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FEATURED Q&A

Has State Lending Hindered Brazil's Capital Markets?



Government influence in credit markets has led to the crowding out of corporate financing from debt and stock markets in Brazil, according to the country's Securities and Exchange Commission, or CVM, led by Executive Chairman Leonardo P. Gomes Pereira. // File Photo: CVM.

Q Brazil's securities industry regulator said June 21 that capital markets activity in Brazil will fail to grow significantly as long as state lenders keep the country's companies hooked on cheap credit, Reuters reported. CVM, as the regulator is known, says that years of what it sees as active state meddling in credit markets have led to the crowding-out of corporate financing from debt and stock markets. Have state lenders been a hindrance to growing Brazil's capital markets? How can Brazil encourage more robust flows of international and domestic capital? What benefits would more sophisticated capital markets bring to Brazil's economy, and what are the downsides of having less state involvement in the financial markets?

A Alexandre Albuquerque, vice president and senior analyst at Moody's América Latina in São Paulo: "The rapid expansion of subsidized loans by government-owned banks, especially by development bank BNDES, has crowded out private lenders and created significant distortions in Brazil's credit and capital markets. After paying 123 billion reais of the loans it received from the national treasury between 2008 and 2014, BNDES still owes roughly 440 billion reais to the government. Those resources allowed BNDES to flood the market with below-market financing to large and small companies, particularly in the infrastructure and heavy-industry sectors. The ample volume of subsidized loans supplied by BNDES discouraged companies from seeking financing from debt and stock markets. Even companies that had access to private market financing would still turn to BNDES because of its favorable loan terms. We expect slower growth at BNDES will ease the

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TOP NEWS

BANKING

Brazilian Banks Eye Large Payday From Carrefour Unit IPO

Banks handling the initial public offering of French retailer Carrefour's Brazilian unit are expected to see the country's largest payday for IPO bankers in eight years.

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PENSIONS

Chile Pension Reform Needs Broader Support: Finance Minister

Chile's government wants to finish the reform before the November presidential election, but the plan needs broader support, said Finance Minister Rodrigo Valdés.

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INSURANCE

Fairfax Financial Completes Allied World Acquisition

Fairfax Financial Holdings Chairman and CEO Prem Watsa said Allied World, which Fairfax is acquiring for \$4.9 billion, has an "extraordinary track record."

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Watsa // File Photo: Columbia University.

BANKING NEWS

Brazilian Banks Eye Large Payday From Carrefour Unit IPO

This month's initial public offering for the Brazilian unit of French retailer Carrefour is expected to generate nearly \$42 million for the group of banks that are handling the offering, Bloomberg News reported July 10, citing a regulatory filing by Carrefour. The lead bookmaker on the offering, Banco Itaú BBA is expected to receive half that amount, with the rest of the participating institutions, Bank of America, Goldman Sachs, Banco Bradesco BBI, Banco Santander, JP Morgan Chase & Co. and BNP Paribas, dividing up the rest. The amount is expected to be the largest payday for IPO bankers in Brazil in eight years, Bloomberg news reported. "This is the year of the comeback for IPOs in Brazil," Joelson Oliveira Sampaio, a finance professor at Fundação Getulio Vargas, told the news service in a phone interview. "The market had stalled, with only a handful of deals since 2014." Just four IPOs were completed in Brazil between 2014 and 2016 amid the country's political and economic turmoil. However, this year has seen a recovery, with 5.82 billion reais coming to market so far this year.

INSURANCE NEWS

Reinsurer IRB Brasil Files for Secondary Share Offering

Reinsurance company IRB Brasil Resseguros on July 7 filed for an initial public offering of shares, Reuters reported. The share sale will be a secondary offering, with shareholders including Fundo de Garantia de Operações de Crédito Educativo, BB Seguros Participações, Bradesco Seguros and Itaú Seguros selling some of their stakes as part of the offering, according to a prospectus on the Web site of

securities regulator CVM. Banco Bradesco's investment-banking unit will underwrite the offering, alongside several other banks, including Banco do Brasil and JP Morgan Chase & Co. The reinsurer is backed by Brazil's government, which owns a stake of 27 percent, according to Reinsurance News. ITB Brasil Re was formed in 1939 in order to offer reinsurance to local insurance companies. It later became the country's largest domestic reinsurance firm.

Fairfax Completes \$4.9 Billion Allied World Acquisition

Toronto-based investment and insurance company Fairfax Financial Holdings has completed its acquisition of Allied World Assurance Co. Holdings for \$4.9 billion, Insurance Journal reported July 6. The acquisition marks the largest-ever purchase for Fairfax, which made several acquisitions last year, including the insurance operations of AIG in Argentina, Chile, Colombia, Uruguay, Venezuela and Turkey. The Allied World acquisition is the "most significant" for Fairfax Financial Holdings, said Prem Watsa, Fairfax's chairman and chief executive officer. Allied World has had an "extraordinary track record," Watsa said in a March letter to shareholders, adding that the insurer has an average combined ratio from inception of 90.7 percent. Additionally, it has an average return on equity of 12 percent for shareholders. Watsa said Allied World CEO Scott Carmilani will continue to run Allied World in accordance with the decentralized management style of Fairfax "with no changes other than what [Carmilani] sees fit to implement," said Watsa.

Nezter Seguros Gets Ratings Downgrade From A.M. Best

Rating agency A.M. Best on July 6 downgraded its ratings for Mexico City-based insurance company Nezter Seguros. A.M. Best downgraded the company's financial strength rating

NEWS BRIEFS

Evertec Buys Chile's PayGroup for \$38 Million

Puerto Rico-based payments processing firm Evertec said July 3 that it had acquired EFT Group, commercially known as PayGroup, for \$38.5 million. Based in Chile, PayGroup offers payment processing and software services targeted primarily to financial institutions throughout Latin America. The company manages a system of electronic payment networks that process more than two billion transactions annually across most Latin American countries.

A.M. Best Holding Insurance Market Briefing in Mexico City

U.S.-based insurance rating agency A.M. Best plans to hold a briefing on Mexico's insurance market during on Aug. 31 in Mexico City, the company announced July 10. In a statement, the company said experts from the company will "deliver market insights, present an overview of the state of the industry and discuss rating trends." The company, headquartered in Oldwick, N.J., will also present changes to A.M. Best's rating methodologies. The event will be held in Mexico City's St. Regis Hotel.

Chile Pension Reform Needs Broader Support: Finance Minister

Chile's government wants to finish a planned pension reform before the country's presidential election in November, but the plan will need broader support, Finance Minister Rodrigo Valdés told reporters June 30. "We have all the intention to, but it doesn't just depend on us exclusively," Valdés said in London on the sidelines of the annual "Chile Day" investment conference. "It takes two to tango and we will see how it goes. It is a complex reform." Valdés added that he wants Chile and Britain to negotiate a trade deal as soon as possible.

to C- from C, its long-term issuer credit rating to ccc- from ccc+ and its Mexico national scale rating to ccc-.MX from ccc+.MX, the rating agency said. The credit ratings are still under review with negative implications. The downgrades reflect "continued pressure" on the Mexican insurer's risk-based capitalization as well as a "significant delay" in the company's correction of its shortfall in its minimum paid capital as a regulator had requested, A.M. Best said in a statement. Nezter also had a weak performance "mainly derived from the lack of consistency between revenues and the company's cost structure," the rating agency added. The insurance company did, however, have an adequate risk-adjusted capitalization as of April, it said. But as of that month, Nezter also underwrote a "considerably small amount of policies" that were unable to mitigate its fixed costs, said A.M. Best. The company's capital position as of last December was also adequate, the rating agency said. In 2015, Nezter Seguros received authorization from Mexico's finance minister to operate as a newly constituted local property title insurance company. The approval was granted after Nezter acquired the former First American Title Insurance Mexico. "This recent acquisition aspect places a burden on the company's brand recognition and is viewed as a challenge in implementing its growth strategy," A.M. Best said in a statement.

REMITTANCES NEWS

Mexico's Remittances Grow 6.3% For Year's First Five Months

The amount of money Mexican workers sent home to their families grew by 6.3 percent in the first five months of 2017 as compared to the same period last year, Mexico's central bank said July 3. Remittances totaled \$11.5 billion for the year through May. In U.S. dollar terms, remittances continue to grow at "a solid pace, but their real purchasing power in local currency has been eroded" by the appreciation

of the peso to the dollar, which has risen 14 percent year to date, and higher consumer prices, Alberto Ramos of Goldman Sachs told clients in a research note. Despite expectations for continued steady money transfers, lagging consumer credit and negative real wage growth will likely weigh on private consumption growth in Mexico's economy during the quarters ahead, Ramos said. Mexico ranked fourth in the world in 2016 for total remittances flows received, behind only India, China and the Philippines. [Editor's note: See [Q&A](#) the effects of possible U.S. taxation on remittances to Mexico in the Feb. 23-March 8 issue of the Financial Services Advisor.]

FEATURED Q&A / Continued from page 1

crowding-out that happened in recent years, diminishing distortions in the corporate finance market and in monetary conditions. This will allow other banks to step in and capture greater market share. With BNDES playing a less active role, private banks will be able to boost their fee income by helping companies sell debt, and eventually take advantage of the country's more developed capital markets to raise funding and increase their participation in financing projects and investments. The government has also taken steps to reduce subsidized lending by creating a new long-term rate, the TLP. Once the new rate becomes effective in January of next year, BNDES will apply the TLP to originated subsidized loans for eligible projects, which, according to the bank's current lending policies, include funding infrastructure projects, innovation and investments in health care and education. Initially, the TLP will equal the TJLP, a rate the central bank sets every three months, which is currently 7 percent. However, in the next five years, the TLP will converge gradually toward the rate of the inflation-linked treasury note NTN-B, which is ultimately determined by the market. Once the TLP is fully matched to the market rate, commercial banks will be in a better position to compete with BNDES in the supply of long-term financing."

PENSIONS NEWS

Pacific Alliance Reaches Tax Deal for Pension Funds

South America's Pacific Alliance trade group has reached a tax agreement for pension funds that operate in the four nations of the bloc in order to boost investment in infrastructure projects, Reuters reported June 29. Administrators of pension funds in the bloc's countries, Colombia, Chile, Mexico and Peru, have some

A Roberto Teixeira da Costa, member of the Financial Services Advisor board and board member of SulAmérica in São

Paulo: "State banks' credit, particularly from BNDES, has always been regarded as one of the factors that affected users of capital markets as an instrument for corporations to raise medium and long-term capital. But several other factors have hindered market development. Certainly, the most relevant has been Brazilian financial markets' high interest rates, which monetary authorities fix every month. The so-called CDI, an interbank reference rate, has often rewarded investors with a very high level of interest rates (to fight inflation). That rate, well above inflation, was a strong disincentive for other securities instruments to compete with government paper. Between 2006 and 2016, the return on government securities was three times higher than an investment in the Bovespa index. Thus, it is an unfair competition for private securities, and particularly for stocks. Right now, with inflation falling to an annual rate of 4 percent, interest rates will converge to a level below 10 percent annually. It will make competition fairer, but not yet as in other developed markets. Other factors have also influenced capital market development. Among them, inflation has

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\$450 billion to invest in highways and other infrastructure projects, Colombian Finance Minister Mauricio Cárdenas told reporters during a summit of the Pacific Alliance countries in the Colombian city of Cali. "We have completed negotiation of a double taxation accord ... that will allow a large segment of investors that are the private pension funds to invest in the countries of the alliance under a homogeneous tax parameters," he said. Cárdenas added that the maximum tax rate to be charged on investment returns of pension funds will be 10 percent. The deal is pending approval by the legislatures of the four member nations.

POLITICAL NEWS

U.N. Security Council Creates Colombia Political Mission

The U.N. Security Council on July 10 unanimously approved a resolution to establish a new political mission to help integrate former rebels of the Revolutionary Armed Forces of Colombia, or FARC, into the country's society, CBS News and the Associated Press reported. The United Nations Verification Mission in Colombia was created for an initial one-year period starting Sept. 17. The new mission will replace a current mission that has been monitoring the FARC's cease-fire and disarmament process. Last month, the FARC handed over all 7,000 of its registered weapons to that U.N. mission, BBC News reported. The resolution approved Monday asks U.N. Secretary General António Guterres to make recommendations about the new mission's size, operational aspects and mandate, CBS News and the AP reported. In January 2016, months before Colombia's government and the FARC signed their peace accord, both sides had asked the United Nations to monitor any cease-fire and disarmament. Last month, Colombian President Juan Manuel Santos asked the Security Council to establish a new political mission for a three-year period, "renewable if necessary."

Venezuela Frees Opposition Leader López From Prison

In a surprise move July 8, Venezuela's government released the country's most prominent opposition leader, Leopoldo López, from prison and transferred him to house arrest. López,

who had been jailed since early 2014 amid a wave of anti-government protests, was released because of health reasons, the government said, The Washington Post reported. The Venezuelan Supreme Court added that López's release was also due to "serious signs of irregularities" in the handling of López's case, though it did not specify what those irregularities were, the Associated Press reported. Concerns about López's health were calmed when

ADVISOR Q&A

Is Piñera a Shoo-in to Return to Chile's Presidency?

Q **Sebastián Piñera on July 2 coasted to victory in the primary of the center-right Chile Vamos coalition, cementing the former president's status as the frontrunner ahead of Chile's November presidential election. Is Piñera a shoo-in to return to the presidency? To what extent do his rivals, such as Alejandro Guillier of the New Majority coalition, pose a threat to Piñera's candidacy? Which issues are driving the presidential race? What influence will outgoing President Michelle Bachelet have on the election?**

A **Peter M. Siavelis, professor and chair of the Politics and International Affairs Department at Wake Forest University:**

"Sebastián Piñera appears to be a shoo-in, barring an electoral bombshell of the type that dramatically derailed the candidacy of the right's Pablo Longueira in 2013. To begin with, outgoing center-left president Michelle Bachelet's sagging poll numbers suggest that Chile is ready for a change of political course in line with a region-wide shift to the right. Much higher-than-expected voter turnout in the primary provides additional evidence of such a trend, as do its results. As the standard bearer for the right-wing Chile Vamos coalition, Piñera received

almost half of the 1.7 million votes cast, suggesting a large base of support. Poll numbers consistently show Piñera with a healthy lead, against his nearest rival, the New Majority's Alejandro Guillier—at times approaching double digits. The fracturing of the center-left has put additional wind in the former president's electoral sails. The threatened departure of the Christian Democrats from the New Majority coalition and the formation of a new alternative leftist coalition, the Broad Front, paints a picture of the once-unified center-left in a state of disarray. The only likely hope for Piñera's competitors is some sort of dramatic twist of electoral fate that would provide an opening for a centrist or leftist candidate to squeak by in a second-round victory, should Piñera fail to garner a majority in the first round. This would also require that the entire center-left coalesces around a single unifying candidate. In this sense, for Piñera's competitors, the race currently boils down to a contest for second place in the hopes for this type of scenario."

EDITOR'S NOTE: More commentary on this topic appears in the July 11 issue of the Latin America Advisor.

NEWS BRIEFS

Rapporteur Recommends Trial for Brazil's Temer

A Brazilian Chamber of Deputies member who was appointed a special rapporteur to study the graft case of embattled President Michel Temer on July 10 recommended that the chamber put the president on trial, Reuters reported. The recommendation of the legislator, Sergio Zveiter, had been widely expected. Temer would stand trial if two-thirds of the lower house votes to proceed and the Supreme Court accepts the charges.

Peru Recalls Ambassador to Ecuador Amid Border Wall Dispute

The Peruvian government has recalled its ambassador to Ecuador after the Ecuadorean government refused to stop building a border wall along a canal separating the two countries, the Peruvian Foreign Affairs Ministry said July 10, Reuters reported. The wall, which is part of an urban revival project, comes as both countries have expressed concerns over flood risks in the area. Peru said the wall violates a peace treaty, while Ecuador said that it lamented Peru's decision but added that Peru had not responded to a request last week to discuss the dispute in a high-level meeting.

Mexico's Inflation Reaches Eight-Year High

Mexico's inflation reached an eight-year high in June but showed signs of leveling off toward the end of the month, reaffirming the central bank's decision to not raise interest rates further, The Wall Street Journal reported July 7. The annual inflation rate increased to 6.31 percent from 6.16 percent at the end of May as the consumer-price index, or CPI, rose by 0.25 percent the same month, according to the National Statistics Institute. In June, the CPI rose by only 0.03 percent in the last two weeks of June.

he made a brief appearance before cheering crowds outside his home, waving a Venezuelan flag and thrusting his fist into the air, The Washington Post reported. López did not speak during the appearance, but he released a statement that fellow opposition leaders read. "If continuing my fight means going back [to prison], I am ready to do it," the statement said. "I reiterate my commitment to fight for freedom." López's supporters also pointed out that while he was moved from prison to house arrest, authorities had not lifted the charges against him of inciting violence during the anti-government protests three and a half years ago. López's ability to lead the current anti-government protests may be hampered by the terms of his house arrest. "What happens now depends very much on what Leopoldo is allowed to do and whether he will have the freedom to exercise leadership of the opposition," Caracas-based political analyst Carlos Romero told The Washington Post. López's father, Leopoldo López Gil, told reporters in Spain, where he is in exile, that authorities placed an electronic monitoring bracelet on his son, but added, "outside of that, we don't know of any other limitation." López's release from prison came as three months of almost-daily protests continued in Venezuela. The violence has left more than 90 people dead, The Wall Street Journal reported.

ECONOMIC NEWS

Mexico's Car Exports to U.S. Rise in Year's First Half

The number of car exports from Mexico to the United States increased in the first six months of this year, despite U.S. President Donald Trump's warnings that he would penalize car companies that import cars and trucks from Mexico to sell in the United States, CNBC reported July 10. Data from the Mexican Automobile Industry Association shows that Mexico exported 1.16 million vehicles to the United States in the first half of 2017, up 15.6 percent year-over-year. The United States has

also taken a greater percentage of vehicles exported from Mexico compared to other countries to which Mexico exports vehicles manufactured in the country. Meantime, U.S. auto sales fell during the first half of this year by 2.1 percent. Six days after his inauguration on Jan. 20, Trump tweeted that "the U.S. has a 60 billion dollar trade deficit with Mexico. It has been one-sided deal from the beginning of NAFTA with massive numbers of jobs and companies lost." Earlier this year, Trump was able to pressure U.S. automaker Ford to stop the building of a vehicle assembly plant in Mexico, but his efforts to dissuade other automakers from moving operations to Mexico have not seen widespread success. When asked by CNBC whether there were plans to stop the building of a BMW assembly plant in Mexico, the chairman of BMW said no changes were planned, and that the plant is scheduled to open in 2019.

Historically Low Peso Pushes Up Inflation in Argentina

The value of the Argentine peso, which is at record lows, is pushing inflation up past central bank targets, Reuters reported July 4. Market expectations of the median inflation rate for this year in Argentina held steady at 21.6 percent, unchanged from a month earlier yet well above the central bank's target range of 12 percent to 17 percent, according to a central bank poll of 54 economists. Economic growth, however, is seen at only 2.7 percent this year, below government expectations. The fast-depreciating peso has become the most influential factor for inflation, Federico Furiase, an economist with consultancy Estudio Bein & Asociados in Buenos Aires, told Reuters. The peso fell 3.1 percent against the U.S. dollar during the month of June. Continued high inflation is putting a damper on consumer purchasing power, The Wall Street Journal reported last month. Retail sales have declined for more than a year as consumers safeguard their cash to pay for higher gas, electricity, water and transportation prices.

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created a preference for short-term instruments, investors historically have channeled their resources to fixed-income securities and savings accounts, and institutional investments do not play the same role as in other countries. Finally, leading corporations such as OGX, Petrobras and JBS, targeted by the 'Lava Jato' investigation, have created a negative image of such companies for the individual investor. Right now, the state is no longer in the process of supplying funds to corporations with negative real rates, associated to the factor that interest rates are coming down, and basic reforms are being discussed in Congress. CVM is also aggressively proceeding with administrative inquiries. These developments are relevant for market growth, a fundamental instrument of our economy."

A **Gustavo Junqueira de Godoy Pereira and Thiago Vallandro Flores, attorneys at Dias Carneiro Advogados in São Paulo:**

"The fact that BNDES and other Brazilian policy banks (such as Banco do Nordeste do Brasil, Caixa Econômica Federal and Banco do Brasil) have been providing subsidized credit may indeed be viewed as impairing the development of the Brazilian capital market, but also as being a consequence of its current stage of development. On the one hand, less expensive loans encourage companies to reach out to Brazilian policy banks when funding is needed. On the other hand, the requirements and regulations applicable to Brazilian capital markets may be a deterrent for companies, particularly less sophisticated companies, which may find requirements and regulations complex and burdensome, including from a cost standpoint. Whether availability of cheap financing from BNDES, in particular, is a cause or a consequence (or even both) of

the current stage of Brazilian capital markets can be debated. Separately, as the basic Brazilian interest rate remains high, investors may not see the capital markets as the most interesting type of investment. That said, Brazil could de-regularize and simplify the regulations in order to make it a more appealing market to companies and, from a macroeconomic perspective, lower the basic interest rate. Having more-developed capital

“**Having more-developed capital markets would bring more transparency to companies' businesses and enhance scrutiny by third parties...**”

— Gustavo Junqueira de Godoy Pereira & Thiago Vallandro Flores

markets would bring more transparency to companies' businesses and enhance scrutiny by third parties, which would require (and lead to) better management and ultimately an increase in the companies' competitiveness. As a downside, some could claim that the government would have less power to control the economy and prices (which is not necessarily beneficial). Finally, it is important to note that capital markets transactions might commence to play a more important role, taking into consideration the current economic/financial crisis that Brazil is facing and recent changes to BNDES' upper management, which could lead to changes in its lending policies."

The Advisor welcomes comments on its Q&A section. Readers can write editor Gene Kuleta at gkuleta@thedialogue.org.

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