MARKETS

WINDS OF CHANGE IN CHILEAN CAPITAL MARKETS

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Chile has experienced substantial changes in its capital market system since the early 80s, with an increase in the number of market participants, product offerings and market depth in part due to the role played by the pension funds. Although Chile has one of the highest market capitalisation levels in Latin America, the overall market equity liquidity has remained relatively low given that the pension funds generally act as buy-hold investors and there is a predominant presence of conglomerates. Chile's capital market watchdog, the Securities and Insurance Superintendence (SVS), is a single-member governmental agency affiliated with the Ministry of Finance whose main responsibility is to enforce the securities laws and regulations by monitoring all activities and participants involved in the securities and insurance markets.

There are three active stock exchanges in Chile. The Santiago Stock Exchange is the main securities exchange, with a market capitalisation of over US$ 209 billion at the end of 2016, and 214 listed companies. Chilean stock exchanges operate as self-regulatory organisations. Their main exchange functions consist of establishing

and enforcing trading rules and regulations that govern and monitor their participants in order to prevent abuses.

Following the trends shown by developed economies, during the course of this year we have witnessed substantial legal changes that have been made with a view to strengthening Chilean capital markets. These reforms include the creation of the Financial Markets Commission (FMC), which will eventually replace the SVS, and the demutualisation of the Santiago Stock Exchange.

The Financial Market Commission

The SVS, led by a Superintendent, currently monitors over 7,000 entities. Although the SVS enjoys good prestige at a local and international level, Chilean lawmakers sought to improve the rulemaking procedure, and the agency's monitoring, due process and transparency standards.

In February, Law No. 21,000 was published (FMC Law), creating a multi-member body called the 'Financial Markets Commission', which is expected to replace the SVS within 18 months of the law's publication. This statute provides that the FMC will secure the proper functioning, development and stability of the Chilean capital markets by creating and enforcing rules that govern market participants, facilitate market participation, and improve the transparency standards.

The FMC will maintain all of the SVS's powers and will enjoy new attributions granted by the FMC law. The most noticeable features of this law are the following:
(i) The FMC will be managed by a committee comprised of 5 members (the Committee), who must have certain professional or academic recognition in the financial system, and who will serve for a 6-year term.

(ii) The FMC will have greater monitoring authorities and, subject to previous court approval, will be able to require banking information, even when subject to secrecy or confidentiality, gain access and enter private property, and intercept communications, as well as other powers.

(iii) While a prosecutor appointed by the Committee will be in charge of investigating violations to capital markets rules and regulations, the Committee will be in charge of imposing the sanctions for such violations. These sanctions include censorship, fines, and the termination of a corporation's existence.

(iv) There will be two types of proceedings before the Committee, general and summary proceedings. The former aims to review most cases brought before the Committee and the latter will review the cases that will be specified in a forthcoming general rule. Prosecutor and committee resolutions are subject to an appeal for reversal and a claim of illegality before the Court of Appeals of Santiago. If the Court of Appeals rejects the claim of illegality,

such judgment will be subject to an appeal before the Supreme Court.

(v) The statute includes a leniency program that rewards self-reporting and cooperation, where an offender can obtain a reduction of up to 100% of the applicable fine provided that the offense involves two or more participants and if such offender is the first person to come forward and voluntarily provide background information. The remaining offenders can only obtain up to a 30% reduction. If only one person is involved in the offense, he or she may obtain up to 80% reduction. The FMC also contemplates exceptions to criminal liability in certain cases.

(vi) In view of tighter corporate governance standards, market players are required to self-regulate by issuing their own rules and codes of conduct.

Demutualisation of the Santiago Stock Exchange

The Santiago Stock Exchange was formed in 1893 and as a floor-based exchange had limited space, so it only allowed a limited number of members. This meant that brokers had to be members of the exchange in order to be on the floor and trade.

Competition among local and international exchanges has been constantly increasing and the electronic communication network and technological advances in data processing have developed significantly. These factors have required stock exchanges to operate efficiently in a globalised market.

Following international trends, Chile's leading stock exchange, the Santiago Stock Exchange, finally demutualised on 12 June 2017. This converts a mutually owned organisation into a for-profit company owned by investors. This is expected to create a new competitive environment among brokers, increase the transparency and efficiency standards, and facilitate access for new market players. Although recently consummated, the stock exchange's demutualisation was approved at a shareholders' meeting held on 17 March 2016, where the shareholders also approved, among other things: (i) to establish a ownership threshold in which no person, individually or jointly with other related persons, may hold, directly or indirectly more that 25% of the company's capital stock; (ii) to include the concept of 'unrelated director' where at least 3 of the 11 board members of the stock exchange must be unrelated to the stock exchange, of which 1 director must be unrelated to companies listed on the stock exchange ; and (iii) new bylaws and internal regulation for the stock exchange.

Conclusion

With the FMC playing a crucial role in improving monitoring and transparency standards and the stock exchange's demutualisation leading to a more competitive market, we expect that these winds of change will boost Chilean capital markets over the short term.

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