

**MISUSE OF PRIVILEGED INFORMATION:  
COSRA/IARC/Latin American Roundtable  
SURVEY**

**September 15, 2011**

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## EXECUTIVE SUMMARY

### Background

Careful handling of material non-public information and mechanisms to discourage its misuse by corporate directors, officers and others are important elements of an effective corporate governance regime, supported by both the IOSCO *Objectives and Principles of Securities Regulation* and the OECD *Principles of Corporate Governance*.

The OECD Principles of Corporate Governance (“OECD Principles”) characterize insider trading as an example of abusive self-dealing, resulting in inequitable treatment of shareholders. “Abusive self-dealing occurs when persons having close relationships to the company, including controlling shareholders, exploit those relationships to the detriment of the company and investors.”<sup>1</sup> The OECD Principles recognize the important role played by policies, practices and formal structures within the corporation (especially the Board) in fostering an environment of equitable treatment of shareholders and in promoting confidence in financial markets. The OECD Principles also stress the need for a strong legal/regulatory regime in this area, calling for the prohibition of insider trading in all jurisdictions. Furthermore, in 2003, the Latin American Corporate Governance Roundtable’s White Paper on Corporate Governance<sup>2</sup> set out a series of recommendations for both companies and policy makers regarding the prevention of abuse of privileged information and insider trading.

The legal/regulatory framework governing the use of material non-public information and the means of its enforcement have also been the subjects of long-standing discussion among Supervisory Authorities. The International Organization of Securities Commissions’ (IOSCO) *Objectives and Principles of Securities Regulation* address corporate governance concerns relevant to the prevention of misuse of privileged information across a number of its recommendations.<sup>3</sup> They state that investors are entitled to protection from misleading, manipulative or fraudulent practices, including insider trading and front running, or trading ahead of customers. To advance this important element of dialogue on securities markets regulation, in 2003, IOSCO’s Emerging Markets Committee published *Insider Trading: How Jurisdictions Regulate It*, which surveyed existing prohibitions on insider trading and set out guidelines for creating or amending existing regulations.<sup>4</sup>

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<sup>1</sup> *OECD Principles, III, B.*

<sup>2</sup> The Roundtable, which brings together policy-makers, regulators, stock exchanges and a range of public and private sector stakeholders from Latin American and OECD countries, adopted the White Paper recommendations by consensus. See Annex 1 for relevant excerpts from the *OECD Principles of Corporate Governance* and the Roundtable’s *White Paper on Corporate Governance in Latin America*.

<sup>3</sup> For example, they state that consideration should be given to the “adequacy, accuracy and timeliness of both financial and non-financial disclosures that are material to investors’ decisions. These disclosures may pertain to specified transactions, periodic reports and ongoing disclosure of and reporting of material developments. The disclosure of current and reliable information necessary to make informed investment decisions is directly related to investor protection and to fair, efficient and transparent markets.”

<sup>4</sup> The report consists of two parts: a synthesis of insider trading regulations and of regulations designed to prevent it.

Supervisory Authorities have been among the most important participants in the Latin America Corporate Governance Roundtable since its inception. The critical nexus between corporate governance and the regulation and supervision of capital markets was recognized from the outset. It is within this context that in December 2009, at the Roundtable's 10<sup>th</sup> Annual Meeting in Santiago, Chile, OECD representatives and the COSRA/IARC Chair discussed launching a joint Roundtable-COSRA/IARC Task Force.<sup>5</sup> The Task Force was subsequently approved by both the Roundtable and COSRA/IARC, with a mandate to gather accurate, factual and quantitative information on the current legal/regulatory environment, to examine the experiences in the region with enforcement of laws and regulations on the use and misuse of privileged information, and to report back to both bodies with findings and recommendations.

The Task Force collected factual information and historical experience from 19 jurisdictions<sup>6</sup> to develop an understanding of how participating jurisdictions address the key issues revolving around privileged information. A survey was prepared and circulated to all COSRA/IARC members. The survey included questions about the existing legal/regulatory framework governing the use of privileged information, the mechanisms available to the authorities and private parties to enforce such framework (both *ex ante* and *ex post*), and the recent historical experience with criminal, civil and administrative enforcement procedures. The survey also inquired about sources of standards and guidance other than laws and regulations, such as those of self-regulatory organizations ("SROs") and other self-regulatory bodies, national codes of best practice, and internal corporate guidelines, policies and codes of ethics. Subsequent to receiving and reviewing the survey responses, the Task Force's reporters conducted conference calls with selected respondents. Throughout, the Task Force sought in particular to understand how corporate governance policies and practices might reinforce or complement the legal/regulatory regime and promote an environment of greater compliance and more effective enforcement.

Consistent with the Task Force's mandate, this report summarizes what was learned about the various legal/regulatory regimes and enforcement experiences in the responding jurisdictions. It sets out the key similarities and differences across the region and draws some conclusions about the impact of different approaches to regulation and enforcement in the area of misuse of privileged information. The report identifies certain practices that have shown themselves to be of value in some jurisdictions and which other companies and Supervisory Authorities may want to emulate so as to more effectively prevent or sanction the misuse of privileged information. Although this report focuses especially on those practices closest to the nexus of corporate governance and securities regulation on the topic of privileged information, it also provides some general observations or guidance that Supervisory Authorities may consider to reduce perceived gaps and weaknesses in their enforcement capacity.

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<sup>5</sup> For more background on the sponsoring institutions and mandate, structure and membership of the Task Force, see Annex 2.

<sup>6</sup> Argentina, Barbados, Brazil, Canada, Cayman Islands, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Honduras, Mexico, Nicaragua, Panama, Peru, Spain, Trinidad & Tobago, and Uruguay.

## Findings

All respondents have in place a regulatory regime governing the use of privileged information concerning public companies. In general, “privileged information” can be summarized as material non-public facts regarding the condition or prospects of an issuer of securities or the securities themselves, or unspecified entities to which such information may relate. However, the definitions in some jurisdictions differ importantly with respect to the degree of materiality such information must have to qualify as “privileged”. Some jurisdictions require evidence that the information be price sensitive for it to be considered material, and hence governed by the regime. Others, in contrast, broaden the concept of materiality to include “any information that a rational investor would take into account in the course of doing due diligence on an investment”, without a requirement that evidence be presented that such information is price sensitive.

A minority of reporting jurisdictions provide for special treatment of market-sensitive privileged information that an issuer of securities may withhold from the market if its immediate disclosure is deemed to harm the interests of the company (“reserved information”). Following an affirmative decision by the company’s Board to withhold such information (i.e., to classify such information as “reserved”), the issuer must advise the Supervisory Authority, disclosing, *inter alia*, information on who has access to such information and what efforts the company will undertake to prevent its misuse.

All surveyed jurisdictions share similar prohibitions regarding the treatment of privileged information by parties subject to the rules. Together these prohibitions are generally referred to as a “refrain or disclose” regime. Persons subject to the regime, may not (while such information remains non-public):

1. Trade on, or otherwise derive a benefit because of their possession of privileged information (illegal "insider trading");
2. Share such information with others, except as required by their professional duties and law (illegal "tipping"); or
3. Recommend to others that they purchase or sell affected securities (illegal "tipping").

In addition to “refrain or disclose” requirements that apply when individuals are in actual possession of privileged information, some jurisdictions limit trading by certain insiders during periods (“black-out periods) when they are presumed to be in possession of privileged information (e.g., immediately prior to quarterly earnings announcements).

In all jurisdictions reporting, both the legal/regulatory framework and the Supervisory Authority’s powers to regulate, supervise, investigate and enforce derive from specific legislation. Also in all such jurisdictions, the regime applies to natural and legal persons; however, abuse committed by legal persons may not be sanctionable in all jurisdictions. In a number of countries it appears that criminal penalties may only be imposed on individuals, a situation that can be considered as limiting the ability to enforce rules against misuse of privileged information.

The legal/regulatory frameworks in many countries also provide for at least some degree of reporting by issuers on the degree of compliance with law and regulations (and sometimes internal policies) regarding privileged information. In some such cases, the Board is specifically charged with

oversight of such reporting. Board responsibility for oversight of the compliance and reporting functions indicates that failure to ensure adequate internal rules and procedures for sharing and control of privileged information may expose members of the Board, senior management and the company to potential liability.

The Task Force examined other sources of standards and guidance for the handling of privileged information in addition to those set out in law and regulation, or the rules of a securities exchange or SRO. Some jurisdictions require that listed companies either comply with a code of corporate governance best practices or explain why they diverge from particular elements of it. Among the surveyed markets, there is considerable divergence regarding the guidance that corporate issuers have on handling privileged information inside a company. Some countries rely solely on general laws and regulations, while other jurisdictions have in addition private sector guidance. Despite their voluntary nature, codes and other standards of practice help to reinforce the important responsibilities of the Board and senior management in approving internal rules, monitoring compliance and ensuring the adequacy of controls in the area of privileged information.

In addition, some jurisdictions require listed companies to have in place formal written policies on how privileged information is managed in the company, and some jurisdictions require that such internal policies be made public. However, the legal requirement that issuers have formal internal policies is far from universal. While it would be useful to have more detailed guidelines specifying, for instance, who is responsible for keeping the information from leaking outside the company, who is responsible for ensuring the information is not misused, who is responsible for overseeing the existing procedures and reviewing these over time, etc., specific mandatory or voluntary corporate guidance is absent in some markets.

Intermediaries, exchanges or other market participants acting under license are also subject to professional codes of ethics. Such professional codes of ethics require persons subject to them to act in the best interests of their clients and to refrain from using material non-public information for their own benefit or the benefit of third parties.

The parties subject to the jurisdiction of the Supervisory Authority and the latter's powers to investigate or impose sanctions vary widely across jurisdictions. For example, Supervisory Authorities outside the larger markets appear to be generally more constrained in whom they may compel to testify or provide evidence, what records they may lawfully request, and whom they may sanction. The Supervisory Authorities in all jurisdictions reporting are empowered to conduct investigations and initiate administrative actions against legal persons who are suspected of acting in violation of the laws and regulations. Many jurisdictions allow victims to bring civil suits directly, either under specific legislation or general anti-fraud provisions of the Civil Code. In a small number of countries, the Supervisory Authority itself may bring an action for compensation of injured parties. But in practice, very few civil actions seeking compensation of victims have been brought by individuals or by Supervisory Authorities.

In all jurisdictions reporting, the law provides for the possibility of criminal prosecution for the misuse of privileged information, with actions initiated by either the public prosecutor or by the Supervisory Authority itself.

SROs may play a role in enforcement by exercising market surveillance and by disclosing the results of their market surveillance activities to the Supervisory Authorities. However, there are significant differences in the adequacy of market surveillance mechanisms across countries. For instance, stock-watch systems to detect and report suspicious trading activity around the dates of release of information about

companies are in place in only a limited number of the reporting jurisdictions. Few SROs are empowered to conduct full investigations and impose sanctions against listed companies or their officers and directors; some do not even have such authority over member brokerage firms.

Supervisory Authorities reported significant weaknesses and gaps that impeded the more effective enforcement of their regimes for the prevention of misuse of privileged information. These weaknesses and gaps can be usefully divided into three (partially overlapping) areas: shortcomings in the legal/regulatory framework; obstacles to more effective policing of the market; and issues that prevent exchanges and SROs from playing a greater role in enforcement. One of the most common limitations cited by Supervisory Authorities in the responses to the survey relates to access and sufficiency of evidence. Most of the jurisdictions reported difficulty or impossibility to access phone records, recordings of conversations, e-mails or bank account information and, in some cases, the impossibility to compel testimony. Another impediment is, in some cases, the absence of a database or other means of identifying parties related to those with access to privileged information.

## **RECOMMENDATIONS**

The Latin American Corporate Governance Roundtable's *White Paper on Corporate Governance* called for improvements in the quality, effectiveness and predictability of the legal/regulatory framework as one of its six consensus priorities for better corporate governance in the region. Improving the effectiveness of enforcement, strengthening the powers and resources of Supervisory Authorities, improving the capacity of the judiciary in areas related to corporate governance, and providing a broader array of private rights of actions for mistreatment of shareholders are all among the specific recommendations of the White Paper.<sup>7</sup> The responses to the survey, in particular those concerning the experience with enforcement actions initiated by both Supervisory Authorities and aggrieved shareholders, indicate the White Paper's recommendations remain salient with respect to the misuse of privileged information. Policy makers, legislators, Supervisory Authorities, companies, investors and other private sector players all have a role to play in improving the regime governing the treatment of privileged information and the effectiveness of its enforcement. Beyond these more over-arching issues, the survey results and discussions with survey participants led to the following recommendations on ways to discourage or prevent the misuse of privileged information.

### **GENERAL RECOMMENDATIONS**

#### **Responsibility for preventing the misuse of privileged information should be a priority for Boards as well as Supervisory Authorities.**

Ensuring the proper handling of material non-public information and sanctioning misuse of privileged information should be a priority for both companies and their Boards, on the one hand, and for Supervisory Authorities on the other. Laxity within the corporation, a weak legal/regulatory framework and ineffective enforcement combine to destroy confidence in listed firms and the public capital markets, resulting in higher cost of finance (governance discount), poorer price discovery, decreased liquidity and inefficient capital allocation. Few, if any, of the respondents to the survey expressed satisfaction with

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<sup>7</sup> See *White Paper, Chapter 5, Section VI : Improving Compliance and Effective Enforcement.*



either the degree of attention to this topic paid by listed companies and their Boards, or the effectiveness of *ex ante* and *ex post* enforcement efforts.

**Boards should strengthen corporate policies and practices on privileged information.**

Issuers, in particular their Boards, should pay greater attention to the adequacy of internal policies and practices relating to the handling of privileged information. Boards should regard the control of privileged information and the prevention of its misuse as a key element of risk management. Anecdotal evidence from the respondents indicates that most companies and their Boards regard internal policies and practices with respect to privileged information as merely a matter of technical compliance, if even that. Failure to regularly review existing policies and practices, and to monitor their effectiveness, exposes firms to potentially serious compliance, reputational and financial risks. In addition, in an increasing number of jurisdictions, Boards that do not adequately oversee the adequacy of their company's policies, practices and systems regarding the handling of privileged information may be exposing their companies and Board members themselves to administrative and civil liability.

**Standards and codes should provide more detailed guidance to companies on appropriate policies and practices with respect to privileged information.**

The existing codes and other sources of guidance in the region appear to differ significantly in the extent to which they recommend specific policies or practices with respect to privileged information or assign responsibility for the implementation and oversight of such policies and practices. Consistent with and reinforcing the recommendation that Boards pay great attention to privileged information as a matter of risk management, issuers of codes of best corporate governance practices and similar sources of standards in the region should examine whether such standards provide sufficient guidance to firms with respect to the Board's and management's responsibility for the adequacy of internal policies and practices relating to the handling of privileged information and the prevention of its misuse. At a minimum, members of the Board of Directors and senior management need to take into account which individuals and entities are covered by the presumption of access to privileged information or identified as insiders in the design and oversight of a company's policies, practices and controls with respect to privileged information.

**Supervisory Authorities should promote internal company policies and practices that complement regulation and enforcement.**

Supervisory Authorities should pay greater attention to how corporate governance standards, policies and practices can better complement and reinforce the effectiveness of the legal/regulatory framework and enforcement in the area of use of privileged information. Differences in the legal responsibility of corporations and their Boards for ensuring against misuse of privileged information, and the impression of many respondents that Boards and management are often less than diligent in their oversight of the quality of internal policies and practices in this area, indicate that there is considerable room for reinforcing external enforcement (i.e., by the Supervisory Authority) with internal practices more reflective of effective corporate governance. Exchanges and SROs should consider adopting policies or a code of conduct for their members regarding the use of privileged information.

### **Trading by company insiders should be as transparent as possible.**

Investor confidence increases as the public capital market has greater access to timely information about trading by corporate insiders. As a consequence, a number of jurisdictions surveyed require reporting of trades in company shares by managers, directors and controlling shareholders. A few markets prohibit trading by insiders around key disclosure dates, such as prior to the release of quarterly financial information (“black-out periods”) or include in their legal frameworks a “short-swing” profit rule requiring insiders to return to the company any profits earned through the purchase and sale of shares within suspiciously short periods. In countries where information on trading by insiders is not completely or timely provided to the market, and/or where such persons are free to trade around key disclosure dates, companies and standard setters should consider the value of voluntary disclosure, black-out period policies and short-swing profit rules. The evidence from Chile indicates that securities of companies that implement voluntary black-out periods are rewarded by the market.

### **Supervisory Authorities should share experiences with regulation and enforcement.**

Supervisory Authorities in all jurisdictions recognize that preventing the misuse of privileged information, and sanctioning it when it does occur, is a difficult challenge everywhere. Even with the best available tools, limitations on availability and timeliness of information impede prevention, and evidentiary requirements complicate enforcement actions. However, divergences in regulations and enforcement experiences reported by the respondents indicate that Supervisory Authorities can benefit from considering how their peers in other jurisdictions address the issue of misuse of privileged information.

### **MORE SPECIFIC SUGGESTIONS**

#### **The adequacy of current definitions of privileged information should be reviewed.**

Policy makers and Supervisory Authorities in some jurisdictions should consider the practicality of the current definitions of what constitutes privileged information. Especially in smaller and less liquid markets, a definition not requiring specific evidence of market sensitivity may, generally speaking, facilitate enforcement.

#### **Supervisory Authorities should regularly review the adequacy of their investigatory toolset.**

Supervisory Authorities should regularly review their investigatory toolset in order to be in a better position to access information necessary to effectively prosecute privileged information cases. Comparing powers with those available to other Supervisory Authorities is helpful. For example, members should refer to the IOSCO Multilateral Memorandum of Understanding (MMoU), which sets forth the basic information and associated investigation powers necessary for effective enforcement. Members may also consider IOSCO’s Emerging Markets Committee report, *Insider Trading: How Jurisdictions Regulate It*, referred to above. Furthermore, systems to detect and report suspicious trading activity should be considered by those Supervisory Authorities not yet equipped with efficient tools of detection.

#### **Disclosure of company policies and practices should be encouraged.**

As noted above, internal corporate policies and practices, and adequate mechanisms to ensure they are followed, are a first line of defense against the misuse of privileged information. The periodic review

and updating of such policies and practices is an essential ingredient of proper corporate governance. As a matter of transparency, to generate external discipline on the governance of listed firms, and to increase momentum for improving standards market-wide, listed companies should disclose their policies and practices with respect to handling of privileged information, and any instances where violations have been uncovered. Consistent with regard for the quality of practices and the adequacy of disclosure, an officer should be assigned responsibility for the supervision in this area and should report directly to the Board of Directors.

**Insiders should disclose entities over which they exercise or influence investment decisions.**

To increase transparency and foster market confidence, and to assist in the enforcement of existing laws and regulations regarding the misuse of privileged information, companies and standard setters should encourage officers, directors and significant shareholders to disclose all entities (including companies, trusts, funds, accounts and other investment vehicles) over which they exercise or influence investment decisions. National codes of best practice, by-laws and board charters should be reviewed with an eye toward increasing the ability of companies, the Supervisory Authority and the market to identify the vehicles whose trading and investment decisions are made or materially influenced by those who may be in possession of privileged information.

## LEGAL/REGULATORY CONTENT

### Sources of Law

All nineteen survey responses made specific reference to securities legislation and regulations issued pursuant to such legislation in describing the existing legal/regulatory regime governing privileged information. In all cases, the Supervisory Authority's powers to regulate, supervise, investigate and enforce derive from specific legislation. In some cases, this legislation also empowers other governmental entities (such as the Public Prosecutor) to initiate civil and criminal actions against alleged wrongdoers. A few respondents mentioned legislation empowering the agency charged with overseeing the national pension fund scheme to enforce certain provisions of the legal/regulatory framework applicable to misuse of privileged information against entities subject to its supervision. In some cases, the legislation relating to the misuse of privileged information also provides injured parties with special causes of action against those who misuse privileged information to their detriment. Finally, a few respondents noted that general principles of the law of damages (tort) in their jurisdiction provide grounds upon which a plaintiff may sue another party for misuse of privileged information. (See "Enforcement Actions", below.)

### Definitions of Privileged Information

All nineteen countries responding to the survey questionnaire affirmed the existence of a legal/regulatory regime governing the use of privileged information in their market. Most commonly, privileged information<sup>8</sup> is defined in legislation and regulation as information that has not been made available to the market and which if made known would, or could reasonably be expected to, have a material effect on the price of a security.<sup>9</sup> However, a minority of respondent countries apply a potentially broader definition, in that a direct impact on the price of the security is not specifically referenced. These broader definitions range from Argentina's, which refers to "facts and situations that ... affect in a substantial manner the placement of negotiable securities or the course of their trading" to certain jurisdictions in Canada which require only that the information would reasonably be expected to affect an investment decision relating to a security. Colombia's definition is similar in referring to information that an investor would take into account in diligently and prudently transacting in the related security. . In Brazil, the concept of privileged information refers to information not yet disclosed about material facts or events. The Brazilian Corporation Law broadly defines privileged information as "any material information not yet released to the public that anyone may receive and shall not make use of to obtain any advantages", while CVM Instruction 358 describes material event as "any decision by controlling shareholders...related to the company's business that may significantly influence regarding the securities issued by the company...(i) their market price; (ii) investors' decisions as to buy, sell, or maintain them, or (iii) investors' decision as to exercise any rights inherent to them". The legislation and regulation in some markets provide a list of non-exclusive examples of yet-to-be disclosed facts and events that normally fall within the definition of privileged information.

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<sup>8</sup> The legal frameworks of Barbados and Trinidad & Tobago do not include a definition of "privileged information" per se, but instead refer to "price sensitive information" and provide for sanctions against parties who make unauthorized use of such information.

<sup>9</sup> Countries that require information be price sensitive to be within the definition of privileged information include: Barbados, Cayman Islands, Chile, Costa Rica, Dominican Republic, Ecuador, El Salvador, Honduras, Mexico, Nicaragua, Panama, Spain, Trinidad & Tobago and Uruguay. Peru's legislation refers to "liquidity, price or quotation".

Most respondents referred to “privileged information” as undisclosed facts regarding the condition or prospects of an issuer of securities or the securities themselves, or did not specify the entity or entities to which such information may relate. However, a few respondents specially referenced information about the activities of entities in the securities markets other than issuers as falling within the definition of “privileged information”. In recognition of the dominant role that pension and mutual funds play in its market (and, *inter alia*, to protect ultimate beneficiaries from “front running”<sup>10</sup> by fund insiders), Barbados’s, Chile’s and Peru’s legal frameworks specifically refer to information concerning the intentions of institutional investors to buy or sell securities. Uruguay’s definition of privileged information makes specific reference to knowledge of pending trading orders, presumably a reflection of the shallowness of the market in many securities. Other respondents referred to non-public information in the possession of government officials and regulators, which may imply that knowledge of investigations, impending determinations and proposed rulemaking by the Supervisory Authority is also comprehended within the definition of “privileged information.”

### **Parties Subject to the Regime**

A party may be said to be subject to the regime governing privileged information because: (1) administrative, civil/judicial or criminal sanctions may be imposed on such party as a result of its abuse of privileged information; and/or (2) certain obligations (e.g., record keeping, reporting, disclosure, approval of and compliance with internal policies) are imposed on such party as part of the framework for policing of the market. From the responses received, it appears that the persons and entities whose actions are governed by the privileged information regime vary from jurisdiction to jurisdiction, in both respects. At a minimum, officers and members of the Board of Directors of issuers of publicly-traded securities are subject to the rules governing the use and misuse of privileged information and may be sanctioned by the Supervisory Authority and the courts. In most countries that responded, market intermediaries (brokers) are also specifically listed as subject to the rules governing the use and misuse of privileged information. Some jurisdictions, e.g., Chile and Honduras, refer to market participants inscribed in the registry of securities and intermediaries, and their respective officers, member of the Board of Directors and employees. Legislation and regulations in certain jurisdictions make specific reference to officers and member of the Board of Directors of the following actors as also potentially liable for misuse of privileged information: rating agencies; SROs; stock exchanges; auditors; and the Supervisory Authority.

From the responses to the survey, it appears that the legislation and regulation in most, but not all, countries requires (or is interpreted to require) some sort of relationship between an individual and an issuer or market participant for the individual to be liable for a violation of the rules governing the use of privileged information. Controlling shareholders and parties related to controllers are often explicitly mentioned as having the required relationship. Some respondents reported that the managers and staff of entities with temporary contractual relationships with an issuer are subject to the regime. Colombia’s description of those covered is typical of many in including individuals who “in the exercise of their functions” come into possession of privileged information. Panama’s legislation requires that the information be obtained because of some sort of privileged relationship (presumably with the issuer or a related party). Argentina’s coverage would appear to be broader, including any person with even an “accidental relationship” with any party explicitly cited in the legislation. Peru’s, Ecuador’s and Colombia’s rules refer to natural or legal persons that directly or indirectly participate in the securities

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<sup>10</sup> “Front running” refers to trading by an intermediary or an employee in advance of executing a trade ordered by such person’s client or employer in order to obtain a benefit for the front runner.

market. In Brazil, simply any person who is aware of information that they know is not yet disclosed is required to refrain from trading in the securities market. Corporate directors, officers and senior managers must obey the “refrain or disclose” rule (described below). In Canada, individuals and companies that are in specified relationships with a public company are determined to be insiders and subject to legal requirements on the use of privileged information; the specific prohibitions on use of privileged information are predicated on actual knowledge of privileged information (as-yet-undisclosed material information), not a presumption of such knowledge (see section on “Parties Presumed to Have Access to Privileged Information”). Costa Rica’s response noted that pending legislation will broaden the coverage to all those who knowingly come into possession of privileged information, thus ensuring that “tippees” are subject to the legal regime in this area.

Colombia noted in its response that in the case of criminal actions, the requirement that an individual have access to privileged information because of the exercise of his or her professional function means that a person who comes into possession of privileged information by dint of a professional relationship and who shares it with another party (a “tipper”) may be prosecuted, but the recipient of such information (a “tippee”) is free of criminal (but not administrative or civil/judicial) liability if he or she does not have a similar relationship to the company.

### **Legal and Natural Persons**

In most or all jurisdictions, the privileged information regime imposes certain responsibilities on legal persons (such as issuers, brokers and SROs). Such responsibilities may include record keeping requirements, the requirement to have and comply with internal policies for the prevention of misuse of privileged information, and the obligation to report violations to the Supervisory Authority. The extent to which legal persons can be sanctioned for abuse of privileged information appears, however, to vary across the countries surveyed. In the Cayman Islands, only natural persons are subject to the rules governing the use of privileged information. In Honduras, legal persons may be held responsible for the actions of employees and can be sanctioned separately and in addition to the members of the Board of Directors, officers and employees found to have violated laws and regulations. The legal/regulatory regimes in Brazil, Canada, Chile, Colombia, Costa Rica, Dominican Republic and Peru do not differentiate between the responsibilities of legal and natural persons. Chilean law specifically provides that the Supervisory Authority may sanction legal entities for infractions committed by officers, members of the Board of Directors and employees. Costa Rica’s legal regime provides explicitly for sanctioning of legal persons. It is interesting to note from a corporate governance perspective that in such cases in Costa Rica, executives and members of the Board of Directors of such legal entities can also be held personally liable for infractions committed by their companies if they did not exercise adequate care to prevent the misuse of privileged information. In Brazil, cases can and have been brought against companies without the need to hold individuals liable as a precondition. In most or all countries, it appears that criminal penalties may only be imposed on individuals.

### **Parties Presumed to Have Access to Privileged Information**

The legal/regulatory framework in most reporting countries identifies certain individuals and/or legal persons who are presumed to have access to, or possession of privileged information about an issuer

(or other relevant entity); or who are considered as insiders of an issuer, as for example, in Canada.<sup>11</sup> The laws of Chile provide that specified individuals and legal persons are presumed to actually possess privileged information, absent evidence to the contrary. However, the formulations in most other jurisdictions that reported refer to a presumption of mere access to privileged information. The significant variance in what individuals and entities are covered by the presumption, and the extent of such presumption, are bound to have significant practical impact in enforcement.

Brazil's definition of those presumed to have access to privileged information is broadly typical in its formulation. It covers direct and indirect controlling shareholders, senior management, members of the Board of Directors and the statutory audit board (*conselho fiscal*) as well as members of any other bodies with technical and advisory functions provided for in the company's charter. Furthermore, in Brazil this is a rebuttable presumption in civil and administrative cases only. In Chile the presumption applies to criminal cases. Mexico and Peru have broad definitions of those covered by the presumption, extending even to a minority shareholder, if such shareholder (and its affiliates) holds ten percent of a company's equity (or five percent in the case of a financial institution). Interestingly, according to its Supervisory Authority, Spain's laws and regulation do not strictly speaking presume that identified parties have access to privileged information, but the list of those insiders provided in the legislation and regulations are for practical purposes an important reference.

In Canada, the specific prohibitions on use of privileged information are predicated on actual knowledge of privileged information (as-yet-undisclosed material information), not a presumption of such knowledge.

The identification of certain parties as presumed to have access to, or actual possession of privileged information may have important consequences for corporate governance of issuers and intermediaries. At a minimum, members of the Board of Directors and senior management need to take into account which individuals and entities are covered by the presumption or identified as insiders in the design and oversight of a company's policies, practices and controls with respect to privileged information.

### **Requirements Imposed on Parties Subject to the Regime**

All respondents to the questionnaire reported that those subject to the rules governing privileged information must obey some variety of "refrain or disclose"; that is, such persons while in the possession of privileged information may not, until such information is adequately disclosed to the market:

1. Trade on, or otherwise derive a benefit because of their possession of privileged information (illegal "insider trading");
2. Share such information with others, except as required by their professional duties and law (illegal "tipping");
3. Recommend to others that they purchase or sell affected securities (illegal "tipping").

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<sup>11</sup> The legal/regulatory frameworks of Barbados, Colombia, and El Salvador do not provide for presumptions. Note the discussion of Spain in the main text.

In Spanish-language jurisdictions, the duty to refrain or disclose is generally articulated as “*el deber de guardar (esticta) reserva*” or a similar formulation.

In addition to “refrain or disclose” requirements that apply when individuals are in actual possession of privileged information, some respondents reported the existence of explicit limitations on trading by certain insiders during periods when they are presumed to be in possession of privileged information. For example, Brazil requires that a company, its controlling shareholders, senior management, members of its Board of Directors, members of its statutory audit board (*conselho fiscal*), and others that according to its charter have special access to information about a public company must refrain from trading in securities of the company during a period of fifteen days prior to the disclosure of quarterly and annual financial information (“black out” periods). Such persons are also prohibited from transacting in the market before the formal end of a public distribution or buy-back of securities of the company. Under a CVM recommendation, Brazilian exchanges and clearing houses have recently initiated the oversight of trading activities of those considered to have the information. Costa Rica and Nicaragua have in place a prohibition against members of the Board of Directors, senior officers, major shareholders and others with presumptive access to material non-public information from effecting the purchase and subsequent sale (or sale and subsequent purchase) of the company’s securities within a period of three months. Similarly, Peru requires that any profits earned by directors or other insiders on account of trading within a three-month period (“short-swing” profits) be disgorged to the company.

The jurisdictions covered in the survey vary in the degree to which certain parties presumed to have access to privileged information (company insiders) are required to report their transactions in securities of their companies. Chilean legislation requires senior officers, members of the Board of Directors, controllers and holders of ten percent or more of the shares of a company to promptly report all their acquisitions and sales of securities of the company to the Supervisory Authority and the stock exchange. Costa Rica has similar insider transaction reporting requirements. In Brazil, insiders are obliged to inform the issuer monthly about their ownership and any transactions undertaken in securities issued by the company, or its parent or subsidiaries, in the case that these are publicly held companies. This information is in turn provided by the company to Brazil’s Supervisory Authority, which publishes on a monthly basis information for each company on an aggregated basis. In Canada, the system of disclosure is organized so transactions by insiders must be disclosed on a transaction-by-transaction basis though an automated system of reporting and released on an ongoing basis.

In Chile, a number of issuers have voluntarily instituted black-out periods for insiders. A recent study published by the Supervisory Authority<sup>12</sup> concluded that bid-ask spreads in securities of such issuers narrowed after the adoption of this practice, indicating that the market regards black-out periods as effective in reducing informational asymmetries.

### **Responsibility for Compliance and Reporting**

In addition to requiring disclosure to the markets, as noted above the legal/regulatory frameworks in most countries covered by the survey responses also provide for at least some degree of reporting by issuers on the degree of compliance with law and regulations (and sometimes internal policies) regarding

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<sup>12</sup> Superintendencia de Valores y Seguros, *Información en los Estados Financieros y Períodos de Blackout: Evidencia para Chile*, Documento de Trabajo No. 10, April 2010.



privileged information. Some jurisdictions specify a particular officer responsible for disclosure to the market and the provision of periodic and specially-requested information to the Supervisory Authority. Without absolving the Board or other managers of their responsibilities, Colombia's legislation refers to the issuer's legal representative (CEO/President) as personally accountable for the clarity, sufficiency and timeliness of a company's disclosures and compliance with laws governing non-public information. Brazil's regulations assign first line responsibility for compliance with disclosure and rules relating to privileged information to each issuer's Director of Investor Relations, who is also responsible for making appropriate internal investigations in the event of a report of atypical trading in the company's securities. In addition, Brazilian rules impose responsibility on the Board of Directors and senior management for seeing that the Director of Investor Relations adequately performs his or her duties in this area. Mexico's legal/regulatory framework holds accountable a listed firm's General Director (CEO) for maintaining a registry of who within the firm has access to privileged information, as well as for securing confidentiality agreements from those outside the company with whom such information is shared. From the responses received, it would appear that in most other markets the legal/regulatory framework is unspecific with regards to which officer is accountable in the first instance for reporting to the Supervisory Authority on issues relating to privileged information, but that in practice such officers are the CEO, Compliance Officer (as in the case in Spain, for example) or Director of Investor Relations, depending on the industry, size and sophistication of the firm.<sup>13</sup>

As in the area of internal policies, assignment of responsibility for reporting by intermediaries and institutional investors (mutual and pension funds) is clearer than it is in the case of issuers. Such entities are generally required to name a Compliance or Internal Controls Officers who is the immediate point of contact with the Supervisory Authority. For example, the Board of Directors of a Peruvian broker or mutual fund is required to appoint an Internal Control Officer responsible for verifying compliance with the broker's or fund's internal norms of conduct. A broker's Internal Control Officer is specifically required by regulation to oversee compliance with "mechanisms and detailed rules with the objective of preventing the improper flow of privileged information." In addition to liaising with the Supervisory Authority, such Officer must report regularly to the Board of Directors at least once every two months on the degree of compliance with the institution's internal policies and applicable laws and regulations.

In addition to assigning responsibility to specific officers and the Board of Directors as described above, the laws and regulations of several respondent countries provide for a general duty of those in senior positions to limit access to privileged information and to oversee the behavior of their subordinates. Peru's regulations, for example, require that all persons who possess privileged information, including members of the Board of Directors, are responsible to ensure that their subordinates also maintain confidentiality and refrain from securing private benefits from such information. Taken together with the specific references to the Board's responsibility for oversight of the compliance and reporting functions noted above, this is another indication that failure to ensure adequate internal rules and procedures for sharing and control of privileged information may expose members of the Board of Directors, management and the company itself to potentially very significant liability.

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<sup>13</sup> The responses of Barbados, Costa Rica, Dominican Republic, Nicaragua and Panama all reported that the laws and regulations in their jurisdictions do not specify a particular officer as responsible for compliance in this area.

## Reserved Information and Related Concepts

According to the responses received, Chile, Colombia, Ecuador, El Salvador, Honduras and Peru have in place special rules governing the identification and control of market-sensitive information that an issuer of securities may withhold from the market if its immediate disclosure is deemed to harm the interests of the company (“reserved information”). Canada’s response to the questionnaire noted that securities legislation of its provinces and the Toronto Stock Exchange permits delayed disclosure of certain information if such disclosure would be unduly detrimental to the company.<sup>14</sup> The reserved information regimes described by the respondents have special significance for the corporate governance of issuers, as in many cases it is the responsibility of an issuer’s management and Board of Directors to make a formal determination of when such information exists, whether it should be withheld from the markets for a time, who is permitted access to the information and how misuse of such information is prevented while it remains undisclosed.

In at least four jurisdictions responding, the rules governing reserved information provide that information may only be classified and treated as reserved after a super-majority vote of the Board of Directors: Chile (three-quarters), Ecuador (three-quarters), El Salvador (unanimous) and Peru (three-quarters). Interestingly, the Securities Markets Law of Ecuador provides that members of the Board of Directors who vote against according information the status of reserved may not be held personally liable for its ultimate misuse. The laws of other countries (e.g., Chile) generally provide that members of the Board of Directors who oppose any action are protected against personal liability if such actions contravene the securities laws. Presumably these rules create a bias in favor of disclosure.

Although not all respondents provided detailed information on this point, it appears that in most “reserved information” jurisdictions following an affirmative decision to withhold material information (i.e., to classify such information as “reserved”), the issuer must advise the Supervisory Authority, disclosing, *inter alia*, information on who has access to the information and what efforts the company will undertake to prevent its misuse. It is not clear from all of the responses to what extent the Supervisory Authority conducts its own analysis of whether such information should, or should not be classified as reserved. In the Colombian case, the Supervisory Authority evaluates the company’s rationale for temporarily withholding the information from the market in accordance with established criteria and can either fix a maximum period for how long the information will remain reserved or else order its immediate disclosure.

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<sup>14</sup> Brazil’s CVM Instruction no. 358 also provides for the temporary non-disclosure of material events the immediate disclosure of which controlling shareholders or the management determine would be damaging to the company. However, in the event of leaks or unexplained price fluctuations, the company must make immediate disclosure.

## Rationale for Regulation

The Task Force’s survey requested each respondent to indicate the principal objectives intended to be achieved by the legal/regulatory framework applicable to privileged information in its jurisdiction. The Task Force asked for a ranking of the importance of such objectives.<sup>15</sup> A slight majority of jurisdictions cited “promotion of timely and complete disclosure of material information to the markets” as most important, with prevention of “achievement of unfair advantage by insiders” as the second most cited principal objective. The chart below indicates the ranking of objectives as cited by each respondent:

<b>Principle Objectives Intended By the Legal/Regulatory Framework Applicable to Privileged Information in Each Jurisdiction</b>					
Country	Promotion of timely and complete disclosure of material information to	Prevention of market manipulation	Achievement of unfair market advantage by insiders	Causing of loss to minority investors	Strengthening of public confidence in the integrity of the
Argentina	1				
Barbados	1	1	1	1	1
Brazil	1				
Canada	1	1	1		1
Cayman Islands	1	1	1		1
Chile					1
Colombia	1		1		1
Costa Rica			1		
Dominican Republic		1			
Ecuador				1	
El Salvador	1				
Honduras	1				
Mexico	1				
Nicaragua			1		
Panama	1				
Peru			1		
Spain	1	1	1		1
Trinidad & Tobago*				1	
Uruguay	1				

<sup>15</sup> (a) Promotion of timely and complete disclosure of material information to the markets; (b) Prevention of market manipulation; (c) Achievement of unfair market advantage by insiders; (d) Causing of loss to minority investors; and (e) Strengthening of public confidence in the integrity of the securities market.

## **OTHER SOURCES OF STANDARDS AND GUIDANCE**

Most respondents to the questionnaire cited one or more relevant sources of standards and guidance for the handling of privileged information in addition to those set out in law and regulation, or the rules of a securities exchange or SRO. Such sources ranged from comprehensive codes of best practice in corporate governance (Argentina, Brazil, Colombia, Mexico, Peru, *inter alia*), to non-mandatory guidelines of the Supervisory Authority (Spain), to guidelines issued by associations of listed companies (ABRASCA in Brazil), to codes of ethics of professional associations (brokers, finance professionals, etc.). In some cases, such guidance is entirely non-binding, while in other instances, such as rules of professional associations, a violation can result in some form of private disciplinary action.

### **Codes of Corporate Governance**

A number of the larger equity markets covered by the survey require that listed companies comply with the market's voluntary code of corporate governance or explain why they diverge from one or more of its provisions ("comply or explain"). However, according to the respondents from such markets (e.g., Argentina), the governance codes rarely include detailed requirements or specific recommendations concerning the handling of privileged information. Rather, codes generally set out principles (such as avoidance of asymmetries of information) and recommend responsibility and oversight for the adequacy of internal controls (including with respect to privileged information). The Brazilian Institute of Corporate Governance's (IBGC) code considers use of privileged information for personal benefit or for the benefit of third parties to be a violation of the basic principle of fairness and recommends that each firm develop and regularly revise its written policies in this area. However, there are no "comply or explain" provisions established in relation to the IBGC code. Despite their voluntary nature, such standards help to reinforce the important responsibilities of the Board of Directors and senior management in reviewing internal rules, monitoring compliance and ensuring their adequacy of controls in the area of privileged information.

### **Ethics Codes**

Most codes of ethics cited by respondents are applicable to intermediaries, exchanges or other market participants acting under license. Such professional codes of ethics require persons subject to them to act in the best interests of their clients and to refrain from using material non-public information for their own benefit or the benefit of third parties.

### **Internal Guidelines and Policies**

The Dominican Republic, Ecuador and Nicaragua all reported that issuers in their markets are required to have in place formal written policies on how privileged information is to be managed in the company. Uruguay's recently-enacted legislation provides that each issuer must have an internal code of corporate governance which includes policies on privileged information; although a regulation setting out the details of the contents of such internal policies has not yet been issued. Such a requirement has been in place in Costa Rica since November 2009. In Chile, internal corporate policies in this area must take the form of a Manual on the Handling of Information of Interest to the Market made available on the issuer's website and filed with the Supervisory Authority.

ABRASCA, the association of listed companies in Brazil, has issued guidelines to assist its members to comply with Brazil's legal requirement that each issuer have a formal Board-approved policy in place. These policies, the content of which is left to each company to determine for itself, are made public and issuers are bound by their contents. As noted above, Brazilian law and regulation requires that such policies impose limits on trading by insiders that at a minimum prohibit such persons from trading for fifteen days prior to the publication of quarterly and annual results. Each company's internal policies must also require members of the Board of Directors and senior managers to report to the company immediately all their transactions in shares of the company and related parties. Spanish law similarly requires that each listed company's internal code of conduct cover, *inter alia*, trading by insiders, declaration of conflicts of interest, duties with respect to privileged information, transactions in treasury stock, duties of the Compliance Officer, and steps to be taken in the event of non-compliance. The securities laws in both Brazil and Spain empower the Supervisory Authority to impose penalties on the officers of companies that do not comply with the internal policy requirements. Peruvian listed companies are required to cover use of privileged information in their internal norms of conduct, but according to the Peruvian respondent, such norms rarely, if ever, go beyond restating the provisions of law and regulation.

However, a legal requirement that issuers have formal internal policies is not universal. Formal internal policies are not required by issuers in Barbados, Cayman Islands, El Salvador, Honduras or Panama. Mexican law, for example, includes a general statement that every issuer "adopt necessary measures" to ensure that non-public information is accessible only by those who need to have it to perform their duties. A formal written internal policy is optional. Colombia's response to the survey noted that issuers in its market typically cover privileged information in their codes of corporate governance or codes of ethics, but this is not a legal requirement.

Regardless of whether required by law or not, it is clear from the majority of responses that Supervisory Authorities favor the existence of formal written policies on privileged information and regard such policies as indicative of an issuer's seriousness about compliance with the legal framework. The requirement in several jurisdictions that such policies be explicitly reviewed and approved by the Board of Directors is another reflection of the principle that ultimate responsibility for the adequacy of the internal control environment rests with the Board of Directors. Accordingly, it seems apparent that for a Board of Directors to adequately fulfill its duties with respect to the adequacy of internal controls and risk management it should ensure that a written internal policy on privileged information exists in the company, and that compliance is monitored and reported on periodically to the Board.

### **Chinese Walls**

The working group asked respondents it contacted after the Rio 2010 meeting how effective they considered "Chinese walls" specifically in preventing the use of privileged information. Chile considered that they were not very effective in the context of prevention, an issue that must be considered in the context of the size of the market and the number of players that may be involved. Mexico and Brazil considered Chinese walls to be effective tools. Mexico considers them necessary in the context of the operations of financial institutions but fail to see their relevance in the context of simple issuers. Brazil considers they are a means to an end, and notwithstanding their effectiveness when duly applied, often they have not been sufficient to avoid administrative responsibility for unlawful activities.

## POWERS OF THE SUPERVISORY AUTHORITY

From the responses received, it appears that in all markets the Supervisory Authority<sup>16</sup> is empowered to take certain steps to impede or prevent the misuse of privileged information before it occurs (*ex ante* enforcement). Ecuador and Nicaragua noted in their responses that the legal framework is not explicit in this area, but that in practice such powers are available. Opportunities for preemptive action generally arise after the Supervisory Authority becomes aware of a possible material fact that has not been made public, or there is evidence of atypical trading in a security. In such cases, most respondents report that the Supervisory Authority is empowered to undertake a variety of actions, including: compelling an issuer to make, correct, amend, or republish disclosures; suspending trading in a security; or temporarily suspending the market activities of an intermediary. Uruguay's response noted that, pending the issuance of regulations under new securities legislation, its Supervisory Authority's powers are limited to compelling disclosure. Peru's Supervisory Authority is empowered to disclose information to the market itself, if it is unsatisfied with the extent of an issuer's own press releases. Preventive actions by a Supervisory Authority usually require an immediate response from the Board of Directors and management of an affected issuer or intermediary, which provides an additional argument for clear and well-understood internal policies in this area and careful Board oversight.

The questionnaire responses evidence a greater variance among jurisdictions in the powers the Supervisory Authority may exercise in the course of an investigation and administrative action than with respect to the preventive actions they may take. The Supervisory Authorities of Brazil, Canada, Mexico and Spain (the largest markets in the survey) would seem to have the broadest investigatory powers in terms of the persons that may be called to testify and the evidence they may be compelled to turn over. The Supervisory Authority in each such country may require testimony and evidence from any party and impose administrative penalties (fines) in cases of non-compliance. Brazil's Supervisory Authority may even compel the delivery of records from Brazilian parties when cooperating with a foreign Supervisory Authority's investigation. While the Supervisory Authorities in all jurisdictions responding to the survey appear to be empowered to conduct routine and exceptional inspections of intermediaries, and in most cases, also issuers, Supervisory Authorities outside the larger markets appear to be more constrained in terms of whom they may compel to testify or provide evidence, what records they may obtain and whom they may sanction. In a number of jurisdictions, the Supervisory Authority's power over persons and entities not within its direct supervision (i.e., those other than issuers, intermediaries and their officers and employees) may be limited, and its ability to levy sanctions against such persons non-existent.

## ENFORCEMENT ACTIONS

Administrative, civil/judicial and criminal actions were cited by the respondents to the survey as potential legal proceedings arising from an alleged violation of the regime governing misuse of privileged information. Not surprisingly, the responses generally focused on the rules relating to investigations and enforcement actions taken by the Supervisory Authority and conducted as administrative, rather than as

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<sup>16</sup> Chile's response noted that that country's pension fund regulator also may take action to prevent the misuse of non-public information by entities under its supervision, without prejudice to the Supervisory Authority's (SVS) independent power to act. El Salvador's pension fund regulator has similar powers.

judicial proceedings.<sup>17</sup> The particulars of the legislation and rules governing administrative and judicial actions vary too widely to be described in any detail in this report. Rather, this section of the report describes patterns that appear to emerge from the responses, and observations that emerge from these patterns.

As a practical matter, in most reporting jurisdictions, responsibility for enforcement of the legal/regulatory framework with respect to the misuse of privileged information rests with the Supervisory Authority and is conducted primarily through administrative actions. Reliance on administrative actions is especially the case among the Latin American respondents, although there seems to be movement toward greater recourse to civil/judicial actions in some of the larger Latin markets. Notwithstanding the primacy of the administrative, in almost all jurisdictions the law also contemplates civil/judicial actions and criminal proceedings against those who use their access to privileged information to secure personal benefit. In Canada, a Supervisory Authority, which may have both administrative and prosecutorial powers, may commence administrative or quasi-criminal proceedings (prosecution of a securities legislation breach as opposed to a criminal law).

### **Administrative Actions**

The legal/regulatory framework of all reporting countries empowers the Supervisory Authority to conduct investigations and initiate administrative actions<sup>18</sup> against persons subject to its jurisdiction who have acted in violation of the laws and regulations governing privileged information. Administrative actions are conducted by the Supervisory Authority and in the event a violation is determined to have occurred, such Authority is generally empowered to impose non-criminal penalties, including fines, disqualification, suspensions, or removal from office.<sup>19</sup> In the majority of jurisdictions, the Supervisory Authority may not order compensation to victims in an administrative proceeding. For example, if Brazil's Supervisory Authority seeks compensation for victims, it must bring a civil/judicial suit before the courts. It is also possible for victims to obtain compensation as part of a consent decree agreed upon according to the Securities Law. Furthermore, in Brazil any person, including individual victims, can bring their own civil action and demand compensation, although this is extremely rare (only one known case). Mexico's Supervisory Authority may not take action on behalf of victims. As noted earlier, in some countries, the jurisdiction of the Supervisory Authority to impose sanctions extends to both legal persons and individuals, while in other cases it extends only to individuals. Administrative penalties imposed by the Supervisory Authority are generally appealable, sometimes to specialized administrative tribunals, sometimes to appeals courts of general jurisdiction.

### **Civil/Judicial Actions**

Respondents from some jurisdictions reported that the Supervisory Authority may initiate civil/judicial cases to seek compensation of victims of misuse of privileged information.<sup>20</sup> In Brazil, the

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<sup>17</sup> The Cayman Islands is unique among respondents to the survey in reporting that all enforcement actions are of a judicial nature and are conducted by the Public Prosecutor.

<sup>18</sup> As noted above, the Cayman Islands is a partial exception in that all enforcement actions are judicial in nature.

<sup>19</sup> In some jurisdictions (e.g., Chile and El Salvador), the regulator of the pension fund system may have similar powers over entities subject to its supervision.

<sup>20</sup> El Salvador's response noted that its Supervisory Authority may only proceed administratively, and hence all judicial civil actions for damages must be pursued directly by the private parties seeking compensation.

Supervisory Authority as well as the Public Prosecutor may bring a civil action against individuals or legal persons seeking compensation (even exemplary damages) for those who have suffered loss. Chile's Supervisory Authority can take similar action. The law in most jurisdictions provides individuals some legal avenue to pursue claims for damages occasioned because of the misuse of privileged information. The source of civil liability may derive from specific legislation (e.g., the securities markets law), or from the general law of civil responsibility for wrongful acts or omissions causing damage to others (tort/civil code).

Of all the respondents, Colombia seems to offer victims the greatest number of options for seeking compensation for the misuse of privileged information. In addition to ordinary civil actions, the law in that country contemplates both class action lawsuits when there are numerous potential plaintiffs, and arbitration through the Chamber of Commerce of Bogotá. At the other end of the spectrum, according to the responses from the Cayman Islands, Nicaragua and Panama, no private right of action exists in those jurisdictions for misuse of privileged information. It appears from the Salvadoran response that private actions are possible in that country, but only for disgorgement of profits to the company (as opposed to aggrieved securities holders). Private enforcement through civil/judicial actions in Argentina is limited by the requirement that the misuse of privileged information must qualify as criminal before an injured party is entitled to compensation.

In Brazil, the CVM can bring a civil action and seek disgorgement and exemplary damages. Any amounts received in the context of such actions goes to a fund from which compensation is provided to victims.

### **Criminal Prosecution**

The laws in all reporting jurisdictions provide for penal actions against those whose misuse of privileged information qualifies as a criminal act. What behaviors rise to the level of crimes varies among jurisdictions. Interestingly, Spain's law provides a monetary threshold – misuse of privileged information resulting in profits (or loss avoided) exceeding €600 thousand qualifies as criminal. In all jurisdictions other than Argentina, where only the Supervisory Authority may initiate a criminal case, criminal actions are formally brought by the Public Prosecutor, although this may occur after an initial investigation by the Supervisory Authority uncovers evidence that the elements of a criminal case may be present. An important distinction between administrative and civil/judicial actions on the one hand, and criminal cases on the other, is the evidentiary standard. In all criminal cases, the defendant must be shown to have committed all elements of the crime “beyond a reasonable doubt”, whereas the standard for an administrative determination or a civil/judicial decision (outside Argentina, as noted above) is lower – generally one of “preponderance of the evidence” or “balance of the probabilities”. Notwithstanding the lower standard of proof, as described below, evidentiary issues are among the most-often cited limitations to more effective enforcement of the legal/regulatory regime governing privileged information, even through administrative and civil/judicial actions. (See “Weaknesses and Gaps”, below.)

In most jurisdictions responding to the survey, administrative and judicial actions are independent and may proceed in parallel. However, regulations in Peru prohibit the Supervisory Authority from undertaking or continuing proceedings to impose administrative sanctions when a judicial proceeding has already been initiated. In Costa Rica, administrative proceedings are subordinated to judicial actions and suspended while the latter are ongoing. And in practice, Spain's Supervisory Authority suspends any



administrative action once a criminal case has been initiated for the same facts and against the same persons.

## **ENFORCEMENT ROLE OF SECURITIES EXCHANGES AND SELF-REGULATORY ORGANIZATIONS**

The Task Force's survey included questions concerning the rulemaking authority of securities exchanges and SROs and their role in enforcement. The Task Force recognized that given the time pressures and the possible need for communications between the respondents and the exchanges, an expectation of complete and detailed responses in this area was unrealistic.

### **Stock Exchange Rules; Jurisdiction**

According to the survey responses, all securities exchanges in the jurisdictions covered, except those of Barbados, Mexico and Peru, have issued rules concerning privileged information and were reported to have certain powers to investigate and sanction. Chile's two exchanges have together issued a common set of requirements in this area, which include recommended best practices. Each of Ecuador's two exchanges has issued its own set of rules. In most reporting jurisdictions, members of the Board of Directors, officers and employees of intermediaries and issuers (as well as the Board, management and staff of the exchange itself) are required by exchange rules to refrain from the use of privileged information for their own benefit or the benefit of third parties. However, in other instances (generally, but not exclusively where the exchange does not serve as the SRO of the securities industry), the rules of the exchange are targeted more exclusively at the management and employees of the exchange itself.<sup>21</sup> Interestingly, the rules regarding use of privileged information of one of Ecuador's exchanges (Quito) apply to intermediaries, the exchange and issuers, while those of the other (Guayaquil) apply only to intermediaries and the exchange itself.

Costa Rica, the Dominican Republic and Uruguay characterized exchange rules in the area of use of privileged information as mere restatements of the legal/regulatory framework.

In Colombia, although La Bolsa de Valores de Colombia S.A. (the Exchange) conducts surveillance of market activity, the Autorregulador del Mercado Valores (AMV) Exercises self-regulatory authority over intermediaries, including with respect to investigation of misuse of privileged information.

Canadian exchanges have in place a policy establishing required disclosure of material information by listed companies, which is considered broader than what is required under securities legislation in its jurisdiction. The manual of the Toronto Stock Exchange (TSX Company Manual) sets out procedures for announcing material information unless disclosure is detrimental to the company. The manual imposes firm rules prohibiting use of information by those in possession unless disclosed to the public.

The majority of jurisdictions reported that the securities exchanges or SROs have the capacity to impose censure/warnings, suspensions, revocation of licenses and fines on parties subject to their rules. Generally, such sanctions may apply to legal as well as natural persons. In jurisdictions, such as Mexico or Argentina, where the exchange participates in market surveillance but has no rulemaking or sanctioning

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<sup>21</sup> Costa Rica and Nicaragua provide examples of this approach.

powers, possible violations must be referred to the Supervisory Authority to initiate enforcement action. In Brazil, SROs may sanction only their members.

### **Codes of Conduct of Intermediaries**

Not surprisingly, the laws and regulations in all responding countries require that financial intermediaries (including brokers) have internal manuals and codes of conduct covering the control of privileged information and the prevention of its misuse. The minimum content of such policies is typically governed by regulation, with compliance supervised in the course of periodic inspections by the Supervisory Authority. Certain jurisdictions rely on the presence of a self-regulatory organization (SRO) such as an association of market intermediaries to regulate and police the securities industry. Some of these have developed codes of practice covering the issue of privileged information (e.g., Argentina and Canada). For example, during a potential offering of equity securities in Canada, dealer members of IIROC are prohibited from communicating with any person or company concerning the potential distribution before it has been disclosed publicly through a preliminary prospectus or press release. Also, rules of the SRO prohibit members from entering an order or trade which would violate securities law, including those prohibiting misuse of privileged information.

## **MARKET SURVEILLANCE**

Exchanges and SROs in certain jurisdictions exercise a degree of market surveillance, either directly or by delegation. Canada's main exchanges contract out the responsibility to monitor price movements around material events of issuers to an SRO responsible for the activity of identifying possible misuse of undisclosed material information. Colombia's response noted that one of its markets (Bolsa Mercantil) conducts market surveillance, inspects brokers and monitors communications between them. The exchange in the Cayman Islands conducts market surveillance and has broad powers to investigate irregularities. The Mexican response noted that the Mexican Stock Exchange has a surveillance unit that is charged with investigating irregularities and reporting possible violations to the Supervisory Authority. Most other responses referred to the surveillance activities of exchanges and SROs as rudimentary, limited or in practice non-existent.

In Colombia, any person acting as an intermediary must be a member of a self-regulatory organization. AMV has signed a memorandum with the regulator (SFC) by which it takes responsibility for the supervision of the activities of its members and supervises market activities including market abuse.

Most respondents did not refer specifically to market surveillance conducted directly by the Supervisory Authority itself. Some jurisdictions, such as Canada in Ontario and Québec, have ongoing live monitoring processes for market activities targeting, among others, the misuse of privileged information. Argentina's response made reference to the Stock Watch program in its market. An action plan in Costa Rica has recently designed a market surveillance system involving an on-line alarm system to notify the Supervisory Authority of trading patterns that might indicate trading on non-public information and other irregularities. In Brazil, SROs must report suspicious transactions, even if an SRO member is not involved.

## RECENT EXPERIENCES OF ENFORCEMENT IN RESPONDENT COUNTRIES

### Detection / Investigation

The questionnaire prepared by the Task Force requested respondents to rank how commonly Supervisory Authority investigations and enforcement actions are initiated in their jurisdiction and by whom.<sup>22</sup>

At the outset, it is important to note that a substantial minority of respondents to the survey reported little or no actual experience of investigations or administrative/judicial proceedings relating to enforcement of the legal/regulatory regime governing use of privileged information. Most such responses were from jurisdictions with small, illiquid or non-existent equity markets. But apparently low levels of enforcement activity were also reported in countries with more active trading in shares.

Four respondents (Argentina, Brazil, Canada and Peru) indicated that, in their jurisdiction, investigations and enforcement actions are sometimes initiated based on complaints received by the Supervisory Authority from the public or aggrieved shareholders, whereas the remaining respondents either rarely or never receive such complaints. Canada was the only jurisdiction that reported that investigations and enforcement actions are sometimes initiated at the instigation of whistleblowers/insiders. Argentina and Canada reported that actions are sometimes initiated by market participants (brokers). Argentina also indicated that actions are frequently initiated at the instigation of investors.

In most jurisdictions, actions were either rarely or never instigated by stock exchanges. In terms of market supervision (trading patterns, etc.), four respondents indicated that actions are frequently initiated through market supervision and monitoring of trading patterns (Canada, Colombia, Mexico and Peru). Two respondents (Argentina and Brazil) stated that such actions are sometimes instigated through market supervision, etc. The remaining respondents indicated either never or rarely. Finally, in terms of actions initiated following routine supervision, six respondents (Argentina, Brazil, Colombia, Mexico, Peru and Spain) indicated that this is a frequent occurrence. In Canada, such actions are sometimes initiated following routine supervision, and the remaining respondents indicated never or rarely.

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<sup>22</sup> The Task Force decided to ask for relative indicators of frequency rather than specific quantitative responses from regulatory authorities due to concerns about information availability, response burden and potential complexities of comparing numbers across jurisdictions based on differing definitions and categories of enforcement.

**By whom are Supervisory Authority investigations and enforcement actions initiated, and how common are they?\***

Country	Complaint from the public / aggrieved shareholder	Whistleblower / insider	Market participant (broker)	Securities exchange	Market supervision (trading patterns, etc.)	Routine supervision
Argentina	S	R	S/F <sup>23</sup>	S	S	F
Barbados	R	R	R	R	R	R
Brazil	S	R	N	N	S	F
Canada	S	S	R	R	F	S
Cayman Islands	R	R	R	R	R	R
Chile	R	R	R	R	F	F
Colombia	R	R	R	R	F	F
Costa Rica	R	R	R	R	R	R
Dominican Republic						
Ecuador						
El Salvador	N	N	N	N	N	N
Honduras	N	N	N	N	N	N
Mexico	R	R	R	R	F	F
Nicaragua	N	N	N	N	N	N
Panama	R	R	R	R	N	N
Peru	S	N	R	N	F	F
Spain	R	R	S	R	N/A	F
Trinidad & Tobago	S	R	S	S	F	F
Uruguay	R	N	N	N	R	R

\*Legend: N = Never; R = Rarely; S = Sometimes; F = Frequently

### Subjects of Enforcement

Respondents were also requested to provide available information on the subjects of enforcement actions. They were asked to indicate how frequently cases were (1) initiated and (2) concluded by the Supervisory Authority or by exchanges, or through private enforcement actions, and to whom these cases were targeted.<sup>24</sup> Apart from Brazil which just reported the recent judgment in the case of Sadia SA, very few final judgments of such cases are reported.

<sup>23</sup> Argentina replied “Sometimes” for brokers and “Frequently” for investors .

<sup>24</sup> Possible subjects referenced in this part of the survey included: (a) Management officers of an issuer; (b) Member of the Board of Directors of an issuer; (c) Controlling shareholders of an issuer;(d) Market participants (brokers and other intermediaries);( e) Others (please specify).

## WEAKNESSES AND GAPS

The weaknesses and gaps that respondents to the survey reported can be usefully divided into three (partially overlapping) areas: (a) shortcomings in the legal/regulatory framework; (b) obstacles to more effective policing of the market; and (c) issues that prevent exchanges and SROs from playing a greater role in enforcement.

### **Legal Framework and Practicalities of Enforcement**

Most respondents cited several weaknesses and gaps in the current legal/regulatory framework governing privileged information that in their view limit its effectiveness. However, six respondents (Canada, Cayman Islands, Dominican Republic, Honduras, Panama and Spain) expressed general satisfaction with the effectiveness of the current legal/regulatory regime.

One of the most commonly-cited limitations to successful administrative and judicial enforcement actions in the survey responses revolves around access, and sufficiency of evidence needed to successfully investigate and prove a case against violators. With respect to the nature of evidence that may be gathered, the Supervisory Authorities of Chile, Costa Rica,<sup>25</sup> Panama and Peru noted that the laws in force do not currently permit access in the ordinary course of supervision to phone records, recordings of conversations, e-mails or bank account information. Under the laws of most countries surveyed, such data may generally only be secured by court order, which can be difficult and time consuming to obtain. Bank secrecy laws were cited as a complication in a number of jurisdictions, including Argentina, Costa Rica, and the Dominican Republic. In the case of Brazil, a recently-signed MOU between the Supervisory Authority and the Central Bank allows the former to obtain banking information such as account records. While not yet tested in practice, the MOU should enable the Supervisory Authority to overcome constraints related to banking secrecy. The inability to gather evidence and compel testimony from persons and entities other than those directly under the supervision of the Supervisory Authority was also cited as a critical limitation on the ability of such entity to be an effective enforcer in Costa Rica and the Dominican Republic.

The Supervisory Authorities of Brazil, Costa Rica, Peru and Uruguay noted that evidentiary requirements (particularly the insufficiency of relying on circumstantial evidence alone to establish liability) impede the successful conclusion of some enforcement actions. In particular, the difficulty of proving a case entirely on circumstantial evidence makes a successful outcome of a case against a “tippee” very unlikely in those jurisdictions where such person may be held liable in theory. As noted earlier, the requirement that criminal behavior must be proven before a party may receive compensation for damages from a defendant is a major deterrent to civil/judicial actions in Argentina. A number of respondents also cited the complexities of calculating the benefit received by the violator as impeding the imposition of an effective deterrent to wrongdoing.

Dissatisfaction with the efficiency and effectiveness of the judicial system is another theme running through the responses to the survey. Colombia’s Supervisory Authority cited the lack of training of ordinary judges in matters relating to financial markets as a limitation to the ability to pursue

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<sup>25</sup> However Costa Rica noted that its pending legislative reform would provide the Supervisory Authority with access to records of the date, time and duration of phone conversations.

civil/judicial and criminal cases. Slowness and the high cost of the judicial process were cited by several other respondents as deterring potential plaintiffs from seeking relief in the courts.

Other perceived lacunae in the legal and regulatory frameworks included: the absence of liability for tippees in a criminal actions (Colombia); no requirement for issuers to have written policies on compliance (Barbados); lack of any norm specifying what persons can be assumed to have access to privileged information (Colombia); insufficiently comprehensive or too recent legislation to regulate and sanction against the use of privileged information (Barbados, El Salvador, Honduras and Uruguay); insufficiency of administrative fines as a deterrent to illegal behavior (Colombia); lack of a detailed regulation on what sanctions may be applied for which violations (Honduras); very limited administrative enforcement powers (Barbados); the delay in the issuance of rulemaking to fully implement recent legislation (Uruguay); and the difficulties in determining actual damages in a civil/judicial action (Costa Rica) .

### **Obstacles to More Effective Policing**

Availability of timely data and resource limitations were at the heart of most obstacles to more effective policing (detection and investigation) of the market cited by the respondents. Chile, El Salvador, Mexico and Panama all cited a lack of material, technological and human resources sufficient for effective market surveillance. Argentina reported a lack of capacity to monitor market activity in real time.

Other issues mentioned by respondents to the survey that might be addressed to improve policing for violations of the privileged information regime included: the absence of some sort of database or other means of identifying parties related to those with access to privileged information (Argentina and Mexico); lack of compliance reporting requirements (Barbados and Nicaragua); poor internal practices, incorrect data and resistance to surveillance efforts by certain issuers, no access to telephone, e-mail and other records, and lack of authority to negotiate plea agreements (Chile); and the need for mechanisms to monitor trading conducted through offshore entities (Peru).

### **Obstacles to Greater Role for Exchanges, SROs, others**

A minority of respondents cited conflicts of interest and lack of resources as reasons why exchanges and SROs do not play a more effective role in enforcing the regime for privileged information. Non-demutualized exchanges have an inherent conflict of interest that may limit their zeal for investigating and reporting violations by the brokers who are the exchange's effective owners.

Several respondents noted a lack of understanding among intermediaries of the importance of good practices in the area of use of privileged information to market integrity. Chile noted a lack of cooperation with surveillance and enforcement efforts by some intermediaries, which can be explained in part by the high degree of concentration of control in Chile, where, in practice, the controller is involved in management and the Board may not be aware of all the controller's activities. Development of a culture of compliance and good corporate governance were cited as important to improvements in this arena by the respondents in Nicaragua and Uruguay.

Mexico cited limits on the powers of its exchange to secure relevant confidential information from issuers, brokers and individuals in its investigations as preventing the exchange from playing a more important part in enforcement. Especially in the smaller markets, it may be difficult or even unrealistic to



expect the exchange to be able to muster the human and other resources needed to make much of a contribution to effective supervision.

## CONCLUSIONS AND RECOMMENDATIONS

The Latin American Corporate Governance Roundtable's *White Paper on Corporate Governance* called for improvements in the quality, effectiveness and predictability of the legal/regulatory framework as one of its six consensus priorities for better corporate governance in the region. Improving the effectiveness of enforcement, strengthening the powers and resources of Supervisory Authorities, improving the capacity of the judiciary in areas related to corporate governance, and providing a broader array of private rights of actions for mistreatment of shareholders are all among the specific recommendations of the White Paper.

We have considered the members' responses to the survey together with result from our discussion with some of the regulators and these have shown that we can build on their successes and suggest adoption, where possible, of similar practices or tools. Corporate governance tools can be an effective way to deal with the improper use of privileged information. We thus recommend that the appropriate public and private sector parties consider adopting, or advocate adoption of, the following practices.

### GENERAL RECOMMENDATIONS

#### **Responsibility for preventing the misuse of privileged information should be a priority for Boards as well as Supervisory Authorities.**

Ensuring the proper handling of material non-public information and sanctioning misuse of privileged information should be a priority for both companies and their Boards, on the one hand, and for Supervisory Authorities on the other. Laxity within the corporation, a weak legal/regulatory framework and ineffective enforcement combine to destroy confidence in listed firms and the public capital markets, resulting in higher cost of finance (governance discount), poorer price discovery, decreased liquidity and inefficient capital allocation. Few, if any, of the respondents to the survey expressed satisfaction with either the degree of attention to this topic paid by listed companies and their Boards, or the effectiveness of *ex ante* and *ex post* enforcement efforts.

#### **Boards should strengthen corporate policies and practices on privileged information.**

Issuers, in particular their Boards, should pay greater attention to the adequacy of internal policies and practices relating to the handling of privileged information. Boards should regard the control of privileged information and the prevention of its misuse as a key element of risk management. Anecdotal evidence from the respondents indicates that most companies and their Boards regard internal policies and practices with respect to privileged information as merely a matter of technical compliance, if even that. Failure to regularly review existing policies and practices, and the monitoring of their effectiveness, exposes firms to potentially serious compliance, reputational and financial risks. In addition, in an increasing number of jurisdictions, Boards that do not adequately oversee the adequacy of their company's

policies, practices and systems regarding the handling of privileged information may be exposing their companies and Board members themselves to administrative and civil liability.

**Standards and codes should provide more detailed guidance to companies on appropriate policies and practices with respect to privileged information.**

The existing codes and other sources of guidance in the region appear to differ significantly in the extent to which they recommend specific policies or practices with respect to privileged information or assign responsibility for the implementation and oversight of such policies and practices. Consistent with and reinforcing the recommendation that Boards pay great attention to privileged information as a matter of risk management, issuers of codes of best corporate governance practices and similar sources of standards in the region should examine whether such standards provide sufficient guidance to firms with respect to the Board's and management's responsibility for the adequacy of internal policies and practices relating to the handling of privileged information and the prevention of its misuse. At a minimum, members of the Board of Directors and senior management need to take into account which individuals and entities are covered by the presumption of access to privileged information or identified as insiders in the design and oversight of a company's policies, practices and controls with respect to privileged information.

**Supervisory Authorities should promote internal company policies and practices that complement regulation and enforcement.**

Supervisory Authorities should pay greater attention to how corporate governance standards, policies and practices can better complement and reinforce the effectiveness of the legal/regulatory framework and enforcement in the area of use of privileged information. Differences in the legal responsibility of corporations and their Boards for ensuring against misuse of privileged information, and the impression of many respondents that Boards and management are often less than diligent in their oversight of the quality of internal policies and practices in this area, indicate that there is considerable room for reinforcing external enforcement (i.e., by the Supervisory Authority) with internal practices more reflective of effective corporate governance. Exchanges and SROs should consider adopting policies or a code of conduct for their members regarding the use of privileged information.

**Trading by company insiders should be as transparent as possible.**

Investor confidence increases as the public capital market has greater access to timely information about trading by corporate insiders. As a consequence, a number of jurisdictions surveyed require reporting of trades in company shares by managers, directors and controlling shareholders. A few markets prohibit trading by insiders around key disclosure dates, such as prior to the release of quarterly financial information ("black-out periods") or include in their legal frameworks a "short-swing" profit rule requiring insiders to return to the company any profits earned through the purchase and sale of shares within suspiciously short periods. In countries where information on trading by insiders is not completely or timely provided to the market, and/or where such persons are free to trade around key disclosure dates, companies and standard setters should consider the value of voluntary disclosure, black-out period policies and short-swing profit rules. The evidence from Chile indicates that securities of companies that implement voluntary black-out periods are rewarded by the market.

### **Supervisory Authorities should share experiences with regulation and enforcement.**

Supervisory Authorities in all jurisdictions recognize that preventing the misuse of privileged information and sanctioning it when it does occur, is a difficult challenge everywhere. Even with the best available tools, limitations on availability and timeliness of information impede prevention, and evidentiary requirements complicate enforcement actions. However, divergences in regulations and enforcement experiences reported by the respondents indicate that Supervisory Authorities can benefit from considering how their peers in other jurisdictions address the issue of misuse of privileged information.

### **MORE SPECIFIC SUGGESTIONS**

#### **The adequacy of current definitions of privileged information should be reviewed.**

Policy makers and Supervisory Authorities in some jurisdictions should consider the practicality of the current definitions of what constitutes privileged information. Especially in smaller and less liquid markets, a definition not requiring specific evidence of market sensitivity may, generally speaking, facilitate enforcement.

#### **Supervisory Authorities should regularly review the adequacy of their investigatory toolset.**

Supervisory Authorities should regularly review their investigatory toolset in order to be in a better position to access information necessary to effectively prosecute privileged information cases. Comparing powers with those available to other Supervisory Authorities is helpful. For example, members should refer to the IOSCO Multilateral Memorandum of Understanding (MMoU), which sets forth the basic information and associated investigation powers necessary for effective enforcement. Members may also consider the IOSCO's Emerging Markets Committee report, *Insider Trading: How Jurisdictions Regulate It*, referred to above. Furthermore, systems to detect and report suspicious trading activity should be considered by those Supervisory Authorities not yet equipped with efficient tools of detection.

#### **Disclosure of company policies and practices should be encouraged.**

As noted above, internal corporate policies and practices, and adequate mechanisms to ensure they are followed, are a first line of defense against the misuse of privileged information. The periodic review and updating of such policies and practices is an essential ingredient of proper corporate governance. As a matter of transparency, to generate external discipline on the governance of listed firms, and to increase momentum for improving standards market-wide, listed companies should disclose their policies and practices with respect to handling of privileged information, and any instances where violations have been uncovered. Consistent with regard for the quality of practices and the adequacy of disclosure, an officer should be assigned responsibility for the supervision in this area and should report directly to the Board of Directors.

#### **Insiders should disclose entities over which they exercise or influence investment decisions.**

To increase transparency and foster market confidence, and to assist in the enforcement of existing laws and regulations regarding the misuse of privileged information, companies and standard setters should encourage officers, directors and significant shareholders to disclose all entities (including companies, trusts, funds, accounts and other investment vehicles) over which they exercise or influence investment

decisions. National codes of best practice, by-laws and board charters should be reviewed with an eye toward increasing the ability of companies, the Supervisory Authority and the market to identify the vehicles whose trading and investment decisions are made or materially influenced by those who may be in possession of privileged information.

## ANNEX 1

**Recommendations from both the *OECD Principles of Corporate Governance* and the *Latin American White Paper on Corporate Governance* addressing abuse of privileged information and insider trading.**

### **OECD Principles of Corporate Governance (2004):**

Principle III.B. Insider trading and abusive self-dealing should be prohibited.

Abusive self-dealing occurs when persons having close relationships to the company, including controlling shareholders, exploit those relationships to the detriment of the company and investors. As insider trading entails manipulation of the capital markets, it is prohibited by securities regulations, company law and/or criminal law in most OECD countries. However, not all jurisdictions prohibit such practices, and in some cases enforcement is not vigorous. These practices can be seen as constituting a breach of good corporate governance inasmuch as they violate the principle of equitable treatment of shareholders. The Principles reaffirm that it is reasonable for investors to expect that the abuse of insider power be prohibited. In cases where such abuses are not specifically forbidden by legislation or where enforcement is not effective, it will be important for governments to take measures to remove any such gaps.

### **Latin American White Paper on Corporate Governance (2003):**

*79. Controlling shareholders, directors, managers and other company insiders should be required to make full reporting of all their transactions in securities of the company and affiliates.*

80. Disclosure of trading plans by insiders is useful to both the market and to insiders themselves, as they retain some trading freedom without the fear of unfounded accusations of trading on the basis of undisclosed information. Penalties for failure to make timely disclosure should be sufficient to deter noncompliance.

*81. To encourage public confidence in the integrity of the markets, all jurisdictions should enforce “short swing profit” rules that require insiders to return to the company the profits earned through the purchase and sale of shares within suspiciously short periods.*

82. Active trading by company insiders always raises the concern that it may be motivated by privileged private access to corporate information. When purchases and sales are made within a very short period by the same insider, the best course for encouraging confidence among investors is to prohibit such transactions and if they occur, to require any resultant profits to be returned to the company.

### **Temporarily Withheld or Reserved Information**

*83. In jurisdictions that permit the board to temporarily withhold material information from the public, there should be strict limits on the nature of such “reserved” information, and the amounts of time such information can remain non-public. The burden should always be on the company’s board and management to demonstrate why continued non-disclosure is lawful and appropriate.*

84. Good governance and responsibility of management and the board to shareholders is predicated on full transparency and disclosure. Although there are times when information in the possession of the board of directors needs to be kept confidential in the best interests of the company, as in cases of ongoing negotiation, this practice should be restricted in terms of the nature of the information and the time period during which disclosure can be withheld. The board of directors should in every case make an explicit finding of why such information should be temporarily withheld. The securities regulator should review the board finding and insist on short periods for withholding information, and reject board decisions where they fail to meet the legal standard.

## **ANNEX 2: TASK FORCE MANDATE**

### **Sponsoring Institutions**

The Latin American Corporate Governance Roundtable (hereinafter the “Roundtable”) is an initiative led by the Organisation for Economic Cooperation and Development (OECD) in partnership with the International Finance Corporate (IFC)/World Bank Group and Global Corporate Governance Forum. Its members include policy-makers, regulators, stock exchanges, and a range of private sector actors from Latin American and OECD countries devoted to improving corporate governance in the region. Its annual meetings are co-hosted by local regulatory authorities and stock exchanges, and are also supported by the Government of Spain.

The Council of Securities Regulators of the Americas and IOSCO’s Inter-American Regional Committee (hereinafter “COSRA/IARC”) are made up of securities regulators from North, Central and South America, the Caribbean and Spain. Their objective is to seek to establish basic and common legal, regulatory and structural principles that promote efficient and liquid markets while ensuring an appropriate level of investor protection.

Both the Roundtable and COSRA/IARC share a long-term commitment to improved corporate governance in the jurisdictions in which they are involved, and a common understanding that an effective enforcement framework provides a key underpinning of good corporate governance practices. It is against this background that COSRA/IARC and the Roundtable established a joint Task Force to develop this report on misuse of privileged information.

### **Task Force Members**

The Task Force was made up of the following COSRA/IARC Members: Autorité des marchés financiers of Québec; Central Bank of Uruguay; Comisión Nacional de Mercado de Valores de España; Comisión Nacional de Valores de Perú; Superintendencia de Valores de la República Dominicana; Comissão de Valores Mobiliários do Brasil; Superintendencia Financiera de Colombia as well as

institutional representatives from COSRA/IARC, OECD, IFC and the World Bank. Mr. Mike Lubrano, consultant to the OECD, and Mr. Jean Lorrain, Director of International Affairs for the Quebec Supervisory Authority, served as co-reporters for the project, with oversight from Ms. Rosario Patron, Chair of COSRA, and Daniel Blume, OECD manager of the Latin American Roundtable on Corporate Governance.

This joint initiative enabled the Task Force to pool specialized resources as well as to ensure wider involvement of the key institutions responsible for enforcement-related actions in the region.

## **Responses**

Prior to the preparation of this Report, the Task Force received responses from 19 COSRA/IARC jurisdictions, including: Argentina, Barbados, Brazil, Canada, Cayman Islands, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Honduras, Mexico, Nicaragua, Panama, Peru, Spain, Trinidad & Tobago, and Uruguay. Since September 2010, Task Force members have reviewed the results of the survey and prepared this Report which sets forth the initial results of the survey. This Report therefore attempts to summarize various key questions and issues raised in the survey responses, including:

- What are the main areas of concern identified in the survey?
- What are the main commonalities between jurisdictions?
- What are the main differences in legal and regulatory frameworks to tackle abuse of privileged information?
- What are the main actions needed by the regulator to make enforcement more effective?
- What are the actions that other institutions and market actors should take to prevent abuse of privileged information?
- What follow-up work should be considered by the Task Force?

A draft version of this Report was discussed during the COSRA/IARC meeting in Rio de Janeiro, Brazil, on October 20, 2010 involving all COSRA/IARC participants and a small number of Roundtable participants with specific expertise on these issues. Preliminary findings from the COSRA/IARC-Roundtable Task Force meeting were reported to the larger meeting of the Roundtable on October 21, 2010, providing an opportunity for the Task Force to obtain feedback and continue this initiative with follow-up work in the future.

The discussions in Rio served to clarify for the Working Group and reporters a number of important issues raised by the survey responses and advanced the Joint COSRA-OECD Task Force's work on this important topic. Respondents to the survey were asked to review all references to their country in the Draft Preliminary Report to ensure that what the reporters have written is factually correct. Respondents were subsequently encouraged to inform the reporters if any important information about their country may have been overlooked.



## **Limitations**

The Task Force received a good number of thoughtful responses to the survey. However, the varying levels of detail provided in the responses to different questions among the respondents presented certain challenges in the process of review and analysis. As a result, the Task Force contacted certain respondents directly to seek clarification of some of the statements in their survey responses and asked some more detailed follow-up questions.

It also bears noting that the issues of corporate governance, privileged information and enforcement are currently of greater importance for some markets than others. Differences in size, complexity and stage of evolution make for different priorities among markets. For example, some jurisdictions already have an active market in shares of listed companies. Others have in practical terms no public equity market at all. Naturally, given the pace at which markets can evolve, the issues considered by the Task Force in this report may well become more relevant to a broader set of jurisdictions in the short and/or medium term. As a result, the Task Force is confident that the issues addressed by this joint initiative will become of greater interest to all.

This initiative has provided information to members about the legal situation and issues faced in the responding jurisdictions. It has also provided the occasion to consider corporate governance issues in the important context of the enforcement against the improper use of privileged information.

Dissemination of this Report was to be initially limited to COSRA members and the participating international organizations in the COSRA meeting until there has been an opportunity for participating members to review it to ensure that any confidential information is excluded.