

Henrique Meirelles: Good governance in the Brazilian financial system

Speech by Mr Henrique Meirelles, Governor of the Central Bank of Brazil, at a seminar organized by the International Institute of Studies of State Law (IIEDE – Instituto Internacional de Estudos de Direito do Estado), Sao Paulo, 5 September 2008.

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1. It is my pleasure to take part of this event dealing with an important and often overlooked topic: corporate governance in the Brazilian financial system. This is an especially dear issue for the Central Bank and particularly for me.
2. To start, I would like to mention that monetary stability is a precondition for good corporate governance. In the inflationary environment Brazil experienced for decades, the requisites for good governance vanished under the prevailing unpredictability and monetary confusion. There is no room for a transparent, disciplined and fair relationship among parties involved in a firm when predictability and stability are absent. In this sense, the main contribution of the Central Bank to corporate governance is to reaffirm its permanent commitment to inflation targeting in the conduction of monetary policy.
3. The Brazilian Institute of Corporate Governance defines governance as “the system by which corporations are managed and monitored, involving relationships between shareholders, board, management, independent auditors and statutory audit committee”. Good practices of corporate governance focus on increasing the company’s value, facilitating its access to capital and contributing towards its stability and soundness. Indeed, this general definition is very similar to the one offered by OECD, to whom corporate governance is summarized as “a set of relationships between the administration of a legal entity, its board of directors, its stockholders and other stakeholders”.
4. A question arising from these definitions is that of how to establish the ethical standards needed in the construction of governance to secure that relationship between the different corporate agents develop in a fair and efficient fashion. Contrasting with more mature economies, which have more thinly distributed stockholding and relatively more liquid exchanges and in which there is more pressure on management to minimize the asymmetry of information, ownership and control in Brazil are not comparably segregated, in spite of the significant increase in initial public offerings over recent years.
5. Therefore, our ownership structure is still characterized by high concentration of stocks with the right to vote, typical of family companies or companies controlled by a restricted group of investors, by superimposition of ownership and management and by scarcely active minority stockholders. Besides, our boards frequently exhibit a diffuse segregation between their own responsibilities and that of the administration, in addition to informal structures, low number of professionally trained board members or members with a small degree of independence.
6. As a result, the main challenge to be faced in Brazil in governance issues involves the relation between controlling stockholders and minority stockholders or creditors. How to face this challenge?
7. As far as the Brazilian financial system is concerned, the Central Bank follows some well established principles of corporate governance, including:
 - Transparency, facilitating the analysis of the activities of the company, its economic and accounting reports and non-financial aspects inherent to its businesses, offering to those interested a comprehensive vision of the

corporation's performance. The administration shall go beyond the obligation to inform, and reach the desire to inform, in addition to fostering good internal and external communication, which shall not be restricted to financial aspects, but shall be wide and comprehensive.

- Discipline, that is to say, commitment by the management in adhering to behavioral standards widely recognized as correct and appropriate.
- Independence, in what it relates to arrangements to safeguard or minimize possible conflicts of interest, such as the control by an executive or a majority stockholder. Such arrangements include, for instance, a balanced composition of the executive board and administration and the use of external audit.
- Accountability, according to which agents of corporate governance shall be accountable for their actions before those who elected them and shall fully answer for acts practiced in the performance of their duties.
- Responsibility, by which executives shall care for the continuity of the organization and, therefore, shall incorporate considerations of social and environmental content in defining their businesses and operations, including a system for corrective actions and punishment, as needs be.
- Equality, which is translated into a fair and equalitarian treatment to all minority groups, either of capital or of other stakeholders, where discriminating policies or attitudes shall be deemed unacceptable.

8. Based on the foregoing principles, the Central Bank, in its supervising role, follows the best international practices, materialized in the standards defined by the Basle Committee of the Bank for International Settlements, according to which corporate governance represents a critical issue in the banking environment. Management shall monitor the establishment of corporate objectives, performance of the day-by-day operations, defense of stakeholder interests, conformity to applicable laws and regulations, and care for the interests of depositors.
9. Therefore, the directive applied by the Central Bank reaches beyond the mere relationship of the institution with external stakeholders or the concern with the truthfulness of its financial statements, since it considers all aspects related to the institution's management and to its internal control systems.
10. In fact, the key to secure efficacy in governing financial institutions necessarily implies an effort to build an effective system of internal controls, able to support stability and continuity of individual activities and, consequently, the systemic stability of the financial system itself.
11. Ladies and gentlemen, I referred above to the fact that Brazil faces more challenges to consolidate good governance in corporate practices compared to more mature economies. As a final message, I would like to underline that monetary and institutional stability and the effort, not only of the Central Bank, but also of other regulatory agencies, including the *Comissão de Valores Mobiliários* (the Brazilian Securities and Exchange Commission), the Superintendence of Private Insurance (Susep) and the Complementary Pension Secretariat, and initiatives from market institutions, such as the *Novo Mercado* implemented by the São Paulo Stock Exchange, in addition to our growing corporate maturity in an increasingly globalized world, enabled us to make significant advances in recent years towards best governance practices, gradually converging to the standards of more advanced economies. There is no doubt that we shall continue to make more and permanent advances, and this is our goal.