



Monthly Report
August

Seminar approaches standardization, transparency and liquidity in the fixed income securities market

ONE YEAR HAS PASSED SINCE THE BEGINNING OF THE SUBPRIME CRISIS, WITH THE CONSEQUENT FEAR OF THE AGENTS WITH RESPECT TO THE START OF A SYSTEMATIC CRISIS IN THE FINANCIAL SYSTEM, AND THERE STILL REMAINS AN INSECURE ENVIROMENT CONCERNING ITS DEPTH AND SPREAD DEGREE, WHAT CONTRIBUTED TO THE EXISTENCE OF AN ENVIRONMENT OF AVERSION TO THE RISK IN THE MAIN INTERNATIONAL MARKETS. THIS SITUATION, WHICH NOW INCORPORATED UNCERTAINTIES DUE TO THE INCREASE OF THE PRICES OF FOOD AND PETROLEUM WORLDWIDE, IT REVERTED THE VIRTUOUS GROWING CIRCLE OF THE SEGMENT, THAT SO FAR WAS PROVIDING A HIGHER DIVERSIFICATION OF THE INVESTORS BASE AND TRADED ASSETS, AS THE RESULT OF THE ADOPTION OF A MORE CONSERVATIVE POSTURE BY THE AGENTS WITH RESPECT TO THE EXPOSURE TO RISKS. IN BRAZIL, SUCH REALITY IS MORE VISIBLE WHEN ANALYZING THE BEHAVIOR OF PROFITABILITY OF THE ASSETS IN SUCH PERIOD AND THE RELOCATION OF RESOURCES AMONGST THE SEVERAL KINDS OF INVESTMENTS. ANDIMA PROMOTED, ON THE 12ND, THE SEMINAR STANDARDIZATION, TRANSPARENCY E LIQUIDITY IN THE FIXED INCOME SECURITIES MARKET, IN WHICH WERE DISCUSSED THE PERSPECTIVES OF LIQUIDITY OF THE SEGMENT IN THE VIEWS OF THE MARKET AGENTS, THE ISSUER AND THE



ENTITIES GUARANTEEING THE INFRASTRUCTURE OF REGISTRATION AND NEGOTIATION OF SECURITIES. THE GENERAL DIAGNOSE WAS THAT THERE WAS SIGNIFICANT ADVANCEMENTS IN TERMS OF STANDARDIZATION AND TRANSPARENCY, MANAGEMENT OF PUBLIC DEBT AND INFRASTRUCTURE OF REGISTRATION AND NEGOTIATION, BUT WITHOUT THE EXPECTED GROWTH OF THE OPERATIONS CARRIED OUT WITH THESE SECURITIES, BY A SERIES OF REASONS PRESENTED AS FOLLOWS. DURING THE SEMINAR, THE ASSOCIATION ANNOUNCED THE LAUNCH, IN SEPTEMBER, OF AN INDICATIVE PRICES INTERVAL TO THE OPENING OF THE FOLLOWING DAY, AS PART OF ITS PROJECT FOR THE CONSOLIDATION, DISSEMINATION AND MONITORING OF PRICES IN THE FIXED INCOME MARKET. IN INTERVIEW TO SINOPSE, THE DIRECTOR OF ANDIMA MARCO ANTONIO SUDANO, MEDIATOR OF ONE OF THE PANELS OF THE SEMINAR, COMMENTS THE MAIN THEMES DISCUSSED IN THE EVENT.

Perspectives of the market agents

Proceeding with the debates initiated on 2006, at the 1st Seminar of Fixed Income in Over-the-Counter Market – which second issue was carried out in 2007 -, the event had the purpose of proposing a reflex on the recent evolution of the Brazilian Fixed Income Market, with emphasis in the matters related to the standardization, transparency and liquidity. It was agreed among the participants that the liquidity in the securities market still very incipient, being presented specific suggestions to stimulate the turn of such papers.

One of the matters in analysis referred to the difficulty of the financial industry to refrain from using the rate of the DI – Interfinancial Deposits as main reference of remuneration. The participants acknowledged the importance of the creation of the IMA – ANDIMA Market Index to the securities market of the federal debt, however pointed out that its use is still limited by the managers of investment funds. If, on the one side, there is the clear perception of the need to perform an effort to the offer of products based on different references of DI, on the other side, we see the low interest of the investors in products with such characteristics. Part of such dilemma is resultant of a cultural matter – heritage of the long inflation period –, but must also be taken into account the proper economic scenery, which remains characterized by high interest rates in the short term and premiums relatively low to the term extension.



Another point agreed upon is that great part of the liquidity – in particular the exposures to the risk pre –it was directed to the derivatives market, which, in the Brazilian case, is particularly developed. To the managers of resources, the operations carried out with public bonds, for involving cash, are restrict, basically, to the short term turnover. With respect to the segment of private securities, there is a general perception that the recent turbulence and the consequent increase of the domestic interest rates blocked the issuance process by the companies, and the increase of such volume is vital to the increase of the business.

From the point of view of the base of investors, prevailed the diagnosis that it is required more advancements in terms of diversity, what includes the return of the pension funds as soon as possible to the secondary market of public securities. In this sense, the rules established by Resolution CGPC nº 21/06 were discussed, which sets forth upon the purchase/sale operations of fixed income securities by the CPCE – Complementary Pension Closed Entities. There are no doubts with respect to the intention of the regulator to promote the migration of the business to the electronic platforms, for assuming that such environments would provide a consistent and transparent process of price formation. On the other side, there is the clear perception that the rule gave rise to a high fear and consequent low incentive to the entities to operate in the Over-the-Counter Market – despite of not foreseeing any concrete hindrance in such sense, only the preparation of reports if business is performed out of the market price in such environment. The result was a higher direction of the purchases, by means of financial institutions, to the primary auctions. There were also criticism to the system of public offerings by the STN – National Treasury, which intensity and regularity meets good part of the demand of the entities and leaves low margin to the performance of the intermediates.

In view that the participation of the pension funds is fundamental to the increase of the liquidity in the secondary market, it was approached the need for reviewing of the demands set forth in such Resolution, theme that ANDIMA is already discussing jointly with Abrapp. Other consideration was that the accounting ranking of the operations and the restrictions to the substitution of the securities included in the class “hold to maturity” also represent a natural obstacle to the increase of the business with public securities carried out by the pension entities, giving rise to a passive management of the portfolios. Considering the actuarial commitments assumed by such entities, it is reasonable to assume that considerable part of its investments must be hold to maturity. Anyway, it was suggested a flexibility in the regulation, in order to establish, pursuant to the due technical justification, possibilities of accounting re-ranking, with the purpose of



enjoying market opportunities, or even the creation of a new “intermediary” accounting category, amongst those existent to the securities hold to maturity and those available for negotiation.

Still with respect to the investors, it was pointed out the important contribution of the foreigners to the extension and change of the profile of the public debt, as well as in the culturing process of the local investor while searching for long term papers and with remuneration references unrelated to DI. In this sense, the exemption to the Income Tax granted in 2006 represented a great gain, in a great extent annulled by the recent imposition of IOF over the exchange operations related to the acquisition of fixed income securities. With respect to this last tax, the general sensation is that, although not observed the desired impact on the flow of resources to the country, in face of the current context of increased interests, the losses in terms of the contribution to the securities market were expressive. In practice, after the adoption of tax, part of the foreign investors opted for offshore synthetic structures, given the complexity and instability of the tax rules.

With respect to the individual clients, it was noted the increase of its participation in the Direct Treasury, despite of the disclosure considered restricted and the monthly limit of application by each investor. Now, in the secondary market, the participants understood as important the inhibitor effect of the current systematics of the Income Tax, based on decreasing rates pursuant to the term of the investment, over the business involving individuals and non-financial legal entities. With respect to the market makers, the adoption of incentive measures to a more active role of such players such as promoters of the securities market was not considered priority, once, although it could contribute to increase the business flow, its performance is not sufficient to increase the liquidity of the operations. There were also comments in respect to the low active performance of the banks (treasuries) in the securities market.

With respect to the instruments, it was pointed out the importance of the development of programs and operations of securities lending, pursuant to the suggestions of ANDIMA’s Work Group studying the subject. Such operations may contribute to the dynamics of the business, in particular as of the performance of short operations with indexed securities. Anyway, there are regulating matters – of tax and accounting nature – that need to be settled to stimulate the participation of the agents in such market.



In general, the recommendations were in the sense of increasing the disclosure of the Fixed Income Market, in the matters of what took place in the last years in the stock market. There was also an agreement with respect to the importance of directing efforts to the financial education of the investor, with the purpose of stimulating investor to search alternatives of Fixed Income with long term, capacitating him to a little more sophisticated risk/return analysis. It was noted a small behavior change, what can be verified in the funds industry: the parcel bind to the DI currently is lower than last year, increasing the pre-fixed funds, even if in a low pace. Notwithstanding, it is unquestionable the predominance of the DI, or of a post-fixed interest rate, as a remuneration reference at the Fixed Income Market. LFT represent 37.7% of the stock of the domestic federal real estate public debt; 93% of the stock of the debentures and the same percentage of the CDB – Bank Deposit Certificate issuances are bound to the DI; and 18.8% of the funds industry are referenced in DI or ranked as of short term. At medium and long terms, however, the expectation is that new opportunities of profits grow once again, in particular with the resume of the monetary flexibility process. It is required, therefore, to start working immediately in such sense.

Views of the issuer and the Systems/Clearings

Pursuant to the thinking of the market players, the authorities understand that the secondary market did not evolve in the same speed of the primary market. They consider, further, that the solution to the problem of lack of liquidity at the fixed income securities market is not subject to a isolated factor, however a set of conditions, in part determined by the economic situation itself.

In the scope of the Central Bank (BC), were exalted the actions directed to the improvement of the business environment, with emphasis in the infrastructure of the financial system, in particular those stimulating the short operations: development of functionalities at Selic – Special Clearance and Custody System (associated and conjugated operations, among others); elimination of accounting obstacles; and performance of long term repo operations (5 to 7 months) with free movement, adopting as foundation securities such as NTN-B and NTN-F. On the side of the National Treasury, the focus in the development of the secondary market is explicit, given the benefits that may be generated in terms of the demand and, above all, of reduction of the indebtedness costs. Amongst the initiatives in this respect, it was pointed out incentive to the creation of new benchmarks to the federal public securities; efforts of reduction and standardization of the maturities of the securities offered in auctions; review, jointly with the BC, of the rules of dealers of the open market; incentive to the



electronic market; increase of the transparency in the debt management (PAF – Annual Financing Plan and monthly schedules of auctions); and defense and forwarding to the government of proposal of exemption of Income Tax over the application in federal public securities by foreigners.

A controversial point that gave rise to a broad discussion were the actions of the authorities and their potential inhibiting effects on the business in the Fixed Income Market. Besides the criticism to the “excess” of public offers by the Treasury, already registered in the previous section, there were comments in respect to the performance of the Central Bank, by means of short term repo operations, in the reserves market. As exposed by a representative of the BC, the performance of the Authority is passive and has the purpose of maintaining the Selic Rate close to the established target, according to determination of Copom – Monetary Policy Committee and, consequently, the need of management of the liquidity in the system. It was registered that the term of such operations is being extended (5 and 7 months), but that such process depends, basically, of the interest of the market agents. Pursuant to the analysis, it seems little reasonable to believe that less action on the part of the Authority in the cash market would cause the liquidity to migrate to the securities market. To the contrary, the expectation is that a more flexible management of liquidity would cause the loss of credibility of the Central Bank.

Other matter in discussion was in which extent the differences existent between the Brazilian and international markets with respect to the form of expression and calculation of the interest rates of the securities may restrict the participation of the foreigners in the domestic securities market. The representatives of the government affirmed that they do not believe this is the main problem. In their view, it is a convention and, therefore, the participants must decide if it would be advisable or not to adopt the model in force abroad, however taking into account at all times the adaptation costs of the systems. The matter was also discussed by the ANDIMA Committee, and no agreement was reached with respect to the eventual benefits of the adoption of the international calculation standard.

The private providers of infrastructure for registration and negotiation of securities, on their turn, consider that the Brazilian systems and clearings offer what can be considered the most modern in the world in terms of “environment”, and that they are always incorporating new functionalities in compliance with the market demands. However, they evaluate that the agents do not use completely great part of the available operations and tools, such as the electronic negotiation platforms. Still with respect to the theme, the effectiveness of the recent



incentives offered to intensify the operations in electronic environments was questioned.

With respect to the difficulties of increasing the business carried out with fixed income securities, the providers of registration and negotiation indicate a few particularities of the National Financial System – such as combination of attractive interest rates with the possibility of daily liquidity of great part of the financial products – as prejudicial to a consistent cultural change process. In the same sense, it was emphasized that the lack of controversy of expectations imposes severe restrictions to the evolution of the secondary market, not stimulating the trading in general. With respect specifically to the securities lending program offered by clearing houses, despite of being acknowledged the evident gains that this instrument may give rise to the lenders of securities – specially to the pension funds -, it is not clearly identified which would be the borrowers of the securities, what could also make the product unfeasible.

In summary, it may be affirmed that the macroeconomic conditions are still very relevant in the determination of the conditions of the business carried out with the fixed income securities. On one side, it favors the preference of the investors by short term applications and pegged to the DI rate; on the other side, stimulate the resistance of the managers to adopt a more active asset management of third parties. The matter continuing pending an answer is the manner in which each segment of participants can contribute to the evolution of such process.

ANDIMA Initiatives

With respect to the diffusion of references to the secondary securities market, since 2000 ANDIMA is the main provider of indicative prices of public bonds, segment that, at the time, was extremely fragmented and with restricted liquidity. The project was demanded to the Association at the end of 1999 by the Central Bank and by the National Treasury, in a document advancing a series of governmental measures directed to the increase the market liquidity. Throughout such period, the work demonstrated consistency, resisting to several “tests”, resultant not only of situation changes, but also business and accounting rules changes (in particular in 2002). The success of the initiative gave rise to the market demand to the creation of references to private assets. As of 2004, ANDIMA started disclosing also indicative rates for a representative sample of the segment of debentures.



With the launch, at the end of 2006, of the Rates Dissemination System, a new and important step was given to the increase of the project of Consolidation, Increase, Dissemination and Monitoring of Prices in the Fixed Income Market. Pursuant to the growing emphasis that is being attributed by international and regulating bodies not only to the matter of transparency, but also to the timely and consolidation of data, in particular with respect to the over-the-counter market, the ANDIMA System constitutes a broad provider of consolidated information, pre and post-negotiation, over the federal public bonds market. It discloses the opening of indicative spreads collected and treated by ANDIMA in the morning and afternoon periods, the results of the calls from active brokers in this segment and the business effectively carried out, as well as the purchase and sale offers of public bonds carried out in the clearing of BM&F Bovespa and at CetipNET (provider included in August). Following, it shall be incorporated the data of operations carried out at Selic, without identifying the counterparties.

The next stage of the effort destined to increase the market transparency and to improve the environment of negotiations is the reinforcement of the instruments directed to the self-regulation of the sector. In view of such target, ANDIMA prepared, with the contribution and approval of Fundação Getulio Vargas and market participants, a sound methodology to estimate and define factual standards for the prices floating in the secondary securities market to the following day ("opening tunnel"). Built in a way not representing a hindering barrier to the business, considering the specifications of each class of assets, the model intends to define credible intervals for the negotiations. The idea is to provide comfort to the investors; to supply the regulators with a technical tool for the evaluation of operations carried out by the institutions; and, above all, create a self-regulation instrument, inducing the associates of ANDIMA to operate within the established standards.



Interview – Marco Antonio Sudano

The 'dictatorship' of CDI

MEDIATOR OF THE FIRST PANEL OF THE SEMINAR STANDARDIZATION, TRANSPARENCY AND LIQUIDITY IN THE FIXED INCOME SECURITIES MARKET, WHICH DISCUSSED THE LIQUIDITY UNDER THE OPTICS OF THE MARKET AGENTS, THE ANDIMA'S DIRECTOR MARCO ANTONIO SUDANO ANALYZE IN THIS INTERVIEW TO SINOPSE THE MAIN THEMES DISCUSSED IN THE EVENT. AND MAKES A WARNING: "BRAZILIAN INVESTOR IS SUBJECT TO THE 'DICTATORSHIP' OF CDI. WE NEED TO UNDERSTAND BETTER OTHER BENCHMARKS, IN ORDER TO STIMULATE LONGER TERM INVESTMENTS".

One of the main points discussed over the Seminar was the need to diversify the investors' base in the securities market, and there were an agreement with respect to the positive impact of the greater participation of the foreign investor. In this sense, how you evaluates the increase of the IOF Exchange rate over the public debt market?

The increase of the IOF rate impacted the foreign investors' demand for public bonds under two aspects: making its return perspective lower, considering the tax to be paid, and affecting the safety with respect to the stability of rules at long term to which it is subject the investment in financial products in Brazil. Even if it didn't impact, as of January/2008, the entry of dollars in the country, the increase of the IOF Exchange changed the investment form of the foreign investors in Brazilian Fixed Income assets. Such agents started to opt by synthetic structures abroad ensuring the equivalent to an investment in public security in the country, without, however, generating in the domestic market the positive impacts that contributed so much with the extension of the maturities of the inflation-pegged bonds. I believe that we must continue working to increase the base of investors in long term fixed income securities. The Brazilian investor is increasing its investments horizon, which is still short in comparison with the international standards. Now, the foreign investor has such culture, and, therefore, enables the speeding-up of such process jointly with the domestic investors, whether individuals or institutional investors.



In addition to the increased standard of the short term interests, what other factors limit the investors' disposition of carrying long term risks?

The Brazilian investor is subject to the “dictatorship” of CDI, that is, we are used to receiving high interest rates for investments with daily liquidity. We must keep stimulating the education process of the investor, in the sense of stimulating the longer term investments, what can be made with limited parcel of the resources with the purpose of obtaining more returns. We need to abandon the CDI as a standard of comparison to our investments and understand a little bit better the other benchmarks. Thus, we created at ANDIMA a set of indexes so that the investors can compare the return of its investments for longer terms. Now, it is required to popularize the same, so that the investors are able to understand the advantages and risks involved with the investments in long term fixed income securities. It is required also to review a few taxes of low collection value, which are heritages of our economic history of high inflation rates.

Still during the Seminar, it was discussed the possibility of changing the current standard of expression and calculation of the interest rates of the securities, based on 252 business days, to the international standard, of 360 days, under the argument that it would contribute to make the Fixed Income Market more attractive to the foreign investor. Which are the advantages and disadvantages of such measure?

The most immediate advantage is the possibility of the foreign investor comparing the interest rates practiced in the Fixed Income instruments in Brazil with other investments alternatives that he follows in global markets. The disadvantage is that the interest rates levels in Brazil is still high, both in actual and nominal terms. The convention by business day is much more adequate to handle our rates than the international standard (30/360 or actual/360), since it generates less distortion to the investor. Other disadvantage would be the need of all participants of the financial market, including the government, adjusting their systems controlling the risk and the result.

To what extent ANDIMA's initiatives to increase the fluidity of the securities market contributed to improve the business environment and stimulate the liquidity of the segment?

ANDIMA is being very diligent to analyze the demands proposed in its forums by the market participants. Based on such analysis, the Association acts jointly with the authorities and other class entities to meet such demands. Throughout the last years, there were several initiatives on behalf of the market fluidity, amongst which the creation of alternative benchmarks to the DI, represented by the IMA family, and the development of tools to increase the transparency, such



as the Rates Dissemination Systems and COMPARE of public bonds. It also stands out in this sense the initiative to change the methodology of indicative intervals to public bonds, what will provide references of opening of important market to the segment. Besides, it were created tools for the investors to calculate the price of more complex instruments and to verify prices between the parties, that is, the calculators CONFERE of public bonds and debentures. Finally, Association is centralizing the discussion about the calculation standards of public bonds and debentures, jointly with the market agents and authorities.