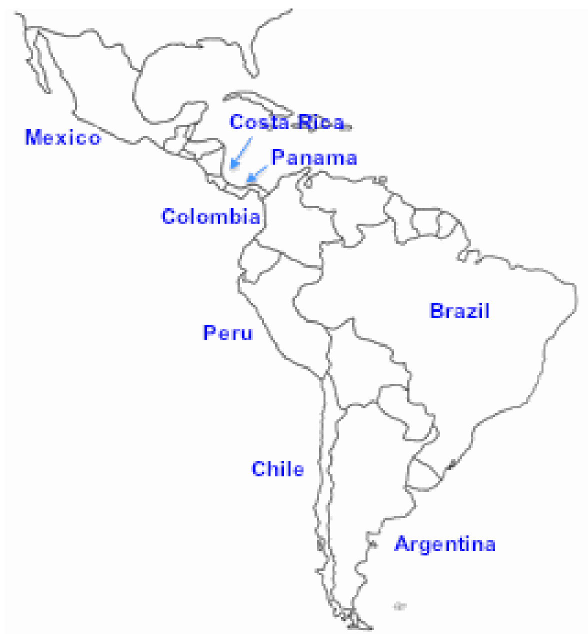
Board Processes in Latin America – Board Nomination/Selection and Handling of Conflicts of Interest

External Frameworks and Internal Practices in Argentina, Brazil, Chile, Colombia, Costa Rica, Mexico, Panama and Peru



Draft for Discussion

Acknowledgments

This synthesis report was prepared by Andreas Grimminger based upon information provided by Corporate Governance Institutes in the eight countries of the study: Instituto Argentino de Gobierno de las Organizaciones, Instituto Brasileiro de Governança Corporativa, Centro de Gobierno Corporativo y Desarrollo de Mercados, University of Chile, Confederación Colombiana de Cámaras de Comercio, Instituto de Gobierno Corporativo - Costa Rica, Centro de Excelencia en Gobierno Corporativo, Instituto de Gobierno Corporativo de Panamá and Procapitales Peru. We wish to thank the numerous individuals from the CGIs who provided the necessary information to produce this comparative study. If you have any questions or comments about this report, please contact Andreas Grimminger (adg2006@columbia.edu) or Daniel Blume (Daniel.Blume@oecd.org).

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Introduction

That a successful, sustainable company needs a strong and efficient board fulfilling its key duties and functions is an often recited, common wisdom that few will deny. An increasingly complex and volatile global economic and financial system necessitates an ever-growing number of skills in both management and the board overseeing management. Having a strong, diverse board also sends a signal to the market, lending legitimacy and credibility to a company's strategy and operations.

However, measuring board performance, in fact how to even define a strong, efficient board is a difficult and complex issue, due to the confidentiality of board deliberations, rendering most board processes hard to judge for the public, in particular the company's shareholders. One of the few board processes that can be easily observed by shareholders, if conducted in a transparent fashion, is the nomination and election of board members. Given the limited visibility of other board processes, as well as the above-mentioned need for a strong board, the identification, selection, nomination and election of board members is perhaps one of the most visible ways to influence good corporate governance.

As with other areas of corporate governance and processes in general, there is not one perfect solution that fits the many different circumstances of companies. However, a number of lessons are worth keeping in mind when analyzing nomination and election of directors.

- "Technical" compliance with rules and guidelines, including proper processes and structures related to the board composition is a necessary first step in building an efficient board. Following established best practice processes in the recruitment and nomination of directors can help professionalize nomination and selection.
- Formal compliance with rules on e.g. the composition of boards alone is not enough, however. Behavioral considerations are becoming more and more important. A good board needs the right mix of discourse and discussion while functioning well at the same time. In addition, team dynamics have to be carefully considered.
- Particularly important is a board's capacity to exercise independent judgment. Recruitment, nomination and election processes are especially relevant to secure such independence on the board.
- Growing challenges necessitate changing director profiles for both small and large companies. While there is a need for experts whose managerial experience is strong enough to exercise independent judgment in relation to the CEO or Chairman, diversity is critical in the long run. As Heidrick & Struggles write in the 2011 European Corporate Governance Report, the "traditional pattern of boards which are made up of very senior people from similar backgrounds and shared experience is changing but this trend must be accelerated to avoid the danger of 'group think'. So, the composition of the board should reflect the values and strategy of the company, as well as its technical and geographic ambitions."[1]

[1] Heidrick & Struggles, "European Corporate Governance Report 2011 – Challenging Board Performance," Heidrick & Struggles International 2011. p. 35 http://www.heidrick.com/PublicationsReports/PublicationsReports/HS_EuropeanCorpGovRpt2011.pdf

- Indeed, empirical research compiled by the Corporate Library shows that diversity makes boards "more efficient overseers and more realistic judges of value."[2] Diversity can mean bringing a different national, gender or socio-economic perspective to the board or simply just a perspective from outside the usual network of the controlling shareholder. Some of the research compiled by the Corporate Library suggests that the extra scrutiny provided by diverse, independent board members is particularly important at strongly-defended companies (i.e. companies with controlling shareholders), where shareholders would otherwise have difficulty holding managers accountable.

With these observations in mind, this study attempts to shed light on the external framework and internal practices of nomination and selection of board members in listed companies in eight countries in Latin America.

Analyzing board nomination and election processes in Latin America is especially interesting and important given the often-concentrated ownership pattern in the region. Companies with concentrated ownership can particularly benefit from having well-functioning, diverse boards since it is an efficient way to counter perceptions that the company only serves the controller's interests, thereby increasing its value to minority investors. Concentrated ownership also provides the rationale in adding a second part to the study, addressing how boards in the region handle conflicts of interest, in particular related-party transactions (RPTs). This is not only one of the key duties of the board, but the process of how the board deals with conflicts of interests (or does not) can also be more easily observed than other processes (since they usually need to be disclosed), thus making it a worthwhile subject in conjunction with nomination in attempting to better understand how boards of directors operate in Latin America.

Structure and Focus

The study is therefore split into two parts, the first dealing with nomination and selection of the board, the second with the board's handling of conflicts of interest. In both parts, the study provides background such as best practices and global developments where applicable. It analyzes the external framework and reports on internal practices where information is available. The study generally focuses on listed companies and does not address particular requirements for bank directors, which in some cases may involve more specific regulation. The subtopics of the two subjects can be seen in the figures below:

Board Nomination and Selection

Framework: Components of the legal, regulatory and best practice framework for board composition

Nomination: Formalization, role of controlling shareholders, institutional investors and committees

Election: Singular or cumulative voting; individual or slate; modes of voting.

Disclosure: Easy access to information on ownership; disclosure of nomination and election process.

[2] "Beyond the Boilerplate – The Performance Impacts of Board Diversity", July 29, 2011. The Corporate Library. http://www2.gmiratings.com/info.php?s=5

Board Handling of Conflicts of Interest/ Related Party Transactions

Legal Definition: Degree of detail of definition of conflict of interest and RPTs in frameworks.

Duties of the Board: Disclosure of Interest; coverage of review and approval of RPTs

Independent Oversight: Role of the Audit Committee; Independent Directors and outside experts.

Disclosure: Release of information on transactions with related parties

Input

To gather the necessary information on the external framework and internal practices on the two subjects of this study, a questionnaire was developed to obtain information not available from other sources.

This study relied first and foremost on the responses to the questionnaire from the Corporate Governance Institutes listed below, all of which participate in the Latin American Corporate Governance Institutes network (IGCLA, for its acronym in Spanish).

Country	Institute/Respondent
Argentina	Instituto Argentino de Gobierno de las Organizaciones (IAGO)
Brazil	Instituto Brasileiro de Governança Corporativa (IBGC), IBGC's Legal Commission
Chile	Centro de Gobierno Corporativo y Desarrollo de Mercados, University of Chile
Colombia	Confederación Colombiana de Cámaras de Comercio (Confecamaras)
Costa Rica	Instituto de Gobierno Corporativo - Costa Rica (IGC – Costa Rica)
Mexico	Centro de Excelencia en Gobierno Corporativo (CEGC)
Panama	Instituto de Gobierno Corporativo de Panamá (IGCP)
Peru	Asociación de Empresas Promotoras del Mercado de Capitales (Procapitales)

In addition, a number of practitioners from the region responded to the part of the questionnaire focusing on internal practices, thus allowing a better understanding of this subject. All respondents are listed in the Annex.

Lastly, special thanks goes to Glass Lewis & Co, the proxy research and advisory firm for providing valuable input and feedback at all stages of the study and for offering insights into a foreign shareholders' perspective.

Key Findings

I. Nomination and Selection of Board of Directors

The Context

Concentrated ownership of most publicly traded companies and often limited liquidity of equity markets is an economic reality for most Latin America countries. In Peru for example, 12 companies account for 90% of all issued shares.[3] Free float, an important indicator of liquidity levels, is relatively limited as well. According to estimates by Morgan Stanley free float ranges from a high of 64% in Brazil (370 domestic companies), 55% in Mexico (131 domestic companies) to between 37% and 50% for Chile (228 domestic companies), Colombia (81 domestic companies) and Peru (201 domestic companies).[4] For comparison, the US S&P 1500 has a free float of 85%, the UK's FTSE All Share (624 companies) of 78% and the large-cap DJ Euro Stoxx (314 companies) 68%. On the other hand, institutional and international investors are beginning to play a more important role and companies without controlling shareholders are increasing, at least in the case of Brazil, where there were 47 companies without a defined controlling shareholder as of August 2011.[5].

The Framework

The framework setting the parameters for board composition in the region relies on a mix of law, regulation and best practice codes.

- Technical issues such as the size of boards and length of board terms are left to company bylaws in all jurisdictions, setting some minimal benchmarks.
- None of the countries in this study regulate or recommend a maximum number of years directors can serve on boards, nor address how many directorships a director can hold, apart from the Código de Comercio in Colombia, which limits directorships to 5 at a time. The IBGC Code in Brazil has a recommendation how long a tenure a director can serve while still being considered independent.
- Chile, Colombia and Mexico set legally binding requirements for listed companies to have a certain number of independent directors, with Brazil requiring it only for companies listed on the Novo Mercado and Level 2 segment. Argentine regulation requires a "sufficient number", but also requires an Audit Committee with a majority of independent directors.

The Nomination process

- The pool of qualified candidates in the region appears to be sufficient. Two examples of institutionalized databases exist in the region. IBGC in Brazil maintains a database of certified directors, and the Chilean Pension Fund Regulator a list of candidates for independent director positions.

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[3] Glass Lewis & Co, "Proxy Paper Guidelines 2011 Proxy Season, Andean Nations", Glass Lewis 2011, p. 5

[4] Morgan Stanley, "A Primer on Corporate Governance in Mexico", June 7, 2011

[5] Graziella Valenti, À espera de uma oferta, Valor Econômico, August 17, 2011. http://www.estudiosaci.com.br/clientes/abvclipping/20110817/03.html

- The profile of directors in the region is most commonly that of current or former executives, lawyers or family members, with the trust of the controlling shareholders.
- By and large, the recruitment process is still informal and mostly based on the network of the controlling shareholder. Larger corporations apply a more formal process and are also more likely to employ the help of professional executive search firms.
- The nomination process is a consensual, largely informal affair:
    - Nomination committees play almost no role in the region.
    - The lack of formal structures facilitates the dominance of the controlling shareholder in the nomination of candidates.
- Other than some institutional investors, mainly pension funds, such as AFPs in Chile and Peru and increasingly "multimercados" hedge funds in Brazil, agreeing on nominees for independent directors in a number of jurisdictions, signs of shareholder cooperation are still rare.

Elections

Director elections are in general consensual in Latin America:

- Contested director elections do not appear to occur frequently.
- The widespread application of pre-agreed slates rather than individual elections supports the view of un-contested elections.
- Cumulative voting is allowed and its application left to company by-laws in all jurisdictions (or to the request of a certain number of shareholders such as in Brazil) to increase minority representation. However, cumulative voting does not appear to be applied widely in practice apart from in Colombia and Chile.

Transparency

- Requirements for the disclosure of information on the ownership of listed companies exist in the majority of jurisdictions.
- The background of candidates needs to be disclosed prior to elections only in Brazil, along with the AGM notice, 15 days prior to the meeting according to the law, 30 days according to the IBGC Best Practice Code. After the elections, most frameworks only require the disclosure of a list of names without relevant background. Disclosure of information on the nomination process itself is also not observed in practice.

II. Board Handling of Conflicts of Interest

Legal Definition

- By the end of 2012, when Mexico is due to adopt International Financial Reporting Standards (IFRSs) in full, all countries in this study, except for Colombia where IFRSs will be gradually phased in, will have requirements in place to follow International Accounting Standard (IAS) 24 and consequently its definition of as well as its reporting requirements of related parties and related party transactions.
- The definition in law, regulation and codes of what constitutes a conflict of interest varies significantly across the region. Definitions in regulations for listed companies

and best practice codes tend to be more explicit than applicable laws. This is not the case in Chile and Peru, however, where company and securities market law offer detailed definitions of issues of conflict of interest. Costa Rica defines the issue in voluntary and mandatory codes, Mexico and Panama in voluntary codes.

Duties of the Board

- The disclosure of any personal interest by directors in a transaction is a binding obligation in all jurisdictions but Costa Rica and Panama.
- All jurisdictions require or recommend directors to abstain from deliberations and voting if they have an interest in the transaction.
- The frameworks diverge in how detailed the duties of the board in the review of RPTs are formulated, as well as whether they are set by binding law or regulation or only recommended by best practice codes.
    - Argentina, Chile, Colombia and Mexico set out the most detailed prescription of procedures that boards have to follow, clearly assigning roles to the board and shareholders, and they do so in law and binding regulation.
    - All other countries address the issue in non-binding recommendations and also remain vague on the actual details of the procedure.
- Codes of ethics seem to be a fairly widespread practice amongst larger companies in the region, without elaborating on the content of the codes.

Independent Review of RPTs

- The issue of independent review, both from within the company and from external sources is not addressed in much detail in the frameworks of the jurisdictions in this study.
- Compliance with IFRS, which all jurisdictions are already following or are in the process of following, implies the need for internal and external audit of RPTs.
- The Audit Committee (or Directors Committee which serves a similar function in Chile) plays an explicit role in reviewing RPTs only in the frameworks of Argentina and Chile. This is also how independent directors implicitly play an important role, since these directors have a statutory role in chairing these Committees. In Mexico, the Governance Committee, composed entirely of independent directors is required to review RPTs and provide its opinion together with that of an external expert.
- Other than that, the consultation of independent, external experts is addressed in the frameworks of only a few countries.

Disclosure of information on RPTs

- The immediate disclosure of conflicts of interest, in particular in relation to RPTs, is not required in any of the surveyed jurisdictions with the exception of Brazil in the Periodic Disclosure Form for listed companies and to a less explicit degree in Argentina and Colombia (for transactions over a certain threshold).
- In Chile and Mexico, transactions involving shareholder, board members or management have to eventually be disclosed in the Annual Report, and Panama and Peru require disclosure to the securities regulator.

Issues for discussion

Based on the findings above, a number of questions arise for further discussion and follow-up.

- Given the dominant role of controlling shareholders in the region, **what kind of nomination process is likely to reinforce more effective boards**?

- The performance of directors (i.e. easily measurable factors such as attendance records, number of directorships held) but also the results of board evaluations could play a role in the nomination or re-election of directors. **Should board evaluations be communicated to shareholders to influence board nomination and composition, or will this disincentivize board members from developing frank evaluations that they can use to improve their conduct?** While board evaluations have been far from common in Latin America, they are destined to gain in relevance as companies compete globally. Already among members of the Roundtable's Companies Circle, 15 of the 19 member companies have begun undertaking board evaluations, and a Working Group on Board Evaluation has been established to consider best practices and promote wider use of them. As Heidrick & Struggles note in the 2011 European Corporate Governance Report, such evaluations "should not only examine board processes and structures, but should also identify experiential and technical gaps, challenge the diversity of the team, assess behaviors and interactions, and above all gauge the role and effectiveness of the chairman… Such a review should challenge the board to compare itself to other 'best in class' boards, both within and beyond its sector." (p. 29)

- If board evaluations cannot be disclosed to shareholders for reasons noted above, then **what other ways can they be used to inform the process of identifying either board candidates or profiles of skills and capacities that would be desirable to add to the board?**

- **Is there a role for nomination committees, or is another form of a structured process more likely to lead to desired results?** For example, in Colombia, according to an independent board member cited in this study, nomination committees are usually composed of shareholders, members of the family council in the case of family-owned businesses, and on occasion senior executives. Is it feasible or desirable to make nomination committees mandatory? Or should they be included in local governance indices/Stock Exchange's requirements? Is there a positive relation between the existence of nomination committees and more transparent/effective board practices?

- What comes first: evaluation of the board or the consolidation of nomination committees? Is there a positive relation between these two?

- The composition of the board should allow the representation of functions and sectors that are important with regards to the company strategy. To be better able to meet developing challenges, recruitment may have to move beyond the typical network of the controlling shareholder. **How can moving beyond the typical network of the controlling shareholder be achieved – what actions can be taken to persuade them to diversify boards, or are minority shareholders a more effective lever for achieving board diversification?**

- In order to increase shareholder cooperation and achieve stronger influence of minority shareholders in the elections of board members, earlier disclosure of nominees as well as information on the candidates play a large role. This is particularly true for foreign shareholders. As the candidates are often brought forward the day of the meeting, shareholders voting by proxy who are not physically present cannot support the designated candidate. **How can companies (and shareholders) be persuaded to disclose candidates earlier?** Disclosure could also move beyond biographical facts and questions of independence and include information on a candidate's other assignments such as on board sub-committees or other boards, in order to gauge whether he/she has sufficient time to dedicate to the company. In the case of elections by slate, the disclosure of the rationale for the company to select this particular mix of candidates, based on their qualifications, experience and diverse perspectives and skill-sets could be encouraged.

- **How far can best practice recommendations go in improving board nomination and election practices? Are there areas where the policy-maker should set parameters in order to advance board processes in the region?**

    - Should other regulators follow the example of the Brazilian securities regulator who, with CVM resolution 480 and 481, requiring extensive disclosure of information on nominees, in part before the annual general meeting?

    - Pension Funds play an active role in the nomination process in Chile, where they are obligated by the regulator to nominate independent directors to companies where they hold interests. Could this be a model for other countries to increase institutional investor activism? Already in Colombia, per Decree 2955 of August 2010, pension fund administrators are obligated to exercise their voting rights where they hold a stake higher than 5%.

- In some countries, laws and regulations regarding board nomination, selection, handling of RPTs and conflicts of interest are very basic, brief and often contained in outdated laws, such as in the case of Costa Rica, where the majority of provisions are contained in the Code of Commerce, enacted in 1964. This points to a huge opportunity to improve and amend such regulations. As IGC – Costa Rica points out, corporate governance codes contain brief references on the matters above, but in reality, influence in the decision-making, administration and auditing bodies of legal entities is not regulated. Regulation is usually limited to situations where there are severe, prosecutable fraud situations. Disciplinary and legal consequences of non-ethical behavior in enterprises/legal entities are not common.

Part 1: Board Nomination and Selection

The first part of this study will address issues surrounding the nomination and selection of directors in Latin America. It will first examine the framework for board composition, such as board size, terms and independence requirements. The subsequent chapter will address issues of nomination, including the recruitment of candidates, while the last two chapters address the actual election and disclosure of the process.

1. Setting the stage –Framework for Board Composition

a. Relevant Laws, Regulation and Best Practice Codes

This section lists the main components of the legal, regulatory and best practice frameworks of the surveyed countries, which regulate aspects of the board of directors of companies to gain a better understanding of the mix of mandatory and voluntary components. The table will also serve as a reference to the applicable laws, regulation and codes for the remainder of the text, including the second part on the board's handling of conflicts of interest.

Table 1: Relevant legal, regulator and best practice framework

Country		Name, Year	Type of Companies
Argentina	**Law**	Companies Law 19550, 1972	All companies
	Regulation	Decree 677, 2001 – Transparency Rules of Public Offering CNV Resolution 515, 2007	Listed Companies Listed Companies, comply-or-explain
	Code	Best Practice Code, 2004	Listed Companies. Voluntary
Brazil	**Law**	Corporations Law No. 6404, 1976 Securities Market Law, 2001	Joint stock companies Listed Companies
	Regulation	CVM Rules 480, 481, 2009 Novo Mercado rules, 2011	Listed companies Novo Mercado segment of BM&BFBOVESPA
	Code	IBGC Best Practices Code, 2009	Listed Companies, voluntary
Chile	**Law**	Ley 18.045 Securities Markets Act, 1981 Ley 18.046 Corporations Act, 1981, Amended by Ley No 19.705, 2000 and Ley N° 20.382, 2009	Listed Companies All companies
Colombia	**Law**	Law No. 964, Securities Market Law, 2005 Decree 3923 of 2006 Law No. 222, 1995 Commercial Code	
	Code	Codigo Pais, 2007 (modified by External Circular 7 of 2011)	Listed companies, comply-or-explain

Costa Rica	**Law**	Code of Commerce, 1964 Stock Exchange Regulation Law, 1997, I amended 2008	All companies Listed companies
	Code	Reglamento de Gobierno Corporativo SUGEF-SUGEVAL-SUPEN-SUGESE, July 2009 (CONASSIF Code) Reglamento de Gobierno Corporativo de la Bolsa Nacional de Valores, Nov 2009 (BNV Code)	Listed financial companies; Mandatory Listed companies; Voluntary
Mexico	**Law**	Securities Market Law, 2005	Listed companies
	Regulation	Issuers Circular 2003	
	Code	Best Practice Code, 2009	Listed companies, comply-or-explain
Panama	**Law**	Corporations Law No. 32, 1927	All Companies
	Regulation	CNV Agreement 12, Recommendations on Corporate Governance , 2002	Listed companies, voluntary
	Code	Best Practices Code, 2010	Listed companies, voluntary
Peru	**Law**	Companies Law, 1997	All companies
	Regulation		
	Code	Principles of Good Governance for Peruvian Companies, 2002	Listed companies, comply-or-explain

As can be seen from the table, corporate governance codes have been established in the region in most cases with the backing of local stock exchanges. All codes are voluntary, in some cases comply-or-explain, with the exception of mandatory requirements for financial institutions in some jurisdictions such as Costa Rica.

b. Board Composition Parameters

Above described framework contains the key parameters regulating board size, terms and composition with respect to requirements or recommendations for independent directors as can be seen below.

Board Terms and Composition

Table 2: Board size, terms and composition

Country		Board Size	Length of Term	Independent Directors
Argentina	**Law**	Min 3	Max 3 years	
	Regulation			"sufficient number", Audit Committee majority, at least 2
	Code			
Brazil	**Law**	Min 3	Max 3 years	
	Regulation	Min 5 Novo Mercado and Level 2		20% (Novo Mercado & Level 2)
	Code	5 – 11	Max 2 years	Majority
Chile	**Law**	Min 5, 7 for certain listed companies	Max 3 years	At least one
Colombia	**Law**	5 – 10		25% (Law 964)
	Regulation	5 -10 (Decree 663)		
	Code	Odd number		
Costa Rica	**Law**			
	Code		Max 3 years	At least 2 (BNV Code)
Mexico	**Law**	5 -15 (banks), max 21 listed		25% (SML)
	Regulation			
	Code	3 – 15		25%
Panama	**Law**	Min 3		
	Regulation	Min 7 (banks under Agreement 4)		20% (Banks and Mutual Funds)
	Code	Odd number	Min 2, max 4	Majority
Peru	**Law**	Min 3	Min 1, max 3	
	Regulation			
	Code			To guarantee capacity for independent judgment

The table shows that there is a wide degree of difference in the degree of detail provided by the framework as well as whether parameters are requirements stated in law and regulation or recommendations in best practice codes.

Regarding the **size of boards**, all frameworks with the exception of Colombia and Mexico set only a minimum number of directors. All jurisdictions leave the exact number to company bylaws. Colombia sets a relatively low maximum number in law and regulation of no more than 10 board members.

Board terms are even less regulated. Only Argentina, Brazil, Chile and Peru limit board terms to a maximum of 3 years by law. Details are left for companies to define in their statutes.

None of the surveyed jurisdictions imposes any limits to the **number of years** a director can serve on a board or the number of times he/she can get reelected. The Brazilian IBGC Best Practice Code does, however, recommend that companies define and disclose the maximum period a board member can serve while still considered an independent board member. Likewise, the **number of directorships** a director can hold is not covered in the framework of any of the eight jurisdictions with the exception of the Código de Comercio in Colombia, which limits directorships to 5 at a time. In addition, the IBGC Code in Brazil recommends that external directors should serve on no more than 5 boards, and a chairman should have not more than 2 other board memberships.

A specific **number or percentage of independent directors** is required or recommended in six of the eight jurisdictions. The exceptions are Argentina and Peru. Argentina's CNV Resolution 516 requires a "sufficient" number of independent directors to guarantee the necessary independence to exercise objective judgment. However, since Audit Committees are legally mandated for listed companies, and have to be in the majority independent directors, a minimum number of 2 independent directors is required in Argentina. Peru's Code only states that the board should have the capacity to exercise objective independent judgment. Only Chile,[6] Colombia and Mexico set legally binding requirements for independent directors for listed companies, while in Brazil, only companies listed on the Novo Mercado and Level 2 need to have at least 20% of independent board members. In Panama, only banks and mutual funds are required to have independent board members.

Definitions of Independence

Definitions of independence are covered in the most prescriptive form, by law, in Chile, under the amended Companies Law 18.046, in Colombia under Law 964, as well as Decrees for financial institutions, and in Mexico under the Securities Markets Law, LMV, as well as the Code. In Brazil, only the Novo Mercado Listing Rules and the Best Practices Code cover the issue. In Argentina, Decree 677 and related CNV regulations, as well as the Corporate Governance Code cover the issue, while Peru addresses it in its voluntary code and Panama in its non-mandatory Agreement 12 as well as the new Best Practices Code. Similarly, in Costa Rica requirements with respect to independence are only covered in its voluntary Corporate Governance Code issued by the Stock Exchange. The eight jurisdictions in this study cover a wide array of dependencies disqualifying candidates from being considered independent. They also display different approaches to the definition of such dependencies, ranging from very broad, general definitions, to detailed definitions of relationships that constitute dependencies. In some jurisdictions, such as Mexico, the legal definition of independence lacks the incorporation of a time-factor because many of the listed companies' independent directors have been serving on boards for more than ten years. For more details on independence requirements such as ownership and relationship

[6] The requirement applies to listed companies with a market value of more than 1.5 million UF (ca. USD 60 million), a free float of more than 12.5% and shareholders holding less than 10% of the voting stocks.

definitions, examples of internal and external dependencies please refer to "Achieving Effective Boards."[7]

- **Director qualifications**

All the surveyed jurisdictions, except Chile, list general qualifications such as relevant experience, knowledge, and professional reputation as well as absence of conflicts of interest as key elements to be considered in selecting directors of the board either in law, regulations or best practice codes. All jurisdictions impose restrictions (minimum age, apart from Brazil and Costa Rica) and incompatibilities (such as not being convicted of criminal offences, etc.) on potential directors.

Summary - Board Framework

The framework setting the parameters for board composition in the region relies on a diverse mix of law, regulation and best practice codes.

The rather technical issues such as the size of boards and length of board terms are left to company bylaws in all jurisdictions, setting some minimal benchmarks. None of the countries in this study regulate or even recommend a maximum number of years directors can serve on boards, nor address how many directorships a director can hold, apart from the Código de Comercio in Colombia and the IBGC Code in Brazil. Such a requirement can be particularly relevant for external, independent directors who are required to satisfy the legal minimum independence requirements, but should also play a leading role on boards.

Naturally, more guidance is devoted to the critical issue of independence requirements for boards as well as definitions of independence. Here the differences between requirements and recommendations in the region become most obvious. Only Chile, Colombia and Mexico and implicitly Argentina via its majority requirements for Audit Committees set legally binding requirements for listed companies to have a certain number of independent directors, with Brazil requiring it only for companies listed on the Novo Mercado and Level 2 segment. Consequently, only these countries cover definitions of independence in binding law or regulation.

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[7] "Achieving Effective Boards -A comparative study of the legal framework and board practices in Argentina, Brazil, Chile, Colombia, Mexico, Panama and Peru," OECD June 2011, in particular pp. 35. http://www.oecd.org/dataoecd/56/59/48510039.pdf

2. Nomination

Given the seldomly contested nature of elections for board members, the nomination of candidates becomes all the more important. Principle VI, D of the OECD Principles lists as one of the key functions of the board to ensure "a formal and transparent board nomination and election process." The Principles further advocate for an "active role for shareholders in the nomination and election of board members." In this context, "the board has an essential role to play in ensuring that this and other aspects of the nominations and election process are respected." The board or nomination committee should do so by first ensuring that established procedures are transparent and respected. Secondly, the board has a "key role in identifying potential members for the board with the appropriate knowledge, competencies and expertise to complement the existing skills of the board and thereby improve its value-adding potential for the company." The Principles add that several countries have an open search process extending to a broad range of people when selecting candidates for boards.

This chapter addresses both the identification and nomination of candidates, including the degree of its formalization, the role of controlling shareholders, institutional investors and nomination committees.

a. Candidate Identification

Two critical aspects to be considered in the identification of potential nominees for boards are the availability of candidates and the manner of recruiting qualified candidates. In this context it is interesting to consider a typical profile of existing directors to begin with.

Director Profiles – Executives, Lawyers and Relatives

The 2011 European Corporate Governance Report by Heidrick & Struggles notes that globalization and a "more complex CEO role have made it crucial for boards to have a core group of directors with specific industry or functional knowledge. It is not enough to have generalists on the board. A more complex CEO role has to be matched by a stronger sparring board as a counterweight."[8] The study also expects chairmen and directors to become:

- *Younger*, due to the need for more diversity and more formal recruitment processes;
- From *alternative backgrounds*, such as advisory, professional services, contrary to the trend of directors all coming from the same circles;
- With *international experience and outlook;*
- *Professionally recruited*, as boards will use clearly defined competencies to create profiles, rather than just relying on the typical CEO/CFO background.

Confirming the need for strong personalities to counter the CEO, Simon Wong notes in a 2011 article for McKinsey Quarterly: "As a principle, boards should ensure that the stature of nonexecutive members is roughly comparable, and equal to or greater than the CEO's. At

[8] Heidrick & Struggles, "European Corporate Governance Report 2011 – Challenging Board Performance," p. 33

one UK company, the chairman has deliberately recruited to the board people who are chairmen at other listed firms. That way, the board is more likely to have the respect of the highly successful CEO, and nonexecutive directors will also treat each other with regard."[9]

So how do directors in Latin America compare against these observations? Based on the responses received they split into three predictable groups: executives, lawyers and relatives. Executives furthermore, as the response from Confecamaras in Colombia and the CEGC in Mexico point out, tend to be from within the company or business group that the issuer is part of. Argentina's response adds that above all, directors need to have the confidence of the controlling shareholder.

Availability of Directors – Beginnings of Institutionalization

Having a large enough pool of candidates available is critical to achieving well-balanced, effective boards. Often, particularly in smaller and less developed countries, a lack of sufficient candidates, particularly for the position of independent directors, is noted.

Only two responses cited the availability of directors as an obstacle. *Panama*'s institute stressed that this is particularly relevant for independent directors, but noted that an improved search process should address this issue. Likewise, in *Colombia*, an independent board member pointed out that there are not enough candidates to fill vacancies. According to the response from *Costa Rica*, the fact that the number of listed companies halved from a high of over 80 in 1995 to just 41 today improved the availability of directors, although new criteria requiring a deeper understanding of financial issues have shrunk the pool.

All other responses indicate that the availability of directors is not an issue. The only two countries in the study to have an institutionalized pool of directors are Brazil and Chile. In *Brazil,* IBGC maintains a Banco de Conselheiros (Board Databank). The database currently has about 600 potential directors, all certified by IBGC. Certification occurs via an online exam or proof of experience. Both methods are valid for 2 years and require continuing education. Use of the database is free for IBGC members, non-members can consult the bank for free, and for a fee of R$ 400(approx. US$230) can select 10 candidate profiles to be contacted.

Chile's Pension Fund Regulator, the Superintendencia de Pensiones, maintains a public list of candidates for independent directors, the Registro de Directores. In order to be an independent director candidate for a pension fund, a candidate has to be registered in the list and provide his/her background, resume and inform of any relationship with public companies or pension funds. As of August 2011, 353 candidates were inscribed in the list.

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[9] Simon Wong, " Boards: When best practice isn't enough," McKinsey Quarterly June 2011. http://www.themckinseyquarterly.org/By_Invitation/Boards_When_best_practice_isnt_enough_2822

Recruitment – The network of the controlling shareholder

The overwhelming majority of practitioners in the region confirm that the recruitment process is still largely informal in the region. A formalized search process, consisting of the determination of the required director profile, an institutionalized search process - potentially involving professional search firms – and a review of qualifications with interviews is still rare in the region and can, if at all, only be observed with larger, multi-national companies.

The contemporary recruitment process in Latin America seems to be determined by the following factors:

- The identification of candidates is dominated by the controlling shareholder. As the response from Panama noted, "loyalty to the main shareholder is the key qualification" for a candidate.
- Word-of-mouth, personal relationships and networks are the primary recruiting tools. Existing directors play an important role in this context.

  When headhunters are used, as indicated by responses from Brazil and Colombia, a more formalized process takes place. In Chile, the Association of Pension Funds Managers implemented a formalized system utilizing headhunters to fill the director positions in companies they hold shares of.

In sum, recruitment appears to still be based on network and personal relationships. A

Example: Nomination Process at the American Red Cross

The American Red Cross in its nomination process of selecting members for its Board of Governors follows a 7-step formalized recruitment and nomination process, based on a set of clearly spelled-out criteria for the potential board member's skills and experience (such as leadership ability, board and executive experience, diversity, specialized knowledge).

Step 1: Evaluation of current board members
Assessment of re-election eligible board members based on skill set requirements. Current members need to receive satisfactory rating.

Step 2: Receiving Recommendations for new board members
Recommendations based on skill set from all stakeholders.

Step 3: Outreach to potential board members
Outreach by sub-set of Board Development Committee and/or third parties.

Step 4: Review Candidate Resumes
Sub-set of Committee reviews and selects resumes.

Step 5: Committee Interview
A committee member reaches out to identified candidate.

Step 6: Additional Interviews and Due Diligence
Third party will conduct due diligence and professional evaluation of candidate.

Step 7: Voting New Members
The Board Development Committee formally votes to recommend candidates to full Board, forwards full profile to Board who will then vote on candidate to be presented to annual meeting for election.

response from a board member in Brazil suggests a transition period that companies are undergoing. Companies implementing best governance practices are beginning to identify the ideal director profile and then base their selection on the analysis of a resume and an interview.

b. Nomination Process

Once candidates are identified, they are nominated by a shareholder to be elected at the shareholder meeting. This section addresses the question of who in practice nominates, the role of institutional investors, incidences of shareholder cooperation and the role of nomination committees in the region.

- **Who nominates?**

None of the countries in the study appear to have a **formal ownership threshold** necessary for the nomination of candidates for the board with the exception of Brazil and Chile. In *Brazil*, CVM Rule 282 of 1998 declares that holders of half percent or more of the total capital stock have the right to nominate candidates for election at the General Meetings of public corporations. In addition, Corporations Law entitles holders of 15% or more of the voting stock, or holders of preferred shares without or with restricted voting rights represening at least 10% of the share capital of the company to elect one member of the board of directors, and its alternate, through a separate voting cast. In *Chile*, shareholders must hold at least 1% of shares in order to nominate a candidate for independent director. In all other jurisdictions setting a threshold is left to the company bylaws.

The formal procedure to nominate a candidate for listed companies is exemplified in Decree 3923 of 2006 in Colombia. Shareholders assemble the list of nominees, along with the written acceptance of the candidates, and present it to the secretary of the General Shareholders' Meeting.

  - **The controlling shareholder**

In practice, all respondents confirmed that the nomination process is dominated by the controlling shareholder. As such it is often current board members, nominated and elected by the controlling shareholder, who put forward new candidates for the board.

Since there is a legal requirement for at least 25% independent directors on the board in *Colombia*, in practice, majority shareholders let minority shareholders choose at least one representative who can be elected in a separate vote. In most jurisdictions, blockholders, in these cases mostly institutional investors, in particular Pension Funds, Administradoras de Fondos de Pensiones (AFPs) and in Brazil increasingly hedge funds, so called Multimercados, are most likely to choose the minority representatives. In Chile, the legally mandated independent director often gets to be nominated by the controlling shareholder if minority shareholders fail to put forward a candidate due to a lack of coordination.

  - **Institutional Investors – Important, room for more**

Institutional investors are playing the leading role in filling the positions of independent directors in the region, and are having growing influence, according to the responses received. In doing so they fulfill a number of functions:

- They *coordinate and agree on a single candidate* if necessary, as indicated by the responses from Brazil, Chile, Colombia and Peru, thereby ensuring the presence of independent representatives on the board.
- They *increase the transparency of the nomination process*. In Colombia, Decree 2955 of 2010 requires that where AFPs exercise their voting rights, nomination criteria have to be established, candidates need to be independent from the AFP and related parties, and AFPs need to document evaluation and reasons for their voting choice.
- They *provide a ready list of suitable candidates*. For example, as indicated above, the Chilean Pension Funds Regulator maintains a list of independent candidates, the Registro de Directores, RD. AFPs are mandated under pension system regulation D.L. 3.500 to elect independent candidates to boards of companies where they hold interests, and candidates they vote for have to be inscribed in the RD.
- They *hold candidates to high standards of independence* and promote an activist stance. As the 2010 White Paper on "Strengthening Latin American Corporate Governance: the Role of Institutional Investors" notes, "in Peru, the representatives of pension funds are forbidden to vote for candidates that are shareholders, directors, managers or workers of an AFP. This has been translated into promoting good governance in their investee companies through the nomination of non-executive and independent directors."[10]

- **Shareholder cooperation – in a nascent state?**

Aside from above described cooperation amongst institutional investors, there is little evidence of shareholder cooperation on the nomination of directors in the region. This could at least in part be due to a lack of coordination of global and domestic shareholders to elect minority representatives, as a practitioner from Glass Lewis notes. Given that foreign shareholders generally own a significant percentage of the free float, but are mostly absent at the general meeting, the opportunities to elect minority representatives are often greatly diminished. Despite having mechanisms available to them, minority shareholders often fail to elect even a single representative to the board due to a lack of coordination. However, as will be discussed below, the fact that only in Brazil companies are required to disclose the names of nominees in advance of the meeting severely hampers coordination as it negates proxy voting as a viable option.

However, this might change in the future, at least in Brazil, due to a combination of regulatory reform and market developments. Brazil's IBGC expects the effect of CVM rules 480 and 481, which drastically increase the amount of information issuers have to disclose (including on board nominees) to have a positive impact on shareholder cooperation. This will be particularly relevant given the growing dispersion of ownership of public corporations in Brazil. A Brazilian regulation allowing any shareholder owning at least 5% of the company's capital to request a list of all shareholders could further facilitate minority shareholder cooperation to elect their candidates.

Legal or regulatory facilitation of shareholder cooperation appears to be necessary for an increase in shareholder cooperation but also meets resistance, as illustrated by a case from Panama. In 2000, Panama's securities regulator CNV issued proxy solicitation requirements, Agreement 16-2000, in order to achieve a more coordinated nomination process. However,

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[10] White Paper on "Strengthening Latin American Corporate Governance: the Role of Institutional Investors", OECD/IFC 2010, p. 59 http://www.oecd.org/dataoecd/56/31/46200302.pdf

when the CNV attempted to enforce it for the first time, a board member of the company under investigation contested the constitutionality of the regulation, which was confirmed by the Panamanian Supreme Court. Agreement 16-2000 was declared unconstitutional in 2002 due to a dispute over the CNV's right to regulate the matter.

- **Nomination Committees – Lacking in law and practice**

Nomination committees, or committees that among other duties handle the nomination process, can, as the OECD Principles state, facilitate the "proper compliance with established nomination procedures and … coordinate the search for a balanced and qualified board." If such a committee exists, and if it also handles questions of remuneration, it should be composed of a majority of independent directors. A quote by a practitioner from the 2011 Heidrick & Struggles study underlines the role a nomination committee can play: "The nomination committee is key. It is in charge of a structured process, it demonstrates the ability to take a longer term perspective and it is more legitimate to bring up the topic of board composition at regular intervals."

In the eight countries of this study, the **legal or regulatory framework does not require nomination committees**. However, they are recommended in the Code of Best Practice in Colombia, the voluntary CNV Agreement 12 of 2003 in Panama, and Circular 516 of 2007 in Argentina. The IBGC Code in Brazil recommends an independent Human Resources Committee merging the responsibilities of both a nominating and remuneration committee. Mexican Securities Law requires a Corporate Practices Committee, which can take on nominating duties. All other jurisdictions do not specifically mention nomination committees in their frameworks; they still fall under the general right of the board to form committees for special purposes, however.

The **composition of a nomination committee** is addressed by all three codes recommending them to a varying degree of detail: The *Colombian* Code notes that the committee should consist of at least one member of the Board. In the case of *Panama*, CNV Agreement 12 recommends that the nomination committee has at least five members, including at least three members of the Board, one of which must be independent; the General Manager, and the Financial Manager or equivalent, and at least 30 percent independent directors. The selection or replacement of a director will be discussed only by directors in the committee; key executive selection/replacement can be discussed by all members of the committee. In *Argentina*, Circular 516 is in fact silent on the matter of composition, but the Best Practice Code recommends a majority of independent directors. The Corporate Practices Committee in Mexico is to be composed entirely of independent directors.

The **functions of the nomination committee** are spelled out by the *Colombian* recommendations with a focus on executive management. They include reviewing performance and compensation of management and developing the criteria for the recruitment of its principal executives as well as the president of the board. In *Panama*, CNV Agreement 12 lists the functions of the committee as to nominate independent directors, oversee their appointment and replacement, and evaluate their independence, as well as review key executive compensation and recommend key executives' removal if warranted. In *Argentina*, under Circular 516/2007, the Nomination Committee is entrusted with the duty to make proposals for criteria and procedures to select board members and top executives, and also to formulate specific recommendation of candidates for those positions.

Due to the voluntary nature of the recommendations in all jurisdictions, **nomination committees are not common in the region** based on the responses received for this study. In many jurisdictions, such as Mexico, companies' boards are mainly composed of shareholders and family members that nominate each other through slate-nomination schemes. Nomination committees seem to be more frequent in Colombia, where according to an independent board member, they are in general composed of shareholders, members of the family council in the case of family-owned businesses and on occasion senior executives. In the 2010 evaluation of listed companies on their compliance with the Colombian code, 18.8% of non-financial issuers and 20.7% of financial issuers had nomination committees established.

- **Role of evaluations – Need to establish evaluations first**

In theory, director and board evaluations can play an important role in the re-nomination and –election of sitting directors as they offer shareholders a credible way to judge the performance of directors. However, as of today, board evaluations themselves are still rare in the region, although they are recommended in the Best Practices Codes of Argentina, Brazil, Mexico and Panama. In addition, in the case where they do occur they are not generally made public to shareholders as boards consider that these evaluations will be less open and constructive in improving board performance if they are disseminated more widely. Consequently, they do not play a role in the nomination process, according to the respondents. To circumvent this dilemma, boards could use evaluations internally for recommending nominees without disclosing the evaluations to shareholders.

Summary – Nomination

Directors in the region today come from a homogenous background of executives, lawyers and people with the trust of the controlling shareholders. There appears to be no shortage of qualified candidates. However, there are only two examples of institutionalized databases of directors in Brazil and Chile.

This underlines the fact that the recruitment process is still informal and largely based on the network of the controlling shareholder. A more structured, formal process occurs at times in larger corporations who are also more likely to employ the help of professional executive search firms.

The nomination process is a similarly consensual, largely informal affair. Nomination committees play no role to speak of in the region. The lack of formal structure facilitates the dominance of the controlling shareholder in the nomination of candidates. Other than AFPs agreeing on nominees for independent directors in a number of jurisdictions, signs of shareholder cooperation are still rare.

3. Election/Selection

To elect the members of the board is a basic shareholder right. According to the OECD Principles, "for the election process to be effective, shareholders should be able to … vote on individual nominees or on different lists of them." This basic right is certainly well established in the region, as can be seen from the table below.

Table 3: Details of voting process in regional frameworks

Country		Regular/ Cumulative	Individual/ Slate	Proxy	Electronic
Argentina	Law	Both, cumulative cannot be ruled out by by-laws	Ind, slate possible		
	Regulation		Ind, slate possible	Yes	Yes, Decree 677
Brazil	Law	Regular, Cumulative if requested by 10%	Slate, separate elections of one member can be requested by 10% preferred and 15% common shareholders	Yes	
	Regulation			Yes	Yes
	Code			Yes	Yes
Chile	Law	Both, majority voting. Independent directors elected by plurality	Individual, if slate, independent director needs to be elected seperately	Yes	Yes
Colombia	Law	Cumulative, unless bylaws establish individual, 25% IDs need to be guaranteed	Slate	Yes	
Costa Rica	Law	Cumulative	Ind, slate possible	Yes	
Mexico	Law	Regular cumulative possible	Slate	Yes	Yes
Panama	Law	Regular, cumulative possible	Both possible	Yes	
Peru	Law	Cumulative, but bylaws can establish different if minority representation guaranteed	Individual	Yes	Yes

In general, the corporate governance frameworks in the eight countries of this study leave most of the details of voting procedures to the bylaws of corporations in their jurisdiction.

Regular vs. Cumulative voting

Some jurisdictions establish cumulative voting as the default mode of voting but give companies the option to establish a regular voting mechanism. If companies do so, however, they need to guarantee the representation of minorities as stated in the *Peruvian* Ley General de Sociedades. Similarly, the *Colombian* Stock Market Law 964 of 2005 allows registered companies to adopt any type of voting system as long as it increases the number of representatives of minority shareholders. The default mode of voting in Colombia is the largest remainder method ("cuociente electoral"). This method of election allows greater opportunity for minority representation on the board, despite not receiving a majority of votes.

Regular vs. Cumulative voting
Cumulative voting is a voting process that increases the ability of minority shareholders to elect a director. This method allows shareholders to cast all of their votes multiplied by the number of directors to be elected for a single nominee for the board of directors when the company has multiple openings on its board. In "regular" voting, shareholders may not give more than one vote per share to any single nominee. In a company with a shareholder owning more than 50% of the voting shares, this majority shareholder can therefore elect all directors. In contrast, under cumulative voting, if the election is, for example for four directors and a shareholder owns 500 shares (with one vote per share), giving him 2,000 votes total – 500 votes per each of the four candidates. While the regular method allows for a vote of a maximum of 500 shares for any one candidate in cumulative voting, he could choose to vote all 2,000 votes for one candidate, 1,000 each to two candidates, or otherwise divide as he sees fit.

In *Brazil, Mexico* and *Panama*, regular voting is the norm, but companies can establish cumulative voting if desired. Cumulative voting is not applied in practice in Panama or in Mexico. In Brazil, under Corporation Law, shareholders with 5% -10% (depending on the size of the company, the higher the capital base, the lower the percentage threshold to request cumulative voting) or more of the voting share capital also have the option of requesting the adoption of a cumulative voting process to elect the members of the board of directors. In *Argentina*, the Company Law sets out cumulative voting procedures in detail and requires that it cannot be ruled out by company bylaws. In practice, however, the response by IAGO notes, cumulative voting is rarely applied and if it is, tends to reflect a level of little cooperation and even hostility among shareholders.

Individual or slate

Whether candidates are elected individually or as a list of all candidates (slate) to be voted on as a whole is **generally left to the bylaws of corporations**. The Costa Rican and Peruvian frameworks for example intend for individual elections, but slates are not ruled out. In Colombia and Mexico, however, all elections are slate elections. In practice, in Costa Rica and Panama, most elections tend to be all directors at the same time. In Chile, most elections are individual, if there was a slate election, the independent director would have to be elected separately.

Separate votes

Albeit applying slate elections, boards in *Colombia* are supposed to be elected in two separate elections, one for the election of the independent members, and one for the remaining candidates. Elections can be held in one, however, if the minimum 25% of independent directors required by law is guaranteed. In practice, this is mostly the case.

In *Brazil*, the Corporations Law entitles holders of 15% or more of the voting stock, or holders of preferred shares without or with restricted voting rights represening at least 10% of the share capital of the company to elect one member of the board of directors, and its alternate, through a separate voting cast. If they cannot meet that threshold alone, each class of shareholders may group their shares together to reach it. Glass, Lewis in its "Guidelines on Proxy Voting in Brazil" notes that in practice, requests for separate elections are only made at the meeting, thus preventing shareholders voting by proxy from participating.

Independent directors in *Chile* are not voted on in a separate election. However, in order to guarantee the legally mandated independent director on the board, a candidate for independent director does not have to win a majority of the voting shares, but only to win the plurality over a competing candidate for that position.

Modes of voting

The actual elections in most of the surveyed jurisdictions occur commonly by **show of hand**. However, in Chile and Colombia, voting by ballot is applied, at least in the case of Chile so that the controlling shareholder cannot optimize his votes based on the votes of other shareholders. In Brazil, according to the responses received, public corporations apply a combination of oral, written, proxy and electronic voting.

In addition, in most elections, all **shareholders vote at the same time**. A response by a corporate governance specialist from Brazil indicates that usually the controlling shareholder votes first.

Proxy voting is allowed in all jurisdictions, but the physical presence is still required in some. However –in practice – given that in most jurisdictions the names of the nominees are not disclosed until the day of the meeting, voting by proxy is not a possibility. In most jurisdictions, the local custodian bank generally sends a representative.

Electronic voting is allowed in the following jurisdictions:

- In *Argentina*, provided that the company bylaws specify the procedure;
- In *Brazil*, CMV Rule 481 explicitly supports electronic and proxy voting; specific provisions require companies to cover costs of public proxy solicitation, but if electronic voting is allowed, costs are waived.
- In *Chile*, the Securities Market Law 18.046 requires companies to install systems guaranteeing the integrity of the vote.
- In *Peru*, digital or notarized signatures are required for electronic and mail voting.

Little information on the application of electronic voting in the jurisdictions is available. In Mexico, the "2010-2011 Corporate Governance Report for Listed Companies" conducted by CECG found that none of the companies in the study had electronic voting schemes. Similarly in Brazil, according to a corporate governance expert electronic voting is still in its infancy.

Summary - Elections

Director elections are a consensual affair in Latin America. Contested director elections do not appear to occur frequently in the countries of this study. As indicated above by the response for Argentina from IAGO, the application of cumulative voting is already considered confrontational. Negotiations, or conflicts occur, if at all, in the composition of the list of directors to be voted on. The widespread application of slate rather than individual elections supports the view of un-contested elections. Cumulative voting is allowed or encouraged in all jurisdictions to increase minority representation, but appears not to be applied widely in practice.

4. Transparency/Disclosure of Nomination and Election Process

A transparent nomination and election process is critical to gain the confidence and trust of the market and minority shareholders, improve the understanding of the processes in practice, and essential to optimize the efficiency of the nomination process and improve boards. In this context, the OECD Principles call for: "full disclosure of the experience and background of candidates for the board and the nomination process, which will allow an informed assessment of the abilities and suitability of each candidate."

In particular, three important aspects should be disclosed: Ownership structures, details on the nominated candidates and the results of the elections.

- **Ownership structures**

A clear and easy process of obtaining information on the ownership of companies is the prerequisite for a transparent nomination and election process. Requirements on disclosure of ownership vary widely in the region.

In *Argentina*, Decree 677/2001 requires that controlling shareholders, directors and top executives of listed companies disclose to the CNV their shareholdings. The Best Practice Code recommends disclosing capital structure and any shareholding agreement on voting that may render a significant change in the control of the company in the annual report.

The Periodic Disclosure Form required under CMV Rule 480 in *Brazil* mandates disclosure of the issuer's economic group regarding information – among other issues – on the holders of direct and indirect controlling interests. The Novo Mercado listing segment of BM&FBovespa additionally requires disclosure of ownership over 5%, up to the level of natural persons.

Law N° 18046 in *Chile* requires a listed company to keep a record of all shareholders, their address and number of shares, in the main office of the company and its website. This information is available for the shareholders of the company and for the Securities regulator.

In *Colombia*, the Superintendencia Financiera operates SIMEV, the "Sistema de Información del Mercado de Valores" which is publicly accessible. Companies are required to disclose the names of direct or indirect owners over 5% in the SIMEV.

The *Costa Rican* Stock Exchange Regulation Law requires disclosure of shareholders holding a stake of 10% or above in listed companies.

In *Mexico*, the Stock Exchange requires the disclosure apart from the number and classes of shares the distinction of whether the shares belong to executive directors, independent directors or family members; the names of those who control –directly or indirectly –more than 30% of the company's ordinary shares; and a list of people that are related to or have a legal/binding relationship with shareholders controlling more than 30%. Disclosure is required once a year in May.

In *Panama,* ownership structures have to be disclosed to the securities regulator, who keeps them on public files. However, only the controlling shareholder has to be identified by name, information that is also public. All other shareholders do not have to be disclosed by name to the CNV by companies, but rather in ranges, i.e. x number of shareholders own between 5% and 10% of shares.

The Superintendencia del Mercado de Valores' (SMV, formerly CONASEV) Reglamento de Propiedad Indirecta, Vinculación y Grupos Económicos in *Peru* states that companies registered in the Registro Público del Mercado de Valores need to provide a list of shareholders who own more than 5% of the equity indicating the percentage of ownership by share class.

Disclosure of Nomination and Election process

With respect to the disclosure of nominated directors and the nomination and election process, the following characteristics are useful to keep in mind to distinguish disclosure regimes:

- *Type of information*: What kind of information on nominees is released? Does it include background information? Are details on the nomination process disclosed? How about election results? Who nominated the specific candidates?
- *Timing of information*: Is information on nominees disclosed ex-ante or ex-post in relation to board elections?

The regulatory regimes of the region differ widely on these issues, both in terms of type of information as well as whether disclosure is required or just recommended. However, they are similar in that none requires or recommends that information on the background be disclosed prior to elections.

In *Argentina,* the selection process for independent directors is disclosed to the CNV after the election, providing all relevant data concerning the director. The Best Practice Code recommends that the procedures for selection and reelection of directors should be disclosed in the company's annual report as non-financial data.

Brazil's CVM Rule 480 requires that background information concerning directors and officers be disclosed after their election. CVM Rule 481 requires specific sections of 480's Periodic Disclosure Form such as information on board nominees to be disclosed in advance of the general meeting. This disclosure has to occur together with the notice with the general meeting notice, which has to occur 15 days in advance according to law and 30 days according to the IBGC Best Practice Code. The rule further requires that a company must provide extensive information on candidates nominated or supported by management or controlling shareholders at the shareholders' meeting.[11] In addition, the Corporations Law states that the minutes of the general meeting shall contain the qualifications and terms of office of each elected candidate and should be filed with the Commercial Registry and published. In practice, the nomination process for directors is disclosed to the market by a document called 'Fato Relevante', Material Fact, if the company is publicly traded. The Fato includes details on the directors that have been elected to the board.

The Corporation Law and Decree N° 587 *in Chile* require that the nomination process as well the election process be disclosed during the shareholders' meeting as well as afterwards, informing all shareholders, the securities market regulator and the entire market of the results. The nominees for independent director position need to be disclosed

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[11] The required information includes: basic personal information, professional relationships over the last 5 years highlighting companies in the same economic group or companies from shareholders with 5% or more of the company's shares; marital relationships or kinship with officers, directors or controlling shareholders of the company or controlled groups; and whether the director was elected by the controlling shareholder.

to the company by the nominating shareholder 10 days prior to the election. All other candidates can be nominated at the meeting and are therefore not disclosed in advance. The background of candidates does not have to be disclosed to the shareholders or the market.

In *Colombia*, only the Best Practice Code covers the issue of disclosure of nomination. It merely recommends that the list of candidates be made available to shareholders prior to the meeting. The code also encourages the use of the company website to do so. However, in practice, a response by an independent board member from Colombia indicated that companies are beginning to disclose whether and how the nomination process considers diversity in identifying candidates in order to include a variety of skills and experiences that contribute to board heterogeneity aligned with the organization's strategy.

In *Mexico*, according to Glass Lewis, names of nominees are generally not disclosed until the day of the meeting. According to the CECG, although companies cover the nomination and election process in their bylaws, there is no public information that can assure that these processes are either transparent or efficient.

Similarly, in *Peru*, only the Best Practice Code recommends that the board should ensure a formal and transparent procedure for the election of board members. The Peruvian response indicates that for listed companies, under 'Reglamento de Hechos de Importancia, Información Reservada y Otras Comunicaciones', communication by companies includes information on change of board members.

Responses from *Costa Rica* and *Panama* indicate that disclosure of nomination and election of directors is not covered in their framework. In fact, the response from Panama implies that the nomination process cannot be considered transparent, in particular for independent directors. This is consistent with a 2004 World Bank Report on the Observance of Standards and Codes for Panama which had pointed out that: "The board nomination process is not transparent, since ex-ante no information is filed on newly-nominated directors."[12]

In general, according to a practitioner at Glass Lewis, the motivation of companies to disclose material, such as background information on board nominees, depends on the ownership structure of a company. If a company is controlled, then there is no need to disclose materials in advance of the meeting because they will reach the necessary quorum of shareholder presence and resolve every agenda item without the need for minority shareholder votes. If, however, a company is not controlled and has a dispersed ownership base, the company will disclose materials in order to garner enough votes to reach a quorum.

Summary – Disclosure

As stated above, the easy availability of information on ownership of listed companies is an essential prerequisite for a transparent nomination and election process. Requirements for the disclosure of such information exist in the in the majority of jurisdictions. However, it is hard to judge how easy it is to obtain such information in practice.

[12] World Bank, "Report on the Observance of Standards and Codes (ROSC): Corporate Governance Country Assessment – Panama," June 2004, p. 14. http://www.worldbank.org/ifa/rosc_cg_pan.pdf

The OECD Principles recommend the full disclosure of the background of candidates prior to elections. None of the countries in this study – with the exception of Brazil – requires or recommends the provision of such information. In fact, most frameworks only require the disclosure of a list of names without relevant background. Disclosure of information on the nomination process itself is also not observed in practice.

II. Board Handling of Conflicts of Interest/ Related Party Transactions

As noted in the introduction, how the board handles issues of conflict of interest is particularly important in the context of concentrated ownership structures. As the 2009 Guide on Fighting Abusive Related Party Transactions in Asia notes, in such cases, "decision-making may be unilateral, and robust discussion lacking on the board. The controlling shareholder is able to recruit and nominate directors who will serve at the pleasure of the controlling shareholder, with other shareholders having limited or no influence on director selection. Given that in many cases the controlling shareholder may have private interests outside of the listed company, the risk of abusive related party transactions is significant."[13]

In order to describe the role of the board in Latin America in handling conflicts of interest, this chapter will first look at the legal definition, types of transactions and thresholds that exist in the region. The following section will address the board duties, review and approval process; and role of codes of ethics. The third section deals with independent oversight, in particular the role of the Audit Committee and external auditors, and the last section addresses the critical issues of disclosure of conflicts of interest and related-party transactions.

1. Legal Definition

A sound legal definition of what constitutes a conflict of interest and more specifically a related party is the essential first step for monitoring and handling these types of transactions. The *OECD Methodology for Assessing the Implementation of the OECD Principles of Corporate Governance* states that jurisdictions should ensure that the definition of "related party" is "sufficiently broad to capture the kinds of transactions in the jurisdiction that present a real risk of potential abuse, it is not easily avoided and is effectively enforced."

International Accounting Standards 24 (IAS 24) is aimed at ensuring that companies' financial statements contain the "disclosures necessary to draw attention to the possibility that its financial position and profit or loss may have been affected by the existence of related parties and by transactions and outstanding balances with such parties."[14] It also offers an extensive definition of what constitutes a related party (see the annex of the separate Roundtable survey on related party transactions for the specifics), and defines a related party transaction as a "transfer of resources, services, or obligations between related parties, regardless of whether a price is charged." Countries adopting International Financial Reporting Standards (IFRSs) thus follow the definition of IAS 24 for the purposes of financial reporting. All countries in this study except for Colombia (which is gradually converging towards IFRSs) have either adopted IFRSs in full, at least for listed companies, or are in the process of doing so such as in Argentina and Mexico, which has set a target date of 2012 for adoption of IFRSs.

[13] OECD, "Guide on Fighting Abusive Related Party Transactions in Asia", OECD 2009. p. 15, http://www.oecd.org/dataoecd/39/57/43626507.pdf

[14] http://www.iasplus.com/standard/ias24.htm

Apart from the adoption of IFRS, the definition of conflict of interest in law, regulation and sometimes codes varies significantly across the region, as can be seen from the table below. Regulations for listed companies and best practice codes are generally more explicit than the general companies' and securities markets' law.

Table 4: Definition of conflict of interest and review triggers

Country		Definition	Threshold for review
Argentina	**Law**	Any interest different from company	
	Regulation	Decree 677 specific definition	1% of equity
Brazil	**Law**	Participation in any transaction with personal interest	
	Code	Not independent from subject, interests other than company	
Chile	**Law**	Acts between company and counterparty in which key personnel may obtain a benefit for themselves	Under 1% of equity if less than approx. 100,000 USD
Colombia	**Regulation**	Participation in any activity with personal direct or indirect interest or in competition with company	
Costa Rica	**Regulation**	Follows IFRS	
	Code	Relationships not to impede adequate price structures	
Mexico	**Code**	Use company's assets only in company's best interest	
Panama	**Regulation**	Voluntary CNV Agreement 12 , using company's business for personal benefit	
	Code	Part of decision that affects outside interest	
Peru	**Law**	Using assets for personal benefits and competing with company; accepting loans	
	Code	Misuse of corporate assets, abusive RPTs	

In *Argentina*, the companies' law does not specifically define conflicts of interest other than having any interest different from the company. For listed companies, Decree 677 addresses the issue more specifically. The wording of Art. 73 is similar to the IAS standard, but goes a little further in defining "key management personnel" from the standard as "directors, members of the board, statutory auditor (síndico) and executive management". Decree 677 also sets a minimum of 1% of the company's equity as a value of any transaction to trigger a review procedure.

The Corporation Law in *Brazil* defines conflicts of interest as directors' participation in any corporate transaction in which they have a personal interest. The IBGC Code of Best Practice defines a conflict of interest as occurring when a director is not independent from the subject being discussed by the board, and may influence or make decisions motivated by interests other than those of the company.

Chile's Companies Law defines RPTs as operations or any kind of acts between the company and a counterparty, in which the controller, a director or officer of the company may obtain a benefit for himself or for a company he represents, currently or during the last 18 months.

For listed companies, in addition, an RPT is an operation in which a company of the economic group it belongs to is the counterparty. A transaction can only be undertaken if it complements the company's social interest and is conducted according to market practices. Transactions of less than 1% of the company's equity (or 2.000 UF, approx. USD 100,000 whichever is less) are not considered relevant, and therefore do not need to follow a review and approval process.

In *Colombia*, Decree 1925 defines conflicts of interest as a directors' participation in any activity in which they have personal or indirect (via a third party) interests that can result in a conflict of interest or competition with the company in violation of the law and without the specific authorization from the shareholders' meeting. External Circular 100-006 of 2008 by the Superintendencia de Sociedades establishes a number of transactions that should be viewed as RPTs.

Costa Rica adopted IFRS in full as early as 2002. In addition, both the mandatory CONASIFF Code for financial institutions as well as the voluntary BNV Code cover the issue. The CONASIFF Code proclaims that relationships between entities of the same group should not impair transparency, adequate price structures, and fair competition. The BNV Code makes very broad mention of the issue and mainly establishes the duties of the board in reviewing such transactions.

Law in *Mexico* does not cover conflicts of interest; nevertheless, most of the Mexican listed companies cover the issue in their bylaws. Also, Mexico's Code recommends using corporate assets or services only in the company's best interest and having a clear policy if used for personal benefit. According to the CEGC the issue of conflicts of interest is ambiguous in Mexico and needs to be dealt with more thoroughly.

In *Panama*, neither the Code of Commerce nor Companies Law regulate conflicts of interest. The non-mandatory CNV Agreement 12 for registered companies lists demanding or accepting payments or other gifts, seeking personal interest with their decisions, or using the company's business for personal benefit as potential cases of conflict of interest for board members. According to the Best Practice Code, conflicts of interests occur when a director or employee of the company is part of a decision that can positively or negatively affect their interests held outside the company.

The Companies Law of *Peru* makes the principal statement that a director, manager, legal representative or partner of any organization with interests opposed to those of the company cannot be chosen as directors of the board. The law also prohibits adopting agreements or using corporate business opportunities for personal or related third party benefit as well as participating in activities that compete with those of the company without specific approval. The Securities Market Law adds that directors cannot accept loans from the company and abuse their positions using corporate assets or services for personal or third party benefit without the board's consent. The Peruvian Best Practice Code includes the misuse of corporate assets and abusive related party transactions as cases of conflict of interest.

Summary: Definition Conflict of Interest

By the end of 2012, when Mexico is due to adopt IFRS in full, all countries in this study, except Colombia should follow IAS 24 and therefore its definition of related parties and related party transactions.

The definitions for conflicts of interest in law, regulations and codes vary significantly across the region. Definitions in regulations for listed companies and best practice codes tend to be more explicit than in company law. This is not the case in Chile and Peru, however, where company and securities market laws offer detailed definitions of conflicts of interest. Costa Rica, Mexico and Panama define the issue only in voluntary codes.

Thresholds below which a transaction does not have to be reviewed for related party transactions can reduce the workload of the board. Only the Argentinean and Chilean frameworks offer such thresholds.

2. The Duties of the Board

OECD Principle VI.D.6 states that one of the key functions of the board is: "Monitoring and managing potential conflicts of interest of management, board members and shareholders, including misuse of corporate assets and abuse in related party transactions." This function should include the following aspects, which will be discussed in this section: The disclosure of any interests in transactions by board members; setting policies with respect to the review of transactions involving conflicts of interests, including whether the board or shareholders vote on the issue; rules on the abstention from discussion and voting on RPTs by the related parties. Lastly, codes of ethics play an important role in setting internal policies.

Table 5: Review and Approval Process of RPTs

Country		Disclose Interest?	Who approves RPTs?	Involved Directors to abstain from voting?
Argentina	Law	Yes		Yes
	Regulation	Yes	Board if Audit Committee puts forward clear opinion, shareholders if opinion cannot be reached	
	Code	Yes		Yes
Brazil	Law	Yes		Yes
	Code	Yes		Yes
Chile	Law	Yes	Board, absolute majority	Yes
Colombia	Law		Shareholders	Yes from review if director, from vote if also shareholder
	Regulation	Yes		
	Code	Yes		
Costa Rica	Regulation			
	Code	Yes	Board	Yes
Mexico	Law	Yes		
	Regulation			
	Code	Yes	Board	No
Panama	Code	Yes	Board	Yes
Peru	Law	Yes	Board, absolute majority	Yes
	Regulation			
	Code		Board	

Disclosure of Interests by Directors

While the review and approval process of RPTs is critical, it relies on directors disclosing their interest in a transaction. In fact, the disclosure of "any situation" that represents or could potentially represent a conflict of interest is a legal requirement in all jurisdictions with the exception of Panama. In Costa Rica, the mandatory CONASSIF and voluntary BNV Code formulate that companies need to establish policies for their boards, which include the duty to communicate any potential conflict of interest. In Panama, the Best Practice Code recommends board members disclose any potential conflict of interest.

Review & Approval of RPTs

Decree 677 in *Argentina* explicitly formulates the review of RPTs as a duty of the board as a whole as well as on the individual board member. The Audit Committee, which has to be in the majority independent, can be called upon by the board or any of its members to provide an opinion on the transaction to the board. Should the Audit Committee, and if consulted with an external expert, not be able to provide a clear opinion, the Board must seek shareholders' approval on the matter. Both the Company Act and the Best Practices Code require and recommend respectively that directors abstain from participating in the board deliberations and decisions when they are involved in such cases.

In *Brazil*, the review and approval of RPTs is not specifically defined as a duty of the board in law or regulation, but is understood to implicitly be part of their general duty of loyalty and care. The IBGC Code of Best Practice, however, explicitly defines the review of RPTs as duty held by directors, who have to assure that transactions are conducted according to market practices. The Corporations Law requires and the Code recommends that directors abstain from voting on a decision in which they may have a conflict of interest. The Brazilian framework does not address how RPTs should be approved.

In *Chile*, Corporation Law No 18046 explicitly defines the approval of RPTs as a responsibility of the board. Since the major amendments to the law in 2009, the review and approval process is formulated in detail. The board needs to approve RPTs with an absolute majority, factoring into its decision the opinion of the auditing committee ("*comité de directores*"), mandatory for listed companies of a certain size. Directors with personal interest in the transaction need to abstain. If the absolute majority of the board needs to abstain due to interest in the transaction, the transaction can only be approved unanimously by the remaining, disinterested directors or by majority in an extraordinary shareholders' meeting.

The review of RPTs is implicitly the duty of the board in *Colombia* pursuant to Law 222 of 1995, since the board has to ensure the compliance with laws and company bylaws. The approval of the transaction falls to the shareholders, however. The law specifically elaborates that the shareholders may only grant permission if the transaction does not do damage to the company. Directors with interest in the transaction have to refrain from board deliberations, and abstain from voting if they are shareholders. The Colombian Country Code recommends that the Audit Committee be responsible for the review of RPTs and provide a written opinion whether they follow market conditions. In the 2010 annual evaluation of listed companies on their compliance with the Colombian code, 32.6% of non-financial issuers and 27.6% of financial ones followed this practice.

The framework in *Costa Rica* does not address the approval process in much detail. The mandatory CONASSIF Code for financial institutions establishes that the board must approve auditable policies but offers no further details. The voluntary CNV Code recommends that RPT reviews be carried out and approved by the board, with the interested party refraining from voting.

Mexico's capital markets law and regulations provide that, with some notable exemptions relating to the size of the transaction, RPTs must be approved by the board after review by the Governance Committee, which is to be entirely composed of independent directors.

According to the Best Practice Code in Mexico, directors should abstain from voting if they have an interest in the transaction and should let this be known to the rest of the board. Also, the Code recommends that the board should establish mechanisms to deal with RPTs but these practices are still only vaguely specified and – according to the CECG – are not yet considered a key duty of the board.

In *Panama*, the voluntary CNV Agreement 12 as well as the Best Practice Code recommend the board to identify and manage conflicts of interest, but leave the establishment of mechanisms to the board. The CNV Agreement and the Code also recommend that directors who have a conflict of interest should abstain from voting.

In *Peru,* Companies Law states that if transactions between related parties do not meet certain requirements (ordinariness and equality) prior approval of the board by absolute majority is required. Peru's securities law provides that RPTs with certain parties (officers, directors or holders of more than 10% of the company's shares) and that meet a size threshold (more than 5% of the company's assets) are required to be approved by the company's Board. Peru's Code of Best Practice recommends that the board reviews and monitors any potential conflict of interest of management, board and shareholders, including abusive RPTs and fraudulent use of corporate assets. According to the Corporation Law, directors have to abstain from deliberations and decisions if they are involved.

Codes of Ethics

The development and implementation of a company code of ethics, which may apply to employees as well as board members, is one way of reinforcing appropriate behavior to guard against the negative effects of conflicts of interest and abuse of related party transactions. According to the annotations to OECD Principle VI.D.6, "in fulfilling its control oversight responsibilities it is important for the board to encourage the reporting of unethical/unlawful behavior without fear of retribution. The existence of a company code of ethics should aid this process…"

Responses by the institutes and practitioners to the question of how widespread codes of ethics were in companies in the region allow for the following observations:

- Company codes of ethics appear to be a fairly widespread practice among larger listed companies. This is particularly true for companies with an international outlook. For example, a 2009/10 study by KPMG of public reports of listed companies in Brazil found that all companies issuing American Depositary Receipts (ADRs) publicly disclose their Codes of Conduct or Ethics. This percentage was substantially lower in other groups (68.4% for Level 1 and 2 companies, 42.2% for Traditional segment companies, and 47% for Novo Mercado companies), indicating that many companies probably do not yet have such codes. The IBGC Code of Best Practice also recommends companies to have codes of conduct. Listed, supervised companies in Colombia, following Circular Básica Jurídica are required to have a Code of Ethics and the board is explicitly tasked with supervising compliance with it.

- Smaller companies tend not to have codes of ethics and as the response from Costa Rica indicated, only a small percentage of companies have codes of ethics in place.

- While the existence of codes of ethics is encouraging, no conclusion can be reached about the quality or degree of implementation of these codes from the responses received. However, as one board member from Chile suggested, company codes of ethics "are widespread, but still very basic compared with the ones I have seen in more developed countries."

Summary: Duties of the Board

The disclosure of any personal interest by directors in a transaction is the essential first step in dealing with the issue of conflict of interests and RPTs. This is well established as a binding obligation in all jurisdictions but Panama.

The role of the board in the review and approval of RPTs is dealt with less uniformity in the frameworks of the eight countries of this study. While all jurisdictions require or recommend directors to abstain from deliberations and voting if they have an interest in the transaction, the frameworks diverge in how detailed the duties of the board in the review of RPTs are formulated, as well as whether they are set in binding law or regulation or only recommended by best practice codes.

- Argentina, Chile, Colombia and Mexico set out the most detailed prescription of procedures that boards have to follow, clearly assigning roles to the board and shareholders through law and binding regulation.

- All other countries address the issue in non-binding recommendations and also remain vague on the actual details of the procedure.

Codes of ethics seem to be a fairly widespread practice amongst larger companies in the region, without elaborating on the content of the codes. The IBGC Best Practice Code in Brazil addresses what a code of conduct should cover in detail.

3. Independent Oversight: Role of Independent Directors and External Experts

Independent judgment is critical to monitoring RPTs and to ensure that approved transactions are in the interests of the company and all shareholders. In this context, independent directors, internal and external auditors and other external experts should play a crucial role in the process surrounding RPTs.

This issue is dealt with only sparingly in the frameworks of the eight jurisdictions.

The **Audit Committee** plays the central role in all surveyed countries:

- At the most basic level, financial statements need to be prepared according to IFRS, which guarantees an ex-post verification of RPTs. The response from Costa Rica indicates the implications of IFRS, as a company's internal financial system has to include information on RPTs according to IFRS guidelines and this information is audited by both external and internal auditors, which report to the Audit Committee which in turn reports to the Board of Directors.
- A more explicit ex-ante review role is assigned to the Audit Committee in only a few of the surveyed jurisdictions. In *Argentina* and *Chile*, the Audit Committee (or equivalent Directors' Committee in the case of Chile) is obligated to provide an opinion to the board on RPTs. In *Mexico*, the Governance Committee is required to secure an independent appraisal and submit it, together with the committee's recommendation, to the full board for consideration before the board approves the transaction. In the case of Argentina, if the Audit Committee is unable to provide a "clean" opinion on the transaction (regarding adherence to market prices etc.), the board is required to seek shareholder approval. The Colombian Code recommends that the Audit Committee review RPTs.
- Brazilian companies are not required to have Audit Committees, nor does the law or regulation address the handling of RPTs. However, in practice, if a company has an Audit Committee or Fiscal Council, these bodies will take over the responsibility of reviewing RPTs. The fiscal council is a non-mandatory body, whose main function is to monitor the activities of management, examine the financial statements each fiscal year and provide a formal report to shareholders. Fiscal Councils operate independently from management and from a company's external auditor, since their members are elected directly by shareholders at the shareholders‟ meetings.

Independent directors should play a key role in reviewing RPTs. The frameworks in the region, however, hardly cover the issue.

- Implicitly, in the countries where the Audit Committee has an assigned role, and the Audit Committee is to be in the majority independent, independent directors occupy a critical role. This is the case in *Argentina* and *Chile*[15], as well as *Mexico*, where the Governance Committee is to be entirely composed of independent directors. The Argentinean Best Practice Code explicitly states that independent directors should approve related party transactions involving majority shareholders.

[15] In the case of Chile, if only one independent director sits on the board, that director must choose one member of the audit committee.

- In a special circumstance, in Brazil, under CVM Release No. 35, if summoned to serve on negotiation committees, independent directors are expected to thoroughly review and engage in the negotiation of the terms of corporate reorganizations involving RPTs.

Independent, external experts are a common way to supplement board expertise, in particular if it involves complex transactions. Argentina, Brazil, Chile and Mexico cover the use of external experts in their frameworks.

- In *Argentina*, as an alternative to the opinion by the Audit Committee, boards can rely on the results of technical evaluations performed by two independent consultants.
- In *Brazil*, the IBGC Best Practice Code recommends that whenever possible, RPTs "must be based on independent appraisal reports, based on realistic assumptions and information endorsed by third parties. The appraisal reports cannot originate from the parties involved in the operation, whether banks, lawyers, specialized consultancies, or other companies."
- In *Chile*, if the majority of the board has to abstain due to involvement in the transaction and an extraordinary shareholder meeting has to be summoned, at least one independent expert has to provide an evaluation of the conditions of the transactions and its impact on the company.
- In *Mexico*, as described above, the Governance Committee is required to seek the opinion of an external, independent expert on whether the transaction is applying market conditions.

Summary: Independent Review of RPTs

The issue of independent review, both within the company and from external sources, is not addressed in much detail in the frameworks of the jurisdictions in this study. Still, following IFRS, which all jurisdictions are required to do or are in the process of adopting should facilitate adequate internal and external audit of RPTs.

An explicit formulation of a role for the Audit Committee in reviewing RPTs, and therefore an implicitly important role for independent directors, can be found only in the frameworks of Argentina, Chile and Mexico. Similarly, the consultation of independent, external experts is addressed in the frameworks of only a few countries.

4. Disclosure of information on RPTs

Principle V.A.5 of the OECD Principles recommends that "disclosure should include, but not be limited to, material information on related party transactions", and the notes to the Principle explains that "it is essential for the company to fully disclose material related party transactions to the market, either individually, or on a grouped basis, including whether they have been executed at arm's- length and on normal market terms". Disclosure is indeed fundamental as it enables shareholders to better understand the rationale for, and nature of related party transactions.

Some countries in this study require or recommend disclosure in some form, but the degree of disclosure varies widely.

- The most stringent requirement is set out in *Brazil* under CVM Rule 480. The Periodic Disclosure Form required under the rule mandates the periodic and continuous disclosure of RPTs involving directors and officers of listed corporations to the CVM and the market.
- In *Argentina*, Decree 677 requires the Audit Committee to disclose its opinion on RPTs involving board members or shareholders to "the market". The Decree also rules that the review and approval procedure must be completed in five days and the RPT must be disclosed (with all supporting documentation) to shareholders and the CNV immediately after approval by the Board.
- In *Colombia*, under Decree 2555 of 2010, listed companies have to publicly (via the website of the SFC) disclose any RPT over a threshold of 1% of operating revenues.
- Under Company Law in *Chile*, a company must identify all transactions related to any shareholder, board member or management and communicate them to the shareholder meeting and publish them in the annual report.
- In *Peru*, Reglamento de Propiedad Indirecta, Vinculación y Grupos Económicos states that the companies registered in the Registro Público del Mercado de Valores must disclose before the securities regulator those transactions between the issuer or related companies and directors or shareholders.
- While not requiring the public disclosure of such transactions, *Panama's* Cabinet Decree 247, which applies to companies registered with the Securities and Exchange Commission, requires the disclosure of all contracts entered into by the company or its directors.

Summary: Disclosure of information on RPTs

Disclosure of RPTs in general is handled in Latin America through the use of IFRS to guide preparation of financial statements. Immediate disclosure of RPTs is not required in any of the surveyed jurisdictions with the exception of Brazil in the Periodic Disclosure Form for listed companies and to a less explicit degree in Argentina and Colombia. In Chile transactions involving shareholder, board members of management have to eventually be disclosed in the Annual Report, and Panama requires disclosure to the securities regulator.

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Respondents

Country	Institution, Respondent
Argentina	IAGO • Jorge Mantiñan • Marcos Bertin
Brazil	IBGC, IBGC's Legal Commission • Luiz Fernando da Costa Dalla Martha
	Paulo Vasconcellos, Board Member, CEO ProxyCon Aquileo Silva, Marcos Duarte, Polo Capital Management
Chile	Centro de Gobierno Corporativo y Desarrollo de Mercados, Universidad de Chile • Dieter Linneberg
	Carlo Solari, Grupo Falabella
Colombia	Confecamaras • Francisco Prada
	Superintendencia Financiera German Estefan, Independent Board Member Francisco Diaz, Organización Corona
Costa Rica	IGC – Costa Rica • Roberto Truque • Adrián Alvarenga
	Álvaro Quesada, Aguilar Castillo Love
Mexico	CEGC • Jorge Fabre • Marta Vaca
Panama	IGCP • Miroslava Zarate • Julieta Rodriguez • Carlos Barsallo
Peru	Asociación de Empresas Promotoras del Mercado de Capitales (Procapitales) • Gerardo Gonzales • Gerardo Herrera
Regional	Glass, Lewis & Co • Dwight Clancy