



ORGANISATION  
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CO-OPERATION  
AND DEVELOPMENT



## *The 2007 Meeting of the Latin American Corporate Governance Roundtable*

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### **Country Report: Voluntary Corporate Governance Code in Peru**

The OECD asked several consultants, regulators, corporate governance institutes and other relevant stakeholders to elaborate reports regarding the development and implementation of voluntary corporate governance codes in each of their countries/regions. The reports, as well as a synthesis report elaborated by the OECD Secretariat based upon them, is provided to the Roundtable participants as background for the meeting's discussion.

The Peruvian report was elaborated by the Securities and Corporations National Supervisory Commission (CONASEV). For any comment or specification regarding the country report please contact Mr. Rodney Rivera at:

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Further information regarding the code as well as its integral text can be found at:

[www.conasev.gob.pe](http://www.conasev.gob.pe)

## THE PRINCIPLES OF GOOD GOVERNANCE FOR PERUVIAN COMPANIES

### DEVELOPMENT OF THE CODE

Peru is constantly trying to keep updated on the progress and discussions carried out regarding good corporate governance of companies. Over the years, the regulatory framework has been modified to respond to these tendencies, concentrating efforts on reaching international standards for Peruvian companies so that they are more reliable to the both Peruvian and foreign investors, especially minority shareholders.

In early 2002, several governmental agencies and private sector guilds began conversations highlighting the importance of fostering healthy practices for corporate governance. As a result of such conversations, a working group called Special Committee (hereinafter called "COMMITTEE") was set up with the task of shaping a code reflecting what the parties considered best practices in corporate governance, taking into account both the international standards and the special characteristics of the domestic market. Such COMMITTEE was conformed by:

- The Ministry of Economy and Finance
- Superintendence of Banking, Insurance and Private Pension Funds Managers (SBS)
- Lima Stock Exchange (BVL)
- The Association of Banks (ASBANC)
- The National Confederation of Private Business Institutions (CONFIEP)
- The Association of Capital Market Promoting Companies (PROCAPITALES)
- Center of Studies on Capital and Financial Markets (MC&F)
- Peru's Securities and Exchange Commission (CONASEV)

In September 2002, the COMMITTEE delivered a document called Principles of Good Governance for Peruvian Companies (hereinafter called "CODE"). For the international standards, this document was mainly based on the Principles of the Organization for the Economic Cooperation and Development (1999 version) because, since their approval, these latter principles always have been very prestigious and have been used as reference worldwide. Nevertheless, such international standards were carefully reviewed so that the outcome would correspond to the idiosyncrasy and characteristics of the Peruvian market. The contribution of the COMMITTEE's participants was essential to achieve this goal.

Currently, there is a project sponsored by CONASEV to update the CODE. The new version of the CODE should be completed and approved by the COMMITTEE the next year.

### CORE PARTS

The CODE includes the following sections:

#### 1. Shareholders' rights

This section deals with practices focused on securing that the shareholders are able to effectively exercise their rights. For example, this section refers to the best practice on registration of the ownership, dissemination of the information required for a shareholders' meeting, representation on the meeting, the inclusion of topics of discussion in the agenda of the shareholders' meeting, the mandatory bid regime (for tender offers) and the like.

#### 2. Equal Treatment amongst the shareholders

This section deals with practices focused on the treatment of minority and foreign shareholders. For example, this section establishes that the corporation should have an adequate number of independent directors, that any conflict of interest by a member of the management or the board of directors must be disclosed and the prohibition of insider trading, among other topics.

### **3. Role of Stakeholders in Corporate Governance**

In this section, the CODE recognizes the existence of stakeholders beyond the shareholders themselves (for instance, workers, providers, creditors and the society as a whole) whose interests in the corporation should also be protected. Moreover, the CODE establishes that it is desirable the creation of mechanisms to the end of making possible the active participation and cooperation of such groups.

### **4. Disclosure Rules**

This section covers several topics. They include the availability and fair access to the information, the quality of the information that the company discloses (especially the financial information), the role of the auditors, their independence, the internal control of the company, etc.

### **5. Responsibilities of the board of directors**

As the title announces, this section deals with the functioning of the board of directors, the fiduciary duties of its members and the various functions it should retain as a minimum to properly comply with its duties.

### **6. Companies not registered in the Public Securities Market Registry**

Taking into account the configuration of the COMMITTEE, the CODE was thought and written for corporations registered in the Public Registry of the Securities Market. In other words, issuers of publicly traded securities or companies belonging to the financial market and supervised by CONASEV or the Superintendence of Banking, Insurance and Private Pension Funds Managers (SBS). Of course, these corporations are but a fraction of the Peruvian economic activity. As a consequence, the CODE included this section stating that is desirable that closely-held corporations comply with the principles insofar as they are pertinent.

One special characteristic of the CODE is that it includes not only recommendations but also some mandatory issues regarding good corporate governance practices established mainly by the Securities Market Act and the Corporations Act. In the case of issuers of publicly traded securities, the CODE includes the following mandatory issues, among others:

- Basic shareholder's rights such as participating and voting in shareholders' meetings, electing members of the board of directors, sharing in the profits of the corporation, participating in decisions concerning amendments to the by-laws among other rights established by the Corporations Act.
- Generic matters should not be incorporated into the agenda.
- Opportunity for shareholders to place items on the agenda at shareholders' meetings.
- If a takeover bid occurs, company's shareholders should have the right to participate in the premium paid by a third party to acquire control of the company.
- In the event of exclusion of a security from the Public Securities Market Registry, those investors who are considered to be affected by such act, may get rid of their securities and sell them in reasonable conditions before the company is withdrawn from the negotiation mechanism.
- All shareholders of the same class should be treated equally.
- Transactions should not be carried out with the use of insider trading nor abusive self-dealing trading.
- Disclosure of financial and operating results of the corporation, the names members of the Board of Directors and main executives, economic groups and material facts related to the issuers, the securities and the offers.

## APPLICATION AND ADOPTION

The CODE was intended to promote the best practices of corporate governance by highlighting them. Consequently, it should be seen as a guideline about a desirable model of conduct for the corporations not as a set of rules. In other words, the CODE never was intended to be mandatory: corporations may or may not comply with it on a voluntary basis.

In December 2003, after a period of public consultation, CONASEV modified the minimum content of the Annual Reports<sup>1</sup> for issuers including a section where the Corporations had to self-evaluate their level of compliance with 26 Principles (recommendations) set up by the CODE. Thus, for every Principle, each Corporation had to grade from 0 to 4 its own level of compliance (0: null compliance and 4: full compliance) and had also to justify its assessment with some objective information.

The obligation was in force, for the Annual Reports corresponding to the year 2004, which had to be presented to CONASEV up to April, 15<sup>th</sup> 2005. This delay in the application intended to let corporations to understand and adapt these new recommendations before they had to make their self-assessment.

By introducing this disclosure obligation, although the CODE kept being formally voluntary, CONASEV gave it certain moral obligation status.

In 2005, when the companies began to disclose their Annual Reports containing the first Corporate Governance self-assessment (for the year 2004), CONASEV started to analyze the impact of the modification. It soon became obvious that some major changes had to be adopted in order to make useful this information and the effort of the issuers to comply with the regulation. The problem was that all the issuers evaluated themselves using their own criteria, so that there was no way to compare amongst the grades they assigned. Additionally, in the absence of objective criteria, several companies graded themselves too generously. Moreover, most corporations did not justify the grade assigned or if they did, the justification was not properly exposed.

For example, a company with no independent directors graded itself with “3” out of “4” in the level of compliance to a principle stating that it is advisable for corporations to have an adequate number of independent directors.

Facing these weaknesses, in 2005, CONASEV introduced new changes in the way the issuers should self-evaluate their compliance with the CODE. According to these new requirements, since 2006 (for the Annual Reports corresponding to the year 2005), in addition to the grades, corporations have to answer a series of pre-determined questions relating to each Principle. Following the previous example, currently the corporation not only grades itself as to the compliance with the principle concerning independent directors, but also has to declare how many directors conform its Board, how many of them are considered independent, how many of them are related to the shareholders or occupy positions within the organization, etc.

In this way, the shareholders, rest of the stakeholders on the company and, generally speaking, any person who reads the Annual Report can assess the reasonableness and the reliability of the grades.

It is remarkable that the last reform also requires all issuers to include its most recent corporate governance assessment in each new prospectus of public offerings registered in CONASEV.

Although 2005 reform improves the quality of information disclosed by issuers, there are some evidence of lack of information and inconsistencies. There are two basic types of inconsistencies: (1) the clear disagreement between answers to the different questions of the test; and (2) the contradiction between the grade and the answers related the principle evaluated.

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1. According to the Peruvian Corporations Act, in all the Corporations the Management and the Board of Directors have to present an Annual Report to the shareholders. CONASEV is empowered to regulate the contents of the Annual Report in the case of companies under its supervision.

## PRINCIPLE “COMPLY OR EXPLAIN”

As it has been explained above, the CODE is not a mandatory set of rules. Hence, there is no enforcement of the principles *per se*. However, several of the principles are actually legal obligations set up in different rules and regulations. In these cases, of course, the principles are not voluntary but their enforceability is a consequence of the legal framework not of the CODE.

Strictly examined, the CODE is not subject to the “comply or explain” principle either. Theoretically, the “comply or explain” principle requires a company to stick to the good practices and, if they do not, describe the reasons preventing them to do so. Unlike that, in Peru issuers are not obligated at all to comply with the CODE and, if they do not, they are not obligated to make such explanation either. Instead, they are required to answer several questions aimed to contrast the consistency of their self-grading with their actual situation. Such a questionnaire, additionally, does not depend on the declared level of compliance: whether the company considers itself in full compliance of the principle or not, it is equally obligated to answer the questions.

## REVIEW PROCESS

Following the 2005 modifications, CONASEV has continued evaluating the information on Corporate Governance and the rules regulating such disclosure.

Between October 2005 and April 2006, CONASEV hired a consultant (Mr. Alfredo Ibarguen) sponsored by CAF to assess the deficiencies of the CODE and update it. The study concluded that the CODE should be updated on the following aspects:

1. Correcting the limited didactic capacity of the CODE justifying, when needed, the inclusion of a certain principle and the mechanisms for its effective implementation.
2. Identifying the Peruvian corporations whose securities are registered in the Public Registry of the Securities Market as the ultimate objective of the CODE.
3. Including matters concerning to the corporate governance that have not been undertaken in the original version of the CODE.
4. Lighten and, if so, suppress those aspects that despite being related to the corporate governance are already regulated by the legal framework.

In September 2006, Mr. Ibarguen's project was published to receive commentaries from the market participants. Although not too many people responded, those who did made valuable remarks that are being taken into account to draft another version.

For this year, it is programmed to complete a new version of the CODE and present it to the COMMITTEE for its approval.

Regarding the self-assessment requirement, in our opinion, the 2005 reform allowed the market participants to obtain a much more accurate idea of the compliance with the CODE. The previous version offered to the market nothing but a grade that, in the absence of more detailed information, had little or no usefulness. Indeed, the reform helped to demonstrate what most of the people who followed the process suspected about the grading system: issuers arbitrarily over-graded their level of compliance. Thanks to the objective questions they are now compelled to answer, it is much easier to detect the over-grading.

The self-grading system, however, keeps on as a distorting element. In most cases, issuers have a very hard time giving themselves harsh grades. Coupled to that, since level of compliance is an enormously subjective judgment (other than the extreme we have cited as examples, where one may make the argument that the information disclosed for the issuer is actually misleading), there is little room for improving such type of self-evaluation. After finishing the CODE's reform, CONASEV should approve a new version of the disclosure system of compliance of corporate governance principles that are consistent with the new CODE.