

## Understanding the Roles of Administrative and Investment Managers of Brazilian FIPs

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In October of 2013, the CVM (the Brazilian SEC) issued a reprimand against an investment fund administrative manager for neglecting to supervise the fund investment manager's performance<sup>[1]</sup>. It was discovered that the investments made by the investment manager did not comply with the fund's statutory investment policy. According to the CVM's judgment, the administrative manager has the duty of assuring the investment manager's compliance with the fund's investment policy and should raise a red flag in the event of noncompliance.

Many other recent decisions of the CVM also deal with the duties of administrative managers (known in Brazil as "*administradores*") and investment managers ("*gestores*") of funds. This has become a recurring topic in cases submitted to the CVM, making it vital to understand the different roles played by these two important agents in the Brazilian private equity industry.

The general duties and responsibilities of administrative and investment managers of *Fundos de Investimentos em Participações* (FIPs) – the most used vehicle used for structuring private equity investments in Brazil – are set forth in CVM's Instrução 391.

According to Instrução 391, the FIP's administrator must be a legal entity duly authorized by the CVM to manage investment portfolios. The administrative manager is initially responsible for setting up the fund and drafting its by-laws. After the fund starts operating, the administrative manager will have to prepare and disclose to the investors and the CVM the proper financial and commercial information concerning the fund.

The administrative manager will also be in charge of a number of tasks in connection with running the FIP, such as keeping records of investors, transactions implemented by the fund, decisions taken in investors' general meetings, as well as issuing opinions on the operations and results of the fund. If the administrative manager is a financial institution, it will also handle all money transfers made to and from the FIP's investors and invested companies. If not, the administrator must contract a financial institution to carry out such services.

As a general rule, the administrative manager must take all the necessary measures to enforce the FIP's by-laws and resolutions issued by the investors' general meetings.

The fund's investment manager, in turn, may be either a legal entity or an individual authorized by the CVM to manage investment portfolios. The investment manager is responsible for handling the FIP's investments according to the investment policy established in the fund's by-laws. It is a quite different role from that of an administrative manager.

The investment manager will select potential investment targets, coordinate the due diligence and negotiate the purchase or subscription agreements. Once an investment is made, the investment manager will participate in the definition of the strategic policies of the invested company through the exercise of voting rights and the appointment of board members. The aim of the investment manager is to maximize the return for the FIP's investors, by increasing the value of the invested companies and making them more profitable.

In performing its duties, the investment manager may be assisted by statutory committees or councils. It is not uncommon for a FIP in Brazil to have an investment committee, which will be heard on investment opportunities.

As stated in Instrução 391, the administrative manager or the investment manager will each be liable for damages it causes to the fund's investors arising out of willful misconduct, gross negligence, breach of the fund's by-laws or violation of law or the CVM's regulation. Financial institutions engaged by the fund to carry out financial services will also be subject to the same liability.

Instrução 391 allows the administrative manager to also take on the role of investment manager. In this case, the fund's administrative manager and investment manager will be the same legal entity.

If the administrative and the investment managers are different persons, according to the CVM the administrative manager may have an additional task. As concluded by the CVM in the decision mentioned at the beginning of this article, the administrator will have to supervise the activities of the investment manager to confirm her/his compliance with the fund's by-laws and warn the CVM of non-compliances. The CVM does not expect the administrative manager to check the conformity of potential investments before they are made, but to confirm that such investments – after they are made – are consistent with the fund's policies. Even though such decision did not involve a FIP, but another kind of investment fund (governed by CVM's Instrução 409), it is likely that the CVM will apply such understanding to all kinds of investment funds, including FIPs.

[1] Proceeding CVM RJ 2012/6987, available at

<http://www.cvm.gov.br/port/inqueritos/2013/rordinario/inqueritos/TA%20RJ2012-6987%20BNY%20Mellon.asp>