

## CVM Postpones the New Investment Fund Regulation's Effective Date

Last June 11th the Brazilian Securities Commission (*Comissão de Valores Mobiliários – CVM*) postponed the new investment fund regulation's effective date from July to October 1<sup>st</sup>, 2015. Issued on December 17th, 2014, CVM's Normative Ruling No. 554 establishes new criteria for qualified investors and creates the category of professional investors, and Normative Ruling No. 555 revokes prior Normative Ruling No. 409 (August 18th, 2004) and establishes new regulations regarding the composition, management, operation and disclosures of investment funds<sup>1</sup>.

The principal intent of the new rules, which we summarize below, is to: (i) tailor regulation presently in force to the reality of the Brazilian contemporary capital market; (ii) simplify the relevant rules, procedures and categories, making their interpretation easier; (iii) make more flexible several existing concentration limits so as to facilitate local investment fund investment abroad and (iv) formally recognize electronic communications.

According to Normative Ruling No. 554/14, in order to be characterized as a "qualified investor" the investor must either: (i) have made financial investment in an amount higher than R\$ 1,000,000 (no longer R\$ 300,000) and duly certify such fact in writing; (ii) be a natural person registered as an independent investment agent, portfolio manager, analyst or securities advisor<sup>2</sup> or (iii) be an investment club managed by a qualified investor shareholder. The professional investor new category, defined below, is also considered to be a qualified investor.

The professional investor must either: (i) hold investments in an amount equivalent to more than R\$ 10,000,000; or be (ii) an insurance company, complementary pension fund entity or an institution otherwise authorized to operate by the Central Bank of Brazil; (iii) an investment fund, or investment club managed by a CVM-authorized portfolio manager; (iv) an independent investment agent, portfolio manager or securities advisor<sup>3</sup> or, lastly; (v) a non-resident investor.

Depending on the classification of the investor as qualified or professional, there is greater or unrestricted portfolio composition flexibility for regarding funds they invest in, especially with respect to diversification of assets, issuers and investment strategies abroad.

Funds shall observe the concentration limits of investments in a single issuer, draft essential information reports, comply with specific rules for investing abroad and disclose information regularly. Funds destined to qualified investors: (i) can accept financial assets other than money as payment for subscriptions, as well as can provide for redemption in kind; (ii) in case of closed-end funds, need not prepare a prospectus nor publication notice of distribution commencement and closing; (iii) can charge performance fees without adherence to certain normative limitations such as those relating to benchmark, frequency of payment and assessment bases, as may be set forth in their by-laws; (iv) can establish different share conversion and redemption payment terms than those established in Normative Ruling No. 554/14; and (v) can render guarantee and grant acceptance or can be a joint obligor on behalf of the fund as respects direct or indirect operations concerning the fund's portfolio.

Funds shall observe the concentration limits of investments in a single issuer, draft essential information reports, comply with specific rules for investing abroad and disclose information

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<sup>1</sup> The normative ruling applies to all CVM-registered investment funds. Structured investment funds, such as Real Estate Investment Funds (*Fundos de Investimento Imobiliário – FII*) (CVM Normative Ruling No. 472), Credit Rights Investment Funds (*Fundos de Investimento em Direitos Creditórios – FIDC*) (CVM Normative Ruling No. 356 and CVM Normative Ruling No. 444), Private Equity Funds (*Fundos de Investimento em Participações – FIP*) (CVM Normative Ruling No. 391), Emerging Companies Funds (*Fundos Mútuos de Investimento em Empresas Emergentes – FMIEE*) (CVM Normative Ruling No. 209) and National Film Industry Financing Funds (*Fundos de Financiamento da Indústria Cinematográfica Nacional – FUNCINE*) (CVM Normative Ruling No. 398), remain subordinated to specific normative ruling.

<sup>2</sup> With respect to their own financial resources.

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regularly. Funds destined to qualified investors: (i) can accept financial assets other than money as payment for subscriptions, as well as can provide for redemption in kind; (ii) in case of closed-end funds, need not prepare a prospectus nor publication notice of distribution commencement and closing; (iii) can charge performance fees without adherence to certain normative limitations such as those relating to benchmark, frequency of payment and assessment bases, as may be set forth in their by-laws; (iv) can establish different share conversion and redemption payment terms than those established in Normative Ruling No. 554/14; and (v) can render guarantee and grant acceptance or can be a joint obligor on behalf of the fund as respects direct or indirect operations concerning the fund's portfolio.

Professional investor funds: (i) are not required to observe the diversification rules regarding financial asset categories and issuer concentration limits established by Normative Ruling No. 555/14; (ii) may apply fund assets abroad without limit; (iii) are not subject to the certain periodic disclosures usually required of funds<sup>4</sup>; and (iv) may invest in any CVM-registered fund. Restricted security offers, as established under Normative Ruling No. 476 of January, 16th, 2009, may only be made to professional investors, with maximum 75 investor demand and 50 investor subscription.

Even though the professional investor qualification requires investments greater than the R\$ 300,000 amount stated in Normative Ruling No. 409/04 (to be revoked and no longer effective as of October 1st, 2015)<sup>5</sup>, the new rule does not impose a minimum investment of R\$ 1,000,000 on the professional investor so as to enable restricted security offers under Normative Ruling No. 476/09. This change facilitates professional investor raising of capital, especially by non-institutional investors.

Those who, in accordance with the new rule, are no longer qualified investors will not have their current investment portfolios affected, since the changes only take effect with respect to new fund investment. The asset positions in qualified investor funds on October 1st, 2015 may be maintained, and no longer qualified investors will be allowed to make new investments in those same funds<sup>6</sup>. Exclusive funds and those currently destined exclusively to qualified investors requiring minimum application of R\$ 1,000,000 may be transformed, via by-law amendment, into funds destined to professional investors, the permanence of and additional investment from shareholders entering up until October 1st, 2015 being possible.

Regarding the simplification of rules, procedures and categories, Normative Ruling No. 555/14 reduces from 7 to 4 the number of classes of investment funds, extinguishing the short term, indexed and foreign debt-type funds<sup>7</sup>. The new rule also creates the "Simple Fund,"<sup>8</sup> a specific fixed-income fund that shall maintain at least 95% of its net asset value in federal government bonds, repurchase agreements secured by such bonds or fixed-income bonds of financial institutions with equivalent risk, and that will not depend on investment suitability assessment.

Regarding concentration limits and the possibility of offshore investment, local funds may invest all of their NAV in foreign financial assets if the funds are intended exclusively for qualified or professional investors. In the case of the qualified investor fund, for unlimited foreign asset investment it is required that: (i) the investment policy determines that at least 67% of the NAV is composed of foreign financial assets; (ii) the invested vehicles are subject to extensive regulation and supervision by the relevant recognized foreign authority; and (iii) the by-laws provide detail on the assets to be acquired abroad<sup>9</sup>. The threshold applicable to

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<sup>4</sup> According to Articles 129 and 56 of Normative Ruling No. 555, the manager of the professional investor investment fund is not required to: (i) calculate and frequently disclose the share value and the net asset value of an open-end fund; (ii) send a monthly statement of the account to shareholders; (iii) make fund information available to all shareholders equally, including as regarding portfolio composition, periodicity, term and information content; (iv) make fund performance information available to shareholders until the last business day of February annually; and (v) disclose, prominently on the fund's webpage, fund performance information regarding the previous 12 months to the last business day of February and August annually.

<sup>5</sup> Article 110-B of the Normative Ruling.

<sup>6</sup> Article 151 of Normative Ruling No. 555/14.

<sup>7</sup> As these types can be considered subclasses of the fixed-income, exchange rate, shares and multi-market funds.

<sup>8</sup> Article 113 of Normative Ruling No. 555/14.

<sup>9</sup> In accordance with as set forth by Article 101, §1º and Annex 101 of Normative Ruling No. 555/14.

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foreign assets regarding funds destined to the public (“retail funds”) was also increased, from 10% to 20% generally and from 20% to 40% for funds destined to qualified investors who do not observe the above requirements.

Concerning the formal recognition of electronic and new media technologies, the new regulation once in effect will allow for: (i) an increase in digital form information disclosure<sup>10</sup>; (ii) general meetings to be conducted by electronic means, with a wide participation of shareholders; (iii) fund share electronic distribution; and (iv) fund administrator digital form deed maintenance and conservation.

The new rules were subject to wide discussion as made possible via Office of the Superintendent of Market Development (*Superintendência de Desenvolvimento de Mercado – SDM*) Public Hearings (SDM Public Hearings No. 03/14 and No. 04/14), with the participation of several key market agents. Funds operating on the date the new rules become effective shall have until June 30th, 2016 to adhere.

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<sup>10</sup> Regulation of “simple” fixed-income funds, for instance, shall require that “all documents and information related to the fund shall be disclosed to shareholders preferentially by electronic means.”