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**Plenary 3**

**Global Portfolio Investments - Opportunities and Barriers  
in Emerging Markets**

*13. Speech by Mr. José Luis Osorio  
President of the Comissão de Valores Mobiliários of Brazil*

*23 May 2002*

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**Presentation by Mr. José Luis Osorio**

**Chairman of Comissão de Valores Mobiliários-CVM (Brazilian Securities and Exchange Commission)**

Good morning everyone. Let me start by saying it is a pleasure to be in Istanbul and by thanking Dr Dogan for inviting me to chair Panel # 3 “Global Portfolio Investments: Opportunities and Barriers in Emerging Markets”.

We are brought together this morning to discuss very important subjects, and I would like to give you a brief outline of how I see them.

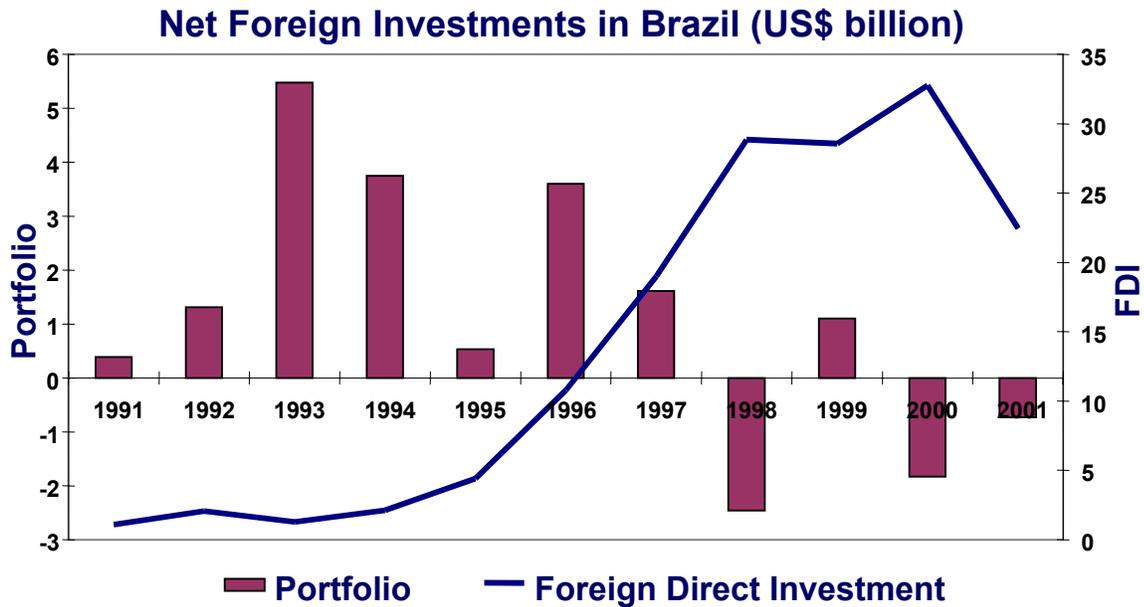
I understand that this discussion is for all emerging economies, and naturally my vision is a Brazilian one. Nevertheless I believe it is applicable to all in Latin America as well as relevant to other emerging countries.

Capital markets should be the main source of funding for the expansion of emerging economies. To carry out this role, the market should be one of the principal points to which private savings are attracted – savings which would then be allocated to the productive process without the excessive costs of financial intermediation. “ For many people, the debate on capital market development may sound unimportant and distant. This is a mistaken view\*.” The truth is that developed economies rely less and less on bank finance. They are always improving their capital markets and, of course, these markets rely on portfolio investors.

In the case of Brazil a quick glance is enough to show that we are no longer attracting portfolio investors.

\* *Congressman Antonio Kandir*

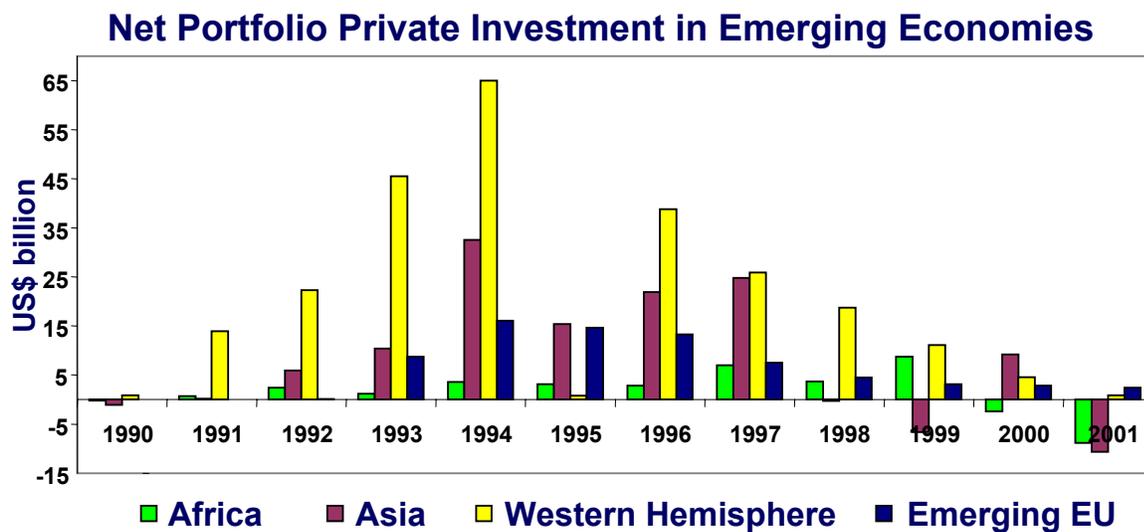
Slide 1



Source: CVM/BACEN

We can also draw some interesting comments from the data for other emerging markets.

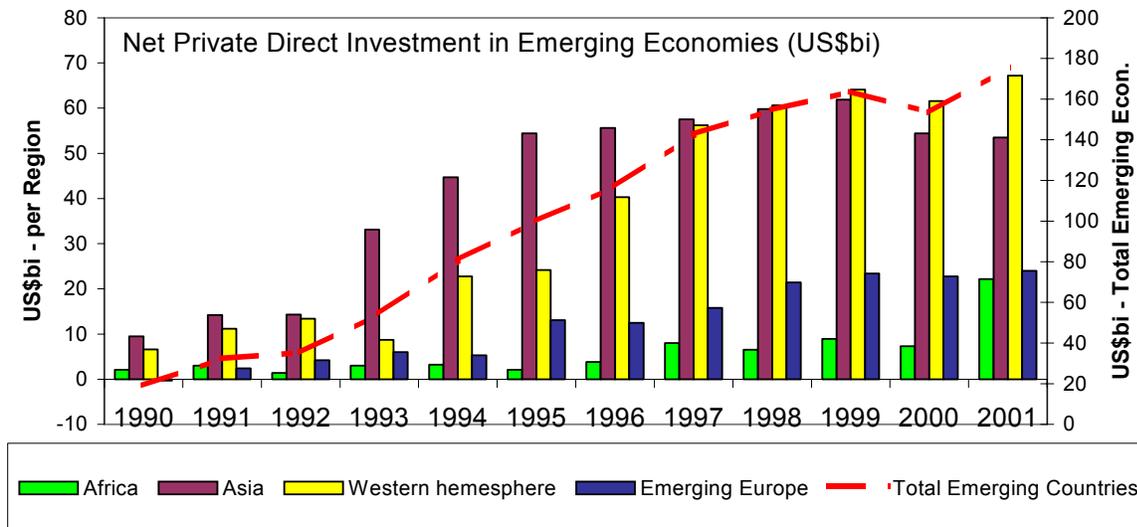
Slide 2



Source: IMF

The figures show that: (i) – emerging markets reflect the same pattern as Brazil i.e. growth until 1994, sharp drop afterwards; (ii) – levels for 2001 are back to those for 1990; (iii) FDI is still quite high while portfolio investments are low.

Slide 3



Source: IMF

Perhaps the big question is why Emerging Markets are attracting FDI and so little portfolio investments.

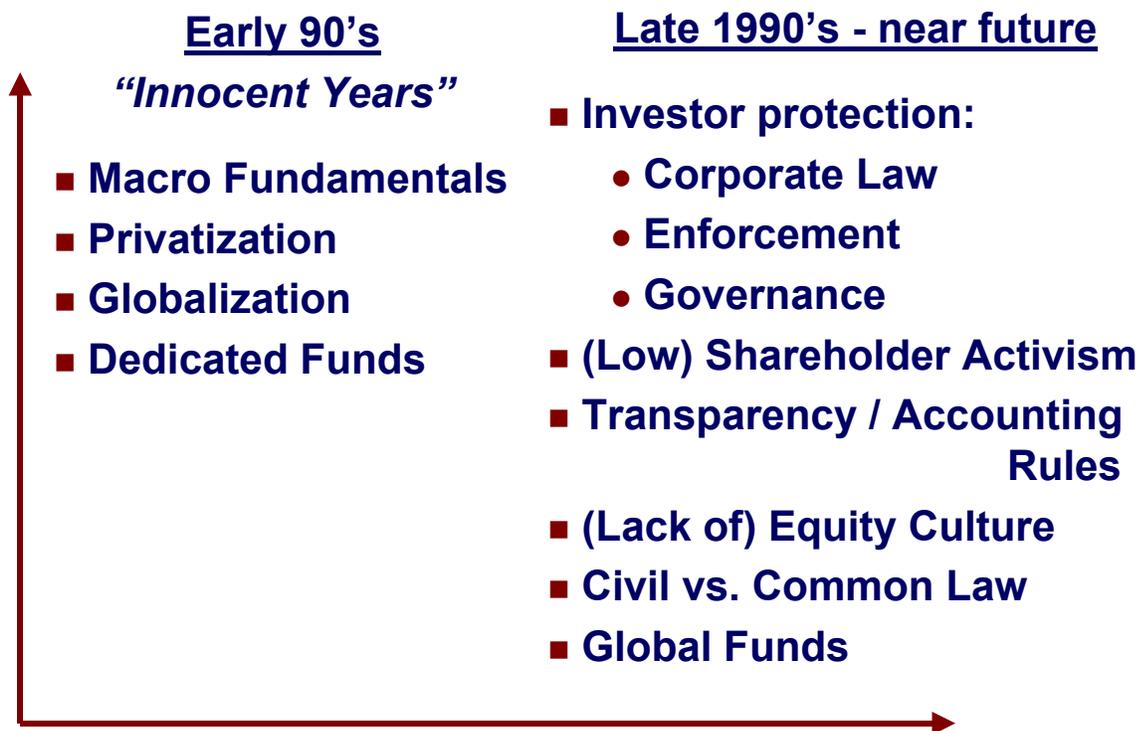
I am sure the panelists will express their detailed opinions on which variables impact portfolio investments. But I would like to suggest what I view are some of the most important aspects.

First, of course, variables such as American, European and Japanese economic growth, interest rates, commodity prices, NASDAQ and so on affect in different ways and naturally have a significant impact on emerging markets. But there is not much we emerging markets regulators can do and they are by definition exogenous.

Let me focus on the variables that can be used on any action plan to be drawn up by regulators to help attract global portfolio investment.

To help myself, I listed different variables that may affect portfolio investors decision. I have also divided them in two groups according to their importance prior and after 1995.

Slide 4



Conclusion:

Accordingly many countries have been implementing reforms in order to address some of those points. And the same process is taking place in Brazil.

Brazil's reform agenda has addressed mainly four areas: minority protection (new corporate law), governance inducement, accounting transparency and better enforcement. For detailed examples of Brazil's reform agenda please see the document attached.

If as a regulator I had to pick one item that in the long term will most help the landscape for attracting global portfolio investors I would say enforcement.

*Panel Three*  
*Mr. José Luis Osorio*



Let's turn now to our distinguished panelists for their views on opportunities and barriers for Global Investors in Emerging Markets.

Thank You.

## **ANNEX: Brazil Capital Markets Reform Agenda**

The Brazilian Securities and Exchange Commission (CVM) reform agenda focuses primarily on improving protection to minority shareholders, developing a corporate governance culture in Brazil, and increasing transparency while strengthening enforcement of existing laws. With the purpose of reinforcing the objectives of strengthening the stock market and protecting minority stockholders, Congress passed two Laws:

- Law 10,303, dated October 31, 2001, created the conditions required for the Brazilian Securities and Exchange Commission to improve market protection and develop governance and surveillance.
- Law 10,411, dated February 26, 2002, granted CVM independent administrative authority, fixed terms in office and stability for its directors.

Examples of improvements under the new Laws include:

- in the case of sale of a controlling interest in a specific enterprise, the Law ensures a tag-along of 80% to minority voting shares relative to the price negotiated by majority stockholders, through a public stock offer;
- extends the right of electing a member to the board of administration of the company by preferred stockholders who hold at least 10% of the company's capital stock (by 2006); additionally, common (voting) shareholders representing more than 15% of common shares, as opposed to 20% as previously required, can now elect one director;
- allows the director indicated by minority shareholder to veto the selection and dismissal of independent auditors;
- allows the Brazilian Securities Commission to request up to a 30-day call in advance if the Shareholder General Meeting relates to complex transactions; and suspend, by up to fifteen days, the course of the advance notice term for call of the general meeting in order to analyze the proposals to be submitted at the meeting.

- defines crimes against the capital market as follows (up to 5 years in prison): crime of market manipulation, undue use of insider information and irregular use of a position, profession, activity or function.

With a view to regulating changes introduced in the legislation, CVM has issued a number of regulatory guidelines, including CVM Instruction n° 358, which superseded Instruction n° 31 and established several rules and bans regarding possible undue and privileged use of relevant insider information to the detriment of shareholders' interest and the company itself.

CVM Instruction n° 361/2002, in turn, presents rules governing tender offers. This instruction establishes, among others, mandatory tender offer in the case of sale of the corporate control, and requires the close out tender offer to be approved by at least 2/3 of the entire free-float in order to delist a company.

Furthermore, CVM has sent Congress Bill n° 3,741, which, by modernizing the accounting approach provided for under the Corporate Act, will contribute to the harmonization of this legal framework and bring it in line with best international accounting practices (International Accounting Standards – IAS), while attaching greater transparency to data of publicly held companies. The initiative is particularly important and necessary in a world where cross-border investments are a vital force behind the development of all nations.

The private sector, in turn, has endeavored to implement new mechanisms and markets that will prove instrumental in expanding the role of capital markets. The Sao Paulo State Stock Exchange (BOVESPA) is a noteworthy example for its sustained efforts in implementing *NOVO MERCADO* (New Market), a section with listing requirements that incorporate the best corporate governance principles and full disclosure rules, with voluntary introduction of more stringent requirements than those established under Brazilian legislation. This initiative, based on the notion that the value and liquidity of stocks are positively related to shareholders' rights, efficiency in guaranteeing investors'

rights and the quality of the information provided, established several pre-conditions for stockholding: (1) one share/ one vote; (2) minority shareholders' full rights to participate in corporate sale negotiations or transactions; (3) offer to delist the company to be made only at the economic value; (4) arbitration chamber for dispute settlement between minority and majority shareholders; (5) minimum free float of 25% of the capital; and (6) audit committee made up by a majority of outside members (minority shareholders).

This strategic objective of fostering market development has likewise been expressed in other spheres of government through concerted action by several agencies with a view to encouraging adoption of governance principles. An example of this policy can be found in Resolution 2,829 issued by the National Monetary Council, which authorized an increase in the percentage of investments by pension funds allocated to securities, provided that the latter are issued by companies that comply with the New Market rules. This vigorous incentive was further buttressed by Resolution n° 1 of the Complementary Social Security Management Council (SPC), which mandated that these entities, on a quarterly basis, make available to their participants the votes cast in General Assemblies of companies in which they hold shares, especially as regards deliberations that may benefit a majority shareholder. CVM has also recently initiated a 30-day public hearing period for a proposed rule which seeks to oblige Mutual Funds managers to make available the same type of information on a periodic basis.

In addition, CVM has sustained its effort to introduce important regulatory reforms, in accordance with an agenda geared to more effective law enforcement and expansion of shareholders protection. This project, started prior to the changes written into the Corporate Act, has resulted in a number of normative actions, the most significant of which are summarized as follows:

- auditors – conflict of interests: separates auditing from consulting activities, and establishes a 5-year rotation period for auditing firms (CVM Instruction n° 308/99, );
- abuse of power – definition of abuse of power on the part of the majority shareholder (CVM Instruction n° 323/00);

- general assembly – matters to be decided by vote may not be included in the meeting’s order of business under “Other” (CVM Instruction n° 341/00);
- legal representative – introduction of the option to eliminate the steps that complicate the appointment process (consularization), on the condition that the company’s by-laws provide for such elimination (CVM Instruction n° 342/00);
- CMN Resolution n° 2,785/00 – simplifies procedures concerning administrative proceedings by reducing the time lapse between inception of proceedings and the final ruling, and increases the penalty applicable to fast track proceedings;
- disclosure and use of information pertaining to public companies (CVM Instruction n° 358/02, discussed above);
- public offer for stock purchase (CVM Instruction n° 361/02, discussed above);
- issuance of Collective Investment Contracts (CICs) – CVM has made CIC registration criteria stricter and more transparent (CVM Instruction n° 350/01);
- regulation of the activity of “autonomous investment agent” – the activity of autonomous agents for investment in securities has been regulated based on the requirement for registration at CVM (CVM Instruction n° 355/01); the brokers will be required to pass an exam to be certified, similar to the NASD series 7 procedure; and
- regulation of new investment funds – New investment options, the Credit Rights Fund also increases the liquidity of those who have certain receivables, and the Index Fund allows hedging and generates business with shares of the index used (CVM Instruction n° 356/01 and 359/01).

And last but not least Enforcement of the Law and of CVM’s own regulations is equally or more important than regulatory advancements. In 2001, CVM judged 37 administrative inquiries, more than twice the average of 18.2 judgements per year from 1996 to 2000.