

Chile

Corporate Governance Institutions, Practices and Developments

1. Key Institutional Features of Corporate Governance and Company Profile in Chile

1.1 Background

Chile's main legislation and regulation on corporate governance is as follows:

Securities Markets Law (Law 18.045): Enacted in 1981 and subsequently modified and improved on several occasions, this law governs the public offering and trading of securities, the markets in which these are traded, their issuers and the intermediaries that operate in these markets. It establishes standards that promote market transparency and effectiveness, such as opportune and accurate disclosure of relevant information about issuers of publicly-traded securities.

Law on Corporations (Law 18.046): Also enacted in 1981 and later modified and improved on several occasions, this law establishes the definition of a public company, classifies public companies, regulates their administration and operation, and defines the bodies that comprise these companies. It establishes a framework that facilitates shareholders' exercise of their rights and their equitable treatment, including that of minority shareholders. In addition, it establishes that the body principally responsible for a company's administration is the board of directors and regulates the responsibility of directors towards shareholders.

Law governing the Superintendency of Securities and Insurance (SVS), enacted in 1980: The SVS is the body responsible for overseeing compliance with the Securities Markets Law, for drawing up the regulation necessary for its implementation, and supervising companies issuing securities or that register securities with the SVS. This supervision is essential to ensure that the legal and regulatory framework on corporate governance is effective in practice.

Law governing the Superintendency of Banks and Financial Institutions (SBIF): The SBIF is the body responsible for regulating the banking industry and for supervising compliance of banks, as among the most important players and intermediaries in the financial market, with the corresponding legislation and regulation.

Law governing the Superintendency of Pensions (SP): The SP is the body responsible for regulating and supervising Pension Fund Administrators (AFPs) and ensuring their compliance with the corresponding regulation. AFPs are among Chile's main institutional investors and, therefore, play a fundamental role in the implementation of good corporate governance practices.

Circulars, Official Letters and General Regulations issued by the SVS, SBIF and SP: They seek to perfect, clarify and update the regulation and functioning of the securities market and companies participating in it.

Regarding stock exchange listing requirements, the Santiago Stock Exchange (SSE), which concentrates the vast majority of trading, listings and liquidity, imposes no additional requirements on issuers beyond what the law requires. While the SSE may halt trading in a share for up to five days if insider trading is suspected or there is unusually volatile trading, this is a rare occurrence, and occasional insider trading episodes are widely held to occur.

Historical issues have spurred the development of the legal and institutional basis described above. It has been argued, for example, that the establishment of a privately administered, defined-contribution pension system in 1982, as it focused public attention on financial markets, may have served to improve the quality of regulation, including the regulation of corporate governance.

Specific events and crises have also served to improve financial market regulation and corporate governance: the 1982-3 banking crisis led to the 1986 banking law restricting related lending and eliminating bank ownership of equity; the control premium paid for Enersis in 1999 and the sale to the controller Telefónica España of the CTC subsidiary Telefonica.net led to the 2000 corporate governance law effectively eliminating dual class shares and establishing a directors' committee to review related party transactions; the CORFO (Chile's Economic Development Agency) – Inverlink financial scandal led to aspects of the MK II law regarding improved security and dematerialization of financial instruments, and perhaps more tenuously, the 2004 sale to the controller Telefónica España of CTC's mobile telephony subsidiary has led to calls for further enhancement of minority shareholder protection.

1.2 Trends

Chile has three stock exchanges: the Santiago Stock Exchange (SSE), the Electronic Stock Exchange (ESE) and the Valparaíso Stock Exchange (VSE). The table below only focuses on the SSE, since it concentrates the vast majority of trading, listings and liquidity.

Year	Number of Companies	Market Capitalization (Million USD of Dec. '09)
2005	245	151.940
2006	244	197.024
2007	238	225.005
2008	235	164.484
2009	232	233.401

Source: SSE

Key Corporate Governance Rules and Practices

The annex covers key corporate governance rules and practices in Chile in relation to rights of shareholders, the composition and responsibilities of the board of directors, and the transparency of companies regarding their operations and financial condition.

2. Development, Enforcement and Assessment of Implementation of Corporate Governance Rules

2.1 Development of Corporate Governance Rules

In recent decades, Chile has carried out a continual process of legislative and administrative reforms that has allowed its capital market to develop and has left the economy in a good position to confront the challenges of increasingly complex and dynamic global markets.

The Ministry of Finance has played a leading role in this process. One of the main roles of the Ministry is to monitor the local financial system and its impact on other sectors in the economy in terms of immediate and long-term issues related to the development of capital markets. It also provides support on public policy issues that have financial components, even though they may be associated with other areas of the economy, such as pension reform. In this context, the Ministry of Finance has developed and supported legal initiatives to regulate the financial system, including corporate governance issues, as was the case with the Corporate Governance Law recently approved (more details in Section 6).

The Ministry of Finance has also worked actively with entities responsible for regulating the financial system – such as Chile’s Central Bank, the Superintendency of Pension (SP), the Superintendency of Securities and Insurance (SVS), and the Superintendency of Banks and Financial Institutions (SBIF) – and with the capital markets advisory council, which is made up of members from different private sectors, to resolve issues related to the modernization of the financial system.

Finally, it is worth recalling that Circulars, Official Letters and General Regulations issued by the SVS, SBIF and SP seek to perfect, clarify and update the regulation and functioning of the securities market and companies participating in it.

2.2 Enforcement of Corporate Governance Rules

The Law on Corporations, the Securities Market Law and other relevant laws grant supervising entities with appropriate authority, power and control mechanisms for the fulfillment of their duties, particularly in overseeing the implementation of laws and regulations. Supervisory bodies’ rulings are public and subject to the scrutiny of the courts when necessary.

The Superintendency of Securities and Insurance (SVS), the main supervisory entity for the capital markets, is an autonomous corporate body affiliated with the Chilean government through the Ministry of Finance. It was created in 1980 and the head is the Superintendent, who is its judicial and out-of-court legal representative, appointed by the President of the Republic. It is responsible for the supervision of all activities and entities involved in Chilean securities and insurance markets, such as, listed corporations, issuance of securities for public offer (stocks, bonds, commercial papers, investment fund shares), stock exchanges, clearinghouses, security brokers, external auditors, mutual fund managers and their funds, investment fund managers and their funds, foreign capital investment funds and their funds, risk-rating agencies, securitization companies, mortgage mutual fund managers and their funds, centralized security deposits, among others. The SVS enforces compliance with all laws, regulations, by-laws, and other provisions governing the operation of these markets.

On the other hand, institutional investors have decisively influenced corporate governance in Chile, pressing for more disclosure requirements and for the protection of minority shareholders rights. In fact, a section of the pension fund law explicitly promotes corporate governance safeguards and a minimum free float of 35% (making 2/3 control impossible). Additionally, pension funds have self-regulated their votes for directors⁷⁶ and have also been using external head-hunting firms to draw up lists of potential candidates, so as to professionalize the selection process.

2.3 Assessment of Corporate Governance Practices

In 2003, the World Bank – IMF Report on the Observance of Standards and Codes (ROSC) reported broad compliance with corporate governance principles in Chile, with no principle deemed “not observed.” The key weaknesses highlighted in the report were poor disclosure of capital structures that allow shareholders to separate control and cash flow rights; general disclosure; auditing; and board functioning, including the definition of board member independence. Later on, in 2008, Chile undertook a self-assessment process with respect to the observance of the OECD Principles of Corporate Governance as part of its entry process to the OECD, already completed.⁷⁷ The state of affairs seems to have improved substantially: all of the OECD Principles of Corporate Governance were identified as either fully or broadly implemented.

4. Corporate Governance of State-Owned and Family-Controlled Enterprises

4.1 State-Owned Enterprises

Chile recognizes the importance of improving the corporate governance of State-Owned Enterprises (SOEs) and accepts the philosophy of applying as far as possible norms for private-sector companies to state enterprises.

The economy’s current norms in this area are consistent with the principles stated above. Those norms include the ones that created the System of State Enterprises (SEP) and regulate its powers. The SEP is a committee, without independent legal status, created by the Corporación de Fomento de la Producción, CORFO (Chile’s Economic Development Agency), to represent the interests of the Republic and, in particular, those of CORFO in most of the enterprises in which it is a partner, shareholder or owner. It does so by appointing directors and controlling the strategic management of the enterprises under its responsibility.

In this line, a code drawn up in 2008 by the SEP for the State enterprises under its tuition aims to establish homogeneous management policies applicable to all SOEs and to provide them with common norms and guidelines for the achievement of efficiency, effectiveness, probity and transparency in their management. A bill presented by the government in 2007 and

⁷⁶ Their self-imposed selection criteria now exclude voting for candidate directors that (i) are ex-executives of the firm; (ii) were previously voted onto the board by the controller; (iii) have been on the board for six years or more; or (iv) have more than one other directorship.

⁷⁷ On 7 May 2010 Chile completed the last step in its path to OECD membership. In signing the OECD Convention, Chile pledged its full dedication to achieving the Organisation’s fundamental aims and became the first South American economy to join the OECD.

nowadays being discussed in Congress, aims at legally validating the principles stated in this code.

4.2 Family-Controlled Enterprises

In Chile, family owned conglomerates make up an important proportion of the controlling shareholders. The main corporate governance issues relating to the way family-controlled corporations operate are the presence of non-professional directors (many of them blood relations to the head of the company) and relating to the risk management of the company that generational succession poses.

5. Role of Professional Service Providers in Corporate Governance

The Chilean corporate governance framework relies heavily on advice and research provided by analysts, brokers, rating agencies and others, which are relevant for investors' decisions. The Securities Markets Law and the Law on Corporations prescribe the duties of all such advisors and analysts, preventing conflicts of interest and promoting transparency.

The Corporate Governance Law recently approved (more details in Section 6) reinforces this approach by requiring all such entities to adopt and make public their policy regarding use of privileged information, internal research, and prevention of front running. Also, the Corporate Governance Law enhances the rule that penalizes the spreading of rumors or false information about listed firms or securities. Moreover, it states that material information delivered to analysts should be simultaneously disclosed to the market, according to the administrative regulations of the SVS.

6. Recent Developments in Corporate Governance

6.1 Corporate Governance Developments

Corporate Governance of Private Enterprises

On 1 January 2010, a new law on corporate governance (Law No. 20.382, the "Corporate Governance Law") was enacted drawing on OECD guidelines and other standards, in order to comply with best international practices in this field, which introduced significant changes to Law No. 18,046 (the "Corporations Law") and Law No. 18,045 (the "Securities Market Law"). A summary of the most relevant aspects of this law is found below.

Independent Directors

According to the amended Article 50 bis of the Corporations Law, listed corporations shall appoint at least one independent member to the Board of Directors, if the following conditions are met: (i) the market capitalization is equal or greater than 1,500,000 UF (approximately US\$56 million); and (ii) at least 12.5% of the voting shares outstanding are held by shareholders that individually owns or controls less than 10% of the voting shares. Regarding this matter, stricter and more objective criteria for determining directors' independence were established.

Directors' Committee

Listed corporations meeting certain market capitalization and ownership dispersion thresholds must set up a directors' committee, which will need to be comprised of three members. This committee will have more authority to revise aspects related to the progress of the company, related party transactions and the interaction with auditors, proposing to the board of directors the best way to proceed in each case.

The majority of the directors' committee members shall be independent directors if certain additional requirements are met. In case of disagreement in their nomination, the board shall prefer those directors elected with a larger percentage of minority shareholders votes. On the other hand, if there is only one independent director, such board member shall designate the remaining committee members among the non-independent directors. The chairman may not serve on the committee or any subcommittee, except in the case of independent directors.

New Responsibility of the Board of Directors Regarding Information

The Corporate Governance Law established that the board of directors shall be responsible for taking actions to avoid the disclosure of information related to the corporation's legal, economic and financial situation, before it's provided to the shareholders and the public, to persons that should not need to have access to the information considering its position or activity in the company.

Prohibitions of the Board of Directors' Members

Members of the board of directors shall not propose amendments to the bylaws, agree on the issuance of bearer securities or adopt policies or decisions that are not in the corporation's best interest. Additionally, the bill extends the prohibitions of the directors on preventing or obstructing any investigations aiming to establish the responsibility in the management of a corporation, to chief officers, managers and key staff of such corporation. Finally, the law also extends the directors' prohibition on inducing to provide irregular accounts, submit false information and conceal information to the managers, key staff, employees, external auditors and rating agencies.

Extraordinary Shareholders Meetings

The Corporate Governance Law introduces, as new matters that need to be agreed in an extraordinary shareholders meeting and require two thirds of the voting shares, the following:

- The sale of 50% or more of the assets of a corporation's affiliate, if that sale represents at least a 20% of the assets of such corporation.
- Any sale of shares of a corporation's affiliate that would result in the parent corporation losing its control over the affiliate company.
- The power to exercise squeeze out rights.
- The approval or ratification of acts or agreements to be entered into or entered into with related parties.
- An amendment of the bylaws aiming to extend the term of a preference share. In this case, the amendment shall be agreed by two thirds of the respective class of shares.

Redemption Rights

Amended Article 69 of the new law states that shareholders shall have redemption rights in the case of (i), (ii) and (iii) of the precedent number. Additionally, the minority shareholders shall

also have redemption rights, in case the majority shareholder acquires more than 95% of the outstanding shares of a listed corporation.

Related Party Transactions

The Corporate Governance Law includes an entirely new title to the Corporations Law (Title XVI) in order to regulate potential conflict of interest in transactions between the corporation and related parties. Although the existing Corporations Law deals with this matter, the new bill expands the definition of related party, includes new procedures and quorums for the approval of such transactions and specifies the prohibition of taking corporate opportunities by any director, chief officer, manager, key executive or controlling shareholder, also including any of their related persons.

Infringement of Related Party Transactions' Provisions

Without prejudice of other sanctions that may be available, the breach of any of the obligations mentioned above, will not affect the validity of the transaction. However, the corporation or shareholders may demand from the breaching party, the reimbursement, in favor of the corporation, for an amount equivalent to the benefits gained by the breaching party as consequence of the transaction. Additionally, the shareholders and the corporation may claim damages. Finally, the breaching party bears the burden of proof that the transaction was carried out according to the law.

Taking of Corporate Opportunity

The new Article 148 of the Corporations Law specifies the prohibition of taking corporate opportunities, establishing that no director, manager, main executive, liquidator, controller or their related persons may use any business opportunities they may know about because of their position in their own benefit. For this purpose, business opportunity shall mean any exclusive plan, project, opportunity or proposal directed to the corporation, aimed to undertake a profitable activity related or complementary to the corporation's line of business.

Privileged Information

The amended article 165 of the Securities Market law imposes the obligation to any person with access to inside information because of his/her job, position, activity or relationship with the securities issuer or with the persons mentioned in article 166 of the same law shall maintain strict reserve, and may not use such information to his own benefit nor to the benefit of another, nor purchase or transfer for himself or for others, personally or through third parties, the securities he has inside information about. The rule that establishes the persons who are assumed to have access to inside information was extended.

Corporate Governance of State-Owned Enterprises

The government presented two bills in 2007 that seek to modernize corporate governance of SOEs. One addresses governance in the Corporación Nacional del Cobre de Chile (CODELCO), the state-owned copper producer,⁷⁸ and the other one addresses governance in

⁷⁸ CODELCO is of great importance to the state of Chile and makes a crucial contribution to fiscal revenue. It should be noted that it is the world's largest copper producer and Chile's largest company. It is totally state-owned and has a 16,000-strong workforce. For this and other reasons, it represents a special case among SOEs in Chile, warranting individual attention and its own bill.

most of Chile's SOEs. The first was approved in November 2009 and the other is being discussed in the Congress.

Specifically, the law that addresses governance in CODELCO introduces important modifications to its statutes, among which are the strengthening of the board of directors, the increased transparency and supervision, and an institutional redesign. In turn, the other bill would strengthen corporate governance in SOEs, creating a modern and uniform regulatory framework, in order to increase transparency and the quality of management and supervision, based on three pillars: the redesign of the SEP Council; the strengthening of boards of directors; and the increased transparency and supervision.

6.2 Enforcement of Corporate Governance Rules

The Superintendency of Securities and Insurance (SVS), the main supervisory entity for the capital markets, has taken several regulatory enforcement actions against companies over the last two years, but only one of them has been related to the non-compliance of corporate governance rules. In December 2009, the SVS sanctioned the board of directors and the management of Farmacias Ahumadas S.A. (FASA), involved in a case of collusion, for violating article 41 of the Law on Corporations, which establishes a standard for the fulfillment of their duties. Specifically, the SVS fined the board of directors of FASA for not exercising their right to be fully informed, established by article 39 of the Law on Corporations, and the president of the board and the company's CEO for concealing relevant information to the board.

6.3 Current Issues and Challenges for Corporate Governance

6.3.1 Challenges

Chilean listed companies show a high level of ownership concentration and many of them are part of major conglomerates. A consequence of this situation is that one of the central corporate governance challenges in Chile is to prevent the risk of minority shareholder expropriation at the hands of controlling shareholders, who do not face the standard "vertical" principal-agent problem of separation of ownership and control in which company management (the effective controlling party) is difficult to monitor and call to account. Instead, in Chile the controlling party is also in effect the manager of the company, and thus to an extent an agent of the minority shareholders: a "horizontal" principal-agent problem. Two high-profile cases of sales of subsidiaries of a listed firm with significant pension fund minority shareholdings to controlling party companies at allegedly below-market prices have highlighted the importance of potential minority shareholder expropriation.

Moreover, ownership concentration implies the absence of a market for corporate control (i.e. hostile takeovers) a standard palliative of the principal-agent problem in Berle and Means-type corporations. Minority expropriation is likely to be especially acute when cash flow rights are separated from voting rights by mechanisms such as pyramid schemes, cross shareholdings, and dual-class shares. While cross shareholdings are illegal in Chile and use of dual-class shares is limited, pyramids are a feature of the domestic corporate landscape. Despite this, controllers in Chile tend to own more equity than is necessary for control, as the low levels of free float attest.

6.3.2 Priorities for Reform

The Ministry of Finance has recently announced a new capital markets reform agenda, denominated Mercado de Capitales del Bicentenario (Bicentenary's Capital Markets) or MKB,

to be developed during the next four years. One of the main issues that this agenda will address is the governance of the Superintendency of Securities and Insurance (SVS) in order to confer the institution higher levels of autonomy and a more robust structure, among others. In doing so, the reform would reduce the risks of political interference and discretionary behavior in the fulfillment of the Superintendency's capital markets supervisory role.

At the same time, the Ministry of Finance is currently drafting the amendment to the Reglamento de Sociedades Anónimas (Regulation on Corporations Law) enacted in 1982, in order to update it in accordance to the latest legal changes—especially the new law on corporate governance—and the jurisprudence and doctrine of the SVS.

6.3.3 Financial Crisis

The positive performance of the Chilean economy during the recent global financial crisis reaffirms the development of the economy's capital markets and the solidity of its financial system. Largely, Chile's favorable situation in this respect is in part due to a good corporate governance framework, in line with best international practices in this field. It's worth noting, for example, that Chilean banks did not present balance sheet issues nor did they indulge in irresponsible behavior that could have exacerbated the restricted credit conditions globally. In general terms, the Chilean corporate sector performed well during the crisis and avoided many of the major failures observed in other economies.

Key Corporate Governance Rules and Practices in Chile

Element	Yes	No	Source(s) of Rule	Comments
RIGHTS OF SHAREHOLDERS				
1. Do shareholders add items to the agenda for shareholders' meetings?	X		CL	Shareholders in possession of more than 10% of the company's equity can convoke to shareholders' meetings in order to discuss special topics.
2. Do shareholders ask questions of directors at shareholders' meetings and do they receive answers?	X		GP	
3. Must company transactions with its insiders be on a non-preferential basis?	X		CL	
4. Is a super majority vote required for major company acts affecting shareholder rights?	X		CL	The agreements of the special shareholders' meeting that imply the amendment of the corporate by-laws or the elimination of the annulment of modifications caused thereby due to irregularity of procedures, shall be adopted with the majority stipulated in the by-laws, which in closely-held corporations may not be less than the absolute majority of the voting shares issued. Agreements related to the extraordinary matters of article 67 require the favorable vote of two thirds of the voting shares.
COMPOSITION AND ROLE OF BOARDS OF DIRECTORS				
5. Must boards have independent directors? What percentage?	X		CL	Listed corporations shall appoint an independent member to the Board of Director, if the following conditions are met: (i) the shareholders equity is equal or greater than 1,500,000 UF (approximately US\$56 million); and (ii) at least 12.5% of the voting shares outstanding are held by shareholders that individually owns or controls less than 10% of the voting shares.
6. Do independent directors have significant influence	X		CL	Listed corporations meeting certain market capitalization and ownership dispersion thresholds must set up a Directors'

Element	Yes	No	Source(s) of Rule	Comments
over (a) internal and external audit and (b) executive compensation?				Committee, which will need to be comprised of three members. The majority of them shall be independent directors if certain additional requirements are met.
7. Do independent directors decide what information the board receives from management?		X		
8. Are the chairman of the board and chief executive officer different persons in the majority of listed companies?	X		CL	The position of manager is incompatible with that of corporation chairman, auditor or accountant and, for listed corporations, also with that of member of the board.
9. Are all board members elected annually?		X	CL	The board of directors shall be completely renewed at the end of the period stated in the bylaws, which may not exceed three years. The board members may be reelected indefinitely in their functions. If the by-laws should not expressly provide otherwise, the board of directors shall be renewed every year.
10. Does the board oversee enforcement of a company code of conduct?		X		
TRANSPARENCY AND DISCLOSURE OF INFORMATION				
11. Do financial statements comply with International Financial Reporting Standards?	X			To date, for listed corporations only.
12. Are the identities of the five largest shareholders disclosed?	X		SL	
13. Is compensation of company executive officers disclosed?		X		
14. Are extraordinary corporate events disclosed?	X		SL	Listed corporations and entities under the SVS supervision shall disclose truthfully, sufficiently and promptly, any material or essential information about themselves and their business when it occurs or becomes known to them.
15. Are risk factors disclosed in securities offering materials?	X		SL	SVS regulates the content of the prospectus and any other information to be disclosed in offering materials.
16. Are transactions of a company with its insiders disclosed?	X		CL	A corporation may exclusively enter into contracts or agreements in which one or more board members have an interest or as representatives of a third party, when such operations are previously known and approved by the board and fulfill equity conditions similar to those usually prevailing in the market. The agreements that the board may adopt in this respect shall be notified by the chairman in the following shareholders' meeting and the matter must be mentioned in the summons to the meeting. The acts or contracts referred to in the foregoing paragraph, as well as the designation of the independent evaluators, shall have the character of an essential event (and therefore informed to the SVS).

Note: CL – company law; SL – securities law; CGC – corporate governance code; SLR – stock exchange listing requirement, GP – general practice but not obligatory