

PUBLIC CONSULTATION

BM&FBOVESPA SPECIAL LISTING SEGMENTS

INTRODUCTION TO THE PRI

The United Nations-supported Principles for Responsible Investment (PRI) is the world's leading initiative on responsible investment. PRI has 1500 signatories globally with USD\$60 trillion in assets under management. Brazil hosts the first local network to be established by the PRI. Since establishment in 2008, it has since grown to 54 asset owner, investment manager and service provider signatories¹.

Responsible investment is an approach to investment that explicitly acknowledges the relevance to the investor of environmental, social and corporate governance factors, and the long-term health and stability of the market as a whole. It is driven by a growing recognition in the financial community that evaluation of ESG issues is a fundamental art of assessing portfolio value and investment performance.

OVERARCHING RESPONSE

We welcome the opportunity to respond to the public consultation on revision of the special corporate governance listing segments of BM&FBovespa. Since their introduction in 2000, the special corporate governance listing standards demonstrated that good governance can lower the cost of capital and attract investment for Brazilian companies². With this revision of the code, BM&FBovespa has an opportunity to ensure these standards meet international best practices and continue to provide high standards of protection for shareholders.

PRI has two overarching recommendations;

- A growing body of evidence demonstrates that environmental, social and governance factors drive better financial results for investors³. Issues such as climate change present risks to business continuity and reputation. PRI encourages BM&FBovespa to **clearly communicate that good governance requires companies to be aware of, and manage environmental and social risks and opportunities**, including risks within the supply chain. This is consistent with the development of other international codes such as Japan's corporate governance code and the King Code in South Africa.
- Furthermore, PRI believes that Investors' fiduciary duties require them to integrate environmental, social and governance factors into investment decision making⁴. To do so, they require full disclosure of ESG issues by the companies in which they invest. We therefore encourage BM&FBovespa to **ensure that the special listing segments drive better ESG disclosure**, linking to other market initiatives on this issue. This will enable

1 Correct as of 1 May 2016: <https://www.unpri.org/signatory-directory>

2 <http://www.irmagazine.com/articles/stock-exchanges-listings/15923/brazilian-companies-blossom-novo-mercado/>

3 Gunnar Friede, Timo Busch & Alexander Bassen (2015) ESG and financial performance: aggregated evidence from more than 2000 empirical studies

4 PRI and UNEP Finance Initiative (2015): Fiduciary Duty in the 21st Century.

https://www.unpri.org/download_report/6091

investors to evaluate how a company is positioned to create value over the medium and long-term, and will support pension funds to comply with the environmental and social requirements of Resolution 3.792 issued by Conselho Monetario Nacional in 2009.

PRI has worked with Investors on a series of collaborations around director nominations⁵, anti-corruption, tax responsibility⁶ and incorporation of environmental, social and governance issues into executive remuneration⁷. We also share the findings of these projects in this response.

The PRI has experience in ESG regulation, guidance and implementation in a number of investment markets, and offers its expertise to support revision of the special corporate governance listing segments.

CONTACT

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5 Discussion papers available at: https://www.unpri.org/download_report/4107 and https://www.unpri.org/download_report/4004

6 Engagement guidance on corporate tax responsibility: Why and how to engage with your investee companies https://www.unpri.org/download_report/8531

7 PRI (2016) Integrating ESG issues into executive pay: A review of global utility and extractive companies (https://www.unpri.org/download_report/8534)

QUESTIONS

I. IDENTIFICATION

1. Choose the alternative that best identifies your respondent profile to this Public Consultation:

Company/Market association – Principles for Responsible Investment.

II. GENERAL QUESTIONS

2. Classify your opinion regarding the following sentence: “The Novo Mercado urgently needs update to alignment with best practices of Corporate Governance internationally”.

- **Agree**
- **Neither agree nor disagree**
- **Disagree**

Comment

Since their establishment in 2000, the special corporate governance listing segments of the BM&FBovespa have demonstrated that higher standards of corporate governance can improve the cost of capital and attract investment for companies listing in Brazil. However, international corporate governance codes continue to be updated as concepts and best practices evolve – recent examples include the introduction of Japan’s Corporate Governance Code and the 2016 revision of South Africa’s King Code. Furthermore, associations such as Amec (The Association of Capital Markets Investors) have raised concerns that the special listing segment standards are no longer providing adequate levels of shareholder protection⁸.

Investor awareness and appetite also continues to grow. Corporate governance is included in the text of the Principles for Responsible Investment, which as of May 2016 have 1,500 signatories representing over USD \$60tn in AUM.

For this reason, we consider it good practice for the special corporate governance segments to be revised, to ensure shareholder rights are protected, to benchmark against international corporate governance standards, and to reflect on any changes to local codes such as the Brazilian corporate governance institute (IBGC) code of best corporate governance practices and the CVM Handbook of Good Practices on Corporate Governance.

Questions 3, 4: No response.

III. MINIMUM FREE FLOAT

Questions 5, 6, 7: No response.

⁸ http://www.amecbrasil.org.br/en/wp-content/uploads/2015/08/CARTA_PRESI_AMEC_06_Atualizacao_do_Novo-Mercado_ingles.pdf

IV. BOARD OF DIRECTORS

8. Which measures do you consider more effective to improve the board of directors' composition of listed companies? It is possible to choose more than one option.

- Adopt and publish clear policy, with objective criteria and expected members' profile, to the nomination of directors and management
- Adopt a Nomination Committee
- Other, specify
- I have no opinion on this subject

Comment

In 2014, PRI convened investors to work on this issue and commissioned research around international best practice on nominations processes.⁹ PRI's research finds that a robust nominations process is of fundamental importance to board effectiveness and hence the company's long-term value creation prospects. We identify three key principles to underpin good Director Nominations processes:

- 1) **Accountability** (covering issues such as: independence of decision making, voting rights related to director nominations and elections, shareholder communications and engagement and duty of care to respect shareholder rights).
- 2) **Effectiveness** (issues such as composition, diversity, succession planning, board evaluations, nomination committee scope and structure, link to company strategy and ethics, tone and sustainability awareness).
- 3) **Transparency** (public disclosures, director information and reporting in outputs).

In response to question 8, we note that both options (***adopt and publish a clear policy*** and ***adopt a nomination committee***) are good practice and can help ensure that the three key principles above are met. We would welcome further dialogue around the findings of our in-depth work on this issue.

9. Related with the independent members' importance in the Board of Directors, choose the option that best reflects your opinion:

- I do not believe that independent members presence is an essential element to a good operation of Board of Directors.
- Yes, it is important the independent members' presence in the Board of Directors and I consider the required percentage in Novo Mercado and Nivel 2, of 20%, suitable.
- Yes, it is important the presence of independent members in the Board of Directors and the required percentage should be greater than 20%. Indicate the percentage in

⁹ PRI (2014): Director Nominations discussion papers (1&2) and Research on company disclosure and practices in the US and France.

the comment field.

- **I have no opinion on this subject**

Comment

PRI agrees that the Board of Directors should include independent members. The presence of independent members is recognized by the International Corporate Governance Network's Global Governance Principles¹⁰ - which propose that the Board should consist of a majority of non-executive directors, of whom a majority are independent - and the Brazilian corporate governance institute (IBGC) code of best corporate governance practices¹¹. Furthermore, PRI's recent discussion paper on Director Nominations¹² noted that the presence of independent members can be important for the proper functioning of specific sub-committees of the Board, such as nominations committees.

Question 10: No response.

11. Regarding the current definition of independent directors in special corporate governance listing segments, choose the alternative that best reflects your opinion:

"Independent Director" means a member of the board of directors that: (i) has no ties to the Company, other than an equity interest; (ii) is not a Controlling Shareholder, spouse or close family member (to the second degree) of a Controlling Shareholder, and neither has, nor has had in the three (3) previous years, any ties to any company or entity related to a Controlling Shareholder (excluding persons with ties to public education or government research entities); (iii) in the three (3) previous years has not been an employee or officer of the Company, or of the Controlling Shareholder or of a subsidiary of the Company; (iv) is not a direct or indirect provider, supplier or buyer of goods and/or services, to an extent that would imply loss of independence; (v) is not an employee or senior manager of any company or entity that is offering or requesting services and/or products to and from the Company to an extent that would imply loss of independence; (vi) is not a spouse or close family member (to the second degree) of any senior manager of the Company; and (vii) is not entitled to any payment by the Company other than the consideration earned as director (excluding cash distributions received in the capacity of an equity holder).

- **I agree with the current definition, because it is comprehensive and objective.**
- **I do not agree with current definition, because it does not cover given situations that the independence could be questioned. (Propose definition improvements in the comment field)**
- **I do not agree with the current definition, which uses a restrictive list of situations that the director would cease to be independent. I endorse an illustrative list of independence criteria.**
- **I have no opinion on this subject**

Comment

The above options do not allow us to reflect our opinion, hence selecting 'no opinion'. On issues

¹⁰ Available at <https://www.icgn.org/>

¹¹ Available at <http://www.ibgc.org.br/>

¹² Available at: https://www.unpri.org/download_report/4107 and https://www.unpri.org/download_report/4004

such as independence, the definition is highly specific. However, on issues such as material relationships, the terminology is not as precisely defined, which allows more room for interpretation on some elements and less on others. We do not have a formal view on whether a rules-based or principles-based approach should be followed. However, if the intent is to provide a comprehensive list of rules, we note two additional situations where independence could be called into question – Directors’ length of tenure and relationship to the auditors.

12. Currently, the own director is responsible for declaring his/her independence, registering it in the minute of shareholders’ meeting that elected him/her. Do you agree with this responsibility attribution?

- I agree with the responsibility attribution to the Board of Directors’ member on declaring his/her independence.
- I do not agree. The Board of Directors should do the independence assessment.
- I do not agree. I believe there is another mechanism more efficient to conduct the independence assessment. Make your suggestions in the comment field
- I have no opinion on this subject

Comment

We do not see these options as mutually exclusive – a Director may declare themselves to be independent as well as be subject to assessment by the Board of Directors, and external evaluators can also be used. Ensuring independence should be considered on appointment of a new Director, and in the event that circumstances change after the Director has been hired, in such a way as to undermine their independence. We would also encourage sharing of contextual information - for example, if issues have been raised which could be perceived to undermine independence, but are determined not to be material, this should be disclosed.

13. It is important to establish a formal assessment process of the Board of Directors?

- Yes
- No
- No opinion

Comment

An evaluation process can identify areas of weakness requiring attention, including those regarding director performance, board composition and director nominations. The absence of a board evaluation process could be a significant cause of concern for investors¹³.

¹³ See discussion papers available at: https://www.unpri.org/download_report/4107 and https://www.unpri.org/download_report/4004

14. Under your judgment, must the formal assessment process of the Board of Directors be mandatory under the special corporate governance listing segments of BM&FBOVESPA?

- Yes
- No
- No opinion

Comment

The special corporate governance listing segments are designed to encourage capital to flow to companies adhering to the highest standards of corporate governance. For this reason, and following on from our response to question 13, we agree that a formal assessment process should form part of the requirements.

15. In case you have agreed with the importance of a “formal assessment process of the Board of Directors”, would you like to suggest any specific assessment model?

Comment

In our analysis of Director Nominations, we find that effective boards undertake regular self-assessments to identify and monitor the strengths and weaknesses of Directors, guide remedial action plans, as well as identify weaknesses in board composition and director nominations. This process is ideally conducted annually. It is often difficult for Shareholders to understand how rigorous an internally conducted evaluation process is, and an external review is therefore sometimes warranted, in tandem with regular internal analysis.

16. Do you consider it is important to establish regular training sessions for the Board of Directors members?

- Yes
- No
- No opinion

Comment

We agree that Boards should undertake regular assessment of member skills and needs (see our responses to questions 13, 14 and 15). Logically, it follows that this should be supported by a training plan designed to address weaknesses, including on key environmental, social and governance issues for the company. This proactive training may also be supported by reactive training triggered by events such as entering new markets, mergers and acquisitions or substantive changes in strategy.

17. Under your judgment, must the conducting regular training sessions for the Board of Directors members be mandatory under the special corporate governance listing segments of BM&FBOVESPA?

- Yes
- No

- No opinion

Comment

Please see our response to question 16.

18. In case you have agreed with the importance of the “regular training sessions for the Board of Directors”, would you like to suggest any periodicity for those sessions to take place?

- Semiannual
- Annual
- Biennial
- Other

Comment

Training should be conducted as frequently as required, based on the board’s assessment of member skills and needs, including skills to manage the environmental and social risks and opportunities facing the company.

19. In case you have agreed with the importance of the “regular training sessions for the Board of Directors members”, would you like to suggest a training model or minimum content of the training program?

We have shared some suggestions in our response to question 16.

20. Under your judgment, which Board of Directors’ advisory committees the companies with the best corporate governance practices should have? It is possible to choose more than one option.

- Audit Committee
- Nomination Committee
- Remuneration Committee
- Strategy Committee
- Compensation Committee
- Corporate Governance Committee
- Related-Party Transactions Committee
- Others: _____

Comment

In our experience, many international companies with strong corporate governance practices hold the top three (Audit committee, Nominations Committee and Remuneration Committee). Others may be required based on the business model. In all cases, the mandate of the committee should

be clear, and the committee should be subject to appropriate accountability.

21. Under your judgment, which option does reflect the best corporate governance practice?

- A permanent Supervisory Board
- An Audit Committee
- A Supervisory Board adaptation in order to perform functions typically attributed to the Audit Committee
- A permanent Supervisory Board prevision and an Audit Committee
- I have no opinion on this subject.

Comment

The audit function is of very high importance, and should have a clear mandate, clear oversight and clear accountability. However, we do not have a view on which of the above structures is preferable, as any or all of the above could be implemented with clear mandates, oversight and accountability.

Questions 22, 23: No response.

24. In case you have answered “Yes” to the previous question, please order the following items from 1st to 7th, being the 1st the most important according to the best practices for Internal Controls, under your judgment.

- Compliance and Risk Area
- Internal Audit
- Statutory Audit Committee
- Complaints and Denunciation Channel
- Risk Management Policy disclosure
- Code of Conduct and Integrity improvements
- Other:

Comment

All of the above can represent good practice for internal controls.

25. Regarding the “Code of Conduct and Integrity improvement” of the previous question, select which of the items listed below should be included in the minimum mandatory content. You may choose more than one option.

- Principles, values and mission of the company
- Objective rules

- **Whistleblower channel**
- **Protection mechanisms against retaliation over the denouncer acting in good faith**
- **Denunciation secrecy**
- **Sanctions applicable in case of violation of the Code**
- **Instances with the responsibility of updating the Code**
- **Others:**

Comment

If an employee code is established, we agree that it is important that this is supported by clear policies, and the above items may all contribute to improving conduct and integrity. However, this can be structured in different ways. For example, in our experience of working on anti-corruption issues¹⁴, we are aware that some firms will hold a separate anti-corruption policy covering both whistleblowing and non-retaliation.

26. Regarding the “whistleblower channel” mentioned before, which characteristics would be essential to this channel?

- **The channel should be external and independent**
- **The channel should answer to a company independent organ**
- **Others – indicate which ones in the comment field**
- **I have no opinion on this subject**

Comment

The process should be independent and reliable, with proper accountability for addressing issues, feedback loops and good quality reporting. It should be supported by a non-retaliation policy. However, we do not advocate any particular model as long as these principles are met.

A PRI coordinated engagement, which ran from 2010 to 2013 and engaged 21 companies in 14 countries on anticorruption, encouraged reporting in line with international frameworks such as the International Corporate Governance Network’s Statement and Guidance on Anti-Corruption Practices and the UN Global Compact’s Reporting Guidance on the 10th Principle Against Corruption.

27. Do you consider important that code of conduct establishes criteria, including social and environmental, to select and hire suppliers?

- **Yes**

¹⁴ Between 2010 and 2013, 21 Signatories ran a co-ordinated engagement on anticorruption, resulting in better processes and disclosure from investee companies.

- No
- No Opinion

Comment

Companies should evaluate the material environmental and social impacts of their supply chain, as these can present material risks to business continuity and company reputation¹⁵. These issues are increasingly the subject of public scrutiny and regulation¹⁶.

Companies should identify and respond to these risks by establishing clear expectations for suppliers, and conducting appropriate due diligence. We are aware that some companies operate a separate ESG policy, which is acceptable as long as the robustness of the policy is not compromised.

Question 28: No response.

VI. TRANSPARENCY

29. Under your judgment, must the publishing of a Sustainability Policy be mandatory under the special corporate governance listing segments of BM&FBOVESPA?

- Yes
- No
- No Opinion

Comment

Good corporate governance ensures that companies have the right skills and structures in place to manage business operations, risk and opportunity. We strongly advocate that special corporate governance listing standards ensure that Boards consider managing material environmental and social issues as a core element of good governance. These factors are increasingly recognized as being a core part of a company's value creation prospects¹⁷, and are reflected in codes such as the King Code in South Africa (currently undergoing revision) and Japan's Corporate Governance Code. As noted in our response to question 27, material supply chain impacts should also be considered.

30. Under your judgment, should it be mandatory to disclosure the ESG (Environmental, Social and Governance) information on internationally recognized standards under the Special Corporate Governance Listing segments of BM&FBOVESPA?

¹⁵ PRI (2014): Water risks in agricultural supply chains investor briefing
https://www.unpri.org/download_report/4031

¹⁶ For example, the UK recently introduced due diligence and disclosure requirements for labour standards in the supply chain under the Modern Slavery Act, and the EU is currently negotiating a Directive on due diligence standards for importers of conflict minerals.

¹⁷ Gunnar Friede, Timo Busch & Alexander Bassen (2015) ESG and financial performance: aggregated evidence from more than 2000 empirical studies

- **Yes**
- **No**
- **No Opinion**

Comment

PRI's view is that an investor's fiduciary duties require them to integrate environmental, social and governance factors into investment decision making¹⁸. To do so, they require full disclosure of ESG issues by the companies in which they invest. We therefore encourage the disclosure of environmental, social and governance issues. This is also consistent with Brazil's participation in the Group of Friends of Paragraph 47 ESG reporting initiative¹⁹, set up following the United Nations Conference on Sustainable Development (Rio+20).

Investors seek disclosures which clearly link a company's business strategy and operations to environmental and social factors enable investors to fully understand how a company is positioned to create value over the medium and long-term²⁰.

Adoption of internationally recognized standards will increase the likelihood that international investors will have access to comparable information across their portfolio.

On governance specifically, the special listing segments will hold companies to a defined corporate governance standard, but we would encourage companies to disclose instances where they exceed the listing segment requirements, or undertake additional activities to enhance their governance.

31. In case you have selected "Yes" at the previous question, what disclosure instrument would better comply with this objective?

- **Global Reporting Initiative (GRI)**
- **Integrated Reporting (IIRC)**
- **Combination of both**
- **I have no opinion on this subject.**
- **Others.**

Comment

Both options have advantages and disadvantages. Integrated reporting encourages ESG issues to be embedded within a company's value creation processes, and reduces the likelihood that they will regard reporting as a compliance exercise. However, it reduces the likelihood that an investor will find consistent, comparable KPIs reported across their portfolio, which can impair investment decision making. PRI is currently conducting analysis of different approaches, with the

¹⁸ PRI and UNEP Finance Initiative (2015): Fiduciary Duty in the 21st Century https://www.unpri.org/download_report/6091

¹⁹ <http://www.unep.org/resourceefficiency/Business/SustainableandResponsibleBusiness/CorporateSustainabilityReporting/GroupofFriendsofParagraph47/tabid/105011/Default.aspx>

²⁰ UNGC and Accenture (2015) – The Investor Study https://www.accenture.com/t20150523T042350_w_us-en/_acnmedia/Accenture/Conversion-Assets/DocCom/Documents/Global/PDF/Industries_15/Accenture-Investor-Study-Insights-PRI-Signatories.pdf

intent of providing more clarity on the investment community's needs.

Irrespective of the framework chosen, to ensure information can be used in investment decision making, PRI encourages BM&FBovespa to ensure that material ESG factors are embedded within financial reports and communicated at the same time as financial results.

Steps taken by international reporting initiatives, such as the recent publication by the Corporate Reporting Dialogue on common principles of materiality²¹, are welcome, but we encourage further efforts to agree common performance metrics.

We encourage BM&FBovespa consider the Sustainable Stock Exchange initiative's model guidance for exchanges as well as Sustainability Accounting Standards Board (SASB) as additional inputs to this discussion.

32. Do you consider that an independent entity must audit or revise such information?

- **Yes**
- **No**
- **I have no opinion on this subject**

Comment

For ESG information to be usable by investors, steps should be taken to ensure accuracy and veracity. We encourage BM&FBovespa to require independent assurance of ESG information, consistent with audits performed on financial results.

VII. SIMPLIFICATION OF REQUIREMENTS

Question 33: No response.

VIII. DELISTING

Question 34: No response.

IX. ARBITRATION

Questions 35, 36: No response.

²¹ Corporate Reporting Dialogue (2016): [Statement of Common Principles of Materiality](#)

X. GENERAL ISSUES

37. Would you like to suggest items for discussion that were not addressed in this questionnaire?

Comment

We noted the following issues are not covered in this consultation;

- Executive remuneration. PRI has recently conducted analysis on linking ESG factors to executive remuneration, which recommends that companies should seek to align goals established in sustainability policies with remuneration packages, and provides guidance on how this can be implemented²².
- Tax responsibility. In 2016, PRI conducted analysis of tax practices and their implications for investors²³.
- Proxy voting issues.
- Issues relating to external auditors.

Question 38: No response.

²² PRI (2016): Integrating ESG issues into executive pay: A review of global utility and extractive companies. https://www.unpri.org/download_report/8534

²³ Engagement guidance on corporate tax responsibility - why and how to engage with your investee companies. https://www.unpri.org/download_report/8531