

Corporate Governance in Latin America

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There has been a remarkable level of recent activity to develop and improve voluntary corporate governance codes within a significant number of Latin American countries. Mexico (December 2006), Colombia (April 2007) and Argentina (October 2007) have all announced the issuance of improved national corporate governance codes, while Peru is currently working to update its code. In addition, Costa Rica (June 2007), and Chile (October 2007) have each just issued their first voluntary national code. In Brazil the Brazilian Institute of Corporate Governance (IBGC) has already issued three versions of its national code and has indicated an intention to update it again in 2009. The Andean Development Corporation (Corporación Andino de Fomento, CAF) has also been working to actively promote corporate governance in Andean countries through its regional code (2005, hereinafter the Andean Code) as well as its implementation processes. Finally, Panama also developed a code in 2003.

In its previous discussions the OECD Roundtable on Latin American Corporate Governance concluded that, while some desirable improvements could be achieved through further legal

reform, major legal reforms have already occurred in Argentina,¹ Brazil and Chile (2000–01) and more recently in Colombia (2005) and Mexico (2006). Within this context, achieving further legal improvements would be politically difficult, so most countries have focused on improving enforcement and private-sector implementation as main priorities.

7.4.1 The Economic Background

Almost five years of uninterrupted economic growth in Latin America to 2007, although modest when compared to booming economies in Asia, brought relative economic stability to a region previously characterized by frequent financial crises. This stability, accompanied by global economic growth and liquidity in the financial markets, has also attracted increasing amounts of foreign investment. Most Latin American financial markets grew significantly during this period, while the demand for local equity now comes from both local and international investors. The stock markets of the largest Latin American economies have shared in this growth, with most stock markets expanding faster than their overall economies' gross domestic product (GDP).

The country whose capital market has attracted most attention is Brazil, because of the growth of the Novo Mercado special corporate governance listing tiers of Bovespa. Up to 2007 the number of listings on the special corporate governance listing tiers of Bovespa had been roughly doubling every year. This increase admittedly started from a low base, but has become increasingly significant, with 66 new listings in 2007.

While other countries in Latin America have not undergone as dramatic a transformation as Brazil, several countries, particularly Colombia and Peru, have also been seeing strong increases. And what we have seen in all of these countries, including also Mexico and Chile, whose markets have not been growing as fast, is that they are eager to prove their corporate governance credentials through legislative reforms or voluntary initiatives or a combination of both.

A second reason is the important role that institutional investors – particularly pension funds – play within the Latin American ownership structure, where there is typically a dominant majority shareholder or controlling group, with institutional investors often in a minority shareholder position.

The experience of Brazil and the interest of other countries in showing that they too are taking corporate governance seriously has promoted a vibrant debate in the region about the best way forward – through legal and regulatory measures combined with active enforcement programmes, or through more self-regulatory measures, such as adoption of ‘comply or explain’-type corporate governance codes, or through the Brazilian Novo Mercado example.

7.4.2 Differing Code Objectives

The *OECD Principles of Corporate Governance* (*OECD Principles*) recognize the variable role of voluntary codes within a country’s corporate governance framework: ‘The desirable mix between legislation, regulation, self-regulation, voluntary standards... will therefore vary from country to country. As new experiences accrue and business circumstances change, the content and structure of this framework might need to be adjusted.’²

Not surprisingly, Latin American experience reflects this variability. Different countries have established different main objectives and elaboration processes for developing their codes, emerging from their particular legal and institutional frameworks. Some countries, notably Argentina, Brazil and, more recently, Mexico and Chile, have focused mainly on using their voluntary national corporate governance codes for educational purposes, providing a convenient benchmarking tool for company management, boards and other relevant players in the market to assess the level and potential for improving corporate governance practices in companies.

Others, including Colombia, Costa Rica, Panama, Peru, Spain and the recent regulator-led code in Argentina, while maintaining an educational value, have focused especially on using their codes as a means for enhancing disclosure and market understanding of company corporate governance practices through a ‘comply or explain’ reporting mechanism aimed at complementing the legal framework. CAF’s Andean Code, while intended for educational purposes to support company adoption of corporate governance and country development of national corporate governance codes, also strongly supports ‘comply or explain’ mechanisms to help ensure that the codes are taken into account.

Behind these objectives is a debate over the appropriate balance between regulatory and voluntary approaches to corporate governance. In Brazil the educational and entirely voluntary nature of the code of the Instituto Brasileiro de Governança Corporativa (IBGC) reflects the fact that it plays a complementary role to the legal and regulatory framework combined with the self-regulatory approach of the Novo Mercado, which enables companies to commit voluntarily to higher corporate governance standards. Because listed companies already have a means of publicly disclosing their commitments to higher corporate governance standards by listing on one of the three corporate governance listing segments of Bovespa, there may be less demand in the market for a separate reporting/disclosure mechanism concerning voluntary measures. Rather, the IBGC, the author of the code, can focus on promoting good practices, particularly on issues not covered by the Novo Mercado, and also on reaching a wider audience than just companies adhering to Bovespa's corporate governance listing standards, including non-listed family-owned companies. The IBGC code is also intended to serve as an important benchmark or reference for the market and regulatory authorities, but it is left to the market to determine how it may best make use of the code, rather than requiring disclosure against its detailed provisions.

While most other Latin American countries are moving towards a 'comply or explain' mechanism referencing their voluntary codes, Mexico is another exceptional case in which the regulator decided to drop an earlier 'comply or explain' mechanism, because Mexico's recent Securities Law amendment established significantly stricter corporate governance standards across a number of areas. As a result, the private-sector leaders in the development of the revised 2006 corporate governance code have chosen to target the voluntary code to a broader audience, including non-listed companies.

In the case of Argentina, an 'educational' code was issued in 2004 by the Instituto Argentino para el Gobierno de las Organizaciones (IAGO), a non-profit private-sector institution (hereinafter IAGO's Code). Likewise, the Comisión Nacional de Valores (CNV), the securities market regulator, has just recently issued a 'comply or explain' code in order to complement the legal framework (hereinafter, CNV's Code). However, because of the recent appearance of the latter, this report will mostly refer to IAGO's Code unless indicated otherwise.

7.4.3 Code Developments

The first wave of codes came following the issuance of the *OECD Principles* in 1999, with Brazil and Mexico issuing their first voluntary corporate governance codes the same year. As global attention to corporate governance continued to increase, and the Latin American Roundtable on Corporate Governance, launched in 2000, worked to develop a White Paper on corporate governance in Latin America, various countries and organizations, including Colombia (2002), Peru (2002), Panama (2003), Argentina (2004), Brazil (updated versions of its code in 2001 and 2004) and CAF (2005), came out with codes. For this first wave of code development the main objective was to build awareness and educate companies and the market about good practices. While development of the Brazilian code began before the issuance of the *OECD Principles* and drew upon an international comparison of other voluntary codes, all other codes cite the *OECD Principles* as a main reference in setting the framework for issues addressed. For those adopted after 2003, the White Paper was an additional reference. Interestingly, while the *OECD Principles* are aimed foremost at the overall policy framework, the most successful codes in Latin America have tended to go into much greater detail concerning company practices.

A second wave of code development has begun, with Colombia and Mexico issuing new versions of their codes that have taken into account recent corporate governance legal reforms, while Peru has also undertaken a recent code review process. Most recently, new codes were issued in Argentina, Chile and Costa Rica. Most of these recent efforts have tended to move beyond basic awareness raising and education on good practices to also incorporate regulatory-mandated 'comply or explain' mechanisms to facilitate reporting on corporate governance compliance, and to create additional incentives for companies and the market to be aware of and make use of the good practices identified in their codes. Proponents of these new codes have in some cases acknowledged weaknesses in their original attempts and have attempted to incorporate lessons learned to ensure that their codes are suitably adapted to the purpose of 'comply or explain' mechanisms.

7.4.4 Main Actors

Corporate governance codes in Latin America were developed by a variety of public- and private-sector parties ranging from regulator-led initiatives in Panama, Peru, Spain and the recent CNV's Code in Argentina, to private-sector-led initiatives (with strong participation of the regulator) in Colombia and Mexico, to corporate governance institutes with mainly private-sector membership leading code development in Argentina (IAGO's Code), Brazil and Chile. In Costa Rica, the code was exclusively developed by the private sector and the stock exchange.

In some countries, institutional investors are already playing a role in promoting best practices through corporate governance codes. Colombia's case is of particular interest, because institutional investors are required to take into account and provide a detailed report on the corporate governance structure of each company, and to disclose the importance of this review within the investment decision-making process. However, this requirement does not imply that a poor evaluation of the company's corporate governance system will limit the investment in all cases.

In some other countries, including Brazil and Chile, certain pension funds have developed their own corporate governance codes. For example, in Chile, where no national corporate governance code was developed until very recently, Cuprum, a pension fund, developed a voluntary code that distributes among its investee companies in order to persuade them to adopt its recommendations. It also follows up and monitors this process through the directors it appoints to the boards of some investee companies. In this sense, a pension fund code can help the market by providing benchmarks that are higher than those legally required, and provide clarity on investor expectations and demand for good corporate governance practices.

However, a broader concern is to avoid creating multiple and conflicting standards that may lead to confusion for companies and the market. For this reason, it is considered good practice for such codes to reference and specify how they relate to voluntary national codes and other legal, regulatory and listing requirements.

Notes

1. Publication deadline before the Roundtable's December 2008 meeting in Mexico City did not allow for this chapter to take into account the most recent developments in the region. However, more recent reports are available on the Roundtable website.
2. Annotations to Principle I of the *OECD Principles of Corporate Governance* (2004).

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(Note on sources: This chapter is based on 'Synthesis Report: Voluntary corporate governance codes in Latin America' and 'Institutional Investors and Corporate Governance in Latin America: Challenges, promising practices and recommendations' by Daniel Blume and Felipe Alonso in the OECD Corporate Affairs Division, presented to the Latin American Corporate Governance Roundtable at its meeting in October 2007 in Medellín in Colombia.)