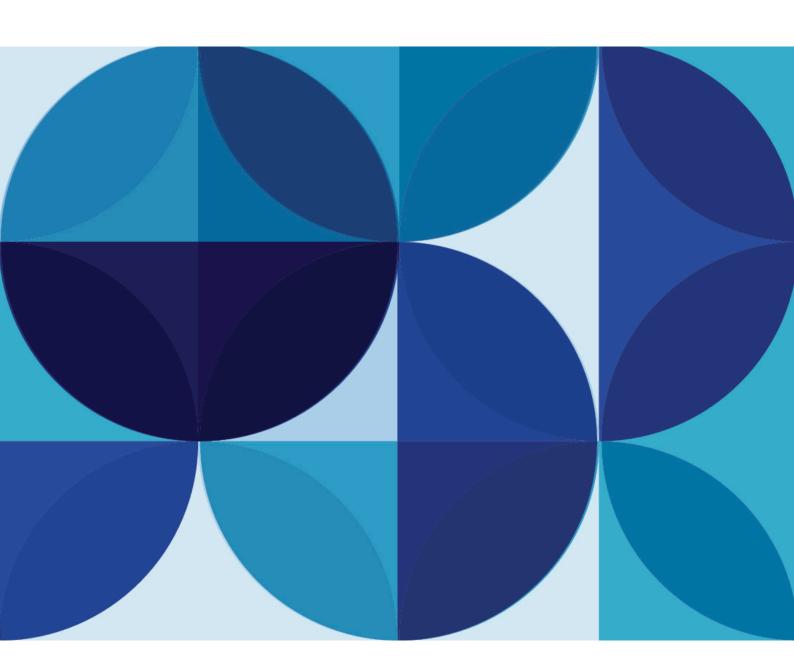
# Public Enforcement of Corporate Governance-Related Rules in Latin America

A comparison of Argentina, Brazil, Chile, Colombia, Mexico and Peru





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## **Foreword**

This report describes the results of an OECD survey submitted to the regulators responsible for the enforcement of corporate governance-related provisions in the six countries (Argentina, Brazil, Chile, Colombia, Mexico and Peru) that participate in the Latin American Corporate Governance Roundtable Task Force on Equity Market Development ("Task Force"). The report aims to identify common and differing approaches to enforcement challenges in the region as well as common objectives, obstacles and relevant experiences, thereby contributing to a better understanding of public enforcement environments in the region and potential avenues for improving them. Building on previous work by the OECD in 2009 and 2004, this report also provides information on changes in the public enforcement of corporate governance-related provisions in Latin America.

The report was developed by Caio Figueiredo C. de Oliveira under the supervision of Daniel Blume, Corporate Governance and Corporate Finance Division of the OECD Directorate for Financial and Enterprise Affairs. The author is grateful for the Government of Spain's financial support of this work and for the securities markets regulators from Argentina, Brazil, Chile, Colombia, Mexico and Peru, who have invested considerable time completing an extensive survey questionnaire. Likewise, special thanks for valuable comments and inputs received from the participants of the Task Force meetings in November 2019 and December 2020, when earlier versions of this report were discussed. Further thanks to Henrique Sorita Menezes and Katrina Baker (OECD) for excellent editorial support.

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### 1. Introduction

This report describes the results of an OECD survey submitted to the regulators responsible for the enforcement of corporate governance-related provisions in the six countries (Argentina, Brazil, Chile, Colombia, Mexico and Peru) that participate in the Latin American Corporate Governance Roundtable Task Force on Equity Market Development.

It employs a broad definition of what constitutes corporate governance-related offenses, following the G20/OECD Principles of Corporate Governance ("G20/OECD Principles")<sup>1</sup>. In aiming to present a helpful comparison of corporate governance-related enforcement practices in the region, the report faces certain challenges in assessing the effectiveness of different enforcement practices in countries that each have their idiosyncrasies. The purpose of this report is hence less intended to be a quantitative comparison and certainly is not meant to serve as an assessment of the quality of enforcement practices across different jurisdictions. Rather, it aims to identify common and differing approaches to enforcement challenges in the region as well as common objectives, obstacles and relevant experiences, thereby contributing to a better understanding of public enforcement environments in the region and potential avenues for improving them.

The Latin American Corporate Governance Roundtable Task Force on Equity Market Development has identified this issue as a priority for work because, from an economic perspective, an equity market that effectively protects minority shareholders tends to lead publicly-held companies to have easier access to capital (Reese and Weisbach, 2002<sub>[1]</sub>), which is the overarching goal of the Task Force.

As recommended in the G20/OECD Principles, "the corporate governance framework [...] should be consistent with the rule of law and support effective supervision and enforcement". Moreover, the G20/OECD Principles state that "supervisory, regulatory and enforcement authorities should have the authority, integrity and resources to fulfil their duties in a professional and objective manner".

This report builds on previous OECD work both with OECD member countries on supervision and enforcement in OECD and G20 countries (OECD, 2013<sub>[2]</sub>) and on surveys conducted for the Latin American Corporate Governance Roundtable ("Roundtable") in 2004 and 2009 (OECD, 2009<sub>[3]</sub>)) on public enforcement issues. Benefiting from the surveys administered in 2004 and 2009, this report also shows the evolution in enforcement in the region during the last decade.

Findings and data from the abovementioned publications are cited throughout the report as relevant, but it is important to highlight at the outset that this research has concluded that private enforcement is a challenge in most countries. Likewise, Latin America is among those regions where private enforcement actions are rare, creating an imbalance that concentrates the burden of ensuring compliance with the legal and regulatory requirements on the agents in charge of public enforcement. The main reason for that is "perceived to be the shortcomings of the judicial system, starting with the incredibly slow pace in conducting the proceedings, which can make the costs of a legal lawsuit unpredictable and usually very high. [...] Moreover, the judiciary does not have, as a general rule, good knowledge of corporate law issues, a problem that is exacerbated by the virtual absence of these kinds of cases in most courts" (OECD, 2013[2]). Likewise, adequate human and budgetary resources were a concern for most surveyed regulators a

<sup>&</sup>lt;sup>1</sup> The scope of the Principles ranges from more market-related offenses such as share price manipulation and insider trading to more company-related ones such as shareholder rights, disclosure practices and fiduciary duties of companies' institutions.

Capital markets operate within a framework of laws and regulations that have the goals of achieving efficiency, stability and fairness. Individuals and institutions that provide services in the capital markets or manage their own assets may comply with established rules because they perceive that they are morally obliged to do so, or simply because they fear the damage to their reputation or the punishment they might suffer in case a wrong-doing is discovered. On the other side of the coin, some individuals violate laws and regulations for many reasons, including due to a misunderstanding of how the rule should be interpreted in the specific case or because there is the perception that the wrongdoing will probably go unnoticed. Supervision and enforcement by government or private institutions of the capital markets rules are, therefore, necessary to guarantee a high level of compliance by market participants.

These three elements – rules, supervision and enforcement – of a securities market are interdependent. If the rules are clear and broadly considered positive for the functioning of the capital markets, participants will tend to comply with them both because they can easily understand how to act properly, and due to the fact that they see their value to the development of the market. The supervision benefits, therefore, from well-designed rules, and it may also prevent problems from erupting into breaches that require enforcement. As part of supervision, active surveillance by regulators through early monitoring and engagements with market participants allow regulatory authorities to better orientate individuals and institutions on how to act according to the rules, and intervening when necessary to avoid greater damage of an offence. Supervision and enforcement are different aspects of the same spectrum: the purpose of supervision is early detection, while the aim of enforcement is to deter future offences by punishing previous ones.

This report focuses on public enforcement by analysing – in the following order – the structure, resources, independence and authority of regulators, as well as the evolution in the actual use of enforcement actions. Likewise, this report explores the opportunities and challenges for the surveyed regulators to adopt new information technologies, and summarises what has been done to digitalise the supervision and enforcement of capital markets rules. While not a main focus of the report, it also touches briefly upon some aspects of the role of the judiciary and private arbitration in enforcement. To conclude, some findings and issues are identified as a reference for consideration among the six surveyed regulators.

## 2. Institutional framework for enforcement

In every Latin American jurisdiction surveyed for this report, the only or one of the most important institutions devoted to the enforcement of laws and regulations related to corporate governance of listed companies are regulatory institutions with their own legal personality.

The surveyed public autonomous entities<sup>2</sup> devoted to the enforcement of laws and regulations related to corporate governance for listed companies (from here on, "regulators") are, in all cases, responsible for the regulation, supervision and enforcement of individuals and institutions that take part in the securities markets, such as investment funds and brokers. In the cases of Argentina, Brazil and Peru, the regulators are solely responsible for the securities markets, but, in the other three surveyed jurisdictions, the regulators are also responsible for distinct sectors of the financial markets (for example, the Chilean regulator is also responsible for the insurance and banking markets).

Every surveyed jurisdiction has, to a smaller or greater extent, shared responsibilities among different public bodies for the regulation, supervision and enforcement of laws and regulations applied to listed companies and financial institutions<sup>3</sup>. Even in Colombia, where the regulator (SFC) has a relatively broad mandate to supervise listed companies and many different financial institutions, there is also a central role for the Stock Market Self-regulator (AMV) in the enforcement of corporate governance rules for listed companies.

No model is clearly the best one. On the one hand, a regulator that creates norms and supervises them in a number of different financial market sectors is able to avoid regulatory arbitrage opportunities among different financial instruments, and has some economies of scale when investigating an institution that operates in different markets. On the other hand, a great number of mandates might slow the decision-making process at the highest body within the regulator due to the number of issues that it will have to deal with, and may create possible conflicts of interests. For example, in some specific circumstances, the goals of guaranteeing financial stability in the banking sector might collide with the duty of enforcing conduct rules for banks acting as underwriters, if a sanction could represent a relevant reputational risk for the financial group<sup>4</sup>.

<sup>&</sup>lt;sup>2</sup> For the purposes of this report, "autonomous entity" means solely that the regulator has its own juridical personality, which is different, for example, from the Ministry that supervises its activities.

<sup>&</sup>lt;sup>3</sup> In the cases of CNV (Argentina), CVM (Brazil) and SMV (Peru), the financial institutions underwriting public offers and acting as administrators of investment funds, for example, would have these activities supervised by the mentioned capital markets regulators (while banking activities would typically be regulated by the respective central bank).

<sup>&</sup>lt;sup>4</sup> Another example would be if the enforcement of a tender offer rule might make the implementation of a merger or an acquisition that could solve the liquidity problem of a financial institution more difficult.

There are remedies, nevertheless, to reduce the difficulties that come with shared responsibilities for the regulation, supervision and enforcement of financial and corporate governance rules. The last column of Table 2.1 shows that most surveyed regulators have agreements, committees and laws that facilitate the cooperation among public authorities and self-regulatory organisations. Such cooperation has the main goals of avoiding regulatory arbitrage opportunities and unnecessary compliance costs by supervised entities (for example, Brazil and Peru have frameworks with this goal), and facilitating the exchange of information between institutions in order to make supervision and enforcement more effective.

In some cases, stock exchanges also have an important role in the enforcement of corporate governance rules for the companies that are listed on them, including not only the compliance with the listing rules but also with a corporate governance code enacted by a third party. The centrality of the stock exchanges, in any case, varies considerably. For example, stock exchanges share a key role with the public authority in Mexico and have their enforcement powers directly established by law, while in Argentina and Peru no self-regulatory organization currently has enforcement powers related to corporate governance rules.

**Table 2.1. Enforcement institutions** 

Country	Institution	Organization	Responsibilities	Cooperation
Argentina	National Securities Commission (CNV)	Autonomous entity <sup>1</sup>	Regulate and supervise all key participants of the securities markets, including disclosure requirements for the CG Code. In relation to listed companies, it has authority to oversee both disclosure requirements and other typical corporate law matters (e.g., breach of fiduciary duties).	Requiring exchanges' cooperation on enforcement is possible, but it is not currently used     Cooperation agreement with the Economic Crime and Money Laundering Prosecutors' Office
Brazil	Securities Commission (CVM)	Autonomous entity <sup>1</sup>	Regulate and supervise all key participants of the securities markets, including disclosure requirements for the CG Code. In relation to listed companies, it has authority to oversee both disclosure requirements and other typical corporate law matters.	Cooperation agreements with other financial supervisory authorities for the exchange of information     CVM also delegates the responsibility for imposing sanctions due to specific violations of regulations to trading venues
Chile	Financial Market Commission (CMF) <sup>2</sup>	Autonomous entity <sup>1</sup>	Regulate and supervise all key participants of the securities, insurance and banking markets. In relation to listed companies, it has authority to oversee both disclosure requirements and other typical corporate law matters.	The Financial Stability Council (CEF) has the goal of facilitating technical coordination and exchange of information among the Minister of Finance, CMF and the regulator of pension funds
Colombia	Financial Superintendence (SFC)	Autonomous entity <sup>1</sup>	Regulate and supervise listed companies, other key participants of the securities markets and financial institutions, including disclosure requirements for the CG Code	The Interinstitutional Committee coordinates the work between SFC and the Superintendence of Companies, which supervises nonlisted companies  MoU with the Colombia's Stock Market Self-regulator (AMV), which has some regulatory and supervisory powers over listed companies
Mexico	National Banking and Securities Commission (CNBV)	Autonomous entity <sup>1</sup>	Regulate and supervise listed companies, other key participants of the securities markets and financial institutions. In relation to listed companies, it has authority to oversee both disclosure requirements and other typical corporate law matters.	The Securities Market Law establishes what are the supervision responsibilities and powers of CNBV and the stock exchanges     The Securities Market Law  T

Country	Institution	ution Organization Responsibilities		Cooperation
	Stock Exchanges	Private entities	Supervise listing requirements and disclosure requirements for the CG Code	
Peru	Superintendence of Securities Market (SMV)	Autonomous entity <sup>1</sup>	Regulate and supervise all key participants of the securities markets, including disclosure requirements for the CG Code. In relation to listed companies, it has authority to oversee both disclosure requirements and other typical corporate law matters.	Cooperation agreement with the Superintendence of Banking, Insurance and Pension Funds for the exchange of information

Note 1: For the purposes of this table, "autonomous entity" means solely that the regulator has its own juridical personality (e.g., "autarquías" in Spanish), which is different, for example, from the Ministry that supervises its activities.

Note 2: In Chile, a new regulator for the financial market has been approved by Congress. The Financial Market Commission is an independent body governed by a board, in charge of regulating and supervising the securities, insurance and banking markets. This new regulator replaced the Superintendence of Securities and Insurance as of December 14, 2017.

Source: Surveyed regulators.

#### Available resources

It is imperative that supervisory and enforcement institutions be staffed with a sufficient number of employees who understand financial markets and have the necessary skills, values and experience. In order for that to be possible, it is advisable to have a fair and demanding selection processes, an adequate level and structure of remuneration, and ongoing training to keep the staff up-to-date with the techniques used by supervised individuals and institutions. All those features are, however, difficult to quantify and, therefore, to compare among jurisdictions and across time<sup>5</sup>. Even trends and comparisons in the number of staff and budget may not be easy to analyse, because regulators have different mandates and regulatory demands change over time according to transformations in the markets.

In the table below, it is possible to visualize the trends in the human resources of the six surveyed regulators since the last stock-taking analysis done by the OECD in 2009.

**Table 2.2. Trends in Human Resources** 

Country	Regulator	Staff (Mid-2019)	Change in Staff (2009-2019)	Enforcement Staff <sup>1</sup> (Mid-2019)	Change in Enforcement Staff <sup>1</sup> (2009- 2019)	Listed Companies <sup>2</sup> (Mid-2019)	Market Capitalization <sup>2</sup> (Mid-2019, in USD billion)
Argentina	National Securities Commission (CNV) <sup>5</sup>	350	84.2%	41	192.9%	95	49
Brazil	Securities Commission (CVM)	501	0.2%	29	-3.3%	330	1,083
Chile	Financial Market Commission (CMF)	652	N/A³	16	N/A <sup>3</sup>	286	234

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<sup>&</sup>lt;sup>5</sup> One form to evaluate and follow those more subjective features of regulators` human resources would be to survey supervised individuals and institutions on their impression on the skills and experience of the regulators` employees, what could be done in the future if there is enough interested from Task Force participants.

Country	Regulator	Staff (Mid-2019)	Change in Staff (2009-2019)	Enforcement Staff <sup>1</sup> (Mid-2019)	Change in Enforcement Staff <sup>1</sup> (2009- 2019)	Listed Companies <sup>2</sup> (Mid-2019)	Market Capitalization <sup>2</sup> (Mid-2019, in USD billion)
Colombia	Financial Superintendence (SFC)	989	35.1%	33	43.5%	68	119
Mexico	National Banking and Securities Commission (CNBV) <sup>4</sup>	1,451	15.4%	N/A	N/A	144	386
Peru	Superintendence of Securities Market (SMV)	261	83.8%	54	N/A	261	154

Note 1: The enforcement staff is composed by the group of employees solely dedicated to enforcement, but, in some cases, such as in CVM (Brazil), there are other employees that work as well with enforcement along with regulation and supervision.

Sources: Surveyed regulators and World Federation of Exchanges.

While CVM (Brazil) has had a stagnant number of employees in the last ten years, the other regulators in the region have experienced a significant increase in their staff since 2009 - of 15% in CNBV (Mexico). 35% in SFC (Colombia) and an impressive increase of 84% in both CNV (Argentina) and SMV (Peru)<sup>6</sup>. Since the number of listed companies has not changed much during the last decades in those five markets (actually, the number of listed companies was reduced in Argentina, Brazil and Colombia)<sup>7</sup>, mentioned increases might have indeed represented a boost in the capacity of mentioned regulators to supervise and enforce corporate governance related rules8.

Another trend that is possible to spot in Table 2.2 is that CNV (Argentina) and SFC (Colombia) are currently, in relative terms, investing more human resources in their enforcement activities than they used to do 10 years ago, while the allocation of staff to enforcement has stayed stable in CVM (Brazil). Specifically in CNV, where the allocation of staff to enforcement activities has increased the most, the change was from a 7% ratio in 2009 to 12% in 2019 (the ratio being, in this case, the number of personnel allocated to enforcement divided by total staff). This makes CNV, together with SMV in Peru (21% of staff focused on enforcement activities), the two regulators in the region with the greatest proportional investment of human resources exclusively to enforcement activities9.

Note 2: Information on the size of markets is based on the number of companies listed in the respective jurisdictions, including non-domestic companies.

Note 3: CMF (Chile) has recently had its mandate enlarged, and that is why it is not possible to compare its current staff with the one it had in 2009.

Note 4: In the case of CNBV (Mexico), the number of staff is as of December, 2018, and there are no numbers for 2009.

Note 5: In 2012, CNV (Argentina) had its enforcement powers expanded. Since then, the securities regulator has been supervising the compliance with rules that were previously enforced by the stock exchanges.

<sup>&</sup>lt;sup>6</sup> In the case of Peru, the recent increase in staff was mostly through fixed-term employment contracts.

<sup>&</sup>lt;sup>7</sup> As presented in the report Equity Market Development in Latin America: enhancing access to corporate finance, which was discussed in the Latin American Corporate Governance Roundtable Task Force on Equity Market Development meeting in Buenos Aires in 2018.

<sup>&</sup>lt;sup>8</sup> For a better picture, of course, it would be necessary to evaluate how other supervised markets evolved and if there were any new rules that demanded more activities from the regulators. For instance, this has been the case for CNV (Argentina), which, since 2012, has been responsible for the supervision of provisions that were previously enforced by the stock exchanges. Moreover, it is important to note that the 10-year positive trend does not mean that mentioned regulators have currently a sufficient number of employees, which is beyond the scope of this survey to evaluate.

<sup>&</sup>lt;sup>9</sup> It should be taken into account that differences in mentioned ratio reflect, as well, idiosyncrasies in the regulators` internal structure. For example, in CVM (Brazil), there are employees that work almost exclusively with enforcement but are not allocated to the body whose sole activity is to enforce capital markets rules.

A comparison of the regulators` human resources, as suggested above, is especially difficult because, among other reasons, mandates of public authorities and the sizes of markets vary meaningfully<sup>10</sup>. That is why the only somewhat meaningful comparison between the six surveyed regulators would probably be one that includes Argentina, Brazil and Peru, which all have regulators with relatively similar mandates focused on the securities markets. The ratio of employees per listed company would be, respectively, 3.7, 1.5 and 1.0, and the ratio of employees per billion of US dollars in market capitalization would be 7.1, 0.5 and 1.7. In this comparison, Argentina seems to be the regulator with relatively more human resources, but it would be beyond the scope of this report to reach any conclusion on whether any of the three regulators are adequately staffed.

In the table below, it is possible to visualize the trends in the financial resources of the six surveyed regulators since the last stock-taking analysis done by the OECD in 2009.

Table 2.3. Trends in financial resources

Country	Regulator	Budget in 2019 (USD million)	Change in Budget (2017-2019) <sup>1</sup>	Change in Budget (2008-2019) <sup>1</sup>
Argentina	National Securities Commission (CNV)	11	9.6%	N/A
Brazil	Securities Commission (CVM) <sup>2</sup>	121	12.3%	44%
Chile	Financial Market Commission (CMF) <sup>3</sup>	43	N/A	N/A
Colombia	Financial Superintendence (SFC)	66	5.8%	15%
Mexico	National Banking and Securities Commission (CNBV)	65	-4.2%	-28%
Peru	Superintendence of Securities Market (SMV)	24	14.6%	N/A

Note 1: Budgetary increase was calculated by adjusting budget in local currency for inflation and then calculating increase. There is no information on the change of budget of CNV (Argentina) and SMV (Peru) from 2008 to 2019 because the IMF did not publish consumer price indexes for those countries during that period.

Note 2: CVM's (Brazil) budget used for the analysis is the one authorised by the central government, which has the power to reduce the budget available during the year. Likewise, public bodies in Brazil have very limited capacity to dismiss public servants and, therefore, the bulk of their budget is often non-discretionary (i.e., it is for paying salaries and cannot be reallocated to investments).

Note 3: CMF (Chile) had its mandate significantly enlarged during the last decade with the merger of different regulatory institutions, and that is why it is not possible to compare its current budget with the ones it had in 2017 and 2008.

Source: Surveyed regulators, who also made the conversions into USD, and IMF for average consumer prices.

The trend in the financial resources available to surveyed regulators has been positive. With the sole exception of Mexico, which has experienced a small reduction in its budget in the last two years, all other regulators – for which there are available information – have had increases in their budgets in the short and long-term. It is not possible to conclude that those authorities have enough financial resources to accomplish their mandates within the scope of this survey, but it is an auspicious sign to discern a positive trend in their budgets in a context in which many governments in the region have been facing fiscal challenges in the last few years.

Any comparison between countries, as discussed in relation to human resources, is controversial, but, repeating the same comparison done above between Argentina, Brazil and Peru, which have regulators with relatively similar mandates, the ratio of budget in 2019 (millions USD) per number of listed companies would be, respectively, 0.12, 0.37 and 0.09, and the ratio of budget in 2019 (millions USD) per billion of

<sup>&</sup>lt;sup>10</sup> It would be possible to compare all the six surveyed regulators if more specific data were compiled on the exact number of employees allocated to supervision and enforcement of listed companies in each institution.

US dollars in market capitalization would be 0.22, 0.11 and 0.16<sup>11</sup>. In this comparison, Argentina seems to have somewhat more financial resources than Peru if one takes into account the size of their respective markets, but a comparison with Brazil is less informative because the average marked value of companies listed in the country is much higher than in its two mentioned neighbours (in other words, CVM's budget seems high if one considers the number of listed companies, but relatively low if the ratio's denominator is the market value of those companies).

#### Independence

As put forward in the G20/OECD Principles, "supervisory, regulatory and enforcement authorities should have the authority, integrity and resources to fulfil their duties in a professional and objective manner". In other words, capital markets regulators should have the structure and instruments to serve the public interest, and not a particular electoral or economic interest.

One typical concern is that the central government might pressure the capital markets regulator to reach a decision that benefits the executive power in the short-term, when a specific issue attracts attention from the media or if a ruling from the regulator might harm financially the executive power. This might be the case, for example, if the regulator might enforce a rule against the interests of the senior leadership of a listed SOE.

Many countries have addressed the issue of independence of the capital markets regulator from the shortterm interests of the central government through the creation of a formal governing body whose members are given fixed terms of appointment. Additional usual forms to reinforce the autonomy of such members have been, in many different countries, to make the appointments staggered and independent from the political calendar (so that a new government cannot completely change the board immediately after it assumes power); to prohibit re-appointments (to minimize the influence of a government to link reappointments to support of their positions on issues); and to require the approval of new appointees by the Parliament (in order to provide for greater authority of the board members to exercise their power).

A governing board that is formally independent from the central government, nevertheless, might encounter some difficulties to make decisions that run up against the short-term interests of the executive power if the central government controls their budget. After all, the effective independence of a formally autonomous high-level decision-making body would be seriously diminished if the central government could significantly reduce the capacity of the regulator to pay its employees and fund enforcement activities. That is why, along with an independent governing body, it is considered a good practice to guarantee that the capital markets regulator could fund its activities without the constant intervention from the central government.

Finally, it is important to observe that independence from the central government is insufficient if the capital markets regulator is biased in favour of some groups of interest that hinder its capacity to serve the public interest. While some other strategies have been tried, probably the most common one is to establish a cooling-off period during which the former public servant cannot provide services for the individuals and entities that she or he used to supervise while in public office. The goal of this rule is to postpone any private benefit that the public official might expect to receive for a decision that she or he is about to make for such a long period of time that the benefit becomes small at its present value.

In the Table 2.4, it is possible to visualize that most surveyed regulators (Argentina, Brazil, Chile and Peru) have boards with fixed terms, while SFC (Colombia) does not have a board, but its most senior official has

<sup>&</sup>lt;sup>11</sup> Both ratios are used, including the one based on the market capitalization, on the assumption that a bigger company will likely also have more shareholders and present greater risks for the economy as a whole, demanding, therefore, more supervisory and enforcement resources from the regulator.

a fixed term. Nevertheless, only in Brazil and Peru reappointment of the senior leadership is prohibited, and just in Brazil and Chile the appointees must be approved by the Parliament as well. In relation to those two features, therefore, there seems to be opportunities for improvement in the region.

In relation to the cooling-off period, there are wide variations in the amount of time that regulators and former senior officials are prohibited from providing services for supervised individuals and entities. In the jurisdictions that currently have such rules (Argentina, Brazil, Chile, Mexico and Peru), the cooling-off periods vary from 3 months to 10 years. While there might not be a clear answer for that issue, it would be an interesting topic of discussion to evaluate whether those extremes in the range of cooling-off periods would be adequate in each context. For example, a cooling-off period that is too short may not be able to effectively reduce the negative incentives that come with the "revolving doors" between the public and private sectors, but a period that is too long might make it virtually impossible for a well-qualified professional from the private sector to serve in a regulator's board.

Table 2.4. Terms of office and appointment of the ruling body

Country	Regulator	Ruling body in charge of corporate governance	Term of member s (in years)  Fixed/n ot fixed	Re- appointme nt Allowed/no t allowed	Appointmen ts are staggered	Appointme nt by:	Approval by Parliament Required/n ot required	Coolin g-off period <sup>1</sup>
Argentin a	National Securities Commission (CNV)	Board of Directors	5	Allowed	No	National Executive Power	Not required	24 months <sup>7</sup>
Brazil	Securities Commission (CVM)	Board of Commissioners	5	Not allowed	Yes	President	Required	6 months <sup>5</sup>
Chile	Financial Market Commission (CMF)	The Board	4-62	Allowed	Yes	President	Required	3-6 months <sup>3</sup>
Colombi a	Financial Superintenden ce (SFC)	Superintendent	4	Allowed	-	President	Not required	-
Mexico	National Banking and Securities Commission (CNBV)	Governing Board	Not fixed	Allowed	-	Ministry of Finance, Central Bank, etc.	Not required	10 years <sup>4</sup>
Peru	Superintenden ce of Securities Market (SMV)	Superintendent/Boa rd of Directors	6	Not allowed	No	Ministry of Finance, Central Bank, etc.	Not required	12 months <sup>6</sup>

*Note 1*: The "cooling-off period", for the ends of this table, is the time during which the former board member cannot provide services for the individuals and entities that she or he used to supervise while in public office.

Note 2: In Chile, the Chair is appointed for the same term as the President of the Republic (4 years); the commissioners are appointed by the President and ratified by the Senate, holding office for 6 years and are replaced in pairs every three years, as applicable.

Note 3: In Chile, Board members and first line directors have a generic cooling-off period of three months. In this period, they are not allowed to provide paid or unpaid services or acquire ownership of any supervised entities, or of those companies that are part of the same business group. There is a longer period of 6 months for Board members or any other CMF employee who, within twelve months prior to the termination of their duties, have participated directly in any administrative decision regarding the entities subject to the cooling off period. Finally, Board members and other CMFs first line directors are not allowed to develop any lobby activity in favour of entities supervised by CMF for a period of two years from the date of termination of their duties.

Note 4: In Mexico, the 10-years cooling-off period was stablished in November 2019 for all senior public servants at the federal government, and not only CNBV's governing board.

Note 5: In Brazil, the cooling-off period applies not only to commissioners, but also to senior employees (directors and the general superintendent). The Brazilian Institute of Corporate Governance advocates for an extension of the cooling-off period to 12 months (Corporativa, 2018<sub>(41)</sub>).

Note 6: In Peru, the cooling-off period applies not only to commissioners, but also to any employee who, due to the nature of his or her function, has accessed confidential information, or whose opinion has been decisive in any regulatory or enforcement decision.

Note 7: In Argentina, the 24 months cooling-off period applies only to commissioners, and not to CNV's employees.

Source: Surveyed regulators.

In Table 2.5, it is possible to discern that some surveyed regulators collect fees from supervised individuals and entities, which could potentially increase their budgetary independence from the central government 12. Nevertheless, all surveyed regulators must have their budget approved by the executive power and the legislature, making them, to a smaller or greater extent, vulnerable to the short-term political agenda. Likewise, in some countries (e.g., in Brazil), the hiring process of public servants depends on a specific approval by the central government, further limiting the regulator's autonomy to invest more in human resources even when the approved budget would allow it. In that context, an interesting issue to be debated is how feasible it would be for regulators in the region to gain greater budgetary and managerial autonomy, and what would be the second-best solutions to guarantee that their activities are preserved in the case of a backlash from central government.

Table 2.5. Flexibility to spend

Country	Regulator	Ma	ain funding resour	Budget approval by		
		National budget (NB)	Fines from wrongdoers	Fees from regulated entities	Government	Legislature
Argentina	National Securities Commission (CNV)	•	-	•	Required	Required
Brazil	Securities Commission (CVM)	•	-	-	Required	Required
Chile	Financial Market Commission (CMF)	•	-	•	Required	Required
Colombia	Financial Superintendence (SFC)	-	•	•	Required	Required
Mexico	National Banking and Securities Commission (CNBV)	•	-	-	Required	Required
Peru	Superintendence of Securities Market (SMV)	-	-	•	Required	Required

Note: In Brazil, the CVM does collect fees and monetary fines from regulated entities, but they are transferred to the Federal Government. CVM's funding comes from Federal Government in accordance with the approved budget. Source: Surveyed regulators.

<sup>&</sup>lt;sup>12</sup> A related discussion would be whether it would be optimal for regulators to finance their activities not only through fee collections, but also with fines. In the case of fines, certain restrictions or safeguards on the use of such funds would be necessary to minimize the potential conflict of interest for regulators to impose inordinately high fines in order to benefit from them.

#### Power to enforce and existing procedures

#### Theoretical framework

As the classic work of (Becker,  $1968_{[5]}$ ) teaches us, public and private policies to combat illegal behaviour depend on many factors, such as the following: (i) expenditures on supervision and enforcement activities, which help to determine the chance that an irregularity is discovered; (ii) the importance of the sanction, such as the value of the fine and for how long someone is restricted from serving as a senior executive; (iii) the damage caused by the illegal action; and (iv) the benefit received by the wrongdoer as a result of the illegal activity. The relationship between all those factors is complex because, among other reasons, involved agents might not be completely rational, and information on expected probabilities and benefits are not easily available. Nevertheless, it is interesting to observe some intuitive relationships between the mentioned factors.

Clearly, the higher the probability of an individual being caught for an illegal behaviour, the less likely he or she will do anything illegal. The probability of a public authority discovering illegal acts is of course related to the available funding for enforcement activities, but the chances will also be affected by the powers the authority has to investigate (the broader its capacity to collect evidence, the easier to eventually argue a case in court) and the quality of complaints that it receives from third parties (for example, complaints from the parties affected by the alleged illegal activity).

The significance of the sanction is also central for the deterrence of illegal behaviour, because, assuming a rational individual who wants to maximize his or her well-being, he or she will not behave illegally if the expected benefit is smaller than the probability of being caught times the expected punishment. In the context of capital markets enforcement, for example, it might mean that the only way of deterring insider trading (which is typically difficult to discover and punish) would be to establish a relatively high sanction for such an offence.

Likewise, it is important to take into account the damage caused by the offences investigated and sanctioned from two perspectives. First, the deterrence benefit of sanctioning illegal behaviour with trivial damage might not justify the costs incurred by the public authority in supervising and enforcing the rules (even more in the context of fiscal constraints that many regulators experience, where the opportunity cost of not investigating other activities could be high). Second, there should be some proportionality between the size of the damage and the importance of the sanction, so that the deterrence effect previously explained exists in practice.

Finally, an effective enforcement system should not forgo a fair treatment to investigated individuals and entities, for at least two very objective reasons. First, unfair or disproportionate sanctioning creates a disincentive for law abiding individuals to participate in the market (for example, a well-qualified and reputable professional might avoid becoming a director of a listed company if there is a perception that the chances of being unfairly sanctioned are high). Second, an enforcement process that is transparent and robust has not only a deterrence goal, but it also serves to orientate how the laws and regulations should be implemented by the market participants.

#### Existent framework

All surveyed regulators investigate and sanction a broad range of offences related to corporate governance, such as the breach of senior executives` and directors' fiduciary duties, disclosure deficiencies, insider trading, abuse of voting rights, abuse of controlling power, irregular public offers, and market manipulation. The sanctions are applied, in a relatively homogeneous way across surveyed jurisdictions, mainly against external auditors, senior executives, directors, controlling shareholders of listed companies and listed companies themselves, and, in less frequent cases, to listed companies` employees and other non-registered persons.

There are no evident gaps in the offences investigated and punished in the surveyed jurisdictions, nor in the universe of people that might be sanctioned. Some related questions that might be of interest, in any case, would be the following:

- whenever there is a related parties' transaction that seems to be adverse for a listed company, whether it would be more effective to pursue an investigation on the breach of senior executives` fiduciary duties who directly made the decision, or on the abuse of controlling power that might have ordered the deal to be closed: and
- if it would be effective to sanction listed companies, and not directly their senior leadership or shareholders, in order to deter disclosure deficiencies.

It is beyond the scope of this survey to evaluate whether surveyed jurisdictions have procedures to sanction that comply with best practices worldwide, but, overall, the answers to the questionnaire by the regulators were reassuring in that they guarantee the possibility to the investigated parties to analyse all the collected evidence and make a final defence before the body with the power to sanction makes a decision, which must be well-explained and based on the collected evidence<sup>13</sup>. Moreover, in some surveyed jurisdictions (Brazil, Chile and Peru), the unit that investigates the apparent irregularity is different from the body that judges in the first instance whether there was effectively an offence, which might be expected to contribute to a more impartial decision on sanctioning.

One issue open to debate regarding due process is on the evidentiary standard necessary for a sanction followed by authorities with power to impose administrative sanctions, such as capital markets regulators. This standard could be identical to the one typically adopted in criminal courts ("beyond a reasonable doubt") or a less strict one ("clear and convincing evidence")14. The advantage of the former standard is that it reduces to a minimum the probability of an unfair sanction, while, on the other side of the coin, the less strict standard increases the probability of a wrongdoer being sanctioned (and, therefore, as discussed before, the chances of the offence to occur would be smaller). This alternative is also related to the broader question of why regulatory agencies have, after all, the power to impose sanctions, instead of the State concentrating all its power to punish in the Judiciary. If one agrees that the agility of regulatory agencies in enforcing laws and regulations is a boon, a possible conclusion would be that the evidentiary standard necessary for an administrative sanction should be less strict than the standard used in criminal courts<sup>15</sup>.

In relation to how investigations are initiated, surveyed jurisdictions seem to have similar triggers: (i) complaints from investors and supervised entities, and (ii) reports from the supervisory units within the regulators. On the second trigger to sanctioning procedures, it is interesting to highlight the case of CVM (Brazil), where a Risk Based Supervision plan is adopted by the regulator in order to prioritise which events and activities will be supervised more closely according to the risk that they pose to the market as a whole. On the one hand, such a plan could increase the productivity of the regulator by allocating its staff to the supervision of activities that present the greatest potential for damage, but, on the other hand, it might deviate resources from the investigation of received complaints.

An issue related to the paragraph above that was not included in the questionnaire but that could be explored in further research is how public and private enforcement can complement each other. For example, in

<sup>&</sup>lt;sup>13</sup> Only CNBV (Mexico) did not respond to the questions on the process for imposing sanctions because it is an issue classified as confidential by the government, which might raise some concerns for the investigated parties as well, potentially impeding their ability to fully understand the instruments that they may use to defend themselves.

<sup>&</sup>lt;sup>14</sup> Among surveyed regulators, for example, CMF (Chile) reported that its sanctioning body follows a "preponderance of evidence" standard, while SFC's (Colombia) standard is "beyond a reasonable doubt".

<sup>&</sup>lt;sup>15</sup> However, one should also evaluate the relationship between the regulators and the courts. If the courts fully defer to the regulator's assessment of the alleged wrong-doing, the regulator's decision might be determinant to a court's ruling in relation to a wrong-doing that could be considered a criminal offense.

jurisdictions where institutional investors are relevant players, the securities regulator might invest less resources enforcing disclosure rules – because major investors will likely make sure that necessary information is being disclosed without the intervention of the government – and focus more on investigating the use of privileged information and market manipulation, which are hardly ever privately enforced<sup>16</sup>.

Surveyed regulators also have relatively broad powers to investigate, such as to request documents or information, to conduct inspections on the premises of supervised entities and to issue summons to witness. CMF (Chile) and SMV (Peru), for example, have recently had their powers to investigate enlarged to include, respectively, the capacity to require information on financial operations protected by banking secrecy, and to request documents related to the review of financial statements by external auditors. Likewise, an additional instrument to investigate that was recently made available to CVM (Brazil) and CMF (Chile) is the leniency agreement, in which the regulator agrees to reduce the sanction to be applied to an entity or an individual who has practiced illicit acts in exchange for cooperation with the investigation (mainly in the form of evidence to prove that others practiced related illicit acts)<sup>17</sup>.

Regulators that took part in the survey, to a smaller or greater extent, have diverse types of sanctions that they might impose, such as reprimands, fines, disqualification to be a senior executive in a supervised entity, cancelation of registration, and prohibition to develop certain activities. In Brazil, a new genre of sanction made recently available to the regulator (CVM) is to prohibit entities from entering into contracts with state-owned financial institutions and from participating in bids with the public administration for up to five years, which could be a potentially severe sanction, for example, to infrastructure companies that constantly bid for new concession contracts and search for funding from state-owned development banks. A question that was not included in the survey, but that would be interesting for the six Latin American regulators, is how to choose between such different types of sanctions and to define a proportional punishment in each case.

Finally, in Table 2.6 below, it is possible to compare the statutory limits for fines in each jurisdiction, and what were effectively the highest fines imposed in the last three years.

Table 2.6. Limits to fine

Country	Regulator	Highest possible fine	Highest fine imposed in thousands USD (2016-2018)
Argentina	National Securities Commission (CNV)	The greatest of: (i) 2.6 million USD; (ii) 5x the irregular economic advantage or the damage	39
Brazil	Securities Commission (CVM)	The greatest of: (i) 12 million USD; (ii) 2x the irregular transaction; (iii) 3x the irregular economic advantage; (iv) 2x the damage	9,200
Chile	Financial Market Commission (CMF)	The greatest of: (i) 0.6 million USD; (ii) 30% of the irregular transaction'(iii) 2x the irregular economic advantage	1,200
Colombia	Financial Superintendence (SFC)	0.07 million USD for individuals     0.3 million USD for entities	53
Mexico	National Banking and Securities Commission (CNBV)	0.6 million USD for misconducts related to the corporate governance of listed companies	498
Peru	Superintendence of Securities Market (SMV)	0.87 million USD	234

Source: Surveyed regulators.

<sup>16</sup> Market manipulation and the use of insider information offences usually demand investigation powers and investments in supervision that would be out of reach for institutional investors.

<sup>&</sup>lt;sup>17</sup> In some leniency agreements, there is also the obligation for the entity or individual to assume a commitment to change practices and to mitigate the damages that have already materialized.

Among the surveyed regulators, CNV (Argentina) and CVM (Brazil) are the ones with the highest ceilings on fines. Also interesting to note is that Argentina, Brazil and Chile have created limits to fines that are flexible according to the size of the damage to the market or the economic advantage to the wrongdoer, which guarantees that fines would be proportional in the case a major illicit activity is discovered. In any case, the fact that Colombia, Mexico and Peru have fixed limits to fines does not appear to have been an issue in the last three years because the highest fines imposed during this period in mentioned countries were below the statutory caps.

#### **Enforcement track**

As mentioned in relation to other aspects analysed before, it is not possible to reach qualitative comparative conclusions for the different jurisdictions, because each regulator and market have their own distinct features, but there are some interesting facts worth highlighting to serve as the basis for discussion. In Table 2.7 below, the recent enforcement track of surveyed regulators is summarized<sup>18</sup>.

**Table 2.7. Regulators enforcement track** 

Country	Regulator	Avg. duration of the process in months <sup>1</sup>	Avg. n. of fines imposed per year (2007- 2008)	Avg. n. of fines imposed per year (2016- 2018)	N. of fines imposed (2018)	Avg. n. of fines imposed (2016- 2018) per n. of listed companies (2019)	Avg. USD of fines imposed per year (2007- 2008)	Avg. USD of fines imposed per year (2016- 2018)	Avg. USD of fines collected per year (2016- 2018) <sup>2</sup>	Avg. USD of fines imposed (2016- 2018) per market cap. Mil.
Argentina	CNV	81.5	4.5	7.3	16	0.08	192 870	77 102	59 071	1.57
Brazil	CVM	42.8	104	187.3	266	0.57	104 000 000	20 580 767	6 098 014	19.00
Chile <sup>3</sup>	CMF	18.0	134	46.7	56	0.16	1 640 000	1 315 733	N/A	5.62
Colombia <sup>4</sup>	SFC	15.0	N/A	7.3	4	0.11	N/A	185 030	183 070	1.55
Mexico <sup>5</sup>	CNBV	N/A	N/A	1 457	1 304	10.12	N/A	18 156 542	8 632 577	47.04
Peru <sup>6</sup>	SMV	5.0	65	36.3	53	0.14	N/A	702 667	702 667	4.45

Note 1: The "average duration of the process" includes both the period of the investigation and the judgement.

Note 2: The "fines collected" are those received by the regulator in the mentioned period, regardless if they were imposed in the same period or previously (CNBV is the exception in this case: the value of fines collected in this table refers only to the fines that were imposed in the same period).

Note 3: For this table, CMF included information related to securities and insurance markets enforcement activities.

Note 4: For this table, SFC included only information related to corporate governance and financial conduct enforcement activities.

Note 5: The sanctioning information on CNBV is related to all markets it supervises.

Note 6: SMV included information on the number of fines related only to issuers, but data on the dollar amount of fines is related to fines imposed to issuers and other securities markets participants.

Source: Surveyed regulators, who also made the conversions into USD.

The information on the average value of imposed fines is subject to potential misinterpretation, because there are a few substantial fines that distort the annual value (for example, this was the case in Brazil in 2008). It is therefore more illuminating to observe trends in the number of fines applied each year. When analysing the number of fines, it is possible to conclude that CNV (Argentina) and CVM (Brazil) have increased their enforcement activities both in the short (2016 to 2018) and long-terms (2007 to 2018). In

<sup>&</sup>lt;sup>18</sup> The choice of focusing on the number and value of fines when analysing the enforcement track is due to the fact that it is much easier to compare fines between different jurisdictions than sanctions with other natures (e.g., reprimands and suspensions), and that the survey published in 2009 (of which the current one is a follow-up) has specific data on fines to which to compare.

the case of CNV, the average number of imposed fines per year in the period from 2016 to 2018 increased by 63% over the average in the period from 2007 to 2008. In the case of CVM, the increase was of 80%.

In the case of CMF (Chile) and SMV (Peru), there has been a short-term increase in their fining activities (the number of fines imposed in 2018 is greater than the average of the previous two years), but the long-term trend is a reduction in the number of fines. Comparing the averages in the periods of 2016-2018 and 2007-2008, there were reductions of 65% and 44% respectively.

The reasons behind the trends in the number of imposed fines might be multiple, and would be an interesting topic of discussion. For example, in the cases of Chile and Peru, regulators might have chosen to focus more on the orientation of market participants and the education of retail investors than on the enforcement of rules. In the cases of Argentina and Brazil, in addition to a change in focus, the regulators might have become more productive or, simply, the number of complaints may have surged in the context of the economic crises that both countries have gone through.

In relation to the recent activities of the surveyed regulators, CVM (Brazil) scores high both in absolute and relative terms among surveyed securities regulators<sup>19</sup> (a ratio of 0.57 if one divides the average number of fines imposed from 2016 to 2018 per the number of listed companies in mid-2019; and a ratio of 19 if one divides the average dollars of fines imposed from 2016 to 2018 per the market capitalization in millions of dollars in mid-2019). If one compares only the three surveyed regulators focused on the securities markets, in second place comes SMV (Peru: ratios of 0.14 and 4.5) and, in third CNV (Argentina: ratios of 0.08 and 1.6). While it is difficult to compare with the others due to its differing mandate, CNBV (Mexico) also has a relatively large sanctioning activity, as shown in Table 2.7, covering all the financial markets that it supervises (securities, banking and others).

A greater number of fines, by itself, is not necessarily positive for the development of the equities markets, but for regulators with an enforcement track record much below the average, it would be useful to understand the reasons behind such differences. An efficient supervision that enables them to detect arising issues and therefore prevent some potential breaches could be one explanation, but, in a cohort of relatively similar jurisdictions, it would be hard to imagine that this factor alone would explain huge differences.

Moreover, two aspects that might impact the credibility of regulators and market participants' perceptions on the effectiveness of enforcement are the time that the sanctioning process takes (from the occurrence of the investigated activity until the actual judgement), and how much the government can effectively collect as a share of the total of fines imposed. As it is easy to spot in Table 2.7, CNV's (Argentina) and CVM's (Brazil) enforcing processes take on average considerably longer than in the other surveyed regulators, which, in the case of CVM, might be explained, at least partially, by the relatively high number of sanctions imposed<sup>20</sup>.

In relation to the effective collection of imposed fines, CVM (Brazil) is the jurisdiction that is furthest below the average, with only 30% of fines collected in the period from 2016 until 2018 in comparison to the amount of fines imposed in the same period. In the case of CNV, which had the second smallest proportion<sup>21</sup>, it was a much bigger 77%. Part of the mentioned mismatch might be due to features other

<sup>&</sup>lt;sup>19</sup> Excluding CNBV (Mexico) from the comparison for a lack of specific information on its enforcing activity related to securities markets.

<sup>&</sup>lt;sup>20</sup> In CNV (Argentina), the average time of the enforcing processes was reduced significantly in the last few years: it was 88 months on average in 2016 and 81.5 months in 2018.

<sup>&</sup>lt;sup>21</sup> Excluding CNBV from the comparison because there is no comparable data to the other jurisdictions as mentioned in Note 2 to Table 2.7.

than CVM's efficacy in collecting the fines<sup>22</sup>, but the difference in collection rates certainly attracts attention, and it could be an interesting exercise for the mentioned regulator to (i) evaluate a more frequent use of other types of sanctions (e.g., disqualification or cancelation of the registration) when the sanctioned individual or entity clearly cannot afford the fine or (ii) streamline its efforts in the judiciary to collect the fines.

Finally, in Table 2.8 below, it is possible to observe the role that self-regulatory organisations have been playing in the enforcement of capital markets rules within the surveyed jurisdictions. Three features are probably worth emphasizing: (i) the Brazilian self-regulator (the stock exchange, B3) is, similarly to the public authority (CVM), the most active in enforcing capital markets rules in the region (and has been recently many times more active than a decade ago); (ii) Colombia's self-regulator somewhat compensates for the relatively small activity in the public enforcement of capital markets rules; (iii) during the last decade, stock exchanges in Argentina and Peru have lost their powers to impose sanctions.

**Table 2.8. Self-regulators enforcement track** 

Country	SRO	Role	Types of sanctions	Avg. n. of sanctions imposed per year (2016-2018)	Avg. n. of sanctions imposed per year (2006-2008)
Argentina	_1	-	-	-	10
Brazil	B3 (stock exchange)	Enforcement of listing rules applied to issuers and their controlling shareholders	Reprimands, fines, delisting, suspension of trading	521	11
Chile	Stock exchanges	Listed companies and broker dealers	Fines, suspension of trading and expulsion	N/A	N/A
Colombia	AMV (Stock Market Self-regulator)	Regulatory and supervisory power over listed companies and financial intermediaries	Reprimands, fines, expulsion, suspension of trading	21	392
Mexico	Stock exchanges	Supervision of listing requirements and compliance with a CG code	N/A	31	N/A
Peru <sup>3</sup>	-	-	-	-	-

Note 1: Since 2012, stock exchanges in Argentina do not have any longer – according to existing regulation – self-regulatory powers to sanction market participants.

Source: Surveyed regulators.

#### **Digitalisation of supervision**

Much has been recently discussed on the potential impact that the use of new information technology, such as machine learning and artificial intelligence, might have for financial markets and their regulators

Note 2: The numbers for the period from 2006 until 2008 include sanctions imposed by the stock exchange directly, before AMV took over its self-regulatory functions in July, 2006.

Note 3: Since 2009, the Bolsa de Valores de Lima no longer acts as a self-regulatory organisation.

<sup>&</sup>lt;sup>22</sup> For example, it might be because solvent investigated parties have the resources to enter into settlement agreements with CVM (which apparently are less common in other surveyed jurisdictions), avoiding sanctions and, therefore, reducing the number of sanctioned market participants who would have assets to pay for the fine.

(Arner et al., 2017<sub>[6]</sub>). According to an article in The Economist ((n.a.), 2019<sub>[7]</sub>), the equity assets under management by passive funds (i.e., managed by robots) in the US surpassed this year how much is handled by humans, and those passive funds have been using increasingly sophisticated strategies. In relation to the effective use of information technologies by capital markets regulators, there are fewer studies, and this survey tries to fill some of this gap in the Latin American region.

One important aspect to notice is that not only big data techniques such as machine learning and artificial intelligence have the potential to help capital markets regulators fulfil their mandates. For example, the use of software to better manage internal processes (eliminating the use of printed documents) and basic statistical checks set up by humans (using a relatively simple spreadsheet, for instance) could already have a great impact on the productivity of the regulators staff.

The six surveyed regulators currently use digital platforms that facilitate the disclosure of required documents by supervised market participants – and that check the timeliness of disclosure – and/or have a software to better manage internal processes. These would constitute the most basic implementation of information technology in the context of capital markets regulation (reducing mainly the work that would be otherwise done by employees without a college education), but, since they are nonetheless potentially relevant, it is salutary to see a pervasive use of mentioned technologies.

At a second level in terms of sophistication, CVM (Brazil), CMF (Chile), SFC (Colombia) and SMV (Peru) reported that they use statistical checks of transactions in public securities markets (for example, trading spikes in advance of a major corporate event), software to facilitate the analysis of big data sets (for example, cleaning and summarising data), and/or autonomous monitoring of publicly available information through manually established rules (for example, key-word surveillance and coherence checks of financial reports). In all those cases, regulators' employees maintain the central role of programming how the data will be analysed and what should be looked for, but information technology becomes an instrument for the supervision and enforcing activities themselves, and not merely a way to simplify ordinary tasks. The use of mentioned technologies has a considerable potential to increase college-educated work-force productivity, and, in many cases, business intelligence software can be used by employees without background in computer science or statistics.

None of the surveyed regulators currently use machine learning and artificial intelligence filters to continuously monitor the capital markets and to look forward to identify problems in advance rather than simply considering enforcement actions after the fact<sup>23</sup>. This would be the apex among the existing information technologies for financial regulation, and would augment not simply the productivity of supervision and enforcement staff, but would also probably allow regulators to comprehend risks in nontraditional markets that are less well understood, such as crowd investing. With the help of mentioned technologies, it is the "machine" that proposes how the data will be analysed and what should be looked for, and the humans take a back-seat, choosing which data-sets should be considered by the software and making the final decision on whether the conclusions provided by it are useful from an economic and a legal perspective. The jury is still out on how useful mentioned technologies could be for capital markets regulators, but it is evident that, at this stage, the investment in training<sup>24</sup> would still be high for those regulators, even more so because some of those institutions have been historically composed of lawyers and economists without necessarily a strong background in data analysis.

All surveyed regulators declared that they have increased the use of technological solutions in the last few years. When asked about the main reasons for such an increase, in order of relevance, they answered, as an aggregate and with equal weights for each, that the most important reason was to augment the ability to supervise new activities outside traditional public securities markets (specifically, it was the most

<sup>&</sup>lt;sup>23</sup> CVM (Brazil) and SFC (Colombia) mentioned that they are currently developing this capacity.

<sup>&</sup>lt;sup>24</sup> Alternatively, the regulators could speed up the process of adopting the state-of-art techniques by outsourcing the data analysis to third-parties, but this alternative would not necessarily be less expensive.

relevant reason for Chile and Mexico), followed closely by the objective of increasing the work-force productivity (most important explanation for Brazil, Colombia and Peru). In third place overall, but the main reason for CNV (Argentina) to increase the use of technological solutions, was the pressure from supervised market participants to have access to easier-to-use digital platforms. The reason for this third place overall might be that the immediate benefits for supervised market participants are felt by the adoption of relatively basic technologies that digitalise paper-based processes, which have already been largely adopted by the surveyed regulators.

The lack of financial resources for the acquisition of software licenses and staff training was the main challenge indicated by CNV (Argentina), CVM (Brazil), CMF (Chile) and SMV (Peru) to increase the use of technological solutions in the future. The second most relevant challenge in aggregate and the most important one for SFC (Colombia) and CNBV (Mexico) was the quantity and quality of the available data. Lastly, with different degrees of importance, other highlighted challenges were (i) the fact that administrative rules sometimes might not allow institutions to hire staff or service providers well qualified in information technology and data analysis (for example, in the case of public procurement, if the rules favour the criteria of the better price over the quality of the service provider) and (ii) that key stakeholders may not be aware of the opportunities presented by machine learning, artificial intelligence and other new technological solutions to improve the enforcement of capital markets regulation (for example, it might be difficult to guarantee an increase in funding for the regulator to invest more in new information technologies if the senior officials in the Ministry of Finance are not convinced of the importance of that investment).

In relation to the two main challenges for the surveyed regulators, while it is apparent that the adoption of state-of-art information technologies will probably depend on the increase of the budget currently available for the surveyed regulators (or, at least, a significant reallocation of available funding), it is interesting to observe that some regulators have already realized that the amount and quality of available data is also an important issue. Indeed, machine learning and artificial intelligence techniques need substantial databases to produce any analysis that is robust and helpful, so, together with the allocation of resources for the acquisition of software licenses and training, it is important for regulators to evaluate whether the existing rules and practices will provide for access to relevant data to be fed into the machine learning software.

## 3. Judiciary and Private Enforcement

Capital markets regulators, which are part of the executive branch, can go as far as imposing administrative sanctions, such as reprimands, cancellation of registration and fines. The punishment for a criminal offense, which in some cases could take the form of imprisonment, and the redress for damages suffered by an investor depend, in fact, on the Judiciary, Public Prosecutors, lawyers and private arbitrators. It is out of the scope of this survey to explore in detail how criminal justice and civil lawsuits have been evolving in the covered jurisdictions, but a few aspects are discussed below and summarised in Table 3.1.

**Table 3.1. Judiciary and Public Prosecution** 

Country	Does the regulator have prosecutorial powers?	Does the regulator cooperate with public prosecutors?	Are judges trained in capital markets issues?	Are there courts specialized in capital markets?	Is private arbitration available to solve SH conflicts?
Argentina	No	Yes	No	No	Yes
Brazil	No	Yes	Some have undergone training offered by CVM	No	Yes
Chile	No	Yes	No	No	Yes
Colombia	No	Yes	No	No	Yes
Mexico	No	Yes	No	No	Yes
Peru	No	Yes	No	No	Yes
Argentina	No	Yes	No	No	Yes

Source: Surveyed regulators.

The organisation of the Judiciary and the relationship between regulators and public prosecutors are quite similar in the surveyed countries. As it is possible to observe in the table above, none of the surveyed regulators have prosecutorial powers (i.e., they cannot initiate a criminal trial), but they all cooperate providing evidence or technical assistance to public prosecutors who have such powers. Mentioned cooperation has a great potential to increase the quality and efficiency of the public prosecution, because the technical knowledge and experience of regulators' staff complement the expertise of prosecutors, who tend to have a training more focused in criminal law. In any case, further research would be necessary to evaluate the quality and efficacy of such cooperation (for example, whether frequent meetings between regulators senior officials and public prosecutors have been happening and were proven useful, and what have been the best mechanisms to assure opportune exchange of information).

On the other side of the bench, it is also important for the access to justice and the efficient functioning of capital markets to have judges who are capable of understanding complex issues related to the capital markets and of ruling within reasonable periods of time<sup>25</sup>. Two ways of supporting the achievement of

<sup>&</sup>lt;sup>25</sup> An issue that was not raised in the questionnaire, but that was raised in Task Force discussions and could be followed up in further research involves the ideal relationship of the capital markets regulator and the judiciary. For example, in Chile there is the requirement for the investors to first present a complaint to the regulator before filing a

those goals would be to provide training to judges on capital markets issues or, through the specialisation of their courts, allow them to have more intensive experience on those issues (e.g., basic knowledge on accounting rules and corporate finance, and training on jurisprudence and doctrine on "business judgement rule"). Of course, a transformation in the specialisation of courts depends on a broader analysis of demands and resources available for the Judiciary, but at least the organisation of some training programs for judges by the capital markets regulator should be an accessible instrument in most jurisdictions (as it has been done in Brazil by CVM).

Finally, an alternative dispute settlement mechanism that might be cost-effective in major disputes among shareholders, directors and officers is the use of private arbitration, because of the specialisation of and time available to arbitrators. This mechanism is available in all six surveyed jurisdictions and in every one of them it operates in a similar way: the involved parties have to agree to submit the dispute to be solved by private arbitrators, and, in the case of Brazil, Chile and Colombia, the articles of a listed company could establish the obligation of shareholders to solve disputes using private arbitration. There are many concerns involved in the framework of private arbitration, but one that could be explored further in the future would be which are the best mechanisms to guarantee that shareholders have the possibility to take part in private arbitration proceedings – which might be confidential – initiated by other shareholders<sup>26</sup>. Likewise, while private arbitration has been frequently used by listed companies in Brazil to settle disputes among shareholders<sup>27</sup>, previous discussions in the Roundtable have suggested that such mechanisms are more commonly used in other jurisdictions by non-listed companies and individuals. Further research would be needed to determine the extent to which the mechanism may be used by listed companies in other jurisdictions in Latin America. Finally, one issue that could be considered is whether the higher direct costs of arbitration (in comparison with the costs of a process in the judiciary) would hinder minority shareholders ability to find redress for the infringement of their rights.

lawsuit, which can be helpful to aid the analysis by the judge, but could create additional barriers to investors' pursuit of redress.

<sup>&</sup>lt;sup>26</sup> Recent OECD work in collaboration with Brazil has explored in-depth corporate arbitration rules and practices by comparing experience across 10 jurisdictions in the interest of enhancing the functioning of Brazil's arbitration system for listed companies, as well as improving incentives and accessibility of the use of derivative suits (OECD, 2013<sub>[2]</sub>). The final report can be downloaded here.

<sup>&</sup>lt;sup>27</sup> Because the Novo Mercado requires companies that are listed in the segment to adopt an arbitration clause in their articles.

## 4. Priorities for improvement and obstacles for enforcement

When asked to prioritize areas for improvement in enforcement, surveyed regulators offered somewhat diverse answers. While abusive related parties transactions and fiduciary duties of senior executives are priorities for improvement across the board (perhaps because of the existence of many company groups in the region), share-price manipulation is among the main priorities only in jurisdictions where secondary markets are relatively more developed (Brazil, Chile and Mexico).

Perhaps the most interesting use of such rankings could be to find opportunities of cooperation between the surveyed institutions who are pursuing similar goals (with a greater or smaller participation of the OECD depending on shown interest and resources available), and, for that reason, it is summarised below whenever an issue is among the top two priorities for at least two regulators:

- Insider trading and the use of privileged information: CVM (Brazil); CMF (Chile); SFC (Colombia).
- Abusive related party transactions: CNV (Argentina); CNBV (Mexico); SMV (Peru).
- Fiduciary duties of directors and senior executives: CNV (Argentina); SFC (Colombia);
- Share-price manipulation: CVM (Brazil); CMF (Chile); CNBV (Mexico).

In relation to the obstacles to a more effective enforcement, judicial processes continue to be considered by regulators – as it was in the last survey a decade ago – the biggest challenge faced by them (currently, it is the self-reported main obstacle for CMF, SFC and CNBV). Specifically when asked to explain why the judicial process was a significant obstacle, surveyed regulators indicated not only the fact that appeals to the Judiciary might sometimes significantly increase the time the State takes to provide a final response to alleged wrong-doings, but also the lack of specialization of judicial courts.

The number and expertise of staff is also an important issue for some surveyed regulators, even for CNV (Argentina) and SMV (Peru), who had their number of personnel increased by 84% during the last decade as observed in the beginning of this report. Another challenge that is especially relevant for some regulators (CVM, CMF and SMV) – but not necessarily across the board – is the operational independence to define their budgets within the limits of the fees that are collected, which may impact the capacity to hire qualified professionals and invest in information technology. In Brazil, for instance, even if there is space in CVM's budget approved by Congress, the hiring process of public servants depends on a new specific approval by the central government.

## 5. Main findings

As mentioned in the introduction, this report has the purpose of serving as a stock-taking exercise to collect information on the current state of public enforcement of corporate governance rules in the six major capital markets in Latin America. Within that scope, some findings have been identified and could serve as a reference for the six surveyed regulators' consideration, as follows:

#### Institutional structures

- While there are some reassuring features of the surveyed regulators` structures (e.g., they have their own legal personality and most of their senior officials have fixed mandates), there is still some potential to increase their political independence. Some of the main findings related to institutional structures:
- CNBV's (Mexico) Governing Board is the only one among the six surveyed jurisdictions that does
  not have a fixed mandate.
- Only CVM (Brazil) and SMV (Peru) have term limits prohibiting the re-appointment of the members of regulators' most senior body.
- All surveyed jurisdictions but Colombia have a cooling-off period for former senior officials of their regulators in order to reduce the risks posed by the "revolving doors" between the public and private sectors.

#### Resources

- Surveyed regulators' staff increased in the last decade (especially in Argentina and Peru), but their number and expertise is still a self-reported obstacle to more effective enforcement, which raises the question of how to ensure that their employees have the necessary skills and experience.
- All surveyed regulators must have their budget approved by the executive power and the legislature, making them, to a smaller or greater extent, vulnerable to the short-term political agenda.

#### **Procedures and sanctions**

- There are no evident gaps in the offences investigated and punished in the surveyed jurisdictions, and it seems that regulators have enough power to investigate and follow some of the best practices required to guarantee due process. In any case, further research on the topics below would be worthwhile:
- evidentiary standards for sanctions e.g., what are the pros and cons of the standards used in
  Chile (following a "preponderance of evidence" standard), and Colombia (following a standard of
  "beyond a reasonable doubt"?

- what would be the best model for *leniency agreements* in the context of capital markets regulation (learning from the recent introduction of that instrument in **Brazil and Chile**)?
- In Brazil, Chile and Peru, the unit that investigates the apparent irregularity is different from the body that judges in the first instance whether there was effectively an offence, which might be expected to contribute to a more impartial decision on sanctioning.
- In **Mexico**, *information on the process for imposing sanctions* is classified as confidential by the government, and this might raise concerns for investors' confidence in the public enforcement system due to a lack of understanding of how it works.
- Surveyed regulators have diverse types of sanctions that they might impose, but a question not yet
  explored is how they may choose between those types and define a proportional punishment in
  each case.
- In **Brazil**, a new genre of sanction made recently available to the regulator (CVM) is to prohibit entities from entering into contracts with state-owned financial institutions and from participating in bids with the public administration for up to five years, which could be a potentially severe sanction, for example, for infrastructure companies that constantly bid for new concession contracts and search for funding in state-owned development banks.
- The limits on fines by regulators in Colombia, Mexico and Peru are relatively low and fixed.

#### **Enforcement track record**

- In most surveyed jurisdictions, there have been short-term increases in the regulators' fining activities, and, in **Brazil**, a significant long-term increase as well. **Mexico** also has had substantial enforcement activity, though it is difficult to compare the two due to Mexico's much broader mandate. The Brazilian self-regulator (the stock exchange) also experienced a relevant increase in its sanctioning activity during the last decade.
- Enforcing processes conducted by CMF (Chile), SFC (Colombia) and SMV (Peru) often take a
  reasonable period of time, ranging from 5 to 18 months on average. CNV's (Argentina) and CVM's
  (Brazil) enforcing processes take on average considerably longer than in the other surveyed
  regulators, which in the case of CVM might be explained, at least partially, by the relatively high
  number of sanctions imposed.
- Surveyed regulators have been able to *collect the majority of the amounts of fines that were imposed*, with the exception of *CVM* (**Brazil**) which collected ca. only 30% in the last three years.
- There are differing approaches and varying responsibilities of stock exchanges in the region for enforcement. In Brazil, Chile, Colombia and Mexico, they currently have the power to enforce corporate governance related rules, while in Argentina and Peru stock exchanges no longer act as self-regulatory organisations.

#### **Digitalisation**

- All surveyed regulators currently use digital platforms that facilitate the disclosure of required documents by supervised market participants and/or have a software to better manage internal processes, while CVM (Brazil), CMF (Chile), SFC (Colombia) and SMV (Peru) reported that they use more sophisticated information technologies. None of the surveyed regulators currently use machine learning and artificial intelligence filters to continuously monitor the capital markets.
- The lack of financial resources for the acquisition of software licenses and staff training were the main challenges indicated by surveyed regulators to increase the use of technological solutions in

the future, followed by the difficulty of guaranteeing sufficient and relevant data to be fed into machine learning software.

#### **Judiciary and arbitration**

- None of the surveyed regulators have prosecutorial powers, but they all *cooperate in the provision* of evidence or technical assistance to public prosecutors who have such powers.
- None of the surveyed jurisdictions have courts specialized in capital markets, but, in all six countries, private arbitration is available to settle conflicts among shareholders, directors and officers.
- In the surveyed jurisdictions, judges that rule on capital markets issues are not usually trained in the field, but the initiative of CVM (**Brazil**) of providing *training for some judges* seems to be an accessible way to improve their qualification.

#### **Priorities**

• Enforcement related to abusive related parties transactions, fiduciary duties of senior executives, share-price manipulation and insider trading are among the main priorities for improvement.

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