ESG INTEGRATION INTO REGULATORY FRAMEWORKS

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ESG is an important information that investors and stakeholders need from companies that interact as investors, clients, suppliers, sponsors, among other relationships.

Reputation has been considered the most important asset for companies, especially large local and international companies. People demand that companies fulfill their role in acting responsible to environment and social causes.

Social networks are very active in punishing and asking for regulators and government actions against companies with reputational problems.

During the last years regulators and investors with the participation of Lima Stock Exchange have been discussing this matter and how to deal with compliance and disclosure, in a way that should be useful to the market.

Some ideas have been developed, based on corporate governance experience in the last twenty years. The quick diagnostic of this matter is as follows:

1. Any regulation regarding ESG compliance and reporting should be mandatory at some point of the time. Voluntary implementation has not been enough motivation for companies to comply with good corporate governance practices in the past. Cost and benefit at company level have been difficult to calculate on an individual basis, no matter that companies and officers believe that the country and the capital markets will be better and more robust with more companies improving corporate governance practices.

2. Investors do not encourage that companies improve good corporate governance practices as part of their evaluation activities. This area is part of their evaluation, but is not key in deciding investing options, basically represent some extra cost or premium in the interest rate. Due the low cost of capital in the last years, this spread does not preclude to made the investment.

3. Capital markets are under pressure because low interest rates, and small differences between long and short interest rates, represents a big advantage for financial sector (banks and similar) which interest, and time of response are better, as compared to go public for debt or equity. Excess of liquidity, fastest time of response and competitive rates without the regulations to be a public company is an advantage to obtain funds from financial system instead of capital markets.

This situation in Peru, represents a challenge for all the participants in Peruvian capital markets. Some of the ideas developed to encourage the compliance and reporting ESG in the Peruvian markets are explaining in the next part of this paper.
We considered develop different strategies for companies (offer side), investors (demand side) and finally for regulators or stakeholders, mainly Superintendencia de Mercado de Valores (SMV, the market regulator) and Lima Stock Exchange.

For the companies, SMV and Lima Stock Exchange are developing two approaches:
1. For corporate governance, we should review what part of the current voluntary code principles or practices should be mandatory, after fifteen years of voluntary implementation. It will be necessary to strength the ability of the SMV to sanction the lack of compliance of the mandatory principles or practices.
2. For environmental and social matters, it will be necessary to develop a plan to increase its compliance and reporting. Since 2017, SMV is requiring information from the companies about their compliance and reporting of ES matters, but only as a starting point, since the current regulation only require report what you have and if the report meets any standard (like GRI). We need to move very fast to increase the compliance and report on ESG matter. We do not believe that a ESG code is a good idea. We believe that using an internationally recognized standard like GRI or Integrated Reporting should be more suitable for this matter.

In the case of investors, Lima Stock Exchange and some institutional investors incorporated the Program for Responsible Investment (PIR) following the United Nations Supported “Principles for Responsible Investment (PRI)”. Currently, the largest institutional investors in Peru are signing the inclusion in this Program. The six principles developed in PRI should be followed by the signatory members.

In the case of Lima Stock Exchange, we have been taking some actions to increase the development of the compliance and reporting about ESG, in addition to be part of PIR, above explained. On 2008 we started the index of good corporate governance (SP/BVL IBGC), including the companies with recognized corporate governance practices. In 2014, with consulting firm EY, we develop a ranking of companies with the best perception of corporate governance (“Voice of the Market”). This perception is the result of a survey conducted to 400 hundred asset managers, bankers, investors and experts. The results of this survey are published in the media and is part of the evaluation of companies that are included in the above index. Currently, companies are very receptive on the recommendations received from this survey. On the ESG matter, Lima Stock Exchange is part of the group of Sustainable Stock Exchanges. Also, we disclosed our carbon footprint for 2016. During 2017 we are supporting the development of a Sustainable Index for MILA market (Mexico, Colombia, Chile and Peru). S&P and RobecoSAM are leading this initiative, with the support of IFC.

On other initiatives, we are developing different seminars and events about ESG in universities, business associations and other local institutions, as part of the efforts to increase the knowledge of the Peruvian community about the importance of ESG matters in the capital markets and the activities of the sustainability business environment.

As it was explained, our strategy for the development of ESG compliance and disclosure consider activities in three levels: Companies, investors and regulators and stock exchange.