

Post-trade and
non-resident
investors:
Opportunities for
improvement from
a local perspective



Presentation at webinar ACSDA

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Topics



- Introduction
- Settlement functions and opportunities for improvement
- Custody function of securities and opportunities for improvement
- Final remarks



Introduction

Introduction



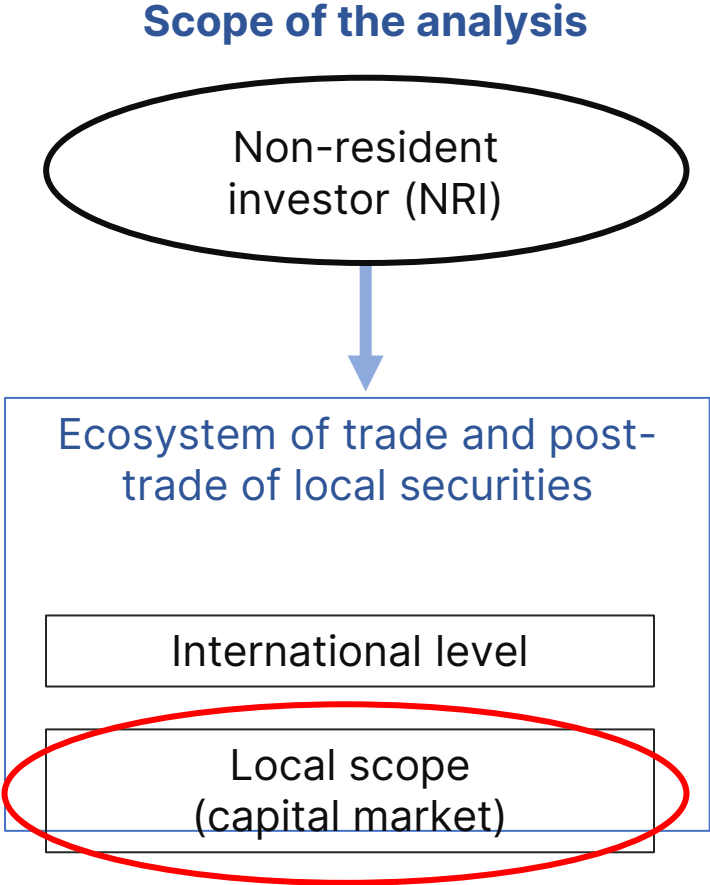
- An important part of this presentation includes some insights originated from a study commissioned by the Financial Integration Group of the Finance Ministers of the Pacific Alliance countries (Mexico, Colombia, Peru and Chile), sponsored by the Inter-American Development Bank.
- More than 40 interviews were held with entities in the Pacific Alliance markets, in Latin America, Europe and the Asia Pacific region.
- Recommendations were presented in order to improve the efficiency of the clearing and settlement function of non-resident investors (NRI) in the countries.
- However, the information presented is also based on the development of other studies by this consultancy and, consequently, there are various aspects that go beyond the aforementioned study.
- This presentation only represents the opinions of the author.

Definitions and context

Non-resident investor (NRI)

- In the present context, we refer to **investors with residence outside the country** where are the investments are.
- Only **portfolio investments**, that is, in the area of investments in publicly offered securities in the local capital market.
- It will also be called "**foreign investor**" or simply "**NRI**"

Definitions and context



Introduction

Why is it important to understand post-trade of NRI operations?

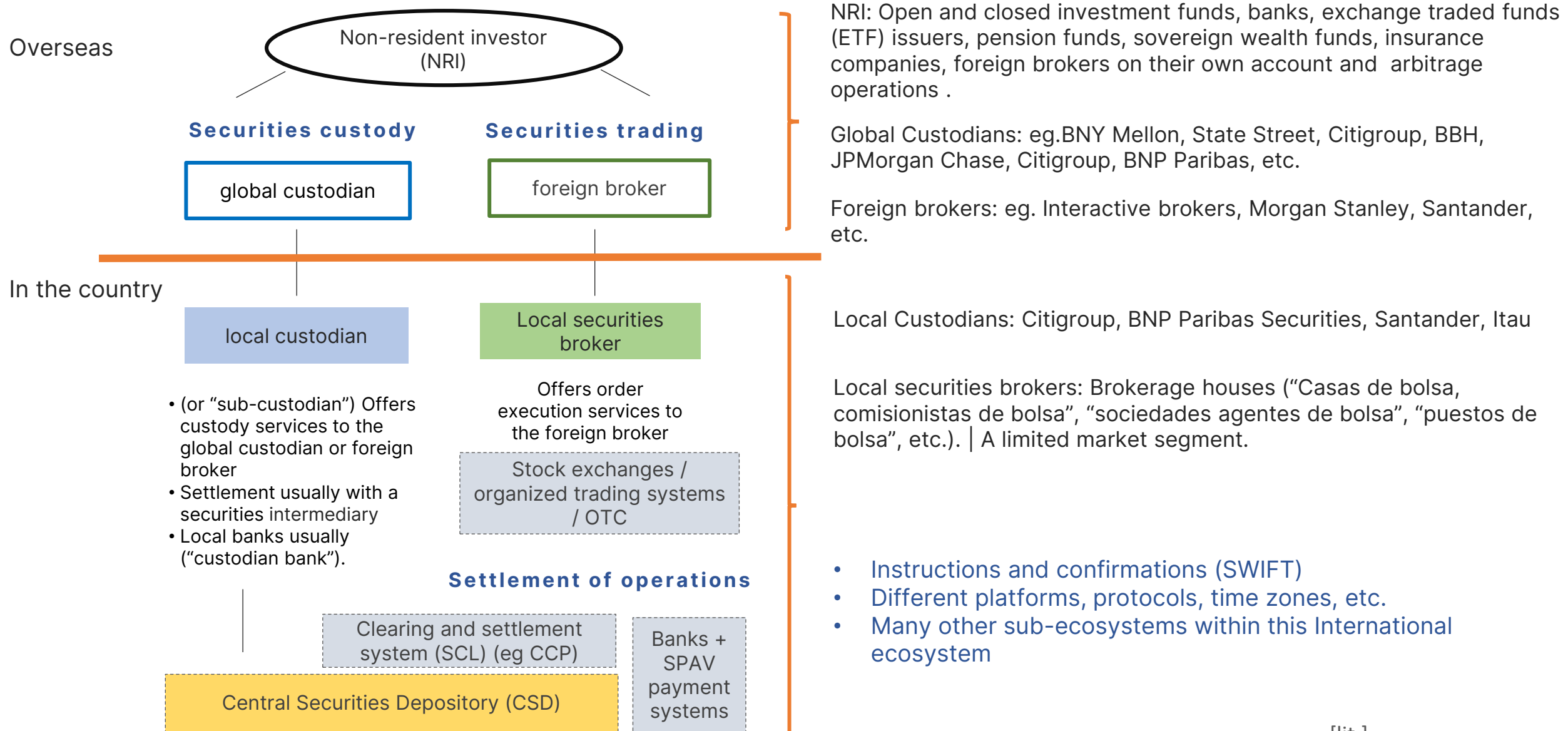
- Foreign portfolio investment contributes to increase the markets liquidity and to develop their efficiency (World Bank*, OECD**).
- Foreign portfolio investment is a very important form of financial integration between the markets of the same region***.
- The post-trade represents the most important cost for the NRI and, therefore, is an aspect of special interest for market leaders and policy makers.

*Aggarwal, Klapper and Wysocki (2013). "Portfolio Preferences of Foreign Institutional Investors" World Bank Policy Research Working Paper 3101.

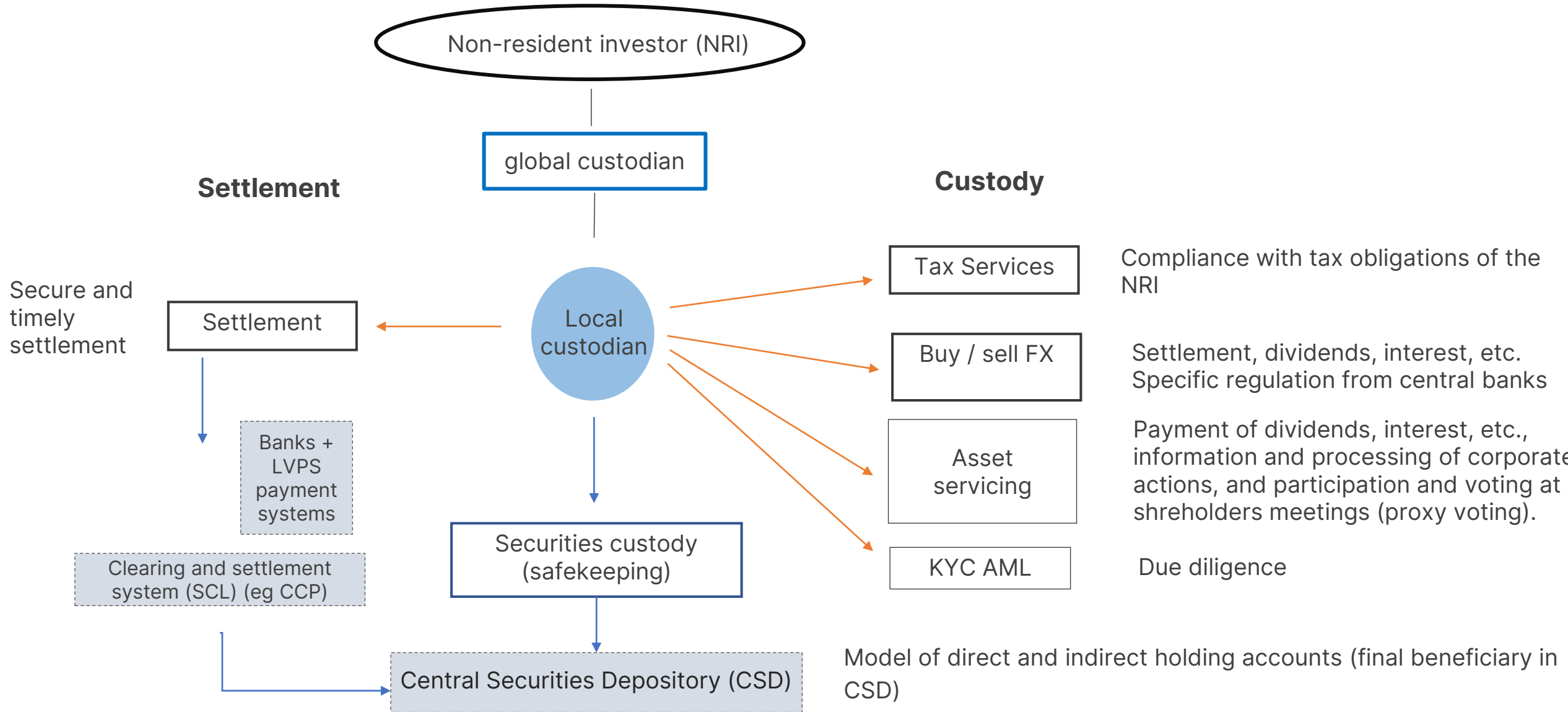
** OECD (2012). "Foreign Direct Investment for Development: maximizing benefits, minimizing costs",

***Larrain, G. and Vicente Lazen (2008). "Financial Markets in Latin America: Convergence and Integration". Center for Financial Stability.

The NRI trading and post-trading ecosystem



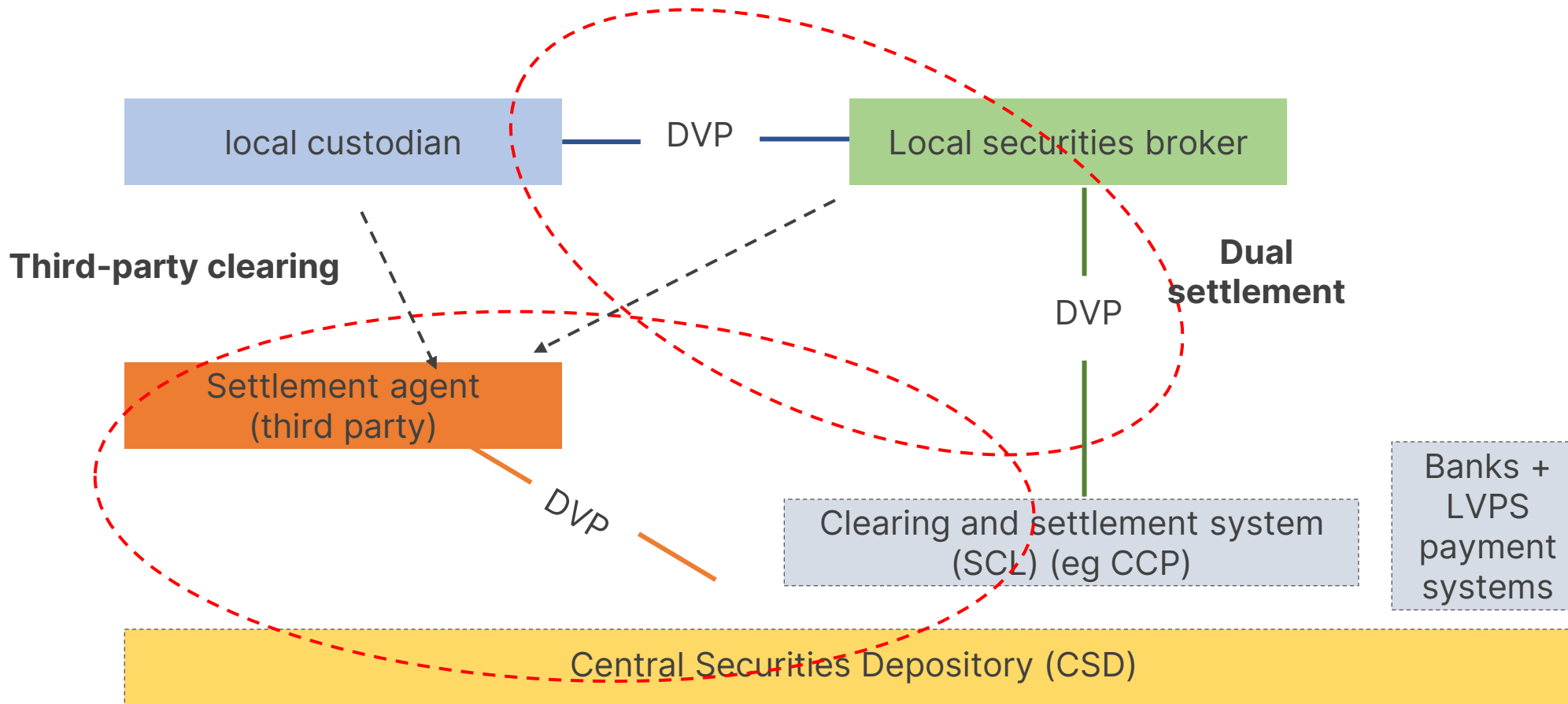
Inherent functions of post-trading and custody



**Settlement function
and opportunities for
improvement**

NRI securities settlement function

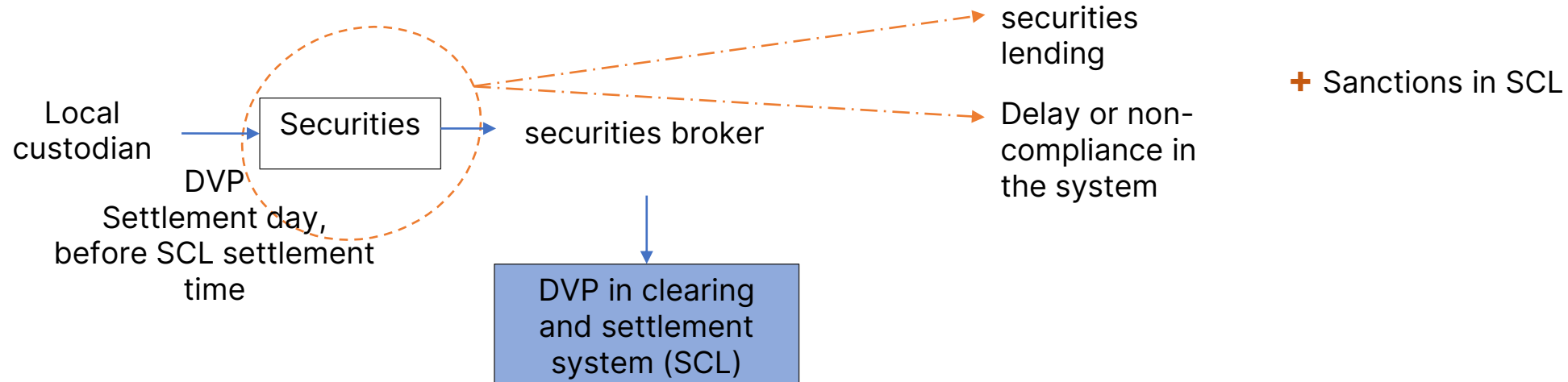
The settlement function's goal is to settle the operations of securities purchase or sale. There are two models: dual settlement model and third-party clearing model.



NRI securities settlement function: Delays and fails in settlement and effect on local securities intermediaries

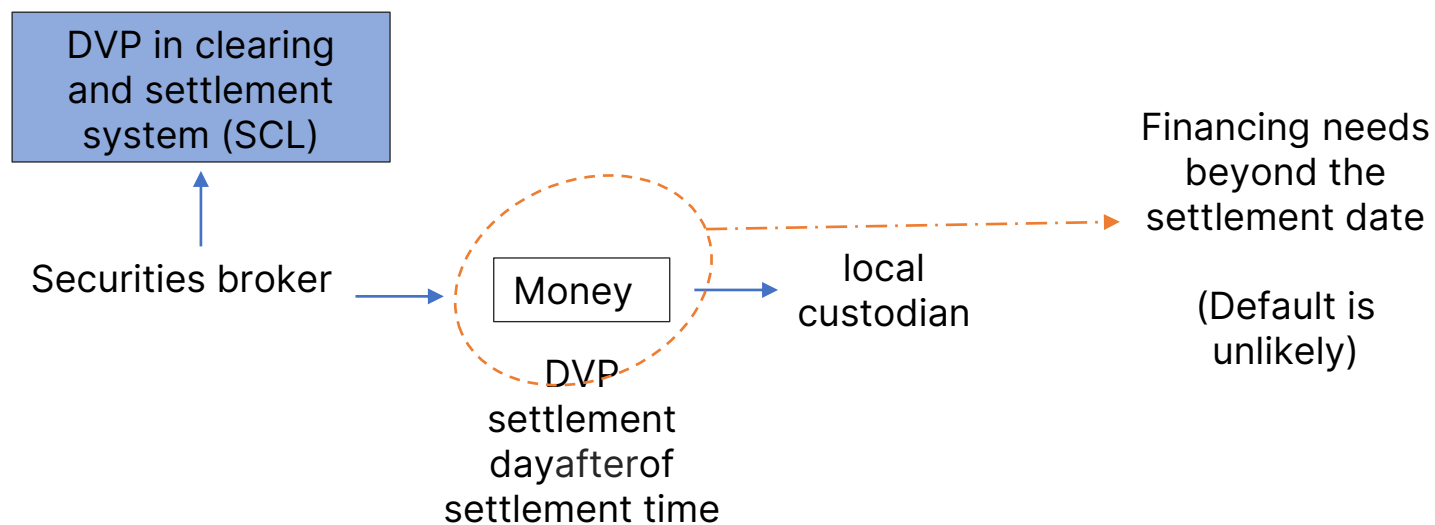
Settlement scheme in Latin America usually of the type “**dual settlement**”, where at least two settlement operations are required: one bilateral and another one in the settlement system (SCL) with the counterparty of the transaction.

Delays and fails when NRI sells



NRI securities settlement function: Delays and fails in settlement and effect on local securities intermediaries

Delays and fails when NRI buys

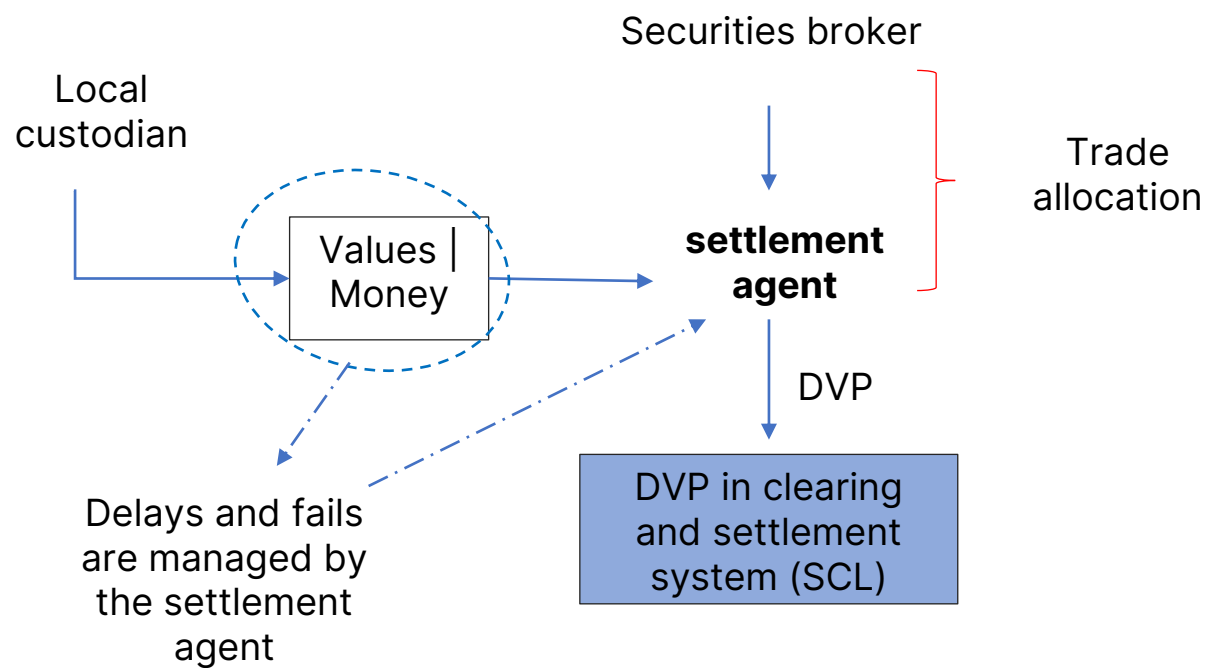


- Opinions of market participants.
- Securities broker can pass on higher costs to its client (usually the foreign broker)...
- But not when trading on your own account (for example doing ADR or ETF arbitrage trades).

NRI securities settlement function: Delays and fails in settlement and effect on local securities intermediaries

In contrast, the “Third Party Clearing” (TPC) model is widely used in Asia Pacific markets and until a few years ago in the European Union.

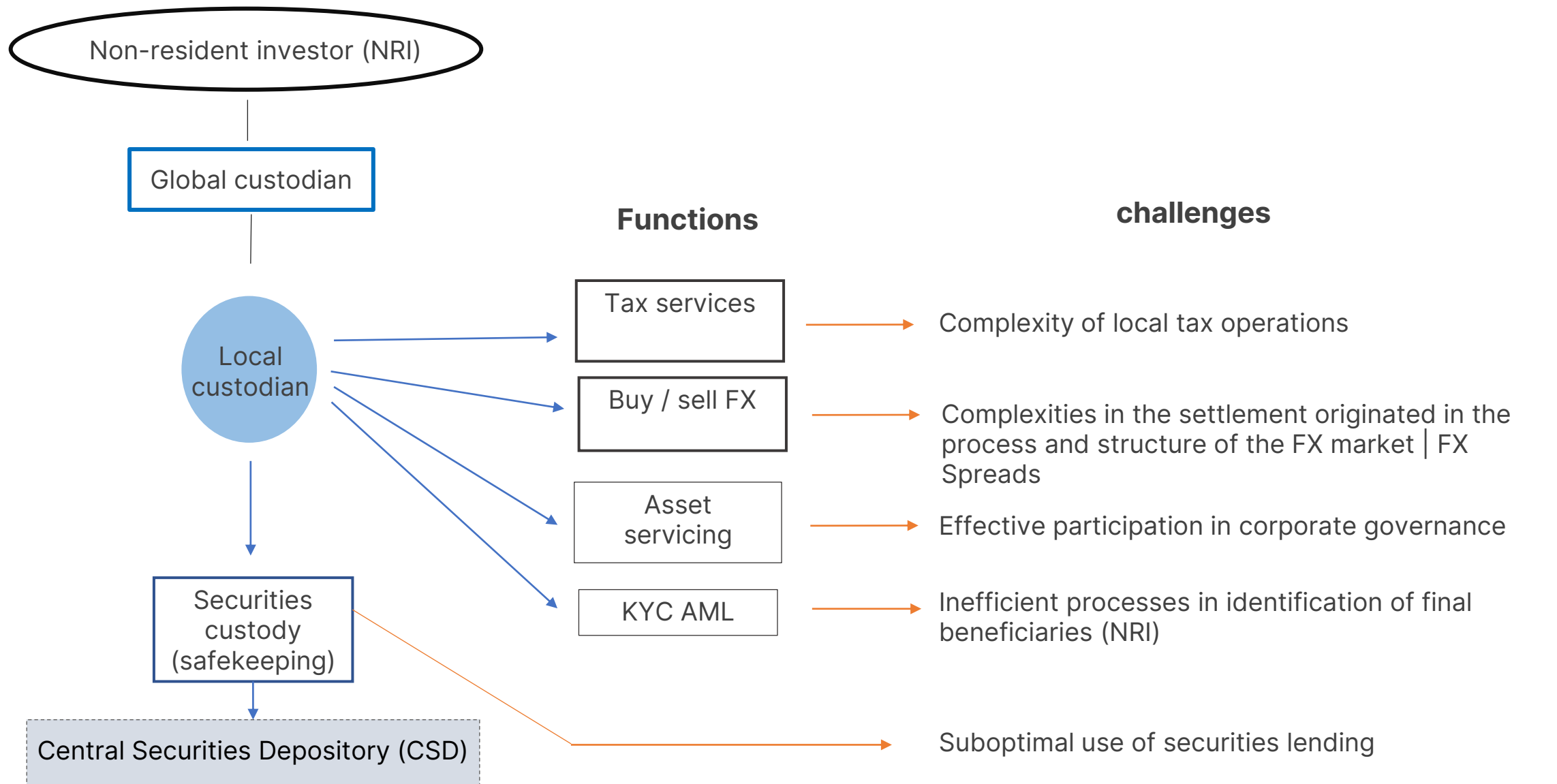
Delays and fails under TPC settlement model



- A variant of this model is the allocation of operations model in Brazil (B3).
- It should be noted that this model triggers more competition in the securities brokers' niche since they do not require as much capital and access to financing.
- It depends on the predisposition to its use by local securities brokers. Advantages and disadvantages.
- It's not something that can be imposed by regulation, but the conditions for the implementation of a TPC model should be facilitated.
- Regulatory feasibility, CCP and settlement system regulation.

**Custody function and
opportunities for
improvement**

Local custody function and challenges in local markets



Concentration in the local custody market

Concentration in the local custody market

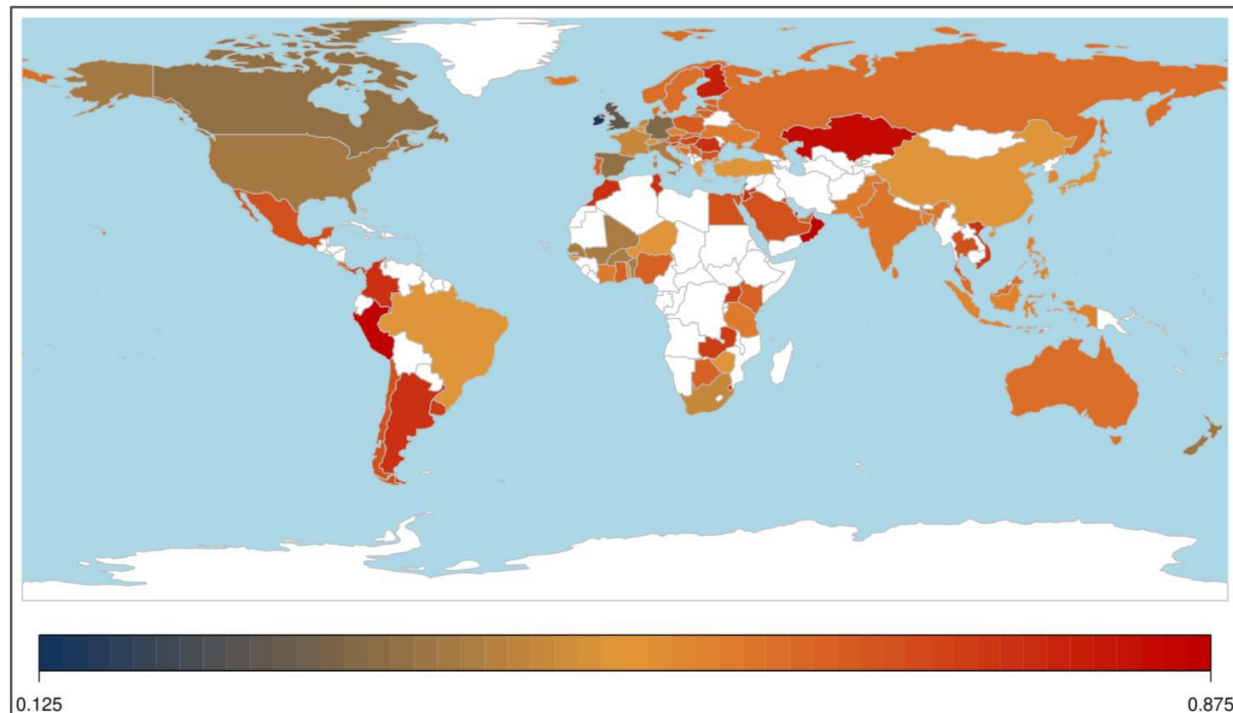


- Local custody services in the Pacific Alliance countries, as in much of Latin America, is manifestly concentrating on the Citi or Citigroup custodian.
- Citi does face competition in those markets from global and regional custodian banks that operate to high standards, so global custodians are not restricted in their choice of local custodian.
- Citi is not the primary global custody provider in the Pacific Alliance markets.
- Factors that can explain dominance of Citi -> presence with more than 30 years, association with banks, well evaluated by users.
- There are no regulatory barriers that could affect market concentration
- Market participants do not link market concentration with difficulties in operational interaction between the two.

Concentration in the local custody market

Although it is true that the custody segment is quite concentrated in the countries of the Pacific Alliance, when observing other more developed markets, a considerable degree of concentration is also noted.

Concentración de mercado de los custodios locales



Fuente: Credit Benchmark¹

Specific recommendations on custody of NRI

Improve NRI market segment information

- Develop market statistics.
- Examples: What proportion of trading is done on behalf of NRI? Statistics of NRI trades executed OTC versus trades executed on exchange? Amounts under custody and settled by NRI? Participation of local custodians?
- Comparative analysis of the cost layers that NRI face.

Use LEI to identify NRI for tax and other purposes

- Real global integration requires use of global identity system.
 - LEI (Legal Entity Identifier) globally used code that identifies legal entities involved in financial transactions (eg EU, US, G20).
 - Tax and LAFT information requirements and proof of identity. Does not prevent the use of a local TAX-ID.
 - Harmonize required information.
-

Specific recommendations on custody of NRI

Strengthen securities lending services based on the CSDs of each country and adopt international practices in securities lending

- Fragmented securities lending facilities with little automation in some markets.
- CSD manages the account system, facilitates collateral management (the calculation, monitoring and movement of guarantees and their proper segregation), the valuation and operation of accounts at the request of the lender. vg. Clearstream, Equilend or Euroclear, Indeval (Valpre) and B3.
- Possibility of lending securities by non-resident investors makes participation more attractive.

Make it easier for CSDs to participate in local custody services

- Well positioned for their operational robustness, economic neutrality and international experience with cross-border links.
- In some areas, it can be an alternative to the local custodian, it would gradually allow greater substitution of services to be explored and it would generate an entry channel for new local custodians.

Specific recommendations on custody of NRI

Strengthen the regulation of issuers for voting by shareholders in shareholders' meetings

- Not all broadcasters adequately explain voting issues or provide simple means of voting (considerations ESG).
- Converge to international practices (by regulatory means) in relation to providing sufficient information regarding the matters to be voted on (See SEC “proxy statement” or “proxy materials”) + vote remotely (electronic ballot or “proxy card”).

Evaluate the internationalization of the currency

- Evaluate the possibility of internationalizing the currency, in order to facilitate its convertibility outside the country (exchange policy).
- Better convertibility helps to simplify operating processes for investors because the FX market is in the financial center and the FX operation is settled on the day of the transaction.
- Likewise, it broaden the selection of a counterparties for the local currency by the NRI, greater liquidity and better prices and access to credit.

Final remarks

Final remarks

- **Role of regulation.** Contribute to simplify (eg tax operations, information requirements), standardize (eg participant identifiers) and converge between countries (eg operational practices).
- **Inefficiencies are barriers to entry.** Consider that inefficiencies can constitute barriers to entry, so not everyone would like to move with the same agility.
- **Particular case of the Mexican market.** Internationalized currency, foreign financing, securities lending and identification of final beneficiary.
- **DLT technology and ecosystem evolution.** Scenario of a migration from the current market model to a model based on securities issued in DLT technology. Opportunities and limitations of DLT technology, decentralization versus intermediation, digital currency.

Thank you

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