



**The Fifth Meeting of the
Latin American Corporate Governance Roundtable
8 - 9 October, 2004**

**Address by
Ms. Isabella Saboya
Investidor Profissional
Brazil**

**Session 1: Legal, Regulatory and Institutional
Framework for Enforcement – State of Play and Key
Challenges**

What do you consider the **greatest successes** and the **greatest challenges** or needs for improvement in your country's **enforcement framework**?

First of all, I would like to name the institutions which I consider to be part of Brazil's enforcement framework. Those would be:

The CVM, our local Securities Commission

The arbitration organizations, more notably Bovespa's arbitration chamber

The Judiciary

The self-regulated organizations, namely Bovespa

And I would also include another entity, which in my opinion is crucial to foster the development of corporate governance in Brazil. This would be the SPC, our pension fund regulatory entity - and I will explain later why I have included SPC.

Let's go for the good news first, the successes:

In the case of the CVM, the first big step to strengthen our enforcement framework was the amendment of Law 6.385, which granted CVM's chairman and commissioners a 5 year term stressing the full independence of our regulators. This same Law granted more powers to the CVM, especially in cases of stock price manipulation and insider trading, which are now considered to be criminal offences. It also allowed CVM to postpone a shareholders' meeting if the subject to be voted is considered to be complex.

Since I think one of the main challenges for CVM is the delivering of landmark decisions which can provide the market with some disciplinary guidance, it would be worth mentioning two decisions which I believe to be very relevant for the market: (i) the first one was the Bombril case whose controlling shareholders and directors were convicted in a related party transaction and (ii) the second was a recent penalty on a couple of investment banks and an auditing company in a debenture offering - it was probably the first case to stress the responsibility of offering coordinators in disclosing complete and quality information to prospective investors.

As to Bovespa, after 3 years of very slow activity, I am delighted to see the huge success of the Novo Mercado segment. This year we had 5 stock issues in the two highest levels of Bovespa's corporate governance segment. Those offerings sum up more than US\$1.2 bn, being more than half of it aimed at financing new investments. Additionally, we had 2 large deals at Novo Mercado's Level 1 from companies that voluntarily granted tag-along rights, which I believe was key for the deals to succeed.

In fact, in my optimistic view, I believe that companies considering raising capital in the future may find difficult to do so without shifting to a higher standard. However, the outcome of our recent deals including the Level 1 companies, seems to me a clear sign that the market is pricing the tag-along value, but it is failing to give any premium to companies granting voting rights to preferred shares or companies with arbitration, which in my personal opinion, can be two relevant provisions in certain cases.

In my point of view, we have tough challenges for the CVM, the Judiciary power, Bovespa's arbitration Chamber and the SPC.

It seems to me that standard-setting decisions from the CVM and from the Judiciary can play a fundamental role in promoting a more efficient and fair capital market. Exemplary cases push market players towards setting higher compliance standards. Needless to say, this can save efforts from our authorities that can be free to focus on more complicated cases and on the enactment of regulations responding to the ever-changing market needs.

Although I have already mentioned two high-profile decisions from the CVM, I think the market is still waiting for such sort of decisions in cases involving controlled companies incorporations and on the controversial issue of conflict of interests. As I honestly don't know what the solution should be for either case, I leave this to our bright lawyers, but the fact is that those two issues have been swords on the head of investors and the main reason to apply major discounts on our valuations.

Another complicated challenge for the CVM is to prove wrong the market's perception that its sanctions are ineffective in practice. As it happens, market players are not well informed about the range of CVM's powers to punish offenders. For example, investors believe that CVM is empowered to order offenders to reimburse a company in an unfair related party transaction. The market also believes that the CVM can void a shareholders' meeting. Therefore, CVM has a tough task in educating the market and eliminating this lack of enforcement feeling.

As to the Courts, I do think we need more expertise, but leading cases also remain important to be seen for instance in Rio de Janeiro commercial court, which so far is the only one in the country.

I would like to stress that in cheering for exemplary cases I am not advocating to find an escape goat, but obviously to have convictions strictly according to the Law.

As to Bovespa's Private Arbitration, it is still considered a promise. We haven't had any cases yet. We might need a simple case, not necessarily one that we see a shareholder noisy battle, but one that solves a genuine doubt which is not so rare in the interpretation of the Corporate Law, companies' by-laws or shareholders' agreement.

In terms of the SPC, the pension funds supervisory body, something must be done to change the way it demands accountability from the pension funds. As far as I know the emphasis has been on the short-run, focusing on pension funds meeting their annual actuarial target, which, in general, is close to inflation + 6-to-8%. To me, it would make more sense for pension funds to focus on the long-term return since most of them have a high duration liability. Obviously, the short-term emphasis reduces their incentives for investing in the equity market. Excluding Previ, which I believe to be an outlier in equities investment, only 15% of pension funds assets are invested in equities.

If pension funds increase their investments in equities, they will have more incentives to push companies towards adopting higher governance standards.

I think that regulatory bodies dealing with pension funds should do their best efforts to issue regulations and demand accountability in a way to create incentives for long-term investments.

If resources for enforcement could be doubled in your country, what priorities should be addressed?

My priorities would be the CVM and the Judiciary power.

For the CVM I think I would focus on training and designing a new career and compensation plan. Maybe one that resembles the plans we have for BNDES or the Central Bank as I believe that CVM's officers' responsibilities are as tough as those of the officers of those institutions.

For the Judiciary, I would set commercial courts at least in the cities with stronger business activities and invest a lot in specialized training for the judges of those courts.