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The Covered Bond for the Brazilian Real Estate Market – LIG

Provisional Measure No. 656, dated October 7, 2014, brought about important novelty to the Brazilian real estate sector, including the creation of the *Letra Imobiliária Garantida* ("LIG") covered bond for the Brazilian real estate market.

Some characteristics of this bond differ from those of other bonds already existent in the Brazilian market, such as the *Letra de Crédito Imobiliário* ("LCI"), the *Cédula de Crédito Imobiliário* ("CCI") and the *Certificado de Recebíveis Imobiliários* ("CRI"), that may make the LIG a more attractive instrument for long-term real estate financing.

The first advantage is its nature. According to Brazilian National Monetary Council ("CMN") regulation yet to be issued, the underlying assets of the LIG are portfolios formed by real estate credits, federal government bonds, derivatives and other bonds. However the LIG does not simply represent a fraction of such assets, as do CCIs or investment fund quotas. It is also a direct payment obligation of the issuer, thus granting a double guarantee to the investor.

The LIG is a bond to be issued by financial institutions, different for instance from the CRI, which is issued exclusively by securitization companies, special purpose companies normally without assets other than those related to the CRI.

Another positive characteristic of the LIG is the constitution of a fiduciary regime over the underlying assets, which will not be subject to the effects of intervention, extrajudicial liquidation or bankruptcy of the issuer, nor will become part of the bankrupt estate, or answer for other debts of the issuer – tax, social security or labor debts included. This special regime, or segregate estate, does not exist relative to the LCI, for example.

Although the LIG's underlying assets form a segregate estate, they remain on the issuer's balance, and the issuer is obliged to replace or complement them in the case they are found to be inadequate or insufficient. This differentiates the LIG from securitization structures based on the "originate to distribute" principle and should foster good practices in the origination of credits, as highlighted in the formal justification of Provisional Measure No. 656/14.

The LIG's issuer is the portfolio manager, however portfolio management is automatically transferred to the fiduciary agent (necessarily a financial institution unrelated to the issuer) in the case of intervention, extrajudicial liquidation or bankruptcy of the issuer, or when the Central Bank of Brazil recognizes its insolvency.

The LIG may be issued with exchange adjustment clauses, and this possibility is not limited to bonds destined to foreign investors. Nonetheless, apparently shyly, during the first year's application of Provisional Measure No. 656 the volume of LIGs with exchange adjustment clauses will be limited to but 50% of the total of LIGs issued by the financial institution.

Capital gains and income resulting from investments in LIGs will be exempt from Brazilian income tax when the beneficiary is an individual resident in Brazil or an individual or legal entity resident or domiciled in a foreign country not deemed as a tax haven under Brazilian legislation. The issuance of LIGs still awaits regulation from the CMN, and the Brazilian Securities Commission – CVM relative to the public offer and distribution of the bonds.

Luiz Roberto de Assis
lassis@levysalomao.com.br

São Paulo
Av. Brig. Faria Lima, 2601
12th floor - 01452-924
São Paulo, SP - Brazil
Phone. +55 11 3555 5000

Rio de Janeiro
Praia de Botafogo, 440
15th floor - 22250-908
Rio de Janeiro, RJ - Brazil
Phone. + 55 21 3503 2000

Brasília
SBN Q 1, Bl B, n. 14, Ed. CNC
2th floor - 70714-900
Brasília, DF - Brazil
Phone. + 55 61 2109 6070

contato@levysalomao.com.br