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**Corporate governance-related regulatory-
framework for non-listed Companies in Brazil**

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This paper was written as a contribution to the Latin American Roundtable on Corporate Governance to answer the following 4 questions:

- What is the legal framework for non-listed company corporate governance-related requirements in Brazil?
- What are the practices and trends regarding disclosure by non-listed companies?
- What changes to legal and regulatory requirements may be desirable, and what would be their costs and benefits?
- How should this be balanced with voluntary efforts to promote better corporate governance of non-listed companies?

Legal Framework for Corporate Governance requirements in Brazil

From a legal standpoint, most companies in Brazil belong to two categories:

- *Sociedade Limitada*, with little disclosure requirements, governed by law #10406 of January 10, 2002 - the Brazilian Civil Code, which broadly corresponds to limited liability companies and limited liability partnerships in US law.
- *Sociedade por Ações*, "publicly held" or "closed", with its constitution, organization and disclosure requirements governed by law #6404 of December 15, 1976 as amended - the Brazilian Corporations Law.

A *Sociedade por Ações* (SA) is considered "publicly held" if it is registered at CVM (the Brazilian Securities and Exchange Commission). A "publicly held" SA may be further considered listed or non-listed depending on whether its securities are admitted to trade in the stock exchange or over-the counter markets. Publicly held companies (whether listed or non-listed) are subject to CVM's supervision and must observe CVM's rules.

For all practical purposes the text below refers to three categories of companies:

- The *Sociedade Limitada* (Ltda), a non-listed company (NLC)
- The "closed" *Sociedade por Ações*, that will be also referred to as a NLC
- The publicly held *Sociedade por Ações*, whether listed or non-listed in the stock market. Since both "publicly held non-listed" and listed companies are subject to very similar requirements they will be regarded as Listed Companies (LCs) in this paper.

It is worth noting that the latter category - publicly held non-listed and listed - number about 800 companies. Of those, some 300 are traded and only 120 are *regularly* traded at the Brazilian Stock Exchange Bovespa. Regularly traded companies account for more than 90% of the Exchange's volume.

The types of company control - whether family-controlled, state-controlled, subsidiary of international corporations etc were disregarded for the purposes of this paper.

Regulatory Framework of Corporate Governance

In a broad sense, regulation of Corporate Governance includes the legal framework described above, and also contractual requirements such as those defined by the stock market, investor, and banking organizations. Regulation may also include Codes of Best Practices designed to promote better performance of all types of companies on a voluntary basis. This broad scope helps to clarify the question of whether more legal requirements OR voluntary efforts are more effective to promote better corporate governance.

The exhibit combines the legal categories of companies with the above-described 3 levels of regulation. Over time, well-designed Best Practices tend to be assimilated by stakeholders and become contractual requirements by banks and investors. These in turn may become legal obligations in the future. Seen as a whole, this framework can be useful to identify areas where advocates of good corporate governance may influence overall regulation.

Practices and trends regarding disclosure by non-listed companies

The simplest form of NLC in Brazil, the Sociedade Limitada, is required to register articles of association at the Trade Bureau and little other formalities. No disclosure of financial statements is necessary. Independent audits are required only for Central Bank regulated organizations that access public savings.

This simple form is the choice of small and middle-sized companies (SME) but also of very large subsidiaries of international companies such as IBM, Carrefour, Ford Motor, Volkswagen and Unilever.

There is an on-going discussion in Brazil on whether large companies should be required to disclose financial statements. These large companies argue

that they are wholly owned by public companies outside Brazil, and that these public companies disclose information at headquarters. On the opposite side of the discussion are their stakeholders and listed companies in the same industry. These listed companies disclose detailed information and complain about the cost and strategic disadvantage of competing against NLCs in the same industry that have a non-disclosure policy. One example is the argument between Pão de Açúcar Group and Carrefour, respectively the 1st and 2nd largest retailers in Brazil.

What changes to legal and regulatory requirements may be desirable, and what would be their costs and benefits?

The Bill of Law #3741 is under discussion in congress since the year 2000 and essentially requires disclosure of financial information of NLCs with revenues over R\$ 300 million (aprox. US\$ 130 million).

Cost and benefits of disclosure are an important issue in Brazil, where companies face an already heavy burden of government bureaucracy. The existing corporations law (Lei das SA) requires the publication of financial statements in the official gazette (Diário Oficial) and in a large circulation newspaper. The extension of this requirement to the smaller *Limitadas* would impose a significant additional cost and should be avoided.

Regulation should define the limits between small, medium and large companies in terms of revenues, equity or number of employees, or a combination thereof. There is one such definition for taxation purposes, but not for disclosure obligations.

The publication of financial statements, minutes of shareholder and board meetings in the official gazette and large newspapers should be optional. The disclosure of information on the Internet is inexpensive and a far more effective alternative for all stakeholders than on printed vehicles, and should become required for LCs and for all but the smallest NLCs.

How should this be balanced with voluntary efforts to promote better corporate governance of non-listed companies?

More legal requirements are not always the most effective way to improve corporate governance standards. Contractual requirements by lenders/investors and voluntary efforts are often more effective and certainly less costly. The Brazilian Institute of Corporate Governance (IBGC) has become over the last 10 years a national reference for its contribution to better governance by educating companies to adopt good

practices and raising the awareness of stakeholders to the advantages of good governance in addition to complying with legal requirements.

IBGC's Code of Best Practices has a set of recommendations that were designed with the most complex kind of organization in mind - the large *listed* company - but that would be helpful to all kinds of organizations, large and small. One of the issues under discussion at the IBGC is how to better focus the very large number of family-controlled NLCs that constitute an important segment of the Brazilian economy. For many such companies, some best-practice recommendations may have to be waived, like for example a majority of independent board directors and a separation of ownership and management. On the other hand, more emphasis should be given to shareholder agreements, family constitutions, family councils and family offices as instruments to better governance.

A separate set of Best Practices for NLCs is not considered desirable. Considering that "Governance is a Journey, not a Destiny", a new version of the Code should consider a timeline for companies from start-up to listed corporation, with best-practice recommendations adequate for each stage of development.

Another line of action would consist of trying to convince associations of banks and institutional investors to require better governance for their own advantage, since better governance means less risk for investors and creditors. For example, there are on-going conversations between IBGC and an association of private equity funds that will hopefully lead to the adoption of Best Practice requirements by members of this association as a self-regulation initiative. The National Development Bank (BNDES), as a government-funded source of long-term financing, should require the disclosure of financial statements and independent audit of its clients. If best practice requirements were extended to commercial banks, they would constitute a powerful incentive for all NLCs to improve their governance standards.

In the future, these constituencies - associations of banks and institutional investors - could be invited by OECD to get more involved with the Roundtable.

Finally, IBGC is looking forward to complement the joint research with CIPE (Center for the International Private Enterprise) of 15 family-controlled Listed Companies, soon to be published, with similar research on

family-controlled Non-Listed Companies. Such research may have a significant impact on the market and support further committee work and education programs already offered by IBGC.

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