Self-Regulation by the Mexican Stock Exchange: A Promising Path Toward Developing Mexico's Securities Market?

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SELF-REGULATION BY THE MEXICAN STOCK EXCHANGE: A PROMISING PATH TOWARD DEVELOPING MEXICO’S SECURITIES MARKET?

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A. What is the Nature and Aim of the Self-Regulation? ...................................214

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This study ventures into a global phenomenon of modern securities markets: self-regulation by stock exchanges. The purpose is to better understand the benefits (or lack thereof) of self-regulation by the Mexican Stock Exchange (MSE), as an alternative channel (to public enforcement by regulators and private rights of action) that may potentially contribute to better achieving the investor protection required by the Mexican securities market to further develop and compete in today’s global marketplace.

The research involves an empirical analysis of 128 decisions issued by MSE during a recent five-year period, involving 89 cases of trading suspension sanctions against issuing companies. Seeking to shed light on the extent to which self-regulation works in the Mexican securities market, the study examines: i) the nature and aim of the self-regulation, on account of the type of wrongdoing regulated and sanctioned; ii) the characteristics of issuing companies being targeted; and iii) the way these companies reacted to MSE’s trading suspension sanctions, in terms of how they complied and corrected their wrongdoing. Reaction to the findings through a series of semi-structured interviews with officers and directors of the Mexican Stock Exchange, the National Banking and Securities Commission (CNBV), the National Banking and Securities Commission (CNBV), and the Secretary of Finance and Public Credit (SHCP), among others, further illustrate the development, role, and challenges of self-regulation in Mexico’s securities market.

The research finds that self-regulation by the Mexican Stock Exchange is largely preventive and procedural in nature, aimed primarily at inducing timely and complete filing of periodic information. Focus is, seemingly, not substantive in terms of detecting and punishing serious misconduct like securities fraud, insider trading, and self-dealing. Moreover, the firms targeted and commonly sanctioned are usually smaller and less profitable, with low trading volumes and share prices.

Nonetheless, compliance rates by issuers, after being suspended, are fairly high, and firms tend to comply very quickly, often resuming trade within hours. Even if the trading suspensions do not seem to have an impact on the price of stock, issuers apparently care significantly about being suspended. Among other factors, there appears to be a reputational component involved. Sanctions are made public and reach the media instantly, and firms reportedly care about potential economic impact regarding access to finance, future ventures, and fines by the regulator.

The study also points to challenges faced by the current self-regulatory regime, including certain wrongdoing not being detected, the absence of stronger sanctions like fines, the need for more revision and auditing, and the need to

1 The Comisión Nacional Bancaria y de Valores (CNBV) is Mexico’s banking and securities regulator.
2 The Secretaría de Hacienda y Crédito Público (SHCP) is Mexico’s Secretary of Finance and Public Credit.
overcome the conflicts of interest derived from the Mexican Stock Exchange becoming a publicly-held company, policing the same market that it manages and in which it trades.

Aiming at contributing to legal scholarship, this paper involves an initial effort to collect and assess data on enforcement activity for Latin America, a region with widespread support for market development but with a hostile corporate environment, often characterized by concentrated ownership structures, strong controlling owners, and tunneling, that could benefit from a better understanding of securities enforcement. Moreover, the research adds new dimensions to the existing literature by both focusing on an emerging region, and addressing self-regulation by stock exchanges as an additional enforcement channel with the potential to contribute to financial development.

This note develops as follows. Section II explores the existing literature. It presents debates on the extent to which self-regulation works in securities markets, and on the optimal levels and modes of securities enforcement required to achieve financial market development. Section III discusses the self-regulatory legal framework of Mexico’s securities markets, with focus on stock exchanges and on the disciplinary measures that the Mexican Stock Exchange may impose on issuing companies. Section IV addresses the research questions and design. Section V presents results and evaluates the findings, and Section VI concludes.

II. BACKGROUND AND EXISTING LITERATURE

A. Brief Note on Self-Regulation in Modern Securities Markets

Self-regulation in securities markets has been around for some time. The New York Stock Exchange (NYSE) was a self-regulatory organization (SRO) that exerted market discipline well before the enactment of the U.S. federal securities laws. But, as a result of globalization, which brought increased activity, technology, and competition to financial markets—and, in turn, demutualized publicly held stock exchanges (traditionally non-profit mutual or member organizations)—self-regulation has gained relevance in securities markets across the globe. It has been considered a means to acquire enhanced disclosure and corporate governance standards, with the purpose of attracting investors and achieving market competitiveness, being increasingly adopted by formal legal systems to strengthen financial markets. This global trend reached Latin America during the past decade, with self-regulation being considered key in promoting a “legal culture” of corporate governance necessary to develop the region’s financial

3 See Joel Seligman, Cautious Evolution or Perennial Irresolution: Stock Market Self-Regulation During the First Seventy Years of the Securities and Exchange Commission, 59 BUS. LAW. 1347 (2007).


5 Id.

6 See LAWRENCE M. FRIEDMAN, THE LEGAL SYSTEM: A SOCIAL SCIENCE PERSPECTIVE 193–
“On the face of it, self-regulation can be defined simply as an institutional arrangement whereby an organization regulates the standards of behavior of its members.”  

It occurs when, absent government oversight, individuals or institutions of a branch of the private sector voluntarily decide that it is in their best interest to establish a private normative order to govern and supervise their activities and affairs. However, “regimes governing company affairs, equity markets, and financial services which have self-regulatory characteristics are not examples of self-regulation in its purest form.” As set forth by Alan C. Page: “Self-regulation is a matter of degree” and “government has been heavily involved not only in the formation of self-regulatory regimes but also in their monitoring and adjustment.”

Rob Baggott classifies varying degrees of self-regulation in terms of (1) formality, (2) legal status, and (3) outside intervention. As opposed to a private organization supervising its own members, a self-regulatory framework with a higher level of formality would, for instance, entail a specialized and independent surveillance body empowered with rule-making and enforcement powers to oversee the organization and its members. This is often the case with SROs in securities markets, which have independent surveillance divisions or non-profit associations.

With regard to legal status, a self-regulatory regime would be governed, in essence, by mere voluntary agreements. However, these agreements are often backed by statutory law, and it is not uncommon for governments to reserve powers for overseeing and enforcing self-regulatory regimes. An example of this would be a securities regulator’s oversight of stock exchanges and associations of broker-dealers, setting general legal guidelines for them to follow. Moreover, it is increasingly common for self-regulation to be recognized and adopted by formal legal systems as supplementary to statutory law, a recent instance being the case of Mexico, further detailed in Section IV.

Finally, in terms of outside intervention, self-regulatory regimes may involve the participation of third parties. Current examples comprise private enterprises to which stock exchanges outsource market supervision to overcome conflicts of interest resulting from becoming for-profit and publicly-held companies trading in the same markets that they manage and police. The Financial Industry Regulatory Authority, Inc. (FINRA) is a private company that has taken on this role for U.S. financial markets since 2007.

Hence, in the context of securities markets, self-regulatory organizations...
would usually entail stock-exchanges and organizations of broker-dealers with authority (often provided by law) to create and enforce rules of conduct (ethical and legal standards) to govern the financial services industry and its members.\(^\text{15}\)

But how ideal is self-regulation in achieving market supervision? Arguments for and against enforcement by self-regulatory organizations have been set forth and different conclusions have been reached. Assessing different empirical accounts within the British financial sector, Brian Cheffins concludes that self-regulation is not ideal to supervise market behavior, as it does not offer clear-cut advantages over enforcement by government regulators.\(^\text{16}\) Self-regulation may be more flexible and offer more expertise and lower costs than government supervision, as has been the British tradition in many sectors.\(^\text{17}\) However, it may also lack the strength, legitimacy, and coercion of public enforcement, as would, for instance, be offered by the Securities and Exchange Commission in the United States.\(^\text{18}\)

Could a healthy balance of both self-regulation and government oversight be a solution? Baggott suggests that the real puzzle lies in determining the effectiveness of the self-regulatory system to be adopted, in terms of satisfying both private and public interests.\(^\text{19}\) He asserts that the right direction involves increased formality, reliance on a statutory framework, and intervention by outside members.\(^\text{20}\)

Would it not be contradictory that a self-regulatory regime be comprised of elements involving mandatory law and government intervention? Probably, to some extent. Nonetheless, it may be necessary. Conditions like recognition of self-regulation by the formal legal system, and the threat of intervention by governmental authority may be elemental in increasing legitimacy and ensuring compliance with standards and rules of conduct within an industry.\(^\text{21}\) Moreover, a self-regulatory organization may well have as an objective avoiding state intervention, and establishing a normative order at the convenience of its members. Hence, a mixed self-regulatory system might reduce the likelihood of private interests prevailing at the expense of public concern. Self-regulation involves a wide variety of areas, and incentives for a stock exchange and broker-dealers to regulate effectively differ across these areas.\(^\text{22}\) These incentives may actually not

\(^{15}\) See Bernard Black, *The Role of Self-Regulation in Supporting Korea’s Securities Markets* 3 (Harvard Law Sch. John M. Olin Program in Law, Economics, and Business, Working Paper No. 226, 2002), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=293565. More specifically, Black defines self-regulation in the financial sector: “[T]o include any actions by professional participants in securities markets, acting through professional organizations or through the stock exchange, to regulate any one of the following three broad areas: (1) regulation of the quality and behavior of public companies, through listing standards that combine minimum size and solvency standards, disclosure standards, and corporate governance standards; (2) regulation of broker-dealers, including both their dealings with each other and their dealings with customers; and (3) regulation of trading, including trade disclosure and investigation and regulation of insider trading, market manipulation, excessive commissions, and front running.” Id.

\(^{16}\) CHEFFINS, *supra* note 9, at 144.

\(^{17}\) Id.

\(^{18}\) Id.

\(^{19}\) See Baggott, *supra* note 8, at 452.

\(^{20}\) Id.

\(^{21}\) Id. at 437.

\(^{22}\) See Black, *supra* note 15, at 5.
involve regulating adequately, and hence the importance of a securities regulator in overseeing the quality of self-regulation.\(^{23}\)

Now, as stock exchanges have demutualized and become publicly-held for-profit organizations during recent years, new perspectives have been added to the debate, questioning the adequacy of enforcement by self-regulatory organizations and offering potential solutions.\(^{24}\) This issue concerns the conflicts of interest that arise from publicly-held stock-exchanges supervising the same markets that they operate, and in which they trade their own stock. One might think that this should not be a problematic issue, given that stock exchanges should be concerned about their reputations and integrity. However, an exchange could use its regulatory powers to gain a competitive advantage over other market participants in the same exchange. It might abstain from properly regulating itself and exert more enforcement on other participants. In addition, it might use its knowledge of the market to its own advantage, positioning itself over competing issuers.\(^{25}\)

Furthermore, with increasing demutualization there is concern that for-profit exchanges might avoid exerting sufficient market supervision and fulfilling their self-regulatory responsibilities, as enforcement involves significant costs (and some of it does not generate revenue) that might be in conflict with maximizing profits.\(^{26}\) This is not only a result of the exchange regulating itself, but of other relevant and influential market participants (member/clients) with which it wants to be in good terms. Other points of conflict involve: business resources versus regulation needs; high-regulatory standards versus low business development; and regulation of member owners versus duties towards public investors.\(^{27}\)

On another dimension, it should be noted that stock exchanges compete against each other for market power at a global level. There is a concern that an exchange might be too permissive in regulating itself and its members, in order to obtain unfair advantages over competitor exchanges.\(^{28}\) This is particularly likely to happen in today’s competitive global environment, where companies have a wide array of exchanges to choose from and to which they are free to list and cross-list. In selecting a market, issuers take into consideration costs of compliance and enforcement level. Hence, there is a tendency by exchanges to reduce costs and surveillance in order to remain competitive, in turn lowering the bar and compromising adequate self-regulation, oversight, and investor protection.

As a result, the literature has offered interesting solutions, namely firewalls to overcome the conflicts posed. For example, some demutualized exchanges have established independent subsidiaries to carry out their self-regulatory operations, or outsourced them to third parties, as is respectively the case in Brazil and the United

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23 Id.


28 See Aggarwal, supra note 24.
States. However, other for-profit exchanges, including the Mexican Stock Exchange, have retained these self-regulatory powers internally. As discussed in Section V, this is a matter of significant concern within the Mexican securities market.

B. Securities Enforcement for Capital Market Development: An Ongoing Debate

This research also builds on the literature seeking to measure optimal degrees of financial regulatory intensity for stock market development around the world. Focus is on the ongoing debates over how much enforcement is required, which mode of securities enforcement is the best channel for achieving that market development, and which measure of enforcement is more appropriate.

These issues emerge from the seminal academic finance theories suggesting that capital market development spurs economic growth, that investor protection is necessary for such development, and that the enforcement of securities laws leads toward that protection. The literature generally agrees on these premises, and on the importance of securities laws in the financial development cycle. Contending theories, however, are much at play about the ideal level of enforcement. Too much regulatory intensity could, for instance, affect the competitiveness of a financial system. Such has been the argument with regard to U.S. markets after the wave of regulation that came with the Sarbanes-Oxley Act and, more recently, with the enactment of the Dodd-Frank Act. On the other hand, beefed-up regulatory intensity might signal investor protection and thus attract investors. Even if the United States is an outlier in terms of exerting unparalleled securities enforcement, it also provides significant benefits associated with investor...
protection, including reduced private benefits of control, lower costs of capital, and valuation premiums. In either case, the consensus is that regulation and regulatory intensity matters: “Financial markets do not prosper when left to market forces alone.”

In addition, there is much debate about whether public enforcement or private enforcement is the better avenue to enhance securities markets, and about which measure of securities enforcement best explains capital market development. These puzzles remain to be solved, but important contributions have been made in recent years.

An important part of the literature has considered private enforcement to be central in explaining the size of capital markets around the world. Others have found that it is not associated to robust markets as is often assumed. For example, there has been skepticism about the benefits and effectiveness of class actions in the United States. Yet an opposing view finds that public enforcement by regulators to some extent prevails.

Studies, however, tend to follow a rather “law in books” approach. For example, an issue with indexing enforcement powers of regulators is whether

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36 Coffee, supra note 33, at 8; see Craig Doidge et al., Why Are Foreign Firms Listed in the U.S. Worth More? , 71 J. FIN. ECON. 205 (2004).

37 See La Porta et al., supra note 33, at 22.

38 See La Porta et al., supra note 33; Simeon Djankov et al., The Law and Economics of Self-Dealing, 106 J. POL. ECON. 1113 (2008); WORLD BANK, INSTITUTIONAL FOUNDATIONS FOR FINANCIAL MARKETS (2006), available at http://siteresources.worldbank.org/INTTOPACCFINSER/Resources/Institutional.pdf. La Porta et al. measure securities enforcement in terms of the powers of financial regulators. They build an index of public enforcement and conclude that private enforcement prevails in explaining market development. Djankov et al. construct a similar public enforcement index and also measure securities enforcement based on powers of financial agencies, with a focus on self-dealing transactions. They too conclude that private enforcement is more strongly associated with investor protection and developed markets. The World Bank has held a similar stance, endorsing private enforcement as a policy, discounting public enforcement as irrelevant in boosting financial markets and economic growth.


42 See La Porta et al., supra note 33; Djankov et al., supra note 38.
these powers are actually employed. Measuring enforcement in terms of resources might also present obstacles, like budgets not translating into actual enforcement action.

Real accounts of enforcement activity, in terms of actions and sanctions, might be a better measure of securities enforcement to explain market development. But, maybe surprisingly, there is limited empirical data available on securities enforcement activity for developed countries. And, as one might imagine, the situation for developing countries is considerably more acute. This hinders both testing the theories on how enforcement may contribute to market development, and solving the puzzle of finding ideal levels and modes of enforcement. In addition to the sparseness of information on actual enforcement actions, the benefits of securities enforcement vary across jurisdictions and are difficult to measure.

The mentioned reasons likely explain why we do not yet find a substantial number of studies using enforcement activity as a proxy. Nonetheless, important work has been achieved, particularly on developed countries. Special focus should, however, be placed on further collecting and organizing enforcement activity data for individual countries to better measure the benefits of enforcement across jurisdictions.

With that in mind, this paper involves an initial effort to gather and assess data on enforcement activity for Latin America, a region with widespread support for market development but with a hostile corporate environment that could benefit from a better understanding of securities enforcement for its development. Seeking to add new dimensions to the discussion, focus is set on a developing country of the region, Mexico, and on an alternative enforcement channel (different from public enforcement and private rights of action) with the potential of contributing to market development: self-regulation.

III. SELF-REGULATION IN THE MEXICAN SECURITIES MARKET

A. An Overview of Self-Regulation in Mexico’s Formal Legal System

The involvement of self-regulatory organizations in Mexico’s securities market acquires more relevance by the day. They have proved to contribute successfully in the establishment of higher corporate and ethical standards within the financial services industry, guaranteeing a seal of

43 See Jackson & Roe, supra note 41.
44 As is often the case, budgets of regulators are wholly allocated to human resources rather than directly to regulation, projects, and other efforts to enhance enforcement action.
45 Jackson, supra note 30, at 253.
46 Id.
47 See id. (comparing legal actions and monetary sanctions by regulators in the United States, the United Kingdom, and Germany); Coffee, supra note 33 (in relation to the United States, Australia, and the United Kingdom); Armour et al., supra note 39 (comparing private enforcement in the United States and the United Kingdom).
48 For several years, Professor Howell E. Jackson, at the Harvard Law School, has been leading an ongoing effort of collecting and analyzing data on securities enforcement in different countries. In that spirit, my current doctoral dissertation, at Stanford Law School, focuses on empirically assessing enforcement activity, seeking to measure degrees and variation of regulatory intensity across Latin American securities markets.
quality and prestige. Therefore, with the purpose of ensuring that these conditions continue and are strengthened, we propose that a minimum regulation to direct and legitimize the self-regulatory organizations of the Mexican securities market be elevated to law.\textsuperscript{49}

The preceding quotation, part of the legislative “Statement of Motives” of the new Mexican Securities Law of 2006, highlighted the role of self-regulation in improving Mexico’s capital markets and voiced the need to strengthen and legitimize it through the legal system. The result was a detailed self-regulation framework mandated by law.\textsuperscript{50}

Clearly defining SROs, the new law empowers them with supervisory and rule-making authority, directing them to implement standards of behavior and operation among their affiliates, with the purpose of contributing to the healthy development of the Mexican securities market.\textsuperscript{51} The law grants SROs enhanced rule-making power to govern, among other matters: (1) requirements of admission, exclusion, and separation of members; (2) information disclosure;\textsuperscript{52} (3) efficiency and transparency of the securities market; (4) the process of adopting self-regulatory norms; (5) the procedures to monitor and ensure their compliance; and (6) the disciplinary and corrective measures and procedures to execute their adoption.

SROs do not need the approval of the National Banking and Securities Commission (CNBV) to issue self-regulatory norms. Yet the CNBV oversees SROs and, among other powers, may veto these norms, order the removal of officers and directors, and approve and revoke SRO status.\textsuperscript{53} Moreover, SROs are required to issue periodic evaluations regarding compliance with their self-regulatory norms and to maintain a registry of the disciplinary and corrective measures they apply, all of which is available to CNBV.\textsuperscript{54}

\textbf{B. A Self-Regulatory Framework for the Mexican Stock Exchange}

The Mexican Stock Exchange (MSE) is Mexico’s only stock exchange. It is a for-profit privately owned institution, operating with authorization of the Secretary of Finance and Public Credit (SHCP) and under the surveillance of CNBV. In addition, following its recent initial public offering of securities, its stock is publicly traded in the MSE.\textsuperscript{55}

Reflecting the role of self-regulation by stock exchanges in the Mexican

\textsuperscript{49} Decreto de Exposición de Motivos [Statement of Motives of the Mexican Securities Market Law], Diario Oficial de la Federación [DO], 30 de Diciembre de 2005 (Mex.), \textit{available at} http://www.cnbv.gob.mx/Normatividad/Ley%20del%20Mercado%20de%20Valores.doc.


\textsuperscript{51} Mexican Securities Market Law, art. 228.

\textsuperscript{52} Information disclosure here is in addition to what the law requires.

\textsuperscript{53} Except for stock exchanges and clearing houses, which the law considers SROs.

\textsuperscript{54} Mexican Securities Market Law, art. 229.

\textsuperscript{55} CNBV launched its initial public offering on June 13, 2008.
securities market, the law considers the MSE to be an SRO (in contrast to associations of intermediaries, brokers, and investment advisors which require recognition by the securities regulator), which, through its internal rules,\(^{56}\) enjoys ample rule-making, supervisory, and enforcement powers over issuing companies, stockbrokers, and other market participants.

MSE’s enforcement is channeled through an internal Surveillance Division, which is headed by a director of surveillance and is in charge of day-to-day monitoring and market supervision. After identifying a transgression, the surveillance team conducts an investigation and refers the matter to one of MSE’s disciplinary bodies: the Disciplinary Committee, the Board of Directors, or the General Management. They, in turn, conduct a disciplinary proceeding\(^{57}\) and may impose corrective action and sanctions.\(^{58}\) These include a variety of warnings, suspension of activities, and suspensions of trading, which are not subject to review. The disciplinary bodies are also MSE’s governing bodies, in charge of management and executive operations.\(^{59}\) This is a potential conflict of interest scenario where a for-profit and publicly held stock exchange “wears two hats,” policing the same market in which it is a player.\(^{60}\)

Perhaps more important, the Surveillance Division plays a preventive enforcement role. Pursuant to MSE’s internal rules, this involves constant monitoring and surveillance of periodic information, relevant events, and stock prices of issuing companies. Using the information, MSE may impose a series of preventive measures, including the suspension of an auction, contingency plans, audits, and most notably, trading suspensions addressed in the present study.

Trading suspensions may be imposed by MSE for different reasons, including misconduct as provided by the National Banking and Securities Commission’s “Regulation for Issuers” (CUE) and MSE’s internal rules.\(^{61}\) One kind of wrongdoing involves information disclosure and entails failure of an issuing company to file the required periodic information (annual, quarterly, and monthly information—both financial and nonfinancial) in a timely fashion and through the authorized channels. This suspension may also be triggered when the information presented is confusing, incomplete, or inconsistent with the legal requirements. The annual information includes, among other documents: i) reports by an issuer’s board of directors, by its chief executive officer, and by its corporate practices and auditing committees containing corporate, accounting, and financial information on matters like company performance, related party transactions, executive compensation, internal controls and auditing mechanisms, financial statements, accounting standards, and shareholder agreements; ii) annual financial statements; iii) an annual report corresponding to the previous fiscal year, signed and certified


\(^{57}\) MSE’s Internal Rules, § 11.016.00.

\(^{58}\) MSE’s Internal Rules, § 11.001.00.

\(^{59}\) MSE’s Internal Rules, § 11.011.00.

\(^{60}\) See Fleckner, supra note 25.

by the chief executive, financial and legal officers, and the corresponding external auditor.\textsuperscript{62} According to MSE’s internal rules, issuers should file, together with this annual report, a questionnaire on their level of adherence to the corresponding corporate governance standards.\textsuperscript{63} Issuers shall also file quarterly reports with updated financial statements and other economic, accounting, and administrative information as required by law.

A second cause for suspension is a failure to disclose material or “relevant events,”\textsuperscript{64} broadly defined by MSE’s internal rules as circumstances of any nature that may influence the price of a share.\textsuperscript{65} Moreover, the Regulation for Issuers includes a significant list of events that should be considered relevant and hence disclosed accordingly.\textsuperscript{66}

Another reason for suspension is referred to by MSE’s internal rules as “special characteristics” in the opinions rendered by external auditors on issuers’ financial statements.\textsuperscript{67} MSE may suspend issuers if they fail to report on omissions, mentions, clarifications, or other special characteristics that the opinions on their statements might present. It may also suspend trade based on the relevance of the special characteristics disclosed by the issuer. In addition, suspension may also be imposed when the external auditor abstains from rendering an opinion about the statements or issues a negative one. MSE should also suspend trade when an issuer’s audit committee (within its board of directors) considers that the policies and accounting standards are not being followed accordingly.

Another cause involves failure to comply with one or more of the listing requirements established in MSE’s internal rules.\textsuperscript{68} These include having at least one hundred shareholders and a stock trading float of at least twelve percent of the issuer’s capital.\textsuperscript{69} If an issuer does not present a satisfactory contingency plan to correct the wrongdoing, after being required by MSE to do so, the trading suspension should be imposed.

Yet another cause of suspension involves foreign companies quoted in the Mexican Stock Exchange’s Global Market through its international trading system. MSE, to avoid disorderly market conditions, imposes a suspension when it identifies that a firm has been suspended from trading in its exchange of origin (e.g., a U.S. firm suspended by the New York Stock Exchange). In addition, MSE may suspend a firm from trading when it does not have access to a foreign issuer’s financial information and is therefore not able to adequately inform the market about the securities of that foreign issuer.

Other causes of suspension, which are not necessarily due to issuers’ misconduct, involve “extraordinary price fluctuations”\textsuperscript{70} and “unusual price movements.”\textsuperscript{71} MSE’s computerized system automatically suspends trade when a

\textsuperscript{62} CUE, §43.
\textsuperscript{63} MSE’s Internal Rules, § 4.033.00 XI.
\textsuperscript{64} MSE’s Internal Rules, § 10.002.00.
\textsuperscript{65} MSE’s Internal Rules, § 1.003.00.
\textsuperscript{66} CUE, §50.
\textsuperscript{67} MSE’s Internal Rules, § 10.015.03; CUE, § 46.
\textsuperscript{68} MSE’s Internal Rules, § 4.040.00 II; CUE, § 29.
\textsuperscript{69} MSE’s Internal Rules, § 4.033.01.
\textsuperscript{70} MSE’s Internal Rules, § 10.008.00.
\textsuperscript{71} MSE’s Internal Rules, § 10.012.00.
IV. RESEARCH QUESTIONS AND DESIGN

A. Addressing the Questions

This study assesses self-regulation in the Mexican securities market, focusing on enforcement activity by the Mexican Stock Exchange. I address the following questions. First, what is the nature and aim of MSE’s self-regulation? Focus is placed on the wrongdoing regulated and sanctioned by MSE, resulting in trading suspensions against issuing companies during the five-year period between May 2004 and May 2009. Second, what type of firms have been the object of MSE enforcement? Attention is placed on characteristics of sanctioned companies, including equity or debt issuances, foreign or domestic firms, size, firm profitability, trading volume, and share price. Third, how have companies reacted to the trading suspension sanctions? Elements examined include the extent to which firms have complied, by correcting their wrongdoing, so as to resume trade, and the length of the suspension sanctions.

B. Methodology

1. Analysis of Trading Suspension Decisions

One hundred and twenty-eight decisions issued by the Mexican Stock Exchange during the five-year period, involving trading suspension sanctions against issuing companies, were analyzed. The decisions were assembled into a total of eighty-nine different cases (generally, the decisions concerned either suspending the issuer and/or lifting the suspension). This involved the total number of decisions related to particular cases in which issuing companies were suspended from trading by MSE between May 2004 and May 2009. Suspensions automatically imposed by MSE’s computerized system, due to price fluctuations, which are not made public and generally do not involve wrongdoing, were not taken into consideration for this study. Each decision’s content was then analyzed and categorized based on its characteristics (coding). The result was a data set containing multiple categories and variables focused on answering the different

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72 According to CUE § 72, MSE is required to publish the corresponding decisions in order to inform the regulator, the market (particularly investors and trading intermediaries), and the general public. In turn, § 10.003.00 of MSE’s Internal Rules provide that the trading suspension decisions be made publicly available both in print, at the Mexican Stock Exchange in Mexico City, and electronically, through the Internet. The decisions analyzed in this study were obtained from the Mexican Stock Exchange’s web portal. To corroborate, their content of the decisions was then reviewed with MSE’s Director of Surveillance during a visit to the Mexican Stock Exchange on December 10, 2009.

73 Suspensions for “Extraordinary Price Fluctuations” and for “Unusual Price Movements,” respectively provided in § 10.008.00 and § 10.012.00 of MSE’s Internal Rules.

research questions.

a. Wrongdoing Regulated and Sanctioned

To identify the nature and aim of the self-regulation under study, three general categories were created for the reasons for which MSE may suspend companies from trading. They involved wrongdoing related to: (1) periodic information disclosure (including the information to be filed with annual and quarterly reports), (2) special characteristics in an external auditor’s opinion about an issuer’s financial statements, and (3) listing requirements. MSE’s internal rules further detail particular reasons of suspension, which were categorized as subsets within the three fields.

With respect to information disclosure, the internal rules provide for different reasons for suspension. One of the reasons, described in Section III, was categorized as lack of information reporting. Subsets in this category included whether firms omitted reporting in annual reports, quarterly reports, monthly reports, and reporting on their level of adherence to Mexico’s Corporate Governance Code.

Another category related to information disclosure involved “relevant events.” Since the trading suspension decisions themselves do not provide detail on the particular relevant events for which the suspension was imposed, the announcements provided by the sanctioned companies as they resumed trade were collected. Additional analysis was carried out and categories describing the different types of relevant events were included in the coding scheme. These involved corporate transactions, namely acquisitions, judicial proceedings, particularly bankruptcy, and financial contingencies.

The second broad category was considered under the rubric of Special Characteristics in Financial Information. Subsets included: suspensions due to omissions, mentions, clarifications or other special characteristics in the opinions by auditors to an issuer’s financial statements; an opinion by an issuer’s audit committee determining that the information presented is not consistent with the corresponding accounting policies and criteria; issuers not disclosing the required information in their audited financial statement; and cases in which the external auditor’s opinion is negative or absent.

The third general category was related to listing requirements. Subsets included suspensions due to issuers not presenting satisfactory contingency plans to correct their wrongdoing, and companies delisting from trading in the exchange.

Based on MSE’s internal rules, another category regarding foreign companies quoted in the Mexican Stock Exchange’s Global Market was added, referred to as “International System of Trading.” This included suspensions prompted by a suspension in the market of origin. The reasons for which these

75 CUE, § 45.
76 CUE, § 46.
77 CUE, § 29.
78 MSE’s Internal Rules, § 10.015.01.
79 MSE’s Internal Rules, § 10.015.03.
80 MSE’s Internal Rules, § 4.040.00 II.
companies were suspended in their market of origin were also included as categories, among them, cases involving relevant event disclosure, bankruptcy, and delistings in the exchanges of origin.

b. Company Characteristics

An additional set of categories focused on responding to the research question regarding the type of companies targeted by the sanctions. A set of characteristics involved the origin of the issuing firms, in terms of whether companies were domestic (Mexican) issuers trading in the Mexican securities market through the Mexican Stock Exchange, or foreign issuers trading in the Mexican Stock Exchange’s Global Market Segment through the “International Trading System.” Another category involved issuance type, focused on whether the sanctioned firms issue equity and trade in the stock market or issue bonds and trade in the debt market. Another set of categories focused on the industry to which the sanctioned firms belonged.

One other subset of categories relates to profitability of the firms. These included indicators like a company’s operating revenue/turnover, return on equity (ROE), and return on assets. Size was also taken into consideration in terms of a firm’s total assets and market capitalization. Finally, share price and trading volume were also accounted for, seeking to find out the condition of the company at the time of suspension.

After constructing the data set, an analysis of the different variables and categories was carried out, aimed at finding patterns and conclusions in response to the research questions.

c. Compliance Following Suspension

To find out how sanctioned companies react to the trading suspensions, and how long it takes for them to correct the wrongdoing and resume trading, the duration of the sanctions in each of the suspension cases was obtained, based on the date and the time of suspension and the date and time when the suspension was lifted. Each of the cases was categorized in terms of its suspension length, namely suspensions that lasted a day or less, between two and five days, between six and thirty days, between six months and one year, more than one year, and suspensions not lifted. Other related coded categories focused on the frequency of the suspensions in terms of the number of suspensions per month and per year.

2. Semi-Structured Interviews

Finally, a series of semi-structured interviews were conducted to supplement the analysis of the decisions. These conversations took place in Mexico City during the week of December 7–11, 2009. They included interviews with the Mexican Stock Exchange’s CEO and its Director of Surveillance, in charge of exerting the enforcement action under study. For the perspective of the securities regulator, interviews were held with the National Banking and Securities Commission’s (CNBV) Vice Presidents of Stock Exchanges and of Market
Supervision. Further, for a policy-making viewpoint, an interview was held with the head of Mexico’s Secretary of Finance and Public Credit’s (SHCP) securities division, in charge of overseeing CNBV. For the perspective of Mexico’s stock brokers, part owners of MSE, an interview was held with the CEO of the Mexican Association of Financial Intermediaries (AMIB). Moreover, for the viewpoint of the issuing companies being sanctioned, interviews were held with securities lawyers and with the President of the Best Corporate Practices Committee, within Mexico’s Business Coordinating Council, in charge of issuing the governance standards to which companies trading at MSE are required to adhere.

V. FINDINGS AND DISCUSSION

A. What is the Nature and Aim of the Self-Regulation?

The causes of wrongdoing leading to trading suspensions identified from the findings reflect that self-regulation by the Mexican Stock Exchange is largely procedural, aimed at inducing timely disclosure of financial and material information. As further detailed below, the sanctions mostly relate to causes like untimely and incomplete filing of periodic financial information, relevant events disclosure, and misstatements in the opinions by auditors to an issuer’s financial statements. Hence, this self-regulation is less substantive in nature, as it does not appear to focus on detecting and punishing serious misconduct such as securities fraud, insider trading, and self-dealing.

The findings show that the highest number of trading suspensions involved misconduct related to untimely or incomplete periodic financial information reporting. This accounted for fifty-eight (55.2%) of the 105 total instances of wrongdoing (in eighty-nine cases of suspension). More specifically, of the fifty-eight instances, thirty-one had to do with annual report filing (53.4%), followed by twenty-one instances related to quarterly reports (36.2%). The few remaining cases consisted of five suspensions for failure to report on the level of adherence to Mexico’s Best Corporate Governance Standards, and one instance regarding a monthly report (a recent filing requirement for trusts as of 2008).

81 Involving both equity and debt issuers, in addition to domestic firms and foreign companies trading in MSE’s International System of Trade.
82 From the eighty-nine total cases, some involved more than one type of wrongdoing.
Figures 1–5: Reasons for Suspension

Pareto cumulative distribution (80%–20% rule) shows that almost 80% of the suspension sanction events are allocated mainly within the lack of information reporting (57.2%) and, to a lesser degree, the International System of Trading (74.3%) categories.
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Mr. Roberto Danel, President of Mexico’s Best Corporate Practices
Committee, and a corporate governance consultant who advises issuers on preparing and filing their financial information before MSE, confirms that, in his experience, the self-regulation is mostly procedural, and that trading suspensions generally derive from quarterly or annual filings being late, or not including the necessary information that issuers are obliged to disclose. Nonetheless, he notes that while MSE does not audit firms, it does carefully review that the information they file is complete and in accordance to what the law requires.

On a related note, self-regulation by MSE also appears to be significantly preventive. MSE’s internal rules classify trading suspensions as either corrective, disciplinary, or preventive measures, depending on the type of procedure applied, but MSE has mainly focused on suspensions of the latter kind. So, even though MSE enjoys enhanced rule-making powers, as provided by the new securities market law of 2006, these powers have seldom been used. Only a few self-regulatory norms have been issued, none of which involve actual market supervision and surveillance matters. The objective apparently has not been to punish issuing companies. On the contrary, MSE actively assists companies in their compliance.

Mr. Pedro Diez, MSE’s Director of Surveillance, agrees that the self-regulation is preventive in nature and that the aim has indeed been to induce timely disclosure compliance. He adds that the focus has not been targeting and punishing firms, as a government regulator would, but rather helping them report to the greatest extent possible. He reports as follows:

Even though MSE does have corrective and disciplinary measures and procedures that go beyond just prevention, our day to day monitoring, surveillance, and enforcement is mostly preventive and focused on inducing timely and complete disclosure compliance. The preventive measures we impose, namely trading suspensions, are directed at achieving an orderly formation of prices and a transparent market, rather than at punishing issuers. Our monitoring and surveillance job in market supervision involves collaborating with issuers and assisting them with their disclosure obligations. We try to minimize the impact by actually calling the issuing companies and encouraging them to provide the necessary information. This has led us to lower the number of trading suspensions in recent years and reflects that we are doing our job effectively.

Though yielding a significantly smaller number of incidents, two additional categories of suspension cases reflect MSE’s focus on inducing governance compliance. Suspensions for relevant events disclosure presented nine instances of

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83 This committee belongs to the Mexican Business Coordinating Council and was responsible for issuing Mexico’s Corporate Governance Standards under the guidelines provided by the OECD.
85 MSE’s Internal Rules, § 10.001.00 XI.
86 Interview with Pedro Diez, Director of Surveillance, Mexican Stock Exchange, in Mex. City, Mex. (Dec. 10, 2009).
87 Id.
the total number of cases (8.6%), of which four (44.4%) were related to corporate transactions, namely company acquisitions. Additionally, two (22.2%) cases involved a bankruptcy proceeding (concerning one company), and two more (22.2%), a financial contingency (also one company). Finally, one matter involved a decision by the issuing company to delist from trading its stock in MSE. As to the second category, special characteristics in the opinions by external auditors about an issuer’s financial statements, there were thirteen incidents (12.4%), of which seven (53.8%) were related to negative opinions by auditors. Another subset involved three (23.1%) sanctions in which the external auditor omitted an opinion on the financial statements. Finally, three (23.1%) cases were related to sanctions for which there were misstatements or omissions in the opinions by auditors regarding an issuer’s financial statements.

When, for instance, MSE identifies relevant events that an issuer fails to disclose, it should carefully assess the nature of the event before deciding to suspend trade. Now, even if discretion may be involved in determining whether to sanction, the aim is still avoiding asymmetries in information and disorderly market price conditions, rather than punishing an issuer for a substantive act or omission that may result in fraud or deceit in connection with the purchase or sale of a security. Mr. Diez cites as an example the case of Controladora Comercial Mexicana, S.A.B. de C.V., in which, despite a bankruptcy proceeding following a well-known corporate scandal involving derivatives in late 2008, the company was allowed to resume trading after the market gained full knowledge of its financial condition.

With regard to special characteristics in the opinion by auditors to an issuer’s financial statements, Mr. Diez further explains that MSE would automatically suspend trade when identifying misstatements or omissions. However, emphasizing the preventive nature of the self-regulation, he states that to avoid confusion in the information filed and, in turn, trading suspensions, MSE has required that issuers file the complete audited financial statements together with the respective opinion, instead of only a summary. This, he notes, explains the low number of suspensions found under this rubric.

What has lead to the procedural nature of the self-regulation under study? Ms. Karla Siller, Director of the National Banking and Securities Commission’s division of Financial Entity Supervision, in charge of overseeing MSE, attributes this to the fact that the law very clearly defines the information that stock exchanges should require from issuers and the causes for which they should impose trading suspensions. In fact, if MSE does not suspend, it could be sanctioned by the regulator for not observing the law and be prevented from operating the market. She adds that, though the self-regulation is quite systematic, MSE does have some discretion in ensuring that the information provided by issuers is complete, and particularly in determining whether an event that a company has failed to disclose is relevant.

88 Controladora Comercial Mexicana, SAB de C.V.
89 Grupo Industrial Saltillo, SAB de C.V.
90 Interview with Pedro Diez, supra note 86.
91 Id.
92 Interview with Karla Siller, General Director of Financial Entity Supervision in the National Banking and Securities Commission, in Mex. City, Mex. (Dec. 8, 2009).
Expressing a similar view, Mr. Efrén del Rosal, CEO of the Mexican Association of Financial Intermediaries (AMIB), reports that there is not much room for more substantive self-regulation in the Mexican securities market because the sector is already heavily regulated. For this reason, self-regulatory organizations like AMIB and, to some extent, MSE have not made much use of their rule-making powers and lack significant discretion when it comes to disciplining their members, as they are basically restricted to following the guidelines already provided by law.93 This may explain why MSE’s trading suspensions and the fines imposed by AMIB involve automated procedures.

Yet another category, also reflecting procedural compliance, involved suspensions derived from issuers not maintaining their listing requirements, of which there was only one case, or companies that were in the process of delisting from the exchange, with four instances. With regard to this category, MSE’s Director of Surveillance reveals that this type of wrongdoing has seldom been enforced in practice since 2004, explaining why we find virtually no cases. An example of what MSE does to assist firms that have problems maintaining listing requirements is to include them in a special kind of auction, which is longer and continues throughout the day, providing investors a more extended reaction time. MSE promotes these auctions and publishes relevant events so that more investors will participate.94

Finally, a category that represented a substantial amount of trading suspensions involved foreign companies quoted in MSE’s International Trading System. This group yielded the second largest number of suspensions with twenty incidents (19.1%). These suspensions were imposed by MSE as a result of the foreign issuers being suspended in their exchanges of origin, due to reasons like bankruptcy proceedings, pending disclosure of relevant events, and exchange delistings. Moreover, all of the foreign issuers suspended traded in the major U.S. exchanges, mostly in the New York Stock Exchange (NYSE), with a few quoted on the National Association of Securities Dealers Automated Quotation (NASDAQ) and on the Over the Counter Market (OTC). In addition, but for a few Latin American, European, and Australian issuers, the vast majority were from the United States.

Perhaps to a greater extent than the rest of the cases identified, trading suspensions concerning foreign issuers are a clear instance of procedural enforcement. These suspensions are imposed in a very systematic way and are not the result of non-compliance with Mexican Law or MSE’s rules. As stated by MSE’s Director of Surveillance, MSE has limited powers to suspend these issuers, and only does so when they are suspended in their exchange or market of origin. Hence, these suspensions do not involve real compliance review or analysis of wrongdoing on behalf of MSE. In fact, MSE does not even have direct contact with the foreign issuers trading in the International System of Trading, but only with their corresponding sponsors, who have access to MSE’s electronic system and feed information to the market on behalf of companies. Nevertheless, there is a serious monitoring effort by MSE to identify relevant events and suspensions in foreign

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93 Interview with Efrén del Rosal, Chief Executive Officer of the Mexican Association of Financial Intermediaries, in Mex. City, Mex. (Dec. 7, 2009).
94 Interview with Pedro Diez, supra note 86.
exchanges, which the sponsors do not always report.\textsuperscript{95}

Finally, there is a bundle of cases in which it was the issuing companies that petitioned to be suspended from trading. Of ten cases, four involved relevant events disclosure. In two of them, companies decided to delist from MSE. Another one had to do with a company whose external accounting auditor was abstaining from issuing an opinion on the financial statements, and three with lack of information reporting. In addition, there were seven cases in which the issuing companies asked MSE for more time to comply. However, they failed to correct the wrongdoing within the extended deadline and were suspended from trading for that reason. There were also four cases in which the securities regulator intervened. In one case it ordered MSE to suspend a company, and in the remaining three instances to lift suspensions.

Is procedural compliance the right way to go? Mr. Guillermo Zamarripa, head of Mexico’s Secretary of Finance and Public Credit’s securities division, asserts that, from a policy stance, the checklist approach that has been followed by both the securities regulator and the exchange in recent years has not been enough to effectively identify wrongdoing and provide the market with complete and accurate information. He notes that the recent corporate scandals of Mexican companies in the derivatives market reflect this. He points out, for example, that without an auditing staff, MSE is not equipped to review financial information substantially. MSE receives and processes information, making it available to the market, which it does reasonably well, monitoring appropriately and imposing trading suspensions. Nonetheless, he believes that more in-depth review is required to avoid abuse. He believes that this task should not be undertaken, at this point, by MSE, but rather by the securities regulator. MSE might ideally take on this role at a later stage of market supervision, as is currently the case of other exchanges and of SROs like FINRA in the United States. Finally, he notes that a strong framework with enough “bite” is currently in place, but the challenge is to better implement it.\textsuperscript{96}

Mr. Diego Martinez Rueda, a former officer of CNBV who worked on designing and drafting Mexico’s Corporate Governance Code, and currently a leading securities lawyer, notes that firms tend to avoid compliance and settle for a checklist approach. He believes that stronger public enforcement by the regulator is key and that it should, consequently, improve self-regulation in Mexico. He makes reference to the record monetary sanctions imposed by CNBV against Controladora Comercial Mexicana,\textsuperscript{97} in relation to the recent scandals in the derivatives market, as a precedent that should lead firms to better comply with their disclosure and governance. Mr. Martinez Rueda concludes that given the unique corporate environment of concentrated ownership structures and strong controlling owners characteristic to Mexico, the business community will only respond to threat of stronger public enforcement. This should, hopefully, shape a more conscious corporate governance culture.\textsuperscript{98}

\textsuperscript{95} Id.
\textsuperscript{96} Interview with Guillermo Zamarripa, Director of the Banking, Savings, and Securities Unit of Mexico’s Secretary of Finance and Public Credit, in Mexico City, Mex. (Dec. 8, 2009).
\textsuperscript{97} In November 2009, for 49 million pesos.
\textsuperscript{98} Interview with Diego Martinez Rueda, Partner, Cervantes & Sainz, in Mexico City, Mex. (Dec. 11, 2009).
Mr. Pedro Zorrilla, Co-CEO of the Mexican Stock Exchange, believes that MSE should move into more active enforcement, especially now that the Securities Market Law empowers it with rule making powers. He emphasizes that MSE’s recent policies are directed at not only reviewing timely reporting, as was traditionally the case, but thoroughly assessing the substance of the information disclosed. He notes that MSE has been taking governance compliance very seriously, and that this effort does not merely involve a “check-list” approach. He emphasizes that MSE has been determined to go more in depth and to carefully review and assess the information disclosed by issuers, making sure that it is sufficient. He considers that MSE has been taking advantage of the enhanced disclosure regimes now provided by law, and that issuers have been adopting a higher sense of accountability.99 Mr. Zorrilla reported as follows:

We work hard at making sure that both issuing companies and financial intermediaries comply with the rules and disclose the necessary financial information, and we do not hesitate to apply the corresponding trading suspension sanctions. Particularly, our procedures on disclosure have gotten more substantial. It is not just a simple check-the-list approach and ensuring timely filing, but a substantive review of what content is or not disclosed. MSE plays a very significant role in reviewing compliance, and issuing companies are not able to negotiate their way into trading again until they fully satisfy the necessary disclosure. In this respect, MSE is playing a valuable role in developing the Mexican Securities Market.100

On a final note, which somewhat harmonizes the previous perspectives, Mr. Roberto Danel notes that this paper’s findings reflect an interesting tendency whereby MSE has recently taken on an important role of revising governance compliance (regardless of how preventive or procedural the enforcement is), for which it is well suited given its closeness to the market. On the other hand, he considers that the securities regulator’s focus and resources have shifted away from revising compliance and increasingly moved toward public enforcement aimed at more serious wrongdoing.101 An example of this trend, he reports, involved the regulator empowering MSE to review the level of issuers’ adherence to the corporate governance standards:

It was decided that MSE would replace the securities regulator (CNBV) in reviewing compliance to the Corporate Governance Code’s standards. This was mainly because the new securities market law of 2006 already included most of the code’s principles, but, most importantly, the result of the regulator’s desire to place more focus and resources on serious misconduct, like fraud and insider trading. I served as emissary between CNBV and MSE during the process and both finally agreed that MSE would take on this role. Since, MSE has focused on inducing compliance

100 Id.
101 Interview with Roberto Danel Diaz, supra note 84.
and on providing relevant information to the market, implementing new technologies and certifying its surveillance processes. CNBV, nonetheless, has oversight and is in constant communication and coordination with MSE. ¹⁰²

**B. What Issuers are Being Targeted?**

As mentioned in the previous section, the highest number of trading suspensions entailed causes related to procedural governance compliance in terms of disclosure, namely untimely or incomplete periodic reporting. As detailed below, trading suspensions for these causes usually involved smaller and less profitable companies with lower trading volumes and share prices. In contrast, the larger and more profitable issuers with higher trading volumes and competitive stock prices did not report as many sanctions due to errors in periodic reporting, but were subject to suspensions for not disclosing relevant events.

It is important to distinguish between domestic and foreign issuers as two separate categories of suspended firms. The results show that out of the eighty-nine cases of suspension, twenty (22.5%) involved foreign issuers. This represents a significant number of companies being targeted. However, as previously discussed, these foreign issuers were not sanctioned for failure to comply with the law and with MSE rules, but instead were suspended from trading as a result of being suspended in their markets of origin. Hence, the focus should be placed on the domestic Mexican issuers, which account for sixty-nine (77.5%) of the suspensions.

Further, it is relevant to distinguish domestic firms that issue debt from those that issue equity, as they trade in different markets, vary in size, and are, in some instances, subject to distinct rules.¹⁰³ Domestic firms included thirty-four equity issuers and thirty-five debt issuers. Not surprisingly, given that debt issuers in Mexico are usually in earlier stages of development and more likely to struggle with disclosure requirements, twenty-nine out of thirty-five cases (82.9%) of suspensions against debt firms had to do with untimely or incomplete periodic information reporting, with the remaining cases also including matters concerning compliance and disclosure.

In contrast, domestic equity issuers presented a lower share of suspensions related to untimely or incomplete periodic information reporting with nineteen out of thirty-four (55.9%). Equity companies were more represented in other classes of misconduct, constituting the majority of the cases pertaining to relevant events disclosure, for which larger and more established companies in the stock market were more often sanctioned.

A considerably smaller share of debt issuers, in comparison to equity companies, never corrected the wrongdoing and resumed trading. These involved twelve instances out of the total thirty-three matters in which suspensions were not lifted.

In addition, the most profitable companies, usually with operating revenues of between eight hundred million USD and up to twelve billion USD, which in

¹⁰² *Id.*

¹⁰³ For example, debt issuers do not have to report on their level of adherence to the corporate governance code.
many cases also presented higher return on equity and return on assets ratios, were typically sanctioned for reasons other than financial information reporting. These companies had a considerable amount of trading float and filed on time. They were mostly involved in suspension cases due to relevant events. Examples included Fomento Económico Mexicano not disclosing the sale of its beer division to Heineken International in late 2009, and the derivatives scandals and subsequent bankruptcy proceedings of Controladora Comercial Mexicana during the global financial crisis of 2008. Although it varies among industries, these firms were also larger in terms of assets, usually well over one billion USD, and market capitalization, with several over one million USD.

In contrast, and consistent with the previous findings, smaller companies with lower profitability and negative ratios were usually the target of suspensions dealing with inadequate and untimely reporting. Moreover, they were firms with lower trading float and it took them longer to comply than the more profitable firms.

With the exception of the larger domestic equity firms (involved in a different type of misconduct), companies that were suspended—mostly for lack of information reporting—usually had very little or no trading volume. This was the case not only during the time of suspension but generally a year before and after they were sanctioned.

With regard to variations in the prices of these companies’ stock before and after the suspension events, there does not seem to be an impact as a result of the sanction. As described earlier, most of these companies had very insignificant or even null share prices, in addition to very low trading floats and volumes. Hence, there was no real change after the suspension events. There were, nonetheless, a few exceptional cases in which the sanction might have had an impact. However, the variations in the stock price were rather due to other reasons. These involved particular events of the larger companies.

For example, Fomento Económico Mexicano (FEMSA) was involved in an important acquisition about which the market knew before the suspension, and Grupo Industrial Saltillo (GISSA), after being suspended, relaunched its shares following a promising restructuring. FEMSA underwent an anticipated rise before the suspension event and GISSA started trading at a higher price after its suspension was lifted.

In these cases there was expectation by the market, likely because of news reports about the companies. Hence, the rise in price, which started before the suspension, was surely not a result of the sanction. The opposite case can be seen with Controladora Comercial Mexicana and Gruma, both involved in scandals during October 2008. In those cases, the average price declined after the suspension. However, given anticipation by the market, prices had been dropping sharply beforehand.

C. How do Firms Respond to the Sanctions?

Although the self-regulation under study is procedural and preventive in nature, rather than directed at detecting and punishing more serious wrongdoing, and is also mostly targeted at smaller firms often in financial distress, it appears to yield relatively high compliance rates.
The findings show that the sanctioned companies usually corrected their wrongdoing and resumed trading very swiftly. Of eighty-nine suspension cases, firms complied in fifty-six instances (62.9%). With regard to the individual causes of suspension, of fifty-eight suspension sanctions related to lack of information reporting, there were forty cases of compliance (68.9%). As to the International System of Trading category, thirteen out of twenty foreign companies resumed trading (65%). For sanctions regarding special characteristics in financial information, eleven out of thirteen complied (84.6%), and with regard to relevant events there were eight cases of compliance out of nine (88.8%).
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Figure 7: Compliance Rate
Moreover, in the cases in which companies did comply, they corrected their wrongdoing within a day or less in thirty out of fifty-six cases (53.6%). In eleven cases (19.6%) it took companies between two and five days to comply. In eight cases (14.3%), firms complied in between six days and a month. In only two cases (3.6%) it took them between one month and one year, and in two more instances (3.6%), over a year.

Figure 8: Duration of Suspension
In terms of cumulative distribution, approximately eighty percent of the cases in which companies complied were allocated within the one day or less category (58.9 cum %), and the one–five days subset (78.6%). It usually took companies less than five days to comply, and in very few instances did it take firms more than one month to correct the wrongdoing.

Although cases involving suspensions related to periodic information reporting were the most numerous, they were also the ones in which companies took relatively longer to comply (the vast majority of the instances in which it took issuers more than five days to comply), and in which issuers never complied (thirty-three cases). Consistent with the findings discussed in the previous section, these mostly involved smaller, less profitable companies, and, in many cases, debt issuers, which tend to be in earlier stages of development.

What does the reaction by sanctioned issuers, in terms of how they have complied to resume trading, tell us about MSE’s self-regulation? MSE’s Director of Market Supervision responds that the high compliance rates, coupled by companies correcting their wrongdoing and resuming trading very swiftly, reflects MSEs consistent effort to achieve complete and timely reporting by issuers.

Are the companies responding to the sanctions per se, or is it rather a result of MSE’s persuasion in inducing them to fulfill their compliance obligations? Mr. Zorrilla, MSE’s Co-CEO, recognizes that MSE’s effort in inducing compliance is key in contributing to the high rates of compliance and the quick reaction by firms, but also notes that issuers are concerned about being suspended and, hence, swiftly comply.

Why do companies care about suspensions? Drawing from his experience as an independent director of firms trading in MSE, Mr. Roberto Danel explains that there is a strong reputational component that concerns issuers. This is especially true, he notes, for firms with foreign partners and for issuers seeking access to finance or having credit obligations with financial institutions. In addition, there is pressure from being under the scrutiny of analysts.

MSE’s Director of Surveillance adds that firms want to avoid being exposed in the media. Trading suspension decisions are not only immediately reported to the market through EMISNET, MSE’s electronic system of disclosure, but are also published in Mexico’s major newspapers and financial bulletins. Moreover, he reveals that the securities regulator threatens to fine companies as a result of the suspensions imposed by MSE. However, during the study period, no fines have been reported by CNBV against the issuing companies in relation to trading suspensions. In fact, there were notably few monetary sanctions against issuing companies and their officers during this period. Mr. Diez reports that in many cases these sanctions are discretionary and not made public.

So, if fines contribute to compliance, why doesn’t MSE impose monetary sanctions against issuers as well? Mr. Diez asserts that fines would be a useful
mechanism to supplement MSE’s market supervision efforts. Not only would they make firms more conscious and lead them to comply, he points out, but they would also be an important source of income for MSE to implement new enforcement programs and measures. He adds that, in the end, MSE has the day-to-day burden of market supervision, and should be rewarded via fines. Should MSE, hence, employ its rule-making powers to provide for fines against issuers?

Mr. Efrén del Rosal, CEO of the Mexican Association of Stock Brokers (AMIB), reports on the experience of AMIB with fines, suggesting that they might work for MSE as well:

MSE does not apply monetary sanctions and fines, and this appears to lack bite. However, the trading suspension is a measure that seem to work effectively. Simply publishing the trading suspension sanctions has a strong impact. With a different approach, at AMIB we do apply monetary fines. They are not very high and, of course, do not compare to a securities regulator’s. Nonetheless, they have proven to be just enough. I often receive complaints and resistance from members, but most are in favor. We also have the advantage that, not being an authority, we do not have to follow the usual jurisdictional due process. Hence, imposing fines is very systematic and works. Based on our experience, it might work for MSE too.

On the other hand, Mr. Rafael Colado, Director of Supervision of Issuing Companies of the National Banking and Securities Commission, presents an interesting and in some ways opposing view of the effectiveness of MSE’s trading suspensions as compared to monetary sanctions like fines. He notes that, contrary to what is often thought, issuers are greatly concerned about being suspended from trading, much more than about a fine. The suspension is immediate and hence causes an impact that issuers may not control, whereas the fine takes a long time to be determined and finally imposed. The fact that a fine by the securities regulator is an act of state authority means that there are multiple legal remedies, including the constitutional trial of “amparo” and it may be years before a company has to pay. In contrast, the trading suspension is imposed by a private organization (the stock exchange) immediately and without any appeal. Moreover, fines are not made public, as opposed to trading suspensions that everyone finds out about instantly. This is precisely why companies tend to react and comply quickly, reflecting the strength of MSE’s self-regulation.

Ms. Karla Siller confirms that the simple fact of being suspended is a sufficient penalty for an issuer. However, she does recognize that fines imposed by other SROs like MEXDER, Mexico’s derivatives exchange, have considerable impact too, and that if MSE were to impose monetary sanctions, they might

110 Id.
111 Interview with Efrén del Rosal, supra note 93.
112 Amparo is a form of constitutional relief against an act of authority that is allegedly in violation of fundamental rights. Relief is usually an injunction preventing execution of the act.
113 Interview with Rafael Colado, Director of Supervision of Issuing Companies of the National Banking and Securities Commission, in Mex. City, Mex. (Dec. 8, 2009).
complement trading suspensions.\textsuperscript{114}

From a similar perspective, Mr. del Rosal points out that although AMIB’s and MSE’s self-regulation cannot be compared to that of the government regulator, its strength is precisely the fact that it is so systematic and leaves no room for discretion, interpretation, or remedies. It is a self-regulatory regime that issuers voluntarily abide by and its procedural character provides a very clear line of what should and should not be done. Moreover, the fact that there is regulatory backing and that the law clearly defines when MSE should suspend an issuer legitimizes the self-regulatory regime and also provides for clear rules of the game. He notes that the perception of the business community is that the securities market is highly regulated and does not leave much room for SRO’s to issue new rules and enforce to greater lengths. This would be redundant with what the regulator already does or at least should do. The Mexican business community, unfortunately, does not yet welcome being overseen by multiple enforcers and would not take it well. The transition has to be gradual. In the meantime, this clear procedural compliance regime, in his opinion, represents the strength of self-regulation in the Mexican securities market.\textsuperscript{115}

Whatever the nature of these efforts by MSE, the findings show a relatively low number of sanctions during the period of study. Does this indicate a low degree of enforcement? Failure to comply with timely financial reporting, the most frequent cause of suspensions, decreased markedly. Sixteen suspensions in 2004 dropped to seven in 2005, and, subsequently, to one in 2007, three in 2008, and four in 2009. Quarterly reports followed a similar pattern, and reporting on adherence to corporate governance standards remained quite low too. Mr. Pedro Zorrilla comments that the low number of sanctions indicates that MSE is doing its job well.\textsuperscript{116} This appears consistent with MSE’s 2005 Annual Report, which compared the levels of compliance in 2004 and 2005:

With regard to the submission of financial information, in March 2003 the CNBV strengthened rules on information disclosure by issuers (including those with medium and long-term debt as well as trusts). In the first year this regulation was applied to fixed-income issuers, the number of companies in breach of the requirements rose sharply (13 issuers in 2004), but with steady work, this number was reduced to only 4 in 2005.\textsuperscript{117}

The enhanced disclosure regime that was first applied to debt issuers in 2003 might explain why these companies yielded a high number of suspensions that year. Afterward, they likely became acquainted with the new disclosure practices during the following years. Mr. Rafael Colado, who oversees issuing companies on behalf of the securities regulator, confirms this finding. He notes that the improvement in compliance has been incredible. This, in part, involves the law being more clear as to the disclosure obligations of issuers, but also the active monitoring and

\textsuperscript{114} Interview with Karla Siller, supra note 92.
\textsuperscript{115} Interview with Efrén del Rosal, supra note 93.
\textsuperscript{116} Interview with Pedro Zorrilla, supra note 99.
surveillance role played by the Mexican Stock Exchange. Both Mr. Colado and Ms. Siller further note that when issuers are suspended, they quickly tend to comply and that, as shown in this paper’s findings, it rarely takes firms more than 20 days, which is the maximum for which a company may be suspended, prior to an extension granted by the regulator. However, they note that MSE has rarely required an extension from CNBV, as it has not been necessary.

Moreover, the amount of sanctions is yet lower for other misconduct, including relevant events disclosure. Mr. Zorrilla insists that MSE has been particularly successful in this rubric and that the low amount of sanctions is actually associated with a high level of compliance. This would be consistent with the rise in the number of relevant event disclosure requests by MSE to both issuers and stock brokers, which, as reported by MSE, increased considerably from 2004 to 2008.

It also calls to attention why there are so few cases of suspensions related to listing requirements. This type of wrongdoing has not been enforced in practice since 2004, so we find virtually no cases. Ms. Siller considers that MSE does not enforce this type of sanction given the small size of the Mexican Securities Market. If it did, very few issuers would likely stay in the market. This explains MSE’s efforts to assist issuers struggling to meet the requirements through mechanisms like the auction described earlier, which MSE promotes to attract investors. Mr. Diez reports that this approach to self-regulation has resulted in reactivating many series of shares, yielding a good number of success stories like that of Grupo Tribasa.

Further, MSE’s Director of Surveillance states that the low number of suspension cases under the category of “special characteristics in financial statements” is not due to a lack of enforcement. Instead it has been the result of MSE requesting that issuers submit a complete text of the audited financial statements rather than just an abstract of the report. This has avoided confusion in the information reports and reduced trading suspensions considerably.

One category that resulted in a considerable number of suspensions involved foreign companies quoted in MSE’s International Trading System. Practically all of the cases related to this cause of suspension, not surprisingly, took place during 2007, 2008, and 2009, with only three cases in 2005. Mr. Pedro Zorrilla points out that the global financial crisis of 2008 likely contributed to the considerable string of suspensions by the New York Stock Exchange that then resulted in sanctions by MSE.

On a related note, what challenges exist for self-regulation by the Mexican Stock Exchange? Ms. Karla Siller places particular emphasis on the potential conflicts of interest that MSE now faces after becoming a publicly-held company,
with its new dual role in managing and policing the same market in which it is an issuing company. Addressing the securities regulator’s view, she suggests that MSE’s surveillance division should acquire further independence and accountability and that an independent committee of surveillance should be in place. She reports as follows:

A concern is that MSE is now a public company and is subject to potential conflicts of interest that may affect its supervision and self-regulatory role. Our perspective is that MSE’s surveillance division should not only be strengthened, but also be granted more independence from MSE. It does not necessarily have to be a different company, as is the case with FINRA in the United States, but it could involve an independent committee within MSE. Being a public company, MSE requires both an audit and a best corporate practices committee. However, they are not focused on surveillance and, hence, MSE should create a new committee focused on supervision. Moreover, the director of surveillance, rather than reporting to MSE’s CEO, should be accountable to an independent body.\(^{126}\)

Mr. Pedro Zorrilla, Co-CEO of the Mexican Stock Exchange explains what measures are currently being taken to counter potential conflicts of interest involving MSE in its dual role of market operator and participant:

Following its IPO, MSE is undergoing a relevant period of evolution and maturity regarding its self-regulatory role. An important pending matter is, indeed, dealing with the potential conflicts of interest that may arise from BMV having a dual role in terms of operating the market and being a participant. In the meantime, to prevent conflict, our surveillance division is channeling to the securities commission, any matter that involves BMV in its role as an issuing company.\(^{127}\)

Further, Mr. Zorrilla reports on the institutional structure of market surveillance that MSE is implementing in order to prevent conflicts of interest. The mechanism includes the establishment of a surveillance committee within MSE’s board, composed of independent directors who will then appoint the director of surveillance. He describes the plan as follows:

\[\ldots\] we are working hard and expect to soon implement the following structure. We plan on establishing a surveillance committee within MSE’s board. The committee would be presided by an independent member of the board and by other independent directors. MSE’s surveillance division would continue with its day to day monitoring activities, but the director of surveillance would be an officer appointed by the surveillance committee, to which the director would be accountable. We expect that this structure will align incentives to prevent conflicts of interest. This is a pending matter following MSE’s IPO that I have to attend to soon, as there may

126 Interview with Karla Siller, supra note 92.
127 Interview with Pedro Zorrilla, supra note 99.
certainly be potential conflicts of interest. At an institutional level, the new structure should provide enough autonomy and be a clear driver to avoid conflicts. It will, in turn, provide legitimacy to MSE. Nevertheless, given our dual role, we have to go even further in complying and setting the example.\textsuperscript{128}

Finally, it is important to note the current status of self-regulation and how it has played out in light of the ongoing financial crisis. From a policy-making perspective, Mr. Guillermo Zamarripa provides an outlook of MSE’s self-regulatory role in light of the current crisis:

From a policy-making view, we can appreciate a forthcoming phase in which, among other dynamics, the current financial crisis seems to be revealing important aspects about disclosure and enforcement. This should ultimately strengthen self-regulatory practices in Mexico. In addition, the Mexican Stock Exchange is now a public company. Hence, a new equilibrium in terms of more scrutiny from a market with more dispersed ownership structure should emerge. This will, for instance, lead MSE to deal with self-regulation more seriously in order to avoid conflicts of interest, given its dual role as both a market participant and the owner and head of the exchange.\textsuperscript{129}

VI. CONCLUDING REMARKS

The study explores securities enforcement action by the Mexican Stock Exchange (MSE) via self-regulation, focusing on recent cases of trading suspension sanctions against issuing companies. The findings shed light on the extent to which self-regulation works in the Mexican securities market, addressing its nature and aim, based on the wrongdoing targeted and sanctioned; the firms that are object of MSE’s enforcement; and the way issuing companies respond to MSE’s trading suspension sanctions, in terms of how they comply in order to resume trading.

The Mexican Stock Exchange gives the impression of having been fairly active, in terms of self-regulation, during the period of study. This appears to be the result of a new legal framework recognizing stock exchanges as self-regulatory organizations, granting them ample rule-making and enforcement powers, in addition to providing for enhanced disclosure obligations and substantive corporate governance provisions. Also, consistent with a global trend, it seems to be a product of the Mexican Stock Exchange demutualizing, becoming a for-profit and publicly-held organization that seeks competitiveness through self-regulation.

Despite the mentioned framework, MSE has followed a preventive role, unlike that of a traditional regulator or enforcer. Its approach has been procedural in nature and focused on inducing governance compliance, rather than substantive, aimed at detecting and sanctioning more serious wrongdoing like securities fraud and insider trading. MSE has, instead, directed efforts at inducing compliance by

\textsuperscript{128} Id.

\textsuperscript{129} Interview with Guillermo Zamarripa, \textit{supra} note 96.
assisting issuers in satisfying their disclosure obligations. Only after frequent communications with issuers, and a considerable number of warnings, does MSE suspend firms from trading, which it does as a preventive measure.

The misconduct being monitored, and for which trading suspensions have been imposed, generally has to do with disclosure compliance. This mostly involved untimely and incomplete periodic information reporting and, to a lesser extent, other disclosure obligations like material events that may have an impact on the price of a company’s stock. With regards to misconduct derived from failure to report periodically, the usual suspects were small companies with little float and low trading volumes. Larger companies, on the other hand, were targets of suspensions related to pending relevant events, including important corporate acquisitions, jurisdictional proceedings, and scandals.

In spite of the procedural and preventive nature of the self-regulation, companies usually comply within hours after being suspended and quickly resume trading. Even though the trading suspensions do not seem to impact share prices, issuers appear to be concerned about being suspended. Among other factors, there is likely a reputational component involved. Sanctions are made public and reach the media instantly and firms reportedly care about potential economic impact with regard to access to finance, potential ventures, and fines by the regulator.

In addition, the wrongdoing and the amount of sanctions have declined during the period of study. This does not imply a lack of enforcement but, on the contrary, preventive action by MSE. In fact, the exchange has found distinct methods to avoid sanctions and suspensions. At the same time, MSE has sought to strengthen the stock of issuers, including extended auctions promoted by MSE which attract investors, requiring particular documents that convey more information and reduce the likelihood of sanctions, and implementing more advanced technological platforms that make reporting easier. This speaks to both the effects of the sanctions, and, likely to a greater extent, to the Mexican Stock Exchange’s preventive efforts of inducing procedural compliance. The enhanced legal framework of disclosure that clearly defines the obligations of issuers is presumably also contributing to compliance.

Despite the fact that MSE has not taken advantage of the rule-making powers provided by the new Securities Market Law, the findings show that the exchange’s objective is, nevertheless, set on gradually building a self-regulatory normative order. However, issuing additional self-regulation norms may be a challenge, taking into account that the financial sector is already considerably regulated and that more enforcement would be redundant and not well-received by market participants. Moreover, the fact that the law clearly defines disclosure obligations may explain why MSE’s self-regulation is predominantly procedural and why it has not issued more rules related to enforcement directed at more serious wrongdoing.

Furthermore, stronger sanctions, like fines, might supplement MSE’s current self-regulatory effort. This could be solved by MSE issuing a self-regulatory norm allowing monetary sanctions. Fines might not only make careless issuers more conscious, but also provide an important source of income for MSE that may be used to implement more progressive enforcement programs and mechanisms.

Additionally, there is concern about solving the potential conflicts of
interest arising from MSE’s current dual role as a publicly-held company trading in
the same market that it polices and manages. A structure that will provide for
independence of MSE’s surveillance division is currently being designed and
should be implemented soon.

Though still in a preliminary stage, and facing a number of challenges,
self-regulation by the Mexican Stock Exchange appears to be a promising means of
enforcement that may contribute to the investor protections required to further
develop the Mexican securities market.