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Corporate Governance in Brazil
- An International Trade Union Perspective

A Hans-Böckler-Foundation research paper
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Table of contents:

Tables and figures

This literature review analyses the corporate governance regime in Brazil from an international perspective. It is the latest in a series of HBS-TUAC discussion papers in the same policy area: Workers' Voice in Corporate Governance – A Trade Union Perspective (2005)[1]; World Bank Approach to Corporate Governance (2006); Corporate Governance in Sweden (2008); and Pension Fund Investment in Private Equity (2008).

The review has consisted of screening the Brazilian corporate governance system using the policy framework set out in TUAC 2005 report "Workers' Voice in Corporate Governance – A Trade Union Perspective"[1]. The framework proposes two complementary approaches to addressing workers' rights in corporate governance:

- worker participation and representation within the company (including rights to representation in the governing bodies), and
- the stewardship of workers' capital invested in equity via their savings in pension funds.

The report is structured in the following parts.

Section one discusses the concept of corporate governance in an emerging economy, before comparing the World Bank-inspired "shareholder value" model for reform with the stakeholder approach, which has been set out in the TUAC framework of 2005 among others.

Section two reviews the characteristics of the ownership structure of Brazilian companies, which is heavily concentrated and under tight family control and looks at how the debt crisis of the 1980-1990s and the following IMF-supported privatisation reforms reinforced those patterns.

The third section analyses the reforms and self-regulatory initiatives that took place in 2001 – reform of the corporate law, creation of voluntary stock exchange listing requirements or 'segments', which proved to be a defining moment in the history of Brazilian corporate governance.

Section four outlines the main elements of the current corporate governance regime based on the corporate law of 2001. Chapter five describes labour rights and worker participation mechanisms. Finally, chapter six reviews pension funds and the prospects for development of shareholder activism in Brazil. Issues for further discussion are set out in the conclusions.

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1 TUAC 2005.

Introduction

1. From 2004 until the beginning of the global economic crisis in 2008, Brazil has been through an exceptional economic cycle of low-inflation economic growth (4.6% annually on average). While economic growth was initially fuelled by exports and external demand, in 2005 the economy saw a welcome rise in domestic household demand and in corporate investments. That helped diversify the country's sources of growth and reduce its over-reliance on international trade and finance. The Brazilian economy has proved to be one of the most resilient to the crisis.

2. The broader international context prior to the crisis contributed to the Brazilian success. As was the case for other emerging economies, Brazil benefited from low interest rates and hence the lower cost of capital to finance the economy while keeping inflationary pressures – a recurrent risk in Brazil – under control. The reduction in the spread between the interest rate levels of the domestic long-term debt market with those of global markets – that is the country's risk premium – helped revive the market for dis-intermediated corporate finance – primary and secondary markets for listed equity and corporate bonds – compared to bank intermediation (credit financing). The rise of the capitalisation of the *BOVESPA*, the country's main stock exchange, was exceptional between 2005 and 2008. Before the global crisis erupted, 30 new companies had listed during the first half of 2007, compared to 26 in 2006, 9 in 2005 and 7 in 2004. Foreign investors contributed significantly to this growth, comprising approximately 12% of the BOVESPA market capitalisation end of 2007. The number of individuals holding shares listed on the stock exchange (compared to corporate and institutional investors) increased dramatically from 85,000 in 2002 to over half a million by the end of 2009, signalling that direct share ownership is increasingly popular among Brazilian households

3. Importantly for the country's monetary sovereignty, the structural change in recent years in the current account balance from USD-denominated government debt securities to Brazilian-currency-denominated equities has meant that the currency risk has been transferred to foreign investors. The Brazilian economy is therefore less exposed to abrupt changes in currency exchange rates that are unrelated to economic fundamentals and hence has more predictable access to finance. And while Brazil has suffered the effects of the financial crisis since the end of 2008, it has proved to be more resilient than most OECD economies.

4. However, the country's current account surplus – which is something new given the country past financial instability – has resulted in an appreciation of the national currency against the background of massive global currency imbalances, particularly between the USD and the Chinese Yuan on the one hand, and the Euro on the other. Ironically, it is the continuing appreciation of the Brazilian currency, which is now threatening the competitiveness of the national economy. This has been aggravated by the recent surge of capital inflows. The government has introduced new restriction to foreign capital flows taking the form of a 2% tax on all portfolio inflows.[2]

2 Brazil taxes foreign portfolio flows, FT, 20 October 2009

5. The growing role played by capital markets in general, and by primary equity listings in particular, has reflected a series of corporate governance reforms and initiatives. Prior to the election of Luiz Inácio Lula da Silva end of 2002 and – it is argued in this paper – in anticipation of his election, important changes were made to the corporate governance framework:

- In 2001 the corporate law N°6.404 of 1976 (*Lei das Sociedades Anônimas*) was amended (Law 10.303);
- That same year a set of voluntary corporate governance stock exchange listing requirements were introduced, the *Novo Mercado;*
- Stronger listing regulation and enforcement rules were implemented in 2002-2008 by the stock exchange authorities, the *Comissão de Valores Mobiliários* (CVM);
- In 2005 a new bankruptcy law was introduced (*Nova Lei de Falências e Recuperação de Empresas*, Law No. 11101);
- Since 2001 greater efforts were made to increase awareness of governance and transparency practices by the IBGC the Brazilian Institute of Corporate Governance.

6. Financial stabilisation, diversification of corporate finance and corporate governance reforms all helped to prevent Brazilian companies from relocating to more shareholder friendly jurisdictions and global regulatory competition. In the 1990s there were concerns that the country's perceived weak regulatory environment would force companies to relocate to OECD jurisdictions, and to the US in particular, in order to obtain better corporate finance conditions, as was seen in the rise of American Depository Receipts. That did not happen and since 2002 the vast majority of Brazilian companies that raised equity capital to finance their future growth did so on the *BOVESPA*.

7. And yet, stabilising the country's access to global finance came at economic and social costs. The IMF-inspired stabilisation policy in the second half of the 1990s prompted waves of de-regulation of investment flows and privatisation, cuts in the country's public pension systems and a transfer of ownership of the economy to foreign investors.

8. The election of Lula as President of the Republic end of 2002 and the new majority rule by his party, the *Partido dos Trabalhadores* (PT), put social inclusion back on the government agenda. Lula and the PT political platform aimed to achieve a "moralization of capitalism" by curbing speculation and short-termist behaviour. The objective was to help channel corporate finance toward productive and employment-generating activities. Measures included support for micro-credit and the active stewardship of public financial institutions such as the state-owned National Bank for Social and Economic Development (BNDES). The Lula government programme for more "responsible capitalism" aimed to reform pre-funding pension schemes so as to increase coverage of the population. While the Brazilian labour movement had been working to improve the governance of pension funds long before Lula came to power, it was under his Presidency that trade union representation on pension boards and promotion of active and responsible investment policies became stand-alone public policy objectives. With the support of the labour movement, particularly in the banking and energy sectors, government policy has given shape to what is in effect a workers' capital strategy.

9. However, and despite the many achievements and progressive reforms enacted by the Lula government since 2003, Brazil remains a country where "three meals a day is still something of the future […] for a lot of people"[3], where half of the workforce earn their

3 President Lula at the Climate Change Summit in Copenhagen http://en.cop15.dk/news/view+news?newsid=3053

livelihood remains in the informal economy, where trade unionists' lives are at risk, and where inequality within society generally and between regions remains high compared to other large emerging economies[4]. High degrees of corporate ownership, and therefore corporate power, in the hands of a few, very rich families, high levels of inequality and a large informal sector have all combined to prevent the private corporation from becoming a wealth creating institution for society at large. Terms like "corporate governance" and "shareholder value" are far from being associated with progressive forces and human development. Successive corporate law reforms and measures, not least the 2001 reform, have failed to tackle the very unequal distribution of power in the Brazilian corporate sector.

10. Within that context, and looking specifically at the corporate governance aspect of the Brazilian economy, this paper argues that there is a need to strengthen the regulatory framework for the private sector and establish a corporate governance system that reflects and protects the investments of and exposure to firm-specific risk of all corporate constituencies: shareholders, creditors, workers, local communities and, last but not least, the public and taxpayers.

I. Corporate governance in an emerging economy context

11. Corporate governance is a concept that has many definitions. The concept can be defined in very broad terms: corporate governance addresses the way private companies are "directed and controlled" (Cadbury 1992), "involves a set of relationships between a company's management, its board, its shareholders and other stakeholders [and] provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined" (OECD 2004). In an emerging economy context the concept of corporate governance to a large extent has been framed by the international financial institutions, the World Bank and its private sector arm the International Financial Corporation (IFC) as being to ensure access to long-term international finance at reasonable cost for the economy and the private sector in particular[5]. Accordingly corporate governance is seen as the transmission tool between global capital markets on one side and economic development of the domestic private sector on the other. Its aim is to enhance local capital-markets – primary and secondary listed equity, corporate bonds – to lower the cost of capital and access to corporate finance.

Governing the firm as if only providers of capital mattered

12. This focus on reducing the cost of capital as the primary goal of corporate governance has implications for the organisation of the economy at large. The objective of developing open and competitive capital market prioritises the interests of one stakeholder: the private investor holding corporate debt (the creditor) or equity (the shareholder). For one World Bank expert, for example, "Corporate governance can be defined in many ways. <u>Most often</u> it refers to the structure, rules and institutions that determine the extent to which managers act in the best interest of shareholders". (CLAESSENS 2003). Hence, corporate governance policy dialogue as envisioned by the World Bank and the IMF in emerging economies has been

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4 World Development Indicators 2009, World Bank, http://hdrstats.undp.org/fr/indicators/161.html

5 see section "Why Corporate Governance Matters for IFC Clients?" in http://www.ifc.org/ifcext/corporategovernance.nsf/Content/WhyCG & "A Corporate Governance Approach Statement by Development Finance Institutions", October 19th 2007 http://www.ifc.org/ifcext/corporategovernance.nsf/Content/DFI_Statement

driven to promote and secure long lasting rights for shareholders and creditors be it domestic or foreign-based – including by regulatory reforms that have shielded regulation and supervisory authorities from any political change of government.

13. Within a World Bank framework the primary need to protect shareholders' interests is based on the separation of ownership (shareholders) and control (managers). Such separation is a pre-requisite for good corporate governance in so far as it helps to discipline top management in terms of maximising the interests of all shareholders, not just the most powerful ones. Tying management to the common interests of all shareholders maximises the value of the share, adds confidence that the staff will maximise profits that drives efficiency of the company, the private sector as a whole, and thereby the economy. Formal separation of ownership and control is facilitated when all shareholders enjoy the same rights vis-à-vis the company, for example: ensuring "one share one vote" principle at the AGM or simplified corporate structures that avoid pyramid networks of holdings and subsidiaries. In absence of such separation, it is likely that the controlling shareholder will have discretionary powers over the company. Top management that is accountable to, and acts in the sole interest of a single shareholder – such as the founding family – is likely to under-perform because there will always be the suspicion that corporate decisions are taken to serve the interests of the controlling families, and not those of shareholder value, which encompasses the interests of the markets and thereby the efficiency of the economy.

Protecting minority shareholders against expropriation by the controlling shareholder

14. A controlling shareholder with influence over the company can expropriate the company's assets in a number of ways, including:

- (i) self-granting of 'excessive salaries' and other remuneration;
- (ii) nomination of executive positions based on family or related party criteria (nepotism) rather than competence;
- (iii) purchase or sale of assets or of shares of the company either well above or well below market prices;
- (iv) insider trading;
- (v) use of the company's assets for personal use or commercial use (e.g., using the company's assets as collateral to cover credit default risk of personal transactions or to obtain advantageous personal access to credit);
- (vi) lower level dividend proceeds (granted to all shareholders) which is compensated by discretionary transfer of funds to the controlling shareholder;
- (vii) corporate management denying access to information, if not physical access to the companies premises or AGM to minority shareholders.

15. The absence of protection of minority interests – it is feared by the World Bank – hampers the influence of "market discipline" on top management, who in turn will be less receptive to signals from capital markets in determining, implementing and adjusting the corporate strategy. The result is the existence of "sub-optimal managerial practices", lower valuation of shares, higher cost of capital and less favourable access to corporate finance, inefficient allocation of capital and, ultimately, lower economic growth.

The World Bank 'LLSV' regulatory reform programme

16. The theoretical foundation of the World Bank's drive to protect minority shareholders interest in the developing and emerging economies is the 'LLSV' framework developed by La Porta, Lopez-de-Silanes, Shleifer and Vishny in 1998 (LLSV 1998). The main policy conclusion brought by LLSV is that "law matters". It is formal public binding regulation that ultimately protects minority shareholders and hence ensures more efficient capital markets and higher economic growth. Based on surveys covering over one hundred jurisdictions, the LLSV finds that the greater the number of formal enforceable rules that exist in favour of minority shareholder, then the better off are the capital markets and the economy. The other key message of the LLSV is that not all types of legal regime are equal and in particular that common law systems – Anglo-American jurisdictions – are inherently superior to civil law – the French system, to which Brazil belongs – and to some extent German (incl. Japanese) and Scandinavian systems. Jurisdictions that offer weak formal shareholder rights and protection among which civil law regimes are over-represented are, according to the LLSV, likely to have ownership concentration with a pre-eminence of controlling shareholders, which are a sign of financial underdevelopment. The LLSV has been revised since 1998, giving rise to a literature that aims to prove the link between the concentration of voting rights in the hands of the largest (controlling) shareholder and sub-optimal operating results and valuation of the company. It is also used as the justification for the World Bank's Investor Protection Index in its annual "Doing Business" publication[6].

17. A number of academics have criticised the LLSV on methodological grounds. The first series of objections relates to the policy conclusion that only formal laws matter. Functional equivalence in legal rules, such as private arrangements, informal relationship and practices, and other extra legal institutions can substitute for formal law in granting protection of minority shareholders in the US (COFFEE 2000) and in Continental Europe (COOLS 2004). This point about functional equivalence is key to the OECD framework – and is perhaps the only issue on which the OECD departs from the World Bank position. The OECD stresses that effective implementation of its Principles of Corporate Governance should place "emphasis on outcomes and, therefore, on functional equivalence. By the latter is meant that there are many different ways, institutions, laws etc, for achieving the outcomes advocated by the Principles. Thus, it is recognised in the preamble to the Principles that implementation needs to be adapted to national circumstances. For example, the protection and enforcement of minority shareholder rights might be achieved via private arrangements, such as by majority shareholders agreeing to restrict the use of their powers to appoint the whole board, special investigation procedures and/or class enforcement procedures. Many of these perhaps imperfect alternatives are deeply rooted in legal and social traditions." (OECD 2006).

Monitoring family-controlled companies

18. Empirical studies have not supported the hypothesis that ownership concentration, which gives a free hand to controlling shareholders and typically the founding family, leads to expropriation and lower firm valuation and/performance. In continental Europe, research reached the opposite conclusion, finding a positive relationship between family control and firm value and operating performance (BARONTINI et al 2005). In the US, a more nuanced outcome has been suggested: the risk of expropriation can be overcome with appropriate safeguards, such as independent directors on the board that help minority shareholders

6 http://www.doingbusiness.org/MethodologySurveys/ProtectingInvestors.aspx

monitor the controlling family in exercising supervision over the company (ANDERSON et al 2003).In the case of Brazil, the results are also mixed. Ownership concentration does not influence either the financial performance or value of the companies, nor the extent to which corporate management is disciplined by the markets and pursues the objective of enhancing shareholder value (DAMI et al 2007). Another paper finds that pyramid ownership structures and ownership concentration are negatively associated with firms' operational returns on assets (ALDRIGHI & OLIVEIRA 2006).

19. The latter points to a specific advantage of having a controlling shareholder: that it is likely to lead to stronger loyalty of top management and thereby better monitoring compared to firms with more dispersed ownership, and hence there is less need for accountability mechanisms or incentives such as stock options that are characteristic of widely-held firms (CHEFFINS 2002). Minority shareholders may actually accept and support the existence of a controlling shareholder exercising effective monitoring of the company as a guarantee for board accountability on their behalf, as is argued in the case of Sweden (TUAC 2008).

20. More generally, it is argued that past studies pointing to a correlation between ownership structure and firm performance suffer from methodological bias. Indeed ownership structure should be treated as an endogenous variable that is the outcome of decisions that reflect the shareholders' strategy to maximize firm performance within a given set of markets and regulatory constraints. For a given firm performance level, ownership structure will differ because of "differences in the circumstances facing firms, particularly in regard to scale economies, regulation, and the stability of the environment in which they operate" (DEMSETZ et al 2002).

21. Critics of ownership concentration, for their part, overlook the problems associated with the alternative model of widely-dispersed ownership structures – namely the bias toward short-termism and purely financial objectives. In the absence of a controlling shareholder, the monitoring of the company on the shareholder side may be left to fund managers and other institutional investors whose main concern is the quarterly performance report and at best the annual shareholder value. Corporate management will be sensitive to pressure for short-term profits even if it comes at the cost of long-term performance. Examples abound of pressures to cut costs and under-invest in the company's assets in order to deliver shareholder remuneration in dividends and share buybacks that will prove to be unsustainable in the long run (TUC 2006, LAZONICK et al 1997, LAZONICK 2008).

A stakeholder approach

22. Clearly, the providers of capital *via* equity or debt must have their legitimate rights protected, not least in developing and emerging economies, where the divide between controlling and minority shareholders has been, and still is, of concern. The problem begins if one considers – as the World Bank does – that shareholders and to some extent creditors should be the only focus of corporate governance. In this case, the indicator chosen for evaluating firm performance is either stock market valuation or the volume of the dividend proceeds. While these are perfectly valid indicators for providers of corporate finance, they do not capture the overall performance of the company vis-à-vis other parties, including labour, nor the potential externalities borne by society (environmental damage, tax evasion among others). The corporate governance framework thus loses much of it all encompassing mission to address the accountability rules between all corporate constituencies (GURN 2007). For example, the issue of whether expropriation by the controlling shareholder may impact on

parties other than the minority shareholders, including the company's own interest, the local community, the workforce, or the taxpayer, simply does not appear in the policy dialogue of the World Bank or OECD experts.

23. A significant literature exists on alternative approaches to corporate governance, which recognise the pluralism of corporate constituencies (BLAIR 1995, PARKINSON 1993, KELLY et al 2000). The assumption that shareholders should be granted exclusive control rights is disputed on the grounds that firm performance is subject to the maximisation of the investment made by all constituencies in the company, not least the workforce. Because they invest specifically in the company (company-specific know-how and expertise, loyalty and reliability) workers are exposed to firm-specific risk – that is risks that cannot be foreseen completely in advance in a contractual form, be it the individual employment contract or the collective agreement. Accordingly, and as noted by the TUAC in 2005 "workers, like other stakeholders whose interests are not fully protected by law and contract, bear residual risk in the corporation. They too can claim a representative role in governance. If they are not represented or if they are under-represented, workers are likely to under-invest in the company for fear of being expropriated by those who are represented. Such under-investment compromises firm performance and weakens its capacity to face up to crisis and manage change". Governance mechanisms that involve workers are numerous. In the vast majority of OECD and emerging economies shop floor trade union representation is supplemented by statutory information and consultation occupational health and safety committees by which worker representative can monitor and improve workers' protection against occupational health and safety risks that are specific to the company. Such statutory rights to worker participation are further developed across the OECD, notably in continental Europe, where Works Councils are the norm and Board level employee representation is common practice.

II. The Brazilian ownership structure

24. There are two models of corporate control and ownership: namely the Rhineland / Japanese concentrated ownership system and the Anglo-American widely-dispersed ownership system. Brazil belongs to the former. A handful of shareholders and wealthy families control large parts of the Brazilian private sector: the Setubal, Villela, Moreira Salles, Odebrecht, Gerdau and Safra families to mention a few Yet even by the standards of emerging country and Latin America, ownership concentration in Brazil is exceptionally high. The private sector is ruled by a "quasi-absolutist exercise of power" by a handful of families (COUNTINHO et al 2003). Past privatisation and de-regulation reforms in the 1990s and changes to the corporate governance regime around 2001 as developed further below, have not substantially changed the Brazilian ownership structure. The privatisation programmes, in particular, had the opposite effect of maintaining the control of families over the private sector. As shown in Table 1, families still represented a solid majority of the largest shareholders in 2002, despite the rise of institutional investors and the wave of privatisation in the 1990s.

Table 1: Status of the largest shareholders in Brazilian companies 1997-2002

(listed and unlisted companies)	**1997**	**2002**
Families	58.2	52.9
Foreign investors	14.5	17.7
Government	9	7.5
Mutual funds	1.9	6
Privately-held companies	6.3	4.6
Foundations	2.5	2.1
Pension funds	2.8	2
Others	4.8	7.2
	100	**100**

Source: ALDRIGHI et al 2006

Archipelagos of hyper rich families

25. Concentration of ownership leads to a gap between the economic ownership structure of the company (which may well be dispersed among many shareholders) and the distribution of voting power (which is concentrated in the hands of a controlling shareholder). This gap can be increased in three ways: (i) the use of dual classes of shares, whereby one class bears voting rights whereas the other has no voting rights, (ii) pyramid structures and (iii) cross ownership. In Brazil dual-classes of shares — are widespread in the economy. 86% of listed companies on the *BOVESPA* exchange had a dual class system in 2005. While the leverage effect on shareholder power is smaller than under a pyramid structure, the dual class system nevertheless is a powerful mechanism by which to increase concentration of shareholder power. For example, in 2001, the Setubal and Villela families exerted effective control over Banco Itaú with just 8.5% of the bank's capital, the Moreira Salles family controlled Unibanco with 10.9%, the Odebrecht family the petrochemical company Trikem with 10.7%, and the Gerdau family controlled its own group, Gerdau S.A. with just 8.3% (COUNTINHO et al 2003). In 2002, on average as shown in Table 2, the largest shareholder of a Brazilian company had 54.9% economic ownership (cash flow rights) of the company's capital and 75% of the voting rights. The gap between cash flows and voting rights was even larger for *BOVESPA*-listed companies. Over three quarters of Brazilian private companies (limited liability status), be it listed or not listed on the *BOVESPA* stock exchange, had a controlling shareholder in 2002, and 39% of all private companies and 32% of *BOVESPA*-listed companies had a controlling shareholder owning more than 90% of the voting rights (ALDRIGHI et al 2006).

Table 2: Cash flow and voting rights of largest shareholders 1997 & 2002

		1997	2002
Number of limited liability firms registered		670	666
Voting rights	all firms	71	75
	BOVESPA listing	69.1	72
Cash flow rights	all firms	49.3	54.9
	BOVESPA listing	44.5	48.1

Source: ALDRIGHI et al 2006

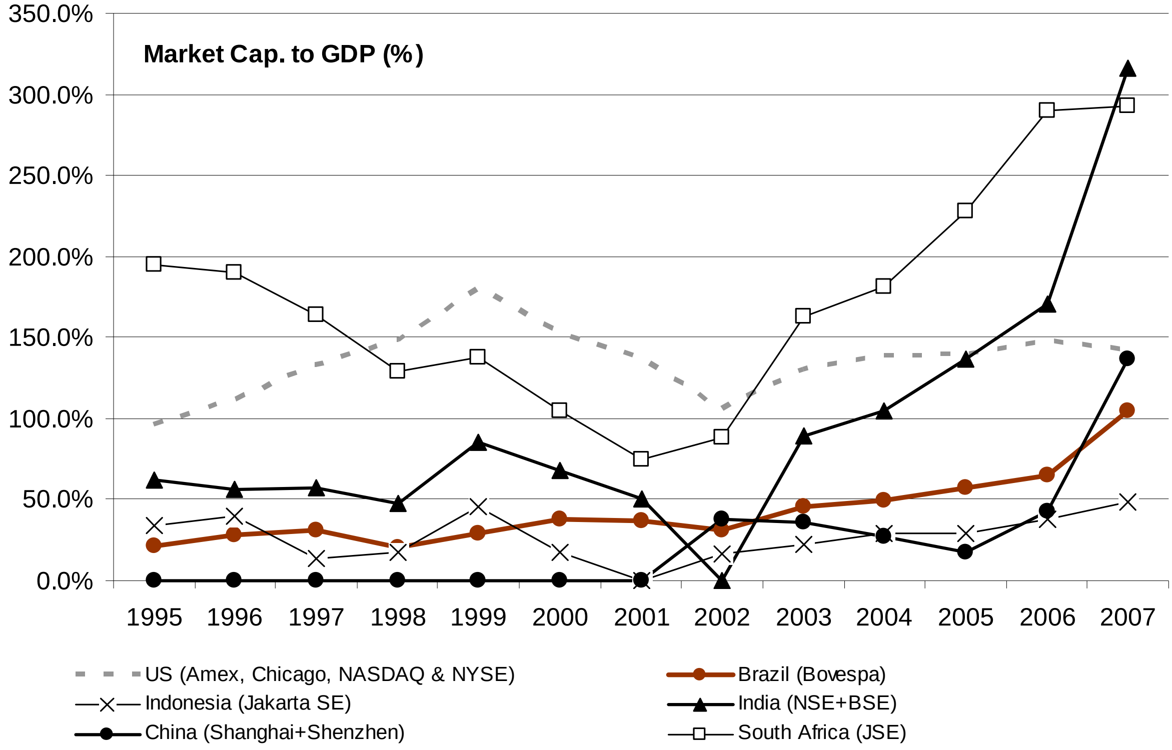
26. Pyramid structures also dilute the rights of minority shareholders, particularly for family-owned holding companies. Nearly half of the 666 limited liability firms registered in Brazil in 2002 had group pyramid structures. In addition to shareholder dilution, pyramid

structures are opaque due to the group and the network of holdings and subsidiaries, making it more difficult for outsiders, including auditors, tax collectors and supervisors, to monitor reporting on activities in the lower tiers of the pyramid structure (including foreign subsidiaries).

Low level of trading and takeovers

27. The high level of ownership and voting concentration has had implications for share trading and the market for corporate takeovers and mergers in Brazil, which have taken the form of the trading of blocks of controlling shares under the counter and outside the scrutiny of exchanges and market-based price fixing. This is confirmed by the low level of daily trading on the secondary market and of market capitalisation relative to GDP as shown in Figure 1. For example between July 1997 and July 1998 just 60 listed companies (out of a total of 463) were traded at least 261 days in this period, and the 10 most-traded shares represented 60-80% of trading volumes. Not only has trading been very limited, in effect it has been restricted to non-voting shares only, hence restricting the ability of the *BOVESPA* stock exchange to become a source of corporate control. By contrast the sale of controlling blocks of shares has included large purchase premiums over the trading price so as to reflect the private benefits arising from the effective control over the company. Having acquired control over the company with the purchase of the controlling block, the new owner would then make a residual tender offer at a much lower price for the remaining shares on the market that were owned by minority shareholders. The premium paid on blocks of shares traded during the 1990s average the 65% in Brazil – a very high premium in comparison to other emerging economies (DYCK & ZINGALES 2004).

Figure 1: Market capitalisation relative to GDP in key emerging economies (1995-2007)



Source: World Federation of Exchanges website

The debt crisis of the 1980-1990s

28. The excessive level of ownership concentration historically was associated with the 1970s and early 1980s and the period of authoritarian government in Brazil. Internal financing and retaining earnings represented the largest source of corporate finance and the only external source of finance was provided by government-controlled credit financing, which in turn was fuelled by the large volume of government debt securities. In contrast, the proportion of private external financing, that is corporate debt and equity raised, played a marginal if not non-existent role. In a country marked by high interest rates and inflation, the Brazilian private banking industry was not able to play the role of the long-term provider of financing to the economy and industrial investments. Private finances were crowded out by the volume of short-term public debt papers, which were inherently less risky and more liquid assets. The low level of volume and diversification of Brazilian corporate finance and the high level of inflation directly benefited from concentration of corporate power in the hands of rich families. Their conglomerates had sufficient market and hence pricing power to better anticipate price inflation by raising their prices faster, while at the same time benefiting from state subsidised lending and other tax privileges. The inflationary economic situation was an ideal background to the oligopolistic structure of the private sector and hence the ownership concentration of companies and the power of controlling families (COUNTINHO et al 2003).

29. Subsidised corporate credit financing was provided by the BNDES. While the original activity of the BNDES was limited to granting tax privileged credit lines, in the early 1980s it diversified its support to include equity investments with the creation of an investment branch. It also facilitated access to finance for other institutional investors seeking to increase their exposure to listed equity[7] and, where needed, substituted for direct state-ownership during the privatisations of the late 1990s. BNDESPAR has remained a central player in Brazilian companies and is a key shareholder of many companies listed on the BOVESPA stock exchange.

30. The government controlled corporate finance system came to saturation point in the 1980 and the crisis of the crisis of Brazilian public finance. The explosion in public debt held in USD denominated securities and the poor country risk rating resulted in high interest rates, high levels of inflation which fuelled persistent macroeconomic instability throughout the 1980s and 1990s. The very idea of diversified, cost efficient and secured corporate financing of the economy was a very distant concept For example, in 1998-2000, Brazilian corporate bonds had a risk spread of 600 basis-points on average (+6% compared with the interest rate of international reference). These risk premiums were linked to the country risk rating, not to the specific risks of the sector in which the borrowing company operated, or the company's own risk profile. Even the bonds issued by the most competitive sectors of the economy, such as commodities and paper, with low firm specific risks were still rated by global rating agencies in the speculative category.

The de-regulation reforms of 1997-1998 and the rise of foreign investors

31. Under pressure from the IMF, the government launched a macroeconomic stabilisation programme in 1994, the *Plano Real*, to fight hyper inflation and reduce the external public debt. The plan included a freezing of the nominal exchange rate at a significantly over-valued

7 Other forms of state-directed corporate finance were at play including restrictions on investments by domestic institutional investors. Insurance companies and pension funds in particular had a mandatory minimum proportion of their portfolio to be allocated in listed equity.

level, restrictive budget policies (including cuts in public welfare and pensions), the repeal of inflation-indexed wage increases (and hence a fall in real wage levels), a vast programme of privatisation and deregulation of key sectors of the economy, banking prudential reforms and market opening to foreign direct investment (IMF 1998 & 1999). The plan led to a massive inflow of foreign capital but came at the cost of a severe fall in the country's terms of trade, large deficits in the trade balance and in the current accounts (reaching 4% of GDP in 1997-1998). A de-leveraging of the economy, both government and private sector, continued until as late as 2004 further limiting the corporate sector's access to external financing.

32. The privatisation programmes, which were initiated in 1997-1998, led to transfer of ownership abroad, particularly in the telecommunications, railways, energy, mining and steel production sectors, and in banking and financial services. Legal restrictions to foreign investments were removed, be it direct investments or portfolio investments, with immediate consequences for the above sectors as well as others such as retail distribution. The link between privatisation and foreign takeovers was made stronger with the comparative advantage of foreign investors compared to their Brazilian counterparts in accessing competitive financing conditions. Brazilian employers lobbied hard for the state-owned BNDES to ease considerably the terms of financing so as to ensure competitive positions in the privatisation auctions. In many instances however, privatisation took the form of co-ownership by foreign and domestic investors as was the case of mining company Cia. Vale do Rio Doce (CVRD or 'Vale') and the aeronautic group Embraer or in the steel sector (CSN, Usimininas, Cia. Siderúrgica de Tubarão and Acesita), where the level of financing required was simply too big for a single buyer. The ultimate result of the privatisations was the increasing domination of foreign investors in many growth and high added-value sectors, as well as key sectors with counter-cyclical activities in services and infrastructures that are less dependent on global business cycles and generate stable cash flows. Over 300 large Brazilian corporations were acquired by foreign groups during the 1995-1999 period. As shown in Table 3 FDI grew substantially between 1995 and 2002, and when the economy recovered after 2003, foreign investors reaped over US10bn in profit repatriation and dividends proceeds equivalent to 60% of the FDI inflows during that period.

Table 3: Foreign direct investment flows and income remittances 1995-2007

in USD Bn	**1995-98**	**1999-2002**	**2003-07**
Foreign investment in Brazil:			
FDI Inflows	15.761	25.102	19.352
of which equity	*14.107*	*23.971*	*16.876*
Profits and dividends outflows	3.772	3.98	10.148
Brazilian investment abroad:			
FDI Outflows	1.149	1.049	9.568
Profits and dividends inflows	0.89	0.955	1.2

Source: Hennings et al 2008

The failure of the privatisations

33. Privatisation programmes initiated under IMF stabilisation programme were intended to help facilitate the development of capital markets, including more trading and liquidity of the secondary equity markets, and to lead to the emergence of a dispersed ownership structure and of shareholder value oriented corporate governance regime. It did not happen that way in Brazil. Indeed the government was so keen to reap the private benefits of the sales of controlling blocks in the state-owned companies, that it actually changed the takeovers to reduce protection of minority shareholders. Prior to the wave of privatisations, minority

shareholders were entitled to the same takeover conditions, including share purchase price, than those benefiting the controlling shareholder. This provision of the corporate law of 1976 (art. 254), known as the tag along rights, was revoked in 1997, so as to inflate the premium paid to the government for the sale of the controlling blocks. Proposals made at the parliament to prohibit the issuance of non-voting shares were defeated. (GORGA 2003)

34. Choosing the auctions of controlling blocks instead of Initial Public Offerings, and the relaxation of regulation protecting minority shareholders, the privatisations maintained the high level of ownership concentration in the private sector. Privatised companies remained in the hands of wealthy or powerful families and at best had to be shared with foreign investors. In addition to the agency conflict between controlling and minority shareholders, a new form of governance relationship emerged between controlling shareholders, and typically between Brazilian and foreign co-owners. As a result, shareholder agreements gained in importance, as they became the centre of negotiations between co-controllers. When privatisation led to full foreign takeover, the corporate governance impact was extreme: the governing bodies, decision making centres and most of the accountability mechanisms were removed and transferred abroad the headquarters of the new owner. Dozens of groups were de-listed from the *BOVESPA* stock exchange to become privately-owned subsidiaries of foreign owned multinational enterprises.

III. The reforms of the early 2000s

35. In 2003 Luciano Coutinho – an academic researcher and investment banker who would later on become Chair of the Board of BNDES – outlined the relevant agenda for a broad reform of the corporate governance related regulatory framework. The move toward capital market friendly reforms, he argued, should follow three core priorities. Firstly the capacity, powers and the independence of the stock exchange supervisor, the CVM, should be reinforced. Secondly, the judicial system should be reformed to become more shareholder- and creditor-friendly with rapid judicial procedures and resolution of conflicts, and reducing the uncertainty of conflicts between different sources of law. Thirdly, corporate law reforms should be pursued to enhance investors' rights (COUTINHO 2003). In doing so, Coutinho underlined the unfinished business of the reforms of the corporate law and the broader regulatory framework for listed companies that took place in 2001-2002.

Civil law versus private arbitration

36. Ranking the above three priorities, Coutinho highlighted the urgent need for a comprehensive reform of the judicial system, which is where he stressed "the real difficulty lies". As a civil-law jurisdiction, the Brazilian judicial system has been long criticised for being excessively bureaucratic, slow and expensive. It is no secret that the World Bank considers civil-law jurisdictions as structurally inferior to common law jurisdictions. The key research paper cited by the World Bank for the methodology of the Doing Business enforcement of contract indicator, states that, because civil law countries are more prone to procedural formalism of dispute resolution than common law countries, they are associated with longer duration of proceedings, "less consistency, less honesty, less fairness in judicial decisions, and more corruption" (DJANKOV et al. 2003). World Bank experts have argued that Brazilian state court judges are ill-prepared to deal with the complexity of corporate

governance cases and lacked the capacity to aggressively investigate cases (CLAESSENS 2001). Companies that are in breach of contractual obligations may take advantage of the lengthy legal procedures – it is said – in order to delay any effective resolution of the claims. For a US law firm the Brazilian courts are "unduly socially-oriented and debtor-friendly" (WEIL 2007). Concerns about the judicial system in Brazil, as in other Latin American countries, were renewed by the OECD and the World Bank in 2009, although some improvements have been achieved with the creation of a specialised commercial court in Rio de Janeiro, which has yet to be replicated elsewhere in Brazil (IFC & OECD 2009a). However criticism has come from labour side as well. According to the ITUC, Brazilian courts have in practice not been able to implement anti-union discrimination laws effectively. The number of cases of illegal dismissals of unionized workers and trade union representatives that are pending in courts are above two million. In half of the cases, settlement process takes five to ten years (ITUC 2009)

37. Alternative procedures to the formal judiciary system have emerged in the past decade, with the introduction of private arbitration which is characteristically more conciliatory for investors, has significantly speedier dispute resolution than civil law system and ensures confidentiality of procedures and records, while no recourse is allowed. The legal grounds for private arbitration are the 1996 Arbitration Act (*Lei de Arbitragem*). After some legal uncertainties private arbitration became legally constitutional in 2000 and hence the enforceability of decisions could not be contested through courts. It was further enhanced in 2002 when Brazil signed the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, thereby giving further assurance to foreign investors as to the protection of their rights. Private arbitration of industrial relation conflicts is also regulated by the Constitution (1998, art. 114). New legislation under the Cardoso government was introduced allowing employers and trade unions to set up company-specific mediation committees to deal with individual claims only (excluding issues related to collective agreements). It should be noted that the choice of private arbitration is not irreversible for workers: in the absence of agreement, dispute resolution then falls to the labour courts to set conditions and settle and enforce resolution between the trade union and the employer. As outlined below private arbitration has also gained in importance with the introduction of voluntary stock exchange listing requirements in 2001, of which the most demanding tier specifically excludes the Brazilian public judicial system and requires mandatory private arbitration in case of dispute resolution.

Reform of the corporate law and of listing regulation

38. In 2001 the corporate law of 1976 (*Lei das Sociedades Anônimas*, 6404/76) was amended by law N°10303. The reform which was adopted on the 31st October 2001 was the outcome of years of intense political infighting following the failure to reform in 1997 at the time of the privatisation programmes. The main amendments made to the 6404/76 law were:

(i) the reduction in the ceiling of non-voting preferred shares as a proportion of total equity from two-thirds to 50%;

(ii) the re-introduction of tag along rights for minority shareholders, but at a lower level (right to at least 80% of the price paid for the controlling block of shares) than the level of the provision that was revoked ahead of the privatisations (100%, see paragraph 33);

(iii) the introduction of provisions allowing minority shareholders with voting rights, and those with non-voting rights to nominate a board member, but with delayed implementation until 2004; and

(iv) new provisions enhancing the enforceability of shareholder agreements – between signing parties, but also vis-à-vis executive directors – which is central given the concentrated ownership structure of the Brazilian private sectors.

39. While achieving some progress toward greater board accountability, the reform was limited in scope by international standards. In fact it has been widely criticised for its lack of ambition: a "frustrating experience", "an illuminating example of how politics of specific interest groups can defeat the economic logic" (ALDRIGHI & OLIVEIRA 2006) which had shown "the extent of conservative resistance to change" (COUTINHO et al 2003) and "is not likely to be a good investment" (GORGA 2003). The drafting of the law was subject to intense lobbying including by two opposite groups: the Brazilian Association of Public Companies (ABRASCA) representing the interests controlling families, and the National Association of Capital Market Investors (ANIMEC) representing the management industry. ABRASCA campaigned successfully.

40. Listing requirements and the powers and capacity of the stock exchange supervisory authority the CVM were also enhanced during this period. In the past CVM enforcement and supervision were very limited. A basic measure such as allowing CVM officers to enter the premises of a financial institution without prior notice and seize data and information on, say, suspicion of insider trading was impossible. As a result detection of breaches and violations of listing and trading regulation almost never happened. That has changed somewhat with the 2001 reform which has enhanced the powers, capacities, independence and enforcement of the agencies. Budget and staffing have increased over the years, and in 2008 an enforcement department was created, the *Superintendência de Processos Sancionadores* (SPS) including 22 full-time inspectors and 8 prosecutors. The number of sanctions has increased over the years, averaging over 100 or so per year in the 2006-2009 (IFC & OECD 2009a). In addition, the CVM has issued several instructions[8] that have direct relevance to corporate governance touching upon the disclosure of voting policy by institutional investors, facilitation of proxy voting procedures and transparency and reporting.

The creation of the Novo Mercado

41. At the same time as the reform of the corporate law, the *BOVESPA* exchange issued three new voluntary listing segments in December 2001 – *Novo Mercado, Nível 1 and Nível 2* – requiring specific corporate governance rules going above and beyond the provisions of the law 6404/76 in protecting the rights of minority shareholders vis-à-vis controlling shareholders. The main additional corporate governance requirements are as follows:

Nível 1, Nível 2 and Novo Mercado:
- Minimum free float of 25% of the capital;
- Enhanced disclosure of the quarterly financial statements;
- Enhanced disclosure of related party transactions to *BOVESPA.*

Nível 2 and Novo Mercado:
- 20% of independent directors on the board;
- unified 2-year term for board members (no staggered terms of appointment for directors);
- Compliance with IFRS or US GAAP reporting standards;

8 The list of CVM instructions are posted at the following URL: http://www.cvm.gov.br/ingl/regu/regu.asp

- Mandatory recourse to private arbitration;
- Six month lock-up period after the IPO before controlling shareholders can sell their shares.

Nível 2:

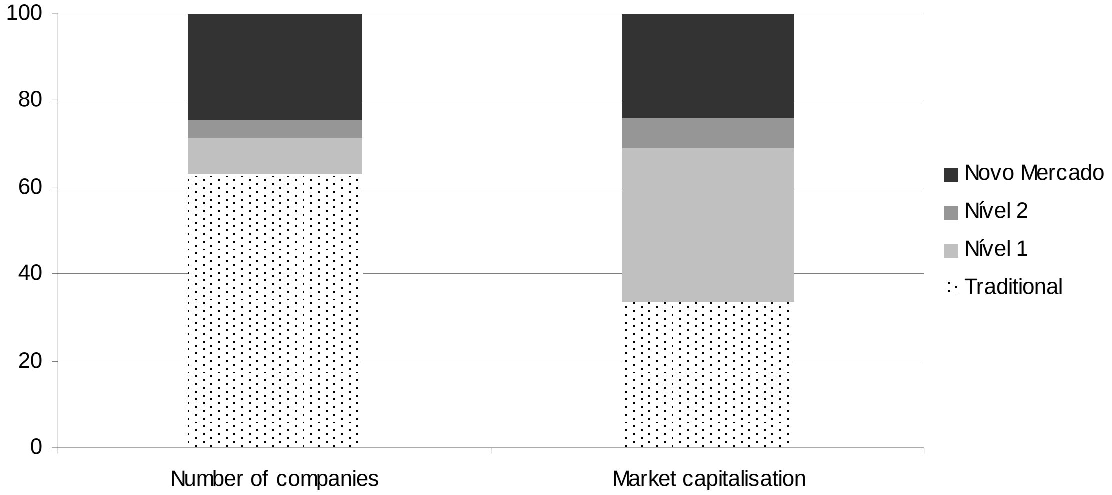
- Tag along rights[9] for preferred (non-voting) shares at 80%.

Novo Mercado:

- One share one vote principle (no dual class system, no preferred shares allowed).

42. The official aim of the *Novo Mercado* initiative was to have a demonstration effect in enhancing shareholder rights and board accountability as an alternative to binding regulation, given the mixed outcome of the corporate law reform. The voluntary prohibition of preferred shares without voting rights would help diversify ownership of companies where past corporate law reforms had failed in 1997 and in 2001. *Novo Mercado* would change the Brazilian ownership structure gradually, making it less concentrated and hence fuel the development of an active secondary equity market, including shareholder activism, if not hostile takeovers. Also it would offer better exit strategies for private equity investment funds seeking to divest themselves of portfolio companies by selling them back to the market. And indeed the introduction of the *Novo Mercado* listing segments has had some traction. Of the 42 firms that went public in Brazil in 2004-2007, 32 chose the voluntary listings, including several companies previously under private equity regime. In 2008-2009 almost all IPOs in Brazil were launched within one of the three corporate governance tiers (*Novo Mercado, Nível 1* and *Nível 2*) and as of December 2009, the *Novo Mercado* tier accounted for 64% of the country's total market capitalisation. As welcome as the success of the Novo Mercado may be, it should be noted that the requirements contained within the different segments, including the most demanding one, are relatively benign in an international comparison, and that Nivel 1, the least demanding tier, is the most popular one among the largest capitalisation member of the main equity index IBOVESPA (see annex 3).

Figure 2: Distribution of BOVESPA-listed companies by their corporate governance tier



Source: Bovespa website, December 2009

43. Various self-regulatory initiatives were either launched or revised in the ensuring period. In April 2001 the Brazilian Institute of Corporate Governance (IBGC) issued a revised version of its Code of Best Practice of Corporate Governance, which first version was drafted in 1999. Compared with the *Novo Mercado*, the IBGC mainly addresses the governance of the

9 Right to takeover conditions, including share purchase price, that are similar or equivalent to those benefiting the controlling shareholder.

company's board structure. Other initiatives did not meet the success expected and were abandoned. For example in June 2002 the CVM published a set of recommendations on corporate governance known as the *Cartilha* covering the organisation of the AGM, board organisation and composition, protection of minority shareholders, tag-along rights, related party transactions, arbitration and independent auditing. The code was meant to be adopted by listed companies on a comply or explain basis. While the text still appears on the website of the CVM[10] there is no evidence that it has been implemented. Later that year, the BNDES established a credit programme for companies linked to corporate governance requirements. The higher the compliance with the corporate governance criteria the lower the interest rate on the loan. The programme was ended in 2003.

New opportunities for private equity and public-private partnerships

44. The success of *Novo Mercado* has also helped develop exit options for private equity funds and their portfolio companies[11]. Half of all IPOs launched on the *BOVESPA* stock exchange in 2004-2006 were made by private equity funds including well known brands such as Natura (cosmetics), Gol and TAM (airline companies), and UOL (Internet provider). Changes to the legal environment of private investment have helped support the development of Brazilian private equity in general. In 2003, a new legal investment status was created by the CVM for collective investment schemes, the *Fundo de Investimento em Participações* (FIP). The FIP are closed-end funds registered with the CVM that have several tax advantages, including some capital gains and income tax exemptions to foreign investors, as well as reduced administration registration procedures. The FIP accounted for 39% of private equity commitments in mid-2008 (CUNTO 2009).

45. In the current capital market downturn, the private equity industry could gain from new opportunities with the development of Public-Private Partnerships (PPPs) in infrastructure and services. In 2004 the *Parcerias Público Privadas* Act expanded the range of contractual arrangements between private operators and public administration beyond public procurement procedures to include various risk transfer schemes including trust funds that have government guarantees to shield private investors from the political risk involved in PPP. Since the introduction of the new legislation, over 20 PPP projects have been launched in the transport sector (including the building of a metro line in Sao Paulo, a toll road in Minas Gerais), and in the water sector (sewage pipeline in Bahia). Other projects could include road maintenance, airports, and prisons. Federal government support for PPPs was further boosted in 2007 with the adoption of a new public investment strategy, the *Programa de Aceleração do Crescimento* (PAC). The PAC – which phase II was launched in March 2010 – aims at developing PPP projects in transport & logistics, energy and water services in both rural (irrigation) and urban (sanitation) areas. On funding side, an investment fund was created in 2007 (CVM Instruction 462) under the national unemployment insurance the scheme, the *Fundo de Investimento do Fundo de Garantia do Tempo de Serviço* (FI-FGTS) to specifically invest in PPPs together with pension funds and the state-owned BNDES bank.

10 http://www.cvm.gov.br/ingl/public/publ/governanca/recomen.doc

11 The business model of private equity funds consists in buying out a company with the explicit intent of selling it back after 3 to 5 years of restructuring in order to realise a capital gain and hence ensure a return on investment for the parent investment fund. Historically, the low level of development of capital markets in Brazil have made exit options relatively unattractive and contributed to the weak development of private equity. Private equity investors had to face longer holding periods for their portfolio companies. In the absence of domestic solutions, exiting took the form of a combined resale at regional level to another investment fund or industrial group (WEIL 2007).

The political economy of corporate governance reform

46. Another reading can be made of the reforms in 2001 and of the *Novo Mercado* initiative in particular. World Bank expert Tom Kenyon, argues that the introduction of the voluntary listings in 2001 was a political move made to prevent drastic changes to corporate governance regulation, should the Workers' Party PT win the general election to be held a year after, which it did. In 2001, the incumbent Cardoso government, which had been in power throughout the stabilisation programmes of the 1990s, had almost no political capital left having lost the confidence of the population. It became clear that the PT led by Lula would be very likely the winners of the elections to be held end-2002. The Cardoso government and the conservative parties were legitimately fearing a 180° change of direction in policy-making toward interventionist policies, public services if not reverting past privatisation of large parts of the private sector. This fear was shared by many investors and controlling families. "The solution they found", Kenyon argues "was to socialize the business risk associated with anti-market intervention. […] By issuing shares to outside investors and undertaking a highly publicized commitment to protect minority shareholder rights [under the banner of the *Novo Mercado* initiative], they reasoned, these companies would raise the costs of political interference. […] new equity issues and tighter corporate governance standards provided the mechanism through which these companies sought to insulate themselves from political interference" (KENYON 2006). During the run-up to the election the governance of the CVM was also reformed to ensure its political insularity from executive government, thereby locking in the status quo ahead of the expected win of the PT at the general election. At the same time, it has been argued that during the crucial electoral campaign in 2002, the PT and candidate Lula embraced a shareholder rights approach to corporate governance in order to appease the fears of institutional investors and financial markets at large. Such a shareholder rights-centred approach, however, was carefully balanced with comparable emphasis on corporate social responsibility (CSR) objectives. (JARDIM 2007 & 2009).

IV. The Brazilian corporate governance regime

47. The Brazilian corporate governance is defined by the provisions laid out in the corporate law 6404/76 as amended in 2001, the bankruptcy law 11101 of 2005, relevant CVM instructions, the Novo Mercado listing segments and the code of conduct of the IBGC. A simplified comparison between these various sources of law and self-regulation is provided in Annex 3. What follows outlines the specific rights and responsibilities of key corporate governance institutions:

- the board of directors and other governing bodies of the Brazilian firm;
- the rights and the responsibilities of the shareholders and the organisation of the AGM;
- the specific duties of the controlling shareholder and the importance of shareholder agreement;
- transparency and reporting;
- creditors' rights.

A one-tier-and-half board structure

48. In principle the Brazilian board structure is based on a two-tier board system. Law 6404 art. 140 & 143 specify that companies should have a board of directors (*Conselho de Administração*) elected by the AGM, and a management board (*Diretoria*). However, and unlike other two-tier systems in place in Europe, the law does not prohibit the combination of CEO and Chair positions. The CEO, who chairs the management board, may be a member of the board of directors and chair it as well. The IBGC code, however, recommends separation of the two positions. Importantly, the corporate law allows the AGM to establish a third governing body, the fiscal board (*Conselho Fiscal*, art. 161) whose role combines that of an external auditor, an ombudsman and a supervisory board. Given the absence of statutory separation of the CEO and Chair positions, but also the oversight function of the Fiscal Board, the Brazilian board may be considered as a one and a half tier system, mid-way between unitary board and full dual board structures.

Election of the Board of Directors

49. The legal provisions with regard to election and nomination of the highest governing body of the Brazilian company, the board of directors are complicated if not confusing. Prior to the 2001 reform, only shares with voting powers had the right to elect to the board of administration – although the company bylaws can provide for preferred shares to have a right to elect one or more board members in a separate ballot (art. 18). The law further provides for a definition of a majority shareholder as an individual, a corporation or group of persons bound by a shareholder agreement, who owns over 50% of the voting rights at the AGM and makes effective use of that voting power lead corporate activities and direct the activities of the company (art. 116). Because the board election procedure by default consists of the presentation of a single slate of candidates, the controlling shareholders would always dominate the election procedure. In order to avoid monopoly of board representation by the controlling shareholder, it is specified that irrespective of the bylaws of the company, minority shareholders with at least 10% of the voting rights can request a multiple voting procedure (art. 141). Unlike the single slate procedures, multiple voting provides an individual common share with as many voting rights as there are seats for re-election at the board and to cumulate those rights on one, or several, candidates. As such article 141 gives minority shareholders a chance to secure at least one nomination of their own at the board.

50. The 2001 reform maintains the above provisions and adds new rights to minority shareholders be it with or without voting rights. The new article 141§4 gives minority shareholders the right to elect a board member in a separate election procedure (excluding the controlling shareholder) provided that the minority shareholders:

a) have at least 15% of voting rights;
b) have at least 10% of total shares; or
c) if none of the above conditions are met, can cumulate their common and preferred shares to reach at least 10% of total shares.

Role of independent directors

51. Article 141§7 specifies that, irrespective of the bylaws, the controlling shareholder shall have the right to appoint the same number of board members as the minority shareholders plus one additional representative. However, article 8§4 included a waiver clause that suspended for three years the above new rights for minority shareholders (which accordingly came into effect in 2004 only). Despite these provisions, and the complexity of

the procedures to say the least, the revised law constitutes an improvement in ensuring diversified board membership and a minimum representation of minority shareholders.

52. On the other hand, the Brazilian corporate law does not lend itself easily to boards that give a prominent role to independent directors as recommended by many codes of conduct and the OECD Principles of corporate governance. The only restriction in the law is that no more than one third of the Board of directors be composed of executive directors. The Novo Mercado and Nivel 2 listing segments on the other hand require that at least a fifth of the board be filled by independent directors, the IBGC code recommends a majority. The criteria for qualifying as an independent director are very much in line with provisions common to OECD countries. He or she should (i) have no ties to the company except for owning equity, (ii) not be linked to the controlling shareholder, (iii) not have been a executive of, or employed by the company, nor be linked to top management, (iv) not be linked to a direct or indirect supplier of the company, and (v) not receive compensation from the company other than that related to the board function.

The fiscal board

53. The fiscal board functions as an independent oversight body. Its existence is not mandatory but can be decided with 5% of common shares, or 10% of voting right shares. The board size must be comprised between three and five members. The fiscal board can attend board meetings, can issue formal opinions in the annual report or to the AGM. It has no veto power over decisions taken by the board but has the whistle blowing right to inform the AGM of any breach in regulation or other irregularity within the company or at the board. In the absence of an external auditor the fiscal board can decide on its own to select an accountant or auditing firm. It also takes a leading role in case of liquidation of the company. The election of the fiscal board favours minority shareholders compared with the election of the board of directors. Holders of preferred shares and minority shareholders holding at least 10% of the voting shares can elect one member in separate elections (161§4). Hence minority shareholders can nominate two representatives out of three to five members.

54. Interestingly, the IBGC code recommends that the controlling shareholder “waive the privilege of electing most of the fiscal council members” and in effect cede the right to majority to holders of preferred shares and minority shareholders. Such a rule would indeed ensure that the fiscal board play a countervailing force – although with limited power – to the board of director.

Directors’ duties and liabilities

55. The law provides for a series of duties including acting in the best interest of the company, the public at large and the social role of the corporation (Art. 154). With regard to the risk for controlling shareholder expropriation, the same article reads that executive directors shall not fail to fulfil their duties toward the corporation, “even at the expense of the interests of those who elected” him or her. This provision is further supported in article 156 on the prevention of conflicts of interest (“An officer shall not take part in any corporate transaction in which he has an interest which conflicts with an interest of the corporation”).

56. Directors’ liability is somewhat limited and proving misbehaviour is arguably difficult to achieve. The only circumstance in which an executive director may be held personally liable for his/her undertakings on behalf of the corporation are fault or fraud, including breach of laws or of the company’s bylaws (art. 158).

Rights and responsibilities of the shareholders

57. The right to convene an AGM rests with the board of directors. However shareholders with at least 5% of capital can call for the organisation of an AGM under certain circumstances. Likewise the fiscal board can convene an AGM within the strict limit of its responsibilities. (art 123). Notice of the AGM should be given 8 days in advance for unlisted companies, and 15 days for listed companies (art 124) which compares with the 30-day notice recommended by the IBGC code.

58. The law does not provide shareholders the right to include a resolution of their own on the agenda of the AGM. It is the party convening the AGM that determines the agenda. As a result, the ability for shareholders, and minority groups in particular to influence the agenda and propose critical resolutions is limited. The only way to do this is to call for an extraordinary general meeting which requires 5% of the capital. Regarding self-regulatory initiatives, the topic is not mentioned at all in the Novo Mercado requirements, while the IBGC code uses particular vague wording in addressing the issue: "mechanisms should be encouraged for the timely receipt of proposals from owners wishing to include them in the agenda of the upcoming general meeting". Clearly, shareholders' access to the AGM agenda is under-developed in the Brazilian framework.

59. The use of dual class system of shares – common shares with voting rights, preferred shares without – which is widespread in Brazil, is restricted in proportion of the total capital. The number of preferred shares may not exceed fifty percent (50%) of all issued shares. (art. 15). As noted above, some of the Novo Mercado listings require one-share-one-vote principle and hence prohibits dual class systems. Single class is also recommended by the IBGC code which adds that, where dual class system exists, there should be enhanced rights attached to preferred shares for key AGM decisions.

Disclosure and approval of directors' remuneration

60. While the law specifies that the AGM should determine the "total or individual" parts of the remuneration of directors' and corporate officers, including "whatever benefits and allowances" (Art. 152.) the rights of shareholders to approve board and executive remunerations with a binding or even advisory vote are limited, except for the equity component. Similar problems arise with individual disclosure of remuneration which is not required by the law in Brazil. Shareholders representing 5% or more of the capital may require individual disclosure by a director of his/her equity holdings, including stock options, and direct or "incidental fringe" benefits issued by the company and by related parties, other companies within the same controlling group, as well as the specific terms of his/her employment contract (art. 157). There is a caveat in the article however: the executive who would be subject to such request for information may refuse or "refrain from publishing" the information, should disclosure pose a risk to the "legitimate interest of the corporation". The IBGC code does not insist on individual disclosure of remunerations, the code states that disclosure should be "by group, if not individually". However, new regulation adopted by the CVM end-2009 (instruction nb 480) specifically requires disclosure of directors' remuneration on an individual basis. Although such regulation covers listed equity only, it is no doubt a welcome move in the Brazilian context.

Regulation of dividend proceeds

61. The law sets specific rules for the distribution of dividends; rules that are unusual to be found in corporate law in an OECD comparison, and reflects the concerns of controlling shareholder expropriation. The original law stipulated that, having allocated 5% of profits to retained earnings (art. 193), the dividend distribution policy should remunerate preferred shares 10% above voting shares; this provision, setting no floor for dividends, did not give assurance that minority shareholders would be treated justly in dividend distribution, because controlling shareholders do not necessarily rely on dividends to obtain returns on the investments given the private benefits that can extract from the company by other means (art. 17). The 2001 reform downgrades the +10% provision to one among several dispositions also including (i) a floor level of 25% of the company's net income in fixing the dividends, or (ii) a tag along rights of 80% of the price paid for the controlling block.

Duties of controlling shareholders

62. The duties of the controlling shareholders as spelled out in the law are testimony to their power and influence in the governance of Brazilian corporations. Indeed art. 116 defines duties almost equivalent to those applying to directors. Controlling shareholders, it is said, shall use their controlling power so as "to make the corporation accomplish its purpose and perform its social role, and shall have duties and responsibilities towards the other shareholders of the corporation, those who work for the corporation and the community in which it operates". Given the risk for expropriation of the company's assets by the controlling shareholder, it is added that the exercise of their voting rights shall be deemed abusive – and the corresponding AGM resolution be revoked – if intended to cause damage to the corporation, to other shareholders or to obtain undue advantages (art. 115). The controlling shareholder will be liable for any damage resulting hereof (art. 117).

The enforceability of shareholder agreements

63. The section relating to the shareholders' agreements, article 118, is even more telling as to the concentration of power in Brazilian AGMs and the underlying tension between the interest of the company and those of the controlling shareholder. Shareholder agreements are private contracts that bind two or more shareholders who as a block constitute the controlling shareholder of the company. The agreement usually covers share trading, tag- and drag-along rights, rights of first refusal, blocking and veto rights on key resolutions, access to nomination and representation at the board, distribution of dividends. While the agreement must be filed with the company to have effect, its content can be kept confidential, with the exception of distribution of dividends which must be disclosed in the annual report (art. 118§5).

64. Yet the most striking aspect of the article relates to the enforceability of the agreement. Paragraph 8 specifies that the chair of the AGM, or indeed the Board of Directors – that is to say the individuals that are bound by directors' duties to act in the best interest of the company (art. 154) – shall reject a vote, and hence a resolution, should it infringe on a shareholder agreement. In effect, this provision ensures the full enforceability of shareholders agreements for the AGM as a whole – that is to non-contracting parties. Also, it raises concerns about the possibility of a conflict between the substance of a shareholder agreement on one hand and the company by-laws or the company's best interests on the other (GORGA 2003). In situation of this sort how should the chair of the AGM (or the Board) react? Should he/she protect the integrity of the company (art. 154)? or those of the shareholder agreement

(art. 118)? The answer, if there is one, is to be found in the duties of the controlling shareholder (art.115-117) and how those duties impact the substance of the shareholder agreement. The issue is of importance at least for the IBGC according to whom the content of shareholder agreements "should not in any way bind or restrict any voting rights of the directors, as they all should loyally and diligently perform their duties to the company, above the personal interests of those who elected them".

Transparency & reporting

65. Financial reporting is regulated by articles 247-250 of the corporate law (6404/76). Publicly held companies have further requirements arising from the securities law 6385/76 and the listing rules of the CVM, including instructions n°202 (1993), 248 (1996) and 457 (2007). In principle, consolidated rules should include any entity controlled by 30% (art 249 & 250). The auditor certifying the accounts is selected and can be revoked by the Board of Directors (art 142§IX), although in principle the AGM has the power to elect and remove the auditor as well (art 122§II). Should there be grounds to suspect that serious irregularities have been committed within the company, shareholders representing at least 5% of the capital also may request the judiciary courts to consider ordering complete inspection of the company's accounting (art 105).

66. Historically transparency and reporting requirements have not been an area of excellence in Brazil. This is not too surprising given the use of pyramid structures for large industrial groups that make consolidated reporting, that is extending the reporting perimeter to include subsidiaries, a challenging concept. It was standard practice to limit effect independent auditing to the balance sheet at group-level. Rarely did auditors certify the subsidiary units of the group. Such non-consolidated accounts meant that controlling shareholders had the extra freedom to manipulate and transfer sensitive accounting information from the parent group structure to subsidiary units. The main concern has been the lack of conformity of accounting rules with recognised international standards either those of the US GAAP, or the international IFRS standards of the IASB. This will change. In July 2007 the CVM issued instruction nb 457 requiring compliance with IFRS for consolidated financial statements with effective implementation in 2010, thereby applying to all listed companies a key requirement of the *Novo Mercado* listing.

67. Regarding transparency of the beneficial ownership, the identity of the shareholders must be registered in the company's book (art 100 et al) and custodians are required to inform the name of the final beneficiary of the shares if there is any corporate event in which his identification is required (Art. 41§3).

Creditors rights

68. Until recently creditors' rights was seen by international investors and donors as a case in point of the "procedural formalism" of Brazilian civil law system. Seizing corporate assets as collaterals to guarantee loans under the law n° 7661 dating back to 1945 was difficult for courts to obtain. The Bankruptcy regime could grant special protection to the insolvent company – the *concordata*. Once initiated, the *concordata* allowed the controlling shareholder to liquidate the company to meet its own interest.

69. In the past decade, incremental changes in creditor and bankruptcy laws have been implemented to facilitate creditors' effective rights, including moving from court-based to private resolution of the company's asset liquidation, speedier resolution procedures and seizure of financial assets and bank accounts to secure credit claims, including the introduction of mechanisms of fiduciary transfer of assets (*alienação fiduciária*). In particular the New Bankruptcy Law of 2005 (*Nova Lei de Falências e Recuperação de Empresas No. 11101*) has aimed at redressing the bias in favour of the controlling shareholder by rebalancing the rights of creditors. At the same time it provides for greater flexibility and speed to facilitate corporate restructuring to allow continuation of activities on the model of the US Chapter 11.

Labour claims

70. A point of concern with the new law is the ranking priority it gives to creditors. Despite its bias in favour of the controlling shareholder, the previous bankruptcy regime had the merit of ensuring the creditor claims by tax authorities and the company workers' wages and social security rights. Under it the proceeds of a bankrupt debtor should first be allocated to fund all labour and tax claims before debt owed to other creditors. In case of continuation of the company's activities, the new owners were liable for any labour or tax claims. The new law regulates better the governance of creditors' claims, with the creation of three class-specific creditor committees – labour, secured private creditors, other creditors – in the approval of restructuring plans. The distribution of the voting rights within the committees are in proportion of the total claims of the given class, except for the labour committee in which individual votes prevail, regardless of the amount of the claim (hence protecting lower paid workers in the company). However, under the new law secured private creditors are ranked before tax claims and come second to labour and social security claims up to a limit of 15 monthly salaries for each worker (art. 83). Under certain conditions the new regime also frees the new owners from any tax and labour succession liabilities (art. 141). The order of priority between private secured creditors and labour claims remains uncertain however. The new law was put to the test in 2006 with the bankruptcy proceedings of the national airline company Varig, which led to a conflict of jurisdictions between the business court of Rio de Janeiro – which granted the resale of Varig's assets free of any labour claims – and its labour counter part – which in parallel ordered a freezing of the company's assets to secure labour claims against the company. Furthermore, a suit has been filed by the *Partido Democrático Trabalhista* (PDT) end-2007 and is still pending is pending before the Supreme Court to contest the constitutionality of the law's provision regarding the capping on labour claimants and the elimination of labour succession liabilities.

V. Workers' rights and participation in the firm

71. Compared with social equity and welfare, but also with the governance of pension funds as developed below, it may be argued that the *democratização da gestão* or democratisation of the company's governance, has been less of a priority for the Lula government since 2002. As such, initiatives such as the recent law proposal for board employee representation in state-controlled companies, are welcome moves. Some unions such as the CUT-affiliated union in the financial sector, the Contraf-CUT, have expressed

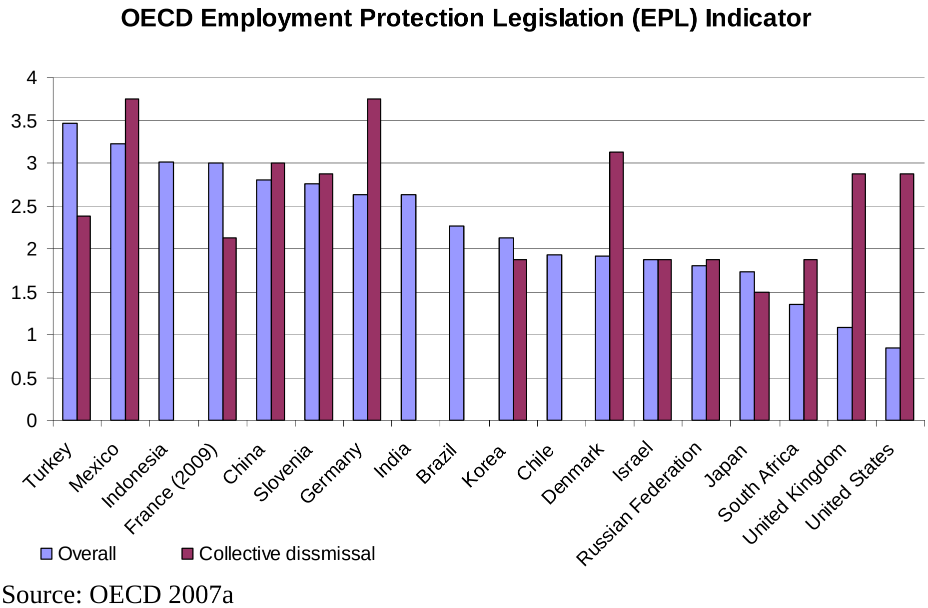
strong support for the proposal as well as for employee representation at the fiscal council and the creation of works council[12].

Labour regulation

72. From a workers' perspective, employment protection legislation is favourable in Brazil compared with OECD standards and other emerging economies as shown in figure 3. Unsurprisingly this has been raised as a source of concern by the OECD and the World Bank whose "Doing Business" report ranks Brazil 141 (out of 183) in terms of ease of employing and firing workers. The OECD and World Bank are particularly concerned by the "generosity" of the labour law regarding dismissals, and statutory rights to compensation which in case of unfair dismissal can amount to one-year pay's Both institutions also criticise the high levels of non wage costs – mainly pension and social security contributions – which typically represent over 60% of workers take-home pay. Also the labour law is said to have a bias toward workers in setting the legal definition of an employment relationship. Giving more weight to substance than procedural form, court rulings have in past helped re-qualify independent contractors as salaried employees and the benefits attached to the latter.

73. The OECD associates the employment protection legislation that benefits the formal sector with the existence of a large informal economy which represents circa 44% of total employment in Brazil. This is comparable to China (50%), higher than in Russia (10-20%) and though not comparable with India (94%) (OECD 2007a). Informal employment covers very diverse structures and activities (small farms in rural areas, self employed in urban ones, hidden employment in registered companies). From a corporate governance perspective, informal employment also includes employment by un-registered small enterprises that are located in the grey area between formal and informal activities. It remains to be seen the extent to which corporate law could be improved in such a way that un-corporatised businesses are registered and brought back into the formal economy.

Figure 3: Brazilian employment protection legislation in an international comparison



Source: OECD 2007a

12http://www.contrafcut.org.br/noticias.asp?CodNoticia=17981&CodSubItem=23 & http://www.cut.org.br/content/view/14053/170/

The *Unicidade* system

74. Regarding trade union rights, freedom of association and collective bargaining, the Constitution recognises the right of workers to join a trade union, with exception of certain public sector jobs. Brazil ratified in 1952 one of the two ILO Conventions on collective bargaining and freedom of association that are referenced as core labour standards, the Convention No. 98 on the Right to Organise and Collective Bargaining. The government has announced its intention to align labour law with the other core labour standard on freedom of association, Convention No. 87 on Freedom of Association and Protection of the Right to Organise (ITUC 2009).

75. The main regulatory basis for labour law is the Compendium of Labour Laws (the CLT) of 1943 which dates back to the authoritarian military regime and under which official trade union organisations were close to quasi-government entities mandated to prevent social unrest and strikes. In particular the CLT lays the foundation for the system of *unicidade* which grants monopoly of representation and hence collective bargaining, to one and unique trade union organisation registered with the Ministry of labour per occupational category and territorial area. As is the case of many civil law countries, all workers whether unionized or not, are covered by the collective agreement signed with the official trade union. In return, workers are subject to a mandatory annual trade union fee equivalent to one day salary, 90% of which is redistributed to the officially recognised unions under the *unicidade* system and 10% of which is transferred to the Ministry of Labour.

76. Since the end of the military regimes, several federal laws have modified the system but its fundamentals remain. In addition to single union system, collective bargaining is also restricted by the authority granted to the judiciary in industrial disputes which in effect has given little space for direct trade union negotiations with employers at company or group levels. Art. 623 of the CLT for instance allows the judiciary to declare void an agreement that would conflict with a law or to intervene in an industrial dispute if public interests are deemed to be at threat. An amendment to the Constitution in 2004 has weakened the substance of this article but in practice interference by the judiciary continues. Trade union pluralism at large also become a public policy priority when the Lula government committed itself to a major trade union reform as part of a National Labour Forum (FNT). The intent was to promote collective bargaining and social dialogue at company level as part of a broad package of reforms as well as the development of contractual settlements of industrial relation disputes, conciliation, mediation and arbitration. However the FNT did not meet the support needed at the Federal parliament and accordingly the Lula government adopted a step by step approach with the ratification of the ILO convention 151 on labour relations in public services and new legislation recognising the role of national and regional trade union centres.

77. Finally, and despite many improvements over the past decade, it should be remembered that being a trade union elected officer remains a dangerous job in Brazil.[13]

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13 As reported by the ITUC, in June 2007 a hand-made bomb was thrown into the offices of the metal workers' union of Taubaté, near Sao Paolo and death threats were made against the president of the union. In October 2007, the President of the Union of Civil Construction Workers of Salto who had publicly alerted against dangerous occupation health and safety conditions in the industry was shot dead by a bullet in the head. In August 2008, a petrol bomb was thrown at the house of the president of the Amapá Transport Workers' Union. This attack took place during a dispute between the union and two local bus companies over pay and health benefits (ITUC 2009)

Worker participation mechanisms

78. In the continental European sense of the term worker participation mechanisms (works councils with information, consultation and sometimes veto rights, board level employee representation) are poorly developed in Brazil. Article 11 of the Constitution of 1988 requires companies employing more than 200 workers to have a system to election employee representatives and article 7§XI recognises some rights of participation by employees in the management of the company. Similarly, article 621 of the CLT explicitly includes the right to establish a works council as part of a collective agreement. Taken together these sources of law could lay the ground work for a works council system. However no regulation has been introduced to ensure effective implementation. Regarding board level employee representation, the corporate law 6404/76 stipulates that “the bylaws may establish the participation of an employee representative in the board, chosen by their votes in a free election, organized by the corporation jointly with the unions that represent them” (art 140).

Works councils

79. Some forms of worker participation mechanism nevertheless exist. Brazilian companies are required to have occupational health and safety committees, the *Comissão Interna de Prevenção de Acidentes*, which are composed of equal numbers of workers representatives elected each year and of management representatives. More recently companies have had the option of setting up trial settlement commissions, the *Comissões de Conciliação Prévia*, to address minor conflicts and disputes between employers and workers to alleviate the procedural burden on the judicial system. On an individual basis, some have internal bodies for representation of workers such as the *Comissão Executiva dos Empregados* of the bank CAIXA. Regulatory initiatives are also taking place below federal level jurisdiction. Early 2009, the Municipality of Sao Paulo drafted a decree requiring the creation of *Conselhos de Representantes dos Empregados*, with information and consultation rights vis-à-vis management, for companies owned by or under control of the municipality[14].

Board level employee representation

80. As noted above employee representation on the board is mentioned explicitly in the corporate law 6404/76 as an option to be determined by the company’s by-laws (art 140). Whilst optional, the provision gives primacy to the union of the company to organise the election process. In practice, board level employee representation mainly is with privatised companies. Just as in France, the Cardoso government used employee shareownership plans and board representation as a way to sweeten the pill of privatisations. An un-confirmed survey by the IBGC is reported to have suggested that 28% of Brazilian listed companies had employee representation on their boards in 2003. Examples of individual companies with employee representatives on their boards – all of which being former state-owned companies – include are steel company CSN, aeronautic group Embraer, utility group Tractebel Energia (formerly GERASUL, controlled by French group GDF-Suez) and group CVRD (‘Vale’). In the latter case, the employee representative on the board of Vale S.A. Eduardo Pinto is also the head of the Brazilian Rail Workers Union the STEFEM. He is reported as playing an active role in helping resolve the current dispute between Vale and the United Steel Workers Union in Canada over Vale Inco (formerly Canadian Inco which was bought by Vale in 2006[15]). Since July 2009, 3200 members of USW at Inco facilities in Sudbury and Port

14 http://sincohab.blogspot.com/2009/02/projeto-de-lei-pretende-regularizar-cre.html

15 http://www.cnw.ca/fr/releases/archive/September2009/21/c7277.html

Colburne Ontario have remained on strike following decision by Vale to close the defined benefit pension plan to new entrants (and provide future employees with a defined contribution plan) to reduce variable remuneration schemes benefiting workers and a plan to between 10-50% of the total workforce.

81. However board level employee representation may well become more important in the near future in Brazil. A current proposal of law n°3407/08 is in the stage of the parliamentary process[16] and would amend the corporate law 6404/76 to require a mandatory employee representation on the board of directors of state-owned companies employing more than 200 workers, including any private company which has the state as controlling shareholder. Nomination would take place through a direct workplace election organised by the company together with the predominant trade union. While the employee representatives would have the same rights and duties than any other board member, the draft law stipulates that they should be excluded from taking part in decisions (including discussions) relating to labour relations, compensation, benefits and conditions, including matters of pension and healthcare. This provision – which is motivated by the risk of conflict of interest with the company – would discriminate against employee representatives as other board members in similar situations – such as those nominated by the controlling shareholder – would not be subject to similar exclusion from decision and discussion. Also, and in line with the corporate law reform of 2001 regarding board nomination by minority shareholders, the proposed law at all time requires board majority in favour of the state as the controlling shareholder.

VI. The Stewardship of workers' capital

82. Prospects have improved considerably in the past decade for the more effective stewardship of the Brazilian workers' capital and ensuring proper accountability of their savings in pension schemes. While the retirement system as a whole essentially draws on PAYG financing[17], Brazil nevertheless has a long history of pre-funded complementary schemes. The first regulation on occupational pension schemes was introduced in 1977 for large state-owned enterprises.

The pension fund landscape

83. Since 1977, the Brazilian pension landscape has been subject to important developments and reform. Maria Chaves Jardim (JARDIM 2007 & 2009) distinguishes four distinct waves:

(i) 1985-1995: the development of occupational pension schemes throughout the private sector;

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16 http://www.camara.gov.br/internet/sileg/Prop_Detalhe.asp?id=394568

17 The Brazilian national retirement framework remains firmly rooted in a universal (mandatory) Pay-As-You-Go system, the Regime Geral de Previdência Social. The regime covers all workers of the private sector, and delivers a maximum monthly pension of USD800. In the public sector, a similar PAYG system is in place, the Regimes Próprios de Previdência Social, but with various specific funding and benefit provisions (over 2400 in total) for inter alia federal government, state and municipality workers. Throughout the 1990s and up until 2003, the national retirement system saw successive parametric reforms, including adjustments to the retirement age, the replacement rates, contribution levels, as well as some harmonization between private sector and public sector regimes. These were set as conditions to IMF financial support to Brazil. see Brazilian Letters of Intent and Memoranda of Economic Policies: http://www.imf.org/external/country/bra/index.htm?type=9998#23

(ii) 1995-2000: introduction of individual retirement schemes and as part of the privatization reforms, a marked shift from defined benefit (DB) to defined contribution (DC) pension schemes;

(iii) 2001: Promotion of private for-profit pension insurance schemes, reform of the governance of the closed schemes to include member-representatives, increasing portability of rights and extension of the coverage to cooperatives, not-for-profit sector, trade union and other industry associations; and

(iv) 2003: (under the Lula government) consolidation of the Cardoso reforms, and extension of the coverage to low-paid public sector workers (FUNPRESP) and to the private sector with new role given to collective bargaining, and banning of DB funding system for all new pension schemes created.

84. For Jardim, the recent pension reforms, including extension of the coverage of the closed schemes and democratisation of their governance, have benefited trade unions and were central in the reform programme of the Lula government and the ruling party the PT following the election of 2002. It was part, Jardim argues, of a political vision to "moralise capitalism" by giving members of the plan and their representatives, the unions, a voice in the investment policy of pension funds (JARDIM 2009)..

85. There are three forms of pre-funded schemes. In addition to the closed occupational not-for-profit schemes (*Entidades Fechadas de Previdência Complementar*), there are open (occupational or retail) for-profit pension funds schemes (*Entidades Abertas de Previdência Complementar*) and individual retirement schemes on the model of the US 401-k. Taking all forms of schemes together, the Brazilian pension industry accounts for circa USD200bn assets under management (2008 figures), which is more than the Chilean (USD74bn), Mexican (USD68bn), Argentinean (USD30bn) and Colombian (USD26bn) counterparts coimbined (OECD 2009). Another point of comparison is with the retail investment funds (mutual funds) for which assets under management in Brazil represent circa USD480bn overall (and USD380bn excluding pension fund's investments from mutual funds' portfolios). Looking specifically at closed pension schemes, in 2003, there were 360 funds with total assets under management of USD83bn covering 2108 employers, 1.7m contributory workers representing 2.2% of the workforce, and another 570000 family related beneficiaries. Concentration remains high as shown in Table 4 with the three large funds accounting for 40% of total assets of closed schemes: PREVI (Banco do Brazil), FUNCEF (savings institution) and Petros (Oil company Petrobras). About 8% of the country's workforce earn wage levels above the ceiling the general PAYG regime (USD 800 monthly) and hence would have incentives to enrol in the complementary system (OECD 2008). It should be noted that the pre-funded system is subsidised substantially by taxpayers. Pension contributions amounting to 12% of the employee's salary for workers plus 20% for employer are tax deductible and since January 2005 all returns on investment are tax free. Despite its 'private' nature, taxpayers and the government indirectly are key stakeholders in the Brazilian pre-funded pension system.

Pension fund governance and investment policy

86. The governance of pension funds reflects very much the Brazilian corporate governance system. All funds are required to have a three-tier board structure comprising of a Board (*Conselho Deliberativo*), an audit Board (*Conselho Fiscal*) and a Management Board (*Diretoria-Executiva*).

Board structure

87. As the highest governing body of the scheme, the *Conselho Deliberativo* has the dominant role in funding and investment policies, including the asset allocation strategy and approval of all transactions representing more than 5% of total AUM. The board nominates members of the Executive Directorate, as well as selecting the actuaries and auditors. For pension funds of large state-owned enterprise, the size of the board is limited to six members, three of which are nominated by the sponsor and three are elected by members and the contracting trade union. The chair of the board is appointed by the sponsor and has a deciding vote in the absence of a majority. Pension funds in the private sector have more diverse governance arrangements. Whilst they are required to adopt the same three tier board structure, it is the by-laws of the schemes that determine the composition and nomination processes, provided that a minimum of a third of the board is filled by member nominated representatives.

88. The *Conselho Fiscal* serves as countervailing body to the *Conselho Deliberativo*, with regard to internal controls and risk management. The composition must be balanced between the sponsor and the members (2 representatives each). While the Board chair is appointed by the sponsor, the *Conselho Fiscal* is chaired by member-nominated director. The *Diretoria-Executiva* is responsible for the effective implementation of the funding and investment strategy of the schemes. Its composition is determined by the Board which in effect results in a similar balance between employer and member-nominated representative. Regulation restricts management board membership to avoid conflict of interest. For example an executive director may not work for any other financial entity during the tenure of his/her mandate and shall respect a 12-month waiver period after the end of the term before joining another financial institution.

Table 4: Ranking of largest pension funds (June 2008)

		Status of the sponsor	**AUM R$bn**	**AUM €bn**	**Active members**	**retirees**
1	PREVI/BB	State-owned	137	53	85.926	83.395
2	PETROS	State-owned	41	16	64.076	54.966
3	FUNCEF	State-owned	33	13	65.139	27.531
4	FUNCESP	Private	16	6	17.408	31.36
5	VALIA	Private	10	4	51.175	21.007
6	ITAUBANCO	Private	10	4	30.221	5.718
7	SISTEL	Private	9	4	2.149	25.663
8	CENTRUS	State-owned	9	4	120	1.679
9	BANESPREV	Private	9	3	7.554	21.791
10	FORLUZ	State-owned	7	3	10.668	12.072
11	REAL GRANDEZA	State-owned	6	2	5.648	6.858
12	FAPES	State-owned	5	2	2.206	1.473
13	FUNDAÇÃO COPEL	State-owned	5	2	9.09	6.183
14	CXUSIMINAS	Private	4	2	16.458	10.411
15	POSTALIS	State-owned	4	2	N.I	N.I.
16	HSBC	Private	4	2	64.598	7.27
17	CBS	Private	4	1	11.464	19.883
18	VISÃO PREV	Private	4	1	14.131	4.202
19	TELOS	Private	4	1	7.167	6.126
20	ELETROCEEE	State-owned	4	1	6.475	7.112

Source: www.petros.com.br

Ownership of the funds and duties of trustees

89. The fund's assets have to be legally separated from the sponsors' balance sheet and are subject to separate financing and actuarial regulations. Legally speaking closed-end funds are established as not-for-profit agencies which financing is ruled by the principle that net investment incomes of the fund belong to member beneficiaries, not the plan sponsor. In case of surplus, the employer is not entitled to access the surpluses or to adjust downward its future contributions. Also, the concept of fiduciary duties, which is fundamental in common law regimes, has only been partially transposed in Brazil as in other civil law regimes. As noted by the UNEP-FI "civil law jurisdictions do not recognise fiduciary duties as such, those duties being a product of the common law. […] Investment decision-makers in these jurisdictions are subject to obligations that […] are articulated in various statutory provisions [including:] a duty to act conscientiously in the interests of beneficiaries, […] a duty to seek profitability […explicit or implicit] requirements to ensure adequate diversification" (UNEP-FI 2005). In the case of Brazil the regulation of the duties of pension fund administrators aims at preventing conflicts of interest, be it with the sponsoring employer or any other entity. It is however less stringent in terms of a requirement to optimise investment returns than the fiduciary duties required under common law. Accordingly the integration of non-financial criteria, including environmental social and governance investment conditions, prima facie would be less likely to conflict with the duties of Brazilian trustees.

Investment regulation and policies

90. Pension funds are required to disclose to the supervisory authority their risk management policy, including risk control systems and actuarial, financial and risk assessment mechanisms. Asset management as such either can be in-house or contracted out. About half of the funds contract out the management, another quarter, including the largest ones, have full in-house structures, the last quarter has mixed organisation.

91. The composition of portfolios is subject to several quantitative restrictions (maximum or minimum limits per asset class as a proportion of the total asset portfolio) which are regulated by the *Conselho Monetário Nacional*, the country's supervisory authority for financial markets. This is not surprising given that Brazil is a civil law jurisdiction and accordingly fiduciary duties are less demanding than in common law regimes. Indeed the comprehensive nature of the fiduciary duties arguable allows for pension investment policy to be ruled by a general prudent person standard and hence does not require supplement action through quantitative restrictions. The Table in annex 4 compares the investment restrictions in place in Brazil with Anglo-American common law jurisdictions and with Sweden a civil law jurisdiction that has a comparable pension system. Recently the Brazilian supervisors have introduced risk-based funding rules which allow pension funds to cross the regulated ceilings on variable income classes (equity, funds, real estate) provided that the fund maintains sufficient reserve surpluses to match the risk profile of the portfolio. While restrictions have been relaxed in the past decade, there are two specific restrictions that are worth mentioning.

92. First and foremost, foreign ownership is heavily restricted. In effect Brazilian pension funds are not allowed to invest in assets that are located and regulated abroad. Exceptions to this rule are investments in retail investment funds (mutual funds) for which exposure to foreign equity is permitted up to 20% of the retail fund portfolio, corresponding to 2-3% of the pension funds' total assets. In addition, any foreign exposure must be limited to the MERCOSUR market, hence excluding most OECD jurisdictions. While restrictions on

foreign ownership are common across OECD and non-OECD jurisdictions, the Brazilian regime is particularly restrictive in a regional context: the ceiling on foreign ownership is 40% in Colombia, 60% in Chile, and 20% in Mexico. The other distinct feature of the Brazilian regime is the ceiling on the pension funds' exposure to listed equities which is variable according to the corporate governance regime. The upper ceiling on normal listed equity exposure is 45% of total asset under management, and increase to 50% if invested in companies complying with the *Novo Mercado* listing segments. The exposure of pension funds to a single company ownership is also restricted, as pension fund cannot hold more than 20% of the capital of a single company.

Obstacles to shareholder activism

93. Historically, shareholder activism has been an alien concept to institutional investors in Brazil, amongst both asset managers and asset owners – pension fund and mutual funds. This was not too surprising given the relationship-based form of governance and ownership concentration that in the past has prevailed in Brazilian companies. The overwhelming power granted to the controlling shareholder by law with stock trading been limited to preferred shares (that is without voting right) gave very little space to any form of activism (which by definition is associated with minority groups building coalitions at the AGM).

Asset allocation

94. Brazilian asset owners contributed themselves to this passivity by their portfolio composition – with relatively little exposure to equity and with a policy of index-tracking. Effective asset allocation of pension funds for instance shows a strong bias toward bonds, which two thirds are government-issued. By contrast allocation to equity accounts for no more than 20% which is small by OECD standards, where allocation is typically above 30% of total portfolio, however it is in the norm in an emerging economy context. In effect such overwhelmingly preference for public debt means that economically pension funds can be considered as quasi-public financing institutions. As shown in annex 5 pension fund portfolio has diversified marginally over the past years. The share of real estate (hotels and shopping malls) which in the 90ies could reach up 8.5% has decreased since, but has not benefited any particular class. Retail funds and private funds represent a very marginal proportion of pension funds' portfolio.

Governance of mutual funds and asset managers

95. The passivity of Brazilian retail investment funds has also reflected the weak governance of the funds themselves. Individual investors in these funds are not necessarily given a right to representation in Brazilian funds which contractual status gives few powers to individual investors and is not suited for effective accountability of the portfolio manager to the individual investors (or quota holders). The creation of a board of directors or governing body with the upper hand over the investment policy of retail fund – and thus its shareholder policy – has yet to be the norm in Brazil.

96. As in other countries, the suspicion has arisen that Brazilian asset managers in charge of retail funds have no real interest in pushing for shareholder activism as long as the investee companies were or could be potential clients of the managers' other services. In response the Brazilian banking industry represented by the National Association of Investment Banks

(ANBID) has developed self-regulatory rules to ensure Chinese walls between their commercial banking activities (of which large companies are important clients), and their asset management activities (clients of which are institutional investors). Various codes and other voluntary initiatives that have emerged in the past decade have helped promote shareholder activism among asset managers, such as the ANBID "Guidelines for a representation policy of funds in meetings" or those of the Association of Capital Market Investor Association (AMEC).

Administrative barriers to proxy voting

97. The limited use of voting rights in the AGM has been associated with difficulties in allowing effective proxy voting. Proxies allow asset owners – pension funds, mutual funds, insurance groups – to delegate their voting rights to their asset managers, to an in-house legal experts or an outside lawyer usually along established sets of guidelines on the way to vote on key resolutions. While retail investment managers have had an obligation to disclose shareholder policy and guidelines in the fund's prospectus since the 1990s, there were not legal enforcement of this rule and until recently the prevailing practice was not to disclose any specific information on these matters. This problem of incentives for mutual funds was addressed to some extent in August 2004 when the CVM issued a binding instruction (nb 409) requiring mutual funds to establish and disclose an active shareholder voting policy. The CVM stressed that exercising voting rights was an integral part of the duties that asset managers owed to their investor clients. More recently the stock exchange authorities have tackled the administrative burden of proxy voting. In 2008 the CVM reduced the administrative requirements – including signature by a Brazilian notary – for the proxies to be made valid at the AGM and allowed for the use of online voting platforms.

The leading role of large pension funds

98. Since the early 2000s in practice the defence of minority shareholders in case of capital restructuring – which is one form of activism – has become more visible as seen in the AGM battles in the case of the group restructuring of Telemar and the takeover bid of Arcelor-Mittal for Ipiranage and the new voting policy by the largest pension funds. In 2002, the pension fund of Petrobras, Petros published a shareholder and investment policy guidelines, and this was followed by Previ and Funcef. They were put into practice in large listed companies in which the three pension funds have equity such as Vale and Embraer. But activism designed to achieve change in corporate governance at a targeted company remains a marginal activity in Brazil. The shareholder activism of Brazilian pension funds may be put at test in the on-going labour dispute over Vale's operations in Canada as mentioned above. As noted in a recent report by SHARE (Canada), Vale is controlled by Valepar (53.6% of voting rights) which in turn is controlled by Litel Participações, a holding company owned by the four largest pension funds, Previ, Petros, Funcef and Funces, with minority ownership of Bradespar S.A. and BNDESPar.

99. Another source of activism could come from the state itself. Because state-ownership remains prevalent in Brazil, the role of the state as a shareholder has also been under scrutiny in the media. In particular there is a growing attention to the investment and shareholder policy of the BNDES which has minority participations in many large Brazilian listed companies via its ownership entity BNDESPar. On the civil society side, the campaign

Plataforma BNDES aims at monitoring and reforming the investment policy of the development bank along ethical and socially responsible lines[18].

18 http://www.plataformabndes.org.br

Conclusion and issues for discussion

100. Corporate governance in Brazil remains dominated by controlling shareholders and wealthy families in particular, who through a dual class system and pyramid group structures have been able to maintain control over the private sector in spite of two decades of deregulation and market opening. This is not surprising in the context of an emerging economy although the level of concentration of ownership in Brazil is particularly high even by emerging economy and Latin American standards. The wave of privatisation in the late 1990s was supposed to have led to improved market discipline among corporate managers and installed shareholder value governance and AGM democracy. In fact it had exactly the opposite effect. The IMF-supported reforms allowed the grip of very wealthy families over the economy to continue, while allowing large parts of the most profitable and competitive sectors to be transferred to foreign ownership.

101. The election of Lula to the Presidency at the end of 2002 and the parliamentary majority won by the Workers' Party the PT can be seen as a catalyst for helping to shake up the well established and powerful interests of Brazilian controlling families. In anticipation of the widely expected electoral win of the PT, the incumbent government of Cardoso succeeded in 2001 where it had failed in 1997 at the time of the privatisations, to partly redress the bias of the regulatory framework in favour of controlling shareholders. It did so with a very measured reform of the corporate law, and with the introduction of voluntary *Novo Mercado* listing segments. From the point of view of the "political economy of reform" the policy of Cardoso was a belated attempt to rehabilitate, in the eyes of the public, the most unequal and authoritarian aspects of Brazilian private sector governance, while at the same time locking into self-regulation the more demanding measures of corporate governance. This two-tier level reform that took place in 2001 – (i) measured reform of corporate law supplemented by (ii) self-regulatory initiatives – and the political independence granted to the stock exchange authority the CVM was aimed at preventing more radical change of policy direction after the election of the PT in 2003.

102. Since 2003 Lula's government has implemented important reforms to increase social inclusion which mark a clear shift from the policies of the past in a progressive direction. Examples include the democratisation of the governance of pension funds as a stand-alone policy objective, which had been initiated by the PT under the last Cardoso government, but which was moved further up the reform agenda. By contrast government activism has been less visible on corporate law issues – confirming the successful initiatives of the pre-Lula election. An exception is that concerning creditors' rights and the reform of the Bankruptcy law in 2005.

103. The reform of the corporate law 6404/76 of 2001 achieved some progress in enabling minority shareholders to serve as counterweights to the controlling shareholder group. But progress was limited – not least for shareholders' right to access the agenda of the AGM which still is something for the future in Brazil. And reform came at the cost of greater complexity of the law itself. The end result is that the corporate governance map of the Brazilian corporation has not increased in clarity. In addition to the visible part of the iceberg – the Board of Directors around which gravitate the Fiscal Board and the AGM – there exists the invisible, or less visible part – the shareholder agreement that binds the shareholders in

forming a controlling block. The fact that controlling shareholders have duties by law that are equivalent to those applying to directors, or that the shareholder agreement – which is a private contract – are binding on the board and on top management are clear indications of where the centre of gravity of corporate power lies in Brazil. Being ruled by civil law doctrine, the duties of directors include a requirement for directors to serve the social purpose of the company. This is something that might be considered undesirable by World Bank and OECD experts for whom directors' duties can only conceivably be toward the shareholders and the shareholders only. It would be important to test the Brazilian corporate law notion of director's duties, which also applies to the controlling shareholder, and in particular to explore what is covered by the social purpose of the company.

104. The reforms initiated by the Lula government, and by PT parliamentarians under the previous Cardoso government, to open up the boards of pension funds to trade unions have paved the way for a workers' capital stewardship framework in Brazil. Today, trade union representatives sit on the boards of the country's largest pension funds. Obstacles to proxy voting have been eliminated and a modest rise in shareholder activism can be observed. Yet, the corporate law still favours the controlling family groups. Also the portfolio composition of pension funds is overwhelmingly in favour of government bonds, whereas the equity exposure – where workers' capital strategies come into effect – is below 20%. As such the investment policy of Brazilian pension funds is aimed at financing government debt. Considering the tax subsidies that benefit the pension industry and their members, one can consider Brazilian pension funds close to quasi-public financial institutions.

105. The development of worker participation mechanisms in the continental European sense of the term – has not been government policy, although in practice there are many board level employee representatives (elected democratically by the prevailing union) and various forms of company-specific worker committee do exist. This could change in the period ahead given the proposed legislation on board level employee representation in state-controlled companies. However, even so, much could be done to improve information and analysis on worker participation and representation on the governing boards of private companies and of pension funds. There is little literature and no comprehensive and systematic surveys available on these issues. Quantitative and qualitative surveys of worker representation in private companies and in pension funds in Brazil would be useful research.

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Annex

Annex 1: Ownership & corporate governance regime of largest listed companies (IBOVESPA index)

Company Name	Listing	Weight in the index	Controlling and other key shareholders
PETROLEO BRASILEIRO S.A. PETROBRAS	-	18.447	BNDESPAR
ITAÚ UNIBANCO HOLDING S.A.	Nivel 1	5.649	Setubal, Villella & Madeira families
BMFBOVESPA S.A. BOLSA VALORES MERC FUT	NMercado	4.897	
GERDAU S.A.	Nivel 1	4.319	Gerdau family, BNDESPAR
BCO BRADESCO S.A.	Nivel 1	3.61	
CIA SIDERURGICA NACIONAL (CSN)	-	3.502	Steinbruch family, BNDESPAR
BCO BRASIL S.A.	NMercado	2.666	BNDESPAR
ITAUSA INVESTIMENTOS ITAU S.A.	Nivel 1	2.231	Camargo Correa
CYRELA BRAZIL REALTY S.A.EMPREEND E PART	NMercado	1.76	
CENTRAIS ELET BRAS S.A. - ELETROBRAS	Nivel 1	1.641	BNDESPAR
CIA ENERGETICA DE MINAS GERAIS – CEMIG	Nivel 1	1.465	
ALL AMERICA LATINA LOGISTICA S.A.	Nivel 2	1	BNDESPAR
SADIA S.A.	Nivel 1	1.265	
LOJAS AMERICANAS S.A.	-	1.163	JP Lemann, M Herrmann Telles & CA Sicupira
ARACRUZ CELULOSE S.A.	Nivel 1	1.158	Ex-Safra family, BNDESPAR
METALURGICA GERDAU S.A.	Nivel 1	1.107	
BRADESPAR S.A.	Nivel 1	1.091	BRADESCO
GAFISA S.A.	*Novo Mercado*	1.054	
GOL LINHAS AEREAS INTELIGENTES S.A.	Nivel 2	1.049	
CIA BEBIDAS DAS AMERICAS - AMBEV	-	1.04	JP Lemann, M Herrmann Telles & CA Sicupira
REDECARD S.A.	NMercado	1.03	
LOJAS RENNER S.A.	NMercado	1.023	
TELEMAR NORTE LESTE S.A.	-	0.963	BNDESPAR
CESP - CIA ENERGETICA DE SAO PAULO	Nivel 1	0.91	BNDESPAR
B2W - COMPANHIA GLOBAL DO VAREJO	NMercado	0.906	
BRF - BRASIL FOODS S.A.	NMercado	0.888	
TAM S.A.	Nivel 2	0.846	
ELETROPAULO METROP. ELET. SAO PAULO S.A.	Nivel 2	0.745	
NET SERVICOS DE COMUNICACAO S.A.	Nivel 2	0.72	
ROSSI RESIDENCIAL S.A.	NMercado	0.719	
JBS S.A.	NMercado	0.689	BNDESPAR
EMBRAER-EMPRESA BRAS DE AERONAUTICA S.A.	NMercado	0.641	Julio Bozano, BNDESPAR
CIA PARANAENSE DE ENERGIA - COPEL	Nivel 1	0.626	BNDESPAR

NATURA COSMETICOS S.A.	NMercado	0.619	G Peirao Leal & AL Seabra
SOUZA CRUZ S.A.	-	0.603	
DURATEX S.A.	Nivel 1	0.602	ITAUSA / Camargo Correa family
CIA BRASILEIRA DE DISTRIBUICAO	Nivel 1	0.588	
CIA CONCESSOES RODOVIARIAS	NMercado	0.585	Camargo Correa family
COSAN S.A. INDUSTRIA E COMERCIO	NMercado	0.56	
BRASKEM S.A.	Nivel 1	0.542	Odebrecht family, BNDESPAR
CPFL ENERGIA S.A.	NMercado	0.463	BRADESPar Camargo Correa, BNDESPAR
CIA SANEAMENTO BASICO EST SAO PAULO	NMercado	0.35	
KLABIN S.A.	Nivel 1	0.345	BNDESPAR
BCO NOSSA CAIXA S.A.	NMercado	0.343	
BRASIL TELECOM S.A.	Nivel 1	0.312	
BRASIL TELECOM PARTICIPACOES S.A.	Nivel 1	0.281	BNDESPAR
LIGHT S.A.	NMercado	0.199	BNDESPAR
CENTRAIS ELET DE SANTA CATARINA S.A.	Nivel 2	0.108	
CIA GAS DE SAO PAULO - COMGAS	-	0.096	
Cia. Vale do Rio Doce (CVDRD, Vale)			BNDESPAR

Annex 2 : Largest Brazilian subsidiaries of foreign multinational groups

Ranking per turnover in the top 50 largest Brazilian companies (2003)	Company	Sector	Location of the MNE headquarters
4	Telefonica	Telecommunications	Spain
7	Volkswagen	Automobiles	Germany
8	Shell	Wholesale (Fuel)	UK/Holland
9	General Motors	Automobiles	USA
11	Bunge Food	Food and Drink	Argentina
14	Carrefour	Retailer	France
16	Esso	Wholesale (Fuel)	USA
17	Texaco	Wholesale (Fuel)	USA
19	Cargill	Food and Drink	USA
21	Nestle	Food and Drink	Switzerland
22	FIAT	Automobiles	Italy
26	Unilever	Pharmacy	UK/Holland
31	Itaipu	Utilities (Electricity)	Brazil/Paraguay
34	AGIP	Utilities	Italy
36	DaimlerChrysler	Automobiles	Germany
40	Ford	Automobiles	USA
43	Bunge Fertilizers	Fertilizers	Bermuda
46	Nokia	Electronics	Finland
49	Basf	Chemicals	Germany

Annex 3: Corporate law, Novo Mercado and IBGC corporate governance requirements

	Law 6.404/76 **(2001 rev.)**	**Nível 1**	**Nível 2**	**Novo Mercado**	**IBGC Code**
Minimum free float of the share capital	n.a.	25%	25%	25%	“As many shares as possible”
Dual classes of share	Dual class allowed: common shares with voting rights, preferred shares non-voting rights	Dual class allowed	Dual class allowed; Six month lock-up period after the IPO before controlling shareholders can sell their shares	Single class only; Six month lock-up period after the IPO before controlling shareholders can sell their shares	Single class recommended; Dual class tolerated but with enhanced rights attached to preferred shares
Controlling shareholder agreement	Confidential (with the exception of distribution of dividends); The chair of the AGM or the Board of Directors must reject a vote or a resolution, should it infringe on the shareholder agreement.	n.a	n.a	n.a	Public disclosure; Content should not restrict directors’ duties toward the company; Creation of a “family council” recommended
Minimum nb of days’ notice of the AGM	15 days	15 days	15 days	15 days	30 days
Access of minority shareholders to the agenda of the AGM	No access to the ordinary AGM. Minority shareholders can call an extraordinary general meeting (and determine the agenda) if they represent at least 5% of the share capital.	n.a	n.a	n.a	“Mechanisms should be encouraged” for any shareholder to include an item on the agenda
Tag along rights of preferred shares	n.a.	Minimum 80%	Minimum 80%	Not applicable (preferred shares not allowed)	100%

Independence of the board of directors	No requirement. (The controlling shareholder (or group) has a statutory right to nominate half +1 of the board members.)	n.a	20% of directors qualify as independent directors	20% of directors qualify as independent directors; Unified 2-year term (no staggered board of directors).	Majority of independent directors; Separation of CEO & chair positions recommended; 1-year term; Creation of an audit committee made up independent directors only.
Fiscal council	Minority shareholders can nominate two representatives out of three to five members.	n.a	n.a	n.a	Controlling shareholder to cede right to majority to minority shareholders.
Executive compensation	Shareholders representing 5% or more of the capital may require individual disclosure by a board member (However, the latter may refuse or "refrain from publishing" the information, should disclosure pose a risk to the "legitimate interest of the corporation).				To be disclosed "by group, if not individually"
Reporting	n.a. (However, for listed companies CVM instruction nb 457 requires compliance with IFRS as of 2010)	Enhanced disclosure of the quarterly financial statements; Reporting of related-party transactions to the *BOVESPA*; English translations;	Enhanced disclosure of the quarterly financial statements; Reporting of related-party transactions to the *BOVESPA*; Compliance with either US GAAP or IFRS norms; English translations;	Enhanced disclosure of the quarterly financial statements; Reporting of related-party transactions to the *BOVESPA*; Compliance with either US GAAP or IFRS norms; English translations;	n.a.
Recourse to private arbitration for dispute resolution	n.a.	n.a.	Mandatory	Mandatory	Recommended

Annex 4: Pension fund investment regulation in an international comparison

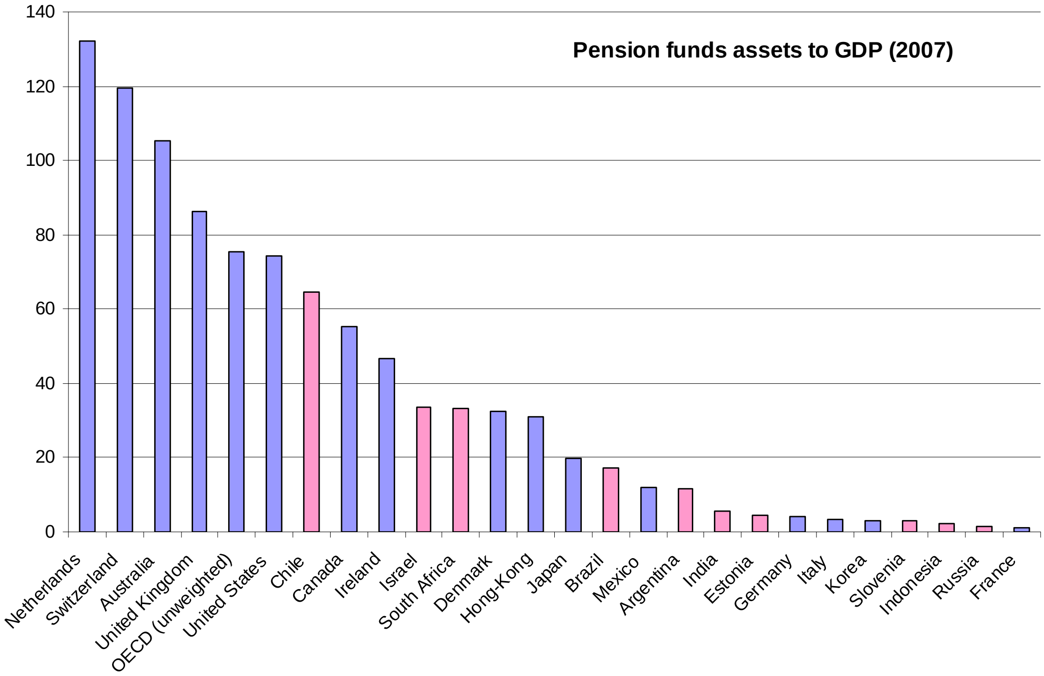
Asset class	Brazil (closed-end)	Sweden (IORP)	Anglo-American
Listed Equity	35 to 45% max 50% in corporate governance "*Novo Mercado*" rated companies.	No limit if quoted	No limit (except conflicts of interest or employer-related
Unlisted equity	20% max	10% max	
Real Estate	8%	No limit	No limit except conflicts of interest or employer-related
Bonds	No limit for gvt bonds 80% max for other bonds	No limit for gvt bonds 75% max for bonds issues by banks 50% max for corporate bonds 10% max for unquoted bonds (CDOs)	No limit, except conflicts of interest or employer-related
Retail funds	No limit on Brazilian funds	No limit (Max 5% for AP funds)	No limit
Private funds	No limit on Brazilian funds	No limit (Max 5% for AP funds)	No limit
Loans	10-15%		No limit, except conflicts of interest or employer-related
Bank deposits	80%		No limit
Foreign assets	Not allowed, except for 2-3% through retail funds and restricted to Brazilian Depositary Receipts within MERCOSUR	No limit (a part from currency exposure provision)	No limit
Investment in single issuer	None for gvt bonds Max 30% for other classes	5% max in shares, bonds and loans issued by a single company or real estate; 10% max in a single investment fund; 5% max in a single real estate investment.	Australia: Diversification principle Canada: max 5-10% UK: Diversification principle US: : Diversification principle, exceptions for DC schemes
Self-investment / Conflicts of interest	10% Max	5%-10% max	Australia : Max 5% Canada: Max 10% UK: 5% US: Max 10%, exceptions for DC schemes
Shareownership concentration in a single issuer	20% max (voting or non-voting)		Canada: 30% of voting rights

Source: OECD 2009a

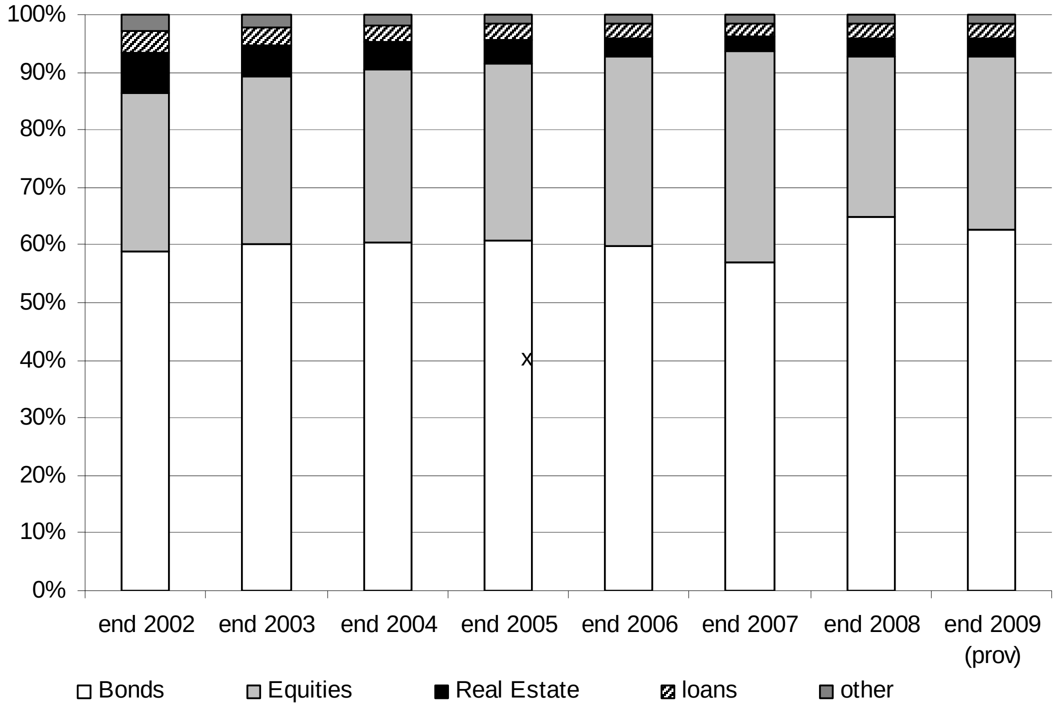
Annex 5: Size and asset allocation of Brazilian pension funds

Source: OECD

- **Size of the pension fund industry relative to GDP across the OECD & emerging economies**



- **Pension fund asset allocation 2002-2008**



- **Pension funds' exposure to listed equity in OECD and emerging economies**