

Recent Trends in Market Surveillance - The Brazilian Case

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The capital market has undergone enormous changes:

- Electronic communication networks
- Great number of complex orders
- Growth in trade volumes and cross border settlements
- New products – advanced derivatives products
- New practices – trading strategies
- New market structures (new venues. fragmentation)
- Systematic Internalization (SI)
- Competition/Fragmentation
- Lack of transparency

As a consequence...

“Recent market developments and advances in technology have allowed market participants to engage in a wider array of abusive market conduct that undermines investor confidence and financial stability”

K. Alexander – university of Cambridge”

Surveillance methods need to keep up with these changes

- Big Data powering surveillance technology
- Changing trading behavior and patterns
- Dark pools growing to market-threatening proportions ($\cong 1/3$ American Market)
- Growing need for near real-time surveillance
- Increased use of order-level surveillance to counter new trading strategies
- Emergence of cross-asset class, cross-market surveillance to detect subtle market abuse
- Cross-communication channel surveillance acting as an extended arm of market surveillance
- Emergence of cloud computing for capital market participants

Structural and organizational issues

- Technological - storage capacity and processing (speed)
- Skills - ability/intelligence (qualified human resources)
- Jurisdiction and Cooperation (cross border trade)
- Increasing costs

Informational issues

- Aggregation of multiple trading platforms data
- Data quality and format issues
- Lack of a uniform entity identifier standard
- Large unstructured data volumes (handling)

- Concentration of liquidity in a single market (equities and derivatives)
- Systematic Internalization - not allowed
- Final beneficiary identification (beneficial owner)
- HFT (16% cash and 17% derivatives)

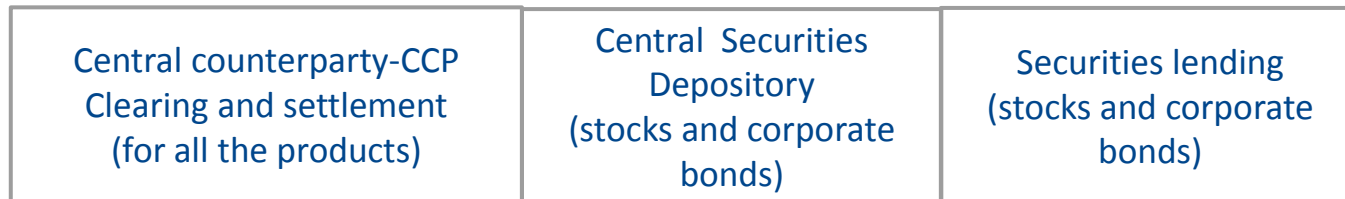
Problems arising from	Impacts/Solution
Structure (fragmentation, dark pools, data aggregation, consolidated tape)	Currently nonexistent
Cross-market and cross-asset trading	Monitoring of all markets managed by BM&FBOVESPA (cash/derivatives/OTC)
AT and HFT	Updated systems of oversight and specialized human resources
Cross-border trading	MMOU signed by the Regulator. Exchange of information subject to its approval.

A Vertically Integrated Exchange

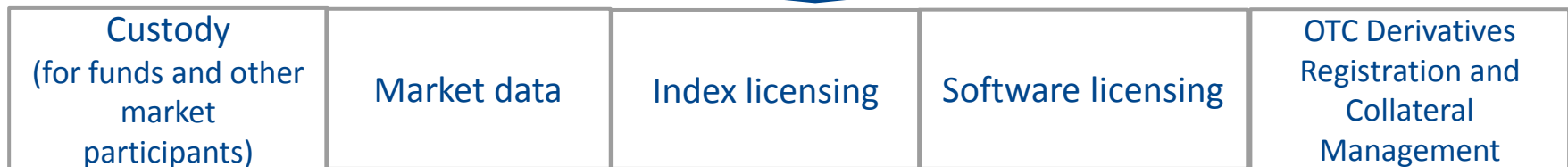
Trading and Services for issuers and commodities



Clearing and Depository activities



Other services



Annex I – Legal Base

Federal Law 6.385/1976

- Provides that exchanges are auxiliary regulatory entities responsible for surveilling market activities and market participants
- Defines as crimes against the capital market the market manipulation, the irregular practice of the profession and the use of insider information

Federal Law 9.613/1998

- Provides for the money laundering crimes or concealment of assets, rights and values

CVM Instruction 461/2007

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

CVM Instruction 8/1979

- Regulatory treatment of market abuse
- Comprehensive categories: conceptualizes generically situations that set up operations or practices incompatible with the regularity that is intended to ensure the securities market: artificial demand; price manipulation on the securities market; fraudulent trading; unfair practice

ICVM 301/99

- Provides for the identification, registration, operations, communication, limits and administrative responsibility mentioned in Law No. 9,613 / 98, related to money laundering crimes or concealment of assets, rights and values.

Main responsibilities established by CVM Instruction 461/2007

- Oversee and supervise trades performed on the organized markets
- Investigate misconduct in compliance with laws and regulations
- Follow the Exchange and OTC activities
- Establish, prosecute and judge administrative cases
- Enforce penalties (administrative final decision)

Shared supervisory functions

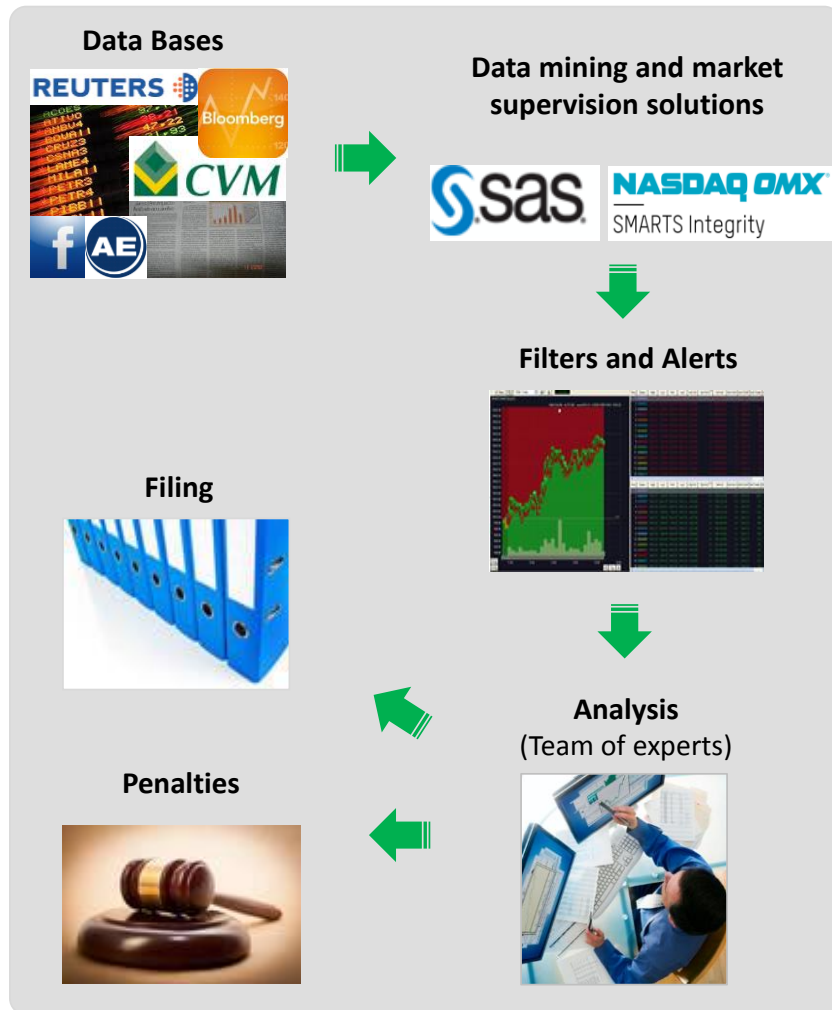
- Listings requirements and real-time surveillance, conducted by BM&FBOVESPA Regulatory Department

Annex II – Market Surveillance Strategy and Statistics

Monitoring 100% of offers and orders

Detection of abusive practices

- Market manipulation (interference free price formation)
- Artificial conditions of demand, supply or price (operations outside the interference-free ordinances)
- Insider trading
- Evidence of money laundering
- Fraud
- Unfair practice (client privilege over another)
- Irregular exercise of position, profession, activity or function
- Abusive practices (layering and spoofing, etc.)



Alerts

- **Market supervision based on statistical models, which produce indicators related to illegal practices**

Alerts Analysis

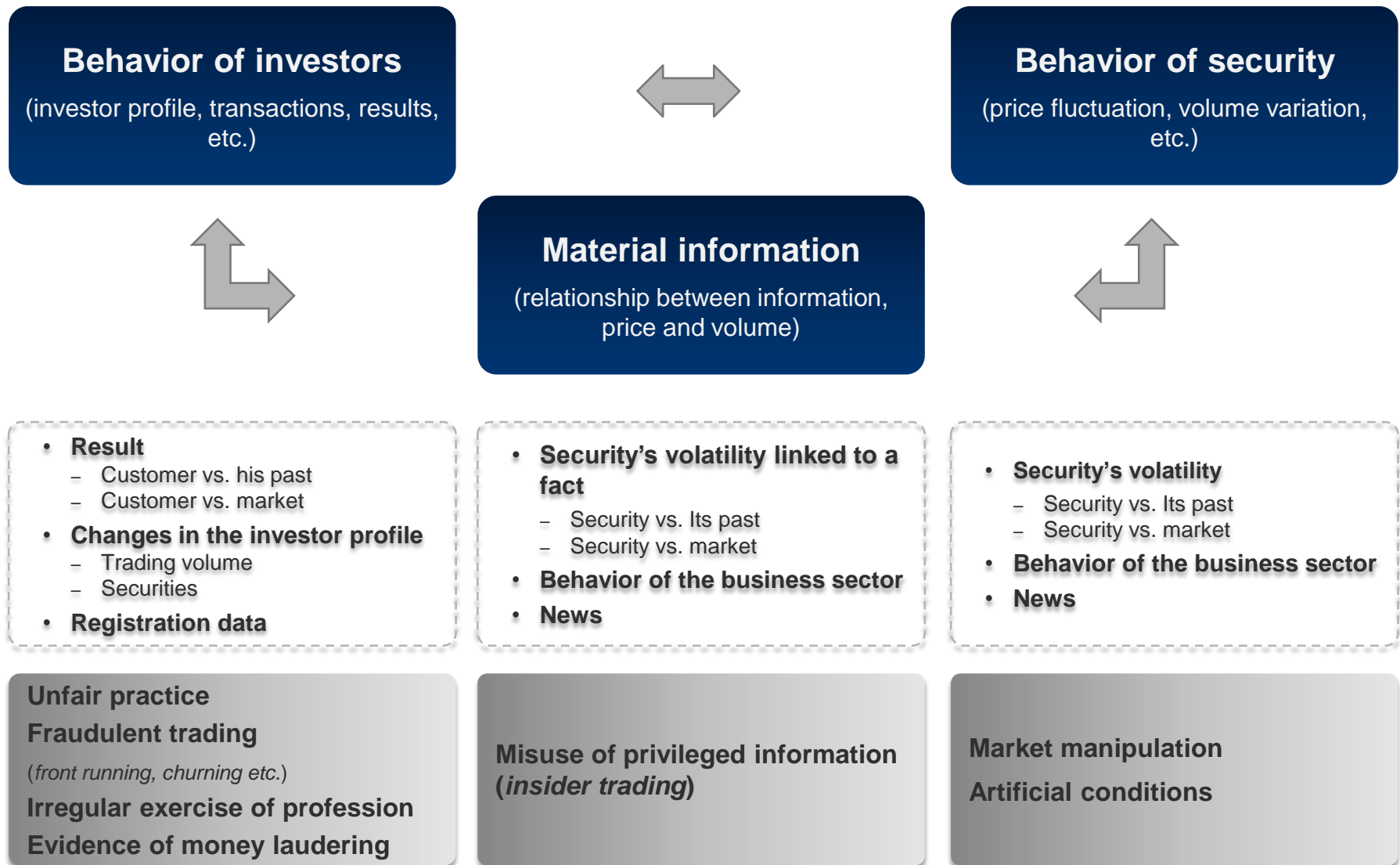
- Historical security data:
 - price, volumes, client profile, profit/losses in day trade, change of **trading profile, concentrated counterparty**

Investigation and Decision

- Requests of information to market participants
 - current account
 - recordings of orders
 - manifestation of the hypotheses
 - exchange of information with other department

Report

- **consolidation of evidence**
- **build the report**
- **definition of the accused**

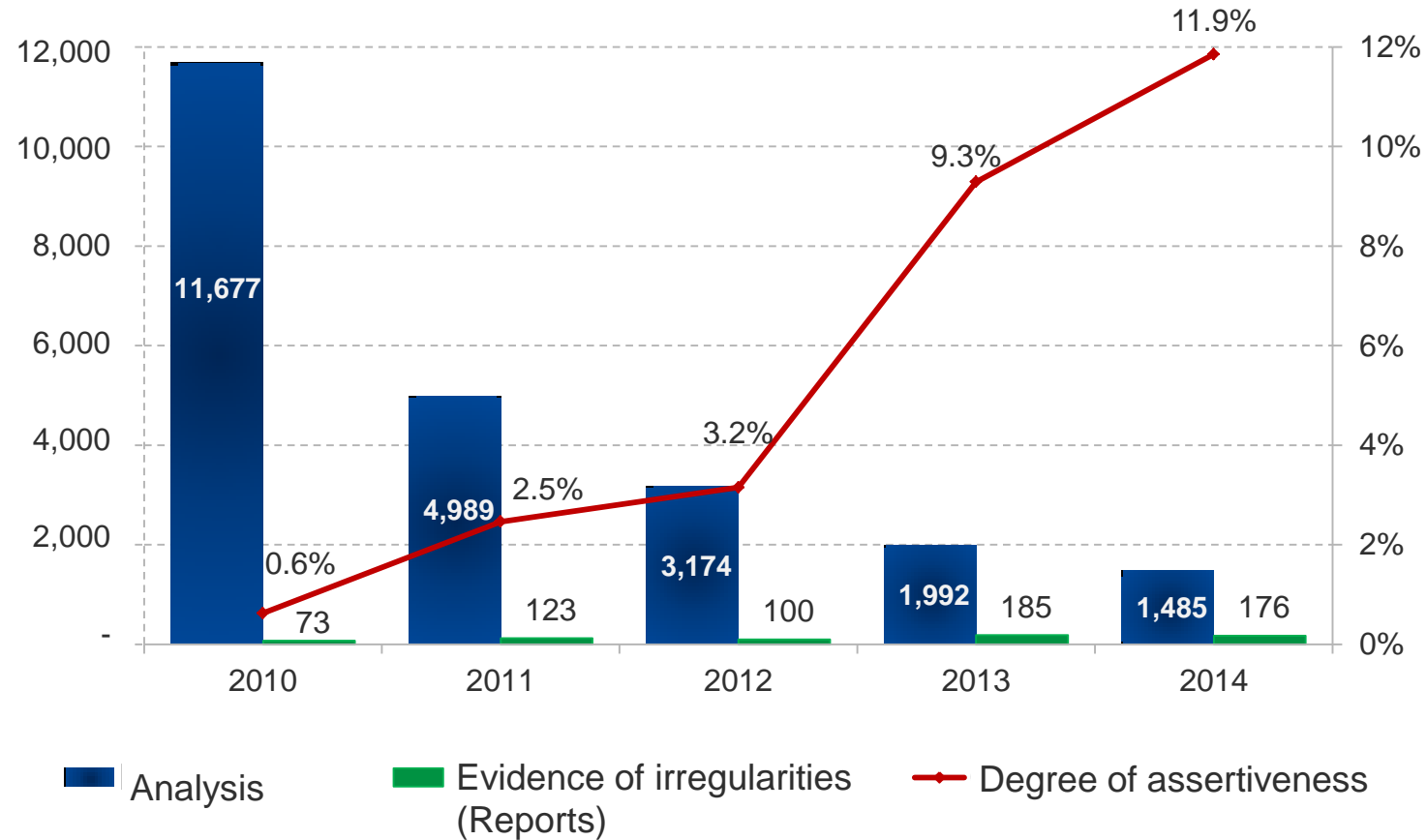


Market surveillance scope

	2012	2013	2014
Number of active investors (thousands)	538.4	560.1	555.3
Offers (hundred thousands)	2.4 *	3.5	4.3
Trades (thousands)	230.3	264.4	284.4
Alerts (market surveillance systems)	25,127	90,782	43,387
Analysis (specialists team)	3,174	1,995	1,485
Request for information	96	168	341
Reports (cases)	100	185	176

(*) Cash Market

Assertiveness degree - analysis



Detection (market abuse e operational risks)

- Market surveillance
 - *Updated systems: SAS/SMARTS*
 - *Assertiveness degree*
- Examinations
- Whistleblowing

Deterrence

- Preventive and incentive measures
- Enforcement actions

Intelligence

- Joint work with CVM
- International presence

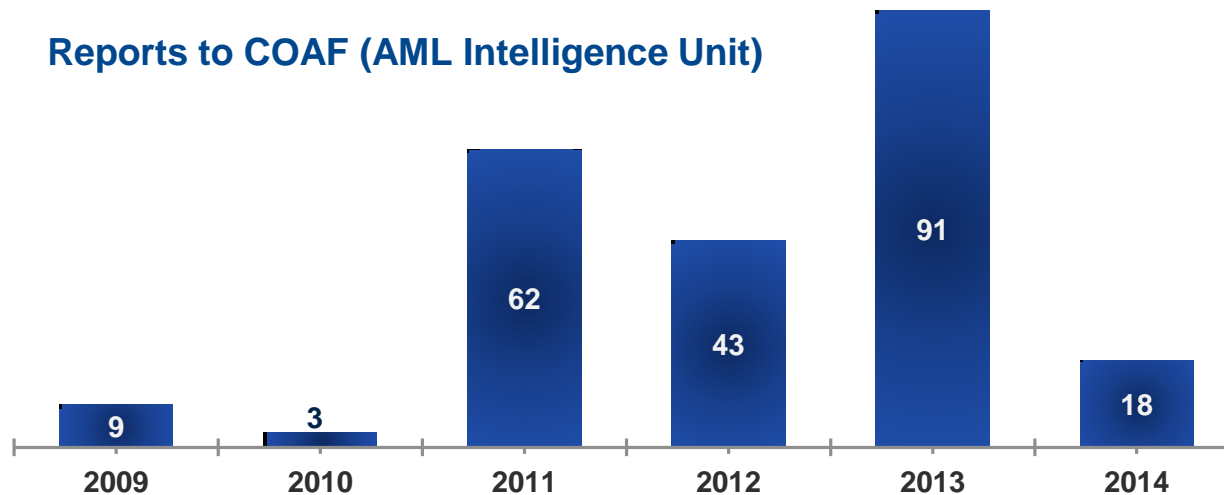


2014 results



	2012	2013	2014
Issued reports	100	185	176
Filed	61	128	115
Referral to CVM	21	23	30
Enforcement measures	18	34	31

Reports to COAF (AML Intelligence Unit)





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