Brazilian Federal Public Debt
ID ETF Program in Brazil

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Summary

1. GUIDELINES FOR THE FEDERAL PUBLIC DEBT MANAGEMENT
   i. Guidelines defined in Brazilian Annual Borrowing Plan (ABP)
   ii. Achievements in Brazilian Financial Market
   iii. STN’s actions to encourage secondary market

2. ID ETF - WHY PARTICIPATE IN THIS PROGRAM
   i. Key Pillars of the ID ETF Program
   ii. Program in alignment with guidelines defined in Brazilian ABP
   iii. Potential Benefits of the ID ETF Program in Brazil

3. SPILLOVER EFFECTS OF THE ID ETF PROGRAM IN BRAZIL
   i. Financial Market Indices Development
   ii. Improvements in the structure of the stock exchange system
   iii. Fixed Income ETF regulatory framework
   iv. New concept of taxation

4. ID ETF PROJECT
   i. Mitigated Obstacles
   ii. Next Steps
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Objective of Federal Public Debt Management

To provide federal government borrowing requirements efficiently and at the lowest long-term cost, respecting the maintenance of prudent risk levels and, additionally, seeking to contribute for the smooth operation of the Brazilian government bond market.

Guidelines of Federal Public Debt Management

- Gradually replacing floating rate bonds with fixed rate and inflation-linked instruments;
- Consolidating the current share of exchange rate-linked instruments, in accordance with their long-term indicative intervals;
- Smoothing of the maturity structure, with special attention to debt maturing in the short term;
- Lengthening the average maturity of outstanding debt;
- Developing interest rate term structure on both domestic and external markets;
- Increasing the liquidity of federal government bonds on the secondary market;
- Broadening of the investor base;
- Improving the External Federal Public Debt (EFPD) profile by means of issuances of benchmark bonds, buyback, and structured operations;
ii. Achievements in Brazilian Financial Market

Improving Public Debt Composition – Moving towards Fixed Rate + Inflation Linked

Brazilian Market Profile

- There is a clear preference for Fixed Income securities in Brazil, specially those indexed to overnight rates.
  (As a result, more than 80% of Brazilian Fixed Income Mutual Funds are indexed to overnight rates. High real yields, prolonged inflation periods, low level of financial education and weak returns in stock markets recently help to explain it)

- Public Bond trades are concentrated in over-the-counter Market.
  (Brazilian DMO has stimulated the use of electronic platforms, specially through our primary dealers system, but its participation in the market is still low, around 5%).

Source: National Treasury
Note1: Federal Public Debt, which includes both domestic and external liabilities.
iii. STN’s actions to encourage secondary market

Two Pillars of STN’s Actions in Domestic Market

1. Reducing the degree of indexation to overnight indices

2. Development of the Brazilian fixed-income market

Other specific goals include reducing the degree of indexation to overnight indices by consolidating alternative price benchmarks, diversifying the investor base and stimulating competition in the asset management sector.

Other Actions in Domestic Market

- Supporting the development of fixed-income indices (benchmarks), with positive impacts on the composition and lengthening;
- Implementing Exchange Traded Funds – ETFs, aiming to explore opportunities for development in the fixed-income market with positive externality to the secondary government securities market and to its investor base;
- Supporting actions seeking to consolidate the private securities market as an important source of financing for private investment (alternatively to public sources);
- Improving the dealer system (market makers) and support the use of electronic platforms;
- The National Treasury will also prioritize studies involving practices and products that can contribute towards the development of the Brazilian fixed-income market.

ID ETF is one of our actions.
iii. STN’s actions to encourage secondary market

Primary Dealers System – fostering ETPs

• In February 2015, incentives towards Electronic Trading Platforms (ETP’s) were put in place for the Brazil’s National Treasury Primary Dealers System.

• Quoting and trading in ETP’s evaluation factors were boosted in the dealer’s accreditation process.

• Since then, **ETP’s market share moved from 1.5% to 11.0% in February 2017.**

![Monthly Volume on Electronic Trading Platforms and its Market Share](chart.png)
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The Issuer-Driven ETF program, or ID ETF, is a World Bank Group initiative to support the development of local currency bond markets via an innovative Government Bond ETF structure.

### i. Key Pillars and Minimum Standards for I-D ETFs

<table>
<thead>
<tr>
<th>Key Pillars of I-D ETF Concept</th>
<th>Minimum Standards</th>
<th>Objective</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Primary Market Support</td>
<td>Guaranteed minimum volume of underlying securities</td>
<td>Enhanced economic viability and quality of the product.</td>
</tr>
<tr>
<td>2. Secondary Market Support</td>
<td>Incentives and measures to enhance liquidity</td>
<td>Higher liquidity, lower transaction costs and fees to investors</td>
</tr>
<tr>
<td>3. Adherence between Index and Development Objective</td>
<td>Proved link between ETF index and development objectives</td>
<td>Ensure focus on development impact</td>
</tr>
<tr>
<td>4. Transparent Selection of Qualified Fund Manager</td>
<td>Transparent, merit based selection process with robust criteria</td>
<td>Mitigate reputational risks, Enhance credibility of product and likelihood of success</td>
</tr>
</tbody>
</table>

ii. Program in alignment with guidelines defined in Brazilian ABP

- **ID ETF Program is part of a broader and continuous STN’s agenda of supporting the development of the Brazilian financial market, especially the secondary market of public bonds.**

iii. Potential Benefits of the ID ETF Program in Brazil

- **Consolidation of government bond benchmarks:** The ID ETF will pursue fixed rate or inflation linked bonds indices, helping to reduce the predominant overnight rates culture. Besides, the Brazilian FI ETF tax model favors long term assets exposure, penalizing floating rate bonds.

- **Improving public bonds liquidity:** The Stock Exchange environment brings transparency, arbitrage opportunities and the entry of new participants in the market, as authorized participants and market makers, will contribute to narrow bid-ask spreads, fostering the development of primary and secondary bond markets.

- **Diversifying investors base:** Centralized trading environment and transparency may also contribute to diversify the investors base. Besides, the global exposure due to World Bank partnership and the possible replication of the initiative in other emerging market economies tend to stimulate the creation of ETFs linked to a basket of ID ETFs from different countries.

- **Development of private credit market:** The ID ETF is seen as the first step to launch FI ETFs linked to corporate bonds, a market where liquidity is still limited in Brazil.
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i. **Fixed Income Indices Development**: In 2015, the S&P Dow Jones and the Brazilian Stock Exchange announced a partnership for the creation a family of stock market indices of companies listed on Brazilian Stock Exchange, focusing on the ETF domestic industry. Last year, through the creation of the S&P/BM&F Inflation NTN-B index, both companies moved into fixed income index market.

ii. **Improvements in the structure of the stock exchange system**: Since 2013 the Brazilian Stock Exchange has been working on customizing its operational system to enable ETF trading in the Brazilian market, including improvements in their securities lending framework.

iii. **Fixed Income ETF regulator Framework**: In 2013, CVM (Brazilian “SEC”) set regulation for Fixed Income ETF in Brazil, supported/motivated by the World Bank (WB) and the Brazilian National Treasury (BNT) initiative;

iv. **New concept of taxation**: The BNT and the Internal Revenue Services (IRS) have worked on the definition of a specific tax rule for ETF that will enable and stimulate Fixed Income ETF trading. The resulting taxation model was established in 2014 and sets decreasing rates in relation to the duration of the funds' portfolios.
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i. Mitigated Obstacles

- 2013: Memorandum of Understanding between Brazil (Ministry of Finance) and IBRD;
- 2013: CVM Regulation (SEC);
- 2014: Taxation rules;
- 2014: Exchange System development;
- 2016: Collaboration Agreement between BNT and WB;
- 2016: Decree setting rules for fund manager selection process.

ii. Next Steps

- **Publishing an Edital (RFP)** with technical criteria to be employed during the ID ETF fund manager selection process;
- Effective launching of the ID ETF.
For additional information access the National Treasury website:

www.tesouro.fazenda.gov.br

https://www.tesouro.fazenda.gov.br/-/etf-apoiado-pelo-tesouro-nacional

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