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CVM

Comissão de Valores Mobiliários

Protegendo quem investe no futuro do Brasil

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The views expressed in this presentation are those of the author and do not necessarily represent the position of the CVM

Topics

- Introduction
- Process: identifying risks, prioritizing entities and defining supervisory actions
- Lessons learned/benefits realized
- Future enhancements

Introduction

- Risk based supervision (RBS) model implemented in 2009
  - The National Monetary Council (CMN) Resolution no. 3.427 provided the mandatory adoption of RBS
  - The CVM Deliberation no. 521/07 established general procedures and responsibilities

- On a semi-annual basis, the CVM reports the activities, findings, and assessments to CMN/COMOC

- The semi-annual written report is made available at our website

Introduction

- Most categories of entities subject to the CVM's regulation are covered either directly by CVM's supervision and/or indirectly by self-regulatory bodies' supervision
  - Public companies
  - Independent auditors
  - Investment funds and asset managers
  - Market intermediaries
  - Self-regulatory bodies (BVMF – stock exchange; CETIP – trade repository; ANCORD – for autonomous investment agents)

- Supervision is handled either by off-site activities and/or on-site inspections

- Thematic supervision complements routine supervision on an as-needed basis

Process

Identifying which risks - focus

Determining which entities to prioritize: criteria

Setting the supervisory intensity: sample size and type of supervisory action

- The pertinent supervision offices propose risks, entities and actions, which are approved by the CVM's Board

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Process – risk identification

1. Essential risks relative to disclosure and conduct requirements set down by law or regulation

- Example: public companies
  - Risk: elaboration and disclosure of financial information not in accordance with the regulation and statutory provisions
  - Supervision focus – ensuring the consistency of financial information with IFRS and with CVM's rules

Process – risk identification

2. Risks caused by new circumstances or innovative instruments and practices
   - The pertinent offices during their regulatory activities
   - Committee on Risk Identification (CIR), created in 2011: systemic or emerging risks
   - As a rule, in terms of supervision, potential risks are turned into a thematic supervision prior to routine supervision

Process – grouping entities

- In general, the concept of a probability-impact matrix is applied to ranking groups of entities (for each risk/focus)
  - First step: entities are clustered in different groups according to their effects (impact) on investors/markets – criteria: entity's size, number of investors , distribution channels etc
  - Second step: it is assigned probabilities of failure to each group – criteria: history of non-conformities, portfolio composition etc

Potencial de dano	baixa	média baixa	média alta	alta
alto			Grupo 2	Grupo 1
médio alto			Grupo 3	
médio baixo		Grupo 4 Grupo 7		
baixo		Grupo 5		Grupo 6

Probabilidade

Examples – public companies

Risk

- Irregularities in relation to:
  - proposals and decisions of management;
  - decisions of general meetings; and
  - conducting of business by management and controlling shareholders

Supervision focus

- M&A transactions
- Related parties transactions
- Capital increase by private subscription
- Capital reduction
- Shares conversion

Criteria for grouping

- Whether the entity'shares comprise the main stock indexes
- Number of shareholders
- Company's net worth
- Number of complaints from investors
- History of sanctions
- Others

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Examples – independent auditors

Risk

- Failure of auditor's opinion in reflecting the non-compliance of financial statements (funds and public companies) with IFRS

Supervision focus

- Inadequacy of auditor's reports that contain unmodified opinion

Criteria for grouping

- Number of public companies clients
- Size of audited companies
- History on continuing professional education
- History of sanctions
- Others

Examples – investment funds and asset managers

Risk

- Improper valuation of portfolio's assets

Supervision focus

- Modified opinion in the auditor's report
- Valuation (selected investment funds and selected asset classes):
  - Market value
  - Manager's policy on pricing

Criteria for grouping

- Number and profile of quotaholders
- Acquisition of assets issued by related parties to the manager
- Proportion of illiquid assets
- Others

Process – supervisory actions intensity

- Regular approach

Risks

Focus

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Priority groups

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Intensity varies:

- number of entities supervised within each group;
- type of off-site supervision; and
- on-site inspections

- Another approach (risk nature and immediate data availability)

All entities are submited to supervision:

some cases - risk indicators are used as filters

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Off-site supervision and

On-site inspection

Lessons learned / benefits realized

- Better targeting at riskier entities/practices – more effective allocation of CVM's scarce human resources

- From fear of red tape to disciplined approach (methods)

- Cultural changes – the CVM and market participants
  - From ex-post posture to ex-ante posture: preventing the risks from materializing

- Better understanding of regulated entities modus operandi: expedite identification of new risks

- Flexibility of the regular process to fit new situations, recognizing that risks evolve and have different features

Foward looking

- The CVM is preparing the next 2 years plan for RBS
  - Introducing activities, such as public offerings
  - Reinforcing and extending the role of on-site inspections

- Deepening the understanding of risks faced by regulated entities and the interaction of said risks with our mandate

- Enhancement of data collection and development of risk metrics

Thank you!

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