Broadening the investors base: practical examples from Brazil

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Investor Base – Main ideas

Why is important to have a large and diversified Investor Base?

➢ A large and diversified investor base is important for ensuring strong and stable demand for government debt securities. The investor base should ideally include both domestic and foreign investors and all types of institutions – ranging from commercial banks to insurance companies, pension funds, and mutual funds, as well as individual investors.

➢ Different time horizons, risk preferences and trading motives is vital for stimulating active trading and high liquidity and enables the government to execute its funding strategy under a wide range of market conditions.

With that, take two interesting examples: Non Resident Investors and Pension Funds
In 2005-06, The National Treasury adopted a series of measures aimed at improving DPF management.

The Brazilian National Treasury took further steps to consolidate the process of market opening to NRI – Non-Resident Investors. On Feb-06 non-residents investors were exempted from withholding tax on gains in operations with domestic federal bonds. That searched for:

- Increasing the participation of foreign investor, which typically prefer long term bonds, especially fixed rated and inflation linked ones;

- Help to increase of participation of these bonds and the lengthening of the average maturity of the public debt.
Investors Base – Advances in Federal Public Debt Management

NRI: Domestic Debt share

Investment Grade

Withholding Tax Exemption (Feb-06)

IOF: 6% tax on foreign investment (Oct-10)

NTN-F 2017 - First nominal 10y bond issued in Jan 2007
In 2006 the scenario for a macroeconomic stabilization was better configured.

- This allowed a portfolio change from the Pension Funds side: leveraged with overnight rate position – from the asset side, and exposed with inflation linked bonds – from the liabilities side

- The unbalance was sub-optimal:
  - Treasury wanted to increase Inflation Linked bonds on the overall debt
  - Pension Funds would lose money in locking in that position
Active behavior with Pension Funds managers

» Then, the Treasury approached Pension Fund managers on 2005-2006

» Show them the importance of rebalancing their portfolios sooner rather than later

Example: Hypothetical Yield for an Inflation-Linked Investment vs Overnight Rate - (% p.y.)
Investors Base – Improvements on Governments’ Funds

“Government’s” portfolio => efforts to align with the Federal Public Debt guidelines

Jan -12

- Fixed rate: 16%
- Inflation linked bonds: 18%
- Floating: 66%

March -12

- Fixed rate: 41.05%
- Inflation linked bonds: 33.8%
- Floating: 25.13%

June -12

- Fixed rate: 42.3%
- Inflation linked bonds: 57.4%
- Floating: 0.3%

After “Extramercado”

After “Extramercado” + FGTS
The Tesouro Direto, a retail sales program to sell regularly bonds to Brazilians citizens through internet, was launched in 2002 with the following objectives: (i) to offer another savings product alternative; (ii) to increase the investors base; and (iii) for didactic purposes (transparency).

- Uses roughly the same on-the-run instruments for debt roll-over. One exception tailored for retailers: Zero-coupon inflation-linked bonds, the most sold.
- Individuals choose one agent (bank or broker) to link them into the system and then are enabled to buy securities regular government securities through the internet.
- Costs vary a lot – there is a list on the website.
- There is weekly liquidity: bonds are bought back by the Treasury every Wednesday.
- Minimum amount per operation: 1/10 of a bond unit => around US$30.0.
- Customized portfolio: 3 kinds of bonds (fixed rate, inflation linked and floating rate) with maturities ranging from 1 to 40 years.
There are 500 thousand Brazilian investors investing directly in stock exchange ... a lot of room for increasing the number of Treasury Direct participants.
Despite it reached R$ 9 billion (roughly USD 4.5 billion), the Treasury Direct Program represents less than 0.5% of the total Federal Public Debt held by the public.
Federal Public Debt Holders: Broadening the Investors base

Public Debt Holders - Snapshot (Jan 2007)

- Financial Institutions: 33%
- Mutual Funds: 23%
- Pension Funds: 15%
- Non-residents: 1%
- External debt: 11%
- Others: 8%
- Insurance: 2%

Public Debt Holders - Snapshot (Aug 2012)

- Financial Institutions: 27%
- Mutual Funds: 24%
- Pension Funds: 16%
- Non-residents: 13%
- Government: 8%
- Others: 4%
- Insurance: 3%
- External debt: 5%

...result of a long term strategy adopted by the National Treasury aimed at diversifying the investor base.
Holders’ Domestic Public Debt Portfolio

By security type (August 2012)

» As regards the debt by type, 50% of bank holdings are fixed rate bonds, while 54% of Mutual Fund’s portfolio is in floating rate bonds. Inflation-linked bonds are 73% of Pension Fund holdings.

By maturity (August 2012)

» Regarding maturities, Pension Fund portfolio’s have longest duration.

Source: National Treasury
For additional information access the National Treasury website:

www.tesouro.fazenda.gov.br

Or contact Institutional Relations area:

brazildebt@fazenda.gov.br

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