Assessing the effectiveness of the Brazilian insider trading laws Viviane Muller Prado.pdf

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ASSESSING THE EFFECTIVENESS OF
THE BRAZILIAN INSIDER TRADING LAWS

Viviane Muller Prado*

1. INTRODUCTION

The finding of an oil well is obviously a piece of information capable of making the share price of a publicly traded energy company oscillate significantly. It is also tempting for people with access to such information prior to its disclosure to try to profit from their privileged situation. In 1977, before it was confirmed that oil had been found in Santos Bay, the shares of Brazil’s most important oil company experienced such oscillations. Such oscillations are very similar to those of another Brazilian case that caught the attention of the media in 2013. However, the enforcement system worked in very different ways in these two cases. In 1977, the Brazilian Securities Commission (Comissão de Valores Mobiliários – CVM) shelved their inquiry in the year immediately following the occurrence of the event in question. In the 2013 case, the CVM started an administrative proceeding, minority shareholders brought individual and collective civil lawsuits before state court, and the Federal Public Prosecutor (Ministério Público Federal - MPF) filed a criminal lawsuit based on charges of insider trading and market manipulation. As of today, the criminal judge overseeing the latter case has already seized the controller and managerial assets to pay for eventual compensation. The stark difference in

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legal process between the two cases suggests that the regulatory instruments and institutions in Brazil evolved considerably in regards to the struggle against trading on nonpublic information.

The prohibition of insider trading was established in 1976. Except for the criminalization of the use of nonpublic information in 2001, the relevant Brazilian legal framework did not change significantly after 1976. In spite of this, it is noticeable that new instruments for enforcing the law were created and the institutions that can participate in this process have expanded. In the administrative sphere, the sanctioning proceedings coexist with the use of settlements (*termos de compromisso*) since 1997. In addition, after 1985 the CVM’s decisions regarding punitive actions have been subject to revision by an administrative tribunal, the Appeals Body of the Brazilian Financial System (*Conselho de Recursos do Sistema Financeiro Nacional - CRSFN*). In the criminal sphere, since 2001 the Federal Public Prosecutor has been charged with carrying out prosecutions in insider trading cases, having courts the final decision. Finally, in the civil liability sphere, since 1989 the Public Prosecutor has had the authority to file public-interest civil lawsuits that may seek compensation for market losses based on insider trading. Moreover, none of these activities precludes third parties from filing individual or collective lawsuits seeking compensation for private losses. There is no doubt that the enforcement system has become more complex.

This paper aims to better understand the Brazilian insider trading regulatory system by conducting empirical research on the enforcement activities of the CVM and the courts (both at civil and criminal levels). To assess the enforcement system, the development of the Brazilian institutional design is described, allowing for the identification of legal and regulatory instruments related to the punishment of trading on non-public information. This broad description reveals mechanisms of the current system and points to challenging features that need specific enhancements in order to improve enforcement.

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5 For other securities regulation enforcement perspective, for example, there is the private or public enforcement debate. For this perspective, see, e.g.: Rafael La Porta, Florencio Lopes de Sinalnes, Andrei Schleifer, What works in securities laws?, 2003, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=425880 (defending the private enforcement as most efficient); Howell E. Jackson, Mark J. Roe, Public and private enforcement of securities laws.
The data gathered throughout this empirical research demonstrates that, in regards to its enforcement regime, Brazil has advanced far beyond those countries that have formal insider trading laws but fail to enforce them. However, Brazil is still susceptible to having regulatory practices in place, but lacking concrete evidence if this is enough to ensure compliance with the laws proscribing insider trading. The objective of this paper, though, is not to evaluate the enforcement system in order to know whether it is sufficient or not to combat the practice of trading on nonpublic information. Rather, this paper sheds light on the need to better understand the role of institutional design in improving the enforcement system. It is important to understand the tools available to a single institution, as well as the coordination, competition or conflict among the various institutions that participate in the enforcement system.

Based on the “really responsive regulation” approach developed by Robert Baldwin and Julia Black, this empirical research aims at providing data with which to consider the following questions: 1) Are the available regulatory tools used in such a way that the final result is to communicate a punitive message? 2) In concrete cases, are the changes in institutional design preventing a particular act or behavior, in the sense of effecting a deterrence strategy? In the case of a positive answer, how so? 3) Is it possible to identify the preconditions that allow for institutional design to facilitate an effective deterrence strategy?

According to the findings of the empirical research, the challenge is to have a coherent use of regulatory tools and to better understand the role of several institutions that participate in the enforcement process (CVM, CRSFN, Public Prosecutor and Courts) and their decisions. The most relevant finding of this research is that variation in responses to common fact patterns from the enforcement system currently in force. The differences in results are not necessarily a consequence of evidentiary problems, but rather are related to the instruments that were triggered and the institutions that participated in the proceedings. The results suggest a lack of predictability regarding the conduct of the institutions, though not necessarily in regards to sentencing or acquitting the indicted party, but rather in regards to their own procedures and the instruments that they will use in the various spheres of regulatory action. This lack of

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8 Baldwin and Julia Black, 2015, p. 20.
institutional coherence can undermine the predictability of the punitive system, and thus produce unequal consequences for trading on nonpublic information. Therefore, a punitive message may not be communicated and the strategy of deterrence may be weakened.

Following this introduction, the remainder of the paper will be divided in three sections. The first and second sections describe the evolution of the legal framework and enforcement data of insider trading rules in Brazil. The third section consolidates and provides a critical assessment of the main findings. Finally, a conclusion is presented.

2. EVOLUTION OF INSIDER TRADING RULES AND OF THE ENFORCEMENT SYSTEM

2.1 The Evolution of the Insider Trading Rules

Under Brazilian Corporate Law, it is forbidden to use relevant information not yet disclosed to the market, by any person with the goal of retaining an advantage in the securities market for themselves or for others.⁹ The use of nonpublic information is considered a crime if practiced by those who have the duty to maintain information confidentiality.¹⁰ This regulatory approach of forbidding insider trading did not arise from this extension, but from the legislative evolution that has occurred since 1976.¹¹

The Corporation Law of 1976 proscribed, for the first time in Brazil, the use of nonpublic information that has not yet been revealed to the market.¹² This rule was only

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¹⁰ Criminalization in the terms of article 27-D, of Law 6,385/1976, in accordance with the Law 10, 303/2001, which includes the following provision: “Art. 27-D. Using relevant information not previously disclosed to the market, of which the parties in question are aware and which they were required to maintain secrecy, and which they were in a position to use for their own advantage or for the advantage of others through the negotiation of securities. The penalty will include between 1 to 5 years of imprisonment and a fine of up to 3 times to value illegal obtained from the transaction.”
¹¹ 1976 was the year in which the Brazilian capital market regulatory system that exists today was created. In this year, the Brazilian Securities Commission (CVM) was created according to Law 6, 385/1976.
¹² The first rule prohibiting insider trading dates to 1965, in the article 3º. n. X of Law 4, 728/1965. However, there was no explicit outlawing of the use of nonpublic information. This rule just delineated the jurisdiction of the capital market regulator, which was the Central Bank. For a critic position on this rule, see Luís Gastão Paes de Barros Leães, Mercado de Capitais e “insider trading”, São Paulo: Revista dos Tribunais, 1982, p. 173 (arguing...
applicable to directors and officers (hereafter referred to as “managers”) and outlined their duty of loyalty and more specifically, their duty to maintain the integrity of any information not yet disclosed to the market.\(^\text{13}\) The law expressly granted the right of the investor to be compensated by the managers that violated the disclosure rules, either when providing false information, maintaining secrets, or using privileged information to his or her own benefit.\(^\text{14}\)

The prohibition of trading on nonpublic information has been extended to other market players through administrative regulation conduct by CVM. In 1979, the CVM published an administrative provision forbidding non-equitable practices and acts that yield, “a treatment to any of the parties in securities transaction, directly or indirectly, effectively or potentially, that puts that party in an unequal position with respect to the remaining participants of the transaction.”\(^\text{15}\) With this rule as a baseline, the CVM began to punish and fine people, beyond just managers, for the use of nonpublic information.\(^\text{16}\)

Later in 1984, and also by means of a CVM administrative provision related to the obligation to disclose relevant facts, there was a broader rule forbidding trade based on non-public information by people other than managers.\(^\text{17}\) In addition, controlling shareholders were put on the list of people forbidden to trade while using nonpublic information.\(^\text{18}\) The prohibition was extended in order to reach all of those who had directly accessed information due to their professional position, function, or in collaboration with the issuing company, even if indirectly.\(^\text{19}\)

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\(^{13}\) According to Article 155, § 1 of the Law 6,404/1976, the directors and officers of a publicly traded company are also responsible for maintaining the integrity of any piece of information not yet disclosed to the public, which was obtained due to the individual’s position within the company and with the significance to influence the company’s share value. It is illegal for such individual to use such information to gain any advantage via the purchase or sale of company stocks. Under Article 155, § 2 of the Law 6,404/1976, the manager must ensure his or her subordinates, or third parties linked to them through a relationship of trust, neither divulge nor use privileged information.

\(^{14}\) Article 156, § 3, of Law 6,404/1976 states that: “Any person harmed by the purchase or sale of shares determined illegal by paragraphs 1 and 2 have the right to be compensated by the guilty party for all losses”.

\(^{15}\) CVM Rule 08, 1979.


\(^{17}\) Regarding CVM Rule 31/1984, in addition to the CVM Explanatory Note 28/1984, see Nelson Eizirik, A Instrução CVM 31/84 e a regulamentação do ‘insider trading’, Revista de Direito Mercantil, n. 55, Ano XXIII, julho-setembro/1984 p. 170-175.

\(^{18}\) CVM Rule 31/1984, Articles 9 and 10.

\(^{19}\) CVM Rule 31/1984, Articles 10 and 11.
In 2001, amid a movement to improve investor protection in the Brazilian capital markets, the Corporation and Capital Market Laws were amended. In this legislative reform, insider trading was criminalized for people who were charged with the obligation of maintaining informational secrecy (the duty of confidentiality). The penalty is a one to five year prison term and a fine of up to three times the amount resulting from the undue advantage that resulted from the crime.\textsuperscript{20}

The 2001 reform brought other references to the use of nonpublic information outside of the criminal perspective. The legal prerogatives of regulators were strengthened, and the CVM was expressively assigned the duty of protecting investors against the use of nonpublic information.\textsuperscript{21} This power was also reinforced by a provision that made the use of nonpublic information illegal for any person that had access to it, and not only for those persons inside the issuing company.\textsuperscript{22}

In the following year, 2002, the CVM edited a provision to strengthen compliance regarding the prohibition of using nonpublic information. This provision outlawed trading by insiders both before and after relevant facts.\textsuperscript{23}

In sum, today in Brazil the use of nonpublic information by any person that trades based on relevant information not previously disclosed is strictly forbidden, and has consequences at the administrative and civil level. In addition, for those who have the duty to maintain informational secrecy, prosecution in the criminal sphere is a possibility.

\subsection*{2.2 The Evolution of the Regulatory Instruments and Institutions Related to Insider Trading Rules Enforcement}

This regulatory evolution did not occur only in regards to the rules that forbid and criminalized the practice of insider trading, but also in respect to the instruments of enforcement.

\textsuperscript{20} Law 6, 385/1976, as amended by Law 10, 303/2001, article 27-D.
\textsuperscript{21} This comes via section sub-item c of item IV in article 4 of the Law 6,385/1976, which expressly states that the CVM will be responsible for “(...) IV. protecting shareholders and investors against: (...) c) the use of relevant information not previously disclosed to the market.”
\textsuperscript{22} This comes from Article 155, § 4, Law 6.404, 1976. This rule clarifies the CVM’s administrative rule already provided in CVM Rule 31/1984.
\textsuperscript{23} The new rule is as follows: “Art. 13. Before trading company stocks, the company must reveal any material facts to the company’s transactions.” (CVM Rule 358/2002)
and the addition, through time, of institutions that contribute to the effectiveness of legal rules regarding administrative, civil, and criminal liability.

The original tool used at the administrative level to punish wrongdoers is the sanctioning proceeding (processo sancionador). Since the creation of the CVM in 1976, the regulator would seek punitive sanctions by establishing an administrative procedure to investigate illegal practices committed in the securities market and to determine the punishments to be applied to those found guilty. Punishment may include: warning, fine, suspension or temporary disqualification to hold positions in public traded companies or in intermediaries, and suspension or revocation of the authorization to perform any activity.24

The punitive activity of the CVM is most often re-examined by the CRSFN. This means that the penalties imposed by the CVM may be made more severe, attenuated, or ruled to be unenforceable by this second administrative level. The CRSFN was created in 1985 and is linked to the Ministry of Finance.25 It is an institution consisting of eight members, half of whom are chosen by state authorities (the Ministry of Finance, the Central Bank, and the CVM) and half who are appointed by market entities (ANBIMA- Brazilian Financial and Capital Markets Association, FEBRABAN – Brazilian Banks Association, ANCORD – Brazilian Broker Association, and ABRASCA – Public Companies Association). Finally, CRSFN decisions can still be subject to appeal in courts.

An innovation occurred at the administrative level in 1997, after the legislative reform, the regulated parties investigated for a wrongdoing were allowed to enter into a settlement (termo de compromisso) with the CVM.26 Through this tool, in a consensual way, the CVM does not carry out the administrative sanctioning proceeding, and in turn the regulated party is required to end the investigated practice and correct any irregularities, in addition to providing

24 Under Article 11, Law 6,385/1976, the CVM may impose the following penalties: (i) warnings; (ii) fines not exceeding the amount of R$ 500,000.00 (five hundred thousand Brazilian Reais), 50 per cent of the amount of the irregular operation, or three times the amount of the economic advantage gained or loss avoided due to the violation; (iii) suspension of corporate directors and executives, as well as members of other entities of the securities’ distribution system from exercising their duties; (iv) up to 20 years of disqualification of the said persons from occupying their posts; (v) suspension or cancellation of permits of regulated professionals; (vi) regarding members of the securities’ distribution system, up to 20 years of prohibition to act on such market; and, (vii) regarding other persons or entities which operate under the Corporation Law, the Capital Market Law or the CVM’s regulations, up to 10 years of prohibition to practice, directly or indirectly, one or more types of transaction in the market.
25 CRSFN was created by Decret 19,152/1985. For the empirical results on the CRSFN activity regarding capital market issues, see Juliana Bonocorsi de Palma, Viviane Muller Prado, Estudos avançados de mercado de capitais. Conselho de Recurso do Sistema Financeiro Nacional, São Paulo, Elsevier, 2014.
26 Article 11, §§ 5 to 8, of the Law 6,385/1976, as writing in Law 9, 457/1997.
compensation for incurred injuries. This instrument implies neither confession nor recognition of the unlawfulness of the conduct being analyzed.\textsuperscript{27} It is important to highlight that settlements do not rule out the possibility for a criminal case.

The decision to reach a settlement is made by the CVM, “at its sole discretion, if the public interest allows.”\textsuperscript{28} The law does not set strict parameters for the decision. It only establish that the “opportunity and convenience of the settlement and appropriateness of the proposal”\textsuperscript{29} should be assessed and the nature and gravity of the violations, the records of the accused, and the effective possibility of punishment in the actual case should be considered.\textsuperscript{30} There is neither review by the judiciary in this administrative decision, nor participation by the CRSFN.

Outside of the administrative sphere, insider trading has liability consequences at the civil level. In order to compensate losses caused by the use of nonpublic information to the market, or to individual investors, a lawsuit can be filed. The compensation can be sought individually or collectively through lawsuits brought by those who have been harmed. Likewise, public-interest civil lawsuits seeking compensation from public prosecutors have been possible since 1989. With the objective of protecting investors, the law expressly provides legitimacy to the public prosecutor, by means of a CVM decision or based on his own prerogative, to pursue judicial measures in order to avoid losses or obtain compensations for losses. There is also the possibility for consensually finalizing the litigation in a public-interest civil lawsuit by signing a consent decree (\textit{Termo de compromisso e ajustamento de conduta – TAC}). Through this instrument, the federal public prosecutor and the CVM end the administrative proceeding and the existing civil lawsuit or abstain from conducting or judging them. The judiciary must approve this decision. However, as in the case of a settlement, criminal charges may still be brought against the defendant.\textsuperscript{31} Signing the consent decree does not imply a confession per se, nor an explicit recognition of the unlawful act.

To access the criminal sphere the CVM is obliged to communicate the suspected practice of insider trading to the public prosecutor’s office, and the public prosecutor in turn is obliged to take the case in front of the court. Criminal courts thus have the final decision in this field.

\textsuperscript{27} Article 11, § 6 and Article 4, CVM Decision (\textit{Deliberação}) 390, 2001.  
\textsuperscript{28} Expressions used in Article 11, § 5, Law 6, 385/1976, as amended by Law 9,457/1997.  
\textsuperscript{29} Article 8, CVM Decision 390/2001, as amended by CVM Decision 486, 2005.  
\textsuperscript{30} Article 9, CVM Decision 390/2001, as amended by CVM Decision 486, 2005.  
\textsuperscript{31} Article 5, § 6., of the Public Civil Action Law, according to the Law 8,078/1990; Article art. 11, § 5 of Law 6,385/1976; Article 7, CVM Decision 390, 2001; and Article 5, § 6. of Law 7,347/1985.
The following table summarizes the instruments and institutions that may participate in the enforcement system regarding the prohibition of trading based on nonpublic information in the Brazilian capital market.

Table 01. Institutions and Enforcement Instruments of Insider Trading Rules

<table>
<thead>
<tr>
<th>Sphere</th>
<th>Instrument</th>
<th>Generated by</th>
<th>Decision</th>
<th>Goal/Effect</th>
</tr>
</thead>
<tbody>
<tr>
<td>Administrative</td>
<td>Sanctioning administrative proceeding</td>
<td>CVM</td>
<td>CVM/CRSFN/Courts</td>
<td>Punishment</td>
</tr>
<tr>
<td>Civil Liability</td>
<td>Settlement</td>
<td>Regulated party</td>
<td>CVM</td>
<td>Payment of value</td>
</tr>
<tr>
<td>Civil Liability</td>
<td>Public-interest civil lawsuit</td>
<td>Federal Public Prosecutor/CVM</td>
<td>Courts</td>
<td>Payment of compensation to losses</td>
</tr>
<tr>
<td>Civil Liability</td>
<td>Consent Decree</td>
<td>Regulated party/Federal Public Prosecutor/CVM</td>
<td>CVM/Federal Public Prosecutor/Courts</td>
<td>Payment of value and/or exit the market</td>
</tr>
<tr>
<td>Civil Liability</td>
<td>Individual or collective civil lawsuit</td>
<td>Investor or association of investors</td>
<td>Courts</td>
<td>Payment of compensation to losses</td>
</tr>
<tr>
<td>Criminal</td>
<td>Criminal lawsuit</td>
<td>CVM/Federal Public Prosecutor</td>
<td>Courts</td>
<td>Punishment</td>
</tr>
</tbody>
</table>
3. ENFORCEMENT SYSTEM

3.1 Administrative Sphere

a) The CVM’s Administrative Punishment Activity from 2002 to 2014

Since the outset, pursuing punitive action in cases of insider trading was on the CVM’s agenda. The first administrative case judged by the CVM was in 1978 and involved punishment for the use of nonpublic information.\(^{32}\)

The specifications of the CVM’s mandate to protect investors against insider trading\(^ {33}\) have been cemented in its punitive activities. In a research project developed on the CVM’s administrative sanction proceeding from 2002 to 2014,\(^ {34}\) it has been shown that there is 40 cases of insider trading in a universe of 677 completed administrative sanction proceeding. Insider trading represents almost 6% of the CVM’s punitive activity.\(^ {35}\) The cases are distributed in the following way throughout the years:

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\(^{32}\) To access the CVM’s decision on SERVIX case, see Inquéritos Administrativos julgados pela CVM, vol. 1, 1979, p. 11-43.

\(^{33}\) This CVM mandate is expressly referred to in Article 4 of the Law 6,385/1976.

\(^{34}\) According to Nora Rachman’s research project, which considers the period between 1976 and 1988, the administrative process of going after insider trading became more constant at the CVM. There was a total of “29 administrative inquiries into the subject of insider trading, aiming at investigating the occurrence of irregularities and applying sanctions, having acquitted the defendant in 10 cases and finding substantial evidence of insider trading in the remaining 19”. From the 19 adjudicated cases, 19 of the indicted parties were acquitted and 23 convicted. The punishments handed out included fines (11 indicted), warnings (9), and suspension (3). It is interesting to note that the 1990s were a period in which few investigation into illicit activities were initiated, with only 5 insider trading cases adjudicated in a 10-year period. Nora Rachman, O princípio do full disclosure no mercado de capitais, 1999 (University of São Paulo’s master dissertation not publisched).

It can be seen that after 2004 there was an adjudicated case on the use of nonpublic information at least once a year. From 2010 on, the number of cases is no less than three. These numbers suggest that the illegal use of nonpublic information is a constant issue of the CVM’s punitive activities, and by deduction, its monitoring activities.

The analysis showed that the 40 cases involved 187 indicted parties, 56 of them being insiders (professionals linked to the issuing company), 12 external connections, and 199 market intermediaries and investors.\(^{36}\) It is significant that the market intermediaries and investors represent two thirds of all of those indicted. This data deserves two comments. First, the extension of the rule regarding the use of nonpublic information to cover people beyond managers\(^ {37}\) was reflected in the CVM’s punitive activity. The second comment is that the high number of indicted market intermediaries and investors cause us to reflect on the instruments capable of mitigating the effects of information leaking outside of the issuing company.

Regarding the applied punishments, the analysis verified that 51 of the 187 indicted parties were convicted and 136 were acquitted. When first seeing these numbers, it may seem that the CVM is lenient in punishing suspicious acts regarding the use of nonpublic information.

\(^{36}\) Prado and Vilela, 2015, p. 3. As indicated by the research papers referenced in this work, this classification used the following criteria: “Internal. This first group includes those that have been indicted that possess a direct and permanent link with the emitting company of the shares in question. These include the companies shareholders, administrators, and associates. External. This group is made up of professionals and institutions without a direct link to the emitting company but that lend services to the company that may generate access to privileged information. For example, the lawyer that assists in the purchase/sale of a controlling share of a company or consultants that help to plan operations. Market. The third group is residual and includes those subjects that are neither internal nor external. Rather these are market agents that in some way have obtained and used privileged information. For example, stock market investors or brokerage companies.” For another way of classifying primary and secondary actors see: Nelson Eizirik, Insider trading in Brazil: Recent developments, \textit{http://www.law.harvard.edu/programs/about/pifs/symposia/brazil/2008-latam/eizirik.pdf}.

However, this conclusion must be contextualized by looking at the regulator’s investigative pattern, especially in 2004, when just one case (Copel/Fator) involved 51 indicted parties, of which 49 were acquitted. In this regard, it is more accurate to look at convictions and absolutions considering the number of cases. Under this criterion, we see that in 14 of the 40 cases considered by the CVM, all indicted parties were convicted; in 9 cases there were both convicted and acquitted parties; and in 17 of the cases all indicted parties were acquitted.

Graph 2 - Number of insider trading defendants (punished and acquitted) and results per case – 2002-2014

In analyzing the graphs above, it is noteworthy that in nearly half of all cases all the indicted parties were acquitted. However, the analysis demonstrates that after 2010 the average number of cases and number of indicted parties convicted rose.\textsuperscript{38} The graph below outlines this phenomenon, as “in 2010 6 cases were adjudicated and 5 indicted parties were punished. In 2011, there were 4 cases with 12 punished parties. Also, in 2012 there were 4 adjudicated cases, 2 indicted parties were punished. In 2013, there were 5 punished parties in 3 adjudicated cases. Finally in 2014, there were 5 cases, with 6 indicted parties being punished.”\textsuperscript{39}

\textsuperscript{38} Prado and Vilela, 2015, p. 6.
\textsuperscript{39} Prado and Vilela, 2015, p. 6.
It is interesting to observe the different punishments and their relationship with the position of the indicted parties. In other words, while there are internal and external parties, some are contractors for the issuing companies and others are private market players. This is relevant to determining if the extension of the enforcement of the insider trading laws to people outside of the company in question results in the ultimate punishment of these individuals. This information can be easily visualized in the graph below.

Graph 3 - Punishment of insider trading defendants and cases tried by CVM (per year) - 2002-2014

Source: (Prado e Vilela, 2015)
This data mainly points out that, despite the high number of indicted parties from the market, the occurrence of punishment is still low. A hypothesis that explains this result, and which still needs to be tested, relates to the difficulty in demonstrating that the origin of the trades in question resulted directly from the use of nonpublic information. Another piece of relevant information is that, in regards to the agents inside the issuing company, besides the managers, controlling shareholders may also be punished. However, at the end of the day, the punishment that appears most frequently is in relation to the parties liable since 1976 for the practice of insider trading, namely, the managers of the companies.

By observing the results of the investigation by the type of punishment, it can be seen that a pecuniary fine is the most common penalty used by the CVM. These fines represent more than 86% of the total applied punishments, followed by, in small number, warnings and
This research also revealed that the CVM tends to calculate its fines by multiplying the value gained by the operation or the loss that has been avoided either two or three times. It can be verified, however, that the transactions that are punished by the CVM do not involve large monetary gains, most being less than 500,000 BRL.

Graph 5 - Ratio between estimated gain or avoided loss and the fine - 2002-2014

Also of interest is the data regarding the category of information that is referred to in the cases of trading on nonpublic information in Brazil. A large amount of the information involves changes in the company’s capital structure, which can have an indisputable impact on the value of the companies traded shares.

\[ \text{Ratio} = \frac{\text{Estimated Gain or Avoided Loss}}{\text{Fine}} \]

Source: (Prado e Vilela, 2015)

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40 Prado and Vilela, 2015, p. 8.
41 Prado and Vilela, 2015, p. 5.
It is impossible to confirm that the 51 indicted agents convicted in the past years represent tangible proof of the CVM’s punitive actions. Nevertheless, when compared the 1990s, and even well before, the number of cases is higher and insider trading has been on the CVM’s radar.

b) CRSFN’s Participation in Enforcing Rules Against the Practice of Insider Trading

By researching the CRSFN’s decisions from 1996 to 2014, we can note the role that the administrative appeals court played in revising the CVM’s decisions on the use of nonpublic information. The table 02 below demonstrates this activity in numbers.
Table 02. CRSFN activity regarding insider trading cases

<table>
<thead>
<tr>
<th>Year of CRSFN's Decision on Insider Trading</th>
<th>Has CRSFN changed CVM’s decision?</th>
<th>Decision</th>
</tr>
</thead>
<tbody>
<tr>
<td>2004</td>
<td>No</td>
<td>Maintains acquittal.</td>
</tr>
<tr>
<td>2006</td>
<td>Yes</td>
<td>Reducing the fine by 50%.</td>
</tr>
<tr>
<td>2006</td>
<td>No</td>
<td>Maintains acquittal.</td>
</tr>
<tr>
<td>2009</td>
<td>Yes</td>
<td>Acquittal.</td>
</tr>
<tr>
<td>2009</td>
<td>Yes</td>
<td>Acquittal.</td>
</tr>
<tr>
<td>2012</td>
<td>Yes</td>
<td>Reduced the suspension time from 5 to 2 years.</td>
</tr>
<tr>
<td>2012</td>
<td>Yes</td>
<td>Reduced the fine from 3 times the value gained and maintains the criteria relating to the value of the pecuniary fine. Punished the acquitted party with a fine.</td>
</tr>
<tr>
<td>2013</td>
<td>No</td>
<td>Maintained conviction.</td>
</tr>
<tr>
<td>2014</td>
<td>No</td>
<td>Maintained conviction.</td>
</tr>
<tr>
<td>2014</td>
<td>No</td>
<td>Maintained conviction.</td>
</tr>
<tr>
<td>2014</td>
<td>No</td>
<td>Maintained conviction.</td>
</tr>
</tbody>
</table>

Since 2012, the CRSFN has maintained the CVM’s decision, making adjustments only to the decision-making process regarding conviction and adjusting the criterion for the establishment of the value of fines. These numbers represent a positive sign for market integrity, mainly because there are doubts about the reality of CRSFNs place in the enforcement institutional design.42

c) Settlement (*Termo de Compromisso*)

The settlement in general was used repeatedly by the CVM between the years of 2007 and 2010; being less frequently used between 2011 and 2013, as the graph 7 below demonstrates.

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42 To access this debate, see Palma and Prado, 2014, p. 105-106.
As the settlements can also be used to analyze cases of the actual practice of the use of nonpublic information, it is pivotal to learn how this instrument is used to manage the cases in which insider trading is suspected. The following data was found in research regarding the use of settlements in cases of insider trading.  

These numbers suggest that proposals for settlements in cases of insider trading constantly appear for the CVM’s consideration, but in the great majority of the settlement is not accepted. From 2008 to 2010, a reasonable number of proposals were accepted, but these

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43 The CVM’s settlement data is on the following paper (not published): Maíra Schweling Scala, Estudos empíricos dos termos de compromisso no âmbito da Comissão de Valores Mobiliários nos casos de insider trading, 2014.
years mark a period when settlements in general were used largely in prosecutions of other unlawful practices. Between 2012 and 2013, settlements are again accepted.

If compared to the number of sanction processes adjudicated for insider trading in the years of 2012 and 2013, more settlements appear instead of full sanction processes. Indeed, in 2012 four sanction processes were adjudicated, while five settlements were signed; and in 2013, there were three sanction processes adjudicated and four settlements signed. This number indicates that the settlements are as relevant as the sanction processes for understanding the CVM’s punitive activity.

The question that naturally emerges then if the signing of settlements is a more advantageous alternative when compared to the penalties applied in the administrative sanction process. This question finds an answer in research developed on CVM settlements involving insider trading. The obligation of the market player in the agreement has been to pay the pecuniary amount. When the settlement delineated how much was gained in the transaction, or the avoided loss, the method used to establish the value of the obligation, with few exceptions, was to double the measured benefit, as the graph 9 below demonstrates.

Graph 9 - Ratio of the value of the final proposal in the consent decree developed by the indicted agent and the value of gain or loss avoided with the operation that motivated the CVM’s administrative process. - 2004-2014

![Graph 9](image)

When examining only the accepted settlements and the criteria used to specify the values that would be paid by the regulated party, the CVM appears to have followed a consistent pattern. However, upon looking at the values in settlements that were not accepted, this result
can no longer be sustained. The settlement in which the party accused of insider trading would be obligated to pay significantly more than two times the value gained (or the injury caused) were not accepted, as can be seen in the graph below.

The argument that may be put forward is that, according to the law, the value in question is not the only criteria for making a decision regarding whether the use of a settlement is convenient and opportune. However, the basis of the regulator’s decision whether to accept a settlement or not often revolves around if the “value being offered is sufficient to dissuade similar actions by the accused and by third parties,” “if the value being offered is adequate,” and “if the proposal is proportional to the graveness of the wrongdoing in question.” Besides these bases, the final decision is often supported by words such as “convenient and opportune” and “a win for the public administration that was quickly processed with minimum cost.”

This vague reasoning creates doubts as to the real causes behind these decisions and opens the possibility for inequity in the treatment of regulated parties.

If we compare the value of the penalty with the pecuniary obligation of the settlement decree, it can be seen that the instruments are very similar, as in most cases they establish the penalty in question at twice the value of the gain attained from using insider information (with

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the exception that in the past cases adjudicated by the CVM the value of the fine was determined by multiplying the realized gain by three.)

The advantage in signing a settlement for regulated parties is clear, there is no recognition of guilt, and the accompanying possibility of wide exposure in the media, or possible future conviction. Such effects can cause an individual's reputation to take a significant hit. On the other hand, the payment must be carried out in ten days and there is no chance for appealing to courts.

d) Consent Decree

In 1990, the public prosecutor and the CVM were authorized to execute consent decrees, whereby they effectively suspend administrative proceeding and lawsuits. There is judicial supervision, as the courts must approve the administrative decision. So far, the CVM and the federal public prosecutor have only signed four consent decrees, three of which refer to insider trading cases.

The first consent decree was signed in 2008 in a case that involved insider trading, and established the possibility for investor compensation. The foreign company Vailly S.A. supposedly bought preferred stock from Suzano before the announcement of a material fact reporting the transfer of the company’s controlling block. Vailly S.A. would sell these shares on the market shortly after the announcement, earning in the process more than 500,000.00 BRL. The CVM and the Federal Prosecution Office filed a Public-Interest Civil Action seeking “payment of compensation for the diffuse damage that it allegedly caused to the securities market and to society,” in an amount three times the net gain that the company derived from Suzano’s stock sales. They also sought “indemnification for individual homogeneous damage caused to investors who negotiated with Vailly before the announcement of the material fact.” A Consent Decree was signed to settle the suit and the administrative proceeding, and Vailly was ordered to pay R$ 2,000,000.00. This amount was required to be paid ten days after the

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45 Article 5°, § 6°, the Law of Public-Interest Civil Action, as restated by Law 8,078/1990.
46 Apart from the three mentioned settlements, there are also the settlements in the case of Aracruz, which were signed in 2012 and 2013. These established payment to the CVM and to the Fund for Defense of Diffuse Interests.
47 The opinion of the Federal Prosecution, the court decision on the consent decree and the judgment of ratification of the consent decree are available at: http://www.cvm.gov.br/port/infos/TERMO%20DE%20COMPROMISSO%20E%20AJUSTAMENTO%20%0308.asp.
Consent Decree was approved in court. As stated in the court decision that ratified this agreement, a portion of the amount (1,425,600.00 BRL) would be assigned to the Fund for the Defense of Diffuse Rights (Fundo de Defesa de Direitos Difusos) and the remainder (551,450.00 BRL) would compensate individual investors. The judge’s reasoning was that the investors should be entitled to the net income that Vailly earned in the trade carried out based on the insider information. The amount would be left in a savings account for twelve months. Any amounts not claimed by investors would be credited back to the Fund for the Defense of Diffuse Interests. The CVM advised the counterparties in the transactions that the amount was available to be claimed.

The second consent decree was signed in 2009 and also involved insider trading. As in the first case, stocks were traded prior to disclosure of a material fact announcing the transfer of a controlling block of shares and the subsequent sale by someone that was part of the controlling group as well as a member of the board of directors of the company Tenda. The buyer was ordered to resign from the director position for three years and to pay R$ 200,000.00 to the Fund for the Defense of Diffuse Interests.

The third Consent Decree involving insider trading was signed in 2010. As in the cases above, someone (an executive manager of Petrobrás) traded Ipiranga stocks before the announcement of a material fact reporting the transfer of Ipiranga’s controlling stake to Petrobras, Ulta, and Braskem. Also, as in the case above, the consent decree suspended the sanctioning administrative proceeding in the CVM and extinguished the Public-Interest Civil Action and the Innominate Provisional Remedy. The amount, as in the other case, was three times higher than the earnings derived in the illegal trading, which totaled (360,202.75 BRL). Since no third parties were identified, the CVM decided that the money should be paid to the Fund for the Defense of Diffuse Interests. In addition to the payment, the executive was prohibited from trading stocks for three years.

It is interesting to observe the use of this instrument concerning three issues: (1) non-pecuniary obligation; (2) criterion for the determination of the settlement value (3) and the recipient of the values paid in the consent decree. This specific information for the only three insider trading consent decree signed can be found in the following table.

49 The consent decree document does not provide any explanation for determining this amount.
50 The Board of Commissioners decision is available at: http://www.cvm.gov.br/port/infos/Ata22062010.pdf.
Table 03. CVM’s Consent Decree regarding insider trading cases

<table>
<thead>
<tr>
<th>Agreement/Case</th>
<th>Non-Pecuniary Obligation</th>
<th>Criteria to Establish the Value of Pecuniary Obligation</th>
<th>Destiny of Values</th>
</tr>
</thead>
<tbody>
<tr>
<td>1º. Vailly/Suzano</td>
<td>None</td>
<td>3 times the gained value</td>
<td>FDID and investors, counter-part in the operations of buying and selling</td>
</tr>
<tr>
<td>2º. Tenda</td>
<td>Not allowed to occupy positions of institutions in the capital market for 3 years</td>
<td>No mention of criteria or stipulation of gains in the operation.</td>
<td>FDID</td>
</tr>
<tr>
<td>3º. Petrobrás/Ipiranga</td>
<td>Not allowed to trade in the market, directly or indirectly, for 3 years</td>
<td>3 times the gained value</td>
<td>FDID. No recognition that there would be certain harmed investors.</td>
</tr>
</tbody>
</table>

There are three concerns regarding these cases. The first one is related to the existence of non-pecuniary obligations of the investigated party. Not allowing being in the market is understood as the most onerous measure for the capital market participants. However, this measure does not appear frequently in other regulatory instruments, including administrative processes and settlements.

The second is related to the criterion used to establish the value of the pecuniary penalty. The criterion was set at three times the gain or the avoided loss. This is the same criterion that has been utilized in past sanctioning processes, and is the highest possible pecuniary penalty. Indeed, it is higher than the criterion used in the settlements. As the decrees have the goal of ending a public civil action that aims at compensating the losses caused, it is interesting to ask how close this value comes to the value used in pecuniary penalties handed down by the regulator. Especially there is often little attempt to verify the damage caused to the market or to investors.

The third observation seems to be the most problematic. It is related to the recipient of the value paid by the investigated party. If, as in the first case (Vailly), a part went to a Fund for the Defense of Diffuse Interests and another part to investors, in both of the following cases (Tenda and Ipiranga), the funds went only to the Fund. Despite recognizing that the decision to pay the counter-part investors does not seem to be the most adequate way forward, sending the whole of this money to the Fund seems to be an even worse solution. This opinion is based on the fact that there is no benefit accrued to the capital market, especially regarding the
improvement of oversight or the market supervision to verify the frankness and strength of the enforcement of administrative sanction processes.

3.2 Criminal Sphere: The First Criminal Cases

Despite the criminalization of trading on nonpublic information in 2001, it was not until 2009 that the Federal Public Prosecutor brought its first inside trading case. The initiative can be explained as being the result of the signing in 2008 of a cooperation agreement between the CVM and the Federal Public Prosecutor in which the two institutions agreed to exchange information and collaborate in crimes against the capital market.

The first criminal case refers to the transaction in which Sadia launched an offer for a voluntary acquisition of Perdigão’s stokes in the market. In this case, Sadia’s managers traded Perdigão’s American Depository Receipts (ADRs) on the New York Stock Exchange (NYSE) using information that had yet to be disclosed to the market. The case was first investigated by the SEC, which accused the Investor Relationship Officer, a member of the board of directors, and an employee at the financial institution that had participated in the offer (ABN Amron). In 2007, the parties under investigation arrived at a cooperation agreement with the SEC, which barred them from participating in market activities for a certain period and required them to pay a fine. The case was also analyzed in the administrative sphere by the CVM, which decided to suspend the individuals from working in publicly traded companies while also requiring them to pay a fine. For only one of the indicted parties did the investigation end with a settlement. This was also the first case in which the defendant was prosecuted criminally for insider trading. In 2008, the CVM communicated the incident to the Federal Public Prosecutor, which filed its first case in 2009. One defendants were indeed found guilty in the higher court (Superior Tribunal de Justiça), with a conviction including a fine and suspension from all trading activities.

The second case involved Randon S.A., a company in the cargo transportation field. In this case, the controlling shareholder, his family (wife and son), and some other managers traded shares two months before the announcement of a new partner in August 2002, an American company named ArvinMerit. During the interim period, the company’s stokes value

51 With the amendment of Law 6,385/1976 for the Law 10,303/2001 (which including the addition of Article 27-D),
increased by 120%. The lawsuit filed by the Federal Public Prosecutor of Rio Grande do Sul against six accused agents occurred in the beginning of 2010. After discussions regarding jurisdiction, the case ended up in the Criminal Branch of São Paulo, which specializes in financial crimes and money laundering.\textsuperscript{52} In July 2012, the process was suspended when the Federal Public Prosecutor accepted a settlement in which the accused agents paid individual fines to the CVM, in addition to completing community service and making an appearance in front of the court. For two of the accused agents the penalty was diminished due to age.

The Public Prosecutor of Rio Grande do Sul submitted an additional denouncement on December 30\textsuperscript{th} 2012, this time in regards to the Mundial case in which ten people were indicted for manipulation of the market. Two of these individuals were accused of insider trading.\textsuperscript{53} There is also a fourth recent case, involving OGX/Eike Batista and submitted by the Federal Public Prosecutor of Rio de Janeiro, which also involves market manipulation and insider trading.\textsuperscript{54}

In the three first processes, the CVM appears as an assistant party to the denouncement. As the CVM and the Federal Public Prosecutor have said, these cases are the “result of an effort for integrated work between the attorney’s office and the CVM, which have acted together to inhibit and combat illicit practices in the capital market.”

**3.3 Civil Liability Sphere**

Corporation Law included a direct reference to the right of investors to seek compensation from the managers that trade on nondisclosure information, in addition to the possibility of applying the general rule of civil liability embodied in the Civil Code. Just a few cases in which an investor sought compensation for losses due to insider trading has been found.

The first case dates to 1977, and in fact represents the first insider trading case judged by the CVM. In this period, a group of investors was seeking indemnification after having purchased SERVIX stokes during the period immediately preceding the divulging of facts relevant to the business of the company. Two suits were brought, but neither was successful. The second case involved ITAP and took place in 1981. In this case, the company’s stokes

\textsuperscript{52} Criminal Lawsuit n. 2009.61.81.009474-0.
\textsuperscript{53} It is in the first federal criminal court of de Porto Alegre, n. 5067096 – 18.2012.404.7100.
\textsuperscript{54} For a media news about this criminal lawsuit, see http://www.valor.com.br/empresas/3768734/procuradoria- oferece-nova-denuncia-contra-tres-ex-gestores-da-ogx.
experienced significant oscillation immediately preceding the announcement of a buy back scheme in an attempt to go private. The investors in this case were also unsuccessful.

The most recent case involves OGX. To date, the minority shareholders have sought relief from the judiciary via two distinct forms: individual and collective. However, as the company already finds itself in bankruptcy court, and faces lengthy proceedings, there is not much hope that the investors will have any of their lost funds.

4. ASSESSMENT

4.1 Questions

This empirical research’s most relevant finding is that each case receives different responses from the enforcement system. This difference in results is not necessarily a consequence of the probationary system, but maybe it is related to the instruments that were triggered and the institutions that participated in the process.

In order to think about this research finding, the “really responsive regulation approach,” developed by Baldwin and Black, is used. This theoretical perspective asserts the relevance of institutional design in enforcement activities and in the comprehension of its problems and opportunities. The authors also note that the responsiveness of regulation is related to the “the logic of different regulatory tools and strategies.”

In the case of the Brazilian insider trading regulation, the objective is to guarantee a fair market with the equitable treatment of investors. In order to reach this goal, a punitive logic is applied. In other words, once it is determined that nonpublic information has been used; the regulated entity is subject to administrative and criminal, as well as civil, liability. Therefore, the whole enforcement system must participate in the success of the deterrence strategy.

Based on the “really responsive regulation” approach and on the empirical results findings, the data analysis aims at answering the following questions: 1) Are the regulatory

55 Baldwin and Black, 2015.
56 Baldwin and Black, 2015, p. 42.
57 Baldwin and Black, 2015, p. 20.
tools used in such a way that the final result is to communicate a punitive message? 2) In concrete cases, are the changes in the institutional design affecting the deterrence strategy? In the case of a positive answer, how? 3) Is it possible to identify the preconditions that allow for such an institutional design to make the deterrence strategy effective?59

In order to answer these questions, the analysis is divided into two perspectives. The first one is internal, and to be found at the CVM. This perspective sheds light on the use, by the regulator, of a range of regulatory instruments to deal with the insider trading (namely, the administrative sanctioning process, consent decree, and settlement). The second perspective analyzes the relationship among the institutions assigned to confront the unlawful practice of insider trading in the administrative, criminal, and civil spheres (namely, CVM, CRSFN, Federal Public Prosecutor and Courts).

4.2 CVM’s Internal Perspective

As discussed previously, the CVM is a key institution for the enforcement of rules regarding the use of nonpublic information. In order to deal with insider trading the institution bears the following prerogatives and duties:

1. Monitor the market and, if insider trading practices are found, start an administrative sanctioning process.
2. Adjudicate the administrative sanctioning process by convicting or acquitting the indicted agent, taking into consideration the probationary framework of the process. In the case of punishment, it is necessary to define which penalty will be applied (warning, fine, or suspension).
3. If the regulated entity, at any time before the final decision, proposes a settlement, the CVM has the prerogative to decide, should it to be found opportune and convenient, if the fact-checking process will be finalized in a consensual manner.
4. In parallel, if needed, CVM contact the Federal Public Prosecutors so that it can implement judicial measures capable of guaranteeing the effectiveness of the enforcement strategy and eventually seek compensation for the losses caused to the market.

59 Baldwin and Black, 2015, p. 20.
5. In all cases, the CVM must communicate the case to the Federal Public Prosecutors, which has the obligation to denounce the case to the judiciary. In the judicial sphere, the CVM can only act jointly with another institution by assisting it.

The first important decision is the one that allows the CVM to decide if the punitive or consensual process will be used to end the case, if the regulated propose a settlement agreement. Can this choice affect the deterrence strategy used against insider trading? A quick answer would be yes, since the consensual venue, in which there is no recognition that unlawful practices occurred, would communicate a less drastic logic of punishment. However, by analyzing this idea in the context of the enforcement system, this answer cannot be supported.

What happens after the administrative punishment? The CVM’s decision to apply punitive measures can be revised by the CRSFN, that at least will extend the date of a final decision. Even after the administrative appellate court decision it is possible to challenge its legality in the judiciary.

However, even before the final judgment the path to a decision’s execution can be a long one. Even if the CVM’s, CRSFN’s, or Judiciary’s decision be to pursue a punitive action, if there is no voluntary payment by the defendant, the value of the penalty will be added to the rolling debt to be charged through the judgment of a compensation action. This part of the process does not occur at the CVM. According to the regulator’s past reports, the percentage of cases in which a fine is levied is very low. This difficult and lengthy process can significantly undermine the punishment strategy. In addition, this reality is also causes the regulators to act cautiously, as the low rate of fines may drive further inspections by the government accountability office. In sum, even though the indicted may be punished in an administrative way, it can take years for the process to be fully effected.

In this context, having a consensual instrument that obliges the regulated party to pay in 10 days has a certain value that the regulator understands to be significant, and would not seem to be contrary to the punishment strategy. In contrast, the settlement and consent decree reveal themselves to be extremely effective instruments to manage the unlawful practices of the market, including insider trading. In addition, they represent an alternative to processes with

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instruction and instrument deficiencies and would allow for better human and financial resource allocation by the regulator.61

After knowing the relevance and potential of the settlement and consent decree, it is important to access the data on how the CVM uses these tools in the administrative process.

In doing so, and when exclusively taking into account the value for accepting the settlement agreement, this study failed to find coherence in the CVM’s actions. In some cases, values that surpass the maximum amount of the penalty (considering the criterion of three times the gained value or avoided loss) are not accepted, while the average accepted amount is two times the gained value. Vague terms such as convenience and opportunity often appear in the arguments used to sustain the decision to accept the consent decrees. This information suggest a lack of an understanding regarding what the minimum parameters for using consent decrees and settlement that can compromise the regulator’s coherent action and thus its ability to achieve a deterrence strategy.

Following the “really responsive regulation” approach, it can be seen that there are pre-conditions that allow the regulatory instruments to communicate deterrence.62 Additionally, the main commitment of this approach is that the regulator acts in a coherent manner. In the absence of such coherent action, it may be accidently communicated that the discretionary powers of the regulator are giving way to arbitrary actions and the notion that different parties are being treated unequally. Indeed, here there is a certain confrontation between two different logics of administrative law being expressed by the CVM. One comes from Brazilian traditional administrative law, and relates to legality principle. The other has a more flexible vision regarding public administration. In this logic, the idea that accountability be sought, via communicative methods, within all reasonable means is a key point. In the very least, in a country with a formal history of administrative law, regulatory innovations must be legitimate.

Finally, the choice of finalizing the process with a settlement affects the access of other institutions. To begin, because this decision is not subject to revision, eliminating any possibility of intervention by CRSFN or by the judiciary. In addition, depending on the phase of the process in which the settlement is signed, fresh criminal investigation can begin without the support of evidence collected in the administrative process. To make matters worse, it would be done without the institution specialized in capital markets. Especially in regards to this last

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61 Kevin E. Davis, Maira Machado, Guilhermo Jorge. Coordination the enforcement of anti-corruption law: South american experiences, September, p. 7, 2014 (forthcoming)
62 Baldwin and Black. 2015, p. 33-36.
finding, the evaluation of the function of the institutional design can affect the group of instruments available in the legal system to realize the deterrence strategy.

4.3 Intra-Institutional Perspective

Beyond the administrative sphere, the legal regime of insider trading can reach the criminal and civil spheres with the participation of the CVM, the Federal Public Prosecutors, and the Judiciary. In order to access the criminal sphere, the main actor would necessarily be the Public Prosecutor, which has standing to file a criminal lawsuit before courts. The knowledge of the fact depends greatly, but not exclusively, on the CVM’s communication of its suspicions of use of nonpublic information.

The empirical research results suggest that there is a stockpile of potential cases judged in the administrative sphere that should be analyzed in the criminal sphere, but that seem not to have been denounced. The next question is: why does it happen?

In Brazil, under the legality principle, the Public Prosecutor has no discretion and is obligated to prosecute every criminal offence that comes to its attention. As revealed by Davis, Machado and Jorge, “strict compliance with this principle is practically impossible.” The authors point out that the legality principle only reduces discretionary powers, but does not totally eliminate them, while also potentially making it difficult to implement enforcement strategies.

This perception has the potential to explain the divergence of processes between the administrative and the criminal spheres, supposing that choices are made. However, the simple possibility of precisely explaining the difference between these numbers deserves attention and places doubt around the idea that the punishment message may be reaching its goal at criminal level. The question that arises is in regards to whether this divergence of numbers is a consequence of a communication problem with the CVM or if the problem is linked to internal issues of the Public Prosecutor, which makes choices without revealing its criteria.

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63 For data before 2008, see Eduardo Ribeiro Faria de Oliveira, Tiago Bottino, Seletividade do sistema penal dos crimes contra o mercado de capitais (Lei n. 6.385/76), available at http://www.conpedi.org.br/manaus/arquivos/anais/fortaleza/3244.pdf (showing that there is a selective criminal system for the capital markets crimes).
64 Davis, Machado and Jorge, 2014, p. 7.
The first criminal case (Sadia/Perdigão case) showed that the legal provision alone was insufficient to truly criminalize insider trading. It was necessary to improve communication between the CVM and the Public Prosecutor through cooperative agreement. However, the information flow from the CVM to the Public Prosecutor is not publicly available. Nor, for that matter, are the criteria for the actions of the Public Prosecutor able to be drawn from the analysis of the final results.

The decision to give the Public Prosecutor jurisdiction, depending on the CVM’s actions, reveals greater institutional complexity that impacts the achievement of the strategy. Communication is a precondition for institutions to work by exchanging information and being clear about the role that each one plays in the institutional design. In the design that has been chosen, the administrative and criminal processes seem to be complementary, as they should be, acting in a collaborative way so that the final result of the punishment message may be achieved.

In this relationship, it is necessary to consider the timing and strategy of the actions of both institutions. In addition it should be questioned whether they should be working together or separately. In the available cases, their joint action appears in different forms. If in the Sadia/Perdigão case, the criminal lawsuit came after the administrative decision, and counted on a joint effort by the CVM and the Public Prosecutor. In two more recent cases (Mundial and OGX) the criminal lawsuit began before the administrative action and in an independent form. The goal here is not to attack the principle of independence between the two spheres, but point out that closer collaboration or more independent action may impact the institutional design and the final result.

Despite the fact that it seems that only time will tell what the best design is, this action may still be the object of better understanding and eventual improvement. It may also be possible for us to better understand the role of each level. As an exercise of comparison, in studies on the enforcement system of anti-corruption laws in Brazil the multi-institutional model or the modular institutional design is often deemed favorable to the punishment system.

66 Davis, Machado and Jorge, 2014.
Based on the available information, it can be established that a pre-condition of good communication of penalization is the existence of a flow of information along with transparency in the act of communicating. In effect, there must be systemic control, and more importantly effective communication relating to the punishment strategy.

4.4 Civil Liability Sphere

Taking into consideration all available empirical research, the action that causes more awkwardness is the access to civil liability, which seems to be disconnected from the punitive message when seeking compensation for losses caused to the market. Indeed, only a few cases were pursued in this manner. The result alone deserves attention, since it raises the questions as to why these cases were pursued (or not) in this form, and why they were treated in a different way in comparison to other cases of the administrative sphere.

Another aspect that can be criticized in regards to the civil sphere is the result. The cases ended up with payment to the Fund for Defense of Diffuse Interests without any benefits to investors or the Brazilian capital market. It is questionable whether this compensation instrument, processed through a trial of public civil action, is necessary. In the context of the enforcement system and the deterrence strategy, what does access to this action actually mean? Does it complement the administrative sanction with the payment of another sum, in addition to the possible accumulation with a penalty extracted from the market? Such doubts remain.

5. CONCLUSION

It can be affirmed that the Brazilian legal system has rules that forbid the use of nonpublic information and that provides processes of sanction through the administrative and criminal punishment systems, in addition to creating civil liabilities.
The main result of this empirical research conducted herein is that the existing cases reached different outcomes depending on which instruments were applied and which institutions had been proactive in verifying the illicit activity. Considering the information gathered, it is possible to say that the available tools are not neutral in the process of communicating a punitive message regarding the act of insider trading. The existence of a diversity of results can affect the message that the practice of insider trading will not be tolerated. Theoretically, the main finding of this study has corroborated the “really responsive regulation” approach, pointing out that the institutional design for the enforcement of rules matters and that its variations can affect the deterrence strategy in order to have a fairer and equitable capital market.