

## CHILE

### SECURITIES

#### *SUMMARY*

Chile has three securities exchanges, with the Santiago-based Electronic Exchange (Bolsa Electrónica) and the Santiago Trading Exchange (Bolsa de Comercio) accounting for nearly all of the transactions. The exchanges trade equities, corporate debt, government debt, and Central Bank debt. Despite rapid growth in equity prices and an associated rise in new stock issues through the mid-1990s, the market remains relatively concentrated and illiquid. The bulk of trading is focused on the shares of only a few companies and daily trading volumes tend to be small. The number of Chilean companies offering shares on the New York Stock Exchange (NYSE) through American Depositary Receipts (ADRs) now totals 25, and much of the trading of shares of Chilean companies now takes place in New York.

There is no legal discrimination or restrictions against foreign securities firms wishing to operate in Chile's securities markets. However, foreign brokerage firms must establish Chilean subsidiaries. At the end of 1997, eight foreign firms, including several from the United States, participated as brokers through their Chilean subsidiaries. U.S. firms can manage pension funds and mutual funds as well as operate insurance companies in Chile.

The most important institutional investors in both the stock and the bond markets are Chile's rapidly growing private pension funds, which at the end of 1997 had US\$31 billion in assets (39 percent of GDP).

Direct purchases of Chilean equities by U.S. investors are permitted, but economically discouraged by requirements that foreign investors maintain their Chilean investments for at least one year and deposit some percentage of their capital in a non-interest-bearing account with the Central Bank. (The reserve requirement rate was reduced to zero in September 1998.) Foreign investors are also liable for Chilean capital gains taxes. Chilean institutions and individuals face a variety of limitations in undertaking investments in foreign securities.

U.S. firms have participated in underwriting Chilean offshore securities issues (bonds and ADR issues).

#### *DESCRIPTION OF THE MARKET*

Chile has three stock exchanges. The Bolsa de Comercio accounts for almost three-quarters of equities trading in the country and slightly more than 48 percent of total value of transactions. At the end of 1997, it was owned by 40 brokerage houses, including five subsidiaries of foreign firms.

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The Bolsa Electrónica, founded in 1989, is the largest exchange in terms of total value of transactions. At the end of 1997, this exchange had 18 brokers and traded the shares of some 324 companies with a total market share of 51 percent. The nation's oldest exchange, the Bolsa de Corredores, based in the port city of Valparaíso, handles less than one percent of total value of transactions.

Market Capitalization		
Bolsa de Comercio, Bolsa Electrónica, and Valparaíso		
Year	Chilean pesos	US\$ billions
1993	19,233,969	45.2
1994	27,349,445	69.0
1995	28,978,489	70.9
1996	27,981,726	66.2
1997	31,592,248	72.1

Source: Superintendency of Securities and Insurance

At the end of 1997, there were 53 full service brokerage houses. An additional nine securities dealers traded fixed-income debt instruments only. Affiliates of Chilean banks had a market share of almost 40 percent through nine securities brokers. About 34 percent of the market was being conducted by seven foreign securities firms; the largest single broker was an affiliate of a U.S. bank.

Securities houses can be either "corredores de bolsa" or "agentes de bolsa." The former must belong to a stock exchange, while the latter cannot trade on the exchanges.

The three exchanges trade primarily equities, corporate bonds, government debt, nominal and inflation-adjusted Central Bank debt, and mortgage debt issued by banks. Interest rates on Central Bank and corporate bonds with maturities of over 30 days are adjusted for consumer price inflation, but 30-day Central Bank paper is expressed in nominal interest rates. Despite past market specialization, both the Bolsa de Comercio and the Bolsa Electrónica handle stock activity, fixed-real-rate bonds, and short-term Central Bank paper. The Bolsa de Comercio runs a small futures market where futures on dollars and the blue-chip stock index are traded. New financial products must be approved by the Central Bank and/or the appropriate superintendency (of banks and financial institutions, or of securities and insurance). In addition, new products to be traded on securities exchanges must be approved by those exchanges.

Rapid economic growth over the past decade and rising investor confidence led to a dramatic increase in stock market activity in terms of volume, market capitalization, share value, and listed companies through the middle of the decade. Share prices increased substantially and new equity offerings far outpaced new issues of corporate bonds. Chile's return to international creditworthiness led several firms to sell bonds on international markets.

In 1996 and 1997, however, local stock exchange trading volume in equities was adversely affected by a general weakening of the Chilean peso vis-à-vis the U.S. dollar and a transfer of market activity to the NYSE. The fact that the most heavily traded Chilean shares are now offered as ADRs on the NYSE is a contributing factor to this development.

Chile's stock market still remains relatively concentrated and illiquid. Shares of the 10 most heavily traded companies on the Bolsa de Comercio, four of which were utility firms, accounted for some 35 percent of the market's capitalization at the end of 1997. Trading in those shares accounted for 60 percent of total 1997 trading volume. In December 1997, average daily trading activity on the Bolsa de Comercio was US\$28 million. The low rate of turnover makes prices highly volatile, especially when outside factors suddenly change a company's earnings prospects.

Foreign investment in Chilean shares contributed to the increase in share prices and to the increase in blue-chip stock price/earnings ratios through the mid-1990s. Most of the foreign share purchases have been targeted at the 25 Chilean firms whose shares are traded in the United States via ADRs. (The total number of ADRs traded on the NYSE is 26 as one Chilean firm, Andina, has issued two ADRs.) The shares traded via ADRs include many of the market's most important companies. There are also 26 foreign investment funds that purchase shares in a variety of Chilean companies.

### **Institutional Investors**

By far the largest institutional investors in Chile are Chile's private pension funds managed by Administradores de Fondos de Pension (also known as AFPs). The AFPs were created in 1981 when the government-run pension system was privatized. Most working adults switched to the private system, and all of those entering the labor force since that time have been required to contribute a fixed percentage of their wages to an AFP of their choice. As the economy has grown, and as new workers have entered the labor force, AFP assets have risen rapidly. At the end of 1997, AFP assets totaled about US\$31 billion. These funds are invested primarily in long-term bonds and the stock market.

Other institutional investors include insurance companies, mutual funds, and foreign investment capital funds. Insurance companies had assets of some US\$8.3 billion as of April 1998, invested primarily in long-term Central Bank bonds. At the end of 1997, mutual fund assets totaled US\$4.2 billion. Of the 92 mutual funds, 33 invest exclusively in securities and 59 in bonds. The number

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of investors participating in mutual funds virtually tripled from 1993 and stood at roughly 210,000 at the end of 1997.

The 26 foreign investment funds allow foreign buyers to invest in Chilean stocks other than through ADRs. (U.S. investors are not prohibited from purchasing Chilean stocks directly, but foreign capital invested in Chile must be kept in the country for a minimum of one year.) The funds are registered under Chile's foreign investment law, Decree Law 600. The foreign investment funds allow U.S. investors to purchase shares in the United States in funds that trade Chilean stocks in the Chilean market. The funds are not limited to U.S. investors. At the end of 1997, assets of foreign investment funds totaled just US\$1.4 billion; at the end of 1994, such assets stood at roughly US\$2.4 billion (indexed to December 1997).

### **Regulation**

Chile's securities markets are regulated by the Superintendency of Securities and Insurance (SVS). The SVS supervises corporations and other entities offering securities publicly, the stock exchanges, brokers, over-the-counter dealers, insurance companies, and mutual and investment funds. It requires quarterly reports and notification of any material facts by all entities offering securities. The Superintendency of Banks and Financial Institutions supervises domestic banks, including trading in their stock. AFPs are regulated by the Superintendency of Pension Fund Administrators. The legal basis for formation and administration of joint stock corporations is Law 18,046 of 1981. Capital markets reforms passed in early 1994 increased the variety of investment options available to the AFPs and tightened conflict-of-interest restrictions.

### ***U.S. PRESENCE IN THE MARKET***

U.S. firms, particularly affiliates of U.S. commercial banks, have a growing presence as stock and bond traders. As of December 1997, four U.S.-owned securities firms had nearly 38 percent of all stock broker assets in the combined market and several other U.S. firms owned partial stakes in, or were affiliated with, other brokers. Most of the U.S.-owned brokers are on the Bolsa Electrónica, and only two are on the Bolsa de Comercio. None are on the smaller Valparaíso-based Bolsa de Corredores.

Among the institutional investors, a number of pension fund management companies, insurance companies, and foreign investment fund management companies are owned by U.S. firms. Seven of the 92 mutual funds, representing some nine percent of the total value, are operated by Citicorp.

***TREATMENT OF U.S. FINANCIAL INSTITUTIONS***

U.S. brokerage firms can establish and operate in Chile according to the procedures of the foreign investment law, Decree Law 600, which is based on the principle of nondiscrimination. Nondiscriminatory treatment is also guaranteed in the Chilean constitution's Article 19. U.S. securities firms may be present in Chile, but only as subsidiaries.

There are no requirements concerning the employment of Chilean nationals or limits on the employment of foreign nationals. However, U.S. and other foreign securities firms wanting to trade stock on an exchange must purchase a seat.

There is no obstacle to a U.S. firm establishing an AFP, as long as the AFP is a Chilean corporation (100 percent foreign ownership is allowed) and is registered with the Chilean AFP superintendency.

Purchases of foreign securities by Chilean residents (banks, pension funds, mutual funds, and insurance firms) are limited according to regulations for each type of institution. The share of assets of pension funds that can be invested abroad in foreign securities was increased to 12 percent in 1997; most new equity purchases by the pension funds in fact have been in overseas markets. Individuals may buy foreign securities, but they are not guaranteed authorization to buy dollars at the official interbank exchange rate (Central Bank authorization is required for foreign currency purchases on the interbank market for operations abroad, although a blanket authorization for certain types of operations is possible). Chilean individuals and firms wishing to make equity investments abroad must register their investments with the Central Bank. Also, the Central Bank has placed limits that allow only relatively large and credit-worthy companies to issue stock in the United States via ADRs. Banks must have a minimum BBB- rating, and other companies a minimum BB rating, to be able to issue ADRs.

As for inward portfolio investment, government policies tend to discourage short-term portfolio investments in two ways. First, investors must keep their capital in Chile for a minimum of one year. Second, a set percentage of all foreign capital inflows (except supplier credits) must be placed in a non-interest-bearing reserve account with the Central Bank for one year. (This requirement may be waived when the capital finances capacity expansion or technological improvement.) In June 1998, the Central Bank lowered the reserve requirement rate from 30 to 10 percent. In September 1998, the rate was reduced to zero. As a general result of these policies, most U.S. investment in Chilean stocks is made either through ADRs traded on Wall Street or through U.S.-based foreign investment funds.

U.S. firms operating in the domestic market have not expressed concern over discriminatory treatment, although some have described the information requirements for beginning operations in Chile as onerous. Neither U.S. nor Chilean firms are typically invited to comment on proposed rule changes. While many foreign firms are satisfied that Chilean regulators take their viewpoints into

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account when considering rule changes, the degree to which this is true appears to be a function of how actively the particular industry association pursues its interests with the authorities.

One area in which current Chilean practice is more favorable than that bound in its GATS schedule concerns the two-year limit on repatriating capital. Current practice is to require that foreign-sourced capital remain in the country one year before repatriation.

In addition, Chile made no commitments in asset management in its GATS schedule. While foreign firms have been permitted to own AFPs and Chilean mutual fund management companies, Chile has made no GATS commitments to continue to permit them to do so.

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<b>Trading Volume in Chilean Markets</b> (billions of pesos indexed to December 1997)		
	1996	1997
Equities	3,822	3,221
Fixed Real Rate Instruments	35,687	38,409
Short-Term Nominal Instruments	50,227	61,350
Currency	5,629	9,110
Futures/Other	35	33
Total	95,401	112,125
(US\$ billions)	(231)	(267)

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Source: Superintendency of Securities and Insurance

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<b>Combined Exchange Activity</b> <b>Bolsa de Comercio and Bolsa Electrónica</b> (billions of pesos, indexed to December 1997)				
	1994	1995	1996	1997
Yearly Trading Volume	47,569	76,055	95,401	112,125
Market Capitalization	33,458	33,627	29,672	31,592
General Stock Index Increase	27.2	-2.2	-19.9	-7.8
Number of Firms Listed	335	323	326	330
Number of Brokerage Houses	75	67	62	53

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Source: Superintendency of Securities and Insurance, Bolsa de Comercio, and Bolsa Electrónica