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# FINANCIAL SECTOR ASSESSMENT PROGRAM

# BRAZIL

## IOSCO OBJECTIVES AND PRINCIPLES OF SECURITIES REGULATION

# DETAILED ASSESSMENT OF IMPLEMENTATION

JUNE 2013 (REVISED)<sup>1</sup>

INTERNATIONAL MONETARY FUND  
MONETARY AND CAPITAL MARKETS DEPARTMENT

THE WORLD BANK  
FINANCIAL AND PRIVATE SECTOR DEVELOPMENT  
VICE PRESIDENCY  
LATIN AMERICA & THE CARIBBEAN REGION  
VICE PRESIDENCY

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## LIST OF ABBREVIATIONS

ABRASCA	Brazil Public Corporations Association
Anbima	Brazilian Financial and Capital Markets Association
ANCORD	National Association of Security Brokers, Exchange and Commodities
APIMEC	Association of Investment Analysts and Capital Markets
AUM	Assets under management
BCB	<i>Banco Central do Brasil</i> —Central Bank
BCP	Basel Core Principles
BDR	Brazilian Depository Receipts
BNDES	<i>Banco Nacional de Desenvolvimento Economico e Social</i> National Bank for Economic and Social Development
Bovespa	BM&F Bovespa Stock Exchange
BSM	BM&F Bovespa regulatory subsidiary
CAR	Capital Adequacy Ratio
CBLC	BM&F Bovespa central counterparty subsidiary
CCP	Central counterparty
CD	Certificate of Deposit
CDI	Certificado de Deposito Interbancario—Interbank Certificate of Deposit
CETIP	<i>Central de Custodia e de Liquidação Financeira de Títulos</i> — Central Custodian and Settlement of Financial Securities
CF	Committee Fiscal
CFC	Federal Accountancy Profession Organization – Conselho Federal de Contabilidade
CGR	CVM Risk Management Committee
CGU	Office of the Comptroller General
CIR	CVM Risk Identification Committee
CIS	Collective investment schemes (mutual funds)
CMN	Conselho Monetário Nacional / National Monetary Council
CNSP	National Council of Private Insurance
COREMEC	Committee of Regulation and Supervision of Financial, Securities, Insurance, and Complementary Pension
COMEF	Financial Stability Committee
CPC	<i>Comitê de Pronunciamentos Contábeis</i> – Brazil Accounting Standards Setter
CPSIPS	Core Principles for Systemically Important Payment Systems
CPSS	Committee on Payment and Settlement Systems
CRE	Administration Committee of External Quality Review
CRI	Real Estate Receivables Certificates
CRSFN	National Financial System Appeal Council
CVM	<i>Comissão de Valores Mobiliários</i> – Brazil Securities Commission
DFP	Standardized Financial Statement Form
DI	Interbank Deposit
DvP	Delivery Versus Payment
ELA	Emergency Liquidity Assistance
FACPC	Foundation for CPC Support

FEBRECAN	Brazil Banking Association
FIDC	<i>Fundo de Investimento em Direitos Creditórios</i> —Receivables Banked Investment Funds
FX	Foreign Exchange
GDP	Gross Domestic Product
IAS	International Accounting Standards
IBRACON	Institute of Independent Auditors of Brazil
ICAAP	Internal Capital Adequacy Assessment Process
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
IOSCO	International Organization of Securities Commissions
IPE	CVM Periodical and Non-Recurrent Information System
IPO	Initial Public Offering
ITG	Intra Group Transaction
MCR	BSM Bovespa Investor Compensation Mechanism
MMOU	IOSCO Multilateral Memorandum of Understanding
MOF	<i>Fazenda</i> —Ministry of Finance
MOPBM	Ministry of Planning, Budget, and Management
NAV	Net Asset Value
NM	Novo Mercado
NPL	Nonperforming Loans
OTC	Over-the-Counter
P/E	Price Earnings Ratio
PREVIC	<i>Superintendência de Previdência Complementar</i> – Superintendency of Complementary Pensions
RAET	Temporary Special Administrative Regime of the BCB
ROA	Return on Assets
ROE	Return on Equity
RTGS	Real Time Gross Settlement
SBR	CVM risk-based supervision system
SME	Small and Medium Enterprise
SUMEF	Subcommittee to Monitor the Stability of the National Financial System
SUSEP	Superintendence of Private Insurance
TC	termo de compromisso / CVM enforcement settlement process
TCU	Brazil Court of Audit

## **I. SUMMARY, KEY FINDINGS, AND RECOMMENDATIONS**

### **Introduction**

1. **The CVM has made substantial progress since the 2002 FSAP.** In 2002 the IOSCO assessment rated 8 principles fully implemented and 22 principles partly implemented. The 2012 Assessment rates 26 principles fully implemented, 5 broadly implemented, and 6 partly implemented. Principle 38 is not rated, as a separate ROSC on systemically important payment systems was conducted as part of this FSAP Update. The detailed assessment highlights significant improvements in the risk-based inspection program, adoption of an innovative issuer disclosure system, a stronger enforcement program and the adoption of IFRS. Long-standing issues on corporate governance and the protection of minority shareholders continue to be challenges. Finally, recommendations to improve prudential regulation of C.I.S. are discussed and proposed.

### **Information and methodology used for assessment**

2. This assessment was conducted as part of a full FSAP update mission, in March 2012. The assessment applies the latest IOSCO Objectives and Principles of Securities Regulation, as adopted by IOSCO in 2010. The IOSCO Methodology For Assessing Implementation of the IOSCO Objectives and Principles, dated September 2011 was used as a benchmark reference for assessing implementation. This assessment is based on extensive interviews with staff of the Brazil CVM, a self-assessment prepared by CVM staff, supporting information provided by the CVM, and a review of applicable laws and important CVM Instructions (regulations) that are translated into English and available on the CVM website. The CVM self-assessment was revised at the completion of the mission and the CVM supplemented it with detailed comments provided in April, May and June 2012.

3. Because the Central Bank of Brazil (BCB) is the prudential regulator for financial intermediaries in Brazil (broker-dealers), the assessment of several principles required an assessment of how the BCB functions as a prudential regulator of the applicable financial intermediaries. Accordingly the assessment of principles 1 – 5 is based on an assessment of implementation at the CVM and the BCB. This analysis is based upon interviews with BCB staff, and a limited review of applicable laws and BCB Rules and CMN Resolutions. As most of the pertinent BCB Rules and CMN Resolutions are not available in English translations, this assessment placed a heavy reliance on the BCP assessment conducted under this FSAP and the excellent assistance provided by the BCP assessors.

4. The assessment also reflects numerous interviews with persons in the financial services sector in Brazil, including officials of the BM&F Bovespa securities market, as well as persons at Anbima, the organization of banks and investment firms in Brazil that performs a variety of self-regulatory functions, and officials of the CRE, which plays a role in the licensing and regulation of audit professionals. A wide array of published research on Brazil's capital markets, economy and regulatory structure is available on the Internet and much of it was reviewed during the course of the assessment. The IOSCO assessment

conducted in 2002 proved to be a useful historical document and valuable benchmark in assessing the progress made during the past decade.

5. The assessment was conducted by Jonathan Katz, an attorney in the United States who served as Secretary of the U.S. Securities and Exchange Commission for 20 years, until his retirement in 2006. Mr. Katz has served as an IOSCO assessor on several other FSAP missions.

### **Institutional and market structure—overview**

6. **Since the last FSAP in 2002, Brazil's economy and financial system have grown in size, strength and sophistication.** Financial system asset holdings doubled in the last decade to 181 percent of GDP in 2011. Financial conglomerates are the key feature of the system, controlling  $\frac{3}{4}$  of the assets, with two-thirds of banking assets held by the top five banks (and about 40 percent by government-owned banks). Assets held by institutional investors rose by 60 percentage points of GDP.

7. **Short-term interest rates are well above those in countries with similar levels of development and macroeconomic stability and this affects the capital market.** Most financial contracts among residents are indexed to the overnight interest rate. This equilibrium reflects long-standing fundamental factors, including the low level of domestic savings and the legacy of high inflation and low policy credibility in the past. It has pervasive implications on financial sector structure, stability, and long-term development.

8. **The Brazilian equity market made impressive gains in market capitalization and liquidity over the past decade.** Total equity market capitalization is about 55 percent of GDP and compares well with countries at similar levels of development and size. This growth has been fueled by a combination of strong market performance and a steady growth in the total quantity of shares, through a combination of IPOs, and follow-on offerings. Market liquidity has also improved considerably over the same period. However, the market valuation of Brazil is low when compared to other Latin American markets. The MSCI Brazil index trades at a price/earnings (P/E) ratio of 9.4 times 2012 earnings estimates. By comparison Mexico trades at 14 times 2012 earnings estimates and Chile at 14.2.

9. **Even after a decade of IPOs and follow on offerings, the Brazilian equity market still has a small number of listings.** Following a record 76 offerings (IPO and follow on) in 2007, the number of offerings in the past three years has stabilized at lower levels (around 22 per year). The pace of IPO activity has been insufficient to raise the number of listings (382) to levels commensurate with Brazil's GDP per capita and size total number of listed companies. Also, the mix of companies on Bovespa is not reflective of the overall Brazilian economy. For example the commodities sector represents only 20 percent of the Brazilian economy but nearly 50 percent of the Bovespa index.

**10. Foreign institutional investors have been critical to IPOs and follow-on offerings.** Between 2004-2011 foreigners purchased on average 69 percent of IPOs and 59 percent of follow on offerings. Typically the offering is a Brazilian listing, with a substantial block of the registered Brazilian offering sold to foreign investors in U.S. and Europe as a U.S. SEC Reg S/Rule 144A private offering. Because Brazilian companies can reach foreign investors, the creation of ADR/GDRs by Brazilian companies has declined dramatically. Since 2004 only five ADRS have been created in 100 IPOs.

**11. Foreign investors are a significant component of the Brazilian secondary market as well.** Foreigners are the largest component of the Brazilian secondary market, with 37 percent of daily trading. Foreigners are also the largest lender of securities (42 percent of lending) and are second only to mutual funds as borrowers of securities (21 percent compared to 70 percent).

**12. Institutional investors in Brazil, including pension funds and mutual funds, have not been substantial investors in the equity markets.** Combined, they account for only one third of market capitalization. Mutual fund AUM invested in equities is well below 20 percent of total AUM. Mutual funds managed by the four largest banks have equity investments ranging from 5 percent to 17 percent. The low level of equity investment has likely been a consequence of the high returns on government debt, making higher risk equity investments less attractive. This environment could change significantly in the near future, if interest rates on government securities decline. The growth of pension funds operating defined contribution plans under a lifecycle approach could also stimulate greater demand for equity (see below). If the absolute amount of domestic investment in the equity market increases significantly, it could result in higher valuations that might encourage a greater number of companies to go public.

**13. The mutual fund industry has AUM of almost 50 percent of GDP.** This figure may be somewhat deceiving as pension funds invest heavily through mutual funds. Mutual fund AUM also includes corporations that use money market mutual funds for cash management purposes (16 percent of AUM). Retail investors (17 percent of AUM) also use mutual funds for short-term money management. As a result mutual fund AUM is heavily weighted in short-term debt investments, particularly overnight repos (20 percent of total AUM). Low liquidity in the secondary market for Government debt and the scarcity of money market instruments likely influences the heavy reliance on repos.

**14. The creation of the *Novo Mercado*, with its higher standards for corporate governance and minority shareholder protection, contributed to the growth of the Brazilian equity market.** In the period 2009-2011, 25 of 28 IPOs were listed on the *Novo Mercado* (N.M.). The number of Bovespa N.M. listed companies has grown from 44 in 2005 to 125 in 2011. Over the same period Level 1 listings grew from 37 to 38 and Level 2 listings increased from 14 to 19. While the number of traditional listings has remained largely flat,

these companies represent 66% of total listed market cap and 76% of total traded value on Bovespa.

**15. Since the 2001 amendments to the Company Law and the adoption of the higher listing standards for N.M. and Levels I and II, efforts to make further improvements in corporate governance through enhanced Bovespa listing standards have been limited.**

In 2010 a package of recommendations was prepared and submitted to a vote of N.M. companies (required to effect changes). While some of the proposals in the package were approved (discussed in Core Principle 17), three key changes were rejected: (1) An increase in the proportion of independent board members from 20 to 30% for Novo Mercado and Level 2 listed companies and the addition of an independent director requirement for Level 1 listed companies; (2) A requirement for an audit committee comprised of a minimum of three members elected by the Board of Directors, of whom at least one must be an independent board member; and (3) A significant change in the takeover rules to require a mandatory bid after a shareholder acquires 30% of outstanding shares (down from 50%).

**16. The limited legal protections for minority investors in the Corporation Law have not been changed.** Many major corporations in Brazil are not listed on the N.M. or Levels I or II. As such they continue to adhere to the governance standards of the Corporation Law. This means that the corporate board of directors likely has none or one nominally independent director and no board audit committee to monitor the sufficiency of externally audited financial statements. They also may have more than one class of equity shares, with as much as 1/2 of total shares being non-voting shares. Companies listed on the traditional Bovespa or Level I have limited “tag along” rights for non-voting shares in the event of a company takeover.

**17. The consolidation of the Brazilian securities markets into a single, for-profit company appears to have strengthened the Brazilian secondary markets. It has also created regulatory challenges for the CVM.** The 2008 consolidation of secondary markets into BM&F Bovespa strengthened market liquidity, reduced fragmentation and improved infrastructure. Conversely, the consolidation into a single secondary market that is a for-profit publicly traded company has raised concerns about high transaction costs and restricted entry by potential competitors. The CVM has recognized the importance of taking a leadership role in examining the shape of the Brazilian secondary markets. It commissioned an independent study of the Brazilian secondary market, due in April 2012.

**18. The derivatives market in Brazil is one of the ten largest in the world.** However it is heavily concentrated in the interbank deposit interest rate future (DI) and foreign currency derivatives. As with the equity market, foreign investors play a significant role in the DI futures market, particularly as the purchasers of interest rate risk.

**19. The private debt market is beginning to grow from a historically low base.** The stock of private debt securities issued by *non-financial* companies has risen from 7 percent of



GDP in 2006 to 11 percent in 2011. While maturity has been lengthening to an average of about 6 years, duration continues to be very short. The CVM has adopted, through Instruction 487, an expedited non-registered offering process to facilitate the private debt market.

20. **Brazil has a universal banking sector and broker-dealer/ financial intermediaries are largely subsidiaries of the largest banks.** The three largest firms are subsidiaries of Brazilian banks and control over 60 percent of assets. Virtually the entire industry is represented by the ten largest firms. The BCB is the prudential regulator of the sector. It applies the same licensing and capital adequacy standards to banks and intermediaries. BCB requires consolidated reporting for the banking conglomerate. The CVM is the business conduct regulator and the sole regulator for a range of retail intermediaries which are not subject to prudential risk regulation.

### **Preconditions for effective securities regulation**

21. **The legal framework for creditor / debtor relationships has improved in the past decade but shortcomings remain.** In conjunction with this FSAP Update, ROSCs were performed on Insolvency and Creditor Rights, Accounting and Auditing, and Corporate Governance. The Insolvency and Creditor Rights (ICR) ROSC found several noteworthy improvements in the legal and regulatory infrastructure. “The Law on Business Reorganization and Bankruptcy of 2005 improved the insolvency system, with the reorganization procedure (*recuperação*) working better than the liquidation proceeding (*falência*). However, there are elements in the framework that need further development to make it a more effective tool. The tax treatment of debt write-offs is not neutral and operates as a disincentive to debt restructuring. Upon reorganization commencement, new financing is almost impossible to obtain because of prudential requirements on and legal uncertainty over the priority of claims of new money. Legal uncertainties over personal liabilities deter creditor participation in insolvency proceedings; it should be clarified that fraud is required to adjudge the creditor personally liable. Further, some important issues are not contemplated in the insolvency law (enterprise groups and cross-border insolvency cases) and eligibility rules could also be reviewed to encompass important sectors (cooperatives, mixed-capital companies, health care plan companies and others) that hitherto lack access to an effective mechanism of restructuring or insolvency liquidation.”

22. **The institutional framework supporting credit enforcement and insolvency could be improved.** The ICR ROSC concluded that the specialized courts in Rio de Janeiro and Sao Paulo are generally satisfactory but the backlog of cases is significant (e.g., in Sao Paulo about 1000 cases per lower court) indicative that more resources are necessary for a fully efficient treatment of insolvency cases.

## **Main Findings**

23. **Principles relating to the regulator (P. 1-8).** The CVM has clearly defined authority to regulate business conduct in the Brazilian capital markets. This authority does not extend to regulating business conduct and investor protection in the purchase and sale of Brazilian sovereign debt. BCB has exclusive responsibility for prudential regulation, including capital adequacy standards, systemic risk and resolution of intermediaries, and secondary market clearance, settlement and payment functions. The CVM Board members have fixed term appointments and the Board members and staff have adequate legal protection in the performance of their duties. While the CVM has obtained increases in its staffing resources in recent years, more resources are required and it still lacks a stable flow of funding. Brazilian civil service appointment procedures may be a significant impediment in the recruitment and retention of staff with critical skills and relevant experience. CVM and BCB share licensing responsibilities. CVM is a member of COREMEC, a regulatory working group under the supervision of the CMN that is responsible for monitoring cross-regulatory issues, systemic risk, and emerging aspects of the financial sector that may not be adequately supervised under existing regulatory policies.

24. **Principles of Self-Regulation (P. 9).** The Brazilian Securities Act establishes criteria for registration of self-regulatory organizations and the BM&F Bovespa and the CETIP are official SROs subject to oversight by the CVM. Bovespa has created BSM as a wholly owned regulatory subsidiary and CETIP has created a separate internal department responsible for regulatory functions. CVM annually reviews the work plan and budget of these regulatory programs. It also receives weekly and monthly activity reports and conducts periodic on-site inspections. Brazil also has several other private member-created and supported organizations that are constituted as professional or trade associations but perform some self-regulatory functions, with some or no official oversight by the CVM. Anbima is a member organization that is not officially designated as an SRO and performs a broad array of SRO functions. It has a written agreement with the CVM to provide supplementary regulatory support in the review of securities offerings. Through its agreement the CVM has adequate oversight authority of the process. Anbima also has a comprehensive SRO program for CIS operators that are Anbima members. Member CIS firms control more than 90% of all CIS assets under management. While the Anbima program encompasses a series of binding codes of conduct, a market oversight and on-site inspection program and a disciplinary program, Anbima's SRO functions for mutual funds are not subject to CVM oversight because it is not an official SRO. Anbima is recognized by IOSCO as an SRO for underwriting purposes with the endorsement of the CVM, and the CVM has a policy of deferring enforcement action in matters when Anbima has taken action.

25. **Principles for the Enforcement of Securities Regulation (P. 10-12).** The CVM market surveillance, on-site inspection and enforcement programs have grown substantially since the 2002 FSAP. The CVM has successfully created a consent decree settlement process (TC) that maximizes efficiency and enables the CVM to require violators to recompense

investor losses when appropriate. CVM has an extensive risk-based supervision program that focuses on the largest entities with the largest number of investors/clients. This is consistent with the highly concentrated nature of the Brazilian financial sector. Prudential supervision of capital adequacy and risk issues for financial institutions (including banks and securities brokerage firms) is the responsibility of BCB.

26. **Principles for Cooperation in Regulation (P.13-15).** CVM has signed cooperation agreements with other Brazilian regulators. It is a signatory to the IOSCO multilateral memorandum of understanding (MMOU) and has bilateral agreements with more than 25 international regulatory bodies. It has used these agreements to share information with other regulators.

**Principles for Issuers (P. 16-18).** Brazil formally adopted IFRS accounting standards in 2009 and all companies in Brazil, publicly listed and private, are required to apply IFRS. In 2009 the CVM created a new company-based disclosure report, the Listed Company Reference Form, supplementing its existing annual and periodic reports. The Reference Form is an automated, structured form, designed to promote prompt corporate disclosure and facilitate access by analysts and investors. The CVM also created an expedited limited offering procedure. Through this procedure issuers may sell debt securities to a limited number of institutional investors. CVM has also created an expedited filing program for its largest and most liquid companies. The Corporation Law provides limited minority shareholder protection in change of control events. For example the Law (§254-A) requires in a change of control, that the purchaser must conduct a tender offer to acquire the remaining voting shares for at least 80 percent of the amount paid for shares comprising the controlling block. There are no “tag along” protection requirements for holders of non-voting shares. The Law also requires a mandatory tender offer in a going private transaction (§4.4). Minority shareholders representing 10 percent of the free float may call for a special shareholder meeting to request a new price evaluation. In these situations only the non-control shareholders are entitled to vote (§4A). A mandatory tender offer is also required if, through open market purchases, the controlling shareholder reduces the company free float below 33%. CVM Instruction 361 requires that tender offers must be provided to all shareholders, with equal treatment for all shareholders in a class. In response to the limited protections in the Corporation Law, the CVM and Bovespa undertook improved corporate governance and minority shareholder protection rights through listing standards for a new equity market. In 2001, BOVESPA created the Novo Mercado (NM) and two listing segments with special, albeit lower, corporate governance standards (level 1 and level 2). Level II companies must have a minimum of five Board members and 20% must be independent. The Novo Mercado has the highest standards. Companies may not issue non-voting shares and the company Board must have 20% independent directors. In the event of a tender offer, there must be full tag along rights and an independent pricing valuation in the event of delisting. An effort to improve these standards in 2010 was only partially successful.

**27. Principles for Auditors, Credit Rating Agencies, and Other Information Service Providers (P. 19-23).** Brazil revised its audit standards in substantial conformance with International Auditing Standards. A series of professional organizations, governed and funded by the profession, with CVM oversight, is responsible for adoption of audit standards, professional qualifications examination and licensing, and a peer review program for monitoring compliance. The peer review process is mandated by CVM regulation. Audit firms reviewed under the peer review program are permitted to select the firm that conducts the review and the fee for the review is negotiated bilaterally. The CVM has broad supervisory authority over this process. Brazil has adopted a mandatory five-year firm rotation requirement for listed companies. One five-year extension is permitted for companies that voluntarily agree to create an audit committee, with a majority of independent members. In April 2012, the CVM adopted Instruction 521 creating a regulatory system for registration and oversight of credit rating agencies.

**28. Principles for Collective Investment Schemes and Hedge Funds (P. 24-28).** In 2005 all regulatory responsibilities for CIS were consolidated and placed with the CVM. The CVM has a comprehensive regulatory regime, including a risk-based on-site supervision program, largely based on disclosure principles. Mutual funds in Brazil are created as *condominiums*, a unique legal structure that doesn't encompass principles of limited liability for investors. Hedge funds are regulated as mutual funds and other CVM regulations cover activities of private equity and venture capital funds. The fund by-laws and fund operator control decisions on suspension of redemptions and the orderly winding-down of a fund. CVM regulations do not require funds to provide investors with an annual report but instead mandate frequent disclosure of portfolio holdings and investors may request a copy of the annual financial statement of the fund.

**29. Principles for Market Intermediaries (P. 29-32).** BCB has primary licensing authority and exclusive prudential regulatory authority over market intermediaries' capital adequacy, systemic risk and firm resolution. BCB applies the same capital adequacy regulatory methods to banks and financial intermediaries (broker-dealers). The CVM has responsibility for regulation of intermediary sales practices and issues related to investor protection and investor suitability. CVM investor protection authority does not apply to the purchase and sale of government securities. In 2011 CVM adopted new comprehensive internal control and suitability regulations for market intermediaries (compliance required by October 2012) that require, inter alia, mandatory recording of all client trade instructions. The CVM licenses and regulates autonomous agents, market analysts and industry advisors who provide general or specific investing advice but are not permitted to control or direct investor funds. The CVM also regulates custodians who must also be BCB licensed financial institutions.

**30. Principles for the Secondary Market (P. 33-37).** Securities exchanges and trading systems must be registered with the CVM and the CVM has continuing regulatory authority over Bovespa and CETIP rules, operations, trading, and new products. CVM has built a

market surveillance capability that complements the Bovespa and CETIP surveillance program. The CVM has broad legal authority to bring enforcement actions for all forms of market manipulation. OTC trading in debt instruments, including corporate debt (limited), FIDCs and other-backed securities is conducted through CETIP, which provides post-trade reporting. Pre-trade transparency is available through unofficial commercial sources.

31. **Principle Relating to Clearing and Settlement (P. 38).** Assessment deferred to the ongoing CPSS-IOSCO ROSC.

**Table 1B. Summary Implementation of the IOSCO Principles—Detailed Assessments**

Principle	Grade	Findings
Principle 1. The responsibilities of the Regulator should be clear and objectively stated.	F.I.	Three entities are involved in the regulation of the Brazilian securities market: the <i>Comissão de Valores Mobiliários</i> (CVM), the Central Bank (BCB) and the <i>Conselho Monetário Nacional</i> (CMN). The CMN is responsible for setting national policy. With regard to capital markets regulation, the BCB acts as a licensing body and prudential regulator and the CVM acts as a licensing body and business and market conduct regulator. While there is some duplication in the licensing of financial intermediaries (broker-dealers), the BCB and CVM have established workable coordination arrangements
Principle 2. The Regulator should be operationally independent and accountable in the exercise of its functions and powers.	P.I.	While the CVM has clear legal independence, the BCB does not. However, its history demonstrates that it is operationally independent. Stability of funding is a long-standing problem. While both agencies have the authority to collect fees from regulated entities this is not a stable source of funding. The actual agency budget must be reviewed by the Ministry of Planning and Budget, approved by the Congress and subject to mid-year, post-hoc, reductions by the Minister of Finance.

Principle 3. The Regulator should have adequate powers, proper resources and the capacity to perform its functions and exercise its powers.	P.I.	While CVM has received increases in budget and personnel in recent years, it still lacks sufficient resources, as well as control over the allocation of its budget. The Brazilian civil service process relies exclusively on hiring via competitive exams, which makes it difficult for the CVM to hire persons with actual experience in the capital markets or persons with highly technical skills necessary for effective regulation. There is an important gap in regulatory authority for investor protection and secondary market trading in government securities.
Principle 4. The Regulator should adopt clear and consistent regulatory processes.	F.I.	The Securities Act provides for a public notice process for CVM regulations (Article 8, §3, I of Law 6.385/76). All proposed and final CVM regulations are published in the Official Gazette of Brazil and are posted on the CVM website. The rule or regulation making process is led by the Market Development Division, involving public hearings and consultations with interested divisions including CVM Legal Department and Board Commissioners. The CVM legal mandate includes investor protection and development of Brazilian capital markets. While it is not formally required to conduct a cost-benefit analysis or consider the costs of compliance when it adopts or amends its rules, the CVM reports that it does consider regulatory costs.
Principle 5. The staff of the Regulator should observe the highest professional standards, including appropriate standards of confidentiality.	F.I.	Law 8112/93 requires a civil servant to observe the law and the highest standards of legality, impartiality, morality, efficiency, and criminal liability in the performance of official duties. In 2009 the BCB posted its Code of Conduct on the BCB website. Internally, the BCB has an Internal Affairs unit to monitor compliance with the Code.

Principle 6. The Regulator should have or contribute to a process to monitor, mitigate and manage systemic risk, appropriate to its mandate.	F.I.	The CVM has created an internal oversight structure to monitor systemic risk in its market and its regulated entities. It is also a participant in an intergovernmental program with other Brazilian financial regulatory agencies.
Principle 7. The Regulator should have or contribute to a process to review the perimeter of regulation regularly.	F.I.	The CVM Policy and Analysis Office and the Risk Identification Committee are specifically charged with ongoing responsibility to examine emerging regulatory issues that may be pertinent to but outside the scope of CVM authority. On a national level, COREMEC has similar authority.
Principle 8. The Regulator should seek to ensure that conflicts of interest and misalignment of incentives are avoided, eliminated, disclosed or otherwise managed.	F.I.	The Brazilian financial markets are heavily concentrated with a small number of universal banks dominating all aspects of the financial services sector. The CVM approach to regulating conflicts of interest is heavily reliant on disclosure of related party or affiliate transactions to clients, investors and the public. The potential for conflicts of interest that could misalign incentives is particularly significant for Brazilian CIS that are owned by banks. In a concentrated industry in which mutual funds engage in a substantial volume of daily trading with an affiliated bank, there is an opportunity for substantial and profitable improper activities.



Principle 9. Where the regulatory system makes use of Self-Regulatory Organizations (SROs) that exercise some direct oversight responsibility for their respective areas of competence, such SROs should be subject to the oversight of the Regulator and should observe standards of fairness and confidentiality when exercising powers and delegated responsibilities.	P.I.	The Brazilian system for regulation of capital markets is notable for its creative use of governmental regulators, licensed self-regulatory organizations directly overseen by the CVM (BM&F Bovespa and CETIP), and voluntary unofficial organizations that perform SRO functions but are not subject to formal governmental regulation and oversight. Several member-based organizations perform one or more functions that are self-regulatory. While the CVM has a variety of working relationships with these entities, it does not require SRO registration, as they are not exchanges, even though they may be viewed as SROs by the industry, the public, and by international organizations, and for some purposes by the CVM. Also the CVM does not supervise their activities, or exercise oversight of the policies and programs they administer.
Principle 10. The Regulator should have comprehensive inspection, investigation and surveillance powers.	F.I.	The Securities Act (Law 6.385/76) provides the CVM with comprehensive inspection, investigation and surveillance powers.
Principle 11. The Regulator should have comprehensive enforcement powers.	F.I.	The CVM may take administrative enforcement action against any person for violations of any provision of the Securities Law, the Corporation Law, CVM regulations, or any other provisions that are under its responsibility. The CVM has authority to impose administratively a warning, a fine, a suspension from serving as a director of market intermediaries and public companies, temporary disqualification up to 20 years, from occupying managerial posts in market intermediaries and public companies, and suspension or cancellation of market intermediaries licenses issued by CVM.

Principle 12. The regulatory system should ensure an effective and credible use of inspection, investigation, surveillance and enforcement powers and implementation of an effective compliance program.	F.I.	Since the 2002 FSAP the CVM has made substantial progress in building credible surveillance, inspection, investigation and enforcement programs. In 2007 CVM published Deliberation 521/07 creating a risk-based supervision system (SBR) that includes off-site and on-Site inspections. The CVM has developed a negotiated settlement process to successfully conclude its investigation. Under CVM Deliberation 390, individuals or entities may agree to settle a matter by agreeing to a consent decree ( <i>termo de compromisso</i> or TC).
Principle 13. The Regulator should have authority to share both public and non-public information with domestic and foreign counterparts.	F.I.	The Securities Act (Law 6385/76, §28) (the “Securities Act”) explicitly directs the Central Bank of Brazil (BCB), the CVM, the Pension Funds Agency (Previc), the Federal Internal Revenue Authority and the Superintendence of Private Insurance (SUSEP) to have a system for the exchange of information relating to the supervision in their respective areas. The same article explicitly provides that the Bank Secrecy Act (Law 105/2001) may not be used to prevent the exchange of information.
Principle 14. Regulators should establish information sharing mechanisms that set out when and how they will share both public and non-public information with their domestic and foreign counterparts.	F.I.	In 2010, the CVM and BCB signed an MoU. The CVM also has written agreements with Previc, the Federal Internal Revenue Authority, SUSEP, the National Treasury Authority, the Federal Prosecutors’ Office, and other agencies. The CVM has written agreements with numerous foreign regulatory bodies. It is a signatory to the IOSCO Multilateral Memorandum of Understanding (MMOU).
Principle 15. The regulatory system should allow for assistance to be provided to foreign Regulators who need to make inquiries in the discharge of their functions and exercise of their powers.	F.I.	The CVM has legal authority to exchange information with foreign authorities and it has written bilateral agreements with, and through the IOSCO MMOU, a wide array of foreign regulators. It has used its authority to exchange information with other regulators.

Principle 16. There should be full, accurate and timely disclosure of financial results, risk and other information that is material to investors' decisions.	F.I.	CVM instruction 400 regulates the public offer for the distribution of securities in primary and secondary markets, setting conditions applicable to public securities offerings, the content and distribution of prospectuses and other relevant offering documents. In 2009, CVM Instruction 480 created a new company-based disclosure system based on an electronic formatted filing system for companies with securities listed for trading on a regulated securities market. This augments the traditional set of disclosure requirements based on the Corporation Law.
Principle 17. Holders of securities in a company should be treated in a fair and equitable manner.	P.I.	Fair treatment of minority shareholders continues to be an important challenge. Notwithstanding the initial success of N.M. and Levels I and II, efforts to make further improvements have been limited. The fair treatment of minority shareholders, and holders of non-voting classes of stock in traditional listing companies and Level I companies continues to be an issue.
Principle 18. Accounting standards used by issuers to prepare financial statements should be of a high and internationally acceptable quality.	F.I.	In 2007 Law No. 11638/2007 amended the Corporation Law and established a national accounting standard setter which adopted IFRS as the Brazilian accounting standard
Principle 19. Auditors should be subject to adequate levels of oversight.	F.I.	Auditors must be licensed and registered with CVM and CFC/CRE. CVM conducts periodic inspections and has enforcement powers. CFC and CRE are controlled by the Accounting Profession. There are no public interest members on their Boards. The Peer review process is not fully independent.
Principle 20. Auditors should be independent of the issuing entity that they audit.	P.I.	The CVM has adopted strong auditor independence standards, including a five-year audit firm rotation requirement. The process for selection and appointment of auditors does not include oversight by a governance body independent in fact and appearance from company management.

Principle 21. Audit standards should be of a high and internationally acceptable quality.	F.I.	IAS was adopted. CFC independence as a standard setter should be examined.
Principle 22. Credit rating agencies should be subject to adequate levels of oversight. The regulatory system should ensure that credit rating agencies whose ratings are used for regulatory purposes are subject to registration and on going supervision.	B.I.	In April 2012, the CVM adopted a comprehensive regulation for registration and oversight of credit rating agencies. It is too soon to assess the implementation of the regulation.
Principle 23. Other entities that offer investors analytical or evaluative services should be subject to oversight and regulation appropriate to the impact their activities have on the market or the degree to which the regulatory system relies on them.	F.I.	The CVM has a formal licensing and regulatory system for market analysts and market consultants. Autonomous agents, which are similar to introducing brokers in the U.S. and may be individuals or entities, also are licensed and regulated by CVM, and BSM. None of these persons or entities is permitted to have control over investor/client funds and assets or exercise discretionary investment authority.
Principle 24. The regulatory system should set standards for the eligibility, governance, organization and operational conduct of those who wish to market or operate a collective investment scheme.	B.I.	All investment funds must be registered with the CVM. There is a fit and proper requirement for the responsible director of the CIS management firm and the firm must demonstrate that it has adequate infrastructure and technical resources. Each CIS must maintain a minimum capital of 300,000 BR. Regulation of risk management, prompt action in the event of breaches or defaults, related party transactions and reliance on annual shareholder meetings to oversee governance are areas that warrant further consideration.
Principle 25. The regulatory system should provide for rules governing the legal form and structure of collective investment schemes and the segregation and protection of client assets.	P.I.	The possible unlimited liability of fund investors is a significant issue that may require legislation to remedy. The winding down process for a fund is controlled by the fund operator and requires a meeting of investors. Reliance on this process in a period of market instability could create risks for investors.

Principle 26. Regulation should require disclosure, as set forth under the principles for issuers, which is necessary to evaluate the suitability of a collective investment scheme for a particular investor and the value of the investor's interest in the scheme.	B.I.	The lack of an annual or periodic report to investors is partially offset by monthly disclosure of portfolio assets and public access to an annual audited financial statement on request. The lack of disclosure of the fund's methodology for calculating NAV should be addressed.
Principle 27. Regulation should ensure that there is a proper and disclosed basis for asset valuation and the pricing and the redemption of units in a collective investment scheme.	F.I.	CVM instructions provide comprehensive regulations governing the daily valuation of fund portfolios according to CVM accounting standards and subject to an annual independent audit. Fund procedures for redemption of investments, as well as suspension, must be disclosed in the fund prospectus and is subject to CVM oversight.
Principle 28. Regulation should ensure that hedge funds and/or hedge funds managers/advisers are subject to appropriate oversight.	F.I.	Hedge funds are classified as multi market mutual funds and are subject to the same regulatory structure as other mutual funds. Accordingly the CVM licenses fund administrators, portfolio managers and the fund itself. Hedge funds must adhere to the same monthly portfolio disclosure, record-keeping, internal control, conflict of interest and asset valuation and daily pricing rules as described above for mutual funds. Also hedge funds are subject to the same prohibition on borrowing that applies to all mutual funds. Leverage is only possible through the use of derivatives. The CVM also has adopted a separate registration and regulatory scheme for venture capital and private equity funds. These are a growing segment of the Brazilian institutional investment sector.
Principle 29. Regulation should provide for minimum entry standards for market intermediaries.	F.I.	In Brazil the responsibility for licensing financial intermediaries is shared by BCB and the CVM. Because broker-dealers are included in the BCB definition of financial institution, BCB has primary licensing responsibility, as well as capital and prudential regulation

Principle 30. There should be initial and on going capital and other prudential requirements for market intermediaries that reflect the risks that the intermediaries undertake.	F.I.	BCB is the exclusive prudential regulator for capital adequacy. It applies the same standards to banks and non-bank financial intermediaries even though the businesses are substantially different. Reporting requirements for small entities could be improved.
Principle 31. Market intermediaries should be required to establish an internal function that delivers compliance with standards for internal organization and operational conduct, with the aim of protecting the interests of clients and their assets and ensuring proper management of risk, through which management of the intermediary accepts primary responsibility for these matters.	F.I.	Existing internal control requirements were strengthened by CVM instruction 505. Firms must be in compliance by October 2012.
Principle 32. There should be procedures for dealing with the failure of a market intermediary in order to minimize damage and loss to investors and to contain systemic risk.	B.I.	BCB has exclusive responsibility for dealing with the failure of a market intermediary. It has a comprehensive monitoring process, with access to information on virtually every financial instrument and transaction. The BCB has broad authority to take prompt corrective action, directly or indirectly through the appointment of a receiver. When BCB takes action because a market intermediary is failing, its deposit guarantee fund does not apply. The Bovespa investor protection fund is limited in the benefits it can provide, a maximum of 70,000 BR per transaction. Also the fund does not cover losses involving government securities, a major component of investment accounts.
Principle 33. The establishment of trading systems including securities exchanges should be subject to regulatory authorization and oversight.	B.I.	The CVM issues licenses and regulates exchanges and securities trading systems. CVM instruction 461 establishes procedures and policies for licensing and regulating exchanges, including types of activities, services and products.

Principle 34. There should be on going regulatory supervision of exchanges and trading systems that should aim to ensure that the integrity of trading is maintained through fair and equitable rules that strike an appropriate balance between the demands of different market participants.	F.I.	CVM has the authority to review and approve all Bovespa and CETIP rules, procedures and new products or services. Both organizations are required to maintain internal regulatory oversight programs.
Principle 35. Regulation should promote transparency of trading.	F.I.	Transparency on Bovespa is strong. Pre-trade order exposure on CETIP may warrant attention if the volume of OTC trading in FIDCs and other instruments grows.
Principle 36. Regulation should be designed to detect and deter manipulation and other unfair trading practices.	F.I.	There is a well-developed surveillance, investigation and enforcement program to address market misconduct.
Principle 37. Regulation should aim to ensure the proper management of large exposures, default risk and market disruption.	F.I.	A variety of factors identified in the description of this principle make it unlikely that a large exposure default would be a catalyst for market disruptions. The CCP appears to be sufficiently liquid to resolve any problems.
Principle 38. Securities settlement systems and central counterparties should be subject to regulatory and supervisory requirements that are designed to ensure that they are fair, effective and efficient and that they reduce systemic risk.	Not rated	<b>CPSS-IOSCO ROSC</b>
<b>Fully Implemented (FI), Broadly Implemented (BI), Partly Implemented (PI), Not Implemented (NI), Not Applicable (NA)</b>		

## Recommended action plan and authorities' response

### *Recommended action plan*

Table 2. Recommended Action Plan to Improve Implementation of the IOSCO Principles

Principle	Recommended Action
Principle 2	It is recommended that the standard for employee liability should be clarified and conformed. CVM and BCB employees should be subject to liability only for willful actions not taken in good faith.
Principle 3	The CVM should seek the authority to recruit and hire, at competitive salaries, a limited number of employees with specialized skill sets and financial sector experience. The CVM's investor protection mandate should apply to the purchase and sale of government securities by retail investors.
Principle 5	The CVM should consider adopting a formal recusal policy for its staff that applies to participation in any material way rather than merely final responsibility for the decision. In conjunction with adoption of such a policy, the CVM should consider providing written guidance.
Principle 9	The CVM should oversee private self-regulatory organizations that perform oversight, policy, examination, disciplinary and qualification/licensing functions that are integral to the national regulatory structure.
Principle 11	The maximum compensation from the Bovespa MCR fund may be too small and too narrow to adequately protect investor accounts. The CVM should examine the issue.
Principle 16	The electronic reference form is an interesting innovation that may benefit from continuing refinement. CVM Instruction 476 and the well-known issuer concept are also sound but fine-tuning may enhance their use. The Corporation law should be amended, eliminating the outmoded newspaper publication requirement for company annual reports
Principle 17 and 20	The Corporation Law should be amended to strengthen minority shareholder protections for traditionally listed companies. Adoption of the full package of 2011 N.M. and Level I and II listing standards should be a priority.



Principle	Recommended Action
Principles 18 and 19	Audit standard and licensing boards should have greater independence from the profession. The Governing Boards should have independent representation from the public.
Principle 19	Audit firms should not be permitted to select the firm that will conduct its peer review and to negotiate bilaterally the amount of the fee.
Principle 25	The legal structure of mutual funds should be revised to provide investors with liability limited to the amount of their investment.
Principle 26	Mutual funds should be required to provide investors an annual report. They should also be required to disclose their methodology for NAV calculation.
Principle 27	CVM should adopt a policy and contingency plan enabling it to intervene to suspend temporarily the redemption of mutual fund shares and to supervise the orderly winding down of a mutual fund when this is required to protect the interests of investors or the stability of financial markets
Principle 30	The BCB should consider whether its VaR model, designed for banks, is optimal for non-bank financial intermediaries and whether its quarterly reporting requirement for smaller non-banks is sufficiently timely.
Principle 31	The CVM should have authority to protect investors from fraudulent sales practices by market intermediaries involving government securities.
Principle 34	Bovespa should reexamine whether there is a need to modify the intraday auction process for block orders, particularly when applied across multiple days

### ***Authorities' response to the assessment***

32. Comissão de Valores Mobiliários (CVM) - the Brazilian Securities Commission welcomes the Assessment of the Securities Regulation Report on Observance and Codes (ROSC SR) under the 2012 Financial Sector Assessment Program. The Assessment, on most of the 37 covered IOSCO Principles, provides an accurate portrait of the Brazilian Regulatory environment.

33. However, despite CVM providing several additional background materials during the ROSC SR process, some negative bias and misleading analysis exist in some parts of the Report. The most serious one is that in our view the Assessment is not fully compliant with the IOSCO's *Methodology for Assessing Implementation of the IOSCO Objectives and Principles of Securities Regulation*, issued in 2011 with the purpose of turning ROSC's

evaluations homogenous. This appeared when addressing – and more important - giving benchmark results on Principles 9, 17, 25, and 33. In addition to this major problem, the description of the Brazilian regulatory environment was sometimes incomplete. We will address these issue principle by principle, as follows:

**34. On Principle 9, the Methodology is very clear that the usage of SRO’s is a discretionary policy option**, and therefore, it is not mandatory, as the assessment suggests, that CVM considers any voluntary SRO (actually a plus on the system prescribed by IOSCO Principles) as an official SRO. The existing official SRO’s do fully comply with the principle, and under our view, the Principle is Fully Implemented. In summary, **CVM strongly disagrees with the partially implemented rating for Principle 9.**

- i. According to the report, the Brazilian regulatory system falls short of the desired standards due to a “lack of governmental oversight of the Anbima, Apimec and Ancord programs”. We argue that such finding not only suggests a misreading of the Brazilian regulatory system, but also fails to abide by the IOSCO Methodology. In full compliance with the principle, any SRO given a role by the legislation is fully accountable to the CVM.
- ii. With regard to the Methodology, it is paramount to recognize that Principle 9 explicitly preconditions its application to situations where “the regulatory system makes use of Self-Regulatory Organizations (SROs) that exercise some direct oversight responsibility for their respective areas of competence” (IOSCO Methodology). This means that it is only in situations where SROs are recognized by the Regulator that the assessment becomes possible. Therefore, it is not reasonable to hold against CVM an evaluation based on some organizations being “viewed” by the market and/or the public as SROs when these entities do not actually have such role formally recognized. It is particularly important to stress that no regulated activities require a mandatory membership of this so called “informal SROs”.
- iii. ANBIMA, APIMEC and ANCORD certification and licensing roles follow rules directly prescribed in the regulation and are fully accountable to the CVM in each and every situation where they are entrusted in this role. The assessment singles out ANBIMA program. By the rationale that can be apprehended from the Assessment, ANBIMA voluntary self-regulation is a factor that if absent would get our regulation closer to a fully implemented rating for principle 9. This rationale seems to be at odds with the IOSCO Methodology that, as previously stated, recognizes the use of SRO’s as a discretionary policy option. Additionally, it must be considered that CVM exercises direct oversight over every single ANBIMA member accredited as a market participant, and that the Commission has the legal power and does not refrain at all from taking action against these members whenever needed. Therefore, the self-regulation that the industry participants voluntarily impose on themselves by adhering to ANBIMA codes of conduct can only increase the market quality and should not be considered a negative aspect.

35. **On Principle 17**, the CVM believes that there is plenty of room for the evolution of Corporate Governance in Brazil. However, **the Assessment seems to address some issues in an inaccurate manner or without the appropriate Methodology backup**. Initially, the existence *per se* of preferred shares, should not affect the evaluation result, or at least, should affect equally every ROSC in countries that permit the existence of this type of share.

- i. In addition, IOSCO Principles and Methodology do not require the existence of a specific Audit Committee. Nevertheless the CVM does encourage the adoption of voluntary Audit Committees, and where those do not exist, other independent boards (the Fiscal Board or the Management Board, depending on the specific case) have the power to hire the auditor, which is never hired directly by the managers.
- ii. It is also important to clarify that there are differences with regard to the communication of position changes on stockholding for the shareholders and the manager: For shareholders having direct or indirect participation of 5%, disclosure is governed by Instruction 358, art. 12, which requires immediate disclosure to the company. For managers, a more broad disclosure is required by CVM Instruction 358, art. 11.

36. **On Principle 25**, CVM disagrees with the partially implement rating, and strongly believes a fully implemented is the correct one. While improvements surely are possible and the comments made in the assessment will be taken into consideration, it is our view that **the arguments made to justify the benchmark rating were based largely on a subjective point of view rather than on objective reasoning based on the necessary usage of IOSCO Methodology**. The report bases its assessment on arguable negative aspects that are out of the Methodology's scope, without considering the balance of characteristics of our regulation, and apparently not taking into account key and unique features of the Brazilian system, and the fact that the Brazilian CIS Industry holds one trillion dollars in assets, and that no systemic problems were observed in recent years.

- i. The principle deals with the quality of the CIS regulation, especially regarding investor's protection, while the assessment was based on a dissatisfaction related to the existence of procedures for orderly winding up of CIS business.
- ii. Undoubtedly, the legislation in place in Brazil prescribes several measures to ensure that the winding up of a CIS to be orderly. For instance, clear rules apply to the valuation of assets and to the equitable treatment of quota-holders. To ensure that winding up is orderly, CVM's Instruction 409 prescribes specific steps to be observed on the liquidation of a fund, including the requirement of an independent auditor statement on the funds' assets and transactions (art. 106). The fund operator must inform the CVM of the winding up of the fund and file all relevant documentation (art. 107). These regulations have been in place since 2004 and passed well through the probation imposed by the 2008 crisis. Throughout this period we found no example of a "disorderly" winding up of any fund.

- iii. Additionally, in cases that winding up occurs in a context of suspension of redemption, our rules are fully compliant with IOSCO Principles, including the specific published paper on the topic (Principles on Suspensions of Redemptions in Collective Investment Schemes, Report of the Technical Committee of IOSCO – January, 19, 2012).
  - iv. On the matter of the unlimited liability constitution of Brazilian CIS, three aspects must be taken into account: first and foremost, IOSCO Principles and Methodology do not prescribe any issue on this matter; second, this aspect was positively considered by FSAP’s Systemic Risk Team, and; third and more practical - CIS in Brazil are not allowed to borrow and derivatives have to be traded in clearing houses or trade repositories (and are therefore subject to margin calls), which in practice severely limit leverage possibilities. On recent years, we did not observe any CIS bankruptcy due to excessive leverage, which is daily monitored by CVM.
37. **On Principle 33**, we understand that our assessment was affected by two items, the supervision of Automated Trading Systems and the limitation of the Dispute Settlement Mechanism. On our self-assessment, we believe that both issues are comprehensively covered in our jurisdiction, and **the correct benchmark rating should be “Fully implemented”**.
- i. According to CVM’s Instruction 461, the exchange’s trading system shall promote, on an ongoing basis, regular, adequate and efficient price formation, prompt trade execution, visibility and registration and public dissemination of data, in a fast, broad and detailed way, so to ensure adequate information disclosure and price formation. The same Instruction states that the exchange’s trading rules shall avoid or curb unfair practices, fraud and manipulation, ensuring that all persons authorized to trade in the environment receive equal treatment. It also sets the rules governing the processing of orders and trades (art. 73, sole paragraph: *“In the case of a centralized and multilateral trading system, price formation shall be achieved through interacting orders, in order of precedence according to the best price, with due regard for the chronological sequence of the orders entered into the system or trading environment, except in the cases of special trading procedures outlined in the exchanges’ regulation”*).
  - ii. This issue is addressed by CVM in many different ways: (i) whenever applying for authorization, the exchange must submit its internal rules for approval, and these rules must be fully compliant with CVM Instruction 461, (ii) during the application process, the applicant exchange must submit a report prepared by an independent auditor describing the “trading, registering and back-up systems” (Instruction 461, annex II, I, “a”), and (iii) once a year, a report is due on the risk management systems that shall be approved by the Board of Directors of the exchange, in consultation with the audit committee, and shall be sent to CVM within five (5) business days of the approval thereof. This report must address, among other things, information system’s regular operation and security. In addition to these reviews, CVM and BSM (the

regulatory body of the exchange) monitor the trading on an ongoing basis, in order to assure the observation of the above mentioned regulatory provisions.

- iii. Concerning the dispute resolution mechanism, we have to consider that the limitation of MRP fund (R\$ 70,000) is not applicable by investor, but by event. So in a case of more than one event with the same investor, an amount of more than R\$ 70.000,00 may be paid. In addition, we have to consider that the average transaction in the Brazilian exchange is only R\$ 9.392,15 (Jan-May 2012 average), so at least on what concerns problems with trade execution, the applicable limit is far beyond the average value of trades.

## II. DETAILED ASSESSMENT

Table 3. Detailed Assessment of Implementation of the IOSCO Principles

Principles Relating to the Regulator	
<b>Principle 1.</b>	The responsibilities of the regulator should be clear and objectively stated.
Description	<p>There are three regulators of the Brazilian securities market: the <i>Comissão de Valores Mobiliários</i> (CVM), the Central Bank and the <i>Conselho Monetário Nacional</i> (CMN).</p> <p>The responsibilities of the CVM are contained in two laws. Law 6.385/76 (“Securities Law”) established the CVM and Law 6.404/76 (“Corporation Law”) governs the structure, organization and responsibilities of corporations. The CVM is subject to Brazil’s Constitution and other laws passed by Congress. The President of Brazil may also issue provisional acts, which are temporary for 30 days, with one 30-day extension, unless ratified by the Congress.</p> <p>The CMN is a policy committee, composed of the Minister of Finance (“MoF”), the Governor of the Central Bank of Brazil (“Bacen” or “BCB”) and the Minister of Planning Budget and Management. The CMN on occasion will issue general policy guidelines that apply to the entire financial services sector in Brazil. The CVM must adhere to them and its regulations and interpretations must not conflict with CMN policy. The CMN does not have supervisory powers.</p> <p>The CVM itself has the power to issue regulations and interpretive guidance consistent with Laws 6.385 and 6.404. CVM Instructions are regulations of general applicability in specific areas of responsibility, such as securities offerings or collective investment schemes. The CVM typically proposes a draft Instruction and invites public comment. Final Instructions are available on the CVM website (English translations are provided on the website for selected Instructions that may be of interest to foreigners). The CVM also issues Deliberations. These are binding statements of the CVM’s understanding of the law. They are issued without a public exposure or comment period. For example, the CVM has issued a Deliberation when it adopted a new procedure for administrative enforcement proceedings. Whenever the CVM suspends trading in a security on Bovespa, it does so through a Deliberation. Occasionally the CVM will issue a Legal Opinion</p>

	<p>to clarify a provision of the law. However legal opinions are not used to provide interpretations of CVM Instructions. The CVM prefers to do this through an amendment to the Instruction. Finally the CVM Department Directors are authorized to publish Circulars that provide guidance on filing information with the CVM or other internal procedures. In limited circumstances the CVM may provide informal guidance on a confidential basis. Any person who objects to a staff Circular may request review by the CVM Board. All administrative proceedings decisions of the Board of the CVM may be appealed to the National Financial System Appeal Council (“CRSFN”). The CRSFN operates under the general authority of the Minister of Finance. The CRSFN is an 8-member group composed of representatives of the CVM, the BCB, SUSEP (the insurance regulator) and the MoF and four members representing the four key industry trade associations (UQBAR, Anbima, Bovespa and IBRACON).</p> <p>The responsibilities of BCB are contained in Law N° 4595. It is subject to the Brazilian Constitution and regulations approved by the CMN. The Central Bank is responsible for granting licenses to all financial institutions in Brazil. This includes market intermediaries (broker-dealers). The BCB has authority for prudential regulation and supervision of financial institutions. This includes responsibility for regulation of capital adequacy standards, resolution of failing financial institutions and securities clearance, settlement, depository and payment systems. All BCB-registered financial institutions that operate as financial intermediaries or C.I.S. must also obtain a license from the CVM. The CVM is responsible for the regulation and supervision of these entities in areas other than capital adequacy, such as investor protection and sales practices, disclosure, internal controls and operations, and trading practices. The CVM also has broad onsite inspection and enforcement authority for matters covered in the Securities Act and the Corporation Law. The CVM is also the primary regulator of the secondary markets for equity, non-governmental debt and derivatives (e.g. BOVESPA).</p> <p>The BCB has primary responsibility for supervision of the payment system and related clearing operations that can be systemically important such as the operations of clearinghouses and securities depositories.</p> <p>The CVM and BCB have established procedures to avoid regulatory duplication. As discussed in principles 13-15, there are written agreements on cooperation among the CVM, BCB, SUSEP and Previc (pension regulator) and coordinating committees have been created by these entities (see principle 6 discussion).</p>
Assessment	Fully Implemented
Comments	<p>The regulatory structure of Brazil has some characteristics of a “twin peaks” regulatory model. The differentiation of responsibility between the CVM and BCB is understood by both agencies. The one important anomaly is the responsibility of the BCB for regulation of the government debt market. This includes responsibility for sales practices, business conduct and investor protection that would otherwise be the responsibility of the CVM. This issue is discussed in the principles on regulation of market intermediaries.</p>

<b>Principle 2.</b>	The regulator should be operationally independent and accountable in the exercise of its functions and powers.
Description	<p>The CVM is made up of a Chairman and four Directors nominated by the President of Brazil and approved by the Senate. All must have a good reputation and proven experience in the securities market. Board members are appointed for five-year terms, with one term ending each year. Board members may be removed if they are criminally convicted or if they are found to have failed to perform their duties. Such a finding must be made in an administrative hearing under the supervision of the Minister of the Economy with the final decision made by the President of Brazil (§6 of Law 6385). Article 5 of Law N° 6385 provides that the CVM is independent and legally autonomous. The BCB is similarly structured. Its Board is appointed by the President and confirmed by the Senate. However, unlike the CVM, BCB Board members do not serve for fixed terms. Its resolutions (regulations) must be issued by the CMN, on which the Governor of the BCB sits.</p> <p>While the CVM is under the general authority of the MoF, its actions are not subject to its review. The CVM has published a set of procedures that governs its disciplinary process (Deliberation 538). All CVM final actions, including Enforcement decisions and negotiated Enforcement settlements, are published in a written statement that is available on its website. Parties adversely affected by CVM action, regulatory or enforcement, may appeal to the CSFRN. The CVM is also subject to Congressional oversight. The Brazilian Court of Audit (“TCU”) audits the CVM financial statements and accounts, and the Office of the Comptroller General (“CGU”) reviews the operations of the CVM and its success in meeting program goals contained in a government-wide performance plan. The CGU also oversees the activities of the CVM Internal Auditor. The CVM and BCB publish annual reports, highlighting their activities and containing audited financial statements.</p> <p>The CVM legal department reports that members of the CVM Board and its staff are legally protected from personal legal action for the bona fide performance of their duties by §22 of Law 9028/95. This protection extends to former employees as well. In the event of a lawsuit, the CVM Legal Department has the authority to represent CVM Board members and staff pursuant to Provisional Measure 2216-37/01.</p> <p>The Governor of the BCB has the rank of Cabinet Minister, which carries legal protection from private legal action arising from the performance of official duties. The BCB reports that its staff and persons appointed by the BCB to act as intervener, liquidator or who sit on the Director’s Council are currently protected from civil liability for actions in the performance of their duties. This protection does not apply to willful or negligent misconduct. The BCB and its employees, including the Governor have in the past faced numerous private actions in relation to their exercise of regulatory powers as well provision of financial assistance.</p> <p>The CVM lacks full control over its budget. Law 7940/89 sets the amount of all fees paid by the financial services industry for regulatory services. The money collected is paid directly to the Brazilian Treasury. The amount of fees collected</p>

	<p>provides a nominal target for the CVM budget that is never reached. The CVM must submit its proposed budget to the Minister of Planning who has full authority to reduce the amount requested. It is then submitted as part of the overall governmental budget to Congress for approval. Congress may also increase or reduce the CVM budget. After Congressional approval, the CVM receives its funding in quarterly installments. Each year in February, the Minister of Finance may further reduce the budget of all government agencies based upon the level of revenue collected by the government. As a result the non-fixed portion of the CVM budget is usually cut at this point.</p> <p>Article 16 of Law N° 4595 provides for the assessment of fees to pay expenses of the BCB. However its budget is also subject to executive branch and Congressional review and approval.</p>
Assessment	Partly Implemented
Comments	<p>While the CVM has clear legal independence, the BCB does not. However, its history demonstrates that it is operationally independent of political influence. While both agencies have the authority to collect fees from regulated entities this is not a stable source of funding, as the actual agency budget must be reviewed by the Ministry of Planning and Budget, approved by the Congress and subject to mid-year reductions by the Minister of Finance.</p> <p>There appears to be an inconsistency between the CVM and BCB on the liability of its employees. The CVM believes that its staff are immune for official actions taken in “good faith”, while the BCB believes that its employees may be liable for negligent acts. It is recommended that the standard for employee liability should be clarified. CVM and BCB employees should be subject to liability only for willful actions not taken in good faith.</p>
<b>Principle 3.</b>	The regulator should have adequate powers, proper resources and the capacity to perform its functions and exercise its powers.
Description	<p>The BCB and the CVM share regulatory authority over financial intermediaries. Both the BCB and the CVM have licensing authority over intermediaries. The CVM is responsible for business conduct and market regulation of intermediaries and the other secondary markets, equity, derivatives and non-governmental debt. The CVM lacks regulatory authority to protect investors from fraudulent sales practices by market intermediaries involving government securities.</p> <p>Law N° 6385/76 provides the CVM with broad authority. This includes substantial powers of surveillance of markets, issuers, and market intermediaries (§8). The CVM may also obtain information on markets, institutions, financial products, customers and parties involved in securities transactions (§9), carry out investigations (§9), impose sanctions for violations of the law (§11), suspend trading of securities on the stock exchanges (§9), and prohibit improper market conduct (§9). The CVM also has the power to share information with domestic and foreign regulatory authorities mentioned above (§28).</p> <p>In Brazil, capital market intermediaries are considered financial institutions, the term that is applied to banks. The BCB is responsible for prudential surveillance,</p>



	<p>principally capital adequacy, and oversight of the currency and government debt markets. Its laws and regulations apply equally to financial institutions, which encompasses banks and capital market intermediaries. The Banking Law (Law 4595/1964) grants the BCB full authority to license banks and take remedial actions, including resolution of non-viable banks. The Banking Law, Law 6024 and Resolution 4019 establish the authority of the BCB to undertake enforcement action, apply penalties and intervene and resolve weak banks independently. Law 6024 grants the BCB the power to intervene and extra-judicially liquidate financial institutions. Capital rules are covered in Resolutions 3444, and 3490 plus other attendant resolutions.</p> <p>Complementary Law No. 105 permits the BCB and the CVM to share information, even if this relates to data protected by bank secrecy. Because the legal departments of CVM and BCB had different interpretations of Complementary Law No. 105, this provision was incorporated into a 2010 Memorandum of Understanding between the BCB and CVM. Notwithstanding this MOU, the CVM has continued to request and obtain a court order whenever it has sought information subject to the Bank Secrecy Act. The use of a judicial process has been the preferred approach of the BCB.</p> <p>As described in principle 2, the CVM does not have complete control over its budget and the overall amount is frequently less than the amount of fees collected. The CVM also is limited in its authority to reallocate budgeted funds. All accounts are designated as fixed cost or investment and the CVM may not reallocate money from one account to another. Also, because personnel costs are paid separately by another government agency, the CVM cannot reallocate money into or out of its personnel account.</p> <p>While the CVM budget is less than the amount of industry fees and less than what they believe is necessary, it has grown since the 2002 FSAP. In 2003, the CVM was authorized to pay staff that are hired under the national competitive examination process according to a special salary scale that is substantially higher than most other government agencies. While salaries may be less than comparable private sector salaries, they are sufficiently attractive to retain staff and the CVM staff turnover rate is very low. Competition for new positions is quite high. In 2011 the CVM was authorized to increase its staff by approximately 20%. Due to budget limitations, the additional staff had to wait until 2012 to begin work.</p> <p>The CVM's staff recruitment process is very complex. The CVM must recruit and select technical staff, other than attorneys, accountants or librarians, through a written competitive examination process. While the CVM may select subjects on the exam, it is administered by an independent institution. Any person with a university degree may take the exam and the CVM is required to offer jobs to the persons who have the highest scores. No interview process is permitted and the CVM has no discretion to select from among the highest qualifiers. There is no ability to give preference to persons with work experience in the financial services sector or special qualifications, such as quantitative analytic skills or expertise in financial analysis. As a result of this process, the CVM has a professional staff with highly diverse academic credentials, including persons with medical and</p>
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	<p>engineering degrees. For this reason the CVM often has to provide extensive training to new recruits.</p> <p>The CVM does not control the number of attorneys it may hire, their salary or their selection or retention. All government attorneys in Brazil are hired and report to the Office of the Federal Attorney. The CVM requests an allocation of attorneys from this office, and that office determines the number of attorneys to assign and selects which attorneys will work for the CVM.</p> <p>The CVM maintains an adequate IT infrastructure to monitor and oversee the securities market. It has a department dedicated to its investor education program.</p>
Assessment	Partly Implemented
Comments	While CVM has received increases in budget and personnel in recent years, it still lacks sufficient resources, as well as control over the allocation of its budget. The Brazilian civil service process relies exclusively on hiring via competitive exams, which makes it difficult for the CVM to hire persons with actual experience in the capital markets or persons with highly technical skills necessary for effective regulation. The CVM should seek the authority to recruit and hire a limited number of employees with specialized skill sets and financial sector experience.
<b>Principle 4.</b>	The regulator should adopt clear and consistent regulatory processes.
Description	<p>The Securities Act provides for a public notice process for CVM regulations (Article 8, §3, I of Law 6.385/76). All proposed and final CVM regulations are published in the Official Gazette of Brazil and are posted on the CVM website. While comment letters submitted to the CVM are not posted on its website, they can be obtained by the public upon request. The CVM typically includes explanatory notes in its final announcement of new or amended instructions (rules).</p> <p>The rule- or regulation-making process is led by the Market Development Division of the CVM which prepares a draft with input from other departments that have direct bearing on the matter under consideration. Subsequently the CVM Board provides formal approval for a public hearing of the draft; it usually lasts for a month. A formal report—“Relatório de Audiência Pública”—is prepared with the public’s comments and CVM’s response. The final rule or regulation and said report are submitted for discussion and final approval by the Board. Board Commissioners and interested departments, including the Legal Department provide comments and suggestions, particularly on the precise formulation of the articles of the rule or regulation. After formal approval, the rule or regulation is enacted and published along with the “Relatório” and a press release.</p> <p>The CVM legal mandate includes investor protection and development of Brazilian capital markets. However, it is not formally required to conduct a cost-benefit analysis or consider the costs of compliance when it adopts or amends its rules. While consideration of costs is not a mandatory requirement, the CVM reports that during the rule-making process it considers the costs of implementing a new regulation, with due consideration of comments submitted by stakeholders.</p>

	<p>CVM Deliberation 538 governs the administrative processes for its disciplinary actions. The CVM has published Instructions (rules) on its registration/licensing procedures for issuers (CVM 400) and corporations (CVM 480), for securities exchanges and trading systems (CVM 461), for market intermediaries (CVM 387 and 505, compliance by October 2012) and for C.I.S. (CVM 409).</p> <p>Any decision on licensing/registration that is made by CVM staff may be appealed to the CVM Board. As discussed previously, all CVM Board actions, regulatory or disciplinary, may be appealed to the CRSFN. They may also be challenged in a judicial proceeding, although this is extremely rare and has not occurred in recent memory. In private judicial proceedings, a court may request the CVM to submit an <i>amicus curiae</i> brief describing how the CVM interprets the relevant law.</p> <p>The CVM is required to publish an annual report of its activities. This report includes a brief notice of the regulatory processes undertaken during the year and is made public on its website. The CVM website contains English translations of many of its significant Instructions.</p> <p>When the CVM conducts an investigation to determine whether there has been a violation of the law or a CVM instruction, it is considered confidential. If the CVM authorizes an administrative disciplinary proceeding, the defendants will be permitted to review the CVM staff investigation file. If the CVM takes action and imposes a sanction, either through adjudication or by a negotiated settlement, it will issue a public statement that identifies the person or entity, the violation and the sanction.</p>
Assessment	Fully Implemented
Comments	The CVM makes effective use of its internet website to provide investors and the regulated industry with information.
<b>Principle 5.</b>	The staff of the regulator should observe the highest professional standards, including appropriate standards of confidentiality.
Description	<p>Brazil has a civil servant law (8112/93) that contains a code of conduct applicable to all Brazilian government staff. The code includes provisions on the appropriate use of information obtained by a government agency/employee, including the observance of confidentiality and secrecy provisions and the protection of personal data. Law N° 8112/93 also requires a civil servant to observe the law and the highest standards of legality, impartiality, morality, efficiency, and criminal liability in the performance of official duties.</p> <p>The CVM also has an Internal Auditor to investigate complaints of improper staff conduct. The Civil Servant law requires an investigation whenever there is information reported of a possible conduct violation (§143 of Civil Servant Law). The Civil Servant Law also requires the CVM to have an Ethics Committee to monitor staff compliance with the code. The members of the CVM Ethics Committee are CVM employees who receive training from the National Ethics Commission. They may recommend disciplinary actions for minor misconduct.</p>

	<p>Serious violations may be referred to the Federal Attorney's Office for criminal prosecution. Under the Brazilian criminal code (§325) the action of "revealing or facilitating the disclosure of any fact that a civil servant comes to know by reason of his/her position and which should have been kept confidential" is a criminal act.</p> <p>In 2009 the BCB posted its Code of Conduct on the BCB website. Internally, the BCB has an Internal Affairs unit to monitor compliance with the Code.</p> <p>CVM staff are permitted to purchase and own securities, but there are restrictions that must be observed. Secrecy provisions are found in the Securities Act and Complementary Act 105. According to these laws, no member of staff is allowed to disclose or use information filed with or obtained by the CVM for personal benefit.</p> <p>New CVM employees must fill out a form identifying all securities they hold and the amount. Furthermore, employees must report all trades to the internal auditor within five days. The reporting requirement applies to CVM employee as well as a spouse or dependent if a joint tax return is filed. Access to derivative markets is limited to hedging purposes only, and new purchases may not be traded within less than six months, unless prior permission is obtained from the Internal Auditor (CVM Decree 351/94).</p> <p>Members of the CVM Board are required to recuse (refrain from participation) themselves from any decision in which they have a personal conflict of interest. There is no written definition or explanation of conflicts of interest and the Board member has personal responsibility to make the decision. Board members may consult with the CVM Ethics Committee. If a CVM Board member declines to participate in a decision they will state for the record that they are not participating. CVM Board minutes are public information. There is not a formal recusal policy or process for CVM staff. Informally, it is assumed that the CVM staff will adhere to the same policy in the event that a staff member makes the decision. This policy apparently would not apply to staff that participate in a consultative role.</p>
Assessment	Fully Implemented
Comments	<p>The CVM should consider adopting a formal recusal policy for its staff that applies to participation in any material way rather than merely final responsibility for the decision. In conjunction with adoption of such a policy, the CVM should consider providing written guidance.</p> <p>The CVM should also consider strengthening its employee securities holding reporting process. For example they could require the staff to file an annual report of all holdings; or periodically review a sample of staff portfolios to confirm compliance. The current mandatory reporting should apply to all spouses/partners and dependent children of CVM staff, even if they file separate tax reports.</p>
<b>Principle 6.</b>	The Regulator should have or contribute to a process to monitor, mitigate and manage systemic risk, appropriate to its mandate.
Description	The CVM has created an internal oversight structure to monitor systemic risk in its

	<p>market and its regulated entities. It is also a participant in an intergovernmental program with other Brazilian financial regulatory agencies.</p> <p>In 2011 the CVM created an Analysis and Research Office and made it responsible for developing and improving the various CVM departments' risk management tools and methodologies. The Office is also responsible for overseeing the various risk-based supervision matrices that the regulatory departments prepare. In 2011 the CVM also issued Internal Rule 12 creating a Risk Identification Committee (CIR). The CIR is composed of the members of the CVM Board, all Heads of Departments, the Head of the Legal Department and the Head of the Research and Analysis Office. The focus of the CIR is on new products, activities and services that may represent potential systemic risk, as well as on the options mitigating any risks. It is also responsible for assessing whether the CVM's powers, operational structure and regulatory framework are sufficient to address the risks identified. During the first year the CIR focused on the sufficiency of the CVM risk-based supervision matrix used to guide its internal and on-site review programs.</p> <p>CMN Decree 5685/06 created the Committee on Regulation and Supervision of the Banking, Securities, Insurance and Pension Funds (COREMEC). COREMEC is in the Finance Ministry and is responsible for promoting coordination and improvement in the regulation and supervision of activities related to public savings and offerings. It is composed of representatives of the BCB, CVM, PREVIC and SUSEP. In 2011 COREMEC created a Subcommittee to Monitor the National Financial System Stability (SUMEF). SUMEF monitors the markets under the jurisdiction of each regulator and is intended to keep COREMEC updated on market interconnection, financial stability and risks that might affect the financial system as a whole. SUMEF is also intended to expedite information sharing among the participants. There are also other specific cooperation agreements (MOUs) between the BCB, the CVM, the SUSEP, and the PREVIC to coordinate and share information relating to financial conglomerates.</p>
Assessment	Fully Implemented
Comments	<p>Creation of COREMEC in 2006, prior to the 2008 financial crisis, is a noteworthy innovation. The CVM has developed and is committed to using risk-based supervision methods. Currently the RBS models emphasize size parameters – important measure of magnitude that may be less effective measures of probability. Continued analysis and refinement of these metrics may be useful. The CVM should also consider whether it is too heavily focused on its RBS system and should place greater emphasis on questions of interconnectedness, contagion risks, and exogenous factors that could contribute to systemic disruptions in the capital markets.</p>
<b>Principle 7.</b>	The Regulator should have or contribute to a process to review the perimeter of regulation regularly.
Description	<p>The CVM reports that its Policy and Analysis Office and its Risk Identification Committee, described in principle 6, are specifically charged with ongoing responsibility to examine emerging regulatory issues that may be pertinent to</p>

	<p>matters of investor protection, market efficiency and fairness, and other regulatory principles, that may be outside the scope of CVM authority. On a national level, COREMEC has similar authority.</p> <p>In recent years the CVM has adopted important new Instructions that substantially alter and update Instructions that had become outmoded. Instruction 480, described in principle 16 created a new company-based electronic reference form for listed company disclosure and Instruction 505, described in principle 31, updates and expands the regulatory requirements for market intermediaries. The CVM also has demonstrated its capacity to submit proposals to Congress for changes in relevant laws; notably amendments to the Corporation Law in 2011 and a proposal to enact a new law concerning collateral requirements in the OTC derivatives market.</p> <p>The CVM is examining the current lack of regulation over agricultural commodity spot markets in Brazil.</p>
Assessment	Fully Implemented
Comments	
<b>Principle 8.</b>	The Regulator should seek to ensure that conflicts of interest and misalignment of incentives are avoided, eliminated, disclosed or otherwise managed.
Description	<p>The Brazilian financial markets are heavily concentrated with a small number of universal banks dominating all aspects of the financial services sector. Since 2008 Brazil has had only one national securities exchange. Also large Brazilian listed companies typically have a single controlling shareholder. In this environment, there is a substantial potential for conflicts of interest and the misalignment of incentives by market participants.</p> <p>The CVM approach to regulating conflicts of interest is heavily reliant on disclosure of related party or affiliate transactions to clients, investors and the public. These disclosure requirements are contained in applicable CVM instructions for CIS operators and managers (CVM 409), listed companies (CVM 480), and independent auditors (CVM 308). The CVM has created a working group to examine its current instruction pertaining to asset-backed securities (CVM 489).</p> <p>As described in principle 22, the CVM has adopted an Instruction to register and regulate credit-rating agencies that addresses conflicts of interest.</p>
Assessment	Fully Implemented
Comments	<p>The potential for conflicts of interest that could misalign incentives is particularly significant for Brazilian CIS that are owned by banks. In a concentrated industry in which mutual funds engage in a substantial volume of daily trading with an affiliated bank, there is an opportunity for substantial and profitable improper activities. Trades that are only basis points away from the best price, if frequent, can result in large profits. Clever trade allocation techniques among a family of funds may result in one fund performing much better than another. The CVM regulation requiring firms to have clear allocation policies is a sound approach, but</p>

	monitoring compliance may be a challenge. Similarly, prospectus and by-law disclosure permitting funds and related banks to trade may be an ineffective vehicle for providing investor protection. Detailed record-keeping requirements coupled with an inspection program may be a burden for the regulator and the regulated.
<b>Principles for Self-Regulation</b>	
<b>Principle 9.</b>	Where the regulatory system makes use of Self-Regulatory Organizations (SROs) that exercise some direct oversight responsibility for their respective areas of competence, such SROs should be subject to the oversight of the Regulator and should observe standards of fairness and confidentiality when exercising powers and delegated responsibilities.
Description	<p>The Brazilian system for regulation of capital markets is notable for its creative use of governmental regulators, licensed self-regulatory organizations directly overseen by the CVM, and voluntary unofficial organizations that perform SRO functions but are not subject to formal governmental regulation and oversight. The BM&amp;F Bovespa BSM and CETIP are the two licensed self-regulatory organization (SRO). They are legally recognized and required under the Securities Act (Law 6.385/76, §17.1) to regulate members and trading. Bovespa also owns and operates its proprietary clearance, settlement, payment and central securities depository system, regulated primarily by the BCB. As described in principle 33, Bovespa and CETIP must submit all new rules, rule amendments, changes in products and services to the CVM for prior approval. Only fees for services are not subject to prior CVM approval.</p> <p>Bovespa created BSM as a legally independent entity, wholly owned by Bovespa, to perform regulatory functions. BSM is governed by its own regulatory board and it has its own annual budget. BSM has responsibility for surveillance of all Bovespa trading platforms, oversight and inspection of member firms, monitoring listed company disclosure, and overall compliance with Bovespa and BSM regulatory requirements. BSM has a staff of nearly 150.</p> <p>CVM Instruction 461, chapter 4 establishes self-regulatory requirements for exchanges. The CVM, as part of its supervisory responsibilities, reviews the BSM budget and annual working plan. It conducts oversight inspections of BSM. BSM is required to submit daily, weekly and monthly reports to CVM, discussed in principle 34. BSM sends immediate referrals to CVM of any trading irregularities that require CVM investigation. BSM is responsible for the Bovespa fund to recompense investors who suffered losses due to intermediaries' misconduct involving Bovespa-listed or traded securities. Applicants who are denied compensation may appeal the decision to the CVM. BSM also has responsibility for imposing disciplinary sanctions on member firms and employees who violate Bovespa or BSM requirements. These sanctions may not be appealed to the CVM for review.</p> <p>CETIP, which is a securities registry and depository for OTC fixed-income</p>

	<p>securities or derivatives, is also a registered SRO. It has a dedicated regulatory department, rather than a legally separate entity. This unit also has its own budget that must be reviewed and approved by the CVM, along with its annual work plan. The CVM has direct oversight authority, receives daily, weekly and monthly reports, and conducts on-site inspections. The CVM regulatory staff meets with BSM and CETIP staff every other month.</p> <p>The Administration Committee of External Quality Review (CRE) is a professional organization of accountants. It is registered and supervised by the CVM. In addition to a CVM license, auditors must be licensed and registered with CRE. The CRE is funded by its membership and is headed by a Board composed of four representatives from the CFC and four from the Institute of Independent Auditors of Brazil (IBRACON).</p> <p>In addition to these registered and regulated SROs, several member-based professional or trade organizations perform one or more functions that are self-regulatory. While the CVM has a variety of working relationships with these entities, it does not require SRO registration, as they are not exchanges. Also it does not supervise their activities, or exercise oversight of the policies and programs they administer. These organizations include Anbima (Brazilian Financial and Capital Markets Association), Apimec (Association of Investment Analysts and Capital Markets), and Ancord (National Association of Security Brokers, Exchange and Commodities).</p> <p>ANBIMA is the largest of these organizations and has the most extensive member regulation program. The association represents more than 340 institutions, including commercial and investment banks, asset managers, brokerage houses and investment consultants. For example its members operate and manage virtually all mutual fund assets under management in Brazil. ANBIMA describes itself as a “private regulator agent, creating and supervising rules according to its Regulation and Best Practice Codes and works together with the Brazilian authorities and public institutions aiming to regulate the activities performed in Brazil’s financial and capital markets” (Anbima website). Anbima is an SRO affiliate member of IOSCO as is BSM (BM&amp;F Bovespa) and CETIP.</p> <p>Anbima licenses its members and has issued 11 Codes of Conduct that its members must comply with. Members who are in compliance may advertise this to the public through the “Anbima gold seal” on promotional materials. In conjunction with this program Anbima staff pre-reviews all member mutual fund advertising materials for compliance with the applicable code. The Anbima codes are not reviewed or approved by CVM.</p> <p>The National Monetary Council of Brazil (“CMN”) requires agents acting in the distribution of financial products within a financial institution to be certified as</p>
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	<p>having proper knowledge of the Brazilian financial markets by an entity with recognized technical capacity. Anbima has a professional certification process for persons covered by this requirement. Also, in 2011 Anbima created a special certification process for mutual fund portfolio members. Anbima members must have one certified person for its mutual funds. The certification must be renewed annually.</p> <p>Anbima has an inspection staff of approximately 30 persons responsible for conducting off-site and on-site inspections. Members that operate mutual funds for example must report NAV daily to Anbima. Anbima reviews any funds for which the NAV or the fund's performance deviates substantially from comparable funds. Anbima uses a risk-based supervision model developed for them by PWC. It has created an industry Monitoring Committee to oversee its risk-based supervision program. Anbima also provides daily price vectors for members to use when pricing illiquid debt securities.</p> <p>Anbima has its own disciplinary program, by which it can impose sanctions including monetary fines, and suspension or expulsion from Anbima. Anbima has adopted a Code of Conduct that governs its disciplinary program. Anbima disciplinary actions may be resolved through an administrative hearing or through a negotiated settlement. In both cases the final action must be reviewed and approved by a Judiciary Counsel, a majority of whom must be professionals not affiliated with the financial institutions. Anbima sanctions are final and may not be appealed to the CVM. The CVM has an agreement with Anbima that it will not take separate disciplinary action, if Anbima has acted; although CVM may impose sanctions on responsible individuals who are not sanctioned by Anbima.</p> <p>Anbima performs another SRO function pursuant to a written agreement with CVM. Anbima staff review all listed company prospectuses and disclosure reports in addition to CVM review. Under this agreement the 20-day statutory review period begins when the issuer submits the prospectus for a follow on offering of securities to Anbima, and CVM has 7 days for review after Anbima.</p> <p>Apimec and Ancord are professional membership organizations that play a role in the qualification and licensing of individuals. Apimec administers a qualification examination to persons seeking a CVM license as a market analyst, as required under CVM Instruction 483. Ancord has similar responsibility for persons seeking an autonomous agent license.</p>
Assessment	Partly Implemented
Comments	<p>Principle 9 recognizes that there is considerable diversity in the regulatory roles and responsibilities of SROs around the world and Brazil is an example of how different SRO models may be used in an effective, collaborative way. The Brazilian regulatory structure makes extensive use of self-regulatory organizations – both legally recognized and regulated SROs and unofficially recognized and unregulated SROs. However IOSCO Principle No. 9 requires SROs to be subject</p>

	<p>to the oversight of primary regulators where they exercise some direct oversight responsibility for their respective areas. As the IOSCO Methodology provides “‘Inappropriate use’ of an SRO by extension might include the exercise of SRO functions by an unauthorized entity or without regulatory oversight”.</p> <p>The CVM licensing and oversight process for BSM/Bovespa and for CETIP is sound and is fully compliant with the IOSCO principle for regulatory oversight of SROs. The partly implemented assessment is based upon the lack of governmental oversight of the Anbima, Apimec and Ancord programs. In reaching this conclusion, it should be stressed that the program administered by Anbima appears to be sound and well constructed. What is missing is an appropriate level of oversight by a government regulator.</p>
<b>Principles for the Enforcement of Securities Regulation</b>	
<b>Principle 10.</b>	The regulator should have comprehensive inspection, investigation and surveillance powers.
Description	<p>The Securities Act (Law 6.385/76) provides the CVM with comprehensive inspection, investigation and surveillance powers. The CVM may monitor all activities and services of securities markets on a permanent basis, obtaining from market participants all information and documents that it may deem necessary. The entities regulated by CVM include investment banks, brokers, dealers, exchanges, organized over-the-counter-markets, custodians, clearing and settlement entities, fund managers, financial analysts and independent auditors.</p> <p>Under the Securities Act the CVM may oversee and regulate the activities and services of the securities market, as well as the disclosure of information regarding the market, individuals participating in it and the securities traded thereon (§8, item III). It may examine and extract examples of accounting records, books or documents, including electronic programs, magnetic and optical files, as well as any other files, and also the paperwork of independent auditors (§9, item I). The law contains a five-year record retention requirement.</p> <p>The Money Laundry Act (Law 9.613/98, §9 and 10) requires entities regulated by the CVM to keep records of any transaction in Real or foreign currency, securities, bonds and notes, bullion, or any asset convertible into money above an amount set by the CVM. The CVM also requires regulated entities to identify their clients and keep their client register updated. CVM Instruction 301 and CVM Instruction 387 specify rules related to the complete client identification. In 2011 CVM adopted a new Instruction (505) which expands the record keeping and internal control requirements for market intermediaries; requiring complete client identification records and a new requirement that all client trading instructions must be recorded.</p> <p>The CVM has the legal authority to conduct off-site or on-site inspections of all regulated entities, including listed companies, on a scheduled or surprise basis, with or without a subpoena. It has the authority to require the production of records and testimony. It may conduct investigations to determine whether</p>

	<p>violations of the law or CVM instructions have occurred, by regulated entities, employees or third parties not directly licensed or registered with the CVM. CVM has its own market surveillance program that has access to trading on Bovespa and CETIP. BSM and CETIP have primary responsibility for real-time market surveillance, and CVM staff focuses on follow up investigations of suspicious trading anomalies and investigation of suspicious activities reported by BSM and CETIP.</p> <p>Both organizations must comply with CVM regulations to conduct surveillance and to monitor compliance with Bovespa and CETIP trading requirements.</p> <p>CVM does not have inspection and investigation authority for market intermediary capital compliance and related prudential supervision, or for oversight of the secondary market clearance, settlement, payment and depository process. BCB has exclusive responsibility in these areas. As discussed in principle 30, BCB applies one set of capital standards to all financial institutions, including banks and market intermediaries. If an intermediary is part of a bank conglomerate BCB requires consolidated financial reports, including a daily risk-weighted financial adequacy calculation and a monthly detailed report (quarterly for smaller institutions). BCB also has exclusive authority to regulate the government securities market, including sales practices.</p> <p>CVM and BCB signed an MOU in 2011 to exchange information. This is particularly important for CVM access to bank records.</p>
Assessment	Fully Implemented
Comments	Following the adoption of the BCB--CVM MOU, CVM reports that it has been successful in obtaining bank record information, typically by first obtaining a court order.
<b>Principle 11.</b> The regulator should have comprehensive enforcement powers.	
Description	<p>Pursuant to the Securities Law (6.385/76, §11), the CVM may take administrative enforcement action for violations of any provision of the Securities Law, the Corporation Law, CVM regulations, or any other provisions that are under its responsibility. The CVM has authority to impose administratively a warning, a fine, a suspension from serving as a director of market intermediaries and public companies, temporary disqualification up to 20 years, from occupying managerial posts in market intermediaries and public companies, and suspension or cancellation of market intermediaries' licenses issued by CVM. The CVM and Bovespa both have the authority to suspend trading of a security in the secondary market and halt or suspend the initial offering of a security, including shares in a mutual fund.</p> <p>While the CVM can require a violator to recompense defrauded persons as a condition to a negotiated settlement, it cannot impose this requirement in a litigated action.</p> <p>The CVM has broad investigative powers. It has the authority to inspect all</p>

	<p>records of, and compel any information from, any individual or legal entity and access the information at any time. This provision applies to all non-regulated individuals or entities, as well as to any government agency or public corporation if the testimony or information is necessary to complete the investigation.</p> <p>When the CVM is unable to obtain information the Securities Law empowers it to seek assistance from another governmental entity. In addition, CVM can seek a court order for special cases (e.g., telephone records) or when information is for any reason denied. The Securities Act also provides that the CVM, the BCB, the SUSEP, PREVIC and the Federal Revenue Office must share and exchange information. CVM has cooperation agreements with these agencies. In addition, CVM also has agreements with the Federal Police, the Public Prosecutor's Office, the Treasury, and the National Secretariat of Public Security (a division of the Ministry of Justice) for information exchange, technical cooperation and enforcement. Under Complimentary Law 105/01 (§9.2), whenever the CVM obtains any evidence of unlawful activity, it must notify the relevant governmental agency in charge of investigating and enforcing the pertinent law. This includes a legal duty to inform the Federal Attorney's Office of possible criminal violations of the Securities and Corporation Laws.</p> <p>CVM Instruction 480 requires public companies to disclose the identity of their controlling shareholders. If it is a legal entity, companies have to identify its direct and indirect controlling individuals. Public companies also are required to disclose any shareholder or group of shareholders holding more than 5% of any kind of shares. (Law 6.385/76, §9.I and III).</p> <p>The Brazilian Constitution guarantees persons a private right of action. In addition to this fundamental right, the Novo Mercado listing rules requires N.M. companies to agree to binding arbitration of any disputes with its shareholders.</p> <p>Private lawsuits against administrators (directors and executives) of public companies can be brought by minority shareholders, similar to US-style derivative lawsuits. However, the effectiveness of these lawsuits is impaired by the fact that they must be approved by the shareholders meeting (not the board as in the US). Controlling shareholders are thus able to block such actions. As a result, lawsuits against directors are rare. Because of these difficulties Brazil has received a low score (3) for ease of private litigation in the annual IFC Doing Business Report. This compares unfavorably to the rest of Latin America (6) and OECD countries (7).</p> <p>Finally, as mentioned in principle 9, injured investors can file a complaint before the BSM Bovespa Investor Compensation Mechanism (MCR) for compensation of losses suffered as a result of actions or omissions of market intermediaries in connection with a Bovespa security. The maximum compensation is 70,000BR.</p>
Assessment	Fully Implemented
Comments	While there remains some uncertainty about the capacity of the CVM to obtain

	<p>through court order records from third parties, such as internet service providers, the CVM has been successful in recent matters obtaining phone records. It also reports that the Federal Police and Federal Attorney have the capacity to obtain this information and have demonstrated a willingness to assist the CVM when necessary.</p> <p>The maximum compensation from the MCR appears to be too small to adequately protect investor accounts. The CVM should examine the issue closely and consider directing Bovespa to increase the maximum size of compensation awards.</p> <p>The availability of private litigation options in Brazil could be improved.</p>
<b>Principle 12.</b>	The regulatory system should ensure an effective and credible use of inspection, investigation, surveillance and enforcement powers and implementation of an effective compliance program.
<b>Description</b>	<p>The CVM has a program in place for surveillance of the securities market, which covers issuers, market intermediaries, collective investment schemes, portfolio and fund managers, stock exchanges and all other market participants. As described previously, primary surveillance responsibility is with regulatory staff of BSM and CETIP. In December 2011 CVM finished the implementation of an integrated surveillance system that analyses information coming from CETIP and BM&amp;FBOVESPA. The system collects and records all the information relating to both markets in order to detect and identify suspect situations of market manipulation and abuse. It generates a list of exceptions, showing unusual movements in price, volume and liquidity. In Bovespa's derivatives market, the CVM relies on an electronic system that is delivered by BM&amp;F in T+1 (the next day). Primary real-time surveillance at Bovespa and CETIP is the responsibility of their regulatory staff.</p> <p>In 2007 CVM published Deliberation 521/07 creating a risk-based supervision system (SBR) that includes off-site and on-Site inspections by a CVM Department with primary responsibility (SFI). A Risk Management Committee (CGR) was also created that is responsible for implementation and monitoring of SBR, through a Biennial Plan of Supervision that must be submitted to the CVM Board for approval. A comprehensive inspection manual was developed with assistance from FINRA, the U.S. SRO. The manual covers all types of regulated entities and contains very detailed inspection protocols for each category of entity. The CVM conducts ad hoc or unscheduled inspections based on risks and complaints as well as scheduled inspections selected through its risk parameters. It also maintains records of inspection results.</p> <p>The CVM SBR is heavily weighted toward the size of an entity and the total number of investors or clients. For example, the ten largest mutual fund operators,</p>

	<p>which collectively control over 90% of assets under management, are reviewed on a two-year cycle. Other funds are grouped by size and risk parameters into seven risk categories and a sample from each category is inspected, as resources permit. In addition the SRI periodically conducts special issue inspections in which a specific area of operation or regulatory concern is inspected at several firms.</p> <p>The inspection program inspects some of each group or type of regulated entity, Besides mutual fund groups, this includes broker-dealers (market intermediaries), autonomous agents, who are contractors of intermediaries and function in a manner similar to an introducing broker in the U.S., transfer agents and custodians, and licensed auditors. Auditor inspections are conducted in coordination with the CVM office responsible for accounting and auditing. CVM also conducts a limited number of on-site inspections of publicly listed companies.</p> <p>Since 2008 the CVM has demonstrated an increasing capacity to be a credible enforcement presence in Brazil. The CVM has developed a negotiated settlement process to successfully conclude its investigation. Under CVM Deliberation 390, individuals or entities may agree to settle a matter by agreeing to a consent decree (<i>termo de compromisso</i> or TC). The CVM may agree to a TC for any violation of the Securities Law or Corporation Law and CVM instructions. It is not available for violations of the Anti- Money Laundering law. As part of the TC, the party must agree to cease the improper conduct and to compensate victims of the misconduct or correct the misconduct. Victim compensation is not a remedy available to the CVM in a litigate proceeding. In a TC, a party does not admit to the violations, but if the terms of the TC are not complied with, the CVM may reinstitute an enforcement action. All TCs are publicly disclosed. The terms of the TC must be reviewed by the CVM Consent Decree Committee and submitted to the CVM Board for final approval.</p> <p>The TC program has been successful. In 2009 there were 58 TC, involving 84 persons resulting in 11 million BR in judgments. In 2010 this increased to 64 TC, 141 persons and 57 million BR. In 2011, there were 45 TC, with 93 persons and 175 million BR. However one action against a corporation that committed fraud in a takeover of another corporation paid a fine of 150 million BR.</p> <p>The CVM has successfully resolved several important cases through TC. For example, in 2010 the CVM settled an insider trading case against a major international investment bank for a judgment of 19 million BR. Also in 2010 four directors of a global Brazilian company settled a case for 15 million BR involving an illegal related party transaction.</p> <p>The CVM continues to litigate some cases where settlement negotiations are</p>
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	unsuccessful or inappropriate. In 2010 the number of fines rose from 115 to 126, totaling R\$575 million (about USD 320 million).
Assessment	Fully Implemented
Comments	Since the 2002 FSAP the CVM has made substantial progress in building credible surveillance, inspection, investigation and enforcement programs. Overall the CVM has demonstrated that it has built a successful surveillance, inspection and enforcement program. This is consistent with views expressed by members of the industry in interviews. One aspect of the program that may warrant CVM consideration is the extensive reliance on monetary fines and the apparently limited use of suspensions or disqualifications. Sometimes a firm may willingly agree to a money fine as a “cost of doing business” in order to avoid a more severe impact from a suspension or disqualification. This comment is speculative.
<b>Principles for Cooperation in Regulation</b>	
<b>Principle 13.</b> The regulator should have authority to share both public and non-public information with domestic and foreign counterparts.	
Description	<p>The Securities Act (Law 6385/76, §28) (the “Securities Act”) explicitly directs the BCB, the CVM, the Pension Funds Agency (Previc), the Federal Internal Revenue Authority and the Superintendence of Private Insurance (SUSEP) to have a system for the exchange of information relating to the supervision in their respective areas. The same article explicitly provides that the Bank Secrecy Act (Law 105/2001) may not be used to prevent the exchange of information.</p> <p>The Securities Act (§10) also provides clear authority to the CVM to enter into agreements with foreign regulators and international organization for “assistance and cooperation in the investigations relating to infringement of regulations pertaining to the securities market occurring in Brazil and abroad”. These provisions do not require the CVM to obtain approval from other government agencies or the judiciary.</p> <p>The Bank Secrecy Act imposes some limitations on the unlimited exchange of information covered by that law. One limitation pertains to the unsolicited exchange of information. The Bank Secrecy Act requires a Memorandum of Understanding (MoU) between the bodies for covered information.</p> <p>A second limitation pertains to foreign requests concerning matters in which the CVM does not have an independent interest. However when this circumstance arises, the foreign request provides a basis for the CVM to open its own inquiry to satisfy the requirement.</p> <p>The Bank Secrecy Act also affects the capacity of the CVM to obtain commercial banking records concerning an individual or entity. While BCB and the CVM have an MoU that specifically addresses this problem, BCB has a strong preference that the CVM obtain a judicial order requiring the production of the information. The CVM reports that obtaining a judicial order has not been a problem and it has been successful all of the last five occasions when this was</p>

	necessary.
	Fully Implemented
Comments	
<b>Principle 14.</b>	Regulators should establish information sharing mechanisms that set out when and how they will share both public and non-public information with their domestic and foreign counterparts.
Description	<p>As explained in principle 13, the CVM has clear authority to enter into information sharing mechanisms with both domestic and foreign regulatory bodies. In 2010, the CVM and Bacen signed an MoU. The CVM also has written agreements with Previc, the Federal Internal Revenue Authority, SUSEP, the National Treasury Authority, the Federal Prosecutors' Office, and other agencies. The CVM has written agreements with numerous foreign regulatory bodies. It is a signatory to the IOSCO Multilateral Memorandum of Understanding (MMOU). The CVM has also signed almost 28 MOUs with foreign counterparts. The CVM stated that these MOUs follow a common standard "that states clearly and in a detailed manner under what conditions and circumstances the authorities would share public and non-public information". This includes the exchange of "fit and proper" information for licensing purposes.</p> <p>While the CVM has the capacity to exchange information with foreign regulators, the Bovespa is limited in this regard. While many of the largest Brazilian companies have ADR's listed in the U.S., Bovespa lacks the authority to sign a written information exchange agreements with foreign exchanges. Bovespa reports that this problem is addressed by requesting the CVM to obtain needed information.</p> <p>CVM staff have a legal duty to protect the confidentiality of information obtained in their official duties, unless it is disclosed during an enforcement or legal proceeding. This applies to information obtained from other domestic and foreign regulators. The CVM reports that it includes a similar confidentiality provision in its MoUs.</p>
Assessment	Fully Implemented
Comments	
<b>Principle 15.</b>	The regulatory system should allow for assistance to be provided to foreign regulators who need to make inquiries in the discharge of their functions and exercise of their powers.
Description	<p>As explained in principles 13 and 14 the CVM has the necessary legal authority to exchange information with foreign authorities and it has written bilateral agreements with, and through the IOSCO MMOU, a wide array of foreign regulators.</p> <p>While the CVM can obtain without a court order any information contained in the records of registered entities such as market intermediaries, CIS, Bovespa, and</p>



	<p>audit firms, it must obtain a judicial order for confidential banking records. As explained previously it has been successful in the last five occasions over two years. CVM reports that the process has not been unduly delayed. The MoU between the CVM and BCB provides for a 15-day response to any request. One limitation that exists concerns information from third parties not a part of the financial sector, such as telephone companies and internet service providers. The CVM lacks a clear mandate to obtain this information. If it is required it must act through the Federal Attorneys Agency as a potential criminal matter. The CVM may compel individuals to testify in its investigations and share the information with foreign regulators. Persons who refuse to testify may be fined by the CVM or referred to the Federal Attorney's office for possible criminal action.</p>
Assessment	Fully implemented
Comments	<p>While the CVM has demonstrated its capacity to provide assistance to foreign regulators sufficiently to warrant a fully implemented assessment, there is some uncertainty as to its ability to obtain telephone and internet records. As the financial market move to a fully electronic environment, this information will become indispensable for the effective investigation and enforcement of the law. This issue was previously discussed in principle 10</p>
<b>Principles for Issuers</b>	
<b>Principle 16.</b> There should be full, accurate and timely disclosure of financial results, risk and other information that is material to investors' decisions.	
Description	<p>Issuer disclosure is governed by the Securities Law (6385/76) and the Corporations Law (6404/76), and CVM Instructions 480, 358 and 400. These laws and regulations require full, timely and accurate disclosure of financial results and other information material to investors.</p> <p><b><i>Securities offerings regulation</i></b></p> <p>CVM instruction 400 regulates the public offer for the distribution of securities in primary and secondary markets, setting conditions applicable to public securities offerings, the content and distribution of prospectuses and other relevant offering documents. There are separate review procedures for initial public offerings and for subsequent public offerings of securities, with different processing timelines. Securities offerings that are not an IPO may be submitted to Anbima for its prior review. When this happens, the CVM review time is shortened to 7 days and the 20-day statutory period begins with the Anbima filing. CVM staff may require issuers to provide additional information or correct misstatements in all offering documents.</p> <p>The CVM also has adopted a limited qualified investor offering process (CVM 476) in which companies may issue securities to 20 investors (one mutual fund group with multiple funds is one investor) based on a solicitation to a maximum of 50 persons. The minimum investment per investor is one million reais. Purchasers are required to hold securities for a minimum of ninety days. There have been a</p>

	<p>few offerings to date, although interest is growing.</p> <p>CVM also has a shelf registration offering process for issuers (CVM 400 §11). The registration receives expedited review, 10 days by CVM, and may stay effective for two years. The process has not been used frequently.</p> <p>Instruction 480 created a new category of company – Issuers with market exposure. These companies have equity listed on an exchange for at least three years, have timely filed reports within the past twelve months and have a market capitalization of 5 billion reais. These companies are eligible for an expedited 5 working day review by CVM of securities offerings.</p> <p>The CVM has broad authority to reject a securities offering. It may be rejected for a failure to provide required information or if the CVM finds “unfeasibility or recklessness of its Founders” (CVM 400 §16). The CVM may also suspend up to 30 days or cancel an offering if it is conducted in a manner contrary to the stated offering or if it is fraudulent or contrary to CVM regulations (CVM 400 §19).</p> <p><b><i>Periodic disclosure requirements</i></b></p> <p>The CVM requires companies to file a full range of disclosure reports, including quarterly reports, special event reports and annual reports. In 2009, when the CVM issued Instruction 480, it created a new disclosure form for companies with securities listed for trading on a regulated securities market. The traditional set of disclosure requirements based on the Corporation Law was augmented by a new set of requirements that are filed on an electronic formatted filing system.</p> <p>Instruction 480 has two types of companies. Filers in category A (approximately 500 issuers) have issued equity securities listed on Bovespa and category B (approximately 100 companies) have issued fixed income securities or other instruments that are not convertible into equity.</p> <p>The Reference Form is structured around specific disclosure requirements: (i) Standardized Financial Statement Form – DFP; (ii) Registration Form; and (iii) Reference Form. Issuers are required to disclose on the Reference Form the following: (i) description of risk factors; (ii) description of material litigation for the issuer or its subsidiaries; (iii) qualitative and quantitative analysis of market risks. The DFP form must be filed within 3 months of fiscal year end and information must be updated within 7 business days of specified material events (CVM 480 §24.3).</p> <p>The ITR form replaces the quarterly report for listed companies. It must be filed within one month of the end of the quarter and contain financial statements reviewed by the issuers’ independent auditor. The Corporation Law requirement that public companies must publish its annual report and financial statements in at</p>
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	<p>least two national newspapers continues to apply.</p> <p>Notifications of Material Information must be filed with the CVM and made public “immediately” (CVM 358 §3 and 5). Material events are defined as any information that could affect the price of a security, influence an investor’s decision to buy or to sell or to exercise any rights. Instruction 358 requires the issuer to release immediately a notification of Material Information to the market, in a clear and precise way, in language considered adequate to investors. A Company may refrain from disclosing information if it would adversely affect the company, but the information must be made public if there is a sudden change in the market price, liquidity or traded volume of the company’s stock (CVM 358 §6). Both the CVM and the Bovespa have the authority to temporarily suspend trading in a company stock, although this is exercised very infrequently (Law 6.385/76, §9.1).</p> <p>The CVM rules (CVM 358 §13) contain a broad prohibition on insider trading by corporate management, Board members, owners of 5% of stock, advisors and others with access, and persons who receive the information from covered persons. The same rule also imposes a trading blackout period for 15 days before the release of quarterly or annual reports. Violations may be sanctioned by the CVM administratively or by criminal prosecution by the Brazilian Federal Attorney’s Office.</p> <p>The CVM review process for filings includes a review of both offering documents and company reference forms. The CVM has a staff of 55 divided into five groups responsible for review of issuer disclosure documents. All IPO filings are reviewed and the staff applies a risk-based approach to selectively review other company reports. All registered companies are placed in 8 risk categories, primarily ranked by market cap and number of shareholders. The largest companies are reviewed every year and a sample from each of the other categories is reviewed annually. The staff will also occasionally conduct special subject reviews of one issue across a large sample of companies. In recent years the staff has examined subjects such as intangible asset accounting practices, financial instrument valuation, and derivatives exposure. Based on these reviews a small number of matters are referred for further investigation by enforcement staff.</p> <p>The Corporations Law and CVM regulations provide that the CVM staff may request amendments or corrections to issuer filings. Law 6.385/76, in article 9, empowers the CVM to require publicly held companies to restate their financial statements, reports or released information. CVM instruction 400 §56 imposes liability on the issuer for the accuracy of reports and imposes a due diligence obligation on underwriters.</p>
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Assessment	Fully Implemented
Comments	<p>The company-based Reference form concept created in Instruction 480 has been discussed in other countries and is an interesting and promising innovation. Some persons who were interviewed suggested that the CVM should consider fine-tuning the process to streamline the length of mandatory disclosure. Also the automated filing system requires companies to manually enter all financial statement information, a highly time-consuming process that creates risks of errors that may adversely affect both the company and its investors.</p> <p>With the advent of the electronic filing process the CVM should recommend a change in the Corporation Law to eliminate the requirement that public companies publish their entire annual report in two national newspapers. This is an expensive requirement that no longer serves a sound public purpose.</p> <p>As discussed in other principles, the CVM RBS should carefully consider whether the size of a corporation, without consideration of other factors, is an optimal risk parameter for examination selection.</p>
<b>Principle 17.</b> Holders of securities in a company should be treated in a fair and equitable manner.	
Description	<p>Problems with corporate governance and the fair treatment of minority shareholders have been an important issue in Brazil for many years. In the past it was common for public companies to issue large quantities of non-voting stock, up to twice the amount of voting shares. In this structure the holders of 17% of the company's stock (51% of voting shares if non-voting shares represented 67%) could control a company. In 2001 amendments to the Corporation Law mandated that non-voting shares could not exceed 50% of the total of shares (with a grandfather clause for companies that had a higher percentage of non-voting shares). The Novo Mercado listing standards prohibit the use of non-voting shares.</p> <p>The Corporation Law provides low thresholds for sound corporate governance. It does not have any independent director requirements nor a minimum number of meetings required for the Board of Directors in a year (other than the annual shareholders meeting). The corporation is also not required to have a Board Audit Committee. Instead there is a requirement for a <i>Committee Fiscal</i>. This committee is very different from an Audit Committee. It is not a Board Committee and its members may be third parties selected by a vote of shareholders, with substantial minority shareholders entitled to a seat; no manager (or his/her relatives) of the same corporate group could be a member of the <i>Committee Fiscal</i>. A group of voting shareholders with at least ten percent (10%) of the share capital may elect a member of the <i>Committee Fiscal</i>.</p> <p>Annual meetings must be announced at least fifteen days in advance (second notice 8 days in advance). The CVM has the authority to extend this period for up to 30 additional days at the request of any shareholder if the meeting will consider</p>

	<p>complex issues or if a required document or information related to a proposal is missing. Public companies must file the minutes of the annual meeting at the CVM no later than seven business days after the meeting. A company must identify proxies to represent votes for, against or abstaining from an action. Any shareholder of 0.5% of shares may request a list of shareholder names and addresses for purposes of soliciting proxies or request to be included in the electronic proxy system (CVM 481). Brazilian law requires all shares to be registered. CVM instruction 481 imposes disclosure obligations for all items to be considered at a shareholder meeting.</p> <p>The Corporation Law imposes broad liability on company officers for fraudulent or ultra vires acts (Law 6.404/76 §158). Under article 159 of the law, a corporation may bring a civil action against any administrator for the losses caused to the corporation's property. In particular, the shareholder meeting must approve that action and were the company fail to initiate the legal action within three months, then any shareholder is entitled to do so. Furthermore, there is a provision for shareholder derivative actions brought by shareholders owning 5% of capital on behalf of the company. Because this requires a shareholder vote it is difficult to use.</p> <p>The Corporation Law provides minority shareholders some forms of protection in cases of change of control. For example the Law (§254-A) requires in a change of control, that the purchaser must conduct a tender offer to acquire the remaining voting shares for at the least 80 percent of the amount paid for shares comprising the controlling block. Alternatively minority shareholders can choose to retain their shares if they pay a premium equal to the difference between the price of the control block shares and the market price. There are no “tag along” protection requirements for holders of non-voting shares. The Law also requires a mandatory tender offer in a going private transaction (§4.4). Minority shareholders representing 10 percent of the free float may call for a special shareholder meeting to request a new price evaluation. In these situations only the non-control shareholders are entitled to vote (§4A). A mandatory tender offer is also required if, through open market purchases, the controlling shareholder reduces the company free float below 33%. CVM Instruction 361 requires that tender offers must be provided to all shareholders, with equal treatment for all shareholders in a class.</p> <p>The Law also includes provisions allowing shareholders with 10% of stock that is voted to require a company to permit cumulative voting. Further, the law also provides for minority shareholders voting in the removal of a <i>specific</i> director. Shareholders with 15% of voting shares are entitled to elect one Board Director. In practice the use of cumulative voting is very rare, according to a 2009 academic</p>
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	<p>study.</p> <p>In response to the limited protections in the Corporations Law, the CVM and Bovespa attempted to improve corporate governance and minority shareholder protection rights through listing standards for a new equity market. In 2001, BOVESPA created the Novo Mercado (NM) and two additional listing segments with minority shareholder protections and corporate governance standards (level 1 and level 2) that are higher than the Corporation Law. All three levels require a minimum 25% free float. Level 1 listing requirements require more extensive company disclosure, including quarterly reports with financial statements and information on affiliate transactions but do not require changes in the Board of Directors or give more rights to investors. Level 2 requires companies to arbitrate disputes with shareholders, grants special voting rights to “PN” (typically a form of preferred share with limited or no voting rights) shareholders on certain fundamental decisions, and provides a 70% “tag along” rights for “PN” shareholders. Level II companies must have a minimum of five Board members and 20% must be independent. The Novo Mercado has the highest standards. Companies may not issue non-voting shares and the company Board must have 20% independent directors. In the event of a tender offer, there must be full tag along rights and an independent pricing valuation in the event of delisting. The company must have at least a 25% free float and provide for arbitration of company disputes.</p> <p>The creation of the Novo Mercado, with its higher standards for corporate governance and minority shareholder protection, has contributed to the growth of the Brazilian equity market. In the period 2009-2011, 25 of 28 IPOs were listed on N.M. The number of Bovespa N.M. listed companies has grown from 44 in 2005 to 125 in 2011. Over the same period Level 1 listings grew from 37 to 38 and Level 2 listings increased from 14 to 19. These companies represent 66% of total listed market cap and 76% of total traded value on Bovespa. The number of traditional listings has remained largely flat.</p> <p>Since the adoption of the higher listing standards for N.M. and Levels I and II, efforts to make further improvements in corporate governance through listing standards have had some, limited, success. In 2010 a package of recommendations was prepared and submitted to a vote of N.M. companies (required to effect changes).</p> <p>Several changes were approved by the affected listing groups and added to Bovespa listing standards. For example companies listed in Levels I and II and the N.M. must have separate CEO and Board Directors. These corporations must also adopt a Code of Conduct and must adopt a policy on stock trading for controlling shareholders, board members and any other consulting or technical committee established by corporate bylaws. Other changes include a prohibition on bylaw</p>
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	<p>clauses that limit the number of votes of a shareholder or group of shareholders to percentages under 5% of total common shares, except in cases of privatizations or when specific laws or regulation apply. Also prohibited are bylaw clauses that (i) require a qualified majority to decide on matters that have to be submitted to general shareholder meeting or (ii) that impose burdens on shareholders that voted in favor of withdrawing or modifying bylaw clauses.</p> <p>Three key changes were proposed but not approved:</p> <ul style="list-style-type: none"> <li>- An increase in the number of independent board members from 20 to 30% for Novo Mercado and Level II and the addition of the independence requirement for Level I;</li> <li>- A requirement for an audit committee comprised of a minimum of three members elected by the Board of Directors, of whom at least one must be an independent board member.</li> <li>- A significant change in the takeover rules to require a mandatory bid after a shareholder hits 30% of outstanding shares (down from 50%).</li> </ul> <p>CVM rules require prompt disclosure of beneficial ownership by a public company and prompt updating. Direct or indirect controlling shareholders, Board members, Inspection committee members and 5% shareowners, must disclose shareholder ownership information, including acquisition, transfer or changes. This information must be submitted to the company within 5 days of any change. The company must file this information and publicly disclose it within ten days of the end of the month in which the transaction occurred. This information must also be disclosed in the company Reference Form, under CVM Instruction 480. This information is available to the public only in a consolidated form, on the CVM's website, through the IPE system (Periodical and Non-Recurrent Information System). The CVM has the authority to sanction persons that do not comply. Companies must also disclose on the Reference Form information on the company's policies on related-party transactions, related-party transactions during the past three years, and policies to avoid conflicts of interest. Brazil has adopted the IFRS principle on disclosure of related party transactions and N.M. companies must disclose this in quarterly reports..</p>
Assessment	Partly Implemented
Comments	<p>The protection of minority shareholder rights continues to be an important regulatory challenge. The creation of Novo Mercado and Level I and II listing requirements that provide greater protection for minority shareholders than the Corporation Law has been successful and the number of companies that comply is steadily increasing as a result of IPOs. However, the weaknesses of the Corporation Law, which govern the traditional listing companies have not been addressed and it still controls governance and minority rights for a substantial portion of Brazilian public companies, including several of its largest companies. Full tag along rights in change of control transactions are not provided to</p>

	<p>shareholders of companies that have not adopted the higher listing standards of Novo Mercado. These companies represent 47% of the total market capitalization of Bovespa. Under the IOSCO Methodology an inability to satisfy key question 3(d), fair and equitable treatment of minority shareholders in change of control transactions, warrants a not implemented assessment. However, because companies with nearly half of the total market capitalization have adopted full tag along rights, balancing these two categories justifies a higher, partly implemented assessment.</p> <p>A Corporate Governance ROSC has been conducted as a part of this FSAP and it provides a detailed analysis of further reforms that should be considered.</p>
<b>Principle 18.</b> Accounting standards used by issuers to prepare financial statements should be of a high and internationally acceptable quality.	
Description	<p>The Corporation Law (6404/1976) requires all public offerings of securities and all issuers of securities to register with the CVM. CVM Instructions 400 (offerings) and 480 (issuers) requires inclusion of audited financial statements, audited by a firm licensed by the CVM, and prepared in accordance with IFRS standards. In 2007 Brazil amended the Corporation Law by Law No. 11638/2007, and established a national accounting standard setter, the Comitê de Pronunciamentos Contábeis (CPC). The CPC formally adopted IFRS as the Brazilian accounting standard with a transition period from 2008-2010, with almost no deviations (an isolated change concerning valuation of mineral rights that affected Petrobras). The CVM endorsed these standards and mandated adoption by public companies for fiscal year 2010. All CPC pronouncements must be approved by the CVM, typically following a public exposure period (CVM Deliberation 520).</p> <p>CPC has a governance board whose membership includes representatives from the public corporation's association (ABRASCA), the accounting and auditing profession licensing body (CFC), the Institute of Independent Auditors of Brazil (IBRACON), BM&amp;FBovespa, and the academic community (FIECAFI). Brazilian regulators participate in a non-voting capacity (CVM, SUSEP, Central Bank, Revenue Dept), as does the Brazilian Bank Federation (FEBRABAN). There are no voting members who represent the general public or investors. Instead the association of securities analysts, APIMEC, is a voting member. The CPC is funded with funds collected from the settlement of CVM enforcement actions and from fees paid by the accounting/auditing industry. To reduce the appearance of industry control, the Foundation for CPC Support (FACPC) was created to provide a conduit for continued industry funding support.</p> <p>CPC Pronouncement No. 26 (equivalent to IAS 1) requires public companies to prepare and submit a full set of financial statements including: a balance sheet or statement of financial position; a statement of the results of operations; a statement</p>



	<p>of cash flow; and a statement of changes in ownership equity. As discussed in principle 16, the CVM has created a company-based disclosure system (CVM 480) that requires public companies to annually submit annual audited financial statements on its DFP form. These must be filed within 3 months of fiscal year end. The ITR form replaces the quarterly report for listed companies. It must be filed within one month of the end of the quarter and contain financial statements reviewed by the issuer's independent auditor. Category A filers (companies with equities listed on Bovespa) must submit consolidated financial statements.</p> <p>In addition to the external auditor, the CVM staff selectively review public company compliance with applicable accounting standards as part of its risk-based company review process (discussed in principle 16). CVM can require companies to correct or restate financial statements and it can bring enforcement actions for violations of the law or CVM instructions.</p> <p>CVM Instruction 480 (§27) requires foreign issuers listed in Brazil to file financial standards compliant with Brazilian CPC/IFRS written in Portuguese and presented in Brazilian reais. The financials must be audited by a Brazilian auditor, or by an external auditor registered with the CVM, or by an external auditor that is registered with an equivalent regulator in the country where the issuer is headquartered. Foreign issuers of Level I Brazilian Depository Receipts (BDR) are exempt from issuer registration (CVM 480, §7).</p>
Assessment	Fully Implemented
Comments	<p>Brazil has adopted and successfully implemented IFRS. Interestingly the BCB continues to require all financial institutions to submit reports using its own accounting standards. As a result all financial institutions that are public companies prepare and publish financial statements using IFRS in addition to the BCB-based financial statements. The BCB has a project to harmonize the two reporting requirements.</p> <p>Several issues regarding the standard setting board should be considered. The Board is funded in part by the accounting profession and its Board does not have any truly public members. The APIMEC is an association of securities analysts. Final approval by the CVM largely offsets these issues of independence.</p>
<b>Principles for Auditors, Credit Ratings Agencies, and Other Information Service Providers</b>	
<b>Principle 19.</b> Auditors should be subject to adequate levels of oversight.	
Description	<p>Under the Brazilian supervisory model for independent auditors, the CVM is the final supervisory authority for the licensing and regulation of the audit profession (Securities Law 6385/1976). In 2010, Law 12249/2010 created the Federal Accountancy Profession Organization – Conselho Federal de Contabilidade (CFC) as the professional organization that sets auditing standards in Brazil. Brazilian standards largely follow International Auditing Standards (IAS). CVM Instruction 308 governs the auditing and supervisory process. Article 21 of Instruction 308 requires auditors to comply with the audit standards promulgated by CFC and</p>

	<p>IBRACON. The CVM reports that it is in line with COSRA Principles for the Oversight of Independent Auditors.</p> <p>In addition to a CVM license, auditors must be licensed and registered by the Administration Committee of External Quality Review (CRE). The CRE is supervised by the CVM and is headed by a Board composed of four representatives from the CFC and four from the Institute of independent Auditors of Brazil (IBRACON). All Board members have to be auditors registered on the National Registry of Independent Auditors and licensed by the CVM. Members serve three-year renewable terms. The CRE administers qualifying examinations and licenses all accountants and auditors in Brazil. In Brazil, persons must pass a series of qualifying exams to be a professional accountant and or an auditor of a public company (CVM Instruction 308, §30; CFC Resolutions 821 and 965). Applicants must have a university degree in accounting to sit for the first level professional accounting exam. In addition, applicants to be auditors must have 5 years of auditing experience (CVM 308 §4-V). Finally, there is a 40-hour/year continuing professional education requirement. Of the approximately 500,000 licensed accountants, some 4,000 are members of the CNAI—the CFC’s National Practice for Auditors—of which approximately 900 have qualified to audit public companies.</p> <p>All audit firms must implement an internal quality control program following IBRACON and CFC standards that fully comply with audit standards and CVM rules (CVM 308, §32).</p> <p>The CVM requires all registered auditors to be peer reviewed (CVM 308, §33). The CRE administers the Brazilian peer review process for auditors (CVM 308, §33; CFC Resolution 1323). Peer reviews must be conducted on a four-year cycle (a three year cycle is planned). Each firm may choose the firm that will conduct the peer review and negotiate the fee for the peer review. There is no prohibition on the reviewing firm subsequently selecting the reviewed firm for its own peer review. Peer reviews must be conducted in accordance with CFC and IBRACON standards and prior notice has to be given to the CVM regarding the selection of the reviewing auditor. The CVM may order the substitution of a reviewing auditor if it considers the review performance to be not satisfactory (CVM 308, §33.5). Reviewing auditors must issue a quality control review report to the reviewed auditor, the CRE and the CVM by October 31 of the year of the review (CVM 308, §33.2). If weaknesses or deficiencies are identified, the reviewed firm must prepare an action plan for correction and submit it to the CRE. The CRE will analyze each review and approve the peer review report. Should the report contain no opinion or an adverse opinion, a specific communication has to be forwarded to the CFC and to the CVM.</p> <p>There is a CVM office, composed exclusively of accountants, responsible for registration and monitoring of auditors. The CVM performs inspections on a periodic basis and on a ‘demand’ basis, (e.g., as a result of monitoring, whistle</p>
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	<p>blowing, financial statement analyses, etc). The office conducted 15 inspections in 2011, a significant increase from previous years (2009 -6, 2010 – 4). It relies on a risk-based supervision model to select its periodic examinations.</p> <p>Auditors must properly maintain all documents, work papers, reports, and reviews for at least 5 years and make them available to the CVM (§25.3 and 25.5). The five-year period may be extended if an administrative sanctioning proceeding (“PAS”) is in progress. Through a PAS, the CVM may apply sanctions such as warnings, fines, suspensions or registration withdrawals, regardless of other applicable penalties, for failures to follow securities regulation and statutes, perform inadequate audit services, or improperly use or allow the use of sensitive information obtained as a result of the audit.</p> <p>The CRE has its own disciplinary process for member firms but not individuals. It may impose small monetary penalties or impose suspensions or terminate registrations. Only significant CRE sanctions are made public.</p>
Assessment	Fully Implemented
Comments	<p>Two key questions for this principle in the IOSCO Methodology warrant comment:</p> <p>3. Is there an oversight body that operates in the public interest, has an appropriate membership, an adequate charter of responsibilities and powers, and adequate funding, such that the oversight responsibilities are carried out in a manner independent of the auditing profession?</p> <p>4. Does the auditor oversight body have an established process for performing regular reviews of audit procedures and practices of firms that audit financial statements of public issuers?</p> <p>A failure to satisfy question 3 results in a Not Implemented rating. A failure to satisfy questions 4 results in a partly implemented rating, provided that 3 is satisfied. The auditor oversight program of the CRE, by itself, would fail to satisfy these key questions. The CFC and CRE are industry-controlled and funded organizations that lack independent public members on their respective governing boards. This lack of true independence is offset by the separate oversight program by the CVM, which is an independent oversight body. Prior to 2011 the CVM program was limited in scope. In 2011 it conducted 15 inspections of audit firms that were selected through a risk-based selection methodology.</p> <p>The peer review process is problematic. The ability of the reviewed firm to select which firm will review it and to control the scope of the review through its control over the amount that will be paid for the peer review is an important limitation of the peer review process.</p> <p>The adoption of a mandatory audit firm rotation requirement is noteworthy. It will be interesting to see if this has a discernible and material impact on auditor</p>

	independence and audit quality.
<b>Principle 20.</b>	Auditors should be independent of the issuing entity that they audit.
Description	<p>CVM Instruction 308 (§22) has a broad auditor independence requirement that extends to anyone at the audit firm or anyone directly or indirectly controlled by or controlling the firm or anyone belonging to the same economic group. Article 23 contains a broad list of prohibited non-audit services that, if performed, would violate its independence requirement. The list in article 23 concludes with a broad prohibition on “VII - any other product or service that influences or that may come to influence the decisions taken by the administration of the institution audited”. Audit firms must rotate their key partners and personnel at least every five years. In addition, CVM Instruction 308 requires audit firm rotation (§31) every five years, with an optional five-year extension for companies that have created an audit committee (CVM 509/2011). In both cases, the cooling off period is three years. The mandatory firm rotation applies to senior level staff, but junior staff may transfer to the new firm.</p> <p>As described in principle 17 the Corporation Law does not require issuers to have a Board of Directors audit committee. In its place there is a Committee Fiscal (CF) composed of persons selected by shareholder vote. Shareholders with 5% holdings are entitled to select one member of the CF. The CF is not involved in the selection or appointment process for the external auditor. The CF was created primarily to provide some level of protection for minority shareholders. It is required to publish its own report in the annual report.</p> <p>The CF Turbinado (CFT) is a committee with slightly higher standards. At least one member must be a “financial expert” and one member must be independent. The CFT must meet six times a year and publish its own report to shareholders. It also has no authority to hire or fire an auditor, but it may make a recommendation to the Board. Creation of a CFT is optional.</p> <p>The officials responsible for selection of an auditor may be liable if the auditor is not independent (CVM 308, §27). Under article 28 of Instruction 308, managers of audited entities must notify the CVM, within 20 days, of a change in company auditor, including an explanation for the change and the consent of the substituted auditor. If the audited entity does not comply with the deadline, the substituted auditor must notify the CVM within 10 days and provide the reason for the change.</p>
Assessment	Partly Implemented
Comments	<p>The IOSCO Methodology requires a Not Implemented rating if key question 6 is not satisfied. Question 6.b.: From the perspective of public issuers: (b) Is there a governance body independent in both fact and appearance of the management of the entity (e.g., audit committee, board of corporate statutory auditors or other body independent of the entity’s management) that oversees the process of selection and appointment of the external auditor?</p> <p>The CF does not play an oversight role in the selection and appointment of the external auditor. The Board of Directors is not independent of management. The</p>

	<p>recent innovation of the CFT may eventually provide an appropriately independent overseer. However, at present, this is a voluntary option and it is not clear how many, if any, companies have created one.</p> <p>While the IOSCO Methodology directs that a not implemented rating be assigned if Question 6.b. is not satisfied, there are other aspects of the Brazilian regulatory system that partially offset this deficiency and warrant a higher rating of partly implemented.</p>
<b>Principle 21.</b> Audit standards should be of a high and internationally acceptable quality.	
Description	<p>The CFC is the official standard setting body for the audit profession. The Brazilian Institute of Accountants (IBRACON) issues auditing standards, and the Federal Accounting Council (<i>Conselho Federal de Contabilidade</i>, or CFC) approves them. CFC and IBRACON standards are based on international auditing standards. The CFC through its resolutions (1201 to 1238/2009) has adopted all International Auditing Standards (IAS). The CVM has supervisory authority to review and approve audit standards.</p> <p>As discussed previously, the CRE through its peer review program and the CVM through its inspection program and review of peer review reports has the authority to impose sanctions for failures to adhere to CFC audit standards.</p>
Assessment	Fully Implemented
Comments	<p>Due to the complexity of the transition from traditional Brazilian audit standards (largely based on U.S. GAAS), the CVM gave a one-year compliance extension to small audit firms in Brazil. As the majority of listed companies in Brazil (representing well over 90% of total market cap) are audited by a large firm, there does not appear to have been a significant impact from this waiver.</p>
<b>Principle 22.</b> Credit rating agencies should be subject to adequate levels of oversight. The regulatory system should ensure that credit rating agencies whose ratings are used for regulatory purposes are subject to registration and on-going supervision.	
Description	<p>The three global credit rating agencies (Standard &amp; Poor, Moodys, and Fitch) perform credit rating services in Brazil. There are also three Brazilian credit rating agencies that are active. As the Brazilian regulatory system did not extensively embed a credit rating requirement in its regulatory policies, the credit rating industry has a smaller level of influence than in many other countries. For example, the BCB has not incorporated credit ratings into its capital adequacy standards for financial institutions (which includes banks and broker-dealers). The CVM has limited its reliance on credit ratings; primarily in areas such as certain short-term debt mutual funds (such as the money market equivalent) and securitized securities (FIDC and CRE).</p> <p>§27 of the Capital Market Law (6.385/76) authorizes the CVM to “establish regulations regarding the activities of securities analysts and consultants” and §11 of the law provides the CVM with broad enforcement powers for violations of any provision of the law. In April 2012, following the FSAP mission, the CVM adopted CVM Instruction 521, a comprehensive set of regulations for the</p>

	<p>registration and oversight of credit rating agencies. As an English translation of the instruction is not available, this description of the instruction is based upon a revised self-assessment provided by the CVM.</p> <p>§1 of CVM 521 provides a definition of credit ratings and §2 provides for CVM registration of credit rating agencies domiciled in Brazil and a mutual recognition process for foreign CRAs that are regulated by a qualified authority in the country where it is domiciled and have a legal representative in Brazil. Annex 13 of Instruction CVM521, requires CRAs to include in the Reference Form the following information: (i) the identification of officers responsible for the form's content; (ii) the track record of the credit rating agency; (iii) human resources; (iv) scope of activities; (v) economic group; (vi) operation and administrative structure; (vii) rules, procedures, and internal controls; (viii) compensation; (ix) conflict of interest; (x) procedures and methodologies of credit rating; (xi) updates to the code of conduct; (xii) transition matrix of credit ratings; and (xiii) default rate matrix. Under §12 of CVM521, the CRA must maintain a website with (i) the Reference Form; (ii) the code of conduct; (iii) the rules, procedures, and internal controls; and (iv) credit rating reports.</p> <p>CVM 521 specifies the basis for cancellation of a CRA registration and the sanctions available to the CVM for violations of the instruction. §29 of CVM521 requires CRAs to adopt and apply rating methodologies and procedures that must be reviewed at least annually. §30 requires CRAs to immediately disclose the potential impact on issued credit ratings of any significant changes in its methodologies and procedures.</p> <p>§20 requires a CRA code of conduct consistent with the IOSCO Code of Conduct for CRAs. The CRA must also adopt mechanisms to identify, eliminate, manage and disclose situations involving conflicts of interest, and a policy related to securities trading by the credit rating analysts and by others involved in the credit rating process. The Code must also address analyst compensation policies and segregation of business and rating functions.</p> <p>Under §16 of CVM521 CRAs must provide in the Reference Form sections (iii) information on human resources and (viii) compensation and in individual credit rating reports the following information: (1) the qualification of the credit rating analyst responsible for the elaboration of the report and the person responsible for approval of the rating assigned, or the members of the credit rating committee; and (2) the characteristics and any limitations in the rating assigned, with regard to the extent, quality and accuracy of the existing documents and historical data.</p> <p>§31 of CVM521 requires the CRA to disclose its ratings performance track record since 2002, per segment, disclosing the initial credit ratings, their changes and the probability of transition, for each rating, within a term of one and three years (credit rating transition matrix); and the probability of an issuer, a structured operation, a financial obligation or any other rated financial asset with a specific rating default within one and three years (default rate matrix). If the credit rating agency is part of a group with operations in other jurisdictions, it should also submit the matrices with the global market information.</p>
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	Under §25 and 28 of CVM521, the CRA must have controls over the confidential information which its managers, employers and advisors have access to, and must ensure complete segregation of the credit rating activities and the other activities performed by the agency or by related third party, adopting operational procedures aiming the preservation of confidential information by all the people involved in the issuing of credit ratings and restricted access to files, as well as the adoption of controls which restrict and allow for the identification of people who have access to confidential information.
Assessment	Broadly Implemented
Comments	As previously noted, the CVM regulation on CRAs was adopted in April 2012, after completion of the FSAP mission. Based upon the information provided by the CVM it appears to address substantially all of the key questions in the IOSCO methodology. Because it is a new regulation, it is difficult to offer an assessment on how the regulation will be implemented and enforced. For this reason, it is not possible to give a fully implemented rating. Given that the CVM has historically not relied heavily on credit ratings for regulatory purposes, it is unlikely that Brazil has a significant risk of having the regulatory problems experienced in other countries.
<b>Principle 23.</b>	Other entities that offer investors analytical or evaluative services should be subject to oversight and regulation appropriate to the impact their activities have on the market or the degree to which the regulatory system relies on them.
Description	The CVM has a formal licensing and regulatory system for market analysts and market consultants. Autonomous agents, which are similar to introducing brokers in the U.S. and may be individuals or entities, also are licensed and regulated by CVM, and indirectly by BSM. None of these persons or entities is permitted to have control over investor/client funds and assets or exercise discretionary investment authority. The role played by unofficial SROs in the qualification process for these categories of entities is discussed in principle 9. The CVM inspection program inspects a sample of each of these types of entities. It devotes special attention to autonomous agents because they play a significant role in the retail brokerage sector.
Assessment	Fully Implemented
Comments	
<b>Principles for Collective Investment Schemes</b>	
<b>Principle 24.</b>	The regulatory system should set standards for the eligibility, governance, organization and operational conduct of those who wish to market or operate a collective investment scheme.
Description	Under the Securities Law (6.385/76, §15) only authorized financial institutions of the “Brazilian Distribution System” registered with the CVM (Instruction 306/99) may offer CIS shares. All investment funds (including Real Estate, Private Equity, Venture Capital and Hedge Funds) must be registered with the CVM. There is a fit and proper requirement for the responsible director of the CIS management firm

	<p>and the firm must demonstrate that it has adequate infrastructure and technical resources (CVM Instruction 306/99, §7, III and §8, V). Although there is no minimum capital requirement for the CIS management firm, each CIS must maintain a minimum capital of 300,000 BR (Instruction 409, §105). Firms must have an internal control and risk management process (CVM Instruction 306, §14). The CVM evaluates the fund management firm's capabilities as part of its licensing application process. No on-site inspection is conducted during the application review. However the CVM (and Anbima) conduct routine on-site inspections of licensed firms. The CVM selects the firms to inspect using its risk-based supervision methodology (discussed in principle 12). The CVM has full authority to conduct investigations and to sanction violations of its laws and regulations.</p> <p>The CVM requires calculation and daily disclosure of a fund's net asset value, and monthly disclosure of the full fund portfolio (certain holdings that are being acquired or disposed may be kept confidential for a short period of time). The CVM also requires funds to disclose other information periodically or immediately if it is deemed material to investors (CVM Instruction 409 §72). An annual audited financial statement must be provided prior to the annual shareholders meeting (CVM Instruction 409/04, art. 84 and 49 §1). The fund administrator is responsible for maintaining all books and records for five years.</p> <p>The CVM also governs which fund expenses may be recovered directly from fund assets(409 §99). Each fund must disclose a single comprehensive fee covering both administration and portfolio management. Multi-market funds may also charge an additional performance-based fee if it is fully disclosed. The CVM does not have rules governing the maximum amount of fees.</p> <p>The CIS Fund manager must be accredited with the CVM as a portfolio manager firm (CVM Instruction 409/04, art. 3). The fund administrator and fund portfolio manager may be the same company or they may be separate entities. The CVM has the same registration process for both applicants. CVM requires at least one individual at each entity to have three-year direct experience and 5 years in related areas.</p> <p>Fund administrators typically are members of Anbima, the industry trade organization. While membership is voluntary, virtually the entire fund industry is a member. In Brazil the fund industry is heavily concentrated, with 10 companies (primarily banks or bank subsidiaries) controlling over 90% of all assets. Anbima is not officially recognized as an industry self-regulatory organization but performs virtually all of the duties of an SRO. Anbima members must meet its qualifications and agree to comply with a series of 11 industry codes of conduct</p>
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	<p>(best practices). Anbima has a supervision program that monitors compliance and conducts inspections. It also has, by membership agreement, the authority to sanction member firms (but not individual employees).</p> <p>All CIS in Brazil are created as a <i>condominium</i>. This is a legal entity that represents the collective fund investors. It does not have a Board of Directors and there is no limited liability (discussed in principle 25). Investor protection is provided through periodic disclosure requirements (principle 26) and an annual shareholders meeting. Any changes in fees, by-laws or other matters that adversely affects investors must be approved by a majority vote at the annual meeting.</p> <p>The fund management firm and the fund portfolio manager are subject to a fiduciary duty to act in the interests of the fund's investors (CVM Instruction 409 §65A and Instruction 306 §14-II). The CVM believes that the general requirement to act in the investor's best interest imposes due diligence and best execution obligations on CIS (CVM 306 §14-II and 409 § 65-A). Other requirements such as the allocation of trades between funds (CVM 409 §60) and churning (306 §16-VI, and 409 §60) are specifically addressed.</p> <p>The CVM has adopted several rules designed to minimize conflicts of interest between investors and CIS managers or administrators. For example the managing director of a CIS operator may not have other responsibilities whether inside or outside the company (306 §7.5 and 6). CIS must have mandatory segregation of activities (Chinese wall). The CIS must have a secrecy and training policy. The CIS must have a policy governing securities trading by CIS employees (306 §15-V). Any benefits obtained belong to the fund itself (406 §65-A). Finally, Instruction 306 (§14-IIIc) requires mandatory disclosure of any other conflicts of interest not specifically listed in the regulation.</p> <p>The CVM has a general prohibition on related party transactions unless there is prior written consent (CVM 306 §16). Typically CIS obtain broad consent to engage in related party transactions through generic disclosure in fund prospectuses. In 2011 the CVM issued Instruction 514, which will require funds to provide disclosure of related party transactions. The Instruction is not in effect as of the date of this assessment.</p> <p>Given the high level of industry concentration, it is not surprising that industry fee levels are high, especially for short-term income funds (akin to money market funds). The CVM is aware of this issue and is considering inclusion of a fee table in the prospectus that would better disclose the impact of different fees.</p> <p>Brazil does not permit the offer and sale of foreign CIS in Brazil, unless the</p>
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	<p>company is domiciled in Brazil and registered with CVM. Brazilian CIS that invest abroad must have custody arrangements with a custodian accredited with the appropriate foreign regulator, who must be a signatory to a bilateral MOU with the CVM or a full signatory of the IOSCO MMOU (Instruction 409, §2.5 and §2.6).</p> <p>The fund administrator may subcontract with third parties to perform administrative services. The administrator retains liability for contractor misconduct (409 §57). A change in the portfolio manager, administrator or custodian requires a vote of investors at the annual meeting (409 §47-II). All delegations to third parties must be disclosed to the CVM (409, §65-VII) and to investors (§57.2). All key subcontractors (e.g. fund managers, custodians, auditors, consultants and registrars) are registered with the CVM and may be subject to enforcement action.</p> <p>In Brazil, securities that are issued based upon ownership of an undivided share of a portfolio of assets, commonly known as asset-backed securities (ABS), are regulated as investment funds. They have the same legal identity – <i>condominium</i> and are regulated by the CVM office responsible for mutual fund oversight. They are not required to adhere to all mutual fund requirements. The most common form is a real estate ABS called a <i>Fundo de Investimento em Direitos Creditórios</i> (“FIDC”). These operate similarly to a closed-end mutual fund. Some FIDC may have static asset pools and some may have pools that change over time. FIDC asset pools must be held by a CVM licensed custodian. The FIDC asset manager is not required to have a CVM license. Unlike mutual funds an FIDC may issue, and typically does issue, more than one class of security with different preferences. The originator of the fund must retain an equity interest in the fund. Previously it was 20% but as of 2012 it may be 5%. These securities are registered at CETIP and may be traded OTC with trades reported to CETIP, although the market is illiquid.</p> <p>A monthly asset valuation report must be filed with BCB and is publicly available.</p>
Assessment	Broadly Implemented
Comments	<p>The broadly implemented assessment is based on CVM responses to 4 questions in the IOSCO Methodology.</p> <p>Question 2(e) pertains to the existence of adequate risk management systems at the fund. There is no specific requirement that funds must have risk management systems. In its self-assessment (as revised), the CVM explains that §14-II of Instruction 306 imposes a general obligation to act with due care and diligence. While a duty of care and diligence is an important regulatory principle, it does not by itself satisfy the need for adequate risk management systems.</p> <p>Question 4 concerns governance systems designed to ensure that funds are owned and operated in the best interests of investors. The CVM self-assessment explains</p>

	<p>that this is addressed by requiring full and timely disclosure to fund participants and a statutory requirement that all material decisions must be voted on by investors at an annual shareholder meeting. While disclosure is an essential component of any system to protect investors, a system based only on an annual meeting of investors is limited in its capacity to provide effective governance oversight.</p> <p>Question 6(d) concerns the regulators' clear responsibilities and powers to take remedial action in the event of breaches or defaults. In its self-assessment the CVM describes its general enforcement powers to sanction through warnings, fines, or revocation of licenses, as well as its capacity to enter into a negotiated consent settlement. These sanctions may not provide prompt remedial action.</p> <p>Question 14(d) pertains to whether the regulatory system addresses issues concerning related party transactions. The financial sector of Brazil is heavily concentrated and funds routinely purchase or sell or invest in securities of a parent or related party. Banks rely heavily on mutual funds for funding through repo transactions and investments in bank deposit or CDs. High reserve requirements create incentives for banking groups to establish mutual funds and secure funding sources through them. Combined repo and bank deposit/CD are approximately 34 percent of total mutual fund assets. The single exposure limit for mutual funds (up to 20 percent of NAV) excludes repo transactions. Because banks are able to engage in a reverse repo with the BCB, at a slightly higher rate, the financial transactions between mutual funds and the parent bank can be an integral component of the bank's business model. Because of this combination of factors, related party transactions present a significant regulatory challenge in Brazil.</p> <p>While there is a "Chinese wall" regulation, under which fund managers should be independent of the interests of the rest of the group there is a risk that during a stress period, managers may have incentives to transfer liquidity across a group. Also, banks may encourage clients to hold their shares in their affiliated mutual funds to ensure adequate funding to the conglomerate. Because the majority of mutual fund assets are invested by institutional or corporate investors, who are more sensitive to changes in market conditions, there is a risk of substantial withdrawals during periods of market turmoil. In case of large outflows under market turbulence, mutual funds may be forced to unwind repo loans and redeem liquid bank CDs. There are no regulatory limitations on related party transactions so long as the practice is disclosed by the fund in its prospectus and in its by-laws. The CVM inspection process examines fund related party transaction records. The broadly implemented assessment also reflects the reliance on the annual meeting to provide effective governance to protect investors.</p> <p>The IOSCO Methodology recommends that a failure to address questions 2(e), 4 and 6(d) warrants a not implemented rating. An inability to address questions 14(d) warrants a partly implemented rating. Based upon the totality of the regulatory system in Brazil, it appears that a broadly implemented rating is</p>
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	appropriate.
<b>Principle 25.</b>	The regulatory system should provide for rules governing the legal form and structure of collective investment schemes and the segregation and protection of client assets.
Description	<p>All CIS in Brazil are created as a <i>condominium</i>. This is a legal entity that represents the collective fund investors. Applications to the CVM must contain a copy of the official registration documents, by-laws and contracts with third parties, such as custodians or third party portfolio managers. A CIS may have only one share class. It does not have a Board of Directors and there is no limited liability. Investors in the fund may be liable personally to the extent that fund assets are insufficient. This is a possibility if a fund invests in options or futures that have open-ended exposure or if there is fraudulent conduct by the management. While the fund investors would presumably have recourse against the fund administrator or manager, this would not eliminate personal liability in the event that the culpable administrator or manager is insolvent. This liability is discussed in CVM instruction 409 §30, which requires disclosure to investors of the possibility of a required additional investment in the event that the fund has a negative net worth.</p> <p>Investor protection is largely based on an annual shareholders meeting. Any changes in fees, by-laws or other matters that adversely affects investors must be approved by a majority vote at the annual meeting. The fund's prospectus and by-laws must fully disclose all investor rights and obligations.</p> <p>The CVM requires all funds to have a custodian that must be a financial institution also registered at CVM to perform such activities. The fund must have a segregated account at the custodian in the name of the Fund (CVM 409 §2.8). The CVM states that this segregated account in the Fund's name is protected in the event of a failure or bankruptcy by the fund administrator or custodian.</p> <p>A Fund may be liquidated for two reasons. If its average total assets are less than 300,000 BR for a 90-day period, the CVM requires liquidation of the fund (CVM 409 §105). The second reason is a vote of the investors at an annual or special meeting. If a fund administrator suspends fund redemption it must schedule a special shareholder meeting within 15 days. At the meeting the investors may vote to change administrators or to liquidate the fund.</p> <p>The CVM has full authority to investigate any infractions by a fund administrator or manager and to take administrative enforcement action (see principle 11). Anbima has similar powers over member firms (almost all funds in Brazil)</p>
Assessment	Partly Implemented
Comments	The IOSCO Methodology requires a not implemented rating if key question 9 is not satisfied: Does the regulatory system adequately provide for an orderly winding up of CIS business, if needed?

	<p>In Brazil the fund manager controls the winding up process and the fund manager must call for a shareholder's general meeting within 15 days to authorize the winding down. This process may be satisfactory in the event that the manager of a solvent and liquid fund decides that a winding up of the fund is appropriate. However, a process that requires a shareholders meeting in 15 days may not produce an orderly winding up if the circumstances involve issues of solvency or liquidity or misconduct. This is potentially a serious risk in a period of market instability. The CVM believes that it has the legal authority to adopt a regulation that would create a process for the CVM to take a greater role in the process but it has not adopted a regulation that provides for the CVM to direct a winding down or to supervise the process. Accordingly the current process does not satisfy the "orderly winding up" requirement. While the Methodology states that the lack of an orderly winding up process is a basis for a Not implemented rating, as a matter of discretion, a partly implemented assessment has been chosen because the process is orderly in some circumstances.</p> <p>While it does not affect the rating under this Principle, the legal structure that allows investors to have unlimited liability on a failure of a fund raises some concerns and may require legislation to remedy. The potential unlimited liability of mutual fund investors is a serious issue for the future of the mutual fund industry in Brazil. Although unlikely given trading rules (e.g., margin calls), imagine what would happen in Brazil if a small obscure multi-mercado fund took an excessive risk by investing substantial amounts of assets in the DI futures market and guessed wrong. Potentially this could result in losses that exceed the total value of the fund. If the fund manager lacked the "deep pocket" to pay the losses, it could result in a negative net asset value and an obligation by fund investors, who had already lost their entire investment, to pay the debt. Such an event could cause a national panic by all mutual fund investors.</p>
<b>Principle 26.</b>	Regulation should require disclosure, as set forth under the principles for issuers, which is necessary to evaluate the suitability of a collective investment scheme for a particular investor and the value of the investor's interest in the scheme.
<b>Description</b>	<p>The CVM requires each fund to provide potential investors with a Fund Brochure (prospectus) reviewed by the CVM that "contain all information relevant to the investor related to the fund's investment policy and the risks involved" (CVM 409 §39). Changes in the Brochure must be filed with the CVM within one day. The Brochure "shall contain, in clear and accessible language to the fund target public, information regarding the following topics, as well as any other information considered relevant" (CVM 409 §40):</p> <ul style="list-style-type: none"> <li>I – management targets as well as fund objectives and target public;</li> <li>II – investment policy and range of assets allocation, the analysis and selection process;</li> <li>III – list fund service providers;</li> <li>IV– clear specification of fund taxes and other expenses;</li> <li>V – detailed presentation of the administrator and manager, with information about their registration in the CVM, their technical departments and other resources and services used to manage the fund;</li> </ul>

	<p>VI – the minimum and maximum limits of investment, and limits on holding or redemption;</p> <p>VII – conditions for quotas redemption and grace period;</p> <p>VIII – policy on distribution of gains, including terms and payment conditions;</p> <p>IX – identification of fund risks;</p> <p>X – information about risk management methods and policies;</p> <p>XI – information on applicable taxes and the tax treatment policy to be followed;</p> <p>XII – policy related to the exercise of the voting right of the companies in which the fund holds an investment;</p> <p>XIII – policy of information disclosure, including the information related to portfolio composition, which shall be identical to all who request it;</p> <p>XIV – identification of the fund’s risk classification agency, whenever there is one, as well as the obtained classification;</p> <p>XV – the place, means and form of obtaining the fund results in previous years, as well as other information regarding previous years, such as accounting statements, fund administrator’s reports and other pertinent documents; and</p> <p>XVI – the maximum percentage of quotas one sole quota holder can retain.</p> <p>The CVM classifies mutual funds into seven categories:</p> <p>I – Short Term Fund; II – Referenced Fund; III – Fixed Income Fund; IV – Stocks Fund; V – Exchange Fund; VI – External debt Fund; and VII – Multimarket Fund.</p> <p>The CVM has a limited number of prudential investment restrictions that apply to each fund type and several that are general in application. For example funds may not have more than 20% of the portfolio invested in securities from a single financial institution or 10% from any other issuer. There are no limits on counterparty trading concentration. Funds may deviate from this restriction if permitted in its by-laws. Funds may not borrow money, but if disclosed, it may invest in derivatives and engage in short selling. Short-term funds (money-market funds) may invest in securities with terms of less than 375 days, and securities must be rated “low risk” by a credit rating agency. The multi-market fund is considered the equivalent of a hedge fund. It may invest in virtually any security and may deviate from concentration limits. These funds may have a performance-based fee structure. Funds of funds must retain a 5% liquidity cushion.</p> <p>CVM regulations do not require funds to provide investors with periodic or annual reports. Investors must receive a monthly account statement of holdings and value (CVM409 §72). Funds must report monthly (10 days after month end) the entire portfolio of assets in the fund (with some exceptions, for 30 -90 days, for confidential acquisition or selling strategies). These reports are publicly available. Also, the CVM, shareholders, and the market must be immediately informed about “any act or fact that could reasonably affect the value of the shares or affect investor’s opinion on buying, selling or keeping those shares” (CVM 409 §72).</p>
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	<p>Funds must provide investors on request a copy of an audited annual financial statement within 90 days after the CIS corporate year (CVM 409 §82). The accounting standards applicable to CIS are set by the CVM (Instruction 438 Investment Fund Chart of Accounts – COFI). The CVM reports that they are compliant with international standards (IFRS).</p> <p>The CVM has broad authority to order funds to correct misstatements in public documents and to impose sanctions for any misstatements. This also applies to non-prospectus disclosures contained in advertising or sales materials. While the CVM does not review sales material, Anbima pre-reviews all advertising and sales material and can require a member firm to revise or correct statements in the materials. The CVM also has the authority to halt an offering of fund shares if necessary (Law 6.385/76 §13).</p> <p>The CVM is considering two significant changes in its disclosure policy. One change would amend CVM instruction 306 and require funds to disclose the valuation methodology used to calculate NAV. Another change would create a “summary prospectus”, a short form easy to understand prospectus that would also provide improved disclosure of fees.</p>
Assessment	Broadly Implemented
Comments	<p>This rating is based on the inability to satisfy two key questions:</p> <p>5. Does the regulatory system specifically require that the offering documents, or other publicly available information, include the following: ... (e) Information on the methodology of asset valuation?</p> <p>9. Does the regulatory system require a report to be prepared in respect of a CIS’s activities either on an annual, semi-annual or other periodic basis?</p> <p>The lack of an annual or periodic report to investors is a serious limitation. The lack of disclosure of the fund’s methodology for calculating NAV is also a deficiency. A strict application of the IOSCO Methodology would require a not implemented rating. A broadly implemented assessment has been chosen instead as there are some offsetting protections such as the requirement that funds disclose monthly its full portfolio holdings, the material events disclosure requirement and the requirement to provide an annual audited financial statement on request.</p> <p>Reliance on Anbima to review mutual fund advertising materials is less than ideal, as Anbima is not a regulated SRO. While this is not the basis for the broadly implemented rating, it is suggested that the CVM consider expanding its role in oversight of advertising materials.</p>
<b>Principle 27.</b>	Regulation should ensure that there is a proper and disclosed basis for asset valuation and the pricing and the redemption of units in a collective investment scheme.
Description	All funds must price portfolio assets and calculate NAV on a daily basis (CVM

	<p>409 §68 and 71). The fund portfolio valuation must be independently audited on an annual basis (CVM 409, §84). Asset valuations must be in accordance with CVM -COFI accounting standards. According to item 1.2.1.3 of COFI, when there is no verifiable market value to a particular asset, alternative methods of valuation may be used, such as:</p> <ul style="list-style-type: none"> <li>(i) the value of another asset that has similar rate, risk and duration;</li> <li>(ii) present discounted cash flow, based on actual interest rates; or</li> <li>(iii) mathematical-statistic pricing models.</li> </ul> <p>Anbima, Bovespa and CETIP provide debt-pricing vectors that are generally used by funds to value debt securities.</p> <p>Anbima staff review all fund NAV on a daily basis to identify price fluctuations or deviations from funds in the same segment. Whenever a pricing anomaly is identified, the fund is contacted and an explanation is requested.</p> <p>As part of their on-site inspections of funds, CVM and Anbima review a sample of fund's NAV calculations and any occasions when alternative pricing methods were used.</p> <p>Under CVM rules the fund administrator is responsible for damages to investors caused by noncompliance with CVM rules. The CVM believes that an error in NAV calculation that damaged an investor would be covered by this provision (CVM 409 §2 and 3).</p> <p>The process for purchasing or redeeming shares in a fund must be specified in the fund's bylaws (CVM 409 §15) and may only be changed by a vote of the investors at a general meeting. Funds may include redemption limitations in its by-laws as well. These must be disclosed in the Fund prospectus. Upon redemption, the fund has five days to process the payment transaction.</p> <p>A fund may suspend purchases and redemptions if it is unable to calculate NAV (CVM 409 §16.2). As discussed in principle 26, whenever this occurs the fund must notify the CVM and its investors within one day and call for a special shareholder meeting within 15 days. Decisions to suspend redemption of purchases or redemptions may only be made by the fund administrator and because of a determination that it is not possible to calculate NAV.</p> <p>The CVM believes that it could order a suspension in purchase or redemption of a specific mutual fund under §9.1I of the Securities Act. This provision states "In order to prevent or correct abnormal market situations, the Securities Commission of Brazil may: I - suspend trading of securities or declare the recess of a stock exchange". The same section of the Securities Act also empowers the CVM to "prohibit market participants, under penalty of fine, from performing any activities it may specify, which it considers to be harmful to normal market functioning." The CVM interpretation of these provisions has never been tested.</p>
Assessment	Fully Implemented
Comments	<p>Decisions to suspend redemption of purchases or redemptions may only be made by the fund administrator and because of a determination that it is not possible to calculate NAV. As described above, the CVM believes that it could order a suspension in purchase or redemption of a specific mutual fund under §9.1I of the Securities Act. The CVM interpretation has never been tested and at best it may not encompass all possible scenarios when a temporary suspension is in the</p>



	interest of fund investors. Although not required under the Assessment Methodology, the CVM is encouraged to consider adopting an Instruction articulating the circumstances when it would take action if an operator suspends redemption or declines to suspend redemptions in emergencies when the protection of investors warrants CVM action and it is not possible to schedule and hold a shareholders meeting in time.
<b>Principle 28.</b>	Regulation should ensure that hedge funds and/or hedge funds managers/advisers are subject to appropriate oversight.
Description	<p>In Brazil hedge funds are classified as multi market mutual funds and are subject to the same regulatory structure as other mutual funds. Accordingly the CVM licenses fund administrators, portfolio managers and the fund itself. Hedge funds must adhere to the same monthly portfolio disclosure, record-keeping, internal control, conflict of interest and asset valuation and daily pricing rules as described above for mutual funds.</p> <p>Also hedge funds are subject to the same prohibition on borrowing that applies to all mutual funds. Leverage is only possible through the use of derivatives.</p> <p>The CVM also has adopted a separate registration and regulatory scheme for venture capital and private equity funds. These are a growing segment of the Brazilian institutional investment sector.</p>
Assessment	Fully Implemented
Comments	Because investors in hedge funds include pension funds and the general public consideration should be given to increased oversight of investment portfolios for systemic risk purposes.
<b>Principles for Market Intermediaries</b>	
<b>Principle 29.</b>	Regulation should provide for minimum entry standards for market intermediaries.
Description	<p>In Brazil the responsibility for licensing financial intermediaries is shared by BCB and the CVM. Because broker-dealers are included in the BCB definition of financial institution, BCB has primary licensing responsibility, as well as capital and prudential regulation, discussed in principle 30.</p> <p>The BCB licensing process is the same for banks and market intermediaries. It requires firms to submit an application that identifies the controlling persons, their relevant experience and qualifications, other information needed to make a fit and proper assessment. The BCB does not have specific criteria other than requiring a relevant university degree and some level of relevant experience. Applicants must submit a business plan and must demonstrate that the applicant has the necessary resources to operate. There is an initial capital requirement of 350,000 BR for a firm that will have no more than ten branch offices. If the firm plans on engaging in repo transactions the minimum capital requirement is 1.5 million BR.</p> <p>Unless BCB conditions the license, a firm may engage in all forms of financial intermediation in equities, debt, futures and derivatives, forex, mutual funds, and securities underwriting. BCB also issues licenses for forex brokerage only. When</p>

	<p>a bank creates a broker subsidiary, it may operate as a legal subsidiary or as an undifferentiated component of the bank conglomerate. Bank employees who provide securities intermediary services to customers must pass an Anbima examination. The CVM also licenses these firms in conjunction with its responsibilities for investor protection and supervision of market conduct. It also has exclusive responsibility for licensing and/or regulating several other types of market intermediaries. Market analysts provide investment recommendations. They must pass a qualifying exam administered by Apimec, which issues a license. Market consultants can provide advice to investors but not have control over investor assets or accounts. They are licensed directly by CVM. In lieu of an examination they must have a relevant university degree and relevant work experience. Independent agents are broker-dealer sales personnel who are not employees of a licensed financial intermediary, but function under a contractual agreement. They are licensed by the CVM after passing an examination administered by ANCORD. Autonomous agents are a hybrid of an investment advisor and an introducing broker that uses the licensed firm to process transactions and provide administrative support. Autonomous agents cannot have custody or investment control of client assets. These responsibilities require an asset manager license (discussed in principle 24). The CVM also licenses transfer agents and custodians, which must also be financial institutions registered with BCB. CVM requires applicants for these licenses to submit a certification by an independent auditor that they have adequate financial resources. The CVM also has a separate license for intermediaries who function exclusively in the commodity futures sector.</p> <p>The CVM posts all approved applications on its website. The application includes the name of the officer in charge of the firm. Firms must provide updated information if there is a change in the name of the responsible executive. The CVM website also includes information on any “autonomous agents” with which the firm has a contractual agreement. CVM instruction 402 provides that any CVM license may be revoked immediately if a registrant no longer meets its requirements. CVM and BCB both have the authority to suspend or impose limitations on a license or on a person employed by the licensed intermediary.</p>
Assessment	Fully Implemented
Comments	<p>The CVM and BCB rely upon qualification exams administered by Anbima, Apimec and ANCORD. None of these organizations is an official self-regulatory organization subject to direct oversight by the CVM. This issue is discussed in principle 9.</p> <p>The BCB requirements for professional experience and relevant credentials are general. It would be beneficial to require expertise and experience that is specific to the business of a broker-dealer.</p>
<b>Principle 30.</b>	There should be initial and ongoing capital and other prudential requirements for market intermediaries that reflect the risks that the intermediaries undertake.

Description	<p>Under BCB resolution 3,490 (August 29, 2007) financial institutions and other institutions licensed by the BCB are required to allocate capital according to the risk of their activities on a permanent basis. There are no specific quantitative liquidity standards. As described in principle 29, BCB requires applicants to have a minimum of 350,000 BR in initial capital. After a firm is licensed and in operation the BCB requires it to submit a daily risk-weighted capital report. The report is prepared by applying BCB risk weighting parameters to the firm's assets and liabilities using a value at risk (VaR) model developed by the BCB. The BCB provides all institutions with the risk weighting parameters on a daily basis. As a general matter, the BCB requires all financial institutions to maintain a minimum 11% capital level. In addition to the daily calculation the BCB requires a detailed monthly report. Non-bank financial institutions with less than 100 million BR in assets are required to file this report quarterly. Non-bank institutions must also provide information on client accounts. The BCB estimates that 2/3 of broker-dealer type nonbank financial institutions file quarterly. The BCB doesn't require any other types of reports from intermediaries. The CVM doesn't require regular reports other than those pertaining to internal control compliance.</p> <p>BCB conducts continuous on-site and off-site monitoring of licensed institutions to identify any deterioration of capital adequacy that could affect the continuity of the financial institution or the stability of financial markets. In Brazil, virtually every financial instrument is registered. This enables the BCB supervisory staff to access all transactional information specific to any financial institution with a one-day lag. The BCB can monitor transaction based detail as well as reconstruct various bank positions, such as liquidity positions, funds provider information, and market risk exposures. When appropriate the BCB can stress test positions and monitor extraordinary trends.</p> <p>The large broker-dealer/intermediaries that are subsidiaries of bank conglomerates do not report separately. Instead the BCB requires a consolidated financial report for the entire conglomerate. According to Resolution 3,444 the regulatory capital requirements must be assessed on a consolidated basis for institutions belonging to both a financial conglomerate (including financial institutions and other institutions licensed by the BCB controlled by banks) and an economic conglomerate (including financial institutions, other institutions licensed by the BCB and other non-financial entities controlled by banks).</p> <p>The BCB has powers to establish prudential preventive measures in order to address such situations. In case of deterioration in the capital adequacy position, below the minimum, the supervisor must be notified within one day. BCB may, at its discretion, determine a reduction in the level of risk or an increase in capital requirements (Resolution 3,490/2007). In more severe cases, the Supervision staff</p>
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	<p>can summon the managers and the majority shareholders of the financial institution by issuing an “attendance order”. The objective is to discuss the problems and possible solutions to be applied and also define a deadline for the institution to present a correction plan. This plan and its timeline must be approved and followed-up by BCB. When carrying out its duties, the Supervision staff may address itself directly to any department or employee of the financial institution (Law 4,595/1964).</p> <p>The BCB has adopted several Resolutions addressing risk management. These include Resolution 3,380, of June 29, 2006, for operational risk; Resolution 3,464, of June 26, 2007, for market risk; Resolution 3,721, of April 30, 2009, for credit risk.</p> <p>Investment advisers, including autonomous agents are not permitted to hold or control client funds and assets. Accordingly they are not regulated by BCB and the CVM does not have capital standards for these entities.</p>
Assessment	Fully Implemented
Comments	<p>Large bank conglomerates dominate the Brazilian financial system. The large broker-dealers are in most cases subsidiaries of these banks. Under the BCB system, the bank has full liability for the obligations of the subsidiary. In this environment, a capital adequacy standard that is based on banking operations is understandable.</p> <p>However, in most jurisdictions the capital adequacy standards for banks are typically very different than the standards for financial intermediaries, reflecting the fundamentally different businesses and the difference between bank customers whose deposits appear on a bank’s financial statements and brokerage customers with accounts that do not appear on a financial statement. Given the rapid changes that can occur in capital markets, regulatory principles emphasize the need for frequent analysis of firm liquidity and regular reporting of detailed information on open positions. In Brazil, detailed reporting on a quarterly basis by smaller non-bank financial institutions may create the possibility of unreported and undetected liquidity and solvency risks for these smaller entities; particularly since 100 million BR does not seem to be a meaningful threshold to define smaller broker-dealers. It is suggested that the BCB consider whether its bank VaR model is optimal for nonbank financial intermediaries. These concerns are mitigated substantially by the capacity of the BCB to monitor virtually all transactions and open positions by regulated firms on a one day delay.</p>
<b>Principle 31.</b>	Market intermediaries should be required to establish an internal function that delivers compliance with standards for internal organization and operational conduct, with the aim of protecting the interests of clients and their assets and ensuring proper management of risk, through which management of the intermediary accepts primary responsibility for these matters.
Description	CVM Instruction 387 requires intermediaries to have an internal control program

	<p>to monitor firm compliance with CVM requirements. In 2011 CVM adopted a new more expansive instruction on firm internal compliance. Instruction 505 (compliance by October 2012) requires intermediaries to have appropriate rules, procedures and internal controls. Firms must designate one manager responsible for implementing the procedures and internal controls. A second official must be assigned responsibility for reviewing compliance. At least two times a year, the executive in charge of oversight must report to the board on compliance (CVM 505, §4). All internal control records must be maintained for five years. Instruction 505 also requires firms to record all conversations with clients involving trade instructions. In addition to this internal evaluation, BSM (Bovespa's SRO unit) performs external audits of firm internal controls at least once a year. The results of this external review are discussed with senior management of the market intermediary and reported to CVM.</p> <p>Bovespa permits member firms to provide direct electronic access, provided it is processed by the firm's electronic order processing systems, with the member firm responsible for the order. All Bovespa requirements on position and credit must be followed. Bovespa trading systems require all orders to identify the client account (access limited to Bovespa and CVM). CVM requires all firms to have a licensed custodian (it may be an affiliate of the broker) that maintains separate client custody accounts.</p> <p>CVM instructions require firms to have written agreements, provide account statements and apply "know your customer" standards. Firms have a legal duty to act in the best interests of clients, ahead of firm interests. All firms must have procedures to prevent conflicts of interest and monitor compliance internally. All client securities are dematerialized at the Bovespa central depository in individual accounts.</p> <p>Bovespa maintains a customer protection fund (MCR) to recompense customer losses due to intermediary misconduct or insolvency. The maximum recovery is 70,000 BR. This fund only covers damages involving securities listed for trading on the Bovespa.</p> <p>While CVM has broad authority to regulate business conduct and promote investor protection, its authority does not cover the purchase or sale of government debt securities. BCB has sole responsibility for regulation pertaining to government securities. There is no protection fund for losses involving government securities and BCB cannot use its enforcement actions to recompense investors for losses.</p>
Assessment	Fully Implemented
Comments	BCB is primarily a prudential regulator and CVM is primarily an investor protection regulator. The assignment of investor protection responsibilities pertaining to government securities to BCB is not optimal. The CVM should have authority to protect investors from fraudulent sales practices by market intermediaries involving government securities.

<b>Principle 32.</b>	There should be a procedure for dealing with the failure of a market intermediary in order to minimize damage and loss to investors and to contain systemic risk.
Description	<p>The BCB is the prudential regulator for all financial institutions in Brazil and has exclusive responsibility for dealing with the failure of a market intermediary. The BCB has the authority to take preventive and corrective action when banks violate its regulations or in the event of operating weakness. The BCB can restrict operations, require additional capital, require plans to correct deficiencies and in critical situations, intervention, removal of management, liquidation and/or the imposition of fines. The BCB can also order emergency preventive prudential measures in order to preserve the soundness, the stability and the regular functioning of the financial system. It can also act to prevent the deterioration of a financial institution, even if it is still compliant with operational limits, including capital requirements.</p> <p>As noted in principal 31, BCB Resolution 4019 requires firm managers to notify it of any situation posing a material risk to a financial institution. BCB may order firms to take corrective measures, including restrictions on operations and activities. In the event of a failure by an intermediary, the BCB may act “extrajudicially” and appoint a temporary receiver to take control of the financial institution. While the BCB lacks the authority to order firms to transfer client accounts, the BCB can appoint a receiver to take control of a firm. This receiver may require the distribution of client funds and securities or the transfer of accounts to another firm. If a BCB action on resolution is appealed to the Brazilian judicial system, the Court has the power to suspend the transaction pending appeal.</p> <p>As previously described in principle 30, the BCB has access, on a one-day delay basis, to virtually every financial transaction and open position. Some of the systems developed by the BCB’s Monitoring Department are: monitoring of outliers (trading prices and day trade chains); market risk monitoring; FX monitoring (includes the detection of money laundering); monitoring of financial indicators and solvency ratings, developed using the supervisor’s criteria.</p> <p>As described in principle 31, Bovespa has a customer protection fund that may compensate clients up to 70,000 BR for losses caused by a Bovespa member’s misconduct. However this does not compensate for losses in government securities or securities not listed or traded on Bovespa. The deposit protection fund of the BCB only covers bank deposits. Bovespa as a CCP has the legal responsibility to complete the settlement of open trades involving a defaulting intermediary. As over 90% of the Brazilian securities industry (by assets and transactions) are subsidiaries of banking conglomerates, which have liability for subsidiary obligations, systemic risk does not appear to be significant.</p>

Assessment	Broadly Implemented
Comments	<p>The BCB as the prudential regulator of the financial sector has comprehensive authority to monitor the financial stability of all regulated entities. Its access to detailed information on all financial instruments and positions on a one-day delay basis provides it with the ability to independently monitor entities. It also has broad powers to take prompt corrective action, including imposing limitations on operations, suspension or termination of managers and board members and emergency corrective action, including appointment of a receiver and or directing liquidation of a failing entity.</p> <p>Key question 3(b) of the IOSCO methodology pertains to the authority of a regulator to direct a firm to transfer customer accounts. The BCB lacks this authority. However, in critical situations in which it appoints a receiver to assume control, the receiver may order customer accounts to be transferred.</p> <p>Key question 3(d) concerns the availability of other methods of protecting client, counterparty and systemic risk, such as client or settlement insurance or guarantee funds. In this regard, there is an opportunity for improvement. While the Bovespa clearance and settlement system is an official central counterparty that guarantees all trades, CETIP is not an official CCP.</p> <p>There is no comprehensive insurance fund for Brazil and firms are not required to have comprehensive insurance or reserve funds for the protection of investors.</p> <p>When the BCB takes action because a market intermediary is failing, its deposit guarantee fund does not apply. The Bovespa investor protection fund is too limited in the benefits it can provide, a maximum of 70,000 BR. Also it does not cover losses involving government securities, a major component of investment accounts. For these reasons there are inadequate resources to protect the clients of a failing intermediary. The IOSCO Methodology provides that a broadly implemented rating is appropriate if key question 3(d) is not satisfied.</p>
<b>Principles for the Secondary Markets</b>	
<b>Principle 33.</b>	The establishment of trading systems including securities exchanges should be subject to regulatory authorization and oversight.
Description	<p>In 2008 all Brazilian securities exchanges merged into a single securities exchange BM&amp;F Bovespa, which operates equities, options, commodities futures and derivatives trading systems. In addition to Bovespa, CETIP is a licensed securities registry and depository that provides order exposure, trade reporting and clearance and settlement for government and private debt instruments. Bovespa and CETIP are registered with CVM. CVM must review and approve all Bovespa and CETIP rules and new products or services. BCB has similar authority with regard to clearance, settlement and payment processing functions.</p> <p>The Securities Act (6385/76, §109, §110) authorizes the CVM to issue licenses and regulate exchanges and securities trading systems. CVM instruction 461 establishes CVM procedures and policies for licensing and regulating exchanges, including types of activities, services and products.</p>

	<p>The CVM instruction provides qualifications standards for applicant exchanges and risk control requirements. Article 42 requires exchanges to create a self-regulatory department charged with supervising member compliance with CVM and the exchange rules.</p> <p>Instruction 461 also requires an exchange to establish rules governing guaranty funds for clearance and settlement. Bovespa has a separate trade processing guaranty fund for each of its four trading systems. Each fund currently has in excess of 30 million BR. CETIP has a single guaranty fund of comparable size. CETIP does not function as a CCP. Since it only clears and settles debt securities that are on its registry and in its depository, it has limited exposure for trade failures. CVM rules do not require Bovespa or CETIP to have arbitration or dispute resolution procedures for client- member firm or member firm-member firm disputes. Bovespa also has the 70,000BR per client per event customer guaranty fund described previously.</p> <p>CVM conducts on-site inspections of Bovespa and CETIP operations and requires the self-regulatory programs at CETIP and Bovespa to report immediately any serious violations or infractions and provide monthly reports on all violations or failures to observe rules. An annual audit report must be submitted covering the adequacy of exchange trading risk-management systems. CVM conducts annual inspections, but does not inspect exchange trading algorithms and trade matching systems.</p> <p>However, the CVM may order a special audit if there is any indication that the trading systems or methods are not operating properly.</p> <p>CVM and Bovespa both have the authority to halt trading or suspend trading in a security on an emergency basis. Bovespa also has a special procedure requiring a special auction whenever there is an offer to sell or purchase a large block of a listed stock, defined as 0.25% of free float for illiquid and 0.50% for liquid stocks. The special auction may require a halt in trading of 5 minutes to one hour to alert the market and submit bids. If a block is split into multiple trades, spanning more than one day, Bovespa may cancel a previous day trade and direct an auction for the entire amount.</p> <p>CVM Instruction 461 (§ 28) requires a daily report on equity market transactions submitted to the auction process and on all transactions cancelled; a report on the open interest of individual positions in the futures and derivatives markets; and a report containing the daily movement of transactions in each trading system. Bovespa and CETIP maintain full audit trails of all transactions. These must be kept for five years. The Bovespa system includes information on the member firm executing the order and the client account of the member firm that submitted the order. The information on the client account can only be accessed by Bovespa and CVM.</p> <p>CETIP is primarily a registry and depository of debt and OTC derivatives. As an adjunct of its registry and depository services it provides order exposure, trade</p>
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	reporting and clearance and settlement services. It maintains an internal regulatory department to monitor compliance with CETIP and CVM rules.
Assessment	Broadly Implemented
Comments	<p>The broadly implemented assessment reflects several areas where further improvement can be made. These include CVM oversight of trading software for trade matching algorithms (Question 5.c.), and creation by Bovespa of a dispute resolution system for members and for customers, other than the limited MRP fund (Question 3.a.).</p> <p>While not a basis for the rating of this principle, comment is made on Question 4.c. under this principle. This pertains to fair access to an exchange or trading system. This is an issue that CVM is currently examining in the context of possible new entrants in Brazil. CVM has commissioned an independent consultant to prepare a report on access to services and competition issues in the secondary market. The report is scheduled for completion in April 2012. The CVM is to be commended for undertaking a thoughtful and independent examination of the complex issues presented.</p>
<b>Principle 34.</b>	There should be ongoing regulatory supervision of exchanges and trading systems that should aim to ensure that the integrity of trading is maintained through fair and equitable rules that strike an appropriate balance between the demands of different market participants.
Description	<p>CVM has the authority to review and approve all Bovespa and CETIP rules, procedures and new products or services. Both organizations are required to maintain internal regulatory oversight programs. Bovespa has created a wholly owned subsidiary, BSM, to provide regulatory services, while CETIP has created an internal department to do the same. Both must submit their annual work plan and internal budget to CVM for review and approval. Bovespa has also created a separate regulatory governing board to provide guidance and oversight to BSM. CVM instruction 461 requires BSM and CETIP regulatory department to submit reports regularly to CVM.</p> <p>These include the following:</p> <ol style="list-style-type: none"> <li>1. A daily report on: <ol style="list-style-type: none"> <li>a) Trades involving the auction process, including any cancelled trades;</li> <li>b) Position balances in the future settlement market, indicating all long, short and naked positions determined by brokerage houses, the positions of the own portfolio apart from the ones pertaining to the clients; and</li> <li>c) Futures and commodities exchanges daily movements of the floor system and the electronic operations trading and registration systems, identifying intermediaries and final investors.</li> </ol> </li> <li>2. A monthly report on: <ol style="list-style-type: none"> <li>a) Failures to comply with regulatory requirements in the securities market, including the floor and electronic trading;</li> <li>b) Completed inspections of member firms, including the scope of the</li> </ol> </li> </ol>

	<p>finalized work, the period involved, the final result and the measures taken.</p> <p>BSM has a real-time surveillance system for each of its four trading platforms. Additionally, the CVM has in place an electronic system to carry out surveillance of the trading with securities on Bovespa and CETIP. The system is designed to detect trades considered atypical relating to its volume, price or liquidity. Bovespa and CETIP staff focus on real-time surveillance and CVM focuses on prior day trading patterns, although it also monitors in real-time.</p> <p>CVM has the authority to investigate and sanction Bovespa and CETIP for any violations of CVM rules or for failures to properly apply or enforce their own rules.</p>
Assessment	Fully Implemented
Comments	As discussed in principle 33, Bovespa has a long-established procedure to require special auctions whenever a large block is exposed for sale. This procedure may have been appropriate at any earlier stage of market development when block orders could disrupt market stability and liquidity and unfairly disadvantage smaller traders. Because of the development of the Bovespa equity market, this process may no longer promote market stability and liquidity. CVM should consider directing Bovespa to reexamine whether a need for the special auction process still exists.
<b>Principle 35.</b> Regulation should promote transparency of trading.	
Description	<p>Bovespa has a fully electronic order exposure system that provides extensive information on bids and offers and the depth of the open order book. High frequency trading is beginning to play a role in Brazilian trading. However there are no alternative trading systems or dark pools in Brazil so all trading including HFT is fully transparent to the market.</p> <p>CETIP is an OTC style, trade reporting system. There is limited pre-trade transparency of indicative interest, primarily through third party commercial sources (e.g. Bloomberg and Reuters).</p>
Assessment	Fully Implemented
Comments	Pre-trade order exposure on CETIP may warrant attention if the volume of OTC trading in FIDCs and other instruments grows.
<b>Principle 36.</b> Regulation should be designed to detect and deter manipulation and other unfair trading practices.	
Description	<p>As described in principles 10 and 34, Bovespa, CETIP and CVM utilize automated surveillance systems to monitor trading activity for the purpose of detecting manipulative, deceptive or fraudulent activities. BSM and CETIP regulation may conduct inquiries of questionable trades or trading patterns involving member firms. If the inquiry pertains to activity by clients of members, they will be referred to CVM for further inquiry and possible action.</p> <p>The Bovespa audit trail provides detailed information on the identity of the firms on both sides of the trade as well as the client accounts on both sides of the trade. This information facilitates rapid investigation of suspicious activities.</p>

	<p>The Securities Law clearly prohibits the full range of market misconduct and provides the CVM with sufficient authority to investigate and take action. If CVM concludes that violations occurred, the Securities Law (Law 6385/76, §11) provides CVM with a range of enforcement sanctions, including money fines, suspensions, disqualifications and license revocations.</p> <p>As described in principle 15, the CVM has an extensive array of multilateral and bilateral agreements to obtain and exchange information with foreign regulators concerning cross-border activities. While the Bovespa does not have formal information exchange agreements with foreign markets that trade ADRs on Brazilian companies, the CVM has been able to obtain this information when required.</p>
Assessment	Fully Implemented
Comments	<p>There is a well-developed surveillance, investigation and enforcement program to address market misconduct. Statistics on this are included in principle 12.</p> <p>One open issue concerns the lack of a formal process for cross-market surveillance of the commodities futures and commodities spot markets. The CVM is aware of this issue, which is mentioned in principle 7 on perimeters of regulation. The commodity futures market in Brazil is small relative to other parts of the derivatives market and accordingly, this limitation doesn't warrant a lower assessment.</p>
<b>Principle 37.</b> Regulation should aim to ensure the proper management of large exposures, default risk and market disruption.	
Description	<p>The Bovespa audit trail system provides full information on the clients and firms on both sides of a trade simplifying surveillance of large activity. The existence in the CSD of individual accounts for every beneficial owner provides even greater information. Bovespa rules' requiring special auctions for block trades enable the exchange to exercise greater control over large exposures. There is no market making in the equity markets and market intermediaries do not engage in extensive proprietary trading, except in government securities by larger banks. Finally there is no trading on margin accounts in the equity market and all short-selling must be covered by borrowing shares from the Bovespa lending facility. Moreover trading in the derivatives market entails significant daily collateral requirements and cross margining across trading platforms is not possible. As a result of these features, the potential for large exposures causing a risk of widespread default or market disruption is very limited.</p> <p>CM-TIMS calculates the total margin required for one investor's portfolio, considering his positions in both option and forward market as well as in the securities lending program. The total margin is the sum of two components: the Premium Margin (the market value of the position) and the Risk Margin (the potential loss of the position).</p> <p>In the Bovespa derivatives market initial and maintenance margin requirements are determined by its proprietary CM-TIMS model. Margin compliance is</p>

	<p>determined once a day and marked-to-market daily. Exceptionally CBLC, Bovespa's CCP subsidiary, may request margin on intra-day basis.</p> <p>CBLC maintains a Settlement Fund to guarantee the settlement of transactions processed through its systems. There is currently approximately 30 million BR in each of four settlement funds, one for each trading platform. This Fund is intended to provide additional guarantee to CBLC since, as clearing agent, the member brokerage house must pledge their seats on the exchange to BOVESPA and to CBLC. This Fund will be used when a CBLC clearing agent fails to provide collateral or to settle trades under its responsibility. If the defaulting firm is a subsidiary of a bank, the bank would be liable for these losses.</p> <p>Bovespa, through its stock lending facility, provides public information on the extent of short selling in a security, including the aggregate volume borrowed in every single share, as well as the securities available for lending (with quantities and rates). This is updated every 15 minutes. Complete data on all the stock lending activity is available on a daily basis for the CVM, including the identification of the actual beneficiary owners. BSM monitors short selling.</p>
Assessment	Fully Implemented
Comments	A variety of factors identified in the description of this principle make unlikely that a large exposure default would be a catalyst for market disruptions. The CCP appears to be sufficiently liquid to resolve any problems. The segregation of securities at the CSD into individual beneficial accounts provides additional protection, although it is possible that fraudulent conduct by an intermediary could subvert this level of protection.
<b>Principles Relating to Clearing and Settlement</b>	
<b>Principle 38.</b>	Securities settlement systems and central counterparties should be subject to regulatory and supervisory requirements that are designed to ensure that they are fair, effective and efficient and that they reduce systemic risk.
Description	As a part of this FSAP the settlement systems of Bovespa and CETIP were assessed as part of a CPSS-IOSCO ROSC. This assessment has not been finalized. However its tentative conclusions including findings that there is general compliance by FMI with the CPSS-IOSCO principles.
Assessment	Refer to CPSS-IOSCO Detailed Assessment Report.
Comments	