

**REPORT ON THE OBSERVANCE OF STANDARDS AND CODES (ROSC)****Corporate Governance Country Assessment****REPUBLIC OF PERU****June 2004**

- I. Executive Summary**
- II. Capital Markets and Institutional Framework**
- III. Review of Corporate Governance Principles**
- IV. Summary of Policy Recommendations**
- V. Annexes**
  - A. Summary of Observance of OECD Corporate Governance Principles
  - B. Summary of Policy Recommendations
  - C. Market Data
  - D. List of Abbreviations

This Corporate Governance Assessment was completed as part of the joint World Bank-IMF program of Reports on the Observance of Standards and Codes (ROSC). It benchmarks the country's observance of corporate governance against the OECD Principles of Corporate Governance and is based on a template developed by the World Bank. This assessment was undertaken on the basis of the template prepared by the Peruvian law firm Bullard, Falla, Ezcurra & Rivarola for the World Bank. Acknowledgments are due to the Ministry of Economy and Finance, the *Comisión Nacional Supervisora de Empresas y Valores* (CONASEV), the *Superintendencia de Banca y Seguros* (SBS), the *Bolsa de Valores de Lima* (BVL), leading experts on legal, accounting and auditing issues, capital market issuers, pension fund managers, academics, investors, and stakeholder groups. Olivier Frémond and Mierta Capaul of the Corporate Governance Unit of the Investment Climate Department of the World Bank drafted the final report. The ROSC assessment was cleared for publication by the CONASEV on August 16, 2004.

## I. EXECUTIVE SUMMARY

This report provides an assessment of the corporate governance policy framework and enforcement and compliance practices in Peru. Corporate governance reform is at an early stage, and some legislation has recently been upgraded to protect shareholder rights.

The major issues are driven by the growing importance of the private pension funds (“AFP”). With USD 6.5 billion (11.4 percent of GDP)<sup>1</sup> of assets under management, AFPs are the most important institutional investors. Assuming a continued annual growth rate of 20 percent, assets under management will rise to 70 percent of 2002 GDP in ten years. At present, the governance structure of the pension fund administrators is weak, and there are not enough checks and balances to deal with conflicts of interest. Improving the internal governance structure is crucial in order to ensure the preservation of private savings for retirement. Voting and board representation policies are being developed by the regulator, so that pension funds can assume an active role as shareholders of their portfolio companies.

The report recommends<sup>2</sup> that: (1) the procedures governing the general meetings (GM) should be amended to encourage shareholder participation; (2) the related party transactions’ approval process should be more transparent and provide shareholders with the possibility to challenge transactions that are unfair to them; (3) the thresholds to challenge corporate decisions should be lowered and harmonized for all listed companies, and (4) there should be a requirement for a minimum number or percentage of independent directors on the boards of listed companies and for the creation of audit committees, and (5) directors should have access to adequate training so as to understand their duties and responsibilities. The report also proposes increased independence and a strengthening of enforcement mechanisms for the securities regulator.

## II. CAPITAL MARKETS AND INSTITUTIONAL FRAMEWORK

Compared to other Latin American countries, Peru’s equity market is relatively important, both in terms of market size and the number of listed companies. At the end of 2002, market capitalization was USD 13.4 billion or 23.5 percent of GDP.<sup>3</sup> This situation is the result of a government policy adopted in the 1970s, which mandated that industrial and other firms distribute so-called “investment shares” (*acciones de inversión*) in the amount of 15 percent of net profits to their employees.<sup>4</sup> These shares were non-voting and had no special dividend or liquidation privileges – they were not even considered part of share capital – but they were listed on the exchange. This is one of the reasons why the majority of listed companies are *sociedades anónimas ordinarias* (SA) rather than public companies (*sociedades anónimas abiertas* (SAA)).<sup>5</sup> Today, about 35 percent of listed shares are non-voting.<sup>6</sup> Most trading is concentrated in voting shares.<sup>7</sup> By law, banks, insurance companies, AFPs, financial institutions, leasing companies, SAAs and agricultural sugar cane companies must be listed.

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<sup>1</sup> Source: *Superintendencia de Banca y Seguros*.

<sup>2</sup> Specific recommendations regarding disclosure and reporting are discussed in the parallel Accounting and Auditing ROSC.

<sup>3</sup> USD 56.9 billion. As a percentage of GDP, the Peruvian market ranked fourth in selected Latin American countries, behind Argentina, Chile and Brazil. In absolute size, Peru was the fifth largest market, after Brazil, Argentina, Mexico and Chile. Source: World Bank World Development Indicators end-2002.

<sup>4</sup> Up to a cap of 50 percent of equity. Another reason is that most privatizations in the 1990s included a 30 percent public offering.

<sup>5</sup> A public company (SAA) must be listed. There are 52 SAAs on the BVL. A *sociedad anónima ordinaria* (SA) automatically becomes a SAA, if certain conditions are met, e.g. if it has 750 shareholders. However, holders of investment shares are not considered shareholders and are therefore not included in this number.

<sup>6</sup> Either preferred shares or “investment shares” (see below).

<sup>7</sup> Two of the largest and most active companies, Buenaventura and Creditcorp (both have ADRs), only have voting shares. Other smaller companies have converted their investment shares into voting shares.

The *Bolsa de Valores de Lima* (BVL) is the country's stock exchange; at year-end 2003, 232 companies and 255 share classes were listed, 158 of which never trade. The ten largest securities accounted for 62 percent of market capitalization and 57 percent of trading volume.<sup>8</sup> The BVL is a SRO. The BVL imposes no listing rules. Free float is estimated at 5 to 6 percent on average, excluding Creditcorp and Buenaventura, which are widely held. According to pension fund managers, only ten to 15 companies have sufficient liquidity to be considered "investible."

The corporate sector is characterized by concentrated family ownership, with various degrees of professional management. Business groups, horizontally and geographically diversified, with or without holding company and with or without bank, but with cross shareholdings, are frequent. Privatized companies also show concentrated ownership patterns, due to the transaction structures which transferred majority control to a strategic investor (60 percent). The most important institutional investors are the four private<sup>9</sup> pension funds, the AFPs.<sup>10</sup> As of December 2003, equity holdings represented 42 percent of assets under management.<sup>11</sup>

The legal framework is based on civil law. The key laws affecting corporate governance are the General Companies Law (*Ley General de Sociedades, 1997*, LGS) and the Securities Market Law (*Ley del Mercado de Valores 1996*, LMV).<sup>12</sup> The LGS establishes basic company forms and shareholder rights. The LMV regulates publicly offered securities, financial intermediaries and other market participants, securities exchanges, clearing and settlement and mutual funds. Two regulatory bodies supervise the financial markets: the *Superintendencia de Banca y Seguros* (Superintendence of Banks and Insurance, SBS), which also oversees the private pension funds; and the securities market regulator *Comisión Nacional Supervisora de Empresas y Valores* (CONASEV). CONASEV is responsible for the surveillance and control of compliance with the LMV and the Law on Investment Funds and their managers. With respect to issuers, it defines and supervises disclosure and enforces certain aspects of the LGS on public SAA companies.<sup>13</sup>

CONASEV is a public institution with separate legal personality. It reports to the Ministry of Economy and Finance. It is governed by a board of nine, appointed by the Minister/the President of the Republic for a three-year term. 140 people work at CONASEV. Its budget is allocated by the government. The enforcement arm of CONASEV consists of an in-house investigation unit with the power to subpoena and seize documents and conduct on-site inspections and an administrative tribunal made up of five outside lawyers appointed and removed by the board. The first line of appeal is the board of CONASEV.<sup>14</sup> Enforcement statistics are not publicly available, and there is no consistency with regard to the publication of rulings: some are posted on the website, some are not.<sup>15</sup>

In 2002, a Committee under the leadership of CONASEV issued a voluntary Code of Good

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<sup>8</sup> Source: *Bolsa de Valores de Lima*, January 2004.

<sup>9</sup> Employees have the choice between the public "pay as you go" system and the private "defined contribution" system.

<sup>10</sup> Integra (ING 60 percent), Unión Vida (Santander 90 percent), Horizonte (BBVA), Profuturo (Citibank 46 percent).

<sup>11</sup> The law permits them to invest up to 45 percent of assets in stocks, including foreign stocks.

<sup>12</sup> And to a lesser extent the Securities Law *Ley de Títulos Valores*, 2000.

<sup>13</sup> LGS, Article 253 states that CONASEV can (i) demand the change into an SAA if applicable; (ii) demand the change of an SAA into any other type of corporation; (iii) demand the presentation of financial information and, at the request of shareholders representing at least 5 percent of subscribed capital, other information related to the management of the corporation, unless such information causes damage to the corporation; and (iv) convene shareholder meetings, if the company does not comply with this obligation as stipulated by the law or bylaws.

<sup>14</sup> For claims among securities exchange members and between them and securities holders it is the administrative tribunal. If the party does not accept the ruling, (s)he can appeal to the superior court of justice.

<sup>15</sup> Recently the Board of CONASEV approved CONASEV Resolution 073-2004-EF/94.10 which regulates the publication and disclosure of CONASEV Rulings.

Corporate Governance.<sup>16</sup> It includes general recommendations on board organization and functions, as well as the protection of minority rights. 2005 will be the first year when listed companies are required to “comply or explain” their adherence to the Code in the annual report.

### III. REVIEW OF CORPORATE GOVERNANCE PRINCIPLES

This section assesses Peru’s compliance with each OECD Principle of Corporate Governance. Policy recommendations may be offered if a Principle is less than fully observed.<sup>17</sup>

#### Section I: The Rights of Shareholders

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

*Assessment: Largely observed*

*Description of practice: Secure methods of ownership registration.* All shares are registered. Public companies must deposit shares that are to be publicly traded in the central depository CAVALI ICLV.<sup>18</sup> Legal proof of ownership for dematerialized shares is registration with CAVALI ICLV.<sup>19</sup> For physical shares, it is registration in the company’s share register.

**Convey or transfer shares.** Shares are freely transferable when listed on a stock exchange.<sup>20</sup> CAVALI ICLV clears and settles transactions on a T+3 DVP2 basis, but does not provide novation.<sup>21</sup> The Central Bank does not have real time gross settlement.

**Obtain relevant information on the corporation on a timely and regular basis.** Companies must make periodic and continuous disclosures. Information is sent to the Securities Market Public Register operated by CONASEV, to BVL and posted on their respective websites. The annual report must be made available to shareholders for inspection before the AGM – reportedly, this sometimes only happens on the same day of the meeting. It is not sent to shareholders (see IVD).

**Participate and vote in general shareholder meetings.** Reportedly, there are instances of companies failing to hold their AGM. Holders of “investment shares” do not have the right to vote.

**Elect members of the board.** Shareholders elect directors for a minimum term of one and a maximum term of three years, after which the board is replaced in its entirety. Cumulative voting is mandatory.<sup>22</sup> Some companies have special classes of shares which grant their owners the right to elect a specified number of directors at separate elections held at special meetings.<sup>23</sup>

**Share in the profits of the corporation.** The board proposes dividends to the AGM for approval. The decision to distribute profits may be delegated to the board.<sup>24</sup> Shareholders representing 20

<sup>16</sup> *Principios de Buen Gobierno Corporativo para las Sociedades Peruanas*, or Principles of Good Governance for Peruvian Companies. This report also refers interchangeably to these Principles as the Code (of Good Governance)

<sup>17</sup> **Observed** means that all essential criteria are met without significant deficiencies. **Largely observed** means only minor shortcomings are observed, which do not raise questions about the authorities’ ability and intent to achieve full observance in the short term. **Partially observed** means that while the legal and regulatory framework complies with the Principle, practices and enforcement diverge. **Materially not observed** means that, despite progress, shortcomings are sufficient to raise doubts about the authorities’ ability to achieve observance. **Not observed** means no substantive progress toward observance has been achieved.

<sup>18</sup> CAVALI ICLV is the registry and clearing house for all transactions on the BVL.

<sup>19</sup> There are approximately 300,000 accounts at CAVALI ICLV. 58 percent of market capitalization is held in dematerialized form.

<sup>20</sup> Possible transfer restriction of “*sociedades anónimas ordinarias*” are overridden by the LMV.

<sup>21</sup> There are 600-1700 transactions per day.

<sup>22</sup> LGS, Articles 163-164.

<sup>23</sup> LGS, Articles 153 and 164.

<sup>24</sup> LGS, Articles 230 -231.

percent of voting capital may demand a dividend of up to one half of net profits. In response to complaints about the non-payment of dividends agreed at the AGM, CONASEV created a special committee for the protection of minority shareholders.<sup>25</sup> However, only shareholders of public SAA companies can seek redress from this committee.

*Policy recommendations:* CONASEV should strictly enforce the requirement for listed companies to hold a yearly AGM. The mandate of CONASEV's committee for the protection of minority shareholders should be extended to all listed companies. If a company has share classes with the right to elect a certain number of directors, this should be indicated in the annual report.

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

*Assessment: Largely observed*

*Description of practice:* Fundamental corporate changes are decided at shareholder meetings.<sup>26</sup> The right to decide on a capital increase may be delegated to the board for up to five years.<sup>27</sup> Sales of assets with a value of more than 50 percent of the capital stock require approval of shareholders representing a majority of voting capital.<sup>28</sup>

*Policy recommendations:* The rules governing the sale of assets need to be refined.

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

*Assessment: Partially observed*

*Description of practice:* The AGM must be held within three months of the fiscal year's end at the company domicile. Meetings are convened by the board. If the board refuses to call the AGM, shareholders representing 20 percent of the voting capital of a SA may ask the court to convene the meeting.<sup>29</sup> In the case of public SAAs, 5 percent of shareholders can request the board or CONASEV to call the meeting.<sup>30</sup>

The notice, containing the agenda, must be published ten days in advance in the case of SAs and 25 days in the case of SAAs. It is not uncommon for agendas to include "other business" as one item or for different issues to be "bundled" as one package for one vote only. Shareholders cannot force items onto the agenda, unless it is they who called the meeting. The GM may only approve resolutions on the agenda.<sup>31</sup> The quorum is 50 percent of voting capital for non-fundamental issues, and decisions are made by simple majority. If quorum is not reached on the first call, the quorum for the second call is 25 percent. For fundamental corporate decisions the quorum is 2/3 on the first call and 3/5 on the second call, and decisions are taken with a majority of total voting capital.<sup>32</sup> The time between calls must be between three and ten days.<sup>33</sup> Shareholders may appoint a representative up to 24 hours before the AGM. Bylaws can mandate

<sup>25</sup> *Comité de protección al accionista minoritario* (Law 26985 of 1998).

<sup>26</sup> The modification of certain bylaws following GM instructions can be delegated to the board/management LGS, Article 198.

<sup>27</sup> LGS, Article 206. The capital increase is capped at 100 percent of paid up capital.

<sup>28</sup> LGS, Article 115 (5).

<sup>29</sup> LGS, Article 117.

<sup>30</sup> LGS, Article 255 .

<sup>31</sup> LGS, Articles 116 and 258.

<sup>32</sup> LGS, Articles 125, 126 and 127.

<sup>33</sup> LGS, Articles 116 and 258.

that only shareholders, directors or managers can act as proxies.<sup>34</sup> There is no general proxy system that does not have a representative of the absent shareholder.

*Policy recommendations:* Policymakers should consider extending the notice period to 30 days (in line with international investor requests).<sup>35</sup> A specific percentage of shareholders, such as 5 percent, should be allowed to force items on the agenda. The revised agenda should be distributed to all shareholders at company expense. Generic agenda items, like “other business,” and the practice of bundling different issues under one item should be prohibited.<sup>36</sup> The legal provisions for listed SAs should be the same as for public SAAs. The proxy system should be overhauled. Voting in absentia should be encouraged.

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

*Assessment: Partially observed*

*Description of practice:* Ownership registration at CAVALI ICLV is at the level of ultimate owners. Legally, the possibility of nominees exist. CONASEV and the stock exchange must be informed by the company within five days when shares are transferred by persons who directly or indirectly hold 10 percent or more, or who go beyond or below the 10 percent threshold.<sup>37</sup>

The LGS permits the creation of different classes of shares. Some have special voting privileges for directors. The rights of such shares are disclosed when registered with the public registry operated by CONASEV, but not in the annual report. CONASEV defines a controlling shareholder as a person who alone or acting in concert holds more than 50 percent of voting shares or who has the power to elect or dismiss a certain percentage of directors.<sup>38</sup> A degree of control disproportionate to equity ownership is also achieved when controlling shareholders park treasury shares, which lose their voting rights, in subsidiaries. Shareholder agreements are legally valid if communicated to the company. If there is a contradiction between the shareholder agreement and the bylaws, the bylaws prevail.<sup>39</sup>

*Policy recommendations:* The annual report should report the rights of the different classes of shares and the names of ultimate beneficial owners above a certain percentage of share capital. The onus for disclosure should be on the shareholder, as well as the company.

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

*Assessment: Partially observed*

*Description of practice:* The substantial acquisition of shares is governed by the LMV as amended by Law 27649 of 2002. Two levels of ownership trigger a tender offer. (1) When an offeror intends, within a 12-month period, to purchase enough shares to reach a 25 percent holding in the target company, (s)he must purchase no less than 5 percent through a tender offer, even if this purchase brings the ownership above 25 percent. (2) If the offeror intends to purchase more than 50 percent, the tender offer must be for at least 10 percent. Failure to comply with the rules triggers sanctions from CONASEV.<sup>40</sup> There are no tag along rights for non-voting

<sup>34</sup> LGS, Article 122.

<sup>35</sup> See Institute of International Finance, “Policies for Corporate Governance and Transparency in Emerging Markets,” 2002.

<sup>36</sup> The Peruvian Principles of Good Governance recommends that “(...) Generic agenda items, like ‘other business’ and the practice of bundling different issues under one item should be prohibited (...)”

<sup>37</sup> Supreme Decree 093-2002-EF, Article 32.

<sup>38</sup> CONASEV Resolution 722-97-EF/94.10, Article 5.

<sup>39</sup> LGS, Article 8.

<sup>40</sup> Article 15 of Law 27649 replacing Article 72 of the Legislative Decree Number 861 of the LMV.

shares and investment shares, which can represent a substantial part of the share capital.

Articles 37-39 of the LMV mandate that a shareholder must have 2/3 of the shares of a listed company to delist; he must extend a tender offer to all shareholders of the affected class. The tender is only public for 20 days, which has created problems in the past. The exit price is either the weighted average market price during the last quarter or determined by an auditing firm appointed by CONASEV.<sup>41</sup> However, there is no threshold where a minority shareholder could require a majority shareholder to buy the minority shareholder's shares or vice versa.

*Policy recommendations:* Since 1997, 179 securities have been de-listed<sup>42</sup> and many more are expected to do so in the future. An efficient and equitable mechanism for de-listing needs to be put in place. Consideration should be given to minority protection measures. Examples would be that majority shareholders with 90 percent or more ownership should be required to purchase the remaining shares at the election of the shareholders and vice versa.

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

*Assessment: Partially observed*

*Description of practice:* In 2003, SBS introduced the legal obligation for pension funds to attend the AGMs of companies in which they hold voting shares.<sup>43</sup> The decree further introduced the obligation to appoint directors to the boards of portfolio companies. The directors elected by the AFPs must not be related to the controlling shareholder of the portfolio company. They must not be employees, major shareholders or directors of the AFP itself, to avoid potential conflicts of interest.<sup>44</sup> However, the definition of "independence" does not include other "insiders," such as e.g. the legal counsel. The director elected by each AFP is expected to report back to the AFP periodically.

The date of record is two days for SAs and ten days for public SAA companies.<sup>45</sup> Shares are not blocked from trading.

*Policy recommendations:* To ensure that the AFPs understand and fulfill their role as fiduciary investors, the detailed regulations of the decree should clearly spell out what is expected of them and to whom they must report what. Different ownership thresholds could trigger different obligations, e.g. policymakers could define the percentage of ownership that obliges pension funds to attend the GM and/or nominate a director. It should also allow pension funds to nominate a representative for all AFPs. The definition of director independence should take into consideration both conflicts of interest within the AFP itself, as well as within the portfolio company and the business group it might belong to. Once elected, directors should be accountable to all shareholders and not only to the shareholders that elected them. This would imply that directors should not be asked to report back to the AFPs. Transparency could be enhanced if the AFPs would disclose their actions to the SBS and to their policyholders.

## Section II: The Equitable Treatment of Shareholders

**Principle IIA:** The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights. All shareholders of the same class should be treated equally. (i) Within any class, all shareholders should have the same voting rights. All investors should be able to obtain

<sup>41</sup> LMV, Article 69. LGS, Article 262, provides a similar right to shareholders of public SAA corporations.

<sup>42</sup> Statistics from the BVL, January 2004.

<sup>43</sup> Decreto Supremo número 182-2003-EF. Approximately 80 percent of the shares in the portfolios are voting.

<sup>44</sup> i.e. not employees, major shareholders or members of the board. Article 94 of Decreto Supremo número 182-2003-EF.

<sup>45</sup> LGS, Articles 121 and 256.

information about the voting rights attached to all classes of shares before they purchase. Any changes in voting rights should be subject to shareholder vote. (ii) Votes should be cast by custodians or nominees in a manner agreed upon with the share's beneficial owner.

***Assessment: Partially observed***

***Description of practice:*** Shareholders holding 5 percent of voting capital can call a GM in a public SAA; it is 20 percent for an ordinary SA.<sup>46</sup> Five percent of voting rights confer the right to information in public SAAs; the percentage is 25 percent for SAs.<sup>47</sup> With 20 percent of voting rights, shareholders can request a court to suspend a decision that has been contested; the same percentage can demand the distribution of a dividend of up to 50 percent of earnings.<sup>48</sup> Shareholders owning 25 percent of voting rights can postpone the GM for three to five days<sup>49</sup> or have their shares listed, even if the other shareholders do not to follow suit. Finally, with 40 percent of the voting rights, provided this percentage constitutes a majority of the votes at a shareholders meeting, pre-emptive rights can be abolished.<sup>50</sup>

Shareholder redress takes different forms, depending on the issue. Article 200 of the LGS grants withdrawal rights in cases where shareholders vote against certain fundamental decisions or are not present at the GM.<sup>51</sup> Shareholders who object to or were absent during voting on certain decisions, can sue in civil court or in an arbitration proceeding. While class actions exist under Peruvian law, these are not used to solve shareholder disputes.<sup>52</sup> With 33 percent of capital, a derivative lawsuit against a director or the board as a whole can be brought, even if the GM did not agree to do so. Any sums recovered are for the benefit of the corporation.<sup>53</sup> In addition, in the event that a shareholder feels that actions by a director have damaged him or her individually, (s)he may bring a civil action or arbitration for redress.

In practice, there have been few actions of corporate or individual claim against the board. Filing corporate action is made difficult because of (i) the high capital threshold; (ii) the difficulties in proving fraud, abuse of power or gross negligence, especially considering the difficulty for minority shareholders to obtain relevant information; and (iii) the lack of specialization in the judicial branch and the high costs of long trials.<sup>54</sup> Most actions brought before the judiciary relate to shareholders meetings, e.g. failure to publish the agenda or voting on items not listed in the agenda. In such cases the evidence required is fairly straightforward, and these cases tend to be solved more expeditiously.

There is no rule requiring custodians to notify beneficial owners of the their options in instructing the custodian to vote the shares. Nonetheless, depending on the provisions of the custodian/trust agreement, beneficiaries may have the right to instruct the custodian how to vote. Custodians can only vote with the proxy of the beneficial owner.

***Policy recommendations:*** High minority redress thresholds combined with concentrated

<sup>46</sup> LGS, Articles 117 and 255.

<sup>47</sup> LGS, Articles 130 and 261.

<sup>48</sup> LGS, Article 145.

<sup>49</sup> LGS, Article 131.

<sup>50</sup> LGS, Article 259.

<sup>51</sup> Change in corporate purpose, transfer of place of business overseas, imposition of new economic obligations and limitations to the share transfers or other cases stipulated in the bylaws.

<sup>52</sup> LGS, Articles 12-13, 139, 181-182. Peru has a legal figure similar to the class action lawsuit called *Patrocinio de intereses difusos (Código Procesal Civil)*. CONASEV is drafting a proposal to make class and derivative actions available for shareholder disputes.

<sup>53</sup> Claims for responsibility filed by the company against the director is adopted through the GM. Shareholders holding 33 percent of capital stock may directly exercise this claim, provided that the lawsuit is on behalf of the company and not on behalf of the private interests of the plaintiffs. LGS, Articles 181-183.

<sup>54</sup> Only civil courts exist in Peru. While arbitration is permitted, it is not widely used and some bylaws expressly prohibit it.

ownership structures mean that shareholders have few oppression remedies in practice. Policymakers should also consider harmonizing the requirements for all listed companies.

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

*Assessment: Materially not observed*

*Description of practice:* Firms must report insider transactions<sup>55</sup> above 1 percent of capital to CONASEV and BVL within five days, unless 3/4 of the board consider that such information is confidential and disclosure could damage the company<sup>56</sup> and the board of CONASEV agrees.<sup>57</sup>

Trading based on privileged information is prohibited. However, market participants and regulators share the view that insider trading and abusive self-dealing remain a problem. Recently, SBS took a step to solve this problem within the pension fund system.<sup>58</sup> Article 61 prohibits pension fund managers to trade the same instruments as the funds they manage on their own account.<sup>59</sup> Since it is legally difficult for CONASEV and SBS to exchange information, AFP employees must provide SBS with an express authorization to inspect their personal transactions starting in 2004. Insider trading penalties include jail terms of up to five years.<sup>60</sup> However, the LMV caps the maximum fine for an offender to 10 percent of annual income.<sup>61</sup> In the last five years, CONASEV has issued rulings on four cases.

*Policy recommendations:* CONASEV should dedicate more resources to market surveillance/investigation. Policymakers should facilitate the exchange of information between the regulatory agencies. Fines should not be capped; these should be structured to be a multiple of gains made or losses avoided. The provision allowing a supermajority of the board to exempt the disclosure of an insider transaction should be revisited. One successful and highly publicized prosecution of an insider trading case could set an example and act as a deterrent to the market as a whole.

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

*Assessment: Materially not observed*

*Description of practice:* Under IFRS 24, there is significant scope for interpretation as to what should be disclosed. In practice, reporting in Peru is often limited to transactions with subsidiaries and associate companies of the same business group. It does not include directors, management or major shareholders. Related-party transactions should also be immediately disclosed as "material events." However, CONASEV does not appear to have the necessary infrastructure to engage in meaningful oversight. There is no obligation to inform the AGM.

Directors may engage in related-party transactions if they take place at market prices and in the ordinary course of business or if 2/3 of the board approve them. The same rule applies to loans and guarantees.<sup>62</sup> If directors have a conflict of interest, they must inform the board and abstain from voting. There are no rules governing the conduct of directors who represent major shareholders or others with vested interests. Controlling shareholders who have a direct or indirect conflict of interest must not vote at the GM.<sup>63</sup> Recently, there have been two well

<sup>55</sup> Insiders include directors and officers, their spouses, parents and relatives up to the 1<sup>st</sup> degree of consanguinity.

<sup>56</sup> Supreme Decree 093-2002-EF, Article 32.

<sup>57</sup> CONASEV Resolution 107-2002-EF/94.10, Article 8.

<sup>58</sup> Supreme Decree 182-2003-EF.

<sup>59</sup> However SBS grants exceptions to this rule, as long as these exceptions are included in the investment policy.

<sup>60</sup> Criminal Code, Article 251(A).

<sup>61</sup> LMV, Article 352.

<sup>62</sup> LGS, Article 179.

<sup>63</sup> LGS, Article 133. Their shares are counted to establish the quorum, but not to make a decision.

publicized cases where related-party transactions allegedly resulted in the expropriation of owners of investment shares. In one instance, the controlling shareholders approved the merger of their loss making a wholly-owned subsidiary with the listed company which had the effect of wiping out the distributable earnings of the listed company. CONASEV challenged the decision. In another case, a mining company sold a valuable mining asset to a related company. When holders of investment shares complained about losing this potentially valuable stream of revenue, the controlling shareholders agreed to buy the shares at the demanded price, and the mining company de-listed.

*Policy recommendations:* The monitoring and strict enforcement of disclosure obligations of related-party transactions should become a top CONASEV priority. Rules that govern the conduct of directors who are connected to major shareholders and other bodies with a vested interest in board decisions should be developed, and a clear definition of “controlling party,” (including direct, family and beneficial ownership) should be formulated. It is not good practice for the board to authorize non arm's length dealings among related parties without shareholder involvement. First, shareholders should have access to this information. Second, shareholders representing a certain percentage of capital should be able to put the transaction to a vote at an extraordinary general meeting. It may be advisable to ban certain related party transactions involving officers and directors, including loans. In addition, any transaction outside the normal course of business should be noted in the financial statements. There should be disclosure and audit of all deals between controlling parties (not just officers and directors) and the company in the annual report.

### **Section III: Role of Stakeholders in Corporate Governance**

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

*Assessment: Largely observed*

*Description of practice:* There are no specific legal requirements that corporations take into account stakeholder interests. The Code of Good Governance does have a section on stakeholder involvement, and several corporations are voluntarily complying with the Code.

*Policy recommendations:* CONASEV should raise awareness about stakeholder issues and corporate social responsibility so that companies are prepared to “comply or explain” their adherence to the Code in the annual report.

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

*Assessment: Largely observed*

*Description of practice:* Labor representatives can seek redress from the Labor Ministry for violations of the Labor Law. In bankruptcy procedures, labor and creditors’ rights are handled by INDECOPI, an administrative authority. Other stakeholders, such as consumers and environmental groups, can seek redress from their respective ministries.

*Policy recommendations:* An Insolvency/Creditor Rights ROSC is recommended for Peru. Stakeholders, including individual employees and their representative bodies, should be able to freely communicate their concerns about illegal or unethical practices to the board and their rights should not be compromised for doing this.

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

*Assessment: Partially observed*

*Description of practice:* Six percent of net profits are distributed to employees and managers - 50 percent on the basis of the number of days worked and 50 percent according to the salary.

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

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

*Assessment:* **Largely observed**

*Description of practice:* The LGS specifies that the board must give shareholders and third parties sufficient and timely legal, economic and financial information.<sup>64</sup> If the annual financial statements uncover a loss of one half of capital and assets are not sufficient to cover the liabilities, the board must call a shareholder meeting and within 15 days inform the creditors and request, if applicable, the declaration of insolvency.

*Policy recommendations:* See recommendations in Section IV.

#### **Section IV: Disclosure and Transparency**

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

*Assessment:* **Partially observed**

*Description of practice:* It is a continuous obligation for listed companies to file periodic financial information with CONASEV and BVL. (1): The annual report contains the chairman's statement, a balance sheet and income statement, a cash flow statement, sources and applications of funds, notes, and the audit report. Consolidation and segment reporting are mandatory.<sup>65</sup> (2): A general description of company objectives is included. (3): Under the LMV, the issuer must disclose share transactions involving 10 percent. With respect to business groups, the rules are stricter: Any shareholder with 0.5 percent or more of the equity of a company belonging to an economic group, must be known to CONASEV.<sup>66</sup> In addition, CONASEV requires the reporting of any shareholder controlling 5 percent of the company controlling the group.<sup>67</sup> On the other hand, ownership disclosure in the annual report is limited to a list indicating the number of shareholders who own between 0-1 percent, 1-5 percent and 5-10 percent of share capital, and the identity and nationality of those who own 5 or more percent. Share classes and their rights are not described.<sup>68</sup> Ownership is not required to be disclosed to the level of ultimate beneficial owner. (4): Board information is sparse; there is currently no disclosure on remuneration.<sup>69</sup> (5): Risk factors are discussed in the notes. (6): A discussion on material events regarding employees

<sup>64</sup> LGS, Article 175.

<sup>65</sup> Statutory dividends and taxes are calculated on the basis of unconsolidated financial statements.

<sup>66</sup> Articles 7 and 11 of Resolution 722-1997-EF/94.10 *Reglamento de propiedad indirecta, vinculación y grupo económico*.

<sup>67</sup> Additional disclosure requirements include e.g. changes in the composition of the board of directors and management of the companies of the group. Since business groups are often international with a large number of foreign operations and continuously undergo management and board changes, they routinely apply for waivers from CONASEV. This makes the ownership oversight of economic groups ineffective in practice (*Reglamento de registro de CONASEV* and Article 32 of the LMV).

<sup>68</sup> Share ownership and the rights of the different classes of shares are publicly available at the Securities Market Public Registry.

<sup>69</sup> If the board is paid more than 6 percent of net profits, this must be disclosed as a material event to CONASEV. However, 6 percent is the maximum deduction under the tax code and companies stay within this limit. As noted in CONASEV Management Resolution N° 096-2003-EF/94.11, disclosure of board remuneration will be mandatory beginning in 2005.

<sup>69</sup> Material events are set forth in CONASEV Resolution No. 107-2002-EF/94.10 *Reglamento de Hechos de Importancia, Información Reservada y otras Comunicaciones*". Any necessary information for an investor to assess the implicit risk of the company, its operations, financial and market situation is considered a material event.

and other stakeholders is not mandatory. (7): Starting in 2005, companies will have to “comply or explain” their adherence to the Code of Good Corporate Governance.

Based upon the preliminary findings of the Accounting and Auditing ROSC,<sup>70</sup> the overall level of compliance is relatively satisfactory, though there are clear cases of non-compliance on a few issues. The fact that 70 percent of all cases<sup>71</sup> before the administrative tribunal of CONASEV are financial reporting cases suggests that (i) compliance needs to be further improved; (ii) CONASEV is attempting to enforce disclosure requirements. The linchpin of the disclosure regime is the requirement that companies disclose material events when they occur. Some companies try to take advantage of the exception made for “reserved” events, where management or the board can allege that the dissemination would harm business interests.<sup>72</sup> According to some market participants, such exceptions are often granted by CONASEV.

*Policy recommendations:* See Accounting and Auditing ROSC.

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

*Assessment: Partially observed*

*Description of practice:* Peru uses IFRS and annual financial statements are audited. However, a significant pool of accountants have not had the training necessary to apply IFRS. There is a scarcity of resources within CONASEV to handle compliance with disclosure. In practice, the CONASEV department in charge of verifying reporting compliance concentrates on monitoring if the reports have been filed on time and in the proper format, rather than the content of the filings. As of today, CONASEV is not in a position to totally ensure compliance with IFRS nor to evaluate the quality of the filings.<sup>73</sup> While CONASEV relies on auditors for quality control, auditors are not legally bound to inform CONASEV of any irregularities found during an audit.<sup>74</sup> There is currently no institutional or peer review process to oversee the quality of audit.

*Policy recommendations:* CONASEV should focus on developing the capacity to review and evaluate the quality of the financial reports filed by listed companies. This could be done on the basis of a “risk analysis” and on a periodic cycle, so that all firms are reviewed within e.g. two years. In addition, capacity should be developed to evaluate and react to material events when they occur. A system of quality assurance should be put in place to determine whether auditors are in compliance with international accounting and auditing standards.

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

*Assessment: Materially not observed*

*Description of practice:* CONASEV regulations require that auditors have no financial interests or dealings with an audited company, e.g.: (i) they must not have held a position with the company during the accounting year or the previous year; (ii) they cannot have any direct or indirect financial interest in the company; (iii) they cannot be immediate relatives of decision-makers in the company; and (iv) they cannot have any economic or administrative ties with the

<sup>70</sup> The Accounting and Auditing diagnostic is expected to be finalized in June 2004.

<sup>71</sup> Interview with the CONASEV administrative tribunal, January 2004.

<sup>72</sup> CONASEV Resolution 107-2002-EF/94.10, Article 8, *Reglamento de Hechos de Importancia Información Reservada y otras Comunicaciones*.

<sup>73</sup> For the financial year ending on 31/12/2002, eight companies filed late and 20 companies did not file at all. *Source:* BVL.

<sup>74</sup> However, Financial Information Rule (RC 103-99-EF/94.10, Article 42) compels auditors to clearly mention when their opinions are adverse or when they prefer to not issue an opinion about the financial statement of any enterprise.

company. Auditors are elected by the AGM, unless this faculty is delegated to the board.<sup>75</sup> In practice, the auditor is often appointed by management, who also approves the audit and receives the management letter.<sup>76</sup> The audit firm may render internal audit and consulting services to the same company for which it conducts an external audit. Audit and consulting fees are not disclosed in the annual report.<sup>77</sup> Rotation of the auditor or lead partner is not required.<sup>78</sup>

There is a significant number of auditing firms in Peru, chasing after a pool of 232 companies. This competitive market suggests that it is difficult for auditors to stand up to their audit clients. External auditors are known to sometimes provide support to management in the preparation of the financial statements. This puts them into a situation of conflict of interest, as they certify the veracity of something they prepared themselves. While in theory the *Colegio de Contadores* can disqualify a member for unethical behavior, in practice this does not happen.

*Policy recommendations:* The definition of auditor independence must be amended to meet international standards. Policymakers should consider options to subject auditors to an oversight body that operates in the public interest that is not under the control of the auditing profession. This issue will be elaborated in detail in the Accounting and Auditing ROSC.

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

*Assessment: Partially observed*

*Description of practice:* There is no obligation to publish financial information in the press.<sup>79</sup> The law only mandates that this information be “available” to shareholders before the AGM. This means that in, some cases, shareholders see the annual report for the first time just before the beginning of the AGM, which does not give them enough time to analyze the financial situation of the company. Once the AGM approves the accounts, these are submitted to CONASEV and BVL and published on their websites. Investors can also obtain records for a fee at the CONASEV Documentation Center.

*Policy recommendations:* Financial statements should be made available well in advance of the AGM, so that shareholders have sufficient time to make an informed decision on whether the financial statements reflect a true and fair picture.

## Section V: The Responsibility of the Board

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

*Assessment: Partially observed*

*Description of practice:* Peru has a single board structure with a minimum size of three directors. The law includes the concepts of regular and “substitute” director.<sup>80</sup> Directors are expected to perform their duties carefully and loyally. They are bound to confidentiality.<sup>81</sup> Each director has the right to be informed of all relevant information, in order to act with full knowledge.

*Policy recommendations:* The institution of “substitute” director serves to diffuse the

<sup>75</sup> LGS, Article 114.

<sup>76</sup> This is not the case in the banking sector.

<sup>77</sup> The Peruvian Code of Good Governance recommends that auditing and accounting fees be disclosed in the annual report.

<sup>78</sup> Resolution CONASEV No. 103-99-EF/94.10, Regulation of Financial Information, Pub. 26.11.1999.

<sup>79</sup> Except for financial institutions.

<sup>80</sup> LGS, Articles 156 and 159.

<sup>81</sup> LGS, Article 171.

responsibility of the board; it provides little practical benefit for shareholders and should be removed from the LGS.

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

*Assessment: Materially not observed*

*Description of practice:* Directors must not adopt resolutions that favor their personal interest or the interest of related parties above the interests of the company, nor use business opportunities derived from their position to their own benefit or the benefit of third parties.<sup>82</sup> Controlling shareholders often exercise significant influence over boards, directly as directors or indirectly through the appointment of board members who report to them.

*Policy recommendations:* The fiduciary duties of the board should be more clearly set forth in the law and by-laws, in order to clarify its primary responsibility to the corporation and all shareholders. Policymakers should consider introducing the concept of “shadow director,”<sup>83</sup> whereby controllers would be held liable if they take decisions reserved to the board.

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

*Assessment: Largely observed*

*Description of practice:* The board has no legal obligation to take into account stakeholder interests, although the Code of Good Corporate Governance encourages it to do so. Directors and officers are liable for damages caused by resolutions taken against the law or the bylaws.<sup>84</sup>

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

*Assessment: Partially observed*

*Description of practice:* In addition to the LGS, Peru relies on its Code of Good Corporate Governance to set the key functions of the board. (1): The board has the overall responsibility for the activities of the company. The LGS states that the board is empowered with the faculties of management and legal representation, except for those matters attributed to the AGM.<sup>85</sup> (2 and 3): The board selects and oversees management, unless the bylaws reserve this faculty to the AGM.<sup>86</sup> (4): Directors with an interest contrary to the interest of the company must inform the board and abstain from participating in the discussion and decision concerning the matter. (5): The submission of the financial statements to the AGM for approval is a responsibility of the board that cannot be delegated.<sup>87</sup> (6): Starting in 2005, companies will have to “comply or explain” their adherence to the Code of Good Corporate Governance; this will require board involvement. (7): The board is responsible for overseeing disclosure and communication.<sup>88</sup>

<sup>82</sup> LGS, Articles 180, 189.

<sup>83</sup> “Shadow directors” are controlling shareholders or shareholders with significant influence over the control of the company, who exert influence over the board even though they are not de facto directors.

<sup>84</sup> LGS, Article 177.

<sup>85</sup> LGS, Article 172.

<sup>86</sup> LGS, Article 185.

<sup>87</sup> LGS, Article 174.

<sup>88</sup> LGS, Articles 175 and 221.

*Policy recommendations:* The Code of Good Corporate Governance should spell out more clearly the duties of the board. Directors should have access to training in order to fully understand their rights, responsibilities and liabilities, as recommended by the Peruvian Code of Good Governance. The quality of disclosure could be enhanced if boards were to create audit sub-committees with financial and accounting expertise.

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

*Assessment: Materially not observed*

*Description of practice:* (1): The LGS permits the board to delegate certain functions to specific members, thus allowing for the creation of specialized committees. The Code recommends that companies establish audit committees. In practice, the few audit committees that have been set up are generally not considered effective, because the CFO and sometimes major shareholders are members of the committee. There is no legal requirement that directors be independent. Non-executive directors with the ability to exercise independent, objective judgment are rare. Boards tend to be dominated by directors who represent the controller. The result is a perception that boards are run by insiders. (2): The board meets upon request of the chairman or when a director or manager requests a meeting.<sup>89</sup> Quorum is half plus one, and resolutions are adopted by simple majority. The meetings may take place virtually (by written communication or electronically), unless one of the directors requests a physical meeting.

*Policy recommendations:* There should be a requirement for a certain number or percentage of independent directors on the board of listed companies, as well the creation of audit committees. In addition to “negative criteria” defining when an individual cannot be regarded as independent, it would be helpful to have some “positive” examples of qualities that increase effective independence. Boards should meet regularly and the quorum should be such that no decision can be taken without the vote of independent directors.

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

*Assessment: Partially observed*

*Description of practice:* Under the LGS, board members should have access to accurate, relevant and timely information. In practice, this may not be the case if management does not cooperate with the directors that represent minority interests.

*Policy recommendations:* Directors should be able to hold management accountable for lack of cooperation in access to information. This should be noted in the minutes of the board meeting and disclosed at the AGM, so that management can be sanctioned for excessive dilatory activity.

#### IV. SUMMARY OF POLICY RECOMMENDATIONS

This section sets out recommendations to improve listed companies’ compliance with the OECD Principles.<sup>90</sup> The next step is the development of a detailed action plan in cooperation with the authorities and in consultation with the private sector and other stakeholders. Key themes can be summarized as follows:

<sup>89</sup> LGS, Article 167.

<sup>90</sup> Specific recommendations regarding disclosure will be separately discussed in the Accounting and Auditing ROSC.

**Legislative reform.** This report identifies several areas where changes to the laws would increase compliance with the OECD Principles. CONASEV's mandate to call an AGM and deal with complaints regarding the distribution of dividends, for example, should be extended to all listed companies. Generally, the procedures governing the GM should facilitate shareholder participation and involvement. To this end, notice periods should be lengthened, shareholders should be able to include resolutions to the agenda, and proxy voting should be facilitated. Another area of concern is that of related-party transactions. The approval process of such transactions should be more transparent. Good practices from around the world could be adopted, including pre-vetting by the audit committee and the possibility for shareholders to challenge transactions unfavorable to them.

Given that redress mechanisms, once rights have been violated, are weak and ownership is concentrated, policymakers may consider strengthening *ex ante* rights of shareholders by lowering the thresholds for calling a GM, requesting information, suspending a decision of the GM and filing a court action. The thresholds could be harmonized between SAs and SAAs.

**Institutional strengthening.** The independence of CONASEV needs to be strengthened. The current process of board nomination is subject to capture and to conflicts of interests. This creates problems, particularly because substantially all rulings of the administrative tribunal are appealed to the board. To strengthen the independence of CONASEV, one solution could be to (1) appoint the chair of CONASEV for a period longer than the executive office; and (2) institutionalize the board by assigning specific institutions such as SBS, the Central Bank, the Ministry of Economy and Finance and others, a seat on the board of CONASEV.

The internal governance structure of the AFPs needs strengthening. Guidelines should clearly define the fiduciary duties of pension fund administrators and put up firewalls against conflicts of interest. In addition, requirements should be put in place to ensure that the AFPs play their role in the governance of their portfolio companies and inform policyholders accordingly.

**Enforcement.** The implementation and enforcement of corporate governance rules remain a key challenge. The assessment recommends improved enforcement of disclosure provisions, with increasing emphasis on a review of content. CONASEV should strengthen its capacity to monitor disclosure. Staff should be trained to gain awareness of corporate governance issues and abuses. Emphasis should be placed on the disclosure of ownership and related-party transactions.

Policymakers should consider facilitating the exchange of information between CONASEV and SBS in order to investigate insider trading. Fines should be stiffened to act as credible deterrents. Procedures need to be put in place to protect shareholders during de-listing.

**Voluntary/private initiatives.** The existing Code of Good Governance echoes OECD recommendations, but is too broad, provides limited detail, and should be revised to more clearly address Peruvian corporate governance issues. One area of focus should be board practices, including director independence, special purpose committees, and board duties. A key missing ingredient is a strong, widely accepted director training organization (e.g. an Institute of Directors). Policymakers and CONASEV, as well as the private sector, have a strong interest in increasing director professionalism. International best practice suggests that the new organization can both serve as a training organization (on a fee basis) and a corporate governance advocacy organization, providing input into future corporate governance reforms. The institution can communicate the variety of new rules to board members and build a culture of strong and independent boards of directors.

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

Principle	O	LO	PO	MO	NO	Comment
<b>I. THE RIGHTS OF SHAREHOLDERS</b>						
IA		X				<ul style="list-style-type: none"> <li>Reportedly instances of companies failing to hold AGM.</li> <li>CONASEV has set up a committee to protect minority shareholders of public SAA companies only.</li> </ul>
IB		X				<ul style="list-style-type: none"> <li>Fundamental corporate changes are decided at shareholder meetings.</li> <li>Majority of voting capital approves sale of assets valued at over 50% of capital stock.</li> </ul>
IC			X			<ul style="list-style-type: none"> <li>The meeting notice and agenda is published ten days in advance for SAs and 25 days for SAAs.</li> <li>Agendas tend to include generic agenda items bundling different issues in one package.</li> <li>Shareholders cannot force items on agenda unless they call the meeting.</li> </ul>
ID			X			<ul style="list-style-type: none"> <li>The rights of different classes of shares are only disclosed at the public registry, not in the annual report.</li> </ul>
IE			X			<ul style="list-style-type: none"> <li>Insufficient minority shareholder protection measures in delisting.</li> </ul>
IF			X			<ul style="list-style-type: none"> <li>Legal obligation for pension funds to attend GMs, but unclear expectations and obligations.</li> </ul>
<b>II. EQUITABLE TREATMENT OF SHAREHOLDERS</b>						
IIA			X			<ul style="list-style-type: none"> <li>Few oppression remedies in practice due to high minority redress thresholds and concentrated ownership structures.</li> </ul>
IIB				X		<ul style="list-style-type: none"> <li>Enforcement of insider trading remains problematic.</li> <li>Maximum fine for an offender is 10% of annual income.</li> </ul>
IIC				X		<ul style="list-style-type: none"> <li>Board can authorize non-arm's length dealings among related parties without shareholder involvement.</li> </ul>
<b>III. ROLE OF STAKEHOLDERS IN CORPORATE GOVERNANCE</b>						
IIIA		X				<ul style="list-style-type: none"> <li>No specific legal requirements that stakeholder interests be considered, but mentioned in non-mandatory CG Code.</li> </ul>
IIIB		X				<ul style="list-style-type: none"> <li>Redress can be obtained from the Labor Ministry, an administrative authority (INDECOP), or other ministries.</li> </ul>
IIIC			X			<ul style="list-style-type: none"> <li>6% of net profits are distributed to employees and managers on basis of number of days worked and salary.</li> </ul>
IIID		X				<ul style="list-style-type: none"> <li>The board must give shareholders and third parties sufficient and timely legal, economic and financial information (LGS).</li> </ul>
<b>IV. DISCLOSURE AND TRANSPARENCY</b>						
IVA			X			<ul style="list-style-type: none"> <li>Compliance with financial reporting must be improved.</li> <li>Companies sometimes exploit exemption for material events disclosures that would harm business interests.</li> </ul>
IVB			X			<ul style="list-style-type: none"> <li>CONASEV lacks resources to oversee disclosure.</li> <li>No institutional oversight of audit quality.</li> </ul>
IVC				X		<ul style="list-style-type: none"> <li>In practice there is lack of auditor independence.</li> </ul>
IVD			X			<ul style="list-style-type: none"> <li>No obligation to publish financial information in the press or to provide sufficient time for shareholders to analyze financial situation of company.</li> </ul>
<b>V. RESPONSIBILITIES OF THE BOARD</b>						
VA			X			<ul style="list-style-type: none"> <li>Regular and "substitute" directors are permitted.</li> </ul>
VB				X		<ul style="list-style-type: none"> <li>Controlling shareholders often exercise significant influence over boards.</li> </ul>
VC		X				<ul style="list-style-type: none"> <li>Directors and officers are liable for damages caused by resolutions taken against the law or bylaws.</li> </ul>
VD			X			<ul style="list-style-type: none"> <li>Key functions of the board are set out in the CG Code.</li> </ul>

<b>Principle</b>		<b>O</b>	<b>LO</b>	<b>PO</b>	<b>MO</b>	<b>NO</b>	<b>Comment</b>
VE	The board should be able to exercise objective judgment				X		<ul style="list-style-type: none"> <li>Boards tend to be dominated by directors who represent the controller.</li> </ul>
VF	Access to information			X			<ul style="list-style-type: none"> <li>In practice, management may not provide access to information for directors that represent minority interests.</li> </ul>

## Annex B: Summary of Key Policy Recommendations

<b>I. THE RIGHTS OF SHAREHOLDERS</b>		
IA	Basic shareholder rights	<ul style="list-style-type: none"> <li>• CONASEV should strictly enforce the requirement for listed companies to hold an annual GM.</li> <li>• CONASEV's committee for minority shareholder protection should be extended to all listed companies.</li> </ul>
IB	Rights to participate in fundamental decisions.	<ul style="list-style-type: none"> <li>• Refine the rules governing sale of assets.</li> </ul>
IC	Shareholders AGM rights	<ul style="list-style-type: none"> <li>• Consider extending the notice period to 30 days.</li> <li>• Allow a specific percentage of shareholders to force items on the agenda.</li> <li>• Generic agenda items and bundling different issues under one item should be prohibited.</li> </ul>
ID	Disproportionate control disclosure	<ul style="list-style-type: none"> <li>• The annual report should report the rights of the different classes of shares and the names of ultimate beneficial owners above a certain percentage of share capital.</li> </ul>
IE	Control arrangements should be allowed to function.	<ul style="list-style-type: none"> <li>• Put in place an efficient and equitable mechanism for de-listing, with consideration for minority shareholder protection measures.</li> </ul>
IF	Cost/benefit to voting	<ul style="list-style-type: none"> <li>• Clearly spell out expectations and obligations of AFPs, and encourage disclosure of actions.</li> </ul>
<b>II. EQUITABLE TREATMENT OF SHAREHOLDERS</b>		
IIA	All shareholders should be treated equally	<ul style="list-style-type: none"> <li>• Harmonize requirements for all listed companies.</li> </ul>
IIB	Prohibit insider trading	<ul style="list-style-type: none"> <li>• CONASEV should dedicate more resources to market surveillance and investigation.</li> <li>• Fines should be a multiple of gains made or losses avoided, and not capped.</li> </ul>
IIC	Board/Mgrs. disclose interests	<ul style="list-style-type: none"> <li>• Monitoring and strict enforcement of disclosure obligations of related-party transactions should become a top CONASEV priority.</li> </ul>
<b>III. ROLE OF STAKEHOLDERS IN CORPORATE GOVERNANCE</b>		
IIIA	Stakeholder rights respected	<ul style="list-style-type: none"> <li>• CONASEV should raise awareness about stakeholder issues and corporate social responsibility so that companies are prepared to "comply or explain" their adherence to the Code in the annual report.</li> </ul>
IIIB	Redress for violation of rights	<ul style="list-style-type: none"> <li>• Conduct an Insolvency &amp; Creditor Rights ROSC.</li> </ul>
IIIC	Performance enhancement	<ul style="list-style-type: none"> <li>• Pay careful attention to the international debate on the use/abuse and expensing of stock options before adopting such practices.</li> </ul>
IIID	Access to information	<ul style="list-style-type: none"> <li>• See recommendations in Section IV.</li> </ul>
<b>IV. DISCLOSURE AND TRANSPARENCY</b>		
IVA	Disclosure standards	<ul style="list-style-type: none"> <li>• See Auditing &amp; Accounting ROSC.</li> </ul>
IVB	Standards of accounting & audit	<ul style="list-style-type: none"> <li>• CONASEV should develop the capacity to review/evaluate the quality of the financial reports filed by listed companies, and evaluate and react to material events when they occur.</li> <li>• Put in place a system of quality assurance for auditors.</li> </ul>
IVC	Independent audit annually	<ul style="list-style-type: none"> <li>• Define auditor independence in accordance with international standards.</li> <li>• Subject auditors to an independent oversight body that operates in the public interest.</li> </ul>
IVD	Fair & timely dissemination	<ul style="list-style-type: none"> <li>• Make financial statements available to shareholders well in advance of AGM.</li> </ul>
<b>V. RESPONSIBILITIES OF THE BOARD</b>		
VA	Acts with due diligence, care	<ul style="list-style-type: none"> <li>• "Substitute" directors should be abolished as this institution diffuses the responsibility of the board and provides little practical benefit for shareholders.</li> </ul>
VB	Treat all shareholders fairly	<ul style="list-style-type: none"> <li>• Clarify the fiduciary duties of the board.</li> <li>• Consider introducing the concept of "shadow director."</li> </ul>
VC	Ensure compliance w/ law	<ul style="list-style-type: none"> <li>• NA</li> </ul>
VD	The board should fulfill certain key functions	<ul style="list-style-type: none"> <li>• More clearly spell out duties of the board in the CG Code.</li> <li>• Provide director training, as recommended in CG Code.</li> <li>• Create audit sub-committees with financial and accounting expertise.</li> </ul>
VE	The board should be able to exercise objective judgment	<ul style="list-style-type: none"> <li>• Introduce required percentage or number of independent directors on board, and quorums such that no decision can be taken without the vote of independent directors.</li> <li>• Require audit committees.</li> </ul>
VF	Access to information	<ul style="list-style-type: none"> <li>• Directors should be able to hold management accountable for lack of co-operation in access to information.</li> </ul>

## Annex C: Market Data

Source: *Bolsa de Valores de Lima* (BVL)

### SUMMARY OF SHARE INFORMATION 1997 - 2003 (\*)

SHARE TYPE	CLASS/SERIES	RIGHTS	1997	1998	1999	2000	2001	2002	2003
Ordinary shares	Single	Full rights	135	138	139	128	123	120	117
Ordinary Shares	A, B, C, ...	With voting rights	29	35	33	35	41	37	39
Preference Shares	A, B, C, ...	No voting rights	5	6	11	10	10	10	10
Preference Shares	A, B, C, ...	With voting rights	1	1	2	2	2	2	2
Investment Shares	Single	No voting rights	123	116	95	86	82	81	78
	A, B, C, ...	No voting rights	0	1	1	1	1	1	1
ADR's	Single		1	1	3	4		3	3
Quotas of participation in investment funds	Single		1	2	2	3	3	5	5
Total shares listed			295	300	286	269	262	259	255

(\*) All figures as of year-end December 31.

**SUMMARY OF DELISTINGS 1997 - 2003**

SHARE TYPE	CLASS/SERIES	RIGHTS	1997	1998	1999	2000	2001	2002	2003
Ordinary shares	Single	Full rights	13	7	13	17	6	6	7
Ordinary shares	A, B, C, ...	With voting rights	2	3	2	2	1	2	3
Preference shares	A, B, C, ...	No voting rights	0	1	1	1	1	1	1
Investment shares	Single	No voting rights	24	14	26	14	4	1	3
Quotas of participation in investment funds	Single		0	0	0	1	0	1	1
Total shares delisted			39	25	42	35	12	11	15

**SUMMARY OF NON-COMPLIANCE WITH FINANCIAL REPORTING REQUIREMENTS (2003)**

Type of non-compliance	Audit & Financial Statements end-02		Quarterly interim statements 3/31/03		Quarterly interim statements 6/30/03		Quarterly interim statements 9/30/03	
	Simple	Consolidated	Simples	Consolidated	Simples	Consolidated	Simples	Consolidated
Submission after deadline	8	6	10	5	23	13	20	6
Failure to submit data	20	2	18	1	24	2	19	1
Incomplete submission	0	0	3	0	2	0	4	0
Sub-total of non-compliance	28	8	31	6	49	15	43	7
Total non-compliance	36		37		64		50	

(\*) Consolidated statements refer to the firm, its subsidiaries and its holdings.

(\*\*) In the case of consolidated information, this is only a partial picture, as it only takes into consideration companies that traditionally submit consolidated accounts. It fails to account for companies that never submitted consolidated accounts, despite the legal requirement to do so.

**SUMMARY OF NON-COMPLIANCE WITH FINANCIAL DISCLOSURE REQUIREMENT  
(2003)**

**NON-COMPLIANCE WITH SUBMISSION OF AUDITED FINANCIAL STATEMENTS BY 12/31/2002**

**Deadline** 4/15/2003

Submission after deadline	8 companies
Failure to submit	20 companies

**NON-COMPLIANCE WITH SUBMISSION OF AUDITED FINANCIAL STATEMENTS BY 03/31/2003**

**Deadline** 4/30/2003

Submission after deadline	10 companies
Failure to submit data	18 companies
Incomplete submission	3 companies

**NON-COMPLIANCE WITH SUBMISSION OF AUDITED FINANCIAL STATEMENTS BY 06/30/2003**

**Deadline** 7/30/2003

Submission after deadline	23 companies
Failure to submit data	24 companies
Incomplete submission	2 companies

**NON-COMPLIANCE WITH SUBMISSION OF AUDITED FINANCIAL STATEMENTS BY 09/30/2003**

Deadline 10/30/2003

Submission after deadline	20 companies
Failure to submit data	19 companies
Incomplete submission	4 companies

## Annex D: List of Abbreviations

AFP	<i>Administradora de Fondos de Pensiones</i> , private pension funds
ADR	<i>American Depository Receipt</i> . A security issued by a U.S. bank in place of the foreign shares held in trust by that bank, thereby facilitating the trading of foreign shares in U.S. markets.
AGM	Annual General Meeting of shareholders
BVL	<i>Bolsa de Valores de Lima</i> , Lima stock exchange
CAVALI ICLV	<i>Institución de Compensación y Liquidación de Valores</i> , the central depository
CONASEV	<i>Comisión Nacional de Supervisora de Empresas y Valores</i> , securities market regulator
EGM	Extraordinary General Meeting of shareholders
GDR	<i>Global Depository Receipt</i> . Receipts for shares in a foreign based corporation traded in capital markets around the world.
GM	General Meeting of shareholders
IAS	International Accounting Standards
IFRS	International Financial Reporting Standards
ISA	International Standards on Accounting
LGS	<i>Ley General de Sociedades 1997</i> , General Companies Law
LMV	<i>Ley del Mercado de Valores 1996 (as amended, 2002)</i> , Securities Market Law
ROSC	Reports on the Observance of Standards and Codes, a joint IMF/World Bank initiative
SA	<i>Sociedades anónimas ordinarias</i> , listed but non-public companies (see text)
SAA	<i>Sociedades anónimas abiertas</i> , public companies
SBS	<i>Superintendencia de Banca y Seguros</i> , Superintendence of Banks and Insurance