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Peru

The Role of Institutional Investors in Promoting Good Corporate Governance Practices in Latin America: The Case of Peru

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Promoting Good Corporate Governance Practices in Peru

The following report is an update of the report that was developed following the May 11th 2007 working group meeting organised by the Association of Private Pension Funds of Peru (Asociación de Fondos Privados de Pensiones – AAFP). The meeting’s objective was to discuss and enhance the Role of Institutional Investors in Promoting Good Corporate Governance Practices.¹ The May 11th meeting was complemented with interviews with the Chief Investment Officers of three AFPs and the Deputy Investment Officer of the fourth AFP, the fund manager of a foreign mutual fund, the general manager of an insurance company, a director appointed by the AFPs and a partner of a local audit firm. This report first sets out the background on the types of institutional investors in Peru, their ownership structure and legal framework relevant to governance issues. It then focuses on pension fund practices related to governance and barriers to further improvements, before concluding with recommendations for these funds to influence better company governance as well as to improve their own.

I.- Background

1. Types of institutional investors in the Peruvian Market

The main domestic institutional investors in the Peruvian Capital Market are the Private Pension Funds, the Mutual Funds and the Insurance Companies. The Private Pension Funds Administrators or Administradoras de Fondos de Pensiones (AFP) are the largest and most important with total funds administered as of October 17, 2008 equal to US\$15 billion or about 12 percent of GDP. As a comparison the Market Capitalisation of the Lima Stock Exchange was USD \$53.3 billion at the same date. As we can see from the tables below, the international financial crisis has had a great impact in the total funds under administration. As recently as the end of August 2008, the AFPs administered U.S. \$ 20.1 billion and the total funds under administration by these three types of institutional investors was U.S.\$ 28 billion.

Total Funds Under Administration

	August 2008	October 17, 2008
Private Pension Funds	US\$ 20.1 billion	US\$ 15.0 billion
Mutual Funds	US\$ 4.9 billion	US\$ 3.6 billion
Insurance Companies	US\$ 3.0 billion	n.a.
Total Funds	US\$ 28.0 billion	n.a.

Source: SBS, CONASEV

¹ It was attended by Pedro Flecha - President of the AAFP; Federico Oviedo – General Manager of the Lima Stock Exchange, Melvin Escudero - Intendente de Gestión de Inversiones de la Superintendencia de Banca Seguros y Pensiones (SBS), Rodny Rivera – Chief of the Economic Studies Area of the Comisión Nacional Supervisora de Empresas y Valores (CONASEV); Mariela García – Finance Manager Ferreyros, Alvaro Clarke – Socio Principal Clarke y Asociados; Eduardo Herrera - Chief Investment Officer of PROFUTURO Pension Fund Administrator; Diego Icaza - Investment Analyst of HORIZONTE Pension Fund Administrator; Roque Benavides – General Manager of Buenaventura, Matthew Sullivan, Consultant - IFC .

Market Share of Investments in Equities

	August 2008		October 17, 2008	
	Investment in Equities	Investment in Equities	Percent of LSE Mkt. Cap.	Percent of LSE Mkt. Cap.
Private Pension Funds	US\$ 7.2 billion	US\$ 4.3 billion	8.11 %	8.11 %
Mutual Funds	US\$ 0.4 billion	n.a.	n.a.	0.47 %
Insurance Companies	US\$ 0.3 billion	n.a.	n.a.	0.31 %
Market Capitalisation Lima Stock Exchange (LSE)	US\$ 88.3 billion	US\$53.3 billion	100.00 %	100.00 %

Given their relative importance, the present report will deal with AFPs. The last ten years (prior to the current crisis) the Pension Funds grew at an average rate of 30% per year.

Pension Funds Evolution Last Ten Years

YEAR	U.S.\$(000)	GROWTH y*/y
2007	20,377,489	41%
2006	14,414,000	52%
2005	9,509,294	21%
2004	7,842,003	24%
2003	6,341,380	40%
2002	4,526,603	25%
2001	3,622,078	32%
2000	2,751,734	14%
1999	2,406,034	39%
1998	1,733,691	15%

Source:FIAP

The ownership of AFPs is concentrated in such a way that the controlling groups hold no less than 91% of equity (see annex1). With the exception of Prima, solely owned by Credicorp, all AFPs have foreign shareholders that have forged alliances with local economic groups.

All AFPs but one (PROFUTRO) have shareholders that are both registered in the New York Stock Exchange and that own directly or indirectly more than 50% of their equity. This has led AFPs to have to follow some of the rules of Sarbanes – Oxley. This has improved the internal governance of these companies. Even Profuturo, which does not fall in this category, has benefited from its partnership in terms of codes of conduct, investment policies and internal controls.

2. Investment Strategies

The basic strategy is the acquisition of minority stakes in companies listed on the Lima Stock Exchange. They use market-based strategies to exit their investments. By law PFA have to be active shareholders (See below I 5b,5g).

Pension Fund Administrators are interested in investing in infrastructure projects and have been doing so. However, both delays in the development of the infrastructure projects and current regulations and procedures have limited their participation in such projects

3. Equity ownership

4.3 billion dollars or 29% of the US\$15 billion administered by AFPs are invested in equities registered in the Lima Stock Exchange (LSE). This percentage of equity in the total portfolio of the Peruvian Pension Funds is one of the highest among the countries reported by FIAP. Total market capitalisation of the Lima Stock Exchange (LSE) is US\$ 53.3 billion.

This comparison does not reflect the actual importance of the equity ownership of AFPs, taking as an example their stake in some of the largest companies of Peru at the end of 2007:

Sector	Company	% Ownership of Common Shares (*)
Financial Services	Credicorp	22
Oil Refining	Relapasa	38
Construction Machinery	Ferreyros	42
Construction	Graña y Montero	29
Food	Alicorp	36
Cement	Cementos Lima	25

(*) Holdings of all AFPs taken together

Source: SBS, CONASEV, BVL

4. Legal investing rules

Investment limits by categories²

- a) Securities issued or guaranteed by the Government of Peru: 30%
- b) Securities issued or guaranteed by the Central Bank: 30%
- c) The sum of a) plus b) cannot exceed: 40%
- d) Securities issued by foreign Government, and financial and non financial entities with economic activities basically located in foreign territories: 30%, but the Central Bank has imposed a tighter operational limit of 20%.

Other important limits:

Investment in all types of securities issued by a single corporation cannot be more than 12% of equity. If more than one type of security representing equity is issued, no fund can hold more than 15% of each type of security.

The sum of all investments made by an AFP in an economic group cannot exceed 25% of the value of each type of fund. Investment limits for securities issued by related parties are reduced by 30%.

Investment Limits by Type of Fund

Since its inception up until November 8, 2006, AFPs administered one fund each. Starting November 9, 2006 AFPs divided their funds into three funds. Currently, each AFP manages three types of funds, which range from lower to higher risk. Anyone over 60 years old has to be in a type 1 fund (conservative fund which is a lower risk fund). As a consequence of the current international financial crisis, the SBS has suggested the

² Legislative Decree No. 1008, May 6 2008, Modified Article 25-D of Law 27988, June 4 2003 which set a 20% limit on “foreign securities”.

creation of a Type 4 fund which would be solely composed of fixed income and cash and short term securities. This fund would be for the workers near retirement age.

Limit: Maximum amount as percent of Type of Fund			
	Type 1	Type 2	Type3
	Conservative Fund	<i>Balanced Fund</i>	Aggressive Fund
Variable income	10	45	80
Fixed income	100	75	70
Derivatives	10	20 ³	30 ⁴
Cash and short term securities	40	30	30

The requirements that a listed company needs to fulfil in order to be suitable for investment are:⁵

- For listed issues: average daily float of US\$ 100 million and must have audited financial statements for at least the last fiscal year.
- For new listings: Issue has to be at least US.\$ 100 million, AFPs cannot buy more than 80% of the offering.

These new regulations open the possibility for expanding the number of companies included in the list. A similar provision (SBS Rule 608 of May 2007) had the positive consequence of allowing AFPs to participate in two new offerings (Intercorp and Maple Gas).

Only 15% percent of the total listed companies have the SBS approval to be in the list of selected companies.

It is not clear whether more companies could be suitable for inclusion in the SBS list if they do moderate (or significant) governance improvements, since in practice it is size and liquidity that determine inclusion on the list.

5. Laws and Regulations with regard to Institutional Investors' duties to its Beneficiaries

a. Disclosure of Compliance with Corporate Governance Principles

Given the fact that all AFPs are listed on the Lima Stock Exchange, they must disclose their compliance with "The Principles of Good Corporate Governance for Peruvian Corporations" a voluntary code, which was drafted in 2002.

b. Fiduciary duties of the pension funds

Pension Fund Administrators must appoint representatives of the funds, who must exercise the rights (and comply with the duties) that are attached to the securities held in the portfolios of the funds. AFPs have to always appoint representatives, regardless of their investment size.

³ Article 1, SBS Rule 11153 from November 23, 2008

⁴ Article 1, SBS Rule 11153 from November 23, 2008

⁵ These are the current requirements established by SBS Rule 11153 from November 23, 2008. Through this rule the SBS is expanding the investment alternatives for AFPs. The investment alternatives include: real state funds, hedge funds, commodity funds, private equity funds, venture capital funds; and also funds that invest in a combination of the investment instruments of the previous types of funds; or funds that invest in indexes constructed on the basis of these investment instruments or similar ones (as determined by the SBS).

The representatives from the funds will defend the rights of the funds with independence from the interests of AFPs, will comply with corporate governance practices and promote their adoption by the investee companies.

The representatives of the funds must voice their points of view on the topics that are discussed, cast their votes and see that they are reflected in the minutes. They must report to the AFP of the result of their endeavours. The AFP must keep the representatives' reports and make them available to the SBS when required.

In the election of members of the board, the representatives are forbidden to vote for candidates that are shareholders, directors, managers or workers of an AFP.⁶

c. Good corporate governance and best practices

Each AFP must adopt the principles of good corporate governance and the best applicable practices in the management of AFP and in the investment decision process of each administered fund, taking as reference the best available standards. The SBS will supervise the adequate compliance with these principles and practices.⁷

d. Investment policy

Each AFP must develop an investment policy that defines the objective of each Type of Fund and the investment diversification policy. This investment policy must be disclosed to the general public.⁸

e. Code of ethics and conduct, SBS Rule 114, January 21 2005

The Board of AFPs must develop a code of ethics and conduct for the personnel who participate in the investment process of the financial resources of the pension funds and of AFPs.

The personnel in the investment area or risk control area must have an internationally accepted CFA certification.

f. Best practices in the investment process, SBS Rule 641, April 19 2005

The Board of AFPs must develop a set of policies that guarantee the best practices in the investment process. The investment committee and the risks committee are in charge of conducting these policies.

⁶ Article 94, Regulation of The Unified Text of the Private Pension Fund Law, enacted by Supreme Decree N° 004-98-EF, modified by, Article 2, Supreme Decree N ° 182-2003-EF, 12-12-2003

⁷ Article 60, Regulation of The Unified Text of the Private Pension Fund Law, enacted by Supreme Decree N° 004-98-EF, modified by Supreme Decree N ° 182-2003-EF, 12-12-2003

⁸ Article 25-C, The Unified Text of the Private Pension Fund Law, enacted by Supreme Decree N° 004-98-EF, modified by Artículo 4°, Ley 27988, 06.03.2003

g. SBS Rule 680, May 11 2007

Resolution 680 of the SBS states that AFPs have to invest in those companies and funds that follow good corporate principles. They have to promote good corporate governance in those companies and good investment practices.

6. Laws and regulations with regard to corporate governance rules

Good corporate governance and best practices

Each AFP must adopt the principles of good corporate governance and the best applicable practices in the management of the AFP and in the investment decision process of each administered fund, taking as reference the best available standards. The SBS will supervise the adequate compliance with these principles and practices.⁹

SBS Rule 680, May 11 2007

Resolution 680 of the SBS, AFPs have to invest in those companies and funds that follow good corporate principles. They have to promote good corporate governance and good investment practices in those companies.

Disclosure requirements

There are no rules requiring disclosure of their policies and practices regarding corporate governance of the companies in which they invest.

II.- The role of AFPs in promoting good governance

Pension Funds Administrators (AFPs) are the main institutional investors in Peru. Although AFPs face the same governance issues as other fund administrators, there is the view that the responsibility of the pension fund is higher because they manage compulsory pension funds as opposed to mutual funds, which are voluntary.

They promote good governance in their investee companies through the appointment of independent directors. Representatives of the pension funds have to participate in AGMs and vote. AFPs have representatives in the “surveillance” committees of the investment funds.

The independent directors¹⁰ have contributed to the modernisation of the board through the introduction of committees, such as the audit committee.

Also, companies have gone from having board meetings 3 times a year, to having board meetings every month. The quality of the information provided to the directors has also improved.

The AFPs Association has taken as its duty that the independent directors appointed by AFPs receive training in different issues regarding their duties and their knowledge of the topics that are discussed in the board

⁹ Article 60, Regulation of The Unified Text of the Private Pension Fund Law, enacted by Supreme Decree N° 004-98-EF, modified by Supreme Decree N ° 182-2003-EF, 12-12-2003

¹⁰ The OECD submitted a follow up question: “What powers do independent board members have? Do they have special audit committee role?” **Answer:** They have the same powers that other board members have. No special powers.

meetings. This is an interactive procedure in which the independent directors bring up the relevant topics to the attention of the Association and the Association sees that the directors be trained in such topics.

AFPs have more power and visibility than the Mutual Funds or the Insurance Companies. The stakes they hold are higher and AFPs can vote together in the election of directors. Also, they can join forces when a particular problem arises with one of the investee companies.

Although this is the case, it has not attracted the attention of the general public.

1. Key risks and main corporate governance problems in Peru from AFP perspective

a. Board practices;

Concentrated ownership traditionally led to boards being dominated by economic groups. Pension funds have accumulated stakes that allow them to elect directors individually or collectively.

Some cases have been reported in which the controlling group withheld information from the directors elected by the pension funds. For example: a parallel meeting would be held without the participation of said directors. Also, a company reduced the number of directors so as to block the access of any independent director to the board. It is fair to say that companies did not expect AFPs to elect directors and that there was an element of shock when AFPs elected directors in a company that had never had independent directors.

With the passage of time AFPs have reached some agreements among themselves and with the issuers on the way to elect directors. Also, current legislation allows AFPs to vote for the list presented to the AGM by the board.

In the ideal scenario, the AFPs will ask the company the type of director they need to complement the skills of the other members of the board. With this input the AFPs will search for candidates. These candidates are presented to the company, and the company¹¹ chooses who will be part of the list that will be presented to the AGM. If an AFP has enough votes to elect a director on its own, it may do it by itself¹².

Managers or other staff from AFPs are forbidden from being appointed as directors.

A partial review of the appointed directors shows that many of these are lawyers or economists. Many of them have a graduate degree in business administration (or similar). And some of them have been high ranking officers in the public sector (former vice ministers of finance, members of the board of the Central Bank, a former head of the Central Bank and a former minister of finance). Several also serve as directors of other companies, so some may be on their way to becoming professional directors.

The demand/supply ratio of directors is hard to determine, however, it is clear that there are many well trained professionals that are willing to participate in the selection process. We have to understand that the process of designating independent directors in the investee companies has been gradually evolving. At the beginning the lawyers related to AFPs or the controlling groups of AFPs were the ones who were appointed as independent directors. Later, members from the most prestigious consulting groups were chosen as

¹¹ In this case “the company” means the controlling shareholders or the people that represent them in the board or in management.

¹² The OECD submitted a follow up question: “What is the legal requirement for how this works?” **Answer:** The legal requirements are stated in corporate law (Ley General de Sociedades). The number of directors is determined by the by-laws of each corporation. The number of votes needed is inversely proportional to the number of directors. If you have enough votes (whether on your own or by pooling your votes with other shareholders) you can elect a director.

independent directors. Finally, inasmuch as the need to appoint independent directors has become known to a wider public, many professionals have submitted their curriculum vitae to AFPs, increasing the pool of available candidates.

b. Control environment (internal controls and risk management)

Independent directors elected by AFPs are encouraged by AFPs to promote audit committees and participate in them¹³.

Also, when potential problems related to transactions may arise at a company pension funds are informed by AFPs-elected directors for them to take action.

Cases:

PCU was merging with its parent company Grupo Mexico and the AFPs' director was nominated as part of the committee that had to evaluate the transaction.

Backus:

When Backus made an offer to buy all investment shares issued by Backus, the AFPs rejected the offered price, hired an independent consultant company to make a valuation and obtained a price that was better than the initial offer (close to double). The AFPs had close to half the investment shares issued by Backus and hence a good negotiating position.

ENERSUR

ENERSUR needed to raise money for the Yuncán project. The AFPs negotiated with the controlling group to participate in the valuation of the project, to have the shares listed a year after the offering was made and to participate in the audit committee.

RELAPASA

When RELAPASA was buying a chain of gas stations that belonged to RELAPASA'S economic group, the AFPs conducted an independent valuation of the transaction.

Real Estate Investment Funds

When problems arose in a couple of real estate investment funds, the AFPs took a more active participation in seeking solutions.

c. Shareholder rights;

Lack of available securities and illiquid markets has led AFPs to buy B shares and investment shares, both of which lack voting rights. In both cases, the possibility to improve the practices is very small¹⁴.

¹³ The OECD submitted a follow up question: "Because these are voluntary?" **Answer:** Yes, these committees are voluntary.

¹⁴ The OECD submitted a follow up question: "Why not avoid equities if there are insufficient opportunities?" **Answer:** The AFPs base their investments in terms of risk and return. So even if opportunities are insufficient, they might consider that the return justifies the risk.

d. Family business issues;

Disclosure issues and fear of loss of control can make it difficult for the independent directors to be accepted.

2. AFPs are active in promoting good corporate governance at different levels:

a. Individual companies they invest in;

AFPs have actively participated in the modernisation of the boards of the investee companies and are active participants in AGMs. They also participate in the surveillance committees of the investment funds and in the bondholders meetings.

They have appointed independent directors that are active in promoting good corporate governance practices.

These directors have encouraged the formation of committees, such as the audit committee.

The frequency of the board meetings has increased from 3 times a year to 12 times a year.

AFPs have elaborated a Handbook for Directors.

The AFPs Association has taken as its duty that the independent directors appointed by the AFPs receive training in different issues regarding their duties and their knowledge of the topics that are discussed in the board meetings. This is an interactive procedure in which the independent directors bring up the relevant topics to the attention of the Association and the Association sees that the directors be trained in such topics.

See examples of activism in 1b).

b. Supported the development of a public policy/regulation on corporate governance

The Pension Fund Administrators' Association supported the committee that drafted the "Principles of Good Corporate Governance for Peruvian Corporations" a voluntary code drafted in 2002.

c. Support an Annual Corporate Governance Contest

AFPs also support the annual Corporate Governance contest established by Procapitales that seeks to foster good corporate governance practices by giving awards to corporations that follow good corporate governance practices.

3. AFPs practices to encourage and promote corporate governance

a. Considering corporate governance risks and opportunities before investing;

It has had very little weight in the decision to invest. The weight is given to profitability of the companies. There are only a few issuers that are eligible for investment by AFPs.

b. Actively exercising ownership rights through:

a. One-on-one meetings;

AFPs visit the companies to discuss their general economic situation and projects. It is during these meetings that governance issues are mentioned. It should be noted that there is not a tradition in the investee companies to receive investment analysts.

b. Voting;

Voting by AFPs is mandatory, they have to attend the AGM, cast their votes and have it registered in the minutes of the AGM.

c. Board representation (nomination of directors);

(See above: I 2a)

d. Putting issues on the AGM agenda;

Only occasionally

4. Differences with mutual funds

Mutual funds that invest in stocks are currently young and small relative to pension funds. In the near future they may pool their votes with the pension funds to elect directors. (Coordination should be facilitated by the fact that the biggest mutual fund managers belong to the same economic groups as the AFPs)

5. Barriers to AFP better utilising their position as a key governance activist

a. Shortcomings of existing regulation;

Investment limits by issuer may limit the ability of AFPs to elect directors. Given the investment limits, the fewer the AFPs that own shares in a company the harder to elect board members. Also, there was a case where the corporation reduced the number of directors to the point where AFPs did not have enough votes to elect a board member.

Investment limits may also act in a perverse way. When a particular asset (or family of assets) experiences an extraordinary growth in value and limits are surpassed, AFP is forced to sell the excess over the limit, even when risk considerations might not indicate any potential problem.

Corporate law requires high percentages of voting rights in order to be able to exercise some rights. For example: in some cases you need 20% of shareholders votes to force some topics onto the agenda.

b. Poor Disclosure of Compliance with the corporate governance code

Listed companies have to reveal their degree of compliance with “The Principles of Good Corporate Governance for Peruvian Corporations” a voluntary code, which was drafted in 2002. The improvement in the quality of the disclosure has been slow. However, more recently, Conasev has been analysing the answers given by the registered companies and when finding inconsistencies or deficiencies, has started to request the companies to amend their responses and inform the market of such amendments. So, Conasev has taken a proactive approach in order to improve the “comply or explain” procedure in Peru.

c. Poor liquidity and few available investments

Liquidity issues and the small number of available investments reduce the possibility of using exiting as an alternative to being an active shareholder.

There is a “market challenge” in order to become more liquid. However the sheer size of AFPs, conspires against this. AFPs are too big for the market. Once they start buying shares in a company they are almost prone to become major shareholders. Also, once one of them starts buying the shares of a listed company, the others follow, since there is a tendency to have similar portfolios. Furthermore, they tend to maintain their holdings. The INCA fund which will follow the INCA index of the Bolsa de Valores de Lima is a type of instrument that may help to increase liquidity. The creation of ETF type of funds may help to increase liquidity. Both the growth of the mutual fund industry and the creation of the multiple pension fund system (each AFP can administer three types of funds) have increased market liquidity. Peru has been given investment grade status by Fitch (April 2008) and S&P (July 2008), and although liquidity in the LSE was expected to increase if and when Peru obtained investment grade status, the effect of the international financial crisis has not allowed this to happen.

d. Concentrated ownership patterns have precluded the AFPs from having significant influence over companies in which they invest;

There is a pattern of concentrated ownership. At first, a company didn't want to accept the presence of independent directors. They had the mechanisms to deny the access to the board. It was through a gradual process of negotiation and probably after they were firmly in control that they allowed the presence of independent directors.

Another company reduced the number of directors to the point where the AFPs were unable to appoint members to the board.

e. Lack of proxy advisory services;

Although AFPs can easily get together to pool their votes or coordinate actions, the lack of proxy advisory services limits their coordination with other shareholders.

6. Corporate governance of AFP: Issues and risks

The following are the key issues and risks in corporate governance of AFPS

a. Board composition (independence);

Concentrated ownership and business alliances between foreign investors and local economic groups have led to very little participation by independent directors.

b. Qualifications of Board members;

Board members depend on or are part of the controlling groups. Some family members of the local economic groups participate in the board.

A head hunter may be used to hire qualified board members.

c. There is no disclosure of policy on activism

Although activism is encouraged by the existing regulation, there is no voluntary or mandatory disclosure on policy activism.

d. Focus on short-term results;

A commercial war among pension funds has led to a focus on short-term results. AFPs publish comparison charts on profitability to attract customers.

The SBS has required AFPs to publish their profitability adjusted by risk. This concept is not easy to comprehend by the general public. Also, it may not be as useful in a context like the Peruvian where you have few securities.

e. Conflicts of interest;

The investment committees of AFPs can include among its members, officers from other corporations that belong to the same economic group as the AFP.

f. Access to insider information;

Some dangers exist because:

A) They belong to an economic group

B) They have appointed directors to their investees companies.

Independent directors appointed by AFPs have a duty to the company (and all shareholders). If these directors need to meet with an AFP, the consensus approach is that they should ask the Pension Fund Association to organise a meeting with all AFPs to prevent any PFA from having an advantage over the others. (This raises a question about information to the other minority shareholders and the type of information that is being released. The directors have to be careful not to release any privileged information).

g. Portfolios tend to look alike

The detailed portfolio of the pension funds was published every month. But, with the argument that the portfolios were almost identical, the period has been extended to every four months. Without discussing whether the objective can be attained through this procedure, there is the fact that the system's transparency has been diminished by this policy change. There is the fact that in order to choose a pension fund, the quality of the portfolio is important and so the need to evaluate or compare among the different portfolios.

It has been argued that the investment limits, the few "approved" investments and the fact that all AFPs have to meet a minimum return on the funds work all in favour of making all portfolios look alike. (The SBS makes a list of "approved" companies). The scarcity of quality issuers goes hand in hand with this regulation (the limits) to contribute to the "copy cat portfolios".

h. Limited monitoring capabilities, given large portfolios, limited staff, and limited ability to engage in active management activities;

Regulatory compliance requires lots of resource allocation. For example, there are many reports to be filed and many investment limits to comply with. The commercial war has forced AFPs to increase the salesmen. There are not many trained specialists. Investment in foreign securities is complex.

i. Political pressures on public pension funds – pension funds may be pressured to make certain investments to support the local economy or for other political reasons;

There is a political pressure to invest in local companies or projects.

The Central Bank has the power to limit the percentage of the fund that can be invested in foreign markets. Up until the current administration¹⁵, there has been an effort by the Central Bank to keep this limit down. The argument was that the funds should be used to develop the country. As a consequence the interest rates have been kept low. Local borrowers have been able to obtain funds at lower rates than their peers from other countries. Even foreign issuers have been able to obtain cheap local funds.

There is an obvious contradiction or conflict of interest. The local firms are being favored at the expense of the future income of the pensioners.

What the funds can invest in has been politically addressed in some cases. There is a government willingness to persuade the funds to invest in infrastructure projects. And although, the AFPs are interested in investing in infrastructure projects and have been doing so, delays in the development of the infrastructure projects and current regulations and procedures have limited their participation in such projects.

7. Recommendation to improve the contribution of AFPs to bettering corporate governance in Peru as well as improving their own corporate governance

¹⁵ More recently the legal limit on "foreign securities" was moved to 30% by Legislative Decree No. 1008 of May 6, 2008 (which modified Article 25-D of Law 27988 of June 4 2003 which set a 20% limit on "foreign securities"). Also, in April 2008 the Central Bank moved the operational limit from 17 to 20%. Since November 2006 the Central Bank has been gradually increasing this limit which has gone from 10.5% to the current 20%.

a. Improve legislation/regulation;

More flexible investment limits:

Increase the percentage of the fund that can be invested abroad.

Lower the percentage of voting rights required to exercise some rights.

Lower the costs of exchanging investment shares or non-voting shares for shares with voting rights. Lack of available securities and illiquid markets has led the AFPs to buy B shares (non-voting shares) and investment shares¹⁶, both of which lack voting rights. In both cases, the possibility to improve the practices is very small.

b. Improve enforcement;

Consolidated supervision and/or better coordination with Conasev.

The biggest mutual fund managers belong to or are related to the same economic groups as AFPs. The same is true for the insurance and banking companies. This may lead to related party transactions that may benefit one of the parties and harm the other.

The surveillance of these practices is not easy for the SBS, since they do not supervise the mutual funds and hence have no access to their portfolios or market transactions.

Consolidated supervision or better coordination with Conasev would be a solution to this problem.

Improvements in the administrative procedures

In Peru the types of offenses must be clearly spelled out in the laws and regulations. So there have been cases where this hasn't been done and hence no sanction could be applied to the offender.

Administrative procedures are slow.

c. Improve IIs' accountability to their beneficiaries and the regulators;

Specify who can belong to the investment committee.

Public disclosure of the members of the investment committee and the risks committee.

Public disclosure of investment policies.

Public disclosure of codes of conduct.

d. Develop proxy rules.

¹⁶ Investment shares are securities that give their holders equity rights but do not have voting rights. B-shares do not have voting rights.

There are no proxy rules or proxy services. So although it is easy for AFPs to coordinate among themselves, it is not easy for them to coordinate with other shareholders. It is hard to identify those shareholders that are not AFPs. A proxy service could be useful.

e. Improve the dialogue between the IIs and their investee companies;

All companies should have conference calls. Currently, only those registered in New York have conference calls, like Compañía de Minas Buenaventura (BVN, Credicorp (BAP) and Southern Copper Corporation (PCU)

f. Improve the Board composition

Have independent directors in the board of pension funds.

ANNEX 1

OWNERSHIP CONCENTRATION IN THE AFPs

AFP HORIZONTE S.A. (Major Holders)				
Shareholder	Nationality	%	Series	Starting date
BANCO BILBAO VIZCAYA - ARGENTARIA S.A.	ESPAÑA	24.85		07/03/2000
HOLDING CONTINENTAL S.A.	PERU	54.36		18/02/1998
PROVIDA INTERNACIONAL S.A.	CHILE	15.87		02/01/1998

AFP INTEGRAL (Major Holders)				
Shareholder	Nationality	%	Series	Starting date
ING INSURANCE INTERNATIONAL B.V.	HOLANDA	13.42	C	18/05/2007
ING LATIN AMERICAN HOLDING B.V.	HOLANDA	20	C	14/07/1995
ING PENSIONES PERU S.A.	PERU	29.5	B	04/12/2001
INTERNATIONAL INVESTMENTS S.A.	PERU	29.5	A	29/10/2004

PRIMA AFP S.A. (Major Holders)				
Shareholder	Nationality	%	Series	Initial date
GRUPO CREDITO S.A.	PERU	99.99		07/09/2005

PROFUTURO AFP (Major Holders)				
Shareholder	Nationality	%	Series	Initial date
J.H.HOLDINGS S.A.	PERU	95.06		19/06/2008