

# Looking to Raise Money and Invest in Brazil. What's a FIP?

While China and India have been the beneficiaries of private equity investors' confidence over the past several years, savvy investors are taking a closer look at Brazil. In fact, a survey conducted this past April by Collier Capital and the Emerging Markets Private Equity Association (EMPEA) indicated that Brazil has overtaken China as the most attractive market for private equity fund managers. Of the 156 global private equity investors polled, the majority of them expect to begin investing in Brazil in the next 12 months.

## Private Equity Investments Through a FIP

One of the most prominent options for capitalizing on investment opportunities in Brazil is currently through a Brazilian Participation Fund, or "FIP" (Fundos de Investimento em Participações). FIPs are closed-end investment funds that can acquire shares, debentures, subscription bonds, convertible securities and derivatives (for hedging purposes only) of any Brazilian publicly or privately traded company. They are restricted, though, from acquiring real property, may not acquire shares issued by the administrator and cannot invest abroad.

## What Are the Rules?

FIPs are regulated by the Comissão de Valores Mobiliários (CVM), Brazil's Securities and Exchange Commission, through Ruling 391. Only qualified investors may participate – financial institutions, insurance companies, pension funds and investors holding other investments of more than R\$300,000, investment funds targeted exclusively to qualified investors, and portfolio managers and securities consultants authorized by the CVM, with respect to their own funds. Each investor must invest a minimum of R\$100,000 in the Fund and ownership is provided through the issuance of quotas by the FIP. Unlike other equity funds, a FIP is required to participate in the decision-making process of the companies in which they invest by appointing members to the companies' Board of Directors and exerting active influence on the companies' strategy and management.

Although the FIP is registered with the CVM, the private companies in which the FIP is investing are not. Consequently, the companies must adopt certain minimum corporate governance practices to be eligible to receive capital from the FIP. These practices require that the company submit its annual financial reports to an external and independent auditor that is registered by the CVM, the Board of Directors to meet annually, shareholder agreements as well as contracts that dictate the scope of the FIP's management of the company, and an arbitrator to be used in the event there are any conflicts between the company and its shareholders.

## Qualifying FIP Income and Capital Gains Exempt from Brazilian Income Taxes

Any income and capital gains earned by a FIP is exempted from the income tax in Brazil. The investor is subject to the withholding income tax at a zero rate in Brazil on the income and capital gains associated with the FIP, as long as: (i) the investor and all its related parties own less than 40% of the FIP's quotas or earnings; (ii) the investor is not domiciled in a tax-haven jurisdiction; (iii) the investment into the FIP from offshore vehicles adheres to the foreign exchange procedures stipulated by Resolution 2689, which regulates the external investors activity in Brazil; (iv) the FIP cannot hold in its portfolio, at any time, debt securities exceeding 5% of the FIP's net equity, except for investments in public bonds or notes convertible or exchangeable in shares of

a publicly held company or closely held company. This tax savings is significant. If these conditions are not met, earnings generated by the FIP are subjected to a 15% withholding income tax, since the FIP observes the CVM requirements for the composition of the FIP's portfolio.

## Loopholes Closed

As of May 12, 2011, the CVM requires all FIPs to invest 90% of their net worth in securities issued by target companies (publicly or privately held Brazilian businesses). The remaining 10% can be invested in these target companies or used either to retain cash or to purchase short-term public debt securities. This guidance from the CVM was enacted to close potential loopholes created by previous legislation relating to taxes on credit and exchange transactions, insurance and securities, which is due when funds enter Brazil. This new requirement prevents FIPs from being used as vehicles for investing in securities that have less-favorable tax treatments than the one applied to the FIP quotas.

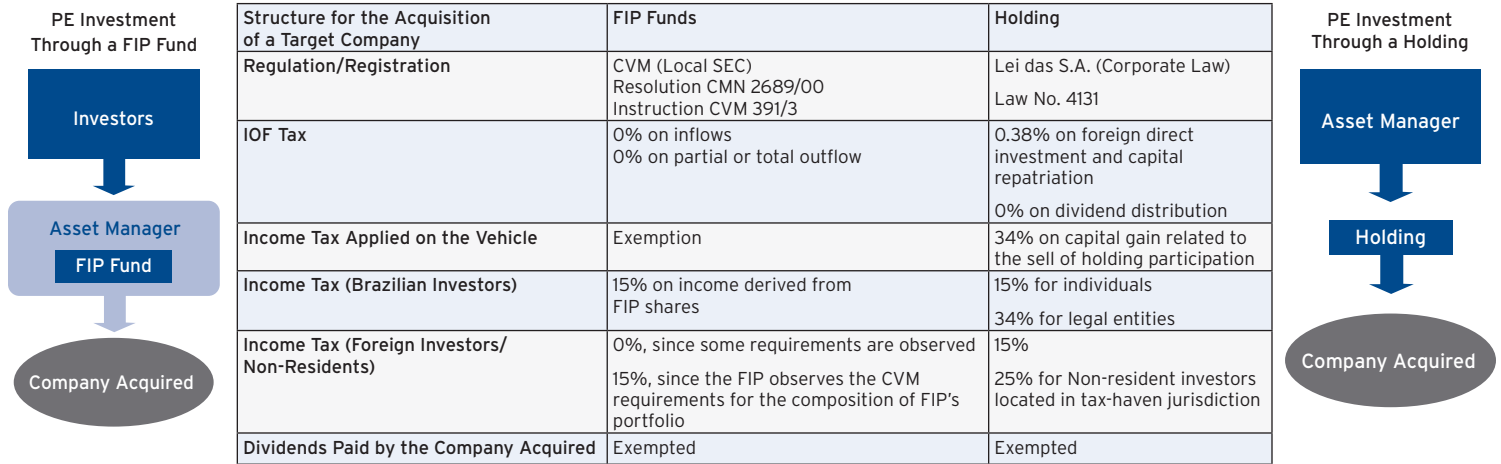
## IOF Tax Reduced for FIPs

All funds investing in Brazil from overseas are subject to an IOF financial tax (Imposto sobre Operações Financeiras). This is a "front-end" tax, which reduces the amount of capital invested as soon as a local representative or custodian converts the invested capital into Reais. Until this past November, investments into the FIP by funds of investors offshore were subject to a 2% IOF tax – the same level that all fixed income investments were charged. However, because FIPs are important drivers of small businesses, especially those engaged in the critically important infrastructure sector, the Brazilian tax authority reduced this IOF tax for investments in FIPs to just 0%.

## Best Practices Code Enacted

Also in March 2011, ABVCAP-ANBIMA (Brazilian Private Equity and Venture Capital Association) and (Brazilian Financial and Capital Markets Association) mandated a

## Investments via FIP Fund versus Investments via Holdings



self-regulation and best practices code for its active members performing administration, portfolio management or share distribution services for FIPs. The code creates a framework for greater transparency, high ethical and equitable practices, and standardized procedures that put the Brazilian private equity and venture capital industry at greater par with its constituents across the globe.

### Now that you know what an FIP is, what should you consider? Navigating the FIP Environment

Brazil has one of the most sophisticated regulatory systems in Latin America. Private equity firms that want to succeed in Brazil need to find the right partner to help navigate Brazil's complex business environment. That partner should help guide investors toward the most appropriate investment structures for their business. It's imperative to find a fund administrator, custodian and portfolio administrator who have the local expertise needed to understand the investment environment and

a track record that is bolstered by quality personnel, robust technical and operational infrastructure and a thorough understanding of local regulations. Building upon its local connections, your chosen service provider should be a valuable resource for business building and for knowledge of other best-in-class service providers.

The right service provider is not only knowledgeable of the many regulations that affect FIP investments, but is able to translate those regulations into profitable opportunities for investors while maintaining stringent adherence to the law. Having a close connection to the regulators is critical in guaranteeing the strictest of standards are being met and no unforeseen regulatory issues disrupt the progression of business. Under Brazilian law, your administrator is responsible for ensuring that the FIP's manager is investing in accordance with CVM regulations – this requires assiduous diligence, robust technology and on-the-ground expertise.

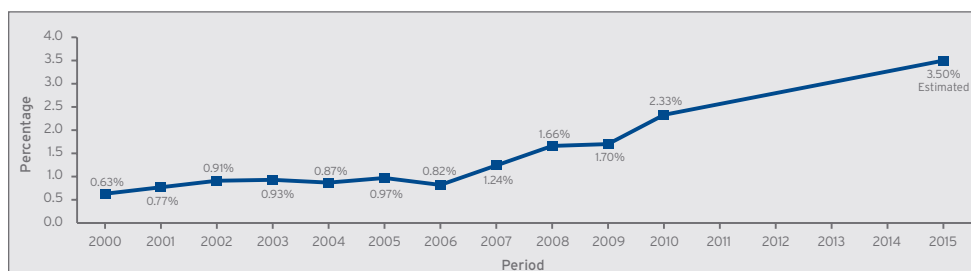
Fund services should be automated and proactive, enabling investors to have an accurate account of their investments' value on a daily basis. Daily NAVs, swift reaction to corporate actions and timely settlements for all investment activity are critical services that no firm can afford not to require.

Citi is a leading provider of fund administration services to private equity clients in Brazil and administers more than \$160 billion in private equity committed capital globally. With more than \$12.5 trillion in assets under custody, \$380 billion in alternative assets under administration and an on-the-ground presence in over 100 countries, we offer unmatched global scale underscored by a commitment to exceptional service.

For more information on how Citi can partner with you to achieve success in the Brazilian private equity market, please contact: Paulo Marins at 5511-4009-3888 or paulo.marins@citi.com.

## Evolution of Private Equity Committed Capital in Brazil versus Brazil GDP

The projection is that private equity will represent 3.5% of the Brazilian GDP in 2015.



Source: FGV - Fundação Getulio Vargas

For more information, please visit [www.transactionservices.citi.com](http://www.transactionservices.citi.com)

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