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ARGENTINA

CAPITAL MARKET ASSESSMENT & DEVELOPMENT PROSPECTS

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Table of Contents

Table of Contents

Glossary **4**

Executive Summary **6**

Table of Recommendations 9

Introduction **11**

Part I. The State of Development of the Capital Markets **12**

Section I. The Supply Side 13

The markets for corporate financing 13

The markets for SME financing 14

The markets for infrastructure financing 16

The markets for housing finance 16

Risk Markets 16

Section II. The Demand Side 17

Section III. Market Infrastructure 18

Section IV. Intermediaries 18

Section V. Legal and Accounting Environment 19

Part II. Key Constraints for Capital Markets Development and Recommendations to Address Them **20**

Section I. Macroeconomic, Fiscal and Monetary Challenges 20

Section II. Structural Problems on the Demand Side 22

Section III. The Supply Side 25

Review of the public offering regime 25

Review of the framework for mutual funds (MF) 26

Section IV. The Supervisory Authority 27

Streamlining Procedures for Public Offering 28

Strengthening supervision 29

Developing a credible and effective enforcement function 31

Preconditions for the effective discharge of key functions 32

Section V. Market Infrastructure 34

Section VI. Securities Intermediaries 36
Part III. Corporate Markets 40
Section I. Lessons from Cross Country Experience 40
Section II. Recommendations for Argentina 41
Part IV. Use of Capital Markets for SME Financing 43
Section I. Key Lessons from Cross Country Experience 43
Section II. Recommendations for Argentina 44
Part V. Use of Capital Markets for Infrastructure Financing 47
Section I. Key Lessons from Cross Country Experience 47
Section II. Recommendations for Argentina 49
On the financing side 49
Other PPP issues 53
Annex 1. Risk Sharing Arrangements 54

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Glossary

ADR	American Depository Receipt
AE	Advanced Economy
AIFMD	Alternative Investment Fund Managers Directive (2011/61/EU)
AMF	Autorité des Marchés Financiers
ANSES	Administración Nacional de la Seguridad Social
ASIC	Australian Securities and Investment Commission
ATS	Alternative Trading System
AUM	Assets Under Management
BD	Broker Dealer
BIMA	*Bolsas y Mercados Argentinas*
CB	Central Bank
CCP	Central Clearing Counterparty
CG	Corporate Governance
CIS	Collective Investment Schemes
CML	Capital Markets Law
CNV	Comisión Nacional de Valores
CRD 4	Capital Requirements Directive 4
CSD	Central Securities Depository
CTA	Commodities Trading Advisers
DTCC	Depository Trust and Clear Corporation USA
EBA	European Banking Authority
ETF	Exchange Traded Fund
EME	Emerging Market Economy
FCM	Futures Commission Merchants
FGS	Fondo de Garantía de Sustentabilidad
FONPYME	Fondo Nacional de Garantías Recíprocas para la Pequeña y Mediana Empresa
FSB	Financial Stability Board
GDP	Gross Domestic Product
HKEx	Hong Kong Exchange
IB	Introducing Broker
IBRD	International Bank for Reconstruction and Development
IOSCO	International Organization of Securities Commissions
KYC	Know Your Client / Customer
LEBAC	Las Letras del Banco Central
MAE	Mercado Abierto Electrónico
MAV	Mercado Argentino de Valores
MDB	Multilateral Development Bank
MERVAL	Mercado de Valores de Buenos Aires
MF	Mutual Fund
MiFID	Markets in Financial Instruments Directive (2004/39/EC)
MoF	Ministerio de Hacienda y Finanzas Publicas (Ministry of Finance)
MSCI	Morgan Stanley Capital International
MSP	Major Swap Participants
NAFIN	Nacional Financiera, S.N.C.

NCR	Net Capital Rule
NFA	National Futures Association
OSC	Ontario Securities Commission
PPP	Public Private Partnership
PROCREAR	Programa Crédito Argentino
PyMe	Pequeña y Mediana empresa
RBS	Risk Based Supervision
REITS	Real Estate Investment Trusts
RFED	Retail Foreign Exchange Dealers
ROFEX	Rosario Futures Exchange
SD	Swap Dealer
SEPYME	Secretaría de PYMEs
SFC	Securities and Futures Commission of Hong Kong
SGR	Sociedades de Garantia Recíproca
SME	Small and Medium Enterprise
SPV	Special Purpose Vehicle/Entity
UCITS	Undertakings for Collective Investment in Transferable Securities
UIF	Unidad de Información Financiera
USA	United States of America
USD	United States Dollars
VaR	Value at Risk
WBG	World Bank Group
401 K	Tax-qualified, defined-contribution pension account, USA

Executive Summary

This report represents a high-level diagnostic of the capital market in Argentina, its potential for corporate, SME and infrastructure financing, and proposed actions to unlock such potential, as well as the respective roles of financial authorities and market participants. A detailed assessment of the government bond market was outside of the scope of the report. However its importance to support the development of the corporate bond market should be highlighted.

Addressing the macroeconomic situation and developing a robust investor base are the key long term challenges for Argentina to develop a resilient capital markets that could be a source of funding for strategic sectors, from corporates to infrastructure and SME financing. On the former, the authorities will need to continue implementing measures to bring down inflation to acceptable levels. In this context, it is key that the use of LEBACs to mop-up liquidity be temporary. Furthermore, consideration should be given to the use of alternative monetary mechanisms that could minimize negative effects on capital market instruments.

In addition, a thorough review of the overall tax framework for financial instruments is recommended. Such a review could lead to tax removals in some segments and potentially higher taxes in others; thus while elimination of the credit-debit tax may not be feasible; consideration should be given to applying it in a revenue neutral way that levels the playing field for capital market participants and potential new instruments, given the substantive distortions that it creates currently for the financial sector and its effects on the real economy. On the demand side, actions are needed to develop a robust institutional investor base to anchor the market. In particular, consideration should be given to the creation of a long term savings schemes, via a 401K and/or incentives for life insurance. In addition, the development of credit enhancements and other type of risk sharing mechanisms to foster investors' participation in strategic sectors is also needed. All this will require coordination among the financial authorities. Furthermore it is acknowledged that many of these measures might require time for their implementation.

In the meantime, there are a few actions that the authorities could take that could deliver "quick wins". On the demand side: (i) the FGS could be given a more active role as an anchor investor in the market through the reform of its investment regime, (ii) a series of reforms could be implemented to ease access and reduce entry barriers for foreign investors to the market, and (iii) ensure that there are suitable vehicles available for retail investors if "repatriated" assets are brought back. On the supply side: the authorities could consider (i) making available a space for private offers, (ii) reviewing the regime for mutual funds to ensure the existence of different types of vehicles for retail participation and long term investment in the market; and (iii) reviewing the procedures for the authorization of public offerings with a view to make additional improvements to it.

Overall, as macroeconomic conditions improve and the actions identified above are implemented, the markets for corporate funding (equity and debt) should expand. There are currently few significant regulatory or infrastructure obstacles for the issuance of corporate equity and debt. The key obstacle is the limited ability of the domestic investor base to absorb large issuances. As well, a comprehensive review of the corporate governance framework is recommended on the equity side. Measures to enhance liquidity for both equity and debt instruments should also be part of a long term strategy for corporate financing. It would be beneficial for the MoF and CNV to consult the domestic and international investor community to find what instrument risks and protections are of priority from a risk/return and regulatory perspective.

The small and medium enterprise (SME) financing market, in contrast, requires significant changes. To a large extent, the current system works due to legacy legislation that directs insurance companies to invest in SME instruments via MFs; thus the yield of such investments, while positive in nominal terms, is below market rates (i.e. provides an implicit subsidy for SMEs). In the long run, as inflation and interest rates decrease, an SME asset class that can be sold on market based terms needs to be developed. The *Mercado Argentino de Valores* (MAV) could have a key role in defining a strategy for the development of the SME asset class, based on an assessment of different instruments and their potential for SME financing including instruments linked to factoring, private offers and alternative markets. The authorities are encouraged to conduct a holistic review of SME access to finance. This would include the causes of the level of informality, and the impact of current guarantee schemes with a view to maximizing their potential for purposes of developing capital market instruments with underlying SME assets or debt.

Structural issues would need to be addressed for the capital markets to play a role in infrastructure financing. On the public private partnerships (PPP) side, the government needs to work on the implementation of the new PPP law, the development of the accompanying regulations, and appropriate standards for the PPP Units, along with the identification of a pipeline of bankable projects. On the financing side, where infrastructure projects have USD earnings, a dollar market (onshore and offshore) is likely to develop. However, financing for peso earning projects is an open question. Solutions to address currency risk do not seem available in the short term due to the high levels of inflation and interest rates. In the medium term the development of inflation linked instruments might be an option – but this is not without risks and needs a calibrated application once interest rates have been brought down.

There are other structural issues that could affect the long term development of the capital markets: ensuring that the Comisión Nacional de Valores (CNV) becomes a credible and effective supervisor should be a key objective, particularly as the market grows in size and complexity. Steps have already been taken in this direction, with the appointment of a new board, which has embarked on a wholesale review of the organization. In addition to changes in the authorization regime highlighted earlier, there is a need to continue working on (i) improving supervision, through the implementation of risk-based supervision at the micro level and the development of a process for the identification of risks at the market wide level, and (ii) developing and implementing a credible and effective enforcement strategy. In the meantime, the framework for independence and accountability will need to be strengthened. It is important that the CNV adequately communicates to the market the changes that it is implementing.

In addition, the CNV has strategic decisions to make concerning competition in financial market infrastructure. Initially, the move of the existing exchanges towards a consolidated model but under a principle of specialization, seems a rational approach that could deliver positive outcomes to the country, provided that contestability remains. Such contestability would be tested by the expansion of the *Mercado Abierto Electrónico* (MAE) into other types of markets and products. It is critical that a credible futures markets be developed (either by *Bolsas y Mercados Argentinos* – BIMA, or MAE). On clearing and settlement services, given the size of the market, a collective industry solution might be desirable, whereby both the central securities depository (CSD) and a potential central clearing counterparty (CCP) would be structured as "public utilities" to service different trading venues. In any event, the authorities are encouraged to conduct a process of consultation with the market about the degree of competition in market infrastructure and the potential effects of different business models on market efficiency, integrity and reliability.

Strategic decisions are also required in connection with securities intermediaries; where a review of the licensing regime is warranted. Overall some level of consolidation might be desirable, but under a regulatory framework that ensures sufficient flexibility to accommodate different types of intermediaries, from dealers to introducing brokers, placement agents, and advisers. The latter three categories would be particularly important to ensure further penetration of capital market instruments to the retail population across the country. In this context, an integrated licensing regime that follows a "cascade" system based on the definition of regulated activities seems suitable. An intermediary could apply for a license encompassing all, or just some, activities - provided that it complies with the capital requirement for the "riskiest" activity along with any qualification requirement applicable to the activities for which authorization is being requested. A process of consultation with capital market private intermediaries should also be conducted to ensure proper calibration of the licensing regime.

Table 1. Table of Recommendations				
Action	**Key Entity**	**Priority**	**Impact**	**Complexity**
General				
Conduct a review of the tax regime, and in particular the credit-debit tax	MoF	Medium Term	High	High
Demand side				
Determine vehicles for long term investment under repatriation provisions and ensure regulations are in place	MoF, CNV	Short Term	High	Medium
Conduct a holistic review of barriers to entry for foreign investors (including opening of accounts, KYC, any remaining capital controls, and market infrastructure issues such as the existence of omnibus accounts)	MoF, CNV, IRS	Short Term	High	Low
Assess the implementation of a 401 K retirement structure and as part of such assessment consider the increase of fiscal benefits for life insurance	MoF	Long Term	High	Medium
Reassess the role and investment regime of FGS so it may act as a more flexible institutional investor to spur the market to generate instruments	MoF	Short Term	High	Low
Keep track of actions required to move towards MSCI emerging market status	MoF, CNV	Short Term	High	High
Supply side				
Review the regime for public offering mainly with the objective of implementing a private offering regime	CNV	Short term	High	Medium
Review the framework for MFs mainly to (i) create distinct categories of MFs for public and private offerings, (ii) align regulations with risk by creating a typology of funds and eliminate distortions that prevent the creation and financial viability of closed-end funds	CNV	Short Term	High	Low
Develop an issuance schedule of government bonds of varying maturities to set a yield curve	MoF	Medium Term	High	Medium
Corporate markets				
Develop a comprehensive strategy for corporate governance	CNV	Medium Term	Medium	Medium
Develop a long term plan to enhance liquidity (including FGS rebalancing, ETFs, etc.)	CNV	Medium-Long Term	Medium/ High	High
Other: review the tender offer regime and article 20 of the CML	MoF, CNV	Short Term	Medium	Low
SME financing				
Conduct a review of (i) barriers to SME access to finance, and (ii) guarantee schemes	MoF	Medium Term	High	High
Develop a comprehensive strategy for use of capital markets, including development of (i) capital market vehicles linked to "true" factoring, (ii) private placements, and (iii) alternative markets	CNV	Medium to Long Term	Medium	High

Infrastructure financing				
Develop a comprehensive strategy integrating government, banking and capital market financing solutions	MoF, CNV	Medium Term	High	Medium
Develop a credible inflation index for the infrastructure bond market as well as general capital markets and the mortgage sector	MoF	Short Term	High	Medium
Develop suitable credit risk and contractual risk guarantee mechanisms	MoF, CNV	Medium Term	High	High
Develop institutions to adequately fund and offer guarantee instruments	MoF, CNV	Medium Term	Medium	High
Set out clear and detailed rules on public/private project risk sharing	MoF	Short Term	Medium	Medium
Develop a currency swap facility	CB	Medium	High	Medium
Institutional (CNV)				
Continue enhancing independence mainly by (i) allocating responsibilities between the Board and functional departments, (ii) securing stable funding, (iii) ensuring adequate legal protection for CNV Board and staff	CNV	Short Term	Medium	Medium
Improve authorization function mainly by (i) reviewing the shelf registration regime and (ii) tracking and publishing statistics as a key mechanism for accountability	CNV	Short Term	High	Medium
Improve supervision by (i) adopting a RBS approach and (ii) developing a process to identify risks at market wide level	CNV	Medium Term	Medium	High
Develop and implement a credible and effective enforcement strategy	CNV	Medium Term	High	Medium
Ensure that preconditions are in place including (i) ability to recruit qualified staff, (ii) recruitment of staff with different profiles, (iii) enhancing automation, and (iv) reviewing the organizational chart	CNV	Short Term	Medium	High
Market infrastructure				
Conduct a consultation on the level of competition for post-trading services	CNV	Medium term	Medium	Medium
Securities intermediaries				
Develop an integrated graduated licensing regime based on the definition of authorized activities	CNV	Medium term	Medium	Medium

Introduction

This report represents a high-level diagnostic of the capital market in Argentina, its potential for corporate, SME and infrastructure financing, and proposed actions to unlock such potential. An assessment of the government bond markets was outside of the scope of the report. However its importance to support the development of the corporate bond market should be highlighted.

The report's findings are based on discussions and information from key representatives of the public sector and a cross section of market participants and other stakeholders. These included representatives from the *Ministerio de Finanzas* (MoF), the *Comisión Nacional de Valores* (CNV), the Central Bank (CB), and the *Unidad de Información Financiera* (UIF). It also met with representatives from the *Mercado de Valores de Buenos Aires* (MERVAL), the *Mercado Argentino de Valores* (MAV) the *Mercado Abierto Electrónico* (MAE), a sample of brokerage houses, banks and fiduciary entities, the *Fondo de Garantía de Sustentabilidad* (FGS - ANSES), an insurance company, a credit rating agency, a sample of law firms, and a tax firm.

The report is organized as follows:

- Part One provides a description of the state of development of the market, in particular the supply and demand side.
- Part Two provides an assessment of critical factors that have an impact on capital market development along with recommendations to address them.
- Parts Three, Four and Five provide a focused analysis of the use of capital markets for corporate, SME and infrastructure financing.

Part I. The State of Development of the Capital Markets

Argentina's private capital markets are small compared to peers. Market capitalization stood at about 11 percent of GDP compared to between 35 to 39 percent for Brazil, Colombia and Mexico and 90 percent for Chile by 2015. The chart below also shows prior historical period data for comparator countries.

Table 2. Stock Market Capitalization as percent of GDP

	2005	2006	2007	2008	2009	2010	2011	2012
Argentina	27.6	30.3	26.3	12.9	12.9	13.8	7.8	5.6
Selected Peers								
Brazil	53.2	64.2	98.2	34.8	70.1	70.0	47.0	51.0
Chile	109.7	112.9	123.0	73.7	121.8	157.0	107.8	118.1
Colombia	31.4	34.6	49.2	35.7	57.0	72.6	60.0	70.9
Malaysia	126.3	144.7	168.3	81.0	126.5	165.8	136.6	156.2
Mexico	27.6	36.0	38.1	21.1	38.1	43.2	34.9	44.2
Peru	48.0	67.9	103.7	45.8	57.6	67.2	46.5	50.3
Poland	30.8	43.4	48.4	17.0	31.0	39.9	26.4	35.8
South Africa	219.3	263.2	278.4	171.3	238.2	169.3	125.5	154.1
Turkey	33.4	30.6	44.3	16.1	36.7	41.9	26.0	39.1

Private bond markets exhibit relatively higher level of development; however only short-term financing is available mainly as a result of high inflation and interest rates. As well, in terms of comparator economies, the bond market remains below potential and levels achieved a decade ago.

Table 3. Total Bond Issuance Volume as percent of GDP

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Argentina	16.9	1.7	1.4	0.8	0.7	0.9	0.6	0.6	0.8	0.4
Selected Peers										
Brazil	4.1	4.2	2.7	1.9	2.0	2.5	2.4	3.9	2.7	2.5
Chile	3.4	2.0	1.6	1.9	3.7	3.9	3.8	5.0	5.6	7.1
Colombia	1.8	2.1	2.5	1.5	4.5	1.2	2.5	3.2	3.7	3.4
Malaysia	10.5	15.0	14.5	8.9	17.9	11.8	12.2	11.5	9.2	8.3
Mexico	2.6	1.9	2.2	1.6	3.1	4.7	3.2	3.9	4.5	4.6
Peru	3.0	1.6	5.3	0.5	3.1	4.6	1.5	3.3	3.1	4.5
Poland	11.2	6.9	5.6	3.5	8.2	8.9	5.2	8.6	7.2	6.7
South Africa	1.3	2.9	2.5	0.9	1.7	2.0	1.9	2.2	2.6	1.0
Turkey	5.5	2.5	2.5	1.4	4.3	9.2	6.4	8.7	9.8	8.9

On the demand side, the institutional investor base is small: the FGS a state fund created as a result of the nationalization of the private pension system is the main institutional investor with assets

under management of US$50 billion. Assets in mutual funds (MFs) and the insurance industry represent roughly 3 percent of GDP each. Direct retail investment is very limited, and foreign investment participation is almost non-existent.

The market has been served by regional exchanges, currently under a process of consolidation, and an over the counter electronic market for debt securities organized by the banks. The number of securities intermediaries has significantly increased since the demutualization of the exchanges and currently stands at about 346. The legal framework for the securities markets is robust, though specific issues need to be addressed. All these issues will be further detailed below.

Section I. The Supply Side

The markets for corporate financing

The corporate bond and equity markets remain small at around 13 percent of GDP currently. Corporate bonds are currently the most frequently used instrument, with USD 4.4 billion of issuance in 2015. Fixed income instrument maturities go up to three years but most are very short term. The government bond market has been limited and to-date focused on short and medium term dollar based instruments given the high peso rates. The larger, better quality companies typically tap international debt markets. This is driven predominantly by high inflation and Peso interest rates, and the local investor base not being large enough to absorb the funding and capital raising requirements of large corporates. Medium size companies get funding from the banking sector, but this funding is also short term.

As of end 2015, there were 207 companies with debt issuances in the market, for an outstanding amount of USD 30.6 billion. Out of these 155 were non-financial companies (with USD 14 billion in outstanding issues), while 52 were banks (with USD 2.9 billion in outstanding issues). The remaining issuances of USD 16 billion are considered as SME issuances. Issuances are in pesos or dollars, depending on investor demand and the company's activity. Issuances in pesos are referenced to Badlar, which is a benchmark rate constructed to reflect banks' wholesale funding rates, although currently it does not seem to be reflective of average bank funding rates as it excludes a significant retail component as well as short term funding (including current accounts) under 30 days. Overall the level of leverage in the corporate sector stands at reasonable levels, with corporates' gross debt to equity ratio at 40 percent. Interest payments are estimated to be around 35 percent.

Debt issuances via trusts and securitizations have been used by a small group of corporates, and the framework is tested and trusted. Securitization issues amounted to USD 2.3 billion as of December 2015. They have mainly been used by a few corporates (mostly retail stores) and banks to finance consumer credit. Thus, most of them are backed by receivables and consumer loans. Most issuances have been short term and dollar denominated.

Private bond markets are highly illiquid. In fact the bulk of trading volumes correspond to the trading of government paper (see Table 2 below).

Table 4. Trading Volumes in MERVAL and MAE

Amounts Transacted in the Stock Market and Electronic Exchange	Annual transacted amounts (US$ mn.)		
	2014	2015	To March 31 2016
Mercado de Valores de Buenos Aires (MERVAL - Securities Exchange)	**66,049**	**62,907**	**16,903**
Government/Public Sector Securities	58,075	55,648	15,512
Private Sector Securities			
Equities	4,849	5,144	911
Negotiable Instruments and financial trust /spv instruments	4,849	1,862	382
Mutual Funds	…	…	
CEDEAR (foreign firm depositary certificates traded in Argentina)	**302**	**252**	**98**
CEVA (Argentine form of ETF type share)	…	…	
Mercado Abierto Electrónico (MAE - open electronic market)	**124,655**	**135,831**	**38,578**
Government/Public Sector Securities	121,723	133,141	38,016
Private Sector Securities			
Negotiable Instruments (fixed income)	2,536	2,365	513
Other private securities (1)	396	325	49

(1) Primarily financial trust (SPV) instruments

Note: Following the effectiveness of Law Nº 26.831 of 2014, reference to the Stock/Commerce Exchange (Bolsa de Comercio) of Buenos Aires has been changed to refer to the Securities Market (Mercado de Valores) of Buenos Aires (MERVAL).

In the Mercado Abierto Electrónico (MAE - open electronic market) only public or private debt securities are traded.

Source: Ministry of Finance, Securities Commision, based on IAMC and MAE data.

As of end 2015, there were 101 listed companies on the equity market. The market is relatively diversified, however, with the majority of companies being non-financial, which differs from the situation in most other emerging markets. Of the 101 companies listed, 89 are non-financial companies (with a USD 61 billion market capitalization for domestic companies), and the remaining 12 are banks (with USD 17 billion equivalent of market capitalization for domestic companies). Total market capitalization of listed domestic companies at the end of 2015 was USD 60 billion, which amounts to 11 percent of GDP. Free float remains low (at about 24 percent for non-financial companies and 7 percent for banks). Large companies have raised equity capital mainly on overseas markets using ADRs, rather than issuing domestically, and the bulk of issuances are dual listings (about 80 percent). A small tranche is listed domestically, while the larger tranche is listed in the USA.

This has concentrated liquidity in the foreign markets. As of end 2015, the equity market turnover ratio was 4.8 percent.

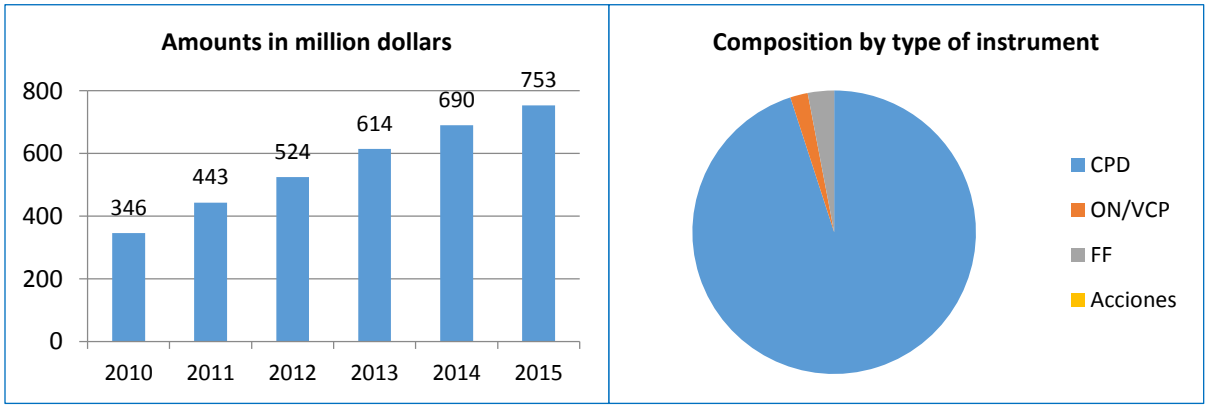
The markets for SME financing

Bank financing has been the major source of external financing for SMEs. Although an overall assessment of SME financing was not conducted; however as per discussions held, it is understood that

the majority of the external financing to SMEs takes place via bank credit.[1] Further it is understood that CB regulations require banks to allocate a specified percentage of their deposits to providing loans to SMEs at a specified rate, currently at 22 percent (known as "*línea productiva*"). However, the penetration of banking credit is low compared to the number of SMEs, which is estimated at about 600,000.

Capital markets play a role in SME financing, mainly as a result of a compulsory investment regime for insurance companies as they are currently required by law to invest 3 percent of assets under management (AUM) in SME assets via MFs –commonly known as "*inciso k*" in the law**.** In practice this financing has been done via the issuance of non-traditional short term instruments by the SMEs (post-dated checks or promissory notes which have performed a role similar to factoring); and occasionally market instruments or "*obligaciones negociables*" that are issued up to 3 years in pesos. These instruments are in turn bought by the MFs, usually at yields below market rates given the need for insurance companies to meet the required investment allocation, and a shortage of these instruments. For 2014, financing via *inciso k* amounted to USD 690 million, and as of October 2015 to USD 753 million.

Charts 1 and 2. SME Financing Via Inciso k: Amounts and Composition



Source: Instituto Argentino de Mercado de Capitales (IAMC)- October 2015[2]

The *sociedades de garantía recíproca* (SGRs) play an important role in SME financing, by providing full credit guarantees to both banking and capital market products. SGRs are credit guarantee entities regulated by the *Secretaría de PYMEs (SEPYME*) and by the CB, the latter if they wish to be granted the "status" of *garantía preferida A*.[3] There are currently about 30 SGRs, and only seven with *garantía preferida A* status, with *Garantizar* SGR having 60 percent market share.[4] Shareholding

[1] For example, in 2014, SMEs in the industrial sector got 63 percent of their financing from own funds, 27 percent from bank financing, 3 percent from suppliers and 4 percent from capital markets. Source: *Inversiones y acceso al financiamiento de las PyMe industriales. Fundación Observatorio PYME.*

[2] CDP refers to "cheques de pago diferido"; ON to" obligaciones negociables"; VCP to "valores de corto plazo" and FFs to "fideicomisos financieros".

[3] As per CB regulations banks only need to provision one percent for loans with a preferred guarantee A (garantía preferida A). In addition they are not required to conduct their own diligence of the loans. Market participants indicated that many banks opt for a streamlined credit analysis.

[4] *Garantizar's* commission schedule is similar to a hedge fund: it charges banks a 2.5 percent fee to invest in the fund and a success fee of an average of 15 percent.

structure varies, from *Garantizar* which has a mixed ownership of SMEs and banks to other SGRs which are closely linked to a specific leading industry (mainly agribusiness). Irrespective of shareholding structure, there are incentives for banks to provide funding to SGRs.[5] Pursuant to CB regulations SGRs must keep a ratio of funding to loans of 4 to 1. Guarantees can be given to a variety of instruments from loans to post-dated checks and even SME bond issuances. In the case of *Garantizar*, the allocation of guarantees is as follows: 80 percent for bank loans, 13 percent for post-dated checks and the remainder for commercial guarantees. As per current regulations, all credit guarantees must be backed with collateral, which can range from a personal promissory note to real estate depending on the amount to be guaranteed.

The markets for infrastructure financing

There has been limited financing of infrastructure via capital markets. There are a few infrastructure related companies listed on the equity markets. In addition, a few companies, mainly from the energy sector have issued corporate bonds. In general such issuances have been short term (up to 3 years) and in dollars. Overall yields of issuances have historically been below market rates, due to the existence of a compulsory investment regime that required insurance companies to invest in infrastructure assets via MFs that specialize in infrastructure firms (similar to the regime in existence for SMEs). However, with the recent removal of this mandatory allocation, infrastructure investments by insurance companies ceased and infrastructure investments now need to compete for yield on market terms.

The markets for housing financing

The market for housing financing is almost non-existent. Long term mortgage loans have not developed, primarily due to the high interest rate environment and lack of reliable inflation data. Thus the mortgage bond market has not developed. Some mortgage certificates have been used to securitize portfolios but not as long term assets. The current creation of an inflation index to be used by the mortgage sector may spur a longer term market, however this is likely only after inflation declines. Long term finance is set to be expanded as the agency for housing, PROCREAR, is planning on financing 25,000 housing units in a first phase. While some of this financing will be subsidized, a significant portion will require the use of market priced bank loans.

Risk markets

Risk markets are underdeveloped. Currency forwards and futures are mainly short term due to the high cost of longer term contracts given wide inflation and interest rate differentials (e.g. between peso and dollar). Recent transactions on the currency futures market ROFEX, on which the CB under the previous government was primarily on one side, along with the potential liabilities arising from pending suits resulting from these transactions, have badly damaged the credibility and reputation of the exchange. For equity derivatives, single stock equity contracts exist, however as there is no operational securities lending and borrowing market, and short selling is not permitted, they are one way, i.e. hedging products are not offered. Commodities futures are listed over agricultural commodities such as grains.

[5] Funding provided to a SGR is 100 percent deductible from banks' income tax.

Section II. The Demand Side

Argentina lacks a sufficiently domestic institutional investor base, which significantly impacts capital raising activities and the liquidity of the domestic market. Overall the number of accounts across the various exchanges has reduced significantly over the last decade from 600,000 to 200,000.

The most important institutional investor is the *Fondo de Garantía de Sustentabilidad* (FGS), a part of the social security agency ANSES, which is a state fund of approximately USD 50 billion. This fund was created as a result of the 2008 nationalization of the private pension funds. The investment regime allows ANSES to invest up to 100 percent of the FGS portfolio in assets with real guarantees, up to 50 percent in government securities, and up to 20 percent in infrastructure. The FGS portfolio is currently invested as follows: 12 percent equity (of which 80 percent is in 9 equities in which FGS has a significant stake), 68 percent public sector bonds, 10 percent infrastructure projects, and a small portion in local MFs (equity and debt). ANSES currently faces a number of restrictions with respect to market activity, the most significant of which is a prohibition on share and corporate bond trading (FGS cannot sell equity, including for the purpose of rebalancing their portfolio).

Insurance companies are small, with assets under management of approximately 3 percent of GDP across all insurance activities, of which life and annuity activity is at an incipient stage at 0.7 percent of GDP. Insurance companies invest in both domestic USD and Peso denominated instruments in order to match the denomination of their product offering. Insurance companies have in the recent past faced a regime of directed investment. Previously they were required to invest 15 percent of assets in infrastructure or SMEs, but in January, 2016 this was changed and they now have a requirement to direct 3 percent of AUM to SME investments that meet specific requirements. Directed lending is creating distortions in the yields of SME instruments that cause them periodically to be substantially below market rates, specifically in MF products that meet the directed lending criteria.

MFs are small, at roughly 3 percent of GDP. As of December 2015 there were 345 MFs. All except one were open-ended funds. MFs are typically short term, and predominantly invested in instruments that meet the criteria for insurance company investment, due to legislation that requires insurance companies to invest through MFs, and also because MFs funds are exempt from the credit-debit tax. The majority of MFs are fixed income funds (60-70 percent of the MF industry, both money market and transactional funds).

Retail investors do not invest in the stock or non-government bond markets, either as long-term investors in securities, or as active traders. There is some retail participation in MFs, although this is not significant. Retail investors prefer USD denominated investments due to inflation and confidence concerns. There seem to be sizeable holdings of retail assets in two categories, neither of which are in the formal domestic financial sector, and do not benefit the development of local capital markets: (i) there is an estimated USD 1-3 billion in safety deposit boxes with domestic banks, and (ii) between USD 3-5 billion in holdings and investments abroad. There is potential for the growth of the domestic retail investor base through repatriation of foreign assets. There is also a significant level of retail participation in Peso denominated LEBACs, (CB issued short term paper) as these instruments provide returns close to

that of inflation. Investors participate in LEBACs through online banking platforms. This is currently crowding out investments in other instruments.

Foreign investors are noticeably missing from the domestic capital markets for a number of reasons, the key being ongoing concerns about the macroeconomic situation and an uncertain policy environment. This applies to equity as well as fixed income, and also non-listed direct investment. However, there are a large number of procedural and regulatory barriers that will continue to be a deterrent for foreign investors, even were the macroeconomic and policy environment to improve. Such barriers include onerous account opening, know your client (KYC), and tax registration procedures and requirements. An example is that if a foreigner wants to open an account in a local bank, it needs a local representative to sign the account opening papers, and cannot do so remotely. However, it is understood that KYC requirements are currently being reviewed with the objective of rationalizing them; including by allowing reliance on the due diligence performed by foreign regulated entities. In addition, it is understood that some capital controls remain, in particular a minimum investment period of 120 days for foreign investments.

Section III. Market Infrastructure

Several regional exchanges where only brokers can have a seat provide trading platforms; however a plan has been submitted for their consolidation into one single market, the BIMA. BIMA will work under the principles of federalization, specialization and interoperability. In practice this means that the different exchanges will not be competing for the same products, rather they will specialize but under a model of interoperability that would potentially allow members to trade in all markets. In this context MERVAL would become the main market, while MAV would become a junior market specialized in SMEs. ROFEX is not currently part of the consolidation plan, due to the potential liabilities that it faces as a result of legal suits regarding currency futures contracts.

A "specialized" market, organized by the banks, the MAE has coexisted with the regional exchanges; and it has now plans to become a full blown market. MAE has mainly functioned as an electronic over the counter money market, settling bilaterally. However, its plans now are to openly compete with BIMA across all asset classes and products. In this regard, it has recently requested approval to expand its license to currency futures.

As per the plans of these two groups, two CCPs could potentially be created. Currently *Banco de Valores* acts as settlement bank for the securities exchange markets. However, both groups have plans to set up CCPs. The mission understands that *Caja de Valores*, the CSD, will continue to serve both markets.

Section IV. Intermediaries

There are currently 366 entities authorized to provide securities intermediary services in Argentina. Of these 323 are "pure" securities intermediaries whose activities range from advice only to

intermediation in the exchanges while 43 are banks.[6] The number of securities intermediaries increased significantly with the demutualization of the exchanges, which was brought about by the Capital Markets Law (CML) approved in 2012.

Trustees have played a key role in the securities market in Argentina as trusts are the preferred SPVs for securitization. Trustees are under the regulation and supervision of the CNV, and also of the CB when the underlying assets are loans. The market is relatively concentrated, with *Banco de Valores* holding about 60 percent of market share.

Section V. Legal and Accounting Environment

Overall the legal framework for the securities market is in place; although a few specific issues need to be reviewed. A capital markets law (CML) was approved in 2012. In general it is perceived to be a modern law that facilitates (i) the issuance of many different instruments, (ii) the organization of different markets under principles that foster their integration, and (iii) competition among intermediaries. That said, there are operational issues that could potentially affect market development going forward, such as: article 20 of the CML that allows the CNV to intervene and appoint directors in listed companies; the lack of a sufficiently defined space for private offerings; and the framework for tender offers, as will be further explained in the next section. There is a separate MF law. In general, this law is considered restrictive as it regulates only funds to be offered to retail investors. These issues will also be further explained in the next section.

The majority of the preconditions for capital market development appear to be in place; however confidence in the judiciary is an issue. An in-depth review of the legal framework was not conducted, however, market participants mentioned the existence of (i) a robust legal framework for trusts which has allowed the development of securitization structures, (ii) a sound framework for corporate insolvency which allows for out of court restructuring, although specific issues need to be addressed in particular the recognition of close out netting for purpose of further development of the derivatives markets (iii) a legal framework for secured transactions, (iv) a legal framework for factoring, and the recognition of electronic invoices, although specific issues need to be addressed for further development of the factoring industry and related capital market instruments, in particular the legal status of invoices and the requirements for their transfer, and (v) robust accounting and auditing practices based on the implementation of IFRS and AIS complemented with a cadre of expert professionals. However, reforms implemented over the last decade eliminated the commercial courts and currently all suits need to be brought to the federal tribunals, which are considered not to have sufficient expertise to deal with financial issues. More generally, foreign participants lack trust in the judiciary. The implications of the latter will be further discussed in the section on infrastructure financing.

[6] Participants observed that the difference in tax treatment of securities accounts versus bank accounts have given an advantage to brokers over banks (related to the credit-debit tax).

Part II. Key Constraints for Capital Markets Development and Recommendations to Address Them

Similar to other countries, the level of development of the Argentinian markets is the result of a complex set of issues. Overall macroeconomic, fiscal and monetary policies are the main factors explaining the current level of development, and in the wake of past government policy shifts that had a significant impact on market participants' confidence in the markets, stabilization of macro indicators is key. Over time, as the macroeconomic environment improves and a careful balance between fiscal needs and financial sector growth is achieved, the markets should grow. In such a scenario, the key long term challenge for Argentina would be the development of a strong domestic institutional investor base to anchor the market, to be complemented with active foreign participation. This requires the implementation of a set of actions; many of which will bear fruits in the long run. However, a few actions have been identified that could deliver "quick wins" to the authorities. All these issues are discussed below.

Section I. Macroeconomic, Fiscal and Monetary Challenges

Macroeconomic, fiscal and monetary policies have had, and will continue to have, a major impact on the capital markets in Argentina, in particular limiting the growth potential of long term funding instruments. Macroeconomic conditions and developments, in particular the high inflation and high nominal interest rates, explain to a large extent:

- the limited ability of the government to issue domestic currency treasury securities that could help form a yield curve;
- the absence of long term finance for corporates, SMEs, housing, and infrastructure;
- the preference for issuance of securities in dollars, and the appetite of investors for dollars as the only viable instrument for long term saving;
- the limited participation of companies and assets in the financial system, given the effects of the credit-debit transaction tax; and
- the flight of capital and a tendency not to place savings in the formal banking system (this last factor is also largely driven by confidence issues).

The new Government has taken, and is continuing to take, actions that will promote further confidence in the markets. By allowing the currency to float, and solving the impasse with the holdout creditors, Argentina was able to regain access to the international debt markets via the issuance of government bonds. These have been critical measures to restore confidence. Furthermore, the

oversubscription of the bonds reflects a vote of confidence in the new government's economic and market policies. Legislative initiatives including the recently approved *Ley de Blanqueo de Capitales*, a reform to the Capital Markets and MF laws, and a new PPP law, all support the expansion of opportunities and investment in the capital markets.

However, bringing inflation to acceptable levels remains key for the development of capital markets and long term finance. Central Bank measures to tackle inflation through the mopping up of liquidity via the issuance of short term, high yielding monetary instruments (LEBACs), at rates of around 35 percent, are temporarily crowding out private sector capital markets. It is expected that inflation will be brought down to levels of about 20 percent by 2017; but reaching single digit inflation is seen as a medium term goal that could take more time (some estimate at least 5 years). In this context, actions are needed along with coordination between the MoF and the Central Bank to assess what instruments could best achieve the goal sought by the Central Bank while minimizing negative effects on the capital markets. The Central Bank may consider scenario analyses on the marginal effects of different policies to determine whether other less direct tools (e.g., reserve requirement ratios) could be used to lower inflation with smaller interest rate effects. In the medium term, alternative solutions might be needed to foster the development of a long term finance market, such as the use of inflation-linked instruments. However, the development of these type of instruments is not without challenges. These issues will be further explored in the section on infrastructure financing.

In addition, a careful balance between fiscal needs and policies to promote financial sector growth needs to be achieved. Tackling the fiscal deficit should remain a priority. However, the current taxation regime is creating distortions that have affected the capital markets and will continue to have a significant impact on it. In particular, the credit-debit tax which imposes a tax on every movement in a checking account (money being deposited or withdrawn) is having a number of distortionary effects both on a broader level (increasing the obstacles for SMEs to transact in the formal banking system) and on specific products and instruments of the capital markets (such as mutual funds). Thus a thorough review of the overall tax framework for financial instruments should be undertaken. This review could lead to tax removals in some segments and potentially higher taxes in others so while elimination of the credit-debit tax may not be feasible; consideration should be given to applying it in a revenue neutral way that levels the playing field for capital market participants and potential new instruments, given the substantive distortions that it creates currently for the financial sector and its effects on the real economy. This is the approach that is being used in Brazil.

Capital market development would be supported by a government securities market to set reference rate benchmarks for private bond issuances. In the past decade the government debt market has been less structured due to extraordinary circumstances. From 2010-12 long term dollar issuances were mainly on account of the rescheduled bondholder's debt. The central bank also issued medium term non-transferable dollar notes and public institutions such as the Banco de la Nacion (BNA) issued two year variable rate peso notes while other non-financial public enterprises issued 3-6 month dollar instruments. From 2012-14 the government issued variable rate 4-year peso bonds as well as 5-6 year BONAR/BONAD bonds linked to the variable Badlar benchmark. Public enterprises continued issuing short term paper. After the debt swap/rescheduling, new government issuances began attracting mostly

domestic investors, and many such issuances funded obligations of the government to other public enterprises.

From 2014-15 the government continued issuing 2-4 year notes and peso bonds at variable rates and some 2 to 10 year dollar and dollar-linked BONAR and BONAD bonds at fixed rates, as well as peso BONAC bonds at variable rates based on the LEBAC or Badlar. All these issuances, albeit, mainly in dollars for the fixed rate segment, attracted domestic investors, but made some minor inroads toward lengthening the yield curve for dollars. In 2016, with the new government, dollar and euro fixed-rate bonds of various maturities (3, 5, 6, 10, 11, 12, 20, and 30 years) were issued with high international investor subscription. On the peso side, a combination of Badlar-based variable notes as well as variable inflation-linked (CER index) notes and some fixed rate notes and bonds were issued in the 2, 5, 7, and 10 year maturity ranges. These issuances have begun referencing different segments of the local yield curve but significantly higher volumes and liquidity/tradability in the peso bond market will be needed, with a regular issuance schedule, before private bond pricing can rely on a reliable rate benchmark in each yield curve segment.

Section II: Structural Problems on the Demand Side

Outside the macroeconomic environment and how it affects market participants' confidence, the largest issue facing the development of the domestic capital markets is the lack of a robust investor base, across all categories of investors: institutional, retail and foreign. This particularly impacts capital raising. Market consensus is that offerings of both equity and corporate bonds can be successfully placed domestically with a size of up to USD 200 – 300 million. Any offering larger than that needs to be placed on international markets as the domestic investor base is too small. Until the demand side of the markets is further developed, larger offerings will continue to be placed abroad, even under improved macroeconomic conditions and improved investor confidence.

Thus, the key priority for the authorities going forward should be the development of a more robust investor base and more optimal deployment of available savings in the economy. Cross country experience indicates that the development of domestic institutional investors is critical. A domestic institutional investor base provides a more stable and longer term investor base than either foreign or retail investors. There are few examples of countries that have successfully developed their domestic capital markets without this class of investors. There are a number of initiatives that can be taken in this respect:

- The FGS could be permitted via a reform of its investment regime, a more active trading role as an anchor investor, leveraging its resources to attract other investors, and generating more liquidity in the securities market, thus being allowed to trade and invest in safe diversified assets and new issuances given its heft in the asset management industry.

- Confidence in private pension funds has been severely dented by the nationalization of the private pension funds, thus it will be important to look at the development of alternative savings regimes

such as a voluntary savings regime based on the USA "401 K" model to encourage long term domestic savings through the formal financial system. Such employer based schemes, while technically voluntary, have automatic enrollment based features which can increase participation.

- In this context, initiatives to grow insurance penetration, particularly life insurance and retirement insurance annuities, should be pursued. These include increasing tax incentives for investors in life insurance products.

The development of a more robust domestic institutional investor base will be a long term endeavor. Some of the actions recommended above could bear fruit in the short term and constitute "quick wins"; in particular those related to the FGS. The impact of others, in particular those related to a private retirement scheme and life insurance would be seen in the medium to long term.

In this context, and in parallel to these reforms, measures to ease access for foreign investors should be prioritized. Increased participation of foreign investors may have the effect of improving confidence for retail investors to bring them back into the market. Thus, efforts in this direction could deliver a "quick win". The efforts to improve access for foreign investors are also largely aligned with the requirements for moving from MSCI Frontier to MSCI Emerging market status (see box 1). This will likely increase foreign investment in Argentinian companies due to the need to rebalance portfolios to track the index.

In particular, as indicated above, investors face a series of procedural and regulatory requirements related to the opening of accounts and the due diligence that participants have to conduct on them and tax registration resulting in onerous administrative costs in terms of time and money that deter foreign investment in the capital markets. These are the most critical changes that could also deliver "quick wins". In the medium term. Other areas where improvements might be needed relate to market infrastructure, including the robustness of clearing and settlement processes, and the development of omnibus accounts.[7] Finally, if Argentina wishes to remain competitive in attracting foreign investor flows into domestic markets, it should review the tax treatment for foreign investors.[8] Coordination will be needed between different entities of government, including the MoF, CB, Ministry of Justice and revenue authority in order to develop a comprehensive approach to reducing barriers for foreign investors.

[7] Omnibus accounts have the potential to reduce costs as one account is needed for many investors, meaning that each investor does not have to be dealt with individually. In 2012 Poland introduced omnibus accounts to open the Polish market to new investors by easing accessibility. Other countries in the EU that use omnibus accounts are Austria, Belgium, Denmark, Finland, France, Germany, Hungary, Portugal and Spain. Omnibus accounts are also used in Switzerland and the USA.

[8] For example Peru recently eliminated the tax on capital gains for foreigners as part of the measures to remain in the MSCI Emerging Markets Index. It is understood that some capital controls may remain and these should be part of the review.

Box 1. MSCI Market Classification Framework

The MSCI Market Classification Framework consists of three criteria: i) economic development; ii) size and liquidity and iii) market accessibility. Of relevance to the easing of foreign investors entrance is the criteria of market accessibility.

Criteria	Frontier	Emerging Market
A. Economic Development		
B. Size and Liquidity Requirements		
B.1 Number of companies meeting the following		
Standard Index Criteria	2	3
Company size (full market cap)	USD 630 mm	USD 1260 mm
Security size (float market cap)	USD 49 mm	USD 630 mm
Security liquidity	2.5 percent ATVR	15 percent ATVR
C. Market Accessibility Criteria		
C.1 Openness to foreign ownership	At least some	Significant
C.2 Ease of capital inflows / outflows	At least partial	Significant
C.3 Efficiency of the operational framework	Modest	Good and tested
C.4 Stability of the institutional framework	Modest	Modest

C. Market Accessibility	
C.1. Openness to foreign ownership	
C.2. Ease of capital inflows / outflows	
C.3. Efficiency of the operational framework	
Market Entry	Market entry –includes investors registration and account set up – existence level of complexity of registration requirements for international investors such as Tax IDs as well as ease/complexity for setting up local accounts.
Market organization	Information flow Competitive landscape Market regulations
Market infrastructure	Clearing and settlement-includes omnibus accounts Custody Registry / Depository Trading Transferability Stock lending Short selling
C.4 Stability of Institutional Framework	

It is important to highlight that foreign investors' participation might not be equal for all market segments. It could be expected that their interest would first be in government securities (new treasury issuances as an initial benchmark) as well as the larger corporates via equity (in which they are already

investing via ADRs); while their participation in corporate bonds might require more time, and additional improvements in the macroeconomic environment. Their participation in infrastructure financing through equity or debt will require that a robust PPP framework is in place, and appropriate risk-sharing mechanisms to cover non-commercial aspects of project risks.

The largest deterrent to retail participation in the capital markets is a lack of confidence, both in the markets themselves, but also in the stability of the regulatory framework, and the macroeconomic and political environment. The repatriation law is intended to deliver a "quick win", and encourage retail investors to bring their resources back into the financial system. The creation of suitable vehicles to channel these funds toward capital markets and the funding of priority sectors in the real economy is a critical step to potentiate this "quick win." As envisioned, closed-end funds appear as a key vehicle toward this end. However, to make repatriation attractive, the taxation of such vehicles going forward (not just for the moment of repatriation) should also be addressed, including a possible elimination of the income tax on capital gains and restructuring the wealth tax. Finally, it is understood that full confidence of investors will require consistent actions of the authorities over time on the macro and institutional front. Furthermore, in the long run, it is critical that the authorities consider a full review of the taxation regime within a revenue neutral context, as it seems to be creating significant distortions to investing in capital markets, and more generally for the financial sector.

Section III. The Supply side

Specific issues affecting the markets for corporate, SME, and infrastructure financing will be discussed separately. That said, there are a few technical issues that could impact all segments of the market. Addressing them could deliver "quick wins". They relate to (i) a review of the public offering regime, (ii) a review of the framework applicable to MFs, and (iii) a review of the procedures for authorization of offerings. The latter change is explained in the next section. In the long term, the need for a thorough review of the tax system should be emphasized as it appears to be creating significant distortions for capital market development as a whole and for the preference of one instrument over another.

Review of the public offering regime

The objective of this review would be to achieve a better balance between investors' needs for information and the cost of disclosure. In particular:

- The creation of a recognized private offering regime that could be applied to all types of instruments, ranging from corporate issuances (both equity and debt) to MFs. The private offering regime could be based on conditions such as the number of investors involved, the maximum amount issued, the minimum size of investment, and the type of investors to which an offer is addressed. On the latter, offers addressed exclusively to sophisticated investors could be part of the private offering regime. This category could include both professional investors, such as institutional investors, and high net-worth individuals. Issues of private

offerings could potentially be exempted from any disclosure requirement vis-à-vis the regulator and would not require authorization by the CNV. Alternatively, some of those offers, such as those addressed to sophisticated investors, could be subject to the filing of an offering memorandum that would not need to be reviewed by the CNV, but that would be subject to antifraud provisions. In either case, all offers conducted under this regime would be subject to a notification requirement. This requirement would allow the CNV to monitor any emerging risks arising from this regime.[9]

- As a result of the above, a review of the current "special" regime for SMEs would be warranted. Such review would aim to determine whether it could be transformed into a proportionate regime for SMEs issuances that could be offered to retail investors.[10] This review would provide the foundation for the development of an "alternative" market at the exchange level, with proportionate listing requirements and to the extent possible reduced transactional costs.

- A "residual" review of the public offering regime would also be beneficial, to ensure the alignment of all these regimes. In tandem with this review, improvements in the authorization function can be considered as further explained in the next section.

Review of the framework for mutual funds (MFs)

The review of the MF regime would aim at ensuring the availability of a wide variety of MFs, under a proper framework that adequately distinguishes between different type of funds and investors for purposes of determining the applicable prudential and disclosure requirements. In particular:

- The development of distinct regimes for MFs offered to the public versus MFs offered under a private offering regime. This review would build on the creation of a space for private offers as recommended above. Funds to be offered to retail investors would be subject to a stricter "prudential" and disclosure framework, while funds to be offered under a private offering regime could be given much more flexibility. It is important to note, however, that while the rules for funds to be offered to retail investors should be stricter, the current regime appears restrictive, in particular in regard to eligible assets. In any event, the specific rules applicable to funds would be developed based on a typology of funds, which would help to ensure that the risks of different structures and types of underlying assets are well disclosed

[9] This "broad" private offering regime exists in countries such as the United States and Canada. In both cases, the current regimes have been the result of evolution in the market. The authorities are best placed to decide how best to tailor them to the specificities of the Argentinian market.
[10] Such type of regime exists for example in the United States.

and managed.[11] For example, specific rules should be developed for money market funds, REITs, ETFs, etc.

- Addressing the obstacles preventing the use of closed end-funds, as these can be important instruments for channeling investment into the real economy (including the sectors of infrastructure, SMEs, and real estate). It is understood that the main obstacles relate to: the current regime that imposes double taxation of closed-end funds thus making them financially unviable; the limited scope of allowable investment in closed end funds; and the joint liabilities of asset managers and depositories of these funds.

- Reviewing the regulations on distribution of MFs to ensure that they do not pose obstacles to an open architecture model. In this context it is important that the framework for MF distribution effectively allows the development of a network of distribution agents and potentially also independent advisors. This might bring additional competition to the industry (and with it potentially innovation and reduction of fees). Finally, certain operational rules that might be affecting the use of distribution agents should be reviewed including: (i) the process of approval of distribution contracts; and (ii) the distribution of KYC responsibilities between the fund manager and the distribution agent. On the latter the CNV could potentially develop rules that allow for the contractual distribution of such responsibilities, provided that certain conditions are met.

- Finally the role and responsibilities of the fund manager versus the depositary could be reviewed. Market participants highlighted the scope of responsibilities of the depositary versus the fund manager as a potential deterrent for further development of the industry. There is no best model to follow.[12] In this respect what is important is that the authorities reviewed the impact of such enhanced obligations.

Section IV: The Supervisory Authority

A series of legacy issues need to be tackled to ensure that the CNV is ready to supervise a more developed and complex market in an effective and expedient manner. Overall, market participants expressed concerns about past practices of the CNV, whereby both regulation and supervision were used to pursue government interests and policies, without rigorous technical foundation. The appointment of a new Board has restored credibility on the CNV. However its challenge is to effect long term changes in the organization, in particular the way it conducts its key functions. The CNV is perceived to have a very

[11] It is noted for example, the prevalent use of open-end structures, which require careful management of liquidity risks. This would be an area that the CNV would need to pay increased attention in line also with current work by the FSB and IOSCO. That said, the framework for open-end funds offered to retail investors currently has certain features that are too strict, particularly with regards to eligible assets.

[12] For example, under the European Union Directives for UCITs the depositary's role goes beyond custody and also encompasses an "oversight" role. This broader role is not a feature of the U.S. system.

formalistic approach, which can result in serious bottlenecks as well as in an ineffective supervision of risks.

The CNV Board is aware of these challenges and steps are being taking to address them. The Board has embarked on a wholesale review of the organization aimed at improving its governance and functioning. As part of such review, the Board has conducted meetings with different market participants to obtain a deep understanding of the market, the potential changes needed in regulation, as well as in its authorization, supervision and enforcement functions. Improving the authorization function

Actions are needed across all regulatory functions; however in the short term improvements in the authorization function could deliver "quick wins." Improvements are also recommended in the supervisory and enforcement functions; however they would bear fruit in the long term, by increasing investors' confidence in the regulatory and supervisory framework. Further the CNV is encouraged to take a holistic view and ensure that all key functions are robust, including regulation and licensing. In this context, sufficient attention needs to be given to investor education –in this case potentially as part of a country strategy on financial education.

It is important that the CNV adequately communicates to the market the changes that it is implementing. Further, ideally many of the changes could be consulted with the market, in particular those that could have an impact on their activities such as changes in the authorization and the licensing regime.

Streamlining the procedures for public offering

Achieving a proper balance between the need to ensure that investors have complete information at the moment of investment and the expediency of the authorization process is a challenge faced by regulatory agencies across all types of markets. The review of offering documents as a condition for the authorization of a public offering is considered a best practice followed by the majority of IOSCO members. The review aims at ensuring that issuers provide a complete and accurate description of the company or vehicle offering securities and its risks. This, in turn, requires a deep understanding of the underlying business by the regulatory authority, so that it can make a judgment on whether the offering documents adequately reflect the risks of the business. Naturally such review can take time, and in many cases can require follow-up questions by the regulator. At the same time, increasingly regulatory authorities are devising mechanisms to optimize this process, as there is a clear understanding of the impact that time can have in the ability of an issuer to take advantage of "windows" of opportunity to tap the market under favorable conditions. The most common mechanisms are (i) a commitment to provide comments all at once under pre-established deadlines and (ii) the development of streamlined procedures for seasoned issuers (shelf registration) and for issuance programs.

It is understood that the CNV has instituted mechanisms aimed at reducing its time of response; however there may be room for improvement. It is understood that the CNV has committed to providing one single set of comments as part of the authorization process, and that a shelf registration regime is already in place. However, market participants have commented that in practice the

authorization of a new issuance could take more than a year. In other jurisdictions where similar concerns have been raised, a review of files has indicated that in many cases the responsibility for delays is on the participants' themselves or at least equally shared, because participants do not provide all documents at once or do not respond to inquiries of the regulator in a prompt manner. In this context, it is recommended that CNV track the time of response of both sides and makes such statistics available to the market as a way to bring accountability to the process. In addition the CNV could review whether the current shelf registration regime could be further optimized, in terms of (i) eligible issuers, (ii) conditions for incorporation of information by reference, and (iii) conditions for automatic approval of the supplemental prospectus.[13] In addition, the CNV could develop guidance notes for "new" issuers, and frequently asked questions related to the authorization process. Additional improvements could be implemented over time, particularly if the number of issuances grows, such as the specialization of staff by types of instruments and products, and the creation of different levels of review for plain vanilla versus new or more complex products.

Strengthening supervision

As envisioned by the Board, supervision at the level of individual firms and products should be strengthened, via the implementation of a risk based approach. In tandem, the CNV would need to conduct a review of reporting requirements to ensure that it currently receives all the information necessary to implement such approach. There is no methodology that can be considered a best model for risk based supervision (RBS); thus the recommendations below should be considered guidance.

- In the case of intermediaries, it is proposed that the CNV implement a risk scoring methodology that focuses on an understanding of the business model of the different intermediaries and its effects on both prudential and conduct risk, and the controls in place to mitigate such risk. Such assessment, along with an assessment of the relative importance of the firms would form the basis for prioritization and to decide the intensity of supervision.

- In the case of issuers, it is proposed that the CNV develop a set of criteria and indicators to determine the frequency and intensity of review of issuers' periodic and ongoing information, including size indicators, indicators that allows the CNV to track substantial changes in the financial position of a company/vehicle, the existence of qualifications in the audit report, etc. As the market grows, such indicators could be developed by sectors, so that outliers could be identified. Finally a robust market surveillance system must be developed, based on automated alerts.

- In the case of MFs, indicators should be developed by types of funds, with a view to identify outliers that would then be subject to closer scrutiny.

[13] While shelf registration is used in many jurisdictions there are important differences in the flexibility of the regime, which to a large extent can be explained by the level of development of the market. The authorities are best placed to determine where to draw the line.[14] Carvajal, Ana, Berg, Alex and Rodgers, Malcolm. Improving Accountability of Securities Regulators, World Bank Group, 2014.

In addition, in line with the plans of the Board, the CNV should develop a process for the identification of risks at the market-wide level, including systemic risk. There is no unique way to implement such processes; however some early lessons are starting to emerge (see Box 2 below). Initially, as envisioned by the Board, an emerging and systemic risk committee could be constituted, along with the development of a set of indicators and tools for market wide analysis. The process for emerging and systemic risk identification could follow a five step approach (identification, assessment, prioritization, identification of the suitable response and monitoring). A risk registry should be developed to provide strong governance arrangements. Finally, the mission encourages the authorities to review whether arrangements for systemic risk identification and management at the financial sector level are also needed.

Box 2. Developing processes to identify systemic risk by securities regulatory agencies

The current global crisis has shown that securities markets can be the source of systemic risk or at least a transmission mechanism. As a result, there is now an understanding of the need for securities regulatory agencies to develop processes that allow them to contribute to the identification of systemic risk, even in cases where they do not have a systemic risk mandate. This is now also embedded in the IOSCO Principles.

The specific framework and processes are largely influenced by the structure of financial regulation and the mandate given to different regulatory authorities within a jurisdiction, as well as the level of market development in that jurisdiction. In general, the processes for systemic risk identification implemented in different countries, in particular G20 jurisdictions, typically contain the following features:

- First, securities regulatory agencies explicitly recognize the role that the board plays in the oversight of processes for risk identification and management. Typically, boards are informed about emerging and systemic risks and actions undertaken or that need to be taken to mitigate them.

- Second, many securities regulatory agencies have found it necessary to create specific organizational structures to support risk identification. Some agencies have established committee type structures, composed of senior level staff of the organization, although the specific department members vary. That is the case for example, of ASIC in Australia and of both, the OSC and AMF, in Canada. In other cases, agencies have established units or departments specialized in risk with the main objective of ensuring a consistent approach to risk management and providing technical support for the development of risk management tools. That is the case for example of the Hong Kong SFC. In both cases, however, there is a recognition that risk identification needs to be the result of a collaborative (organization wide) approach. In addition, some agencies are creating teams or units to further their capacity to identify risks within different levels of the organization, such as the SEC in the United States.

- Third, securities agencies typically attempt to establish strong links between the organization's strategic planning and its risk management processes. This effort reflects an understanding that identification of risks, particularly those that can impact the ability of the agencies to fulfill their mandate, should drive the strategic direction and activities of the organization.

- Fourth, increasingly regulators are establishing risk registries as a key governance arrangement for the

process of identification of emerging and systemic risk. A good example is the risk registry developed by the Hong Kong SFC.

- Finally, in many cases agencies have recognized the need to change the profile of positions and/or to add staff with different skillsets to the relevant operational units, to ensure that the agency adequately discharges its role of contributing to systemic risk identification.

Developing a credible and effective enforcement function

Finally, it is critical that the CNV develops a credible and effective enforcement function, supported by an understanding that the key role of enforcement is to affect behavior. The principles below seek to provide guidance on the key aspects of such a strategy.

- **Enforcement should focus on material issues:** the public interest is not well served when scarce resources are used in an unfocused and undifferentiated manner, responding simply to day to day pressures, rather than to a clear strategy that focuses the bulk of resources to those misconducts that produce the most harm to investors and to market integrity as a whole. In practice, the focusing of resources requires the development of guiding criteria to determine the materiality of cases. These criteria should include considerations such as the strategic significance of the case (i.e. what is the extent of harm or loss; what is the impact on the regulatory objectives), the benefits of pursuing misconduct (i.e. is enforcement cost-effective), as well as issues specific to the cases (i.e. what evidence is available).

- **Enforcement should serve the ultimate objective of affecting behavior and improving overall business standards in the securities market:** to serve its purpose the enforcement function needs to be used in a way that not only remedies problems but deters future misconduct and contributes to strengthening investor confidence. This has several implications in connection with the type of actions that can be taken, their severity and their disclosure.

- **Shortcuts to proceedings, such as settlement, need to be used carefully so as not to damage public confidence in the enforcement function:** enforcement actions can be resource and time intensive, especially where the matters are complex. Thus in some countries regulatory agencies use settlements as a way to leverage resources. While shortcutting the enforcement process is indeed attractive to regulatory agencies with serious resource constraints, the regulator has to consider carefully whether shortcuts are a short term gain at the medium to long term cost of its regulatory objectives and the credibility of its enforcement function. Key factors that could affect the credibility of settlements involve whether they can be entered without admission of guilt, whether they can be used when the misconduct involves fraud or reckless disregard, whether the sanctions imposed are significantly reduced vis-à-vis the sanction that would come as a result of a proceeding, and whether there is sufficient disclosure of the terms of the agreement. These issues are far from settled and different jurisdictions adopt different practices.

Preconditions for the effective discharge of key functions

The CNV should continue to migrate towards a system that ensures its independence from both the government and commercial interest, as required by the IOSCO Principles. This is critical to keep market and investors' confidence in the CNV**.** The CML already contains some provisions that foster independence. In addition, the following steps should be considered:

- **Robust governance:** the Government has already taken critical steps to ensure that a robust governing body is in place, with the appointment of the five directors that comprise the Board. In addition, the Board should review its current functions with a view to ensuring proper allocation of responsibilities. There is no single model that could be predicated as the best; however based on cross country experience the it is recommended that the Board focus on providing the strategic direction to the institution - via the approval of regulations and of the strategy for each of the key functions - and conducting strong oversight of day to day operations. In turn, day to day operations including authorizations and licenses should be delegated to the functional departments. Finally, the Board should review the ethics rules applicable to the whole organization, including rules governing conflicts of interest.

- **Strong legal and operational arrangements to protect the Board and staff against suits:** experience indicates that weak provisions could have a chilling effect on the supervisors' disposition to pursue and impose strong measures against breaches of laws and regulations. It should be emphasized, however, that the IOSCO Principles do not require full immunity. For example, a system would meet the Principles even if staff could be sued for actions or omissions arising from the discharge of its functions, if staff can only be found liable for gross negligence, and the supervisory agency assumes the upfront cost of legal defense, irrespective of whether the suits take place while the staff member is in office or not.

  Stable sources of funding: the IOSCO principles are neutral about the funding model for regulatory agencies. Experience indicates that the mechanisms in place on who decides on the level of funding and its allocation have a more significant impact on independence than the source of funding itself (whether from the regulated entities in the form of fees, from a public budget or a mix). In practice, this means that the CNV should have a key role in both areas, and that any potential approval of the level and allocation from a governmental agency, such as the MoF, should be done at a high level (rather than on a line by line basis).

At the same time it would be important to develop a framework for strong accountability. Basic mechanisms of accountability exist in most IOSCO jurisdictions; but their value in assessing the overall performance of the regulatory agency (i.e. effectiveness of securities regulators in achieving its mandate) is limited. Best practices are emerging in leading jurisdictions, which are anchored in both ex-ante and ex-post mechanisms. Ex-ante mechanisms include the definition and publication of strategic priorities by the regulator, and of specific actions attached to such priorities to which some measure of success is linked. These strategic priorities are the basis for ex-post reporting, whereby the regulator on an annual basis reports on whether the actions previously identified as key to meet the priorities established were

completed and if not, the reasons that prevent the regulator from achieving them. While annual reports are already published in many jurisdictions, the difference vis-à-vis leading agencies is precisely that this reporting is linked to strategic priorities and those in turn to risks, thus providing meaning and context to the activities and actions reported. [14]

In addition, several preconditions need to be in place for the CNV to be able to achieve significant improvements in its key functions.

- Ability to pay competitive salaries and to train staff as needed: it is acknowledged that this is a challenge for many regulatory agencies as in many cases salaries are bound by the civil service scale. However, in line with progress obtained in some jurisdictions, it is recommended that to the extent possible salaries for financial sector supervisors, including CNV staff be set in relation to a private sector benchmark.[15] Complementarily, the CNV should be in a position to provide on-going training to staff.

- Recruitment of staff with a diverse skillset: in many countries regulatory agencies have relied mostly on lawyers and accountants. However, as markets develop, other skillsets become necessary for a robust assessment of the risks inherent in the securities market.[16] Thus the it is recommended that CNV evaluate the need to add different profiles, such as macroeconomists and financial analysts, to its current structure.

- Robust IT systems and resources: automation is critical to enhance the efficiency of a regulatory agency. In this context, the following areas should be a priority for the CNV: (i) enhancing systems aimed at collecting information from market participants including during the authorization process as well as systems to distribute such information to the public in friendly formats and on as "real time" basis as possible --the former includes a review of the potential application of XBRL language to the financial information received from regulated entities; (ii) strengthening market surveillance systems; and (iii) expanding the level of automation of internal processes related to key basic functions, in particular authorization, licensing, supervision and market surveillance and enforcement

- An appropriate organizational structure: the definition of a clear strategy to conduct each key function, along with procedures to support them and a clear definition of responsibilities between the board and the functional departments are the key issues that need to be addressed to achieve regulatory outcomes. That said, it is useful that the CNV conducts a review of the organizational structure to ensure that at a high level it is in line with its key functions (regulation,

[14] Carvajal, Ana, Berg, Alex and Rodgers, Malcolm. Improving Accountability of Securities Regulators, World Bank Group, 2014.

[15] Examples of countries where salaries of the securities regulatory agency are not bound by civil service salaries are OSC Canada, Hong Kong SFC and Costa Rica SUGEVAL. In the case of OSC and SFC salaries are benchmarked with a peer group.

[16] That has been the experience for regulatory agencies in industrialized countries, including for example the US SEC, OSC Canada and AMF France.

authorization, licensing, supervision and enforcement and potentially investor education), and its strategic view of how best to perform them so that a clear view of risks to the regulatory mandate (investor protection, deep and liquid markets and financial stability) inform both day to day activities and the annual plans of the organization. Thus, while the organizational structure of other agencies could be taken as a reference, the mission highlights the importance that any changes be done after careful consideration of the specificities of the Argentinian market.

Section V: Market Infrastructure

The CNV has strategic decisions to make concerning competition in market infrastructure. As indicated earlier, there are currently separate projects to (i) consolidate the existing exchanges into one single market under the principles of specialization, federalization and interoperability, along with the creation of a CCP to serve these markets; and (ii) to transform the current electronic over the counter money market (MAE) into a full blown market with its own CCP.

The IOSCO Principles do not prescribe a particular model for market infrastructure, and different models can be observed across countries which are a result of both market development and strategic decisions of the authorities. In many countries market infrastructure has started under a vertical integration model, whereby a single trading venue (exchange) was served by a single clearing entity and a single settlement entity, all under common ownership. As markets have developed, competition has appeared. In general, there has been more competition in trading services. However the level of competition in clearing and settlement services has varied greatly depending on the country and the asset class (see Table 3). Along with competition there have been processes of consolidation (including at a cross border level) as a way to reap the benefits of economies of scale and scope.

Table 5. Cross country experiences with market infrastructure

United States	European Union	Australia	Hong Kong
On the equity side, there has been a proliferation of trading platforms, while both clearing and settlement services are provided by one single entity, the Depository Trust and Clear Corporation (DTCC), through separate subsidiaries. This model was the result of a process of industry consolidation that took more than two decades. This collective solution is reflected in the	Competition exists not only at the level of trading platforms, but of CSDs and CCPs. Initially the CSDs and CCPs work along domestic lines. Regulatory pressure and more recently regulatory intervention have fostered effective competition with the aim of creating a truly pan European market.	Concerning equity markets, competition has been allowed on trading services. However, a moratorium on competition in clearing services was imposed in 2013. In parallel with this moratorium the Government issued a consultation paper to discuss the consequences of competition in clearing services as well as the degree of contestability of settlement services.	The Hong Kong Exchange (HKEx) group has a legal monopoly in exchange traded Hong Kong listed equity securities and a *de facto* monopoly in domestic exchange traded futures. Alternative trading systems (ATS) can be established as long as they trade products not covered by the legal monopoly.

governance arrangements of DTCC and its position as a public utility. The land-scape is different for derivatives, where there is competition in clearing services.	Competition has existed for OTC derivatives clearing.

Different market structures are subject to different risks. As a result, it is difficult to determine a priori which structure can deliver the best outcomes for a country in terms of ensuring the best balance between market efficiency and financial stability. In general all three services (trading, clearing and settlement) are subject to economies of scale, scope and network effects. As a result benefits are sometimes derived from consolidation. However, consolidation may have negative effects on innovation, users' responsiveness and pricing –and may potentially exacerbate "too big to fail" problems. That is why there is recognition of the importance of regulatory contestability and along with it the potential need for rules on fair access, price transparency, unbundling of services and interoperability to ensure that competition can take place. At the same time competition may lead to negative outcomes if risks arising from market fragmentation cannot be adequately managed. [17]

Accordingly, the decision on the level of competition to apply to market infrastructure in Argentina needs to be tailored to the specific characteristics of the market. Therefore the comments and recommendations provided below should be taken as guidance. Further, their implementation might require changes to the law.

- On trading services, the move of the existing exchanges towards a consolidated model, but under a principle of specialization, seems a rational approach that could deliver positive outcomes to the country, provided that contestability remains. Such contestability would be tested by the expansion of MAE to other types of asset classes and markets. A credible market for futures would also need to be developed (either by BIMA or MAE). Given the large infrastructure funding needs in the economy, there is a large importance to be placed on currency futures (USD / Peso), particularly in an environment of currency volatility. It is therefore important to look at options to restart the futures market in a sustainable and secure manner. Given the reputational issues surrounding ROFEX, it may be the case that the exchange will be unable to rebuild its brand and reputation, and an alternative venue for the trading of these instruments should be considered.

- On clearing and settlement services, given the small size of the market, a collective industry solution might be desirable initially, whereby both the CSD (the *Caja de Valores S.A*) and a potential CCP would be structured as public utilities to service different trading venues, including

[17] For example very interesting discussions are taken place at the EU level regarding the risks derived from interoperability in CCPs.

the futures markets.[18] This public utility nature should be reflected in the governance arrangements of both institutions and thus changes might be needed for *Caja de Valores*, while the governance arrangements of the prospective CCP would need to be carefully designed. Further, under this model, it would be desirable that settlement takes place in central bank money. Both the CCP and the CSD would need to be considered systemically important institutions given the impact that their failure would have on the functioning of the markets. As a result they should be subject to enhanced licensing requirements and enhanced supervision. In particular in the case of the CCP, particular attention will need to be given to its minimum capital and risk management requirements, including the existence of a robust default waterfall and business continuity plan.

- The development of a CCP would likely change the role of Banco de Valores. In any event, if Banco de Valores were to continue providing post-trading services for the market as a whole (or at least for the BIMA market), then a review of its current structure and the activities that it can undertake would be advisable. Currently Banco de Valores performs additional activities that pose conflicts of interest that might be difficult to manage.

In line with the above, it is proposed that as part of the decision making process the authorities conduct a consultation process. This would be to obtain a deeper understanding of the impact that different models (from a public utility model to the coexistence of different CCPs in effective competition) could have on the development of the Argentinian markets, and in particular on their efficiency, reliability and integrity. Such consultation should reflect on the role of foreign investors and their impact on the choice of model.

Section VI. Securities Intermediaries

Strategic decisions are also required in connection with securities intermediaries. The current legal and regulatory framework provides for the existence of several types of licenses, some of them with limited capital requirements. Some participants raised concerns about the number of intermediaries currently in the market, the level of capitalization of some of them, and the need for a process of consolidation.

The IOSCO principles do not require a particular model of licensing regime for securities intermediaries, but it does require that their licensing requirements, and in particular their capital, be aligned with the risks of the activities authorized and effectively undertaken. In practice the licensing regime varies greatly across countries, and is influenced by other strategic decisions such as whether the country follows a universal banking model or not (see Table 4).

[18] See Committee on Payments and Settlement Systems. Market structure developments in the clearing industry: implications for financial stability. Report of the Working Group on Post-trade Services November 2010. The Paper provides a good description of different market structures and the potential risks associated with them.

Table 6. Cross country experience with licensing regimes

United States	European Union
There are separate licensing regimes for intermediaries in the securities markets and intermediaries in the commodities markets as a result of the division of responsibilities between the SEC and the CFTC. Banks cannot apply for either of these licenses directly. **Securities intermediaries** There are separate licenses for brokers, swap securities dealers, municipal advisors and investment advisors. Neither municipal advisors nor investment advisers are required a minimum capital. For the remaining, the minimum capital varies from USD 5,000 for the least risky type of activity (such as a business limited to selling mutual funds) to USD 250,000 for the most risky type of activity (such as holding customer funds and assets). As per the net capital rule (NCR), all BDs are required to maintain net capital in specified amounts that are determined by the type of business conducted by the BD. **Commodities intermediaries** There are separate licenses for swap dealers (SDs), major swap participant (MSPs), futures industry participants; futures commission merchants (FCMs); introducing brokers (IBs); commodities trading advisers (CTAs); floor brokers and floor traders; and retail foreign exchange dealers (RFEDs), who deal in foreign exchange contracts with retail clients. Minimum capital requirements apply to SDs, MSPs, FCMs, RFEDs and IBs, but not to CTAs, floor brokers and floor traders. IBs do not require capital if their obligations are guaranteed by an FCM and they deal only through that FCM. For FCMs, the minimum adjusted net capital requirement is the greatest of **(i)** USD 1,000,000; (ii) the FCM's risk-based capital requirement, computed as eight percent of the total risk margin requirement for positions	There are separate licenses for investment firms and management companies. Banks can apply directly for these licenses without the need for a subsidiary. **Investment firms** MiFID defines a series of authorized activities for investment firms, while the CRD IV Directive defines prudential requirements applicable to them. In practice as per CRD IV there are roughly 11 different categories with capital ranging from EUR 25,000 (for firms that only receive or transmit orders or provide investment advice and that fall under the Insurance Directive) to EUR 730,000. It is important to mention that the Directives provide some level of discretion to national authorities in their transposition. As a result there could be differences in capital requirements across EU countries. In general, investment firms are also subject to a risk-based adjusted capital via the imposition of the Basel framework. The main exception is firms that do only transmission or reception of orders or investment advice, for which there is no "own funds" requirement. A report by EBA to the EU Commission from 2014 has recommended a substantive change in the approach. It proposes to create three categories: systemically important firms, (ii) firms considered of lesser importance and (iii) small and non-interconnected firms. Only the first ones would be subject to the full Basel framework. Firms falling under tiers 2 and 3 would be subject to "a modified prudential regime, simplified and tailored in a way that enables a better consideration of proportionality and risk sensitivity". **Management companies** Managers of CIS are subject to separate authorization requirements via the EU Directives for UCITs and AIFM. CIS managers are subject to minimum capital requirements. In addition, own funds requirements apply

carried by the FCM in customer accounts and non-customer accounts; (iii) the amount of adjusted net capital required by the NFA; or (iv) for securities brokers and dealers, the amount of net capital required by the SEC. For IBs subject to minimum capital requirements, the minimum adjusted net capital requirement is the greatest of: (i) USD 45,000; (ii) the amount of adjusted net capital required by the NFA; or (iii) for securities brokers and dealers, the amount of net capital required by the SEC.	to them and more recently a minimum amount based on the fixed costs of the preceding year.

Overall experience indicates the benefits of ensuring competition in the securities intermediary industry as competition can bring down fees, encourage innovation and foster penetration of capital markets. There are risks stemming from increased competition. However, save for systemically important intermediaries, the regulation of securities intermediaries does not aim to avoid their failure, rather it aims to ensure that any insolvency is handled in an orderly manner, with the least disruption possible for investors. Thus, such risks can be addressed via a regulatory framework that (i) aligns capital and authorization requirements more generally with the risk posed by the intermediary, and (ii) provides a strong framework for the custody of clients' assets including an investor compensation scheme, along with a strong risk based supervisory approach.

In the context of Argentina, at the outset it seems that the number of intermediaries is high and that some level of consolidation might be desirable. However any review of the licensing framework should ensure sufficient flexibility to accommodate different types of intermediaries from dealers to introducing brokers, placement agents, and investment advisers. The latter three categories would be particularly important to ensure further penetration of capital markets instruments to the retail population across the country. In this context, an integrated licensing regime that follows a "cascade" system seems suitable for the country. An intermediary could apply for a license encompassing all, or just some of the activities, provided that it complies with the minimum capital requirement for the "riskiest" activity along with any qualification (fit and proper) requirement applicable to the respective activity for which authorization is being requested. A solvency regime would accompany the minimum capital requirements. Based on cross country experience, it is recommended that such solvency regime be implemented in a proportionate manner. An initial high-level proposal is outlined below (see Table 5). Additionally, a whole separate category of information service providers could be created, which would include research analysts, credit rating agencies, auditors and price vendors.[19]

[19] In most countries research is usually conducted by sell-side analysts that belong to securities firms (broker-dealers) and is thus considered a complementary activity. However it is recommended to create a separate "regulated" activity to ensure that independent research analysis could exist, subject to conflict of interest

Table 7. A proposal for an integrated licensing regime for securities intermediaries

Activity	Qualification requirements	Capital Requirements	Risk-adjusted capital	Liquidity and leverage ratios
Investment advice	Yes	No	No	No
Reception and transmission of orders (introducing broker)	Yes	First echelon of capital	No	No
Structuring and distribution of securities	Yes	First echelon of capital	No	No
Portfolio management (both individual and collective)	Yes	Second echelon of capital	If only activity, adjustments only for operational risk based on AUM	No
Execution of orders on behalf of third parties	Yes	Second echelon of capital	Yes (potentially a streamlined framework)	Potentially liquidity
Acting as principal (underwriting, dealing on own account, etc)	Yes	Third echelon of capital	Yes	Yes
Provision of custody services	Yes	Third and potentially fourth echelon of capital- potentially the minimum capital of a bank for custody of CIS	If only activity adjustments only for operational risk based on asset under custody	No
Systemically important intermediaries	Yes	Enhanced capital requirements	Yes	Yes

Particular consideration would need to be given to qualification requirements. As the type of MFs expand, the qualifications needed for fund managers might need to be specifically tailored to the new risks faced by such funds. For example, in the case of REITs or infrastructure funds, some of the expertise required is not just financial. Based on the experience of other countries, it is recommended that the regulations leave room for joint ventures.

In line with the recommendation above, any change in the licensing regime should be subject to broad consultation with the market. Licensing requirements could potentially act as an undue barrier; thus it is critical that they be appropriately calibrated to encourage innovation while at the same time ensuring robust risk management. Thus, the proposal above should only be taken as guidance. For example, the authorities should consider whether a category of specialized intermediaries for the SME market is warranted.

requirements. This category could be under a licensing regime for information service providers or be a first "activity" under a securities intermediary license.

Part III. Corporate markets

Section I. Lessons from Cross Country Experience

Even within Emerging Market Economies (EMEs), the markets for corporate financing are at different stages of development. The causes of this are complex, **and often relate to the macroeconomic, fiscal and monetary environment, and the lack of a large investor base.** In addition, in most countries there are structural issues that affect the willingness of companies to come to market. On the equity side, many companies are unable or unwilling to meet the transparency and disclosure, and corporate governance requirements of a public offering and associated listing on the exchange. They may not want to share ownership as many of them are family owned. For bond issuance, a key factor is the cost of bond issuance compared to bank lending, especially in countries where banks are very liquid. Further, even in cases where corporates do come to market, the capital markets have not been able to provide long term financing. Improved macroeconomic conditions help to address some of these challenges, however in many countries the dominance of the banking sector is much harder to tackle.

In addition, a key "regulatory" challenge is how to balance the needs of investors with the costs of disclosure. Countries are testing different solutions as to how to ensure that "proportionate" regimes are in place. These solutions relate to the creation of a space for private offerings, and the creation of proportionate regimes for public offerings, as discussed above. On the equity side, such proportionate regime needs to be concerned not only with disclosure but also with corporate governance.

For both equity and debt, secondary market liquidity is an ongoing issue for many EMEs.[20] The problem is more acute for corporate bond markets, although it must be recognized that bonds are by nature less liquid. To a large extent liquidity is dependent on the existence of a wide investor base with different investment profiles; thus problems of the investor base largely explain the level of liquidity of many emerging markets. That said, the more limited the availability of instruments, the more investors might opt for a buy to hold strategy. Some measures can potentially be taken, such as the implementation of market makers and changes to the way securities are traded.[21] However, experience indicates that there

[20] Liquidity concerns also exist in the most advanced economies, although their causes differ. On the equity side, there are concerns that market fragmentation brought by the proliferation of trading platforms and dark pools, and the increased use of high frequency trading are affecting liquidity and more generally changing the structure of the markets, to the detriment of long term investors. On the corporate bond side, the implementation of Basel III has triggered a re-pricing of market making activities. This in turn is leading to changes in the market structure of corporate bonds, from principal to agency models, whereby liquidity would now need to be given by investors themselves.

[21] For example, in some countries the less liquid securities are not traded on continuous markets; rather a call market is in place, so that liquidity can be concentrated at specific points in time.

is no easy solution. Further, some minimum level of liquidity might be necessary for participants to engage in market making activities along with a careful consideration of the potential incentives that could be provided to them.

Section II. Recommendations for Argentina

There are currently few significant obstacles for the development of the equity and corporate bond markets in terms of the regulatory framework for issuance and ongoing disclosure, and the market infrastructure for issuers. As the macroeconomic and monetary conditions improve, the domestic markets for corporate funding (equity and debt) should expand, along with an increased participation from foreign investors. Furthermore, with the change in government, there has been a renewed interest in issuance to fund investment in anticipation of an improved macroeconomic climate. In equities foreign investment may include direct joint equity stakes in selected expanding industries as well as increased foreign investment in domestic equity indices. Debt investors will likely await for additional government benchmark issuances, and/or well established large corporate issuances, and project finance with specific credit enhancement guarantees is an area where investor supply will need to be sought. Thus far in 2016 there have been two international corporate transactions. There is an anticipated pipeline of 5-6 more transactions.

That said, along with the review of the public offering regime recommended above, a key pending issue on the equity side is formulating a clear strategy for corporate governance. Market participants consider that the current governance requirements at MERVAL are roughly in line with those in the international markets; and that the key problem is enforcement. However, it would be useful to assess whether a two-tiered structure might be more suited to the market. The first tier would have higher requirements aligned with those in the international markets, while the second tier would have a more basic framework. This could potentially help to attract foreign investors to the domestic market, while at the same time providing flexibility to accommodate medium size companies for which the higher requirements might be too difficult to comply with. A similar approach was used by Brazil, with the creation of the *Novo Mercado*. In tandem stronger enforcement mechanisms would need to be devised (probably beyond a "comply or explain" regime).

On the corporate bond side, the key challenge is to continue lengthening the maturity of the debt. Overall there are no quick solutions. Improvements in macroeconomic conditions are critical, as is the development of a broader and deeper market of domestic government securities to set a yield curve. However, achieving single digit inflation would be a medium to long term goal. In this context, the development of inflation linked products should be explored following the recent use of dollar issuances. As further explained in the section on infrastructure financing, certain preconditions will need to be in place for the development of those products: first inflation will need to have been brought down significantly and a credible index should exist for peso issuances.

For both equity and debt, going hand in hand with steps to increase the domestic investor base and measures to increase supply, would be a review of other measures to increase liquidity and improve price formation. These will include making the asset management regime of FGS more flexible, by allowing it to rebalance its equity portfolio so it can play a larger role as an investor in the listed corporate

market, and as a more active participant contribute to the overall liquidity of the market. In addition, in the long term, the potential development of a market making framework (which will require an operational securities lending and borrowing and short selling framework), should also be considered as was recently done in Peru.

ETFs are a product that may contribute to the formation of liquidity in the markets, with the caveat that liquidity benefits from their introduction are typically concentrated in the already larger, more liquid stocks and bonds as these are the ones most suitable for inclusion in an ETF index. As investors are comfortable with the risks involved in the purchase of government paper, ETFs based on a basket of underlying government bonds could potentially generate a catalytic effect in the creation of ETF products for broader asset classes including corporate bonds and equity. This could also be a good way to attract retail investors to the exchange, amplifying their investment opportunities across fixed-income and equity products in a cost-effective way and under a single trading environment. For fixed income products, ETFs would also be a way to enhance transparency, consolidate bond indices (tracked by the ETFs) and potentially diversify the investor base and liquidity of the underlying instruments.

Finally, other technical issues should be addressed. On the equity side, a review of the tender offer regime is advisable given the potential for increased M&A activity resulting from increased foreign participation in the markets. Also, as already contemplated, the powers of the CNV over companies that have done a public offering should be reviewed with a view to eliminating “exorbitant” powers which should be removed.

Part IV. Use of Capital Markets for SME Financing

Section I. Key Lessons from Cross Country Experience

Worldwide SMEs consider access to finance as one of their greatest obstacle to growth. In EMEs, formal SMEs represent 45 percent of employment and 33 percent of GDP, while the credit gap for formal SMEs is estimated at USD 0.9 to 1.1 trillion. Another USD 0.5 to 0.6 trillion represents the credit gap for the estimated 60 to 70 million formal microenterprises in EMEs. [22]

Thus, there is an increasing need to explore mechanisms to expand sources of funding for SMEs. As in advanced economies (AEs), finance to the SME sector in EMEs has been predominantly in the form of bank lending. This is due to the high initial due diligence and ongoing monitoring costs of SMEs, relative to the size of credit demanded. Banks can have an ongoing relationship with SMEs and their owners and/or management, involving multiple financial products. This allows them to reduce such costs, or cross-subsidize them by selling other products or services. It is estimated that financing from banks accounts for approximately 50 to 70 percent of the external financing used to fund SMEs' investments in growth.[23] However, the crisis has led to an active debate about broadening the range of financing instruments available for long term financing of SMEs. Alternatives may enable better responses to the diverse needs of the SME sector, and reduce vulnerability to credit shocks.

Cross country experience indicates that capital markets can play an important but complementary role in SME financing. Bank financing remains key for SME financing due to the reasons stated above. However, depending on their level of development, capital markets can play a role in improving SMEs access to funding as summarized below:

- Refinancing of SME lenders: such refinancing can take place via (i) corporate bond issuances allowing SME lenders to improve their funding structure and/or costs which in turn could be reflected in better terms for SMEs, and (ii) securitization structures that allow them to divest their portfolio of SME assets and free capital that can be used again for SME lending. Issuances by SME lenders can be observed already in many emerging markets. However, SME securitization remains a niche market, only developed in a few industrialized countries. Nevertheless interesting experiences with SME securitization have taken place in countries like the United States and

[22] World Bank Group, International Monetary Fund, and Organization for Economic Cooperation and Development, Report to the G20: Capital market instruments to mobilize institutional investors to infrastructure and SME financing in emerging market economies, September 2015.
[23] Ibidem.

Spain from which lessons can be drawn on the potential use of guarantees to leverage capital markets for SME financing.

- Financing of SMEs: there are two ways in which capital markets can directly support SMEs:

    - By providing liquidity: this takes place mainly via the securitization of SME receivables. Countries like Chile (via the *Bolsa de Productos*) and Mexico (via NAFIN) have been successful in developing electronic platforms for factoring trading, and reverse factoring. In Chile's case, credit insurers enhance the ratings of listed factoring receivables on the Bolsa, making them even much more liquid. Capital market instruments linked to reverse factoring can be seen in Chile and Peru, where funds have also been created to invest in pools of receivables.

    - By providing long term funding: this can be done via different types of instruments in the private and public markets, such as private placements and public issuances via alternative markets and/or main markets, respectively. Experience indicates, however, that these avenues are mainly available to the medium and more formal SMEs. Further, while many alternative markets have been developed in both industrialized and emerging markets, their long term viability is a challenge. [24] Thus, they need careful designing.

Section II. Recommendations for Argentina

Similar to the cross country experience, in Argentina, access to finance is one of the most important constraints that firms face. Nearly half of firms rate it as a major obstacle (compared to 30 percent overall, for the LAC region). There are substantial gaps in long-term finance to support productive investment - evident in the short term nature of bank loans, and amplified by the low depth of capital markets and small size of institutional investors. Argentina has one of the lowest investment to GDP ratios in the LAC region (less than 15 percent of GDP), suggesting capital accumulation constraints to economic growth. Micro, Small and Medium Enterprises (MSMEs) are the most affected by economic volatility and finance constraints, despite playing a critical role in employment and growth. Access to finance is a particularly acute problem for MSMEs since, for example, they only receive credit representing two percent of GDP while formal MSMEs account for at least 50 percent of GDP, generate over 70 percent of total employment, and 47 percent of sales.

In this context, it should be emphasized that any strategy for the use of capital markets for SME financing needs to be linked to an overall strategy for SME access to finance. Thus, it is recommended that two reviews be done as key inputs for an SME finance strategy:

[24] Harwood, Alison and Konidaris, Tanya. SME Exchanges in Emerging Market Economies, A Stocktaking of Development Practices, World Bank Group, Working Paper WPS7160, January 2015.

- A review of current barriers for SME access to finance, including the high level of informality of the SME sector in Argentina. Many countries face this type of challenge; however there appear to be additional distortions that exacerbate the problem in Argentina. In particular the mission notes the impact that the credit-debit tax might be having on the reluctance of companies to transact through the formal banking system, and consequently in their access to finance.

- A review of current guarantee schemes, including those provided by the SGRs and also FONPYME, with a view to understanding their cost and impact and ways to better leverage them, potentially also for purposes of facilitating the development of capital market instruments. In this context, there are potential benefits to develop a system of guarantees to be provided on a pooled basis (for a pool of SME loans or other SME assets). The experience of Spain, with SME securitization funds provides important lessons as to how to leverage guarantees in the context of capital markets. The MoF, CNV and domestic investment banks and securitization companies can coordinate to develop viable proposals for such instruments.

As for the capital markets component, the current SME check-based market needs an overhaul. As indicated above, the current system works due to legacy legislation which forces insurance companies to purchase SME instruments via MFs; thus the yield of such investments, while positive in nominal terms, is often below market rates. If such legacy legislation were to be removed is likely that investment in SME related instruments would significantly decreased, as was the case for real estate investment. Thus, it might be necessary to implement any change in a gradual way; while the authorities work on the creation of an SME asset class that can be sold on their own risk/return merits.

MAV could play a key role in the development of an SME asset class. While exchanges have traditionally focused on the development of public markets, it seems that MAV is taking a more holistic approach, whereby its goal is to accompany SMEs along the financing chain, from instruments in the private markets --such as venture capital and private placements-- to issuances in the public markets. This approach is welcome. However, it is important that broad consultation takes place within the investor and borrower community as well as with CNV and MoF, so that the strategy developed responds to a country view of the potential of SMEs.

It is recommended that the following issues be explored as part of the development of such a strategy:

- An analysis of the potential viability and development of capital market products linked to factoring and reverse factoring, such as funds that invest in SME receivables: capital markets products linked to "true" factoring could allow for SME access to finance on market terms, once the current compulsory regime for insurance companies is phased-out. Under the current system (based on post-dated checks) guarantees and the financing itself are based on an analysis of the credit risk of the SME. In contrast, under a "true" factoring regime financing would be based on the credit risk of the companies to which SMEs supply good or services; rather than SME credit risk. Further, if the schemes are developed based on reverse factoring, then the risk could be limited to very large and known companies. Tax issues are the key factor discouraging the

creation of factoring instruments in the domestic market, given their underlying asset revolving nature, and thus paying the credit-debit tax frequently makes the vehicles financially unviable. In fact, there are funds constituted abroad investing in these type of assets. Thus, this issue would need to be addressed. In addition, it would also be desirable that other legal issues were tackled, in particular strengthening the legal standing of invoices (to become "*titulo ejecutivo*") and facilitating their transfer. A similar type of analysis could be done in connection with leasing assets. Since these are technically not capital market products, the MoF may wish to take the lead on this along with consultation with other ministries and financial authorities.

- An analysis of the potential role of private offerings for SME financing. In other countries private placements are a key mechanism for medium size SMEs to access the capital market given the more limited disclosure that applies to them. Thus, as indicated in a previous section it is recommended that the authorities consider the development of a private offering regime. Conversations with the market suggest that some level of private offers is taking place; however reporting to the CNV is not required under the current legal framework.
- An analysis of the potential role of an alternative regime for public offerings tailored to SMEs (both equity and debt). As emphasized above, this regime would be suitable for the larger SMEs. It is understood that the creation of such an alternative regime is being explored by MAV. The initial strategy is to work on creating a specialized segment, whereby MAV would cater to SMEs of a particular sector (such as mining), based on regional strengths. Such approach seems legitimate. Further, it has been used by other alternative markets, in particular the TSX Venture Exchange in Canada. A similar approach could be taken for other strategic sectors such as agribusiness.

The authorities are encouraged to assess what should be the right balance between the development of bespoke solutions and standardized instruments. In its strategy MAV highlights the development of bespoke products. Yet, in the long run standardization is needed to foster the development of the securities and derivatives markets as it allows better pricing and potentially increased liquidity. For example, although there is a wide range of bespoke agri-finance products and instruments to address the funding needs of agribusiness, thought should be given as to which subset of that is most suitable for trading on exchanges, to build a liquid and sustainable exchange instrument.

Part V. Use of Capital Markets for Infrastructure Financing

Section I. Key Lessons from Cross Country Experience

Both AEs and EMEs face an infrastructure financing gap that traditional funding sources will not be able to meet. It is estimated that an additional USD 1 trillion to USD 1.5 trillion of annual investment in low and middle income countries will be required through 2020 to meet the infrastructure demand from industry and households[25]. However, in the majority of EMEs, the need for fiscal consolidation and the size of the funding gap makes it clear that stronger private participation in infrastructure is needed. Bank lending has been a key source of funding for private participation. Yet, additional funding channels will be needed to finance a stronger private participation as it is estimated that the capacity of banks to provide such financing would be constrained both by the size of the gap as well as the impact that Basel III requirements might have in their appetite to provide long term loans. As a result, increasingly institutional investors are being looked at as a potential source of funding, given their sizable AUM, their need to diversify their portfolios and the theoretical alignment of infrastructure financing with their long term liabilities.

Despite its theoretical appeal, currently large institutional investors in AEs invest less than 1 percent of their AUM in infrastructure[26], and the level of investment is even more limited in EMEs.[27] This disconnect is a result of a complex set of issues ranging from the lack of investable ("bankable") projects and concerns about the fairness and integrity of the PPP processes, to rigidities in the investment regime of institutional investors and the lack of risk sharing mechanisms that could align the projects to their risk-return appetite.[28]

Increasingly EMEs are taking actions to tackle these obstacles in a holistic manner. Some early lessons are emerging from those experiences:

- First, at a high level, traditional funding sources including sponsor and bank financing remain key, and thus the strategy for countries is to find integrated solutions that optimize the use of all types of funding.

[25] See WBG, IMF and OECD, Report to the G20: Op cit.
[26] Excluding indirect investment via the equity of listed utility companies and infrastructure companies.
[27] However, there is significant variation in their risk appetite. In particular, the Canadian and Australian funds have a five to 10 percent allocation for infrastructure (one as high as 15 percent). In EMEs, institutional investors in Chile, Mexico and Peru lead infrastructure investment. Ibidem.
[28] Ibidem.

- In the short to medium term the participation of domestic institutional investors is more likely for brownfield projects, while traditional funding sources would probably remain the main source of funding for greenfield projects. However significant innovation is taking place and different structures are being tested that could potentially change this balance.

- Different instruments can and are being used to channel this investment –aside from the traditional investment via listed companies with an infrastructure related business and their bond issuances. Funds, both equity and debt, seem to hold important potential to attract domestic institutional investors, given their benefits in terms of diversification and the possibility to "outsource" due diligence to a professional manager – although issues of fees, duration of the fund and more generally alignment of incentives need to be given careful consideration. Further, debt funds can potentially be used to offload bank loans, freeing bank capital to be used again in infrastructure financing. On the fixed income side, there is also an increased use and testing of project bonds.

- In general, robust risk-sharing arrangements are needed to make PPPs viable and to secure funding from institutional investors. Particularly in the case of debt instruments, credit risk guarantees are being used to bring the instruments to an acceptable risk level (See Annex I for a detailed explanation of risk sharing mechanisms). The WBG is currently supporting many EMEs to develop such guarantees (see Box 3 below).

- Many emerging markets face challenges in attracting foreign institutional investors. In addition to the challenges identified earlier, currency risk is in many cases a key hurdle as there are seldom effective long term-hedging instruments available in EME currencies. Therefore, this is a risk that institutional investors would need to take on and be adequately compensated for, or it must be transferred to a third party. In many EMEs the only counterparty capable of taking on currency risks are the national governments and MDBs. So far global institutional investors have been mostly limited to purchasing local sovereign bonds. Infrastructure bonds issued as quasi-sovereign instruments (such as those issued by Peru) may have appeal.

Box 3. World Bank/Country Initiatives in Infrastructure Finance

The World Bank Group has been recently involved in various infrastructure finance programs in Latin America.

In Colombia, the WBG provided technical advice in designing the financing instruments for the national roads and highways (4G) program where it assisted in the structuring of project bonds with a view to making them marketable to external and internal private institutional investors (e.g., pension funds).

In Brazil the WBG has been advising the government on the development of standardized infrastructure bonds involving the guarantee of interest payments during the construction phase and the credit enhancement of bond principal – this involves the development of domestic banking institutions to have capacity to purchase collateral which would back up such guarantees.

In Peru, the WBG is involved in preparing a guarantee project that would backstop the domestic development bank allowing it to offer guarantees to project concessionaires and financiers/investors. The program is developed hand in hand with the modernization of the PPP rulebook and changes in regulations to ensure that the government lays off any commercial and market risks to the private sector, in order to minimize its fiscal exposure to projects.

Section II. Recommendations for Argentina

On the financing side

Similar to many other emerging markets, Argentina faces a significant infrastructure financing gap. The private sector estimates that up until 2025, there will be a demand for USD 1 trillion worth of projects including at the federal, provincial, and municipal levels and for both the private and public sectors, distributed roughly in the following primary areas with the residual in a number of miscellaneous areas of infrastructure:

- USD 275 billion: Housing
- USD 160 billion: Energy
- USD 150 billion: Urbanization
- USD 90 billion: Water/sewerage
- USD 60 billion: Roads/highways
- USD 265 billion: Other (health, industrial, gas, education, railroads, agriculture, telecoms)

Thus, there is an opportunity to expand private participation in infrastructure execution and financing, inter alia, via PPP contracts. In fact, Argentina has a history of the use of PPPs, mainly in the telecommunications and energy sector. While PPPs were regularly used in the 1990s, their use was

halted during the last decade. As a result PPP contracts went from USD 10 billion outstanding in 1992 to USD 3 billion in 2015.

There is interest by the new Government in expanding the use of PPPs. PPPs are currently being used in the renewable energy sector, supported by a specific law for that sector. In addition, a new draft PPP law has been prepared. With this draft law the Government seeks to address the key concerns that have kept the private sector from engaging in PPPs, in particular the need to ensure the right to use arbitration abroad in case of conflicts, and clear termination rights and penalty clauses linked to mechanisms for their execution abroad, and the possibility of robust risk sharing arrangements. The law has been drafted at a high level (it is a "*ley marco*"), and would thus require the issuance of a sets of rules and regulations to make it fully operational.

As in other countries, financing would require integrated solutions. Furthermore, as per conversations held, banks are aware of the need to strengthen their teams with project finance experts to be able to contribute to PPP financing. Many of them would have the backing of their parent offices, both in terms of expertise and potentially also funding.

Financing through capital markets faces challenges. In contrast with other countries in the region, Argentina lacks a robust institutional investor base with a sizable amount of assets under management to anchor infrastructure financing. Thus, in the short to medium term, financing via the capital markets will likely require the participation of foreign institutional investors. In this context, FGS has a significant amount of AUM that could play an important catalytic role, if its resources are strategically used to attract such investors.

There are clear differences in financing options for projects earning in dollars versus those earning in pesos.

- **For projects earning in dollars:** the option of bank financing in dollars would likely be available. Domestic banks could obtain the dollar funding from their parent companies (in cases where they are part of an international group) or by tapping the international markets. Alternatively the concessionaries could access international banks directly. A key challenge would be the tenor of the debt.[29] Capital market solutions could potentially be developed to lengthen the tenor of such financing. That could be done, for example, by complementing bank financing with infrastructure debt funds, in which FGS or the MDBs could act as strategic investors. The ideal would be that such vehicles were structured locally; however given current barriers to foreign investment it is likely that at least initially they would be created abroad. Another option would be the issuance of project bonds in the international capital markets (placed via Regulation 144 A and Regulation S). There is also potential for the development of equity funds to expand the financing for the equity portion of the project. As is the case for debt funds, it would seem likely that these vehicles would initially be created abroad as private equity funds.

  For projects earning in pesos: the availability of private financing is an open question.

[29] It is expected that Basel III would have an impact on the risk appetite for banks to provide long term loans.

- At the outset it would seem that foreign investors would not be willing to invest in pesos since currency hedging is financially prohibitive at current interest rates. However, solutions that would require the Government to take the currency risk do not seem advisable nor sustainable.

- Thus, inflation linked funding might be an alternative solution.[30] However, preconditions would need to be met, in particular (i) interest rates would need to come down significantly, (ii) a robust index would need to be available, and (iii) a cross currency swap or other type of currency hedge would need to be available for foreign investors, which initially might need to be provided by the CB. It is important to highlight that the use of instruments linked to inflation does give rise to concerns. On one hand, there are concerns that they could embed inflationary expectations in the financial system; on the other, that any index used would lag actual inflation. Finally, time would also be necessary for market participants to regain trust in inflation indexes given past experiences with the underlying data used to calculate the inflation index.

Overall foreign institutional investor participation, even in cases where financing in dollars is suitable, will likely be dependent on the Government taking a large share of the risk. That has been the case for most of the projects financed through capital markets in Latin America, even when tapping the international markets in hard currency. This could potentially mean the need for both contractual guarantees, as well as credit risk guarantees (see Annex I for information on both types of guarantees).

MDBs could play a role jumpstarting the guarantee market; however the sheer size of the infrastructure portfolio requires the development of domestic solutions. Domestic financial institutions with some heft, such as *Banco de la Nación* could play a catalytic role in credit enhancement instruments. These could be initially backed by government capital guarantees which could be initially counter-backed by a multilateral guarantee to provide full investor confidence. The banking and/or capital market laws may need to be amended to specify the capital and leverage requirements allowing a financial institution to be licensed to offer this type of guarantee product. But once the mechanism was in place and funded, it could begin operating with fewer wrap-around guarantee layers provided that an initial set of projects obtained the needed financing.

The guarantee business could have several participants. Other large domestic banks such as the *Banco de la Provincia de Buenos Aires* could potentially be players in the credit enhancement market. As well, banks such as *Banco de la Nación* could potentially "sell" some of its guarantee exposure to other banks or guarantee companies (SGRs) in Argentina (in small strips) while passing on a pro-rata portion of the guarantee premiums. The financial and regulatory authorities would need to decide if this would be sound as most such guarantee companies to date mostly focus on guaranteeing bank credit or

[30] There is mixed experience with the use of inflation linked instrument in EMEs. Chile is an example of the successful use of inflation linked bonds.

guaranteeing other forms of SME funding which in aggregate are much smaller sums than amounts guaranteed under infrastructure projects. However, if the mechanism became successful under one or two institutions, these could eventually lay off small parts of their exposure to other firms that transact in credit enhancements.

Box 4. Methodological Issues – Default Probabilities.

An institution assuming these guarantees would need to count on a methodology for provisioning of risks under PPP contracts based on an actuarial analysis of potential contractual breach or credit default situations. Such a methodology can be developed by analyzing the global portfolio of infrastructure projects' financial performance and risk factors that triggered defaults and under what project, contractual and financial structures. Once an adequate level of actuarially calculated reserves is determined, the initial pipeline of projects can count on a backstop guarantee for the reserves of the guaranteeing institution. In other words, a second generation of backstop guarantees initially provided by multilateral institutions would be, not for individual projects, but to support the balance sheet (i.e. actuarial reserves) of the institution offering the guarantee. As per above such guarantees can be separate for bond credit risks and/or for government-related risks such as incomplete partial payments or the ultimate termination risk.

To reach a viable institutional structure, this would ex ante require a balance sheet analysis of the selected institution, required reserves and solvency calculation based on actuarial risk estimates of a relevant portfolio of PPP projects, contingencies and VAR analysis under worse case scenarios, range estimates of the probability of invoking guarantees by creditors or concessionaires, back up financing lines for liquidity, and finally, pricing of guarantees. Other metrics underlying any such guarantee funding would include ensuring outright or shadow rating of projects (the latter where project bonds are not publicly available), and the need for the institution to partner with investors, brokers and underwriters in assessing project risk and investor risk appetite. The selected guaranteeing institution's instruments for credit enhancement could include not only project bonds, but also debt funds, securitizations, and equity funds.

Finally, a few operational and regulatory aspects would need to be resolved to make the constitution of some of the instruments described above possible, in the domestic markets. As indicated all the vehicles suggested above (funds and project bonds) could be created and placed in the international markets. However, in line with a long term goal of attracting international investors to the domestic markets, the authorities should ensure that such vehicles and instruments could potentially be constituted and placed in the domestic markets. Thus as recommended earlier: (i) all issues that have prevented the development of closed-end funds (e.g. tax treatment, etc.) would need to be addressed; (ii) a regime for offers exclusively addressed to qualified investors should be implemented to facilitate the placement of these products; and (iii) the accounting treatment for non-traded bonds and mark-to-market versus book value requirements, would need to be clarified to ensure transparency in the instrument's valuation. Finally consideration should be given to increasing the maximum allocation for FGS to invest in infrastructure.

Other PPP issues

As indicated above, the Government would need to issue rules to ensure proper implementation of the PPP law. These include critical aspects such as: (i) methodologies to evaluate project viability; (ii) eligibility criteria; (iii) unsolicited proposals; (iv) bidding, selection and procurement process; (v) institutional structure; (vi) contract management and oversight; (vii) financial structuring and financing plan; (viii) risk allocation; and (ix) model contracts.

While a centralized PPP Unit is not essential (though some countries opt for such model), there is a need to develop across-the-board standards for PPP processes and documentation in order to provide certainty to investors. These standards include for potential project bidders, sponsors and partners: the bid documentation and tendering document including the subsequent detailed preparation of project feasibility studies (including design, engineering, and geological studies, environmental and social impact assessments); financial modelling and risks simulation; risk impact and mitigation studies; development of project specific performance indicators; and the financial close package.

Finally, for the Government to ready itself for the infrastructure finance and PPP "industry" it needs to:

- identify a project pipeline and develop a multiannual report for the participating line ministries and subnational governments that summarizes the status of existing and potential PPP projects;
- conduct a project screening and prioritization exercise for potential PPP projects, within and across sectors and regions, taking into account the priorities of the country, sector strategies, needs, technical and financial feasibility, readiness, and other relevant considerations;
- conduct pre-feasibility and detailed feasibility studies as required by Government guidelines and developing a business case for government approval;
- appraise and structure the pipeline of projects following Ministry of Finance guidelines based on international best practices by providing the necessary financial, technical and legal inputs;
- identify, allocate and mitigate risks as discussed in this report;
- tender and negotiate with the private sector until both commercial and financial closure aspects are achieved;
- provide guidelines for contract management as well as operations and maintenance oversight during the life of PPPs;
- refine the existing guidelines for evaluating potential fiscal impact; and
- standardize PPP processes and documentation across sectors.

Annex I. Risk sharing arrangements

A robust PPP framework should have a clear delineation of risk sharing between the public and private sectors. The general principle is that, irrespective of the structure, timing or contingencies of a project, the private sector should be equipped to take all commercial risks since that is the type of "market" risk which is of private sector competence. The Government (or a guarantor, directly or indirectly) should only assume political/regulatory type risks, or in the case of credit risk, provide for the credit enhancement of a bond if that is the only method to raise it to a rating commensurate with the risk appetite of financial market investors.

Thus, the two main parties to be covered for risk by the government and/or associated guarantors are (i) the concessionaire (real sector enterprise) risk against government contractual breaches, or (ii) investor (financial market) risks associated with performance of a bond instrument particularly during non-revenue earning stages of a project. Accordingly, the main project guarantees pertain to contractual issues or credit issues. Thus the credit enhancement mechanisms for infrastructure projects can be elaborated as follows:

Contractual Risk Guarantee: these typically cover potential risks to the concessionaire firm which would not be able to meet the income projections of the project (thus also putting bond investors or banks at risk) due to breach of contractual provisions by the government as a PPP partner, or due to contingencies that reflect catastrophic level events that affect project execution. The usual triggers include the inability to execute previously promised commitments such as allowing (i) land purchases, (ii) rights-of-way for certain facilities or areas, (iii) previously agreed guaranteed minimum revenues (below which the government would compensate), (iv) pre-agreed cost sharing of project costs in the form of government budget obligations that do not materialize, (v) expropriation of assets, (vi) change in agreed tariffs where these are regulated (e.g.: energy prices, toll road fees), and (vii) unexpected major geological risks that make the project cost/benefit unviable).

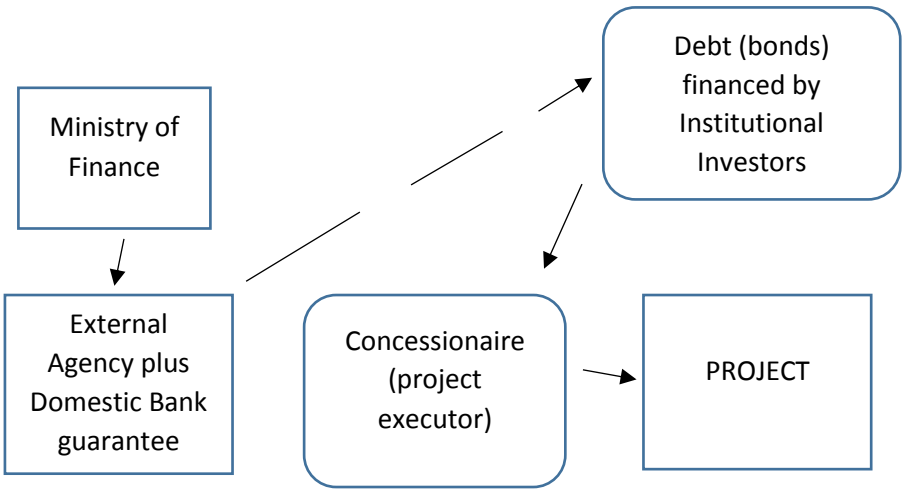
When such breaches or risks materialize and the concessionaire is not compensated, this can also result in project termination risk, i.e., where the concessionaire has the legal right which it invokes, to end its participation and execution of the project. The guarantee in these instances, by a third party, would compensate the concessionaire upon the verification of such a contractual breach and thus provide continuity. In the case the concessionaire does not continue, the guarantee can cover the contract termination risk which means that other private parties involved in the execution or financing of the project have their exposure covered.

Partial Credit Guarantees: these typically cover potential credit risks at key stages of the project which would be deemed unacceptable to financial/bond investors without compensatory protections such as credit enhancement mechanisms. The main risks pertain to fear of default and occur initially at the construction phase of the project where bond risk can relate both to (i) inability of the project to make

timely coupon/interest payments, or (ii) put the bond principal at risk by the time the maturity of the final bullet payment approaches.

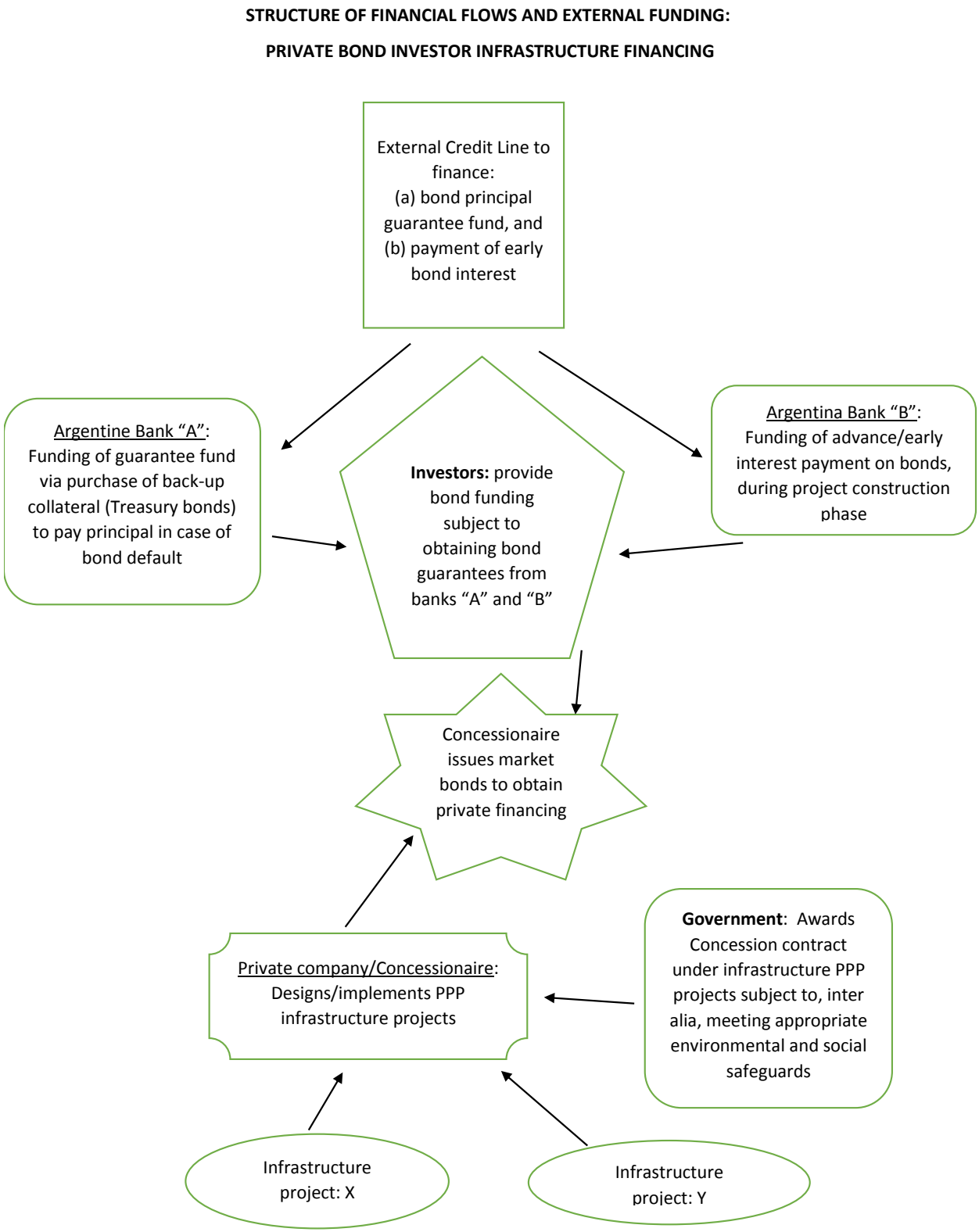
Figure 1 describes a potential direct guarantee for bond investors in PPP projects to be provided under initial pipeline projects. Such a partial credit guarantee could be provided by an external agency or as a wrap-around guarantee to an Argentine bank that offered domestic guarantees; and include either a rolling coupon payment guarantee and/or a final principal payment guarantee, or both. An alternative model for a similar structure would be a guarantee provided to the concessionaire to cover contractual risk breaches versus an outright credit risk / debt guarantee.

Figure 1: Potential external guarantee structure to cover project credit risk in favor of investors



A second type of structure is shown in Figure 2 below. In this case, the guarantee relies on channeling the product via large domestic banking institutions with an initial back-stop of such banks' balance sheets by the government, and backed by a long term contingent external credit line. In this case, the guarantee is a credit guarantee for bond investors. However, two types of guarantees are envisioned and they are split by different institutions to avoid an excessive balance sheet burden on either institution. One guarantee is for interest coupon payments during construction to assure investors of expected bond earning. The other is the guarantee of principal at bond maturity, or alternatively, at the end of the construction period.

Figure 2: Potential external-backed structure to cover project credit risk in favor of investors



In the illustration, the bank providing the guarantee of bond principal (*Bank "A"*) would use a long term external credit line to purchase government paper as collateral with which to offer and back up the guarantee. The collateral would earn interest during the term of the bond so the initial outlay to purchase government securities would be much smaller. As well, the earnings on the government securities would be sufficient to pay off the credit line interest. If the guarantee was invoked, the collateral would be liquidated and paid out to honor the bond principal payments. The bank would then need to repay the credit line provider over the life of the loan for the present value of the principal. However, the idea of the mechanism is to provide a higher rating for the bond to enhance its credit.

In the second case, *Bank "B"* would pay the interest on the bond during the construction phase of the project. Once the project was in its operational phase, *Bank "B"* would capture part of the revenues associated with the interest coupons and use it to repay itself, or repay the credit line provider for the liquidity extended to *Bank "B"* for that purpose.

PPP Contract Issues. Other risks to the government rather than to the concessionaire or investor, pertain to the issue of renegotiation of contracts midway through execution. Renegotiation is sometimes inevitable. However, the government should have a baseline scenario such as a purely public sector executed project using private contractors, to periodically calibrate against PPP/concessionaire contract renegotiation and cost escalation requests in order to determine at which point the cost/benefit advantages of using PPP arrangements are outweighed by renegotiation costs.

Such decisions not to continue a contract and seek alternatives, are by nature extremely difficult since a "no-go" decision on a renegotiation implies that the public sector must take on the remainder of the project by itself, or a new bidder must be sought, both options having also potentially costly outcomes. Thus, contract renegotiation clauses must provide for contingencies that are well beyond the predictability of commercial risk, and barring contractual breaches by the government, essentially force majeure events.

Another key issue in public/private risk sharing pertains to availability payments (*vigencias futuras*). These were traditionally and originally meant for the government to close project funding gaps that would later be covered by revenue streams. Their payment was linked to performance indicators. However, in some countries in the region, they are being used by the Government as a mechanism to address the reluctance of investors to take construction (project) risks. That has been the case of Peru, where for particular projects the Government has issued certificates to the construction company with an unconditional and irrevocable payment obligation once certain construction milestones were achieved. These certificates were then securitized and sold to domestic and foreign investors. These instruments have been very effective in raising private sector financing and building a track record of institutional investor participation in infrastructure financing; however they constitute a significant contingent liability for the Government. As a result they should not be viewed as a long term solution.

Selected Issues on the PPP Framework. The new PPP law has several good features which will help to promote the use of capital market financial solutions. The new law also compares favorably with the old law which had some instances of government interference in PPP arrangements or the government playing on overly central controlling role under PPP projects. Under the new law the explicit instance of

special purpose vehicles (SPVs) is featured and which updates and modernizes the PPP framework – while Argentine legislation already earlier had instances of uses of trusts and SPVs for example, for securitization, given the project-specific design under PPPs it is a positive feature to include SPVs under PPPs as a unique application.

The law permits project cost variations within a 20% range without needing renegotiation (although there does not seem to be any mention about renegotiations of contracts if cost estimates need to be exceeded). In some surveys of Latin America PPP contracts between 30% and 55% of PPP contract amounts were renegotiated and most of such renegotiations were initiated by concessionaire). Thus, the provisions for contract renegotiation should be defined in detail lest PPP projects end up costing the Government the same or more than if the Government had simply put out contracts to bid under a 100% publicly sponsored project.

The law makes reference to minimum revenue guarantees. While this is fine and part of standard practice, it should not to be abused as standard feature in all cases and in some instances revenue generation is purely a commercial risk that should be assumed by the private party). Other features such as contractual guarantees are positive elements though in practice the detailed instanced of application will need to be defined, for example, to include breach of certain promises such as (a) land rights, (b) regulated tariff levels, (c) fiscal matching resources (d) right-of-way promises, and other causes for compensation or contract termination. As well, the new law has positive features to project debt payments upon invoking termination. The causals of termination of course require specificity and exactitude while drawing the line between guarantees and compensation for contractual versus outright termination.