

## CORPORATE GOVERNANCE ASSESSMENT - MEXICO

### I. Disclosure and Transparency

Information to be disclosed to shareholders

#### a) Financial Statements

Preparation. Mexican corporations' financial statements are prepared in accordance with accounting principles generally accepted in Mexico, Mexican GAAP, which vary in certain respects from accounting principles in other jurisdictions. Rather than being prepared on an historical cost basis, Mexican GAAP financial statements include the effects of inflation, as required by Accounting Principles Bulletin B-10, Recognition of the Effects of Inflation on Financial Information, prepared by the referenced Mexican Institute of Public Accountants. The application of Bulletin B-10 represents a comprehensive measure of the effects of price level changes in the Mexican economy and is considered a more meaningful presentation than historical cost-based financial reporting for accounting purposes.

Presentation to shareholders. The General Law of Corporations (*Ley General de Sociedades Mercantiles*) ("LGSM"), enacted in 1934, sets forth in its article 172 that corporations, under the responsibility of their directors, have to present to the shareholders, on an annual basis, a report including at least (i) a report of the directors about the corporation's operations for the prior fiscal year, (ii) a report on policies, accounting criteria and information applied in preparing the financial statements, (iii) financial statements for the prior fiscal year, including statement of results, changes in financial condition and notes. This report, which is not a detailed report but includes a complete set of the financial statements, has to be made available to shareholders at least 15 days prior to the date set forth for the annual shareholders meeting, that has to approve the financial statements. The annual shareholders' meeting needs to take place within the first four months of each calendar year, as mandated by article 181 of the LGSM.

Revision by auditors. Financial statements need to be reviewed by an auditor (*comisario*) that is appointed by the shareholders meeting, in accordance with article 164 of the LGSM. The auditors need to present a report to the annual shareholders meeting regarding the accuracy and sufficiency

of the financial information presented by the Board of Directors, and render their opinion in regard thereto.

b) Economic, accounting and legal information to be filed with the CNBV

Public corporations are obligated to comply with provisions contained in circulars issued by the National Banking and Securities Commission (*Comisión Nacional de Seguros y Valores*) ("CNBV"), the entity that is in charge of overseeing the securities market and, in general, the financial sector. Circular 11-11 sets forth certain reporting requirements that have to be met. These requirements include the submission to the CNBV of economic, accounting and legal information that has to be filed periodically with the CNBV. Economic and accounting information needs to be filed on an annual and quarterly basis.

The information to be filed on an annual basis the day after the date on which the annual shareholders' meeting is held, if the corporation is domiciled in Mexico City or within the three days following if the corporation is domiciled in a different entity, includes:

- (i) Report on the resolutions taken by the shareholders, including resolutions taken in respect of application of profits and, if applicable, distribution of dividends and manner of payment to shareholders;
- (ii) Copy of the report of the directors presented to the shareholders' meeting;
- (iii) Copy of the report of the auditors presented to the shareholders' meeting;
- (iv) Copy of the financial statements, audited by an independent auditor registered with the General Bureau of Tax Auditing (*Dirección General de Auditoría Fiscal Federal*);
- (v) Report on investments in other securities;
- (vi) Statement detailing fixed assets;
- (vii) Report on debt service for the year;
- (viii) Consolidated and unconsolidated financial statements;
- (ix) Financial statements of entities in which the respective corporation owns more than 25% of the capital stock;
- (x) List of members of the Board of Directors and principal officers of the corporation;
- (xi) Certification of the secretary of the Board of Directors as to the books of the corporation.

Quarterly financial information includes quarterly financial statements that have to include all information contained in templates that form part of the referenced circular 11-11, which include fairly detailed financial information, capitalization and notes on financial statements.

Legal information to be filed includes:

- (i) Copies of calls for shareholders' meetings, to be filed the day after publication thereof is made;
- (ii) Certified copies of shareholders' meetings minutes;
- (iii) Copies of notarial deeds containing minutes that required notarization, bylaws and any amendments thereto;
- (iv) Copies of specimen share certificates, in the event of capital increases;
- (v) Reports on loan agreements, to the extent they are secured, limit distribution of dividends or require specific financial ratios, including their principal terms and conditions; and
- (vi) Copies of any notices given to shareholders.

In addition, corporations are obligated to file information that may be of importance for the market.

Officers that provide the CNBV on behalf of the issuers with reports and all information that has to be made available to such entity, are registered by the CNBV. These officers shall be responsible if any information is not disclosed on time. Sanctions are applied in terms of the LMV to these officers.

c) Disclosure related to Directors

Circular 11-29 issued by the CNBV requires that issuers of securities disclose in their prospectuses the following information with respect to their officers and directors:

(i) Name and number of the members of the board of directors; dates in which they were appointed; powers and authority of the board of directors; and period in which the directors will hold such position.

(ii) Name of the principal officers, as well as the years in which they have worked with the issuer or its affiliates.

(iii) Resumes of officers and directors, including (a) work experience, (b) age, (c) studies, (d) time that they

have hold the position currently held, (e) previous employers, indicating if there is any relationship between such employers and the issuer.

(iv) Family relationships among members of the board of directors.

(v) Total amount of the compensations paid to officers and directors during the previous year. Issuers must also disclose the number of officers and directors who received such compensation. If such compensation included bonuses, pension plans or stock acquisition plans, such benefits must be described.

(vi) Number of shares or options owned by officers and directors. In the case of options, it must be disclosed the class, amount, strike price and expiration date.

(e) Related Party Transactions

In accordance with Circular 11-29 issued by the CNBV, only when preparing prospectuses for the placement of securities, is it necessary to disclose related party transactions, providing information as to whether they are arms-length or not. No further requirements exist in respect of these transactions.

## II. Minority Shareholders Rights

The LGSM sets forth the basic provisions for the incorporation of corporations, shareholders' rights, management and oversight of management and financial performance. It also sets forth the basic rules for the disclosure to shareholders of financial information and establishes certain minority shareholders' protection rights.

a) Incorporation and registration of basic corporate documents

Incorporation of a corporation requires the notarization of the incorporation deed and the registration at the Public Registry of Commerce, of the incorporation deed and, subsequently, the registration of general powers of attorney that are granted to individuals that may exercise certain capacities on behalf of the corporation and of amendments to the corporation's bylaws (*see arts. 5-7 of the LGSM*). Thus, a registration form, publicly available at the Public Registry of Commerce of the corporation's domicile, records certain provisions of the bylaws of the corporation, as well as a list of attorneys-in-fact that may bind the corporation

in a variety of issues. While this could be the first source of publicly available information related to a private or public corporation, this registration form is not exhaustive and, pending automatization and interconnection of all Public Registries in the country, is not a source of updated and reliable information unless one has accurate and sufficient data to be able to access the correct files.

b) Shareholders' voting rights

Pursuant to article 112 of the LGSM, shares of a corporation grant their holders the same rights, except to the extent that authorization has been granted by the CNBV to issue stock with no voting rights or limited voting rights. Such authorization is granted on a discretionary basis by the Commission and may be requested by issuers in accordance with Article 14 bis of the Securities Market Law (*Ley del Mercado de Valores*) ("LMV"). Non voting or limited voting right stock may only represent up to 25% of the capital stock of the public corporation, unless any such stock is convertible into full voting stock within the ten years following its issuance; the CNBV is, in these events, entitled to authorize a percentage in excess of the 25%. Except for the non-voting or limited voting stock, every share has the right to one vote at any shareholders' meeting at which resolutions are required to be passed.

Section Sixth of the LGSM establishes the provisions related to the shareholders' meetings and those issues regarding the corporation that have to be resolved by the vote of the shareholders. Shareholders' meetings may be of an ordinary or extraordinary nature. Quorum requirements and necessary votes are different, the LGSM setting forth a minimum of issues that have to be passed at extraordinary meetings that, in general terms, require a quorum of 75% of the stock and resolutions taken at such meetings, a minimum of 50% plus one share of the total voting stock, to be passed. Bylaws may provide higher percentages. The minimum of issues that have to be resolved by these meetings are the following:

- Extension of the term of existence of the corporation
- Anticipated dissolution of the corporation
- Capital increase or reduction
- Change in the corporate purpose
- Change in the nationality of the corporation
- Transformation of the corporation into a different type
- Merger

- Issuance of debentures
- Issuance of preferred stock
- Amortization of stock
- Amendments to the bylaws

The bylaws of the corporation may, however, include further issues in which a majority voting is required. The minimum statutory provisions, however, are the ones listed.

Ordinary shareholders' meetings may resolve upon the appointment of members of the Board of Directors, appointment of auditors, approval of financial statements, distribution of dividends, granting of powers of attorney and other issues. The repurchase by a corporation of its stock, requires the authorization of the Board of Directors, provided, however, that the ordinary shareholders' meeting has authorized the amount of capital stock that may be used for such repurchase, in accordance with Article 14 bis of the Securities Market Law (*Ley del Mercado de Valores*) ("LMV").

For the appointment of directors, a minimum of 10% of the capital stock of the corporation is required to appoint one director. Any shareholder or group of shareholders holding such minimum may appoint, by statute, one director and his/her alternate. Percentages may be lowered in the bylaws, but may not be higher than the 10% provided by the statute.

Bylaws may provide for further resolutions that require the shareholders vote.

c) Proxy vote

The exercise of shareholders rights may be done through proxy. Typically, a proxy seldom incorporates the specific language relating to the matter to be transacted upon. A proxy gives the proxy-holder the discretionary right to vote in respect of the items covered in the corresponding agenda, unless a specific limitation is contained in the proxy itself. Specific instructions given to the proxy-holder are unusual.

d) Registration of shares

Pursuant to article 78 of the LMV, registration of public corporation's shares is achieved through the deposit of the stock of the corporation with the central depository, named *S.D. Indeval, Institución para el Depósito de Valores, S.A. de C.V.* or Indeval, per its acronym. Indeval issues to the respective depositor a certificate of deposit that, with

the corresponding registration made by the respective broker in its books, constitutes evidence of ownership of the corresponding shares.

e) Classes of shares

Concern with the issue of control has caused a limited float of voting stock among the public. Few companies are widely held and minorities are afforded few rights. Regulatory constraints as to foreign ownership, while in the process of being eliminated -i.e. the financial sector, for example- caused the creation of non-voting stock (Series "N") or limited voting stock (Series "L", as in the case of Telmex), which is limited by the LMV to 25% of the outstanding capital stock, or the so called CPO structure - for example, see prospectus describing the so-called NAFIN Master Trust-. In some limited instances (Televisa, Corbi, Gemex) voting power has been "neutered" through "acciones vinculadas" or combined units, where voting and non-voting stock are intermingled within the context of a trust. The Trustee is empowered and instructed to vote with the majority, in respect of the voting share component of the unit. Preferred stock has not generally been accepted. In general, voting powers are not of any particular relevance, especially where public companies are concerned. Liquidity has been much more relevant than any voting concerns. To illustrate the point, given situations where Mexican companies have different classes of listed securities on the Mexican Stock Exchange, those which allow holdings without limitation as to nationality, even though they may have limited or non-voting status, command a premium over full-voting securities. Simply the market is deeper as far as investor participation is concerned; voting powers are not considered relevant by market participants.

The CNBV has in the past allowed the registration and placement of securities, in different classes, where voting is limited or neutered, via CPO's or combined units. The general trend has now been to encourage issuers to list one class of securities, and in smaller companies, to insist that the by-laws be amended to reflect one sole class of securities. Neutered investment through CPO's or linked units (i.e., Grupo IMSA) have been limited in time to ten years, absent regulatory (not by means of by-laws) constraints on foreign investment.

f) Transfer of Shares

Shareholders are allowed to freely transfer their shares. There are, however, certain areas that do have

restrictions in respect of foreign investment (airlines, petrochemicals, public transportation, to name a few) and thus, any such shares need to be transferred to qualified investors.

While insiders are allowed to transfer their shares, they are subject to certain reporting requirements. Shareholders already owning more than 10% of the stock of a corporation, need to inform the CNBV of any additional acquisition or sale of stock representing 10% or more of the total capital stock. In addition, insiders are not allowed to sell or purchase shares or other securities of a corporation within the three months following a purchase or sale of such corporation's securities. (See section on Insider Trading below).

g) Enforcement of shareholders' rights

Pursuant to the LMV, the CNBV has the power to investigate violations to the Securities Market Law and delist securities if the issuers have not complied with disclosure and registration requirements provided in the LMV. Specific provisions also address violations to insider trading rules. There are, however, no provisions in the securities regulations that provide for the enforcement of shareholders rights of listed companies. The Mexican Civil Code sets forth the general provisions related to damages caused to third parties, deceit and bad faith. Pursuant thereto, a party would be able to seek, through civil procedures, indemnification or the nullification of a transaction and restoration to prior positions.

However, it should be noted that shareholders rights and more specifically, the rights of minorities are very limited. There are no remedies in equity and Mexican courts have taken the position of enforcing form over substance. Litigation in Mexico is of limited value, and usually requires substantial expense. Cases are not reported, and the few decisions that are, reach the federal circuit courts and occasionally, the Supreme Court, where the particular facts are not reported, but simply a paragraph containing the principle upheld is published. Typically, if a dispute arises among shareholders, matters may end up in criminal courts, where the possibility of seeking a warrant for arrest as a means of personal pressure, is usually sought. In summary, the courts seldom address enforcement of shareholders rights -and only then in family feuds- and we are aware of only a handful of precedents, where shareholders disputes have reached the courts, in regard to publicly listed companies (realistically, there is not yet such a thing as a Mexican

publicly "held" company, as such term is used in other jurisdictions (they continue to be closely held); perhaps in some ways, the exception may be Telmex).

In recent cases involving government intervention of troubled financial institutions, equity capital has been applied against losses; all then existing shareholders are thus eliminated; and, thereafter, the government recapitalizes the institution and then sells the new stock.

Market participants in respect of Mexican issuers simply do not consider voting or minority rights as being relevant.

#### h) Other Minority Shareholders' Rights

The LGSM establishes other minimum mandatory minority rights; however, the bylaws may establish minority rights in addition to those afforded by the LGSM. Such minority rights are usually established through special quorum and voting rights at Board and Shareholders' meetings level. Rights granted by the LGSM to minority shareholders are the following:

(i) Article 144 of the LGSM provides that if the board of directors of a corporation is comprised of three or more members, shareholders representing 25% or more of the outstanding capital stock have the right to appoint one board member. This percentage is reduced to 10% if it is a public corporation. A similar provision applies to the appointment of statutory auditors, which are mandatory under Mexican law.

(ii) Pursuant to Article 161 of the LGSM, an action based on civil liabilities against directors of a corporation may only be initiated, generally, if a shareholders' meeting so approves. As an exception, shareholders representing 33% or more of the outstanding capital stock of a corporation may bring such an action against a director, provided that (i) such shareholders shall not have voted in favor of a decision adopted by the shareholders resolving not to bring such an action against the relevant director, and (ii) the claim covers all the damages alleged to have been caused to the corporation and not merely the portion affecting the plaintiffs. Any recovery of damages with respect to such an action will be for the benefit of the corporation and not for the shareholders bringing the action.

(iii) As provided by Article 184 of the LGSM, shareholders representing 33% or more of the outstanding capital stock of a corporation may request, in writing, at any time, that the board of directors or the sole director, as the case may be, or the statutory auditors, convene a shareholders' meeting to discuss and resolve any of the

issues set forth in their petition. In the event that the meeting is not convened, such shareholders may file a complaint before a competent judge. In terms of Article 185, a holder of a single share may request that a shareholder's meeting be convened if (i) no shareholders' meeting has been held in two (2) consecutive fiscal years, or (ii) shareholders' meetings held during such period have not discussed the financial statements for the relevant corporation, the appointment of directors or statutory auditors and their corresponding compensation.

(iv) According to Article 195 of the LGSM, if the capital stock of a corporation is represented by several classes of shares, any proposal that may adversely affect the rights of holders of a given class of shares must be approved by shareholders of such class at a special meeting.

(v) Under Article 199 of the Law, a decision to be taken at a shareholders' meeting may be postponed for three (3) days if 33% or more of the shareholders present at such a meeting so request, provided that such request may only be made if the shareholders consider that they have not been fully informed.

(vi) In terms of Articles 201 and 202 of the LGSM, holders of 33% of the outstanding capital stock of a corporation may challenge any shareholders' action by filing a complaint with a competent court, within fifteen (15) days counted from the date of the shareholders' meeting at which such action was taken, which complaint must specify the article of the by-laws or the statutory provision which was violated, provided that such a complaint may only be filed to the extent that the shareholders challenging such action either (i) did not attend the shareholders' meeting at which the challenged action was passed, or (ii) if they did attend, they voted against the challenged action. A competent court may suspend the execution of such action if the shareholder seeking relief posts a bond in an amount determined by such court.

(vii) Pursuant to Article 206 of the Law, if the shareholders' meeting approves a change of a corporation's corporate purpose or nationality or a reorganization to from one type of corporate form to another, any shareholder who has voted against such change or restructuring has the right to withdraw as a shareholder of the relevant corporation and receive an amount calculated as specified in the LGSM, provided such shareholder exercises his/her right to withdraw within fifteen (15) days following the adjournment of the relevant meeting.

(viii) Under Article 220 of the LGSM, any holder of stock representing the variable portion of a corporation's

capital stock has the right to withdraw fully or partially his capital contribution. If notice of withdrawal is received prior to the last quarter of the relevant fiscal year, the withdrawal becomes effective at the end of the fiscal year in which notice was given. Otherwise, the withdrawal becomes effective at the end of the following fiscal year.

### III. Oversight of Management

#### a) Acts of Management

In accordance with the LGSM, shareholders appoint the directors of a corporation. The bylaws of each corporation generally include a section that sets forth the duties and capacities of the directors. In some instances, such duties and capacities are detailed, and directors may not exceed their functions. Day to day management is appointed generally by the directors, although such appointment is not mandatory. The different statutes provide for obligations and liabilities of the directors, as follows:

##### (i) LGSM

The Board of Directors as a body is entrusted with the "administration" of a corporation. Administration does not mean the day-to-day management, but rather the supervision of the management, which is conducted by employees of the corporation. From the point of view of hierarchy, the shareholders acting through a shareholders' meeting are the supreme governing body of a corporation.

Individual directors as such, do not have authority to represent the corporation. The Board of Directors as a body usually has broad powers, which it may delegate to individuals.

The position of a director must be performed personally or by alternate directors previously appointed by resolution of a shareholders' meeting. A director cannot appoint a proxy holder or attorney-in-fact to represent him in directors' meetings.

Directors are usually elected, reelected or replaced at the annual shareholders meeting. In any case, they remain in office until the directors who replace them are appointed and take office.

If, with regard to a particular matter, a director has a conflict of interest with that of the corporation, he must so advise the other directors and refrain from discussing and

voting on the matter. A director who fails to comply with this limitation shall be liable to the corporation for any damages and losses caused to it.

Directors are jointly and severally liable to the corporation for:

- 1.- The existence of shareholders capital contributions.
- 2.- Compliance with legal and by-law requirements with respect to the payment of dividends.
- 3.- The existence and maintenance of systems of accounting, control, registration, filing and information required by law.
- 4.- Exact compliance with resolutions adopted by shareholders' meetings.

A director who, being blameless, has expressed his/her opposition when the respective matter is voted on will not be liable.

Directors are jointly and severally liable to the corporation with those Directors whom they replace for the irregularities committed by them, if the new Director is aware of such irregularities and does not denounce them to the auditors.

It should be noted that Directors' liabilities referred to in the LGSM are basically to the corporation and not to anyone else.

Such liability may only be demanded by resolution of a shareholders' meeting, which will designate a person to exercise the respective action in the courts. The Directors who are accused by resolution of a shareholders' meeting shall immediately cease to perform their duties.

Shareholders holding 33% or more of the corporate capital may directly exercise actions demanding Directors liability if certain requirements are met. There have been few cases in the courts where directors' liability has been enforced.

(ii) Tax Laws

As a general rule, a director will have no liability to the taxing authorities, unless he/she personally participates

in the respective violation of the laws. As an exception, directors could be liable with the corporation to the tax authorities for some very basic omissions by the corporation in compliance with tax laws, including:

- 1.- Failure of the corporation to register as a taxpayer.
- 2.- Failure to advise the tax authorities of a change of domicile of the corporation in certain cases.
- 3.- Failure to keep accounting records or hiding or destruction of accounting records.

Adequate assistance by accounting firms should help to avoid the occurrence of matters that would give rise to tax liability.

(b) Board structure and composition

Generally, Mexican law does not require specific number of members of the board of directors of a corporation. As an exception, regulated financial entities<sup>1</sup> like banks and broker dealers are subject to specific regulation. Following please find a summary of the requirements for the board of directors of banks, broker dealers and financial holding companies.

1. Banks and Financial Holding Companies

(i) The board of directors of Mexican banks and financial holding companies may not have more than 15 members.

(ii) No more than one third of the members of the board of directors may be employees of the bank and financial holding companies. Only the general director and the officers of the two top levels of management may be directors. Spouses of directors, relatives of two or more directors, persons who have pending litigation with the bank, bankrupt persons, persons sentenced for criminal offenses and supervisors and regulators may not be directors.

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<sup>1</sup> The regulated financial entities are: financial holding companies, banks, brokers dealers, securities specialists, stock exchanges, managers of investment funds, general deposit warehouses, credit unions, financial leasing companies, savings and loans entities, non-ban banks, securities clearing and deposit institutions, rating agencies, credit bureaus, public trust engaged in financial activities, insurance and reinsurance companies, bonding companies and managers for retirement funds.

(iii) Shareholders representing 10% or more of the corporate capital may appoint a director.

(iv) The majority of the members of the board of directors must be Mexicans or residents in Mexico.

(v) The board members must be qualified and have a good reputation. Their appointment must be approved by the CNBV.

## 2. Broker Dealers

(i) The board of directors of Mexican broker dealers may not have more than 15 members.

(ii) The board members must be qualified and have a good reputation. Their appointment must be approved by the CNBV.

(iii) Shareholders representing 10% or more of the corporate capital may appoint a director.

(iv) The majority of the members of the board of directors must be Mexicans or residents in Mexico.

### (c) Sanctions to directors

The CNBV has authority to remove directors of regulated financial entities only. As mentioned before, the appointment of such directors must be approved by the CNBV.

The CNBV is entitled to impose fines to members of the board of directors of issuers of securities who have obtained profits disclosing false or misleading information or that participated in insider trading.

The above referred powers are expressly established in the Banking Law, the Securities Market Law and other laws regulating financial entities. The CNBV has broad supervisory and regulatory powers with respect to financial entities and issuers of securities. It is a supervisory arm of the Ministry of Finance and Public Credit and the agency primarily responsible for supervising banks and auxiliary banks and implementing government banking policy, and also the entity in charge of the supervision and regulation of the Mexican securities market. The CNBV is the agency resulting from the merger, effective May 1, 1995 of the Comisión Nacional Bancaria or the National Banking Commission, with the Comisión Nacional de Valores, or the National Securities

Commission. It is responsible for inspecting banking institutions and monitoring their internal policies and procedures, and advises and reports to the Ministry of Finance and Public Credit on these matters. The CNBV also issue regulations governing banks, approves individuals elected by shareholders to serve as directors and statutory auditors of a bank or such financial services holding companies under its supervision and individuals appointed as senior officers of a bank or such financial services holding companies. Recently, and particularly in respect of the intervention of the Mexican banks in the past few years, the presence of the CNBV and the enforcement of its powers has been more important than in the past. Supervision is becoming more stringent in order to avoid collapses such as the one in the financial sector in the future. In addition, requirements for companies that intend to list securities in the market, are becoming stricter and intend to follow international standards.

(d) Effective control

Most companies continue to be controlled by immediate family members, which control the board. As a generation passes it is customary to establish a "control trust" (fideicomiso) where voting rules are established, together with stringent requirements for the sale of stock outside of the trust or to outsiders. In addition, the capital stock may be divided into two series: Series "A", limited to Mexican shareholders or companies -where the family members participate-, representing at least 51% of the equity, and Series "B", with no restrictions. Series "A" will appoint the majority of board members. Thus, if the controlling trust or the family controls the majority of Series "A", it will appoint the majority of the board and management.

Other schemes include combining non-voting stock with voting stock. Sometimes, key management is offered shares, but so long as such shares are kept in a trust, which basically eliminates independent voting.

It is fair to say that publicly listed corporations are now seeking the enrollment of more "independent", professionally recognized directors, although "independent" is still rather relative. Board members are now taking a more prudent and active role -especially in the wake of the disasters in the banking sector. However, most boards are ineffective and many times, a formality. Corporate decisions are implemented within smaller executive committees. Usually, the CEO, COO and CFO are members of the board; thus, there is an overlap among management and directors.

Experiences where shareholders have attempted to hold directors or managers liable, have been few and indeed, rare. Usually, if a fraud has been committed, it is the government who initiates criminal actions.

(e) Insider trading

Article 16 et seq. of the LMV, set forth the concept of inside information and list those persons or corporations that are considered as insiders. Transcribed hereinbelow is article 16 bis 1 with the list of insiders:

"Article 16 bis 1.- For purposes of this law, the following shall be deemed to have access to privileged information of the corresponding issuer:

I. The members of the board of directors, directors, managers, commissioners, external auditors and secretaries of collective corporate bodies of corporations that have securities registered with the National Registry of Securities and Intermediaries;

II. Shareholders of the referenced corporations that control 10% or more of the shares representing their capital stock;

III. Members of the board of directors, directors, managers and commissioners of corporations that control 10% or more of the capital stock of the corporations referenced in the foregoing insert;

IV. Independent service providers of such corporations and their advisors in general, as well as commissioners of any corporation or business that has participated, advised or collaborated with an issuer, in any event that may be construed as privileged information;

V. Shareholders controlling 5% or more of the capital stock of credit institutions that maintain their securities registered with the National Registry of Securities and Intermediaries;

VI. Shareholders controlling 5% or more of the capital stock of financial holding companies or of credit institutions, as well as those controlling 10% or more of the capital stock of other financial entities, when

all of them are part of the same financial group<sup>2</sup> and at least one of the corporations forming part of the group, is an issuer of securities registered with the National Registry of Securities and Intermediaries, and

VII. Members of the board of directors of the holding companies and the other corporations referred to in the foregoing paragraph.

The individuals referred to in insert II. of this Article, shall inform the National Securities Commission in respect of variations in the percentage of their stock participations, involving the acquisition or divestiture of stock representing ten percent or more of the capital stock of the corresponding corporation, within the ten business days following the date of the appropriate transaction."

Insiders are restricted from trading with securities of issuers in respect of which they are considered as insiders in a restricted timeframe. The LMV provides that an insider may not, directly or indirectly, acquire securities from the issuer in respect of which he/she is an insider, during a three-month period following the date on which he/she effected the last divestiture on any type of securities of the same issuer, and viceversa. Sanctions may be imposed by the CNBV. In addition to the foregoing, the LMV also sets forth sanctions such as imprisonment for dealing with insider information. These sanctions do not apply to all the insiders defined in the law, only to a selected group. The foregoing is contained in Article 52 bis 2 of the LMV, which sets forth, in this respect, the following:

"Art. 52 bis 2.- The members of the board of directors, directors, managers, commissioners of issuers of securities, credit instruments or documents referred to in article 3 of this law, shall be sanctioned with imprisonment of six months to five years, and fines from two to three times the benefit obtained or the loss avoided:

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<sup>2</sup> Mexico's financial system is based on the universal model, that permits the integration of a diverse scope of financial services providers under one holding corporation.

II. That, through the use of privileged information, as defined in Article 16 bis of this law, regarding the corporation to which they are related, obtain an undue benefit or avoid a loss, directly or through a third person, through the acquisition and/or sale of securities, credit instruments or documents ... issued by the corporation, whenever there is a variation equal or greater than 10% between the purchase or sale prices in the transactions entered into by the persons referred to in the first paragraph hereof, before the privileged information is made public, and the market price of the securities, credit instruments or documents issued by the corporation with which the relationship exists.

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The above sanctions also apply to persons with managerial functions, employment, commissions or charges in brokerage firms or other entities acting as advisors in transactions regarding the public offering of securities, credit instruments or documents, when they enter into transactions described above within the 30 business days prior to or following the date of the respective public offering".

The CNBV issued in 1993, a circular with provisions that issuers have to comply with in connection with the disclosure of privileged information. Pursuant to this circular, issuers that have the knowledge of acts, facts or situations that may be price sensitive, are obligated to disclose them on the business day following the day they obtain such information, by means of a publication in a major newspaper and the delivery of such information to the CNBV and the Stock Exchange, in order that the Stock Exchange may, immediately, release such information to its members and make it public to investors.

(f) Composition of the Board of Directors

As referenced above, the members of the Board of Directors are appointed by the shareholders, at ordinary shareholders' meetings. A group of shareholders holding a minimum of 10% of the voting stock, by statute, have the right to appoint at least one director and his/her alternate. Bylaws of the corporations, however, may grant more rights, depending upon how the respective boards are integrated, without violating the required minimum. Directors are appointed and may not resign or leave their office until a substitute has been appointed by the

respective shareholders. Generally, directors are appointed by cumulative voting, but the minimum right to appoint a director by shareholders of 10% has to be respected.

### III. Corporate Governance; Practice Code

The National Banking and Securities Commission (*Comisión Nacional Bancaria y de Valores*; the "CNBV") has been in the past few years trying to improve the protection for investors in the Mexican market. The two main areas of concern are the quality of the information disclosed by issuers<sup>3</sup> and the protection of minority rights.

Currently, there are no specific regulations governing the protection of minority rights for shareholders of corporations that have their securities listed on the Mexican Stock Exchange, different from those applicable to non-listed corporations that have been stated above. The CNBV has expressed that, in its view, it is not necessary to implement new laws or regulations governing the protection of minority rights and the corporate governance of issuers of listed securities. Instead, the CNBV considered it necessary that the issuers of securities, working together with the supervisory authorities issue non-binding recommendations with respect to corporate governance. As a result, the CNBV has issued in September 1999, a non-binding corporate governance practices code (the "Practices Code"), which was developed by a working group formed by officers of the CNBV in charge of market regulation, presidents or directors of some of the largest and most influential issuers of securities, officers of financial institutions, members of the brokers association and experts.

The Practices Code includes recommendations in connection with the organization and functioning of the Board of Directors of issuers, as well as to the protection of minority rights. It also recommends the creation of special committees of the Board of Directors.

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<sup>3</sup> For such purposes, Circular 11-29 of the CNBV was enacted on December 31, 1997. Such circular provides, among other things, the form and detail of the financial, business, legal and accounting information required for the registration of securities, including the information that must be included in prospectuses. Circular 11-29 also, establishes liabilities for officers, directors and advisors of the issuers for disclosing false or misleading information.

As mentioned before, the Practices Code is not mandatory. The only regulation that will be enacted in connection thereof will be a provision establishing that issuers must disclose the level of adherence to the practices recommended by the Code. The CNBV anticipates that the market will discriminate those issuers who do not follow the recommendations of the Practices Code.

Among the practices included as recommendations in the Practices Code are the following:

1. There must be a reduced number of directors (i.e. less than 15).

Currently, except as stated otherwise herein, corporations are able to appoint as many directors as they wish. Large board of directors lack efficiency in the supervision of day to day management.

2. The shareholders are able to elect individual directors and not vote for all members of the board together.

While in theory a group of shareholders representing 10% of the outstanding voting stock may elect a member of the Board of Directors, generally a group of individuals is proposed to the shareholders' meeting to form the Board. Unless there is a strong involvement in the management by any such group of shareholders, it is not common that the 10% group does, in fact, appoint a director individually.

3. At least 20% of the members of the Board of Directors must be independent. It is understood that an independent director is a director who is not a shareholder, officer, employee, advisor, business partner of the issuer or a relative of such persons. Certain directors must be appointed specifically to protect minority rights. Currently, there is no such requirement, except in financial services corporations, as stated above.

4. The board of directors must have committees on (i) finance and planning, (ii) recommendation, evaluation and compensation, (iii) auditing. No committees are currently mandated by statute.

5. The members of the board of directors must have more direct liability for the information disclosed to the market. The confidentiality and insider trading provisions must be reinforced. Please see above for a discussion on these issues.

6. The documents that will be discussed at the board meetings must be distributed to directors at least fifteen days prior to the date of the meeting.

7. The financial statements must include the opinion of the auditing committee and the names of all directors.

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