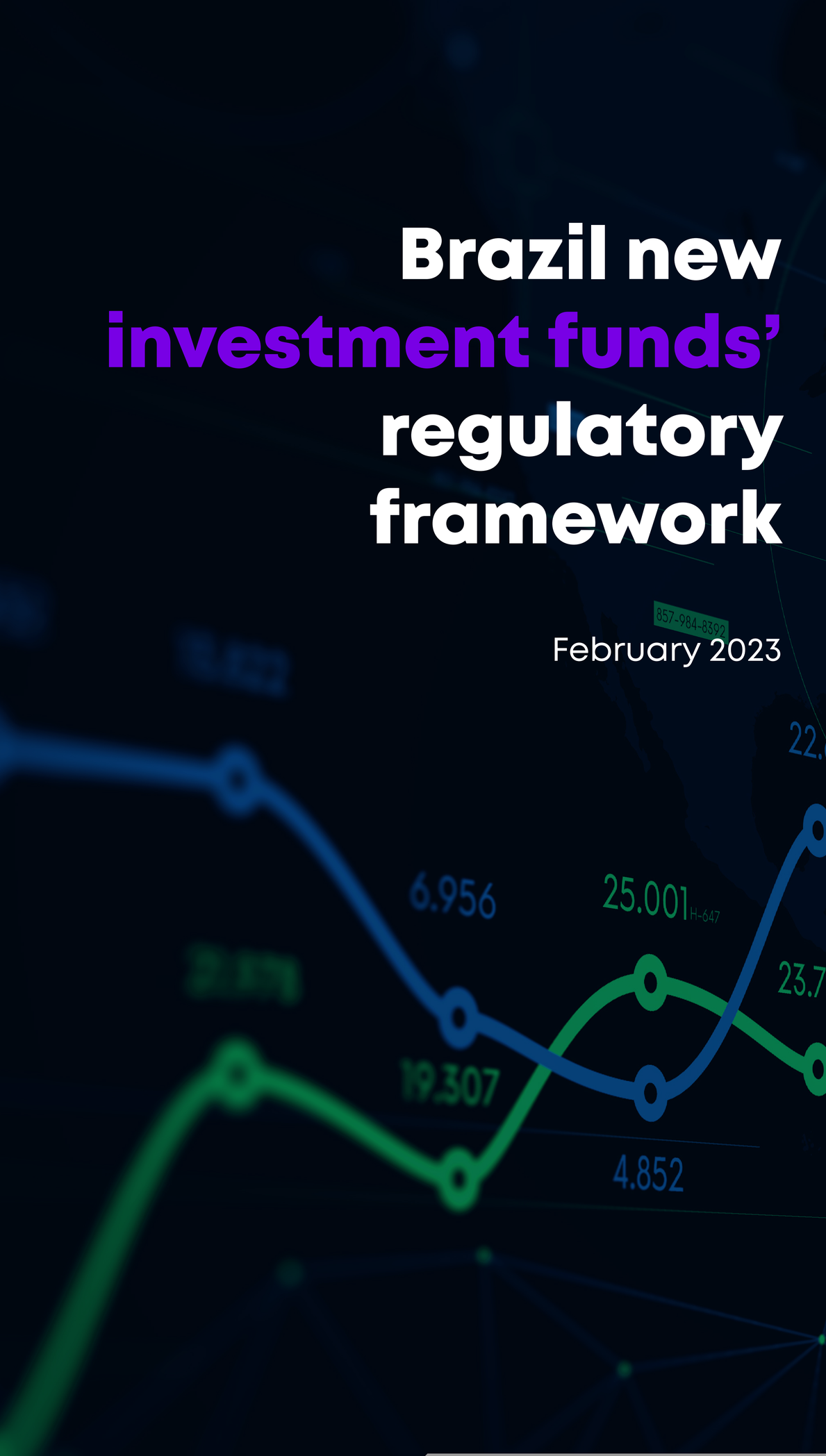
# Brazil new investment funds' regulatory framework

February 2023




Investment Funds

Lefosse

On December 23, 2022, the Brazilian Securities and Exchange Commission ("CVM") issued Resolution No. 175 ("Resolution"), which modernizes the regulatory framework related to investment funds, systematizing and regulating innovations brought about by Law No. 13,874, dated September 20, 2019, known as "Economic Freedom Law" ("EFL").

The Resolution's enactment consists in the final landmark of the largest public hearing ever conducted by the CVM and seeks to not only connect the local market to the most advanced practices developed internationally, but also to consolidate market practices and decisions of the board of CVM in this regard.

## ECONOMIC FREEDOM LAW'S REGULATION

The EFL introduced important modifications to the Brazilian Civil Code, especially through the addition of specific provisions related to investment funds. In order to reflect these amendments and prevent duplication of EFL's provisions into different regulations, the Resolution made the following adjustments:

**(i)** Creation of a general section, which contains provisions applicable to every category of investment funds;

**(ii)** Introduction of a specific section destined to regulate particularities of fixed income, currency exchange, multimarket and stock investment funds, regulated by CVM's Instruction No. 555, dated December 23, 2014, as amended ("Instruction 555"), which used to be referred to as "555 Funds", are now categorized as financial investment funds ("FIF"); and

**(iii)** Introduction of a specific section destined to regulate the particularities of credit rigths investment funds ("FIDC").

In the public hearing' final report, CVM clarified that, despite the fact that the Resolution has been enacted with sections referring only to FIF and FIDC, additional sections related specifically to the remaining investment funds categories, (such as real estate investment funds (FII), equity investment funds (FIP), and exchange traded funds (ETF) will be introduced until the Resolution comes into force.

Notwithstanding the implementation of innovations brought about by the EFL, the Resolution preserved more traditional structures historically used in the Brazilian market (such as single class funds, shareholders unlimited liability and funds of funds.

## TERM

The Resolution will come into force on April 3, 2023, but with some exceptions. The new provisions related to maximum distribution fee will come into force only on October 1, 2023, as will the provisions related to limits of exposure to capital risks in FIF. Multiclass structures in which funds will have classes and subclasses of shares, will come into force only on April 1, 2024 – by then it is expected that a change in tax legislation and regulation will account for the existence of multiclass structures, providing legal assurance with regards to the tax treatment related thereto. Furthermore, the adaptation of existing funds must occur until December 31, 2024, with the exception of FIDC and FIDC-NP, which must adapt prior to December 31st, 2023.

We outline below some of the main modifications made by the Resolution.


## 1. SHAREHOLDERS' LIABILITY

The Resolution determines that the fund's bylaws shall define wether the shareholders' liability is limited to the value of their shares. When the fund opt for the limitation of liability, its name shall expressly contain the suffix "Responsabilidade Limitada" ("Limited Liability"). If the liability is not limited, the investor must sign an acknowledgement letter

regarding the assumption of unlimited liability.

In the absence of a limitation to the shareholders' liability, they will be liable for potential negative net equity, without prejudice to the liability of services providers for losses incurred by willful misconduct or bad faith.

The Resolution also allows classes of shares with limited and unlimited liability to simultaneously exist in the same fund.

## 2. CIVIL LIABILITY OF SERVICES PROVIDERS

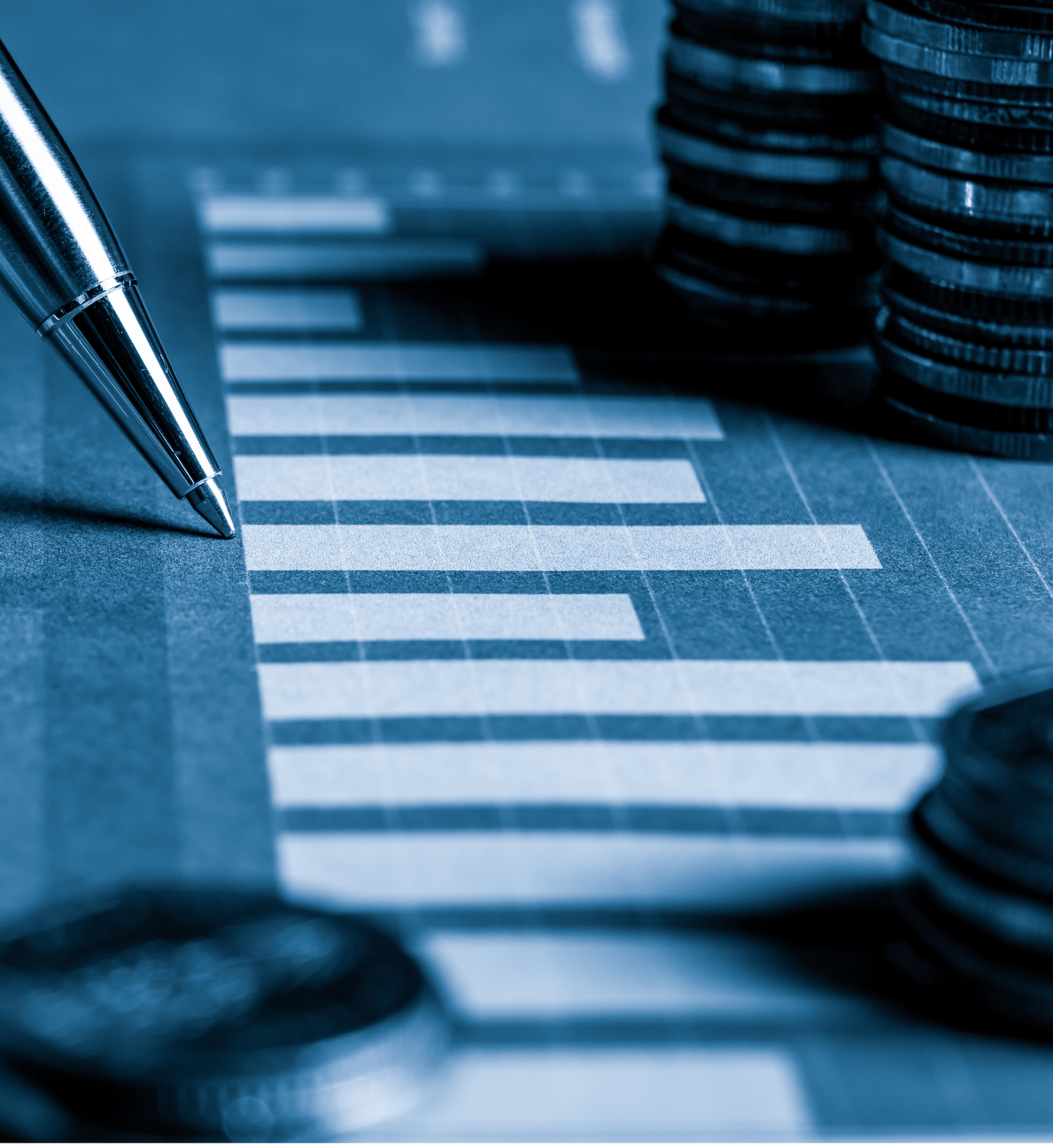
The new regulation provides that, in accordance with usual market practice (including in foreign jurisdictions), the main responsibilities should be split between the fiduciary administrator and the portfolio manager, both of which shall be concurrently named "Essential Services Providers", jointly liable for the fund's formation, definition of the terms of its bylaws and hiring all other service providers.

The Essential Services Providers and all other service providers of the fund are accountable before CVM, within their specific realms of responsibility, for their own acts or omissions contrary to the Law, the fund's bylaws and applicable regulatory provisions, without prejudice to their common duty to supervise other service providers, in events expressly set forth in the Resolution, in the fund's bylaws or in the respective services agreements, which may freely establish the responsibilities of each part. Overall, the Resolution makes it clear in assigning the attributions of each Essential Service Provider that the fiduciary administrator is responsible for managing the fund's shareholders, and the portfolio manager shall manage the fund's assets.

## 3. MULTIPLE CLASSES OF SHARES AND SEGREGATION OF ASSETS

The bylaws of the funds may establish different classes of shares, with distinct rights and obligations. All classes of shares must belong to the category of the fund, and the creation of a class which alters the applicable tax treatment regarding the fund or other existing classes is forbidden.

The fund can have a single class of shares, which can be divided into subclasses that can only differ in relation to target-public, investment terms and conditions, amortization and redemption, as well as fees for fiduciary administration, portfolio management, maximum distribution, entrance and exit. Only subclasses of restrict classes (exclusively destined to professional and qualified investors) may have differences with respect to other economic and governance rights.



Each class' assets are segregated from each other, and the assets are accountable only for the obligations of the respective class, which must have its own bookkeeping and financial statements, subject to independent auditing. Moreover, aiming to standardize and organize the multiclass structure, the Resolution also determines that:

**(i)** should there be different classes of shares, the fiduciary administrator shall segregate the assets of each class, provided that subclasses, which will not have separate assets, can still be created;

**(ii)** the fund's bylaws must define if the fund will issue single class shares or different classes of shares, although new classes may be established during the fund's life; and

**(iii)** in funds with different classes of shares, matters concerning all shareholders shall be resolved in general shareholders' meetings, and specific matters related to a determined class or subclass must be resolved in special shareholders' meetings.

## 4. INSOLVENCY REGIME

The Resolution also regulates the insolvency regime applicable to investment funds in which the shareholders' liability is limited to the amount subscribed by them – a necessity given the legal and regulatory provisions regarding the limitation of the investor's liability. In case of negative net equity, the fiduciary administrator must:

**(i)** regarding, exclusively, the class of shares that has negative net

equity, immediately: close for redemption, suspend subscription and amortization of shares, inform the portfolio manager about the negative net equity, disclose a material fact notice and cancel redemption that have not been already converted;

**(ii)** within 20 (twenty) days: prepare a negative net equity termination plan, jointly with the portfolio manager, and convene a shareholders meeting to resolve on the plan, within 2 (two) business days after the conclusion of its drafting, submitting it to the respective meeting.

In case the negative net equity termination plan is not approved, the shareholders may decide for (a) the injection of additional resources; (b) the spin-off, merger or incorporation of the class to another fund which has trended a bid analyzed by Essential Services Providers; (c) liquidation of the class; or (d) filing for insolvency proceedings of the class of shares. The filing for insolvency proceedings prevents the fiduciary administrator to resign from the fiduciary administration of the fund, but it does not prevent its removal by decision of the shareholders meeting. Additionally, the public hearing report clarifies that, although not expressly regulated in the Resolution, creditors of the class of shares may request its insolvency, considering that CVM's regulation is restricted to the capital markets and is not intended to restrict rights of creditors in general.

## 5. INSIDER TRADING

Provisions related to the prohibition of use undisclosed privileged information to have an advantage in the negotiation of shares in organized markets (i.e., insider trading) were incorporated to the Resolution. The executive officers of the portfolio manager who participate in the decision making with regards to matters related to the fund's portfolio management, the executive officers of the administrator who is responsible for the fund and all shareholders who participate in the decision making with regards to matters related to the general management of the fund, with access to undisclosed relevant information regarding the fund, may establish an investment and divestment individual plan seeking to avoid an assumption of unlawfulness in their trades.

## 6. ESG FUNDS

ESG funds The Resolution has also introduced innovations related to sustainability matters. Multiple minimum standards have been established so that investment funds may include in their name references to ESG (environmental, social and governance) factors, such as, for instance, “ESG”, “environmental”, “green”, “social”, “sustainable” or any other terms related to sustainable finance. In this regard, the fund’s bylaws must indicate: (a) what are the expected ESG benefits and how they will arise from the investment policy; (b) what methods, principles or guidelines are followed in order to classify the fund or the class in accordance with its name; (c) what is the entity responsible to certify or present a second opinion regarding the classification, if any, as well as information related to its independence with respect to the fund; and (d) specification regarding the form, the substance and the disclosure periodicity of the report on ESG results achieved by the investment policy in a given period, as well as the identity of the agent responsible for issuing the report.

It should be noted that the Resolution prohibits the use of such terminology if the investment policy comprises environmental, social and governance factors to the activities related to the fund’s portfolio management, but does not seek to create socioenvironmental benefits. Furthermore, the disclosure material which mentions ESG factors shall inform, objectively, if the fund or the class possesses an investment policy that aims to promote socioenvironmental benefits or connects socioenvironmental factors to the investment policy without pursuing to create socioenvironmental benefits.

## 7. OMISSION OF THE FUND’S PORTFOLIO – MODIFICATION OF CVM’S RESOLUTION NO. 172

The Resolution contains provisions which update references of CVM’s Resolution No. 172, published on November 1, 2022, and in effect as of December 1, 2022, which permitted, experimentally, that some funds regulated by Instruction 555 (classified as “equities – assets” and “social securities equities – assets equities”) omitted, for 180 (one hundred and eighty) days, the composition of their portfolios, without the need of prior CVM authorization.

## 8. GOVERNANCE

To promote greater agility and predictability in the governance of investment funds, the Resolution has brought new features in relation to the draft discussed in the public hearing, and now authorizes the regulation of certain matters in the bylaws (dispensing with a resolution by shareholders meetings), regardless of the fund's category, such as: (a) pledge of assets as collateral for transactions involving the class's assets in classes exclusively destined to qualified investors; (b) issuance of new closed-ended class shares at the manager's discretion (authorized capital); (c) price of issuance of the closed-ended class share; (d) preemptive rights in the issuance of closed-ended class shares; and (e) establishment of side-pocket in the management of exceptional illiquidity.

## 9. EXPENSES

The new regulation contains some modifications in the expenses that can be charged directly to the fund, as a general rule. Some charges previously provided for only in the regulation of specific investment funds will now apply to any fund, such as expenses inherent to the constitution, merger, incorporation, spin-off, transformation or liquidation of the class and, in the case of closed-ended classes, expenses related to the primary distribution of shares. Expenses not provided for as fund expenses shall be borne by the Essential Service Provider that has incurred it. Restricted class FIDC (exclusively destined to qualified or professional investors) may establish further charges that are not provided for in the general rule.

## 10. FINANCIAL INVESTMENT FUNDS

Further to the categorization, which now brings together equity, foreign currency exchange, multimarket and fixed income investment funds, below are some of the most relevant changes:

### Investment in financial assets abroad

In order to complement the flexibilization of the Brazilian Depositary Receipt (BDR) market, the Resolution now allows funds destined to the general public to invest up to the totality of their resources in financial assets abroad, provided that through investment vehicles abroad that, in addition to the requirements for investment in assets of such nature by FIFs (regardless of their target public), comply with multiple additional requirements, such as calculation methodology for pricing assets and recognized and monitored leverage by a local supervisor, risk management with periodic reporting, limitation of the percentage of its investments in certain assets, among several others.

FIDC are not allowed to make investments abroad – despite the market's suggestions that this type of investment be authorized and regulated within the scope of the Resolution during the public hearing, CVM was not swayed by the arguments.

## Exposure to risk of capital (leverage)

An innovation brought by the Resolution is the definition of limits for exposure to risk of capital in funds, in view of the types of classes of shares they have, with percentages of the net equity that can be used in the hedges and margins resulting from exposure to risk of capital, regardless of targetting the general public or qualified investors, preserving the possibility of the bylaws to establish lower limits. Classes targeted exclusively to professional investors do not have exposure limits, except as set forth by their own bylaws.

For “Fixed Income“ classes, there is a gross margin limit to 20% of the class’ net equity; for “Foreign Exchange” or “Equity“ classes, the gross margin limit is 40% of the class’ net equity; and for “Multimarket“ classes, there is a gross margin limit of 70% of the class’ net equity. Transactions in the portfolio of classes targeted to the general public that may give rise to this risk of capital exposure must be covered or guaranteed by margin in organized markets.

## Identification of assets

The Resolution determines that all assets of the portfolio shall be identified by an ISIN (International Securities Identification Number) code, in order to establish an international standardization in the identification of financial assets, assigning to each asset traded in the market a unique identification code. Alternatively to the ISIN code, at the discretion of the CVM’s Superintendência de Supervisão de Investidores Institucionais – SIN (Superintendency of Supervision of Institutional Investors), any other code that is capable of identifying the financial assets in an individualized manner may be accepted.

## Distribution of shares

Further to transferring the specific regulation related to the distribution of shares of closed classes destined to qualified investors to the regulation of public offerings (CVM Resolution No. 160, which comes into force on January 2, 2023), the Resolution exempts the participation of an intermediary in the acquisition of shares of open-ended classes by other funds, provided that one of the Essential Service Providers of the invested class must remain responsible for prevention of money laundering and financing of terrorism (PLDFT).

## Investment in new types of assets - cryptocurrencies and decarbonization credits

Cryptocurrencies, decarbonization credits - CBIO and carbon credits are expressly defined by the Resolution and included among the list of assets eligible for investment by FIF, provided that they are registered in a central depositary system authorized by the CVM or by the Brazilian Central Bank, or traded in a market operated by an entity authorized by CVM to operate organized markets; and, regarding cryptocurrencies, transactions abroad must be supervised by a local supervisor that has legal authorization to supervise and inspect the transaction, including to avoid abusive practices in the market and money laundering, terrorism financing and proliferation of weapons of mass destruction.

### Concentration limits per issuer

In an important innovation, the investment of resources in shares of investment funds is no longer subject to concentration limits per issuer, and the specific creation of funds or classes of investment in shares is no longer necessary to make such investments, although still allowed - in which case it must comply with the requirement of investing at least 95% of its net equity in shares of investment funds.

### Concentration limits per type of asset

The rules regarding the concentration limits per financial asset for FIFs have been made more flexible in general, and classes targeted exclusively to professional investors may waive concentration limits altogether (per type asset or per issuer). In the public hearing report, CVM published the following table for reference purposes, which facilitates consultation of the general rules for concentration limits by financial asset (disregarding the limits that are calculated jointly for different categories of funds):

| Target-Asset | Limits | | | |
|---|---|---|---|---|
| *Public* | *General Public* | | *Qualified Investors* | |
| *Market maker* | *without Market Maker* | *with Market Maker* | *without Market Maker* | *with Market Maker* |
| FIF | 100% | | | |
| ETF | 100% | | | |
| FII | 20% | 40% | 40% | 60% |
| Open-ended FIDC | 20% | N/A | 40% | N/A |
| Closed-ended FIDC | 20% | 40% | 40% | 60% |
| Open-ended FIAGRO | 15% | N/A | 30% | N/A |
| Closed-ended FIAGRO | 15% | 25% | 30% | 40% |
| Equity Investment Fund | 15% | 25% | 30% | 40% |

## 11. CREDIT RIGHTS INVESTMENT FUNDS (FIDC)

The specific normative section of the Resolution also brings relevant changes for the FIDC:

### Distribution of shares of FIDC to the general public

Facing a growing market demand, the Resolution authorized the distribution of FIDC shares to the general public, and no longer only to qualified and professional investors, so long as the following requirements are cumulatively met:

**(i)** only senior shares are made available to the general public;

**(ii)** the fund's bylaws establish a schedule for amortization of shares or distribution of earnings;

**(iii)** in the case of an open-ended class, the grace period, if any, alongside the total period between the redemption request and its payment, cannot be longer than 180 (one hundred and eighty) days;

**(iv)** investment policy that does not admit investments in: (a) credit rights arising from commercial agreements of purchase and sale of products, goods and services for future delivery or provision, except if the assignors are companies that hold concessions of public services or companies formed to implement investment projects in the area of infrastructure or intensive economic production in research, development and innovation, considered as a priority in the form regulated by the Federal Government; and (b) credit rights arising or assigned by the administrator, manager, specialized consultancy, custodian, entity registering the credit rights and parties related to them; and

**(v)** subclass of senior shares be subject to risk classification by a risk classification agency registered at the CVM.

In view of this relevant alteration, the investment of resources in federal court-order debts ("precatórios federais") now counts with additional safety mechanisms, related to the uncertainty of constitution, enforceability and ownership of federal court-order debts, in order to adapt these assets to the general public. As an example, the promotional material of the FIDC targeted to the general public should highlight the specific risks of the investment in such assets, if permitted in its investment policy, and the shareholders must attest that they have had access to specific information about these risks, in signing the joinder and risk awareness term. The federal court-order debts that comply with the requirements above will not be considered as "non-standardized" credit rights. The class targeted to the general public will not be allowed to acquire shares of FIDC with an investment policy that permits investments in classes of shares that may hold non-standardized credit rights. These will only be permitted to professional investors, with the exception of subscription of subordinated "junior" shares by the assignor of the credit rights and their related parties.

### Non-standardized credit rights

Non-standardized FIDC cease to exist and the regulator now adopts the concept of "non-standardized credit rights" (**"NS-Credits"**). Credit rights that meet at least one of the following characteristics will be considered NS-Credits:

**(i)** are due and pending of payment at the time of assignment;

**(ii)** arise from public revenues originated or derived from the Union, the States, the Federal District and the Municipalities, as well as their autarchies and foundations;

**(iii)** result from lawsuits or arbitration procedures in progress, constitute the object of litigation, have been judicially pledged or given as collateral;

**(iv)** the constitution or legal validity of the assignment for the class of shares is considered a preponderant risk factor;

**(v)** the debtor or co-obligor is a company under judicial or extrajudicial reorganization;

**(vi)** are assigned by a company under judicial or extrajudicial reorganization, with the exception of credit rights assigned by a company under judicial or extrajudicial reorganization that cumulatively meet the following requirements: (a) do not originate from commercial agreements of purchase and sale of products, goods and services for future delivery or provision; and (b) the company is subject to a judicially homologated recovery plan, regardless of the final and unappealable decision on the homologation of the judicial or extrajudicial recovery plan;

**(vii)** are of future existence and unknown amount, provided they arise from an already existing relationship;

**(viii)** are derivatives, when not used for protection or risk mitigation of credit rights; or

**(ix)** shares of FIDC that invest in the aforementioned credit rights.

Federal court-ordered debts, provided they are not being contested, judicially or otherwise, and have already been issued and sent to the competent Federal Regional Court, are not classified as NS-Credits.

The FIDC classes of shares that admit the acquisition of NS-Credits must be targeted exclusively to professional investors, with the exception of subscription of subordinated “junior” shares by the assignor of credit rights and their related parties.

### Possibility of acquisition of credit rights originated or assigned by the fiduciary administrator, portfolio manager, special consultants or their related parties

Another relevant alteration is the possibility of acquisition of credit rights originated or assigned by the fiduciary administrator, portfolio manager, special consultant or respective related parties, so long as: (a) the administrator, the manager, the registering entity and the custodian of the credit rights are not parties related to each other; and (b) the registering entity and the custodian are not parties related to the originator or assignor; in the case of classes exclusively destined to professional investors, only the requirement provided for in item "(b)" applies.

### Distribution of FIDC shares to assignors of the credit rights

In relation to the draft of the Resolution discussed in the public hearing, the CVM also accepted the suggestion to exclude the provision that prohibited the distribution of FIDC shares to the assignors of credit rights, except with respect to a subclass of shares subordinated to all the others for the purpose of amortization. Thus, the subscription of shares by the assignors of credit rights is authorized for any subclasses of FIDC shares.

### Verification of credit rights basis

Although it is the responsibility of the portfolio manager to verify the basis of the credit rights, the manager may hire a third party to perform the verification, which may be the registering entity, the custodian or the special consultant of the FIDC, provided the third party is not a related party to the manager; in any case, the manager will remain responsible for overseeing the third party's compliance with the rules and procedures applicable to the verification. The verification of the basis of replaced and defaulted credits remains primarily an attribution of the custodian institution, although the bylaws may establish that the quarterly verification of the backing is a responsibility of the administrator.

WEBINAR | New investment funds' regulatory framework


Click here and access the full webinar recording, with André Mileski and Julio Queiroz, our partners, Alexandre Costa Rangel, CVM's Director, and Carolina Cury, Head of Legal Asset at BTG Pactual.

# Our Practice

## Investment Funds

Lefosse's Investment Funds practice will continue to follow the news and changes that impact the sector. For further clarification on this subject, or others that may be of interest to you, please contact our professionals.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