



ILPA / Cimarron Institutional Investor Delegation
10 February 2012

Private Equity Funds Regulation in Brazil

Francisco Santos

Head, Collective Investment Schemes Department

The views expressed in this presentation are the views of the speaker and do not necessarily reflect the views or policies of the CVM.

Direct Investment

- Federal Law 4131 of 1962 and Federal Law 6404 of 1976
 - Used for private investments in companies, plants, etc.

Investment in Securities Portfolios

- CMN resolution 2689 of 2000
 - Used for investments in publicly traded equity, debt and for funds

Mutual Funds

- CVM Instruction 409 of 18 August 2004

PE/VC Funds

Fundos de Investimento em Participações – FIP (Private Equity)

- CVM Instruction 391 of 16 July 2003
(http://www.cvm.gov.br/ingl/regu/cvm_391.ASP)

Fundos Mútuos de Investimento em Empresas Emergentes - FMIEE
(Venture Capital)

- CVM Instruction 209 of 25 March 2004

Number and Commitments by type of vehicle in Brazil

	2004	US\$ billions	2008	US\$ billions	2009	US\$ billions
LP	29	3,45	45	9,06	63	13,41
FMIEE	21	0,17	26	10,39	34	0,58
FIP	11	0,62	37		67	5,96
Holding	20	0,52	31	0,53	31	0,85
Direct Investment	0	0	13	4,53	16	5,06
Other	16	0,84	29	2,09	28	3,04

The **FIP** structure is, according to this survey, responsible for **over 20% of the PE/VC commitments** in Brazil

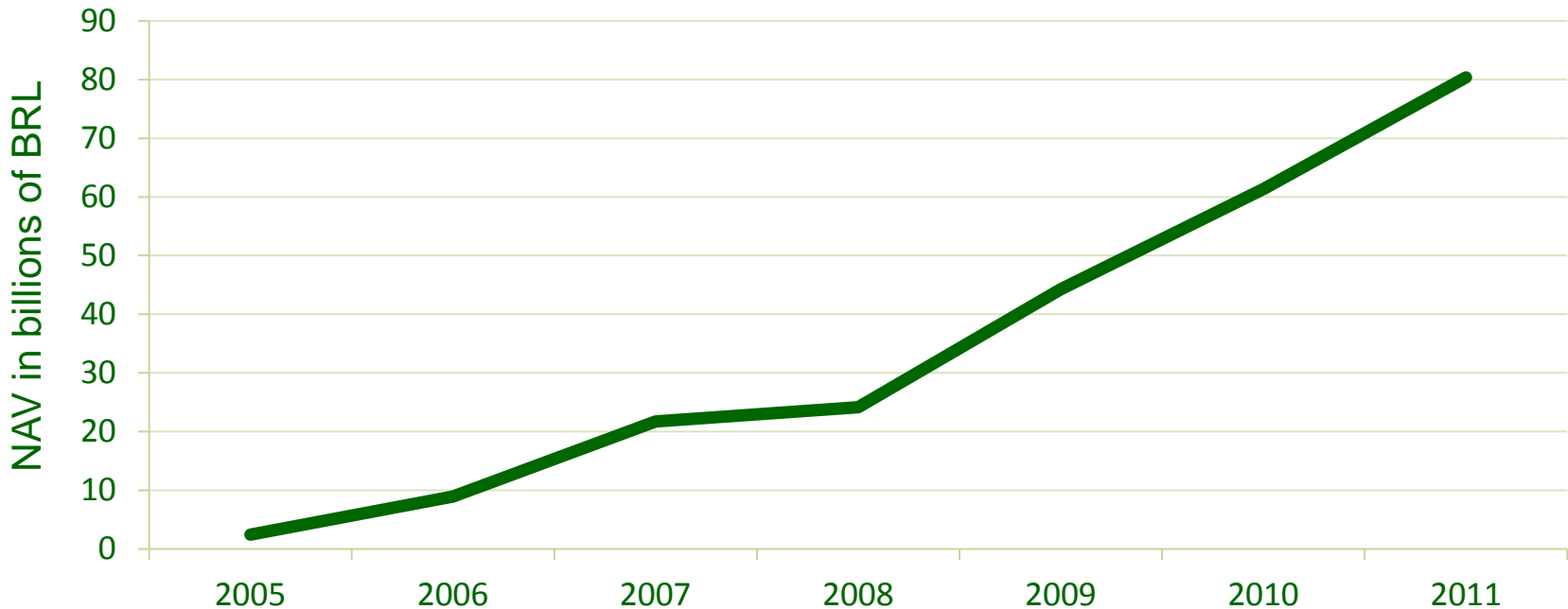
Worth noting: there is no local legal structure 100% equivalent to the LPs. We believe that the most similar one is the CVM FIP.

FIPs have been gaining the preference of international investors mainly due to its **beneficial tax treatment of capital gains**

	FIP	Holding
Regulation of vehicle	<i>CVM Rule 391</i>	<i>Companies Law (6404)</i>
Registration of investors	<i>CMN Resolution 2689</i>	<i>Federal Law 4131</i>
IOF (tax on financial transaction)	<i>2% on inflows; 0% on outflows</i>	<i>3x 0.38% on inflows, dividend distributions or outflows</i>
Income tax on the vehicle	<i>0% on capital gains</i>	<i>34% on capital gains</i>
Income tax on domestic investors	<i>15% on redemption of quotas</i>	<i>20%</i>
Income tax on international investors	<i>0% for investors holding less than 40% of the FIP; 15% for others</i>	<i>15%</i>

Between 2005 and 2011 FIPs' NAV have shown a **CAGR** of over **78%** in BRL (**85%** in USD).

At the end of 2011 FIPs' NAV was about US\$43 billion.
Growth was **31%** between the end of 2010 and the end of 2011.
The number of funds has gone from 27 in 2005 to **416** in 2011.



According to EMPEA (Emerging Markets and Private Equity Association) Brazil has raised **US\$4.5 billion** in **2011** behind only of **China**

EMPEA also lists Brazil as **one of the most attractive markets for PE/VC** investments.

The numbers of the industry show that there is still a lot of space for growth **Commitments** have raised from the equivalent of **1% of the GDP** in 2004 to **2,33% in 2009**. World average is about 3,7% and in markets such as the USA, Israel and the UK it gets close to 5%.

- Exiting
- Profitability
- Investment opportunities
- Skilled participants
- Sound regulatory framework

Track record

The conjunction of the factors above has made possible a high number of recent successes in many different sectors such as ALL (transportation and logistics), CPFL (energy generation and distribution), CSU Cardsystems (administration of credit cards), DASA (laboratorial services), Gafisa (real estate development), Gol (airline), Natura (cosmetics), Localiza (rental cars), Lupatech (precision foundry), Submarino (e-commerce), TAM (airline), UOL (internet access provider), Totvs (ERP systems), Datasul (ERP systems), and many others.

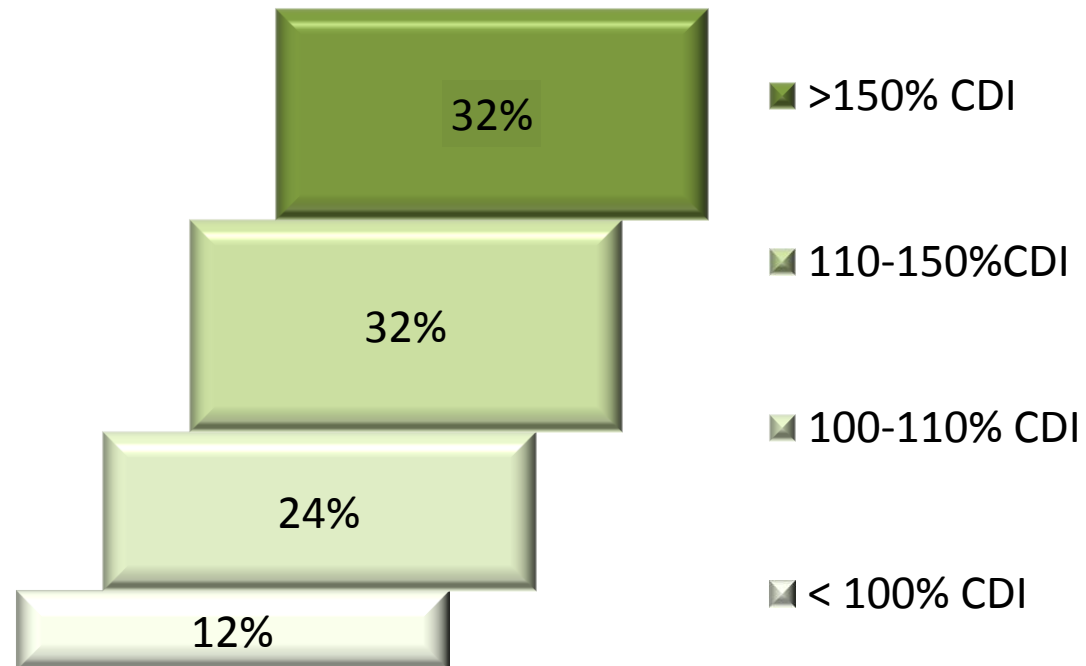
The existence of **exit doors** is fundamental to the PE/VC cycle. In the last decade, the availability of exit options for PE/VC investors have grown considerably.

Exit door (Us\$ Milion)	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>
IPO		380	130		273
Secondary Public Sale	180	484	336	228	772
Trade Sale	2	9	104	338	1825
Secondary Private Sale			4	3	13
Buyback	13	14	2	97	20
Write-off		1			59
	194	888	576	666	2961

Equity Public Offers Registered at CVM



Annual returns on investment in PE/VC in Brazil above the CDI (Interbank interest rate)



Data considers 25 transactions – 15 IPOs and 10 trade sales in 2004-2009

Source: Carvalho et al. – Private Equity and Venture Capital in Brazil – 2nd Census – FGV Center for PE and VC Research (In Portuguese)

Investment **opportunities** will continue:

- Economic Growth : Growing middle class / Relevance of Internal Demand and Demographic bonus
- Solid macro economic policies : Fiscal responsibility, Inflation control and Market driven exchange rate
- Solid democracy and institutions
- Increase in consumption by lower middle-class and Housing Deficit
- Potential to be a top energy supplier worldwide (Oil and Ethanol)

Some **sectors** are particularly expected to benefit from PE/VC investments

- Agriculture
- Food processing
- Education
- Energy and Infra-structure
- Real Estate
- Health
- Retail

All fund administrators have to be registered at the CVM

Requirements for registration of asset managers (CVM Rule 306)

Individuals

- University graduate
- Professional experience
 - 3 years in asset management
 - 5 years in the market capitals
- Unblemished reputation

Firms

- Legal purpose of managing assets
- Technical department specialised in securities analysis
- Responsible director registered as asset manager

Most associated to ABVCAP and ANBIMA (self-regulation codes)

Essential features

- Flexibility
- Transparency and Disclosure
- Gatekeepers
- Registration
- Supervision
- Enforcement



Incorporated as a **closed-end** condominium

Invests in

- **Shares** or
- Securities (debentures, warrants, etc) **convertible/exchangeable for shares**

Participates **actively** in the decision-making of the invested firms by

- Holding shares of the controlling block
- Taking part in a shareholders' agreement
- Other ways that ensure effective influence in the strategic policies and management

Governance of the invested companies

- Fund's bylaw shall provide the criteria for investment in **listed companies**

- Specific governance requirements for **closed companies**
 - No Partes Beneficiárias
 - Unified term of office of one year for all board members
 - Disclosure of agreements with related parties, shareholders agreements and option plans
 - Resolution of corporate disputes through arbitration
 - Annual audit by auditor registered with the CVM

Requirements for the **registration** of the fund

- Incorporation documents and by-laws
- Name of the independent auditor hired
- Shares to be issued
 - Maximum and minimum numbers
 - Issuance prices
 - Costs
 - Other relevant information
- Marketing material for the placement of the fund's quotas, including prospectus, if available
- Any additional information intended to be provided to potential investors

- Information on **Manager** and **Administrator**
- **Investment policy**
- Rules and deadlines for capital calls
- Rules and criteria for making the investments
- Procedures for eventual execution of new investment commitments
- **Fees**
- **Valuation methodology**

- **Disclosure** to investors – what/when/how
- **Expenses**
- Powers of general meeting of quota-holders
- **Conflicts of interest**
- Decision-making processes
- Rules for replacing manager
- Conditions for **winding-up**

Within 8 days

- **Changes to by-law**
- Replacement of management
- Consolidation
- Mergers
- Spin-off
- Winding-up
- Placement of new quotas

- **Safeguarding of documents** pertaining the funds' operations
- Pay at his own expense for **costs** of advertising the fund
- Pay at his own expense any punitive **finances** by the CVM
- To exercise for the **fund** all its **rights**
- Maintain all funds' assets in custody with a CVM authorised **custodian**
- **Comply with the resolutions passed by the general meeting of quota-holders**
- **Comply and ensure compliance with all provisions of the fund's bylaws**

- **Receive deposits** into his current account
- **Borrow or lend**, except those modalities allowed by CVM (e.g. equity lending/borrowing, as regulated by CVM)
- Give warranty, acceptance or otherwise **be a guarantor** in anyway with the assets of the fund
- **Promise** predetermined **returns** to investors
- Invest
 - Abroad
 - Purchase real estate assets
 - In quotas issued by the fund itself

Formalities to call meetings

- At least 15 days in advance
- May be called by manager or by quota-holder with at least 5% of the fund

One quota, one vote

- By-law may allow the existence of more than one class of shares with different economic rights, only regarding the setting and calculation of management and performance fees
- By-law may allow the existence of more than one class of shares, with different political rights only applicable for those subjects specified
- These possibilities don't exist in the mutual fund regulatory framework, where only one class of shares is allowed

Only the quota-holders general meeting can decide on

- Annual **review** of the fund's **accounts**
- **Amend** the fund's **bylaws**
- Dismiss or **replace** the **manager**
- Decide on **consolidation, merger, spin-off** or **winding-up**
- Decide on the **issuance and placement of new quotas**
- Extend the **fund term**

Instrução CVM 400 of 29 December 2003

- Need for full registration and Prospectus
- Detailed and strict regulation applies, including full disclosure requirements and quiet period
- Possible **exclusions or discounts** in the requirements for public offerings depend on factors such as
 - Whether issuer is already a listed company
 - Value of the securities offered or the total value of the offering
 - Target-public, including details regarding location and quantity
- Suspension or cancelling of offers may happen in different conditions that need to be mentioned in the offering documents

*Instrução CVM 476 of 16 January 2009 – **Private Placement / Limited sales efforts offerings***

- No need for registration
- Exclusively for **qualified/accredited investors**
 - Funds
 - Investment > R\$1 million; maximum 20 buyers (up to 50 investors visited)
- Distribution by registered distributor
- Prohibition of mass offering (TV, radio, etc) and minimum interval of 4 months between offers
- Information to investors
 - True
 - Consistent
 - Accurate
 - Sufficient for the investment decision-making
- Disclosure of possible **conflicts of interest** and **Suitability**

Risk-based

- Potential impact vs Probability
- Methodology made known in website
- Includes analysis of constitutive and offering materials

Electronic filters

- Use of database to find inconsistencies and identify non-compliances

On-site inspections

- Preventive / Routine
- On demand

Self-regulation

- ABVCAP/ANBIMA self-regulation code

Alerts

- Harm has ceased or been reverted
- Adjustment of conducts
- Low relevancy – Low risk to regulatory objectives

Sanctions

- Repetition / Reincidences
- Serious infractions
- Example setting
- Efforts to reduce lead time between infraction and sanction



CVM

Possible Regulatory Improvements

Article 35, III of CVM Rule 391

- Fund as guarantor with agreement of investors

Accounting rules

Consolidation and update of the rules applicable to the Venture Capital Funds

Evaluation if there is the need for a different approach to seed capital and early stages funds

Worth noting: In regulatory change process the **participation of stakeholders** is encouraged (no surprises approach)

- Before: Agenda setting
- During: Public hearing
- After: Continuous review

Keep up the **offer of skilled professionals**

- Quality - complexity of businesses
- Quantity – size of the business opportunity

Focus on **early stages**

- Improve attention to seed and start-up

ABVCAP - Brazilian Private Equity and Venture Capital Association
<http://www.abvcap.com.br>

ANBIMA – Brazilian Investment Banks Association
<http://www.anbima.com.br>

SRF – Internal Revenue Secretary
<http://www.receita.fazenda.gov.br/>

CVM – Securities Commission of Brazil
<http://www.cvm.gov.br>



CVM

Comissão de Valores Mobiliários

Protegendo quem investe no futuro do Brasil

Thank you!

Francisco Santos

sin@cvm.gov.br