BSM

BM&F BOVESPA MARKET SUPERVISION

Panel 5

BSM Market Surveillance:

Market Manipulation and Insider Trading

7th IOSCO AMCC Training Seminar

Tokyo, April 2014

Visit BSM website

www.bsm-autorregulacao.com.br

Regulatory framework

- **IOSCO Objectives and Principles of Securities Regulation**

  – Principles for Secondary Markets

    ✓ Principle 36: *Regulation should be designed to detect and deter manipulation and other unfair trading practices.*

- **The Brazilian regulatory framework**

  – Federal Law 6.385/1976 (amended by Federal Law 10.303/2001)

    ✓ Establishes that Market Manipulation and Insider Trading are crime against Capital Markets

    ✓ Provides that exchanges are auxiliary regulatory entities responsible for surveillance the market activities and market participants

  – CVM Instruction 461/2007

    ✓ Regulates and governs regulated securities markets and makes provisions on the formation, organization, operation and extinction of stock exchanges, commodities exchanges, futures exchanges and organized over-the-counter markets

    ✓ BMF&BOVESPA Market Supervision as mandatory Self-Regulatory Organization

- **The Brazilian regulatory framework (cont.)**

  - CVM Instruction 8/1979

    - ✓ I - Managers and stockholders of public companies, intermediaries, and other participants in the securities market are prohibited from creating artificial conditions of demand, supply, or price of securities, from engaging in price manipulation, in the execution of fraudulent operations, and in the use of unfair practices.

    - ✓ II - For the purposes of this Instruction, the following concepts shall apply:

      - a) <u>artificial demand, supply or price conditions</u> of securities are those created as a result of trades performed by participants or intermediaries that, due to fraudulent action or intentional omission, cause direct or indirect alterations in the flow of purchase or sale orders for securities;

      - b) <u>price manipulation</u> on the securities market is the utilization of any process or stratagem intended directly or indirectly to raise, maintain, or lower the quotation of any security, inducing third parties to purchase and sell it;

      - c) <u>fraudulent trading</u> on the securities market is that which uses deceptions or stratagems to induce or maintain third parties to commit errors, for the purposes of obtaining illicit equity gains for the parties involved in the operation, the intermediaries or third parties;

      - d) <u>unfair practice</u> on the securities market is that which directly or indirectly results, effectively or potentially, in treatment for any of the parties in negotiations involving securities, which places them in an improper position of imbalance or inequality with respect to the other participants in the transaction.

Market Surveillance

What we are looking for

- Insider trading
- Front running
- Market Manipulation
- Money Laundering and Money Pass
- Frauds
- Churning
- Trading with BVMF3 (self-listing)
- Others

2013

100% orders ($\cong$ 7 billions)
100% tradings ($\cong$ 500 millions)

91,000 alerts

1,995 analysis

185

Surveillance Reports

How do we do

Data bases

Data mining and market supervision solutions
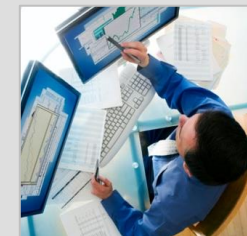

Filters and alerts

Notification for the CVM

Analysis
(Team of experts)

Penalties

Data bases

Data mining and market supervision solutions

News / Facts

The investor

The asset

Market Surveillance - Macro-process

Data Mining

80 different databases

Flexibility
- Create indicators
  - ✓ Filters
  - ✓ Alerts
- Modify indicators

Alerts

1st evaluation
Completely Internal

- Frequency
- Relevance

Investigation

2nd evaluation

Atypical
- Client
- Securities

Report

Build case

Bring action against
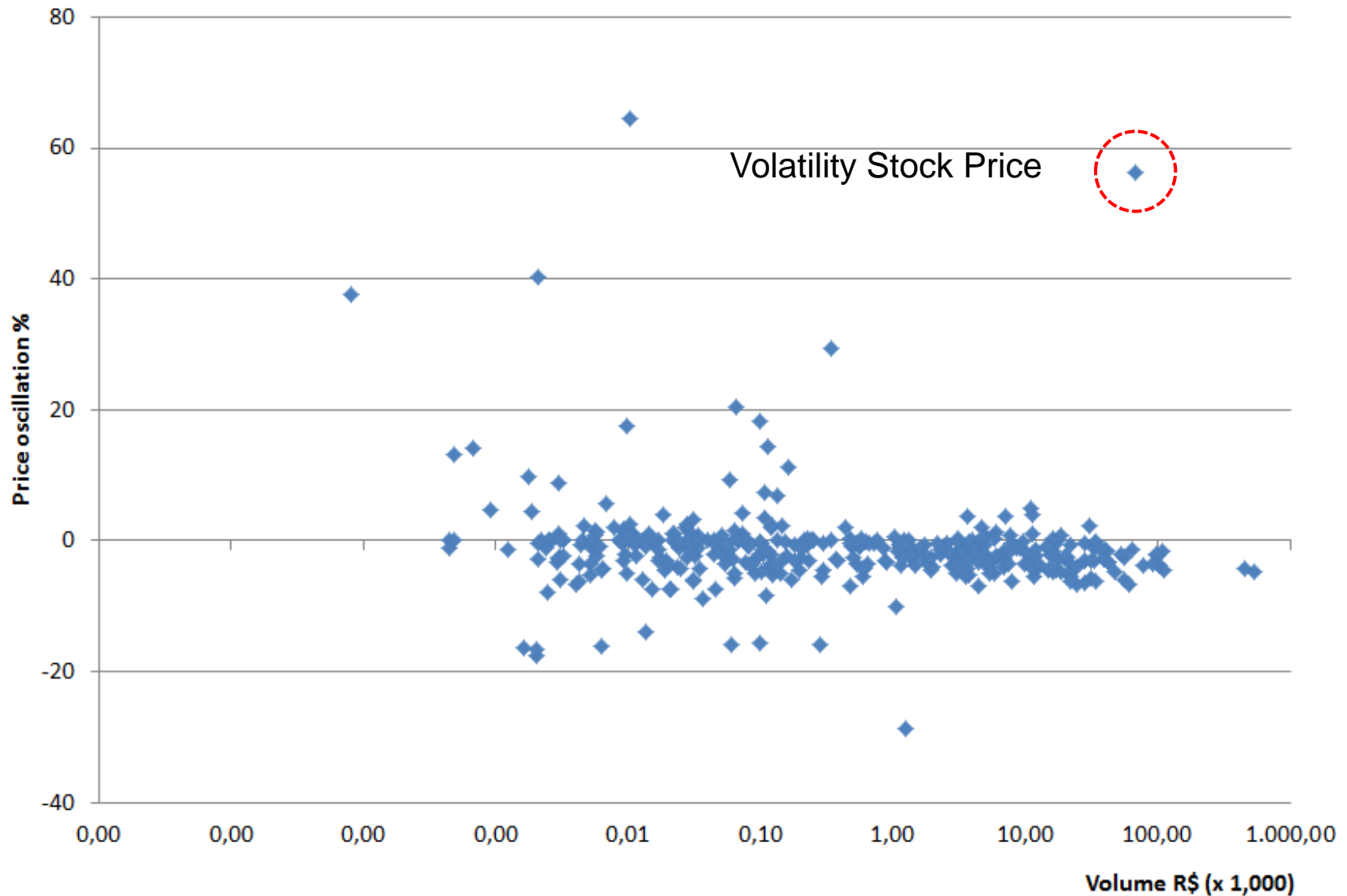- Broker
- Professional
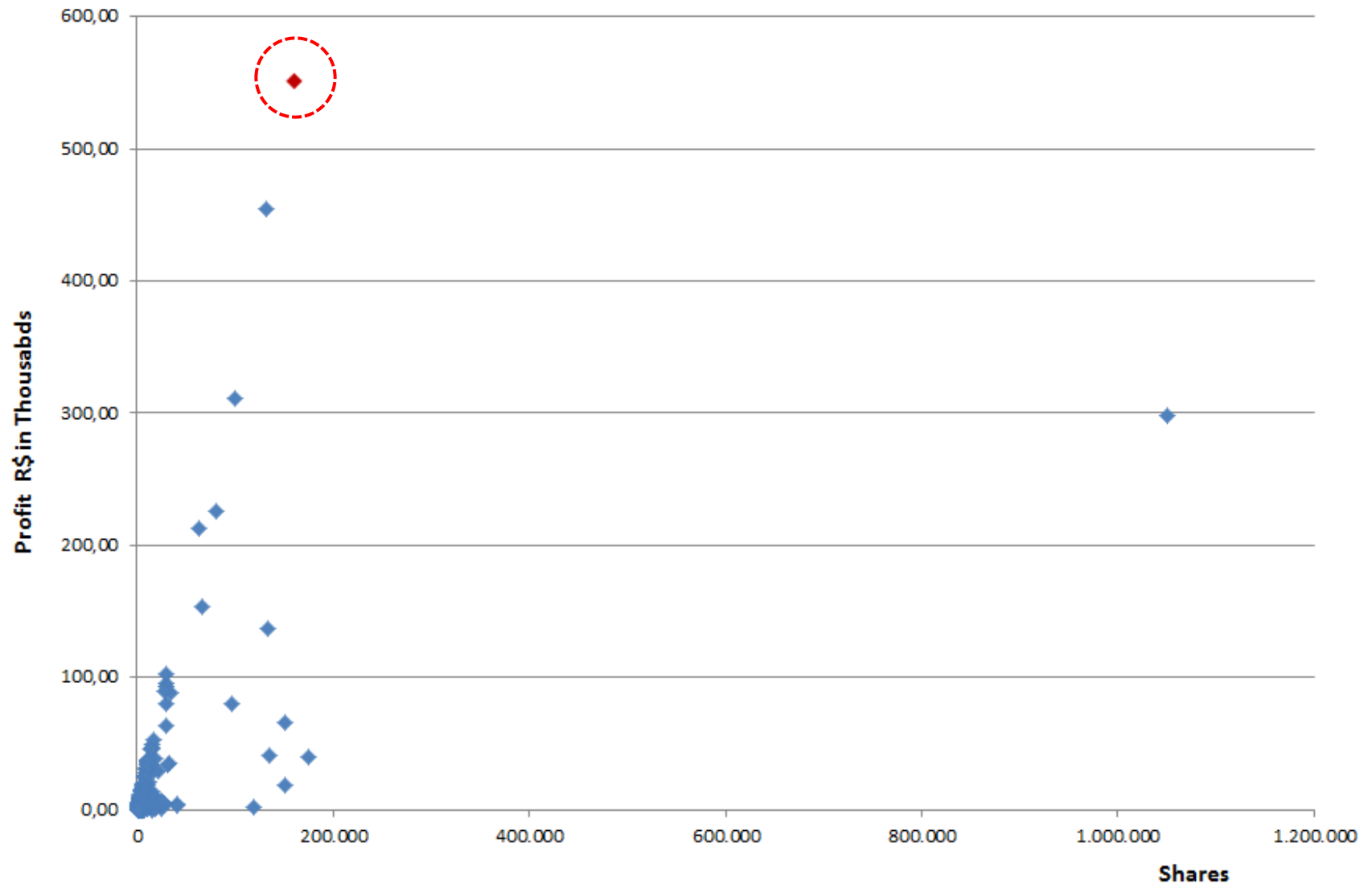- Independent contractor

> Information
> Supervision
> Decision
> Enforcement

Price Volatility Asset Filter Alert

Investor Profit

Investor Profit

BSM Action

2007, August 3 and 4: Price oscillation alert before the acquisition.

2007, August, 7th (T+2). Send the information (report) to CVM with beneficial owner identified.

7.23.2007 - Vailly **BOUGTH** 160.000 shares at average

8.3.2007 - 15h08 - acquisition information is public (event).

Vailly SOLD 160,000 shares at average price **R$8,91** with profit **R$ 551.450,00.**

Legend: quantity — price • Vailly Bought * Vailly Sold
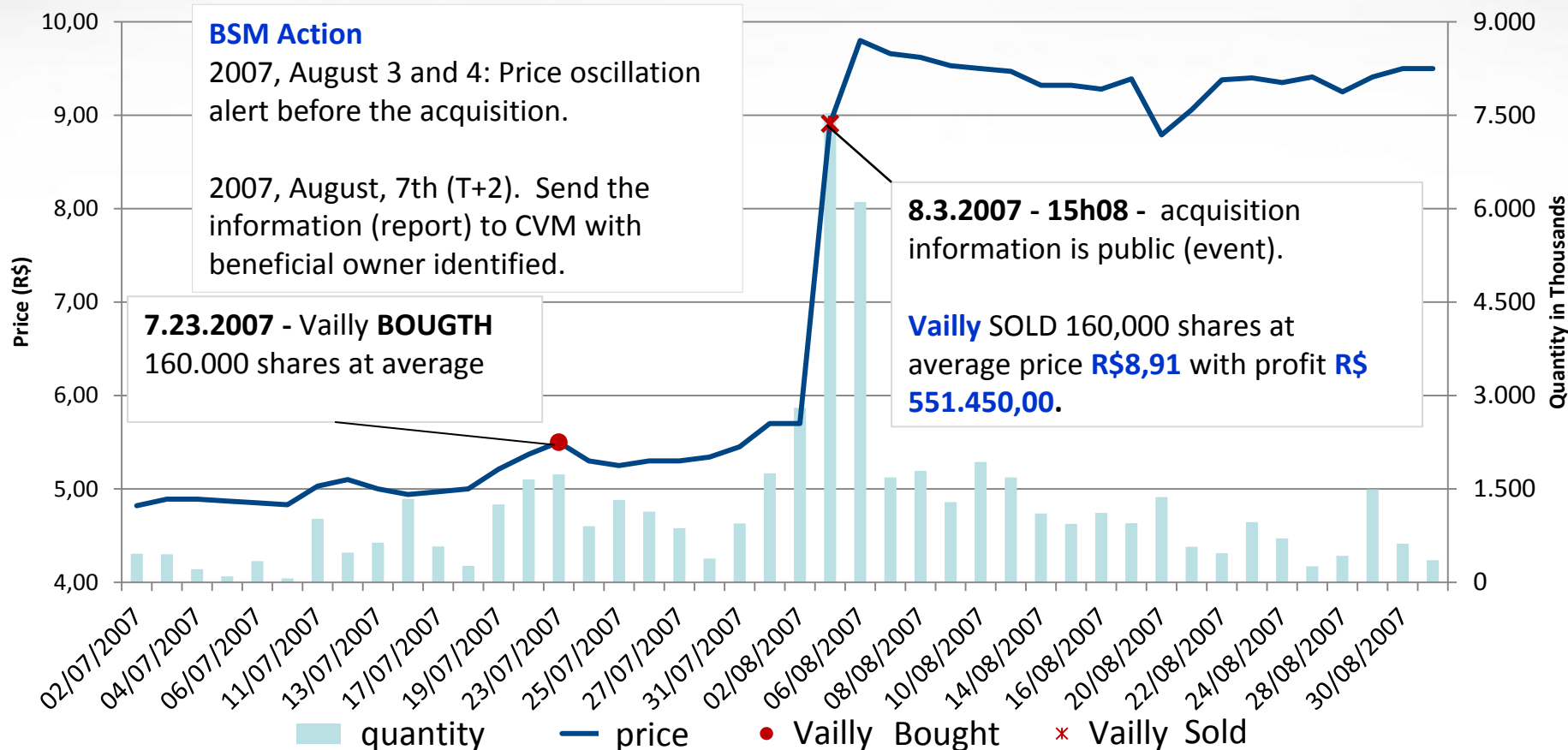
Results:

Settlement CVM – MPF: R$ 2,2 thousand in March 2008

http://www.cvm.gov.br/port/infos/TERMO%20DE%20COMPROMISSO%20E%20DE%20AJUSTAMENTO250308.asp
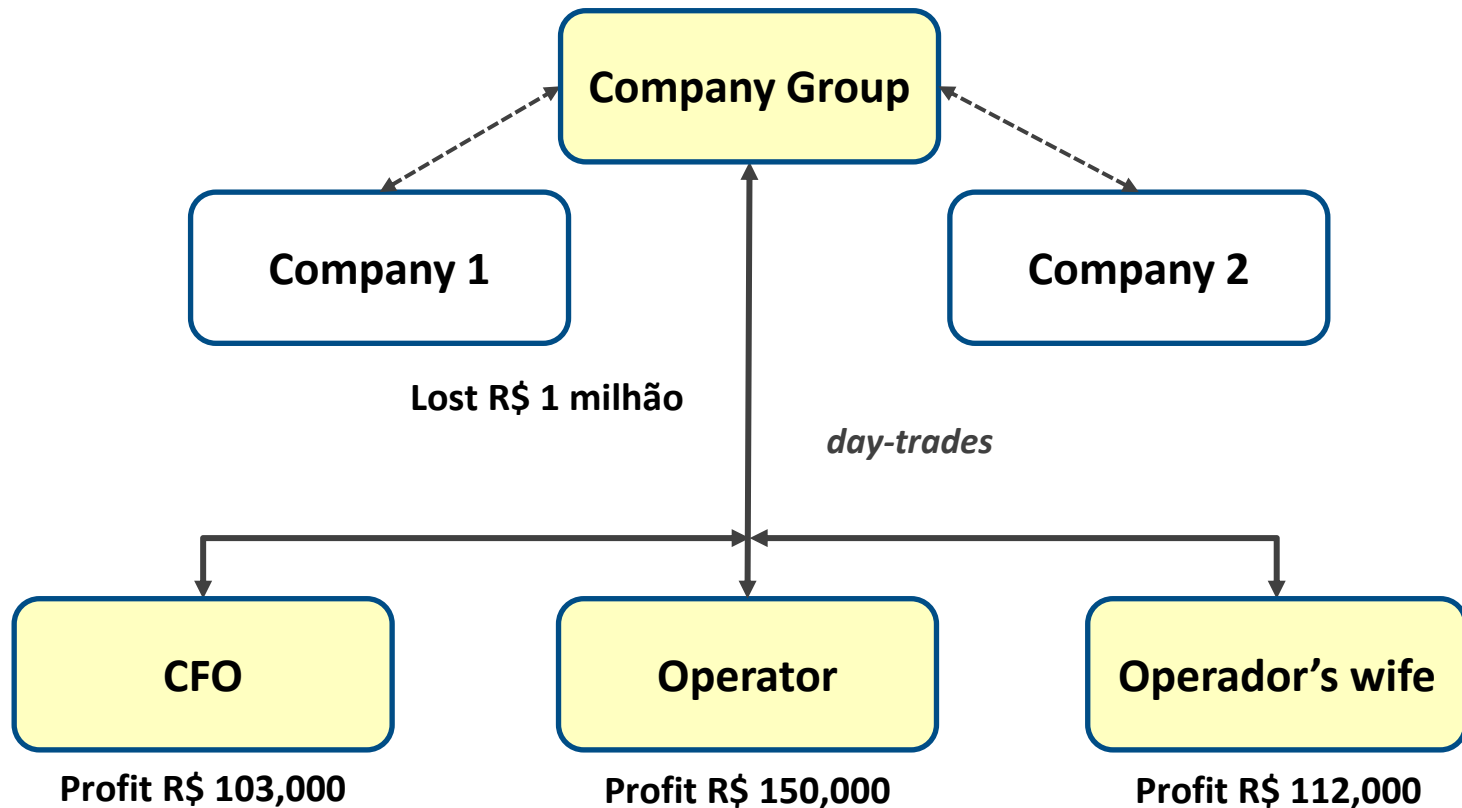
Case 2: Market manipulation

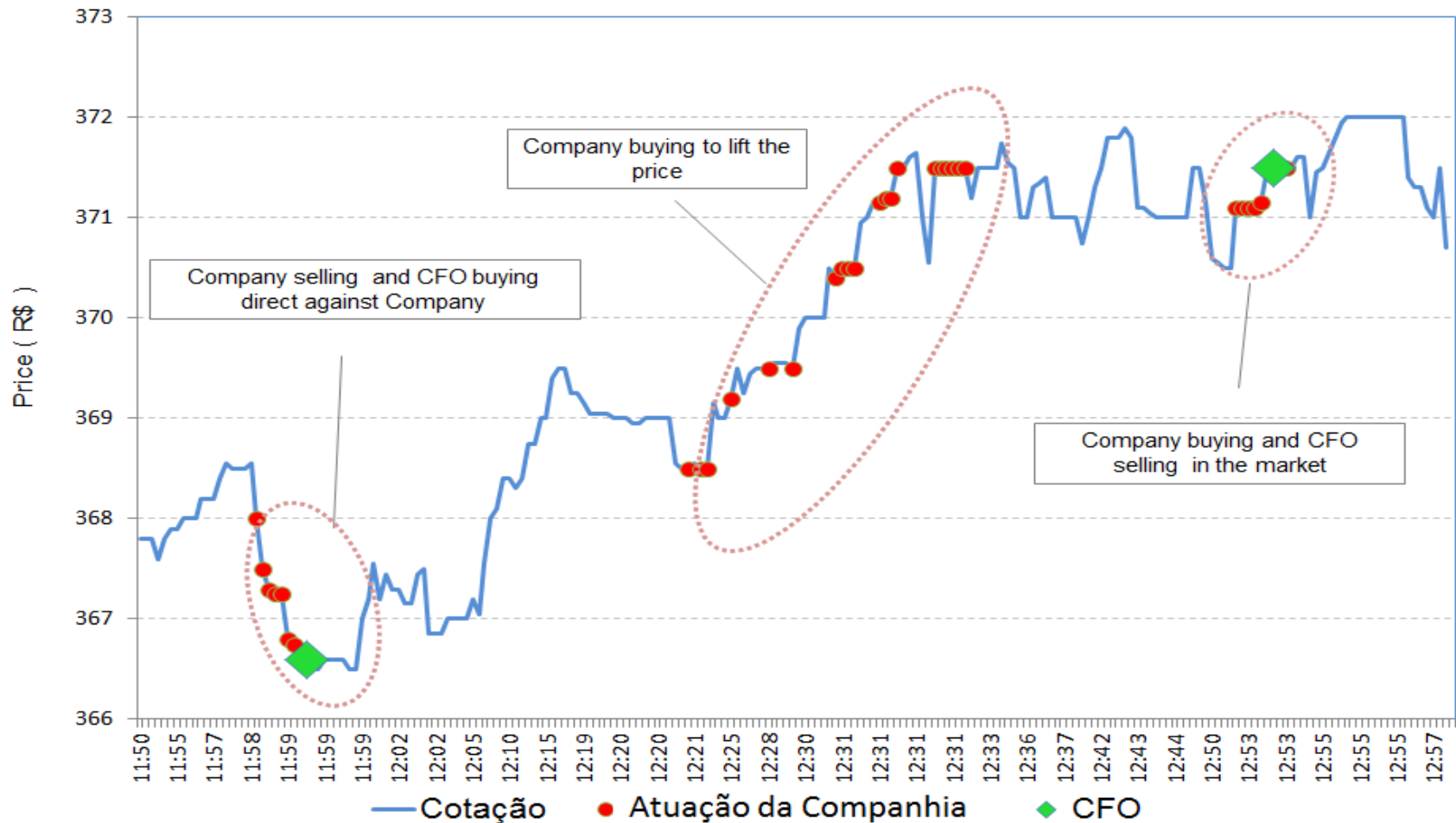## Profit & Loss Filter Alert and Success Index - asset analysis

Winners

Losers

The **same operator** in the **same broker**

Net Value P&L (R$ reais)

Success index
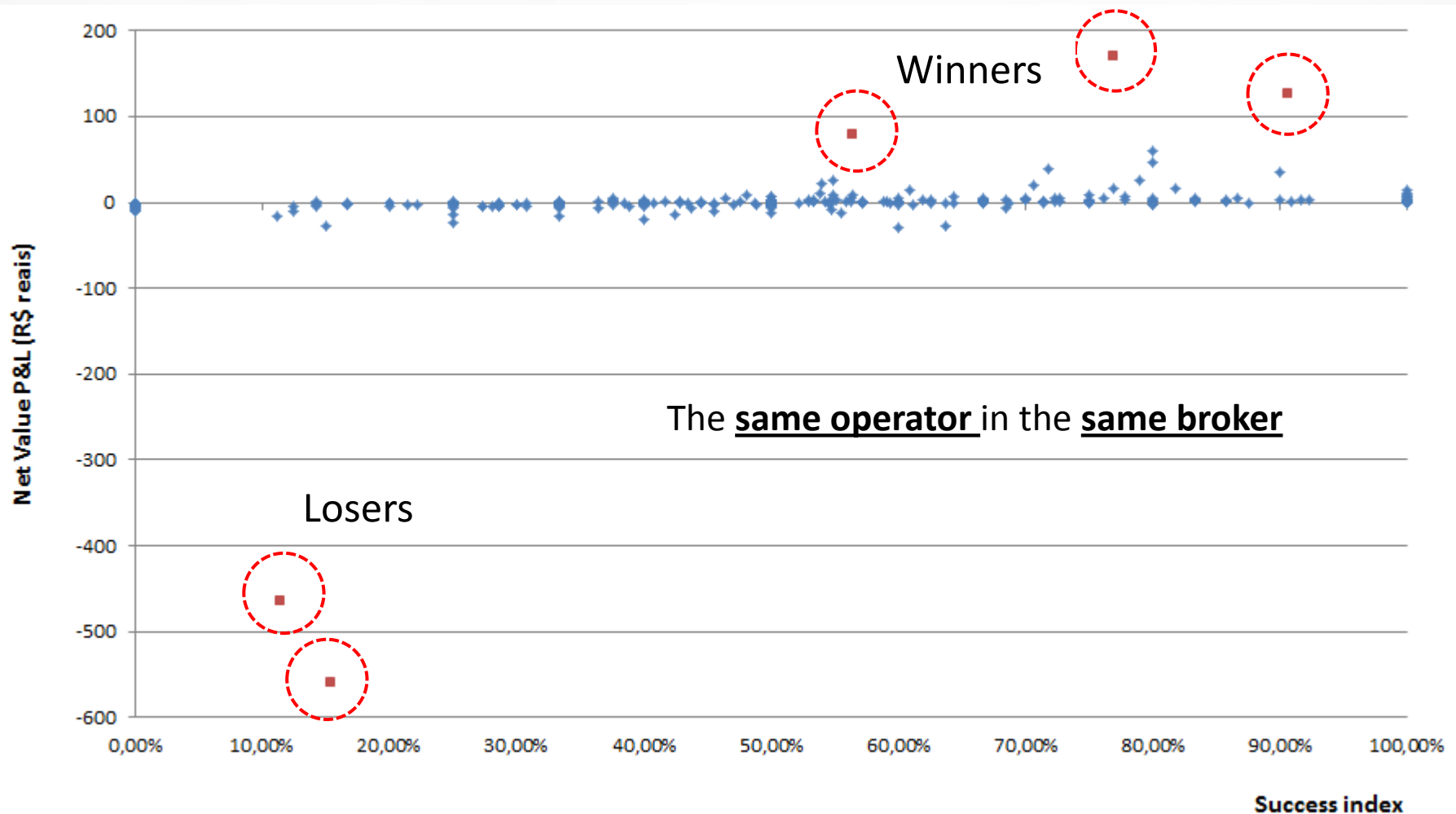
Case 2: Market manipulation

The "losers": 2 companies lead by the CFO (partner) and executed by the operator
The "winners": Operator, his wife and CFO

Case 2: Market manipulation

Results:

- Operator: Settlement – R$ 900,000
- CFO: send to the Securities Commission (CVM)

http://www.bsm-autorregulacao.com.br/ProcessoAdm47-2012.asp

Case 3: artificial conditions

- The problem

  – Broker trading artificially high volumes only to rise in the BM&FBOVESPA ranking in derivatives contract

- Broker's objectives

  – Rise in the BM&FBOVESPA ranks (volume of contracts traded)

    ✓ From 7th to 2th in Derivatives (1st in the specific contracts)

  – Attract institutional investors (which in Brazil seek work with the brokers best ranked)

- How we detect?

  – Filter: concentration filter counterparts (the own broker's portfolio x specific investment fund)

    ✓ 81,7% Broker's owner portfolio direct to "fund"

    ✓ 1,7 thounsands trades

    ✓ High volume with insignificant losses

Case 3: artificial conditions

- Results

    - Broker and operators: Settlements in a total of R$ 500,000.00

    - Volume of trades expunged from the statistics

    http://www.bsm-autorregulacao.com.br/ProcessoAdm59-2012.asp

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