

Brazilian FIA-MAs: a New Option for Investments in Mid-Market Companies and Private Equity

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The CVM (the Brazilian SEC) regulated last year a new type of investment fund: the *Fundo de Ações – Mercado de Acesso* or simply FIA-MA. The declared purpose of the FIA-MA is to encourage investments in mid-market companies and foster new IPOs.

According to CVM's new *Instrução* 549, a FIA-MA must invest at least 2/3 of its net worth in shares issued by companies listed in stock exchange or over-the-counter market segments focused on mid-market companies and that impose additional corporate governance practices in comparison to those set forth in law. It is tailored to benefit the Bovespa Mais[1], a special over-the-counter market managed by BM&FBovespa, the main Brazilian exchange, currently the only listing segment in Brazil that targets mid-market companies.

Where organized as closed-end funds, FIA-MAs may invest up to 1/3 of their net worth in shares and other securities of unlisted companies. Prior to *Instrução* 549, the *Fundo de Investimento em Participações – FIP* (also known as Brazilian private equity fund) was the only type of fund allowed to invest in unlisted companies. Similarly to a FIP, a FIA-MA must have decision-making powers with respect to the unlisted companies in which it invests and such companies must follow higher corporate governance practices. The unlisted companies must also undergo an appraisal every year to determine their fair value.

While a FIP may invest all of its net worth in unlisted companies, it is only available to accredited investors (financial institutions, insurance companies, investors with large portfolios and other sophisticated investors). The FIA-MA, on the other hand, may be offered to all kinds of investors, including non-accredited investors. It is the first Brazilian fund that allows less sophisticated investors to invest at least partially in assets negotiated in the private equity sector, opening up new investment alternatives.

To make the FIA-MA more appealing, the Brazilian government enacted Law 13,043/14, establishing that if certain conditions are met, gains obtained by individuals from the redemption of quotas of a FIA-MA are exempt from income tax. This exemption only applies if the FIA-MA (i) invests at least 67% of its net worth in mid-market companies[2], (ii) imposes a minimum period of 180 days for the redemption of quotas; and (iii) has at least 10 investors. Additionally, each investor (or group of related investors) must own no more than 10% of the fund's quotas.

Despite the risk involved in the liquidity of mid-market companies' securities, the FIA-MAs may be organized either as closed-ended or open-ended funds. *Instrução* 549 authorizes the FIA-MA's administrative manager to retain the services of a market maker. The market maker will buy and sell the fund's quotas on a regular and continued basis, ensuring liquidity and establishing some control over the average price of the fund's quotas.

In FIA-MAs organized as closed-ended funds, the new regulation allows the repurchase of quotas by the fund when they are negotiated for a price lower than their net worth value.

The new regulation has also brought about some other interesting rules. For instance, FIA-MA's investment managers are allowed to charge performance fees based on the fund's performance in comparison to inflation or interest rate indices^[3]. The reasoning behind this rule is that stock market indices normally used as a gauge for performance fees do not properly capture the development of mid-market companies, in particular unlisted ones.

Another important rule applies to FIA-MAs offered exclusively to accredited investors. In this case, the FIA-MA's investors may execute partnership agreements committing to provide money to the fund in the future, upon capital calls made by the fund's manager. The investor does not have to put money upfront but undertakes to make the investment when and if the fund's investment manager finds good and viable investment alternatives. This enables the FIA-MIA to operate similarly to a FIP and thus be used as an alternative vehicle for private equity investments in Brazil.

[1] In Issue No 1 of our M&A/Private Equity Newsletter we take a look at the Bovespa Mais.

[2] Law 13,043/14 sets forth which companies will be considered mid-market companies. Basically, they have to have a market value under BRL 700 million and annual gross revenues under BRL 500 million.

[3] As a general rule, the benchmark used to calculate the performance fee in funds available to non-accredited investors has to be directly linked to the type of assets held in the fund's portfolio.