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Brazil

Regulation

FUNDS AND FUND MANAGEMENT 2009

2.1 Types of funds

The principal types of investment funds are the following:

- Investment funds (Fundo de Investimento): FI
- FI quota funds (Fundo de Investimento em Cotas de FI): FIC
- Credit assignment investment funds (Fundos de Investimento em Direitos Creditórios): FIDC
- Fund in FI Cotas of Credit Assignment Funds (Fundo de Investimento em Cotas de FIDC): FICFIDC
- Participation funds (Fundos de Participações)
- Investment funds in emerging companies (Fundos de Investimento em Empresas Emergentes)
- Real estate funds (Fundos Imobiliários)
- Mutual privatization funds (Fundos Mutuos de Privatização)

2.2 Laws

Investment funds used to be regulated by the Central Bank of Brazil (BACEN) and stock funds complied with the Securities and Exchange Commission of Brazil (CVM) regulations. In May 2002, both entities established that all funds would be regulated by CVM, assisted by BACEN (Decision 10 of 2 May 2002). An agreement was finally signed in July 2002. Since 22 November 2004, all funds have been regulated by CVM.

On 18 August CVM issued Instruction 409 regulating the general rules that govern the setting up, functioning, and disclosure of information of investment funds and FI quota funds. Consequently, the administrators had to make the necessary changes in the regulations and call the respective meetings in order for these to be carried out not later than 31 January 2005 and for the fund to be

adapted to the provisions of this instruction, in accordance with the changes introduced by CVM Instruction 411 of 25 November 2004, and 413 of 30 December 2004, not later than 31 March 2005.

Over the last few years significant changes have been made to the laws regulating the operation of investment funds, so as to adapt them to the country's new economic reality, brought about by the real economic plan.

The principal laws governing the operation of funds are as follows:

- CVM Instruction 209 of 25 March 1994
- BACEN Resolution 2907 of 29 November 2001
- CVM Instruction 356 of 17 December 2001
- BACEN Circular 3086 of 15 February 2002
- CVM Instruction 391 of 16 July 2003
- CVM Instruction 409 of 8 August 18, 2004
- CVM Instruction 438 of 12 July 2006
- CVM Instruction 472 of 31 October 2008

Investment funds (FI) and FI quota funds (FIC) may be an open or closed condominium (joint ownership), which corresponds to the sharing of capital to acquire different financial assets available on the financial market, under strict compliance with the related rules. The redemption of quotas is allowed in an open condominium (CVM Instruction 409/04, article 5). In a closed condominium, the redemption of quotas is only permitted at the end of the term of validity of the fund or by decision the meeting.

The legal concept of a trust does not exist in Brazil. The investment fund has features similar to those of a trust, such as the responsibility of the fund manager, the financial institution (the same as the trustee in the trust), but with some relevant differences. For example, the fund manager acts in the name of the fund, not in his/her own name, which is the case of the trustee.

CVM Instruction 438 will come into force on 1 January 2007 and will establish the accounting practices and preparation of the financial statements for the investment funds (FIs)

CVM's Instruction 456 establishes, among other implementations, the permission for investment funds to perform investments in financial assets similar to the ones which already have their negotiation permitted in Brazil, as long as these have their negotiation accepted in stock exchanges, futures, and

commodities exchange, or are registered in a system of records, custody, or financial settlement duly authorized in their native country and is supervised by recognized local authority, or whose existence is assured by a custodian entity, contracted by the fund manager, and which is duly authorized to perform this activity in its native country and is supervised by recognized local authority.

The instructions that will address the accounting practices and preparation of the financial statements for the following funds: FIDC, FP, FIEE, and FUNCINE are in a public hearing.

2.3 Managers, trustees, and custodians

The administrators of investment funds may be the corporate entities authorized by CVM to professionally manage portfolios.

The functioning of the funds depends on prior registration in CVM, which is done by the administrator sending in the respective documents, and registration is considered as automatically conceded on the date informed on the respective official receipt of filing.

Financial assets and the operational modes that comprise the fund portfolio should be kept in appropriate custody and recorded and/or maintained in a deposit account directly in the name of the fund, in specific accounts opened in the Special System for Settlement and Custody (SELIC), in recording systems and in financial asset settlement systems licensed by BACEN or at institutions or entities licensed to render these services by the aforementioned governmental agency or by CVM.

There are no limits on fees for managers and trustees, and in practice, they are controlled by the market mechanism only.

2.4 Investment restrictions

CVM Instruction 409/04 and subsequent amendments establish the diversification limits for investment fund portfolios.

FI

Investment funds, according to the composition of their equity, are classified as:

- short-term funds (Fundo de Curto Prazo);
- referenced funds (Fundo Referenciado);
- fixed income funds (Fundo de Renda Fixa);

- stock funds (Fundo de Ações);
- exchange funds (Fundo Cambial);
- foreign debt funds (Fundo de Dívida Externa); or
- multi-market funds (Fundo Multimercado).

The funds classified as referenced, fixed income, exchange, foreign debt, and multi-market may also be classified as long-term when the average term of their portfolio is more than 365 days

Short-term funds

They should invest their resources exclusively in prefixed federal government bonds or private bonds or bonds indexed to the SELIC rate or another interest rate, or bonds indexed to price indexes with a maximum term to run of 375 days, and an average for the fund portfolio of less than 60 days, and the use of derivatives is permitted only for protection of the portfolio and the realization of repurchase operations guaranteed by federal government bonds.

Referenced funds

The funds classified as referenced funds should identify their performance indicator in their denomination, in keeping with the structure of the financial assets that integrate the respective portfolios, provided that they meet, cumulatively, the following conditions:

- At least 80 percent of their net equity is represented, alone or cumulatively, by:
 - securities issued by the National Treasury and/or the Central Bank of Brazil; and
 - fixed income securities, which are issued by an institution classified as low credit risk or similar, certified by a risk rating agency located in Brazil.
- They stipulate that at least 95 percent of the portfolio is composed of financial assets that are indexed, directly or indirectly, to the variation of the chosen benchmark performance indexer.
- They restrict their respective operations in the derivative markets to operations with the objective of hedging positions held on demand, up to the limit of these positions.

Fixed income funds and exchange funds

The funds classified as fixed income and exchange should have at least 80 percent of the portfolio in assets directly related, or synthesized via derivatives, to the risk factor that gives rise to the name of the class.

Stock funds

The funds classified as stock funds should have at least 67 percent of the portfolio in shares traded on the cash spot market of the stock exchange or an organized over-the-counter market entity.

Foreign debt funds

The funds classified as foreign debt funds should invest at least 80 percent of their equity in representative securities of the Brazilian foreign debt. They are permitted to invest up to 20 percent of their net equity in other securities traded on the international market.

Multi-market funds

The funds classified as multi-market funds should have investment policies that involve various risk factors, without a commitment to concentrate on any special factor or on different factors of the other foreseen classes.

FIC

The FIC fund should invest at least 95 percent of its equity in quotas of funds, overseas investment funds and investment funds of the types regulated by CVM. The portion corresponding to the remaining 5 percent of its equity should be invested in:

- securities issued by BACEN or by the National Treasury and credits securitized by the National Treasury;
- fixed income bonds issued or accepted by financial institutions; and
- repurchase agreements.

The prospectus and regulations in force of the fund should specify the maximum percentage of equity that may be invested in one unique investment fund.

FIDC

This fund should invest at least 50 percent of its total equity in loan assignments. The remaining capital may be invested in:

- securities issued by the National Treasury;
- securities issued by BACEN;
- credits securitized by the National Treasury;
- securities issued by states and municipalities;
- time deposits (certificates and receipts of deposit); and
- other marketable securities and fixed income financial bonds, except quotas from the Social Development Fund (FDS).

Securities issued by an entity or government may not exceed more than 10 percent of the fund's total equity. If the abovementioned securities are issued by a bank or another financial institution, the total value of the fund's equity may not exceed 20 percent.

FICFIDC

This fund should invest at least 95 percent of its total equity in loan assignment investment funds. The remaining capital can be invested in:

- securities issued by the National Treasury;
- securities issued by BACEN;
- credits securitized by the National Treasury;
- fixed income bonds issued or accepted by financial institutions; and
- repurchase agreements.

Investments in quotas from the same fund can exceed 25 percent of the fund's total equity, if it is stated in the fund's bylaws.

Participation funds

These funds, established through CVM's Instruction 391, of 16 July 2003, presented in 2007 a significant increase in the share of the investments received by the investment funds existent in Brazil and, due to this, KPMG in Brazil highlights their main characteristics:

- They aim the acquisition of shares, debentures, subscription bonuses, and other convertible or exchangeable securities into shares of companies' issue, either publicly-held or privately-held.

- They participate in the decision making of the investee, and with effective influence on the definition of its strategic policy and management, mainly through the appointment of members of the Board of Directors.
- Their participation in the decision making of the investee is determined by the possession of shares that are part of the respective control block, by the celebration of an agreement between the shareholders or even by the celebration of an adjustment of other nature or the adoption of procedure which ensures to the fund the effective influence on the definition of the investee's strategic policy and on its administration.
- Only qualified investors may invest in the fund, under the terms of CVM's regulation related to investment funds in securities, with a minimum subscription amount of BRL 100,000.
- They should describe in its promotional material the inherent risks of the concentration and possible lack of liquidity of the assets that compose the portfolio resulting from his/her/their investments.

2.5 Borrowing

Investment funds are not authorized to make or take out loans.

They may however hold interest bearing securities and bonds issued by other bodies, if the interest bearing bond or security is an asset usually available in the Brazilian financial market subject to the restrictions described above.

2.6 Accounts and prospectus

The institutions managing funds must place at the disposal of the condominiums information on the number of quotas that are the property of each one and their respective value.

All funds must issue a prospectus.

2.7 Supervision

All the funds specified in section 2.4 are under the supervision of CVM.

CVM requires that the investment funds have to change their external auditors every five years, and can contract them again after a minimum period of three years. (CVM Instruction 308/99.)

In addition, CVM requires the disclosure, in explanatory notes, of information related to the rendering, by the independent auditor or parties related to it, of any service that is not an external audit, whenever the overall remuneration is

more than 5 percent of the remuneration for the audit services (CVM Instruction 381/03).

It is important to stress that the provisions enacted by the National Monetary Council and by BACEN remain in force, as long as CVM Instruction 438 is not in force, which will occur as from 1 January 2007.

2.8 Fund ownership

There is no limit on the percentage of units which any person or group of persons may hold in a fund.

2.9 Fund structure

In general, investment funds have similar structures, varying only as to the type of operation carried out. Credit Assignment Investment Funds have two kinds of quotas:

- Senior quotas: held by the investors and remunerated in accordance with the regulations.
- Subordinated quotas: held by the entity which originated the loan assignments. The subordinated quotas constitute a guarantee for the senior quotas.

2.10 Bank secrecy

The aforementioned institutions supervise investment fund operations. Additionally, they are subject to bank secrecy in the same way as the operations of the managing financial institutions.

2.11 Setting up funds

Setting up an investment fund does not involve significant costs and can be completed in approximately one month after presentation of the fund's bylaws to CVM.

The fees payable to the fund manager must be stated in the fund's bylaws (CVM Instruction 409/04, article 61).

The stock funds must pay an inspection fee to CVM every three months. This fee is calculated and paid quarterly, based on the average daily net equity referring to the immediately prior quarter. (Law 11076/04)

2.12 Foreign funds

CMN Resolution 2689/00 abolished foreign capital funds and granted foreign investors free access to the types of investment existing on the Financial and Capital Market in Brazil, permitting the migration from fixed income to variable income funds or vice-versa without restrictions.

Hence a foreign investor can be a unit-holder in funds regulated by CVM and BACEN, in the same manner as investors residing in the country.

Foreign capital entering the country is subject to registration at BACEN and exchange closing.

2.13 Bearer shares

It is not possible to hold bearer shares in Investment Funds.

2.14 Use of the internet

The Internet has been widely used in Brazil as a marketing tool for investment funds. Most financial institutions that manage investment funds have Web sites where the characteristics of the investment funds they sell are explained and potential investors are invited to invest.

Electronic mail has been utilized by fund managers as an effective means of communication with unitholders.

2.15 Miscellaneous

National Association of Investment Banks (ANBID - Associação Nacional dos Bancos de Investimento) is the entity that represents financial institutions active in the capital market. Its members are basically investment banks and commercial banks with an investment portfolio.

ANBID has a classification for the funds industry, based on the investment policy of each institution. The objective is to provide investors, administrators, the press and other interested parties with information on the funds industry segmented into distinct families according to the various risk profiles, potential return and investment objectives.

Methodological notes on the classification

- The basic criteria used for segmentation purposes were to gather together families of funds with similar investment objectives. As complementary criteria, the use of specific strategies to attain the desired objective was considered.

- Generally speaking, two major investment objectives were defined: to exceed a given benchmark or to replicate it.
- Thus, two major segments were created: the referenced funds, the aim of which is to replicate the selected parameter as closely as possible - without gaining or losing - and the non-referenced and differentiated funds, the purpose of which is to exceed a certain benchmark, if any. In the absence of that parameter for comparative purposes, those funds follow a policy of adding value for the unit-holder through investing in a certain class of financial assets.
- Equity funds were also divided in a similar way as passive funds, the purpose of which is to replicate a certain benchmark as closely as possible - without gaining or losing - and active funds, the purpose of which is to exceed a given benchmark. In order to exceed their benchmarks, active funds are expected to have a behavior - risk - different from the comparison, with higher or lower volatility.
- An example of segmentation by investment strategy is given by the multi-portfolio families. Funds that follow a policy of unleveraged asset allocation should be classified here. Multi-portfolio leveraged funds were also segregated. This last case may include some of the funds now referred to as derivative funds.
- It is worth mentioning that the risk potential built into the investment strategies used to attain the related objectives was also taken into consideration. The principal risk parameter was the use of leveraging. For that purpose, a fund is considered leveraged whenever the probability of the loss exceeding funds assets (except for cases of default) is different from zero.

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