institution.

- Exchange houses.
- Investment fund management companies.

The universal banks are intended to provide services to individuals (population) and legal entities (enterprises and organizations), receive deposits and lend to both. In addition to debit cards, they will be able to issue credit cards, something not contemplated in prior law. This type of institution would be allowed to: engage in a wide range of financial services, such as the purchase and sale of currencies, factoring, transactions with letters of credit and other documents of international trade, provide services to hedge the risks associated with interest rate and foreign exchange fluctuations and engage in other activities necessary for risk management, and offer advisory and investment banking services, among others. Another novel feature is that the new legislation also mentions offering microcredits as one of the functions of universal banks.

Corporate banks would have similar functions to those of universal banks, but these would only be provided to legal entities and would specialize in international banking and investment banking.

Second-tier banks, as the name implies, would not engage in transactions directly with individuals and legal entities, but would channel their resources through other financial institutions, which would perform risk analyses and assume the risk of directly interfacing with the clients. Second-tier banks would not take bank deposits from individuals and businesses.

The investment bank would have among its main functions to advise on capital market transactions and the operation of foreign financial markets, as well as the organization of investment funds and business administration. It would promote investment projects and could issue debentures and act as an agent in the issuance of bonds and other securities. It would invest in capital markets, advise or participate as an agent in purchase and sale transactions of companies or obligations. It would provide financial engineering services, offer products to hedge interest rates, currency exchange fluctuations and perform financial leasing operations, among others.

Non-banking financial institutions aim at extending credit and providing various other financial services, but could not take deposits from individuals and businesses. Among the services mentioned, the ability to provide microcredit products stands out, which again shows that the new legal framework tries to have the financial system respond to the national small-scale private sector.

Finally, exchange houses are to continue their essential function of foreign exchange operations; and the Investment Fund Management Companies would have the mission of managing investment funds created both inside and outside national territory.

At the moment, there is no information on which existing Cuban banking institutions would fall within each of the categories established by the new regulations, nor is it known if new institutions will be created or some of the existing ones merged. The Central Bank's website does not yet have an updated financial system structure.

With regard to foreign financial institutions, they will be able to continue to establish representative offices in Cuba, which would be run by and on behalf of their parent office. They can provide advisory services and technical assistance in order to facilitate foreign trade and coordinate business activity, but not carry out financial operations in national territory.

However, something novel appears in the new regulations - the ability of foreign investors to participate in the national banking and financial system. Previously, it seemed possible under Decree-Law 173, although it was not explicitly stated, that a financial institution with totally foreign capital could be created. Now Article 21 provides as follows:

Foreign financial institutions or foreign investors can participate in the banking and financial sector under the following modalities:

1. Through the acquisition of shares of Cuban financial institutions created under the Foreign Investment Law; and
2. Through the formation of financial institutions organized as corporations with mixed public and private capital or totally foreign capital or as international economic associations, as provided in the Foreign Investment Law.

Article 24.1 lists the requirements to establish a totally foreign-owned institution. In essence, it provides that they have the obligation to demonstrate that they are subject to supervision by and are located in a country with which the superintendence of the Central Bank of Cuba can sign agreements that ensure adequate coordination and exchange of information with the supervisory authorities of the country of origin.

Interested parties should send the application to the Central Bank of Cuba, accompanied by the documents required to form all financial institutions. The documents include: type of institution to be organized and activity it intends

to perform, organizational documents of the applicant entity, copies of financial statements, feasibility study and business plan, information on shareholders and share capital, proposed organizational structure for the financial institution, name of the person proposed for president, as well as the senior managers, among other requirements.

Finally, it is worth noting that the new legal framework conserves the ability for financial institutions to provide services in national currency as well as in foreign currency. Therefore, this suggests that monetary unification will not lead to a prohibition on the use of foreign currencies to operate bank accounts and make loans.

As in the 1990s, we will have to see how much of this new regulation will actually be implemented. The new structure and covered financial services appear to be broader and more diverse, but the actual demand for such options will depend on structural changes in the enterprise system and the consumer markets.

While the new regulations do not seem to be promoting a banking reform, they do leave the financial system comfortably poised and prepared to accompany a deepening of the structural changes in the economy, in case these changes are adopted in response to the current crisis.