Mexico

Summary of Current Shareowner Rights

Percentages cited reflect information gathered by GMI about 26 companies in Mexico as of 15 May 2008.

Mexico's economy historically has been controlled by a small group of elite families, and many of the country's major companies follow that model to this day. Shareowner rights in Mexico are sometimes negatively affected because many of the country's publicly listed companies have majority non-independent boards and controlling shareowners. High levels of related-party transactions are common in Mexico. At the same time, shareowner activism in Mexico is low as a result of some restrictive regulations. Mexican pension funds invest primarily in government bonds and have a reputation for being passive owners. Until relatively recently, changes in control were rare in Mexico, and those that did happen suffered from a lack of transparency.

Issue	Current Standard or Usual Practice	Level of Practice Adoption, Exceptions to Usual Practice, and Trends (if any)
What is the average percentage of independent board members on public company boards (% independent board members)?	49%	Non-independent board members who are company employees or otherwise connected to the CEO and/or controlling shareowner are common in Mexico.
What percentage of companies report significant related-party transactions (1% of revenue or more) within the last three years?	46%	Many Mexican companies engage in high levels of related-party transactions.
What percentage of publicly traded companies have a controlling shareowner (e.g., family, government, majority block holder)?	50%	Mexico's economy historically has been controlled by a small group of wealthy families with financial and political ties. Small- and medium-sized enterprises make up more than 95% of businesses in Mexico, and most of them are family controlled.
Is voting by proxy permitted?	Yes	
Must shares be deposited or blocked from trading in order to vote?	Mostly, yes	This practice is common in Mexico. 85% of the companies researched for this manual require shares to be deposited or blocked before a vote.
Are there share ownership limitations in this market?	Yes	Companies in certain sectors (e.g., media, transportation, glass production, beer production, cement, and telecommunications) have implemented share ownership limitations.
Are there [other] common restrictions on the rights of shareowners to vote in person or by proxy?	No	
Do companies adhere to a majority voting standard in the election of board members?	Sometimes	Majority voting is not common in Mexico. Only 30% of the companies researched for this manual have implemented majority voting in the election of board members.

Issue	Current Standard or Usual Practice	Level of Practice Adoption, Exceptions to Usual Practice, and Trends (if any)
Do companies allow for cumulative voting in the election of board members?	No	Cumulative voting is not the practice in Mexico.
Are shareowners able to affect a company's remuneration policy through shareowner approval (binding or nonbinding) of the remuneration committee report, the proxy's Compensation Discussion and Analysis section, or otherwise?	No	
Are shareowners able to affect remuneration policy through binding shareowner approval of specific equity-based incentive plans or otherwise?	No	
Are shareowners permitted to introduce dissident resolutions (binding or nonbinding) at an annual meeting?	No	
Do shareowners have a right to convene a general meeting of shareowners outside the annual meeting process (e.g., an extraordinary general meeting or special meeting) if only 10% or less of the shares are represented in the group requesting the meeting?	Yes	Mexico's *Ley del Mercado de Valores* (Securities Market Law) of 2006 allows shareowners with at least 10% of the voting and limited voting shares[14] the right to call a shareowners meeting.
What percentage of companies include golden shares in their capital structure?	0%	Golden shares are not in use in Mexico.
Are shareholder rights plans (poison pills) allowed in this market?	No	Poison pills are not in use in Mexico.
If shareholder rights plans are in use, do they have to be approved by shareowners?	NA	
Do all shareowners have the right to approve significant company transactions, such as mergers and acquisitions?	No	The shareowners' right to approve significant company transactions is limited in Mexico.
Do companies require a supermajority vote to approve a merger?	In most cases	Most Mexican companies require a supermajority vote to approve a merger.
Are companies subject to a fair price provision, either under applicable law or as stated in company documents (such as the charter or bylaws)?	No	This kind of provision is not the practice in Mexico.
Are class action suits commonly used in this market?	No	Class action shareowner lawsuits are not permitted by Mexican law.
Are derivative suits commonly used in this market?	No	This practice is not found in Mexico.

[14]Shares with some form of restriction on voting rights.

Current Engagement Practices and Shareowner Rights Developments

In Mexico, shareowner engagement is still a new concept. Like most markets in Latin America, Mexico's economy has historically been controlled by a small group of wealthy families. As the country adopted corporate capitalism, this history translated into the emergence of clusters of family-controlled companies. With limited access to traditional sources of capital, most major companies were either state controlled or were run by financially self-sufficient family groups. Mexico's capital markets remain small and illiquid and are still not a primary source of financing for the country's major corporations.

Although Mexican controlling shareowner families have been more inclined recently to use public stock offerings to raise capital, many have been reluctant to give shareowners any real control. Half of the Mexican companies researched for this manual have controlling shareowners, and more than half of the board members at the Mexican companies researched are not considered to be independent. Common practice for controlling families is to place many family members, company employees, and affiliates on the board, which ensures loyalty and limits the potential for effective shareowner activism. Cross-shareholding arrangements and interlocking board memberships are common in Mexico. An increasing number of Mexican companies have included more independent board members in recent years. The country's 2006 *Código de Mejores Prácticas Corporativas* (Corporate Governance Code) includes new requirements for the inclusion of independent board members.

Amendments made in 2001 to Mexico's *Ley General de Sociedades Mercantiles* (Company Law) include provisions to improve the regulation of basic shareowner rights. The country's 2006 Securities Markets Law, which regulates public companies, requires that boards be composed of, at minimum, 25 percent independent board members.

Even though Mexico has privatized social security and has a number of large private pension funds, shareowner activism by institutional investors is still uncommon. Recent years of macroeconomic stability and uninterrupted economic growth encouraged private investment in the region, but Mexican institutional investors have been slow to acquire stakes in domestic companies—and even slower to engage in shareowner activism. Despite the fact that new regulations enacted in 2005 allow pension funds to invest in local equities, few funds have chosen to do so. Mexican pension funds continue to hold primarily government bonds.

To encourage risk diversification and guard against economic downturns, federal regulations restrict Mexican pension funds from investing more than 15 percent of their holdings in stocks; in fact, Mexican pension funds currently have invested only about 2 percent of their capital in local equities. Mexican pension funds have the lowest rates of investment in local equities in Latin America. Mexican mutual funds have invested 19 percent of their USD70 billion assets in equities but typically acquire small stakes with limited voting power and abide by the prevailing institutional culture of passivity.

Shareowner activism by institutional investors in Mexico is further restricted by regulations that limit pension funds to investing in instruments that replicate selected share indexes and forbid them from investing in individual listed Mexican companies.

Like most of Latin America, Mexico is affected by low market liquidity. Value traded as a percentage of market capitalization in 2006 was only 23.2 percent in Mexico, as compared with 155 percent in the United States during the same period. Slow-moving capital markets combined with a regulatory and institutional framework that discourages shareowner activism have made it difficult for investors to divest from troubled companies and have helped foster a culture of passive, long-term investment. Not surprisingly, engagement consultants and proxy advisory services are not common in Mexico.

A major shareowner rights initiative spearheaded in 2005 by Gil Francisco Díaz, then Mexico's Secretary of Finance, and supported by the country's major political parties and corporations, was stifled by an opposition group led by Mexican TV mogul Ricardo Salinas.

Legal and Regulatory Framework

Although the country's governance policies still lag behind some internationally accepted best practices, Mexican regulators are taking steps to provide better protection for minority shareowners and improve overall governance practices. A number of important reforms to the Mexican corporate governance framework have been made in the past 10 years. Mexico's capital market regulator, the *Comisión Nacional Bancaria y de Valores* (National Banking and Securities Commission) cooperated with the *Bolsa Mexicana de Valores* (Mexican Stock Exchange) to produce the country's first Corporate Governance Code in 1999. An amended copy of the governance code published in 2006, the 2001 Company Law, and the 2006 Securities Market Law are the basis for current Mexican governance practices.

A 2005 World Bank study ranked Mexico third from last in a global comparison of shareowner rights. Even with recent improvements in the 2006 Securities Market Law, a number of factors and mechanisms in Mexico still discourage shareowner engagement and activism. Protection of minority shareowner rights and the right of shareowners to participate in fundamental decisions and make their voices heard at the annual meeting continue to be areas in Mexican governance practices in need of improvement.

Although several federally imposed restrictions impede the ability of outsiders to take control of companies in certain industries, poison pills are not used in Mexico. The Mexican government reserves the right to take control of corporations in strategic sectors, and it exercised this right during the country's 1982 financial crisis.

As a rule, Mexican regulations allow foreign investors to control up to 100 percent of the capital stock of Mexican companies. Some sectors, however, are affected by regulations that limit shareowner rights. Examples of such regulations are the Federal Telecommunications Law and the Foreign Investment Law, which prohibit foreign investors from controlling more than 49 percent of the outstanding shares of Mexican telecoms. Any share transfers resulting in a violation of these foreign ownership requirements are invalid under Mexican law. The same restrictions apply to companies in the transportation sector.

Because of the country's high degree of concentrated economic power, shareowners in Mexican companies can be negatively affected by frequently occurring related-party transactions. Shareowners have complained that the majority owners continue to use the assets of publicly listed companies to boost their private business endeavors. Nearly half of the Mexican companies researched for this manual have engaged in significant related-party transactions in the past three years.

Mexico's Company Law includes provisions on a board member's fiduciary duty to shareowners. Breaches of fiduciary duty in which board members knowingly act to benefit one shareowner to the detriment of others can be penalized with prison sentences ranging from 3 to 12 years. Despite some recent improvements, shareowners still cannot rely on Mexico's court system to enforce minority shareowner rights. Arbitration is in its early stages, and Mexico's legal system suffers from a reputation for being slow, inefficient, and weakened by corruption.

In contrast to the rights of minority shareowners in developed markets, it is generally more difficult for minority shareowners in Mexico to exercise their rights as the result of the powers that board members or majority shareowners enjoy. Mexican laws require non-Mexican shareowners to agree to be considered Mexicans with respect to their shares and forfeit the right to invoke the protection of their own governments. Shareowner rights in Mexico are limited by the fact that Mexican civil procedure does not allow shareowners to initiate the same types of class action lawsuits or shareowner derivative actions as some other markets permit. Although class action lawsuits do not exist in Mexico, the country's laws do provide shareowners of 20 percent of the shares outstanding with the right to contest shareowner resolutions. In addition, according to Article 38 of the Securities Market Law, shareowners representing at least 5 percent of a company's outstanding shares may directly bring a civil liability action against any board member or committee member.

Mexico's 2006 Securities Market Law allows shareowners of 10 percent of the shares to appoint one board member and call emergency general meetings. Shareowner rights are not limited by staggered board structures. Mexican companies have a single-tier board structure.

The 2003 White Paper on Corporate Governance, published by the Latin American Roundtable on Corporate Governance, a working group organized jointly by the International Financial Corporation, the Organisation for Economic Co-operation and Development, the World Bank, and the Inter-American Development Bank, identifies privately managed pension funds as the "set of domestic institutional investors that typically carries the most weight in the region." The study states that "the degree to which pension fund managers view promoting transparency and corporate governance as part of their mandate to maximize return for their clients will be an important determinant of the pace of improvements in the coming years" and highlights the need for the creation of a strong regulatory framework and proper incentives to push fund managers to take on a more active role. Encouraging pension funds to engage the companies in which they invest remains an important area of public policy in Mexico.

Key organizations with information relevant to shareowner rights in Mexico include the following:

Bolsa Mexicana de Valores (Mexican Stock Exchange) (www.bmv.com.mx)

CNBV: Comisión Nacional Bancaria y de Valores (National Securities and Banking Commission) (www.cnbv.gob.mx)

Secretaría de Hacienda y Crédito Público (Secretariat of Finance and Public Credit) (www.shcp.gob.mx)

Comisión Nacional del Sistema de Ahorro Para el Retiro, CONSAR (National Retirement Savings Commission) (www.consar.gob.mx)

Centro de Excelencia en Gobierno Corporativo (Center for Excellence in Corporate Governance) (www.uas.mx/cegc)

Consejo Coordinador Empresarial (Mexican Business Coordination Council) (www.cce.org.mx/cce/home.htm)

Organisation for Economic Co-Operation and Development (www.oecd.org)

Inter-American Development Bank (www.iadb.org)

International Finance Corporation (www.ifc.org)