Santander
GLOBAL BANKING & MARKETS

Santander – investing in Latin American equities through derivatives

Santander is the largest financial franchise in Latin America, but that does not prevent it from acting with agility and foresight. Leveraging its expertise and capabilities in western Europe – with leadership positions in Spain and the UK – an aggressive hiring policy targeting professionals exiting from troubled institutions has provided the final edge for it to become a main player in the region's derivatives markets

Due in part to last year's financial turmoil, innovation in derivatives in general and structured products in particular has become less valued. There was a time when issuing new and creative ideas on a regular basis was a given for any bank that wanted to be among the elite structuring banks. That is no longer the case. However, consistencies in delivering diverse products, counterparty risk quality and excelling in post-sale commitment have become precious assets.

"Santander offers a wide range of products and services to its institutional and retail investors without the need to enter into turbulent waters, providing ideas that fit well investors' needs in the Latin American region," says Manuel Villa, global head for equity derivatives at Santander.

Innovation and creativity are still important, but knowledge of the local market, demand for outstanding local service and commitment in the countries has left some banks at one side of the road. Derivatives in several markets of the region may still be developing but combining global capabilities, along with knowledge of local markets, allows Santander to offer a product with which only very few can compete.

To start with, only a handful of banks can offer similar counterparty credentials for investors. Santander's market capitalisation is well over $100 billion. The bank has top credit ratings among financial institutions and is the largest franchise in Latin America. Santander Group is a top three bank in each of the Americas key markets, with a presence in other countries. With this footprint, and its strong presence among institutional investors in the US and Europe, Santander's next challenge is to become the top provider of access to its international client base; to the wide range of equity strategies available locally. The bank keeps expanding its equities team in New York with this objective. Significant recent hires include James Rist, who has been selling derivative products to US hedge funds and institutions for over a decade.

"The delta one access activity is a perfect fit for a platform

(l–r) Hugo Azevedo and Carlos Henrique Ernanny from the team based in Brazil; and Marcio Souza, Ignacio Mendive and James Rist from the New York team

that has deep relationships with the long-only and hedge fund customer base, which keeps demanding more efficient solutions for their investment needs and stronger counterparts for their trading", says Ignacio Mendive, Santander's head of equities, New York. This investment in the Latin American derivatives platform, combined with the imminent launch of its Direct Market Access (DMA) product, will enhance Santander's current position as a broker of reference for Latin America with the international institutional investor base.

Trading equity derivatives in Brazil

Timing is everything and Brazil's time is now. With a gross domestic product (GDP) forecast of over $1.5 trillion for 2009, interest rates at their lowest level in 15 years and, with a daily equity turnover of more than $3 billion, the Brazilian equity derivatives markets is the place to be. Looking closer to their main equity index – IBOV – members, PETR4 and VALE5, first-maturity at-the-money calls have

Santander snapshot (November 2009)	
Market capitalisation	$145 billion
Free float (%)	99.6%
Shareholders	3 million
Clients	90 million
Employees	170,000
Branches	
Continental Europe	3,700
UK	1,300
Latin America	6,100
US	750
Ratings	AA (S&P)/Aa3 (Moody's)

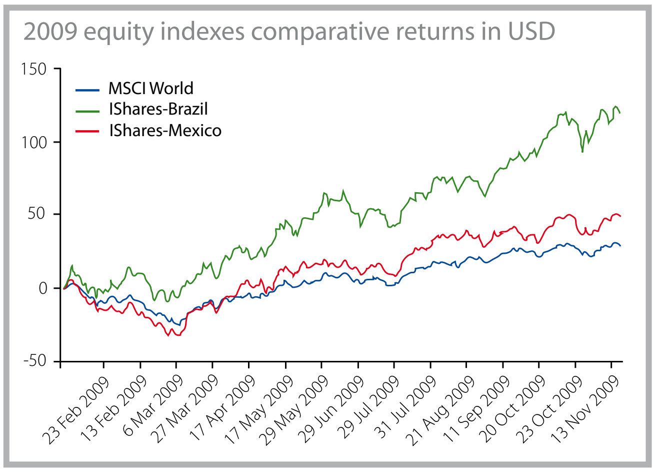

Figure 1 clearly shows the outperformance of the two largest Latin American economies compared with the MSCI Global Index during 2009. Foreign investors were again the biggest net buyers of Brazilian equities during the last quarter, with net purchases of well above $3 billion (September–November).

the narrowest relative bid/ask spread considering all major equity options markets around the world.

"Most international derivatives houses are already setting up or are even implementing their regional headquarters here, and Santander has decided to be the largest player," says Roberto Barbuti, head of equities at Santander Brazil. Having recently set up its local equity derivatives team, Santander has boosted its equity derivatives treasury operations and is planning to make it even bigger. Among the products offered to its clients are: market-making for local single names (over 30 different stocks covered); equity indexes and American depositary receipt (ADR) options; participation notes over Brazilian local names, equity indexes and exchange-traded funds (ETFs); and equity-linked notes over Brazilian ADRs.

Having approximately "160 long-only and hedge funds, 400 pension funds, 70 brokerage houses, and over 50 private banks and family offices as potential local clients, it is clear that the path is long but very promising", highlights Hugo Azevedo, head of equity derivatives sales in Santander Brazil. Even better news is that potential clients are not only the local ones. Efforts in several items were made to achieve and service an existing growing demand over Brazilian equity derivatives originated offshore, especially from institutional and private investors.

A leading role in other Latin American markets

In November 2009, the largest ETF listed in Latin America was listed in Madrid to make it available to European investors. Santander is the market-maker for one of the most liquid stocks in Mexico that tracks the main local index. "There is not an easier and simpler way to access exposure to Mexico than investing in the Naftrac iShare", says Sergio Zermeño, head trader at Santander Mexico and one of the 'founding fathers' of the instrument. "Liquidity in the Naftrac jumped 10 times once local pension funds (Afores) were allowed to invest in 2006, and now is the right time to enable foreign investors to participate in a booming market through this excellent tracker."

The pension funds industry is worth approximately $100 billion, with an average growth above 10% for the last few years. It is expected that in, 10 years' time, they may represent close to 50% of the country's GDP.

Business in equity derivatives is rapidly increasing in Mexico as these local Afores are becoming active participants in the over-the-counter (OTC) market. Even though it has been four years since they were allowed to trade derivatives and only two of a total of 16 local pension funds are really active so far, Santander has seen throughout 2009 a turning point for the local OTC markets.

"We expect this upward trend in trading to continue as more players will become active using derivatives to manage their portfolios", says Javier Concha, head of equity derivates sales at Santander Mexico. Only a few years ago it was difficult to even quote plain vanilla options on the main index for Mexico (that is, the IPC). Today Banco Santander leads the market with a team of professionals dedicated to trading local equity derivatives.

Banco Santander has been launching structured notes for local investors with payouts that range from plain vanilla protected notes linked to global single indexes to yield-enhancing best-of structures of local baskets. The bank has been working very successfully with family offices and third-party banks in Chile, which has been a very pleasant surprise.

"Over the past six months we have had good demand from clients that we thought would be dormant for longer after the financial crisis, and the interest for structured investments is clearly still rising among them," says Ricardo Torres, head of equities at Santander Chile. "We find education as the key tool to engage clients with products that include derivatives; only by investing our best people's time explaining the rationale and possible payouts of the structures we offer can we avoid misunderstandings from those investors and build confidence in products that too many times have been put down to bad service".

Levels of financial sophistication may still lag behind more developed regions. Therefore, education is the basis of success and, to make a significant difference in the market, Santander is committed to spending as much time as needed teaching the sales forces how best to place their structured investments. Increasing derivatives business in Latin America is not just innovation and marketing, as it may be in other regions or during other times, it is about having the patience and constant effort needed for raising awareness of derivatives potential benefits and also risks; basically it is about educating the client base.

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