

Disclosure and transparency: how are the current rules being observed by Brazilian issuers?¹

2019 was an extremely positive year for the Brazilian capital markets, with the local index (*Índice Bovespa*) breaking successive scoring records. In 2020, this scenario has been completely altered by the crisis of the novel coronavirus, which caused intense devaluation of such index and significant volatility.

In times of euphoria or depression, efficient communication between listed companies, shareholders and the market should be seen as strategic, especially in relation to information that has the potential to influence investors' perceptions. In other words, material information.

Article 157, paragraph 4, of Federal Law 6,404 (Brazilian Corporation Law) and article 2 of CVM Instruction 358 provide the definition of material information in Brazil. Generally speaking, this is all information that may have a significant influence on the price of the securities issued by listed companies, on the decision of investors to trade them, or to exercise their rights as holders of these securities. Thus, changes of control, corporate transactions (acquisitions, mergers, spin-offs, etc.), public offerings, debt renegotiations, bankruptcy requests, among others, are examples of material information under the Brazilian disclosure regime.

Legislation and regulation require issuers to disclose notices to the market ("*anúncios de fatos relevantes*", in Portuguese) in order to promote wide and immediate dissemination of material information. In this sense, informational asymmetries between those who have access to confidential information and other market agents could be mitigated.

Timing for the disclosure

What, then, would be the best time for issuers to disclose notices to the market?

Under "standard conditions for temperature and pressure", the disclosure of notices to the market outside of the trading hours is considered the best practice to be followed. This is because, free from the pressures generated by the performance of the securities during the trading session, investors can more easily assimilate the content of the notice and reflect on possible changes to their investment strategies.

Therefore, ideally, listed companies should wait for the end of the trading session to release their announcements. In this way, investors would have the entire interval

¹ Article originally published in Portuguese at *Revista Capital Aberto* website. Available at <<https://capitalaberto.com.br/secoes/ensaio/divulgacao-de-fatos-relevantes-como-as-atuais-regras-vem-sendo-observadas/>>.

between the disclosure and the opening of the subsequent session to assess the content of the information made available.

However, professionals working in the capital markets often face situations that are far away from such standard conditions. For example, the identification of leakages of confidential information, or the verification of atypical fluctuations in the quotation or in the volume traded, are events that demand immediate response from the firm, even during market hours. Especially in times of fake news, rumours can arise at any time, go viral through social networks and messaging applications and affect share prices. In these situations, waiting for the trading session to close in order to provide clarification would mean leaving investors exposed to these rumours for hours, without an official statement from the impacted issuer.

If there is no doubt about the damage caused by the delay in responding to fluctuations or leakages, unnecessary disclosures of material information during trading hours can also cause disturbances. It so happens that, until May 2, 2018, there was no established procedure, in the framework of the Brazilian capital markets, to smooth the impacts of the disclosure of notices to the market during market hours.

Until recently, an investor could be surprised, when following the market through news terminals, with the announcement that a certain company, in which he/she allocates a considerable portion of his/her investments, had entered into a corporate transaction with its main competitor. Soon after the respective notice to the market was released, the information would also have repercussions in the media. Everything “live”, with the trading session in progress.

Under what conditions will this transaction be implemented? What are the values involved? Is it a stock-for-stock transaction, or will there also be payments? Has there been any change of control? Will minority shareholders be entitled to tag along? What is the expected value of synergies? In summary, what changes for current shareholders?

These are some of the questions that would come to the mind of any investor reasonably familiar with transactions of this nature. However, even if the announcement had provided satisfactory answers, the investor would be obliged to analyse the information in the middle of the trading session, with the company's stock trading in a normal course. When it comes to complex deals, this investor would certainly not be in the best scenario to take investment decisions.

The analogy with the mechanic who tries to change a tire while driving the car is worth it. The procedures established by CVM Instruction 590 and B3 Issuer Manual represent a kind of “pit stop”, a technical pause for the “tire change” to be carried out with greater safety.

Current disclosure procedures

In order to address this situation, on September 11, 2017, the Brazilian Securities and Exchange Commission (CVM) edited the CVM Instruction 590, which made specific adjustments to instructions 358 and 461.

Paragraph 2 of article 5 of Instruction 358 nowadays provides that the disclosure of notices to the market, during market hours, should occur with the observance of the procedures established in the regulations edited by the stock exchanges. Consequently, article 60 of Instruction 461 currently provides that stock exchanges should set the procedures to be adopted in cases of disclosure of material information during trading hours. Thus, by means of minimal modifications, the federal public regulator transferred to the stock exchanges the competence to rule the matter.

Currently, B3 is the only active stock exchange in Brazil. On April 18, 2018, through the Circular Letter 018/2018-PRE, B3 presented its new procedures, to be followed by listed issuers (i.e. companies and investment funds), for the disclosure of notices to the market, as provided in items 8.2.2 and following sections of its Issuer Manual.

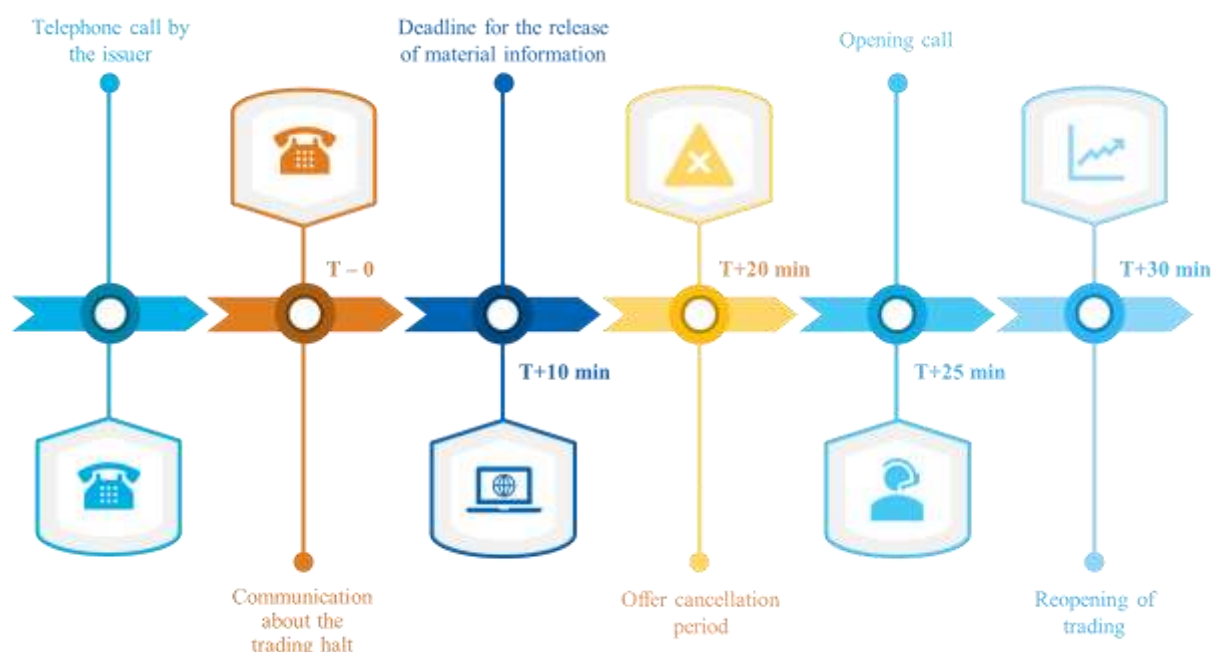
Thus, according to item 8.2.2, issuers must disclose notices to the market at least 30 minutes in advance to the market opening, or at any time after its closing. Such provision should be understood as a general rule, so that corporate disclosure should be made, preferably, until 9:30 am, or after 5:00 pm (or 6 pm, in periods of extended market hours, such as during daylight saving time).

Items 8.2.3 and 8.2.3.1 establish that, in exceptional cases when it is absolutely necessary to disclose an announcement during the trading session, the issuer must previously contact B3, by means of a telephone call. The exceptional nature of this procedure should be considered especially in cases of loss of control over the confidentiality of the information. After all, it is possible that an issuer had planned to disclose material information after the end of the trading session, but was surprised by the leakage of that same information, thus being obliged to promote the necessary disclosure immediately.

Once the telephone call is received, B3 takes a series of operational procedures in order to grant the trading halt of the respective securities², as well as to communicate it both to the issuer and to the market, in the form of a “news pending” alert. After the halt, item 8.2.3.3 requires the issuer to release the announcement within 10 minutes.

² Except in the cases indicated in item 8.2.3.4.

In summary, such procedures are illustrated in the following flowchart:



As a rule, the trading halt lasts for 20 minutes, followed by two periods of 5 minutes each, aimed at conducting the necessary operational procedures for the reopening. In all, securities trading is resumed after 30 minutes from the halt.

Back to the practical case described above, if it were imperative for the company involved in the corporate transaction to communicate such material information during the trading session, it would be obliged to contact B3, which therefore would temporarily suspend the trading of its securities. With the halt, the investor would become aware that something significant about the company would be communicated in a maximum of 10 minutes. In the end, if the company had used the entire period, the investor would still have another 20 minutes to interpret the reported information, until the trading of the securities resumes.

Disclosure standards

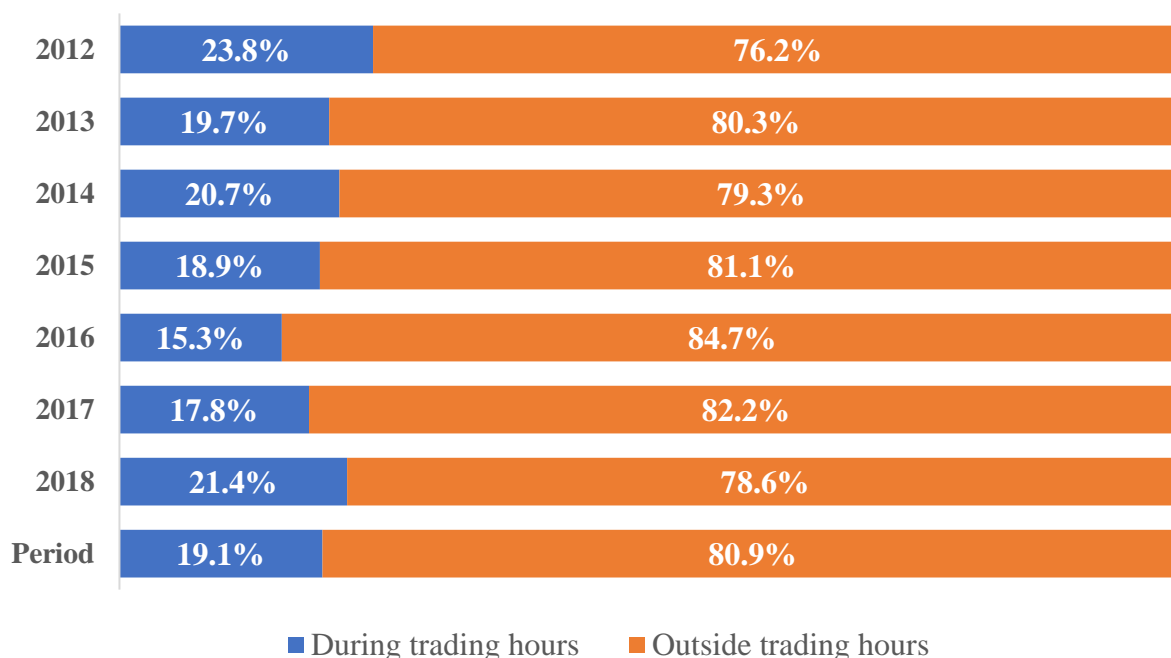
With the current rules in force for almost two years, would it be possible to notice any change to the periods of the day when issuers usually release their announcements?

The answer to this question involves checking the data related to the disclosure of material information, and comparing verified standards, before and after the current rules came into force.

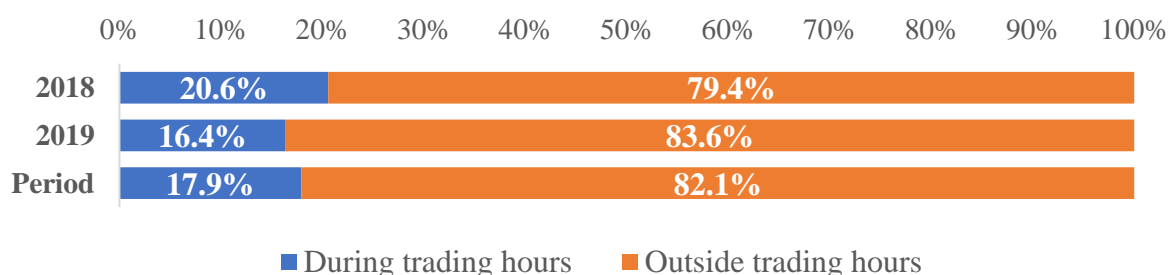
Considering the period of 6 years and 4 months prior to the amendment of the B3 Issuer Manual – from January 1, 2012 to May 1, 2018 – 7,757 notices to the market (80.9% of the total) were released outside of the trading sessions, while 1,829 communications (19.1%) were made during trading hours. Roughly speaking, for every 4.5 notices to the market, one was disclosed while negotiations were ongoing. Comparatively, between May 2, 2018 (date of entry into force of the current procedures) and December 31, 2019, 3,073 announcements (82.1%) were made outside of the sessions, while 671 (17.9%) were made during trading hours.

The historical data series can be seen in the following infographics.

Disclosure of notices to the market between
1/JAN/12 and 1/MAY/18



Disclosure of notices to the market between
2/MAY/18 and 31/DEC/19

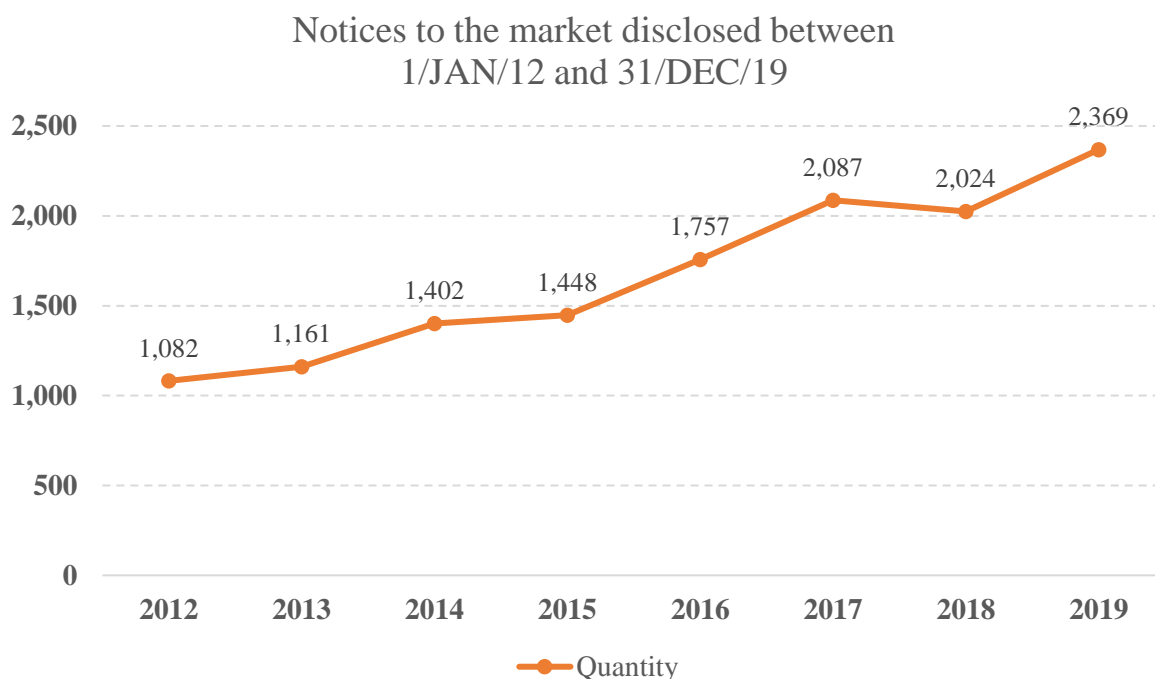


Source: B3's Issuers Regulation Department

In a preliminary analysis, the data suggest a slight drop in the percentage of notices to the market released during market hours, when comparing the figures for the periods before and after the current set of rules came into force.

In more detail, the percentage of announcements disclosed during the trading sessions in the last eight months of 2018 (20.6%) and, mainly, in 2019 (16.4%) indicates a reversal of the upward trend observed in the previous years, considering the numbers observed in 2016 (15.3%), 2017 (17.8%) and in the first four months of 2018 (21.4%).

Considering the political and economic context of the last biennium in Brazil, this reversal is even more impressive. This period was marked by the electoral process in the second semester of 2018 and by the significant increase in the *Índice Bovespa* level in 2019 (from 87,887 to 115,645 points, comparing the closings of the last trading sessions of each year). Particularly in 2019, 42 public offerings (between IPOs and Follow-ons) were carried out, which involved around 90 billion Brazilian Reais. In electoral periods and when the market is heating up, it is natural for companies to intensify their corporate communication, as shown in the following infographic.



Source: B3's Issuers Regulation Department

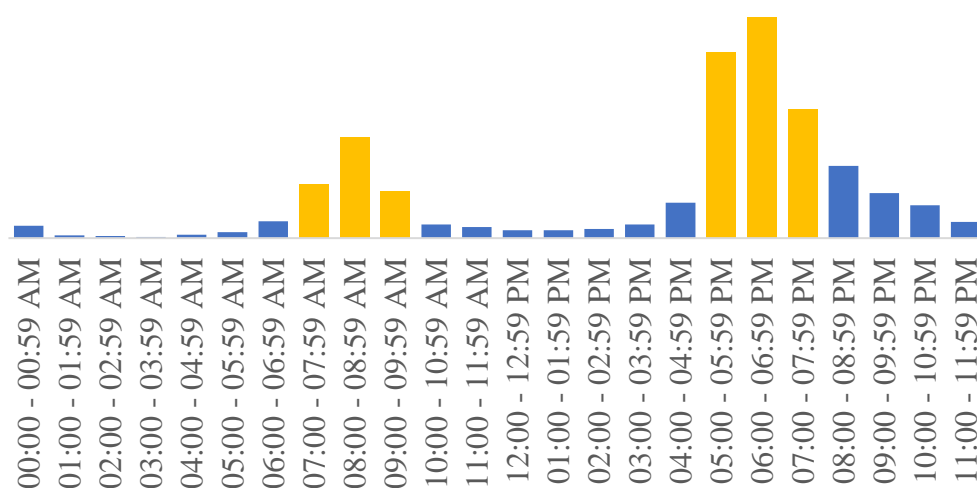
Even so, there was a reduction in the percentage of announcements released during the trading sessions. This finding reinforces the perception that, previously to the current rules, there were cases in which material information was unnecessarily disclosed in market hours. This is because, until recently, the procedure for releasing notices to the market was the same, regardless of whether the communication was made

during or outside trading hours, as there was no established rite for trading halts in the event of disclosure of material information during trading sessions.

However, by analysing the behaviour of the two main categories of issuers - companies and investment funds - it is possible to see different patterns in the way they deal with the release of notices to the market.

Companies disclose their announcements, with greater recurrence, at two times of the day: in the morning, between 7 a.m. and 9:59 a.m., and in the late afternoon, between 5 p.m. and 7:59 p.m.

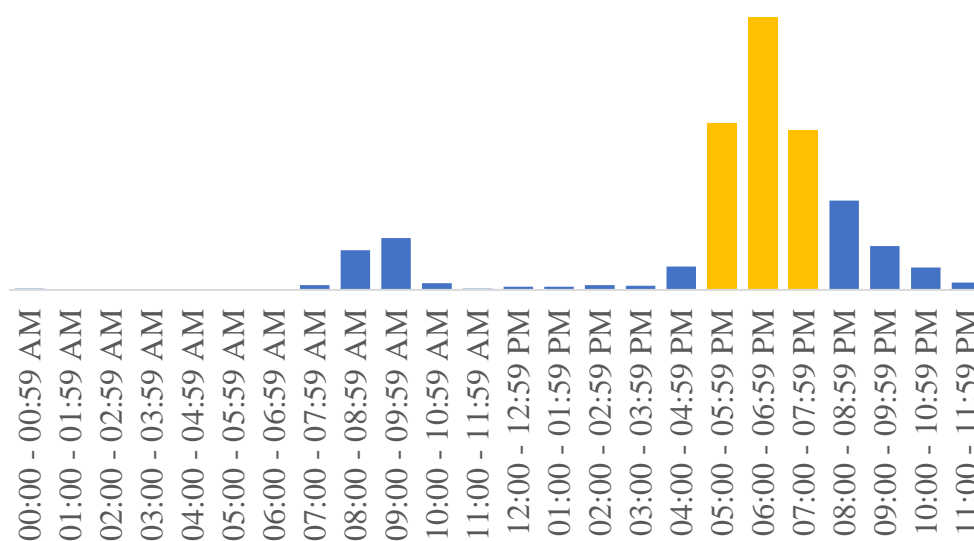
Disclosure of notices to the market, by companies,
between 01/JAN/2012 and 31/DEC/2019



Source: B3's Issuers Regulation Department

Funds partially replicate the behaviour of companies, with the peak of information disclosure in the late afternoon, between 5 p.m. and 7:59 p.m. However, unlike companies, there is no significant concentration of notices to the market released in the morning.

Disclosure of notices to the market, by investment funds, between 01/JAN/2012 and 31/DEC/2019



Source: B3's Issuers Regulation Department

Enforcement actions taken by B3

But, after all, is the current regime being followed by Brazilian companies and funds?

The data on sanctioning actions published by B3 show that, between May 2, 2018 and December 31, 2019, among the 671 notices to the market disclosed during trading hours, in 612 opportunities the Issuer Manual procedures were fully complied with. In percentage terms, this is a level higher than 91.2% of adherence. In 59 occasions (approximately 8.8% of cases), issuers made their communications in breach of the rules. The most recurrent cases are related to the absence of telephone calls to B3, prior to the release of material information during trading sessions³, and violations of the 10-minute period, counting from this contact, for the disclosure of notices to the market.

It is interesting to note that these identified infractions were committed by 57 different issuers (41 companies and 18 funds), with only two companies having repeated breaches of this nature. In other words, the recurrence rate was a mere 3.5%.

³ Even in cases in which the issuer discloses material information during trading hours, without previously contacting B3, the trading is halted as soon as the respective notice to the market is identified.

The effect of the novel coronavirus

Between the end of February and the beginning of March this year, Brazil registered the first cases of Covid-19, and the effect on the capital markets was instantaneous. The *Índice Bovespa*, which reached 107 thousand points on March 4, 2020, started operating in the range between 60 and 70 thousand points in the last week of March.

In the face of a crisis of such proportions, there was an expected increase in the number of notices to the market disclosed by the issuers. During January and February 2020, 113 and 129 notices to the market were disclosed by the listed companies, respectively. In the trading sessions of March until the 22nd (period marked by the intensification of the pandemic, with consequential market-wide circuit breakers triggered by B3), 168 announcements were disclosed.

However, an analysis of the announcements released during the first months of 2020 indicates relatively low percentages of communications made during the trading sessions. In the first three months of 2020, the percentage of announcements during trading hours was only 6% (January), 2% (February) and 7% (March). Despite the scenario of greater criticality generated by the pandemic, the level of 7% of information reported during the aforementioned March trading sessions shows a sensitive adherence by listed companies to the best practices – in the sense of only disclosing material information during the trading sessions when strictly necessary – especially in considering the numbers verified in the historical data series.

Conclusion

The current rules for the disclosure of notices to the market were edited after a long period of discussions on how to improve communication between issuers and investors, especially during trading sessions. This objective involves the promotion of a transparent and reliable capital market, capable of providing investors with the means to take reflected and informed decisions. However, the mechanism for trading halts needed to be well-dosed, so as not to restrict, for too long intervals, the liquidity of these same investors.

The moment when the current rules came into force could not be more correct, considering the importance of material information for the investors' perception of the market's behaviour. After all, attracted by the bull market scenario verified in 2019 and by the record cuts in the benchmark interest rates, the number of investors operating on the stock exchange market practically doubled in Brazil, surpassing the mark of 1.5 million individuals. The improvement of regulation is part of this movement to popularize the local capital market.

The data analysed in this article indicate that the new procedures for the disclosure of material information, including the possibility of trading halts, may have

served as a determining factor for the reduction of the percentage of notices to the market disclosed during market hours.

The establishment of a mechanism to temporarily suspend trades seems to have reinforced the orientation that material information should only be brought to the attention of the market during the trading session in exceptional cases, when such communication is effectively necessary due to events beyond the issuer's will, such as fluctuations or leakages.

In addition, the data related to the enforcement actions taken by B3 attest that the current rite for communicating material information is being satisfactorily followed by issuers. Even considering the novelty of the new procedures, as well as the short period of time since the rules came into force, the percentage of non-compliance was relatively low, with rare recurrences in infractions. And issuers maintain this attitude even in the face of the unprecedented crisis generated by the novel coronavirus pandemic.

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