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Latin American Corporate Governance Roundtable*

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**White Paper Progress Report – Peru**

This paper was originally prepared jointly by Ms. Lilian Rocca Carbajal, Chair of CONASEV, Mr. Federico Oviedo Vidal, General Manager of the Lima Stock Exchange, and Mr. Carlos Eyzaguirre, consultant and former head of CONASEV in September 2005. It has been updated by Mr. Eyzaguirre and incorporates comments from Conasev as background for the June, 2006 meeting of the Roundtable. The original version was circulated more widely for review and comment and reflects input from representatives of the Pension Fund Association (AFP), National Confederation of Private Entrepreneurial Institutions (CONFIEP), the Supervisor of Banking, Insurance and Private Pension Funds Administrators (SBS), and Mr. Javier Tovar, attorney and former head of CONASEV. It is published under the responsibility of the OECD Secretariat.

## INTRODUCTION

Based on the reform priorities of the Latin American White Paper on Corporate Governance, this report provides comments regarding progress in Peru over the past three years, key developments, obstacles to progress and priorities for further improvement. The Policy recommendations of the Report on the Observance of Standards and Codes (ROSC) - Corporate Governance Country Assessment (Republic of Peru), completed as part of the joint World Bank - IMF Program of ROSCs in 2004, were taken into consideration.

While this report was originally prepared for the September, 2005 meeting of the Roundtable, it has been updated for the June 2006 Roundtable meeting in Buenos Aires with a new introduction to highlight most recent developments, and further adjustments to the main text of the report where changes have occurred. In updating this report, it is interesting to note that a new landmark was established and that progress has been made in all five areas considered as reform priorities.

In April 2006, a new landmark was established when FONAFE (Fondo Nacional de Financiamiento de la Actividad Empresarial del Estado - The State Owned Enterprises Holding) approved the Framework for Good Corporate Governance for State Owned Enterprises. The Framework is based on the OECD Guidelines and on best practices from selected countries. Also one previous landmark development has been improved: the Disclosure of Compliance with the Principles. Companies must answer more specific questions related to their compliance with the "Principles," and CONASEV has been working with the companies to improve their reporting.

In terms of the five priorities covered by the Latin American White Paper, the following developments have occurred over the past nine months:

- 1.- Taking Voting Rights Seriously: By clarifying the way to calculate the 5% of shares needed to request a special shareholders meeting, CONASEV has made it easier for shareholders to ask for such a meeting. Also, Congress has enacted regulation to promote the conversion or redemption of investment shares, which are equity securities without voting rights.
2. Treating Shareholders Fairly during changes in Corporate Control and Delistings: After public consultation, a new Public Tender Offer (OPA) and De-listing Offer (OPC) Rule was enacted. The new rule allows the acquisition of significant ownership prior to making the tender offer, simplifying the workings of the corporate control market.
3. Ensuring the Integrity of Financial Reporting and Improving the Disclosure of Related Party Transactions: The new rules simplify the type of information that companies have to disclose in relation to Indirect Ownership, Related Parties and Economic Groups. It also allows CONASEV to make certain presumptions with regard to related parties and economic groups that will help CONASEV improve transparency.
4. Developing Effective Boards of Directors: FONAFE is developing rules for the selection of board members and CEOs. FONAFE is also working to establish audit committees and on guidelines for director selection and performance evaluation.
5. Improving the Quality, Effectiveness and Predictability of the Legal and Regulatory Framework: Rule regarding "corrective measures". The new regulation allows CONASEV to impose corrective measures instead of sanctions when the offence hasn't had an effect in the market.

Many of these changes have yet to be put to a test since a very short period of time has passed since they have occurred. The new rules on disclosure of compliance with the "Principles" will help to evaluate how

the voluntary code is working in Peru. The Framework for SOEs is certainly a great step in improving the governance and efficiency of Peruvian SOEs.

The new OPA Rules bring us into un-chartered territory in Perú. It is a big change in the market for corporate control that opens the possibility for more activity in this market. The process of public consultation proved to be useful for the regulator to make changes according to what the market participants were asking.

Support for the effort being done by FONAFE in improving SOE corporate governance is clearly needed.

## **LANDMARKS**

In recent years, corporate governance awareness has been increasing in Peru, and some of its landmarks are: the publication of the Principles of Good Corporate Governance for Peruvian Corporations, Disclosure of Compliance with the Principles, and the regulation of the Fiduciary Duties of Private Pension Fund Administrators, which has led to an increased focus on election of directors that are independent of company management and the controlling shareholders. In April 2006, a new landmark was established when FONAFE ( Fondo Nacional de Financiamiento de la Actividad Empresarial del Estado - The State Owned Enterprises Holding) approved the Framework for Good Corporate Governance for State Owned Enterprises.

### **1. The Principles of Good Corporate Governance for Peruvian Corporations**

The Principles of Good Corporate Governance for Peruvian Corporations (from here on the Principles), were drafted by a committee in which both the public and the private sector participated. The Principles are a voluntary corporate governance code<sup>1</sup> that was made public in September 2002.

The Peruvian Securities Commission chaired the committee and its members were the Ministry of Finance (MEF), the Supervisor of Banking, Insurance and Private Pension Funds Administrators (SBS), the Lima Stock Exchange (BVL), the Banking Association (ASBANC), the National Confederation of Private Entrepreneurial Institutions (CONFIEP), the Association of Capital Market Promoting Enterprises (PROCAPITALES) and the Center of Studies on Financial and Capital Markets (MC&F).

### **2. Disclosure of Compliance with the Principles**

With the 2004 annual report, listed companies have started to disclose their compliance with the Principles. General Management Rule N° 096-2003-EF/94.11 was published in December 2003,<sup>2</sup> and its purpose is the promotion of best practices and the disclosure of the degree of compliance with the Principles by listed companies.

This resolution mandates the inclusion of information on shareholder structure, independent directors, board committees and remunerations in the annual report and in the prospectus of listed companies. It also includes a new appendix in the annual report: "Information on Compliance with the Principles of Good Corporate Governance for Peruvian Corporations".

In order to improve the quality of the disclosure, changes to this resolution were published in January 2006 (General Management Rule N° 140-2005-EF/94.11, 07/01/2006). Companies must answer more specific questions related to their compliance with the "Principles". CONASEV invited the administrators of listed

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<sup>1</sup> The Principles are divided in six chapters: I. The Rights of Shareholders, II. The Equitable Treatment of Shareholders, III. The Role of Stakeholders, IV. Disclosure and Transparency, V. The Responsibilities of the Board, VI. Non-listed Companies.

<sup>2</sup> Disclosure of how companies are implementing this voluntary code became mandatory on January 1, 2005.

companies to CONASEV and explained to them what kind of quality of disclosure was expected and what was the purpose of this disclosure.

### **3. Fiduciary Duties of the Private Pension Funds Administrators (AFPs)**

The Supreme Decree N° 182-2003-EF published in December 2003 modified several articles of the Regulations of the Law of the Private Pension Fund Administrators System that had been approved by Supreme Decree N° 004-98-EF.

The modified article 94 states that the representatives of the AFPs have to perform the duties and defend the rights that pension funds have as holders of securities. Also, the representatives of the AFPs have to follow best corporate governance practices and promote them in the portfolio companies of the administered pension funds.

Before these changes, article 94 only established that the AFPs had the right to elect board members in the portfolio companies of the administered Pension Funds. Also, the AFPs couldn't participate in or interfere with the administration of the portfolio companies of the pension funds.

### **4. The Framework for Good Corporate Governance for State Owned Enterprises (SOEs)**

FONAFE, the state ownership agency responsible for co-ordinating governance of state-owned enterprises, has established a Framework for Good Corporate Governance of SOEs, based on the OECD Guidelines and on best practices from selected countries. Each SOE is developing its own code following the Framework. Completion of the codes is expected by June 2006. FONAFE is also developing rules for the selection of board members and CEOs. For example, in the case of CEOs the board will propose three candidates, an executive recruitment firm will evaluate them and the board will take this evaluation into account when making their decision. FONAFE is also working to establish audit committees and in guidelines for director performance evaluation. For the first time, consolidated financial statements have been done and published for the SOEs as a group; this has been done for fiscal year 2004 and it is expected that fiscal year 2005 consolidated statements will follow soon.

## **COMMENTS TO THE REFORM PRIORITIES**

### **1. Taking Voting Rights Seriously**

Overall, there has been some progress in the degree to which shareholder voting rights are understood and recognized, including through increased attention given to the Peruvian Principles of Corporate Governance.

#### **a) The Principles of Good Corporate Governance for Peruvian Corporations and Voting Rights**

In the appendix "Information on compliance with the Principles of Good Corporate Governance for Peruvian Corporations," listed companies disclose their degree of compliance with some of the recommendations of the Principles. The recommendations that facilitate effective shareholder participation in general shareholder meetings and the exercise of voting rights which are evaluated in the appendix are:

- Generic items should be excluded from the agenda.
- General shareholder meetings must be held in an easily accessible location.
- Shareholders should be allowed to introduce items in the agenda of the general shareholder meetings.
- The bylaws of listed companies shouldn't limit the rights of shareholders to appoint any person as a representative.

In a sample<sup>3</sup> of listed companies (from now on “the sample”) based on the report on compliance with the principles corresponding to financial year 2004, 93% of the companies indicated full compliance with the recommendations (this is a subjective evaluation, the scale goes from one to four). However, CONASEV’s review of the reports reveals that the companies didn’t give any explanation at all or the explanations that they gave weren’t good enough to support their subjective evaluations.

Regarding financial year 2005, according to companies information<sup>4</sup> there is a light reduction in the average ratings provided through companies’ subjective evaluations. However, companies that participate in the public securities market have provided better and more specific information about the degree of their compliance with corporate governance recommendations.

#### b) Calling Shareholder Meetings of Sociedades Anónimas Abiertas (SAAs) by CONASEV

The Ley General de Sociedades (LGS), which is Peru’s Corporations Law, sets out rules and restrictions concerning the governance of SAAs<sup>5</sup>.

SAAs are public companies; therefore according to regulation they must list on a stock exchange. However, not all listed companies are SAAs. Currently, there are 229 issuers registered in CONASEV, of which 53 are SAAs. Any company must be transformed into or adapted to (depending on whether it changes company form or company category) an SAA when it meets one or more conditions stated by the LGS (described in footnote 4).

Peru’s Corporations Law states that CONASEV must call a general shareholder meeting for SAAs when: a) the board doesn’t call a meeting in the circumstances mandated by the law or the by-laws; b) shareholders representing at least 5% of the voting stock request the board to call a meeting, the board doesn’t call it and these shareholders request CONASEV to call the meeting.

In December 2003, CONASEV issued a rule<sup>6</sup> concerning the rights of shareholders of SAAs to request information pertaining to the SAA economic performance and the cases in which CONASEV calls a meeting.

The rules develop the way in which CONASEV must perform its duties of supervision and control of SAAs. Accordingly, CONASEV can take the measures needed to guarantee that general shareholder meetings are effectively held. The regulation has also specified the types of sanctions that apply in each case.

During 2004, CONASEV convened three general shareholder meetings of SAAs.

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<sup>3</sup> The sample includes 55 listed companies. Of these 55 companies: 28 companies have securities that form part of the General Index of the Lima Stock Exchange, 30 companies are issuers of public offerings (80% of the outstanding debt as of December 2004) and eight are new issuers of public offerings (since 2004). Economic sector they belong to: agricultural 2, banking and finance 10, industrials 15, mining 10, public utilities 8, insurance 1, foreign issuers 2, “other” 7.

<sup>4</sup> Information reviewed by CONASEV until May 15, 2006.

<sup>5</sup> Article 249 of the LGS states that a company is a Sociedad Anónima Abierta when one or more of the following takes place:

- a) Has made a public offering of stock or convertible debt;
- b) Has more than 750 shareholders;
- c) More than 35% of its equity belongs to 165 or more shareholders, without taking into account those shareholders whose individual holdings represent less than 2/1000 or more than 5% of its capital;
- d) Is declared as such in its by-laws;
- e) All shareholders unanimously approve its conversion to SAA.

<sup>6</sup> CONASEV Rule N° 111-2003-EF, published December 30, 2003. Particularly the resolution’s objective was to regulate Article 253 (clauses 3 and 4) and Article 255 of the LGS.

More recently, in 15 February 2006, CONASEV Rule N° 007-2006-EF/94.10 was issued. In this ruling CONASEV established that in order to ask for a special general shareholders meeting, the 5% of shares needed to request the meeting has to be calculated taking into account only the shares that belong to the class of shares asking for the meeting. Shares that have their voting rights suspended (for being part of the portfolio holdings of the company or its subsidiaries) must not be taken into account. In this way the law can be enforced more easily. CONASEV has also specified that when shareholders request to convene a meeting, they don't have the power to evaluate or modify the items on the agenda.

c) Institutional Investors and Voting Rights

As explained above, the new article 94 of the Regulations of the Law of Private Pension Fund Administration System states that representatives of the AFPs must defend the rights of the pension funds as securities' holders (while acting independently of the interests of the AFPs), follow best corporate governance practices and promote the adoption of these practices by the administrative bodies of the portfolio companies of the funds. The representatives of the AFPs must cast their votes on the issues being discussed, make sure their votes are registered in the minutes of the meetings, and report back to AFPs.

The SBS is working to detail the regulation pertaining to the conduct of the representatives of the AFPs, the rules they must follow for the election of board members, and the sanctions for not complying with the rules. The SBS has noted in this project that the most efficient way to defend the rights of the pension fund contributors, who are the real "owners" of the pension fund shares in the companies, is through the election of independent directors who can contribute to the administration and management of the corporations, and at the same time defend the interests of all the shareholders and not only those of the majority groups or the controlling shareholders.

d) Withdrawal rights in the case of a "Reorganización Simple"

In a "reorganización simple," one or more company's assets are transferred to create a new corporation(s) or an existing one(s). The company receives in exchange shares of the new or existing corporation(s) to which the assets were transferred<sup>7</sup>.

Since, the effect of this procedure can be the same as with a merger or a spin off, and in these two cases shareholders have withdrawal rights, (but not in the case of "reorganización simple"), CONASEV has drafted a project that gives withdrawal rights to shareholders in cases of "reorganización simple," and gives creditors the possibility to challenge these processes.

e) Investment shares

Investment shares are securities that do not give their owners the right to vote or to participate in Shareholder Meetings<sup>8</sup>. Corporations' awareness of corporate governance principles and its importance have been increasing over time. Consequently, some enterprises have considered that maintaining investment shares wasn't a plus for them (either for conceptual or practical reasons regarding funding through international markets or to have a better public image). Hence, there has been a gradual process by which some listed companies have voluntarily converted their investment shares into common stock (either voting or non-voting shares), thus decreasing the amount of investment shares that remain in public hands. However, investment shares remain a significant part of the market, still accounting for 7.7% of market capitalization, 17.5% of the traded amount of stocks, and 41.6 % of the total number of trades with stocks (from January to June 2005).

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<sup>7</sup> Article 391 of the LGS.

<sup>8</sup> Investment shares were created by law in the 1970s and are not considered as shares by the LGS.

**f) Law that promotes the conversion or redemption of Investment Shares, Law 28739, 23May 2006**

The purpose of the law is to promote the conversion of investment shares to common shares, bonds or commercial paper, or their redemption. In the absence of explicit acceptance or rejection of the offer, the company can consider that its offer has been accepted if, after publishing the names of those who haven't accepted or rejected the offer, the offer isn't rejected. A valuation company that must be registered with CONASEV determines the price. Valuation criteria are established by CONASEV. For listed shares, the price to be offered for the exchange or redemption can't be lower than its six-month average price.

**OTHER PRIORITIES**

- CONASEV should be able to convene general shareholder meetings for all listed companies and not only for SAAs. The regulation could follow the existing regulation for SAAs that was explained above.
- For listed companies that aren't SAAs, extend the period of time that goes from the publication of the notice calling for the meeting and the day when the meeting takes place. Currently, the notice calling for the meeting must be published 25 days in advance for SAAs and 10 days for other listed companies.
- The percent of voting stock needed to include items in the agenda should be lowered. Currently, shareholders representing 5% of voting stock of SAAs can request the inclusion of new items in the agenda and 20% for the case of other companies. This last percentage should be reduced.

**2. Treating Shareholders Fairly during changes in Corporate Control and Delistings**

**a) Public Take Over Offers (OPA) and De-listing Offers (OPC)**

The Principles recommend that shareholders should have the right to receive the premium paid to take control of a company. The management of the company being taken over should behave with neutrality and shouldn't take defensive measures unless agreed by the general shareholder meetings. During changes of control the valuation criteria behind the offer should be clearly spelled out.

The Principles recommend that de-listing rules should provide reasonable pricing procedures for the shares being de-listed.

There has been a gradual improvement in OPA rules. Changes have been made both in form and content.

OPA regulation was first clearly spelled out in the 1996 Capital Markets Law (Decreto Legislativo 861). In 2002, Law 27649 made changes in the Capital Markets Law that included improvements in OPA and OPC rules<sup>9</sup>.

Amendments to OPA rules specify that these tender offers are mandatory for those who "intend" to acquire or increase their holdings in a corporation that has at least one class of voting shares listed in the Stock Exchange. In addition CONASEV was given more power to regulate OPAs. A particular case to be regulated was the one in which an OPA is mandatory after a significant acquisition has taken place ("subsequent take over offer" in this case).

Law 27649 included OPC rule changes for securities without market price and opened the possibility that CONASEV appoints not only auditing companies to determine the de-listing price, but also, banks, investment banks or consulting companies. Valuation has to be done using internationally accepted valuation techniques.

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<sup>9</sup> The Unified Text of the Capital Market Law was enacted by Supreme Decree N° 093-2002-EF.

A 2002 CONASEV Rule modified OPC regulation regarding the use of market price to take into account market conditions like liquidity, traded volume and trading done by the party wishing to de-list the stock or related parties. CONASEV decided to suspend the use of the weighted average price (of the last three months prior to the de-listing request) as the de-listing price. As a consequence, the majority of companies that wish to de-list shares must hire a valuation company to determine the de-listing price. CONASEV appoints the valuation company through a competitive bidding process. Such company has to be independent of the company that is de-listing its shares. (See CONASEV Rule 018-2002-EF/94.10) This regulation is now included in the new takeover and de-listing rules mentioned below.

After public consultation a new Public Tender Offers (OPA) and De-listing Offers (OPC) Rule was enacted (Resolución CONASEV N° 009-2006-EF/94.10, 4 March 2006). OPAS take place after significant acquisitions are made. Before this rule, a significant acquisition took place after buying shares that represented 25% of the voting stock. Now a significant acquisition also takes place when someone acquires a number of shares or obtains the political rights that allow him to elect or remove the majority of the board or change the company charter. Also, with the new Rule the cases in which an OPA is mandatory after a significant acquisition has taken place (“subsequent tender offer”) are the following: a) when the acquisition is the consequence of acquiring the parent company b) when the acquisition is the consequence of buying the shares in a public offering c) when the significant acquisition is made in one single purchase or d) when it is made through no more than four purchases within a period of three years. The price to be paid can’t be lower than the price set by a valuation company. These changes are intended to simplify the market for corporate control. Also, before this rule, a competitive offer that increased the price automatically substituted the original offer. Now the new and the old offer can co-exist. Parallel to this, the investors can change their decision to accept an offer at any time. Before, once the shares were tendered, the investors had to wait until the offer expired to request their shares and only if the offer failed.

#### OTHER PRIORITIES

- Given the lack of liquidity in Peruvian capital markets, CONASEV is working on a project to modify the Ley General de Sociedades (LGS) in order to specify a better criterion to establish the price that must be paid when withdrawal rights are exercised. This project would make changes to Article 200 of the LGS that would give CONASEV the power to establish criteria to set that price. The criteria will most likely be similar to those applied to OPCs.

### **3. Ensuring the Integrity of Financial Reporting and Improving the Disclosure of Related Party Transactions**

#### a) International Standards

Companies are mandated to use IAS (International Accounting Standards) since 1994. Companies must apply norms that were modified and issued by the International Accounting Standards Board in December 2003 and March 2004 (IAS and International Financial Reporting Standards) starting January 1<sup>st</sup> 2006 (on a voluntary basis since 2005).

However it is worth noting that article 31 of the Capital Markets Law allows banks, finance companies, insurance companies, AFPs and other entities under the SBS supervision to present their financial statements in a way that the SBS has regulated. As a consequence, there isn’t full compliance with international accounting standards.

The Rule for preparing and presenting financial information<sup>10</sup> defines auditor independence. The definition includes most of the international standards of auditor independence. However, CONASEV is preparing a change in the rules that will improve compliance with international standards.

b) Material Fact Disclosure Regulation

Material fact disclosure regulation issued by CONASEV in December 2002<sup>11</sup> has improved the quality of disclosure. It clearly spells out the characteristics of the facts that have to be disclosed. It also introduces the obligation of listed companies to define their internal rules of conduct for the handling of material facts. Also, companies are mandated to publicly disclose “other communications”. The resolution states that “other communications are: press releases, press conferences, meetings with analysts and investors, etc. where information about the general performance of the issuer or its economic group is given.

Listed companies report changes in the holdings of those shareholders that own more than 5% of common stock.

c) Disclosure of Compliance with the Principles

As mentioned above, the General Management Rule N° 096-2003-EF/94.11 mandated that the annual report and the prospectus include information about compliance with the Principles and shareholder structure. To improve the quality of the disclosure, changes to this Rule were published in January 2006 (General Management Rule N° 140-2005-EF/94.11).

d) Electronic Information System for Data Exchange

In February 2003 CONASEV approved the MVNet System<sup>12</sup>. Data exchange between CONASEV and its supervised entities is done through this electronic system. MVNet is an efficient and secure electronic system that uses digital signatures. Its objective is to reduce the costs of providing information to investors. It reduces the costs of financial disclosure for issuers and the information is automatically disclosed in real time through CONASEV's and the Lima Stock Exchange's websites.

To improve the system, in May 2004 CONASEV<sup>13</sup> extended the use of MVNet to 24 hours a day, 7 days a week, with exceptions have to be specified by CONASEV. The purpose is to have information continuously delivered to the market without “working hours” constraints. It is also expected that this policy will reduce the possibility to misuse privileged information and allow the efficient use of technological resources (e-government).

e) Disclosure about indirect ownership, affiliation and economic groups

A new regulation about ownership, affiliation and economic groups was issued by CONASEV in December 2005<sup>14</sup>. This resolution simplifies the type of information that companies have to disclose. Companies that are part of a related economic group are allowed to publish information only for those companies that they consider to be “more important” (Any filing related to economic groups is considered to be disclosure of a material fact. In that sense, a company is “more important” for the group, if the fact that it is part of the economic group influences the investment decision of a judicious investor). It simplifies the amount of

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<sup>10</sup> CONASEV Rule N° 103-1999-EF/94.10, published November 26, 1999.

<sup>11</sup> CONASEV Rule N° 107-2002-EF/94.10, published December 28, 2002.

<sup>12</sup> CONASEV Rule N° 008-2003-EF/94.2, published February 7, 2002

<sup>13</sup> CONASEV Rule N° 049-2004-EF/94.10, published May 4, 2004.

<sup>14</sup> CONASEV Rule N° 090-2005-EF/94.10, published December, 28, 2005.

information that big corporations have to disclose. CONASEV can make the presumption that two legal entities are related if a third or more of its directors, managers or workers are the same. Another presumption that CONASEV can make is that the legal representatives, directors or managers of a legal entity are its controllers. Also CONASEV can presume that the legal entities that are related have the same controllers. CONASEV can then make the presumption that if the legal representatives of offshore companies are the same as the administrators of the corporations; the offshore and the corporation belong to the same economic group. (A new definition of an economic group has been introduced: an economic group is defined as the group of entities under the control of one person or the same group of persons.)

## OTHER PRIORITIES

- Review of the rules for disclosure of related party transactions. Although there have been important improvements in the disclosure of financial information and related party transactions, there is a need to improve disclosure and supervision of these transactions.
- Improve transparency of content of financial statements by an effective supervision.
- Material fact disclosure regulation should be improved in such a way that all “reserved facts” that are published by the press should be immediately made public through a statement of the listed company.

### **4. Developing Effective Boards of Directors**

#### a) Independent Directors and Board Committees

Peruvian Capital Markets regulation does not mandate the creation of board committees or the election of independent directors to the boards of listed companies. However, the Principles recommend the election of a sufficient number of independent directors<sup>15</sup> and to form special bodies.

Disclosure of compliance with the Principles in the annual report and the prospectus must include information about those directors that are considered to be independent and describe the special committees created within the board. The function of each committee must be described and also its composition.

The sample of 55 listed companies corresponding to financial year 2004, shows that 26 companies declared to have independent directors on their boards (of these, 22 identified their independent directors) 8 declared that they didn't have independent directors, 16 didn't comment on this issue and 5 didn't submit the report on compliance with the principles.

Regarding financial year 2005, according to companies information<sup>16</sup> 123 companies declared to have at least one independent director on their board, 64 companies declared that they didn't have independent directors and 2 companies didn't specify this issue.

Concerning board committees, 21 companies revealed that they have at least one committee, 20 reported not having any committee, 9 didn't report on this issue and 5 didn't submit the report on compliance with the principles. The most important committees are the auditing committee and the executive committee. In general terms no description was made of the committees' functions or of its structures. It is important to

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<sup>15</sup> Principle II.B states: “A sufficient number of directors should be elected, capable of exercising independent judgment to tasks where there is a potential for conflict of interest, being able, for such purpose, to take into consideration the participation of shareholders lacking control. Independent directors are those selected for their professional prestige and who are not connected to the company management, nor to the control group of the same.”

<sup>16</sup> Information reviewed by CONASEV until May 15, 2006.

remark that some listed companies are amending their by-laws to adapt them to the observance of corporate governance principles (e.g. to form auditing committees).

These results show that given the current regulatory framework that exists in Peru, a lot of guidance is still needed to have adequate disclosure by the issuers on their compliance with the Principles.

#### b) The AFPs and the Development of Efficient Boards

The last amendment to the Regulations of the Law of Private Pension Fund Administrators has given the AFPs a more active role in promoting effective boards. The fiduciary duties of the Pension Fund Administrators have led them to promote change in the direction of better corporate governance in the portfolio companies of the pension funds.

After the mentioned amendment, the AFPs have been involved in the election of independent directors in portfolio companies. Also, they have developed a consultation system for the cases in which they want to group their votes for the election of directors.

To avoid conflicts of interests, the regulation specifies that in the elections of directors of portfolio companies, AFPs can't vote for candidates that are shareholders, directors, managers or employees of the AFPs. SBS's complementary regulations have established requirements regarding the ethical and professional conduct of the officers that participate in the investment decisions and procedures, and call for the creation of ethical codes and professional standards of conduct (including the handling of privileged information). AFP internal audit units are in charge of ensuring compliance with these codes.

The AFPs have developed a handbook for directors. This is a good tool, given the fact that some directors are highly specialized professionals but do not necessarily have experience as board members.

The pension funds have started to be more active in introducing audit committees in portfolio companies and in evaluating both mergers and assets sales.

c) See above the efforts being made by FONAFE (In LANDMARKS point 4).

#### OTHER PRIORITIES

- Training of directors and definition of their fiduciary duties.
- Promoting the benefits of the election of independent directors and the formation of board committees like audit committees.

### **5. Improving the Quality, Effectiveness and Predictability of the Legal and Regulatory Framework**

CONASEV has a tradition of public consultation to introduce changes in the Law and in CONASEV's own regulations. Proposed changes in the Law and regulation are published in its Web. To further improve this procedure, comments and suggestions made during the public consultation process should be also published in the website as they arrive.

#### a) Sociedades Anónimas Abiertas (SAAs)

As previously explained, regulation on the rights to ask and receive information pertaining to the SAAs' economic performance and also CONASEV's role in calling general shareholder meetings was enacted in December 2003.

The regulation defines what “information on the economic performance” means and specifies that CONASEV will make public the criteria utilized in its rulings to qualify the information as such.

b) Rules regarding how regulation and rulings become publicly available

Since 2004, CONASEV has specified the way in which its regulation and rulings become publicly available<sup>17</sup>. The general principle is to reveal all rulings that have an effect over an undefined number of people whose rights might be affected by such decisions. Disclosure is made via the official government newspaper (“El Peruano”) or CONASEV’s website.

c) Criteria Used to Sanction

To improve CONASEV’s regulatory framework, CONASEV’s board approved the criteria to be used in the administrative procedures related to non-compliance with the timely disclosure of financial statements and non-compliance with procedures that SAAs have to perform in order to protect minority shareholders. The criteria used to sanction are publicly available at: <http://www.CONASEV.gob.pe/normas/CriteriosSancion.asp>

d) Material Facts Disclosure Rules

As explained in section 3b, in December 2002, the current Material Facts Disclosure Rules were approved<sup>18</sup>.

e) Law Project to facilitate collective actions

Currently, CONASEV is working on a project to introduce in Peruvian legislation some of the benefits of class action suits. The project specifically focuses on securities holders and users of services of entities supervised by CONASEV.

One or more security holders, or one or more users of entities supervised by CONASEV, can bring a civil suit that gives them the possibility of collective action.

The project promotes the protection of rights that otherwise couldn’t be claimed because the costs for a single individual are higher than the damage that was done to this individual. Claims by different individuals can be accumulated in a single procedure.

f) Changes in the Existing Derivative Suit<sup>19</sup>

The LGS states that shareholders representing at least one third of voting stock can initiate a derivative suit against board members or CEO on behalf of the company. CONASEV considers that given the high degree of ownership concentration in Peruvian corporations the current threshold is too high and is suggesting its reduction.

g) Law Project of Derivative Suit

Currently according to LGS, a shareholder (or a creditor) is able to initiate a derivative suit against a board member or a CEO (called “pretension social de responsabilidad”) on behalf of the company. However, CONASEV has drafted a project that intends to introduce in a comprehensive way derivative suits in Peruvian regulation.

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<sup>17</sup> CONASEV Rule 073-2004-EF/94.20, published July 22, 2004

<sup>18</sup> CONASEV Rule 107-2002-EF/94.10, published December 28, 2002

According to the proposal, anyone who could have been harmed in the securities market could file a derivative suit. Derivative suits can become a true preventive mechanism. For example shareholders, any board member or CEO could file a derivative suit against any other board member, CEO, representative, or other shareholder on behalf of the issuer.

#### h) Efforts to streamline enforcement: Sanctioning procedures, commercial courts and arbitration

Regarding sanctioning procedures, the administrative decisions of CONASEV's Administrative Court or CONASEV's Board can be appealed to the courts. The appeals processes can last one to two years in the first instance, eight months to a year and a half before the appeals court, and one to two years in the Supreme Court.

Most judges have no special training on Financial and Capital Markets issues. And until this year there were no specialized courts dealing with commercial issues.

Since April 2005, commercial courts started operating. Seven lower courts and one upper court are operating. 22 lower courts and two upper courts should be operating by the first quarter of 2006. The juries have started with no back load. It is expected that this will help them to work faster, and comply with procedures in time. The challenge is to get uniform criteria and jurisprudence that will help to have stability in the courts rulings. No capital markets case has yet been taken to these courts.

Regarding arbitration, the rules are specified in The General Arbitration Law and Corporate Law specifies that compulsory arbitration can be included in the by-laws of the corporation. Arbitration is also included in Peru's Securities Law and its Regulation as a way to solve disputes. And the Arbitral Court of the Lima Stock Exchange can solve disputes between broker-dealers and between broker-dealers and their clients.

Although arbitration is relatively new, there is a trend to include arbitration clauses in the by-laws of corporations. There are no specific statistics on the use of arbitration to solve shareholder conflicts. However, there is evidence that the use of arbitration to solve disputes has increased. As an example, statistics from the Arbitral Court of the Lima Chamber of Commerce show that the number of arbitration cases brought to this court has gone from 2 cases in 1993 to 124 in 2004, for a total of 984 for the whole period. There are 107 cases in process as of March 31, 2005.

#### g) Corrective Measures (Rule N° 008-2006-EF/94.10)

This new regulation allows CONASEV to impose corrective measures instead of sanctions. The listed company must restore the situation that existed prior to their offence and repair or compensate for any damage that it has done. In order to qualify for a corrective measure instead of a sanction the following conditions must exist: the offence must be small or not serious, have no material effects, no effect on the market and the offender must not have perpetrated the same offence within the last three years. (Offenses are defined as light, serious and very serious – leves, graves o muy graves.)

#### OTHER PRIORITIES

- The reserved facts regulation should be reviewed to prevent abuses.
- Eliminate or minimize potential regulatory arbitrage and excessive costs to market participants that comes from existing regulation in the financial sector. It is necessary to review the regulation of private offerings, the current information requirements by both CONASEV and the SBS and the current scheme of administration by AFPs of voluntary funds not related to pensions. Given the low

liquidity conditions that exist in the Peruvian Capital Market, there is a need to improve the current valuation schemes used by CONASEV and the SBS, which currently use two different methods.

- Continue with training of judges in capital markets issues, especially in the case of recently created commercial courts.
- Strengthen CONASEV's budgetary autonomy with the aim to reduce current constraints that restrict its supervisory and enforcement tasks.