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# CORPORATE GOVERNANCE IN BRAZIL: RECENT IMPROVEMENTS AND NEW CHALLENGES

*John William Anderson, Jr.\**

## I. INTRODUCTION

THE purpose of this article is to present a general overview of certain improvements in Brazilian regulation and legislation in connection with corporate governance principles. In the aftermath of the recent corporate scandals in the United States, which raised debates and concerns about corporate governance, transparency in the disclosure of corporate information, and liability of the management of publicly traded corporations, I believe it is appropriate to analyse the merits of certain instruments of the Brazilian legal system and their coherence with the current world scenario.

For the purpose of establishing a worldwide-accepted basis for comparison and evaluation of such improvements, the relevant regulatory and legislative provisions shall be analysed in light of the Organization for Economic Co-operation and Development (OECD) Principles of Corporate Governance (OECD Principles<sup>1</sup>).

In particular, this article will analyse certain improvements in Brazilian legislation and regulation in connection with the following: (1) the relationship between controlling and minority shareholders; (2) transparency within the disclosure of material information; and (3) the responsibilities of the directors and managers of corporations. The OECD Principles dedicate section II to "Equitable Treatment of Shareholders," section IV to "Disclosure and Transparency," and section V to "The Responsibilities of the Board." The choice of the first topic can be explained by the historical development of Brazilian corporations, and the resulting high degree of ownership concentrations in major Brazilian corporations. High levels of ownership concentration are likely to generate a non-transparent environment and non-equitable treatment of shareholders. The second and third topics are intimately related to the recent scandals in the U.S. capital markets and the general concerns arising there from.

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1. Organisation for Economic Co-operation and Development, OECD Principles of Corporate Governance [hereinafter OECD Principles], available at <http://www.oecd.org> (last visited Mar. 26, 2003).

The first part of this article analyses the role of the OECD Principles, their importance in the context of economic globalisation with special focus on the guidelines relating to the three topics described above. The second part addresses the history of Brazilian corporations and the reasons for the major corporate governance related problems in Brazil. The third section of this article analyses some of the recent changes in Brazilian legislation and their contribution to the further development of corporate governance in Brazil. The fourth part of this article describes the improvements arising from the creation of the so-called New Market (*Novo Mercado*) within the São Paulo Stock Exchange (*Bolsa de Valores de São Paulo* - BOVESPA), an alternate listing mechanism with increased requirements of corporate governance. The fifth part addresses recent provisions enacted by the National Monetary Council (*Conselho Monetário Nacional* - CMN), which takes into consideration corporate governance practices for purposes of granting authorization for the incorporation and operation of financial institutions. The sixth part is dedicated to a general analysis of the impacts of the enactment of the Sarbanes-Oxley Act in the United States, and its likely effects on Brazilian corporations. The final part of the article offers my remarks and conclusions.

## II. CORPORATE GOVERNANCE, GLOBALISATION, AND THE OECD PRINCIPLES

It is imperative to clarify the meaning and scope of corporate governance within the context of the present work as such words could be used to describe virtually any governance regime or any governance-related provisions of any given company. For the purpose of this article, corporate governance shall mean the set of principles, provisions, and practices governing a given company, aiming to optimise such company's performance, and protect shareholders and stakeholders such as investors, employees, and creditors, thus facilitating access to capital.<sup>2</sup> The adopted definition is intimately related to capital markets, which develop through the use of corporate governance practices to make corporations more attractive to investors in order to facilitate corporate access to capital. As demonstrated below, this is the view and concept adopted by the OECD Principles.

The OECD Principles were endorsed on May 26-27, 1999, as a result of global concerns about corporate governance. The OECD Principles are of great importance in the current process of economic globalisation and in the context of increasing cross-border financial transactions.

Globalisation is a commonly used (but controversial) term, which embodies several meanings and an equal number of ideological and philo-

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2. This definition was based on the Brazilian Securities and Exchange Commission (*Comissão de Valores Mobiliários* - CVM). Securities and Exchange Commission of Brazil, *CVM Recommendations on Corporate Governance*, available at <http://www.cvm.gov.br> (last visited Oct. 6, 2003).

sophical discussions. The common sense interpretation generally accepts the idea of globalisation as a process of integration of countries catalyzed by the improvements in communication and sharing of information among nations, as a consequence of developments in technology. Such process results in an increasing flow of trade, capital, money, direct investment, technology, people, and ideas across national boundaries.

A discussion on the merits of globalisation or the actual integration of countries is outside the scope of this article. For purposes hereof, the existence of an increasing economic globalisation will be presumed. The results of economic globalisation can be described as the increase in international trade, cross-boarder investments, and international financial transactions.<sup>3</sup>

Such increasing interdependence of nations in the economic field and the related increase of cross-border transactions have contributed to the development of comparative law in current legal practice.<sup>4</sup> Worldwide, corporate lawyers face the challenge of dealing with and removing obstacles arising from foreign laws and regulations, while seeking to protect their clients' interests around the world. Following the same trend, international organizations have acknowledged the issues and concerns arising out of the increase in cross-border transactions. International organizations are studying and developing principles and guidelines that aim to harmonize the legislation of different countries. This legislative harmony is achieved by setting forth new standards compatible with a global environment.

This is the background upon which the OECD Principles have been developed. As stated in the preamble of the OECD Principles, they "represent a common basis that the OECD Member countries consider essential for the development of good governance practice."<sup>5</sup> Although not binding upon OECD members and non-members, the Principles "can be used as a benchmark by governments as they evaluate and improve their laws and regulations" and "also can be used by private sector parties that have a role in developing corporate governance systems and best practices."<sup>6</sup>

The OECD Principles emphasize the role of corporate governance in economic globalisation, mainly as an incentive to the flow of investments in corporations through capital markets. As set forth in the Preface of the OECD Principles, corporate governance helps to assure that: (1) cor-

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3. See HAL S. SCOTT & PHILIP A. WELLONS, *INTERNATIONAL FINANCE: TRANSACTIONS, POLICY, AND REGULATION*, 1-32 (8th ed. 2001). The authors, quoting DUFEE & CHUNG, *INTERNATIONAL FINANCE AND INVESTING*, 3-29 (R. Kuhn ed. 1990), describe international financial transactions as banking transactions involving a foreign resident in the domestic market or offshore markets. They also highlight the increase in international financing in the past years in several types of financial markets.

4. See H. Patrick Glenn, *Comparative Law and Legal Practice: On Removing the Borders*, 75 TUL. L. REV. 977 (2001).

5. See OECD Principles, *supra* note 1, at 11.

6. *Id.* at 8.

porations use their capital efficiently; (2) corporations take into account the interests of a wide range of constituencies (the stakeholders); and (3) the boards of corporations are accountable to the company and the shareholders. Companies that comply with good governance principles present a safer option for investors, specifically in the international capital markets. Investors, as rational maximizers of wealth concerned with their financial return, will likely invest in companies that provide them with tools to monitor and influence their financial return.

Part I of the OECD Principles refers to the rights of shareholders. Basic shareholder rights described in the Principles include: (1) the right to secure methods of ownership registration; (2) the right to convey or transfer shares; (3) the right to obtain relevant information on the corporation on a regular basis; (4) the right to participate and vote in general shareholder meetings; (5) the right to elect members of the board; and (6) the right to share in the profits of the corporation. One of the important features of this principle is that the shareholder is aware of its rights, of material information in connection with a given company, and of the instruments available to enforce such rights.

Part II of the Principles refers to the equitable treatment of shareholders—a principle that is relevant in light of the commonly used separation of ownership and control. The general principle is described as, “The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights.”<sup>7</sup>

Two key issues are further described in Part II in connection with this principle: (1) the risk of capital of the corporation being misappropriated by corporate managers, board members, or controlling shareholders; and (2) the risk of corporate boards, managers, and controlling shareholders engaging in activities that may advance their own interests at the expense of non-controlling shareholders. These issues are some of the main concerns of corporate governance in Brazil.

The third section of the OECD Principles refers to the role of stakeholders, and is intimately related to the social role of a company or corporation. The Principles emphasize the rights of stakeholders guaranteed by law.

The fourth section of the OECD Principles refers to disclosure and transparency. It sets forth that, “the corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company.”<sup>8</sup> The OECD Principles further provide for other important characteristics, such as types of information that should be disclosed, the role of the independent auditor, and standards to be observed in the disclosure of corporate infor-

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7. *Id.* at 19.

8. *Id.* at 21.

mation. The Principles also describe the need for a strong disclosure regime as a “pivotal feature of market-based monitoring of companies” and highlight its contribution to the “shareholders’ ability to exercise their voting rights” and to their assessment of “the stewardship of management.” Eventually, such a regime would enable shareholders and investors to “make informed decisions about the valuation, ownership and voting of shares.”<sup>9</sup>

Finally, the OECD Principles address in Part V the responsibilities of the board of directors of a given company. Pursuant to those principles, “[t]he corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board’s accountability to the company and the shareholders.”<sup>10</sup> This set of guidelines is intimately related to the corporate scandals in the U.S. market and have been reflected in the laws and rules enacted thereafter. The Principles set forth a type of fiduciary duty to the members of the board. As described above, “[b]oard members should act on a fully informed basis, in good faith, with due diligence and care, and in the best interest of the company and the shareholders.”<sup>11</sup> The notion of “best interest of the company” is expanded in other sections of those guidelines. In particular, special attention is given to the avoidance of conflicts of interest and to the independence of the board from the management.

Having described the worldwide-accepted standards of corporate governance, this article continues with the analysis and evaluation of Brazilian laws and rules. Before discussing specific corporate governance issues, however, a general understanding of the economical context of Brazilian corporations is provided.

### III. BACKGROUND OF OWNERSHIP CONCENTRATION IN BRAZIL

As stated previously, one of the major challenges of implementing good corporate governance in Brazil is the high ownership concentration in Brazilian companies. Most major Brazilian corporations are under family or state control. This scenario can be explained after a brief look at the history of Brazilian corporations and related financing mechanisms.<sup>12</sup>

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9. *Id.* at 37.

10. *Id.* at 22.

11. See OECD Principles, *supra* note 1.

12. A more complete description of the evolution of Brazil’s corporate sector can be found in Flavio Marcilio Rabelo & Luciano Coutinho, *Corporate Governance in Brazil*, at 7-13, available at <http://www.oecd.org> (last visited Oct. 6, 2003). This paper was discussed at the Policy Dialogue Meeting on Corporate Governance in Developing Countries and Emerging Economies organized by the OECD Development Centre and the European Bank for Reconstruction and Development, held at OECD headquarters on April 23-24, 2001.

The concentration of ownership can be attributed roughly to governmental action during the twentieth century through the 1990s. During the 1930s and 1940s, the Brazilian federal government was responsible for the funding of corporations, mainly through government-owned financial institutions. After that time period, Brazil's corporate sector continued to be formed by a process of import substituting industrialization, until the 1970s. This process was characterized by high tariff protection and massive government-originated cheap financing to corporations. After the 1970s, Brazil (like most South American countries) faced a heavy financial crisis, characterized by the increase of external debt by the Brazilian government and a high inflation regime. This scenario, also marked by a huge de-leveraging of the corporate sector, reinforced the concentration of ownership in Brazilian corporations, mainly because of the lack of competition in such a rough economic environment.

During the 1990s, foreign investors began looking at emerging markets as a consequence of the low interest rates in developed countries arising from the attempt of central banks to resume economic growth in the recession spread through G-7 countries. Within this context, Brazil received a massive amount of foreign capital, both by means of foreign direct investment and through the Brazilian privatisation initiatives, especially in the steel, petrochemical, energy, telecommunications, and banking sectors.

Brazil then experienced apparent stabilization, mainly because of the 1994 Real Plan created by the economic team led by Fernando Henrique Cardoso (president of Brazil from 1994-2002), which resulted in an overvalued exchange rate. The overvalued exchange rate undermined Brazil's trade balance and led the country to a large deficit in the foreign current-account transactions, causing and mostly revealing the fragility of Brazil's competitiveness in comparison to international markets. The fragility of competitiveness was felt in the Brazilian corporate sector, especially in manufacturing and industrial sectors.

As described by Rabelo and Coutinho, "the Brazilian-owned corporate sector at the end of the 1990s was one of evident fragility, characterized by:

- (1) persistent financial vulnerability resulting from very high capital costs;
- (2) significant regression of the long-term domestic financing base and of the capital market, which delayed the centralisation of capital and perpetuated the concentrated structure of family ownership;
- (3) weak competitive performance with outstanding trade fragility in all sectors of high added value and high technological content (competitiveness is strong only in commodities sectors with large production scales and low added value sectors that use raw materials and agricultural inputs and are energy intensive); and
- (4) widespread loss of national ownership in many sectors, weakness and reduced size of the remaining Brazilian business groups, which

make it very difficult for them to become active world players.”<sup>13</sup>

The authors, continuing to analyse the economic situation of Brazil further state:

Thus, although Brazil benefited from an abundant inflow of capital to stabilise inflation, the government opted for an onerous economic policy marked by five years of currency overvaluation and extremely high interest rates. The high price paid for this policy included much lower economic growth; a burgeoning public debt; the erosion of several industrial sectors; the persistence of backward corporate governance and the widespread loss of national control of industrial and service enterprises.<sup>14</sup>

Currently, Brazil presents a very unstable financial scenario. After the foreign exchange devaluation in January 1999, Brazil had to call upon International Monetary Funds (IMF) loans in order to honour its external debts committees. After the presidential election of October 2002, in which Luís Inácio Lula da Silva (the left wing candidate) was elected, there was a general uncertainty about a possible recovery of the Brazilian economy and the retaking of the country's economic growth.

In sum, the brief description of Brazil's economic and financial history leads to the following conclusions with respect to the current panorama of Brazilian corporate governance:

- (1) Due to more than thirty years of economic crisis, from high inflation to foreign exchange overvaluation, traditional economic groups that benefited from the government's cheap financing up to the 1970s have managed to keep control of companies through a lack of competition. Therefore, corporate ownership concentration by local family-controlled business groups is a strong characteristic of Brazil's corporate sector and encourages the establishment of good corporate governance principles in Brazil.
- (2) The state plays an important role in corporate ownership concentration. Despite the privatisation initiatives, a considerable number of Brazilian corporations are state-owned.
- (3) The privatisation process generated certain changes in the usual capital concentration structure of Brazilian corporations. On one hand, local business groups had to build partnerships with other groups, funds, financial institutions, and foreign investors in order to participate in the relevant bidding procedures, thus initiating a more representative shared control experience in Brazilian corporations. On the other hand, control of a considerable number of privatised companies was acquired by foreign firms. The shared control initiatives arising from the privatisation process did not undermine the ownership control concentration of Brazilian corporations.

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13. *Id.* at 11.

14. *Id.* at 12.



In view of the above, concerns about corporate governance in Brazil, including concerns with board responsibility, disclosure and transparency, and the role of stakeholders, will be related to the relationship between controlling shareholders and minority shareholders.

During the past years, Brazilian laws and rules have been criticised widely by the international community as being friendly to controlling shareholders. However, as explained below, Brazil has been taking relevant steps to improve corporate governance. Such legal and regulatory improvements are mainly a result of efforts of the legal and business society studying, discussing, and proposing the necessary changes in laws and rules and acknowledging the need for good corporate governance principles for the development of the Brazilian capital market.

#### IV. RECENT CHANGES IN BRAZILIAN CORPORATIONS LAW

This section describes recent changes in Law No. 6,404 of March 13, 1974 (Corporations Law), carried out by means of Law No. 10,303, of October 31, 2001. Together with the relevant descriptions, it also discusses the related merits of such alterations in relation to corporate governance in Brazil.

##### A. DE-LISTING OF CORPORATIONS

Controlling shareholders are obliged by law to make tender offers to buy the totality of shares being traded in the market in the case of de-listing of a corporation. However, before the enactment of Law No. 10,303/01, the legislation was silent with respect to the price that should be paid in connection with the purchase of such shares. This gap expanded controlling shareholders' ability to maintain ownership concentration and legally "expropriate" minority shareholders by paying a price even below the fair market value for their shares. The Corporations Law currently provides that the price of such shares shall be fair, meaning at least equal to the value of the company calculated by certain accounting criteria, or as set forth by the CVM. In addition, minority shareholders have the right to have the valuation procedures of their shares revised. Although these changes are considered by many to create the opportunity for a lot of conflicts between minority and controlling shareholders, the provisions provide minority shareholders with tools to prevent expropriation of their shares. Those changes are aligned with the OECD Principles, as they create the environment for more equitable treatment of shareholders.

##### B. BALANCE BETWEEN PREFERRED AND COMMON SHARES

One of the greatest distortions in the Brazilian stock market was the existence of dual class shares (ordinary and preferred) and the proportion required of each class. Preferred shares, without voting rights, could re-

present up to two-thirds of the total equity capital of a given corporation. Upon the enactment of Law No. 10,303/01, entities that are incorporated (either listed or not) or existing corporations that decide to go public after the enactment of such law are allowed to issue not more than 50 percent of its total shares without voting rights. Although there are several discussions and critical issues in connection with the existing listed corporations, which are entitled to maintain the two-thirds proportion, the legislative initiative purports to reduce capital concentration. This reduction allows for more sufficient seeking of equitable treatment of shareholders and independence in the management of companies.

### C. ARBITRATION FOR DISPUTES SETTLEMENT

Concerns with the lack of swiftness in the Brazilian judicial system and the consequent lack of the enforcement of legal provisions have been acknowledged widely by local and foreign investors. Recent changes in corporation law allowed the insertion of an arbitration clause in corporations' by-laws or charter documents for purposes of settling disputes among controlling shareholders, minority shareholders, and the corporation. The advantages of arbitration as compared to traditional judicial systems are broadly known. Advantages include celerity of the procedures and the technical specialization of the arbitrators. This change is most welcome, given the fact that certain questions about the constitutionality of Law No. 9,307 of September 23, 1996 (the Brazilian arbitration law) have been settled recently by the Brazilian Supreme Court. Arbitration is a great step for the implementation of good principles of corporate governance in Brazil and is aligned with the OECD Principles as a useful tool to grant shareholders the opportunity to obtain effective redress for violation of their rights.<sup>15</sup>

### D. COMPOSITION OF THE BOARD OF DIRECTORS

One of the changes in the Corporations Law provides for the possibility of employees to elect one representative in the board of directors with the assistance of the applicable labour union. This change represents an express recognition of the rights of stakeholders by the legal framework, as set forth by the OECD Principles.<sup>16</sup> The implementation of this provision should be monitored in order to assure that such participation in corporate governance by stakeholders is effectively conducted.

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15. OECD Principles, *supra* note 1, at 31-32. "Many countries have found that alternative adjudication procedures, such as administrative hearings or arbitration procedures organised by the securities regulators or other regulatory bodies, are an efficient method for dispute settlement, at least at the first instance level."

16. *See id.* at 20. Principle III, entitled "The Role of Stakeholders in Corporate Governance," states: "The corporate governance framework should recognise the rights of stakeholders as established by law and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises."

Another change with respect to board composition is the mechanism created in order to assure minority shareholder representation in the board of directors. The recent changes in the Corporations Law grant shareholders, owning at least 15 percent of the voting capital, and preferred shareholders owning at least 10 percent of the total amount of the equity capital of a given corporation, the right to elect a representative to the board. The current law further provides that if such percentages are not reached by each of the aforementioned class of shareholders alone, their proportions can be considered jointly in order to achieve 10 percent of the total amount of equity capital. They are then entitled to elect one representative to the board.

The recent changes also grant the representative of the minority and preferred shareholders a veto right in the choice of the independent auditor.

In spite of the above-described improvements, other aspects of the Corporations Law are still criticized. Criticisms include the ability of the controlling shareholder to elect the majority of the board and to influence the election of the preferred shareholders' representative (the preferred shareholders are allowed to elect their representative from a list of three candidates presented by the controlling shareholders). Despite these criticisms, changes in the composition of the board of directors lead to more equitable treatment of shareholders and transparency provisions, as described by the OECD Principles.

#### E. OBLIGATION OF TENDER OFFER IN THE SELLING OF CONTROL

The Corporations Law obligates the party acquiring control of a corporation to make a tender offer to purchase the shares of minority shareholders. Originally, in the event of such control sales, minority shareholders with voting shares had the right to sell their shares for the same price paid to the controlling shareholder.

One distortion of good principles of corporate governance in Brazil was a previous change in the Corporations Law that promoted the privatisation process. This allowed controlling shareholders to acquire the shares not belonging to the control block for a much lower price. As pointed out by Rabelo and Coutinho, "the minority shareholders [we]re forced either to accept the offer or risk being left with shares no longer liquid in the market."<sup>17</sup>

The current Corporations Law requires that the party purchasing control pay to minority shareholders with voting rights a minimum price equivalent to at least 80 percent of the amount paid per share in the purchase of the control block. Alternatively, the party acquiring control can offer minority shareholders the possibility of staying in the corporation by the paying of a premium equivalent to the difference between the market value of the shares and the price paid per share to the previous

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17. *Id.* at 35.

owners of the control block. In addition, if preferred shareholders are not granted priority in dividend distribution, or a dividend that is 10 percent higher than the one to be distributed to owners of common shares, they have the right to sell their shares to the party acquiring control for the same price paid to the holders of common shares (tag along right). The above-described changes represent a legislative attempt to correct past distortions, and undermine the ability of controlling shareholders to obtain undue advantages at the cost of the minority shareholders.

The changes in the Corporations Law were highly celebrated by the Brazilian business and legal communities and are seen as the result of a long and intense legislative process leading to the adoption of generally accepted corporate governance practices. Such changes have been discussed not only in political and academic fields, but were also the object of a number of regulatory initiatives. The following sections address the corporate governance improvements arising from the creation of the New Market and the differentiated levels of listings in the São Paulo Stock Exchange.

## V. BOVESPA, THE NEW MARKET, AND DIFFERENTIATED CORPORATE GOVERNANCE LEVELS

In December 2000, the São Paulo Stock Exchange (BOVESPA)<sup>18</sup> announced the creation of the New Market (*Novo Mercado*), a special listing segment.<sup>19</sup> This special listing feature encompasses the negotiation of shares issued by companies that voluntarily bind themselves to the adoption of different practices of corporate management and disclosure levels. Following the creation of the New Market, BOVESPA created the “Differentiated Practices of Corporate Management.” The general idea is that the corporations adhering to the especial listing requirements adopt practices that are stricter than the ones prescribed by the Corporations Law and therefore are more attractive to investors. Such higher standards contain important provisions in connection with corporate governance practices, which shall be analysed below.

### A. ADHERENCE TO THE NEW MARKET

Before describing the improvements arising from the creation of the New Market, it is necessary to explain the institutional character and regulatory power of BOVESPA and its relation to the New Market.

BOVESPA is organized as a civil association (non-profitable organization), formed by the securities trading companies and is subject to the supervision of the CVM. The exchange has self-regulating powers, which

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18. BOVESPA is currently the largest stock exchange market of Latin America. It is a concentration of the entire negotiation of stocks within Brazil after the unification of the Brazilian stock exchanges.

19. The creation of the New Market has a clear inspiration in the differentiated listing segments of the Frankfurt Stock Exchange in Germany. England and Italy have also had similar experiences.

enable BOVESPA to enact rules and supervise the compliance of such rules by the following agents: (1) the trading companies which are members of BOVESPA; (2) the companies listed at BOVESPA; and (3) investors in securities traded within BOVESPA. In addition, BOVESPA has certain powers in connection with the transactions performed within the stock exchange, such as powers to suspend negotiations or the settlement of transactions, if such transactions appear to infringe any applicable laws and rules.<sup>20</sup>

Adherence to the New Market is voluntary. It occurs upon the execution of an agreement (the agreement) entered into between BOVESPA, the controlling shareholders and directors of the company, and the company itself. In the agreement, the parties agree to comply with the provisions of the rules of the New Market (the rules) and to submit their disputes to the Arbitration Chamber of the New Market (Arbitration Chamber). The execution of such agreements is further evidence of the regulatory power of BOVESPA. Submission of disputes to the arbitration proceedings means that the rules can be enforced more efficiently. The contractual nature of the agreement avoids questions and challenges (especially at the judicial level) in connection with the regulatory and supervisory power of BOVESPA.

#### B. ARBITRATION CHAMBER

The Arbitration Chamber is composed of thirty arbitrators chosen by the board of BOVESPA. The following three procedures are available for purposes of the settlement of disputes: (1) ordinary arbitration (longer, more extensive); (2) summary arbitration (shorter procedures); and (3) *ad hoc* arbitration (in which the parties are free to choose the procedure). The benefits of arbitration in connection with corporate governance practices, as described above, include allowing shareholders to obtain effective redress for violation of their rights, especially in a sophisticated environment like the stock exchange.

#### C. LISTING REQUIREMENTS

In order to be eligible for listing in the New Market, a company must comply with certain minimum requirements in addition to the general legal and regulatory requirements for being listed at BOVESPA. The requirements described below clearly represent a higher standard in terms of corporate governance principles.

To be listed on the New Market, the company must: (1) have its equity capital divided exclusively in ordinary shares, (2) all shareholders should have voting rights, (3) maintain shares representing at least 25 percent of the total equity capital in circulation, and (4) have no beneficial participations in circulation (as defined under article 46 of the Corporations

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20. Law No. 6,385, of December 7, 1976, and CMN Resolution No. 2,690, of January 28, 2000.

Law).<sup>21</sup>

The provisions described above create a higher standard of corporate governance practices, especially in connection with the equitable treatment of shareholders. The provisions are stricter than the guidelines provided by the OECD Principles, which set forth that “all shareholders of the same class should be treated equally.”<sup>22</sup> The New Market rules purport to create a single class of shares being traded, which is evidenced by the prohibition of the issuance of beneficial participations.

The minimum percentage of shares in circulation is also an attempt to mitigate the concentration of capital, as it supports and encourage the notion of capital dispersion. It prevents controlling shareholders from further concentrating their existing power and maintains the publicly held character of the corporation.

The dispersion of capital is a strong and general concern of the rules. One of the requirements for corporations that join the New Market by means of an initial public offering is that the controlling shareholders and management of the corporation must refrain from negotiating shares and derivatives of such shares for six months. After this initial six-month period, the controlling shareholders and the management are allowed to negotiate the maximum amount of 40 percent of their shares and derivatives of such shares.

#### D. DISCLOSURE REQUIREMENTS

The rules provide for stricter disclosure requirements. As demonstrated below, the rules are aligned to the disclosure and transparency guidelines of the OECD Principles.

In addition to the general disclosure requirements for corporations listed in stock exchanges and the internal requirements set forth by BOVESPA, corporations listed in the New Market are obliged to include the following elements in their quarterly information (information disclosed to the CVM and to BOVESPA on a quarterly basis): (1) consolidated financial statements (balance sheet, income statement, and consolidated performance); (2) demonstration of cash flows; (3) the shareholdings of any shareholder holding more of 5 percent of the company's capital; (4) consolidated information of the direct and indirect shareholdings of the controlling shareholder, members of the board of directors, and the fiscal committee (the same information must be provided in connection with shareholdings of such persons during the previ-

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21. “Beneficial Participations” (Partes Beneficiárias) are described under article 46 of the Corporations Law as “negotiable securities, without nominal value, which are not part of the corporate capital.” Beneficial Participations confer to its holders a participation in the profits of a given corporation. Such holders are not be granted any kind of shareholders' rights, except for the right to supervise the actions of the management of the corporation.

22. See OECD Principles, *supra* note 1.

ous twelve months);<sup>23</sup> and (5) the proportion between the total issued shares and the shares of the corporation that are in circulation.<sup>24</sup> Quarterly information must be provided together with a report issued by an independent auditing company.

The provisions provide a more thorough disclosure of financial information of the corporations on a more frequent basis and take into account several concerns outlined in the OECD Principles. It is important to note that the major share ownership addressed by the OECD Principles has been contemplated by the rules.<sup>25</sup> In addition, the role of the independent auditing companies has also been addressed by the rules, even in connection with quarterly information, thus addressing the concerns of the OECD Principles with "external and objective assurance" of the disclosure of financial information.<sup>26</sup>

Furthermore, the new rules provide that annual public meetings with analysts and any other interested persons should be conducted in order to discuss and disclose economic information, projections, and future projects of the given corporation. The presentation of copies of present and future shareholders' agreements and stock option plans, as well as an annual calendar of corporate events is also required. Those requirements follow the path set forth by the OECD Principles, which recommend the disclosure of the objectives of a given company, material foreseeable risk factors, material issues regarding employees and other stakeholders, and governance structures and policies.<sup>27</sup>

Finally, corporations in the New Market must make their financial statements comply with United States Generally Accepted Accounting Principles (U.S. GAAP) or International Accounting Standards (IAS) and publish certain information in English. The concern with worldwide-accepted accounting principles is expressed in section C of the fourth guideline of the OECD Principles, as "high standards of accounting, financial and non-financial disclosure, and audit."<sup>28</sup> These requirements are a remarkable step in terms of Brazilian regulation in connection with disclosure and signal an adjustment of the Brazilian market of publicly traded shares to reliable disclosure standards.

#### E. CONTROLLING SHAREHOLDERS, BOARD OF DIRECTORS, AND MANAGEMENT

The regulatory framework of the New Market also addresses certain further concerns with the equitable treatment of shareholders by creating an environment to prevent insider trading and abusive self-dealing and

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23. This item must also be included in the annual information disclosed by public companies pursuant to the applicable law.

24. This item must also be included in the annual information disclosed by public companies pursuant to the applicable law.

25. See OECD Principles, *supra* note 1, at ch. IV, § A(3).

26. *Id.* at section C.

27. *Id.* at section A.

28. See OECD Principles, *supra* note 1, section 3.

mechanisms of disclosure that aim to prevent conflicts of interest between shareholders and members of management.

The rules require, in addition to compliance by the board of directors with the legal provisions therein, disclosure of any agreements and contracts entered into between the company and its affiliates, any members of the board of directors or any of its affiliates, or the controlling shareholders of any of its affiliates, the value of which is more than R\$200,000 (approximately U.S.\$56,000) or is equivalent to 1 percent of the net equity of the given corporation.

In addition, members of the board of directors and of the fiscal committee (defined below) and controlling shareholders of a corporation must disclose to BOVESPA the amount of securities of the company (including derivatives of such securities) held by each of the parties. Negotiations or any changes in connection with such securities must be reported to BOVESPA within ten days of the end of the month in which such transactions or changes take place. The same requirements are also applicable to securities held by the spouse, companion, or legal dependent (as defined by the annual federal income tax statement) of the persons mentioned above.

#### F. PUBLIC OFFERINGS - DISPERSION, DE-LISTING, AND SALE OF CONTROL

Concerns with the equitable treatment of shareholders and transparency can also be found in other provisions of the rules of the New Market pertaining to public offerings. As shown below, the rules enhance certain standards and practices, creating a more favourable environment for investors. In particular, I will address certain provisions in connection with dispersion of capital in public offering of shares, sale of corporate control, and de-listing.

As set forth above, the dispersion of the securities of the corporation listed in the New Market is a general objective of the rules. When carrying out a public offering, at least 10 percent of the shares being offered by a given corporation must be sold to non-institutional investors or individuals. In addition, the corporation must assure that all interested investors have access to the terms of the offering.

A sale of control must be carried out upon a public offering, in which all other shareholders of the given corporation must be offered the shares first, under the same conditions offered to the potential buyer (tag along right).<sup>29</sup> The minimum percentage of shares in circulation must be re-established after the selling of control takes place.

In case of de-listing or cancellation of the registration for trading in the New Market, the corporation has to conduct a public offering to buy all of the shares in circulation for their economical value, to be determined

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29. Again, the regulatory changes precede the changes now incorporated in the Corporations Law.



by a specialized company (to be selected the board of administration of the company).

#### G. CONSEQUENCES OF THE CREATION OF THE NEW MARKET

An initiative of BOVESPA in creating the New Market was to create an attractive environment for investors and increase the trading level and procurement for publicly traded shares. Corporations would benefit from listing in the New Market, having more liquidity for their shares and the potential reduction of the cost for procurement of funds. The latter is assured by the publicity granted by BOVESPA to the companies that adhere to the New Market, such as trading of securities in a separate electronic system and the permission to use special logotypes.

The New Market and the differentiated practices of corporate management of BOVESPA are considered an important step toward the development of the Brazilian capital markets by several governmental agencies and public organs.<sup>30</sup>

In Resolution No. 2,829, of March 30, 2001, the CMN expressly recognized the advantages (transparency and good corporate governance practices) of the New Market by extending the limits for investments by pension funds in publicly traded companies that adhered to the New Market rules. In addition, the *Banco Nacional de Desenvolvimento Econômico e Social* (BNDES) created the Program for the Support of New Corporations, granting more favourable conditions of repayment of lines of credit to corporations that adhered to the rules of the New Market or to the differentiated corporate management practices of BOVESPA.

Furthermore, the economic results of the New Market rules and the differentiated levels of BOVESPA were attested recently by different studies. In a research conducted by the University of São Paulo in which twenty-five securities of eighteen corporations were analysed between June 2001 and May 2002, the university found that: "upon the increase in transparency, the value of the securities increase, the volatility decreases, and volume of trading increases."<sup>31</sup> The study took into consideration corporations that adhered to the rules of the New Market and to the differentiated corporate management levels of BOVESPA.

The governmental recognition and the above-mentioned economic findings demonstrate the important role of corporate governance in generating liquidity for the shares of corporations and ultimately the devel-

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30. *Differentiated Practices of Corporate Management*, available at <http://www.bovespa.com.br> (last visited Oct. 6, 2003). In addition to the New Market, BOVESPA created the "Differentiated Practices of Corporate Management." Under this set of rules, corporations are classified as either Level 1 or Level 2 in accordance with the level of corporate practices achieved. In general, Level 1 corporations commit to increase the level of disclosure information and to maintain the dispersion of securities traded. Level 2 corporations agree to observe additional practices, which are stricter.

31. Antonio Gledson de Carvalho, available at <http://www.bovespa.com.br> (last visited Oct. 6, 2003).

opment of capital markets. The New Market and the other corporate governance levels created by BOVESPA represent a very important market initiative towards such goals.

In addition to market initiatives, Brazilian regulatory agencies have expressed concerns over good corporate governance practices. The next section of this article analyses certain provisions in connection with financial institutions. These provisions exemplify the contribution of the Brazilian financial and monetary authorities to the dissemination of corporate governance standards.

## VI. NEW CORPORATE GOVERNANCE RULES FOR FINANCIAL INSTITUTIONS

On November 28, 2002, the CMN enacted Resolution No. 3,040.<sup>32</sup> This Resolution changed the rules in connection with the incorporation, authorization for operation, transfer of corporate control, corporate reorganization, and revocation of authorization for the operation of financial institutions in Brazil.

The new rules apply to multiple banks, commercial banks, investment banks, development banks, credit, financing and investment societies (*sociedades de crédito, financiamento e investimento*), real estate financing societies (*sociedades de crédito imobiliário*), mortgage banking companies, development agencies (*agências de fomento*), leasing companies, securities trading (brokerage) companies, securities distribution (dealership) companies, and foreign exchange brokerage companies. The Resolution demonstrates the concern of the monetary authorities of Brazil with the corporate governance practices of financial institutions.

Under the new rules, a company must submit a business plan to the Central Bank of Brazil, in order to obtain the authorization for functioning as a financial institution. The plan must include: (1) the general business objectives of the prospective financial institution; (2) products, services, and technologies to be implemented; (3) applicable forecasts and strategies; (4) a detailed description of the organizational structure of the financial institution; (5) the attributions and responsibilities assigned to each corporate level; and (6) a description of the internal controls, including the mechanisms that will guarantee adequate supervision by management and effective use of internal and external auditing as instruments of corporate control.

Another document required by the Central Bank for granting the aforementioned authorization is described as a "definition of the standards of corporate governance to be observed by the institution, including a detailed description of the structure of incentives and the wage

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32. In accordance with articles 2, 3, and 4 of Law No. 4,595, of December 31, 1964, the CMN is the organ responsible for the definition of the general credit and monetary policy of Brazil. In view of that, the CMN is the organ to issue the general provisions of Brazilian banking regulation.

policy.”<sup>33</sup>

The above-mentioned provisions are deeply aligned with the disclosure and transparency guidelines of the OECD Principles. In requiring these disclosures, the monetary authorities are showing their concern with material information described in section A of chapter 4 of the OECD Principles, including company objectives, members of the board and key executives and their remuneration, and governance structures and policies.

The new rules also address issues in connection with internal and external auditing. The latter feature is expressly contemplated in section C of the disclosure and transparency guidelines of the OECD Principles. The accuracy of the financial information of financial institutions is clearly a concern of the authorities.

The new CMN Resolution further sets forth that the direct corporate control of financial institutions can only be held by: (1) individuals, (2) financial and similar institutions, and (3) other legal entities that have as their sole corporate purpose ownership participation in financial and similar institutions. Although the primary objective of such restriction is to promote the separation of financial activities from other activities carried out by the controlling shareholders, which is not directly related to corporate governance principles, it should be noted that the new provisions confer a greater transparency and solidity to the management of financial institutions. They also correct deficiencies that might be generated by the concentration of ownership (such as conflicts of interest), a distinct characteristic of Brazilian corporations.

The enactment of the above provisions by the CMN demonstrates increasing concern with corporate governance principles. In June 2002, the CVM, the agency in charge of the regulation and supervision of the Brazilian securities market, published its corporate governance guidelines. The CVM guidelines, although not binding upon investors, created a higher standard for companies. Corporations not complying with such guidelines will have to explain to the commission the reasons for non-compliance.

Through Resolution No. 3,040/02, the CMN signals to the market the importance of corporate governance principles, which will be taken into consideration for the granting authorization for the constitution and operation of financial institutions.

An overview of the improvements and challenges of corporate governance practices in Brazil would not be complete without an analysis of Sarbanes-Oxley Act and its impact on Brazilian corporations due to its relevance and importance to the international capital markets.

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33. *Id.*

## VII. THE SARBANES-OXLEY ACT AND ITS IMPACTS IN BRAZILIAN CORPORATE GOVERNANCE PRINCIPLES

### A. THE SARBANES-OXLEY ACT AND ITS INTERNATIONAL IMPACT

The Sarbanes-Oxley Act of 2002 (the Act), as passed by the Congress of the United States on July 25, 2002, can be described as an attempt at the “restoration of trust in the integrity of the disclosure and accounting practices that inform capital markets.”<sup>34</sup> The Act is a response to certain corporate scandals in U.S. capital markets. The case of Enron (America’s fifth largest company), for example, involved misstatements of profits obtained through questionable accounting practices (including the destruction of documents) upon the consent of analysts, independent auditors, and lawyers.

The Act contains relevant provisions in connection with disclosures by publicly traded corporations, the liability of management and directors, the auditing procedures of corporations, and other deficiencies (such as insider trading and doubtful transactions), which would impair the rights of minority shareholders and other investors and likely culminate in new corporate scandals.

The Act contains the following disclosure-related provisions: (1) the Securities and Exchange Commission (SEC) is authorized to require public companies to disclose material changes in financial condition or operations on a rapid and current basis (real time disclosures, in section 409); (2) each financial report filed with the SEC must reflect all material correcting adjustments identified by the registered public accounting firm in accordance with U.S. GAAP and SEC rules and regulations (including off-balance sheet transactions); (3) a company must disclose if the board’s audit committee (as created by the Act) has at least one member who is a financial expert under the terms of the Act; and (4) a company must disclose its adopted code of ethics for senior financial officers or the reasons for failure to adopt such code.

The liability-related provisions require CEOs and CFOs of publicly traded corporations to certify the information provided in each annual and quarterly report filed with the SEC under the Securities Exchange Act of 1934. The Act also increases the criminal penalty for false statements by such officers (for example, the imposition of a fine of up to U.S.\$5,000,000 and/or imprisonment of up to twenty years in case of willful conduct). In addition, several other concerns and practices are addressed and prohibited by the Act including: (1) prohibition on loans to directors and executive officers unavailable to outsiders; (2) forfeitures by CEOs and CFOs of incentive pay and securities trading profits when there are accounting restatements based on misconduct; (3) ban on trading by directors and executive officers in a public corporation’s stock dur-

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34. See Covington & Burling, *Summary of Sarbanes Oxley Act of 2002* (July 26, 2002), available at <http://www.cov.com> (last visited Oct. 6, 2003).

ing pension fund blackout periods; (4) prohibition of improper influence by directors and officers in the conduct of audits; (5) authority for barring persons from serving as officers and directors of public companies; and (6) acceleration of reporting deadlines for trades of company stock by directors, executive officers, and 10 percent equity holders to as short as two days.

The influence of the Act in international corporations is notorious. Many debates have arisen in the international community after the enactment of the Act, especially in light of the rigorousness of its provisions. As pointed out by Mullen, the size of the U.S. market and its influence on market expectations will cause international corporations to have a closer look at the Act.<sup>35</sup>

On the one hand, the Act will be used as a source of inspiration for changes and improvements of legislations and regulations throughout the world in an attempt to prevent the occurrence of similar scandals and infractions. The Act will also represent a benchmark for international companies that aspire to access foreign capital markets, as the standards of corporate governance and disclosure practices set forth by the Act will be taken into consideration by investors. On the other hand, the Act has generated concerns for companies that have issued securities in the U.S. market (e.g., the case of the American Depositary Receipts of certain Brazilian corporations currently traded in U.S. stock exchanges).<sup>36</sup> Such companies will have to comply with or seek exemptions from the new provisions. Compliance with the provisions of the Act can be difficult and burdensome, especially in situations in which the laws of the countries of such corporations set forth requirements that are incompatible with the provisions with the Act.

In view of the above, and in light of the fact that most safe harbours and exemptions in connection with the Act will be developed upon the enactment of regulations by the SEC, there has been constant debate and exchange of information among securities and exchange commissions from all over the world.

The CVM and associations of publicly traded corporations have pointed out several concerns with the effects of the Act on Brazilian corporations. Most of the associations of companies highlight the severity of the provisions and the lapse of time required for the compliance with such rules, especially in connection with the liability of officers. Other

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35. Michael Mullen, *US Adopts New Corporate Governance Standards: What is the International Impact*, available at [http://www.whitecase.com/article\\_us\\_adopts\\_new\\_corporate\\_governance\\_standards\\_international\\_impact.html](http://www.whitecase.com/article_us_adopts_new_corporate_governance_standards_international_impact.html) (last visited Oct. 6, 2003).

36. American Depositary Receipts – ADRs are securities representing securities of non-U.S. companies, which are traded in the U.S. market. An ADR facility is created upon the execution of a depositary agreement. The depositary will hold the actual security of the given non-U.S. entity (what will be reflected in the custodian agreement, and the presence of a local custodian will be required), and the receipts will be issued by the depositary and traded in the U.S. market. The purpose of the facility is to allow the trading of foreign securities in the U.S. market.

concerns include incompatibilities of the Act in comparison with the laws and rules of Brazil. To illustrate the situation the next section considers the potential conflicting issues within the Brazilian legal system arising from the creation of the audit committee by the Act.

#### B. THE AUDIT COMMITTEE UNDER THE BRAZILIAN LEGISLATION

On January 9, 2003, the SEC proposed rules to implement the provisions of Section 301 of the Act.<sup>37</sup> Section 301 requires the SEC to adopt rules directing the national securities exchanges, NASDAQ, and any other national securities associations to prohibit the listing of securities of an issuer that is not in compliance with the audit committee requirements established by the Act. Under the Act, the audit committee is a committee of the board of directors, and “shall be directly responsible for the appointment, compensation and oversight of the work of any public registered accounting firm” employed by the company “for the purpose of preparing or issuing an audit report or related work.”<sup>38</sup>

The requirements of the Act in connection with the audit committee are: (1) independence of the members (in accordance with certain objective criteria, which prohibit, for example, members of the audit committee from accepting any fees from the company other than for service as a member of the board of directors or committee thereof); (2) the responsibility to select and supervise the independent auditor; (3) the responsibility to establish procedures for handling complaints regarding the accounting practices of the company; (4) the authority to engage independent counsel and advisers; and (5) the provision of appropriate funding for the independent auditor and external advisors engaged by the audit committee.

Some of the exceptions provided by the proposed rule of the SEC are relevant to the analysis of the challenges for corporate governance practices in Brazil. Although Section 301 of the Act does not distinguish between U.S. and foreign issuers for purposes of its application (the SEC expressly states that, “with the growing globalisation of the capital markets, the importance of maintaining effective oversight over the financial reporting process is relevant for listed securities of any issuer, regardless of its domicile”<sup>39</sup>), it allows the SEC to: (1) exempt from the independence requirements particular relationships with respect to the members of the audit committee (such as representatives of the employees, of foreign governments, and controlling shareholder); and (2) exempt from the independence and oversight requirements companies that have alternate mechanism for oversight of the audit committee under the laws of their home jurisdiction.

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37. U.S. Securities & Exchange Comm’n, *Proposed Rule: Standards Relating to Listed Company Audit Committees*, at <http://www.sec.gov/rules/proposed/34-47137.htm> [hereinafter *Proposed Rule*] (last visited Oct. 6, 2003).

38. See Sarbanes-Oxley Act of 2002, 15 U.S.C. § 301(2) (2002).

39. See *Proposed Rule*, *supra* note 37.

The latter aspect has crucial importance to Brazilian legislation, as the Corporations Law contains the fiscal committee, which has similar attributions in comparison to the audit committee, and could be considered as an alternate mechanism thereto.

The proposed rules exempt foreign private corporations from compliance with the audit committee requirements, provided that: (1) there are legal or regulatory provisions creating and ruling the alternative organs (in relation to the audit committee); (2) the members of the alternate organ are separate from the board of directors of the company; (3) the members of the alternate organ are not elected by the company's management and no executive officer of the company is a member of such organ; (4) the alternate organ must be responsible for supervising the independent auditors of the company under the foreign country's legislation; (5) the alternate organ must be responsible, to the extent permitted by the foreign country's law, for the appointment and retention of the independent auditors of the company; and (6) independence standards for members of the alternate organ must be available under the foreign country's legislation.

The company relying on the above-described exemption must observe all of the other proposed requirements for the audit committee and must disclose fully its reliance on the exemption and its assessment of whether, and if so, how, such reliance would materially adversely affect the ability of the audit committee to act independently and satisfy the other requirements.

The Corporations Law provides for a similar organ in Brazilian corporations, known as the fiscal committee. The fiscal committee is an independent organ of a Brazilian corporation (not a part or a committee of the board of directors), which has a minimum of three and a maximum of five members (plus a substitute for each member elected) elected by the shareholders with voting rights. Holders of preferred shares with or without restricted voting rights may elect one member of the committee and a substitute. Minority shareholders may also elect one member of the committee and a substitute, provided that they jointly represent at least 10 percent of the totality of the shares with voting rights.

Pursuant to article 163 of the Corporations Law, duties of the fiscal committee are to: (1) supervise the actions of the management and compliance of the management with its statutory duties; (2) issue an opinion on the annual management report; (3) issue an opinion on the proposals of management that are submitted to the general meeting of shareholders (such as proposals that address changes in the corporate capital, the issue of debentures or subscription bonuses (*bônus de subscrição*), investment plans or capital budget, dividend distribution, transformation, incorporation, mergers or spin-offs of the company); (4) report to the general meeting of shareholders any omissions of management that would be necessary for the protection of the interests of the company, or any errors, frauds, or crimes committed by management; (5) call an ordinary or

extraordinary general shareholders meeting, if the management fails to do so for more than a month; (6) analyse, at least on a quarterly basis, the financial statements of the corporation; (7) analyse and issue an opinion on the financial statements of the company every fiscal year; and (8) exercise the above-described duties within any liquidation proceedings as set forth by the applicable laws.

The fiscal committee has a general duty to oversee the management of Brazilian corporations. Specifically in connection with independent auditors, section 4 of article 163 allows the fiscal committee to request from the independent auditors explanations, additional information, and the investigation of specific facts.

Furthermore, the fiscal committee has certain independence requirements, as set forth in section 2 of article 162 of the Corporations Law. In addition to certain technical requirements, the following persons cannot be elected to the fiscal committee: (1) members of the management organ; (2) employees of the company or any of its affiliates; or (3) the husband, wife, or any relative (up to a third degree) of any member of the board of directors of the company.

A preliminary analysis of the provisions of the fiscal committee demonstrates that it cannot be considered as an alternate organ to the audit committee under the Act and the rules proposed by the SEC. The independence criteria set forth in article 162 of the Corporations Law should be verified and the procedures set forth for the election of the members of the fiscal committee would meet the independence requirements of the audit committee. This should be asserted through a specific consultation with the SEC.

Furthermore, certain attributions (or in some cases, the lack of competence) of the fiscal committee would not be in accordance with the rules proposed by the SEC. Pursuant to article 142 of the Corporations Law, the board of administration of Brazilian corporations is entitled to appoint and discharge the independent auditors. This should be one of the attributions of the alternate organ to the audit committee. In addition, although the fiscal committee has competences to monitor the activities of the independent auditors, the general supervision of such independent auditors is an exclusive competence of the board of directors. It must be understood that the main objective of the fiscal committee is the supervision of the activities of the board of directors.

Final comments on the proposed rules were due by February 18, 2003. By the time the final set of rules are enacted by the SEC, it will be possible to verify if any changes will make possible the reliance of Brazilian corporations on these exemptions.

## VIII. CONCLUSION

This review of certain improvements in the Brazilian legal system with respect to corporate governance practices presents positive perspectives. During the past three years, considerable steps towards the development



of the good corporate governance were taken in the legislative and regulatory areas. Market initiatives, such as the ones conducted by the BOVESPA, demonstrate that the business community follows the same direction. As outlined above, the improvements mentioned herein are in accordance with the OECD Principles.

In light of such positive perspectives, Brazil is equipped to deal with upcoming challenges to a true and extensive adoption of good corporate governance practices.

A first and crucial challenge is the enforcement of the above-described provisions, especially in light of the lack of celerity within the Brazilian judicial system. There is also a challenge in the burdens and costs relating to the adoption of some of the practices described herein. The adherence of companies to some of the market initiatives and the decision of other companies to go public (taking into consideration the changes in the Corporations Law) may be affected for those reasons. Finally, the establishment of corporate governance practices in Brazil faces the challenges imposed by the imperative harmonisation of rules of commercial practices, which may be impaired by severe compatibility issues.

Although recognizing the complexity of such challenges, it should be noted that the successful retrospective in terms of elaboration and implementation of improvements in corporate governance practices demonstrates that the relevant sectors of Brazilian society are conscious of the benefits of the globally accepted principles of governance practices.<sup>40</sup>

Corporate governance mechanisms are considered to create efficiency in the allocation of resources and to foment economic development upon the creation of a safe and inviting environment for domestic and international investors. Brazil currently faces a general uncertainty with respect to its political and economic future. During the recent presidential elections, candidates' promises addressed subjects such as economic growth and development, which reflected some of the aspirations of the Brazilian people.

The recent improvements in Brazilian legislation and regulation with respect to the implementation of enhanced corporate governance principles indicate that Brazil has acknowledged that strengthening its capital market is a key to its economic growth and development. Hopefully, the efficient implementation and effective enforcement of these enhanced corporate governance standards will lead to the achievement of such goals.

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40. We acknowledge that there has been a frequent and relatively strong opposition from controlling shareholders towards some of the improvements described herein. Nevertheless, good corporate governance practices have been expressly supported by groups of controlling shareholders and associations of publicly held corporations.