

Economic Watch

Pensions

Lima, 20 May 2011
Economic Analysis

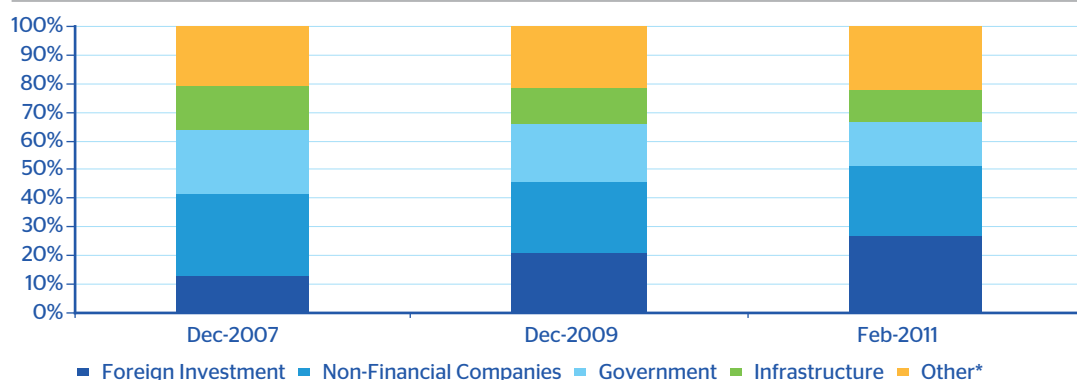
Rosario Sánchez
rdpsanchez@grupobbva.com.pe

Pension funds and infrastructure in Peru

- **Peru still has a high infrastructure deficit**, which can be financed using pension fund resources.
- **The slow process of awarding concessions leads to a lack of projects to finance**, and thus to an accumulation of committed resources that are still awaiting investment.
- **Significant efforts have been made in recent years to channel investments into the infrastructure sector** through a series of measures that range from the creation of financial instruments (an infrastructure trust and infrastructure fund) to regulatory changes.
- **There is still much room for improvement in regulatory matters.** These changes could range from alterations in the concession process to more specific regulations covering limits to investment in pension funds.

Chart 1

Participations in investment by pension funds (%)



* These include financial companies, fund administrators and securitization companies

Source: SBS and BBVA Research

Infrastructure financing through pension funds is still insufficient

Although Peru has improved 18 positions on the infrastructure quality ranking of the Global Competitiveness Index prepared by the World Economic Forum (from 110th to 92nd in 2009-2011¹, infrastructure development in the country remains among the poorest in the world, with an investment gap of an estimated USD 37,760m in 2008-2018, particularly in the transportation and electricity sectors². This situation could limit economic growth, generate problems of competitiveness and restrict improvements in social welfare. The resources gathered by pension funds are thus an attractive alternative for financing infrastructure investment projects, from the public-sector point of view, that of fund members and the country in general. The advantages of this participation are as follows: (1) It would free the government budget and redirect it to other urgent items; (2) It would improve the funds' investment profile; and (3) It would boost the quality and quantity of the infrastructure needed to sustain Peru's growth.

According to data from the Superintendency for Banking, Insurance and AFPs (SBS), at the close of February³ investment by pension funds in infrastructure accounted for 11.1% of their total portfolio assets, i.e. around USD 3,416m. The investment was focused mainly on energy (60%), and to a lesser extent on transportation (21%) and telecommunications (18%).

Table 1

Companies and infrastructure investment projects in which the AFPs have invested, as of February 2011.

Sector	Companies investment projects and investment fund
Telecommunications	Mobile Telefónica, Mobile América and Telefónica of Perú
Electricity Distribution	Luz del Sur, Edelnor and Larraín Vial Investment Fund
Electricity Generation	Cahua, Duke Egenor, Edegel, Enersur, Electroandes Larraín Vial Investment Fund, Kallpa, Southern Cone y AC Captales Investment Fund, Inkia Energy
Electricity Transmission	Consorcio Transmántario, Larraín Vial Investment Fund Red de Energía del Perú, Aguaytía and AC Captales Investment Fund
Hydroenergy Projects	Consorcio Trasvase Olmos y Fondo de Inversión de Larraín Vial
Hydrocabrons	Relapasa, Gas Transportation of Perú, Perú LNG, Plus Camisea, Hunt Oil, Maple Energy PLC, AC Captales Investment Fund Larraín Vial I42American Energy Investment Fund
Transportation: Road Network	IIRSA Sur (Sections 2, 3 y 4), IIRSA Norte, Interocéánica V
Transportation: Railways	AC Captales Infrastructure Investment Fund
Transportation: Aeronautical	Lima Airport Partners y AC Captales Investment Fund
Sanitation	Consorcio Agua Azul, AC Captales Investment Fund and Infrastructure Trust.

Source: SBS

Despite the fact that this represents an increase of around USD 440m over the last two years, the share of assets for infrastructure has fallen considerably (16.8% in February 2009). As portfolio components have shifted over this period, investments abroad have gained more weight (from 17% to 27% of the fund), encouraged by the increased limits established by the Central Bank⁴. Local companies have also been more active, particularly in the mining sector and industries such as food and drink and cement, among others.

Currently 73% of the infrastructure portfolio (around USD 2,483m) is channeled indirectly through the purchase of shares and corporate bonds in companies related to this sector and through three existing mutual funds (by initial private share offers):

1. <http://www.weforum.org/reports/global-competitiveness-report-2010-2011-07-01>

2. El reto de la infraestructura al 2018 "La brecha de inversión en infraestructura en el Perú 2008", IPE, August 2009.

3. For statistics, see http://www.sbs.gob.pe/O/modulos/JER/JER_Interna.aspx?ARE=O&PFL=O&JER=150

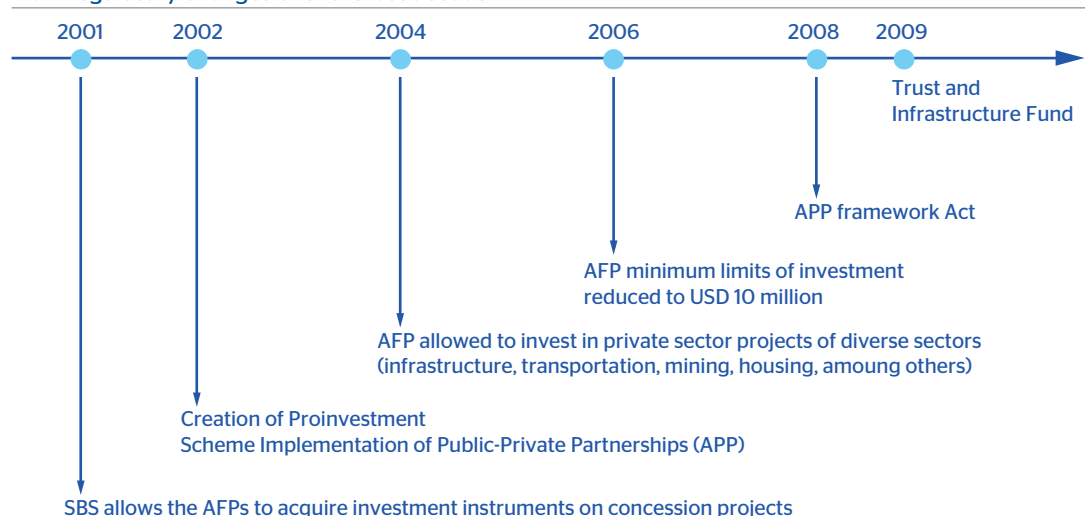
4. In February 2009, the limit established by the Central Bank for investment by pension funds abroad was 20% of their portfolio. Currently the limit is at 30% <http://www.bcrp.gob.pe/docs/Transparencia/Normas-Legales/Circulares/2010/Circular-030-2010-BCRP.pdf>

- **Fondo de Inversión en Infraestructura**, Servicios Públicos y Recursos Naturales de AC Capitaes: created in September 2004 for a 30 year period, and committed resources of USD 50m. It finances projects at any stage of development through capital allocations. Currently, the value of investments is around USD 55m, with the only participants in the fund being AFPs. It participates in major projects, including three electric transmission lines, the railroad in the central area, the Jorge Chávez airport, air freight terminals and an oil and biofuel refinery.
- **Fondo de Inversión Larraín Vial Energía Latinoamericano**: this fund is focused on assets related to the energy sector in Latin America (mainly Chile, Peru and Colombia). It participates in the development of projects and companies in different areas of electricity generation (water, gas and coal) and aims to maintain control of these companies. Currently it has around USD 100m and aims to reach a total of USD 150m. It has a duration of 12 years, which is extendible for periods of two years with the agreement of its contributors. In Peru, the fund has invested in a natural gas plant in Termochilca, which will install up to 200 MW of generation capacity in the south of Lima. Termochilca has already been awarded an 8-year USD 450m energy supply contract with the electricity distributor Edelnor.
- **Sigma Fondo de Inversión en Infraestructura**: it was created a few months ago and by the second half of the year expects to have a committed capital of USD 200m, with a high level of participation by AFPs. The fund's operation period is 12 years, with a target return of between 15% and 20%. Its main investment will be in greenfield projects through capital contributions and a maximum investment per project of 40% of the fund.
- **Fondo de inversión en infraestructura**: created in February 2009 by the Ministry of Economy and Finance, with a government contribution of USD 100m through Cofide⁵. In September 2009, the fund's management was awarded to a consortium formed by Brookfield Asset Management and AC Capitaes SAFI. The process of obtaining authorization from the Superintendency of Banking, Insurance and AFPs (SBS) to be included on the list of eligible investments for pension funds ("AFPable") lasted around 10 months. Currently it has some USD 440m committed (USD 200m by AFPs, USD 100m by Brookfield, USD 100m by Cofide and USD 40m by CAF). Although no investments have actually been made yet, some infrastructure projects that could guarantee a good return have been identified.

The remaining 27% has been invested directly. This includes corporate bond issues for projects in the telecommunications and the energy sector, as well as other debt instruments for highway projects. One example of this is the financing used for the IIRSA Sur highway. As this work progresses, the Ministry of Transport issues annual works payment certificates (CRPAO), which are used by the concessionaire to gather funds on the capital markets. Another form of direct finance is the infrastructure trust. This was created by the initiative of the AFPs as part of the Economic Stimulus Plan designed by the government during the international financial crisis. The trust invests in debt instruments for infrastructure projects that are previously approved by the Investment Committee (which is formed by a representative from each of the four AFPs). So far it has participated in two projects. The most recent (March 2011) has been an investment of around USD 125m on the Taboada project, and previously in May 2010 there was an investment of around USD 35m on the Huascacocha project.

5: Under the Investment Fund Law, passed by Legislative Decree No. 862, the executive authorized the Ministry of Economy and Finance to contribute capital of USD 100m to Corporación Financiera de Desarrollo (Cofide) to enable it to participate in setting up the Infrastructure Investment Fund.

Chart 2

Main regulatory changes over the last decade

* Includes financial companies, fund and administrators and securitized bonds
Source: BBVA Research

Both projects belong to the sanitation sector. They are developed under the public-private partnership (PPP) scheme, with the government moving in if the company cannot repay its obligations. The trust participates by acquiring advance works certificates (CAO), which are self-financed with the payment flows from Sedapal customers⁶.

Legal framework for pension fund investment in infrastructure

The participation of AFPs in financing infrastructure began in October 2001 through Resolution SBS No. 725-2001. This law enabled the Superintendency for Banking, Insurance and AFPs to issue authorization for them to acquire investment instruments (securities representing credit rights, preference shares and common stock) on projects for which the State had granted concessions and whose total amount is not under USD 50m, or its equivalent in local currency. Later, Resolution SBS No. 643-2004 reduced this amount to USD 20m, and also authorized the AFPs to participate in private sector projects in a variety of areas (infrastructure, housing, the use of natural resources, and others whose nature requires medium and long-term finance). In 2006 the range of investment instruments for projects awarded in which the AFPs could participate was extended. First it included debt securities (through Resolution SBS No. 440-2006, published in March); then it again reduced the committed amount of investment to USD 10m (Resolution SBS No. 1152-2006 of September 2006). All the changes introduced over this period aimed at generating, promoting and boosting investment in various medium and long-term instruments, particularly in infrastructure. Chart 3 sums up the main changes in the regulatory framework over the last decade⁷.

Limitations and main efforts carried out to promote investment in infrastructure

The legal framework in Peru promotes investment in infrastructure through a scheme of concessionary contracts that in general last between 20 and 30 years. This scheme may be through a government auction, a public-private partnership (PPP) or simply private initiative. By its nature and due to all the considerations and problems that arise (bureaucracy, political considerations, delays, problems of competence, controllership, and legal matters, among others), these processes tend to be fairly long-drawn out, and on average last more than five years for a concession⁸. The slow procedure involved in approving projects restricts the number offered. The

6: Servicio de Agua Potable y Alcantarillado de Lima, the company supplying drinking-water and sewage services in Lima. A government-owned company in private law set up as a public limited company.

7: For a more detailed analysis, see Chapter 7 of the book "A balance and projections of the experience in infrastructure of pension funds in Latin America" published by BBVA Research in 2010.

8: According to a study carried out by Payet 2009 based on six randomly selected infrastructure projects.

results can be seen in the availability of resources committed to infrastructure by the different mutual funds that have not been able to be invested yet. There have also been restrictions on the government budget side, specifically in the case of co-financed PPPs. This is because co-financing commitments cannot exceed 7% of GDP (as of February 2010, these commitments were equivalent to around 6% of GDP).

Despite these limitations, in recent years, significant efforts have been made to channel investments into the infrastructure sector through a series of measures that range from the creation of financial instruments (such as the infrastructure investment and trust funds mentioned in the previous section) to regulatory changes. On the regulatory side the changes introduced over recent years aim to reduce the bureaucratic obstacles and thus the time taken to approve these projects. Among the main recent regulatory changes are the following:

- Prioritization of infrastructure investment projects: Urgent Decrees Nos. 001-2011 and 002-2011 issued by the government have prioritized 33 infrastructure projects for 2011. This simplifies the legal demands, including environmental certificates, transfer of land and publicly-owned buildings, among others. This measure was also applied in previous years, with positive results in terms of reducing the time taken to complete the process.
- Relief from the application of the public private procurement methodology to investment projects prioritized for 2011. This measure is for projects declared as of great importance and with costs over 100,000 UI⁹, if they require co-financing of more than 30%.
- Changes to the law on electricity concessions to speed up the procedure affecting the studies needed to construct new hydroelectric projects.
- Creation of an Investment Committee for ports that will promote private investment in the terminals administered by the National Ports Authority.
- Greater flexibility in environmental demands affecting hydroelectric plants. If this law is approved, it will no longer be necessary to have an Environmental Impact Study (EIS) approved before obtaining the final concession for the construction of a hydroelectric plant. Instead, the EIS will be required when the construction of the project is already underway. This law is currently being debated in congress and is awaiting approval.

Despite the regulatory progress and new investment initiatives and instruments over recent years, infrastructure investment is still not at the levels required to close the gap that Peru currently suffers from. In fact, the rapid growth in pension funds, and thus the resources they could invest in infrastructure, demands new changes that can boost the availability of infrastructure projects. There are still regulatory and legal areas that can be improved to create incentives and promote financing for infrastructure projects. Below we outline some of the areas that we believe could be improved:

- Reducing the time taken to process concessions. Currently these last on average more than five years and involve more than 20 government departments. Making processes run in parallel (currently they are sequential) and limiting the departments involved could help reduce the time taken to grant these concessions.
- Creating specific individual limits by asset: current law establishes limits to investment by pension funds according to the issuer, issue, category of instrument (fixed-income, equity, among others). Investments by pension funds in infrastructure have to adapt to these limits, according to the instrument invested in (the infrastructure fund is considered within the equity limits, while the trust is considered within the fixed-income limits). We believe it would be of great help to create specific limits for infrastructure investment that are not dependent on the limits for other investment instruments.
- Counting not only investments made by pension funds, but also the amounts committed to projects. In this way when payment is actually made the investment structure would not be greatly affected.
- Establishing clear regulations that would make it easier for an instrument to be eligible as a pension fund investment ("AFPeable"), particularly in the case of infrastructure.

9. Unidad Impositiva Tributaria (UIT), currently worth PEN 3,600.

DISCLAIMER

This document and the information, opinions, estimates and recommendations expressed herein, have been prepared by Banco Bilbao Vizcaya Argentaria, S.A. (hereinafter called "BBVA") to provide its customers with general information regarding the date of issue of the report and are subject to changes without prior notice. BBVA is not liable for giving notice of such changes or for updating the contents hereof.

This document and its contents do not constitute an offer, invitation or solicitation to purchase or subscribe to any securities or other instruments, or to undertake or divest investments. Neither shall this document nor its contents form the basis of any contract, commitment or decision of any kind.

Investors who have access to this document should be aware that the securities, instruments or investments to which it refers may not be appropriate for them due to their specific investment goals, financial positions or risk profiles, as these have not been taken into account to prepare this report. Therefore, investors should make their own investment decisions considering the said circumstances and obtaining such specialized advice as may be necessary. The contents of this document is based upon information available to the public that has been obtained from sources considered to be reliable. However, such information has not been independently verified by BBVA and therefore no warranty, either express or implicit, is given regarding its accuracy, integrity or correctness. BBVA accepts no liability of any type for any direct or indirect losses arising from the use of the document or its contents. Investors should note that the past performance of securities or instruments or the historical results of investments do not guarantee future performance.

The market prices of securities or instruments or the results of investments could fluctuate against the interests of investors. Investors should be aware that they could even face a loss of their investment. Transactions in futures, options and securities or high-yield securities can involve high risks and are not appropriate for every investor. Indeed, in the case of some investments, the potential losses may exceed the amount of initial investment and, in such circumstances, investors may be required to pay more money to support those losses. Thus, before undertaking any transaction with these instruments, investors should be aware of their operation, as well as the rights, liabilities and risks implied by the same and the underlying stocks. Investors should also be aware that secondary markets for the said instruments may be limited or even not exist.

BBVA or any of its affiliates, as well as their respective executives and employees, may have a position in any of the securities or instruments referred to, directly or indirectly, in this document, or in any other related thereto; they may trade for their own account or for third-party account in those securities, provide consulting or other services to the issuer of the aforementioned securities or instruments or to companies related thereto or to their shareholders, executives or employees, or may have interests or perform transactions in those securities or instruments or related investments before or after the publication of this report, to the extent permitted by the applicable law.

BBVA or any of its affiliates' salespeople, traders, and other professionals may provide oral or written market commentary or trading strategies to its clients that reflect opinions that are contrary to the opinions expressed herein. Furthermore, BBVA or any of its affiliates' proprietary trading and investing businesses may make investment decisions that are inconsistent with the recommendations expressed herein. No part of this document may be (i) copied, photocopied or duplicated by any other form or means (ii) redistributed or (iii) quoted, without the prior written consent of BBVA. No part of this report may be copied, conveyed, distributed or furnished to any person or entity in any country (or persons or entities in the same) in which its distribution is prohibited by law. Failure to comply with these restrictions may breach the laws of the relevant jurisdiction.

In the United Kingdom, this document is directed only at persons who (i) have professional experience in matters relating to investments falling within article 19(5) of the financial services and markets act 2000 (financial promotion) order 2005 (as amended, the "financial promotion order"), (ii) are persons falling within article 49(2) (a) to (d) ("high net worth companies, unincorporated associations, etc.") Of the financial promotion order, or (iii) are persons to whom an invitation or inducement to engage in investment activity (within the meaning of section 21 of the financial services and markets act 2000) may otherwise lawfully be communicated (all such persons together being referred to as "relevant persons"). This document is directed only at relevant persons and must not be acted on or relied on by persons who are not relevant persons. Any investment or investment activity to which this document relates is available only to relevant persons and will be engaged in only with relevant persons. The remuneration system concerning the analyst/s author/s of this report is based on multiple criteria, including the revenues obtained by BBVA and, indirectly, the results of BBVA Group in the fiscal year, which, in turn, include the results generated by the investment banking business; nevertheless, they do not receive any remuneration based on revenues from any specific transaction in investment banking.

BBVA is not a member of the FINRA and is not subject to the rules of disclosure affecting such members.

"BBVA is subject to the BBVA Group Code of Conduct for Security Market Operations which, among other regulations, includes rules to prevent and avoid conflicts of interests with the ratings given, including information barriers. The BBVA Group Code of Conduct for Security Market Operations is available for reference at the following web site: [www.bbva.com / Corporate Governance](http://www.bbva.com/CorporateGovernance)".

BBVA is a bank supervised by the Bank of Spain and by Spain's Stock Exchange Commission (CNMV), registered with the Bank of Spain with number 0182.

This report has been produced by the Pensions Unit:

Financial Systems and Regulatory Chief Economist

Santiago Fernández de Lis
sfernandezdelis@grupobbva.com

Pensions Chief Economist

David Tuesta
david.tuesta@grupobbva.com

Javier Alonso
javier.alonso.meseguer@grupobbva.com

Liliana Castilleja
liliana.castilleja@bbva.bancomer.com

Soledad Hormazábal
shormazabal@grupobbva.cl

María Claudia Llanes
maria.llanes@bbva.com.co

Rosario Sánchez
rdpsanchez@grupobbva.com.pe

BBVA Research

Group Chief Economist

Jorge Sicilia

Chief Economists & Chief Strategists:

Financial Systems and Regulatory:
Santiago Fernández de Lis
sfernandezdelis@grupobbva.com

Financial Systems
Ana Rubio
arubiog@grupobbva.com

Regulatory Affairs
María Abascal
maria.abascal@grupobbva.com

Pensions
David Tuesta
david.tuesta@grupobbva.com

Spain and Europe:
Rafael Doménech
r.domenech@grupobbva.com

Spain
Miguel Cardoso
miguel.cardoso@grupobbva.com

Europe
Miguel Jiménez
mjimenezg@grupobbva.com

United States and Mexico:

United States
Nathaniel Karp
nathaniel.karp@bbvacompass.com

Mexico
Adolfo Albo
a.albo@bbva.bancomer.com

Macro Analysis Mexico
Julián Cubero
juan.cubero@bbva.bancomer.com

Emerging Markets:

Alicia García-Herrero
alicia.garcia-herrero@bbva.com.hk

Cross-Country Emerging Markets Analysis

Asia
Stephen Schwartz
stephen.schwartz@bbva.com.hk

China
Daxue Wang
daxue.wang@bbva.com.hk

India
Sumedh Deorukhkar
deorukhkar@grupobbva.com

South America
Joaquín Vial
jvial@bbvaprovida.cl

Argentina
Gloria Sorensen
gsorensen@bbvafrances.com.ar

Chile
Alejandro Puente
apuente@grupobbva.cl

Colombia
Juana Téllez
juana.tellez@bbva.com.co

Peru
Hugo Perea
hperea@grupobbva.com.pe

Venezuela
Oswaldo López
oswaldo_lopez@provincial.com

Financial and Economic Scenarios:

Financial Scenarios
Sonsoles Castillo
s.castillo@grupobbva.com

Economic Scenarios
Juan Ruiz
juan.ruiz@grupobbva.com

Market & Client Strategy:

Antonio Pulido
ant.pulido@grupobbva.com

Global Equity
Ana Munera
ana.munera@grupobbva.com

Global Credit
Javier Serna
Javier.Serna@bbvauk.com

Interest Rates, Currencies
and Commodities
Luis Enrique Rodríguez
luisen.rodriguez@grupobbva.com

Contact details:

BBVA Research
Paseo Castellana, 81 - 7th floor
28046 Madrid (España)
Tel.: +34 91 374 60 00 y 91 537 70 00
Fax: +34 91 374 30 25
bbvaresearch@grupobbva.com
www.bbvaresearch.com