



**A Guide to Selected Emerging Markets
for Microfinance Issuers and International
Investors:**

Brazil



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BRAZIL



CAPITAL MARKETS ACCESSIBILITY CHART	DIFFICULTY LEVEL
Investment Considerations for Foreign Investors	
Investment Regulatory Requirements:	
Foreign Direct Investment (FDI)	High for MFIs; low for commercial financial institutions
Portfolio Investments (PI)	High for MFIs; low for commercial financial institutions
Foreign Credit	Medium
FX Convertibility	Medium
Repatriation	Low
Taxes on Gains	Medium to Low
Taxes on Income (dividends)	Medium to Low
Issuance Considerations for MFIs	
Publicly Registered Securities	High
Private Placements	High

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SUMMARY OF THE MICROFINANCE MARKETS AND CAPITAL MARKETS

Microfinance Market Overview:

- The potential for growth in Brazil's microfinance market remains substantial—Brazil has one of lowest penetration rates in the world at only 2 percent.
- Brazilian MFIs exist in two categories: OSCIPs, civil society, non-profit organizations, and SCMs, for-profit financial organizations.
- Crediamigo, the largest MFI in Brazil, was created by the state-owned development bank Banco do Nordeste do Brasil.
- MFIs are restricted from accessing the public capital markets and are not able to take deposits from customers; these are two restraining factors that have impeded their ability to grow and develop substantially when compared to MFIs in other regions of Latin America.

Capital Markets Overview:

- Brazil's financial market is the largest in Latin America and the most developed emerging markets class.
- Brazil's bond market has more than US\$ 850 billion of debt outstanding.
- Brazil's equity market is the third largest in the world, with total market capitalization of US\$ 1.3 trillion.
- BM&FBOVESPA, Brazil's principle stock exchange, is the second largest exchange in the Americas.
- Bonds may be issued in public markets without ratings, though ratings are recommended. Major ratings agencies with a presence in Brazil include Standard & Poor's, Fitch, Moody's, SR Rating and Austin Rating.
- The Brazilian Real is an independent, free-floating currency but it is not yet fully convertible. All foreign exchange transactions carried out in the Brazilian foreign exchange market must be registered with the Brazilian Central Bank.

Key Foreign Investor Considerations:

- Brazil is generally open to foreign investment, but has a limited number of sectors expressly protected.
- There is no income tax treaty currently in effect between Brazil and the United States. Capital gains and interest income are taxed at a rate of 15 percent.
- In late 2009, in an effort to curb the sustained appreciation of the Brazilian real against the dollar, a 2 percent tax on inflow to portfolio investment was enacted.
- All foreign investment, regardless of type, must be registered electronically with the Central Bank of Brazil Information System (SISBACEN) through either the Foreign Direct Investment Module (RDE-IED), in the case of foreign direct investment, or through the Financial Registration Module (RDE-ROF), in the case of portfolio investment and all other capital.

Key Local Microfinance Issuer Considerations:

- Securities offerings require compliance with CVM regulations as well as approval by the applicable exchange.
- BM&FBOVESPA offers special listing segments for companies that wish to offer a higher level of corporate governance to investors.
- Brazilian issuers may also issue securities in foreign markets through depository receipt programs.
- OSCIPs and SCMs are restricted from accessing public capital markets.

MICROFINANCE MARKET OVERVIEW

History and growth

Microfinance emerged in Brazil during the early 1970s primarily as non-profit or “charitable” microfinance institutions (MFIs) focused on helping impoverished regions and rural areas¹. The country’s first MFI was created under a program started in 1972 in the city of Recife named *Uniao Nordestina de Assistencia a Pequenas Organizacoes* (Northeastern Union of Assistance to Small Enterprises; UNO) that was focused on microcredit for the informal sector². Although these initial programs in Brazil were considered by the rest of Latin America to be examples of MFI expansion, they faced several hurdles that prevented substantial growth and development. One obstacle was the fact that these institutions’ business model was not sufficiently focused on promoting repayment from borrowers. Furthermore, due to the restrictive government regulations on financing not-for-profit organizations, these MFIs were funded mainly by donations from philanthropic organizations, making it difficult for them to sustain themselves over the long term. Brazil’s Usury Law also prohibited non-financial institutions from charging a monthly interest rate of more than 1 percent, making profitable microfinance products difficult to deliver³. Additionally, hyperinflation in Brazil’s macroeconomic environment throughout the 1970s, 1980s, and 1990s compounded the restrictive effects already weighing on growth in the sector.

In the late 1990s, the Brazilian government developed two new microfinance legal structures to facilitate growth of the microfinance sector: *Organizacoes da Sociedade Civil* (Public Interest Civil Societies; OSCIPs) and *Sociedades de Credito ao Microempreendedor* (Microfinance Credit Societies; SCMs). OSCIPs are non-profit, civil organizations that offer microfinance loans as part of larger social services and initiatives. SCMs are for-profit financial institutions that principally offer credit products. Both entities were created to be exempt from the Usury Law, and therefore are able to charge rates above the 1 percent ceiling⁴. Neither entity has the ability to take deposits from customers.

Another important development that helped the microfinance industry grow was the involvement of the *Banco Nacional de Desenvolvimento Economico e Social* (National Bank for Economic and Social Development; BNDES) through the creation of the *Programa de Credito Produtivo Popular* (Program of Popular Productive Credit; PCPP) which facilitated lending to MFIs through a revolving line of credit with BNDES. By late 2000, PCPP had given out US\$ 48 million in loans to 33 MFIs⁵.

In 2003 President Luiz Inácio Lula da Silva introduced a new requirement for all banks to direct a minimum of 2 percent of demand deposits towards microcredit operations. President Lula also set forth new measures that made it possible for low-income people and small businesses to open bank accounts and access their funds more easily. These measures included increasing the availability of local financial agents in lower income communities as well as creating products and services specialized for members of these communities⁶. Finally, Lula created *Programa Nacional de Microcredito Produtivo Orientado* (National Microcredit Program Oriented to Production; PNMPO), a program targeted at helping

microentrepreneurs access production oriented credit⁷.

Microfinance is still an emerging industry in Brazil and demand far outweighs supply. The penetration rate of MFIs in Brazil is estimated to be only 2 percent (2008)⁸, with variance by region within the country. The North is the poorest region and contains one third of Brazil's population. The South, home of Sao Paulo and Rio de Janeiro, is where most of Brazil's wealth is concentrated and is also the center of growth and development for the country⁹.

The strongest growth within the microfinance sector occurred in the early 2000s, with estimates suggesting that the number of clients served increased from 3,000 in 1995 to 160,000 in 2001¹⁰. More recently, the sector has grown approximately 200 percent between 2005 and 2008¹¹.

There are also a number of other financial intermediaries that serve the poor but are not defined as MFIs. This includes credit cooperatives, *financeiras* (regulated financial institutions that do not require collateral when making loans but charge higher interest rates) commercial banks, credit card companies, store credit, supplier credit and informal moneylenders (*agiotas*).

Governing Regulations

Due to the varied types of microfinance institutions operating in Brazil, regulatory frameworks differ across the sector. Early not-for-profit MFIs were not regulated by a governing body. However, when the government created OSCIPs and SCMs, these entities were each given a separate set of rules and restrictions on how they operate. OSCIPs have less stringent laws, have more flexibility in the types of products offered and are only required to report select periodic information to the Ministry of Justice. SCMs are regulated by the Central Bank, face more confining laws and are required to report more often. They are also subject to maintaining minimum capital (R\$ 100,000), liquidity and leverage standards (five times liquid assets). Nonetheless, neither OSCIPs nor SCMs are allowed to take on public deposits¹².

Credit cooperatives are run by central networks that provide standard regulations for all of their member institutions to follow. They are supervised by the Central Bank of Brazil (*Banco Central do Brasil*: BCB) and still constitute a small percentage of the financial services providers in the country. One important distinction between cooperatives and MFIs is that cooperatives are allowed to take deposits from their members¹³.

Largest Players

The largest MFI operating in Brazil today is *Crediamigo*, created by the state-owned development and commercial bank, *Banco do Nordeste do Brasil*. This MFI serves 463,000 clients and has an active portfolio of US\$ 215 million¹⁴. *Crediamigo* is supervised by the central bank and does not have the same regulatory requirements as SCMs because it is fully funded by *Banco do Nordeste do Brasil*¹⁵.

Aside from *Crediamigo*, another MFI that follows the commercial bank model is *Banco Popular do Brasil*, which was established in 2004 as an independent subsidiary of *Banco do Brasil* that offers microcredit loans.

THE 10 LARGEST MFIS IN BRAZIL BY GROSS LOAN PORTFOLIO OUTSTANDING AS REPORTED TO MIX MARKET (AS OF DECEMBER 2008)¹⁶		
RFI	GROSS LOAN PORTFOLIO	CLIENTS
Crediamigo	214,892,000	463,020
Central Cresol Baser	152,437,018	40,596
Cresol Central	102,101,864	59,188
Real Microcrédito	38,281,483	82,779
CEAPE MA	12,085,747	18,857
Banco Popular do Brasil	9,270,259	138,241
ICC BluSol	5,157,582	3,416
Banco da Família	4,844,891	6,480
Banco do Empreendedor	4,311,919	2,387
ANDE	4,004,954	22,565

Microfinance Transactions

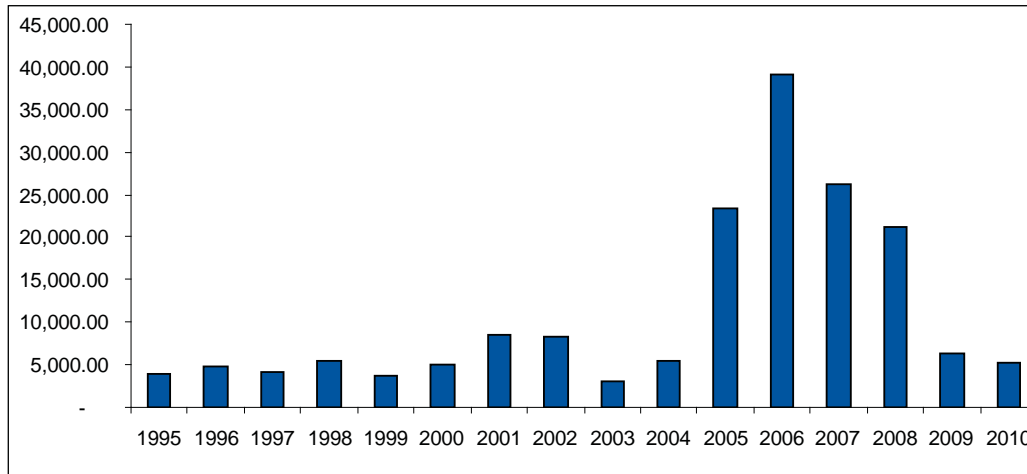
Because SCMs and OSCIPS do not have access to the public capital markets due to restrictions on sources of funding, there have not been any recent notable transactions in this sector. MFIs indirectly use the public capital markets as sources of funding through the issuance of public debt offerings by BNDES and the subsequent channeling of those funds to the individual MFIs¹⁷.

CAPITAL MARKETS OVERVIEW

General Size and Activity

Brazil has the largest financial market in Latin America and the most developed in the emerging markets class. The Brazilian capital markets have experienced tremendous growth in the past decade due to the macroeconomic and political stability the Brazilian economy has enjoyed during this period. The government bond market is large with US\$ 710 billion outstanding while the corporate sector has US\$ 154 billion outstanding, representing 82 percent and 18 percent of total debt outstanding, respectively¹⁸. Below is a graph that tracks historical debt issuance in Brazil and demonstrates its peak in 2006 due to the broader market growth that the country was experiencing at this time.

Historical Debt Issuance 1995 to 2010 in USD millions



Brazil's equity market is the third largest in the world, with a total market capitalization of US\$ 1.3 trillion, showing Year-on-Year (Y-o-Y) growth of approximately 109 percent¹⁹. This significant growth can be attributed to government stimulus plans as well as a decline in the price of local assets that followed the global recession. Asset prices drew domestic and foreign investor demand which was also fueled by the relative attractiveness of Brazilian commodities versus other countries in the region²⁰.

Key Players

The largest issuer of fixed income securities in Brazil is the national government, with banks and financial institutions being the second largest²¹. A large percentage of financial institution issuance comes from development banks that have strong ties with the government such as BNDES, who issued the largest non-government debt transaction in 2009 of US\$ 670 million. Brazilian corporations also have the ability to finance themselves through the capital markets, although they make up a much smaller percentage of total debt issuances. Notable 2009 issuances for corporations include *Vivo*, a mobile telecommunications company that issued US\$ 430 million, and *EcoRodovias*, a Brazilian infrastructure logistics firm that issued US\$ 320 million²².

Regulatory Framework and Bodies²³

Brazil's financial system is regulated by the *Conseho Monetario Nacional* (National Monetary Council; CMN), which serves to coordinate financial monetary, credit, budget, fiscal and debt policies and to oversee the liquidity and solvency of financial institutions.

The Central Bank (BCB) is the executive arm of CMN. It is responsible for the sound operation of the Brazilian financial system. BCB also ensures compliance with the inflation targets set by the CMN, sets accounting standards, and broadly provides supervision and regulation of the national financial system and markets.

Finally, the *Comissao de Valores Mobiliarios* (Securities and Exchange Commission; CVM) is responsible for ensuring the proper functioning of the exchanges and over-the-counter markets²⁴.

Local Currency and Convertibility

The Brazilian Real (BRL) is the official currency of Brazil. Although it is an independent, free-floating currency, it is not yet fully convertible.

Only local authorized agents are entitled to carry out foreign exchange transactions. All local commercial banks in Brazil are authorized entities²⁵. There are also a number of institutions that can only perform specific foreign exchange transactions that must be pre-approved by the BCB²⁶. All foreign exchange transactions carried out in the Brazilian foreign exchange market must be registered under the BCB. Accounts denominated in BRL are open for both residents and non-residents of Brazil. However, foreign currency-denominated accounts are permitted only in specific cases.

In October of 2009, the CMN began to implement a 2 percent Financial Operations Tax, (*Imposto sobre Operações Financeiras*; IOF) on foreign capital inflows. The tax is levied on both equity and fixed income inflows (excluding foreign direct investment) and is collected as the foreign capital enters the country. This tax was originally in place from March 2008 through October 2008 but was eliminated when the credit crisis emerged globally. The purpose of the tax is to control the excessive appreciation of the BRL²⁷.

The exchange rate at the end of the 4th quarter of 2009 was 1.74 BRL per U.S. dollar. Between 2005 and 2008 the BRL appreciated significantly as a result of market growth. During the recent credit crisis, the BRL depreciated against the U.S. dollar substantially and traded as high as 2.62 on December 2008. Nonetheless, economic fundamentals remained solid in Brazil with BCB U.S. dollar reserves sufficiently high, inflation under control and an easing monetary policy that lowered the Brazilian basic rate. Foreign investors began to return to the Brazilian market in early 2009 due to a reduction in prices of local assets and the high interest rate environment that remained despite the easing cycle. Both the

stock market and sovereign debt fund flow into the country were favorable to the BRL, causing the US\$/BRL conversion rate to reach a low of 1.70.



Prevalent Accounting Standards

The prevalent accounting standard in Brazil is the Brazilian GAAP (Generally Accepted Accounting Principles), which although similar to U.S. GAAP, is not identical. Brazil is currently in the process of changing over to International Financial Reporting Standards and is expected to be fully migrated in 2010²⁸.

The Corporations Law of 1976, as amended, describes the specific accounting and financial reporting requirements with which public issuers must comply²⁹.

Foreign Participation

Both institutional and individual investors can invest in Brazil. Non-resident investors are allowed to invest in the same financial products available to Brazilian investors. Section 2 of this report contains additional information on provisions for foreign investors in Brazilian capital markets.

Foreign portfolio investments (including both stocks and fixed income securities) had net inflows of US\$ 46.2 billion for 2009. This is a significant increase from net outflows of US\$ 767 million in the previous year. The Central Bank estimates show that foreign investors hold approximately 8 percent of total outstanding Brazilian locally issued debt as of November 2009³⁰.

Securities Exchanges

Overview of Debt / Equity Exchanges

The *Bolsa de Valores, Mercadorias & Futuros de Sao Paulo* (BM&FBOVESPA) is the principal public stock exchange in Brazil. The BM&FBOVESPA was created on May 8, 2008 by the merger of the Brazilian Mercantile and Futures exchange (BM&F) and the Sao Paulo stock exchange (Bovespa). BM&FBOVESPA operates under the regulation of the CVM. In 2008, Bovespa accounted for 75 percent of the volume of shares traded in Latin America.

Among its broad range of trading products, BM&FBOVESPA offers equities, securities, indices, interest rates, foreign exchange futures and spot contracts. Together, the companies have formed the third largest exchange in the world in terms of market value, the second largest in the Americas (after the U.S.), and the leading exchange in Latin America.

There are currently 385 companies listed on BM&FBOVESPA that have a combined market capitalization of US\$ 1.27 trillion. In 2008 this amount was US\$ 748 billion, representing 393 companies. The largest sector of the exchange is financial institutions, which constitute 41 percent of all listings.

In 2009, the trading volume for the equity market reached a total of US\$ 703 billion, in comparison to US\$ 748 billion in 2008. During the year, daily averages reached US\$ 2.88 billion, in contrast to US\$ 3 billion during the previous year. The trading volume for the fixed income secondary market in 2009 totaled US\$ 211 million, compared to US\$ 710 million in 2008³¹.

An even larger venue for trading bonds in the secondary market in Brazil is on the over-the-counter (OTC) market, which in contrast to the centralized, free-trading environment of the stock exchange, involves participants trading directly with one another, either by telephone or electronic systems. All derivatives and securities carried out in OTC markets must be registered through *Balcão Organizado de Ativos e Derivativos* (Clearinghouse for the Custody and Settlement of Securities and Derivatives; CETIP). Created by financial institutions and the BCB, CETIP began operating in 1986 to provide more safety and efficiency to operations in the Brazilian financial market. CETIP is currently the largest custodian of corporate securities in Latin America. It ensures the support required for the entire cycle of operations for securities and derivatives. CETIP operates in the entire Brazilian territory and comprises an interconnected online financial network, which operates in real time. All Brazilian banks participate in CETIP, along with real estate companies, broker dealers, investment funds, insurance companies, pension funds and non-financial companies who issue securities. The markets served by CETIP are regulated by BCB and the CVM³².

Rating requirements

The application of a credit rating for bonds issued in public markets is not mandatory. The rating agencies operating in Brazil are Standard & Poor's, Fitch, Moody's, SR Rating, and Austin Rating, the last two being Brazilian agencies. Most issuances are rated by Standard & Poor's and Fitch³³.

Notable recent transactions

During 2009, IPOs raised US\$ 26.2 billion through five primary subscriptions and 19 follow-on equity offerings. Foreign investor participation in IPOs for 2009 represented 57.5 percent of total volume made up primarily of U.S. (68 percent) and European investors (28 percent). The largest of these IPOs was by *Banco Santander Brasil*, which also qualified as the largest IPO for a Brazilian company.

LARGEST IPO TRANSACTIONS 2009 ³⁴		
ISSUER	SECTOR	AMOUNT (US\$)
Banco Santander Brasil	Financial Institution - Bank	7.7 billion
Marfrig Alimentos SA	Consumer - Food	810 million
Cyrela Brazil Realty	Real Estate	610 million
CCR	Infrastructure	540 million
PDG Realty	Real Estate	540 million

Banking Sector

Relevant Regulations and Regulator

Brazil's banking system is highly regulated. Brazil's Central Bank is the regulatory authority that enforces compliance with all normative rules and laws issued by the CMN. The legal base for the regulation of Brazil's financial and banking sector is Article 192 of the Federal Constitution. Specifically, Law 4.595 and additional normative rules set forth by the monetary authorities outline the following requirements³⁶:

- exposure to individual clients cannot exceed 25 percent of the bank's capital base;
- cannot grant loans to any related party, which includes: company holding over 10 percent of their capital stock, company in which they hold more than 10 percent of capital stock, executive officers or family members;
- only use real estate property for purposes related to their business; and
- allocate 25 percent of average balance sheet of demand deposits to rural credit, 65 percent of the average balance of savings accounts to real estate financing and 2 percent of reserve requirements of demand deposits to the microfinance segment

Minimum capital standards were revised and strengthened in 1994 with the CMN Resolution 2.099, bringing them closer in line with Basel Accords risk weighted capital standards. Brazilian banks must maintain a minimum of 11 percent risk weighted assets, as defined by the Basel I Accord³⁷.

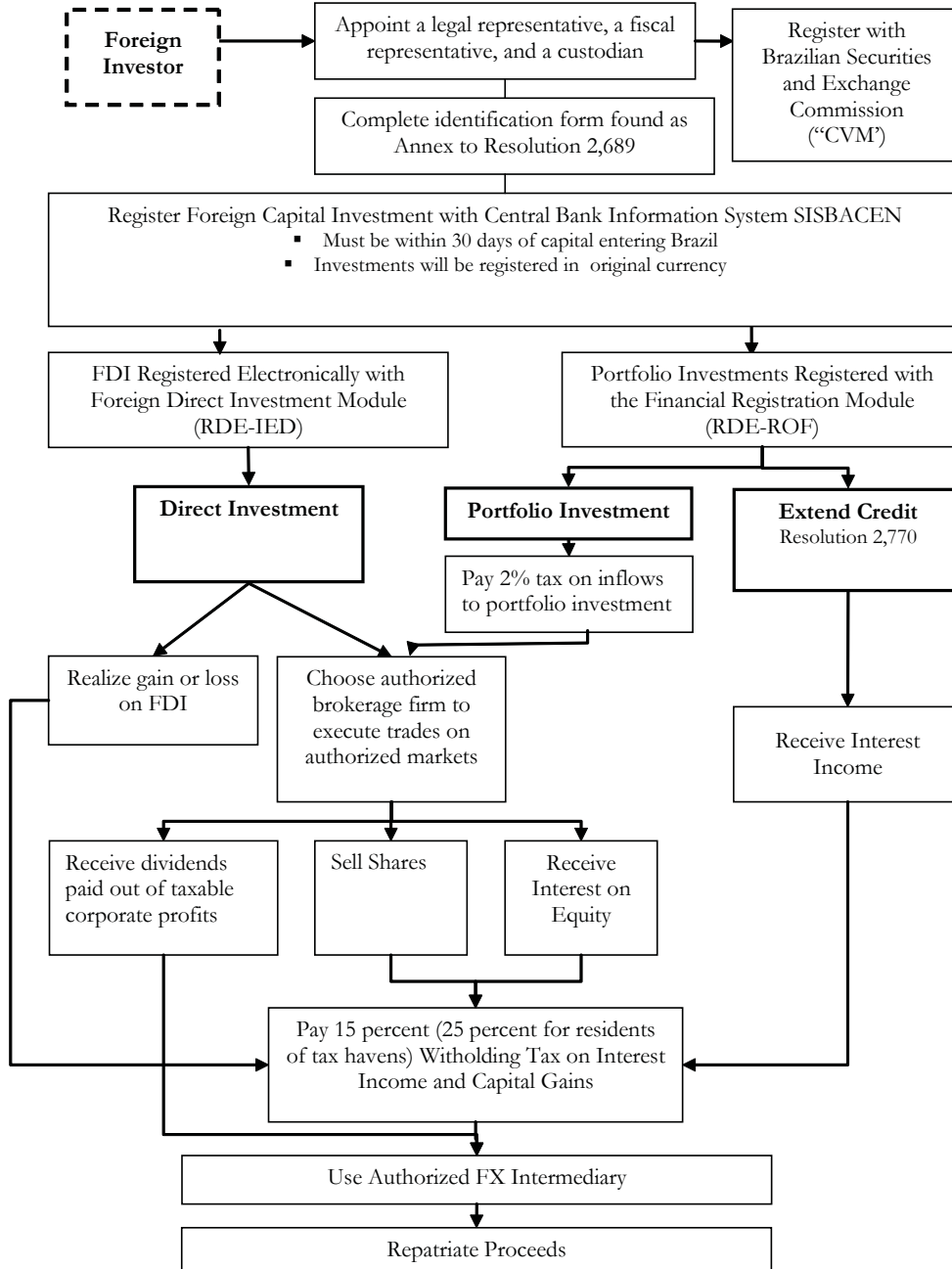
Key Players

The banking system in Brazil is fairly consolidated, having gone through a lengthy process of integration and mergers after 1994's *Plano Real*, a monetary reform package that aimed to put an end to three decades of rampant inflation. Today, the five largest banks control 67 percent of total assets and 77 percent of total deposits. These banks include *Itau Unibanco*, *Banco do Brasil*, *Bradesco*, *Banco Santander Brasil* and *Caixa Economica Federal*. The largest bank by assets is the government-controlled *Banco do Brasil*, with more than US\$ 374 billion in total assets, US\$ 182 billion in total deposits and market capitalization of US\$ 47 billion. The largest fully private bank is *Itau Unibanco*, with more than US\$ 330 billion in total assets, US\$ 105 billion in total deposits and market capitalization of US\$ 82 billion³⁸.

Although one of the largest banks in the country is a foreign bank (*Banco Santander Brasil*), overall participation of foreign institutions is not significant as compared to other Latin American countries. For instance, in Brazil, foreign banks account for 19.8 percent of total assets, far below the 80 percent of total assets that is held by non-domestic financial institutions in Mexico. This has allowed for most credit decisions to remain within the country and has helped strengthen the local capital markets³⁹.

FOREIGN INVESTOR CONSIDERATIONS

Summary Chart: Key Steps for Investment and Repatriation in Brazilian Capital Markets by U.S. Investors



Overview

Brazil is characterized as being generally open to and encouraging of foreign investment and receives the most foreign direct investment of all Latin American countries. The United States has traditionally been the largest foreign investor in Brazil⁴⁰. At the end of 2009, Brazil enacted capital controls on foreign portfolio investment in an effort to slow the appreciation of the domestic currency against the dollar⁴¹.

The Central Bank has several restrictions which govern foreign investment in Brazil. Resolution No. 2,689 regulates the way non-residents can invest in Brazil. Additionally, foreign capital restrictions are set forth in Law 4131 and Law 4390. Both laws are regulated by Decree 55.762⁴².

Brazil is a member of *Mercosur*, the regional free trade agreement among Argentina, Brazil, Paraguay, and Uruguay founded in 1991. Brazil is a member country of the Multilateral Investment Guarantee Agency of the World Bank Group. Brazil does not currently have any trade or investment treaties with the United States.

Key Regulations Governing Foreign Direct Investment

Foreign capital is defined by Law 4131 as, “any good, machinery and equipment that enters Brazil with no initial disbursement of foreign exchange, and is intended for the production of goods and services, as well as any funds brought into Brazil to be used in economic activities, belonging to individuals or companies resident or headquartered abroad”⁴³.

Resolution No. 3,455 establishes that all foreign capital entering Brazil must be declared and registered electronically with the Central Bank of Brazil Information System (*Sistema de Informações do Banco Central*; SISBACEN) through either the Foreign Direct Investment Module (RDE-IED), in the case of foreign direct investment, or through the Financial Registration Module (RDE-ROF), in the case of all other capital. Registration must occur within 30 days from the date capital will be deposited or reinvested in Brazil and will be cancelled after 60 days if no inflow of resources or reinvestment occurs. Instructions for access to SISBACEN and to register foreign capital are available at the Central Bank’s website, www.bcb.gov.br. In the case of investments in financial institutions, registration must be preceded by an authorization from the financial institution⁴⁴.

Foreign direct investments should be registered by the company receiving the foreign direct investment and by the non-resident investor’s representative, in accordance with the instructions available on the Central Bank’s website⁴⁵.

The amount registered with the Central Bank as foreign investment includes:

- the original investment (whether in cash or in kind);
- subsequent additional investments (including capitalization of credits); and
- profit reinvestments.

Registration occurs in the currency of the country of origin, or in the case of the reinvestment of profits, the registration will be made in both the national Brazilian currency,

as well as in the currency of the country to which the capital would have been remitted, converted at the average exchange rate during the time in which the reinvestment was effected⁴⁶. The sum of registered investments is used as the basis for calculating capital gains taxes when repatriating capital⁴⁷.

Restrictions on Foreign Investments

With a few exceptions specifically stated by law, there are no restrictions on nonresident investment in Brazilian companies. Notably prohibited by law are foreign investments made in the health services, nuclear energy, print media, and radio and television industries⁴⁸. Also, foreign banks headquartered in localities in which legislation imposes restrictions on the operations of Brazilian banks are prohibited by Law 4131 from acquiring more than 30 percent of voting shares of Brazilian banks⁴⁹.

Key Regulations Governing Foreign Portfolio Investments (Market Investments—Debt & Equity)

Both institutional and individual investors can invest in Brazil. Non-resident investors are allowed to invest in the same financial products available to Brazilian investors.

Resolution 2,689 and Circulars 2.963 and 2.975 make provisions on investment through the free rate exchange market into Brazilian financial and capital markets by non-resident investors⁵⁰. In the cases of direct and portfolio investment, non-residents wishing to invest in Brazilian capital markets must first:

- appoint one or more representatives in Brazil;
- complete the identification form found as an annex to Resolution 2,689, which includes identification of the investor, the representative, and declaration of the investor's tax status; and
- register with the Brazilian Securities and Exchange Commission.

Of note, if the representative is a person or non-financial corporation, the investor must appoint an institution authorized to operate by the Central Bank of Brazil as co-responsible for compliance with regulatory provisions. The representative's role includes maintaining the necessary registration form as well as the representation agreement and submitting this to the Central Bank of Brazil and Brazilian Securities and Exchange Commission whenever required⁵¹.

Taxation of Portfolio Investment

As of October 20, 2009, Brazil has instituted a tax of 2 percent on all capital that enters the country as portfolio investment. This capital control is an attempt to slow the appreciation of the Brazilian real, which had gained 36 per cent against the U.S. dollar in 2009 at the time this tax was enacted, and had been appreciating steadily before that. This tax does not affect foreign direct investment and applies only to foreign capital entering Brazil as portfolio investment⁵². Further, Brazil also taxes domestic companies that issue depository receipts at a rate of 1.5 percent. This tax will most likely be passed on to investors by Brazilian issuers, meaning foreign depository receipts will be subject to similar taxation on foreign portfolio investment⁵³.

Direct Lending—Foreign Credit Activities

Direct lending operations, including directly funded imports, leasing with payment date after 360 days, and import of goods without exchange coverage, are subject to registration with the Financial Operations Registration Module through SISBACEN⁵⁴.

The following information is required for purposes of registering foreign credit activities:

- all principals of the transaction (debtor, creditor, agents, guarantors, etc.);
- financial conditions and payment term of the principal, interest, and associated fees; and
- statement of position by the creditor or document specifying the terms of the transaction, as well as a statement of position by the guarantor, if there is one.

Before deciding on an investment in Brazil, foreign investors are urged to consult with Brazilian legal counsel regarding these and other applicable regulations of foreign investments in Brazil.

Restrictions on Foreign Holdings

Foreign Exchange Regulation

Until 2005, Brazil maintained strict foreign exchange controls by restricting access to the commercial exchange market. As of 2005, reflecting the positive fundamentals present in the Brazilian economy, considerable liberalization of exchange regulation resulted in a more flexible exchange market⁵⁵. CMN Resolution 3,265 in 2005 established free negotiation between agents authorized to operate in the foreign exchange market and their clients, applicable to transactions of any nature, without set limits and without prior authorization⁵⁶. Residents and non-residents alike are allowed to open and maintain accounts denominated in Brazilian currency in authorized Brazilian banks⁵⁷.

All foreign capital, including foreign capital in Brazil and Brazilian capital abroad, must be registered with the Central Bank. As outlined previously, foreign capital must be self-declared and registered within 30 days of entrance into the country.

There is no restriction to receive or send foreign exchange transfers to and from abroad. Such transfers may be made from an authorized bank without approval of the Central Bank. All foreign exchange transaction must be performed through authorized agents, including commercial banks, savings banks, brokerages, and securities dealers⁵⁸.

Expatriation and Repatriation of Capital

Foreign capital that is registered with the Central Bank may be repatriated at any time without prior authorization⁵⁹. The portion of remitted capital that is in excess of the amount registered with the Central Bank is treated as a capital gain for the foreign investor and subject to a 15 percent withholding tax (25 percent for investors residing in tax havens, defined as countries with a tax rate below 20 percent)⁶⁰.

Additionally, interest paid to foreign residents is subject to a 15 percent withholding tax (25 percent in the case of creditors residing in tax havens).

Repatriation of capital is restricted when capital has not been registered in the SISBACEN system. Remittance of profits, repatriation, and registration of profit reinvestments are all tracked and taxed based on the amount of foreign investment registered.

TAX CONSIDERATIONS

Capital Gains Taxes

Capital gains earned by non-Brazilian residents are subject to an income tax of 15 percent. The tax amount is withheld and paid by the Brazilian source, unless otherwise provided⁶¹.

Taxes on Foreign Portfolio Investment

Foreign capital entering Brazil as portfolio investment is subject to a 2 percent tax rate.

Dividends or International Tax Income

Dividends payable by a Brazilian company to Brazilian residents or non-Brazilian resident shareholders are not subject to Brazilian withholding taxes. Additionally, if Brazilian companies choose to remunerate shareholders by paying interest on equity holdings, withholding taxes will be applied at 15 percent (25 percent if the recipient resides in a tax haven)⁶².

Other Withholdings

Interest payments on loan transactions made by Brazilian entities to non-Brazilian residents are subject to a withholding income tax rate of 15 percent (25 percent if the recipient is resident in a tax haven jurisdiction) unless a tax treaty exists between Brazil and the country where the recipient of the interest payment resides.

Income payable by a Brazilian party to a foreign entity in connection with royalties or technical assistance agreements involving transfers of technology are subject to a withholding income tax rate of 15 percent or lower depending on applicable tax treaties⁶³.

Brazilian government debt is currently exempt from withholding taxes, and as a result, is a focus of foreign investors.

Tax Treaties with the United States

Brazil does not have a bilateral tax or investment treaty with the United States⁶⁴.

The Brazil/USA Investment Guaranty Agreement allows the U.S. Government to issue guaranties assuring against loss of an eligible American investment in Brazil due to specific non-business risks, including currency issues, trade disruption, and the like. Issuances of guaranties are subject to the approval of the Brazilian government and eligible investments must contribute to economic and social development. Requests for approval must also be registered with the Overseas Private Investment Corporation (OPIC)⁶⁵.

Types of Accessible Capital Markets

Public Exchanges

Markets traded on the BM&FBOVESPA include equities, commodities, futures, exchange traded funds, corporate bonds, and protected and participated investments. Several benchmark indices track the performance of the stock market as a whole. The principal index is Ibovespa, a theoretical portfolio which accounts for 80 percent of the number of trades and financial volume in the cash market with stock weightings determined by liquidity. Another important index is IBrX, which is composed of the 100 most traded shares on BM&FBOVESPA's cash market

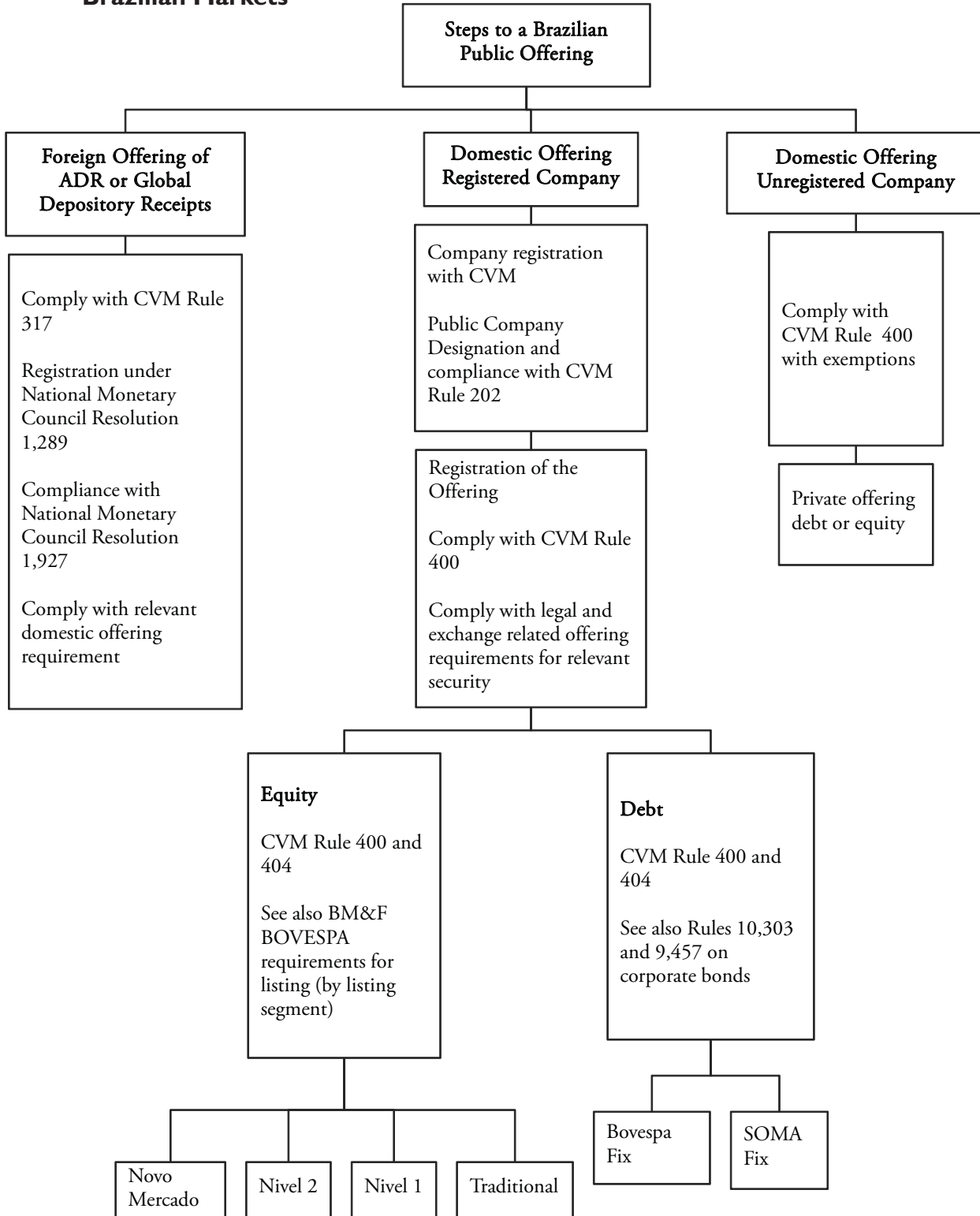
To trade on the BM&FBOVESPA, all investors must choose a brokerage firm authorized to trade on the exchange⁶⁶.

Over the Counter Market

Brazil has a large and developed OTC market dominated by a number of large dealers. Of particular note, and unlike OTC markets in other countries, there are reporting requirements for OTC transactions in Brazil. Every transaction must be reported to one of two central registration and confirmation organizations, the BMF or CETIP, to be considered legal and enforceable. OTC transactions with counterparties outside of Brazil are not subject to this reporting system because they are booked elsewhere. These reporting requirements make the Brazilian OTC market transparent relative to other countries, which allows for easy access to aggregated data for market participants and increased surveillance capabilities for the regulatory authorities⁶⁷.

LOCAL MICROFINANCE ISSUER CONSIDERATIONS

Summary Chart: Keys Steps for Microfinance Issuers to Issue in Brazilian Markets



Overview

Overview of Securities and Issuance

Through a combination of legal reform and efforts of BM&FBOVESPA to improve corporate governance, issuance in Brazil's capital markets has grown rapidly since 2000. In 2002, CVM Rule 6,385 amended previous legislation (Rules 6,404 and 6,385) regarding the public offering of securities in Brazil and made it easier to issue and invest in the local Brazilian markets.

Issuers must still consider a number of legal requirements as well as the additional requirements of the BM&FBOVESPA to access the Brazilian debt and equity markets.

All companies seeking to list securities in local exchanges or the OTC market must be registered with the CVM and must also register the offering with the CVM. The prospectus for the offering must be subsequently registered with and reviewed by the CVM. BM&FBOVESPA outlines additional requirements for companies wishing to list and issue securities.

Securities available for local issue and considered securities by Brazilian law include:

- shares, debentures, warrants and coupons;
- stock indexes;
- commercial papers;
- subscription rights;
- subscription receipts;
- options;
- share deposit certificates;
- certificates of investments in film production and certificates representing mercantile contracts for deferred purchase of energy;
- collective investment contracts;
- real estate receivable certificates;
- future contracts, options and other derivatives; and
- any negotiable instruments or collective investment contracts, when publicly offered, which grant participation, partnership or remuneration rights, including those resulting from the provision of services, which income arises from the work of the entrepreneur or third parties.

Shares traded on a stock exchange cannot be traded in the OTC market, except in the case of a public distribution. OTC transactions are not coordinated by CVM, though they are subject to its supervision. CVM Rule 202 defines regulations regarding trading in organized and non-organized OTC markets.

The following securities may be traded on the organized OTC market:

- securities registered with CVM for trading on the OTC market;
- certificates of investments in audiovisual production;
- quotas of closed-end investment funds, subject to a public distribution; and
- other securities authorized by the CVM.

Making an Offering

The first step to making a public offering in Brazil is for the prospective issuer to register as a company with the CVM. Brazilian law outlines several legal definitions for an entity to be considered a company. The most common company structure is *Sociedade Anônima* (S.A.).

Listed S.A.s are those with shares publicly traded on the stock market while Closed Capital S.A.s obtain capital through private offerings of their shares⁶⁸. “*Companhia*,” “*Cia*,” “*Sociedade Anônima*,” or “S.A.” must precede or follow the company’s name.

Entities must complete the following requirements to register as a company:

- at least two people subscribed to entire allotted share capital;
- at least 10 percent of subscribed capital paid in cash;
- 10 percent or more of the value of the subscribed shares deposited with *Banco do Brasil S.A.* or any other financial institution authorized by the CVM;
- registration of the Articles of Incorporation with the *Junta Comercial*; and
- publication of the Articles of Incorporation with the official gazette of the federal or state government, and in a widely circulated newspaper, within 30 days of registration.

CVM Rule 202 outlines the legal requirements for issuers of publicly traded securities. The rule outlines the procedure for issuers to obtain registration and lists documents to be filed. A corporate officer must be responsible for the relationship with the public and is liable for effective disclosure of material information. The issuer is also subject to obligations of financial disclosure and other significant information. Civil associations, foundations, cooperatives and other forms of non-profit organizations are subject to different legal restrictions⁶⁹.

Requirements for Registration of an Offering with the CVM

The Brazilian system does not define securities as registered or unregistered. Instead, security offerings are classified as either registered or unregistered. Accordingly, CVM regulation outlines the requirements for making a registered offering (offering rules vary by the type of security to be offered). A registered offering is one that involves issuance in a public market (stock exchange or OTC market) and does not fall into the exempt categories laid out by CVM Rule 400 or any related legislation⁷⁰.

A non-registered company may place securities via private transactions or through CVM Rule 400 exemptions. If the company later issues publicly traded securities, the securities issued outside the regulated registration process may then be publicly traded without further registration.

CVM Rule 400 outlines requirements for public offerings of securities including:

- the procedure for the offerer and underwriter to obtain registration;
- documents to be filed and outline of the review period;
- requirements related to the production of a prospectus and disclosure of minimum mandatory content;

- offerer, issuer and underwriter liability for omission and misstatements in the prospectus; and
- offerer, issuer and underwriters' duties to disclose information and sell securities to the general public.

Important aspects of Rule 400 include the provision that a commission of CVM officials may grant dismissal of certain requirements, as well as the provision for shelf registration. The two aspects of reform insert flexibility into the process and make issuance easier for companies that intend to regularly access the markets.

Brazilian Access to Foreign Markets

Brazilian issuers may also issue securities in foreign markets. CVM Rule 317 outlines guidelines for dual securities offerings with simultaneous issuance in local markets and issuance of American Depositary Receipts (ADR) or global depository receipts abroad.

Issuers who wish to register ADRs or Global Depositary Receipts (GDRs) must fulfill the following requirements:

- appointment of a non-Brazilian depository to issue depository receipts abroad;
- registration of the depository receipts under CVM Rule 317;
- registration under National Monetary Council Resolution 1,289 of the Central Bank of Brazil; and
- compliance with National Monetary Council Resolution 1,927 (amends Rule 1,289).

Resolution 1,927 must be fulfilled by both the custodian and issuer of the securities that back the depository receipts.

The Depositary Receipt (DR) program may or may not be sponsored by the Brazilian issuer of underlying securities.

After registration of the DR program with the CVM and the Central Bank as outlined above, shares held by Brazilians or foreigners may be deposited with the custodian for issuance of the corresponding DRs abroad. Foreign investors may sell the DRs abroad, or request cancellation of the DR and sell the underlying shares in Brazil.

Local Exchange Requirements

As discussed in previous sections, the majority of activity in Brazil's Capital Markets takes place on the BM&FBOVESPA. In addition to providing the opportunity to trade securities deemed legal by CVM requirements, the BM&FBOVESPA offers a number of special listing segments for companies that meet additional criteria. Special listing segments of the BM&FBOVESPA include *Novo Mercado*, *Nível 1*, *Nível 2*, and *BM&FBOVESPA Mais*.

Most notably, the *Novo Mercado* is a special listing segment for companies that commit themselves to a significantly higher level of corporate governance than those required by the CVM or other Brazilian legal agencies. The vast majority of companies that have gone public

since its inception have listed on the *Novo Mercado*⁷¹. *Nível 1* and *Nível 2* companies commit to higher corporate governance, though to a lesser degree than companies listed on the *Novo Mercado*. BM&FBOVESPA *Mais* is an OTC market for small and medium businesses to issue securities. Other OTC markets include SOMA and CETIP.

Corporate fixed income securities are traded on BM&FBOVESPA Fix and over-the-counter on SOMA Fix.

Disclosure requirements and shareholder rights:

Brazilian law requires that all listed companies disclose the following:

- quarterly and year-end financial statements in Brazilian GAAP;
- all shareholders agreements; and
- stock option plans.

Under the Corporate Law of 2001, companies constituted prior to October 2001 may hold up to two-thirds of share capital in non-voting shares. Companies constituted following October 2001 publication of the law may hold up to one-half of share capital in non-voting shares. BM&FBOVESPA outlines additional requirements for companies wishing to list in special listing segments.

Nível 1 companies must also disclose:

- quarterly and annual cash flow statements;
- related parties transactions;
- annual agenda of all scheduled corporate events, published in January; and
- insiders trades of company securities, monthly.

Nível 2 companies must disclose all required information for listed companies and *Nível 1* companies as well as quarterly and year-end statements in IFRS or U.S. GAAP. *Nível 2* companies must also grant preferred shares the right to vote on selective issues outlined by BM&FBOVESPA regulation.

Novo Mercado companies are subject to the same disclosure requirements as *Nível 2* companies. In addition, they must:

- issue common shares only;
- maintain a free float of at least 25 percent of its outstanding shares;
- extend to all shareholders the same terms and conditions enjoyed by controlling shareholders in the event of sale of control (offer full tag along rights);
- appoint a minimum percentage of independent board members;
- submit transactions with related parties to shareholders approval;
- make mandatory tender offers in case of delisting from the *Novo Mercado* or BM&FBOVESPA, or deregistration with the CVM;
- make efforts to increase the number of shareholders in public offerings of securities; and
- submit any disputes to arbitration by the *Camara de Arbitragem do Mercado*.

Securities Available for Issuance

Debt

To sell bonds in the primary and/or organized secondary markets, the issuer must be registered with the CVM as a public company and must also register the offering with the CVM⁷². The registration of the bond indenture and transcripts of Board or General Shareholders meetings related to the offering must be filed with the Commercial Registrar. The issuance must be brought to market by a financial institution. A bond rating is not mandatory⁷³.

Rule 6.404 outlines guidelines for issue value, and the underwriter of the issuance must confirm compliance with Rule 6.404. Fixed collateral bonds are limited to 80 percent of the value of collateralized assets and floating collateral bonds are limited to 70 percent of company assets minus the book value of fixed collateral debts. Unsecured bonds have a limit of 100 percent of book equity. There is no limit for subordinated bonds⁷⁴.

Both public and private companies can issue commercial paper. Commercial paper must have a minimum maturity of 30 days and maximum maturity of 360 days for a public company. There is no collateral requirement but it may be subject to personal guarantees by owners or corporate officers⁷⁵. Under Brazilian bankruptcy laws, short-term debt does not have any priority over long-term debt.

Most privately placed bonds are convertible, while publicly traded bonds are not⁷⁶. Investment banks must register corporate bonds with the *Sistema Nacional de Debêntures* (National Debenture System) and CETIP, *Câmara de Custódia e Liquidação*, or with BM&FBOVESPA Fix⁷⁸.

For further detail about issuance of a specific debt security, consult the applicable CVM regulation. Issuance of corporate bonds is regulated by Rule 4.606 of 1976, and modified by Rules 9.457 of 1997 and 10.303 of 2001. CVM Rules 400 and 404 discuss regulations related to book building, shelf registration, green shoe options, and standardized bond indentures. CVM Resolution 3339/2006 outlines guidelines for fixed income repurchase operations⁷⁷.

Equity

Offerings include a retail and an institutional tranche. *Novo Mercado* listing requirements ensure that a minimum portion of shares are sold to retail investors, usually 10 percent of the offering size⁷⁹.

Companies trading on the *Novo Mercado* must:

- maintain up-to-date the registration with the CVM for the trading of its common shares on stock exchanges;
- have applied for the registration for the trading of its securities at BM&FBOVESPA;
- signed the *Novo Mercado* Agreement;
- amended their bylaws to insert the *Novo Mercado*'s required clauses;

- maintain the Minimum Free Float outlined by BM&FBOVESPA *Novo Mercado* requirements; capital stock is represented only by common shares (exceptions outlined by BM&FBOVESPA);
- have no Founders Shares; and
- have complied with legal and regulatory provisions that apply to the *Novo Mercado*.

All companies listed on the *Novo Mercado* must maintain a minimum free float of 25 percent of the company's total capital stock. After a formal request for listing on the *Novo Mercado* has been submitted, BM&FBOVESPA may grant extensions to comply with the minimum free float requirements.

To make a public offering on the *Novo Mercado*, a company must:

- make efforts to achieve widely dispersed share ownership through special procedures described in its prospectus;
- present a well organized prospectus that complies with all legal guidelines outlined by CVM Rule 400 as well as the following BM&FBOVESPA requirements that it be sent to BM&FBOVESPA and publicly disclosed;
- present updates of information provided to the CVM to register as a public company authorized for trading on stock exchanges as well as updates of all information submitted to the CVM to make a public offering;
- perform an economic and financial feasibility study, when CVM rules require one;
- in the prospectus, include a description of risk factors, a detailed overview of company activities (per specific *Novo Mercado* requirements), a management report analyzing and discussing the financial statements included in the prospectus;
- disclose, per *Novo Mercado* requirements, information regarding all security issuances, past legal arbitration, related transactions, upcoming events, detailed ownership and management information; and
- must state and submit to the Arbitration Clause.

Additional considerations include a lock-up period and minimum free float requirements outlined by the *Novo Mercado*.

Lock up period: The controlling shareholder and the senior managers may not sell or offer to sell any shares or derivatives for six months following the initial offering. For an additional six months, the controlling shareholder and the senior managers may not sell or offer to sell more than 40 percent of shares and derivatives held immediately after that public offering.

In the event that a proposed capital increase is not fully subscribed and results in a disruption of free float maintenance, minimum free float must be restored within six months of subscription ratification.

Potential issuers are urged to consult with Brazilian legal counsel regarding these and other applicable regulations in order to fully comply with current regulatory requirements for offering public securities in Brazil.

Key Contacts for Additional Information

Banco Central do Brasil (Central Bank of Brazil)

<http://www.bcb.gov.br>

Comissão de Valores Mobiliários (Securities and Exchange Commission of Brazil)

<http://www.cvm.gov.br>

ANDIMA

<http://www.andima.com.br>

BM&FBOVESPA

<http://www.bmfbovespa.com.br>

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