REPORT ON THE OBSERVANCE OF STANDARDS AND CODES (ROSC)

Corporate Governance Country Assessment

COLOMBIA

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This Corporate Governance Assessment was completed as part of the joint World Bank-IMF program of Reports on the Observance of Standards and Codes (ROSC). It benchmarks the country's observance of corporate governance against the OECD Principles of Corporate Governance and is based on a template developed by the World Bank. The diagnostic was undertaken on the basis of the completed template prepared by Fedesarrollo. The assessment took place in parallel with the Accounting and Auditing ROSC and the CFAA conducted by the World Bank. Acknowledgments are due to the Ministry of Finance, the Superintendency of Securities, the Stock Exchange of Colombia, the Central Depository, the Chambers of Commerce, Association of Pension Funds, Association of Accountants, leading experts on legal, accounting and auditing issues, capital market issuers and institutional investors. Olivier Frémond and Mierta Capaul of the Corporate Governance Unit, Private Sector Advisory Services of the World Bank drafted the final report. The ROSC assessment was cleared for publication by the Ministry of Finance on August 13, 2003.

EXECUTIVE SUMMARY

This report assesses the corporate governance policy framework, enforcement and compliance practices in Colombia. The capital markets are small relative to the economy and trading volume is low: equity trading totals about USD 1 million, as compared to USD 1 billion in fixed income trading. The corporate sector is largely owned and controlled by family groups and conglomerates. The challenge is to create an environment where medium-sized companies can raise capital in the market and help them make the transition from tightly-controlled family firms to public companies. While pension funds represent a large and rapidly growing source of funds, they are reluctant to invest in equities. It has been demonstrated across countries that capital market development correlates positively with the degree of shareholder protection and good corporate governance.

Awareness of the importance of corporate governance issues is growing. Success stories of privatizations linked with good corporate governance highlight the importance of the issue. Colombia is an interesting example of the interplay between legal changes and voluntary initiatives based on the incentive to attract capital. It has put a minimum corporate governance disclosure regime in place for companies that wish to be eligible for pension fund investments.

Policy recommendations may be grouped under three broad headings: legislative reform, institutional strengthening and voluntary/private initiatives. The report recommends (i) the adoption of a securities bill as proposed by the securities regulator *Supevalores;*[1] (ii) the adoption of IAS and ISA and the creation of an independent audit oversight board; (iii) improved enforcement; (iii) enhanced monitoring of compliance with the code of good governance, for example by introducing a comply-or-explain requirement; and (iv) the creation of a director training organization. Together, these measures give issuers the choice to implement best practice and investors a benchmark against which to measure good corporate governance.

I. CAPITAL MARKETS AND INSTITUTIONAL FRAMEWORK

Colombia's market capitalization totals USD 13.2 billion, or 15.8 percent of GDP.[2] In May 2003, there were 109 companies listed on Colombia's only exchange, *Bolsa de Valores de Colombia;* only 20 of these trade regularly, and 52 do not trade at all.[3] The turnover ratio declined from 0.22 in 1998 to 0.05 in 2002.[4] De-listings outnumbered new listings and share offerings between 2000 and 2002,[5] but companies continue to enter the market, including through privatizations.[6]

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[1] Superintendencia de Valores, referred to hereafter as *Supervalores*

[2] In a survey of Latin American and Caribbean nations, Colombia ranks behind Argentina, Brazil, Mexico and Chile. It is ninth in the region in terms of market capitalization to GDP. Statistics from the World bank's *World Development* Indicators and *Global Development Finance*, 2003, using 2001 data.

[3] *Source: Bolsa de Valores de Colombia*, May 2003.

[4] *Source*: *Supervalores.*

[5] 39 delistings in 2000, ten each 2001 and 2002. This trend is expected to continue as tax exemptions are phased out.

[6] An often cited success story is that of ISA, a SOE dedicated to transport and electricity. ISA had public offerings in 2000 and 2002. It increased its attractiveness for minority investors by amending its bylaws to reflect good corporate governance practices, including minority shareholder board representation. Today, ISA has a free float of 25 percent and 93,000 shareholders. ETB, the public telephone company of Bogotá is trying to follow ISA's example and has an IPO scheduled for June 2003.

Free float averages 15 percent and has been decreasing as controlling shareholders increase their stakes.[7] Ownership is thus highly concentrated.[8] A recent study found that the three largest shareholders in the ten largest non-financial, privately owned firms owned 63 percent of capital – the third highest concentration of all countries surveyed.[9] Four large business groups dominate Colombia's corporate sector, three include listed firms.[10] In 2002, nine of the ten largest firms by trading volume belonged to one of the groups.

Key laws affecting corporate governance are the Commercial Code (amended by Law 222 of 1995),[11] Financial Framework Law 35 (1993), Law 446 (1998), Resolutions 400 and 1200 (1995), Resolution 275 (2001) and norms issued by *Supervalores* Colombia follows a civil law tradition, but recent changes have been influenced by common law.

The capital market regulator is *Supervalores*. It reports to the Ministry of Finance and supervises the securities market. It has investigation and sanction powers. Sanctions can be appealed before an administrative judge.[12] A committee of five[13] acts as regulatory board, representing the Ministries of Finance and Economic Development, *Superbancaria*, *Superintendencia de Sociedades* and the President. The Superintendent can also issue regulations. The Superintendent is appointed by the President and can be removed at any time. The *Bolsa* is a de-mutualized stock company (*Sociedad Anónima).* Nominally an SRO empowered to monitor its members, the *Bolsa* is closely supervised by *Supervalores*. It does not have separate listing rules.

Supervalores Resolution 275 of 2001 was the first regulation to address corporate governance.[14] It established broad conditions with which corporations must comply in order to be eligible for investment by pension funds. It requests that companies establish mechanisms to ensure the protection and equitable treatment of shareholders. These must be disclosed in a company level "code of good governance." While some companies just summarize bylaws with appropriate cross-references to Resolution 275, others understand that the code is a signal to investors of their commitment to corporate governance. A model code was drafted under the leadership of *Confecámeras*[15] in 2001. *Confecámeras* also organizes awareness raising events and will soon open an institute of corporate governance and director training with regional offices.

II. REVIEW OF CORPORTE GOVERNANCE PRINCIPLES

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[7] *Source: Bolsa de Valores de Colombia*, May 2003. Resolution 275 (2001) establishes a minimum free float of 20 percent in four years for companies who want to attract pension fund investment. See Annex D for an overview of ownership structure.

[8] With the exception of the business group *Sindicato Antioqueño*, where reportedly no single shareholder holds more than three percent of any one company of the group. However, cross-shareholdings are common, and control is highly concentrated.

[9] After Mexico and Greece. Source: Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer and Robert Vishny, "Law and Finance," NBER Working Paper No. 5661, July 1996.

[10] The *Santo Domingo* Group (e.g. Bavaria, Caracol), *Ardilla Lulle* (e.g. RCM, Coca Cola/Pepsi Cola, Textiles), *Grupo Aval* (e.g. Banco Bogotá), *Sindicato Antioqueño* (e.g. Cementos Algos)

[11] Jointly referred to hereafter as "The Commercial Code as amended"

[12] The plaintiff must first exhaust all appeals before *Supervalores* and pay any fine (or take out insurance in the same amount) before an appeal can be filed.

[13] *Sala General*

[14] Law 100 of 1993 (sections 3-4) granted *Supervalores* the authority to issue such rules for pension fund investments.

[15] *Confecámaras* is the Colombian Confederation of Chambers of Commerce created in 1996 (www.confecamaras.org.co).

This review assesses Colombia's compliance with each OECD Principle of Corporate Governance. Policy recommendations may be offered if a Principle is less than fully observed.[16]

Section I: The Rights of Shareholders

Principle IA: The corporate governance framework should protect shareholders' rights. Basic shareholder rights include the right to: (1) secure methods of ownership registration; (2) convey or transfer shares; (3) obtain relevant information on the corporation on a timely and regular basis; (4) participate and vote in general shareholder meetings; (5) elect members of the board; and (6) share in the profits of the corporation.

Assessment: ***Largely observed***

Description of practice: **Secure methods of ownership registration.** All shares are registered. The central depository *Deceval*[17] and trusts[18] can keep the share registry on behalf of the company. Legal proof of ownership is book entry in the share registry. The concept of nominee does not exist.

Convey or transfer shares. Shares are freely transferable. A transfer endorsement and letter of transfer are required to amend the share registry. DECEVAL clears and settles transactions on a T+6 basis. There is an additional one day delay before final registration. Clearance and settlement processes do not comply with ISSA G30 2000 recommendations. There is no DVP.

Obtain relevant information on the corporation on a timely and regular basis. 15 working days before the Annual General Meeting (AGM), companies must have their financial statements, dividends' distribution proposal, reports of the board and legal representative,[19] as well as the report of the *revisor fiscal* available for inspection.[20] Company bylaws, accounting books, AGM minutes and BOD minutes are kept in the mercantile registry managed by the chambers of commerce.[21] All registered records are publicly accessible for a small fee.

Participate and vote in general shareholder meetings. Article 379 of the Commercial Code confers each holder of ordinary shares the right to participate and vote at the AGM.[22]

Elect members of the board. The AGM elects directors through an "electoral quotient" (*cuociente electoral*) system devised to safeguard proportional representation of all shareholders. Board members are chosen from shareholder-proposed lists.[23] Firms are said to select board size in accordance with the controller's determination to appoint the board majority with the lowest possible number of shares.[24] Cumulative voting is not allowed.

Share in the profits of the corporation. The minimum mandatory dividend is 50 percent of net

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[16] **Observed** means that all essential criteria are met without significant deficiencies. **Largely observed** means only minor shortcomings are observed, which do not raise questions about the authorities' ability and intent to achieve full observance in the short term. **Partially observed** means that while the legal and regulatory framework complies with the Principle, practices, and enforcement diverge. **Materially not observed** means that, despite progress, shortcomings are sufficient to raise doubts about the authorities' ability to achieve observance. **Not observed** means no substantive progress toward observance has been achieved.

[17] *Depósito Centralizado de Valores*. Substantially all traded shares (ca. 15 percent) are deposited with **DECEVAL.**

[18] *Sociedad Fiduciaria.*

[19] The "legal representative" is the CEO or another executive empowered to take binding decisions on behalf of the company.

[20] Article 447 of the Commercial Code.

[21] Article 26-28 of the Commercial Code

[22] Except owners of preferred shares who are not allowed to vote, except for issues affecting their class

[23] See Annex C for an illustration of how this system functions..

[24] If the board has seven members, the controller can get a majority (four members) with 56.8 percent of capital.

profits, unless the sum of all reserves is over 100 percent of subscribed capital (then minimum dividend is 70 percent).[25] Majority requirement to change minimum dividend is 78 percent of capital.[26]

Policy recommendations: The clearance and settlement cycle should be lowered substantially and DVP adopted in order to minimize transfer risks. Alternative board voting systems, e.g. cumulative voting and proportional representation, should be permitted under the law.

Principle IB: Shareholders have the right to participate in, and to be sufficiently informed on, decisions concerning fundamental corporate changes, such as: (i) amendments to the governing documents of the company; (ii) the authorization of additional shares; and (iii) extraordinary transactions that in effect result in the sale of the company.

Assessment: ***Partially observed***

Description of practice: Fundamental issues are decided at extraordinary general meetings (EGM).[27] 70 percent of represented capital may raise and decide on issues not on the agenda. Share issuance up to the level of authorized capital is a board decision. The board may approve "large" transactions without shareholder approval. In some cases, mergers have been structured as acquisitions, thereby not requiring EGM approval. Most decisions are taken by simple majority.[28]

Policy recommendations: Only items on the agenda should be voted on. Shareholder approval should be mandatory for the acquisition/sale of substantial assets, including acquisitions.[29]

Principle IC: Shareholders should have the opportunity to participate effectively and vote in general shareholder meetings and should be informed of the rules, including voting procedures, that govern general them. (i) Shareholders should be furnished with sufficient and timely information concerning the date, location and agenda of general meetings, as well as full and timely information regarding the issues to be decided at the meeting. (ii) Opportunity should be provided for shareholders to ask questions of the board and to place items on the agenda at general meetings, subject to reasonable limitations. (iii) Shareholders should be able to vote in person or in absentia, and equal effect should be given to votes whether cast in person or in absentia.

Assessment: ***Partially observed***

Description of practice: The AGM takes place within three months of fiscal year-end. If no meeting is called, it takes place automatically on the first business day in April at company headquarters. *Supervalores* may summon a meeting when it has failed to occur, the *administradorest*[30] committed irregularities, or at the request of shareholders holding 20 percent of capital.

The AGM is summoned through a notice in the press.[31] If financial statements are to be approved, notice must be made at least fifteen business days in advance. Otherwise, the minimum notice is five business days. The agenda always includes: (i) approval of financial statements; (ii) election of the board; (iii) election of the *revisor fiscal*. The agenda is not circulated in advance, and shareholders cannot add to it. They may, however, raise and vote on

[25] Article 454 of the Commercial Code.
[26] Article 240, Law 222 of 1995. Ownership concentration is often adapted to this supermajority requirement to determine dividends.
[27] Amendments to company bylaws, increases and decreases of authorized capital, mergers, transformations and spin-offs, the waiver of pre-emption rights, share buy-backs, changes to company objectives, and changing company form.
[28] With the exception of waiver of pre-emptive rights and changes in the dividend pay-out ratio (70 percent).
[29] The proposed Capital Market Law introduces withdrawal rights in case of a sale of substantial assets.
[30] The term *administradores* encompasses board members, senior executives and the liquidator. (Article 22, Law 222 of 1995)
[31] Articles 180, 182 and 424 of the Commercial Code

any issue not included. The quorum is half plus one of subscribed shares.[32] If no quorum is met on first call, a new date is set within ten to thirty days with no quorum for the new meeting.

Shares are blocked from trading 11 days before the AGM for their associated votes to count. Shareholders may appoint proxies. Proxy appointments need not be notarized. Voting by mail and electronic voting are permitted, if all shareholders vote. If a single shareholder decides not to vote, the decisions adopted are null and void.[33]

Policy recommendations: The notice period should be extended to 30 days, and a detailed agenda, including the names and biographies of board candidates, should be circulated at company expense. A small number of shareholders (e.g. five percent) should be able to call a meeting and force items onto the agenda. Distance voting mechanisms should be made more practical. A date of record should be introduced in order to encourage investors to vote.

Principle ID: Capital structures and arrangements that enable certain shareholders to obtain a degree of control disproportionate to their equity ownership should be disclosed.

Assessment: ***Materially not observed***

Description of practice: Companies may issue shares with varying voting rights. There are three basic share classes: common, non-voting preferred[34]and privileged shares.[35] Privileged shares have preferences similar to those of preferred shares, but also carry one vote per share. Multiple voting shares and voting caps are prohibited.

Issuers must disclose the identity of their 20 largest registered shareholders in the annual report; however, this obligation does not extend to the ultimate beneficiary. Shareholders are not required to disclose beneficial ownership once their ownership exceeds a certain threshold. Intricate webs of ownership, including pyramid structures and cross-shareholdings, make it nearly impossible to ascertain the proportionality between cash flow rights and control.[36] While shareholder agreements must be delivered to the company, and shareholders have a theoretical right to review them, shareholders do not always seem to be aware of their existence.

Policy recommendations: The annual report should disclose the board and management holdings and the names of beneficial owners above a certain percentage of share capital. The onus for disclosure should be on the shareholder, as well as the company. All shareholders agreements should be disclosed.

Principle IE: Markets for corporate control should be allowed to function in an efficient and transparent manner.

Assessment: ***Materially not observed***

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[32] Article 68 of Law 222 of 1995

[33] Articles 19, 20 and 21 of Law 222 of 1995. The new capital markets law proposes to reduce the requirement to 70 percent.

[34] If there are two accounting periods in which dividends have not been paid, preferred shares automatically acquire voting rights. Preferred shares (i.e. non-voting) may represent no more than 50 percent of capital. Privileges include a minimum dividend payable with preference to the ordinary dividend and preferential reimbursement in the event of liquidation. Article 63 of Law 222 of 1995.

[35] Article 381 of the Commercial Code

[36] See diagram in Annex D.

Description of practice: If an investor seeks to acquire more than ten percent of share capital, s/he must do so through a public tender offer. If an investor holding over ten percent of capital wants to increase his participation by five percent or more, he must also make a tender offer.[37] Since there are no beneficial ownership disclosure requirements, it is hard for the market to know when such an event occurs. The board has the power to create anti-takeover provisions *ex ante* (usually spelled out in shareholder agreements), e.g. golden parachutes, that protect management.

In the case of delistings, a public tender offer for all outstanding shares must be made at a price agreed upon among shareholders or following one of the valuation methods approved by *Supervalores*. The offer only remains valid for the tender offer period.

Policy recommendations: Shareholders should disclose ownership, once their share holdings exceed a certain threshold. The rules for protection of minority shareholders in delistings should ensure that the delisting price is based on an independent appraisal and that it remains valid for a certain time after the company goes private.

Principle IF: Shareholders, including institutional investors, should consider the costs and benefits of exercising their voting rights

Assessment: ***Not observed***

Description of practice: Laws 100[38] and 50 regulate the pension fund system. Six pension fund administrators manage about USD 6 billion in mandatory pension funds, USD 1 billion in severance funds,[39] and USD 1 billion in voluntary[40] pension funds.[41] Pension funds are supervised by *Superbancaria*. The equity investment limit for mandatory pension funds is 30 percent of assets; a much smaller fraction is actually invested. Market illiquidity and a distortion in the incentive system due to minimum return regulations that sanction under-performance do not reward above average returns and are disincentives for pension fund investment in equities.

It is up to the pension funds to monitor whether their portfolio companies comply with the provisions of Resolution 275, e.g. whether they have adopted a code of good governance which addresses the points raised in the Resolution and whether they deem the code appropriate. Institutional investors do not disclose their voting policy and do not vote in practice.

Policy recommendations: In order to make the obligation of complying with the code of good governance more enforceable and monitor compliance, policymakers should consider introducing a comply-or-explain mechanism, which requires that companies comply with the code or explain reasons for non-compliance in their annual report. This could become a listing rule or fall under *Supervalores'* disclosure oversight powers. Revisions to the pension funds law should include discussions on the role and responsibilities of institutional investors, their incentive system and obligation to disclose voting policy. Awareness of international experiences of shareholder activism should be raised.

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[37] Article 1.2.5.6. of Resolution 400 (1995), amended by articles 1 of Resolution 571 and 643 and by Resolution 68 of 2001

[38] Social Security Law 100 of 1993 provided *Supervalores* with the legal basis to issue Resolution 275 of 2001.

[39] Known as *Cesantías* in Colombia. These are forced savings covering unemployment insurance.

[40] Tax free savings up to 30 percent of salary. The savings have to remain in the fund for a minimum of five years.

[41] *Source*: Asociación Colombiana de Administradoras de Fondos de Pensiones y de Cesantía (Asofondos), May 2003.

Section II: The Equitable Treatment of Shareholders

Principle IIA: The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights. All shareholders of the same class should be treated equally. (i) Within any class, all shareholders should have the same voting rights. All investors should be able to obtain information about the voting rights attached to all classes of shares before they purchase. Any changes in voting rights should be subject to shareholder vote. (ii) Votes should be cast by custodians or nominees in a manner agreed upon with the share's beneficial owner.

Assessment: ***Partially observed***

Description of practice: In theory, shareholders have broad legal venues for redress. If a board or shareholder meeting decision violates the law or bylaws, it can be challenged before a civil judge within two months.[42] Shareholders with less than ten percent of capital and without board representation may complain to *Supervalores* if their rights have been violated directly or indirectly by AGM, board or management decisions.[43] Derivative suits against the firm's *administradores* can be initiated by an EGM called by shareholders with 20 percent of capital.[44] Law 472 of 1998 introduces class action suits when collective rights and interests are violated.

Conflict resolution is subject to arbitration[45] or the courts. Specialized commercial courts do not exist. The greatest barriers to redress are the cost of litigation and length of court procedures.[46]

Shareholders can "put" their shares to the company, if they do not agree with certain fundamental decisions.[47] The put price is "fair market value" as determined by an independent expert appointed by the chamber of commerce. The new securities bill proposes to expand decisions where withdrawal rights apply to include the sale of substantial assets.

The bylaws contain information on the various share classes and the rights assigned to them, the annual report does not. Changes to the rights of a particular class must be approved by supermajority vote in a special meeting for shareholders of the affected class.

Custodians vote according to registered shareholder instructions. Owners generally give custodians wide discretion on how to vote. In the case of ADRs, it is the local trust that is the record holder and exercises all shareholder rights. The ADR contract specifies if the trust must obtain voting instructions from ultimate beneficiaries.

Policy recommendations: In practice, shareholder redress is generally unavailable. Reducing minority rights thresholds (e.g. five percent) would improve the situation. The new capital markets law proposes the creation of "minority shareholder associations" that could seek redress on behalf of individuals. It remains to be seen how this will encourage minority activism. The legal framework should encourage foreign investors to vote.

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[42] Article 191 of the Commercial Code
[43] Article 141 of Law 446 of 1998
[44] *Acción social de responsabilidad*, Article 25, Law 222 of 1995
[45] If so specified in the bylaws. A high profile dispute between shareholders under arbitration involves the former controlling shareholders of Banco de Colombia against Banco Industrial Colombiano, which acquired the former in 1996. The former controlling shareholders claim that the share exchange ratio was calculated in a fraudulent fashion.
[46] A civil procedure takes 780 days on average (*Source*: *Corporación Excelencia en la Justicia).*
[47] *Derecho de retiro* applies in the case of mergers, spin offs or transformations. Article 12 of Law 222 of 1995

Principle IIB: Insider trading and abusive self-dealing should be prohibited.

Assessment: ***Materially not observed***
Description of practice: *Administradores* cannot purchase shares of their company, except with authorization from 2/3 of the board or the AGM.[48] There are no black-out rules and no rules for controlling shareholders.

No person, directly or indirectly, may perform operations in the market using privileged information;[49] s/he can be sanctioned with a fine of up to USD 1765[50] or the value of the transaction, whichever is higher.[51] Any employee, director or officer of a firm who, for his own or another's benefit, misuses information he obtains because of his corporate duties, is subject to a fine. In 2000, unauthorized use of insider trading information became a criminal felony.[52]

Only one insider trading and self-dealing case has been sanctioned to date, but other investigations are underway.[53] *Supervalores* and the *Bolsa* have insufficient tools to detect insider dealings; they lack an electronic surveillance system and have no method for monitoring practices like "front running." Surveillance is complicated by the fact that banks and insurance companies may trade over the counter. Anecdotal evidence and a strong suspicion by *Supervalores* and the *Bolsa* suggest that insider trading is common, especially in fixed income.

Policy recommendations: Administradores should be permitted to buy shares subject to strict disclosure and black-out rules. Insiders should include majority shareholders and groups of companies. *Supervalores* or the *Bolsa* should install an electronic surveillance system to monitor insider trading. Policymakers should consider to oblige all institutions to trade on the exchange.

Principle IIC: Members of the board and managers should be required to disclose any material interests in transactions or matters affecting the corporation.

Assessment: ***Not observed***
Description of practice: There is no accounting standard for related party transactions like IAS 24.[54] Related transactions are disclosed as "material events" and in the footnotes. Loans to senior management and directors are permitted. An *administrador* may not participate in any transaction where there is a conflict of interest, except with AGM authorization.[55] According to market observers, this rule is rarely observed. Related party transactions do not take place under desired levels of transparency and are not sufficiently regulated.[56]

Policy recommendations: If a director has a conflict of interest, s/he should have to advise the board and refrain from voting. This should equally apply to directors connected to major shareholders with a vested interest in board decisions. Transactions between issuers and

[48] Article 404 of the Commercial Code. Breaches are sanctioned with up to 200 minimum wages (min. wage approx. USD125.-).
[49] Article 75 of Law 45 of 1990.
[50] Exchange rate is 2,832.861 Colombian pesos per USD. This amount will be updated with the I.P.C (Consumer Price Index).
[51] Article 6 of Law 27 of 1990.
[52] Article 258 of Law 599 of 2000.
[53] *Source: Supervalores*.
[54] Firms wishing to qualify for pension fund investments must establish internal procedures regarding related party transactions.
[55] Article 23 of Law 222 of 1995
[56] Somewhat stricter provisions governing related party transactions apply to financial institutions.

shareholders with a participation above a given threshold,[57] the legal representative, directors or their relatives should require unanimous board approval (without the interested party's vote). Policymakers should also consider to follow the Chilean example, where shareholders representing five percent of capital can request that the transaction be approved at an EGM with 2/3 of voting shares. Disclosure of ownership and related party transactions should be a top priority for the supervisor in monitoring disclosure.

Section III: Role of Stakeholders in Corporate Governance

Principle IIIA: The corporate governance framework should recognize the rights of stakeholders as established by law and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises. The corporate governance framework should assure that the rights of stakeholders that are protected by law are respected.

Assessment: ***Observed***

Description of practice: The Labor Code, Commercial Code as amended, Corporate Restructuring Law 550 of 1999 and other laws and regulations set forth the rights of stakeholders, such as employees and creditors. Employees are considered creditors, allowing them to secure their wages when restructurings occur.[58] When a firm seeks to restructure debt, employees and creditors have voting rights, and employees are represented on the board during liquidation.[59] Although good governance codes should address stakeholder issues, no specific regulations about how to involve stakeholders exist.

Principle IIIB: Where stakeholder interests are protected by law, stakeholders should have the opportunity to obtain effective redress for violation of their rights.

Assessment: ***Partially observed***

Description of practice: The Constitution and other laws provide redress for consumer groups, creditors and others; obligations to labor are dealt with comprehensively. Environmental legislation is considered advanced for the region. Class-action type mechanisms permit affected parties to seek protection and/or compensation, but the court system is slow and inefficient. Insolvency laws favor debtors, leading to perceptions that creditor rights are poorly protected.

Policy recommendations: An Insolvency and Creditor Rights ROSC is recommended to assess the creditor rights and insolvency framework in detail.

Principle IIIC. The corporate governance framework should permit performance-enhancement mechanisms for stakeholder participation.

Assessment: ***Largely observed***

Description of practice: Options are not regulated by law, nor are they common.[60] Employee share plans are approved by the AGM and disclosed as labor debt.

Policy recommendations: Careful attention should be paid to the international debate on the use/abuse and expensing of stock options.

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[57] The proposed securities bill proposes five percent.
[58] Labor law establishes that in the event of a merger, employment contracts of the "absorbed" company remain in effect.
[59] Law 55 of 1999
[60] With the possible exception of the *Sindicato Anitoqueño*.

Principle IIID: Where stakeholders participate in the corporate governance process, they should have access to relevant information.

Assessment: ***Observed***
Description of practice: Listed companies have general obligations regarding dissemination of their financial statements and other corporate matters. Upon a merger or spin-off, the company must publish information that draws creditors' attention to their rights. In restructuring processes, notice must be sent to creditors so that they can attend the restructuring meeting and vote.

Section IV: Disclosure and Transparency

Principle IVA: The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and the governance of the company. Disclosure should include, but not be limited to, material information on: (1) The financial and operating results of the company. (2) Company objectives. (3) Major share ownership and voting rights. (4) Members of the board and key executives, and their remuneration. (5) Material foreseeable risk factors. (6) Material issues regarding employees and other stakeholders. (7) Governance structures and policies.

Assessment: ***Partially observed***
Description of practice: The Commercial Code as amended requires publication of an annual report and mandates its contents. Resolution 400 of 1995 stipulates the disclosure to *Supervalores* and the *Bolsa* of periodic and material financial information for listed companies. The annual report includes a balance sheet, income statement, cash flow statement, statement of changes in equity and notes. It also includes the *revisor fiscal's* report and a management discussion and analysis, with limited discussion of company objectives. Information on risk management and material risk factors is mandatory, as is certification of internal control by the *revisor fiscal*. The names of board members and key executives are disclosed; there is little disclosure of remuneration and governance structures. Publication of material issues regarding employees or other stakeholders is not required.

Accountability for financial statements rests with the legal representative and the *revisor fiscal.* According to market participants, the quality of financial information is poor. Between 1997 and 2002, the Superintendency brought 62 sanctions for disclosure violations against companies, their legal representatives and/or *revisores fiscales*.

Policy recommendations: Supervalores should continue with its reviews and enforcement of disclosure, focusing on content rather than form. Special attention should be paid to the disclosure of ownership and related party transactions.

Principle IVB: Information should be prepared, audited, and disclosed in accordance with high quality standards of accounting, financial and non-financial disclosure, and audit.

*Assessment: **Materially not observed***
Description of practice: Decree 2649 of 1993 defines Colombian GAAP, which differs materially from IAS.[61] Accounting standards are issued by a number of superintendencies and other public bodies. Companies must prepare parallel information for different regulatory bodies,

[61] See the forthcoming Auditing and Accounting ROSC for more details.

each based on a different standard and code. Policymakers agree that the quality of Colombian accounting standards is substandard. Colombian auditing standards do not comply with ISA.

There are 93,000 practicing accountants in Colombia.[62] A university degree in accounting and one year practice are sufficient for registration as an auditor. Law 43 of 1990 regulates the accounting profession and sets up a rudimentary code of ethics. The law provides legal backing to the *Junta Central de Contadores*, the accounting and auditing oversight board, which reports to the Ministry of Education. While the *Junta* theoretically includes representatives from various superintendencies and other public bodies,[63] in practice it is dominated by practitioners.

Policy recommendations: Colombia should consider adopting IAS in its entirety and ISA and assigning all accounting issues to a single superintendency.

Principle IVC: An annual audit should be conducted by an independent auditor in order to provide an external and objective assurance on the way in which financial statements have been prepared and presented.

Assessment: ***Materially not observed***

Description of practice: The Commercial Code created the figure of *revisor fiscal*, who combines the functions of an external auditor with those of what is known in Mexico as a *comisario* and in Brazil as the *conselho fiscal*. The AGM nominates the *revisor fiscal,* whose duties include: (i) certification of the quality of internal controls defined broadly (including processes and operations); (ii) certification that the firm complies with laws and bylaws; (iii) signing of financial statements together with the legal representative. There is an inherent conflict of interest in that the *revisor fiscal* gives the company instructions and then audits their execution. Market observers express concern about the independent judgment of the *revisor fiscal*, especially in cases where his or her salary is paid by the company.[64]

Accounting firms may provide auditing and consulting services to the same company, but they may not be performed by the same person. Auditing and consulting fees are not separately disclosed in the annual report. Current law requires the auditor's opinion to be signed by the individual auditor thus, responsibility and liability rests on the individual. [65]

Policy recommendations: The functions of the *revisor fiscal* should be separated into internal audit functions and external audit. The external auditor should be fully independent. Auditor independence should be clearly defined, e.g. (i) fees from any one client should not represent more than a certain percentage of total revenues; (ii) individual auditors or firms should rotate at certain intervals; (iii) the provision of certain non-audit services to the audit client should be restricted. A breakdown of auditing and consulting fees should be disclosed in the annual report.

Principle IVD: Channels for disseminating information should provide for fair, timely, and cost-effective access to relevant information by users.

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[62] *Source: Junta Central de Contadores*, May 2003.

[63] *Ministerio de Educación Nacional, Supervalores, Superbancaria, Superintendencia de Sociedades, Superintendencia Nacional de Salud, Dirección de Impuestos y Aduanas Nacionales, Contaduría General de la Nación.*

[64] See the forthcoming Auditing and Accounting ROSC for more details

[65] The new securities bill proposes the possibility to initiate derivative action against *revisores fiscales.*

Assessment: ***Largely observed***
Description of practice: Issuers convey periodic and continuous information to *Supervalores* via the Internet and to the *Bolsa* in hard copy. Year-end financial statements are reported by March 1 of the following year and interim financial statements within 30 days after each quarter.[66] Material information must be disclosed immediately to the market. Companies may ask for a delay up to four months for what they consider "business secrets." Within a month of AGM approval of the annual financial statements, a copy must be filed with the mercantile registry.

Users can access information at the *Supervalores* and *Bolsa* websites.[67] At its discretion, *Supervalores* may order newspaper publication of a material event or a public announcement before trading opens. Filings with the mercantile registry are available at respective chambers of commerce.

Policy recommendation: Policymakers should ensure that the four-month delay permitted to companies in reporting material events deemed to be business secrets is not abused.[68]

Section V: The Responsibility of the Board

Principle VA: The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders. Board members should act on a fully informed basis, in good faith, with due diligence and care, and in the best interest of the company and the shareholders.

Assessment: ***Partially observed***
Description of practice: The regulatory framework applies equally to all *administradores*, i.e. senior management, the legal representative, the liquidator, and directors.[69] The board of directors consists of at least three members, each with an alternate.[70] The board is accountable to the company and shareholders. Directors are expected to act in good faith, with loyalty and due diligence.[71] While the law does not include a "business judgment rule," the director "model" is the "diligent and careful conduct of a good businessman in the administration of his…affairs."

Policy recommendations: The role and accountability of the board of directors should be clearly defined vis-à-vis senior management and especially the legal representative or CEO. Consideration should be given to abolishing the concept of alternate directors.

Principle VB: Where board decisions may affect different shareholder groups differently, the board should treat all shareholders fairly.

Assessment: ***Materially not observed***
Description of practice: The loyalty duty implies that the *administradores* have an obligation to act with integrity, giving priority to the corporation's interests above all others. When a board

[66] Insurance companies and capital investment corporations have 45 days.
[67] www.supervalores.gov.co and www.bvc.com.co.
[68] A similar exception exists in Brazil, which, according to local lawyers, is exploited, especially in sensitive matters such as prospective divestitures and acquisitions.
[69] Article 22 of Law 222 of 1995
[70] Article 434 of the Commercial Code. The average board size is reportedly five to seven principals and their alternates.
[71] Articles 22 and 23 of Law 222 of 1995

decision affects shareholder classes differently, the decision must comply with the law and bylaws and ensure equitable treatment of all shareholders.[72] In practice, large shareholders appoint directors connected to them who tend to defend their interests.

Policy recommendations: The "duty of loyalty" obligation should be strengthened by enhancing minority shareholder participation in the nomination and election of independent directors. Colombia should also build director professionalism by supporting the Institute of Directors.

Principle VC: The board should ensure compliance with applicable law and take into account the interests of stakeholders.

Assessment: ***Largely observed***
Description of practice: The Commercial Code as amended establishes that the *administradores* and the *revisor fiscal* must ensure compliance with law and bylaws. There is an automatic presumption of fault or negligence when a director (i) breaches the law or bylaws; (ii) exceeds authority limitations set in the bylaws or AGM or; (ii) distributes dividends in violation of Commercial Code provisions.[73] While board liabilities are extensive, they are not matched by corresponding powers, given that boards are often simply the instrument of the controller.

There is no legal provision that establishes a board obligation to take into account stakeholder interests, but Resolution 275 recommends that companies recognize stakeholder rights and promote synergies between them.

Policy recommendations: Boards are often just rubber stamp bodies, but their legal liabilities are huge. Conversely, controlling shareholders who exercise indirect power over the boards, are not liable for their actions. Policymakers should consider introducing the concept of "shadow director," whereby controllers would be held liable if they take decisions formally reserved to the board. Boards must be educated about stakeholder rights as an integral part of director training.

Principle VD: The board should fulfill certain key functions, including (1) Reviewing and guiding corporate strategy, major plans of action, risk policy, annual budgets and business plans; setting performance objectives; monitoring implementation and corporate performance and overseeing major capital expenditures, acquisitions and divestitures. (2) Selecting, compensating, monitoring and, when necessary, replacing key executives and overseeing succession planning. (3) Reviewing key executive and board remunerations, and ensuring a formal and transparent board nomination process. (4) Monitoring and managing potential conflicts of interest of management, board members and shareholders, including misuse of corporate assets and abuse in related party transactions. (5) Ensuring the integrity of the corporation's accounting and financial reporting systems, including the independent audit, and that appropriate systems of control are in place, in particular, systems for monitoring risk, financial control, and compliance with the law. (6) Monitoring the effectiveness of the governance practices under which it operates and making changes as needed. (7) Overseeing the process of disclosure and communications.

Assessment: ***Materially not observed***
Description of practice: The legal framework says little about director responsibilities; most specifics are left to company bylaws. The Commercial Code empowers the board to sign and execute contracts on behalf of the company and take all decisions needed to fulfill corporate interests. Legal duties include (i) furthering the firm's social purpose; (ii) ensuring strict compliance with the law and by-laws; (iii) overseeing the *revisor fiscal's* fulfillment of duties; (iv) safeguarding industrial secrets; (v) abstaining from disclosure of privileged information; (vi)

[72] Article 23 of Law 222 of 1995.
[73] Article 200 of the Commercial Code, modified by Article 24 of Law 222 of 1995.

treating all shareholders equitably; (vi) respecting shareholders' rights to inspection; (vii) abstaining from direct or indirect participation in activities that compete with the company, or any act that could imply a conflict of interest unless expressly authorized. According to the Commercial Code, it is the board that appoints the legal representative or CEO and sets his remuneration; however, market participants report that the controlling shareholder often chooses the CEO.[74] The *administradores* are charged with ensuring the integrity of the corporation's accounting and financial reporting systems.[75] They, together with the *revisor fiscal*, are liable for damages from a company's failure to submit financial statements.[76]

Policy recommendations: The new law should unambiguously assign certain non-transferable duties to the board, such as setting corporate strategy, hiring and firing the CEO, approving related party transactions, monitoring conflicts of interest. The code of best practice should expand on the law and include clear guidelines as to the board's role, responsibilities, operation, structure, and qualification requirements. The proposed Institute of Directors should focus on director training – both on the technical side and on fiduciary duties and liabilities. Consideration should be given to introducing director accreditation.

Principle VE: The board should be able to exercise objective judgment on corporate affairs independent, in particular, from management: (1) boards should consider assigning a sufficient number of non-executive board members capable of exercising independent judgment to tasks where there is a potential for conflict of interest. Examples of such key responsibilities are financial reporting, nomination, and executive and board remuneration. (2) board members should devote sufficient time to their responsibilities.

Assessment: ***Materially not observed***

Description of practice: The concept of "independent director" is absent from Colombia's legal and regulatory framework. Some blue chips have "independent directors," but they are mostly trusted friends and acquaintances appointed by the controller without minority shareholder involvement, unless shareholder agreements specify board representation for minorities. Audit committees are not mandatory.[77] The board is not required to meet regularly, and directors need not disclose attendance. Directors must not serve on more than five boards at a time.[78] In practice, the positions of chairman and CEO are usually separate; in this case, the CEO is not a director, but sets the board agenda, controls access to information and often dominates the board.

Policy recommendations: The new securities bill should require a minimum percentage of independent directors and define "independence" within the Colombian context.[79] If policymakers decide to continue with the tradition of alternate directors, each alternate should be elected together with the principal director on an individual basis, rather than numerically. Alternate directors serving for independent directors, should also be independent. Special training courses for independent directors should be developed, along with a potential certification program for independent directors. Audit committees, made up of a majority of independent directors, should be made mandatory and their functions clearly defined.

[74] Article 440 of the Commercial Code
[75] Article 19, Decree 2649 of 1993
[76] Article 42, Law 222 of 1995.
[77] Audit committees are mandatory for banks.
[78] Article 202 of the Commercial Code
[79] The draft securities bill proposes that 35 percent of the board be independent.

Principle VF: In order to fulfill their responsibilities, board members should have access to accurate, relevant and timely information.

Assessment: ***Observed***
Description of practice: Board members have access to confidential information. Law 222 of 1995 states that board members (i) should treat commercial and industrial information confidentially and (ii) cannot disclose or use confidential information without justification.[80] In practice, the CEO controls access to information.

III. SUMMARY OF POLICY RECOMMENDATIONS

This section sets out recommendations to improve listed companies' compliance with the OECD Principles. The next step is the development of a detailed action plan, formulated in cooperation with the authorities and in consultation with the private sector and other stakeholders.

Legislative reform: Securities issues are now part of the Financial Framework Law, which focuses mainly on prudential regulation for banks. The proposed securities bill would repeal the law as it applies to securities and replace it with a bill based on the IOSCO Principles. It would help to clearly delineate the competencies of *Supervalores* and *Superbancaria* and provide an opportunity to set minimum corporate governance standards for issuers, broker/dealers, central depositories, trading systems, stock exchanges and rating agencies. The bill should focus on shareholder protections, more transparency and enhanced board responsibilities. *Priority:* ***medium***

There is general agreement that Colombian accounting standards are substandard. It is proposed to withdraw the authority to issue accounting standards from the entities that currently do so and create a technical board in charge of accounting issues related to IAS. ISA should be adopted and an independent audit oversight board created, dominated by non-practitioners. *Priority:* ***high***

Institutional strengthening: Issuers must comply with numerous, often confusing laws, rules and regulations issued by different regulators. Fragmented supervision can also lead to arbitrage between different Superintendencies and to a lack of oversight for conglomerates. One of the objectives of regulators should be to streamline the regulatory framework and to assign clear responsibilities to each regulator with the correspondent authority to monitor and enforce compliance. *Priority:* ***high***

Supervalores should continue to strengthen its capabilities to monitor disclosure and enforce corporate governance requirements. Compliance with the code of good governance should be monitored by *Supervalores* or through the listing rules. New emphasis should be placed on the disclosure of ownership, and related party transactions. *Priority:* ***high***

Voluntary/private initiatives: Colombia is creating a director training organization. Given the high-profile, collaborative effort involved and the regional presence in the country's main commercial centers, this has the potential to become a strong, widely accepted director training organization. Consideration should be given to introducing director accreditation. *Priority:* ***high***.

[80] Article 23, Numbers 4 and 5.

Annex A: Summary of Observance of OECD Corporate Governance Principles

PRINCIPLE		O	LO	PO	MO	NO	Comment
I. THE RIGHTS OF SHAREHOLDERS							
IA	Basic shareholder rights		**X**				• DECEVAL clears and settles transactions on a T+6 basis, no DVP. • Concept of nominee does not exist. • Shares blocked 11 days before AGM. • Board elected by proportional representation (*cuociente electoral*).
IB	Rights to participate in fundamental decisions.			**X**			• Few items require supermajority • Board may issue shares up to level of authorized capital; no time limit • No shareholder approval for large transactions. • 70% of represented capital at the meeting may raise and decide on issues not on the agenda
IC	Shareholders AGM rights			**X**			• No agenda for AGMs. • First call quorum 50% + 1; no second quorum. • 15 day notice period with approval of financials (otherwise 5 days) • 20% of capital may call meeting.
ID	Disproportionate control disclosure				**X**		• Multiple voting shares and voting caps prohibited. • Annual reports must disclose 20 largest shareholders (not ultimate beneficiary); shareholders need not disclose beneficial ownership. • Pyramids and cross-holdings common • Shareholders can inspect shareholder agreements, but usually don't know about them.
IE	Control arrangements should be allowed to function.				**X**		• Public tender offer threshold: 10% and each subsequent 5%. • Board can create anti-takeover provisions. • Delisting requires tender for all outstanding shares.
IF	Cost/benefit to voting					**X**	• Equity investment limit for mandatory pension funds is 30 % of assets, but less usually invested. • Pension funds monitor portfolio company adoption of code of good governance.
1. II. EQUITABLE TREATMENT OF SHAREHOLDERS							
IIA	All shareholders should be treated equally			**X**			• Shareholders with <10% of capital may appeal to *Supervalores* • Derivative suits permitted by shareholders with 20% of capital; class-action suits also permitted. • Cost and length of court procedures limit redress; no specialized commercial courts. • Shareholders can "put" shares to the company if not in agreement with fundamental decisions. • Custodians vote according to registered shareholder instructions (ADR rights specified in depository contract).
IIB	Prohibit insider trading				**X**		• Unauthorized use of insider trading information is a criminal felony. • *Administradores* cannot purchase shares of company, except with prior authority from 2/3 of board or the AGM. • No black-out rules and no rules for major/controlling shareholders. • Insider market operations can result in fines of up to higher of USD 1765 or value of transaction • Only one insider trading and self-dealing case has been sanctioned to date; *Supervalores* and *Bolsa* have insufficient tools to detect insider dealings; market participants report insider trading is common.
IIC	Board/Mgrs. disclose interests					**X**	• No accounting standard for related party transactions • Related transactions are disclosed as "material events" • Loans to senior management and directors are permitted. • Director may not participate in transactions where there is a conflict of interest, except with AGM approval; insufficient adherence and regulation in this area.
2. III. ROLE OF STAKEHOLDERS IN CORPORATE GOVERNANCE							
IIIA	Stakeholder rights respected	**X**					• When a company seeks to restructure debt, employees and creditors have voting rights; employees represented on board during liquidation.

PRINCIPLE	O	LO	PO	MO	NO	Comment
IIIB Redress for violation of rights			**X**			• Redress for consumer groups, creditors and others addressed in Constitution and other laws; obligations to labor dealt with comprehensively. • Environmental legislation considered advanced for region. • Insolvency laws favor debtors.
IIIC Performance enhancement		**X**				• Options not regulated and uncommon. • AGM approves employee share plans (reported as labor debt.)
IIID Access to information	**X**					• No general stakeholder information requirements. • During a merger / spin-off, company must publish information to support creditor rights.
3. IV. DISCLOSURE AND TRANSPARENCY						
IVA Disclosure standards			**X**			• Year-end financials reported by March 1 and interim financial statements within 30 days after each quarter. • Material information disclosed immediately to market; companies may request four month delay for "business secrets." • Market participants rate quality of financial information as poor. • Disclosure of material risk factors is mandatory. • Name of board members and key executives disclosed, but little on remuneration and governance structures. • 62 Superintendency sanctions for disclosure violations 1997-2002.
IVB Standards of accounting & audit				**X**		• Market analysts, policymakers agree on low quality of local GAAP. • Auditing standards do not comply with ISA. • Oversight board (Junta Central de Contadores) dominated by practitioners, reports to Ministry of Education.
IVC Independent audit annually				**X**		• *Revisor fiscal*, nominated by AGM, combines functions of external and statutory auditors. • Conflict of interest in that the *revisor fiscal* gives company instructions to correct mistakes and then audits their execution. • Some *revisor fiscal* functions should be board responsibilities. • Market concern about independent judgment of *revisor fiscal*. • Auditor's opinion must be signed by individual auditor, so responsibility and liability rests on the individual.
IVD Fair & timely dissemination	**X**					• Issuers inform *Supervalores* via Internet, *Bolsa* on paper. • Information on *upervalores* and *Bolsa* websites or mercantile registry.
4. V. RESPONSIBILITIES OF THE BOARD						
VA Acts with due diligence, care			**X**			• Board has three members, each with an alternate. • Directors must act in good faith, with loyalty and due diligence. • Law does not include "business judgment rule."
VB Treat all shareholders fairly				**X**		• Loyalty duty implies that *administradores* must prioritize company's interests above all others. • In practice, large shareholders appoint directors connected to them who tend to defend their interests.
VC Ensure compliance w/ law		**X**				• Commercial Code establishes that *administradores* and *revisor fiscal* must ensure compliance with law and bylaws. • No legal provisions establishing board obligations to stakeholders. • Resolution 275 recommends that the corporation recognize the rights of stakeholders and promote synergies between them.
VD The board should fulfill certain key functions				**X**		• Legal framework says little about director responsibilities; most specifics are left to company bylaws. • The board sets the CEO's compensation, and ensures the integrity of the corporation's accounting and financial reporting systems • Board shares liability with *revisor fiscal* for damages from a company's failure to submit financial statements.
VE The board should be able to exercise objective judgment				**X**		• No concept of "independent director" • Some blue chips have "independent directors" on their boards • Audit committees are not mandatory under Colombian law. • No requirement for the board to meet regularly, and directors need not disclose board meeting attendance. • Directors must not serve simultaneously on more than five boards.
VF Access to information	**X**					• Board members may have access to confidential information. • In practice, the CEO controls access to information.

Annex B: Summary of Policy Recommendations

I. THE RIGHTS OF SHAREHOLDERS		
IA	Basic shareholder rights	• Clearance and settlement cycle should be substantially shortened • DVP should be adopted to minimize transfer risks. • Alternative board voting systems, e.g. cumulative voting and proportional representation, should be permitted under law.
IB	Rights to participate in fundamental decisions.	• Only items on agenda should be voted on. • Shareholder approval should be mandatory for acquisition/sale of substantial assets.
IC	Shareholders AGM rights	• Notice period should be extended to 30 days and include detailed agenda with names and biographies of board candidates. • Small number of shareholders (e.g. 5%) should be able to call meeting and force items onto agenda, which should be circulated at company expense. • Distance voting mechanisms should be made more practical. • Date of record should be introduced in order to encourage investors to vote.
ID	Disproportionate control disclosure	• Annual report should disclose board and management holdings and names of beneficial owners above certain percentage of share capital. • Onus for disclosure should be on shareholder, in addition to company.
IE	Control arrangements should be allowed to function.	• Shareholders should disclose ownership, once share holdings exceed a certain threshold. • Rules for protecting minority shareholders in delistings should ensure that delisting price is based on independent appraisal and that it is valid for a period after company goes private.
IF	Cost/benefit to voting	• In order to make obligation of complying with code of good governance more enforceable and monitor compliance, policymakers should consider introducing comply-or-explain mechanism, which requires companies to comply with code or explain in annual report why not. Could become listing rule or fall under disclosure oversight powers of *Supervalores*. • Voting by investors should be made as easy as possible. • Revisions to pension funds law should include discussions on role and responsibilities of institutional investors, their incentive system and obligation to disclose voting policy. Awareness of international shareholder activist experiences should be raised.
II. EQUITABLE TREATMENT OF SHAREHOLDERS		
IIA	All shareholders should be treated equally	• In practice, shareholder redress remains generally unavailable. • First step to improve situation would be to reduce minority rights thresholds (e.g. 5%). Legal framework should encourage foreign investors to vote.
IIB	Prohibit insider trading	• *Administradores* should be able to buy shares subject to strict disclosure and black out rules. • Insiders should be redefined to include majority shareholders and groups of companies. • *Supervalores* or *Bolsa* should have electronic surveillance system to monitor insider trading. • Consideration should be given to prohibiting loans to controlling shareholders. • Policymakers should consider obliging all institutions to trade on exchange.
IIC	Board/Mgrs. disclose interests	• Director with conflict of interest should have to advise other directors and refrain from discussing and voting on the matter. This rule should also apply to directors connected to major shareholders or other bodies with vested interest in board decision outcomes. • Transactions between issuers and large shareholders (e.g. 5%) and other insiders should be approved unanimously by board (without interested party's vote). Issuers should report all related party transactions in special section of annual report. • 5% of capital should be able to request that related party transaction be approved at EGM with 2/3 of voting shares. • Disclosure of ownership and related party transactions should be top priority for supervisor when monitoring disclosure.
III. ROLE OF STAKEHOLDERS IN CORPORATE GOVERNANCE		
IIIA	Stakeholder rights respected	
IIIB	Redress for violation of rights	• Insolvency and Creditor Rights ROSC recommended to assess creditor rights and insolvency framework in detail.
IIIC	Performance enhancement	• Careful attention should be paid to international debate on use/abuse and expensing of stock options.
IIID	Access to information	
IV. DISCLOSURE AND TRANSPARENCY		
IVA	Disclosure standards	• *Supervalores* should continue with reviews and enforcement of disclosure, focusing on content rather than form. • Special attention should be paid to disclosure of ownership and related party transactions.
IVB	Standards of accounting & audit	• Colombia should consider adopting IAS and assigning all accounting issues to one superintendency. • Auditing standards should be brought in line with ISA. • Please see more detailed recommendations in Auditing and Accounting ROSC.

IVC	Independent audit annually	• Functions of *revisor fiscal* should be separated into internal and external audit functions. • Internal audit function could be assumed by a compliance officer. • External auditor should be fully independent. Auditor independence should be clearly defined, e.g. (i) fees from any one client should not represent more than a certain percentage of total revenues; (ii) individual auditors or firms should rotate at certain intervals; (iii) provision of certain non-audit services to the audit client should be restricted. A breakdown of auditing and consulting fees should be disclosed in annual report.
IVD	Fair & timely dissemination	
V. RESPONSIBILITIES OF THE BOARD		
VA	Acts with due diligence, care	• Role and accountability of the board of directors should be clearly defined vis-à-vis senior management and especially legal representative or CEO.
VB	Treat all shareholders fairly	• "Duty of loyalty" obligation should be strengthened by enhancing minority shareholder participation in nomination and election of independent directors. • Colombia should also build director professionalism by supporting Institute of Directors.
VC	Ensure compliance w/ law	• Policymakers should consider introducing concept of "shadow director," whereby controllers would be held liable if they take decisions formally reserved to board. • Boards must be educated about stakeholder rights as an integral part of director training.
VD	The board should fulfill certain key functions	• The new law should unambiguously assign certain non-transferable duties to board, such as setting corporate strategy, hiring and firing CEO, approving related party transactions, monitoring conflicts of interest. • Code of best practice should expand on law and include clear guidelines as to board's role, responsibilities, operation, structure, and qualification requirements. • Proposed Institute of Directors should focus on director training – both on technical side and on fiduciary duties and liabilities.
VE	The board should be able to exercise objective judgment	• New securities bill should require minimum percentage of independent directors and define "independence" within Colombian context. • If policymakers decide to continue with tradition of alternate directors, each alternate should be elected with principal director on an individual basis, rather than numerically. • Alternate directors serving for independent directors, should also be independent. • Special training courses for independent directors should be developed, along with potential certification program for independent directors. • Audit committees, made up of majority of independent directors, should be mandatory and their functions clearly defined.
VF	Access to information	

Annex B: Summary of Policy Recommendations

I. THE RIGHTS OF SHAREHOLDERS		
IA	Basic shareholder rights	• The clearance and settlement cycle should be substantially shortened • DVP should adopted to minimize transfer risks. • Alternative board voting systems, e.g. cumulative voting and proportional representation, should be permitted under the law.
IB	Rights to participate in fundamental decisions.	• Only items on the agenda should be voted on. • Shareholder approval should be mandatory for the acquisition/sale of substantial assets, including acquisitions.
IC	Shareholders AGM rights	• The notice period should be extended to 30 days and include a detailed agenda, including the names and biographies of board candidates. • A small number of shareholders (e.g. 5%) should be able to call a meeting and force items onto the agenda, which should be circulated at company expense. • Distance voting mechanisms should be made more practical. • A date of record should be introduced in order to encourage investors to vote.
ID	Disproportionate control disclosure	• The annual report should disclose the board and management holdings and the names of beneficial owners above a certain percentage of share capital. • The onus for disclosure should be on the shareholder, in addition to the company.
IE	Control arrangements should be allowed to function.	• Shareholders should disclose ownership, once their share holdings exceed a certain threshold. • The rules for protection of minority shareholders in delistings should include that the tender price remains valid for a certain time after the company goes private.
IF	Cost/benefit to voting	• In order to make the obligation of complying with the code of good governance more enforceable and monitor compliance, policy makers should consider introducing a comply-or-explain mechanism, which requires that companies either comply with the code or explain in their annual report why not. This could become a listing rule or fall under the disclosure oversight powers of Supervalores. • Voting by investors should be made as easy as possible. • Revisions to the pension funds law should include discussions on the role and responsibilities of institutional investors, their incentive system and obligation to disclose voting policy. Awareness of international experiences of shareholder activism should be raised.
II. EQUITABLE TREATMENT OF SHAREHOLDERS		
IIA	All shareholders should be treated equally	• In practice, shareholder redress remains generally unavailable. • A first step to improve the situation would be to reduce minority rights thresholds to e.g. 5 %. The legal framework should encourage foreign investors to vote.
IIB	Prohibit insider trading	• Administradores should be permitted to buy shares subject to strict disclosure and black out rules. • Insiders should be redefined to include majority shareholders and groups of companies. • Supervalores or the Bolsa should install an electronic surveillance system to monitor insider trading. • Policy makers should consider to oblige all institutions to trade on the exchange.
IIC	Board/Mgrs. disclose interests	• If a director has a conflict of interest, he should have to advise the other directors and refrain from discussing and voting on the matter. This rule should also apply to directors connected to major shareholders or other bodies with a vested interest in board decision outcomes. • Transactions between issuers and large shareholders (e.g. 5%)and other insiders should be approved unanimously by the board (without the interested party's vote). Issuers should report all related party transactions in a special section of the annual report. • Disclosure of ownership and related party transactions should become a top priority for the supervisor when monitoring disclosure.
III. ROLE OF STAKEHOLDERS IN CORPORATE GOVERNANCE		
IIIA	Stakeholder rights respected	
IIIB	Redress for violation of rights	• An Insolvency and Creditor Rights ROSC is recommended to assess the creditor rights and insolvency framework in detail.
IIIC	Performance enhancement	• Careful attention should be paid to the international debate on the use/abuse and expensing of stock options.
IIID	Access to information	
IV. DISCLOSURE AND TRANSPARENCY		
IVA	Disclosure standards	• Supervalores should continue with its reviews and enforcement of disclosure, focusing on content rather than form. • Special attention should be paid to the disclosure of ownership and related party transactions.

IVB	Standards of accounting & audit	• Colombia should consider adopting IAS and assign all accounting issues to a single superintendency. • Auditing standards should be brought in line with ISA. • Please see more detailed recommendations in the Auditing and Accounting ROSC.
IVC	Independent audit annually	• The functions of the revisor fiscal should be separated into internal audit functions and external audit. • The internal audit function could be assumed by a compliance officer. • The external auditor should be fully independent. Auditor independence should be clearly defined, e.g. (i) fees from any one client should not represent more than a certain percentage of total revenues; (ii) individual auditors or firms should rotate at certain intervals; (iii) the provision of certain non-audit services to the audit client should be restricted. A breakdown of auditing and consulting fees should be disclosed in the annual report.
IVD	Fair & timely dissemination	
V. RESPONSIBILITIES OF THE BOARD		
VA	Acts with due diligence, care	• The role and accountability of the board of directors should be clearly defined vis-à-vis senior management and especially the legal representative or CEO. • Consideration should be given to abolishing the concept of alternate directors.
VB	Treat all shareholders fairly	• The "duty of loyalty" obligation should be strengthened by enhancing minority shareholder participation in the nomination and election of independent directors. • Colombia should also build director professionalism by supporting the Institute of Directors.
VC	Ensure compliance w/ law	• Policymakers should consider introducing the concept of "shadow director," whereby controllers would be held liable if they take decisions formally reserved to the board. • Boards must be educated about stakeholder rights as an integral part of director training.
VD	The board should fulfill certain key functions	• The new law should unambiguously assign certain non-transferable duties to the board, such as setting corporate strategy, hiring and firing the CEO, approving related party transactions, monitoring conflicts of interest. • The code of best practice should expand on the law and include clear guidelines as to the board's role, responsibilities, operation, structure, and qualification requirements. • The proposed Institute of Directors should focus on director training – both on the technical side and on fiduciary duties and liabilities. • Consideration should be given to introducing director accreditation.
VE	The board should be able to exercise objective judgment	• The new securities bill should require a minimum percentage of independent directors and define "independence" within the Colombian context. • If policymakers decide to continue with the tradition of alternate directors, each alternate should be elected together with the principal director on an individual basis, rather than numerically. • Alternate directors serving for independent directors, should also be independent. • Special training courses for independent directors should be developed, along with a potential certification program for independent directors. • Audit committees, made up of a majority of independent directors, should be made mandatory and their functions clearly defined.
VF	Access to information	

ANNEX C: Electoral Quotient System in Colombia

In Colombia, board members are elected by shareholders at the Annual General Meeting (AGM) through a system called "electoral quotient." In this system, holders of voting shares are requested to cast their votes for competing *lists of board members,* each list making up the entire board, rather than individual candidates. The selection of individual board members then takes place as follows:

First, the total number of votes present at the AGM is computed and the quotient "Q" is calculated by dividing this computed number by the total number of seats on the board up for election/re-election, and rounding down Q to the lowest integer number.

Holders of voting shares are then asked to cast their votes for the competing lists of board members and a tally is prepared. Each list *Ln* received a number of votes *Vn.*

The number of votes cast on each list *Vn* is then divided by the quotient Q. The result for a given list *n* is a number consisting of an integer I*n* and a fraction *Fn*..

Seats allocation takes place as follows. Each list of board members *Ln* is first allocated as many seats on the board as its *In* integer number. If the sum of the *In* numbers is less than the total number of seats up for election/reelection, the remaining seat(s) are allocated on the basis of the highest fractions *Fn,* in decreasing order.

Although the system was devised to introduce proportional representation, in practice, board candidates of minority shareholders are seldom elected because of the concentrated ownership structure of companies. Consider the following example. A company is owned 90 percent by a controlling shareholder and ten percent by minority shareholders. The board of directors with five seats is up for reelection. The total number of votes present at the AGM is 240. There are two competing lists, L1 put forth by the controlling shareholder, and L2 put forth by minority shareholders. The following votes are cast:

L1 List 216 votes

L2 List 19 votes

Blanc votes 5 votes

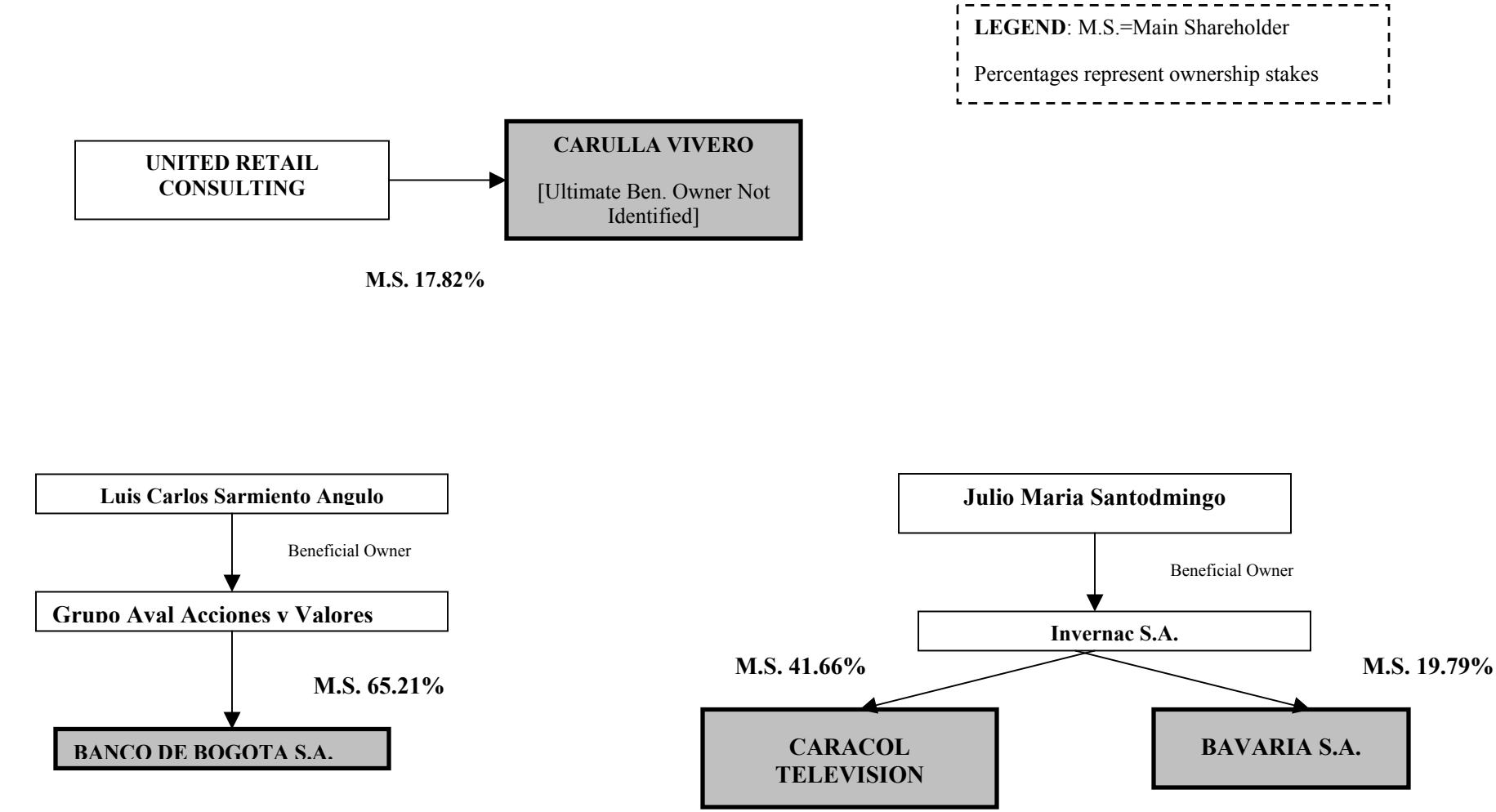
The quotient Q is therefore 240/5 = 48; and

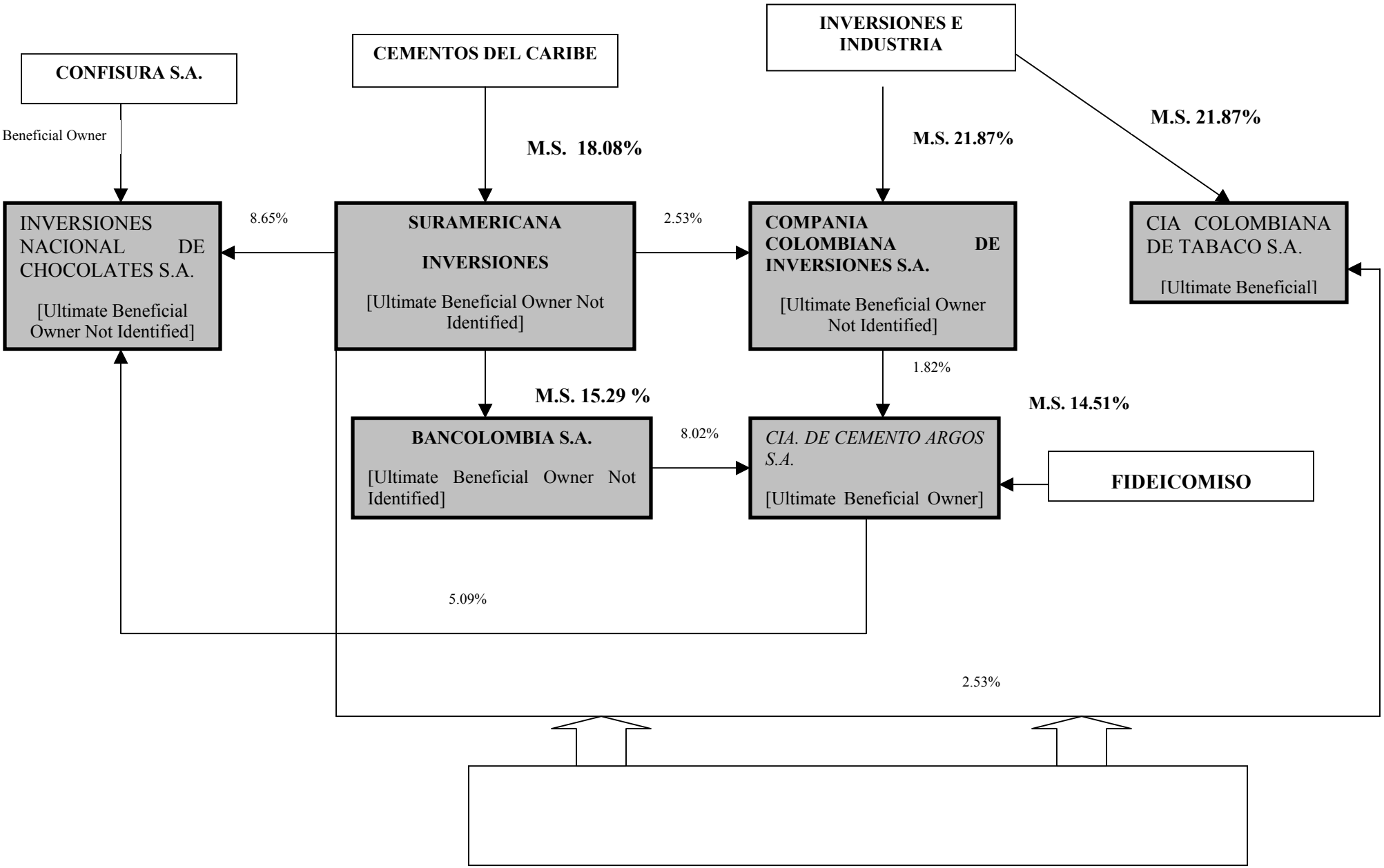
$L1/Q = 4.50 \Rightarrow I1 = 4 ; F1 = 0.50$

$L2/Q = 0.40 \Rightarrow I2 = 0 ; F2 = 0.40$

In the first round of allocation, the list put forth by the controlling shareholder (L1) will be allocated four seats since I1 equals 4; the L2 list put forth by minority shareholders will not be allocated any seat since I2 equals 0. In the second round of allocation, the extra seat will be allocated to the L1 list since F1 (0.50) is greater than F2 (0.40). Thus in spite of the electoral quotient system, the L2 list will not be allocated any seat.

ANNEX C : OWNERSHIP OF TOP TEN COMPANIES IN COLOMBIA




CONFISURA S.A.
Beneficial Owner
CEMENTOS DEL CARIBE
M.S. 18.08%
INVERSIONES E INDUSTRIA
M.S. 21.87%
M.S. 21.87%
INVERSIONES NACIONAL DE CHOCOLATES S.A.
[Ultimate Beneficial Owner Not Identified]
8.65%
SURAMERICANA INVERSIONES
[Ultimate Beneficial Owner Not Identified]
2.53%
COMPANIA COLOMBIANA DE INVERSIONES S.A.
[Ultimate Beneficial Owner Not Identified]
CIA COLOMBIANA DE TABACO S.A.
[Ultimate Beneficial]
1.82%
M.S. 15.29 %
M.S. 14.51%
BANCOLOMBIA S.A.
[Ultimate Beneficial Owner Not Identified]
8.02%
CIA. DE CEMENTO ARGOS S.A.
[Ultimate Beneficial Owner]
FIDEICOMISO
5.09%
2.53%