



ORGANISATION  
FOR ECONOMIC  
CO-OPERATION  
AND DEVELOPMENT



# Mexico

## The Role of Institutional Investors in Promoting Good Corporate Governance Practices in Latin America: The Case of Mexico

Mexico's initial report and updates were elaborated by the Jorge Fabre from the Mexican Center for Excellence in Corporate Governance.

For any comments or questions regarding this country report please contact Jorge Fabré at [jorge.fabre@anahuac.mx](mailto:jorge.fabre@anahuac.mx).

## Table of Contents

### Contents

Introduction; Corporate Governance in Mexico, recent developments .....	3
Principles of Corporate Governance.....	4
Summary .....	4
General Overview .....	4
The Principles .....	6
Principle I: Ensuring the Basis for an Effective Corporate Governance Framework.....	6
Principle II: The Rights of Shareholders and Key Ownership Function .....	7
Principle III: The Equitable Treatment of Shareholders.....	7
Principle IV: The Role of Stakeholders in Corporate Governance.....	8
Principle V: Disclosure and Transparency .....	8
Principle VI: The Responsibilities of the Board.....	9
Legal Framework .....	13
Rating Agencies .....	14
Background of Institutional Investors in Mexico .....	15
Key elements that could affect future corporate governance developments .....	15
Mutual Funds (Sociedades de Inversión).....	17
Pension Funds (Siefos, Infonavit and Private Plans).....	18
Private Equity Funds.....	22
Corporate Governance of II's. ....	23
Conclusions and Key Recommendations.....	24
Table- Mexico's Institutional Investors (September 2008) .....	26

**THE ROLE OF INSTITUTIONAL INVESTORS IN  
PROMOTING GOOD CORPORATE GOVERNANCE PRACTICES IN MEXICO  
A DISCUSSION FRAMEWORK FOR COUNTRY WORKSHOPS**

## **Introduction; Corporate Governance in Mexico, recent developments**

In recent years there has been a number of major reforms related to corporate governance in Mexico, including the drafting of an early voluntary code of best practice (1999) updated in 2006, the redrafting of key provisions of the Securities Market Law (including requirements for mandatory audit committees and independent board members), new regulations of the market for corporate control, and regulations issued in 2003 that resulted in an “issuer manual” specifying disclosure guidelines for listed companies that largely meet OECD benchmarks. Efforts to bolster corporate governance practices are viewed as crucial to broadening the investor base in Mexico and attracting portfolio equity capital. The progress that has been made in promoting good corporate governance has been set against a concentrated ownership and control structure of many Mexican firms, weak enforcement of shareholder rights and concerns of reform fatigue.

In efforts to address the problems of poor corporate governance and a weak financial market, a new Securities Market Law was enacted in Mexico in 2006. In addition to encouraging corporate governance, the new Law promotes venture and private capital flows into small and medium-sized companies, through increased transparency, disclosure and better board structures, procedures and clearly defined responsibilities of boards and individual directors. The new law improved Mexico’s ranking in the World Bank’s and IFC’s “Doing Business 2007” report, positioning it in 43<sup>rd</sup> place up from the 62<sup>nd</sup>. Yet owners of the SMEs and family-controlled companies have limited knowledge of how to implement corporate governance principles and procedures. Small and medium-sized enterprises comprise more than 95% of businesses in Mexico and most of them are family-controlled.

The Code of Best Practices was enacted in 1999 by the private sector and in 2006 it was revised. Compliance with the Code is voluntary for listed companies, but since 2003 a policy of “comply or explain” was adopted by the National Securities Commission. The surveys on adherence to the Code have been reported by each listed company since then, and a gradual improvement in corporate governance can be inferred from the positive influence of the Code.

The Mexican Stock Exchange has an overall market cap equivalent to 35% of Mexico’s Gross Domestic Product (GDP), and 139 domestic listed companies.

*The most updated research regarding corporate governance in Mexico is annexed here and it is from the joint initiative of the Financial Standards Foundation and Universidad Anáhuac México Sur’s Business School. It can be found on <http://www.estandardsforum.org/jhtml/country/Mexico/sp/13/6>*

# Principles of Corporate Governance

## Summary

**Enacted**

The 2006 release of the new Securities Market Law and the revised version of the Mexican Corporate Governance Code, incorporating lessons learned from implementation of the original 1999 Code as well as international developments, bring Mexico a step closer to a well-developed corporate governance framework. Back in 2003, a Report on Standards and Codes by the World Bank benchmarked Mexico's observance of corporate governance against the Organization for Economic Co-operation and Development's Principles for Corporate Governance. According to the report and a report by the Institute of International Finance released the same year, major progress had been achieved in establishing a successful structure and culture for good corporate governance. However, both reports cautioned that real progress in Mexican corporate governance has to account for the concentrated ownership and control structure of many Mexican firms. The 2006 Securities Market Law strengthens the responsibilities of directors and boards for publicly traded companies. It addresses minority rights protections and emphasizes the independence of boards vis-a-vis the controlling shareholders. Its successful implementation will be crucial to lift Mexican corporate governance to a new level and broaden its investor base.

## General Overview

There have been a number of reforms in the Mexican corporate governance framework in the last decade. They have been most comprehensively documented by a 2003 Report on Standards and Codes (ROSC) by the World Bank, which benchmarked Mexico's observance of corporate governance against the Organisation for Economic Co-operation and Development (OECD) Principles of Corporate Governance, and by a report by the Institute of International Finance (IIF) in the same year. The IIF noted that "Mexico is at the forefront of efforts to improve corporate governance practices among emerging market countries" (p. 2) and complimented Mexican authorities, most notably the capital market regulator, the National Banking and Securities Commission (Comision Nacional Banacaria y de Valores, or CNBV), for working diligently to improve the corporate governance framework. In doing so the authorities cooperated with the Mexican Stock Exchange (Bolsa Mexicana de Valores, BMV) and leading Mexican business organisations to produce the first Corporate Governance Code for Mexico (Código de Mejores Practicas Corporativas) in 1999. A revised version of the Code, incorporating lessons learned from implementation of the original code and international developments, was released in November 2006. It particularly emphasizes the functions of the board and it includes a recommendation for company board's to issue codes of ethics and social responsibility.

Nonetheless, both the World Bank and the IIF assessments note that progress in establishing a successful structure and culture for good corporate governance has to account for the concentrated ownership and control structure of many Mexican firms, and, at least at the time of the assessments, weak enforcement of shareholder rights. As the IIF notes, traditionally, most large companies have been organized as business groups, which are conglomerates owned and controlled by families and/or consist of holding companies that invest in other companies characterized by vertical or horizontal integration. The resulting cross-shareholding between firms and the exchange of positions in boards of directors result in various interlocking directorates. Consequently, while members of the board may come from outside the corporate structure of the firm, they are not necessarily independent. The IIF cited several

studies that indicated that adherence to the principles of the Corporate Governance Code was not commonly observed in the areas of board composition, independence of the audit committee, existence of a committee of compensation and evaluation, and disclosure of compensation schemes for executives. However, especially in the area of director independence, progress in promoting the inclusion of independent board members and establishing audit committees as part of firms' control functions was already under way at the time of the 2003 assessments, and has been further advanced since. This is especially due to the passage of the new 2006 Securities Market Law, which gives many corporate governance provisions the statute of law.

The Mexican legal framework is based on civil law. The two key laws affecting corporate governance are the Company Law (Ley General de Sociedades Mercantiles, or LGSM), and the Securities Market Law (Ley del Mercado de Valores, or LMV). The LGSM, enacted in 1934 and most recently amended in 1996, establishes basic company forms and shareholder rights. The LMV, which regulates public companies, was introduced in 1975, but major amendments went into effect in 2001. The new Securities Markets Law was enacted in 2006. According to the 2007 Financial Sector Assessment Program (FSAP) Update by the International Monetary Fund (IMF), the law changed the securities market framework in three broad areas. It expanded the CNBV's authority, it introduced significant changes in the corporate governance of publicly listed companies; and it created "two new corporate vehicles, designed to facilitate the ability of small and medium-sized companies to raise capital and transition to public listed company status" (p. 12).

More specifically, the new LMV intends to improve the regulation of information disclosure and minority shareholder rights. It also reorganizes and clarifies the duties and liabilities of the board of directors and the relevant officers. In doing so, according to Stolper, writing for the International Financial Law 2007 Global Report, "it incorporates standards that are more compatible to international practices, such as a duty of loyalty and a duty of care." Under the previous LMV Mexican public companies had to adopt specific amendments to their corporate structure, but they are now only required to amend their bylaws regarding their name, as all other changes applied by virtue of the LMV and do not need to be included in a company's bylaws. Also, Mexican committees now need to create at least one committee which acts as an audit and corporate practices committee. The committees have to consist of only independent directors (with the exception of controlled companies, which may have a corporate practices committee comprised of a majority of independent directors). The Board has to be comprised of, at least, 25% independent directors. Further, as Stolper notes, the role of the statutory auditor (comisario) has been taken over by the board of directors through the audit committee, the new corporate practices committee, or an external auditor.

Another area where progress has been made concerns the foundation of a director training organisation. The 2003 World Bank ROSC had noted the absence of such an institution as a key missing ingredient in Mexico's corporate governance reforms. The Centre for Excellence in Corporate Governance (Centro de Excelencia en Gobierno Corporativo, or CEGC) was founded in March 2004. Its objectives are to provide board members and executives with information, methodologies and best corporate governance practices that will increase efficiency and transparency levels, facilitate compliance with existing regulations, and generate greater investor confidence to enhance their economic and social value. Since its foundation, according to the CEGC website, 3050 executives and directors have participated in 49 seminars in twelve cities.

The BMV is a member-owned, for-profit institution. The 2007 IMF update on its original FSAP notes that between 1995 and 2001, trading activity as well as the number of listed companies on the BMV declined. As the IMF notes, Mexico's equity market remains relatively small and illiquid, and is not a major source of financing for most companies. Among the eight largest economies in the Americas, relative to GDP, Mexico nonetheless has the second smallest stock market. After a number of compulsory delistings by the CNBV, the number of listings declined to 132 (155 listed stocks). The daily trading volume on the BMV is highly concentrated in a very small number of issuers. Four stocks (Telmex, AMX, Walmex, and Cemex) comprise approximately 50 percent of the primary equity market index (Indice de Precios y Cotizaciones, or IPC). Overall, the IMF notes, market capitalization of the BMV has grown from US\$104 billion in December 2002 to US\$236 billion at the end of 2005. Free float is limited and trading volumes are also low.

In its 2008 Doing Business report, the World Bank calculates investor protection in Mexico in 2007 as being equal to the OECD and above the regional average. The Investor Protection Index is a subcomponent of the World Bank's 2008 Doing Business Indicators, and consists of three dimensions of investor protection: transparency of transactions (Extent of Disclosure Index), liability for self-dealing (Extent of Director Liability Index) and shareholders' ability to sue officers and directors for misconduct (Ease of Shareholder Suits Index). The indices range between 0 and 10, with higher values indicating greater disclosure, greater liability of directors, greater powers of shareholders to challenge the transaction, and better investor protection. Mexico scores 8.0 in the disclosure index against an OECD average of 6.4. It scores 5.0 in the Director Liability Index against an OECD average of 5.1 and 5.0 in the Shareholder Suits Index against an OECD average of 6.5.

## The Principles

### **Principle I: Ensuring the Basis for an Effective Corporate Governance Framework**



The capital market regulator is the CNBV. It is a supervisory arm of the Secretariat of Finance and Public Credit (Secretaría de Hacienda y Crédito Público, or -SHCP) and supervises banks and the securities market and enforces shareholders rights. The CNBV is headed by a 10-member Board of Governors. Five members, including the President of the Commission, are appointed by the SHCP, three members are appointed by the Central Bank, and the pension regulator and the insurance regulator each appoint one member. According to the 2007 IMF FSAP update, the CNBV has certain operational independence but the SHCP has broad supervisory responsibility over the CNBV, such as setting its annual budget, and the final authority over legal interpretations of the relevant laws.

The Mexican legal framework is based on civil law. The two key laws affecting corporate governance are the LGSM, and the LMV. The LGSM, enacted in 1934 and most recently amended in 1996, establishes basic company forms and shareholder rights. The LMV, which regulates public companies, was introduced in 1975, but major amendments went into effect in 2001. The new Securities Markets Law was enacted in 2006. According to the IMF's 2007 FSAP Update, the law expanded the CNBV's authority and introduced significant changes in the corporate governance of publicly listed companies.

Nonetheless, as both the 2003 World Bank and the IIF assessments note, progress in establishing a successful structure and culture for good corporate governance must account for the concentrated ownership and control structure of many Mexican firms, and, at least at the time of the assessments, weak enforcement of shareholder rights. As the IIF notes, traditionally, most large companies have been organized as business groups, which are conglomerates owned and controlled by families and/or consist of holding companies that invest in other companies characterized by vertical or horizontal integration. However, none of the available reports explicitly addresses Mexico's compliance with this principle.

## **Principle II: The Rights of Shareholders and Key Ownership Function**



In its 2003 ROSC, the World Bank rated Mexico's observance with the sub-principles of Principle II as follows: "Basic Shareholder rights" and "Control Arrangements should be allowed to function" were rated as "Largely Observed," indicating that only minor shortcomings are noted, and that these do not raise questions about the authorities' ability and intent to achieve full observance in the short term. "Rights to participate in fundamental decisions," "Shareholder's Annual General Meeting rights," and "Disproportionate Control Disclosure," were rated as "partially observed," indicating that while the legal and regulatory framework complies with the Principle, practices and enforcement diverge. Finally, the sub-principle labelled "Cost/benefit to voting" was rated "Materially Not Observed," indicating that, despite progress, shortcomings are sufficient to raise doubts about the authorities' ability to achieve observance.

The 2003 World Bank report made a number of recommendations. Rules blocking shares should be clarified. Voting procedures for all kind of investors should be made as simple as possible. Large transactions should require shareholder approval. To strengthen the rights of small shareholders, a small number of shareholders should be able to force resolutions onto the agenda and request a formal poll. A minimum interval should be established between first and second meetings. Legal provisions that define share types and rights should be simplified.

The 2006 Securities Market Law provisions give shareholders greater rights than previously. With 10% of shares, shareholders can appoint one director to the board, and call for extraordinary general meetings. With 5% of shares, civil lawsuits can be presented against directors and executives, and with 20% judicial opposition can be presented against annual general meeting (AGM) resolutions. At AGMs, shareholders must define the policies for the use of company assets in favor of related executives or directors as well as operations with related parties or amounts, the nomination of directors, and policies for internal auditing systems.

## **Principle III: The Equitable Treatment of Shareholders**



In its 2003 Corporate Governance Country Assessment of Mexico, the World Bank rated Mexico's observance with the sub-principles of Principle III as follows: "Prohibit insider trading" was rated as "largely observed," indicating that only minor shortcomings are observed which do not raise questions

about the authorities' ability and intent to achieve full observance in the short term. "Equitable treatment of shareholders" and "Board/management disclose interests" were rated as "partially observed," indicating that while the legal and regulatory framework complies with the Principle, practices and enforcement diverge.

The World Bank further explains that companies can issue multiple series of shares with different rights. However, all classes may participate in corporate profits. The report made a number of recommendations. In order to strengthen minority shareholder rights, the World Bank assessment team proposed the harmonization of existing thresholds at a level sufficient to allow minority shareholders to effectively exercise their rights. With regard to insider trading, it suggested that an exemplary insider trading conviction might reduce this practice in Mexico. The CNBV should develop disclosure of ownership and related party transactions as priorities in its monitoring of companies. At the same time the World Bank report complained that "although recent reforms are having an impact, investors cannot rely on the court system, as the legal process remains inefficient, slow, and sometimes corrupt. Arbitration is in its early stages" (p. 7).

## **Principle IV: The Role of Stakeholders in Corporate Governance**



In its 2003 ROSC, the World Bank rated Mexico's observance with Principle IV as follows: "Access to Information" was rated as "Observed," indicating that the country has fully implemented the principle. "Legal Rights of stakeholder are respected," "Stakeholder Redress for violation of rights," and "Performance-enhancing mechanisms" were rated as "Largely Observed," indicating that only minor shortcomings exist, and these do not raise questions about the authorities' ability and intent to achieve full observance in the short term.

The World Bank explains that Mexican workers do not typically participate in management or sit on boards. The Federal Labor Law (LFT) created institutions to resolve conflicts between employees and companies. These are called Juntas de Conciliación y Arbitraje. The LFT also regulates environmental matters. Mexican Generally Accepted Accounting Principles (GAAP) require disclosures of environmental damage, and disclosures of environmental policy must be made in the annual report. Creditors are protected under the commercial bankruptcy law of 2000 (Ley de Concursos Mercantiles), which according to the World Bank "represents a significant improvement over the old bankruptcy code" (p. 8). The LFT entitles workers to 10 percent of corporate profits. Issuers may create benefit/compensation plans for employees through shares or share options, but these are not very common.

## **Principle V: Disclosure and Transparency**



In its 2003 ROSC, the World Bank rated Mexico's observance with Principle V as follows: "Fair and timely dissemination" was rated as "Observed," indicating that the country has fully implemented the principle. "Disclosure standards" was rated as "Largely Observed," indicating that only minor shortcomings are observed, which do not raise questions about the authorities' ability and intent to achieve full observance in the short term. "Standards of accounting and audit" and "Independent audit annually"



were rated as "Partially Observed," indicating that while the legal and regulatory framework complies with the principle, practices and enforcement diverge.

The annual report must contain a section that includes a summary of the issuer's history, development, and description of its core business. The 2003 World Bank report notes that a "company must disclose details of its ownership structure, dividend policy, material risk factors, voting rights attached to different share classes and the process for changing voting rights, audit fees, information on retirement/pension plans, share distribution plans, and policies on risk management, including internal controls and going concern risks" (p. 10) In addition, it has to disclose the level of adherence to the Mexican Code of Best Practices in Corporate Governance.

In Mexico, basic accounting requirements are stipulated in the LGSM. Under the Securities Market Law, listed companies are required to prepare consolidated financial statements following the standards approved by the CNBV, which, in turn, requires application of the accounting standards approved by the national standard-setter. The CNBV has established procedures to review financial statements of the regulated entities in order to enforce compliance with accounting and auditing requirements. Under the Securities Exchange Law, the CNBV is empowered to impose sanctions for the violation of the reporting requirements. The 2003 World Bank assessment recommends that the CNBV increase its enforcement capability with regard to disclosure content, and continue its zero-tolerance policy toward late filings.


## **Principle VI: The Responsibilities of the Board**



In its 2003 Corporate Governance Country Assessment of Mexico, the World Bank rated Mexico's observance with the sub-principles of Principle VI as follows: "Access to information" was rated as "Observed," indicating that all essential criteria are met without significant deficiencies. "Ensure compliance with law" was rated as "Largely Observed," indicating that only minor shortcomings are observed, which do not raise questions about the authorities' ability and intent to achieve full observance in the short term. The sub principles "Acts with due diligence and care," "Treat all shareholders fairly," "The board should fulfill certain key functions," and "The board should be able to exercise objective judgment" were rated as "Partially Observed," indicating that while the legal and regulatory framework complies with the Principle, practices and enforcement diverge.

Mexico has a single-tier board structure. An updated Mexican Code of Best Practices in Corporate Governance was released in November 2006. It particularly emphasizes the functions of the board and it includes a recommendation for company board's to issue codes of ethics and social responsibility. The 2006 LMV reorganizes and clarifies the duties and liabilities of the board of directors and the relevant officers. In doing so, according to Stolper's 2007 report, "it incorporates standards that are more compatible to international practices, such as a duty of loyalty and a duty of care." Mexican committees now need to create at least one committee which acts as an audit and corporate practices committee. The committees need to consist entirely of independent directors (with the exception of controlled companies, which may have a corporate practices committee comprised of a majority of independent directors). Further, as Stolper notes, the role of the statutory auditor (comisario) has been eliminated and been taken over by the board of directors through the audit committee, the new corporate practices committee, or an external auditor. The LMV states that failure to fulfilling the Duty of Care

includes unjustified nonattendance to board meetings and failure to provide information relevant to decision making. Failure to comply with the duty of loyalty is penalized with jail time of 3 to 12 years if directors knowingly benefit one shareholder to the detriment of others, vote if they have a conflict of interest, or misuse confidential and relevant information.



## Sources of Assessment

Institute of International Finance, "Corporate Governance in Mexico: An Investor Perspective," May 2003. Available from The Institute of International Finance website. Accessed on March 21, 2008. (IIF 2003)

Organization for Economic Co-operation and Development, "White paper on Corporate Governance in Latin America," Paris, France: OECD, 2003. Available from the Organization for Economic Co-operation and Development website. Accessed on March 21, 2008. (OECD 2003)

International Monetary Fund, "Mexico: Financial Sector Assessment Program Update -- Detailed Assessment on the Implementation of the IOSCO Objectives and Principles of Securities Regulation," Country Report No. 07/168, Washington, D.C.: IMF, May 2007. Available from International Monetary Fund website. Accessed on March 21, 2008. (IMF 2007)

World Bank, "Report on the Observance of Standards and Codes: Corporate Governance Country Assessment Mexico" September 2003. Available from the World Bank website. Accessed on March 21, 2008. (WB 2003)

## Relevant Organizations

Centre for Excellence in Corporate Governance --- Centro de Excelencia en Gobierno Corporativo (CEGC) (website in Spanish only)

Mexican Business Coordination Council -- Consejo Coordinador Empresarial (CCE)

Mexican Institute of Finance Executives -- Instituto Mexicano de Ejecutivos de Finanzas (IMEF)

Mexican Stock Exchange -- Bolsa Mexicana de Valores (BMV)

National Banking and Securities Commission -- Comisión Nacional Bancaria y de Valores (CNBV)

## Relevant Legislation/Regulation

Securities Market Law, 2006 -- Ley del Mercado de Valores, 2006 (in Spanish only)

Code of Best Practices in Corporate Governance, 2006 -- Código de Mejores Prácticas Corporativas, 2006 (in Spanish only)

Company Law, 1934 -- Ley General de Sociedades Mercantiles, 1934 (last published reforms as of 2006) (in Spanish only)

Law for Investment Funds, 2001 -- Ley de Sociedades de Inversion, 2001 (last published reforms as of 2007) (in Spanish only)

Issuers Manual, 2003 -- Circular Única, 2003 (in Spanish only)

National Banking and Securities Commission's Law, 1995 -- Ley de la Comision Nacional Bancaria y de Valores, 1995 (last published reforms as of 2007) (in Spanish only)

### Supplementary Sources

Lara, G., "Estado actual del Gobierno Corporativo en México [Current State of Corporate Governance in Mexico]," Instituto Iberoamericano de Mercados de Valores, 2006. Available from Rubio Villegas law firm website. Accessed on March 24, 2008. (Lara 2006)

Stolper, A., "The Latin Approach," International Financial Law Review Global Report Supplement, 2007. Available from IFLR website. Accessed on March 21, 2008. (Stolper 2007)

World Bank, "Report on the Observance of Standards and Codes: Accounting and Auditing - Mexico," March 2004. Available from the World Bank website. Accessed on March 21, 2008. (WB 2004)

World Bank, "2008 Doing Business: Mexico," 2007. Available from the Doing Business website. Accessed on March 21, 2008. (World Bank 2007)

## Legal Framework

The major laws and regulations that apply to institutional investors are the Securities Markets Law of July 2006 (*Ley del Mercado de Valores, LMV*) and the Circular Única of the Comisión Nacional Bancaria y de Valores (CNBV) of December 2006. A 2001 Financial System Stability Assessment (FSSA) by the International Monetary Fund (IMF) found that Mexico was in broad observance with the Objectives and Principles of Securities Regulations promulgated by the International Organization of Securities Commissions (IOSCO). Furthermore, in 2006, the Securities Market Law has been enacted with more detailed responsibilities for publicly traded companies in terms of corporate governance. The responsibilities of the regulator have been strengthened, and the duties of market intermediaries have been clarified.

Reforms in the Securities Market Law have provided minority investors with a number of improved protections under the law. Minorities representing 10 percent of voting and limited voting shares have the right to appoint a board member and his alternate, the right to appoint a comisario, the right to call a shareholders' meeting, and the right to delay a vote for three days when they believe that not enough information has been provided. The new Law has increased the right of shareholders to initiate civil lawsuits against members of the board of directors, lowering the percentage of voting to 5 percent, and with 20% they can present legal opposition to resolutions of the Assembly.

The Law in Article 28 has defined the obligations of the board of directors and from Article 30 to 40 defined the fiduciary and loyalty duties of directors. The role of comisario (statutory auditor) has been erased and substituted by the role of the board of directors and the independent auditor. Duties have also been defined for committees of corporate practices and audit functions. Furthermore, duties have also been defined for the CEO. (LMV 2006).

Currently, boards of directors must have at least 25% independent members, and the committees have to be chaired by independent directors. The board has a defined role that includes setting the strategy and internal-control guidelines, identifying opportunities for generating value, monitoring the management, approving financial statements, remuneration packages for key managers, and approving relevant and/or related party transactions. Directors now have defined duties of diligence and loyalty with specific liabilities if they fail to exercise them. Independent directors may not include management or employees, persons with significant influence on decision-making power, shareholders, major suppliers or customers, and relatives by blood or affinity to the fourth degree of any of the prior categories. Shareholders maintaining control of the corporation will be responsible for the damages caused, when they approve or reject transactions in the shareholders' meeting that produce notoriously injurious effects for the corporation, in violation of the opinion or resolution of the board.

The Law creates a new legal model for corporations: the sociedades anónimas promotoras de inversión (SAPI's), which is exempted <sup>1</sup>from certain obligations provided under the General Law of Business Corporations (*Ley General de Sociedades Mercantiles*) (the "LGSM") that have limited the ability to give certain corporate and economic rights to investors/shareholders of the widely common Mexican

---

<sup>1</sup> *Sociedades Anónimas Promotoras de Inversión Under the New Mexican Securities Market Law (Ley del Mercado de Valores)*, Yves Hayaux-du-Tilly L. and Alberto Balderas F. 2006.

sociedades anónimas (SAs) by making invalid some shareholders' agreements and thus making SAs difficult for new/external investors. This new legal framework will broaden the rights that may be given to investors/shareholders of SAPIs, give certainty to investors and induce joint-ventures and investments in the capital stock of said corporations. The overall objective was the creation of an investment-friendly corporation in order to attract external investment to the highly concentrated ownership company scope in Mexico and therefore incentivise stock-dispersion as well as foster listings in the stock market. A SAPI may "go public" and register its shares (or the securities representing them) at the Securities National Registry (RNV) and list them with the Mexican Stock Exchange (Bolsa Mexicana de Valores, BMV) without making a public offering, by filing a registration statement with the CNBV and providing investors a detailed prospectus. If a SAPI decides to "go public" it must (i) have at least one independent director as member of its board of directors; (ii) create a committee formed by some of its own directors in order to assist the board in the gradual implementation of corporate practices applicable to listed companies; and (iii) change its corporate name to sociedad anónima promotora de inversión bursátil (SAPIb) in order to adopt a 3-year plan to gradually implement the legal regime of a publicly held corporation (the "Transformation Plan"), and modify its capital structure to adequate it to the regime applicable to publicly held corporations, in an Extraordinary Shareholders' Meeting.

## **Rating Agencies**

Regarding the advice provided by rating agencies on the quality of companies' governance practices, and its use by institutional investors, Alberto Jones, CEO of Moodys in Mexico, explained that they do take into consideration Corporate Governance Practices when assigning a rating. A company with good governance practices aspires to two levels above a company with poor corporate governance practices. So from the best possible rating a company could receive, it could go down two notches if it does not have good corporate governance practices.

Regarding the use of this information by institutional investors, they do not conduct (with the exception of private equity funds), any other type of research or analysis on the governance practices of the companies they will invest in. However, the rating score given by the Rating Agency is thought by the institutional investors as comprehensive in terms of that analysis, and while constructing their investment portfolio, the ratings profile is a limit either by regulation or by the Board of the funds themselves.

## Background of Institutional Investors in Mexico

The types of institutional investors (IIs)<sup>2</sup> in the Mexican Financial Market include foreign and domestic pension funds; mutual funds; private equity firms; insurance companies; banks and brokerage houses. The kind of investment strategies that IIs tend to most commonly employ are minority stakes acquired in the market. They tend to be passive shareholders investing in listed companies.

The total amount of assets managed by institutional investors in Mexico is USD \$287 billion or 32% of GNP. The largest institutional investors in Mexico are the pension funds and the mutual funds, with a combined USD \$178 billion in assets under management, that amounts to 20% of the GNP of 893.365 billion USD (2007 IMF) as of September 2008. In equity or equity indexes, institutional investors in Mexico have USD \$35.5 billion invested as of September 2008. USD \$251 billion are invested in fixed income instruments. Most of the portfolios are in debt, so instead of making corporate governance an indispensable consideration while reviewing investee companies, the funds' manager or the funds' board mainly focus on the rating the credit rating agencies have given to that debt.

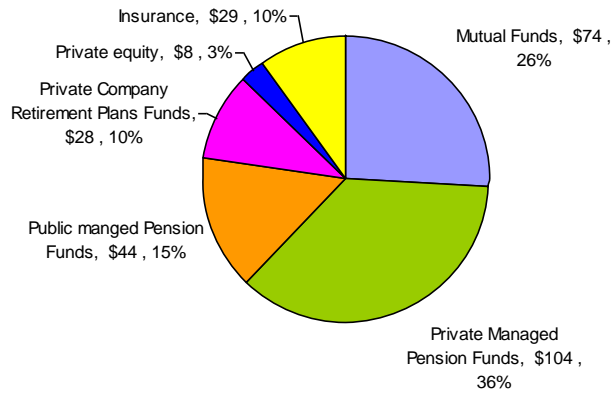
### Key elements that could affect future corporate governance developments

- The amount of savings in the pension system that could be allocated in the near future to capital markets is a big opportunity for the development of the depth of the Mexican financial markets. However at the moment, relatively few listed companies exist in the Mexican Bolsa. Reforms to the Securities Market Law included stronger corporate governance rules and a new legal vehicle (the Sociedad Anónima Promotora de Inversión or SAPI) designed for privately held medium sized companies that through adherence to stricter corporate governance practices could benefit from better access to finance from private equity and/or public investors, with the future expectation of increasing listings in the Stock Market.
- Issuers of equity float small percentages of their shares in the public markets. Ownership structures for the greater part of listed firms have groups of shareholder control clearly identified.
- Pension funds are not allowed to invest in direct shares; currently their equity investments are limited to share indexes.
- Pension funds and Mutual funds do not appear to recognise, that they have a fiduciary responsibility for their clients' investments. No one on their behalf is assigned to overview any type of governance or proxy analysis. They are only doing financial analysis (technical and fundamental).
- Foreign assets in the portfolios of pension funds have been gradually increasing due to the lack of investment choices in the Mexican market.

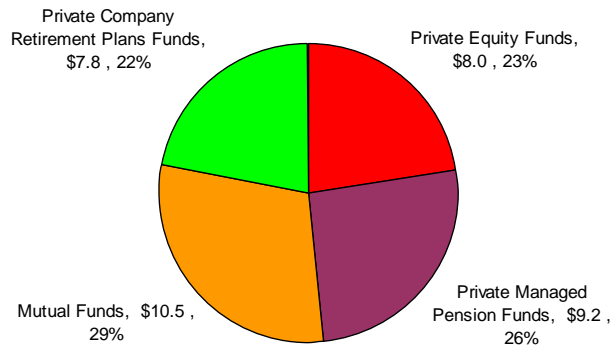
---

<sup>2</sup> Organisations that invest, including insurance companies, depository institutions, pension funds, investment companies, mutual funds, and endowment funds.

**ASSETS UNDER MANAGEMENT BY INSTITUTIONAL INVESTORS IN MEXICO (\$287 USD BILLIONS) AS OF SEPTEMBER 2008**



**TOTAL ASSETS INVESTED IN EQUITIES IN MEXICO (\$35.5 USD BILLIONS)**





## Mutual Funds (Sociedades de Inversión)

Mutual funds are regulated mainly by the mercantile law, the Securities Market Law, the law of Sociedades de Inversión and the Circular única issued on December 4, 2006.

### a) Classification of Mutual Funds:

Debt instruments:	Short term, (one year) Medium term (more than one year less than three years) and Long term (more than three years)
Equity:	Specialised in stocks (at least 80% in stocks) Mostly in stocks (Between 50 and 80% in stocks) Mostly in debt (Between 50 and 80 % in debt) and Specialised in debt (At least 80% in debt)

These mutual funds can also be specialised by sector, indexed, or discretionally if they have a specific investment target.

### b) Assets under management:

Mexican mutual funds have 1,508,236 clients and manage for them assets worth USD \$ 74 billion equivalent to 8% of GNP as of September 2008.

There are 31 firms that operate 498 mutual funds. 310 are Debt Instrument with USD \$63.6 billion and 1,418,712 clients. 188 are Equities with USD \$10.5 billion with 89,524 clients.

### c) Investment regime and ceilings

These are set forth in Article 4 and 5 of the Circular única:

One mutual fund operator may not acquire more than 40% of the shares of a single issuer, and the portfolio of each of its mutual funds may not be invested in less than 6 issuers. These are risk dispersion measures.

### d) The Role of Mutual Funds in Promoting Good Governance

Mutual funds in Mexico can influence and promote good governance in their investee companies but so far little efforts have been made by them to be perceived as effective agents of good governance. According to the Mexican Association of Securities Intermediaries (AMIB), mutual funds can influence good governance on the level of supporting the development of public policy and regulation on corporate governance. Since only minority positions are bought by them, they are not different from other minority shareholders.

According to the AMIB, the key risks and main corporate governance problems have to do with the reluctance of companies to have adequate disclosure and transparency, even though the regulatory framework has advanced considerably; as well as family business issues. Currently fund managers are

considering corporate governance risks and opportunities before investing, but they are not actively exercising ownership rights. There is a closer consideration of governance issues by mutual funds than by pension funds and by foreign mutual funds than by domestic ones.

According to the AMIB, to improve the contribution of mutual funds to bettering corporate governance practice, they should develop standards of good governance practice that funds should seek their investees to follow and also improve the dialogue between the mutual funds and their investee companies.

Mutual funds have not been active and effective monitors of corporate activities mainly due to the limited monitoring capabilities, given large portfolios, limited staff, and limited ability to engage in active management activities; and the need or desire to maintain liquid portfolios, which results in the acquisition of small blocks without significant voting power; but mostly by the prevailing institutional culture of "passivity".

## **Pension Funds (Siefores, Infonavit and Private Plans)**

### **a) Classification**

The Pension System in Mexico has the following types of funds:

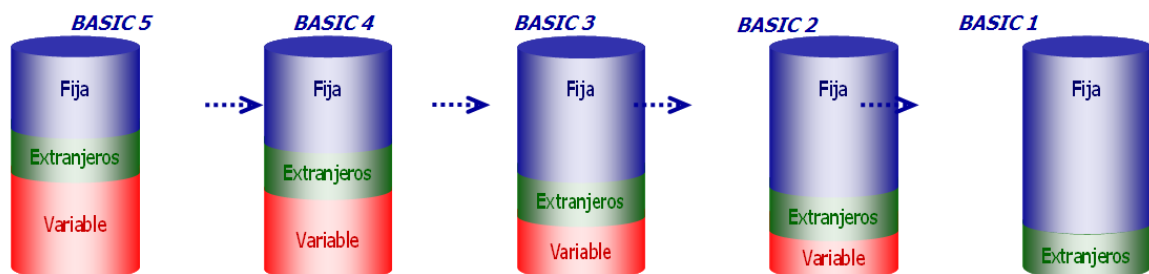
1. The public system for retirement created individual retirement accounts in 1997 managed by private pension fund companies known as AFORES. The system has two components: Retirement funds managed by private pension funds administrators (SIEFORES) and the housing funds managed by the Federal Institute of Social Housing (INFONAVIT).

According to Circular 15-19 of the CONSAR -the Pension Funds' regulator- issued on July 2007, three new SIEFORES with different investment regimes could be established within each pension fund. However, direct investments in stocks will still not be permitted and the SIEFORES will only invest in equity through indexes. New stock indexes, (IOSCO and EU member countries), will also be available in the Stock Exchange.

Retirement accounts managed by the private pension system currently are concentrated in five types of SIEFORES funds: Basic 1 (Allowed to invest only in fixed income instruments) and Basic 2 (Allowed to invest in fixed income and up to 15% in variable income instruments, although this ceiling will be lifted in early 2008 to up to 30%).

Limits for Value at Risk (VaR) and Variable Income Instruments (equity) are established for the five types of SIEFORES in accordance with the higher risk-return preference of younger workers.

Age	18 to 26	27 to 36	37 to 45	46 to 55	56 to
Structured Instruments	10%	7.5%	5%	1%	0%
Variable	30%	25%	20%	15%	0%
REITS*	10%	10%	5%	5%	0%
VaR	2%	1.6%	1.3%	1%	0.6%



\*(REITS or FIBRAS in Spanish are Real Estate Investment Trusts or Fideicomisos Inmobiliarios de Bienes Raíces).

Additional changes include that now the CEO of an AFORE should reside in Mexican territory, have at least 5 years of experience in top finance positions, not have worked in a regulatory agency or political institution for the last 2 years.

2. The pension system for public sector employees was reformed in April 2007 and now has one AFORE owned by the government, and individualised accounts for its clients.

3. Private Retirement Plans designed by companies for their employees. These funds are managed by banks, brokerage houses, Insurance companies, the companies themselves mutual funds and others.

## b) Assets under management

The Mexican pension system has 39,000,000 accounts. The total amount in the system for private sector employees as of September 2008 was USD \$103 billion.

There are 18 private firms (AFORES) that operate 90 pension funds administrators or SIEFORES. Whereas 6.73% of their portfolios are invested in variable income national instruments, 6.29% is invested in variable income foreign instruments, 17.64% is invested in debt instruments of private Mexican companies, 5.92% is invested in debt instruments of private foreign companies, and 63.43% is invested in Mexican government instruments.

Additionally there are 1,793 registered private retirement or pension fund plans designed by companies for their employees as of January 2008. These private pension plans are not part of the Mexican Public System for Retirement and have USD \$28 billion of assets under management (PRIVATE PLANS). 49% of

the assets are managed by banks, 28% by brokerage firms, 7.5% by insurance companies 6% by the private companies themselves and 8% by mutual funds.

These assets are invested as follows:

Financial institutions Debt 8%

Municipal bonds 1%

Foreign investments 1%

Private companies debt 3%

Variable income instruments 28%

**c) Investment regime and ceilings**

SIEFORES can invest up to 30% of their portfolio in variable income instruments, but they cannot buy direct shares. They can invest in indexes, sovereign/private bonds. Of bond debt emissions, a SIEFORE can buy up to 20% a single offering. If it is an AAA emission they can buy up to 5% of the same issuer. 3% for AA and 1% for A, and at least 2 rating agencies have to qualify the issue. Up to 20% of the portfolio can be invested in foreign instruments. Please refer to the next table provided by the CONSAR:

This document is a summary of the applicable regulation and it should be used only as a guide of the investment regime. The applicable regulation might have change since this document was last updated. This document does not substitute, add nor modify the applicable regulation; making it public does not bind CONSAR nor any other participant in the Retirement Savings System (SAR). Last update: Circular 15-20; August 2, 2007

		Limits by kind of SIEFORE (fund) <sup>1</sup>				
		1	2	3	4	5
Market Risk	Value at Risk [VaR <sub>historical</sub> (1-α=95%,1day)]	0.6%	1.0%	1.3%	1.6%	2.0%
	Equity (only through indices)	0%	15%	20%	25%	30%
	Foreign Currency (Dollars, Euros, Yens or currencies to acquire equity)	30%	30%	30%	30%	30%
	Derivatives	yes	yes	yes	yes	yes
Credit Risk	mxAAA <sup>2</sup> and Government securities	100%	100%	100%	100%	100%
	mxAA- rated securities	35%	35%	35%	35%	35%
	mxA- rated securities	5%	5%	5%	5%	5%
Concentration / Counterparty Risk	Local Securities					
	mxAAA rated securities from one issuer <sup>3</sup> or counterpart	5%	5%	5%	5%	5%
	mxAA rated securities from one issuer or counterpart	3%	3%	3%	3%	3%
	mxA rated securities from one issuer or counterpart	1%	1%	1%	1%	1%
	BBB+ rated sec. denominated in foreign currency from one issuer	5%	5%	5%	5%	5%
	BBB- rated sec. denominated in foreign currency from one issuer	3%	3%	3%	3%	3%
For.	A- rated foreign securities from one issuer or counterpart	5%	5%	5%	5%	5%
	Maximum ownership of one issue <sup>4</sup>	20%	20%	20%	20%	20%
Other Limits	Foreign securities (if fixed income, minimum rate is A- )	20%	20%	20%	20%	20%
	Securitizations <sup>5</sup>	10%	15%	20%	30%	40%
	Structured securities (issued by Mexican nationals) <sup>5</sup>	0%	1%	5%	7.5%	10%
	REITs (Real estate must be in Mexican territory)	0%	5%	5%	10%	10%
	Inflation protected securities minimum <sup>6</sup>	yes (51% Min.)	No	No	No	No
Conflict of interests	Securities endorsed by related parties	15%	15%	15%	15%	15%
	Securities endorsed by parties related to the Afore <sup>7</sup>	5%	5%	5%	5%	5%

1- All limits expressed as percentages of assets under management (Activos Netos) but the maximum ownership of one issue. All limits are maximums, but the inflation protected securities minimum.

2- These are local rates for securities issued by Mexican nationals in Mexico. Global rates apply to foreign securities. All securities must have at least two rates. All securities must be issued through public offers.

3- Issuer or endorser in the percentage it guarantees. Counterparty exposure in repos and derivatives must be added to exposure acquired through securities.

4- Percentage of the total amount stated in the prospectus, adjusted by later amortizations and repurchases.

5- Securitizations must comply with Circular 15-19's appendix K to consider the SPV as an independent issuer; structured securities must comply with appendix L.

6- Minimum limit on securities that guarantee a return equal or in excess of Mexico's inflation rate.

7- This limit is contained in the Law (Art. 48, fracc. X ), although Circular 15-19 sets a limit of 0% for related parties that are financial institutions.

Differentiation factors among funds

#### d) The Role of Pension Funds in Promoting Good Governance

The transparency of debt emissions has improved since pension funds absorb parts of them, and they have become very influential in that market. However they feel that further improvement in disclosure and transparency both for issuers and for underwriters is an area of opportunity in Mexico.

AFORES supported the enactment of the new Securities Market Law in 2006, which mainly included tougher corporate governance standards, and they are not active promoters now of corporate governance improvements because they feel that the law took care of that issue with companies. The general perception is that the new law solved that issue. Their perspective is that their lack of interest in actively influencing better governance could be overcome if and when investment ceilings and direct share purchases are allowed.

Pension funds hire the services of custodians to represent them in shareholder meetings of issuers. Custodians vote with the management's proposal unless they receive specific instructions from the pension fund to vote in some other way. Banks, broker-dealers, Operators of Investment Companies and Distribution Companies may provide shareholders of Investment Companies deposit and custody services for their securities.

## Private Equity Funds

### a) Classification

According to the Mexican Private Equity Association AMEXCAP, private equity in Mexico is represented mainly by foreign funds, and nearly 55% are real estate funds. The housing sector has been growing at an average rate of 15% for the past 5 years in Mexico. Commercial and retail developments have followed the housing boom of the growing middle class. Another private equity investment sector is co-participation with the public sector in national infrastructure projects. The remaining private equity funds (approx. 45%) invest in service industries (mainly financial services and entertainment) and in transformation industries.

### b) Assets under management

According to AMEXCAP in the year 2000 there were only USD \$1 billion in 2007 the industry is represented by 35 registered funds that have a combined total of approx. USD \$8 billion.

### c) Investment regime and ceilings

Qualified investors are allowed to participate in private equity funds. Private equity funds tend to have investment strategies where they buy majority stakes through direct negotiations. A recent Deloitte survey of the private equity industry in Mexico<sup>3</sup>, confirms that more than 70% of the funds prefer to buy majority stakes. During the initial phase of investment decision-making, private equity funds (their investment committees) are very active and participative in reviewing governance practices in their target companies. In the implementation phase of the financial operation, funds invested in the service or transformation industries remain active shareholders. However, funds invested in real estate or infrastructure projects are passive shareholders in this phase, and mainly rely on local operators for execution. During the exit-stage both types of private equity funds are active shareholders.

### d) The Role of Private Equity Funds in Promoting Good Governance

In general, private equity funds are more aware and involved than other types of institutional investors in the promotion of better corporate governance in Mexico. They feel they are in a good position to influence better standards among Mexican businesses.

---

<sup>3</sup> Fondos de Capital Privado, un vistazo al Mercado nacional. Deloitte, 2006

When reviewing investment options, they evaluate management and board. They normally acquire majority stakes and name board members. They actively exercise ownership rights and include them in their investment contracts and shareholder agreements. From their perspective, the main risks they face in governance of Mexican companies are family business issues and shareholder rights when the investee company is not regulated by the new Securities Market Law. One key regulatory issue is that the General Mercantile law dates from 1937 and has not been modified since.

Another key issue that has been set forth by AMEXCAP regarding the improved contribution that institutional investors could make in corporate governance in Mexico is that pension funds should be allowed to invest in private equity funds and in direct shares in the near future.

Financial intermediaries seldom promote private equity options among their asset classes for their portfolios. The lack of private equity culture works both ways: businesses tend to have family ownership averse to selling control or even minority stakes, and financial intermediaries (brokers and promoters) have little knowledge of this asset class, or sometimes feel that private equity is a potential competitor for them.

Some barriers for private equity funds are the lack of depth in the market, a short offer of securities and concentrated ownership patterns. Exit strategies for the investment of private equity funds, tend to be through sales to other strategic investors, and very rarely through a public offering, thus one of the major obstacles for the development of this industry is the complexity that a fund faces when exiting their investments.

## **Corporate Governance of II's.**

The Board of Directors of Mutual Funds and Pension Funds must be integrated by a minimum of 5 and a maximum of 15 board members, and at least 33% have to be independent. The board has to have an Audit Committee led by an independent director. Normally other committees that report to the Board of Directors are formed, including the Risk Committee, the Compensation Committee and the Investment Committee. Risk and Investment Committees are also led by independent directors.

The Corporate Governance of Private Equity Funds is different because they are incorporated as private businesses under the Mexican mercantile law, so no specific requirements by financial authorities are set. However most Mexican funds are subsidiaries of international funds that comply with international governance standards. According to the AMEXCAP, self-regulation schemes where funds and their risks are assessed by rating agencies is desired by the industry.

## Conclusions and Key Recommendations

As detailed before in this report, corporate governance practices have improved significantly due to the new Securities Market Law. Institutional investors are of the opinion that the new Law ensures standards of compliance in the matter, therefore the need for further actions to change this opinion. From the perspective of the Mexican Stock Exchange (BMV), institutional investors must realise that they are shareholders, not only long term passive investors, and thus their focus on the management of the issuer has to increase, and they must become active in the board and shareholder organs of the enterprises when they have larger percentages.

- Pension Funds will change when they are allowed to buy direct equity stakes, currently they mostly concerned about asset allocation in indexes. Without that, there will be no major incentives to distinguish investments in better governed issuers. However, liquidity in the market is a concern. Also the number of issuers in the market is small, and therefore increased equity investments could produce an increase in risk.
- Mutual funds and insurers are passive shareholders in their investments, so one idea from the BMV would be to generate an index or scale generated by the BMV or other organizations that would differentiate companies with better governance. Another recommendation would be that Investment Committees of these II's design investment policies that take corporate governance into account.
- Rating agencies should play a significant role in providing information about the governance of companies involved in debt and equity emissions. Further efforts with these agencies should be made, in order to use them as promoters the region for obtaining a stronger focus on good governance from II's. Currently mutual funds and pension funds rely mainly on these ratings for their investment considerations. The unfavourable cost-benefit ratio for mutual and pension funds for analysing corporate governance is one of the main reasons why they rely on other assessments and supervision entities.
- Further improvements in transparency of voting policies from pension and mutual funds should be encouraged.
- The fund manager should have some liability under regulation for the lack of supervision of corporate governance issues and performance of the investments made by the fund, especially pension funds that deal with retirement of many citizens.
- A CalPers or TIIA/CREF type of Code for Pension Funds should be implemented for AFORES in Mexico. They should report on the degree of compliance and have specific dates or terms for full compliance under a new regulation.



## **Participants**

Asociación Mexicana de Intermediarios Bursátiles AMIB  
Asociación Mexicana de Fondos para el Retiro AMAFORE  
Asociación Mexicana de Capital Privado AMEXCAP  
Bolsa Mexicana de Valores BMV

## **Sources**

World Bank, "Report on the Observance of Standards and Codes: Corporate Governance Country Assessment Mexico," September 2003.

Securities Market Law, 2006 - Ley del Mercado de Valores, 2006 (LMV)  
[http://www.cnbv.gob.mx/recursos/LMV\\_2006.doc](http://www.cnbv.gob.mx/recursos/LMV_2006.doc)

Sociedades Anónimas Promotoras de Inversión Under the New Mexican Securities Market Law (Ley del Mercado de Valores), Yves Hayaux-du-Tilly L. and Alberto Balderas F. 2006.

Fondos de Capital Privado, un vistazo al Mercado nacional.  
Deloitte, 2006

**Table- Mexico's Institutional Investors (September 2008)**

	Investment US billion	Legal & Investment Regime	Shareholder Activism	Corporate Governance Activism
<b>Mutual Funds</b>	<ul style="list-style-type: none"> <li>• \$74</li> </ul>	<ul style="list-style-type: none"> <li>• May not acquire more than 40% of a single issuer.</li> <li>• Portfolio of each of its mutual funds may not be invested in less than 6 issuers.</li> <li>• Regulated by the Securities Market Law.</li> </ul>	<ul style="list-style-type: none"> <li>• Passive</li> </ul>	<ul style="list-style-type: none"> <li>• Little efforts made by them to be effective agents of good governance.</li> <li>• Only minority positions are bought.</li> <li>• There is reluctance from companies to have adequate disclosure and transparency, as well as family business issues.</li> <li>• Rating scores are their proxy for activism.</li> </ul>
<b>Pension Funds*</b> *Only includes private pension fund management and excludes INFONAVIT and other public funds	<ul style="list-style-type: none"> <li>• \$99</li> </ul>	<ul style="list-style-type: none"> <li>• 30% can be invested in variable income.</li> <li>• Can only invest in share indexes.</li> <li>• Bond emissions, can buy up to 20% of a single offering.</li> <li>• Up to 20% of the portfolio can be invested in foreign instruments.</li> <li>• Regulated under Pension System Law.</li> </ul>	<ul style="list-style-type: none"> <li>• Passive</li> </ul>	<ul style="list-style-type: none"> <li>• Transparency of debt emissions has improved since pension funds absorb parts of them.</li> <li>• Disclosure and transparency issues are a risk area.</li> <li>• They feel that the Securities law took care of the corporate governance of companies.</li> <li>• Rating scores are their proxy for activism.</li> </ul>
<b>Private Equity</b>	<ul style="list-style-type: none"> <li>• \$8</li> </ul>	<ul style="list-style-type: none"> <li>• Regulated under Mercantile Law.</li> <li>• No investment ceilings.</li> <li>• Companies they invest in can be regulated by Mercantile Law or by the Securities Market Law.</li> </ul>	<ul style="list-style-type: none"> <li>• Active</li> </ul>	<ul style="list-style-type: none"> <li>• When reviewing investment options, they evaluate management and board.</li> <li>• Normally acquire majority stakes and name board members.</li> <li>• Main risks in governance are family business issues and shareholder rights when the investee company is not regulated by the Securities Market Law.</li> <li>• Some barriers include lack of depth in the market, short offer of securities and concentrated ownership patterns.</li> </ul>

