



Market based financing for global economic growth - A forward looking approach

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CVM and Enforcement as a key element of regulation

We all agree on the key role capital markets may – and should – play in the process of supporting economic growth. And that is basically what we will be discussing in these two days!

In order for capital markets to effectively and successfully support a country's economic growth, it is crucial that the regulator (be it the CVM or any other) be positioned both internally and externally as a part of the equation.

CVM, like every other capital market regulator, has a number of different roles and attributions – all of which, in the end of the day, contribute to the same end – an open and resilient capital market – which walks hand in hand with economic growth.

Such roles include supervisory, educational and legislative duties. However, no matter how great CVM can be at carrying these out, they will have served no purpose, nor bring any results, if we do not excel in the enforcement process – in my view, one of our greatest challenges. The quality, strength and degree of the enforcement process is and will continue to be the leading indicator of how credible a capital market is and of what it can and is likely to become.

In our experience, the first direct interaction most investors have with the CVM is a cry for help in the form of a complaint. So, basically, when all is well – radio silence, but when an investor feels that he was harmed or received unfair treatment – we must be ready to promptly listen, understand, act and communicate.

The enforcement process begins long before having to actually rule on a case – it begins from the moment a complaint is filed – or from the moment CVM, as a supervisory agent, formally identifies a potential irregularity and begins to question it.

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The outcome of the process depends greatly on the level of our efficiency and ability to:

- i. conduct productive investigations;
- ii. build grounded cases; and
- iii. make proportional, balanced and timely choices, selecting events that shall be investigated, pursued and taken to trial.

These are CVM's main pillars supporting its enforcement duties, while striving to maintain and promote sustainable capital market activity.

Having said that, the enforcement process is highly sensitive for three main reasons:

- it has a significant and direct impact on the defendant's life and business;
- it demands a strong, ongoing and rational effort from the regulator – given that high quality and efficient enforcement requires consistent and objective findings based on solid legal ground rather than personal views or beliefs; and
- it is not only directed at the wrongdoer in question, but also serves an educational purpose for the market in general that views due and timely enforcement as an discouragement to practice unlawful activities.

However, no matter how hard we excel in setting rules or how committed our supervision plans are, unless our enforcement is perceived as effective, our reputation and credibility will hardly be acknowledged, which will have a negative impact on the overall enforcement activity and on market confidence.

On the other hand, whether you are an A+ or an F student in the subject of enforcement, criticism and demands will always be present! When faced with such scenario, we have two options:

- i. take a defensive position and claim that we have done everything in reach and that our constraints leave no room for much improvement; OR
- ii. acknowledge our weaknesses, but work on a solid plan to overcome them – we cannot allow bureaucracy and other limitations to keep us from evolving towards a more open, robust, safe and credible market.

We, as a Commission, once again in our history chose the second alternative. Not necessarily the easiest one and certainly the alternative that is far from our comfort zone.

In the beginning of 2013, we, at CVM, felt that our overall role would be better executed if we stopped, stepped back, and

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- i. asked ourselves how the capital markets could and should evolve throughout the next decade; AND
- ii. what ought to be done in these next ten years in order to accomplish and understand such envisaged robust capital market.

The task of predicting the development of the Brazilian capital markets is not an easy one – however, I think it's safe to say that the upcoming reality will be a lot different and demanding than the one we know today' – mainly due to the geometric progression of new technologies, speed and flow of information and how knowledge, in general, will be acquired, kept and managed.

However, no matter how demanding or challenging such a new reality will be, it is crucial that we define a clear list of priorities.

It did not come as a surprise when one of the first conclusions that came out of our Strategic discussion was that we should pay special attention to our Enforcement Process.

Many factors may undermine enforcement measures. Specifically in our case, market participants usually identify three main bottlenecks:

- 1) the absence of electronic proceedings;
- 2) the time it usually takes to investigate a matter and to take a case to trial; and
- 3) outdated sanctions that may not be sufficiently severe;

I would like to side with the investors specifically concerning this last point - not only for punishment purposes - but also because the sanctions are designed to effectively discourage wrongdoings, and not to be viewed by the potential wrongdoer as a possible (but bearable) negative variable of the transaction. Market participants must be aware that there are real and meaningful consequences for those who violate the rules.

It is imperative that our enforcement activities have accountability, be consistent, efficient and provide prompt responses. That will support markets that work well and investors that feel protected. As a result, the cost of capital to finance growth will also be lower, which will intensify and stimulate investments and reinforce a positive cycle. In other words, promote effective credible deterrence is a key element in improving investor protection and confidence in the capital markets!

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Given the significance of the matter, in August 2013 (following our strategic session), a Task Force composed of individuals from various divisions across the commission was set up in order to streamline the process of enhancing and improving our enforcement, with the duty of reporting back, within 12 months or so, with objective recommendations to this end.

The team has reported back with their views and suggestions – and, currently, CVM has been working on the implementation of some elected recommendations with the aim of strengthening our enforcement efforts and consequently our capital market fundamentals.

To illustrate what I just told you, I will give you a glimpse of **FIVE** of these recommendations – all of which are already underway and capable of adding value to the Brazilian capital market.

The FIRST recommendation was to centralize information from the different divisions engaged in enforcement under one control/reporting area so that our Senior Staff could have an overall picture and access to a consolidated database of the enforcement efforts across the organization.

To address this point, we expanded and strengthened the role of our former control/reporting area (CCP), which is now responsible for consolidating, evaluating and sharing enforcement data.

We trust this measure will promote interaction among the divisions and, thus, bring more transparency, value and synergy into our enforcement process. After a few months of its implementation, it is clear how such measure made it easier to monitor the different stages and progress of an ongoing investigation or administrative proceeding.

The SECOND recommendation relates to the better use of technology in the Commission. Such recommendation will have to be tackled in stages and will entail multiple initiatives, such as:

- i. The Commission is carefully planning the upgrade/expansion of its computer systems that monitor trading activities. The existing one suits us well today but we must anticipate our upcoming needs;
- ii. We also have begun implementing an Electronic Information System where every investigative and sanctioning proceeding will eventually be electronic. We trust that this measure will benefit procedural actions and promote higher interaction between the divisions; and

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iii. We are in the midst of completing the implementation of a new interview recording system in order to improve the enforcement activities led by the departments involved in sanctioning proceedings. Such system is expected to provide a more accurate, reliable and faster information gathering process.

The THIRD recommendation relates to fortifying our external partnerships with the Federal Police, the Judiciary sector and, particularly the Federal Public Prosecutor's Office.

The coordination and arrangements with these partners are extremely important for consistent sanctioning actions against capital markets violations that go beyond our mandate as it is the case of Insider Trading and Market Manipulation.

Each of our partners has specific expertise and authority that, when combined, can provide a stronger system of oversight, monitoring and enforcement. Such cooperation ensures that our enforcement and sanctioning activities are complete and broadly covered.

For instance, last year, the CVM and the Federal Prosecutor's Office renewed a Technical Cooperation Agreement entered into by them to jointly promote actions for the exchange of information and the improvement of regulatory activities, monitoring and investor education.

Under this Agreement, during the year of 2013, we worked together with the Federal Prosecutors in at least 5 occasions, which included judicial blocking of assets and search and seizure orders to investigate churning practices and other market abuse.

CVM is usually invited by courts to act as *amicus curiae* in some judicial cases discussing capital markets issues. So, more and more, we will have the opportunity to expose and explain our views as part of the Judiciary decision process.

The FORTH recommendation is to enrich our joint enforcement efforts with the Self Regulatory organizations.

CVM has many important partners in self-regulation, which minimizes duplicated regulatory efforts and plays an important role in optimizing the overall market enforcement actions.

The BM&FBOVESPA Market Supervision (BSM), for example, operates through self-regulation under the supervision of the CVM and helps us with the surveillance of the capital markets, inspecting and supervising the broker dealers.

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The BSM and the CVM regularly exchange information over this matter, which strongly helps enforcement measures from both entities.

We encourage other SROs to continue exploring concrete ways to optimize our Enforcement efforts.

The FIFTH recommendation sets certain goals in terms of speed and quality – for both CVM's Divisions and the Board of Commissioners.

The process of accommodating both speed and quality is not easy – especially considering that time is essential in certain phases of the enforcement process. However, it is fair to say that taking to trial a 10-year old case, for example, is not good practice and often hinders the commissions' capacity of assessing its merits.

Thus, our challenge here is to accelerate the phases of the enforcement process without affecting the quality or the nature of the procedure – which is not an easy task! Cases are unique and often require different administrative steps along the way! Having said that, we all know that if something is material and important for the capital markets guidance and development, it should not take so long between the fact and its trial.

As a well-known Brazilian lawyer and politician (Rui Barbosa) well said, "late justice is not justice, but qualified and manifest injustice".

As a consequence of this reflection, three main and complementary objectives were formally established:

- i. A commitment to clean the shelves: by the end of this year, the divisions dealing with enforcement are expected to have directed to the investigation stage all internal proceedings of which the triggering event occurred prior to Jan 1 2009;
- ii. By the end of 2015, there should be no proceeding waiting for trial that has been allocated to a Commissioner before Jan 2013.
- iii. We are monitoring the percentage of administrative proceedings not resulting in convictions, in order to identify and correct inconsistencies in the investigation and trial procedure as a whole.

All things considered, from 2016 onwards, it is expected that there should be no proceeding waiting for trial for more than two years after having been allocated to a Commissioner.

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It is worth mentioning that the recent proceedings will continue to be taken to trial on the same basis as before. There will be no delay or disturbance in the judgments despite the objectives of cleaning up the past I just mentioned.

On the resources side, this year, we managed to increase our group of analysts in about 10%. Half of the analysts were allocated among enforcement-related areas, such as the Division of Enforcement and the Division of On-Site Inspections.

Also, we are in the process of increasing the number of advisors for each member of the Board of Commissioners. We expect this measure will assist the Commissioners in the sanctioning process and contribute towards timely and more effective actions.

Following what is already under execution, I would like to highlight where our discussions are heading in the next 12-18 months in this effort to continue strengthening the enforcement process.

The basis of a solid capital market is to ensure all relevant information is provided timely and equally to all participants, preventing specific agents from profiting by misusing non-disclosed information.

Fighting against the use of privileged information is one of the Brazilian market key issues today and a significant concern for us. We strongly believe that a healthy capital market cannot coexist with insider trading and asymmetric information, once it brings uncertainty and lack of confidence to investors.

Again here, we should avoid excuses such as "this is too difficult to solve", or "the market is relatively small and is hard to prevent people from talking" and so on.

I know it is not easy, but the issue is basic and for no other reason, a frequent complaint I hear when I talk to institutional investors who invest in Brazil.

If we want Brazil to have an increasingly relevant capital market, we need to continue addressing the subject; no matter how challenging it is we cannot give up and need to have a plan!

In concrete terms, we are right now starting to shape a task force involving every area of the CVM, which, in some way, oversees and enforces insider trading.

This task force will be responsible for researching new technologies and methods of investigation and study how we should better organize ourselves in order to approach this subject with more effectiveness in an active capacity building effort.

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Such efforts will possibly involve the review of policies and procedures designed by financial conglomerates and corporations in order to prevent the misuse of material, nonpublic information, with the objective not only of identifying flaws, but most of all, identifying and recommending standards that should be pursued.

Anticipating this task force, in the first half of this year, CVM has already taken two initiatives towards enhancing our approach in how we deal with insider trading.

Firstly, we segregated the supervision of primary and secondary insider activity between two different areas, taking into account their specific expertise.

Secondly, CVM started monitoring 100% of the trades by primary holders of information within 15 days of the release of financial reports as trading is forbidden during this period by the CVM's rules.

I am looking forward to having this task force up and running in the next few months and I am certain they will come back with concrete and useful recommendations.

On a final note, it is undeniable the current tendency of increasing international activity in the securities and derivatives markets.

In order to undermine potential problems arising from this fact, the CVM signed the IOSCO Multilateral Memorandum of Understanding concerning consultation, cooperation and the exchange of information for the purpose of regulatory enforcement regarding securities markets. Such adhesion helped strengthen the CVM's supervision by a faster and safer way of sharing information regarding investigations of misconducts in the capital markets. In 2013 alone, we had 18 consultations between other jurisdictions and the CVM.

Although much progress has been made throughout the history of the Brazilian Commission and independently of what we are working now for the next few years, the enforcement activity is so key that it should always be in the agenda under the section **Areas for Improvement** so solutions can be re-assessed and improved as the world evolves.

High standards of behavior should be clear and well adopted by the market players. Non-compliance with them must lead to a quick, effective and proportional answer by the regulator. Such timely and coherent actions bring credibility and predictability to the market, which, as a result, makes investors feel safe and reliant on the regulator's supervision.

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This atmosphere of credibility paves the way for more investments in Brazilian securities and, consequently, for the growth of the capital markets as a whole.

However, we must avoid the myth of Sisyphus – where that unfortunate man is doomed to forever push a huge and heavy boulder up a mountain only to watch it roll back down again and so on. That is: we must be careful not to let the efforts we are undertaking at CVM roll downhill.

After establishing our priorities in the Strategic View and setting the game plan to achieve them, monitoring the results is extremely important for a successful venture. And that is, also, another commitment of the CVM.

May Albert Camus forgive me but, personally, I do not believe that the struggle itself is enough to fill a man's heart.

We cannot settle for less than the results we expect to achieve. In our case, those would be: to provide a safer and reliable environment for investors and sustain the development of a capital market increasingly important in providing long-term financing.

We hope that the high-level discussions we are having here and the exchange of experiences can contribute with our objectives and set new basis for a solid – and worldwide – economic growth.

I apologize if I over used my time slot and I now look forward to hearing the views from my colleagues from other capital markets on this subject.

Thank you!

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