

Session 2: Role of Stock Exchanges in Corporate Governance: the Impacts of Demutualization and Cross-border Integration

IX Latin American Roundtable on
Corporate Governance

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Mexico - December 2, 2008



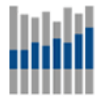
Agenda

- Outlook in LatAm Capital Markets
- Developments and Challenges Facing Issuers, Stock Exchanges and Regulations
- Implications for CG Practices
- Proposed Issues for Discussion



Outlook

- International financial conditions have changed dramatically since IIQ 2007
- Risk-aversion has increased, so did country-risk premium and ultimately interest rates in emerging economies
- Capital inflows turned into outflows
 - A combination of liquidity needs in the developed economies and fundamentals in certain emerging economies
- How were capital markets in LatAm affected? And, what can be done to facilitate access to financing in this environment?



On Issuers

- Issuers and Cross-listings
 - Benefits: cost of capital, liquidity, risks
 - Costs: compliance (mostly fixed)
- Along financial liberalization in the 1990s, a recurrent history of macroeconomic instability and violations of property rights favored local companies listing abroad, e.g. south-north cross-listing, particularly in the United States through the ADRs
- Due to the (mostly) fixed costs of cross-listing, larger firms were able to do so



On Issuers (cont.)

- Such dynamics, in turn, reduced liquidity in local markets, raising the costs of listing locally, then triggering a new wave of cross- (or even de-) listings in local markets (vicious circle)
- Hence, those firms that had to adopt stringent CG practices to comply with US standards, partially or fully abandoned local markets
- Not (enough) incentives for firms listed just in local markets to follow suit



On Issuers (cont.)

- Change in international conditions, the consolidation of the market-friendly reforms and improvements in macroeconomic management in most LatAm countries, resulted in a change of that pattern
- Consequently, an incipient process of south-south cross listing is under way (Mexico, Brazil)



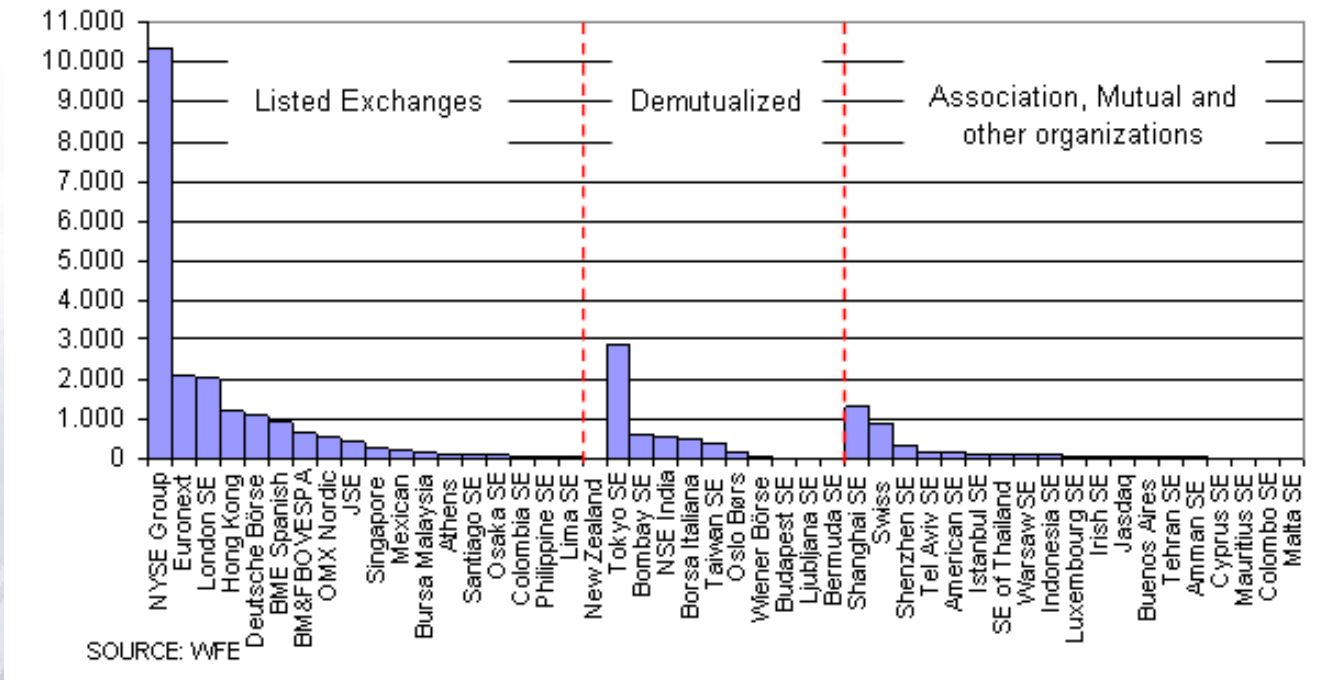
On Stock Exchanges

- Increased global competition pressures stock exchanges to lower listing costs and increase the scope of services available
- Trading volumes are key for generating revenues and enjoying economies of scale
- Demutualization (Bolivia, Venezuela) and going public (Brazil, Chile, Colombia, Mexico and Peru) have been part of the strategies pursued by stock exchanges
- Integration with futures' exchanges (Brazil) has been another response

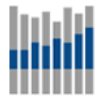


On Stock Exchanges (cont.)

- Would M&A be the next step in LatAm?



- Some pre-conditions are called for, so as to facilitate stock exchanges to continue doing business in a more efficient manner
 - Infrastructure
 - Convergence in the legal and regulatory framework



On Regulations

- National regulators have continued the process of aligning regulations with international standards (IOSCO)
- Nevertheless, there are significant asymmetries across countries regarding compliance with IOSCO principles
- This fact makes it difficult for any process of integration while at the same time opens a window of opportunity for regulatory arbitrage by firms and investors



Impact on Corporate Governance

- Largely determined by local regulations (institutional CG). Hence, asymmetries in the regulations are reflected on the actual practices.
- Cross-listing exacerbates the asymmetries of CG practices in local markets
- Good CG practices are a driver for attracting investors, so stringent regulations do make a difference (i.e. Novo Mercado)
 - This effect should be balanced against the costs of compliance (i.e. some de-listing in NYSE after SOX)
- Consequently, markets with poor CG practices suffered from a drain of good governed firms, shrinking market activity



Proposed Issues for Discussion

1. Globally driven

- a. Would good governed firms which had been the primary target of capital inflows in the region, be the first victims of capital outflows?
- b. Would capital market financing still be an option for firms in LatAm once the world is moving towards bank-based dominated?
- c. Would good CG still play a positive role for firms in terms of performance and access to financing in LatAm in the current situation?

2. Regulatory driven

- a. Is there a need for further convergence to a common set of basic regulations across LatAm that would facilitate to broadening and deepening regional capital markets?
- b. Are regulations lagging behind market developments?
- c. Will the asymmetries in the regulatory framework affect the possibility to cross-list?
- d. What are the key drivers for the incipient periphery-periphery cross-listing? Is it just market size and liquidity? Does hedging sovereign risk play a role?



Proposed Issues for Discussion (cont.)

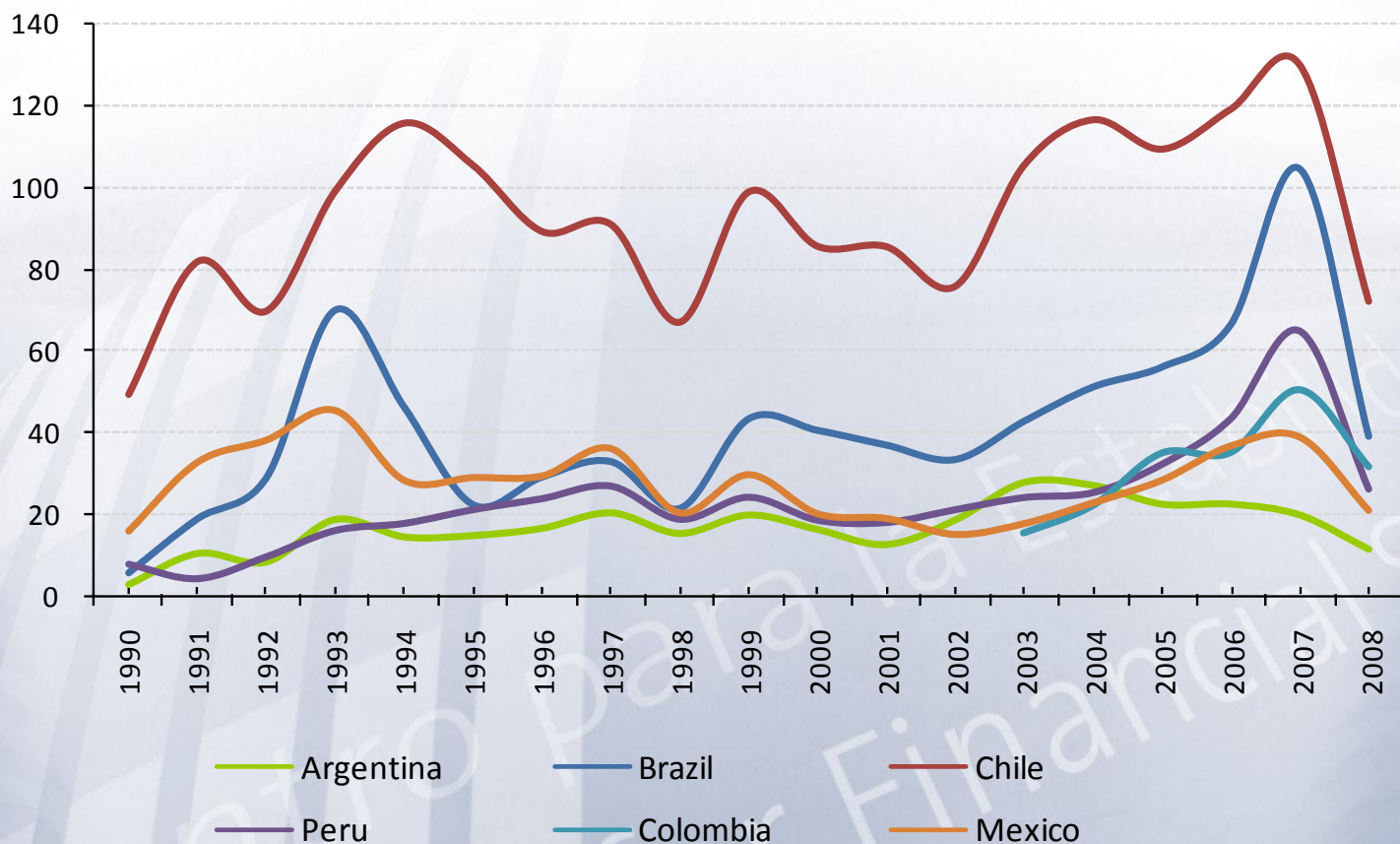
3. Locally Driven

- a. Is there a differential performance among stock exchanges development due to the strategies pursued (i.e. demutualization, and listing vs. mutual structure, integration of spot and futures exchanges?)
- b. How has the current financial turmoil affected those that chose to become for-profit, listed and/or merged?
- c. Does the local establishment of stricter CG requirements facilitate the listing of stocks in local markets through new sources of capital?



Outlook (Annex)

- Market Capitalization (% GDP)





Outlook (Annex)

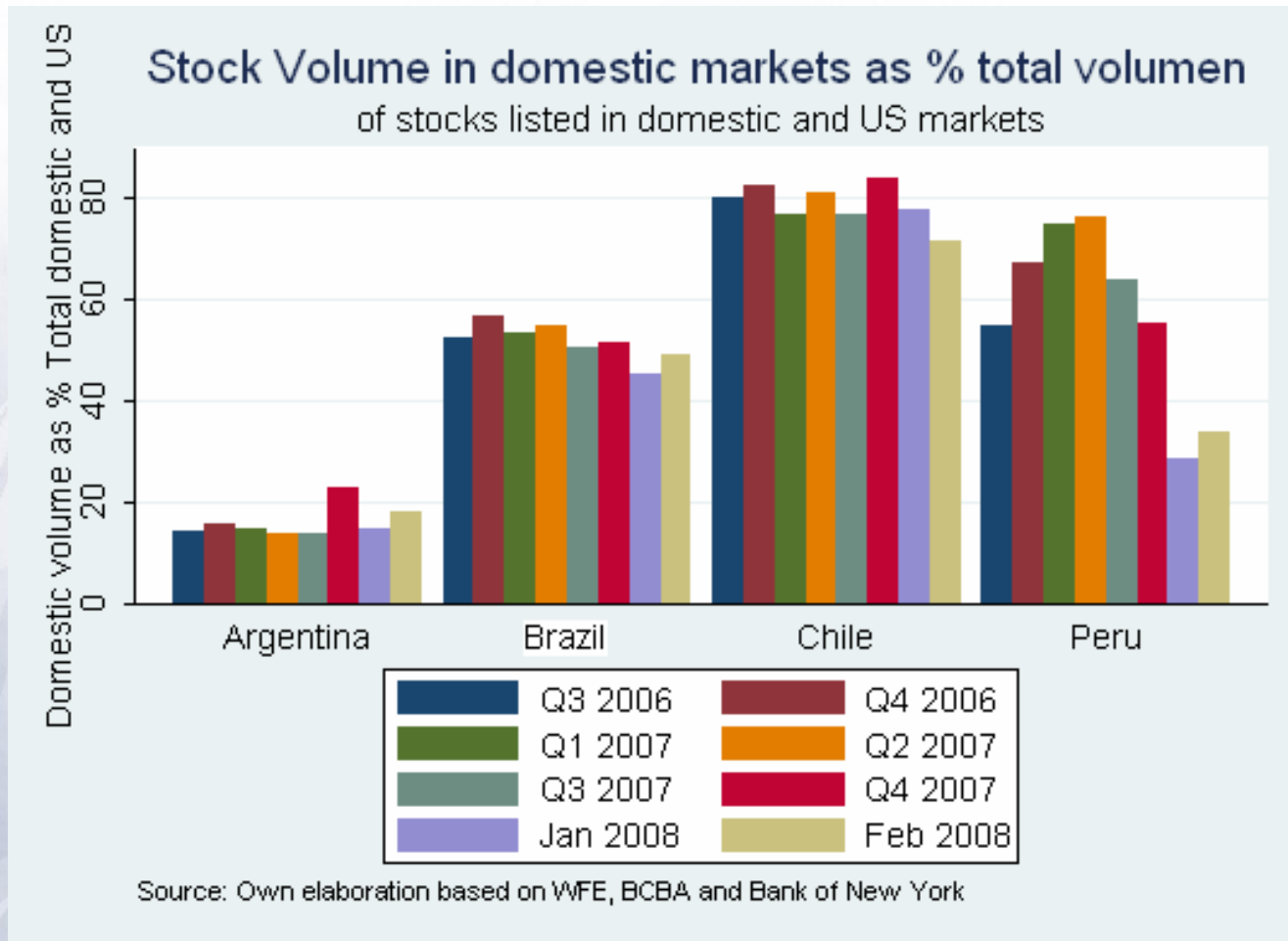
- Market liquidity (% GDP)





On Issuers (Annex)

- However, LatAm exhibits assymetries





On Regulations (Annex)

- **Regulators**
 - Independence and Resources: a key issue to strengthen, particularly in Argentina
 - Responsibilities and Accountability: very broad and limited to annual budget revision, with the exception of Brazil and Chile
 - Regulatory process formulation: Mexico exhibits a continuous revision process
- **Self-regulated organizations (SROs)**
 - In general, SROs are empowered to sanction market intermediaries
 - However, they were seldom exerted with the exception of Colombia (CG of the SROs)



On Regulations (Annex)

- **Enforcement**
 - Regulators have adequate investigative powers
 - Some restrictions arise due to applicable secrecy laws (Chile, Colombia, Peru)
- **Cooperation**
 - In some cases, it is restricted when exchanging information with other local regulators (Chile)
 - International cooperation has expanded (particularly in the 1990s) through bilateral and multilateral MOUs
- **Information disclosure**
 - Requirements are similar across countries