

Regulatory Structure for Private Equity in Brazil

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Investment Vehicles in Brazil

- Foreign Direct Investment
 - Federal Law 4131 of 1962
 - Used for private investments in companies, plants, etc
- Investment in Securities Portfolios
 - CMN Resolution 2689 of 2000
 - Used for investments in publicly traded equity, government and corporate debt, derivatives and funds
- Mutual Funds
 - CVM Instruction 409 of 2004
- PE/VC Funds
 - CMN Resolution 2689 of 2000
 - Fundos de Investimento em Participações – FIP (Private Equity Funds): CVM Instruction 391 of 2003
 - Fundos de Investimento em Empresas Emergentes - FMIEE (Venture Capital Funds): CVM Instruction 209 of 2004

Investment Vehicles in Brazil

- The FIP structure was, according to this survey, responsible for over 20% of the PE/VC commitments in Brazil: favorable 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>

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

FIP Regulation

Fund Managers and Administrators

- Fund administrators act as gatekeepers regarding the fund managers
- All fund managers and fund administrators must be registered with CVM
 - Legal fiduciary duties
 - Supervision and enforcement by CVM (on site inspections and electronic supervision of the funds based on the information filed)
 - CVM is revising the requirements for fund managers
- Most associated to ABVCAP and ANBIMA (self-regulation code on top of legal requirements)

FIP Regulation

Main Characteristics

- Incorporated as a closed-end condominium
- Funds' shares to be distributed only to qualified investors
- Invests in:
 - Shares and
 - Other securities (debentures, warrants, etc) convertible/exchangeable for shares
- Must participate actively in the decision-making of the invested firms by:
 - Holding shares of the controlling block,
 - Taking part in a shareholders' agreement or
 - Other ways that ensure effective influence in the strategy and management (as appointing board members)

FIP Regulation Registration

- Requirements for the registration of the fund
 - Incorporation documents and bylaws
 - Name of the audit firm hired
 - Shares to be distributed
 - Maximum and minimum amounts
 - Issuance price
 - Distribution costs
 - Other relevant information
 - Marketing material, including prospectus, if available
 - Any additional information to be provided to potential investors
 - Fund manager qualifications

FIP Regulation Bylaws

- Information on fund manager and administrator
- Investment policy
- Rules and deadlines for capital calls
- Rules and deadlines for making the investments after paid up and for capital restitution, if not
- Procedures for new investment commitments
- Valuation methodology
- Fees

FIP Regulation Bylaws (contd.)

- Disclosure to investors – which information/form/timeframe
- Expenses attributable to the fund
- Powers of general meeting of shareholders
- Information on possible conflicts of interest
- Investments (divestments) decision-making process
- Rules for replacing the manager
- Conditions for winding-up

FIP Regulation

Information to CVM (all public)

- Immediately, material information not considered to be strategic to the investments
- Within 8 days
 - Changes to the bylaws
 - Replacement of manager
 - Merger
 - Spin-off
 - Winding-up
 - Distribution of new shares
- Quarterly, NAV and number of issued shares
- End of semester, portfolio composition, financial statements
- Annually, audited financial statements

FIP Regulation

Obligations of administrator/manager

- Safeguarding of documents pertaining to the funds' operations
- Exercise all the fund's rights
- Keep all funds' assets in custody with a CVM authorised custodian
- Comply with the resolutions of the general meeting of shareholders
- Comply and ensure compliance with all provisions of the fund's bylaws
- Pay at his own expense for costs of advertising the fund
- Pay at his own expense any punitive fines imposed by the CVM

FIP Regulation

Prohibitions for administrator/manager

- Receive deposits of fund's moneys in his own current account
- Borrow or lend fund's securities and other assets, except for stock lending as regulated by CVM
- Give warranty or otherwise be a guarantor in anyway with the assets of the fund, except if authorised by the GSM
- Promise predetermined returns to investors
- Invest
 - Abroad
 - In real estate assets
 - In shares issued by the fund itself

FIP Regulation

General Meeting of Shareholders

- Formalities to call meetings
 - At least 15 days in advance
 - May be called by administrator or by any shareholder with at least 5% of the fund
- One share, one vote
 - Bylaws may allow the existence of more than one class of shares with different economic rights, only concerning setting and calculation of management and performance fees
 - Bylaws may allow the existence of more than one class of shares with different political rights, only applicable to those matters as specified in the bylaws
 - These possibilities don't exist in the mutual fund regulatory framework, where only one class of shares is allowed

FIP Regulation

General Meeting of Shareholders

- Only the general shareholders' meeting can decide on:
 - Annual approval of fund's financial statements
 - Amendments to the fund's bylaws
 - Dismissing or replacing the manager and administrator
 - Merger, spin-off or winding-up of the fund
 - Issuance and distribution of new shares
 - Extending the fund's term

FIP Distribution

Public Offering (ICVM 400)

- 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 are possible, but depend on factors such as:
 - Value of the securities offered or the total value of the offering
 - Target-public, including details regarding location and quantity

FIP Distribution

‘Private Placement’ (ICVM 476)

- No need for registration with CVM
- Exclusively for qualified investors and
 - Investment > R\$1 million; maximum 20 buyers (up to 50 investors visited)
- Prohibition of mass marketing (TV, radio, web)
- Distribution by registered financial institution
- Information to investors:
 - True
 - Consistent
 - Accurate
 - Sufficient for the investment decision-making
- Disclosure of possible conflicts of interest and suitability assessment

FIP Regulation

Governance of Invested Companies

- Governance of the invested companies
 - If the invested companies are not listed, there are specific governance requirements:
 - No *partes beneficiárias* (founder's shares)
 - Unified one year terms for all board members
 - Disclosure of shareholders agreements, stock options plans and any related party transactions
 - Resolution of corporate disputes through arbitration
 - Audited financial statements (audit firm must be registered with the CVM)
 - If the companies go public, they must at least maintain the same CG practices

Main factors for industry growth in Brazil

- Profitability
- Investment opportunities
- Skilled participants
- Sound regulatory framework
- Track record
- Exit options

Corporate Governance in Brazil

- Significant improvements since 2000
 - Self-regulation / market mechanism: Novo Mercado
 - Legislation and regulation: reform of the Corporate Law, Securities Law and CVM rules
 - CG practices generally evolving
- Strengthening of the regulator itself – enforcement and supervision greatly improved
- Enhanced disclosure (ongoing disclosures similar to prospectuses, significant improvement in information for GSMs, IFRS since 2010)
- Regulation for proxy contests and shareholders participation in GSMs
- Rules to deal with the possibility of takeovers

Corporate Governance in Brazil

- On Dec/2012, NM companies represented 31% of market cap and 43% of daily average trading value of the BM&FBovespa
- CG practices:
 - “Our analysis shows that corporate governance practices improved significantly in the 2004-2009 period. This evolution is due to two main factors: 1) growth in Novo Mercado and Level II listings, mainly through the entry of new firms with high corporate governance practices (IPOs) and 2) improvement in the governance practices of the firms that were already listed. Governance practices for firms already listed on Novo Mercado and Level II were stable during that period. There were broad improvements for already listed firms, including board structure, board procedures, shareholder rights and disclosure. We also find that many firms in Novo Mercado/Level II exceed the minimum listing requirements.” (*)

(*)The Evolution of Corporate Governance in Brazil, B.Black, A. G. Carvalho and J. O. Sampaio, 2012

Corporate Governance in Brazil

- Primary market post crisis much weaker than before
 - Part of it is the prices level (entrepreneurs not accepting current levels)
 - Part of it caused by Brazil not having developed an IPO market for SMEs (domestic investor base, smaller intermediaries)
 - Doesn't seem to be anything related to institutional or CG framework
- The relevant setback has been the behavior of the Brazilian state as the controlling shareholder of public companies (listed SOEs)
 - Raising concerns, among investors, that generally are not so present in the case of private sector companies any more

Next steps

- Improve mechanism for SMEs IPO market
 - Led by CVM, BM&FBovespa and other public sector bodies
 - Adjustments in legislation, regulation and self-regulatory rules to allow more flexible mechanisms for smaller issuers
 - Relevant banks and brokers involved: supply and demand