CFA Society Brazil

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5 August 2016

Re: IOSCO Growth and Emerging Markets Committee Corporate Governance Taskforce Report on Corporate Governance

CFA Institute[1] and the CFA Society Brazil[2] welcome the opportunity to comment on recommendations of the IOSCO Growth and Emerging Markets Committee Corporate Governance Taskforce. Corporate governance is the system of internal controls and procedures by which individual companies are managed. It provides a framework that defines the rights, roles, and responsibilities of various groups – management, board, controlling shareowners, and minority or non-controlling shareowners – within an organization. At its core, corporate governance is the arrangement of checks, balances, and incentives a company needs in order to minimize and manage the conflicting interests between insiders and external shareowners. Its purpose is to prevent one group from expropriating the cash flows and assets of one or more other groups.

We welcome the work of the Task Force on this topic and are happy to work with the Task Force on this topic in the future. For this purpose, we believe the comments we offer here contribute to your efforts in elaborating guidelines that may be effective in building sounder and more reliable Capital Markets worldwide.

I. Board Composition

It is imperative that members of the board bring the skills and qualifications needed to a board of directors. We therefore believe that it is important for companies to disclose the

[1] CFA Institute is a global, not-for-profit professional association of more than 131,000 investment analysts, advisers, portfolio managers, and other investment professionals in 147 countries, of whom nearly 123,700 hold the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 144 member societies in 69 countries and territories.
[2] The CFASB is an entity subordinated to the CFA Institute and is formed solely by individuals certified as Chartered Financial Analysts.

experience and qualifications of its board members, so that investors can understand how well the board is positioned to serve as investors' representatives.

In our opinion, the report fails to address the importance and functioning of an audit committee[3] on the board of directors so we would like to discuss briefly best practices concerning board audit committees.

Audit committees must have authority over their own budgets and over external auditors. It is through these protections that investors will come to trust the financial reports released by companies. In addition, all audit committee members should be independent. Independence is needed to prevent insiders from influencing the work and oversight of the committee and the work of the external auditors.

External auditors should act under the direction of an issuer's board of directors. While the audit committee is responsible for managing the audit process, the board of directors as a whole is ultimately responsible for the auditors' performance. This perspective extends the arm of culpability to a range of people whose actions are accountable if the issuer's financial statements are materially misleading.

The board and the board audit committee must have sufficient powers and resources to take or force action that ensures that the interests of shareowners are protected. Such powers should enable audit committee members to assess accounting issues and practices with the independent auditors without having to be dependent on management for such information.

A. Independence

We feel that company boards should have an independent majority. An independent majority on the board is more likely to consider the best interests of shareowners first. It also is likely to foster independent decision-making and to mitigate conflicts of interest that may arise.

Independent non-executive directors should not have been connected to a director, chief executive, or substantial shareowner of the issuer *within the preceding five years* in any fashion. Individuals with any sort of links to insiders are more likely to make decisions on the basis of those links than on what is best for shareowners. In addition, we reinforce the idea that the qualification of such inadequate relationships should not be limited to those at the economic level solely. After five years, the allegiance may diminish to a point where the

[3] It came to our attention that the issue of establishing audit committees was tackled in the questionnaire that served as basis for your report; however, such an important matter was not present in the report itself. As you well know, BM&F BOVESPA is currently conducting a public hearing that deals with the recommendation of mandatory establishment of audit committees as a condition for companies to be listed in the higher standards of "Novo Mercado".

independent, non-executive director may make decisions that run counter to the interests of the insider.

We wish to directly address the issue of is an appropriate balance between executive (*managing*) and non-executive (*supervisory*) directors mentioned in the Task Force report. We believe that a well functioning board must include industry expertise in order to maximize its effectiveness. Therefore it is not always a negative to have executives other than the CEO on the board in order to provide this expertise. However, if there are executives on the board, there must be controls in place to ensure that the CEO and management can still be held accountable by the board.

For example, executives on the board should not have a vote in related party transactions in which they are involved and should not serve on the nominating, audit or compensation committees of the board.

B. Diversity

The board should strive for a diversity of backgrounds, expertise, and perspectives, including an increased investor focus.

Board composition with these attributes will:

i. Improve the likelihood that the board will act independently of management and in the best interests of shareowners;
ii. Reduce the influence of board members who are executive or financial officers of other companies who might have a natural inclination to support management's perspectives;
iii. Ensure that board members are able to understand the many complicated financial transactions and activities;
iv. Ensure that company activities are presented properly in the financial statements;
v. Ensure that shareowner and investor views are considered along with the perspectives of CPAs.

C. Time Commitment

Board members should limit the number of board memberships they accept at any one time. Limiting the number of board mandates provides board members with more time to adequately consider the issues affecting a company and to decide on matters in a manner that serves shareowners' best long-term interests.

We believe the report should call for disclosure of how many board positions each member of the board holds in total. Shareowners should know how each board member is allocating his time. Moreover, the industries in which each board member is involved should be clearly disclosed.

Finally, we also recommend that board members should limit their length of service on a specific company's board to no more than 15 years. This would enable new board members with fresh insights and ideas and renewed independence to be elected.

D. Nominations Subcommittee

Members of company boards of directors help set the strategic direction, the ethical tone, and the overall governance for their firms. Consequently, recruitment and nomination of board members is an important part of a company's governance. To ensure that board members represent shareowner interests, companies must make the nominations process transparent, fair, and independent, regardless of their size, domicile, or industry. Listed companies should have a nominations committee and disclose whether each member is independent.

An independent nominations committee helps ensure boards have a process to recruit and maintain independent and well-qualified directors that make the best interests of shareowners their paramount objective. Disclosing whether committee members are independent helps investors understand the structure of the board and whether to vote for a director who is an insider or is subject to other conflicts.

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E. Board Evaluation

Each company should have a mechanism to evaluate the performance of boards and the performance of individual board members. It is advisable that boards periodically bring in outside and independent parties to evaluate the proper functioning of a board.

II. Remuneration and Incentive Structures

A. Role of Main Corporate Bodies

i. Advanced Approval by Shareholders Meeting

We believe that it is a useful exercise for shareowners to approve the remuneration policy of the company as recommended by the remunerations committee at a company's annual meeting. This "say on pay" vote allows shareowners to voice their opinion on pay policy – without getting into the details of setting pay themselves. We have found that such say on pay votes encourage more engagement between shareowners and issuers.

ii. Remuneration Committee and Disclosure of Policies and Individual Compensation

The remunerations committee should set pay, and disclose in detail their policies, procedures and rationale for setting executive pay. It is the responsibility of the remuneration committee to adequately communicate to shareowners how pay in both the long term and short term aligns with the creation of shareowners value.

It is appropriate to disclose the individual pay of the top executive officers and the compensation packages of these officers to shareowners, as these individuals have the biggest influence on the value of the shares owned by shareowners. This information allows shareowners to better understand how pay and performance are linked.

III. Risk Management and Internal Controls

A. Risk Factors Policies and Systems

A board must treat risk oversight as an ongoing process inextricably linked to the business plan and its execution, not as a compliance exercise or a checklist item to be marked off once a year. An update of critical risks should be included on the board agenda at every meeting.

B. Policies and Systems

Risk management policies and systems should be well described by companies in public filings. However, there is a natural tension with respect to the disclosure of strategic risks. The more a company discloses about key risks, the more information it risks "giving away" to its competition.

We believe that a board should clearly communicate the risk management process—including board risk oversight—to investors so that shareowners have adequate information to judge for themselves whether the process of risk oversight is rigorous and being handled properly.

A board should have a regular and dynamic process for considering risks, including interviewing market participants who may have a specialized understanding of the company's operations. Bondholders, shareowner activists, and companies throughout the supply chain may be able to help boards understand and mitigate as many risks as possible.

C. Leading Role of the Board

We believe that the entire board should embrace risk as a board-level responsibility. The board as a whole should oversee robust processes for identifying, understanding, and when necessary, mitigating risks to the operations, strategy, assets, and reputation of the company. The board understands that companies generate profits by taking risks and should encourage intelligent risk-taking that aligns with the company's strategy.

Concluding Remarks

CFA Institute and CFA Society Brazil welcome IOSCO's Growth and Emerging Markets Committee Corporate Governance Taskforce Report on Corporate Governance. We are happy to discuss these matters further if you wish to contact us.

Yours faithfully,

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