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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

The 2010 Meeting of the
Latin American Corporate Governance Roundtable
Rio de Janeiro, October 21-22 2010

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Purpose and scope

To better understand the functioning of boards in Latin America:

- Take stock of the corporate governance framework, consisting of laws, regulations and voluntary codes, focusing on listed companies
- Complement analysis of legal/regulatory framework with information on actual practices
- Provide preliminary recommendations as a basis for discussion, to be modified as appropriate to take into account Roundtable participant perspectives.

This study would have not been possible without the input from the Corporate Governance Institutes

Topics of the Study

- Board Duties
- Board Handling of Conflicts of Interest
- Board Selection and Structure Criteria
- Criteria for Independence
- Board Committees
- Chairman/CEO Separation
- Board Risk Management
- Board Evaluation

Legal Framework

Summary Legal Framework

- The corporate governance frameworks in the 7 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.
- Strong reliance on voluntary codes addressing most board topics in detail. In general, broad formulations are made in laws, with the specific duties and requirements covered in codes.
- 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.

Practices

- Limited impact of voluntary or comply-or-explain codes as a way to enhance corporate governance, as most companies in the region tend to comply only with legal requirements.
- Although there have been commendable developments in the region to make more information on board practices available, additional information is still needed to come closer to achieving a comprehensive picture of board practices in the region.

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 essential in convincing companies and boards of the value of efficient boards.

Preliminary recommendations for discussion

The report “***Achieving Effective Boards***” was prepared as a basis for discussion, aimed at supporting improvements to the functioning of boards in Latin America.

The recommendations included in the report to enhance board effectiveness are preliminary, *input from Roundtable participants is essential* to developing recommendations for follow-up.

The findings by board topic presented in this section focus on the current practices and preliminary recommendations. Findings on the legal framework by board topic are included in the report.

Board Duties

Practices

- Well-prepared/informed boards seem to be found most frequently in big, resourceful companies. Information for directors is often made available 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.

Preliminary recommendations for discussion

- Increase efficiency of boards in the region by integrating the responsibility of continuous training to the duties of the board.
- Adequate information systems for directors should be established, including the disclosure of the agenda and relevant information sufficiently in advance of board meetings so directors can attend fully informed and prepared.

Board Handling of Conflict of Interest

Practices

- When non-executive and independent directors who do not own shares serve on the board, conflicts of interest are less common.
- Weak compliance of directors on monitoring and supervising conflicts of interest as well as lack of discussion of conflicts of interest in board meetings.
- Implementation of Codes of Ethics is addressed in few jurisdictions, information on the use of preventive measures was not available.

Preliminary recommendations for discussion

- Clarify the separation of duties and definition of roles and responsibilities for directors and shareholders; define specific potential cases of conflicts of interest in the regulatory framework and enforce their disclosure.
- Document the discussion of conflicts of interest during board meetings.
- Widespread application of Codes of Ethics could contribute to reduce unethical and/or unlawful behavior.
- Increase the use of preventive measures, and enforce sanctions to manage cases of conflict of interest.

Board Selection and Composition Criteria

Practices

- Shareholders, former or current executives are commonly selected as directors in some jurisdictions; strong concentration of power in boards in the hands of controlling shareholders.
- Survey data shows boards size ranging between 5 and 11 members.

Preliminary recommendations for discussion

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

Criteria for Independence

Practices

- Information on compliance with independence requirements was not available.
- Companies tend to comply with the minimum number of independent directors required by law.

Preliminary recommendations for discussion

- Incorporating independence requirements into laws or mandatory regulations.
- Encourage more transparency of nomination processes and the release of information on the background of candidates.
- Promote awareness of the benefit of having directors with diverse and independent opinions in order to overcome the reluctance of many companies in the region to have independent directors on their boards.

Board Committees

Practices

- 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.
- 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

- Extending the legal coverage of committees, their composition and functions, since they are currently, if at all, mainly covered in codes.
- Demonstrating the benefit of establishing committees could convince corporations of their value-generating virtues.
- Encourage the availability of more information about committees.
- Consider recommendations on the handling of multiple meetings as well as Director's remuneration.

Chairman/CEO Separation

Practices

- Information on the separation of roles of Chairman and CEO was only available for two countries.
- The use of a lead non-executive director if the roles of Chairman and CEO are combined was not observed.

Preliminary recommendations for discussion

- Consider requiring Chairman/CEO separation in law or regulation (Currently only in Chile and Colombia, and soon in Brazil).
- Company's statute needs 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).
- Consider having a lead non-executive director as an appropriate alternative if the roles of Chairman and CEO are combined.

Board Risk Management

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 including main risk factors is not common practice.

Preliminary recommendations for discussion

- Avoid functional overlap between the responsibilities of the board and management, clearly defining risk functions, mainly management and monitoring.
- 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.

Board Evaluation

Practices

- Board evaluations are not common practice in the region.
- In general, 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

- Board evaluations should be recommended at least in voluntary codes.
- The usefulness 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 and provided to companies, and if necessary adapted to local circumstances.

We appreciate any comments and feedback as well as additional information on the legal framework and/or current practices on your jurisdictions to be incorporated to the report.

Thank you!