REPORT ON THE OBSERVANCE OF STANDARDS AND CODES (ROSC)

Corporate Governance Country Assessment

PANAMA

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This Corporate Governance Assessment was completed as part of the joint World Bank-IMF program of Reports on the Observance of Standards and Codes (ROSC). It benchmarks the country's observance of corporate governance against the OECD Principles of Corporate Governance and is based on a template developed by the World Bank. This assessment was undertaken on the basis of the template prepared by the Panamanian law firm Sucre, Arias, and Reyes for the World Bank. Acknowledgments are due to the Ministry of Economy and Finance, the *Comisión Nacional de Valores* (CNV), the *Superintendencia de Bancos*, the *Bolsa de Valores de Panamá*, leading experts on legal, accounting and auditing issues, capital market issuers, pension fund managers, academics, investors, and stakeholder groups. Mierta Capaul and Tatiana Nenova of the Investment Climate Department of the World Bank drafted the final report. The ROSC assessment was cleared for publication by the Ministry of Economy and Finance on June 17, 2004.

I. EXECUTIVE SUMMARY

This report provides an assessment of the corporate governance policy framework and enforcement and compliance practices in Panama. Much progress has been made since the drafting of the new Securities and Banking Laws in the late 1990s. For example, before 1999, the only required disclosure for listed firms was the issuance of the prospectus. Now, the quality of periodic reporting is approaching international good practice. While corporate governance reform is still at an early stage, it is an essential ingredient to promoting high standards and safeguarding the reputation of the Panamanian capital markets among investors.

The major issues are driven by the preponderance of banks.[1] Given abundant debt financing, there is little need for equity financing. In addition, institutional investors are largely absent from the equity market. The main legislation concerning listed companies is based on US laws and is sophisticated, though poorly enforced. The 1927 Corporations Law is drafted to provide maximum flexibility to off-shore companies. For listed firms, ownership and other disclosure requirements, as well as minority rights in general, could be strengthened in the Securities Law, given the reluctance to make the Corporations Law more prescriptive. While elaborations of this law are the purview of the securities regulator, the *Commission Nacional de Valores* (CNV), its power to regulate issuers has been successfully challenged in court, setting a dangerous precedent and undermining its ability to enforce the law and issue rules and regulations.[2] For example, Regulation 16-2000 on the solicitation of proxies, was declared unconstitutional in 2002 due to a dispute over the CNV's right to regulate the matter. Issuers have also threatened to legally challenge Regulation 12-2003, the Panamanian Guidelines on Corporate Governance, once they are compelled to disclose compliance with the Guidelines in 2005.[3]

The report recommends: (1) a sufficient level of disclosure in practice, to enable the identification of beneficial owners and their exact stakes, in the annual report;[4] (2) simplified shareholder redress, including a more active role for the securities regulator, so as to enable shareholders to challenge corporate decisions; (3) the creation of an effective audit oversight mechanism; (4) the re-introduction of the regulation on proxy solicitation, requiring the provision of sufficient information for shareholders to make informed voting decisions; (5) mandatory audit committees for all listed companies; (6) clearer fiduciary duties and liabilities of directors, and (7) the availability of relevant and useful training for board members. The report also proposes strengthening the securities regulator's ability to issue and enforce regulations on listed firms, their boards and shareholders and stricter monitoring of the quality of disclosure.

II. CAPITAL MARKETS AND INSTITUTIONAL FRAMEWORK

Compared to other Latin American countries, Panama's equity market is small and illiquid, with a market capitalization of USD 3.2 billion, or 38 percent of 2003 GDP.[5] Banks and insurance companies dominate listings. The Panama Stock Exchange (PSE) is the country's stock exchange. As of April 7, 2004, 25 of Panama's 41,190 operating companies had their equity securities listed; ten of these did not trade during 2003.[6] The market is highly concentrated - the

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[1] Banking sector assets represent 278 percent of GDP. Source: Banking Superintendency, *Sistema Bancario de Panama*, 2004.
[2] See Annex D, "Court Challenges to the Regulatory Powers of the CNV."
[3] Summarized in Annex E. Regulation 12-2003 is a voluntary set of guidelines and recommendations issued by the securities regulator. For the purposes of brevity, this report refers to this regulation as the "Guidelines."
[4] International best practice requires the disclosure of all owners with a minimum of 5 percent or 10 percent.
[5] 2003 GDP was USD 12.887 billion (Source: Ministry of Economy and Finance). See Annex C for additional Panamanian and regional market statistics.
[6] National Economic Census (*Censo Económico Nacional*), General Comptroller's Office, 2000.

ten largest securities account for 89 percent of market capitalization and 92 percent of trading volume.[7] Free float was quite low, at about 10 percent on average. No new companies have listed since 2002. One company issued shares in 2003; a total of eight issues were made in the past five years. In contrast, three companies have delisted so far in 2004, and since 2000, 14 have cancelled their registration with the CNV. The major impulse for delisting has come from "going private" transactions following international takeovers. Companies obtain access to important tax benefits as a result of registration and listing.[8]

The corporate sector is characterized by concentrated family ownership. Many companies are still controlled and managed by their original founders. Small shareholders are usually connected to the controlling group. Second and third generation successors will likely face control/governance issues in the next few years. Pyramid structures are widespread in the banking sector, covering insurance firms, pension and investment funds, and other financial firms. The groups are ultimately controlled by a handful of individuals and families. This creates the potential for conflicts of interest and related lending. Banks are not important blockholders beyond their group holdings. In 1993, private pension funds were created to complement the social security system.[9] The two largest pension fund managers, *Progreso* and *Profuturo*, manage these funds, the severance pay funds,[10] seniority bonuses,[11] and a part of the public employee pension funds[12] (USD 217 million and USD 186 million, respectively).[13] Listed domestic equity represents just 4 percent of *Profuturo*'s and almost none of *Progreso*'s portfolio.

The legal framework is based on civil law, with frequent borrowings from US legislation. The key laws affecting corporate governance are the Code of Commerce (Law No. 2 of 1916, CC[14]), the Corporations Law (Law No. 32 of 1927, based on the Delaware Code 1927, CL) and the Securities Law (Decree-Law No. 1 of 1999, based on the US Securities and Exchange Act, SL).[15] The CC establishes basic company forms.[16] The CL regulates the constitution and liquidation of corporations, as well as their governing organs and documents, and has not been substantially reformed since 1927. Decree-Law 5 of 1997 introduces technical amendments to the CC, CL and SL, in view of their modernization, but few material changes.[17] The SL regulates publicly offered securities, financial intermediaries and other market participants, clearing and settlement, mutual funds, investment funds, and pension funds. It also includes regulations on ownership disclosure of issuers, financial disclosure, accounting standards,[18] public tender offers, and insider trading. Finally, it covers a few specific minority rights, e.g. the disclosure of related-party transactions, director liability, and minority redress mechanisms.[19] The two main regulatory bodies that supervise the financial markets are the *Superintendencia de Bancos* (Superintendency of Banks) and the securities market regulator, CNV.[20] CNV regulates public

[7] Source: PSE, April 2004.
[8] Registered firms do not pay capital gains, dividend, and complementary taxes. Firms need to be registered in order to list.
[9] Law 10 of 1993
[10] *Fondo de cesantía.*
[11] *Prima de antigüedad.*
[12] SIACAP.
[13] The CSS (Social Security Fund) is prohibited from investing in the stock market.
[14] As amended by Law No. 9 of 1946, Decree-Law No. 5 of 1997.
[15] As developed further in the Regulations (*Acuerdos*) to the SL.
[16] Corporation (SA), limited liability company, and various forms of partnership.
[17] The law allows e.g. for electronic maintenance of companies' stock register, as well as the presence of shareholders at the AGM by electronic means instead of in person. It also allows companies, rather than individuals, to be board members.
[18] Article 8(5) requires the CNV to determine the format and content of financial disclosure, to decide which are the acceptable accounting norms in preparation of financial statements, and to adopt norms that establish the independence of auditors.
[19] Decree Law No. 247 of 1970, in force as per the current SL, specified minority rights.
[20] Insurance companies are supervised by *Superintendencia de Seguros y Reaseguros*.

offerings and licenses the PSE, the clearing corporation *Central Latinoamericana de Valores, S.A.* (LatinClear), broker-dealer houses, investment advisors, analysts and investment firms. It also examines, supervises and controls the activities of those involved in the securities market. The power of the CNV to regulate the SL has been successfully challenged in court.[21] The PSE is a for-profit listed company, and an SRO. The are no listing rules beyond the requirements of the CNV. LatinClear, regulates the deposit, custody, clearance and settlement of listed securities.

The CNV is an official, autonomous body under the Ministry of Economy and Finance. The three Commissioners are appointed by the Executive, and can only be removed by the Supreme Court. Their term is five years. The CNV files annual reports to Parliament, and is audited by the General Controller's Office. It has 46 employees.[22] The CNV submits its budget to the Ministry of Economy and Finance and Congress. Its revenues cover 50 percent of its budget.

The CNV has full investigative powers, access to documents of any registered entity, and power to extract sworn statements from registrants, provided there are well-founded reasons to believe that the SL or its regulations have been violated. The CNV may initiate an administrative investigation and impose fines of up to USD 100,000 for a single violation, and of up to USD 1 million for multiple violations in a single transaction or in a series of related transactions.[23] The CNV can suspend trading or cancel the registration of any issuer. It is also obliged to report fraud and insider trading to the Attorney General, who then initiates a criminal charge. PSE's enforcement arm (staff of two) supervises all operations. The PSE can and does suspend trading (mainly for late disclosure), and can delist, although it rarely uses the latter power.

The Corporate Governance Guidelines issued by the CNV will enter into force by 2005, on a comply and explain basis.[24] Corporate governance of banks is regulated by Regulations No. 4-2001 and 1-2002, issued by the Superintendency of Banks. Most of the regulations are voluntary; the two mandatory requirements on banks are the creation of an audit committee and of a risk management function. The *Asociación Panameña de Ejecutivos de Empresas* is an NGO that has fostered business ethics in the private sector.

III. REVIEW OF CORPORATE GOVERNANCE PRINCIPLES

This section assesses Panama's compliance with each OECD Principle of Corporate Governance. Policy recommendations are offered if a Principle is less than observed.[25] While the Principles relate to listed companies, the recommendations may be helpful for all companies (SA).

Section I: The Rights of Shareholders

Principle IA: The corporate governance framework should protect shareholders' rights. Basic shareholder rights include the right to: (1) secure methods of ownership registration; (2) convey or transfer shares; (3) obtain relevant information on the corporation on a timely and regular basis; (4) participate and vote in general shareholder meetings; (5) elect members of the board; and (6) share in the profits of the corporation.

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[21] The CNV can issue *Acuerdos* (which are binding), *Opiniones* (which are non-binding legal interpretations) and *Resoluciones* (which are CNV decisions on specific matters, e.g. the granting of a license to a stock broker or the imposition of a fine).

[22] For comparison, the Superintendency of Banks has 251 employees. Salaries at the CNV are significantly lower than those for comparable positions in the private sector.

[23] The ten largest fines imposed since its inception have been actively disputed in court, and none of them have been collected. The CNV's right to impose fines on management, directors, and major shareholders has been disputed in court. No judgment has been issued (see also Annex D, "Court Challenges to the Regulatory Powers of the CNV").

[24] Regulation No. 12-2003. For new issues, the Guidelines are already in effect.

[25] **Observed** means that all essential criteria are met without significant deficiencies. **Largely observed** means only minor shortcomings are observed, which do not raise questions about the authorities' ability and intent to achieve full observance in the short term. **Partially observed** means that while the legal and regulatory framework complies with the Principle, practices, and enforcement diverge. **Materially not observed** means that, despite progress, shortcomings are sufficient to raise doubts about the authorities' ability to achieve observance. **Not observed** means no substantive progress toward observance has been achieved.

Assessment: ***Largely observed***

Description of practice: **Secure methods of ownership registration.** Shares of listed companies are 100 percent registered.[26] This does not mean that they are held in the name of the ultimate owner; commonly, the shares are registered in the name of the nominee (e.g. the broker). For shares deposited with LatinClear, legal ownership is certified by the book entry of the broker executing the trade.[27] Shares not deposited with LatinClear are registered in the company's share register.[28] In this case, LatinClear appears as the owner of record in the company' share register, and the broker is the nominee. Only 10 percent of shares are deposited with LatinClear.

Convey or transfer shares. Listed shares must be freely transferable. Securities traded on the PSE must be cleared and settled by LatinClear. LatinClear clears and settles transactions in DVP3 on T+3,[29] but does not provide novation. Foreigners are prohibited to own, hold shares in, or serve as directors in, retail firms.[30]

Obtain relevant information on the corporation on a timely and regular basis. Companies make periodic and continuous disclosures to the CNV, which are provided to the public upon request and will soon be available on the web. Companies do not usually distribute their annual report to shareholders before the day of the annual shareholder meeting (AGM).[31]

Participate and vote in general shareholder meetings. Companies are not required to hold AGMs by statute, but listed companies do so in practice.

Elect members of the board. CL does not regulate the election of directors. *Ex-ante*, no information is filed on newly-nominated directors. Usually, a single vote is held for the entire slate of directors proposed by the board at the AGM. Cumulative voting is allowed by law, if specified in the articles of incorporation.[32] In practice, cumulative voting provisions are not common.[33] Shareholders can nominate directors at the AGM without prior announcement - should that happen, a ballot vote is held. A majority of shareholders can remove directors.

Share in the profits of the corporation. Shareholders do not propose the distribution of profits nor do they approve dividends. There is no statutory provision for a minimum dividend payment.

Policy recommendations: Listed companies should be required to hold an AGM. Financial statements should be made available well in advance of the AGM for shareholders to have sufficient time to make an informed decision on whether the financial statements reflect a true and fair picture. The manner of election of directors should be specified in the law. It should not be possible for shareholders to propose a director at the meeting, without prior announcement.

[26] CL allows for bearer and registered shares.

[27] *Régimen de Tenencia Indirecta*.

[28] According to Section 36 of CL, every corporation has the obligation to keep a stock ledger, listing the names of all stockholders of the company, their domicile, number of shares corresponding to each one, date of acquisition and amount paid. In addition, in the case of controlling stakes, companies are obliged to keep track of indirect holdings to the level of the beneficial owners. There is no obligation to include said information in the share register.

[29] More than half of all transfers take place outside the stock market (1,395 out of 2,254 transaction in 2003). Source: LatinClear.

[30] This restriction is due to a constitutional limitation that reserves retail commerce for Panamanian nationals - a limitation that does not extend to any corporation engaged in the business of providing services of any nature.

[31] It is usually not available until two to three days before the meeting.

[32] Cumulative voting allows minority shareholders to cast all their votes for a single candidate. Suppose that a publicly traded company has two shareholders, one holding 80 percent of the votes and another with 20 percent. Five directors need to be elected. If there is no cumulative voting rule in place, each shareholder will have to vote separately for each director. The majority shareholder will get all five seats, since he will outvote the minority shareholder each time by 80:20. With cumulative voting, the minority shareholder can decide how to place his votes. The optimal strategy would be to take all his votes (five times 20 percent) and cast them for one board member. The minority shareholder will then win that seat.

[33] *Aseguradora del Atlántico* (ADELA) has a cumulative voting provision.

Information on newly-nominated directors should be available to shareholders before the AGM.

Principle IB: Shareholders have the right to participate in, and to be sufficiently informed on, decisions concerning fundamental corporate changes, such as: (1) amendments to the governing documents of the company; (2) the authorization of additional shares; and (3) extraordinary transactions that in effect result in the sale of the company.

<u>Assessment</u>: ***Partially observed***
<u>Description of practice</u>: Fundamental corporate changes are decided at extraordinary shareholder meetings (EGMs).[34] Major corporate transactions, such as mergers and windings up, as well as changes to company business or objectives require the approval of more than 50 percent of outstanding capital.[35] The shareholder meeting has exclusive power to amend the articles of association,[36] but can delegate the power to amend the bylaws to the board.[37] Though the shareholder meeting alone can authorize increases in share capital, the board usually controls the share issues, determining price and payment conditions. Pre-emptive rights are not mandated by law. Large sales of assets are approved by 50 percent of capital stock.[38]

<u>Policy recommendations</u>: The shareholder approval rights of changes in bylaws need to be strengthened. Policymakers should consider introducing pre-emptive rights.[39]

Principle IC: Shareholders should have the opportunity to participate effectively and vote in general shareholder meetings and should be informed of the rules, including voting procedures, that govern them. (1) Shareholders should be furnished with sufficient and timely information concerning the date, location and agenda of general meetings, as well as full and timely information regarding the issues to be decided at the meeting. (2) Opportunity should be provided for shareholders to ask questions of the board and to place items on the agenda at general meetings, subject to reasonable limitations. (3) Shareholders should be able to vote in person or in absentia, and equal effect should be given to votes whether cast in person or in absentia.

<u>Assessment</u>: ***Partially observed***
<u>Description of practice:</u> While not mandated by law, the AGM is typically held within three months' of the fiscal year's end. Shareholders with 5 percent[40] of the vote can request the court to convene a shareholder meeting. There is no statutory provision for a quorum at the AGM or EGM. In practice, the average quorum at AGMs is 60-70 percent.[41] (1) Notice must be at least ten days in advance[42] and is usually served by mail or published in a local newspaper. The notice includes the time and place of the meeting and the agenda.[43] Agendas are standard and do not specify the real nature of issues to be discussed.[44] (2) Shareholders cannot put items on the agenda before the meeting. Issues not on the agenda can be raised and decided at the AGM. At EGMs, only items on the agenda can be discussed. (3) CL allows the bylaws to set voting rules. Often, a shareholder stands and presents a motion for unanimous approval. Unless a shareholder or group objects to this initiative, the decision is taken by show of hands. If an objection is raised, then a formal vote by ballot is conducted. Proxy votes do not require notarization, proxies do not need to be physical persons, and shareholders can vote by telephone, fax or any other

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[34] Section 51, CL.
[35] Sections 74 and 81, CL.
[36] Amendments to the Articles of Incorporation require a 50 percent approval (Section 22, Subsection b, CL).
[37] Bylaws develop the articles of association in detail, but cannot contradict them. 80 percent of companies do not have bylaws.
[38] Section 68, CL. The law fails to specify the exact definition of "large sales," and there as been no jurisprudence on the matter.
[39] Pre-emptive rights give existing stockholders the opportunity to purchase shares of a new issue before it is offered to others. The purpose of these rights are to protect shareholders from dilution of value and control when new shares are issued.
[40] Article 39 of the SL mentions "1/20th of capital." In the opinion of certain legal scholars, this can be interpreted as 20 percent.
[41] Estimation by Sucre, Arias, and Reyes. Note that 57 percent (the average of the combined share of the top three shareholders of the ten largest traded companies) is held by the controlling shareholders.
[42] Section 42, CL. The bylaws of the corporation generally establish the means through which notice is given to shareholders.
[43] Section 40, CL.
[44] The agenda generally comprises four items: (a) reading of the minutes of the previous AGM; (b) presentation of financial statements; (c) appointment of the members of the board of directors, and (d) other matters.

electronic means.[45] The proxy statement is sent out without audited financial statements, information on auditors, directors, and any fundamental changes proposed.

Policy recommendations: Policymakers should consider extending the minimum meeting notice period to 30 days (in line with international investor requests).[46] It should be possible to place items on the agenda before the AGM and have the relevant information distributed at company expense. No resolutions should be adopted at the AGM, unless they were on the agenda or unless 100 percent of shareholders decide to do so. Generic agenda items, like "other business" should be prohibited. Regulation 16-2000 regarding proxy voting should be reintroduced. In particular, proxy solicitation should require the mailing of audited financial statements, information on auditors, directors, and any fundamental changes proposed.

Principle ID: Capital structures and arrangements that enable certain shareholders to obtain a degree of control disproportionate to their equity ownership should be disclosed.

Assessment: ***Materially not observed***
Description of practice: Any type of shares with any voting rights can be issued according to the CL. In practice, only common and preferred (non-voting) shares exist. The listed preferred shares enjoy a right to a fixed or special dividend, preference in dividend distribution and liquidation proceeds.[47] The articles of an SA need not specify the number of shares, nor the rights and privileges of each share class.[48] For listed firms, the annual report contains only basic information on the total number of shares issued in each class. The SL mandates that companies disclose direct, indirect and in concert ownership of 25 percent of capital; however, in practice, no more than the first level of ownership is disclosed, if anything, so it is impossible to ascertain the ultimate owner.[49] Disclosure of shareholder agreements is not mandated. Buy-backs are allowed; treasury shares do not have to be cancelled, but cannot be voted.[50]

Policy recommendations: The annual report should detail the rights of the different classes of shares and the names of beneficial owners above a certain percentage of share capital, which by international practice is below 25 percent. The onus for disclosure should be on the shareholder, as well as the company. Shareholder agreements should be disclosed in order to be enforceable in a court of law. Shares bought-back by the corporation should be cancelled after a certain time, e.g. one year. For listed firms, it should not be possible to leave the privileges of each share class unspecified in the articles of association.

Principle IE: Markets for corporate control should be allowed to function in an efficient and transparent manner.

Assessment: ***Largely observed***
Description of practice: Large control blocks can be acquired off the market in private negotiations, on the market by open-market purchase, or via a tender offer (OPA).[51] An OPA

[45] Decree-Law 5 of 1998.
[46] See Institute of International Finance, *"Policies for Corporate Governance and Transparency in Emerging Markets," 2002.*
[47] Three banks have opted to issue preferred shares in order to meet the Basle II capital requirements without diluting control. The shares represent 5 percent of total market capitalization and 16 percent of the trading volume, as of 2003.
[48] Section 2, Subsection 5 of CL states that the articles of incorporation must contain the number of shares in each class, preferences, privileges, voting powers and restrictions or requirements of shares in each class. If those details are not specified, they should be determined at a future date by a majority resolution of shareholders or by a resolution of a majority of directors.
[49] The onus of disclosure lies with the company, not the shareholders. Regulation 18-2000, referring to Art. 19 of Regulation 6-2000, requires the disclosure of the name, number of shares held and share ownership percentage of beneficial owners with control. Article 1 of the SL defines "control" as 25 percent, and "beneficial owner" as "direct or indirect ownership of a person or persons acting in concert."
[50] Regulated by Sections 15-18, CL, which regulate the source of funds to be used to buy back shares.
[51] The OPA (*oferta pública de acciones)* is regulated by Sections 94-103 of the SL and Regulation 7-2001.

must be used for acquisitions of 25 percent or more, or for any acquisitions that will cause the acquirer to obtain 50 percent or more of the capital. Notice is given to the CNV at the time of OPA, and a copy is filed with the target and the PSE. Such deals require real-time disclosure as material facts, publicly and to the CNV. In the case of a privately negotiated change of control, the content of the material fact disclosure is not regulated, but typically includes the identity of the buyer and the price. The use of anti-takeover devices is not frequent. There are no delisting provisions, including no squeeze-out provisions. There have been less than a dozen public tenders since 2000, all friendly deals. For example, C.A. Beverages (CAB) purchased control of Coca Cola de Panama in a friendly deal in 2000. In 2002, CAB made an OPA to all shareholders, at the same price at which it acquired the controlling block. In this way, the firm acquired 96 percent of the shares and delisted.

Policy recommendations: An efficient and equitable mechanism for delisting needs to be put in place. Consideration should be given to minority protection measures, in particular minimum prices for squeeze-outs. The OPA section of the law should be developed in more detail. Unless ultimate ownership is known by the regulators, takeover regulations cannot be enforced.

Principle IF: Shareholders, including institutional investors, should consider the costs and benefits of exercising their voting rights.

Assessment: ***Materially not observed***
Description of practice: Most retail investors are connected with the controlling shareholders and tend to vote with them. Retail investors regularly attend AGMs and initiate discussions, but do not disagree or litigate. Institutional investors do not typically invest in Panamanian equities. Pension funds regulation[52] is incipient, and there is no general obligation to disclose voting policy or to vote. The CNV's pension fund unit was created in March 2004.

The law makes it easy for institutional investors to vote: the date of record is up to 40 days prior to the AGM,[53] and shares are not blocked from trading.

Policy recommendations: CNV should issue detailed regulation regarding the working of pension funds – including guidelines on how to deal with conflicts of interest. Policymakers should also consider a requirement for funds to disclose their voting policies.

Section II: The Equitable Treatment of Shareholders

Principle IIA: The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights. All shareholders of the same class should be treated equally. (1) Within any class, all shareholders should have the same voting rights. All investors should be able to obtain information about the voting rights attached to all classes of shares before they purchase. Any changes in voting rights should be subject to shareholder vote. (2) Votes should be cast by custodians or nominees in a manner agreed upon with the share's beneficial owner.

Assessment: ***Materially not observed***
Description of practice: There are common (voting) and preferred (non-voting) shares. Shares have the same voting rights within each class, and voting rights information is readily available. There are several redress mechanisms available to shareholders. Arbitration courts are an option to shareholders of the rare firms whose bylaws contain an arbitration clause. Civil circuit courts have jurisdiction over the SL to impose civil liability. The CNV's right to initiate a class action suit on behalf of shareholders is limited to the following circumstances: (1) the persons involved cannot be easily identified or are numerous, or (2) individual damage is too small to initiate a personal action.[54] The CNV can request the court to order an examination of the issuer's books.[55]

[52] Regulated by Law 10 of 1993, as amended by the SL.
[53] Section 45, CL.
[54] Article 210 of SL, copied from Article 172 of the Consumer Protection Law 29 of 1996.

Five percent of shareholders can also do so.[56] Any shareholder can protest AGM resolutions; however, grounds are limited to technical matters,[57] making this redress mechanism ineffective in practice. Dissent does not give rise to withdrawal rights. Shareholders may file a lawsuit against the company for misrepresentation.[58] The direct action has never been used. Alternatively, and only in case of a violation of the SL, shareholders can file a complaint with the CNV, which in turn undertakes an investigation.[59] Holders of 5 percent of outstanding shares can obtain the legal representation of the company and bring a criminal proceeding against directors, management, lawyers, and auditors in case of fraud, crimes against company property, patrimonial crimes, illegal appropriation.[60] This criminal proceeding was significantly strengthened with the Financial Crimes Law (*Ley de Delitos Financieros*) 45 of 2003.[61] Finally, the company can hold directors liable for poor management.[62] However, the lack of a derivative action for civil claims makes this venue impractical for redress.[63] In practice, there have been no actions against boards of listed firms. Filing corporate action is hampered by the difficulties in proving cases, especially considering the difficulty for minority shareholders to obtain relevant information; the lack of specialization in the judicial branch and the high costs of long trials.[64]

Nominees have three days to notify the beneficial owner about an AGM. There is no rule requiring nominees to notify beneficial owners of their options in instructing the nominee how to vote shares. If shareholders would like to instruct the custodian how to vote, they need to draft a special document for the purpose, which adds complexity and discourages shareholder activism.

Policy recommendations: The pursuit of oppression remedies through the courts is not a practical redress option, given the lack of specialization in the judicial branch and the high costs of long trials. Policymakers should consider authorizing the CNV to intervene on behalf of shareholders should the CNV investigation warrant such intervention. Dissenting/withdrawal rights (not through the court) should be created for shareholders who disagree with AGM resolutions. Consideration should be given to lengthening the term for nominees to notify shareholders of an AGM. Proxy solicitation should include a standard form that provides the opportunity for the shareholder to instruct the custodian how to vote on each issue.

Principle IIB: Insider trading and abusive self-dealing should be prohibited.

Assessment: ***Largely observed***
Description of practice: There is a general prohibition on using privileged information in trading

[55] The CNV is authorized to request "special reports" from issuers, with respect to the independent auditor's opinion. The CNV determines the contents of these reports and how often they should be provided for by the issuer (Article 9 of Regulation 8-2000).
[56] Article 1379-94 of the Code of Civil Procedure.
[57] This is a direct action against AGM resolutions that contradict the law, bylaws, or articles. Within 30 days, a shareholder can use a summary proceeding, and thereafter, the ordinary proceeding is available (Art. 38).
[58] Sections 195 and 204 of the SL.
[59] Including misrepresentation of financial statements, insider trading, manipulation of market, or selling securities without being registered. Resolution N° 244-01 issued by the CNV imposed fines on Financiera El Roble, S.A., Aquilino de la Guardia Romero, Epimenides Díaz, Carlos de la Guardia, Arthur Andersen and others for false information.
[60] Article 36 of SL.
[61] The scope of crimes was widened. For example, "falsifying accounts" now includes "omitting material information." This criminal liability is extended to all insiders who certify the accounts (directors, officers, the external auditor). Finally, the maximum punishments are increased to five to seven years in prison.
[62] Article 41 of SL (Article 444 of the CC). Decision is by an AGM resolution.
[63] A general derivative action for any third party, not specifically shareholders, is provided in theory by Article 996 of the Civil Code, which has never been used in practice.
[64] Summary proceedings take three years on average, as opposed to general commercial litigation which averages seven years. The proceeds are significantly delayed at the appeals level.

securities.[65] Director shareholdings need not be divulged, unless the holdings constitute control. There is no mandatory reporting on trading by insiders. This curbs effective insider trading surveillance. Penalties are civil in nature; damages are triple the gain or the loss avoided.[66] The CNV has only received one complaint for alleged insider trading, involving shares of *Capitales Nacionales,* that was dismissed after the CNV determined that no violation had occurred. The CNV recently implemented an electronic surveillance system of access to tick-by-tick trades.

Policy recommendations: Holdings and trading of insiders should be disclosed as material facts.

> **Principle IIC:** Members of the board and managers should be required to disclose any material interests in transactions or matters affecting the corporation.

Assessment: ***Largely observed***

Description of practice: The disclosure of related party transactions (RPT) is theoretically compliant with IAS-24.[67] Disclosure includes a description of any business or contract in which the registered company or its controller is a party, and in which any of its related parties may have direct or indirect interest, with indication of the name of the person and its relationship with the company, the nature of their interest and the amount. Information is disclosed to the CNV, PSE and to the public on an annual basis. In practice, RPTs are not disclosed consistently, and neither the CNV nor auditors can effectively catch an omission of material information. The approval process is less regulated. The Corporate Governance Guidelines[68] do contain some provisions in this regard, although they do not carry the force of law. RPTs are approved by a majority of the board of directors, and the law does not prohibit the related party to vote.[69] In the case of banks, the Superintendency of Banks imposes limits on related loans and investments.[70]

Policy recommendations: CNV should put emphasis on enforcing disclosure of RPTs. Related parties should not be allowed to vote where they have a material interest. Policymakers should consider introducing a requirement for listed companies to create audit committees, whose tasks would include the pre-vetting of related party transactions.

Section III: Role of Stakeholders in Corporate Governance

> **Principle IIIA:** The corporate governance framework should recognize the rights of stakeholders as established by law and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises. The corporate governance framework should assure that the rights of stakeholders that are protected by law are respected.

Assessment: ***Observed***

Description of practice: There are no specific requirements that corporations take into account stakeholder interests. Stakeholder rights are commonly regulated in their applicable legislation (e.g. the Labor Code covers employees' rights; the Civil Code and consumer laws provide rights to creditors and consumers). Employees have extensive legal and contractual (labor) rights. In restructuring, the company faces restrictions in firing employees, and liability for the labor compensation rights (together with any new owners of the restructured entity).[71]

The debt collection mechanism followed by banks is efficient. Further, banks review each credit quarterly for signs of financial distress. The Antitrust and Consumer Rights Law defines the

[65] Section 196, SL 1999.
[66] Section 204, SL, 1999.
[67] Regulation 6-2000. Loans to related parties are treated like any other related party transaction.
[68] Regulation 12-2003, see Annex E.
[69] Article 34 of SL mandates disclosure of RPTs to the AGM, but it is not enforced in practice.
[70] Banks can lend or invest up to 5 percent of their capital without collateral to a related party (per loan / investment), and up to 10 percent with collateral, but the total cannot exceed 50 percent.
[71] Section 14 of the Labor Code.

rights of consumers.[72]

Principle IIIB: Where stakeholder interests are protected by law, stakeholders should have the opportunity to obtain effective redress for violation of their rights.

Assessment: ***Observed***

Description of practice: Typically, creditors attempt an out-of-court negotiation upon default. Failing that, secured credits carry a first right for collection from secured assets, both in and out of bankruptcy. Liquidation is drawn-out, so creditors prefer to use a three-month proceeding to acquire the right to administer the debtor upon default.[73] Creditors may file summary "Executive Claims" in order to judicially collect payment of debts.[74] If the credit is unsecured, the creditor may petition to a judge to sequester the corporation's assets prior to filing the actual executive claim. If the credit is secured (with either pledged or mortgaged assets), then the creditor will usually file an embargo petition on the secured assets, along with the executive claim. Companies with 20 or more employees must have a Company Committee as a conciliation device before taking matters to the Ministry of Labor or to courts.[75] Employees can seek redress from the General Work Department of the Ministry of Labor,[76] or can undertake judicial actions at the Sectional Labor Courts.[77] Consumers can use both administrative and judicial procedures to request the annulment of adhesion agreements, exercise warranty rights and obtain payment for damages, either individually or through class actions.[78] Environmental infractions carry administrative, criminal and civil liabilities.

Principle IIIC. The corporate governance framework should permit performance-enhancement mechanisms for stakeholder participation.

Assessment: ***Largely observed***

Description of practice: Companies do not have to share profits with their employees, and options are unregulated. The SL only states that offers and sales of securities to employees, directors or officers are exempt from registration with the CNV.[79] The major banks have started to offer stock option plans to their executives comprising a small part of their compensation. Some listed banks have adopted non performance-related employee share ownership plans.

Policy recommendations: Careful attention should be paid to the international debate on the use/abuse and expensing of stock options before adopting such practices.

Principle IIID: Where stakeholders participate in the corporate governance process, they should have access to relevant information.

Assessment: ***Observed***

Description of practice: Social balance sheets are uncommon – an exception is the annual Social Report issued by *Empresa General de Inversiones*, the holding company of *Banco General*. Other financial institutions publish internal bulletins where they inform on the activities in which their employees participate. Creditors have adequate access to debtor information.

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[72] Law 29 of 1996.

[73] Title XVII ("Concurrence and Preference of Credits"), Book IV, of the Civil Code makes debtors liable with all current and future assets, and defines an order of priority of claims.

[74] Section 1612-3 of the Code of Procedure.

[75] Section 186 of the Labor Code. The Committee is composed of two union representatives (or representatives elected by the employees if no union exists) and two representatives of the employer.

[76] An individual or a collective conciliation before starting a judicial legal proceeding against the employer.

[77] Except for cases related to employee termination, which are addressed to the Conciliation Boards, labor issues are adjudicated privately by collegiate bodies. Decisions are appealed at the Superior Labor Court, and further at the Supreme Court of Justice.

[78] Administrative procedures are handled by the Antitrust and Consumer Affairs Commission (CLICAC) for claims up to USD 500. Class action and claims above USD 500 must be filed before Commercial Courts.

[79] Section 82.

Section IV: Disclosure and Transparency

Principle IVA: The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and the governance of the company. Disclosure should include, but not be limited to, material information on: (1) The financial and operating results of the company. (2) Company objectives. (3) Major share ownership and voting rights. (4) Members of the board and key executives, and their remuneration. (5) Material foreseeable risk factors. (6) Material issues regarding employees and other stakeholders. (7) Governance structures and policies.

Assessment: ***Partially observed***
Description of practice: Listed firms need to file quarterly and annual reports to the CNV, and make them public.[80] (1) The annual report contains the consolidated financial statements, notes and the auditor report. (2) The CNV requires the filing of a management discussion and analysis, though some issues of quality of the information arise for some companies. No discussion of company objectives is required.[81] (3) Disclosure of capital and voting structure details is voluntary. Only the first level of ownership of blocks of 25 percent is disclosed. (4) The names of directors and senior management are reported. However, this can be avoided by nominating legal persons rather than individuals to the board.[82] There is no information on board remuneration. (5) Material foreseeable risk factors are discussed in the notes to the financial statements. (6) Material issues regarding employees and stakeholders are reported as material facts. (7) Regulation 12-2003 prescribes a "comply or disclose" corporate governance policy that will go into effect in 2005.

The CNV sanctions issuers whose reports are late with a fine of up to USD 3,000, suspension, or delisting.[83] The CNV reviews reports during 20 working days after submission, and informs the issuer if additional information must be submitted. Compliance with disclosure deadlines is satisfactory, and the CNV plans to focus future efforts on improving quality. The CNV monitoring team is composed of a staff of five for market monitoring and three for registration.

Policy recommendations: The disclosure requirements should be strengthened to include more mandatory reporting on performance, ownership and the board of directors. Enforcement needs to be extended to include the monitoring of the quality of information filed, in addition to the timeliness of reporting. This will require additional staff to be assigned to the monitoring team.

Principle IVB: Information should be prepared, audited, and disclosed in accordance with high quality standards of accounting, financial and non-financial disclosure, and audit.

Assessment: ***Partially observed***
Description of practice: Listed companies have the option of complying with IFRS/ISA or US GAAP/GAAS, and most domestic companies comply with the former. Annual accounts must be audited by an accredited independent auditor, typically a "Big Four" firm. There is a second tier of reputable, and quality audit firms. The Accountants Administrative Council (*Junta Técnica de Contabilidad*)[84] is composed of practitioners and university representatives, and is presided over by the Vice Minister of Commerce and Industry. The *Junta* issues licenses to public accountants.[85] Theoretically, it is also in charge of enforcing compliance with the Code of

[80] The *Informe de Actuación Anual* is similar to the 10-K. Regulations 8-2000 and 18-2000, Art. 71, 79 of SL.
[81] Though some companies may include an analysis of perspectives, for example *Compañia Istmeña de Seguros*, S.A.
[82] Decree-Law 5 of 1997.
[83] In 2000, 76 fines where imposed. In 2001 the number of fines was reduced to 42, while in 2002, 23 fines where applied.
[84] Public Accountant's Law 57 of 1978.
[85] An accountant's license requires a professional accounting degree, but no experience. Any licensed accountant can audit listed firms; there is no registration with the CNV. There are over 100 accounting firms and 5,000 accountants.

Ethics[86] and ensuring professional quality and liability. The *Junta* is the only body that can suspend or cancel a public accountant's license, but it has not imposed any public disciplinary sanction since it was created in 1978.

Policy recommendations: Statutory auditors need an effective oversight mechanism. It should provide the following functions: (1) qualification of auditors; (2) setting professional standards; (3) enforcing those standards through on-site inspections and disciplinary proceedings and; (4) reporting to the public. Assessing the extent to which accounting and auditing standards are observed would require a ROSC review of accounting and auditing practices.

Principle IVC: An annual audit should be conducted by an independent auditor in order to provide an external and objective assurance on the way in which financial statements have been prepared and presented.

Assessment: ***Partially observed***
Description of practice: The standard of auditor independence is quite stringent. An independent auditor[87] cannot have been employed in a management capacity, be related by family to such persons, or have financial interests with the company. Auditors are, in practice, appointed and removed by the board of directors. The CNV recently opined (no power of law) that certain non-audit services conflict with auditor independence.[88] Audit and consulting fees are not disclosed in the annual report. Rotation of audit teams (not audit firms) is to occur every three years.[89] Auditors are obliged to report criminal activities to the Attorney General. Auditors rarely issue qualified opinions. They are typically not present at the AGM to notify shareholders of any concerns. Auditing liability exists and has been invoked in court in a recent case.[90]

Policy recommendations: Duties of auditors to warn the AGM of problems with the financial statements should be strengthened. Three-year rotation rules may be excessively short, as there are benefits to auditors knowing the company well. A five year rule may be more appropriate, in accordance with international practice (e.g. seven years in the US, five years in France).

Principle IVD: Channels for disseminating information should provide for fair, timely, and cost-effective access to relevant information by users.

Assessment: ***Largely observed***
Description of practice: Issuers have 60 days after the close of each quarter and 90 days after the close of the fiscal year to file reports with the CNV. Companies have the option of publishing the annual report in a national newspaper or specialized magazine, mailing it to all shareholders, or making it available on their website.[91] In practice, companies often only publish a summary.

Material facts, defined as information that may significantly affect the price of a security,[92] must be disclosed in real time. The announcements are not pre-vetted by the PSE, and trading is not suspended. The law provides for an exemption if management considers that the disclosure of the information would damage company interests. This exemption carries the potential for abuse.

Policy recommendations: Investors should have access to complete annual reports in a timely

[86] The *Junta* attempted to enforce uniform compliance with IFRS, but was successfully challenged before the Supreme Court. However, in the case of listed firms, IFRS is mandatory. This is regulated by the CNV in the case of firms and by the Superintendency of Banks in the case of banks.
[87] Regulation No. 8-2000.
[88] Opinion No. 8-2003, issued in December 10, 2003.
[89] Regulation No. 8-2000.
[90] BNP vs. KPMG. Subsequent to this case, Law 45 of 2003 further imposed criminal liability on auditors. Insurance is not popular among domestic auditors.)
[91] Regulation 18-2000.
[92] Article 77 of SL.

fashion, e.g. the CNV should publish filings on its website. Issuers should not be able to invoke the "sensitive information" exemption without express CNV permission, and there should be strict conditions and a time limit to any exemption.

Section V: The Responsibility of the Board

Principle VA: The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders. Board members should act on a fully informed basis, in good faith, with due diligence and care, and in the best interest of the company and the shareholders.

Assessment: ***Largely observed***

Description of practice: Panama has a single-tier board structure with a minimum of three directors. In practice, the top ten listed firms have an average board size of 7.5, ranging from three to 14 members. Directors can hide behind legal vehicles when serving on the board, which renders the pursuit of director liability problematic.[93] There are no requirements for director qualifications or independence by law. The typical board consists of directors representing the main shareholder, the general manager (who, in some cases, is also the chairman, as in four of the top ten listed firms), an attorney as a secretary, and possibly an important businessman related to the company, e.g. as a major supplier or customer. Within a business group, the senior owners commonly sit on the holding board, while more junior family members sit on subsidiary boards. There is a significant overlap among boards of holding and subsidiary companies. The board is accountable to the company and to third parties, but not directly to shareholders.[94]

Policy recommendations: The board should be accountable to the company and to shareholders. Companies should not be allowed to nominate legal persons or nominee directors to the board, and board remuneration should be disclosed.

Principle VB: Where board decisions may affect different shareholder groups differently, the board should treat all shareholders fairly.

Assessment: ***Partially observed***

Description of practice: Directors are liable for a duty of care and diligence;[95] however, this duty has never been invoked in a court of law. The law does not provide for a "business judgment rule." Other duties are not expressly spelled out. By recommendation of the Corporate Governance Guidelines, directors have a duty to inform the board in case of conflict of interest, and are recommended not to use corporate business opportunities for their personal benefit.

Policy recommendations: The fiduciary duties of the board should be more clearly set forth in the law, in order to clarify the board's responsibility to the company and all shareholders. Shareholder ability to invoke director liability should be strengthened.

Principle VC: The board should ensure compliance with applicable law and take into account the interests of stakeholders.

Assessment: ***Largely observed***

Description of practice: Directors have a general duty to obey the law, articles of incorporation, and bylaws. The board has no legal obligation to take into account stakeholder interests. Director duties do not switch to creditors in bankruptcy, but there are associated liabilities, e.g. if they declare dividends or distribute assets that reduce the value of the assets of the company to less than the amount of its obligations. Furthermore, creditors have the (court-granted) right to administer the debtor upon default, whereby directors cede control.

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93 Decree-Law 5 of 1997.

94 Article 41 of SL (Article 444 of the CC).

95 Article 979 of the Civil Code provides a general duty of *Pater Familias*. The liability is provided in Article 41 of SL (Article 444 of the CC).

Principle VD: The board should fulfill certain key functions, including (1) Reviewing and guiding corporate strategy, major plans of action, risk policy, annual budgets and business plans; setting performance objectives; monitoring implementation and corporate performance and overseeing major capital expenditures, acquisitions and divestitures. (2) Selecting, compensating, monitoring and, when necessary, replacing key executives and overseeing succession planning. (3) Reviewing key executive and board remunerations, and ensuring a formal and transparent board nomination process. (4) Monitoring and managing potential conflicts of interest of management, board members and shareholders, including misuse of corporate assets and abuse in related-party transactions. (5) Ensuring the integrity of the corporation's accounting and financial reporting systems, including the independent audit, and that appropriate systems of control are in place, in particular, systems for monitoring risk, financial control, and compliance with the law. (6) Monitoring the effectiveness of the governance practices under which it operates and making changes as needed. (7) Overseeing the process of disclosure and communications.

Assessment: ***Partially observed***

Description of practice: In practice, the board fulfills all key functions; however, such regulation is spelled out only for banks.[96] The Corporate Governance Guidelines prescribe powers and duties of directors, but do not have the force of law. (1) The board has absolute control of the business of the corporation. (2) The board plays a key role in the selection, compensation, monitoring, and replacement of key executives. In the largest listed companies, there is professional management unrelated to the board. (3) It reviews key executive and board remuneration. While sitting fees are usually nominal,[97] in some cases, director remuneration is a percentage of profits and can be substantial. The board nomination process is not transparent, since *ex-ante* no information is filed on newly-nominated directors. Further, any shareholder can nominate directors at the AGM without prior arrangements. (4) Insider-dominated boards may not succeed in preventing misuse of corporate assets and abuse in related-party transactions. (5) Directors do carry liability for preparation and presentation of financial statements. (6) The Guidelines prescribe a "comply or disclose" policy on corporate governance practices that will take effect in 2005. (7) The board is responsible for overseeing disclosure and communication.

Policy recommendations: It is advisable that the key functions of the board be formally spelled out for listed firms. Director training and awareness-raising would aid directors to fully understand their rights, responsibilities and liabilities. Disclosure of individual director compensation may provide a first step to preventing abuse through insider over-payment.

Principle VE: The board should be able to exercise objective judgment on corporate affairs independent, in particular, from management: (1) boards should consider assigning a sufficient number of non-executive board members capable of exercising independent judgment to tasks where there is a potential for conflict of interest. Examples of such key responsibilities are financial reporting, nomination, and executive and board remuneration. (2) board members should devote sufficient time to their responsibilities.

Assessment: ***Materially not observed***

Description of practice: There is no statutory requirement for listed firms to have independent directors. The chairman[98] usually is, or represents, the main shareholder. The Corporate Governance Guidelines recommend that 20 percent of directors be independent and that an audit committee with at least 30 percent independent members be created. In contrast, banks must have a 100 percent independent audit committee. Directors are not considered independent if they hold over 5 percent of shares, have management functions, or are related to those who do. There is no maximum term for directors or limit on the number of directorships held. There are no statutory requirements for the frequency of board meetings. In practice, meetings may be every two to three months. Board minutes and attendance records are not public.

Policy recommendations: Good practices are moving in the direction of a greater role for special purpose board committees, particularly in the areas of audit and compensation. While it may not be practical in the Panamanian context to require a certain number or percentage of independent directors on the boards of listed companies, board members should make public their relationship

[96] Regulation No. 4-2001.
[97] About USD 100 per board meeting.
[98] Referred to as President.

to controlling shareholders, management and the company. It is also important that directors devote enough time to their duties. Policymakers should consider whether it would be advisable to make mandatory the filing of board minutes with the CNV.

Principle VF: In order to fulfill their responsibilities, board members should have access to accurate, relevant and timely information.

Assessment: ***Largely observed***
Description of practice: There is no statutory right for individual directors to access information, but courts can grant access to internal company documents to the board as a whole.

Policy recommendations: Regulations should be adopted to grant access to internal company documents to individual (and particularly independent) directors.

IV. SUMMARY OF POLICY RECOMMENDATIONS

This section summarizes, extends and prioritizes the above recommendations to improve Panama's compliance with the OECD Principles. Key themes can be summarized as follows:

Legislative reform. Given the reluctance to make any changes to the CL that would make it less flexible, policymakers should consider introducing corporate governance reforms for listed firms through amendments to the SL. The SL should also explicitly grant CNV the power to regulate listed companies; in general, CNV's jurisdiction and regulatory powers need to be clarified and upheld. Ownership disclosure of ultimate owners should be significantly strengthened to permit the identification of significant shareholders. Regulation on proxy solicitation should be re-introduced, e.g. along the lines of Regulation 16-2000. ***Priority: high***

Enforcement. Emphasis on the enforcement of CNV regulations is a priority. The assessment recommends improved enforcement of disclosure provisions, with increasing emphasis on a review of content. CNV staff should be trained to gain awareness of corporate governance issues and abuses. Emphasis should be placed on the disclosure of ownership and related-party transactions. Law 45 of 2003 makes a first step in holding directors more accountable for their actions. Efforts in this direction need to be continued. One possible avenue to be explored is the requirement for issuers to file board minutes with the CNV. ***Priority: high.***

Institutional strengthening. The governance structure of CNV may be reconsidered in order to strengthen CNV's enforcement powers. An in-house appeals committee, independent of the Commissioners, for example, would ease the enforcement process, since current recourse is immediately at the court level. An alternative - that of implementing a single regulator over banks, insurance and pension companies, and issuers - is currently under discussion and should be carefully considered. This would enable a single monitor over business groups to tackle issues that several bodies with overlapping jurisdiction are less able to do. Shareholder redress should be a more practical option. A more active role for the securities regulator in this respect would be helpful. Finally, an effective oversight mechanism for statutory auditors should be created in order to improve the certification and quality of auditors. ***Priority: medium***

Voluntary/private initiatives. Audit committees should be introduced in listed non-bank companies, as the Corporate Governance Guidelines foresee. The creation of a director training organization will help increase director professionalism, as training is provided (on a fee basis); and in addition represents a driving force for corporate governance advocacy, providing input into future reforms. ***Priority: medium.***

Annex A: Summary of Observance of OECD Principles of Corporate Governance

Principle		O	LO	PO	MO	NO	Comment
I. THE RIGHTS OF SHAREHOLDERS							
IA	Basic shareholder rights		X				• Basic rights observed. Law fails to regulate AGMs and director election. Some weaknesses in annual disclosures.
IB	Rights to participate in fundamental decisions.			X			• Shareholders participate in most fundamental decisions with 50 percent majority. Weak AGM approval rights of changes in bylaws. No pre-emptive rights.
IC	Shareholders AGM rights			X			• No formal AGM quorum; shareholders cannot add to the agenda. AGM notice period ten days. 5 percent of shareholders can call shareholder meeting.
ID	Disproportionate control disclosure				X		• Companies disclose at 25 percent level. Ultimate ownership, shareholder agreements, and capital structure not well disclosed. Buy-backs should be cancelled after a period.
IE	Control arrangements should be allowed to function.		X				• Limited takeover rules. No delisting or squeeze-out rules.
IF	Cost/benefit to voting				X		• At present, uncommon for institutional investors to have voting policies, and most do not vote.
II. EQUITABLE TREATMENT OF SHAREHOLDERS							
IIA	All shareholders should be treated equally				X		• Neither court nor CNV redress is practically available. No dissenting/withdrawal rights.
IIB	Prohibit insider trading		X				• Insider trading enforcement is adequate, and will be further strengthened with a future electronic surveillance system.
IIC	Board/Mgrs. disclose interests		X				• Accounting standards follow IAS 24. RPTs not approved by AGM, and related parties can vote on board approvals.
III. ROLE OF STAKEHOLDERS IN CORPORATE GOVERNANCE							
IIIA	Stakeholder rights respected	X					• Stakeholders have a number of legal protections. Employee have extensive legal and contractual rights.
IIIB	Redress for violation of rights	X					• Stakeholder have access to legal process to obtain redress.
IIIC	Performance enhancement		X				• Profit-sharing is rare (banks use it); options are not regulated.
IIID	Access to information	X					• Employees, bondholders have rights to information by law.
IV. DISCLOSURE AND TRANSPARENCY							
IVA	Disclosure standards			X			• Annual and quarterly reports. Some missing non-financial disclosure (ownership, identity of beneficiary behind legal bodies as directors, board remuneration, governance).
IVB	Standards of accounting & audit			X			• IAS or US GAAP used. Weak enforcement of compliance.
IVC	Independent audit annually			X			• Good auditor independence and liability provisions. Auditor warning of problems to AGM is weak.
IVD	Fair & timely dissemination		X				• Many channels of information. Annual reports not published in their entirety. “Sensitive information” exemption abused.
V. RESPONSIBILITIES OF THE BOARD							
VA	Acts with due diligence, care		X				• Single tier boards. Often, Chairman and CEO are same person, or from the same family. Insider-dominated board not sufficiently accountable to company and shareholders.
VB	Treat all shareholders fairly			X			• Limited legislative guidance on duty of care and duty of loyalty, no cases. Weak /impracticable director liability rules.
VC	Ensure compliance w/ law		X				• Directors have a general duty to observe law and articles.
VD	The board should fulfill certain key functions			X			• Boards are captive to majority owners, and their oversight of board nomination / remuneration, as well as prevention of assets misuse and related parties abuse, is weak.
VE	The board should be able to exercise objective judgment				X		• No statutory rules that govern independence for issuers, except for banks. Weak definition of independence.
VF	Access to information		X				• Court-granted access to information to the board as a whole, but not to individual directors.

Annex B: Summary of Policy Recommendations

I. THE RIGHTS OF SHAREHOLDERS		
IA	Basic shareholder rights	• Require listed companies to hold an AGM. • Require financials to be available well in advance of the AGM. • Specify in the law a mechanism for election of directors, including advance nomination and detailed information on each director in advance of AGM.
IB	Rights to participate in fundamental decisions.	• Require AGM approval for changes in bylaws. • Introduce mandatory pre-emptive rights.
IC	Shareholders AGM rights	• Consider extending meeting notice period to 30 days. • Require advance placement of items on the agenda, forbid ad-hoc item decisions at AGM with no prior notice, as well as generic agenda items. • Require the enclosure of relevant documents in proxy solicitation materials.
ID	Disproportionate control disclosure	• Require disclosure of rights of share classes and holdings of major owners in annual report. • Require disclosure of shareholder agreements. • Require cancellation of treasury shares after a certain time, e.g. one year.
IE	Control arrangements should be allowed to function.	• Introduce a de-listing mechanism, including a minimum price for squeeze-outs. • Develop in more detail the OPA section of the law.
IF	Cost/benefit to voting	• Develop detailed regulation of pension funds, addressing also conflict of interest issues. • Consider requiring pension funds to disclose their voting policies.
II. EQUITABLE TREATMENT OF SHAREHOLDERS		
IIA	All shareholders should be treated equally	• Consider authorizing the CNV to intervene on behalf of shareholders after investigation. • Create dissenting/withdrawal rights for shareholders who disagree with AGM resolutions. • Consider lengthening the term for nominees to notify shareholders of an AGM.
IIB	Prohibit insider trading	• Mandate disclosure of insider holdings as material facts.
IIC	Board/Mgrs. disclose interests	• Forbid voting on RPTs by related parties with material interest in the transaction. • Consider requiring audit committees, whose tasks would include the pre-vetting of RPTs.
III. ROLE OF STAKEHOLDERS IN CORPORATE GOVERNANCE		
IIIA	Stakeholder rights respected	NA
IIIB	Redress for violation of rights	NA
IIIC	Performance enhancement	• Pay careful attention to the international debate on the use/abuse and expensing of stock options before adopting such practices.
IIID	Access to information	NA
IV. DISCLOSURE AND TRANSPARENCY		
IVA	Disclosure standards	• Extend CNV enforcement to include the monitoring of the quality of information filed.
IVB	Standards of accounting & audit	• Create an independent auditor supervisory body.
IVC	Independent audit annually	• Strengthen the auditor duty to warn the AGM of problems with the financial statements.
IVD	Fair & timely dissemination	• Mandate the publication of the annual reports in full, including notes to statements. • Require CNV permission to issuers to invoke the “sensitive information” exemption.
V. RESPONSIBILITIES OF THE BOARD		
VA	Acts with due diligence, care	• Strengthen board accountability to the company and to shareholders. • Forbid the nomination of legal persons to board. • Mandate the disclosure of board remuneration.
VB	Treat all shareholders fairly	• Clearly set in the law the fiduciary duties of the board. • Strengthen shareholder ability to invoke director liability.
VC	Ensure compliance w/ law	NA
VD	The board should fulfill certain key functions	• Spell out in the law the key functions of the board for listed firms. • Undertake director training and awareness-raising for director rights, duties and liabilities.
VE	The board should be able to exercise objective judgment	• Consider the usefulness of special purpose board committees, e.g. audit, compensation. • Require board members to disclose their relationship to controlling shareholders, management and the company. • Consider mandating the filing of board minutes with the CNV.
VF	Access to information	• Create rules granting access to internal company documents to individual (and particularly independent) directors.

Annex C: Markets and Market Participants

Panama's capital market is small and illiquid, though its market capitalization to GDP is comparable to those of Brazil or Argentina.. Value traded, and turnover relative to market capitalization are lower than those of comparison countries, based on standard market indicators.

Panama and Selected Latin American Countries: 2002 Equity Market Statistics

	Market Capitalization		Value Traded	Turnover	# of Listed
	mln. USD	% of GDP	% of GDP	Ratio	Companies
Panama	**3,225**	**37.9**	**0.004**	**0.02**	**25**
Argentina	38,927	30.00	0.91	1.66	107
Brazil	234,560	47.11	1.21	3.37	367
Chile	86,291	125.74	0.91	0.93	240
Colombia	14,258	18.30	0.08	0.55	114
Ecuador	2,153	7.85	0.02	0.23	30
Jamaica	8,500	114.83	0.27	0.28	39
Mexico	122,532	19.57	0.27	1.52	159
Peru	16,055	26.26	0.13	0.52	197
Trinidad and Tobago	10,605	102.73	0.46	0.55	35

Source: World Bank World Development Indicators. GDP figures from EIU. All figures for year-end 2003, Panama figures April 2004.

Note: Central American markets are small and illiquid. For example, Honduran equities did not trade in 2003.[1] There is therefore no reliable data in the past five years on market capitalization and trading volume in those countries. To give an approximate idea of the size of Central American stock markets, below are some dated statistics (note that Belize does not have a stock market):

	Market Capitalization		Value Traded	Turnover	# of Listed
	mln. USD	% of GDP	% of GDP	Ratio	Companies
Costa Rica	2,300	14.56	1.37	12.00	22
El Salvador	1,520	11.01	0.17	1.30	32
Guatemala	232	1.11	0.03	0.01	10
Honduras	n.a.	n.a.	0.05	n.a.	32
Nicaragua	n.a.	n.a.	0.07	n.a.	11

Source: World Bank World Development Indicators. Honduras and Nicaragua figures from the respective stock exchange websites. Costa Rica data for 1999, El Salvador and Guatemala data for 2001, Honduras and Nicaragua data for 2003.

[1] Source: Honduras stock exchange web-site.

Annex D: Court Challenges to the Regulatory Powers of the CNV

Elaborations of the Securities Law are the purview of the securities regulator, the *Commission Nacional de Valores* (CNV). Nonetheless, the power of the CNV to regulate issuers has been at times, and successfully, challenged in court, setting a dangerous precedent and undermining the CNV's ability to enforce the law and issue rules and regulations. By the Securities law (SL), the CNV can issue: *Acuerdos,* which are binding; *Opiniones,* which are non-binding legal interpretations; and *Resoluciones*, which refer to specific CNV decisions, e.g. the granting of a stock-broker license.

For example, Article 284 of the new Securities Law #1 of 1999 required all existing financial companies to renew their licenses, granted under the old Securities Law Cabinet Decree 247 of 1970. On October 2, 2000, the CNV issued Opinion 14o, 12-2000, which clarified the deadline for the new licenses to be obtained. The Panamanian Association of Securities Brokers (*Asociación de Agentes Vendedores de Valores de Panamá*) disputed this CNV Opinion before the Supreme Court, attempting to avoid the licensing expense.[1] After two and a half years of legal action, on April 23, 2003, the court upheld Opinion 12-2000 as legal.

As a second example, there is the much publicized case of the disputed proxy solicitation requirements, *Acuerdo 16-2000*. *La Prensa*, a large listed publishing firm, violated proxy solicitation requirements[2] at its AGM, held on March 22, 2001. In response to the CNV's investigation of the violation, a member of the board of *La Prensa* protested to the Supreme Court the CNV right to regulate proxy voting requirements by means of *Acuerdos*. Even though the CNV right to regulate the matter is expressly spelled out in Articles 91 and 93 of the Securities Law,[3] the plaintiff maintained the unconstitutionality of those articles. This claim was based on Article 179 of the Constitution, which states that only the Executive branch is authorized to regulate legal matters. The Supreme Court held that, while the CNV was authorized to issue *Acuerdos* under Decree Law 1 of 1999, it was not authorized to issue *Acuerdos* relating to proxy voting requirements, because Articles 91 and 93 referred to "executive regulations," rather than CNV *Acuerdos*.

In sum, the regulatory powers of the CNV have been called into question for two principal reasons: (1) conflicts between the civil law framework in the country and the common law nature of securities law; and (2) lack of care in drafting certain parts of the new Securities Law. The power of the CNV to elaborate the SL is essential for effective enforcement of Corporate Governance issues by the regulator, and should be clarified and upheld.

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[1] The legal grounds for the protest was the civil law, holding that the law does not have effect on the past in detriment to vested rights (Article 3, Civil Code).

[2] Law 1 of 1999 (SL), *Acuerdo* 5-2000 and *Acuerdo* 16-2000.

[3] Article 91, Decree Law 1 of 1999: "Every person or group of persons that, acting together, requests of more than 25 beneficial owners of registered securities, voting proxies, authorization or consent in relation to any matter or meeting, must comply with the provisions of the present Title and with the regulations (so called "*Acuerdo*") adopted by the Commission on the procedures for distribution and use that must be given to said request, the information which must be divulged in it for the benefit of the stockholders and on the right form of said request." Article 93 of Decree Law of 1999: "Upon determining the information which must be included in the requests referred to in this Title, the Commission shall be limited to require the inclusion of information of importance so that the security holders can take informed decisions on the matter or the meeting referred to in the request for voting proxies, authorization or consent, and shall refrain from requesting information which does not comply with said purpose or impose a burden not justified on the person that must divulge said information. The Commission may establish different information disclosure requirements based on the type of matter or meeting which, is the subject of the request for voting power, or of the authorization or consent, in consideration of the issuer or of the security in question or of the type of security holder to whom the request is addressed, among other factors."

Annex E: Summary of Agreement 12-2003 (of November 11th, 2003)

Regulation 12-2003 prescribes a "comply or disclose" corporate governance policy, effective as of 2005. Its recommendations increase transparency, and define the duties and powers of directors and officers.

Duties of the Board of Directors, Article 6

The board: (1) establishes communication and information channels with stakeholders; (2) regulates conflicts of interest of board members and key executives; (3) appoints, removes and evaluates top executives; (4) is responsible for internal control mechanisms, including oversight of internal accounting records and monitoring of the financial position of the company, as well as corporate risk policies.

Related Party Transactions, Article 7

Board members and officer disclose conflicts of interest to the board. Payments to directors and officers, and personal interests in corporate business opportunities, are forbidden.

Independent Directors, Article 8

The majority of directors should be non-executive, and the General Manager, Operations Manager, and Financial Manager should not chair the board. It is recommended that 20 percent of directors be independent. A Director is not independent if he is the beneficial owner of at least 5 percent of shares with voting rights, has duties in the administration or management of the company, or is the spouse of or has family ties to any such individuals (Article 2.5).

Shareholder Rights to Information, Article 9

Shareholder access to information is augmented, namely on insider pay and auditor selection.

Audit Committee, Articles 2.2, 11-13

The audit committee examines, evaluates and surveys the accounting and financial system of the corporation, verifies the independence of the external auditor, and follows up on internal systems of management controls. The audit committee is composed of 30 percent independent directors, chaired by the Treasurer of the Board. Its basic powers are to receive direct reports from the internal auditor, and determine their remuneration, appointment and removal. It can also investigate any matter within its competence. The audit committee: proposes the hiring of the external auditor; reviews the corporate accounts; oversees the internal control systems; inspects the corporate assets; links internal and external auditors; oversees disclosure to shareholders; reviews the nature of other services rendered by the external auditors; and reviews the interim and annual financial statements of the corporation.

Compliance and Risk Administration Committee, Articles 2.3, 14, 15

The compliance and risk administration committee surveys compliance with corporate governance and other rules. It is composed of at least three non-executive members, and of 30 percent independent directors. The committee supervises compliance with the rules of corporate governance and makes written reports to the shareholder meetings; identifies corporate risks and creates the policies and proceedings for their administration; and verifies that all operations carried out between the corporation, shareholders and/or key executives are under arms-length conditions and are disclosed to the shareholders.

Nomination Committee, Articles 2.4, 16, 17

The nomination committee has at least five members, including at least three members of the Board, one of which must be independent; the General Manager, and the Financial Manager or equivalent, and at least 30 percent independent directors. The selection or replacement of a director will be discussed only by directors in the committee; key executive selection/replacement can be discussed by all members of the committee. The functions of the committee are to nominate independent directors, oversee their appointment and replacement, and evaluate their independence, as well as review key executive compensation and recommend key executives' removal if warranted.

Transparency and Disclosure, Articles 5, 19-24

The regulation mandates a "comply or explain" approach to the above requirements, in both the prospectus and periodic reports.