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White Paper Progress Report – Colombia

This report on developments in Colombia was prepared by Clemente Del Valle Borráez and Mauricio Carvajal Cordoba of the Colombian Securities and Exchange Commission (Superintendencia de Valores) with additional input from Andrés Bernal of Confecamaras, and Carlos Rodriguez and Elizabeth Prada of the Colombian Stock Exchange (Bolsa de Valores), and taking into account comments from Superbancaria and the Asociación Nacional de Empresarios de Colombia. This paper also draws upon the results of an opinion survey on corporate governance in Colombia of 20 key agents of the market, including issuers, investors, and legal firms among others. The survey was conducted by the joint CIPE - Confecameras Program on Corporate Governance and the Colombian Securities and Exchange Commission. This report is published under the responsibility of the OECD Secretariat.

Issue 1. Taking Voting Rights Seriously.

White Paper Recommendation: Steps should be taken to facilitate shareholder participation in General Meetings and voting of shares. Institutional investors that in many cases have taken too passive a role should be encouraged to exercise their ownership rights in a more active and informed manner. If the legal framework allows shares with different voting rights, this needs to be fully justified and accompanied by commensurately stronger and more effective protection of minority shareholders.

Has there been progress on this issue over the past three years?

From a regulatory perspective, the main Colombian rules concerning shareholder voting rights are contained in the Code of Commerce, as modified by Law 222/1995.

While Law 222/1995 was not issued in the period of the last three years, it is important to mention that it eased the requirements for proxy voting. Today, the only requirements for valid proxies are: (a) that they must be in writing; and (b) must specify the meeting or meetings for which they are given. Proxies with blank spaces are prohibited. In addition, the law provides for the possibility of distance meetings. The Law requires that certain decisions be taken only when they were previously included in the agenda (mergers spin-offs, transformations and voluntary de-listing). Act 222/1995 also includes a regime for non-voting shares, setting out the legal framework for the protection of their holders, including the events in which they will have the right to vote. According to Act 222/1995, non-voting shares can represent no more than 50% of the total outstanding shares of any corporation.

More recently, Resolution 275/2001 issued by the Superintendency of Securities (hereinafter Supervalores) required issuers to adopt and publicly disclose codes of good governance, which must necessarily include specific mechanisms for better informed shareholder meetings. Resolution 116/2002 issued by Supervalores makes the adoption of rules for the fair treatment of all shareholders in general meetings mandatory[1].

In addition, the recently approved Securities Market Law (discussed in more detail below) permits share issuers to adopt mechanisms for the election of the board other than the currently used electoral quotient system. The quotient system uses a complex mathematical formula intended to introduce proportional representation and strengthen the ability of minority shareholders to elect board members. However, in practice the concentrated ownership structure of most Colombian companies still makes it difficult for minority shareholders to have enough votes to elect their choices. This matter will be the subject of a further regulation to be developed by the Ministry of Finance and Supervalores, in order to introduce mechanisms different from the electoral quotient system such as cumulative voting.

The Colombian Stock Exchange (CSE) has also played an important role in facilitating and encouraging greater shareholder participation. With support from the Inter-American Development Bank, CSE initiated a multi-year program in 2002 to measure the corporate governance practices of Colombian issuers, both of fixed income and equity, through a survey of 136 questions. From a universe of 335 possible candidates, a sample of 40 was selected.

The selected companies include public and private sector entities from a variety of sectors such as financial, public services, commercial, and investment companies, among others, and include big, middle and small size companies. In the opinion of the CSE, the sample is representative of the Colombian market and reflects the interest of issuers in corporate governance practices as a mechanism that brings transparency.

[1] Resolution 116 sets out requirements for proxy voting. For instance, proxies must identify clearly who is entitled to act on behalf of the shareholder. The company directors and executives can not be proxy. The board of directors must appoint a compliance officer in charge of verifying that proxy vote requirements are satisfied.

The initial results were presented in mid-2004 and are available upon request[2]. The second phase of the program involves a series of one-to-one visits to every single participant in the survey. The agenda followed during these visits focuses on increasing issuer awareness of the shareholder voting rights and good practices of corporate governance. So far, the Exchange has studied and visited 34 issuers out of the 40 selected. Phase 3 of the program will focus on a sub-sample of 10 issuers out of the 40, which will address, in an in-depth manner, topics of corporate governance practices of particular interest to such companies, with the assistance of international advisors, who will provide guidance on best international practice to be implemented. The program will end with a seminar during which issuers that participated in Phase 3 will discuss their experiences among an audience of around 300 participants, which will most probably take place in November 2005.

One of the most interesting results of this program has been the direct participation of an important percentage of issuers' CEOs (nearly 70%). The survey has revealed some interesting facts: for instance, all the companies visited by the CSE have adopted internal and external control mechanisms with regard to risk management; 15 out of the 40 companies visited have at least one independent member on the board[3], and 30 have included an arbitration clause in their corporate governance codes or by-laws.

In general, it can be said that issuers, directors, investors and other market participants are now more aware of the importance of shareholder voting rights.

What have been the key developments?

One of the key developments is the new Securities Market law, issued by Congress in July 2005. The new Law makes clear that shareholder agreements may have no effect unless they are fully disclosed to the market. As is well known, the disclosure of shareholder agreements is of great importance for the transparent operation of shareholder meetings and investor confidence.

Issuers, directors, investors and other market participants are now more aware of the importance of shareholder voting rights. Several issuers have already created on their websites specific sections for investor information, which facilitate the dissemination of information to the shareholders throughout the year and in the events of meetings[4].

As said before, in order to comply with the requirements set out in Resolution 116/2002, boards of directors have now adopted the practice of appointing an official in charge of verifying the legality of proxies and the fair treatment to all shareholders by issuer's staff.

Several codes of good governance adopted by Colombian issuers have introduced rules that make the thresholds for calling a shareholder meeting more flexible[5]. In addition, it has now become a common

[2] Additional information on the survey results can be obtained from Ms Elizabeth Prada at Bolsa de Valores de Colombia, eprada@bvc.com.co.

[3] The survey was extended before the passing of the new Securities Market Law. As explained in the annex, the new regulation introduced some requirements on independent members at the board.

[4] To mention a couple of examples, Bavaria S.A.'s web site offers to its investors information such as the financial results of the company, a copy of the on-going information the issuer has provider to the securities supervisor, and notice of prospective conference calls in which investors can participate; ISA S.A. offers in its website a "shareholder schedule" page in which investors are informed of all events and dates relevant to them, and in which investors can also access easily detailed information about the company financial evolution and the company's shares performance in the stock market.

[5] For instance, in the case of Caracol S.A., at least 1% of the outstanding shares can request the board to call for a meeting. If the board considers the request is not reasonable, then the requesting shareholders can ask Supervalores to decide on the issue.

practice that, in order to guarantee a more transparent selection of auditors, shareholders are presented audit proposals from different firms[6].

In the course of developing its corporate governance program described above, the Colombian Stock Exchange has identified the following advancements in the Colombian market:

- High level of engagement of senior management on this topic;
- Commitment of the majority shareholders for the protection of minority shareholders;
- The possibility that a group of shareholders that represents at least 10% of the total equity has the capacity to call for a shareholder's meeting;
- Internal and external control mechanisms for the issuer;
- Board of directors with independent members´ participation;
- Arbitration clause in their codes.

The joint CIPE - CONFECAMARAS Program on Corporate Governance has also been very active in organizing awareness-raising seminars and producing corporate governance-related publications.

What have been the obstacles to progress?

The notice period for general ordinary shareholder meetings continues to be fifteen (15) working days, and five (5) calendar days in case of extraordinary meetings. These periods of time are generally regarded as relatively short, particularly from the viewpoint of foreign investors. While issuers could indeed adopt longer notice periods voluntarily, they are reluctant to do so. Setting of mandatory longer periods will require a reform to the Code of Commerce.

While Act 222/1995 provides for the possibility of distance meetings[7], they are a very rare practice among public companies. As a matter of fact, in order for a distance meeting to be valid, 100% of the outstanding shares must partake, which is very difficult to achieve with regard to most issuers. The adoption of a more flexible majority should be considered.

Colombian institutional investors continue to take too passive a role as investors[8]. They are not required to disclose a voting policy, nor have they voluntarily adopted the practice.

As permitted by law and regulation, pension funds, which are the main institutional investors, can invest up to 30% of their portfolio in equity securities. However, approximately 47% of their portfolio is currently invested in Colombian sovereign debt, while only about 4.3% of their portfolio is invested in stocks. There are some cases, however, in which institutional investors – particularly pension funds - have pushed hard for the adoption of better practices by issuers and have either been offered participation at the board or have managed to obtain it[9].

However, Colombian rating agencies do not include consideration of corporate governance issues in their assessments.

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[6] Colombian law does not rule explicitly on whether contacting audit firms and analyzing their proposals is a task to be conducted by the board or by the chairman of the company. In practice the task is sometimes carried out by the board while in other times is carried out by the chairman of the company.

[7] In the Colombian context, "distance meetings" can take one of two forms: (a) meetings through any technological channel that permits simultaneous or successive communication, such as teleconference and conference call; (b) written vote by all shareholders on a proposal. The vote can be sent by fax, mail delivery, etc. In this case all shareholders must cast their vote, otherwise the decision is void. Once all the shareholders have cast their votes, the legal representative then verifies whether the applicable majority has been satisfied and drafts the official "meeting" minute.

[8] The Confecamaras survey indicates that over 60% of the interviewees still perceive the institutional investors as passive in terms of corporate governance.

[9] That has been the case in Edatel S.A., ISA S.A. and ETB S.A., three partially state-owned companies.

Finally, despite the progress noted above, in the course of its corporate governance program, the CSE has identified cases in which good governance principles are limited by poor access to information and the absence of a dedicated contact point in companies.

What should the priorities for further improvement be?

Accordingly, a future reform of the Code of Commerce should adopt longer notice periods for shareholder meetings, so that foreign institutional investors are in a position to adequately examine documentation for shareholder meetings and make better informed decisions. It is still possible to vote on items not included in the agenda, but removing this shortcoming of the legal framework will also require a reform to the Code of Commerce.

Shareholder approval should also be required for the sale of substantial assets.

Modifying codes in Colombia is a time-consuming experience. Additionally, one of the pitfalls of Resolution 275/2001 is that it did not define a governance standard clearly. Thus one of the priorities should be the introduction of either listing requirements by the CSE, accompanied by a comply-or-explain scheme agreed by the interested groups, including the relevant superintendencies, the CSE, institutional investors and issuers, in which the latter are encouraged to adopt commitments on, inter alia:

- Transparency measures for shareholder meetings;
- Notice periods much longer than the minimum ones required by commercial law;
- Votes only on items explicitly included in the agenda, with no exceptions permitted;
- Shareholder approval required for the sale of substantial assets.

In addition, Supervalores and Superbancaria, hand in hand with the institutional investor industry (including associations such as Asofondos, Fasecolda and Asofiduciarias) should examine in a closer manner international experiences with incentive schemes for more active institutional investors, in order to evaluate how they might be implemented in Colombia. Training shareholders so that they can play a more active and demanding role is one of the great challenges in terms of corporate governance in Colombia. This campaign must be based on the important benefits that the incorporation of better practices can bring for shareholders. In this same line of reasoning, more exhaustive procedures to monitor issuers in terms of corporate governance are imperative.

Supervalores should lead and effort jointly with investors, rating agencies and other market participants also in order to examine in detail the international debate currently in process as to whether rating agencies can and should pay more careful attention to issuers' corporate governance practices. Consequently, one of the main challenges consists of promoting better "market education" with regard to corporate governance standards, so that the emergence of corporate governance-based premiums in the markets and other economic incentives become possible.

Finally, the protection of minority shareholders' rights in closed (unlisted) enterprises is vital. Corporate Governance cannot indeed be limited just to the security issuers[10]. In fact, the incorporation of best practices in closed held companies facilitates the entrance of new issuers and therefore can contribute to the market's depth.

Issue 2. Treating Shareholders Fairly during Changes in Corporate Control and De-listings.

White Paper Recommendation: The legal and regulatory framework must provide for clear and ex ante rules regarding how minority shareholders are to be treated when there is a change in corporate control.

[10] There is consensus among the agents interviewed in the Confecamaras survey about the importance of corporate governance in unlisted companies.

Improvements should also be made to ensure a fair, practical and predictable system for valuing the shares of minority investors in cases of de-listings or exercise of withdrawal rights.

Has there been progress on this issue over the past three years?

There has been progress with regard to tender offers, which are currently regulated in Resolution 400/95 issued by Supervalores. Tender offers are mandatory whenever:

- Any beneficial owner intends to become the holder of 10% or more of the outstanding shares of a listed company;
- Any beneficial owner of 10% or more of the outstanding shares of a listed company intends to acquire an additional 5% or more of the outstanding shares;
- The general meeting of shareholders votes favourably to de-listing the company, but the decision is reached with the favourable vote of less than 99% of the outstanding shares. In this case, all the shareholders that voted favourably must extend a tender offer to those who voted negatively.

Three public tender offers, and one case of voluntary delisting have taken place in the last three years. At the time of this writing, two additional cases of de-listing are in process. In all these cases of de-listing Supervalores has monitored that the dissenting shareholders are offered the possibility to sell their shares to those who voted in favour of de-listing the company, which is a right set out by the outstanding law.

Additionally, a tender offer will also be conducted in the case of Bavaria S.A., a Colombian issuer whose control was transferred by the merger of two foreign companies.

In the same period approximately twenty five cases of mergers and spin-offs occurred, which have also posed important challenges for the supervisor in order to guarantee an appropriate treatment to minority shareholders.

Law 222/1995 introduced the right of withdrawal in cases of mergers, split-offs, change of corporate form (transformación) and voluntary de-listings. In the event of disagreement about the share value in cases of withdrawal, Supervalores is empowered to nominate experts for the valuation upon request. Every shareholder can withdraw on an individual basis without regard to its share percentage. In the last three years, only in one case did Supervalores appoint valuation experts as part of a withdrawal process; the case is to be decided by Supervalores in the following days.

As explained below, Supervalores recently released for public comment a proposed new regulation on the issue of public tender offers. A large number of comments have been received and they are being analyzed at the time of this writing. It is expected that the new regulation will be issued by the end of 2005.

What have been the key developments?

Supervalores has played an active role in guaranteeing that the market is properly informed in cases of change of control and de-listing, by requiring full, timely disclosure of relevant information[11]. Some of the actions taken on a regular basis have included:

- Requiring issuers to confirm or deny press reports referring to possible transactions for the change of control;
- Reviewing contracts among the parties, to make sure they are not adopting mechanisms that impede free concurrence in the securities market;

[11] The survey showed that 40% of the market agents consider to a great extent that the Supervalores emphasis on corporate governance "is appropriate" and the remaining 60% think it is on the right path.

- Ordering temporary suspension of trading during mergers, public tender offers and spin-offs, so that the market is informed in an appropriate manner when trading is resumed; and
- Sending officials to verify that shareholders are properly informed in general meetings.

What have been the obstacles to progress?

Issuers do not always disclose relevant information on a voluntary, timely basis, particularly in cases of prospective changes in the control of the company. Too often Supervalores must require issuers to either deny or confirm press reports. Trading suspensions caused by puts or calls outside of range prices have become common recently[12].

In addition, regulatory changes with regard to public tender offers are also needed. The current regulation, which was introduced in 1995, must be updated to address issues such as:

(a) Events under which the offer must reach 100% of the outstanding shares: Currently there are no circumstances under which the bid must necessarily extend to 100% of the outstanding shares. However, there is an international regulatory trend under which, once the entering controller reaches a certain percentage of the shares, such party must extend its bid to 100% of the outstanding shares. The convenience of introducing a similar requirement to the Colombian regime is being examined.

(b) The current regime does not set out in a complete manner the events under which a public tender offer of acquisition is not required (see the following section).

(c) The current regulation does not make clear whether a tender offer can be modified, or withdrawn, once it has been launched.

(d) The seller is required to publish only one newspaper announcement. The period between the announcement and the day of the acceptance is one of 15 days. Acceptance of the bid takes place within the daily share trading session at the exchange, on a single day. Practice has shown that at least two newspaper announcements and longer acceptance periods could facilitate the participation of a larger number of minority shareholders.

What should the priorities for further improvement be?

In the opinion of some market actors, the regime for disclosure of relevant information in the case of changes of corporate control is ambiguous and leaves room for interpretation. Accordingly, Supervalores is working now on a reform of these rules, and it is expected that the new regulation will improve the timely disclosure of information, particularly in cases of control change. Some of the changes refer to:

- The introduction of clearer guidelines as to when preparatory actions or preliminary dealings must be disclosed to the market;
- In general, the proposed regulation sets out guidelines on what constitutes material information in a much more precise manner than the currently existing ones;
- A more precise regime on when relevant information may be kept confidential on the request of the issuer. Currently the maximum time period during which information can be kept confidential is four months, which can not be enough in the case of some complex transactions;
- In some cases the issuer is required to disclose material information related to its parent or subsidiary corporations.

[12] By 1st September 2005, approximately 185 stock trade suspensions have occurred throughout the year. For further information please see: La Republica (available at: http://la-republica.com.co, 1 September 2005).

An additional priority is the proposed regulation on public tender offers It proposes to adopt international standards with regard to thresholds, price-fixing criteria, and concurrent offers in response to the current shortcomings in the legal/regulatory framework cited above. Some of the proposed changes can be described as follows:

(a) Thresholds: Following widely accepted international standards, a public tender offer would be required whenever:

- Any beneficial owner intends to become the holder of 25% or more of the outstanding shares of a listed company. In that case the bid must extend to at least 10% of the outstanding shares;
- Any current beneficial owner of at least 25%, but less than 50%, of the current outstanding shares of a listed company intends to acquire an additional 5% or more of the outstanding shares. In that case the bid must extend to at least 10% of the outstanding shares.
- Any person intends to become the beneficial owner of more than 50% of the outstanding shares of a listed company. In that case the bid must extend to 100% of the outstanding shares.

(b) Exceptions to the general principle: The proposed regulation sets out more completely the cases or legal events in which the conduct of a public tender offer is not mandatory, such as successions, donations, assignment due to corporate winding-ups, debt conversion into capital stock, inter alia.

(c) Price: Who launches a bid determines the price to be offered. However, when there is a contract or prior agreement between the prospective buyer and seller, the contract may set out a price, in which case all shareholders, and not only the controlling one, shall be offered the same price.

(d) Offer periods and withdrawal: The offer periods would be extended so that minority shareholders are in a better position to properly inform themselves. The proposed regulation makes clear the conditions under which a tender offer can be modified, or withdraw, once it has been launched.

(e) Acceptance mechanism: the proposed regulation defines clearly the periods of time within which a shareholder interested in selling shall accept the offer. The current regulation under which the bid is accepted within the exchange's daily share trading session would be repealed.

In addition, Supervalores and the Colombian Stock Exchange are working together in a programme for the promotion of the securities market (the so-called "Colombia Capital" initiative). This programme, for which financial assistance from multilateral agencies is being sought, is intended to help bring new issuers to the market, but will also have an important component of follow-up with the current issuers, in order to encourage a deeper commitment to the rules of the market, with a particular emphasis on disclosure of relevant information. Awareness-raising events will contribute to more responsible issuers with regard to market information, both in control changes and other major events.

Issue 3. Ensuring the Integrity of Financial Reporting and Improving the Disclosure of Related Party Transactions.

White Paper Recommendation: National accounting standards should be brought into compliance with International Financial Reporting Standards and the quality of the financial reporting process should be assessed with a view to eliminate conflicts of interest. The disclosure of related party transactions and potential conflicts of interest in such transactions should also be improved and supported by better information about corporate ownership and control structures.

Has there been progress on this issue over the past three years?

International financial reporting standards have not been adopted by Colombia yet. Currently, different governmental entities have regulatory powers as to accounting issues so that there is not a unified system of

accounting applicable to all economic agents[13]. The self-regulation of the accounting industry is weak. As a result, supervisors have to devote important human resources to check the integrity of financial reports.

In Colombia, the adoption of international financial reporting standards requires the passage of a bill in Congress. A committee formed in 2003 by several public sector entities drafted a proposed bill for adoption of the standards. The proposal was released for public comments in the second half of 2004, and the overwhelming amount of comments received from different sectors showed that this issue in Colombia remains highly controversial.

With regard to related-party transactions, codes of good governance adopted by issuers are required to include self-regulatory rules on transactions with related parties. With few exceptions, however, these rules are somewhat general and therefore difficult to enforce. While the Code of Commerce sets out a duty of loyalty for directors, in practice there are no clear, mandatory guidelines, and well defined enforcement powers as to related party transactions. To sum up, the disclosure of operations with related parties is still perceived as insufficient. Market actors are aware that unless there is clear, timely and detailed disclosure on beneficial ownership, any provisions about disclosure of operations between related parties will not be entirely effective.

What have been the key developments?

As explained below under Issue 4, the new Securities Market Law makes audit committees mandatory, which will assist the board in its task of assessing the integrity of financial information. In addition, the law explicitly places on the highest executive of the company the duty to establish appropriate mechanisms to guarantee the quality and integrity of financial reports. The shareholders meeting must be informed as to how these control mechanisms performed throughout the year.

From 2002 onwards, issuers have been required to identify and disclose their twenty major shareholders. Due to the high levels of concentration in corporate ownership, in most cases, most of the twenty major shareholders retain percentages well below five percent. The requirement does not extend, however, to beneficial ownership, and so in practice there continues to be uncertainty in the market about who in fact controls Colombian companies.

In addition, Supervalores and Supersociedades (the general corporation superintendency) have actively co-operated to identify and declare the existence of corporate groups, which facilitates a more effective control on the disclosure of related party transactions. According to Law 222/1995, directors of a parent corporation must disclose the transactions carried out with other corporations of the group to the general shareholders meeting.

Finally, a new regulation on transfer pricing has recently become effective, which indeed will contribute to enhanced surveillance of related party transactions. The regulation is to be enforced by the tax authority and will discourage issuers to enter into transactions whose prices are artificial.

What have been the obstacles to progress?

Due to a lack of legal clarity, some understand that audit of interim reports is not mandatory, except in the case of banks and other financial intermediaries under the supervision of Superbancaria.

On the other hand, some Colombian constituencies, e.g. the accounting industry, are still clearly opposed to the adoption of international financial reporting standards. This lack of consensus represents a significant obstacle to advancement in this important matter.

[13] There are approximately 42 PUCs (*Planes Únicos de Cuentas*,i.e. accounting schemes) currently outstanding in Colombia.

Criticism of the draft bill referred to above has focused on three of its main proposals:

- The fact that international financial standards would be mandatory even for small and medium enterprises;
- The fact that the so called revisor fiscal, which is currently a hybrid between an external and internal auditor, would transform into a truly independent, external auditor. The proposed regulation prevents the revisor fiscal from offering services other than the audit one; introduces a rotation requirement; and changes the current system in which the audit staff is paid by the audited company.
- The fact that oversight of the accounting and audit industry would cease to be largely based on self regulation as it has been so far, and become a task much more controlled by government.

For the time being it is uncertain when the proposal for the adoption of IFRS will be taken to Congress. In the meantime, Supervalores and Superbancaria (the financial intermediaries' supervisor) are working together with a view to implement international financial reporting standards for the financial and securities market participants. Most probably this will be done by regulation.

What should the priorities for further improvement be?

International financial reporting standards must be adopted. This is perhaps one of the biggest challenges for Colombia with regard to corporate governance. Awareness-raising efforts regarding the need for this important step must be intensified. Another important issue relates to the role of external auditors. External auditors are perceived as one of the weak elements in the Colombian corporate governance system. Accordingly, it is necessary to implement regulatory actions that preserve and strengthen the fiscal auditor's independence so that auditors can fully comply with their functions. As mentioned previously, it is necessary to prohibit the offering by revisores fiscales of services others than the audit one; a rotation requirement should be introduced and the current system in which the auditor staff is paid by the audited company should be removed.

In addition, rules on the requirements and disclosure of related party transactions should be strengthened. Rules on black out periods for trading by insiders should be introduced. Supervalores and Supersociedades must keep playing a very active role in identifying and officially declaring the existence of corporate groups.

Issue 4. Developing Effective Boards of Directors.

White Paper Recommendation: Laws and practices reflect that all directors, individually and collectively, should act independently in the interest of the company and all of its shareholders. There should be greater specificity concerning the procedural steps for fulfilment of the director's duties of care and loyalty and an explicit ambition by boards to clearly define their work procedures as well as those of special board committees. Boards should also improve their ability to manage conflicts of interest and ensure compliance with laws and ethical standards.

Has there been progress on the issue over the past three years?

Act 222/1995 sets out a general regime of duties for directors, including rules on conflicts of interest. In the last 3-4 years, several issuers have adopted codes of good governance which also include explicit rules on directors and conflicts of interest resolution[14].

With regard to the financial sector, Act 795/2003 reinforced the duties of directors and mandated that in no case may the majority of the board be made of directors who are at the same time executives of the company.

[14] Out of 88 codes of good governance checked, 43 of them included specific rules for conflict of interest management.

A director training facility will begin to operate in late 2005 under the initiative of several private entities such as Confecámaras (the chamber of commerce association), the Cámara de Comercio de Bogotá (which is the main local chamber of commerce) and the Universidad de los Andes. The operation of the training centre will be of great importance in the light of the requirements on board independence set out by the new Securities Market Law.

What have been the key developments?

With the new Securities Market Law (July 2005), audit committees became mandatory for all issuers. The committees must be composed of at least three board members. All the independent members must be part of the audit committee, which can also include non-independents. One of the independent directors must be in charge of the management of the committee, and will assist the board in assessing: (a) the progress in the implementation of corporate internal control programs and (b) the quality and integrity of financial information subject to public disclosure. The rules on audit committees will be mandatory by 2006, i.e. issuers have been given one year to make their by-laws conform.

Secondly, at least 25% of the members of the board will be independent directors[15]. In addition, based on international experience, the new law sets out the criteria under which a director shall be deemed as independent[16].

In addition, the new regulation eliminates the need of electing alternate directors, and clearly mandates that no individual shall be simultaneously the chairman of the company and the chairman of the board.

What have been the obstacles to progress?

In Colombia's corporate world, it is still common that board members are not provided, well in advance, with all the relevant information for their decisions. The corporate culture with regard to board-payment standards and time devotion is far from encouraging professionalism.
Before the new Securities Market Law, issuers in general had been reluctant to disclose a firm, permanent commitment to put independent members on their boards[17]. As explained above, they are now mandatory in the percentage set out by the new regulation. However, there is some uncertainty and lack of knowledge about how to implement the requirements set out by the new Securities Market Law[18]. That is probably why

[15] In a board composed by 5-8 members, at least 2 of them must be independent; if composed by 9-10 members, at least 3 of them must be independent.

[16] Inter alia, no individual shall be deemed as independent with regard to a company if she:

1. Is an employee or executive of the company, or an employee, director or executive of the company's parent corporation, or for any of its subsidiaries or affiliates, including those who were at that position within the preceding year;
2. Is a shareholder who directly or by agreement is in the position to control the majority of the outstanding votes, or the majority of the board.
3. Is a shareholder or employee for any association, not for profit organization or corporation that: (a) provides services to the company or to any of its affiliates, as far as no less than 20% of such association, not-for-profit organization or corporation's operational income in the preceding fiscal year came from the company; (b) receives donations from the company, as far as no less than 20% of such association, not-for-profit organization or corporation's total donations in the preceding fiscal year came from the company;
4. Is a director for any entity in whose board a legal representative of the company sits.
5. Draws any type of income or compensation from the company, unless such income or compensation is drawn in the condition of board member

[17] 50% of the market agents interviewed in the Confecamaras survey think that prior to the new securities law there had been no development in the incorporation of independent members in boards of directors, while other 30% considered there had been little advance.

[18] 20% of the market agents interviewed for the Confecamaras survey expressed some concerns about the new regulation on this issue.

the opinions of the market actors about the new regulation are diverse. The greatest concerns are about the required percentage of independent members (25%).
It has been said that it is too difficult to find suitable, independent executives in Colombia. Hopefully, the aforementioned training facility to come soon into existence will contribute to the availability of qualified independent directors. In general, training for all the market agents is critical, so that misperceptions that have appeared around the new law can be cleared up.

What should the priorities for further improvement be?

Colombia should seriously consider the possibility of reforming the Code of Commerce, so that the board's role and responsibilities are much more clearly defined. While audit committees are extremely important, creation of committees for other important responsibilities, such as executive nomination and compensation, board evaluation, and conflict-of-interest resolution, should be fostered.

Accordingly, one of the priorities should be the introduction of either listing requirements by the stock exchange, or of a comply-or-explain scheme either by the stock exchange or by the regulator, in which issuers are encouraged to adopt commitments on:

- Transparent compensation schemes, including a fixed component and also a component depending on company earnings;
- Mechanisms for board evaluations;
- Ample notice periods for the calling of board meetings, and duties to provide sufficient information to directors on major corporate decisions.

Supervalores, Confecamaras, CSE, ANDI and other organizations are exploring how a standard of this nature could be adopted.

Finally, under the new Securities Market Law:

- The government is expected to issue a regulation on methods for board election different from the electoral quotient system. The regulation must be clear and fair enough to stimulate market changes on this critical issue.
- Supervalores must play an active role in enforcing the requirements under which directors can be considered independent.

Issue 5. Improving the Quality, Effectiveness and Predictability of the Legal and Regulatory Framework.

White Paper Recommendation: Parallel to strengthening the capacity of rule-making and enforcement bodies, steps should also be taken to ensure that the framework supports effective use of private actions. Depending on the legal context, this may include the introduction of class action suits and mechanisms for alternative dispute resolution, such as private arbitration in the areas of company law and corporate governance.

Has there been progress on the issue over the past three years?

As a general rule, commercial and corporate private actions in Colombia can be taken either to civil courts or arbitration. In other words, Colombian law does not preclude the use of private arbitration to solve corporate-related disputes between companies, or between companies and shareholders.

Unfortunately there are no statistics available as to the number of shareholder conflicts taken to private arbitration rather than to courts. But in any case corporate arbitration clauses are common: a survey

conducted by Cámara de Comercio de Bogotá -the main local chamber of commerce- in 2004[19] showed that approximately 74% of the corporations newly registered in August 2004 before the Chamber of Commerce included an arbitration clause in their by-laws.

In many cases, however, the arbitration clause covered only disputes arising among shareholders, but not those arising either among shareholders and the corporation or among shareholders and directors. This short scope for arbitration clauses is also present in codes of good governance.

Civil courts continue to be relatively slow. According to some statistics published in 2002 by Corporación Excelencia en la Justicia (a local, private, not-for-profit organization with a view to helping to improve the functioning of the judiciary), a civil action takes on average more than 3 ½ years. Judicial consideration of any security case will take no less than 2 years at best[20]. The judiciary is still highly congested by actions against mortgage banks derived from the well-known 1998-2000 mortgage loans legal crisis.

Some decisions of the Constitutional Court in economic and corporate matters have been criticized and have created concern among local and foreign investors about legal predictability. In addition, high courts (i.e. Corte Constitucional, Corte Suprema de Justicia, Consejo de Estado and Consejo Superior de la Judicatura) have often ruled differently on similar matters, and have also mutually challenged their respective powers, particularly with regard to acción de tutela (a streamlined procedure introduced by the 1991 Constitution for the protection of fundamental rights), thereby creating serious concerns as to legal certainty.

What have been the key developments?

In 2004, an enforcement department was created within Supervalores, which centralized the sanctioning power previously de-centralized in different departments. Under the new scheme (i.e., from February 2004 to September 2005), 32 sanctions (mainly fines) have been imposed on market participants.

With regard to the judiciary, some rules that help strengthen enforcement have been issued in the last three years. Act 794/2003 introduced important changes to the Civil Procedure Code, in areas such as service of process, distribution of jurisdiction among the different levels of civil courts, mechanisms for collection of evidence, and also removed some delaying technicalities identified in the past. The Congress has passed a bill aimed at protecting domestic and foreign investors from legislative changes in certain regulatory topics relevant for commercial and economic activity (the so-called Proyecto Ley Inversionista), thereby helping to increase legal predictability.

As stated above, there are no official statistics available on the number of shareholder conflicts taken to private arbitration rather than to courts. However, we know that some of the most important shareholder and contract conflicts that have arisen in the last years have been taken to arbitration facilities offered by chambers of commerce. Arbitration remains in general inaccessible for small causes of action.

On the other hand, the Securities and Corporation Superintendencies (Supervalores and Supersociedades), continue in the exercise of their jurisdictional powers granted by Act 446/1998 (as modified by Act 795/2003). These powers are exercised in cases of disagreement on valuation of shares and corporate decisions challenged by minority shareholders. Jurisdictional procedures before the superintendencies are indeed more streamlined than judicial ones, as they take one year on average, which indeed compares favourably to the 3 ½ years taken by civil court procedures. Concerning Supervalores, one important case was already decided, but the entity's decision was not upheld by the court of appeals. To promote a more independent judgement, from 2004 onwards Supervalores' judicial powers are carried out by the internal legal office, rather than by departments in charge of supervision on a regular basis.

[19] Gobierno Corporativo, Arbitraje y Métodos Alternativos de Solución de Conflictos. Jaime Alejandro Moya. Contained in: Códigos, Técnicas y Herramientas. CONFECÁMARAS, 2005
[20] Source: Portafolio, 23 September 2004, page 12.

Fortunately, a debate is taking place about the need to set clear boundaries among the powers of the high courts. This will require a constitutional reform.

What have been the obstacles to progress?

As referred to above, the main obstacles to the quality and predictability of the regulatory framework relates to the congestion at the judiciary and the constitutional jurisprudence. Arbitration is still used in large (i.e. economically very important) causes of action, but not for the small ones. Act 550/1999 (insolvency law) has also been criticized as it does not strike the correct balance between creditor rights and those of debtors that have resorted to bankruptcy protection (Acuerdos de reestructuración). While Act 550/1999 was of utmost importance in the 1997-2001 credit crunch, it is time now for legislative reform.

There is no specialized judicial system for financial issues, that is, no specific sector within the judiciary is composed exclusively or primarily of judges trained on financial or capital market issues (there were courts specialized in commercial matters in the past, but they were eliminated presumably due to budgetary issues). Thus the quality, correctness and timely issuance of judicial decisions in these matters are far from being guaranteed.

Adoption of stricter financial standards has been a significant and ongoing issue of debate in Colombia. In August 2003, Superintendencia Bancaria (Superbancaria) published on its website for comments a draft of a Circular Externa that was meant to impose mandatory requirements that would be stricter than those set by Law 222/1995 and Decreto 663/1993 (the so-called Estatuto Orgánico del Sistema Financiero). As a reaction to the published draft, Superbancaria received opinions from people within the financial sector as well as from the academic community, the banking and insurance associations (Asobancaria y Fasecolda), and several financial institutions.

In addition to the comments received regarding particular aspects of the proposed regulation, most of the participants preferred to consider adoption of codes of good governance, such as the one proposed, on a voluntary basis. Some of them argued that issuing this sort of instruction might exceed Superbancaria's legal power, while others considered that if a financial institution wishes to stay competitive in a global market with global investors, sooner or later it has to embrace standards of Corporate Governance.

Therefore, after exchanging views with the financial sector, Superbancaria decided to postpone the aforementioned initiative in order to find proper incentives that could lead to a voluntary adoption of this type of standards. It is in the search of those incentives that a considerable obstacle has been found.

Nonetheless, the issue is still very much alive, and Superbancaria is seriously considering giving it a new impulse, maybe by implementing an "adopt or explain" scheme and by changing some of the previous content of the project.

What should the priorities for further improvement be?

There are several issues of priority in Colombia to improve the quality, effectiveness and predictability of the legal and regulatory framework.

First, a more precise definition of the attributions of the Colombian high courts is necessary, and also the setting of clearer boundaries for legal procedures such as "acción de tutela". This resource must be permitted only in exceptional cases, precluding its use as a general, almost unlimited recourse as it is in fact used today.

A more efficient judiciary is also of utmost importance. Decisions taken by Supervalores in exercise of jurisdictional powers are appealed before the judiciary, therefore, those decisions are inevitably affected by

the general delays of the court system. Judges primarily trained on financial and capital market issues, or at least in commercial and corporate matters, should be re-introduced[21]. Colombia should examine the experience of those countries that have a specialized financial justice primarily budgeted by the industry itself.

While at first there was an initiative to include class action suits in the recently approved Securities Market Law, the law as finally passed did not incorporate them. Some considered jurisdictional powers assigned to the superintendencies by Act 446/1998 as enough for the protection of investors. In any case Supervalores must make efforts to strengthen its institutional capacity for issuer supervision and also for the prompt adjudication of judicial causes.

In addition, Supervalores is leading a joint effort in which different entities (including but not limited to the CSE, Confecamaras and ANDI) are exploring whether to introduce listing requirements on a comply-or-explain model, which should, inter alia, encourage a more widespread use of arbitration in corporate and shareholder controversies.

Finally, it would be desirable to modify Act 550/1999 in order to strike a better balance between the rights of creditors and debtors in insolvency cases. Supersociedades is currently in the process of drafting a new set of rules on bankruptcy. It is expected that the new regulation will be taken to Congress and passed by the latter before December 2006 (which is the expiry date for Act 550/1999).

[21] Specialised commercial courts were introduced in 1989, but then removed in 1997.

Annex 1
The New Colombian Securities Market Law and Corporate Governance

The new legal framework places special emphasis on protecting investors' rights. One of its main objectives is the improvement of corporate governance practices by promoting greater transparency and disclosure, equitable treatment of minority shareholders and effective boards of directors.

Requirements for all securities issuers:

Both debt and equity issuers are required to comply with new requirements as follows:
Board of Directors
The board of directors of the securities issuers will be comprised of a minimum of five (5) and a maximum of ten (10) main members, of which at least twenty five percent (25%) must be independent.

Auditing Committee

The securities issuers must establish an auditing committee which will be made up of at least three (3) members of the board of directors, including all the independent ones. The president of said committee must be one of the independent board members. In addition, the members of the committee shall have sufficient experience to fulfil their responsibilities appropriately. The law itself sets out in detail some circumstances that must be fulfilled for a board member to be deemed as independent.

Requirements for listed companies:
Equity issuers are required to comply with new requirements as follows:

Mechanisms for selection of members of the Board of Directors

All the listed companies may adopt as part of their by-laws a board election system different from the electoral quotient. The Ministry of Finance is required to produce further regulation on the mechanisms acceptable for this purpose.

Protecting the investors

The law establishes that in case a number of shareholders (holders of at least five percent (5%) of the outstanding shares), raise issues or formulate proposals to the board of directors, the board must consider them and respond in writing, indicating clearly the reasons that motivated their decisions.

Re-acquisitions of shares

The re-acquisition must be carried out through mechanisms that guarantee equal conditions to all shareholders. Consequently, the price for re-acquisition will be based on a technical, recognized procedure.

Agreements between shareholders

Shareholder agreements must be disclosed to the market; otherwise they will be deemed as invalid and ineffective for all legal purposes.