Argentina

This report examines and makes recommendations aimed at strengthening equity market development in Argentina.

The report was developed as part of the work of the OECD Latin American Corporate Governance Roundtable's Task Force on Equity Market Development, and served as a reference for Task Force discussions that took place in Argentina in June 2018. The report on Argentina and additional country reports on Brazil, Chile, Colombia, Mexico and Peru have drawn upon an OECD survey of company and investor perceptions in these six countries as well as additional research and interviews with market regulators, participants and other stakeholders. The six country chapters have also served as a reference for the 2019 OECD publication, "Equity Market Development in Latin America: Enhancing Access to Corporate Finance", which provides a more comparative perspective on developments across all six countries.

The report was prepared by Pablo Souto (Senior Associate of Global Outcomes) under the supervision of Daniel Blume, Senior Policy Analyst, OECD Corporate Governance and Corporate Finance Division Special thanks are due to the representatives of the following institutions that provided invaluable assistance in the process of disseminating and encouraging their members to participate in the surveys: Soledad Castro (Bolsas y Mercados Argentinos), Marcelo Lohrmann (Asociación Argentina de Compañías de Seguros), Alejandro Loizaga (Cámara Argentina de FCI), Alejandro Massa (Asociación Civil de Aseguradores de Vida y Retiro de la República Argentina), and Carlos Oteiza (Cámara de Sociedades Anónimas). Executives from participating firms, investors and other market participants were also very helpful in providing additional insights that enriched the document significantly. Any errors and omissions are the full responsibility of the author.

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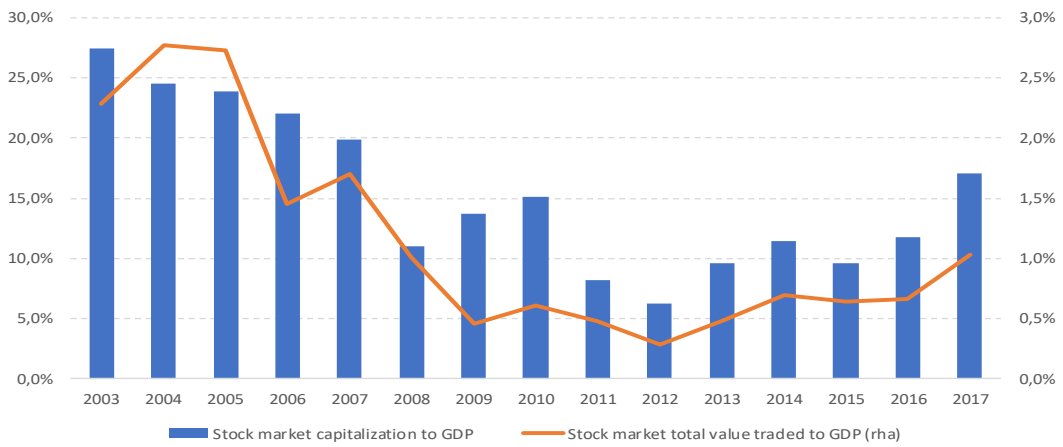
1. Introduction

Domestic equity markets took a big hit from the 2001-2002 crisis, putting Argentina into a declining trend for a decade. As shown in Figure 1.1, both equity market capitalisation and trading (liquidity) reached a record low in 2012 and have partially recovered since then.

Figure 1.1. Equity market capitalisation and trading volumes (in % of GDP)



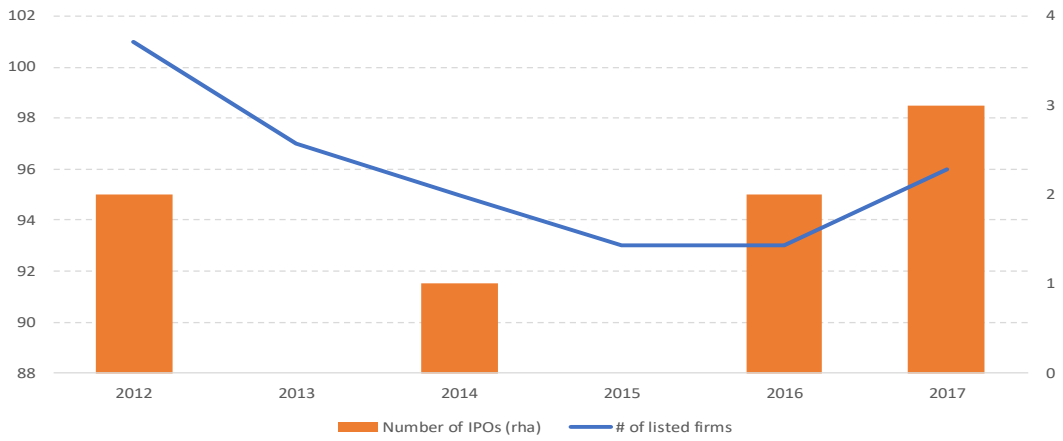
Source: WFE, FIAB and World Bank

The growth of equity markets since 2012 is largely explained by increased dynamism of existing firms rather than the entrance of new players. As reflected in Figure 1.2, the number of listed firms in 2017 was slightly lower than it was back in 2012, but significantly lower than the 2003-2008 average of 104. In the last decade, the number of de-listings has outnumbered those of new listings; on average, for every new listing there were 1.4 firms being de-listed.

The number of IPOs has averaged 1.3 new issuers over the 2012-2017 period. Both domestic and international factors have had an impact on planned IPOs during 2017 and early 2018 that had to be postponed or cancelled.

Another feature that helps explain the very low level of liquidity of the domestic market is that of the preference of some firms to cross-list or just be listed abroad. Data for 2017 show that nine out of the 10 largest traded firms in the domestic market are also listed in foreign markets through ADRs/GDRs programmes.

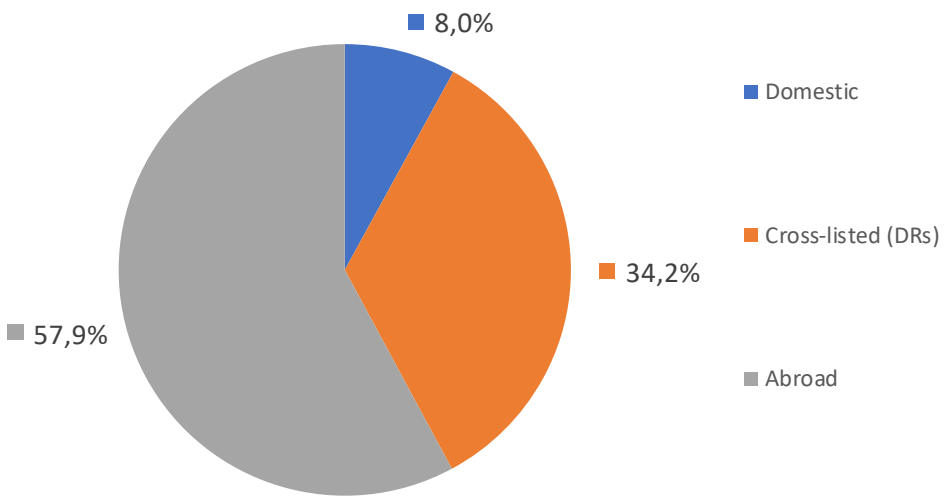
Figure 1.2. Number of listed firms and IPOs



Source: WFE and FIAB

And it is in the foreign markets where liquidity is; traded value of depository receipts of Argentinean companies was approximately USD 28 bn.[1], which would represent 82% of total trading (domestic and abroad). Four firms are only listed abroad, in US markets.[2] The value of total trading of those four firms in 2017 amounted to USD 47.4 billion[3]., seven times the total trading value in the domestic equity market. Figure 1.3 puts this number in perspective so as to acknowledge how important the issue of "exporting liquidity" is in Argentina. Most of the equity of Argentinean companies is traded in foreign markets, either through direct listing in the US with no domestic listing (57.9%), or as an ADR for cross-listed companies (34.2%). Trading in the domestic stock exchange (both of cross-listed firms and those being only locally listed) accounts for only 8% of the trading value of Argentinean equity.

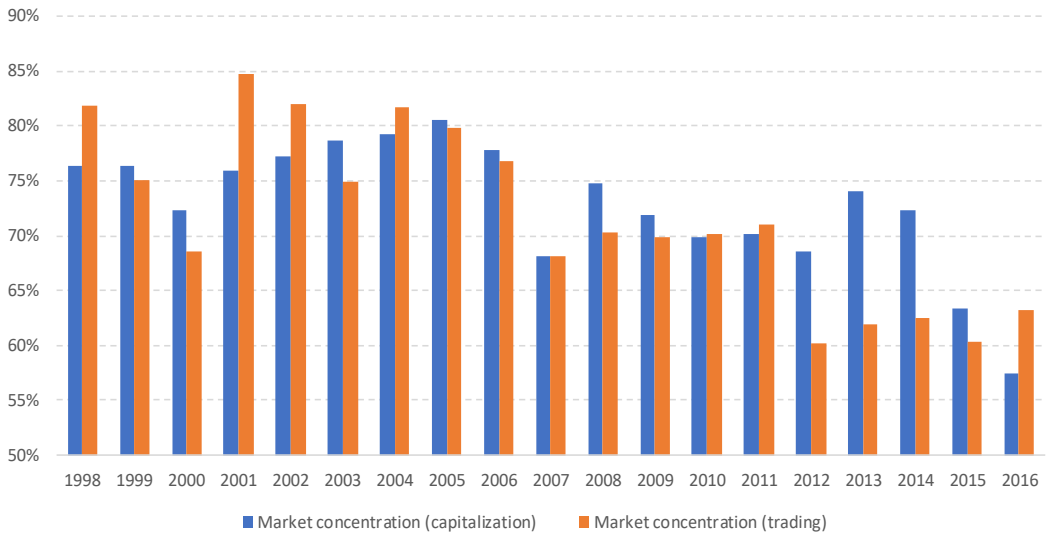
Figure 1.3. Equity trading values by type of issuer (2017)



Source: Elaboration based on WFE, Citi and Nasdaq

Despite the declining trend of listed firms in the last decade, market concentration (measured as the participation of the 10 largest companies) didn´t increase as would have been expected, but the opposite. In Figure 1.4 such trend is clear, as it reflects market concentration measured as the market capitalisation and trading volumes of the ten largest listed firms; Argentinean figures are similar to the regional average.

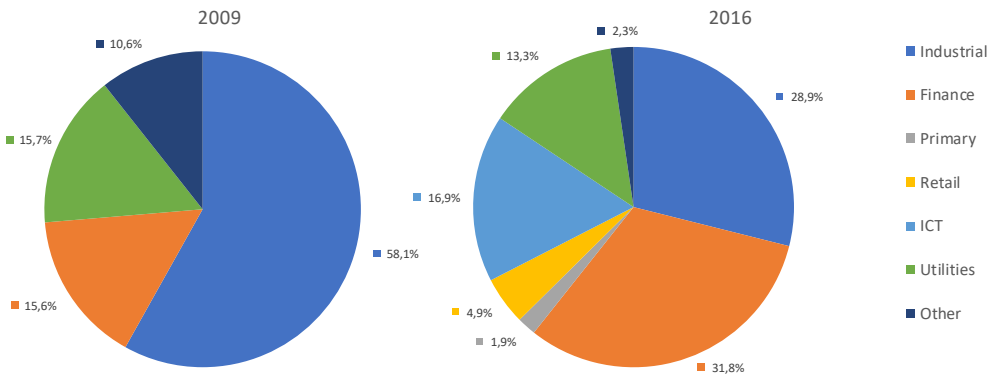
Figure 1.4. Market concentration



Source: World Bank Global Financial Development Database

Similar considerations could be made with respect to market concentration in terms of the economic sectors that are represented in the equity market. Figure 1.5 exhibits a comparison of the relative importance of economic sectors in terms of market capitalisation. A more diverse set of listed firms is seen in 2016 when comparing to 2009. These number should be considered with caution; concentration levels in only four sectors in 2009 (a feature that repeats until 2015) could be due to measurement issues.

Figure 1.5. Representation of economic sectors (by market capitalisation)



Source: FIAB

Such diversification doesn´t match that of the Argentinean economy. Although such matching is not per se a desirable feature, one would expect equity markets to reflect the structural features of the economy and somehow replicate the performance of the country, under both investment return and risk (hedging) considerations. In particular, finance and utilities are overrepresented (they account for 4% and 2% of GDP respectively) while primary[4] and retail are underrepresented (accounting for 12% and 16% of GDP). This incipient diversification includes the listing (or expected listing) of firms from new sectors (pharmaceuticals, biotechnology, ICT), and signals an opportunity for growing companies operating in dynamic and competitive sectors to access capital through the domestic market.

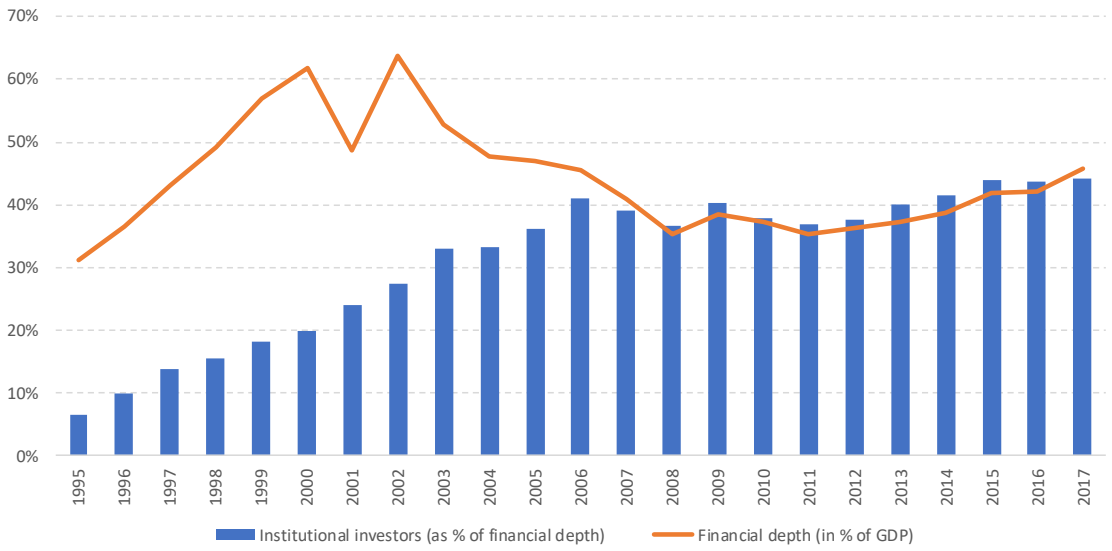
The year 2017 appeared to mark a turning point in terms of equity as a relevant source of financing in domestic capital markets. According to CNV (2017), capital raised through equity represented 20.1% of total financing in capital markets. It ranked second -- after corporate bonds or obligaciones negociables -- while in 2016, equity raising only accounted for 2.4% of the total. Back then, equity financing ranked fourth as an instrument for financing, lagging behind corporate bonds, financial trusts and the discounting of cheques.

As in many other Latin American markets, ownership structures of firms are highly concentrated regardless of being listed or not. Indeed, eight out of the ten largest listed firms are part of an economic group with a controlling shareholder (see OECD 2015). A recent report by the Instituto Argentino de Mercado de Capitales (2018) shows that 26 out of the 30 largest listed firms have a controlling shareholder (or group of control, such as the members of a family)[5]. This structural feature limits the scope to expand liquidity by limiting the potential growth of free float in the market. Data for 2014 estimates the free-float of the Argentinian domestic market at 4% of GDP, compared to 27% for Brazil, 25% for Mexico, 15% for Colombia and 11% for Peru.[6]

On the other side of the market (investors), the role of institutional investors (IIs) remains low in equity markets, as per Figure 1.6. In a country where financial intermediation is low (representing 40% of GDP on average over the last decade), and is still dominated by the banking sector, institutional investors have managed to maintain their participation over the same period. Figure 1.6 provides an indicator of financial depth (assets under management by banks and institutional investors, namely pension funds, insurance companies and open mutual funds), and also the share of such intermediation explained solely by the institutional investors. As can be seen, until the 2001-2002 crisis, financial depth was on an upward trend, and so was the relative importance of IIs at the expense of the banking sector.

Right after the crisis, financial intermediation was severely affected, particularly in the banking sector, and therefore IIs managed to increase their participation in a shrinking market. But since 2007, both financial intermediation and participation of IIs have remained stable and shallow.

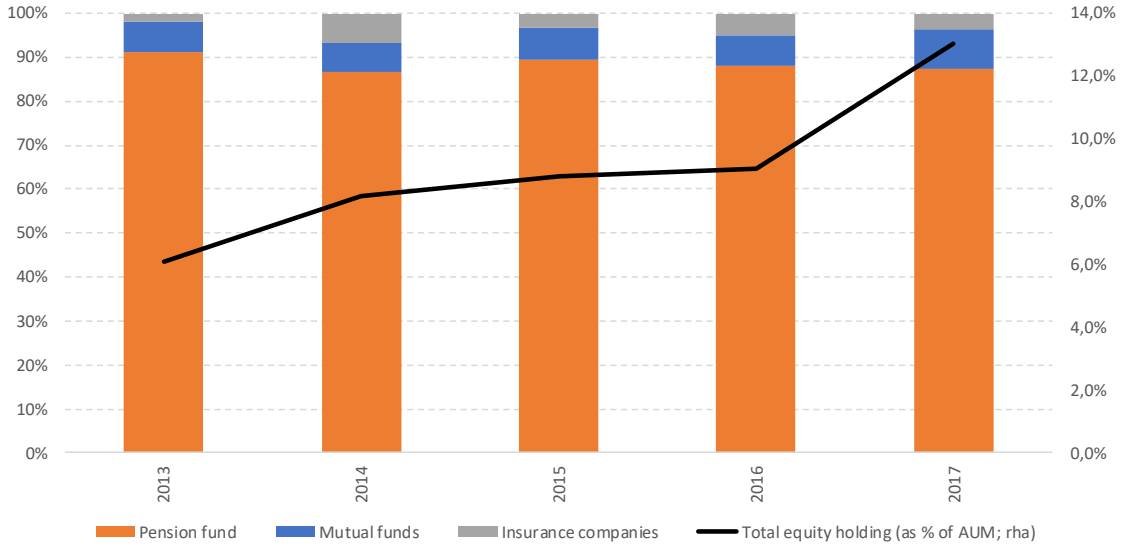
Figure 1.6 Financial intermediation (measured as financial assets hold by banks and institutional investors)



Source: Elaboration based on INDEC, BCRA, SSN, CAFCI and Anses

In such context, institutional investors exhibit relatively low equity holdings[7] over total portfolio, although they have been on an upward trend since 2013 as per Figure 1.7. They represented more than 13% of total Assets Under Management (AUM), but largely explained by the pension fund (Fondo de Garantía de Sustentabilidad or FGS). Out of total equity holdings by IIs, the only pension fund in Argentina holds almost 90% of this amount.

Figure 1.7 Equity holdings by institutional investors



Source: own elaboration based on SSN, CAFCI and Anses

The relative participation of equity in total AUM is significantly larger in the FGS than in insurance companies and mutual funds, where they were only 2% and 3% of their respective AUM. Strikingly, only a handful of life and retirement insurance companies have a stake in equity of listed firms; provided they held long-term liabilities, one could expect that matching assets-liabilities duration would prompt them to be more active in equity markets.

A significant reform of the tax treatment of financial instruments came into force in December 2017. From the investor's perspective (as natural persons, not legal entities) major changes were implemented, where capital gains and/or interest/dividends that were previously exempted from the income tax are now subject to such tax with particular conditions and deductions. Table 1.1 provides a simplified explanation of the current treatment of different types of investments conducted by natural persons.

Table 1.1. Tax treatment of financial instruments for natural persons (applicable income tax rates)

Instrument	Capital gains	Dividends/interest
Cryptocurrencies	15%	15%
Saving deposits	N/A	Exempted
Time deposits (in Ar$)	N/A	5%
Time deposits (in USD or inflation-adjusted Ar$)	N/A	15%
Sovereign bonds (in Ar$)	5%	5%
Sovereign bonds (in USD or inflation-adjusted Ar$)	15%	15%
Corporate bonds or Obligaciones Negociables (in Ar$)	5%	5%
Corporate bonds or Obligaciones Negociables (in USD)	15%	15%
Domestic equity (listed)	Exempted	7%-13%
Domestic equity (non-listed)	15%	7%-13%
ADRs of domestic companies	15%	7%-13%
Mutual funds participations	Identical treatment as that of the investments of the fund	

Source: KPMG (2017)

On the other hand, companies were subject to a 35% corporate tax until 2017 that will be reduced to 30% (in 2018 and 2019) and further to 25% (since 2020). Until 2017, dividends were exempted at the natural person level. With the reform, if companies decide to pay dividends, they are taxed at the rate presented in Table 1.1 for those sub-periods, a measure which potentially could discourage the issuance of dividends. The rationale behind this reform is to encourage firms to reinvest profits as a way to boost corporate investment in the short to medium-term, provided firms' *raison d´être* is to provide a steady flow of income to shareholders in the long-term. The effect on equity markets is yet to be seen.[8] Ultimately, the aggregated tax rate if dividends are paid has not changed significantly[9], and therefore the analysis is more about an intertemporal choice of whether to pay income taxes in the present or in the future.[10]

There is wide consensus that the development of capital markets in Argentina is a top priority both for policy-makers and market participants. In a context where -- according to World Bank figures[11] -- almost half of domestic firms identify access to finance as a major constraint for their development, and where only 4% of firms resort to capital markets to finance their investments, the potential gains from more developed capital markets seem obvious. In addition, spurring public investment has also been a key policy initiative and the public-private partnership mechanism is expected to play a catalyst role. Again, well-functioning capital markets will be needed to make that happen.

From a broad perspective, both macroeconomic volatility and a weak institutional framework have been pivotal in restraining the development of capital markets. At a micro level, the lack of a strong base of institutional investors, low liquidity and certain costs related to accessing the capital markets have been recognized as particular issues that need to be addressed. A reform of the capital markets law (Ley de Financiamiento Productivo) that intends to remove some of those barriers was passed by Congress in 2018. Among several elements, the reform included: i) the introduction of new financing mechanisms for SMEs (certain account receivables could be traded in public markets or *factura de crédito electronica*); ii) restrictions in preferential subscription rights, that are now only allowed if included in the company's by-laws; iii) heightened protection of minority shareholders' rights in the case of a public takeover bid; and iv) streamlining the functioning of both open- and closed-end mutual funds, and of the corporate bonds market (*obligaciones negociables*).

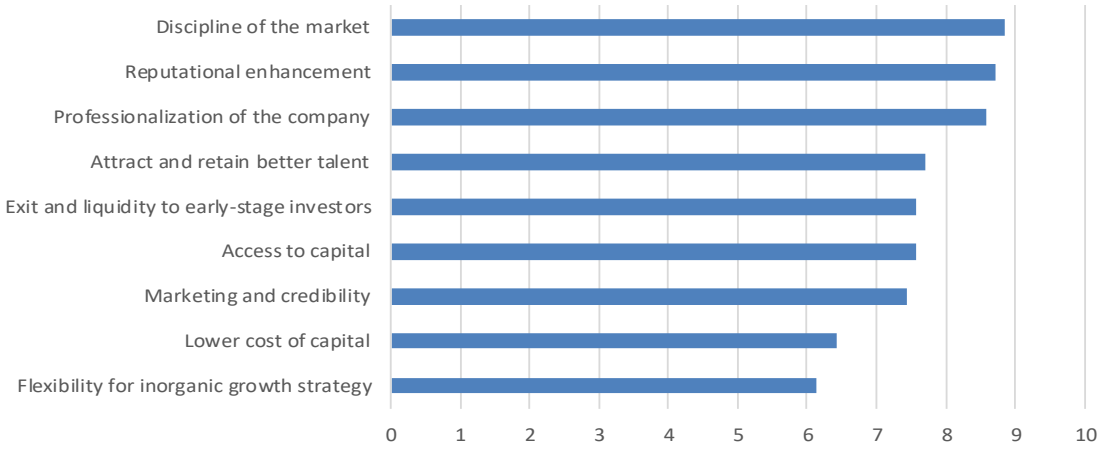
2. Listed and non-listed companies

Listed

The OECD survey of listed firms obtained responses from nine enterprises[12], all of them locally incorporated; most of the respondents have a controlling shareholder, which is a family in half the cases. All but one are part of an economic group, playing the parent company role in 75% of the cases. Two of the respondents are cross-listed, whereas the other seven are only listed in the domestic market. The respondents represent 22.5% of total domestic market capitalisation, as of April 2018. Almost all sectors are represented, ranging from utilities, financial, retail and industrial firms.

When it comes to the benefits of being listed, the three most important elements that were identified by respondents (on a 1-10 scale) are related to soft benefits, rather than the canonical view that conditions and access to capital are the key benefits from going public. As Figure 1.8 reflects, discipline of the market (8.9), reputational enhancement and raised profile (8.7), and professionalisation of the company (8.6) rank at the top, whilst the reduction in the cost of capital ranks very low as a benefit of being listed (6.4, the second lowest).

Figure 2.1 Benefits from going public (0-10 scale)



Source: Own elaboration

The importance of these benefits should not be underestimated nor are they well understood by outsiders. Representatives from listed firms have emphasized how going public impacted the culture of the firm, the internal organisation and the decision-making process. Firms found that internal awareness-raising campaigns and capacity building activities proved helpful in facilitating those changes.

Listed firms identify the overall cost of going public as a relevant deterrent for firms to access capital markets. They suggest that lack of specific expertise at the firm level prompts

firms to outsource or seek expert external advice, which is also in short supply, and therefore costly. When breaking down the costs, fees from advisors (investment banking, legal services) are identified as the most important one-off costs related to going public (IPOs). Fees charged by the stock market were particularly relevant for those being cross-listed, not for those listed in the domestic market. And complying with regulatory requirements was slightly costlier than with listing requirements, according to the firms' perception. In this latter case, whether being listed domestically or cross-listed made no difference in the responses.

Once listed, firms consider that ongoing costs related to compliance with auditing/control procedures (7.9) and regulations (7.1) are the most relevant. Compliance with corporate governance regulations and investor relations activities rank in a second group, with a score of 6.4. Tax treatment and stock exchange fees are not identified as relevant costs of being listed. It is notable that all of these costs were rated at slightly less significant levels than the most highly rated benefits of going public cited above.

The corporate governance implications of being listed have been identified as the most important risk or consequence of going public; this corporate governance risk provides further support to the previous finding about the organisational challenges and benefits that going public have had on firms. Therefore, the adoption of good corporate governance practices not only is valued by the market once the firm is listed, but has a critical role in facilitating the cultural change needed for private firms to become public. At the other end, tax issues are not identified as a risk.

Firms identified themselves as having a good record in corporate governance practices on all fronts, particularly transparency (9.0). Board nomination, composition and remuneration (7.9) and the related-party transactions regime (7.9) were the areas with lowest scores. But when addressing the level of corporate governance practices in the market, then the score is slightly lower; in particular, the previous areas with highest scores are perceived as not so good. The change is not significant (for instance, transparency goes from 9.0 to 8.4), which could reflect the typical bias when comparing oneself to the average.

Non-listed

The questionnaire was completed by six firms[13], although two of them did so partially (they didn´t provide information about their financing structure but responded to the other more qualitative questions). Half the respondents are part of an economic group as subsidiaries. Only one of the respondents conducts additional operations abroad.

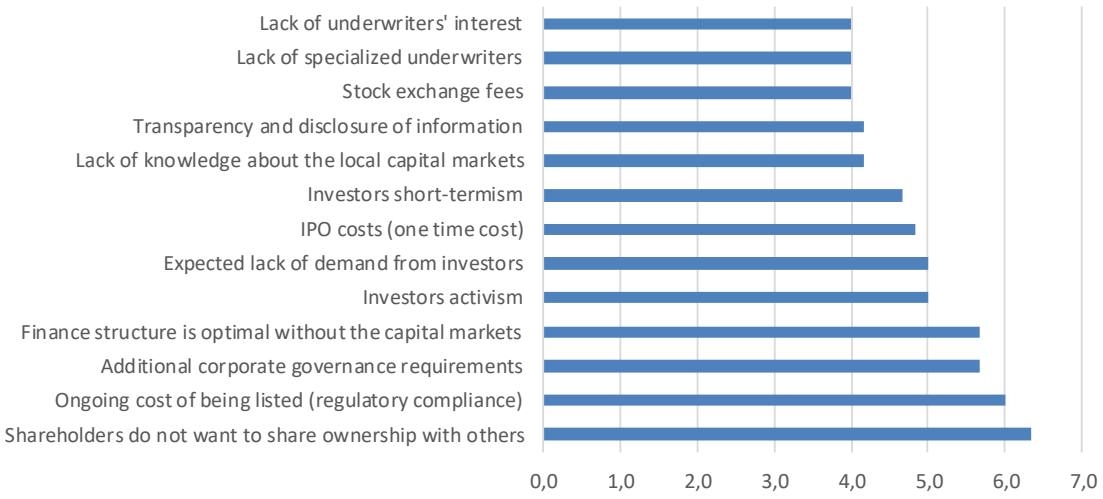
The ownership structure of the sample is fully diverse, including one family-owned company, one state-owned, three with controlling shareholder (in one of the cases also have foreign investors with a participation of more than 5% of equity), and another one with dispersed ownership.

All of the firms are classified as large enterprises, with one corresponding to a medium-sized firm, following the domestic criteria for SMEs. In terms of economic sectors, respondents are from the oil industry, ICT, pharmaceuticals, financial and health care services.

The reasons why these firms decided to remain in the private domain are quite diverse, with no single element being particularly decisive in such decision. Figure 1.9 provides the results of the scores that each of the reviewed elements obtained. Interestingly, out of the two most relevant reasons for not going public, one relates to actions that could be

addressed by policy-makers (regulatory costs) and the other one relates more to a "cultural" factor in the local business community, that is related to sensing they may lose control.

Figure 2.2 Relative importance of elements for not going public (0-10 scale)



Source: Own elaboration

Despite that, they acknowledge that access to broader sources of capital (and at a lower cost) are the most relevant and potential benefits from going public. Reputational effects rank third. At the other end, attracting and retaining talent and the professionalisation of the company are the least important elements, which could reflect the companies´ belief that they already have qualified human capital.

Respondents perceived that tax treatment, corporate governance requirements and losing control were the most visible risks ahead if they decide to list their shares. The latter element coincides with the reluctance of current shareholders to allow newcomers. Comparatively, the benefits from going public received a score higher than the costs; average benefits scored 6.9, whilst average costs scored 6.5. Although those numbers may not be fully comparable, it´s worth noting that four out of the six firms gave higher scores to benefits than to costs.

When it comes to corporate governance, respondents have a more lenient perception about their own company practices vis a vis those of listed firms. In particular, respondents identify related party transactions procedures and transparency (to their stakeholders) as the strongholds of their governance structure; the protection of minority shareholders and issues related to the board (nomination, composition and remuneration) are the least valued elements.

In all six elements of the corporate governance structure, non-listed firms perceive that their own practices as equal to or better than those of listed firms. Only board nomination/composition/remuneration, and protection of minority shareholders are the areas where they see both groups as having similar standards. As mentioned before, this latter area is the one with the lowest score, pointing to a more general issue of the overall framework for protecting minority shareholders´ rights, irrespective of whether companies are private or public.

Both

Non-listed firms adhere to the "traditional" storyline that accessing equity markets provides an opportunity to access broader sources of capital and at a lower cost. But such perception appears to change once firms go public; in their view, a lower cost of capital is much less relevant, whereas "soft" elements (such as reputational effects and the professionalisation of the company) are identified as the most important benefits. Moreover, these last elements are less valued by non-listed firms as a potential benefit of going public.

A study by Grandes et. al. (2007), based on listed firms in Latin America, suggests that macroeconomic instability (in authors' terms systematic factors or market risk) rather than microeconomic elements (e.g. idiosyncratic factors or firm´s risk) are more relevant in explaining the opportunity cost of equity. Even more, stock liquidity and the issue of being cross-listed don´t provide significant explanatory power for the cost of capital; e.g. being cross-listed doesn´t entail a significant reduction in the cost of capital for firms. Since several structural features of global capital markets were modified as a consequence of the 2008 international crisis, further work should be done to better understand the effects that going public could have on the cost of capital.

The perception of firms regarding corporate governance practices is high on average. Interestingly, non-listed firms perceived themselves as outperforming listed ones in this regard. The protection of minority shareholders´ rights is the area which both groups recognize they perform least well. Although there are no recent studies about the quality of corporate governance in listed firms, studies by CEF (2005) and Anzoategui and Streb (2009) conclude that transparency practices -- as a proxy of corporate governance -- have large room for improvements; on a 0-100 scale, the studies calculate a Transparency and Disclosure Index for non-financial listed firms, and they averaged a 45.6 score for year 2007, slightly above the 2005 index that was 43.2. The index assessed the extent of disclosure over 35 items, related to board structure and procedures, qualitative and quantitative information about the firm, and information relevant for shareholders.

Regarding the costs of going public, both groups identify compliance with regulations as a relevant cost for firms being listed. Listed and non-listed firms alike suggested that there is room to simplify regulatory procedures and reduce the costs of going public, and streamline regulations once being listed thus also reducing costs. For example, one of the respondents contended that the mandatory disclosure of financial information of controlled companies is a requirement that increases listing costs.

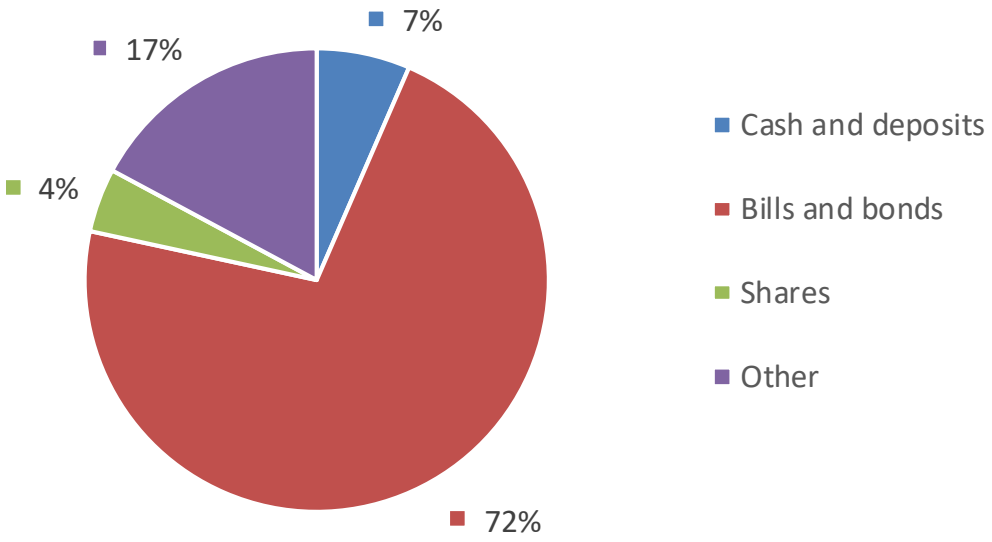
3. Institutional investors

As described in section 1, the universe of institutional investors in Argentina is comprised of one (public) pension fund, insurance companies and mutual funds. We received responses from 22 investors[14], although five of them were incomplete. We kept then a sample of 17 institutional investors, including the pension fund and 16 insurance companies; none of the mutual funds responded to the questionnaire.[15] These investors managed assets over USD 70 bn. as of December 2017. A large share of respondents (85%) are part of a financial conglomerate.

Almost 60% of investors are subject to regulations that set a cap on equity investments, and one-third declare that they pursue actively-managed strategies. Only one respondent conducted transactions in foreign markets during 2017 but did not provide more information about the reason for doing so.

All respondents had only domestic assets by end-2017, exhibiting a large allocation in fixed-income instruments, as per Figure 2.1.[16] The proportion of equity shares is significantly low. To further emphasize this feature, only two investors had an equity position of over 10% of total AUM while five investors don´t hold any equity position at all. Direct holdings of shares is the predominant form of equity investment, seconded by mutual and investment funds.

Figure 3.1 Portfolio composition of institutional investors (end-2017)



Source: Own elaboration

Only one-quarter of investors (four institutions) declared that they regularly engage with investee companies. They all claim that engagement is done on a voluntary basis, while requesting information from the investor relation unit is the preferred mechanism (all four respondents use this mechanism). Half the respondents appear to be very active shareholders, since they claim that the review of the corporate governance reports prompted them to contact investee companies, they vote at shareholders meetings, and contact senior management and (one) also board members.

The perception of investors regarding the commitment of listed firms to corporate governance practices is largely described as acceptable (65%), while good (30%) and very good (5%) are less common. None of the respondents qualified such commitment as poor or very poor. Argentinean investors perceived that domestic corporate governance practices are -- on average -- of equal or lower quality than those in other countries (whether LatAm, other non-OECD, or OECD countries).

They attach a noteworthy importance to corporate governance as a driver for investment decisions. On a 0-10 scale, corporate governance obtained an average score of 8.8, with only two responses at the lower end (a score of 7).

Yet only 41% of respondents state that better corporate governance would prompt them to increase their equity exposure; interestingly, 35% are uncertain about the impact of improving corporate governance on their equity exposure. This latter perception could not be attributed to investor´s size or current equity allocation.

Investors considered that all of the six key elements of a corporate governance framework should be boosted by listed firms. On a 0-10 scale, those six elements average a score of 8.2. In particular, transparency (9.1) should be the highest priority area for improvement. Risk management and internal controls are the second area of concern. At the other end, board effectiveness (7.8) and protection of minority investors' rights (7.9) were identified as the less relevant elements, but with high scores as reported. In the case of the protection of minority investors' rights, qualified institutional investors have also pointed out that there is room for the judiciary to play a more active role in this regard, by strengthening and enforcing those rights in a more efficient manner.

Reducing trading costs could help develop the capital market, according to 75% of respondents (25% consider that such reduction could have a meaningful impact). Only one respondent provided further information, and identified brokerage costs, clearing and settlement, and regulatory burden as the areas where more action is needed. At the other end, stock market fees were not considered relevant to reducing trading costs.

Other institutional investors also found it difficult to invest long-term. Retirement insurance companies are faced with regulations that require a minimum rate of return for policyholders; a return that is computed on a monthly basis. Therefore, despite holding intrinsically long-term liabilities (average maturities of 15 years), those companies have incentives to invest short-term to ensure compliance with such minimum required return and therefore the attractiveness of equity investment is diminished; fixed-income instruments, particularly sovereign bonds, provide for that need. In addition, once the economy normalizes and interest rates become positive in real terms, if short-term returns are pursued the potential gains from investing in equity are reduced.

Listed small- and medium-size enterprises (SMEs) are almost absent in the domestic market. Therefore, it is no surprise that liquidity emerges as the leading bottleneck that prevents investors to invest in those companies. Lack of analyst coverage and not being part of equity indices rank at a second level of importance.

Finally, some investors have claimed that equity markets could be more attractive if cash dividend policies became widespread. True, the instability of the domestic economy makes it difficult for domestic companies to engage in such type of contractual agreement with shareholders, but nevertheless some guidance could be provided in this respect.

4. Perspectives from other stakeholders

In the case of Argentina, systemic factors (institutional weaknesses and macroeconomic volatility) are -- relative to the rest of the region -- far more relevant in explaining the underdevelopment of financial markets in general, and equity markets in particular. Structural changes are needed to overcome those deterrents, and their impact is more on the medium- to long-term. But micro factors are also relevant and could provide a boost to equity markets in the short- and medium-term.

To further inquire into those deterrents, a number of interviews with the stock exchange, two listed firms, three institutional investors, the regulator (CNV), and other market participants (such as one trader and a law firm) were conducted. The following paragraphs provide the salient outcome of such interactions.

The recurrent implementation of government-sponsored subsidized credit facilities works as a deterrent for the proper functioning of capital markets, by signalling firms to engage (and use resources) in accessing those concessional facilities rather than exploring market-based financing instruments.[17] Although well-intended, those policies may have had the opposite effect and limit the development of capital markets; this in turn, would call for further government actions given the limited size of the capital market, then entering into a vicious circle. Argentina has widely adopted these types of policies -- particularly after the 2001-2002 crisis -- but began dismantling them since 2017; the impact of these recent measures is yet to be seen.

The nationalisation of private pension funds in 2008 has had long-lasting and profound impacts on financial markets that can´t be overlooked. In particular, it has had a significant impact on capital market development by affecting issuers´ and investors´ incentives alike. The incipient development of a strong base of institutional investors came to a halt. Such event not only discouraged long-term savings but also created one single public pension fund (FGS) that has had a disproportionate presence in equity markets since then; its equity holdings represent 20% of total AUM (an allocation that is standard for a pension fund), but such figure represents a large stake in the market and in certain companies; for example, the FGS has a participation in 15 out of the 20 largest companies, ranging from a participation of 1.2% up to 28% of shareholdings.

Many interviewees cited a perception within the market that the governance of the fund at certain stages has been guided more by political rather than investment considerations, resulting in vulnerabilities to arbitrary interference in firms´ decision-making (in particular, over those companies where the fund has a large stake, as mentioned before) that spooked other firms from going public due to the risk of political interference in their businesses.[18] A more recent market-friendly approach by the FGS and the recent modification of the capital markets law could be regarded as a turning point in eliminating the reluctance of firms to tap equity markets; the 2016-17 increase in the number of IPOs may be a signal in this respect.

Soon after nationalisation, inflows into the FGS were only a consequence of the return of current investments. Therefore, equity positions are largely held and not actively traded.

This means that a significant part of the already low floating (and related liquidity) of companies´ shares is not in fact floating in the market. Ultimately, market liquidity dries-up unless significant demand arises, which could be a window of opportunity for the FGS to trade in equity without having a disruptive impact on market prices. The currently sought re-categorisation of the domestic market from frontier to emerging market could be a driver in this regard. The role of market-makers -- large institutions or brokers willing to buy or sell a security they hold on inventory on a continuous basis -- in the stock exchange is still at an early stage of development, given the absence of active and large investors or investment banks who typically perform such functions in more developed markets; promoting the figure of market-maker could be conducive to increasing liquidity.

For a number of reasons related to the competitiveness of financial markets, integration has been a feature of capital markets worldwide over the last decade or so. Argentina has recently embarked on such a process. Domestic capital markets have experienced a process of vertical integration as a consequence of the legal reform that took place in 2012 (Ley 26831). The creation of ByMA, which now handles all equity trading in Argentina, and the integration with the custodian entity (Caja de Valores) and listing of its shares in 2017 is the salient example in this regard.

Nevertheless, domestic markets failed to further integrate horizontally and the coexistence of other large markets[19] (such as Mercado Abierto Electrónico, Rosario Futures Exchange, Mercado a Término de Buenos Aires, etc.), although some of them are exploring and have made advances in their integration, leaves domestic markets at a competitive disadvantage. In a fragmented market, liquidity is also fragmented, and supervisory costs are higher. For example, if best execution -- a practice intended to particularly protect small investors -- is the rule for stock brokers, then fragmentation also adds up to trading costs.[20]

As it was described in Section 1, local financial markets are underdeveloped, although within this adverse context, the market has experienced an increase in its complexity. New products, new types of participants, and new practices have changed the types of relationships in the market and the characteristics of the conflicts and disputes. An efficient resolution of such conflicts is critical to further facilitate the development of capital markets. A competent and effective judiciary is needed to provide certainty to market participants in conflicting areas; and those competencies require a continuous process of capacity building of the members of the judiciary.

Such complexity also affects the enforcement ability of the regulator (Comisión Nacional de Valores, CNV). The CNV has traditionally been understaffed and suffered budgetary restrictions that limited its independence and scope of action[21]. Some progress has been made in this regard, when for example the CNV decided in August 2017 to extend the scope of the fees it charges to market participants, and to increase the number of staff devoted to working on corporate governance issues. For example, some market participants have claimed that the CNV lacks sufficient resources to conduct a continuous and comprehensive monitoring and analysis of certain practices, such as insider trading and corporate governance, while at the same time supervision of formal compliance with issues of relatively minor importance may be heavy-handed. Nevertheless, there is wide agreement that the recent reform of the capital markets law has significantly strengthened the regulator's independence, while also abolishing the Central Bank authority to intervene in capital markets when trading of certain instruments could be regarded by such institution as a menace to the existence of the domestic currency.

Despite such budgetary restrictions, the CNV asserts that a number of stumbling blocks (inhibitors) have been removed since 2016. The most relevant examples of legal and

regulatory restrictions that were recently eliminated include foreign exchange and capital controls; sovereign default, taxation of (listed) equity capital gains for foreign investors; the possibility for the CNV to intervene in companies; requirements for domestic registration of foreign shareholders wishing to exert their voting rights in domestic companies;, prohibition of short-selling and ETFs; and tax asymmetries in the case of closed-end mutual funds.

Finally, compliance costs have been identified as a barrier for further development of capital markets. Market participants consider that there are similar formal requirements of reports and information from both the stock exchange and the regulator that could be streamlined, and therefore simplify compliance. A good example is the proposed modification of the requirements for being classified as a qualified investor that the CNV has put forward for public consultation.

Related to costs, some experts pointed out some sort of segmentation in the domestic market when it comes to listing, since most regulations, requirements, processes, etc. seem to target or be more suitable for large companies; at the other end, SMEs find it economically non-viable to issue shares below a certain threshold.[22] This is -to some extent- striking since the Argentinean economy, like many others in the region, is characterized by the dominant presence of SME whereas large firms are very limited in number and also face lesser constraints in accessing capital.

Also, there is room to further promote the use of Fintech and facilitate investors' participation moving towards paperless processes. The recent initiative by the CNV aimed at developing crowdfunding online platforms is a good step in this direction.[23]

5. Conclusions and policy options or potential recommendations for discussion

There is a clear need to spur capital market development and provide firms with further sources of capital. Weak institutions and macroeconomic instability prompted domestic savings to be invested abroad. There is ample consensus about the importance of repatriating those savings[24] and also providing incentives for current savers to invest in domestic securities.

As it has been already mentioned in section 1, a reform of the capital markets law has been recently passed by Congress, which addresses some of the recommendations put forward in this section.

Corporate governance

There is a perception both among listed and non-listed firms that their corporate governance practices rank high or very high. On the other side, investors are less optimistic, with most finding them "acceptable" and only 35% finding them better than acceptable. They also claim that corporate governance should be an important element for the investment decision. But at the same time, they have a small participation in equity markets and in most cases they follow a passive strategy and index tracking, with financials playing a leading role.

Moreover, they don´t regularly engage in companies´ affairs and their governance (activism). And this is a rational decision provided they hold relatively low stakes and hence a cost-benefit analysis calls for no active involvement. In that context, it could be the case that investors´ perception is guided by their partial attention to governance issues and not a consequence of in-depth analysis of governance practices. The absence of a metric of corporate governance practices makes it difficult for investors to have a quantitative tool to incorporate governance into investment decisions. The development of such a metric on a regular basis, for instance promoted by the stock exchange but conducted independently, would pave the way for a better understanding of actual governance practices for investors. Were the local market to be classified as emerging, then international institutional investors might demand such tools to assess the extent and quality of those practices. The development of a panel for better governed firms is currently under analysis by ByMA.

As mentioned before, certain institutional investors have claimed that equity markets could be more attractive if cash dividend policies became widespread. In this respect, the 2018 tax reform provides the opposite incentive as already explained; corporations -regardless of whether they are listed or not- are encouraged not to pay dividends, at least in the short-term. From a corporate governance perspective, listed firms have to disclose whether they have a dividend policy, as part of the compliance with the corporate governance code (Código de Gobierno Societario, section V.6).

No systematic analyses exist regarding the outcome of this annual requirement. Anzoategui and Streb (op.cit.) conducted an empirical analysis of transparency practices by listed firms, and items related to dividend policies ranked among the lowest transparency scores; more

recent anecdotal evidence suggests the finding remains relevant, with formal policies existing only in a few companies, while decisions are made on a discretionary basis subject to market conditions, financial results, expectations, etc. Although these are important elements, they could be part of a dividend policy to reduce the scope for arbitrary decisions by controlling shareholders. Dividend policies could well be part of good practices to be requested for firms to be listed in a special corporate governance panel and/or be subject to formal regulations. The recent reform in the income tax rates for corporations, where the consolidated tax rate is reduced if companies re-invest profits instead of paying dividends, provides an incentive against the proposed change.

Financial literacy

Firms are reluctant to open up their capital due to concerns about losing control. This is particularly acute in the case of family-owned firms. But such concern could be overestimated and investment opportunities could be lost, affecting the long-term prospects of firms. In some cases, they have relied on state-sponsored credit facilities that are being dismantled and fading away. In this situation, it is important to reach out to those constituencies and remove those preconceptions about capital markets. Moreover, awareness-raising should also emphasize how -- contrary to common belief -- elements such as reputation, professionalisation of the company, and market discipline may be those where most benefits could be reaped while going public.

It is acknowledged that efforts have been made in this respect -- both by the CNV and ByMA -- but more is needed, and the instruments of dissemination should be revisited. The conduct of a quantitative study that shows how firms benefit from going public could be conducive to such advocacy. From the investors' side, there is a perception that the importance of corporate governance in the investment decision is overstated by investors themselves, but not put into actual practice. Hence, advocacy among institutional investors regarding this issue should be considered.

Also, capacity-building activities for the judiciary on the current status of capital markets, players, instruments and new developments is needed to strengthen the rule of law. To our knowledge, there are no systematic initiatives in this area, so there is ample room for developing those types of programmes tailor-made for the members of the judiciary.[25] And it is here where the regulator, market participants and business associations have a common interest and could work together in putting forward such initiatives.

Dispute resolution mechanisms

The weaknesses in the functioning of the judiciary call for market-based solutions in case of controversies in capital markets. Most markets already have dispute resolution mechanisms (Tribunal Arbitration) that have had limited participation. The advantages of using such instances need to be further disseminated and strengthened. As part of the advocacy campaign, reports by the markets on the number of cases that were brought for arbitration, the final outcome and the associated costs should be prepared on a regular basis.[26]

Requirements and costs

There is broad agreement that compliance with regulations is costly for listed firms. In addition, as previously mentioned, back in 2017 the CNV increased the amounts and scope

of the fees it charges to market players. This practice intends to reduce the regulator´s dependence on the fiscal budget, so as to further its independence and effectiveness; but this is done at the expense of higher costs to issuers. A complementary mechanism to reduce such conflicting objectives could be to rely more on fines and sanctions imposed, which are regarded by some market participants as extremely low, accompanied by safeguards to avoid creating incentives that lead to excessive or disproportionate fines as well.

Over the last years, there have been initiatives to develop tailor-made products with reduced requirements so as to lower listing costs; in particular, they have targeted SMEs. In 2017, the CNV issued regulations to allow for a differentiated regime for SMEs (the so-called Régimen PyME CNV) that intends to attract those firms with lower entry and listing requirements and allow for a broad set of financing instruments to be issued by companies. The recent reform introduced the possibility for the CNV to reduce or waive SMEs from paying certain fees related to listing. The reforms' effects are yet unknown, but previous experiences -- such as the SMEs panel launched in 2006 -- have shown that there can be high risks down the road.[27] However, deeper analysis is needed for this particular constituency which exceeds the scope of the current analysis.

Therefore, a strategic decision should be considered about the scope for reducing further the requirements -- for example, addressing the mandatory requirement to disclose financial information of controlled companies -- and take more risk in the market. In such a context, the existing limitations for the type of investors that are authorized to invest in those securities (qualified investors) should be strengthened, as proposed by the CNV as mentioned before.[28]

As CNV considers the development of a revised corporate governance code, it will be important to take account not only the potential benefits of promoting better corporate governance practices but also the potential regulatory burden that may be involved in requiring increased disclosure. Moreover, the reported consideration by BYMA of a special listing tier for issuers with higher corporate governance standards also needs to be taken into account as CNV considers further development or scaling back of disclosure requirements related to corporate governance, in order to be able to take account of different standards being applied to different companies in the Argentinean market.[29]

Investors

Previously, we have mentioned the importance of the FGS as a state-owned and large holder of minority stakes in many Argentinian listed companies. Interviews with market participants and press reports cited highly politicized market interventions conducted by the pension fund in the past that may have deterred companies from entering the market. Such actions have impeded it from fulfilling the potential role that pension funds play in some other Latin American countries as engaged minority shareholders with a positive influence on corporate governance and market development. In fact, instead of being a source of liquidity, the FGS has contributed to reduced liquidity by following more of a buy-and-hold strategy.

But including a reform for the FGS into an agenda to spur equity markets does not appear to be critical. The fund is expected to fade away in the medium-term since its holdings are expected to be used to pay off long pending retirement benefits. Since 2003 a number of pensions have been incorrectly paid, and the courts have repeatedly issued rulings requiring the government to fix that. In 2016 a law was passed mandating the FGS´s resources to be

used to settle those claims. Therefore, the recommendations in the following sub-sections are based on structural issues assuming that no significant role is expected from the FGS.

The government may instead wish to consider other reforms aimed at strengthening the role of other institutional investors, both domestic and foreign. If the FGS over the medium term is required to dispose of its assets in equity, this may also provide an opportunity to increase liquidity if other investors who buy the shares have a more active trading strategy.

Insurance regulations have established a minimum allocation (3%) of insurance companies' portfolios into mutual funds investing in SMEs, the so-called Fondos comunes de inversion PyMEs, that need previous authorisation by the CNV.[30] This is the only minimum investment requirement for insurance companies, since all other investment limitations set a cap on their holdings. By introducing a minimum investment, investors are forced to allocate resources to those instruments regardless of their quality. Although well intended, this type of regulation limits the decision-making of investors, and their removal should be considered.

Similar considerations could be made regarding the minimum return set for retirement insurance companies, described in section 3. Lengthening the period over which the minimum return is requested would help in providing incentives to invest in longer-term securities, such as equity.

Fiscal policy is another area which could be conducive to more developed capital markets. Following the recent establishment of a panel for companies with better corporate governance practices, fiscal incentives to invest in those companies could be considered. But such incentives should include mechanisms for verification and enforcement to ensure that such provisions are not followed in name only but that they truly incentivize better corporate governance practices. For example, reduced income tax rates could be applied for dividends and/or capital gains coming from best governed companies. The tax bill passed in December 2017 -- that expanded and introduced new income tax deductions for individuals buying long-term instruments (such as retirement and life insurance policies)—is a good example of fiscal policy oriented towards a more dynamic capital market.

Notes

[1] According to the 2017 Report of City Depositary Receipt Services

[2] Mercado Libre, Adecoagro, Globant and Arcos Dorados

[3] One firm alone (Mercado Libre) accounts for 87% of this figure.

[4] Including agricultural, fishing, mining.

[5] Those 30 firms account for 80% of total market capitalisation (as of May 2018).

[6] Presentation made by Bernardo Mariano at UCEMA. See: https://www.ucema.edu.ar/sites/default/files/2017/eventos/congreso_mc_mariano.pdf

[7] In the case of mutual funds, holding of domestic equity was estimated. We assume that 85% of equity holdings correspond to domestic listed firms. Such percentage is based on reports prepared by the CAFCI.

[8] The complexities derived from the actual determination of the tax base and tax rates for natural persons prompted fiscal authorities to postpone certain administrative deadlines. Therefore, the actual impact on equity markets in particular, but capital markets in general, is difficult to assess since some aspects of the reform are yet not fully clear for taxpayers.

[9] By 2020, profits will be taxed at the company level at 25%, and an additional 9.75% (13% of 75% after tax profits) at the natural persons level.

[10] If one assumes that the reform does discourage firms from paying dividends, then *ceteris paribus* stock prices (as the present value of future dividends) should fall accordingly. More realistically, the compounded return of non-paid dividends is to be compared to the return of paid dividends in an alternative investment option.

[11] Data for 2010 from the Global Financial Development Database

[12] The survey was sent to 103 listed firms

[13] The questionnaire was sent to 25 firms

[14] The questionnaire was sent to 105 institutional investors.

[15] No further distinctions within the respondents would be made when analyzing the responses to avoid identification of respondents.

[16] We took a simple average. If using a standard measure (weighted-average) final results will replicate the portfolio allocation of the pension fund because of its relative size, therefore distorting somehow the data.

[17] According **to** Cecilia Lanús Ocampo, chairwoman of the IV Argentinean Congress of Capital Markets. See: http://www.eleconomista.com.ar/2017-05-tenemos-mercado-capitales-moderno/

[18] Anecdotal evidence could be found in: https://www.lanacion.com.ar/1576415-imprevista-irrupcion-de-moreno-y-kicillof-en-la-asamblea-del-grupo-clarin and https://www.cronista.com/finanzasmercados/Asamblea-del-MacroANSeS-habilita-opcion-de-designar-mas-directores-20120416-0043.html

[19] These other markets don´t trade equity, but other financial instruments that are also traded at ByMA (fixed-income) and/or are instruments that provide for market completeness (derivatives)

[20] Presentation made by Bernardo Mariano at UCEMA. See: https://www.ucema.edu.ar/sites/default/files/2017/eventos/congreso_mc_mariano.pdf

[21] The Resolución General N° 153-E/2017 of the Ministry of Finance somehow acknowledges this situation. Additionally, see CEF (2005)

[22] Some estimates point to a minimum market capitalisation of USD 500 million for an IPO to become viable.

[23] CNV Resolución General 717/17.

[24] In 2016 and 2017 a tax amnesty was implemented, which resulted in the declaration of USD 100 bn. of undeclared assets by individuals, mostly hold abroad.

[25] During the period 2005-2009, the Center for Financial Stability implemented a project to assist members of the judiciary on financial matters.

[26] Of course, ensuring anonymity of the participants.

[27] The first SME to be listed in such panel went bankrupt six months later.

[28] For example, an individual with a net wealth equal or higher than USD 28.000 is considered qualified investor. Under the current proposal, individuals should have financial investments over USD 240,000.

[29] Subsequent to the period during which this report was prepared, the CNV released the revised Code (Código de Gobierno Societario) that is grounded under the revised G210/OECD Principles of Corporate Governance. Also, ByMA launched the special listing panel for better-governed companies, that includes two tiers CG and +CG. As of July 2019, there are three companies listed in the latter panel, and none in the former.

[30] These types of instruments are supposed to finance productive or infrastructure projects implemented by SMEs.

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