Exchange Consolidation and Post-trade Infrastructure in the Americas

Thomas Murray analyse capital markets infrastructure risk in the Americas and review changes to regulation and market infrastructure

The Americas region can be split into three sub-regions: the more developed English speaking north with larger economies and very sophisticated markets; the Spanish speaking south, Latin America, with emerging but dynamic economies; and the mixed English-Spanish speaking Caribbean with very small countries and markets. Despite having some cultural and background similarities, the markets in each of these sub-regions have remained separate, with their own trading locations, capital market infrastructures and regulations.

However, in May 2011, the exchanges of Chile, Colombia and Peru, Bolsa de Comercio de Santiago, Bolsa de Valores de Colombia and Bolsa de Valores de Lima respectively, together with their respective central securities depositories (CSDs), DCV, DECEVAL and CAVALI, launched a consolidated market known as MILA, Mercado Integrado Latinoamericano or Latin American Integrated Market. MILA permits brokers and investors located in one of these countries to invest directly in equities listed in any of the three exchanges. However, they need to appoint an agent bank or sign an agreement with a correspondent broker in the other countries in order to manage their post-trade processing. Mexico also recently announced that it is assessing the operational costs and challenges of joining the MILA alliance and has signed a letter of intent with the existing members to join MILA.

Although expectations were high and there was excitement in these markets, volumes have remained low. Between 30 May and 31 December 2011, total trading amounted to just over US$15 million (50 per cent in Colombian securities, 49 per cent in Chilean securities and 1 per cent in Peruvian securities). Although the MILA market is the result of a long and thorough process between the exchanges, CSDs and regulators in the three markets in order to harmonise regulations and procedures, much remains to be done. There is also some uncertainty in the market in terms of default and bankruptcy procedures, in particular owing to the lack of DvP settlement. Custodians have also been left out of the party, which means that custody remains under the broker instead of the agent bank. Tax and guarantees are also based on specific market regulations without any harmonisation.

Despite these shortcomings, MILA is the second largest market in Latin America after Brazil by market capitalisation (US$599.2 billion at 31 December 2011) and with 546 issuers in different sectors, concentrates a diversified basket of securities. It represents a unique opportunity for Latin America to be seen as a single and significant investment market. The cultural and language similarities should facilitate the further development of MILA into a single entry platform in the region.

The impact on the post-trade infrastructures in these markets has not been significant to date, although some operational changes have been necessary including the requirement for CSDs to open accounts at the other member depositories. There could be some additional changes as harmonisation of procedures takes place, as well as an increase in revenues if trading and settlement volumes continue to pick up. However, in the longer term, there could be significant implications if there were to be full integration at the CSD level. At the clearing level, a unified mechanism, or potentially a single central counterparty (CCP), could be beneficial to reduce liquidity demands and guarantee settlements executed under a different regulatory environment.

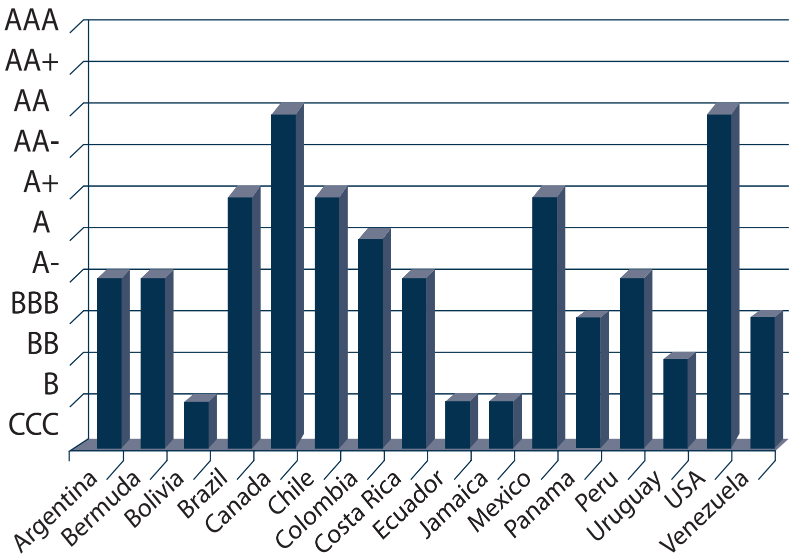
There have been other attempts to integrate the markets in the region. This includes the Caribbean Exchange Network (CXN), which was set up to integrate the operations of the exchanges in Jamaica, Barbados and Trinidad and Tobago with the long-term aim of creating a common Caribbean securities market. The exchanges in Central America (Panama, Costa Rica and El Salvador) also have a memorandum of understanding (MoU) in place to integrate the markets, although no actual consolidation has taken place.

Attempts to consolidate financially or merge exchanges in the region have failed. This includes the proposed merger between the Colombia and Lima stock exchanges, which was cancelled in August 2011, as well as the planned merger between the Toronto and London Stock Exchanges in June 2011. The proposed merger between Deutsche Borse and NYSE-Euronext was called off in February 2012 as a result of intervention by the European Commission.

Creating a unified market would bring a number of advantages, potentially resulting in greater investment in the region. A single market infrastructure would reduce costs and simplify procedures for investors that need to manage their investment in different markets by harmonising disclosure requirements, investment limits, regulations, etc. A similar objective is being sought by the European Central bank, which is working on a centralised settlement platform in Europe, Target2 Securities (T2S). It should enable common post-trade processing, although safekeeping, asset servicing, client access and other ancillary services will remain at the local depositories.

Thomas Murray has been following the developments and changes taking place in the Americas region and has assigned an overall risk rating to the capital market infrastructure in the main markets as shown opposite.

Capital Markets Infrastructure Risk Ratings in the Americas



Other Developments in the Americas:

In addition to the above-mentioned developments in terms of market integration, there have been a number of recent changes in the region that have been incorporated in the ratings as follows:

- **Argentina:** The central bank recently imposed additional repatriation restrictions. As a result, foreign investors are now required to obtain prior approval before executing foreign exchange (FX) transactions for repatriations up to the US$5,000 monthly limit.
- **Brazil:** BM&FBOVESPA is working on a project to unify its four clearing houses by creating a unique risk management system.
- **Canada:** Following the failure of the proposed merger between The London Stock Exchange and TMX Group, a consortium of Canadian financial institutions created the Maple Group and made an offer to acquire TMX and the Canadian Securities Depository (CDS). The offer expired on 29 February 2012.
- **Chile, Colombia and Peru:** As a complement to the MILA market, there is a project to integrate the FX market in the three countries to facilitate settlements executed through its platform.
- **Costa Rica and Nicaragua:** The stock exchanges of Costa Rica and Nicaragua signed a cooperation agreement that will permit the introduction of an information platform to allow Nicaraguan brokers and issuers to access information on the Costa Rican market.
- **USA:** A new CCP for mortgage-backed securities has been developed by the Fixed Income Clearing Corporation (FICC), a subsidiary of the Depository Trust and Clearing Corporation (DTCC), and will be phased in over a two-month period from 2 April. ■

CMIRR Ratings Definitions:

AAA	extremely low
AA+, AA, AA-	very low
A+, A, A-	low
BBB	acceptable
BB	less than acceptable
B	quite high
CCC	high
CC	very high
C	beyond any acceptable level of risk exposure