The Fifth Meeting of the
Latin American Corporate Governance Roundtable

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Opening Address by
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LATIN AMERICAN CORPORATE GOVERNANCE ROUNDTABLE

Ladies and Gentlemen:

- Expressing gratitude. It is a great honor for me to address this meeting of the Latin American Corporate governance roundtable. The presence of so many distinguished experts from across the region, from OECD countries and from various international organizations attests the importance of the issues that we are here to discuss.
- Historical background. These opening remarks would be misplaced without a brief glance at our historical background. Around four years ago, in 2000, we were holding in Brazil, also with the joint support of CVM, Bovespa and IBGC, in conjunction with the OECD and the World Bank, the First Latin American Corporate Governance Roundtable. With no more than 30 persons inside, that was the beginning of everything and also the turning point of a big change in terms of corporate governance to Brazil and to a great part of many Latin American countries. Time has passed, dialogue has surged, major legislation and regulatory reforms have been conducted, shareholder activism has increased and, overall, commitment with corporate governance has deepened. We have a document that represents our commonalities and differences as well as the main actions taken by our region throughout this whole entire period. This document – the White Paper on Corporate Governance in Latin America – maps great part of our achievements since 2000 and was extensively used in the beginning of this year, during the review of

the OECD Principles of Corporate Governance, which we are all familiar with.

- Raising enforcement worry. And what does this broad-scoped revision recommend? What were its main findings? Out of question that, isolated considered, enforcement is the sole principle question that needs to be enhanced. First of all it should be highlighted that we are all facing the same and almost universal problem. Proper enforcement appear to be a priority for every and all countries, no matter its level of economic development, its legal family or its politics. The main factor that seems to favorably affect enforcement is institutional strength and credibility. I guess we will have the opportunity to hear more about this and about other efforts, attempts and ideas during the meeting.
- Introductory words about enforcement. Until recently, a good deal of literature on corporate governance took enforcement as a given, assuming either that it is perfect or that it is constantly imperfect. In fact, enforcement is seldom either, and the structure of enforcement mechanisms and the frequency and severity of imperfection **play** a major role in the costs of transacting and in the forms that contracts take. Yet, effective and low-cost enforcement structures, as well as the public perception that such enforcement structures do work properly and timely are perhaps the most important sources of market trust.
- Enforcement and quality of rules. The first thing to be highlighted is that rules should need to approach a self-enforcing profile, meaning that the more rationale and efficient rules are, the more likely it will be that such rules shall be voluntarily enforced, with no need of direct intervention of the regulator. So, enforcement discussions

begin way before the moment of really applying the law, but rather in the moment of making the law and associated regulation. Framing appropriate legal structures is as much important as applying them, and this is also a key point to be stressed from the point of view of the regulator.

- Self-enforcing rules. Under what conditions will rules tend to be self-enforcing? The answer can be stated very simply. Rules will be self-enforcing when it is worthwhile to the parties to live up to them – that is, in terms of costliness of measuring and enforcing rules, the benefits of complying with the rules will exceed the costs. Novo Mercado and Level 2 of Bovespa may be mentioned as good examples of self-enforcing rules. The regulator role in this situation is much lighter, it only provides supervision of the self-regulatory rules. This reaches the point of the costs and limits of regulation, which is also a delicate tradeoff between burdens and benefits.
- The need to enforce rules. Once regulation is enacted, one cannot fully rely on its spontaneous compliance. There is also the need of policing and enforcing rules, and then comes the issue of public enforcement by the regulator. Regulatory enforcement involve a neutral regulator with the ability, at relatively affordable costs, to enforce rules such that the offending party always had to be punished by its fault to a degree that made it costly to violate the regulation.
- Obstacles and questions raised by enforcement. But here start the questions. Enforcement is costly. Indeed, it is frequently costly even to **find out** that a rule has been broken, more costly to be able to measure the relevance of such violation, and still more costly to be able to apprehend and impose penalties on the violator.Enforcement also comprehends effective judicial systems, which include well-

specified bodies of law and agents such as lawyers, arbitrators, mediators, and confidence that the outcomes of a case rest on its merits.

- Formal and informal constraints to enforcement. It also seems clear to me that enforcement is not only an official public problem, but also a private one. There must be an adequate mixture of formal and informal constraints. Perhaps we would have a much more effective system if investors started being more demanding about corporate governance before making their investment decisions, like they apparently did in the recent IPO´s in Brazil. Investors must analyze and study a paper before buying it, in order not to complain about non-existent rights later on: if they want to buy preferred shares, they must demand for better quality rights to these papers, which align their interests with the interests of the company's controlling shareholder. By the same token, issuers that want to improve its own corporate governance may trigger a process of converting their preferred shares into ordinary ones, or of granting preferred shares full tag along rights in case of sale of control. I cannot think of any enforcement action that could have reached any similar effective result.
- The risk of an over-regulatory approach. This approach also prevents the risk of an over-regulatory behaviour. As an example we can use the mentioned preferred shares. Non-voting shares can be used as a valuable tool for making feasible a wide variety of transactions, especially in the case of corporate reorganizations and debt restructurings. Non-voting shares may also fit the needs of investors interested in earning superior rents who may want to trade these superior dividends for voice rights. Therefore, simply and generally

forbidding non-voting shares may not be a good measure from a market point of view, in despite of the fact that the vast majority of best practices compilations set forth the one-share-one-vote ideal. This could be an over-regulatory approach, a disproportionate measure, because we would be imposing a general ban on a clearly useful device. Definitely, that does not seem to me to be the right regulatory answer to the problem, neither the more effective one.

- Enforcement and CVM: focused supervision. Since 2002 the CVM is legally granted authority to give priority to certain cases, according to its relevance to the capital markets. I have been referring to this prerogative as "focused supervision" – a supervision that does not waste money, time and resources with cases that are clearly not urgent or relevant. We do not have unlimited resources. Whatever resources we spend enforcing a question are resources that could be spent on other priority questions.
- Describing focused supervision. It does not mean that the CVM will only concentrate on the largest companies, or on those issues with more publicity and newspaper coverings, living without properly answer the other complaints. My idea here is that the Comission as a whole – and not only its Board – embark on a joint effort, everybody attending to the weekly meetings we hold to examine denounces, consultations, and solicitations addressed to us in the period before and, afterwards, we will select (as the law allows us to do) the ones that, in our opinion – in the opinion of the entire Commission, including the technical staff and the board – may have a major influence over the market.
- Probable outcomes of focused supervision. It is, though, extremely important that the CVM anticipates itself, not only imposing

penalties but also issuing its opinion about the most sensitive cases as soon as possible, specially in the case of companies that have a significant amount of dispersed shareholders. The more investors, the greater the impact that a CVM's delay will have on the security perception of these investors. We believe that it's a way of giving a proper answer not only to the markets, but also to the public opinion. In fact, the deficiencies of Brazilian judiciary system, namely, its delay in answering in a proper time the lawsuits filed, as well as the lack of specialized courts, create great expectations towards CVM's advisory activities. CVM´s opinion on a certain case may help solving future disputes and situations, or even preventing them, serving asa precedent. Additionally, going to court has a financial cost (lawyer's fees, looser's fees, judiciary taxes, expert's fees, and so on so forth), whereas going to CVM costs nothing more than hiring a lawyer (if any is needed). In other words, it is an extremely cheap way of obtaining a deeply technical opinion on an important matter.

- The CVM and the judiciary. But, of course, the CVM, like its counterparts all over the world, does not have the power of declaring acts null and void, nor is allowed to interfere in the decisions taken by general shareholders meetings or board of directors. This power belongs to the courts. For more these reasons, it is crucial that the CVM and the judiciary engage themselves into a joint effort of sharing their common experience and expertise, in order to provide a fair and effective enforcement system for issuers, intermediates and investors.
- Final words and thanks. I am pleased to see in this room so many high-level representatives of companies, financial institutions,

regulators and judicial authorities actively supporting this effort in Latin America. I believe it is a very timely initiative. Again, let me thank our local partners, Bovespa and IBGC for their support and involvement on the realization of this event. Let me also thank the World Bank, the OECD and the IFC who are the global promoters of this important work. I very much look forward to following the discussion over the next couple of days, and also the future progress of the Latin American countries right after this roundtable.