



*Public Documents
of the XXVIth Annual Conference of
the International Organization of
Securities Commissions
(IOSCO)*

23-29 June, 2001, Stockholm, Sweden

Plenary 3

**Market and Information Access for the Investor
in the Internet Age**

*13. Market and Information Access for the Investor in the Internet Age,
Speech by Mr. José Luis Osorio*

President of the Comissão de Valores Mobiliários of Brazil

27 June 2001

STOCKHOLM SPEECH

Let me start by saying it is a pleasure to be here today to discuss Market Information Access for the Investor in the Internet Age. The two main words in this title underscore the driving forces that are transforming the market throughout the world and definitely Brazil in particular: Information and Internet.

It was tempting to discuss the program of this panel on a broader sense around quotes such as:

“The internet is said to be both overhyped and undervalued” – The Economist June 99

“In five years time all companies will be internet companies or they won't be companies” – Andy Grove 99

But, I made an effort not to be carried away by too much theory and decided to concentrate on the implications of this panel for Brazil and other emerging markets.

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My speech will be structured in two sections. First, I will present some background figures on the Brazilian information infrastructure and whenever applicable on data about other Latin American markets. Without claiming to have a full understand of Latin American or other emerging market equity culture, or the lack of it, I believe that there are similarities between Brazil and other emerging markets that apply to all. On the second part of my speech, I will discuss the main questions of this panel as it applies to Brazil. That is:

- 1) Financial information, increased information, too much information and its impact on the market
- 2) The ability of market participants to use available information and
- 3) The role of regulators on financial information and cross-boarder information flow.

Concerning telecom infrastructure, most Latin American countries privatized their telcos in the 90's. Brazil did it on July 98. Since then, the number of fixed lines has increased from 24 million to 42 million in April 2001, with almost 100% digital lines. Wireless growth was even more dramatic, from 7.4 million lines to 24 million in the same period. As can be seen this has provided a big boost to internet development.

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LatAm Market (in millions)	1999	2000	2001E	2002E	2003E	2004E	2005E
Population	476.8	483.9	491.2	498.5	506.0	513.6	521.3
Number of PCs	n.a.	27.5	34.3	42.9	52.8	64.3	78.0
Internet-access devices at year-end*	5.8	9.8	14.2	19.1	24.6	32.0	46.0
Internet accounts at year-end**	4.1	6.9	9.9	14.3	19.7	25.6	31.8
Growth rate of internet accounts	n.a.	68%	44%	44%	37%	30%	24%
Internet accounts per household	n.a.	5%	7%	10%	14%	17%	21%
Internet users (IDC)*	8.6	14.9	21.8	31.0	42.9	57.6	75.0
- Argentina Internet Users (IDC)*	n.a.	1.3	2.0	3.0	3.9	5.4	6.9
- Brazil Internet Users (IDC)*	n.a.	6.9	10.2	14.9	20.8	28.4	36.6
- Chile Internet Users (IDC)*	n.a.	1.1	1.6	2.1	2.7	3.6	4.4
- Mexico Internet Users (IDC)*	n.a.	2.8	4.0	5.9	8.3	10.7	13.9
- Other Internet Users (IDC)*	n.a.	2.9	4.0	5.2	7.1	9.5	13.2
Internet users (broad definition) (UBSW)***	n.a.	n.a.	26.1	48.2	89.2	129.4	174.7
- Brazil Internet Users (UBSW)***	n.a.	n.a.	12.0	22.3	41.2	59.8	80.7
Internet users vs. Total pop. (broad def.)	n.a.	n.a.	5%	10%	18%	25%	34%

*IDC – International Data Corporation
forecast.

**Assumes 80 accounts for every 100 access
devices.

***UBSWarburg broad definition includes all users with any Web contact: residential, office,
educational, government, institutional

Sources: population and households, ITU Jan. 1999; devices and users, IDC (June 2000, "Internet
Commerce Market Model")

Just for the record, statistics about Internet users can vary widely according to each research
method (one can consider an internet user as an individual accessing the net once a week for

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at least one hour, whereas another might consider any individual accessing the net in one month for 5 hours and so on). We have seen studies varying from 5 million internet users in Brazil to as much as nearly 12 million users. Randomly, we chose to peak IDC database, with almost 7 million people with internet access. However, this figure includes home access only. It does not consider work, school or other kind of connections. Research institutions based on this 7 million IDC figure, estimate that the total number of internet users, considering all accesses, exceeds 8 million people.

Now, I will lay out some characteristics of the internet user in Brazil.

Many signs indicate that Brazilians are very enthusiastic towards the use of the Internet. For example, this year 93% of all 14 million individuals that filed their income tax report did it through the net. For the record this was the 3rd year that the Brazilian IRS allowed electronic filing.

Internet banking figures have also being impressive: (i) 20% of all banking transactions are already made through the internet; (ii) more than 10% of the clients of Bradesco, the largest private bank in Brazil, have registered internet banking accounts (1,3 million accounts in 11 million clients – Bradesco's registered internet accounts were less than 900,000 clients in

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December 1999); (iii) over 12% of Banco do Brasil' clients use its internet site (1,5 million out of a total client figure of 12 million); (iv) banks with a more sophisticated client base show an even greater proportion of internet clients vis-a-vis the total number of clients – Itaú posts 15% of internet clients and Unibanco, actually the pioneer in Internet banking, shows a 20% figure.

All those numbers clearly sets out an indication that Brazilians are inclined to use the Internet.

However, as far as traditional media for financial information is concerned, the picture is not so bright. Very seldom open TV channels broadcast information on the stock market and specially on any stock in particular. Because of a history of macroeconomic problems, TV financial coverage concentrates on inflation, balance of payments, currency devaluation and so on. Cable has some specialized financial programming, although its access is restricted to 3,3 million cable + satellite subscribers against some 48 million households with a TV set. We do not have CNBC or CNNFN equivalents in Portuguese, although some cable carry it, such as Bloomberg, which has a Portuguese spoken channel. Reuters has 2,000 to 3,000

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subscribers, Bloomberg counts with 1,500 terminals, whereas Agencia Estado, the largest local business news has 11,000 subscribers. In short, financial information is almost only available to professional investors.

Brazil also has two business daily newspapers: Gazeta Mercantil and Valor, with daily editions of 150,000 and 130,000 respectively. Regular papers have the same tendency of open TV on their business news, that is, to focus on macroeconomic issues.

After this background information, I would now like to turn to the second part of my speech.

Traditionally the US market has been the model for other burgeoning equity cultures (The Economist April 01) and Brazil is no exception.

Several explanations can be drawn to explain why there is such a developed retail equity culture in the US. We have seen extensive literature trying to explain the reasons behind a developed financial market through differences in: protection to the minority shareholder, better enforcement, more transparency, the system of law (common vs. civil). We do not dispute these claims, which we definitely believe to be important to market development, and we are currently seeking improvement in each of those areas in Brazil. However, there is

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another reason behind market development which is often overlooked: the infrastructure that has been developed for over a century in the US, where several small and large brokers distribute research, solicit equity business and so on. This developed financial information infrastructure typically contrasts with the undeveloped status of most emerging markets. Brazil certainly lacks a retail base of investors. Data from a recent issue of The Economist magazine shows that almost 50% of the US population own shares either directly or indirectly (includes mutual funds and 401k plans). This percentage would be equivalent to some 130 million people owning shares. The figure for shares owned directly is close to 70 million people. Once again considering every kind of ownership, UK has some 14,7 million, Germany stands with nearly 14,5 million, France with 7 million and Japan with 11,4 million individual investors. All those figures overshadow Brazil's very small base of only 1 to 2 million. Considering individual investors actually trading at least once every 12 months, the figure drops to an insignificant 82,000 individual investors. However, this figure was only 48,000 in the end of 1999, when the number of online e-brokers really started to increase in Brazil. Thus, if one considers that the lack of access to financial information is part of the problem, then the internet has the potential to change this.

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While we have seen that institutional investors have had access through traditional methods, such as equity research produced by brokers, electronic Bloomberg or other similar technologies, information has historically been too expensive to retail investors. There are no brokers outside the major capitals. Mutual funds have been the only alternative marketed to small investors and the industry generally sells their products based on track records and institutional brand name, not the stock fundamentals or the investment strategy. Internet has the potential to change this vicious cycle because transaction costs are low and the marginal cost to include information in the net is also low. Early data indicate that penetration is growing through the use of the internet. Most of the financial sites have stock trade simulators which teach individuals the workings of a stock exchange market. Since the beginning of internet trading in Brazil, almost two years ago, the participation of individuals, both in terms of volume and number of transactions, have been growing through Bovespa's Home Broker Protocol. Individual investor internet trading represents 1% of the volume and nearly 6% of total transactions – this compares to 0,5% of volume and 4,8% of total transactions one year ago. São Paulo Stock Exchange expects Home Broker figures to be at 30% of total transactions and 10% of all trading volume by 2005. Indeed, 55 brokers, out of a total of 129 member firms registered with Bovespa, now offer online trading through

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Bovespa's Home Broker system. Back in April 1999, only 6 member firms offered this system. Online trading has been growing rapidly, with average daily volume increasing 115% from April 2000 to April 2001, and 23% from December 2000 to May 2001 alone. Average daily volume was only US\$100,000 in April 1999 when the system was launched. It increased to US\$3,5 million in April 2000 and to US\$5,2 million in May 2001.

In sum, there is strong indication that for the first time the Internet is making information available to the typical small investor. Currently, 50% of Brazil's 170 banks offer internet banking services. The major portals have links to online e-brokers. One independent online e-broker (not linked to any major bank), is the leader in internet trading volume. It is early to tell if the increased number of investors is due to the internet, but it is my belief that the Internet can truly fill a gap that has never developed, i.e., access to small investors of micro financial information.

There is one more example showing that the internet might actually help small investors: in a recent process of delisting, a group of shareholders opposed the price offered to buy back minority shareholders' stake. They constructed an internet site as a vehicle to organize the maximum number of shareholders to discuss their strategy. Before the internet, this opposition group would have to try contacting each shareholder on an extensive list and it

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would probably only contact the largest shareholders. It is worth to mention that proxy fights are not common practice in Brazil. Thus, internet may also help to foster shareholders' activism.

INTERNET REGULATION

To turn to regulation on the net. So far we have decided for minimum regulation. The more cynical can say we do not have the resources. It is true. However in my opinion the best way to regulate what we do not know but it is probably very good for our market, is not to harm it with regulation.

During the first couple of years of Internet trading in Brazil, the CVM has opted for a light-handed regulatory approach. We have tracked closely the first efforts of the São Paulo Stock Exchange and half a dozen pioneer brokers since 1999, making sure that those efforts did not hurt any one of our current regulations and that the individual investor's best interests were cared for. Early on, we built a database of technical and statistical data from online brokers to oversee them, but we issued no new regulation. The Internet was to be viewed only as a new communication channel between the broker and the investor, not much different from the

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telephone. This approach was chosen not because we were convinced of it, but because we simply did not have sufficient experience to foresee the new regulatory issues that the Internet could bring forth. Most of all, we felt that the Internet could drive a whole new group of small investors to the market, as it apparently has done. That is why our main concern, two years ago, lay on promoting the efforts of the brokers and the exchange and not burdening it with new regulations.

Of course, to mobilize capital to the equity market through the Internet, we, as regulators, need to develop a trustable information and trading environment.

Today, we have a somewhat clearer view of the regulatory issues in this new medium. During this period, we have acquired a significant collection of surveillance cases related to Internet trading which have shown us that the Internet may indeed originate totally new regulatory issues. We have right now a working group at CVM set up with the mandate of studying the need and the form of a new regulation for Internet trading. This new regulation, probably still in the form of guidelines, would address the following main areas: (1) investor information and education through the websites; (2) technical capacity issues; (3) systems and data security; (4) self-regulatory responsibilities of the exchange; (5) chat rooms and e-mail

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exchange services by the brokers; (6) derivatives trading. If we decide, based on our growing experience, that such new regulation is indeed needed, these would be some of our areas of concern. We also intend to draw from the experience of intermediaries, investors, the exchanges and other countries in this work.

Thank you very much.

ANEXO

Falar do site da CVM – 475 access per day and 4,048 page views per day

Another regulatory challenge that the Internet poses to us refers to cross-border trading. At this moment, Brazilian investors are only allowed to invest in foreign companies through Brazilian Depositary Receipts programs. This rule is enforced by the Central Bank through strict controls over foreign exchange transactions. However, there has been in the last two years many offers of day trading technologies to Brazilian investors, through which they could trade remotely in American markets, such as the Nasdaq National Market System or the New York Stock Exchange. These offers have originated from foreign brokers or IT companies sponsored by foreign brokers. The CVM current policy towards these offers is to issue “stop orders” whenever they are detected, based not only on the prohibition on investment outside BDR programs but also on the simple fact that those foreign brokers are not accredited members of the national intermediaries financial system, accredited by the CVM and the Central Bank. We feel, however, that the trend towards greater markets linkage and growth of cross-border trading is a strong one, which may cause in the future a revision of our current policy.