

Brazil Policy - Board Independence (Nivel 1 and Traditional listing segments)

Background and Overview

In 2002, the Sao Paulo Stock Exchange (BM&FBovespa) created differentiated listing segments with higher corporate governance standards, aiming at improving the Brazilian capital market. The voluntary listing segments are named Nivel 1, Nivel 2, and Novo Mercado. Companies not listed under any differentiated listing segment are traded under the "Traditional" group. According to BM&FBovespa's rules, companies in the Novo Mercado and Nivel 2 segments, the highest ones, are required to maintain a minimum of 20-percent board independence. Nivel 1 and Traditional groups have no independence requirement.

ISS' current policy framework establishes a minimum independence level of 30 percent for companies listed as Novo Mercado and Nivel 2, above the BM&FBovespa threshold but consistent with current market practice (ISS data for 2016 proxy season shows an average board-independence level of 36 percent for companies listed under these segments). ISS' policy for Brazil currently does not specify a board-independence minimum threshold for companies in the Nivel 1 and Traditional groups.

Key Changes Under Consideration

In the updated policy, ISS will require a minimum level of board independence at all Brazilian companies, maintaining higher standards for those listed under the highest corporate governance segments, Nivel 2 and Novo Mercado. The revised policy will include the following guideline:

"Vote against the bundled election of directors if the post-election board at Nivel 1 and Traditional companies does not have at least one independent member."

Recognizing that companies listed under Nivel 1 have chosen to adhere to a differentiated corporate governance segment while companies in the Traditional group have not, and that the latter group would see the largest impact in vote recommendations (*see numbers below*), ISS proposes that the change in policy be implemented for Nivel 1 companies in 2017, and for Traditional companies in 2018.

Nonetheless, companies in the Traditional group will see a warning-language paragraph included in their 2017 proxy season reports, highlighting that, starting in 2018, ISS' policy will require at least one independent board member.

Intent and Impact

By establishing a minimum board-independence threshold for all Brazilian companies, ISS aims at bringing its Brazilian policy in line with market practice. ISS voting analytics indicate that 76 percent of the Nivel 1 companies covered by ISS have independent members serving on their board of directors. Regarding the companies traded in the Traditional segment, 45.2 percent already have some level of board independence.

The revised policy also reflects the expectation of international institutional shareholders. In its 2016 policy survey, ISS asked market actors if it is a reasonable expectation that companies listed as Nivel 1 and Traditional should have a minimum level of board independence, even though current regulations do not include board independence among these groups' requirements. Out of 74 participants that answered the question, 70 agreed that companies in the Nivel 1 and Traditional segments should also face a minimum board-independence requirement.

ISS data from the 2016 proxy season show that only six (24 percent) out of 25 Nivel 1 companies did not have any board independence, while 17 (55 percent) out of 31 companies classified as Traditional had no independent directors. By adopting a two-step implementation process, with the new requirement valid for Nivel 1 in 2017 and for Traditional companies in 2018, ISS intends to minimize such impact, giving companies that face fewer regulatory corporate governance requirements more time to adjust their practices to the revised policy.

Request for Comment

- Should ISS include a minimum-independence level threshold in its policy guidelines even for companies listed under listing segments that do not have a minimum requirement?
- Will the implementation of the minimum-independence level threshold for the Traditional listing segment in 2018 provide companies with a reasonable timeframe to adapt to ISS' policy adjustments?