Thank you for this opportunity to discuss the issue of Related Party Transactions in the context of State Owned companies.

By means of introduction, let me tell you who I am, and what I am doing here. I have the honour of presiding Amec – the Brazilian Association of Capital Market Investors. Our association is now 7 years old, and is comprised of 62 institutional investors with assets under management in Brazilian equities of approximately BRL 500 billion. Our goal is to defend the rights of minority shareholders, as a necessary step to build a healthy capital market.

I`ve had the pleasure of participating in most meetings of the Latin American Corporate Governance Roundtable, both in my current capacity and representing the IBGC – Brazilian Institute of Corporate Governance – which I also led for a while.

In our last meeting in Quito we discussed the issue of RPTs extensively. As the discussions progressed, it became clear that the issue of RPTs within SOEs was particularly important, and deserved special attention. A suggestion was made – and I am partially to blame – that this discussion be brought to the SOE Network, and that what brings me here.

I wanted to jump right into the discussion of RPTs, but the very interesting discussions we had yesterday induced me to making a break here, and comment on some of the aspects we have touched, that are specific to SOEs.

It is clear that SOEs are a very relevant aspect of the economies of our region, and in many cases also of the capital markets. Therefore, ensuring that SOEs perform is a necessary condition for the development of these capital markets. In addition, let`s not forget that an increasing part of the assets that will pay our pensions is invested in the market, and thus in part in SOEs. If they do not perform, our pensions are at risk. And while I`ll focus my remarks on companies that tap public markets for equities or debt, the same can be said of fully owned SOEs. If they do not perform and if they are not sustainable, they`ll represent a threat to public finances.

This rationale becomes even more important as SOEs can be used as vehicles to reduce – rather than increase – transparency of public accounts. Let me illustrate with a quick example from the Brazilian reality: the Brazilian treasury has lent more than BRL 300 billion to the BNDES over the past few years. The BNDES has taken this money and invested in long-term projects that are a part of the strategic PAC program, many times at below market rates. Without such financial support, one can argue that at least some of these public policy projects would not happen. But that is not all: the loans do not affect the data on government expenditures. But as interest accrues to the BNDES, it posts nominal profits, that are used to pay dividends to the government… which represent current revenue and thus improve the deficit figures. This is to show that RPTs are relevant in all contexts, even though I will focus on companies with private investors.

Now, as we approach the end of our meeting, there are some aspects of the SOE discussion that called my attention, and that I wanted to share with you.

First is my impression that the corporate governance discussion of SOE seems to be excessively focused on control. We saw this in most presentations, in most discussions, in the working papers that were distributed, and I see this in my experience as a board member of SOEs. My friends, let me tell you: CORPORATE GOVERNANCE IS NOT CONTROL. Control is clearly a part of corporate governance, but it can never its sole component. If we consider definitions of corporate governance such as those of the IBGC we will see that corporate governance is, and I quote, "the system through which organizations are led, monitored and incentivised, involving relations between owners, board, management and control structures". It is a system of checks and balances. It thus needs balance. Stick, but also carrot. If we build corporate governance just to CONTROL, we risk corrupting the term, and defeating the whole purpose.

This was the reason behind my question yesterday to the representative of DEST… if the OWNER`s "corporate governance" policies encompasses everything that must be done by other parts of the system what we have is not corporate governance. It is command and control.

Which brings me to my second point. We spent a lot of time discussing the construction of corporate governance structure. This stems from the premise that having these structures is a clear positive for the corporate governance of SOEs. I would argue that it is not. It is worse to have the veil of good governance and the absence of its content, than to have nothing at all. I repeat my question to Mr. Machado…under these conditions, what does the board do. And I offer an answer: NOTHING. The only reason why boards exist and became a centrepiece of all modern corporate governance structures is the assumption that a group of people will be better equipped for the job of monitoring a company than a single individual would. If directors arrive to the meeting having a specific script to follow, that was decided in the offices of the government, the whole exercise is pointless. The decisions were already made ! Directors can calmly say that they cannot be held accountable because they are only following the wishes of the controlling shareholder.

One can easily say that this is absolutely inconsistent with proper checks and balances, and with the law itself in most jurisdictions – and it is certainly the case in Brazil. Let me borrow the deep philosophy of Mr. Ben Parker – uncle of Peter Parker, otherwise known as Spiderman. She said "with great power comes great responsibility". I propose to turn that around… "with great responsibility comes at least commensurate power". We should not expect boards to work if they are in fact just rubberstamping decisions made at the nation`s capital. And in those circumstances, the whole corporate governance edifice comes crumbling down. The state pretends to build a board. Directors pretend to govern. And the result is a disaster waiting to happen.

And I`m not even getting started on the frustrated expectations driven by this dysfunctional structure. That could be the topic for another conversation.

Well, I hope we are all in agreement that a bad board is worse than no board at all. So let us assume we have a good board. We have an empowered board. This brings me to my third point. Mr. Christiansen said in the opening remarks of our meeting, and I'll try to quote him: "If you don't have transparency, the whole discussion on corporate governance is irrelevant. We have nothing." Well, let me aggravate

your statement… we have worse than nothing… we have a smokescreen. We have an alibi for bad decisions.

It seems to me strange that SOEs that tap public markets provide significant non public information to its controlling shareholders. Actually, this is clearly illegal. Yet, this is what happens everyday in Brazil given the amount of tinkering that takes place at SOEs by their controlling shareholder. Again, don't even get me started on the opportunities for insider trading…

My point is… transparency is a state of mind. Going back again to the IBGC definitions… transparency is more than the duty to inform… it is the will to inform. To provide information that is accurate, timely, and objective.

Brazil has made many advances in transparency recently – both in the capital markets and in government. Over the past few years the CVM has passed regulation that brought disclosure to levels close to those of more developed countries. On the government side, the intense use of the internet, as well as the "Information Access Law" increased transparency significantly. For listed SOEs, this would possibly mean cristal clear transparency… but it does not. As a citizen you can find out the minibar costs of a minister's recent trip. But you get no information on the working of boards of directors of SOEs.

Take Petrobras, for example. If you go to the CVM website the latest "extract" of a minute of a board meeting dates back from 2012… and simply states the dismissal of a senior officer. Nothing else.

Boards of SOEs do not describe their inner workings. Do not report on their performance. Do not publish their decisions and minutes. Do not evaluate themselves. Actually, how could them… ? When in many situations Ministers of State are directors? Would they ever evaluate themselves badly? What would then happen? They would quit? DEST would fire them?

How can we live in a system that praises transparency, but still have the most important body in the corporate governance of SOEs be absolutely opaque?

The reason I am bringing all this up is that we need boards that deliver at SOEs. We need the regulation, we need the political will, and we need the people who will understand their duties.

Boards that deliver are the only solution to monitor one of the main sources of problems in all organizations… related party transactions.

Daniel, I would very much like to recommend to the members of the SOE network the reading of materials produced by the RPT Task Force of the Roundtable. It would be repetitive for me to go over all of the issues surrounding this important aspect of governance. But I will make some brief comments nonetheless.

RPTs are transactions which allow the shifting of value and/or costs between different stakeholders. In the case of a company controlled by an entity that holds less than 100% of the capital, these agency problems are easily understood. And that is precisely the case of listed SOEs.

The problem starts with the definition of RPTs. In our contribution to the RPT Task Force, Amec divided them in two kinds: ongoing transactions and one-off situations.

Ongoing transactions can include:

- Loans to or from related parties
- Loan guarantees
- Management Compensation
- Management Fees
- Competing market opportunities
- Use of corporate assets
- Use of assets owned by controlling shareholders
- Marketing or service contracts (including commissions)

Capex / Opex Allocation

- One-off situations typically include:
- Mergers between related parties
- Incorporation, reverse takeovers
- Rights issues, such as the one undertaken by Petrobras in 2010.

If we are talking about SOEs, the problem get more complicated. As pointed out by Mike Lubrano, rapporteur of the RPT task force, does a contract with a supplier that can contribute financially to the next campaign of the incumbent government qualify as an RPT? What about the soft decisions that can be disguised as business oriented, but in fact are politically motivated – such as the discussions on tariffs charged by Eletrobras and Petrobras?

I would argue that all, or most of these transactions should be labelled RPTs – provided they are DISCRETIONARY.

To illustrate, one might ask… is paying taxes an RPT ? The obvious answer is no. But adhering to a voluntary tax relief program, that involves a large up-front payment as a compensation for cancelling lawsuits against incorrect taxes is clearly an RPT.

Once RPTs are correctly identified, what do we do with them ?

The answer is, of course, to treat them in the usual corporate governance structures. Some guidelines may include:

1. **Policy** – the board of directors must have a policy to deal with RPTs, ranking them by relevance and risk, and establishing procedures to deal with them.
2. **Decision** – The decision to undertake a conflicted transaction needs to be taken at the level immediately above the conflict. At the end of the day, the board has a final say in most ongoing transactions. But the board will only be a legitimate decision maker if it manages its inherent conflicts. RPTs need to be evaluated and decided upon by non-conflicted, ie, independent

directors. If that is not possible or enough, the shareholder meeting should decide, with the abstention of conflicted shareholders (namely the controlling shareholder). This typically happens in the case of the one-off decisions I mentioned. A clear process of `majority of the minority` needs to be established. And it must be followed strictly. If disguised conflicted parties are able to vote, the whole process becomes counterproductive.

3. **Control** – internal control bodies, such as Audit Committee, Conselho Fiscal and internal audit must be provided roles in monitoring RPTs, and ensuring that policies set by the board are followed correctly. Again, the existence of independent members is essential to ensure integrity of the process.
4. **Disclosure** – Information on policies and on relevant RPTs need to be disclosed according to the transparency principles I mentioned… the will to inform. Relevant information.
5. **Regulatory overview** – Regulators should strive for the integrity of disclosure regarding RPTs, as well as to provide recourse to investors in case of foul play.

As we can see, the only way the RPT problem will be adequately dealt with at SOEs is through the existence of a proper system of checks and balances. All governance structures need to function. Truly independent directors are an important part of this process.

Which is just a reminder that governments interested in walking the talk of corporate governance must undertake a serious revision of the way boards are built. We saw yesterday a few a examples of good initiatives to ensure that, notably in Peru and Colombia.

Brazil is only beginning this process. Despite clear legal provisions for the election of independent directors, the process has been tainted for years. Quasi-state entities voted to elect respectable businesspeople for these positions, with the intention of providing an appearance of independence. Even after strong actions of the CVM to avoid this, we still see, as we speak, the government trying to interfere in the election of independent directors at certain listed SOEs.

In a country where the state is as pervasive as Brazil, captains of industries are in an ill position to act in a truly independent manner, if that involves denying the wishes of government. This is the reason why, despite all the talk of transparency, corporate governance and independence, the board of directors of certain listed SOEs in Brazil presided over massive destructions of value – to the detriment of investors, of the reputation of our capital markets and of the future of our country.