Season Preview 2019 – LatAm

Overview of the State of Proxy Voting in Brazil

With 2018 making distance voting a reality for shareholders of Brazilian issuers, we were eagerly anticipating that those voting by proxy would have a greater practical impact on meeting outcomes. Specifically, on topics as relevant and significant as executive remuneration, the election of directors, and requests to establish supervisory councils. Conversely, we recognise that proxy voting in Brazil is still in its very early stages, with issuers, regulators and market participants all learning together.

Procedural Takeaways

We had the opportunity to take stock of 2018's meetings, directly with the department responsible for managing issuer development at B3, the São Paulo Stock Exchange. This discussion proved to be rather enlightening, providing us with practical perspective on what actually goes on at meetings, as well as the impact of the recent implementation of remote voting in Brazil.

Additionally, B3 were kind enough to share with us data gathered from the 2018 and 2017 proxy seasons, allowing for further insights into the reality of Brazilian shareholders' meetings:

- Condensed timeframe: Similarly to 2017, the majority of Brazilian issuers (72%) held their shareholders' meetings during the last week of April;
- Further, the average quorum required for meetings to be installed didn't differ significantly from 2017 to 2018, with an increase of 1%;
- On the other hand, the initial application of Instruction 561 regarding remote voting prompted a surge in the average installation quorum, which went up by 6% from 2016 to 2017.
- Condensed custodial pipeline: Similarly to last year, distance voting was concentrated in just a few custodians (with one custodian having dealt with 99% of all proxy cards).
- Among the 93 companies required to offer distance voting, 89% of the 2018 distance votes were sent to B3 through custodians (a significant increase when compared to 2017, where only 65% of distance votes were sent via this method).
- Nearly all of the companies required to make use of distance voting in 2018, made proxy forms available to the market (93%; of those same companies, 64% received votes cast via the proxy cards).

We also observed a relationship between issuers' free float and proxy votes received. There was a clear trend between companies that received the highest number of distance votes/proxy cards, and those with the greater number of investors and the highest percentage of free float. Some illustrative examples from the information provided by B3 –

- 25% average free float;
  - Remote votes received: 108 companies;
- 58% average free float;
  - Remote votes received: over 300 companies .

The 30 companies that received the largest number of distance votes had a total average free float of 52.3%. Other revealing examples, further supporting the direct correlation between companies' free float and the use of distance voting:

- Totvs S.A. – 59.83% of free float shares cast their votes via proxy card;
- Cyrela S.A. – 45.39% of free float shares cast their votes through these.

Also worthy of mention is the fact that almost 80% of shareholders who cast their votes via proxy card did so in up to 10 different shareholders' meetings:

- Almost 99% of these shareholders were foreign investors;
- Remote voting process was used mainly by institutional investors.

Further, distance voting representation increased considerably – 51% of minority shareholder votes cast at 2018 meetings used this method (40% in 2017).

Conversely, there was no change from last year in the percentage of minority shareholders that did not exercise their voting rights – 44% continued to not have a say at shareholders' meetings of the companies in which they invested.

Practicalities of Distance Voting & Effect on Shareholders Exercising Their Voting Rights

(a) Remuneration & Election of Directors

Shareholders voting remotely have had the opportunity to cast votes on more matters than ever before. Nevertheless, procedural inconsistencies and disclosure mishaps continued to alienate those voting by proxy.

In fact, from the data gathered by B3, we were surprised to learn that in 97% of the cases where remuneration policies were not supported by shareholders, those same policies were nonetheless approved.

Correspondingly, and regrettably, proxy voting also had little to no impact on the outcome of the election of directors:

- From 165 companies that held board elections, 20 saw proxy votes cast against their candidates; however, all 165 companies had their proposed boards approved.

From a more procedural perspective, it's interesting to note that out of the same pool of companies, 98 companies held their elections through slates, another 63 held their elections individually, with a mere four companies appointing their board members via the cumulative voting process.

In practice, we support the adoption of cumulative, since it allows holding individual board members accountable (as opposed to slate elections). However, cumulative voting in Brazil seems to be a solution in search of a problem – voting on each director individually could present the same benefits, while simplifying the procedure. Complications of cumulative voting include the fact that it can be requested up to 48 hours before the meeting (providing little practical benefit to those who are not planning to attend it in person). Given the potential for shareholder votes on cumulative voting to be disregarded if the election is held as a slate, we will, in general, not recommend that shareholders support the request to adopt this voting method when companies do not disclose, well in advance of the meeting, if it will be implemented.

On the other hand, if shareholders abstain from the voting options related to this election method, where cumulative voting is, in fact, adopted, there is a risk that a company's board of directors or supervisory council may be elected by a small percentage of shareholders – given that shareholders' votes cast towards a different election procedure will be disregarded. However, we recognise that most shareholders voting by proxy will not meet the minimum cumulative voting ownership threshold (5% of a company's outstanding share capital) for the vote to count.

Another interesting takeway from the 2018 data gathered by B3 is the fact that the proxy card's mandatory cumulative voting related proposals did not result in a proportional increase in the implementation of this election method:

- Out of 104 companies who included the "request for cumulative voting" within their proxy cards, 90 requests were rejected.
- Further, several companies released their final voting maps with sufficient quorum to apply the cumulative voting process, but did not.

Last season showed that shareholders voting by proxy continue to face serious obstacles to participating in board elections when information is not made available with enough time before the meeting date – where information regarding a proposal to elect directors or to adopt cumulative voting has not been made available 21 days prior to the meeting date*, in many cases those voting by proxy will not have the opportunity to cast informed votes on board elections (*updated proxy cards may be resubmitted up to 20 days before meeting dates).

(b) Supervisory Council

We also note that there were a few issues with the request to establish the supervisory council. This council can be a useful tool for ensuring proper oversight of companies' accounting and financial reporting; remote shareholders seemed to agree, as 92% of the requests to approve the establishment of this council were passed. If quorum were sufficient for its implementation, the company should have proceeded with the pertinent steps to provide and request candidates for shareholders to vote on. However, as it turned out, this did not fare too well from a remote voting outlook. While most shareholders opted to support the supervisory council's installation, those votes proved, in many cases, to be unfruitful.

Most companies that included the names of potential nominees on the proxy form – allowing for shareholders voting remotely to decide not only on the council's establishment, but also on the appointment of its respective members – apparently did not anticipate that shareholders would vote in favour of establishing the council:

- In the majority of cases, either (i) the council wasn't established despite shareholder support (with no nominees to sit on it), or (ii) it was established, with candidates being proposed at the meeting, declining those voting by proxy to have a say in the election of the council.

Accordingly, we have recently updated our policy on this issue, and will not recommend that shareholders support the formation of a separate supervisory council unless the proposed members have been disclosed and represent a sufficiently diverse perspective to add value for all shareholders.

Regional Developments (within other LatAm Markets)

In the rest of Latin America, changes are taking much longer. With a heavy concentration of controlled companies, minority shareholders are yet to become looked-after participants. The different markets are instead focusing on other matters they consider more pressing, such as the recent launching of the BIVA stock exchange in Mexico, for example, or Colombia's entry in the OECD.

In spite of this, small advances are being made. Most recently, Argentina's BYMA Stock Exchange (*Bolsas y Mercados Argentinos*) established a Corporate Governance panel, which will include two different levels, one for companies with common shares and one vote per share, and the other one for the rest.

Any Argentinian public company voluntarily deciding to adhere to this panel will have to comply with the newly presented governance regulations, which are aligned with the Corporate Governance principles of the OECD. Some of the biggest companies in the country have already declared their adherence to the panel.