*Chapter 2*

# The Latin American context: market and institutional investor characteristics

Chapter 2 reviews Latin American market and institutional investor (II) characteristics to establish the context for their role in corporate governance. It traces economic and capital market developments in Latin America over the last decade, describing the size, liquidity and growth of Latin America's largest market economies, and their relatively low levels (with the exception of Brazil) in comparison to more developed OECD countries and many other emerging markets. The chapter also describes the dominant role played by pension funds among IIs in many Latin American countries, and the constraints and incentives they face in investing in listed companies. The chapter then describes specific legal and regulatory approaches taken in different Latin American countries to encourage and enable IIs to responsibly exercise their ownership rights and promote good corporate governance in the companies they invest in, along with market, regulatory and cultural barriers for IIs to play that role.

## 2.1. Economic and capital market developments in Latin America

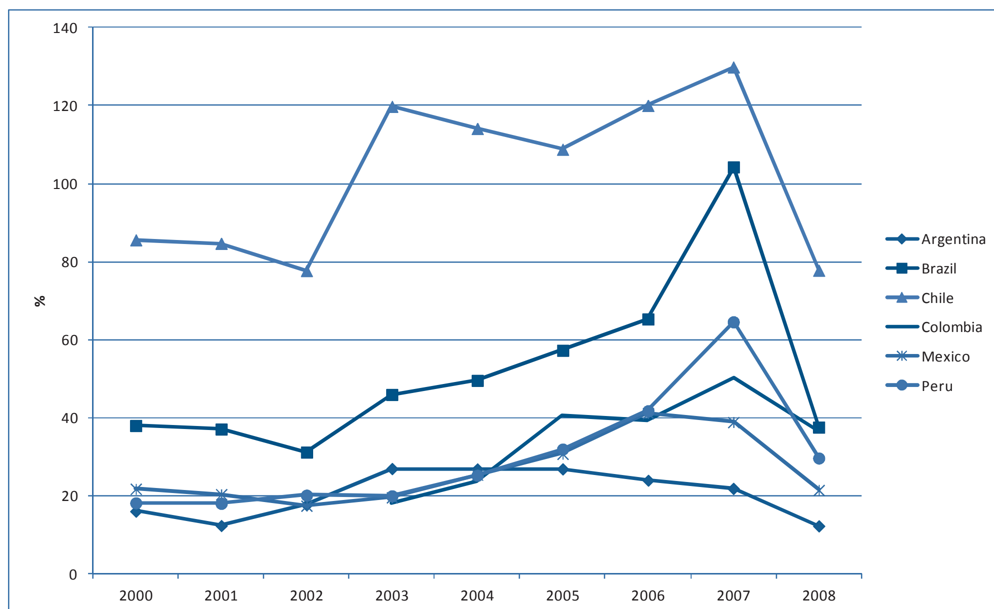
This report was developed during a period of financial and equity market turmoil in which markets were extremely volatile. Stock market indexes dropped sharply all over the world beginning in the second half of 2008, including in Latin America. While there has been a strong recovery in share values during 2009, the IPO market in Latin America remained weak relative to the middle part of the decade. Pension fund and other investment fund holdings experienced a corresponding drop in value during the downturn, generating some pressure to move assets from equity funds to more conservative investment strategies such as investment in bonds and other government debt instruments. There may also be increased pressure to impose regulatory restrictions aimed at minimizing the risk of such losses in the future.

Earlier data collected for this review through 2007 provided a picture of steady and stable growth in Latin America over a five-year period. Different countries' markets have grown at different speeds, with some like Argentina relatively stagnant, and others, particularly Brazil, but also Chile, Colombia, Mexico and Peru, showing sizeable recent increases. Although these data do not fully reflect most recent and substantial losses in the market and the subsequent rebound, it nevertheless provides good insight into the overall market structure and characteristics of key Latin American countries, and the role of different types of institutional investors in Latin American equity markets.

Most stock markets had been expanding faster than their overall economies' Gross Domestic Product (GDP) during this decade through 2007 (Table 1 below), and experienced a considerable drop in 2008. Brazil's market has been the most dynamic Latin American equities market, though it too has slowed sharply, In 2009, BM&FBOVESPA reported 15 new listings and 4 new listings in 2008, against 64 in 2007, 26 in 2006, 9 in 2005 and 7 in 2004 . By value, the total volume of stock issues[1] increased from US$10.9 billion in 2005 to US$16.2 billion in 2006, reaching US$41.9 billion by 2007. This figure dropped to US$25.7 billion for 2008 but jumped in 2009 to US$41 billion.

While Brazil and Mexico, the first and second largest economies in the region, have the correspondingly two largest stock markets, Chile had the highest market capitalization ratio as a percentage of GDP - 124% as of 2007, which fell to around 80% in 2008. The Chilean market size to GDP is well above Latin American standards, and comparable to those of the most developed markets in the world.

Figure 2.1. **Market capitalization as % of GDP for selected Latin American countries (2000-2008)**




*Source*: Stock Market's Significance in the National Economy, World Federation of Exchanges.

Although the overall growth in these countries' stock markets was positive in the period leading up to the financial crisis, there remains an important concern, exacerbated to some extent by the crisis, that, apart from Brazil, the markets have not developed sufficient levels of liquidity to sustain a healthy market for investors, including institutional investors. Table 2.1 provides a wider set of indicators against which to assess recent activity in the market, in which the dramatic drop in share values during 2008 both in Latin America and elsewhere clearly appears, while there has been limited IPO activity in most markets.

Market liquidity in Latin America is relatively low in comparison to more developed OECD as well as many emerging markets. For example, in 2009, value traded as a percentage of GDP was far higher in Thailand (71%) and Turkey (128%) than the 47% rate of even the leading Latin American country, Brazil. Latin America also fared far less well in comparison to OECD countries such as Spain (104%), the UK (84%), and the US (280%). These percentages rose significantly among all countries in 2008 following the financial crisis, when trading volume increased dramatically, but again, as evident in Table 2 above, value traded in all Latin American countries except Brazil was substantially lower than in most other countries shown in

the table. High ownership concentration and low liquidity leaves IIs with relatively tight investment options in terms of number of companies in the market and amount and class of stock to invest in. In addition, the scope of companies in which the regulator allows Pension Fund Administrators (PFAs) to invest is even narrower. This limits competition among institutional investors for companies to invest in, often leading to portfolio replication among pension funds, reduces the opportunities for exit from the investment, and increases the vulnerability to financial downturns. Hence, long-term IIs such as PFAs have heavily oriented their portfolios towards government and corporate debt, since bond markets have also been "complacent" in terms of performance.

Table 2.1. **Domestic market cap, value of local shares traded, number of local listed companies and IPOs**

| | Market Cap | Market Cap | Value Traded | Value Traded as % of Market Cap 2009 | Listed companies 2009 | Change in number of listed companies compared to 2008 |
|---|---|---|---|---|---|---|
| | USD bn (2009) | USD bn (2008) | USD bn (2009) | | | |
| Argentina | 45.7 | 39.8 | 1.5 | 3.28% | 101 | **-11.0** |
| Brazil | 1 337.2 | 592 | 623.3 | 46.61% | 377 | **-6.0** |
| Chile | 230.7 | 131.8 | 38.1 | 16.51% | 232 | **-3.0** |
| Colombia | 137.3 | 87.7 | 18.6 | 13.55% | 87 | 0.0 |
| Mexico | 352. | 234 | 74.5 | 21.16% | 125 | 0.0 |
| Peru | 71.7 | 37.9 | 3.4 | 4.74% | 195 | **-6.0** |
| Australia | 1 262. | 683.9 | 889.3 | 70.47% | 1882 | **-42.0** |
| India | 1 306.5 | 647.2 | 263.3 | 20.15% | 4955 | 34.0 |
| Spain | 1 434.5 | 948.3 | 1 502.6 | 104.75% | 3435 | **-101.0** |
| Thailand | 176.9 | 103.1 | 126.1 | 71.28% | 535 | 10.0 |
| Turkey | 234. | 118.3 | 301.1 | 128.68% | 315 | -2.0 |
| UK | 2 796.4 | 1 868.1 | 2 342.8 | 83.78% | 2179 | **-236.0** |
| US[a] | 15 077.4 | 11 458.0 | 42 209.9 | 279.95% | 4401 | 126.0 |

a) Aggregated data from NASDAQ and NYSE.

*Source*: World Federation of Exchanges and Iberoamerican Federation of Stock-Exchanges.

Additional weaknesses or vulnerabilities in the functioning of Latin American markets have been identified in relation to the overall market infrastructure. With relatively few listed companies and low liquidity, there is less of a market willingness to pay for corporate governance services, such as proxy voting services and rating agency services that take corporate governance into account as part of their criteria for rating companies. At the same time, in more developed markets, rating agencies have become a target of criticism in some cases for having conflicts of interest related to providing separate consulting services to companies at the same time as they are rating them. This has resulted in stronger calls for measures to be taken to ensure or require that such services disclose their ownership interests, any potential conflicts of interest they may have, and how they are addressing them. In Latin America, because there is relatively little market demand for these services, most regulators have not yet focused on and set up requirements aimed at minimizing such conflicts of interest in their practices.

## 2.2. Characteristics of institutional investors in Latin American markets

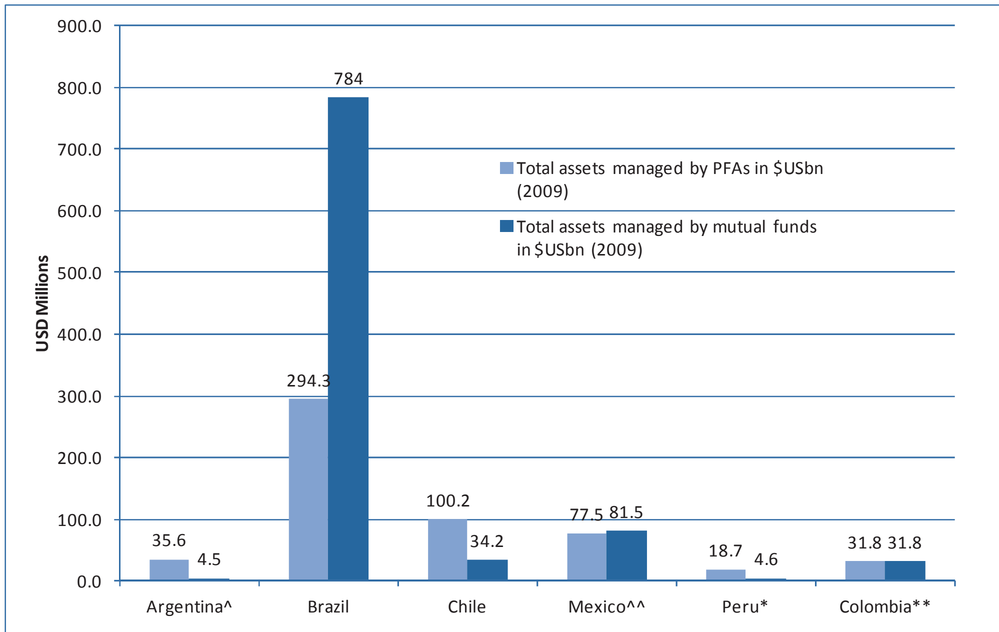
Despite these limits on investment opportunities and other weaknesses in the development of capital markets in Latin America, institutional investors have no doubt been playing a role in stock market growth, as the largest and most influential minority shareholders in many listed companies. The *White Paper* noted the particular importance of pension funds in Latin America in its chapter on key regional characteristics:

> *"The one set of domestic institutional investors that typically carries the most weight in the region is privately managed pension funds. The degree to which pension fund managers view promoting transparency and corporate governance as part of their mandate to maximise return for their clients will be an important determinant of the pace of improvements in the coming years. But the interest of fund managers in maximising returns for investors cannot be taken as a given. Whether an individual fund manager takes an active interest in the good performance of individual investee companies depends on the set of incentives the fund manager faces, including the regulatory framework and the character and efficiency of the funds' own governance. Pension fund governance and accountability therefore remains an important public policy priority for the region."*

Indeed, pension system reforms starting with Chile in 1981 and continuing in the 1990s with many other Latin American countries, moving from a pay-as-you-go to an individual account system, have provided an important contribution to growing pools of domestic investment. Pension

fund assets under management in the region have grown by an average of 16 percent annually since 1999, reaching US$390 billion by the end of 2006.[2] These funds are the most dominant institutional investors in the market in many Latin American countries (Figure 2.2 below). Brazil is the strongest exception, where mutual funds make up a much bigger share, and to a lesser extent in Colombia.

Figure 2.2. **Assets managed by PFAs and mutual funds**




^Argentina: Pension fund data provided by the Argentinean Securities Regulator (CNV) for December 2009.

^^Mexico: Mutual fund data as of September 2009.

*Peru: Mutual funds figures are based on CONASEV statistics for December 2009 (at exchange rate 31/12/2009).

**Colombia: "Mutual funds" figures based on 2007 figures provided by the Superfinanciera (only include trust funds).

PFAs data source: International Association of Pension Fund Supervision Organs, AIOS- June 2009. Brazil figures for Dec. 2009 provided by IBGC.

Mutual funds data source: 2009 Investment Company Factbook, ICI (*www.ici.org*).

Differing legal and regulatory frameworks also have an important influence on the activities of different institutional investors. To ensure risk diversification and guard against the effects of potential economic downturns, Latin American pension funds face regulatory limits on how much of their funds can be invested in stocks (in contrast to the US and UK, where such limits are not established – see Table 2.2 below). Some

countries report variable limits on the amounts that can be invested in stocks, with maximum percentages differing depending on the risk strategies of different funds (e.g., "conservative" vs. "aggressive"). At the same time, there tend to be even stricter limits on investment in foreign securities, due to a public policy objective of having these domestic funds directly support the domestic economy.

Table 2.2. **PFAs portfolio ceilings by main asset classes in Latin American and OECD countries**

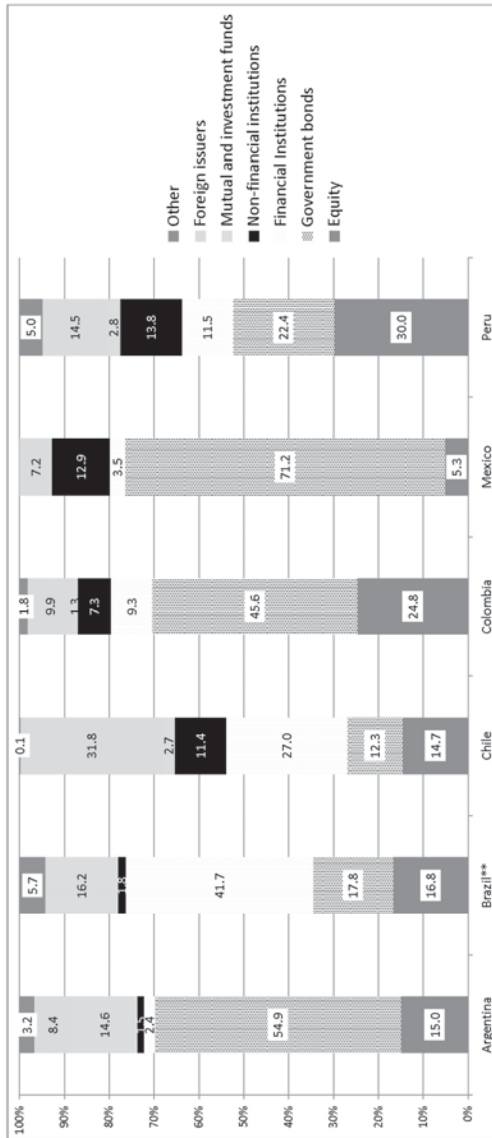
| | Government securities | Financial institutions | Stocks | Corporate bonds | Investment funds | Foreign securities |
|---|---|---|---|---|---|---|
| **Argentina** | 80 % | 40 % | 50 % | 40 % | 20 % | 10 % |
| **Brazil** | No limit | 20 %-80 % | 35% - 50% | 20 %-80 % | 20 %-80 % | 10 % |
| **Chile** | 40 %-80 % | 40 %-80 % | 0 %-80 % | 30 %-60 % | 0 %-40 % | 40 % |
| **Colombia** | 50 % | 30 % | 40 % | 30 % | 5 % | 40 % |
| **Mexico** | None | 10 % | 15 % | 5 %-No limit | - | 20 % |
| **Peru** | 30 % | 40 % | 10% - 80% | 40 % | 15 % | 10.5 % |
| **UK** | No limit | No limit | No limit | No limit | No limit | No limit |
| **United States** | No limit | No limit | No limit | No limit | No limit | No limit |

*Source*: OECD, 2008 and country reports.

Limits on investments in foreign securities and low liquidity in Latin American markets has contributed to what the Chileans and Brazilians call the *"manada"* effect, which means that pension fund managers end up structuring almost identical portfolios due to limited supply of stocks in the national market as well as investment limits set by the regulator. Pension fund managers tend to replicate the "average" portfolio, which is often based on following the practices of one or more of the largest pension fund managers. In Chile and Peru, this effect is also caused by a requirement of minimum return that has induced pension funds to choose similar portfolios.

Within this framework of limits, a significant share of pension fund portfolios is being invested in equity markets, with Peru leading all Latin American countries at 30%, and Mexico on the opposite end of the scale with about 5. 3% of their pension funds invested in local equities. While government bonds are in several cases the largest form of pension fund investment, equities are often the second biggest category (See Figure 2.3 below).

Figure 2.3. **Portfolio composition of PFAs (2009)***




*Note: All figures are based on end 2009, except Argentgina which are based on 2007 data and Brazil on June 2008.

**Equity for Brazil includes local and foreign.

*Source*: AIOS. For Brazil: Previdencia Social.

Data on **mutual fund investment portfolios** and percentages invested in equities was not available in all countries, but Mexico reported US$10.5 billion (14 percent) of its US$75 billion was invested in equities, while about 19 percent of Brazil's US$615 billion in mutual funds was invested in equity. In Argentina, where mutual funds may invest up 25 percent of their assets in foreign equities, the use of CEDEARs (Certificados de Depósito Argentino) and international agreements (e.g., those of Mercosur) allow investments through such instruments and in such markets to be considered as investments in domestic equities. As a result, many mutual funds tend to invest in Brazilian companies (while Brazilian mutual funds invest far lower percentages of their portfolios in their own countries' equity).

This publication does not provide comparable data on the size of other institutional investors, such as insurance funds, financial institutions, and private equity, because for the most part their influence on corporate governance of listed companies is much less important, as their investment in equity markets tends to be much smaller than those of mutual funds and especially pension funds.

A notable exception mentioned in the country reports concerns the **growing role of private equity** in Mexico and Brazil, of particular relevance in helping to prepare privately held companies to adopt measures, including corporate governance improvements. In Brazil, private equity investments, in some cases concentrated on bringing privately held companies to the market through improvements in corporate governance, had grown from US$5.6 billion at the end of 2004 to US$16.7 billion as of July 2007. In Mexico, private equity investments rose from USD$1 billion in the year 2000 to USD$8 billion as of 2007. Overall, however, these amounts remain quite small in comparison to the size of mutual and pension fund investments in Latin American companies.

In addition, Roundtable participants from Argentina and other smaller, less liquid markets such as in Central America suggested a potential for **banks to play a larger and complementary role** to other institutional investors in influencing corporate governance through their review of corporate governance practices as part of their lending processes. The role of financial institutions in Latin America and their impact on corporate governance is attracting growing attention in the region, including as an issue discussed at the 2009 meeting of the Roundtable. However, given the predominant role of pension and mutual funds among institutional investors in Latin America, this report has chosen to concentrate mainly on these two types of investors in its analysis and recommendations.

An additional issue of growing prominence in Latin America relates to the role of the state – for example as owners of sovereign wealth funds,

pension funds and state-owned enterprises, and the state's influence on corporate governance through these different potential channels for investment. The OECD's *Guidelines on Corporate Governance of State-Owned Enterprises* provide relevant guidance in this regard, but the subject is a complex one that merits further attention. The Roundtable may wish to consider giving additional follow-up attention to both the role of financial institutions and the role of the state in corporate governance, since these issues could not be addressed within the scope of this report.

## 2.3. Overcoming barriers to positive II influence on corporate governance in Latin America

Latin American countries have taken differing legal and regulatory approaches to the question of how best to encourage and enable IIs to responsibly exercise their ownership rights and promote good corporate governance in the companies in which they invest. But there remain many market, regulatory and cultural barriers for IIs to play that role. A quick overview of some of the highlights of these legal approaches is provided below along with cross-references to the relevant recommendations contained in the following chapter of this publication.

### *2.3.1. Relaxing regulatory limits on investment in equity*

Countries of the region have different regulatory limits set on the amounts that pension funds may invest in equities, as shown in Table 4 above. These limits generally reflect the regulator's views on prudential regulation of the industry and their interest to limit unnecessary risk-taking for the benefit of the funds' beneficiaries, the desire to protect and encourage the development of local capital markets and to take account of the level of sophistication of the funds to make investment decisions outside such parameters.

On average, pension funds are allowed to invest up to 50% of their funds in stock of companies (Chile and Peru provide for a threshold of up to 80%, whereas the limits to invest in foreign stocks are generally much lower – on average 10% (Chile and Colombia provide for a threshold of up to 40%). In short, the regulator directs the pension funds to invest in more conservative instruments, which in some cases may limit the extent to which funds can distinguish companies with better corporate governance and invest in them at higher levels to reward them for their better practices.

Within the framework of such limits, the approach taken in Brazil has sought to establish incentives for pension funds to reward good governance

by establishing ***variable limits on investments in equity.*** Brazilian regulators allow PFAs to invest up to 50% of their portfolio in equities from the three corporate governance listing segments of the stock market, the Novo Mercado, on which companies are required to commit to higher than legally-required standards of corporate governance. These PFAs may only invest up to 35% of their portfolios in the regular market segment. However, the overall share of pension fund investment in equities was only about 20% on average (including foreign equities) in 2007, well short of either the 35% or 50% limits, making it unclear whether such incentives are having an impact in practice. This suggests that as a general rule, regulatory limits on equity investment need to be regularly reviewed with a consideration of practical market realities and whether such limits are achieving their intended purposes. Nevertheless, it remains clear that the corporate governance listing segments provide an important signal of higher corporate governance commitments to which investors are responding. Indeed, companies in Novo Mercado's corporate governance listing segments had outperformed those listed in other market segments by 25% in terms of share value as of 2007.[3]

Lacking a Novo Mercado-style corporate governance benchmark which enables companies to make binding commitments to higher than legal standards, other countries have not followed suit with such incentives for PFAs to invest in better governed companies.

The most restrictive approach to prudential regulation among the six countries reviewed was found in Mexico, where pension funds were not permitted to invest in individual listed companies until recently. Before new regulations were issued in 2009, the only option for pension funds to invest in equity was through instruments which replicate selected share indexes. A new regulation issued in July 2009 by CNBV, the Mexican securities regulator, allowed for the establishment of new investment trust funds, called Development Capital Certificates (DCCs), regulated by the CNBV, which can invest in individual companies which may be either private or publicly-traded. Pension funds are allowed to invest up to 10 percent of their portfolios in DCCs, providing them with a means for differentiating between well-governed and less well-governed companies. Although the DCCs were established primarily as a way to raise capital for infrastructure projects, this new initiative does provide an instrument for institutional investors that potentially could be used to target some of their resources directly towards better-governed companies. In February 2010, the Mexican Pension Fund Regulator (CONSAR) issued a new regulation which allows PFAs to invest directly in equity with a ceiling of 35% of their portfolio for the highest risk funds.

### *2.3.2. Requirements for active ownership*

On the other hand, a number of countries, including Chile, Colombia and Peru, have taken a more direct regulatory approach to imposing requirements on pension funds to take actions aimed at promoting their role as active and informed owners.

**Peru,** whose pension funds have invested the highest proportion of their portfolios in equities of any Latin American country, seeks to promote active pension funds by defining their ***fiduciary duties to require activism*** (see also Section 3.5). According to Peru's country report, the law requires that its PFAs (known as AFPs because of their acronym in Spanish) "appoint representatives of the funds, which must exercise the rights (and comply with the duties) that are attached to the securities held in the portfolios of the funds… [R]epresentatives of the funds will defend the rights of the funds with independence of the interests of the AFPs, will comply with corporate governance practices and promote their adoption by the investee companies… [R]epresentatives of the funds must voice their points of view on the topics that are discussed, cast their votes and see that it is reflected in the minutes. They must report to the AFP on the result of their endeavours… In the election of members of the board, the representatives are forbidden to vote for candidates that are shareholders, directors, managers or workers of an AFP[4]… Resolution 680 of the SBS…[requires PFAs] to invest in those companies and funds that follow good corporate principles. They have to promote good corporate governance in those companies and good investment practices… No rules require disclosure of their policies and practices regarding corporate governance of the companies in which they invest."

A key factor behind these IIs' steps to actively exercise their ownership rights is a recognition that many pension funds in Latin America have a significant social purpose and a duty to protect the interests of the people in the country, particularly those who contribute to the system. This recognition also drives pension funds to take a particular interest in improving their domestic markets and economies to fulfil that social function (through limitations on investments in foreign debt and equity). However, this role of pension funds should not underestimate the responsibility of IIs to maximize in a safe way the returns to their beneficiaries, which in some cases may come from foreign investments, rather than only focusing on the domestic market. With considerable evidence (not least that within Latin America itself) that improved corporate governance significantly enhances the performance and the value of companies, the focus of pension funds and other IIs on corporate governance improvements in their portfolio companies can reasonably be expected to

deliver better results for both their beneficiaries and the respective host countries.

**Chile** has also taken a step to mandate active ownership by ***requiring its pension funds to vote*** on all matters in the shareholders' meetings (see also Section 3.5). While this has ensured that Chilean institutional investors play an active role, some analysts have noted a potential weakness in the law in that IIs can have other conflicts of interest. For example, an II's controlling shareholder could be involved in a takeover bid or in acquiring a significant stake in a company in which the II holds shares, and could seek the pension fund's support in agreeing that shares be offered at a low price, even though the pension fund's affiliates have an interest in obtaining as high a price for shares as possible. In Chile, a pension fund could not abstain in such a case.

**Colombia** adopted a new approach in 2007, requiring that pension funds specifically take into account corporate governance in their investment analysis and decisions, and to disclose the importance that they place on corporate governance in their investment decision process (see also Section 3.2). This approach was facilitated by Colombia's recent adoption of a national corporate governance code and a requirement that all companies issue detailed annual corporate governance reports disclosing whether they are complying with the code's measures and explaining how they do it, while an explanation is voluntary in cases of non-compliance with code provisions. Similar to pension funds, the regulatory framework in Colombia through Circular 54 requires that managers of mutual funds consider within their investment policies the relevant corporate governance regulations, in particular the adoption of the national code by the corresponding issuers.

**Argentina's** approach to pension fund influence on company governance has been transformed by the nationalization of its pension system beginning in January 2009 (see Sections 3.8 and 3.10). Privately managed pension funds, which invested approximately 15 percent of their funds in Argentina's equity market, were transferred under state management. Argentina's publicly-owned pension fund system, the so-called Sistema Integrado de Pensiones Argentino (SIPA), established a Council of the Fondo de Garantía de Sustentabilidad to monitor its financial resources. The Council is composed of a representative from the Social Security Administration (ANSES), one from the Chief's Cabinet Office, two from the retirees, three from the workers, two from business associations, two from banking associations, and two from the National Congress. A separate Congressional oversight commission has also been established, and the Fund is also subject to internal audit, control and oversight by a range of other internal government and Congressional audit and oversight bodies.

### *2.3.3. Enabling IIs to participate and vote in shareholder meetings*

Another barrier to IIs responsibly exercising their ownership rights is the lack of laws and regulations enabling IIs to exercise their voting rights in practice. In particular, in country task force discussions held in **Brazil** and **Chile**, one of the key concerns raised by investors was the need to facilitate participation of shareholders in general meetings, either through streamlined proxy voting procedures or direct participation. **Brazil's** regulator, CVM, recently reviewed requirements to try to facilitate the use of proxy voting and other forms of shareholder participation by clarifying that a shareholder who wishes to delegate his voting powers to other authorized representatives is not required by law to have the authorization document with his signature notarized (see Section 3.5). In December 2009, CVM issued Instruction 481 which provides a new framework of the disclosure of information and documentation related to shareholder meetings and seeks to increase and regulate investor participation. "Online General Meetings", a website through which shareholders can participate in the meetings of their investees without physically attending them, announced in September 2010 that already 12 companies in Brazil had agreed to use this innovative system to allow for remote voting in Annual General Meetings. Foreign shareholders, investment funds and shareholders are expected to benefit, since it will be easier and quicker to establish powers of attorney in favour of local representatives, making it easier to be represented at distant locations.

In addition, CVM's proposals, implemented at the beginning of 2010, also provide for the use of blogs, web sites and on-line broadcasts of shareholders' meetings. While these are new measures and it is too early to know how widely Brazilian companies will adopt these practices, they represent important steps to facilitate shareholder participation, and several companies have already shown interest in adopting some of these measures.

### *2.3.4. Co-ordination of minority shareholder support for better governance*

Low liquidity and scarcity of investible shares have caused long-term investors, especially pension funds, to have similar portfolios and therefore to own shares in the same companies. While this similarity of portfolios has the drawback of failing to provide pension beneficiaries with a range of choices and a competitive market from which to choose a pension plan, the reality of having relatively few listed companies to invest in also presents an opportunity for pension funds to have a greater impact as minority shareholders, by co-ordinating and pooling their votes to pursue common goals.

The *OECD Principles'* annotations state that shareholders should be allowed, and even encouraged, to consult with each other, subject to exceptions to prevent abuse. The aim of this recommendation is to facilitate the exercise of shareholder rights by reducing the costs and increasing the effectiveness of shareholder intervention, partly resolving the "free rider" problem. However, many OECD countries have tended to focus on several issues where the potential for abuse could be a concern, imposing disclosure requirements in relation to co-operation when the co-operation relates to acquiring, holding, voting or disposing of a company's securities. This may relate particularly to takeover bids, tender offers, disclosure requirements triggered by crossing of thresholds related to significant holdings, insider dealing and insider reporting.

In the Latin American context, such concerns remain important to address, particularly for institutional investors who may be acting in concert to assume control. In the majority of cases, however, control is well established by a dominant shareholder or controlling group, and institutional investor co-operation is considered desirable from the perspective of influencing corporate governance improvements, including in particular the election of board members by minority shareholders as a counterbalancing interest to controlling shareholders. Particularly in the case of pension funds, for which investment limits generally preclude taking of ownership control, the concern about circumventing takeover regulations would seem to be less significant. The active and coordinated actions taken by **Peru's** and **Chile's** pension funds in electing board members are a positive example of these types of actions.

Another approach to coordination, more focused on ensuring that minority shareholder rights are respected more generally, occurs in **Brazil,** led by the Capital Markets Investors Association (AMEC), a body made up of representatives of several independent portfolio management companies as well as those linked to financial institutions (see Section 4.3). AMEC was established in order to represent the interests of fund investors as minority shareholders. They have kept a close eye on market transactions and, for example, requested information from the boards and investor relations department of numerous listed companies.

### *2.3.5. Developing clear governance benchmarks*

A common concern identified by many of the country task forces was the lack of an objective benchmark, rating system or platform under which better-governed companies can make clear their higher standards to obtain a competitive advantage over less well-governed companies, in order to be rewarded by the market. The special corporate governance listing segments

of BM&FBovespa have emerged as the most successful objective corporate governance standard of the region. Companies voluntarily choose to list in the corporate governance segments and therefore comply with higher governance standards than those prescribed by law, which is giving them higher market value, since investors are willing to pay a premium for better governed firms. The corporate governance listing segments accounted for approximately 64% of the total market capitalization in BM&FBovespa as of October 2009. Likewise, virtually all IPOs in Brazil are listings in one of the three corporate governance segments.

Voluntary codes of corporate governance applied through a regulatory-mandated comply or explain mechanism also have the potential to become an objective standard by which IIs could take into account governance considerations. Colombia, whose regulator recently decided to strengthen disclosure requirements concerning compliance with its voluntary corporate governance code is notable to watch because of its corresponding requirement that pension funds take company corporate governance into account in their investment decisions. Currently, these types of codes exist in several other Latin American countries as well (Argentina, Panama, Peru and Mexico) with varying degrees of disclosure required. Chile has no disclosure requirements in relation to its voluntary corporate governance code. Enforceability has been a main issue, since the codes are voluntary and the degree of disclosure that occurs can be quite uneven, making it difficult for investors to have a good basis for comparison and to actually pay a premium on those companies implementing the code's recommendations.

### *2.3.6. Promoting successful practices to overcome cultural resistance*

In some of the countries of the region, active ownership is perceived by IIs as a risk for potential claims from beneficiaries and investors, since they might blame such activist strategies in the event that equity investments do not deliver sufficient returns. In this sense, some II managers prefer to refrain from interfering with a portfolio company's management or board, or even to vote in the shareholders meetings, reinforcing a culture of passive ownership. Likewise, the sanctions that may result from PFA mismanagement may sometimes deter managers from having a larger equity portfolio, and encourage them to rely on "complacent" fixed-income instruments with lower risk of default such as government bonds. However, within a competitive market for pension fund plans, this practice could be countered to some extent by clear disclosure to pension fund beneficiaries about the real performance and risks associated with their retirement

savings. In this respect, investor education on the benefits of good corporate governance as a contribution to higher share value and reduced risk could also be helpful in overcoming passive investor behaviour.

## Notes

1. Capital increases in BM&FBOVESPA (Sao Paulo Stock-Exchange) from both initial and secondary public offerings.
2. See the Latin American Economic Outlook, Chapter 2, "Pension Reform, Capital Markets and Corporate Governance," published by the OECD Development Centre.
3. Guerra, Sandra, *"Brazil, the Virtuous Circle";* Governance, September 2007 - Issue 167.
4. Article 94, Regulation of The Unified Text of the Private Pension Fund Law, enacted by Supreme Decree Nº 004-98-EF, modified by, Article 2, Supreme Decree N ° 182-2003-EF, 12-12-2003.

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