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Achieving Effective Boards

A comparative study of the legal framework and board practices in
Argentina, Brazil, Chile, Colombia, Mexico, Panama and Peru

Draft for Discussion

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Introduction

An effective Board of Directors is at the heart of the governance structure of a well-functioning and well-governed corporation, acting as the ultimate internal monitor. Ideally, the Board defines long-term corporate strategy, puts the key agents in place to implement them, and monitors performance against the strategy set out. Consequently, bad company performance and governance begins with a Board not fulfilling its key responsibilities.

However, almost by definition, Boards of Directors operate out of sight of the public and most investors. While the nature of confidential board deliberations makes it impossible to demand full transparency of board meetings, there needs to be trust and confidence in the proper functioning of the Board. Uncertainty is bad for investment decisions, and as the *Practical Guide to Corporate Governance – Experiences from the Latin American Companies Circle* points out, investor reactions during the recent financial crisis has made the demand for improved boards even stronger.¹

Given these observations, it is all the more important to better understand the functioning of boards in Latin America. The aim of this study is to take stock of the corporate governance framework, consisting of laws, regulations and voluntary codes in seven of the most important markets of the region, and complement it with information on actual practices. Based on these findings, recommendations are advanced to address some of these shortcomings, as well as reflecting the input received from the Corporate Governance Institutes of the region participating in the study.

This study would have not been possible without the input from the Corporate Governance Institutes listed below, all of which participate in the Latin American Corporate Governance Institutes (IGCLA) network.

Survey Respondents

Country	Institute/Respondent
Argentina	Instituto Argentino de Gobierno de las Organizaciones (IAGO)
Brazil	Instituto Brasileiro de Governança Corporativa (IBCG)
Chile	Centro de Gobierno Corporativo y Desarrollo de Mercados, University of Chile
Colombia	Confederación Colombiana de Cámaras de Comercio (Confecamaras)
Mexico	Centro de Excelencia en Gobierno Corporativo (CEGC)
Panama	Instituto de Gobierno Corporativo de Panamá (IGCP)
Peru	Procapitales

¹ International Finance Corporation, OECD and Global Corporate Governance Forum, *Practical Guide to Corporate Governance – Experiences from the Latin American Companies Circle*, Washington DC, 2009. p. 69

The study focuses on the eight topics listed on the right. This selection was developed in conjunction with the institutes as the most relevant topics based on the circumstances of the participating jurisdictions. Additional topics such as board compensation, time availability, the role of board in related party transactions and in financial conglomerates were suggested by the Institutes for future studies.

The *structure of this study* follows these eight topics. Each topic is introduced by a legal map illustrating where the topic is covered in the respective jurisdiction. A brief evaluation of the legal and regulatory framework follows, attempting to establish the degree of coverage of the topic in the region. The subsequent section describes the available information on current practices with respect to the topic. The concluding section offers recommendations.

The *legal mapping*, which forms the basis of the evaluation, was provided by each Institute for their respective jurisdiction.

Information on practices featured in this study came from two sources: the input from the Institutes based on their experience, and a number of surveys and studies listed in the Annex.

Topics of the Study

1. Board Duties
2. Board Handling of Conflicts of Interest
3. Board Selection and Structure Criteria
4. Criteria for Independence
5. Board Committees
6. Chairman/CEO Separation
7. Board Risk Management
8. Board Evaluation

Key Findings of the Study

This section summarizes the main findings of this study on two levels. The first section addresses the key findings and recommendations to take away on a general, overall level. The second section summarizes the key findings and recommendations for each of the eight topics. **Recommendations should be considered as preliminary propositions as a basis for discussion, to be modified as appropriate to take into account Roundtable participant perspectives.**

► Overall Findings

Boards in Argentina, Brazil, Chile, Colombia, Mexico, Panama and Peru

Legal Framework

Summary Legal Framework

- The corporate governance frameworks in the evaluated jurisdictions cover all eight topics of the study. The role of the board in risk management by law and the evaluation of the Board in any form are the least addressed topics.
- Overall, a strong reliance on voluntary codes can be observed when addressing most board topics in detail. In general, broad formulations are made in laws, with the specific duties and requirements covered in codes. The Securities Market Law in Mexico, Law 964 in Colombia and the amended Company Law in Chile are exceptions in for example mandating specific independence requirements.
- The disclosure of board practices, ranging from the existence and number of committees, to the composition of the board is not covered in any framework, with the exception of Brazil, since the issuance of CVM Instruction 480 in 2009.

Recent legal developments and their impact on boards

The most recent legal and regulatory developments in the surveyed jurisdictions occurred in Brazil, Chile, Mexico and Panama.

- In Brazil, BM&FBOVESPA announced alterations to listing rules for companies listed on the corporate governance differentiated Novo Mercado, Level 1 and 2 on September 9, 2010. Board-relevant changes included in the new listing rules are mandatory chairman/CEO separation and the recommendation to introduce a code of conduct. These rule changes are expected to come into effect by the end of 2010. CVM Instruction 480 on securities issuers' rules, enacted in 2009, specified what information has to be published by issuers of securities. This now includes information on committees and board nominees, among others. Lastly, the 4th edition of the IBGC Code of Best Practices was released in 2009 incorporating lessons learned.
- In Chile, Law No. 20.382 of 2009 was enacted to amend the Securities Law Nr. 18.045 and Companies Law No. 18.046. One independent director is now mandatory for most listed companies apart from smaller companies and those with highly concentrated ownership, and the Directors' Committee must ideally be comprised of a majority of independent directors with necessary audit expertise.
- In Mexico, the 1999 Best Practice Code was revised for the second time in 2010. Listed companies

(SABs) have to disclose their compliance with the Code once a year. In the absence of a comprehensive company law reform in Mexico, the Code, together with the 2006 Securities Market Law, has introduced modern board practices to Mexico.

- In Panama, the first Best Practice Guide was published by the Instituto de Gobierno Corporativo de Panamá in 2010, containing chapters on Boards and Board Committees.

Practices

- Evidence from existing information suggests that the impact of voluntary or comply-or-explain codes as a way to enhance corporate governance practices may be limited, as most companies in the region tend to comply only with legal requirements.
- As can be seen in the Annex in the table listing of the available surveys and studies in the region, there have been commendable developments in the region to make more information on board practices available. However, additional information is still needed to come closer to achieving a comprehensive picture of board practices in the region.
- Corporate Governance Institutes have a crucial role in gathering and analyzing practice information. Self-assessments of companies against best practice codes, as for example the answer from Peru pointed out, may be too positive or just follow a box-ticking approach. The upcoming Corporate Governance Index in Mexico, based solely on the analysis of information made publicly available by companies, could offer a promising alternative to self-assessments.

Preliminary recommendations for discussion

- Supplement the role of voluntary or comply-or-explain codes to influence board practices. In certain cases, clear, implementable, and mandatory requirements may serve the purpose of changing board practices better. Codes should continue to advocate best practices.
- Improve the disclosure, quality and timeliness of information in general. In particular, information on internal controls, risks management policy (including main risk factors), nomination and compensation of directors should be released.
- Corporate Governance Institutes have a crucial role in gathering and analyzing practice information to fill the empirical gap on board practices. This information is crucial in convincing companies and boards of the value of efficient boards.
- Companies should document in internal manuals the corporate governance practices implemented, so there is a track-record of practices that can be reviewed over time in case a new management or board takes over.

► Findings by Board Topic

1. Board Duties

Legal Framework

- Specific responsibilities are covered in most countries, but only Colombia and Mexico cover them in law.
- Right to access information is anchored in few laws, duty to dedicate sufficient time and resources in even fewer.
- Duty of directors to provide material information about corporations is covered across the region, but in varying degree of detail.
- Loyalty to corporation and all shareholders addressed everywhere except Panama.
- Personal Liability established in Argentina, Brazil, Chile and Mexico, joint liability in all seven jurisdictions. Liability generally limited to fraudulent behavior and failing to meet duty of diligence.

Practices

- Well-prepared and well-informed boards seem to be found most frequently in big, resourceful companies. Information is also often made available too late.
- Where directors are former or current executives, the board tends to be well-informed.
- Mechanisms to address the non-compliance of directors with their duties are difficult to implement.
- Data from surveys, where applicable, suggests that board responsibilities such as setting corporate strategy are considered to be well implemented.

Preliminary recommendations for discussion

- Increase efficiency of boards in the region by integrating the responsibility of continuous training to the duties of the board.
- In order to be able to fulfill duty to be informed, adequate information systems for directors should be established. This includes the disclosure of both the agenda and relevant information sufficiently in advance of board meetings so directors can attend fully informed and prepared.

2. Board Handling of Conflict of Interest

Legal Framework

- Definitions of what constitutes conflicts of interest are more explicit in regulations and codes than in laws.
- Disclosure of conflicts of interest is covered by all surveyed jurisdictions in their regulatory frameworks.
- Management of conflicts of interest varies throughout the region; in general affected directors abstain from voting in board deliberations.
- The implementation of Codes of Ethics is addressed in few jurisdictions.

Practices

- Conflicts of interest have been less common when non-executive and independent directors who do not own shares serve on the board in Argentina.
- Evidence from surveys suggests weak compliance of directors with their responsibility of monitoring and supervising conflicts of interest as well as lack of discussion of conflicts of interest in board meetings.
- No information on the use of preventive measures was available.

Preliminary recommendations for discussion

- The separation of duties and definition of roles and responsibilities for directors and shareholders could be clarified.
- Specific cases of potential conflicts of interest in the regulatory framework should be defined and their disclosure enforced.
- The discussion of cases of conflict of interest during board meetings should be documented.
- A more widespread application of Codes of Ethics could contribute to reduce unethical and/or unlawful behavior.
- The use of preventive measures and enforcement of sanctions to manage cases of conflict of interest should be more widespread.

3. Board Selection and Composition Criteria

Legal Framework

- Size of the board in the form of minimum and/or maximum number of directors is regulated by law throughout the region.
- Composition is covered in laws, regulations and codes, requiring in most jurisdictions a sufficient number or a fixed percentage of independent directors.
- Requiring relevant experience and knowledge as criteria to be selected as director is required or recommended throughout the region.
- Election and dismissal of directors are in general the responsibility of shareholders.
- Board meeting frequency is not addressed in all the jurisdictions; where it is, monthly and/or quarterly is the rule.
- Office terms with a maximum length of up to 3 years are mostly established by law.

Practices

- Shareholders, former or current executives are commonly selected as directors in Argentina.
- Studies indicate a strong concentration of power in Brazilian boards in the hands of controlling shareholders.
- Board members tend to keep their status as directors for extensive periods in Mexico.
- Survey data shows boards size ranging between 5 and 11 members.

Preliminary recommendations for discussion

- An adequate balance between the number of independent directors and directors with relevant knowledge, expertise and experience is essential for effective boards.
- Limits should be considered on multiple board memberships as a way to increase directors' performance.
- A meeting attendance policy for directors contributes to reduce absenteeism from board meetings.
- Annual evaluation of directors' performance can help to avoid prolonged, ineffective office terms.

4. Criteria for Independence

Legal Framework

- Independence requirements are covered by law only in Chile, Colombia and Mexico.
- Peru's Code offers a very broad definition; all other frameworks address ownership issues, family relations or internal dependencies within companies or external dependencies between companies.
- However, different approaches to the definition of such dependencies, ranging from very broad, general definitions, to detailed definitions of relationships that constitute dependencies can be found throughout the region
- The disclosure of background information of board nominees, including their independence status is only covered under the new CVM Instruction 480 in Brazil.

Practices

- No information on practices on compliance with independence requirements in practice is available.
- Companies tend to have the minimum number of independent directors required by law, indicating that, perhaps, the value of independent opinion on the board is underappreciated.

Preliminary recommendations for discussion

- Consideration should be given to strengthening independence requirements by incorporating them into Company and Security Market Laws or mandatory Regulations.
- Greater transparency of nomination processes and the release of information on the background of candidates should be encouraged.
- The development of studies showing the empirical benefit of having directors with diverse and independent opinions on the board could be beneficial in order to overcome the reluctance of many companies in the region to have independent directors on the board.
- Confecamaras suggests strengthening the capabilities of Corporate Governance Institutes, allowing them to build databases of independent directors and certify directors on their expertise in corporate governance and management.

5. Board Committees

Legal Framework

- Audit committees are mandatory for listed companies in Argentina, Colombia and Mexico. The equivalent Directors' Committee in Chile is mandatory over a certain market value.
- Other types of committees are generally non-mandatory in the region. Possible functional committees put forward in Codes in the region include compensation and nomination, corporate governance, risk management, compliance and sustainability.
- Regarding the composition of committees, the Mexican Securities Market Law requires the mandatory Audit Committee, and the Corporate Governance Committee to be composed of independent directors only. All other Laws and Codes in the region require at a maximum a majority of independent directors in the Audit Committee.
- A specific frequency of committee meetings is addressed in very few frameworks.

Practices

- Survey data from Brazil, Chile, Colombia and Mexico suggests that the use of committees, other than the Audit Committee or its equivalent where mandated by law, remains low.
- Information on composition of committees is generally not available, but will be soon in the case of Brazil, since CVM Instruction 480 requires companies to disclose committees and their composition.
- The benefit of committees seems to be perceived as low in some jurisdictions, seen more as a burden than a useful tool.

Preliminary recommendations for discussion

- Consideration should be given to extending the legal coverage of committees, their composition and functions, since they are currently, if at all, mainly covered in codes.
- Demonstrating, preferably empirically, the benefit of establishing committees could convince corporations of their value-generating virtues.
- However, the availability of more information about committees is a precondition to do so and should be encouraged.
- Issuing recommendations about the functioning of committees and the handling of multiple meetings as well as Director's remuneration should be considered.

6. Chairman/CEO Separation

Legal Framework

- Mostly recommended in codes and corporate governance guidelines; by law only in Chile and Colombia (soon to be mandatory under Novo Mercado listing rules in Brazil). It is not covered in Argentina.

Practices

- The majority of listed companies in Brazil separate the roles of Chairman and CEO.
- Survey data for Chile shows that the majority of interviewed directors do not perform management

roles.

- The use of a lead non-executive director if the roles of Chairman and CEO are combined was not observed.

Preliminary recommendations for discussion

- Countries should consider requiring Chairman/CEO separation in law or regulation.
- Company statutes need to clearly state the responsibilities and functions of the CEO, director, and chairman, to avoid over-concentration of responsibilities, attributions, functions, and power (not always required in the legal and regulatory framework of the surveyed jurisdictions).
- A lead non-executive director should be considered as an appropriate alternative if the roles of Chairman and CEO are combined.

7. Board Risk Management

Legal Framework

- Not regulated by law in any jurisdiction.
- Risk identification, disclosure, management, monitoring and evaluation are regulated in codes, decrees, rules and circulars in all jurisdictions but Chile.
- Preventive risk measures are not extensively regulated in the region.

Practices

- While risk identification and management is in general the responsibility of management, and risk disclosure, evaluation and prevention the responsibility of the board, this functional division is not uniformly applied throughout the region.
- Discussing the company's risks in board meetings and disclosing information on risk management policy and main risk factors to the public is not common practice throughout the region.

Preliminary recommendations for discussion

- The responsibilities of the board and management regarding the identification, disclosure, management, evaluation and prevention of risks should be clearly defined to avoid functional overlap (usually between the risk management and monitoring functions).
- Introduce and implement the use of risk prevention measures to better understand and minimize corporate risks.
- Boards should define the risk appetite of the company and create a specific committee or department for risk management, which defines the strategy for the management and disclosure of risks and reports directly to the board.
- Better disclosure, quality and timeliness of information on internal controls and risk management policy, including main risk factors, would increase understanding of this practice in the region.

8. Board Evaluation

Legal Framework

- Only Argentina, Brazil, Mexico and Panama address the issue of board evaluation in voluntary codes and resolutions.
- Argentina and Brazil recommend an annual evaluation of the board, based on pre-established benchmarks. Brazil and Mexico also recommend an evaluation of individual board members.
- CVM Instruction 480 requires companies to disclose evaluation mechanisms of board members and committees in Brazil.

Practices

- Board evaluations are not common practice in the region.
- Contributions from Argentina and Colombia suggest that boards resist evaluations since they are not mandated to do so.
- Individual director evaluations appear even less common than those of the whole board.

Preliminary recommendations for discussion

- As a first step to better establish the concept in the region, board evaluations should be recommended at least in voluntary corporate governance codes.
- The utility of board evaluations for the company, the board and individual directors needs to be better demonstrated.
- To overcome the barrier of lack of know-how, board evaluation methodologies could be developed for the context of each jurisdiction and be provided to companies.

I. Board Duties

1. Background

Principle VI.A of the OECD Principles states that “Board members should act on a fully informed basis, in good faith, with due diligence and care and in the best interests of the company and its shareholders.” As explained further in the methodology to the OECD’s Principles, the objective sought by the principle is a board, which is informed and objective in its oversight of professional management. According to the *Methodology for Assessing Implementation of the OECD Principles*, this is “arguably the most important individual principle of the Principles,” since if all companies and jurisdictions were to fully implement and enforce it, there would be little need for other individual principles. Indeed, many other principles are intended to ensure that this principle is implemented as effectively as possible.

The OECD Principles further state the two key elements of the duty of board members: the duty of care/diligence and the duty of loyalty. Duty of care/diligence can be viewed as the responsibilities of Directors to be fully informed and to exercise care and diligence in decision-making, including by ensuring that key corporate information and compliance systems are fundamentally sound and underpin the monitoring role of the board. Loyalty is generally defined as a duty to the company and all of its shareholders rather than to a controlling shareholder or group, such that Directors ensure against conflicts of interest, for example, that may occur through remuneration policies, related party transactions or self-dealing.

2. Legal Framework

a. Overview

Country	Law	Regulation	Best Practices Code
Argentina	Companies Law N° 19550, 1972, Art. 274, 275, 276, 277, 278 and 279 (board integrity), Article 59 (board duties)	Decree 677, 2001 Art. 8 (board duties) CNV Resolution 516, Anex I	Best Practice Code, 2001 Code Point 1.1 (board integrity), Point 1.5 (board duties)
Brazil	Corporation Act (Law 6404/76) Art. 153,154, 155,157,158, 159 Civil Code, Art 1010, 1011, 1013, 1016	Instruction 480 CVM, 2009 : Art. 42, 43 Novo Mercado Rules, 2000	Best Practice Code, 2009 2.1, 2.2, 2.3.2
Chile	Ley 18.045 Securities Markets Act, 1981, Art 10, 55-57 Ley 18.046 Corporations Act, 1981, Art 7, 39, 40-43, 45, 46 Ley No 19.705, 2000 Ley N° 20.382, 2009, Art 10		
Colombia	Law No. 964, 2005, Art 44 Law No. 222, 1995, Art. 22,23, 24, 25 Commercial Code, 1971, Art 185, 200	Decree 663, Art 72 Circular Basica Juridico, 7.1 Decree 2555, 2010, Art. 3.1.9.1.3, 5.2.4.1.5 Decree 2955, 2010, Art 2.6.13.1.7., y 2.6.13.1.8	Best Practice Code, 2007 Medida No. 17, 18, 19, 20
Mexico	Securities Market Law (LMV), 2005 Art. 26, 28, 29, 30, 32-35, 41, 125	Issuers Circular, 2003, Anexo S	Best Practice Code, 2010 Practice 7, 21, 22

Panama	Corporation Law, 32, 1927, Article 50, 51, 53, 54, 64, 86, 87, 88, 89 Commercial Code, No 2, 1916, Art 444 Penal Code, Art 247, 250	SB Agreement No. 4, 2001, Art 9 CNV Recommendations on Corporate Governance, 2003, Article 6	Best Practice Code 2010, 2.7
Peru	Companies Law, 1997, Art. 171, 173, 175, 176, 177, 180, 348, 351, 354, 373, 376, 379 Securities Market Law, 1996, Art 12, 32, 34, 41, 43, 51	CONASEV Regulations, No 359 and No 009	Best Practice Code, 2002 Principle II.B, II.D, V.A, V.B, V.C, V.E, V.F.

b. Degree of coverage

This section covers four areas of board duties: general responsibilities, duty of care and diligence, duty to inform, and loyalty. It also addresses the potential consequences of breaching those duties under liability.

► General Responsibilities

Argentina, Brazil, Colombia, Mexico and Panama spell out specific responsibilities of the boards in some detail in law, regulation or voluntary codes. All these documents state, in one way or the other that the board should discuss, approve and monitor decisions involving strategy, risk, human resources, internal control and succession processes for board members and officers among others. While the board is responsible for supporting and continuously overseeing the company's management with respect to businesses, risks and people, it should not interfere in operating matters.

Mexico is the only jurisdiction to address these responsibilities in law, in the 2006 Securities Market Law (LMV). It covers the responsibilities described above, and Article 28 adds ensuring equal treatment of shareholders, the protection of their interests and their access to information; and the promotion of timely and responsible disclosure of information and transparency in the administration to the tasks of the board.

In *Colombia*, while the responsibilities of boards are covered in detail in Decrees, they apply only to financial institutions and intermediaries (Decree 663), collective investment schemes (Decree 2555) and Institutional Investors such as Pension Funds (Decree 2955).

Most responsibilities in *Argentina* are listed only in company statutes, but Resolution 516 of the Securities Commission (CNV), which introduces a comply-or-explain regime for corporate governance practices, lists additional, specific non-binding responsibilities. They are broadly similar to the ones listed above, with the exception of listing the development of programs for the continuous education of directors as a task of the board. Lastly, in *Brazil* and *Panama* above responsibilities are only addressed in their Best Practice Codes.

► **Duty of Care and Diligence**

Definition

The definition of duty of care and diligence is covered by all surveyed jurisdictions in law, with the exception of Panama. Apart from Mexico, all company laws invoke the concept of an honest businessman in their definitions. Brazil's Corporation Act can serve as an example: "In the exercise of his duties, a corporation officer shall employ the care and diligence, which an industrious and honest man customarily employs in the administration of his own affairs." (Article 153) Mexico's LMV requires directors to act in good faith and in the best interest of the company.

Duty to be informed and devote sufficient time

A key prerequisite to fulfill the duty of care and diligence is to devote sufficient time to and be well informed about company affairs. Consequently, the corporate governance framework in most countries devotes space to these particular aspects of director's duties.

The *Argentinean Code* requests that directors dedicate sufficient time and obtain all the necessary information to form an objective, independent judgment. The *Mexican Code* also recommends that directors devote the necessary time to fulfill their role, requesting attendance of at least 70% of meetings. The LMV goes one step further in declaring that directors fail to comply with their due diligence requirements if they do not attend board meetings, unless they have a justified cause in the opinion of the shareholders. In *Colombia*, the Code requests directors to inform themselves, when first nominated to the board, about the company and the sector.

Laws and codes in many jurisdictions combine the duty to be informed with the right of directors to access information. While the right for directors to access relevant information is advocated in the Colombian Code, *Panama's* CNV Recommendation 12 calls for all board members to have equal access to the company's information system, but puts the onus on the board itself to establish such a system. The Recommendation does not contain a particular clause on the need for the individual director to be informed. Brazil's Code adds that the board is free to request all the necessary information to perform its functions, which includes, if necessary, consulting external experts.

Chile and *Peru* enshrine the right of directors to be fully informed at any time into their company law. Directors are expected to exercise this right in such a way that it does not affect the company's management. In *Mexico*, the LMV requires that directors have access to all necessary information for their decision-making process.

► **Duty to Inform**

Material Information on Corporation

While it is the duty, and the right of directors to be informed about corporate affairs, ensuring that all relevant information about the corporation is released to the public is one of the key responsibilities of boards in most jurisdictions, albeit covered in varying degrees of detail.

The most straightforward formulation can be found in *Brazil* and *Chile's* Companies Laws. Both cover similar ground in requiring the board to immediately inform the stock exchanges and the public about any decision of the general meeting or of the corporation's administrative bodies or any other material

information, which could be of relevance to market participants. Directors may restrict the publication of such information if it would put the business of the corporation at risk. Under Chilean law, three quarters of acting directors can vote to restrict it. In both Brazil and Chile, the respective securities regulator needs to be informed of the decision to restrict information. This particular directors' duty is formulated with similar clarity in Colombia, under Decree 2555 applicable to all issuers of securities.

Under *Peruvian* Companies Law, the board is required to disclose to shareholders and the public all information about the legal, economic and financial situation of the company as specified by law. The Peruvian Securities Market Law then introduces the concept of restricted information, to be authorized by a board vote. Somewhat vaguer, *Mexico's* LMV tasks the board with the establishment of information and communication policies with shareholders and the market. Similarly, albeit only in non-binding recommendations, *Panama's* CNV assigns the duty to create information and communications policies to the board. In *Argentina*, the duty to inform is even less explicitly formulated in Decree 677. The Decree establishes among the duties of a director to act with the diligence of a good businessman in the preparation and disclosure of information to the market.

Information on Director's ties to corporation

Surprisingly few jurisdictions require the disclosure of information of a director's ties to the corporation. Only Brazil, under Corporate Law, and Argentina in its Corporate Governance Code cover the release of information on any interest held in the corporation, such as shares, options, or contracts.

Transparency of decision-making

Under Mexico's LMV, a director is required as part of his duties to disclose to the board or committees any information that could be relevant for their decision-making, unless it is confidential. The Colombian Code recommends documentation in the board's minutes of the factors that went into the decision making process/rationale of the Board.

► **Loyalty**

Towards all shareholders

A director has to fulfill his fiduciary duty towards all shareholders and the corporation as a whole, not just the shareholders who elected him. This important concept is explicitly formulated in law in Brazil, Chile and Peru's Company Law, Colombia's Law 222 and Mexico's LMV. In Argentina, it is covered by Decree 677. The only country not to have the concept of loyalty to the corporation in its legal framework seems to be Panama. The response from Panama suggests that the fiduciary duty of directors towards all shareholders is only assumed, and there are no regulations addressing such duties, which is especially important in light of majority shareholders who may control the board.

Confidentiality

The second key concept with respect to loyalty is that of directors keeping confidentiality in relation to the corporation's business or any information directors may have access to because of their position and which the company has not officially disseminated. This concept is covered in Brazil and Chile's Company Law, and in Mexico's LMV. In Argentina it is only covered in the Best Practice Code.

Colombia's Law 222 and Peru's Securities Market Law are less descriptive, as they simply prohibit board members from using privileged information. Panama's corporate governance framework is silent on the matter.

► **Liability**

Given the importance of ensuring liability of directors for their actions, it is not surprising that it is established in all jurisdictions. Most establish personal, as well as joint liability by directors, limited, apart from Panama, to civil liability. The limits to liability are also spelled out in some of the legal frameworks, and shareholders are given the opportunity to initiate civil lawsuits in a few surveyed jurisdictions.

Personal liability is established in Brazil under Company Law if an officer acts with fault or fraud within the scope of his authority or acts against laws or bylaws. Argentinean Companies Law imposes personal liability for those that fail their duties of due diligence, while Chilean Securities Market Law makes directors personally liable for restitution when they are breaking the law. Under Mexico's LMV, a director or individual with decision-making authority who fails to comply with his/her Duty of Loyalty and causes economic damage to the corporation, is personally liable.

More common is **joint liability**, which is established in all jurisdictions. The board of directors is jointly liable for the losses to the corporation and its shareholders caused by failure to comply with the duties imposed by law, and fraudulent or negligent behavior. Interestingly, in Chile, under Article 41 of the Company Law 18.046, and Colombia under Art 24 of Law 222 liability cannot be limited by the shareholders meeting or corporate by-laws.

Exemptions from liability are granted under Law in Argentina, Brazil, Chile, Colombia and Peru when the director did not have knowledge of the action, voted against it or made his opposition to the decision known. Brazil's Company Law also explicitly states that directors cannot be held liable for actions taken during the ordinary course of business, while Mexico's LMV introduces a business judgment rule which is intended to protect directors from liability for specific business decisions that result in losses to the corporation when they (i) acted in good faith; (ii) complied with the requirements established by law and by-laws; (iii) acted on an informed basis, (iv) acted in the honest belief that the action taken was in the best interests of the corporation; or (v) took all the necessary measures to carry-out the resolutions adopted at a shareholders' meeting.²

Apart from Panama, all surveyed jurisdictions **apply civil liabilities for wrongdoing**. In Panama the Penal Code introduces prison sentences of 4 to 7 years for directors approving transactions that lead to the liquidation or insolvency of a financial institution with public resources, and 5 to 8 years for directors who omit, deny or provide false data to supervisory authorities to hide liquidity or insolvency situations.

In addition, the Company Laws in Argentina and Brazil, and Colombia's Law 222 entitle the shareholder's general meeting to bring action for civil liability against any officer for the losses caused to the corporation. The Laws also entitle any shareholder to pursue the action if it has not been initiated within three months from the date of the general resolution of the shareholders' meeting. If the general

² See Yves Hayaux-du-Tilly L. Alberto Balderas F, *New Mexican Securities Law*, January 2006. Available from <http://www.jnrr.com.mx/publicaciones/NewMexicanSecuritiesMarketLaw.pdf>

meeting fails to institute proceedings, shareholders representing at least 5 percent of the capital may do so. In Mexico, the case is slightly different, under the Circular Unica de Emisores, 15% of shareholders of a SAPIB³ and 5% of a SAB can hold directors liable in a civil lawsuit.

3. Current Practices

Information provided for this topic by the participating institutes and from available surveys is rather fragmentary and anecdotal. This is in part of course due to the difficulty of empirically measuring most of the responsibilities of directors. Nevertheless, some interesting insights can be gleaned from the information available.

With respect to the **responsibility of diligence** of a director to be adequately prepared for board meetings, information from Brazil suggests that mainly the big companies have established the practice of providing material in advance so that board members can efficiently prepare for their duties. IBGC noted that some companies are establishing web-based governance portals allowing directors to more easily obtain information. In Argentina on the other hand, directors tend to be well-informed according to IAGO's response, since the board is usually made up of current and former executives as well as shareholders. The answer from Panama stressed that since there are no provisions that require directors to be informed and prepared for board meetings, it is customary that information becomes available to directors only during the meeting.

The answer from Colombia pointed to a problem, which could also be indicative of problems in other jurisdictions. The answer from Confecamaras raised the issue of a **lack of mechanisms to address the non-compliance of directors** with their duties, since the regular judicial process is overwhelmed with the complexity of issues at stake. This task falls exclusively to the regulators who can only act when complaints are brought before them. The stronger independence of supervisors or the constitution of specialized commercial courts was urged in this context.

All other information provided in this section is based on surveys conducted in Brazil, Mexico, Chile, Colombia and Peru. According to the 2009 IBCG/Booz&Co study, the top five duties companies in Brazil perceived as "very important" or "important" in a Board are: Performance Monitoring, Strategy Designing, Strategic Decision Taking, Financial Statements Validation and Risk Management. Based on the research, IBGC/Booz&Co concluded that boards in general were fulfilling their duties satisfactorily, while 75% of the companies apply a Code of Conduct to their boards in order to assure their integrity.

The 2009 Deloitte Study in *Mexico* surveyed 160 board members and executives of 144 companies, both listed and unlisted, and superficially covered board responsibilities. It reveals that the directors interviewed were generally satisfied with the role the board is playing in setting corporate strategy, the availability of information for the board's decision-making process to take decisions, and the clarity of rules and responsibilities of the board.

³ SAB and SABIPs were created by the LMV in 2005. SAPIB means: the 'Limited Liability Corporation that promotes equity through public trading. The SAPIB is the bridge from a medium-size corporation privately traded, to a publicly held corporation. SAB means the 'Limited Liability Corporation Publicly Traded'. It is the form that every company that trades in the Mexican Stock Market must follow.

Similarly, the 2009 study for *Chile*, conducted by the Center for Corporate Governance and Capital Markets, based on interviews with 63 directors of listed and closely held companies, sheds some light on issues related to responsibilities. Taking and validating strategic decisions, monitoring the principal risks of the corporation as well as its financial health all ranked as the highest responsibilities for those interviewed. The 2007 McKinsey Study on Improving Board Practices in Chile found that the most critical function named by 249 respondents was to develop corporate strategy and supervise investment, such as mergers and acquisitions. According to the responses, developing corporate strategy had the biggest negative difference between perceived importance and actual implementation.

In *Colombia*, the 2008 survey on compliance of 177 issuers of securities with the Code of Best Practices found very high levels of implementation for board responsibilities. Access to relevant and sufficient information to perform a director's role was found to be at 83.7%. The recommendation that meeting minutes should include the analysis and rationale and other sources of information decisions were based on, was reported to have been implemented by 84.6% of companies. The recommendation demanding directors' access to relevant information for decision making at least 2 days before the meeting as well as ways to access/require the information, was only implemented by 66.7% of companies. However, this represented a marked improvement over 2007, when only 17.3% had implemented the recommendation.

In *Peru*, the 2008 report on compliance with corporate governance principles issued by CONASEV (the securities regulator) analyzed 69 listed companies in depth. With respect to responsibilities of the board, companies found their compliance to be highest with the recommendation pertaining to guiding and evaluating the overall strategy and risk management of the company, and lowest with the recommendation to supervise the effectiveness of corporate governance policies.

4. Summary and preliminary recommendations for discussion

Duties and Responsibilities of the board are spelled out in law, regulation and codes throughout the region. Some jurisdictions opt for a more detailed description of general responsibilities, while others emphasize the legally binding character of duties. Interestingly, the duty of directors to be informed and prepared for board meetings is explicitly covered in only a few laws and codes. The responsibility of directors to ensure that all material information on the corporation is disseminated is covered in all jurisdictions, however, again with varying degrees of detail and legal obligation. The liability of individual board members and the board as a whole is covered in all surveyed jurisdictions, but information on the degree of use of liability provisions would be beneficial in order to gauge the relevance of this instrument in the region. Information on actual practices with respect to other areas of board responsibilities is equally sparse, but suggests that the efficiency of boards is an issue in the region.

Consequently, recommended actions focus on increasing the efficiency of boards in fulfilling their duties.

- Continuous training as a responsibility/duty of the board is virtually absent from the corporate governance frameworks of the seven surveyed jurisdictions with the exception of Argentina and Brazil. More emphasis should be put on this aspect, since giving directors the necessary tools can contribute to better prepared and more professional boards with stronger capacity to effectively exercise their duty of care.

- In order to facilitate directors fulfilling their duty to be informed, it is equally important to establish real-time information systems, especially for large companies with complex operations.
- This includes giving directors the opportunity to be fully informed and prepared to effectively discuss the company's affairs at their meetings by disclosing the agenda and relevant information sufficiently in advance of the board meeting.

II. Board Handling of Conflicts of Interest

1. Background

An important supervisory function of the board is to monitor and manage potential conflicts of interest involving management, directors and shareholders, including misuse of corporate assets and abuse in related party transactions. These functions are sometimes assigned to the internal auditor, who should maintain direct access to the board. Principle VI of the OECD Principles states that the board should encourage the reporting of unethical or unlawful behavior without fear of retribution. The existence of a company code of ethics aids this process, which should be underpinned by legal protection for the individuals concerned. In addition, the monitoring of managerial performance requires preventing conflict of interest and balancing competing demands on the corporation, so the board can exercise objective judgment.

The 2003 White Paper points out (pars. 73-77) that "The legal framework should require full disclosure on a periodic basis of director affiliation and interests and total remuneration. Publication of such information should be included in the periodic reports of the company made available to shareholders. Certain types of corporate activities involving potential conflicts of interest on the part of controllers and company management – including transactions with affiliated parties, lending to insiders, management contracts with controllers or affiliates and co-investment by the company in other ventures of the controlling shareholder should be under special scrutiny."

2. Legal Framework

a. Overview

Country	Law	Regulation	Best Practices Code
Argentina	Companies Law No. 19550, 1972, Art 272	CNV Resolution 516, 2001, Point 2 Decree 677, 2001, Art 8	Best Practice Code, 2004, Point 1.7.3
Brazil	Corporations Law No. 6404, 1976, Art 156	CVM Instruction 480, 2009, Articles 16, 13.3	Best Practice Code, 2009, 2.25, 6.2, 6.2.1, 6.2.2
Chile	Law No. 20382, 2009, Articles 146, 147, 148		
Colombia	Law No. 222, 1995, Article 23	Decree 663, 1993, Art 98, 146 Decree 1925, 2009, Art 1, 2, 3, 4, 5	Best Practice Code, 2007, Mesures 17, 18, 19, 20
Mexico	Securities Market Law, 2005, Art 124 Credit Institutions Law, 1990, Art 23		Best Practice Code, 2010, Practices 39, 40
Panama		SB Agreement No. 4, 2001, Art 9 Cabinet Decree 247, 1970, Art 34 CNV Agreement 12, 2003, Articles 6, 7	Best Practice Code, 2010, 2.4, 2.7, 4.4, 7

Peru	Corporations Law No. 26887, 1997, Articles 161, 162, 180 Securities Market Law, 1996, Articles 51, 85		Best Practice Principles, 2002, Principles V.D., V.E.
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b. Degree of coverage

► Definition

The definition of conflict of interest varies significantly across the region, ranging from broad statements on having interests that are not aligned with those of the company to very specific cases of potential conflict of interest. Regulations for listed companies and best practice codes are generally more explicit than companies' laws with regards to the definition of conflict of interest. In Mexico and Panama, the respective companies' laws do not define conflict of interest.

Argentina's Companies Law defines conflict of interest as having any interest different from that of the company. However, Decree 677 for listed companies offers a more specific definition referring to any kind of corporate activities for which competition, use of company's assets, use of confidential information, seeking personal or third party benefit from business opportunities, and any other situation creates or could create a conflict of interest.

Brazil's Companies Law, similar to *Argentina's*, defines conflicts of interest as directors' participation in any corporate transaction in which they have personal interest, whereas for the Brazilian Code a conflict of interest occurs when a director is not independent from the subject being discussed by the board, and may influence or make decisions motivated by interests other than those of the company. In addition, the Code mentions that directors should avoid the misuse of corporate assets and, in particular, the abuse of related party transactions. It also includes the prohibition of loans in favor of controlling partners and managers.

Until October 2009 conflict of interest for only non-listed companies was explicitly covered under *Chile's* Companies Law 18.046. However, law 20.382 amended the Companies Law and now specifically describes cases of related party transactions for listed companies. It states that a company can only undertake these transactions if they complement the company's social interest, are conducted according to market practices, and are disclosed to and approved by the board (transactions of less than 1% of the company's equity, if less than 2.000 UF [ca. USD 80.000], are not considered relevant, and therefore do not need to follow the mentioned requirements).

In *Colombia*, Decree 1925 defines conflicts of interest as a directors' participation in any activity in which they have personal or third party's interests that can result in a conflict of interest or in competition with the company in violation of the law and without the specific authorization from the shareholders' meeting.

Mexico's Code recommends using corporate assets or services only in the company's best interest and having a clear policy if used for personal benefit.

Neither *Panama's* Code of Commerce nor Companies Law regulates conflict of interest. However the non-mandatory CNV Agreement 12 for registered companies lists demanding or accepting payments or other gifts, seeking personal interest with their decisions, or using the company's business for personal

benefit as potential cases of conflict of interest for board members. Agreement 4 for banks only states that directors' participation in the board should not present ethical material conflicts or conflicts of interest. According to the Best Practice Code, conflicts of interests occur when a director or employee of the company is part of the deliberations of a decision that can affect positively or negatively interests held outside the company.

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

► **Disclosure of Conflicts of Interest**

The issue of disclosure is, in one way or another, covered in all the jurisdictions. The Companies Law in Argentina, Brazil, Colombia and Peru, Best Practice Code in Brazil, Mexico, and Panama, Colombia's Decree 1925, and Panama's CNV Agreement 12 require directors to disclose "any situation" that represents or could potentially result in a conflict of interest. Argentina's CNV Resolution 516, as well as the Best Practice Code, relies on the mandatory requirements included in the company's statutes to make directors disclose any personal interest in the company's decisions. In addition, the following regulations require disclosure of specific cases of conflict of interest. Brazil's CVM Instruction 480 obliges companies to disclose rules and practices regarding related party transactions, including naming the related parties, their relationships, and the specific transactions. Chile's Law No. 20.382 obliges directors to inform the board about their interest or participation in related party transactions. Under the Colombian Best Practice Code, disclosure rules apply only to directors' relationship with other directors, companies, suppliers, clients, or any other interest group that could be the source of a conflict of interest. In the case of Mexico, the Securities Market Law obliges directors to inform the audit committee or external auditor of any known wrongdoing on the part of the company or its members. Panama's article 34 of Cabinet Decree 247, which applies to companies registered with the Securities and Exchange Commission, requires the disclosure of all contracts entered into by the company or its directors.

► **Procedures**

Dealing with cases of conflict of interest

As a general practice to deal with cases of conflict of interest in most countries, directors should abstain from participating in the board deliberations and decisions when they are involved in such cases. This practice is stated in the Companies Law in Argentina, Brazil, Colombia and Peru, Brazilian and Panamanian Best Practice Codes, Colombia's Decree 1925, Mexican Code, Securities Market Law (for SABs and stock exchanges) and Credit Institutions Law, and Panama's CNV Agreement 12. However,

this requirement is not observed under Chilean legislation. In the specific case of Colombia, the Companies' Law obliges directors to abstain from participating in any action that can potentially constitute a conflict of interest (for personal or third party benefit), unless the action does not jeopardize the company's best interest, and there is an explicit authorization from the shareholders' meeting. Similarly, per Argentina's Code, independent directors should approve related party transactions that involve majority shareholders. Also stated by the Code is that the companies' statutes should mandate solving conflicts of interest between shareholders and directors through arbitration.

Preventive Measures

Implementing specific measures to reduce or prevent the risk of conflict of interest is part of boards' loyalty and due diligence duties according to Argentina's Decree 677. In Brazil, the clear separation of duties and definition of roles and responsibilities for directors, including the degree of authority to make specific decisions, is recommended in the Code as a measure to minimize possible sources of conflicts of interest. In addition, regarding related party transactions, the Brazilian Code also mentions that directors should ensure that these transactions are conducted according to market practices, and clearly stated in the company's reports. In Panama, CNV Agreement 12 for registered companies and the Best Practice Code recommend the board to identify, disclose, and manage conflicts of interest. The Code also recommends that directors submit their resumes (Curriculum Vitae) to the Chairman, including all their commercial and business activities. Also, it is the responsibility of the board to supervise and manage related party transactions. It's also mentioned in Agreement 4, that to avoid conflict of interest the CEO, COO and CFO of banks could constitute a board's minority, but never preside over it. Peru's Code requires the board to review and monitor any potential conflict of interest among the management, board and shareholders. The Mexican Code recommends that to prevent a potential conflict of interest, the CEO and top executives should abstain from participating in the deliberations regarding the designation or removal of the chairman and top management, evaluation and compensation of the chairman and top management, and setting the payments for the chairman and high management in the case of a liquidation.

Record Keeping

Once a case of conflict of interest is identified and the person involved is temporarily removed from the deliberation and decision process, the situation should be documented in the minutes of the meeting as required in the Brazilian Code. In the same way, Chile's Law 20.382 requires the record keeping of the rationale behind the decision process why a related party transaction was approved as well as the reasons why the specific director was excluded from the decision-making process. The Colombian Code recommends that, in general, the sources of information, studies undertaken, and the reasoning behind the decision-making process as well as the voting motives against and in favor should be stated in the minutes.

Penalties and Sanctions

Significant penalties are included in the legal and regulatory framework of some countries. The Brazilian Companies Law requires that the "officer concerned" who benefits from unethical or unlawful behavior should be obliged to transfer all the benefits to the company. Chile's law 20.382 states that directors who fail to inform the board of their interest or participation in a related party transaction are liable for the damage the transaction causes to the company and its shareholders. In Colombia, under Decree 663, the Superintendency of Banks is empowered to impose sanctions, and/or establish mechanisms to fix specific

violations, to directors of financial institutions and intermediaries who with access to privileged information do not abstain from actions that can cause conflict of interest. Under Decree 1925, shareholders are also liable for the transactions they approved that have affected the company, having to return the profits made and pay for the damages caused to the company. Also, the directors who obtain explicit authorization from the shareholders' meeting with false or incomplete information cannot use such authorization to be excused for the liability caused to the company and its shareholders.

3. Current Practices

In *Argentina*, current accounting standards require the inclusion in the balance sheet of all information on related party transactions. However, current accounting standards do not require the disclosure of potential conflicts of interest of directors in the company's periodic financial reports. It is common practice in Argentina according to IAGO, especially for Small and Medium Enterprises (SMEs) and family owned companies, to select all or mostly all shareholders as directors. However, from IAGO's perspective, conflicts of interest have been less common in cases in which non-executive and independent directors who do not have shares serve on the board.

As noted by IBGC, in *Brazil*, while related party transaction disclosure is regulated for listed companies in the special listing segments, it is a very common issue for non-listed companies due to their status as family owned companies. The 2009 IBGC/Booz survey reports that 70% of the companies surveyed rarely or never discuss cases of conflicts of interest in board meetings. However, the research shows that 78% of companies do have some mechanisms to address cases of conflicts of interest in place (54% of the respondents revealed having a policy for insider information, 34% having a policy for related party transactions, 28% using mediation as an alternative to solve such conflicts, and 22% making directors abstain from voting on decisions where they have conflicts of interest). The report also found that only 35% of the companies find it "important" or "very important" to develop and implement a policy to mitigate risks associated with conflicts of interest. The KPMG annual study on listed companies showed that all companies issuing American Depositary Receipts (ADRs) publicly disclose their Codes of Conduct or Ethics. This percentage was substantially lower in other groups (68.4% for Level 1 and 2 companies, 42.2% for Traditional segment companies, and 47% for Novo Mercado companies), indicating that many companies probably do not yet have such codes. As for having a policy on related party transactions, only 12.5% of companies with ADRs and less than 6% of other types of companies have one. According to the 2009 IBGC's Corporate Governance Award data, only 0.3% of listed companies disclose substantial information on policies that deal with related parties transactions and conflict of interest, but 60% were found to disclose at least some information on these issues.

Chile's 2009 Center for Corporate Governance and Capital Markets report found that 97% of directors (72% of whom serve on listed companies) affirmed having mechanisms to resolve conflicts of interest between shareholders and top executives of the company. Among these, the most used mechanisms are on related party transactions, on the use of inside information, and disclosure of relevant information. However, the report states, one of the least discussed issues among directors is the management of conflicts of interest.

In *Colombia*, according to Confecamaras, the issue of conflicts of interest is managed by the shareholders meeting and not by the board. This situation makes handling conflicts of interest more difficult, although it allows minority shareholders to have more control and at the same time discourages directors from participating in potential situations of conflict of interest. In addition, Confecamaras pointed out that in

most cases directors' involvement in conflict of interest situations is caused by a lack of awareness of any wrongdoing, or simply because directors are also the owners of the company and therefore don't find it inappropriate to personally benefit from company affairs. The Colombian answer points to the lack of jurisprudence or civil legal action being taken with regard to directors' involvement in cases of conflicts of interest.

Neither *Panama's* Code of Commerce nor Companies Law regulates conflicts of interest; therefore, according to the answer from Panama, directors of non-regulated companies do perform transactions and conduct business with the company.

CONASEV's 2009 Corporate Governance Compliance Report found that in *Peru*, out of 69 joint stock companies (26 listed on BVL), 6 explicitly mentioned that their boards do not comply with the responsibility of monitoring and supervising potential conflicts of interest among managers, board members, and shareholders. Among the 62 companies with boards that comply with the regulation however, 25 stated that the issue is not included in and therefore not regulated by the companies' statutes. Also, 48 companies indicated having an Ethics Code or similar document that addresses the issue of conflicts of interest. Finally, three companies declared having had at least one case of conflict of interest discussed by their boards in 2008.

4. Summary and preliminary recommendations for discussion

As observed in the regulatory framework and current practices, the definition of what constitutes a case of conflict of interest is diversely covered in the region. In one jurisdiction, the misuse of corporate assets is considered a conflict of interest, whereas in another, the abuse of related party transactions constitutes a case of conflict of interest. The disclosure obligation is more uniformly covered given that, either by law, best practice code, or regulation, the reporting of "any situation" that represents conflicts of interest is required in almost all jurisdictions. However, not all the countries have preventive measures and sanctions in place to deal with situations of conflict of interest.

The following are, given this analysis, possible recommendations regarding conflict of interest:

- Clear separation of duties and definition of roles and responsibilities for directors, including the degree of authority to make specific decisions, has been implemented by some countries as a measure to minimize potential sources of conflicts of interest.
- Regarding the issue of disclosure, Confecamaras recommends establishing a procedure that requires board candidates to disclose any relationship with other directors, companies, suppliers, clients, or any other interest group that could be the source of a conflict of interest, so as to minimize the risk of entering into a potential case of conflict of interest. Moreover, listing specific cases of potential conflicts of interest in the regulatory framework to be reported to the board could improve understanding and facilitate disclosure.
- Lacking also in the regulation of most surveyed jurisdictions is the requirement of a Code of Ethics or Conduct. Countries should consider introducing such codes to reduce potential for directors' unethical or unlawful behavior.
- Formalizing the discussion of conflicts of interests or potential cases of conflict of interest in board meetings, increasing the use of preventive measures and enforcing sanctions to manage conflicts of interests is recommended.

III. Board Selection and Composition Criteria

1. Background

The adequate composition and structure of the board should ensure that it can fulfill its key responsibilities. Principle VI of the OECD Principles lists a number of criteria. The board itself plays a key role in identifying potential board members with the appropriate knowledge, competencies, and expertise to complement the existing skills of the board, thereby improving its value-adding potential for the company. At the same time, the composition and structure of the board should guarantee the necessary independence and objectivity to exercise objective judgment. Serving on too many boards can interfere with the performance of board members; whether multiple board memberships are compatible with effective board performance should be carefully considered when there is no legal cap on the number of memberships. Disclosing information on number of board memberships as well as attendance records, other work undertaken on behalf of the board, and the directors' remuneration could facilitate ensuring that board members enjoy legitimacy and confidence in the eyes of shareholders.

As the 2003 White Paper points out, the optimal board size, meeting schedule and director qualification criteria will vary depending on the nature of an individual company's business, and can be expected to change over time as the company matures. However, experience has shown that boards that exceed 10-12 members may function less well. Companies and their boards have an obligation to carefully consider their policies with respect to the terms of office of directors, the size of the board and the qualifications required of board members. They should make these policies explicit and review and revise them periodically.

2. Legal Framework

a. Overview

Country	Law	Regulation	Best Practices Code
Argentina	Companies Law N° 19550, 1972, Art 58, 255, 256, 257, 262, 263 and 264	CNV General Rules, 2001, Section XXI - Article 4 CNV Resolution 516, 2001, Point 7, 8, 9, 13 and 14	Best Practice Code, 2004, Point 1.4
Brazil	Corporations Law No. 6404, 1976, Art140,142, 146, 147	Novo Mercado rules, 2000, 4.3 Composition	Best Practice Code 2009, 2.14, 1.4, , 2.20, 2.21, 2.36 2.4, 2.5, 2.7
Chile	Law No. 18046, 1981, Art 31-36 Law No. 20190, 2007 Art 430 Law No. 19705, 2000, Art. 2(7), 27 (9-11) Law No. 20.382, 2009 Articles 32, 50 bis		
Colombia	Law No. 1328, 2009, Article 83 modifies article 22 of Law 964, 2005 Law No. 964, 2005, Article 44	Decree 663, 1993, Article 73. Junta Directiva 1, 4, 7	Best Practice Code 2007, 2.1. Tamaño, Conformación y Funcionamiento, Medida No. 12, 13, 14, 15, 16.
Mexico	Securities Market Law, 2005, Art 24, 26, 122, 123, 124 Credit Institutions Law, 1990,		Best Practice Code, 2010, Practica 9, 10, 14, 15

	Artículo 22, 23		
Panama	Corporations Law No. 32, 1927, Article 49, 52, 57, 58, 59, 60, 61, 62, 63	SB Agreement No. 4, 2001, Article 9	Best Practice Code, 2010, 2.3, 2.4, 2.5, 2.6, 2.9
Peru	Corporations Law No. 26887, 1997 Art.153, 155, 160, 161, 163, 164, 165, 172, 173, 177, 178, 247, 325, 331		Best Practice Principles 2002, Principles V.D., V.E., V.F., V.H.

b. Degree of coverage

► Size

Board size is addressed in law throughout the region, but only Brazil, Colombia and Mexico stipulate a maximum number. The Companies Law in *Brazil* sets a minimum of 3 board members, a minimum of 5 under Novo Mercado rules, and between 5 and 11 under the Brazilian Code. *Colombia* in its Law 964 for listed companies and Decree 663 for financial institutions states a board size of between 5 and 10 members, whereas the Best Practice Code just requires an odd number of members. *Mexico*'s regulatory framework specifies a maximum board size of 21 members (15 for stock exchanges) in the Securities Market Law (between 5 and 15 members for banks per the Credit Institutions Law), and between 3 and 15 members per the Best Practice Code. The Companies Laws in *Peru* and *Panama* set a minimum of 3 board members, while a minimum of 7 is stipulated by Agreement 4 for Panamanian banks. The Panamanian Code as well as the Colombian Code mentioned earlier recommends an odd number of board members. In the case of *Argentina*, the Companies Law requires a minimum number of directors of 1 (3 for certain joint stock companies per art. 299) giving the shareholders' meeting the authority to set the specific size, within the minimum and maximum number stipulated in the company's statute. In the case of *Chile*, the Companies Law requires a minimum of 5 for listed companies (3 for closely held companies), and 7 for listed companies with a Directors' Committee.

Board Size Requirements throughout the region

Country	Laws	Regulation	Code
Argentina	Min 1 (3 for companies under art 299)		
Brazil	Min 3	Min 5 (Novo Mercado)	5 - 11
Chile	Min 5 Min 7 (companies with Directors' Committee)		
Colombia	5-10	5-10 (Decree 663)	Odd number
Mexico	Max 21 Max 15 (stock exchanges) 5-15 (banks)		3-15
Panama	Min 3	Min 7 (banks) (Agreement 4)	Odd number
Peru	Min 3		

► **Composition**

Requirements and recommendations on the number of independent directors of the board are covered in law, regulation and voluntary codes. The requirements range from general recommendations, to specific numbers and percentages of board members. Specific legal requirements on board composition are observed in *Chile*, *Colombia*, and *Mexico*, while in *Argentina*, *Brazil* and *Panama* decrees, rules and resolutions establish this obligation. *Brazil*, *Mexico*, *Peru*, and *Panama* also have the recommendation on composition included in best practice Codes. *Chile*'s new 2009 corporate governance law requires at least one independent director for listed companies with a market value of more than 1.5 million UF (ca. USD 60 million) and a free float of more than 12.5%. *Brazil*, *Colombia*, *Mexico* and *Panama* set the number of independent directors as relative, fixed percentages of board members. *Peru*'s Code only states that the board should have the capacity to exercise objective independent judgment. *Argentina*'s CNV resolution requires a "sufficient" number of independent directors to guarantee the necessary independence to exercise objective judgment. In the case of *Mexico*, the Code, the Credit Institutions Law, and the Securities Market Law all set a minimum of 25 percent of independent directors as does *Colombia*'s Law 964 for listed companies. In *Panama* the Securities Market Decree sets the minimum at 20 percent. In *Brazil*, the Novo Mercado rules require a 20 percent minimum as well. The Codes of *Brazil* and *Panama* recommend a majority of independent directors in the composition of boards.

► **Competence**

All the surveyed jurisdictions mention relevant experience, knowledge, and professional reputation as well as absence of conflicts of interest as key elements to be considered in selecting directors of the board either in law, regulations or best practice codes. *Argentina*'s Code and *Mexico*'s laws also require evidence of proven ethical behavior and being a respected member of society.

► **Nomination and Designation/Termination**

In all the surveyed jurisdictions in the region, the election and dismissal of board members are carried out by the shareholders. *Colombia*'s Decree 663 for financial institutions states that successors need to be approved by the Superintendency of Banks. The Decree also states that the absence of a board member for more than 3 months will result in the loss of his or her seat to be filled by a substitute.

► **Meeting Frequency and Record Keeping**

As a general rule across these surveyed jurisdictions, the content of each board meeting should be documented in the minutes (Libro de Actas) of the board. Regarding the frequency of board meetings, *Mexican* law and *Panama*'s Agreement 4 for banks state that the board should meet at least quarterly, whereas in *Colombia* the meetings' frequency should be monthly according to Decree 663 for financial institutions and the Best Practice Code. According to *Brazil*'s Best Practice Code, the frequency of meetings is determined by the company's circumstances, to ensure the effectiveness of the board's work. However, the Code recommends that board meetings should not be more frequent than once a month. *Argentina*, *Chile* and *Peru*'s regulatory frameworks do not address meeting frequency.

► Terms of Office

An office term of up to 3 years seems to be the norm under the Companies Law of *Argentina* and *Brazil* as well as *Chile's* Law 18046. In the case of *Peru*, the Companies Law requires the statute of the company to set an office term of no less than 1 and no more than 3 years. If the company's statute does not specify a fixed number, the office term should be 1 year. Under *Colombia's* Decree 663 for financial institutions, the terms are variable as set by the General Annual Shareholders' Meeting, which determines the beginning and end of the office term. *Brazil's* Code recommends the term of office of a board member to not exceed 2 years. *Panama's* Code, on the contrary, recommends an office term of no less than 2 and no more than 4 years, which should be stipulated in the company's statute.

3. Current Practices

Comments from IAGO suggest that it is common practice in *Argentina* to select shareholders, or former or current executives as board directors, who have a great deal of knowledge of the company. The size of the board usually depends on operational needs as well as on the number of shareholder groups that should be represented on the board. In SMEs, directors are typically the executives and majority shareholders of the company, or people closely affiliated with them, such as family members or friends, often lacking the relevant knowledge and skills to effectively fulfill their roles.

Various studies from *Brazil* touch upon selection criteria, board size and composition. With respect to board size, on average, per the 2009 IBGC/2009 IBCG/Booz&Co survey, boards have between 5 and 11 members with, on average, 20% of independent directors. According to the annual KPMG survey, the size of the board ranges between 7.3 and 9.3 members for listed companies. Sandra Guerra's study on boards of listed companies shows that directors are mostly elected and/or dominated by controlling shareholders or their representatives (about 52% of listed companies). In addition, in 42% of the cases the chairman is a controlling shareholder or part of the controlling block and in 27% of listed companies the CEO is also a member of the controlling family. These numbers reflect the strong concentration of power in Brazilian listed companies. According to the IBCG/Booz&Co survey, 30% of board members are owners of the company, 14% are related to the company, 28% are not involved with the company but are not independent either, 22% are independent, and the remaining 6% do not belong to a specific category. Per the 2009 IBGC's Corporate Governance Award data, 76% of listed companies have only non-executives on their boards (except for the CEO). The annual KPMG survey also stated that Novo Mercado companies have a higher percentage of independent directors (34.1%) than companies on Level 1 and 2 and Traditional segment (21.9% and 13.4% respectively). On meeting frequency, the survey found that companies on Level 1 and 2 have on average 9.8 meetings a year, while for Traditional segment companies the frequency goes down to 6.2 meetings a year. Regarding office terms, a 1- or 2-year-period was observed in 74% of listed companies, according to IBGC's 2009 Award data.

The 2009 study by the Center for Corporate Governance and Capital Markets based on interviews with directors (72% of them were from listed companies) in *Chile* found that 13% of board seats are filled by independent directors, 80% of boards include between 7 and 9 members, and that in 67% of the cases the office term is between 3 and 4 years, with only 14% stretching this period to over 6 years. The survey also shows that 91% of the time the board meets monthly. According to the 2007 McKinsey report on 262 Chilean directors and executives (36% of them listed companies), 49% of boards have 5 members or less,

34% have between 6 and 8 members, and just 1% are composed of 11 directors or more. This same survey shows that the directors' selection criteria in Chile (sample of 241 participants) focus more on personal qualities (96%), experience (94%), and independence (90%) than on time availability (50%) and political and corporate contacts (45%).

The Superintendency of Finance annual evaluation of listed companies' compliance with the corporate governance code in *Colombia* found compliance with the recommendation to meet monthly to be 58.12% in 2008 compared with 60.00% in 2007. Almost 90% of companies in both the 2007 and 2008 evaluations reported implementing the recommendation requiring individuals with professional background, academic training, and experience to be selected as directors.

In *Mexico* a 2009 Deloitte survey shows that on average, boards have 10 members, 3 of whom are usually independent and 3 have ties to the company. The fact that almost 4 out of 10 board members are also shareholders of the company reflects the high percentage of family-owned companies in Mexico. Regarding the frequency of meetings, the majority (39%) of respondent board members meet four times a year, but in 15% of the cases, meet more than 10 times each year. The survey also shows that most directors (48%) serve between 2 and 6 years, but a hefty 26% of respondent members keep their status as directors for more than 8 years.

The 2008 report on compliance with corporate governance principles issued by CONASEV shows that in *Peru*, of 203 listed companies, 63 declared not having independent directors on their boards, and 139 declared having at least 1. According to the report, the average board size is 6.3 directors. The report also observed that, in general, listed companies consider their compliance with the principles to be higher than what is reflected in reality. However, CONASEV considers that companies are being more transparent regarding their compliance, and therefore improving the quality of information included in the report when compared with previous reports.

4. Summary and preliminary recommendations for discussion

While only Brazil, Colombia and Mexico set a maximum board size, data from surveys does not suggest that unduly large boards pose a problem in the region, with boards having on average between 7 and 10 members. Board composition is an issue attracting greater attention. Independence requirements vary throughout the region. Only Brazil, Colombia, Mexico and Panama set the number of independent directors as the recommended relative, fixed percentages of the board members, but not for all market segments. Data from Brazil show the dominance of controlling shareholders in the composition of boards. With respect to director's meeting attendance, only Colombia's decree for financial institutions states that the absence of a board member for more than 3 months results in the loss of the director's seat to be filled by a substitute. Monthly and quarterly board meeting frequency seems to be the rule, when addressed in regulation. Concerning the duration of an office term, most countries require terms of 1 to 3 years by law.

Preliminary recommendations for discussion on the issue of selection and structure of the board:

- Requirements limiting the number of board memberships are not yet widely spread in the region's regulatory framework, although serving on too many boards is considered by OECD's Principle VI E.3 as a practice that can interfere with the performance of board

members. Integrating a multiple board membership policy into the region's corporate governance regulatory framework should be considered.

- The composition of the board should support the necessary diversity and independence to exercise objective judgment. Although most jurisdictions require a sufficient number, or fixed percentage of independent directors, consideration of this issue must also take into account the importance of ensuring that directors have the appropriate knowledge, expertise and experience. Making the information on board composition, independence status, and director background publicly available would help to reinforce consideration of these objectives.
- A meeting attendance policy for directors is lacking in the regulation of most countries. Only Colombia's decree for financial institutions states that the absence of a board member for more than 3 months triggers filling of the director's seat by a substitute. Countries should consider the the benefits of introducing such a policy to potentially increase directors' attendance of board meetings.
- Directors' training and evaluation are mentioned as practices that need to be improved and used more extensively. The performance of directors should be evaluated annually, according to best practices, to avoid prolonged ineffective office terms.

IV. Criteria for Independence

1. Background

One of the key tenets of the OECD Principles and best corporate governance practices is that the board should be able to exercise objective independent judgment on corporate affairs. The 2003 White Paper recommends "to promote the integrity of the board, shareholders should endeavor to have a sufficient number of directors that are independent from management and controlling shareholders" (par. 95). The White Paper also states that "there is still much room for improvement in the practices of appointing directors who can contribute independent judgement. Since the objective criteria for "independence" may vary among countries and companies, depending on the patterns of control and affiliations with other companies, the definition of independence for an individual company can usefully be defined with reference to national codes, regulations or best-practice guidelines that reflect national circumstances. Regardless of how a company defines "independence," the shareholders need to be actively involved in the process of developing such criteria for independence" (par. 97).

It should be underlined that the call for independent objective judgement is intended to apply to all directors, and not just those that are defined as "independent." All directors should act in the interests of the company and its shareholders as a whole, rather than representing particular constituencies. However, considerable attention is devoted to defining what constitutes an "independent director" because of the special role such directors may play on audit committees or through other mechanisms to review sensitive issues such as related party transactions, remuneration policies, or other concerns related to ensuring equal treatment of minority shareholders.

2. Legal Framework

a. Overview

Country	Laws	Regulation	Best Practices Code
Argentina		CNV General Rules, 2001 Section III - Article 11 CNV Res 516, 2001	Best Practice Code, 2001, Code Point 1.3
Brazil	Corporation Act (Law 6404/76), Art. 143, 143 § 1°	Novo Mercado rules, 2000 2.1 CVM Instruction 480	Best Practice Code, 2009, 2.15, 2.16, 2.16.1
Chile	Ley N° 20.382, 2009, Art 32, 50 bis		
Colombia	Law 964, 2005, Art 44	Circular Basica Juridico, 2.2 Decree 663, Art 73	
Mexico	Securities Market Law, 2005, Art 24 Credit Financial Institutions, 1990 Art 22	Issuers Circular, 2003, Anexo S	Best Practice Code, 2010, Art 108, 109
Panama		Superintendency of Banks Agreement No. 4, 2001, Art 9 Securities Market Decree No 1, Art 120 CMV Recommendation 12 on Corporate Governance 2003, Article 8	Best Practice Code 2010, 2.6

Peru	Companies Law, 1997, Artículo 160		Best Practice Code, 2002 Principle II.B, V.E
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b. Degree of coverage

This section covers the scope of definitions for independence throughout the seven surveyed jurisdictions. The issue of the number of independent directors required or recommended to sit on boards in the region is addressed in the previous section.

► Definition

Definitions of independence are covered in the most prescriptive form, by law, in Chile, under the new Law 20.382, amending the Companies Law 18.046, in Colombia under Law 964, as well as Decrees for financial institutions, and in Mexico under the LMV, as well as the Code. In Brazil, only the Novo Mercado Listing Rules and the Best Practice Code cover the issue. In Argentina, the general CNV Rules cover the issue, while Peru addresses it in its voluntary code and Panama in its non-mandatory Agreement 12 as well as the new Best Practice Code.

The seven surveyed countries cover a wide array of dependencies disqualifying candidates from being considered independent. They also display different approaches to the definition of such dependencies, ranging from very broad, general definitions, to detailed definitions of relationships that constitute dependencies.

The Peruvian code casts the widest and least specific net. The only definition that the voluntary Peruvian Corporate Governance Code offers is that an independent director should be selected for his/her professional reputation and should not in any form be involved in the management or the controlling group. All other frameworks offer more specific definitions, which can be categorized whether they address ownership issues, family relations, internal dependencies within companies or external dependencies between companies.

Ownership

Being the owner, or closely related to the owner of a significant stake in the corporation or affiliated entities is one of the most obvious cases for a lack of independence. When specified, the thresholds for stakes in the region are quite different.

In *Colombia*, under Law 964, only a director who is directing the majority of votes or determining the majority of the composition of the board cannot be considered independent.

Argentina's CNV rules, *Brazil's* Novo Mercado Rules and Code and *Mexico's* LMV all state that being either the controlling shareholder, a member of the controlling group, having significant influence or any

relationship⁴ to the controlling shareholder prevents candidates from being considered independent. Argentina's CNV rules define significant influence as holding the equivalent of 35% of capital. While the Mexican LMV does not define a threshold, the Best Practice Code puts it at 20%. The Brazilian Code does not offer a numerical definition, but states that an independent director should not be bound to the organization apart from owning non-relevant holdings in it. Those, in turn, depend on the individual share structure of each company. In addition, the Brazilian Code recommends that an independent director should not be bound by a shareholders' agreement.

The strictest and clearest definition, albeit non-binding, is offered in *Panama*, under CNV Agreement 12, which states that a person cannot be considered independent if he/she is "directly or indirectly the beneficial owner of outstanding shares of the issuer, in a proportion equal or superior to 5% of the total of shares issued and outstanding with voting rights, or of its controlling person, or any person of 2nd degree of consanguinity." (Art 2, 5a)

In *Chile*, the definition is less specific, but includes a much broader range of persons affiliated with the company, as it spawns the categories of ownership and both internal and external dependencies. Under the new Law 20.382, candidates are not considered independent, if they, in the past 18 months, had any economic, professional, commercial or financial involvement, interest, or dependency of a relevant volume, with the corporation, its majority owner, or senior executives of any of these or affiliated entities. This includes any person to the second degree of consanguinity or affinity.

Dependencies

As can be seen in the Chilean example above, independence requirements can exclude a wide array of possible dependencies. Some frameworks in the region spell dependencies out more specifically, in what can be roughly categorized as internal dependencies within companies or external dependencies between companies.

- Internal

Argentina's CNV Rules formulate this dependency in its broadest form, simply stating that any form of dependency to the issuer in the last 3 years prevents qualification as an independent director.

Brazil's Code and Novo Mercado Rules, Colombia's Law 964, and Mexico's LMV all state that a candidate should not have been an **executive, relevant employee or officer of the corporation**, or even a controlled organization under Brazil's Code. These positions should not have been held within the last three years under Brazil's Code, or one year in Colombia and Mexico. Panama's CNV Agreement 12 states that an independent director should not be a person that has duties in the daily administration or management of the issuer or its controlling shareholder. Panama's Code includes any form of employment within the last two years. As the only document in the region, the Code considers a director, who has served on the board for 15 years or more as non-independent. Persons related to any of the above mentioned are also excluded from being considered independent directors in all four countries.

⁴ Relations qualifying as dependent are usually considered until the second degree of affinity and consanguinity. Argentina's CNV Rules and Mexico's LMV extend it to the fourth degree of consanguinity. Mexico's LMV also mentions mistresses and concubines as dependent relations.

Not receiving compensation other than director's fees is specifically mentioned in Brazil's Code and Novo Mercado Rules and Colombia's Law 964 as a criterion for independence. Brazil's Code notes that in general, an independent director should not be financially dependent upon the organization's compensation.

- External

External dependence criteria involve any form of contractual relationship or professional association with the relevant entity. Again, some jurisdictions opt for a wider, less specific definition; others attempt to spell out concrete criteria.

Argentina's CNV rule states that directors, in order to be considered independent, cannot have professional relationships with or belong to an organization or professional association that in turn has professional relationships or receives remuneration from the issuer or its shareholders who have "significant participation," in the issuer, defined as at least 35% of the capital.

Brazil's Code and Novo Mercado Rules, Chile's Company Law, and Mexico's LMV address **business and contractual relationships** as criteria for a lack of independence. Brazil's Code states that an independent director should not be supplying, purchasing, or bidding, directly or indirectly, to provide services and/or products to the organization or to a director of the organization. The Novo Mercado Rules formulate it somewhat narrower, stating that an independent director should not be a direct or indirect supplier or purchaser of the Company's services or products or both, to a degree that results in loss of independency. In Chile, the independent director should not have been, in the past 18 months, a director, manager or principal executive, a partner or shareholder who owns directly or indirectly at least 10% of a provider or client of the corporation, or even a principal competitor. Mexico's LMV goes a step further stating that an independent director should not be a customer, supplier, service provider, debtor, creditor, partner, or director/employee of a company that is an "important" customer/supplier/provider/debtor or creditor of the issuer during the twelve months preceding the appointment. "Important" is defined in the Code as 10% or more of total sales/revenue in the past 12 months. Under the LMV, these conditions also extend to anyone related to someone meeting these criteria. Panama's Code states that significant clients, suppliers or creditors of the company cannot be independent.

Special emphasis is put on **audit and advisory services** in some frameworks. Chilean Law states that the independent director cannot - in the past 18 months - have been a partner or shareholder who owns, directly or indirectly at least 10% of any entity providing consulting, law or external audit services to the company. In Colombia, under Law 964, partners or employees of a company providing advisory or consulting services to the issuer or an affiliated entity on a relevant scale, defined as 20% or more of operating income, are excluded from being independent directors. Brazil's Code recommends that an independent director should not have been a partner, in the last three years, of an audit firm, which is auditing or has audited the organization in the same period.

Brazil, Chile and Colombia specifically address **members of non-profit organizations** who might receive significant funds from the issuer as not qualified to be independent directors. Colombia's Law 964 specifies significant funds as 20% or more of the total donations to the entity.

Cross company directorships by executives are directly addressed in Brazil's Code and Colombia's Law 964. Brazil's code notes that directors need to stay independent with regard to the CEO. The

Director of company A, who is the CEO of company B, is no longer independent when the CEO of company A also becomes Director of company B. Colombia's law states that an executive of a company on whose board a legal representative of the issuer is a member cannot be considered independent.

► Declaration/Disclosure

In Chile, under the new Law 20.382, at least two days before the election, the candidate for independent director needs to provide a written, **certified declaration** to the General Manager that he is not involved in any of the relations indicated by law and that no other relation to the corporation, its controlling shareholders or principal executives exist that could deter the independent director's ability to work autonomously, efficiently and without potential conflicts of interest hampering the candidates independent judgment. In addition, the candidate needs to vow to maintain independence throughout the entire mandate.

In Brazil, under the 2010 CVM Instruction 480, a listed company needs to **publicly disclose information** on board nominees. The guidelines make it mandatory for companies to provide background information on members of their boards, including directors' independence status, which is particularly relevant to judge whether companies comply with the minimum level of board independence required by the corporate governance-differentiated listing segments of the Novo Mercado.

3. Current Practices

As for other topics in this study, information on current practices for this topic is mostly anecdotal, combined with findings of the surveys introduced above.

In *Brazil*, according to IBGC, the independence of directors continues to be a challenge. As seen above, definitions of independence are offered only in the Novo Mercado rules and the voluntary Code, with the Code being more stringent. As IBGC notes, companies prefer to follow the less stringent Novo Mercado or Sarbanes-Oxley criteria⁵ for those companies with ADRs. With respect to disclosure of information on the independence status of directors, however, information provided by Institutional Shareholder Services (ISS) shows that CVM Instruction 480 has had a profound impact. In 2009, less than 5 percent of Brazilian companies analyzed by ISS disclosed the names of board nominees prior to their meetings. In 2010, among the main-index companies, only eight, or 15 percent of the Ibovespa companies analyzed, did not provide timely disclosure of nominee's information or failed to meet the independence criteria of their listing segment. However, ISS noted, several companies still failed to clearly indicate who, if any, of their directors were independent. Also, about 32 percent of the 141 companies that included director elections in their annual agendas failed to meet the minimum 20 percent board independence requirement established by the stricter Novo Mercado and Level 2 listing segments of BM&FBovespa. ISS also reports that some companies contended that under BM&FBovespa guidelines they should be able to round down when calculating the number of required independent directors. For instance, a few companies with seven board members, technically requiring 20%, i.e. 1.4 independent board members, elected only one independent director. Nevertheless, the KPMG study on Corporate Governance and Capital Markets in Brazil confirmed the impact of more demanding listing requirements, as it finds that

⁵ Sarbanes-Oxley criteria, given that they are intended for the US market with its widely dispersed ownership structure focus on independence from management, i.e. non-executive directors rather than independence from the controlling shareholder.

companies listed on the Novo Mercado and/or the NYSE have a higher percentage of independent directors on their boards (around 33%). At Level 1 and Level 2, this percentage falls to 21.9%, and in the main market (where there is no requirement for independent directors) to 13.4%.

Studying attitudes among 85 Brazilian companies, both listed and unlisted, the 2009 IBGC/Booz&Co study showed that 26% of the companies consider their board's composition to be satisfactory and 60% of the companies currently do not consider it important to change their board's composition.

This attitude by companies is also reflected in practices in *Argentina*. According to the answer by IAGO, it is common practice that listed companies have the minimum number of independent directors required by law. This is generally two in order to be able to have a majority of independent directors in the Audit Committee. According to IAGO, this reflects a perception of low value with respect to independent directors in Argentina.

Similarly, the contribution from Confecamaras in *Colombia* suggested that the closed culture of companies, and especially of its controlling shareholders reluctant to disclose relevant information on companies, prevents outsiders without any connection to the company from becoming effective directors. In addition, difficulties in achieving compliance with confidentiality agreements due to judicial inefficiencies add to the reluctance to give outsiders access to information. Findings from the 2008 survey on compliance with the Code of Best Practices seem to confirm this. According to the Code, directors employed in any form by the company should not be in a majority on the board. Implementation of this recommendation was found to be at only 50.4%.

Showing the dominance of controlling shareholders, the 2009 study for *Chile* by the Center for Corporate Governance and Capital Markets quoted data by the Securities Regulator, SVS, which revealed that on the Chilean blue chip index IPSA 40, controlling shareholders with 64% of ownership elect 80% of directors. In the 2007 study by McKinsey and ICare on Corporate Governance in Chile, 79% of 226 respondents stated that they had at least one independent director on their board. Of these, 36% had two, and 19% more than three. It is important to point out that these answers were based on the definition of independence in Chile prior to the changes introduced by Law 20.382 in October 2009. Independence was then not defined in terms of economic, family or other relationships to management, but rather as the directors who are elected by the non-controlling shareholders, making this criterion harder to meet. A director was considered independent if, after subtracting the votes of the controller and related persons from his total votes, he still would have been elected.

In the sample of 144 companies with operations in *Mexico*, the 2009 Deloitte Study found that the average board consisted of 10 members, 3 of whom were considered independent.

Peru's 2008 evaluation of compliance with the corporate governance recommendations issued by CONASEV reveals that of the 69 listed companies studied in depth, 48 companies declared having at least one independent director, and 20 having none. For those who had independent directors, the average number of independent directors was found to be 2.4.

4. Summary and preliminary recommendations for discussion

With the exception of Peru, criteria to be met in order to be qualified as an independent director in the seven surveyed jurisdictions can be considered fairly strict. However, only Chile, Colombia and Mexico actually enshrine these criteria into law, making them legally binding. In Argentina they are binding under CNV general rules, while in Brazil such requirements are only binding for companies listed on the Novo Mercado and Level 2 segments of the market. Brazil's CVM Instruction 480 is the only rule in the region requiring the public disclosure of information on board nominees, including their independence, showing that there is much room for improvement in this area. Information on practices, where available, shows that the value of independent directors is still underappreciated in the region. Comprehensive, reliable data on the number of independent directors on boards in the region is not available.

Preliminary recommendations for discussion :

- Consideration should be given to strengthening independence requirements by incorporating them into Company and Securities Market Laws or mandatory Regulations.
- Greater transparency of nomination processes and the release of information on the background of candidates should be encouraged, at the very least by incorporating recommendations into Best Practice Codes in the region.
- The development of studies showing the empirical benefit of having directors with independent opinions on the board could be beneficial in order to overcome the reluctance of many companies in the region. This is particularly true for family-owned companies.
- Confecamaras suggests strengthening the capabilities of Corporate Governance Institutes, allowing them to build databases of independent directors and certify directors on their expertise in corporate governance and management.
- As recommended by the 2003 White Paper, shareholders should be more active in developing independence criteria and monitoring their implementation in the region. Evidence from this study suggests that this is not a common practice at this time.

V. Board Committees

1. Background

The 2003 White Paper recognizes the fact that specific Committees serve an important function for Board of Directors stating that “practices are clearly moving in the direction of a greater role for special purpose committees of the board of directors, particularly in the areas of audit and compensation.”(par. 103). The White Paper also states that “improved board practices and structures, including standing committees, can increase the effectiveness and credibility of the board” (par. 101), and recommends that when special purpose committees are established, their remit, composition, working procedures and principal activities should be formally documented and disclosed. In order for these committees to actually improve the functioning of the board and assure investors that they serve a meaningful purpose, their role, mandate, status and composition should be clarified and communicated to the market, including issuance of periodic reports to shareholders on their principal activities (pars. 105-106). Regarding the establishment of specific committees, in addition to the audit committee, the annotations to Principle VI.D.4 note that it “is considered good practice in an increasing number of countries that remuneration policy and employment contracts for board members and key executives be handled by a special committee of the board comprising wholly or a majority independent directors.” This is echoed by the 2010 OECD publication, *Corporate Governance and the Financial Crisis: Conclusions and Emerging Good Practices to Enhance Implementation of the Principles*, which although not expressly recommending the creation of other specific committees, points to the utility of other committees such as the “board nomination” committee.

2. Legal Framework

a. Overview

Country	Laws	Regulation	Best Practices Code
Argentina	Companies Law N° 19550, 1972, Art. 269	CNV General Rules, 2001 Section III - Articles 13, 14, 15, 16, 17 Decree 677, 2001 Article 15 CNV Res 516, 2001 Point 6, 23 to 27	Best Practice Code, 2001 , Code Point 1.6.1 and Section 3
Brazil		Instruction 480 CVM, 2009 Annex 24 – item 12.1 (“a” to “c”), item 12.7	Best Practice Code, 2009 ,2.28, 2.29, 2.29.1, 2.30, 2.30.1, 2.31, 2.34.3
Chile	Ley N° 20.382, 2009 ,Art 50 Bis, 246 Ley No 19.705, 2000, Art 3 (4m)		
Colombia	Law No. 964, 2005, Art 45	Circular Basica Juridico, 7.7.1.1.1. Funciones generales, 7.7.1.2. Comité de Auditoría, 7.7.1.2.2 Conformación del Comité	Best Practice Code, 2007 Medida No. 23, Medida No. 24, Medida No. 25, Medida No. 26.
Mexico	Securities Market Law, 2005, Art 25, 42, 126 Credit Financial Institutions, 1990 Art 21	Issuers Circular, 2003, Anexo S	Best Practice Code, 2010

Panama		Superintendency of Banks Agreement No. 4, 2001, Art 9 Recommendations on Corporate Governance by the CNV, 2003, Article 10, 11, 12, 13, 14, 15, 16, 17	Best Practice Code 2010, Chapter III
Peru	Companies Law, 1997, Art 174		Best Practice Code, 2002 Principle V.E

b. Level and type of coverage

► Types of committees

In all surveyed jurisdictions, law and/or regulation give the Board the right to form committees for special purposes. The most common special committee, the Audit Committee, is mandatory for listed companies under CNV regulation 677/01 for listed companies in Argentina, and under law in Colombia and Mexico. In Chile, under Corporation Law, a listed company with a market value of more than 1.5 million UF (ca. USD 60 million), and 12.5% free-float, needs to create a Directors' committee, whose main functions besides auditing include the review of related party transactions, and the examination of the remuneration and compensation plans for key executives.

Brazilian Company Law provides for a special kind of committee, a fiscal council, a non-mandatory body, whose main function is to monitor the activities of management, examine the financial statements each fiscal year and provide a formal report to shareholders. Councils operate independently from management and from a company's external auditor, since their members are elected directly by shareholders at the shareholders' meetings. Members of the fiscal council are separate from the board of directors and report directly to the shareholders. The fiscal council may be a permanent body or be temporarily created at the request of shareholders representing at least 10% of voting shares. The Brazilian Best Practice Code clarifies that the "Audit Committee is a controlling body (whose functions are delegated by the Board of Directors), while the Fiscal Council is an inspection body, whose functions are directly defined by the shareholders and, by law, does not report to the Board of Directors." (5.5)

Other types of committees are mentioned in voluntary recommendations and are similar across jurisdictions. An exception is the Executive Committee, which appears in the Argentinean Code of Corporate Governance, and also in the Company Law. Its members are involved in the day-to-day management of the affairs of the company. In addition, similar to other countries, the Argentinean Code suggests that at the very least the following committees should be formed by the Board of Directors: Audit, Compensation, Nomination and Corporate Governance, and Finances. The 2010 Corporate Governance Code in Mexico adds evaluation and planning to the functions committees should cover, while the CNV Recommendation in Panama mentions Compliance and Risk Administration Committees. The Brazilian IBCG Code is the only code to mention a Sustainability Committee, while it also points out that an excessive number of committees can result in undue interference with management.

► **Size and Composition**

The dominating prescription for the size of committees is three directors or more. In Colombia and Chile this is prescribed by law and in Argentina by CNV decree. Brazil and Mexico cover the issue in their Code. The Mexican code is the only document setting an upper limit to committee size at a maximum of seven members.

The Mexican Code states that all members of committees should be independent, although during a transition process of institutionalization an independent majority is sufficient. The Audit Committee is to be chaired by an independent director with relevant expertise in the field. However, in a rare case where the law goes beyond voluntary codes, the Mexican Securities Market Law requires that the Audit and Corporate Governance Committees be exclusively made up of independent directors, since listed companies are not granted a transition period. The Chilean Directors' committee, under the Companies Law, has to be made up of a majority of independent directors. In cases where there is only one independent director, which is the minimum required by law, the independent director selects the other members of the committee and chairs it.

In Argentina, per Decree 677, listed companies are required to have a majority of independent directors as members of the Audit committee. According to Resolution 516, it has to be chaired by an independent director. The Brazilian Code notes that all committees should preferably be made up of directors, "coordinated" by an independent director. In addition, the Audit and Human Resources committee should preferably be formed by independent directors only. In this respect, the CNV recommendation in Panama suggests 30% independent directors in the committees, and in general directors that are not involved in the day-to-day management of the corporation, chaired by the Treasurer of the board. The new Panamanian Best Practice Code states that the Audit Committee should be selected from the independent directors of the board. The Colombian Code recommends all independent members of the Board to be part of the Audit Committee.

► **Duties**

In general, considerably more relevance is devoted in the laws, regulations and codes to the duties of committees than to their powers. Although there are too many specific duties to be listed, a few noteworthy issues are discussed here.

The **frequency of committee meetings** is addressed in three surveyed countries. In Panama, the Audit Committee should at least meet monthly according to CNV recommendation. The IAGO Code in Argentina suggests meeting at least three times a year. In Colombia, according to listed company law, meetings should be held at least every three months.

With respect to the **disclosure of information**, the Argentinean Decree 677 charges the Audit Committee with the duty to disclose to the market information with respect to transactions involving potential conflicts of interests.

Lastly, the Chilean Companies' law Art 50 bis states that the Directors who are members of the Directors' committee "besides the responsibility inherent to their position as board member, shall be **jointly liable** of any damages caused to the shareholders and the corporation."

► Disclosure

Unique in the region, Brazil's CVM Instruction 480 of 2009 requires disclosure of committees, their composition and remuneration practices since the first quarter of 2010.

3. Current practices

A number of surveys which have been conducted over the last few years in Brazil, Chile, Colombia and Mexico, shed some light on the actual numbers of committees.

In *Brazil*, two different surveys provide data, the 2009 IBCG/Booz&Co study on Brazilian Corporate Governance Outlook based on 2008 data and the KPMG study which has been held annually since 2006. According to IBCG/Booz&Co based on 85 Brazilian companies both listed and unlisted, only 29% of the companies have at least one committee to support the board's activities, with the most common one being the Human Resources Committee, followed by the Audit Committee. According to the KPMG study, which includes all companies listed in Brazil on BM&F BOVESPA and the Brazilian Stock Exchange, board's committees are more common in companies with dual listings on the New York Stock Exchange (81.3 %) with an average of 2.9 committees per company. Companies in the traditional market at BM&F BOVESPA adopt committees in 24.4% of the cases with an average of 0.4 committees; companies listed on the Novo Mercado, Level 1 and Level 2 have board committees in around 40% of the cases, with an average of 1.2 committees per company.

The 2009 study of the Center for Corporate Governance and Capital Markets in *Chile*, found that 75% of companies had a Director's Committee – legally mandated for larger companies – in place. 52% had a separate Audit Committee and 21% a Risk Committee.

In *Colombia*, the 2008 survey on compliance with the Code of Best Practices found that only 28% of corporations had instituted committees other than the legally mandated Audit Committee. Relatively more companies had implemented a Nomination Committee than the recommended Corporate Governance Committee.

In *Mexico*, a 2009 survey by Deloitte of 160 board members and executives of 144 companies with operations in Mexico found that the companies of 67% of respondents had an Audit Committee, followed by the Committee for Corporate Governance (Comite de Practicas Societarias) with 42%. The average size of committees in the survey was found to be 5, meeting an average of 4 times a year.

In *Peru*, out of 203 corporations included in the 2008 report on compliance with corporate governance principles issued by Conasev, 84 corporations had at least one committee. Of the 69 listed companies analyzed in more depth, 31 had an Audit Committee with an average of 3.7 members that met 4.4 times a year.

Information on more than the mere number or existence of committees was not available. However, recent regulatory developments in Brazil could soon change that. Based on early disclosure following CVM Instruction 480, IBGC has drawn some preliminary conclusion such as that committees are mostly formed by directors, as well as external consultants and in some cases by executives named by the controlling shareholders. External consultants are often brought on board to provide necessary expertise in family-owned companies, and seem to be used as a transition model when family board members lack adequate board skills.

4. Summary and preliminary recommendations for discussion

The analysis of the legal framework makes it clear that most aspects of committees are dealt with only in voluntary codes. The surveys' data above shows that committees are not widespread in the region, and are established when they are legally required as is the case for Audit Committees in Argentina, Colombia and Mexico and the Directors' Committee for most listed companies in Chile. Compliance with best practices going beyond legal requirements thus seems low. One possible explanation for this was revealed by the answer from Confecamaras in Colombia, which noted that it appears that the value of committees in the management of the board is not truly appreciated by Boards in Colombia. In addition, the requirements for independence in the committees put an undue burden on the few independent directors on the board. The inadequate compensation of Directors adds to the problem. The Argentine answer suggests the same pattern.

Some possible areas for reform and future initiatives with respect to committees include the following:

- Consideration should be given to extending the legal coverage of committees, their composition and functions. They are currently not regulated by any form of law in Panama, where they are only referred to in the by-laws of corporations or the Best Practice Code. Peru's legal framework is equally silent on the matter.
- The Colombian answer suggests that it would be useful if the benefit of establishing committees could be empirically shown so that corporations could be convinced of their value-generating virtues.
- In order to do so, the availability of more information on committees, their composition and work is a precondition. Brazil's CVM instruction 480 is an important step towards this end.
- In addition, the Colombian respondents suggested including recommendations about the functioning of committees and the handling of multiple meetings as well as Director's remuneration into best practice codes.

VI. Chairman / CEO Separation

1. Background

The 2003 White Paper states that the separation of CEO and Chairman "should be regarded as best practice" in jurisdictions where it is not mandatory (par. 98). The OECD's Principle VI.E recommends that "in a number of countries with single tier board systems, the objectivity of the board and its independence from management may be strengthened by the separation of the role of chief executive and chairman...". This Principle adds that "separation of the two posts can help to achieve an appropriate balance of power, increase accountability and improve the board's capacity for decision making independent of management [and] can also help to ensure high quality governance of the enterprise and the effective functioning of the board".

This is echoed by the 2009 OECD publication, "Corporate governance and the financial crisis: Key findings and main messages", which in its section on boards states that "it should ...be considered good practice that the functions of Chief Executive Officer and Chair of the Board of Directors in unitary boards are separated."

2. Legal Framework

a. Overview

Country	Law	Regulation	Best Practices Code
Argentina	Companies Law No. 19550, 1972, Article 270		
Brazil		CVM Corporate Governance Recommendations, 2002, II.4	Best Practice Code 2009, 2.10, 2.34.2
Chile	Companies Law No. 18.046, 1981, Article 49		
Colombia	Law No. 964, 2005, Article 44		
Mexico	Securities Market Law, 2005, Art 28, 44		Best Practice Code, 2010, Practice 8
Panama			Best Practice Code, 2010, 2.12
Peru			Best Practice Principles 2002, Principles V.I.

b. Degree of Coverage

The Chairman/CEO separation is specifically prescribed in Chile under its Companies Law, and in Colombia under Law 964, which mandates that the Chairman of the board cannot be the company's legal representative (company's president, CEO, or director). Brazil will also make it a mandatory requirement

under the new listing rule changes of Novo Mercado. The issue of separation of the roles of Chairman and CEO is mostly recommended in best practice codes in Brazil, Mexico, Panama, and Peru. In Brazil, the CVM also recommends the Chairman/CEO separation under its corporate governance recommendations. The Companies Law in Argentina, Law 964 in Colombia and the Securities Market Law in Mexico do define the different roles, responsibilities, and authority of the president of the board and the general manager of the company, but do not explicitly require a separation of the two posts.

Per the *Brazilian* Best Practice Code, the duties of the chairman are different from and complementary to those of the CEO. To avoid concentration of power at the expense of adequate supervision of management, the positions of Chairman and CEO should not be held by the same person. In addition, while it is recommended that the CEO should not be a member of the board, he/she should attend the board meetings as a guest, since it is a key function of the CEO to be the link between the board and the rest of the organization. To this end, communication should occur in a clear and continuous manner, leading to effective decision making processes. In addition, Novo Mercado has recently reviewed its rules and has proposed the mandatory requirement of Chairman/CEO separation of roles as a prerequisite to all market segments (Level 1, Level 2 and Novo Mercado). Although approved, BM&FBOVESPA foresees the new rule coming into effect by the end of the year, after being sanctioned by the CVM.

The *Peruvian* Best Practice Code does state that the CEO, as the legal representative of the company, can participate in board meetings. The Code also states that the position of CEO is incompatible with that of directors for public companies, and with that of the president, auditor or accountant for any company. It is also recommended by the Code that the functions of the president of the board and the CEO should be clearly stated in the company's statutes to avoid functional overlap and potential conflicts of interest. In addition, the structure and organization of the company should avoid the concentration of power, responsibilities and functions in the figure of the president of the board, the CEO, and any other top executive of the company.

Chile's Companies Law 18046 requires that the manager or general manager (CEO), as appropriate, be the corporation's legal representative, who should not have the right to vote in the board meetings. The position of manager is incompatible with that of the chairman, auditor or accountant and for listed corporations, also with that of director.

3. Current Practices

It is common practice for all types of companies in *Argentina* to not separate the Chairman/CEO functions according to IAGO, since it is not required by legislation.

There is growing evidence of the separation of the two posts in *Brazil*, according to IBCG. One of the reasons for this trend appears to be the professionalization and succession of management to younger family members in family-owned companies where the founder remains on the board as chairman. The 2009 IBGC/Booz survey found that 85% of the companies surveyed do have separation of Chairman and CEO functions, while the remaining 15% of companies combine both functions. The annual KPMG study shows that the majority of Brazilian public companies separate the role of Chairman and CEO. Even companies listed on the traditional segment have a separation rate of 77.8%, with even higher numbers in other segments: 84% for Novo Mercado, 89.5% for Level 1 and 2 and 84.4% for companies listed on the NYSE. According to the 2009 IBGC's Corporate Governance Award, 71% of listed companies do

separate the roles of chairman and CEO. The findings of the two studies above are consistent with the results obtained by Sandra Guerra in her 2009 study on boards where in a sample of 65 listed companies, 80% of the companies had separated the positions of Chairman and CEO.

According to the 2007 McKinsey report on *Chilean* companies, (36% listed companies), 74% of 258 respondents had separated the roles of president and CEO. In addition, 77% of 260 respondents considered the separation of roles between the board and the CEO to be clear. The 2009 Center for Corporate Governance and Capital Markets report found that 82% of directors (72% of whom serve on listed companies) do not perform management roles.

Panama's legislation does not distinguish between chairman and CEO. In fact, the Companies Law only refers to the president of the company, who is the legal representative. Also, because the powers and duties of the company's president are not defined in law, the president can also be the chairman of the board.

4. Summary and Preliminary recommendations for discussion

It is regarded as best practice that the Chairman of the board and the Chief Executive Officer should not be the same person “to achieve an appropriate balance of power, increase accountability and improve the board's capacity for decision making independent of management.” The regulatory approach to either recommend or require the Chairman/CEO separation varies across the region. Only Chile and Colombia require the legal separation of the Chairman/CEO. Brazil will also make it a mandatory requirement under the new listing rule changes of Novo Mercado. Best practice codes in Brazil, Mexico and Peru recommend the separation of the posts of Chairman and CEO. Laws in the other surveyed jurisdictions do not explicitly require a separation of the two posts, but define the different roles, responsibilities, and authority of the president of the board and the general manager of the company. The designation of a lead non-executive director as an appropriate alternative in cases where the role of chief executive and chairman are combined is not addressed in any regulatory framework.

The following are some possible recommendations regarding the Chairman/CEO separation:

- The responsibilities and functions of the CEO, director, and chairman/executive president should be clearly stated in the company's statute, which is not always required under the legal and regulatory framework. The company's structure should avoid the over-concentration of responsibilities, attributions, functions, and power of chairman/executive president, CEO, and other top managers.
- Countries should consider requiring a clear separation of the roles of chairman and CEO in their regulatory frameworks. In countries with single tier board systems, where the role of chief executive and chairman are combined, the designation of a lead non-executive director should be considered as an appropriate alternative.

VII. Board Risk Management

1. Background

An area of increasing importance for boards, closely related to corporate strategy, is risk policy. The OECD's Principle VI states that such policy involves specifying the types and degree of risk that a company is willing to accept in pursuit of its goals. Risk policy is thus a crucial area for management that must balance risks to meet the company's desired risk profile. It is the board's responsibility to oversee the risk management policy as well as the internal control systems. Monitoring of governance by the board also includes continuous review of the internal structure of the company to ensure that there are clear lines of accountability for management throughout the organization.

The responsibility of the board to provide risk management has received increased scrutiny during the financial crisis. The 2009 OECD report on *Corporate governance and the financial crisis: Key findings and main messages* notes that boards lacked a clear understanding of the changing risk profiles of the businesses they manage. The report recommended to explicitly "state the board's oversight role to ensure the establishment of effective internal control systems to be able to effectively monitor and understand treatment of risk, and thereby reach good decisions that appropriately take risk into account." The OECD's follow-up report on the crisis, *Conclusions and emerging good practices to enhance implementation of the Principles*, states that "the board's responsibility for defining strategy and risk appetite needs to be extended to establishing and overseeing enterprise-wide risk management systems," and concluded that, with regards to the financial crisis "in some important cases the risk management system was not compatible with a company's strategy and risk appetite."

2. Legal Framework

a. Overview

Country	Law	Regulation	Best Practices Code
Argentina		CNV Resolution 516, Point 5 Decree 677, 2001, Article 8	Best Practice Code, 2004, Point 1.7.8
Brazil		CVM Corporate Governance Recommendations, IV.4 CVM Instruction 480, 2009, Annex 24: Item 4, 5	Best Practice Code 2009, 2.31
Chile			
Colombia		SB Circular Basica Juridica T1-Chapter 9, Item 7	
Mexico		Banks Circular, 2005, Article 70 Stock Exchange Circular, 2004, Article 126	Best Practice Code, 2010, Practices 45, 50, 51

Panama		SB Agreement No. 4, 2001, Article 10 CNV Agreement 12, 2003, Article 6	Best Practice Code, 2010, 2.4, 2.7, 4.3
Peru			Best Practice Principles 2002, Principles IV.F., V.D., V.F

b. Degree of Coverage

The issue of risk management is not explicitly regulated by law in the surveyed jurisdictions. What is required by law is the right of directors to be informed by the management of any issues that affect or can affect the company. However, different types of regulations from decrees, securities resolutions, banking and stock exchanges circulars to best practice codes cover the identification, disclosure, management, supervision, evaluation and prevention of risks in the region. However, this issue is not addressed in the Chilean corporate governance framework.

► **Identification and Disclosure of Risk**

Risk management policy is an important component of internal control systems. Internal control systems (ICS) as well as risk management systems (RMS) should be able to identify the risks to which the company is exposed. In the seven surveyed jurisdictions, the identification of risk is mainly the responsibility of management, while the disclosure of risks is generally the responsibility of the board and board’s committees; only in Peru it is the responsibility of the internal auditor.

Argentina’s CNV Resolution 516 requires the board to disclose existing management risk policies including internal control and information system policies. This requirement also includes reporting if such policies are being continuously updated reflecting best practices. The Best Practice Code recommends the board to ensure the correct functioning of the ICS, including disclosure and information.

Brazil’s Best Practice Code recommends that the board ensure that management preemptively identifies and lists the main risks to which the organization is exposed, through an adequate information system. CVM’s Instruction 480 requires registered companies to identify and include in the “Formulário de Referência” the risks factors related to shareholders, subsidiaries, suppliers, clients, company’s industry (including industry regulation), foreign countries where the company operates as well as legal issues. The market risk management policy should also be fully described.

Colombia’s Circular Unica Juridica for companies registered with the Superintendency of Finance states that it is the responsibility of the board to know and be informed of the risks associated with the company’s operations. According to Law 222, mentioned in the circular, the board is responsible for the disclosure of risks to all the parties involved in the specific risk processes.

Mexico’s Best Practice Code recommends that committees evaluate the mechanisms presented by the management to identify the risks to which the company is exposed, and inform the board of the result of the evaluation. The Code also recommends that the committees issue an opinion to the board regarding the evaluation of the risk disclosure policy. It is also recommended that the CEO present the board with a risk situation report at every board meeting.

Panama's Agreement 4 for banks holds the board responsible for knowing and understanding the main risks to which the bank is exposed, and for ensuring that the management adopts the necessary measures for the identification of these risks. The board should also keep the Superintendency of Banks informed of situations, events or problems that affect or could significantly affect the bank, and the concrete actions to address the identified deficiencies.

Peru's Best Practice Code recommends internal auditors to keep the board and management informed about the internal control issues that need attention as well as the corresponding actions taken.

► **Management and Monitoring of Risk**

The management and monitoring of internal control and risk management policies and systems by the management, as well as the subsequent oversight function of the board is crucial to ensure effective board risk management. In some jurisdictions, it is the responsibility of the board to manage and monitor the ICS (Peru), and in others the responsibility of a committee (Mexico).

Argentina's Decree 677 states that directors should establish the necessary internal controls to guarantee prudent management. The Best Practice Code recommends the board to ensure the correct functioning of the ICS, including its control, supervision and monitoring.

Brazil's Best Practice Code recommends the board ensure that management calculates the probability of risks occurring, in addition to the financial exposure to such risks and the measures and procedures adopted for their prevention and mitigation.

Colombia's Circular Unica Juridica for companies registered with the Superintendency of Finance requires companies to have in place a risk management system to monitor, manage, prevent and avoid the occurrence of risks. The registered companies should also apply the risk management rules established by the Circular to the following risk management systems: market risk, credit risk, operative risk, liquidity risk, money laundering and financing of terrorism risk, guarantee risk, and insurance risk. These specific risk management systems are part of the ICS. The board should designate the directors in charge of ICS and risk management.

In *Mexico*, the Circular for banks as well as the circular for stock exchanges requires the boards of such institutions to establish a committee for the management of risks. This committee should also ensure that these institutions comply with the objectives, policies and procedures for the management of and exposure to risks previously approved by the board (for more information on the composition and structure of the Risk Committee see "Board Committees").

Panama's Best Practice Code holds the board responsible for establishing an adequate risk management framework. Similarly, Agreement 4 for banks makes the board responsible for the establishment and maintenance of an effective ICS. Therefore, the board should know and understand the main risks to which the bank is exposed, establish reasonable limits and procedures for these risks and make sure that the management adopts the necessary actions for the measurement, monitoring, and control of these risks. In addition, the board should make sure that the management monitors the effectiveness of the internal control system. Agreement 12 recommends the board of registered issuers to manage corporate risk, establish the necessary ICS, and supervise the ICS annually.

Peru's Best Practice Code recommends that the board should evaluate, approve and manage risk management policies, as well as ensure the integrity of control systems, including financial and non-financial risks.

► **Evaluation of Risk Management**

In most of the jurisdictions except Mexico, the evaluation of existing risk management systems and policies is the responsibility of the board. Argentina's and Panama's Best Practice Codes and Colombia's Circular Unica Juridica state that it is the responsibility of the board to ensure the correct functioning of the ICS/RMS, including risk evaluation. In Colombia, under Law 222, the board should also establish and review risk evaluation and control mechanisms, and address any deficiency. Panama's Agreement 12 recommends the board of registered issuers to supervise the ICS annually, while Agreement 4 for banks makes the board responsible for ensuring that the management monitors the effectiveness of the internal control system. The board should also establish and review at least once a year the objectives and procedures of the internal control system. In Mexico, under the Best Practice Code, the evaluation of the mechanisms presented by the management to identify, analyze, manage and control risks is the responsibility of the committees, which should inform the board of the result of the evaluation.

► **Prevention of Risk**

Preventive risk measures are not extensively regulated in the region. Where it can be observed, risk prevention is the responsibility of the board. In some jurisdictions, like Brazil, the Code holds the board responsible for assuring that the management fulfills its responsibilities for the measures and procedures adopted for risk prevention and mitigation. In other jurisdictions, like Colombia, the law (222) makes the board responsible for following up at least every 6 months on the measures taken to control or mitigate risks in board meetings through the Audit Committee's periodic reports. For Panama's banks, under Agreement 4, the approval of the organizational and function manuals, policies and procedures, control of risks and other manuals, as well as the incentives, corrective sanctions and measures to encourage the suitable operation of the internal control system is the responsibility of the board.

3. Current Practices

In *Argentina*, according to IAGO, risk monitoring is undertaken by the board, especially in large institutions. In the case of SMEs, the board's responsibilities are limited to what is legally required, and the management of risk is undertaken by management. In addition, IAGO notes, it is not common practice in the country for boards to formally discuss the company's risks, including risk aversion, ICS, and the monitoring of risk systems. In general, the management of risk is performed by each manager in a decentralized manner, and as a result it is not usually discussed in board meetings.

IBGC notes that risk management has become an increasing concern for boards and companies in Brazil. While CVM Instruction 480 now requires listed companies to disclose their main risks and management risk policies, there is no evidence yet on their enforcement. The 2009 IBGC/Booz survey found that 85% of the respondents declared the board's management of risks "Important" or "Very Important". Also, 71% of the companies state that risks issues are always or very frequently discussed in board meetings. The annual KPMG outlook of Brazilian listed companies shows that the U.S. rules are stricter than those in Brazil in terms of annual disclosure of risk factors and their corporate management practices. According

to the KPMG's study, 78.1% of listed companies disclose substantial information about risk issues. On the Novo Mercado, 17% of listed companies have the risk disclosure requirement, whereas in the traditional segment this figure is 13.3%. Surprisingly, 43.9% of companies on Level 1 and 2 follow this practice. According to Sandra Guerra's 2010 study on boards (data from 65 listed companies) the lack of boards' risk monitoring function is the second most important deficiency regarding board responsibilities (the first one is related to succession planning).

Chile's 2009 Center for Corporate Governance and Capital Markets report found that 54% of directors (72% of whom serve on listed companies) disclosed having a specific risk management department. Also 54% of directors revealed having a clear risk management policy for the identification and management of risks. In addition, 37% of the companies in the study perform an annual revision and control of risk policy, while one fifth of the sample performs this control monthly. The study also observes that according to the directors' answers, the most important type of risk is market risk, followed by financial, operational, liquidity, legal and finally by credit risk.

In *Colombia*, according to Confecamaras, the absence of long term planning in SMEs contributes to the fact that there are no preventive measures being discussed in board meetings. Board meetings are then mostly used to discuss issues currently being faced by the company, which require immediate actions. However, for larger corporations and listed companies, the risk monitoring function is more developed.

4. Summary and Preliminary recommendations for discussion

The issue of risk management is not covered in law, but rather under codes and regulations in the surveyed jurisdictions. The definition of the risk profile of the company is clearly the responsibility of the board. However, while the identification and management of risks are generally the responsibilities of management, and risk disclosure, evaluation and prevention the responsibilities of the board, these functional divisions are not always clear. The lack of clear functional responsibilities between the management and the board, and the absence of risk preventive measures are the main deficiencies that can be observed in the region.

The following are some possible preliminary recommendations for discussion regarding the treatment of risk management policy:

- Ensure that the roles of the board and the CEO regarding the risk management and oversight functions are clearly defined in order to establish effective internal control systems, which can successfully monitor and understand risks, and therefore be better aligned with the company's strategy and risk appetite.
- Countries should consider introducing risk management systems that facilitate better understanding of and reaction to risks to which the company is exposed.
- Strategic risk management should be seen as one of the most important functions of boards, particularly after the loss of value suffered by companies during the financial crisis caused by unforeseen/overlooked risks. Boards should define the risk appetite of the company and create a specific committee or department for risk management, which defines the strategy for the management and disclosure of risks and reports directly to the board.
- Improve the disclosure, quality and timeliness of information on internal controls, risks management policy, including the main risk factors.

VIII. Board Evaluation

1. Background

The OECD Principles as well as the 2003 White Paper recommend that in order to improve board practices and the performance of its members, boards of listed companies should undergo annual internal evaluations covering both the competencies and performance of their members as well as the board's functioning as a whole (par. 118). The procedures for such evaluations may be left to the individual company but the company's statement on board responsibilities and work procedures as well as national codes of best practice can serve as benchmarks in the board evaluation process. The 2010 OECD report, *"Conclusions and emerging good practices to enhance implementation of the Principles"* goes further than the White Paper or Principles, stating that "To promote competent boards, it is good practice for board members to have access to training programs, underpinned by periodic external board evaluations." Relevant parts of this evaluation can also be made available to the public.

2. Legal Framework

a. Overview

Country	Laws	Regulation	Best Practices Code
Argentina		CNV Res 516, 2007, Point 10	Best Practice Code, 2001, 1.8
Brazil		CVM Instruction 480, Annex 24 – item 12.1 "e"	Best Practice Code, 2009, 2.18
Mexico			Best Practice Code, 2010, Art 22
Panama			Best Practice Code, 2010, 2.11

b. Level and type of coverage

While the evaluation of executives, the review of remuneration systems of executives and of the board itself is a well-established concept in the frameworks for the seven surveyed jurisdictions, only four jurisdictions cover the issue of evaluation of the board. Argentina, Brazil, Mexico and Panama all refer to the issue in voluntary codes or resolutions.

► Evaluation

Argentina's CNV Resolution 516 recommends that the board evaluate its proper functioning on an annual basis. The board should develop a written document to serve as a benchmark for the evaluation. The Best Practice Code adds that the board should also establish a training program for its members in order to maintain and improve their capacity and efficiency. *Brazil's* Best Practice Code recommends the formal assessment of the Board and each of the Directors to be made on a yearly basis. The assessments should reflect each organization's circumstances and be supported by formal processes, with a well-defined

activity scope and qualifications. The implementation of a mechanism that evaluates performance of board members as well as their compliance with their responsibilities and fiduciary duties is recommended under Practice 22 in the *Mexican Code*. *Panama's* Best Practice Code prescribes the evaluation of the board, committees and possible individual directors at least once a year, based on properly defined criteria.

▶ **Process and Disclosure**

The Brazilian Code is the only document in the region addressing the process of board evaluation as well as disclosure. The Code recommends that the Chairman be responsible for performing the board evaluation and – to strengthen the objectivity of the process – permits the participation of external specialists. The Code emphasizes that individual assessments, covering attendance and involvement/partaking in meetings are critical for the nomination of directors in future re-elections. The Code further recommends that the assessment process and results be communicated to the owners under a specific item in the report of the board. Adding more weight to this recommendation, CVM Instruction 480 now requires listed companies to disclose performance evaluation mechanisms of board members, committees and management.

3. Current Practices

Board evaluation is virtually non-existent in practice in the region. The answer from IAGO suggests that even in *Argentina*, one of three countries that cover the issue in voluntary codes, companies do not perform board evaluations since it is not mandated by law. Similarly, the contribution by Confecamaras pointed out that in *Colombia*, boards resist evaluation since they are not obligated to do so. In addition, techniques for board evaluations are unknown, and costs associated with hiring outside consultants represent an additional barrier for the practice to take hold.

IBGC noted that in the case of *Brazil*, since the issue is relatively new, many initial obstacles have to be overcome. One of these obstacles is that individual evaluations based on peer reviews do not work well in the Brazilian culture, and consequently most evaluations available to IBCG assessed the board as a whole. The 2009 IBCG/Booz&Co study confirmed these findings. 75% of the 85 companies evaluated in the study did not perform board evaluations, 13% performed self-evaluations, and 7% other evaluations, i.e. with external consultants.

The 2009 Center for Corporate Governance and Capital Markets Study for Chile confirms the findings for other jurisdictions. 77% of interviewed directors declared that their company did not have any formal evaluation mechanism. In the 2007 McKinsey study for 253 companies, the number is even worse, at 79%.

4. Summary and preliminary recommendations for discussion

With the exception of Argentina, Brazil, Mexico and Panama, board evaluation is not established in the corporate governance frameworks in the region. The little evidence available with respect to current practices suggests that even in these jurisdictions, companies do not commonly evaluate their boards. External evaluations do not seem to be a factor.

Preliminary recommendations for discussion in the area of board evaluation include the following:

- As a first step to better establish the concept in the region, it should be recommended in voluntary corporate governance codes.
- The utility of board evaluations for the company needs to be better demonstrated in avoiding prolonged, ineffective office terms; for the board in becoming a better decision-making body; and even for the individual director, in gaining crucial qualifications.
- To overcome the barrier of lack of know-how, board evaluation methodologies should be developed in the context of each jurisdiction and be provided to companies.

Annex: Studies and Surveys with information on practices

Institution/Study	Publication Year	Method	Number/Type of Companies	Function of Respondents
Brazil				
IBGC/Booz& Co, <i>Panorama da Governança Corporativa no Brasil</i>	2009	Survey (137 questions)	85 companies out of 300 local companies with sales in excess of R\$200 million, 68% listed: -28% on Novo Mercado -25% Level 1 and 2 -15% on Traditional Segment	Chairmen, Directors
KPMG, <i>A Governança Corporativa e o Mercado de Capitais: Um panorama das corporações brasileiras na BM&FBOVESPA e nas Bolsas norte-americanas</i>	2009/10	Survey (37 questions)	Companies listed on BM&F BOVESPA: i) 34 companies with ADRs, L 2 and 3; ii) 100 companies listed on Novo Mercado iii) 57 companies listed on Level 1 and 2 of; iv) Most liquid 45 companies on Traditional Segment	Analysis of Public Reports
IBGC, <i>Corporate Governance Award</i>	2009	20 Corporate Governance Aspects	Listed companies on BM&FBOVESPA (387 companies in 2009)	N/A
Sandra Guerra, <i>The roles of the Board of Directors in listed companies in Brazil</i>	2010	Survey	65 listed companies on BM&FBOVESPA	122 Managers
Chile				
Center for Corporate Governance and Capital Markets, <i>Principios y Practicas de Gobiernos Corporativos</i>	2009	Interviews	63 Directors 72% listed companies, 22% closed, and 6% other	Directors
McKinsey, <i>Potenciando el Gobierno Corporativo de las Empresas en Chile</i>	2007	Survey	262 Respondents, 39% listed Companies locally or abroad, 61% Closed	General Manager (49%), Director (34%), President (17%)
Colombia				
Superintendency of Finance, <i>Resultados EncuestaCodigo Pais</i>	2008	Survey	177 Issuers	
Mexico				
Deloitte, <i>Estudio de Mejores Practicas en Consejos de Administracion</i>	2009	Survey	160 Respondents from 144 companies with operations in Mexico, 29 of them listed in Mexico	Directors and Executives
Peru				
CONASEV, <i>Grado de Cumplimiento de los Principios de Buen Gobierno Corporativo</i>	2009	Evaluation	203 companies registered in Public Capital Market Registry, required to present their annual report for general findings, 69 companies are studied in	Analysis of Public Reports

depth