LATIN AMERICAN CORPORATE GOVERNANCE ROUNDTABLE TASK FORCE REPORT ON RELATED PARTY TRANSACTIONS

December 2012

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CHAPTER 1: OVERVIEW

Introduction

1. The Latin American Corporate Governance Roundtable agreed to establish a Task Force on Related Party Transactions at its meeting of 29-30 November, 2011, following discussion of a preliminary survey of practices in the region, "Survey Report on Related Party Transactions," available at http://www.oecd.org/dataoecd/60/26/49289164.pdf (the "Survey Report").

2. The objective of the Task Force is to exchange information, from Latin American countries and beyond, regarding successes and challenges involved in developing effective frameworks to prevent abuse of related party transactions ("RPTs"); and to have an impact on improving these frameworks and company practices by developing country-specific information and recommendations for participating Latin American countries.

3. Consistent with the Survey Report's understanding of RPT, the scope of the Task Force's work is limited to the treatment of transactions between a company and entities that control, are controlled by or are under common control with the company, along with business conducted by the company directly or indirectly with persons and entities with the potential to influence the company's behaviour, including shareholders, directors, employees and others. Any discussion of the problems presented by and the proper treatment of RPTs naturally involves consideration of the conflicts of interest that such transactions present for some of those associated with the company. However, the broader legal and regulatory framework with respect to conflicts of interest and duty of loyalty are not the focus of the Task Force's work.

4. While the Survey Report provided a good starting point for understanding the overall frameworks of participating countries and identifying some issues and priorities for additional attention, further development of this information and more in-depth discussion of the most involved stakeholders on these issues is needed to develop country-specific recommendations that may influence further, significant improvements in the treatment of related party transactions.

5. The Task Force includes representatives of securities regulators from the region, and additional relevant stakeholders and experts nominated either by the regulator or the OECD Secretariat from each participating country (Argentina, Brazil, Chile, Colombia, Mexico and Peru; each such set of participants, is referred to herein as a "Country Level Task Force"). In addition, the OECD has invited additional experts from OECD countries and international organizations to support the Task Force's deliberations.

6. Concerning the scope of work programme for this group, the Task Force agreed to accept as a starting point to explore in greater depth the following issues:

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

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

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

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

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

  - Offer guidance on appropriate procedures for Board or shareholder review of RPTs?

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

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

  - Require fairness opinions or empower minority shareholders or independent directors to request such independent assessments?

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

- Should there be a greater role for private remedies (shareholder suits, alternative dispute resolution, voluntary best practice recommendations etc.)?

- Taking into account that there are costs associated with greater regulation in any area of economic activity, is there a danger of over-regulation of RPTs and accordingly should there be greater reliance on market forces?

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

7. A written questionnaire supplementary to the one prepared for the Survey Report was circulated to all Task Force members, and responses received in April and May 2012. After a preliminary review of the responses by the reporter, a series of conference calls was held with the members of each Country Level Task Force. Subsequently, the initial draft of this Report of the Country Level Task Forces on Related Party Transactions, which included country-specific chapters and draft recommendations, was presented and discussed at the first meeting of the Task Force held in Rio de Janeiro on 28 June, 2012.

8. Valuable inputs were received from Task Force members as well as the international experts invited to comment on the country-specific chapters at the Rio meeting. Upon conclusion of its discussions, the Task Force agreed to finalize the Report, incorporating the comments received at the meeting, and to include in the final version suggestions for possible region-wide coordinated efforts that may be taken in support of the country-specific and general recommendations of the Report. The Task Force also agreed to move to a dissemination phase to promote the Report's findings and

recommendations. The members of the Task Force will meet again back-to-back to the 2013 meeting of the Latin American Corporate Governance Roundtable, when they will be invited to report on actions to implement the recommendations.

International trends and recommendations on related party transactions

9. The OECD Principles of Corporate Governance (2004) include the following key recommendations:

- Principle III.A.2: Minority shareholders should be protected from abusive actions by, or in the interest of, controlling shareholders acting either directly or indirectly, and should have effective means of redress.

- Principle III.C: Members of the board and key executives should be required to disclose to the board whether they, directly, indirectly or on behalf of third parties, have a material interest in any transaction or matter directly affecting the corporation.

- Principle V.A.5: Disclosure should include, but not be limited to, material information on … related party transactions.

- Principle VI.D.6: The board should fulfil certain key functions, including … monitoring and managing potential conflicts of interest of management, board members and shareholders, including misuse of corporate assets and abuse in related party transactions.

10. The Roundtable's "White Paper on Corporate Governance in Latin America" (2003) also highlighted the issue of related party transaction disclosure as one of six key priorities for ongoing attention, stating:

- **Ensuring the Integrity of Financial Reporting and Improving the Disclosure of Related Party Transactions**. National accounting standards should be brought into compliance with International Financial Reporting Standards and the quality of the financial reporting process should be assessed with a view to eliminate conflicts of interest. The disclosure of related party transactions and potential conflicts of interest in such transactions should also be improved and supported by better information about corporate ownership and control structures.

11. More specific recommendations in the White Paper were set out in Paragraphs 73 – 77 under the heading, "Conflicts of Interest and Related Party Transactions":

> ***73. The legal framework should require the company and controlling shareholders to identify all parties with whom controlling owners have a material business relationship relevant to the company, and to fully disclose all material related-party transactions.***
>
> 74. The legal framework should require full disclosure on a periodic basis of director affiliation and interests and total remuneration. Publication of such information should be included in the periodic reports of the company made available to shareholders.
>
> ***75. Companies should articulate and fully disclose their policies with respect to transactions that might raise concerns for minority shareholders because of potential conflicts of interest of controlling owners, directors and managers.***

76. Certain types of corporate activities involving potential conflicts of interest on the part of controllers and company management – including transactions with affiliated parties, lending to insiders, management contracts with controllers or affiliates and co-investment by the company in other ventures of the controlling shareholder – have come under special scrutiny by minority shareholders in Latin America. In response, companies in the region have begun to adopt special procedures for review of such transactions to ensure that they are conducted in the best interests of the company. These procedures may involve review by special committees of the board composed of independent directors, securing opinions of independent outside experts, and in some cases a requirement of minority shareholder approval.

77. All companies should identify activities that present particular potential for conflicts of interest and clearly articulate their policies for how to ensure such conflicts do not result in transactions on terms unfavourable to the company. These policies should be fully disclosed to shareholders and the public. Certain types of transactions permitted under national law (e.g., lending by non-financial companies to insiders, controllers and their affiliates) may present so great a potential for real or perceived conflicts of interest, that the wisest company policy may be simply to prohibit them. In the case of permitted transactions, a useful approach may be to place the burden of proof on the company and the conflicted party to demonstrate that the terms of such transactions are in the interests of the company and all shareholders.

12. The OECD's Corporate Governance Committee decided to tackle the issue of related party transactions in 2011 through a comparative review of 31 OECD and G20 member countries, including in-depth reviews of **Belgium, France, India, Israel** and **Italy**. All five markets feature a strong presence of corporate groups and concentrated ownership, again offering an opportunity to extract lessons that may be relevant for Latin American consideration as well.

13. Some of the findings from the report, "Related Party Transactions and Minority Shareholder Rights" (See http://www.oecd.org/dataoecd/28/29/50089215.pdf), are highlighted below for the Latin American Task Force's consideration:

Overall considerations on RPTs

- The framework for oversight of related party transactions involves consideration of a trade-off. On the one hand, it is widely accepted that related party transactions can be economically beneficial, especially in company groups where there are often developmental arguments that they substitute for under-developed markets and institutions. Therefore, RPTs generally are not banned with some exceptions such as loans to directors.

- On the other hand, there is a clear concern that such transactions can be abused by insiders such as executives and controlling shareholders. Some empirical work has pointed to lower share valuations in companies that report high levels of RPTs.

- Considering the challenges associated with these trade-offs, OECD and G20 approaches to oversight of RPTs are still evolving, and effective overall solutions still have not been found in many jurisdictions.

Board review processes and duties

- Board review and approval of RPTs is the primary method used by OECD and G20 countries to prevent abuse of RPTs. Often independent board members play an important role in such

reviews, particularly in audit committees or through requirements that any member of the board with an interest in an RPT refrain from voting.

- Belgium, India, Israel and Italy all place the first responsibility on an audit or specialised committee of the board comprising a majority of independent directors. Director independence is reinforced in some countries (Italy and Israel) where minority shareholders have some rights to nominate and elect independent directors. For this system to work it is clear that regulators must have the right to determine who is a minority shareholder. Enforcement of underlying directors' duties to the interests of the company remains important as well.

- Materiality thresholds are clearly necessary in establishing an efficient management regime for RPTs. Qualitative criteria in Italy did not work well in practice so they replaced it with quantitative criteria such as whether the value of the transaction exceeds 5 per cent of different balance sheet items related to calculations of the company's market value, assets and liabilities. In the case of pyramids, the ratio for materiality is 2.5 per cent, reflecting the stronger incentives to abuse RPTs. Cumulative thresholds for transactions with the same related party should also be considered. However, such essentially arbitrary criteria carry the risk of manipulation by companies, so that they need to be underpinned by actions such as requiring continued reporting to the regulator of transactions below the limit.

Shareholder review processes and duties

- Shareholder review is required most often only in special cases as an alternative or complement to board procedures, such as when the board or its audit committee recommends against the transaction or cannot vote due to conflicts of interest. In a few cases, shareholders review a much wider range of transactions. (France, for example, requires the auditor to prepare a special report for AGM ex post review of all non-recurring related party transactions and/or those occurring under abnormal conditions.)

- Shareholder approval is an important safeguard in some jurisdictions to provide a check against board review not necessarily functioning as it should under all circumstances, especially for RPTs involving the issuance of securities. Approval by a majority of all shareholders is often viewed as providing insufficient assurance and Italy, Israel and France call for approval by disinterested shareholders (majority of the minority).

- Israel also has protection against "hold-up" by a small minority (for majority of minority vote to be accepted, it must represent at least 2 per cent of total voting rights*)* who can abuse their position.

- Israel also has an explicit duty for all shareholders "to act in good faith and in a customary manner" towards the company and towards other shareholders, including a duty to avoid discrimination against other shareholders. Belgium, France and Italy also have provisions aimed at preventing the abuse of other shareholders by a majority investor.

The quality of information and its disclosure is a key issue

- Variations in reporting can be quite significant. Efforts to improve the accounting and auditing profession need to continue.

- Compliance with International Financial Reporting Standards, which address annual reporting requirements for RPTs through IAS 24, does not guarantee good disclosure of RPTs. It needs to

be accompanied by other measures such as requirements for ongoing (i.e. immediate) disclosure of material transactions, which may be detailed separately according to their materiality and conditions (i.e. fewer or no requirements for recurring transactions conducted at "market prices").

- Belgium has established a specific duty for its independent directors to evaluate RPTs and to designate an independent financial expert to assist them with the valuation. In Italy, designation by the board or its independent directors of an independent financial expert is a statutory right recommended in Italy's comply or explain corporate governance code, but it is not mandatory.

- Italy and India call for companies to issue public policy statements about processes and policies to be followed in approving RPTs.

Review of RPTs within corporate groups is a particular challenge

- Some countries, particularly in Europe, allow for greater leeway within corporate groups to conduct transactions between members of the same group, allowing for consideration of group interests and not just the interests of the company in relation to RPTs. Disclosure in some cases may be less stringent for RPTs within groups in some contexts. However, there is no consensus among OECD countries about the best approach for dealing with RPTs within groups. In Israel and India, directors' duties are defined as in the interest of the company and not the group. Israel also establishes specific disclosure requirements for RPTs involving both listed and non-listed companies within the group. The decision by a group whose head (typically the controlling owner) may decide how to allocate resources and handle RPTs between companies within the same group versus the director's duty of loyalty to the interest of the company whose board he or she serves on is a particular tension in this context. A wider concern is that disclosure about the nature, rationale and structure of corporate groups is often not reported fully in one place, such as in a company's corporate governance statement.

Enforcement also requires further attention

- Enforcement is often weak, but can include funding support for derivative suits. (Israel's regulator covers court fees; India has a fund to support derivative suits.) Israel and Italy also play an active role in reviewing individual transactions and in some cases Israel's regulator requires that the company provide an expert opinion at the company's expense. Israel and Italy also scrutinize whether shareholders have been correctly classified as interested or disinterested. Enforcement is considered crucial in concentrated ownership environments, as market mechanisms sometimes are limited in guarding against abuse.

14. The OECD Corporate Governance Committee will meet in November 2012 to consider possible conclusions and guidance on good practices consistent with the findings summarized above, and taking into account the OECD's previous RPT work in Asia and Latin America. The Asia Corporate Governance Roundtable provided an earlier opportunity for a set of countries with a more homogeneous set of characteristics (mainly emerging markets with concentrated and family ownership, dominance of corporate groups, common use of pyramid structures) to consider safeguards against abusive related party transactions.

15. The Asia Roundtable's RPT Task Force issued the following set of "Key Recommendations" in its 2009 **"Guide on Fighting Abusive Related Party Transactions"**:

1. The legal definition of "related parties" should refer to control and be broad enough to capture relevant transactions that present a risk of potential abuse. It should be sufficiently harmonised with

respect to different bodies of law such as company law, listing rules and accounting standards in each jurisdiction to avoid misunderstanding and an excessive regulatory burden, thereby underpinning better implementation and enforcement.

2. The legal and regulatory framework for "related party transactions" should provide appropriate and effective threshold-based tiers, referring to materiality for disclosure and shareholders' approval and/or board approval of related party transactions according to the risk of potential abuse. It should also take into account regulatory efficiency, weighing the potential costs and benefits.

3. A company should develop and make public a policy to monitor related party transactions that should be subject to an effective system of checks and balances as well as a disclosure process. This can include the possibility for non-controlling shareholders to review the independence of directors in a timely manner.

4. The external auditor should be independent, competent and qualified in order to provide an assurance to the board and shareholders that material information concerning related party transactions is fairly disclosed and alert them to any significant concerns with respect to internal control. The policy framework should support this role effectively.

5. Independent directors should play a central role in monitoring related party transactions, such as designing board approval procedures, conducting investigations and having the possibility for obtaining advice from independent experts. Their role should be supported by the policy framework.

6. Objective judgment in the decision making process of the board should be ensured. This would include giving non-controlling shareholders sufficient influence over the nomination and election of directors, in particular independent directors, and the design of their incentive structures, such as remuneration policy.

7. Where reliance is placed on shareholders' approval, a voting system should be established with a majority of disinterested shareholders for the approval of related party transactions at Shareholder Meetings.

8. The legal and regulatory framework should ensure that legal action, including specialised courts and alternative dispute resolution, does not prohibit minority shareholders from seeking legal redress quickly and cost effectively.

9. A coherent regulatory system dealing with related party transactions, particularly disclosure, board oversight and shareholder approval should be established in each jurisdiction to facilitate implementation and enforcement efforts.

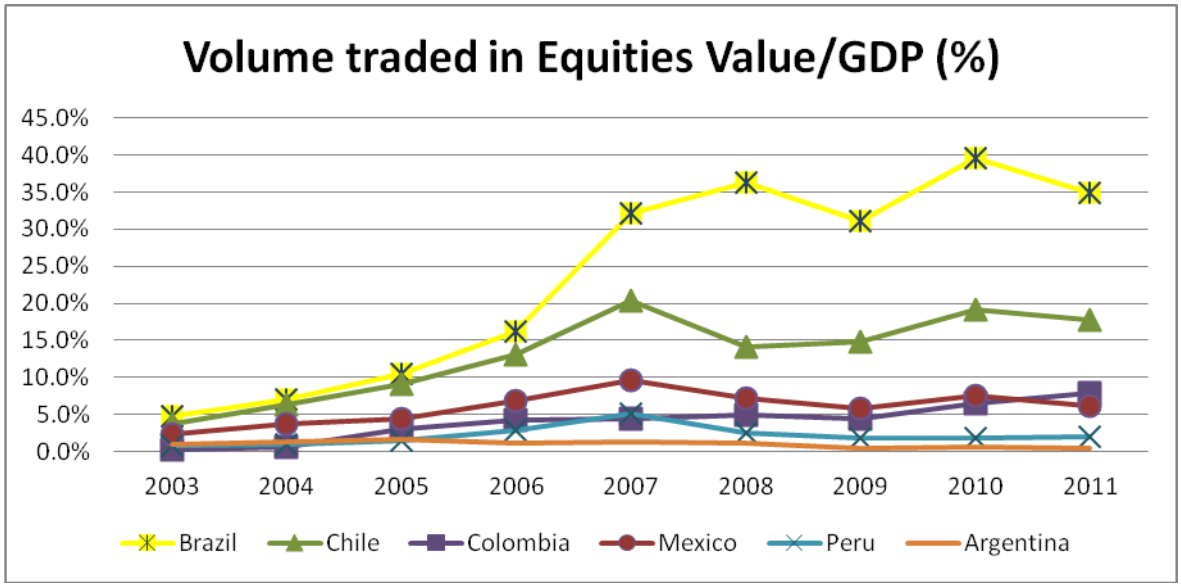
The Latin American Market Context

16. As noted in previous Roundtable publications (the "Latin American White Paper" (2003) and "Strengthening Latin American Corporate Governance: the Role of Institutional Investors" (2011)), Latin American equity markets continue to face the dual challenge of attracting both issuers and investors in an environment of low liquidity, concentrated ownership, and the strong influence of corporate groups. Nonetheless, progress has been seen in levels of market capitalization and trading volumes in most of the Latin American countries (see Figures 1 and 2), most notably in Brazil and Chile. One view is that at least part of this success is attributable to corporate governance improvements and enhanced minority shareholder rights (through, for example, Novo Mercado reforms and strengthened disclosure requirements in Brazil, and major company law reforms in Chile). Colombia and Mexico also undertook important

reforms related to the appointment and role of independent directors and audit committees in the mid-2000s, while Argentina's and Peru's most significant reforms originated earlier in the decade.

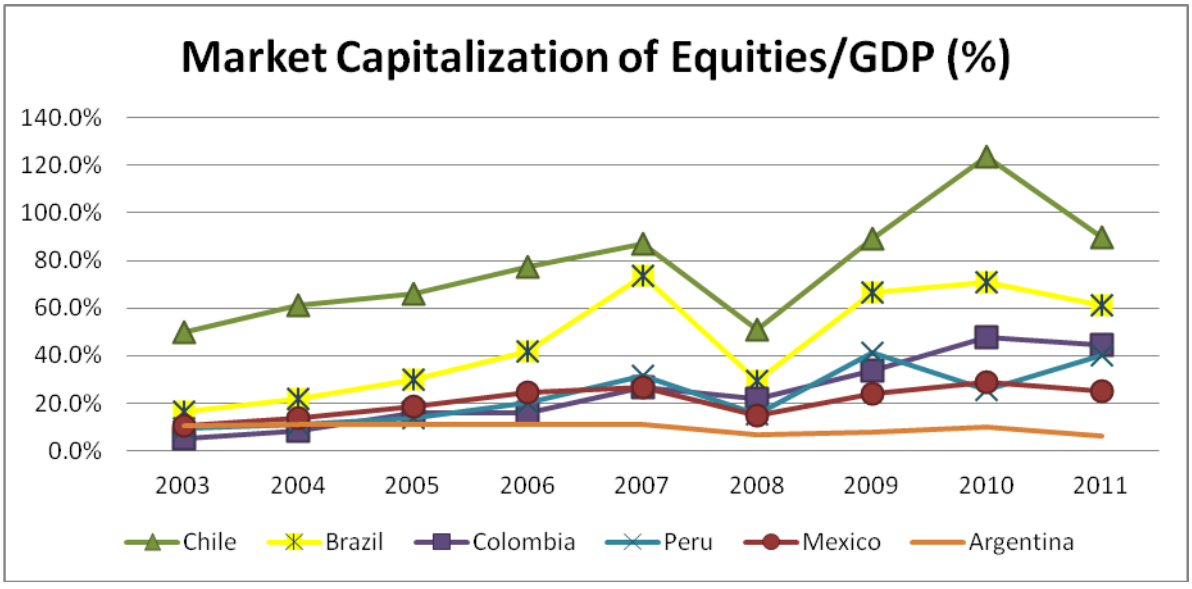
17. In this context, regulators, stock exchanges and other market players represented in the Latin American Task Force see minority shareholder protection, enforcement capacity and specifically the protection against abusive related party transactions as important priorities for further review.

Figure 1



Source: World Federation of Exchanges and Stock Exchange Data

Figure 2



Source: World Federation of Exchanges and Stock Exchange Data

Common Themes and Actions for the Task Force's Consideration

18. The remainder of this paper summarizes the responses and discussions of each of the six Country Level Task Forces, and suggests country-specific recommendations to be coupled with supportive region-wide efforts. The written responses and conference calls conducted in the course of preparing this Report and the discussions during the Task Force's Rio meeting highlighted some themes common to the discussions within most or all of the County Level Task Forces. These common themes may indicate priority areas where increased information-sharing and cooperation among all the members of the Task Force will yield useful guidance for the treatment of RPTs on a region-wide basis.

19. **Need for more comprehensive and data driven analysis on both a country and comparative basis.** None of the Country Level Task Forces was satisfied with the current level of information on RPTs in its market. Most reported very little analytical work conducted thus far by academics or securities markets analysts, in most cases in no small part because of the paucity of quality data. All expressed a desire to develop better sources and systems for collecting comprehensive and consistently-presented data on RPTs from which to develop analysis that can serve as an input into policy-making and enforcement efforts.

20. **RPTs and state-controlled companies.** Some of the largest listed companies in Latin America are controlled by the state, especially in the energy, power and utilities sectors (most notably in Brazil and Colombia). Several countries (and some sub-sovereigns) are currently contemplating IPOs of state companies. The controversy that arose in 2008 over the issuance of shares of Petrobras to the Brazilian state in exchange for access to oil reserves, which many viewed as dilutionary and an abuse of minority shareholders, focused the attention of investors on the risks associated with transactions between state-controlled companies, or between a company with a substantial state presence and the state itself. The members of most of the Country Level Task Forces expressed an interest in better understanding the regional and global experience of state-controlled companies in order to develop appropriate frameworks for protecting minority shareholders' interests.

21. **RPTs, transfer pricing and tax compliance.** In responses to the questionnaire, during the conference calls and at the Rio meeting, members of a number of Country Level Task Forces made reference to the rules and procedures governing transfer pricing among affiliated companies for tax purposes. The definition of "related party" in the tax laws, and the rules for pricing inter-company transactions for purposes of determining earnings subject to corporate income tax typically differ significantly from the definition and rules set out in company and securities legislation. This is not surprising given the different objectives of tax, company and securities legislation. Opinions differ concerning the practicality and desirability of harmonizing definitions and treatment of RPTs. However most Task Force members expressed a desire to better understand the tax treatment of RPTs. A dialogue with tax authorities would help to determine what can be learned from their experience and whether better coordination between tax authorities and securities regulators would further the objectives of both in this area.

22. **Corporate structures and RPTs within Groups**. Most of the written responses of the Country Level Task Forces did not report instances of specific corporate structures that exacerbate or mitigate the potential for RPTs. However, during the conference calls, some participants noted a preference among some industrial groups to combine all ventures under a single listed holding (e.g., Peru), which would ordinarily limit the potential for abusive RPTs, while others reported that most of the companies listed in their markets were under common control with other listed firms (e.g., Colombia), presenting the opportunity for RPTs that could result in unfair transfers of value between the holding and its subsidiaries. Recently, a listed Colombian infrastructure concession company announced that it would merge with its unlisted affiliated construction company in part for the purpose of "internalizing" RPTs to eliminate any

potential for real or perceived unfair treatment of minority shareholders.[1] Given the prevalence of formally constituted and de facto economic groups in the region, it would seem that further work on RPTs in the group context is warranted.

23. **Strengthening the enforcement environment.** There appear to be relatively few cases among the countries surveyed of private enforcement actions by shareholders concerning abusive related party transactions. Apart from Brazil, where more than 30 enforcement actions have been brought by CVM on RPT cases, most regulators from the region have taken either only very few or no enforcement actions. There was no consensus among Task Force participants as to whether the infrequency of cases is due to a lack of abuse in the market, lack of public enforcement capacity or insufficient shareholder incentives to pursue such actions. However, at least among investor participants in the Task Force, there was a view that more aggressive enforcement actions are needed to prevent abuse.

24. The country chapters that follow in this Report provide a more in-depth look at the specific approaches and challenges that each country faces in dealing with related party transactions, along with possible next steps for consideration in each country.

25. For a more comparative overview, Annex A, which originally appeared in the Roundtable's 2011 "Survey Report on Related Party Transactions," sets out at a glance the key elements of how different countries in the region handle related party transactions.

[1] Shareholder approval for the merger of Constructora Conconcreto and Inversiones Conconcreto was approved by the shareholders of both companies in May 2012. See www.conconcreto.com for details of the merger.

CHAPTER 2: ARGENTINA

Incidence and impact of RPTs

26. Members of the Argentine Task Force were unaware of any studies of RPTs of Argentine listed companies undertaken by academics or securities markets analysts. Most noted that the absence of a standard format for disclosure in accordance with Decree 677/01 (discussed below) would probably make cross-company aggregation or comparison difficult. Argentina's securities market regulator (Comisión Nacional de Valores – CNV) confirmed that RPT disclosures are not tabulated for statistical purposes. The members of the Argentine Task Force from the Center for Financial Stability (Centro para la Estabilidad Financiera - CEF) reported that Argentina's tax authority has done some work in the area of transfer pricing among affiliated companies, but that this work has not been made publicly available.

27. Members of the Argentine Task Force also noted that the transfer of the private pension funds to state control in 2008 resulted in the Argentine Social Security Administration (Administración Nacional de la Seguridad Social - ANSES) holding significant minority stakes in most of the country's largest listed companies. It was reported at the Rio meeting that ANSES has positions ranging from 0.14% to 30% in 44 of the 50 largest firms by market capitalization.[2] In May 2012 the Government of Argentina nationalized a 51 per cent majority stake in the country's largest listed company, YPF. As a result, today approximately 25 per cent of total market capitalization is in state hands.[3] Commercial and financial dealings among companies with significant state investment and influence over management, and between them and the state amount to RPTs. However, no comprehensive survey of such transactions has been undertaken by the government or private parties.

General framework

28. Amendments to Argentine law in 2001 (Decree 677/01[4], incorporated into Law 17,811[5]) define as material related party transactions ("Material RPTs") acts or agreements that meet the following criteria:

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

[2] Prior to 2011, pension funds were prohibited from voting more than 5% of the shares of a public company. This restriction was lifted by decree in 2011. ANSES's legal department is charged with overseeing the participation of the institution at AGMs and nominating directors where its holdings are sufficient to elect them. ANSES-nominated directors are classified as independent.

[3] As shown in Tables 1 and 2, Argentina's equity market capitalization and trading volume as a percentage of GDP were already at low levels relative to other Latin American countries during the past decade, with market capitalization generally fluctuating between US$30 and US$40 billion. In the context of recent increases in state ownership, market capitalization has dropped even further and stood at just over US$20 billion in September 2012.

[4] Also referred to as Transparency Regime for Public Offerings (Régimen de Transparencia en la Oferta Pública).

[5] Also referred to as the Public Offering Law (Oferta Pública de Valores Mobiliarios).

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

(2) The acts or agreements are for a "relevant amount", defined as 1% of corporate capital (as measured on the company's last published balance sheet) and at least A$300,000 (US$60,000).[6]

29. The definition of "related parties" for such purposes is therefore different from that of IAS 24 (and Argentine accounting standards); some transactions that have to be detailed in the notes to the financial statement under IAS 24 may not fall within Decree 677/01's definition of Material RPTs.

30. Decree 677/01 imposes responsibility on listed companies to disclose Material RPTs to the CNV immediately after their approval by the Board, and to make the supporting opinions of the Audit Committee and/or the independent experts (as discussed below) available to shareholders at the company's offices. The notice of the transaction provided by the listed company to the CNV in accordance with Decree 677/01 is in turn made public on the CNV's website, the Financial Information Highway (Autopista de Información Financiera - AIF). However, there is no required standard format for the content and presentation of such notice. Companies are required to provide the CNV with copies of the minutes of Audit Committee consideration of RPTs and any reports of independent experts consulted, but this information is not made public through the AIF.

31. After the issuance of CNV General Resolution 604 earlier this year, listed companies must disclose in their prospectuses and annual filings the composition of their shareholding, including beneficial ownership and those individuals and companies that would meet the definition of a related party. Such companies must provide summary information on major contracts with related companies. Principle 1 of the CNV's Corporate Governance Code (the standard for the country's "comply or explain" regime; General Resolution 606) provides that all listed companies should make full disclosure at all times of their relationships with controllers, other company members under common ownership and control (economic group), and other related parties.

32. Argentina's regime for consideration and approval of Material RPTs is distinctive in that on its face it does not actually require Board review of any RPT. However, Decree 677/01 provides that if the following steps are undertaken, in any suit brought by a shareholder against the Board, the shareholder will bear the burden of proof to demonstrate that the RPT was disadvantageous to the company and not on market terms:

(1) Review by the company's Audit Committee and issuance of an opinion to the Board that the transaction is in the interests of the company and in accordance with market conditions;[7]

(2) Evaluation of the transaction by two independent experts (optional at the request of the Audit Committee; mandatory in the case of absence of a qualified Audit Committee);

(3) Notification to the shareholders after final Board approval; and

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[6] Members of the Argentine Task Force noted that this threshold has been adjusted for inflation only once since Decree 677/01 was issued in 2001 (through Decree 1020/03 in 2003) and should probably be revised again.

[7] The Audit Committee may issue a general opinion applicable to a series of transactions that occur on a regular basis, effective for a time period of up to one year or until the end of the current fiscal year.

(4) In the event of failure of the Audit Committee or the experts to approve the transaction[8], submission to and approval by the shareholders meeting (excluding the votes of interested shareholders).

33. If an RPT is not reviewed and approved in accordance with the procedure just described, the Board members who approve the transaction bear the burden of proving that it took place at market conditions and benefited the company if the transaction is challenged by a shareholder. Unless the company and directors can affirmatively meet this standard of proof, they will be liable to the shareholders for any losses. In practice, this shifting of the burden of proof is a strong incentive for Argentine Boards to formally review Material RPTs.

Role of the Board

34. Nothing in the current legal/regulatory framework requires the Board to establish specific policies for the disclosure, review and approval of RPTs. It was the view of most if not all members of the Argentine Task Force that practically all listed firms comply with the letter of Law 677/01, but do not attempt to customize their practices to the company's particular circumstances, or adopt voluntary best practices.

35. Argentina's Commercial Companies Law (Law No. 19,550) clearly provides for unlimited, joint and several liability of Board members for damages arising from their failure to comply with their general duties of loyalty and care, or with specific rules, such as those noted above in the case of Material RPTs of listed companies. While there is a great deal of court experience and case law with respect to the general duties and obligations of Board members, there is very little jurisprudence in the area of RPTs of public companies, given the rather dramatic decline in the public equity market since Law 677/01's passage, and the lack of a substantial domestic institutional investor base to serve as champions of the rights of minority investors.

Role of Shareholders

36. As noted above, Argentina requires shareholder approval of a Material RPT if after consideration by the Board and the Audit Committee (or the receipt of two independent appraisals, if required), no determination is made that the RPT is at market conditions. A shareholder meeting can then be convened to consider such RPT. The Commercial Companies Law provides that shareholders whose interests conflict with those of the company have an obligation to refrain from voting on related party transactions. As in the case of Board approval, approval by the shareholders meeting reverses the burden of proof should a shareholder later challenge the transaction.

37. Section 72(b) of Law 677/01 also requires approval from shareholders at an ordinary shareholders meeting whenever the company executes a material management or administrative services agreement with a related party.

Enforcement

38. The CNV has ample legal authority to investigate suspected violations of law and regulation, and may impose administrative penalties including; fines on individual violators; disqualification for up to five years to serve as officers or directors of a public company; and/or prohibition from making public offerings for up to two years. However, CNV's administrative powers do not extend to ordering restitution

[8] One member of the Argentine Task Force noted that current law in unclear as to what the legal effect is of a "mixed" opinion among the Audit Committee and the two experts.

for shareholders. While the CNV does not have the power to prevent the execution of RPTs through an injunction, it is empowered to order rescission of a transaction if it determines that such transaction was not carried out in accordance with the law. Enforcement activities of the CNV, including orders to initiate investigations as well as final determinations, are made public through the AIF. Administrative penalties of the CNV are subject to review by specialized appellate courts.

39. The members of the Argentine Task Force from the CNV reported that their agency focuses its efforts in the area of related party transactions on investigating and prosecuting cases where companies fail to disclose Material RPTs in a timely and complete manner. The cases so far have involved transactions between members of the same industrial or financial group. The CNV reported two recent successful CNV enforcement actions relating to failure to make timely material events disclosure of RPTs - one concerning intercompany loans and the other regarding both sales of shares and a loan between a listed company and other companies under common control. In both of these 2011 cases, the CNV imposed fines on the company, Board members and management. In the former case, Board members were fined A$300,000 and in the latter a total of A$950,000

40. Members of the Argentine Task Force were not aware of any recent civil litigation relating to allegations for improper RPTs by listed companies. As a general matter under Argentine corporate law, shareholders have broad legal rights to demand the nullification of acts taken by the Board and shareholders in contravention of law, and to sue the responsible officers and directors for restitution to the company (rather than the shareholders themselves) for the resulting losses. Aggrieved shareholders have the option to bring suit in the national courts or via arbitration through a permanent board of arbitrators (usually the well-regarded Arbitration Chamber of the Buenos Aires Chamber of Commerce). Proceedings in both the courts and through arbitration ordinarily include a preliminary mediation phase. Settlements reached through mediation remain confidential, however, which impedes the development of jurisprudence.

Recommendations and next steps

41. Most members of the Argentine Task Force expressed the view that now is not a propitious time for significant modifications to the legal/regulatory regime governing RPTs of public companies. Several opined that there were other areas more in need of immediate attention to reassure minority shareholders of fair treatment and to reverse the secular decline in market capitalization and trading volumes. The specific rules for ex ante Board review of RPTs put in place by Decree 677/01, supported by the general framework for ex post enforcement of director duties under Law 17,811 might in practice be adequate should some form of normality return to the Argentina equity market.[9] For the moment, there is simply too little public equity market activity to judge conclusively.

42. Nonetheless, the members of the Argentine Task Force argued strongly for greater efforts to collect and analyze information on RPTs of Argentine public companies, along with those of the larger unlisted companies whose impact on the economy is even greater (and who may return to the public

[9] The representative from the Chamber of Companies (Cámara de Sociedad Anónimas – CSA) noted that the shares of several Argentine companies trade internationally in the form of American Depositary Receipts (ADRs) and that their experience provides evidence for the compatibility of Argentine rules with international standards and expectations.

markets at some future point in time). [10] Members of the Argentine Task Force highlighted the following as areas of focus for future work:

43. **Consistency and detail of reporting of Material RPTs**. The more comprehensive the content and more consistent the presentation of the disclosures concerning RPTs, the more effectively such disclosures can be analyzed by the CNV, shareholders and the market. Improving the quality and consistency of such disclosures would also greatly facilitate any future systematic analysis of RPTs for purposes of better understanding the prevalence and types of RPTs and better gauging the effectiveness of the procedures for their review and approval by Boards. Implementation of IFRS, as well as the implementation of the Corporate Governance Code, is expected to help substantially in this regard,. The roles that changes in mandatory and voluntary standards (and more active administrative enforcement by CNV of such standards) can play should be examined.

44. **Examine the experience of unlisted companies.** Review by one member of the Argentine Task Force of the information available on the website of the National Commercial Courts evidenced a significant number of disputes involving RPTs in unlisted companies. The representative of the Chamber of Companies on the Argentine Task Force expressed support for importing Decree 667/01's provisions into the Commercial Companies Law for all companies, listed or not. Careful comparison of the experience with ex ante and ex post controls in the case of public and private companies could contribute to a better understanding of whether the current differences in the regimes are any longer desirable.

45. **State shareholding.** As noted earlier, the government's participation in the equity of listed companies is significant and growing. Business conducted among companies with significant state investment and influence over management, and between them and the state should be regarded as RPTs. It is important for policy makers and the market to understand the prevalence, nature and risks of such dealings. Directors on the Boards of such companies face special challenges, especially those elected by the state, who may be government officials themselves.

[10] Several members of the Argentine Task Force questioned whether it is even worth the effort of to discuss the legal/regulatory framework for RPTs applicable to public companies, when there has been such a decline in market cap.

CHAPTER 3: BRAZIL

Incidence and impact of RPTs

46. Brazil's supervisory authority, (Comissão de Valores Mobiliários – CVM), reported that all of the 63 companies that comprise the country's main share index[11] reported RPTs in 2010. Most of the transactions reported were conducted with subsidiaries (1,526 transactions, of which the vast bulk were with wholly-owned, or almost wholly-owned subs); followed by transactions with companies under common control (314 transactions); affiliates (75 transactions); and shareholders (38 transactions). Sixteen percent of the 37 companies in Governance Metrics International's (GMI) 2008 Brazil sample reported significant RPTs (at least 1% of revenue) within the previous three years; the CVM believes that this percentage is understated and should be closer to 100%.

47. All members of the Brazilian Task Force believe that RPTs are an important potential source of inequitable treatment of minority shareholders. The Brazilian Institute of Corporate Governance (Instituto Brasileiro de Governança Corporativa – IBGC) cited two academic studies that found a negative correlation between the incidence of RPTs and market valuations.[12] The CVM noted that RPTs receive priority attention under its Risk-Based Supervision Program. The Brazilian Association of Capital Markets Investors (Associaçao de Investidores no Mercado de Capitais – AMEC) stated that its members believe that abusive RPTs both are a significant source of value destruction for minority shareholders and create a "perception discount" with market-wide consequences.

48. Members of the Brazilian Task Force were not aware of comprehensive statistics on the most prevalent types of RPTs among Brazilian listed companies. The IBGC's response to the questionnaire quoted one study[13] that had to be limited only to Novo Mercado companies because the data available from other firms through Reference Form reporting (discussed below) was incomplete and presented in confusing and inconsistent fashion. In the absence of hard statistics, CVM surmises that inter-company loans are the most frequent type of RPT among listed companies in Brazil. AMEC cited loan guarantees, management contract fees and licensing of corporate brands as among other frequent (and sometimes problematic) RPTs. However, members of the Brazilian Task Force generally agreed that the experiences of recent years indicate that those related party transactions that present the greatest potential for abuse are those involving corporate reorganizations (including mergers, acquisitions and spin-offs) involving parent and subsidiary companies or companies under common control.

49. The Brazilian state plays a large role in the economy and a direct and indirect role in several of the most important listed companies such as Petrobras, Banco do Brasil and Companhia Vale do Rio Doce

[11] IBOVESPA, which accounts for about 80% of Brazil's market capitalization.

[12] "Related Party Transactions: Legal Strategies and Corporate Governance and Firm Value Relation in Brazil", Raphael Sasso, Viviane Prado and Alexandre Di Miceli, 2009; "Related Party Transactions, Corporation Governance and Performance: A Panel Data Study", Patricia Oda, 2012. Sasso, Prado and Di Miceli studied 49 listed companies and found a significant negative relationship between the incidence of RPTs and price-to-book valuations (PBV). Companies with fewer RPTs averaged a 3.43 PBV, while those with a higher proportion averaged only a 2.19 PBV.

[13] Oda, op cit.

(Vale). In 2010, Petrobras, the national oil company listed on BM&F Bovespa with 54 per cent direct state ownership, issued shares to the Brazilian state in exchange for access to oil reserves, a transaction which many investors viewed as dilutionary and an abuse of minority shareholders. Investor confidence in the ability of Petrobras's Board to ensure fair dealing with the state was also undermined when, at the oil giant's March 19 2012 AGM, pension funds of state enterprises joined state development banks (BNDES and BNDESpar) in voting as minority shareholders and using this status to elect to the Board members that private sector minority shareholders did not consider to be independent of the state's controlling interest. Petrobras share prices fell steadily in the period following the decision. On August 29, 2012, AMEC published a letter to Petrobras' Chairman and CEO, co-signed by a group of international asset owners and asset managers representing US$1.9 billion in assets, expressing concern over government "interference" in the operation of the firm to the detriment of the long-term and short-term interests of the company and its minority shareholders. At the time of writing, the AGM decision was also the subject of an ongoing investigation by CVM. These and other actions of the Brazilian government have focused the attention of investors on the risks associated with transactions between state-controlled companies, or between a company with a substantial state presence, and the state itself.

Current framework

50. In addition to the ex post reporting of RPTs required by IAS 24[14], Section 16 of the "Reference Form" established by CVM Instruction 480/09 (which every Brazilian public company must keep on file electronically with the CVM and periodically update) includes provisions relating to RPT disclosure. A description of the company's policies and practices for engaging in RPTs, its policies with respect to conflicts of interest, the evidence required to ensure the fairness of the terms of RPTs, and the main features of each related party transaction concluded by the company during the last three years must be included in the company's Reference Form. CVM Instruction 281/09 also requires the disclosure of information on any transaction subject to shareholder approval. The Reference Form was introduced for the first time for the 2010 reporting year. CVM noted deficiencies in the quality of reporting, but believes significant improvements were evident between reporting years 2010 and 2011.[15] Both the IBGC and AMEC registered disappointment with the quality of reporting of RPTs by Brazilian companies in their Reference Forms. In particular, the responses from these members of the Brazilian Task Force cited excessive aggregation of transactions in the disclosures, opacity with respect to ultimate beneficiaries and related parties, and incomplete reference to the benchmarks used for determining the fairness of individual transactions (including the rationale for the benchmarks selected). All members of the Brazilian Task Force supported intensifying the efforts of investors and groups such as IBGC and AMEC to communicate to companies their expectations respecting the quality of RPT disclosure.

51. CVM instructions provide standards for the immediate disclosure of certain transactions, including RPTs that qualify as material events. Such transactions include: (1) incorporation, merger or de-merger of the company itself or related companies; (2) changes in company assets; and (3) consummation or termination of significant contracts. Material event disclosure of RPTs must include identification of all related parties and their interests in the transaction and the counterparties.

[14] Brazilian publicly-traded companies and those with annual revenues exceeding R$300 million are required to prepare their financial statements in accordance with IFRS. Companies listed on the Special Corporate Governance Levels of the Bovespsa (Nivel 1, Nivel 2 and Novo Mercado), must include in their quarterly reports the same explanatory notes with respect to RPTs that are required to be included in the annual audited financial statements.

[15] CVM noted that the association of capital markets participants (ANBIMA) reviews certain public offering documents of issuers to assist in compliance and to raise reporting standards. In particular, ANBIMA reviews the part of the Reference Form (Section 16) that refers to RPTs and the footnotes to the financial reports required by IAS 24.

52. Brazil's Corporation Law provides that affiliated companies may, on a voluntary basis, formally identify themselves as a company group. Members of such a group must present both individual and consolidated financial statements (which would in any case be required under IFRS in instances of de facto control). Even within such a voluntarily constituted group, inter-company transactions must be carried out on terms equitable to both companies. The CVM reports that because of provisions of the Corporation Law that listed companies find onerous, there are few if any instances today where such companies formally identify themselves as a group under the Law.

Role of the Board

53. Brazil's Corporation Law provides for general directors' duties of loyalty and care. The Law requires that any transactions with officers and directors, controllers and affiliates must be conducted on terms equitable to the company and minority shareholders. However, the Law does not set out specific procedures to be followed in negotiating and approving such RPTs. However, in 2008, the CVM issued guidelines (Parecer de Orientação 35; hereinafter referred to as Guideline 35) to provide guidance on how directors can fulfil their fiduciary duties in cases of mergers and acquisitions involving parent companies and their subsidiaries, or companies under common control. In essence, under Guideline 35 the CVM will consider that the legal obligations under the Corporation Law have been met if: (1) the RPT was approved by a majority of non-controlling shareholders (including holders of non-voting and restricted-voting shares; majority of minority rule); or (2) negotiation of the RPT was conducted on behalf of the company by a special independent committee and such committee recommended the transaction to the Board. Guideline 35's provision for direct negotiation of the transaction by independent parties (as opposed to ratification by some sort of outside expert or the Audit Committee, or a committee of independent directors) is unique among the countries surveyed. In the CVM's view, good faith approval by the Board of the terms of an RPT that were directly negotiated by independents on behalf of the company satisfies the Board's fiduciary duties.

54. Members of the Brazilian Task Force generally agreed that Guideline 35 has had a positive impact on the behaviour of public companies in managing RPTs in connection with corporate reorganizations. However, some members noted that some recent cases have demonstrated that technical compliance with the requirements of Guideline 35 is no guarantee of fair treatment of minority shareholders. IBGC suggested that the independent committee provided for in Guideline 35 would be more effective and credible if its composition were discussed in advance with minority shareholders. AMEC's representative on the Brazilian Task Force expressed the view that unless the work of independent committees and appraisers is conducted in a structured and transparent manner, these mechanisms can serve as a smoke screen. And while members of independent committees (both Board members and non-Board members) have legal responsibility to the company for their actions, this should not be seen as diminishing the Board's and management's ultimate fiduciary responsibility for ensuring the fairness of RPTs, a duty which they may not delegate to outsiders.

55. The representatives of both AMEC and IBGC noted that some companies have voluntarily adopted special procedures, in line with the recommendations of the IBGC Code of Best Practices, to provide shareholders with assurance that related party transactions are conducted on market terms. AMEC cited the example of CCR, an important toll road operator controlled by a consortium of construction companies that requires supermajority approval of such contracts by the Board (excluding conflicted directors) and gives independent directors the power to request appraisals whenever they have doubts about the terms of such transactions.

Role of Shareholders

56. Brazil's legal regime for RPTs provides a number of entry points for shareholder intervention[16]. Most corporate reorganizations, which are viewed by the members of the Brazilian Task Force as the type of RPT with the greatest potential for shareholder abuse, must ultimately be submitted for shareholder approval. The Corporation Law requires that mergers between parent and subsidiary companies, or between companies under common control, be approved by the shareholders of each company. In addition, the purchase by one company of any company whose value is more than 10% of the purchaser's equity, or at a substantial premium to its value based on certain metrics, must also be approved by the purchaser's shareholders.

57. Brazil's Corporations Law generally prohibits a shareholder from voting on a resolution in which such shareholder has a "particular" interest or on which the shareholder and the company have conflicting interests. However, both AMEC and IBGC believe there is insufficient clarity about the scope of this requirement and that controllers have sometimes avoided it on technical grounds. Both institutions would like to see more explicit enshrinement of the majority of the minority rule in Brazilian legislation, CVM regulations and individual company codes. It is the CVM's position (lately reaffirmed in the course of a CVM consultation made at the request of Tractebel) that where a shareholder is on the other side of a transaction with the company, such shareholder does have a "particular" interest and therefore may not vote.[17] However, CVM cannot mandate a majority of the minority rule in the case of an acquisition of a controlled company by its parent, since Brazilian company law is explicit in providing that the parent company may in such circumstances participate in the vote of the shareholders of the subsidiary. In such cases the managers and directors of the subsidiary remain subject to the duties of loyalty and care, and Guideline 35 supports the view that review and endorsement by a special independent committee or approval by the majority of the minority may, in practice, be called for. AMEC has questioned the consistency of CVM decisions with respect to the majority of the minority requirement and believes that several loopholes and lacunae, in addition to less than aggressive enforcement, means that the full benefit of the Tractebel case has not been felt in the market.

Enforcement

58. CVM views its primary supervisory role with respect to RPTs of listed companies as to monitor management's and the Board's compliance with their fiduciary duties to the company. The principal question it seeks to answer is whether the company followed procedures (such as consideration of other providers or the prices of comparable transactions in the market and the involvement of independent parties) adequate to ensure that the RPT is conducted on terms equitable to the company. In specific cases where comparative data is readily available, the CVM may also examine whether the terms appear in line with those of similar transactions. Some members of the Brazilian Task Force (notably AMEC) believe that the CVM's analysis could and should extend beyond the formalities of Board approval into consideration of the underlying economics of the transactions. In the view of AMEC, a more sophisticated examination and understanding of the real economics behind suspect transactions would raise "red flags" that would require follow-up and result in more effective enforcement. CVM and some other members of the Brazilian Task Force questioned whether the CVM has the capacity or is the party best positioned to assess the economics of such transactions.

[16] A bill (Projecto de Lei no. 6962/2010) under consideration by the Brazilian Congress at the time of writing, would require shareholders approval of related party transactions that meet certain (yet to be defined) criteria.

[17] In response to a request for interpretation submitted by Tractebel to the CVM in 2011 prior to consummation of a related-party transaction that did not involve a corporate restructuring (and that therefore was not technically subject to Guideline 35), the CVM reaffirmed its position on what constitutes a "particular" interest and required approval of a majority of the minority shareholders.

59. As noted above, the CVM gives priority to ex ante review of corporate reorganizations involving RPTs under its Risk-Based Supervision Program. Virtually all such transactions are examined by the CVM. CVM also reports that it looks into all allegations of abusive RPTs it receives from investors and internal whistleblowers. Because of the complexity and short time frame of some RPTs, and significant resource constraints, ex ante reviews conducted by the CVM are not always completed prior to consummation of the transactions in question. After review of a proposed RPT, the CVM may initiate an enforcement action if it believes there is a likelihood of wrongdoing. The CVM believes that even when no enforcement action is ultimately taken, and the terms of the proposed transaction remain unchanged, the agency's review improves the RPT's transparency and provides shareholders with a better understanding of whether they should or should not approve it (if such approval is required).

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

61. According to its review of enforcement actions in recent years relating to RPTs, the CVM settled 9 cases by consent decree and sanctioned wrongdoers in the remaining 21. The CVM believes that consent decrees are an effective means of enforcement because they serve to educate the investing public and may include direct compensation to injured parties. CVM identified five cases involving improper RPTs between 1993 and 2011 that resulted in the payment of compensation to investors or the company in amounts ranging from R$138,000 to R$2.3 million. However neither AMEC nor IBGC were aware of such cases, indicating that greater publicity of consent decrees that include the payment of compensation to injured parties would be beneficial. The 21 cases where officers, directors and controlling shareholders were sanctioned by the CVM involved public warnings, fines ranging from less than R$4,000 up to R$45 million (M&G Polyester) and disqualification of officers from two to up to 30 years (Fazendas Boi Gordo). AMEC noted that such enforcement actions did not result in compensation to investors and suggested that follow-on civil cases are difficult to undertake because of the inefficiencies of the courts.

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

63. Under Brazil's Corporation Law, controlling shareholders are liable to minorities for abuse of corporate powers, including for: actions that benefit another corporation to the detriment of minority shareholders of the company; liquidation of the company in order to obtain unfair advantage to the controllers or third parties to the detriment of the remaining shareholders; and RPTs (either directly or

through third parties) on terms unduly unfavourable or inequitable to the company. Although there is no specific private right of action against directors by shareholders, the latter can bring claims for damages resulting from breach of fiduciary duty of the former under the general law of torts (damages).

64. Shareholders of companies listed on Level 2 and the Novo Mercado of the Special Corporate Governance Levels and on the Mercado Mais small cap segment of BM&F Bovespa are obliged to submit complaints before the exchange's Market Arbitration Chamber. While some cases have been brought before the Chamber, none of these cases have dealt specifically with RPTs, according to an official of the Chamber. Although decisions of the Arbitration Chamber remain confidential, a recent amendment to its rules provides that the Chamber will publish an anonymized summary of arbitral awards grouped by topic that can be taken into consideration by arbitrators in later cases and thus contribute to the development of a body of jurisprudence.

Recommendations and next steps

65. Members of the Brazilian Task Force expressed different, and in some cases, opposing views on the current legal/regulatory environment governing RPTs and the effectiveness of enforcement. Nonetheless, there appears to be consensus on a number of areas where advances can be made:

66. **Analysis of newly-available data.** Member of the Brazilian Task Force believe that the availability of data on RPTs of public companies has improved in the wake of greater experience with IFRS and the requirements of the Reference Form. This data should now be mined to provide visibility on what kinds of related party transactions are most frequent and most significant and to identify what economic sectors most commonly experience RPTs. The CVM is particularly interested to determine whether there is a correlation between the presence of one or more controlling shareholders and the frequency and materiality of RPTs, and in such cases whether particular types of RPTs, such as brand licenses, royalties, and management service contracts are especially common.

67. **Improve and coordinate information systems.** CVM and BM&F Bovespa are working to better coordinate their information systems and to automate procedures.

68. **Improve the quality of disclosure.** While some members of the Brazilian Task Force (notably the CVM) believe the current legal framework for disclosure is adequate, no member expressed satisfaction with the current quality and consistency of RPT disclosure by companies across the market. The goal should be for disclosure to be as disaggregated as practicable and for it to include as much as possible of the details of each transaction and the steps taken by the Board and otherwise to ensure independent determination of its fairness, so that shareholders and the market can make an informed judgment of whether the Board and management have acted in the interests of all shareholders. Regulators and market watchdogs can step up their efforts to insist on more coherent and complete transparency by companies that are currently doing the minimum permissible (or less). If improvements in RPT transparency stall, it may be appropriate to re-evaluate the current legal/regulatory framework.

69. **Examination of the economic substance of RPTs.** As noted earlier, there were disagreements among members of the Brazilian Task Force about how far the CVM can or should go into examining the economics of individual RPTs. One possible avenue to explore might be whether it is desirable and practical for the CVM to be empowered to order an independent evaluation at the cost of the company if the shareholders or CVM complain. An important question would be what the evidentiary impact of such an evaluation would be.

70. **Well-articulated company policies on RPTs.** Member of the Brazilian Task Force generally agreed that Brazilian firms should put in place explicit policies setting forth the definition of RPTs,

limitations, thresholds, standard for fairness, required appraisals and documentation and requirement of Board and shareholder review of RPTs. IBGC noted that Item 6.2.1 of the IBGC Code of Best Practices recommends such a policy. Section 16.1 of the Reference Form requires disclosure of the company's policy on RPTs (although many firms merely recite the legal requirements and refer to the market conditions standard in their responses to this section of the Form). AMEC cited the RPT policy of CCR, a listed Brazilian toll road operator, as exemplary both in its content and in the company's record of compliance therewith.

71. **State-owned enterprises**. The Brazilian state has historically justified as necessary to protect the public interest its interventions in the operation of companies in which it holds majority and minority stakes. In light of the reaction of the capital markets to the Petrobras capital increase noted above and similar episodes, some members of the Brazilian Task Force believe it is imperative that the Brazilian government define the parameters and limits of its view of the public interest in such firms. Without greater clarity about the government's objectives and approaches to state ownership of public companies, uncertainty is likely to generate a drag on further investment and on market valuations. A dialogue between representatives of the state, companies with state ownership and the market would assist in both the articulation of policy and its communication to investors, domestic and international.

CHAPTER 4: CHILE

Incidence and impact of RPTs

72. Chile is a relatively small, middle-income, open economy. Its public equity market is characterized by a high degree of defined control and the presence of companies identified with a relatively small number of entrepreneurial individuals and groups. While its market capitalization as a percentage of GDP (150% in 2010) is the highest of any Latin American country, the liquidity of the Chilean market, as measured by trading volume as a percentage of GDP, (25.5%) is in the mid-range of the six countries featured in this report.[18] Most listed companies are part of a corporate group, with one study finding that some 50 major conglomerates had ownership control of more that 70% of non-financial listed companies, representing 91% of total equity listed on the Santiago Stock Exchange.[19]

73. The principal domestic institutional investors are the country's six pension fund managers (Administradores de Fondos de Pension - AFPs) who administer Chile's well-established mandatory pension savings scheme. As of April 2012, the value of assets held by the AFPs exceeded 150% of annual GDP. Chile also has a significant mutual fund industry. The legal / regulatory framework for capital markets and company law has been revised repeatedly over the past 15 years in response to domestic and international events. The securities regulator (Superintendency of Securities and Insurance – SVS) maintains a high profile and Chile's public institutions are generally viewed as among the better-functioning in the region.

74. Article 147 of the Corporations Law requires that all company insiders must report any prospective related party transaction to the Board of Directors. Chilean Boards are required to report all their approvals of RPTs to the subsequent shareholders meeting. Annual reports of Chilean companies must specify all the activities of their Committees of Directors (described below), including a specific report on their review of RPTs. In addition, listed companies must immediately disclose all relevant information on RPTs that qualify as material events under the general provisions of the Securities Markets Law.

75. The SVS counted 485 of 550 listed companies as reporting RPTs in their 2011 financial statements (as required under IAS 24 and SVS regulations). Transactions among companies in the same economic group, services and advisory agreements, leases, inter-company loans, cross guarantees and provision of collateral, and sales of goods and services are all relatively common Chilean RPTs. A third of Chilean listed companies reported significant RPTs (at least 1% of revenue) between 2008 and 2010. Some members of the Chilean Task Force noted that allocation of business opportunities among related companies also poses some of the same potential challenges as RPTs with respect to the equitable treatment of shareholders.

[18] World Bank indicators.

[19] Based on 2002 data from the report "Do Markets Penalize Agency Conflicts Between Controlling and Minority Shareholders? Evidence from Chile", Fernando Lefort and Eduardo Walker (2007), in The Developing Economies, Vol. 45, pp. 283-314.

76. The structure of ownership and control in the Chilean market, combined with the size of the economy, presents ample opportunities for related party transactions. Members of the Chilean Task Force recognized that these can be advantageous to companies and their shareholders, but may also pose risks of unfair treatment of minority shareholders if not carried out in an equitable fashion. Although Chilean listed firms are required to disclose RPTs (see above) and most filings are available through the web sites of the SVS and the stock exchanges, to the knowledge of the members of the Chilean Task Force no systematic study has been conducted of the incidence of RPTs among Chilean listed firms, their impact on company performance and stock price, or on the equitable treatment of shareholders in cases of material RPTs. Accordingly, there is no consensus among members of the Chilean Task Force on whether or not, or which types, of RPTs may raise issues of inequitable treatment of minority shareholders.

Current Framework

Role of Board

77. The Corporate Governance Law of 2009 significantly altered the legal framework for RPTs in Chile. The Law included amendments to Chile's Corporations Law and Securities Market Law that explicitly charged the "Committee of Directors" of the Board with initial responsibility for scrutinizing RPTs. The Committee of Directors analyzes the transaction and must advise the Board on whether the terms are in line with current market prices and conditions. According to Article 50 bis of the Corporations law, the Committee of Directors must include at least one independent director as Chair and must be made up of a majority of independent directors if the Board has more than one independent director. When independent directors do not comprise a majority, the independent Chair selects the other members of the Board to serve on the Committee of Directors. This "Audit Committee plus" is also charged with assisting the Board with other tasks deemed to require special scrutiny, including approval of the financial statements and the adequacy of the external audit. In analyzing the fairness of an RPT, the Committee of Directors and the Board can, at their own discretion, hire independent appraisers or experts to assist in their review.

78. Chilean law does not provide a single threshold amount below which an RPT is exempt from the requirement of Committee of Directors approval. All transactions exceeding UF 20,000 (approx. US$937,000) or 1% of net assets are always subject to approval by the Committee. The Board may as a general policy provide that transactions below both 1% and UF 20,000 do not require case-by-case review by the Committee of Directors or the Board. How RPTs with a value exceeding UF 20,000 but still below 1% of net assets must be treated is subject to the discretion of the Board on a case-by-case basis. The Board may also define certain types of transactions as in the company's ordinary course of business, and thereby exempt them from case-by-case review regardless of their size. Several members of the Chilean Task Force noted that there is little legal guidance on what qualifies as a transaction in the ordinary course of business, or general understanding of how this exception has been applied by Chilean Boards.

79. When review of an RPT is required, the Committee of Directors must opine on the transaction's fairness and benefit to the company, and may consult appraisers and experts before sending its recommendation to the full Board. After receipt of the opinion of the Committee of Directors, the RPT must be approved by an absolute majority of those Board members who do not have an interest in the transaction (the input of interested directors may nonetheless be considered).

Role of Shareholders

80. Unless it involves a transaction of a character required to be approved by shareholders for reasons other than that it is an RPT, Chilean shareholders are only involved in the review of RPTs if a majority of the Board is conflicted, or if because of a combination of conflicted directors and directors who

decline to opine on the transaction, an absolute majority of the Board does not approve the transaction. In such case, the opinions of the Committee of Directors and Board members are presented to the shareholders meeting, along with a report of at least one independent appraiser. According to the Corporations Law as revised in 2009, a supermajority of 2/3 of outstanding shares at an extraordinary meeting of shareholders is required to approve the transaction under such circumstances. Even in such cases, the law provides that shareholders may only approve the transaction if it is in the corporate interest, and at market prices and conditions at the time of the transaction. Presumably, this provision of the law provides minority shareholders with a right of action against those who voted to approve the transaction if the former can subsequently demonstrate that the transaction approved by the supermajority was nonetheless conducted on unfair terms.

Enforcement

81. Chile's SVS has generally broad investigatory and sanctioning powers. The institution is empowered to investigate any violation of the capital markets laws and regulations and may impose administrative penalties (including fines and removal/disqualification from office) against a broad array of wrongdoers.

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

83. Examples where the SVS has sanctioned officers and directors of Chilean companies for failure to comply with rules governing RPTs include: fining of the CEO of Essbio (a water company) in 2004 for failure to disclose his connections with another company that provided services to Essbio; fines imposed in 2006 on directors and the CEO of Schwager Energy for failure to comply with the procedures for disclosure and approval of an RPT with a company associated with its controlling shareholder; and sanctions imposed in late 2011 on the directors of Pehuenche, a subsidiary of Endesa Chile (the country's largest power company) for not taking appropriate steps to ensure that the conditions of a power supply contract with the parent were on market terms. In the first two cases, the sanctions have already been upheld by appellate courts. Court review of the Penuenche case is pending.

84. In a key ruling published after the Rio meeting of the Task Force, the SVS determined that a proposed capital increase in power generation company Enersis, to be effected through the contribution of real assets of the parent in exchange for shares, could not be consummated as originally structured and instead required the company to comply with all the requirements for review and approval applicable in the case of an RPT (See Box 1).

Box 1. New SVS ruling on major RPT calls for second opinion on valuation to ensure fair treatment of minority shareholders

Chile's largest private power producer, Enersis, announced in July 2012 a planned US$ 8 billion capital increase suggested by its parent, Spain's Endesa, which owns a tad more than 60 per cent of Enersis' shares. Endesa proposed to pay for its portion of the capital increase by contributing non-cash assets, including interests in other Latin American power companies, many currently under Enersis' management and control. Minority shareholders would have to pay for their new shares with more than US$ 3 billion in cash to avoid seeing their stakes diluted. Without issuing an opinion on the merits of the proposal, Enersis' Board immediately called for an extraordinary shareholders meeting to consider the capital increase, which would be subject to a legally-required two-thirds vote for approval, and commissioned a valuation that in essence confirmed Endesa's valuation of the assets it would be contributing.

Before the extraordinary meetings of shareholders could be convened, Chile's AFPs, the country's private pension fund operators and most important institutional investors, strenuously and publicly objected to the terms of the proposed capital increase. They questioned the valuation of the Endesa assets and complained that the transaction should have been treated as a related party transaction to protect minority shareholders. In an interpretation issued August 3, Chile's securities regulator, SVS, cited Endesa's conflict of interest and stated its view that in order to ensure fairness to minority shareholders, company should apply the legal regulations on RPTs and treat the contribution of assets as a related party transaction. This interpretation triggered the legal requirements for RPTs that the Board would have to secure new independent valuations of the Endesa assets and that a majority of the members of the Board of Enersis not related with Endesa would have to approve the terms of Endesa's contribution to the capital increase. Since six of the seven directors of Enersis were elected with the votes of Endesa the transaction would have to be approved by two-thirds of the shareholders, as required for related-party transactions, with full information and disclosure about the opinion of the Board members. Pursuant to Chilean law even when related party transactions are approved by the shareholders, they must be in the corporate interest and on market terms.

Enersis officially stated its intention to comply with the SVS's interpretation and delayed the capital increase pending further consideration by its Board.

85. Members of the Chilean Task Force were not unanimous about whether the possibility of sanctions imposed by the SVS serves as a sufficient deterrent to abusive RPTs. One member noted that although some SVS fines have been substantial on occasion, they do not result in restitution to unfairly-treated shareholders (who must proceed with lengthy court actions).

86. Chilean law does not provide a special cause of action for shareholders to seek redress for an RPT that is conducted on terms disadvantageous to them. Such actions must proceed under that general law of torts (damages). Members of the Chilean Task Force were not aware of any comprehensive analysis of the experience in Chile with shareholder actions to seek restitution for abusive RPTs. Some members of the Chilean Task Force were sceptical of the technical capacity of Chilean courts to properly adjudicate civil claims in connection with RPTs, with one noting that courts' ability to compel the production of evidence ("discovery") is limited. The Corporations Law is explicit in providing that notwithstanding a violation of the requirements of law with respect to the approval of and RPT, a court may not order that such transaction be rescinded, leaving only ex ante injunction and ex post financial compensation as remedies for aggrieved minority shareholders. The legal framework in Chile does not provide for specific criminal liability for abusive related party transactions.

Recommendations and next steps

87. As noted above, the legal framework governing RPTs by listed companies in Chile was significantly tightened by the Corporate Governance Law of 2009. Today companies face clearer and stricter rules with respect to Board review and approval of related party transactions. In light of the

recentness of the latest legal reform, and in the absence thus far of hard data and analysis from which to draw conclusions about how well the new framework is working and to what extent, if any, RPTs may present a problem in the Chilean context, the members of the Chilean Task Force did not feel it appropriate to recommend any concrete changes to the current legal / regulatory framework. Rather, there was a consensus that more work needs to be done on several fronts in order to determine what, if any, policy responses are desirable in this area.

88. Next steps should include work in the following areas:

89. **Compilation and analysis of available data.** Members of the Chilean Task Force believe that since the SVS has full access to all disclosures on RPTs, it is in a position to create a consolidated statistical database of all the information on RPTs made available by public companies through the SVS and the stock exchanges. Securities analysts and academics can then draw on the database to reach their own conclusions on the character and extent of RPTs, the adequacy of enforcement actions and remedies, and whether or not there is need for changes to law, regulation or SVS practice.

90. **How Boards define "transactions in the ordinary course of business".** As noted above, each Chilean Board is permitted to define its own policy on what types of RPTs are "transactions in the ordinary course of business" and hence need not be approved on a case-by-case basis. Members of the Chilean Task Force expressed interest in studying on a systematic basis how Boards have reached such determinations, how many transactions fall within the definitions, and whether there is consistent and reasonable practice. Publicizing the information gathered could provide useful guidance to Boards.

91. **Shareholder approved transactions.** Several members of the Chilean Task Force expressed special concern (and perhaps suspicions) regarding RPTs that are not approved by the Committee of Directors, but that nonetheless are carried out after a required 2/3 majority of the Board approve them. The circumstances and rationales behind such approvals are worth examining.

92. **Balance between access to information and protection of proprietary data.** Current Chilean law provides for a 15-day period prior to a shareholders meeting during which shareholders are permitted access to corporate records, including those relating to RPTs. Further empirical work needs to be done in order to better understand whether this rule correctly balances the shareholders' need for transparency against the company's interest in protecting proprietary information.

93. **Voluntary guidance; self-regulation.** To date, Chile's approach to addressing corporate governance issues has been largely "hard law" based, especially when compared to that of other countries in the region. Private sector initiatives, such as self-regulation and voluntary codes, have played less of a role than they have in countries like Brazil or Colombia. Some members of the Chilean Task Force feel that too much of hard law approach may lead to overly prescriptive, costly-to-implement rules and regulatory inefficiency. The Chilean market might benefit from greater practical guidance for Boards on how to handle RPTs that would supplement, or even replace some of the current legal/regulatory framework. Chilean Task Force members indicated that the SVS would have the convening power to bring the right private sector parties together to undertake such an effort. The SVS noted that it is collaborating with the Chilean Institute of Rational Business Management (Instituto Chileno de Administración Racional de Empresas) on a code of best practices and that this effort may be the right forum to develop voluntary standards for the treatment of RPTs.

CHAPTER 5: COLOMBIA

Incidence and impact of RPTs

94. No member of the Colombian Task Force was aware of any recent systematic analysis of the types and dimension of related party transactions among listed companies. However, it is well-known that the universe of Colombian listed companies includes many firms under common defined control. According to Colombia's unified financial sector regulator (Superintendencia Financiera de Colombia – Superfinanciera), 80% of the financial system's assets are estimated to be under the control of institutions that belong to groups. The country's largest set of financial institutions (Grupo Aval) and the well-know Antioqueño Group (whose combination of financial and industrial holdings amount to a significant percentage of Colombian GDP) number among Colombia's best-known economic groups. Superfinanciera noted that all 183 companies listed on the Bolsa de Valores de Colombia reported related party transactions in their most recent financial statements. The counterparts to most of these transactions are believed by the members of the Colombian Task Force to be companies within the same industrial or financial group, with Superfinanciera citing loans, guarantees, service and management contracts, and shared IT services as among the most prevalent types of transactions.

95. Members of the Colombian Task Force reported no instances where RPTs were cited in law suits, regulatory investigations and enforcement actions, or in the financial and popular press as sources of inequitable treatment of minority shareholders. Although there has been substantial growth in the coverage of the Colombian securities market in recent years, financial journalists and securities analysts have not highlighted concerns about RPT issues in their publications. However, in light of the structure of ownership and control just described, and the concomitant potential for real or perceived abuses, Superfinanciera and other members of the Colombian Task Force believe that significant attention should be given to promoting greater transparency of, and developing clearer standards for consideration and approval of RPTs. For example, Superfinanciera has through regulation obliged all financial institutions subject to its supervision to adopt in their codes of conduct specific parameters for when and how RPTs should be conducted. The self-regulatory organization for the securities markets (Autoreguladora del Mercado de Valores – AMV) has paid special attention in recent years to instances of underwritings of securities by securities companies affiliated with issuers.

Current Framework

96. The Government of Colombia and the Superfinanciera have made convergence to IFRS a priority since the passage of Law 1314 in 2009, although no final target date has been set.[20] Current Colombian national accounting standards still differ significantly from IAS 24 in establishing a 10% beneficial ownership threshold for determining whether a person or entity falls within the definition of "related party". Colombia's numerical threshold contrasts sharply with IAS 24's more principles-based "significant influence" test for determining whether a shareholder should be considered a "related party".

[20] The President of Colombia decreed on December 30, 2011 that large and medium-size companies can voluntarily apply IFRS beginning this year.

97. For purposes of material events disclosure, the same definition of "related party" as is used for financial reporting applies. However, Colombian law does provide certain thresholds below which immediate disclosure is not ordinarily required. Only transfers of goods or services representing 5% of the assets of the company, guarantees of obligations equal to or exceeding 1% of assets, and loans representing 10% or more of assets must be immediately disclosed to the market.

98. Superfinanciera believes that once Colombian accounting standards have converged to IFRS, the regulator will have a stronger hand to impose greater transparency (both in financial statements and material events disclosures) with respect to all material RPTs and the standards and procedures applied in their review and approval.

99. Colombia's Commercial Code sets forth criteria pursuant to which companies are considered to be members of an economic group, through the definitions of "control situation" and "business group". Groups are subject to certain regulations governing relations between them, particularly with respect to: (1) consolidation and other aspects of financial reporting; (2) subordination in bankruptcy and liquidation; and (3) cross-shareholding. Companies considered members of the same group automatically qualify as related parties.

100. The management of companies in an economic group must submit a special report to the shareholders on an annual basis setting out the details of transactions with parent and subsidiary companies. However, such report is not required to provide similar information on dealings with companies under common control, but which are not in a parent or subsidiary relationship.

Role of the Board

101. Colombian company law and securities regulation impose no special requirements on when a Board must review RPTs or what procedures should be followed. However, the legal framework applicable to banks and credit institutions requires unanimous Board approval of all material related-party loans, as well as any transactions between banks and credit institutions and their shareholders, managers, or managers' relatives. While the general corporate law and the rules relating to economic groups require that transactions with related parties must be in the interests of the company and on market conditions, they do not specifically require the Board or a Board committee to review or opine. What policies a company follows, and what might serve as the basis for lawsuits against Board members for breach of duty of loyalty and care, rest exclusively on interpretation of the general fiduciary duties of directors.

102. However, the importance of economic groups and the prevalence of common ownership of listed and unlisted companies was on the minds of the task force convened by Superfinanciera in 2006 to draft a uniform national code of best practices in corporate governance (the Código de Mejores Prácticas Corporativas de Colombia – Código País / Country Code).[21] Standard 26 of the Country Code recommends that the Audit Committee of the Board elaborate a written policy on RPTs, setting forth standards and procedures required for their approval. Superfinanciera reports that as of 2010, approximately 27% of Colombian listed companies had adopted Standard 26 in whole or in part (in some cases assigning responsibility for elaborating the firm's RPT policy and reviewing material RPTs to someone other than the Audit Committee).

[21] The recommendations of the Country Code are voluntary. However, pursuant to Circular 007 issued in February 2011, Superfinanciera requires that all listed companies explain in their annual responses to the Country Code survey why they do not comply with any of the recommendations (comply or explain).

Role of Shareholders

103. Colombian law and regulation applicable to public companies imposes no special requirement for shareholder approval of RPTs. However, Standard 8 of the Country Code recommends that companies require shareholder approval of all material transactions with related parties, with the exception of those carried out at standard prices and in the ordinary course of business. According to the 2010 reporting of compliance with the Country Code, only 13 of the 165 respondents had adopted a policy to require all material RPTs to be approved by the shareholders.[22]

Enforcement

104. Members of the Colombia Task Force reported no instances of administrative, civil or criminal actions in recent years relating to allegations of abusive RPTs. While Colombia's supervisory authority may issue administrative penalties and fines if it finds a violation of law in connection with an RPT, its power with respect to the transaction itself is more circumscribed. Superfinanciera may not reverse transactions, nor can it seek redress for shareholders, although it may impose fines or enjoin transactions it determines are not in accordance with market conditions, and its investigations may be used in subsequent civil suits by shareholders for damages.

105. Colombia is the only country among the respondents to the survey whose law provides for class action suits for damages resulting from violations of the corporations and securities laws. As a matter of black letter law, shareholders may even ask a court to order rescission of an improper and abusive RPT. However, members of the Colombian Task Force reported that no class action suit has yet been brought against officers or directors of a company alleging improper related party transactions. They expressed scepticism that the Colombia judicial system as it currently stands has the practical ability to process such cases in a consistent and expeditious fashion. Most judges are little trained in commercial and securities law and would find adjudicating such cases beyond their capacity.

Recommendations and next steps

106. As noted above, despite the impression that RPTs have not been a major source of abuse of minority shareholders in recent years, the members of the Colombian Task Force believe the topic deserves continued attention because of the prevalence of economic groups and the potential for real or perceived mistreatment of shareholders. Important initiatives in this area that members of the Colombian Task Force believe should be pursued include:

107. **Post IFRS implementation analysis of RPTs.** Superfinanciera believes convergence of Colombian accounting standards with IFRS will provide greater clarity with respect to the prevalence and types of RPTs in the Colombian market and strengthen the authority's hand in enforcing more complete and accurate disclosure. Accordingly, Superfinanciera intends to conduct a comprehensive study of RPTs in the Colombian market after full convergence and will use the results to evaluate the adequacy of the existing legal/regulatory framework and voluntary practices.

108. **Revision of the Country Code.** The review of the Country Code in 2012 presents an opportunity to review the experience with current practices and analyze the reasons behind the incomplete implementation of its current RPT recommendations (Standards 8 and 26). Superfinanciera expects that the members of the committee revising the Country Code will revisit: (1) the definition of related parties

[22] A significant number of respondents who have not complied explained that they have not adopted such a policy because the company does not engage in material RPTs not in the ordinary course of business.

and materiality; (2) recommendations for disclosure and approval practices; (3) the roles of the Board, committees, shareholders and third parties; and (4) penalties and remedies in cases of non-compliance.

109. **Economic groups.** Reflecting the reality of the Colombian economy and securities market, members of the Colombia task force believe that the regime for RPTs must take into account the special nature of economic groups. Review of the legal/regulatory framework and voluntary practices under the Country Code should take into account the behaviour of economic groups and come up with workable solutions that promote greater transparency of intra-group transactions and ensure equitable treatment of minority shareholders of group companies.

110. **Financial institution regulation.** Superfinanciera has identified a number of inconsistencies in the regulations applicable to the different types of financial institutions due to differences in the definitions of related parties, applicable materiality thresholds, and the accounting and capital treatments accorded different types of RPTs. These present opportunities for regulatory arbitrage. Accordingly, Superfinanciera intends to conduct a detailed study of RPTs of financial institutions with the ultimate goal of arriving at a single definition and consistent treatment across the industry.

CHAPTER 6: MEXICO

Incidence and impact of RPTs

111. To the knowledge of the members of the Mexican Task Force, no recent studies by academics or securities analysts have been conducted on the topic of related party transactions. While comprehensive data on the incidence of related party transactions among listed firms have yet to be compiled, of the 46 Mexican companies in the GMI sample from 2008, 46% reported significant RPTs within the past three years. Mexico's banking and securities regulator (Comisión Nacional Bancaria y de Valores - CNBV), believes the majority of RPTs among listed companies occur between companies in the same industrial or financial group, principally companies that consolidate financial statements. The most commonly reported types of RPTs vary across industries, and may include purchases and sales of goods and services, loans and lease transactions, and purchases of real property. Some members of the Mexican Task Force noted that domestic and foreign investors are well aware that RPTs are relatively common in Mexico. However, without more data and analysis it is impossible to say with any certainty how frequently improper RPTs actually occur, or whether investor perception of abuses is holding back the development of the Mexican capital market.

Current Framework

112. Many of the innovations in Mexico's corporate governance regime for listed companies over the past decade or so have derived from changes to the Securities Market Law (Ley del Mercado de Valores) and to the issuance and revision of the Code of Best Corporate Practices (Código de Mejores Prácticas Corporativas), issued by the Business Coordinating Council (Consejo Coordinador Empresarial) and used as a point of reference, through a comply or explain regime, in CNBV regulations. The principal legal form for listed firms, the Sociedad Anónima Bursátil (SAB), and the articulation of directors' duties of loyalty and care for such companies are established not in the Commercial Companies Law (Ley General de Sociedades Mercantiles), but in the Capital Market Law's revisions of 2005. Similarly, it is the regulations under the Securities Market Law that in effect require the Boards of Mexican listed companies to have in place a Corporate Practices Committee charged with ex ante oversight of certain activities (including RPTs) and an Audit Committee to oversee ex post compliance with required standards and procedures (especially financial reporting and disclosure).

113. Annex N of the Issuers' Provisions Compilation (Disposiciones de Carácter General Aplicables a las Emisores de Valores y a otros Participantes del Mercado de Valores, also known as Circular Única de Emisoras - CUE) issued by the CNBV sets out the rules for disclosure of related party transactions in annual reports of public companies. IFRS went into force for all Mexican non-financial listed companies on January 1 of this year, so disclosure of related party transactions in financial reports in accordance with IAS 24 is also now the rule in Mexico.

114. The CUE imposes an obligation on listed companies to immediately disclose (as a material event) any RPT whose amount is equal to or exceeds:

(1) 5% of assets, liabilities or consolidated capital; or

(2) 3% of consolidated sales in the previous year.

This requirement explicitly does not exempt companies from the obligation to make immediate disclosure of transactions that do not meet either of the above thresholds, but are nonetheless material events under the general rules for disclosure of events that must be made immediately known to shareholder and the markets.

Role of the Board

115. The Boards of Mexican listed firms are, in practice, required to establish a Corporate Practices Committee, as required by Article 20 of the Securities Market Law.[23] Most Corporate Practices Committees also oversee executive evaluation and compensation (and some may even be charged with planning and budget supervision). The responsibilities of the Corporate Practices Committee must include recommending to the Board appropriate policies on RPTs. On an annual basis, the Chairman of the Corporate Practices Committee must submit to the full Board, and ultimately to the shareholders meeting, an annual report on the committee's activities, detailing, inter alia, all transactions of the company with related parties, and the procedures by which the committee and Board reviewed and determined such transactions to be in the interests of the company and in accordance with market conditions. The annual report of the Corporate Practices Committee is not ordinarily reviewed by the firm's auditors, but Mexico charges the Audit Committee with responsibility for ensuring that the procedures just described are followed.

116. In practice there are three reports produced annually with respect to RPTs of a Mexican listed company: the auditor's footnote to the financial statements in compliance with IAS 24, which is reviewed by the Audit Committee; another produced by the Corporate Practices Committee as part of its annual report to the Board; and a third report on inter-company transactions prepared by the company's management in connection with the firm's income tax returns. This last report is not required to be reviewed by any committee of the Board.

117. The members of the Mexican Task Force agreed that over the past few years the seriousness and consistency with which Corporate Practices Committees of Mexican public firms have performed their duties has increased. There is a firm understanding of the important role of this Board committee in assisting the Board in areas included within its competence, and of the principle that the Board remains ultimately responsibility for decisions it takes on the advice of its committees.

118. CUE Article 71 requires that when a single RPT or series of related RPTs within a single year amounts to the sale or acquisition of goods and services (or the provision of guarantees or assumption of liabilities) valued at 10% or more of the company's consolidated assets, the company's Corporate Practices Committee shall select a qualified independent expert to opine on the fairness of the terms and whether they are consistent with market conditions. The report of the expert should be considered in the deliberations of the committee and the Board (including to decide whether the transaction should be approved if the transaction is reviewed by the shareholders meeting). As noted above, any such report must be duly noted in the annual report that the Corporate Practices Committee submits to the Board and the shareholders.

[23] As noted in the Survey Report, the Corporate Practices Committee must be composed entirely of independent directors, unless the company has a controlling shareholder, in which case only a majority of independent directors is required.

Role of Shareholders

119. Under Mexico's Securities Market Law, transactions (regardless of whether they are RPTs) equal to or in excess of 20% of a company's assets are generally required to be submitted for the approval of the shareholders meeting (including holders of non-voting and restricted-voting shares). Interested shareholders are required to recuse themselves from voting (i.e., there is a "majority of the minority" requirement). However, transactions made in accordance with Board policies and guidelines on RPTs that are between a parent company and its subsidiary in the ordinary course of business and at market prices or supported by the valuation or appraisal of qualified external experts do not have to be submitted for shareholder approval. Interestingly, even if a shareholders meeting approves a transaction, holders of 20% or more of the company's shares remain entitled to challenge the resolution of the shareholders meeting, and an injunction can be ordered by a court, on the condition that the objecting shareholders post bond sufficient to cover any damages that may result if the transaction is ultimately adjudged lawful by the court.

120. Article 27 of the Securities Market Law requires that transactions (whether RPTs or not) equal to or exceeding 20% of consolidated assets be submitted to the shareholders for their approval after review by the Corporate Practices Committee and approval by the Board. Members of the Mexican Task Force had no knowledge of any attempt to parse through corporate disclosures of Mexican listed firms to determine how often fairness opinions and shareholder approval has been sought in the case of large transactions.

Enforcement

121. The Securities Market Law accords the CNBV broad investigatory powers. It may request additional information from any listed company or regulated entity and is empowered to conduct formal investigations of any violation of the Securities Market Law and the regulations there under. However, the CNBV may impose only administrative penalties against officers and directors of companies for failure to comply with the disclosure rules related to RPTs. While it may impose such administrative sanctions, CNBV cannot require companies or individuals to compensate shareholders or effect restitution to companies for carrying out RPTs that result in inequitable treatment of minority shareholders.

122. Since amendments to the Securities Market Law approved in 2006, the power to order restitution or other compensation to shareholders for violations of the Securities Market Law or the Commercial Companies Law is reserved solely to the civil courts. According to members of the Mexican Task Force, there have been numerous press reports of suits by minority shareholders of airport operators, steel companies, hotel chains and other companies alleging improper RPTs resulting in damages to their economic interests.

123. Mexican law provides that private rights of action under the Securities Market Law against officers and directors can be brought either by the company itself, or by holders of 5% or more in the aggregate of the company's shares. Members of the Mexican Task Force noted that shareholders who believe an RPT was improperly approved may single out the members of the firm's Corporate Practices Committee or the external auditors that signed off on the disclosure of RPTs in the financial statements in any lawsuit for damages. As noted earlier, in the case of large transactions (20% or more of assets) where shareholder approval is required by the Commercial Companies Law, dissenting holders of 20% or more of shares can petition for injunction and judicial review of the transaction's fairness. However, in all other cases, interested parties may sue only for damages and may not request unwinding (rescission) of the transaction.

124. The CNBV and the Mexican Stock Exchange (Bolsa Mexicana de Valores – BMV) believe that some Mexican investors remain under-educated about their rights as minority shareholders and accordingly

and BMV has included the topics of reporting violations and seeking recourse through the courts in their investor education programs.

Recommendations and next steps

125. The members of the Mexican Task Force highlighted the following as topics of priority for further work on RPTs in the Mexican market:

126. **Role of external auditors.** One member of the Mexican Task Force suggested that the coverage of the external audit be broadened to include a review of the discussion of RPTs included in the annual report of the Corporate Practices Committee. Such a review would encourage consistency with disclosure under IAS 24 and should not add substantially to the company's costs. It would also limit any confusion that may exist inside or outside the company as to the respective responsibilities of the external auditors, the Audit Committee and the Corporate Practices Committee with respect to review and transparency of RPTs.

127. **Harmonization of Commercial Companies Law.** As noted earlier, the corporate law of Mexico has remained static in recent years, while there have been important advances in securities law and regulation and best practices standards-setting. Many elements of the Code of Best Practices' provisions regarding RPTs have now been incorporated by the CNBV into the Single Issuer Disclosure Form known as the CUE. It is expected that amendments will be proposed to the Commercial Companies Law later in 2012 that will treat the topics of the role of the Board and the *síndico* (statutory auditor). If handled carefully, this revision could be an opportunity to harmonize the Commercial Companies Law with the Securities Market Law and the CUE. Harmonization would increase legal certainty and assist judges, who are trained to focus on the literal reading of the statutes, to more consistently enforce the overall framework.

128. **Review of actual practices.** Members of the Mexican Task Force supported the idea of a comprehensive review of corporate disclosures to get a better handle on the incidence and types of RPTs in the Mexican market, the policies and practices adopted by Corporate Practice Committees and Boards to ensure their fairness, and the actual experience of shareholders meetings in approving large RPTs.

129. **Shareholder activism.** As noted above, the CNBV and the BMV believe that there is insufficient awareness of shareholders rights and have included the topic in their investor education programs. Several members of the Mexican Task Force singled out the managers of Mexico's growing mandatory pension savings scheme (AFOREs) as the natural champions of shareholder activism. Others noted that there remains a confusion among some directors of AFORES with respect to their fiduciary duties (i.e., do the Boards of AFORES have a duty to act in the interests of beneficiaries/pensioners or those of the AFORE's own shareholders?). Establishing through legislation or via guidance from the pension system regulator (CONSAR) that shareholder rights are an asset of the AFOREs whose value is to be maximized by their managers and directors for the benefit of beneficiaries/pensioners would eliminate this uncertainty.

CHAPTER 7: PERU

Incidence and impact of RPTs

130. According to the members of the Peruvian Task Force, the issue of related party transactions has to date not received a great deal of attention among capital markets and corporate governance professionals. It is not a major element in the Principios de Buen Gobierno Corporativo para las Sociedades Peruanas (the country's corporate governance code) and RPTs have not been a significant source of law suits or complaints brought to Peru's securities regulator (Superintendency of Capital Markets – SMV, formerly CONASEV). Nor has there been much in the way of media or securities analyst coverage of potentially abusive RPTs. Most of the analyses of related party transactions conducted so far have been carried out by auditing firms and have focused on the tax implications of inter-company transfers. As possible explanations for the relative lack of focus on RPT issues, members of the Peruvian Task Force cited the stage of capital market development, the sector of the largest number of listed firms (natural resources extraction) and the preference among entrepreneurial groups to form a holding company as the vehicle through which minority equity interests are offered in the public markets.

131. At the same time, no comprehensive data has been collected or analysis conducted of the actual incidence of RPTs and the types of transactions that prevail. Quick-and-dirty sampling indicates that RPTs are not uncommon among Peruvian listed companies. For last year's survey, SMV sampled the 40 most actively-traded companies on the Lima Stock Exchange and found that 35 of these reported RPTs in their 2010 financial statements (as required under Peruvian accounting rules and IFRS, the latter in force for all listed non-financial Peruvian firms beginning this year). More recently, SMV reviewed the financial statements of the 34 issuers included in the Lima Stock Exchange Index (of the total of 269 listed companies) and determined that 27 reported RPTs. Most such transactions involved purchases and sales of goods and services and inter-company loans. Less frequently encountered were RPTs in connection with mergers and acquisitions, and management contracts. SMV expressed disappointment in the level of detail provided on the nature and terms of RPTs included in company disclosures.

Current Framework

132. Peru's Securities Market Law provides that transactions with certain related parties that meet a size threshold are required to be approved by the company's Board. RPTs that require Board approval include those that:

(1) Are conducted with officers, directors or holders of more that 10% of the company's shares; and

(2) Represent more than 5% of the company's assets, a relatively high threshold in comparison with most other Latin American markets surveyed.

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

134. As noted in last year's Survey Report, there are no special rules for reporting related party transactions to the Board, shareholders or the public, beyond the requirements of IAS 24 for quarterly and annual financial reports. RPTs are subject to the same general "material events" disclosure regime as other developments related to the company's operations that can be expected to affect investment decisions. There are no special size or other thresholds that trigger an obligation to make immediate public disclosure.

135. The members of the Peruvian task force noted that the regulatory framework governing the holding company for state-owned companies (FONAFE) provides for the disclosure of all transactions among such companies, or between such companies and FONAFE itself. The government of Peru is currently considering the listing of some FONAFE companies on the Lima Stock Exchange.

Role of the Board

136. Other than the general requirement of Board approval of RPTs that exceed the thresholds noted above, there is little guidance on what standards and procedures Boards should use in determining that an RPT is in the interests of the company and on market terms. Neither the legal/regulatory framework nor Peru's corporate governance code indicates that any committee of the Board should play a role, or that independent expert opinions need to be considered (except, as stated above, when the RPT is between two companies controlled by the same entity). As far as members of the Peruvian Task Force are aware, there has been no analysis conducted of how often Boards of Peruvian companies actually review and approve RPTs, either to comply with the legal requirement under the Securities Market Law or pursuant to their own bylaws or practices.

Role of Shareholders

137. The Peruvian legal/regulatory framework includes no special provisions for shareholder approval of RPTs. Members of the Peruvian Task Force noted that there is no restriction, however, on Peruvian companies adopting bylaws provisions that provide for shareholder approval in certain circumstances. Similar to provisions of the laws of other surveyed countries, Peruvian law requires that all transactions that exceed a certain percentage of a company's capital (50% in Peru's case) can only be carried out after an affirmative vote of the shareholders meeting. Members of the Peruvian Task Force were unaware of any incidence of shareholder approval of an RPT (other than incidentally in the case of mergers and acquisitions).

Enforcement

138. The SMV is empowered to investigate, impose sanctions and issue injunctions on its own initiative or at the request of a complaining shareholder. The SMV Law (which transformed the CONASEV into today's SMV) increased SMV's supervisory powers (especially in relation to market manipulation) in anticipation of the regulator playing a greater role in building confidence in Peru's rapidly-growing securities market by ensuring better transparency and fair treatment of minority shareholders.

139. The members of the Peruvian Task Force had little to report in the way of practical experience with enforcement. SMV has yet to take any enforcement action in connection with an allegedly improper related party transaction. As noted earlier, the regulator has not received complaints about such transactions and members of the Peruvian Task Force were aware of no press reports of civil suits. Members of the Peruvian Task Force voiced little confidence in the potential effectiveness of judicial enforcement, characterizing Peru's court system an inefficient and inexperienced in corporate and securities matters. The legal and practical capacity of the Lima Stock Exchange to investigate and sanction

are regarded by the members of the Peruvian Task Force as quite limited; the market's experience with self-regulation is, in their view, not encouraging.

Recommendations and next steps

140. The members of the Peruvian Task Force cited the following as areas for further collaborative efforts on the topic of RPTs in Peru.

141. **Revision of the code.** Peru's corporate governance code was issued ten years ago. The SMV has convened representatives of the public and private sectors to draft a revised version. A diagnostic phase is currently underway, which includes a review of the history of the past decade and written and verbal consultations with companies and market participants. This diagnostic phase should be exploited as an opportunity to gather more information about the incidence and nature of RPTs in the Peruvian market and company practices and experiences with respect to review and approval of RPTs. Analysis of the data can be expected to generate specific recommendations for treatment of RPTs in the next version of the code.

142. **Standardization of RPT transparency and disclosure standards.** Members of the Peruvian Task Force expressed the view that disclosure of information on RPTs in the Peruvian market is often incomplete or opaque. Standards for clear and complete disclosure in financial reports and material events disclosure should be developed in the form of regulations of the SMV and/or provisions of the revised Peruvian corporate governance code.

143. **Articulation of clear company policies.** Members of the Peruvian Task Force noted that there is no impediment to companies taking the initiative to develop their own practices with respect to Board (and perhaps even shareholder) review and approval of RPTs. The committee charged with revising Peru's corporate governance code should consider including a recommendation that every Board issue a written policy on RPTs, articulating clearly which are permitted and which are not and specifying the criteria and procedures for their approval, including the role of Board committees, the full Board and shareholders.

144. **Regional market integration.** Members of the Peruvian Task Force noted that the prospect of greater regional equity market integration represented by the MILA (Mercado Integrado de Latino América), a trading platform that currently links the equity markets of Colombia, Peru and Chile, may provide impetus for harmonization of both RPT disclosure and approval practices among listed companies in the three markets. Peru would appear to be the MILA country with the least specificity in its laws and voluntary standards as regards RPTs. Accordingly, efforts by the legislature, SMV and the committee that will re-draft the corporate governance code should take into account the current framework and trajectory of Chile and Colombia with an eye toward possible convergence.

CHAPTER 8: POLICIES, BEST PRACTICES AND AN AGENDA FOR THE REGION

145. Members of the Task Force from all the participating countries met in Rio de Janeiro on June 28, 2012 to discuss the initial draft of this Report. The day-long discussion of the work of each Country Level Task Force was lively and productive and provided opportunities to share information, experiences and opinions. In addition to discussing the country-level recommendations of the draft Report and points of region-wide consensus, members of the Task Force considered how region-wide efforts might support some of the country-level recommendations for future action. Members of the Task Force cited the Latin America Corporate Governance Roundtable's historic convening power, the recognized quality and commitment of its membership, the credibility the Roundtable has earned over the years with both the public and private sectors and the important work that OECD has advanced in on the topic of RPTs among member and non-member countries as positioning the Roundtable to play a valuable role in advancing the dialogue on RPTs in Latin America.

146. The discussions at the Rio meeting evidenced a strong consensus among the members of the Country Level Task Forces on the central elements of an effective legal/regulatory framework governing RPTs. On the one hand, the Task Force recognized that many related party transactions are economically beneficial and that policy makers should take into account the potential costs of regulatory requirements intended to prevent abusive RPTs. However, Task Force members also strongly agreed on the importance of addressing several elements in the legal/regulatory framework to protect the interests of all shareholders and to provide an adequate degree of transparency to the financial market. These include:

a. Requirements for immediate and adequate disclosure of RPTs that meet reasonable materiality standards. Members of the Task Force all believed that the adoption of IFRS (including IAS 24) across the region is a positive force for better RPT transparency. But financial statement transparency is only one element of an adequate disclosure framework. Each country must also have in place an effective continuous disclosure regime that ensures that shareholders and the markets can monitor the company's RPT practices and make their own informed judgements about whether transactions are conducted on market terms and are in the best interests of the company and all its shareholders.

b. Board responsibility. All Task Force members agreed that the legal/regulatory frameworks throughout the region should continue to provide that the Board of Directors bears primary responsibility for ensuring the transparency and fairness of RPTs. In order to be effective and credible, the rules for Board review and approval should ensure that conflicted directors are excluded from the process. Boards need to have sufficient business knowledge and experience among their members and access to appropriate independent outside expertise to effectively carry out their responsibilities. The legal/regulatory framework should ensure clarity as to what constitute *de minimus* or ordinary course transactions that need not be subject to one-by-one Board review in those jurisdictions that provide for such exceptions. While some Task Force members recommended as good practice to give independent Board members a stronger legal role in reviewing and making recommendations on related party transactions, there was not consensus on this point, and only Chile has adopted such a model through its Committee of Directors, which either is composed by a majority of independent directors, or is chaired by an independent member.

c. Shareholder approval of exceptional RPTs. While there is broad consensus within the Task Force that the Board should bear primary responsibility for RPT oversight and approval, there was also consensus that instances arise where shareholder approval may be appropriate in addition to Board approval because of the special nature of the transactions (e.g., mergers and acquisitions) or where circumstances bring into question Board independence. Most Latin American countries that have adopted such provisions (Argentina, Brazil and Mexico) generally exclude interested shareholders from the vote (majority of the minority) to reinforce the credibility of the process. But there was not consensus across the Task Force on this point, considering that Chile allows interested shareholders to vote but requires a two-thirds majority. The legal/regulatory framework should clearly set out the criteria for when RPT approval requires the additional step of a shareholder vote. Shareholder review and approval should not, however, be used as a means of absolving the Board of its responsibility to act in the best interests of shareholders.

d. Quality and independence of auditors and valuation experts. Boards, shareholders and the financial markets inevitably rely on the quality of the opinions and valuations provided by third parties. Reliance on their opinions and valuations requires confidence that these are not tainted by conflicts of interest. Accordingly, it is of central importance that the regulatory regime and professional standards provide clear criteria for independence and high standards for ethical conduct.

e. Effective enforcement and ability to seek compensation for damages. Enforcement remains a challenge throughout the region. Members of the Country Level Task Forces generally agreed that to be effective, the enforcement regime must empower the supervisor to investigate and sanction violations and initiate civil and criminal actions against wrongdoers. The legal/regulatory framework should also provide avenues for aggrieved shareholders to seek restitution for losses resulting from RPTs that are not conducted on terms fair to the company and minority shareholders.

147. Specific areas where the Roundtable, with the support of the RPT Task Force and perhaps also the Companies Circle, could facilitate region-wide efforts (with specific actions highlighted in bold) include:

148. **Collecting, sharing and analysis of data on RPTs.** One clear conclusion that emerges from the work of the Country Level Task Forces is that there remain large gaps in the currently-available data on the incidence and variety of RPTs in the participating countries. Insufficient scientific analysis has been conducted using what data does exist. At the Rio meeting, members of the Task Force expressed general support for **coordinating country-level data gathering to stimulate region-wide systematic analysis of the types and incidence of RPTs throughout the region and the challenges these may pose for capital market development and regulation.** Such coordination could be facilitated through a sub-committee of the Task Force, perhaps in conjunction with a respected academic institution.

149. **Completeness and consistency of disclosure (IAS 24 presentation).** All Country Level Task Forces expressed agreement that improving transparency of RPTs is an important lever for encouraging more vigilant and responsible Boards and ultimately fairer treatment of minority shareholders. At least some members of every Country Level Task Forces feel that existing mandatory requirements and/or voluntary guidance with respect to the disclosure of RPTs is inadequate in their market. However, other Task Force members cited examples of conscientious disclosure by some issuers that can serve as models for other companies in their markets and beyond. **The Task Force can build on these examples to develop an ideal format for both periodic and material event disclosure of RPTs to serve as a point of reference for regulators, standard-setters and companies in the region.** In particular, given that IFRS either has only recently been adopted, or is still in the process of adoption in the participating

countries, **now would be a propitious time to develop and promote a model format and content for IAS 24 disclosures in annual reports that can be adopted by regulators and auditing firms in order to promote more complete and comparable transparency with respect to RPTs across the region.**

150. **Materiality thresholds.** Comparison of the legal/regulatory frameworks and voluntary standards reveals a marked divergence across the Task Force countries in the standards of materiality (including transaction size thresholds) that trigger disclosure requirements and the obligation for Board or shareholder review. The rationale for existing thresholds is sometimes hard to articulate and some members of the Task Force questioned whether the wide variance does not indicate that at least some of them should be revisited and reconsidered in a comparative context.

151. **RPTs in economic groups.** Economic groups are a common feature of all the markets discussed in this Report. Members of the Task Force from all participating countries recognized that membership in an economic group can afford a company significant benefits and that related party transactions between two companies in the same economic group are often practically unavoidable and can be to their mutual benefit. How membership in an economic group affects the role and responsibilities of a company's Board and the legitimate rights and expectations of shareholders, including with respect to the appropriate treatment of RPTs, are questions that were debated both within the Country Level Task Forces and during the Rio meeting. **Members of the Task Force expressed interest in continuing to examine the special case of RPTs within groups at the regional level, and to include this topic among those taken up efforts to coordinate with OECD efforts on RPT issues beyond the region.**

152. **Company-specific policies.** The legal/regulatory frameworks and/or voluntary guidance in place in all Task Force countries either require or encourage firms to develop and publish company-specific policies that detail what types of RPTs the company will, and will not engage in, along with the criteria and procedures for approval of permitted RPTs. In countries, like Chile, where the legal/regulatory framework provides that Boards need not approve individual *de minimus* and ordinary course transactions, company-specific policies need to be explicit about how the company defines what sorts of RPTs fall within these exceptions. However, according to Task Force members, most such company policies simply parrot legislation and provide shareholders with insufficient detail on what standards and procedures will actually be applied. **The Task Force, with the assistance of the Companies Circle, could help advance the adoption of more substantive and better-tailored policies by articulating the elements that should be included in any company-specific policy on RPTs, identifying best practice companies in the region (some of which have already been suggested by Task Force members), and disseminating the policies of such companies and the companies' experiences with their application.**

153. **Taxonomy of state ownership.** Questions related to RPTs in listed companies with significant state ownership were considered by several of the Country Level Task Forces and discussed by the Task Force as a whole during the Rio meeting. Task Force members agreed that different types of state ownership (e.g., majority vs. minority ownership, direct vs. indirect ownership, strategic vs. commercial objectives) create different challenges and probably require different policy responses. Task Force members shared the view that regardless of ownership structure and objective of state ownership, every such company should have clear policies with respect to what RPTs will and will not be conducted and what standards will be applied to determine whether individual transactions will receive approval. The Board should ultimately be accountable to shareholders for compliance with such policies and the accounting and disclosure standards with respect to RPTs of companies with state ownership should be at least as stringent as those applicable to fully private firms.

154. Task Force members expressed interest in developing a region-wide taxonomy of state-ownership patterns that could be a helpful first step in considering what sorts of RPT policies and practices are appropriate for companies with different degrees of state ownership and objectives. Task Force

members, especially those from countries that already have large listed companies in state hands, expressed enthusiasm for **engaging with the newly-established OECD/CAF Latin American Network on Corporate Governance of State-Owned Enterprises to jointly examine possible approaches to managing RPTs of SOEs in ways that minimize the potential for mistreatment of private sector investors and holding back capital market development.**

155. **Beyond the region.** As noted in Chapter 1 of this Report, the OECD has been actively engaged with both member and non-member countries on the topic of RPTs, including in connection with the work of the OECD Asian Corporate Governance Roundtable. While there are clear distinctions between the market structures, legal/regulatory frameworks, ownership patterns, and legal frameworks in Latin America and other regions, there are also certain commonalities, including the predominance of identified control and the presence of economic groups. Several members of the Task Force expressed enthusiasm for the prospect of **developing a structured dialogue between the Task Force and individuals and institutions that have been active in analysis, policy-making and practice with respect to RPTs in Asia and perhaps other regions**.

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

Country	Financial Statement Disclosure	Material Event Disclosure	Board Review Thresholds	Committee Review	Shareholder Review	Majority of Minority Requirement	Supervisor's Powers	Private Rights of Action
Argentina	Local GAAP conforms to IAS 24[24]	35% shareholders; A$300K (US$60,000)	None; but Board review reverses burden of proof	Audit Committee	Only if Board does not approve	Yes	May not enjoin; may reverse RPTs	
Brazil	IFRS /IAS 24	General materiality standards	None	Special Committees[25]	In cases of corporate reorganization	Yes (except in case of acquisition of controlled company by parent company)	May postpone shareholder meetings; can seek compensation for injured parties	By derivative action or by 5% of shareholders
Chile	IFRS/IAS 24	General materiality standards	RPTs above UF 20K (US$937K) or 1% of assets	Committee of Directors	Only if Board does not approve	No, but 2/3 majority required		Shareholders may sue only for damages
Colombia	Local GAAP 10% beneficial ownership threshold	As percentage of assets: sales 5%; guarantees 1%; loans 10%	None	Not required	Not required	n/a	May not enjoin or reverse RPTs	Class actions permitted; may request reversal of RPTs
Mexico	Local GAAP conforms to IAS 24[24]	5% of assets, liabilities or capital; 3% of sales	RPTs above 10% of assets	Governance Committee	In all transactions in excess of 20% of assets[26]	Yes		By derivative action or by 5% of shareholders; may sue only for damages
Peru	IFRS/IAS 24	General materiality standards	RPTs with 10% shareholders and 5% of assets	Not required	In all transactions in excess of 50% of assets[26]		May enjoin RPTs	

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

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

[26] Regardless of whether such transactions are RPTs.