



BM&F BOVESPA

A Nova Bolsa

How Have Stock Exchanges in the Region Impacted Corporate Governance?

Armínio Fraga

**Latin American Roundtable of Corporate
Governance**

October 2010

Concept and brief history

Consistent Results

Review Process

Main Challenges

- Novo Mercado, launched in December 2000, is a special listing segment based on corporate governance requirements over and above the Brazilian Corporate Law and the capital market regulation
- Option between Law (regulation) and Codes (recommendation – “comply or explain”) – Novo Mercado is an opt-in system
- Novo Mercado is a private initiative, based on the self-regulation power of the Exchange, in order to improve the quality (or the credibility) of public companies and capital market

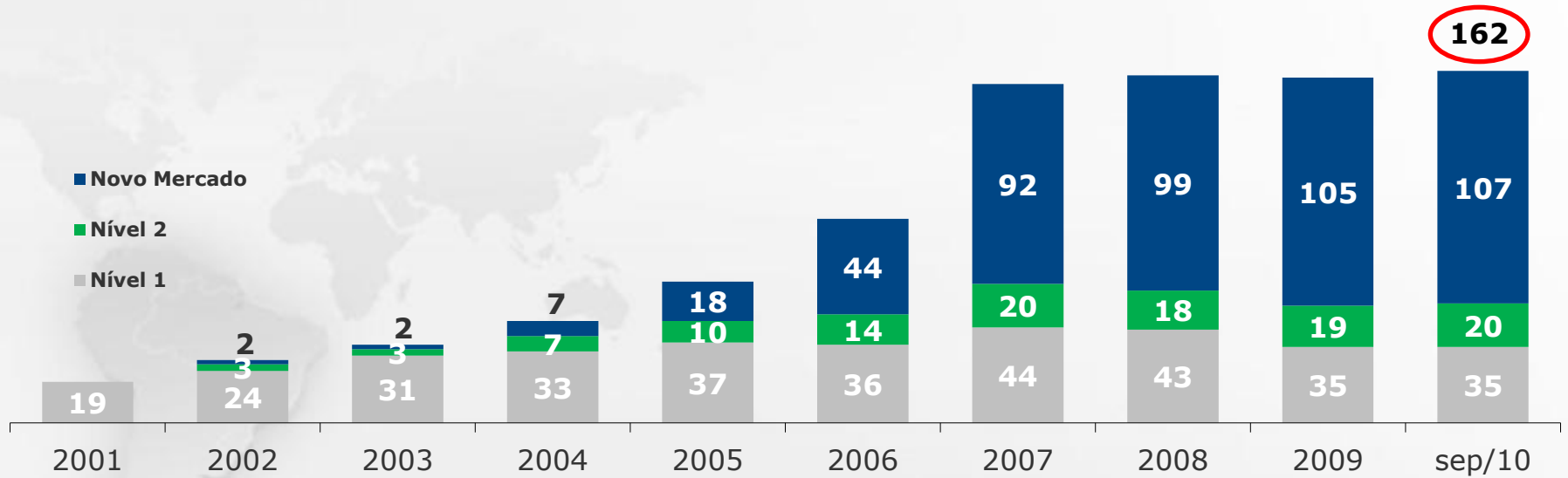
- Main problem identified by the Exchange: the lacking of enough or suitable protection for minority shareholders
- Main goal of the Exchange: the creating of a receptive environment for public offerings
- Corporate governance and market:
 - ✓ Corporate governance practices can provide the alignment of interests between investors and companies
 - ✓ For investors: it implies risk mitigation
 - ✓ For companies: it implies better valuation

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Higher transparency

NÍVEL 1
BM&FBOVESPA

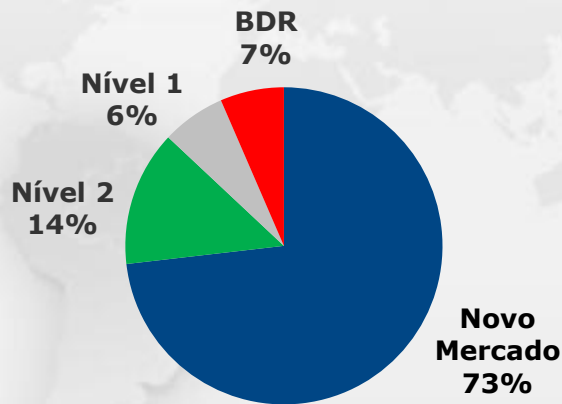
Shareholders' rights
Corporate governance
Higher transparency

NÍVEL 2
BM&FBOVESPA

Only voting shares
Shareholders' rights
Corporate governance
Higher transparency

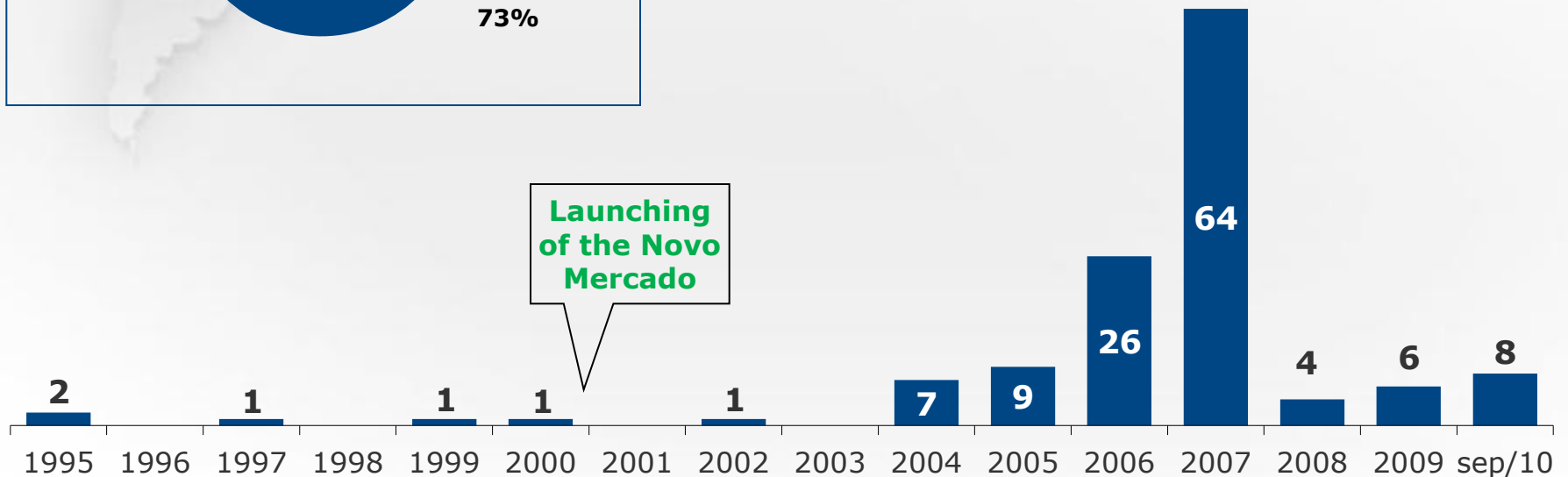
NOVO MERCADO
BM&FBOVESPA

IPOs by listing segment
(2004 - Sep/2010)



Participation of listing segments at the
Stock Exchange (Sep/10)

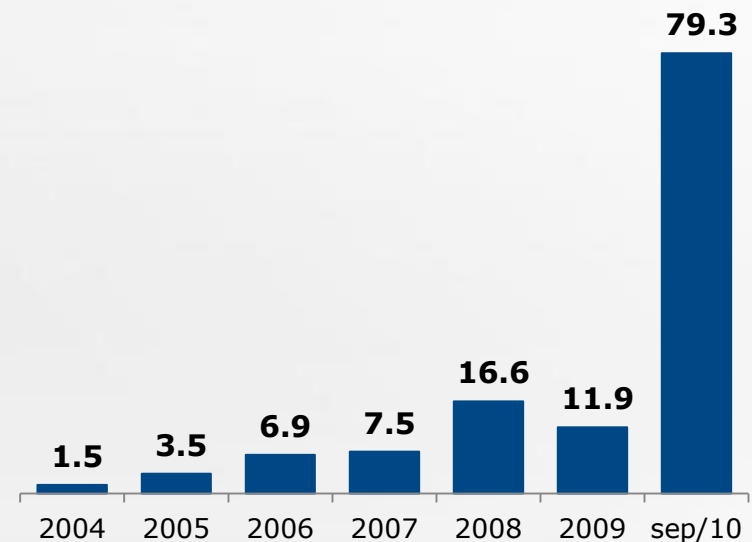
- 34% of total listed companies
- 66% of market capitalization
- 77% of traded value



- Initial public offerings (IPOs)



- Follow on offerings



Foreign investors represented around 75% of the offerings

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Objective

- Preserving the value of the Novo Mercado as a local and international benchmark

Drivers

- Evolution of the Brazilian regulation
 - ✓ Convergence to the International Financial Reporting Standards (IFRS)
 - ✓ More transparency required by CVM
- Financial crisis
 - ✓ Which mechanisms could guarantee the effectiveness of the Board of Directors?
- Birth of the first Brazilian “corporations” (dispersed ownership)
 - ✓ Brazilian Corporate Law, enacted in December 1976, was designed for companies with controlling shareholders
 - ✓ Novo Mercado, created in December 2000, focus on mitigating agency conflicts between controlling shareholder and minority

- **Ownership structure: from concentrated to dispersed**

- ✓ How to protect the shareholders and the companies?
- ✓ How to avoid conflict of interests?
- ✓ Anti-takeover clauses adopted by companies (“poison pills”): defense measures or real obstacles to change the control and the management?
- ✓ Transfer of control is the most sensitive item of the current review

- **The Stock Exchange proposal**

- ✓ Mandatory bid triggered by accumulation of a material ownership interest based on the City Code and the Takeover European Directive
- ✓ Material ownership: 30% of voting shares
- ✓ Equitable price: the highest price paid by the acquirer in the last 12 months
- ✓ Members of the board of directors must disclose your opinion about the offer (against or in favor)

- Started in October 2008 and is still open
- Relevance of a wider debate, instead of a process confined to the Exchange own perception:
 - ✓ Establishment of the Novo Mercado Advisory Committee (*Câmara Consultiva do Novo Mercado*), or CCNM;
 - ✓ Discussion forums with issuers in all the phases;
 - ✓ Open seminars for the public in general.
- Direct contact with the Board members of the listed companies

- 90-day period:
 - ✓ Initially from July 7th through August 6th , 2010
 - ✓ Extended until September 8th
 - ✓ Re-open of the Closed Hearing for another 30-day period: from October 5th through November 3rd
- The revised rules may only be adopted if not opposed by more than one-third (1/3) of the issuers voting in each listing segment:

Segments	N1	N2	NM
Issuers	35	19	105
Veto threshold	11	6	35
Companies participation (*)	28 (80%)	13 (68%)	93 (89%)

(*) In the first round of the Closed Hearing

- All documents related to the Closed Hearing, including the companies' responses, were available in the Internet

- Tender offer requirement triggered at 30% accumulation of material ownership interest **Not approved**
- Requirements related to the board of directors
 - Increasing to 30% (from 20%) the percentage of independent directors **Not approved**
 - No accumulation of the positions of chairman of the board and CEO **Approved**
 - Mandatory establishment of an audit committee **Not approved**
 - Requirement for the Board of Directors to advise the shareholders and the market on the terms and conditions of any tender offer **Approved**
- Restrictions to certain bylaws provisions
 - Requiring qualified majority vote (qualified quorum) **Approved**
 - Entrenched provisions (“Cláusula Pétrea”) **Approved**
 - Poison pill provisions
- Voting limitation – no limitation permitted under 5% of the shares **Approved**
- Mandatory adoption and release of
 - Securities trading policy **Approved**
 - Code of Conduct **Approved**

- Clarify one aspect of the response from the companies
- Mandatory Tender Offer with 30% trigger and highest price paid in the last 12 months – “Tender offer at 30% - NOT APPROVED”
- Restriction of any poison pill provision – APPROVED
 - ✓ Poison pill provision defined as any mandatory tender offer different from the one presented by the Exchange - “Tender offer at 30%”
- Proposal from the Exchange submitted to the listed companies
 - ✓ For new companies joining Novo Mercado only the Tender Offer-like provision if adopted will follow the proposal “Tender offer at 30%”
 - ✓ As a result, if approved:
 - The “tender offer at 30%” will be voluntary, but the only alternative for new companies joining Novo Mercado
 - New companies will not be allowed to adopt any type of “poison pill” provision

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- How to improve the Novo Mercado in order to suit all sorts of ownership structures
 - ✓ Larger number of companies with increased diversification of ownership structures
- Safe harbor for already listed companies
 - ✓ It will be increasingly harder to propose changes without guaranteeing a safe harbor
- Market support and stakeholders' engagement are necessary
 - ✓ Novo Mercado become a reality because investors demanded corporate governance reforms and the companies themselves saw these obligations as advantages
- Decision making process within companies is complex
 - ✓ Technical team (IR and Legal), Executives, Board, Controlling shareholders
 - ✓ Minority shareholders (?)
- Mandatory Tender Offer rule will have to be addressed in a different way
 - ✓ Maybe approved as voluntary and optional for new companies
 - ✓ Brazilian "Takeover Panel"
 - ✓ Corporate Law Reform



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Shareholders' rights

- **Only voting shares**
 - Alignment between economic exposure and voting rights
 - Brazilian Corporate Law allows non-voting shares – 2/3 (until 2001) and 1/2(after 2001) of the total capital
- Full tag-along rights extend to all shareholders in case of change of control
- Public tender offering at economic value in case of delisting
- Arbitration panel to solve conflicts

Transparency (monitoring)

- Disclose of additional information
- Board of directors with at least 5 members being 20% of them independent ones

Dispersion

- Minimum free float of 25%
- Procedures in public offerings to enhance the dispersion of the company shares

Novo Mercado Advisory Committee (CCNM)

- October 2008: formed the *Novo Mercado* Advisory Committee (*Câmara Consultiva do Novo Mercado*), or (CCNM), as a body composed of 21 external members, including investors, issuers, lawyers, investment banks and market associations.
- November 2008 - January 2009: The CCNM was divided in smaller working groups for analysis of specific topics.
- February - March 2009: the key items defined for review were circulated to about 50 market entities for additional feedback.
- April 2009: recommendations were submitted to the board of directors of BM&FBOVESPA

Discussion forums for issuers

- June 2009: first round of discussion forums (comprising 16 events attended by representatives of about 100 issuers listed on all corporate governance segments)
- Special discussion forum for debate of the tender offer requirement in the event of accumulation of material ownership interest

“Challenges of the *Novo Mercado*” seminars

- Held on September 3 and 10, 2009, in Rio de Janeiro and São Paulo, respectively
- Special panels discussed the most sensitive topics
- 27 lecturers and over 700 attendees, in addition to the specialized press

- October 15, 2009: End of the period for issuers' to respond to the proposed changes
- The board of directors of BM&FBOVESPA met to evaluate the CCNM recommendations and consider the feedback received from issuers and the Exchange's technical staff (Board meeting held in December 2009)
- January 2010: Completion of the first draft rules
- January – March 2010: First draft listing rules circulated to specialists for analysis and feedback
- April – May 2010: Completion of the second draft rules
- May 2010: Seminars held for presentation and discussion of the second draft rule
- June 2010: Refined drafts were submitted to the board of directors of BM&FBOVESPA and approved for presentation at a closed hearing

- Closed hearing
- Draft rules to be refined based on feedback from the closed hearing
- Final draft rules to be submitted to approval by the board of directors of BM&FBOVESPA, along with the sanctions for noncompliance with the revised regulations
- Revised rules to be forwarded for CVM approval
- Issuers to be communicated of the final wording and date of effectiveness of the revised rules.
- The revised rules are expected to take effect **between December 2010 and January 2011**
 - Rules whose enforcement requires issuers to act promptly to amend the bylaws – deadline typically expiring within six months or the date on which the annual shareholders' meeting next convenes, whichever is later.
 - Rules requiring the bylaws to be adjusted for conformance with the revised rules – deadline typically expiring within 3 years.