

Latin American White Paper on Corporate Governance

The White Paper on Corporate Governance in Latin America was developed in co-operation with the World Bank Group through a series of meetings of the Latin American Roundtable on Corporate Governance, an initiative involving senior regulators, policy-makers, investors, business groups and NGOs from countries throughout Latin America, as well as participants from the OECD and a range of other international organizations. The White Paper was developed through discussions over the course of four Roundtable meetings held in Brazil, Argentina, Mexico and Chile between 2000 and 2003. The OECD and IFC serve as Secretariat for the Roundtable, which also receives support from the Global Corporate Governance Forum and the Inter-American Development Bank.



WHITE PAPER ON

**CORPORATE GOVERNANCE
IN LATIN AMERICA**

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White Paper on Corporate Governance in Latin America

Foreword

Good corporate governance is critical to private-sector led economic growth and enhanced welfare that depend on increased investment, capital market efficiency and company performance. The OECD's work to support good corporate governance is carried out through Regional Corporate Governance Roundtables established in co-operation with the World Bank Group in Asia, Eurasia, Russia, South East Europe and Latin America. The Roundtables provide an effective framework for ongoing policy dialogue and a multilateral exchange of experiences. The approach is inclusive and consensus-driven, building on partnerships with key constituents in participating countries.

The White Paper on Corporate Governance in Latin America was developed by the Latin American Roundtable on Corporate Governance, a forum that brings together policy makers, regulators, business leaders, investors and experts from the region, as well as counterparts from OECD countries. Using the OECD Principles of Corporate Governance as a conceptual framework for analysis and discussion, the White Paper examines the importance of good corporate governance for the region, discusses trends and characteristics particular to the region, and sets out the Roundtable's recommendations and priorities for reform. Launched in 2000, the Roundtable developed this White Paper over the course of four meetings held in Brazil (2000), Argentina (2001), Mexico (2002), and Chile (2003), as well as through ongoing contacts between meetings.

The Latin American Roundtable and the process of developing the White Paper have increased understanding of the challenges and opportunities ahead, including the need for change. But the most critical phase of reform -- implementing the White Paper's recommendations and ensuring that they are enforced -- still lies ahead. To capitalise on the present interest in reform and to turn the White Paper recommendations into reality, efforts must intensify to design policies to achieve these recommendations, and to find ways to ensure their effective implementation.

Co-operation among policy-makers, regulators and private sector practitioners from Latin America as well as from OECD countries has been fundamental to the Roundtable's approach to achieving good corporate governance in the region. I would like to express my sincere gratitude to all of the Roundtable's participants, as well as to the Global Corporate Governance Forum, the Inter-American Development Bank and the national institutions that co-hosted the meetings on the White Paper. The OECD and the International Finance Corporation served as the Secretariat for this work, which was carried out pursuant to the Latin America Regional Programme of the OECD Centre for Co-operation with Non-Members (CCNM) in co-operation with the World Bank Group.

I look forward to the continuation of these co-operative efforts. This White Paper should serve as a basis for ongoing dialogue on policy design, implementation and enforcement, and to promote and assess further progress towards good corporate governance in the region.



Donald J. Johnston
Secretary General

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CHAPTER 1 - ABOUT THIS WHITE PAPER

1. This White Paper builds on the discussions of the Latin American Corporate Governance Roundtable, which is a regional forum for policy dialogue. The Roundtable is organised in close co-operation among the Organisation for Economic Co-operation and Development, the World Bank, International Finance Corporation and key regional partners from the public and private sectors. Participants in the Latin American Roundtable include senior policy makers, regulators, corporate leaders, investors, labour organisations, other non-government organisations and multilateral organisations with an interest and expertise in the area. The Roundtable process receives financial support from the Global Corporate Governance Forum.

2. At its first meeting in São Paulo, Brazil, in April 2000, the Latin American Corporate Governance Roundtable agreed to develop a Regional Corporate Governance White Paper. The purpose of the White Paper is to summarise common policy objectives and reform priorities. In developing the White Paper, the Roundtable has followed the structure of the OECD Principles of Corporate Governance, which the Financial Stability Forum has adopted as one of its twelve key standards aiming to promote stability in the global financial system. In addition to the five chapters of the OECD Principles, Roundtable participants agreed to also address questions of implementation and enforcement for inclusion in the White Paper.

3. The work to identify common policy objectives and reform priorities has been carried out with a view to concrete steps that can be taken to improve corporate governance and thereby increase investment, capital market efficiency, company performance and social welfare. The White Paper is intended principally for policy makers, regulators, and private standard setting bodies, including stock exchanges. Some recommendations are also directed to corporate executives, board members, individual and institutional investors and other professionals, whose decisions on a day-to-day basis determine the effectiveness of the corporate governance regime. More specifically, the White Paper is intended to:

- Give policy makers and private sector leaders, including international institutional investors, experts and multilateral institutions, an overview of the main issues and developments in the Latin America region, providing benchmarks for measuring progress;
- Provide a set of recommendations for reform to improve corporate governance in the region, for implementation by governmental authorities, multilaterals and private sector institutions; and
- Constitute input to the current assessment of the OECD Principles of Corporate Governance to be completed in 2004.

4. The White Paper is a non-binding, consultative document, developed on a consensual basis by an informal, but highly influential group of policy makers, regulators, market participants and other experts. In order to ensure maximum relevance, the White Paper was developed through an inclusive process, endeavouring to consider all constituencies with an interest and expertise in corporate governance. Its

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content was discussed during each of the meetings of the Roundtable (São Paulo in April 2000, Buenos Aires in March 2001, Mexico City in April 2002 and Santiago in May 2003) and participants were invited to provide comments during the periods between meetings.

5. Several national and regional organisations and groupings have issued guidelines, statements of best practices and recommendations for policy reforms. Also, individual companies and investors active in Latin America have developed policies that include the quality of corporate governance as criteria for their operations and investment decisions. The White Paper should be seen as complementary to these efforts.

6. The White Paper will be made available through Roundtable participants to key national policy makers, regulators, standard-setting bodies, relevant private sector institutions and civil society. It will also be submitted to all relevant multilateral institutions, for consideration by their respective governing bodies. The IFC and other Roundtable participants who are investors in the private sector will circulate the White Paper to their current and prospective investees in the region. The White Paper will be widely disseminated directly to the public, and posted on the Internet website of the Roundtable at www.oecd.org/daf/corporate-affairs/.

7. The work of the Latin American Corporate Governance Roundtable forms part of a global effort. Similar Roundtables are established in Russia, Asia, South East Europe and Eurasia.

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CHAPTER 2 THE IMPORTANCE OF GOOD CORPORATE GOVERNANCE FOR LATIN AMERICA

8. Good corporate governance is a crucial part of private sector-led economic growth in Latin America. It is recognised as a public policy concern of rapidly growing importance in the region, which relies on the private sector as an efficient vehicle for welfare creation. Privatisation of formerly state-owned enterprises has meant that Latin American countries increasingly depend on private sector corporations to create jobs, generate tax revenues and furnish consumers with goods and services. Employment generation, development of indigenous technology, and ultimately the international competitiveness of the Latin American economies must rest on a base of firms that do not suffer from cost of capital disadvantages, and that adapt sound management and corporate governance practices to domestic circumstances.

9. The impressive reforms of the public and private pension schemes in much of Latin America and their projected growth provide additional justification for giving special attention to the questions of good corporate governance and capital markets development at this point in time. The responsibility for providing a secure retirement for Latin America's working population has largely shifted to privately-managed pension funds, and a growing portion of these funds is invested in securities of publicly traded companies. The success of these pension systems is therefore dependent on the incentives for, and the ability of, fund managers to make the right judgements about the long-term competitiveness of the companies in which they invest, and the fair treatment of investors by those who control such companies. Assuring the maximum degree of transparency and internal and external accountability by publicly traded companies increases the likelihood that today's investment decisions by pension funds will pay off for retirees down the road.

10. The pension fund systems in Latin America are only one demonstration of how essential good corporate governance is for efficiently channelling savings to productive new investment. Good corporate governance plays a critical role in the process of building strong domestic capital markets – including the public securities markets, the banking and non-bank financing system and even private equity and venture capital sectors. It increases public confidence in the securities markets, which adds liquidity. It also helps to reduce uncertainty and increases the performance and prospects of institutional investors, including mutual funds and the insurance companies. Deeper, broader and more liquid capital markets serve the investment needs, not only of existing businesses, but also of tomorrow's new enterprises and industries.

11. An additional public policy concern relates to the internationalisation of financial markets, where good corporate governance is seen as an important building block in limiting financial turmoil and moderating volatility in today's global financial system. A transparent market environment for international capital flows enhances stability and serves as an early warning system and a buffer for corporate and financial distress. Hence the adoption by the Financial Stability Forum of the OECD Principles as one of its twelve key standards.

12. The past two years witnessed a series of high profile corporate governance failures in the United States and other OECD countries. These events contributed to a contraction in the public securities markets

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and triggered an array of public and private sector responses, aiming to restore market integrity and public confidence. An important lesson of this experience is that building corporate governance is always a work in progress, even in economies with a well-developed institutional framework.

13. Apart from its contribution to lowering capital costs, good corporate governance adds value to the corporation by providing more effective mechanisms for building competitive businesses. Proper checks and balances within the corporation provide for better strategic thinking and provide management with fresh perspectives and “reality checks.” Competent, experienced and well-selected company directors add real value to the decision-making of the firms on whose boards they serve. The benefits of good governance in terms of long-term value creation raises confidence among all stakeholders of the corporation. While improved regulations and better enforcement are important steps in the process of improving corporate governance, particularly in emerging market economies, such initiatives need to be complemented by the private sector’s awareness and active commitment. Business leaders must therefore play a prominent role in the public dialogue on corporate governance.

14. Much of the Roundtable’s work, like the public discussions of corporate governance in Latin America and around the world, focuses on the case of publicly traded companies and on non-listed firms with the potential in the short-term to go public. The Roundtable nevertheless recognises that good governance is an important concern also for non-listed companies, most of which will continue to rely on self-financing, private equity sources and the banking system for expansion and growth. Non-listed companies, often founder-owned or family-owned, must adopt sound accounting and auditing practices and appropriate checks and balances in strategic planning and management, if they are to remain competitive. This is particularly important in Latin America where the economic future of the region to a large extent will depend on the success of its small and medium-sized firms. Several of the recommendations made in this White Paper are also intended to have direct application to the case of non-listed companies.

15. Accordingly, it is not just investors in the *public* securities markets that have a critical interest in the proper administration and transparency of the companies in which they invest. Banks, private equity operations, specialised financial institutions and other sources of finance outside the public markets need to internalise corporate governance as a critical component of risk assessment and risk management. Failure to take adequate regard of the importance of corporate governance of borrowers (by both banks and their regulators) contributed to recent banking system crises in the region (and elsewhere) and continues to complicate bank/enterprise restructuring.

16. Finally, strengthening disclosure, transparency and accountability in private sector firms greatly increases the likelihood of success of the wide and varied efforts being undertaken in the region to contain official corruption and restore public faith in government. Many, if not most, cases of public corruption involve collusion between public officials and private sector participants acting in their capacity as executives, employees or controllers of private firms. Adequate checks and balances within the corporation, proper oversight of executive management by the board of directors, better internal controls and clear lines of accountability reduce the opportunities for managers and others associated with the company to involve the firm in incidents of public corruption.

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CHAPTER 3 - SOME REGIONAL CHARACTERISTICS

17. The participants in the Latin American Roundtable are confident that, in today's global economy, corporate governance is a topic that should be discussed and addressed not only at the national and global levels, but also at the regional level. The legal, economic, historical, political, social and linguistic commonalities within Latin America, and the growing regionalisation and internationalisation of the capital markets fully justify taking a regional approach to analysing current challenges and prioritising responses. Fruitful interchanges among the region's policy makers, securities regulators, stock markets, institutes of directors, investor groups and others have taken place both within and outside the context of the Roundtable meetings. Regional dialogue has served as a springboard for collaboration, technology sharing, and valuable collective undertakings. The enthusiastic support that public and private sector participants have shown for the Roundtable and other regional initiatives are ample testament to the value of regional dialogue and decision-making on corporate governance issues in Latin America

18. Even before the recent wave of international media attention to high profile corporate governance failures world-wide, this issue crystallised as a critical concern for policy in Latin America's four largest capital markets (namely Argentina, Brazil, Chile and Mexico). More recently, improving governance has emerged as an important public policy priority in the Andean countries, particularly in Colombia, Peru and now Bolivia, and throughout much of the rest of Latin America. Key shared characteristics of the economies in the region today shape both the responses of the corporate sector to rapid technological change and economic globalisation, and the challenges of corporate governance, including:

- Privatisation. Although the countries of the region have adopted a variety of different models to promote economic transformation and growth, the late 1980s and the 1990s clearly marked a shift in the division of responsibility between the public and private sectors. There is now greater consensus that the private sector must provide most of the goods and services demanded by citizens. However, the promise that privatisation held out for the development of broader and deeper capital markets, greater access to financing and lower cost of capital, has yet to fully materialise.
- Concentration of Ownership, Defined Control and the Need for Capital. Latin America's publicly traded companies continue to be characterised by a high degree of concentration of ownership. Even among the largest public companies, families more often than not hold controlling stakes. As in most of the rest of the world, family control remains the norm for most of the region's non-listed small and medium-sized enterprises. Clearly identified and actively-engaged majority shareholders can be a great strength for a company by ensuring active oversight of management and by providing a ready source of financial support to the company at critical junctures. However, if retained earnings and the financial resources of controllers are insufficient to meet the needs of growth, the challenge is to tap local and international sources of capital, and to adapt governance practices to satisfy the demands of outside sources of finance, without sacrificing the benefits of the alignment of interests of ownership and defined control.

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- Importance of Industrial Groups. The role that industrial, and sometimes financial/industrial, groups play in the development of privately-owned industry in Latin America is well documented. The key characteristics of such groups are common control and ownership of large firms in often unrelated industries, and sometimes close links, if not common control, between large industrial and financial sector enterprises. It is common for the profits of some group companies to serve as “cash cows” to finance the growth of more capital hungry enterprises in the group. Such groups developed in part as an effective means of financing capital intensive enterprises in the absence of efficient capital markets and well-administered legal systems (i.e., groups internalise capital markets). The economic (and political) importance of such groups, and their influence with important financial sector players can crowd out small and medium-sized companies’ access to public and even private capital markets. At the same time, the group phenomenon can stunt access to both domestic and international capital markets, even for large enterprises. The opacity that typically characterises intra-group transactions and the absence of independent-level firm decision-making are now increasingly seen as obstacles to cost-effective financing. In the course of the past few years, a number of groups have begun to unbundle their operations and more clearly separate the activities, financing and governance of group member companies. How groups re-orient themselves, and the mechanisms they put into place in response to calls for greater transparency and independent management of business lines, are important elements of the evolution of a market economy in the region.
- Restructuring of Banking Systems. The structure of domestic financial systems has changed dramatically in recent years in some of the largest economies in the region. State ownership has declined, and in some countries international banks have replaced domestically controlled institutions that were once closely linked to domestic industrial groups. At the same time, specialised financial intermediaries have come to play a more important role. These developments should bring with them the spread of a more modern credit culture and greater competition among sources of credit as well as among firms seeking finance in both the private and public markets.
- Regionalisation, Internationalisation, and the Importance of Multinational Enterprises. Even during the period of import substitution in the middle to latter part of the twentieth century, economic links with Europe, North America and Japan remained important. Multinational companies continue to maintain a significant presence in Latin America. Today, we are witnessing a new round of economic integration across borders, both within the region and beyond. Mercosur, NAFTA and other sub-regional groupings are important realities. It is hard to speak any longer of their member countries as completely independent economic units. The effects of regionalisation and internationalisation of product markets on cross-border industrial organisation are still “shaking out.” One dramatic aspect of this “shake out” is the series of consolidations and changes of control of major energy, telecoms, utility and financial institutions by trans-national enterprises. Side effects of this trend include the exit of some leading domestic blue chips from domestic and international public securities markets and the adoption by local subsidiaries of multinational companies of “hybrid” governance models that incorporate elements of the governance traditions and practices of both the host country and the country of the parent company.
- Limited Domestic Capital Markets and Growing Importance of Foreign Listings. The increasing internationalisation of industry and finance in Latin America has contributed to the recent shrinkage in the number of companies listed in domestic markets, as companies have de-listed and gone private. This comes at a time when domestic trading volumes are already under pressure as trading in shares of the larger regional companies continue to shift to the

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deeper depository receipt markets in New York. The transparency standards and substantive corporate governance practices expected by international markets are now also germane to Latin American companies dependent on such markets to raise new capital or maintain liquidity in their securities. In the aftermath of highly-publicised corporate governance failures, U.S. lawmakers, the U.S. Securities and Exchange Commission and the U.S. stock exchanges moved away from their traditional deference to local governance practices of foreign private issuers. Foreign private issuers were explicitly included within the coverage of 2002's Sarbanes-Oxley Act. Today, Latin American companies with American Depository Receipt (ADR) programmes are of necessity grappling with how to adapt their governance practices to comply with applicable requirements of the 2002 legal/regulatory reforms in the United States.

The shift in trading of blue chip firms to the international markets has called into question the viability of domestic stock exchanges and their contribution to national economies. How can stock exchanges that were built on blue chip trading volume now serve the capital raising needs of smaller companies that can not yet migrate to international markets? Markets throughout the region are developing their own responses. Bovespa's Novo Mercado initiative, along with changes in listing standards and the contribution of national exchanges to the development of voluntary codes of best practice, evidence an increasing recognition on the part of the exchanges that healthy mid-cap markets can only be built on a foundation of mandatory and voluntary standards that protect the rights of shareholders and encourage companies to adopt best practices of governance.

- Mandatory Privately-Managed Pension Schemes. The one set of domestic institutional investors that typically carries the most weight in the region is privately managed pension funds. The degree to which pension fund managers view promoting transparency and corporate governance as part of their mandate to maximise return for their clients will be an important determinant of the pace of improvements in the coming years. But the interest of fund managers in maximising returns for investors can not be taken as a given. Whether an individual fund manager takes an active interest in the good performance of individual investee companies depends on the set of incentives the fund manager faces, including the regulatory framework and the character and efficiency of the funds' own governance. Pension fund governance and accountability therefore remains an important public policy priority for the region.
- Legal Traditions and Enforcement Patterns. Countries in Latin America share a common legal origin – the European civil code tradition. But the legal/judicial commonalities within the region extend as well to the approaches taken to enforcement of laws and contracts. In general, the incidence of civil litigation is small in comparison to European and North American patterns, with greater emphasis placed on administrative and criminal judicial actions. Private dispute resolution mechanisms, such as mandatory arbitration, are comparatively new and largely untested.

CHAPTER 4 - THE REFORM PRIORITIES

19. Given that the economies, markets and companies of the region face a similar set of challenges, it is not surprising that the Roundtable has come to focus on a common set of issues that derive from these challenges. In focusing on these issues, participants have reached a consensus on the following priorities as most deserving of attention in most or all countries:

- **Taking Voting Rights Seriously.** Steps should be taken to facilitate shareholder participation in General Meetings and voting of shares. Institutional investors that in many cases have taken too passive a role should be encouraged to exercise their ownership rights in a more active and informed manner. If the legal framework allows shares with different voting rights, this needs to be fully justified and accompanied by commensurately stronger and more effective protection of minority shareholders.
- **Treating Shareholders Fairly during Changes in Corporate Control and De-listings.** The legal and regulatory framework must provide for clear and *ex ante* rules regarding how minority shareholders are to be treated when there is a change in corporate control. Improvements should also be made to ensure a fair, practical and predictable system for valuing the shares of minority investors in cases of de-listings or exercise of withdrawal rights.
- **Ensuring the Integrity of Financial Reporting and Improving the Disclosure of Related Party Transactions.** National accounting standards should be brought into compliance with International Financial Reporting Standards and the quality of the financial reporting process should be assessed with a view to eliminate conflicts of interest. The disclosure of related party transactions and potential conflicts of interest in such transactions should also be improved and supported by better information about corporate ownership and control structures.
- **Developing Effective Boards of Directors.** Laws and practices reflect that all directors, individually and collectively, should act independently in the interest of the company and all of its shareholders. There should be greater specificity concerning the procedural steps for fulfilment of the director's duties of care and loyalty and an explicit ambition by boards to clearly define their work procedures as well as those of special board committees. Boards should also improve their ability to manage conflicts of interest and ensure compliance with laws and ethical standards.
- **Improving the Quality, Effectiveness and Predictability of the Legal and Regulatory Framework.** Parallel to strengthening the capacity of rule-making and enforcement bodies, steps should also be taken to ensure that the framework supports effective use of private actions. Depending on the legal context, this may include the introduction of class action suits and mechanisms for alternative dispute resolution, such as private arbitration in the areas of company law and corporate governance.

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- **Continuing Regional Co-operation.** Roundtable participants and others with an interest in corporate governance in the region should continue to co-operate on a regional basis, with a view to monitoring the implementation of the conclusions and recommendations reflected in the White Paper, and to exchange experience that will help improve implementation and enforcement of national initiatives.

20. Consideration of these priorities needs to take into account the special economic circumstances of the region, in particular the persisting pattern of concentrated ownership and control. In addition, the Roundtable recognises that any adjustments in the regulatory framework should always be carried out after careful analysis of the costs and benefits of introducing new rules. The regulatory impact should be carefully assessed to avoid unintended negative effects that from society's perspective exceed the benefits and hamper economic activity.

CHAPTER 5 - RECOMMENDATIONS

I. The Rights of Shareholders

Taking voting rights seriously:

21. *When voting and dividend rights diverge, the regulatory framework for protection of minority shareholders should be commensurately stronger and more effective.*

22. Legal frameworks need to provide greater certainty in the relationships among the investors in the equity of an enterprise and the way the various organs of governance may exercise power. Legislative frameworks, stock exchange requirements and securities regulations need to weigh carefully the advantages and disadvantages of permitted forms of equity, and assess whether permitted forms of equity serve the long-run needs of companies and the capital markets. It should be taken into account that large differences in voting rights among the same class of shareholders may create incentives for those with disproportionate voting rights to take decisions that are not in the common interests of all shareholders. The most appropriate solution may be to mandate a one-share/one-vote requirement unless it can be demonstrated that sufficient checks and balances, effective legal protections and enforcement mechanisms are in place to ensure that the contractual and statutory rights of limited voting and non-voting shares will be adequately protected. Investors should also be diligent to understand the risks, and make effective use of their voting rights.

23. *Steps should be taken to facilitate effective participation of all shareholders in General Meetings and their ability to vote their shares – also across national borders.*

24. The regulatory framework and company practices should eliminate “red tape” concerning the information available to shareholders, their participation in General Meetings and the conduct of General Meetings, including those procedural formalities that can not be shown to serve an effective purpose in protecting the interests of the company or its shareholders. They should also provide for adequate notice periods and voting procedures for Annual and Extraordinary General Meetings of Shareholders, which take into account the time requirements for effective and informed cross-border voting. The legal framework, exchange rules and company by-laws should require the circulation of General Meeting agendas that provide sufficient details and background information about the matters to be addressed for shareholders to make informed decisions. Where “blocking” of shares prior to voting is still required, legislation and practice should move toward a record date system that does not penalise shareholders who wish to vote at the General Meeting. Procedures for shareholders to introduce matters to the agenda should be simplified.

25. The legal and regulatory regimes should encourage the development of smooth processes for proxy voting by providing custodians (including ADR depositaries and custodians) with explicit protection against legal liability if they comply with specified and reasonable procedures and carry out their duties without gross negligence. The absence of legal clarity can raise concerns over possible lawsuits that discourage such depositaries and custodians from revising their operating practices to encourage effective and timely share voting by beneficial owners.

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26. Where non-voting shares are permitted, the legal/regulatory framework and company practices should recognise the interests of the company in providing holders of such equity securities the opportunity to have their views taken into account in the company's decision-making process. Accordingly, under ordinary circumstances holders of non-voting shares should be accorded the same rights and treatment regarding notice of and opportunity to be heard in the General Meetings.

27. *The regulatory framework and company practices should be adapted to accommodate new information and communication technologies that improve and facilitate dissemination of corporate information and the execution of key ownership functions.*

28. Stock exchanges and companies should take advantage of new information dissemination technologies to provide shareholders and the markets with as timely access to required disclosures as possible. Securities regulators should review existing technical requirements to encourage the use of secure new information technologies, including requirements that inhibit the voting of shares or granting of proxies by electronic means. Companies should adopt new technologies where they permit shareholders to more effectively and efficiently carry out their functions as holders of equity securities.

29. *ADR programmes should provide ADR holders with the same rights and practical opportunities to participate in company governance as are accorded to holders of the underlying shares.*

30. The rights of ADR holders should include pre-emptive rights in new share offerings where such rights are granted to holders of the underlying shares. The systems established by companies, custodians and ADR depositories should be modernised to provide rapid dissemination of shareholder information to ADR holders and timely transmission of their instructions to shareholders meetings. National legislation in the country of the issuer, and the practices of custodians, depositories and clearinghouses should ensure that the proxy voting system functions equally well for ADR holders as it does for those who hold the underlying shares.

31. Blanket proxies to management to exercise voting rights of shares held as ADRs, and practices that similarly introduce a bias in respect of non-voted ADRs, should not be considered good practice and custody agreements that provide for such practices should be avoided.

32. *Legal provisions intended to provide minority shareholders with the opportunity to elect directors should be workable in practice.*

33. Where legislation provides for proportional director nomination, cumulative voting or other mechanisms to promote minority shareholder participation, voting systems should function in practice in a way that provides non-controlling shareholders with a realistic opportunity to collectively achieve a voice by influencing the composition of the board of directors. When the legal framework does not include provisions that provide minority shareholders with the opportunity to influence the board composition, other means, such as listing requirements and voluntary commitments among shareholders to achieve a proper diversity among board members could be considered.

Encouraging the emergence of active and informed owners:

34. *Governments, regulators and beneficiaries should insist that pension funds and other institutional owners have the incentives and governance structures that encourage them to exercise their ownership functions in an informed and effective way.*

35. The right regulatory environment and good governance practices encourage institutional investors to: (1) make investment decisions that are intended to maximise returns for shareholders; and (2)

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effectively exercise their fiduciary duties as shareholders in the companies in which they have invested the funds entrusted to them. The pension system regulatory regime and its supervisory system should provide pension managers with the appropriate incentives to maximise returns on fund investments. The priorities in this area may vary from country to country, but in each case policy makers, regulators and supervisory authorities should be vigilant to protect against the potential for conflicts of interest on the part of fund managers, or fee structures that set inappropriate benchmarks, or other aspects of the regulatory framework that cause managers to act in ways that do not maximise returns for investors.

36. Likewise, special attention needs to be paid to the management of investments of state-owned development banks (and their multilateral counterparts, such as International Finance Corporation, Inter-American Investment Corporation, Andean Development Corporation, etc.) and the effects of government-controlled finance allocation on governance. While direct state ownership of industry has declined, in several countries state-channelled resources and multilateral development bank financing remain important sources of long-term financing. Governments and multilateral development banks need to ensure that such sources of financing and guarantees insist on the highest standards of governance and transparency demanded in the capital market. Co-investment strategies, where public and private sector entities invest on the same terms, can provide a mechanism for ensuring a level playing field while encouraging the broader adoption of common governance standards by institutional investors of all types.

37. Objective evaluations of governance and transparency practices should be factored into the investment decisions of state-owned and multilateral development banks and affect pricing. State-owned and multilateral development banks should therefore consider policies that recognise the risk mitigation accorded by good governance practices by progressively improving the financing terms for clients as they meet objective benchmarks outlined in national codes or articulated in bank-specific or collectively-developed programmes.

38. *With a view to encouraging active and informed shareholder participation by pension funds and other institutional investors, outdated and unnecessary restrictions on the ability of such investors to exercise their shareholder rights should be removed.*

39. Pension funds, both private voluntary and privately managed mandatory schemes, are potentially the most powerful group of domestic investors with an interest in good corporate governance. Given the mandatory nature of some schemes, and the critical social function they perform, regulators need to be particularly diligent that companies that issue securities eligible for investment by pension funds are sufficiently transparent and well-governed.

40. At the same time, legislators, regulators and beneficiaries should recognise that existing shortcomings in pension fund governance and regulations that discourage competition in portfolio management (such as requirements that explicitly or implicitly require fund portfolios to mimic an index) limit the incentives for fund managers to put a high enough premium on transparency and governance. An appropriate policy response in such circumstances (and one with which there are a number of recent experiences in the region) may be to modify the legal investment regime – i.e., by permitting proportionally greater investment in companies that meet certain objective corporate governance and disclosure requirements.

41. *Institutional investors who act as fiduciaries should articulate their approach to the corporate governance of investees and their policies voting shares held in such companies and disclose these on a regular basis to the public and their beneficiaries.*

42. Institutional investors should provide as much detail as possible in the disclosure to their beneficiaries and the public regarding their standards for corporate governance of portfolio companies and

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their general policy concerning the execution of key rights, such as pre-emptive and tag-along rights. The disclosure on voting practices should set out the institutional investor's assessment of the costs and benefits of actively participating in corporate governance as a shareholder, and, for example, identify on what specific types of General Meeting agenda items it would ordinarily exercise its vote. Institutional investors should also disclose the process and procedures that they have in place to make decisions on how to exercise their voting rights, including their reliance on proxy advisory services and co-operation with other institutional investors to nominate board members. The purpose of this information should be to provide beneficiaries with an adequate basis upon which to make an informed judgment about whether the institutional investor is taking into account the risks of poor corporate governance in portfolio companies, and whether the institutional investor takes the opportunity to reduce risk and maximise return for beneficiaries by actively participating in governance as a shareholder.

II. The Equitable Treatment of Shareholders

Fair treatment in changes of control:

43. *The legal framework, supplemented where appropriate by the charter documents of the company, should provide, clearly and ex ante, how minority shareholders are to be treated when there is a change in corporate control.*

44. Improved predictability with respect to shareholder treatment during changes in corporate control will allow investors to make better informed investment decisions, increases the ability of markets to properly price traded shares, and should result in less overall volatility stemming from uncertainty and disappointment. Companies with minority shareholders should ensure the highest possible degree of transparency with respect to the economic and non-economic terms of any transaction that results in a change in control over the company. Details of all material contractual arrangements in connection with the sale of a controlling block of shares should be communicated to minority shareholders, including all fee arrangements (including with third parties) and non-financial arrangements, such as non-compete clauses and supply contracts among the buyer, the selling controller and officers and directors of the company.

45. Similarly, any tender offer regime should provide for full disclosure by all parties (including buyers, controllers, managers and corporate directors), director accountability, a single price and reasonable time for shareholders to decide whether to tender. Each member of the board should carefully consider the fairness of any offer, and formally communicate such director's opinion to shareholders. Recent legal reforms in the region indicate a clear consensus that mechanisms requiring partial or complete mandatory tender offers (including "tag along" rights) in the case of changes of corporate control facilitate equitable treatment and promote confidence and sound capital market development. Where existing law provides for different options, the charter documents of the company should remove any ambiguities.

46. *The legal framework should provide a clear definition of those events that fundamentally transform the nature for the company, or that are so potentially prejudicial to minority shareholders that they trigger the right of minority shareholders to withdraw from the company.*

47. The company laws of the region generally recognise that there are certain types of events, such as a transformation of the business purpose of the company, or a restructuring of its capital stock, that so fundamentally affect the relationship between the company and its shareholders that fairness requires that dissenting shareholders be permitted to withdraw from the company. National laws should be as explicit as possible about what types of corporate actions trigger withdrawal rights and provide as detailed a definition of these events as practicable. Where national law is unclear, or where leeway is provided under the company law, company charters should fill in the needed gaps.

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48. *The legal framework should provide a fair, practical and predictable system for valuing the shares of minority investors in cases of de-listings or exercise of withdrawal rights, which comes as close as possible to providing minority shareholders with their pro rata interest in the economic value of the company.*

49. Legislation, exchange rules and company charter documents have in practice failed to ensure equitable treatment of shareholders in cases of “squeeze-outs,” de-listings, and exercise by shareholders of statutory withdrawal rights. In such cases, the objective of policy should be to permit shareholders to secure the *pro rata* economic value inherent in their shares. While no method is perfect, those that rely on independent appraisal are superior to those that rely on historical capital, or easily manipulated market prices of illiquid securities. In the event of a “squeeze out”, a decision to de-list or an event that triggers statutory withdrawal rights, each member of the board should carefully consider the fairness of any such transaction to withdrawing shareholders, and formally communicate on the record their opinion to shareholders. Directors who are shareholders should disclose what actions they will take with respect to their own shares when more than one course of action is available.

III. The Role of Stakeholders in Corporate Governance

50. *The board of directors should ensure that reliable reporting structures are in place to provide familiarity and compliance among corporate officials with legislation related to the rights of employees and other stakeholders.*

51. It is important that certain rights that are granted to employees and other stakeholders in relation to the corporation, or in the governance process of the corporation, be recognised and respected, and that compliance be enforceable. Seeing that the rights of such stakeholders are respected in practice is a responsibility of company management, while the board of directors is responsible for vigilantly overseeing management’s efforts in this respect. This requires, among other things, that effective internal structures are in place to inform corporate officials about these rights and to hold them accountable whenever these rights are not respected. It should be the responsibility of the board to make sure that such information and reporting structures for compliance are established.

52. *Companies should consider on a voluntary basis to prepare and issue periodic reports on stakeholder relations.*

53. Corporate competitiveness is the result of teamwork with contributions from various resource providers, including employees. Shareholders may therefore have an interest in understanding how companies, beyond legal requirements, seek to develop such relationships in order to promote the future prospects of the corporation. Relationships with stakeholders other than employees, including local communities, are of importance. It is essential that such relationships are entertained with full integrity and pursued in a transparent way that makes the nature of commitments as predictable as possible. To the extent that national and international standards for disclosure of stakeholder relations gain acceptance, companies should employ them in their annual or other periodic reports. One example of such a benchmark is the Global Reporting Initiative.

54. *The board and management should encourage and facilitate the reporting of illegal or unethical behaviour.*

55. Illegal and unethical practices by corporate officers may not only violate the rights of stakeholders, but also be to the detriment of the company and the shareholders in terms of reputation effects and an increasing risk of future financial liabilities. Internal reporting structures and policies should therefore ensure that individual corporate officers do not use their position, for example as employers, to

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stifle stakeholder complaints by threats or illicit compensations. Companies are also encouraged to establish procedures and protections for employees and other “whistle-blowers” who make complaints concerning illegal and unethical behaviour. For example, some companies have established an ombudsman to deal with stakeholder complaints. Regulators may wish to establish confidential phone and e-mail facilities to deal with complaints. Procedures and protection for employee complaints can usefully be supported by a company code of ethics that in no uncertain terms formulates the basic values to which employees at all levels should adhere in their professional capacity.

IV. Disclosure and Transparency

The Quality and Integrity of Financial Reporting

56. *The legal and regulatory framework concerning the financial reporting process should be assessed with a special view to potential conflicts of interest of those involved, including external auditors.*

57. The annual report is the most important and comprehensive public information about the company. Efficient capital markets therefore require that the information is prepared, verified and disseminated in a correct and timely fashion. In this process it is important that the division of responsibilities among various company organs and external service providers is well defined and that their judgement and actions are not compromised by conflicts of interest.

58. *Standard setters for publicly traded companies should with all deliberate speed bring national accounting standards into full compliance with International Financial Reporting Standards (IFRS).*

59. Investors in publicly traded companies are entitled to financial information that is accurate, complete, comprehensible and comparable across companies. Increasingly, this means that investors, both domestic and international, need financial statements to be prepared in accordance with recognised standards that invite, rather than prevent, comparisons among companies in the same industries without regard to where they are located. Even where national accounting standards differ materially from IFRS, publicly traded companies should, on a voluntary basis or in compliance with listing rules, provide investors with statements prepared in accordance with IFRS.

60. *Financial reports should be audited by an independent, competent and qualified external auditor in accordance with high international standards.*

61. A critical step in the disclosure process is the external audit. Efficient markets and investor confidence require that the external audit is carried out in a professional manner that is free from any conflicts of interest that may compromise the judgement of the auditor and the quality of the audit. The legal and regulatory framework should strive to ensure auditor independence by including clear rules concerning rotation of audit firms and/or audit partners, disclosure of non-audit fees, and by prohibiting audit firms from providing certain services that clearly compromise their ability to carry out an objective audit. In all cases, the external auditor should be contracted for a limited and specified period. This contract may then be renewed after satisfactory evaluation of independence and performance. In the case of permitted non-audit services, the board of directors or the Audit Committee should be responsible for deciding that provision of such services by the external auditor will not compromise the quality or objectivity of the audit. For this reason, it is recommended that the company, for example, fully disclose all non-auditing services provided by the company’s independent external auditors to the company and its related parties. Shareholders are also entitled to know what portion of the auditor’s fees is represented by both audit and non-audit services to the company and affiliates. The ambition to improve auditor

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independence and accountability to shareholders is further reflected in the International Organisation of Securities Commissions (IOSCO) standard “Principles of Auditor Independence and the Role of Corporate Governance in Monitoring and Auditor’s Independence”.

62. It is also important that the development and implementation of audit standards is overseen by an effective body that acts in the interest of the public and is independent from the audit and accounting profession. In this respect, the IOSCO “Principles on Auditor Oversight” can serve as a useful guide on the required mechanisms for effective oversight.

63. Finally, it is important that the audit profession in Latin America meets the highest professional standards. Auditing firms that operate on a global scale and provide services to Latin American companies should therefore ensure that their practices in Latin America meet the quality standards that are applied in other, and more developed, capital markets.

64. *The company should disclose to shareholders all business relationships, and material provisions of contracts, with conduits of corporate information, such as rating agencies, investment banks and analysts.*

65. Companies, shareholders and others with an interest in the company rely on outside professional service providers for critical functions. Shareholders are entitled to have a transparent and reasonable basis upon which to assess the quality and objectivity of the advice received from such professionals. This can be accomplished only if the business relationships and material contract provisions with such professionals are disclosed to shareholders in a timely and complete manner.

Disclosure of Ownership and Control:

66. *The legal framework should allow for effective means to obtain information about beneficial ownership and control.*

67. Accurate information about ultimate ownership is essential for identifying potential conflicts of interest, related party transactions and insider trading -- transactions that may be to the detriment of minority shareholders. The authority and obligations of oversight bodies, custodians, financial intermediaries, other service providers and corporations regarding ultimate ownership and control of the company should be specified and enforced. Efforts should be made to improve co-operation among such bodies in order to identify significant beneficial owners so that regulations that depend on such information, for example those concerning related party transactions, can be enforced. A useful reference in this work is the OECD template “*Options for Obtaining Beneficial Ownership and Control Information*”. In a practical way, the template describes the suitability and effectiveness of three non-mutually exclusive options: 1) Up-front disclosure; 2) Imposing an obligation on service providers to maintain beneficial ownership and control information; and 3) Reliance on an investigative system. The template is structured as a tool for self-assessment regarding the suitability and effectiveness of these three options.

68. *Laws and regulations should make it clear that it is the responsibility of every listed company to disclose its ownership structure and that shareholders holding a specified portion of capital and votes respectively should disclose their holdings and report any changes in its ownership to the company, the stock exchange and the public at large.*

69. Transparency of a company’s ownership and control structure is necessary if present and potential shareholders are to assess their ability to influence the decision making process. Current and prospective shareholders should fully understand the identity of those with *de facto* control of the company

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and be able to identify what others have an economic interest in the company. In order for shareholders to vote their shares and exercise other ownership and economic rights in an informed and timely fashion, they should have immediate and costless access to shareholder lists.

70. *The legal framework and stock exchange rules should provide for full disclosure of shareholder agreements that could conceivably have an impact on how the company is governed or how other shareholders may be treated. Such agreements include understandings with respect to the exercise of voting rights, puts and calls, rights of first refusal, voting of treasury shares and powers of certain shareholders to nominate corporate officers.*

71. Shareholders are entitled to fully understand the mechanisms through which control over the company's operations is exercised. In many cases, agreements among controlling shareholders determine the ultimate power relationships in the firm and what divergences of interest may exist between controllers and other shareholders. Prospectuses and annual reports should be required to include a full statement of all material aspects of any existing shareholder agreements, and such agreements should be recorded in the shareholder registry and made available to shareholders at minimum cost. The legal framework should provide that shareholder agreements not disclosed in accordance with legal requirements and in the shareholder registry are unenforceable. Non-disclosure of shareholder agreements should also be subject to the same sorts of administrative and judicial sanctions as other failures to disclose material information to investors – but it should be the parties to the agreements, and not the company itself, that pays the penalty.

72. In carrying out their duties, members of the board of directors should be free to exercise their best judgement in the interests of the company and all shareholders. Accordingly, shareholder agreements should not in any way constrain the ability of individual board members to act. Provisions of shareholder agreements that purport to give the power to individual shareholders to instruct board members on how they should vote in the board should be null and void under national law. National laws that authorise shareholders to instruct the board members they appoint on how they should exercise their duties on the board should be repealed.

Conflicts of Interest and Related Party Transactions:

73. *The legal framework should require the company and controlling shareholders to identify all parties with whom controlling owners have a material business relationship relevant to the company, and to fully disclose all material related-party transactions.*

74. The legal framework should require full disclosure on a periodic basis of director affiliation and interests and total remuneration. Publication of such information should be included in the periodic reports of the company made available to shareholders.

75. *Companies should articulate and fully disclose their policies with respect to transactions that might raise concerns for minority shareholders because of potential conflicts of interest of controlling owners, directors and managers.*

76. Certain types of corporate activities involving potential conflicts of interest on the part of controllers and company management – including transactions with affiliated parties, lending to insiders, management contracts with controllers or affiliates and co-investment by the company in other ventures of the controlling shareholder – have come under special scrutiny by minority shareholders in Latin America. In response, companies in the region have begun to adopt special procedures for review of such transactions to ensure that they are conducted in the best interests of the company. These procedures may involve review by special committees of the board composed of independent directors, securing opinions of independent outside experts, and in some cases a requirement of minority shareholder approval.

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77. All companies should identify activities that present particular potential for conflicts of interest and clearly articulate their policies for how to ensure such conflicts do not result in transactions on terms unfavourable to the company. These policies should be fully disclosed to shareholders and the public. Certain types of transactions permitted under national law (e.g., lending by non-financial companies to insiders, controllers and their affiliates) may present so great a potential for real or perceived conflicts of interest, that the wisest company policy may be simply to prohibit them. In the case of permitted transactions, a useful approach may be to place the burden of proof on the company and the conflicted party to demonstrate that the terms of such transactions are in the interests of the company and all shareholders.

78. In the case of family-controlled public companies, company policies regarding the interaction of the company and the family (such as family-member employment in the company and family shareholding blocs) should be clearly explained and disclosed.

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

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

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

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

Temporarily Withheld or Reserved Information:

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

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

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Corporate Governance Policies:

85. *All listed companies should provide, at least on an annual basis, an updated report on internal corporate governance structures and practices. Such reports should be the responsibility of the board of directors, and where one exists, the governance committee of the board.*

86. Companies should report on the content of their existing policies, any changes made since the last disclosure, why such changes were made, the procedures for ensuring compliance, and an assessment of the company's compliance. Regulators and exchanges should require such disclosure, and where recognised standards exist, provide that the company describe the justification for any divergence from the practices recommended in such standards.

V. The Responsibilities of the Board

Board Integrity and Director Independence:

87. *The legal framework as well as generally accepted practices should clearly reflect that all directors, individually and collectively, should act in the interest of the company and all of its shareholders. Although the votes of individual shareholders or groups of shareholders may place a director on the board, this does not imply that such shareholders may control such director's behaviour as a board member.*

88. In carrying out its duties, the board should not act, or be seen to act, as an assembly of representatives for various constituencies. While individual board members may indeed be nominated or elected by a single shareholder or a group of like-minded shareholders voting together, it should be very clear that once they assume their responsibilities as board members, all directors are subject to the same duties as prescribed in company law, the company charter and other relevant documents. It is an important feature of the board's work that the duties of each board member, no matter how selected, are carried out in an even-handed fashion with respect to the interests of the company and all shareholders.

89. Charters of many companies provide for minority shareholders and others to nominate directors to the board. Indeed, this White Paper and many model codes recommend that mechanisms be adopted to ensure that minority shareholders have an opportunity to contribute to company governance by nominating directors. This should not be interpreted as an endorsement of "constituent" directors, but rather as a means of achieving the kind of diversity of experiences and outlook on the board that is desirable.

90. Charters and other relevant documents that permit shareholders to interfere with the exercise by directors of their duty to act in the best interests of the company and all shareholders in areas that are within the competence of the board should be avoided. Shareholders express their will and protect their interests through the exercise of their contractual and statutory rights, including participation in shareholders meetings, not by instructing directors on how to vote in the boardroom. The legal framework and company charters should not permit practices (such as "pre-meetings" and instructions on how to vote by shareholders whose votes placed a director on the board) wherein shareholders may limit the ability of directors to exercise their duties to act in the best interest of the company and all shareholders.

91. *In the case of companies controlled by a single shareholder or group of shareholders acting in concert, the board has a responsibility to ensure that the special role of the controlling owner is understood by other investors and to ensure that the relationship between the company and the controlling owner is conducted in a fair and transparent fashion.*

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92. In practice, controlling owners may indeed contribute valuable input, contacts and networks that benefit the board's work and corporate operations. When this is the case, it is nevertheless crucial that these relationships are well understood and communicated and that the compensation to be provided to controllers in exchange for such contributions is fixed when the contribution is made and not determined by the controllers later on at their own discretion.

93. *Greater specificity is required in the legal frameworks of the region with respect to the procedural steps directors should take to fulfil their duties of care and loyalty to the company.*

94. The legal frameworks of the region are reasonably clear that directors owe the company (and by extension its shareholders) a duty of loyalty and a duty of care. However, there remain gaps in the legal framework with respect to the specific responsibilities of directors in cases of extraordinary corporate events that require shareholder approval, such as changes of control, mergers, restructurings, substantial new investments, sales of critical assets, and related party transactions. Given the dearth of experience and precision in interpreting the duty of loyalty and care by courts in the countries in the region, lawmakers and regulators should favour "bright line" rules, which provide that certain specified events trigger well-defined procedural steps that directors are required to take. One of the key issues that such "bright line" rules should be designed to address is the information disequilibrium between controller, directors and managers on the one hand, and minority shareholders on the other. In such cases, the law, listing requirements-, and company by-laws should at a minimum require all directors to individually disclose any interests in the transaction under consideration, and to provide a signed written opinion to shareholders with their recommendations.

95. *To promote the integrity of the board, shareholders should endeavour to have a sufficient number of directors that are independent from management and controlling shareholders.*

96. Company management should see the board as a valuable resource. This requires that directors are willing and able to reach independent judgements and provide objective direction to the CEO and senior management. Importantly, independent directors can play a key role in some of the board's most critical functions, such as reviewing related-party transactions and overseeing the audit and internal controls. Relationships between directors and controllers do not automatically compromise directors' ability to exercise judgement independently of management, but it is generally in the interest of the company and all its shareholders if the board also includes directors that are neither executive managers of the company nor directly linked with controlling shareholders.

97. While progress has been made in the last few years, there is still much room for improvement in the practices of appointing directors who can contribute independent judgement. Since the objective criteria for "independence" may vary among countries and companies, depending on the patterns of control and affiliations with other companies, the definition of independence for an individual company can usefully be defined with reference to national codes, regulations or best-practice guidelines that reflect national circumstances. Regardless of how a company defines "independence", the shareholders need to be actively involved in the process of developing such criteria for independence.

98. A basic criterion in all cases is that corporate executives can not serve as independent directors. Several countries in Latin America already require the separation of CEO and Chairman of the board of directors, something that should be regarded as "best practice" also in Latin American jurisdictions where such a mandatory requirement does not exist.

99. In order to further strengthen the capacity and contributions by independent directors, the company may consider the possibility for independent directors to meet among themselves on a regular basis (i.e., apart from management and directors associated with controllers). They should also be able to

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count on adequate financial and professional resources to carry out their functions in an informed and professional manner.

100. Board practices and structures should reinforce the ability of individual board members and the board as a whole to act independently of management and controlling shareholders.

101. Improved board practices and structures, including standing committees, can increase the effectiveness and credibility of the board. Such improvements are particularly important when there is a widespread belief that directors affiliated with controlling shareholders, management or other interested parties will be biased in decisions that involve the interests of such parties. Every company should have a very clear policy setting out how its board will consider and decide matters which involve potential conflicts of interest. Such policies should be drafted taking into account the particular circumstances of the company's business, its ownership and management, and the composition of its board. Board policies should require directors with an affiliation with a party interested in a transaction under consideration to remove themselves from board discussions and voting. Where the nature of the company's business is such that such transactions are commonplace, the best solution may be to establish a standing "conflicts committee" of the board with clear terms of reference and composed of directors that are not affiliated with the involved parties.

102. Regulators and stock exchanges should take steps to accelerate the process of establishing committees of the board with at least a majority of independent directors to serve functions that may involve inherent conflicts of interest. Examples include the oversight of audits, remuneration and review of related party transactions.

103. World-wide, practices are clearly moving in the direction of a greater role for special purpose committees of the board of directors, particularly in the areas of audit and compensation. The content of national codes of best practice, and corporate governance policies adopted by important Latin American companies also reflect a growing consensus that special purpose committees can be an effective means of ensuring that the board does in fact carry out key functions, and of reassuring investors. Nevertheless, a majority of listed Latin American companies need to do more in order to develop effective committee practices.

104. In order to ensure clear lines of responsibility and accountability to the full board and, ultimately, to the company and its shareholders, only members of the board should be members of board committees. Members of board committees with responsibility for oversight of critical management functions and conflicts of interest should meet among themselves on a regularly-scheduled basis. Independent members of the audit committee should meet periodically with the company's external auditors without the presence of management. However, in the ordinary practice of meetings, key management figures, such as the Chief Executive Officer, Chief Financial Officer and those in charge of internal controls, can be expected to attend meetings of the audit committee.

105. When special purpose committees are established, their remit, composition, working procedures and principal activities should be formally documented and disclosed.

106. While the use of special purpose board committees has spread around the globe in recent years, there is still a fair amount of confusion in many jurisdictions concerning their legal status, responsibilities, composition, etc. In order for these committees to actually improve the functioning of the board and assure investors that they serve a meaningful purpose, their role, mandate, status and composition should be clarified and communicated to the market, including issuance of periodic reports to shareholders on their principal activities.

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107. *Policy-makers and regulators should review the experience with internal bodies of vigilance and revise the legal framework to reflect a realistic assessment of their future utility.*

108. Traditional internal bodies of corporate vigilance (e.g., conselhos fiscais, revisores fiscales, sindicatos, comisarios) may sometimes play a complementary role to the board in protecting the interests of particularly vulnerable minorities, such as holders of non-voting and limited voting shares. In such instances, policy makers and regulators should work to reinforce their effectiveness by providing them adequate authority within the company to exercise their duties in an effective manner. Companies need to provide such bodies with the resources required to fulfil their roles, and should communicate to shareholders both the remit of such bodies, and the activities they undertake for the protection of the company and its shareholders.

109. However, practitioners and legislators need to be realistic about the functions, responsibilities, and practical capacity of conselhos fiscais, revisores fiscales, sindicatos and comisarios. In many cases, board committees are likely to prove superior in protecting the rights of shareholders and ensuring long-term effective company management. In any case, the traditional internal bodies of corporate vigilance cannot be substitutes for, and may sometimes duplicate, the work of a well-functioning audit committee of the board of directors in overseeing the adequacy of the company's internal control systems and the integrity of its independent external audit. Because they are composed of directors with a direct relationship to the other members of the board and management, board committees can count on the resources of the board, and as directors involved in developing strategy and overseeing the business of the company, members of the audit or other special committee have greater access to management and information.

110. *Policy-makers and companies should carefully consider whether the benefits of permitting "alternate" or "supplementary" directors justify the potential risks to board effectiveness. Where a case can in fact be made for permitting such a class of directors, the legal framework and where necessary, company charters, should make clear what are the roles and responsibilities of directors that serve as "alternate" or "supplementary" directors, and what are the implications for "full" or "principal" directors. The existence of "alternate" or "supplementary" directors should never be allowed to dilute the incentives for all directors to diligently carry out their duties in the best interests of the company and shareholders.*

111. Many, if not most, jurisdictions in the region permit a company's board of directors to include both principal and alternate directors (or "suplentes"). Such directors generally are entitled to attend board meetings, but can only legally exercise their vote in the event of the absence of a principal director (often the principal director with whom that alternate was paired when selected by the AGM). In some cases, the distinction between principal and alternate directors is ignored in practice, with all directors equally involved in board activities and most if not all decisions taken by consensus. However, in other circumstances, the existence of alternates may reduce the intensity of involvement of principal directors, including their attendance at board meetings, at the same time as it sends a signal to alternates that they are little more than observers. The upshot can be less than sufficient involvement by both sets of directors. When such is the case, the legal framework or company charter should abolish the practice of alternative directors. In every case, shareholders and directors should clearly understand what is expected from alternate directors in terms of participation in the activities of the board, and their legal responsibilities vis-à-vis the company and shareholders.

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Developing a Culture of Effective Boards:

112. *All companies, whether listed or privately held, should develop and make available to shareholders a written set of policies that defines the role and working procedures for the board and its directors.*

113. An effective board of directors adds value to company operations across a number of dimensions. In order to achieve greater board effectiveness and provide shareholders with greater clarity as to how the board intends to carry out its responsibilities, it is important that the board members themselves actively engage in the formulation of their tasks and work procedures. One useful way of doing this is to develop a written document that can serve as guidance as well as a tool for evaluation. This document should be available to all shareholders. Relevant portions should be included in the annual report, which should also record the board's activities, the competencies of individual board members and their participation in board meetings.

114. *The board should ensure compliance with applicable law and seek to ensure that an ethical culture pervades the operation of the company.*

115. It is in the long term interests of a company not only to comply with the law but also to establish an ethical culture to govern its dealings on a day-to-day basis with its clients and its stakeholders. These goals might be furthered by the board developing, on a voluntary basis, ethical standards for the enterprise. Such standards could include as a reference elements of widely recognised instruments such as the *UN Global Compact* and the *OECD Guidelines for Multinational Enterprises*. As noted in the section on stakeholders, boards should also be encouraged to develop procedures and safeguards to protect "whistle-blowers," who report unethical or illegal activities within the company. Such reporting can be facilitated by providing such persons with confidential access to someone on the board, often a member of an audit committee or an ethics committee.

116. *Company charters and other relevant documents should set out director mandates, board sizes, board meeting schedules, director qualification criteria and board and director evaluation measures that increase the likelihood that boards and directors will have the capacity and willingness to carry out their duties.*

117. In order for a board of directors to function effectively, the members of the board should have a mix of professional and personal characteristics and they should meet an adequate number of times per year to review the company's operations, exchange views and make informed decisions. The optimal board size, meeting schedule and director qualification criteria will vary depending on the nature of an individual company's business, and can be expected to change over time as the company matures. However, experience has shown that boards that exceed 10-12 members may function less well. Companies and their boards have an obligation to carefully consider their policies in respect of the terms of office of directors, the size of the board and the qualifications required of board members. They should make these policies explicit and review and revise them periodically.

118. In addition, the boards of listed companies should undergo annual internal evaluations covering both the competencies and performance of their members as well as the board's functioning as a whole. The procedures for such evaluations may be left to the individual company but the company's statement on board responsibilities and work procedures as well as national codes of best practice can serve as benchmarks in the board evaluation process. Relevant parts of this evaluation can also be made available to the public.

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119. Open-ended or excessively long mandates for board appointments are inconsistent with the objective of ensuring that the board's membership includes the right mix of professional skills and personal characteristics. Likewise, the value of board and director evaluation is diminished if directors have lengthy terms of office. Accordingly, shorter terms for directors (one or two-year terms subject to re-election) are preferable.

120. Those who nominate and elect directors should ensure that nominees have adequate available time to devote to their responsibilities.

121. Individuals who exhibit the right professional qualifications may nonetheless be unsuitable for board service because their other obligations deprive them of sufficient time for their duties as directors. The legal/regulatory framework and company practice should at a minimum require that the pre-existing professional commitments of director nominees be disclosed to shareholders. Nominees should be required to update companies on whose boards they sit, and shareholders, of all significant time commitments they assume after election.

122. Companies should provide adequate information, and financial and other resources to their boards of directors to permit them to effectively perform their oversight role.

123. Timely, high-quality agendas and information from management are prerequisites for effective board performance. In addition, boards of directors and board committees occasionally require the services of independent outside legal, accounting and other expertise in order to effectively perform their oversight role. Boards therefore should be provided with the means to access a reasonable amount of the company's budget to contract outside such expertise, when a majority of its members determines it necessary. The budget provided the board for contracting such services, and its policies for when such services will be secured, should be fully disclosed.

Remuneration of Directors:

124. Directors should receive remuneration that: (1) adequately reflects the time, effort and experience they bring to the task; (2) provides reasonable incentives for performance that align the interests of directors with those of shareholders; and (3) does not compromise the ability of the directors to exercise independent judgement in the sole interest of the company and its shareholders.

125. Appropriate remuneration of directors is a key element of developing a culture of director professionalism. Lack of explicit remuneration, or token payment, discourages directors from devoting adequate time to their duties and may encourage them to extract compensation for their services in less transparent ways. Likewise, disguising special payments to insiders and others as directors' fees diminishes the credibility of the board as an independent and effective body acting in the best interests of the company and all shareholders.

126. Remuneration packages for directors may combine fixed payments with incentive arrangements designed to align the interest of directors with shareholders. However the optimal mix of fixed and incentive remuneration for different countries and companies will depend on a variety of factors including: available talent pool; legal framework; share liquidity; company prospects; market volatility; and macroeconomic conditions. Where directors in a listed company are compensated in part in shares, such shares should be of the same class as those that are publicly traded, to ensure alignment of interest between the directors and the public shareholders.

127. The company's procedures for proposing and approving the remuneration packages of directors should be transparent to shareholders.

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128. Shareholders are entitled to understand the factors that determine the ultimate composition and value of the remuneration of directors. Accordingly, boards should endeavour to make the process of setting director remuneration as open, transparent, professional and objective as possible. One useful way to accomplish this is through a standing committee of the board charged with periodically evaluating the company's director remuneration policies. Listed companies should make their director remuneration policies available to the public, and include in their annual reports the criteria upon which directors fees are set.

Improving Skills; Director Education:

129. Directors should be encouraged to undertake initial and continuous training that will improve their ability to carry out their board functions in a professional manner.

130. Representatives of the corporate sector, in association with other interested parties, such as securities exchanges, investor groups, etc., should encourage and participate in the design and dissemination of training programmes to promote director professionalism and capacity. Such programmes, provided by institutes of directors, business associations, academic institutions and others, can contribute to the development of a culture of director professionalism.

131. Quality director education programmes, whether delivered by institutes of directors, business associations, business schools or other professional educators play a key capacity-building role by increasing the pool of qualified, independent directors to serve on the boards of Latin American companies. Latin America is at a stage of reconsideration and re-conception of the role of the board of directors. More active participation in director education by experienced company directors and senior managers can help to steer the discussion in more thoughtful and practical directions and accelerate the adoption of best practices by companies.

Boards in Small and Medium-Sized Firms:

132. Chambers of commerce, other private sector groupings, banks and lenders, and, where appropriate, public authorities, should encourage the development of a culture of good governance and transparency among non-listed firms.

133. Non-listed companies (typically founder- and family-owned) have long played an important part in the development of industry in Latin America. In the next decades the challenge for such firms will be to modernise their financing, corporate governance and management practices to keep pace with their sometimes more agile global competitors. The future viability of the public securities markets in the region will depend on how well today's medium-sized firms prepare themselves to meet the expectations of investors with increasingly global access to investment opportunities. To advance this goal, the boards of such firms should develop a statement on the role of the board and evaluation of its effectiveness.

VI. Improving Compliance and Effective Enforcement

Effectiveness of Regulatory and Supervisory Enforcement:

134. In order to promote clarity and facilitate compliance, legislators and regulators should identify and remove any inconsistencies and contradictions in rules and laws affecting corporate governance.

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Efforts should also be made to achieve the most effective apportionment of powers and efforts among the courts, the supervisory authorities and private enforcement mechanisms.

135. As business practices and financial markets evolve, there is always a risk that existing rules and regulations overlap or prove inconsistent with more recent provisions. It may also be the case that laws and regulations in related or more remote areas may have an impact on the interpretation and effective enforcement of governance-related rules. Such overlaps may create uncertainty and inflict unnecessary costs for companies, investors and enforcement agencies. When introducing new laws and regulation, or revising existing provisions, it is therefore indispensable to devote the necessary time and resources to analyse the regulatory impact and possible unintended consequences. Effective enforcement also requires that the allocation of responsibilities for supervision, implementation and enforcement among different authorities is clearly defined so that the competencies of complementary bodies and agencies are respected and used most effectively.

136. The greatest possible degree of political and financial independence should be accorded to those regulatory and supervisory agencies that are responsible for rule-making and enforcement in the area of corporate governance.

137. It is the consensus of the Roundtable participants that regulatory and supervisory agencies, notably the national securities commissions, should continue to play an increasingly important role in the formulation, implementation and enforcement of corporate governance rules and regulations. The effectiveness of a regulatory or supervisory agency depends importantly on the public's perception of its ability to promulgate and enforce rules with objectivity and professionalism. Accordingly, such agencies should be insulated from undue political interference by ensuring them the greatest possible autonomy in carrying out their mandate. This will typically imply that political authorities do not indirectly influence the direction of their work through the budgetary process. Mechanisms that promote the budgetary stability and autonomy of agencies with rule-making and enforcement powers in the area of corporate governance should be established. This may include multi-year funding related to their present and predicted caseload as well as the introduction of user fees. Along the same lines, it may also include appointment of agency heads to fixed terms during which they may not be removed except for malfeasance.

138. As an immediate step, the resources and capacity of the regulatory and supervisory agencies should be made a public policy priority.

139. Credible administrative enforcement requires supervisory agencies to have sufficient resources to conduct timely, quality investigations. The volume of corporate governance-related cases that regulators and supervisors have been called upon to examine has increased dramatically in recent years and this ballooning of caseloads is expected to continue. However, the resources of such agencies have not grown commensurately. Unless the widening gap between caseloads and supervisory agency resources is narrowed, the credibility of the latter will diminish, and along with it, public confidence in the corporate governance system.

140. Consistent with the country's constitutional framework, the legal and regulatory regime should provide the regulatory and supervisory agencies with maximum powers to investigate and resolve cases in a fashion that fosters public confidence in enforcement and deters rule-breaking.

141. The legislation establishing the supervisory agencies charged with enforcement of corporate governance rules typically does not accord them as broad a set of investigative and enforcement powers as is permissible under the country's constitutional framework. To provide them with greater powers to collect and compel evidence in a timely fashion, including subpoena powers that do not involve lengthy recourse to the courts, is critical to the credibility of administrative decisions and their enforcement. Similarly,

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regulatory and supervisory agencies should be empowered to bring civil actions on their own initiative for the benefit of shareholders, without prejudice to such shareholders' own actions.

142. Agencies charged with enforcement need to have the authority to take meaningful action - both to prevent the most blatant of corporate governance abuses, and to settle cases whenever they are amenable to resolution through administrative means. Granting the supervisor the power to issue temporary injunctions in defined instances (such as in cases of challenges to the legality of actions taken during General Meeting procedures and otherwise where irreparable harm might ensue) enhances the credibility of the supervisor and the enforcement process. Likewise, the effectiveness of the supervisor is enhanced when it is empowered to settle cases through arbitration and mutual agreement (consent decrees).

143. The regulatory and supervisory agencies should be permitted to appear before the courts in civil cases involving shareholder rights, and submit advisory opinions which the courts should consider in reaching their determinations.

144. It is recognised that the judiciary in most or all jurisdictions in the region generally has insufficient familiarity with the evolving legal and regulatory framework for corporate governance. Permitting the regulatory and supervisory agencies to provide courts with their interpretation of the law in this area can facilitate timely and correct resolution of individual cases, and at the same time make the application of the legal and regulatory framework more consistent and predictable.

145. The capacity of the judicial system to deal with commercial disputes should be improved.

146. An efficient and predictable judicial system is a key prerequisite for achieving credible corporate governance and a well-functioning business sector. This requires sufficient resources, including compensation levels for judges and court personnel necessary to ensure the recruitment and retention of educated and experienced professionals who will perform their duties with the full integrity required of such positions, and with the continuity necessary to maintain a stable and predictable judiciary.

147. Training programmes should be enhanced to improve judicial understanding of commercial law, especially with respect to company law, securities law and bankruptcy law. Judges would also benefit from training in basic business and economic concepts that underlie such legislation, since the lack of such knowledge can result in an extremely literal application of legislative language that may be unreasonable in the context of normal business practices.

Private Rights of Action:

148. The legal framework should provide shareholders with as broad an array as possible of actions to protect their rights and obtain redress for violations of their rights.

149. A number of the recent legal reform efforts in the region have included expansion of the range of rights of action available to shareholders (including collective action through "investor associations"). This reflects a general disappointment with the legal tools currently at their disposal, most of which present severe technical and practical obstacles. Class actions, derivative suits, direct rights of action against *de facto* controllers, and rights to compel mediation and arbitration have all been topics of consideration. It is the consensus of the Roundtable's participants that the current framework for shareholder actions is inadequate in most of the region and that broadening the set of instruments available to shareholders and investor groupings will increase the likelihood that they will be able to achieve redress in the courts. It is also recognised that for such reforms to be successful, they need to be pursued with a close eye to country specific legal traditions.

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Improving the Variety and Capacity of Mechanisms for Adjudicating Disputes:

150. *The legal framework should contemplate and remove obstacles to effective use of private arbitration and other potentially efficient mechanisms for the settlement of shareholder disputes.*

151. Shareholders are entitled to adequate and efficient means of redress for violations of their rights. It is recognised that most courts in most countries in the region lack the technical expertise and experience to fairly and efficiently settle shareholder suits. Where qualified judges or specialised courts exist, they are unlikely to have sufficient resources to handle the caseload. Experience in OECD countries and the region indicates that private voluntary arbitration can provide an efficient and effective alternative. However, in order for private arbitration to work, national legal frameworks must provide for judicial recognition of arbitral awards without *de novo* review of the facts. Courts should also have streamlined procedures for enforcement of arbitral awards. However, private arbitration is not a substitute for strong judicial institutions, and arbitrators can encounter the same problems as the judicial system in identifying and interpreting the law. An active and consistent judiciary that contributes to the interpretation of the law through its rulings will also re-enforce the effectiveness and reliability of private dispute resolution mechanisms. Most importantly, the execution of arbitration decisions depends on the effectiveness of the judicial system.

152. *Stock exchanges and companies should encourage private arbitration of disputes between companies and shareholders by promoting professional shareholder arbitration panels and encouraging companies to include submission to arbitration in their by-laws.*

153. Dispute resolution procedures such as administrative hearings or independent arbitration procedures are emerging as an important and cost-effective alternative to the use of the courts system. The use of private arbitration mechanisms as an alternative to court litigation can reduce the workload of the judicial system and serve the business community by speeding up the resolution of commercial disputes, such as those involving minority shareholder disputes. If supported on a sustained basis with sufficient resources and a judicial system that ensures that its decisions are enforceable, private arbitration can provide an efficient, fair and predictable environment for resolution of commercial disputes.

154. *Cross-border co-operation in enforcement should be encouraged through the use of Memoranda of Understanding between and among enforcing agencies.*

155. Co-operation in securities law enforcement in the region, and between the countries of the region and OECD countries has been greatly facilitated in recent years by the negotiation of Memoranda of Understanding between national securities regulators. These Memoranda of Understanding provide a clear framework and procedures for sharing information and co-ordinating investigation that is tailored to fit within the respective legal frameworks of each country and the mandates and legal authority of their agencies. The coverage of Memoranda of Understanding between securities regulators should be expanded, wherever possible, to include co-operation in the enforcement of laws and regulations relating to corporate governance, and agencies other than securities regulators involved in the enforcement of the corporate governance legal framework should be included as parties to the Memoranda.

VII. Regional Co-operation:

156. *In order to enhance co-operation among countries and international organisations, the Latin American Roundtable should continue to facilitate Latin American access to the international corporate governance dialogue. Following the issuing of this White Paper, its efforts should focus on reviewing progress and supporting dialogue in the areas of policy design, implementation and enforcement.*

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157. In order to maintain and attract investment it has become increasingly important to assure domestic as well as foreign investors that corporate governance reforms are progressing in a consistent and irreversible manner. It is also important that countries are given an opportunity to explain to an international audience specific aspects of their domestic corporate governance system and pursue a dialogue on strengths and potential weaknesses. The Roundtable can help to reinforce reform efforts by reviewing progress and issuing periodic reports on these developments.

158. It is also important that the process of policy design, implementation and enforcement is viewed in an international context where an exchange of practical experiences and best practices will serve as important information for national initiatives.

159. In addition to the Roundtable participants, multilateral development banks conducting business in the region, national bodies and standard-setters with an interest in corporate governance should work together on a regional basis to implement the conclusions and recommendations reflected in the White Paper. Such efforts should also include representatives of the principal trade and financial partners of the region.

160. Parallel with the Roundtables, and with the support of Roundtable sponsors like the Global Corporate Governance Forum, pre-existing and newly-chartered institutes of directors and corporate governance advocates have begun meeting regularly to share expertise, training materials and business strategies with each other and with similar organisations outside of Latin America. This sort of co-operation between private sector initiatives with similar goals encourages the more rapid development of a corporate governance culture and expertise in the region, by permitting national groups to build upon the base of work already done by their counterparts in neighbouring countries. Non-governmental organisations with an interest in corporate governance, including national institutes of directors and corporate governance advocates, but also academic institutions, business groupings and others should continue the collaboration and expand joint training programmes and production and publication of specialised materials for directors and governance advocates.

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ANNEXES

Editor's note: The annexes to this White Paper are intended to provide factual background. They are published under the responsibility of their authors, as they have not been discussed or endorsed by the Roundtable's participants. Throughout the Roundtables, numerous papers and reports have been prepared by participants. These are available on the OECD website at www.oecd.org/daf/corporate-affairs/.

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ANNEX A: SUMMARY REVIEW OF LATIN AMERICAN CORPORATE GOVERNANCE INITIATIVES¹

161. Argentina. The Argentine capital markets reform was decreed into law and became effective in June 2001. The new law covers a broad range of governance issues, with provisions including: mandatory tender offers once 35% of shares have been acquired by a single shareholder or controlling group; procedures to ensure that minority shareholders receive a “fair price” in squeeze-outs and de-listings; majority independent audit committees; establishment of arbitration courts for the resolution of conflicts; and a greater role for shareholders through increased participation in shareholder meetings. In 2002, two existing private sector associations, FUNDECE and IDEA, jointly established the Instituto Argentino para el Gobierno de las Organizaciones (IAGO). IAGO aims to raise awareness of governance issues and provide director training.

162. Bolivia. In early 2003, the Bolivian government drafted a bill entitled the “Law on Governance of Stock Companies”. The bill is currently in the Bolivian Congress, but many companies have expressed opposition to its content. In 2002, the government enacted a law specifically for the “capitalised” public companies resulting from the privatisation process, which covers various aspects of corporate governance, including supermajority shareholder vote requirements for the sale of assets or realisation of major investments. The banking regulations now include various governance requirements for banks and certain other financial institutions, such as creation of audit committees, participation of directors on credit committees, regulation of activities of internal supervisors and rotation of external auditors. The private sector has not yet made any significant initiatives, although a Centre of Corporate Governance is being established.

163. Brazil. In the last few years, Brazil has seen a comprehensive and far-reaching set of corporate governance reforms and other initiatives. In October 2001, the reform of the Corporation Law was finally passed, after overcoming significant opposition in Congress. The reform strengthens minority shareholders rights and improves standards of disclosure, with improved laws on tag-along rights, de-listing, non-voting shares, election of board members by minority shareholders and private arbitration. In conjunction with this, there was also a reform of the CVM Law, giving the CVM (Brazil’s securities commission) greater functional and financial independence. Subsequently, during the course of 2002 and 2003, the CVM issued various regulations, which complemented these legal reforms. In July 2002, the CVM published its Recommendations on Corporate Governance.

164. In 2001, BOVESPA (the Sao Paulo Stock Exchange) launched three new market segments – the Special Corporate Governance Levels 1 and 2 and the Novo Mercado – with each market segment requiring progressively stricter standards of corporate governance. In very basic terms: Level 1 requires improved disclosure; Level 2 requires both improved disclosure and strengthened shareholder rights, including submission of disputes to a Market Arbitration Panel; and the Novo Mercado requires improved disclosure, strengthened shareholder rights, submission of disputes to the Market Arbitration Panel and the

1 . This annex does not aim to be comprehensive or exhaustive, but rather is intended to provide an indication of the range of recent corporate governance-related developments in the region.

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absence of non-voting shares. Currently there are twenty-eight companies listed on Level 1, three on Level 2 and two on the Novo Mercado. It is anticipated that all future IPOs will likely take place on the Novo Mercado and many private companies are contemplating listing on this market segment. However, the development of the Novo Mercado has unavoidably been held back by the stagnation of the Brazilian capital markets in the two years since the launch of the initiative.

165. Established in 1995, the Instituto Brasileiro de Governança Corporativa (IBGC) continues to grow with membership now at approximately 400 members, an increasing array of training and advocacy activities and with new chapters opening in Rio de Janeiro and Porto Alegre, building upon IBGC's activities in Sao Paulo. In April 2001, the IBGC launched its enlarged and revised Code of Best Practices. Several companies and pension funds have now launched their own corporate governance codes. From June 2003, new regulations from BNDES (the Brazilian national development bank) were proposed that would link their lending operations to improved standards of corporate governance, offering better financing terms to companies that meet various objective standards of good governance.

166. Chile. Chile was the first country in the region to undertake significant reforms to the legal and regulatory framework for corporate governance. In December 2000, the new Tender Offers and Corporate Governance Law was enacted. Subsequently, the Superintendency of Securities and Insurance (SVS) issued several complementary regulations, stating precisely how the new legislation should be understood and enforced by the SVS itself. The main provisions of the new law relate to: defining the circumstances and procedures for mandatory tender offers; stricter rules prohibiting insider trading; stronger enforcement powers for the SVS; reinforcing the role of institutional investors (particularly pension funds and mutual funds); expanding the possibility for exercising withdrawal rights; the creation of derivative actions as an alternative mechanism to assure enforcement; tighter regulation of related party transactions and conflicts of interest; and the obligation to create committees of directors (whose powers and responsibilities would include those usually associated with audit committees). The Chilean private sector has not yet undertaken any major corporate governance initiatives. However, with the encouragement of the SVS, two leading business schools are planning the establishment of a Chilean Institute of Directors.

167. Colombia. In the last few years, Colombia has seen various regulatory and legislative initiatives. In March 2001, Colombia's securities commission, the Superintendencia de Valores ("Supervalores") enacted Resolution 275. Resolution 275 establishes a legal obligation for issuers who intend to be recipients of pension fund investment to disclose their governance practices in some detail. In recent years, a series of draft laws have been introduced to reform the framework of securities regulation. During 2001, the government submitted a draft securities law, but this was subsequently withdrawn from Congress in July 2002 as a result of intense political pressures from, among others, some of Colombia's largest companies. Supervalores is now working on a new draft for the law project. The provisions of this draft legal reform would require the establishment of audit committees, mandate that a third of board members must be independent, require disclosure of related party transactions and require tender offers under certain circumstances.

168. Private sector efforts in Colombia have been led by Confecamaras (the Confederation of Chambers of Commerce). The Confecamaras Corporate Governance Project has organised numerous events to raise awareness of governance issues throughout the private sector, inviting companies, investors, the mass media and national and international experts to participate. In August 2003, the Colombian Corporate Governance Code for Listed Companies was published. This Code was drafted by a committee that included a broad range of private sector representatives, including the Colombian Stock Exchange, the National Association of Pension Funds, and the Chambers of Commerce of Bogotá and Cartagena. Overall co-ordination of this effort was provided by Confecamaras. In conjunction with the chambers of commerce of each region, Confecamaras has now developed a director training programme.

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169. Mexico. In April 2001, the Mexican Congress approved reforms to the Securities Markets Law, which went into effect in June 2001. The specific measures encompassed in these reforms include: granting the National Banking and Securities Commission the power to regulate tender offers in order to prevent the exclusion of minority shareholders from the benefits of these transactions; restrictions on the issuance of non-common shares; prohibition of issuance of “stapled shares” (where voting and non-voting shares are sold simultaneously), unless the non-voting shares are convertible into common shares within five years; requirements for independent members on boards of directors, appointment of board members by minority shareholders and the establishment of audit committees; stricter enforcement, with certain violations punishable as criminal offences; and changing the regulatory approach from a merit-based approach to a disclosure regime. A private sector institute for corporate governance, the Instituto Mexicano de Gobernabilidad Corporativa (IMGC) is being established, whose activities will include director training. The Business Coordinating Council (CCE), which sponsored the Mexican Code of Corporate Practices in 2001, also has a corporate governance initiative, which aims to promote awareness of governance issues within the private sector. Compliance with the Code is voluntary, but listed firms are obliged to disclose annually their degree of compliance.

170. Peru. In July 2002 the “Principles for Good Governance of Peruvian Corporations” was published. This initiative was co-ordinated by the Comisión Nacional Supervisor de Empresas y Valores (CONASEV) and builds upon the *OECD Principles*. The Peruvian Principles were discussed and endorsed by representatives of both the private and public sectors. From the private sector, leadership was provided by the National Association of Private Institutions (CONFIEP) and the Banking Association (ASBANC). From the public sector, CONASEV was joined by the Ministry of Finance, the Banking and Insurance Superintendency and the Lima Stock Exchange. The Asociación de Empresas Promotoras del Mercado de Capitales and the Centro de Estudios de Mercado de Capitales also supported the initiative. In July 2003, the Peruvian Committee on Corporate Governance was established, incorporating the Asociación de Directores Corporativos (ASDIC), experts and leading business schools in Peru.

171. Venezuela. In Venezuela the recent awareness-raising efforts have been led by the Asociación Venezolana de Ejecutivos (AVE), with support from various other associations and organisations, including the Centro de Divulgación del Conocimiento Económico (CEDICE) and the Instituto de Estudios Superiores de Administración (IESA). In July 2003, AVE launched a programme to disseminate knowledge about corporate governance issues and in August 2003 established an Executive Council for Corporate Best Practices, with the participation of a broad range of private sector and public sector entities, including the Comisión Nacional de Valores (CNV) and the Bolsa de Valores de Caracas (BVC).

172. Regional Initiatives: In addition to efforts undertaken by domestic groups, a number of institutions have also played an important role in advancing the corporate governance agenda regionally. In addition to the OECD and IFC, the Inter-American Development Bank (IDB), Inter-American Investment Corporation (IIC), the Andean Development Bank (CAF) and the Ibero-American Federation of Securities Exchanges (FIABV) all participated actively in the Roundtable process.

173. IFC, together with the OECD, serve as the Secretariat to the Latin American Corporate Governance Roundtable. In addition, IFC has provided technical assistance in connection with a variety of national efforts, including the legal and regulatory reforms in Chile, Brazil and Colombia. IFC seeks to implement the recommendations of the White Paper through its work with investee countries. The methodology IFC developed in Latin America for assessing and improving the corporate governance of clients is now applied, with appropriate modifications, on a global basis.

174. IDB will host a forum of high-level policy makers on the topic of corporate governance (at which implementing the recommendations of this White Paper will be discussed) on November 14, 2003. The IDB Group supports securities markets operations focused on introducing legal and regulatory frameworks,

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setting prudential norms, supporting professional training, establishing supervisory procedures and financial information systems, restructuring market oversight entities, modernizing accounting standards, auditing practices and information disclosure requirements, introducing corporate governance rules and legislation. The so-called “cluster” for Accounting and Auditing standards and information disclosure requirements of the multilateral investment fund represents a programme particularly relevant for disclosure and governance. The programme aims to improve the transparency of information systems and is being undertaken in 11 countries, i.e., Argentina, Bolivia, Colombia, Costa Rica, El Salvador, Guatemala, Mexico, Nicaragua, Panama, Paraguay, and Peru.

175. CAF has developed a Corporate Governance Initiative with the assistance of the private sector, government entities and academic institutions as counterparts within the Andean Region. The initiative includes the creation of an Andean Corporate Governance Network for the exchange of information. Its programme includes three components: 1) the design of a communications and information dissemination strategy on Good Corporate Governance Practices directed at small and medium-size enterprises, management and labour associations, the news media and academia; 2) the preparation of a regional guide of corporate governance principles and practices based on the OECD "White Paper"; and 3) a pilot programme which selects companies within the five countries in the Andean Region to receive special technical assistance in the implementation of corporate governance best practices.

176. The Council of Securities Regulators of the Americas (COSRA) has undertaken a programme of work initiated in 2001 with a stock-taking of the legal/regulatory frameworks throughout Latin America. This program was a key input into the work subsequently undertaken by the International Organization of Securities Commissions (IOSCO) on a world-wide level.

177. In April 2002 at the Mexico City meeting of the Roundtable, representatives from national groups working on director training in the region established the Network of Institutes of Corporate Governance of Latin America. With support from the Global Corporate Governance Forum (GCGF), OECD, IFC and the U.S. Center for International Private Enterprise, the Network provides a platform for sharing director training and corporate governance promotional materials and facilitates discussions among like-minded national organisations on institution-building strategies and approaches to legal/regulatory and private voluntary reform efforts. The Network has conducted a series of regular meeting since its foundation, and its members participated in August 2003 in the Corporate Governance Leadership Program organised by the GCGF and Yale University's International Institute of Corporate Governance. In addition to serving as a means for sharing resources, knowledge and experience, the Network has provided impetus for the creation of new national institutes throughout the region, with its membership growing from the initial three formal member groups, to now include representatives from Argentina, Bolivia, Brazil, Chile, Colombia, Mexico, Peru and Venezuela.

Sources. This Summary Review was written with the assistance and input of many individuals and groups throughout the region, including: IBGC, BOVESPA, Confecamaras, the Mexican Ministry of Finance, Asociación Venezolana de Ejecutivos (Venezuela), Cesar Fuentes (Peru) and Nabil Miguel (Bolivia).

ANNEX B: CASE STUDIES, LESSON OF RECENT REFORM EFFORTS

**The Politics of Implementing Corporate Governance Reform:
Some Lessons from the Chilean Experience**

Alvaro Clarke²

1. Background

178. The topic of corporate governance in Chile was relatively unexplored until 1997, when the so-called “Chispas” case drew public attention. This episode involved Endesa España, a Spanish utility holding company, and Enersis, the holding company of Endesa Chile, at that time the largest private electricity company in Latin America. In early 1997, Endesa España opened discussions with several executives of Enersis with the intention of consummating a strategic alliance in which Endesa España would take control of Enersis so it could control also Endesa Chile. Among these executives was the CEO of Endesa Chile and President of Enersis. The objective was to acquire the so-called “Chispas” stocks. The “Chispas” were a set of mini-holding companies, originally established as part of an employee stock ownership programme. Their sole assets were shares in Enersis. These shares represented 29% of the ownership in Enersis which owned in turn 20% of Endesa Chile. Each Chispa had two classes of stock, Class A shares that had almost 100% of the ownership but no voting rights, and Class B shares that represented little equity in the Chispas, but had majority voting power. Class A shares were owned mainly by a number of small shareholders and pension funds and Class B shares were in the hands of the above-mentioned Enersis executives.

179. Endesa España wanted to acquire both classes of shares and launched a tender offer to acquire Class A stock of the Chispas. The executives promoted among the shareholders the idea that the price offered by Endesa España for the Class A shares was a good deal, but several market participants expressed disagreement. Even though Endesa España was successful in acquiring the proportion of ownership needed, the operation attracted unusual publicity because of the large price differential between class A and class B shares (the latter being priced 1000% higher).

180. In October of that year, details of the acquisition strategy were made public by the press, because Endesa España had filed several documents with the U.S. SEC and the Spanish CNMV, explaining the terms of the agreement (Endesa España shares were publicly traded in both countries). Among these terms were payments to the Enersis executives linked to profitability goals, Endesa España’s right to appoint a parallel CEO in both Enersis and Endesa Chile and the possibility of Endesa España operating in the Latin

². Principal Partner, Clarke y Asociados, Former Finance Vice-Minister and Former Chairman, Chilean Superintendency of Securities and Insurance.

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American region without the participation of its Chilean partner. After these disclosures, the board of directors of Enersis, in which the only minority directors were those elected by the AFPs (Chile's pension funds), declared that the details of the alliance were unknown to them, and rejected it completely. The CEO was dismissed and Endesa España agreed to reconsider the agreement.

181. The main experiences of this episode were the asymmetric distribution of the control premium, evidenced in the different prices offered and paid to Class A and Class B shareholders of the Chispas, the capacity of shareholders with more negotiating power (i.e. Enersis executives) to obtain better prices for their shares, the disclosure of material information to foreign regulators while withholding the information domestically even though it critically involved a Chilean company, the lack of diligence of minority directors in controlling and monitoring managers, the subsequent squeeze-out faced by shareholders unwilling to tender their shares and, the power vacuum generated by ADR holders disabled by law to vote and elect directors.

2. The theory behind the reform

182. As a consequence of this episode, the Chilean government set out to design a new regulatory framework for corporate governance and takeovers. To assist in this effort, the Ministry of Finance and the Superintendency of Securities and Insurance called on International Finance Corporation (IFC) in order to have an external partner with recognition and experience.

183. The first task involved devising a theoretical framework that would support the entire design and subsequent debate of the bill. Therefore, two main areas in corporate governance were identified: the agency problem and the private benefits of control. The first involves the different incentives faced by managers in contrast with shareholders and the latter relates to the fair distribution of value among the different shareholders.

184. At that time, the main problem presented by Chilean corporations was related to private benefits of control, since the ownership structure is ordinarily rather concentrated.

185. The problem of private benefits of control itself can be decomposed into two areas: firstly, transfer pricing and misdirection of corporate opportunities; and secondly, the treatment of minority shareholders in the case of takeovers.

186. The issue of transfer pricing implies that managers and directors selected by the controlling shareholders (insiders) enter into agreements on behalf of the corporation with parties in which the controlling shareholder has a greater share of the equity or some other sort of economic interest. For this reason, it is not uncommon for companies' legislation and corporate charters to require shareholder approval of sales of all or a substantial part of corporation's assets.

187. The problem of misdirection of corporate opportunities is related to the capacity of controlling shareholders to appropriate for themselves commercial opportunities beneficial to the corporation. The classic case is when a potentially profitable business opportunity is proposed to the corporation and the directors elected by the controlling shareholders redirect the business toward another firm in which they somehow have a greater economic interest.

188. A number of mechanisms have been put in place in different contexts to deal with the problem of concentration and the resulting issues of transfer pricing and misdirection of corporate opportunities. Among them: the one-share one-vote principle, the reinforcement of the voting rights, the requirement of high quorums for shareholders meetings and the existence of pre-emptive and withdrawal rights. Some of

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them were already existent in Chile at the time of Chispas case, but others were included or reinforced in the new legislation.

189. A takeover is another type of mechanism through which insiders or controlling shareholders can benefit privately at the corporation's expense. Clearly, takeovers are efficient mechanisms to discipline the management and the new regulation was designed so as not to discourage them, although clear and defined procedures and rights were set.

190. Takeovers are carried out when the bidder believes it can extract benefits from the acquisition. Those benefits are related to the capacity to generate higher cash flows for the corporation (in that case the transfer is said to be efficient) or to the capacity to extract private benefits at expense of the corporation (an inefficient transfer).

191. When a takeover is initiated, the bidder offers to pay a price per share higher than the current market price with the expectation that its controlling position will allow the bidder and the new controller to create more value than the incumbent. A central issue is who is the beneficial owner of that differential, known as the "control premium". The central argument in the design of our reform was that a stock is worth the present value of its cash flows and therefore if the control premium is due to an efficient transfer, then it must be allocated equally among all shareholders. Similarly, if the control premium is due to an inefficient transfer (private benefits for the insiders), then it also must be allocated among all shareholders since those private benefits are extracted from minority shareholders.

3. The Reform

192. Having set the theoretical framework and the principles to be followed, the Chilean government drafted the Law on Tender Offers and Corporate Governance that included the following central topics:

193. Tender offers: A tender offer must be conducted whenever the acquisition allows one person or a group acting in concert to control the corporation. The price per share must be the same and prorated for all shareholders. Additionally, whenever its interest reaches two thirds of the voting shares, the controller is required to carry out a tender offer for the remaining shares. Also, when the intention is the attainment of the control of a subsidiary, a tender offer for that subsidiary must be made before tendering for the shares of the holding company.

194. Related party transactions: These transactions must be approved by the board of directors, those with an interest in the transaction are not allowed to vote, and be consistent with standards of fairness similar to those that normally prevail in the market. The option of an independent assessment (appraisal) is required in certain circumstances.

195. Auditing Committee: The creation of an audit committee is required for corporations with a stock value greater than U.S. \$45 million. The committee must be composed mainly by independent directors when possible, and its tasks are the examination of reports of independent auditors, executive compensation, related party transactions and other tasks established in the company's charter.

196. Derivative lawsuits: Derivative lawsuits were included to allow a shareholder or group of shareholders of a company, holding at least 5% of the company's shares, or any director of the company, to claim in the name and on behalf of the corporation, for compensation of the losses caused to it by anyone that has violated the Corporations Law, its regulations or the company's charter.

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197. Rights of ADR holders: ADR holders are allowed to vote at shareholders meetings, and to exercise withdrawal rights and pre-emptive rights³.

198. The new regulation on corporate governance resulted in a modern legislative regime in accordance with the current principles on this issue. As such, Chile has been highly rated by international entities in its degree of shareholder protection. For instance, the Santander Central Hispano bank rated Chile first among the major Latin American markets in shareholder protection; McKinsey&Company highlighted the low shareholder protection premium required for Chilean stock, implying reduced room for improvement; and the World Bank's Review of Standards and Codes (ROSC) report observed that Chile broadly complied with all of the principles on corporate governance set by the OECD.

4. The Politics of implementing a corporate governance reform

199. The Chilean government initiated the discussion of the draft law on Tender Offers and Corporate Governance in early 1998 and, in early 1999, the bill was presented to the parliament for discussion. Undoubtedly, it was a long and complex task, but a number of factors that affect the success of a reform on corporate governance were taken into account.

200. Circumstances: public opinion is importantly affected by the circumstances surrounding the discussion of regulation on corporate governance. For example, depressed stock markets and public awareness events influence public attention in the direction of regulatory action. The latter was the case in Chile, where the Chispas case reached such public notoriety that there was a broad consensus that some regulation must be erected relatively soon.

201. Interest groups: An important part of the initial opposition to some aspects of the bill was based on lack of adequate knowledge of the initiative. Some of the most common criticisms voiced were that the new regulation would imply an expropriation of value from current insiders, that it would deter foreign investment, that it would incentivise the de-listings of corporations or that it would merely imply greater costs for shareholders. Therefore, it was very important to initiate promotional efforts. That task was carried out by campaigning with the objective of reaching a critical mass of advocates to share their positive views with other market participants. In that sense, investors were especially active in advocating the reform. SVS⁴ organised meetings with top executives of pension funds, investment funds and foreign investors with entrepreneurs and legislators in order to convince these last of the benefits of the initiative. Political parties, of course, were central players in the process. The vision of the initiative had to be centred and balanced, since right-wing political factions would immediately oppose a bill with anti-entrepreneurship connotations and, on the other side, the centre-left parties would not support timid initiatives.⁵

³. The bill also included topics not related to corporate governance: The reform set the groundwork for the creation of an emerging market for small companies, the liberalisation of requirements for mutual funds (minimum equity, number of shareholders, participation in shareholders meetings, short sales and allowable investments), the creation of funds for qualified investors, the liberalisation of investment management for investment (closed-end) funds, the creation of stock options and the increase of resources for the Chilean Superintendency of Securities and Insurance.

⁴. SVS: The Chilean Superintendency of Securities and Insurance

⁵. At the time the reform was undertaken, the executive was represented by a centre-left coalition and the Congress had a balanced representation of government and opposition. To approve the bill it was necessary to create a majority in each chamber including votes from both the opposition and the governing political parties.

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202. With the passing of time, the principles underlying the proposed reform were understood by most of the parties and, most importantly, they were perceived to be fair. When people perceive that something is fair it gets difficult for them to oppose to it.

203. Ownership structure: Regulations protecting minority shareholders rights can face strong opposition from controlling shareholders. This happens to be the Chilean case where the major corporations are controlled by shareholders owning around 70% of voting shares. But that is precisely the reason why a reform was so important, since the development of a participative stock market requires clear regulations for all constituencies and especially for minority shareholders. These minority shareholders include institutional investors, like pension funds, mutual funds, investment funds and insurance companies, which are more sophisticated and are able to monitor their investments more efficiently, producing positive externalities to the market. These are particularly listened to by regulators and legislators. Recent privatisation experiences are also important. Legislators concern themselves with the protection of small shareholders and the governance structure of newly privatised companies.

204. Design of the bill: In Chile, the contribution of external advisors was important, since they helped to build a good theoretical base and enriched the discussions thanks to their experience in the implementation of similar regulations in other markets. The good name of recognised international organisations and people also contributed to promote the initiative. The presentation of the bill was rigorous and included theoretical discussions, international experiences and detailed analyses of cases and scenarios. Additionally, some consideration must be given to the inclusion of topics different from corporate governance. In Chile the bill on Tender Offers and Corporate Governance included a set of other instruments aimed at liberalising and promoting the capital market. That was an additional measure that contributed to add support to reform, because the bill had to be approved as a whole. Finally, the inclusion of a transition mechanism can be useful when facing reforms felt by some to be too radical if implemented at once. In the Chilean case, a three-year opt out provision was included.⁶

205. Integration with the world: The more a country is integrated with the rest of the world, the more necessary it is for it to adopt best practices, especially in the capital markets. When politicians and interest groups are aware of the need to attract foreign investment, the process of adopting better corporate governance rules becomes easier. In Chile, an important part of the argumentation in favour of the new rules was based on the need to reinforce access to foreign equity by improving the protection of overseas investors. Moreover, the adoption of shareholder protection rules is vital for national stock exchanges looking to reinforce their presence in the region. The Chilean stock exchanges understood that loose protection mechanisms would intensify the migration of Chilean corporations abroad.

206. Communication policy: The SVS relied heavily on the publicity of the bill in order to expose its vision of the reform and to put the topic of corporate governance firmly on the public agenda. The Chairman of SVS attended an important number of seminars and the SVS published a book, including the opinions of several leading academics in support of the reform.

207. Negotiations: The political position of the government was complex, since it was necessary to navigate between two different approaches, each associated with one political coalition. For instance, right-wing parties would not support a bill that from one moment to another would withdraw the control premium from the controlling shareholders. That was one of the final obstacles in reaching a consensus. Therefore, the government had to negotiate with these senators the possibility of a transition mechanism that would allow the current controlling shareholders to opt out from the regulation on tender offers for a

⁶. This is a three year exemption from the mandatory tender offer requirement for companies that opt for such exemption.

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period of three years. Harshly criticised by some congressmen of the ruling coalition, the opt out provision almost caused another important delay in the approval of the law. With hindsight though, there were no avalanches of takeovers, which was the effect that some opponents expected as a consequence of the passage of the reform. As this article is being written, the opt out period is about to expire and a definitive and sound regulation on tender offers will be fully in place soon.

4. CONCLUSIONS

208. If a bill on corporate governance is promulgated according to the basic principles on this issue, so it is not substantially changed along its way through the congress, we can say we were successful in creating a strong regulation on corporate governance. Also, success implies that reform must be understood, accepted and faithfully complied with.

209. In order to meet the proposed goals, a number of factors can play in favour or against and the government must be prepared to strengthen the positive aspects and to deal with the adverse ones. These factors include: (a) the circumstances that chronologically surround the discussion; (b) the existence and weight of interest groups; (c) the degree of integration of the market with the rest of the world; (d) the communication policy; and (e) the process of negotiations among the parties.

210. Public opinion is affected by the prior events and by the way these are informed and interpreted by the media. The public influences the legislators, who are also influenced by other groups with different interests. It is important to co-ordinate alliances with institutional investors so these can turn into active promoters of the reform, not only toward legislators but also toward the parties against it.

211. In the design of the bill, the existence of a solid conceptual base is of fundamental importance. A solid framework for analysing and discussing the problem presented inevitably leads the debate in constructive directions and, at the same time, away from partial considerations or from power battles.

ANNEX C: OWNERSHIP STRUCTURE AND CORPORATE GOVERNANCE IN LATIN AMERICAN COUNTRIES – AN EMPIRICAL OVERVIEW

Fernando Lefort⁷

I. Introduction

212. This annex provides a brief review and comparison of ownership and control structures, including board composition, of Latin American companies. It builds on recent empirical and descriptive articles on corporate governance in Latin American economies. This annex also presents new information based on data from ECONOMATICA⁸, annual reports from various companies and the 20-F forms filled with the SEC by Latin American companies listed in US markets (ADRs).

213. The most important challenge to be faced in preparing a review and comparison of this type is the poor and dissimilar quality of information among different countries. Information on listed companies is also incomplete due to a scarcity of empirical research at the country level and differing legal requirements about ownership disclosure. There are no region-wide papers on ownership structures in Latin American economies, and only the cases of listed companies in Brazil and Chile have been studied in some detail at the country level. The region also presents important disparities in ownership disclosure requirements. In most cases, notably Mexico and Argentina, not even listed companies are required to disclose full ownership structures, while in others ultimate ownership is difficult to assess because of the prevalent use of holding companies as ownership vehicles. In many cases, the only reliable information is that reported in the 20-F forms filled by large Latin American companies listed in the US markets. Finally, there is no systematic information available on ownership and control structures of non-listed companies.

214. Despite these difficulties, it is clear that two main features characterise the ownership and control structures of most companies in Latin America. First, these companies present a very high ownership concentration. Second, many firms are directly or indirectly controlled by one of the numerous industrial, financial and mixed conglomerates that operate in Latin American economies. A conglomerate is a group of firms linked to each other through ownership relations and controlled by a local family, a group of investors acting in concert or, as has recently become more frequent, by a foreign company. Usually, conglomerates are controlled by the dominant shareholders through relatively complex structures including the use of pyramids, cross-holdings and dual class shares.

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⁸ ECONOMATICA is an Investment Analysis Data Base that provides financial and market information for listed companies in Argentina, Brazil, Chile, Colombia, Mexico, Peru and Venezuela.

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215. High ownership concentration and conglomerate structures also importantly affect board room composition. Most board members in Latin American companies are related to controllers through family ties, friendship, business relationships and labour contracts.

216. The ownership structure of Latin American firms presents other interesting features. Despite massive privatisation of state-owned companies, the state is still an important shareholder in many large companies throughout the region. In addition, in many cases, the privatisation process importantly shaped the configuration of the ownership and control structures of the privatised companies.

217. Pension fund reform in the region has also had an impact on ownership and control structures in Latin America.⁹ Directly, pension funds are important minority shareholders in many companies in the region and elect members to their boards. Indirectly, pension fund reform has triggered capital markets and corporate law reforms which have contributed to overall improvement in corporate governance mechanisms.¹⁰

218. Finally, Latin American capital markets have recently experienced a wave of mergers and acquisitions where ownership of flagship domestic companies has been transferred to foreign companies. In addition, during the last 10 years many of the largest Latin American companies have been on North American markets through the ADR mechanism, while domestic trading has contracted, presenting lower turnover ratios and a very low level of new equity issues.

II. Ownership and control structure and identity in Latin America

219. This annex examines ownership structures and board practices in six Latin American economies. Table 1 presents selected capital market indicators of these economies. In order to have a rough idea, consider that while the level of annual per-capita income varies from US\$2,000 (Colombia and Peru) to US\$5,000 (Mexico), the ratio of market capitalisation to GDP varies from less than 20% in the case of Argentina to more than 100% in the case of Chile. As we have already mentioned, all six economies present a low turnover ratio with Colombia's the lowest (1%) and Brazil's and Mexico's, 12% and 13% respectively. The number of listed firms ranges from 459 in Brazil to 74 in Colombia.¹¹

I. Ownership concentration

220. La Porta et al. (1998) clearly document that, in most developing economies, there is a high level of ownership concentration. A simple measure of ownership concentration can be obtained by looking at the percentage of shares held by the largest shareholders of a set of companies. Table 2 provides such a measure for the single largest, the three largest and the five largest shareholders for a comprehensive set of listed companies from ECONOMATICA in Brazil, Chile, Colombia and Peru, and for the subset of ADR issuing companies in Argentina and Mexico. The evidence is clear. The largest single shareholder in these firms holds, on average, 53% of total shares, and the five largest shareholders add up to almost 80% of total shares. This evidence probably underestimates actual ownership concentration for two reasons. On the one hand, the large firms considered in the sample tend to be less concentrated than smaller firms and, on the other hand, usually several of the five largest shareholders represent, in fact, the same beneficial owner.

⁹ See Walker and Lefort (2001).

¹⁰ See Walker and Lefort (2001) and a more detailed explanation below.

¹¹ Figures from ECONOMATICA.

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221. This is not, however, the only evidence available of the high level of ownership concentration in Latin American firms. Empirical evidence derived from slightly different samples of companies supports the results reported in Table 2 of this annex. For the case of large and listed Argentinean corporations, Apreda (2001) and de Michele (2002) report that among the 20 largest listed companies, controlling shareholders hold 65% of equity. In the case of Brazil, Leal et al. (2002) find that, on average, the five largest shareholders of a typical Brazilian firm hold 58% of total capital. Similar results are found in Lefort and Walker (2000c) for listed firms in Chile. They report that the five largest shareholders hold 80% of shares. Finally, Babatz (1997) confirms our findings on ownership concentration in Mexico. The largest shareholder owns 65% of company shares of the average listed company, and 49% in the case of ADR-issuing firms.

2. *Ownership and control structure*

222. The very high levels of ownership concentration described above clearly imply that, in Latin American firms, corporate control is tightly exercised by majority shareholders. Therefore, a focus of the corporate governance concern in the region is possible divergence of interest between majority and minority shareholders. Such divergence of interest can be exacerbated by the use of structures designed to separate control rights from cash flow rights. In this sense, an important feature of corporate control structures in the region is the widespread presence of industrial, financial and mixed conglomerates. A conglomerate is a relatively complex corporate structure used by a common owner or group of owners in order to control a wide variety of assets belonging to different listed and non-listed firms. Controllers of Latin American conglomerates use these devices, among other things, to separate ownership from control through pyramid structures, dual class shares and cross ownership.

223. The identity of controllers has been changing during the last few years. Although domestic families are still very important players, control has been passing to teams of executives and to foreign companies. In most cases, the only relevant minority shareholders are institutional investors both domestic and foreign. Tables 3 and 4 present evidence regarding the identity of controllers in large listed Latin American companies, the degree of affiliation to conglomerates and the extent of the separation of cash flow and control rights. The tables were constructed using a variety of sources that are detailed below.

224. Although conglomeration is the most pervasive form of corporate structure in Latin America, different Latin American countries present different patterns of conglomerate control. Apreda (2001) and de Michele (2002) provide a simple description of ownership structure in large listed Argentinean corporations. As we already mentioned, they report that among the 20 largest listed companies, controlling shareholders hold 65% of equity. The identity of controllers has dramatically changed in the last 5 years with foreign ownership increasing dramatically. Considering the 40 largest listed Argentinean companies, 25 are foreign controlled, 14 are controlled by a local family and there is only one state-owned company. Although pyramid structures are widely employed in Argentina, no precise measure of the extent of this practice is available economy-wide. Khanna and Yafeh (2000) detect 11 conglomerates participating in the ownership of large listed Argentinean firms. Using data of the 24 Argentinean firms that have issued ADRs, we find 93% of affiliation to groups through pyramids but little use of non-voting shares (only 3.9%). In these companies, the controlling group has rights, directly or indirectly, over 68% of firm's cash flows.

225. In the case of Brazil, the most salient feature of control structures is the widespread use of non-voting shares in order to separate control from cash flow rights. Distortions introduced by the tax and regulatory regime during the eighties encouraged the issuance and purchase of non-voting shares in that

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country. Brazilian law allowed companies to issue dual class shares in a ratio of up to 1/3 of voting shares to 2/3 of non-voting shares.¹² Leal et al. (2002), Leal and Oliveira (2002) and Siffert (2002) describe in some detail the ownership structure of Brazilian companies. As in the other countries in the region, they find that conglomerates are the predominant form of corporate structure in Brazil. Khanna and Yafeh (2000) encountered 38 conglomerates participating in the ownership of large listed Brazilian firms. Using data on the 39 ADR Brazilian issuers, we find 89% of affiliation with conglomerates through pyramids. However, dual class shares are the most common way of separating voting from cash flow rights in Brazilian firms. Almost 90% of 459 listed Brazilian firms reporting to ECONOMATICA have non-voting shares that represent 120% of total voting capital. In spite of the substantial use of dual class shares and pyramids, Brazilian controllers hold more equity than strictly needed for control. In these companies, the controlling group has rights, directly or indirectly, over 60% of firm's cash flows.

226. In terms of the identity of controlling shareholders, these studies show that when considering the 100 largest non-financial firms in Brazil, 2 are characterised by disperse ownership, 29 are controlled by a family (local group), 37 are controlled by a foreign firm and in 32 the controller is the federal government. Table 3 presents these results in percentage terms.

227. Like other Latin American countries, Chile presents a very high ownership concentration and a corporate structure dominated by the presence of conglomerates.¹³ Lefort and Walker (2000c) indicate that 68% of listed non-financial Chilean firms are controlled by one of the approximately 50 non-financial conglomerates, representing 91% of the assets of non-financial companies listed in Chilean stock markets. At present, approximately half of these 50 conglomerates are controlled by a foreign multinational company.

228. Chilean conglomerates are structurally relatively simple. The most common way of separating voting from cash flow rights is through simple pyramid structures with only 1/3 of affiliated listed companies being second or higher tier in the pyramidal structure. In contrast, only 7.5% of listed firms have dual class shares while cross-holdings are forbidden by law.¹⁴ Although controllers of Chilean companies tend to separate their voting rights from their cash flow rights through the use of these pyramids, as in the Brazilian case, they usually hold more equity than strictly needed for control. In fact, on average, 57% of consolidated equity is directly or indirectly owned by controllers. Many times, beneficial ownership is difficult to ascertain due to the extensive use of private holding companies as investment vehicles due to their tax efficiency.

229. Although deficiencies in data make it impossible to present detailed and definitive conclusions about ownership structure in Mexico, Babatz (1997), Castañeda (2000) and Husted and Serrano (2001) shed some light for the case of this country. As in the other markets considered in this study, ownership concentration is very high in Mexico and conglomerates are the most common form of corporate structure. These hold, on average, 65.5% of listed companies shares. In the Mexican case, separation of ownership and control is achieved through both dual class shares and pyramid structures. Table 4 shows that 37% of listed firms have issued non-voting shares and 59% of listed firms belong to a pyramid structure. There are several classes of shares issued by companies. Usually, class A shares convey full voting rights and are

¹² Recently, however, the law was amended decreasing the proportion of new non-voting shares to 50% of total capital.

¹³ Lefort and Walker (2000c), Agosin and Pastén (2000) and Majluf et al. (1998) are recent papers on conglomerates and corporate structure in Chile.

¹⁴ Firms refrain from issuing dual class shares in order to attract pension fund investments and avoid being penalised by risk rating agencies. See Lefort and Walker (2000c).

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tightly held by the controlling family. Most traded stocks have limits regarding voting rights and are held by the minority interest. Foreign ownership has also increased lately. According to Babatz (2000), 18% of Mexico's 150 largest listed companies are foreign controlled.

3. Institutional investors

230. Individual investors are unimportant in most Latin American companies. However, institutional investors, in particular pension funds, do play a role in corporate governance. Early pension fund reform in Chile followed by later reforms in Argentina, Colombia, Peru and Mexico gave private pension funds an important role as suppliers of capital. In addition, pension reform has triggered capital market and corporate law reforms that have helped to improve overall minority shareholders protection. Walker and Lefort (2001) provide several examples that indicate that pension reform relates to the accumulation of "institutional capital"¹⁵, creates a more dynamic legal framework¹⁶, increases specialisation, innovation, transparency and integrity of capital markets, and also improves corporate governance practices¹⁷. They also present statistical evidence consistent with the hypothesis that pension fund reform reduces firms' cost of capital, lowers security-price volatility, and increased trading volumes.

231. In several cases, pension funds, individually or as a group, have achieved large enough holdings of shares to justify an important role as minority shareholders, thus overcoming the classical free rider problem. In addition, because of the nature of the funds administered by pension fund managers and their political influence, they have become important opinion leaders in issues regarding corporate governance and minority shareholders protection. Examples of this type of influence by institutional investors are the ENERSIS and Terra cases in Chile.¹⁸ More specifically, Walker and Lefort (2001) show that by the year 2000, pension fund holdings of corporate bonds and stocks as a fraction of market capitalisation accounted for 15.9% in Chile, 24.8% in Argentina and 32.1% in Peru. In the case of Mexico, because of both the short life of the pension reform and the channelling of their investments into indexed government bonds, domestic institutional investors still play a very limited role in private capital markets (Husted and Serrano (2001)). In Brazil, Siffert (2000) indicates that, sometimes because of the privatisation process, there has been an increase in companies displaying shared control, where institutional investors, both domestic and foreign, hold large stock blocks and act as relevant, though not controlling shareholders.

¹⁵ See Valdés and Cifuentes (1990).

¹⁶ Iglesias (1999) cites 25 legal reforms in Chilean capital markets that were triggered by pension fund investing needs.

¹⁷ For example, in conjunction with the country's pension fund reform, a new bankruptcy law was implemented in Argentina (Law 24.552 of 1995). In Chile, the Association of Pension Funds (ASAFP) notifies the authorities and influences public opinion about corporate governance situations that are negative for pension funds. Also pension fund managers are typically required by the Superintendency of Pension Fund managers (SAFP) to file reports regarding events or transactions by security issuers that may have negative effects on pension fund investments. In Peru, being "AFPable" became a new status for securities issuers, requiring more information transparency (Ramos, 1999).

¹⁸ In the first, a mutual fund manager opposed the bid by ENDESA Spain and called for an extraordinary shareholders meeting. In the second, pension fund managers informed the regulator about the poor conditions of the sale of Terra to Telefonica Spain.

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III. Board practices and composition in Latin America

232. Corporate law in most Latin American countries explicitly indicates that boards are the main decision making body of a company and that board members owe duties of loyalty and care to all shareholders. However, as a consequence of the high ownership concentration observed in most firms in the region, boards in Latin American countries tend to be much weaker than in the US or UK, and constitute a poor governance mechanism. In general terms, boards in Latin America serve mainly an advisory function for controllers, include very few independent board members and exhibit few if any functioning committees.

233. Independence is an important characteristic for a board member. Hillman and Dalziel (2003) argue that a board room has to present an adequate balance between independent and non-independent board members in order to provide both monitoring capacities and strategic resources to the company. In recently adopted rules, the SEC made the distinction between non-independent and affiliated board members. While a non-independent board member is a person related to the company through a job or some other business or material relationship such as being a supplier or a competitor¹⁹, an affiliated member is a major shareholder of the company, a controller or a person related to the controller of the company. However, in Latin America, because of the extensive use of pyramid structures and the important level of involvement of controllers in the day-to-day business of the company, affiliated board members tend to be also non-independent as defined by the SEC.

234. There is very little systematic information on board composition in Latin American countries. For many countries, the only available information is reports on 20-F forms filed with the Securities and Exchange Commission. Table 5 summarises our findings through various sources. On average, Latin American board rooms have less than 8 board members and less than half of them can be considered both independent and non-affiliated. There are few studies for Brazil, Chile and Mexico that help to complement this result.

235. The structure and functioning of boards in Brazil is analyzed by Ventura (2000), Leal and Oliveira (2002), Spencer Stuart (1999) and Outra and Saito (2001). As noted above, they find that Brazilian boards serve mainly an advisory role and their members tend to be affiliated with the controlling group. Specifically, 49% of board members are affiliated with controlling shareholders and less than 20% of directors would qualify as independent using US standards. Moreover, CEOs tend also to be affiliated with controllers and only 17% of companies have standing board committees.

236. Lefort and Walker (2000c), Iglesias (1999), Majluf et al. (1998) and Spencer Stuart-PUC (2000) look at board composition and functioning in Chile and reach similar conclusions. In particular, the survey prepared by Spencer Stuart-PUC shows that only 55% of directors would qualify as independent and non-affiliated using the SEC definitions: that is, they have no direct family or work relationship with the company or related companies. However, the number of truly independent board members is almost certainly much lower since many self-regarded independent directors have an important part of their income provided by the controllers through other board memberships or consulting activities. Lefort and Walker (2000c) show that when considering the 5 largest conglomerates, more than 80% of directors can be considered affiliated to the controllers. Even in the case of companies where pension funds own shares, on average, only 10% of board members are actually elected with pension funds votes.²⁰

¹⁹ A non-independent board member is prone to present conflict of interests.

²⁰ Iglesias (2000).

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237. Additional evidence indicates a lack of monitoring activities of Chilean boards. Spencer Stuart-PUC reports that only 29% of boards of directors in Chile have established standing board committees. Lefort and Walker (2000c) look at interlocking boards in Chilean conglomerates and find, on average, that each board member of a listed firm affiliated to a conglomerate sits on 1.6 board rooms. In addition, conglomerates do not share directors. Only 3% of directors out of a total sample of 1,530 sit on boards of two or more companies belonging to different controllers.

238. Things are not very different in Mexico. As indicated by Babatz (1997) and Husted and Serrano (2001), appointing directors in Mexico is largely a family affair. A simple look at board composition shows that 53% of directors are either top executives of the firm, of other firms of the group, or relatives of such executives. However, the lack of independence is probably worse because political dependence and other kinds of relationships such as the local “compadrazgo” (godfather relationships).

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Table 1
Market Indicators

Country	GDP per cap.(US\$) (1) (2002)	GDP per cap.(US\$) PPP adjusted (1) (2002)	Market Cap./GDP (2) (1997)	Total Value Traded/GDP P (2) (1997)	Claims of Deposit money banks on private sector/GDP (2) (1997)	Claims of other intermediarie s/GDP (2) (1997)	# of listed firms (3) (2002)	# of ADR (4) (2002)
Argentina	2400	-	0.11	0.04	0.15	0	152	24
Brazil	3580	7300	0.19	0.12	0.23	0.05	459	39
Chile	4590	9100	0.84	0.09	0.45	0.12	260	24
Colombia	2020	6060	0.13	0.01	0.16	0.15	74	3
Mexico	5070	8790	0.32	0.13	0.22	0.03	201	37
Peru	2080	4660	0.11	0.04	0.09	0.01	175	2
Average	3290	7182	0.28	0.07	0.22	0.06	220.2	21.5

(1) Country Risk Guide, Coface (2003).

(2) Dermigüç-Kunt, Asli and Ross Levine (2001), "Financial Structure and Economic Growth". MIT Press. (Data of 1997).

(3) ECONOMATICA.

(4) www.NYSE.com

Table 2
Ownership Concentration

Country	Sample (2002)	% of largest shareholder (2002)	% of 3 largest shareholders (2002)	% of 5 largest shareholders (2002)
Argentina**	15	61%	82%	90%
Brasil*	459	51%	65%	67%
Chile*	260	55%	74%	80%
Colombia*	74	44%	65%	73%
Mexico**	27	52%	73%	81%
Peru*	175	57%	78%	82%
Average	168.3	53%	73%	79%

* Data from ECONOMATICA.

** Data from 20-F ADR filings.

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Table 3
Controller Identity

Country	Domestic-private Controlled	Foreign Controlled	State Controlled	Disperse Ownership	# of Groups (1) (1997)	% of affiliation to groups (2) (2002)
Argentina*	38.6%*	59.1%*	2.3%*	0%*	11	93%
Brazil**	43%**	33%**	21%**	3%**	38	89%
Chile	69%	30%	0.8%	0%	50***	68%
Colombia					7	50%
Mexico		18%****			14	72%
Peru					5	100%
Average					19.2	79%

(1) Khanna and Yafeh (2000) "Business Groups and Risk Sharing Around the World". Working Paper. Except Chile.

(2) For Argentina, Brazil, Colombia and Peru, data from 20-F ADR filings.

* Apreda (2000). 40 largest firms.

** Siffert, Nelson "Governança Corporativa: Padroes internacionais e evidencias empiricas no brasil nos anos 90". Working Paper.

***Lefort, Tarziján, Espinosa (2003) "Corporate Investment in Chile: Group Effect". Pontificia Universidad Católica de Chile .

**** Babatz (2000).

Table 4
Separation of ownership and control

Country	% de firms with non voting shares (1) (2002)	Non voting/ voting shares (2) (2002)	% of firms in pyramids (3) (2002)	% cash flow rights of controller (2002)
Argentina	3.9%	0.14	93%	68%
Brazil	86.9%	1.29	89%	60%
Chile	7.2%	0.07	68%	57%**
Colombia*	7.1%	0.09	50%	-
Mexico	37.8%	-	72%	59%
Peru*	61.0%	0.25	100%	-
Average	34.0%	0.37	79%	61.0%

(1) Number of firms with preferred shares/number of total firms (Economática).

(2) Number of preferred shares/Number of common shares (Economática).

(3) Data from 20-F ADR filings.

* Only two firms in the sample.

** Lefort and Walker (2000b) "Ownership and Capital Structure of Chilean Conglomerates: Facts and Hypotheses for Governance". Abante.

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Table 5
Board Structure

Country	# of board members (2002)	% of independent members (2002)	Board Members/ Board Seats (2002)
Argentina*	8.1	38.8%	1.20
Brazil*	8.5	28.6%	1.10
Chile**	7.6	55.0%	1.60
Colombia***	5.0	50.0%	-
Mexico*	11.4	54.0%	1.09
Peru***	6.0	62.4%	-
Average	7.8	48.1%	1.25

* Data from 20-F ADR filings.

** Spencer-Stuart (2000) "Directors Guide".

*** Data from 20-F ADR filings (2 firms).

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ANNEX D: GLOSSARY

Alternative dispute resolution: The use of private arbitration and or mediation to resolve civil disputes that might otherwise go to court. For example, a stock exchange may offer private arbitration binding on listed companies to shareholders seeking redress for violations of their rights. While normally seen as a supplement to the judiciary, to be effective private arbitration and mediation should have some formal legal backing.

Annual report: A report issued by open companies to their shareholders each year. Normally contains information on overall performance, future prospects and audited financial information.

American Depository Receipt (ADR): A certificate issued by a U.S. depository that represents a number of shares of stock issued by a non-U.S. company. ADRs are normally traded on a U.S. exchange, but may not give the holder all the rights that shares in a U.S. company would.

Audit committee: A committee formed from members of the company's board of directors or supervisory board. Non-executive board members normally make up all or a majority of the committee. The audit committee normally oversees the company's financial reporting and sometimes risk management and or legal compliance. The committee may also have the power to assess and / or block related party transactions.

Beneficial owner: The person who benefits from the ownership of a security or other property, the *de facto* owner. The beneficial owner may not always be the same as the nominal owner (who is registered as the owner or who holds the title to the property).

Capital increase: An issue of new shares by a company.

Class action lawsuit: A lawsuit filed by one or more persons on behalf of a group of individuals all having the same grievance. Until recently these suits were only allowed in certain common law countries.

Control pyramid: Ownership structure where a parent company will control a fraction of another company, which may own a control fraction of a third company, etc. This will allow the owner of the parent company to control the subsidiaries while having a fraction of the underlying ownership. Can be combined with cross-shareholdings to make very complex corporate structures.

Controlling shareholder: A shareholder who has enough votes to choose a majority of the board and exert *de facto* control over management. A shareholder may be able to control the company while owning less than 50% of the equity through the use of shares with special voting rights, control pyramids, and other tactics.

Corporate governance: The relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined.

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Cross-shareholding: When two or more companies hold each other's shares. Frequently used in conjunction with control pyramids.

Cumulative voting: Under cumulative voting, shareholders assign votes to one or more candidates for the board, instead of voting separately for each board member. Each shareholder receives a number of votes proportionate to their shareholdings—i.e. their number of shares multiplied by the number of open board seats. Under cumulative voting, 10%-15% of vote is normally enough to select one board member. This may allow minority shareholders to choose some members of the board.

Derivative suit: A law suit seeking damages from board members or other company officers filed by a shareholder or shareholders on behalf of the company. If successful, damages can be used to defer the legal expenses of the filing shareholders, but the remainder is awarded to the company, not directly to the filing shareholders.

Duty of care: The duty of a board member to act on an informed and prudent basis in decisions with respect to the company. Often interpreted as requiring the board member to approach the affairs of the company in the same way that a "prudent man" would approach their own affairs. Liability under the duty of care is frequently mitigated by the business judgement rule.

Duty of loyalty: The duty of the board member to act in the interest of the company and shareholders. The duty of loyalty should prevent individual board members from acting in their own interest, or the interest of another individual or group, at the expense of the company and all shareholders.

General meeting: Meeting of shareholders, at which board members may be elected and shareholder resolutions, items requiring shareholder approval (i.e. a merger) and external or statutory auditors may also be approved or rejected. Shareholders may also have the opportunity to put questions to the company's management at the general meeting.

Independent board member: Typically refers to a non-executive board member who has no business or contractual relationship (other than his or her service as a board member) with the company, is not under the undue influence of any other board member or group of shareholders, and who is generally capable of acting in an informed and objective manner. However, criteria for independence may vary among countries and companies, depending on the patterns of control and affiliations with other companies. The definition of independence for an individual company can usefully be defined with reference to national codes, regulations or best-practice guidelines that reflect national circumstances.

Insider: A company board member, official, or a controlling shareholder. Can also refer to other *de facto* insiders, e.g. a shadow director or someone else who exerts control over day-to-day operations of the company.

Institute of Directors (IoD): An organisation for board members that normally provides training along with other services.

International Financial Reporting Standards (IFRS): The financial reporting standards created by the London based International Accounting Standards Committee (IASC). Dozens of countries have adopted IFRS, or actively harmonise their accounting rules with IFRS. These standards are also commonly referred to as International Accounting Standards (IAS).

Minority shareholder: A shareholder whose stake in the company is too small to allow them to have a direct influence on the company's board or management. A shareholder who is not a controlling shareholder.

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Proxy: Someone empowered to vote on behalf of other shareholders at the general meeting. Also refers to the mail-in ballot that shareholders in some countries can use to vote in the general meeting without attending.

Pre-emptive rights: The right of existing shareholders to participate in any capital increase. Pre-emptive rights should preclude the company selling new shares on favourable terms to only some shareholders or to non-shareholders.

Related party transaction: A transaction carried out between the company and one or more of its officers, board members, or significant shareholders, their close relatives or associates, or an entity in which they have an interest.

Shadow director: a common law designation for someone who does not serve on the board, but exerts considerable influence on its deliberations.

Stakeholders: Individuals or groups, in addition to shareholders, who have a significant interest in, and/or influence over, the company's operations and the achievement of the company's goals, such as employees, creditors, suppliers, customers, and the community.

Statutory auditor: Elected by shareholders to oversee the internal auditing and financial reporting of the company and in some cases compliance with regulation and shareholder resolutions. Statutory auditors make up the company's audit board.

Tag-along rights: When a controlling shareholder sells enough equity to control the company to a new owner, the right of other shareholders to sell their shares, usually on the same terms as the controlling shareholder; i.e. a requirement for someone seeking to acquire a control stake to offer to buy equity from all shareholders, not just the controlling shareholder.

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