Organisation for Economic Co-operation and Development

Background Issues Note on Equity Market Development in Latin America

Latin American Corporate Governance Roundtable Task Force on Equity Market Development

10-11 October 2017
Sao Paulo, Brazil

This Issues Note is provided as background for the discussion at the 1st meeting of the Latin American Equity Market Task Force. It will be further developed following the meeting to take account of input received during the discussion and any written comments received. For further information or to provide comments, please contact Daniel Blume, Senior Policy Analyst, OECD Directorate for Financial and Enterprise Affairs: Daniel.Blume@oecd.org.

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I. INTRODUCTION

1. The Latin American Corporate Governance Roundtable Task Force on Equity Market Development, involving government policy ministries, regulators, stock exchanges and private sector stakeholders from Argentina, Brazil, Chile, Colombia, Mexico and Peru along with other selected experts, has been established to review the state of Latin American equity markets and their corporate governance standards. Its objective will be to enhance understanding of the current state of development and barriers to development of Latin American equity markets in the interest of identifying shared priorities for achieving further progress consistent with the *G20/OECD Principles of Corporate Governance*.

2. The motivation for doing so stems from a recognition of the limitations of relying solely on retained earnings, bank loans or other shorter-term financing to meet investment needs, and the positive impact of equity finance on innovation and productivity. Some sectors in the economy may be less well-suited to be financed by bank debt. Companies looking to innovate and grow may have difficulty obtaining loans for a promising e-commerce or start-up idea, or to make use of other non-tangible assets. As noted in Isaksson and Celik (2013), "Equity finance plays a unique role in supporting corporate innovation and growth. Because equity capital has only a residual claim on corporate earnings, it can be used to finance projects with uncertain and long-term returns, such as research, product development, innovation, or the opening of new markets. The transferability of shares in the public equity market allows for the separation between the investment horizon of the individual saver and the investment horizon of the corporation, so that a promising research project or product innovation does not have to be stopped because a shareholder has an immediate need for cash." A related concern is that if local equity markets are not considered an attractive financing source for a country's largest and most sound firms, and they instead rely on banks as their primary source, this may have a crowding out effect that reduces the availability of such funding for SMEs and households.

3. Moreover, once companies access equity markets through an initial public offering (IPO), they may also facilitate access to bond markets and open up the possibility of obtaining further finance through secondary offerings at relatively lower costs. Such access to finance through secondary offers has been shown to be even more important during times of economic crisis: OECD (2015c) reviewed global trends for non-financial companies' access to finance and found that the total amounts raised in both advanced and emerging economies through secondary offerings were particularly following the crisis in 2009, reaching nearly USD 500 billion, when other finance sources were less available.

4. While the benefits of accessing equity capital may be recognized, the work of the Roundtable has found that Latin American countries face similar challenges in trying to develop their capital markets as an active source of financing for company growth. The challenges are two-fold: on the one hand, companies can be reluctant to undertake new or secondary listings, because they perceive that the shares will not receive sufficient value to make it attractive in comparison to other sources of finance (e.g., not high enough demand by investors or too costly to list). On the other hand, investors are sometimes reluctant to invest in Latin American markets (e.g. if they lack confidence that high standards of corporate governance are reflected in the legal framework and its enforcement, or in actual practices adopted, or if there are insufficient offerings or liquidity in the market). The Roundtable has suggested that fostering good corporate governance practices can play an important part in bridging this gap, by raising the value of companies and their attractiveness to investors, while creating stronger incentives for companies to list and trade on Latin American markets.

5. The *G20/OECD Principles of Corporate Governance*, as revised in 2015, give increased emphasis to the importance of understanding market conditions and the dynamics and incentives of

different market actors as part of the consideration necessary to develop an effective corporate governance framework that supports a well-functioning capital market.

6. Yet, while better corporate governance may be part of the solution, it does not appear to be sufficient in itself to spur greater equity market development. The Task Force's first meeting therefore should be used to consider and explore more broadly what the barriers to the development of more active equity markets may be -- whether from the perspectives of companies, investors, stock exchanges, policy or regulatory officials, or other market participants or experts; and to identify where there are information gaps that require further research to come to more fully informed views.

7. Some attempts have already been made to identify these gaps and to take steps to address them. For example, current work of the OECD Corporate Governance Committee is looking at how greater regulatory flexibility may be tailored to address differing circumstances and conditions for different types of companies and other market participants. Within Latin America, increasing attention is being given to strengthening regional market integration and harmonizing standards to facilitate region-wide share trading and a wider pool of investors for IPOs. This is one of the rationales for the Latin American Integrated Market (MILA) initiative that has led to the development of a common trading platform among the stock exchanges of Chile, Colombia, Mexico and Peru. But the interest to promote region-wide trading has been wider, involving Argentina and Brazil as well. The emergence of "*Multilatina*" companies functioning in multiple markets has further reinforced the interest in considering the possibility of more harmonized standards supported by stronger enforcement co-ordination in cases involving multiple jurisdictions, to give investors confidence that corporate governance requirements will be respected and enforced.

8. This Issues Note provides an initial stock-taking of the state of equity market development in the region and some of the initiatives that have been taken in support of this objective as background for the discussion of the Task Force scheduled on 10-11 October, 2017. Inputs from the discussion will be used both as inputs to further development and refinement of this report, as well as for the future work streams of the Task Force.

9. The Issues Note is structured as follows: after this brief introduction, **Section II** reviews the evolution of Latin American equity markets in comparison to other regions since the global financial crisis of 2008; the second part of the section then provides a preliminary diagnosis of some of the factors impacting on equity market development and the obstacles and challenges faced in the region. **Section III** describes some of the more significant country-specific and regional efforts, including corporate governance initiatives that have been aimed at building investor confidence, attracting issuers or facilitating cross-border investment in the region. The concluding **section IV** identifies where further information and analysis for the Task Force may be useful to support its objective to promote the development of more vibrant and active equity markets in Latin America.

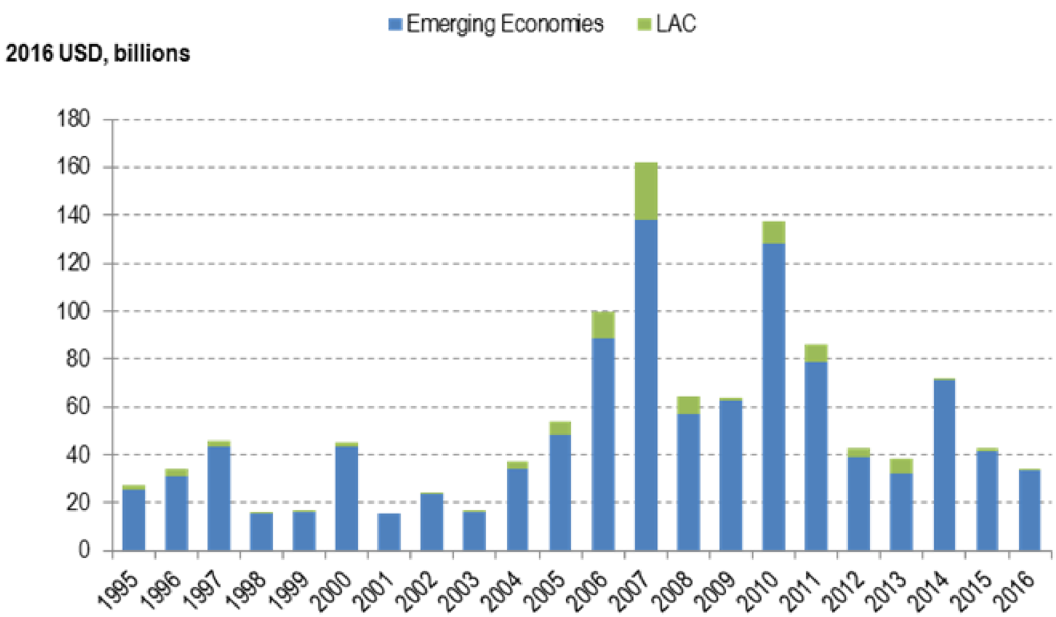
II. EQUITY MARKET DEVELOPMENT IN THE POST-CRISIS PERIOD[1]

2.1 Review of recent developments

10. Global trends in equity markets have shown a decrease in the overall number of public listing and initial public offerings. In the last 17 years, advanced economies like United States, Germany, UK and France have lost in total more than half of their listed companies. In addition, a global shift in the IPO market towards emerging economies has been observed. During the 1995-2001 period, almost 90 per cent of the capital raised in the form of IPOs was allocated to advanced economies; whereas from 2008-2016 that number drops to 53 per cent. In other words, emerging economies have moved from being responsible for less than 20 to more than 50 per cent of the total capital allocated worldwide to new listed companies (OECD, 2017d).

11. Unfortunately, the LAC region has not benefited from the global shift in capital allocated towards emerging markets (see Figure 1). The initial public offering activity in emerging markets is driven mostly by Asian economies and not by LAC[2] emerging markets. More importantly, the lacklustre activity in the region has been in a declining trend since the financial crisis. In the region, Brazil has been responsible for most of the activity in the IPO market and the rest of the region has shown modest signs of activity in the past few years.

Figure 1. Amount issued by non-financial corporations



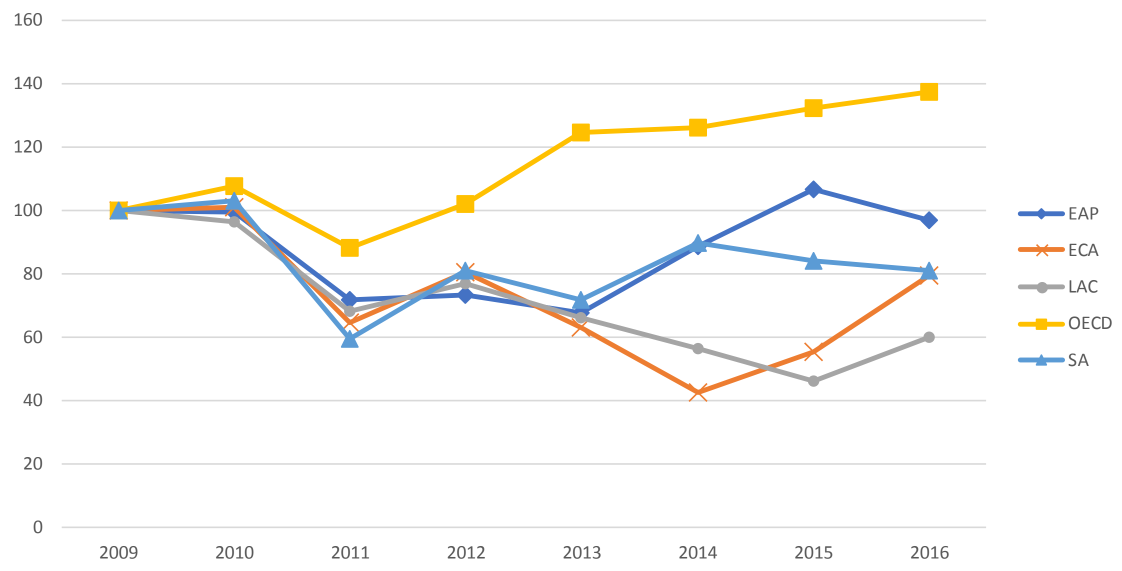
Source: Thomson Reuters, OECD calculations adapted from OECD Business and Finance Scoreboard 2017

[1] The OECD wishes to acknowledge the work of Pablo Souto, consultant with Global Outcomes based in Argentina, as the main author of the following sections reviewing recent market developments and synthesizing work undertaken to date on obstacles and challenges to greater equity market development in the region.

[2] LAC: Latin America and the Caribbean; SA: South Asia; EAP: East Asia and Pacific; ECA: Europe and Central Asia; all developing regions exclude high-income countries.

12. Latin American equity markets exhibited some dynamism during the first decade of 2000, with listed companies' market capitalization as a share of GDP rising from 28% of GDP on average for the period 1995-2000, to 52% of GDP for the period from 2005 to 2010 (OECD 2013)[3]. Such growth allowed the region to start a process of catch-up to fill the gap with other developing and developed markets. However, following the global financial crisis, the region's equity markets have experienced the slowest recovery in the post-crisis period, as shown in Figure 2. At the time of the crisis, the non-OECD countries of Europe and Central Asia (ECA) had the lowest ratio of market capitalization to GDP, while in 2016 this unfortunate position was held by Latin America and the Caribbean (LAC) as a consequence of the above mentioned slower recovery path.

Figure 2. Equity market capitalization as a share of GDP – Selected regions (index 100 = 2009)



Source: own elaboration based on World Development Indicators

13. While Figure 2 provides a snapshot of how the region has underperformed other regions since the crisis in relative terms, Table 1 below also shows the widening gap between Latin America and other regions (and OECD member countries) in absolute terms.

[3] The OECD's 2013 review of trends and factors impacting on Latin American equity market development focused on seven Latin American markets: Argentina, Brazil, Chile, Colombia, Ecuador, Mexico and Peru.

Table 1. Latin American market shares in comparison to OECD and other regions

Region / country	Market capitalization (as % of GDP)		Traded volume (as % of GDP)	
	2007-2011	2012-2016	2007-2011	2012-2016
EAP	67.7%	59.2%	106.1%	133.8%
ECA	40.9%	29.6%	40.6%	17.5%
OECD	81.1%	100.2%	144.9%	124.7%
SA	79.1%	68.0%	60.5%	29.3%
LAC	49.5%	35.8%	22.6%	17.3%
Argentina	13.6%	9.7%	0.8%	0.5%
Brazil	66.0%	39.0%	39.0%	28.9%
Chile	118.7%	93.3%	22.1%	12.1%
Colombia	55.6%	45.9%	8.0%	5.5%
Mexico	35.4%	38.3%	9.4%	10.5%
Peru	55.3%	41.0%	3.8%	1.6%

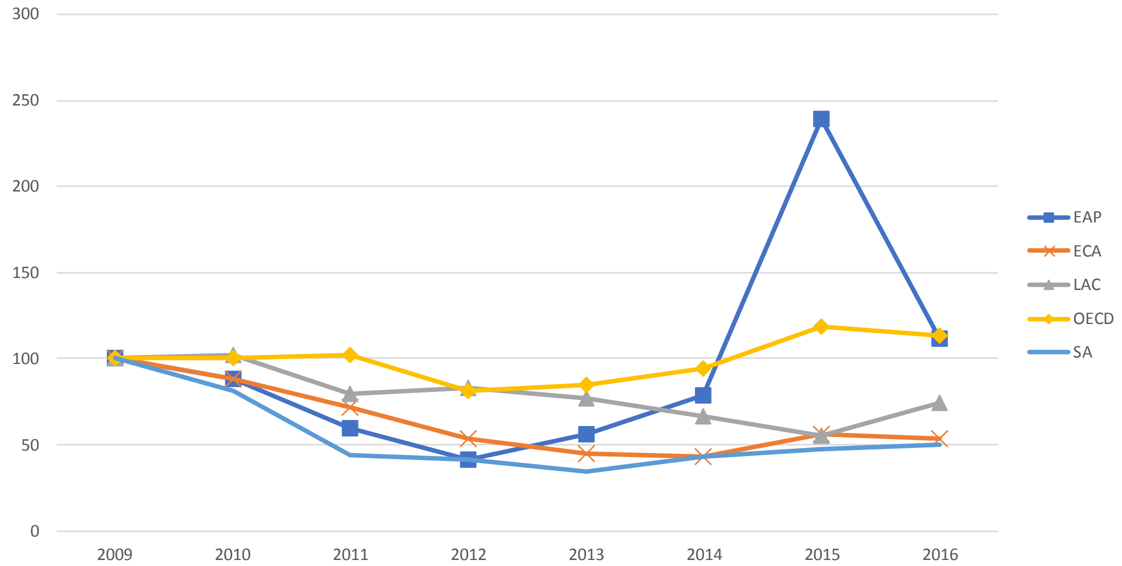
Source: World Development Indicators

14. The advances made in the decade before the crisis, when LAC managed to increase its total market capitalization (as a share of global market capitalization) from 1.6% to 6% between 2000 and 2012, have not been sustained more recently. The latest figures show a marked retreat to 2.3% of market capitalization as a share of global market capitalization in 2016.[4] Interestingly, these stylized facts are common to the six LAC economies under analysis, with acute drops in market capitalization in Brazil, Chile and Colombia.

15. The high level of ownership concentration in Latin American markets has been well documented in past OECD work (OECD, 2013). This has resulted in relatively low levels of free float and contributed to lower liquidity than in other regions, as measured by equity trading volumes as a percentage of GDP. Low liquidity in turn can have negative consequences in terms of share price volatility and further inhibit investment. Only OECD countries and the East Asia and Pacific region have on average recovered liquidity ratios to the pre-crisis level. As per Figure 3, the other regions are still on a downward trend and therefore struggling to return to levels not seen in the past decade. In a context of reduced market liquidity across the globe after the crisis, Latin American markets had navigated under these conditions better than developed markets, therefore reducing the gap in terms of liquidity (OECD, 2013). The evolution of liquidity ratios since 2011 has reversed this relative gain in the region.

[4] It must be noted at the outset that the performance of equity markets is strongly influenced by overall economic conditions (while not the only determinant). As the most recent *OECD Latin American Economic Outlook* (OECD, 2017c) concludes, "The tailwinds that propelled economic growth in LAC in the past decade are gone. The region is undergoing a prolonged economic slowdown …Weak global growth prospects, low commodity prices and tight financing conditions have undermined the potential for the region's growth."

Figure 3. Equity market traded volume as a share of GDP – Selected regions (index 100 = 2009)



Source: own elaboration based on World Development Indicators

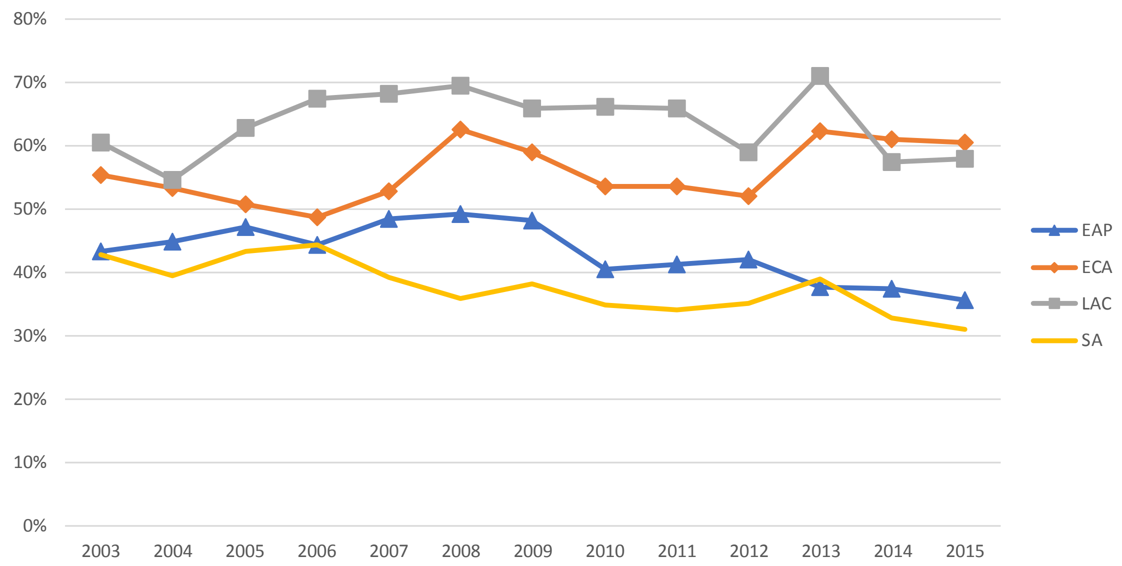
16. As shown it Table 1, LAC and ECA are the regions with the lowest liquidity ratios; on the other hand, South Asia -- the other region that has not yet recovered its pre-crisis liquidity levels - still enjoys high liquidity ratios (over 30% of GDP) that have doubled those in LAC and ECA. Within the region, only Brazil exhibits liquidity indicators that are similar to the South Asian average but still far from other developing and developed economies.

17. In sum, when the crisis hit, LAC had the lowest liquidity ratio and has not managed to recover those values. In some countries such as Argentina and Peru, liquidity ratios are extremely low, averaging 0.5% and 1.6% respectively over the 2012-2016 period. According to WEF (2016), low liquidity "… increases transaction costs for market participants, prevents participation of certain investor types and increases risks".

18. A similar picture can be described when looking at the number of listed companies; both LAC and ECA are the two developing regions where the number of listed companies in 2016 remained below the number they had back in 2009. Within LAC, there are some asymmetries though; on the one hand, Argentina, Chile, Brazil and Colombia have not yet recovered the number of domestic listed companies, whereas Mexico and Peru have managed to increase such figures.

19. Equity markets in LAC and ECA not only suffer from (relative) slow growth and low liquidity, but also exhibit higher market concentration ratios in terms of the market share held by the 10 largest listed companies in each market in comparison to other developing regions, as per Figure 4. Moreover, market concentration has remained stable over the last decade, in contrast to EAP and SA where a declining trend can be observed. While Chile and Brazil have market concentration ratios slightly below 45%, on the other extreme Colombia has the highest value in LAC, amounting to over 70%. Similar considerations can be made in terms of the levels of market concentration in terms of liquidity (traded volume). The fact that high levels of market share concentration have been recorded over the last two decades, and those levels appeared not to have been affected by the crisis, they may reflect a structural and solid feature of the domestic equity markets.

Figure 4. Equity market concentration - Selected regions (market capitalization of 10 largest companies as share of total market capitalization)



Source: own elaboration based on World Federation of Exchanges

20. These high market share concentration levels are a symptom of the dominant presence of large companies, which are further indicated by the average market capitalization of domestic companies. The average market capitalization of domestic companies in LAC was USD 1.6 bn. over the 2012-2016 period; almost as large as the OECD average that was USD 1.8 bn. Taking into account some volatility in year-to-year valuation, the average market share concentration has remained relatively stable in LAC over the last decade, contrary to EAP where it increased significantly.

21. One possible explanation of the relative low liquidity in Latin American equity markets is that liquidity has itself moved to other markets, through the listing in more developed ones, such as the US and certain European markets. In a context where liquidity is key for investors, the region has "repatriated" some of the liquidity that it lost in the previous decades, but still there is much to be done. As per latest figures, in most LatAm countries, the traded volume in the domestic equity market represents between 60% and 70% of total trading (including home and abroad) with the notable exception of Argentina where the domestic market only accounts for 22% of total trading.[5]

22. When it comes to liquidity, the existence of a vast array of financial instruments can help to attract investors to domestic markets. In particular, the literature has identified bond markets as a complement to equity markets that in turn reinforce each other. An initial review of data obtained from the World Federation of Exchanges shows traded volumes of corporate bonds in public stock exchanges to be relatively low among countries in the region.[6] On the one hand, in most countries except Colombia -- and, to a lesser extent Chile -- traded volumes in bonds are very low (see figure 5); at the end of the spectrum,

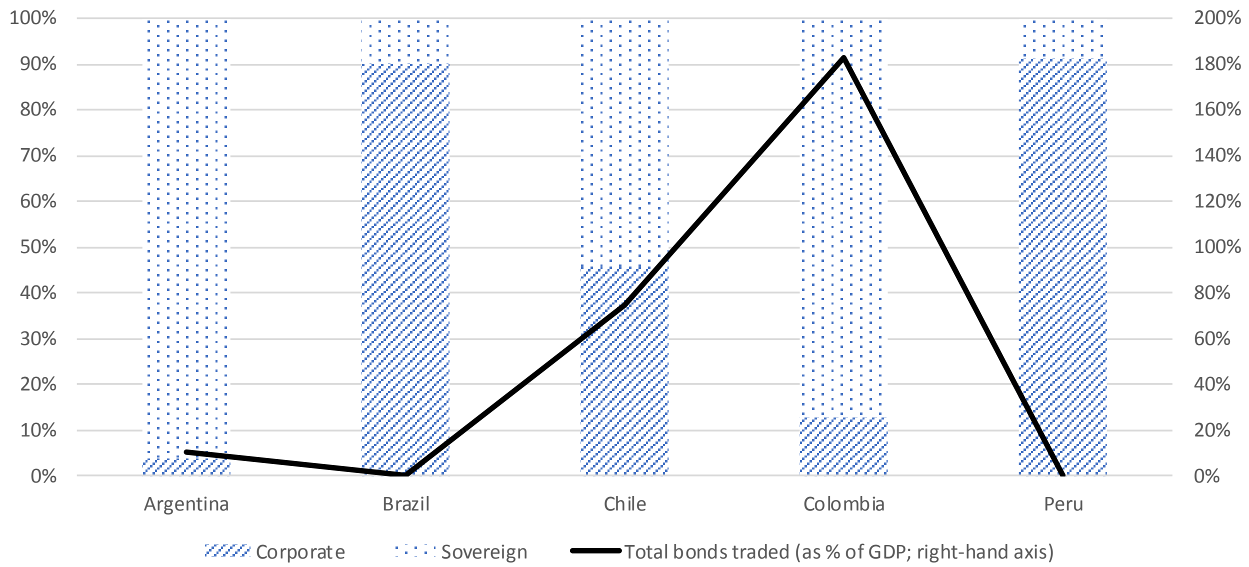
[5] Using data from City 2016 Report on Depositary Receipt Services.

[6] It is important to note that these data may present an incomplete picture of the situation since they do not take into account bond trading that may occur in other venues outside of exchanges, and data were not available for Mexico.

Brazil and Peru exhibited liquidity ratios well below 1%.[7] What is interesting is that in those countries where bonds traded in public exchanges are almost insignificant, most of the trading volume is accounted for by corporate bonds. In Argentina, where bonds traded represented 10% of GDP, most of the activity is explained by sovereign bonds, similar to Colombia where bonds traded in public exchanges are the largest in the region. Such complementarity (positive correlation between the development of sovereign and corporate bonds markets) has been reported in Laeven (2014) for a large number of developed and developing economies; in fact, he claims that when it comes to domestic currency corporate bond markets, the existence of a developed sovereign bond market is needed as a catalyst for the former to develop, since the latter provides a reference yield curve and liquidity.

23. The peculiarities of some countries in LAC in this regard could be partly explained by the presence of market fragmentation; for example in Argentina, where most sovereign bonds are traded in a different market, rather than in Argentina's principal stock exchange, the Bolsas y Mercados de Argentina (ByMA).Additional information and insights from the Task Force members in this regard would facilitate a deeper understanding of the functioning of bond markets and its interconnectedness with stock exchanges.

Figure 5. Corporate and sovereign bonds traded volume (2012-2016 average)

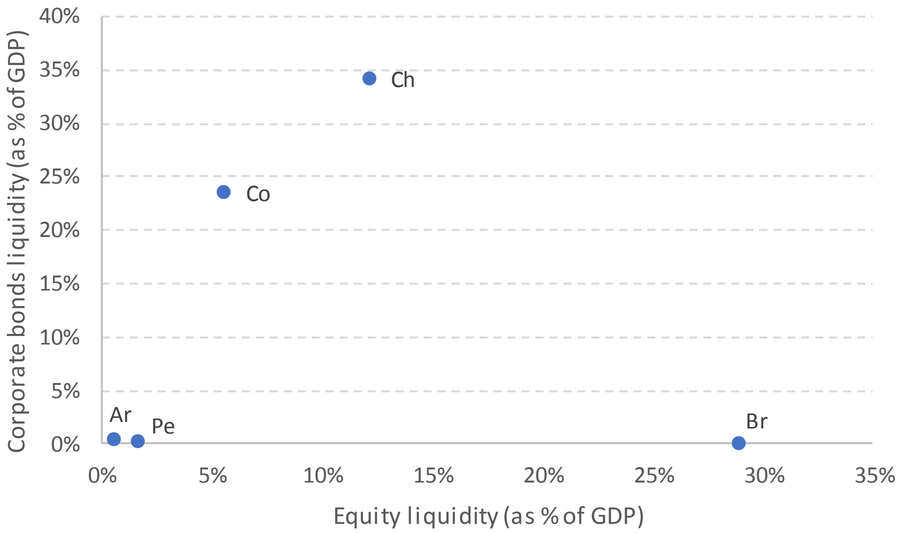


Source: own elaboration based on World Federation of Exchanges (no disaggregated data were available for Mexico).

24. In such a context, a natural question is whether corporate bonds and equity markets are a necessary complement to attract liquidity and reduce transactions costs and in doing so reinforce each other. Data plotted in Figure 6 suggests that this may be the case, as most countries with higher liquidity ratios in equity are also those with higher liquidity ratios in the corporate bond market. Only Brazil stands out as a country where this relationship is not found, which could deserve a particular analysis.

[7] Trading value in bonds as % of GDP.

Figure 6. Equity and corporate bonds liquidity (2012-2016 average)

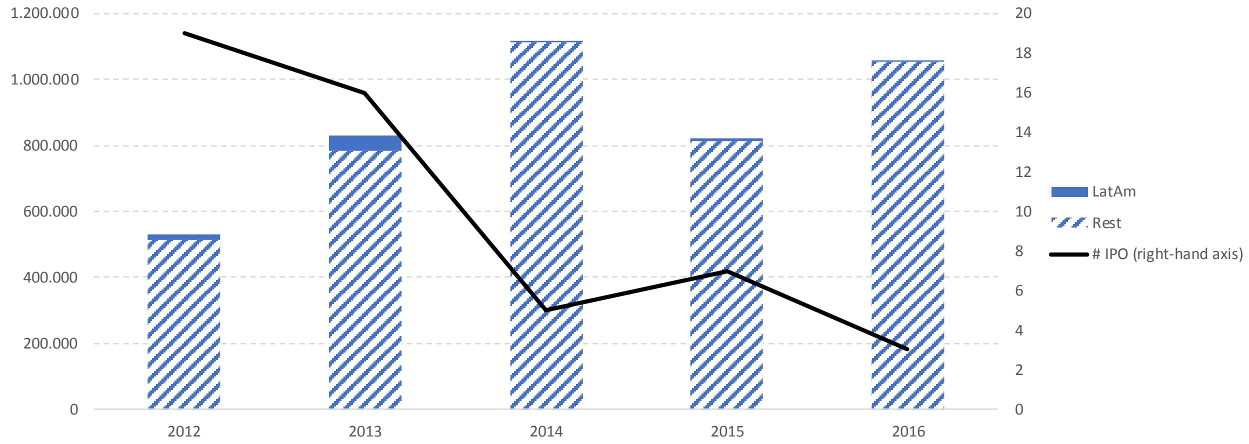


Source: own elaboration based on World Federation of Exchanges

25. Another instrument that has attracted much attention in many markets around the globe is Exchange Traded Funds (ETFs). Concerns have been raised about the effect that their growth and use of passive investment strategies has had in reducing the focus on individual companies' fundamentals and corporate governance. An additional concern is that ETFs, along with high frequency trading (HFT) including algorithm-based trading have served to concentrate trading on the largest and most liquid companies, reducing the availability of investment for smaller companies (OECD, 2015c). The development of such investment vehicles is still at a relatively early stage in Latin America, but with significant differences within the region. Mexico, and Brazil to a lesser extent, are the two countries that account for the largest volume of ETF trading within the region, representing almost 98% of total trading volume in Latin America. Overall, ETF trading represents a minor share of equity trading in most countries except Mexico, where the ratio reached a significant 22.9% of Mexico's total trading volume as of 2016. By comparison, Colombia's ETF trading volume was 4.8%; Peru 2.8%; Brazil 2.4% and Chile just 0.6%, despite leading the region in the number of ETF's listed for trading at 219. No ETFs are listed in the Argentinean exchanges.

26. Considering the above trends, it has been a challenge for domestic markets to attract new companies to issue new shares. After a boom of IPOs in the region in the mid-2000s --led by Brazil -- equity markets have experienced a sustained decline in IPOs particularly after the international financial crisis. As documented in Figure 7, the relevance of Latin American companies´ IPOs is almost nil at the global level. Their number has decreased and the capital raised has also been on a downward trend over the last five years, both in absolute and relative terms. Over the last five years, IPOs in the Mexican market accounted for the largest share within the region, surpassing Brazilian ones that were the stars of IPOs over the preceding five years.

Figure 7. Global and Latin American companies IPO market capitalization on 1st day of trading in USD millions, and # of Latin American IPOs)



Source: own elaboration based on World Federation of Exchanges

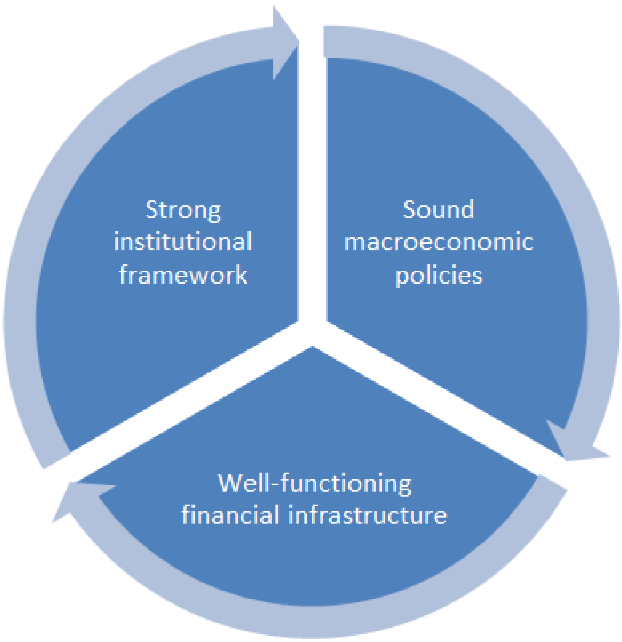
27. In OECD (2015a), the challenges posed by the presence of large company groups with concentrated ownership have been described. The OECD's work has pointed out that in its early stages, conglomerates were often dominated by financial institutions, with an important rationale for the group to serve as a vehicle for corporate finance that was not being supplied by the capital markets. While more systematic data analysis would be required to confirm, it appears that to some extent such conglomerates continue to serve as a source of finance for companies in the region, in particular through mergers and acquisitions that may serve as a substitute for more direct finance through local stock markets.

28. As mentioned by OECD (2013), Latin American capital markets had embarked on a process of domestic consolidation and regional integration with the exception of Argentina, where several exchanges co-existed. A legal reform that was passed in 2012 intended to consolidate Argentinean markets, but progress towards this goal only become apparent in 2017 with the launching and public listing of ByMA, although some further consolidation remains pending. With this move, the six largest capital markets in Latin America had -- to a large extent -- completed the process of both domestic consolidation and listing of their own shares. The benefits of further integration between those markets, such as the MILA venture, is still an issue of debate in the region.

2.2 Preliminary diagnosis, obstacles and challenges

29. In light of these trends and features of Latin American markets, what are the main obstacles or incentives necessary to turn things around? From a broader and macro perspective, sustained development of capital markets is rooted in the presence of three main pre-conditions (Laeven 2014), as per Figure 8.

Figure 8. Pre-conditions for sustained capital markets development



Source: own elaboration based on Laeven (2014)

30. Over the last decade, most countries in the region had implemented sound macroeconomic policies, which have included the opening up of capital as a cornerstone of the policy mix. Consequently, technological advances in the financial industry and the internationalization of financial markets pose a challenge to the development of domestic capital markets. Will they be able to compete with more developed markets? Should they focus on certain *niche* markets?

31. On the one hand, larger flows could result in lowering the cost of capital for firms and individuals and enhance risk-sharing, therefore facilitating market access to traditionally credit-constrained sectors (small and medium firms, entrepreneurs, households).[8] On the other hand, the possibility to tap international capital markets could result in large and high-quality domestic firms migrating their financing to those markets, and therefore reducing the availability of the most liquid and sound stocks and bonds in the domestic market. The net effect is still ambiguous and subject to further research (Laeven 2014).

32. The review conducted in the previous section showed that the dynamism observed by domestic equity markets prior to the 2008-2009 crisis couldn´t be sustained after the global turmoil. For the years prior to the crisis, OECD (2013) identified five elements that explained such dynamism, namely: macroeconomic stability, increasing terms of trade, low international interest rates (high level of global liquidity), improved legal and regulatory protections for investors, and better corporate governance practices among many Latin American companies. When global financial conditions deteriorate (or stagnate), then it became increasingly difficult for domestic firms to raise capital in home markets.

33. At the same time, discussions and debates in the Roundtable came to conclude that there continued to be factors hindering the development of capital markets (OECD, 2013). The most relevant were:

[8] See Borenstein et. al. (2006).

- Foreign exchange controls were cited as a major barrier in Argentina to foreign investment in the stock market, distorting the costs of financing.

- It was suggested that many companies are reluctant to list, especially in smaller markets, due to concerns that increased disclosure will have negative impacts on tax liabilities or other government intervention in business operations.

- Companies may also be concerned that disclosure requirements could put them at a competitive disadvantage vis a vis their non-listed (and in some cases multi-national) competitors.

- Family founders may also have concerns about loss of control of the company, and may decide that the costs of listing and complying with regulatory and disclosure requirements are higher than the benefit they may receive from cheaper access to capital obtained on the market.

- There are also challenges on the demand side in attracting investors for smaller companies, and in the absence of liquidity, about the potential volatility of share prices.

34. Despite the marked improvements (reforms) in the legal and regulatory frameworks and the enhancement of the protection of investors' rights that the region embarked on over the last years, the continuation of such reforms is critical (Laeven and Perotti 2001). In most cases, it could be argued that the region hasn´t gone through reversal episodes over the last two decades when it comes to reforms aimed at promoting investors´ confidence; but the risk is still there and hence it is important to acknowledge that such reforms would have their bulk of impact in the long-term, so building up investor confidence is an ongoing process that requires continued attention by policy-makers.

35. Although full agreement exists regarding the need to have well-regulated capital markets, the specifics of the best enforcement framework are not yet clear, at least from an academic perspective; the role of public enforcement vis a vis private mechanisms is still a topic of debate.

36. On the one hand, LaPorta et al. (2006) find that laws mandating public disclosure and facilitating private enforcement through liability standards benefit the development of securities markets, while public enforcement of securities laws has little impact. This suggests that securities laws that empower the market by setting mandatory disclosure and liability standards are to be preferred over laws that focus primarily on regulatory enforcement of laws. Similar conclusions have been elaborated in World Bank (2006).

37. On the other hand, Jackson and Roe (2009) find that disclosure does indeed correlate with capital markets development, but so does public enforcement. In fact, they claim that public enforcement is more important than private liability standards as elements that foster the development of capital markets.

38. Such debate is of utmost importance for policy-makers in developing economies, provided the hard budget constraints faced by regulators. In such circumstances, relying on private mechanisms could provide more room for enforcement, but at the expense of limiting the impact of the more relevant tools policy makers have at their disposal. Finding a proper balance is more a matter of art than science, requiring country-specific elements to be taken into account. A key factor to consider in determining such a balance is the efficiency and quality of the court system in handling private actions.

39. In a comparative study conducted by Eichengreen and Luengnaruemitchai (2006), on creditor and investor rights, the time and costs of contract enforcement, and transparency were identified as driving forces explaining the relatively more developed capital markets in Asia vis a vis Latin America. Those forces have had an impact in facilitating the level of integration among Asian capital markets, particularly bond markets, hence further reinforcing the development virtuous circle.

40. As noted at the outset of Section II, the concentrated ownership structure of listed companies in Latin America is a well-known feature of the market. It must be recognized that Latin America in this respect is not alone, as most OECD and G20 countries have varying degrees of concentrated ownership (OECD, 2017b). Even in countries such as the United Kingdom and United States known for dispersed ownership structures, a growing number of listed companies have a significant number of listed companies with concentrated ownership (OECD, 2017b). In Latin America, OECD (2015a) concluded that ownership concentration and the formation of company groups are closely related. Given that those two elements have not changed much after the crisis, they could be explanatory variables for the level of domestic equity markets depth, but don't provide an explanation for the poorer performance of these markets since the crisis. The actual impact of concentrated ownership structures on the development of capital markets continues to be a subject of debate within academic research.[9]

41. A number of challenges to foster equity market development were identified by OECD (2013), namely:

- Achieving the balance between regulation aimed at ensuring minority shareholder protection and investor confidence, while maintaining the necessary flexibility for companies to adopt practices tailored to their specific circumstances, and minimizing the costs and compliance burdens that may deter companies from making use of equity finance opportunities;

- Ensuring effective and efficient enforcement of corporate governance rules through regulatory institutions; and predictable and timely court processes;

- Shifting the focus of board improvements from static analysis of board member composition to a more dynamic focus on how it functions and how it can most effectively tackle the issues of greatest importance to the company, such as strategy, risks and value creation.

- Developing a corporate governance culture for both listed and non-listed firms that is based on the value that good corporate governance can create for an enterprise, rather than simply adopting formalistic structures and processes to meet third party requirements.

- Addressing the corporate governance challenges associated with conglomerate structures, particularly in relation to disclosure and review of related party transactions;

- Considering the potential for listing of state-owned enterprises to spur equity market growth, while at the same time ensuring that the state acts according to high corporate governance standards in its role as owner, setting a positive example for other listed companies in the market;

- Considering the state's role as a direct source of investment in companies – whether through the equity markets or through more direct corporate finance – and its implications for the viability and attractiveness of equity market financing for corporate investment needs;

- Considering the use of corporate bond markets as an intermediate vehicle to enhance corporate governance and disclosure while providing family founders with the means to maintain full company control, which may ultimately facilitate later consideration of listing.

[9] Laeven (2014) and La Porta et. al. (2006) argue that concentrated ownership is a deterrent to capital markets development. At the regional level, Claessens et. al. (2000) provide evidence of this effect in the case of Brazil. Evidence of no significant relationship between ownership concentration and capital markets development is provided -among others- by Gilson (2006) and Roe (2002).

- Considering the establishment or promoting the use of SME listing segments with fewer corporate governance requirements, as some markets in the region have already done, and considering the impact of the tax code on incentives to list. Differing definitions of SMEs and lack of good, comparable data may be hindering a full understanding of the necessary steps to facilitate their access to finance in the region.

42. A comparative study conducted by the World Economic Forum (WEF, 2016) identified a number of additional initiatives or opportunities for private and public action that could foster the development of capital markets in Colombia. Many of those initiatives are also relevant for and applicable to most of the other Latin American countries, as per the OECD Roundtable conclusions cited before. In particular, the WEF study calls for:

- Promoting issuer and retail investors education;

- Simplifying the listing process and costs and evaluating the convenience of developing specific market segments related to company size;

- Strengthening minority shareholders rights protection mechanisms;

- Expanding the investor base and their investment options by allowing certain participants to increase their activity in equity and risky markets;

- Streamlining the processes for foreign investors to participate in the domestic market;

- Increasing market liquidity through the removal of unnecessary regulatory restrictions aimed at mitigating risk (e.g. on transactions that typically require leverage) while fostering sound risk management practices at the intermediaries' level

- Generating cost efficiencies (economies of scale) in the market through lower regulatory compliance costs, horizontal and vertical integration of infrastructure providers, and simplifying tax operations

43. As it emerges from such study and the one by the OECD already mentioned, many of the actions that are needed are circumscribed to the market infrastructure and the institutional framework pre-conditions. Similarly, in terms of market infrastructure, Laeven (2014) cites fixed costs (listing requirements, transaction costs and fees, taxes, the costs associated with hiring an internationally recognized auditor among others) as elements that are particularly acute in developing markets, mostly affecting small and medium size firms and investors.[10] The Laeven study further cites the quality of information disclosed by issuers as weak.

44. In addition to these structural features, once countries have successfully implemented sound macroeconomic policies and confirmed their willingness to implement sustained market-friendly reforms in a context of increasing financial internationalization, new demands from issuers and investors may have arisen. Provided that these new demands are not yet met, they could help in explaining the poor performance of domestic capital markets in LAC after the crisis. For example, could it be attributed to firms being reluctant to raise capital in a more challenging macroeconomic environment? Has the cost of capital increased for firms? Have investors become more demanding in terms of the institutional

[10] We should keep in mind that larger firms and investors are those most benefited by financial internationalization, since they can choose to raise capital or invest resources in most developed markets without incurring significant costs.

framework (including corporate governance), market infrastructure, financial products available (market completeness)?

45. To conclude, a long-term perspective may be needed when assessing the development of domestic capital markets in Latin America over the last years. As it has been put by Laeven (2014), "…there are no quick fixes: the development of markets is a gradual and interactive process, stretching over long periods of time". Within that context, it is important for policy makers to be supportive of sound macroeconomic policies, sustaining an investor-friendly institutional framework and facilitating the development of an efficient financial market infrastructure.

46. Moreover, it could be the case that the development of certain markets becomes inefficient due to market size, transactions costs, etc. In those cases, a pragmatic approach is needed and the convenience of regional and/or international integration should be evaluated. The MILA is a vivid example of this approach; only time will tell whether integration in this case was the optimal solution, but more information is needed to provide a conclusive assessment.

III. LATIN AMERICAN REGIONAL AND COUNTRY-BASED INITIATIVES TO PROMOTE EQUITY MARKET DEVELOPMENT

47. The relatively poor performance and ranking of Latin American markets in comparison to other regions and global trends should not be taken as an indicator of inattention or lack of action in the region to try to promote greater equity market development. Some of the inactivity can certainly be attributed to underlying economic conditions, as noted above.

48. Recent corruption scandals (e.g. Petrobras, Odebrecht, etc.) involving listed companies in a number of different Latin American countries have probably also contributed to greater hesitation on the part of investors.

49. Nevertheless, policy-makers, regulators, stock exchanges and other market participants have undertaken a range of initiatives aimed at strengthening Latin American equity market development, either on a regional or country-specific basis. These can be categorized as:

a) corporate governance-related initiatives aimed at increasing investor confidence;

b) initiatives aimed at encouraging businesses to use equity markets; and

c) initiatives aimed at reducing barriers to cross-border trading and investment.

50. While some of these initiatives do not fit cleanly into a single category and may address multiple aspects, an initial attempt has been made below to briefly highlight some of the better known and more recent initiatives undertaken across these categories.

51. It must first be noted that the overall legal and regulatory requirements in each country provide the main framework for the functioning of markets in the six participating Task Force countries. These generally include legal requirements set out in company laws, securities laws and related accounting and audit laws. These legal requirements may be seen as the first line of defense for investor protection, as

failure to respect them can, at least theoretically though not always in practice, result in enforcement actions to compel companies to comply.

52. These legal requirements are generally complemented by voluntary corporate governance codes, usually either written or officially endorsed by each country's regulator, in order to provide a formal mechanism aimed at encouraging adoption and communication to the market of good corporate governance practice, on a voluntary, "comply or explain" basis. The frameworks and processes followed in each of the six task force countries are covered in considerable detail in the Latin American Corporate Governance Roundtable's 2016 report, *Strengthening Corporate Governance Codes in Latin America* (Chaher, 2016).

53. These codes, while voluntary, provide an important mechanism to support institutional investors' understanding of listed company practices, to facilitate their ability to take into account companies' corporate governance practices as part of their decisions on how to allocate their portfolios for investment, or to engage with companies on corporate governance issues. In some countries, including Chile, Colombia and Peru, regulators have established requirements for pension funds to vote in shareholder meetings and/or to take corporate governance into account in their investment decisions. In the case of Brazil, an attempt has been made to encourage institutional investors to become active investors in the market through the development by the Association of Capital Market Investors (AMEC) of a stewardship code. On the other hand, the OECD's work in this area (and annotations in the G20/OECD Principles) have suggested that institutional investors follow a wide range of business models, and that for some it will not be cost effective to become actively engaged in the corporate governance of the companies they invest in. Mandatory requirements therefore face the risk of becoming box-ticking exercises if the investors do not perceive the benefits of their engagement. Nevertheless, disclosure of corporate governance practices against voluntary codes can reduce the costs for investors to access and make use of such information.

54. The additional initiatives described below represent some of the more visible actions taken to provide complementary elements to the legal and regulatory frameworks alluded to above, but should not be considered a comprehensive inventory at this early stage in the Task Force's work.

3.1 Latin American initiatives to promote greater investor confidence

3.1.1 The Novo Mercado experience

55. One of the best known initiatives in the region for strengthening investor confidence in equity markets, at least in its initial years, was the Novo Mercado initiative in Brazil, launched at the end of 2000. While the Novo Mercado experience is now well known not only in Brazil but regionally and globally, it is worth summarizing briefly some of its main components and impacts. Brazil's stock exchange, then known as BOVESPA[11], established three special corporate governance listing segments that issuers could sign up to in order to demonstrate to the market their adoption of higher than legally required corporate governance standards.

56. Among the standards adopted at the highest "Novo Mercado" level were requirements for companies to:

- issue only common shares (one share, one vote) and no preferred (non-voting) shares;

[11] BOVESPA subsequently changed its name to BM&F BOVESPA following a merger in 2008, and most recently following an additional merger in 2017 adopted its current name of B3.

- provide tag-along rights to minority shareholders ensuring that in case of takeovers they are offered the same price as the controller;

- ensure that at least 20 percent of the board is independent;

- use International Financial Reporting Standards or US Generally Accepted Accounting Principles;

- follow more stringent requirements for disclosure of related party transactions and information on trading among company insiders and the controlling group;

- commit to resolve disputes through an arbitration chamber established at the Exchange in order to bypass Brazil's slower and less predictable court system;

- maintain at least 25% free float.

57. At the slightly less stringent listing level 2, companies followed the above standards with the exception that they were allowed to maintain preferred non-voting shares, which nevertheless were provided tag-along rights guaranteed to receive 80% of the price received by the selling controlling shareholder and voting rights for certain key decisions taken in the general meeting. Level 1 was focused mainly on enhanced disclosure requirements, along with the 25% free float requirement. By 2002, BOVESPA instituted a requirement that all new listings on the market register at least at Level 1.

58. Following an initial quiet period, the IPO boom that followed in Brazil in the mid-2000s is well known. A handful of companies signed up to the highest levels in 2002 and 2003. Then the number of companies listing at Novo Mercado level began doubling annually, to seven in 2004, 18 in 2005, 44 in 2006, and 92 in 2007. At the time, Brazil became known as a global best practice success story, demonstrating how mechanisms that allowed companies to make legally binding commitments to higher corporate governance standards could attract stronger investor interest, higher share prices and entice companies to come to the market (Santana et al., 2008).

59. However, in the decade since Brazil's market peak of 64 IPOs in 2007, Brazil has not been able to sustain the same success. The number of IPOs dropped to just 4 in 2008 amidst the global financial crisis, and has not been higher than 11 in any year since (including just 1 per year in 2014 to 2016).

60. Some market participants have argued that in recent years, legal frameworks in Brazil and in other countries have continued to evolve towards higher corporate governance standards, meaning that companies on the higher listing segments no longer stand out to the same extent they once did. For example, every Task Force country in the region now requires financial reports to be filed according to IFRS, and some, such as Chile, already prohibit or sharply limit the use of non-voting shares. Sensing a need to take action to maintain its reputation for being at the leading edge with its corporate governance standards, the BM&F BOVESPA Exchange sought to enact additional measures beginning in 2008 to strengthen investor protection for companies on the top tier. These efforts met with mixed success, as companies already listed on the Novo Mercado and other tiers voted not to enact a number of the measures, and the reforms were only partially enacted in 2010. A new set of amendments to the standards was approved by companies on the special listing segments in June 2017, adjusting the definition of independent directors, establishing stricter rules related to internal audits and audit committees, and other adjustments of takeover and free float requirements. However, none of these improvements in standards have had as dramatic of an impact on the market as the initial set of standards established for Novo Mercado.

61. Meanwhile, other stock exchanges in the region have also undertaken initiatives to promote better corporate governance. These initiatives have been beneficial in publicizing and signalling to investors the efforts of companies to adopt or improve corporate governance standards. However, unlike B3, which requires issuers of new IPOs to follow the higher standards on at least one of its listing segments, these initiatives have been more voluntary in nature, and the mechanisms to ensure their enforceability are not as strong.

3.1.2 Other Stock Exchange Initiatives: Colombia, Peru and Argentina

62. Colombia's Stock Exchange *(Bolsa de Valores de Colombia)* has established a specific Investor Relations Recognition (IRR) designation for companies that follow higher than legally required standards of disclosure, currently constituting 32 issuers (debt and equity). The BVC certifies them on an annual basis as Investor Relations Quality Issuers, and includes them in a BVC index known as COLIR as a way to facilitate investor trading of these issuers' stocks (OECD 2017). Among the standards issuers commit to are:

- Having an investor relations officer (IRO) available to interact in English and Spanish (an IRO is not required by regulation, nor to list).
- Disclosure of quarterly consolidated balance and income statement (consolidation is only required annually by law).
- An updated website with high standards of information, both in English and Spanish, including among others:
    - i. Corporate structure (including subsidiaries local and off-shore);
    - ii. Corporate governance documents (governance code, ethics code, AGM and board regulation);
    - iii. Copy of the comply-or-explain report of the *Código País*;
    - iv. CVs of directors and officers;
    - v. Social responsibility commitments;
    - vi. Copy of material information sent to SFC;
    - vii. List of equity analysts that follow their stock.
- Quarterly events (conference calls) required to investors.

63. The Peruvian stock exchange (*Bolsa de Valores de Lima)* Good Corporate Governance Index was created nine years ago with an aim to provide greater visibility to firms which implement good corporate governance practices in relation to Peru's voluntary corporate governance code (Chaher, 2016). A small number of audit firms approved by the stock exchange are hired each year to make assessments of "*the appropriateness of [firms'] compliance [with] the code*". They do this according to a standardized methodology which was adjusted after the country code was updated in 2010. These assessments are used to generate an individual score for each company, which becomes one factor contributing to that company's standing within the index. Other factors included are the liquidity of the company's stock, and the findings of the *La Voz del Mercado* report, a survey of capital markets stakeholders and local corporate governance experts. This survey is intended to reflect the market's opinion regarding corporate governance compliance of the main listed companies. The Peruvian framework has provided the market, especially investors, with a set of tools to assess the value of the practices recommended by the code. In addition, the stock exchange and EY give interested issuers individual feedback on their *La Voz del Mercado* results, thus, contributing to awareness raising and capacity building. Peru has complemented an issuer-driven

model in which companies have to report their progress, with a market demand-driven one based on polling market participants, thus generating a robust and practice- driven focus.

64. Argentina's newly formed stock market, *Bolsas y Mercados Argentinos* (ByMA), reportedly is planning to create its own version of Novo Mercado by establishing a segment available only to companies with high standards of corporate governance (Chaher, 2017). In parallel, Argentina's Ministry of Finance has been developing an Argentina Capital Markets Reform Initiative that will be aimed at considering other incentives necessary to attract more companies to the market, including through enhanced integration of the large number of regional exchanges in the country and through consideration of tax incentives.

65. Certain limited comparisons have been carried out seeking to link commitments made by companies to higher corporate governance standards to their better performance or higher share values (for example, a review of performance of members of the Latin American Companies Circle between 2005 and 2008[12]); and tracking of the performance of companies in the Novo Mercado index. Whether such results can be replicated in other markets such as in relation to the Lima and Colombia stock exchange initiatives, would require further review and analysis. In particular, if such higher performance exists relative to other companies in those same markets, the question to address is whether it can reasonably be attributed to higher corporate governance standards or may be attributed to other factors such as company size, liquidity, sector, risk levels or other factors. A broader question is whether such initiatives have any positive impact on efforts to attract new companies to the market, or whether, to the contrary, companies considering listing may see the higher standards adopted by leading companies as too expensive or burdensome to entice them to seek to follow the same path.

3.2 Initiatives aimed at encouraging businesses to use equity markets

66. An earlier initiative was undertaken in 2012 and 2013 when Brazil's stock exchange joined forces with Brazil's securities regulator (*Comissão de Valores Mobiliarios -- CVM)* and other government entities and market stakeholder groups in an inter-agency public-private "Technical Committee" to review and compare international practices aimed at attracting small and medium enterprises with growth potential to the market. Brazil's Mais listing segment -- launched in 2005 for small and medium enterprises -- experienced little demand in its initial years despite relaxed, transitionary requirements for listing. The Mais listing segment was reported to have 13 issuers as of August 2016, while the number of companies listed on the Novo Mercado, Level 1 and Level 2 have risen to a combined total of 178 (Prado, 2017).

67. The Technical Committee developed a number of recommendations elaborated in a 2013 presentation to the Latin American Corporate Governance Roundtable, including several aimed at facilitating company access to the market. These included simplifying the process and reducing the costs of IPOs; reducing listing maintenance costs; and developing and implementing an issuer education programme. The group also suggested analysing alternative models for access to the market with additional discounts and access restricted to super-qualified investors. Other recommendations sought the establishment of equity funds permitting investment in eligible companies. Market incentives recommended by the group included the provision of IPO guidance free of charge; exemption from registration analysis fees and listing maintenance fees; sponsorship of research reports for a period of 2 years; and a reduction in the offering settlement fee applied to issuers. Adjustments in tax incentives were also advocated. Information was not available at the time of writing regarding the extent to which any of these recommendations have been followed up. B3's representative will be providing an update at the Task Force meeting.

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[12] See OECD/IFC, (2009).

68. The Argentina Capital Markets Reform initiative, already described above, also may be categorized as a reform with the major objective of enticing new issuers to join the market.

3.3 Initiatives aimed at encouraging regional, cross-border trading

69. The Colombian, Lima and Santiago stock exchanges joined together to begin operation of the Integrated Latin American Market (MILA) in 2011, seeking through the unification of their platforms to increase the range of options and liquidity they offer to issuers and investors[13]. MILA works, for example, by allowing a Colombian investor to purchase shares in a Chilean listed company by using a broker in Bogota. The three stock exchanges' initial aim was to promote their combined markets as an attractive alternative to Brazil and Mexico, the region's two larger markets. However, the three founding members' market capitalization and trading volumes have remained well below those of Mexico and Brazil. In August, 2014, Mexico formally became the fourth member of MILA, further increasing its overall size, number of issuers and trading volumes, so that MILA markets' overall size now exceeds that of Brazil, while still falling well short of Brazil's trading volumes (see Table below). At the same time, Latin American markets have not escaped a more general downward trend in size and trading volumes experienced by emerging markets during this recent period.

Table 2. Integrated Latin America Market (MILA)

	Market cap (USD Bn)	Issuers*	Traded volume (equity, USD Bn)
Peru BVL	57	310	2
Colombia BVC	86	73	15
Chile BCS	190	310	21
Mexico	402	143	127
MILA	735	836	166
Brazil BM&FBOVESPA*	491	359	498

Source: World Federation of Exchanges as reported by BVC as of December 2015 (*) Domestic and foreign issuers (including some non-corporate regulated entities)

70. Stock exchange officials concede that the integration initiative has not led to the increased trading volumes that some had hoped for. Differences remain among the participating countries in terms of regulatory, tax and tariff policies. However, the initiative has led to increased co-ordination among the participating countries' regulatory authorities, and it could ultimately lead to convergence in regulatory and best practice standards as well as strengthened cross-border enforcement among the participating countries' regulatory authorities (Mendoza, 2014b). The Colombian government reported to OECD during its accession process that MILA has also helped to consolidate and deepen the process of financial integration among these members of the Pacific Alliance.

[13] The discussion of MILA in this section is excerpted from the OECD Corporate Governance accession review of Colombia (OECD, 2017a).

71. The work of MILA has been taken up in a range of publications developed with the support of the Inter-American Development Bank (see for example, Perry, G. 2016; and Larrain Rios, G. 2016a and 2016b), calling for strengthened financial integration and regulatory harmonization to support increased cross-border investment for the development of equity markets in the region. While much of this work has focused particularly on the Pacific Alliance (MILA) countries of Chile, Colombia, Mexico and Peru, some of it has undertaken a broader comparison involving also Argentina and Brazil. The work of the Task Force on Equity Market Development is not intended to duplicate this work, but to serve as a complementary forum for reflection among policy-makers, regulators and participants, looking more closely at the issue of how approaches and frameworks for corporate governance are similar or differ across key markets in the region, and what the implications may be.

IV. OPTIONS FOR FUTURE WORK-STREAMS OF THE TASK FORCE

72. Despite the range of initiatives and efforts in the region, the overall recent downward trend in market activity and current lack of an active IPO market remains clear. Among the issues that may merit further examination include the following:

1) **Developing a better understanding of Latin American market characteristics.** This Issues Note has provided a brief introduction to overall trends in terms of the relative size, liquidity, number of IPOs, and other features of Latin American stock markets. But a more complete review and analysis of the capital market "ecosystem" in Latin America is needed: the types of companies that are currently listed and, perhaps more importantly, those that may be most likely to benefit from joining the market. For these potential market participants, how are they are currently financed, and how well positioned are they in terms of addressing the corporate governance requirements of Latin American markets or demands of investors for good practice. Likewise, a better understanding is needed of the different market actors (banks, brokers, other underwriters) involved in bringing companies to the market, and financing and trading their shares; and the pool of investors available for such IPOs and share trading, including the main types of investors active in each market, both domestic and foreign. To complete the picture, a deeper understanding of the business models of the stock exchanges themselves (which have become for-profit entities over recent years) may provide further insight into the incentives they face in the context of attracting new stock issuers versus advancing other market segments that may be more profitable, such as the derivatives market, ETF trading or information and IT services.

2) **Developing a better understanding of the dynamics of cross-listing.** A closer look at data regarding trends and use of depository receipts in exchanges outside of the region by companies that are based in Argentina, Brazil, Chile, Colombia, Mexico and Peru could help to underpin an analysis of how different countries' frameworks may influence listing trends. In addition to tracking on a comparative basis the universe and size of domestic companies' listings abroad versus in domestic markets, the possibility of surveying these companies to understand their motivations for listing abroad versus domestically -- and the differing requirements and conditions they face in each market -- could shed further light on the dynamics and factors that may be limiting use of Latin American equity markets.

3) **Developing a better understanding of market incentives to make use of equity markets.** The Roundtable's 2013 report on trends and factors impacting on Latin American equity market development already reached some conclusions regarding the issues that may make companies reluctant to raise capital through Latin American equity markets, and that may also serve as barriers to attracting domestic or foreign investment. This could be complemented through surveys of market participants (institutional investors and listed companies or companies with listing potential) that could provide some additional insight as to perceptions within the market. Rather than launching new surveys, a starting point could be to gather information on surveys of such market participants that have already been carried out. Case studies looking at specific experience involving recent IPOs in the region could provide an alternative means of understanding the incentives or disincentives involved in different steps in the IPO and investment chain that may constitute costs or deterrents to use of equity markets.

4) **Developing a clearer framework for comparing corporate governance standards and practices across the region.** The list of references at the end of this section shows that there has been no shortage of attempts to compare corporate governance frameworks across the region (and

more widely), both by academics as well as by international and regional organizations. One of the more comprehensive attempts may be found in the OECD Corporate Governance Factbook 2017, which provides a side-by-side comparison of all OECD and G20 countries and includes Argentina, Brazil, Colombia, Chile and Mexico. If Peru is also interested to provide similar information on its legal and regulatory framework, a more complete comparison of corporate governance frameworks could be developed at relatively low cost. Other OECD Latin American Roundtable publications have attempted to drill down to provide comparisons on particular priority topics, including on:

a. board practices and treatment of conflicts of interest (OECD, 2012a);
b. frameworks for review and disclosure of related party transactions (OECD, 2012b);
c. frameworks and practices for enforcement (2009);
d. treatment of misuse of privileged information (2011a);
e. the role of institutional investors (2012a);
f. corporate governance of company groups (2015) and disclosure by company groups (2017).

Each of the above OECD reports required substantial work to survey market regulators and in some cases also practitioners to develop a clear and accurate comparison of requirements and practices. Taking into account the large amount of corporate governance-related information already available, careful consideration should be given to what would be the added value of additional survey work, especially since updating all of them would represent a substantial investment of time and resources. Considering the potential wide scope of such a project, it is seen as more prudent to have a first round of discussion to understand what may be the priorities among different stakeholders in the region for obtaining and making use of comparative information. For example, how could the Task Force best assess potential links between what are considered good corporate governance standards or practices and their impact on markets?

5) **Developments related to enforcement may also merit further focus --** both public and private as well as in the use of arbitration -- as a particular area that has evolved since the OECD last carried out its review in 2009. How enforcement is handled when involving cross-border cases may also be worth examining more closely, particularly if the region is moving in the direction of encouraging increased cross-border trading.

73. The above list should be considered as a starting point for the Task Force's consideration, and may require adjustments and prioritisation based on the Task Force's discussions, taking into account limited resources for Secretariat and consulting work. Capacity to carry out such work would also depend on the willingness of Task Force participants to provide or develop information as necessary with respect to experience in their markets.

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