



THE WORLD BANK

Report on the Observance of Standards and Codes (ROSC)

CORPORATE GOVERNANCE
COUNTRY ASSESSMENT

Brazil

JUNE 2012

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This updated assessment of corporate governance in Brazil has been prepared by Alexander Berg of the World Bank Global Capital Markets Development Department with Pasquale Di Benedetta, as part of the Reports on Observance of Standards and Codes Program. This report also includes summary findings from a separate report on corporate governance in the banking sector, prepared by Ms. Laura Ard. The report is based in part on a template/questionnaire completed by the Instituto Brasileiro de Governança Corporativa (IBGC). The findings of the ROSC are based on the Detailed Country Assessment (DCA), which is presented as a separate annex. The due diligence mission was carried out in December 2011.

The assessment reflects technical discussions with the CVM, BM&FBOVESPA, the Brazilian Central Bank, AMEC, IBGC, Abrasca, and representatives of companies, banks, and market participants. The assessment draws heavily on several surveys on corporate governance, including the 2011/2010 KPMG/CEG Survey of 212 listed companies, the Capital Aberto Yearbook 2011, and unpublished data on corporate governance of listed companies prepared by Dr. Alexandre Micelli of the University of Sao Paulo.

Comments on the draft were received from Patrick Conroy, Jonathan Katz, Joseph Mubiro Kizito, and Mr. Roberto Rocha.

About the ROSC

What is corporate governance?

Corporate governance refers to the structures and processes for the direction and control of companies. Corporate governance concerns the relationships among the management, board of directors, controlling shareholders, minority shareholders and other stakeholders. Good corporate governance contributes to sustainable economic development by enhancing the performance of companies and increasing their access to outside capital.

The OECD Principles of Corporate Governance provide the framework for the work of the World Bank Group in this area, identifying the key practical issues: the rights and equitable treatment of shareholders and other financial stakeholders, the role of non-financial stakeholders, disclosure and transparency, and the responsibilities of the board.

Why is corporate governance important?

For emerging market countries, improving corporate governance can serve a number of important public policy objectives. Good corporate governance reduces emerging market vulnerability to financial crises, reinforces property rights, reduces transaction costs and the cost of capital, and leads to capital market development. Weak corporate governance frameworks reduce investor confidence, and can discourage outside investment. Also, as pension funds continue to invest more in equity markets, good corporate governance is crucial for preserving retirement savings. Over the past several years, the importance of corporate governance has been highlighted by an increasing body of academic research. Studies have shown that good corporate governance practices have led to significant increases in economic value added (EVA) of firms, higher productivity, and lower risk of systemic financial failures for countries.

The Corporate Governance ROSC

Corporate governance has been adopted as one of twelve core best-practice standards by the international financial community. The World Bank is the assessor for the application of the OECD Principles of Corporate Governance. Its assessments are part of the World Bank and International Monetary Fund (IMF) program on Reports on the Observance of Standards and Codes (ROSC).

The goal of the ROSC initiative is to identify weaknesses that may contribute to a country's economic and financial vulnerability. Each Corporate Governance ROSC assessment benchmarks a country's legal and regulatory framework, practices and compliance of listed firms, and enforcement capacity vis-à-vis the OECD Principles.

- ▶ The assessments are standardized and systematic, and include policy recommendations and a model country action plan. In response, many countries have initiated legal, regulatory, and institutional corporate governance reforms.
- ▶ The assessments focus on the corporate governance of companies listed on stock exchanges. At the request of policymakers, the World Bank can also carry-out special policy reviews that focus on specific sectors, in particular for banks and state-owned enterprises.
- ▶ Assessments can be updated to measure progress over time.
- ▶ Country participation in the assessment process, and the publication of the final report, are voluntary.

By the end of December 2012, 82 assessments had been completed or were underway in 58 countries around the world.



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ROSC

The 2012 Corporate Governance ROSC for Brazil

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ACRONYMS

ABRASCA: Brazilian Association of Public Companies (Associação Brasileira de Companhias Abertas)

ANBIMA: Brazilian Financial and Capital Markets Association (association of market participants)

BCB: Central Bank of Brazil

BM&FBOVESPA: Stock Exchange of Brazil

BRL: Brazilian Real

BRIC: Brazil, the Russian Federation, India, and China

CAF: Takeover Panel (Comitê de Aquisições e Fusões)

CBLC: Companhia Brasileira de Liquidação e Custódia (the former name of the central depository))

CEO: Chief Executive Officer

CFC: Federal Accounting Council (Conselho Federal de Contabilidade)

CODIM: Steering Committee for Inf. Disclosure to the Market (Comitê de Orientação para Divulgação de Informações ao Mercado)

CFO: Chief Financial Officer

CPC: Committee on Accounting Pronouncements (Comitê de Pronunciamento Contábeis)

CVM: Comissão de Valores Mobiliários (the Securities and Exchange Commission of Brazil)

DCA: Detailed Country Assessment (annex to the ROSC report)

EGM: Extraordinary General Meeting

GDP: Gross Domestic Product

GMS: General Meeting of Shareholders

IBGC: Instituto Brasileiro de Governança Corporativa (Brazilian Institute of Corporate Governance)

IBRACON: Brazilian Institute of Accountants

IFRS: International Financial Reporting Standards

IOSCO: International Organization of Securities Commissions

ISA: International Standards on Auditing

MF: Ministério da Fazenda, the Ministry of Finance of Brazil

OECD: Organisation for Economic Co-operation and Development

PN shares: Shares without voting rights

ROSC: (Corporate Governance) Report on Standards and Codes

RPT: Related Party Transaction.

SOE: State Owned Enterprise

SRO: Self regulatory organization

DEFINITIONS

Cumulative voting: Cumulative voting (voto multiplo) allows minority shareholders to cast all their votes for one candidate. Suppose that a publicly traded company has two shareholders, one holding 80 percent of the votes and another with 20 percent. Five directors need to be elected. Without a cumulative voting rule, each shareholder must vote separately for each director. The majority shareholder will get all five seats, as s/he will always outvote the minority shareholder by 80:20. Cumulative voting would allow the minority shareholder to cast all his/her votes (five times 20 percent) for one board member, thereby allowing his/her chosen candidate to win that seat.

Pre-emptive rights: Pre-emptive rights give existing shareholders a chance to purchase shares of a new issue before it is offered to others. These rights protect shareholders from dilution of value and control when new shares are issued.

Pyramid Structures: Pyramid structures are structures of holdings and sub holdings by which ownership and control are built up in layers. They enable certain shareholders to maintain control through multiple layers of ownership, while at the same time they share the investment and the risk with other shareholders at each intermediate ownership tier.

Shareholder agreement: An agreement between shareholders on the administration of the company. Shareholder agreements typically cover rights of first refusal and other restrictions on share transfers, approval of related-party transactions, and director nominations.

Withdrawal rights: Withdrawal rights (referred to in some jurisdictions as the "oppressed minority," "appraisal" or "buy-out" remedy) give shareholders the right to have the company buy their shares upon the occurrence of certain fundamental changes in the company.

Corporate Governance Country Assessment

Brazil

June 2012

EXECUTIVE SUMMARY

This report assesses Brazil's corporate governance policy framework. It highlights recent improvements in corporate governance regulation, makes policy recommendations, and provides investors with a benchmark against which to measure corporate governance in Brazil. It is an update of the 2005 Corporate Governance ROSC.

Brazil's experience over the past 10 years has shown the value of corporate governance reforms, both in Brazil and around the world. Good corporate governance enhances investor trust, helps to protect minority shareholders, and can encourage better decision making and improved relations with workers, creditors, and other stakeholders. It is an important prerequisite for attracting the patient capital needed for sustained long-term economic growth.

The report (and this summary) is organized into four sections:

- ▶ The commitment of the public and private sectors to reform
- ▶ Shareholder rights
- ▶ Disclosure and Transparency
- ▶ Boards of directors

Commitment. Both the public and private sectors have made significant reforms to the corporate governance framework.

The central and most innovative reform has been the special corporate governance listing tiers on the stock exchange (BM&FBOVESPA). The new listing tiers were introduced in 2000, but gained force in 2005-2007 as more than 100 IPOs took place on the new listing tiers, resulting in more than 100 companies on the highest level (the Novo Mercado). The Novo Mercado rules call for the removal of non-voting shares, full tag-along rights, 20% independent boards, and improvements to disclosure. The special listing tiers have had a major impact on shareholder protection, and company behavior, as companies opted to improve their governance in order to get access to the market. Several important reforms designed to strengthen the Novo Mercado rules were defeated in 2010.

The CVM has also been active in introducing new regulations and stepping up its enforcement efforts. Perhaps the most important regulatory reform was the introduction of Instructions 480 and 481 in 2009, which required the posting of a wide variety of financial and nonfinancial disclosure on the internet, and appears to have greatly improved the quality of disclosure.



Various private sector initiatives have also made important contributions. The Brazilian Institute of Corporate Governance (IBGC) has continued to grow into one of the world's leading corporate governance advocacy and training bodies, and maintains the IBGC Code of Corporate Governance, the reference point for good corporate governance practices in Brazil. Abrasca, the Brazilian Association of Publicly-Traded Companies, introduced a Code of Self-regulation and Good Practices for Publicly-Traded Companies in August 2011. The code innovates by introducing the “apply or explain” approach, in which Abrasca members can decide not to adopt one or more rules.

The financial sector self-regulatory bodies have made important contributions. AMEC fights for the shareholder rights of its members. ANBIMA has introduced various self-regulatory codes for institutional investors and other market intermediaries.¹ CODIM is an innovative organization that works quietly to help listed companies improve their disclosure practices.

Shareholder rights. Many shareholder rights are in place. Shareholders can participate at the general shareholder meeting, and rights improved in 2009 with the promulgation of new CVM instruction 481. Minority shareholders have rights to appoint board members, and (and 10% shareholders can require cumulative voting). However, for outsiders who are not able to use the Corporate Law provisions, influencing board elections is generally considered to be difficult and not transparent.

Shareholders must approve many important decisions, including changes to the bylaws, and increases to authorized capital. The board has the authority to issue shares up to the amount of authorized capital, with no time limit. Shareholders have a right of first refusal in the subscription of an increase in capital, in proportion to the number of shares they own. Public companies are not required to offer pre-emptive rights if shares are offered for sale as a public offering. Companies can make these rights tradable, through rights offerings.

Shareholder rights to approve large transactions are relatively limited; most transactions can be approved at the board level (with no requirements for oversight by independent members). Neither shareholders nor an independent board committee approve related party transactions.

The most controversial shareholder rights issues in Brazil relate to takeovers and corporate restructuring. The threshold for a mandatory tender offer is 50 percent of shares. For traditional listed companies and Level 1 companies, a tender offer must be made for all voting shares, at 80% of the price paid to the controlling shareholders, but there are no requirements for an offer to be made to non-voting shareholders. For companies with non-voting shares listed on Level 2, the price offered to both voting and non-voting shareholders must be equal to the price paid to controlling shareholders. Many complaints and questions have been made recently by minority shareholders regarding price paid for their shares and biased valuations.

¹ Associação Brasileira das Entidades dos Mercados Financeiro e de Capitais (ANBIMA)

Lawsuits against administrators (directors and executives) can be brought to court by the company upon a request of minority shareholders, similar to US-style derivative lawsuits as well as directly by shareholders. Normally minority shareholders sue the company not the managers. Minority shareholders from Sadia did sue directors and managers, but is considered to be a rare case, coordinated by foreign shareholders. However, the use of these rights is often frustrated by the court system. However, CVM plays the dominant enforcement / redress role. CVM can investigate complaints, detect problems or frauds in companies and take action if the law is violated. CVM has imposed fines on companies or directors and officers that did not fully discharge their duty of loyalty. For example, each individual involved in the Sadia derivative case was fined around 150.000 dollars. In the past few years, CVM has adopted a strategy of settling out-of-court through the process of *Termos de Compromisso* (consent decrees). The consent decrees allow the CVM to settle charges before trial (and sometimes even before a process is opened), without an admission of guilt.

Disclosure and Transparency. Disclosure and transparency have improved since the last ROSC in 2005, thanks to two key regulatory measures: the imposition of IFRS accounting standards (through law 11.638 /2007 and CVM Instruction 457) and CVM Instruction 480 in 2009.

Listed companies must prepare and disclose consolidated financial statements in accordance with IFRS, beginning with reporting periods ending in 2010. Instruction 480 represents the latest step in a series of measures designed to improve financial and non-financial disclosure. Companies are required to complete a comprehensive “Reference Form” that includes a long list of disclosure items. These are maintained in an updated form on the CVM’s website. As a result, the legal framework now meets many of the disclosure requirements of the OECD Principles. The Reference Form is in many ways more comprehensive than the “comply or explain” requirement found in other countries, even though there is no mandated corporate governance code.

Companies have complained about the new Reference Form requirements, and compliance is very uneven. However, most observers believe that it is improving. CODIM is preparing a set of guidelines to assist in the preparation of the Reference Forms.

Boards of Directors. Unlike other areas of the corporate governance framework, requirements for the boards of directors of listed companies are relatively limited. Board practices in Brazil vary widely. The universe of the 372 listed companies can be broken down into two groups. The first group (which is a subset of the companies listed on the special corporate governance tiers) consists of between 50 and 100 companies with boards that function at a high level, and use international standards as a benchmark. The second group complies with legal requirements, but functions with a “traditional” model, with relatively weak boards and strong influence of the controlling shareholder. The number of companies in the first group has been growing rapidly, but some of the largest companies (including those with State ownership) remain in the second group.

Board structure and duties are driven by the Corporate Law and the Novo Mercado listing requirements. Listed companies have unitary boards. They can also have a *conselho fiscal*, or statutory audit board, which is also appointed by shareholders and has oversight responsibility. The *conselho fiscal* plays an important role in company oversight. While some doubt that the *conselho fiscal* can fulfill its wide mandate in practice, it remains popular among some non-voting shareholders and pension funds.

The Corporate Law establishes fiduciary duties. In voting, directors are subject to general duties to serve the best interests of the company. However, some provisions of the law regarding shareholder agreements (especially Article 118 which states that “the AGM or board meeting shall not count the votes that infringes a duly filed shareholders agreement”) may undermine the board’s duties to the company. In practice, directors take their responsibilities seriously, and awareness of liability and the importance of their role continue to increase. IBGC has played a major role in increasing the awareness of the role of the board member.

However, discussions with market participants indicate that directors in most companies tend to display more loyalty to the shareholder that has elected him/her (especially in companies with shared-control by large blockholders) than to the interests of the company and of all shareholders. Recent cases such as those with Sadia and Aracruz — two traditional companies that suffered heavy losses due to speculative positions in the derivatives markets — cast doubt that all directors are properly exercising their duty of care. These and other cases (especially those in banks) have been described as a “wake up call” for directors, reminding them of their liability.

Boards of companies on Novo Mercado (120 companies out of the 372 listed companies at the end of 2011) and Level 2 (20 companies) are required to have at least 20% independent members, and separate chairmen and chief executives. Companies claim that on average their boards are composed of between 25% and 35% independent directors. However, most of these surveys focus on the largest and more liquid companies of the stock markets (including those listed on Novo Mercado), and many traditional listed companies do not reportedly have independent members.

Board committees are not well-developed in Brazil. There are no general requirements for subcommittees of the board to be established. Banks and financial institutions must have audit committees. In December 2011 CVM issued Instruction 509/2011 that provides an incentive to create an audit committee by allowing companies that do so to double the mandatory audit rotation period to ten years.

In practice, it is common for the largest Brazilian companies to establish “committees”. However most of these committees have outside experts as members, and in several cases, there are no board members on the committees.

Next Steps. Policymakers in Brazil continue to make steady progress towards improving corporate governance. The depth of corporate governance regulation has continued to increase, particularly in the area of disclosure. Many companies and owners are behaving differently. However, for the Brazilian market to grow, improvements to the legal protection of minority investors should continue. Brazil must regain the momentum from the creation of the Novo Mercado and move towards the application international best practices to all publicly listed companies in Brazil.

Recommendations are developed in detail beginning on page 41. Key reforms to consider include the following:

- ▶ The corporate governance framework is remarkable for its lack of a true audit committee of the board. The audit committee is now mandatory in most countries around the world, and is not particularly controversial. The current framework (including the *conselho fiscal* and a “statutory audit committee” that is not composed of board members) is not a substitute for a strong board committee. Corporate governance reformers should develop a rationale for why the current framework is inadequate, and the benefits of moving towards a true board committee structure. CVM should be provided with the legal authority to introduce a Regulation that makes this committee mandatory for all listed companies.
- ▶ increase the resources allocated to corporate governance oversight at the CVM, especially to the Corporate Finance Department.
- ▶ Minor updates to disclosure requirements in Instructions 480 and 481 to bring disclosure fully in line with the OECD Principles Longer term, corporate governance and shareholder protection will improve with the adoption of significant amendments to the Corporate Law.

Landscape

Introduction

This Corporate Governance ROSC Assessment (CG ROSC) was commissioned by the Comissão de Valores Mobiliários (CVM, the Securities and Exchange Commission) of Brazil. The primary audience of the report is the Government of Brazil and those responsible for setting and enforcing corporate governance policy. Other stakeholders, including investors, financial intermediaries, business associations, the audit and legal professions, and the companies themselves, can also benefit from this report in terms of assessing and implementing good corporate governance.

The purposes of this CG ROSC are to²: (i) benchmark Brazil's legal and regulatory framework, practices, and enforcement framework against the OECD Principles of Corporate Governance (OECD Principles), the international reference point for good corporate governance; and (ii) develop a series of recommendations to reduce or close potential gaps.

The OECD Principles focus on listed companies, both financial and non-financial, but also touches upon corporate governance issues relevant to other publicly interest entities, notably non-listed banks, financial institutions, SOEs, and large private enterprises. This report updates a previous report published in 2005.

Listed Companies and Capital Markets in Brazil

Corporate governance regulations apply to listed companies, financial institutions, and state-owned enterprises (SOEs). The Brazilian financial system is organized around a few financial conglomerates that control over 75 percent of the system's assets. Conglomerates are typically headed by a commercial bank and include asset management, investment banking, and insurance and derivatives services. Total (gross) assets in the system are equivalent to around 180 percent of GDP, about 40 percent of which are held by commercial and multiple banks, 26 percent by mutual funds, 10 percent by pension funds, and 6 percent by insurance companies.

The remainder of this section reviews listed companies and the equity markets (the focus of the OECD Principles). Corporate governance issues in banks are addressed in a special section on page 35.

The financial markets have surged in recent years and have weathered the global financial crisis relatively well.

The Brazilian equity market made impressive gains in market capitalization and liquidity over the past decade, and has recovered from declines during the global financial crisis. The Financial Indicators table and the charts on the following pages show the increasing breadth and depth of the equity markets. The BM&FBOVESPA is the country's stock exchange. BM&FBOVESPA, market intermediaries, and the listed companies are overseen by the CVM.

As a result of rapid growth over the past decade, market capitalization and liquidity of the Brazilian equity market is now comparable to other BRICS countries. Equity market capitalization has grown from US\$482 billion to US\$1.23 trillion at the end of December 2011, or about 49.6%

² This Corporate Governance ROSC is based on a revised assessment methodology. In response to the revised OECD Principles of 2004, as well as the 2008-2009 global financial crises, the World Bank has updated its methodology and developed a new set of some 650 data points to more objectively benchmark a country's corporate governance framework against the OECD Principles of Corporate Governance. The data is complemented by qualitative findings made during a series of meetings with key stakeholders in Brazil in December 2011.

of GDP (see Table 1). The market index fell during and after the 2008 global financial crisis, losing 58% of its value, it regained most of its pre-crisis level in less than one year. Market growth has been fueled by a combination of strong market performance and a steady growth in the total quantity of shares, through a combination of IPOs and follow-on offerings. Market liquidity, measured by average daily trading value, has grown nearly 600% from US\$667 million (2005) to US\$3.89 billion (2011). In companies with both voting and non-voting shares, most trading is in non-voting shares due to concentrated ownership.

As in many emerging markets, the market capitalization is concentrated in the largest companies; 53% of market capitalization (2010) is concentrated in 10 companies, of which the two largest companies (Petrobras and Vale) account for almost half. While the relative significance of the financial sector has declined in recent years, it remains as the largest sector and five of the ten largest listed companies are financial institutions.

The creation of the Novo Mercado³ corporate governance tiers on BM&FBOVESPA, with their higher standards for corporate governance and minority shareholder protection, resulted in major changes in the Brazilian equity market.⁴

Public offerings on the special tiers took off in 2004/5. Between 2004 and 2008, 113 companies went public (58 in 2007 alone), representing nearly one-third of the 382 total companies listed as of 2010. Following the global financial crisis of 2008, the number of offerings in the past three years has continued at a slower rate (6 in 2009, 11 in 2010, and 11 in 2011). Brazilian IPOs tend to be larger in size than most emerging markets. Of the 22 IPOs in 2010 and 2011, only one was smaller than US\$240 million. Traditional listed companies continue to represent approximately 35 percent of total market capitalization.

Novo Mercado, Level 2, and Level 1 companies now account for 182 listed companies, representing 39% of total listed companies, 66% of market capitalization, and 81% of traded value.⁵

While the total market capitalization is substantially larger than other Latin American markets, the total number of listed companies is not comparably larger. Chile, with its much smaller economy has 229 listed companies.⁶ The differential is even more significant given the overall size of the Brazilian economy compared to other countries in the region. Thanks to the influence of a few large offerings, the total amount of capital raised through IPOs is high relative to other countries, but the number of new issuers is relatively low. The number of listed companies is also low when compared with other prominent emerging market countries. According to one recent report, only 30 percent of the 1,000 biggest companies in Brazil are listed on the stock exchange.⁷

The special corporate governance tiers have driven the growth of the market

Despite these gains, the number of listed companies is not large by international standards.

³ This report will sometimes use the term “Novo Mercado” (“New Market”) to refer to all of the special corporate governance tiers on BM&FBOVESPA, although the Novo Mercado formally only refers to the highest of the three tiers.

⁴ See a discussion of the background to the creation of Novo Mercado beginning page 13.

⁵ As of April 2012. Source: BM&FBOVESPA.

⁶ Bovespa has also innovated by launching Bovespa Mais in 2005. Bovespa Mais as a market alternative for small companies wishing to come to the market. As of March 2012, there were 2 companies listed. Possible explanations as to why more companies have not come to market include competition from banks, lack of awareness, lack of interest by intermediaries (investment banks, legal consultants, companies, investors), and market conditions.

⁷ Financial Times, Brazil Capital Market Special Report, October 3, 2012.

Additional reforms can be expected to continue to contribute to long-term market growth and development

Ownership of most listed companies and financial institutions is concentrated

Many observers believe that the behavior of the equity market since 2000 and increases in the number and value of listed companies can be explained by improvements to corporate governance regulation and oversight. Additional corporate governance reforms can be expected to continue to contribute to long-term capital market growth and development.

Ownership

Ownership of most large companies remains concentrated, at levels common to most emerging market countries.⁸ Brazilian companies can be placed into one of five categories:⁹

- ▶ **Family Ownership.** 42.9% of traditional-listed companies and 35% of special-listed companies are controlled by families. For these companies, the majority-owner usually serves as Chairman of the Board and, in a lower frequency, as CEO as well.
- ▶ **Shared Control.** 28.6% of traditional-listed companies and 44.7% of special-listed companies are controlled by large blockholders acting in concert generally through formal shareholders' agreements. For these, the Chairman of the Board and CEOs are usually representatives of controlling blockholders.
- ▶ **Foreign ownership.** 16.4% of traditional-listed companies and 3.6% of special-listed companies are controlled by foreign multinationals. In this case, both Chairman of the Board and CEO positions tend to be filled by executives from the controlling firm.
- ▶ **State control.** 11.6% of traditional-listed companies and 3.0% of special-listed companies are controlled by the government. In this case, both Chairman of the Board and CEO positions are occupied by people indicated by the government, in most occasions based on political criteria.
- ▶ **Dispersed or “pulverized” companies.** 0.79% of traditional-listed companies and 13.7% of special-listed companies have dispersed shareholding structures. In these cases there is not a majority owner.

In other countries this degree and form of concentrated ownership brings a number of corporate governance challenges:

- ▶ In general, concentrated ownership (and membership in group structures) increases the risk for minority shareholders from abusive actions by controlling owners and more generally discourages shareholders from participating in the governance process. The same owner may control listed and private firms and the relationship between the different firms is not transparent to outsiders. It is not always easy for minority shareholders to identify “related parties” or to assess the fairness of a transaction. This can provide controlling shareholders with multiple and often perfectly legal opportunities to engage in activities that advance their own interests at the expense of minority shareholders.

⁸ Sources: 2011 *Capital Aberto Yearbook*; Da Silveira, Alexandre Di Miceli, Corporate Governance and Capital Markets in Brazil: History and Current Overview (2010). Available at SSRN: <http://ssrn.com/abstract=1492216>; 2011/2010 KPMG/CEG Survey.

⁹ Dr. Alexandre Di Miceli, unpublished database on ownership of listed companies in Brazil.

- ▶ Family ownership in other countries has raised a separate but related set of concerns, including: (i) informal policies, procedures, and control structures; (ii) informal, unprofessional, or unqualified boards that do not provide strategic guidance or oversight to management, and (ii) a lack of management succession planning.
- ▶ The large number of state enterprises and listed companies with significant ownership by the State means that the SOE governance agenda, and the role of the State as owner, are key policy concerns.
- ▶ The recent evolution of “pulverized” companies that do not have clear controlling shareholder raises special concerns, especially in the area of takeover regulation.

The gross assets held jointly by institutional investors (mutual funds, pension funds, and insurance companies) increased by about 60 percentage points of GDP (from 14 to 74 percent of GDP) over the last decade, compared to 20 percentage points (to 78 percent of GDP) in the case of banking assets. Assets in closed and open private pension funds amount to, respectively, 15 and 6 percent of GDP. The growth of the closed system has been relatively modest, measured either by assets and contributors, but the introduction of new defined contribution funds for civil servants at the federal, state and municipal levels in 2013 will imply a significant growth in the future.

Local institutional investors play a significant role.

Insurance companies, which manage open pension plans, have been growing very rapidly but still remain below benchmark in terms of assets and premiums.

Assets held by institutional investors rose by 60 percentage points of GDP. The structure of public debt has become more resilient and the private bond market more vibrant. Equity market capitalization is high but new listings have been concentrated in a few large issuers. International investors play important roles in the equity, fixed rate debt, and derivatives markets.

Mutual funds have also been expanding rapidly, with asset holdings rising from about 30 percent of GDP in 2003 to nearly 50 percent in 2011. Mutual funds are the dominant institutional investor in Brazil; the total value of equity holdings represents approximately 10-15% of the total equity market cap. However, the portion of assets allocated to equity investments is low by global standards. Globally 39% of mutual fund assets are invested in equities. In Brazil the share of equity funds account for only 12% of assets under management. The low level of equity investment reflects a national preference for investing in largely risk-free government debt offering substantial returns, although this environment could change significantly in the near future, with the decline in real interest rates on government securities.

In 2011, the total inflow of funds to the Brazilian equity market from foreign investors was a positive balance of BRL 8.23 billion, including BRL9.58 billion in acquisitions during stock offerings and negative BRL1.35 billion in the secondary market.

Foreigners play a major role in the market.

Foreign institutional investors have been critical to IPOs and follow-on offerings. Between 2004-2011 foreigners purchased on average 69 percent of IPOs and 59 percent of follow on offerings. Foreign investors represented 34.7% total trading volume, increasing from 29.6% in 2010.

FIGURE 1: IBovespa vs. Other Major Market Indices

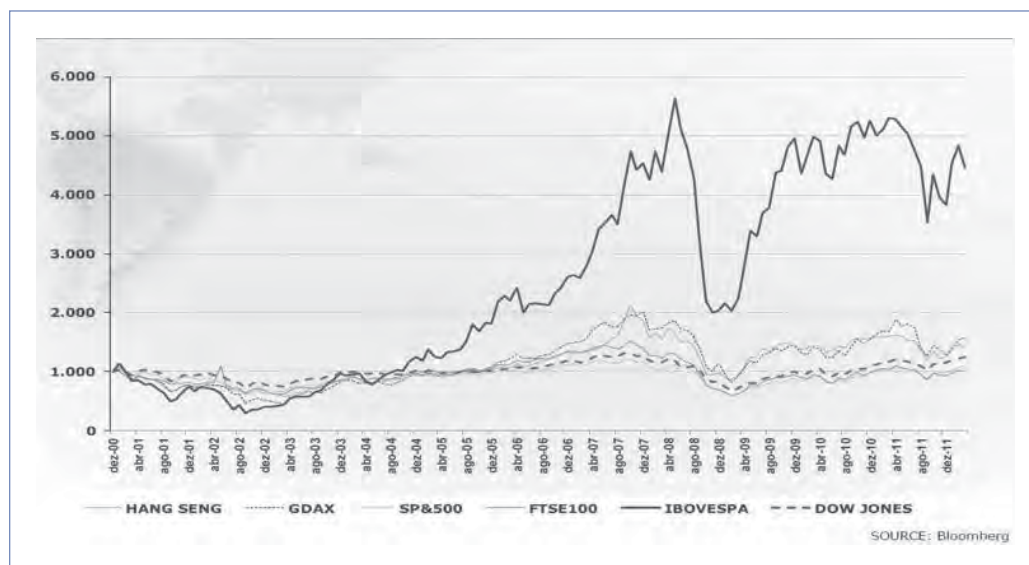


FIGURE 2: Listed Companies on the Special Corporate Governance Tiers

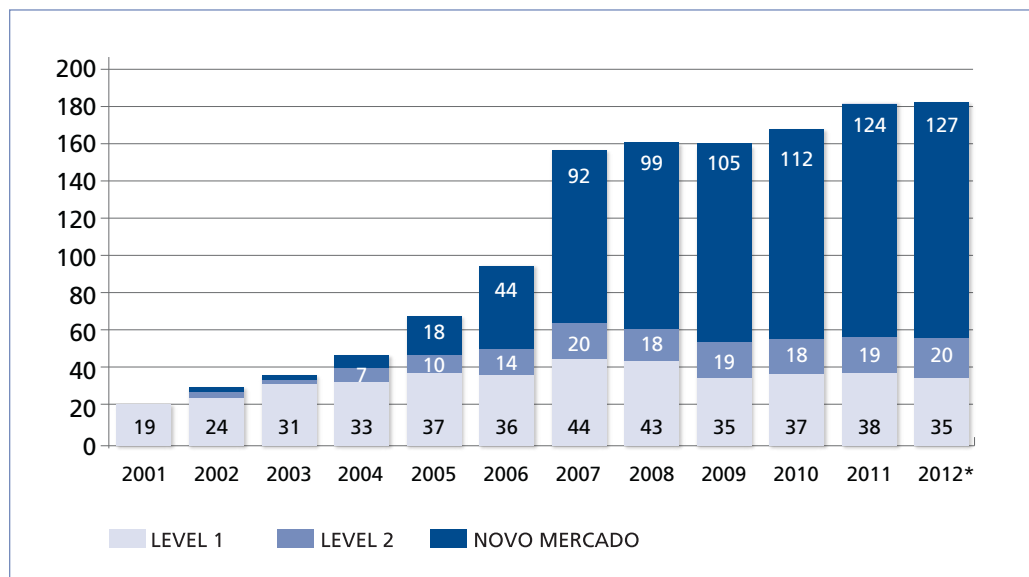


Table 1: Brazil and other BRIC Countries — Key Financial Indicators (2011)

	Brazil	China	India	Russian Federation	South Africa
BANKING					
<i>DEPTH/SIZE</i>					
Domestic Bank Deposits/GDP (%)	66.5	164.4	66.7	41	63
Private Credit/GDP (%)	58.0	127.4	50.6	45.0	68.9
<i>STABILITY</i>					
Private Credit to Deposits (%)	87.2	77.5	75.8	110.2	110.1
Liquid Assets/Deposits & Short Term Funding (%)	54.3	31.8	6.7	48.0	21.1
Bank Capital to Assets (%)	10.3	6.4	7.1	12.6	7.3
NPLs to Total Gross Loans (%)	3.5	1.0	2.3	6.6	4.7
Provisions to NPLs (%)	155.0	278.1	55.2	104.5	34.9
Regulatory Capital to Risk-Weighted Assets (%)	17.3	12.7	14.2	14.7	14.9
STOCK MARKETS					
Percent Market Capitalization of Top 10 Largest Companies (%)	53.1	25.3	31.1	62.1	25.2
Percent Value Traded of Top 10 Traded Companies (%)	47.7	8.3	23.8	96.0	12.1
Number of Listed Companies	366.0	2342.0	5112.0	327.0	355.0
Stock Market Capitalization/GDP (%)	49.6	46.3	54.9	42.9	209.6
Stock Market Turnover Ratio (%)	69.3	188.2	56.3	127.3	39.8
Gross Portfolio Equity Assets/GDP (%)	0.7	0.8	-	0.3	30.3
Gross Portfolio Equity Liabilities/GDP (%)	14.2	2.9	-	9.4	25.5
DEBT MARKETS					
Outstanding Domestic Private Debt Securities/GDP (%)	21.5	25.1	4.6	-	17.3
Outstanding Domestic Public Debt Securities/GDP (%)	38.6	20.6	27.7	4.7	30.6
Outstanding International Private Debt Securities/GDP (%)	6.3	1.7	-	7.2	9.8
Outstanding International Public Debt Securities/GDP (%)	2.1	0.1	-	1.7	2.7
Gross Portfolio Debt Assets/GDP (%)	0.5	2.7	-	2.0	2.8
Gross Portfolio Debt Liabilities/GDP (%)	9.7	0.5	-	2.6	12.5
NON-BANK FINANCIAL INSTITUTIONS					
Insurance Premiums (Life)/GDP (%)	1.4	2.1	3.1	0.1	9.6
Insurance Premiums (Non-Life)/GDP (%)	1.0	1.0	0.4	0.9	1.5
Insurance Company Assets/GDP (%)	9.0	-	-	1.7	-
Mutual Fund Assets/GDP (%)	46.5	4.6	4.6	0.2	30.6
Pension Fund Assets/GDP (%)	13.9	-	-	-	-

SOURCE: World Bank Finstats Database 2012

Key Findings

The following sections highlight the principle-by-principle assessment of Brazil's compliance with the OECD Principles of Corporate Governance.

COMMITMENT AND ENFORCEMENT

The last Corporate Governance ROSC was completed in 2005. Since that time both the public and private sectors have continued to work to build a strong legal and institutional framework for corporate governance. Corporate governance in Brazil is an unusual mix of conservatism and innovation. Several reforms in Brazil qualify as some of the most innovative (and high-impact) reforms in emerging markets. However, some components of the corporate governance framework have received less attention (see in particular the section on boards of directors, below).

Legal Framework

Company law has traditionally tilted in the direction of the interests of large business groups

Brazil has a civil law legal tradition with significant influences from the US. The current Corporate Law was introduced in 1976. According to Brazilian legal scholars, that law tilted company law in the direction of the interests of large business groups. For example, up to 2/3 of share capital could consist of non-voting shares.

The law was twice reformed (in 1997 and 2001).¹⁰ The 1997 reforms were generally seen as harmful to investor confidence and capital market development. The number of listed companies dropped from 550 in 1996 to 440 in 2001. Many companies chose to list on the US market using American Depositary Receipts (ADRs). The stock exchange worried about the continued relevance of the securities market inasmuch as "...virtually no new companies had tapped the equity market. No initial public offerings. No secondary offerings."¹¹

The 2001 reform reversed course to some extent, and reduced the level of non-voting shares from 2/3 to 1/3 of the capital stock, although existing listed companies were exempted. Tag along rights were reinstated for voting shareholders, with the minimum price of 80% of the price paid for obtaining control.

Laws and regulations are developed with significant consultation

CVM and the self-regulatory organizations carefully consult on new laws and regulations. CVM provides a consultation period, and issues a "Consultation Period Report" to specify which items were included or discarded in the final version of the Regulation. The regulator considers costs and benefits in every public consultation.¹² The SROs, other stakeholders, and the companies work to explain changes in laws and recently passed regulations (notably IBGC, IBRI, and ABRASCA). CVM issues "Parecer de Orientação" (translated as Legal Opinion) to explain changes in regulation and to clarify its position on matters that can be unclear for market participants. All legislation, regulations and code are fully accessible in internet.

¹⁰ The 1997 reform aimed to facilitate the ongoing privatization program. The most controversial change was the elimination of tag-along rights for minority voting shareholders; new owners could now buy a controlling block without having to make a tender offer for the shares of any minority groups. As a result, the government managed to capture the entire control premium paid by acquirers. The 1997 reform also reduced other minority rights, including withdrawal rights in mergers and spin-offs.

¹¹ Novo Mercado and Its Followers: Case Studies in Corporate Governance Reform. *Global Corporate Governance Forum Focus Note 5*, available at [http://www.ifc.org/ifcext/cgf.nsf/AttachmentsByTitle/Focus+5/\\$FILE/Novo+Mercado+text+screen+4-21-08.pdf](http://www.ifc.org/ifcext/cgf.nsf/AttachmentsByTitle/Focus+5/$FILE/Novo+Mercado+text+screen+4-21-08.pdf).

¹² See for example *Public Consult Reporting for Instruction 509*.

Because investor protection and corporate governance weaknesses were seen as the core problem in capital market development, BM&FBOVESPA launched a new market tier in December 2000 in an effort to address these weaknesses. The special corporate governance tiers (often referred to loosely as “Novo Mercado”) were created to allow companies to highlight their improved corporate governance practices.

The “Novo Mercado” rules represented a significant break with the past

By 2002, BM&FBOVESPA had amended its mandatory listing rules to require that any new listings involving a public share offering must be registered, at a minimum, as Level 1.

Three new tiers of listed companies were created (see table on following page). Companies listed on the highest level (Novo Mercado) must adopt a series of corporate governance practices most requested by minority shareholders, including:

The Novo Mercado rules included several important innovations in the Brazilian context

- ▶ “One share/one vote”
- ▶ Mandatory recourse to arbitration for dispute resolution
- ▶ Board independence

“Level 2” requirements are close to those of Novo Mercado, but allow nonetheless companies that want to maintain non-voting preferred shares to demonstrate their commitment to good governance. “Level 1” requirements focus on transparency.

The new rules are enforced as BM&FBOVESPA listing rules; delisting from the Novo Mercado or “Level 2” results in a mandatory buyout offer to minority shareholders. By design, the rules do not include many issues addressed by reformers in other countries, for example related to board composition and practices.

In 2010, Bovespa launched a comprehensive consultation with its member companies to enhance the Novo Mercado framework. The consultation process included 16 forums with 169 representatives of listed companies, and “Challenges” seminars that involved more than 700 people, and further review by the listed companies.

Bovespa worked to strengthen the Novo Mercado framework in 2010 but several recommendations were not approved by the listed companies

Three key recommendations of the consultation groups were not approved by the listed companies:

- ▶ An increase in the number of independent board members from 20 to 30% for Novo Mercado and Level 2) and the addition of the independence requirement for Level 1;
- ▶ A requirement for an audit committee comprised of a minimum of three members elected by the Board of Directors, of whom at least one must be an independent board member.
- ▶ A significant change in the takeover rules to require a mandatory offer after a shareholder hits 30% of outstanding shares (down from 50%).

Table 2: Bovespa Special Corporate Governance Listing Tiers — Key Elements and Recent Additions

	Novo Mercado	Level 2	Level 1	Traditional Listed
TRANSPARENCY				
Improved financial disclosure (quarterly/consolidated)	✓	✓	✓	✓
Review by an independent auditor.	✓	✓	✓	✓
IFRS or US GAAPP	✓	✓	✓	✓
Disclose insider trading of company shares (monthly)?	✓	✓		
Immediate disclosure of related party transactions				
CORPORATE GOVERNANCE AND SHAREHOLDER RIGHTS				
Voting shares only	✓	No**	No	No
Tag Along Rights (Voting/Non Voting Shares)	100%/N.A.	100%/100%	80%/None	80%/None
Public tender offer at economic value in case of delisting	✓	✓		
Minimum of five board members	✓	✓		
Minimum of 20 percent of independent members	✓	✓		
Arbitration of shareholder-company disputes	✓	✓		
At least 25-percent free float	✓	✓	✓	
Prohibition on voting restrictions for small shareholders	2010	2010		
No special quorum	2010	2010		
"Eternity clause"	2010	2010		
Restrictions on <i>clausulas pétreas</i> (poison pills)	2010	2010		
No joint Chair/CEO	2010	2010	2010	
Board must make statement on takeover	2010	2010		
Companies must have securities trading policy	2010	2010	2010	
Companies must have/disclose code of conduct	2010	2010	2010	

SOURCE: BM&FBOVESPA Listing Regulations. "2010" means that this requirement was introduced as a requirement in 2010.

**Level 2 companies can keep existing (and issue new) preferred shares. Preferred shares have tag-along rights at the minimum of 80 percent of the price received by the controlling shareholder. Preferred shares are also entitled to voting rights in some situations (company mergers and incorporations and contracts between the controlling shareholder and the company).

Institutional Framework and Public Enforcement

The CVM (*Comissão de Valores Mobiliários*, the Securities and Exchange Commission of Brazil) oversees markets, market intermediaries and listed companies. The Central Bank of Brazil oversees banks and non-bank financial institutions and listed issuers. The CVM has made a strong commitment to improving corporate governance in Brazil.

The CVM is managed by a chairman and four commissioners, appointed by the President, after approval by the Federal Senate. The chairman and the commissioners are appointed for five years. They can only “lose their mandate in case of resignation, transited judicial conviction or administrative procedure”. Observers give high marks to CVM’s ability to maintain its independence while pushing forward reforms.

Law 7940/89 sets the amount of all fees paid by the financial services industry for regulatory services. The money collected is paid directly to the Treasury. The amount of fees collected provides a nominal target for the CVM budget that is almost never reached. The CVM must submit its proposed budget to the Minister of Planning who has full authority to reduce the amount requested. It is then submitted as part of the overall governmental budget to Congress for approval. Congress may also increase or reduce the CVM budget.

The CVM also is limited in its authority to reallocate budgeted funds. All accounts are designated as fixed cost or investment and the CVM may not reallocate money from one account to another.

CVM can issue Instructions, Legal Opinions and Circular Notices. Instructions are the main form of regulation and deal with specific matters the regulator must supervise.

The CVM budget has grown over the last decade, but is less than what will be necessary as the market grows in size and sophistication.

Despite some improvements in recent years, with a better base salary to attract new workers, some aspects of personnel staffing continue to be a challenge. Stability and independence are important features and initial remuneration is not far from what the private sector offers. Salaries are sufficiently attractive to retain staff and the CVM staff turnover rate is very low. Competition for new positions is quite high. However, career plans tend to be less attractive and salaries for senior staff are not competitive with those in the private sector. The hiring process is not as efficient as in private sector, as it follows the same exam-based process as for any other public body, and a tender process is required by the law. CVM cannot interview candidates for its technical staff, which can make it difficult to bring in the required expertise.

The amount of resources provided to CVM in the area of information technology (IT) is acknowledged by management to be insufficient, and much IT is now outsourced. Improving access to the information available on the CVM website will require constant improvement.

Since 2007, the CVM has used risk-based supervision approaches, and has formal strategies and plans to focus its resources on those institutions and practices that pose the greatest risk.

The CVM was designed to be politically and financially independent

The budget process may reduce the CVM’s operational independence

CVM’s powers are generally appropriate

CVM’s resources are generally considered to be insufficient

Risk based supervision

BOVESPA plays a key role in the corporate governance framework, via the special listing tiers

The CVM is becoming increasingly aggressive in its enforcement actions

BM&FBOVESPA has a positive reputation. Since its demutualization BM&FBOVESPA is listed on the Novo Mercado and routinely wins corporate governance awards.

Beyond the requirements for the special corporate governance tiers, on-going listing requirements are limited (listing requirements are generally issued by CVM).

CVM can accept complaints and investigate, can detect problems or frauds in companies and take action if the law is violated. CVM can also act as an expert witness, and provide relevant and required information for a legal process. But CVM cannot directly intervene in a shareholder dispute.

CVM has significant enforcement powers. It can impose both warnings and fines. In 2010, a total of 93 administrative sanction proceedings were opened by CVM, representing a 24% increase on the previous year. Major cases are brought to CVM's enforcement department (26 cases in 2010), and adjudicated by the CVM Chair and Board; the rest are handled directly by the line departments (67 in 2010). In 2010 the number of fines rose from 115 to 126, totaling BRL575 million (about USD 320 million).

TABLE 3: CVM Enforcement Actions 2009-2010

	2009	2010
Reprimands	19	9
Fines	115	126
Suspensions	0	5
Disqualifications	1	9
Cancellations	0	0
Prohibitions	0	1
Acquittals	69	399

Consent decrees have become an important tool, but remain controversial

In the past few years, CVM has adopted a strategy of settling out-of-court through the process of *Termos de Compromisso* (consent decrees). The consent decrees allow the CVM to settle charges before trial and sometimes even before a process is opened), without an admission of guilt.

CVM has also imposed fines on companies or directors and officers that did not fully discharge their duty of loyalty. For example, each individual involved in the Sadia derivative case was fined around 150,000 dollars. All processes can be accessible on the CVM's website.¹³ Consent decrees were used to settle 24 cases in 2010. They remain somewhat controversial. On the one hand, the CVM can bring quick and large penalties without the need to resort to the courts (that can then be appealed). While the settlements are made public, including all decisions and technical

¹³ In 2010, Sadia (a large meat processing company) was forced to post a BRL545 million write down to cover derivative bets made by management against the dollar. The company dismissed its CFO and later dismissed four directors. Paper and pulp company Aracruz saw \$2.13 billion in losses stemming from similarly wrong bets.

opinions of the relevant CVM internal committee, they do not become clear legal precedents for the market.¹⁴

The court system in Brazil is considered to be problematic, and is not seen as a good source of shareholder redress. Court actions are considered to be expensive and slow in Brazil.

Courts are expensive to use

One of the innovations of Novo Mercado has been the requirement for mandatory arbitration for dispute resolutions related to corporate and capital market questions involving the company, its shareholders (including the controlling shareholders), its officers, and BM&FBOVESPA. The exchange established a Market Arbitration Panel in 2001, staffed with arbiters who have expertise in the issues that will most likely be heard in this forum.

The Market Arbitration Panel has apparently heard approximately 20 cases.

Using the Doing Business 2012 “Enforcing Contracts” indicator as a proxy for overall commercial court effectiveness, courts in Brazil appear to be significantly slower than the OECD average, and slightly slower than the average compared to other countries in the region, but less costly than the average in OECD countries.

TABLE 4: Doing Business 2012: Enforcing Contracts

Indicator	Brazil	Latin America Average	OECD Average
Procedures (number)	45	40	31
Time (days)	731	708	518
Cost (% of claim)	16.5	31.2	19.7

Institutional Investors and Shareholder Engagement

Many institutional investors do vote, and the average attendance rate of institutional investors is higher than that of individual investors. However, institutional shareholder engagement with companies appears to be relatively limited. Institutional investors remain most concerned with company behavior during takeovers and mergers, when they work to coordinate their actions and file suit when they feel their rights are not respected.

Institutional investors attend and vote, but do not disclose their voting or voting policies.

Institutional investors are encouraged to develop voting policies, and some are required to publicly disclose their voting. CVM Instruction 409 requires the disclosure of voting policies (if there is one) in the bylaw and prospectuses of investment funds, and establishes that a voting summary has to be disclosed monthly. Pension fund regulation also requires voting disclosure. ANBIMA's self-regulatory code requires member funds to have and disclose their voting policy. As of the end of 2011, 526 funds have complied with the Code and post their voting policies on the website of ANBIMA.

¹⁴ The settlements must be published in the Official Press by Law 6385, art. 11, § 7.

SHAREHOLDER RIGHTS

Shareholder Meetings

Shareholders have full rights to participate at the GMS

Shareholders have the right to attend and cast votes at the General Meeting of Shareholders (GMS). The first call of the general meeting shall be made 15 business days in advance of the meeting. The CVM can extend the term for the call of the general meeting of a publicly-held company by up to 30 days. Shareholders do not have a legal right to amend or add items to the GMS agenda. The IBGC Code recommends a 30 day notice period.

At least one month before the date of the annual general meeting, key documents must be made available for the inspection of shareholders, including financial statements, a management report, the auditor opinion, the opinion of the conselho fiscal, and any other relevant documents.

Shareholders may be represented at a general meeting by a proxy. The proxy can be a shareholder, an officer of the company, or a financial institution. Companies in the past had raised some barriers to participation by proxy through the use of attendance requirements.

Shareholders have some rights to ask questions at general meetings. The right to “clarification” is granted by the Corporate Law and is generally respected. However, there is no mechanism or legal provisions stating how shareholders must assert such right or how GMS must be held in cases where shareholders want to pose questions. According to some market participants, normal company practice is to send relatively junior staff to meetings to answer questions.

Shareholder meeting practices have improved thanks to new (2009) CVM regulation

Instruction 481 (2009) details requirements for the meeting notice and agenda, and proxy voting, and has resulted in significant improvements to the quality of the meeting agendas. Instruction 481 mandates listed companies to:

- ▶ Produce a meeting agenda that presents all matters to be discussed at the meeting.
- ▶ Disclose all required information for the meeting on the CVM’s webpage.
- ▶ Disclose mechanisms to receive shareholder suggestions to the GMS agenda (although in practice market participants argue that it continues to be difficult to alter the agendas).
- ▶ Remove barriers to the use of proxies.
- ▶ Introduce electronic voting. In practice alternate voting systems are rarely used but their use is increasing.¹⁵

Accessing the shareholder list is possible in theory but institutional investors claim that it is difficult in practice.

According to the Corporate Law, any shareholder whose shares with or without voting rights represent one-half of one per cent or more of the capital shall be entitled to request a list of the

¹⁵ http://www.capitalaberto.com/english/ler_artigo.php?pag=2&sec=83&i=2439&txt=Natura

addresses of the shareholders for the purpose of voting.¹⁶ However, in practice it can be difficult to access the shareholders list.¹⁷

Appointing board members

The Corporate Law provides possibilities for minority shareholders to directly appoint board members. The “voto multiplo” (cumulative voting) procedure allows 10% of voting shareholders to request the voting procedure, which should result in a distribution of seats according to ownership. Shareholders with 15% of voting capital and shareholders with non-voting shares equal to 10% of capital (or the sum of shareholders with voting shares and non-voting shares equivalent to 10% of capital, if none of the first 2 groups was able to reach the percentage needed) can also appoint their own director.

Minority shareholders have significant rights to board appointments, although the ownership thresholds are high

The IBGC Code recommends a nominations committee of the board. However, almost no companies have set up board-level nomination committees.

For company outsiders that do not take advantage of applicable provisions in the Corporate Law, influencing board elections is generally considered to be difficult and not transparent.

Major transactions and corporate events

Shareholders must approve all changes to the bylaws, including increases to authorized capital.¹⁸ The board has the authority to issue shares up to the amount of authorized capital, with no time limit.

Tag-along rights are (only) provided to companies listed on Novo Mercado or Level 2

Shareholders have a right of first refusal in the subscription of an increase in capital, in proportion to the number of shares they own. Public companies are not required to offer pre-emptive rights if shares are offered for sale on public offerings.

Many companies make rights offerings (making rights tradable).

Most tender offers take place after an acquirer negotiates a private acquisition with the controlling shareholders. A transfer of control occurs when controlling shareholders directly or indirectly assign a majority of voting shares to the new controlling shareholder(s), who must then make a

The threshold for a mandatory tender offer is 50 percent

¹⁶ Under Article 126 of the Corporate Law, any shareholder whose shares with or without voting rights represent one-half per cent or more of the capital shall be entitled to request a list of the addresses of the shareholders. CVM Instruction 481 goes further and requires companies to comply with requests for a list of shareholder addresses made pursuant to art. 126 §3 of Law 6404 of 1976 within no more than three business days.

¹⁷ There appears to be an active debate between CVM and shareholder groups on this issue. Shareholder rights groups report some difficulties with accessing the list before the shareholder meeting. The problem is that there is not yet a consensus on interpretations of Articles 100 and 126 of the Corporate Law, which indicates that shareholders have the right to request and receive a list of shareholders in order to “defend their rights”. There is still no common understanding of this concept, and if “defend their rights” applies only to cases where shareholders rights are hindered or have been violated. Article 126 of the Corporate Law deals with the shareholders list, but it indicates that shareholders may request the list solely for the purpose of enabling the public request attorney and not to organize and vote together, or to obtain a quorum for meeting approval. There is no Parecer de Orientação that would clarify the matter for this specific article.

¹⁸ CL, Article 122

tender offer to all shareholders.¹⁹ For traditional listed companies, a tender offer must be made for all common (voting) shares, at 80% of the price paid to the controlling shareholders. There are no requirements for an offer to be made to non-voting shareholders.

For companies listed on Novo Mercado or Level 2, the price offered to voting shareholders must be equal to the price paid to controlling shareholders, and the price offered to non-voting shareholders must be 100% of that price.

Canceling the registration of a publicly-held corporation for shares to be traded in the market is only possible if the corporation that issued the stock, the majority shareholders, or the controlling corporation makes a tender offer to acquire the outstanding shares. Currently the fair price of the tender offer must be calculated based on one or more of the following criteria: net assets appraised at market value, discounted cash flow, comparison by multiples, share quotation in the securities market, or other criteria adopted by the CVM. After the delisting tender offer, any shares remaining after the tender offer must be redeemed at that price.²⁰

The new Takeover Panel may help to protect minority shareholder rights in the future

Several complaints and questions have been made by minority shareholders regarding price paid for their shares and biased valuations during reorganizations, mergers, and takeovers.

In June 2012 a variety of stakeholders and self-regulatory organizations agreed to form a “takeover panel”, the CAF (Comitê de Aquisições e Fusões), modeled on the UK’s Takeover Panel. The CAF will be composed of nine members from the various SROs and organizations (including BM&FBOVESPA, AMEC, and ANBIMA). The CAF will be governed by a self-regulatory code. A company will be able to either include a provision in its bylaws that requires it to submit to CAF any public tender offers and corporate restructuring transactions. Alternatively, the company will be able to place a specific transaction before CAF on a case-by-case basis.

Shareholder rights to approve large transactions are relatively limited

Shareholders do have the right to vote for some major transactions, including “the corporation’s transformation, consolidation, incorporation and divestment, its dissolution and liquidation...” However, most transactions are approved at the board level (with no requirements for oversight by independent members).²¹

Neither shareholders or independent directors approve related party transactions

Older analysis suggests that RPTs are significant and frequent among Brazilian listed companies, that there is a negative correlation between the use of RPTs and corporate governance quality, and between RPTs and firm market value.²²

19 Section 254-A of the Corporate Law, Section 29 of CVM Instruction 361.

20 The CVM requires the price to be set by an independent evaluator, per CVM Instruction 361 (updated by CVM Instruction 436 of 2006). The evaluator must be a financial institution with special/proven experience, and must follow criteria set out in the Instruction. The evaluator must declare that there is no conflict of interest that reduces his independence, and must disclose the cost of the report and the valuation methodology. The evaluator does not have to be authorized by the CVM.

21 http://www.capitalaberto.com.br/English/ler_artigo.php?pag=2&sec=77&i=3108&btxt=Tractebel

22 Da Silveira, Alexandre Di Miceli, Prado, Viviane Muller and Sasso, Rafael De Campos, “Related Party Transactions: Legal Strategies and Associations with Corporate Governance and Firm Value in Brazil” (2008). Available at SSRN: <http://ssrn.com/abstract=1307738>.

Protecting shareholders from insider trading

Both the Corporate Law and CVM Instruction 358 address illegal insider trading. In general, insiders must not use any commercial opportunity which may come to his/her knowledge, by virtue of his/her position, for his/her own benefit or that of a third party, whether or not harmful to the corporation. “Any officer who may receive any confidential information not yet revealed to the public shall not make use of such information to obtain any advantages for himself or for third parties by purchasing or selling securities.”

Insider trading is prohibited by the Corporate Law, but prosecutions are few.

Companies are required to implement and disclose a “Trading Policy” to establish closed periods and internal procedures for share trading by insiders. Trading by insiders must be disclosed to the company, CVM and stock exchange, and is also disclosed in a specific form.

As in many countries, detecting and enforcing violations of illegal insider trading rules has proven to be a significant challenge. In 2009, the public prosecutor and the CVM filed the first lawsuit based on charges of insider trading. Charges were brought against persons involved in the merger of Perdigão and Sadia that occurred in 2006. Both administrative and criminal proceedings were brought. Officers from Sadia pled guilty to insider trading, and were convicted with both a fine and imprisonment. (This sentence was later converted to suspension of acting as a public company administrator, and services to the community).

The level of insider trading in the market is unclear. Although market participants believe insider dealing occurs, they believe it is improving.

Shareholder Recordkeeping

Companies are required to keep a share registry. Most large (listed) companies outsource the registry function to third party registrars. There are four big registrars (Itau, Santander, Banco de Brasil, and Bradesco), covering 98% of the listed sector. Service providers must be licensed by CVM to carry out these services.

Shareholders and the market benefit from and are protected by an efficient shareholder recordkeeping infrastructure

BM&FBOVESPA provides its own central depository services for equity trading.²³ The depository complies with CPSS/IOSCO standards for depository, clearing and settlement systems.²⁴ The depository holds shares in the name of the final owner. Shares held at the depository appear as an entry for “CBLC” on the books of the registry, and the depository does daily reconciliations with the various registries. It does not itself offer registry services. Shareholders can obtain statements directly from the depository. The depository holds about 40% of shares.

Brazil supports an active market for custody services. Clients include foreign investors and domestic institutional investors. Custodians and registrars are licensed and supervised by CVM, and are liable to the shareholder and third parties for any breaches of its obligations. They are lightly regulated but it does not appear to be a concern or problem in practice. Custodians do not vote on behalf of shareholders.

²³ The central depository was formerly a wholly owned subsidiary of the BM&FBOVESPA, the *Companhia Brasileira de Liquidação e Custódia (CBLC)*.

²⁴ Not independently verified for this assessment.

Shareholders have significant (if theoretical) rights to private redress under the law.

Shareholder Redress

Shareholders have a number of possible options for redress, with generally reasonable thresholds. However, relatively few of these legal actions are applied in practice.

Lawsuits against administrators (directors and executives) can be brought to court by the company upon a request of minority shareholders, similar to US-style derivative lawsuits. However, the effectiveness of these lawsuits is impaired by the fact that they must be approved at a shareholder(s) meeting (and not the board as in the US); and controlling shareholders have historically disfavored such lawsuits.²⁵ As a result, lawsuits against director(s) are rare. Minority shareholders normally sue the company. Minority shareholders from Sadia did sue directors and managers, but is considered to be a rare case, coordinated by foreign shareholders.

Shareholders can attempt to stop or reverse a decision of the GMS, board, or management, if any of these bodies do not discharge their duties in the sole interest of the company. In general, it is rare to have a decision by the board reversed; GMS reversals are more common.

Shareholders have other powers.

At the request of shareholders representing at least 5% of voting or non-voting capital, the court can order an inspection of the books of the corporation, “whenever acts contrary to the law or to the bylaws occur, or there are grounds to suspect that serious irregularities may be present.”²⁶ In practice, however, shareholders call for an inspection through the Conselho Fiscal.

The Corporate Law also establishes an appraisal right (*direito de recesso*) for shareholders dissenting from certain corporate resolutions.²⁷ The bylaws can establish the criteria for appraisal of the stocks of dissenting shareholders, subject to a minimum value based on the book value of the corporation as recorded in the latest financial statements. The application of appraisal rights often gives rise to controversies and lawsuits. In Brazil, this is particularly common in transactions involving the incorporation of a controlled company.²⁸

25 If the GMS fails to approve the lawsuit, minority shareholders representing at least 5% of capital may still file the claim. But the incentives for minority shareholders to file such claims are low, because they will bear the initial costs of the lawsuit and the verdict—which is somewhat uncertain and typically takes a long time—will go to the corporation.

26 CL, Article 105.

27 See CL Articles 136 and 137. Appraisal rights can be triggered by the following events: a change in the proportion of classes of stock that causes a loss to the dissenting shareholder (unless this is expressly allowed for in the bylaws); a change in the redemption or amortization terms of one or more classes of preferred shares, the creation of a new, more favored class that causes a loss to the dissenting shareholders; a reduction of the compulsory dividend; a change in the corporate purpose; merger or incorporation by another company or participation in a “group of corporations;” spin-off of the corporation, but only if the spin-off results in a change in the corporate purposes.

28 A leading case involving the use of appraisal rights was VASP, formerly a Brazilian airline corporation which went out of business after bankruptcy. The CVM examined the exchange ratio of stocks and ruled in favor of the minority shareholders. See CVM Administrative Procedure 23/99 (Processo Administrativo Sancionador 23/99).

Another leading case was the incorporation of Banco Santander Noroeste S.A. by its controlling company, Banco Santander Brasil S.A. After the CVM ruled in favor of minority shareholders, Banco Santander appealed in court, but the CVM decision was ratified. See CVM Administrative Procedure 24/04 (“Processo Administrativo Sancionador 24/04”) and decisions by the São Paulo Appeal Court (“Tribunal de Justiça de São Paulo”) Nos. 510.984-4/8, 219.385-4/2, and 516.357-4/0. Source: Legal Protection of Minority Shareholders of Listed Corporations in Brazil: Brief History, Legal Structure and Empirical Evidence, Bruno Meyerhof Salama and Viviane Muller Prado, 2011.

Shareholders with at least 5 percent of the voting or non-voting capital (and the *conselho fiscal*) can call a shareholder meeting.

Doing Business 2012 sheds some additional light on this question. The following table shows Brazil's scores on the "protecting investors" index. Brazil scores highly on the extent of related party transaction disclosure, and higher than the regional and OECD averages on the extent of director liability, but much lower than average on the ease of shareholder lawsuits. This suggests that significant procedural improvements can be made in order to improve the ability to seek and obtain appropriate redress.

...but are rarely significant in practice

Table 5: DB Investor Protection Index Components (2012)

DB Investor Protection Indicator	Brazil	Latin America	OECD Average
Extent of disclosure index (0-10)	9	4	6
Extent of director liability index (0-10)	7	5	5
Ease of shareholder suits index (0-10)	3	6	7
Strength of investor protection index (0-10)	5.3	5.1	6.0

DISCLOSURE AND TRANSPARENCY

Company Reporting

Companies must prepare financial statements (including a balance sheet, income statement, and statement of changes in financial position, and explanatory notes). Law and regulation does not require the preparation of an "annual report" that contains additional information, although many (large) companies do so. Significant information is instead made available on company and CVM/BM&FBOVESPA websites.

Companies prepare financial statements but not an annual report

Financial Reporting and Auditing

Financial reporting for listed companies must now be prepared according to IFRS

Law 11.638/2007 (combined with CVM Instruction 457/2007²⁹) significantly upgraded financial reporting requirements. The new CVM instruction requires the preparation and disclosure of consolidated financial statements in accordance with the IFRS, beginning with reporting periods ending in 2010.³⁰

Financial reporting issues are addressed in more detail in the Accounting and Auditing ROSC for Brazil (forthcoming).

²⁹ As amended by CVM Instruction 485 of 2010.

³⁰ The use of IFRSs was optional for listed companies from 2007 through 2009.

The CPC is responsible for the oversight of accounting and auditing standards

Auditor oversight is enforced by both CVM and the CFC

The financial statements of publicly held corporations must be audited by independent auditors registered with the CVM.³¹ The Federal Accounting Council (*Conselho Federal de Contabilidade*, or CFC) issues audit standards. CFC has fully adopted International Auditing Standards (Resolutions 1201 to 1238/2009). Auditors must also observe the “Code of Professional Ethics of the Accountant” (*Código de Ética Profissional do Contador*, or CEPC) issued by the CFC.³² The Code of Ethics includes independence requirements harmonized to the most recent IFAC version, based on Section 290 of the IESBA Code.³³

CVM recognizes the role of the Committee on Accounting Pronouncements (*Comitê de Pronunciamento Contábeis* — CPC) in drafting accounting standards. The CPC is composed of accounting experts from several academic, business and regulatory institutions.

CVM has the authority to monitor and enforce compliance with accounting standards.³⁴

Auditors of listed companies must be licensed by the CVM and with the CFC.³⁵ Auditors have a three-level oversight framework, including internal quality control programs, peer reviews (at least every four years), and review by CVM.³⁶ The Securities Act empowers the CVM to apply sanctions such as reprimands, fines, suspensions and to cancel their license. A specialized department of the CVM, composed exclusively of accountants, is dedicated to registration and continuous monitoring of auditors, according to the principles of risk based supervision.

CVM has carried out a significant number of enforcement actions against auditors over the past five years.³⁷ The CVM has also been successful in negotiating consent decrees, some for relatively sizable settlements. In 2011, CVM settled with KPMG for BRL 1,500,000 (about USD 800,000) and with Deloitte for BRL 240,000 (US\$ 127,945).

31 Law 6.404/1976 (and amendments), Article 177, §3. In addition to a CVM license, auditors must be licensed and registered by the Administration Committee of External Quality Review (CRE). The CRE is supervised by the CVM and is headed by a Board composed of four representatives from the CFC and four from the Institute of Independent Auditors of Brazil (IBRACON). All board members must be registered in the National Registry of independent Auditors and licensed by the CVM. Members serve three-year renewable terms.

32 CFC Resolution 803/1996 (amended by Resolution 1.307/2010)

33 CPC has a governance board whose membership includes representatives from the public corporation's association (ABRAS-CA), the accounting and auditing profession licensing body (CFC), the Institute of Independent Auditors of Brazil (IBRACON), BM&FBOVESPA, and the academic community (FIPECAFI). Brazilian regulators participate in a non-voting capacity (CVM, SUSEP, Central Bank, Revenue Dept.), as does the Brazilian Bank Federation (FEBRABAN). The CPC is funded through fees from enforcement actions and from fees paid by the accounting/auditing industry.

34 Article 177, Corporate Law 6.404/1976, and CVM Instruction 457/2007 (as amended by CVM Instruction 485/2010).

35 External auditors are disqualified if: a) they cannot prove their participation in the Continuing Education Program in accordance with the resolutions of the CFC that address this matter; b) they are suspended from the profession; c) they lose their licenses issued by Regional Accounting Councils (CRCs) or if d) they are excluded from CVM or Central Bank records.

36 The CVM requires all registered auditors to be peer reviewed (CVM 308, §33). The CRE administers the Brazilian peer review process for auditors (CVM 308, §33; CFC Resolution 1323). Peer reviews must be conducted on a four-year cycle (a three year cycle is planned). Each firm may choose the firm that will conduct the peer review and negotiate the fee for the peer review. There is no prohibition on the reviewing firm subsequently selecting the reviewed firm for its own peer review. The CVM may order the substitution of a reviewing auditor if it considers the review performance to be unsatisfactory (CVM 308, §33.5). If weaknesses or deficiencies are identified, the reviewed firm must prepare an action plan for correction and submit it to the CRE. The CRE will analyze each review and approve the peer review report. Should the report contain no opinion or an adverse opinion, a specific communication has to be forwarded to the CFC and to the CVM.

37 These include 15 fines, 2 license suspensions, and 4 reprimands

CVM and CFC are considered by the market to be working to meet the goal of audit quality. However, the emergence of accounting problems with some listed companies in the past years (e.g. Banco Panamericano and Agrenco) may indicate that all audit firms may not be complying with the highest audit standards.³⁸

In 1999, CVM mandated auditor rotation every five years. In 2008, the CVM suspended this requirement (until the end of December 2011) in order to allow audit firms and their clients to complete the shift to IFRS. As in other countries, the audit rotation requirement has been controversial, and its benefits have been difficult to document.

The CVM has launched a series of initiatives with auditor rotation

In December 2011, CVM issued Instruction 509/2011 which modifies the past audit committee requirement, and provides an incentive to create a “statutory audit committee”. Companies that implement an audit committee can double the audit rotation period to ten years.

For financial institutions, the Central Bank (through Resolution 3.606/2008) eliminated the rotation of audit firms, while maintaining the requirement for rotation of the audit partner and other members of audit team management.

Shareholders do not approve the election and dismissal of the external auditor. The Corporate Law establishes that the board of directors is responsible for election and dismissal of external auditors. In general, the auditor is required to report to the board as a whole, and not to an independent audit committee. However, audit committees implemented under new Instruction 509 do have responsibility for the external auditor.

Auditors are accountable to the board, not to shareholders

To date, the small number of independent audit committees (outside of financial institutions) may mean that auditor selection and retention process is controlled by management and controlling shareholders, which can reduce the value of the audit for minority shareholders.

Non-financial Disclosure

In addition to financial statements, companies must make a variety of non-financial disclosures.

Many of these disclosures are made through the “Reference Form”, as required by CVM Instruction 480.³⁹ The Reference Form is the latest step in a series of measures designed to improve financial and non-financial disclosure. Companies are required to complete a comprehensive list of disclosure items. These are maintained as a separate document on CVM’s website, and a new document is added as conditions change and the information is updated. The overall amount of information is equivalent in many respects to what is required by a securities prospectus. The Reference Forms are presented in a CVM (and BM&FBOVESPA and the company’s) website, but not in an annual report.

³⁸ In November 2010 the BCB detected significant accounting inconsistencies at Banco Panamericano, Brazil’s 22nd in size at the time, and the bank was rescued through a BRL2.5 billion (US\$1.45 billion) deposit from the main shareholder funded by a loan from the deposit-insurance scheme (FGC—Fundo Garantidor de Crédito). Panamericano, which focused on consumer finance and car loans to lower-income clients, had allegedly been selling loan portfolios to larger banks while retaining the portfolios on its books.

³⁹ CVM Instruction 480/2009 (as amended by CVM INTRUCTION 488/2010), Annex 24.

As a result, non-financial disclosure requirements now meet most of the standards of the OECD Principles. The Reference Form is in many ways more comprehensive than the “comply or explain” requirement found in other countries, even though there is no mandated corporate governance code.

Some observers have doubts about the content of the information presented in the early batches of Reference Forms prepared by listed companies. There was wide variation in the way that information was presented. Companies have complained about the new requirements, and compliance is very uneven. One article warned that different companies presented identical information.⁴⁰ However, most observers and the CVM believe that compliance has improved with each passing year.

Company objectives/ management discussion and analysis

The management discussion and analysis (MD&A) must be updated in the Reference Form on an annual basis.⁴¹ The MD&A should include:

- ▶ Comments by the board on the company’s financial condition
- ▶ The “main elements of the business of the issuer”
- ▶ Results of operations of the issuer
- ▶ Material events that affect the issuer’s financial results
- ▶ Accounting issues and policies (including any problems in the audit report)
- ▶ Internal controls

Major share owner- ship, voting rights, dis- proportionate control measures

Shareholders must inform their company about direct and indirect significant (5%) ownership, and any subsequent transactions in shares.⁴² The rule covers any “person or company or group of people acting together or representing the same interest that have either direct or indirect participation corresponding to 5% of (voting or non-voting) capital. Shareholders must inform the company of any share transactions, and the company must in turn publish the information. Listed companies must also update the Reference Form with complete information about significant/controlling owners, including,

- ▶ A description of the issuer’s economic group;
- ▶ Identification of the controlling shareholder or group, providing key details

⁴⁰ *Capital Aberto*, Year 7, # 81, May 2010, Page 14-18: “The hour of truth: First batch of management pay data in Brazil reveals distortions and excesses — not to mention laziness and negligence in providing the information”. *Capital Aberto Magazine (International Edition)*, Year 1, # 2, Apr - Jun 2011, “Information scrooges: Unless companies cooperate, Brazil’s Reference Form won’t be helpful to investors”.

⁴¹ *Reference Form*, item 10.

⁴² CVM Instruction 358, Article 12. “Direct or indirect controlling shareholders and the shareholders that vote for members of the conselho fiscal, “as well as any person or company or group of people acting together or representing the same interest that have either direct or indirect participation corresponding to 5% (five percent) or more in type or class of shares representing the capital of a publicly held company”, must immediately inform the company about their holdings.”

- ▶ Identification of other significant (5%) shareholders;
- ▶ A description of any shareholder agreements;
- ▶ Pyramid structures;
- ▶ Limits of voting rights;

Voting caps are legal and must be in the bylaws in order to be enforced.

Companies appear to disclose ownership information, to the extent that this issue is no longer considered to be a significant policy issue in Brazil. The quality of information varies among listed companies, and tends to improve as the size and liquidity increases. Sometimes ownership information is not clear, or fully integrated; to understand ownership positions it is necessary to establish the interrelations between shareholders and then count the number of shares.

Disclosure of remuneration is one of the most contentious aspects of the disclosure framework. Companies must disclose the aggregate remuneration of its board members and senior executives in the Reference Form.⁴³ Companies must also disclose the minimum, average and maximum compensation package paid in the previous year. Companies are not required to disclose on an individual basis.

Remuneration policy
for board and key
executives

Compliance with these requirements is mixed. For example, one article warned that 8 out of the 20 largest companies on the iBovespa index declined to disclose per the requirements. The 2011/2010 KPMG/CEG Survey of 212 listed companies showed that about 60% of companies (including ADR issuers) did not disclose the maximum/average/minimum compensation. Some of the companies that did not disclose were supported by a court injunction that was obtained by the *Instituto Brasileiro de Executivos de Finanças* of Rio de Janeiro (Ibef-RJ, the Brazilian Association of Finance Executives) that authorized companies to refrain from any specific disclosure.

In addition, companies must disclose “the policy or practice of remuneration” in the Reference Form. There is again wide variation in practice, with some larger companies producing and disclosing world-class remuneration policies, and other companies providing boilerplate disclosures that simply repeat aspects of the law. Researchers and analysts have found it difficult to see links between remuneration and long term performance.

Companies are required to disclose considerable information about board members, including when directors were elected to the board, their current mandates, their curriculum vitae with all relevant information, other directorships, whether or not board members are considered independent (for Novo Mercado companies), and attendance records (available in board meeting minutes on the CVM website).

⁴³ Item 13, Reference Form.

Related party transactions

Companies must produce financial statements according to IFRS, and should thus disclose related party transaction details in notes to the financial statements. The Reference Form requires significant additional disclosures on related party transactions, including:

- ▶ The issuer's rules, policies, and practices regarding transactions with related parties;
- ▶ Details on specific transactions including names of related parties, details on the transactions, and reasons for the transaction;
- ▶ For each transaction, identification of measures to address conflicts of interest, and "arms-length" nature of the transaction.

The quality of information varies greatly among public companies and tends to improve as the size and liquidity increases.⁴⁴ For example, for the 100 most traded companies at BM&FBOVESPA, only 20.2% had clear rules or policies, and formal and detailed transactions with related parties.⁴⁵

Foreseeable risk factors

Companies are required to disclose material foreseeable risk factors in the Reference Form.⁴⁶ Companies must also disclose their policies on risk management and internal controls.⁴⁷ According to the 2011/2010 KPMG/CEG Survey, except for companies issuing ADRs 2 and 3, "...there is a low percentage of companies that reported the existence of a formal policy on risk management", including Novo Mercado (17%), Nível 1 and 2 (43.9%), and traditional tier companies (13.3%).

Issues regarding employees and other stakeholders

Companies must make a number of disclosures about employees in the Reference Form, including number of employees, outsourced workers, turnover rate, compensation policies, and the relationship between the issuer and unions (Items 14.1-14.3). Disclosures on creditors are limited to links between creditors and officers of the company. Issuers must also disclose their environmental policies.

BM&FBOVESPA and several other institutions have created a corporate sustainability index ("ISE"), designed to measure the return on a portfolio composed of shares of companies highly committed to social responsibility and corporate sustainability, and also to promote good practices in the Brazilian corporate environment.⁴⁸

Governance structures and policies

Listed companies make a variety of governance disclosures through the Reference Form, which in total are equivalent to the types of disclosure that might be made through the corporate governance

⁴⁴ See for example: *Capital Aberto*: Year 9, # 97, September 2011: "Tractebel committee evaluates dealings with GDF Suez". *Capital Aberto* Year 8, # 87, November 2010: "On the same boat CVM prohibits Tractebel controlling shareholder from voting, but minority shareholders converge and approve operation". *Capital Aberto* Year 7, # 79, March 2010, Page 64-65: "The bad example of state-controlled companies: Recent episodes offer important lessons about the practices of these companies".

⁴⁵ Source: 2011 *Capital Aberto* Yearbook.

⁴⁶ Specific disclosures include risks that are specific to the industry or geographical areas (item 4.1), dependence on commodities (Item 7.3), financial market risk (interest rate and currency risk) (Item 10.2), risks related to derivatives (Item 5.2), off-balance sheet transactions (item 10.8), and environmental risks (items 7.4 and 10.5).

⁴⁷ Risk management disclosure requirements include details on the issuers' market risk management policy, and whether, over the last fiscal year, there were significant changes in key market risks to which the issuer is exposed or the risk management policy adopted.

⁴⁸ ISE criteria are available at http://www.bmfbovespa.com.br/Indices/download/ISE_ing.pdf.

code “comply or explain” process in other countries.⁴⁹ The quality of information disclosed is mixed, with larger companies generally providing higher quality information.

A unique non-governmental organization, CODIM (Steering Committee for Information Disclosure to the Market) was created with the goal of being a new and efficient working tool for the improvement of information disclosure. The Committee offers non-regulatory guidance and advice to public companies, investor relations professionals, investment analysts, investors, asset managers, among others, regarding the most appropriate alternatives for disseminating information to the public. CODIM is composed of two members from each of its 12 member bodies (including CVM). The mission of CODIM includes the development of basic principles and the use of technological resources compatible with the needs of market participants.

Market participants are working to improve the overall quality of disclosure

BOARD PRACTICES AND COMPANY OVERSIGHT

The Role of the Board

Listed companies have a one-tier board of directors (*conselho de administração*).⁵⁰ Under the Corporate Law, the board should consist of at least three members, with no legal maximum size. Novo Mercado and “Level 2” companies must have at least 5 directors.^{51 52} In practice, board size in listed companies averages between 7.5-8.5 directors, depending on the survey.

Shareholders may also elect a *conselho fiscal* (CF). The *conselho fiscal* plays a different role from the board and its committees (although its role is sometimes confusing, especially to foreign observers). By law, the CF must have between 3-5 members. Its members must not be officers, directors, or employees of the company, or relatives or spouses of any officer or director.⁵³

Board structure and duties are driven by the Corporate Law, and to some extent by the BM&FBOVESPA special listing requirements

The *Conselho Fiscal* plays a potentially useful role in company oversight

The creation of the CF is optional — each company can have “permanent” CF or create one on a temporary basis. A temporary CF must be created at the request of shareholders representing 10% of the common shares or 5% of the preferred shares. The law gives preferred shareholders the right to elect one member of the CF, and minority common shareholders holding at least 10% of the common shares the right to a second seat. Other common shareholders can then elect the remaining members, in a number equal to those elected by preferred shareholders and minority common shareholders plus one. This ensures that the controlling shareholders control the fiscal board.

49 Companies must describe the responsibilities of each management body and committee, the rules, policies and practices of the board, the date that fiscal council/audit committee was created, evaluation mechanisms, the individual responsibilities and powers of each of the officers, mechanisms for evaluating the performance of the members of the board, committee members and officers, the rules, policies and practices with respect to shareholders' meetings, and compensation mechanisms and policies

50 The term *administrador* refers to the board of directors and management, (Article 145 of Corporate Law).

51 There is some disagreement over whether the *conselho fiscal* is equivalent to the central European “supervisory board”. There are in fact three distinct supervisory board models: the Brazilian model, with a unitary board and a CF, which some call a “Latin board”; the German/Scandinavian-style supervisory board, in which the shareholders appoint the supervisory board and the supervisory board appoints the management; and a third model in which the shareholders appoint both the supervisory board and the management board in a two-tier structure. Corporate governance reformers tend to favor a strong supervisory board structure (because there is clear oversight of management) over the third model because the supervisory board is relatively weak and underdeveloped.

52 The IBGC Code recommends between a minimum of 5 and 11 members.

53 These requirements are supervised by the CVM, which has issued Parecer de Orientação nº 19 elaborating on the role of the CF.

According to one older study, about 2/3 of companies surveyed had a permanent or semi-permanent conselho fiscal in 2005. Most permanent CFs had minority representatives, but 56% have only one minority shareholder representative on the fiscal board, and only three firms had three or more minority representatives (who therefore comprise a majority of the board).⁵⁴

Conselho fiscais have wide powers to supervise management and the board, oversee financial reporting, consult with external auditors, issue opinions on major corporate transactions, and call an GMS. They can also put directors or managers under criminal investigation. *Conselho fiscal* members are obliged to denounce fraud, accounting misconduct, and any wrongdoing to the board, and if the board does not take action, report the problem at the GMS. The Corporate Law gives each member the power to act individually; the final report presented to the board and the GMS must be approved by each and every member.

Corporate governance experts in Brazil express varying degrees of doubt that the conselho fiscal can act as a substitute for an effective board and audit committee, and they appear to be declining in popularity with the gradual rise of the board “audit committee”. However, *conselho fiscais* remain popular among some non-voting shareholders and pension funds — PREVI, for example has required that their portfolio companies install a permanent *conselho fiscal*. It is relatively easy for non-voting (PN) shareholders to nominate a representative to the *conselho fiscal* and, even though the controller appoints the majority of its members, the power to act individually strengthens the role of minorities, who tend to be active.

Fiduciary duties are defined in the 2001 Corporate Law

Directors owe duties of care, diligence, loyalty and confidentiality to the company.⁵⁵ Directors should employ the care and diligence that an industrious and honest person employs in the administration of his own affairs. According to Article 155, board members “... shall serve the corporation with loyalty, shall treat its affairs with confidence and shall not ... use any commercial opportunity which may come to his knowledge, by virtue of his position, for his own benefit or that of a third party, whether or not harmful to the corporation.”

However, the provisions on shareholder agreements undermine the fiduciary duties to the company. Directors voting under shareholder agreements are constrained to vote per the agreement, and therefore in the interest of the shareholder signatories to the agreement. In voting, directors are nevertheless subject to general duties to serve the best interests of the company.

In practice, directors take their responsibilities seriously, and their awareness of their liabilities and the importance of their role continue to increase. IBGC has played a major role in increasing the awareness of the role of the board and board members. However, discussions with market participants indicate that some directors in most companies tend to display more loyalty to the shareholder that has elected him/her (especially in companies with shared-control by large blockholders) than to the interests of the company and of all shareholders.

⁵⁴ Black, Bernard S., De Carvalho, Antonio Gledson and Gorga, Erica, *The Corporate Governance of Privately Controlled Brazilian Firms* (December 1, 2009). *U of Texas Law, Law and Econ Research Paper No. 109*; as published in *Revista Brasileira de Finanças*, Vol. 7, 2009; *U of Texas Law, Law and Econ Research Paper No. 109*; *Cornell Legal Studies Research Paper No. 08-014*; *ECGI - Finance Working Paper No. 206/2008*. Available at SSRN: <http://ssrn.com/abstract=1003059>

⁵⁵ The law refers to “administrators” (administradores), and applies to directors and senior management.

Recent cases such as those with Sadia and Aracruz — two traditional companies that suffered heavy losses due to speculative positions in the derivatives markets — cast doubt that directors are exercising their duty of care properly in all listed companies. These and other recent cases (especially those in banks) have been described as a “wake up call” for directors, reminding them of the liability for decisions taken by management.

The IBGC Code provides an excellent description of board good practices, including board responsibilities. In practice, there is a large variation in board practices across the listed sector.

Board oversight of general corporate strategy and major decisions

By law, the board must “... establish the general strategy for the corporation’s business.”⁵⁶ As in other areas, practices vary. The boards of some advanced Brazilian companies provide strategic guidance to their firms; on the other hand, many (and according to some the majority) boards are not active enough to be considered to be playing a central and strategic role.

The IBGC Code notes that the main responsibilities of the board should include “discussion, approval, and monitoring of decisions involving ... Corporate Governance Practices.” Many boards are concerned with corporate governance, especially at larger companies.

High performing boards are often supported by a professional and qualified secretary of the board. In Brazil, anecdotal evidence suggests that the majority of companies do not have a professional and qualified secretary of the board, although this practice seems to be increasing in practice.⁵⁷

Effective governance is also supported by board evaluations. The practice of formal board evaluations remains relatively rare (e.g. one survey indicates that 25% of the top 100 companies report that the board evaluates its performance).

The Corporate Law (article 142) notes that the board must “elect and discharge corporation officers and prescribe their duties in accordance with the relevant provisions in the bylaws.” The IBGC Code (section 2.3) goes further and states that the main responsibilities of the board include “... hiring, dismissal, assessment and compensation of the CEO, and the other officers, starting with the proposed candidates submitted by the CEO.”

The board’s role in selecting and compensating management can be compromised by a variety of factors: (i) sometimes the Chairman individually selects or appoints the CEO (generally because he/she is a controlling shareholder); (ii) the combination of the positions of chairman and CEO (in about 25% of companies), and the role of the government in appointing CEOs in state-owned companies.⁵⁸

Board responsibilities are not well developed in law or regulation

Monitoring effectiveness of company governance practices

Selecting/compensating monitoring/replacing key executives

⁵⁶ Article 142, Corporate Law

⁵⁷ Capital Aberto, Year 8, # 94, June 2011: “Messengers of the board: A century old in other countries, the title of secretary for corporate governance is becoming widespread in Brazil’s publicly traded and privately held companies”.

⁵⁸ Capital Aberto Year 8, # 90, February 2011: “An affair of state: Job appointment at government-controlled companies puts businesses in peril and worries investors”; and Year 8, # 92, April 2011: “Vale exposes the weakness of boards when facing controlling shareholders”.

In companies with a strong majority shareholder, he/she is ultimately responsible for setting the CEO remuneration instead of the board as a group. In state-owned companies, regulatory restrictions limit the board's ability to link remuneration to experience, skills and performance. In companies under foreign control (such as multinationals), CEO compensation is usually dependent on the global compensation practices of the controlling company.

Few companies appear to have formal succession plans in place.

Aligning executive and board pay

Companies are not obliged to develop a clear policy on executive remuneration (although they are required to disclose if one exists in the Reference Form). There is no requirement to align executive compensation to the company's performance. Some firms with advanced governance structures provide very detailed information about their compensation policies and links to performance.

For financial institutions and institutions that are authorized by the BCB (except for credit unions and microfinance institutions), Resolution 3.921/10 requires the establishment and maintenance of a policy on executive remuneration, taking into account the risks the institution is subject to, and its income and performance.

Transparent board nomination/election process

The board's role in nominating board members (and establishing a transparent process) appears to be modest. Companies follow the Corporate Law with respect to requests for board appointments or cumulative voting (see "board appointments", above).

Oversight of insider conflicts of interest

There are no specific legal provisions regarding the board's role in oversight of internal controls, or the monitoring of related party transactions. The IBGC Code addresses board responsibilities for the oversight of internal controls, and monitoring of potential conflicts of interests.

Anecdotal evidence suggests that there is great heterogeneity in the adherence to good board practices among listed firms; many (if not most) boards do not actively and systematically oversee the system of internal controls designed to mitigate conflicts of interests.

Oversight of accounting and financial reporting systems

Per the Corporate Law article 177, the financial statements must be signed by the officers of the corporation and by legally qualified accountants. The board must also "select and discharge independent auditors". Companies are not obliged to develop a risk management policy, establish a specific risk management framework, establish an independent internal audit department/function, or a compliance function.

The CVM requires firms to disclose in the Reference Form several aspects related to their risk management, including their risk management policies. A 2011 survey⁵⁹ of 212 large listed companies showed that:

- About 1/2 of the companies have established a formal risk management policy and an (executive) risk management committee
- About 60% of the companies disclosed the presence of an independent internal audit function.

⁵⁹ Source: 2011/2010 KPMG/CEG Survey.

- ▶ In only 15% of the companies does the internal auditor report directly to the board of directors or to the audit committee.
- ▶ Financial firms have generally established a compliance function, but others have not.

CVM Instruction 358 requires boards to develop information disclosure policies. CVM Instruction 480/2009 requires firms to establish an investor relations function. In practice, the boards of companies with the most advanced governance practices do oversee company disclosure and communications practices.

Overseeing disclosure and communications processes

Board Independence and Objectivity

Boards of companies belonging to the Novo Mercado and Level 2 listing segments (about 147 out of the 430 listed companies in April 2011) are required to have at least 20% independent members. The Novo Mercado requirements also mandate that the positions of chairman and chief executive be separated (item 4.4).⁶⁰ The IBGC Code recommends a majority of independent members (Item 2.16).⁶¹

Novo Mercado and Level 2 segments require at least 20% independent board members

In practice, a number of surveys (in 2010 and 2011) indicate that on average the boards of listed companies are composed of between 25% and 35% independent directors. However, most of these surveys focus on the largest and most liquid companies of the stock markets (including those listed on Novo Mercado), where there is an explicit requirement. Some researchers complain that it is difficult to determine if reporting firms are correctly judging independence of their board members.⁶² Between 75 and 85% of listed companies separate the roles of Chairman and CEO.

There are no standard requirements for subcommittees of the board to be established in Brazil, outside of the voluntary IBGC Code. Banks are required to create audit committees. A new CVM instruction has loosened auditor rotation requirements for companies that implement a statutory audit committee.⁶³

Board committees are not well-developed in Brazil

According to the Annual Report Survey 2011/2010 carried out by KPMG/CEG, a minority of listed companies has established an audit committee, including traditional listed companies

⁶⁰ Since May 2011, this requirement applies to companies listed on the Novo Mercado, Level 1 and Level 2. The “accumulation of positions of chairman of the board of director and chief executive officer” will be permitted on an exceptional and transitional basis for a maximum period of three years starting from the date the Company shares begin to trade on the Novo Mercado.

⁶¹ Per the listing rules, “Independent Director” means a member of the board of directors that: (i) has no ties to the Company, other than an equity interest; (ii) is not a Controlling Shareholder, spouse or close family member (to the second degree) of a Controlling Shareholder, and neither has, nor has had in the three (3) previous years, any ties to any company or entity related to a Controlling Shareholder (excluding persons with ties to public education or government research entities); (iii) in the three (3) previous years has not been an employee or officer of the Company, or of the Controlling Shareholder or of a subsidiary of the Company; (iv) is not a direct or indirect provider, supplier or buyer of goods and/or services, to an extent that would imply loss of independence; (v) is not an employee or senior manager of any company or entity that is offering or requesting services and/or products to and from the Company to an extent that would imply loss of independence; (vi) is not a spouse or close family member (to the second degree) of any senior manager of the Company; and (vii) is not entitled to any payment by the Company other than the consideration earned as director (excluding cash distributions received in the capacity of an equity holder).

⁶² Sources: 2011 Capital Aberto Yearbook, and 2011/2010 KPMG/CEG Survey.

⁶³ CVM Instruction 308, article 31, requires audit firm rotation (“mandatory rotation”), except if the audited entity is a public company whose bylaws establish a permanent audit committee, situation in which firms may rotate every ten years (Instruction 509/2011). In both cases, the cooling off period is three years.

(26%), level 1/level 2 listed companies (45.5%), and Novo Mercado listed companies (36.4%).⁶⁴ Because of the central bank requirement, the great majority of these audit committees have been established in financial institutions.

However, these “board committees” are not composed exclusively of board members. The KPMG/CEG survey indicates that the proportion of board members on audit committees is 52.7% in ADR companies, 56.3% of Novo Mercado listed companies, 54% of level 1/level 2 listed companies, and 26% in traditional listed companies. Representatives of controlling shareholders and other relevant blockholders, outside consultants and corporate officers (CEOs, CFOs, etc.) are usually part of these committees.

The Corporate Law and the Code contain some conflict-of-interest provisions for board members, but implementation is unclear and controversial

Under the Corporate Law, “an officer or a director shall not take part in any corporate transaction in which he has an interest which conflicts with an interest of the corporation, nor in the decisions made by the other officers on the matter. He shall disclose his disqualification to the other officers and shall cause the nature and extent of his interest to be recorded in the minutes of the board of directors’ meeting.” He or she must also recuse himself from voting and participating in the discussion. The board member must only disclose any transaction in which he has an interest which conflicts with the interest of the company, but not any indirect conflicts of interest. There is no general responsibility for the board to monitor conflicts of interest or related party transactions.⁶⁵

In practice, market participants report that boards do sometimes disclose conflicts of interest. However, the perception in the market is that some board members, often indicated by a group of shareholders still participates in discussions with the interest of the group which indicated him/her.

Most board members do not appear to be overstretched, and are overcommitted to their duties

Boards in Brazil meet on average 7–10 times per year, depending on the survey. However, this average may not be the same for all types of companies; the median number of meetings of companies surveyed is around 6 times per year. The average may be biased upwards by larger companies and by companies with shared-control by large blockholders, whose boards tend to meet much more frequently. Another survey in 2009 showed that 42% of the respondents meet 12 times per year.⁶⁶

The Brazil Institute of Corporate Governance is an internationally-recognized source of training and corporate governance good practice

The Brazilian Institute of Corporate Governance (IBGC) was founded in 1995. IBGC has led the introduction and dissemination of the corporate governance concept in Brazil and continues to focus on the development of best practices. The IBGC organizes conferences, publishes guidelines and other publications, provides training to board members and key executives, encourages networking amongst professionals as well as contributes to the development of best practices within organizations. Courses have been delivered to more than 4,000 executives, entrepreneurs, board members and researchers. The IBGC also developed the Code of Best Practices in Corporate Governance.

⁶⁴ Many of the companies that have audit committees are financial institutions, where the audit committee is required. 100% of the ADR companies report an audit committee, but these are conselho fiscais reported as audit committees because of the arrangement with the US SEC for ADR listed companies.

⁶⁵ The IBGC Code assigns the role of monitoring conflicts of interest and related party transactions to the board. “Once a conflict of interest is identified with regard to a specific topic, the person involved should move away and physically remove themselves from discussions and decisions, without neglecting the administrator’s legal duties. The temporary removal should be recorded in the minutes.” IBGC Code Section 6.2.2.

⁶⁶ Sources: 2011 Capital Aberto Yearbook; 2011/2010 and 2010/2009 KPMG/CEG Surveys; 2009 IBGC Booz & Co.

IBGC gives awards to companies and individuals who have demonstrated the best of corporate governance principles. The end results of IBGC's efforts are to foster business development both domestically and abroad with the belief that the ideals and concepts we promote will ultimately benefit the future of Brazil.

The IBGC's work has not been supported by any legal requirements for training, beyond the IBGC's own code.⁶⁷

SPECIAL ISSUES IN THE BANKING SECTOR

This corporate governance ROSC was carried out in conjunction with a special review of the corporate governance of the banking sector.⁶⁸

Brazil's financial system has grown in size, strength, diversification and sophistication, hand in hand with the country's economic progress. Like other companies, large banks are transitioning towards more formalized corporate governance processes, consistent with international standards. However, role of boards is still evolving. While much of the corporate governance framework is in place, the necessary governance and risk management cultural changes are progressing more gradually.

The Brazilian financial system is organized around a few financial conglomerates that control over 75 percent of the system's assets. Conglomerates are typically headed by a commercial bank and include asset management, investment banking, and insurance and derivatives services. Total (gross) assets in the system in 2011 are equivalent to around 180 percent of GDP, about 44 percent of which are held by commercial and multiple banks, 25 percent by mutual funds, 11 percent by pension funds, and 6 percent by insurance companies.

There are 167 commercial banks, of which 14 are considered to be large. Foreign banks own about 20 percent of banking assets. Government-owned banks account for over 40 percent of total (gross) banking assets. The main government-owned banks include two commercial banks (Banco do Brasil and Caixa Economica Federale) and one development bank (Banco Nacional de Desenvolvimento Economico e Social—BNDES).

Like other companies, banks have improved their corporate governance policies

Most large banks are owned and controlled by families or the Federal government

⁶⁷ The IBGC Code (item 2.17) recommends that "Given the need to improve their performance and focus on the long term, it is essential that Directors seek to constantly improve their skills." It also recommends that directors must go through an induction program.

⁶⁸ The banking sector review included a survey of practices in six leading banks.

The financial regulators have put in place a variety of corporate governance regulation

Key corporate governance regulations for banks include:

- ▶ The Banking Law which gives the National Monetary Council the authority to establish rules on governance, subject to the general rules of corporate law.
- ▶ Resolution 2554 which requires the establishment of a structure for internal controls, including financial information systems, operational and management systems, and compliance procedures.
- ▶ Resolution 3198 which requires an audit committee for financial institutions that meet specified characteristics;
- ▶ Resolution 3041 which establishes fit and proper requirements for directors and managers in key risk positions;
- ▶ Resolution 4019 which provides the BCB with the ability to require early correction of issues identified through its supervisory process based on judgmental (risk oriented) views on the adequacy of internal controls and corporate governance rather than waiting until a bank's condition demonstrably deteriorates from the given deficiency to be able to require corrective action.

In practice, banks are heavily influenced by their controlling shareholders

Discussions with key stakeholders indicated that, as in many other companies, owners, boards, audit committees, and executive management often see their primary responsibility as one of protecting the controlling owner.

- ▶ Controlling owners are heavily represented on the board and tend to drive the strategic planning process with insufficient input from the full board and even less from the control functions (risk management and internal audit).
- ▶ The role of controlling owners (or their board representatives) is intertwined with management, potentially blurring lines of responsibility and accountability.

Financial institutions are required to implement internal controls

In accordance with Resolution 2554, financial institutions are required to implement adequate internal controls for their activities, including financial information systems, operational and management systems, and compliance procedures.

Since 2004 large banks, insurance companies and open pension funds must establish an audit committee.

As noted above, the audit committee as mandated by BCB and SUSEP (and CVM) is not a sub-committee of the board of directors, but has functions similar to those of its equivalent committees abroad. Although there is no rule requiring that board members have a seat on the audit committee, the usual practice at large and complex banks is to have at least one board member also acting as an audit committee member.

Bank audit committees must have a minimum of three members, at least one of whom should be an expert in accounting and auditing issues.

Among its responsibilities, the audit committee is responsible for reviewing financial statements, monitoring the work of external auditors, and reporting to the board on issues pertaining to internal controls, external audit and the quality of financial statements. Management is required to communicate violations to the audit committee within 24 hours of detection.

In practice, bank audit committees are quite active in the oversight of audit activities and operational risks. However, communication with and commitment by the Board to address activities and issues could be strengthened.

Banks are in the process of cultivating and integrating strong cultures of risk management.

Individual banks and banking groups are required to have comprehensive risk management policies and processes in place to identify, evaluate, monitor and control or mitigate material risks commensurate with the size and complexity of their activities. Risk management policies in financial institutions must be approved and reviewed, at least once a year, by senior management and the board of directors.

Bank boards (and in some cases the controlling owners) do carry out strategy planning, to varying extents. The largest banks operate with a rigorous complex of management level committees. Discussions with banks indicated that inputs from risk management and internal audit are considered, to varying extents, in strategic planning and decision making processes. However, the role of these functions can be further elevated to more proactively influence performance and decision-making.

Board risk committees are not typically in place, although some banks are considering or in the process of establishing them.

Risk governance is also evolving

IMPLEMENTATION OF THE 2005 CG ROSC

A review of the recommendations of the 2005 Corporate Governance ROSC indicates that the implementation of the recommendations of the 2005 CG ROSC is mixed (see table on page 39).

- ▶ A number of reforms were completed, including new procedures for proxy voting, improved disclosure, and the introduction of IFRS.
- ▶ Other reforms have been partially implemented (particularly those that have been implemented by the success of Novo Mercado, which does not affect the entire listed sector).
- ▶ Other recommended reforms (including full access to the shareholder list, improvements to meeting notice period, improvements to related party transaction approval process, changes in the law to remove the board's requirement to comply with shareholder agreements) were not implemented.

Many of the core recommendations of the 2005 CG ROSC were not implemented

Corporate governance in Brazil has meets many international standards

Of the recommendations from 2005, 4 of the recommendations can be assessed as implemented, 12 as partially implemented, and 7 as not implemented. Some of these recommendations would require changes to the Corporate Law, which has not been significantly revised since 2001.

FINDINGS OF THE DCA

The Detailed Country Assessment of the OECD Principles of Corporate Governance is summarized in the tables at the end of the report, and compared with average results from selected countries in Latin America and Asia. These results indicate that:⁶⁹

- ▶ **Brazil is a leader in many aspects of good corporate governance practices, especially in the area of disclosure and shareholder rights.** Across the areas of shareholder rights, equitable treatment of shareholders, and disclosure, as defined by the OECD Principles, Brazil now exceeds or is on par with many market leaders in Asia (India, Thailand, and Malaysia).
- ▶ **Nevertheless, more work remains to be done.** The ratings on Chapter 6 (board responsibilities and practices) indicate that Brazil can do more in a number of areas.
- ▶ Using the WB methodology to assess compliance with the OECD Principles, 10 Principles were fully observed, 16 were broadly observed, 35 principles were partially observed, and 3 were not observed.

⁶⁹ All comparisons of scoring with the previous ROSC should be interpreted with care, due to the use of different methodologies, averaging systems, new principles assessed, etc.

TABLE 6: Implementation of Recommendations from the 2005 CG ROSC

RECOMMENDATIONS OF 2005 ROSC	IMPLEMENTATION
Mainstreaming Corporate Governance	
1. Consideration should be given to increased director training, awareness-raising, and empowering of directors representing pension funds on boards of listed companies.	Partially Implemented
2. Policymakers should fortify the bylaws of large listed SOEs so that they could migrate to the corporate governance segments, providing listed firms with a model to emulate.	Partially Implemented
3. Policymakers should consider ways to increase court specialization in commercial matters, as well as a strategy of training judges and improving the effectiveness and speed of the proceedings.	Partially implemented
4. As the main long term lending institution, BNDES should revive its campaigns to promote good corporate governance.	Not implemented
5. Best practice suggests that Institutional investors, e.g. pension funds and asset managers, disclose their voting policy. Careful monitoring and enforcement of such practices is needed.	Partially implemented
6. The market would benefit from Chinese walls and other provisions ensuring against conflicts of interest among investment advisers, analysts, brokers, rating agencies.	Partially implemented
Strengthening shareholder rights	
7. For withdrawal rights to provide minority protection in case of oppression, the right of a dissenting shareholder to sell shares to the company should be effectively assured at fair market value. Arbitrary determination of "economic" or book value may not assure adequate dissenting shareholder protection.	Partially implemented
8. Policymakers should assure themselves whether 15 days of notice is adequate in all cases for purposes of voting at the GMS, including in the case of foreign investors and depository receipts holders.	Not implemented
9. In the long term, the current procedures for proxy voting, particularly but not only, in the case of foreign investors (notarization, certified translation, etc) are not consistent with modern capital market standards.	Implemented
10. The introduction of proxy voting by mail will increase minority investor participation in corporate governance.	Implemented
11. Tag-along rights for PN shares are suggested by good international practice as one of the main instruments for minority investor protection.	Partially implemented
12. Shareholder access to the full shareholder list will ease communication among minority investors. Considerations of abuse of the information could be addressed in alternative ways, e.g. by only disclosing email addresses.	Partially implemented
13. Off-exchange sales of control should be assured to occur at a fair price and comparable conditions to control changes executed on the stock exchange. Best practice suggests that the target company board issue an opinion on the expected merger.	Partially implemented
14. Policymakers should establish clear, bright line rules on how related party transactions should be approved and disclosed.	Partially implemented
15. A mechanism of credible monitoring of compliance with RPT rules should complement such efforts.	Not implemented

TABLE 6: Implementation of Recommendations from the 2005 CG ROSC

Providing transparency and disclosure	
16. The annual report content should be clearly determined in current legislation. Annual reports, per best practice, include cash flow statements, segment reporting, and a detailed management discussion and analysis chapter.	Implemented
17. Accounting and auditing standards require an update to the level of international standards.	Implemented
Promoting effective boards	
18. Policymakers should ... determine the need and appropriateness for fully-independent audit committees as part of the board of directors, per international standards.	Partially implemented
19. The GMS approves an overall package of director and executive pay, proposed by the board. The board then determines the allocation of the total sum among board members and executives.	Not implemented
20. More detailed information should be made available on newly nominated directors, over and above the requirements of CVM Instruction 367/02.	Implemented
21. Directors best service company interests by treating shareholders equally. Shareholder agreement provisions explicitly requiring directors to act in the interest of a certain group of shareholders potentially undermine the fiduciary duty of directors to the company.	Not implemented
22. Rules on frequency of board meetings will serve to encourage directors to devote sufficient time to their responsibilities.	Not implemented
23. Companies listed on Level II or Novo Mercado should establish full audit committees as part of their board of directors.	Not implemented

Recommendations

Brazil's corporate governance framework has shown marked improvement since it last underwent a corporate governance ROSC. Corporate governance regulation has continued to strengthen, particularly in the area of disclosure, and the Novo Mercado listing framework became a major success. The recent market boom suggests that the country is experiencing a major shift towards an "equity culture". Many companies and owners have begun to behave differently.

However, for the Brazilian market to continue to grow, the legal protections afforded minority investors must be strengthened. Brazil must regain the momentum that resulted in the creation of the Novo Mercado and move towards the application of international good practices to all publicly listed companies in Brazil.

Now might be an appropriate time for the regulators and other market stakeholders to take stock of the progress of Brazil's capital markets, and determine their future direction. Early in the last decade, Brazil developed a comprehensive five year strategy for the development of its capital markets. This strategy was the result of a successful partnership between the public and private sectors. The original Five Year Strategy to develop the capital markets proved to be highly successful; as markets mature and a diversified investor base emerges, new challenges will present themselves. Developing at this time a follow up strategy through another strong public private partnership would be beneficial.

Priority 1: Move towards international standard board practices

Board practices are lightly regulated in Brazil, and as a result there is a wide variation in terms of their role, responsibilities, functions and behavior. While the boards of many top companies are reported to govern at a relatively high level, many others function in a traditional manner, and are not clearly distinct from shareholders or management. The majority of listed companies does not yet have an audit committee of the board, to monitor the sufficiency of risk and other internal controls as well as externally audited financial statements.

Given the controversy and difficulty surrounding the 2010 amendments to the Novo Mercado rules, CVM should be provided with the legal authority to adopt an Instruction that focuses on the board of directors. An Instruction could directly address those elements of the governance framework that have not been adopted by the Novo Mercado, and at the same time extend the scope of regulation to cover all listed companies. The relevant sections of the IBGC Code of Corporate Conduct would make an excellent starting point.⁷⁰

Consider adopting an instruction on boards, with a focus on the adoption of an international standard audit committee

Elements of the Instruction might include:

- ▶ Clear statement on the role and responsibilities of the board (based on the IBGC Code)
- ▶ Adoption of an independence requirement (2 members) that was proposed to and rejected by the companies listed on Novo Mercado in 2010.

⁷⁰ Audit committees are already mandatory for financial institutions above a significant size. Article 15 of Resolution 3198 defines the role of the audit committee, which includes the oversight of the whole external audit process, including the selection of the independent auditor, of the internal audit process, financial reporting, and the systems of internal controls.

- ▶ The creation of an “international standard” audit committee composed solely of board members, with a majority of independent members.
- ▶ Clear requirements (or recommendations) for board induction training and on-going professional development.
- ▶ Clear description of the role of the audit committee, including:
 - Oversight of internal and external audit, and financial reporting.
 - Oversight of the system of internal controls.
 - Oversight of conflicts of interest, including approval of all related party transactions.
 - Oversight of the process to select, appoint and retain the independent auditor

Consider extending the Level 1 listing standards to the traditional listed sector

Priority 2: Raise listing standards for the traditional listed sector

Traditional listed companies are now subject to minimal regulation by BM&FBOVESPA. The special corporate governance tiers do not by definition address the traditional listed companies, and there is little regulation of board practices.

One approach to gradually including more companies in the special corporate governance tier is to consider extending the Level 1 listing standards to the traditional listed sector. Given the adoption of IFRS and the new disclosure requirements that apply to all listed companies, Level 1 is no longer significantly different from the rest of the listed sector. However, requiring companies to sign a listing agreement/contract would help acquaint and accustom them to additional (modest) corporate governance regulations and better prepare them for further adoption of additional rules in the future.

The listing rules for Novo Mercado and Level 2 should eventually include a mandatory requirement to use the new CAF (takeover panel) in the event of relevant disputes.

Priority 3: Target Enforcement by Increasing CVM Resources

The CVM has played a crucial role in pushing forward numerous market integrity initiatives including corporate governance regulation and its enforcement. Several steps could be taken by CVM and the government to improve CVM enforcement capabilities.

Given the increase in CVM's role and responsibilities, resources should be increased

In general, resources in the CVM are insufficient, given the ever expanding scope and nature of its work. The CVM and the MF should work to develop a long-term strategy to resolve the human resource constraints faced by the CVM, including the limitations inherent in the civil service exam, the relatively low salaries for senior managers, and additional training resources. The amount of resources provided to CVM in the area of IT should also be increased, and the current outsourcing model should be reconsidered in light of the costs and risks associated with the model. Improving the accessibility of the information available on the CVM website.

The Corporate Finance department within CVM has done a good job of gradually increasing compliance with the new rules. CVM should work (in conjunction with the SROs and especially CODIM) to focus on several key disclosure areas where compliance remains deficient. These include ownership disclosure, group structures, related party transaction disclosure requirements, and disclosure of information before shareholder meetings.

Continue to focus on disclosure compliance

Given the importance in Brazil of the regulation and oversight of complex financial transactions (including takeovers, use of appraisal rights, etc.) CVM staff might benefit from a high-level training program in this area.

The CVM would also benefit from having clear legal authority to order disgorgement/restitution to defrauded investors, which now requires a negotiated settlement.

The new CAF represents an important step forward for the market. However, international experience in the few countries that have developed takeover panels suggests a few key success factors for its implementation. These include:

Key success factors for the CAF (takeover panel)

- ▶ Ensuring that members of the panel have a very high level of qualifications, expertise and integrity;
- ▶ Ensuring the independence of the members of the panel from the various special interests
- ▶ Providing the panel with appropriate resources, as necessary
- ▶ As noted above, success will include evolving the takeover panel towards the types of panels found in other countries, and giving it a mandatory and authoritative role in resolving relevant cases.

Priority 4: Update CVM regulation as necessary

A few aspects of Instruction 480 could be updated or clarified to bring the regulation further in line with the OECD Principles. These include requiring companies to disclose in the Reference Form:

- ▶ Non-commercial objectives (especially important for state-owned/controlled companies)
- ▶ A summary table on the attendance record of directors over the past year
- ▶ Clarify that directors should disclose all other directorships in the Reference Form.

Minor update to Instructions 480 and 481 to bring them fully in line with the OECD Principles

The board of directors or its audit committee should also report to shareholders that the external auditor was “independent, qualified, and acted with care” in performing their audit.

The regulations (through future revisions to Instruction 481) could also explicitly require companies to provide shareholders with information on the rules, including voting procedures, which govern the shareholders meeting.

Priority 5: Update the Corporate Law

Longer term, corporate governance and shareholder protection will improve with the adoption of significant amendments to the Corporate Law. A list of items that could be addressed in future amendments include:

- ▶ Clarifying conflicts of interest at the board level (and especially identifying indirect conflicts of interest).
- ▶ Specifying that the board is responsible for monitoring and managing conflicts of interest
- ▶ Requiring the board to approve all related party transactions.
- ▶ Extending the meeting notice period (in line with international standards)
- ▶ Removal of provision on shareholder agreements overriding duty to company
- ▶ Allowing a small number of shareholders to force amendments and add items to the shareholder meeting agendas
- ▶ Specify a duty of loyalty for board members during takeovers or changes in control
- ▶ Setting a time limit for the board to issue new shares after authorized capital has been increased by shareholders
- ▶ Clarifying Articles 100 and 126 to allow investors to better coordinate before shareholder meetings.
- ▶ Give shareholders the right to approve extraordinary transactions, including “transfers of all assets and/or sale of the company”.
- ▶ Giving shareholders the right to approve significant related party transactions.

The government could also review obstacles to private actions by shareholders. The level of the Doing Business “Ease of Shareholder Suits Index” in Brazil in 2012 was 3 (relative to a level of 6 for other Latin American countries), suggesting that legal changes could be made in this area following further study.

Priority 6: Stewardship of institutional Investors and the Government

Future revisions to the regulatory framework for investment and pension funds should require them to develop a policy for dealing with conflicts of interest that may affect their decision-making as regards the exercise of their ownership rights, and to publicly disclose the policy.

The ANBIMA Code of Conduct should explicitly encourage institutional investors to vote their shares independently and in the best interests of beneficial owners and to engage constructively with companies. The creation of a separate “stewardship” code (along the lines of the UK Stewardship Code) might also be a useful step.

Government has a special stewardship role to play in the oversight and governance of the Federally-controlled companies that are also listed. However, market observers have described several examples of situations in which the government did not appear to act in the interests of small shareholders, or give appropriate autonomy to the board of directors.

The government should take the lead in putting strong corporate governance in place. It should establish explicit areas where it will take decisions, and delegate as much as possible to a strong and empowered board of directors. The government should also appoint strong independent members to the board.

To reflect this commitment to good corporate governance, the government should also move to fully support BM&FBOVESPA’s work to improve corporate governance, by moving state-controlled companies on Level 1 to Level 2 or (ideally) to the Novo Mercado tier.

ANBIMA and CVM should work to continue to refine the rules that govern the voting of shares by institutional investors

Government can also support good corporate governance in Brazil through its control of significant listed companies

Summary of the Detailed Country Assessment: Brazil

The charts on the following pages are based on the Detailed Country Assessment. They follow the chapters of the OECD Principles of Corporate Governance, and present the scores for each of following chapters:

- ▶ Ensuring the Basis for an Effective Corporate Governance Framework
- ▶ The Rights of Shareholders and Key Ownership Functions
- ▶ The Equitable Treatment of Shareholders
- ▶ The Role of Stakeholders in Corporate Governance
- ▶ Disclosure and Transparency
- ▶ The Responsibilities of the Board

The structure of the Detailed Country Assessment (DCA) is based on the official “Methodology for Assessing the Implementation of the OECD Principles on Corporate Governance” (Assessment Methodology), as developed by the OECD (with assistance from the World Bank),⁷¹ which establishes a framework for assessing each of the 64 OECD Principles. For each Principle, there are a number of questions on the legal/regulatory/institutional framework, and a separate set of questions on how this framework is applied in practice.

Scores are based on the following formulas:

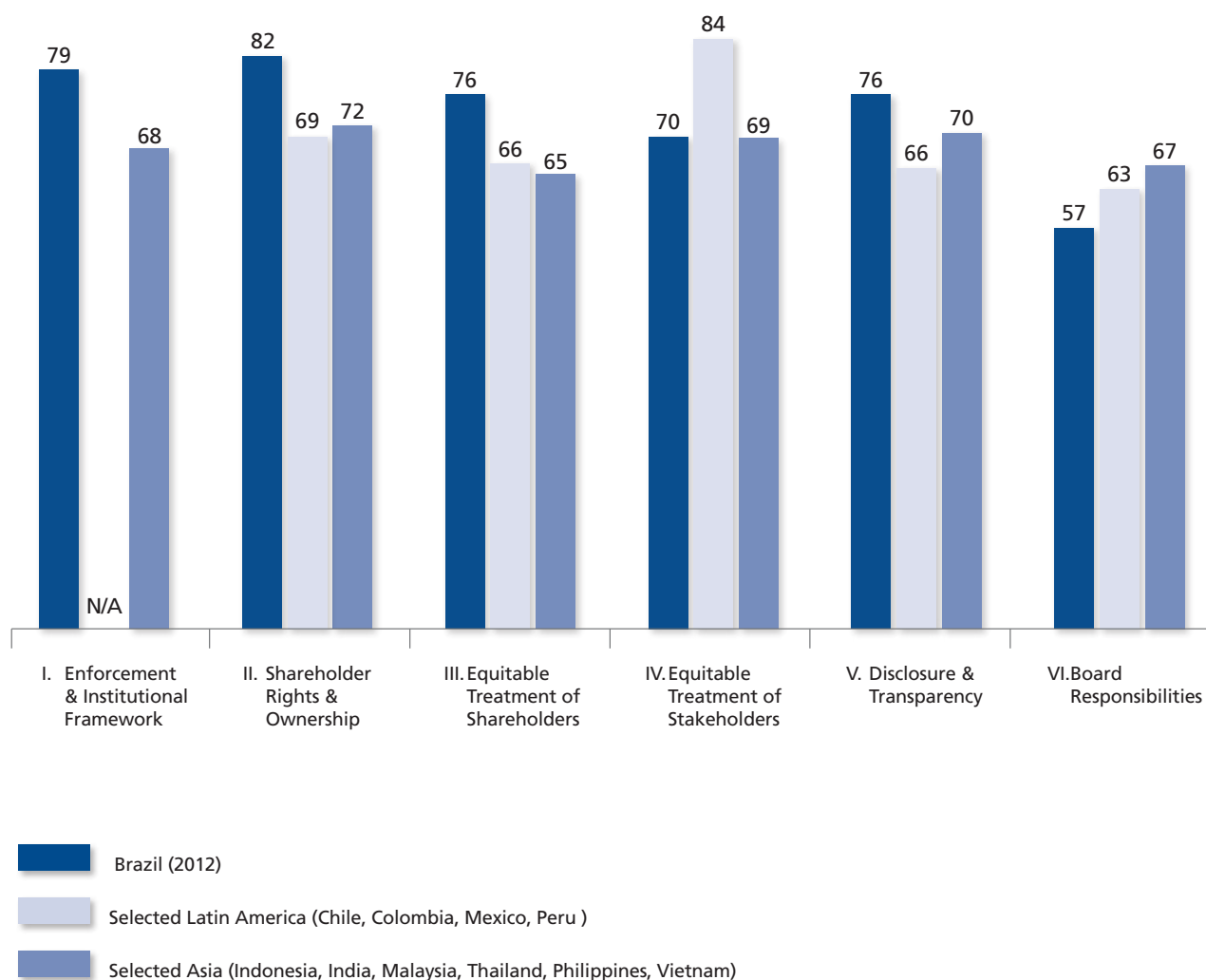
- ▶ The ratings of the questions in the legal/regulatory/institutional section of each Principle are added together, and given a weight of 50%.
- ▶ The ratings of the questions in the enforcement/compliance section are added together, and given a weight of 50%.
- ▶ The two weighted scores are then added together.

The implementation status of each Principle is assessed as follows:

- ▶ Principles are assessed as **fully implemented** if the overall implementation score is greater than 95 percent
- ▶ Principles are assessed as **broadly implemented** if the overall implementation score is greater than 75 percent and less than or equal to 95 percent
- ▶ Principles are assessed as **partially implemented** if the overall score is greater than 35 percent and less than or equal to 75 percent
- ▶ Otherwise the Principles are assessed as **not implemented**.

⁷¹ Available at <http://www.oecd.org/daf/corporateaffairs/corporategovernanceprinciples/37776417.pdf>

Brazil Country Assessment vs. Regional Averages | Summary



SOURCE: Figures for other countries represent weight-averaging of scores from previous ROSCs. Averages should be interpreted with caution due to changing methodologies over time.

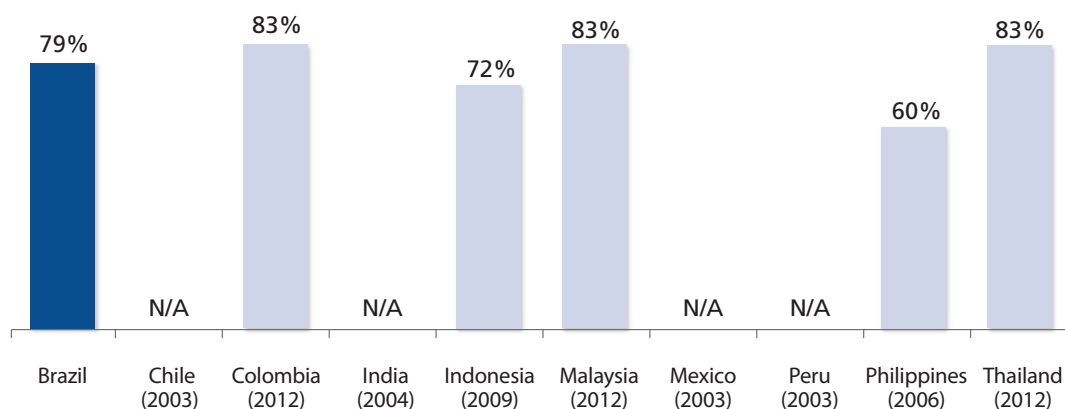
Data for Chapter I (Enforcement and Institutional Framework) are not available for the selected Latin American countries because those countries were assessed before the most recent changes to the OECD Principles (which introduced Chapter I).

OECD Principle Assessment: Corporate Governance Framework | Brazil



SOURCE: Detailed Country Assessment. Figures represent the percent implementation of each OECD Principle. 95% = Fully implemented, 75-95% = Broadly Implemented, 35-75% = Partially implemented, and less than 35% = not implemented.

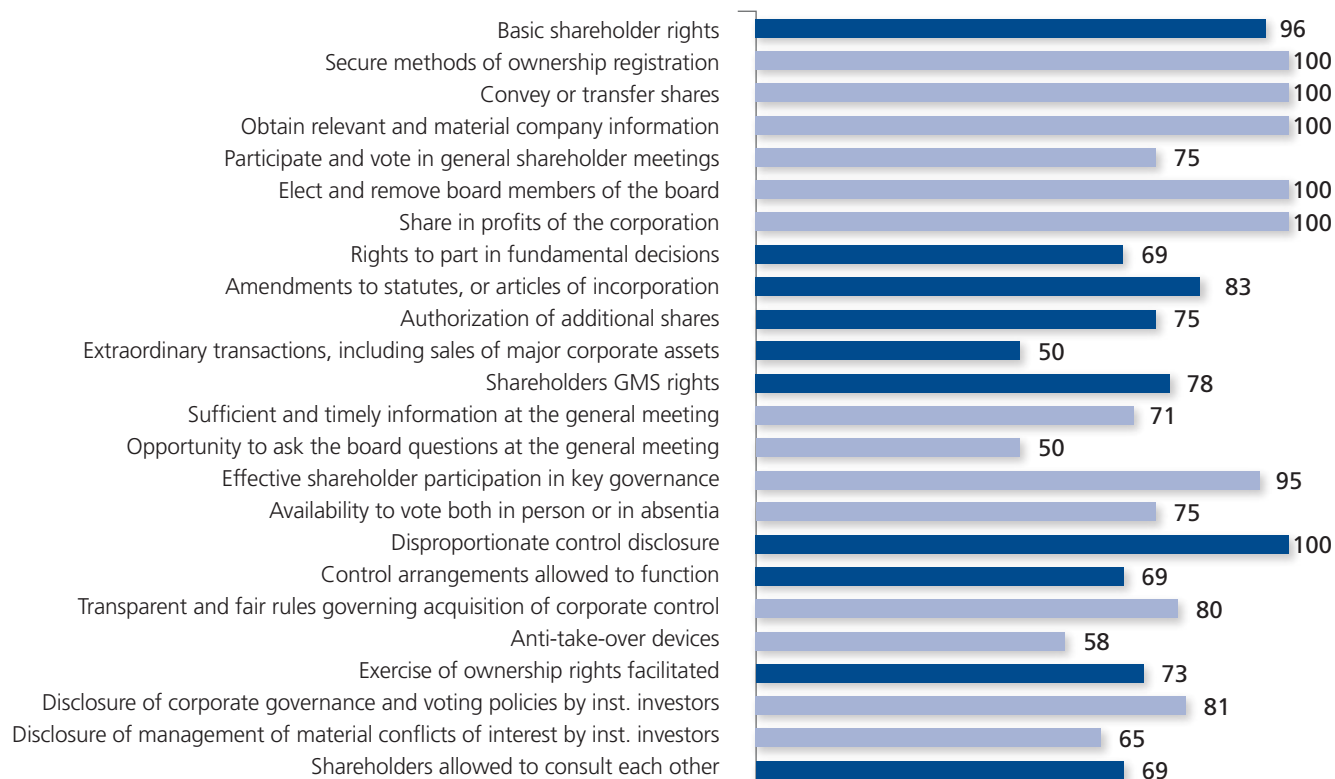
International Comparisons



SOURCE: Figures for other countries represent weight-averaging of scores from previous ROSCs. Averages should be interpreted with caution due to changing methodologies over time. Data from previous ROSCs are not directly comparable because reports were completed in prior years (year of ROSC publication in parenthesis).

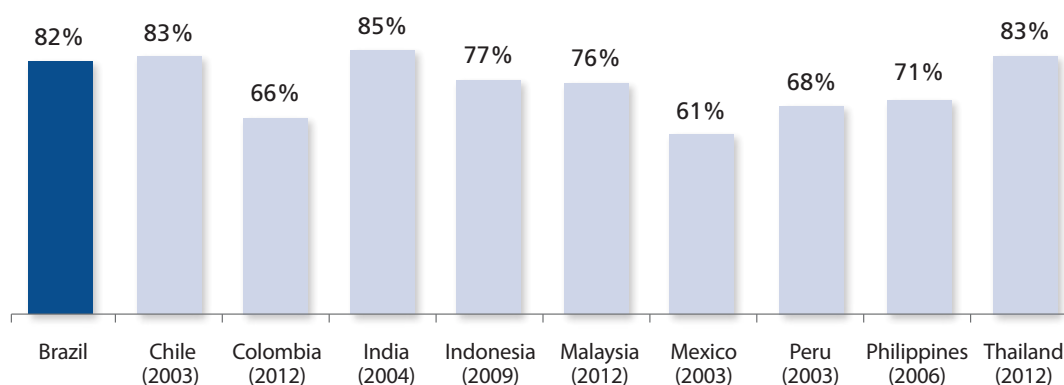
Data for Chapter I (Enforcement and Institutional Framework) are not available for many countries because those countries were assessed before the 2004 changes to the OECD Principles (which introduced Chapter I).

OECD Principle Assessment: Shareholder Rights | Brazil



SOURCE: Detailed Country Assessment. Figures represent the percent implementation of each OECD Principle. 95% = Fully implemented, 75-95% = Broadly Implemented, 35-75% = Partially implemented, and less than 35% = not implemented.

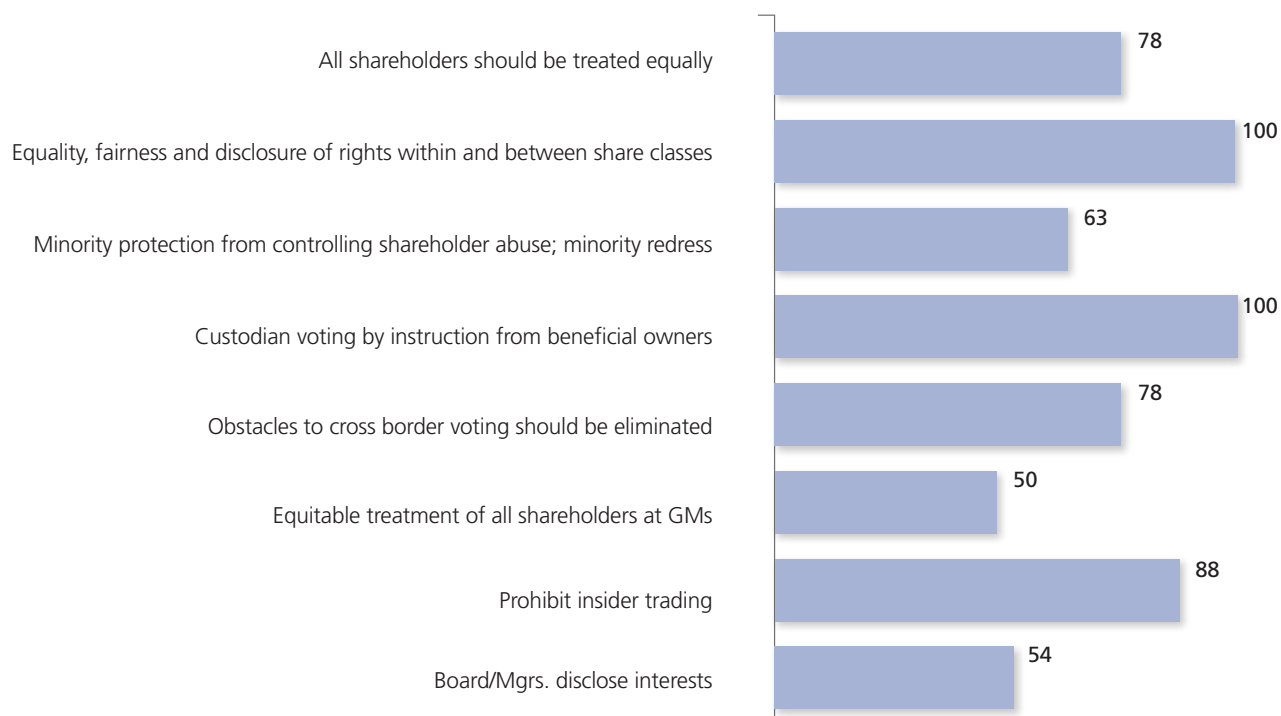
International Comparisons



SOURCE: Figures for other countries represent weight-averaging of scores from previous ROSCs. Averages should be interpreted with caution due to changing methodologies over time. Data from previous ROSCs are not directly comparable because reports were completed in prior years (year of ROSC publication in parenthesis).

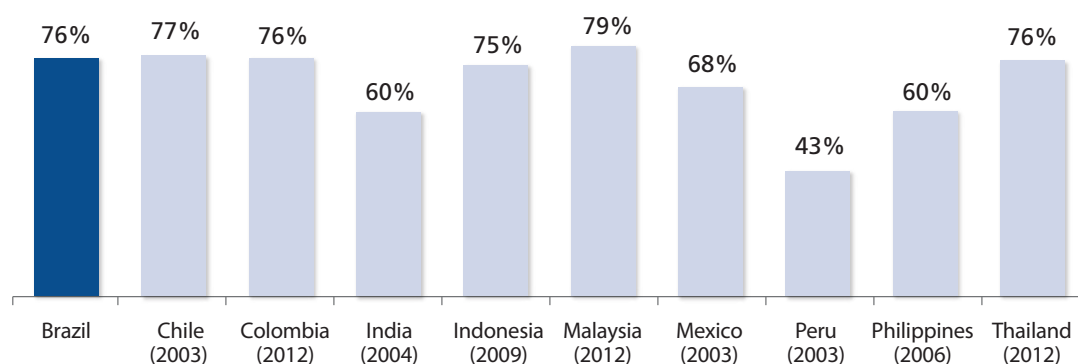
Data for Chapter I (Enforcement and Institutional Framework) are not available for many countries because those countries were assessed before the 2004 changes to the OECD Principles (which introduced Chapter I).

OECD Principle Assessment: Equitable Treatment of Shareholders | Brazil



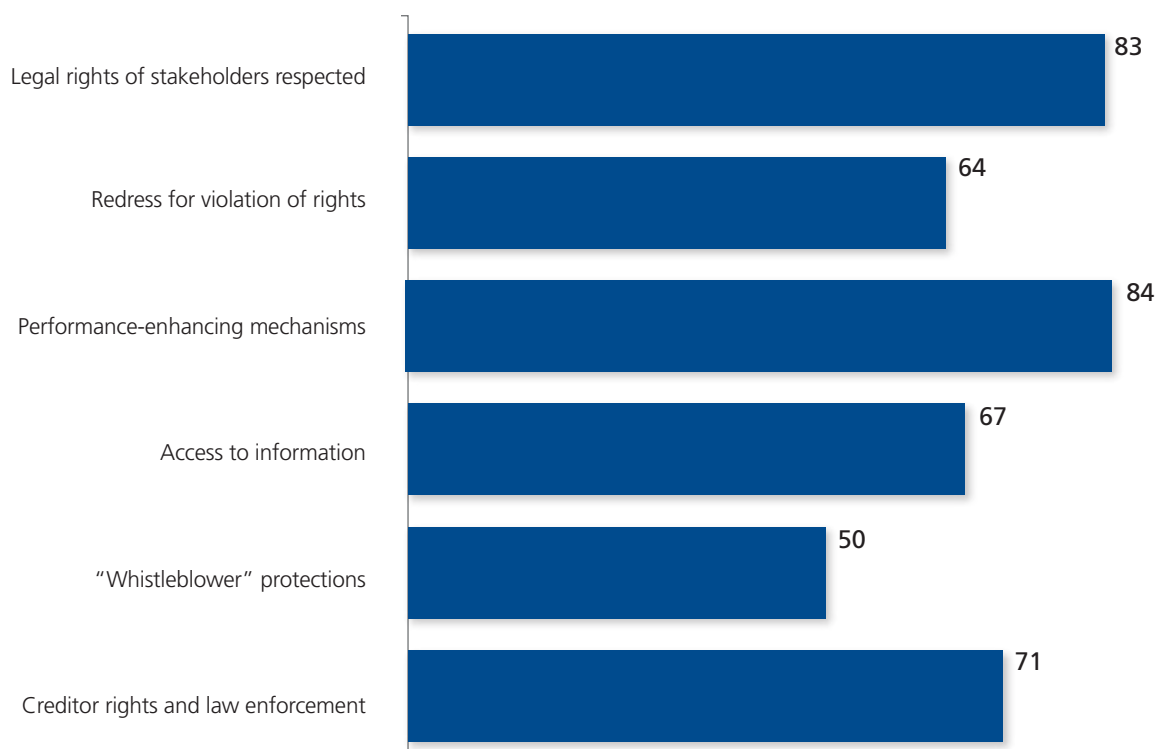
SOURCE: Detailed Country Assessment. Figures represent the percent implementation of each OECD Principle. 95% = Fully implemented, 75-95% = Broadly Implemented, 35-75% = Partially implemented, and less than 35% = not implemented.

International Comparisons



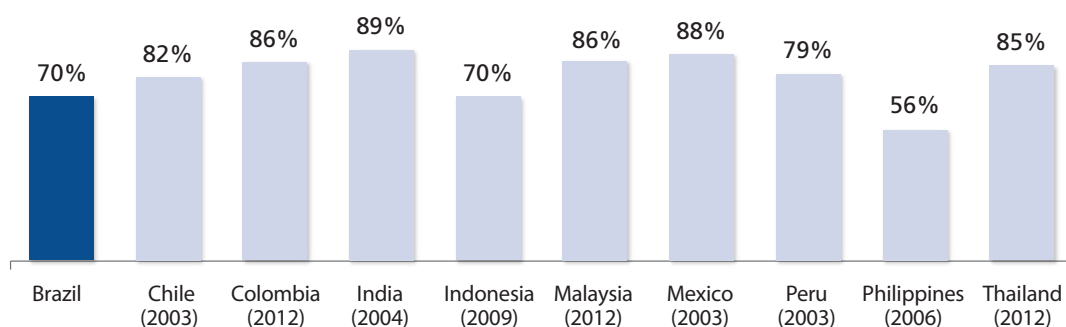
SOURCE: Figures for other countries represent weight-averaging of scores from previous ROSCs. Averages should be interpreted with caution due to changing methodologies over time. Data from previous ROSCs are not directly comparable because reports were completed in prior years (year of ROSC publication in parenthesis). Data for Chapter I (Enforcement and Institutional Framework) are not available for many countries because those countries were assessed before the 2004 changes to the OECD Principles (which introduced Chapter I).

OECD Principle Assessment: Equitable Treatment of Stakeholders | Brazil



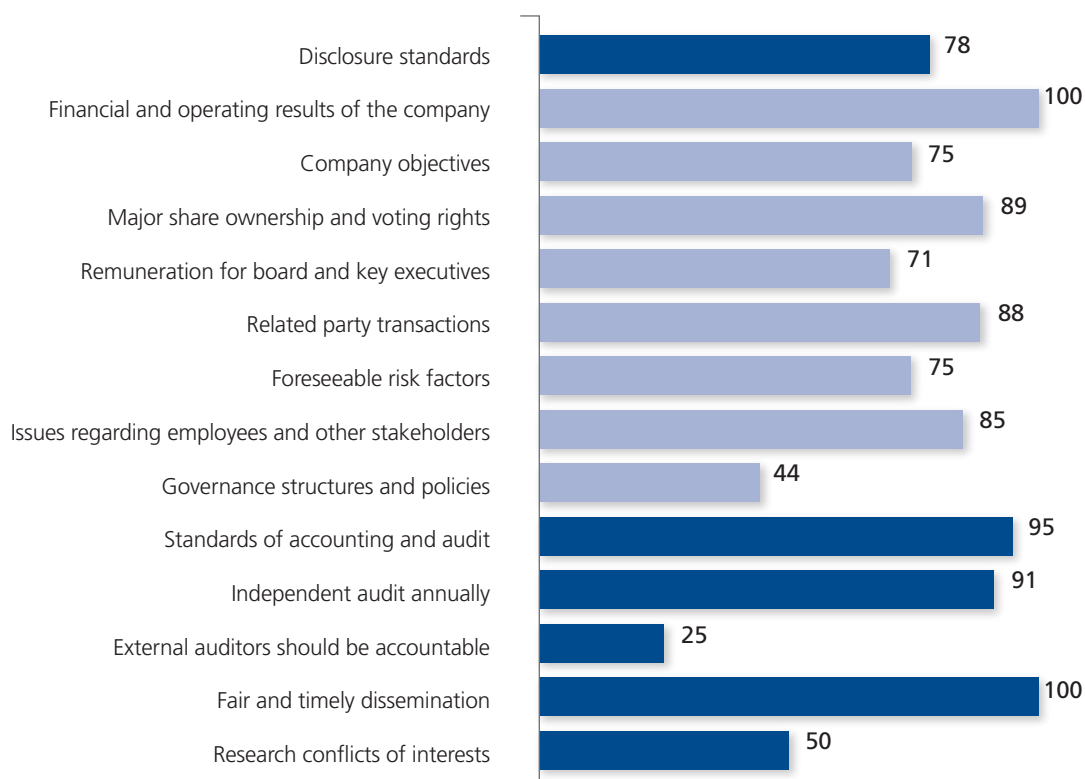
SOURCE: Detailed Country Assessment. Figures represent the percent implementation of each OECD Principle. 95% = Fully implemented, 75-95% = Broadly implemented, 35-75% = Partially implemented, and less than 35% = not implemented.

International Comparisons



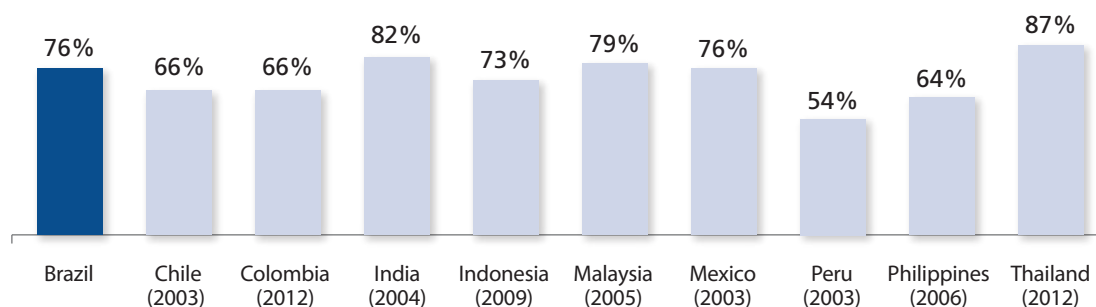
SOURCE: Figures for other countries represent weight-averaging of scores from previous ROSCs. Averages should be interpreted with caution due to changing methodologies over time. Data from previous ROSCs are not directly comparable because reports were completed in prior years (year of ROSC publication in parenthesis). Data for Chapter I (Enforcement and Institutional Framework) are not available for many countries because those countries were assessed before the 2004 changes to the OECD Principles (which introduced Chapter I).

OECD Principle Assessment: Disclosure and Transparency | Brazil



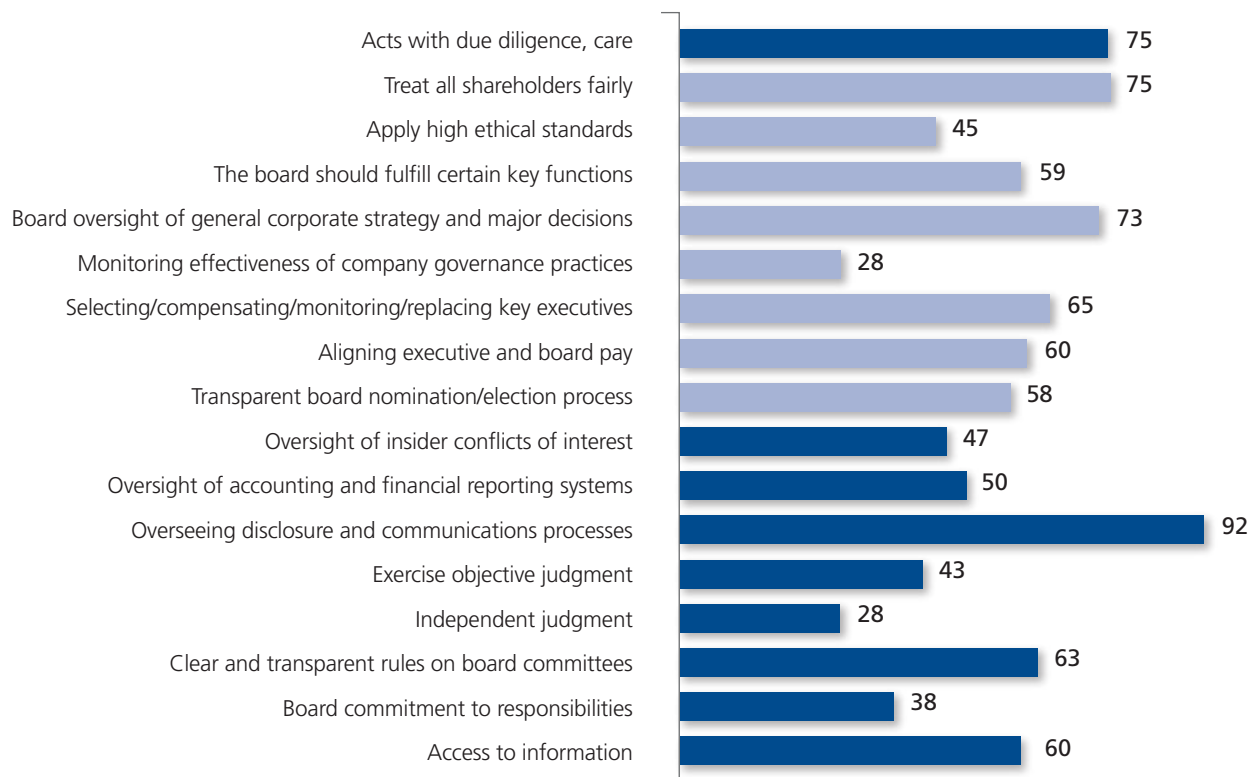
SOURCE: Detailed Country Assessment. Figures represent the percent implementation of each OECD Principle. 95% = Fully implemented, 75-95% = Broadly Implemented, 35-75% = Partially implemented, and less than 35% = not implemented.

International Comparisons



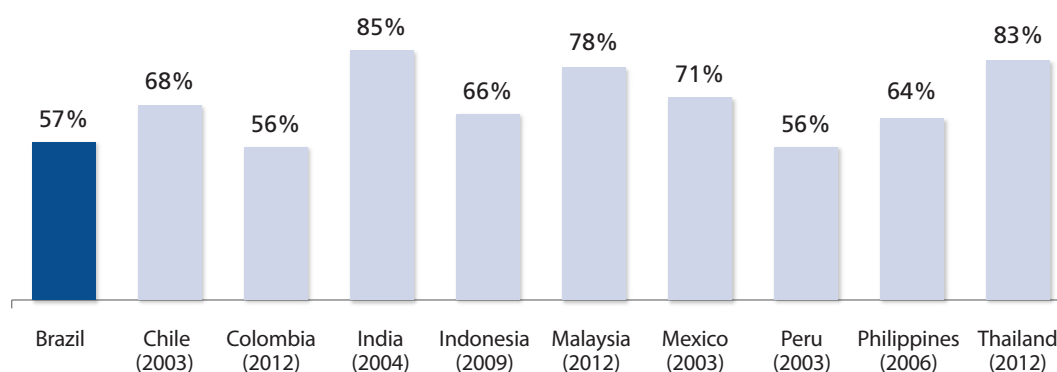
SOURCE: Figures for other countries represent weight-averaging of scores from previous ROSCs. Averages should be interpreted with caution due to changing methodologies over time. Data from previous ROSCs are not directly comparable because reports were completed in prior years (year of ROSC publication in parenthesis). Data for Chapter I (Enforcement and Institutional Framework) are not available for many countries because those countries were assessed before the 2004 changes to the OECD Principles (which introduced Chapter I).

OECD Principle Assessment: Responsibilities of the Board | Brazil



SOURCE: Detailed Country Assessment. Figures represent the percent implementation of each OECD Principle. 95% = Fully implemented, 75-95% = Broadly Implemented, 35-75% = Partially implemented, and less than 35% = not implemented.

International Comparisons



SOURCE: Figures for other countries represent weight-averaging of scores from previous ROSCs. Averages should be interpreted with caution due to changing methodologies over time. Data from previous ROSCs are not directly comparable because reports were completed in prior years (year of ROSC publication in parenthesis).

Data for Chapter I (Enforcement and Institutional Framework) are not available for many countries because those countries were assessed before the 2004 changes to the OECD Principles (which introduced Chapter I).

	Principle	FI	BI	PI	NI
I. ENSURING THE BASIS FOR AN EFFECTIVE CORPORATE GOVERNANCE FRAMEWORK					
IA	Overall corporate governance framework			X	
IB	Legal framework enforceable /transparent			X	
IC	Clear division of regulatory responsibilities		X		
ID	Regulatory authority, integrity, resources		X		
II. THE RIGHTS OF SHAREHOLDERS AND KEY OWNERSHIP FUNCTIONS					
IIA	Basic shareholder rights				
IIA 1	Secure methods of ownership registration	X			
IIA 2	Convey or transfer shares	X			
IIA 3	Obtain relevant and material company information	X			
IIA 4	Participate and vote in general shareholder meetings			X	
IIA 5	Elect and remove board members of the board	X			
IIA 6	Share in profits of the corporation	X			
IIB	Rights to part in fundamental decisions				
IIB 1	Amendments to statutes, or articles of incorporation		X		
IIB 2	Authorization of additional shares			X	
IIB 3	Extraordinary transactions, including sales of major corporate assets			X	
IIC	Shareholders GMS rights				
IIC 1	Sufficient and timely information at the general meeting			X	
IIC 2	Opportunity to ask the board questions at the general meeting			X	
IIC 3	Effective shareholder participation in key governance decisions		X		
IIC 4	Availability to vote both in person or in absentia			X	
IID	Disproportionate control disclosure	X			

	Principle	FI	BI	PI	NI
IIE	Control arrangements allowed to function				
IIE 1	Transparent and fair rules governing acquisition of corporate control		X		
IIE 2	Anti-take-over devices			X	
IIF	Exercise of ownership rights facilitated				
IIF 1	Disclosure of corporate governance and voting policies by inst. investors		X		
IIF 2	Disclosure of management of material conflicts of interest by inst. investors			X	
IIG	Shareholders allowed to consult each other			X	
III. EQUITABLE TREATMENT OF SHAREHOLDERS					
IIIA	All shareholders should be treated equally				
IIIA 1	Equality, fairness and disclosure of rights within and between share classes	X			
IIIA 2	Minority protection from controlling shareholder abuse; minority redress			X	
IIIA 3	Custodian voting by instruction from beneficial owners	X			
IIIA 4	Obstacles to cross border voting should be eliminated		X		
IIIA 5	Equitable treatment of all shareholders at GMs			X	
IIIB	Prohibit insider trading		X		
IIIC	Board/Mgrs. disclose interests			X	
IV. ROLE OF STAKEHOLDERS IN CORPORATE GOVERNANCE					
IVA	Legal rights of stakeholders respected		X		
IVB	Redress for violation of rights			X	
IVC	Performance-enhancing mechanisms		X		
IVD	Access to information			X	
IVE	“Whistleblower” protection			X	
IVF	Creditor rights law and enforcement			X	

	Principle	FI	BI	PI	NI
V. DISCLOSURE AND TRANSPARENCY					
VA	Disclosure standards				
VA 1	Financial and operating results of the company	X			
VA 2	Company objectives			X	
VA 3	Major share ownership and voting rights		X		
VA 4	Remuneration policy for board and key executives			X	
VA 5	Related party transactions		X		
VA 6	Foreseeable risk factors			X	
VA 7	Issues regarding employees and other stakeholders		X		
VA 8	Governance structures and policies			X	
VB	Standards of accounting & audit	X			
VC	Independent audit annually		X		
VD	External auditors should be accountable				X
VE	Fair & timely dissemination	X			
VF	Research conflicts of interests			X	
VI. RESPONSIBILITIES OF THE BOARD					
VIA	Acts with due diligence, care			X	
VIB	Treat all shareholders fairly			X	
VIC	Apply high ethical standards			X	
VID	The board should fulfill certain key functions				
VID 1	Board oversight of general corporate strategy and major decisions			X	
VID 2	Monitoring effectiveness of company governance practices				X
VID 3	Selecting/compensating/monitoring/replacing key executives			X	

	Principle	FI	BI	PI	NI
VID 4	Aligning executive and board pay			X	
VID 5	Transparent board nomination/election process			X	
VID 6	Oversight of insider conflicts of interest			X	
VID 7	Oversight of accounting and financial reporting systems			X	
VID 8	Overseeing disclosure and communications processes		X		
VIE	Exercise objective judgment				
VIE 1	Independent judgment				X
VIE 2	Clear and transparent rules on board committees			X	
VIE 3	Board commitment to responsibilities			X	
VIF	Access to information			X	

Note: FI=Fully Implemented; BI=Broadly Implemented; PI=Partially Implemented; NI=Not Implemented;



THE WORLD BANK

This report is one in a series of corporate governance country assessments carried out under the Reports on the Observance of Standards and Codes (ROSC) program. The corporate governance ROSC assessments examine the legal and regulatory framework, enforcement activities and private sector business practices and compliance, and benchmark the practices and compliance of listed firms against the OCED Principles of Corporate Governance.

The assessments:

- use a consistent methodology for assessing national corporate governance practices
- provide a benchmark by which countries can evaluate themselves and gauge progress in corporate governance reforms
- strengthen the ownership of reform in the assessed countries by promoting productive interaction among issuers, investors, regulators and public decision makers
- provide the basis for a policy dialogue which will result in the implementation of policy recommendations

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