INTRODUCTION

In July 1965, Brazil enacted a comprehensive statute regulating its capital markets. Although many of the provisions of this "Capital Markets Law" are clearly designed to protect investors, its origins cannot be found in any sensational scandal or market collapse. When the Finance Minister in late 1964 appointed the committee that was to draft the law, he stated that its purposes were "to accelerate the rhythm of economic development through a sound policy of democratization of capital" and to employ "selective disciplinary measures aimed at expanding and strengthening the capital markets." Significantly, the law includes not only purely regulatory measures such as requirements of corporate disclosure and prohibitions against fraud and manipulation, but also various "promotional" provisions, including favorable income-tax treatment for purchasers of corporate shares, and provisions aimed at strengthening the stock exchanges and creating private development banks.

The Brazilian statute adopts United States regulatory patterns to a significant degree. For example, like the federal securities laws, it places great reliance on the prophylactic effects of disclosure by companies whose securities are publicly held and on self-regulation by the stock exchanges. Furthermore, after enactment of the statute the Brazilian government, through the Agency for International Development, re-

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* A.B., 1948, LL.B., 1958, Harvard University. Assistant Director, Division of Trading and Markets, Securities and Exchange Commission. The Securities and Exchange Commission, as a matter of policy, disclaims responsibility for any private publication by any of its employees. The views expressed herein are those of the author and do not necessarily reflect the views of the Commission or of the author's colleagues on the staff of the Commission.

1 The term "capital markets" is used here to denote the markets for long-term debt and equity securities, as contrasted with the "money market," which is usually defined as the market for short-term government securities and commercial and financial paper. See Bd. of Governors of the Federal Reserve Sys., The Federal Reserve System: Purposes and Functions 85-86 (5th ed. 1963).

2 "Capital Markets Law" is the popular name of L. No. 4728, July 14, 1965 (Braz.) [hereinafter cited as Cap. Mkt. L.].

3 Ministry of Finance Instruction No. 422, Dec. 10, 1964. Most of the translations of statutes and other materials used in this Article were prepared by the American Chamber of Commerce for Brazil. The remainder were prepared by the author.
quested assistance from the United States Securities and Exchange Commission in drafting regulations. Pursuant to this request, I spent six months in Rio de Janeiro as a consultant to the Central Bank of Brazil.

The reason for Brazil’s interest in United States securities regulation is not difficult to understand. The growth of the capital markets in the United States over the last thirty years suggests that a comprehensive system of regulation may be helpful, if not essential, in creating the conditions of confidence and stability necessary for the development of these markets. An official of the Inter-American Development Bank expressed an increasingly common view when he stated last year that the first step in building capital markets in Latin America “is to win the confidence of the saving public by the passage of pertinent legislation and the effective and equitable enforcement thereof.”

This Article will describe the Brazilian regulatory program and will attempt to evaluate the measures that have been taken in the light of the program’s basic purpose of developing capital markets to help channel savings into local industry. First, however, for readers not familiar with Brazil, a brief description of that country’s background is warranted.

THE BRAZILIAN BACKGROUND

The Economy

Brazil is a country of approximately eighty-five million people, occupying an area greater than that of the continental United States. Until well into the twentieth century, its economy was based upon the export of agricultural or mineral commodities. In fact, each major stage of its growth was marked by the dominance of a particular export—sugar in the sixteenth and seventeenth centuries, gold and diamonds in

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4 For example, reported volume on the New York Stock Exchange rose from approximately $4.5 billion in 1940 to more than $387.8 billion in 1961. Special Study of Securities Markets, H.R. Doc. No. 95, 88th Cong., 1st Sess., pt. 1, at 27 (1963) [hereinafter cited as Special Study].


Brazil is only one of several nations which have recently taken steps to regulate their capital markets in an effort to channel savings into industrial production. The United States Agency for International Development, the International Bank for Reconstruction and Development, and the Inter-American Development Bank have sponsored studies of the capital markets of numerous Asian and Latin American countries.
the eighteenth century, rubber in the late nineteenth century, and coffee in the late nineteenth and early twentieth centuries.

Industry started late in Brazil. During the colonial years local manufacturing was forbidden by Portugal's mercantilist policies; after independence in 1822 it was discouraged by the landowning aristocracy that ruled the country. A textile industry was established in the latter part of the nineteenth century, but it was not until World War I, when the availability of imported goods was severely limited, that industrialization started in earnest. This process gathered momentum during the worldwide depression of the 1930's, when the decline in the international price of coffee led Brazilian coffee producers to invest their surplus capital in local industries. In addition, the shortages caused by World War II stimulated industrialization and for a short period made Brazil a major exporter of textiles.

During the postwar years Brazil has made enormous strides on its way to becoming an industrialized nation. Aided by a government policy of imposing selective currency exchange controls and tariffs which discouraged the importation of consumer goods competing with those manufactured locally, Brazil's industrialization has spread from textiles and certain light industries to steel, automobiles, petroleum refining, and a variety of other products and activities. For example, in 1965 Brazil produced 164,699 trucks and automobiles, making it the ninth largest motor vehicle producer in the world. In many respects, Brazil can be regarded today as a highly industrialized nation.

Unfortunately, the entire country did not share in the rapid economic growth experienced by Brazil after World War II. Industrialization has been concentrated in the South, particularly in the "golden triangle" formed by the cities of Sao Paulo, Rio de Janeiro, and Belo Horizonte. This area today has features in common with the United States and Western Europe—large urban centers and a middle class that includes skilled workers and professional managers. Generally, however, the remainder of the country has retained an economy based on low-yield agriculture, vast land holdings and a feudal social system. The Northeast is particularly backward economically and, despite a government program aimed at its development, is still poverty-stricken.

6 For a general picture of economic development in Brazil, see BAEK, INDUSTRIALIZATION AND ECONOMIC DEVELOPMENT IN BRAZIL (1965); FURTADO, THE ECONOMIC GROWTH OF BRAZIL (1963); GORDIN & GROMMS, UNITED STATES MANUFACTURING INVESTMENT IN BRAZIL 1-11 (1962).
The Capital Markets

Although Brazil has made enormous strides toward becoming an industrialized nation since World War II, the Brazilian stock markets have not been an important factor in supplying capital for the growth and maintenance of Brazil's industries. In 1965 the Rio de Janeiro and Sao Paulo stock exchanges, the only exchanges of any economic importance, had a combined trading volume of under 200 billion cruzeiros, or about ninety million dollars, which is about one-third of an average day's volume on the New York Stock Exchange. Moreover, trading is largely limited to about twenty-five or thirty blue chips. Because of the small number of active stocks and the low volume of trading, small changes in the supply of or demand for shares tend to bring extreme fluctuations in price, and the distribution of a new issue of a stock that is already traded on a stock exchange often leads to a severe drop in the market price.

The weakness and narrowness of the Brazilian markets, which are by no means unique among developing countries, have a number of causes. Before discussing them, it should be pointed out that the inability of the stock exchanges to provide good markets for securities itself discourages financial intermediaries, investors, and companies needing financing from using the markets which do exist, and the narrow patronage keeps the markets weak. For this reason any successful government program to develop the markets must be many-sided, attacking this vicious circle at a number of points.

The Brazilian investor has never had the habit of investing in long-term or equity securities. This attitude can be traced to the 1890's, when a period of speculation in the shares of industrial companies ended in a disastrous crash. This experience seems to have made mistrust of corporate shares a part of popular wisdom and to have confirmed the Brazilian investor's preference for real estate over securities. Moreover, this attitude was reinforced by over-enthusiastic attempts

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7 See the annual statistical summaries published by the two major Brazilian stock exchanges. The rate of exchange at the end of 1965 was 2,220 cruzeiros to the dollar.
8 There are 25 stocks of 24 companies traded on the "principal market" of the Rio de Janeiro Stock Exchange. Most of these have an average daily volume of between 1,000 and 10,000 shares, although three or four stocks have a considerably higher volume. Also approximately 80 stocks are listed on the "secondary market" where volume varies greatly from day to day. It is probable that many of the reported transactions on the secondary market are "merely registrations (in some cases for tax purposes) of untraded stocks." DELTEC-PANAMERICA S.A., REPORT ON THE STOCK EXCHANGES IN BRAZIL 3 (1965).
9 This episode has been memorialized in a famous Brazilian novel, TAUNAY, O ENCOLHIMENTO (1894-1895).
during the 1950's to distribute the shares of several industrial companies, including those of Brazilian subsidiaries of United States corporations in the automotive and other industries. These distributions were made with the aid of door-to-door salesmen using high pressure techniques. Owing to the inadequate communications system of the country and the fact that neither the stock exchanges nor the investment firms that handled the distributions assumed responsibility for providing a trading market in the shares that had been sold, it became difficult for purchasers to dispose of their shares at a reasonable price. As we shall see, this episode was to have important effects on the thinking of the framers of the regulatory program a decade later.

The attitudes of entrepreneurs have much to do with the weakness of the markets. Because of their reluctance to share their membership, profits, or secrets with others or to run any risk of losing complete control of their companies, many of Brazil's industrialists are unwilling to go to the public for financing. Thus many of Brazil's most important enterprises are closely held by a single family or other small group. The paternalism of these industrialists, which seems inconsistent with mature securities markets, may be explained in part by the fact that many entrepreneurs came from the ranks of plantation owners, accustomed to being absolute masters of their own domains. However, this hostility to "going public" will probably become less prevalent as these early industrialists give way to the next generation, whose members are likely to be less personally identified with their businesses.

This attitude toward disclosure unfortunately also survives in companies that have sold shares to the public. Invariably, publicly owned companies in Brazil continue to be controlled by small groups who own a majority of the voting shares. In some cases only preferred shares, which have a guaranteed rate of interest but no voting rights (unless dividends are not received for three consecutive years), are issued to the public. Since financial statements of most companies are not audited and accounting methods vary greatly from company to company, [14]

\[\text{11 See BARR, op. cit. supra note 6, at 100; DIAMOND, DEVELOPMENT BANKS 52 (1957).}\]
\[\text{12 There probably does not exist in Brazil a single example of Adolf Berle's "modern corporation," in which management and ownership are divorced. See BERLE, THE 20TH CENTURY CAPITALIST REVOLUTION 20-95 (1954).}\]
\[\text{13 The Brazilian Company Law provides that not more than half of a company's capital may be in nonvoting shares. Decree-Law No. 2627, arts. 9 & 81, Sept. 26, 1940 (Braz.).}\]
\[\text{14 Financial statements must be approved by the company's "fiscal council," which}\]
the public stockholders usually find it extremely difficult, if not impos-
sible, to obtain up-to-date or reliable corporate information. It is fre-
quently impossible to ascertain the compensation of the directors, who
are usually also the principal stockholders. Furthermore, the receipt of
dividends and the actual transfer of shares can often be accomplished
only with a good deal of inconvenience, involving several visits to the
offices of the company.

During the 1960's inflation has also been an inhibiting factor on the
stock market. In the United States, inflation is sometimes thought to be
a favorable influence on the prices of corporate shares, on the theory
that corporate profits can be expected to parallel general price increases,
if indeed they are not an important cause of them. While this may hold
true where the rate of inflation is only a few percentage points a year, it
does not in Brazil, where the rate of inflation reached a high of eighty-
seven per cent in 1964, as measured by the cost of living in Rio de
Janeiro. Many potential investors consumed their savings in order to
maintain their standard of living. Those who still had savings to invest
attempted to compensate for their rapid devaluation by investing in
"hard" foreign currencies, apartments in fashionable neighborhoods,
marketable commodities or short-term securities with a high fixed rate
of return. It may seem logical that investors should also purchase
stock in times of extreme inflation, since industrial corporations are
usually in a good position to protect their profits against devaluation of
the currency by raising prices. However, because of the Brazilian in-
vester's frequent inability to ascertain the amount of the company's
profits or to protect himself against self-dealing by corporate insiders,
he has no assurance that he will share equitably in these profits. Fur-
thermore, high interest rates on fixed-income securities make equities
relatively unattractive. As a result, the effect of Brazil's inflation has
been to inhibit the development of the stock markets.

Another cause of the market's weakness has been their institutional
framework. The stock exchanges have operated under a law of 1896
consists of at least three persons who are not employees, directors or their relatives.
Decree-Law No. 2627, arts. 124, 126 & 127, Sept. 26, 1940 (Braz.). In practice, the approval
of the fiscal council has little meaning, since its members are usually not qualified as
accountants and their actual independence is questionable.
16 Conjuntura Economic, Feb. 1966, p. 11. In 1965 the rate of inflation was 45%.
Ibid.
18 For a discussion of the impact of inflation on capital markets, see Office of Ap-
plied Economic Studies, Ministry of Planning and Economic Coordination, Situação
which limits each exchange in Rio de Janeiro and Sao Paulo to fifty brokers, who can pass their "seats" on to their sons and who have an officially sanctioned monopoly on all transactions in securities and exchange of currency. Over the years most of these brokers concentrated their efforts on the lucrative foreign currency exchange business and did not attempt to develop an active market for corporate shares. Nonmember firms, on the other hand, were not encouraged to sell shares of corporate stock to the public, since the law obliged them to effect these transactions on a stock exchange and to pay a commission to an exchange member. The lack of interest in the stock markets and the difficulty of access to corporate information have also meant that few firms, member or nonmember, have research staffs to provide their customers with financial analyses of corporations. 

In the late 1950's and early 1960's, as the rate of inflation accelerated, a public market developed in bills of exchange. These are six- to eighteen-month obligations "accepted" by a credit company and sold to the public at a discount from their face value. Although these instruments' rates of return vary with fluctuations in the cost of credit, a six-month bill of exchange normally costs the borrowing company about sixty-five per cent per annum and yields about thirty per cent per annum to the investor. The difference between these two rates is the result of stamp and income taxes, acceptance and selling fees, and a commission required to be paid to a stock exchange broker. At the end of 1965, bills of exchange with a total face value of about 612 billion cruzeiros were outstanding.

The growth of the market in bills of exchange has an enormous potential significance for the future of the Brazilian capital markets. It has for the first time created the nucleus of a securities industry. There are approximately 300 credit, finance, and investment firms, some of which have branch offices in several cities and experienced back-office and sales staffs. Although their principal interest has been in the acceptance and sale (through affiliated distributing firms) of bills of exchange, several of them have also begun selling other types of securities, including corporate shares. Moreover, the Brazilian public, or at least that part of it with savings to invest, has now become accustomed to

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17 Decree No. 354, arts. 1 & 3, Dec. 16, 1895 (Braz.). See also Decree No. 2475, art. 29, March 13, 1897 (Braz.). For a discussion of current developments on this point, see text accompanying notes 79-80 infra.

18 O MERCADO BRASILEIRO DE CAPITAIS 60-71.

purchasing securities. It seems not unlikely that these investors will begin buying corporate shares once the rate of inflation has been reduced and the distortions caused by extreme inflation have been eliminated.

The Regulatory Program

General Considerations

The Statute

The Brazilian regulatory program is embodied in the Capital Markets Law, a statute of impressive scope, which covers the principal regulatory areas governed by the U.S. Securities Act of 1933 and the Securities Exchange Act of 1934. It also includes income-tax provisions; regulates open- and closed-end investment companies; authorizes the establishment of private development banks; and contains a number of amendments to the Brazilian Company Law, designed in general to give companies greater flexibility in corporate procedures and in the types of securities they may issue.

The statute places regulation of the capital markets under the jurisdiction of the National Monetary Council, a body responsible for direction of the government's monetary policy, and the Central Bank, which very roughly corresponds to the Federal Reserve System. Rule-making is the province of the Monetary Council, which, having no staff of its own, acts as a kind of reviewing agency for rules presented to it for approval by the Central Bank, which has responsibility for the administration and enforcement of the statute.

To a great extent, the statute leaves the formulation of regulatory

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20 See note 2 supra.
23 Decree-Law No. 2627, Sept. 26, 1940 (Braz.) (hereinafter cited as Decree-Law No. 2627).
24 The statute authorizes companies to issue registered shares that are transferable by endorsement, and convertible debentures. Cap. Mkt. L., arts. 32-38 & 44. It provides that financial institutions may act as transfer agents for companies. Cap. Mkt. L., art. 39. Furthermore, it allows companies whose shares are registered or endorsable to have authorized but unissued capital. Such companies, unlike other Brazilian corporations, may purchase their own shares out of accumulated or excess profits, and issue options for future subscription of shares. Cap. Mkt. L., arts. 45-48.
25 Cap. Mkt. L., art. 2. This body is composed of the Finance Minister and eight other high government officials and respected private citizens. See Banking Reform Law, L. No. 4595, art. 6, Dec. 31, 1964 (Braz.). This statute also established the Central Bank.
26 Cap. Mkt. L., art. 5.
standards to the Monetary Council. Thus the Council is authorized to adopt rules relating to virtually all aspects of the stock exchanges, including their organization, membership, operations, rates of commissions, credit arrangements for the purchase of securities, and protections against fraud and manipulation. Companies or persons controlling companies issuing securities to the public, as well as companies whose shares are traded on a stock exchange, are required to register with the Central Bank and to make disclosures and comply with terms and conditions to be established by rule. Brokers and other financial institutions desiring to operate in the capital markets are also required to be registered and to meet various requirements, notably financial responsibility, which the Monetary Council is to establish.

The decision to grant broad discretion to an administrative agency was based upon both administrative and political considerations. Certainly, the Central Bank, whose predecessor, the Superintendency of Currency and Credit, had exercised regulatory supervision over credit, finance, and investment companies, was in a better position than the legislature to establish meaningful standards for the capital markets. Furthermore, the Brazilian government probably determined that it would be easier to enact a sweeping but relatively simple statute than to attempt to justify to the legislature the adoption of specific standards. Another consideration was the need for prompt action. In mid-1965 the government which had taken office in April 1964 was in the process of putting through congress a broad program of economic reform of which the Capital Markets Law was only a part, and although it then had sufficient momentum to overcome the opposition of the stock exchange brokers to a statute that threatened to end their

28 Cap. Mkt. L., art. 10.
29 The United States is one of the few countries in the world whose securities laws are administered by a specialized agency. See Securities Exchange Act of 1934 § 4, 15 U.S.C. § 78d (1964). "[A]ll the countries of Western Europe suffer . . . from the lack of any administrative agency comparable to the SEC." 1 Loss, Securities Regulation 451 (2d ed. 1965). Israel and the Philippines have specialized agencies to administer their securities laws. See Domn, The Stock Market in Israel, in The Principal Stock Exchanges of the World 296, 313-14 (Spray ed. 1964); Roxas, The Securities Market in the Philippines, in id. at 275, 286. In Japan and India this function is performed by the Ministry of Finance. See Associates of the Securities Department, The Industrial Bank of Japan, Tokyo, The Stock Exchanges of Japan, in id. at 239, 242; Ojha, Stock Exchanges in India: Their Development, Structure and Operation, in id. at 319, 325-26.

monopoly, it might have been much more difficult to secure legislative approval later.

The Capital Markets Law represented an innovation in Brazilian legislation. No previous statute had ever given a government agency administrative discretion of such scope. Brazil, like other civil-law countries, has a somewhat formal judicial tradition, to which the idea of allowing government officials to regulate with only the guidance of general standards is quite foreign. Furthermore, the Brazilian Constitution expressly forbids the delegation of powers from one branch of the government to another, a difficulty which can presumably be overcome by taking the position that government administrative rulings are merely interpretations of the general statutory purpose. The novelty of the Capital Markets Law in this respect must be kept in mind if the difficulties that have been encountered are to be fully understood.

**Purposes of the Program**

Whatever the superficial similarities between the Brazilian program of securities regulation and the United States federal securities laws, their purposes are quite different. The United States legislation was enacted to protect investors and, perhaps secondarily, the national economy from abuses related to the purchase and sale of securities. While a fortunate by-product may have been the strengthening of the markets, this was hardly its chief purpose. The Brazilian program, on the other hand, is designed principally to develop and build the markets, and the protection of investors is only a means of attaining that goal. This is illustrated by the reaction of the stock market to the enactment of the Capital Markets Law. In July and August 1965, stock prices did not drop in the expectation of increased government control; instead, they rose by 139 per cent in these two months. Other factors, such as improved economic conditions, were also involved in the price rise, but there can be no doubt that Brazilian investors and financial firms regarded the statute as a crucial positive factor, since it indicated a decision by the government to aid in the development of the markets.  

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54 This and other comments on the Brazilian legal system are based largely on extensive conversations with Dr. Antonio de Bulhões Carvalho, a member of the Brazilian Bar, to whom I owe a deep debt of gratitude for the time and trouble that he took in explaining Brazilian legal procedures and standards. It should be emphasized, however, that Dr. Bulhões Carvalho bears no responsibility for the accuracy of this Article.  
55 Brazil Const. art. XXXVI, para. 2.  
57 See text accompanying note 3 supra.  
Brazilians both in and outside the government probably overestimated the effect that the statute could have on the stock markets. Economic growth, possibilities of profit, and political stability are likely to have more influence on the decisions of investors than the existence of regulation. Furthermore inflation may be a decisive factor. Nevertheless, in a country where an automotive industry has grown up from nothing largely as the result of a government decision, it is not surprising that people attach a great deal of significance to the government's announced intention to help the stock market.

The first and most important aim of the Capital Markets Law is to develop standards of conduct for persons participating in the capital markets in order to create justifiable investor confidence in them. Keeping in mind that it is dangerous to generalize about the opinions or conduct of a group of persons, it may be ventured that the commonly shared standards of some Brazilian businessmen are not such as to encourage persons to entrust their savings to them. Few corporate directors seem to feel a sense of responsibility toward minority stockholders. Manipulation of stock prices is rather generally practiced, and some well established securities firms have sold shares to the public at prices several times the price quoted on the stock exchange. These and other practices have created a not unwarranted cynicism in many Brazilian investors. In fact, some securities men state that they would not dare recommend the purchase of corporate shares to their customers for fear of being regarded as unethical.

The real goal of the Capital Markets Law and the rules to be adopted thereunder is not merely to create legal norms and persuade or oblige company managements and financial institutions to obey certain rules of conduct, but to create an improved sense of fiduciary obligation and commercial morality, without which it is difficult to imagine broad public participation in the capital markets. While legal rules can lead

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98 See p. 1285 supra.

40 These observations are based upon many discussions with government officials, investment men, other businessmen and attorneys in Brazil. With regard to the manipulation of securities, for example, a Brazilian investment man referred recently to "the small circle of men who, on a short-term basis, make the prices at the stock exchange." Lemann, As Bastidores da Bolsa, Jornal do Brasil, June 12, 1966, p. 22. At a symposium on the capital markets of Brazil's Northeast, held in Salvador, Bahia, on May 11-12, 1966, an industry spokesman submitted several written questions to the President of the Central Bank, one of which was the following: "What control is the Central Bank exercising over the share-selling operations conducted by unauthorized firms, at prices markedly higher than the quotations on the stock exchange? This is a lamentable and notorious fact, which can endanger the capital markets, particularly in this region."
the way to this goal, they cannot by themselves create a shared set of ethical values. An American writer has put the problem well in discussing the obligations of corporate directors: "Responsibility, to the man who feels it, is not made clearer by legal subtleties. If he does not feel it, these legal subtleties are humorously innocuous."41 To induce a feeling of responsibility is an inherently difficult and long-range goal, and results can only be expected to come gradually, as businessmen begin to see the practical advantages of having honest, solidly based capital markets.

The developmental purpose of the program and the gap between business morality and the standards that are necessary for the existence of mature capital markets create special difficulties in formulating and enforcing these standards. The regulatory measures, if too far ahead of generally accepted standards, may inhibit rather than further market development. For example, if requirements of corporate disclosure as comprehensive as those of the United States securities laws were to be imposed, they would probably deter some companies from going to the capital markets for financing. To take another example, Brazilian investors generally prefer to purchase shares in bearer form in order to preserve their anonymity, to avoid progressive income tax rates, and to avoid including their shares in the "declaration of assets" required by the tax law.42 The abolition of bearer shares may be desirable in order to control manipulation and "insider" trading as well as to enforce the tax law,43 but such a step would undoubtedly discourage investment in corporate shares.

Of course, persons with experience in government regulation learn to expect, and to discount heavily, predictions that proposed regulatory measures will destroy the markets. Furthermore, some temporary setbacks may have to be accepted in order to achieve the long-range goal of raising standards of conduct. Nevertheless, government officials who have the task of developing the capital markets cannot entirely ignore claims that regulation, however reasonable and necessary, will hurt the markets. In each specific case, the question of "how much regulation" has to be answered on the basis of a careful appraisal of the situation and the probable effects of the measures proposed.

42 See L. No. 4069, art. 51, June 11, 1962 (Braz.).
43 Market surveillance procedures, such as those conducted by the Securities and Exchange Commission and the principal United States stock exchanges, occasionally include the identification of large purchasers and sellers of securities. This information is usually secured by making inquiries of brokerage firms.
The second basic purpose of the Capital Markets Law is to create and strengthen the institutions necessary for the successful operation of the markets. This role of securities regulation is practically nonexistent in the United States, where regulation has been employed principally to control existing institutions which have evolved in a process of natural growth through private rather than governmental decisions. In Brazil, the government has had to play a major role as a builder of institutions because of the need to eliminate obsolete legal restrictions which have been obstacles to the development of the markets, and because the Brazilian legal system tends to prohibit any institution or activity whose existence is not specifically provided for. Thus the Capital Markets Law includes provisions which would allow credit, finance, and investment companies to join the stock exchanges, provide financial assistance to the exchanges in modernizing facilities, and allow private development banks (which would, among other things, serve as a conduit for the funds of both foreign and local investors to enter the stock market) to be established.

44 This is not an uncommon problem in developing countries. See ADVISORY COMMITTEE ON PRIVATE ENTERPRISE IN FOREIGN AID, FOREIGN AID THROUGH PRIVATE INITIATIVE 28 (1965).

45 Cap. Mkt. L., art. 7 provides:

The National Monetary Council shall fix the general rules to be observed in the constitution, organization and operations of the stock exchanges, with regard to:

II— the number of brokerage companies which are members of the Exchange, and the requirements or conditions of admission with regard to the integrity, financial ability, and technical qualifications of their management, and the form of representation on the Exchanges.

In May 1966 the National Monetary Council published for comment a regulation covering the organization, membership, and operations of the stock exchanges, which would assure the admission to membership of any financial institution authorized by the Central Bank to operate in the capital markets.

46 "The Central Bank is authorized for a period of 2 (two) years from the coming into force of this Law, to give financial assistance to the Stock Exchanges, whenever, in its discretion, this is necessary to enable them to adapt to the provisions of this Law." Cap. Mkt. L., art. 9, para. 5. As of August 1966, this provision had not been implemented.

47 Cap. Mkt. L., art. 29. This provision was implemented by Resolution 18 of the Central Bank, which was adopted on February 18, 1966. By August 1966, three private development banks had been registered with the Central Bank and several others were expected to follow suit. The effect that these institutions will have on the capital markets cannot yet be estimated. The fact that the first three development banks are all closely connected with commercial banks, which have traditionally avoided long-term commitments, raises doubts whether they will be willing to take the kind of risks, particularly in the stock of small and medium-sized enterprises, that would make them most helpful in the development of Brazil's capital markets. If the government's plans for reviving the stock exchanges are successful, however, private development banks can be expected
A third purpose of the new law is to offer incentives to companies to issue their shares to the public. The statute provides favorable income-tax treatment to stockholders of companies with "open capital," a term that the National Monetary Council has defined by rule.

The Staff Problem

Brazil, like many developing countries, has a crucial shortage of trained manpower. This is particularly evident in the government, which has difficulty in competing with private industry for the inadequate number of persons with professional training, particularly those individuals who in the United States would be called "middle management." As a result of this shortage, the drafting of the Capital Markets Law and of the principal regulations has thus far been accomplished largely through the voluntary, unpaid services of lawyers and investment men outside the government.

The Capital Markets Law contemplates continuous regulatory supervision of the markets by the Central Bank, which has established a Capital Markets Section to exercise this function. Such an administrative system of control has certain potential advantages, including more effective enforcement of the securities laws and the opportunity for an expert group of administrators to act as a positive force in guiding and assisting the development of the capital markets. All of this presupposes, however, that the administrators can be found, and the Brazilian government appears to have devoted too little attention to this problem. In view of the limited size of the markets, the staff required at present would probably not have to number more than a few individuals; however, without this nucleus the regulatory program can hardly be implemented.

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44 See Cap. Mkt. L., arts. 55 & 56. These provisions give stockholders of companies with open capital the following advantages: (a) they pay 25% withholding tax on the dividends paid on bearer shares, compared to 40% for stockholders of companies with closed capital; (b) they pay no withholding tax on dividends paid on registered shares, compared to 20% for companies with closed capital; (c) they are allowed deductions from income tax amounting to 50% of the price of the registered or endorsable shares purchased and up to 600,000 cruzeiros of dividends paid, whereas no such deductions are allowed to shareholders of companies with closed capital.

Furthermore, companies with open capital are exempted from a 7% tax on distributed profits, with the result that companies with closed capital pay at a rate of 35%.

45 See Cap. Mkt. L., art. 59; notes 85-88 infra and accompanying text.

50 See note 52 supra.

51 For example, meaningful examination of applications for registration of new issues to begin involving themselves in underwriting and other stock-market activities. For later developments, see N.Y. Times, September 17, 1966, p. 33, col. 2.
The problem of staffing the government agency suggests that other methods should be used to supplement direct government regulation. Self-regulation by the stock exchanges, which has an honored place in the scheme of United States securities regulation, is contemplated by the Capital Markets Law. Self-regulation not only has the advantage of removing part of the regulatory burden from the government, but the goal of raising ethical standards can also be more easily accomplished by members of the securities business themselves. A suggestion made by a respected colleague is more likely to be accepted than one which comes from a bureaucrat. However, self-regulation is likely to be effective only if the stock exchanges or other self-regulatory agencies are under active supervision by the government.

Another method of enforcement not requiring significant agency manpower is to allow a person who is injured by misconduct in violation of the securities law to bring a civil action against the guilty party. Provision for civil liability relieves the administrative agency of much of the enforcement burden and at the same time may actually be a more effective deterrent against violation of the law than any fear of administrative action by a harried and understaffed government agency. Moreover, where it is not feasible to provide adequate enforcement by inspecting brokerage offices and investment firms, or by other continuous supervisory methods, it may be possible to encourage the public to complain of misconduct to the government. A relatively small staff of investigators could then follow up complaints which appear to have merit.

will require a permanent staff of lawyers, accountants, securities analysts, and examiners. The staff of the Securities and Exchange Commission is composed of such persons, together with administrative and clerical employees. See generally SEC, UNITED STATES SECURITIES AND EXCHANGE COMMISSION: ITS FUNCTIONS AND ACTIVITIES (1965).


This study contains an interesting discussion of the advantages and limitations of self-regulation. Id., pt. 4, at 993-97.

"Regulation in the area of securities should . . . be a cooperative effort, with the Government fostering maximum self-regulatory responsibility, overseeing its exercise, and standing ready to regulate directly where and as circumstances may require." Id., pt. 4, at 720.

The United States federal securities laws contain several civil liability provisions. See, e.g., Securities Act of 1933 §§ 11 & 12, 15 U.S.C. §§ 77k & 77 l (1964); Securities Exchange Act of 1934 § 9(e), 15 U.S.C. § 78i(e) (1964). Furthermore, the courts have held that there is an implied civil right of action under the anti-fraud provisions of the securities laws. See Kardon v. National Gypsum Co., 69 F. Supp. 512 (E.D. Pa. 1946); 3 Loss, op. cit. supra note 32, at 1757-1805. However, the practical value of civil liability in Brazil may be limited. See notes 56-74 infra and accompanying text.

See the discussion of the procedures of the New York Stock Exchange for handling public complaints in Special Study, pt. 4, at 522-24.
The Disclosure Philosophy

Like the Securities Act of 1933, the Brazilian Capital Markets Law relies heavily on disclosure in regulating the public distribution of securities. The statute does not deprive the Brazilian investor of "his inalienable right to make a fool of himself." It simply... [attempts] to prevent others from making a fool of him."57 Offerings of securities to the public by issuers, controlling persons, or financial firms must be made through a financial institution and must be registered with the Central Bank.58 The disclosures which must be made are to be specified by rule, and will presumably include financial statements certified by an independent auditor and information concerning the business and property of the company.59 There are no prospectus requirements, but all selling literature must be filed with the Central Bank, which may suspend the offering at any time if any of this material is false, biased or imprecise, or if the issuance of the securities is judged to be illegal or fraudulent.60 The Central Bank has no power, however, to prevent the distribution of securities on the ground that they lack merit.

The philosophy of disclosure, as opposed to substantive regulation, seems to have been influenced by the United States pattern of regulation and to have been adopted with a surprising absence of discussion. It is noteworthy that the Securities Act of 1933 was enacted only after an intense debate on the adequacy of disclosure as a means of protecting investors. The disclosure philosophy was attacked on the ground that

57 1 Loss, op. cit. supra note 32, at 128. It is noteworthy that, in a recent poll concerning the investment activities and attitudes of 1,000 Rio de Janeiro residents of above-average income, 25% of those who did not intend to purchase shares of corporate stock gave as their reason their lack of confidence in the issuing companies. IBOPE, SURVEY ON THE INVESTMENT HABITS AND CAPACITY OF THE CARIOCA (RIO) POPULATION (1966). An item that recently appeared in Time magazine illustrates the relationship between disclosure and investor confidence. It stated that European investors are attracted to Wall Street partly because they can get far more relevant information about U.S. companies than about indigenous corporations, even though European firms are becoming somewhat less secretive about their operations. Says a Bache salesman in Paris: "We can tell a Frenchman what we think General Motors will earn in the next quarter, but he normally cannot find out what a French company earned last year until sometime this summer—and then it probably won't be the right figure."

58 Cap. Mkt. L., arts. 5 & 21.
59 A proposed regulation has been drafted containing such requirements but as of August 1966 it had not been published for comment.
60 Cap. Mkt. L., art. 21, para. 3.
those needing investment guidance would either lack the intelligence or training to understand the financial reports and other disclosures, or would be "so concerned with a speculative profit as to consider them irrelevant." The decision to rely on disclosure may have been based partly on the fact that the Securities Act of 1933 expressly preserves the effect of state laws, many of which permit the securities administrator to refuse a permit to issue securities to the public if the offering is not "fair, just, and equitable."

The case against relying on disclosure may be even stronger in Brazil than it was in the United States. The reputed success of numerous fraudulent schemes, including the sale in the country's interior of securities of nonexistent companies, is testimony to the Brazilian investor's lack of sophistication in matters involving securities. Furthermore, Brazil has few professional investment advisers who could bring the required disclosures to the attention of investors in an easily understandable way. Moreover, it is not at all unusual for the underwriting and selling costs of an offering to exceed twenty per cent of the amount that the issuer actually receives. In some cases, the insiders of the company form a "holding company" which purchases the shares and sells them to the underwriters at a premium, for resale to the public at an even higher price. It is possible, however, that the Central Bank could prohibit such schemes under its authority to suspend fraudulent offerings.

Despite these disadvantages, regulation by disclosure may nevertheless be the most practical system for Brazil, assuming that methods can be found to bring the disclosures to the attention of the investing public. One regulation already proposed would require that participants in underwritings, as well as the stock exchanges, make accessible to investors and investment advisers material that has been filed with the Central Bank. A government program to educate investors concerning the requirements of the law and how they can protect themselves would also be helpful. The alternative to a disclosure system—to give the government the responsibility of passing on the merits of securities—would overtax the Central Bank's manpower resources and would subject companies seeking financing to an excess of red tape.

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61 Loss, op. cit. supra note 32, at 124, quoting Professor William O. Douglas.
63 See note 59 supra and accompanying text.
Protection of Minority Stockholders

Although the Capital Markets Law does not deal with the rights of minority stockholders, this matter is of sufficient importance to the development of the stock markets to deserve some discussion here. The Brazilian Company Law gives minority stockholders a number of important protections, including the right to inspect the company's books and records, the right to withdraw in the event of certain corporate changes, preemptive rights to subscribe new issues of securities, and the right to bring a derivative suit against directors.

It appears, however, that stockholders seldom avail themselves of these legal safeguards. Part of the reason for this is their ignorance of corporate matters and their habitual docility. Brazilian investors appear to be more interested in receiving an assured return on their investment than in protecting themselves against self-dealing by company management. It is this mentality that leads investors to prefer non-voting preferred stock over common stock and bills of exchange or other fixed-income securities over equity securities. Practical difficulties also prevent stockholders from enforcing their rights in court. Involved court procedures create lengthy delays and large legal expenses, and the Brazilian judiciary is often unfamiliar with the business background of the law. Thus the courts tend to have little interest in picking their way

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66 Decree-Law No. 2627, arts. 56 & 57.
67 Decree-Law No. 2627, art. 107.
68 Decree-Law No. 2627, art. 111.
69 Decree-Law No. 2627, art. 123. This section provides that a company may sue its directors "for losses directly caused to the company's assets" and if it does not do so within six months after the first stockholders' meeting after the losses are discovered, any stockholder may bring such suit on behalf of the company. See 2 Trajano de Miranda Valverde, Sociedades por Acces 926-32 (2d ed. 1955).
70 A notable exception to this quality of docility is Sr. Jose Vargas de Andrade, Jr., who is a minority stockholder of several large Brazilian corporations. Sr. Vargas has brought to Brazil the North American custom of asking embarrassing questions of company management at stockholders' meetings. For example, on March 31, 1966, he attended the annual meeting of Companhia Cervejaria Brahma, Brazil's largest beer and soft drink company, whose stock is a leading "blue chip" on the Rio de Janeiro Stock Exchange. Sr. Vargas inquired into the percentage of profits paid to company directors, an item that the Company Law, Decree-Law No. 2627, art. 136, requires to be stated in the profit and loss statement but which was not in the company's statement published for the six-month period ending December 31, 1965. It turned out that the directors' percentages of profits (aside from any dividends they may have received by virtue of being stockholders) amounted to 3,060,882,000 cruzeiros, or slightly more than the $ billion cruzeiros paid out in dividends for the same period. The financial reports and minutes of the annual meeting were published in Jornal de Comercio, March 22, 1966 and April 22, 1966.
through complex corporate transactions for the benefit of a complaining stockholder.

If the stock markets are to develop, the passive attitude of stockholders needs to be changed. Just as self-regulation is in many respects a more efficient method of control over the trading markets themselves than direct regulation by the government, self-protection by stockholders within the corporate framework is a more efficient method of protection against corporate abuses. One way of inducing Brazilian minority stockholders to exercise their rights and to take a greater interest in internal company matters would be to assure them representation on the companies' boards of directors. While the Company Law does not provide for cumulative voting for directors,\(^1\) it does permit a corporation to limit the number of votes of large stockholders.\(^2\) For example, the bylaws could provide that the holdings of any stockholder in excess of one hundred shares will have only one-tenth of a vote.\(^3\) It seems unlikely, however, that many companies have adopted provisions of this kind. A recent government-sponsored study suggests that a requirement that minority groups holding at least twenty per cent of the voting shares be represented on the board of directors would help to democratize Brazilian corporations and to reduce the concentration of control by small (usually family) groups.\(^4\) Such a step would have an advantage over the existing statutory protections afforded minority stockholders in that it would require that the voice of a substantial minority be heard in the management of a company.

It is possible that this reform could be effected, at least for companies whose shares are traded on a stock exchange, without the necessity of amending the Company Law. The Capital Markets Law requires that these companies register with the Central Bank and that the rules shall specify "the cases in which the Central Bank may refuse, cancel or suspend the registration."\(^5\) It is not clear what kind of rules this provision contemplates, but it would appear that companies could be required to provide representation of minority stockholders on their boards of directors as a condition of listing on an exchange. In fact, a proposed

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\(^1\) In the United States, 21 states require cumulative voting while 17 permit it if provided for in the articles of incorporation or by-laws. See LATTIN, CORPORATION 314-17 (1959).

\(^2\) Decree-Law No. 2627, art. 80.

\(^3\) See TRAJANO DE MIRANDA VALVERDE, OP. CIT. supra note 69, at 34-35.

\(^4\) O MERCADO BRASILEIRO DE CAPITAL 82.

\(^5\) Cap. Mkt. L. art. 26(II).
rule of the National Monetary Council contains such a requirement for stockholders owning fifteen per cent of the outstanding stock.\textsuperscript{16}

\textit{Regulation of the Markets}

Although the Brazilian trading markets for corporate shares have not been free from manipulation and other abuses, their principal problem is not lack of control, but lack of development. Extreme price fluctuations in stocks that are traded,\textsuperscript{17} and the failure of any trading market to develop in several issues that were sold to the public, have played an important part in preventing the growth of confidence in the stock markets. In view of the lack of effective corporate safeguards, a stockholder's most valuable right, as a practical matter, may be the ability to sell his shares at a reasonable price. The quality of the trading markets, in terms of the liquidity of securities, is therefore a matter of importance in the development program.

The system of trading employed on the Rio de Janeiro and Sao Paulo stock exchanges is not conducive to the development of the markets.\textsuperscript{18} During the daily trading session, the twenty-five active stocks that comprise the "principal market" are called out one by one, and the brokers, standing around a circular counter, shout or hand-signal their bids and offers. When a sale is made, a clerk in the center of the circle collects the order slips from the buying and selling brokers and sends them to a board where the transaction is posted. This system has several drawbacks, especially for stocks in which there is a significant amount of activity. Each stock can be traded for only a few minutes each day and an investor may not receive a report of his completed transaction until twenty-four hours after he gave the order to his broker. Moreover, the fact that all bids and offers have to be made within a short time causes confusion and could facilitate manipulation. Furthermore, any in-

\textsuperscript{16} This use of the rulemaking power of the National Monetary Council to change the requirements of the Company Law would be somewhat similar to the creation in the United States of "federal corporation law," through administrative rulemaking and court decisions under the federal securities laws. See Fleischer, \textit{Federal Corporation Law: An Assessment}, 78 Harv. L. Rev. 1146 (1965).

\textsuperscript{17} For example, between June 1962 and February 1963, the Rio de Janeiro Stock Exchange stock price average rose from 115 to 387; between March 1963 and May 1963, it fell from 368 to 243. O \textit{Mercado Brasileiro de Capitais} 62. Furthermore, in April 1966, a month during which prices were relatively stable, one stock traded on the Rio de Janeiro Exchange fluctuated between 480 and 768, while others had fluctuations of over 25%.

\textsuperscript{18} The trading system of the Rio exchange is described in the monthly magazine of the Getulio Vargas Foundation. See Conjuntura Economica (English-language ed.), April 1964, pp. 47-51. A few modifications have been made since the article was published.
crease in the membership of the stock exchange or in trading activity would increase these difficulties.

In May 1966, the National Monetary Council published for comment a regulation covering the membership, organization, and operations of the stock exchanges. This regulation would enable credit, finance, and investment companies, as well as other qualified financial institutions to join the stock exchanges, thus increasing the size of their membership and ending the monopoly of the hereditary stock exchange brokers. Once the regulation is adopted, it is expected that several such institutions will become members of the principal stock exchanges. Although the regulation does not prescribe any particular type of trading system for the exchanges, it does require that one of the objectives of every exchange be "to promote a system of trading that ensures price continuity and liquidity in the markets for securities." It appears likely that the two principal stock exchanges will eventually change (at least for the more active stocks) to a continuous auction method of trading, such as exists on the major American exchanges. In such a system, transactions can be executed throughout the trading session at "posts" on the floor of the stock exchange. If this occurs, it may well be that some of the more highly capitalized members will begin to act as professional dealers, performing the same function as "specialists" on the United States exchanges, standing ready to buy or sell certain stocks at all times and ensuring that there is always a market for such stocks at a price reasonably related to the previous price at which they were traded.

The Capital Markets Law seeks to assure investors that a share of corporate stock purchased on a stock exchange meets certain standards of quality. It repeals a statute which required that every corporation

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80 In late 1964, the Finance Minister had occasion to refer to "the necessity of the stock exchanges of the country to . . . evolve from the traditional trading system toward a continuous auction—the only method in which the investor will have ample opportunity and stimulus in the purchase and sale of securities—following the example of the stock exchanges in more highly developed financial centers." Minister of Finance Instruction No. 422, Dec. 10, 1964; see Conjuntura Economica (English-language ed.), April 1964, p. 10.
81 For a description of the trading system on the New York Stock Exchange, see Special Study, pt. 2, at 40-45.
82 In the United States, the major stock exchanges have standards for listing securities which take into account size, earnings record, distribution of securities, and compliance with disclosure and other requirements. See, e.g., NEW YORK STOCK EXCHANGE, COMPANY MANUAL A-10, B.3-4. Listed and certain unlisted companies are required by law to register with the Securities and Exchange Commission and to make a wide range of disclosures. Securities Exchange Act of 1934 §§ 12, 15, 14 & 16, 15 U.S.C. §§ 78l, 78m, 78a & 78p (1964).
register its shares on a stock exchange\textsuperscript{83} and substitutes a provision that only companies which comply with certain disclosure and other requirements may have their shares traded on an exchange.\textsuperscript{84}

Furthermore, the Brazilian government has used the tax-incentive provisions of the Capital Markets Law to encourage the creation of good trading markets for stocks. As stated above, the Capital Markets Law gives substantial income tax benefits to stockholders of "companies with open capital,"\textsuperscript{85} leaving this term to be defined by rule by the National Monetary Council.\textsuperscript{86} The framers of the definition appear to have been concerned with the failure of trading markets to develop in new securities and the weakness of the markets in existing securities.\textsuperscript{87} They therefore concluded that it would not be sufficient for a company to achieve merely a broad distribution of its shares in order to attain the status of a company with open capital—it's shares would also have to have "a high degree of negotiability."\textsuperscript{88} In part this decision was based on a concern that closely held companies would be able to evade distribution requirements by transferring shares to nominee accounts, and in part it represented an attempt to use the fiscal incentives provided by the Capital Markets Law to create trading markets in corporate shares.

Thus the definition, adopted in February 1966, has two principal requirements. First, a company with open capital must have at least fifteen per cent of its capital stock owned by at least 500 stockholders, each holding at least 100 and no more than 100,000 shares.\textsuperscript{89} Secondly, there must be a minimum volume of trading on a stock exchange in the shares of the company, amounting to at least eight million cruzeiros per week and forty million cruzeiros per month, and equal to at least one quarter of one per cent of the company's outstanding stock, with transactions occurring on at least one day of each week and five days of each month.\textsuperscript{90} Stockholders of companies that are trying to achieve these standards can receive the tax benefits on a temporary basis for a maxi-

\textsuperscript{83} Cap. Mkt. L., art. 19, para. 2. The Central Bank has postponed the effectiveness of this provision until rules governing registration of listed companies can be adopted.

\textsuperscript{84} Cap. Mkt. L., art. 19; see Cap. Mkt. L., art. 20.

\textsuperscript{85} Cap. Mkt. L., arts. 55 \\& 56; see note 48 supra.

\textsuperscript{86} Cap. Mkt. L., art. 59.

\textsuperscript{87} See text accompanying note 10 supra.

\textsuperscript{88} Central Bank Resolution No. 16, art. I, Feb. 8, 1966 (Braz.) [hereinafter cited as Cent. Bank Res.].

\textsuperscript{89} Cent. Bank Res., art. IV(a), as amended.

\textsuperscript{90} Cent. Bank Res., art. IV(b).
mum period of three years. After that time, the companies must meet all the standards. 91

While it is too early to know the results, a few comments may be made. The idea of offering fiscal incentives to companies to open up their capital to the public seems an intelligent and imaginative method of strengthening the capital markets. Combined with the current difficulty of Brazilian companies in finding alternative methods of financing, it should help to achieve a broadening of share ownership. From this point of view, defining "open capital" in terms of distribution of shares seems sensible. This type of criterion has been employed for many years by United States stock exchanges as a listing standard, on the theory that good trading markets cannot exist unless a certain degree of share distribution has been achieved. 92

Including requirements of trading volume in the definition, however, is open to criticism on several grounds. First, the fact that a stock is traded in the required volume by no means assures investors a good trading market. The goal is not merely volume of trading but liquidity—that quality of a market which enables a seller readily to find a buyer (or vice versa) at a mutually agreeable price. 93 Second, the attainment of trading standards depends upon the existence of a stock exchange which can provide a trading market in the security. Since the only active stock exchanges in the country are those in Rio de Janeiro and Sao Paulo, it will be very difficult for companies in other regions to qualify for the tax benefits. 94 Third, there are companies whose

91 Cent. Bank Res., arts. IV(b)-(c), VII, VIII & IX.
92 "In all instances . . . [these standards] include minimum standards of distribution and floating supply, but are not necessarily confined to those standards." Special Study, pt. 2, at 815.
93 Id., pt. 2, at 16.
94 The "open capital" provisions have received heavy criticism on this score from government officials and industrialists in the economically backward Northeast. See Address by Clidenor do Egito Araujo, Superintendency for the Development of the Northeast (SUDENE), in Salvador, Bahia, May 13, 1966. See also the written questions referred to in note 40 supra. In fact, all of the 16 companies that had met the "negotiability" standards by August 1966 were traded on one of the two principal stock exchanges and only one was located outside the industrialized South. Since companies with "open capital" themselves receive preferred tax treatment, an effect of these provisions is to place companies in the Northeast and other remote regions of Brazil at a competitive disadvantage with those located in the South.

I can attest personally to the inactivity of the regional stock exchanges. I attended a trading session of the stock exchange in Recife (Pernambuco), Brazil's third largest city and "capital" of the Northeast, in April 1966. No transactions in corporate shares were completed. The session lasted approximately ten minutes.
stock has fairly broad distribution, but whose shares are seldom traded, in some cases because their shareholders regard the stock as a long-term investment. Such companies will be in a worse position to qualify than a company whose shares are extremely speculative and have a high rate of turnover.

Perhaps the principal criticism of the measure, however, is that it gives companies and their principal stockholders an incentive to trade in their own shares. It thus unintentionally encourages artificial transactions and wash sales for the purpose of achieving the required volume of trading. Furthermore, such trading has a high potential for price manipulation and trading on the basis of information not available to public investors.

The government's direct attempt to create trading markets by giving incentives to companies and their stockholders seems to be a misguided effort, the disadvantages of which outweigh any possible benefits. It may well be that the creation of public markets in securities is a matter that a government can best approach obliquely, by encouraging the stock exchanges and their members to establish a system for the quotation of continuous markets and by giving companies incentives to achieve the broad distribution of securities that would make the existence of liquid trading markets possible.

CONCLUSION

The Brazilian program of securities regulation is an interesting experiment, which deserves the attention of all those concerned with capital markets in developing countries and with the interaction between law and economic development. It represents a conscious attempt to alter habits of investment and to build capital markets through the creation of high legal and ethical standards of behavior—a "climate" in which mutual confidence between company managements, financial intermediaries, and investors can exist. Although it is still too soon to estimate its success, I believe that it is already beginning to change the attitude of Brazilian investors toward the stock market, if only because the very interest that the government has shown is taken by many to mean that these markets have a promising future.

It would be a mistake, however, to overestimate the effects of regulatory measures on the markets. Until economic conditions in Brazil, particularly the rate of inflation, make the purchase of shares of corpo-
rate stock a practical course of action for investors, it would be unrealistic to expect that the markets will undergo a major development. When that day comes, the regulatory measures now being adopted will be valuable in providing a favorable legal and institutional atmosphere for the continued growth of the markets.