LATIN AMERICAN CORPORATE GOVERNANCE ROUNDTABLE SURVEY REPORT ON RELATED PARTY TRANSACTIONS

Acknowledgments

This synthesis report was prepared for the 2011 Latin American Corporate Governance Roundtable by Mike Lubrano, based upon information provided by regulatory authorities from Argentina, Brazil, Chile, Colombia, Mexico and Peru, and also takes into account information provided by eight Latin American corporate governance institutes for the separate 2011 Roundtable report on board nomination, election and conflicts of interest. The author wishes to thank Luis Enriquez of IFC for his additional input to this survey, and Grant Kirkpatrick and Daniel Blume of the OECD for their helpful comments.

If you have any questions or comments about this report, please contact Mike Lubrano (mlubrano@comcast.net) or Daniel Blume (Daniel.Blume@oecd.org).

Table of Contents

INTRODUCTION

Protection of minority shareholder rights has long been identified as a priority of the Latin American Corporate Governance Roundtable, and related party transactions have been highlighted as one of the key practices requiring attention, both from enforcement authorities and the market, to ensure fair treatment of all shareholders. In connection with its focus on the fair treatment of minority shareholders, the Roundtable decided in 2010 to launch specific work with regulatory authorities: first through a report, completed earlier this year in co-operation with COSRA, on the misuse of privileged information; and now with this current survey report on the treatment of related party transactions in **Argentina, Brazil, Chile, Colombia, Mexico** and **Peru**.

This work comes in the context of increasing global attention to the issue of how related party transactions are handled around the world, due to the opportunities for they present for abuse. The Asia Roundtable on Corporate Governance completed a report on this issue in 2009, and the OECD Corporate Governance Committee has recently undertaken a review of OECD member and other key (mostly G20 member) economies. The OECD review notes that the concern with related party transactions hinges on a policy trade-off between their benefits and their risks. On the one hand, there is international policy consensus that related party transactions can be economically beneficial, including in company groups where they may provide an alternative means of financing growth and development between related companies. On the other hand, there is a clear concern that such transactions can be abused by insiders such as executives, board members and controlling shareholders. Indeed, the OECD's initial work in this area has pointed to a number of studies finding negative impacts of RPTs on company valuations (although subject to some caveats on the difficulty of establishing causality and other methodological limitations). In Latin America, where corporate ownership is generally concentrated in the hands of a controlling shareholder or group, minority shareholders have a particular concern to ensure that such transactions do not result in disproportionate gains to the controlling shareholder at the expense of the company and minority shareholder interests.

While this survey represents a first step in the Roundtable's efforts to consider how to ensure effective corporate governance arrangements for the oversight of related party transactions, it is hoped that it may also spur further consideration and actions to address this issue in the future.

The purpose of the present exercise is to provide a useful, basic inventory of the legal/regulatory regimes and recent experiences with enforcement relevant to the treatment of related party transactions in Latin America. The responses to the survey indicate a considerable variance in the content of the legal/regulatory framework among the respondent countries, different practices in how related party transactions are reviewed and approved by companies, and a variety of experiences with enforcement by supervisory authorities. **Annex 1** provides a brief comparative overview of the main features of the six surveyed countries' frameworks for the review of related party transactions.

This draft survey report is not intended to be a comprehensive or scientific review of the content and effectiveness of different Latin American countries' treatment of related party transactions. It is based on responses from only six supervisory authorities to a small, but hopefully well-crafted set of very basic

questions. The questionnaire was not sent to parties other than the supervisory authorities. Respondents were not requested to do extensive research in preparing their responses to the survey, but instead were asked to provide answers based on easily available data and their institutions' general views on the topics raised by the questions. In this context, this report is intended as a first step towards obtaining a wider set of inputs and understanding of how related party transactions are handled in the region, and how legal and regulatory frameworks and voluntary practices can be improved to reduce the risk of abusive practices.

1- RECENT OECD AND ROUNDTABLE WORK ON RELATED PARTY TRANSACTIONS

This report takes into account the following OECD and Roundtable work relevant to consideration of related party transactions:

- OECD Principles of Corporate Governance;
- Methodology for Assessing the Implementation of the Principles of Corporate Governance;
- Past work of the Latin American CG Roundtable – White Paper on Corporate Governance in Latin America;
- IOSCO Technical Committee paper on Protection of Minority Shareholders in Listed Issuers;
- OECD Guide on Fighting Abusive Related Party Transactions in Asia;
- OECD Peer Review on Minority Protection: Related Party Transactions;
- Board Processes in Latin America – Board Nomination/Selection and Handling of Conflicts of Interest prepared for 2011 Roundtable meeting.

2- INCIDENCE AND TYPES OF REALATED PARTY TRANSACTIONS

Most of the respondents to the survey have yet to conduct a comprehensive review of the reporting of related party transactions (RPTs) by public companies in their financial statements. Based on its review of a subset of reporting companies, Brazil's supervisory authority, CVM, reported that all of the 63 companies that comprise the main share index (IBOVESPA, which accounts for about 80% of Brazil's market capitalization) reported RPTs in 2010. Most reported transactions were with subsidiaries (1,526 transactions, of which the vast bulk were with wholly-owned, or almost wholly-owned subs); followed by transactions with companies under common control (314 transactions); affiliates (75 transactions); and shareholders (38 transactions). Sixteeen percent of the 37 companies in Governance Metrics International's (GMI) 2008 Brazil sample reported significant RPTs (at least 1% of revenue) within the previous three years; the CVM believes that this percentage is understated and should be closer to 100%.

SVS, Chile's supervisory authority, counted 266 of 309 companies as reporting RPTs in their 2010 financial statements. Transactions among companies in the same economic group, inter-company loans and purchases and sales of goods and services dominated Chilean RPTs. A third of Chilean listed companies reported significant RPTs (at least 1% of revenue) within the last three years.

In its response to the survey, Colombia's supervisory authority, Superfinanciera, reported that all 183 companies listed on the Bolsa de Valores de Colombia reported related party transactions in their most recent financial statements. The counterparts to most of these transactions are believed to be members of the same industrial or financial group. Of the 46 Mexican companies in the GMI sample from 2008, 46% reported significant RPTs within the past three years. Mexico's supervisory authority, CNBV, reported that the majority of RPTs among listed companies in its market are between companies in the same industrial or financial group, principally with companies with whom they consolidate financial statements. Many if not most such transactions involve purchases and sales of goods and services within the group. For the survey, CONASEV, Peru's supervisory authority, sampled the 40 most actively-traded companies on the Lima Stock Exchange and found that 35 of these reported RPTs in this past year's financial statements. Most such transactions involved purchases and sales of goods and services and inter-company loans. Two-thirds of the most actively-traded companies reported significant RPTs within the last three years.

3- FINANCIAL STATEMENT DISCLOSURE OF RPTS: APPLICATION OF IAS 24 AND LOCAL ACCOUNTING STANDARDS

International Accounting Standard 24 (IAS 24) requires that financial statements prepared under IFRS disclose any "transfer of resources, services or obligations between related parties," as such related parties are defined in the Standard[1]. Financial statements prepared under IFRS generally include a footnote detailing all the company's transactions that come within the ambit of IAS 24, indicating the identity of the counterparty, its relation to the company and the nature and value of the transaction. The logic of IAS 24 is that a reporting company's "financial statements [should] contain the disclosures necessary to draw attention to the possibility that its financial position and profit or loss may have been affected by the existence of related parties and by transactions and outstanding balances with such parties."

However, IAS 24 is an ex post disclosure rule. As a financial reporting standard, IAS 24 imposes no requirements for how RPTs should be scrutinized by a company's management, auditors, Board of Directors or shareholders. Nevertheless, by requiring ex post transparency of such transactions in financial statements, it encourages at least some level of ultimate market and/or shareholder scrutiny of dealings between the company and related parties.

In effect, five of the six countries that responded to the survey have adopted IAS 24 as the standard for reporting RPTs in the financial statements of public companies. Brazil, Chile and Peru have fully

[1] **See Annex 2** for a full summary of how IAS 24 defines related parties and related party transactions. In addition to IAS 24, adoption of IFRS also involves several other highly relevant standards. In particular, IAS 27, 28 and 31 require both a list and a description of the significant investments in subsidiaries, associates and entities under joint control. However, the consolidation perimeter for financial reporting purposes is not entirely coincident with the perimeter of a group (i.e. not all companies belonging to a group are included in the consolidated accounts).

converged to IFRS insofar as the application of IAS 24 is concerned.[2] Argentina's national accounting standards relating to the disclosure of RPTs in financial statements have been amended over time to conform for all practical purposes to IAS 24's requirements. Argentine listed companies will be required to present their financial statements in accordance with IFRS beginning in fiscal year 2012. Similarly, Mexico's current Financial Information Standard (NIF) C-13 fully conforms to IAS 24, and Mexican non-financial public companies will be required to prepare their financial statements in accordance with IFRS beginning next fiscal year.[3]

While Colombian national accounting standards are gradually converging to IFRS, they currently differ significantly from IAS 24 in establishing a 10% beneficial ownership threshold for determining whether a person or entity falls within the definition of "related party". Colombia's numerical threshold contrasts sharply with IAS 24's more principles-based "significant influence" test for determining whether a shareholder should be considered a "related party".

4- REQUIREMENTS FOR IMMEDIATE DISCLOSURE OF RPTS UNDER CORPORATION AND SECURITIES LAWS

The legal/regulatory frameworks of the countries surveyed differ significantly with respect to requirements for certain RPTs to be disclosed immediately to the public and/or the supervisory authority ("material event disclosure"). The laws and regulations of Brazil, Chile and Peru leave to the general materiality standards of the corporations and securities laws the determination of whether an RPT is significant enough to merit immediate disclosure.[4] However, the respondents from Argentina, Colombia and Mexico reported that their frameworks provide specific criteria for when an RPT must be immediately disclosed to the market.

Amendments to Argentine law in 2001 (Decree 677/01, incorporated into Law 17,811) impose responsibility on listed companies to disclose to the supervisory authority (CNV) and the public RPTs that meet the following criteria:

(1) The transactions are with individuals and legal persons having "control or significant participation" in a company, defined as those with 35% or more of the share capital, who can otherwise elect one or more directors to the board, or who are parties to a

[2] Chile's SVS issued an official circular (No. 595; April 8, 2010) setting forth certain minimum standards of disclosure in notes to financial statement prepared in accordance with IFRS, including the types of information expected to be published with respect to RPTs.

[3] It is noteworthy that in addition to complying with IAS 24 (starting in 2012), Mexican companies must disclose in their annual reports all RPTs for the previous three years, including in particular transactions with companies in which the issuer is a 10% shareholder and with holders of 10% or more of the issuer's shares.

[4] It is important to recognize that the rules of Brazil's Novo Mercado and Special Corporate Governance Listing Segment 2 (to which a majority of Brazilian listed companies by market capitalization have voluntarily acceded) require a company to inform the public and the exchange immediately of any transaction with a related party in value equal to or in excess of R$200,000 (US$114,000) or 1% of shareholders' equity, whichever is greater.

shareholder agreement that creates a group of shareholders with the power to elect one or more directors or otherwise directly affect the governance and management of the company ; and

(2) The acts or agreements are for a "relevant amount", defined as 1% of corporate capital (as measured on the company's last published balance sheet) and at least A$300,000 (US$60,000).[5]

Accordingly, the definition of "related parties" for material events disclosure in Argentina is generally narrower than that of IAS 24 (and Argentine accounting standards); i.e., many transactions that have to be included in the financial statement notes need not be the subject of material event disclosure.

Unlike Argentina, Colombia's legal/regulatory framework does not include a separate, more lax, definition of "related party" for purposes of determining when material event disclosure is required in respect of an RPT. The same definition of "related party" as is used for financial reporting serves. However, Colombian law does provide certain thresholds for RPTs below which immediate disclosure is not ordinarily required. Only transfers of goods or services representing 5% of the assets of the company, guarantees of obligations equal to or exceeding 1% of assets, and loans representing 10% or more of assets must be immediately disclosed to the market.

Mexico's securities law regime imposes an obligation on listed companies to immediately disclose an RPT whose amount is equal to or exceeds:

(1) 5% of assets, liabilities or consolidated capital; or
(2) 3% of consolidated sales in the previous year.

This rule explicitly does not exempt companies from the obligation to make immediate disclosure of transactions that do not meet either of the above thresholds, but which nonetheless should be regarded as material.

5- DISCLOSURE OF AFFILIATIONS AND POTENTIAL CONFLICTS OF INTEREST OF BOARD MEMBERS AND SENIOR EXECUTIVES

The legal/regulatory frameworks of all six countries include requirements concerning disclosure by directors (and officers) of potential conflicts of interest. However, these requirements vary in their detail. Directors of Argentine listed companies (and the shareholders who elect them) must disclose their relationship to controlling shareholders and whether the directors meet the criteria for independence. These disclosures are publicly available through the CNV's on-line Financial Information Highway. The Brazilian respondent to the survey noted that its new on-line issuer disclosure form (Formulário de Referência) requires officers and directors to make public their current and past employment positions and family relations. This information is repeated in the information presented to shareholders in advance of election of directors. The applicable laws of Argentina, Brazil, Chile, Mexico and Peru provide that directors and officers who have a direct or indirect interest in a transaction under consideration by the

[5] Argentine listed companies are also required to similarly disclose transactions with officers, directors and members of the statutory audit board.

company must immediately inform the Board (or in the case of Chile, the committee of directors) and absent themselves from discussions on such transaction.

In addition to the disclosure requirements referred to above, the insider-trading provisions of the laws of most or all respondent countries require that upon taking their positions, directors and officers of the company must disclose their shareholding in the company, its affiliates or companies under common control, and periodically update such information. Brazil's law also provides that if 5% or more of the shareholders so request, officers may be required to disclose any transactions in securities, compensation or other benefits received in the preceding year from the corporation, its affiliates or any company under common control.

6- THE ROLE OF THE BOARD IN RPTS: DUTY OF LOYALTY AND DUTY OF CARE.

Directors' duties of loyalty and care are embedded in the legal/regulatory framework of all six countries that responded to the survey. These duties derive from national corporations laws, and in the case of Mexico, also from the recently enacted capital markets law. As applied to RPTs, the duties of loyalty and care generally require: (1) that a director always place the interests of the company and all its shareholders ahead of his/her own interests or those of any particular shareholder; and (2) that a director exercise due care to ensure that the company is not disadvantaged by a transaction with a related party. Some form of "business judgment rule" prevails in all six jurisdictions, protecting officers and directors from challenges in the courts or by the supervisory authorities for decisions made in good faith, in the absence of conflicts of interest, and in a manner reasonably believed by such officers and directors to be in the best interests of the company.

All six respondents to the survey reported that while the statutory duties of loyalty and care as applied in their jurisdictions have general application to how Boards address the challenge of RPTs, such duties do not in and of themselves prescribe what processes and procedures Boards must follow in reviewing such transactions. However, the duty of loyalty almost certainly implies that at a minimum a director must disclose his or her interest in any transaction under consideration by the company and not participate in any board vote concerning such transaction.

Brazil and Colombia appear to be the respondent countries whose approach to RPTs rests most exclusively on interpretation of the general fiduciary duties of directors. Colombian law and regulation impose no special requirements on when a Board must review RPTs or what procedures should be followed. Similarly, Brazilian corporations and securities laws include no specific statutory provisions requiring Board review of RPTs. However, in 2008, Brazil's CVM issued guidelines (Parecer de Orientação 35; hereinafter referred to as Orientation Guideline 35) with respect to how directors can fulfill their fiduciary duties in cases of RPTs in the context of mergers and acquisitions involving parent companies and their subsidiaries, or companies under common control. The guidelines lay out a series of fourteen practices, which while not mandatory in all cases, are in the view of the CVM consistent with the exercise of directors' duties of loyalty and care. These practices include, inter alia: immediate disclosure of negotiations consistent with the legitimate requirements of confidentiality; consideration of alternative strategies less susceptible to abuse of minority shareholders (such as tender offers for the acquisition or for exchange of shares); independent appraisals / fairness opinions; and full documentation and disclosure of the deliberations and rationale for the final decision of the board of directors. In addition, the CVM recommends that an independent committee be set up to negotiate the transaction in accordance with the

guidelines and that the transaction be submitted for the approval of the unconflicted shareholders (majority of minority rule).

7- THE ROLE OF THE BOARD ON RPTS: STATUTORY/REGULATORY REQUIREMENTS FOR REVIEW AND APPROVAL

In contrast to Brazil and Colombia, the legal/regulatory frameworks of Argentina, Chile, Mexico and Peru include specific, detailed provisions governing when and how a Board of Directors of a company must review an RPT to determine that its terms are consistent with the market and that the transaction does not disadvantage the company or minority shareholders. Argentine and Chilean laws appear to provide the greatest specificity with respect to the procedures a Board should follow in reviewing an RPT.

Argentina's regime is distinctive in that on its face it does not directly require Board review of any RPT. However, if an RPT is not reviewed and approved by the Board and is subsequently challenged in court by a shareholder, the company and its directors bear the burden of proving that the transaction was at market conditions and benefited the company. Unless the company and directors can affirmatively meet this standard of proof, they will be liable to the shareholders for any losses. On the other hand, if the Board does review and approve the transaction (or if it is approved by the shareholders as described below) the burden of proof shifts to the aggrieved shareholder to show in court that the transaction was not at market conditions and was detrimental to the company. In practice, this shifting of the burden of proof is a very strong incentive for Argentine Boards to formally review material related party transactions.

As for the procedure that Boards should follow, Argentine law permits the Board or any of its members to require the Audit Committee of the Board to determine whether the terms of an RPT are consistent with "normal and usual market conditions". The Audit Committee is then required to decide within five calendar days and may request a report (fairness opinion) of two independent appraisal firms. The Board and Audit Committee are required to then report their determination and disclose the appraisers' valuations to the shareholders within one day of approving the RPT. The vote of each of the directors is required to be recorded in the Board's minutes.

Since the 2009 amendments to Chile's corporations and securities laws, the "Committee of Directors" of the Board has been explicitly charged with initial responsibility for scrutinizing RPTs. (This committee, which must include at least one independent director as Chair and which must be made up of a majority of independent directors if the Board has more than one independent director, is also charged with other Board tasks felt to require special scrutiny, including approval of the financial statements and adequacy of the external audit. When independent directors do not comprise a majority, the Chair may also select the other members of the board to serve on the Committee of Directors. In practice, it is an Audit Committee-plus.) Chilean law does not provide a threshold amount below which an RPT is exempt from the rule. However, all operations of value exceeding UF 20,000 (approx. US$937,000) or 1% of net assets are always subject to it. The Board may as a general policy provide that transactions that exceed neither 1% nor UF 2,000 require no case-by-case review by the Committee of Directors or the Board. How RPTs in value exceeding UF 2,000 but still below 1% of net assets are to be reviewed and approved is subject to the discretion of the Board on a case-by-case basis. The Board may also define operations that are in the company's ordinary course of business that will be exempt from case-by-case review. When review is required, the Committee of Directors must opine on the transaction's fairness and benefit to the company, and may consult appraisers and experts. After review by the Committee of Directors, the RPT must be

approved by an absolute majority of those Board members who do not have an interest in the transaction (however interested directors may be consulted).

Like the Argentine and Chilean legal / regulatory regimes, Mexico's capital markets law and regulations provide that, subject to certain important exemptions,[6] RPTs must be approved by the Board after review by a committee entirely composed of independent directors (in the Mexican case, the Governance Committee).[7] The Governance Committee is required to secure an independent appraisal and submit it, and the committee's recommendation to the full Board for consideration before the Board approves the transaction. Unique among the countries responding to the survey, Mexico charges another Board committee, the Audit Committee, with responsibility for ensuring that the procedure just described is followed.

Peru's securities law, like Argentina's in practice, provides that RPTs with certain parties and that meet a size threshold are required to be approved by the company's Board. RPTs that require Board approval include those that:

(1) Are conducted with officers, directors or holders of more that 10% of the company's shares; and
(2) Represent more than 5% of the company's assets.

Directors affiliated with the RPT counterparty or otherwise conflicted may not participate in the approval process. In addition, if the company and the related party are under common control (e.g., members of a financial or industrial group), then an independent appraiser must be contracted.

8- THE ROLE OF BOARD COMMITTEES AND INDEPENDENT DIRECTORS IN REVIEW OF RPTS

As noted in the previous section, the legal/regulatory regimes in Argentina, Chile and Mexico provide for an initial review of RPTs by a Board committee. In all three cases, the Board committee in question must be composed of at least a majority of independent directors (i.e., directors who are not affiliated with management or controlling shareholders).[8] Since Brazilian law does not explicitly require Board approval of RPTs, there are no statutory requirements for committee or independent director review of such transactions. However, as noted above, through Orientation Guideline 35, the CVM has taken the position that review of RPTs by an independent committee may be required for board members to carry out their fiduciary duties in respect of such transactions. It is important to note that such an independent committee

[6] The Board of a Mexican listed company may issue policies to exempt from governance committee review and Board approval RPTs whose size is below 10% of assets, as well as transactions with subsidiaries in the ordinary course of business supported by independent appraisals.

[7] The Governance Committee of the Board of a Mexican listed company must be composed entirely of independent directors unless the company is a 50% or more subsidiary of another company, in which case only a majority of independent directors is required (to the extent this circumstance is disclosed).

[8] As noted above, Chile's Committee of Directors must have a majority of independent directors if the Board has more than two such directors. Where the Board has only one independent director, the independent director must serve as chair and has the power to select the Committee's other members.

may be composed of: (a) directors, a majority of whom are independent; (b) independent non-Board members, if such a committee is provided for in the company's by-laws; or (c) one member selected by management, one selected by minority shareholders, and the third chosen jointly by the first two.

The respondents from Colombia and Peru reported no special role for committees in the legal/regulatory framework for review of RPTs in their jurisdictions. However, Colombia noted that its national corporate governance code recommends that RPTs be reviewed by an Audit Committee composed of a majority of independent directors.

The respondents from all six reporting jurisdictions noted a few aspects of the current legal / regulatory framework that encourage the development of Boards capable of independent judgment. Argentina, Chile and Mexico require the intervention of special committees that must include at least two independent directors.[9] Chilean Corporate Law requires that listed companies permit cumulative voting, which in practice is what allows the country's large pension fund industry to elect directors to the Boards of many important companies. Colombian listed companies must have Board with at least 25% independent directors, with an Audit Committee made up of a majority of independent directors. Brazilian law does not require committees, but it allows minority shareholders to require cumulative voting and includes provision for minority shareholders representing 15% of voting shares or 10% of total capital (in the case of non-voting shares) to elect a Board member by separate ballot. In addition, the rules of Brazil's Novo Mercado and Special CG Listing Segment 2 (which together represent the bulk of market capitalization and trading volume) require 20% of directors to be independent. At least 25% of the members of the Board of Mexican public companies must be independent directors, and holders of 10% or more of the company's shares are entitled to nominate a director to the Board. The respondent from Peru noted that current regulation mandates cumulative voting.

9- SHAREHOLDER REVIEW AND APPROVAL OF RELATED PARTY TRANSACTIONS

As noted above, the Board (as opposed to shareholders) is charged with primary responsibility for review and approval of RPTs (when such is required) under the legal/regulatory regimes of all the countries responding to the survey[10]. However, the laws of several jurisdictions include provisions requiring shareholder review in certain exceptional circumstances.[11]

Argentina requires shareholder meeting approval of an RPT only if after consideration by the Board and the Audit Committee (and the receipt of two independent appraisals), no determination is made that the RPT is at market conditions. A shareholder meeting can then be convened to consider such RPT, with any shareholder with an interest in the transaction excluded from the poll. As in the case of Board

[9] See footnote 7 with respect to Chile.

[10] Superfinanciera's response to the survey noted that Colombia's voluntary code of best practices recommends that all material RPTs be reviewed and approved by the shareholders meeting. However no data was provided on how many companies follow this recommendation or how such companies implement it in practice.

[11] The corporations laws of all the jurisdictions surveyed provide that certain fundamental transactions must be approved by the shareholders' meeting, irrespective of whether they are RPTs. The by-laws of individual companies may enumerate additional sorts of transactions that are reserved for consideration by the shareholders.

approval, approval by the shareholders meeting reverses the burden of proof should a shareholder later challenge the transaction.

Brazil's legal regime for RPTs provides a number of entry points for shareholder intervention. Most corporate reorganizations, which are viewed by the CVM as the type of RPT with the greatest potential for shareholder abuse, must ultimately be submitted for shareholder meeting approval. Brazil's corporations law prohibits a shareholder from voting on a resolution in which such shareholder has a personal interest or on which he and the company have conflicting interests. It is the CVM's clear position (lately reaffirmed in the course of a CVM consultation made at the request of Tractabel) that where a shareholder is on the other side of a transaction with the company, such shareholder may not vote. However, in the case of an acquisition of a controlled company, the parent company may participate in the vote of the shareholders of the subsidiary, but in such cases the managers and directors of the subsidiary remain subject to the duties of loyalty and care, and Orientation Guideline 35 strongly supports the view that review and endorsement by a special independent committee or approval by the majority of the minority may, in practice, be required..

Unless it involves a transaction of a character required to be approved by shareholders regardless of whether it is an RPT, Chilean shareholders are only involved in the review of RPTs if the majority of the Board is conflicted or if because of a combination of conflicted directors and directors who decline to opine on the transaction, an absolute majority of the Board cannot approve the transaction. In such case, the opinions of the Committee of Directors and Board members are presented to the shareholders meeting, along with a report of at least one independent appraiser. According to the law as revised in 2009, a supermajority of 2/3 of outstanding shares is required to approve the transaction under such circumstances. Even in such cases, the law provides that shareholders may only approve the transaction if it is in the corporate interest, and at market prices and conditions at the time of the transaction. Presumably, this provides minority shareholders with a right of action against the majority.

Under Mexican law, all transactions (regardless of whether they are RPTs) equal to or in excess of 20% of a company's assets are required to be approved by the shareholders meeting (including holders of non-voting and restricted-voting shares). Interested shareholders are required to recuse themselves from voting (i.e., there is a "majority of the minority" requirement). However, interestingly, if a shareholders meeting approves such a transaction, holders of 20% or more of the company's shares remain entitled to challenge the resolution of the shareholders meeting, and an injunction can be ordered by a court, on the condition that the objecting shareholders post bond sufficient to cover any damages that may result if the transaction is ultimately deemed lawful by the court.

Similarly, Peruvian law requires that all transactions that exceed 50% of a company's capital can only be carried out after an affirmative vote of the shareholders meeting.

10- BOARD POLICIES AND VOLUNTARY PRACTICES

All of the survey respondents reported that there is no requirement in their jurisdiction that a Board of Directors have in place a policy on related party transactions. The countries with the most detailed provisions in law for Board review of RPTs, Argentina, Chile and Mexico, arguably leave little room for

Board policies on this subject.[12] Brazil's CVM listed several practices that some institutional investors have put forth as potentially effective ways to prevent RPTs that act to the detriment of minority shareholders, including charter provisions that require Board review and approval of RPTs over a certain threshold and codes of conduct that prohibit certain types of RPTs deemed of particular risk to minorities.[13] The respondent from Colombia noted that the country's voluntary national code of best practice recommends that material RPTs be reviewed by the Audit Committee, which should be made up of a majority of independent directors. The code also recommends that the Board approve a policy on receipt of external advice, including independent appraisers in the case of RPTs.

11- ENFORCEMENT: SCRUTINY AND POWERS OF THE SUPERVISORY AUTHORITY

As reported by all respondents, the predominant avenue for enforcement against abusive RPTs is scrutiny by the supervisory authority of the securities markets, and ex post enforcement mechanisms.

Among the respondents, Brazil's CVM seems to have the broadest arsenal of enforcement powers. Under its statute, the CVM can conduct investigations and initiate administrative proceedings in connection with illegal actions or inequitable practices by officers, directors, shareholders, and virtually any other party involved in a suspected abusive RPT in connection with a public company. The CVM has statutory authority, at its own initiative or at the petition of minority shareholders, to extend the notice period of a shareholders meeting, in the case of complex transactions that require additional time for shareholder consideration, or to suspend the calling of a shareholders meeting for up to 15 days in order to permit the submission by shareholders of their reasons for considering the transaction as improper. The CVM is also empowered to impose fines, suspensions and disqualifications against those it finds in violation of the legal / regulatory regime for RPTs. In addition, both the Federal Prosecutor's Office and the CVM may bring suit against such parties for damages caused to investors. Only an action brought by aggrieved private parties in court can result in the unwinding of an abusive RPT; however, the results of the CVM's investigations and administrative determinations can be taken into consideration by the court in reaching its judgment.

Based on their responses to the survey, Mexico's supervisory authority, CNBV, and Chile's, SVS, appear to also to have generally broad investigatory and sanctioning powers. They are empowered to investigate any violation of the capital markets laws and regulations and may impose administrative penalties against a broad array of wrongdoers.

Argentina's CNV does not have the power to prevent the execution of RPTs through an injunction. However, it is empowered to order rescission of a transaction if it determines that such was not carried out in accordance with the law. The CNV may issue warnings and impose fines on individual violators and/or

[12] However, Argentina's Corporate Governance Code, with which listed companies must comply or explain, does include provisions relating to the disclosure of RPTs and Board policies with respect to transactions with shareholders, officers, directors or member of the statutory auditor, or other companies in the same industrial or financial group.

[13] As noted earlier, the rules of Brazil's Novo Mercado and Special Corporate Governance Listing Segment 2 require a member company to inform the public and the exchange immediately of any transaction with a related party in value exceeding certain thresholds.

disqualify them for up to five years to serve as officers or directors of a public company. Argentine public companies may be prohibited from making public offerings for up to two years. While Colombia's supervisory authority may issue administrative penalties and fines if it finds a violation of law in connection with an RPT, its power with respect to the transaction itself is more circumscribed. Superfinanciera may neither enjoin nor reverse transactions, nor can it seek redress for shareholders, although its investigations may be used in subsequent civil suits by shareholders for damages. Peru's CONASEV has the power to issue injunctions on its own initiative or at the request of a shareholder.

12- ENFORCEMENT BY MINORITY SHAREHOLDERS; REMEDIES

Brazil's corporations law permits derivative actions, but these require approval of a majority of shareholders, which is usually impractical in the case of controlled companies. However, as an alternative, the law provides that holders of 5% or more of a company's shares may bring suit in their own right against directors. As noted earlier, the Federal Prosecutor's Office and the CVM can pursue compensation on behalf of minority shareholders.

Under Brazil's corporations law, controlling shareholders are liable to minorities for abuse of corporate powers, including for: actions that benefit another corporation to the detriment of minority shareholders of the company; liquidation of the company in order to obtain unfair advantage to the controllers or third parties to the detriment of the remaining shareholders; and RPTs (either directly or through third parties) on terms unduly unfavorable or inequity to the company. Although there is no specific cause of action prescribed for private actions against directors by shareholders, the latter can make claims for damages resulting from breach of fiduciary duty of the former under the general law of torts.

Chilean law does not provide a special cause of action for shareholders to seek redress for an RPT that is conducted on terms disadvantageous to them. Such actions may proceed under that general law of torts. The corporations law of Chile is explicit in providing that notwithstanding a violation of the requirements of law with respect to the approval of RPTs, a court may not order that such transaction be rescinded, leaving only financial compensation as the remedy for aggrieved minority shareholders.

Colombia is the only country among the respondents to the survey whose law provides for class action suits for damages resulting from violations of the corporations and securities laws. As a matter of black letter law, shareholders may even ask a court to order rescission of an improper and abusive RPT. However, Colombia's supervisory authority reports that no class action suit has yet been brought against officers or directors of a company alleging improper related party transactions.

Mexican law provides that private rights of action under the capital markets law against officers and directors can be brought either by the company itself, or by holders of 5% or more in the aggregate of the company's shares. As noted earlier, in the case of large transactions (20% or more of assets) where shareholder approval is required, dissenting holders representing 20% or more of shares can petition for injunction and judicial review of the transaction's fairness. However, in all other cases, interested parties may sue only for damages and may not request unwinding (rescission) of the transaction.

13- ENFORCEMENT IN PRACTICE: EXPERIENCE TO DATE

All the supervisory authorities responding to the survey reported that they had not collected data on private lawsuits relating to abusive RPTs. Accordingly, all the information on enforcement actions reported by respondents was in respect of actions undertaken by the authorities themselves against companies, their officer and directors. Of the six countries responding to the survey, Argentina, Brazil and Chile reported successful cases.

Argentina's supervisory authority cited two recent successful CNV enforcement actions relating to RPTs. One related to intercompany loans and the other to both sales of shares and a loan between a listed company and other companies under common control. In both cases (each resolved this year), CNV imposed fines on the company, Board members and managers for failure to issue timely material event disclosures.

As illustrations of the kinds of RPT-related situations it has investigated and successfully concluded, Brazil's supervisory authority reported one that involved failure to make a material events disclosure upon consummation of loan by a subsidiary to its parent (investor relations officer fined), and another where subsidiaries of a company were sold to the parent company's controlling shareholder at unfair conditions (fines and disqualification of persons involved).

Chile's SVS's enforcement actions in the area of RPTs have focused not on review of the substance of transactions but rather on failure to comply with the requirements of Board review and disclosure. SVS has successfully prosecuted cases in which relations between controllers, directors or officers and counterparties in transactions with the company were concealed (and therefore Board review of such RPTs did not occur). These administrative actions can give rise to subsequent civil suits by aggrieved shareholders seeking compensation for damages.

Colombia, Mexico and Peru reported no cases of public or private enforcement in recent years.

14- MARKET MECHANISMS AND SHAREHOLDER ACTIVISM

Most of the respondents to the survey did not report any special market mechanisms or instances of shareholder activism for the prevention of abusive related party transactions. The Brazilian response to the survey cited the efforts of institutional investors to encourage listed companies to include in their by-laws and codes of conduct provisions for independent review and approval of RPTs that exceed a certain size (and even outright prohibitions against transactions with certain types of related parties). The establishment of Conselhos Fiscais (statutory audit boards) by vote of minority shareholders, submission of complaints to the CVM and the Novo Mercado arbitration panel, and public name and shame campaigns were also mentioned as potential tools for shareholder activists. Brazil's association of capital market investors (AMEC) has yet to issue any special recommendations for the treatment of RPTs by listed companies.

15- AREAS FOR ATTENTION

Respondents varied widely in their reactions to the survey's question about which types of RPTs presented the greatest opportunity for abuse of minority shareholder rights.

- Argentina's supervisory authority reported that it is focusing its efforts in the area of related party transactions on investigating and prosecuting cases where companies fail to immediately disclose RPTs that meet the disclosure requirements of Law 17,811. These have all so far been cases involving transactions between members of the same industrial or financial group.

- Brazil's response to the survey indicated that the CVM is focusing its RPT supervision efforts mostly in connection with mergers and acquisitions involving controlling shareholders. In response to the survey, the CVM cited difficulties meeting the applicable evidentiary burden as an obstacle to more effective enforcement.

- Chile's response to the survey reflected SVS's greatest concern over RPTs involving transactions between companies of the same economic group.

- Colombia's Superfinanciera noted a prevalence of intra-group RPTs, but reported little concern that these have resulted in negative consequences for minority shareholders. However, the supervisory authority noted the difficulty of tracing the real beneficiaries of transactions can be an obstacle to effective public and private enforcement.

- Mexico's CNBV noted certain concerns with the enforcement of minority shareholder rights in connection with intra-group transactions.

- CONASEV reported no cases of RPT-related shareholder abuse in Peru, but noted that disclosure of RPTs has been incomplete and that Peru's adoption of IFRS is expected to have a positive impact.

16- ISSUES FOR DISCUSSION AND CONSIDERATION OF NEXT STEPS

Survey respondents and others have raised a range of concerns in relation to preventing abuse of related party transactions, but information is still lacking in the development of a better understanding of experience in this field and how these concerns can be most effectively addressed.

Questions that may merit further exploration, both during the Roundtable's discussion and through potential follow-up work on this issue among relevant experts include:

- How prevalent are related party transactions in different countries in the region (more specific data on the incidence of RPTs) and how vulnerable are they to abuse?

- Beyond the perspective of regulators, how widespread is the concern among minority shareholders, institutional investors or other stakeholders that such transactions are abusive?

- Are thresholds for when RPTs are required to be reviewed at board level set at appropriate levels? Considering the sharp variance of thresholds across Latin American countries, would there be benefit in seeking convergence towards a particular level?

- Considering the concerns expressed in particular about RPTs within industrial and financial groups, are more specific policies and regulatory requirements needed to address the special considerations related to intra-group transactions? Is greater transparency and enforcement attention needed for intra-group transactions, or rather greater flexibility because RPTs are a "normal" and beneficial part of company group business?

- What more could or should regulators do to try to ensure fair treatment of shareholders concerning related party transactions?

  – Offer guidance on appropriate procedures for board or shareholder review of RPTs?

  – Seek amendments to voluntary national corporate governance codes to promote best practices?

  – Review RPTs in certain cases with a view towards certifying whether they were undertaken under normal market conditions?

  – Require fairness opinions or provide authority for minority shareholders or independent directors to request such independent assessments?

- Is the legal / regulatory regime governing RPTs more effective when the supervisory authority has the power to pursue compensation for minority shareholders? Should supervisory authorities be given greater leeway to directly support efforts by minority shareholders to recover damages in cases of abusive RPTs?

- Is this an issue better left to market forces and private remedies (shareholder suits, alternative dispute resolution, voluntary best practice recommendations etc.)?

- Is there positive experience in the region (or elsewhere) with private enforcement remedies and jurisprudence in relation to abusive related party transactions that can be built upon?

Depending on the Roundtable's discussion and preliminary responses to these questions, the Roundtable may consider establishing a task force with broader membership to explore these issues and questions in greater depth through meetings and electronic discussions over the course of 2012.

ANNEXES

ANNEX 1: COMPARATIVE OVERVIEW OF LATIN AMERICAN COUNTRY FRAMEWORKS FOR RPT REVIEW

	Financial Statement Disclosure	**Material Event Disclosure**	**Board Review Thresholds**	**Committee Review**	**Shareholder Review**	**Majority of Minority Requirement**	**Supervisor's Powers**	**Private Rights of Action**
Argentina	Local GAAP conforms to IAS 24[14]	35% shareholders; A$300K (US$60,000)	None; but Board review reverses burden of proof	Audit Committee	Only if Board does not approve	Yes	May not enjoin; may reverse RPTs	
Brazil	IFRS /IAS 24	General materiality standards	None	Special Committees[15]	In cases of corporate reorganization	Yes (except in case of acquisition of controlled company by parent company)	May postpone shareholder meetings; can seek compensation for injured parties	By derivative action or by 5% of shareholders
Chile	IFRS/IAS 24	General materiality standards	RPTs above UF 20K (US$937K) or 1% of assets	Committee of Directors	Only if Board does not approve	No, but 2/3 majority required		Shareholders may sue only for damages
Colombia	Local GAAP 10% beneficial	As percentage of assets: sales 5%;	None	Not required	Not required	n/a	May not enjoin or reverse RPTs	Class actions permitted; may request reversal of

[14] Argentine and Mexican listed firms will follow IFRS beginning in 2012.

[15] CVM Orientation Guideline 35 indicates that review by a special committee (which need not be a committee of the Board) may be required for compliance with the Board's fiduciary duties.

	ownership threshold	guarantees 1%; loans 10%						RPTs
Mexico	Local GAAP conforms to IAS 24[14]	5% of assets, liabilities or capital; 3% of sales	RPTs above 10% of assets	Governance Committee	In all transactions in excess of 20% of assets[16]	Yes		By derivative action or by 5% of shareholders; may sue only for damages
Peru	IFRS/IAS 24	General materiality standards	RPTs with 10% shareholders and 5% of assets	Not required	In all transactions in excess of 50% of assets[16]		May enjoin RPTs	

[16] Regardless of whether such transactions are RPTs.

ANNEX 2: SUMMARY OF IFRS IAS 24 DEFINITION OF RELATED PARTIES AND RELATED PARTY TRANSACTIONS FOR FINANCIAL DISCLOSURE

Objective of IAS 24

The objective of IAS 24 is to ensure that an entity's financial statements contain the disclosures necessary to draw attention to the possibility that its financial position and profit or loss may have been affected by the existence of related parties and by transactions and outstanding balances with such parties.

Who Are Related Parties?

A related party is a person or entity that is related to the entity that is preparing its financial statements (referred to as the 'reporting entity') [IAS 24.9].

- (a) A person or a close member of that person's family is related to a reporting entity if that person:
  - (i) has control or joint control over the reporting entity;
  - (ii) has significant influence over the reporting entity; or
  - (iii) is a member of the key management personnel of the reporting entity or of a parent of the reporting entity.
- (b) An entity is related to a reporting entity if any of the following conditions applies:
  - (i) The entity and the reporting entity are members of the same group (which means that each parent, subsidiary and fellow subsidiary is related to the others).
  - (ii) One entity is an associate or joint venture of the other entity (or an associate or joint venture of a member of a group of which the other entity is a member).
  - (iii) Both entities are joint ventures of the same third party.
  - (iv) One entity is a joint venture of a third entity and the other entity is an associate of the third entity.
  - (v) The entity is a post-employment defined benefit plan for the benefit of employees of either the reporting entity or an entity related to the reporting entity. If the reporting entity is itself such a plan, the sponsoring employers are also related to the reporting entity.
  - (vi) The entity is controlled or jointly controlled by a person identified in (a).
  - (vii) A person identified in (a)(i) has significant influence over the entity or is a member of the key management personnel of the entity (or of a parent of the entity).

The following are deemed not to be related: [IAS 24.11]

- two entities simply because they have a director or key manager in common
- two venturers who share joint control over a joint venture
- providers of finance, trade unions, public utilities, and departments and agencies of a government that does not control, jointly control or significantly influence the reporting entity, simply by virtue of their normal dealings with an entity (even though they may affect the freedom of action of an entity or participate in its decision-making process)
- a single customer, supplier, franchiser, distributor, or general agent with whom an entity transacts a significant volume of business merely by virtue of the resulting economic dependence

What Are Related Party Transactions?

A related party transaction is a transfer of resources, services, or obligations between related parties, regardless of whether a price is charged. [IAS 24.9]

Disclosure

Relationships between parents and subsidiaries. Regardless of whether there have been transactions between a parent and a subsidiary, an entity must disclose the name of its parent and, if different, the ultimate controlling party. If neither the entity's parent nor the ultimate controlling party produces financial statements available for public use, the name of the next most senior parent that does so must also be disclosed. [IAS 24.16]

Management compensation. Disclose key management personnel compensation in total and for each of the following categories: [IAS 24.17]

- short-term employee benefits
- post-employment benefits
- other long-term benefits
- termination benefits
- share-based payment benefits

Key management personnel are those persons having authority and responsibility for planning, directing, and controlling the activities of the entity, directly or indirectly, including any directors (whether executive or otherwise) of the entity. [IAS 24.9]

Related party transactions. If there have been transactions between related parties, disclose the nature of the related party relationship as well as information about the transactions and outstanding balances necessary for an understanding of the potential effect of the relationship on the financial statements. These disclosure would be made separately for each category of related parties and would include: [IAS 24.18-19]

- the amount of the transactions

- the amount of outstanding balances, including terms and conditions and guarantees
- provisions for doubtful debts related to the amount of outstanding balances
- expense recognised during the period in respect of bad or doubtful debts due from related parties

Examples of the Kinds of Transactions that Are Disclosed If They Are with a Related Party

- purchases or sales of goods
- purchases or sales of property and other assets
- rendering or receiving of services
- leases
- transfers of research and development
- transfers under licence agreements
- transfers under finance arrangements (including loans and equity contributions in cash or in kind)
- provision of guarantees or collateral
- commitments to do something if a particular event occurs or does not occur in the future, including executory contracts (recognised and unrecognised)
- settlement of liabilities on behalf of the entity or by the entity on behalf of another party

A statement that related party transactions were made on terms equivalent to those that prevail in arm's length transactions should be made only if such terms can be substantiated. [IAS 24.21]

Source: IASPlus web site sponsored by Deloitte: see http://www.iasplus.com/standard/ias24.htm