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**Panel 4: Challenges Related to the Implementation of the IOSCO  
Principles and of the IOSCO MOU in Emerging Securities Markets**

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IOSCO - Annual Conference

*Challenges Related to the Implementation of the IOSCO Principles and of the IOSCO  
MOU in Emerging Securities Markets*

Marcelo Fernandez Trindade  
Chairman  
Securities Commission of Brazil  
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- Thank you. It is an honor to participate in the discussions today. I hope that Brazilian case can be a useful source of information and reflection for the other countries. First, I must say that we owe part of the results to IOSCO's support in raising awareness about the Principles, which as you know are a "*race-to-the-bottom*" collection of standards that touch the core of securities regulation.
- Jumpstarting stock markets in emergent economies has proved difficult in the absence of an effective legal framework, because law is regarded necessary to set a level playing field. The IOSCO principles recognize that a change in legal arrangements may be needed to give them real effect. But it also agrees that legal reforms are costly, lengthy and complicated and, not only in emerging countries, you know how it starts but not how it ends.
- The first point I would like to share with you from the Brazilian experience is that market agents and self-regulatory organizations can be a huge force to overcome market deficiencies. In many cases, they can serve as functional proxies for legal reforms, bridging gaps between legal requirements and investors' expectations.
- Secondly I would like to mention two areas where, in my point of view, legal reforms remain the only way to achieve full implementation of the IOSCO Principles: the independence of regulators, as a necessary compliment to champion investors rights, and the regulators full access to information protected by bank secrecy. In the first case, we also have, in Brazil, a successful case to share. In the second one, we are still facing the challenge of changing the law.
- Self-regulation in Brazil in recent years. Let me start by our self-regulation experience. Brazil had one important legal reform in 2001, aimed to boost minority shareholders' protection. But in 2000, even before 2001 Law, Bovespa — the Brazilian Stock Exchange — took the lead in the creation of Levels 1, 2 and Novo Mercado, special listing segments that require progressively stricter listing standards of corporate governance. To adhere to these segments, companies must voluntarily abide, by private agreement with Bovespa, to comply with far-reaching corporate governance rules. Such rules must be disclosed both in the issuer's prospectus and in the company's bylaws, so that the regulator can enforce them. Today we see that this effort started and patiently disseminated years ago was a turning point for Brazilian capital markets. In the last

years we had concrete proof that the market repays those who care about investors' rights.

- All the IPOs we had since 2002 — and almost all of the stock offerings — were from companies that largely exceeded legal standards even after the reform, giving protections to meet investors' top-notch demands. Even considering the great liquidity of international markets in recent years, it appears to me that the results we achieved were grounded on investors' confidence in the quality of our market structure, reflecting an ongoing work of our local market players.
- Another remarkable point about the performance of Brazilian markets in recent years is that it shows a market-based reaction, with no government intervention. On the one hand, investors were more demanding about higher corporate governance standards; on the other, issuers were awarded with unprecedented proceeds. Investors were driven by diligence about their money, without artificial incentives like tax exemptions.
- The role of the regulator and its independence. Since issuers voluntarily agreed to follow self-regulatory rules — that were not imposed — it is more likely they would be voluntarily enforced. Regulator' role, therefore, should be lighter. But, high levels of voluntary compliance with self-regulation are not enough. State enforcement is as much as needed. Severe constraints exist on both incentives and ability of a customer-controlled body, such as stock exchanges, to enforce rules against its member firms and its listed companies. This enforcement shortfall is inherent in any self-regulatory system. By contrast, regulators are designed to initiate law enforcement independently, which places them in a better position to prevent harmful actions from occurring. Therefore, enforcement is always a key point.
- In our experience enforcement begins way before the moment of really applying the law. The use of public hearings as an indirect enforcement tool is a good example. Very often, public hearings are recalled as an attribute recommended for the sake of regulators (they are mentioned as such by the IOSCO Principles) because of market agents' contribution to the ending quality of rules. But the debate fostered by public hearing process can also enhance enforcement and reduce its costs. Since public hearing brings together interest groups that will be affected, it develops a previous understanding of new rules, a prior elaboration on the rationale of such new rules. At the end of the day, when the regulation finally comes into effect, it embraces greater consensus and understanding. It builds a “self-enforcing” approach, meaning that the more consensual and democratic rules are, the more likely it will be that such rules shall be voluntarily enforced.
- Also, the traditional view of enforcement as arising only from direct application of law no longer gives a complete picture of the issue. I believe that enforcement — especially in emerging market jurisdictions — is a collaborative process that also comprises advisory activities, rather than only punitive ones. The advisory activity of CVM has surged in the last years. Our staff is increasingly asked to give opinions to investors and to answer complaints related to market practices. There seems to be a trend that such

advisory activity becomes as important as punitive actions taken by the CVM. We believe this to be an improvement towards enforcement, because it enhances preventive measures, working as a means to prevent future disputes and damages to the markets. The general delay and lack of specialization of Brazilian judiciary system also create expectations towards Commissions' advisory activities. CVM's opinion on a certain case may help solving future disputes and situations, or even preventing them, serving as a precedent.

- But all this work at the Commission would not be possible without the independence that we have. Independence means that the regulator and the regulatory institution have both an arm's-length relationship with private interests and political authorities. The main challenge to achieve independence may be legal reform. The CVM is celebrating 30 years in 2006, but only in 2001 Brazilian Law was reformed to ensure such independence by conferring organizational autonomy for the CVM, appropriate funding for our activities, fixed and staggered five-year terms of appointment for Commissioners and restrictions on removal from office without cause.
- Nevertheless, I think that the cultural aspects are also important here. After the legal reform we had a sheer rise in our enforcement activity, but we also learned that we could be much more efficient on that. Enforcement is costly. It costs to find out that a rule has been broken, to measure the relevance of such violation and to prosecute an infraction and impose penalties. Did we have the resources to keep enforcement activities abreast of our market development? That question has led us to come near to the risk-base supervision discussions most in fashion today. We are still in an early stage of approach, and there are, of course, cultural barriers to follow a "*non-zero failure policy*". But, personally, by seeing our recent market activity, I am convinced that such a policy is needed to calibrate our actions.
- The bank secrecy challenge. The last barrier that I would like to mention is related to the cooperation in regulation, which lies at the basis of IOSCO MOU. Although CVM has adequate enforcement powers and fully supports information sharing among regulators, it does not have direct access to information protected by the bank secrecy law, which is only granted through the judiciary branch, on a case-by-case basis, or through voluntary cooperation of the Central Bank. Bank secrecy monopoly is a hurdle for pursuing some serious violations, such as insider trading and market manipulation.
- The law should allow the regulator to have direct access to data that is protected by bank secrecy as long as such requests can be justified as part of an ongoing investigation or is made at the request of foreign authorities. Last year, in the wake of a political crises we had in Brazil (which highlighted the problem) a bill has been proposed to remove bank secrecy taboo among financial sector authorities. But we still facing resistances in Congress.
- In despite of this fact, we have been able to cooperate with requests for assistance, since we have all the information related to stock and futures exchanges, including the names of the final beneficiaries of each transaction. In the last two years and a half, the CVM

received 15 requests from foreign regulators for enforcement-related assistance and were able to answer them. However, given the legal barrier on CVM's assistance possibilities, we were not able to track the money after it leaves the sellers' accounts without going to courts or getting previous authorization from the Central Bank, with the natural delays.

- As to this issue, the resolution undertaken in April 2005, by the Presidents Committee, fixing 2010 as a deadline for IOSCO members to subscribe the MOU has been of great help. It has allowed CVM to engage in an extensive policy dialogue with Brazilian authorities, in order to show the importance of removing the barriers that block our country's broader participation in international cooperation.
- I very much look forward to following the discussion and I am happy to hear from you and to answer any questions you may have.