SYMPOSIUM ON BUILDING THE FINANCIAL SYSTEM OF THE 21ST CENTURY:
AN AGENDA FOR LATIN AMERICA & THE UNITED STATES
HARVARD LAW SCHOOL, CAMBRIDGE, MA • JUNE 13–15, 2008

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FIRST ANNUAL SYMPOSIUM ON BUILDING THE FINANCIAL SYSTEM OF THE 21ST CENTURY:

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FRIDAY, JUNE 13

17:40 Assemble in main lobby of The Inn at Harvard to walk to Caspersen Room

18:00-18:10 **GREETINGS** – Caspersen Room, 4th floor of Langdell Hall

Hal S. Scott, Nomura Professor and Director, Program on International Financial Systems (PIFS), Harvard Law School
Ary Oswaldo Mattos Filho, Dean, Fundação Getúlio Vargas, School of Law

18:10-18:50 **KEYNOTE ADDRESS** – Caspersen Room, 4th floor of Langdell Hall

Maria Helena Santana, Chairperson, Comissão de Valores Mobiliários, Brazil
Introduced by: Thomas Decoene, President, Itaú Securities, Inc.

Brian O'Neill, Deputy Assistant Secretary for the Western Hemisphere, U.S. Department of the Treasury
Introduced by: Merilee Grindle, Edward S. Mason Professor of International Development, Kennedy School of Government; Director, David Rockefeller Center for Latin American Studies, Harvard University

19:00-19:45 Cocktail Reception – Adolphus Busch Hall, 29 Kirkland Street

19:45-21:30 Dinner – Adolphus Busch Hall, 29 Kirkland Street

21:30-24:00 After-Dinner Cocktails – The Inn at Harvard

SATURDAY, JUNE 14

7:00-7:50 Breakfast Buffet – The Inn at Harvard
7:00-7:50 Breakfast Meeting of Panelists, Reporters, and Facilitators (Please sit at the specified tables.)

7:50 Assemble in main lobby of The Inn at Harvard to walk to Austin Hall

8:10-8:25 **WELCOME & OPENING REMARKS** – Austin North, 1st floor of Austin Hall

Hal S. Scott, Nomura Professor and Director, Program on International Financial Systems (PIFS), Harvard Law School
Antonio Dieck, Dean, Graduate School of Business Administration and Leadership, EGADE of Tecnológico de Monterrey

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8:25-8:45 **PANEL SESSION** – Austin North, 1st floor of Austin Hall

Topic 1: Corporate Governance

Latin America Panelist: Jorge Familiar, Executive Director, Central America, Mexico, Spain and Venezuela, World Bank Group

U.S. Panelist: Mark Taborsky, Managing Director/External Management, Harvard Management Company, Inc.

8:55-10:10 **SMALL GROUP SESSIONS**

Room	*Facilitator*	*Reporter*
1	Nora Rachmam, Maria Casas	Bruno Meyerhof Salama
2	Carlos A. Barsallo, Jordan Siegel	Thomas S. Heather
3	Shamaila Khan, Ary Oswaldo Mattos Filho	Mike Lubrano
4	Fernando Jiménez de Aréchaga, Michel Tulle	Rodrigo Olivares-Caminal
5	Facundo Gómez Minujín, Álvaro Clarke	Mercedes Pacheco

10:15-10:25 Refreshment Break – Austin Rotunda

10:25-10:45 **PANEL SESSION** – Austin North, 1st floor of Austin Hall

Topic 2: Global Financial Stability—The Impact and Control of the Liquidity and Credit Crises

Latin America Panelist: José Miguel Barros, Senior Partner, LarrainVial S.A.

U.S. Panelist: Jose-Luis Guerrero, Chief Executive Officer, Head of Global Markets Americas, HSBC, U.S.

10:55-12:15 **SMALL GROUP SESSIONS**

Room	*Facilitator*	*Reporter*
1	Luis de Gárate, Gordon F. Kingsley, Jr.	Mike Lubrano
2	Jorge Perez-Maldonado, Thomas J. McDonald	Thomas S. Heather
3	Jaime de la Barra, Manuel Garciadiaz	Bruno Meyerhof Salama
4	Antonio Dieck, Maurella R. van der Ree	Rodrigo Olivares-Caminal
5	Lucia Skwarek, Pedro García	Mercedes Pacheco

12:20-13:25 Lunch – John Chipman Gray Room, 2nd floor Pound Hall

KEYNOTE ADDRESS

Héctor Medina, Executive Vice President of Planning and Finance, CEMEX, Mexico

Introduced by: Antonio Dieck, Dean, Graduate School of Business Administration and Leadership, EGADE of Tecnológico de Monterrey

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13:30-15:00 **PANEL SESSION – PLENARY DISCUSSION ONLY** – Austin North, 1st floor of Austin Hall

Topic 3: The Role of Private Pools of Capital in the Latin American/U.S. Capital Markets

Latin America Panelist: Guillermo Larraín Ríos, Chairman, Superintendencia de Valores y Seguros

Latin America Panelist: Luiz Francisco Novelli Viana, President & Partner, TMG Capital Partners

U.S. Panelist: Arturo Estrada, Managing Partner, Financial Advisory Services, Deloitte

U.S. Panelist: Kenneth Rogoff, Thomas D. Cabot Professor of Public Policy, Department of Economics, Harvard University

15:00-17:45 Free Time & Reporters Meeting

15:05-16:30 Boston Duck Tour – Reservations required, meet in front of Austin Hall

17:50 Assemble in main lobby of The Inn at Harvard to walk to The Faculty Club

18:00-18:45 **KEYNOTE ADDRESS** – The Faculty Club, 20 Quincy St.

Guillermo Babatz Torres, President, Comisión Nacional Bancaria y de Valores, Mexico
Introduced by: Roberto Danel, Chairman, Corporate Best Practices Committee of the Business Coordinating Council

18:45-19:45 Cocktail Reception – The Faculty Club, 20 Quincy St

19:45-21:30 Dinner – The Faculty Club, 20 Quincy St

21:30-24:00 After-Dinner Cocktails – The Inn at Harvard

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SUNDAY, JUNE 15

7:00-7:50 Breakfast Buffet – The Inn at Harvard

7:00-7:50 Breakfast Meeting of Chairs and Reporters (Please meet in the Boardroom, 1st floor of The Inn at Harvard)

7:50 Assemble in main lobby to walk to Austin Hall – The Inn at Harvard

8:10-9:15 **PRESENTATION & DISCUSSION** – Austin North, 1st floor of Austin Hall

Topic 1: Corporate Governance

Latin America Chair: Roberto Danel, Chairman, Corporate Best Practices Committee of the Business Coordinating Council

U.S. Chair: Raul J. Valdes-Fauli, Managing Partner, Fowler Rodriguez Valdes-Fauli, LLP

NO BREAK – PLEASE REMAIN IN ROOM

9:15-10:15 **PRESENTATION & DISCUSSION** – Austin North, 1st floor of Austin Hall

Topic 2: Global Financial Stability—The Impact and Control of the Liquidity and Credit Crises

Latin America Chair: Ary Oswaldo Mattos Filho, Dean, Fundação Getúlio Vargas, School of Law

U.S. Chair: Laura Alfaro, Associate Professor of Business Administration, Harvard Business School

10:15-10:30 Refreshment Break – Austin Rotunda

10:30-11:30 **PRESENTATION & DISCUSSION** – Austin North, 1st floor of Austin Hall

Topic 3: The Role of Private Pools of Capital in the Latin American/U.S. Capital Markets

Latin America Chair: Guilherme da Nobrega, Chief Economist, Itaú Securities, Inc.

U.S. Chair: Samuel Libnic, General Counsel & Managing Director of Latin America, Citigroup Latin America and the Caribbean

11:30-13:00 Closing Lunch – The Inn at Harvard

First Annual Symposium on Building the Financial System of the 21st Century:

An Agenda for Latin America and the United States

Harvard University, Cambridge, Massachusetts • June 13-15, 2008

Laura Alfaro	Associate Professor of Business Administration, Harvard Business School, U.S.
Guillermo Babatz Torres	President, Comisión Nacional Bancaria y de Valores, Mexico
Ricardo Baldin	Partner, PricewaterhouseCoopers Auditores Independentes, Brazil
José Miguel Barros	Senior Partner, LarrainVial, S.A., Chile
Fernando Barros Tocornal	Partner, Barros & Errazuriz Abogados, Chile
Carlos A. Barsallo	Director of Risk, Ethics & Independence, Deloitte, Panama
Sherman G. Boone	Assistant Director, Office of International Affairs, U.S. Securities & Exchange Commission (SEC), U.S.
Gregorio G. Canales	Managing Partner, Canales Zambrano, S.C., Mexico
Michel Canta	Chief Economist, Research Department, Superintendency of Banking and Insurance of Peru, Peru
Eugenio Cárdenas	Partner, Corporate and Financial Law, Benitez, Ruiz, Falce & Cárdenas, Mexico
María Casas	Partner, Baker & McKenzie, S.C., Mexico
Álvaro Clarke	Director, Corporate Governance and Capital Markets Center, U. de Chile KPMG/ Clarke & Asociados, Chile
Antônio D.C. Castro	President, Associação Brasileira das Companhias Abertas (ABRASCA), Brazil
Guilherme da Nóbrega	Chief Economist, Itaú Securities, Inc., Brazil
Roberto Danel	Chairman, Corporate Best Practices Committee of the Business Coordinating Council, Mexico
Luis de Gárate	Director, Graduate Programs in Finance, EGADE de Tecnológico de Monterrey, Mexico
Jaime de la Barra	President, Compass Group, Chile
Thomas Decoene	President, Itaú Securities, Inc., U.S.
Alberto Diamond	Senior Partner, KPMG Central America, S.A., Panama
Antonio Dieck	Dean, Graduate School of Business Administration and Leadership, EGADE de Tecnológico de Monterrey, Mexico
Nelson Eizirik	Partner, Carvalhosa & Eizirik, Brazil
Jorge Errázuriz	Vice Chairman, Celfin Capital, Chile
Arturo Estrada	Managing Partner, Financial Advisory Services, Deloitte, Mexico
Jorge Familiar	Executive Director, Central America, Mexico, Spain, and Venezuela, World Bank Group, U.S.
Sergio J. Galvis	Partner, Sullivan & Cromwell, U.S.
Pedro García	Partner, Morales & Besa Abogados, Chile
Manuel Garciadiaz	Partner, Davis Polk & Wardwell, U.S.
Facundo Gómez Minujín	Managing Director, Head of Legal & Compliance for Latin America, JPMorgan Chase Bank, Argentina

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Jonatan Graham Canedo	International Lawyer, Cleary, Gotlieb, Steen & Hamilton, U.S.
Jose-Luis Guerrero	Chief Executive Officer, Head of Global Markets Americas, HSBC, U.S.
Thomas S. Heather	Partner, White & Case, S.C., Mexico
Fernando Jiménez de Aréchaga	Partner, Jiménez de Aréchaga,Viana & Brause, Uruguay
Shamaila Khan	Managing Director, TIAA-CREF, U.S.
Gordon F. Kingsley, Jr.	Managing Director, Forum Asset Management, LLC, U.S.
Alberto Kiraly	Managing Director, BES Investimentos, S.A., Brazil
Susan Knapp	Managing Director, Moody's Investors Service, U.S.
Maurice Kugler	Visiting Professor of Public Policy, John F. Kennedy School of Government, Harvard University, U.S.
Daniel Laniado	Partner & Managing Director, Strategy Consulting Mexico and Latin America, Deloitte, Mexico
Guillermo Larraín	Chairman, Superintendencia de Valores y Seguros, Chile
Samuel Libnic	General Counsel & Managing Director of Latin America, Citigroup Latin America and the Caribbean, U.S.
Mike Lubrano	Managing Director, Corporate Governance, Cartica Capital, LLC, U.S.
Ary Oswaldo Mattos Filho	Dean, Fundação Getúlio Vargas, School of Law, Brazil
Thomas J. McDonald	Chief Strategic Officer, Equity International, U.S.
Héctor Medina	Executive Vice President of Planning and Finance, CEMEX, Mexico
Paulo de Lorenzo Messina	Partner, Leoni Siqueira Advogados, Brazil
Luiz Francisco Novelli Viana	President & Partner, TMG Capital Partners, Brazil
Brian O'Neill	Deputy Assistant Secretary for the Western Hemisphere, U.S. Department of Treasury, U.S.
Rodrigo Olivares-Caminal	Associate Professor, University of Warwick, U.K.
Mercedes Pacheco	Executive Director, Senior Legal Counsel, Santander Investment Securities, Inc., U.S.
Patricio Parodi	Chief Executive Officer, Consorcio Financiero, S.A., Chile
Jorge Perez-Maldonado	Management Director, Metrofinanciera, S.A. de C.V. SOFOM, E.N.R., Mexico
Jean Polgar	Vice President, Wellington Management Company, LLP, U.S.
José Eduardo Carneiro Queiroz	Partner, Mattos Filho Veiga Filho Marrey Jr. e Quiroga Advogados, Brazil
Nora M. Rachman	Chief Legal Counsel, Bovespa, Bolsa de Valores de São Paulo S/A (BVSP), Brazil
Kenneth Rogoff	Thomas D. Cabot Professor of Public Policy, Department of Economics, Harvard University, U.S.
Gonzalo Romero	Senior Analyst, Forum Asset Management, LLC, U.S.
Bruno Meyerhof Salama	Professor of Law, Fundação Getúlio Vargas, School of Law, Brazil
Maria Helena Santana	Chairperson, Comissão de Valores Mobiliários, Brazil

First Annual Symposium on Building the Financial System of the 21st Century:

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Harvard University, Cambridge, Massachusetts • June 13-15, 2008

Paul T. Schnell	Senior Partner, Head of Latin America Practice, Skadden, Arps, Slate, Meagher & Flom, LLP, U.S.
Hal S. Scott	Nomura Professor and Director, Program on International Financial Systems, Harvard Law School, U.S.
Diego Serrano-Redonnet	Partner, Perez Alati, Grondona, Benites, Arntsen & Martinez de Hoz (h), Argentina
Jordan Siegel	Assistant Professor, Harvard Business School, U.S.
Denise Simon	Senior Managing Director, Halbis Capital Management, Inc., U.S.
Lucia Skwarek	Investment Officer, Fintech Advisory, U.S.
Mark Taborsky	Managing Director/External Management, Harvard Management Company, Inc., U.S.
Guillermo Tagle	Chief Executive Officer, IM Trust, Chile
Pedro Paulo Teixeira	Partner, TMG Capital, Brazil
Michel Tulle	Senior Director, Franklin Templeton Investments, Argentina
Raul J. Valdes-Fauli	Managing Partner, Fowler Rodriguez Valdes-Fauli, LLP, U.S.
Maurella R. van der Ree	Chief Operating Officer, Latin America Asset Management, HSBC Investments, Inc., U.S.
J Weinstein	Deputy Director, Program on International Financial Systems, Harvard Law School, U.S.
Andrés P. Zenarruza	Counsel, Citibank Argentina, Argentina
Emilio Zuñiga	Vice President, Latin Pacific Capital, S.A., Peru

SYMPOSIUM REPORT

FIRST ANNUAL
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Overview

Leaders from the public and private financial sectors of Latin America and the United States gathered from June 13-15, 2008 at Harvard Law School for the first annual Latin America-United States Symposium, organized by the Program on International Financial Systems. Three distinct issues of mutual interest to both regions were discussed by the attending participants.

Session I focused on the effect of corporate governance on the development of financial markets and the different rules associated with the varying ownership structures present in the two regions: the closely-held Latin American firm in contrast with the widely-held American public enterprise. Participants also discussed the different approaches to corporate governance that the U.S. and various Latin American countries have taken—approaches that run the gamut from a system of tight regulatory controls to a principles-based method of self-regulation.

Session II considered global financial stability in specific regard to the liquidity and credit crises in the U.S. While acknowledging the crises' limited direct impact on Latin America, participants agreed that the situation reveals the need for higher levels of disclosure and stronger regulation of structured credit products.

Finally, Session III provided an in-depth discussion on the development of private pools of capital in Latin America. Participants engaged in a comparative analysis with the purpose of assessing the relative roles and importance of private equity in Latin America and in the United States. There was consensus that, given underinvestment and scarcity of capital in Latin America, private equity will be key to industrial growth and financial development in the region. It was concluded, as well, that strengthening investor protection through tighter corporate governance standards and the creation of institutions that enable private capital investment will be required.

Session 1: Corporate Governance

A. Different Rules for Different Ownership Structures

Aware of the many different aspects involved in the topic of corporate governance, Symposium participants narrowed the scope of the discussion to evaluate specifically the role of corporate governance in the development of financial markets. They took into special consideration Latin America's current need to achieve market integration and build adequate financial systems.

Participants agreed that significant support for capital markets in Latin America exists. Using the U.S. as a historical model of financial development, they agreed that the establishment and implementation of corporate governance rules and institutions would be the first step in protecting market integrity, attracting investment, and making way for further stages of progress. These further stages of progress were defined among others, as deeper stock markets, market competition, and diffuse ownership.

Higher corporate governance standards and rules have recently been introduced to the securities regulations of select Latin American countries (i.e. fiduciary duties, minority protection rules, tender-offer legislation and tag-along rights for sale of control, increased representation of minority shareholders on boards and disclosure of material information, etc.). Such measures may initially send a signal of investor protection and attract capital. Despite the inclusion of such measures, however, participants voiced concern that the basic preconditions that serve as a foundation to a financial market appear to be absent in Latin America, namely: secure property rights and enforceability of contracts. This is particularly the case in a closely-held corporate environment where a tradition of family business and state-owned firms persists, and where strong dominant owners are more likely to extract private benefits of control. Consequently, participants agreed that although the law may provide for substantial investor and minority protection rules, if basic property and contractual rights are not in place, and without enforcement and the presence of a strong judicial system, the development of strong markets will be hindered. Concern was also voiced regarding the lack of widespread corporate governance expertise and knowledge in the region, including a problem of semantics where there is no clear consensus on the meaning of the term corporate governance itself. The lack of incentives for intermediaries and the lack of market information for analysts are further challenges mentioned.

Nevertheless, it was concluded that some corporate governance is better than none, and that establishing higher standards and implementing them through the different regulatory and self-regulatory approaches available should gradually lead to a culture of investor protection favorable for financial market consolidation. A number of participants were impressed with those owners of Latin American firms who have sacrificed the private benefits of control in exchange for corporate governance benefits (including better access to financing, cost of capital reduction, and visibility). This is not the case in all emerging economies, and seems to signal a positive evolution of the family-owned enterprise in Latin America.

Participants discussed the different rules and principles of corporate governance in their respective countries, taking into special consideration how their markets have been evolving. It was evident that such rules vary distinctly based on the ownership structures of both regions: the closely held/family-owned Latin American firm in contrast with the widely-held American public corporation. However, in advance of analyzing the aforementioned rules and approaches, it was argued by some participants that a particular type of ownership structure should not be considered a necessary precondition to the development of financial markets, and that a closely-held corporate structure is not necessarily negative. The proof tendered was that a capital market may successfully exist in an environment of closely-held firms. Indeed, this is the hallmark of private equity. In fact, practically all of the public firms of Latin America have strong controlling owners (including consolidated multinational organizations). It was nonetheless acknowledged that a financial system in its further stages of development, like that of the United States, is likely to give rise eventually to a widely-held corporate structure. This diffuse structure drives strong demand for investor protection by stock owners and thus, further accelerates widespread support for capital markets. An indicator of this tendency, as pointed out by a participant, is the fact that the São Paulo Stock Exchange (BOVESPA) now has several issuers that are considerably widely-held.

The session identified the following differences in corporate governance rules and principles as they are applied to the United States and Latin America:

Voting Rules and Proxy Advice

Participants emphasized the importance of a strong voting system in the development of financial markets, as this gives shareholders a more active role and boosts firm performance. It was also noted that, given the vast number of dispersed shareholders that compose the American public firm, voting acquires a more significant role, with active proxy advice taking place. In a typical Latin American firm, this is less likely due to majority ownership; instead, non-voting shares of public firms in the market are the common trend. Though important, it therefore appears that voting only comes into play in more developed financial systems of dispersed ownership. It was concluded however that less developed markets with closely-held environments need not wait until reaching advanced stages before improving access to the ballot via more detailed regulation and proxy advisors. Reference was made to Brazil's creation of an "only voting shares exchange" through the Novo Mercado segment of BOVESPA.

In light of agency costs, participants noted that interest in voting may be diminished in the United States. For example, a single shareholder may lack the incentives and resources to engage in voting, let alone monitoring management. Furthermore, shareholders seldom have a majority in the U.S. public firm, and participants stated that, with few exceptions, there comes a point where no single individual or concentrated group may have enough capital to control a large public enterprise; such is the current case in the United States.

However, in response to those views, the point was made that the definition of control differs significantly in both regions. In Latin America, a 51% majority is required, but in the United States, a much lower percentage (along the lines of 10%-20%) may be enough to exercise control. In addition, it was noted that institutional investors, rather than individual shareholders, often carry the burden of costs associated with voting. Institutional investors are playing a more active and significant role in closely-held Latin American firms, with the case of CEMEX (Cementos Mexicanos) offered as an example, a company that is now partially owned by institutional investors. As institutional investors become more active, these new players will likely have an impact in the voting process of firms from less financially-developed Latin American countries.

Independent Directors

The recent spate of corporate governance provisions related to independent directors in both U.S. and Latin American legislation was a topic of discussion. The importance of firm monitoring through independent directors was noted. It was also clearly acknowledged by those present that the role of directors in the two regions differs significantly. For example, as provided by law, the Board of Directors has a very significant oversight role, being the primary decision-making body in U.S. corporate structures *(Delaware General Corporation Law § 141. "… (a) The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors…"),* whereas in Latin America this board tends to have a more symbolic role. Instead, the General Shareholders Meeting (Asamblea de Accionistas) is the supreme governance body.

Participants were concerned about the fact that new legislation in Latin American countries requiring independent directors on the boards of public companies and financial institutions is not consistent with the reality of closely-held ownership. In addition, this legislation was considered excessive by some since it requires extremely high independent director quotas (i.e. 25%) that in many cases issuers are not able to meet. In fact, it was emphasized that "so-called" independent directors are often appointed by the controlling owners simply to comply with the legal requirement.

Since there are not enough independent directors to satisfy the legal requirements, in many cases the same directors hold seats on boards of different firms, which often creates conflicts of interest. Additionally, as a result of certain Latin American legislation incorporating fiduciary duties of loyalty and care, potential liability has also contributed to a deterrence of directors. Furthermore, the scarcity of independent directors has led to a professionalization of the role with university courses offering certification. Some participants voiced their disapproval of this trend, since they fear that the true nature of the independent director may be lost in this process.

Nevertheless, participants acknowledged that independent directors indeed play an important monitoring and advisory role in the corporate governance of an organization and that particular consideration should be taken in adjusting the role of the

independent director to Latin American business culture. Participants predicted that, as Latin American financial markets develop and gradually shift towards widely-held ownership structures, independent directors will become more relevant.

Minority Shareholder Protection, Tender Offer Rules and Tag-Along Rights

As a result of its closely-held corporate environment, minority shareholder protection has been weak in Latin American countries. Some participants argued that, given the extent to which closely-held small and medium-sized private firms represent an important sector of the Latin American economy, minority protection is not truly relevant. For example, a typical firm may have 99% of its shares in the hands of a sole controlling owner, with a second shareholder (often the spouse with 1%), included merely to comply with the legal requirement.

It was nonetheless acknowledged that increased minority shareholder rights, particularly in the public firm, would help build a stronger financial system. In fact, as financial markets have developed, securities and stock exchange laws have been concurrently incorporating enhanced minority protection rules. The tag-along rights recently included in Brazilian law were held up as an example. New rules on public offerings regarding tag-along rights have also been added to the Mexican Stock Exchange Law (Ley del Mercado de Valores de 2006). In the case of this legislation, if there is a sale of control, the buyer is forced to extend its offer to all the shareholders of the target company regardless of the type of share (this applies even to shares with limited or restricted voting rights or non-voting stock.)

Participants argued that the reason behind these tag-along rights was more to provide minority shareholder protection than to promote a more active environment of tender offers and takeover activity.

B. Different Approaches to Corporate Governance

To analyze the different approaches used by public firms in the U.S. and Latin America in the adoption of corporate governance standards, participants engaged in a comparative exercise involving the United States, México, Brazil, and Chile. Two broad categories were involved in the discussion: (1)the issue of regulation vs. self-regulation (a subject that includes the adoption of specific rules and principles, the use of real cost-benefit analysis when legislating, and the role of corporate governance advisory firms) and (2)the importance of enforcement in achieving sound corporate governance and financial market development.

Regulation v. Self Regulation

Opinions diverged widely on the subject of regulation. Some participants believed that voluntary adherence to standards is insufficient and that rules are required for good corporate governance. Others concluded that imposing mandatory provisions is not always the answer, given that ethical behavior in relation to corporate governance cannot be regulated. Along those lines, participants mentioned that the recent introduction of substantive corporate governance rules in Latin American countries has not always been a popular and effective approach. For example, it was mentioned that México has produced good corporate governance legislation, but that it has not been well accepted by firms and in many cases has backfired; firms follow a “check-the-box” approach simply to comply with the legal requirements. Additionally, there were comments about corporate governance rules not being popular in Panama.

The absence of real cost-benefit analysis in the process of corporate legislation was also discussed. Such analysis could reduce compliance costs and the burdens attendant upon corporate governance requirements (an example being the excessive costs of compliance related to the certification of internal controls in terms of Section 404 of the Sarbanes-Oxley Act of 2002). The lack of cost-benefit analysis and appropriate corporate governance culture makes regulation even less attractive. Participants highlighted a successful example of voluntary corporate governance adoption in the case of CEMEX, which through its “CEMEX WAY” policy standardized its global operations (including internal controls) before the turn of the century. Consequently, the wave of substantive corporate governance provisions that arrived after 2002 did not represent a significant burden to the company.

The point was strongly made that leadership from all parts of the finance community, and especially from its new players, can make a significant difference. Corresponding authorities (primarily securities commissions, central banks and ministries of finance); private enforcers (including intermediaries such as analysts, consultants and brokers); associations of share owners; accounting and law firms; and perhaps most importantly, corporate governance advisory firms (which, with the exception of Brazil, do not exist in Latin America) should all be called upon to provide this leadership. Additionally, participants made reference to the important role played by stock exchanges in Latin America, including, among others, the Brazilian Novo Mercado

and the Bolsa Mexicana de Valores, which has fostered the gradual transition of Mexican SAPI/SAPIB firms (Sociedad Anónima Promotora de Inversión/Bursátil) towards higher corporate standards and public markets. As pointed out, such leadership should be promoted to further a culture of corporate governance awareness in Latin America. Many participants believe that a self-regulatory approach should be tried first, and that future legislation on the subject would then be better received.

The most frequently mentioned example was that of Brazil, which, in contrast to México, Chile, and even to the U.S., was considered highly self-regulated by participants. Participants highlighted Brazil's reliance on principles rather than rules, another aspect that puts its corporate structure in sharp contrast with the aforementioned countries. Brazil was held up as a model to follow, with the Novo Mercado offered as an important paradigm of self-regulation (and one that is in direct opposition to the U.S. regulatory trend). Emphasis was placed on the successful self-regulatory and enforcement mechanisms that Novo Mercado has established without the need for regulators or legislators. It was generally agreed that such an environment allows a firm to adjust its corporate governance to its own particular stages of growth and development. It was also noted that this can promote equitable treatment towards minority shareholders and the loosening of the private benefits of control.

Enforcement and Financial Market Success

Due to the presence of important securities authorities from Latin America at the Symposium, the topic of enforcement received special attention throughout the weekend. Effective enforcement was proffered as perhaps the most important factor in ensuring investor protection, attracting capital from overseas, and contributing to the overall success of financial markets.

Many commented on the link between the accomplishments of the São Paulo Stock Exchange (BOVESPA) and the tighter financial enforcement recently exercised by the Brazilian Securities and Exchange Commission (CMV-Comissão de Valores Mobiliários), including unprecedented intervention in recent high-profile insider trading prosecution cases. With a new division and a special team devoted to enforcement, the CMV has adopted stricter procedures allowing more successful prosecutions. Current regulation also defines illegal practices and crimes more clearly. Nevertheless, as described in the previous section, participants agreed that Brazil's success has relied more on the promotion of a solid self-regulatory environment and a principles-based approach, rather than enforcement, which was actually considered by participants to be much lower than enforcement in Chile, México, and of course the United States.
Participants did however comment again upon the inefficacy of corporate governance provisions and minority protection rules in the absence of elemental property and contractual rights and adequate enforcement by the courts. Several participants wondered why, with similar rules, Mexican markets have not yet had the success that Brazil has recently enjoyed. This is especially surprising considering the competent teams of the Mexican Banking and Securities Commission (Comisión Nacional Bancaria y de Valores-CNBV). Some considered, however, that CNBV is an administrative body

constantly being deterred from enforcing its sanctions by the Judicial branch. The CNBV has been deterred from enforcing its sanctions given the unreasonable use of the judicial remedies available to the party being sanctioned, including the ability to seek redress before a constitutional trial known as “Amparo”. Others noted that, despite its role of ensuring investor protection, the enforcement a securities commission may provide does not solely guarantee the success of a stock market.

Finally, as with self-regulation, a group of participants believed that regardless of the presence of effective enforcement, legal provisions will only be popular and in turn contribute to the development of financial markets when a cultural awareness for corporate governance prevails.

Session 2: Global Financial Stability—The Impact and Control of the Liquidity and Credit Crises

Although Latin American participants were not overly concerned that the liquidity and credit crises would directly affect their respective countries, they were nonetheless eager to study the causes leading to the crises with the goal of preventing or predicting similar future problems.

A. Transparency and Disclosure

It was clear to all that the crises were borne out of an extremely risky market environment that was created through the combination of excess liquidity, lax lending policies, and complex liquid and structured credit products (i.e. asset-backed securities such as collateralized debt obligations – CDOs). In addition to those elements, the asymmetry of financial information—an absence of disclosure—was listed as a prevailing cause and one that precipitated a lack of confidence.

In addition to the lack of transparency, overconfidence on the part of investors was noted as one cause of the crises; participants referred here to a fundamental macroeconomic problem, namely the greed inherent in human nature. The innovative and complex financial tools (i.e. asset-backed securities, structured credit products, off-balance sheet vehicles etc.) that were created to sustain this system were very difficult for the public to understand given their intricacy. Participants believed there is a lesson to be learned: investors must acquire an awareness of true risk and be willing to shoulder hazard when necessary so long as there is an environment of adequate clarity and information available to them.

Overall, it was concluded that there should be more disclosure by issuers about their offerings. Participants also believed that investors should be more transparent regarding their holdings, and that banks should have to disclose their positions. Special focus was placed on the negligence of credit rating agencies and the lack of transparency in their methodology. Many believe such agencies have practically lost all credibility and that there is little use in further regulating them. They were compared more than once to the accountants and auditors involved in the 2001 corporate debacles. Participants agreed that less dependency on credit rating agencies should be the norm in the future.

It was agreed that disclosure about monetary policy by authorities, including the Federal Reserve and the U.S. Treasury, should also be increased, including more information on asset prices and inflation control, as well as on the liquidity to the different sectors of the economy.

B. Regulation

Although it was not clear to participants what specifically should be regulated as a result of the liquidity and credit crises, it was agreed that the pendulum will likely shift again towards regulation in the United States. Discussion focused on the temptation of the U.S. federal government to over-regulate the market, considering how it has reacted to crises in the past. The potential for rushed and excessive legislation, such as the wave that occurred in response to the 2001 corporate scandals with Sarbanes-Oxley, was a concern for participants. There was even concern that this potential legislative contagion could spread into Latin America. An alternate view was that such a phenomenon could be positive, as there are Latin American countries with little or no regulation on important subjects, including credit rating agencies. Brazil and Chile were singled out as countries that would benefit from further regulation as they move towards more advanced stages of financial growth and development.

Participants agreed that the preferred response to the crises would prominently involve increased disclosure. There was also agreement that asset-backed securities such as CDOs should be further regulated, rather than banned. Furthermore, though not very clear, other issues to be considered for regulation were capital, liquidity, lending activity, trader compensation and leverage restrictions.

On implementing regulation there were different viewpoints. One line of reasoning argued that regulation would be the only way to acquire transparency on asset-backed securities. Others differed, stating that the system is already too regulated, with the crises having derived from heavily regulated financial institutions (banks), and not from less regulated segments (i.e. hedge funds). Though they agreed that it is always possible to put forth a complex set of rules, a principles-based approach was suggested.

Others supported a self-regulation model, reference again being made to Brazil's Novo Mercado. They insisted that self-regulation and a principles-based policy promotes business ethics and educates investors, and is therefore the key approach to follow, with others adding that it all comes back to implementing good corporate governance.

C. Monetary Policy and Bailouts

Participants wondered whether loose monetary policy paved the way for the housing bubble. It was observed that the sharp reduction of interest rates by the U.S. Federal Reserve, among other actions taken, precipitated subprime lending. When the capital markets turned down, interest rates were lowered, allowing for the stock market to improve. However, this pushed investment bankers to creatively manufacture or find instruments that would provide for higher return rates, actions that led to the crises. The question arose as to whether the Fed should control asset prices and inflation.

Federal bailouts of banks was also discussed. Some argued that, given economic national interest, the U.S. will always have a safety net and will never allow important financial institutions to go bankrupt (the same was held to be true for many Latin American countries, with specific reference made to Brazil). Other participants questioned the value of rescuing banks, as intervention fosters irresponsibility on the part of both lenders and borrowers.

There was considerable criticism of the U.S. government for allowing the housing bubble to grow so large before letting it burst and for the government's lack of will to allow citizens to suffer losses when necessary. Participants also wondered how long the liquidity facilities extended to banks by the U.S. Federal Reserve will remain in place. Some believed these measures were necessary in order to avoid systemic risk, while others questioned the consequences should the measures become permanent.

The group agreed that, despite being painful, the government has to allow people to take losses as soon as possible and avoid postponing a potentially worse future explosion. Many participants suggested that only through a structure of rewards and punishments will borrowers become more conscious and responsible; they believe that responsibility should be shifted from lenders to borrowers.

D. Impact on Latin America

Participants concluded that the liquidity and credit crises will have a limited direct impact on Latin America. For one thing, Latin America has very modest holdings of U.S. securitized debt. In addition, the securitization of certain Latin American countries had higher underwriting standards and/or better aligned incentives. The consensus was that Latin America currently enjoys a positive economic scenario that will help the region to avoid the adverse effect of the crises. Latin American countries have good reserves and enjoy considerable capital from exports, among other positive indicators. In addition, the pension fund system has allowed higher levels of savings, even higher than in the United States. It was observed that some countries have a capital surplus in their balance of payments, with Chile mentioned specifically. The successful housing industry in México was also mentioned as a positive sign.

The specter of fallout from the crises, even in an indirect manner, troubled many participants, but it was acknowledged that this situation is part of an economic cycle that has also provided benefits in the past. Nevertheless, to guard against potential secondary effects, it was agreed that Latin American financial authorities should monitor secondary effects during the next two to three years.

Translating the consequences into real terms was of interest to participants. It was acknowledged that the downturn in the U.S. economy caused by subprime lending could affect trade, foreign investment and commodity prices. One of the most troubling potential consequences could be a reduction in imports to the U.S. from Latin America, although this effect could be mitigated by an important internal market that will likely

continue to be very active. The point was made that Latin America may also face financial difficulties regarding the prices of oil, food, iron, etc., and that a commodities bubble may burst at any time.

Participants agreed that, although the crises will have to be dealt with directly by the U.S. at a national level, some international cooperation and consultation might come into play, particularly from Europe, as it is the region most affected after the United States. It was agreed that Latin American intervention would be quite limited in solving the crises, but that the situation will serve as an important lesson to the global finance community.

Session 3: The Role of Private Pools of Capital in the Latin American/U.S. Capital Markets

A. A Comparative Analysis

The final session of the Symposium focused on the importance of private pools of capital in light of Latin America's current need for a more developed private equity market. Participants conducted a comparative analysis between the United States and Latin America, with special attention paid to the case of Brazil since it possesses the most active private equity market in Latin America. In order to give a fuller picture of the region, the cases of México (where apparently a very low rate of private equity activity exists) and Chile were also examined.

The differences between the role of private pools of capital in the United States and Latin America were discussed in this session. In the first place, it was recognized that the United States has, at least until recently, enjoyed high liquidity in addition to an important array of debt instruments which have encouraged fundraising and investment. Given the access to easy credit, it was noted that private equity funds in the United States have increased considerably in size, carrying out massive and highly leveraged deals. In contrast, there was widespread agreement that underinvestment (bottlenecks and fragmented sectors) has been the case in Latin America, due to a scarcity of capital and debt instruments.

Furthermore, it was observed that a large number of U.S. managers have pursued highly leveraged deals with private capital in an auction-driven market that promotes competition for transactions. Latin America, on the other hand, has fewer managers with the incentive to pursue private equity deals, and smaller, less-leveraged and privately negotiated arrangements prevail. Nevertheless, participants commented that, at least according to the Latin American model, private equity without leverage does seem to work well. In fact, it was added that leverage is no longer an essential element in the value creation process advanced by managers who have significant ownership stakes.

One distinction made between the two regions was that private equity in the U.S. does not usually create new industries but rather reallocates assets, while in Latin America, private capital investments usually result in the creation of new industry segments. The point was made that private equity firms in the U.S. seem primarily to invest in already consolidated industries, with new companies usually created out of venture capital. Venture capital firms also generally fund smaller projects, in contrast with the large investments funded by private equity mega funds.

Venture capital has not been very common in Latin America as it is associated with high risk; particularly absent appropriate property rights and contract enforceability. However, due to its emerging stage, Latin America has made a priority out of industry growth, and private equity is becoming an essential means to that goal given the scarcity in capital. Hence, under such a scenario, it would seem that a new conception

of private equity may be taking shape in Latin America, where private equity is starting to play a very similar role to that of venture capital.

In the U.S., value creation and improvement in the internal rate of return is generally accomplished by corporate restructuring, which paves the way for going private deals. In Latin America, however, firm value often results from investing in growth and business creation, a process more likely to involve taking firms public.

B. Are Private Pools of Capital Good for Latin America?

While analyzing the different environments of the two regions in relation to private pools of capital, participants considered whether it was advisable for Latin America to move towards the U.S. model before attaining a larger level of economic development. General consensus held that in relation to private equity, Latin America is still in an emerging state. However, some asserted that private capital in the region is essential for further investment in growth, the creation of value, and the development of new industries.

The multiple benefits of private pools of capital were outlined in the session. Such capital provides a necessary supplement to local banks, even when those banks are generally healthy and experiencing consistent growth. Private pools of capital also require less protection since they are composed of more qualified investors; this is likely to promote financial innovation. In addition, they may serve as an important means of reducing information asymmetries between capital market investors.

Although a number of issues need to be addressed to further enhance its private equity markets, it was agreed that Latin America appears to be in a good position to attract capital. Structural reforms, including privatization, considerable improvement in capital markets regulation, and higher corporate governance standards have all contributed to this favorable situation. Sounder macroeconomic policies have attracted foreign investment and have, in turn, led Latin American investors to the international market.

C. Some Restrictions

Although private equity investors have become very interested in Latin American business, and transactions in this market have increased significantly, it was observed that it has nonetheless been difficult to bring a significant number of transactions to a close, at least in certain parts of the region. While noting that there does seem to be enough capital for investment in Latin America, participants pointed to certain restrictions and obstacles that might be deterring investment. The concentrated ownership structure common to Latin American business was presented as one considerable limitation, as it results in low sale of companies. Such low level of sales also results from the buy and hold strategies often adopted by dominant institutional investors such as pension funds and insurance companies.

It was noted that investors will only proceed with a business opportunity if they are assured of profit in return. If faced with an environment of flimsy investor protection and property rights and where contractual enforcement is not in evidence, they will look elsewhere. It was observed further that these factors hinder public offerings of start-up firms since they deter both the venture capital firm and the entrepreneur from entering into the necessary agreements, regardless of the existence of investor protection rules.

D. A Series of Recommendations

In order to command the attention of private equity investors, it was agreed that investor protection in the region needs to be strengthened. This can be achieved through firmer corporate governance rules and the creation of institutions that enable investment, such as those that have contributed to Brazil's incredible growth rate.

Given the scarcity of capital for investment, it was suggested that financial markets in Latin America depend too much on banks and that a more complex set of instruments is required. It was also pointed out that access to the stock markets is limited to low-risk firms, which more often than not are the large consolidated enterprises that comprise Latin American public markets (firms with a much higher average market cap). There is a small number of listed firms, and IPOs seldom take place; according to participants, this scenario limits going-private transactions thereby inhibiting the use of private equity**.**

Participants differed on the question of whether more regulation is needed to develop the Latin American private equity market. Some participants noted that certain funds that invest in private equity, such as mutual funds, are heavily regulated in the U.S., and that a sound institutional and regulatory framework for capital markets is likewise required in Latin America. However, others argued that, despite concerns about unregulated market segments such as hedge funds, problems often arise from regulated markets and further regulation is not always the answer. These participants pointed to the recent liquidity and credit crises in the U.S. as an example. But on the other hand, that it is also necessary to reduce capital controls.

Finally, there was a great deal of discussion in relation to the small and medium sized firms (PYMES – Pequeñas y Medianas Empresas) that represent an important sector of the Latin America economy. These firms are currently hindered by a lack of access to capital and appropriate financing, which results from the absence of basic corporate governance standards. It was suggested that private pools of capital will likely play a very relevant role in activating this important segment of the Latin American market making way for further financial development.

PRESENTATION OF FINAL PLENARY SESSION

Building the Financial System of the 21st Century:

An Agenda for
Latin America and the U.S.

Session I

Corporate Governance

Different Rules for Different Ownership Structures
(Majority Owned in Latin America, Widely-Held in U.S.)

U.S.	Latin America
Voting rules	More non-voting common
Role of directors	Independent directors less important
Tender offer rules	Tag-Along rights
Need for proxy advice	Voting less important
Protection of minority shareholders	More important, given dominant shareholders



Approaches to Corporate Governance

- Self-regulation v. Regulation
- Use of real cost-benefit analysis
- Performance orientation v. Check-the-box
- Role of corporate governance advisory firms
- Principles v. Rules
- Degree of enforcement



	U.S	Mexico	Brazil	Chile
Self Regulation (Listed Companies)	2	1	4	0
Real Cost-Benefit	1	1	1	1
Principles Rather Than Rules	0	1	5	0
Strength of Enforcement	5+	2*	1	3
Importance of Advisory Firms	3	0	1	1
Role of Institutional Investors**	3	1	2	3

*Also 2 in UK

**LA=mostly pension funds





Session II

Global Financial Stability—The Impact and Control of the Liquidity and Credit Crises

Transparency

- More need for disclosure by:
  - Issuers about offerings
  - Investors about holdings (hedge funds)?
  - Banks about positions
  - Rating agencies about methodology
- New model: less dependence on rating agencies
- Accounting principles
  - Consolidation
  - Fair market value



Build-to-Originate

- Less monitoring by the banks and inadequate monitoring by investors
- Who ends up with risk?
- Good that banks spread risk?
- Ban products like CDOs?—probably not, but need to strengthen role of regulation



Monetary Policy and Bailouts

- Did loose monetary policy create the housing bubble?
- Should the Fed control asset prices as well as inflation?
- Moral hazard
  - Fed bails out banks
  - Banks bail out clients
- More regulation…of what?
  - Capital (Bear Stearns had plenty of capital)
  - Liquidity
  - Activity (stop build-to-originate)
  - Limit trader compensation
  - Limit leverage (of hedge funds, commercial banks already limited by capital requirements)



Impact on Latin America

- Limited direct impact: little holding of U.S. securitized debt
- Mexican and Chilean securitization had higher underwriting standards and/or better aligned incentives
- But downturn in U.S. economy caused by subprime could effect trade, foreign investment, and commodity prices



National or International Response

- Principally national
- With international consultation and cooperation
- Limited role for Latin America but Latin America can learn from U.S. mistakes (leap frog)

Session III

The Role of Private Pools of Capital in the Latin American/U.S. Capital Markets

Private Pools of Capital

- Is more PE good for Latin America?
- What accounts for the low rate of PE activity in Mexico compared to Brazil (assuming the Deloitte survey results are representative of the Mexican market)?
- Why does PE in Brazil create new leading companies whereas PE in U.S. reshuffles assets?
  - U.S. PE separate from VC and VC does create new companies
  - U.S. PE gets lower multiples on sales due to unattractive public market exits
- Does bank-centric financial system pose an obstacle to private equity development?



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APPENDIX I

KEYNOTE ADDRESSES

GUILLERMO BABATZ TORRES

Keynote Address

Keynote Address

Guillermo Babatz Torres
President, Comisión Nacional Bancaria y de Valores, Mexico
Saturday, June 14, 2008

I would like to thank the organizers of the conference for the opportunity to speak this evening in front of such a distinguished audience.

"Healthy and competitive financial markets are an extraordinary effective tool in spreading opportunity and fighting poverty. Because of their role in financing new ideas, financial markets keep alive the process of "creative destruction" –whereby old ideas and organizations are constantly challenged and replaced by new, better ones. Without vibrant, innovative financial markets, economies would invariably ossify and decline." Rajan and Zingales, Saving Capitalism from the Capitalists.

- I think this quote very neatly synthesizes how a well-functioning financial system fosters economic progress and promotes equality of opportunities.

- I will take this opportunity to reflect on the kind of financial system our countries should strive for in the 21st century. To my mind, it should be a system characterized by its power to spread opportunities among the population. What do I mean by "spreading opportunities"? A financial system that makes it possible to:

    - Save when times are good or the person is in its most productive years;

    - Borrow in times of need, to finance education or to make relatively large acquisitions such as a home;

    - Facilitate transactions among individuals and businesses;

    - Fund productive projects either through equity or debt, and by productive I mean economically and socially valuable projects (infrastructure);

    - Protect our property against hazards, and our families and ourselves against illness or the loss of a family member;

    - Retire with an appropriate income during our old-age;

- To my mind, a well functioning financial system would make possible what I mentioned through the products and services offered by different sorts of financial intermediaries:

    - Large, medium or small;

    - Privately owned, state owned or mutually owned;

    - Banks, asset managers, credit unions, non-depository lenders, insurance companies, capital markets;

- … and this ideal financial system would be well balanced between different forms of intermediation.

- When we think about what the financial system in our country does, it becomes quite obvious how far we still are from the kind of financial system our societies need:

    - Many households, the majority of them in some of our countries, do not even have access to the most basic financial product such as a savings account or a debit card. Imagine living without access to a safe place to keep what you made this fortnight, or to need to travel with enough cash to last for the whole trip, cash that may be the result of six months or a year worth of savings;

    - Most of the families in the region cannot pledge their future income to buy a house, so they resort to saving for this purpose for ten years or more, or to informal housing markets where they will build their home incrementally and at very large costs;

    - Same thing goes for education, so smart, eager and hard working individuals miss out the opportunities of the information age because they could not borrow to support them through college;

    - Most households are not insured against the death of their income earners, making them unnecessarily vulnerable;

    - On the same footing, firms do not find the external resources they need to expand rapidly or to compete with larger, better equipped entities, thus inhibiting competition and retarding economic growth.

    - Or governments, be them local or national, cannot find the resources to build infrastructure that will enhance the development opportunities of local communities.

- As may already be clear by my comments thus far, I believe financial inclusion must be among our top priorities. For many years, government's efforts have centered around a system mainly aimed at the purpose of funding investment projects (mainly large investment projects), sometimes overlooking the importance of a wide access by the population to basic financial services. Gladly, this focus has strongly shifted in favor of financial inclusion during the last few years.

- Now, in order to build the financial system for the 21st century, we need to place solid foundations upon which to build it. To my mind those foundations are:
    1. Secure property rights and enforceability of contracts upon which any market economy is based.

    2. Macroeconomic stability.

    3. Clear regulation for financial intermediaries and markets. These regulations must address both prudential and conduct of business issues. They should also incorporate the legal framework to properly deal with failed intermediaries.

    4. Competition in the market place. Competition among peers (banks vs. banks, asset managers vs. asset managers, etc.), but also among different mechanisms to supply the financial product in question (bank loans vs. corporate debt; bank deposits vs. mutual fund accounts, private equity funds vs. IPOs, bank-based mortgage finance vs.

securitized-base mortgage finance, life insurance companies vs. fund managers, etc.), and competition among foreign owned and domestically owned intermediaries.

5. Basic infrastructure supported by industry-wide efforts to capture positive externalities on issues such as credit bureaus, payment and settlement systems, securities custody, exchanges, card systems, deposit insurance systems, etc.

6. Adequate supervision to limit the number of failed intermediaries, and mechanisms to swiftly deal with those that fail to prevent contagion and systemic collapse.

7. Effective consumer protection rules and supervision to limit fraud and abuse, as well as consumer education, which not only protects consumers but also enhances the competitive nature of the market place.

- We should note that these foundations may not be set up without active government participation. This is not to say that public sector must take upon itself the development of the system, and much less the provision of financial products. It is a task that requires a strong and committed public-private partnership.

- I already mentioned how financial systems throughout Latin America still are a far cry of what our economies and peoples need. However, we can objectively say that the last ten years, say… since the '97 Asian Financial Crisis, we have made great progress delivering better financial services and products, giving access to a larger share of the population and firms, and building the foundations for a modern financial system.

    - Just to mention a few examples of the kind of progress we have seen, we can mention how a larger proportion of the population is getting access to financial services, through correspondent banking in Brazil, or through microlending in Perú, Ecuador and Bolivia, or via mortgage loans for social housing in Mexico.

- On my next comments, I will be referring to what has happened in Mexico over the course of the last few years in terms in our efforts to set up these foundations for an efficient financial system.

- Macroeconomic stability:

    - Inflation and inflationary expectations are relatively low. I cannot under-stress the importance of low and stable inflation expectations for the healthy growth of financial markets. We have entered a challenging phase on this front given price pressures for commodities and grains. However, we are institutionally much better equipped to deal with inflation threats now that we have a credible independent central bank.

    - Our country, as most others in the region, is not dependent any more on foreign savings and international capital markets to secure the rollover of public debt. I would argue this is the main reason why financial and exchange rate markets in the region have performed so well in the midst of the international financial crisis. Now, we are not forced to tap international capital markets in order to secure the rollover of debt.

    - Macro stability and new-found sources of internal savings, especially social security related pensions funds, have set the ground for the creation of a liquid, peso

denominated sovereign yield curve. Ten years ago the Mexican government could only get funds for a year when borrowing at fixed rates. Now, the government regularly holds 10, 20 and 30 year fixed-rate security auctions, and the 10 year security note has become the most liquid spot on the yield curve. Also, the cash market is supported by a growing and liquid derivatives market, both exchange-based and OTC.

- Lastly, macroeconomic stability has brought credibility to the financial system as a safe venue for savings amongst the population. This complements the efforts on pension reform to drive the growth of financial savings in the country.

- How is Mexico doing on the regulatory framework for financial intermediaries and markets? I would argue that the modernization of the legal framework for financial markets of the last ten years has produced a solid foundation for the system.

    - We now have a well-defined framework for the mandate and powers of each of the financial authorities.

    - We have very sound prudential regulations for intermediaries, based on the international standards.

    - We have a solid and modern Securities Markets Law, in which minority rights, corporate governance and disclosure requirements are in line with those of the most advanced markets. Same thing goes for conduct of business issues.

    - Of particular importance are the powers granted to the Banking and Securities Commission to investigate suspicious market activities, and in case necessary hold market participants accountable through its enforcement powers.

    - We now also have a modern framework for the resolution of weak banking institutions, and will soon complement it with a special bankruptcy regime for banks.

    - The outcome of this strong prudential framework is that today we boast a strongly-capitalized, well-reserved system, anchored in healthy loan and securities portfolios.

- So, on the macroeconomic and regulatory front we seem to be doing OK. What about competition in the market place? Here the picture is troubling, but I am confident we are headed in the right direction.

    - One important aspect of our financial system is the complete openness to foreign capital. The three largest, and five of the seven largest financial conglomerates operating in Mexico are foreign-owned. In this sense, our system is among the least protectionists in the world.

    - However, the largest 5 banks comprise around 80% of banking assets in the system, and the dominant players in the banking arena are also dominant in the broker, insurance and asset management business. This has often meant these large financial conglomerates are shielded from competition. But as I mentioned, we see very encouraging signs of competition.

- The number of licensed banks has increased almost 50% over the last three years. Some of these banks are bringing new business models that threaten to change the status-quo. In particular, banks owned by large retail chains (Coppel, FAMSA, WalMart) have the opportunity to offer low-cost financial services to a wider share of the population, relative to the more traditional branch-based banking services. This move from Mexican authorities has been widely questioned given the links between these new banks and the commercial activities of its owners. However, we are certain that the advantages brought by fiercer competition will far outweigh the extra burden on authorities to prevent the conflict of interest between the commercial and financial activities of these new banks.

- Another sign of increasing competition is evident in the mortgage markets. While 6 years ago it was quite difficult to take out a mortgage loan, now there is a wide array of options open to consumers buying homes starting at the equivalent of USD 15,000. These mortgages are for the most part fixed-rate or minimum-wage indexed, at rates that are only 3-4 percentage points above the sovereign peso rates. These mortgages are offered not only by banks, but also by specialized mortgage institutions and state-managed housing funds. This year up to 35% of the close to 800,000 mortgages that will be granted, is going to be financed by issuance of MBS, enabling non-depository lenders to compete with banks.

- The Mexican system is turning to be a well-balanced system among the different forms of financial intermediation. Savings managed by institutional investors and the issuance of securities in the local markets are growing at stronger rates than banking deposits or bank loans. So the competition is not only heating up between banks, but also between banking and non-banking alternatives.

- In this sense it is very important to keep fostering the growth of our capital markets. On this front I will only mention that we are enthusiastic about the IPO of the Mexican Bolsa that took place yesterday. The IPO means that now the Bolsa will be run with a much stronger commercial orientation, while its governance has shifted from a broker-dominated one to a market-based one with a strong board comprised by a majority of independent members. We believe this new set-up will ignite the activity of our markets, offering new alternatives to firms seeking funds. Of course we could also get help from a competitor to the Bolsa springing up.

- So, in competition we have strong issues to deal with, but we are certainly making progress.

- Now let me speak a bit about supervision. Everything I have said so far must give you an idea of the huge challenge we have in terms of effective supervision. I am deeply convinced that what our market needs is not more rules, but more effective supervision and enforcement. Why is this challenging?

    - The market is growing at a brisk pace.

    - There are a significant number of new entrants, both banks and non-depository institutions.

    - New financial technologies are being swiftly incorporated into local activities.

- Large, strong financial conglomerates are involved in banking, brokering and asset management business simultaneously, with the inherent conflict of interest among these different activities.

- We have opted for licensing banks with strong ties to commercial and industrial interests.

- Our challenge is to spot troubles at intermediaries or markets in advance, and to swiftly deal with those troubles to prevent contagion from failed institutions or segments of the market. And we must strive to do this without inhibiting competition and technological advance.

- On the enforcement side, one large pending issue is the administrative reform of the courts, something that is needed throughout the region. But also, as a country we still have an enormous challenge in always placing the interest of investors and consumers ahead those of powerful economic and political interests.

- Similar to the challenge on supervision, is the one regarding consumer protection. We are only at the very first stages of this process, but we know it is imperative to get it right if we are going to deliver on the promises of our new financial system.

    - We need to create a modern regulatory framework for consumer protection. This should be based on disclosure that is simple, understandable and that enables comparisons among the products and services offered by competitors. Easier said than done.

    - We must also work on consumer education and consumer awareness. If competition is going to drive prices down and improve service levels, we need informed consumers that actively seek the best options available to them.

    - One of the lessons this past crisis holds for us is that “predatory” lending practices to vulnerable groups may lead to predictably high default rates, ultimately leading to market breakdown. Indeed, the “subprime” lending default crisis has led to a breakdown for parts of the U.S. mortgage market, for example, that of lending to minorities. We clearly run the same risk in our countries when we are developing lending markets to previously unbanked individuals.

- According to this account, it is clear that in the case of Mexico we need to focus our efforts on three fronts: enhancing competition in the market place, effectively supervising the regulated intermediaries and preventing market abuse through strict enforcement of our laws and regulations, and improving the regulatory framework for consumer protection while heightening consumer awareness and consumer education.

- Before finishing, there are a couple of points I would like to mention. First, it is the fact that the financial savings in Mexico is flowing mainly through institutional investors, not banks’ balance sheets, while at the same time the growth rate of bank loan portfolios far outstrips the growth of their deposit base. I would guess this is so for much of the region.

    - The inevitable consequence of these dynamics, is that banks will have to resort to the capital markets to off-load their balance sheets in a continuous manner.

- Given the recent events in the U.S., one may be tempted to say we should resist this tendency towards a growing securitization market. I would say quite the contrary: we should embrace securitization as the means to finance bank loan portfolios, in particular mortgage portfolios.

- However, we should very closely study the events of the last year, to understand what went wrong, and prevent a similar fate for our nascent securitization markets. Apart from evident issues such as enhanced disclosure standards for structured finance, or closer scrutiny of credit rating agency practices, I would strongly argue for the following two principles to be applied in our markets:

- 1°, institutional investors must be discouraged from buying privately-placed structured securities. As long as structured finance securities are publicly offered, the quality of disclosure will be standardized and scrutinized both by the market and regulators.

- 2°, regulators and investors should be keenly watching whether the incentives of those participating in the structuring of the asset-backed securities are well aligned with those of investors. In particular, I believe that within the structure, there must be a clear counterparty taking a substantial the first-loss risk. That counterparty should be a regulated, well capitalized, knowledgeable entity that is not only able to measure the risk being taken, but is also able to take timely measures when the underlying portfolio shows the first signs of trouble. This role might very well be played by mortgage originators or servicers, mortgage insurance companies, and financial guarantee insurance companies.

- To my mind, what made securitized portfolios of subprime loans so fragile, was the fact that first-loss risk of the underlying assets were too widely dispersed, with the consequence that there was no single participant within the system that had the incentive to closely monitor the quality of the book of loans, neither at the moment of issuance, or throughout the life of the security.

- My last comment relates to the exciting opportunity we have for speeding up the access to financial services to the lower income segments of our markets. I firmly believe that technological advances have made it possible to deliver basic financial services at reasonable costs. In our case, a market lagging far behind others in the region in this regard, we are working in two related initiatives:

  - Correspondent banking, following the steps of Brazil and others to promote the delivery of basic financial services through retail shops associated with banks. This will permit banks to offer their basic products at significantly lower costs, especially outside of large cities, enabling them to reach out to a much wider share of the population.

  - Mobile payment technology. This allows individuals to use their cell phones as electronic purses to make purchases, and to transfer money among users. This again, has proven useful in other countries like Kenya, Philippines and South Africa.

  - If we are able to combine both of those features in our market, we will bring into the financial system millions of households that have so far been prevented from enjoying even the most basic financial services.

- I’ll leave it at this, and open it up for comments.

HECTOR MEDINA

Keynote Address

Keynote Address

Hector Medina
Executive Vice President of Planning and Finance, CEMEX
Saturday, June 14, 2008

Good afternoon.

I am really glad to be here with you today and feel very honored to speak at this prestigious institution. I would like to thank Eugenio Cárdenas and his colleagues at Harvard Law School for their invitation to participate in this Symposium.

At CEMEX, we are dedicated to help people building the future, so I warmly congratulate all the organizing team for bringing us together to discuss the need of building the financial system of the 21st century.

As our contribution to this great purpose, I intend to offer you today some comments on the CEMEX growth process in the context of the global markets. My comments will refer mainly to the challenges we have met, and how we have dealt with them. I hope I can make these comments in a simple way so that they will elicit your questions. And hopefully, from my comments and from the Q and A, we are all able to derive some interesting thoughts.

Let me start by touching very briefly on what is CEMEX today.

Certainly, a good definition of CEMEX is that it is a multinational building materials company that has grown steadily for the last 20 years at better than 20% annually in terms of EBITDA. CEMEX operates in more than 50 countries, in all continents, and its business is concentrated in what we call the cement value chain. And just as a matter of reference, in global terms, we rank first in Ready mix concrete production, second in aggregate production and third in cement production.

Over the last 20 years we have faced many challenges, but today I would like to focus on four major ones, as they are relevant to the global market context. Because it is relevant to this symposium, I will emphasize the financial aspect, but I am sure that whatever success we have had, it has been accomplished because of a very strong integration between our business and financial strategies.

In the mid eighties we only had assets in Mexico. That is when we decided to focus in the cement value chain, and because of the way we viewed the development of our industry, we also decided we should grow outside Mexico, if we wanted to preserve our independence.

But there was a major issue. Cost of capital. That was our first challenge.

The global cement industry landscape was at that time, in a process of consolidation lead mainly by European cement companies that already were large multinationals. So, if we wanted to grow through acquisitions, we had to compete head on with companies that had access to international capital markets at costs that were significantly lower than ours.

Our strategic position in Mexico was already very strong, and we had behind us 80 years of a deeply engrained cost efficiency culture. But when we decided in 1992 to acquire two large Spanish cement companies, we were bidding against at least two major European competitors that had a clear cost of capital advantage. We were determined to survive, so in order to win,

we based our bid on European cost of capital. And we did a tremendous effort to turn around the acquired companies as fast as we could, merge them, and integrate them to the CEMEX system so that they could produce the returns that would compensate for the cost of capital difference.

Now we had a European base. Now we could finance our growth from Spain with access to capital in conditions that would be closer to those enjoyed by our European competitors.

The possibility of listing CEMEX Spain was now open to us. And we considered this option several times, but the perceived complexity of having two different companies, one being part of the other, listed in different markets, made us decide against it. In a way, this decision recognized what we could call the cost of complexity. A concept that I think has become even more relevant in the present time.

Now let me turn to a challenge that is highly related to the Cost of Capital, but that is certainly also very important for companies based on emerging markets. To put it very simply, at least in part causing the cost of capital disadvantage, at the time when we started our growth strategy, the global equity markets had a serious lack of confidence in companies based on emerging markets.

Either because most of our international investors were specialized –emerging markets investment funds- that did not like the fact that we were moving into Europe, or because they could not understand why we were doing it, their reaction was very bold: they just plainly dumped us.

On the other hand, the debt markets behaved differently. Backed by the largest bridge loan granted to a company of Latin American origin since 1983, we were able to complete the acquisition of Valenciana and Sanson in Spain for close to $2.5 billion in 1992.

The following year, we refinanced our acquisition debt by issuing a jumbo bond for one billion dollars, again, the first of its kind in Latin America, which reflected a growing confidence in CEMEX by the debt markets.

Furthermore, as the Tequila Crisis unraveled at the end of 1994 and the international capital markets once again dried-up for Mexican companies, having a strong position in a better-quality credit market like Spain proved very useful.

And also based on the free cash flow generated by our Mexican and Spanish operations, we strengthen our position in Latin America. And beyond.

Starting in 1994, we made successive acquisitions in Venezuela, Panama, the Dominican Republic, Colombia, and shortly afterwards in Costa Rica, Nicaragua and Puerto Rico. By 1997 we began to extend our reach into South East Asia, specifically to the Philippines, Thailand and Indonesia —from where we later exited—. In 1999, we entered North Africa, with an important acquisition in Egypt.

This phase was based on the disciplined implementation of our business strategy, on our ability to transform our post-merger integration process into an additional competitive advantage, and on the standardization of our key business processes and technological platforms, to develop what came to be known as “the CEMEX Way.” Not a very original title, if you ask me.

Nevertheless, our European competitors still had lower cost of capital than us. We had to do better.

We developed a strong confidence building campaign.

We recognized the value of consistency, so we defined and declared a set of simple but rigorous criteria to guide our investments. Let me tell you what they are:

Any investment must produce a return on capital employed above our weighted average cost of capital, and exceed a target of 10% in the medium and long term.

Any investment has to benefit from our existing management and turnaround experience. This is essential, because capturing synergies, spreading best practices, and retaining talent are key drivers in creating sustainable value.

And, any investment must allow us to maintain our solid capital structure, since quickly regaining our financial flexibility is critical to our profitable growth process.

Of course this was accompanied by an intense communication program. We wanted to make our strategy as transparent as possible. And we were determined to promise only what we knew we could deliver.

As part of these efforts, in 1999 we became listed in the New York Stock Exchange. A step that was long overdue, but when we took it, we were completely prepared for it.

Today, CEMEX has a widely diversified investor base. US and European long term value investment funds now own a good part of CEMEX. Our retail US investors have also grown in number. And, of course, hedge funds also own CEMEX. And liquidity is now at the same level, and sometimes higher, than our European competitors.

Now let me turn to another important challenge.

In the last seven years, CEMEX has made three very large acquisitions: Southdown, a large cement company in the US in the year 2000, RMC, a multinational ready mix company in 2004, and last year, Rinker, Australian based but with large aggregate and ready mix operations in the US.
Through this process, the company has become large and complex.

But as in all challenges, we like to see the opportunity side. And though few people believed there are significant economies of scale in the cement industry, we have successfully focused on developing ways to extract value from this complexity.

We have developed a integrated management platform that is designed to profit from the size and geographic diversification of our business. Of course centralization plays an important role in our design. And we believe that centralizing certain functions, at the same time that improves efficiency, in fact creates a improved environment for innovation.

Let me give you a few examples:

Cement is an energy intensive industry. Energy is more than 40% of the direct cost of manufacturing cement. Because of this, we have a central energy group that is in charge of

developing and implementing our energy strategy. And, taking advantage of our global presence, they have been able to contain our energy costs very successfully, even in the current 135 dlls per barrel environment.

Another example is our international cement trading group. This strategic arm has been instrumental in several ways: the optimization of our global cement production capacity, the opening of new markets and, not least the obtaining of valuable marketing information.
But certainly, it is the finance team that has had, from the start of our growth process, to face the cost of capital challenge. As the old rental car company add use to say: “When you are number two, you have to try harder”. And we keep trying harder. Our finance team has had to understand and navigate the global financial markets in order to synchronize our financial strategy with our business strategy and thus create value.

To finish my initial comments, let me turn now to the fourth challenge. One that is at the heart of this symposium: the regulatory environment.

Being a successful player in many different markets, means we have to understand and comply with many different regulatory environments. Let me refer now specifically to the financial markets.

We all know how the regulatory environment has developed in the last few years. In our case, for the most part, some of this increased regulation has created an opportunity that we have been able to transform, at least temporarily, into a competitive advantage.

Let me explain why.

Because we needed to improve our communications with the investment world, we increased the transparency of our reporting way before it was imposed on us by regulations.

Because the of the centralization process in the development of the so called CEMEX Way, we had to fully document all of our business processes, way before we had to comply on that matter with Sarbanes Oxley. For us this was a matter of business strategy, and the costs of doing it were really a strategic investment that keeps paying off.

But I said that these advantages are of temporary nature because we know that our competitors have to comply also to stay in business. And because in the financial markets we compete for financial resources, we have many competitors that are not in the cement business.

Also, there seems to be a certain degree of increased convergence in the financial regulatory environment worldwide. This should reduce somewhat the extent of this challenge.

And, of course, I think that at meetings like this, where the financial system of the new century is being built, you are facing a great opportunity to improve the possibilities for more emerging market businesses to become more competitive, to become more global, to grow and prosper.

This concludes my initial remarks.

Thank you.

MARIA HELENA SANTANA

Keynote Address

Keynote Address

Maria Helena Santana
Chair, Comissão de Valores Mobiliários, Brasil
Friday, June 14, 2008

Ladies and Gentlemen,

I would first like to thank the Harvard Law School's Program on International Financial Systems for the invitation to be here in the first symposium aiming at setting an agenda for building up the financial system of the 21st century in this region. I think Brazil has a great deal to contribute to this discussion and, therefore, I intend to bring up insights on our recent experience in developing the capital markets. I am sure that the outcome of our discussions will be concrete and positive, given the most qualified participants.

Our agenda bears three major topics: corporate governance; the impact and control of the liquidity and credit crises; and the role of private pools of capital in our capital markets. I intend to bring forth my viewpoint on the recent evolution of the Brazilian capital market, on where we are and how we have reached so far, an analysis which -- certainly not by chance – has to do with the three themes, to a greater or lesser extent. Incidentally, we have here, among us, one of those responsible for the positive results that I will present to you, Prof. Ary Oswaldo Mattos Filho, who, on his tenure as chairman of the Brazilian Securities and Exchange Commission (Comissão de Valores Mobiliários) in the 1990s, for instance, enacted the regulations that have permitted the inflow of foreign portfolio investment in Brazil.

Prior to reviewing data on the current status, I would like to backtrack a little, and evaluate part of the 1990's Brazilian market scene. I have brought here a picture based on the stock-market's evolution, as all of us know that building up this segment constitutes the greatest hurdle -- among so many -- which we face when working to develop the markets in our region.

Brazil saw, at that time, a clear market liquidity runoff, with a fall in trading volumes, a great number of delistings, and very rare share offerings.

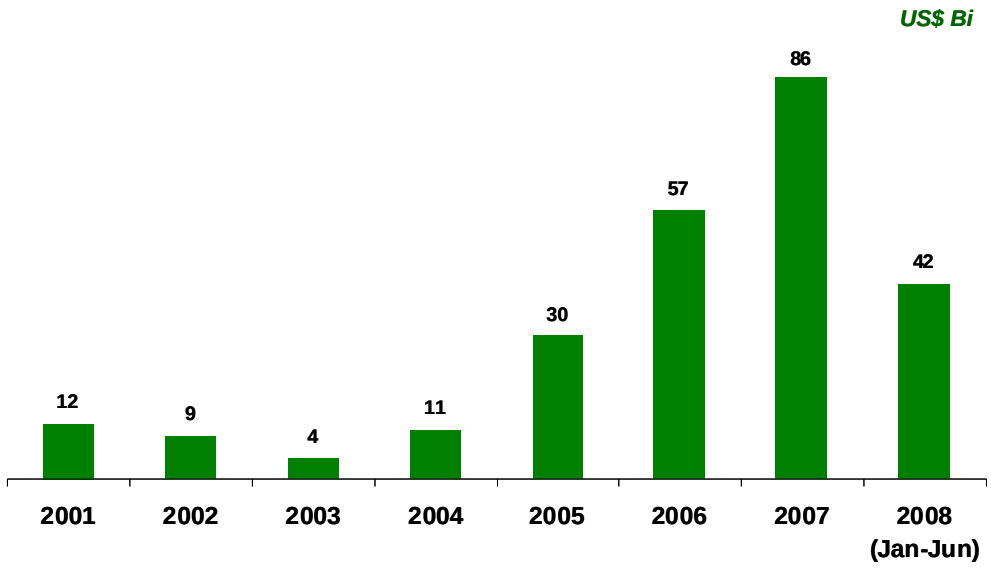
In the secondary market, the monthly average value traded in Bovespa fell from US$ 15.9 billion in 1997 to US$ 8.5 billion in 2000, that is, the traded volume had been reduced by half in those three years. The number of companies listed at the stock exchange had also been shrinking, from 589 companies in 1996 to 495 in 2000.

Regarding the primary market, the outlook was definitely depressing. Only 8 IPOs -- new companies with share offerings -- took place between 1995 and 2000. And even in the following years conditions remained quite similar -- between 2001 and 2003, only one company went public in Brazil with a share offering.

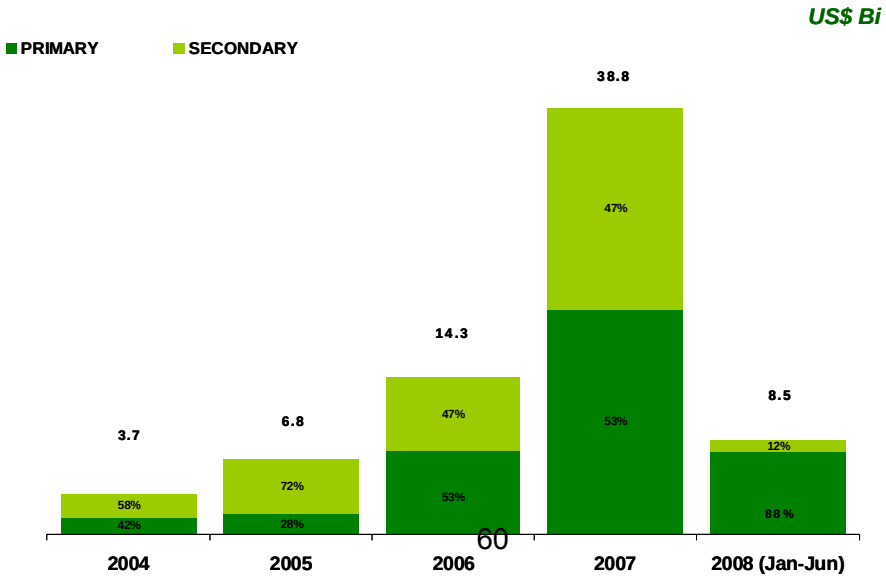
In those years, only those IPOs that involved the simultaneous listing of the company with the NYSE were deemed feasible, a fact which, right from the outset, limited the universe only to deals of major companies and at sufficiently large volumes to allow liquidity in the two markets. Actually, our companies had to borrow credibility from another jurisdiction, more attractive and friendlier in order to attract investors. In the investor's perception, the Brazilian market was in need of the good old, and indispensable, legal certainty.

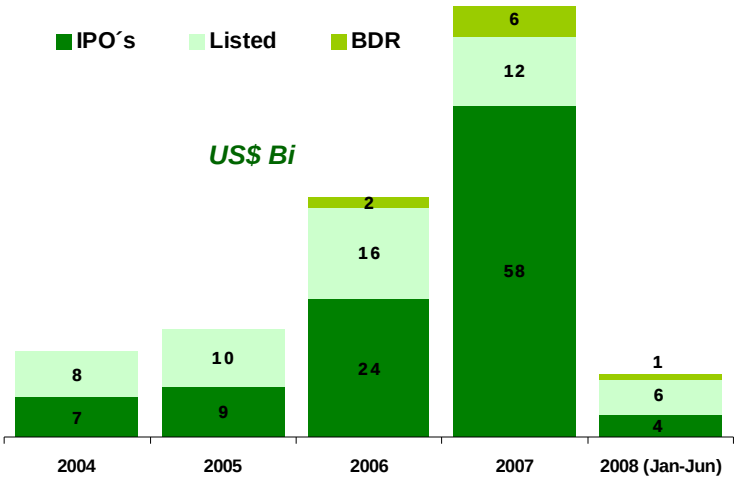
Finally, the market was too much concentrated in terms of players: only a few international investment banks actually operated there, and on the buyers side, the investors were strictly the institutional ones.

Now, in 2008, I wish to show you some figures -- and I will be able to do so with the support of images thanks to the great kindness of the organization, that has set up the necessary equipment here.



As you can see, the volumes of securities offerings in the Brazilian market have exhibited an impressive growth, to a total of US$ 86 billion in the past year. This is an impressive volume by itself, made even more significant by the conditions in which it happens. We do not currently have in effect any type of artificial incentive or inducement to market growth -- there are no tax breaks to issuers or buyers or even mandatory allocation of resources by pension funds or by individual investors, devices already used in Brazil in the past, and which, in my opinion, have brought about significant distortions to market evolution. What we see nowadays stems only from market mechanisms in operation, together with a sufficiently attractive regulatory environment, as I will try to demonstrate.





Here we see the share offerings, which restarted as from 2004, having grown much in relative terms to the total amount raised in the market, totalling US$ 38.8 billion in 2007, 53% being secondary share offerings. I will return to the point of secondary placements later on.

US$ 31 billion (80%) of this volume was placed in IPOs, carried out by 64 companies in 2007 -- and more than 100 (exact 106) new listings since 2004. I would like to point out that, of the total placed in this period of a few years, more than 70%, in average, were bought by foreign institutional investors. But -- what is most important for us here, who know of the strategic importance for a country to be able to count on an operating capital market – is that only two out of the more than 100 IPOs of this period involved dual listings, both in the North American market. All the other new public companies were listed only with the Brazilian stock exchange, meaning that investors, when buying their shares, knew that they would count only on the Brazilian market liquidity, on the infrastructure of our local market, and on the regulatory environment and protection that this market would be able to ensure. Yet, they did not discount on share prices for that, as I am sure you all here are aware of.

The ability to attract capital was such that, last year, for the first time, we received the listing of issuers established in other countries of the region, through the depositary receipt mechanism that we offer to foreign issuers, the BDR.

It would be reasonable to attribute this exuberance only to the immense international liquidity plus the improvement of the Brazilian economy as a whole, in macroeconomic terms. In fact, the stabilization of our economy, now with the actual prospect of sustainable growth, as well as the deep liquidity, played a very important part in opening the market, as becomes obvious by the fact that this cycle unfolded only as from 2004, when such conditions started to exist.

However, I believe that, if only these were the determining factors, other bigger emerging economies, offering more attractive growth rates than those of Brazil, would have displayed a better performance than our market, and this did not take place, as you know.

Brazil was, in 2007, the 5th market in absolute financial volume of share offerings in world terms, behind only of the New York, Shanghai, London and Hong Kong stock exchanges, according to data compiled by the World Federation of Exchanges - WFE.

My view of the entire scenario, which includes the great receptiveness of the foreign investors to the offerings by Brazilian companies listed only in the domestic market, is that this performance is due, in great part, to the evolution in our regulatory environment – as you will see it does not involve only public regulation. These results started to be generated years ago, by virtue of effort and commitment to long term demonstrated by market entities and by the public agents, probably in this exact order of importance.

I would like to present a timeline with a number of important initiatives. The effort to improve Brazilian companies' governance practices bore a central role among them, as you will be able to see.

The Brazilian Corporate Governance Institute—IBGC—was set up in 1995, at the time under the name of Brazilian Institute of Directors, and has, since then, dedicated itself to qualifying directors and senior officers of companies of all sizes and, especially, those under family control –in the application of the principles of sound corporate governance. The IBGC is currently a reference in Latin America, having provided support to the establishment of similar initiatives in other countries.

Speaking about transparency, in 1998, the National Investment Bank Association -- ANBID launched its self-regulatory code for public offerings of securities, imposing stricter standards than those of the legislation of the time, so as to raise the quality of the prospectuses presented to investors. The association currently has other self-regulation codes, which deal with investment funds, securities services, private banking, in addition to a certification program for those who distribute investment products.

Coming back to corporate governance, Brazil was the venue, in the year of 2000, of the first Latin American Corporate Governance Roundtable, promoted by the IFC/World Bank and by OECD. The assistance and the support brought by specialists and large international investors—I have the pleasure to see here Mike Lubrano—have greatly contributed to build up awareness in Brazil as to the role of investor protection, of transparency, and of sound governance in capital market development.

After that, at the end of 2000, Bovespa launched its listing segments Novo Mercado and Corporate Governance Levels 1 and 2, providing for disclosure and investor rights requirements which, again, went far beyond the legislation. At that time, Congress was discussing a bill for amending the Brazilian Corporate Law, but it was clear that the correlation of forces would not allow for that reform to bear the reach that CVM itself and the market wished. The lobby of listed companies was contrary to the most relevant changes, such as the establishing of full tag-along and voting rights for all shares. In view of this, the stock exchange decided to implement, by self-regulation, for voluntary adoption by companies, the rules that were deemed to be the most relevant to provide for equitable treatment of capital providers.

It is hard to overestimate the significance that the establishing of these listing rules had to the growth seen in our market. It is simple to conclude so, as all the Brazilian companies that came to the market after that were listed in one of the levels created by Bovespa, the overwhelming majority directly in the Novo Mercado, the most demanding of the three. This seems to have been a demand from the investors, which the companies decided to accept in exchange for better conditions to their offerings.

Talking now directly about regulation, the Corporate Law reform went into effect in 2002, which, although less than what was needed, brought about important changes to the protection of

minority shareholders. This reform reinstated tag along rights for the voting shares in case of sale of control, which had been eliminated from the law in 1997 for the privatization program. It also increased representation of minority shareholders in the board of directors, in addition to other protection instruments (such as: in case of delisting and of the increase of controlling shareholder stake, there must be a tender offer at a fair price; increase of advance term for calling shareholders' meetings; and the possibility of interrupting this term for the CVM to analyze the legality of the proposals presented, or for the shareholders to have more time to analyze information).

This same reform also amended the Securities Market Act, which had set up the CVM in 1976. The reform broadened the jurisdiction of CVM, its powers and its institutional autonomy, as well as defined as crimes illegal practices such as insider trading and market abuse.

Then, in 2002 and 2003, the CVM conducted a wide-ranging review of extremely important legislation, such as the regulation on tender offers, disclosure of material information, public offerings, investment funds - and specifically ABS funds - among others.

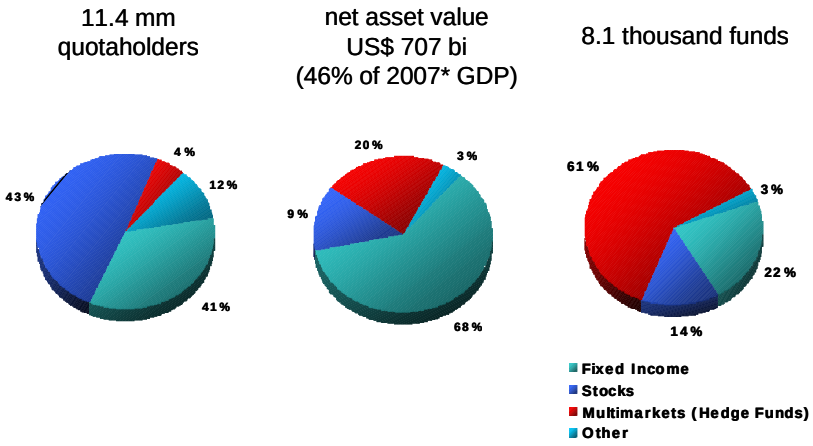
I would like to point out, lastly, the priority assigned by the CVM, as from a strategic planning carried out in 2005, to rule enforcement. For a market like ours -- this may not be the case of other markets in Latin America -- which depends on attracting capital from overseas in order to meet the needs of its economy, I think that the most important role of the securities market regulator is ensuring that the rules are complied with, leading to greater investor confidence.

CVM has been working to speed up the decisions on enforcement cases, thus reducing the inventory of pending cases, as well as the time gap between the facts investigated and the decision on penalties to be imposed. We also used, for the first time last year, tools like the freezing of assets of investors suspected of insider trading, which has caused a jump in the market perception as to the effectiveness of the regulator action.

However, there are other forms of enforcement -- maybe more relevant, as they can prevent the problems, to which the CVM has intensively dedicated itself. On the one hand, putting forth opinions on the legality of ongoing transactions, so as to preserve the legal certainty of the market and enforce its rules. A landmark case, in this sense, was the determination for Mittal Steel to hold a tender offer directed to the Arcelor Brasil minority shareholders following the acquisition of Arcelor's control in Europe.

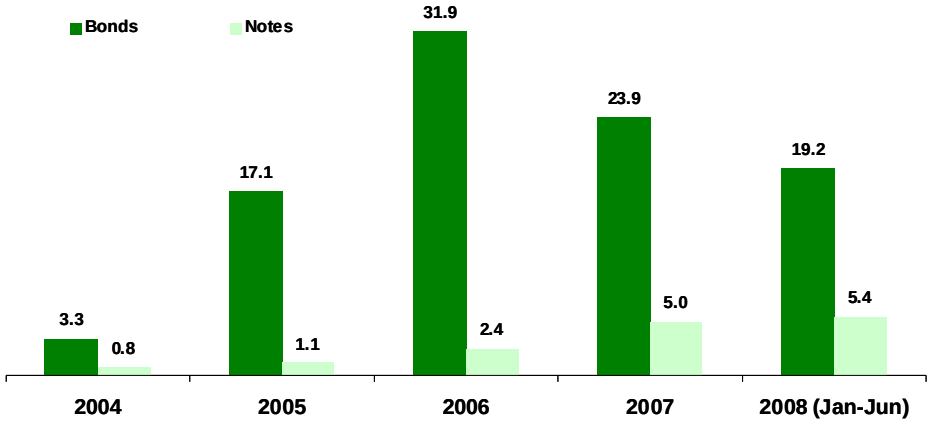
On the other, and also quite relevant in my opinion, is the promotion of investor education by CVM, often in partnership with market entities and with other Brazilian regulatory bodies. A well informed and diligent investor represents, no doubt, a powerful weapon to ensure that rules be complied with. It also encourages competition and efficiency within the market. I would like to mention here, in this respect, a tool that the CVM has placed in its fully dedicated internet Investor's Portal. This tool allows for the comparison between all registered investment funds with their different features: profitability between funds of the same class, management fees or performance fees. The tool also takes into account characteristics such as the size of the fund's net asset value and possible restrictions to certain kinds of investors.

April/2008

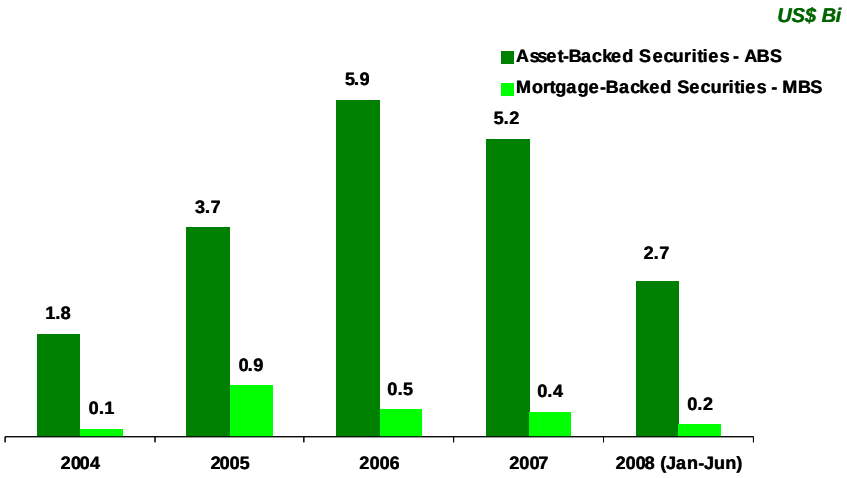


Talking about investment funds, I bring you here a current picture of this industry in Brazil. With assets amounting to US$ 707 billion, and more than 11 million shareholders, this is one of the main focus of CVM action, as it is, among the products we regulate, the most important channel for the investment of individual savings. Measures such as calculating daily NAV, with disclosure to the public and to the Commission within 48 hours, and the opening of funds portfolios on monthly bases, render this a very developed industry in terms of transparency, which we partly supervise on an automated basis, as from the data sent by the administrators.

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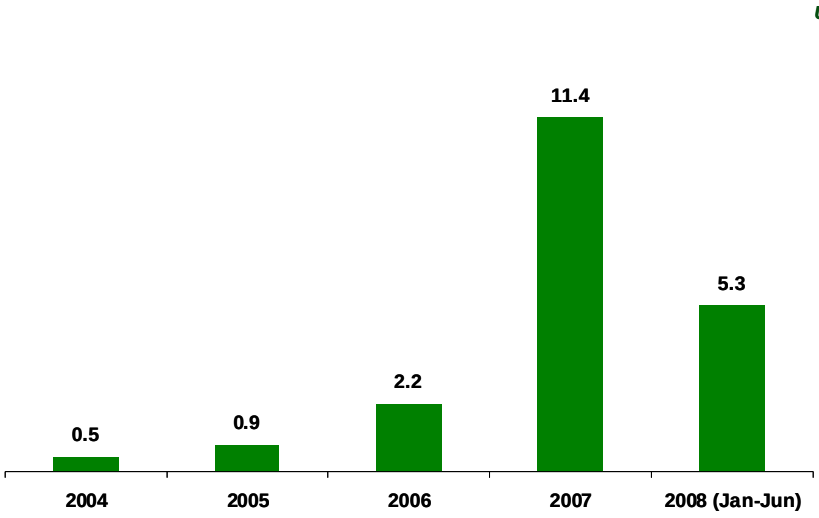
In order to give you a more thorough picture on the Brazilian market, I would like to show you the corporate debt market numbers. Extremely relevant volumes and, thanks to the improvement of our economy, currently providing companies with terms around 7 years.



I

Still in the debt market, there is also the relevant growth of securitization products, although the potential provided by these instruments has still not been exploited in a significant manner by the small and medium-sized closely held companies, as one may expect it to be. This market is still in its infancy in Brazil, being dominated by first-level securitization products - funds which buy credit pools directly - or, at most, second level, when these vehicles acquire CCBs -- bank credit certificates. This is a diversified market as to the types of credits, involving personal credit, credit card loans, auto loans, mortgages, and even student loans, and tends to grow as the credit supply to the economy itself evolves to the standards of more developed countries, a process which has already started.

Specifically with regard to the mortgage backed securities market, its volumes do not impress and reflect the degree of development of the real estate credit market itself. Due to macroeconomic conditions and to the extremely high interest rates, this is a market that has just started to grow, stretching terms a little and starting to target clients beyond the higher-income brackets.

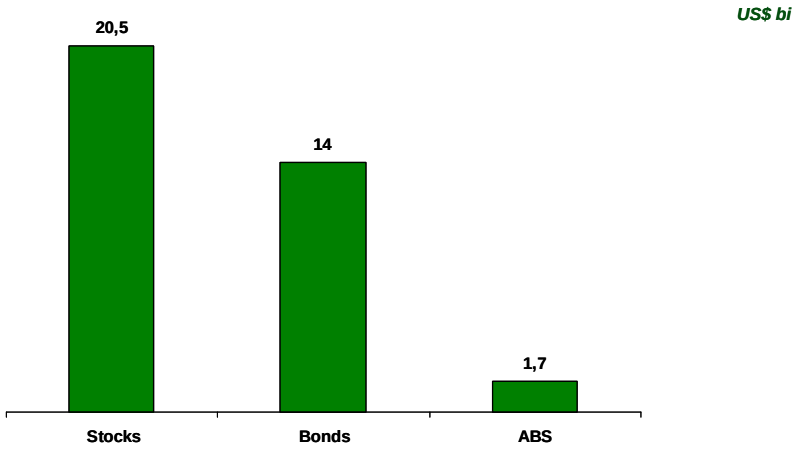


And now some figures on one of the themes proposed for the agenda of this meeting –

these are the investment funds through which the private equity and venture capital industries have structured themselves to raise capital, in Brazil. As you can see, volumes raised have also grown much in this segment, in the recent years, a fact which I believe bears close relation with the opening of a domestic market for IPOs. Moreover, as I have already mentioned in the beginning, almost half of the volumes sold in the IPOs related to secondary share offerings. Investor receptiveness to this type of offering -- and specially in IPOs -- is also something completely new for us and specific to this cycle of market development. It seems to me that investors have been more receptive to this type of offering due to the improvements in corporate governance and company disclosure practices that are required by the Novo Mercado rules.

This new reality has, of course, been extremely positive for the VC and PE sectors, even providing several of the funds with a way out through these offerings and, thus, recycling their portfolios. Not having a market listing as an alternative to exit had been one of the major problems of the industry in the country, as most funds belonged to the first PE/VC cycle in Brazil, already 10 years old, and therefore more than on time to divest.

I am sure that, along the symposium, we will be able to discuss the great importance of these investors to innovation and to the survival of innovating businesses as companies and what other measures were taken in Brazil to stimulate this industry.



Finally, as closing, I would like to put forth a comment on how we see the future, after the crisis that, at this moment, hits the markets and economies in the developed world, and its effects upon Brazil, another one of the themes proposed for this symposium.

As I have already mentioned, both the bank credit market and the securitization market itself are in a very distinct stage – less mature - in Brazil, regarding what is seen especially in the North American market. So, from the point of view of origination and distribution of ABS and MBS, we could not have - and do not have – the same problems there.

The originate-to-distribute model is still not representative in Brazil, although it is already present, especially on the part of locally-established international banks.

Our investment funds have only recently been authorized by CVM to invest abroad, in the international markets. Even so, as this is a process still in the beginning, it is being carried out by the regulation in a very gradual manner, with some restrictions. Pension funds, although allowed to invest part of their assets overseas, do not enjoy a tax treatment conducive to this option. So, the structured products that are behind the liquidity and credit crises weren't present in the Brazilian institutional investors portfolios. And thus we have not seen any impact there, also on this side.

The over-the-counter derivatives market in Brazil does exist and displays a considerable volume and relevance for the financial institutions, but does not suffer from the problem of lack of transparency such as it seems to be in the central markets. Due to the requirements by their specific regulators, financial institutions, pension funds, insurance companies, and investment funds are required to register their OTC trades with these products in systems provided by the organized market entities, such as the exchanges and CETIP.

But, despite the scenario I have described, we have certainly undergone the effects of the crisis, especially because of the drying up of liquidity and of the growth of risk-aversion.

So, on the one hand, the market was practically closed to new medium-sized company share offerings, which have comprised an important part of those that have come to the market in the recent years. Only offerings of high volumes, and preferably, of listed companies or those with established businesses, have been feasible this year. On the other, due to greater volatility -- and obviously, to the continuous commodity prices hikes -- the volumes on cash and derivatives secondary markets have grown significantly.

Yet, there is an attractive pipeline of public offerings. There are now six new IPOs in the pipeline. 22 other companies have already registered at the CVM in 2008 and are probably waiting for better market conditions to bring their offers. This indicates that market agents have not regarded this recent cycle as only a window of opportunity. Despite the unfavorable conditions, they continue placing access to the market as part of companies' strategies.

I do agree with them in the sense that I believe that this recent growth of our market occurred on sufficiently sound bases for it to represent something that is definitive, at a new threshold, from which we will develop further (although maybe not in the 2007 levels, at least for several years). But, obviously there is a lot to do and, fortunately, both public and private agents also agree on this point.

I am looking forward to this weekend's discussions with you.

APPENDIX II

CONCEPT PAPERS

Corporate Governance and the Small and Medium Firms in Mexico

Antonio J. Dieck, Ph.D.
Dean EGADE Campus Monterrey
Tecnologico de Monterrey

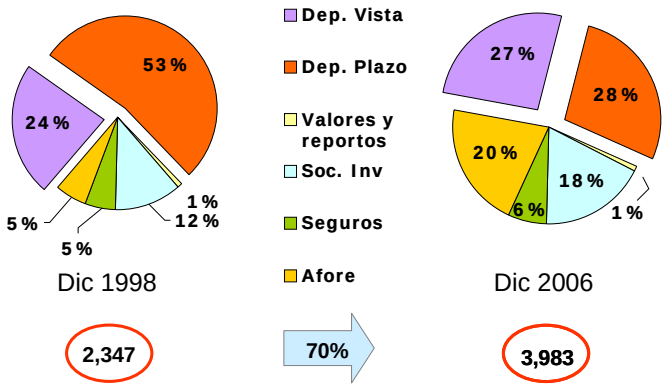
Luis De Garate, Ph.D.
Director Graduate Programs in Finance
EGADE Campus Monterrey
Tecnologico de Monterrey

Program on International Financial System
Harvard Law School
Cambridge, Massachusetts, USA
June, 2008

Agenda

- The Mexican Savings Market and the firm.
- Corporate Governance and the Mexican Law System.
- EGADE: Actions in order to implement Corporate Governance in Medium and Small firms.

Evolution of the Savings Market in Mexico

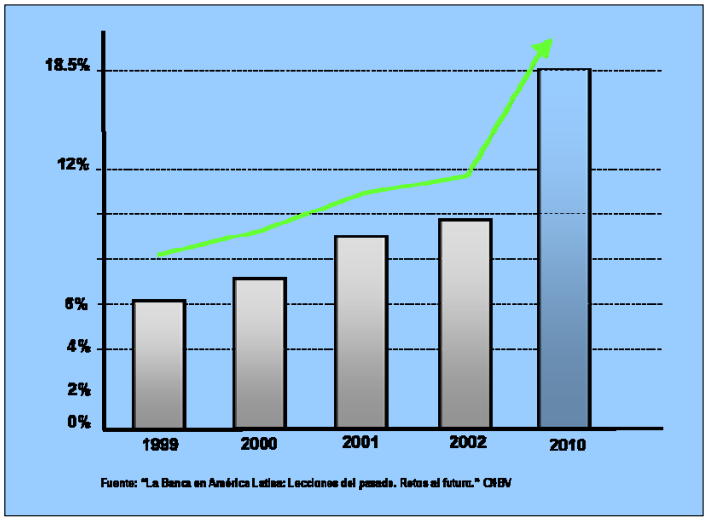


Dic 1998 | Dic 2006

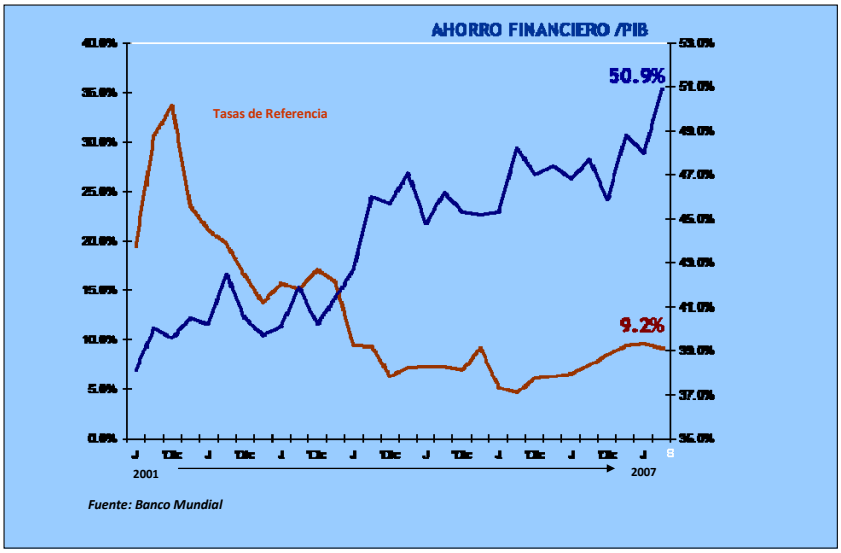
2,347 → 70% → 3,983

Fuente: Banco de México y ABM
Miles de Millones de Pesos

Savings as a percentage of Mexico´s GDP

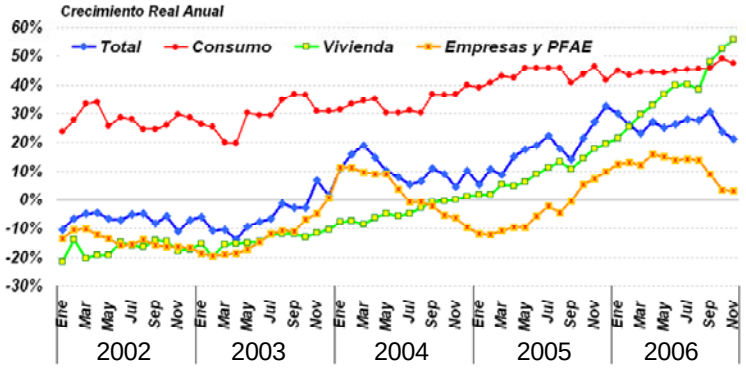


The cost of money in Mexico



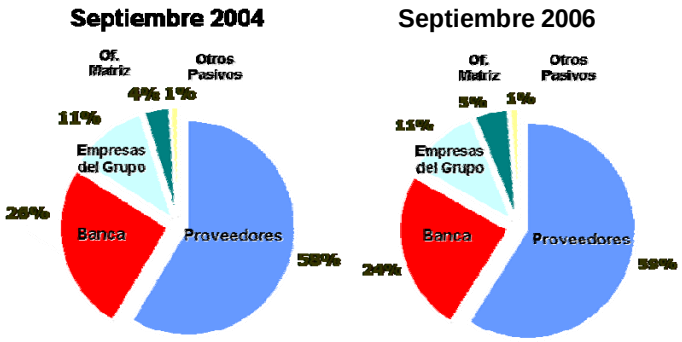
5

Trend of the commercial banks loans and credits in Mexico



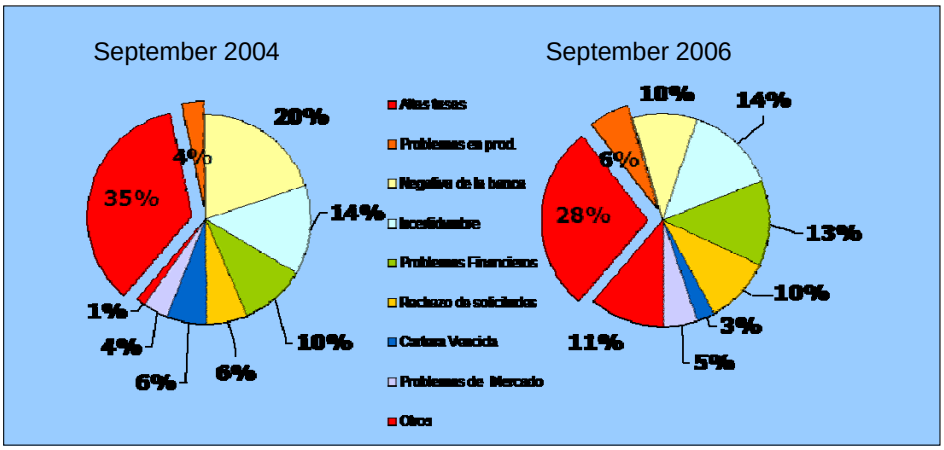
Fuente: Banco Iberoamericano de Desarrollo y Banco Mundial

Who is lending the money in Mexico?



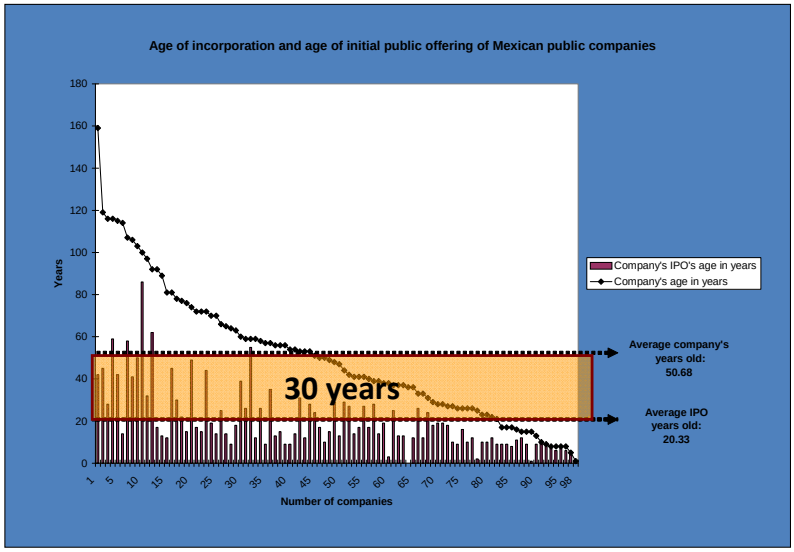
Otros Pasivos se refiere principalmente a mercado de deuda y capitales.
Fuente: Encuesta de Evaluación Coyuntural del Mercado Crediticio, Banco de México.

Survey from Bank of Mexico: Reasons why savings are not used for investment



Fuente: Banco de México y AMIB

Why not the Financial Market?



Agenda

- The Mexican Savings Market and the firm.
- Corporate Governance and the Mexican Law System.
- EGADE: Actions in order to implement Corporate Governance in Medium and Small firms.

Law system

- The Mexican law system is based upon the Napoleonic Code. Despite this, the practice of mercantile law by corporations is similar in many ways to that of its American counterparts.
- The mercantile law is federal oversee.
- Minority rights proposed by the OECD are covered by the Mexican regulation.

Law system

Corporate governance mechanisms	Characteristics
Laws	• General Mercantile Societies Law (LGSM) • Stock Market Law (LMV)
Ownership structure	• Dual-class shares • Pyramiding • Cross-holdings • Cross-listings
Shareholders' meetings	• Ultimate body of corporate control • Ordinary and extraordinary
Board of directors	• Must be composed by no more of 21 directors • Boards must be composed by at least 25% of independent directors • Functions of hiring CEO, evaluating CEO's performance • Audit Committee and Best-Practices Committee integrated by independent directors.

Law system

Corporate governance mechanisms	Characteristics
CEO	• The person in charge of the direct management in the company • Election of CEO through Best-Practices committee
Mergers and acquisitions	• Approval from the extraordinary shareholders' meeting • Anti-takeover mechanisms are allowed

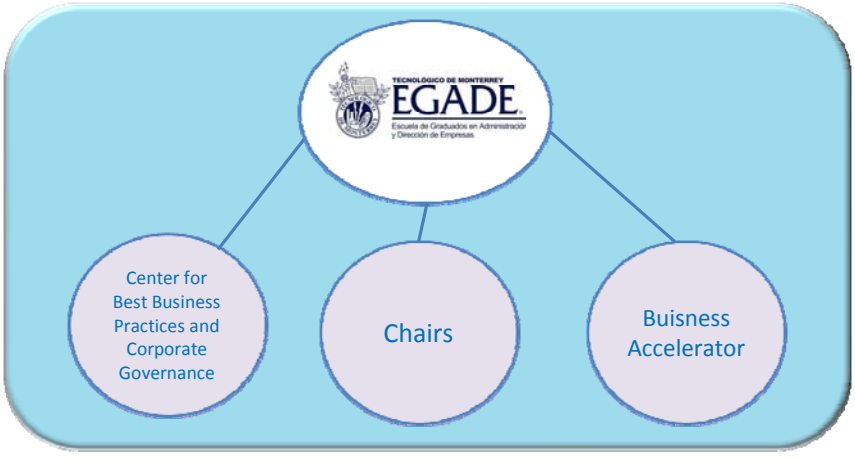
Law system

- Mexican Stock Market Law (2005).
- Code of Corporate Best Practices (1999, 2007).

Agenda

- The Mexican Savings Market and the firm.
- Corporate Governance and the Mexican Law System.
- EGADE: Actions in order to implement Corporate Governance in Medium and Small firms.

EGADE Actions



Corporate Governance Functions

- The Code identifies three basic functions:
  - ✓ Auditing functions;
  - ✓ Evaluation and compensation of owners and officers
  - ✓ Finance and planning.

Audit Functions

(Recommendations)

- Verify that the business accounting is timely and reliable.
- Review the external auditor work programs, his observation letters and the reports of internal and external audits.
- Approve the politics and criteria for the presentation of the financial reports.
- Make sure there is an internal control system.
- Identify those risks that can jeopardize the creation of businesses within the company.
- Implement an Ethics Code.

Evaluation and Compensation

(Recommendations)

- Identify the opportunity cost of the administrator (¿How much can he earn in another job?)
- Identify the activities of the administrator and separate them from his proprietary rights.
- Assign a base salary to his opportunity cost and his responsibilities as the administrator.
- Avoid taking out excess resources from the company.

Finance and Planning Functions

(Recommendations)

- Formalize the Strategic Planning including the guidelines that would lead it.
- Analyze and evaluate the possible investments and funding sources with a formal criteria and valuation techniques.
- Establish budgets in a formal way and give them the proper monitoring.
- Evaluate the investments that have take place and compare them with the expected results.
- Try to financing the company or extra leverage it.
- Invest in technology and training, innovation and marketing.
- Generate clear financial politics.
- Identify which are the risks, internal and external, that can fall into the fulfillment of the business objectives.

Conclusions

- Even though the savings market in Mexico is increasing, the financial markets still are not an option for the small and medium size firms.
- The corporate legal framework in Mexico have evolved. The Stock Market Law (2005) and the Code of Corporate Best Practices (1999, 2007) have shaped this environment.
- The Small and Medium Firms need money in order to finance their projects. They need to implement Corporate Governance in order to get this resources.

Insider Trading Law in Brazil:
Recent Developments [*]

Nelson Eizirik [**]

As the Brazilian economy faces an unprecedented period of growth, the country's securities market begins to draw considerable attention from foreign investors.

At the same time, the Brazilian Securities Commission has been making great efforts to deter insider trading practices. This is evidenced by (i) the increase in the number of administrative actions initiated by the Brazilian Commission against potential insiders and (ii) by the enactment of various amendments to existing laws and regulations.

This paper intends to provide a brief overview of the Brazilian insider trading legislation and to discuss two of its most important features: the extension of the prohibition's reach and the criminalization of that practice.

Insider trading proscription in Brazil has developed mostly as a matter of corporate law. It was not until 1976, with the enactment of Brazilian Corporate Law (Law n° 6.404 of 1976), that the disclosure of nonpublic information and the prohibition of its use for private benefit were effectively regulated.

Administrative regulations issued by the Brazilian Securities Commission pursuant to its rulemaking authority have also played an important role in the implementation of insider trading provisions.[1]

The main legal restrictions to insider trading are provided by articles 155 and 157 of our Corporate Law. Pursuant to articles 155 and 157, corporate officers and directors not only have to comply with their duty of loyalty towards the corporation but also owe the obligation to disclose relevant information to the public.

According to article 157, §4, officers and directors of listed corporations "*shall immediately inform the stock exchange and publish in the press any resolution of a general meeting or of the corporation's administrative bodies or any relevant fact which occurs in its business affairs, which may substantially influence the decision of market investors to sell or buy securities issued by the corporation*".

Article 155, §1, provides that an officer or a director of a publicly held corporation shall "*treat in confidence any information not yet revealed to the public, which he obtained by virtue of*

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[*] Concept paper presented on the occasion of the First Annual Symposium on Building the Financial System of the 21st Century: An Agenda for Latin America and the United States, held in June 13-15, 2008 by the Harvard University.

[**] Senior partner with Carvalhosa & Eizirik Law Firm

[1] The Brazilian Securities and Exchange Commission has been vested with considerable rulemaking authority for the implementation of both the Brazilian Corporate Law (Law n° 6.404 of 1976) and the Brazilian Securities Market Law (Law n° 6.385 of 1976). Equally important, the Agency has broad adjudicatory authority to administratively impose sanctions to violations of both of these statutes, as well as to its own regulations. The Commission may impose the following penalties: (i) warnings; (ii) fines not exceeding the amount of R$ 500,000.00 (five hundred thousand Brazilian Reais), 50 per cent of the amount of the irregular operation, or three times the amount of the economic advantage gained or loss avoided due to the violation; (iii) suspension of corporate directors and executives, as well as members of other entities of the securities' distribution system from exercising their duties; (iv) up to 20 years of disqualification of the said persons from occupying their posts; (v) suspension or cancellation of permits of regulated professionals; (vi) regarding members of the securities' distribution system, up to 20 years of prohibition to act on such market; and, (vii) regarding other persons or entities which operate under the Corporate Law, the Securities Law or the Commission's regulations, up to 10 years of prohibition to practice, directly or indirectly, one or more types of transaction in the market.

his position and which may significantly affect the pricing of securities, and shall not make use of such information to obtain any advantages to himself or to third parties by purchasing or selling securities".

The duty to disclose is grounded on the need to provide equal access of information to all investors trading in stock exchanges or in the over-the-counter-market.

The standard of loyalty described in article 155 is considered part of the fiduciary duty owed by corporate officers and directors to the corporation, its shareholders, and investors. The breach of such duty may give rise to civil liability and administrative penalties against insiders who traded to their own advantage and in detriment of the corporation and its shareholders' interests.

Together, these two provisions are said to establish in the Brazilian legal system the American "*disclose or refrain from trading*" principle. In other words, Brazilian Corporate Law requires corporate officers and directors to publicly disclose all of the material facts in their possession before buying or selling securities or, in case they are neither able nor willing to do so, refrain from trading.

In causes of action originated under articles 155 and 177, liability arises only with respect to the misuse of material information unknown to the public at large.

The Brazilian definition of materiality is largely influenced by North American case law: "material" is the type of information of which disclosure is likely to: (i) substantially affect the prices of the corporation's securities in the market or (ii) influence the decisions of possible investors. In other words, the information must be price-sensitive and must relate to any event that may affect the corporation's business or the trading of its securities in the market.[2]

The duty not to trade on uneven circumstances will cease only after the material information has been effectively disclosed in a manner that ensures its availability to the entire investing public. So, investors will be able to trade on an equal basis only to the extent that the market has already started to reflect (by the rising or falling of stock prices) the information made public.

An interesting question arose as to whether trading contemporaneously to the disclosure of material information would constitute an illegal act. The Brazilian Securities Commission held that an order to buy placed on the same day, but within a few hours of the disclosure of relevant information would still constitute the trading based on a material fact privately known by the defendant, a lawyer hired by the issuer.[3]

If the corporate officer has legitimate grounds to keep relevant information confidential on the account of the corporation's strategic interest, the general duty of immediate disclosure

[2] On this regard, Rule 358/2002, article 2, sets forth a series of potentially material facts that may subject corporate officers to the disclosure requirement. The list is non exhaustive and encompasses, to name a few examples, changes in corporate control, mergers, acquisitions, changes in a corporation's assets, changing in accounting *criteria*, and renegotiation of debts.

[3] See Administrative Proceeding n° 04/04, decided on 28.6.2006. The proceeding was brought by the Brazilian Securities Commission against two respondents, both lawyers working on a company's ongoing merger, for allegedly trading on inside information. The defendant in question contended that trading contemporaneously to the public disclosure of the operation would not constitute trading on nonpublic material facts. The Commission found that the order to buy was in fact issued two hours prior to the disclosure and therefore the information in his possession was indeed nonpublic and material. He was nevertheless held not liable on grounds that there was no intent to profit.

does not apply.[4] However, should there be a tipping of the confidential information to third parties or the trading on privileged information, officers and directors are supposed to disclose such information to the market immediately.

Pursuant to Rule 358 of 2002, article 6, § 1, although it is generally accepted that corporations are allowed to prevent some relevant facts from becoming public, there are two exceptions to this rule, both of which requiring controlling shareholders and corporate executives to immediately break confidentiality and disclose all of the material facts to the general public: (i) in cases where evidence leads to a possible leak of information that ought to have remained confidential, and (ii) upon the event of an abnormal market fluctuation, with sudden variations in stock trading volumes and stock prices.[5]

Brazilian law accepts the distinction between primary insiders, or tippers, and secondary insiders, or tippees. Tippers are primary insiders who give "hints" to others (secondary insiders), directly or indirectly, about corporate affairs.

Primary insiders have direct access to material information of corporations pursuant to their conditions as controlling shareholders, corporate executives and in light of their professions. They have access to the material facts directly from its source and have enough experience to ascertain their materiality.

Secondary insiders usually receive the "tips" from primary insiders; they are not subject to confidentiality duties and are not necessarily capable of recognizing the materiality of the information.

Accordingly, the Brazilian Securities Commission has developed two standards of liability for insider trading violations. As far as primary insiders, their position in the corporation allows the assumption that they hold all of the material facts regarding the corporation's business and internal affairs.

Within the above assumption if the respondent is, for instance, a corporate officer, his position in the corporation certainly allows him access to material information about that corporation.

Should such persons engage in trading activities, the Commission, in order to comply with its burden of proof, need only show the existence of undisclosed material information and that the alleged insider traded with securities issued by the corporation.

Yet this assumption is not absolute. In fact, the Commission has in some cases accepted affirmative defenses through which the respondent can show that his decisions to trade were not influenced by privileged information.

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[4] Rule 358 of 2002, article 6: "*The material events may, exceptionally, not be disclosed if the controlling shareholders or the managers understand that their revelation will risk the company's legitimate interest*".

[5] Rule 358 of 2002, article 6, §1: "*The persons mentioned above are under the obligation, directly or through the Director of Relations with Investors, to immediately release the material events, in the case information becomes public or if there is an atypical oscillation in the quotation, price, or negotiated quantities of the securities issued by publicly-held companies or those related to them*".

With relation to secondary insiders, the Brazilian Commission bears the burden to prove that the respondent had previous knowledge of the undisclosed material facts and that he traded on the basis of such information.[6]

In any event, it is the Commission's duty to prove that the undisclosed information is actually material.

Up to this point we have discussed somewhat settled issues of the Brazilian insider trading regulation. Now we shall turn to the analysis of two substantial changes made to insider trading laws and regulations.

Currently, the Brazilian insider trading laws are binding to a wide range of persons who trade securities grounded on material information undisclosed to the public.

However, Brazilian Corporate Law, when originally enacted, solely provided for the liability of corporate executives, their subordinates, and the employees directly involved in the decision-making process. As a consequence, insider trading prohibition could only be imposed on a limited number of persons. Such narrow reach of the law was consistently criticized by scholars.

Academic studies soon began to consider extending the prohibition to controlling shareholders as well, on the grounds that the trading on inside information by such persons could be construed as an abuse of their controlling power.

In 1988, Rule 31 extended the reach of insider trading prohibition. The Rule prohibited *anyone* with knowledge of a material fact to *trade* with securities. Still, the legal prohibition only applied to the *trading* (buying or selling) of securities; hence, there were no legal rules disciplining the *tippers*. The *tipper* couldn't trade, but it could *tip* a third party without breaking any confidentiality duties.

The modifications introduced by Rule 31 were later incorporated into the Corporate Law itself by means of a legislative reform (Law n° 10.303 of 2001). The 2001 reform amended article 155 and complemented the existing standard for insider trading prohibition, considering illegal any *use* of material information with intent to profit, directly or indirectly.

The Brazilian Securities Commission regulated article 155, as amended, in broad terms. Rule 358 of 2002, article 13, expanded the list of possible insiders to include: (i) the corporation itself; (ii) the controlling shareholders (both direct and indirect); (iii) the officers; (iv) the members of boards or councils; or (v) anyone who, by virtue of his position in the corporation or in any of its affiliated, parent or colligated company(ies) has access to relevant facts.

Moreover, article 13, §1, of the said Rule prohibits *any person* from trading on facts known to be material, especially those persons with access to a corporation's inside information by virtue of a professional, commercial or trust relationship, such as lawyers, accountants and market analysts.

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[6] Accordingly, The Commission has decided that a professional relationship between a third party and a corporation does not, *per se*, leads to the conclusion that the *outsider* had access to inside information. Access is not presumed about third persons; instead, it must be proven by the prosecution. See Administrative Proceeding n° 22/04, decided on 20.6.2007.

Rule 358 also enhanced the range of persons who are subject to the duty of disclosure and to the duty of confidentiality. The duty of disclosure falls upon: (i) the market relations officer; (ii) the controlling shareholders; (iii) the directors; and (iv) the members of boards, councils, or any organs with advisory or technical functions created in consonance with the corporation's bylaws.

The legislative reform of 2001 also enacted article 27-D in the Brazilian Securities Market Law (Law n° 6.385 of 1976), which defines the crime of misuse of privileged information."[7] The criminal prosecution of insider trading also requires that the information be material, in much the same way that the civil liability regime does.

However, criminal liability for insider trading is of narrower applicability. Article 27-D is applicable to persons who are subject to confidentiality duties to the corporation. It then applies only to primary insiders. Secondary insiders, on the other hand, may be held guilty only to the extent that they held a duty of confidentiality to the corporation.

Such persons must actually use the information not yet disclosed to the market to trade with securities. *Tippers*, who do not trade on the information, are not criminally liable.

The agent must have, subjectively, intended to profit from the use of the information not yet disclosed to the market. Criminal prosecutors, for this reason, bear the burden of showing that the agent must have *intended* to acquire a private advantage.

The crime still requires that the misuse of privileged information actually results in profits on behalf of the agent; the crime is only consumed upon the gain of an unduly advantage.

Finally, violations against insider trading legislation allow for cumulative penalties ranging from administrative, criminal (fines and imprisonment) and damages. The Brazilian Securities Commission is not entitled to pursue criminal charges; that is only entrusted to the Public Prosecutor's Office, which has, furthermore, the authority to collectively pursue damages on behalf of the harmed investors. Private plaintiffs may, on the other hand, pursue damages individually.

There is one last contemporary trend in Brazilian practice that is worth noticing. Contrary to what happens in the common law tradition, changes to corporate rules in Brazil are traditionally statutory in nature, with little room for the creation of new liability theories by courts (such as, for example, the "misappropriation of corporate information" theory).

Brazilian courts are not generally familiar with matters relating to the securities market. This is due partially to the fact that private enforcement of securities market's violations is relatively unheard of.

Moreover, most of the Brazilian insider trading prosecution occurs at the administrative level. As a result, few judicial precedents exist with regard to securities market regulation.

[7] Securities Market Law (Law n° 6.385 of 1976), article 27-D: "*To use relevant information not yet disclosed to the market, which one may know and which must remain confidential, so as to create undue advantages, for oneself or others, through the negotiation of securities, in one's behalf or on behalf of others: Penalty – imprisonment of one (1) to five (5) years and fine of up to three (3) times the amount of the undue advantage obtained as a result of the crime*".

Simply put, current prohibition of insider trading in Brazil is largely a product of the Commission's regulations and decisions.[8]

This scenario is nevertheless likely to change in the upcoming years.

In the last two cases regarding possible insider trading violations, the Commission has sought to proceed judicially, instead of administratively, to enforce insider trading provisions.[9]

Since the Commission has no powers to prosecute securities market violations in courts, it had no choice but to act in cooperation with the Public Prosecutor's Office.

The Commission's enforcement powers, however broad, are limited with respect to fact-finding possibilities. Long and burdensome investigations generally precede the beginning of adjudicatory proceedings conducted by the Commission.

In fact, the administrative proceedings brought by the Commission – from the beginning of an investigation until a final decision is rendered – may last a few years, depending on the complexity of the case. This passing of time may considerably lessen the effectiveness of an enforcement action.

There are two important incentives to the modification of the Commission's enforcement pattern: judicially ordered provisional measures and a far-reaching judicial discovery process.

Provisional measures may be directed to the freezing of assets or even to suspend a transaction until the closing of the entire proceeding, therefore allowing for a greater effectiveness in the event of a conviction. Also important, judicial actions in Brazil do provide for a more efficient, judge-centered, discovery process.

Additionally, an eventual insider sued in courts by both the Brazilian Securities Commission and the Public Prosecutor's Office is more likely to consider settling the action by means of a consent decree. Brazilian authorities have, on this regard, demanded an amount that provides for the disgorgement of the profits gained and that is, at the same time, compatible to the damages suffered by investors.

Administrative, judicial and criminal proceedings, as mentioned earlier, are considered by Brazilian law as independent courses of action. The Commission may, however, upon signing a consent decree, agree not to initiate an administrative enforcement action, thus providing for an additional incentive to respondents. Criminal prosecution is, in all cases, mandatory.

This should increasingly force insider trading cases into the Judiciary and should soon result in a series of decisions on the matter. Time will tell if the Judiciary's interpretation of insider trading legislation is consistent with that of the Brazilian Securities Commission's. In any

[8] Consequently, if one were to look for guidance on how Brazilian authorities deal and interpret securities market's affairs, the analysis of the Agency's "administrative case law" and regulations would be imperative.

[9] The two cases involved possible insider trading practices in connection to M&A operations and were extensively covered by the media. In both cases, the Brazilian Public Prosecutor's Office, assisted by the Brazilian Securities Commission, brought collective actions against potential insiders. The collective actions also sought provisional measures intended to freeze the assets of the defendants, which were ultimately granted by the judicial authorities. One of such cases was brought against a foreign corporation and was settled with a consent decree in which the defendant agreed to give up all profits earned, as well as to pay a certain amount for compensation for the losses suffered by the investors who traded on unequal circumstances.

event, this process, together with the recent developments in our insider trading laws, will inevitably contribute to the creation of an even more reliable market.

Changing the Paradigm of Stock Ownership: From Concentrated Towards Dispersed Ownership? Evidence from Brazil and Consequences for Emerging Countries

Érica Gorga *

version: May 2008

(Ongoing work. Please do not quote without author's permission.)

Abstract

This paper analyzes micro-level dynamics of changes in ownership structures. It investigates an unique event: changes in ownership patterns currently taking place in Brazil. It contributes to the corporate governance literature, building on this empirical evidence to further advance theoretical understanding on how and why concentrated ownership structures can change towards dispersed ownership.

Commentators have been arguing that the Brazilian capital markets are finally taking off. The number of listed companies and IPOs in the Sao Paulo Stock Exchange (Bovespa) has greatly increased. Firms are adhering to higher standards of corporate governance through migration to Bovespa's special listing segments. Companies have sold control in the market and the stock market has recently seen an attempt of a hostile takeover. This paper discusses these current developments. It analyzes ownership structures of companies listed in Bovespa's listing segments based on data from 2006 and 2007. It provides the first evidence on the decline of ownership concentration in the structure of Brazilian corporations.

There is, however, an important caveat: ownership has become more "dispersed" in Novo Mercado, the listing segment that requires firms to comply with the one-share-one-vote rule. This paper, then, investigates firms' migration patterns. It analyzes what companies have listed in Novo Mercado, Level 2 and Level 1. I find that 85% of Novo Mercado's are "new entrants" firms. Traditional firms have mostly migrated to Level 1, the least stringent segment regarding corporate governance practices. This suggests that we can identify two very different corporate worlds in Brazilian capital markets: the new fashion corporations who adopt better corporate governance patterns, and the old fashion corporations, who still have not changed their main patterns of corporate governance or corporate ownership.

The paper additionally explores the main consequences of increased dispersion of ownership in private contracting, such as shareholders' agreements and bylaws. I present evidence on the increasing reliance on shareholders' agreements to coordinate joint control and to bind directors' votes. I also discuss the new and growing adoption of poison pills in bylaws.

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In addition, this paper supplements recent literature on controlling shareholders. Examining the conditions that have lead Brazilian concentrated ownership to become significantly more dispersed helps to shed light on the incentives that may alter preferences of controlling shareholders. This discussion allows us to understand why controlling shareholders opted for a greater diversity of ownership structures. The analysis enables us to draw comparisons and extract conclusions that contribute to the comparative corporate governance debate and advance our knowledge of corporate structures in other emerging countries.

Conclusion

Departing from a unique vantage point, this paper aims at drawing general conclusions from the Brazilian experience of changing patterns of corporate ownership.

Designing special listing segments with higher standards of corporate governance appears to be an important solution for fostering markets stuck in low-level equilibrium due to poor protection of minority shareholders and poor corporate governance. The Bovespa experiment has shown that many new companies have chosen to adhere to special segments characterized by more stringent corporate governance practices than the ones adopted by companies in the standard market. They are looking for finance in the capital markets instead of making use of their usual alternatives (e.g., debt). So, private regulation may work where public regulation has failed to foster market development.

Nonetheless, this paper cautions that the majority of traditional companies have not yet migrated to Bovespa's new listing segments the way players of the market were expecting them to do. This shows that path dependence still applies: firms tend to persist with their patterns of initial ownership and changes in corporate governance practices that depend on changes in ownership structures may remain hard to achieve.

Brazilian capital markets are going through an important change. The "new entrants" have caused the level of ownership concentration to significantly diminish in Novo Mercado. However this change is accompanied by persistence of the traditional concentration of ownership in Level 2, Level 1 and the standard market. Therefore, we find new practices of corporate governance coexisting with old practices.

This article also identifies an important challenge for the corporate governance literature in general. Corporate governance scholars have restricted their research to companies' charters and bylaws. The analysis of shareholders' agreements in Brazil points out that the contractual relations that affect corporate governance may be more complex than typically expected. An analysis of Brazilian corporate governance that does not take shareholders' agreements into consideration is certainly incomplete. Shareholders' agreements are central in assessing the concentration of corporate control in Brazil. Whether this also applies to assessing corporate governance in other countries is still an open question that deserves more attention from researchers.

Shareholders' agreements are used by companies with a larger degree of ownership dispersion as mechanisms that coordinate joint control and voting rights. In this sense shareholders' agreements substitute share ownership. Furthermore, this analysis makes it clear that control comes in foms other than direct or indirect equity ownership. In addition, shareholders' agreements greatly affect how directors can vote, making them representatives of shareholders' interests and largely undermining their independence.

Poison pills have been cropping up in companies bylaws, which is a remarkable development of increasing dispersion of ownership. We still have to wait to see how poison pills will affect potential attempts of takeover or sales of control. It is unclear whether public regulation will evolve to tackle this phenomenon. It is also unclear what private actors will propose, as they seem to have not yet realized how poison pills may adversely affect the development of the market, by increasing the entrenchment of managers.

Corporate Governance Policies and the Consequences of Its Application in Some Small Latin American Countries

Fernando Jiménez de Aréchaga

I. Background

1.1 Uruguay is a small country, with an open economy, a high literacy rate, a consolidated democracy and a tradition of independency of its judicial system. The level of corruption is low, according to international evaluations, and it is ranked second in this respect in Latin America, behind Chile. There is free inflow and outflow of capital and, in this context, the country has developed an important financial sector with major international Banks operating in Uruguay, such as Citibank, Santander, HSBC, BBVA, Credit Agricole, ABN, etc.

1.2 Uruguay is surrounded by two huge neighbors, Argentina and Brazil; 15 and 45 times bigger respectively. Its internal market is of only 3.1 million inhabitants. Because of its small size, the maintenance of a cultural and legal tradition based on the rule of law has been essential to stimulate and attract foreign investors. The success of the country in this respect has been recognized by the international community as a whole, as Uruguay has always honored its international obligations even in extremely difficult circumstances, such as the devaluation of the Brazilian currency in 1999 and Argentina's default in 2001. These factors are, perhaps, the main reason that explains the development of an important regional financial market.

II. Laws and Regulations applicable to Uruguayan Banks and other Financial Institutions.

2.1 Because Uruguay's off-shore banking activity is significant -especially if one considers the small size of the country -financial institutions operate with very few employees in comparison to international standards and compared to the volume of assets managed. The largest private Bank in the country has a headcount of 500 individuals and the average amount of employees of an entity is estimated to be between 250 to 300. If these figures were to be substantially modified, the increase of costs would immediately affect the rate of efficiency of the Banks involved. It is a fact that the retribution of personnel is a key element in the balance sheet of all financial entities operating in Uruguay.

2.2 In addition, Uruguayan capital markets lacks sufficient liquidity; only sovereign bonds and fixed rate securities are traded publicly on a daily basis. There are very few trade operations with shares in the Uruguayan public stock exchanges.

III. The role attributed to the Board of Directors in Basel II

3.1. Therefore, the model defined first in the Sarbanes-Oxley Act in 2002 and later on in Basel II, in which the powers and functions to be performed by the Board of Directors play a key role, might impact negatively the Uruguayan banking market in terms of costs and rates of efficiency. It is a common practice in the country that important regulations are submitted to public consultation before they are formally enacted by the Central Bank. After completing this process, the Central Bank of Uruguay approved a series of regulations following Basel II recommendations (the "Rules") regarding banking corporate governance issues. These Rules provide that the Board of Directors should have an appropriate structure so as to have an independent approach of the management of the Bank, free of any political influences or other external interests.

3.2. Along these lines, the Rules provide that non-executive Directors should not interfere with the management of the Bank and that the Board should approve the strategy and key significant policies of the banking institution.

3.3. Basel II corporate governance principles, which are now customary and are admitted practice in the most relevant jurisdictions of the world have been contested by the authorities of the major international Banks in Uruguay. Banks in Uruguay interact with the Central Bank through the Private Banks Association where they gather to defend their common interests. In practical terms, the problem is that Banks incorporated as corporations in Uruguay, generally do have one sole shareholder (their own Head-Office) that supervises the functions of the local management (including the Directors). Executive Directors of the local Bank in Uruguay report directly to their Head – Offices in Madrid, Paris, New York, etc. Therefore, the members of the Board of Directors of a Bank appointed in accordance with the Rules, will inevitably play a more nominal role. The Banks have argued that the creation of an independent Board in Uruguay will not only imply a substantial increase of costs, but also, it might be a duplicative control of local management since reporting with Head-Office will not be eliminated or replaced by the mere creation of this ad-hoc Board in Uruguay.

3.4. During the consultation process prior to the approval of the Rules that took place late last year, the CEO of the Private Banks Association submitted a memorandum to the Central Bank where it was stated that the existence of the Board of Directors could be justified in two ways: a) as a mere legal requirement or b) on a more general approach, it should be necessary to define if the "existence" of the Board is justified by the creation of added value and not founded exclusively in the local legal order. And from this standpoint the conclusion would be that if the contribution (of the Board) to the results of the Bank exceeds its costs, then, the evolution and development of the legal regime would probably introduce other alternatives instead of requiring having a Board. In other words, it has been contended that in this last scenario the most probable consequence is that the current applicable laws and by-laws would be amended accordingly. So it is reasonable to state that we are in the presence of an economic problem that the projected Board of Directors should contribute to solve.

The conclusion arising out of this reasoning is that the existence of an independent Board of Directors, as currently provided by Rules, is only justified when there exists multiple shareholders and when the structure of ownership of the Bank is disseminated. But, as it is the case in Uruguay, when the supervisors are faced with stock companies belonging to one single shareholder, the issue that these corporate governance policies address does not exist in the first place. In effect, when a phenomenon of concentration exists, an independent Local Board would be a costly and duplicative solution since control functions will, in practical terms, still be exercised by Head-Office.

3.5. The Private Banks Association also contended, during the consultation process, that the discussion of the consequences and impact of the composition of the Board of Directors in a financial institution is far from being conclusive. There are some authors like Adams(*), who have argued that a majority of external Directors in fact increases the power of the Local CEO. In an also relevant argument for the Uruguayan situation, Betch (*) has said that concentration of the ownership of a company can even be an alternative way to solve the agency problem between owners and administrators.

3.6. The Private Banks Association concluded that evaluation of corporate governance policies in countries like Uruguay should not be limited to the scheme of the Board of Directors if there are other ways to obtain exactly the same results (i.e. an independent approach and supervision of the way in which the local CEO's are performing their functions). The quality of the corporate governance policy, as it is recommended by

Basel II, should not focus exclusively in the formalities of a Board of Directors and should also take into consideration other mechanisms by which the same results can be achieved.

3.7. The petition filed by the Private Banks Association was dismissed by the Central Bank. The Superintendency of Financial Institutions of the Central Bank of Uruguay insisted in enforcing the Rules of corporate governance along the lines recommended by Basel II.

The experience in Uruguay shows how the special characteristics of a given country, its size and population and the negative impacts resulting from the creation of a formal and prestigious Board of Directors can affect the enforcing of policies which, apparently, are accepted widely by the international community.

In fact, the formal enforcement of these Rules create an important problem in the Uruguayan banking system which may affect its competivity vis a vis other financial markets in the region. However, because of the pressure exerted on small countries like Uruguay by first world countries, the Central Bank of Uruguay opted to enact and enforce the Rules ignoring the special circumstances of the Uruguayan market.

(*) Adams, R., “Powerful COEs and their Impact on Corporate Performance”, New York University, working paper, 2003.

(*) Becht, M., “Corporate Governance and Control”, Handbook of the Economics of Finance, North Holland, 2002.

Debt Markets: Where From and Where To?

Dr. Rodrigo Olivares-Caminal[*]

Upon reviewing trends in domestic insolvency law regimes around the world, one point is strikingly clear, i.e. many insolvency laws have recently been amended or are currently under review. One reason is a political reaction to address—for the interests of various parties—the financial and economic cycles which gave rise to some unforgettable crises (e.g. the Asian crisis of 1997; Argentina's external debt default in 2001 and its banking crisis in 2002; or, the more recent US sub-prime mortgage crisis also known as the 'credit crunch' crisis). This review of insolvency laws is also a response to a global impetus focused on avoiding liquidation of troubled companies as well as to the adoption of UNCITRAL's cross border insolvency Model Law.

As stated by Stone, corporate restructuring on a large scale is usually made necessary by a systemic financial crisis, i.e. a severe disruption of financial markets that by impairing their ability to function, has large and adverse effects on the economy[1]. The episodes of Enron, Parmalat, Yukos and Worldcom—which were shadowed by the recent collapses of banks[2], structured investment vehicles (SIVs)[3] and hedge funds[4]—are helpful to remind us that developed countries are not strangers to the need of restructuring, although restructuring is more frequent in developing states due to the lack of sound institutions to counter effect the impact of systemic financial crises[5]. What are some of the key characteristics of recent legislation?

Time is Money: 'Expedited' Insolvency Laws

Since corporations doing business in countries undergoing crises are not exempt from the turmoil, it can be argued that recently amended insolvency laws are aiming for expedited debt restructuring procedures. Clear examples are the recently amended laws of Argentina (2002), Turkey (2004) and Brazil (2005), all of which streamlined or included an expedited debt restructuring procedure similar to the US Chapter 11 pre-packaged deals. Also, e.g., Peru (2002) or Bolivia (2003) adopted pre-negotiated plans as a restructuring option. The difference between the pre-packaged deals and pre-negotiated plans is the moment of solicitation of the creditor's consent. As clearly stated by Jacoby[6], the difference lies in if it is 'pre-voted' or 'post-voted', assessed as of the moment that a court approval (homologation) is requested by the debtor. The key element of these expedited mechanisms is that by giving limited intervention to the court the debtor has the chance to 'cramdown' the dissenting minorities thereby solving the ever feared problem of the holdout creditors.

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[1] Mark Stone, *Corporate Sector Restructuring: The Role of Government in Times of Crisis*, International Monetary Fund, Economic Issues No. 31, June 2002.

[2] These include Bearn Sterns in the US, Northern Rock in the UK and IKB Deutsche Industriebank AG in Germany.

[3] Inter alia, Cheyne Finance, Rhinebridge, Whisthejacket Capital, Golden Key, Mainsail II, etc.

[4] These include Bear Stearns High-Grade Structured Credit Strategies Master Fund Ltd., Carlyle Capital Corporation, Bear Sterns High-Grade Structured Credit Strategies Enhanced Leverage Master Fund Ltd. and Peloton Partners.

[5] A 2003 report on Argentine corporations after the 2001-2002 crises stated that over USD 31.5 billion were restructured including 95% of the stock of corporate bonds (Deutsche Bank, *Compañías Argentinas: de las Cenizas a los APEs*, November 2003).

[6] Melissa B. Jacoby, *Prepacks and the Deal-litigation Tension*, March 2004, 23-2 ABIJ 34.

The intervention of the court is limited in the sense that its role would be limited to: (1) ensure that certain principles (equity, fairness, etc.) have not been violated by the debtor and that the required restructuring threshold has been achieved; and, (2) to homologate the approved plan/agreement making it mandatory to the dissenting minority. If we are facing a pre-negotiated plan, the court will also have to summon creditors to vote the plan under the auspices of the court. However, it is worth noting that the debtor would not request the court's approval if it has not—as its name indicates—pre-negotiated the creditor's consent yet. It is worth noticing, that there are some countries where such proceedings do not even involve a court and where the overseeing authority is an administrative entity (e.g. Peru or Bolivia).

Out-of-Court or Minimum Court Involvement Restructuring Methods in Latin America

Restructuring Method	***Countries***
Pre-Packs Plans	Argentina Brazil Colombia[1] Uruguay
Pre-Negotiated Agreements[2]	Bolivia Peru
Non-Bankruptcy Restructurings	Chile Ecuador Mexico[3] Paraguay Venezuela

[1] All insolvency proceedings in Colombia are out-of-court driven.
[2] Pre-Negotiated agreements in Bolivia and Peru are filed with filed with the regulatory authority (not a court) to summon the creditors to vote and obtain the benefits of its approval.
[3] Although it is a non-bankruptcy workout, the Mexican Law of Commercial Insolvency (§312) contemplates the possibility to recourse to the conciliators of the overseeing authority (INFECOM) to reconcile debtor and creditors' interests.

Other countries, like Japan or Malaysia, have created specific bodies to deal with the restructuring of their corporations on an expedited basis. These restructuring bodies have their own budget to acquire the debt of distressed companies. More examples of the expedited trend in restructuring can be exemplified by soft law or codes of conduct for certain types of debt as is the case in India[7], Italy[8] or Japan[9]. The initiative of codes of conduct is no other that the well

[7] See the Revised Guidelines on Corporate Debt Restructuring (CDR) Mechanism issued by the reserve Bank of India in 2001 as amended and restated in 2005.
[8] See the *Codice di Comportamento tra Banche per Affrontare i Processi di Ristrutturazione atti a Superare le Crisi di Impresa* issued by the Italian Banking Association in 2000.

known London approach coined in 1976 as result of Zaire's payment problems to its creditors (mostly banks).

Importantly, the substance of the new 'expedited' bankruptcy laws is that they provide a signal to creditors that they may be better off engaging in swift, voluntary and less cumbersome restructurings than actual insolvency proceedings.

During the economic stability periods corporations invest and try to expand. During recessive periods, corporations try to maintain their market share and develop new lines of business. In both cases, corporations recourse to different financing techniques to raise the required capital to achieve their objectives. Subject to their debt-to-equity ratio, corporations have to decide if they are going to finance themselves with debt or equity[10].

All time low default rates prior to the US sub-prime mortgage crisis had pushed non-bank financial institutions into new areas in order to extract value during a period of excess cash and low returns which in turn has enabled arranging banks to structure ever bigger and more complicated debt packages comprising tranches of senior debt, second lien, mezzanine and sometimes junior mezzanine[11]. This de-equitization trend based upon the lower cost of debt, excess liquidity in banks due to their tradability in the secondary debt market and collateralized debt obligations repackaging (CDOs and CDOs-squared[12]) has made bond debt (as well as loan debt) relatively more attractive in certain markets vis-à-vis equity. This trend has been recently reversed due to the lack of liquidity as result of the uncertainty created by the sub-prime mortgage crisis.

Role of Converging Investment Funds

It is also important to refer to Hedge Funds and Private Equity Firms, two very important financial players, since the line dividing their activities is blurring. Hedge Funds are typically active in the distressed debt market acting on a short-term basis and providing important returns to their clients. On the other hand, Private Equity Firms operate on a long term basis obtaining loans and buying companies to turn them into profitable entities and sell them for a difference in the acquisition price[13].

In booming periods, Hedge Funds and Private Equity Firms co-exist peacefully but the negotiation skills or aggressiveness (depending your view) of certain Hedge Funds and the fact that they started overlapping in the same business opportunities (although on different sides of the negotiation table) have made them recourse to new techniques. Some Private Equity Firms have requested their lending bank to have the right to know the holder of the loans on a name-by-name basis aiming to avoid being faced with Hedge Funds; and others, by means of side letters, have even barred certain Hedge Funds from voting in the event that the latter have acquired the debt in the secondary market[14].

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[9] See the Guideline for Multi-Creditor Out Of Court Workouts established by the Japanese National Bankers' Association and other relevant organizations in 2001.

[10] See Jack S. Levin, *Structuring Venture Capital, Private Equity and Entrepreneurial Transaction*, Aspen Publisher, 2000.

[11] See S. Patel and M. Fennessy, The Changing Nature of Stakeholders in Restructurings, International Corporate Rescue, Volume 3, Issue 5, 2006, page 266.

[12] A CDO-squared or a CDO^2 is a type of CDO where the underlying portfolio includes tranches of other CDOs.

[13] There is some criticism that private equity firms are now more focused on getting their risk-free adjusted returns up front in the way of fees, and not waiting for the back end so much, but this is another tale, beyond the scope of this piece.

[14] See Henny Sender, Debt Buyers vs. The Indebted --- Showdown Between Hedge Funds and Private Equity May Be Inevitable, The Wall Street Journal, 17 October 2006.

Debt grants their holders a right to collect monies. Therefore, the corporation is obliged to repay the agreed sums of money and the fulfilment of this obligation can be enforced by courts, eventually leading to insolvency. In the case of equity, technically there is no liability. Holders of equity have a residual right over the assets of the company.

Opportunities for International Arbitrage

Since corporations usually have an international presence in different markets, they are able to take advantage of obtaining financing from other financial markets in a foreign currency with better terms, resulting in lower costs. On the other hand, if a corporation does not have international presence and it tries to obtain financing abroad, which—in the case of developing countries and some developed countries as well—the debt would be denominated in a strong foreign currency in order to avoid risks (financial, currency, political, etc.). In both cases, corporations will end up being indebted in a foreign currency while its income is normally denominated in the local currency of the country of said corporation's place of business.

When the economies of the countries of these indebted corporations are going through a recessive period, they are faced with low rates of return. Upon a crisis, currencies of legal tender are prone to devaluation resulting in even lower rates of return. While the income of corporations is reduced, the burden to pay principal and/or interests of the corporation's indebtedness in a foreign and 'strong' currency increases. This mismatch, in many cases has ended in restructuring episodes. As Rieffel stated, a sharp depreciation of the domestic currency in the course of a crisis causes companies to default on their loans from domestic banks as well as from foreign creditors, rendering a large segment of the corporate sector insolvent[15].

The use of expedited debt restructuring episodes—a debtor driven approach—allows debtor and creditors to negotiate the terms of an agreement in a shorter period of time than traditional reorganization procedures avoiding the problem of hold-out creditors, long and costly procedures, full disclosure of information, bad press, etc.

As the Argentine crisis in 2001-2002 has proven—not only with the sounded Multicanal case trialed in New York but with many other Argentine companies that recently had restructured their debts[16]—expedited debt restructuring episodes were essential in facilitating reorganization procedures. Highly indebted corporations have been able to 'wash' their balances over a short period of time with the collaboration of their creditors gaining a solid credit ratio. Although we would expect, as it is common, increased business activity in the debt market, that may not be the case since trying to block a restructuring to obtain better terms might become too risky[17]. *In lieu*, buying shares of a distressed company upon an event of default (when non-qualified investors usually try to get rid of their shareholding or qualified investors sell their shareholdings due to a liquidity problem as result from the crisis) might provide the possibility to buy shares of a highly indebted company at low cost. Actually, this is what Hedge Funds are doing: trading. Hedge Funds have the added value of their expertise in the distressed debt market.

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[15] Lex Rieffel, *Restructuring Sovereign Debt: The Case for Ad-hoc Machinery*, Brookings Institution Press, 2003, pages 43-44.

[16] Among others, Acindar S.A., Autopistas del Sol S.A., CTI Holdings S.A., Metrogas S.A., Química Estrella S.A.C.I, Sideco S.A., and, Telecom Argentina S.A.

[17] Moreover, it should also be borne in mind that most of the companies undergoing reorganizations—at least from the Argentine experience—are utilities companies or service providers which in the case of liquidation do not have many assets to liquidate.

Thus—over a short period of time—by means of an expedited debt restructuring procedure, the default would be cured and a big portion of the company's liabilities would have disappeared from the balance sheet. Consequently, an expedited debt restructuring procedure contributes to the viability of the company and could increase the value of the shares that were bought at steep discount after an event of default. The example of Telecom Argentina S.A. can be used to demonstrate the decrease experienced in the price of share certificates (ADRs) of a highly indebted company upon financial distress and its rebound upon achieving a successful restructuring (see table below).

Fluctuation of the Price of Shares (ADRs) of a Telecom Argentina S.A. undergoing a pre-pack deal

Date	***Status of the Restructuring***	***Value of the ADRs (USD)[1]***
02/10/2001	Six months prior to default	1.60
02/04/2002	Announcement of the need to suspend payments on principal	1.40
24/06/2002	Announcement of moratorium on interests	0.61
03/10/2002	Initial restructuring proposal	0.87
09/01/2004	Announcement of APE proposal	11.05
23/08/2004	Announcement of the results of the solicitation process	8.60
21/10/2004	Filing of the pre-pack with the court for homologation	6.18
04/02/2005	Noteholders' meeting endorsing the pre-pack	7.05
04/03/2005	One month after achieving the restructuring	8.42

[1] There are other factors besides the APE restructuring that might also impact on the price of the share (i.e. country risk, company's performance, etc.). Due to the scope of this article, no further analysis is provided on this regard.

The Emergence of SIVs and SIVs-lite

Other important note is the emergence of SIVs. SIVs are structured investment vehicles that are characterized by the following operating structure: (1) buy assets with long dated maturities; (2) borrows by using short dated paper; (3) exploits positive yield spread; and, (4) as result of being a rated structure have access to cheap financing[18]. The capital structure of SIVs is of USD 1billion to USD 30billion in size. Cheyne Finance was the first SIV portfolio that faced distress as result of the turmoil originated by the US sub-prime mortgage market[19]. However, there were other SIVs that suffered mismatches by the short of liquidity in the market and followed the instability of Cheyne Finance. The following table illustrates the impact of the sub-prime mortgage crisis in different SIVs:

[18] In order to be able to obtained the desired rating SIVs have to have a capital cushion to absorb losses and an offshore bankruptcy remote issuer.
[19] See Financial Times, 'Lex Column: Cheyne Reaction', 30 August 2007.

Structured Investment Vehicles in Distress		
SIV	**Capital**	**Status**
Cairn Capital	USD 1.6 billion	Restructured
Victoria Finance Corporation	USD 8.0 billion	In default
Axon Financial Funding	USD 8.5 billion	In default
Orion Finance	USD 0.8 million	In default
Sachsen Funding	USD 2.2 billion	Waivers Negotiated
Golden Key	USD 1.3 billion	Receivership
Mainsail II	USD 1.3 billion	Receivership
SIV Portfolio (Cheyne Finance)	USD 8.0 billion	Receivership
Rhinebridge	USD 0.9 million	Receivership
Whistlejacket Capital	USD 8.0 billion	Receivership

The latest amendments to the US Bankruptcy Code[20] have left open the door to a new type of SIV which relies on the market value of the assets and the ability to realize on this value by selling the assets in the market, i.e. SIV-lite[21].

These two attractive investment vehicles are going to proliferate do to their enhanced 'synthetic' capacity to do business which implies a reduced working capital structure and an enhanced profit making capability.

The Context of Sovereign Debt

In the field of sovereign debt restructuring, two significant events took place in 2004-2005. Iraq[22] and Argentina[23] reached an agreement to restructure a significant part of their external debt—which in each case was slightly over USD 120 billion[24]—achieving a 75% reduction[25]. While the Iraqi case is important due to its geopolitical weight and its landmark

[20] Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23 (2005).
[21] See Jim Croke, Thomas Mitchell and Sharad Samy, 'Into the Lite', IFLR, February 2007.
[22] For a more detailed description of Iraq's debt composition see Michael A. Weiss, 'Iraq: Debt Relief', CRS Report for the US Congress, updated on 11 March 2005, available at http://www.fas.org/sgp/crs/mideast/RS21765.pdf . Though Iraqi's debt is not part of the scope of this thesis, however reference to it would be made for illustration purposes.
[23] Argentina's debt, USD 120 billion, includes the so called eligible debt (debt to be under the scope of the restructuring as will be seen in more detail in the chapters addressing Argentina's debt restructuring episode) and the debt owed to bilaterals and multilaterals. See Dr. Guillermo Nielsen, Speech of Secretary of Finance: Argentina's Restructuring Guidelines (22 September 2003) at http://www.argentinedebtinfo.gov.ar/ing_presen.htm.
[24] Although in both cases was above USD 120 billion not all their external debt was subject to the restructuring.
[25] Other sovereign debt restructuring episodes followed. These were: Antigua & Barbuda, Belize, Dominica, Dominican Republic, Grenada, Iraq and Serbia and Montenegro. Due to their relative importance vis-á-vis their impact on the international financial architecture they are not analyzed in this work.

significance *vis-à-vis* the Paris Club[26], the Argentine case is important for its implications to the international financial architecture[27] due to the complexities that it entailed.

The new developments in sovereign debt restructuring include: (1) Argentina—International Monetary Fund's 'star-performer'[28]—obtained a 75% nominal haircut (Buenos Aires Terms[29]) after the rejection of the 92% net present value reduction originally proposed (Dubai Terms[30]); (2) Iraq obtained the approval to achieve a 75% write-off on its bilateral loan agreements (Paris Club)[31]; (3) the *LNC vs. Republic of Nicaragua* case that was resolved in a Belgium court[32] addressing the *Pari-Passu* clause issue and overturning the *Elliot* case[33]; (4) Germany's issuance of the 'Aries' Bond, repackaging the Paris Club's debt owed by Russia in order to count the proceeds as budget revenues and, thus help meet European Union's budget deficit criteria[34]; (5) Belgium passed Law 4765 providing insulation to the payments done through *Euroclear* to avoid a new *Elliot* case[35]; (6) extensive Italian litigation that derived in the sanction of two banks in 2005 (Intesa and Unicredit) by the *Commissione Nazionale per la Societá e per la Borsa* (Consob); (7) the filing of a bill of law with the Italian parliament to protect investors due to the lack of information and breach of fiduciary duties by banks as the result of Argentina's default, which resulted in a decree enacted by the *Consiglio dei Ministri* to indemnify retail investors; (8) *Urban vs. Republic of Argentina* was the first ever class action certified upon a sovereign default[36]; and, (9) Silvia Seijas, Heather M. Munton and Thomas L. Pico Estrada vs. the Republic of Argentina where—indirectly—organized creditors (blocking holdings) were a

[26] The Paris Club is an informal group of official creditors willing to treat in a co-ordinated way the debt due to them by the developing countries. It describes itself as a 'non-institution'. Decisions are made on a case by case basis in order to permanently adjust itself to the individuality of each debtor country. It was established in 1956, when Argentina agreed to meet its public creditors in Paris. See http://www.clubdeparis.org/en/index.php and International Monetary Fund, 'A Guide to Committees, Groups and Clubs: A Factsheet', August 2006, available at www.imf.org.

[27] For a description of the emergence of the 'International Financial Architecture' see Mario Giovanoli 'A New Architecture for the Global Financial Market: Legal Aspects of International Financial Standard Setting' in Mario Giovanoli eds., 'International Monetary Law: Issues for the New Millenium', Oxford, 2000, pages 3-59. For a detailed description of the proposals on the new International Financial Architecture see Barry Eichengreen, 'Towards A New International Financial Architecture: A Practical Post-Asia Agenda', Washington, DC: Institute for International Economics, 1999; and See Rosa M. Lastra, 'Legal Foundations of International Monetary Law', Oxford University Press, 2006, pages 448-499.

[28] See e.g. International Monetary Fund, 'IMF Executive Board Discusses Lessons from the Crisis in Argentina', Public Information Notice (PIN) No. 04/26, 24 March 2004.

[29] This was the second restructuring proposal made by the Argentine Government on 1 June 2004 in Buenos Aires, the capital city of Argentina. Therefore, it is known as the Buenos Aires terms in relation to the place of announcement of the proposal.

[30] This was the first restructuring proposal made by the Argentine Government on 22 September 2003—almost two years after the moratorium—and it was known as the Dubai terms because it took place within the IMF and World Bank Annual Meetings in Dubai.

[31] The settlement with the Paris Club was reached on 21 November 2004.

[32] Republique Du Nicaragua v. LNC Invs. LLC, No. 2003/KR/334, at 2 (Cour D'Appeal de Bruselas, Neuvieme Chambre [Ct. App. Brussels, 9th Chamber] 2004) (on file with author).

[33] See Elliott Assocs. L.P., General Docket No. 2000/QR/92, Court of Appeals of Brussels, 8th Chambers, September 26, 2000 (not reported). Also see 948 F. Supp. 1203, S.D.N.Y., 13 December 1996; 961 F. Supp. 83, S.D.N.Y., 28 April 1997; 12 F. Supp. 2d. 328, S.D.N.Y. 6 August 1998; 194 F. 3d. 363, 2nd. Cir. (N.Y.), 30 October 1999; and, 194 F.D.R. 116, 54 Fed. R. Evid. Serv. 1023, S.D.N.Y., 1 June 2000.

[34] See Jane Brauer and Ralph Sueppl, 'Russia's New Aries Bond', Merrill Lynch Emerging Markets Report, IEM: Sovereigns, 30 June 2004; and, Tim Ash, 'Russia: Repackaging of Paris Club Debt to Germany', Bear & Sterns, Sovereign Eastern Europe Update, Emerging Markets Sovereign Debt Research, 30 June 2004.

[35] See [C-2004/03482] and Chambre des Représentants de Belgique, Chambre 2e Session de la 51e Législature 2003-2004, pages 63-65 (on file with author).

[36] H.W. Urban GmbH v. Republic of Argentina, No. 02 Civ. 5699 (TPG), 2003 U.S. Dist. LEXIS 23363 (S.D.N.Y. Dec. 30, 2003).

threat to a sovereign debtor[37].

Sovereign debt restructuring has an important degree of complexity (multi-jurisdictional legitimacy, problems of collective action and others). Although each sovereign debt restructuring episode is unique, there are certain similarities that can be recognized. After the restructuring experiences of the late 1990s (i.e. Russia, Ukraine, Pakistan, Ecuador and Uruguay) and the criticism the IMF has suffered due to its International Lender of Last Resort (ILOLR) role in the Mexican and Asian crises[38], it can be said that two alternatives were developed to tackle the key problem of the holdout creditor in the context of sovereign bond restructuring (a statutory Sovereign Debt Restructuring Mechanism proposed by the IMF and commonly known under its acronym *SDRM*[39]; and, a contractual approach by the use of exit consents[40] and collective action clauses, CACs)[41]. Both alternatives draw from corporate restructuring techniques either out-of-court (i.e. CACs and exit consents) or under supervision of a 'court' (SDRM).

Restructuring sovereign debt is like out-of-court corporate debt restructuring. The only considerable difference is that both—debtor and creditor—know that upon failure of the debt restructuring process in the corporate context there is a last resort that does not exist in the sovereign context (i.e. bankruptcy).

Although the SDRM, a regime based on US Chapter 11, has been considered for the sovereign context, the lack of fear of ending being winded up as the result of a liquidation process—something which is not and would not be available for sovereign states—alters the whole rationale in sovereign debt restructuring. Neither the government of a sovereign can be replaced nor can the sovereign be closed down and sold to the highest bidder[42].

Since the bankruptcy instance does not exist in the sovereign context, both debtor and creditors had become more aggressive. Hence, it is a challenge for academics and practitioners to come up with creative and innovative solutions to restructure sovereign context. Another tool developing in the context of sovereign debt is the use of derivative products (credit default swaps or CDS). Their success and capability of confronting a mass default alike the ones of Argentina is still to be proven.

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[37] See Silvia Seijas, Heather M. Munton and Thomas L. Pico Estrada vs. The Republic of Argentina (04 Civ. 400). On 15 November 2004, Argentina filed a Memorandum of Law with the District Court of the Southern District of New York in opposition to plaintiffs' motion for a preliminary injunction. Argentina confirmed that it would not use exit consents in their final exchange offer launched on 12 January 2005.

[38] See Charles W. Calomiris, 'The IMF's Imprudent Role as Lender of Last Resort', The Cato Journal, Vol. 3, Issue 17 (1998). See also Rosa M. Lastra, 'Lender of Last Resort, an International Perspective', The International and Comparative Law Quarterly, Vol. 48, No. 2 (Apr., 1999), pp. 340-361.

[39] See International Monetary Fund, 'Proposals for a Sovereign Debt Restructuring Mechanism (SDRM)', A Factsheet - January 2003, available at http://www.imf.org/external/np/exr/facts/sdrm.htm

[40] See Lee Buchheit and G. Mitu Gulati, 'Exit Consents in Sovereign Bond Exchanges', *UCLA Law Review* 48:59-84, 2001.

[41] Both alternatives within the contractual approach either have flaws (e.g. CACs are not included in all bonds, only in those issued as of late 2003) or can be improved (e.g. by using them combined or with special features. It can be argued that in the restructuring of Uruguay sovereign debt in 2003 various techniques were used together (i.e. 'tick-the-box' exit consents, the adoption of CACs with the possibility of aggregation and term enhancements). However, it is worth noticing that in the case of Uruguay there was no default and the restructuring was launched to prevent a moratorium on the outstanding debt.

[42] See Lex Rieffel, *Restructuring Sovereign Debt: The Case for Ad-hoc Machinery*, Brookings, Washington DC, 2003, page 293.

Vulture Funds: Good Guys or Bad Guys?

Holdouts include different kinds of creditors, but mainly consist of vulture funds and retail creditors. Vulture funds have an eminent role in the international financial markets, as they purchase defaulted debt to satisfy the seller's liquidity requirements. Needless to say, in order to take the risk that implies purchasing defaulted debt, the debt is purchased at a large discount on its par value. The vulture fund bets on recovering the debt's par value through a legal action, therefore not only covering collection expenses but also obtaining an additional gain, which is its source of income. Apart from being essential for financial markets, this business is in compliance with the rule of law. For example, a vulture fund that purchased defaulted bonds of the Republic of Argentina by mid 2002 –when the bonds were traded in the secondary markets at 0.20% or less of their par value- and at the time of the exchange selected the peso-denominated bonds at a price of 35 to 37 cents, would have obtained an annual yield of 25%[43]. This is the reason why many Italian creditors—fearing that as result of the default they will not be able to recover their investment—traded their debt to vulture funds, which made the latter obtain a significant gain[44].

Vulture funds that did not take part in the exchange offer have become popular for their judicial attempts to recover their credits, and this is why holdouts have been related to vulture funds, although they are not necessarily the same thing. While a 'holdouts' is a creditors that do not take part in a debt exchange, a 'vulture fund' is an investment fund that operates in the distressed debt market. The most widely known case of a holdout that was also a vulture fund is the infamous *Elliot*[45].

Concluding Remarks

In summary, we are heading towards an environment where (1) traditional players (e.g. Investment Banks) are losing terrain with Hedge Funds (e.g. Silver Point represented the creditors in the Chapter 11 restructuring proceeding of Tower Automotive *in lieu* of the investment bank involved, i.e. Morgan Stanley); (2) Hedge Funds and Private Equity Firms are starting to face each other on opposite sides of the table; (3) the use of expedited debt restructuring mechanisms, as the codification[46] of private workouts would start to be seen more often; (4) a much more complex restructuring environment will arise as result of the sophistication of international financing (structured vehicles) and globalization; (5) vulture funds and those market players that try to create value on their investment by means of litigation are not necessarily bad since they perform much of the 'cleaning of the leftovers' of a crisis; and, (6) the current structural context including volatility across the markets, inflation fears and rocketing commodity prices will foster a vast activity in the distressed debt.

[43] See The Economist, '*A Victory by Default',* 3 March 2005.

[44] See the article Publisher in Infobae on 2 February 2005, titled '*Los italianos ya vendieron 40% de los bonos en Default*'.

[45] See Elliott Assocs. L.P., General Docket No. 2000/QR/92, Court of Appeals of Brussels, 8th Chambers, September 26, 2000 (not reported). Also see 948 F. Supp. 1203, S.D.N.Y., 13 December 1996; 961 F. Supp. 83, S.D.N.Y., 28 April 1997; 12 F. Supp. 2d. 328, S.D.N.Y. 6 August 1998; 194 F. 3d. 363, 2nd. Cir. (N.Y.), 30 October 1999; and, 194 F.D.R. 116, 54 Fed. R. Evid. Serv. 1023, S.D.N.Y., 1 June 2000.

[46] The term codification is used as the mechanism of becoming part of the norms of each jurisdiction.

APPENDIX III

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