The Legal, Regulatory and Institutional Framework for Enforcement Issues in Latin America:

A comparison of Argentina, Brazil, Chile, Colombia and Peru

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As background for the 5th meeting of the Latin American Roundtable on Corporate Governance of October 8-9, 2004 focusing on enforcement issues, the OECD commissioned experts from Argentina, Brazil, Chile, Colombia and Peru to respond to questionnaires aimed at setting out the legal, regulatory and institutional framework for enforcement in their countries. The survey results provide a rich snapshot of practices and recent developments in each of these countries.

Because each country has its own framework and set of requirements, data were not necessarily comparable for many of the issues addressed. For example, different types of fines are issued for different types of offences, so that aggregated numbers do not do justice to the range and type of enforcement actions taken in each country. Nevertheless, the questionnaires provide a rich basis for improving understanding of how these five countries offer differing and sometimes similar approaches to enforcement.

This introduction provides a brief summary of some of the highlights, on as comparable a basis as possible, and includes a summary table to help highlight these comparisons. The more detailed questionnaire results are provided as a separate document, "Questionnaire on Enforcement Issues: Results for Argentina, Brazil, Chile, Colombia and Peru." It can be downloaded from the OECD Web site at http://www.oecd.org/daf/corporate-affairs on the pages dealing with the Latin American Roundtable (5th meeting), and should be consulted to better understand the explanations behind the numbers and brief comparative descriptions provided below.

The Administrative Framework for Enforcement

The main enforcement body for publicly listed companies in each country – the securities commission – has a commission head appointed by the President/Executive Branch in all five cases. The Chilean and Colombian presidents can remove the commission head freely, while greater political independence is sought in Argentina, Brazil and Peru by providing fixed-term appointments and a provision that the head can only be removed for committing a major offence.

Securities commission budgets range from a high of US$25.8 million for Brazil's Comissão de Valores Mobiliários (CVM) to a low of US$2.46 million for Argentina's Comisión Nacional de Valores (CNV). Chile, Peru and Colombia fall in the middle range with US$9 million, $7.86 million and $5.4 million respectively. In proportion to market capitalization, Peru's budget is the largest, followed by Colombia and Brazil. However, the budget figures have not been reviewed for comparability, for example, to take into account whether they include overhead costs, rent vs. ownership of facilities, differences in cost of living, etc. Perhaps a more straightforward way to judge relative size is through the number of employees. Again, Brazil has the largest staff, with 363 current employees, Chile is second with 246, followed by Colombia with 168, Peru with 144 and Argentina with 142.

Argentina, Chile and Colombia have each established enforcement departments with 8-10 employees, while Peru spreads enforcement activities across two divisions, and Brazil allows each of its 11 divisions to investigate and initiate enforcement complaints.

All five countries have detailed systems and procedures for ensuring due process. Decisions to fine or sanction are taken by the securities commission board in Argentina and Brazil, whereas this authority in Colombia is provided primarily to the Superintendent-Delegate for Investigations (with additional sanction authority provided to the Superintendent of Securities). In Chile it is handled by a 3-person committee comprised of the securities commission chair, deputy head and legal department head; in Peru an administrative court makes the initial decision, which may be appealed to the commission board.

Fines and Sanctions

One of the most striking differences across the five countries surveyed is evident in relation to the level and type of fine and sanction activity taking place in each country. This section focuses mainly on fines because of the greater ease of quantifying and comparing practices, since only certain countries provided a detailed breakout of other types of sanctions that they imposed. It has also been pointed out that much enforcement-related activity can be preventative, offering guidance to ensure that companies comply with the law, rather than imposing fines or sanctions for breaking the law.

Brazil reported far more enforcement activity in this category than any other country – more than 5,400 fines imposed by CVM over 3 years. Most of this activity involved what are called "obligatory fines", which are financial charges imposed whenever somebody fails to attend to, or causes a delay in complying with, any CVM order of any type. These fines averaged a little over US$1,000 each, ranging from a low of US$8 to as much as US$34,511. A second category of fines are issued as an outcome of an administrative inquiry or punitive administrative procedure, of which 313 were imposed from 2001-2003. Fines from these administrative procedures could be far more significant, with the highest fine in 2002 set at US$22.4 million. While some fines in this category were as low as $359, they averaged US$220,935 over the 3-year period.

Brazil, Chile and **Colombia** appear to have the greatest possibility to issue high levels of fines, given their authority to impose fines at a level that is a percentage of the value of the operation. For **Chile**, this has culminated with the US$55 million fine imposed in the Chispas case. In **Colombia**, on the other hand, the highest fine issued over the past three years has been US$51,000.

In practice, the average amount for fines can vary substantially, as it did in **Chile** between US$2257 in 2002 and US$77,022 in 2003. **Argentina** (US$7,000-10,000), **Colombia** (US$9,000) and **Peru** (US$10,621) experienced similar levels of average fines over the last three years.

It was clear from the questionnaire results that many fines and sanctions were appealed in court. For example, in **Argentina**, nearly all fines are appealed in practice: 29 out of 32 since 2001. Argentina has had remarkable success with its cases in court, having no rejections over the last three years. Its resolutions in these cases have been upheld 18 times, with the other 11 still pending. However, actually collecting the fines appears to be more difficult, with just 13 collected from 2001-2003. Most sanctions that have been appealed have also been either upheld by the courts or are still pending.

Brazil's CVM had mixed success in the appeals process. Looking at fines resulting from administrative and punitive procedures, some 267 fines were appealed between 2001-2003; only 20 of these rulings have been reversed, whereas 90 have been maintained as originally issued and another 108 have been modified in final rulings. Others are still pending. More striking and perhaps disappointing for CVM is the fact that actual fines collected in this category were relatively low: 57 fines over 3 years, averaging less than $2,000 each -- far below the initial average imposed of US$220,000. In the more numerous "obligatory fines" category, CVM has succeeded in collecting 1,571 fines over 3 years, averaging about US$1,000 each, while 1,712 fines in this same category were "cancelled" by a superior administrative or judicial body.

Colombia, Chile and Peru have had fewer legal challenges to their fines and sanctions:

- In **Colombia**, just one fine out of 20 was appealed in 2003, and just 9 appeals occurred out of 82 fines issued over the last three years. The other 73 have all been collected.
- In **Chile**, six cases have been appealed in the courts over the last three years, with a ruling in SVS' favour in the significant Chispas case, 1 ruling against, and four pending. During this same period, 41 out of 85 fines have been paid.
- In **Peru**, out of 128 fines and sanctions issued over the last three years, just 22 have been appealed. The process of resolving these has been relatively slow, with 1 case upholding Conasev's position, and the other 21 still pending in the courts.

Judicial Capacity

Judicial capacity is seen as a key factor in strengthening corporate governance enforcement. However, respondents to the questionnaire in all five countries suggested that most or all judges lack training in financial and capital markets issues. Specialized commercial courts are seen as one way to promote greater judicial expertise on these issues, but only **Brazil** has established such a court, with the initiation of a specialized commercial court in Rio de Janeiro that has not been replicated elsewhere in Brazil.

Significant variation in the length of court appeals processes was evident in the five countries surveyed. **Argentina** and **Peru** reported slightly shorter appeals processes than the others of 1-3 years in the lower courts, and one year or more at the Supreme Court level. **Chile** and **Colombia** suggested that 2-3 years were necessary in the lower courts, with another 2-3 years in Chile at the Supreme Court level, and 4-6 years in Colombia. **Brazil** reported varying lengths of time depending on the jurisdiction, with Sao Paolo taking up to 6 years, and even longer if the appeal reaches the Supreme Court; in Rio de Janeiro the initial court process takes 3 years.

Arbitration

The Latin American White Paper on Corporate Governance promotes alternative mechanisms for dispute resolution such as private arbitration as one way to achieve more efficient resolution of shareholder disputes. Private arbitration for corporate disputes between companies and shareholders is permitted in all five countries, but in countries such as **Argentina** and **Chile** its use is mainly limited to addressing private disputes. **Brazil**, **Colombia** and **Peru** appear to have promoted the use of arbitration for settlement of shareholder disputes more actively, with Peru reporting a significant increase in its use. Brazil through its Novo Mercado listing rules requiring that companies commit to the use of private arbitration for the settlement of disputes has established explicit incentives for its use, but so far these listed companies have not made use of this provision in practice.

Self-regulatory institutions

Major differences were reported across the five countries in the volume of enforcement activity carried out by their stock exchanges. **Bovespa** clearly had the most active oversight record among the five countries' stock exchanges, reporting 336 suspensions of trading of listed companies over three years. Bovespa also reviews listed company information and transactions on an ongoing basis and has "cancelled" more than 74,000 transactions over three years that it considered to have atypical price and volume fluctuations or other indicators outside of normal parameters. These transactions are submitted to an auction instead. Bovespa also stresses that much of its actions are preventive in nature, involving thousands of formal requests for clarification each year, more than 200 reports sent annually to CVM, and a range of auditing and checking practices at brokerage firms.

Argentina, Colombia and **Peru** had the second most active enforcement activities among self-regulatory institutions. The Buenos Aires Stock Exchange reported 25 suspensions of trading over three years. **Colombia**'s stock exchange issued 4 sanctions on its members and their staff in the last year, and 32 in the last 3 years. The commodities exchanges imposed 15 sanctions on their members in the last year, and 46 in the last two years. The Lima Stock Exchange reported 16 sanctions over three years, and 96 claims and accusations made by clients of broker dealers, 15 of which led to administrative investigations.

Chile reported just one sanction applied in the last three years, and 7 investigative procedures.

Actions by Institutional Investors

The Latin American White Paper encourages the emergence of active and informed owners, citing the role of institutional investors such as pension funds as a particularly important potential influence on corporate governance practices. The questionnaire focuses especially on the role of pension funds, given the significant role that they play in Latin American economies in providing capital, including capital invested in equities.

Chile's pension funds are the most developed, with US$46.8 billion representing more than 50% of that country's GDP, and regulations that establish five levels of risk related to percentage of equity holdings ranging from 0 to 60% (with actual percentage of pension funds invested in equities averaging 13% across the five). **Peru** has recently adopted a new approach similar to Chile's, moving from an overall ceiling of 35% investment in equities to establishment of three risk levels for investment in equity from 10 to 80%. While overall pension fund holdings in Peru (US$6.4 billion) represent just 11% of GDP, approximately 35% of these holdings are currently invested in the stock market.

Brazil has the largest overall amount invested in pension funds (US$74 billion, or 15% of GDP), with 27 percent invested in equity. Brazilian pension funds which are normally restricted to a 35% ceiling for equity investments are allowed to invest up to 45% for Novo Mercado level 2 investments, and up to 50% for companies with the highest corporate governance standards at level 1.

Argentina's (US$16 billion) and **Colombia**'s (US$10 billion) pension funds are more limited in terms of percentages invested in equities, at 10% and 4% respectively, and corporate governance-related activities were reported as being more limited.

Chilean law and regulation appears to be most extensive in outlining a responsible role for pension funds in promoting good corporate governance. Chilean pension funds are required to attend and vote in shareholder meetings, and through cumulative voting practices, they can have a significant influence in appointing directors. Many of the largest have adopted explicit policies to appoint independent directors, and out of 643 directors integrated into Director or Audit Committees, 44% are considered to be independent. Pension funds also normally play an active role in takeover and asset-selling processes. Despite the prominent role of pension funds in company governance, some restrictions remain that limit their ability to influence governance practices in Chile. For example, pension funds are not permitted to consult among themselves in advance of voting decisions.

Peru also reported significant pension fund activity related to corporate governance. For example, pension fund regulations specify that they should apply the principles of good corporate governance and the best practices available in the conduct of their business. For board elections, they cannot vote for candidates who are shareholders, directors, managers or employees of the pension fund administrator, they must report on their voting records, and to report beginning in 2004 on how they follow Peruvian corporate governance principles. They are also active in takeover and asset selling processes.

Brazil has fewer regulatory requirements for pension funds, but its three largest funds have adopted corporate governance codes. However, it was also noted that pension funds normally elect directors with a relationship to the pension fund itself, such as a pension fund employee, which therefore may not be seen as fully independent. Asset managers for investment funds have played a more active role in promoting independent directors.

Comparative Data on the Enforcement Framework for Argentina, Brazil, Chile, Colombia and Peru

		Argentina	Brazil	Chile	Colombia	Peru
1.a.	**Administrative level**					
	Main enforcement body	CNV	CVM	SVS	Supervalores	Conasev
	Length of term for chair?	7 years	5 years	No fixed term	No fixed term	3 years
	Appointed by?	Exec. Branch	President	President	President	President
	Can be removed?	For major offence	If convicted	Yes, freely	Yes, freely	For major offence
	Budget	US$2.64 million	US$25.8 million	US$9.08 million	US$5.4 million	US$7.86 million
	Number of employees	142	363	246	168	144
	Supervised entities:	429	9208	3904	503	363
	Note: overall numbers not comparable due to different types of entities supervised in each country.					

		Argentina	Brazil	Chile	Colombia	Peru
1.b.	**Administrative procedures and sanctions**					
i.	Principal offences	See country questionnaire results for detailed summaries -- relatively similar list for most countries.				
ii.	How many in enforcement dept.?	10	Each division enforces	8	9	No. 2 divisions investigate.
iii.	Due process to sanction?	Yes	Yes	Yes	Yes	Yes
iv.	Who is authorized to sanction?	CNV board	CVM board	SVS Head Deputy Chair and legal head	Superintendent- Delegate for Investigations	Conasev administrative court. Appealable to board
v.	<u>Fines issued</u>					
	2001	4	2378	13		
	2002	18	1347	4		
	2003	5	1697	68*	20	48 fines
	Last 3 years	27	5422	85	82	128 fines & sanction
				*16 significant in 2003		
vi.	<u>Amount of fines</u>					
	Highest permitted	US$500,000	US$171,000 x3 or 50% of operation or 3x amount gained through violation.	US$387,500 x3 or 30% of operation.	Repeated fines of US$15,000, or % of transac.	USD280,000, but max 10% of offender's income.
	Highest actual	US$267,000(2004)	US$22.4 mil. In 2002	Chispas US$55million	US$51000	
	Lowest in practice	US$2,000 (2002)	US$8	No minimum	No minimum	US$914
	Average in practice	US$7-10000	US$220,935 for punitive fines	US$77022 in 2003 US$2257 in 2002	US$9000	US$10621 in 2003
vii	Fines collected					
	2001	2	609			
	2002	2	420			
	2003	9	568	38	19	33
	Last 3 years	13	1597	41	73	NA
viii.	Appeals dismissed or upheld	Data complex due to time lags and many categories of sanctions, not easily comparable. See individual country results for details.				

		Argentina	Brazil	Chile	Colombia	Peru
c.	**Judicial Power**					
i.	Are most judges trained on Financial and Capital Markets?	No special training but commercial forum in place.	No	No, not most	No specific sector trained	Most no special training.
ii.	Are there specialised courts for Capital Markets?	No	Yes, specialized comm. court in Rio	No	No	No
iii.	How long do appeals processes last?	1-3 years at lower court, 1+ at Supreme Court	6 yrs. in Sao Paolo, 3 yrs in Rio Longer if appealed to Supreme	2-3 years at lower court, 2-3 at Supreme	1st 2-3 years 2nd 4-6 years	1st 1-2 years 2nd 8-18 months 1-2 years Supreme
d.	**Private Enforcement**					
i.	Is private arbitration available for corporate disputes between companies and shareholders?	Yes	Yes	Yes	Yes	Yes
ii.	Private or public disputes?	Private	Both permitted, but normally private	In practice, private	Both included	Both
iii.	Are shareholder conflicts solved through private arbitration?	Yes	Yes	Allowed, but not in practice	Some cases, but no data	Yes, use increasing

		Argentina	**Brazil**	**Chile**	**Colombia**	**Peru**
e.	**Self-regulatory, stock exchanges**					
i.	How many sanctions applied:	Buenos Aires Stock Exchange	Bovespa		Colombian Stock Exchange	Lima Stock Exchange
	Last year?	5 suspensions	68 suspensions 16336 transactions cancelled		4 on securities intermediaries.	1
	Last three years?	25 suspensions 3 cancellations of authority to negotiate securities	336 suspensions 74400 cancellations of transactions	1 sanction	32, including one related to use of privi-leged info.	16 sanctions
ii.	Investigation procedures	Mercado de Valores	Bovespa		Commodity exch. and stock exch.	
	Opened last year	2	18,502 analyses of atypical transactions		1 each	23 complaints, 8 investigations
	Last 3 years	6	42,152 analyses of atypical transactions. These are informal procedures; if evidence of illegal behaviour, info sent to CVM	7	1 on stock 2 on commodity exchanges	96 complaints leading to 15 administrative investigations.

2		Argentina	Brazil	Chile	Colombia	Peru
	Emergence of Active and Informed Owners					
	Market indicators for Pension Funds					
	Portfolio of pension funds	USD16billion	USD 74 billion	USD46.8 billion	USD 12 billion	USD 6.4 billion
	% of GDP	15 %	15%	50+ %	12 %	10.7 %
	% invested in equity	10 %	27 %	Up to 60%, but actual amounts range from 9-21% in funds allowing equity investment.	4.9% (up to 30%)	35.5%
	% in Governmental debt	64 %			48%	
	% in Banking system	5 %				
	% in Investment funds	2.5 %				
	Equities, debt and funds abroad	9 %				
	Market indicators for other investment funds					
		Investment Funds		Insurance companies	Securities intermed, funds	Insurance companies
	Portfolio	USD1.7 billion			USD2.5 billion	USD 1.6 billion
	% of GDP	1.6 %		18 %	2%	2.7%
	% invested in equity	9.5 %				
	Mutual funds % of GDP			9 %		3.4%
	Close-ended invest funds % of GDP			2 %		

		Argentina	Brazil	Chile	Colombia	Peru
2a.i.	**I.I. actions and constraints to support better cg?**					
	Are they allowed to invest in equity?	Yes, 1 type	Yes, up to 35%, or up to 45-50% for Novo Mercado Lev. 1-2	Yes, 5 levels of equity risk offered (0 to 60%)	Yes, up to 30%, but minimum yield limit requirements.	Yes, PFs offer 3 levels of equity risk (10% to 80%), up to 35% overall.
ii.	Allowed or required to vote in Shareholder meetings?	They have right but no obligation	Not required, but must report on voting	Yes, duty to attend and vote	Allowed but not required	Allowed; registered in minutes.
iii.	Do PFs have CG Code?	No	3 largest do	Some developing codes, rules for board selection.	No code required but law sets some requirements	No, but regulations call on PFs to apply good corporate governance.
iv.	Do they elect independent directors?	No obligation, Some issuers have granted right	Asset managers do, PFs elect directors often related to PFs	Yes	In a few cases	Yes, increasingly. Statute for PF election of indep. directors under development.
v.	Are independent directors elected by PFs integrated into Audit Committee?	Audit Com. must have majority of indep. directors	PF-elected directors usually linked to PFs	Yes, through cumulative voting, 44% independent	No audit com. required	Only 2 cases
vi.	Are they active in takeover or selling assets processes?	Not particularly	Not feasible for takeovers, but block trading frequent	Yes	Mostly no	Yes
vii.	Does PF regulation require corporate governance standards?	No	Yes, can invest higher % in companies complying with higher Bovespa cg standards.	No, but fiduciary responsibility as managers, voting	Yes in many aspects, e.g. director indep., prohibiting self-dealing	Yes, required to follow good CG practices and beginning in 2004 report on how they applied them.
viii.	What constraints or incentives for active ownership?	No particular constraints but no regulatory incentives	PFs not constrained but must achieve minimum return or face investigation.	PFs not allowed to consult among themselves on votes.	No constraints or incentives	Limits on investment per issuer may constrain ability to elect board members