Chile

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

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 Chile and additional country reports on Argentina, Brazil, 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.

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1. Introduction

The Chilean capital market is considered among the strongest in Latin America, but it lags behind when compared to other emerging economies around the world. Corporations' need of capital varies over their life cycle, and the regulator should keep pace in offering the appropriate conditions for the market to be able to provide such financing to boost development and competitiveness in the economy. This chapter describes the Chilean capital market and aims at identifying perceived current barriers and constraints to its development. It concludes by discussing potential incentives and policy recommendations that could be implemented to spur greater participation in the Chilean capital markets.

The report is structured as follows: Following this introduction, Chapter 2 reflects on the importance of having a sound capital market. Chapter 3 presents descriptive statistics on capital market development in Chile and its main characteristics. Chapter 4 presents results of a questionnaire distributed among Chilean companies and institutional investors surveyed about the perceived barriers to developing the Chilean capital market; it also presents the reflections of the capital market authority and the main Chilean Stock Exchange – the Santiago Stock Exchange. Chapter 5 selects the main takeaways of Chapter 4 and discusses possible ways to facilitate more active markets or reduce the identified barriers. This section draws from companies' opinions expressed in the questionnaire, research and conversations held with different people involved in the capital market ecosystem: companies' representatives, the Chilean capital market regulator, the Stock Exchange and well-known academics. The chapter concludes with policy options for further consideration.

2. Sound capital markets and access to equity financing for economic growth

Chilean companies need financing sources to grow. The choice between debt and equity, and the source of financing can vary depending on a firm´s life cycle, market conditions and company preferences. One of the possible financing sources is the capital market, which – unlike banks' credit – provides companies with *patient capital*, promoting long-run innovation, risk-taking, and growth. A country on the path of development such as Chile should ensure that equity financing remains a feasible and good source of financing for companies to meet their investment needs. The decision is relevant, especially for *growth companies*[1] if they want to pass from a small-to-medium to a large company with the potential to have impact on the real economy and boost overall economic growth (Isakson and Çelik, 2013).

A sound capital market serves also the purpose to promote sustainable growth and increase financial stability in the economy. It channels resources from household savings to productive investments in the form of long-term capital, contributing to diversifying risk in the economy, reducing information gaps between investors and corporations, and facilitating investment by reducing the cost of mobilising savings. Consequently, a sound capital market improves the resource allocation in the economy. An efficient, strong and deep capital market can also attract foreign investment, crucial for a country in a developing stage. Moreover, capital markets by providing long-term risk-sharing capital have the potential to facilitate productivity gains in the corporate sector (OECD, 2016) which is crucial for Chile and also support broader economic growth.

The primary market and secondary market can only fulfil their roles if they are efficient and complete. An efficient primary market allows access to financing and good capital allocation between firms. An efficient secondary market should be large, deep, resilient and liquid, achieving scale for capital mobilisation and risk diversification. If the Chilean market does not reach these standards, reforms are needed to fully grasp the advantages. This chapter focuses principally on primary markets as a financing source for companies, but some characteristics of the secondary market are also described and discussed.

Trends in global capital markets and the Latin American opportunity

The use of capital markets around the world is changing in several ways. Two changes that deserve to be highlighted for the purpose of this chapter are the relative decreasing use of capital markets in advanced economies and the global shift towards the use of public equity in developing regions.

Recent OECD studies indicate that the number of new companies in advanced economies that use public equity markets has been decreasing since 2000 by 30-40% (OECD 2015a, OECD 2017a). This is probably due to multiple causes, one of which is that companies currently wait longer to become publicly listed and thus the average size of IPO firms has been increasing over time. On the flip side, the smaller growth company IPOs (below USD 50M) have almost disappeared and mid-sized growth company IPOs (below USD 100M) is also on the decline[2]. This not only means that today's IPOs are larger, but also that their

most rapid growing phase within the capital market can be already over by the time they become publicly listed. This can be a source of concern when there is no evidence that this decline has been compensated for by an increase in various forms of private equity supply (OECD, 2015a).

Against this trend, OECD research shows that there has been a shifting of the use of public equity to other developing regions: during the period 1995-2000 only 12% of all equity raised in the world was by non-OECD companies that listed on a stock exchange outside OECD. By 2017 that percentage rose to 50%. However, almost all growth is attributable to Asia. Since 2000, Asian companies have raised USD 1.2 trillion through IPOs and USD 2.6 trillion through secondary public offerings (SPOs). Moreover, unlike in more developed economies, in Asia, equity markets for growth companies remained strong (OECD, 2017a).

In contrast with the growth of Asian markets and despite big efforts in past decades, Latin American markets remained underdeveloped and, in certain cases – like the Chilean case – they show characteristics similar to those belonging to advanced economies, where public equity market use is in decline. The question of why Asian markets were so successful in developing their capital markets and attracting foreign investment in contrast to the experience in Latin American markets requires further analysis that is beyond the scope of this chapter[3]. But in focusing on the Latin American and Chilean cases, it seems that the search must begin from a regional and national understanding of the markets´ characteristics and their development drivers. Today, when the region seems eager for economic reforms to boost growth, it is important to develop a better understanding of capital markets in the region to support policy makers' efforts to develop a successful path that may be inspired by other regions' success, while offering tailored solutions that address the complexities and particular characteristics of the Latin America region and of each specific country.

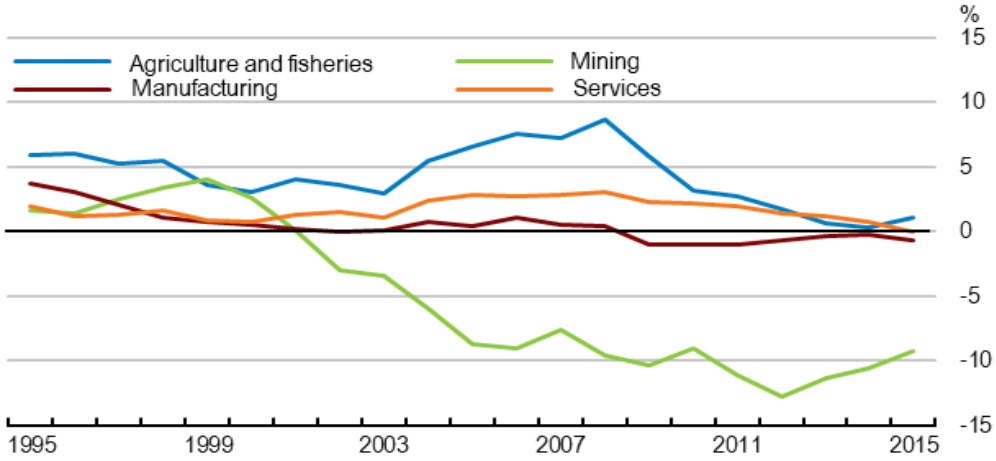
Chile could benefit from capital market development

Chile has an open, market-oriented economy characterised, in relative terms, by a high level of foreign trade, good reputation for strong financial institutions, and solid macroeconomic policy framework. Regardless the fact that in recent decades, Chile has been one of the fastest-growing economies in the OECD, progress has slowed in the last couple of years. The reasons are both intrinsic and extrinsic. Even if for 2018 growth prospects seem auspicious, declining productivity gains (see Figure 2.1) are limiting prospects for rising incomes and better-quality jobs (OECD, 2018).

Companies rely heavily on bank lending as a financing source and firm's indebtedness is high. The Chilean financial sector is robust in comparison with the region, reflecting a higher per capita income, strong institutions, sound macroeconomic policies, and substantial past reforms. However, it faces challenges, particularly from the debt side. Corporate debt has increased not only in comparison with Latin America, but also compared to some developed economies (Figure 2.2), which – if unattended[4] – could be a cause for concern. According to a Chilean Central Bank study, in June 2016, debt of non-banking firms reached US294 billion (6 600 million UF), 80% of which is concentrated in large companies. The indebtedness growth in public companies is mainly driven by bond issuances in foreign markets, but large non-listed companies are the ones accumulating more commercial debt, reaching 67% of the total banking debt (Fernández et al 2017). As large non-listed companies are the ones that may be in the best position to make use of equity finance, their high debt levels would appear to reinforce the initial premise of this

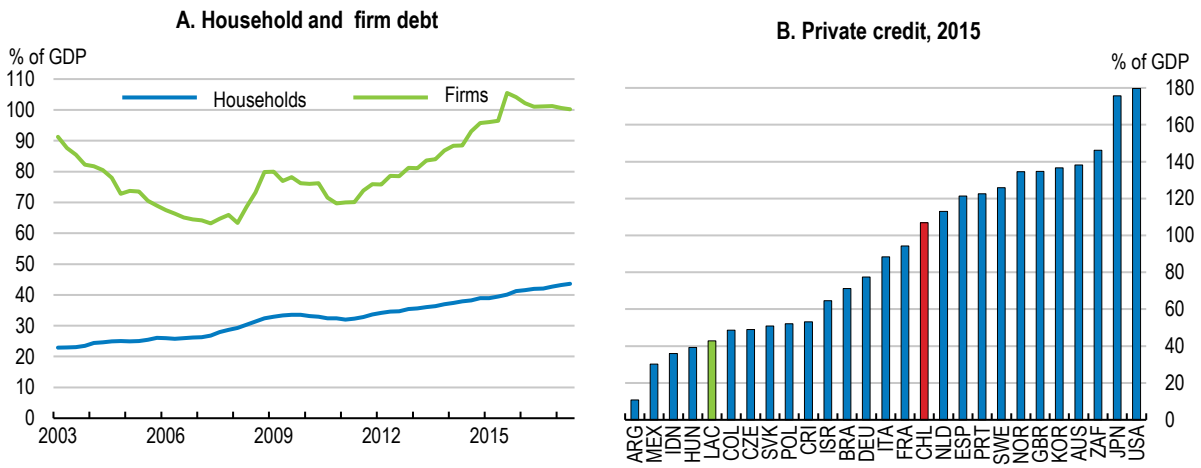
chapter that Chilean corporations could strongly benefit from more active participation in local equity markets.

Figure 2.1. Chilean decline in multi factor productivity



Note: Five-year moving average. Multi-factor Productivity is adjusted for human capital and hours of work.
Source: OECD Economic Surveys: Chile 2018 © OECD 2018

Figure 2.2. Rapid increase of levels of indebtedness in Chile



Note: LAC is the un-weighted average of Argentina, Brazil, Colombia, Costa Rica and Mexico.
Source: OECD Economic Surveys: Chile 2018 © OECD 2018

Bank credit is costly for young and smaller companies. As banks lack incentives to engage in risky proposals with high potential, bank funding for such companies is not made under good terms, which may limit growth for innovative firms that are not capital intensive. According to OECD research, the interest rate for SMEs in Chile rose to 9.29%, while the interest rate for larger firms is much lower (3.8%), (OECD, 2017b).

Financing sources are not well diversified. According to a comprehensive company survey published in 2017 (Cuarta Encuesta Longitudinal de Empresas or ELE-4) developed by the Chilean Ministry of Economy, covering 325 334 companies of all sizes (micro to large),

the most relevant sources of financing among companies in 2015 were banks (53.3%), own resources (37.2%) and suppliers (31.7%). When asked about constraints to growth, 33.2% of the companies indicated "lack of financing" as a very important factor. Regarding non-traditional financing sources, only 591 declared financing from venture capital (0.2%), only 153 companies declared financing from crowd funding (0.04% of the total), and only 85 declared financing from “angel investors” (0.02%). Greater access to external funding, particularly from the capital markets, could spur more investment and raise sustainable growth rates.

Existing financial support programmes are focused on the first growing phase. Start-up financing is crucial to innovation. Chile has a long tradition of promoting innovative entrepreneurship, having systems to support financially and non-financially innovative start-ups (for a comprehensive analysis see OECD, 2016c). Efforts are centralised in the Production Development Corporation or CORFO, and its programmes have been successful in boosting the start-up scene in the country. According to end-2015 estimates by CORFO, Chilean start-ups included one unicorn (i.e. a start- up worth at least USD 1 billion), four centaurs (worth between USD 100 million and USD 1 billion) and 36 little ponies (worth between USD 10 and 100 million). However, there is less support after the early stages of a company´s life cycle. Private investment and venture capital – which has grown exponentially in Chile in recent years[5] and is also supported to some extent by CORFO – are seen as feasible alternatives to obtain funding to grow, but even if this development is very much welcomed by the market, it’s still limited. These types of investments also need to evolve in providing exit options and liquidity to investors.

Chile's framework for capital market regulation has undergone a continuous update process.[6] However, further reflection could be beneficial to understand the outcomes of the reforms, how regulations have dealt with the barriers to equity market development, how it can be made more flexible to adjust to disruptive changes, and which areas need further development and regulatory support.

In this context, Chilean companies could benefit more from market-based financing. Developing the Chilean equity market will not only improve opportunities to innovate, invest and grow for companies, but will also help to diversify large companies’ debt dependence, which is good for the country.

Box 2.1. Improving Chilean capital market institutions: new capital market regulator and long-awaited stock exchange demutualisation

During 2017, two milestones for the financial market were achieved: the establishment of a new capital market regulator, and the demutualisation of Chilean stock exchanges, further adapting these Chilean institutions to international standards.

In February 2017, after years of discussion in Congress, Law No. 21,000 replaced the former Chilean capital market authority Securities and Insurance Superintendence (SVS) with the Financial Market Commission (hereinafter, CMF for its Spanish acronym), which started operations on December 14, 2017. The role of the CMF is much broader and it intends to include oversight of the whole financial sector (although, a new banking bill sent to Congress still has to be approved). For the first time, the Law explicitly provides that the market regulator should also promote market development as part of its mandate, calling for the CMF to secure the proper functioning, development and stability of the financial market, facilitating the participation of market agents and promoting duly standards. The

new regulatory body has an improved governance structure (under a new collegiate supervision scheme), more independence, new and enhanced attributions, and improved specific administrative sanctioning regimes. Additionally, the functions of investigation and sanctioning are for the first time separated.

Moreover, the law stresses the fact that market participants should self-regulate in corporate governance matters, business ethics, transparency and fair competition. The obligation to self-regulate may be fulfilled in the following ways: (i) by being part of the Financial Self-Regulation Committee that may be constituted (to date it has not been constituted) or (ii) the entities may establish their own rules and codes of conduct in the aforementioned matters, for subsequent approval by the CMF, without being obliged to be members of the Self-Regulation Committee that may exist. The Committee must ensure effective compliance with the good practices enacted and resolve conflicts that occur between market players.

In June 2017, la Bolsa de Comercio de Santiago (hereinafter Santiago Stock Exchange or SSE) became a demutualised institution. SSE is the leading Chilean exchange, with a market capitalisation of 296 billion as of December 2017, trading over USD 2 billion a day in equities, fixed income securities, money market instruments, investment fund shares and foreign securities. From its founding, only members could act as stockbrokers. In 2016 shareholders approved the long-awaited demutualisation process, converting the exchange into a for-profit organisation starting June 2017. The demutualisation process also improved the corporate governance of the exchange, with an aim to increase levels of competition, enhance efficiency, improve transparency and increase liquidity in the Chilean capital market. Under the new regulation, no member can own more than 25% (higher than the legal requirement, ensuring that no member can have control), and at least three board members should be independent.

3. The Chilean capital market has evolved, but much could be done to boost competitiveness

The Chilean capital market, while not large, has been considered relatively strong and developed in comparison with other countries in the region. Today, there are more markets with new financial instruments available, market infrastructure has been reformed and strengthened, and the investor base remains solid, but there is room for improvement, and the country could advance in overcoming persistent challenges to attract foreign investment and boost equity market development.

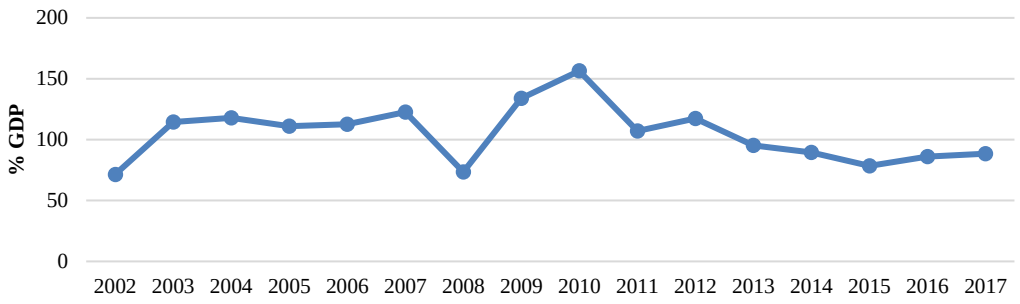
Chile compares favourably in terms of market capitalisation within the region (ranked not far behind Brazil and Mexico), but less well in terms of trading volumes and market liquidity (Table 3.1). Chilean market capitalisation for 2017 accounted for 88.5 % of its Nominal GDP at year-end 2017 (Figure 3.1). While the figure implies a significant size relative to the size of the economy, it is important to bear in mind that in emerging markets – due to ownership concentration – market capitalisation substantially overstates the value of stocks that are actually traded in these markets. Just to give a sense of the magnitude, the real free-float market capitalisation taking into consideration pyramidal structures of ownership has been calculated at as low as 14% of total capitalisation in Chile (Braun and Larraín, 2009).

Table 3.1. Main comparison measures among Latin American markets

	Number of domestic listed companies		Market Capitalisation Total – USD million		Value of share trading Total – USD million	
	2017	2016	2017	2016	2017	2016
B3 SA Brasil Bolsa Balcao	335	338	954,711.1	745,113.9	666,670.2	523,693.5
Bolsa Mexicana de Valores	141	137	417,021.6	370,595.2	113,559.2	124,105.5
Bolsa de Comercio de Santiago	212	214	294,675.8	227,888.6	36,250.7	23,534.0
Bolsa de Valores de Colombia	67	68	121,477.1	103,855.2	13,320.3	13,188.8
Bolsa de Comercio de Buenos Aires	96	93	108,739.9	53,335.9	7,554.8	4,700.9
Bolsa de Valores de Lima	218	217	99,218.6	82,732.1	6,349.6	2,668.9

Source: World Federation of Exchanges (WFE) Annual Statistics 2017

Figure 3.1. Chilean market capitalisation ratio as a percentage of GDP– evolution



Source: own elaboration based on World Bank data and Santiago Stock Exchange data for 2017

Chile has three stock exchanges, the Santiago Stock Exchange ("SSE") being the most important in terms of traded volume, number of brokers and products, and infrastructure development. It is followed far behind by Bolsa Electrónica de Chile (BEC) and Bolsa de Valores de Valparaíso (BOVALPO), which hold less than 1% of market participation considering amounts traded in all markets. This chapter only refers to SSE and will not review the aggregate values of the other two exchanges.

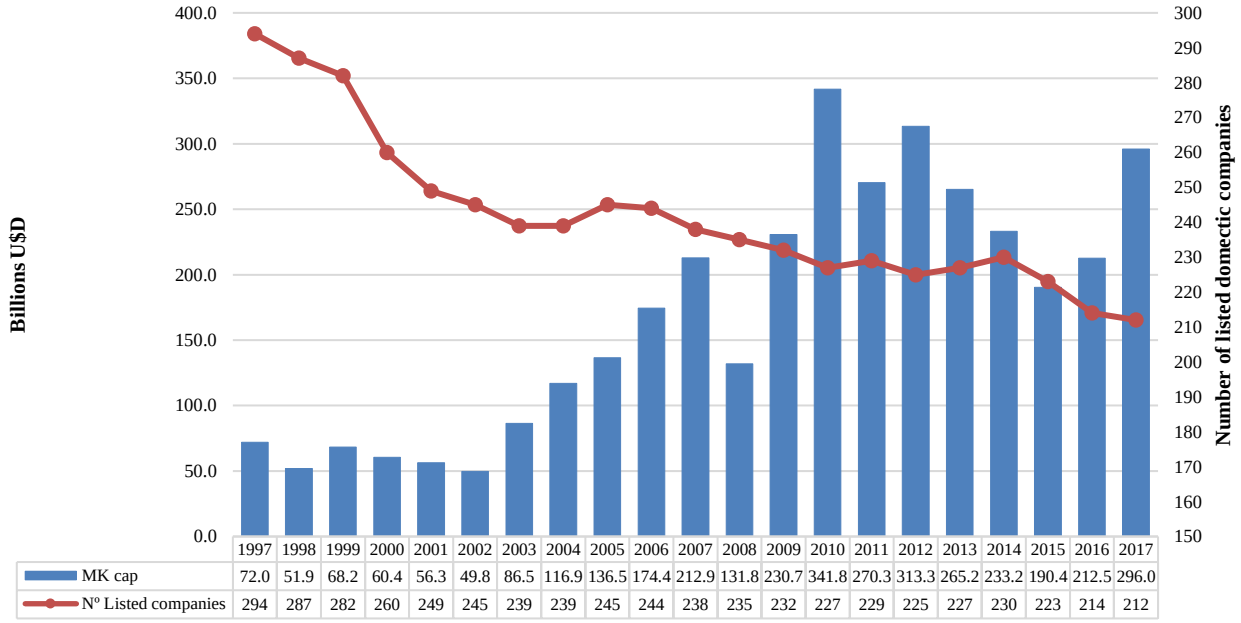
Stock market capitalisation amounted to USD 294,7 billion at the end of 2017 for 212 domestic companies. There were almost 7 500 000 transactions in the SSE totalling an accumulated volume of USD 36 billion. In 2017 the main indexes attained record numbers not seen since 2010[7]: IPSA marked 5,546.60 points at the end of the year, showing an increase of 34.04% in comparison with 2016, while IGPA increased 34.95%.

Chile participates in the Integrated Latin American Market (MILA), which is the result of an agreement signed between Santiago Exchange, Colombian Stock Exchange, Lima Stock Exchange and Mexican Stock Exchange, forming a regional market for equities trading in the four countries. MILA's mission is to integrate the markets of its member countries and promote the growth of its participants' financial business, providing the best alternative for investment, diversification, liquidity and funding. At the end of 2017, MILA had a total market capitalisation of USD 933 billion, with Chile having the second largest participation (32%), after Mexico.

Chilean stock market has changed

The stock market has been subject to significant changes over the last two decades. The number of listed companies is in decline while the size of listed public companies has increased. From a peak of 294 firms in 1997 (See Figure 3.2), at the end of 2017 there were 212 listed domestic companies (around 12.5 firms per million inhabitants). This is however, a fair amount when compared to other Latin American markets, with Chile having the highest rate of listed companies per inhabitants, followed by Brazil and Mexico. For 2017, the average market capitalisation of a Chilean public company was USD 1.3 billion compared to an average of USD 0.2 billion in 1997.

Figure 3.2. Market capitalisation of listed companies and listed domestic companies in the last 20 years



	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
MK cap	72.0	51.9	68.2	60.4	56.3	49.8	86.5	116.9	136.5	174.4	212.9	131.8	230.7	341.8	270.3	313.3	265.2	233.2	190.4	212.5	296.0
Nº Listed companies	294	287	282	260	249	245	239	239	245	244	238	235	232	227	229	225	227	230	223	214	212

Source: own elaboration based on World Bank data and Santiago Stock Exchange data for 2017

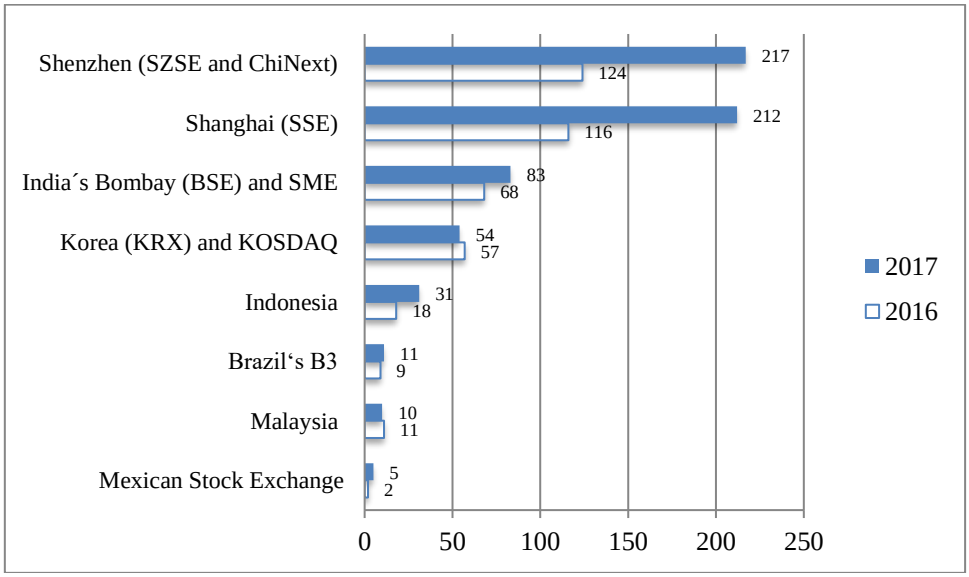
The pace of new listing is low (2.2) and delisting is growing faster (49 delistings in the period 2007-2017). However, after two years of zero IPOs (2014-2015), there have been 4 IPOs as of June 2018, a sign of a generalised optimism due to better international market conditions, a better country growth prospective and more business-friendly government policies, which may open the door for more upcoming IPOs (at least one more IPO has been announced: Mallplaza). But even if that is the case, the Chilean IPO numbers fall behind Latin American big markets and far behind other developing countries (Figure 3.3). The size of IPOs is fairly large for the market size. In the past 5 years there have been no IPOs under USD100 million and in the past 10 years there have been only 3 IPOs under USD50 million.

Table 3.2. Limited number of Chilean IPOs, 2007-2018

Company´s name	Month and year IPO	Property % IPO	Funds raised (M$)	Funds raised (US million)	Current status
Multiexport Foods S.A.	July 2007	15%	49 881 955	96.6	Listed
Socovesa	October 2007	25%	81 090 000	161	Listed
Azul Azul	November 2008	55%	9 504 116	14.7	Listed
Enjoy	July 2009	30%	23 100 000	42.7	Listed
Hites	December 2009	29.5%	21 466 200	43	Listed
Cruzados	December 2009	80%	12 400 000	24.7	Listed
Compañía Pesquera Camanchaca S.A.	December 2010	31,5%	108 844 537	223.1	Listed
CFR Pharmaceuticals	May 2011	23.8%	172 720 000	368.8	Delisted
Empresas Aquachile	May 2011	35.8%	175 311 000	374	Listed
Australis Seafoods	June 2011	12.8%	33 300 000	71.2	Listed
Cruz Blanca Salud	June 2011	35%	111 031 838	235.2	Delisted
Ingevec	March 2012	28.9%	12 506 000	25.8	Listed
Hortifrut	July 2012	29%	33 141 336	67.3	Listed
Inversiones la Construcción S.A.	July 2012	33%	227 321 071	468.1	Listed
Echeverría, Izquierdo	August 2012	25%	42 375 536	87.4	Listed
Empresa Constructora Moller y Pérez Cotapos	March 2013	30%	42 115 843	89.1	Listed
Empresas Lipigas	November 2016	20%	102 217 064	151	Listed
SMU	January 2017	24%	129 950 000	200	Listed
Empresas Tricot	August 2017	29%	91 516 057	141	Listed
Salmones Camanchaca	February 2018	30%	64 706 000	108	Listed

Source: Based on desktop research, Santiago Stock Exchange Annual Statistic Reports and CMF Annual Statistic data

Figure 3.3. Number of IPOs in other emerging markets 2016-2017



Source: Own elaboration based on EY - Global IPO trends: Q4 2017

The overall slow-down in IPOs and number of listed companies in Chile probably has multiple causes. Listing requirements do not seem to be one of them, since the procedure

for listing in Chile is considered relatively simple overall, and it is generally considered that it does not involve too high costs (see Section 3). There are no minimum capital requirements or trading volume requirements to list as in other countries. Moreover, Chilean Stock Exchanges are mandated by law to accept the listing of shares when they have already been registered with the capital market regulator.

Some explanations relate to cyclical patterns that are consistent with overall international economic conditions at the time. Others relate to the cycles for the need of capital of Chilean companies, which are affected by national perceptions that evolve with time, country growth and political conditions. The appetite for use of capital market financing appears to be low among issuers and investors. Bank financing costs being at historically low levels is another usually mentioned cause. Recent economic scandals in listed companies may also have had a certain negative effect on capital market perceptions. Finally, it has been associated with the limitations of the Chilean secondary market, and, to a lesser extent, with the migration of Chilean firms to international markets, as discussed below. Some of these explanations relate not only to capital markets, but are part of a much broader economic or political context. Those explanations that relate to the market itself are explored further in Sections 3 and 4.

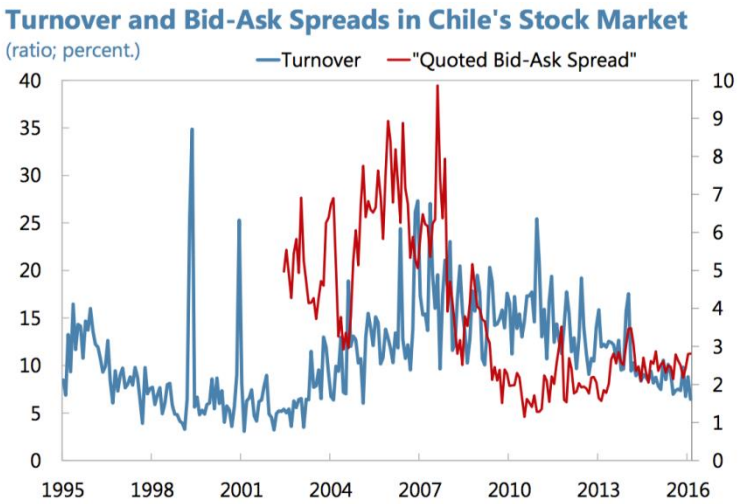
Liquidity, market concentration and ownership concentration as stock market limitations

Measuring liquidity through traditional measures including turnover and bid-ask spreads (Figure 3.4), the IMF has found that the Chilean stock market is relatively illiquid when compared to other economies (IMF 2016). Studies have shown that illiquidity harms the market in various ways[8]. Illiquid stock markets may increase the cost of equity, because of higher expected return demands. In this sense, empirical results of an IMF research suggest that illiquidity in the Chilean market raises the excess required return associated with the least liquid stocks by about 0.3 percent, implying an increase of about 3.5% per annum in the cost of equity for data 2002-2015 (IMF 2016). Low liquidity is also a deterrent to foreign investors and an important cause of segmentation (Bekaert and Harvey, 2003). Moreover, research has shown that firms become less likely to issue equity when the liquidity of an equity market worsens. As such, stock market illiquidity is associated with lower growth opportunities for growing companies, as it might influence their listing decision (Stulz et al. 2013; Hanselaar et al., 2017).

It is important to remark that liquidity is especially important for Chilean capital markets, as tax benefits are linked with liquidity requirements. According to the Chilean Income Tax Law, capital gains are tax-exempt only when the stock has high trading volume[9] ("presencia bursátil", which can be translated as stock exchange trading presence), and fulfilling certain requirements of acquisition and alienation.

Liquidity limitation in Chile is both a consequence of the reduced number of listed companies and ownership concentration, which limits the free float. It is also important to highlight that there is a mere 10% requirement for the proportion of equity capital that must be floated.

Figure 3.4. Traditional measures of market liquidity



Note: The chart shows average monthly turnover—trade volume divided by market capitalisation—(left scale) and quoted bid-ask spreads in percent of mid-price (right scale) for all listed shares. Only primary listings are included. Quoted spreads include only those below 50 percent of mid-price.
Source: IMF (2016), Stock Market Liquidity in Chile, based on Bloomberg LP and Thomson Reuters Datastream

Another limitation of the market is concentration. Similar to most Latin American markets, Chile has historically been considered a highly concentrated market and normally only 10 companies account for around 50% of transactions. In 2017 only 10 (20) companies accounted for 54% (72%) of the total amount traded, and the 20 most capitalised and traded companies accounted for 64% of the total market capitalisation.

Likewise in Latin America, there is high ownership concentration of individual firms, usually in the hands of conglomerates or business groups that are also concentrated in number and operate through pyramidal structures (Lefort and Walker, 2000). Company groups control several individual companies in unrelated sectors of the economy and hold interest in financial and non-financial firms. Virtually all Chilean companies have a controller and in 50% of firms, the controller's stake exceeds two-thirds, which gives super-majority control to take important corporate decisions according to the Chilean law (Donelli et al, 2013).

Lefort and Walker have shown that approximately 70% of non-financial companies listed in Chile belong to one of 50 business groups, which together control 91% of the assets of non- financial corporations in the country (a stable proportion since 2009). They also conclude that the controlling shareholders of Chilean conglomerates, in general, have more shares than are necessary to maintain control, with 57% of consolidated capital being directly or indirectly owned. This is a consequence of pyramidal structures. Taking into consideration that the average group is composed of 2.5 layers, 18% of the overall equity is sufficient to control 50% of the voting rights in all group companies in the pyramid, while 36% suffices to control two-thirds of the voting rights, the super-majority threshold required to pass certain measures (Lefort and Walker, 2000; 2007).

Migration to other venues

Since the nineties, Chilean firms started to participate in foreign markets. The participation has usually taken the form of cross-listings in the U.S. market through American depositary receipts (ADRs) and in much less scale in other markets (such as Eurozone, Brazil and – recently – Norway). As of March 2018, there were 11 local companies trading ADRs.

Participation of institutional investors in the capital markets

As in the rest of the world, in Chile, institutional investors (IIs) have gained a relevant role in the market, but the six existing Pension Funds Administrators (hereinafter, AFPs as per their Spanish acronym) are particularly important. This role is explained because of the large volume of funds accumulated since the start of the private pension system in the early 1980s. Pension funds accounted for a total value of USD 210 billion as of December 2017, representing 74.4% of the national GDP. Of the total assets, 57% (USD 120.1 billion) are invested in national assets, divided into 79.4% in fixed income assets and 20,1% in variable income assets (others, 0,5). This 20.1% is equivalent to USD 24.1 billion, representing 8.2% of the total local market capitalisation – 16% of total assets is invested companies' shares, but limited to 111 companies (Superintendence of Pensions trimestral investment report, December 2017).

In addition, the total assets managed by funds and insurance companies continue to show an increasing trend, reaching USD 95.1 billion towards the end of 2017 (SVS quarterly statistical report, September 2017).

Chilean IIs play an increasingly important role in stock market growth as the largest and most influential minority shareholders in many listed companies. However, regulatory limitations on investment, asymmetries in treatment and benefits, high ownership concentration and low liquidity leave institutional investors with relatively tight investment options in terms of number of companies in the market and amount and class of stocks in which they may invest. This limits competition among institutional investors for companies to invest in, often leading to portfolio replication – mainly in the case of AFPs- , reduces the opportunities for exit from the investment, and increases the vulnerability to financial downturns (OECD, 2011).

4. OECD Survey Results: Perceived barriers to developing the Chilean capital market

To understand the characteristics of the Latin American markets, the OECD developed a questionnaire with the intention to enhance understanding of why firms and investors are using capital markets, how they perceive the costs and which barriers they identified, among others. The questionnaire was sent to a sample of Chilean companies including listed companies, non-listed companies and institutional investors. The selected sample included companies of different sizes based on their market capitalisation and different economic activities. However, due to a low response rate and despite carrying out several interviews with market participants to ensure consideration of a range of market perspectives, the research in this section might not be fully representative and should therefore be considered as a sample of perceptions.

Companies' perception

Sixteen companies answered the questionnaire, of which thirteen are listed and three non-listed. The three non-listed companies have potential to become listed. Two-thirds of all companies are part of an economic group; from them, 45.5% are the parent companies and 54.5% subsidiaries. Two of the respondent companies are listed in a foreign stock exchange via American depositary receipts.

a. Listed companies perceptions of costs and benefits of being listed

When asked to rate proposed benefits that listed companies have obtained from being listed, considering a scale from 1 to 10, in which 1 means "very low" and 10 is "very high", responses were varied (Table 4.1). The highest rated benefits were: reputational enhancement and raised profile, discipline of the market, and professionalisation of the company.

Table 4.1. Benefits from being listed – listed companies

Benefits	Average
Reputational enhancement and raised profile	9.2
Discipline of the market	9.1
Professionalisation of the company	8.8
Flexibility for inorganic growth strategy (M&As)	8.2
Access to capital (availability when needed)	8.1
Provision of exit and liquidity to early-stage investors	8.1
Marketing and credibility with stakeholders	7.9
Lower cost of capital	7.6
Ability to attract and retain better talent	6.9

Source: own elaboration based on OECD questionnaire – Chilean responses

In general, costs of the listing process were not considered especially high by the market (nor in the questionnaire responses nor in follow- up interviews --Table 4.2). It is notable, for example, that investment banking fees, which were rated as the most important cost of listing in other jurisdictions, was not among the top ranked concerns in Chile, where compliance requirements figured more highly. The listing process (both vis-à-vis the regulator and the stock exchange) is also considered quite simple.

Neither were ongoing costs considered high in general, but *compliance* (with securities market regulations, corporate governance regulation and audit requirements) was considered relatively higher than other ongoing costs (although still far lower than the ratings listed companies gave to the benefits of listing). In follow-up interviews, participants remarked that, although the costs are not exceptionally high, compliance is a burden for companies, and in most cases compliance ends up being merely formal due to unnecessarily detailed regulation. Most participants agree that something could be done to reduce the regulatory burden, especially in relation to corporate governance issues (See Section 4). Requirements to remain listed are not considered as difficult as in other markets (in the sense that in Chile there are no minimum capital thresholds to become listed, low thresholds for free float and no minimum trading values as in other stock exchanges).

Table 4.2. IPO costs and on-going costs of being listed

IPO costs (one-time)	Average*	On-going costs	Average*
Necessary adjustment to meet regulatory requirements	6.1	Compliance with securities regulation	6.5
Necessary adjustment to meet listing requirements	5.5	Compliance with corporate governance regulation	6.4
Legal fees	5.5	Compliance with audits and controls	6.2
Investment banking fees	5.2	Investor relations activities	4.9
Preparing the prospectus	3.8	Tax treatment	4.5
Stock exchange fees	3.3	Stock exchange fees	3.4

Source: own elaboration based on OECD questionnaire – Chilean responses
Note: * Considering a scale from 1 to 10, in which 1 means “not important at all” and 10 means “very important”.

b. Listed companies perception of corporate governance practices

Regarding the level of development or sophistication of corporate governance in each company, participants rated quite high their own practices, with an overall average of 8.79. When asked about listed firms’ commitment to good corporate governance practices in general in Chile, participants also rated all practices high (but somehow lower than their own practices), with an overall average of 8.26.

Table 4.3. Perception of corporate governance practices

	In your company (Average)	In general in Chile (Average)
Transparency (level of financial and non-financial information provided to stakeholders)	9.3	8.4
Minority shareholders' rights and protection	9.3	8.3
Internal controls, risk management and audits	9.2	8.5
Related-party transactions regime	8.8	8.6
Board nomination, composition and remuneration	8.2	7.9
Board effectiveness	8.0	7.9

Source: own elaboration based on OECD questionnaire – Chilean responses

Perceptions of listed companies about ways to invigorate the Chilean capital market and possible regulatory changes are discussed in Chapter 5.

c. Perceptions of non-listed companies

The number of non-listed companies with potential of being listed that answered the survey is too small to provide for aggregated results, but an overall synthesis of their answers is presented below.

Non-listed companies see the benefits of listing (in this case, with special relevance of access to funding, reputational enhancement and ability to attract and retain better talent), but there are barriers that still deter them from doing so. Although they do not see high burdens in the market infrastructure to list (procedure in the stock exchange and regulators, fees, lack of advisors or underwriters among others were not considered especially important), compliance with regulations is a burden, since they still don´t have all the mechanisms in place to comply with them. The highest rated risks related to listing were: "lack of knowledge among your decision makers about the local capital markets", "additional corporate governance requirements" and "our shareholders do not want to share ownership with others".

In follow-up interviews they expressed that they feel that there is no guidance or peer learning available to help them to address the challenges. They are also worried about under-valuations in the IPO process and not being able to attract big market investors (mainly AFPs), because of their lack of diversification within the firm, their inability to become part of most important indexes and to attract analysis of their results.

The main cost identified is related to "corporate governance requirements", but when asked about the level of development or sophistication of corporate governance in their own companies, they tend to rate it quite high (8.8 on average in a scale from 1 to 10). However, they rate listed firms' commitment to good corporate governance practices lower than listed firms themselves, reaching an overall rating of 5.9 (in comparison with an 8.3 average rating evaluated by listed firms – see Table 4.3).

When asked about possible measures to take to invigorate capital market development, they point out that growth companies are somehow "left alone in the road", in the sense that there is not too much information in the market about the benefits and costs of being listed, how to start the process, how to put in place compliance mechanisms before an IPO and how to attract potential investors in the process. It was also pointed out that currently there is "a communication bridge" between large companies and growth companies that allows

peer learning. Finally, regarding their ability to attract investment, they think that AFP limitations to invest in higher risk assets could be more flexible.

Institutional Investors' perceptions

Twelve institutional investors answered the questionnaire, of which one was an AFP, two were insurance companies and nine were General Assets Managers ("Administradoras Generales de Fondos" or "AGFs", which are special legal entities engaged in administration of third parties' funds). Of the participant IIs, 64% are part of a corporate group or financial conglomerate and 18% have traded in in a non-Latin American market.

Regarding engagement with companies, 55.5% of the answers indicate that companies do not engage with investee companies. Of the 44.5% of the IIs that engage with companies, only one does it because of regulation and others engage on a voluntary basis. When they engage, they seem to use multiple ways, such as voting at shareholders' meetings, communicating with senior management and requesting information to the investors' relations unit.

When asked about listed firms' commitment to good corporate governance practices in Chile, 50% of the respondents estimate that commitment is "good" or "very good"; 40% find it "acceptable" and 10% find it "poor". This perception differs by far from the perception of listed companies, which have tended to rate their corporate governance practices consistently higher. Regarding their opinion of which corporate governance areas are a priority to be improved (see Table 4.4), they pointed to transparency, board effectiveness and minority shareholder´s rights as the most important.

Table 4.4. Corporate Governance areas to be improved

	Average
Transparency	9.3
Board effectiveness	8.5
Minority shareholders' rights	8.4
Related-party transactions	7.9
Board nomination and composition	7.6

Source: own elaboration based on OECD

When surveyed IIs that invest abroad were asked to compare corporate governance practices in Chile with other Latin American countries, it appeared that practices in other Latin American countries are perceived to be worse than in Chile. In comparison with other OECD countries, they consider that corporate governance practices are better in those countries (80%). Finally, when compared with other non-OECD countries the answer is mixed, but in general practices in Chile are considered higher (Table 4.5).

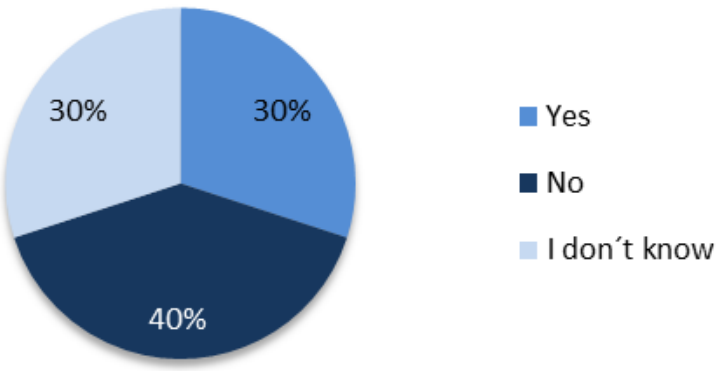
Table 4.5. Corporate Governance Practices in other jurisdictions in comparison with Chilean Corporate Governance Practices

	Much lower	Lower	About the same	Higher	Much higher
Argentina	-	100%	-	-	-
Brazil	-	100%	-	-	-
Colombia	-	75%	25%	-	-
Mexico	-	75%	25%	-	-
Peru	-	50%	25%	25%	-
Other OECD countries	-	-	20%	60%	20%
Non-OECD countries	50%	25%	-	25%	-

Source: Own elaboration based on OECD questionnaire – Chilean responses

All IIs surveyed rate corporate governance 7 or higher in the scale of importance for their investment decision. However, when asked if better corporate governance practices will lead them to increase their exposure to domestic equity, the answer is mixed.

Figure 4.1. Answers – Would better corporate governance practices lead you to increase your exposure to domestic equity?

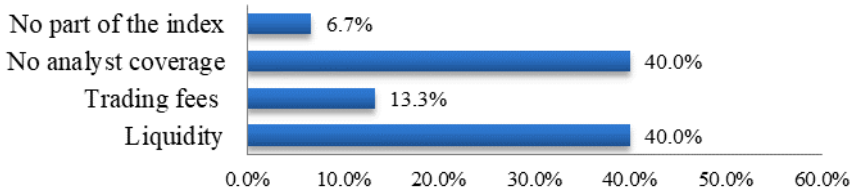


Source: own elaboration based on OECD questionnaire – Chilean responses

Explanations in general indicate that IIs in Chile – except AFPs that are heavily regulated – act as investors and not as shareholders, searching high returns in their investment and not caring too much or even analysing the governance of the company (because of the business model in the majority of cases). They also point out that "good corporate governance" is very hard to measure in Chile since there is not an index or exact parameter, and the only way would be to engage in an analysis of each company, which would be too costly.

When asked if trading costs are a barrier to further develop the domestic equity market 78% of those surveyed estimate that costs may act as a barrier, but *not significantly* (while none considered these barriers significant). The remaining 22% answered that trading costs are not a barrier. The most significant bottlenecks to invest in smaller listed companies are lack of liquidity and lack of analyst coverage, as shown in Figure 4.2 below:

Figure 4.2. Answers – What are the bottlenecks to invest in smaller listed companies?



Source: own elaboration based on OECD questionnaire – Chilean responses

Regarding the opinion of IIs on measures to further develop the domestic capital markets, they suggest to create a platform for IPO access (segmented market) with tax incentives to invest on it, give growth companies support in the design of processes for internal control and compliance, give authorisation to AFPs to invest in riskier assets, find mechanisms to give analyst coverage to non-indexed and smaller companies' shares, and enhance the tax incentives for foreign institutional investors to invest in the market.

Regarding the capital market infrastructure, they call upon the Stock Exchange to open new markets and to improve information about each one of them. One of the IIs pointed out that there is little information on the MILA market and Venture market.

Finally, institutional investors raised the point that any public policy option to invigorate capital markets should consider incentives not only to AFPs, but also for other types of institutional investors.

Regulator perception

According to discussions with representatives of the Chilean capital market regulator (Comisión para el Mercado Financiero or "CMF"), all Chilean companies can benefit from raising capital through the Chilean capital market. Current regulation does not establish differentiated requirements between different sizes of companies for listing purposes. While it is true that no specific regulatory or tax benefits have been established to boost growth companies IPOs, there have been incentives for investment in risk capital by collective investment vehicles[10] (funds), regulated and unregulated, resources that are presumed to be used to finance the projects of smaller companies.

Regarding listing barriers for companies, the CMF points out that the unique listing process grants access to all companies. Listing costs, associated with the information that must be presented to the regulator, are incurred just once. Therefore, potential more significant barriers may relate to ongoing regulatory compliance (obligations of providing continuous financial and non-financial information to the market) and by legal provisions applicable to listed companies (corporate governance provisions addressing board responsibility, shareholders protection rules, and limitations on the free disposal of assets, among others).

Current corporate governance standards required by law (minimum number of directors, independent director requirements and Directors Committee among others) could translate into proportionally higher costs for smaller companies and, therefore, have a limiting effect. However, it is not clear what would be the effect of not imposing those standards by law, since probably, investors would not invest or would also require them as a condition to make the investment.

There are no barriers for institutional investors to participate in the Chilean capital market. Only limitations are given by investment limits whose objective is to diversify risk and avoid over-concentration in particular investment vehicles. The regulator considers that institutional investors have pushed to raise corporate governance standards in Chilean firms (although most of these standards are already required by law), and today they see that they are advancing in incorporating socially responsible investment into their investment decisions.

Santiago Stock Exchange perceptions

According to discussions with representatives of the Santiago Stock Exchange, one of the main reasons for companies to list in Chile is to access a broader base of investors to support expansion, allowing a diversification of financing sources. Listing also allows companies to access to better financing conditions, get more visibility, and to differentiate themselves from their competitors. Additionally, the Stock Exchange highlights that entering into the stock market allows companies to improve the quality of their management through the implementation of higher standards in terms of corporate governance practices.

The barriers for a company to list are mainly related to their size. There is no regulation in Chile that facilitates access to the equity market for small and medium-sized companies. All companies must go through a single listing process that involves significant resources and high compliance at the same pace as a big company. In the view of those interviewed, Chile should move forward from a legal and regulatory point of view to have a process according to the size of these companies that would allow them to facilitate their participation in the capital market.

Regarding the barriers that institutional investors may find in Chile's market, the Stock Exchange's representatives suggested that low corporate governance standards might be limiting investment. While it is true that Chile has advanced in implementing better corporate governance practices (with initiatives both from the regulator and the private sector), they suggested that the country needs to advance in a culture of corporate governance, improve transparency standards, and provide monitoring tools which are needed for attracting more investment, generating trust in the Chilean market and boosting the competitiveness of the country.

5. Towards strong, vibrant, and competitive equity markets: barriers to and facilitators of more active markets

If Chile wants to invigorate its equity market, the first step for change is to understand the financing chain for Chilean companies, seeing the equity market as a good financing alternative when firms want to grow and engage in innovative projects that require patient capital. Public policies should ensure that capital markets remain a possible and attractive option for companies after early stages that rely either on private sources of finance or in some cases are supported by the government. From the other side, for companies to have access to capital, investors must be willing to supply it. However, without liquidity, robust investor protection and good corporate governance practices that underpin confidence in the markets, investors may be less willing to provide capital. In this sense, public policies should also create the conditions for efficient allocation of resources while aiming to attract investment, raising the competitiveness of the country and promoting economic growth.

The second step for change is integration. Companies with listing potential do not exist in a vacuum. They exist because of a growing process, which to be effective needs the engagement and willingness from a whole corporate market ecosystem. To grow, companies not only need financing; they also need sustainable business models and a plan to adopt on-going compliance with regulation and good corporate governance practices that attract investment before listing, among others. This is not an easy task that can be mandated by regulation, but public policies may incentivise or facilitate education, dialogue and peer-learning experiences.

With the input of answers provided in response to the questionnaires and fruitful conversations held with the regulator (CMF), Santiago Stock Exchange, companies' representatives and other relevant actors, we have identified some topics that may be acting as barriers to capital market development. . Section 4 presented a more neutral analysis of these areas. This section presents areas that may require policy reflection and adjustments to better lead towards strong, vibrant, and competitive capital markets.

Improving transparency and shareholder protection framework to enhance competitiveness

The Chilean Financial market has been praised for its strong legal framework and good institutional supervision. But despite clear advances in the corporate governance framework[11] in relation to other emerging economies and Latin American countries, Chile has somehow lost competitiveness in transparency and the protection of minority shareholders (as identified below), which can be acting as a barrier to equity market development.

According to the OECD questionnaire, "transparency" is identified as the main corporate governance area to be improved (with an overall valuation of 9.3 out of 10). The same barrier was identified by interviewees, especially with relation to transparency of corporate structures and ultimate beneficial ownership. Moreover, the survey "La Voz del Mercado" carried out in 2017 by the Santiago Stock Exchange and EY Chile, shows that 31.6% of

respondents find the quality and transparency of the information that companies reveal to the market as deficient or average.

Furthermore, according to the World Bank publication Doing Business 2018, Chile ranked 57 out of 190 economies in Protecting Minority Investors, lower than Colombia (rank: 16), Argentina (rank: 43), Brazil (rank: 43), Peru (rank: 51) and other emerging economies such as Indonesia (rank: 43) and South Africa (rank: 24). Some of the measures of quality where Chile scored less well in this regard are the extent of corporate transparency index (2 out of 10), extent of ownership and control index (4 out of 10), and extent of director liability index (6 out of 10).

International research has shown that better shareholder protection and enhanced transparency reduce the potential for information asymmetries, improves efficient allocation of resources into sound innovative firms, encourages trading activity and improves market liquidity, invigorating the capital markets (Djankov et al., 2008) thereby attracting investment and boosting economic growth (Haidar, 2008). Research in emerging markets has shown that improved disclosure predicts higher market value (Black et al., 2015) and IMF research suggests that minority shareholder protection could be improved in Chile to enhance market liquidity and boost IPOs by reducing costs (IMF, 2016).

Improving international access to the Chilean capital market to attract foreign investment

According to some interviewed market participants, particularly foreigners, Chilean companies do not offer foreign investors ease to exercise their rights as shareholders, which acts as a barrier to attract foreign investment. Moreover, some public policies are not as flexible as expected in order to fully attract international investment.

Firstly, it was highlighted that Chilean companies do not offer information prior to shareholders´ meetings in English (it is only available in Spanish, to some extent) and they do not provide the possibility for distance voting or remote attendance to shareholders´ meetings. It is also noted by Chilean media[12] that few companies offer foreign investors information about directors´ nominations and professional profiles, resulting in little support during the voting proxy season by international advisory firms, such as Institutional Shareholder Services (ISS). As an example of this tendency, one specific answer of the Survey "La Voz del Mercado" pointed out that "*some companies have limited disclosures in English and do not run a dual-language website. The timeliness of shareholder assembly documentation also lags some of Chile's Latin American peers, often too late for those investors who vote by proxy to participate or too light on disclosure to allow investors to vote with any confidence*".

It is worth noting that Chilean companies do not have regulatory barriers to provide information in English, to enable use of distance voting or remote attendance to shareholder´s meetings, but very few companies provide options to foreign shareholders as is evidenced by the Chilean Corporate Governance Code results. Moreover, it is noted that there are Chilean providers of these types of services.

Secondly, institutional investors noted that some Chilean public policies make it difficult to sell investment products to international investors. For example, it was mentioned that the process to obtain a Tax ID for foreign investors could be further simplified, as the current process may be detrimental for Chile´s competitiveness in relation to other Latin

American countries and other countries with strong financial services industries. Boosting liquidity and market deepening to attract investment

Liquidity is a critical enabler of equity market development, and according to participants interviewed for this research, one characteristic of the Chilean market that could be improved is liquidity. Liquidity is also identified in the OECD questionnaire as one of the bottlenecks of institutional investors to invest in smaller listed companies.

As analysed in Section 2, illiquidity harms the market in various ways, deterring companies in their listing decision and rendering the secondary market unattractive to institutional investors, particularly foreign investors with several investment options in other markets. Conceptually, liquidity depends on forward-looking confidence in the integrity of both corporate governance and the secondary trading marketplace, and according to several opinions of interviewees, Chile can advance in two senses.

Liquidity can be improved through a better corporate governance framework. As described previously, research suggests that an improvement in the minority shareholder protection framework could enhance market liquidity in Chile (IMF, 2016).

Liquidity can also be improved by introducing specific measures in the secondary market. It can be improved by encouraging greater institutional investor participation in the market, by promoting the creation of new markets and diversification of investment products or by improving technology, among others.

One specific enabler that was mentioned by participants of this research is the introduction of new instruments and new markets. Particularly, institutional investors pointed out that they would welcome the opening of an options market. Santiago Stock Exchange has advanced in developing the necessary infrastructure and internal regulation for introducing an options market, and the Chilean capital market authority has already submitted first comments regarding the regulation. Therefore, to the extent that the observations made by the CMF are amended by the Stock exchange and re-sent to be approved, the options market could enter into operation.

According to some research, options markets affect the liquidity and expected returns of underlying assets when the economy features asymmetric information by providing hedging benefits and increasing the risk-sharing between liquidity demanders and liquidity suppliers (Zhang, 2016). However research also shows that derivatives markets function better when the underlying assets hold liquidity themselves, which is not the case for most Chilean shares. An analysis of incentives should be performed to truly understand the conditions under which an options market may be most successful and beneficial for the Chilean capital market.

Advancing in the creation of a corporate governance culture to safeguard investors

Regardless of the fact that corporate governance practices were well evaluated by company questionnaire respondents, investor responses as well as interviews with market participants also pointed out that there is room for improvement. Particularly interviewees remarked that Chile still needs to advance in creating “a culture” of corporate governance and disclosure, by means that Chilean market participants still need to advance in understanding corporate governance as a means of creating long-term value, boosting financing sources and growth. Also, it was commented that, while there has been some progress of this understanding at the level of listed companies, that is not the case for non-listed companies. Good corporate governance should be present and evolve at all stages of

the life-cycle of a company, and growth companies should advance in incorporating good practices prior to listing.

In 2017, the Santiago Stock Exchange and EY Chile carried out a survey, *La Voz del Mercado*, among capital markets stakeholders and local corporate governance experts to reflect the market's opinion on the corporate governance of IPSA companies measured by 5 drivers: profit-earning capacity; ownership safeguards; transparency; treatment of shareholders; and sustainability. According to the survey, 46% of the companies were considered as regular or deficient in their corporate governance management, 49% were considered good, 5% very good and none was considered excellent. The results of this survey show that there is room for improvement.

A good culture of corporate governance cannot be imposed by regulation, but certainly regulation could help companies to reflect on their practices and to disclose them to both shareholders and stakeholders. It was also a generalised comment among interviewees that the current Chilean corporate governance code is not fulfilling this role, and that companies are mostly engaging in a formal exercise that is seen as costly and burdensome. This is also reflected in the questionnaire responses that show that participants consider "corporate governance" as one of the highest on-going costs of being listed (see Table 4.2).

The first Chilean corporate governance code[13] was issued, after a public consultation process, in 2012 under SVS (today CMF) General Rule No. 341. The code was a regulatory response, as private self-regulation initiatives aimed at developing and adhering to corporate governance codes were not successfully implemented. The code was updated and replaced by SVS General Rule No. 385 in 2015, after another public consultation process. The objective of the capital market authority is to generate debate within companies in matters of corporate governance practices and to improve the information reported by corporations in the local market, in order to generate incentives for investors to make their investment decisions privileging those companies in which their interests are best protected.

Both instruments consist of a questionnaire about specific practices of corporate governance that the board of a company must implement or else explain why particular practices have not been implemented. While the purpose of the instrument, as declared by the authority, is not to achieve a high percentage of adoption of practices, compliance with the code does raise some issues of concern, especially regarding the usefulness of the discussion and the information provided for companies, shareholders, potential investors and other stakeholders.

Rule No. 341 consisted of a questionnaire of 19 practices and had an overall appliance of 65%, but research shows that 60% of those practices were adopted before the rule – showing little impact – and information contained in the answers seems to be standardised and scarce, suggesting a mere formal compliance or a "box-ticking" exercise (Godoy, Walker and Zegers, 2018).

Rule No. 385 broadens the scope of the original 19 practices by disaggregating the original practices into 99 sub-practices, aiming to better capture the different reality of each entity. Today, reported implementation only reaches an overall level of 30%. Again, while reaching a high implementation percentage is still not the final objective, the rule has been criticised by the market actors, who do not feel represented by the instrument, and feel therefore driven to issue formal answers because of the way that practices are presented (i.e. too specific to leave room for alternatives, according to some opinions expressed in follow-up interviews) and the time-consuming exercise of revising 99 detailed practices.

Currently, the process is felt to be a bureaucratic burden rather than a reflective exercise, and is identified as one of the main costs that act as barriers to equity market development (see Section 3).

Improving the path for institutional investment: grasping more flexible investment regulation and constant re-evaluation

Chilean IIs, and especially AFPs, have been recognised as responsible for a significant deepening of the Chilean stock market since the 1980s. However, Chilean IIs are subject to regulations and reputational risks that are acting as a barrier to developing the Chilean equity market. While it is true that regulation is rooted in achieving objectives of financial stability and investor protection, finding the right equilibrium also should take into consideration the need to avoid excessive burdens, bureaucracy or constraints on investment.

First, it is important to note that Chilean institutional investors are not a homogenous group. They differ in legal forms, business models, business practices and competitive circumstances which makes a one-size-fits-all approach limiting. Chile needs to identify institutional investors' incentives in order to regulate accordingly and avoid any unjust asymmetry between investors[14]. Much of the debate has been focused on AFPs due to their importance and to their mandatory nature, but evaluating the regulatory framework for other investment vehicles is also necessary.

As stated in the paragraph above, in many respects, and especially due to the size of their portfolios and their role in society, Chilean AFPs are thought to be the ones that contribute the most to the development of domestic capital markets by, among other things, investing in different types of securities, providing liquidity, knowing the markets, engaging actively with companies in favour of good corporate governance practices and equitable treatment of shareholders, and pursuing investment strategies with long-term goals. However, the overall regulatory and supervisory framework, the minimum return regulation[15], and the significant reputational costs associated with incurring losses may have led fund managers to avoid riskier investments. By concentrating their investment on large, well-known firms, AFPs end up structuring almost identical portfolios due to limited supply of stocks in the national market as well as investment limits[16] set by the regulator (for a in depth analysis, see OECD/IFC 2011 and World Bank 2011). Limitations are not only regulatory, but also come from public scrutiny of the system, which due to certain corporate governance scandals in the market and negative media coverage of pension funds' role and losses incurred in the process, may have contributed to savers adopting a shorter-term investment horizon. Within this environment of heightened public sensitivity, pension funds may feel an even greater pressure to avoid exposure to risk, including to less liquid and potentially more volatile growth companies.

It is worth recognising that, gradually, investment regulation has become to some extent more flexible. However, AFPs still have credit rating regulations that limit their ability to invest in less liquid listed companies, lower rated issuers, limitations on long-term asset investment and limitations on indirect riskier investment. After Law No. 19,795 that implemented a multi-fund scheme that allowed AFPs to offer five differentiated funds with different investment risks and restrictions on their asset allocation, there have been only a few *major* changes in the investment policy in the past years. The latest changes were introduced by Law No. 20,950 (known as the "Law to Boost Productivity") issued in 2016, which allowed investment in instruments, transactions and agreements representative of

real estate assets, private equity, private debt, infrastructure and other types of assets determined by the Investment Regime; and bonds issued by investment funds governed by Law No. 20,712

Changes incorporated by Law 20,959 were only made available to AFPs with the issuance of a new Investment Regime by the Pension Authority (previous consult of Central Bank), which implied that the new investment framework is in force only from November 2017 onwards.

It is also worth recognising an advance in the regulation of other institutional investors apart from AFPs, as Law 20,959 also made more flexible the investment regime for other institutional investors.

It is too soon to assess the effectiveness of the changes. AFPs and other IIs are just in the process of building knowledge among teams to evaluate the risks associated with these other types of investments. However, based on past examples, a mere authorisation will not imply a change of conduct in the AFPs and other institutional investors, and measures to incentivise investment could be studied in the near future, depending on the practical outcomes of the Law.

In relation to other institutional investors (such as Mutual Funds and Investment Funds), there have been public policies advancing on the right path, making the system more modern, more flexible and more attractive to foreign investment, but in the opinion of such IIs, more could be done. In 2014, Law 20,712 (also known as the Single Funds Act or "LUF" as per its Spanish acronym) was issued with the purpose of simplifying the system, adding competitiveness to the fund market and turning Chile into an investment platform for investors with a Latin American strategy. While is true that LUF strengthened the framework for attracting investors, there are still some pending issues that do not allow use of the legislation to its full extent (such as, clarity in all requirements contained in LUF, more flexibility to obtain a Tax ID for foreign investors, more flexibility to allow AFP investment in local products, among others). Moreover, it has not yet proven to enable and attract foreign investment, and interviewees commented that almost no foreign investors are using the law to its full potential.

As a final point and due to problems experienced in relation to past ambitious legislation, it is important to keep re-evaluating the regulatory framework for Chilean IIs. Regulation should not impose an excessive burden (according to some market participants, today IIs spend as much as 20% of their total spending on *compliance*) and the regulator should ensure optimisation of resources in its approach to the relation established with IIs.

Incorporation of flexibility and proportionality principles into the corporate governance framework as a facilitator for growth companies

Companies that use or potentially want to use capital markets are not a homogenous group. They differ greatly with respect to size, ownership structure, stage of development and the industries in which they operate. This is why the G20/OECD Principles state that policy makers have a responsibility to make sure that the corporate governance framework for listed companies is flexible enough to meet the needs of firms that operate under widely different circumstances. Flexibility and proportionality start with the basic understatement that "one size does not fit all", but it does not imply to weaken the effectiveness of the corporate governance framework, but to adapt the regulation to different incentives and needs of market participants. Although there are some measures in this sense, the Chilean

market could benefit from a broadened incorporation of this concept to the capital market legal framework.

Flexibility and proportionality rules are especially relevant for growing companies that want to have access to the equity market. As explored in Section 2, growth companies IPOs have almost disappeared in the Chilean market. Today Santiago Stock Exchange trades almost exclusively stocks from large corporations, and growth companies have little interest in listing their stock because of lack of flexibility, compliance costs and inflexible regulations on pension fund investments.

Becoming public is no longer a natural step in the development of a new business, and companies are choosing to remain privately held (which may limit their growth prospects and also deprive a broader public to share in their wealth creation and diversification), to search for M&A alternatives (which in certain cases might harm competition) or to use venture capital (which may not offer the guarantees to investors expected from listed companies, and restricts liquidity). While all these options are possible, the equity market should still be an alternative to diversify financing sources and provide liquidity to investors.

As a response to the decline in the interest of companies in listing in equity markets, regulators around the world have incorporated flexible standards. For example, in the United States the Jumpstart Our Business Start-ups (JOBS) Act, aiming at easing the regulatory process for passing the listing threshold and lowering the costs to remain listed, created a special growth companies market (On-Ramp market). To do so, the law established a new category of public companies called "emerging growth companies (EGCs)", a status available for up to the first five years after an IPO for companies with less than $1 billion in annual revenue and publicly traded shares of less than $700 million[17]. This status permits confidential review of filings by the SEC with public release no later than 21 days before start of the company's road show, testing the waters, scaled disclosure requirements, and phase-in of certain requirements following an IPO (IPO On-Ramp). Other international initiatives include regulatory adjustments in Israel to allow for a longer transition period to implement corporate governance rules that are associated with a full IPO and scaling with respect to disclosure for companies under a certain size.

Other countries had advances in the creation of SME exchanges, platforms or a separate board housed within the main exchange, which is often accompanied by relaxing the requirements for listing. This tendency has been especially strong in Asia, where 11 jurisdictions have one or more SME exchanges or platforms. In China, the Shenzhen Stock Exchange has developed a three-tier trading venue, comprising the Main Board, the SME Board, and ChiNext, a high-tech venture board.

Despite the growing tendency of creating SME markets, few have succeeded, so any country wishing to incorporate such a market needs to reflect on the real needs of the country and learn from experiences of similar developing markets. In 2015 the World Bank issued a stocktaking of practices in SME Exchanges in Emerging Market Economies that have proved to have better results. While the report does not recommend a specific model to follow, the analysis suggests approaches that are widespread and/or could be beneficial to consider such as (1) focus on SMEs with a sizeable growth rate; (2) have the SME exchange legally related to the main board; (3) do not reduce disclosure content to reduce costs; (4) allow private placements; (5) have well-regulated advisors to vet issuers and provide comfort to investors about the quality of the issue; (6) have outreach, public awareness campaigns and training for SMEs; and (7) consider tax incentives for investors (World Bank, 2015).

In 2001 in order to boost the Chilean capital market, Law 19.768 introduced an Emerging Stock Exchange ("Bolsa Emergente"), aiming to attract emerging companies to the stock market (companies in rapid expansion and with an innovative business plan). The Law mainly provided tax benefits (emerging companies could benefit from the capital gains tax-exemption without fulfilling the requirement of high liquidity stock exchange trading presence), but also included other incentives through CORFO (such as reimbursement of some listing expenses). While we are not aware of any study on the real impact of the regulation, the general consensus is that the market did not attract truly emerging firms, and the companies that listed their shares as a consequence of this process were already big and were attracted mainly because of the tax benefits.

A comprehensive study may be necessary to better understand the possible causes of the low impact of the Chilean Emerging Stock exchange. However, it must be highlighted that today there is more information and more successful examples to follow. In addition to tax incentives, it is possible to have scaled disclosure requirements and phase-in of certain corporate governance requirements following an IPO, foster the creation of specific investment vehicles for this market, offer SMEs financial assistance to cover the expenses associated with the pre-listing process and provide incentives to financially analyse smaller firms. The support that companies have during the process, which should be based on peer leaning and dialogue, is of extreme importance as well as public support of these type of initiatives and also promotion of financial education.

Besides SME markets, the Chilean equity market could benefit from creating specialised venture exchanges, focused on mining or tech companies, for example. This idea was explored in previous debates about ways to invigorate capital markets and was followed by an agreement in 2015 of the Santiago Stock Exchange and the TSX Venture Exchange (part of the Toronto Stock Exchange). Through this agreement, SSE implemented a dual-listing process that allows the listing of mining companies in an exploration stage, allowing access to the existing venture capital market segment in the Toronto Stock Exchange. While it may be too soon to assess the impact of this initiative, it is an example that appears to have potential, particularly if promoted in the local market and among local companies, taking into consideration the scarce presence of listed mining firms in a mining country like Chile. However, there are some constraints that may be deterring Chilean companies to take advantage of this new market, particularly the fact that it requires a dual listing process and that the process starts in a foreign stock exchange.

Another possibility to explore is equity crowdfunding. The crowd-funding industry has faced considerable growth since the creation of the first Chilean crowd-funding platform in 2012. According to current Chilean laws, equity crowdfunding – in the understanding that it would be a public offer – is regarded as a securities offer and thus subject to regulation that may impede the development of the industry, taking in consideration its size and characteristics. Although it must be noted that Chilean capital market authority has introduced flexibility[18], there are other international examples that may be worth considering as well.

Jurisdictions around the world have started to look at equity crowdfunding as a possibility for financing growing companies and regulation has started to appear, especially in developed countries such as the UK and US, but also in developing countries, like Malaysia and Brazil. For example, in 2017 Brazilian regulation waived the registration of public offerings of stock up to USD 1.5 million made within a 12-month period by companies not registered with CVM that have obtained up to an annual gross revenue of USD 3 million.

Conclusions and policy options or potential recommendations

Capital markets are an effective channel for financial intermediation between savers and firms with good investment projects. By entering into the equity market, companies obtain new patient capital to develop innovative projects and new financing sources are open (SPOs, bonds among others), while investors earn profits on their savings, achieving diversification and liquidity. Capital markets only fulfil their purpose if they are efficient, meaning that they need to be strong, deep and liquid enough.

Access to equity financing is especially important for growth companies. While equity financing does not intend to be a substitute for bank lending, it should be seen as a complementary resource, especially for high growth companies that need *patient capital* and an exit option for venture capital and other private equity financing.

Whereas capital markets are healthy in some emerging markets, capital markets in Latin America are underdeveloped. Boosting capital markets should be high on the financial reform agenda going forward in the region. The answer must come from every country considering its own particularities, but peer learning is important when the region is going through similar challenges. Chile should be part of the dialogue and solutions, providing the voice of a strong market within the region, but that still struggles against persistent barriers both to companies and investors.

Regardless of advances in the Chilean capital market framework described in this chapter, Chilean companies still are not fully tapping the capital market's possibilities. The Chilean market has not been successful in attracting growth companies. Some of the causes that have been explored in this chapter relate to the relative ease of accessing bank financing, concentrated ownership structures, market illiquidity and concentration, and the need to create a stronger culture of corporate governance among companies (even before their listing). These findings are reflected in the OECD survey responses and substantiated as well as broadened by the interviews with the regulator, the stock exchange and other important actors of the market. In this context, some ways of improving the development of the market and going against its limitations are explored below[19].

Attract investment and spur liquidity by improving transparency and strengthening shareholder rights

While ownership concentration is an intrinsic characteristic of the market, some measures in line with this core characteristic can be taken to spur liquidity and lower concentration levels. Liquidity is vital for the emergence of new instruments, capital-raising activity, and the functioning of secondary markets. More trading reduces the cost of immediate execution, lowering bid-ask spreads and reducing a firm's opportunity cost of capital.

One path to increasing liquidity could be to strengthen corporate transparency, particularly by promoting ownership structure disclosure. Greater transparency of ownership could re-boost the attractiveness of Chilean companies as a destination for minority shareholder investment. This would require legal or regulatory action.

Also, to attract international investment, Chilean companies should advance in providing easily accessible information in English before important events and enabling the exercise of shareholders rights through distance voting and remote attendance. This depends in part on the willingness and awareness of companies, but public policies could find ways to incentivise companies' behaviour, including through strong public enforcement of these and other shareholder rights.

Opening new markets that could boost liquidity

Because Chile needs to advance in offering more liquidity, opening an options market could go in the right direction. SSE and the regulator should work in co-operation towards the objective of initiating such operations in the near future.

Create a culture of corporate governance rather than formal compliance with governance codes

Chilean code compliance has proved to be largely formal. While this could be due to weaknesses of the instrument itself, the most fundamental step is advancing in creating a culture of corporate governance, contributing to awareness-raising and capacity building, under the understanding that corporate governance is a means to create value for companies and for the society as a whole.

The effort should be concerted among capital market participants. The regulator should review measures to improve Chilean corporate governance code compliance, which could involve a principle-based regulation rather than a pure specific practice-based regulation. Mechanisms should be developed to engage companies in a real reflection with reports that would be truly useful for investors rather than a mere formal exercise, involving public-private dialogue based on an assessment of the outcomes.

Evaluate the use of investment flexibility for Institutional Investors – particularly AFPs

Changes in the right direction to invigorate capital markets have been recently effectuated to the institutional investors' regulation, providing more investment flexibility and allowing investment in new instruments. Results are expected to come in the near future. While it may be too soon to think about further relaxing investment regulation, some measures to incentivise actual investment in growing companies could be studied.

The capital market authority should ensure that more flexible investment treatment is given to all IIs and not only AFPs. Also, it should ensure that flexibility is given to all IIs in similar conditions avoiding unjustified asymmetries. Moreover, the authority should ensure that flexibility already provided by previous legislation is made fully available to IIs, by reviewing existing regulations to ensure that it is not impeding the flexibility that the legislation has been intended to provide.

Incorporate flexibility and proportionality in the legal framework to boost growing companies IPOs

While it is true that the decision to remain private or go public does not depend entirely on regulatory changes, flexibility and proportionality should be considered within the current regulation to better adapt to a new reality of a longer pre-IPO lifecycle for private companies. The Santiago Stock Exchange and public sector should work to enhance awareness of the capital market as a good financing option, establish dialogue with companies and study:

The possibility to establish an SME market, which should give flexibility and proportionality to current rules to truly attract growing companies to participate in the market and investors to invest in such companies.

The possibility to develop specialised venture markets within the Santiago Stock Exchange, following the example of the existing Venture market that has focused on the mining sector implemented through an agreement between the Santiago Stock Exchange and TSX Venture Exchange of the Toronto Stock Exchange. Consideration should be given to developing rules that provide flexibility to avoid a dual listing process.

The possibility to modify regulation applicable to equity crowdfunding, by relaxing standards of public offerings in certain limited and studied cases.

Notes

[1] Growth companies are those that have the potential to escape a static state of being a small or medium-sized enterprise. In the Eurostat-OECD Manual on Business Demography Statistics (2007) they are defined as "All enterprises with average annualised growth greater than 20% per annum, over a three year period should be considered as high-growth enterprises. Growth can be measured by the number of employees or by turnover". Being the main drivers of job creation, innovation and productivity, the access of growth companies to alternative sources of finance is especially crucial for economic development (OECD, 2015a).

[2] Globally, the average annual number of growth companies that made an IPO of less than USD 50M (USD 100M) was 1 373 (1 739) in the period 1996-2000. That number fell to 1 041 (1 179) in the period 2001-2007 and to only 627 (785) in the period 2008-2016 (OECD 2017).

[3] Ten years ago, the World Bank analysed the state of capital markets in Latin America, and concluded that despite the intense reform effort in the early 1990s, they remained underdeveloped, both compared to other regions and in expectation of the region's economic and institutional fundamentals (De la Torre, Gozzi, and Schmukler, 2007).

[4] This peak in indebtedness is partially due to historical low credit rates as stimulus to support demand. Chilean authorities have been constantly monitoring corporate debt, which has been a topic of discussion and stress testing by the Central Bank (see Financial Stability Reports 2016 – 2017).

[5] According to the Chilean Venture Capital Association presented in 2017 Chile Day, the VC Industry in Chile has expanded during the last 4 years, achieving $350 million assets under management and reaching 0,336% of GDP as of 2017 as compared to 4 years before.

[6] In 2001, Chile issued Law No. 19,768 and No. 19,769 (also known as the "Capital Markets I" Reform), which contained several measures to boost capital markets. In 2007, Chile issued Law No. 20,190 ("Capital Markets II" Reform), containing further measures. In 2010, Chile issued Law 20,448 ("Capital Markets III"), introducing a series of reforms in the field of liquidity, financial innovation and integration of the Capital Markets. In further years, other Laws were issued for what is considered as "Capital Market Bicentenary Reform Agenda", a collaborative process that allowed the private sector to contribute with initiatives. Part of this reform process is contained in the following regulation: Law 20,522 of 2011, that modernises and promotes the competition of the financial system; Law 20,544 of 2011 referred to derivatives taxation; Law 20,667 referred to the insurance contract; Law 20,715 of 2013, on protection of credit debtors; Law 20,712 of 2014, also known as Single Funds Act ("LUF" as per its Spanish acronym); Law 20,789 of 2014, which gives legal recognition to the Financial Stability Board (already created by decree in 2011). Lately efforts relates with the modernisation of the regulatory architecture, as discussed in Box 2.1.

[7] Source: Santiago Stock Exchange data

[8] For an in-depth analysis see Holden et al., 2014.

[9] To improve liquidity, the SVS – today CMF – improved the definition of stock exchange trading presence in 2012.

[10] CMF is presumably alluding to the Single Funds Act ("LUF" as per its Spanish acronym) contained in Law 20 712 issued in 2014. LUF sought to make investment in the country's investment funds bigger and more diverse, introducing certain tax incentives for investment in funds. LUF also intends to attract foreign investment and turn Chile in a regional platform by creating a single tax for foreign investors, simplifying tax

payment procedures, and exempting from taxation those foreign investors that invest in funds 80% of their portfolios in foreign assets.

[11] For the past 20 years, the corporate governance framework has been repeatedly improved. In 2000, Congress passed Law No. 19,705, which introduced new tender offer and corporate governance rules (e.g., independent directors, internal committees and the regulation of related-party transactions); In 2001, Law No. 19,768 and No. 19,769 (also known as the Capital Markets I); and in 2007, Law No. 20,190 of 2007 (Capital Markets II). In 2009 there was a whole strengthening of corporate governance framework through Law No. 20,382 (enacted for the OECD accession process), this law improved the protection for minority shareholders through enhanced transparency standards and mechanisms for addressing use of privileged information, related party transactions and conflicts of interest, and through provisions to improve the definition of independent directors and strengthen their role, incorporating a Directors' Committees.

[12] Please see (only available in Spanish): http://www.pulso.cl/empresas-mercados/asesores-internacionales-recomendaron-votar-directorios-locales-2017/

[13] The word "code" is used for convenience, but it must be clarified that Chile has a disclosure regulation rather than a "code" in the narrow sense. In Chile, listed companies are obliged to perform a self-assessment with regard to the adoption of good practices of corporate governance contained in Rule Nº 385 issued by the capital market regulator.

[14] For example, it was mentioned in an interview with the Association of Mutual Funds that the current pension investment framework provides more flexibility for AFPs than for mutual funds in those products that can be offered by both AFPs and Mutual Funds.

[15] Aside from the investment restrictions, pension funds are subject to a minimum return regulation that establishes that administrators are responsible for ensuring an average real rate of return over the last 12 months that exceeds either (i) the average real return of all funds of the same type (i.e., Funds C are benchmarked with other Funds C) minus two percentage points for Funds C, D, and E, and minus four percentage points for Funds A and B, or (ii) 50 percent of the average real return of all the funds of the same type, whichever is lower.

[16] Chilean pension fund administrators invest in different assets subject to a set of quantitative restrictions that are defined by law and that specify how much pension fund administrators are allowed to invest in specific instruments.

[17] In 2012 after the Act was enacted, nearly 87% of the firms filing for an IPO in the US market have identified themselves as EGCs under the IPO On-Ramp. An SEC report found that after the JOBS Act, smaller IPOs – i.e., those seeking proceeds up to $30 million – constituted approximately 22% of all IPOs from 2012-2016 as compared to 17% from 2007-2011 (US Treasury, 2017).

[18] In order to allow the existence of certain securities crowdfunding models, in exercise of an express legal attribution, SVS issued regulations No. 336 of 2012 and No. 345 of 2013. Both regulations allow "private offers" which, under special circumstances, are exempt from the provisions of the Securities Market Law. Rule No. 336 refers to the private offering of securities, which, among other things, allows the offer to be directed to qualified investors, regardless of their number, and also allows the securities to be offered to a maximum of 50 retail investors. On the other hand, Rule No. 345 allows public offerings of securities without registration in certain cases, for example, when the offerings are directed to employees of the entity or when the instrument offered represents more than 10% of the issuer's capital and the minimum investment of each investor is at least 2% of the issuer's capital.

[19] This chapter was initially written as background for the discussion for the second meeting of the Task Force on Equity Market development held in Buenos Aires, Argentina on June 11, 2018. These ideas were presented for discussion, taking into account the interviews and survey results undertaken for the preparation of the report, and do not necessarily represent the position of the OECD, its Secretariat, its members, or individual participants in the Task Force.

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