OICV-IOSCO 2013 LUXEMBOURG ANNUAL CONFERENCE

RESPONSIBLE INVESTMENTS

THE RIGHT APPROACH TO CHANNEL PRIVATE CAPITAL IN VIEW OF SOLVING SOCIAL PROBLEMS

(Thursday, 19th September)

Environmental

Should we encourage Private Investors to support the Green sector?

- I believe we must encourage private investors to consider environmental aspects as a part of their investment approach, taking into account that the interest in these issues has increased significantly within the society and the fact that the activities of companies can have a direct impact on the environment.
- This should be handled by the companies themselves through various mitigation mechanisms, such as the implementation of Environmental Management Systems.
- Not only does it benefit society, but also the companies themselves, as it improves and consolidates the institutional image, i.e. improving the perception of the company to the society.

The Peruvian Experience:

- In the case of Peru, many companies have added the environmental component into their strategic plans. I would like to highlight the case of three representative companies in the mining sector: Compañía de Minas Buenaventura, Volcan and Compañía Minera Milpo.
- We must take into account that more than 40% of the General Index of the Lima Stock Exchange includes mining companies, which will obviously have an impact on the environment.
- The actions performed by these companies are diverse and include environmental programs, quality control of air and water, environmental studies, waste management, among others, which have a positive impact on the environment and on the population.
- Peru is also making efforts with regards to the Carbon Market, with the aim of reducing emissions of gases that affect the atmosphere through Certified Emission Reductions (CER), which is complemented by the creation of The General Environmental Law.

Social

Can social problems be increasingly solved by the private sector?

- Private sector involvement in the resolution of social problems is extremely important, but I must emphasize that this role is complementary to the role of governments.
- Social issues are related to the tasks of social responsibility that companies must continuously run, i.e. relationships with key stakeholders such as employees, suppliers, customers and the community.
- Business activities cannot be separated from the environment in which they develop.
- Some measurable social impact indicators are evident in terms of education, health, employment, poverty , among others.
- Not only does it benefit society in terms of improvements in their quality of life and welfare, but also companies improve their corporate image, thereby improving perceptions about them.

The Peruvian Microfinance Sector:

- According to the index Global Microscope on the business environment for microfinance 2012 , prepared by the Economist Intelligence Unit, for the fifth consecutive year Peru ranks first in the developing microfinance in the world, within a sample of 55 countries. This is a result of a competitive microfinance sector and a sophisticated regulatory environment.
- The microfinance sector has a significant social impact, allowing the financing of micro and small enterprises, thereby stimulating production and employment levels, as well as income levels of the population contributing to improve their quality of life.

Social

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- In Peru, the Micro and Small Enterprises (MSEs) generated 42.1% of the country's GDP and employs 59.6% of the economically active population, which is approximately 9.12 million workers.
- MSEs’ segment has generated great interest in the financial sector in recent years, leading to large banks to create specialized segments for lending to MSEs.

Governance

Should we force investors to integrate «governance» into their decision making?

- **The importance of Corporate Governance**

  Corporate governance practices promote information transparency because it lets the alignment of interests among shareholders, managers and directors, thus strengthening the confidence of existing and potential investors and from other stakeholders related to the firm. Therefore, these practices contribute to achieve reliable and efficient markets to the extent that they lessen information asymmetries.

  For the side of companies that adopt corporate governance practices, there are multiple benefits, including better risk management; value and efficiency; promotion of a climate of respect for the rights of shareholders and investors; an easier access to capital markets; and reduction of the cost of capital, among others. And, although the adherence to these practices represents a great challenge, it is entirely possible to maintain the company objective to maximize profits.

- **Good governance in investment decision making process and Fiduciary responsibility**

  I am certainly aware of the importance of good corporate governance practices for both companies that apply them and investors that allocate resources to these companies, but I think that we cannot "force" investors to integrate governance into their decision making. Instead, we should rather develop other ways to encourage, not to require, them to do it. For example, requiring a disclosure of the commitment with social responsible investments and the policies and initiatives adopted in this feel. This information should be updated at least once a year.

  Regarding the fiduciary responsibility on the part of investment managers to maximize financial returns for their clients, in practice, environmental, social and governance (ESG) risks have tended to be neglected in the investment process.

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Thus the maximization of investment returns for clients has focused on the achievements of short term returns. Likewise, long-term and systemic risks have been overlooked and there has been low interest by investors to influence the behavior of companies in order to create long-term sustainable returns.

However, this situation is changing. For instance, ESG issues have become more material in last years. Also, investors' expectations are changing. An increasingly greater number of private institutional investors have been making commitments to responsible investment , e.g. entities signatories of the PRI (Principle for Responsible Investment).

Therefore, it is likely expected that fiduciary duties that institutional investors owe their clients will develop to reflect these changes. That is, the interpretation of fiduciary duty, both in practice and at law, is likely to be much wider than at present.

<u>The ESG issues should also be disclosed by institutional investors as a part of their commitment with social responsible investments and the policies and initiatives adopted in this feel. This information should be updated periodically</u>.

- **Should Fund Managers divest form companies who source textile products from factories located in the Tragic Rana Plaza**

<u>The key point here is that the fund managers should state their policies in the field of responsible investments. They should be as clear as the Principles for Responsible Investment Initiative (PRI) are. In this way the decision process for situations like Rana Plaza is easier. It´s also clear that the investments options for Institutional investors should be wide enough to assure the adequate substitution of investments, when it´s necessary</u>.

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- **Good governance and financial performance**

  There is wide evidence that the adoption of good corporate governance practices by companies has a positive relationship with their financial performance. For example, some studies as Bemchuck et. al (2009) and Gompers et. al (2003) found that the incorporation of principles of corporate governance improves financial performance and the value of companies.

  Since its creation in 2008, the performance of the Corporate Governance Index has showed a higher average return (22.1%) than the General Index of the Lima Stock Exchange. This means that companies who follow principles and standards of good corporate governance have shown a better performance than their peers in the market.

  This index intends to reflect the behavior of listed companies that followed good corporate governance practices. These companies must fulfill several conditions in order to be considered as part of the index, which currently includes ten companies belonging to different economic sectors.

Peru: Regulatory approach on Corporate Governance

- The Superintendency of the Securities Market (SMV) had played an important role for promoting the use of good corporate governance practices by companies in Peru. One of the most important efforts leaded by the SMV was the development, (with the support of eight entities from the public and private sectors), of the “Principles of Good Governance for Peruvian Companies” in 2002.
- The code was structured according to globally accepted guidelines with certain nuances that took into account the characteristics of Peruvian companies, shareholding structure and the legal framework in which they develop.

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- It should be highlighted that the principles are voluntarily adopted by companies, wether listed on the Lima Stock Exchange or not. However, listed companies must publish within their Annual Reports a self-assessment on the implementation of these principles.
- During the last years, the Peruvian Congress has also amended the Securities Market Act and the Company Act in order to improve the practices of good corporate governance in our country.
- In February 2012, the SMV established the Committee for Updating the Principles of Good Corporate Governance, which is integrated by 14 institutions from the public and private sectors, with the purpose to update de principles issued in 2002. Nowadays, we are working, with the support of CAF, in drafting a new code that takes into consideration last developments in corporate governance issues, especially after the severe effects that global financial crisis have had in market’s confidence.

Regulation

Should regulation be used to channel private capital to ESG Investments?

- In my opinion, regulatory interventions must be made only where this is likely to produce the best outcomes. Probably, areas of Environment and Social Responsibility provide more room for regulatory intervention, for example, in order to implement the policy measures necessary to avert the most serious consequences of climate change.
- As the securities market regulator, I think we must play an active role in **promoting** the adherence by companies to practices of Responsible Investments. The international financial crisis has prompted renewed investor interest in the institutional market framework. The objective to achieve stable, well-functioning and well-governed markets has become relevant in recent times.
- For this purpose, it will be of upmost importance that regulators receive the inputs and points of view of investors, issuers, stock exchanges and other participants of the market.
- Although I consider we cannot force investors to channel resources to ESG investments, we can indeed promote through regulation a greater transparency of information in the market that allow them to have the sufficient information to adequately channel their resources. With a greater transparency of information, I mean information that is made available through annual reports, material facts, issuance agreements, prospectuses, among others.

The case of Asset management industry

- <u>Before the international financial crisis exploded, nations with highly developed financial systems applied minimalist regulation and relied on “light touch supervision” and market discipline.</u>

Regulation

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- However, the severity of the crisis experienced in recent years has revealed serious shortcomings in the regulation of the asset management industry. As we know, many investors suffered losses during the global financial crisis through investments made by fund managers acting as their agents both at the retail and wholesale level.
- As a consequence, the topic of due diligence undertaken by fund managers in their asset choice has become a cornerstone of the discussion among regulators and policymakers. After the crisis, nations are moving towards a more interventionist approach.
- Nevertheless, we should be careful that these regulatory measures do not end up generating additional charges on the industry and discouraging the entry of new players, finally drying the market. The regulation must be oriented to ensure that all the relevant information needed by investors to adequately assess their investment risks is available.

- **Peruvian mutual funds industry**

  Unlike what happened internationally with other mutual fund industries, in the last ten years the regulatory framework of mutual funds has become more flexible in our country, due to two factors. The first one is that as a young industry (less than 20 years) it started to operate within a strict regulatory framework that had to be loosen as the industry matured. The second factor is that these collective investment schemes were not affected by the crisis because their investments are basically directed to local market.

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