OECD

The Sixth Meeting of the
Latin American Corporate Governance Roundtable

20 - 21 September, 2005
Lima, Peru

Enforcement Issues Paper

Introduction

The Latin American Roundtable on Corporate Governance has identified the need for strengthened corporate governance enforcement as a major priority to be pursued in its future work. The 5th Roundtable meeting in Rio de Janeiro, held in October, 2004, focused on enforcement-related issues. This paper highlights some of the key issues raised at that meeting, as well as others identified for further development and follow-up, to serve as background for the discussion on enforcement planned at the 6th Roundtable meeting in Lima of 20-21 September, 2005.

Underlying the effort to strengthen corporate governance and enforcement is a desire to enhance the investment climate in the region – to the benefit of both investors and entrepreneurs in Latin America. As Marcelo Trindade, head of Brazil's securities regulator, CVM, noted in his introductory remarks at the Roundtable meeting in Rio, "Effective and low-cost enforcement structures, as well as the public perception that such enforcement structures do work properly and timely are perhaps the most important sources of market trust."

The *White Paper on Corporate Governance in Latin America*, issued in late 2003, set out consensus priorities and recommendations agreed among key corporate governance players in the region participating in the Latin American Roundtable on Corporate Governance. The White Paper's enforcement-related recommendations are provided for reference as an annex to this report. Participants at the October, 2004 Roundtable meeting expressed an interest in going further. The 2004 Roundtable meeting addressed four key aspects of enforcement:

- Improving compliance and enforcement through more effective regulatory and supervisory enforcement;
- Making effective use of shareholder rights by encouraging the emergence of active and informed owners;
- Strengthening civil enforcement through more effective private rights of action; and
- Improving the variety and capacity of mechanisms for adjudicating disputes.

In addition, the 2004 Roundtable meeting addressed the role of the media in promoting better enforcement. While the White Paper itself does not contain specific recommendations on the role of the media, its importance is highlighted in the White Paper's case study on lessons from Chilean experience in implementing corporate governance reform.

A preliminary version of this paper was prepared for the consideration of a smaller, Latin American Roundtable task force meeting held in Sao Paulo in May, 2005. At that meeting it was agreed that the preliminary draft already provided a good overview of the most important issues to be addressed, but that it would be desirable to develop it further to focus on a few key issues to go into greater depth and facilitate progress.

This revised version of the paper includes additional, updated information on country experience and identifies three issues for greater focus in the enforcement session planned in Lima:

- **Pursuing greater regulatory efficiency through focused enforcement.** Regulators noted the scarcity of resources and time to pursue all violations that may occur. Participants from Brazil and Chile have both pointed to efforts they are making to practice "focused supervision" as an important means for focusing on the most urgent and relevant cases that may have greatest impact on capital markets. Brazil's CVM was granted legal authority to prioritize in this way in 2002, and Chile has more recently begun to implement such an approach, which will be presented and discussed during the enforcement session in Lima. Participants at the Task Force meeting suggested interest in learning from OECD country experience on this issue – particularly countries such as Australia, Canada and the United Kingdom that have actively promoted this approach internationally (An OECD Secretariat presentation on focused enforcement, by an ex-securities regulator who has worked in Canada and the UK, is planned at the Roundtable as well). However, implementing targeted approaches also has raised questions about equal treatment of all companies under the law and how best to communicate these approaches to maintain incentives for all – not just targeted companies – to comply with legal requirements.

- **Finding the right enforcement mix: compliance, disclosure, or voluntary approaches.** As also highlighted in the Synthesis Note on Progress in Implementing the Latin American White Paper on Corporate Governance, country approaches to setting and implementing corporate governance standards differ markedly, with some led more by regulators (Chile, Colombia), some where the stock exchange and private sector groups play a greater role (Brazil's Novo Mercado and IBGC), and others adopting a mix between voluntary and mandatory measures. Peru's experience is an interesting example of this mixed approach that will be examined more closely at the Roundtable meeting in Lima. Through the joint efforts of public and private institutions, Principles of Corporate Governance for Peruvian Corporations were issued in 2002. While these principles are voluntary, listed companies beginning in 2004 have been required to disclose information on the extent to which they are implementing them in their annual reports to Peru's securities regulator, Conasev, which at least in theory should allow the market to take these actions into consideration. But the first set of reports submitted for 2004 yielded uneven information, indicating that implementation will be a gradual, educational process. Chambers of Commerce and individual companies have been active in adopting corporate governance codes in a range of countries, but these are less likely to influence investor choices in the absence of disclosure processes that allow investors to easily determine whether a company is actually adhering to its code. Still, many participants have suggested that the least time-consuming and most cost-effective form of enforcement involves establishing the kind of incentives and structures under which companies will comply voluntarily, so that no enforcement action is required.

- **Speeding up legal processes, and the importance of alternatives.** The 2004 Roundtable meeting went into some depth regarding the challenges associated with exercising private rights of action and enforcing company violations through slow and sometimes unpredictable court systems. All countries surveyed reported experience with lengthy court processes, sometimes further undermined by lack of judicial expertise. This has discouraged shareholders from exercising their rights to take private actions to ensure that they receive a fair return on their investments, knowing that any challenge will take at least 2-3 years, or even up to 6 years or longer when appeals continue to the Supreme Court. A session on alternative mechanisms for dispute resolution revealed some positive developments in making use of alternatives to judicial enforcement. Argentina, Brazil, Colombia and Peru reported some limited progress at the 2004 meeting in increasing use or agreement to make use of arbitration to settle shareholder disputes. It was suggested that Argentina could benefit from a more unified regulation on arbitration to overcome a currently atomized approach differing across sectors. But some resistance continues, particularly from controlling shareholders who may see an advantage in addressing disputes through the longer process of the court system, because decisions that they have controlled can remain in effect while a challenge is pending.

Another alternative to the court system to be discussed at the Roundtable in Lima is the use by Supervalores and Supersociedades in Colombia of jurisdictional powers that allow them to exercise powers in cases of disagreement on valuation of shares and corporate decisions challenged by minority shareholders. This provides an opportunity to develop specialised expertise in company law that is often lacking at the judicial level, allowing cases to be processed in one year on average, comparing favourably to the 3½ year average for civil court procedures in Colombia. However, Colombia's regulator has also noted that this approach has its limitations, since those who are penalized can appeal, leading to more lengthy delays in resolving disputes.

Ongoing and Emerging Issues for Enforcement Reform

The 2004 Latin American Roundtable meeting produced a detailed report on the different actions and elements of the enforcement frameworks in Argentina, Brazil, Chile, Colombia and Peru.[1] Subsequent consideration of these issues, including through the country Progress Reports and Synthesis Note on Implementation of the Latin American White Paper on Corporate Governance prepared for the Lima Roundtable meeting, appeared to indicate broad support for and attention to several elements of a strengthened enforcement regime.

In addition to those issues already cited above and set out in The White Paper, the following have been raised:

Encouraging the creation of specialised courts. A representative of the Rio de Janeiro specialised commercial court reported positive experience in increasing judicial expertise and streamlining court procedures through the appointment of specialised judges to deal with commercial law. Peru also has just established a specialised commercial court, beginning in April, 2005 with seven lower courts and one upper court. It is too early to assess experience with this initiative, which will be increased to 22 lower courts and two upper courts by the first quarter of 2006. Many Roundtable participants have expressed the view that shareholder disputes are of a complexity and nature requiring specialised training, in economics, commercial law, principles of accounting, etc. that make corporate governance disputes particularly well-suited for treatment in specialised courts. However, a number of other policy fields have advocated development of specialised courts, raising questions of overall political priorities for what issues may best be singled out for special attention.

The need for awareness-raising and training of media, judiciary, lawyers and shareholders. The need for further training and awareness-raising was a recurrent theme throughout the last Roundtable meeting. It was suggested that universities and professional associations should get more involved in this objective, offering courses at all levels, including continuing education.

Despite increased awareness of corporate governance overall, it was suggested that media in Latin America have not been as aggressive as in OECD countries in reporting on corporate governance issues and problems. However, in OECD countries as well, the media are best able to report on such problems when institutional investors, shareholder advocates, auditors or others uncover problems first and make the media aware of them. The Confécameras federation of Chambers of Commerce in Colombia and the Institute of Brazilian Corporate Governance have both sponsored journalist training exercises with support from the U.S. Center for International Private Enterprise. Regulators may also wish to increase their involvement in such initiatives. The difficulty can be to attract journalists' interest and willingness to invest the time, particularly within the fast-paced world of daily journalism.

[1] See http://www.oecd.org/Roundtables for all papers issued by the Latin American Roundtable on Corporate Governance, and for more specific references on enforcement, see, for example, "The Legal, Regulatory and Institutional Framework for Enforcement Issues in Latin America: A Comparison" http://www.oecd.org/dataoecd/32/30/34254149.pdf, "Questionnaire on Enforcement Issues: Results for Argentina, Brazil, Chile, Colombia and Peru" http://www.oecd.org/dataoecd/48/38/33940927.pdf.

The challenge for lawyers and judges in resolving disputes that often revolve around questions of determining a fair market value for shares is that their expertise may be limited to general legal issues, while lacking an economic framework and technical expertise necessary to better understand and evaluate the actions of the parties involved. Some work has been done to establish corporate governance programs at some law schools as well as at business schools to bring to bear the different disciplines important to the field (economics, law, management, accounting), but much more could be done.

It was also suggested that shareholders need to be educated to better understand and make use of their rights. But it was also noted that education alone will not change behaviour if the incentives and prospects for having an impact remain small. One participant remarked that too often shareholders see exercise of their rights as a kind of lottery-type exercise that is completely unpredictable, and could result in either lengthy processes with no return, or a jackpot.

Regulatory bodies could be more proactive in defending investor rights, for example, by providing advisory opinions. In the absence of sufficient exercise of shareholder rights by the shareholders themselves, many observers see regulators as the main lever for promoting enforcement. Some suggested that regulatory bodies could be more proactive in examining issues where there is a potential for conflict among shareholders, to issue advisory opinions before an action is taken that may spur legal challenges. While regulators also need to take care to ensure that they are adequately protected against their own liability in such cases, pre-empting disputes through such opinions may allow them to be much more easily and quickly resolved, and may also help to set precedents that will help to avoid similar disputes in the future. Courts should also request and accept these advisory opinions.

Increased involvement at a preliminary stage in the enforcement process was also advocated, including greater advisory activity by regulatory agencies, and use of consent decrees to resolve disputes quickly and avoid time-consuming enforcement processes or recourse to the courts.

Importance of regulatory independence. The White Paper stresses the importance of providing political and financial independence for the regulatory body in order to minimize political influence and maximize their credibility as objective enforcers of the law. While certain countries like Argentina, Brazil and Peru have legal protections in place for the head of their regulatory body, including fixed terms and provisions stating that they can only be removed for major offences, others including Chile and Colombia have no fixed term and can be removed more freely. Mechanisms to ensure resource stability removed from political influence are also an important part of maintaining regulatory independence.

The enforcement issues paper written by José Luiz Osorio, former chair of Brazil's CVM, highlighted several additional enforcement issues that were considered at the 2004 Roundtable meeting[2]. Some of these were directly discussed and integrated into the summary of key issues raised at the 2004 meeting, highlighted above, while others were less directly discussed but are provided below for continuing consideration.

Better disclosure of information on shareholder meeting resolutions. One clear way to illuminate conflicts of interest in advance, in such a way that all shareholders can vote on an informed basis, is to require that any shareholder meeting resolution involving an important business decision, such as mergers and acquisitions or material transactions with related parties, should be presented with arguments, perhaps with a legal or investment opinion, that show the potential benefits to the company. It is also important for this information to be readily and cheaply accessible. Sunshine through better disclosure is probably the best disinfectant to help deter conflicts of interest. Resolutions presented have to be for the benefit of the company and not any particular group of shareholders. Only through better disclosure can we improve the discussion of those issues that can lead to abuse and consequently create the need for enforcement. Examples

[2]See "Issues Paper on Enforcement," by José Luiz Osorio, Jardim Botanico Partners at http://www.oecd.org/dataoecd/48/40/33940906.pdf

are: the company proposes a resolution, management acts in self interest, controlling shareholders vote on an important matter in a way that shows a clear conflict of interest, e.g. management fees based on sales, inter-company loans to controlling groups and other related transactions, such as acquisition or sale of assets to or from shareholders. Only with the requirement of a document explaining the benefits to the company can "stupid votes" be prevented.

Providing investors with more time to take informed decisions. A useful tool for regulators is the capacity to suspend a shareholder meeting for a certain period. Time is probably the investor's best friend, and prevention is always preferable to prosecution where enforcement is concerned, even in the most efficient markets. Very often time is needed for investors to analyse matters and to discuss their implications for the company with managers and controllers to allow these latter to explain their objectives and reasoning. Recent legal reforms empower the CVM to increase the number of days before a meeting to 30 if, upon the request of a shareholder or *sua sponte,* the CVM deems the agenda items particularly complex. The CVM can also suspend a shareholders meeting to request additional information or to provide an opinion in reference to a specific resolution on the agenda. Documents distributed to shareholders must be made available to the stock exchange and the CVM to ensure adequate, timely disclosure. Since this power was granted, the CVM has received 20 requests, resulting in 4 extension orders. In one case, the CVM, *"sponte propria"*, has recommended the extension of the notice period of a meeting in a matter deemed to be complex, and the recommendation was followed. This is designed to give all concerned enough time to analyse and clarify possible conflicts of interest and sometimes to CVM to issue an opinion. Early results seem to show that this is a powerful and efficient tool for the regulator.

Ensuring the Integrity of Auditor and Accounting Standards. Rotation of the auditing firm and the adoption by regulators and stock markets of international accounting standards are good examples of important initiatives. Information is the primary resource for enforcement. If the data are reliable and presented in a manner that are easily understood everywhere, enforcement will be made easier. Long relationships between audit firms and companies can lead to cozy ties and lax audits. Rotation creates an automatic review and this is good, especially in a region that is known to have few resources for an effective review by the regulator.

Country progress reports on implementation of the White Paper indicate that some progress has been made in bringing local accounting regimes – or at least some aspects -- into compliance with International Financial Reporting Standards. But in several cases, legislation will be required to come into more complete compliance, and proposed bills in Brazil, Colombia and Chile have yet to be approved (in the case of Brazil, this legislation has been pending for five years).

More active enforcement actions by institutional investors. Institutional investors have to wake up to their responsibilities as fiduciaries of those on whose behalf they are investing funds (e.g. pensioners, mutual fund investors). This group traditionally represents the largest single group of investors in equities in Latin America, though some such as Mexico are more restricted in how public funds can be invested in equities. There is great value in initiatives that require institutional investors to disclose on a regular basis their policies on voting, as well as how they actually voted and participated in shareholders meetings. Brazilian CVM (for mutual funds) and SPC (for pension funds) have both required such disclosure. It is too early to assess their impact on the market, and it may not be the only way to encourage investor activism, but it is certainly a beginning. Perhaps the press can help in this area by developing rankings, publicizing votes and so on. In countries where foreign investors play an important role, their activism should also be encouraged.

Development banks also play a vital role in providing long-term funding and subscribing for shares often at times when no other investor is performing this function. Great progress could be made if the Development Banks would insist that corporate governance issues, such as the ones in the White Paper or the IFC corporate governance methodology presently in effect, be analysed and addressed in their investment decisions and reflected in pricing.

Voting versus non voting shares, tag along and other rights. Several countries and many companies in the region have their liquidity concentrated in non-voting shares (though Chile does not have non-voting shares). Several issues can be raised around this topic. For example, during changes of control, shareholders that own non-voting shares have increasingly protested that they have not been fairly compensated as owners of voting shares.

Curiously this process in Brazil was accelerated during the privatization period as the new owners, having paid perhaps too much for control, tried to compensate by paying low prices for non-voting shares during delistings. Brazil, Chile and México have issued new "OPA" laws and regulations to mitigate the delisting problem. However if the market does not price this and other potential risks associated with non-voting shares, one cannot ask for the regulator to enforce what is not in the law. The same rationale goes for companies that deserve a premium for good corporate governance, as several have extended tag-along rights for non-voting shares and other rights non-existent in the law, e.g. minority shareholder board representation. In short, the markets also have to play their part. All things being equal, they must be willing to pay more for companies which maintain good corporate governance practices, and penalize the valuation of shares of companies which do not.

Annex 1: Selected Recommendations on Enforcement:

Excerpts from the White Paper on Corporate Governance in Latin America

At least four distinct sections of the White Paper deal with issues that are important to better enforcement:

i. Encouraging the Emergence of Active and Informed Owners (White Paper, pars. 34-42);
ii. Effectiveness of Regulatory and Supervisory Enforcement (White Paper, pars. 134-147)
iii. Private Rights of Action (White Paper, pars. 148-149);
iv. Improving the Variety and Capacity of Mechanisms for Adjudicating Disputes (White Paper, pars 150-153).

Encouraging the emergence of active and informed owners:

34. Governments, regulators and beneficiaries should insist that pension funds and other institutional owners have the incentives and governance structures that encourage them to exercise their ownership functions in an informed and effective way.

35. The right regulatory environment and good governance practices encourage institutional investors to: (1) make investment decisions that are intended to maximise returns for shareholders; and (2) effectively exercise their fiduciary duties as shareholders in the companies in which they have invested the funds entrusted to them. The pension system regulatory regime and its supervisory system should provide pension managers with the appropriate incentives to maximise returns on fund investments. The priorities in this area may vary from country to country, but in each case policy makers, regulators and supervisory authorities should be vigilant to protect against the potential for conflicts of interest on the part of fund managers, or fee structures that set inappropriate benchmarks, or other aspects of the regulatory framework that cause managers to act in ways that do not maximise returns for investors.

36. Likewise, special attention needs to be paid to the management of investments of state-owned development banks (and their multilateral counterparts, such as International Finance Corporation, Inter-American Investment Corporation, Andean Development Corporation, etc.) and the effects of government-controlled finance allocation on governance. While direct state ownership of industry has declined, in several countries state-channelled resources and multilateral development bank financing remain important sources of long-term financing. Governments and multilateral development banks need to ensure that such sources of financing and guarantees insist on the highest standards of governance and transparency demanded in the capital market. Co-investment strategies, where public and private sector entities invest on the same terms, can provide a mechanism for ensuring a level playing field while encouraging the broader adoption of common governance standards by institutional investors of all types.

37. Objective evaluations of governance and transparency practices should be factored into the investment decisions of state-owned and multilateral development banks and affect pricing. State-owned and multilateral development banks should therefore consider policies that recognise the risk mitigation accorded by good governance practices by progressively improving the financing terms for clients as they meet objective benchmarks outlined in national codes or articulated in bank-specific or collectively-developed programmes.

38. With a view to encouraging active and informed shareholder participation by pension funds and other institutional investors, outdated and unnecessary restrictions on the ability of such investors to exercise their shareholder rights should be removed.

39. Pension funds, both private voluntary and privately managed mandatory schemes, are potentially the most powerful group of domestic investors with an interest in good corporate governance. Given the mandatory nature of some schemes, and the critical social function they perform, regulators need to be

particularly diligent that companies that issue securities eligible for investment by pension funds are sufficiently transparent and well-governed.

40. At the same time, legislators, regulators and beneficiaries should recognise that existing shortcomings in pension fund governance and regulations that discourage competition in portfolio management (such as requirements that explicitly or implicitly require fund portfolios to mimic an index) limit the incentives for fund managers to put a high enough premium on transparency and governance. An appropriate policy response in such circumstances (and one with which there are a number of recent experiences in the region) may be to modify the legal investment regime – i.e., by permitting proportionally greater investment in companies that meet certain objective corporate governance and disclosure requirements.

41. Institutional investors who act as fiduciaries should articulate their approach to the corporate governance of investees and their policies voting shares held in such companies and disclose these on a regular basis to the public and their beneficiaries.

42. Institutional investors should provide as much detail as possible in the disclosure to their beneficiaries and the public regarding their standards for corporate governance of portfolio companies and their general policy concerning the execution of key rights, such as pre-emptive and tag-along rights. The disclosure on voting practices should set out the institutional investor's assessment of the costs and benefits of actively participating in corporate governance as a shareholder, and, for example, identify on what specific types of General Meeting agenda items it would ordinarily exercise its vote. Institutional investors should also disclose the process and procedures that they have in place to make decisions on how to exercise their voting rights, including their reliance on proxy advisory services and co-operation with other institutional investors to nominate board members. The purpose of this information should be to provide beneficiaries with an adequate basis upon which to make an informed judgment about whether the institutional investor is taking into account the risks of poor corporate governance in portfolio companies, and whether the institutional investor takes the opportunity to reduce risk and maximise return for beneficiaries by actively participating in governance as a shareholder.

Effectiveness of Regulatory and Supervisory Enforcement:

134. In order to promote clarity and facilitate compliance, legislators and regulators should identify and remove any inconsistencies and contradictions in rules and laws affecting corporate governance. Efforts should also be made to achieve the most effective apportionment of powers and efforts among the courts, the supervisory authorities and private enforcement mechanisms.

135. As business practices and financial markets evolve, there is always a risk that existing rules and regulations overlap or prove inconsistent with more recent provisions. It may also be the case that laws and regulations in related or more remote areas may have an impact on the interpretation and effective enforcement of governance-related rules. Such overlaps may create uncertainty and inflict unnecessary costs for companies, investors and enforcement agencies. When introducing new laws and regulation, or revising existing provisions, it is therefore indispensable to devote the necessary time and resources to analyse the regulatory impact and possible unintended consequences. Effective enforcement also requires that the allocation of responsibilities for supervision, implementation and enforcement among different authorities is clearly defined so that the competencies of complementary bodies and agencies are respected and used most effectively.

136. The greatest possible degree of political and financial independence should be accorded to those regulatory and supervisory agencies that are responsible for rule-making and enforcement in the area of corporate governance.

137. It is the consensus of the Roundtable participants that regulatory and supervisory agencies, notably the national securities commissions, should continue to play an increasingly important role in the

formulation, implementation and enforcement of corporate governance rules and regulations. The effectiveness of a regulatory or supervisory agency depends importantly on the public's perception of its ability to promulgate and enforce rules with objectivity and professionalism. Accordingly, such agencies should be insulated from undue political interference by ensuring them the greatest possible autonomy in carrying out their mandate. This will typically imply that political authorities do not indirectly influence the direction of their work through the budgetary process. Mechanisms that promote the budgetary stability and autonomy of agencies with rule-making and enforcement powers in the area of corporate governance should be established. This may include multi-year funding related to their present and predicted caseload as well as the introduction of user fees. Along the same lines, it may also include appointment of agency heads to fixed terms during which they may not be removed except for malfeasance.

138. As an immediate step, the resources and capacity of the regulatory and supervisory agencies should be made a public policy priority.

139. Credible administrative enforcement requires supervisory agencies to have sufficient resources to conduct timely, quality investigations. The volume of corporate governance-related cases that regulators and supervisors have been called upon to examine has increased dramatically in recent years and this ballooning of caseloads is expected to continue. However, the resources of such agencies have not grown commensurately. Unless the widening gap between caseloads and supervisory agency resources is narrowed, the credibility of the latter will diminish, and along with it, public confidence in the corporate governance system.

140. Consistent with the country's constitutional framework, the legal and regulatory regime should provide the regulatory and supervisory agencies with maximum powers to investigate and resolve cases in a fashion that fosters public confidence in enforcement and deters rule-breaking.

141. The legislation establishing the supervisory agencies charged with enforcement of corporate governance rules typically does not accord them as broad a set of investigative and enforcement powers as is permissible under the country's constitutional framework. To provide them with greater powers to collect and compel evidence in a timely fashion, including subpoena powers that do not involve lengthy recourse to the courts, is critical to the credibility of administrative decisions and their enforcement. Similarly, regulatory and supervisory agencies should be empowered to bring civil actions on their own initiative for the benefit of shareholders, without prejudice to such shareholders' own actions.

142. Agencies charged with enforcement need to have the authority to take meaningful action - both to prevent the most blatant of corporate governance abuses, and to settle cases whenever they are amenable to resolution through administrative means. Granting the supervisor the power to issue temporary injunctions in defined instances (such as in cases of challenges to the legality of actions taken during General Meeting procedures and otherwise where irreparable harm might ensue) enhances the credibility of the supervisor and the enforcement process. Likewise, the effectiveness of the supervisor is enhanced when it is empowered to settle cases through arbitration and mutual agreement (consent decrees).

143. The regulatory and supervisory agencies should be permitted to appear before the courts in civil cases involving shareholder rights, and submit advisory opinions which the courts should consider in reaching their determinations.

144. It is recognised that the judiciary in most or all jurisdictions in the region generally has insufficient familiarity with the evolving legal and regulatory framework for corporate governance. Permitting the regulatory and supervisory agencies to provide courts with their interpretation of the law in this area can facilitate timely and correct resolution of individual cases, and at the same time make the application of the legal and regulatory framework more consistent and predictable.

145. The capacity of the judicial system to deal with commercial disputes should be improved.

146. An efficient and predictable judicial system is a key prerequisite for achieving credible corporate governance and a well-functioning business sector. This requires sufficient resources, including compensation levels for judges and court personnel necessary to ensure the recruitment and retention of educated and experienced professionals who will perform their duties with the full integrity required of such positions, and with the continuity necessary to maintain a stable and predictable judiciary.

147. Training programmes should be enhanced to improve judicial understanding of commercial law, especially with respect to company law, securities law and bankruptcy law. Judges would also benefit from training in basic business and economic concepts that underlie such legislation, since the lack of such knowledge can result in an extremely literal application of legislative language that may be unreasonable in the context of normal business practices.

Private Rights of Action:

148. The legal framework should provide shareholders with as broad an array as possible of actions to protect their rights and obtain redress for violations of their rights.

149. A number of the recent legal reform efforts in the region have included expansion of the range of rights of action available to shareholders (including collective action through "investor associations"). This reflects a general disappointment with the legal tools currently at their disposal, most of which present severe technical and practical obstacles. Class actions, derivative suits, direct rights of action against *de facto* controllers, and rights to compel mediation and arbitration have all been topics of consideration. It is the consensus of the Roundtable's participants that the current framework for shareholder actions is inadequate in most of the region and that broadening the set of instruments available to shareholders and investor groupings will increase the likelihood that they will be able to achieve redress in the courts. It is also recognised that for such reforms to be successful, they need to be pursued with a close eye to country specific legal traditions.

Improving the Variety and Capacity of Mechanisms for Adjudicating Disputes:

150. The legal framework should contemplate and remove obstacles to effective use of private arbitration and other potentially efficient mechanisms for the settlement of shareholder disputes.

151. Shareholders are entitled to adequate and efficient means of redress for violations of their rights. It is recognised that most courts in most countries in the region lack the technical expertise and experience to fairly and efficiently settle shareholder suits. Where qualified judges or specialised courts exist, they are unlikely to have sufficient resources to handle the caseload. Experience in OECD countries and the region indicates that private voluntary arbitration can provide an efficient and effective alternative. However, in order for private arbitration to work, national legal frameworks must provide for judicial recognition of arbitral awards without *de novo* review of the facts. Courts should also have streamlined procedures for enforcement of arbitral awards. However, private arbitration is not a substitute for strong judicial institutions, and arbitrators can encounter the same problems as the judicial system in identifying and interpreting the law. An active and consistent judiciary that contributes to the interpretation of the law through its rulings will also re-enforce the effectiveness and reliability of private dispute resolution mechanisms. Most importantly, the execution of arbitration decisions depends on the effectiveness of the judicial system.

152. Stock exchanges and companies should encourage private arbitration of disputes between companies and shareholders by promoting professional shareholder arbitration panels and encouraging companies to include submission to arbitration in their by-laws.

153. Dispute resolution procedures such as administrative hearings or independent arbitration procedures are emerging as an important and cost-effective alternative to the use of the courts system. The use of private

arbitration mechanisms as an alternative to court litigation can reduce the workload of the judicial system and serve the business community by speeding up the resolution of commercial disputes, such as those involving minority shareholder disputes. If supported on a sustained basis with sufficient resources and a judicial system that ensures that its decisions are enforceable, private arbitration can provide an efficient, fair and predictable environment for resolution of commercial disputes.

154. Cross-border co-operation in enforcement should be encouraged through the use of Memoranda of Understanding between and among enforcing agencies.

155. Co-operation in securities law enforcement in the region, and between the countries of the region and OECD countries has been greatly facilitated in recent years by the negotiation of Memoranda of Understanding between national securities regulators. These Memoranda of Understanding provide a clear framework and procedures for sharing information and co-ordinating investigation that is tailored to fit within the respective legal frameworks of each country and the mandates and legal authority of their agencies. The coverage of Memoranda of Understanding between securities regulators should be expanded, wherever possible, to include co-operation in the enforcement of laws and regulations relating to corporate governance, and agencies other than securities regulators involved in the enforcement of the corporate governance legal framework should be included as parties to the Memoranda.