The Role of Institutional Investors in Brazilian Corporate Governance
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PART I
1. **Summary, Conclusions and Policy implications**

This report was prepared after discussions at the Latin American Corporate Governance Roundtable in Quito, Ecuador, in 2013.

Amec has offered to coordinate a task force that would gather investors and other entities in the Brazilian capital markets with the objective of providing an overview of the institutional investor landscape in the country, and its impact on the corporate governance of listed companies.

This report is divided in the following way. After this brief introduction, it provides an overview of the Brazilian market, zooming on the many different categories of institutional investors. For each category we provide a description of the market structure, regulation, self-regulation, internal governance and stewardship activities. We also discuss trends and challenges affecting each class of investor.

We follow with an analytical discussion of stewardship, with a focus on the exercise of voting rights by institutional investors. We then follow with our tentative conclusions and policy implications, which are summarized on the bullet points below:

- The first challenge seems to be the risk aversion that determines a low exposure to equities among all investors in Brazil.
- Harmonization of investment rules affecting institutional investors seems to be warranted.
- Brazilian institutional investors lack the regulatory, self-regulatory or commercial pressures to exert fiduciary duties in relation to the political rights that are entitled to the securities they hold.
- There is space to rethink the self-regulatory framework so that it may become more effective.
- Asset owners also have the ability to demand more engagement.
- Brazil needs a Stewardship Code.
- Further collaboration is needed between different classes of investors – notably local and foreign institutional investors.
- The costs and bureaucracy of voting need to be addressed.
- It is urgent to improve the effectiveness of shareholder’s rights.
PART II – Landscape of Institutional Investors
2. Economic Evolution

The performance of the Brazilian economy has been highlighted many times over the past few years. Resilience during the economic crisis and the remarkable growth rate of 2010 certainly suggested that the era of the “country of the future” – as Brazil was perennially referred to, was gone.

However, as one zooms in and out from the usual windows of analysis, the picture is murkier. Sustainable long-term growth remains a challenge, whereas recent weakness puts into question the current economic model.

Brazilian GDP grew 85% over the past 20 years. Its Latin American peers, in turn, grew 95%, and the world as a whole – heavily influenced by Chinese growth, grew 111%. This translates into yearly averages of 3.1%, 3.4% and 3.8%, respectively.

A breakdown of this period according to the incumbent administrations, we see that Brazilian growth was only above average during the Lula period (2003-2010) – and still only marginally so. Recent economic weakness has been even more marked.

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<tbody>
<tr>
<td>Brazil</td>
<td>3.1% 2.6%</td>
<td>4.0%</td>
<td>1.6%</td>
</tr>
<tr>
<td>Latam</td>
<td>3.4% 2.5%</td>
<td>4.1%</td>
<td>3.2%</td>
</tr>
<tr>
<td>World</td>
<td>3.8% 3.4%</td>
<td>3.9%</td>
<td>3.4%</td>
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Sources: IMF, The Economist (proj.)

Lackluster growth casts a shadow over a number of impressive accomplishments over this period. The first is naturally the end of hyperinflation, achieved in 1994. Economic stabilization was followed by a number of reforms that built a credible inflation targeting system, managed by a Central Bank with relative operational independence, technical excellence and transparency. Recently, though, inflation has shown signs of returning, and that became a significant theme during the debates of the recent presidential campaign.
But perhaps the two most remarkable achievements in terms of economic development in Brazil are (1) the reduction in inequality; and (2) the expansion of bank credit. Both facts are a direct consequence of government policies that increased income and consumption for the lower classes. In effect, this has increased significantly the Brazilian middle class, with access to consumer goods and – ideally – investment products. As we shall see, this last aspect is still lagging behind.
Domestic Credit / GDP

Source: Central Bank and JP Morgan

Social Classes

Source: LCA and JP Morgan
3. **Capital Markets Evolution**

The Brazilian capital markets are among the most developed among the so-called Emerging Markets – and particularly in Latin America. With a current market capitalization of app. USD 1 trillion (42% of GDP) and a daily turnover of app. USD 3.5 billion, its equity market could be perceived as an important dynamo powering the country’s economy. It is not.

Size and liquidity in Brazil are (arguably) a function of certain specific characteristics of the Brazilian economy. First, the state of financial infrastructure in Brazil grants the country the respect of global investors, attracted by features such as real-time bank flows, central custodian and depositary services, good prudential bank regulation and rule of law. Many of these features – it must be said – are the result of the long period of economic instability and inflation, that led to strong investments in regulation and technology. Also, it is a testament to Brazil’s resilience to the many crises that affected it over the past few years.

Second, there is a small number of very large companies, stemming from banks to NOC Petrobras, as well as consumer powerhouses Ambev and BRF which represent the core of the Brazilian market. Many companies listed their shares in response to certain policy incentives, including tax breaks and investment schemes targeting state owned companies (notably in telecoms).

The government did try to foster the development of the capital markets a few times. However, these initiatives were either misguided or lacked follow up. For example, tax incentives of the 1970s attracted companies and investors to the market for the wrong reasons. Like an arranged matrimony, many times they were not ready for each other.

Other legal and cultural aspects reduce incentives for companies to offer their shares to the public. In addition, a low aggregate internal savings rate and a deficient, pay-as-you-go system of public pension do not bode well for the creation of an investment climate in the capital markets.

BMF Bovespa estimates that today less than 1% of the Brazilian population has exposure to the equity markets. At the same time, there are approximately 370 listed companies in Brazil – a very small number in relation to the size of the economy. It is estimated that Brazil has up to 15,000 companies that have the scale to be publicly listed. Another way to look at it is to compare Brazil with other countries, as depicted below. India, for example, has almost 6,000 publicly traded companies.
This shows that the Brazilian capital markets – albeit large in terms of liquidity – are not a relevant tool to finance local companies. This is also highlighted by the small number of IPOs over the past few years.
It is important to mention that in the 10 years prior to 2004, the Bovespa has witnessed 6 IPOs, which raised circa USD 1 billion. Growth between 2004 and 2010 was remarkable, but a few comments are in order.

First, one can argue that growth was started by the regulatory reforms of the early 2000s. In 2001, Brazil updated its Corporate Law, increasing shareholder rights and the powers of the regulator. In the same year, BMF Bovespa launched the Novo Mercado – a widely acclaimed initiative that created a special segment to which companies could voluntarily adhere. Requirements include additional protections to shareholders and transparency rules.

In 2010 the primary equity market was further incentivised by the record-breaking rights issue of Petrobras. That, however, represents the high watermark for IPOs in Brazil ever since. In 2014 the data are particularly gloomy. To date we have witnessed just one IPO.

Any analysis of the Brazilian capital markets must therefore be made in the context of this tough reality. Albeit big, equity markets are a figment of what they could be in relation to the size of the Brazilian economy. From the supply side, there is a tiny number of listed companies – usually large ones – while the majority of firms choose to remain private. From the demand side, Brazilians have a low savings rate, and are particularly conservative in their investments, preferring fixed income instruments and real estate to the volatility of the equity markets.

Still, as we shall see below, Brazil developed a complex and deeply regulated structure of institutional investors. They represent a pool of capital that is fairly large. And, as options in the equity markets are limited, they become significant investors in listed companies.
4. **Main Institutional Investors in the Brazilian Market**

4.1. **Equity and ‘Multimarket’ Funds (listed equities)**

4.1.1. Market description

Brazil’s mutual fund industry is the fifth largest in the world\(^1\), with assets under management that exceed USD 1 trillion\(^2\). This represents a real growth of almost 1,000% over the last 20 years – period that represents the stabilization of the Brazilian economy, following the Real Plan. In other words, real growth reached approximately 13% per year.

The industry comprises 267 registered fund managers or advisers, with responsibility over 14,097 mutual funds. Even considering a certain degree of double counting (certain funds invest in other funds), the size of the industry remains quite remarkable.

As we shall see on Sections 4.1.2 and 4.1.3 below, the industry is VERY regulated. While regulation and self-regulation have allowed a scenario of high trust between asset owners and asset managers, one may also argue that it has straight jacked managers into very specific classifications that may hinder product differentiation.

For a number of reasons that stem from culture, economics and competition, the equity exposure of this large mutual fund industry is very small. Pure equity funds represent 7% of the industry’s AUM. Multimercado funds, which may invest a given percentage of their assets in equities do represent a more sizeable 19% of the industry – but even if the aggregate equity exposure of that category were high (and it is not), it would still suggest a conservative asset base.

One reason is the low savings rates of Brazilian individuals. The country occupies the 26\(^{th}\) place in the world in terms of individual savings. It reaches only USD 950 per year, or approximately one month worth of the per capita GDP. This clearly reduces the risk appetite of the average Brazilian investors. In addition, high interest rates provide another explanation. As the table shows, equities provide returns that are only marginally superior to fixed income products – with much higher volatility. As long as this picture remains in place, it will be hard to incentivize mutual funds – and their clients – to invest in equities.

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\(^1\) Data on this section derive mostly from Anbima’s 2014 Mutual Fund Industry Yearbook.

\(^2\) Excluding financial hubs such as Luxembourg and Ireland.
4.1.2. Regulation

The mutual fund industry is regulated by the CVM – Comissão de Valores Mobiliários.

The first legal document establishing the mutual fund industry in Brazil dates back to 1959. The industry remained of little relevance in subsequent years (in 1970 there were only 11 funds in Brazil) until the market boom and bust of 1971. Shortly thereafter the CVM was created, in 1976.

The CVM became the sole regulator of capital markets in 1999 (bank regulation remains with the Central Bank). In 2001 the CVM gained new powers to regulate listed companies and investors alike – including formal independence from the government, with board members appointed by the Senate for a rolling 5 year mandate.

The current regulatory landmark for the industry is the Instruction 409, issued by the CVM in 2004. Since then, this document has been amended 10 times in order to update the regulation to the needs and lessons of the marketplace.

Some of the recent changes allowed, for example, the inclusion of foreign assets among the investment universe of mutual funds that cater to institutional investors.

The CVM is currently working on a significant revision of Instruction 409, after an extensive public hearing that received 31 contributions from asset managers, lawyers and associations.

Among the accomplishments of Instruction 409 one may highlight:

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3 Source: Varga (2009)
- Segregation of activities and the creation of a checks and balances structure, with clear definition of the role of each participant;
- Increased the responsibilities of the investment manager versus the administrator, including items such as investment policy, risks and portfolio limits of concentration;
- Defined the distributor responsibility (now responsible for taxes that investors should pay on top of the fund return);
- Created a presentation standard for fund performance, with 12 months for returns and AUM, fund starting date, administration and performance fees;
- Created an official classification for the funds, as follows:
  - “Fundos de Curto Prazo” (Short Term Fixed Income Fund). Mostly composed by bonds with a maximum maturity of 365 days;
  - “Fundo Referenciado”, the fund should follow a specific benchmark;
  - “Fundo de Renda Fixa”, the fund should invest a minimum of 80% of its portfolio in fixed income asset;
  - “Fundo de Ações”, the fund should invest a minimum of 67% of its portfolio in stocks;
  - “Fundo Cambial”, the fund should invest a minimum of 80% of its portfolio in assets linked to the FX rate;
  - “Fundo de Dívida Externa”, the fund should invest a minimum of 80% of its portfolio in Brazilian Foreign Debt;
  - “Fundo Multimercado”, the fund should invest in several asset classes.

The current structure and the main types of players in the Brazilian mutual fund industry are outlined below:
• **Administrator** is the legal entity authorized by CVM, responsible for the set of services related directly or indirectly to the functioning and the maintenance of the fund. Services such as control and processing of quotas transactions, mark to market, etc. They are also responsible for hiring other services providers, such as auditors, (money) managers, custody agents and distributors;

• **Auditor** is responsible for auditing the fund accounting;

• **Investment Manager** is responsible for the portfolio asset allocations, and must be registered with the CVM;

• **Custodian** is responsible for the custody and transfer of the fund assets;

4.1.3. **Self- Regulation**

Pursuant to an agreement with the CVM, Anbima – the Brazilian Association of Financial and Capital Market Entities – is the main self-regulatory entity in relation to mutual funds in Brazil.

Anbima was created in 2009 as a result of the merger of Anbid (the Investment Banking Association) and Andima (the Association of Capital Market Entities). Membership is currently comprised of 310 firms, including banks, brokers and asset managers.

Self-Regulation of mutual funds is but one out of 10 areas in which Anbima has enforcement activities. In all of them Anbima spousles principles that include fair competition, standardization of procedures, greater transparency of information and ultimately improvement in fiduciary standards and promotion of best practices.

The Self- Regulation Code of Fund Management addresses issues such as registration of funds, sending out information, fund advertising, mark-to-market, management and distribution of funds and suitability, among others. It also provides judgments and punishment of offenders.

With this institutional framework, Investment Funds in Brazil offer investors a secure and transparent environment.

**An analysis of the last 15 or 20 years shows an almost total lack of investor losses caused by fraud, an unprecedented fact in the world.** It is important to emphasize that the regulatory and self-regulatory framework is undergoing continuous and rapid improvement, as it keeps pace with the dynamism of the Brazilian financial markets.

Participating Institutions engaged in one or more of the following activities shall be subject to the provisions of Anbima’s Code:

- Administration of Investment Funds;
- Management of Investment Funds Portfolios;
- Consultancy on Investment Funds;
- Distribution of shares of Investment Funds;
- Investment Funds Treasury;
- Investment Funds assets control;
Investment Funds liabilities control; and
Investment Funds assets custody

All institutions adherent to the Anbima’s Code are required to:

- Have a formal policy on investment decisions and on the selection and allocation of assets;
- Have a risk-management methodology;
- Have a business continuity plan;
- Have a policy on information security; and
- Prepare a statement providing that the internal areas of compliance, risk-management and mark-to-market are not subject to the funds management area or any sales areas.

There are three levels involved in fund management. The manager who decides on the portfolio, the administrator, who ultimately makes the assessment of the fund’s NAV and finally the custodian, who holds custody of the fund's portfolio securities. In general and particularly in the funds managed by independent managers, these functions are performed by different institutions, guaranteeing the investor a level of security rarely found in other world markets. In addition funds are registered as companies independently of their managers, administrators or custodians. They are therefore protected from any problems, such as bankruptcy of the managing institutions.

4.1.4. Internal governance

Once the basic provisions of the CVM regulation and Anbima Code are observed, the internal governance practices of fund management companies vary widely. And these practices tend to be a function of the ownership structure of each particular asset manager.

Managers can be broadly segregated into members of financial conglomerates (bank owned) and independent ones. Between these two types one can still observe others, such as subsidiaries of global asset managers, joint ventures, family offices (in which most assets are owned by a handful of family groups), and others.

Bank owned asset managers command a significant market share in Brazil. In 2014, they represented approximately 70% of the industry’s AUM – whereas the 6 largest retail banks alone represent 60%. This is a direct consequence of the control of distribution channels. Retail branches perhaps represent the most important one. Retail clients are served under closed or semi-open architectures, while high net worth individuals are offered more choice.

Independent asset managers include a panoply of organizations, ranging from the USD 22 billion powerhouse Hedging Griffo to smallish firms managing a few million reais. They also
vary significantly in terms of asset class exposure (from 100% equities to 100% fixed income) and – for those exposed to equities - in terms of activism.

Finally, there are differences in the internal governance depending on whether the asset manager caters to pension funds or not. These clients have their own regulation on stewardship matters (see Section 4.3), and therefore require a more formal structure.

4.1.5. Considerations on Stewardship

Given their scale, bank owned asset managers have the resources to invest in dedicated governance teams, as well as more formal procedures for stewardship. Given Anbima’s determination, all have formal Voting Policies. However, these tend to be rich in goals, but poor in details. As a result, actual stewardship actions on the part of bank owned asset managers vary widely.

There are ongoing discussions related to the management of conflicts of interests between a bank’s asset management operations and its remaining commercial activities. While Chinese wall policies exist, there are little data on their effectiveness.

As the boxes below suggest, there is significant room for improvement in terms of obtaining more stewardship actions from bank owned asset managers. They are a significant part of the absenteeism identified in Section 8.1.

The same can be said – for different reasons – in relation to independent asset managers. The 200+ firms that comprise this group lack, in their majority, the scale to produce a systematic stewardship policy. Many simply do not attend shareholders’ meetings at all. Those that do are motivated by firm specific values and/or investment strategies that may demand a more activist stance.

For both bank owned and independent asset managers, there is little regulatory or commercial incentive to practice stewardship at invested companies.
Box: A Large Fund Manager, part of Commercial Bank

ANBIMA's Code of Regulation and Best Practices for Investment Funds (the "Code") from the Brazilian Association of Entities of the Financial and Capital Markets ("ANBIMA"), to which we adhere, sets forth that all participating institutions responsible for the management of Investment Funds must adopt a Voting Policy in compliance with the guidelines prepared by ANBIMA's Board of Regulation and Best Practices.

The aforementioned Code establishes that management companies are responsible for representing the funds in the meetings of both the companies and investment funds that are the issuers of the securities part of their portfolios, unless otherwise expressly noted in the Code.

Our policy on the exercise of voting rights has, as a basic premise, the approval of decisions that we consider beneficial for the funds or that add value to the funds and shareholders, in their best interest, always based on the principles of transparency, ethics and loyalty and respecting the principle of separation of duties and decisions, with the ultimate objective of applying our duty of care and performing our fiduciary duties in the best possible way.

Due to the aforementioned, except for the following situations, we have participated in all Shareholders' Meetings which decided on matters we considered relevant for shareholders/investment funds: Investment funds that (i) have an exclusive or limited target audience, provided the inclusion of the wording in the regulation regarding the adoption of a voting policy by the fund is approved in the meeting; (ii) invest in financial assets whose issuers are based abroad; (iii) invest in Brazilian Depositary Receipts (BDR); and (iv) the shareholders in the General Shareholders' Meeting decide against the exercise of the voting right by the Fund.

The following matters demand representation and compulsory vote: (i) Election of representatives of minority partners in the Board of Directors, if applicable; (ii) Approval of option plans for the compensation of directors, provided "within the price range purchase options are included (the exercise price of the option is lower than that of the subjacent share, considering the Shareholders' Meeting calling date); (iii) Acquisition, merger, taking over, split-up, changes in the controlling interest, corporate restructurings, changes and conversion of shares and remaining changes to the company's articles of incorporation that may, in the manager's point of view, significantly impact on the value of the assets owned by the investment fund; other matters that imply a different treatment; (iv) Changes to payment conditions and terms, guarantees, advance maturity, redemption in advance, repurchase and/or remuneration different from what was originally agreed.

The team that actively participates in the representation is comprised of 5 (five) professionals with ample voting powers. Votes are always supported by prior decisions formalized in weekly meetings attended by the team responsible for managing the investment funds, the team responsible for their analysis, superintendents, and directors. The decision on the non-representation must be formalized in the minutes of the mentioned meeting.

The major challenge to be met is to facilitate the voting process in the Shareholders’ Meeting by reducing bureaucracy and expanding the process with the objective of bringing up the quorum of participating shareholders, primarily in the case of relevant decisions. This year, we have participated in 12 Shareholders’ Meeting and elected three members.

The fund holders represented in the Shareholders’ Meetings are informed of votes and decisions through a report made available in the management institution’s website or, depending on the case, by mail or email sent directly to them.
Box: A Large Fund Manager, part of Commercial Bank

As a PRI signatory, we recognize that effective research, analysis and evaluation of ESG (environmental, social and governance) issues are a fundamental part of assessing the value of companies over the medium and longer term. Therefore, it is a relevant part of our investment process: stock selection, portfolio construction and voting.

The Equity Funds area and more specifically Research Team have developed a qualitative research model that incorporates ESG factors to investment decision process. The methodology evaluates the following aspects, among others: (i) inclusion in sustainability and governance indexes, (ii) Board of Directors - percentage of independent members, (iii) compensation policy.

A lot of times, the Board of Directors’ compensation package is based on a market survey conducted by an independent company. It is very difficult to perform a detailed analysis of those packages so we focus our research on verifying whether the changes proposed are aligned with the company’s performance and shareholders’ interests. Our analysis is comprised of: (i) fixed remuneration, (ii) benefits, (iii) variable remuneration, and (iv) long-term incentives.

As part of our fiduciary responsibility, the exercise of our voting rights is in accordance with the Self-Regulatory Code and Guidelines for Investment funds of ANBIMA which governs the general principles and the relevant matters that are mandatory for the exercise of voting rights. The main focus of our analysis is the quality of Board of Directors and Supervisory Board members.

We have developed our own methodology to evaluate the candidates for both the Directors and Supervisory Board based on a rating that analyzes the following items: (i) scholar background; (ii) professional experience; (iii) availability to fulfil his/her duties; (iv) years of experience within the Board of Directors; (v) IBGC certification.

It is a responsibility of the Equity Research Team to analyze the agenda of the meeting and propose a voting guidance to be approved by our internal Committees and Senior Management.

According to ANBIMA, attendance in the general meetings is optional in many cases. Usually, we follow those guidelines. Nevertheless, there has been a new trend from minority shareholders regarding the appointment of members to Board of Directors and Supervisory Boards. The disclosure of the candidates for those positions in the General Meetings agendas has been an important step forward and contribution for higher engagement from market participants in those matters.

4.2. Private Equity Funds (FIPs)

4.2.1. Market description

Investments in Private Equity involve components of low liquidity, a long-term horizon and asymmetric knowledge. While these characteristics clearly increase risk, they can also increase expected return. In Brazil, a country with high relative interest rates, return expectations tend to be even greater. Nonetheless, there remains significant potential for growth, given Brazil’s large number of mid-sized and family owned companies, many of which could benefit from involvement with private equity. In addition to growth capital to fund expansion plans, Private Equity brings improved corporate governance, a means of succession planning and financial and operational expertise to help companies grow.
The Private Equity industry in Brazil has seen consistent growth over the last two years. In 2011, committed capital for Brazilian Private Equity funds totaled just US$ 29 billion. However, by the end of 2012, committed capital had totaled more than US$ 38 billion, and by the end of 2013, it reached US$ 45 billion, an increase of 55% in just two years.

Foreign capital commitment is also growing rapidly, and now represents more than half of aggregate commitments, evidence of growing interest from international investors in a market where Private Equity penetration is just 0.37% of GDP, with investments of US$ 8 billion. By way of comparison, aggregate Private Equity investment in the USA represents 1.02% of GDP, meaning Private Equity investment in Brazil has significant headroom for growth.

4.2.2. Regulation

Private Equity funds in Brazil are structured as Fundos de Investimento em Participações ("FIP"), which are regulated by Rule 391, dated July 16, 2003, as amended, issued by the Brazilian Securities Commission (Comissão de Valores Mobiliários, or “CVM”) ("Rule 391/03").

FIPs were created to meet the demands of the Brazilian capital markets as well as the interest of both Brazilian and foreign investors in investing in small and medium-sized companies based in Brazil, which equity interests are not listed and traded in the stock exchange or organized over-the-counter markets. This is one of two types of investment fund in Brazil that is allowed to invest in equity interests issued by non-listed, privately-held companies.

FIPs are close-ended investment funds that are allowed to invest in shares, debentures, subscription bonds, convertible securities issued by Brazilian companies (sociedade por ações), provided that such investment assures to the FIP significant influence in the management and decision making-process of the investee companies. Although Rule 391/03 fails to provide a precise definition for “significant influence in the management and decision-making process”, it does provide examples of how FIPs may comply with this requirement by exercising certain degree of influence over decisions relating to the strategic policies and management of the investee companies. The following are examples of specific actions that are considered as “significant influence” in the management and decision making process of the investee companies, as provided by Rule 391/03: (i) acquisition of controlling interest in the investee companies; (ii) execution of shareholders’ agreement assuring certain voting and/or veto rights to the FIP; (iii) appointment of members of the board of directors; and/or (iv) execution of agreements, establishment of certain procedures or exercise of rights ensuring that the FIP has the ability to influence strategic decisions related to the investee companies.

Rule 391/03 has been recently amended to provide for certain exceptions to the requirement described above. Thus, FIPs are not required to have significant influence in the management and decision-making process of investee companies that are listed in special trading segment

4 The other being Fundo de Investimento em Empresas Emergentes – FIEE, which is constrained to invest in companies with sales below BRL 100 million.
focused on the access of new companies, which establish special corporate governance standards, provided that (i) such investments of the FIP in these companies do not represent more than 35% (thirty five per cent) of the net equity of the FIP or (ii) the lack of significant influence in the management and decision-making process occurs during the divestment period.

In addition to the requirement described above, pursuant to Rule 391/03, FIPs are only allowed to invest in non-listed, privately-held companies that observe at least the following corporate governance practices (to be provided for in the companies’ bylaws): (i) restriction to issue participation certificates (partes beneficiárias); (ii) members of the board of directors shall have an unified term of office of 1 (one) year; (iii) assurance that the company will disclose information about agreements with related parties, shareholders’ agreements, stock option programs for the acquisition of shares and other securities; (iv) submission to arbitration chamber for the resolution of corporate disputes; (v) in the event of going public, the company shall adhere to special segment of stock exchange or entity maintaining organized over-the-counter market ensuring, at least, levels of corporate governance practices referred to in items (i) to (iv) above; and (vi) financial statements audited on an annual basis by independent auditors registered with CVM.

4.2.3. Self-Regulation

The self-regulatory bodies of Private Equity funds in Brazil are Associação Brasileira das Entidades dos Mercados Financeiros e de Capitais – ANBIMA and ABVCAP – Associação Brasileira de Private Equity & Venture Capital. ANBIMA and ABVCAP have enacted the ANBIMA/ABVCAP Regulation Best Practice Code – Private Equity and Venture Capital Funds (Código de Regulação e Melhores Práticas para o Mercado de FIP e FIEE, or the “Code”), which must be observed by all effective members of the ABVCAP and all institutions affiliated with ANBIMA that are engaged as administrators, portfolio managers, custodians and/or placement agents of FIPs (“Participating Institutions”). Entities which are not Participating Institutions may also choose to adhere to the Code, demonstrating alignment with the best practices within this industry (“Adherent Entities”).

FIPs that are administered and/or managed by Participating Institutions or Adherent Entities must be registered with ANBIMA/ABVCAP and are required to comply with all provisions of the Code, including governance practices such as those described below, which must be provided for in the FIPs’ bylaws: (i) description of the investment, divestment and co-investment policy of the FIP; (ii) information about situations that could imply potential or actual conflict of interests between the administrator, the portfolio manager and/or members of the investment committee, on one side, and the FIP, on the other side, as well as the commitment of such parties to disclose these situations to the administrator and to the quotaholders of the FIP; (iii) information about policies and procedures to be observed in case key members of the management team of the portfolio manager and/or members of the investment committee of
the FIP are also key members of the management team of the portfolio manager and/or members of the investment committee of other funds that could compete with the relevant FIP; (iv) if applicable, description of rights or obligations that may be attributed on a preferential basis to certain quotaholder or group of quotaholders, in those cases where such preferential treatment is permitted; (v) description of the composition and attributions of the general meeting of quotaholders, investment committee, technical department, information department and/or oversight committee, as applicable; and (vi) description of duties and responsibilities of the administrator and portfolio manager of the FIP.

4.2.4. Internal governance

As explained in previous sections, the Brazilian financial and capital markets are strongly regulated by the Central Bank of Brazil (“Bacen”) and the Brazilian Securities and Exchange Commission (or Comissão de Valores Mobiliários, also known as “CVM”). In order to incorporate and operate Private Equity funds (FIPs), which are closed-ended condominiums regulated by the CVM, a series of necessary service providers must be hired, including the: (i) administrator (which can also perform the investment management activities); (ii) investment manager; and (iii) custodian. All of them are regulated and supervised by the CVM and/or Bacen.

Therefore, even though the FIPs do not have a specific internal governance, besides certain provisions in their bylaws, their internal governance encompasses the policies of their service providers, which must have a valid and extensive internal governance policies, once such policies must be presented and reviewed, in some cases, by the authorities (such as CVM and Bacen) and/or self-regulatory institutions prior to their registration or adhesion.

4.2.5. Considerations on Stewardship

The ownership engagement may vary substantially among the different types of investors. The FIPs main investors in Brazil are the institutional investors (public pension funds), which are very active in engaging in the FIPs and in the companies’ portfolios affairs. In order to invest in such FIPs, such public pension funds nowadays require that all investments must be approved by an Investment Committee with majority votes held by the investors and, therefore, with veto powers over the investment proposed by the investment manager.

On the other hand, the ownership engagement to be performed by administrators, investment managers and custodians are strongly regulated by the Brazilian legislation. Their fiduciary duty is well stated in the regulation issued by the CVM, including conflict of interest situation and alignment of interest.
4.2.6. Trends and Challenges

Private Equity is becoming an increasingly important part of Brazil’s economic landscape, and is helping to bridge the gap between investors and companies in need of expansion capital. In 2014, several funds raised capital to invest in Latin America, totaling US$ 3.5 billion in the first half alone. From this, approximately 60% is expected to focus on Brazil’s domestic market.

While Brazil remains an attractive market, challenges remain. The country continues to grapple with high interest rates, which constrain the availability of low-cost financing options and increase equity returns required from investors.

As such, although Brazil remains a key area of focus, investors are beginning to pay increasing attention to other Latin America countries including Colombia and Peru, which possess high growth rates coupled with political and economic stability. Many times, these countries are direct competitors for the capital flowing into Latin America.

Finally, as significant amounts of capital have been invested in the region over the last several years, investors in Private Equity funds are beginning to turn their attention towards exits. While trade sales are the most common way out of investments, IPOs are an option for larger companies. Measures from the BM&F Bovespa are currently poised to increase access for smaller companies to the country’s stock markets, which should further increase liquidity options for PE and ultimately attract even more capital to the country.

On the internal governance front, one point of constant debate is the structure of the Investment Committees of FIPs – particularly those that cater to Closed Pension Funds. These committees many times have a final say on investment or divestment activities. In other cases they have veto powers over certain decisions. It is argued that this structure hinders the fiduciary aspects of the role of the investment manager. The existence of these committees is a consequence of past situations in which pension funds suffered severe losses due to governance issues in the investment process. However, as the industry has matured, most players already possess adequate governance processes and, as a consequence, clients are starting to reduce the importance of governance committees.

Another important issue is the fact that many FIPs remain shareholder in listed firms (eg, if an invested company does an IPO and the fund remains invested). In such situations, the FIPs may act either as controlling shareholders or as active minority shareholders. The transition from a contractual relation with invested company to that of a regular public market shareholder is not always easy, and lead to some complex governance and stewardship issues. One example is the impression that directors elected by private equity funds are ‘representatives’ of such funds on the board of directors – as should be expected under certain private shareholders agreements. Once the firm is public, this frame needs to change.
4.3. Closed Pension Funds

4.3.1. Market description

While most of the Latin American private pension industry has been developed after the Chilean pension reform in 1981, the first Brazilian regulations on pension funds were issued in 1977. Since 2001, new Law and regulations have been issued so as to promote the dynamism of the market and incorporate international standards, best practices and innovations.

Brazilian closed private pension entities are non-profit organizations that can be established on a single-employer or multi-employer basis and by labor unions and class associations. The accumulated assets are legally segregated from the sponsoring undertaking and submitted to specific accounting, financing and actuarial regulations. Historically, the industry has grown based on the employment ties in State owned, large multinational companies following the Bismarckian tradition, but soon private enterprises also began to offer benefit plans to its employees.

Since 2003, some innovations have been implemented so as to extend the coverage to other groups, including small and medium enterprises, labor unions, professional associations and civil servants. In that year, discretionary vesting promises were also replaced with a statutory vesting period of three years and the portability of assets between pension plans was improved. The evolution of the Brazilian Closed Pension System may be summarized as follows:

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Pension Funds</strong></td>
<td>118</td>
<td>244</td>
<td>360</td>
<td>324*</td>
</tr>
<tr>
<td><strong>Sponsors</strong></td>
<td>500</td>
<td>1000</td>
<td>2,333</td>
<td>3,008</td>
</tr>
<tr>
<td><strong>Unions, Associations and Class Entities</strong></td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>490</td>
</tr>
<tr>
<td><strong>Participants (millions)</strong></td>
<td>1.18</td>
<td>1.71</td>
<td>1.63</td>
<td>2.4**</td>
</tr>
<tr>
<td><strong>Retirees (millions)</strong></td>
<td>-</td>
<td>0.13</td>
<td>0.38</td>
<td>0.72**</td>
</tr>
<tr>
<td><strong>Investments (billions)</strong></td>
<td>US$ 3.7</td>
<td>US$ 12.1</td>
<td>US$ 66.5</td>
<td>US$ 286***</td>
</tr>
<tr>
<td><strong>%PIB</strong></td>
<td>1.4%</td>
<td>2.3%</td>
<td>13.6%</td>
<td>13.8%%***</td>
</tr>
</tbody>
</table>

* Sep/2013; ** Jun/2013; ***Dec/2013
By the end of 2013 there were 324 pension funds covering 6,724,130 people (active participants, retirees and beneficiaries). Closed entities accounted for 13.8% of GDP, with assets under management totaling approximately US$ 286 billion. Pension funds offer defined benefit plans, defined contribution plans or mixed arrangements, which are DC plans with some ingredients of defined benefit provision like the cash balance plans, floor benefit plans and target benefit plans. Most plans also offer risk benefits such as disability pension, death benefits and so on.

The funds sponsored by labor unions and professional associations, in turn, can only manage Defined Contribution plans. In occupational schemes, the accumulated funds in individual accounts are portable under certain conditions and withdrawals are allowed upon retirement and termination of employment or associative tie.

### Retirement Plans by Type

<table>
<thead>
<tr>
<th>Type of Plan</th>
<th>Plans</th>
<th>%</th>
<th>Investments (%)</th>
<th>Population* (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Defined Benefit</td>
<td>334</td>
<td>30,61%</td>
<td>73,39%</td>
<td>42%</td>
</tr>
<tr>
<td>Defined Contribution</td>
<td>406</td>
<td>37,21%</td>
<td>9,40%</td>
<td>23%</td>
</tr>
<tr>
<td>Variable Contribution</td>
<td>351</td>
<td>32,17%</td>
<td>17,22%</td>
<td>36%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>1,091</strong></td>
<td><strong>100%</strong></td>
<td><strong>100%</strong></td>
<td><strong>100%</strong></td>
</tr>
</tbody>
</table>

Source: PREVIC – Quarterly Statistical – Sep/13; *PREVIC – Activity Report – Dec/12
4.3.2. Regulation

Established in 2009, the National Superintendence of Pension Funds (Previc) is the supervisory agency of Brazilian pension funds. Before that, such responsibility belonged to the National Secretariat of Pension Funds (SPC), which was subordinated to the Social Security Ministry.

The new agency is semi-autonomous, administered by a board, and has its own budget financed mainly through levies paid by the pension funds based on the assets under management. Such levies are to be calculated on a sliding scale, based on the size of the actuarial reserves of each plan. Previc’s organizational structure also comprises an ombudsman and a corregedoria, a department in charge of policing compliance with internal processes, as well as the Complementary Pensions Chamber of Appeals (Camara de Recursos da Previdência Complementar - CRPC). Such bodies are composed by representatives from pension fund entities, plan sponsors, plan participants and the government.

The Board of Directors comprises the superintendent and four other directors, all of which chosen amongst professionals of good reputation and recognized competencies, identified by the Minister of State for Social Security and approved by the President of the Republic. Directors are forbidden from participating in any professional or political activity that would conflict with their responsibilities.

The “formulation of policies” is an attribution of the SPPC (Secretariat of Complementary Pensions Policies) a body subordinated to the Social Security Ministry.

The regulation of the pension system is an attribution of the National Regulatory Board for Complementary Pensions (Conselho Nacional de Previdência Complementar - CNPC). It is chaired by the Social Security Minister and composed by representatives from Previc, SPPC, the Office of the Presidency of the Republic, Planning, Finance and Budget Ministries, pension funds, sponsors, participants and beneficiaries.

In view of the country’s more stable economic environment and declining interest rates, where exposure to greater risks is increasingly crucial for pension funds to reach their profitability goals and obtain higher returns, a distinct – and more dynamic – investment approach from pension entities is vital.

In such context, the Brazilian Monetary Council (Conselho Monetario Nacional - CMN) enacted Resolution n. 3.792/2009, which sets forth a new regulatory framework to govern the investments performed by the foundations, allowing them to invest more aggressively in several asset classes, yet keeping the criteria of transparency, control and supervision. The main asset classes are and their quantitative limits are the following:

(i) Government bonds - 100%;
(ii) Debentures and states and municipalities bonds 80%;
(iii) Variable Income - 70%
(iv) Structured investments - 20%;
(v) Foreign investments - 10%
(vi) Real estate - 8%
(vii) Hedge Funds - 10%
(viii) Infrastructure - 20%
(ix) Loans to participants - 15%
(x) Multi-assets funds - 10%

Brazilian pension funds’ investment portfolio is allocated as follows:

<table>
<thead>
<tr>
<th>Type of Investment</th>
<th>dec/13</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fixed Income</td>
<td>165.076</td>
<td>60.4</td>
</tr>
<tr>
<td>Public Bond</td>
<td>28.786</td>
<td>10.5</td>
</tr>
<tr>
<td>Private Loans and Deposits</td>
<td>11.384</td>
<td>4.2</td>
</tr>
<tr>
<td>SPE</td>
<td>79</td>
<td>0.0</td>
</tr>
<tr>
<td>Fixed Income Fund</td>
<td>124.827</td>
<td>45.7</td>
</tr>
<tr>
<td>Stocks</td>
<td>35.943</td>
<td>13.2</td>
</tr>
<tr>
<td>Variable Income Fund</td>
<td>43.338</td>
<td>15.9</td>
</tr>
<tr>
<td>Structured Investments</td>
<td>8.261</td>
<td>3.0</td>
</tr>
<tr>
<td>Emerging Companies</td>
<td>147</td>
<td>0.1</td>
</tr>
<tr>
<td>Participations</td>
<td>7.178</td>
<td>2.6</td>
</tr>
<tr>
<td>Real Estate Fund</td>
<td>935</td>
<td>0.3</td>
</tr>
<tr>
<td>Investments Abroad</td>
<td>177</td>
<td>0.1</td>
</tr>
<tr>
<td>Stocks</td>
<td>10</td>
<td>0.0</td>
</tr>
<tr>
<td>Foreign Debt</td>
<td>166</td>
<td>0.1</td>
</tr>
<tr>
<td>Real Estate</td>
<td>12.372</td>
<td>4.5</td>
</tr>
<tr>
<td>Operations with Participants</td>
<td>7.380</td>
<td>2.7</td>
</tr>
<tr>
<td>Participant Loan</td>
<td>6.694</td>
<td>2.4</td>
</tr>
<tr>
<td>Real Estate Loan</td>
<td>685</td>
<td>0.3</td>
</tr>
<tr>
<td>Others</td>
<td>748</td>
<td>0.3</td>
</tr>
<tr>
<td>Total</td>
<td>273.294</td>
<td>100</td>
</tr>
</tbody>
</table>

Notes: 1 Includes Short-Term, Referenced, Fixed Income, Multimarket, Exchange and FIDC (Investment Fund in Credit Rights); 2 Includes Stocks and Market Index; 3 Until 2009 consolidated in the group Real Estate

The Brazilian supervisory body (Previc) requires benefit plans to have appropriate valuation models in place either internally or via external service providers. The valuation method must
follow the best practices in the financial market and be based on the fair value of assets, taking also into consideration the pension plan type.

The actuarial valuations shall be based in biometric, demographic, economic and financial assumptions, which must be suitable to the pension plan, its member and beneficiary profile, the economic environment and the applicable legislation, as well as the business activity carried out by the sponsoring employer.

The maximum discount rate set forth by regulation is presently at 5.75% per year (minus inflation), but it shall be gradually reduced until it reaches 4.5% in 2018. The downward movement was necessary to reflect the low interest rate environment in the domestic market.

4.3.3. Self-Regulation

The Brazilian National Association of Pension Funds is a not-for-profit organization, which represents common interests of pension funds. Its organizational structure is composed by local managements, study centers and technical commissions in local and national levels, thus providing a favorable environment to the exchange of experiences and members’ participation.

Abrapp’s mission is to promote the development of Brazilian pension fund market and foster technical excellence. The association maintains a productive and effective dialog with authorities, the most important entities of the Brazilian market, as well as academic institutions.

The market, in turn, recognizes Abrapp as a center of technical excellence and a reference in terms professional development through the courses and seminars it promotes.

4.3.4. Internal governance

The internal governance of closed pension funds varies according to a number of variables. Maybe the most prevalent is the nature of the sponsoring entities – whether state-owned or private.

Pension funds of state-owned companies are regulated according to Complementary Law 108. In addition to regulating the relations between the pension fund and the contributing entity (for example, limiting employer contributions to 100% of the employees’ contributions), it sets the organization chart of the pension entities.

The entities are governed by a Deliberative Council, comprised of up to six members. Half of the members are to be appointed by the employers, and the other half by employees. The chairman of the Council is appointed by the employer, and has the quality vote in case of a tie. In addition, some funds establish in their bylaws that certain officers (such as the Chief Investment Officer) are appointed directly by the employer.
Entities that are sponsored by private sector companies do not have such provisions. They are regulated by Complementary Law 109, and therefore have more freedom in designing their internal governance. This usually leads, however, to even greater influence from the employer in the fund’s governance structure.

4.3.5. Considerations on Stewardship

The level of specialization of stewardship functions is highly dependent on the size and scale of the pension fund. And given the concentration of the industry (the top 3 pension funds represent 44% of the total assets; the top 10 represent 60%), a small number of funds have a substantial structure to monitor invested companies, whereas the large majority lacks such a structure.

The box below highlights the stewardship practices of Previ, the largest pension fund in Brazil (25% of the industry).

**Box: PREVI – The largest closed pension fund in Brazil**

**Participation in General Shareholders’ Meetings**

PREVI does not have a formally established Voting Policy.

We participate in the Shareholders’ Meetings of companies classified as invested companies (in which PREVI has representatives in Boards of Directors, elected with its institutional support, and/or when our share interest surpasses 0.25% of the company’s equity). Voting decisions (by proxy) are issued based on the technical analysis carried out by the employees responsible for the follow-up of investments in these companies.

In the companies in which we have preferred shares, voting rights are exercised as set forth by the law. Voting decisions are prepared based on the company’s best interest and on the principles and recommendations of PREVI Code of Best Corporate Governance Practices, with the support of PREVI Legal Advisory Area.

We do not often participate in the Shareholders’ Meetings of remaining companies, which represent some 5% of the funds invested in variable income.

The results of Shareholders’ Meetings are published, on a quarterly basis, in PREVI site (www.previ.com.br), in Investments/Governance/Shareholders Meetings Results.

**Governance in companies and real-estate projects**

PREVI (the Social Security Fund for Banco do Brasil Employees) promotes best Corporate Governance practices in invested companies and real-estate projects, as well as sustainable and socially responsible initiatives and practices regarding these investments.

The analysis, evaluation and follow-up of investments are based on studies that take environmental, social, and economic data into consideration, as well as on official indicators and applicable laws. Through our teams of analysts, we monitor the level of adherence of invested companies to PREVI Code of Best Corporate Governance Practices. We also encourage these companies to publish sustainability reports to have a transparent communication and make quality information about their economic, social and environmental performance available.

With the wide experience of PREVI in managing its participation in real-estate projects, the fund prepared
PREVI Code of Best Corporate Governance Practices in Real-Estate Projects, based on the balancing of two visions: the project’s and the owner’s. The first one is focused on maximizing value in a sustainable way, and the second one aims to ensure the duly render of accounts and transparency in the management of the project.

PREVI collaborates with the management of companies and real-estate projects in which it invests by recommending candidates to their Boards of Directors and managers to commercial buildings. The invested companies and real-estate projects that adopt PREVI’s corporate governance principles benefit from the generation of value of the assets that are part of PREVI share interest portfolio and from the longevity of such investments.

Total of seats in the governance area of invested companies (on June 2, 2014):

To fill in the 222 seats, we elect 151 members, 78 of which to the Boards of Directors (50 full members and 28 deputies) and 73 to Conselhos Fiscais (37 full members and 36 deputies). It’s important to highlight that the number of members is lower than the total number of seats because some members are replicated in mandates of companies pertaining to the same economic group, as established in the Shareholder Agreement of some companies in which PREVI has share interests.

4.4. State-led Investment Vehicles

4.4.1. Market description

The state is very pervasive in capital allocation in Brazil – and its presence has been growing over the past few years. For example, Government directed credit amount to approximately 50% of total credit in the country. This strong presence is also felt in equity investments.

The sections below will describe the most important vehicles for that presence and, when available, information on their governance activities.

4.4.2. BNDES

The most important state controlled vehicle for equity investments in Brazil is the BNDES – the National Development Bank. Its balance sheet has grown exponentially over the past few years. The bank relies on funding from ‘special accounts’ – subsidized schemes such as the FAT (Fundo de Amparo ao Trabalhador), FNM (Fundo Nacional da Marinha Mercante), PIS/PASEP, and others. In addition, in recent years the Treasury has been advancing significant amounts to BNDES as loans (almost BRL 500 billion), and capitalized the institution via the transfer of stakes in other state-owned firms.
BNDES’s involvement in capital markets is mostly concentrated on its subsidiary BNDESPAR. Its objectives are (1) to participate in certain deals to provide capital to privately owned businesses, in line with BNDES’s policies; (2) to support companies that combine economic, technological and management efficiency with adequate prospective rates of return, under terms and conditions that are compatible with their activities; (3) to support new ventures, which include new technologies; (4) to contribute to the strengthening of the capital markets, by means of securities offers and the democratization of ownership; and (5) to manage a securities portfolio for its own account and for third parties.

As a wholly owned subsidiary of BNDES, BNDESPAR must follow policies determined by its sole shareholder – especially in relation to its investment policy in equities. That policy encompasses the strengthening of the capital structure of Brazilian firms, promotion of best practices in management, corporate governance and sustainability, the development of the Brazilian capital markets and the creation of value for BNDESPAR’s portfolio, reinforcing the bank’s ability to fulfil its institutional role.

BNDESPAR’s equity holdings should be minority stakes, with a temporary character and avoid executive involvement. The actual share of an invested company’s capital held by BNDESPAR varies according to the former’s size, its innovation content and the strategic role of projects that it develops.

When it comes to stakes in private or less liquid public companies, BNDESPAR usually seeks certain contractual rights such as: (1) appointment of member(s) to the board of directors; (2) installation of a Conselho Fiscal; (3) tag along rights under the same terms obtained by the controlling shareholders, as well as veto rights over certain relevant decisions, such as dilutive rights issues that can be detrimental to minority shareholders, corporate reorganizations, issuance of guarantees to third parties, and related party transactions. In addition, the
shareholders’ agreements signed with the controlling shareholders of such companies should include – among other governance rules – a provision that related party transactions should take place under fair conditions (arm’s length).

In invested companies with similar profiles, BNDESPAR has the right to demand that the board of directors include at least one independent director – thus reinforcing its commitment with the implementation of best practices of corporate governance in companies that might do an IPO in the near future.

Description of the Governance Team and Interaction with Investment Officers

BNDES has two areas that are responsible for equity transactions: the Capital Markets Area (AMC) and the Venture Capital Area (ACE). While the former focuses on listed equities, the latter is in charge of all private equity transactions, either directly or indirectly (i.e., via private equity funds).

AMC has an Investment Unit (DEINV), two monitoring units (DEPAC1 and DEPAC2) and one Capital Markets Department (DEMEC). The latter focuses on divestment activities. In addition, it counts on a Legal Unit (JUAMC) and a Control Manager (GECON).

ACE consists of one Investment Unit (DEIN), one Monitoring Unit (DEGEP), one unit to monitor private equity funds, one Legal Unit (JUACE) and one Control Unit (GECON).

It is therefore clear that the unit responsible for searching and undertaking investment opportunities is segregated from those entrusted with monitoring. This ensures those functions as specialized and allows for better focus on each activity (investment, monitoring, and divestment).

Early in the investment process the Investment and Monitoring Units undertake a collaborative effort in order to ensure that lessons learned on the monitoring of similar companies (in relation to industry, size, etc.) are taken into account in the investment decisions. This ensures that expectations are aligned.

Once an investment is made, it shifts from the Investment to the Monitoring Unit. In this phase, we undertake a number of meetings so that information is adequately transmitted. Flags identified in the investment phase are thus brought to the attention of those entrusted with monitoring.

Monitoring activities, in turn, focuses on the adherence to the strategy chosen by the company upon the investment analysis. It also focuses on whether the goals of that particular investment are being met and the execution of the business plan submitted to BNDES. It also emphasizes improvements in corporate governance practices – including environmental and social issues, with the goal of generating shareholder value. At the same time, monitoring activities aim at creating divestment opportunities. Examples include the organization of meetings and exploration of business opportunities among portfolio companies.
To achieve this, the monitoring team invests time in building relationships with company executives. It also exercises rights pursuant to the law and shareholders’ agreements, and attends shareholder meetings. It is important to mention that BNDES appoints members to the board of directors and to Conselhos Fiscais in invested companies. The goal of such appointments is to contribute in defining strategy and implementing best practices.

The team also follows the quarterly reports produced by invested companies.

DEIN and DEGEP teams comprise 11 and 16 professionals respectively. DEINV is composed of 10 members, while DEPAC1 and DEPAC 2 house 13 and 10 employees respectively. JUAMC has 14 lawyers to support these teams, and GECON has 8 employees.

BNDESPAR currently appoints 76 directors in 72 portfolio companies.

### 4.4.3. FI-FGTS

The FGTS (Fundo de Garantia por Tempo de Serviço) was created in 1966. It is a fund financed by contributions from firms and employees, and its goal is to provide support to workers in times of need (unemployment, disease, etc.). It therefore funds the national unemployment insurance scheme, in addition to other programs.

In 2007, a new law authorized the FGTS to invest part of its proceeds in an investment fund managed by state-owned Caixa Economica, that would invest in shares of companies active in infrastructure projects. Its investment policy has a number of guidelines, including:

- Investable industries: roads, ports, waterways, airports, railways, energy and sewage.
- Industry concentration: 40% of NAV
- Maximum Individual company exposure: 20% of NAV
- Minimum equity commitment from owners as a share of total capitalization of invested company: 10%

The fund may acquire stakes in companies up to the amount of BRL 40 billion. From that amount, BRL 29 billion have been paid-up by the FGTS, and BRL 25 billion actually invested in equity and debt instruments. The fund’s portfolio currently comprises 41 companies or projects, and 49 different securities (22 equity, 20 debentures, 2 structured funds and 2 private equity funds).

There is no record of stewardship activities performed by the FI-FGTS.

### 4.4.4. Other vehicles

Brazil has other state-led vehicles that invest in equities. Among those, one can mention the Fundo Soberano do Brasil (FSB – Brazilian Sovereign Fund) and regional development banks.
such as the Banco do Nordeste do Brasil (BNB) and Banco de Desenvolvimento da Amazônia (BASA).

The FSB was created in 2008 with the formal objectives of promoting investments in Brazil and overseas, generating public savings, mitigating the effects of economic cycles and fostering strategic development projects at home and overseas. It is therefore significantly different from the usual concepts of sovereign funds, which aim at absorbing excess foreign inflows, usually as a result of natural resource windfalls.

The FSB was capitalized with the transfer of minority stakes in some state-owned firms. Over the past few years, the lack of public savings in Brazil meant that the fund was used to cover certain budget shortfalls.

The FSB is managed by a Council, composed by the Finance Minister, the Planning Minister and the head of the Central Bank.

The FSB does not have a proper voting policy for its equity holdings. However, as local assets are administered by BB DTVM – the asset management arm of state-owned Banco do Brasil – that entity’s voting guidelines apply to the FSB. As all current holdings are stakes in companies controlled by the Federal Government, BB DTVM’s policy indicates that the FSB is many times conflicted to participate in shareholders’ meetings of invested companies – thus abstaining from voting. But the decision is made on a case by case basis.

Other investment vehicles include regional development funds (FINOR/FINAM). They invest in smaller – many times unsustainable companies. The FINOR financial statements, for example, show a securities portfolio of BRL 17 billion – almost fully written off. There are no stewardship activities in such vehicles.

### 4.4.5. Trends and Challenges

Given the scale of government interference in capital allocation, stewardship policies of state-led investment vehicles are very important for the general corporate governance practices in Brazil. With the exception of the BNDES, there are no significant stewardship practices in many of these vehicles.

As far as the BNDES is concerned, nominal policy suggests a preoccupation with corporate governance practices. The bank has listed the following items as its main focus in stewardship activities:

- Composition of management and potential conflicts when shareholders are officers
- Alignment between controlling and minority shareholders, and between management and shareholders.
- Succession plans; segregation between business and family matters
- Strengthen the board of directors as the place to undertake strategic discussions
- More transparency of management compensation and financial statements
- Clear policy for related party transactions
Increase attendance at shareholders’ meetings

However, reality sometimes diverge from those stated aims. The bank currently stands accused by the CVM of interfering in the election of minority representatives to the boards of listed state owned companies. Decision is still pending.

4.5. Insurance Companies

4.5.1. Market description

The Brazilian insurance industry is fairly large – but still below what could be expected given the size of the Brazilian economy. Insurance premia amounted to USD 75 billion in 2012\(^5\). The Brazilian penetration (premiums/GDP) is 2.9%, which compares to the OECD average of 8.7%\(^6\).

The main product lines in the Brazilian insurance industry are general insurance (33% of total premia), health, life, open pensions and ‘capitalization’\(^7\).

4.5.2. Regulation

The insurance industry in Brazil is highly regulated. The current framework\(^8\) dates back from 1966, when the CNSP – National Council on Private Insurance and SUSEP – Superintendence of Private Insurance – were created. The CNSP is composed by representatives from the Ministry of Finance, of Justice, of Social Security and members from the Central Bank, the CVM and the SUSEP. It is therefore the rule-making body that governs the industry. SUSEP, in turn, is the regulatory agency that implements such rules.

The agency inherited certain regulatory activities until then exercised by IRB (The Brazilian Reinsurance Institute) – the state-owned reinsurance monopolist that exists until this date.

In 1985 the market was partially liberalized. SUSEP allowed the creation of new insurance products, more freedom in the investment of technical reserves and eliminated certain bureaucratic rules that stymied competition.

With the enactment of the 1998 Constitution, after the return of democracy, insurance companies started to be seen as institutional investors – and thus part of the national financial system. In 1996 the law allowed the entry of foreign insurance companies in the country, and broke the legal monopoly of IRB in reinsurance, thus allowing competition in that segment as well.

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\(^5\) Source: CNSeg
\(^6\) Source: OECD StatExtracts
\(^7\) This is a savings-cum-lottery product
4.5.3. Self-Regulation
The insurance industry has developed a system of entities under the umbrella of CNSeg – the National Confederation of Insurance. Its members’ organizations are the respective federations of the main insurance lines (General, Open Pensions, Health and Capitalization). The CNSeg system issues rules on a number of activities, such as portability of policies among firms, brokerage, etc.

There is no self-regulation related to the investment activities of insurance firms.

4.5.4. Internal governance
The investment of Technical Reserves held by insurance companies is regulated by the CNSP Resolution 226/2010. The resolution imposes certain restrictions on investment activities, such as limitation on the use of derivatives and on the acquisition of assets abroad.

In contrast with the regulation of closed pension funds, the resolution does not establish minimum or maximum allocations per asset class. However, the legal structure of the industry determines a very high risk aversion. The weighted average allocation of insurance companies to equities is a meager 14%. And that number is highly skewed by a handful of large firms that are heavily weighted towards equities. If we exclude Bradesco (78% equities), Itau (50%) and Sul America (54%), the average exposure to equities drops to 5%\(^9\).

4.5.5. Considerations on Stewardship
In light of the low exposure to equities, insurance companies rarely attend shareholders’ meetings of listed companies. The above mentioned outliers are exceptions here again. All of them are linked to broader financial groups. Therefore, their stewardship policies follow those of the asset managers that are part of the same group.

4.5.6. Trends and Challenges
From the point of view of their impact on capital markets, insurance companies stand out for their low exposure to equity instruments and consequently, on the stewardship process of invested companies. Given the long-term nature of these firms’ liabilities, this is a surprising finding.

It seems important to determine the reasons for this excessive conservatism and underdevelopment of governance practices.

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\(^9\) Source: SUSEP
4.6. Foreign Investment Vehicles

4.6.1. Market description
The inflow of foreign capital to Brazil has been increasing over the last two decades with growth in capital markets investment and foreign direct investments. For the purpose of this paper, this section will focus on the development of capital markets, the main foreign investment vehicles and the challenges faced by international institutional investors in Brazil. The Brazilian capital market became open to international investors since the early 1990s with the beginning of equity market liberalization. In 1991 foreign investment laws were changed allowing foreign institutions to own up to 49% of voting and 100% of non-voting stock in Brazilian companies, and international institutional investors were allowed to administer portfolios of Brazilian securities. However the real boom in capital market investment from foreign institutional investors only started in the early 2000s. In particular the resolution 2.689 from the CMN (National Monetary Council) passed in 2000 made it available for international investors (institutions and individuals) to hold any asset class available to domestic investors in Brazil.

Currently, about 40% of all direct stock investments are made by international investors, who also account for about 25% of the investments in the listed derivatives market. With regards to initial public offerings (IPO’s), international investors account for 60% to 70% of the total distributed locally. However, a significant proportion of foreign investors invest in Brazil indirectly, via instruments such as depository receipts (DRs), or ‘synthetic’ securities representing Brazilian securities, exchange traded funds (ETFs) or indices.

Foreign institutional investors in Brazil typically have the choice between direct investment on the BM&FBOVESPA in equity and fixed income, or indirectly via the offshore investment route into ETFs, ADRs and GDRs, which remains the easiest option to get exposure to the Brazilian market. With regards to foreign private equity investments, please refer to chapter 4.2 of this document. Whilst the last 20 years have seen significant growth in foreign institutional investment, with a peak in 2008/2009, the last few years have shown a much more sober interest in the market. Fears and concerns over government interventionism and influence have reduced the flows of capital from institutional investors who are worried about the ownership of their assets. However, the other interesting development in recent years has been the increased shareholder activism by those very foreign institutional investors, sometimes in partnerships with local investors, to address these governance shortcomings.

4.6.2. Regulation
Foreign capital in Brazil, in its broader definition, is governed by Law 4.131 (the Foreign Capital Law) of September 1962 and Law 4.390 of 29 August 1964, which were put into effect by decree 55.762 of 17 February 1965 and its subsequent amendments. Non-resident investors have to fill out the form attached to the CMN resolution 2689 and make the required
registration with the CVM. Bonds and securities belonging to foreign investors must be kept in custody by entities authorized by the CVM or the BACEN. In some cases, it can also be with entities registered with the SELIC or in the registration and financial system managed by CETIP. Resolution 2689 (also see CVM INSTRUCTION 325 of January 27, 2000), requires international investors to hire local institutions to act as their:

- **Legal representative** responsible for presenting all investor registration information to the Brazilian Authorities. When the representative is an individual or non-financial corporation, the investor must indicate a financial institution duly authorized by the Central Bank that will be jointly responsible for the representative’s obligations.

- **Fiscal representative** responsible for taxes and fiscal issues on behalf of the investor before the Brazilian authorities.

- **Custodian** responsible to hold updated reports and control all the assets of the international investor in segregated accounts, and able to provide this information at any required time, to the authorities and to the investor. The custodian can also be the tax and legal representative.

### 4.6.3. Self -Regulation

Besides the rules of BM&FBOVESPA applicable to local and international investors, there isn’t any organization formally representing international investors per se. However, AMEC, the Brazilian Association of Capital Markets Investors gathers 63 foreign and domestic institutional investors responsible for managing investments of approximately BRL 500 billion in the Brazilian stock market. Its core mission is to defend the rights of minority shareholders of Brazilian publicly held companies by promoting good corporate governance practices and creating value to companies.

### 4.6.4. Internal governance

Foreign institutional investors are primarily governed by their home market laws and regulations. However, as explained in previous sections, the Brazilian financial and capital markets are strongly regulated by the BACEN and the CVM, which will govern foreign investors’ exposure to the Brazilian market.

### 4.6.5. Considerations on Stewardship

The ever-growing interest in governance and stewardship activities from international investors has followed an increased state of concern by those very investors about the levels of governance in Brazil and in particular state intervention. With highly criticized government
influence at companies such as Eletrobrás and Petrobras, there is growing discontent about the current economy structure and many investors are now looking at other Latin American countries to get an exposure to the continent. Mexico, Peru and Colombia are the prime recipients of those redirected flows.

The last decade has seen the development – or return in some cases – of a strong state-ownership and the interference of politics in business. This model has certain clear downsides. State-owned companies represent close to 40% of companies in Brazil. Even following the wave of privatization in the 1990s, the Brazilian government remains an important shareholder in many Brazilian companies via pension funds and retains a strong influence over the entire market regardless of its actual participation in the share capital of companies. The effect on the stock market perceptions has generally been negative with, in aggregate, Brazilian companies trading at a 20% discount equivalent to their peers in the rest of the BRICs, reflect investors’ caution with regards to the state’s weight in the economy.

The creation of the Novo Mercado on the BM&FBovespa in 2000 created a new voluntary listing segment requiring stricter corporate governance rules than the ones provided under Brazilian law. Despite the benefits of this approach, it also allowed for a dual regulatory system to happen, allowing old established and powerful companies to continue with the old rules while pushing others to adhere to a more stringent system. Another significant problem facing minority shareholders is the fact that the current Brazilian corporate law allows companies to issue shares with no or comparatively reduced voting rights and no tag-along rights. In terms of legislation, the powers of the CVM are very limited with regards to minority rights violation. The only avenue for contestation is through the legal system, which is costly, cumbersome and slow.

International investors are however waking up to this challenge and becoming more and more vocal about these issues. Widespread family ownership with preference shares, insufficient regulation and the strong influence of the State in the Brazilian economy, remain key risks for foreign institutional shareholders in Brazil.

### 4.6.6. Trends and Challenges

**Growing international activism**

Minority shareholders at Petrobras won a significant battle at the 2014 AGM. On 2nd of April 2014, the slate put forward by international minority shareholders won by an overwhelming margin marking a watershed change in the company’s governance, being the first time that minority holders of both ordinary and preference shares will be represented on the board of Petrobras by truly independent directors.

The risk of misappropriation of value in companies controlled by block shareholders – may they be founding families, individuals or Government – remains a major fear for international minority investors. Indeed, political interference with Petrobras has led to a significant loss of
shareholder value, and with it, further erosion of foreign institutional investors’ trust and confidence in the market.

Whilst these developments are unlikely to put an end to the Brazilian Government’s interference with Petrobras, for now at least, it is a step in the right direction. Another interesting aspect of shareholder activism in Brazil has been the growth of coordinated engagement programs by Brazilian investors (albeit in their very infancy) but most notably, the last two years have seen growing collaboration between local and foreign investors.

Investors have become more active and organized, reiterating their concerns with companies pre- and post-AGM via letters to the board and the regulator. Organizations such as the GIGN have also helped spread the message about shareholder initiatives in Brazil internationally and garner further support with a broader group of investor.

**Some positive improvements in minority shareholder rights**

The 2013 proxy season marked a milestone in the disclosure of minority shareholders’ board and fiscal council representatives at the company. In 2014, the re-election of an independent director to the seat representing minority shareholders and the appointment of another independent director representative for preferred minority shareholder are unprecedented moves. The recommendations provided in the Oficio Circular 2014 of the CVM from on the nomination of directors were also a significant move forward.

**Encouraging regulatory changes but many challenges lie ahead**

The Dilma Rousseff government II will face significant challenges with regards to attracting foreign institutional investors who became disillusioned by her first mandate. As international investors are starting to differentiate between emerging markets and are paying attention to other Latin American markets, Brazil has been losing out to Mexico (the region new favored economy) as well Peru and Colombia. Brazil’s relatively closed economy but particularly the high level of government intervention as well as the red tape and overly burdensome regulation have made the country more and more unattractive and risky for international investors. This increasing demand for better governance and respect for shareholder rights has also been accompanied by improvements on the regulatory side. Law 11.431/11 made positive amendments to the Brazilian Corporation Act, particularly with regards to the possibility of remote participation in shareholders’ meetings.

The most notable development in terms of regulation is the recent proposed amendments to the CVM ruling 481/09 regarding the participation of shareholders in annual general meetings. On the 20 October 2014, the CVM opened for public consultation its proposed amendments to its ruling regulating the participation and voting processes at publicly listed companies.
The main objective of the proposal is to facilitate the participation of shareholders in annual general meetings, as well as the processes around shareholder proposals, in order to improve the corporate governance structure of the Brazilian market.

The draft proposes a new voting system. For this very reason the CVM adopted the more cautious approach to limit its application to those assemblies that are more predictable and regular, both with respect to its occurrence and in relation to the agenda items. Once these new mechanisms are tested and improved as appropriate, the CVM will be in a better position to consider extending the use of remote voting to companies’ extraordinary general meetings.

Furthermore, the draft provides for the inclusion of candidates’ name and shareholders’ proposals on the ballot. While this is common practice in other jurisdictions, the lack of disclosure of such items on the agenda and proxy cards has been a highly contentious issue in Brazil. Therefore improving current practice in this regard is likely to greatly increase effective shareholders’ participation, particularly with regards to foreign investors.

4.7. Investment vehicles targeting smaller companies

4.7.1. Market description

During 2014, CVM has established new regulation and amended existing regulation to create funds dedicated to invest in SMEs. Those initiatives were part of a larger program to create incentives to develop a public market for SMEs in Brazil.

This market is still incipient. Currently, BMF BOVESPA’s Access Market, Bovespa Mais, has 9 companies listed and the average size of a public offering is over USD 500 million, limiting the participation of SMEs that cannot use the capital markets as a financing alternative.

In order to understand the causes of this limitation and to propose measures to develop the access market in Brazil, a working group composed by ABDI (Brazilian Agency for Industrial Development), BNDES (Brazilian Social and Economic Development Bank), BMF BOVESPA, CVM, and FINEP (Brazilian Agency for Innovation) led an SME Initiative, including a fact finding mission to 7 countries with Access Markets considered relevant or having an important participation of SMEs in the capital markets. A broad discussion with Brazilian market participants and the proposal of some regulatory, fiscal and market structure measures to create an environment favorable to the SMEs were conducted by the group10.

One of the main conclusions of the group was that in order to develop an SME market it was essential to create a solid demand for this type of asset-class, which normally involves a long-term perspective of returns, a higher appetite for risk and patience with a low liquidity asset. Moreover, specialization of players, either in the structuring and distribution of operations and in the buy-side is considered very important.

4.7.2. Regulation

As part of the proposals presented the SME Initiative, the CVM has created three types of funds dedicated to invest in SMEs, two of them, denominated “Access Market Fund”:

1) “Access Market Fund” structured as an Open End Fund – follows the basic rules set forth by Instruction 409, the Provisional Measure 651/2014, yet to be converted into Law, establishes that any investment fund investing 67% of its assets in Eligible Companies has an exemption of Income Tax for its shareholders. The fund has to be named “Access Market Fund” and have a 180 days redemption policy. Moreover, there is a concentration limit, requiring the fund to have at least 10 shareholders, none holding more than 10% of the fund interest.

2) “Access Market Fund” structured as a Closed End Fund – regulated by CVM Instruction 549/2014, establishes a fund that has to invest at least 67% of its assets in companies listed in the Access Market. Moreover, it can invest up to 33% in private companies, under the same conditions of the Participation Fund (Private Equity/Venture Capital structures), i.e., as long as the companies have some minimal standards of corporate governance and the fund has established a governance that allows it to directly influence the strategy and management of the company. The Instruction establishes the details. The manager of the Fund is authorized to charge a performance fee and to repurchase the quotas of the funds, under certain circumstances.

3) Participation Funds – they are commonly used for Private Equity and Venture Capital investments. They are regulated by CVM Instruction 391 that was altered by CVM Instruction 540/2014, in the context of the SME Initiative. The main change was to allow those funds to invest up to 35% of its assets in public companies listed on Access Market with no obligation to have direct influence in the company’s strategy and management.

It is important to stress that although the funds have to be named “Access Market Funds” or have limits to allocate in Access Market there is a difference in the companies they will target. The Closed end fund and the Participation Fund have an obligation or limit to invest in companies listed in the Access Market, such as BM&FBOVESPA’s Bovespa Mais.

However, to be able to have the exemption of the Income Tax, the mutual fund “Access Market Fund”, structured as an Open End Fund has to invest in Eligible Companies, as set forth
by the Provisional Measure 651. An Eligible Company is defined as a company that follows certain corporate governance rules, compatible with both Novo Mercado and Bovespa Mais listing segment) and has a certain size in terms of market capitalization (R$ 700 million) and gross revenue (R$ 500 million). Moreover, 67% of its public offering has to be primary, meaning that most of the proceeds will be destined to the company and not a secondary sale of its original shareholders.

4.7.3. Self-Regulation
The funds dedicated to SME companies listed in Access Markets, such as Bovespa Mais, follow the same structures of Self-Regulation, since they are special classes of the same general regulation of mutual funds, closed-end funds and participation funds.

4.7.4. Internal governance
No difference from other funds of the same type.

4.7.5. Considerations on Stewardship
Although there should be no difference from other funds of the same type, it is interesting to notice that the new regulation aimed at creating some hybrid funds enables to invest in private companies and follow them in their first years as public companies. In this sense, managers of such funds, should be a mix of a Private Equity and Mutual Fund manager, being responsible to oversee the preparation of the company in terms of governance, controls, etc, while they are private, even having a direct influence in the management of the company. On the other hand, as the company listed in the Exchange, her/his role will be similar to managers of mutual funds.

4.7.6. Trends and Challenges
Since the regulation for this type of fund has just been established it is yet to be seen how they will evolve in the future. The current challenge is to create a critical mass of such funds able to generate demand to invest in the SMEs. So far, two asset managers announced plans to set up “Access Market” Funds.
5. **Sustainable Investing**

From an investor’s perspective, sustainable investing can be defined as an investment approach that integrates long-term environmental, social, and governance (ESG) criteria into investment and ownership decision-making with the objective of generating superior risk-adjusted financial returns. These extra-financial criteria are used alongside traditional financial criteria.

The focus on superior risk-adjusted financial returns distinguishes sustainable investing from similar-sounding approaches such as “impact investing” or “ethical investing”, in which lower financial returns may be accepted as a trade-off for meeting social or environmental goals.

Below, an overview of some key investment approaches that have been compiled by Kerste et al, 2011.

**Sustainable investing**: Investment approach that integrates long-term environmental, social, and governance (ESG) criteria into investment and ownership decision-making with the objective of generating superior risk-adjusted financial returns. These extra-financial criteria are used alongside traditional financial criteria such as cash flow and price-to-earnings ratios.

**Responsible investing**: Investment approach that integrates consideration of environmental, social and governance (ESG) issues into investment decision-making and ownership practices, and thereby improving long-term returns to beneficiaries. This definition is derived from the UN-backed Principles for Responsible Investment. Please note that the terms “sustainable investing” and “responsible investing” can be used as synonyms.

**Ethical investing**: An investment philosophy guided by moral values, ethical codes or religious beliefs. Investment decisions include non-economic criteria. This practice has traditionally been associated with negative screening.

**Impact investing**: Investment approach that aims to proactively create positive social and environmental impact against an acceptable risk-adjusted financial return. This requires the management of social and environmental performance (in addition to financial risk and return). With impact investing, “impact” comes first, whereas with sustainable investing, “financial returns” come first.

**SRI** (“Socially Responsible Investment”, or “Sustainable and Responsible Investment”): Generic term covering ethical investments, responsible investments, sustainable investments, and any other investment process that combines investors’ financial objectives with their concerns about environmental, social and governance (ESG) issues.
5.1.1. Market description

In Brazil, among the ANBIMA Funds categories there is the Sustainability – Governance Shares, which represent a small part of the total AUM, either compared with the total of the categories, or with the total of the mutual funds investing in public shares:

<table>
<thead>
<tr>
<th>AUM (BRL billion)</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>2014*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td>590.77</td>
<td>720.15</td>
<td>914.21</td>
<td>1,123.14</td>
<td>1,102.26</td>
<td>1,352.51</td>
<td>1,642.41</td>
<td>1,834.57</td>
<td>2,204.72</td>
<td>2,495.97</td>
<td>2,605.37</td>
</tr>
<tr>
<td>Shares</td>
<td>50.02</td>
<td>61.48</td>
<td>75.72</td>
<td>114.68</td>
<td>119.02</td>
<td>191.39</td>
<td>183.98</td>
<td>206.14</td>
<td>259.35</td>
<td>198.11</td>
<td></td>
</tr>
<tr>
<td>Shares - Governance - Sustainability</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>1.03</td>
<td>1.96</td>
<td>1.34</td>
<td>1.28</td>
<td>1.75</td>
<td>1.58</td>
<td>1.28</td>
<td></td>
</tr>
<tr>
<td>% Governance - Sustainability / Total Shares</td>
<td>0.00%</td>
<td>0.00%</td>
<td>0.00%</td>
<td>0.09%</td>
<td>0.12%</td>
<td>0.11%</td>
<td>0.07%</td>
<td>0.05%</td>
<td>0.07%</td>
<td>0.05%</td>
<td></td>
</tr>
<tr>
<td>% Sustainability - Governance / Total Funds</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.5%</td>
<td>1.0%</td>
<td>1.0%</td>
<td>0.7%</td>
<td>0.8%</td>
<td>0.6%</td>
<td></td>
</tr>
</tbody>
</table>

(* Sep/2014)

Source: Anbima

5.1.2. Considerations on Stewardship

Public Equity

Sustainability/Governance Funds have either to follow accepted market benchmarks or to be supervised by boards not subordinated to the fund managers. See Boxes on “Santander Asset Management - the Ethical Fund”, and “Itaú Asset Management (IAM) and SRI”.

The most accepted market benchmark for SRI investing in Brazil is the Corporate Sustainability Index of BM&FBovespa (ISE), launched in 2005 and the fourth initiative of its kind in the world. One of the several questionnaires of the Index is the Corporate Governance one, developed and updated on a yearly basis by the Brazilian Institute of Corporate Governance (IBGC).

The screening processes that demand boards are usually based on questionnaires that include key corporate governance questions.

Private Equity

Most of the private investments are made using the Brazilian Equity Investment Funds (FIPs), which demand the closely-held corporations to comply with the corporate governance practices listed in Section 4.2.

Market driven initiatives and benchmarks
In Brazil, initiatives like the United Nations Principles for Responsible Investment (UN PRI) [www.unpri.org](http://www.unpri.org), the UNEP FI Principles for Sustainable Insurance (UNEP FI PSI) [www.unepfi.org/psi/](http://www.unepfi.org/psi/) and the Corporate Sustainability Index (ISE – BM&FBOVESPA) [http://isebvmf.com.br](http://isebvmf.com.br), incorporate ESG issues into both investors decisions and companies management, which means good corporate governance practices have to be taken into consideration.

### 5.1.3. Trends and challenges

The Brazilian SRI funds are a very small niche in the stock mutual fund universe of the country. However, one cannot say that independent asset managers do not include SRI screening in their stock selection criteria.

The use of SRI screening by the most prominent independent asset managers is a potential topic for future research (PINTO, LEMME and LEAL, 2014) and represents an interesting potential for the development of SRI investments in Brazil, especially the ones related to institutional investors, like the Closed Pension Funds (4.3). One of the main reasons is that the largest pension funds are UN PRI signatories and are subject to the annual reporting and assessment process. From the 2013/14 reporting cycle, signatories will be required to report via an online tool and disclose a subset of these indicators on the PRI website. This increase in the transparency of the signatories is expected to be a major driver for the adoption of better environmental, social and governance good practices by investors and companies.
Box: Santander Asset Management – the Ethical Fund

Santander Brazil Asset Management’s investment philosophy is based on the fundamental belief that superior financial performance in the long run is achieved by companies that operate under a triple bottom line approach. This means that companies canalize their strategies to maximize their environmental, social and governance performance (ESG).

Since 2001, Santander Brazil Asset Management applies its own methodology, in line with traditional analysis, for consistent evaluation of ESG criteria companies. Our methodology was developed internally and in partnership with specialized entities. To evaluate each company we apply a standard questionnaire that includes six dimensions:

i) products’ nature
ii) management and transparency
iii) governance
iv) environment
v) stakeholder engagement and
vi) risk management.

The analysis is carried out by dedicated staff, which applies a score based on predefined criteria, according to companies’ public information. This procedure allows us to identify companies that are outstanding in relation to sustainability strategy, and to traditional financial analysis, balancing short and long term.

Our SRI best in class approach combined with essential criteria drives the companies to continuous improvement of its processes and products, aiming effective contribution to sustainable development. Companies are reassessed every two years. However, before this period, the analysis may be reviewed if necessary. And for continuous update on all relevant facts, our team relies on public information tools and support in the areas of Sustainable Development and Environmental Risk of Banco Santander, as well as the Advisory Board of Ethical Fund.

The Advisory Board of Ethical Fund is an independent body that validates the analysis and has veto power. It consists of six permanent members: four independent specialists in the social, environmental, and governance with proven experience in the capital market and business; and two internal members represented by the Office of Sustainable Development.
Box: Itaú Asset Management (IAM) and SRI

As managers of our clients’ assets, we have the duty to base our investments on a comprehensive understanding of all risks and opportunities that result from our decisions. We consider ESG (Environmental, Social and Corporate Governance) issues to the extent that they can materially affect the value of assets where we invest. IAM was the first large investment manager in Brazil to become a PRI (Principles for Responsible Investment) signatory, in 2008. Since then, it has worked to promote these principles in the Brazilian market.

IAM was experienced in Responsible Investment prior to joining the PRI and in 2004 launched the Itaú Excelência Social Ações Fundo de Investimento – FIES (Itaú Social Excellence Stocks Fund), marking the beginning of its ESG integration journey. At its launch, FIES conducted sector-based negative screening and norms-based exclusion for specific stocks. This approach evolved over time to turn FIES into an incubator for ESG integration techniques developed by IAM. Since 2010, FIES has applied the ESG integration model to the remaining investment universe after the screening process.

IAM has a SRI statement which focuses on mainstream investment and ownership activities. We consider ESG issues to the extent that they can materially affect the value of our investments, thus helping us deliver better risk-adjusted returns to our customers. Our overall approach to ESG integration in listed equities is described in the White Paper: ESG Integration into Fundamental Equity Valuation.11

IAM’s approach, initiated in 2010, embeds ESG into the equity research process and integrates it into DCF models. We have a dedicated internal SRI/ESG analyst, who works along our equity analysts and portfolio managers - active strategies to model ESG impacts in target prices. The research is used by Portfolio Managers according to their specific strategies / mandates. The ESG Integration Method of IAM incorporates these variables into our fundamental equity valuation model, by analyzing ESG impacts on cash flow and the cost of capital.

Our proxy voting policy12 formally establishes the consideration of best ESG practices when voting. In order to achieve this, the SRI/ESG analyst monitors all AGMs in order to influence PM voting on such matters.

Responsibility for implementation rests with the dedicated SRI/ESG analyst and a specialist PM serving as focal points. The SRI/ESG analyst conducts industry and stock research together with research analysts. This research is distributed to all analysts and PMs at IAM.

The SRI/ESG analyst works along the Brazilian Equities analysts whenever an investment case is presented. At this point, ESG issues, identified and modeled, are incorporated into the DCF. The SRI/ESG analyst and specialist PM also conduct specific company visits (individual engagements) to explore issues and gather insights on their approach. Specifically regarding corporate governance analysis and standards, IAM monitors companies’ governance level and practices according to BM&FBOVESPA corporate governance standards.

To date, our ESG method has covered 100% of companies listed on the IBOVESPA and on the ISE index (BOVESPA Corporate Sustainability Index). In 2014, 20 companies have been visited by the ESG/SRI analyst and the specialist PM to present the ESG valuation models and receive feedback on the analysis (individual engagements).

IAM flagship ESG fund is the FIES (Itaú Social Excellence Fund). Managed by the ESG specialist PM, the FIES fund is a long only equity fund with a high degree of ESG integration. It is worth mentioning that the fund has an external ESG committee with the power to exclude companies/industries from the fund’s investable universe.


6.1. Entities

The sophistication of the Brazilian capital markets can be seen on the number of entities that have been created to discuss and foster its development. Here is a sample of the main ones:

**ABRAPP (Brazilian Pension Fund Association)**
The Brazilian National Association of Pension Funds is a not-for-profit organization, which represents common interests of pension funds. Its organizational structure is composed by local managements, study centers and technical commissions in local and national levels, thus providing a favorable environment to the exchange of experiences and members’ participation. Abrapp’s mission is to promote the development of Brazilian pension fund market and to foster technical excellence. The association maintains a productive and effective dialog with authorities, the most important entities of the Brazilian market, as well as academic institutions.

**ABRASCA (Brazilian Association of Publicly Held Companies)**
Abrasca - Brazilian Association of Publicly-Held Companies, a non-profit civil association, was created on December 21, 1971, with the mission to represent and develop mechanisms to defend the interests of publicly-held companies. The entity is the sum of efforts targeted at research, study and debate for sector expansion and national economic growth. In addition to establishing a forum to improve dedicated services to shareholders and the follow-up of legal structuring and operation reforms of companies.

**ABVCAP (Brazilian Private Equity and Venture Capital Association)**
Founded in 2000, ABVCAP is a non-profit organization that represents the private equity and venture capital industry and promotes the development of long-term investments. In its 13 years of existence, ABVCAP has helped to improve industry conditions, advance understanding about the industry and promote best practices that are aligned with international industry standards.

**AMEC (Association of Capital Market Investors)**
AMEC was created on October 26th 2006 by a group of institutional investors – both independent and linked to financial groups. Its main goals are the protection of minority shareholders’ rights, and development of Brazilian stock markets. To achieve such goals, AMEC provides debates and discussions among its members, following strict internal protocol, including the management of potential conflicts of interest. The matters are discussed by the Technical Commission, and then submitted to the Executive Board and finally to the Board of Directors. Over its 6 years of operation, AMEC has become the most important forum for institutional investors in Brazil on matters related to corporate governance practices and shareholders’ rights. As such, it fits recommendations issued around the world, such as those in the Kay Report (UK). AMEC’s opinions have achieved recognition among investors, companies and regulators for its content and independence. Today membership is comprised
of 64 institutional investors—both local and foreign—with an AUM in Brazilian equities of approximately BRL 500 billion.

**ANBIMA (Brazilian Association of Financial and Capital Market Entities)**
The entity has the purpose of representing and defending the interests of the institutions that operate in these markets. The legitimacy of this representation can be attested by the plurality of institutions that make up our more than 300 members of all sizes and from all segments. These institutions include commercial and investment banks, managers, administrators, brokers, distributors and multiple-purpose banks. All these institutions, together, allow the Association to speak on behalf of the Brazilian market and legitimately defend their interests.

In our view, only solid and strong institutions are capable of helping the capital market become an instrument for the financing of Brazil’s economic development. Therefore, the Association brings together efforts to support the development of financial and capital markets, expanding its participation in long-term financing, while seeking to meet the needs of its members and aligning these needs with those of investors and the Brazilian society.

**APIMEC (Association of Capital Market Investment Analysts and Professionals)**
APIMEC NACIONAL was established in June 1988, with the purpose to integrate the Regional APIMECs: São Paulo, Rio de Janeiro, Minas Gerais, Northeast, South and Brasília, comprising about 2,000 members altogether. It is the self-regulator of Brazilian investment analysts and focuses its activities on the certification and supervision of professionals, institutional representation vis-à-vis government and market entities and international interchanges with other analysts’ societies throughout the world. APIMEC promotes bi-annually its national congress and, annually, the APIMEC Awards, which distinguish professionals and companies that have outstood in the categories: analyst, public company, press, investor relations and special. The Regional chapters are engaged in meetings with companies, training, courses, seminars, etc.

APIMEC has the responsibility to set rules related to the implementation of the certification program aimed at the achievement of the CNPI - Certificado Nacional do Profissional de Investimentos (national certification) and the CIIA - Certified International Investment Analyst. While APIMEC was already accredited as the certification entity under the Brazilian Securities Commission, as of October 2010, APIMEC assumed the position of self-regulator by delegation. The focus of APIMEC’s self-regulatory activity will be the guarantee of independence of opinion, transparency in situations of conflict of interest and symmetrical access to information.

It should be noted that APIMEC has already launched its PEC (Continued Education Program), thus ensuring that all accredited analysts are permanently qualified to exercise their function. Since September 2008 the Local Content and the Foundation examinations have been applied online by the Getúlio Vargas Foundation in more than 60 test centres throughout the country.
**BM&FBovespa**

BM&FBovespa is a company that manages the organized securities and derivatives markets, providing registration, clearing and settlement services. It acts as central counterparty, guaranteeing financial liquidity for the trades executed in its environments. The Exchange offers a wide range of products and services such as spot FX, equities and fixed-income securities trading, as well as trading in derivatives contracts based among other things on equities, financial securities, indices, rates, commodities and currencies. It lists companies and other issuers, is a securities depository, has a securities lending service and licenses software. BM&FBovespa has a diversified and integrated trading model offering a complete custody system. Trading takes place in an exclusively electronic environment. The Exchange enables customers to trade equities, to hedge and to execute arbitrage, investment diversification, allocation and the leveraging of positions.

**IBGC (Brazilian Institute of Corporate Governance)**

Founded on November 27, 1995, IBGC - Brazilian Institute for Corporate Governance – is the main reference in Brazil for the development of the best practices in corporate governance. With over 1,900 members, IBGC promotes talks, academic forums, debates, conferences, training, and networking among professionals, in addition to preparing publications and research work. The Institute is headquartered in São Paulo and operates regionally through four Chapters: Minas Gerais, Paraná, Rio de Janeiro, and Rio Grande do Sul. Its activities aim to disseminate the corporate governance concept and to encourage a better performance of organizations. IBGC is currently regarded as the Center of Excellence in Corporate Governance for Latin America, the Caribbean, and Portuguese-speaking Africa, a title awarded by the Global Corporate Governance Forum (GCGF). International events include – until this year – the activities of the Global Reporting Initiative (GRI) in Brazil, a global network aiming to encourage organizations to adopt the best practices. Also in 2012, the Institute helped the World Bank with information on the corporate governance framework in Brazil to update the Report on the Observance of Standards and Codes (ROSC).

This is how the Institute contributes to a sustainable performance and influences agents of society to show greater transparency, fairness, and responsibility.

**IBRI (Brazilian Investor Relations Institute)**

IBRI was founded on June 5, 1997 to enhance the role of Investor Relations professionals in the Brazilian capital markets and contribute to strengthening and improving the IR community.

IBRI’s philosophy of work includes raising the profile of partnerships with entities in the domestic and international markets which have common objectives in the IR area. In this context, IBRI believes that the partnerships which have been established have generated value
for the members as well as contributed to enriching the technical discussions with official bodies – with which IBRI has signed agreements – such as the CVM (Brazilian Securities and Exchange Commission).

6.2. Guidance

The above mentioned entities have produced a number of documents, codes and studies that aim at providing guidance to market players.

However, one document stands above all in terms of corporate governance practices and the role of owners, including institutional investors: the IBGC Code of Best Practices.

The code was originally drafted in 1999, and is now on its fourth edition. In fact, the IBGC is undertaking a review process aiming at the fifth edition as this document was being prepared.

One of the chapters of the code deals specifically with ‘owners’, including the role of institutional investors. However, it is not very detailed when it comes to stewardship.

Brazil does not have a Stewardship Code to this date.
PART III – Analysis and Conclusions
7. Legal Framework for GMSs of Listed Companies

In addition to the strong financial infrastructure described on Section 3, Brazil also counts on a Corporate Law that can be considered quite advanced. Law 6.404 was enacted in 1976 and – in spite of numerous amendments over the years – is considered by market players to be a very good piece of legislation.

This certainly applies to the regulation of shareholders’ meetings. In contrast to other jurisdictions, shareholders have full power to control the corporation. That power cannot be hindered in any stance by the bylaws or the board of directors. In addition - and this is especially interesting for a legal document that is almost 40 years old – the law establishes many things that need to be approved by shareholders, including controversial ones such as the financial statements and management compensation (“say on pay”). One could comfortably say that – at least in theory – Brazil is a true Corporate Democracy.

However, reality sometimes diverges from theory. While law 6.404 has many interesting features in terms of shareholders’ rights, it is also an extremely detailed piece of legislation. As a consequence, all legal acts are surrounded by strong bureaucratic rules. For example, shareholders can be represented by third parties in a shareholders’ meeting. But the power of attorney must have been issued no more than one year prior to the meeting. For diversified, global investors, this many times translates into lost votes. Also, shareholder identification can be quite burdensome, with rules that allow companies to void votes for technicalities such as a lacking stamp on a stack of legal documents that can be required. In contrast with the state of the art financial infrastructure – which in theory could allow for electronic validation of votes – many physical documents may be requested by the company – and will be anytime a shareholder becomes a nuisance.

For shareholders who surmount the hurdles to be present and vote, their powers are significant. Still, market players and legislators agreed that given the prevailing model of companies with a controlling shareholder, additional powers must be guaranteed to minorities so that their votes could become significant. That is particularly true on the election of board members.

As a consequence, Law 10.303 in 2001 included additional means through which minority shareholders could elect members to the board of directors and/or to the Conselho Fiscal. Shareholders representing a very small percentage of capital may request, for example, the multiple voting procedure, through which board seats are filled one by one, proportionally to shareholders present at the meeting. In addition – even when such a system is not requested – shareholders representing 15% of capital - and not related to the controlling shareholder – are entitled to elect a member to the board. Holders of non-voting shares also have a similar right, although with certain restrictions.
In light of such strong shareholder powers, one could easily expect voter turnout to be quite large at GSMs of Brazilian companies. As we shall see on the next section, this is far from the reality on the ground.
8. Current Issues on Engagement

8.1. Historical Absenteeism

We are unaware of previous attempts to gauge the participation of investors at the Annual
General Meetings (AGMs) of listed companies in Brazil. In 2013, Amec attempted such a study
for the very first time.

The first finding of this study is the sheer lack of data. There is no specific legal framework
regarding the record keeping of events surrounding shareholders’ meetings. This is odd –
particularly considering that Brazilian legislation has clear rules that have to do with how
shareholders vote their shares. Examples include Article 117 of the Corporate Law, which
establishes instances in which the shareholders can be held accountable for their vote. It
includes situations such as voting to elect directors that are unsuited to the job, voting for
bylaw changes that damage the company, voting for the approval of financial statements that
are unfit or fraudulent, and so forth.

The first step for these legal definitions to hold is to have a record of who voted how during
the meeting. Most companies do not have that information.

In most cases, the minutes are the only document that can describe what happened in a
shareholders’ meeting. And that document rarely spells out individual votes or remarks –
except when the shareholder makes a separate statement. This is especially true for matters
approved by ‘a majority’ of shareholders present.

Minutes can be kept in summary form, which doesn’t even include the signatures of
shareholders present. The only way to find out who went to a meeting (but not how they
voted) is by inspecting the “list of presence” – a private and highly cryptic document that
companies are not comfortable in sharing publicly.

This reality casts a particular difficulty for analysts trying to understand the trend in
institutional shareholder presence and votes on the AGM of listed Brazilian companies.

Amec’s study therefore started with a broad sample of respondents – the 20 largest
companies represented on the benchmark Ibovespa Index. Only 10 companies responded –
and a tiny 2 companies were able to fully answer all questions posed by Amec’s team.

The idea was to measure shareholders’ participation in the AGMs of 2006, 2009 and 2012 –
thus allowing for a temporal analysis of the voting process.

The first picture that emerges is one of strong absenteeism – and of a very slow process of
reduction. Respondents reported that approximately 26% of (non-controlling) shareholders
were present in the meetings held in 2006. Six years later, that number increased to 33%.
When looking at particular classes of investors, the Picture can by murkier still. The exhibits below illustrate two different companies for which data was available. It shows, for the three meetings studied (2006, 2009 and 2012), the average participation of each class of investor. Here, 100% means that all of the shareholders of that class that owned the stock were present at the meeting.\(^\text{13}\)

Company A below has a typical profile of shareholders present on its AGM. Almost by definition, the entire control group is always present. Individuals, local mutual funds and local pension funds are all present in their low 20%s. Foreign investors, on the other hand, are more than 40% present. And that is on the face of large bureaucratic obstacles surrounding the vote of foreigners in Brazilian companies.

Company D, on the other hand, had a very large participation of local mutual funds – and a much lower one for foreigners. Local individuals and funds were negligible.

\(^\text{13}\) Regardless of its meaning for the shareholder base as a whole. In other words, numbers are not a percentage of voting capital, but rather of the share of that investor class on the shareholder list who attended the meeting.
It is interesting to notice that Company A is widely recognized for having a strong IR department, that engages with shareholders and encourage their participation in AGM. Not by coincidence, participation rates have been increasing – even though the rate has been much less encouraging in the case of local mutual funds.

Company D, on the other hand, has seen participation rates fall for all classes – with the exception of foreign investors.

Some tentative conclusions of this study were:

1. There is an urgent need to improve record keeping surrounding shareholders’ meetings.

2. Despite regulatory and self-regulatory initiatives, the global participation rate is creeping up very slowly – and heterogeneously among classes of investors.

3. Foreign investors are – perhaps surprisingly – among the most present investors in Brazilian AGMs. This possibly stems from regulatory standards that are present in their respective countries (e.g., ERISA interpretation in the USA).

4. Local pension funds – with a regulatory imperative to vote in most cases – are much more present in AGMs than local mutual funds – which have only a loose self-regulatory framework.

5. It is possible to increase attendance at the company level, by means of a proactive IR initiative.

8.2. The 2014 Season

There are no hard data on the evolution of absenteeism on the 2014 AGM season. However, Amec has reported a number of interesting developments.
First, CVM’s interpretation of its own regulation allowed for the first time significant proxy access for minority investors. This means that non-controlling shareholders are now free to nominate independent candidates to the board of directors – and the company is forced to broadcast these names. In so doing, these nominations are included on proxy cards for investors voting from a distance, thus rendering the candidates viable.

This apparently small change meant a completely different balance of power for investors. Given the prevalence of investors voting by proxy, the only way to get meaningful support for independent nominations is to make proxy voting possible.

Despite the importance of the new rule, Amec members reported less than 20 cases in which the new provision was used. This may be due to a learning curve on the part of activist investors regarding this new right. In very few situations companies dragged their feet in order to let time lapse and effectively render innocuous the publication of independent names.

It is anticipated that in the 2015 voting season this right will be used by a larger number of investors.

### 8.3. The Distant Voting Proposal

In 2011 Corporate Law was amended – among other things – to delegate to the CVM the power to regulate distant voting for listed companies. Since then, the regulator has been in intense dialogue with market participants to achieve the best possible model for that regulation. The results were published on October 20th 2014, when the CVM put the draft regulation in a Public Hearing that will last until December 19th.

The CVM concluded that most problems for effective proxy voting in Brazil had to do with (1) short legal deadlines to call meetings (as little as 15 days); (2) the need for annual renewal of the power of attorney documentation; and (3) different requests made by issuers to validate representation, such as notarization, consular accreditation, official translation and registration of multiple documents. While the hurdles are more numerous and evident for foreign investors, they also apply to local institutional and individual investors.

The CVM also opted to focus on the pipelines of proxy voting, instead of venturing into the high tech world of real-time broadcast of shareholders’ meetings and voting instructions. Market players agreed that the former are much more important that the latter – and possibly easier to deal with.

The proposal relies on the sophisticated network of service providers that are a hallmark of the Brazilian capital markets. The central depositary custodians and others will be responsible for relaying voting information between issuers and investors – in the same way that they already do for corporate events such as dividend payments.
The second innovation of the proposal is the creation of a ‘Voting Bulletin’ that should be made available 30 days prior to the meeting, containing all relevant information and alternatives for the voting process.

Here the devil is in the detail: the CM regulation will only be effective if it is able to ensure that all information flows freely between companies and investors, and in both ways. This means that nominations and shareholders’ resolutions filed by non-controlling shareholders need to find their way to the Bulletin in a timely manner.

A third aspect worth highlighting is the emphasis on shareholders’ resolutions – a tool that is rarely used in Brazil. Corporate Law allows shareholders who own 5% of the Company to call a shareholders’ meeting, including the items that he or she want discussed. The CVM is suggesting a reduction in that threshold, especially for larger companies. Also, it is making clear that the tool can also be used to include items on the agenda of a meeting called by management. It will be interesting to see how this evolves in the future.

Market players have welcomed CVM’s proposal which, in large part, reflect their own experiences and suggestions to improve the proxy voting process. Once it is enacted – possibly for the 2016 GSM season – it will probably have a huge impact on the engagement of investors on listed companies in Brazil.
9. **Determinants of Engagement of Institutional Investors**

The overarching reason why institutional shareholders need to engage with invested companies is that this action is necessary to ensure effective oversight of management. At the same time, institutional investors are fiduciaries. In other words, they manage other people’s money. As such, they should exert their best efforts to fulfil their role in the checks and balances of their invested companies.

Brazil has opted for a regulatory obligation of pension funds to vote. However, other types of investors are subjected to different regulations – or lack thereof. In the case of mutual funds, for example, the approach is self-regulatory. And yet, the self-regulation is written in a way that allows for considerable discretion on the part of asset managers on whether to exercise voting rights or not.

Voting entails costs – both financial (lawyers, paperwork, travel, analysis,...) and reputational (relationships with clients, conflicts of interest, liabilities,...). Given discretionary powers, fiduciaries will only exercise voting rights when benefits outweigh such costs. Benefits, in turn, can also be financial or reputational. Financial benefits have to do with the actual impact of the votes on each individual firm’s performance. Reputational benefits have to do with the investment manager’s commercial image as a diligent fiduciary.

Financial benefits, however, are very hard to gauge. And in any event, they are reduced given the diversification of the typical equity portfolio. In other words, managers have relatively small stakes in each company, thus reducing the potential immediate benefit to itself and to its clients. Given that performance is usually measured in windows of 1-3 years, it is also hard to take advantage of the long-term effects of better governed companies.

Reputational benefits, on the other hand, depend on the importance that clients attach to the diligent exercise of fiduciary duties. As we have seen above, though, distribution and past performance are by far the largest determinants of commercial success of a given firm. The perception of value of stewardship at the asset owned level is still very low.
10. Conclusions and Policy Implications

The picture that emerges from this report, as well as from the practical experiences of investors and of the entities involved in its drafting – especially Amec, given its mission – allows for a few conclusions that may indicate areas of future improvement in the relations between institutional investors and their invested companies:

1. Brazil posts a solid financial infrastructure, which allowed for the development of a substantial industry of institutional investors. This however did not translate into a fruitful market for equities or an environment of proper checks and balances between firms and their institutional owners.

2. The first challenge seems to be the risk aversion that determines a low exposure to equities among all investors in Brazil. This may be a result of (1) high and persistent interest rates, (2) availability of subsidized capital from government sources; and (3) a cultural environment that fails to adequately protect shareholder rights. A revision of the macro and microeconomic reasons that drive these factors seem essential to restore dynamism to the Brazilian equity market.

3. Institutional investors are regulated by a patchwork of laws, agencies and regulation that are more related to the liability side of institutions than to the asset side. This leads investors with similar actuarial challenges to have widely different incentives in their investing activities – which in turn lead to different, suboptimal portfolios, low exposure to equities and low engagement with invested companies. Harmonization of investment rules affecting institutional investors seems to be warranted.

4. Despite the scale and the high level of sophistication of Brazilian institutional investors, their stewardship activities remain below what one would expect to adequately monitor invested companies. This is evident from the low turnout at shareholders’ meetings, even after the increase of activist initiatives over the past 25 years. It is therefore important to address the issues behind this fact.

5. It may be argued that Brazilian institutional investors lack the regulatory, self-regulatory or commercial pressures to exert fiduciary duties in relation to the political rights that are entitled to the securities they hold. Regulation – with the exception of closed pension funds – does not require funds to vote. Self-regulation provides a very lax standard that is the benchmark guiding most voting policies; and asset owners do not seem sophisticated enough to demand solid stewardship policies. Concentrated distribution of investment products (by means of bank network) is another obstacle to more pressure from clients.

6. While there is a consensus among market players that regulation should not force institutional investors into voting, there is space to rethink the self-regulatory framework so that it may become more effective.
7. Asset owners also have the ability to demand more engagement. Our group did not arrive at specific conclusions as to how to foster that.

8. Brazil lacks a Stewardship Code. It seems urgent to develop one – possibly under a *comply or explain* system. This Code must be a tool assisting institutional investors of all kinds to implement solid engagement policies.

9. Further collaboration is needed between different classes of investors – notably local and foreign institutional investors. Service providers, such as depositaries, custodians, proxy consultants, etc. should also get involved into discussions on how to improve stewardship practices in Brazil.

10. The costs and bureaucracy of voting need to be addressed. While many aspects are determined by corporate or general law (which is hard to change), many others can be changed via regulation or best practices. The CVM is already addressing this with the current proposal to regulate distance voting. The Interagents Group is also addressing other issues with a draft bill to remove certain obstacles surrounding shareholders’ meetings. But more can be done.

11. It is urgent to improve the effectiveness of shareholders’ rights. Institutional investors have little incentive to be active owners if they feel that it is a bad investment of their most precious resource (time). Enforcement against wrongdoing is often perceived as too little, too late. This needs to change. Also, it is important to reinforce existing procedures for reparation of damages, ensuring that these are relevant and channeled to investors.
11. Acknowledgments

This report would not have been possible without the dedicated help of a number of professionals, who devoted their time and energy to further the understanding about the Brazilian institutional investor framework. Starting with the membership and staff of Amec.

In particular, we thank Mr. Bruno Bastit, managing director of Quetzal Strategy-ESG Advisors, who worked as an adviser for Amec in this project.

Mr. Pedro Leles – a former member of Amec – devoted considerable time to this project.

Mr. Carlos Brandão was the contact person between the task force and the IBGC, another important contributor.

We also acknowledge support form entities like the CAF (Brazilian Take Over Panel) and its legal advisor Vanessa Brenneke. At BMF Bovespa – always involved in market improvements - we are thankful for the collaboration of Ms. Cristiana Pereira and Ms. Adriana Sanches.

ABRAPP, ABVcap, ANBIMA and BRAIN BRASIL also contributed with their efforts and existing data to our effort. BNDES, Previ, Bradesco, Itaú and Banco do Brasil also provided important input.
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