*THE 2007 MEETING OF THE LATIN AMERICAN CORPORATE GOVERNANCE ROUNDTABLE*

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# Country Report: Voluntary Corporate Governance Code in Brazil

The OECD asked several consultants, regulators, corporate governance institutes and other relevant stakeholders to elaborate reports regarding the development and implementation of voluntary corporate governance codes in each of their countries/regions. The reports, as well as a synthesis report elaborated by the OECD Secretariat based upon them, is provided to the Roundtable participants as background for the meeting's discussion.

The Brazilian country report was developed by **Leonardo Viegas**, a founding member of the **Brazilian Institute of Corporate Governance (IBGC)**, who served on its board and in the ad-hoc committees that developed the last two versions of the Institute's Code of Best Practice. For any comment or specification regarding the country report please contact Leonardo at: lviegas@attglobal.net

Further information of IBGC's activities as well as the integral text of its code can be found at: www.ibgc.org.br



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# THE BRAZILIAN CODE OF BEST PRACTICE OF CORPORATE GOVERNANCE
# THE IBGC EXPERIENCE

**SUMMARY**



## INTRODUCTION

The purpose of this report is to describe the major steps in developing, promoting and implementing IBGC's Code of Best Practice of Corporate Governance.

## BACKGROUND

The Brazilian Institute of Corporate Governance (IBGC) was founded on November 27, 1995 as a non-profit entity entirely committed to promoting good corporate governance practices in Brazil. One of the most important steps taken by the IBGC to spread the ideas of corporate governance came with the publication in May 1999 of its first version of a Brazilian Code of Best Practice. The gradual acceptance of this first version encouraged the development of an expanded version in 2001 and a third version in 2004. A fourth version of the IBGC Code may be published in 2008.

## EVOLUTION AND DEVELOPMENT

### The first version of the IBGC Code of Best Practice

Brazil had a number of good sources for the development of its first code of best practice of corporate governance. The Brazilian Corporate Law of 1976 was a valuable starting point. In 1996-7, several papers and discussions held by the investment, business, and academic communities increased the interest in the subject of corporate governance and offered important contributions.

In 1998 Holly Gregory and Elizabeth Forminard, under the auspices of Ira Millstein, released a study "International Comparison of Board Best Practices". It was a comparison, topic by topic, of 15 codes of best practice, including the Cadbury, Viénot, Dey, General Motors and NACD reports. The IBGC used this study in connection with local sources and established a common denominator of each topic with adjustments to fit the Brazilian context. The resulting document was launched on May 6,1999 at the São Paulo Stock Exchange Bovespa. This first version of the IBGC code of best practice – released when even the expression corporate governance virtually unknown in Brazil – focused essentially on the Board of Directors like most US/UK-inspired codes.

The subjects included in the first code were:

- The Board of Directors: Mission, Functions, Committees, Independent audits, Board size, Executive sessions, Guests at the meetings, and board and director evaluation.
- The Director: Qualifications, Term of office, Age limit, Remuneration, Hiring of external services, Independence, Internal and external directors, Chairman and CEO, Lead Directors.
- Transparency and Disclosure: Board spokesperson, Quality of information, Disclosure of evaluation systems, Shares held by directors and remuneration, Governance practices adopted.
- Board processes: CEO evaluation, Succession planning, Introduction of new directors.
- Board meetings: Information, Agenda, and Minutes of meetings.

This first version of the code was written essentially by a "Committee of two": the founders of the IBGC, Bengt Hallvist and the late João Bosco Lodi.

**The expanded second version of the code**
In the US and the UK, the weak link between the shareholders and management is the Board of Directors. However, with the prevalence of controlling owners in Brazil the challenges are different. For this reason the IBGC decided to develop a new version of the code that defined corporate governance as a system that involved all the practices and relationships between the owners, the board of directors, management, the independent auditors, and the fiscal council, and to suggest courses of action which might help companies to become more competitive in their search for capital.

The new version was also influenced by:

- The revision of the Brazilian corporate law, issued by Congress in 2000. This revision was generally considered a step forward but fell short of major advances in the protection of minority shareholders.
- The launch of Bovespa's Novo Mercado in December 2000 with focus on greater transparency and fairness to minority shareholders.
- The Principles of Corporate Governance, issued in 1999 by the OECD, which also covered shareholder rights and equitable treatment, stakeholders, disclosure and transparency.

The IBGC established an ad-hoc committee comprised of its board and its CEO (10 people), but no external guests, to develop the expanded code. After several meetings and discussions, the second version of the IBGC Code was launched in April 2001 at Bovespa, followed by similar events at Federasul, (Federation of Commerce of Rio Grande do Sul), and at the CVM (Brazilian equivalent of the Securities and Exchange Commission) in Rio de Janeiro.

In comparison with the first version the code was greatly expanded and added the following sections:

- A short statement of objectives of the code of best practices: a) performance improvement and b) access to capital.
- A description of three guiding principles of good corporate governance: Transparency, Accountability and Fairness.
- Besides the core subject of the Board of Directors, new chapters on *a)* Ownership – shareholders and/or partners, *b)* Management – CEO and Officers, *c)* Independent Auditors *d)* The Fiscal Council/Supervisory Board and *e)* Ethics/Conflicts of interest.

**The third and present version of the Code**
In April 2004 the IBGC launched the third revised and enlarged edition of its Code of Best Practice at an IBGC event open to the general public, followed by a presentation at the American Chamber of Commerce in São Paulo and at a large law firm in Rio de Janeiro.

Since the first version of the code in 1999, Brazil had seen significant progress in the institutional and corporate environment. This new edition tried to capture the business, legal, and regulatory changes that occurred and that affected the corporate environment. Most important additions to the third version were:

- Corporate Responsibility became a fourth basic principle, along with transparency, fairness, and accountability
- New items were included to describe the Family Council, free-float, length of mandate of auditors, and non-audit services
- More detailed description of committees, especially the audit committee with regard to requirements of the Sarbanes-Oxley Act
- Better description of director's independence
- Requirement of continued director education
- Social and environmental responsibility practices
- More detailed description of the Fiscal Council duties and responsibilities
- Enhanced description of codes of conduct, related party transactions and conflicts of interest
- Risk Management.

In June 2003 an ad-hoc committee of fourteen senior IBGC members was set up to revise the Code. An estimated number of 500 hours of meetings and discussions were spent by the committee, including a weekend of total immersion and heated debates in a resort near São Paulo in October. As in the previous versions, all the work done by the committee was pro-bono.

**Consultation process**
During the development of the codes many parties were heard, including the Government, legislators, different types of investors, the Stock Exchange, CEOs, auditors, lawyers, professional associations, as well as foreign corporate governance entities. The IBGC codes, however, were prepared with total independence by the IBGC, its management and board of directors.

Contacts with legislators were informal and took place in meetings and presentations like at the time of the revision of the corporate law in the year 2000. A few contacts with CVM took place at IBGC's initiative to inform them of the Code's development progress and to ask for their points of view. Most of the contributions, however, came from the private sector and IBGC associates.

Before the final publication, the third version of the Code was placed for two months in public consultation on the IBGC web site for both IBGC members and the general public, and in special events and meetings with professional associations. Many contributions were accepted and added to the code.

A total of 44,000 copies of the codes were printed (23,000 of the third version alone) under sponsorship of organizations such as Bovespa, Apimec (Association of Capital Market Analysts and Professionals), the law firm Bocater Camargo e Costa e Silva, the executive search firm Spencer Stuart, bookshop Siciliano, Jacto SA and Pricewaterhouse Coopers (who published a

Spanish version), and the American Chamber of Commerce. There was only a small financial contribution by the IBGC.

## CHANNELS OF DISTRIBUTION AND PROMOTION

The publications of the IBGC Codes of Best Practice were important milestones in the development of better corporate governance in Brazil and for the activities of the Institute itself.

The promotion and distribution of the codes relied on the effort of IBGC's own members and received general support of CVM, the Stock Market and other market associations, investors and corporations. Main promotion activities of the IBGC consisted of:

- Launching of each version in special events of great visibility that attracted the business community and the specialized medias
- A presentation of the additions made to the previous version at a special lunch meeting for IBGC associates in São Paulo and regional chapters in Rio de Janeiro, Porto Alegre and Curitiba
- Press releases and interviews to the business media
- Presentations by IBGC board and committee members as guest speakers in different audiences – companies, professional associations and the academy
- The Codes became textbooks and reference manuals for every IBGC open and in-house courses – over 2500 students from 1998 to 2006. IBGC's course offerings in 2007 include:
    - The traditional (18th version since 1998) Director Course aimed at educating board members of both listed and non-listed companies. It lasts for 8 full days (64-hours) distributed over four months and includes modules on corporate governance concepts and history, systems and relationships, best practices, finance and business Strategy, capital markets and board dynamics, plus an optional, 8-hour accounting module.
    - An 8-hour cost-free introductory course for new corporate IBGC members.
    - A 3-day (24-hour) course on corporate governance for family-controlled companies.
    - A 4-day (32-hour) advanced coursed aimed mainly at veterans of the Director Course designed to discuss advanced topics and eventually be the basis for the certification of corporate directors.
    - A 2-day (16-hour) course on the control function of the board, focusing topics such as risk management, the audit committee, external and internal audit, and the fiscal council.
    - A new, 2-day (16-hour) course on corporate governance tools designed to present models of company statutes and bylaws, shareholder agreements, board and committee regiments, meeting calendars, agendas and minutes.
    - The Board Case, now in its sixth version, a 2-day role-playing course that simulates the actual functioning of a board in five meetings, where the participants play director roles.
    - The code of best practices are enclosed in all course materials and quoted every time it can be used as a reference. Participants are told jokingly by instructors that the small size of the code was designed so that it can be kept also at the bedside.

Other important channels of distribution were:

- IBGC monthly events in São Paulo and regional chapters, where free copies are available for visitors
- IBGC web site for free downloads of the Code
- Events by partners such as Bovespa, Apimec (The Association of Capital Market Analysts and Professionals), Abrasca (Brazilian Association of Public Corporations), IBRI (Brazilian Institute of Investor Relations) and many others that took the Code as a reference for their own practice.
- Leading business schools in different cities.

In the beginning, printed copies were available for free. As the demand increased, the IBGC charged a small price for spare copies and delivered them by mail.

The three versions of the IBGC Code of Best Practice were effective instruments to promote the Institute and the cause of good corporate governance. The Code used a plain, practical language style and had a precise distribution focus. All those who attended IBGC's monthly events and courses were interested in some question of governance and for them the Code became a valuable guide.

## ACCEPTANCE AND ADOPTION

The IBGC Codes were adopted gradually over time. The players in the market were used to deal with hard law and regulations, and it was an unusual initiative to publish a code for voluntary adoption, designed to play an educational role and lay the foundations of good corporate governance practices. The practical value of the Code was tested at IBGC's own board meetings. It was often used as a reference and got accepted as a valuable tool to link the Institute's values/vision to the practical details of board work.

At the time the first version of the IBGC Code was being developed, there was a growing interest in corporate governance. Some government, business and academy entities like the CVM, large pension funds, Bovespa and Apimec, as well as large accounting firms, were about to develop their own codes, guides and self-regulations related to corporate governance, each focusing on their own needs and constituencies. In some cases there were opposing points of view like, for example, a "market view vs. company view" and a "shareholder view vs. stakeholder view" that had to be harmonized.

Two of the most relevant factors for the acceptance and adoption of the IBGC Code were the intense co-operation between all these players and the not-for-profit, independent image of the Institute. The business experience of IBGC's leaders and the Institutes' strong international network added extra credibility. Another factor was the wave of corporate scandals in the year 2000 in the United States, because it raised the interest in corporate governance problems, although the context in the US was different than in Brazil.

On several occasions directors and officers of important corporations quote the IBGC code as a reference of their own practices. On one such occasion the Chairman of the Board of a large bank, who was the guest speaker at an IBGC event, told an anecdote on how he was persuaded by other directors to adopt IBGC's recommendations contrary to his own opinion. There are often quotes in press interviews, newsletters and web sites that benchmark company's procedures with IBGC's recommendations, or on why their practices differ from the Code.

In hindsight, the IBGC was at the right time at the right place and was able to gather the interest of all players in the market, making each version of the Code a useful reference for all.

## TIMELINE OF CORPORATE GOVERNANCE INITIATIVES

The following timeline illustrates the convergence of important initiatives of the IBGC or of players with whom the IBGC cooperated:

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| **November 1995** | Founding of the IBGC. |
| **May 1998** | Pioneer educational programs of the IBGC for a group of Brazilian businessmen in New York/Boston (1998) and London/Paris (1999) followed by regular courses on corporate governance in Brazil. |
| **May 1999** | Launch of the first version of IBGC Code of Best Practice of Corporate Governance. |
| **October 2000** | The National Congress approves a limited revision of the Brazilian Corporate Law of 1976. |
| **December 2000** | Bovespa launches the Novo Mercado. Regulations focus on transparency and fairness to minority shareholders as opposed to IBGC's focus on the board of directors. |
| **April 2001** | Second version of the IBGC Code is released and incorporates several Novo Mercado provisions. |
| **June 2002** | CVM, the Brazilian Securities Commission, publishes an 11-page primer of recommendations on corporate governance (known as "Cartilha") that imply higher behavior standards than required by law or by CVM itself. The level of adherence to these practices should be filed annually by corporations in the form "comply or explain" - if a company did not adopt a recommendation, it should explain its reasons. The "Cartilha" recommends procedures for the shareholders' general assembly, shareholder agreements, voting process, board composition, committees, protection of minority shareholders, tag-along, related party transactions, arbitration and independent auditing. The best practices are similar to the IBGC's code but smaller in scope, especially with regard to the board of directors. As would be expected, the "Cartilha" represents the investor's point of view, while the IBGC Code describes both the investor and the company's point of view.<br><br>The "Cartilha" is still on CVM's web site but there is no indication that it has been or will be enforced in the near future. |
| **December 2002** | Petros, the second largest pension fund in Brazil, publishes an Investment Governance Handbook to guide its internal investment policies. Similar handbooks were later published by the first (Previ) and third (Funcef) largest pension funds. These handbooks were reviewed in detail by the IBGC by request of those organizations and incorporated several suggestions. They have different objectives than the IBGC Code because they concern the investor's interest, but incorporate the same principles. |
| **December 2002** | The National Development Bank BNDES releases an "Incentive Program for Good Corporate Governance" that provides for longer-term loans and lower interest rates according to a rating system of four levels. A new bank management that took office in 2003 unfortunately withdrew this incentive program that would have had a powerful impact on the borrower's governance practices. There are some indications that this Program might be implemented in the near future. |

**April 2004** Third version of the IBGC Code is released after 10 months of meetings, discussions and consultations.

**September 2005** Publication of a self-regulation code by the National Association of Investment Banks (ANBID), in which the level of compliance with the IBGC Code of Best Practice must be explicitly described in the prospectus of security issuers.

**December 2005** Bovespa launches the ISE – The Corporate Sustainability Index. ISE was formulated on the basis of the international Triple Bottom Line (TBL) concept, which performs an integrated assessment of environmental, social and economic-financial elements. Another three indicators were added to the TBL principles: corporate governance, general characteristics, and nature of product.

ISE reflects yield from a portfolio consisting of shares issued by companies with the best rating on all of the dimensions that measure corporate sustainability. It was created as a benchmark for socially responsible investment and also to encourage best practices in Brazilian business. It is calculated by BOVESPA in real time during trading sessions based on prices of the latest trade in the cash market. ISE shares are selected among the most heavily traded stock on BOVESPA in terms of liquidity and are also weighted in the portfolio by market value of assets available for trading.

The IBGC has a seat in the Deliberative Board of the ISE, along with other organizations such as ABRAPP (Brazilian Association of Pension Funds), ANBID (National Association of Investment Banks), APIMEC (Association of Capital Markets Analysts and Investment Professionals), IFC (International Finance Corporation), Ethos Institute of Social Responsibility, and the Brazilian Ministry of the Environment.

The IBGC Code inspired the corporate governance dimension of the ISE questionnaire and its development was coordinated by the IBGC.

**January 2006** First revision of Bovespa's Novo Mercado is issued. The independence definition set out by the IBGC's Code of Best Practices was incorporated in the listing rules of Bovespa's special corporate governance segments. Therefore, companies listed in level 2 and the New Market must have at least 20% of their Board of Directors comprised of persons who fit the independence definition.

**THE IBGC CODE AS PART OF THE REGULATORY FRAMEWORK**
(Please see attached illustration used in IBGC courses and presentations)

Legal provisions, contractual requirements such as Bovespa's, and self-regulation codes such as IBGC's are all designed for companies but have different objectives. Legal provisions basically protect society. Contractual requirements mainly protect investors. The IBGC code is intended primarily to help companies to improve performance and to tap lower-cost financial resources. IBGC's code recommendations (sometimes regarded as "soft law") are broader in scope and formulated for voluntary adoption by companies.

This resulting regulatory framework of legal, contractual and voluntary rules has some overlaps and redundancies but complement each other, each one with different scope, focus and approach – as well as different "teeth". They cannot replace each other. If they get too close to each other, the voluntary codes should promote higher standards and/or correct their focus.

Generally speaking, corporate governance provisions in the IBGC code set the highest standards among all self-regulation codes. Over time, IBGC's standards have been referred to by other codes, such as Anbid's, or get absorbed by contractual and legal requirements. This may be a warning sign that the "IBGC bar" should be raised, or that the focus should move to other organizations such as, for example, the vast number of non-listed, family controlled companies.

One exception to the general rule that the IBGC codes set the highest standards is the CVM requirement of a maximum mandate of 5 years for the external auditors of public corporations. In this case the IBGC chose a more flexible approach than CVM's because of its broader scope of non-listed as well as listed companies. The IBGC Code recommends that the contract renewal with the audit firm after 5 years should be approved by the majority of the shareholders present at the general assembly, including both common and preferred shareholders. In other words, the external auditor's mandate may be longer than 5 years as long as shareholders evaluate the auditor's independence.

Bovespa's Novo Mercado focuses essentially on the protection of investors, with such requirements as voting rights, tag along, solution of conflicts through arbitration, disclosure etc. In questions of transparency and shareholder rights, the Novo Mercado and the IBGC code have equivalent standards. On the other hand, the IBGC code gives a lot more emphasis on questions of board structure, relationships, committees, independence, conduct and ethics, etc. The IBGC code is broader in scope than Bovespa and the law. The Novo Mercado and the IBGC code should not be compared but rather complemented.

As long as all players in the market continue to use the IBGC Code as a reference, there will be a powerful incentive for the adoption of the Code by companies, whatever their motive – easier access to capital, better management, solutions to ownership and succession problems, and sustainability.

## FUTURE DEVELOPMENTS

Future versions of the Code will suggest more and better ways to improve performance of companies, to resolve governance problems, and to devise better return on investments and financial strategies. There will be an even stronger focus on non-listed, family-controlled companies of any size.

For the IBGC, corporate governance is a long-term development process that should start early in the company life cycle and consist of several steps. The Institute wishes to help making the transition from a startup company to a large public corporation less painful and more secure, and contribute to realize the potential of all kinds of companies.

## BIBLIOGRAPHY AND RELATED LINKS


- IBGC - Code of Best Practice of Corporate Governance, www.ibgc.org.br
- Bengt Hallqvist, Private Institute for Corporate Governance, the Brazilian Experience
- Bovespa –São Paulo Stock Market and Novo Mercado www.bovespa.com.br
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