

Brazil

Summary of Current Shareowner Rights

Percentages cited reflect information gathered by GMI about 58 companies in Brazil as of 15 May 2008.

Leaders in the Brazilian securities market have made great efforts in recent years to distinguish Brazil from other prominent emerging markets in order to attract investment; as a result, the market has evolved rapidly and undergone significant change. A newly created set of voluntary listing levels focused on corporate governance has clearly improved accountability and thereby enhanced Brazil's image as an investor-friendly market. Nevertheless, the high percentage of publicly held companies with controlling shareowners continues to deter some foreign investors.

Although listed companies are required to disclose their bylaws, these documents do not always explicitly address shareowner rights (e.g., majority or plurality voting in election of board members and the right to act in concert through written communication). Many companies do not post other key governance documents (e.g., corporate governance guidelines and committee charters) on their corporate websites. Moreover, only some companies make their key governance documents, such as bylaws or articles of association, easily accessible to the public, which prevents analysts and investors from fully understanding shareowners' rights.

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)?	34%	
What percentage of companies report significant related-party transactions (1% of revenue or more) within the last three years?	NA	<p>The <i>Comissão de Valores Mobiliários</i> (CVM or Securities and Exchange Commission) and the <i>Instituto Brasileiro de Governança Corporativa</i> (Brazilian Institute of Corporate Governance or IBGC) recommend that related-party transactions be disclosed, that they be on market terms, and that companies not make loans to related parties. IBGC recommends that the fairness of a related-party transaction should be based on an independent assessment; CVM recommends also that minority shareowners be given the opportunity to request that an independent entity assess the fairness of a related-party transaction. The stock exchange, Bovespa, has different rules for special corporate governance levels (Levels 1 and 2 and the Novo Mercado).</p> <p>Of the 37 companies researched for this manual that do disclose related-party transactions, 16% reported such transactions of 1% or more within the last 3 years.</p>

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What percentage of publicly traded companies have a controlling shareowner (e.g., family, government, majority block holder)?	74%	
Is voting by proxy permitted?	Yes	This practice is common in Brazil.
Must shares be deposited or blocked from trading in order to vote?	Mostly, no	Few companies specify that shares must be deposited.
Are there share ownership limitations in this market?	Mostly, no	Only a few companies in “sensitive” industries, such as aerospace and defense, have such limitations.
Are there [other] common restrictions on the rights of shareowners to vote in person or by proxy?	No	Shareowners in Brazilian companies can appoint proxies. The proxy may be a shareowner, a corporation officer (e.g., the company secretary), a lawyer, or a financial institution.
Do companies adhere to a majority voting standard in the election of board members?	Mostly, yes	
Do companies allow for cumulative voting in the election of board members?	Yes	Any shareowner holding at least 5% of shares may request that cumulative voting be adopted.
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	Shareowners do not affect company remuneration in this way.
Are shareowners able to affect remuneration policy through binding shareowner approval of specific equity-based incentive plans or otherwise?	Yes	Under Brazilian corporate law, shareowner approval is required for the adoption of equity compensation plans.
Are shareowners permitted to introduce dissident resolutions (binding or nonbinding) at an annual meeting?	Usually, no	Although a general right to propose a dissident resolution at an annual general meeting is not provided for under relevant laws, dissident resolutions can be put on the agenda of an extraordinary general meeting (EGM) by the person requesting that meeting. To be put on the agenda, the proposal requires the support of 10% of company shares. Therefore, although a dissident resolution is technically possible, this right is difficult to exercise in practice.
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	Shareowners representing at least 5% of shares have the right to convene an EGM or special meeting.

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What percentage of companies include golden shares in their capital structure?	3%	
Are shareholder rights plans (poison pills) allowed in this market?	No	Because of the high concentration of voting power in Brazilian companies, takeovers have been relatively uncommon. More companies without a single controlling shareowner are emerging, however, particularly in the Novo Mercado listing segment (see below). In these companies, usually a controlling shareowner group will form through a shareowners' agreement. Some companies are also beginning to adopt provisions in their bylaws that require a shareowner to make a mandatory tender offer if the shareowner acquires a number of shares beyond a threshold percentage—usually 20%. These “porcupine provisions,” which are sometimes mistakenly referred to as poison pills, afford minority shareowners an opportunity to tender their shares at a fair price. The threshold for the mandatory bid is lower than usual in the Brazilian market but not out of line with some thresholds in other markets.
If shareholder rights plans are in use, do they have to be approved by shareowners?	No	As stated above, shareholder rights plans are not currently used in Brazil. But other takeover defenses used in this market require shareowner approval.
Do all shareowners have the right to approve significant company transactions, such as mergers and acquisitions?	Yes	
Do companies require a supermajority vote to approve a merger?	Sometimes	This right must be determined on a company-by-company basis. It is usually contained in the bylaws. Although not commonly found, some companies may require a supermajority without disclosing it.
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	Only companies listed in the Novo Mercado section are (voluntarily) subject to a fair price provision.
Are class action suits commonly used in this market?	No	Such lawsuits are uncommon in Brazil.
Are derivative suits commonly used in this market?	No	These lawsuits are uncommon in Brazil.

Current Engagement Practices and Shareowner Rights Developments

In December 2000, Brazil's primary stock exchange, Bovespa, launched a separate listing segment, *Novo Mercado* (New Market), providing publicly held companies an opportunity to voluntarily comply with more stringent corporate governance rules than are required by Brazilian corporate law and the CVM. The Bovespa has four levels of listing requirements—Bovespa's original listing requirements, Level 1, Level 2, and the Novo Mercado level—with increasing degrees of rigor (the key requirements are listed below). Between its inception in 2000 and June 2008, nearly 100 listed companies had joined the Novo Mercado.

Given the highly concentrated voting power found in the vast majority of publicly held companies in Brazil, shareowner engagement practices are severely limited. It is common in Brazil for the founding family of a company to enjoy a majority shareholding position; usually, this ownership structure is maintained by issuing both voting common shares and nonvoting preferred shares. Often, the controlling shareowner group owns the majority of the common shares and elects a majority of the board members.

Brazil does not require companies to maintain a certain number of independent board members, although the law stipulates that no more than one-third of board members may be executives of the company. (At least 20 percent of the board members of companies listed on Level 2 or the Novo Mercado must be independent.) Minority common shareowners holding at least 15 percent of a company's outstanding common shares have the right to elect one representative by a majority vote.

Preferred shareowners are also entitled to elect a board member when at least 10 percent of shareowners are present at the meeting or 10 percent of preferred shares are under free float³ (regardless of whether 10 percent of shareowners are present or represented at the meeting). If minority shareowners do not meet the 15 percent threshold for common shares or the 10 percent threshold for preferred shares, they may still elect a board member as a group if they can muster 10 percent of the *total* shares.

Cumulative voting in the election of board members is another method minority shareowners of common stock can use to gain representation on the board. Under Brazilian corporate law, any shareowner holding at least 5 percent of a company's outstanding common shares may request that cumulative voting be adopted. A recent study of Brazilian corporate governance⁴ found that, in practice, however, cumulative voting is seldom used; only 12 percent of the companies surveyed reported that cumulative voting had been used in the past five years.

The power and influence wielded by controlling shareowners has diminished somewhat over the past several years. For example, companies listed on the Novo Mercado must maintain a free float of at least 25 percent of the shares representing their capital stock. In July 2008, in an effort to make company managers more accountable to minority shareowners, legislation was enacted that requires mutual funds to vote their shares at company meetings. Opinion is divided, however, over the impact this regulation will have on companies; if mutual funds are required to vote, some corporate governance analysts argue, they may simply vote in favor of management, thereby muffling the dissident voices of more informed and active shareowners.

"Tag-along" rights—sometimes referred to as "takeout" rights—are an aspect of shareowner rights unique to Brazil. Pursuant to Brazilian corporate law, a new controlling shareowner who acquires 50 percent of the common shares is required to offer to buy all remaining common shares at 80 percent of the per-share price paid for the controlling shares. Preferred shareowners are not necessarily entitled, however, to any tag-along rights; that is, minority owners of common shares and owners of preferred shares are subject to inequitable treatment when a change of control occurs. A company listed on Level 2 of the special corporate governance levels is required to grant the same rights to majority and minority owners of common shares, and owners of preferred shares are entitled to 80 percent of the value of any

³Free float is the proportion of shares that are not held by large owners or insiders or shares with sales restrictions.

⁴Black, Bernard S., Antonio Gledson De Carvalho, and Erica Gorga, "An Overview of Brazilian Corporate Governance" (July 2008). University of Texas Law and Econ Research Paper No. 109; Cornell Legal Studies Research Paper No. 08-014; ECGI Finance Working Paper No. 206/2008. (<http://ssrn.com/abstract=1003059>)

proceeds from a sale. Companies listed in the top tier, the Novo Mercado, are not permitted to issue more than one class of stock and are also required to extend the same rights to all shareowners in such circumstances (100 percent tag-along rights).

Legal and Regulatory Framework

The CVM, the *Conselho Monetário Nacional* (National Monetary Council), and the *Banco Central Do Brasil* (Central Bank) govern the Brazilian securities markets. The Central Bank has the sole authority to grant licenses to brokerage firms and is responsible for regulating foreign investments and foreign exchange transactions. Enacted in 1976, the *Lei das Sociedades Anônimas* (Corporations Law) established distinct rules for privately held companies and publicly held corporations (Law 6.404/76), which fostered the emergence of stock exchanges.

All publicly held companies are registered with the CVM and are subject to reporting requirements. A company registered with the CVM may have its securities traded either on the Brazilian stock exchanges or in the Brazilian over-the-counter market. Under Brazilian law, a company may request that trading be suspended in anticipation of a material announcement. The stock exchange or the CVM may also suspend trading if they believe that a company has provided inadequate information with respect to a material event or has provided inadequate responses to inquiries by the CVM or the stock exchange.

The 1976 Corporations Law provides the majority of legal and procedural restrictions on public companies in Brazil. Board members are allowed to serve for terms of up to three years and may be removed at any time, with or without cause. Usually, board terms are not staggered in Brazil. Pursuant to Brazilian corporate law, the adoption of equity compensation plans requires shareowner approval. Shareowners representing at least 5 percent of shares have the right to convene an extraordinary general meeting.

Brazilian securities regulations require publicly held companies to disclose to the CVM and Bovespa any material development related to their business. Those companies listed on the special corporate governance levels (Levels 1 and 2 and the Novo Mercado) have greater transparency requirements. Companies listed on Level 1 must disclose an annual corporate agenda and consolidated financial statements, but these can be based on local standards. Level 2 and Novo Mercado companies must prepare quarterly and annual financial statements in English and according to international standards, such as U.S. generally accepted accounting principles (GAAP) or International Financial Reporting Standards (IFRS).

An overview of the key requirements for companies listed at each tier of the special corporate governance levels of the Bovespa exchange follows.

Companies listed at Level 1 must

- issue both common and (nonvoting) preferred shares,
- disclose an annual calendar of corporate events,
- disclose quarterly statements with cash flow demonstration (statement of cash flows),
- report related-party transactions exceeding BRL200,000 or 1 percent of the company's net worth, and
- maintain a free float of at least 25 percent of the shares representing their capital stock.

Companies listed at Level 2 must

- issue both common and (nonvoting) preferred shares,
- grant tag-along rights at the minimum of 80 percent to preferred shareowners,
- prepare financial statements in an internationally recognized standard (IFRS or U.S. GAAP) and include full disclosure of material related-party transactions,
- maintain a minimum of 20 percent independent board members, and
- maintain a free float of at least 25 percent of the shares representing their capital stock.

Companies listed at the Novo Mercado Level must

- issue only common shares with voting rights,
- prepare financial statements in an internationally recognized standard (IFRS or U.S. GAAP), which includes full disclosure of material related-party transactions,
- grant 100 percent tag-along rights to all shareowners,
- maintain a minimum of 20 percent independent board members,
- maintain a free float of at least 25 percent of the shares representing their capital stock, and
- disclose related-party transactions involving the greater of BRL200,000 (a bit more than USD100,000) or 1 percent of the company's net worth.

Under Brazilian corporate law, companies are not required to have an audit committee, nominating committee, or corporate governance committee, nor are they required to adopt and disclose a code of ethics. Few Brazilian companies establish standing board committees, but when they do, the committees usually have few decision-making powers and are often composed of inside board members.

A publicly held Brazilian company must provide in its bylaws for an audit board (or fiscal council). The purpose of this separate body, which may not be composed of board members or members of senior management, is to review and express an opinion on the company's financial statements. According to Instruction 381 of the CVM, a company must declare whether its independent auditors supplied any non-auditing services in the past year.

The IBGC, which was created in 1995, has published a "Code on Best Practices of Corporate Governance." The CVM released a similar set of recommendations. Neither of these codes is binding, however, and the "comply or explain" principle is not observed.

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

Comissão de Valores Mobiliários (Securities and Exchange Commission of Brazil) (www.cvm.gov.br)

Sao Paulo Stock Exchange (www.bovespa.com.br/indexi.asp)

Banco Central Do Brasil (Central Bank of Brazil) (www.bcb.gov.br)

Instituto Brasileiro de Governança Corporativa (Brazilian Institute of Corporate Governance) (www.ibgc.org.br)

Conselho Monetário Nacional (National Monetary Council) (www.bcb.gov.br/?CMN)