



REPORT OF THE PERUVIAN TASK FORCE ON INSTITUTIONAL INVESTORS AND CORPORATE GOVERNANCE

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INTRODUCTION

At the Latin American Corporate Governance Roundtable's 2010 meeting, participants endorsed the publication of a set of White Paper recommendations focusing on the role of institutional investors in corporate governance, entitled *Strengthening Latin American Corporate Governance: the Role of Institutional Investors* (now available in English and Spanish: see <http://www.oecd.org/daf/corporateaffairs/roundtables/latinamerica>). It was proposed at that time that individual Latin American countries consider establishing task forces to review the recommendations and assess what actions could be taken to advance on the recommendations.

With Peru's agreement to host the 2011 Roundtable meeting, a number of Peruvian stakeholders agreed to respond positively to this proposal, and to establish a task force to develop a report and recommendations for consideration at the November 29-30, 2011 Roundtable meeting in Lima.

The first meeting of the Task Force was held March 23, 2011 with the objective to define the interest of the participants in convening a task force. The group agreed that the purpose would be to review the recommendations from the White Paper report, to decide which recommendations could be applied to Perú, and to see how to improve those recommendations that are already being applied.

The most relevant stakeholders participating in this and subsequent meetings of this group included representatives from the pension fund administrators, mutual fund administrators, companies listed in the Lima Stock Exchange (BVL- Bolsa de Valores de Lima), representatives from the BVL, the Peruvian Securities Commission (SMV- Superintendencia del Mercado de Valores), the Banking, Insurance, Pension Fund Administrator Supervisor (SBS- Superintendencia de Banca, Seguros y AFPs), PROCAPITALES, with guest participation from the Organisation for Economic Co-operation and Development (OECD), International Finance Corporation (IFC), and the Global Corporate Governance Forum (GCGF).

The group held regular meetings up to November 2011, first monthly then biweekly. During some of these meetings, members of OECD, IFC and GCGF also participated. All the recommendations were discussed both to assess the current state and to decide which recommendations should be considered for Perú.

Individual meetings were also held with the legal counsels of the Pension Fund Administrators (AFPs), the head of the Mutual Fund Association and its legal counsel, the SBS, the SMV and the BVL to more clearly define the recommendations that would be taken as commitment by each group.

BACKGROUND

PENSION FUNDS

The pension funds are the largest institutional investors in Perú. There are four AFPs in Perú. Ownership is very concentrated. As of September 2011, the total portfolio of the pension funds was 28 billion dollars or 16.9% of GDP. Their annual average growth rate for the last ten years has been 29.2%.

Pension Funds Evolution Last Ten Years

YEAR	U.S.\$(MILL.)	GROWTH y*/y
2010	30,854	29%
2009	23,901	50%
2008	15,901	-22%
2007	20,377	41%
2006	14,414	52%
2005	9,509	21%
2004	7,842	24%
2003	6,341	40%
2002	4,526	25%
2001	3,623	32%

Source:FIAP

As of September 2011, stocks represented 28.5 % of the pension funds' portfolio or about US\$ 8 billion (7.7 billion excluding investments in foreign stocks). As comparison the Market Capitalization of the BVL was 113 billion dollars. This comparison does not reflect the actual importance of their holdings as can be seen in the table below. These holdings give the PFAs the opportunity to be active shareholders.

Pension Funds Selected Holdings in the BVL (% of Common Stock) Dic.2010

Company	Industry	%
Banco Continental	Banking	4.6%
Credicorp	Financial Holding	13.2%
Intergroup	Financial Holding	16.2%
Alicorp	Food and Beverage	33.4%
Cementos Lima	Cement	23.8%
Cementos Pacasmayo	Cement	21.9%
Ferreyros	Construction Equipment	36.9%
Graña y Montero	Construction	37.9%

Refinería La Pampilla	Refining	25.8%
Atacocha	Minning	33.1%
Buenaventura	Minning	12.3%
Volcan	Minning	33.3%
Edegel	Electric Utility	12.1%
Edelnor	Electric Utility	10.0%
Enersur	Electric Utility	27.5%
Luz del Sur	Electric Utility	13.0%

Source: SBS, CONASEV, BVL. Percents are estimates based on available data.

Investment Rules

Investment limits by categories

- 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 Governments, and financial and non financial entities with economic activities basically located in foreign territories: 50%, but the Central Bank has imposed a tighter operational limit of 30%.

Other important limits:

Investment in all types of securities issued by a single corporation can't 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

Each AFP manages three types of funds, which go from lower to higher risk. Anyone over 60 years old has to be in a type 1 fund (conservative fund which is a low risk fund).

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

MUTUAL FUNDS

The portfolios managed by the mutual funds is 4,8 billion dollars as of September 2011 or 2.8% of GDP. There are 6 mutual fund administrators. Most mutual fund administrators are owned by the banks or financial institutions. The annual average growth rate for the mutual funds has been 38%. As of September 2011 stocks accounted for 8.2% of their portfolio, following a conservative approach.

Mutual Funds Evolution Last Ten Years

YEAR	U.S.\$(MILL.)	GROWTH y*/y
2010	5,579.36	15%
2009	4,858.09	72%
2008	2,816.85	-35%
2007	4,332.33	68%
2006	2,581.08	29%
2005	1,997.42	13%
2004	1,766.91	-12%
2003	2,007.22	34%
2002	1,497.49	27%
2001	1,181.73	168%

Source: SMV

As these two groups of institutional investors are the most active in the Peruvian equities market, the Task Force focused particularly on their role as well as on relevant legal and regulatory requirements and voluntary recommendations already established in the market.

REVIEW OF THE RECOMMENDATIONS

1. Recommendation No. 1: Policies and good practices to encourage more active involvement of institutional investors (IIs) in promoting better governance

Perú has a voluntary corporate governance code, “Principles of Good Corporate Governance for Peruvian Corporations” (from now on the Principles). As such, there is a comply or explain policy. Issuers registered in the SMV’s Public Registry have to answer a questionnaire regarding their compliance with the code. The answers to the questionnaire are presented in an annex in the corporation’s annual report. The answers are provided by the company with no external audit made to them. (As such, some questions have been raised with regards to the validity of the answers.)

The Pension Fund Administrators’ Association was part of the committee that drafted the Principles for Peruvian corporations.

The current Principles for Peruvian corporations were drafted in 2002. Since then the OECD has issued their revised Principles of Corporate Governance. The SMV will conduct a revision of the Peruvian Principles.

2. Recommendation No. 2: Distinguishing better-governed companies for investment purposes

As explained above, there is an annual disclosure of compliance with corporate governance principles.

Furthermore, the Bolsa de Valores de Lima (BVL - Lima Stock Exchange) has created the Index of Good Corporate Governance (IBGC - Indice de Buen Gobierno Corporativo). To be included in IBGC, the corporate governance of the companies must be evaluated by a “validating” company accredited by the BVL (most of which are auditing companies, like Price, Deloitte, PCR, Ernst & Young, KPMG, Grant Thornton).

Validation is based in the questionnaire used by the SMV. In addition each principle has specific criteria defined, to make the evaluation the most objective possible. If the company passes a minimum threshold (currently at 70% of points), it is a candidate, but, it still has to pass minimum liquidity requirements to be included in the index (previously the threshold had been at 60%).

The accreditation process by the BVL implies that the validating company has to present their credentials to the BVL, to be evaluated. The criteria are: experience of the firm in corporate governance consulting or validating corporate governance, and the qualifications of the team that will do the validations.

At the moment there are 9 companies in the IBGC. A maximum of 10 can belong to the index. However, a total of 17 companies (including the ones in the index) have been “recognized” as being above the minimum of 70% of compliance points.

Companies in the IBGC

Company	Industry
Alicorp	Food and Beverage
Banco Continental	Banking
Buenaventura	Minning
Milpo	Minning
Cementos Pacasmayo	Cement
Edegel	Electric Utility
Ferreyros	Construction Equipment
Graña y Montero	Construction
El Brocal	Minning

Source: BVL

Additional companies above the 70% threshold

Company	Industry
AFP Horizonte	Pension Fund Administrator
AFP Integra	Pension Fund Administrator
Banco de Comercio	Banking
Copeinca	Fishing
Gold Fields La Cima	Minning
Manufacturera de Metales y Aluminios Record	Manufacturing
Profuturo AFP	Pension Fund Administrator
Backus y Johnston	Brewery

Source: BVL

To give more visibility to these companies the BVL is taking the following actions:

- a) A special section with the companies included in the IBGC will be designed in BVL’s daily Bulletin (The bulletin is freely available in the BVLs Web);*
- b) The recognized companies will be distinguished from other companies in the electronic trading platform of the BVL, by appearing with a different color.*

SMV will contribute to these efforts by including a link to the IBGC on SMV's web site... Pension funds must adopt the principles of good corporate governance and the best applicable practices in the investment decision process of each administered fund.

For new issuers, the AFPs must verify that they show an adequate level of compliance with the principles of good Corporate Governance. Companies have to meet additional float and liquidity requirements to be eligible as pension fund investments. When investing the pension funds' resources in mutual funds and close end funds the AFPs must promote an adequate level of compliance with the principles of good corporate governance. The task force discussed the possibility of increasing investment limits for those issuers with good corporate governance. This action must be weighed against principles of risk diversification of the portfolios. The possibility of increasing pension fund investment limits was also considered for instruments of low capitalization, new issuers and investment funds which invest in these types of companies.

The SBS will study mechanisms to favor the investment in companies with better corporate governance.

Since better corporate governance may imply less supervision costs, it may be possible to reduce some administrative costs to the issuers that show good corporate governance practices.

The SMV will study mechanisms to reward companies with good corporate governance.

The task force also discussed the importance of quarterly conference calls and the quarterly management report as an important way to inform the investors. Some issuers have started to have field trips to their facilities for investors, particularly those interested in raising capital or issuing bonds.

The SMV will establish minimum standards for the quarterly management report.

3. Recommendation No. 3: Distinguishing better-governed companies for investment purposes

The Association of AFPs has developed a corporate governance handbook as guidance for board directors. And, as mentioned above (see 1), the Pension Fund Administrators' Association was part of the committee that drafted the Peruvian Corporate Governance Principles.

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 look after the adequate compliance with these principles and practices.

There is no requirement for the IIs to disclose or formalize their policies related to corporate governance.

The Task Force reviewed the corporate governance policies of foreign institutional investors and agreed that the market needed to know what the Peruvian IIs were expecting from them in terms of corporate governance.

The Pension Fund and the Mutual Fund industries are considering recommending a set of corporate governance guidelines that could be followed by investee companies, in order to generate a positive incentive in such companies, as good corporate governance practices make them feasible investment targets.

Both types of institutional investors will define whether the guidelines will be established by each II or by their associations.

4. Recommendation No. 4: Exercising ownership rights in portfolio companies

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.

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 the result of their endeavors. 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.

Mutual funds are not required to vote in shareholders meetings.

An effort should be made to facilitate the ability of shareholders to add topics to the annual shareholder meeting agenda.

5. Recommendation No. 5: Voting at General Meetings of Shareholders

As explained above (see 3), 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.

Voting policies of foreign IIs were analyzed by the task force.

The Pension Fund industry is considering enhancing and revealing their voting policies.

Since 2008, electronic voting is permitted at the shareholders meetings, which will facilitate participation by more shareholders.

6. Recommendation No. 6: Encouraging communication between IIs and investee companies

The fact that there are a small number of qualified issuers and IIs facilitates communication among them.

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.

The information provided to the IIs should not include information that is not disclosed to the market as a whole.

AFPs also communicate with the investee companies to find out what are their needs in terms of the qualifications of the directors that the AFPs can appoint.

Quarterly conference calls should be encouraged, since these provide an opportunity for all shareholders to ask questions to management in an open environment. Currently, only companies registered in foreign exchanges have conference calls (Southern, Buenaventura, Credicorp, etc.), but, we also see new companies having conference calls (Alicorp's first conference call was this last quarter).

Improvement in the quality of the quarterly management reports by setting minimum standards is needed.

7. Recommendation No. 7: Encouraging communication among various IIs

II associations can be used to discuss and communicate common interests. In no case should communication lead to market manipulation or actions that impact on corporate control.

AFPs communicate among themselves to elect directors in the investee companies; although, in some cases a single AFP has enough shares to elect a board member by itself.

AFPs also communicate to defend the shareholders rights of their funds, and there are several examples in which they have successfully done such defense.

8. Recommendation No.8: Improving the functioning of the Board of Directors

The main mechanism to influence the Board of Directors has been the appointment of independent directors by the AFPs.

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 the relevant topics to the attention of the Association, and the Association sees that the directors be trained in such topics.

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 company 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 so by itself.

It should be noted that in Perú, managers or other staff from AFPs are forbidden from being appointed as directors.

The AFPs will enhance the procedures to select the most qualified candidates for independent directors, in order to guarantee the best interests of the funds.

The AFPs will encourage director training in corporate governance and look for adequate procedures to evaluate their performance.

The AFPs will encourage the evaluation of the board of directors within their investee companies.

9. Recommendation No.9: Strengthening the accountability of management

Directors appointed by the IIs can seek to improve the monitoring of management by the board of directors, making sure that management complies with the objectives and strategy set forth by the board of directors to improve shareholder value.

10. Recommendation No.10: Addressing internal corporate governance issues of institutional investors

Since AFPs are registered in the Public Registry of the SMV, they also have to answer the questionnaire related to their compliance with the Principles.

The investment committees of AFPs can include among its members, officers from other corporations that belong to the same economic group as the AFP. The regulation establishes that the AFP must make sure that the persons responsible of the investment policies approval, those in charge of their compliance and those that participate in the investment process must not have conflicts of interest.

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 certification at the initial level.

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

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.

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

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.

The AFPs will enhance their corporate governance practices.

The AFPs will make public their code of ethics on their web sites.

The Rules for the Mutual Funds and Mutual Funds Administrators establish that they have to develop Internal Rules of Conduct.

The Mutual Funds will consider revealing the corporate governance practices that they follow.

Since the current association only includes those Mutual Fund Administrators related to banks, the Association is considering creating a more inclusive association.

The Mutual Fund Association requests the inclusion of self-regulation in their regulations.

11. Recommendations to Strengthen Market Forces

Ensuring the integrity of external advice:

There aren't many advisory firms specialized in the evaluation of corporate governance practices. Rotation is not required for firms that validate the issuers that want to belong to the IBCG. The BVL has been asking the validating firms to present their working papers.

In order to seek uniform validating standards, the BVL will develop a set of frequently asked questions for these validating companies to use as reference.

It is worth noting that Mutual Funds do use arbitration as an alternative dispute resolution mechanism.

Influencing the perception of corporate governance in the market:

This year Expobolsa, the most important regular event that the BVL presents annually to the market, had a panel to discuss corporate governance issues. With Procapitales acting as moderator, the panel included three issuers with best practices, one pension fund and an institutional investor. This event was transmitted by TV and also was on-line. Around 2,500 investors had free accesses to Expobolsa.

The participants in the task force will seek interviews with the media on corporate governance issues to increase public awareness and understanding of these issues.

CONCLUSIONS

- Institutional investors realize the importance of being active and informed shareholders.
- There was a consensus in the Task Force that the recommendations are a useful input to improve corporate governance practices in Perú.
- Much care has to be taken in order to not impose excessive costs to the institutional investors.
- The size of the Peruvian Capital Market limits the amount of available suitable investments. This makes it more practical for institutional investors to set a minimum standard of corporate governance for the companies in which it invests.
- The Task Force was aware that some recommendations will take time to be adapted to the Peruvian reality and to each type of institutional investor.
- Commitments undertaken by the participants should have a timetable for their implementation.
- Institutional investors may need technical support from OECD, IFC and GCGF to implement the recommendations.
- Task Force participants should seek to maintain a working and consulting relationship among them.