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REPORT ON THE OBSERVANCE OF STANDARDS AND CODES (ROSC)

Corporate Governance Country Assessment

MEXICO

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This Corporate Governance Assessment was completed as part of the joint World Bank-IMF program of Reports on the Observance of Standards and Codes (ROSC). It benchmarks the country's observance of corporate governance against the OECD Principles of Corporate Governance and is based on a template developed by the World Bank. This assessment was undertaken on the basis of the template and report prepared by ESANE Consultores, SC for the World Bank. Acknowledgments are due to Secretaría de Hacienda y Crédito Público, Comisión Nacional Bancaria y de Valores, Bolsa Mexicana de Valores, Indeval, Institutos Mexicanos de Contadoras Públicos, Consar, leading experts on legal, accounting and auditing issues, capital market issuers, institutional investors, and stakeholder groups. Mierta Capaul and Alexander Berg of the Corporate Governance Unit Private Sector Advisory Services of the World Bank drafted the final report. The ROSC assessment was cleared for publication by the Ministry of Finance on September 18, 2003.

EXECUTIVE SUMMARY

This report provides an assessment of the corporate governance policy framework, enforcement and compliance practices in Mexico.[1] Mexico has overhauled its policy framework over the past two years and developed world-class standards in a number of different areas. The key challenge for policymakers is to continue to enforce new laws and regulations, while carefully monitoring the corporate governance environment to determine if additional measures are necessary.

This report highlights the recent improvements to the laws and regulations, makes policy recommendations where appropriate, and provides investors a benchmark against which to measure corporate governance in Mexico. In recent years there have been a number of major reforms, including the drafting of an early code of best practice, the redrafting of key provisions of the securities market law (including requirements for mandatory audit committees and independent board members), new regulations of the market for corporate control, and regulations issued in 2003 that resulted in an "issuer manual" specifying disclosure guidelines for listed companies that largely meet OECD guidelines. However, experience around the world suggests that implementation and enforcement of the rules remain key challenges. In addition, the assessment notes the future importance of corporate governance for the AFORES, as they begin to invest in the equity (and debt) of Mexican listed firms.

The report identifies key next steps that focus on implementation, including (i) the creation and rapid development of a director training institution, to communicate the variety of new rules to board members and to build a culture of strong and independent boards of directors; (ii) focused enforcement of the new disclosure provisions, with increasing emphasis on a review of content; (iii) the development of corporate governance standards for the AFORES with respect to their portfolio companies; (iv) the review of several legal provisions, and a general need to simplify the legal and regulatory framework. Together, these measures will help to implement the recent reforms and provide new opportunities for issuers to implement best practices.

I. CAPITAL MARKETS AND INSTITUTIONAL FRAMEWORK

Mexico's equity market is small relative to its economy and to other countries' in the region. At the end of 2002, market capitalization was USD 126.5 billion or about 17.5 percent of GDP.[2] As a percentage of GDP, the Mexican market was the seventh largest in Latin America, behind Chile, Brazil, Jamaica and Trinidad. In terms of absolute size, Mexico was the third largest, after Chile and Brazil.[3] The *Bolsa Mexicana de Valores* (BMV) is the country's stock exchange; 170 companies were listed at year-end 2002.[4] Teléfonos de México (Telmex) accounts for over 11 percent of market capitalization, and about 61 percent of market capitalization comes from the largest ten companies.[5] The BMV is nominally an SRO, but operates under close supervision of the *Comisión Nacional Bancaria y de Valores* (CNBV). Free float averages 12 to 15 percent of capital. Ownership is thus highly concentrated. A study using data from the mid-1990s found

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[1] This report was prepared in cooperation with the World Bank team preparing the Accounting and Auditing ROSC. For a complete treatment of accounting and auditing standards, compliance, and recommendations, please refer to that ROSC.
[2] Source: Emerging Markets Database and EIU preliminary 2002 GDP forecast.
[3] Source: World Development Indicators, 2001 data.
[4] Compared to 195 listed companies in 1998. The actual number of traded companies was smaller, since trading in 35 of the listed issues was suspended. The BMV estimates that in about half of these cases the suspension is permanent, pending delisting.
[5] Source: BMV, data for March 2002.

that the three largest shareholders in the ten largest non-financial, privately-owned firms owned 64 percent of capital, the second highest concentration of countries surveyed.[6] Foreign ownership and/or voting rights are restricted in some sectors. In many firms, one class of shares gives full voting rights to the family controllers, while others have limited or no voting rights. Financial and industrial groups have been key in Mexican economic development. Business groups are characterized by vertical, horizontal, or conglomerate integration. Holding companies make most key decisions, including financing, dividend policy, fixed assets, and hiring of top managers.

The legal framework is based on civil law. The two key laws affecting corporate governance are the Company Law (*Ley General de Sociedades Mercantiles, or* LGSM), and the Securities Market Law (*Ley del Mercado de Valores*, or LMV). The LGSM, enacted in 1934 and most recently amended in 1996, establishes basic company forms and shareholder rights. The LMV, which regulates public companies, was introduced in 1975, but major amendments went into effect in 2001.[7] CNBV has issued a number of regulations (*circulares*) that cover aspects of corporate governance, including disclosure obligations. In early 2003, these *circulares* were reissued and updated in the form of an "issuers manual" as the *Circular Única* (CU).

The capital market regulator is the CNBV. It is a supervisory arm of the Ministry of Finance and supervises banks and the securities market and enforces shareholders rights. It is governed by a three-member board, including a chairman. The chairman is appointed and removed by the Ministry of Finance (SHCP), and in practice, changes with each Presidential administration. CNBV has some operational independence but no authority over its budget.[8]

In 1999, a private sector group (*Consejo Coordinador Empresarial)* issued voluntary corporate governance practices (*Código de Mejores Practicas Corporativas,* or CMP), developed in consultation with a wide range of experts. These include recommendations on board organization and functions, as well as the protection of minority rights. In October 1999, CNBV issued a circular requiring that companies file "comply or explain" reports on compliance with the CMP.

II. REVIEW OF CORPORATE GOVERNANCE PRINCIPLES

This section assesses Mexico's compliance with each of the OECD Principles of Corporate Governance. Policy recommendations may be offered if a Principle is less than fully observed.[9]

Section I: The Rights of Shareholders

Principle IA: The corporate governance framework should protect shareholders' rights. Basic shareholder rights include the right to: (1) secure methods of ownership registration; (2) convey or transfer shares; (3) obtain relevant information on the corporation on a timely and regular basis; (4) participate and vote in general shareholder meetings; (5) elect members of the board; and (6) share in the profits of the corporation.

Assessment: ***Largely observed***

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[6] Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer, Robert Vishny, "Law and Finance," NBER Working Paper No. 5661, July 1996.
[7] There is no practical distinction between "public" and "listed" companies in Mexico.
[8] Until three years ago, CNBV had its own budget authority.
[9] **Observed** means that all essential criteria are met without significant deficiencies. **Largely observed** means only minor shortcomings are observed, which do not raise questions about the authorities' ability and intent to achieve full observance in the short term. **Partially observed** means that while the legal and regulatory framework complies with the Principle, practices, and enforcement diverge. **Materially not observed** means that, despite progress, shortcomings are sufficient to raise doubts about the authorities' ability to achieve observance. **Not observed** means no substantive progress toward observance has been achieved.

Description of practice: **Secure methods of ownership registration.** All shares are registered. Public companies deposit their shares in the central depository (Indeval).[10] 99 percent of shares are estimated to be on deposit.

Convey or transfer shares. Shares are freely transferable.[11] Indeval clears and settles transactions on a T+2 DVP basis. Clearance and settlement appears to comply with ISSA G30 2000 recommendations. Shares are not blocked from trading before AGMs but cannot be withdrawn from the Indeval system. Share blocking rules are not clear to all market participants.[12]

Obtain relevant information on the corporation on a timely and regular basis. Companies are required to make periodic and continuous disclosures to shareholders and the public. This information is available on EMISNET, the BMV's information disclosure system.

Participate and vote in general shareholder meetings. A complicated pattern of non-voting and limited voting shares provide exceptions to the one share/one vote rule.

Elect members of the board. Shareholders elect members of the board of directors. Cumulative voting is not allowed. However, minority shareholders who own 10 percent of full-voting or limited-voting shares may appoint one board member (and his/her alternate).[13] In practice a slate of candidates is proposed to the annual shareholders' meeting (AGM) by management.

Share in the profits of the corporation. The board proposes dividends to the AGM for approval.

Policy recommendations: Share blocking rules should be clarified and specified. Voting procedures should be made as user-friendly as possible for all shareholders.

Principle IB: Shareholders have the right to participate in, and to be sufficiently informed on, decisions concerning fundamental corporate changes, such as: (i) amendments to the governing documents of the company; (ii) the authorization of additional shares; and (iii) extraordinary transactions that in effect result in the sale of the company.

Assessment: ***Partially observed***
Description of practice: Fundamental issues are usually decided at extraordinary general meetings (EGM).[14] To be listed, companies stipulate in their bylaws that the AGM/EGM must approve share capital increases and reductions.[15] However, the board may approve "large" transactions without shareholder approval.[16]

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[10] Indeval (*Institución para el Depósito de Valores, S.A. de C.V.)* provides services relating to the custody, administration, and transfer of securities, and holds shares through a standard two-tier holding structure. Each public company must deposit its shares in Indeval, in most cases through a "jumbo" certificate. To access Indeval's services, each shareholder must hold shares with one of Indeval's direct participants (custodians or brokerage firms). Each direct participant maintains two accounts at Indeval, one for foreign beneficial owners and one for Mexican beneficial owners. Evidence of ownership consist of (a) the broker/ custodian's books and records, and (b) a certificate issued by Indeval indicating the total number of shares that each custodian has on deposit.
[11] There are a number of exceptions to this general rule that are described in Annex D.
[12] The IIF, in its May 2003 survey of corporate governance practice in Mexico, states that voting shares are blocked before shareholder meetings, contrary to practice described by Indeval.
[13] This percentage may be lowered in the bylaws.
[14] Fundamental decisions are defined here to include drawing up/amending company bylaws, capital increases/decreases (including issuing new shares), mergers, changing rights or transforming share types/classes, the waiver of pre-emption rights, issuing bonds, share buy-backs, large transactions, changes to company objectives, and changing company form.
[15] CU, Article 8.
[16] Large transactions are defined as the purchase or sale of at least 10 percent of assets, guarantees for amounts above 30 percent of assets, and any other transaction representing more than 1 percent of total assets.

Policy recommendations: Large transactions should require shareholder approval.[17]

Principle IC: Shareholders should have the opportunity to participate effectively and vote in general shareholder meetings and should be informed of the rules, including voting procedures, that govern general them. (i) Shareholders should be furnished with sufficient and timely information concerning the date, location and agenda of general meetings, as well as full and timely information regarding the issues to be decided at the meeting. (ii) Opportunity should be provided for shareholders to ask questions of the board and to place items on the agenda at general meetings, subject to reasonable limitations. (iii) Shareholders should be able to vote in person or in absentia, and equal effect should be given to votes whether cast in person or in absentia.

Assessment: ***Partially observed***

Description of practice: The AGM must be held within four months after the fiscal year's end at the company's domicile. The quorum is 50 percent of capital stock, and resolutions are passed by a majority of shares represented. If quorum is not reached at the first call, there is no quorum for a second AGM, and the resolutions are passed by a majority of shares represented. The EGM quorum is 75 percent of capital stock, and resolutions are passed by a majority of 50 percent of the capital stock. It is not unusual for a call to state that, absent a quorum on first call, a second call will follow an hour later. Meetings are typically convened by the board, but may be convened by the *comisario*. Shareholders who own 10 percent of full-voting or restricted voting shares may request the board of directors or the *comisario* to convene an AGM or EGM.[18]

The notice must contain the meeting agenda and be published in the Official Gazette and a newspaper of wide circulation, fifteen days in advance. The notice must be delivered to CNBV and to the BMV, which makes it public. Upon notice publication, issuers must give shareholders all necessary information on all issues to be addressed, at no cost and in a timely manner.

Shareholders cannot force an item onto the agenda. The AGM may only approve resolutions on items on the published agenda.[19] Indeval produces a document (*constancia*) to provide evidence of ownership at general meetings. Voting is done on a show of hands. A poll may be requested by the person presiding or a majority of shareholders present.[20] Minority owners of 10 percent of full-voting or restricted voting shares can delay the vote at the AGM for three days, if they consider that they received insufficient information. Shareholders may be represented by proxies, who must prove their legal status through a mandatory, company-approved form. The minutes of the meeting must be delivered to CNBV and to BMV, which publishes an extract.

Policy recommendations: A small number of shareholders (e.g. 5 percent) should be able to force resolutions onto the agenda and request a formal poll. Additions to the agenda should be re-

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[17]Although the OECD Principles recommend that shareholders approve large transactions, the level at which shareholder approval would be required varies from country to country. In Chile, for example, shareholders vote on decisions to dispose of or mortgage 50 percent or more of the company's assets. In Russia, a similar threshold is 2 percent.

[18] When no meeting has been convened in two consecutive periods, or when those meetings did not address the required agenda, any shareholder can request the board of directors or the *comisario* to convene an AGM or EGM When any lawfully requested meeting is not convened within the 15 days of the request, shareholders can ask a court to convene the meeting.

[19] If all shares are represented at an AGM or EGM, an item not included on the agenda may be added and voted upon.

[20] As in most civil law countries, the formal rule is that shareholders must own shares on the date of the shareholders meeting to vote, and the concept of "record date" is not recognized under Mexican law. However, as all shares are registered by Indeval, in practice shares are not blocked before the meeting. Although the formal company share registry cannot be updated, shares can be transferred within the Indeval system. Thus, shares cannot be withdrawn from Indeval between the date of issuance of the *constancia* and the meeting date. Thus, the date of issuance of the *constancia* by Indeval is the record date for the meeting. The holder of the *constancia* can vote the shares even if he has subsequently traded them. Indeval issues the *constancia* five working days before the meeting for issuers domiciled in Mexico City (eight working days if domiciled elsewhere). The issuer must provide Indeval with a copy of the meeting notice at least one day before its publication.

circulated and published at company expense. A minimum interval should be established between first and second meetings. Policymakers should consider extending the meeting notice period to 30 days, in line with international investor requests.[21] The process of making minority appointments to the board during the annual meeting should be standardized.

Principle ID: Capital structures and arrangements that enable certain shareholders to obtain a degree of control disproportionate to their equity ownership should be disclosed.

<u>Assessment:</u> ***Partially observed***
<u>*Description of practice*</u>: New rules require issuers to disclose their ownership structure in the annual report. The "managers and shareholders" section must list board member and employee holdings, shareholders with 55 percent or more of voting shares, the identities of ultimate shareholders holding shares through legal entities that hold more than 10 percent of shares, and the names of the ten most important shareholders. The issuer must indicate if any other shareholder controls it directly or indirectly. Shareholders must disclose ownership as a result of new takeover provisions introduced in 2002. They must notify CNBV and the BMV by the following business day if they obtain 10 to 30 percent of outstanding shares. Insiders must make disclosures when they increase their holdings by 5 percent; buy or sell of shares valued at over USD 150,000[22] during the same quarter, or if they acquire over 5 percent of shares and have any intent to acquire "significant positions" (over 30 percent of voting shares) or control. No specific disclosure requirements apply to cross-shareholding or shareholder agreements, and compliance with ownership disclosure is spotty. A review of several annual reports suggests that it is difficult to obtain a clear picture of ownership through public disclosure.

1989 regulatory changes designed to promote foreign investment had the effect of creating dual-shareholding structures; the issuance of limited voting shares became a desirable way to raise capital without losing control to foreign investors. There are three basic share classes: common shares with full voting rights, non-voting shares, and limited voting preferred shares. Limited-voting shareholders have the right to vote for certain fundamental decisions, but cannot vote for directors.[23] Various synthetic instruments were created during the 1990s, which further separated ownership from control. A number of companies placed shares in a trust, which in turn issued *Certificados de Participación Ordinaria* (CPOs), usually on a one-for-one basis. There are two types of CPOs: ordinary (which cannot be traded) and "CPOs of origin," which are listed and traded. Holders of CPOs do not vote; the CPO trustee votes the shares with the controlling shareholder. In addition, a number of companies issued *unidades vinculadas* (UV),[24] which represent bundled common and limited-voting shares, and can be listed and traded. Finally, many Mexican companies have issued ADRs and GDRs, often based on CPOs or UVs. According to a recent study,[25] 23 percent of listed firms have restricted shares, and 40 percent of the BMV

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[21] See e.g. the Institute of International Finance's *Policies for Corporate Governance and Transparency in Emerging Markets,*.
[22] 500,000 UDIs. Insider reporting must be done directly to CNBV within five business days following the end of the quarter.
[23] Prices for limited-voting shares are generally lower than those with full voting rights, with some exceptions according to market liquidity and demand.
[24]Stapled" shares or UV shares: packages of voting and limited/non-voting shares that are simultaneously sold to investors.
[25] Lorenza Martínez and Alejandro Werner, *"Capital Markets in Mexico: Recent Developments and Future Challenges.*" Paper prepared for the Seminar organized by Banco de México "Estabilidad Macroeconómica, Mercados Financieros y Desarrollo Económico," November, 2002.

market value consists of restricted voting shares. Among the firms with restricted shares, on average 42 percent of their shares are either restricted, or are UV shares.[26]

The 2001 LMV reform limits the issuance of limited-voting shares to 25 percent of public float.[27] It also prohibits mechanisms that make the access to common shares more expensive, such as "stapled" shares, unless the restricted shares are convertible to common stock in five years.[28]

Policy recommendations: Legal provisions that define share types and rights should be simplified. Complex dual-shareholding structures that separate cash flow from control rights, such as UVs and CPOs, should be clearly disclosed in the annual report. Enforcement of ownership disclosure requirements should become a top priority, with zero tolerance for non-compliance. Shareholder agreements should be disclosed.

Principle IE: Markets for corporate control should be allowed to function in an efficient and transparent manner.

Assessment: ***Largely observed***
Description of practice: Since 2002, takeover regulations protect minority shareholders during changes of control. If an investor acquires between 30 and 50 percent of a company, he must launch a public tender for at least 10 percent of outstanding capital. Investors seeking to acquire over 50 percent must tender for all outstanding shares.[29] Tender offers must apply to all share classes, at the same price, and must be valid for at least 15 business days. The new LMV allows firms to introduce *"ex ante"* poison pills. This requires an EGM decision and CNBV approval.[30]

Controlling shareholders wishing to delist a company must make a public offer for outstanding shares; the offer remains valid for six months. The price is either the average market price of the previous 30 days or book value per the previous quarterly statements, whichever is higher.[31]

Policy recommendations: Complex shareholding structures serve to shield controlling shareholders and management from hostile takeovers. Independent appraisals or valuations should be required to set the price of a tender offer made during the delisting process.

Principle IF: Shareholders, including institutional investors, should consider the costs and benefits of exercising their voting rights.

Assessment: ***Not observed***
Description of practice: Public companies are usually under the influence of one or two shareholders, who monopolize AGMs. Institutional investors appear to use "exit" rather than "voice" to influence the management of their portfolio companies. Foreign investors tend to vote with the majority, with management, or not at all. Thus, institutional investors do not play an active role at AGMs, although interest in voting is increasing. Public pension funds (AFORES) cannot yet invest in equities.[32]

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[26] Restricted shares stapled with common shares.
[27] CNBV can increase the limit by another 25 percent, provided the shares acquire full voting rights within five years.
[28] Article 14 Bis 3.II.
[29] CNBV can grant exceptions in certain cases.
[30] Article 14 Bis3.VII.
[31] CU, Article 8, III.
[32] The Mexican individual retirement funds, (SIEFORES - *Sociedades de Inversión Especializadas en Fondos para el Retiro*), the backbone of the new fully-funded second-pillar pension system, are managed by investment management firms (AFORES,

Policy recommendations: Voting by all investors should be made as easy as possible. Revisions to the pension funds law should include a discussion on the corporate governance roles and responsibilities of these investors. Once pension funds are allowed to own shares, the AFORES should be obliged to disclose their voting policy.

Section II: The Equitable Treatment of Shareholders

Principle IIA: The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights. All shareholders of the same class should be treated equally. (i) Within any class, all shareholders should have the same voting rights. All investors should be able to obtain information about the voting rights attached to all classes of shares before they purchase. Any changes in voting rights should be subject to shareholder vote. (ii) Votes should be cast by custodians or nominees in a manner agreed upon with the share's beneficial owner.

Assessment: ***Partially observed***
Description of practice: Companies may issue multiple series of shares with different rights. All classes may participate in corporate profits. The LGSM does not permit the issuance of shares with unequal voting rights within a class. Changes to the rights of a particular class must be approved by supermajority vote in a special assembly of shareholders of the affected class and later submitted to the EGM.

Custodians appear to follow a variety of market practices. The policy of some major custodians is that: (i) they do not attend AGMs if they receive no instructions from shareholders; and (ii) they vote only those shares for which they have received instructions (although all their shares are counted for purposes of quorum). Other custodians do vote shares without instructions, but in the best interests of shareholders. The ADR depositary is the holder of record and exercises all shareholder rights. If the ADR depositary grants a proxy to the ADR holders or if they exchange their depository receipts for the underlying shares, the latter may attend and vote at meetings.

Recent reforms have provided minority investors with a number of improved protections under the law. Minorities representing 10 percent of voting and limited voting shares have the right to appoint a board member and his alternate, the right to appoint a *comisario*, the right to call a shareholders meeting, and the right to delay a vote for three days when they believe that not enough information has been provided. Minorities representing 15 percent of voting, limited, or non-voting shares may directly initiate civil lawsuits against directors and *comisarios*. The effect is the same as a derivative suit; if the investors win, the company receives compensation. If they lose, they pay the court costs. Minorities representing 20 percent of voting and limited voting shares have the right to petition a court to cancel a resolution taken at a shareholders meeting.

Shareholders have the ability to "put" their shares to controlling shareholders if they do not agree with fundamental decisions taken by the company. The offer price is either 95 percent of the average market price of the previous 30 days or book value according to previously approved financial statements, whichever is lower.[33]

Although recent reforms are having an impact, investors cannot rely on the court system, as the legal process remains inefficient, slow, and sometimes corrupt. Arbitration is in its early stages.

Administradores de Fondos de Ahorro para el Retiro). Currently, the investment options of the AFORES are restricted. They can only invest in Mexico, in debt instruments, and largely in public sector debt and denominated in pesos.
[33] CU, Article 8, III.

Policy recommendations: If policymakers want to strengthen minority shareholder rights, one option is to harmonize existing thresholds at a level sufficient to allow minority shareholders to effectively exercise their rights. This level should be based in part on the effective free float in the market. The legal framework should allow and encourage ADR holders to vote. Policymakers should consider allowing CNBV to file suit on behalf of shareholders in certain matters.

Principle IIB: Insider trading and abusive self-dealing should be prohibited.

Assessment: ***Largely observed***
Description of practice: Insiders must report their share dealings to CNBV, and cannot buy and sell the same shares within a three month period.[34] Insider trading is prohibited and criminalized, but reportedly remains widespread. CNBV has pursued 27 insider trading cases since 1996; about half the cases were settled, and the remainder were contested and tied up in court.

Policy recommendations: An exemplary insider trading conviction would serve to reduce the incidence of insider trading in Mexico. CNBV should increase the transparency of its own decisions and sanctions through their timely disclosure under the law.

Principle IIC: Members of the board and managers should be required to disclose any material interests in transactions or matters affecting the corporation.

Assessment: ***Partially observed***
Description of practice: Board members may not participate or vote on issues where they have a direct, personal conflict of interest.[35] However, no rules governing the conduct of directors who represent major shareholders or others with vested interests in board decision outcomes.

Issuers must report all related-party transactions in a section of the annual report. Related-party transactions must also be immediately disclosed as "material events." The Auditing and Accounting ROSC, however, found that the financial statements of several companies sampled failed to provide full information on related-party transactions. Some companies did not disclose outstanding amounts and pricing policies to determine arm's length dealings among related parties.

Policy recommendations: Together with ownership disclosure, the disclosure of related-party transactions should become a top CNBV priority in disclosure monitoring. Rules should be developed that govern the conduct of directors who are connected to major shareholders, "shadow directors," and other bodies with a vested interest in board decisions.

Section III: Role of Stakeholders in Corporate Governance

Principle IIIA: The corporate governance framework should recognize the rights of stakeholders as established by law and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises. The corporate governance framework should assure that the rights of stakeholders that are protected by law are respected.

Assessment: ***Largely observed***
Description of practice: Workers do not typically participate in management or sit on boards. The Federal Labor Law created institutions to resolve conflicts between employees and

[34] CNBV can authorize trading during the three month period when certain conditions established in the CU are met.
[35] LMV, Article 14 Bis 5. If a director has a conflict of interest, he must so advise the other directors and refrain from discussing the matter. A director who fails to comply shall be liable for any resulting damages and losses caused to the company.

companies (*Juntas de Conciliación y Arbitraje*). Federal law regulates environmental matters. Disclosures of environmental policy must be made in the annual report, and Mexican GAAP requires disclosures of environmental damage. Creditors are protected under the Law of Corporate Bankruptcy, which represents a significant improvement over the old bankruptcy code.

Policy recommendations: An Insolvency/Creditor Rights ROSC is recommended to assess the new creditor rights and insolvency framework in detail.

Principle IIIB: Where stakeholder interests are protected by law, stakeholders should have the opportunity to obtain effective redress for violation of their rights.

Assessment: ***Largely observed***
Description of practice: Stakeholder rights are supported by disclosure and reporting requirements. Competent authorities enforce rights if a violation is noticed or reported. Under the Environmental Act, firms must disclose polluting activities and report per standards, like ground water pollution. They must disclose clean-up measures and policies to prevent future contamination.

Principle IIIC. The corporate governance framework should permit performance-enhancement mechanisms for stakeholder participation.

Assessment: ***Largely observed***
Description of practice: Federal Labor Law entitles workers to 10 percent of corporate profits (*Participación de los Trabajadores en la Utilidad*). Issuers may create benefit/compensation plans for employees through shares or share options, but these are uncommon. In companies with compensation plans, the percentage of employee-owned shares is low. At Bimbo, for example, less than 1 percent of shares held by employees are owned by top executives.[36]

Policy recommendations: Careful attention should be paid to international debates on the use/abuse and expensing of stock options; Mexico should tailor its regulatory framework to the consensus.

Principle IIID: Where stakeholders participate in the corporate governance process, they should have access to relevant information.

Assessment: ***Observed***
Description of practice: Recent reforms have made it possible for stakeholders to have access to more company information than in the past. Issuers must disclose events of interest to stakeholders, such as conflicts with suppliers or strikes, which have an effect on the stock price.

Section IV: Disclosure and Transparency

Principle IVA: The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and the governance of the company. Disclosure should include, but not be limited to, material information on: (1) The financial and operating results of the company. (2) Company objectives. (3) Major share ownership and voting rights. (4) Members of the board and key executives, and their remuneration. (5) Material foreseeable risk factors. (6) Material issues regarding employees and other stakeholders. (7) Governance structures and policies.

Assessment: ***Largely observed***
Description of practice: Mexico has a comprehensive system of information disclosure. Annex N of the CU (March 2003) provides the format of the statutory "annual report" that issuers must

[36] Bimbo represents 2.7 percent of the IPC / Price and Quotations Index.

release by June 30 each year.[37] Listed companies must also file quarterly disclosures of unaudited quarterly financial statements (with prior year comparisons). Quarterly filings are due 20 days after the end of the first three quarters, and 40 days after the fourth quarter's end. Corporations must immediately disclose "material events" that could influence market price.[38]

The annual report must contain a section that includes a summary of the issuer's history, development, and description of its core business. The company must disclose details of its ownership structure, dividend policy, material risk factors, voting rights attached to different share classes and the process for changing voting rights, audit fees, information on retirement/pension plans, share distribution plans, and policies on risk management, including internal controls and going concern risks, and the level of adherence to the corporate governance code. The company must disclose changes to bylaws and deviations from standard corporate law (e.g. special quorums). It must disclose the number of board members, aggregate compensation, aggregate benefits, responsibilities, relationships, and share ownership. The annual report should also detail audit committee functions and include the name of the lead financial expert. Since 2000, financial statements in annual reports must be "certified," and management (CEO, general counsel, and CFO) must attest to the financial statements' accuracy. CNBV is responsible for the monitoring and enforcement of disclosure compliance, while the BMV mainly performs monitoring functions. CNBV recently initiated a process to review financial statements of listed firms and auditor working papers. However, resources are scare. CNBV is authorized to institute administrative proceedings to pursue administrative penalties, and it shall express an opinion to the Attorney General concerning market abuse offenses. Prison penalties for management, directors and auditors are up to ten years. The BMV may temporarily suspend trading in the event of disclosure violations. CNBV can institute administrative proceedings to pursue administrative penalties. The regulatory mechanisms of both supervisory agencies are well structured and established, and the number of disclosure infractions has decreased in recent years. However, emphasis has been on monitoring the disclosure process rather than content, and few fines have been imposed against companies, managers, or individuals in recent years.

Policy recommendations: CNBV should increase its enforcement capability with regard to disclosure content, and continue its zero-tolerance policy toward late filings. Immediate attention should be paid to key non-financial disclosure issues, including the disclosure of ownership and related-party transactions. The CMP should be updated to reflect and go beyond new circulars and laws.

Principle IVB: Information should be prepared, audited, and disclosed in accordance with high quality standards of accounting, financial and non-financial disclosure, and audit.

Assessment: ***Partially observed***

Description of practice: The Mexican Institute of Public Accountants (*Instituto Mexicano de Contadores Públicos*, or IMCP) issues Generally Accepted Accounting Standards (Mexican GAAP) and Generally Accepted Auditing Standards (GAAS). Mexican GAAP differs in certain respects from IAS, and IAS is supposed to be applied when Mexican GAAP does not provide a specific standard. The Accounting and Auditing ROSC revealed shortcomings in the actual application of accounting regulation. Most worrisome from a corporate governance perspective

[37] The report format resembles a US 10K.
[38] See LMV (Article 16) and Annex F for a full definition of relevant events.

were the lack of compliance with rules requiring the disclosure of voting rights, and failures to provide complete information on related-party transactions.[39]

The investor community has a mixed perception of the quality of financial reporting. On the one hand, Mexico is now perceived by the market as rising to meet international standards. The quality, quantity and delivery of disclosed information have improved. This is evidenced by the fact that 30 companies were sanctioned for non-compliance with quarterly information disclosure requirements in 1999, while only three were sanctioned in 2002. Today the leading companies have investor relations departments. However, the Accounting and Auditing ROSC indicates that until recently, enforcement has focused on formal issues, rather than content.

Policy recommendations: From a corporate governance perspective, top priority should be placed on the compliance with rules requiring disclosure of voting rights and related-party transactions, and movement toward full and immediate adoption of IAS 24.

Principle IVC: An annual audit should be conducted by an independent auditor in order to provide an external and objective assurance on the way in which financial statements have been prepared and presented.

Assessment: ***Partially observed***
Description of practice: Auditors usually report to management, although they are formally appointed by the board upon the audit committee's recommendation. The law requires the auditor to sign his/her opinion, placing the burden of responsibility and liability on the individual.

The CU defines auditor independence. Highlights of the new rule include: (i) revenues to the accounting firm from any one client must not represent more than 10 percent of the accounting firm's total revenues, and the audit firm cannot be an important client of the issuer; (ii) audit partner rotation is required every five years; (iii) the accounting firm is prohibited from providing certain non-audit services to the audit client, including bookkeeping, operating or designing information systems, valuations or appraisals, internal audit, executive search, and legal services. According to data from CNBV, 81 percent of issuers were complying with the auditor rotation requirement in 2001, up from 72 percent in 2000.

CNBV has regulatory oversight of the accounting and auditing of listed firms. It can initiate judicial proceedings for criminal sanctions in case of fraud. The CU gives CNBV power to create an independent accounting oversight board. However, some policy questions remain unresolved, especially the source of funding.

Policy recommendations: The authorities should work to resolve pending issues around the creation of an independent accounting oversight board. Auditor liability must be clearly defined in the law, and specific penalties must be established for non-compliance.

Principle IVD: Channels for disseminating information should provide for fair, timely, and cost-effective access to relevant information by users.

Assessment: ***Observed***
Description of practice: All the information filed with CNBV is accessible through its BMV website. All relevant information is simultaneously available to CNBV, BMV, and the public.

[39] Selected significant areas of difference are described in the Accounting and Auditing ROSC and in the Annexes to this report.

Section V: The Responsibility of the Board

Principle VA: The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders. Board members should act on a fully informed basis, in good faith, with due diligence and care, and in the best interest of the company and the shareholders.

Assessment: ***Partially observed***

Description of practice: Mexico has a single-tier board structure. Directorships must be performed personally or by alternate directors (substitutes) appointed by shareholder resolution. Each director can have only one alternate, who must also be independent. There is no fixed term.

The company's operations are overseen by one or more statutory examiners (*comisarios),* elected by the AGM. 10 percent of shareholders may appoint a statutory examiner. In theory, the *comisario* is an individual who is entrusted with the vigilance over the company on behalf of shareholders. In practice, the *comisario* is usually the external auditor or a partner in the external auditor's firm.[40] Before the CMP recommendation, many believed that over 95 percent of the *comisarios* were the same individual as the outside auditor. They may attend board meetings and call an AGM. *Comisarios* are usually unpaid, particularly if they work for the auditor's firm.

Policy recommendations: The institution of the *comisario* may sometimes play a complementary role in protecting the interests of minority shareholders. However, these traditional organs of corporate vigilance are not substitutes for a well-functioning audit committee of the board of directors in overseeing the adequacy of the company's internal control systems and the integrity of its independent external audit. The role, responsibilities and powers of the *comisario* vis-à-vis the audit committee should be reviewed.

Principle VB: Where board decisions may affect different shareholder groups differently, the board should treat all shareholders fairly.

Assessment: ***Partially observed***

Description of practice: Directors are not to represent or act for the benefit of the group of shareholders that elected them; their duties are to all shareholders and to the company. Board members assume personal responsibility that could arise from civil lawsuits initiated by shareholders. In practice, there have been few instances where shareholders have held directors or managers liable. Directors have been held personally liable for criminal offenses like fraud and breach of security market regulations. The government usually initiates criminal actions.

Policy recommendations: The LGSM should clearly specify the duties and liabilities of directors. Fiduciary-type duties must be strengthened. Equally importantly, Mexico should build director professionalism by creating and supporting an Institute of Directors.

Principle VC: The board should ensure compliance with applicable law and take into account the interests of stakeholders.

Assessment: ***Largely observed***

Description of practice: Director responsibilities referred to in the LGSM are to the company. Board members are not required to take the interests of stakeholders into account in corporate decisions. The CMP recommends that the audit committee ensure the "existence of mechanisms"

[40] The CMP recommends that the external auditor (the person who signs the audit report of the annual financial statements of the corporation) should not be the same person who acts as the statutory examiner, but allows both to be partners in the same firm.

that allow the board to determine if the corporation complies with applicable laws, and review the matter at least once a year. Data from CNBV suggests that 66 percent of companies complied with this recommendation in 2001.

Principle VD: The board should fulfill certain key functions, including (1) Reviewing and guiding corporate strategy, major plans of action, risk policy, annual budgets and business plans; setting performance objectives; monitoring implementation and corporate performance and overseeing major capital expenditures, acquisitions and divestitures. (2) Selecting, compensating, monitoring and, when necessary, replacing key executives and overseeing succession planning. (3) Reviewing key executive and board remunerations, and ensuring a formal and transparent board nomination process. (4) Monitoring and managing potential conflicts of interest of management, board members and shareholders, including misuse of corporate assets and abuse in related-party transactions. (5) Ensuring the integrity of the corporation's accounting and financial reporting systems, including the independent audit, and that appropriate systems of control are in place, in particular, systems for monitoring risk, financial control, and compliance with the law. (6) Monitoring the effectiveness of the governance practices under which it operates and making changes as needed. (7) Overseeing the process of disclosure and communications.

Assessment: ***Partially observed***
Description of practice: Company law says little about the responsibilities of directors; most specifics are left to company bylaws, which generally set forth director duties and functions.

The LMV assigns the board the non-transferable duty of approving transactions taking place outside the "ordinary course of business" between the firm (and its subsidiaries[41]) and its shareholders, its board members or people associated with them through patrimony or family ties; sale and purchase of assets representing 10 percent or more of assets; guarantees surpassing 30 percent of assets; as well as other transactions involving more than 1 percent of assets.[42]

The CMP addresses most of the board functionality recommended by the OECD Principles (except for the lack of specific recommendations on risk management and monitoring the company's governance).[43] However, compliance remains moderate. Statistics from CNBV suggest that: (i) 63 percent of companies complied with the recommendation that the board should ensure that actual investment corresponds to the company's strategic plan; (ii) 57 percent complied with the recommendation that the audit committee should review internal controls; and (iii) 58 percent complied with the recommendation that the board should review the terms and conditions on which the CEO and senior management are hired, and establish general guidelines.

In practice, the "secretary of the board" or "company secretary" oversees governance matters. In many companies this role is played by the general counsel of the company.

Policy recommendations: The revised CMP should address the above board responsibility issues, including responsibility for risk management, governance monitoring and oversight. The basic duties outlined in the CMP should be added to the revised LGSM (e.g. management remuneration). The revised law and CMP should form the basis of new director training programs.

Principle VE: The board should be able to exercise objective judgment on corporate affairs independent, in particular, from management: (1) boards should consider assigning a sufficient number of non-executive board members capable of exercising independent judgment to tasks where there is a potential for conflict of interest. Examples of such key responsibilities are financial reporting, nomination, and executive and board remuneration. (2) board members should devote sufficient time to their responsibilities.

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[41] CU, Article 8, II.
[42] LMV Article 14 Bis 3.IV.d
[43] The CMP recommends that the board (i) define the company's strategy; (ii) ensure that shareholders and the market have access to company public information; (iii) establish internal control mechanisms; (iv) assure that the company can adequately to comply with applicable laws; and (v) regularly assess CEO and management performance.

Assessment: ***Partially observed***
Description of practice: The LMV requires the board to have five to 20 members, 25 percent of whom must be independent from management and controlling shareholders. The CMP introduced the concept of "patrimonial director" - one with significant personal company ownership - and recommended that independent and patrimonial directors should jointly represent at least 40 percent of the board. [44] Listed companies have not achieved 100 percent compliance with board independence requirements; according to CNBV, 81 percent had at least 20 percent independent directors in 2001. Several market participants suggested that the actual independence of nominally independent board members was uncertain. There are no specific provisions or recommendations on the separation of chairman and chief executive, or board performance reviews. There are also indications that companies may be confusing the CMP's independence "recommendations" with LMV "requirements."

The 2001 LMV reform mandated audit committees with a majority of independent directors, including chairman, for listed companies. The audit committee has main functions to: (i) prepare and present an annual report to the board, which presents it to the AGM; (ii) opine on related-party transactions between the firm (and its subsidiaries) and its shareholders, its board members or those associated with them through patrimony or family ties and; (iii) propose the hiring of independent specialists to give fairness opinions on related party transactions if necessary; (iv) opine on the fairness of public offer prices during delisting; and (v) recommend the appointment of the external auditor to the board, and authorize non-audit services of the auditor.[45]

The board must meet at least quarterly. 25 percent of directors or a statutory examiner can call a board meeting. The CMP recommends that members "dedicate the necessary time and attention" to their duties and participate in at least 70 percent of meetings.[46] They need not disclose their attendance. There is no limit as to the number of board seats any one person may hold.[47]

Policy recommendations: CNBV should focus on enforcing LMV board independence requirements. The revised CMP should include recommendations on board self-review. Special training courses for independent directors should be developed, including a possible certification program for independent directors.

Principle VF: In order to fulfill their responsibilities, board members should have access to accurate, relevant and timely information.

Assessment: ***Observed***
Description of practice: Board members have the right to obtain relevant information on a timely and regular basis. They have access to professional advice at company expense on company matters. The CMP goes further and recommends that directors should have access to all information relevant for decisions to be taken at a board meeting at least five business days in advance. This does not apply to strategic, confidential matters, but the Code recommends the establishment of a mechanism to enable directors to adequately assess these types of proposals.

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[44] Significant participation is defined as 2 percent of shares. The participation of a patrimonial director is beneficial; s/he will act as a highly motivated owner. The annex describes the definition of "independence" laid out in the law.
[45] CU, Article 8 (II and III) and Article 84.
[46] This provision is not applicable to alternate directors.
[47] A person cannot be a director of a brokerage, if s/he is member of the board of a financial institution of another financial group.

III. SUMMARY OF POLICY RECOMMENDATIONS

This section sets out recommendations to improve listed companies' compliance with the OECD Principles. Annex B details the above policy recommendations. Several key themes that focus on implementation are prioritized as follows:

1. **The creation of a director training institution.** A key missing ingredient in Mexico's corporate governance reforms is a strong, widely accepted director training organization (e.g. an Institute of Directors).[48] The government (including CNBV) and the private sector have a strong interest in increasing director professionalism. International best practice suggests that the new organization can both serve as a training organization (on a fee basis) and a corporate governance advocacy organization, providing input into future corporate governance reforms. The institution can communicate the variety of new rules to board members and build a culture of strong and independent boards of directors. *Priority:* ***high***

2. **Enforcement**. Experience around the world suggests that implementation and enforcement of the new corporate governance rules remain the key challenges. The assessment recommends continued enforcement of the new disclosure provisions, with increasing emphasis on a review of content. CNBV should continue to strengthen its capacity to monitor disclosure and to enforce the corporate governance provisions of securities law. Staff should be trained to gain awareness of corporate governance issues and possible abuses. New emphasis should be placed on the disclosure of ownership, and related-party transactions. CNBV has to strengthen in practice, the technical autonomy and the executive powers conferred in Article 1 of the LCNBV. *Priority:* ***high***

3. **The development of corporate governance standards for the AFORES with respect to their portfolio companies.** CONSAR and CNBV should begin development of corporate governance standards for the AFORES. Revisions to the pension funds law should include a discussion on their corporate governance roles and duties. Once pension funds are allowed to own shares, the AFORES should be obliged to disclose their voting policy. *Priority:* ***high***

4. **Legislative reform**. This report identifies several areas where changes to the laws would increase compliance with OECD guidelines; these are catalogued in Annex B. A "technical" update of the LMV should clarify certain provisions, and introduce into law key areas introduced in the CU (e.g. the creation and powers of an accounting oversight board). Planning should begin for the redrafting of the LGSM, in the medium to long term. While this process will be complex, it is critical to maintain regulatory momentum. *Priority:* ***medium***

   At the same time, the CMP should be redrafted, to remove or harmonize items that have already been addressed by legal changes (e.g. independence requirements) but to strengthen other areas where "soft law" can have a real impact. The Committee should carry out a detailed analysis of what has worked and what has not worked in the area of board structure (committees) and functionality, and redraft the code as a result. *Priority:* ***medium***

   Accounting reform remains an additional important priority. *Priority:* ***high***

[48] At the time of publication of this report, an organization to provide director training was in the process of formation in Mexico.

Annex A: Summary of Observance of OECD Corporate Governance Principles

	Principle	O	LO	PO	MO	NO	Comment
I. THE RIGHTS OF SHAREHOLDERS							
IA	Basic shareholder rights		X				• Strong shareholder record keeping and clearing/settlement. • Most rights observed. • 10% sh get to appoint a director.
IB	Rights to participate in fundamental decisions.			X			• Shareholders have authority over fundamental transactions. • Board approves large transactions. • AGM quorum =50%, EGM quorum = 75%.
IC	Shareholders AGM rights			X			• 15 day meeting notification, electronic agenda published. • No way to force items onto agenda. • No electronic or mail voting.
ID	Disproportionate control disclosure			X			• Company must disclose control, and most important sh. • 5% sh must disclose ownership. • No disclosure of cross-shareholding/sh agreements • Compliance with ownership disclosure mixed.
IE	Control arrangements should be allowed to function.		X				• Mandatory tender for 100% if acquiring >50%. • Tender offer must apply to all classes of shares at same price.
IF	Cost/benefit to voting					X	• Increasing interest in voting. • Still relatively little institutional investor interest.
II. EQUITABLE TREATMENT OF SHAREHOLDERS							
IIA	All shareholders should be treated equally			X			• Large deviations from one-share, one-vote. • Limited voting shares now limited to 25%. • Very poor opportunities for shareholder redress.
IIB	Prohibit insider trading		X				• Insider trading prohibited and criminalized. • Insiders must report share dealings to CNBV.
IIC	board/Mgrs. disclose interests			X			• Board members must report conflicts of interest. • Issuers must report related party transactions.
III. ROLE OF STAKEHOLDERS IN CORPORATE GOVERNANCE							
IIIA	Stakeholder rights respected		X				• Workers do not typically participate in management or boards. • Creditors are better protected under the new Bankruptcy Law.
IIIB	Redress for violation of rights		X				• Government enforces rights if violations reported.
IIIC	Performance enhancement		X				• Employees can own shares and options.
IIID	Access to information	X					• Based on public disclosure; see section IV below.
IV. DISCLOSURE AND TRANSPARENCY							
IVA	Disclosure standards		X				• Disclosure standards modernized and strong. • Code requires disclosure in a number of areas. • Mixed compliance with ownership and related party transaction disclosure rules
IVB	Standards of accounting & audit			X			• Listed companies use Mexican GAAP • Deviations from theory and practice
IVC	Independent audit annually			X			• 90+% of listed companies use Big 4. • Review/oversight body under discussion.
IVD	Fair & timely dissemination	X					• Strong electronic information system (SEDI/EMISNET).
V. RESPONSIBILITIES OF THE BOARD							
VA	Acts with due diligence, care			X			• Single tier board structure. • Statutory examiners represent shareholders in theory but not necessarily in practice.
VB	Treat all shareholders fairly			X			• Board members have duties to shareholders and company. • Lawsuits extremely rare.
VC	Ensure compliance w/ law		X				• Board members are not accountable to stakeholders. • The CMP recommends that Board establish mechanisms to ensure compliance with law.

VD	The board should fulfill certain key functions			X			• Company law says little about the responsibilities of directors. • The CMP addresses most board functionality recommended by OECD Principles (but compliance remains moderate).
VE	The board should be able to exercise objective judgment			X			• Board must have five to 20 members. • 25 percent must be independent. • Audit committees mandatory.
VF	Access to information	X					• Board members have the right to obtain relevant information on a timely and regular basis.

Annex B: Summary of Policy Recommendations

I. THE RIGHTS OF SHAREHOLDERS		
IA	Basic shareholder rights	Share blocking rules should be clarified and specified. Voting procedures should be made as user-friendly as possible for all shareholders.
IB	Rights to participate in fundamental decisions.	Large transactions should require shareholder approval.
IC	Shareholders AGM rights	A small number of shareholders (e.g. 5 percent) should be able to force resolutions onto the agenda and request a formal poll. Additions to the agenda should be recirculated and published at company expense. A minimum interval should be set between first and second meetings. Policymakers should consider extending meeting notice period to 30 days, in line with international investor requests.
ID	Disproportionate control disclosure	Legal provisions that define share types and rights should be simplified. Complex dual-shareholding structures that separate cash flow from control rights, such as UVs and CPOs, should be clearly disclosed in the annual report. Enforcement of ownership disclosure requirements should become a top priority, with zero tolerance for non-compliance. Shareholder agreements should be disclosed.
IE	Control arrangements should be allowed to function.	Complex shareholding structures serve to shield controlling shareholders and management from hostile takeovers. Independent appraisals or valuations should be required to set the price of a tender offer made during the delisting process.
IF	Cost/benefit to voting	Voting by all investors should be made as easy as possible. Revisions to the pension funds law should include a discussion on the corporate governance roles and responsibilities of these investors. Once pension funds are allowed to own shares, the AFORES should be obliged to disclose their voting policy.
II. EQUITABLE TREATMENT OF SHAREHOLDERS		
IIA	All shareholders should be treated equally	If policymakers want to strengthen minority shareholder rights, one option is to harmonize existing thresholds at a level that is sufficient to allow minority shareholders to effectively exercise their rights. This level should be based in part on the effective free float in the market. The legal framework should allow and encourage ADR holders to vote. Policymakers should consider allowing CNBV to file suit on behalf of shareholders in certain matters.
IIB	Prohibit insider trading	An exemplary insider trading conviction would serve to reduce the incidence of insider trading in Mexico. CNBV should increase the transparency of its own decisions and sanctions through their timely disclosure under the law.
IIC	Board/Mgrs. disclose interests	Together with ownership disclosure, the disclosure of related-party transactions should become a top CNBV priority in disclosure monitoring. Rules should be developed that govern the conduct of directors who are connected to major shareholders, "shadow directors," and other bodies with a vested interest in board decisions.
III. ROLE OF STAKEHOLDERS IN CORPORATE GOVERNANCE		
IIIA	Stakeholder rights respected	An Insolvency/Creditor Rights ROSC is recommended to assess the new creditor rights and insolvency framework in detail.
IIIB	Redress for violation of rights	None.
IIIC	Performance enhancement	Careful attention should be paid to international debates on the use/abuse and expensing of stock options; Mexico should tailor its regulatory framework to the consensus.
IIID	Access to information	None.
IV. DISCLOSURE AND TRANSPARENCY		
IVA	Disclosure standards	CNBV should increase its enforcement capability of disclosure content, and continue its zero-tolerance policy toward late filings. Immediate attention should be paid to key non-financial disclosure issues, including the disclosure of ownership and related-party transactions. The disclosure of governance policies and material risk factors should be mandatory. The CMP should be updated to reflect and go beyond the new circulars and laws.
IVB	Standards of accounting & audit	From a corporate governance perspective, top priority should be placed on the complete adoption of (and compliance with) rules requiring disclosure of voting rights and related-party transactions (i.e. full and immediate adoption of IAS 24).
IVC	Independent audit annually	The authorities should work to resolve pending issues around the creation of an independent accounting oversight board. Auditor liability must be clearly defined in the law, and specific penalties must be established for non-compliance.
IVD	Fair & timely dissemination	None.
V. RESPONSIBILITIES OF THE BOARD		
VA	Acts with due diligence, care	The institutions of the *comisario* and alternate director may serve to diffuse the responsibility of the board, duplicate the responsibility of the audit committee, and appear to provide little practical benefit for shareholders; policymakers should review their effectiveness before any update of the LGSM.
VB	Treat all shareholders fairly	The LGSM should clearly specify director duties and liabilities. Fiduciary-type duties must be strengthened. Equally importantly, Mexico should build director professionalism by creating and supporting an Institute of Directors.
VC	Ensure compliance w/ law	None.

VD	The board should fulfill certain key functions	The revised CMP should address the above board responsibility issues, including responsibility for risk management, governance monitoring and oversight. Basic duties outlined in the CMP should be added to the revised LGSM (e.g. management remuneration). The revised law and CMP should form the basis of new director training programs.
VE	The board should be able to exercise objective judgment	CNBV should focus on enforcing LMV board independence requirements. The revised CMP should include recommendations on board self-review. Special training courses for independent directors should be developed, including a possible certification program for independent directors.
VF	Access to information	None.

ANNEX C: MARKETS AND PARTICIPANTS

Economic Background[49]

The Mexican economy has gone through a dynamic transformation since the Tequila Crisis of 1995, with the private sector playing an increasing role. Strong growth was accompanied by significant increases in the share of private investment in GDP, while public investment remained at a low and declining level. As shown in the table below, increases in industrial production played a major role, reflecting the private sector's role as the engine of growth. Unemployment rates in the meantime declined from a high of 6.3 percent in 1995 to 2.2 percent in 2000.

Mexico: Annual Growth and Investment as a Share Of GDP

	1995	1996	1997	1998	1999	2000
Real GDP Growth, % (1993 prices in pesos)	-6.2	5.2	6.8	4.9	3.8	6.9
Industrial Production, % Change	-7.5	10.7	8.4	6.2	3.7	6.6
Public Investment as a % of GDP	3.7	3.0	3.1	2.6	2.1	2.2
Private Investment as a% of GDP	12.4	14.9	16.4	18.3	18.9	18.6

Source: Mexico Country Assistance Strategy

A steady expansion of exports characterized Mexico's growth during this period under NAFTA. The value of exports grew at an average nominal rate of 15.9 percent per year, with its share in GDP growing from 14 percent of GDP in 1994 to 29 percent in 2000. The export expansion was helped by the strong performance of the U.S. economy, and the progressive economic integration under the NAFTA. The share of exports to the U.S. in the total exports increased in tandem, indicating an increased reliance on the U.S. economy.

However, domestic finance played a minimal role in growth in financing this growth and export expansion during the period. Credit to the private sector actually contracted from 34 percent of GDP in 1995 to around 10 percent in 2000. Steady flows of foreign direct investment (FDI) in effect represented the major source of financing. External private debt flows were volatile, providing a major share of financing in 1998 (3.1 percent of GDP) and turned into a net outflow in 2000 (-0.1 percent) (see Table below). With the increased risk aversion away from the emerging markets, private debt flows are expected to remain at a low level. With the weakened U.S. economy, FDI flows also face the risk of slowdown. This pattern of financing chiefly supported the expansion of the firms that had access to external financing — top-tier companies. The rest of the corporate sector benefited little from the external financing, and was at a disadvantage due to the domestic credit contraction.

Mexico: Domestic Credit to the Private Sector (% of GDP)

	1995	1996	1997	1998	1999	2000
Credit to Private Sector	34.0	20.7	16.1	14.4	11.7	10.0
FDI	3.3	2.8	3.2	2.8	2.5	2.4
Equity Portfolio Investment	0.2	0.8	0.8	-0.2	0.8	0.1
Debt	-5.2	0.5	0.7	3.1	1.7	-0.1

Sources: Institute of International Finance and Bank of Mexico.

The slowdown in the U.S. economy, particularly since September 11, 2001, hit Mexico quite hard. The economic slowdown has been amplified in Mexico, with GDP contracting by 0.3 percent in 2001, and merchandise exports by 4.8 percent. Unemployment has edged up to 2.5 percent. Unlike the contraction after the Tequila Crisis, the current economic contraction was not caused by macroeconomic imbalances, and has highlighted the importance for Mexico to address the long-standing private sector development agenda to foster home-grown, broad-based growth.

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[49] This section is adapted from Annex B10 (Private Sector Strategy) of the Country Assistance Strategy for Mexico.

Equity Market in Mexico

History

The introduction of the capital market law (*Ley del Mercado de Valores*) in 1975 was a key first step in the development of Mexico's equity markets. The equity market began to grow in importance, but in a cycle that was to be repeated several times over the next 25 years, rapid growth culminated in a crash in 1979. In 1982, with the nationalization of private banks, the devaluation of the currency and the imposition of stringent capital controls, investors lost confidence and the market suffered another decline.

Eventually market valuations were so low that investing in stocks became more attractive. By the end of the 1980s the economic stabilization program started to show signs of success and by the early 1990s the economy regained access to international markets. The market rebounded, and the average annual growth of the stock price index (SPI) in dollar terms from December 1982 to December 1993 was 55 percent. Market capitalization as a percent of GDP grew from three percent in 1985 to 45 percent in 1994, after reaching 50 percent in 1993. The total number of public offerings during the same period was 76. Several major privatizations were major factors in market growth (Telmex, Mexicana, and the financial institutions).

High valuations provided large incentives for firms to issue capital, resulting in a large number of public offerings. From 1991 to 1994 Mexican companies averaged 18 public offerings per year (excluding the financial sector), with an average annual value almost USD 80 million. The number of listed firms increased from 119 in 1990 to 185 in 1994.

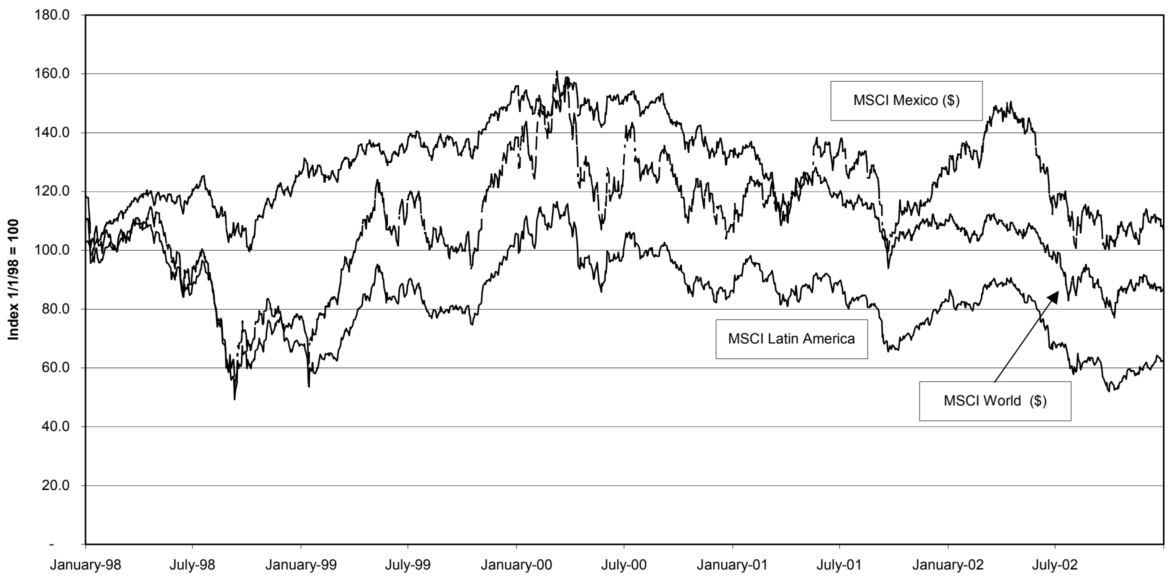
By 1993 Mexico's equity market was the largest in Latin America and was continuing to grow rapidly. Mexico occupied 13th place in terms of market capitalization/GDP, but the last place regarding the number of public firms in terms of millions of inhabitants in a sample of 24 countries. The market had a reasonable level of liquidity, comparable to New Zealand and Australia and higher than France, Brazil, Spain, Italy and Argentina. Price/book value and price/net worth ratio were higher than the ratios for developed markets, reflecting optimism about the future growth of Mexican companies.

Declines since 1994

After a dramatic drop in December 1994 during the "peso crisis" the stock market has stagnated, and has become relatively small and illiquid. Market capitalization and the number of listed firms declined dramatically. In 1990 there were 131 firms trading (excluding financial firms), and by 2001 there were only 116. This reduction in listed firms implies that the benefits associated from being public became less important relative to the high costs of keeping the firm listed and to the cheap cost of repurchasing own stocks.

This decline took place during a decline in the Mexican banking sector. The securities market, including equity and debt issuance, experienced a significant increase during the first half of the decade from financing less than 1 percent of private investment in 1989 to more than 6 percent in 1993. Since then it has not reached the levels observed before 1995.

Share Prices: Mexico vs. Latin America and the Rest of the World
1998-2002
(January 1, 1998 = 100)



Although the Mexican market has not performed well, but it has performed significantly better than many of its neighbors. Returns to holding Mexican equities have been negative for the past three years, but investors are approximately even over the past five years. The following chart shows that the MSCI Mexico index is up 6.9 percent in dollar terms from its level five years earlier. The MSCI Latin America index has fallen (in dollar terms) to 59.1 percent of its value five years earlier, and the total World index (including all markets covered by MSCI) fell to 86.8 percent of its level in October 1997.

Mexico's securities markets today

Mexico's financial market, and particularly its equity market, is now relatively small and highly integrated with US markets. The tables on the following two pages present market capitalization in Mexico and its regional neighbors, from 1990 through 2002. At the end of 2001, market capitalization was about 20.5 percent of GDP. The Mexican market was the seventh largest in Latin America, and well behind Chile, Brazil, Jamaica and Trinidad, and smaller than the six large OECD countries chosen for comparison. In terms of absolute market size, Mexico's market capitalization was USD 126.5 billion at the end of 2001, the third largest of the big three markets in Latin America.

Market relevance (as measured by market capitalization and the number of listed companies) has been shrinking since 1993, as in most markets around the world. Although the total number of IPOs carried out over the past five years is larger than the number of delistings, the number of IPOs has rapidly declined. From 20 IPOs in 1997, only three were carried out in the three years through 2002. The large delisting in 2001 included the USD 12.0 billion takeover of Groupo Financero Banamex Accival, acquired by Citigroup.

The *Bolsa Mexicanos de Valores* (BMV) is the country's stock exchange, and 170 companies were listed at the end of 2002. However, trading in 35 of these issues was suspended, and the BMV estimates that in about half of these cases the suspension is permanent, pending delisting. Teléfonos de México (Telmex) accounts for more than 11 percent of the market capitalization of the index, and about 61 percent of the market capitalization comes from the largest ten companies. Market relevance (as measured by market capitalization and the number of listed companies) has been slowly shrinking in Mexico in recent years, as in most markets around the world. The number of listed companies has declined from 195 companies since 1998.

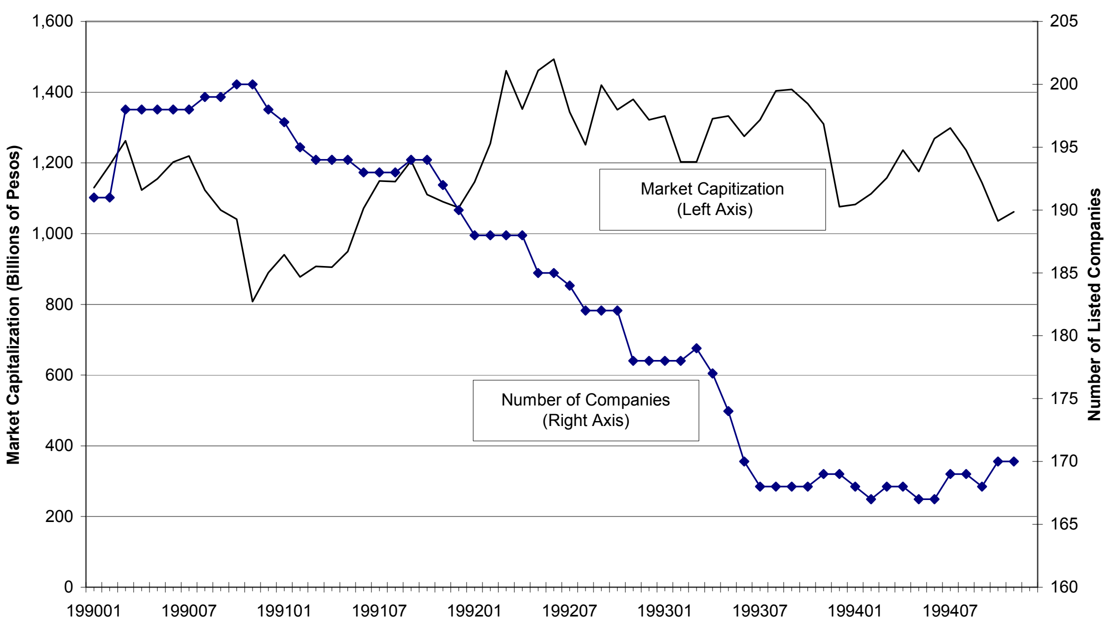
The money market (mainly CETES treasury notes) accounted for almost 97 percent of the average daily turnover of the Mexican Stock Exchange (BMV) over the last four years (USD 9.3 trillion), while only 3 percent of the turnover was due to trading in equity.[50]

Mexican Stock Exchange: IPOs, Capital Increases and Delistings
1997 – Present

	IPO		Capital Increases		Delistings	
	Number	Market Value*	Number	Value	Number	Market Value
1997	20	$387.8	4	$ 175.8	4	$ 37.6
1998	0		0		2	$ 36.0
1999	5	$ 360.8	2	$ 11.6	3	$ 32.7
2000	1	$ 387.8	3	$ 387.3	4	$ 153.0
2001			1	$ 6.0	3	$ 12,548.8
2002	2	$ 698.7	1	$ 66.0		
Total	**28**	**$1,835.10**	**11**	**$646.70**	**16**	**$12,808.10**

Market values is equal to the cost of the delisting transactions (X), in millions of US Dollars. Exchange rate 1 dollar = 10 Mexican pesos.

Mexico: Market Capitalization and the Number of Listed Companies
1997 - Present



[50] Bryan W. Husted and Carlos Serrano, "Corporate Governance in Mexico," available at http://egade.sistema.itesm.mx/investigacion/documentos/documentos/9egade_husted.pdf

Market Capitalization as a Percent of GDP
Mexico and Selected Countries
1990 - 2001

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Mexico	12.5	31.2	38.2	49.8	31.0	31.7	32.1	39.1	21.8	32.1	21.6	20.5
Argentina	2.3	9.8	8.1	18.6	14.3	14.6	16.4	20.2	15.2	29.6	58.4	71.6
Barbados	16.5	18.3	16.3	20.0	30.0	26.6	38.8	52.0	102.0	81.1	65.0	..
Bolivia	..	..	..	..	0.4	1.4	1.5	4.1	6.8	1.4	..	19.5
Chile	45.0	80.8	70.8	100.3	133.9	113.3	96.2	95.7	71.1	100.8	85.6	89.3
Brazil	3.5	10.5	11.6	22.7	34.7	21.0	28.0	31.6	20.4	43.1	38.1	37.1
Colombia	3.5	9.8	11.5	16.6	17.2	19.3	17.6	18.3	13.5	13.7	11.5	15.8
Costa Rica	..	..	5.5	4.5	..	..	6.6	6.4	9.3	14.6	..	..
Dominican Republic	..	..	..	..	..	..	..	0.9	..	0.8	..	..
Ecuador	..	..	0.5	7.7	15.0	14.7	10.2	10.8	7.7	2.2	5.2	7.9
El Salvador	..	..	..	..	..	..	4.4	4.5	12.0	17.2	15.5	10.9
Guatemala	..	..	..	..	..	0.8	1.1	0.8	0.9	1.2	1.3	1.1
Honduras	..	1.3	..	..	7.9	8.5	..	..	8.7	..	..	..
Jamaica	21.4	25.6	89.2	31.5	37.1	22.6	29.9	28.6	29.1	34.3	46.5	59.6
Panama	..	..	3.4	5.8	9.0	10.5	15.7	26.1	41.0	39.2	27.9	25.6
Paraguay	..	..	..	0.3	0.6	1.6	4.0	4.0	3.6	5.5	..	..
Peru	3.1	4.7	7.3	14.7	18.2	22.0	22.0	29.8	20.5	25.9	19.7	18.1
Trinidad and Tobago	13.7	12.9	9.6	10.6	13.4	21.1	24.4	53.5	64.2	65.2	56.2	46.2
Uruguay	..	..	..	1.7	1.0	0.9	1.3	1.0	0.9	0.8	..	0.8
Venezuela, RB	17.2	21.0	12.6	13.3	7.0	4.7	14.3	16.4	7.9	7.2	6.7	4.9
Australia	35.2	47.0	46.1	67.0	63.2	65.3	74.9	70.6	87.9	104.9	95.6	101.5
France	25.9	28.5	26.1	35.7	33.4	33.6	38.0	48.0	68.3	102.6	111.8	141.5
Germany	21.0	22.2	17.2	23.7	22.5	23.5	28.2	39.0	50.9	67.8	67.8	57.2
Spain	21.7	26.8	16.4	23.9	30.7	33.9	39.8	51.8	68.6	72.0	90.3	103.5
United Kingdom	85.9	95.8	86.9	120.1	116.7	124.9	147.5	151.4	168.3	203.5	182.2	152.8
United States	53.2	68.9	71.6	78.0	72.5	93.4	109.5	137.0	154.1	180.1	153.5	137.5

Source: World Development Indicators. Countries listed include all countries with data in WDI in Latin America / Caribbean region, plus selected OECD countries.

Market Capitalization (Current USD)
Mexico and Selected Countries
1990 - 2001

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Mexico	32.7	98.2	139.1	200.7	130.2	90.7	106.5	156.6	91.7	154.0	125.2	126.6
Argentina	3.3	18.5	18.6	44.0	36.9	37.8	44.7	59.3	45.3	83.9	166.1	192.5
Barbados	.3	.3	.3	.3	.5	.5	.8	1.1	2.4	2.0	1.7	1.8
Bolivia	..	..	..	..	.0	.1	.1	.3	.6	.1	..	1.6
Chile	13.6	28.0	29.6	44.6	68.2	73.9	65.9	72.0	51.9	68.2	60.4	56.7
Brazil	16.4	42.8	45.3	99.4	189.3	147.6	217.0	255.5	160.9	228.0	226.2	186.2
Colombia	1.4	4.0	5.7	9.2	14.0	17.9	17.1	19.5	13.4	11.6	9.6	13.2
Costa Rica	..	..	.5	.4	..	..	.8	.8	1.3	2.3	..	..
Dominican Republic	..	..	..	..	..	..	..	.1	..	.1	..	..
Ecuador	..	..	.1	1.1	2.5	2.6	1.9	2.1	1.5	.4	.7	1.4
El Salvador	..	..	..	..	..	..	.5	.5	1.4	2.1	2.0	1.5
Guatemala	..	..	..	..	..	.1	.2	.1	.2	.2	.2	.2
Honduras	..	.0	..	..	.3	.3	..	..	.5	..	..	..
Jamaica	.9	1.0	3.2	1.5	1.8	1.3	1.9	2.1	2.1	2.5	3.6	4.6
Panama	..	..	.2	.4	.7	.8	1.3	2.3	3.8	3.7	2.8	2.6
Paraguay	..	..	..	.0	.0	.1	.4	.4	.3	.4	..	..
Peru	.8	1.1	2.6	5.1	8.2	11.8	12.3	17.6	11.6	13.4	10.6	9.8
Trinidad and Tobago	.7	.7	.5	.5	.7	1.1	1.4	3.1	3.9	4.4	4.3	3.9
Uruguay	..	..	..	.3	.2	.2	.3	.2	.2	.2	..	.2
Venezuela, RB	8.4	11.2	7.6	8.0	4.1	3.7	10.1	14.6	7.6	7.5	8.1	6.2
Australia	108.9	148.5	144.6	204.9	218.9	245.2	312.0	295.8	328.9	427.7	372.8	374.3
France	314.4	348.1	350.9	456.1	451.3	522.1	591.1	674.4	991.5	1,475.5	1,446.6	1,843.5
Germany	355.1	393.5	348.1	463.5	470.5	577.4	671.0	825.2	1,094.0	1,432.2	1,270.2	1,071.7
Spain	111.4	147.9	99.0	119.3	154.9	197.8	242.8	290.4	402.2	431.7	504.2	597.5
United Kingdom	848.9	988.0	927.1	1,151.6	1,210.2	1,407.7	1,740.2	1,996.2	2,374.3	2,933.3	2,577.0	2,149.5
United States	3,059.4	4,087.7	4,485.0	5,136.2	5,067.0	6,857.6	8,484.4	11,308.8	13,451.4	16,635.1	15,104.0	13,983.8

Source: World Development Indicators. Countries listed include all countries with data in WDI in Latin America Caribbean, plus selected OECD countries.

Shares of Mexican Companies Issued Traded Abroad

The Mexican market is characterized by a large number of companies listed and trading in other countries.

Until 1989, law and regulation tended to discourage foreign ownership and listing. However, with the publication of the Foreign Investment Law, companies were encouraged to attract foreign investors. Foreign investment laws allowed foreign investors to purchase Mexican shares, but limited the voting rights of these shares. As a result, foreign investment was attracted, at the cost of abandoning any previous commitment to "one share one vote."

A boom in Mexican ADRs and foreign investment followed the reform of 1989. Foreign investment in the Mexican stock market recovered significantly in 1996, but remained roughly constant at a level of 15 percent. However, investment in Mexican firms through foreign markets via ADRs increased more rapidly.

The issuance of ADRs caught the local market in a vicious circle. The BMV lost its attractiveness as a market to raise capital at low cost. Valuations remained low. The price earnings ratio has declined about 25 percent from its maximum reached in 1995. With low liquidity, it was impossible for large firms to raise all the needed capital in the domestic market. As a result, migration of Mexican firms to U.S. or other international markets continued for the most attractive Mexican companies. By September 2002, 74 companies were trading in foreign markets out of 130 that were traded on the MSE. Of those firms 33 had ADRs in the NYSE, 2 in Amex, 2 in Nasdaq, 18 in European markets, 26 traded on the Portal system of US or SEAQ, and 51 over the counter (OTC). Other firms are listed on Nasdaq (ELAMEX) without being listed in the BMV.

López de Silanes (2000) provides an international comparison of the degree of migration or cross-listing of public firms. Mexico had largest percentage (37.9 percent) of firms operating in the NYSE, NASDAQ, OTC or applying rule 144a as a share of the total number of listed firms in domestic markets.[51] For "listed" ADRs, Mexico holds second place (15.4 percent), after Ireland with 24.3 percent, and followed by Holland with 14 percent, Sweden with 13 percent, Norway with 11 percent and Canada with 9.8 percent.

During 2001 the value traded of Mexican firms in foreign markets was more than nine times the value traded on the BMV. More than 24 percent of capital raised from 1990 to 2001 was been done in foreign markets. According to the BMV, 45 percent of market capitalization is in the hands of U.S. investors.

Explanations for the Stagnation

Several explanations have been put forward to explain the recent stagnation. First, as noted above, the recent decline in equity markets has been widespread and deep around the world. Second, the macroeconomic instability that characterized Mexico for decades partially explains the low levels of domestic savings, and thus to some extent the size of the equity markets. Average savings in Mexico in the period 1986-1996 was 18.5 percent of GDP, while for Chile it was 23 percent and for Brazil 21 percent. Besides the low levels of savings, financial intermediaries have not had an interest in attracting small agents to financial markets so the financial savings have been even lower.

However, many analysts agree that the decline in Mexico's equity markets is also partially explained by a poor protection of minority shareholders. Mexico's civil law heritage is characterized by a poor protection of property rights, and a large literature analyzes the negative implications of a stock market regulation that does not protect the rights of minority shareholders (La Porta et al, 1999).

Ownership Structure

Ownership of Mexican companies is highly concentrated. Companies are closely held, and relatively few shares are actively traded. According to one recent study, the three largest shareholders in the ten largest non-financial, privately-owned firms in Mexico owned 67 percent of capital, the second highest concentration in the sample (after

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[51] Mexico was followed by Ireland with 33.8 percent, Norway with 33.3 percent, Canada with 32.8 percent and Sweden with 20.8 percent.

Greece). According to one report, 18 percent of the largest 150 companies in Mexico are foreign-controlled firms.[52] Almost all of these firms have a high share of publicly traded stock.

Free float represents only a small percentage of the firm ownership.[53] Although there are many difficulties in calculating the free float, government officials estimate it to be on the order of 12 to 15 percent.

Using data from 1995-97, a recent study indicated that 100 percent of the 20 largest Mexican companies were controlled by families. Most companies continue to be controlled by immediate family members, who control the board and many key management positions. As a generation passes it is customary to establish a "control trust" (*fideicomiso*) where voting rules are established, together with stringent requirements for the sale of stock outside of the trust or to outsiders. The capital stock is often divided into multiple share classes, with one class limited to Mexican shareholders or companies (controlled by the controlling trust or the family, and representing at least 51 percent of the equity) and another class without ownership restrictions (but often with restrictions on voting rights). Sometimes, key management is offered shares as long as shares are kept in a trust, eliminating independent voting.

Financial and industrial groups are important in Mexico, and have played an important role in the development of the Mexican economy. Business groups are typically holding companies and are characterized by vertical, horizontal, or conglomerate integration. The holding company (*el corporativo*) usually makes most key decisions, including financing, dividend policy, fixed assets, and hiring of top managers. The growth of these groups was driven by Mexican industrial policy of the late 1970s.[54]

Ten Largest Mexican Business Groups

	Sales	**Net Income**	**Total Assets**
Carso Global Telecom	97.4	23.1	185.1
Telmex	96.3	25.1	178.7
Cementos Mexicanos	45.9	9.8	112.8
Grupo Carso	40.6	4.9	63.5
Grupo Alfa	40.3	3.8	67.6
Fomento Económico Mexicano	38.6	3.9	40.5
Grupo Bimbo	28.8	2.0	22.9
Controladora Comercial Mexicana	27.2	1.3	18.2
Cintra	26.0	1.1	19.0
Vitro	25.9	1.5	31.3
Savia	25.3	(1.1)	59.6
Billions of pesos. (As of May 11, 2001, 1 peso = US $0.1088). *Source: Expansión 2000, as quoted in* Husted and Serrano..			

Cross-holding of shares between firms generally takes place within business groups, so that companies remain in family control. However, family control has reportedly become more diffused as ownership passes to the second or third generation.

There is relatively little retail investor interest in Mexico. According to the BMV, broker/dealers hold around 160,000 accounts, of which perhaps one third are duplicates.

Institutional Investors

Institutional investors in the Mexican financial markets are relatively small today in Mexico. As a result, banks, pension funds, investment funds, and insurance companies do not typically play a major role in corporate governance.

[52] Expansion, 2000.
[53] La Porta, et al., 1999.
[54] Husted and Serrano.

Pension Funds

The 1997 reform of the public pension system in Mexico will eventually have a large impact on Mexican financial markets and the corporate governance of Mexican companies.[55]

The Mexican design is based on a multi-pillar approach to old-age security. The reform consisted of a publicly managed first pillar providing a guaranteed minimum pension equal to the indexed minimum wage, a fully-funded second pillar with mandatory individual savings accounts and competitive, but exclusive and specialized, mutual fund management, and a third pillar consisting of voluntary savings.

Individual retirement funds (SIEFORES - *Sociedades de Inversión Especializadas en Fondos para el Retiro*) constitute the backbone of the new fully-funded second-pillar pension system. The SIEFORES will are managed by investment management firms (AFORES, *Administradores de Fondos de Ahorro para el Retiro*). Each worker can contribute to a chosen AFORE. The system began with 17 different approved AFORES, but mergers have resulted in industry consolidation and a total of 11 AFORES today (although two new AFORES are in formation). AFORES are single purpose business entities with independent capitalization. Each AFORE must maintain a minimum paid-in capital of N$25 million and a special reserve capital equal to the minimum capital or 1 percent of total assets of the SIEFORES under management. If owned by financial institutions, AFORES must be subsidiaries. The main owners of AFORES are mutual funds and banks.

Currently, the investment options of the AFORES are very restricted. They can only invest in Mexico, in debt instruments, and most must be in public sector debt and denominated in pesos. Currently,

- 82 percent is government bonds (of which 12 percent fixed rate)
- 18 percent private sector – fixed rate bonds.
- 99 percent is in peso denominated securities
- 1 percent is in US dollar denominated securities.

There is currently no possibility for the AFORES to create equity SIEFORES, and according to CONSAR there is little interest in expanding into equity. However, the rules on portfolio allocation are under review. An amendment to the pension law in October 2002 allows for a greater investment flexibility and, thus, diversification potential. However, future changes to the investment regime will require the approval from the majority of the board of directors of CONSAR, and a favorable opinion from its Consulting and Surveillance Committee. The new law also lifts the restriction from buying foreign securities. The new investment limit is 20 percent of assets under management of the AFORES. However, a temporary limit of 10 percent will apply until Congress reevaluates the subject in April 2003.

CONSAR was granted new regulatory powers to implement a "family of funds" concept, that will allow workers to "adjust the investment strategy to their preferences", and allow some funds to be invested in equity. In an interview CONSAR predicted that AFORES would be able to invest in equity in late 2003 or early 2004. The BMV and others are working to convince union leaders and others to allow AFORES to invest in equities.

Flows into the funds are significant. Every two months the AFORES receive $US 200 million. Contributions consist of 6.5 percent of wages of private-sector workers, and the total of funds under management is projected to grow at 20 percent per year. Funds under management (as of January 30, 2003) totaled $N 318,147 million, or about USD 31.8 billion. This figure represents about 6 percent of GDP, and CONSAR projects that it could grow to about 50 percent of GDP within ten years.

The AFORES are regulated by CONSAR (*Comisión Nacional de Sistemas de Ahorro para el Retiro).* CONSAR reports to the SHCP. The Consulting and Surveillance Committee is a key body of CONSAR. It has equal representation of employers, employees and government authorities. Rules drafted by the staff of CONSAR are first

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[55] For a complete description of the Mexican reform see World Bank Policy Research Working Paper 1933, *The 1997 Pension Reform in Mexico.*

approved by the Consulting and Surveillance Committee, and then by the governing body. The establishment of AFORES requires the authorization of CONSAR, which may grant or deny authorization at its own discretion after examining the business plan, shareholding, systems, control, and management of the firm. CONSAR is empowered to revoke the authorization of an AFORE or SIEFORE that fails to meet the standards set forth in law and regulations.

The law regulates the corporate governance and management of the AFORES. AFORES must have investment committees (with an "independent advisor") and a risk management committee (to manage portfolio risk). The general director / CEO is a member of both committees. All board members are approved in advance (and can be removed by) CONSAR. The AFORE must make specific disclosures, outlined in CONSAR circulars 9 & 10. The disclosures include the disclosures of risk, the characteristics of the portfolio, a description of risk-adjusted returns. Workers get account statements six times per year.

Interest in Corporate Governance

Globalization and trade liberalization have created a more competitive environment and the need for better management within Mexican companies. As in many countries, foreign investors have demanded better corporate governance, which has resulted in the evolution of Mexican corporate governance over the last 15 years. This process culminated in 1999 with the publication of the Code of Best Corporate Practices. The Code stressed the importance of independent directors (and set a minimum of 20 percent of board members), disclosing the nature and current position of directors, and sending information to directors in advance of meetings. The Code also highlighted the strategic function of the board as one of its main responsibilities. The Code encouraged companies to disclose the degree of adherence to such practices in their annual reports. As of January 1, 2001, the CNBV requires that all firms listed in the stock market disclose their compliance with the Code on an annual basis (CNBV, 1999).

Mexican companies that are listed in the New York Stock Exchange are already required to comply with all of the requirements of the U.S. Securities and Exchange Commission.

However, market perception is that a few of the larger companies in Mexico do engage in some of these desired governance practices (e.g., Alfa, Proeza), but that most firms do not yet comply with the spirit of the new reforms.

ANNEX D: CORPORATE GOVERNANCE INSTITUTIONS

This annex provides a brief overview of the role, structure, and powers of:

- Ministry of Finance and Public Credit (Secretaría de Hacienda y Crédito Público, SHCP)
- Comisión Nacional Bancaria y de Valores (CNBV)
- Mexican Stock Exchange (Bolsa Mexicana de Valores, or BMV)
- Banco de México

Ministry of Finance and Public Credit (Secretaría de Hacienda y Crédito Público, SHCP)

The Ministry of Finance and Public Credit (SHCP) is the Ministry in charge of authorizing the operation of financial institutions. It may also grant concessions for stock exchanges, central securities depositories and clearing houses. The SHCP is empowered by the LMV to revoke concessions granted to the financial institutions that carry out activities in the securities market.

SHCP's Secretary is appointed directly, and can be removed, by the President of Mexico.

Comisión Nacional Bancaria y de Valores (CNBV)

The CNBV is the agency resulting from the merger, effective May 1, 1995, of the *Comisión Nacional Bancaria* (National Banking Commission) and the *Comisión Nacional de Valores* (National Securities Commission). The CNBV has broad supervisory and regulatory powers with respect to financial entities and issuers of securities. It is a supervisory arm of the Ministry of Finance and Public Credit and the agency primarily responsible for supervising banks and auxiliary banks and implementing government banking policy, and the entity in charge of the supervision and regulation of the Mexican securities market. It is responsible for inspecting banking institutions and monitoring their internal policies and procedures, and advises and reports to the Ministry of Finance and Public Credit on these matters.

Governance and Independence

The CNBV is governed by a board of 13 people. The Chairman of the board is appointed and removed by SHCP. The Vice Chairman is appointed by the board. In practice, the position of chairman changes with each Presidential administration.

The CNBV is not a truly independent agency, and works closely with the SHCP on many decisions. A "working commission" consists of people from each organization, including the superintendence of financial institutions and the securities market. CNBV reportedly has a significant degree of independence on technical issues. Until three years ago, the CNBV had its own budget authority.

Most corporate governance and securities market issues are supervised by the Vice-chairmanship of securities supervision of the CNBV. This group only supervises the issuers and the market as a whole, not entities (brokers). Staff is approximately 136 people, about 10 percent of the CNBV total. Salaries are reported to be competitive, partially because of a lack of hiring in the private sector. Work rules and civil service inflexibility is reported to be a larger problem than salaries.

Responsibility

The Law of the CNBV establishes that the CNBV is the regulator empowered to supervise and regulate financial institutions, including the stock exchange and any other person that carries out any of the activities regulated in the financial system provisions. The CNBV supervises the securities market. It has rule-making, enforcement and surveillance powers. The CNBV can formulate secondary regulation within the scope of the statutes that specifically empower it. Over the last five years, the CNBV has promulgated regulation regarding public disclosure of relevant events, tender offers and repurchase of shares by issuers.

The CNBV regulates public offerings. With the June 2001 amendments to the LMV, Mexico officially adopted a full disclosure system. Prospectus requirements now comply with the relevant IOSCO principles. Issuers must file an information prospectus related to the financial, administrative, economic, accounting and legal status of the company; financial statements audited by an independent auditor; a legal opinion, and comply with bylaws provisions of the LMV (Art. 14 Bis 3, recognizing some shareholders minority rights). Regulations established by the CNBV detail and specify the filing content ordered by law. These requirements apply for both public and listed companies.[56]

The CNBV has the authority to impose penalties on issuers in the case of breach of market regulations that protect shareholder rights. The CNBV may initiate actions against issuers or securities firms in the event of criminal offenses. Pursuant to the LMV, the CNBV can impose administrative penalties. Over the last five years, the CNBV has imposed penalties in market abuse cases. Primarily, the CNBV has fined operations contrary to sound market practices, that involved wash sales, market manipulation and insider trading, resulting in the imposition of penalties of almost USD 5 million.

The CNBV recently has become more active in utilizing its enforcement authority. The 2001 LMV reforms eliminated the structural issues that limited enforcement. Pursuant to the reform, the CNBV's powers to investigate market abuse, including insider trading were considerably extended. The reform detailed the activities that the CNBV can carry out in such cases, including: conducting inspection visits, requiring information from any person who could contribute to the investigation and interviewing third parties. The CNBV has enough qualified personnel to conduct the proper surveillance of the securities market.

Enforcement

Although more organizational emphasis has been placed in other areas because of recent financial crises, the CNBV has worked to improve investor protection in Mexico. The two main areas of concern have been the quality of information disclosure and the protection of minority shareholder rights. The enforcement power of the CNBV has greatly improved with the passage of the 2001 LMV reform. Article 43 of LMV allows the CNBV to issue subpoenas and request information. Access to bank records was already available, thanks to the merger with the CNB.

According to the law, the CNBV can now publish sanctions, but only after they are final.

In terms of banking supervision and oversight, the presence of the CNBV and the enforcement of its powers is also stronger than in the past. Supervision is becoming more stringent in order to avoid future financial sector collapses.

Some issuers and their lawyers have complained in the recent past that the CNBV is too active in the enforcement of its mandate, and that its activities extend beyond its constitutional rights.

Mexican Stock Exchange (Bolsa Mexicana de Valores, BMV)

The BMV is the country's only stock exchange. The BMV adopted its current form in 1975, following a merger of exchanges in Mexico City, Guadalajara and Monterrey.

Governance

By law, the BMV is a self-regulatory organization and is required to contribute to the integrity and transparency of the equity market.[57] In fact, self-regulation is limited, and the BMV is closely supervised by the CNBV. The BMV is a joint-stock company, with a board of 12 members:

- ½ are members / brokers
- ½ are independent, including chairman (who is also president / CEO)
- There are no government directors.

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[56] LMV, Article 14.
[57] LMV, Article 125.

The board meets every two months. The board has an audit committee, a human resources committee, and a financial planning committee. Since 1977, they have a listing committee of 9, with a majority of independent members. There is also an informal "issuers committee".

The Chairman / Chief executive of the BMV is appointed and can be removed by the shareholders' meeting. The CNBV can remove the Chairman and the chief executive of the BMV in the following cases:[58]

- Lack of "technical capacity", "prestige" or satisfactory credit record for the performance of their duties.
- If they do not meet the established requirements.
- Serious or repeated breach to the LMV and its implementing regulations.

The stock exchange must make the same disclosures as other public companies.

In 2001 the BMV started the process of demutualization. Non-brokers can now become investors in the BMV.

Systems

Since 1999, all trades on the exchange are executed through an electronic system (BMV-Sentra Capitales).

Electronic information disclosure in Mexico is processed by the BMV. Information must be sent through Emisnet, a web-based system, managed by the BMV, for disclosure of information and relevant events. to the BMV, the CNBV and the investing public. In 1997, the decree that required the immediate disclosure of material information led to the development of an information processing system. EMISNET was launched in May of 1998. More recently, features have been added to process the disclosure of quarterly and annual reports, announcements of share buy-backs, etc. The system has allowed issuers and the exchange to cut expenses, and has allowed an end to the paper filing. EMISNET is now open to a number of other groups, including debt committees, mutual funds, and rating agencies.

Emisnet is now called SEDI.

Listing

Listing rules are established in CNBV regulation. Listed companies must comply with rules related to the exchange's surveillance powers as an SRO, and disclose company compliance with the Best Practices Code. The continuing obligations and requirements for listed companies are:

- Minimum equity (equivalent to USD 4.5 million)
- Minimum trading conditions, including number of trades (at least 36 trades semiannually)
- Minimum number of outstanding shares (at least 8 million),
- Minimum average share price (the average semiannual stock price must exceed 1 Mexican peso)
- Minimum number of shareholders (at least 100)
- The issuer must have at least 12 percent of its equity among investors

The BMV must verify annually that listed issuers comply with these requirements and any other established by the BMV. The first two criteria must be verified semiannually. Issuers must also comply with the CNBV's periodic disclosure requirements (see Annex G below).

The CNBV must authorize delisting, which is a difficult process.

[58] LMV, Article 42

Sanctions

The BMV can adopt preventive measures to obtain "transparent and orderly price formation". The BMV is able to impose penalties on issuers, intermediaries (members) or their traders when they fail to comply with this regulation. Preventative measures can include the suspension of trading, of a single security or the entire market. Sanctions to issuers can include:

Admonitions (warnings). Depending on situation, warnings can require penalized issuers, members or traders to comply with an obligation, within the period set by the BMV. If this is not possible, warnings get the attention of the penalized person and make him/her know that in the case of a relapse of conduct, the BMV may impose a higher penalty (suspension of a member's activities, suspension of activities of a member's trader, or suspension of the registration of an issuer's security).

Suspensions. Suspensions occur when the person responsible for non-compliance has been previously warned one or more times, or in opinion of the BMV, the conduct is considered serious. Suspensions are executed upon authorization of the CNBV.

A suspension is not lifted until its causes have not been overcome. Moreover, if any issuer does not comply with the maintenance requirements imposed by the CNBV and the BMV, it must prepare a compliance program. The compliance program is disclosed through Emisnet and the company must show significant progress to correct the infractions. The BMV may suspend the quotation of the issue if the issuer does not present a compliance program, if it is not adequately disclosed, or if during a period of one year, the problem continues or worsens. If the issuer chooses not to disclose the compliance program, the BMV could request the CNBV to delist the shares.

Examples of Recent BMV/CNBV Sanctions

Non-fulfillment of "minimum maintenance requirements"	Suspension	COMERCI	October 29, 2001 to November 14, 2001.
Failure to deliver information according to CNBV regulation	Quotation suspension	VIDEO	April 25, 2001 to August 7, 2001.
	BMV adopts preventive measures in order to avoid disorderly market conditions	CBIGF	July 25, 2001 to August 21, 2001.

Banco de México

Pursuant to the provisions of the Bank of Mexico Law, Banco de México is entitled to issue regulations regarding the issuance of debt and operations in the derivatives market.

Mexican Institute of Public Accountants (*Institutos Mexicanos de Contadoras Públicos*, IMCP)[59]

The Mexican constitution authorized the creation of the Mexican Institute of Public Accountants as a self--regulated Professional Body to regulate the accounting and audit profession in Mexico.[60] The first professional accounting association in Mexico was organized as the Association of Public Accountants, which in 1923 became the Institute of Public Accountants of Mexico for degreed practitioners. In 1945 with the enactment of federal law to regulate professions in Mexico, Article 5 of the Constitution authorized the creation of the State Society of Public Accountants which, in 1965 was organized under the umbrella of a federal organization known as the Mexican Institute of Public Accountants (IMCP).

The IMCP is a voluntary professional organization of licensed accountants and auditors. The fundamental objective of IMCP is to advocate the unification of standards of practice and to accomplish the implementation and acceptance of standards, principles and procedures for accounting, auditing and professional ethics by its membership.

59 This section adopted from the Accounting and Auditing ROSC.
60 Article 5 of the Mexican Constitution, Chapter VI, dated May 26, 1945.

The law creates the legal framework for the creation, governance for public accounting in Mexico through the establishment of 40 State Societies of Public Accountants under the Federal umbrella of the Mexican Institute of Public Accountants with the authority to issue professional standards, a Code of Ethics and, investigate and sanction registered public accountants through its Honor Committee. In practice, most complaints are handled through the IMCP Honor Committee.

To fulfill its objective IMCP is governed by a National Executive Committee, which includes a Vice President of Legislation who is in charged with the supervision and coordination of the Committees for bylaws, professional ethics, continuing education, accounting standards, and audit standards and procedures. The Committee of Accounting Principles (CPC) of the IMCP is currently the accounting standard setting body in Mexico. The Committee on Standards and Audit Procedures (CONPA), established in 1955, is the audit standard setting body in Mexico.

In 1999, IFAC recommended quality control reviews, and a quality control review process is now under creation in Mexico. However, in 2002, as a result of corporate accounting scandals in the US, and the drafting of an IOSCO technical paper on auditor oversight, Mexico began steps in the direction of an independent accounting oversight board.[61] The *Circular Única* gives the CNBV the power to create one. However, a number of policy questions remain unresolved, especially a source of funding.

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[61] *Principles for Auditor Oversight*, Statement of the Technical Committee of IOSCO, October 2002.

ANNEX E: COMPANY LAW OVERVIEW

Overview of Legal Framework

Laws

The Mexican Constitution established a federal structure for the regulation of commerce and financial services. The legal framework is based on the civil law tradition. Pursuant to article 73, Section X of the Constitution, the legal framework that governs listed companies is composed of laws legislated by the Mexican Congress, including:

- The Commercial Code (regulating commercial activity).
- *Ley General de Sociedades Mercantiles* (the General Law of Commercial Companies, **LGSM**), regulating the organization, shareholder rights, and bylaws of companies, was enacted on August 4, 1934. It underwent its last major amendments in 1996. Although the LGSM sets forth the principles of the protection of shareholders rights, it does not require that regulators protect the rights of shareholders, or identify a specific agency in charge of enforcing such rights.
- *Ley del Mercado de Valores (*the Securities Market Law, abbreviated **LMV**) The LMV, which specifically regulates public companies, was introduced on January 2, 1975. It was amended in a major reform on June 1, 2001. The LMV provides that regulators have the obligation to protect the rights of investors in public corporations. Under the LMV, the CNBV is the agency entrusted with the obligation to enforce shareholders rights and plays an active role in enforcing shareholders rights. In addition, the BMV plays an active role in overseeing shareholders rights, although it has limited enforcement powers.
- *Ley de Sociedades de Inversión (*Mutual Funds Law, abbreviated LSI). This statute was first introduced on January 14, 1985. It was superseded by new legislation enacted on June 4, 2001 that came into force in December 2001.
- *Ley de Inversión Extranjera* (Foreign Investment Law, abbreviated LIE).

CNBV has issued a number of regulations (circulares) that cover aspects of corporate governance, including disclosure obligations. In early 2003 these circulares were reissued and updated in the form of an "issuers manual" as the ***Circular Única*** **(CU)**.

The corporate forms allowed under Mexican law are[62]:

- Joint-stock Company (*Sociedad Anónima*, or S.A.)
- General Partnership
- Limited Partnership
- Limited Liability Company
- Special Partnership with shares
- Co-operative Society

Large companies (and all listed companies) are in the form of *Sociedad Anónima*. There is no distinction between "public" and "listed" companies in Mexico. An S.A. may have fixed or variable capital, in which case the acronym "S.A." becomes "S.A. de C.V."

The main differences among the corporate forms allowed under Mexican law is that partnerships are associations in which all the partners are liable in a subsidiary, unlimited and joint manner for business obligations. In both the limited liability company and the joint-stock company, liability is limited to contributions of capital. Co-operative societies differ, since they are owned by the labor providers.

[62] LGSM, Article 1.

Code of Best Practice

In September 1999, the CNBV issued a non-binding corporate governance practices code – the Code for Improvement of Corporate Practices (*Código de Mejores Practicas,* or CMP). The CMP was developed by a working group formed by officers of the CNBV in charge of market regulation, presidents or directors of some of the largest and most influential issuers of securities, officers of financial institutions, members of the brokers association and experts. The CMP included recommendations on the organization and functioning of boards of directors, as well as the protection of minority rights. It also recommended the creation of special committees of the board.

The CMP is not mandatory.[63] The only legal requirement is that issuers must disclose the level of adherence to the practices recommended by the Code. The CNBV anticipates that the market will discriminate those issuers who do not follow the recommendations of the CMP. In October 1999, the CNBV issued a circular requiring that public companies publish reports on compliance with the principles set forth by the CMP, effective January 1, 2000.

The table at the end of the annexes presents the code of best practices, including data on compliance with the code recommendations.

Legal Capital

The purpose of legal capital is to guarantee that the entity may face its obligations. In a normal company, the minimum legal capital is 50,000 pesos. For banks, the minimum legal capital is 0.12 percent of the net capital of the banking system. Legal capital is typically divided into the fixed minimum (the above amounts) and the variable portion, which is unlimited. Changes in the legal capital are usually made in the variable portion which requires no formalities other than proper documentation. In the case of financial entities increases and decreases of capital require the authorization of the SHCP.

Five percent of annual after-tax profits must be allocated to a legal reserve account until it reaches 20 percent of the capital stock of the company.

Incorporation

Incorporation requires the notarization of the incorporation deed and its registration at the Public Registry of Commerce and, subsequently, the registration of general powers of attorney that are granted to individuals that may exercise certain capacities on behalf of the corporation and of amendments to the corporation's bylaws[64].

A registration form, publicly available at the Public Registry of Commerce of the corporation's domicile, records certain provisions of the bylaws of the corporation, as well as a list of attorneys-in-fact that may bind the corporation in a variety of issues. While this could be the first source of publicly available information related to a private or public corporation, this registration form is not exhaustive and, pending automation and interconnection of all Public Registries in the country, is not a source of updated and reliable information unless one has accurate and sufficient data to be able to access the correct files.

Section I: The Rights of Shareholders

Secure Methods of Ownership Registration.

In Mexico, all shares are registered (bearer shares have been prohibited since 1984). The registration of public corporation's shares is achieved when they are deposited in the central depository, named *S.D. Institución para el Depósito de Valores, S.A. de C. V.* (Indeval).[65] The first securities depository in Mexico was created in 1978, as a

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[63] A number of provisions of the CMP were subsequently incorporated into the LMV, and are thus mandatory.
[64] See Articles. 5-7 of the LGSM.
[65] Article 78, LMV.

government agency with its own legal identity and capital, and received its first securities deposit in 1979. In 1987, the securities depository was privatized and adopted its current name.

Indeval is the only company in Mexico authorized to operate as a securities depository under the terms established in Article 55 of the LMV. It provides standard depository services, including securities safekeeping, transfer, administration, as well as the clearing and settlement of transactions, in an immobilized environment.[66] Indeval also provides other value-added services, including securities lending, ISIN code allocation, and links to foreign depository networks.

Indeval works through a standard two-tier holding structure. Each public company must deposit its shares in Indeval, in most cases through a "jumbo" certificate. To access Indeval's services, each shareholder must hold its shares with one of Indeval's direct participants (custodians or brokerage firms). Each direct participant maintains two accounts at Indeval, one for foreign beneficial owners and one for Mexican beneficial owners. Evidence of ownership consist of (a) the broker/ custodian's books and records, and (b) a certificate issued by Indeval indicating the total number of shares that each custodian has on deposit.

There are reportedly a few shares outside the Indeval system, and 99 percent of shares are estimated to be on deposit.

Convey or transfer shares.

Shares of public and listed companies are transferred at Indeval. The clearance and settlement processes appear to comply with ISSA G30 2000 recommendations.[67] Indeval clears and settles transactions executed on the BMV on a T+2 basis, using DVP. Services include:

- Securities purchases and sales, repurchase agreements, and corporate actions,
- Settlement of domestic trades in a maximum of 48 hours (T+2), in a delivery-versus-payment (DVP) scheme,
- Real-time link between Indeval's SIDV system and the Banco de México SIAC and SPEUA systems for inter-account cash transfers.

The cost of the whole process depends on the brokerage firm fee for the stock exchange transaction, but ranges between 0.5 percent and 1.5 percent.

Shares are freely transferable; the management of public companies does not have any discretion over who can become a shareholder. However, special rules can apply to foreign shareholders. Although restrictions on foreign investment have been relaxed in many areas since 1989, the Foreign Investment Law (LIE) prevents foreign participation in some banned sectors (e.g. TELMEX, media, airlines, petrochemicals, public transportation) and any such shares need to be transferred to qualified investors. To implement these restrictions, Indeval continues to require that each participant maintain separate accounts for foreign and Mexican investors.

Some other exceptions apply to the general rule of free transferability of shares:

- The law also establishes some restrictions on "T" series shares issued for employees.
- Transfers must be in accordance with the insider trading and takeover rules. Insider trading rules prevent insiders from transferring shares until information is made publicly available. Shareholders already owning more than 10 percent of the stock of a corporation need to inform the CNBV of any additional acquisition or sale of stock representing 10 percent or more of the total capital stock.
- Shareholders may reportedly accept, by contract, certain limitations on transferability. Typically, shareholders accept by contract rights of first refusal or first offer. Shareholders also may accept limitations to sell their shares to competitors, provided that any such restriction is for a short time period.
- The bylaws of a <u>private</u> corporation may establish restrictions on transferability, such as requiring an approval from the board of directors or the right of first refusal when another shareholder is transferring

[66] Source: www.INDEVAL.com.mx.
[67] See ISSA Market 2000 Compliance Report for Mexico at http://www.issanet.org/projects/rec2000-mx.html.

shares. If the board of directors does not approve the transfer, the same board shall designate a buyer who will have to pay the same price for the shares.

Obtain relevant information on the corporation on a timely and regular basis.

Companies are required to disclose information on a quarterly, annual, and extraordinary basis, and must disclose information in advance of the annual shareholders meeting. This information is available on SEDI (formerly Emisnet), the BMV's information disclosure system. See Annex G for more details.

Participate and vote in general shareholder meetings.

Except for the non-voting or limited voting stock, every share has the right to one vote at any shareholders' meeting at which resolutions are required to be passed. Indeval produces a document to provide evidence of ownership at general meetings.

Elect members of the board.

Shareholders elect members of the board of directors.

Cumulative voting is not allowed under the law. However, minority shareholders have special rights to appoint directors and statutory examiners. Those shareholders who own 10 percent of full-voting or restricted voting shares have the right to appoint one board member. Any shareholder or group of shareholders holding such minimum may appoint, by statute, one director and his/her alternate. The percentage may be lowered in the bylaws, but may not be higher than the 10 percent provided by the statute. Bylaws may provide for further resolutions that require a shareholder vote.

The appointment of the board members (and/or the statutory examiners) designated by the shareholders may be revoked only when the entire board or all examiners are revoked as well.

While in theory a group of shareholders representing 10 percent of the outstanding voting stock can elect a member of the board, in practice a complete slate of individuals is proposed to the shareholders' meeting by management. Thus unless the minority shareholders are somehow related to management, it is relatively uncommon for a 10 percent group to actually appoint a specific director.

Share in the profits of the corporation.

Dividends are determined by the board and proposed to the annual shareholders meeting. The meeting approves dividend distribution, and payment is made through Indeval and financial institutions. No distribution of profits may be made as long as losses suffered in previous fiscal years have not been restored, or have been absorbed through application to other asset accounts, or until capital has been reduced.

Public corporations must announce publicly the payment of a dividend in a newspaper indicating the amount and date of payment and the reference to the number of the coupon that is to be used to collect the dividend. Copies of the announcement are delivered to the BMV, the CNBV, and Indeval. Funds are transferred to Indeval for the payment of dividends. Dividends are paid in local currency only. Different dividend payments and dividend payment schedules are not permitted for minority and majority shareholders or for domestic and foreign shareholders. If a class of shares is entitled to a preferred dividend, cumulative dividends are permitted. Under the LGSM, a certain class of limited voting shares is entitled to cumulative dividends.

For private corporations, a notice needs to be sent by mail to the shareholders of record that did not attend the meeting that approved the payment of dividends. Dividends are paid in cash at corporate headquarters.

Fundamental Corporate Decisions

The general assembly of shareholders is the supreme body of the company. It may agree to and ratify all acts and operations, and its decisions shall be carried out by such persons as it may appoint; or in the absence of such appointment, by the sole director or the board of directors.[68] Shareholders can direct the board to take a course of action, and can invalidate a decision of the board.

The ordinary shareholders meeting should take up the following matters, in addition to any other items included on the agenda:[69]

- The discussion, approval, or modification of the report of the directors, taking into consideration the report of the statutory examiners, and the taking of such measures as they may consider expedient;
- Appointment of the board of directors and the statutory examiners;
- Determination of the remuneration to be paid to the directors and statutory examiners, when not determined in the bylaws. All members must be removed at same time. The CMP suggests full disclosure of remuneration.
- Approval of financial statements, distribution of dividends, granting of powers of attorney and other issues;
- Share repurchase requires the authorization of the board of directors, once the ordinary shareholders' meeting has already authorized the amount of capital stock that may be used for such repurchase, in accordance with Article 14 bis of the LMV.

Shareholder meetings may be ordinary or extraordinary.[70] Ordinary (annual) meetings require a quorum of 50 percent of shares.[71] Extraordinary meetings require in general a quorum of 75 percent of shares, and resolutions are passed with a minimum of 50 percent plus one share of the total voting stock.[72] The bylaws of the corporation may include additional issues for which supermajority voting is required, and may require higher voting majorities. Shares without voting rights are not taken into account for the purpose of determining quorum. Restricted shares and shares with limited voting rights are counted only when shareholders have the right to vote on the specific resolutions.[73]

If the first meeting quorum is not met for an AGM, there is no quorum requirement, and resolutions can be passed by a simple majority of the shares present. At extraordinary meetings, resolutions must be passed by a majority of the voting stock. It is not unusual for a call to state that absent a quorum on first call, a second call will follow an hour later, with whomever shows up.

According to Mexican law, veto provisions attached to a particular kind of shares are explicitly forbidden. However, certain issues require special high quorums that can derive de facto in a veto power on the interest of the majority. Article 182 of the LGSM sets forth the set of issues that must be passed by extraordinary meetings.

Shareholders in Mexico have preemptive rights. The LGSM provides that shareholders shall have the right of first refusal to subscribe to shares issued in the event of an increase of capital, in proportion to the number of shares they hold. This right must be exercised within 15 days after the date of publication of the resolution of the shareholders meeting to increase the corporate capital in the Official Gazette of the company's domicile. These provisions apply equally to Mexican and foreign shareholders.

Under Article 206 of the LGSM, any shareholder who voted in opposition to a resolution to a change of the company's purpose, a change of the company's nationality, or a conversion of the company from one type to another has the right to "withdraw" from the company and be "reimbursed" for the book value of shares, provided that he make such request within the fifteen days following closure of the assembly.

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[68] LGSM, Article 178.
[69] LGSM, Article 181.
[70] Section Six of the LGSM establishes the provisions related to shareholder meetings and those issues regarding the corporation that must be resolved by shareholder vote.
[71] LGSM, Article 189.
[72] LGSM, Article 190.
[73] LVM, Article 14 Bis 3 F. II.

Topics to be addressed by Ordinary and Extraordinary Meetings of Shareholders

Basic List	Meeting	Notes
Drawing up and amending the company charter	EGM	Includes extension of the duration of the company, a change of the company's nationality.
Capital increase	EGM	Provisions related to new capital issuance are established by the LGSM, and depend on the type of company, the type of capital, and the companies' bylaws. In general terms, the consent of shareholders representing a majority of outstanding capital is enough to authorize new capital, but the bylaws may reduce the percentage for specific corporate forms.
Capital decrease	EGM	
Issuing share capital	EGM	Includes issuance of preferential shares, redemption by the company of its own shares and issuance of beneficial shares.
Mergers and takeovers	EGM	
Changing the rights or transforming share types/classes	Class EGM	"Any proposal which could impair the rights of any class must be approved in advance by the affected class, in special assembly, by the same majority vote required for amendments to the organizational instrument…"[74]
Winding up the company	EGM	
Other Items		
Appointing, removing and setting the remuneration of the board	AGM[75]	
Appointing, removing and setting the remuneration of the auditor	Board	
Disapplication of pre-emption rights	No	Shareholders can renounce their own pre-emption rights.
Issuing bonds	EGM	
Share buy-backs	Board	In order to avoid conflicts of interest, issuers must have an information mechanism so that related parties are not involved in share repurchases. The 2001 LMV reform specified that the maximum amount of share buy-backs must be approved at general shareholders' meeting and then authorized by the board, and established the obligation of the board to appoint the persons responsible for the acquisition and offering of the issuer's shares. This amount cannot exceed net profit, including retained earnings. The repurchase possibility must be stipulated in the company's statutes. Issuers may buy back shares only through the BMV at their market value, but only after every cumulative dividend had been paid. The transaction will take place only with "liberate" shares (with no distinction of its owner) through bid offering. If the issuer intends to buy-back more than 1 percent of the outstanding shares during the same trading session, it must disclose its intent as a "relevant event" through SEDI (Emisnet), disclosing the shares series, percentage, price and amount. A public offering must take place whenever the issuer intends to buy-back, during a

[74] LGSM, Article 195.
[75] LGSM, Article 181.

Basic List	Meeting	Notes
		period of 20 days, 3 percent or more of outstanding shares. Share buy-backs are forbidden if the issuer does not fulfill listing requirements.
Large Transactions	Board[76]	Includes the purchase or sale of at least 10 percent of assets, commitments for the amounts higher than 30 percent of assets, and any other transactions representing more than 1 percent of total assets.
Changes to company objectives	EGM	
Changing company form	EGM[77]	Includes extension of the term of existence of the corporation, change in the nationality of the corporation.

Shareholder Meetings

Ordinary shareholders meetings must be held at least once per year, within four months after the close of the fiscal year. Ordinary and extraordinary meetings must be held at the company's domicile, except in case of an “act of God.” The Company Secretary is responsible for legal compliance of shareholder meetings, including notice requirements, quorum requirements, attendance lists and meeting minutes. The CNBV is responsible for verifying that the company and its Secretary are following all these procedures established by Law.

Meetings are typically convened by the board, but may be convened by the statutory examiner. Shareholders who own 10 percent of full-voting or restricted voting shares of listed companies have the right to submit a written request at any time to the board of directors or to the statutory examiners to convene a general assembly of shareholders, and resolve any of the issues set forth in their petition.[78] In the event that the meeting is not convened, the shareholders may file a complaint before a competent judge.

Any shareholder may also request that a shareholder's meeting be convened if (i) no shareholders' meeting has been held in two (2) consecutive fiscal years, or (ii) shareholders' meetings held during such period have not discussed the financial statements for the relevant corporation, the appointment of directors or statutory examiners and their corresponding compensation.[79]

To call an extraordinary meeting, the board or shareholders representing 10 percent of capital stock, regardless the kind of shares they hold, may call an ordinary or extraordinary shareholders´ meeting through the notice publication at the Official Gazette or daily newspaper. All information regarding every issue to be discussed must be available to shareholders regarding the issues that will be discussed.

Voting rights are assigned depending on the class and number of shares held by each shareholder. The LGSM and the LMV state that shareholders prove evidence of ownership by producing a share certificate and/ or the corresponding registration in the company’s share registry. For public companies, Indeval participants receive a certificate (*constancia)* issued by Indeval specifying the number and kind of shares they own on behalf of ultimate owners. Custodians appear to follow a variety of market practices. The policy of some major custodians is that:

- Custodians do not attend shareholders meetings if they receive no instructions from shareholders;
- Custodians vote only those shares for which they have received instructions, and abstain on others (although all their shares are counted for purposes of quorum)
- Portfolio investors only rarely attend meetings Based on requests from shareholders, the custodians / brokerage houses can call the issuers and request “passes” to the shareholders meeting for ultimate shareholders.

Other custodians do vote shares without instructions, but in the best interests of shareholders.

[76] LMV, Article 14 Bis 3 F.IV, Point D.
[77] LGSM (Article 182 F. VI and VII).
[78] Article 14 Bis 3 F. VI. For unlisted companies, according to LGSM Article 184, the threshold is 33 percent.
[79] LGSM, Article 185.

As in most civil law countries, the formal rule is that shareholders must own shares on the date the shareholders meeting is held in order to vote, and the concept of "record date" is not recognized under Mexican law. However, because all shares are in effect registered by Indeval, in practice shares are not blocked before the shareholders meeting. Although the formal share registry at the company cannot be updated, shares can be freely transferred within the Indeval system. The practical implication is that shares cannot be withdrawn from Indeval, from the date of issuance of the *constancia* to the day after the shareholders meeting.[80]

As a result, the date of issuance of the *constancia* by Indeval is, in effect, the record date for the meeting. The holder of the *constancia* is able to vote the shares even if he has subsequently traded the shares. Indeval issues the *constancia* five working days before the shareholders meeting if the issuer is domiciled in Mexico City or eight working days if the issuer is domiciled in another city.[81] The issuer must provide Indeval with a copy of the meeting announcement at least one day before its publication.[82]

The holders of depositary receipts (such as ADRs or GDRs) are not recognized in Mexico as the holders of the underlying securities in the depositary receipt programs, and cannot attend shareholders meetings. The depositary is the record holder of the underlying securities and may attend meetings and exercise all rights pertaining to the shares. The depositary may designate the ADR holders as its proxy to attend and/ or vote at a shareholders meeting. Accordingly, ADR or GDR holders may attend and vote at meetings, if the ADR depositary grants a proxy to the holders of the ADRs.

ADR or GDR holders can vote if they exchange their depository receipts for the underlying shares before the meeting, then they will become the owners of record and could attend meetings and vote. The shares must first be removed from the depositary receipt program in order for the shareholders to attend meetings and vote. Once the shares are removed, the ADR or GDR holder must either hold the share certificates or deposit the shares with a financial institution in Mexico or abroad, at which time the ADR or GDR holder becomes the shareholder of record.

Voting Tabulation

There are no mandated legal provisions governing the counting of votes, and the bylaws govern voting procedures. According to the authorities, the most common practice is that votes are counted by a company secretary and a member of the board is appointed as responsible of the ballot. In general practice a "teller" (*escrutador*) is appointed to prepare the attendance list and (if necessary) to count the votes cast to approve resolutions. The teller is usually a shareholder attending the meeting. The teller prepares an attendance list that is signed by the shareholders or proxies attending the meeting.

In general practice, vote counting is typically carried out by a simple show of hands of the shareholders or proxies who are present at the meeting. Formal counting may be required by the person presiding over the meeting or at the request of a majority of the shareholders or the proxies present at the meeting. Management of the company is not required to tabulate the votes. Any shareholder may propose a motion to call for tabulation. The motion must be approved by a majority vote of shareholders or proxies present at the meeting.

Minutes of the meeting always must be prepared, read, and approved before the meeting is adjourned. Shareholders have the right to request access to the minutes of the meeting, and therefore such minutes of the meeting always must be available to the shareholders. There are specific provisions regarding the right to have access to a company's minutes that contain the results of votes cast at a shareholders meeting. Although not customary, the bylaws of the company may establish rules governing the right to have access to the minutes of a meeting. For public corporations, a copy of the minutes must be delivered to the CNBV and the BMV. An extract of the minutes is published in the daily publications issued by the BMV.

[80] LMV Article 78, third paragraph.
[81] INDEVAL internal manual. The internal manual and regulation manual are designed and updated by INDEVAL, but every change or modification must be authorized by Interval's board of directors, the CNBV, and Banco de México.
[82] LMV, Article 78, fourth paragraph.

Generally, company records are not available to shareholders with the exception of annual or quarterly financial statements.

(1) Shareholders should be furnished with sufficient and timely information concerning the date, location and agenda of general meetings, as well as full and timely information regarding the issues to be decided at the meeting.

Notice of the General Assembly of shareholders must be published in the Official Gazette of the company's domicile, and/or in a newspaper of wide local distribution in such domicile, fifteen days in advance of the scheduled assembly unless a different time period is prescribed in the bylaws.[83] Public corporations must deliver a copy of the notice to the CNBV and to the BMV. The BMV makes the notice public through a daily publication and through SEDI (Emisnet). Notices must be published in Spanish, must contain the entire agenda, the date, and the exact location where the meeting is to be held, and must be signed by the person calling the meeting.[84]

The LGSM states that corporations must present a report to shareholders (referred to in Spanish as *Informe Anual)* at least 15 days prior to the date of the annual shareholders meeting.[85] The report must include the report of the board to the shareholders (including the audit report), a statement on accounting policy, and the audited consolidated and unconsolidated financial statements and notes. The *Informe Anual* is generally considered to be a "glossy" brochure-style report (when published alone). It must also be published in newspaper or in official gazette.

In addition, the statutory examiners must prepare a report for the general assembly.[86] This report should represent their opinion "…regarding the truthfulness, sufficiency and reasonableness of the information presented by the board of directors to such shareholders' assembly." (See *statutory examiners* in Annex H below).

After the shareholders meeting these reports and other information must be publicly disclosed. The information must be filed the day after the date of the annual shareholders' meeting, if the corporation is domiciled in Mexico City or within the three days following if the corporation is domiciled in a different entity. The information includes:

- Report on shareholder resolutions;
- Copy of audit report presented at the shareholders' meeting;
- Financial statements of entities in which the respective corporation owns more than 25 percent of the capital stock. Circulars 11-10 and 11-11 issued by CNBV requires listed companies to provide additional reports reconciling the effects of inflation, foreign currency, inventories, furniture, plant and equipment, investments in subsidiaries and associations, other assets, contingent liabilities and assets pledged against loans. For those companies listed in the U.S. Exchange the financial statements must include a footnote reconciling Mexican GAAP with US GAAP;
- List of members of the board of directors and principal officers of the corporation; and
- Certification of the secretary of the board of directors as to the books of the corporation and the shareholder meeting records.

Other legal information to be filed includes:

- Copies of calls for shareholders' meetings, to be filed the day after publication thereof is made;
- Certified copies of shareholders' meetings minutes;
- Copies of notarial deeds containing minutes that required notarization, bylaws and any amendments thereto;
- Copies of specimen share certificates, in the event of capital increases;

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[83] According to Article 186 of the LGSM.
[84] In the case of private corporations, the bylaws may provide that shareholders of record receive the notice by mail within a certain number of days prior to the meeting. A shareholders meeting for private corporations may be held without prior notice only if, at the time of the meeting, the total number of all outstanding shares is duly represented.
[85] LGSM, Article 172.
[86] LGSM, Article 166, Section 4.

- Reports on loan agreements, to the extent they are secured, limit distribution of dividends or require specific financial ratios, including their principal terms and conditions; and
- Copies of any notices given to shareholders.

Minority shareholders who own 10 percent of full-voting or restricted voting shares have the right to delay the vote at a general shareholders' meeting for three days if they consider that not enough information has been provided, and shareholders who own at least 20 percent of the company's stock, regardless the kind of shares they hold, have the right to judicially oppose shareholder resolutions. See *Shareholder Redress*, below.

Generally, a shareholders meeting only may approve resolutions on items included in the published agenda. Only if all shares at the time the meeting is held are represented at the meeting may an item not included in the agenda be added and voted on. Otherwise, if a resolution is adopted with regard to an item not mentioned in the agenda, the resolution is null and void.

The LGSM and the LMV do not impose special notice requirements upon companies whose shares are traded outside of Mexico, such as American Depositary Receipts ("ADRs") or Global Depositary Receipts ("GDRs"). However, the CNBV and the BMV require that companies that have shares traded outside of Mexico must publish in Mexico any notices published outside of Mexico.

Upon publication of notice for the shareholders' meeting, issuers are obliged to give shareholders all necessary information regarding every issue to be addressed, free of charge and in a timely manner. Any issue mentioned in Article 181 or 182 of the LGSM (the specific obligations of the shareholder meetings) cannot be included in the Agenda as a "General Matter".

The CMP recommends that:

- "General matters" not be included on the agenda, and that different topics should not be grouped within a single item. This allows shareholders to vote on each item separately, and forces the disclosure of information on all topics to be discussed at the meeting.
- The company provides the shareholders with a proxy containing detailed information and possible voting alternatives on the items of the agenda, in order to facilitate the instructions to representatives on how to vote on each item of the agenda on the day of the Meeting. According to information on CMP disclosure compiled by the CNBV, 50 percent of companies complied with this recommendation in 2001, up from 31 percent in 2000.
- The company should include the proposals of members to be appointed for the board of directors and a brief professional profile of each candidate, as part of the information delivered to the shareholders. According to information on CMP disclosure compiled by the CNBV, 50 percent of companies complied with this recommendation in 2001.

(2) Opportunity should be provided for shareholders to ask questions of the board and to place items on the agenda at general meetings, subject to reasonable limitations.

The shareholders may propose to the board of directors to place specific items on the agenda, but the board is not required to do so. There is no method of forcing an item onto the agenda, however.

(3) Shareholders should be able to vote in person or in absentia, and equal effect should be given to votes whether cast in person or in absentia.

Shareholders may be represented at meetings by proxies. Shareholder proxies must accredit their legal status through a mandatory form approved by the company, which must contained the specific instructions to the proxies. The LMV also states that any individual, acting on behalf of any shareholder at the GSM, must certify its legal personality by proxy on a company's forms designed for such a purpose. The company secretary will verify this procedure and inform the shareholders' meeting of it.

Proxies may be shareholders or but this is not required. Board members and *comisarios* of the company cannot be appointed as proxies.

There is no requirement for the proxy appointment to be notarized, and shares are not required to be deposited before the meeting. Voting by mail or through other channels of communication is not permitted.

Equitable Treatment

Historically, Mexican law and practice did not encourage the issuance of shares without voting rights. However, the regulatory changes in 1989 designed to promote foreign investment had the side effect of creating dual-shareholding structures. This was because the issuance of limited vote shares became a desirable way to raise capital without losing the control to foreign investors. The downside of these actions was that the deviation from one share one vote became more severe. [87] Majority shareholders offer non-voting shares to minority shareholders in order to maintain control.

Generally, shares of Mexican corporations have equal value and confer equal rights to their holders. Companies may issue more than one series of shares, and shares of different series may grant different rights, provided that all series of shares are entitled to participate in the profits of the corporation. Any provision that excludes a shareholder or a series of shares from the profits of the corporation is null and void. The LGSM does not permit the issuance of shares with unequal voting rights within a particular class.

There are four basic classes of shares: full voting shares (classes A and B), non-voting shares (class C), limited voting shares (classes D and L), and preferred shares. The basic rights of the different shares types are laid out in the table below. Only preferred shares offer guaranteed cash flow rights while the others have no fixed cash flows or covenants. Investors with restricted shares are not invited to participate in the processes of changes of control and the price per share is generally lower than those shares with full voting rights (with some exceptions, according to market liquidity and demand).

In addition, a variety of synthetic share classes were created over the 1990s to separate ownership from control. A number of companies placed restricted-voting shares in the neutral trust, which in turn issues *Certificados de Participación Ordinaria* (CPOs), which back the restricted share, usually on a one-for- one basis. There are two types of CPOs: ordinary (which must be redeemed in order to be traded) and CPOs of origin, which are listed and traded. The holders of CPOs do not attend or vote at shareholders meetings. In addition, a number of companies issued *unidades vinculadas (*vinkulated, or "stapled" shares, UV) which represented bundled restricted and common shares. Finally, many Mexican companies have issued ADRs and GDRs, often based on CPOs or UVs.

Some statistics show the magnitude of the deviation of the "one share one vote" rule. [88] Out of the 11 most important listed firms, five have only ordinary shares while six have restricted vote shares, from which 4 operate this kind of shares. Of 104 IPOs undertaken from 1992 to 1999 23 percent were of restricted shares. Also 23 percent of listed firms have restricted shares and 20 out of 138 listed firms did not made any PO of common shares during that period. Among the firms with restricted shares, on average 42 percent of their shares are either restricted, or are UV shares (i.e. restricted shares stapled with common). Finally, 40 percent of the MSE market value consists of restricted vote shares. These numbers are more dramatic when traded shares are considered. For 23 firms common stocks are not traded and restricted stocks represent 45 percent of the traded value.

In the 2001 LMV reform, provisions were added to strengthen the relationship between cash flow and control rights. The reform limited the issuance of restricted shares to 25 percent of public float. The CNBV can increase this limit upon request, to an additional 25 percent, provided that these shares convert to shares with full voting rights in no more than five years. Consistently, the new legislation prohibits the implementation of mechanisms that make the access to common shares more expensive, such as "stapled" shares (package of voting and non-voting shares that are simultaneously sold to investors), unless the restricted shares are convertible to common stock in no more than five years.

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[87] Bank of Mexico paper.
[88] Taken from: Martinez, Lorenza and Werner, Alejandro, 2002. "Capital Markets in Mexico: Recent Developments and Future Challenges." Paper prepared for the Seminar organized by Banco de Mexico *"Estabilidad Macroeconómica, Mercados Financieros y Desarrollo Económico."*

Summary of Share Classes and Rights

Class	Name of Class	Maximum Issuance	Ownership restrictions	Name a Director	Name Statutory Examiner	Initiate lawsuits	Challenge	Suspend AGM
A	Full voting	100%	Mexican Only	Designate at least a majority	10%	15%	20%	20%
B	Full voting	100%	Mexican or Foreign	10%	10%	15%	20%	20%
C	Non-voting shares	25%	Mexican or Foreign	No	10%	15%	No	No
D	Limited Voting Shares	25%	Mexican or Foreign	10%	10%	15%	20%	20%
L	Limited Voting Shares	25%	Mexican or Foreign	10%	10%	15%	20%	20%
CPO	Certificados de Participación Ordinaria	Variable – from 1 to 100%	Mexican or Foreign	Depends on rights of CPO	10%	15%	Depends on rights of CPO	Depends on rights of CPO
CPO	CPO of Origin (listed / tradable)	Variable – from 1 to 100%	Mexican or Foreign	Depends on rights of CPO	10%	15%	Depends on rights of CPO	Depends on rights of CPO
UV		Variable – from 1 to 100%	Mexican or Foreign	Depends on rights of CPO	10%	15%	Depends on rights of CPO	Depends on rights of CPO
O			Mexican (financial groups only)	10%	10%	15%	20%	20%

Note: Thresholds represent the percent of capital required for each action.
Name a Director: Capital required to appoint 1 director, summon shareholders' meetings; postpone the vote on any matter for which there is deemed insufficient information. For "B" class shares, shareholders have right to appoint at least a majority of directors if capital is only composed of this class.

Name Statutory Examiner: Capital required to appoint a statutory examiner

Initiate lawsuits: Initiate civil lawsuits against companies' administrators, statutory examiners or members of the audit committee.
Challenge: Judicially challenge/oppose resolutions adopted at general shareholders' meetings;
Suspend AGM agreements: suspend agreements reached at AGM meetings
Source: LVM.

Non-voting shares. Companies may issue shares with no voting rights. Under the Mexican Foreign Investment Law (*Ley de Inversiones Extranjeras*, LIE), which governs public and private Mexican corporations that have shares placed with foreign investors, corporations may issue "neutral" shares granting limited or no voting rights to Mexican and foreign investors. This type of share is issued by corporations that have percentage restrictions on the participation of foreign investors and enables foreigners to exceed the limits by acquiring neutral shares, which are not computed as a foreign investment.

Non-voting shares can be voted only at special shareholders meetings of such class, when the rights and obligations of such class are under discussion. The quorum requirement for a special meeting of non-voting shares is 75 percent of the outstanding shares of a class. If a quorum is not obtained at the first meeting, a quorum of 50 percent of the outstanding shares of a class must be present for a subsequent meeting. At such a meeting, decisions must be approved by a vote of at least 50 percent of the shares of the relevant class present at the meeting. There is no minimum ownership percentage required for shareholders to call for a meeting.

Limited Voting Shares. Limited voting shares have the right to vote only at extraordinary shareholders meetings to approve specific important issues, including resolutions on matters related to the duration, premature dissolution, change of corporate purpose, nationality and transformation of the company, and merger or spin-off of the company.[89]

Companies may issue preferred shares with limited voting rights that have a preferential right to collect dividends. In this case, ordinary shares may not collect dividends until a 55 percent dividend has been paid to the limited voting shares. Limited voting shares also have preferred rights over ordinary shares in the event of the liquidation of the corporation. The bylaws may also provide that a higher dividend shall be payable to the limited voting shares as compared to the ordinary shares.

As noted in the table, restricted voting shareholders have minority rights. The LMV foresaw the possibility of other types of restricted or limited shares that have different rights than current "restricted shares". In the eventuality that these shares are issued in the future, the LMV guarantees the holders will also have the rights of minorities.[90]

Shares of Brokerage Firms. For the shares of brokerage firms, an investor who acquires or sells "O" shares must inform the CNBV, within three business days following the transaction. (Brokerage firms have two kinds of shares: "O" and "L". "O" shares represent ordinary capital and "L" shares represent the additional capital. "L" shares are limited-voting and could be issued up to 40 per cent of ordinary capital prior CNBV authorization.)

Labor shares. The bylaws may provide for the issuance of shares in favor of those persons who render their services to the company, which normally are known as "labor" shares. The bylaws shall establish the terms and conditions of the labor shares.

***Certificados de Participación Ordinaria* (CPOs)**. In order to allow foreign investors to purchase otherwise restricted shares (e.g. series A shares), Mexican law allows companies to place a portion of their shares in a neutral trust. The allocation of shares into a neutral trust, as well as all subsequent changes to the allocation, must be registered with the CNBV. The primary trust established for this purpose is the Nafinsa Master Trust, however there are also trusts established by Banamex and Inbursa.

Restricted shares are placed in the neutral trust, which in turn issues *Certificados de Participación Ordinaria* (CPOs), which back the restricted share, usually on a one-for- one basis. There are some CPOs which are backed by multiple shares of different classes such as in the case of several American Depositary Receipt (ADR) programs. CPOs issued by the neutral trust retain cash flow rights, but not the voting rights associated with the restricted shares. Instead, the trust will vote all the shares in the trust according to the position of the majority shareholders at the general meeting.

The number of CPOs is limited and varies from issue to issue at the discretion of the individual companies. It is important to note that with this type of CPO, the CPOs themselves are not traded, only the underlying share. Foreign investors are only able to purchase restricted securities that either have a sufficient number of CPOs available in the neutral trust or that are currently backed by a CPO.

Whenever a foreign investor purchases shares that are included in the above mentioned trusts, the local custodian must deliver the shares to a special account at Indeval corresponding to the neutral trust. After this delivery settles, Indeval notifies the trustee. The neutral trust, in turn, will verify that there is a sufficient number of shares available in the trust and will create a CPO. When a foreign investor sells shares backed by a CPO, the CPO is dissolved, and the neutral trust delivers ordinary shares to the local custodian for delivery to the buyer. In the event there are insufficient shares in the trust, the neutral trust will not be able to issue a CPO, thus creating an irregular position for the foreign investor.

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[89] Article 113, LGSM.
[90] Article 14 Bis 3 F. III.

The CPO limits may be reached at any time during the day. The actual number of CPOs available is not known until the end of the day. Therefore, while there may be sufficient CPOs on trade date, there may be insufficient CPOs on settlement date.

In the event that a foreign investor purchases a restricted security that does not have a corresponding CPO backing it, (i.e., an irregular position) foreign investors are obligated to sell the shares on the market. If a foreign investor chooses to maintain the restricted shares not backed by a CPO, the investor runs the risk of having the securities confiscated by the CNBV, as stipulated in the Foreign Investment Law.

There is a second type of CPO called a **CPO of Origin**. This type of CPO is issued, listed and traded exclusively in CPO form. Although the CPO of Origin is backed by ordinary shares, it cannot be converted back into ordinary shares for a period of time specified in the trust contract. While CPOs of Origin are placed in a trust with a designated trustee, they are not part of the Nafinsa Master Trust. Since foreign investors are purchasing CPOs directly (instead of restricted shares for which a CPO must be issued), there is no risk that the foreign investor will exceed the limit of the trust. In addition, companies issuing CPOs of origin can choose to assign limited voting rights to the final beneficial owners of CPOs of origin.

Benefit Shares. When initiating the redemption of shares, corporations may issue "benefit" shares that are shares that are substituted for the redeemed shares. The benefit shares are entitled to receive dividends, but may not grant corporate rights and may not be part of the capital stock of the company.

Shareholder Redress

It is widely recognized that the Mexican legal system is inefficient and very slow, and in many cases corrupt. Problems in the courts are driven by history; for many years the judiciary was not independent and was under the control of the executive branch. Although recent reforms are beginning to have an impact, investors today cannot use the court system as an effective source of shareholder redress.

Arbitration is in its early stages in Mexico. Twelve cases have been settled by the Mexican Institute of Arbitration, including one large case. However, it does not appear to be binding; lawsuits can follow an arbitration decision.

Appeals to CNBV decisions are made in special "fiscal courts".

In theory, minority investors are provided with a number of protections under the law. Minorities representing 10 percent of *voting and limited voting* shares have:

- The right to appoint a board member.
- The right to appoint a statutory examiner.
- The right to call a shareholders meeting.
- The right to delay for three days the vote on any issue when the shareholders believe that not enough information has been provided.[91]

Minorities representing **15 percent** of *voting, limited, or non-voting* shares have may directly initiate civil lawsuits against directors, statutory examiners, or members of the audit committee.[92] The effect is the same as a derivative suit; if the investor wins his case, the company (and all shareholders) receive compensation. If the investor loses, he pays court costs.

Minorities representing **20 percent** of *voting and limited voting* shares have the right to petition a court to cancel a resolution taken at a shareholders meeting, if they can vote on that particular issue, and if the following LGSM conditions are met:

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[91] Under Article 199 of the LGSM, the threshold is 33 percent for non-public companies.
[92] Art. 163, LGSM, and Article 14 Bis 3. F. VI.

- That the petition be presented within the fifteen days following the date the assembly was closed;
- That the claimants did not attend the assembly, or voted against the decision; and,
- That the petition specify the provisions of the organizational instrument or the rule of law violated and the manner in which such provision was violated.

Shareholders have the ability to "put" their shares to controlling shareholders if they do not agree with fundamental decisions taken by the company. The offer price is either 95 percent of the average market price of the previous 30 days or book value according to previously approved financial statements, whichever is lower.[93]

Decisions relating to the liability of directors or the statutory examiners may not be judicially challenged. Article 202 of LGSM states that a Judge may suspend execution of decisions which have been challenged, as long as the plaintiffs have posted a bond sufficient to cover the damages and losses which may be suffered by the company due to the failure to implement such decisions, in the event that the judgment declares such opposition to be unfounded.

[93] CU, Article 8, III.

ANNEX F. OWNERSHIP DISCLOSURE, TAKEOVER RULES, INSIDER TRADING, AND PREVENTION OF SELF-DEALING

Ownership Disclosure

Recent reforms have greatly improved the disclosure of ownership of listed companies. Circular 11-33 (as updated in the *Circular Única*) mandated ownership disclosure in the annual report beginning in 2001, and the implementing regulations of the 2001 LMV reform (which went into effect in April 2002) mandated ownership disclosure by shareholders.

Ownership disclosure in the annual report

Companies are required to disclose their ownership structure information to the regulatory authorities. Circular 11-33 of the CBNV established that the issuer must disclose its shareholder structure in the annual report, due to the CNBV at the end of June each year. In accordance with Annex I of Circular 11-33, the "managers and shareholders" section of the annual report must disclose:

- Any members of the board or employees having any ownership of the issuer's shares;
- Information on shareholders with 55 percent or more of each shares series with full voting rights; and,
- The names of the ten most important shareholders must be disclosed (even if individual ownership represents less than 55 percent). This list must include the names of the shareholders, the number of shares owned, and the percentage of outstanding shares of each series they own. If there is any significant change in the ownership of stock of these shareholders during the last three years, it must also be disclosed.
- The issuer must indicate if other firm, foreign government, or any other person, controls it directly or indirectly, providing the names and a brief description of the nature of control, considering the amount and percentage of stock with full voting rights. It will be necessary to describe any commitment, known by the issuer, that could represent a change of control upon its shares.

For the purpose of this general provision, "shareholder" is the person or firm that receives any benefit from the shares, even though he/she is not registered as the owner. These benefits include the right to vote, to sell the shares and to receive economic gain. Moreover, shareholders control the issuer if they determine management or the firm's policies.

If the companies do not disclose this information, sanctions are foreseen in the law. If issuers decide not to disclose this information, the BMV may suspend quotation, with CNBV's authorization. If such information remains undisclosed, the CNBV will sanction the issuer.

All issuers end up making some disclosure of ownership in the annual report. However, based a small sample of annual reports, the information contained in the annual report does not necessarily disclose the ultimate ownership, since in most of the cases the owner is a commercial company or a trust. Ownership structure may also be difficult to understand because of lack of information or bad administration of the shareholder account.

The following are two examples of how the issuers disclose their share structure at the annual report:

GRUPO BIMBO (2001)

The number of shares authorized to date is of 1,175,800,00 shares of "Serie A". The Families Servitje, Mata, Jorba and Sendra, through some limited share partnerships (as shown in the Table), maintain in a direct or an indirect form a majority participation in the social equity of BIMBO.

Name	No. of shares	% of social equity
Normaciel, S.A. de C. V.	434,185,485	36.9
Promociones Monser, S.A. de C. V.	134,854,636	11.5
Philae, S.A. de C.V.	58,173,026	5.0
Grupo Valacci, S.A. de C.V.	49,197,077	4.1
Distribuidora Comercial Senda, S.A. de C.V.	44,740,000	3.8
Fideicomiso Banamex 14483-3 (trust)	42,967,349	3.7
Marlupag, S.A. de C.V.	40,303,384	3.4
Fideicomiso Banamex 14484-1	14,270,717	1.2
Group of individual shareholders or companies 1/	128,199,954	10.9
TOTAL	946,891,628	80.5

1/ At an individual basis their holdings do not represent more than 5% of the social equity.
Source: BIMBO Annual Report 2001

GRUPO MODELO (2001):

Individual shareholders or companies who are beneficiaries of 5% per cent or more of the social equity with voting rights:

Banco Nacional de México, S.A.
1,459,389,728 shares of "Serie A"
56.1% of shares with voting rights

Anheuser Busch Companies, Inc.
1,142,017,984 shares of "Serie B"
43.9 of shares with voting rights.

Disclosure by Beneficial Owners

The CNBV published new rules regarding substantial shareholding reporting requirements that became effective 26 April 2002. Shareholders must notify the CNBV and the BMV on the following business day if the acquisition of shares passes the following thresholds:

- Any shareholders obtaining between 10 percent and 30 percent of outstanding shares;
- Executives (including board members) must report any increase of 5 percent of the outstanding shares;
- Insiders are required to disclose the purchase or sale of shares valued at 500,000 UDIs (approximately USD 150,000) within the same quarter. Insider reporting must be done directly to the CNBV within five business days following the end of the quarter.

In addition to the general rule, there are also specific substantial shareholder reporting requirements for financial institutions, as well as a limit on ownership of a financial group by a single beneficial owner. According to Mexican regulations, a single final beneficial owner acquiring or selling more than 2 percent of the capital of a financial group is required to inform the Mexican Ministry of Finance. The Ministry of Finance must approve any acquisition of more than 5 percent of the capital of a financial group with a total limit placed at 20 percent on any single beneficial owner. In all cases, the beneficial owner is responsible for monitoring these limits.

Market for Corporate Control

According to the former law, takeover transactions took place outside of the framework of the BMV. The CNBV reported the transaction to the BMV. As a result, shareholders and the public were excluded from most information about the transaction, and shareholders were often in the position of not knowing who had obtained control.

In order to protect minority shareholders during changes of control, the LMV reform empowered the CNBV to regulate takeovers. The implementing regulations became effective in April 2002.

The CNBV increased minority shareholder protection by requiring certain types of transactions to be executed as public offers rather than ordinary stock exchange transactions. All tender offers must apply to all share classes, at the same price. All tender offers must be for a period of no less than 15 business days.

- Investors seeking to obtain **50 percent plus one share** of the outstanding shares of a company are required to do so through a public tender offer. The tender offer must be done for the entire amount outstanding to allow all shareholders to participate under the same terms and conditions. If after the conclusion of the tender offer less than 15 percent of the shares remain outstanding, the investor must either extend the offer or launch a second tender offer for the outstanding amount. The CNBV may authorize the exception and the request must be accompanied by a favorable opinion of the board of directors (audit committee), which must explain reasons justifying the request, indicating that shareholders interests will not be affected.

- If an investor seeks to acquire **between 30 percent and 50 percent** of the outstanding shares of an issuer, the investor is required to do so through a public tender offer for at least 10 percent of outstanding capital.

When an individual or group of purchasers try to acquire the control of any company, by one or several operations of any nature, simultaneous or successive, they will have to make a tender offer, that must be authorized by the CNBV, and must be extended to all share series, at the same price.

The board of directors must express an opinion through SEDI (Emisnet) regarding the tender offer, in case of conflict of interest and more than one offer. Another opinion from an independent specialist hired by the Audit Committee must be expressed regarding minority shareholders' rights. Shareholders who are members of the board must also disclose any decision they have made for their shares through SEDI.

The Federal Commission of Competition (*Comisión Federal de Competencia*, CFC) regulates such changes of control in order to avoid certain market structures such as monopoly. A recent example that required the approval of the CFC was the acquisition of Banamex by Citigroup.

Given that changes of control are considered a relevant event, the market must be informed of the transaction intent, or of its execution, through the SEDI (Emisnet) system. In addition, provision 11–29 establishes the disclosure requirements of the bidding and buying processes, which, generally are:

- To state that is a public offer of buying of shares;
- The name of the stock;
- The title of the acquired corporation;
- The issuer's logo and title;
- Disclosure code;
- The number of represented stock of the issuer's social capital;
- The number of stocks to acquire with an explanation of each (class, series, nominal value in its case and others that allow for full identification);
- The issuer's social capital percentage that represent the stocks of the bid, bid-price per stock, amount of the bid, period of the bid, registration date in the stock market, liquidation date, transaction procedure, title of the broker dealing with the transaction, mention of stocks written in the *Sección de Valores del Registro Nacional de Valores* (stock section in the national stock registry) and that are suitable to quote in the BMV; and
- a corporation of variable capital, a transcription of the last paragraph of Article 14 of the LMV; place and date of the announcement, authorization from the CNBV, in this case, the mention of the bid and the course

of action, the cancellation of the issuer's stock registration in the stock section of the national stock registry, will be petitioned.

Public tender offers done by any person or group must be presented to CNBV through an informative prospectus containing relevant information such as agreements with buyers, shareholders, members of the board, and other parties, and their rights and duties.

A public listed company is able to include some provisions in its bylaws that are designed to prevent hostile takeovers.[94] However, the authorization of the CNBV is needed. With these provisions, the board of directors may have the power to approve the takeover.

Since 2000, the most important merger and acquisition activity took place among institutions of the Mexican Financial System due to global banking trends. The following table lists the most relevant cases.

Selected Takeover Activity 1999- 2001

2001	Citigroup made a tender offer in order to acquire 100 percent of ordinary outstanding shares of Banacci (Grupo Financiero Banamex-Accival) at USD 12.5 billion or USD 2.6544 per share. The conclusion of the transaction depended on the approval of securities authorities in both countries. In the U.S., Citigroup prepared Form S-4 to the SEC (Securities Exchange Commission). In Mexico, the register of Citigroup's shares and the tender offer were accepted by the SHCP and the CFC.
2000	In an extraordinary shareholders' meeting, GFB (Grupo Financiero Bancomer) approved the merger with Grupo Financiero BBV/Probursa. Prior to Citigroup's tender offer for Banacci, GFBBVA Bancomer would have been the largest Mexican financial institution. During 2001, BBVA (Banco Bilbao Vizcaya Argentaria) bought ownership of the Bank of Montreal in GFBB (Grupo Financiero BBVA Bancomer). At the end of the deal, BBVA had 48.5 percent of GFBB's outstanding shares.
2000	Banco Santander Central Hispano obtained definite and complete control over Grupo Financiero Serfin by paying USD 1,465 million. As a result of this acquisition it became the third financial group in Mexico with 18 percent of total asset market share, 16.2 percent of deposits, 11.5 percent of loans, and 2.2 million clients. With the acquisition of Serfin, Grupo Santander Central Hispano becomes the most important financial group in Latin America, with 17 banks in 12 countries.
2001	Banorte (Banco Mercantil del Norte) obtained control over 100 percent shares of Bancrecer paying USD 165 million. By the beginning of 2002, Banorte started the integration of Bancrecer to the structure of GFNorte (Grupo Financiero Banorte).
2000	Through extraordinary shareholders' meeting, Grupo Financiero Inverlat changed into Grupo Financiero Scotiabank Inverlat.
1999	Grupo Sanborns (listed issuer) with Comercial Carso (1999)
2000	Grupo Industrial Camesa (listed issuer) with Grupo Empresarial Privado Mexicano
2000	Carso Global Telecom (listed issuer) with Banesci 2000 and Inveresci 2000
1999	Cemex acquired 90 percent of capital stock of Assiut Cements Co., the biggest Egyptian cement company at USD 372.6 million (1999)
2000	Cemex acquired 91.7 percent of capital stock of Southdown Inc at USD 2,800 million (2000)
2001	Cemex acquired 99 percent of capital stock of Saraburi Cement Co in Thailand at USD 73 million
2001	Grupo Elektra (listed issuer) with Grupo SyR
2002	Kimberly Clark Mexico (listed issuer) with Papeles Industriales Crisoba, one of its subsidiaries (2002)
2002	GrupoCarso (listed issuer) and GrupoMéxico (listed issuer) signed joint venture agreement between their railroad transportation subsidiaries (2002). GCarso and its subsidiary Empresas Frisco, S.A. de C.V.(FRISCO), Grupo Financiero Inbursa, S.A. de C.V. and its subsidiary Sinca Inbursa,S.A. de C.V., Sociedad de Inversión de Capitales (SINCA), and GMexico and its subsidiary Infraestructura y Transportes México, S.A. de C.V. (ITM), signed a Joint Venture Agreement by which FRISCO and SINCA will transfer all the shares of Ferrocarril del Sureste, S.A. de C.V. (FERROSUR) to ITM and in parallel subscribe 20 percent of the capital stock of ITM.

[94] LMV (Article 14 Bis 3, f. VII)

Delisting

Controlling shareholders wishing to delist a company (either through the decision of the CNBV, because of regulatory violations, or upon request from the issuer) must make a public offer for outstanding shares; the offer remains valid for six months. The price is either the average market price of the previous 30 days or book value per the previous quarterly statements, whichever is higher. Securities written in the RNV are then "canceled" (delisted). In cases where all shareholders agree on delisting, majority shareholders are not required to place the public offer.

If all shareholders do not participate in the buyout, controlling shareholders must set up a deposit funds and set up a trust account, to allow remaining shareholders to redeem the shares over the next six months. As a result of the difficulties of listing, many "zombie" companies remain "listed" for many years, some with no hope.

Shareholder Agreements

Shareholders' agreements are not governed under any specific statute of the Mexican legal framework. As a result, they are regulated by each company's bylaws.

Insider Trading

The CNBV is empowered to impose fines regulate insider trading. These powers are expressly established in the Banking Law, the Securities Market Law and other laws regulating financial entities.

In 1993 the CNBV issued regulations on insider trading, and established requirements for issuers to disclose privileged information. Issuers that have the knowledge of acts, facts or situations that may be price sensitive, are obligated to disclose them on the business day following the day they obtain such information, by means of a publication in a major newspaper and the delivery of such information to the CNBV and the Stock Exchange, so that the Stock Exchange may immediately release such information to its members and the investing public.

The LMV defines the concept of "relevant event", which is privileged information if it is not disclosed to the public. Article 16 Bis 1 defines those persons that presumably have knowledge of relevant events. Articles 52 Bis 2 and 52 Bis 3 establish sanctions for the unlawful use of insider trading. The LMV states that "…People that disclose this private information should abstain from carrying out the transactions for their own reasons, or third parties or, in this case, inform or provide recommendations to third parties so that they can make transactions, with any type of stock, whose price could be influenced by such information as long as this has the indicated purpose."

The CNBV prepared general rules applicable to the acquisition of shares by insiders:

- Insiders (as defined below) who increase their holdings of the shares of the issuer (or increase their stock holding of participation certificates) by 55 percent of the total, must inform the CNBV and the BMV, so that the latter is disclosed to the public the following working day.
- Several insider groups must immediately disclose all share transactions to the CNBV and to the public: members of the board of directors, executives, issuers' shareholders that directly or indirectly control 10 percent or more of the stock, and any group that owns more than 25 percent of total shares.[95] Administrative sanctions can be imposed in the event of non-compliance.
- In addition, insiders must inform the CNBV of the purchase or sale of shares worth more than 500,000 investment units (about USD 150,000) over a period of five working days.

Under the amendment of the LMV, enforcement of full disclosure has been reasonably effective. Insider trading, and dissemination of false information are considered criminal offenses. The CNBV has imposed fines for insider trading cases for almost 30 million Mexican pesos (approximately USD 3 million).

[95] LMV, Article 16 Bis 1.

Until 1996, there was basically no insider trading enforcement. It was not legally clear if the CNBV could take action against individuals, and there was no market surveillance system. By the middle of 2003, 27 cases have been sanctioned. Insider trading cases were basically of two types. About 50 percent of the time, the cases were settled immediately, and fines (up to twice the benefit received, plus interest) were paid.

Appeals were filed in the remaining cases, and take many years to resolve.

Definition of the "Relevant Event"

LMV, ARTICLE 16 Bis

A relevant event is understood to be the act, fact or event capable of influencing stock prices written in the national stock registry. The knowledge of relevant events that have not been disclosed to the public—that fall under the following paragraph—is considered to be insider trading for the purposes of the Law.

Issuers with stocks written in the national stock registry will be obligated to inform the public, through the stock market that quote the same for this purpose, the relevant relative events, in the moment that they occur; however, <u>they will be able to delay disclosure, when</u>:

1. They adopt the necessary measures to guarantee relevant known information, exclusively for people who have access;
2. Consumer acts, fact nor events are dealt with.
3. Information by means of massive communication that induces error or confusion with respect to the relevant event do not exist, and
4. Rare fluctuations of transaction stock price or volume do not exist. Any change in the supply or demand of the stocks or price, that is not consistent with past patterns and cannot be explained by the information that the public has.

People that disclose this private information should abstain from carrying out the transactions for their own reasons, or third parties or, in this case, inform or provide recommendations to third parties so that they can make transactions, with any type of stock, whose price could be influenced by such information as long as this has the indicated purpose.

Definition of "Insiders"
LMV, ARTICLE 16 Bis 1

For purposes of this law, the following shall be deemed to have access to privileged information of the corresponding issuer:

1. Members of the board of directors, executives, management, commissioners, independent external auditors, examiners and secretaries of collegiate organizations of the corporations who have securities registered with the National Registry of Securities and Intermediaries;
2. The shareholders of the stated corporations that directly or indirectly have control of 10 percent or more of the represented social capital stocks. For these purposes, they will compute those ownership stock to another person regarding such shareholders exercise their paternal authority or are affected in trust, regarding the ones that resemble trustee or trustor;
3. Members of the board of directors, executives, management, and commissioners of corporations that have, either directly, or indirectly, control of 10 percent or more of the social capital of the referenced corporations;
4. The members of the board of directors, executive, management, agents, and of the member corporations of the business group that pertain to the issuer;
5. Independent service providers of such corporations and their advisors in general, as well as commissioners of any corporation or business that has participated, advised or collaborated with an issuer, in any event that may be construed as privileged information;
6. Shareholders controlling 5 percent or more of the capital stock of credit institutions that maintain their securities registered with the National Registry of Securities and Intermediaries;
7. Shareholders controlling 5 percent or more of the capital stock of financial holding companies or of credit institutions, as well as those controlling 10 percent or more of the capital stock of other financial entities, when all of them are part of the same financial group96 and at least one of the corporations forming part of the group, is an issuer of securities registered with the National Registry of Securities and Intermediaries, and
8. Members of the board of directors of the controlling corporations and the companies that are referred in the previous fraction.
9. For the group of people that have 25 percent or more or the representative stocks of the issuer's social capital, related either patrimonially, as controllers or in partner corporations of the same business group; the partner, and those people linked by reason of a blood or marriage relationship, either civil or second grade.
10. Those people making transactions with stocks separate from investment past in the market, and could have reasonable have had access to privileged information by way of people who are referred to in the past fractions—I to IX.

For the events of this fraction, it is understood that it is reasonable to think that people could have had access to the privileged information, those people that could have had contact or communicated by any means, with the people that are referred to in the fractions I to IX or with partners or spouses of these people, or even better, they have relationships either personal, professional, or work with said people.

The members of the board of directors and executives to which are referred to in fraction I and those people who are referred to in fractions II and IX, of this article, should inform the CNBV of the stock transactions issued by the issuer, which are attached. The cited Commission will establish the form that such information should present itself, and in this case, make the knowledge known to the investment public, during general provisions.

Pursuant to article 16 Bis 2 of the LMV, directors shall refrain from either directly, by interposed person or trust, acquiring any kind of securities issued by the company they are related to given their position or entail, during a

[96] Mexico's financial system is based on the universal model, which permits the integration of a diverse scope of financial services providers under one holding corporation.

period of three months, counted from the last sale of any kind of securities issued by the same company. Equal abstention shall be observed for the sale and last acquisition of any kind of securities issued by the company.

LMV Criminal Penalties for Insider Trading

LMV

ARTICLE 52 Bis 2. – People that are referred to in Article 16 Bis 1 of this Law—those that unlawfully reveal privileged information as is alluded to in Article 16 Bis of the same law, as well as those related to the issuer as stated previously—will be sanctioned with imprisonment anywhere from three days to six months.

ARTICLE 52 Bis 3.- People that are referred to in Article 16 Bis of this the present relative legislation, relative to an issuer, they, or a third party obtain a profit that does not exceed more than 5000 days of salary, either they do it themselves or through an agent, during the acquisition or, in this case, the alienation of stocks issued by the cited issuer conforming to the present legislation—those that unlawfully use privileged information as is alluded to in Article 16 Bis will be sanctioned with imprisonment anywhere from three days to six months.

If the profit obtained by the people that are referred to in the previous paragraph, exceeds 5000 by not 15000 days of salary, they will be punished with a prison sentence anywhere from six months to three years.

In the assumption that the profit gained exceeds 15000 days of salary, the prison sentence could be anywhere from three to ten years.

The profit and its respective calculation will be determined depending on the events of the crime, which is referred to in this article. They also have a base in the concept and method established in the Article 51 Bis, in the second and third paragraphs of this Law.

Other Abusive Self-Dealing.

Approval of Related Party Transactions

Related party transactions were addressed in the 2001 reform of the LMV. The board must now approve all operations that deviate from the company's ordinary business, or are conducted between the issuer and its shareholders, managers or with "whoever such persons have a patrimonial entail or their next of kin."[97] To provide independent and objective guidance, the LMV requires the audit committee to give an opinion on related party transactions to the board.[98] The Chairman and a majority of members of the audit committee must be independent.

The audit committee of the board of directors must approve "non-core" transactions, including any acquisition of 10 percent of total assets, commitments of 30 percent of total assets, and any other operation representing more than 1 percent of the assets of the firm. The audit committee can hire independent specialists to give fairness opinions on transactions with related parties, if necessary.

According to the Mexican legal framework, transfer pricing issues are regulated by the Income Tax Law and monitored by the SHCP.

Disclosure of Related Party Transactions

Issuers must report all related party transactions in a special section of the annual report.

Any director who has a conflict of interest with the company in any transaction must disclose it to the other directors and abstain from any discussion or decision with respect thereto. A director who violates this provision shall be liable for any loss or damage incurred by the company.[99] Prior to the reform, related party transactions were only disclosed in the prospectus, in accordance with Circular 11-29 issued by the CNBV.

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[97] LMV, Article 14 Bis 3, Section IV, Subsection D).
[98] LMV, Article 14 Bis 3, Section V, Subsection B).
[99] Article 156, LGSM.

Annex G: Disclosure

Basic Disclosure Requirements

Mexico has put in place a comprehensive system of information disclosure for listed companies over the past five years. Until 1997, no prospectus regulation existed. Today, issuers must submit substantive quarterly and annual reports to the CNBV, to the BMV and to the public. All of the relevant information that contributes to the adequate decision making process on the part of the public investor should be included in these reports.[100] Issuers must also continuously disclose relevant events (see above), and promptly present relevant information at the shareholders meeting.

Officers that provide the CNBV on behalf of the issuers with reports and other must be registered by the CNBV. These officers are deemed responsible if any information is not disclosed on time. Sanctions are applied (under the terms of the LMV) to these officers.

Most information is disclosed through the Mexican Stock Exchange's information system (SEDI, formerly EMISNET). Information must be sent through Emisnet to the Mexican Stock Exchange, which will be responsible for transmitting it to the CNBV and investors. Emisnet is a web-based system, managed by the BMV, for disclosure of information and relevant events. Information is warehoused at the Mexican Stock Exchange's website (www.bmv.com.mx). All relevant information is made simultaneously available to the CNBV, the BMV, and the public.

Today the leading and most transparent companies follow international disclosure standards: they file complete quarterly reports, have conversations with analysts, and have investor relations departments. However, this group reportedly includes no more than 20 companies.

The CNBV now reviews the form and the substance of disclosed information, although in most cases the review is not at a very high level. Resources for review of disclosure are relatively scare. However, as a result of recent measures, issuers comply with the fulfillment of the requirements established both by the BMV and the CNBV to continue listing. Since these measures, such as suspension, were established, delivery of information has improved from 30 cases of non-fulfillment of requirements of quarterly information (1999) to less than 3 (2002).

More detailed reviews take place in the banking sector.

Information disclosed for the annual meeting

The LGSM states that corporations must present a report to shareholders (referred to in Spanish as *Informe Anual)* at least 15 days prior to the date of the annual shareholders meeting.[101] The report must include the report of the board to the shareholders (including the audit report), a statement on accounting policy, and the audited consolidated and unconsolidated financial statements and notes. The *Informe Anual* is generally considered to be a "glossy" brochure-style report (when published alone). It must also be published in newspaper or in official gazette.

In addition, the statutory examiners must prepare a report for the general assembly.[102] This report should represent their opinion "…regarding the truthfulness, sufficiency and reasonableness of the information presented by the board of directors to such shareholders' assembly." (See S*tatutory Examiners* in Annex H below).

After the shareholders meeting these reports and other information must be publicly disclosed. The information must be filed the day after the date of the annual shareholders' meeting, if the corporation is domiciled in Mexico City or within the three days following if the corporation is domiciled in a different entity. The information includes:

- Report on shareholder resolutions;

[100] LMV, Article 14 Bis 2.
[101] LGSM, Article 172.
[102] LGSM, Article 166, Section 4.

- Copy of audit report presented at the shareholders' meeting;
- Financial statements of entities in which the respective corporation owns more than 25 percent of the capital stock. Circulars 11-10 and 11-11 issued by CNBV requires listed companies to provide additional reports reconciling the effects of inflation, foreign currency, inventories, furniture, plant and equipment, investments in subsidiaries and associations, other assets, contingent liabilities and assets pledged against loans. For those companies listed in the US Exchange the financial statements must include a footnote reconciling Mexican GAAP with US GAAP.
- List of members of the board of directors and principal officers of the corporation;
- Certification of the secretary of the board of directors as to the books of the corporation and the shareholder meeting records.

Other legal information to be filed includes:

- Copies of calls for shareholders' meetings, to be filed the day after publication thereof is made;
- Certified copies of shareholders' meetings minutes;
- Copies of notarial deeds containing minutes that required notarization, bylaws and any amendments thereto;
- Copies of specimen share certificates, in the event of capital increases;
- Reports on loan agreements, to the extent they are secured, limit distribution of dividends or require specific financial ratios, including their principal terms and conditions; and
- Copies of any notices given to shareholders.

Annual Disclosure (Annual Report)

Circular 11-33 (November 2000) introduced the statutory "Annual Report" that must be disclosed to the public. The Annual report is a statutory filing that must be made to the CNBV by June 30 of each year. The format of the report is specified by the Commission and laid out in Annex N of the *Circular Única* (and is considered to be similar to a 10K). The Annual Report is accompanied by statements by the general director, the chief financial officer, the general counsel, and the auditor to the accuracy of the financial statements, and report on the issuer's adherence to the CMP. Two sets of annual reports have now been prepared (2000 and 2001) and compliance with specific requirements is improving.

Summary of Information Disclosure Requirements

	Type of Disclosure	**Public Disclosure Requirement**
Annual Report	Annual report in the format laid out by the commission (Annex N of the Circular), including - statements by the general director, the chief financial officer, the general counsel, and the auditor to the accuracy of the financial statements - report on the issuer's adherence to the CMP.	No later than June 30 of the following year.
Quarterly Report	Quarterly report, including statements of accuracy from officers (as in annual report), including: - financial statements (unaudited) - same information as annual report - comparisons with prior-year periods	20 days after the end of the first three quarters, and 40 days after the end of the fourth quarter
Cont. Disclosure	Notice to shareholders on rights offerings and capital increases notice of delivery or exchange of shares, bonds or other securities. Notice on the payment of dividends. Any other notice directed to shareholders, bondholders, or other securities holders or the investing public.	Same day

Quarterly Disclosure

The Circular Unica specifies that listed companies must make quarterly disclosures as well. Required quarterly disclosure unaudited quarterly financial statements (with prior year comparisons), but using the same accounting standards as the annual report. Quarterly filings are due 20 days after the end of the first three quarters, and 40 days after the end of the fourth quarter.

Continuous Disclosure

In addition, corporations are obligated to disclose "relevant events", acts, events or occurrences capable of influencing the price of a security. See *insider trading* in Annex F for a full definition of relevant events. Share buy-backs and related party transactions previously approved by the Audit Committee must be disclosed. Relevant events must be disclosed through SEDI (Emisnet).

Specific Disclosure Requirements

The financial and operating results of the company.

As detailed above, Mexican listed companies are required to publicly disclose the company's financial statements to shareholders and to the public, on a quarterly and annual basis.

The investor community has a mixed perception of the quality of financial reporting in Mexico. On the one hand, disclosure requirements and compliance have greatly improved with the passage of the most recent Circulars over the past three years, and the quality and quantity of disclosed information has improved. Mexico is now perceived by the market as rising to meet international standards. The delivery of information has improved substantially, from 30 cases of quarterly information disclosure non-compliance in 1999 to less than three in 2002.

However, the general findings from the due diligence exercise conducted by World Bank staff in connection with the Accounting and Auditing ROSC in Mexico (presented in the table below) indicate that there is still some way to go. Until recently, enforcement has been relatively lax, sanctions have focused on administrative misbehavior, rather than violations of accounting standards or incomplete disclosure.

Conclusions on Financial Reporting from the Accounting and Auditing ROSC

1. The quality of corporate financial reporting has improved in the recent past.

2. Divergent interpretations of International Accounting Standards and their use along with Mexican Accounting Regulations lead to confusions on the part of the users of financial statements.

3. Lack of adequate disclosures on relevant issues (such as segment reporting; reporting for interests in joint ventures and; provisions, contingent liabilities and contingent assets) and too much information on some less important issues adversely affect the usefulness of financial statements from investor's point of view.

4. Most of the respondents did not agree with the statement that corporate financial statements for external users are generally prepared in full compliance with the mandatory reporting requirements.

5. Most of the respondents agreed that the preparation of general purpose financial statement is influenced by the preparation of financial statements for tax compliance.

6. Most of the respondents did not agree with any of the following statements:

   - when the financial statements receive clean opinion from auditors, they are perceived as being accurate;
   - the audited financial statements provide a transparent representation of the underlying economics of transactions;
   - practicing auditors strictly adhere to high quality standards of professional conduct, are independent, and perform their responsibilities with integrity and objectivity;
   - auditors are serious about compliance with accounting and auditing standards; and
   - there is an active regulatory oversight for ensuring compliance with the established accounting and auditing standards.

Accountability for financial statements has improved. According to the LGSM, the board is legally responsible for the financial statements. The *Circular Única* includes the concept of Sarbanes-Oxley-style "certification", in which the management (the CEO, general counsel, and Chief Financial Officer) must attest to the accuracy of the financial statements. of directors.

The law imposes civil liabilities in the case of negligence, transgressions and fraud, on the part of the board and the *Comisario*. However, there are no provisions for civil and criminal penalties to deter fraudulent or erroneous attestation of financial information by auditors.

The CNBV is responsible for both monitoring and enforcement of disclosure compliance, while the Mexican Stock Exchange performs mainly monitoring functions. The CNBV can assess civil and criminal penalties to up to ten years of prison for violations of the accounting, reporting and auditing requirements to management, directors and outside auditors of public companies. The BMV may impose temporary suspension of trading in the event of disclosure violations. However, these suspensions require further confirmation from the CNBV to become indefinite. The regulatory mechanisms of both supervisory agencies are well structured and established, and the number of disclosure infractions has decreased in recent years. However, the emphasis has been on monitoring the disclosure process rather than content, and few fines have been imposed against companies, managers, or individuals been imposed in recent years.

The CNBV has recently initiated a process to review financial statements of the listed companies and other participants in the securities markets, including brokerage firms and investment funds. In addition, the CNBV has started to visit the accounting firms to review audit work papers to identify violations of established accounting and disclosure requirements. For such violations, the CNBV is authorized to institute administrative proceedings. At present there is no public record of sanctions for violations with the accounting, reporting and auditing requirements of listed companies or its external auditors. The banking regulatory arm of CNBV and CNSF also perform at least annually a review of financial statements of banks and insurance companies.

Company objectives.

As described in Annex N of the Circular Única, the *reporte anual* must contain a special section called "The Firm" that includes a brief summary of the issuer's history, development, and description of its core business. It also must describe:

- Main Activity
- Channels of Distribution
- Trademarks, Brands or Other Contracts
- Principal Customers
- Legal Framework and Tax Bases
- Human Resources
- Market Information
- Financial Information per Business Unit, Geographical Zone, and Exportation Sales
- Corporate Structure
- Description of Principal Assets
- Judicial or Arbitrage Processes

Major share ownership and voting rights

The company is required to disclose full details of the ownership of equity in the company, and to disclose the voting rights attached to different categories of shares. See "Ownership Disclosure" above for additional information.

Members of the board and key executives, and their remuneration.

Full disclosure of is required of aggregate board remuneration, including aggregate pensions and benefits, including:

- Name and number of the members of the board of directors; dates in which they were appointed; powers and authority of the board of directors; and period in which the directors will hold such position.
- Name of the principal officers, as well as the years in which they have worked with the issuer or its affiliates.
- Resumes of officers and directors, including (a) work experience, (b) age, (c) studies, (d) time in current position, (e) previous employers, indicating if there is any relationship between such employers and the issuer.
- Family relationships among members of the board of directors.
- Total amount of the compensations paid to officers and directors during the previous year. Issuers must also disclose the number of officers and directors who received such compensation. If such compensation included bonuses, pension plans or stock acquisition plans, such benefits must be described.
- Number of shares or options owned by officers and directors. In the case of options, it must be disclosed the class, amount, strike price and expiration date.

The section "Management" in the annual report includes a discussion of the auditor, and describes any change (due to removal or resignation) of external independent auditor during the last three years. It should specify if during the last two years the auditors have expressed an opinion with qualification, negative opinion, or abstention regarding the financial statements. Audit fees must also be disclosed.

Material foreseeable risk factors. The company must disclose its policies on risk management, including internal controls and going concern risks. Disclosure is made first to the board and then to the CNBV, through the annual and quarterly reports. Market perception is that some non-financial issuers effectively implement policies on risk management.

Material issues regarding employees and other stakeholders.

No specific disclosures relative to employees or other stakeholders are required.

Governance structures and policies. Among the annual information the issuers must disclose in order to continue listing, is the report relative to the application of the CMP. This report includes an assessment of the company's compliance with the Code, in response to specific questions set for by CNBV's rules. The CNBV Market Surveillance Department has oversight powers to look for any breach of rules and enforcement actions. The penalties can range from fines to a halt in trading.

The CMP further suggests:

"It is suggested to the board of directors to include in its annual report to the shareholders meeting the relevant aspects involved in the tasks performed by each intermediate governance body. It is suggested to make available to the shareholders the reports of each governance body submitted to the board together with all other material for the Meeting, with the exception of information which confidentiality may affect the competitiveness of the corporation. In addition, it is recommended to include in the annual report the names of the members of each intermediate body.

Accounting Standards

The IMCP is authorized to issue Generally Accepted Accounting Standards (Mexican GAAP) and Generally Accepted Auditing Standards (GAAS) in Mexico. The Committee of Accounting Principles (CPC) of the IMCP is currently the standard setting body in Mexico. The CPC consist of 15 to 20 members who are accounting practitioners and researchers with a minimum ten years of experience in dealing with matters related to generally accepted accounting principles (GAAP). The National Executive Committee of the IMCP appoints the President and Secretary of the CPC. The President of the CPC and the Vice President of Legislation of the IMCP jointly appoint all other members of the CPC who must be ratified by the National Executive Committee of the IMCP. After the CPC in consultation with CNBV drafts an accounting standard, it is submitted to the membership as "Exposure Draft" for comments, once all comments are taken into account, a final version of the standard is submitted for vote to the members of the CPC, requiring 2/3 for approval. The approved standard is then sent for voting to the National Executive Committee of the IMCP, also requiring 2/3 for approval and dissemination. The issued accounting standard is known as "Bulletin" and the interpretations to the standard or "Bulletin" is known as "Circular". As of February 2002 there were 33 Bulletins and 23 Circulars issued and published. In addition to the CPC of the IMCP, the CNBV and CNSF issue accounting and reporting standards to satisfy their regulatory requirements. The CNBV has also issued additional disclosure requirements for publicly traded companies.

Mexican GAAP varies in certain respects from IAS. An analysis prepared for the Accounting and Auditing ROSC in 2002 addressed 164 accounting requirements under applicable IAS, and determined comparability of the counterpart Mexican GAAP, categorizing them approximately as follows—68 percent fully comparable, 8 percent broadly comparable, and 24 percent non-comparable or nonexistent.

The IMCP recognized that Mexican GAAP did not cover specific standards. Bulletin A-8, which went into effect January 1, 1995, attempted to reduce the gap between Mexican GAAP and International Accounting Standards. Bulletin A-8 requires the use of IAS when Mexican GAAP does not provide a specific standard. Once the Mexican Institute of Public Accountants (IMCP) issues a specific standard covering the subject matter, it supersedes the IAS standard "used in lieu". However, the application and use of the required IAS has not always been followed in actual practice.

The Accounting and Auditing ROSC analysis of the requirements under applicable Mexican GAAP revealed various incompatibilities with International Accounting Standard requirements. Selected significant areas of difference are described in the table below.

Significant Areas of Difference between Mexican GAAP and IAS

- Mexican GAAP requires the presentation of Statement of Changes in Financial Position while IAS requires the presentation of a Cash Flow Statement
- Mexican GAAP requires adjustments to financial reporting at all levels of inflation while IAS requires adjustments in hyperinflationary economies defined as cumulative inflation over three years approaching or exceeding 100 percent. This treatment is considered to represent a comprehensive measure of the effects of price level changes in the Mexican economy and to be a more meaningful presentation than historical cost-based financial reporting.
- The concept of segment reporting, as defined in IAS, does not exist under Mexican GAAP. Exposure Draft Bulletin B-5 was issued in September of 2002 which is comparable to IAS 14. Bulletin A-8 and Circular 49 require the use in lieu of IAS 14 in the absence of a local standard.
- IAS 31 requires the reporting in the consolidated financial statements of the venturer its interest in the jointly controlled interest using one of the reporting formats for proportionate consolidation or in the alternate the equity method. This requirement does not exist under Mexican GAAP. Bulletin A-8 and Circular 49 require the "use in lieu" in the absence of a local standard.
- IAS 18 defines when income from the sale of goods, services, royalties, interest and dividends should be recognized measured at fair value of the consideration received or receivable. Mexican GAAP does not have such a requirement. Bulletin A-8 and Circular 49 require the "use in lieu" in the absence of a local standard.
- IAS 21 requires that non-monetary items denominated in foreign currency recorded at historical must be shown using the exchange rate in effect at the date of the transaction and, non-monetary items recorded at fair value, denominated in a foreign currency must be shown using the rate of exchange in force at the date when the value was determined. Bulletin B-15 under Mexican GAAP does not have such rule.
- Expenditures for the development of intangibles are expensed under Mexican GAAP, Bulletin 38 while IAS 38 requires the capitalization if certain requirements are met. In addition, pre-operational expenses can be capitalized under Mexican GAAP while IAS prohibits such capitalization.
- IAS 36 requires the assessment at the date of each balance sheet of the determination of whether or not an asset is impaired. If such indication exists the enterprise should estimate the recoverable amount of the asset. The recoverable amount is the higher of an asset's net selling price and its value in use. Value in use is the present value of the estimated cash flows expected to raise from continuing use of the asset and from its disposal at the end of its useful life. Bulletin C-15 issued by IMCP October 15, 2002, does not use the concept of recoverable amount for an asset to be disposed.
- IAS 37 requires disclosures of provisions, contingent liabilities and contingent assets in the financial statements of the enterprise. Mexican GAAP does not have such a requirement. Bulletin A-8 recommends the "use in lieu" but is not mandatory in use under Circular 49.

The Accounting and Auditing ROSC also reviewed compliance of financial statements with Mexican accounting standards. A review in September 2002 of 25 sets of financial statements of companies listed on the BMV and in the US revealed some shortcomings in the actual application of accounting regulation. The review found that the overall presentation of financial statements needs to be streamlined and standardized. In many cases, financial statements included excessive information on immaterial aspects and inadequate information on more relevant aspects. The table below describes some divergences between established accounting regulations and actual practices.

Compliance with Accounting and Auditing Standards

- ***Disclosure of Accounting Policies.*** Many companies disclosed accounting policies for borrowing costs, inventories and financial instruments.
- ***Shareholders' Equity.*** Various companies did not disclose the number of shares issued and fully paid, and issued and not fully paid as well as the rights, preferences and restrictions attaching to the class, including restrictions on distributions of dividends and repayment of capital
- ***Consolidated Financial Statements.*** Many companies did not provide information on all the subsidiaries and associates. Some of the required disclosures in consolidated financial statements were not available especially on banks, were non-financial subsidiaries are excluded from consolidation.
- ***Related-Party Relationships and Transactions.*** The financial statements of many of the sample companies failed to provide complete information on related-party relationships. Some companies did not disclose the outstanding amounts and the pricing policies to determine arm's length dealings among the related parties.
- ***Segment Reporting.*** Although the segment-reporting requirement in Mexican GAAP is not in full conformity with IAS, Bulletin A-8 and Circular 49 require the mandatory "use in lieu" of IAS 14. Except in the case of some large-size enterprises, this type of information was rarely disclosed in the financial statements.
- ***Financial Instruments***. A number of companies did not disclose information about its exposure to credit risk for financial assets. Some companies did not disclose the amount of deferred gain and the expected timing of income recognition when the financial instrument was accounted as a hedge of risk associated with anticipated future transactions.
- ***Employee Benefit Costs.*** Some companies did not disclose the accounting policy adopted for equity compensation plans.
- ***Taxation.*** Some of the companies did not disclose separately the aggregate amount of temporary differences associated with investments in subsidiaries for which deferred tax liabilities have not been recognized**.**
- ***Restriction on Fixed Assets, Contingent Liabilities and Provisions.*** Most of the companies did not provide clear information on restricted fixed assets that were pledged as security, existence of contingent liabilities and provisions.

Market perception is that Mexican auditors play a fairly strong role at fostering appropriate accounting policies, and promoting effective internal controls, but are relatively weaker on deterring fraud, managing risks, and promoting accurate disclosure.

Market participants believe that issuers have a “fairly” good level of compliance with accounting standards. Most companies comply adequately, according to auditors. Auditors’ reports with exceptions represented 5.93 percent and 6.91 percent of total issuers’ reports for 2000 and 2001, respectively.

According to experienced practitioners, regulators and rating agencies in the country, the established practice of preparing financial statements primarily for tax purposes leads to either misapplication of requirements or reluctance to use IAS whenever Mexican GAAP is not available (for example in revenue recognition). As a result of this, “…financial statements tend to lose usefulness from the point of view of general purpose financial reporting.”

The IMCP does not believe that it is wise or possible to complete a rapid transition to IAS, because of “legal reasons” and different contexts. As a result, they have been moving forward incrementally.

Auditing Standards

Auditor Independence

External auditors are formally appointed by and report to the board, although in practice auditors report to management. Current law requires the auditor’s opinion to be signed by the individual auditor thus, responsibility and liability rests on the individual alone. Internal auditors also report to the board. Local member firms of the four large international networks audit a large majority (90+ percent) of listed companies, banks and insurance companies.

The CMP recognized these conflicts of interest and recommended that the "technical capacity" and independence of the external auditors should be considered in the selection process, and many of these recommendations were adapted in the *Circular Única*, which defines independence is defined according to the table on the following page. The highlights of the new rules include:

- Revenues to the accounting firm from any one client must not represent more than 10 percent of the firm's total (the CMP had recommended a level of 20 percent), and the auditing firm cannot be an important client of the issuer;
- Audit partner rotation is recommended (but not firm rotation) every five years (the CMP had recommended six years);
- The accounting firm is prohibited from providing a number of non-audit services, including bookkeeping, operating or designing information systems, valuations or appraisals, internal audit, executive search, and legal services.

According to data from the CNBV, 81 percent of issuers were complying with the six year auditor rotation requirement in 2001, up from 72 percent in 2000.

Auditor Independence Requirements (*Circular Única*)

Independence does not exist between the auditor that expresses an opinion about the financial statements of an issuer and the issuer whenever as of the date of subscription of the contract and during the audit:

- The revenues received by the accounting firm from the issuer, its holding, subsidiaries or associates, due to the services provided, represent 10 percent or more of the revenues of the firm during the immediate previous year.
- The auditor, the accounting firm or any partner or professional employee might be an important client or supplier of the issuer, its holding, subsidiaries or associates during the immediate previous year to that in which the service is intended to be provided. It is considered that a client or supplier is important whenever its sales or purchases to the issuer, its holding, subsidiaries, affiliates, or associates represent 20 percent or more of total sales or purchases.
- During the last two years, the auditor, any partner or professional employee of the accounting firm has been member of the board or hold a management or executive position in the issuer, its holding, subsidiaries, affiliates, or associates.
- The auditor, the accounting firm, any partner or professional employee, or any of his or her immediate family members has any investment, debt instruments, or stock options of the issuer, its holding, subsidiaries, affiliates, or associates. This does not apply to the ownership of stocks through mutual funds.
- The credits and liabilities that the auditor, the accounting firm, any partner or professional employee or any of his or her immediate family member keep with the issuer, its holding, subsidiaries, affiliates, or associates represent 10 percent or more of its wealth except for the following loans obtained from financial institutions under its normal lending procedures, terms, and requirements: credit cards, automobile, and mortgage loans.
- The issuer, its holding company, subsidiaries, affiliates, or associates has any investments in the accounting firm.
- The accounting firm provides, in addition to auditing services, the following:
    - Preparing of the accounting records and financial statements of the issuer, its holding, subsidiaries, affiliates, or associates, the same as originating source data underlying the mentioned financial statements or any or its items.
    - Directly or indirectly operating the issuer's information system or managing its local area network.
    - It is not considered as a lack of independence, the valuation, assessment, design, and implementation of internal accounting controls, and risk management controls provided by the auditor.
    - Operating, supervising, designing or implementing hardware and software systems of the issuer that aggregates source data underlying the financial statements or generates information that is significant to the preparation of the financial statements.
    - Valuations or appraisals.
    - Performing, temporarily or permanently, management or any decision-making functions for the issuer.
    - Internal audit relative to financial statements and accounting controls, except when the issuer assumes the responsibility and decision-making relative to the establishment and maintenance of a system of internal control, scope and frequency of activity of internal audit and its results.
    - Searching for or seeking out prospective candidates for managerial, executive or director positions.
    - Providing legal services, either corporate or others, in which the issuer is required to practice before

courts.
  - Any other that creates conflicting interest between the auditor and the issuer.
- The auditor, the accounting firm, or any partner or professional employee fees depend on the success of any transaction achieved by the issuer.
- The auditor, the accounting firm, or any partner or professional employee does not followed the Ethics Code issued by the Mexican Institute of Public Accountants.
- The auditor could not express his or her opinion on financial statements of the same issuer for more than five consecutive years, having the possibility to be re-assigned after a period of two years.

CNBV can initiate a dismissal due to violations of the accounting, reporting and auditing requirements. The Department of Internal Revenue maintain a list of registered qualified auditors. CNBV requires the appointment of auditors in the IRS list.

Auditing Standards

The Mexican Institute of Public Accountants (*Instituto Mexicano de Contadores Públicos*, A.C.) issues Auditing Standards and Procedures (*Normas y Procedimientos de Auditoria*) and a Professional Ethics Code (*Código de Ética Profesional*). The Professional Ethics Code was issued by the IMCP in 1955 and later revised in 1968 and 2000, and governs the audit process. It is regulated by the IMCP, which can sanction the auditors and even expel them from the Institute. The CNBV can also impose sanctions, such as veto on the auditors and their reports.

According to CNBV's regulation, the accounting firm must keep a manual of policies and procedures that assures the maintenance of an adequate quality control of audit services and review the compliance with independence requirements. This manual must provide at least, the following:

1. Procedures that clearly determine the responsibilities of partners or any other firm employee in charge of performing the audit, and include confidential covenants for each one.
2. Internal programs of permanent training for employees and partners of the accounting firm.
3. Information systems that allow both partners and employees to have periodical information with respect to those issuers that independence must be kept.
4. Mechanisms of communication with partners and employees that allow the request of information that assess the compliance to independence criteria.
5. Disciplinary procedures that guarantee the compliance of the policies.

The accounting firm of the auditor must be part of a quality review program that shall embody:

1. The level of compliance to requirements of quality control for its accounting and audit practice.
2. The content and level of compliance of the manual.

The quality review program must observe the policies, standards and procedures set by a committee of members of accounting firms that pretend to audit issuers. The review must follow certain standards and procedures:

1. It must be practiced at least every three years.
2. The results of the review must be contained in a report.
3. The accounting firm discloses the report mentioned in the previous fraction for both the issuer and the Exchange. This report is available to any other investor.

The accounting firms are not allowed to perform self-reviews. Reciprocal reviews are not permitted. Before 2001, there was no regulation considering any audit and accounting firms review.

The IMCP has established an Honor Council that is responsible for analyzing complaints regarding any associate. If the complaint is supported by the facts, the associate will deserve any of the following sanctions: private admonition, public admonition, suspension of associate's rights, or banishment. The IMCP may even denounce such accountant to competent authorities.

Audit Standards must follow three basic rules:
- Independence

- Training plans within the firm for both employees and partners, and compliance with the IMCP's Professional Continuous Education (*Educación Profesional Continua*).
- Professional concern related to procedures that determine functions and responsibilities, confidential commitments, audit jobs assignments, and surveillance of audit policies and practices.

Information lodged with the regulator is not open for public inspection.

According to the analysis carried out for the Accounting and Auditing ROSC, the Code of Ethics has serious deficiencies. The Code is 12 pages in length and covers very briefly the following subjects:

- general ethical professional standards as a public accountant;
- ethical aspects of practicing as an independent public accountant, (under which independence issues as an outside auditor are addressed in 1 page);
- ethical aspects of a public accountant employed in private practice, government and teaching and;
- sanctions and penalties (half a page).

The first three pages of the Code of Ethics are covered by Postulates which are defined in the Introduction as the essence of the profession intentions to live and act within ethical professional behavior. Postulate VIII reads "*Loyalty to the one who pays for the services*. The public accountant must abstain from taking advantage from situations that could cause damage to the one who contracted his services". Postulate X reads *"Respect to peers and to the profession.* All public accountants must take care of his relationship with collaborators, peers and the professional organizations that is member, always looking not to damage the dignity of the profession but rather enhancing it behaving to favor the group".

These two Postulates clearly undermine the required objectivity and integrity of the public accountant in Mexico in safeguarding the public interest as its principal objective. Additionally, they appear to be contributing factors to the lack of public records for investigation, disbarment and sanctions to auditors for violations of the professional standards of practice. The IFAC Code of Ethics which is intended to serve as a model to its member countries is 118 pages long of which 60 detailed pages cover the general guideline and definition to independence and applications of independence principles to specific situations.

As detailed in the Accounting and Auditing ROSC, Mexican Generally Accepted Auditing Standards (GAAS) are different in audit approach from International Standards on Auditing (ISA) Most of the existing audit standards and procedures have been influenced by US GAAS but lack the detailed application guidance that is characteristic of the US standard setting process. ISA audit design and planning promote the Risk-Based Audit model and are proactive in the detection of fraud and error while the Mexican standards promote a reactive audit approach to the detection of fraud and error.

Some of the deficiencies in Mexican standards in reference to ISA are summarized in the following table.

Mexican Auditing Standards and International Standards Compared

- **ISA 200, *Objective and General Principles Governing an Audit of Financial Statements.*** The Mexican Auditing Standard addresses in Bulletin 2010 the personal traits of the auditor: independence, it does not clarify when independence is impaired, professional competence and due care, professional behavior and technical standards without referring specific adherence to the Mexican Code of Ethics for Professional Accountants. Objectivity and integrity are not address. The Professional Code of Ethics for Accountants is only 12 pages long and lacks depth and detail in the application of the standards.
- **ISA 210, *Terms of Audit Engagement.*** Bulletin 3110 addresses the requirements for an engagement letter. Paragraph 25 briefly states that if there is a change in the engagement which implies a lower level of assurance, the auditor should request in writing and evaluate the impact on the opinion of such a change. The standard, however, does not address a potential withdrawal if conditional in the scope or not able to obtain sufficient audit evidence to change the opinion.
- **ISA 220, *Quality Control for Audit Work.*** Bulletin 3020 Addresses Quality Control and the need for the firm to place policies and procedures that assures adherence to the audit standards and the Code of Ethics enacted by the IMCP in the performance of audit engagements. The standard briefly touches on independence without stating or clarifying when it is impaired. The standard does not address nor mention the need for integrity, objectivity and confidentiality. The most important requirement of Quality Control is the presence of an

independent and external monitoring system which is an ISA Quality Control standard.

- **ISA 240, *Fraud and Error*.** The ISA standard requires the auditor to design the audit program to detect existence of any fraud or error (skepticism) while Bulletin 3070 requires the auditor to design the audit program in accordance with the required audit standards and the auditor should expand the audit program it the audit shows possibility of the presence of errors and irregularities, The two standards are significantly different in audit approach.
- **ISA 310, *Knowledge of the Business*.** There is no Mexican standard covering this requirement.
- **ISA 402, *Audit Considerations Relating to Entities Using Service Organizations.*** There are no comparable Mexican standards.
- **ISA 500, *Audit Evidence.*** The Mexican standards address evidence from the perspective of validating management assertions of the financial information. The standard does not address the obtaining of audit evidence from test of controls and whether or not the auditor should consider the sufficiency and appropriateness of the audit evidence to support the assessed level of control risk.
- **ISA 570, *Going Concern.*** The Mexican audit standards do not address a going concern standard in the design, planning and performance of audit procedures and the evaluation of the results thereof. The Mexican audit standard address going concern in the opinion section of the standards, Bulletin 4010, paragraphs 81 to 89.
- **ISA 610, *Considering the Work of Internal Auditing.*** There are no Mexican Auditing Standards covering comparable requirements/practices.
- **Communications of Audit Matters with those Charged with Governance.** There are no Mexican Auditing Standards covering comparable requirements.

According to the Accounting and Auditing ROSC, it appears that the auditors generally comply with the Mexican standards and that large audit firms make best efforts to apply ISA-compatible procedures and practices. However, the lack of detailed Mexican standards and implementation guidelines generally leads to divergences in the practical application of comparable international audit practices. The possibility that actual auditing practices might depart from some important international standards is reinforced by the concern of the CNBV and CNSF for enforcement of the requirements reflected in the strict wording of the Mexican Auditing Standards and Code of Ethics for Auditors.

Independent oversight of the auditing profession

IMCP currently has complete oversight over the accounting and auditing standard setting process. CNBV has been granted regulatory supervision over the accounting, reporting and auditing requirements of listed companies. The CNBV is empowered to take disciplinary actions for enforcing the code of professional ethics and auditing standards. The CNBV may impose the following disciplinary penalties against errant auditors: monetary penalties, admonishment, reprimand, removal from the list of qualified auditors kept by the Department of Internal Revenue, request for investigation and temporary or permanent suspension from IMCP and in some instances can initiate judicial proceedings in the case of fraud for criminal sanctions. The State Societies of Public Accountants and the IMCP have the authority under Article 5 of the Constitution to initiate investigations through the Honor Committee of any complaints against licensed Public Accountants and report findings to the Secretary of Public Education. Presently no public record exists of sanctions to individual auditors or firms for violation of audit standards in performing audits of listed companies.

The statutory regulatory bodies rely heavily on the auditors for ensuring compliance with the established accounting and disclosure requirements. But due to lack of legal limitations and the independence of external auditors guaranteed by the legal acts, these bodies rarely enforce actions against those external auditors who fail in ensuring compliance with the accounting and disclosure requirements. Such enforcement actions can be taken by CNBV.

It is evident that the Mexican Institute of CPAs lacks independence in the audit supervision process due to conflicts of interest created by its complete control of self-regulation of the profession. The Institute issues accounting, auditing and ethics standards. In addition, it acts as the only enforcer for violations through its Honor Committee.

Current law requires the opinion of the financial statement to be signed by the individual auditor thus, responsibility and liability rests on the individual alone. The scope of responsibility should be expanded to include the firm of public accountants. Decisions concerning audit quality and procedures are rarely made by one individual member of the firm, normally, the firm's management sets the guidelines and the policies and procedures that members of the firm must follow in audit engagements. A system of independent outside practice review (Quality Control) will insure compliance and adherence to audit standards and procedures for audit of listed companies, banks and insurance companies

In 2002, as a result of corporate accounting scandals in the US, and the drafting of an IOSCO technical paper on auditor oversight, Mexico began steps in the direction of an independent accounting oversight board.[103] The CU gives the CNBV the power to create one. However, a number of policy questions remain unresolved, especially a source of funding.

Audit Committee

The 2001 LMV reform followed the recommendations of the CMP and requires listed companies to establish an audit committee of the board, to ensure effective and independent oversight of the audit function. The LMV established that the audit committee must have a majority of independent directors, including its chairman.[104] This committee will verify related-party transactions and will inform the board of these transactions. The audit committee must propose the hiring of independent specialists to give fairness opinions on transactions with related parties if it deems it necessary. The audit committee has to prepare an annual report indicating its activities and present it to the board of directors, which, in turn, will have to present it in the shareholders' meeting.

Data from the CNBV indicate that companies are moving to comply with the audit committee requirement. For example, 58 percent of companies reported that the chair of the audit committee was independent in 2001, up from 26 percent in 2000.

The Audit Committee can meet with the statutory examiner, who will not have the right to vote. The head of internal audit and the external auditor cannot attend audit committees. Internal audit reports are reviewed by external auditors, and all findings are discussed at the audit committee and then reported to the board.

The CMP lays out the audit committee's function in some detail. The committee should perform the following functions:

i. recommend to the board the nominees for external auditors of the corporation;
ii. recommend to the board the terms and conditions under which such external auditors should be hired and the scope of their professional mandate;
iii. support the board by supervising the performance of the audit's contracts;
iv. act as a communication channel between the board of directors and the external auditors, as well as ensure the independence and objectivity of such auditors;
v. review the work program, management letters, and the external auditor's report, and inform to the board of directors accordingly;
vi. recommend to the board the basis by which the financial information will be prepared;
vii. assist the board by reviewing the financial information and its disclosure process;
viii. contribute in the definition of the general guidelines for the internal control system and evaluate its efficiency;
ix. assist the board in the coordination and evaluation of the annual internal audit programs;
x. coordinate the activities of the external auditor, internal auditor and statutory auditor; and
xi. verify that mechanisms are implemented in order to ensure compliance with all applicable legal provisions.

The audit committee has a number of other responsibilities to improve the quality and flow of information disclosed by the company to the board and to shareholders:

- The committee should submit to the approval of the board of directors the accounting policies used in the preparation of the financial information (complied with by 59 percent of companies in 2001, up from 41 percent in 2000), and must justify any changes to accounting policies;

[103] *Principles for Auditor Oversight*, Statement of the Technical Committee of IOSCO, October 2002.
[104] Article 14 Bis 3, F V.

- The committee should submit for board approval the mechanisms that are necessary to ensure good quality of the financial information presented to them. In the process, the internal auditor, the external auditor and the Statutory Auditor of the corporation may participate.

Auditor Liability

Auditors can purchase an insurance policy against lawsuit. Applicable laws do not limit the use of liability insurance, and policy in this regard is not a matter of shareholders' approval. However, there are no known cases of audit firms with insurance policies in Mexico. CNBV is not aware of any case where auditors were sued.

The 2001 LMV reform took several steps to increase auditor liability, and the CU established rules for auditor independence. The CNBV has imposed a veto on a few auditors. However, market perception is that auditors face little or no liability for their actions, since no cases of board members nor accountants charged for disclosure misbehavior have been made public. Under the law, only individuals are responsible and sign the audited opinion. It is general knowledge among the users of financial statements that if anything goes wrong, the firm blames the signing auditor and washes its hands from any responsibility.

Information Channels

All the periodic information filed with the CNBV is available and readily accessible to the public at the Mexican Stock Exchange, which maintains most of it also available through the internet at their website (Emisnet). The CNBV maintains a National Registry of Securities available to the public, providing information about all registered securities with the Commission.

Both the Mexican Stock Exchange and the CNBV are responsible for monitoring and enforcing functions on disclosure. The Monitoring of Market area at the BMV verifies the disclosure of relevant information of the issuers in Emisnet.

Annex H: Responsibilities of the Board

Board of Directors Overview

The board of directors as a body is entrusted with the "administration" of the corporation. Administration does not imply day-to-day management, but rather the supervision of management, which is conducted by employees of the corporation. The shareholders (acting through the shareholders meeting) are the supreme governing body of the Mexican corporation.

Directors are usually elected, reelected or replaced at the annual shareholders meeting. Directors remain in office until the directors who replace them are appointed and take office. Shareholders representing 10 percent of voting and limited voting shares (25 percent if not a public company) have the right to appoint a board member.[105] Article 162 of the LGSM establishes that "directors shall immediately cease carrying out of their duties upon declaration of the resolution of the general assembly of shareholders claiming against them for liability they may have incurred". In addition, Article 14 Bis F. III of the LMV establishes that the appointment of board members and statutory examiners designated by the shareholders may be revoked only when all the members are revoked as well.

The board must meet at least once per quarter.[106] 25 percent of board members or any of the statutory examiners can call a board meeting.

Individual directors as such, do not have authority to represent the corporation. The board of directors as a body usually has broad powers, which it may delegate to individuals.

Traditionally, board membership was an almost ceremonial function. Boards were large, and lacked any efficiency for the supervision of day-to-day management. Payment for membership was often a gold coin.

In the case of financial groups, banks, brokerage houses, and auxiliary credit organizations, the majority of board members must be Mexican or foreign residents (who must live in Mexico with absences no longer than 6 months). For affiliates, a majority of board members must be residents in Mexico.

Alternate Directors

The LGSM allows directors to have "alternates" (substitutes) to represent him or her in case of absence. Each director can have only one substitute to represent him in case of absence. Substitutes of independent directors must be independent as well. The position of a director must be performed personally or by alternate directors previously appointed by resolution of a shareholders' meeting. A director cannot appoint a proxy holder or attorney-in-fact to represent him in board meetings.

The CMP recognizes that the institution of alternate directors is somewhat at odds with modern board practices, and recommends against them. Data from the CNBV suggests that 50 percent of companies had alternate directors in 2001, down from 71 percent in 2000. For companies that continue to have alternate directors, the CMP recommends they only act on behalf of the specific director they represent, and that each director suggests his or her own alternate. 31 percent of companies reported that they followed this best practice recommendation in 2001, leaving 19 percent of companies who did not follow any of these alternate director recommendations.

Finally, the CMP recommends that directors and their alternates (if any) must keep "mutually informed" on matters discussed in the board meetings they attend. CNBV data show that 72 percent of companies reported compliance with this recommendation in 2001.

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[105] Article 144 of the LGSM.
[106] LMV, Article 14 Bis 3, F IV. Confusingly, the CMP calls for a smaller board size (five to 15 members), and a smaller share of independent directors (20 percent).

***Comisarios* (statutory examiners)**

The company and its operations are overseen by one or more statutory examiners (*comisarios),* elected by the Ordinary General Assembly of Shareholders. In theory, the *comisario* is an individual who is entrusted with the vigilance of the corporation on behalf of shareholders. Ten percent of shareholders have the right to appoint a statutory examiner.

In practice, the *comisario* is most often a partner in the external auditor's accounting firm. The CMP recommends that the external auditor (the person who signs the audit report of the annual financial statements of the corporation) should not be the same person who acts as the statutory examiner, but allows both to be partners in the same firm. Before the CMP recommendation, many observers believed that over 95 percent of the *comisarios* were the same individual as the outside auditor.

Any person can be a statutory examiner. Several groups are ineligible to be statutory examiners, including:[107]

- The directors of the company.
- Relatives of the directors in any degree of lineal ascent or descent, collateral blood relatives of the directors to the fourth degree, and relatives related by marriage to the second degree.
- Individuals who are legally ineligible to engage in commerce;
- Employees of the company concerned, employees of companies who hold more than a 25 percent interest in the company concerned, and employees of companies in which the company concerned holds more than 50 percent of the shares;

Statutory examiners may attend board meetings, call a shareholders meeting, and have full access to company information. Their full powers are presented in the table below.

Powers of Statutory Examiners

- To verify the making and continued existence of the guaranty required under article 152, and inform the general assembly of shareholders of any irregularity without delay;
- To demand from the directors a monthly report which includes, as a minimum, a statement of financial condition and income;
- To audit the operations, documents, records, and other supporting evidence, to the extent necessary to oversee the company's operations in accordance with their obligations and to render the opinion described in the following paragraph;
- To deliver annually to the general assembly of shareholders their opinion regarding the truthfulness, sufficiency and reasonableness of the information presented by the board of directors to such shareholders' assembly. Such report must include, at a minimum:
    - The opinion of the statutory examiners as to whether the accounting and informational policies and standards followed by the company are adequate and sufficiently take into consideration the particular circumstances of the company;
    - The opinion of the statutory examiners as to whether such policies and standards have been applied on a consistent basis in the information presented by the directors;
    - The opinion of the statutory examiners as to whether, as a consequence of the foregoing, the information presented by the directors correctly and sufficiently reflects the financial condition and income of the company;

- Insert items in the agenda of the meetings of the board of directors and of the assembly of shareholders;
- Convene ordinary and extraordinary assemblies of shareholders in the case of director misconduct or in any other case they consider appropriate;
- To attend all meetings of the board of directors, of which they must be given notice, at which they shall have the right to participate in discussions, but not to vote;

[107] LGSM, Article 165.

- To attend audit committee meetings as invited guests, with the right to be heard but not vote.
- To attend assemblies of shareholders, at which they shall have the right to participate in discussions, but not to vote; and
- In general, to oversee without limitation, and at any time, the operations of the company.

Any shareholder can inform the statutory examiners in writing of any irregularities in the administration of the company, and the statutory examiners must include these accusations in their reports to the general assembly of shareholders, with such comments and proposals as they consider relevant.

Statutory examiners are elected by the general meeting of shareholders. If for any reason there are no statutory examiners, the board of directors shall call a general assembly of shareholders within three days for the purpose of making the corresponding appointment.[108] If the board of directors does not convene such assembly within the period indicated, any shareholder may petition the judicial authority of the domicile of the company to convene such assembly. In the event that the assembly does not meet or, having met, does not make the appointment, the judicial authority of the domicile of the company, at the request of any shareholder, shall name the statutory examiners who shall serve until the general assembly of shareholders makes a definitive appointment.

Statutory examiners may use the services of company employees, or the services of independent technical professionals who are appointed by the statutory examiners.

Statutory examiners shall be individually liable to the company for complying with the obligations imposed upon them by law and the bylaws.[109] Statutory examiners who have a conflict of interest with the company in any operation must abstain from any participation in that decision, or face liability equal to the damage they cause.[110]

The CMP also recommends that the audit committee should ensure that the statutory examiner is qualified, and that his or her background be disclosed in the annual report.

Comisarios frequently receive no fees, particularly if he or she works for the same firm as the auditor. Otherwise, the fees for acting as a *comisario* are generally low, and might include a sitting fee for board meetings.

Committees of the Board

The CMP recommends that the board create "one or various intermediate governance bodies" to cover the following areas:

- evaluation and remuneration
- finance and planning
- auditing

Each of these recommended committees (or committee functions) is discussed in detail below (audit committee recommendations are discussed in Annex G above). The audit committee recommendation is the most significant, because it was later adopted into law in the LMV reform in 2001. Boards must establish an audit committee, composed of board members, with a majority of independent directors, including the chairman.[111] The audit committee must verify related-party transactions and inform the board. The audit committee must propose the hiring of independent specialists to give fairness opinions on transactions with related parties if it deems it necessary. The audit committee has to prepare an annual report describing its activities and present it to the board, which in turn must present it to the shareholders' Assembly.

The CMP also recommends that any committees should be:

[108] LGSM, Article 168.
[109] LGSM, Article 169.
[110] LGSM, Article 170.
[111] LMV, Article 14, Subsection 3, Fraction V.

- created only when there is a clear purpose and membership avoids conflicts of interest;
- Composed only by directors;
- Composed of a minimum of three board members and a maximum of seven (no alternates);
- Regularly inform the board of directors of their activities.
- The Chairman of each committee may invite to its meetings the officers of the corporation whose duties are related to the functions of such body.

It is suggested that each independent director participates in at least one of the intermediate bodies, and that the audit committee be chaired by an Independent Director.

Equitable Treatment by Board Members

Under most interpretations of the LGSM, the board of directors has "fiduciary duties" to the company and to all of its shareholders. The directors, once appointed, do not simply represent or act for the benefit of the group of shareholders that elected them. Rather, the fiduciary duties are to all of the shareholders of the company and to the company itself. At all times the board of directors must pursue the best interests of the company.

Board members must abstain from participating and voting on issues that may represent a conflict of interest.[112] If, with regard to a particular matter, a director has a conflict of interest with that of the corporation, he must so advise the other directors and refrain from discussing and. voting on the matter. A director who fails to comply with this limitation shall be liable to the corporation for any damages and losses caused to it.

According to the LGCM, the board is accountable to shareholders (the General Assembly). Article 157 states that "directors shall have the responsibilities inherent in their office and those derived from such obligations which the law or the bylaws may impose upon them." The members of the board assume personal responsibility that could derive on civil lawsuits initiated by unsatisfied shareholders. The LGSM provides only very basic specific duties for the board, and specifically states that "directors shall be jointly liable with the company:"[113]

1. For the factual existence of the capital contributions made by the shareholders;
2. For compliance with the requirements established by law or the bylaws relating to dividends paid to shareholders;
3. For the existence and maintenance of systems of accounting, control, book-keeping, filing, or information which may be required by law;
4. For strict compliance with the resolutions of the assembly of shareholders."

[112] There are no rules or recommendations for shareholders related to this issue.
[113] LGSM, Article 158.

Specific Rules for Boards of Financial Institutions

Generally, Mexican law does not require specific number of members of the board of directors of a corporation. However, regulated financial entities (banks and broker dealers) are subject to specific regulation. Following please find a summary of the requirements for the board of directors of banks, broker-dealers and financial holding companies:

Banks and Financial Holding Companies

The management of a commercial bank is entrusted to a management board and to a General Director. The management board is required to have an audit committee. The General Director should elaborate and present to the management board, for its approval, the right policies for the adequate employment programs as well as policies for human and material resources of the institution. The General Director should provide all kind of information to the management board, so that they can take the right decisions.

The board of directors of Mexican banks and financial holding companies may not have more than 15 members. No more than one third of the members of the board of directors may be employees of the bank and financial holding companies. Only the general director and the officers of the two top levels of management may be directors. Spouses of directors, relatives of two or more directors, persons who have pending litigation with the bank, bankrupt persons, persons sentenced for criminal offenses and supervisors and regulators may not be directors. An individual can serve on only one bank board.

Shareholders representing 10 percent or more of the corporate capital may appoint a director. The majority of the members of the board of directors must be Mexicans or residents in Mexico. The Banking Law establishes that a board member should be a person who has technical quality, honorability and an adequate credit background, and a wide knowledge and experience in financial, legal, and administrative matters. Their appointment must be approved by the CNBV. The CNBV must also approve individuals elected by shareholders to serve as statutory examiners of a bank under its supervision and individuals appointed as senior officers.

The commercial banks articles of associations establish the procedures for nominating and electing the members. The Banking Law establishes that the CNBV can remove board members.

The Banking Law also establishes that the board is required to have an audit committee.

Broker Dealers

The board of directors of Mexican broker dealers may not have more than 15 members. The board members must be qualified and have a good reputation. Their appointment must be approved by the CNBV. Shareholders representing 10 percent or more of the corporate capital may appoint a director. The majority of the members of the board of directors must be Mexicans or residents in Mexico.

Investment Companies

Significant recent legal developments have taken place in the investment company industry, concerning the number and type of members of boards of directors. The new Mutual Funds Law (*Ley de Sociedades de Inversión* / LSI), which became effective on December 4, 2001, provides that boards of directors must consist of no less than five and not more than 15 members, of which at least one third should be independent, not having any link whatsoever with their stockholders, either familiar, business or professional, and should comply with strict personal requirements, such as financial expertise and trustworthiness.

In the case of investment company operators, shares distributors and valuation companies, the members of their board of directors should comply with the same strict personal requirements as investment companies, except for independent directors, and operators should appoint compliance officers to observe compliance with regulations and internal rules.

In general, civil actions against directors may only be initiated by the shareholders meeting, which will designate a person to exercise the respective action in the courts. [114] The directors who are accused by resolution of a shareholders' meeting shall immediately cease to perform their duties.

Since the LMV 2001 reform, shareholders who own at least 15 percent of the company's capital stock, with or without voting rights, may directly initiate civil lawsuits against the company's management, statutory examiners or members of the audit committee.[115] This assumes that (i) such shareholders have not voted in favor of a decision adopted by the shareholders resolving not to bring such an action against the relevant director, and (ii) the claim covers all the damages alleged to have been caused to the corporation and not merely the portion affecting the plaintiffs. Any recovery of damages with respect to such an action will be for the benefit of the corporation and not for the shareholders bringing the action. There have been few cases in the courts where directors' liability has been enforced.

Statutory examiners must also disclose conflicts of interest and withdraw from any further deliberation or resolution on that issue. The Banking Law also establishes that in case of conflicts of interest, the board members must not participate in the analysis and voting of the issues related to a conflict of interest.

Any director that is absent at a meeting or votes against the approval of a resolution will not be held liable for such action. Directors, once found liable and removed from office, only may be appointed again if the judicial authorities determine that the action brought against them was unfounded. Directors are jointly and severally liable to the corporation with those directors whom they replace for the irregularities committed by them, if the new Director is aware of such irregularities and does not denounce them to the auditors.

There are no rules governing the conduct of directors who are connected to major shareholders or other bodies with a vested interest in the outcome of board decisions.

In practice, directors have not been held personally liable for breach of fiduciary duty. Experiences where shareholders have attempted to hold directors or managers liable have been few and indeed, rare. Directors have been held personally liable for criminal offenses, such as fraud and breach of certain security market regulations. Usually, if a fraud has been committed, it is the government who initiates criminal actions.

Duties and Liabilities to Stakeholders

The members of the board are not required to take the interests of stakeholders taken into account when making corporate decisions. Directors' liabilities referred to in the LGSM are basically to the corporation and not to anyone else.

The CMP recommends that the audit committee should ensure the "existence of mechanisms" that allow the board to determine if the corporation duly complies with applicable laws, and to hold a review on the matter at least once a year. Data from the CNBV suggests that 66 percent of companies complied with this recommendation in 2001, up from 66 percent in 2000. The committee should inform the board of directors about the corporation's legal status on a regular basis.

In practice, issuers (and boards) rely on a Normative Comptroller (*Contralor Normativo*); this same person takes charge of fulfilling the legal obligations of the issuer. Board members have no obligation to disclose their policy on bribery, corruption, or political donations.

Generally, a director will have no liability to the tax authorities, unless he/she personally participates in the respective violation of the laws. As an exception, directors could be liable with the corporation to the tax authorities for some very basic omissions by the corporation in compliance with tax laws, including:

1. Failure of the corporation to register as a taxpayer.

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[114] LGSM, Article 161.
[115] LMV, Article 14 Bis 3.

2. Failure to advise the tax authorities of a change of domicile of the corporation in certain cases.
3. Failure to keep accounting records, or hiding or destroying accounting records.

Adequate assistance by accounting firms should help to avoid the occurrence of matters that would give rise to tax liability.

Board Functionality

Basic company law says little about the responsibilities of directors; most specifics are left to company bylaws. The bylaws of each corporation generally include a section that sets forth the duties and capacities of the directors. In some instances, such duties and capacities are detailed, and directors may not exceed their functions. Day to day management is generally appointed by the directors, although such appointment is not mandatory.

The CMP laid out a much more detailed set of (recommended) duties for the board. The board should carry out the following functions:

(i) define the strategic view of the corporation;
(ii) ensure that the shareholders and the market have access to the public information of the corporation;
(iii) establish internal control mechanisms;
(iv) assure that the corporation has adequate mechanisms to comply with the applicable laws; and
(v) assess, on a regular basis, the Chief Executive Officer (CEO) and the high ranking officers' performance.

The 2001 LMV reform added to the formal responsibilities of directors (see *related party transactions*, above). The board now has the non-transferable duty of approving:

- all non-related operations (with the company's normal activities) held between the firm and the company's partners or with any company's administrator;
- purchases of 10 percent or more of the assets;
- granting and of any guarantee that surpasses 30 per cent or more of the company's assets.
- Among other activities that represent more than 1 percent of the company's assets.

Reviewing and guiding corporate strategy, major plans of action, risk policy, annual budgets and business plans; setting performance objectives; monitoring implementation and corporate performance and overseeing major capital expenditures, acquisitions and divestitures.

The CMP recommends that the board define each corporation's strategy, and recommends the creation of a Finance and Planning committee of the board. The Finance and Planning Committee should perform the following functions:

(i) evaluate and suggest, if appropriate, the investment policies proposed by the CEO and then submit them to the board for approval;
(ii) evaluate and suggest, if appropriate, the financing policies (equity or debt) proposed by the CEO and then submit them to the board for approval;
(iii) evaluate and suggest, if appropriate, the general guidelines for the strategic plan of the corporation;
(iv) give an opinion on the annual budgets assumptions and then submit it to the board for approval;
(v) follow up the budget's disbursement and the development of the strategic plan; and
(vi) identify the risk factors to which the corporation is subject and assess the policies for its management.

The CMP specifically recommends that

- the finance and planning committee should submit to the board of directors an evaluation of the feasibility of the main investments and financing transactions of the corporation, same which should be in line with the existing policies.
- the committee should periodically evaluate the strategic position of the corporation in terms of the strategic plan.
- the committee should assist the board in reviewing the consistency of the investment and financing policies with the strategic plan of the corporation.
- The committee should assist the board in reviewing the financial projections of the corporation while assuring their consistency with the strategic plan.

Data from the CNBV suggests that 63 percent of companies complied with these recommendation (basically unchanged from the previous year).

In addition, CMP gives the audit committee responsibility for establishing internal control mechanisms, to assure that the corporation has adequate mechanisms to comply with the applicable laws. The audit committee should submit for board approval the general guidelines of the internal control system. Data from the CNBV suggests that 57 percent of companies complied with these recommendation (basically unchanged from the previous year).

Law and regulation do not impose any no particular requirements regarding risk policy on non-financial companies. In accordance with the circulars 14-23, 10–247 and 14-73, the board of directors of banks, brokerage houses, and development banking institutions, respectively, should define their objectives according to the type of risk. These rules apply whether the institutions are listed or not.

Selecting, compensating, monitoring and, when necessary, replacing key executives and overseeing succession planning.

The role of the board in the selection, compensation and oversight of management and executives, including succession planning, formally depends on the company's bylaws. However, the CMP makes a number of recommendations that the board should be formally involved in the area of executive oversight. In particular, it recommends the creation of a Evaluation and Remuneration committee. The Evaluation and Remuneration committee should carry out the following functions:

(i) suggest to the board procedures to nominate the CEO and high ranking officers;
(ii) propose to the board the criteria to evaluate the CEO and the high ranking officers, following the general guidelines established by the board; and
(iii) analyze and submit for the board of directors' approval the proposal made by the CEO regarding the remuneration structure to be paid to the main officers of the corporation.

The CMP specifically recommends that the board should be supported by reviewing the terms and conditions on which the CEO and the high ranking officers are being hired, as well as the possible payments in case of separation from the corporation; such terms and conditions should follow the general guidelines approved by the board. Data from the CNBV suggests that 58 percent of companies complied with these recommendation (basically unchanged from the previous year).

The CMP also recommends disclosure of remuneration in the annual report, but only 37 percent of companies complied with this recommendation in 2001.

Reviewing key executive and board remunerations, and ensuring a formal and transparent board nomination process.

Shareholders directly appoint and remove board members, including minorities representing 10 percent of voting and limited voting shares, which as explained, have the right to appoint a board member. In practice management is responsible for the board nomination process. A complete slate of individuals is proposed to the shareholders' meeting by management, and it is uncommon for a 10 percent group to actually appoint a specific director.

The LGSM establishes that the ordinary assembly determines the remuneration to be paid to the directors and statutory examiners, when not determined in the bylaws.[116] There are no requirements for members of the board to stand down for re-election. Directors' service contracts and benefits are subject to restriction by shareholder intervention.

[116] LGSM, Article 181 F. III.

There are no minimum qualifications for appointment of board members by law, regulation or recommended practice. The LMV, and other financial laws and regulations, states minimum qualifications only for those who can be appointed as independent members.

Monitoring and managing potential conflicts of interest of management.

The board does not appear to have any responsibilities (under law or the CMP) to monitor or manage conflicts of interest of management, other than its basic responsibility to appoint and monitor the CEO and the management team.

Ensuring the integrity of the corporation's accounting and financial reporting systems, including the independent audit, and that appropriate systems of control are in place, in particular, systems for monitoring risk, financial control, and compliance with the law.

As noted above, the audit committee functions recommended by the CMP firmly establish board control over the company's accounting and financial reporting systems:

- The company should have an internal audit department (complied by 83 percent of companies in 2001, 79 percent in 2000).
- The committee should submit accounting policies for approval by the full board (complied by 59 percent of companies in 2001, 41 percent in 2000).
- Changes to accounting policies must be justified.
- The board be assured that the midterm and annual financial information is prepared with the same criteria, policies and practices (complied by 76 percent of companies in 2001, 55 percent in 2000).
- The committee should submit for board approval the mechanisms that are necessary to ensure good quality of the financial information presented to them.
- The committee should submit for board approval the general guidelines of the internal control system (complied by 66 percent of companies in 2001, 57 percent in 2000).
- The committee should assist the board by evaluating the effectiveness of the internal control system (complied by 65 percent of companies in 2001, 48 percent in 2000)

Monitoring the effectiveness of the governance practices under which it operates and making changes as needed.

There is no body within companies formally designated to oversee compliance of governance practices. In practice, the "secretary of the board" or "company secretary" is normally responsible for overseeing governance matters. In many companies this role has been played by the general counsel of the company.

The CMP recommends that the board should include in its annual report to the shareholders meeting the relevant aspects involved in the tasks performed by each intermediate governance body. make available to the shareholders the reports of each governance body submitted to the board together with all other material for the Meeting, with the exception of information which confidentiality may affect the competitiveness of the corporation. In addition, it is recommended to include in the annual report the names of the members of each intermediate governance body. However, only 31 percent of companies complied with these provisions in 2001.

Overseeing the process of disclosure and communications.

The CMP's recommendations aim to define guidelines that contribute to improve the performance of the board of directors as well as the disclosure of information to shareholders and market. Specifically, the recommendations have the following objectives: (i) that corporations broaden the information related to their management structure and functions of their corporate bodies; (ii) that corporations have mechanisms in place to make sure that the financial information provided to the markets is sufficient; (iii) that processes to promote the participation and communication among board members exist; and (iv) that procedures to promote an adequate disclosure of information to shareholders are present.

In order to keep communication channels open with shareholders and potential investors, it is suggested that each corporation should have in place policies, mechanisms and designate responsible parties to inform these investors. However, only 38 percent of companies complied with this provision in 2001.

Independent Judgment

According to the new LMV, the board must have a minimum of five and a maximum of 20 members, 25 percent of which must be independent from management and controlling shareholders. The table below describes the definition of "independent" laid out in the law. The definition of independence does not include "political" relatives (those married to members of the controlling family) or to the ties of *"compadrazgo*" that are important in Mexico.[117] The CMP introduced the concept of "patrimonial director", and recommended that independent directors and patrimonial directors should jointly represent at least 40 percent of the board. According to CNBV information, 81 percent of companies reported that they had at least 20 percent independent directors in 2001, up from 76 percent in 2000.

Definition of Director Independence

Article 14 Bis of the LMV (as adopted in the 2001 amendment from the CMP) defines independent members of the board as those selected for their capacity, experience and professional prestige, and do not fall in to any of the following categories at the time of their designation:

1. Being employees or officers of the corporation;
2. Not being employees or officers but being shareholders of the corporation, have authority over the corporation officers;
3. Being consultants of the corporation or partners or employees of a firm which acts as consultant for the corporation or its affiliates when their income significantly depends on such business relation; Income is considered significant when 10 percent or more of the income of the consultant or firm depends on the corporation.
4. Being clients, suppliers, debtors or creditors of the corporation, or partners or employees of a corporation which is an important client, supplier, debtor or creditor; It is considered that a client or supplier is important whenever its sales or purchases to the issuer represent 10 percent or more of total sales or purchases. It is considered that a debtor or creditor is important whenever its sales or purchases to the issuer represent 15 percent or more of total sales or purchases.
5. Being employees of a non-profit institution, university or entity that receives important contributions from the corporation (15 percent or more of the total donations received);
6. Being CEO or a high ranking officer of another corporation whose board of directors has a member that is the CEO or a high ranking officer of the corporation; and
7. Being family related of any of the persons mentioned in the subsections (i) to (vi) above. This case is applicable to the spouse and up to the third degree in cases off consanguinity and affinity for the cases described in subsections (i) and (ii); and to the spouse and up to the first degree in the cases off consanguinity and affinity, for the cases described in subsections (iii) to (vi).

The substitute for an independent board member must also fulfill the independence requirements.

The CMP also recommends that companies should identify independent directors and patrimonial directors in the annual report. According to CNBV information, 41 percent of companies reported compliance with this recommendation in 2001, up from 28 percent in 2000. The CMP also recommended that brief (updated) resumes of each member of the board be included in the annual report.

There are no specific provisions or recommendations on the separation of chairman and chief executive, or reviews of performance of the board.

Market regulators do not have the power to remove a board member, except for the financial institutions (CNBV is directly in charge of the supervision and regulation of this activity). Cases of prosecution (such as the Banca Confia-Jorge Lankenau Rocha case) are due to major violations (corruption).

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[117] *Compadrazgo* refers to the relation between the parents and godparents of a child. Godparents are symbolically adopted as members of the Mexican family. Often "*compadres*" are closer than siblings. It is difficult to discover relations of *compadrazgo* because of their informal nature.

The CMP also recommends that directors must:

- Disclose to the Chairman and secretary of the board any situation that may result in a conflict of interest and refrain from participating in such matters;
- Use the assets and/or services of the corporation only for business purposes, and clearly define the policies that would apply for the use of such assets for personal matters;
- Maintain absolute confidentiality of all information which may affect the operation of the corporation as well as of the deliberations that take place at the board meetings;
- Participate on the board of directors with opinions, recommendations and suggestions that derive from the analysis of the corporation's operations.

There are no regulations for board attendance. The CMP recommends that board members "dedicate the necessary time and attention to the performance of their duties", and participate in at least to 70 percent of the meetings each year (this provision is not applicable to the alternate directors). It is apparently common that company bylaws establish a minimum of 70 percent of attendance. There is no requirement that board members disclose their attendance at board meetings. There are no rules or recommendations that set any limits on the number of boards on which an individual may serve.

Board access to information

Board members have the right and ability to obtain relevant information on the corporation on a timely and regular basis. The board and individual members have access to professional advice at the expense of the corporation in regard to matters concerning the corporation. Even though a legal foundation does not exist, the board of directors can secure the services of a consultant, provided it appears in the annual report.

The CMP goes somewhat further and recommends that directors have access to all the relevant information for the decisions to be taken at a board meeting at least five business days prior to the meeting. This does not apply to "strategic matters that require confidentiality", but the Code recommends that a mechanism be established to enable directors to adequately assess these types of proposals.

The CMP also recommends that when directors are appointed for the first time, they should be provided with "adequate information" and training. At a minimum, the corporation should provide data related to the corporation and its business environment, as well as the obligations, responsibilities and duties that are inherent to a Director.

Boards in Practice

As a result of the recent reforms, it is clear boards in Mexico are changing to meet the targets of the CMP. Boards and board members are playing a more and active role. Audit committees are becoming more effective and much more serious, and companies are now looking for more "independent", professional directors, although "independent" is still rather relative. By one estimate, by early 2002 80 percent of companies complied with about 80 percent of the recommendations of the CMP.

However, for the remaining 20 percent, several aspects of the reform, especially the introduction of independent directors on the board, have proven to be difficult to accept. In many cases, boards reportedly remain ineffective and many times, a formality. By many accounts, audit committees still tend to be ineffective, and members to not have time to invest or background required.

Many family companies went to the capital market during the boom years of the early 1990s, but with a small equity market and low liquidity today, they see little benefit in working with minority shareholders. Service providers, affiliates, and friends of the controlling shareholders all worry about losing business and personal contacts that came with the old way of doing business. Interlocking directorates and the lack of "professional directors" tends to lead to a lack of confrontation at board meetings.

Two sets of data shed light on board practices in Mexico. A recent study undertook a brief review of the practices of the ninety largest corporations in Mexico, and helps to provide some initial data on board composition in Mexico.[118] Data gathered included the composition of the board of directors based on board membership, positions on the board, company affiliation, and role as insiders or outsiders.

This review found that[119]:

- Fewer than 25 percent of the chief executive officers (CEOs) of the 90 largest Mexican companies also serve as chairmen of the board. Usually, the founder or senior family member (generally an ex-CEO) is still tied to the company and serves as chairman of the board, while a younger family member acts as CEO. The Mexican pattern contrasts with the global pattern in which companies tend to combine the functions of CEO and chairman of the board.
- 53 percent of directors are top executives of the firm, the firm's group, or relatives of such executives. However, it is currently impossible to determine the extent to which the other members of the board belong to one of the other categories of insiders mentioned by the Code, let alone the existence of political or compadrazgo relations.
- Interlocking directorates are very common both within companies of the same business group (e.g. Carso, Alfa, Vitro) and across groups. Only sixteen of the ninety largest companies have no interlocks with other firms. These firms tend to be independent companies that do not belong to any group (e.g., Soriana or Casa Autrey). Among the 90 largest companies in Mexico, five directors sit on at least ten different boards.
- The pyramidal structure of ownership in Mexico fosters participation on several boards. For example, Dionisio Garza Medina, CEO of the Alfa Group, sits on the boards of almost all of the group's subsidiaries. He sits on the board of the Alpha Group, on the board of one of its subsidiaries, Hylsamex, and of Hylsa, a subsidiary of Hylsamex. Only three of Garza Medina's ten directorships do not come from the group he leads. Carlos Slim Helu of Telmex sits on 9 boards, all but one of which is from the group he controls.
- Possibly as a consequence of the low level of debt financing, banks do not play a significant role on boards, as evidenced by the fact that few of the directors of the 90 largest Mexican companies come from banks. In fact, only four bankers sit on two or more corporate boards.[120]

In addition, this report has compiled information obtained from the CNBV on compliance with the recommendations in the CMP. This is presented in the following table.

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[118] Husted and Serrano.
[119] Husted and Serrano.
[120] Husted and Serrano.

Section	N	It is recommended / suggested that…	Percent Compliance 2000	2001
I. Board of Directors				
I.1 Functions				
	1.	The board of directors should carry out the following functions: (i) define the strategic view of the corporation; (ii) ensure that the shareholders and the market have access to the public information of the corporation; (iii) establish internal control mechanisms; (iv) assure that the corporation has adequate mechanisms to comply with the applicable laws; and (v) assess, on a regular basis, the Chief Executive Officer (CEO) and the high ranking officers' performance.		
I.2 Integration				
	2.	The board should be made up of five to 15 members.		
	3.	It is recommended not to have alternate directors on the board; but if there were, they should only act on behalf of the specific Director they represent. In the latter case, it is recommended that each Director suggests who could act as its alternate.	29/21	50/31
	4.	Independent directors and patrimonial directors should jointly represent at least 40 percent of the board of directors. Likewise, independent directors should represent at least 20 percent of the total members of the Board.	75	81
	5.	Include in the annual report information regarding which members are independent directors and which ones are patrimonial directors, indicating for the latter the category to which they belong.	28	41
	6.	Include in the annual report a brief updated resume of each member of the board.		
I.3 Structure				
	7.	The board of directors shall perform the functions of evaluation and remuneration; auditing; finance and planning as defined below in the Code, through one or various intermediate governance bodies.		
		It is recommended that the following principles apply to the intermediate governance bodies:		
	8.	One or more may be created, whenever there is a clear purpose and its membership avoids conflicts of interest.		
	9.	Should be integrated only by directors (no alternates).		
	10.	Intermediate governance bodies should have a minimum of three members and a maximum of seven.		
	11.	Intermediate governance bodies should regularly inform the board of directors of their activities.		
	12.	The Chairman of each intermediate governance body may invite to its meetings the officers of the corporation whose duties are related to the functions of such body.		
	13.	In addition to his/her board duties, it is suggested that each independent Director participates in at least one of the intermediate bodies. d		
	14.	The intermediate body responsible of the auditing function be chaired by an independent director.	26	58
I.4 Operation				
	15.	The board of directors meets at least 4 times a year.		
	16.	The board have a process in which, at least 25 percent of the directors can call for a board meeting.		
	17.	The directors have access to all the relevant information for the decisions to be taken according to the agenda for the meeting, with at least five business days prior to the meeting. The foregoing will not be applicable to strategic matters that require confidentiality; nevertheless, in this case, a mechanism should be established in order to enable the directors to adequately assess the proposal related to such strategic matters.		

			Percent Compliance	
Section	**N**	**It is recommended / suggested that…**	**2000**	**2001**
	18.	When directors are appointed for the first time, they should be provided with adequate information of their acquired responsibilities. As a minimum, the corporation shall provide data related to the corporation and its business environment, as well as the obligations, responsibilities and duties that are inherent to a Director.		
I.5 Duties				
		It is recommended that directors follow six principles for such purpose:		
	19.	Disclose to the Chairman and secretary of the board any situation that may result in a conflict of interest and refrain from participating in such matters;		
	20.	Use the assets and/or services of the corporation only for matters related to it, and clearly define the policies that would apply for the use of such assets for personal matters;		
	21.	Dedicate the necessary time and attention to the performance of their duties, assisting at least to 70 percent of the meetings (not applicable to the alternate directors);		
	22.	Maintain absolute confidentiality of all information which may affect the operation of the corporation as well as of the deliberations that take place at the board meetings;		
	23.	Directors and their alternate directors, if any, must keep mutually informed in relation to the matters discussed in the board meetings they attend; and	69	72
	24.	Participate in the board of directors with opinions, recommendations and suggestions that derive from the analysis of the corporation's operations.		
II. Evaluation and Remuneration Function				
II.1 Generic Functions				
	25.	The evaluation / remuneration committee should observe the following functions: (i) suggest to the board procedures to nominate the CEO and high ranking officers; (ii) propose to the board the criteria to evaluate the CEO and the high ranking officers, following the general guidelines established by the board; and (iii) analyze and submit for the board of directors' approval the proposal made by the CEO regarding the remuneration structure to be paid to the main officers of the corporation.		
II.2 Operational Issues				
	26.	The board should be supported by reviewing the terms and conditions on which the CEO and the high ranking officers are being hired, as well as the possible payments in case of separation from the corporation; such terms and conditions should follow the general guidelines approved by the board.	58	56
	27.	The annual report presented by the board of directors, discloses the policies adopted and the terms and conditions of the remuneration package of the directors, the CEO and the corporation's high ranking officers..	33	37
III. Audit Function				
III.1 Generic Functions				

Section	N	It is recommended / suggested that…	Percent Compliance 2000	2001
	28.	The committee should perform the following functions: (i) recommend to the board the nominees for external auditors of the corporation; (ii) recommend to the board the terms and conditions under which such external auditors should be hired and the scope of their professional mandate; (iii) support the board by supervising the performance of the audit's contracts; (iv) act as a communication channel between the board of directors and the external auditors, as well as ensure the independence and objectivity of such auditors; (v) review the working program, management letters, and the external auditor's report, and inform to the board of directors accordingly; (vi) recommend to the board the basis by which the financial information will be prepared; (vii) assist the board by reviewing the financial information and its issuing process; (viii) contribute in the definition of the general guidelines for the internal control system and evaluate its efficiency; (ix) assist the board in the coordination and evaluation of the annual internal audit programs; (x) coordinate the activities of the external auditor, internal auditor and Statutory Auditor; and (xi) verify that mechanisms are implemented in order to ensure compliance with all applicable legal provisions.		
III.2 External Auditors' Selection				
	29.	For the financial statements external audit and any other external review, board should not hire any accountant firm whose income for fees for all the services rendered to the corporation represent more than 20 percent of its total income.		
	30.	In order to ensure objectivity in the audit report, a rotation mechanism of the partner in charge of the preparation of the audit report should be recommended to the board. It is suggested that this rotation be made at least every six years.	72	81
	31.	The person who signs the audit report of the annual financial statements of the corporation should not be the same person who acts as the Statutory Auditor. Nevertheless, both persons may be partners of the same firm.		
	32.	The committee should ensure that the professional profile of the Statutory Auditor enables him/her to adequately perform its duties. Furthermore, it is also recommended that the annual report presented by the board of directors discloses relevant information regarding the professional profile of the Statutory Auditor.		
III.3 Financial Information				
	33.	The company should have an internal audit department.	79	83
	34.	The committee should submit to the approval of the board of directors the accounting policies used in the preparation of the financial information.	41	59
	35.	When changes in accounting policies are submitted for board's approval, a proper justification should be provided.		
	36.	The board be assured that the midterm financial information is prepared with the same criteria, policies and practices as the annual financial information is. In the process, the board may obtain support from the internal auditor, the external auditor and the Statutory Auditor of the corporation.	55	76
	37.	The committee should submit for board approval the mechanisms that are necessary to ensure good quality of the financial information presented to them. In the process, the internal auditor, the external auditor and the Statutory Auditor of the corporation may participate.		
III.4 Internal Controls				
	38.	The committee should submit for board approval the general guidelines of the internal control system.	57	66
	39.	The committee should assist the board by evaluating the effectiveness of the internal control system and by giving an opinion on the financial and operational controls.	48	65
	40.	The external auditors should validate the effectiveness of the internal control system and present a report on such controls.		

			Percent Compliance	
Section	**N**	**It is recommended / suggested that…**	**2000**	**2001**
III.5 Review of Regulation Compliance				
	41.	The committee should ensure the existence of mechanisms that allow the board to determine if the corporation duly complies with all applicable laws and regulations. In order to achieve the latter, hold a review on the matter at least once a year.	54	66
	42.	The committee should inform the board of directors about the corporation's legal status on a regular basis.		
IV. Finance and Planning Functions				
IV.1 Generic Functions				
	43.	The Finance and Planning Committee should perform the following functions: (i) evaluate and suggest, if appropriate, the investment policies proposed by the CEO and then submit them to the board for approval; (ii) evaluate and suggest, if appropriate, the financing policies (equity or debt) proposed by the CEO and then submit them to the board for approval; (iii) evaluate and suggest, if appropriate, the general guidelines for the strategic plan of the corporation; (iv) give an opinion on the annual budgets premises and then submit them to the board for approval; (v) follow up the budget's disbursement and the development of the strategic plan; and (vi) identify the risk factors to which the corporation is subject and assess the policies for its management.		
IV.2 Operational Issues				
	44.	The committee should submit to the board of directors an evaluation of the feasibility of the main investments and financing transactions of the corporation, same which should be in line with the existing policies.	63	63
	45.	The committee should periodically evaluate the strategic position of the corporation in terms of the strategic plan.	64	63
	46.	The committee should assist the board in reviewing the consistency of the investment and financing policies with the strategic plan of the corporation.	63	62
	47.	The committee should assist the board in reviewing the financial projections of the corporation while assuring their consistency with the strategic plan.	63	63
V. Disclosure of Information to the Shareholders				
V.1 Information and Agenda of Shareholders Meetings				
	48.	It is suggested not to include in the agenda an item referred to as "General Matters" as well as to avoid the grouping of matters related to different topics within a single item. The latter has the purpose to allow stockholders to vote each item separately, in addition to provide them with information on all topics to be discussed at the meeting.		
	49.	The company should make available 15 days prior to the day of the meeting, all information on each item of the shareholders meeting agenda.		
	50.	The company should provide the shareholders with a proxy containing detailed information and possible voting alternatives on the items of the agenda, in order to facilitate the instructions to representatives on how to vote on each item of the agenda on the day of the Meeting.	31	50
	51.	The company should include the proposals of members to be appointed for the board of directors and a brief professional profile of each candidate, as part of the information delivered to the shareholders.	49	50
V.2 Information and Communication between the Board of Directors and the Shareholders				

Section	N	It is recommended / suggested that…	Percent Compliance 2000	2001
	52.	The board of directors should include in its annual report to the shareholders meeting the relevant aspects involved in the tasks performed by each intermediate governance body. make available to the shareholders the reports of each governance body submitted to the board together with all other material for the Meeting, with the exception of information which confidentiality may affect the competitiveness of the corporation. In addition, it is recommended to include in the annual report the names of the members of each intermediate governance body.	22	31
	53.	In order to keep communication channels open with shareholders and potential investors, each corporation should have in place policies, mechanisms and designate responsible parties to inform these investors.	32	38