

THE ASSET
MANAGEMENT
REVIEW

TENTH EDITION

Editor
Paul Dickson

THE LAWREVIEWS

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PREFACE

Last year we reflected on how 2020 might primarily be remembered as the year of the novel covid-19 pandemic. A few events of global significance punctured covid-19's monopoly of economic news: the Democrats winning the White House; an eleventh-hour 'deal' being reached between the European Union and the United Kingdom a mere week before the end of the transition period; and a wrong turn in the Suez canal. However, a year on and the pandemic continues to dominate the global geopolitical landscape and remains a source of significant uncertainty. While it is clear that 2021 will also be overshadowed by the pandemic, successful vaccination campaigns appear to be providing fragile grounds for economic optimism in the near future. Yet unprecedented levels of government spending combined with labour shortages and supply chain disruption mean any recovery will have to grapple with rising inflationary pressures. In the asset management world, it is clear that the sector has faced one of its greatest and most sustained tests in recent history. The need for the industry to remain adaptable and resilient has perhaps never been greater.

Leaving all of this aside though, the importance of the asset management industry continues to grow. Nowhere is this truer than in the context of pensions, as the global population becomes larger, older and richer, and government initiatives to encourage independent pension provision continue. Both industry bodies and legislators are also increasingly interested in pursuing environmental, social and governance (ESG) goals through private sector finance. This should not be a surprise: lack of shareholder engagement has been identified as one of the key issues that contributed to the governance shortcomings during the financial crisis. Given the importance of the asset management industry in investing vast amounts on behalf of clients, the sector is the natural focus of regulatory and governmental initiatives to promote effective stewardship and take the lead in instilling a corporate cultural focus on sustainability and ESG initiatives.

The activities of the financial services industry remain squarely in the public and regulatory eye, and the consequences of this focus are manifest in ongoing regulatory attention around the globe. Regulators are continuing to seek to address perceived systemic risks and preserve market stability through regulation. Operational resilience – a concept focused on ensuring asset managers' holistic preparedness against any risk event, particularly significant operational risks – continues to be a significant focus point for global regulators.

It is not only regulators who continue to place additional demands on the financial services industry: the need to rebuild trust has led investors to call for greater transparency around investments and risk management from those managing their funds. Senior managers at investment firms are, through changes to regulatory requirements and expectations as to firm culture, increasingly being seen as individually accountable within their spheres of

responsibility. Industry bodies have also noted further moves away from active management into passive strategies, illustrating the ongoing pressure on management costs. This may, in itself, be storing up issues for years to come.

The rise of fintech and other technological developments, including cryptocurrencies, data analytics and automated (or ‘robo’) advice services, is also starting to have an impact on the sector, with asset managers looking to invest in new technologies, seeking strategies to minimise disruption by new entrants, or both. While regulators are open to the development of fintech in the asset management sector, they also want to ensure that consumers do not suffer harm as a consequence of innovations. Regulators across various jurisdictions launched the Global Financial Innovation Network (GFIN), which aims to facilitate collaboration and communication between regulators regarding financial innovation and to create a cross-border sandbox in which firms can test their new technologies. This continues to be a period of change and uncertainty for the asset management industry, as funds and managers act to comply with regulatory developments and investor requirements, and adapt to the changing geopolitical landscape and respond to the ongoing uncertainties brought about by the global pandemic. Although the challenges of regulatory scrutiny and difficult market conditions remain, a return of risk appetite has also evidenced itself, and the global value of assets under management continues to increase year-on-year. The industry is not in the clear, but, prone as it is to innovation and ingenuity, it seems well placed to navigate this challenging and rapidly shifting environment.

The publication of the tenth edition of *The Asset Management Review* is a significant achievement, which would not have been possible without the involvement of the many lawyers and law firms who have contributed their time, knowledge and experience to the book. I would also like to thank the team at Law Business Research for all their efforts in bringing this edition into being.

The world of asset management is increasingly complex, but it is hoped that this edition of *The Asset Management Review* will be a useful and practical companion as we face the challenges and opportunities of the coming year.

Paul Dickson

Slaughter and May

London

August 2021

BRAZIL

Fernando J Prado Ferreira, João Pedro Ribeiro Taveira and Leonardo Duarte Moreira¹

I OVERVIEW OF RECENT ACTIVITY

Brazil has been subject to important regulatory changes in recent years with regard to asset management activities by virtue of several new regulations issued by the National Monetary Council (CMN), the Brazilian Securities Commission (CVM) and the Central Bank of Brazil (CBB) aimed at modernising and optimising the regulatory framework in light of recent market practices.

As further detailed below, noteworthy CVM regulations include:

- a* CVM Resolution No. 30 of 11 May 2021, which sets forth the suitability rules related to securities distribution;
- b* CVM Instruction No. 554 of 17 December 2014, which established the new classification of qualified and professional investors;
- c* CVM Instruction No. 555 of 17 December 2014, which established the new general regulatory framework applicable to investment funds; and
- d* CVM Instruction No. 21 of 25 February 2021, which sets forth the rules applicable to the professional management of securities portfolios.

On 25 February 2021, the CVM issued Resolution No. 19, replacing CVM Instruction No. 592 of 17 November 2017, as the regulation that sets forth the requirements and ongoing compliance obligations that investment advisers shall be subject to in order to obtain and maintain investments advisory licences.

Effective as of 1 June 2020, CVM Instruction No. 619 establishes the possibility of investment advisory entities located outside of Brazil obtaining recognition from the CVM. Once recognised, the foreign entity would be able to carry out cross-border securities advisory activities as though the entity was duly licensed in Brazil.

Private equity funds, which are subject to specific regulation by the CVM, have also been subject to a new regulatory framework by means of the enactment of CVM Instruction No. 578 of 30 August 2016 (see Section VI).

The CMN in turn has updated its regulation on foreign investments in Brazil with the issuance of Resolution No. 4,373 of 29 November 2014. In addition to modernising and simplifying the rules applicable to foreign investments, the new rule also implements new mechanisms to increase the volume of foreign investments in Brazil.

¹ Fernando J Prado Ferreira is a partner, and João Pedro Ribeiro Taveira and Leonardo Duarte Moreira are associates at Pinheiro Neto Advogados.

Within their respective areas of authority, on 27 March 2015, the CBB enacted Circular No. 3,752 and the CVM enacted Resolution No. 13, of 18 November 2020, which further regulates foreign capital in Brazil. More recently, the CVM enacted CVM Instruction No. 585 of 5 April 2017 with the purpose of facilitating the offering of foreign securities in Brazil through Brazilian depositary receipts.

It is also worth highlighting CVM Instruction No. 568 of 17 September 2015, which, *inter alia*, amended the rules applicable to reporting obligations involving significant ownership in publicly held companies, including specific calculations for holdings through derivatives and convertible instruments.

There has been an attempt to diversify and facilitate the possibility and variety of investment opportunities by the Brazilian authorities. These new rulings effectively introduce the new regulatory framework applicable to all market participants.

II GENERAL INTRODUCTION TO THE REGULATORY FRAMEWORK

The Brazilian financial system can be divided in three tranches: normative agencies, supervisory agencies and market participants.

From a general perspective, federal laws applicable to the capital markets in Brazil contain general provisions with the purpose of establishing what the Brazilian capital markets comprise, which entities may be agents of the market and the different independent agencies that have powers to oversee it and the limits of their authorities.

The normative agencies are responsible for enacting the general regulations and guidelines of the financial system under their respective areas of authority. Such normative agencies are the CMN, which is the main normative agency of the Brazilian financial system; the National Private Insurance Council (CNSP), for the insurance, capitalisation and open-ended private pension segments; and the National Supplementary Pension Council, for private pension funds.

The supervisory agencies are generally responsible for monitoring and enforcing regulations and the compliance of relevant market participants (financial institutions, stock exchanges, investment funds, portfolio managers, etc.). They are responsible for regulating, supervising, developing and controlling their corresponding segments of the financial system. Such supervisory agencies are the CBB, the CVM, the Private Insurance Authority (SUSEP) and the National Supplementary Pension Authority (PREVIC).

The supervisory agencies also have normative functions. For instance, Law 6,385 of 7 December 1996 (the Securities Market Law), which created the CVM, delegates authority to the CVM to, *inter alia*, establish the regulations governing the activities of asset managers, advisory entities and investment funds.

In summary, the regulations setting forth the specific set of rules that each player and transaction has to comply with are CVM instructions, CBB circulars and CMN resolutions.

The structure of the Brazilian financial and capital markets is also composed of a self-regulatory agency, the Brazilian Financial and Capital Markets Association (ANBIMA), which created a set of rules with increased corporate governance for its associates (e.g., asset managers, banks and brokerage firms) to comply with.

In this regard, ANBIMA issued a new set of rules on 4 May 2018 establishing the best practices to be adopted by its associates regarding asset management. The new Code for Regulation and Best Practices for Asset Management replaced the Code for Investment Funds; it has been in force since 2 January 2019 and was amended on 1 July 2021.

i Portfolio management and securities advisory services

Local professional management and administration of securities portfolios can only be carried out in Brazil by a natural person or a legal entity duly authorised by the CVM. The natural person must be resident in Brazil, and the legal entity must be organised and headquartered in Brazil.

Portfolio management activities in Brazil are distinguished by two types of portfolio managers with different areas of expertise: fiduciary administration, with direct or indirect responsibility for the custody and controllership of assets and liabilities and, generally, for the supervision of the markets; and asset management, with responsibility for the decision-making process of investments. This distinction is duly reflected by CVM Resolution No. 21, which establishes that portfolio managers, depending on the activities performed, shall request their registration under the fiduciary administrator category, under the asset manager category, or under both.

Additionally, CVM Resolution No. 21 consolidated some other significant changes to rules applicable to the management of securities portfolios, which had been previously enacted by CVM Instruction No. 558, of 26 March 2015. The following changes are noteworthy: assignment of certain responsibilities to statutory officers; possibility of distribution of quotas of investment funds under management; and improvement of rules of conduct and information duties.

Regarding the new information duties required from portfolio managers, they must now publish their internal policies and manuals on the internet, as well as disclose and keep an updated reference form similar to a prospectus applicable to listed companies.

In addition, portfolio managers must file the annual version of their reference form with the CVM by 31 March of each year.

In addition to asset management activities, it is possible to seek a securities advisory licence with the CVM that only authorises the holder to provide non-discretionary investment recommendations, as per CVM Resolution No. 19. By virtue of an innovation introduced by the recently revoked CVM Instruction No. 592, and consolidated by CVM Resolution No. 19, asset managers accredited with the CVM pursuant to CVM Resolution No. 21 are no longer automatically authorised to provide securities advisory services, with a separate and specific licence for carrying out non-discretionary investment advisory activities being necessary.

In addition, CVM Resolution No. 19 also establishes that such two activities cannot be carried out by the same person and, in the case of legal entities, a physical segregation between the two is required.

Moreover, pursuant to CVM Resolution No. 19, investment advisory entities located outside of Brazil may obtain recognition from the CVM that will allow the entity to carry out cross-border securities advisory activities as though the entity was duly licensed in Brazil.

To obtain this recognition, the foreign entity must comply with the requirements and obligations set forth in CVM Resolution No. 19 and must also: (1) be authorised to carry out its businesses and be supervised by a competent authority in a jurisdiction that has signed a mutual cooperation agreement with Brazil or that is a signatory to the multilateral IOSCO Memorandum of Understandings concerning Consultation and Cooperation and the Exchange of Information; (2) appoint a legal representative in Brazil with powers to receive service of process; and (3) comply with Brazilian anti-money laundering and suitability rules.

ii Investment funds

Portfolio management in Brazil is usually carried out through investment funds. Under local regulations, investment funds are considered as a pool of resources incorporated under the form of a condominium (i.e., they are not corporate organisations) intended for investments in financial instruments and securities, as well as in any other assets traded in the financial and capital markets, according to the terms and conditions established in their by-laws.

A condominium is a type of unincorporated entity in which two or more persons hold joint title to certain assets, being attributed a notional part (quota).

A condominium has no legal personality apart from that of its owners. Even though funds do not have a legal identity under Brazilian law, orders for the purchase and sale of securities are carried out in its name.

Investment funds can be divided into closed-ended and open-ended funds.

Generally, open-ended funds are characterised by the possibility of quota holders to redeem their quotas at any time, and a prohibition, as a general rule, on quotas being assigned or transferred.

Closed-ended investment funds, on the other hand, do not allow the redemption of quotas at any time, except in the case of liquidation of the fund; and their quotas may be transferred by means of a term of assignment and transference, or through a stock exchange or over-the-counter (OTC) market.

The creation, management and operation of most investment funds in Brazil is currently regulated by CVM Instruction No. 555, which became effective on 1 October 2015. However, certain types of funds are subject to specific regulations, including, inter alia, receivables investment funds (FIDCs), real estate investment funds (FIIs) and private equity funds (FIPs), as further detailed in Section VI.

CVM Instruction No. 555 has introduced relevant changes to the Brazilian investment fund industry, including:

- a* a new classification of investment funds;
- b* a clearer obligation for portfolio liquidity management;
- c* a higher threshold for offshore investments by investment funds;
- d* no minimum investment being required for investing in foreign investment funds;
- e* new rules regarding performance fees; and
- f* all communication with quota holders may be carried out electronically.

As a general rule, the distribution of fund quotas must be carried out by duly qualified entities pertaining to the Brazilian securities dealership system. As mentioned above, however, CVM Resolution No. 21 authorises portfolio managers, even if they are not accredited as a securities distributor, to distribute quotas of managed funds (i.e., they are not authorised to distribute quotas of third-party funds).

iii Investor classification

To improve and structure the market, CVM Instruction No. 554 establishes three categories of investors in the Brazilian financial and capital markets, each requiring their own appropriate level of regulation. The rules set forth the criteria for an investor to be characterised as a qualified and as a professional investor. Retail investors are, therefore, those investors that do not fall under the previous categories (by exclusion).

Pursuant to CVM Instruction No. 554, the following shall be considered professional investors:

- a* financial institutions and other entities authorised to operate by the CBB;
- b* insurance companies and capitalisation societies;
- c* open and closed-ended pension funds;
- d* individuals or legal entities that hold financial investments in an amount in excess of 10 million reais;
- e* investment funds;
- f* investment clubs managed by a professional manager;
- g* portfolio administrators and securities consultants authorised by the CVM in relation to their own monies; and
- h* non-resident investors.

Likewise, the following shall be considered qualified investors:

- a* professional investors;
- b* individuals or legal entities that hold financial investments in an amount in excess of 1 million reais;
- c* individuals that have been approved in specific certification examinations; and
- d* investment clubs managed by quota holders.

CVM Instruction No. 554 came into effect on 1 October 2015, jointly with CVM Instruction No. 555.

iv Foreign investment considerations

Pursuant to CVM Instruction No. 555, investment funds have different limits of investment in offshore assets depending on their target public, as detailed below. In general, these limits were increased when compared with the limits imposed by the previous rule, CVM Instruction No. 409 of 18 August 2004.

Classification	Limit (per cent)
Fixed-income investment fund – foreign debt	100 (unlimited)
Funds targeted exclusively to professional investors	100 (unlimited)
Funds targeted exclusively to qualified investors that meet certain additional requirements	100 (unlimited)
Funds targeted exclusively to qualified investors that do not meet the above-mentioned conditions	40
Funds targeted to the public in general (retail)	20

Funds targeted exclusively to professional investors may invest 100 per cent of their assets offshore. As explained above, there is no minimum investment required from investors to acquire quotas of such funds, but they must be professional investors.

It is important to stress that Brazil still has very strict controls on foreign exchange transactions (i.e., on the inflow and outflow of funds to and from the country). According to the Brazilian foreign exchange regulations, all exchange transactions must be carried out through an authorised exchange entity in Brazil.²

² In addition to all foreign exchange transactions having to be carried out through an authorised exchange entity, other requirements include that a relevant foreign exchange contract must be signed describing the

With regard to foreign investment in the Brazilian capital and financial markets, CMN Resolution 4,373 establishes that they must be duly registered with the CBB and the CVM, as well as meet other requirements established therein. As a general rule, the investment must be made in organised capital markets (e.g., stock exchanges and OTC markets).

In addition to investing in the Brazilian capital and financial markets, foreign investments can also be made directly in the form of equity of Brazilian companies. These investments shall also be registered with the CBB under the Electronic Registration System – Foreign Direct Investment.

v Offering of foreign securities

Under Brazilian law, the offering of foreign securities is subject to regulation that affects the possibility of offering such products on a public basis in Brazil.

The public offering of securities in Brazil is primarily regulated by the Securities Market Law and CVM Instruction No. 400 of 29 December 2003, as amended. According to these regulations, as a general rule, public offerings must be previously registered with and authorised by the CVM.

Foreign securities are generally not eligible for registration in Brazil. Therefore, in order for foreign entities to offer their products in Brazil, they shall adopt certain procedures to avoid their public disclosure in Brazil.

Brazilian law does not provide a definition of what constitutes a private placement of securities. Consequently, the concept of private placement is based on what would not constitute a public offering under Brazilian law, and therefore would not require registration with the CVM.

Individuals or legal entities resident in Brazil are permitted to invest abroad, provided that information relating to such assets owned abroad is fully disclosed to the CBB and the Brazilian tax authorities. The obligation to disclose to the Brazilian authorities the existence of assets owned abroad lies exclusively with the owners of such assets.

Nevertheless, specific entities of the Brazilian financial system, such as pension plans, insurance and reinsurance companies, governmental entities, banking companies and investment funds, have certain limitations when it comes to investing abroad (e.g., rules regarding portfolio diversification and asset concentration limits per investor and type of asset). The main rules regarding foreign investment restrictions by Brazilian entities are detailed in Section II.iv, and Section VI.

III COMMON ASSET MANAGEMENT STRUCTURES

The regulatory framework for investment funds (the main vehicle for investments in Brazil) recently underwent important amendments.

With the objective of streamlining and updating the structure of the investment fund industry, CVM Instruction No. 555 has modified the main existing types of investment funds. The new structures permitted by CVM Instruction No. 555 are as follows:

respective parties, the date, the nature of the transaction and the exchange rate, among other information; and that all foreign exchange transactions must be registered at the CBB electronic data system (SISBACEN).

Classification	Main risk factor	Possible subcategories
Fixed-income investment fund	Variation of interest rate, price indices or both	<ul style="list-style-type: none"> • Short-term • Long-term • Indexed • Simple • Foreign debt • Private credit • Foreign investment
Shares investment fund	Price variation of equity securities traded in the organised market	<ul style="list-style-type: none"> • Level I Brazilian depositary receipts • Access market • Foreign investment
Exchange investment fund	Price variation of foreign currency or the variation of exchange coupons	<ul style="list-style-type: none"> • Foreign investment
Multi-market investment fund	Various risk factors (for operators with different strategies and in different markets)	<ul style="list-style-type: none"> • Long-term • Private credit • Foreign investment

Other important types of funds not regulated by CVM Instruction No. 555 are further detailed in Section VI.

IV MAIN SOURCES OF INVESTMENT

The Brazilian investment fund industry is placed in the top 10 asset management industries in the world, with around US\$1 trillion distributed in approximately 20,000 investment funds. This also represents more than 50 per cent of the national GDP.

The Brazilian investment fund industry experienced a scenario of domestic interest rates falling, which resulted in a substantial increase on the investments in more sophisticated vehicles such as stocks funds, hedge funds, exchange traded funds (ETFs), structured funds (FIPs, FIDCs and FIIs), pension funds and funds investing abroad.³

The Brazilian fund industry is getting closer to global tendencies as we observe the rise of digital platforms, the advance of regulations and the increase of allocations abroad.

This industry is still greatly concentrated in fixed-income investments, largely because of the high interest rates maintained in previous years, in addition to the country's long-term investor concentration profile, such as government and private pension funds, which has culminated in fixed-income investment funds accounting for 38.4 per cent of the Brazilian fund industry's equity.

V KEY TRENDS

After being expected by market participants for a long time, a new regulatory framework for the investment fund industry was recently implemented, along with the entering into force of CVM Instructions Nos. 554, 555 and 558 (which has been simply consolidated by the recently enacted CVM Resolution No. 21).

Ten years after the enactment of CVM Instruction No. 409, the new regulations have been designed to bring more efficiency, transparency and competitiveness to the fund industry. They also mark the maturity of the local market, demanding stricter structures, transparency and professionalism from market participants.

³ Based on information provided by the 2020 Brazilian Mutual Fund Industry published by the Getúlio Vargas Foundation Centre for Financial Studies.

In addition, the regulator has demonstrated a better understanding of the market's dynamic, thus creating and regulating new sought-after investment opportunities. This could prove essential for making the Brazilian market more attractive to international investors, paving the way for continuous growth of the industry.

On the other hand, the new regulations have also made investment in foreign markets more accessible to Brazilian investors, and an increase of investment funds aimed at investing offshore can be noted.

There is potential for development in other specific sectors governed by the CVM; for example, FIPs and securities advisory services, by virtue of the new rules being implemented, shall contribute to the process of aligning the local rules to the industry's international standards and best practices, as well as to the technical and operational needs of market players.

Moreover, the Brazilian regulatory authorities have been adopting a stricter stance on compliance. Since the strengthening of the anti-money laundering regulations in 2012 with the enactment of Law 12,683 of 9 July 2012, important anti-corruption rules have also been enacted (Law 12,846 of 1 August 2013 and Decree No. 8,420 of 18 March 2015).

Finally, both CVM and ANBIMA have issued stricter rules for the development of both advisory and discretionary management activities. This trend towards further regulation should be taken into account when analysing establishing a presence in the Brazilian market.

VI SECTORAL REGULATION

i Insurance

Brazilian accredited insurers are regulated by three authorities: CNSP, SUSEP and CMN.

Pursuant to CMN Resolution No. 4,444 of 13 November 2015, as amended, insurers can only invest in five different types of assets: fixed income, variable income, real estate, investments subject to currency exchange variations and others (including shares of some types of investment funds, certificates of structured transaction and others).

Brazilian insurance companies are prohibited from investing offshore, except through local investment funds and branches of Brazilian insurance companies located offshore. With respect to the former, Brazilian companies are allowed to invest up to 10 per cent of their funds and financial resources in quotas of local investment funds qualified as 'foreign debt'. Thus, Brazilian insurance companies would invest in a local investment fund that, in turn, would invest in the offshore market.

ii Pensions

Under Brazilian legislation, there are two types of pension funds: private funds, which are classified as either open-ended or closed-ended; and public funds, which are exclusively composed of pension plans whose members are employees of authorities and government-held companies of the union, states, federal district and municipalities.

While the pension plans offered by open-ended pension funds may be contracted by any individual or group of individuals, those offered by closed-ended pension funds are generally accessible only by sponsors.

The private pension segment is generally governed by Supplementary Law 109 of 29 May 2001, as amended.

While open-ended pension funds are organised as regular joint-stock companies, being regulated by the above-mentioned authorities, closed-ended pension funds can only be organised as foundations or non-profit companies, and are regulated by PREVIC.

The investment restrictions applicable for Brazilian accredited insurers outlined in Section VI.i are the same for open-ended private pension companies.

In addition, CMN Resolution No. 4,661 of 24 May 2018, as amended, further regulates closed-ended pension funds, and sets forth the limits and rules for investment by closed-ended pension funds.

Closed-ended pension funds may invest in:

- a* fixed-income assets;
- b* variable income assets;
- c* structured transactions;
- d* offshore investments;
- e* real estate; and
- f* transactions with members of a related pension plan.

Brazilian closed-ended pension funds are only allowed to invest up to 10 per cent of their net equity offshore through a local investment fund (e.g., feeder fund). In addition, a single Brazilian closed-ended pension fund may not hold more than 25 per cent of the net equity of an offshore investment fund. These restrictions are due to the government's efforts to prevent Brazilian residents' savings being invested outside the country and exposed to offshore risks.

There have been discussions about the possibility of changing the above-mentioned thresholds; however, there is still no concrete proposal in place in this regard.

iii Real property

FIIIs are governed by Law 8,668 of 25 June 1993, as amended, and further regulated by CVM Instruction No. 472 of 31 October 2008, as amended. Such funds are designed to invest in real estate projects and are necessarily closed-ended funds. Investments are permitted in the following:

- a* real estate properties and rights;
- b* equity of real estate companies;
- c* special purpose entities with real estate business;
- d* other funds (FIPs, FIIIs and FIDCs); and
- e* real estate receivables certificates and other instruments.

iv Hedge funds

There are no specific rules regarding hedge funds in Brazil. Local authorities do not consider them as a separate category of investment funds, being generally regulated by CVM Instruction No. 555. Therefore, such funds may be organised as, for instance, multi-market investment funds with diverse investment policies.

v Private equity

FIPs are primarily governed by CVM Instruction No. 578, as amended.

Pursuant to CVM Instruction No. 578, FIPs are characterised as closed-ended investment funds that invest in shares (stock), convertible or non-convertible debentures, subscription warrants, and other securities either convertible into or exchangeable for shares issued by publicly or privately held corporations, as well as equity investments in limited liability companies; and, as a general rule, actively participate and monitor the management of the invested company. It is also permissible that FIPs invest in shares of other FIPs.

At least 90 per cent of a FIP's net equity must be invested in permitted investments, which may now include foreign assets, provided such assets also comply with FIP investment restrictions. Foreign investments by FIPs are limited to 20 per cent of their net equity.

In addition, FIPs shall have a definite term of duration and be targeted exclusively to qualified investors. In terms of classification, FIPs may fall under the following categories:

- a* seed capital;
- b* venture capital;
- c* infrastructure;
- d* research, development and innovation; and
- e* multi-strategy.

CVM Instruction No. 578 stipulates that most of the operational rules governing an FIP and its operations, particularly those involving, inter alia, governance matters, minimum net equity requirements, investment policy, capital calls, distributions of proceeds and duration, may be established in the FIP's by-laws. Therefore, the FIP structure is very flexible.

vi Other sectors

FIDCs

FIDCs are specifically governed by CVM Instruction No. 356 of 17 December 2001, as amended.

FIDCs enable the securitisation of virtually all types of receivables, and are thus the main vehicle currently used for securitisation in the local market. Moreover, they must invest at least 50 per cent of their portfolio in receivables. Quotas of FIDCs may be divided into senior and subordinated quotas. As a general rule, senior quotas shall have priority for amortisation and redemption, while subordinated quotas permit the creation of over-collateral.

The regulations also set forth rules regarding non-standardised FIDCs. Pursuant to CVM Instruction No. 444 of 8 December 2006, such funds broaden the possibility of investment in receivables such as government bonds and litigated claims.

ETFs

Governed by CVM Instruction No. 359 of 22 January 2002, as amended (CVM Instruction No. 359), Brazilian ETFs are index-tracking funds; therefore, their portfolios reflect a given index of reference (benchmark).

Until 2013, Brazilian ETFs investments could only reference Brazilian stock and variable-income asset indexes. However, the enactment of CVM Instruction No. 537 of 16 September 2013, which amended CVM Instruction No. 359, finally made fixed-income ETFs accessible from a regulatory perspective and anticipated certain issues regarding the upcoming enabling of international ETFs (local ETFs that replicate international indices).

As of 2014, upon the concession of a few waivers, the first international ETFs were launched under CVM Instruction No. 359, giving such ETFs investors exposure to foreign assets. On 12 July 2016, the CVM announced that additional waivers for the offering of international ETFs to the general public could be granted on a case-by-case basis.

The number of Brazilian standard ETFs has grown since the first ETF was established; however, the number of Brazilian ETFs referencing foreign indexes is still unfortunately extremely low.

VII TAX LAW

i Overview

Given that Brazilian investment funds are treated as condominiums and not as legal entities, any income or gains obtained by such funds from their transactions are not subject to taxation in Brazil. The taxation occurs only when the income or gains are eventually distributed to quota holders.

As a general rule, foreign exchange transactions are subject to tax on financial transactions (IOF F/X) pursuant to Decree No. 6,306 of 14 December 2007.

Although the remittance of funds to or from Brazil are generally subject to IOF tax at a rate of 0.38 per cent, such transactions are subject to a zero rate if related to the inflow and outflow of funds invested by foreign entities in the Brazilian financial and capital markets. In addition, foreign exchange transactions carried out by Brazilian investment funds in connection with the execution of investments in the international market are subject to IOF at a rate of zero per cent.

ii Open-ended investment fund: taxation of Brazilian quota holders

Under Brazilian tax legislation (Normative Ruling No. 1,585 of 31 August 2015 (IN 1,585/15)), as a general rule,⁴ income and gains distributed from open-ended funds to quota holders resident in Brazil related to the redemption or amortisation of a fund's quotas would be subject to a withholding income tax (WHT) assessment at variable regressive rates (22.5 to 15 per cent) depending on the holding period of the investment and on the maturity term of a fund's portfolio.

If a fund has a long-term portfolio (assets with a redemption term exceeding 365 days), the WHT would be assessed at the following rates:

- a 22.5 per cent for a holding period of up to 180 days;
- b 20 per cent for a holding period of between 181 and 360 days;
- c 17.5 per cent for a holding period of between 361 and 720 days; and
- d 15 per cent for a holding period of longer than 720 days.

If the fund has a short-term portfolio (assets with a redemption term of less than 365 days), the WHT would be assessed at the following rates: 22.5 per cent for a holding period of up to 180 days, and 20 per cent for a holding period longer than 180 days.

In addition to the above, Brazilian quota holders of open-ended funds would be subject to a WHT assessment on a semi-annual basis (on the last days of the months of May and November) at rates of 15 or 20 per cent, depending on the classification of the fund as either long-term or short-term.

This twice-yearly taxation is also known as *come cotas* taxation, which is deemed an advance payment of the WHT to be assessed in cases of redemption or amortisation of quotas, and shall not result in an increase of the overall tax burden of the investment (i.e., the WHT will be offset by the *come cotas* previously paid).

If a quota holder is a legal entity, the WHT tax potentially paid by the investor as a result of its funds investment would be considered as a prepayment of the corporate taxes due by such investor, which means that the investor would be entitled to offset the WHT tax against the corporate income tax (IRPJ and CSL) assessed at, as a general rule, a combined rate of 34 per cent on the taxable income derived by the entity.

Moreover, financial income derived by Brazilian legal entities from investment in funds would be subject, as a general rule,⁵ to the assessment of the contribution on gross revenues (PIS/COFINS) at a combined rate of 4.65 per cent.

iii Closed-ended investment fund: taxation of Brazilian quota holders

Closed-ended investment funds are generally taxed upon their liquidation, the amortisation of quotas or the redemption of quotas pursuant to the regressive rates established by IN 1,585/15:

- a* 22.5 per cent for a holding period of up to 180 days;
- b* 20 per cent for a holding period of between 181 and 360 days;
- c* 17.5 per cent for a holding period of between 361 and 720 days; and
- d* 15 per cent for a holding period of longer than 720 days.⁶

If the fund has a short-term portfolio (assets with a redemption term of less than 365 days), the WHT would be assessed at the following rates: 22.5 per cent for a holding period of up to 180 days, and 20 per cent for a holding period longer than 180 days.

If a Brazilian individual disposes its quota in a private transaction carried out outside the stock exchange and the organised OTC markets, as a rule, the capital gain obtained would be subject to WHT assessment at the following progressive rates:

- a* 15 per cent on the amount of gains not exceeding 5 million reais;
- b* 17.5 per cent on the amount of gains in excess of 5 million reais but not exceeding 10 million reais;
- c* 20 per cent on the amount of gains in excess of 10 million reais but not exceeding 30 million reais; and
- d* 22.5 per cent on the amount of gains in excess of 30 million reais.

Unlike open-ended investment funds, *come cotas* taxation (see Section VII.ii) is not applicable to closed-ended funds.

As for investors who are legal entities, the income derived from a closed-ended investment fund will be generally subject to the assessment of IRPJ and CSL at, as a general rule, a combined rate of 34 per cent, and investors will be allowed to offset such tax with the WHT previously levied on their investment in the fund.

Income derived from investment in the fund will be also subject to PIS/COFINS, as a general rule,⁷ at a rate of 4.65 per cent for corporate entities.

iv Taxation of non-resident quota holders

Currently, foreign investments into quotas of an investment fund (regardless of whether they are open or closed-ended) carried out pursuant to CMN Resolution 4,373 are generally⁸ subject to WHT at a rate of 15 per cent on the income and gains distributed by the fund, unless the quota holder is located in a tax haven jurisdiction,⁹ in which case the investor will receive the same tax treatment applicable to Brazilian individuals. However, the capital gain obtained by a non-resident quota holder will be exempted of WHT assessment if the disposal of the quotas occurs in a transaction carried out in the Brazilian stock exchange.

As a general rule, the remittance of funds into Brazil carried out by foreign investors for purposes of subscribing quotas of Brazilian investment funds are currently subject to IOF assessment at a flat rate of zero per cent. Likewise, the remittance of funds from Brazil carried

out by Brazilian investment funds as a return of foreign investment, regardless of whether it is derived from amortisation or redemption of quotas, is also currently subject to IOF assessment at a zero per cent rate.

v IOF bonds

Finally, the IOF assessed on bonds and securities transactions (IOF bonds) may be levied on the disposition of investment fund quotas by both Brazilian and non-Brazilian investors at a rate of 1 per cent per day. IOF bonds are currently limited to the gain ascertained in a transaction, and reduced pursuant to the length of time that the investment is held by the investor. For instance, transactions with securities held by the investor for at least 30 days will not result in the collection of the IOF bonds.

VIII OUTLOOK

The current regulatory framework is expected to improve the structure and profile of the Brazilian investment fund industry, creating great potential for growth and development for managers, national and international investors, and savers.

CVM Instruction No. 554 improves the definitions of the classes of investors and clarifies the regulations that each of such classes is subject to, thus increasing the transparency of and accessibility to asset management products.

In addition, CVM Instruction No. 555 offers new and efficient investment opportunities for local and foreign investors, especially with regard to the accessibility of foreign markets to Brazilian investment funds. The internationalisation of investments can also benefit the ever-increasing pension fund segment, which may be intensified by the new rule.

The rules set forth by CVM Resolution No. 21 are also evidence of progress in the continuous improvement of the Brazilian investment funds market. The modernisation of the rules applicable to portfolio managers stands out especially with regard to:

- a* the requirement to specifically assign the responsibility for compliance and risk management to a statutory officer;
- b* the improvement of the rules of conduct and internal controls;
- c* the segregation of custody and controllership of assets and liabilities activities from management activities; and
- d* the distribution of funds quotas by portfolio managers, even though the portfolio managers are not financial institutions.

Notwithstanding the above, CVM Resolution No. 21 tends to, directly or indirectly, generate additional costs for market participants, given that it increases the monitoring and disclosure duties regardless of the size of the portfolio manager.

CVM Instruction No. 558 had intensified the enforcement of transparency, diligence and loyalty principles required from portfolio managers. The CVM's intention was to implement mechanisms to allow investors to analyse and compare the way that portfolio managers are more or less structured. This scenario has not changed with the replacement of CVM Instruction No. 558 by CVM Resolution No. 21, given such regulations have the same wording.

The above is also true with regard to the CVM Instruction No. 592, recently replaced by CVM Resolution No. 19, the rule that currently governs the development of securities advisory services in the country.

Professional asset management activity has been the target of several regulations in advanced markets such as Europe and the United States since the financial crisis of 2008. The current regulations in such jurisdictions, in addition to various requirements regarding disclosure, also contain requirements (all under the strict supervision of the competent authorities) concerning, for example:

- a* the custody of assets;
- b* disclosure of systemic risks;
- c* bookkeeping;
- d* registration of financial statements; and
- e* in some cases, the necessity to fulfil minimum financial requirements.

Therefore, it is possible to identify a move in the regulations applicable to investment funds towards those applicable to the banking and insurance markets.

It would not be surprising if, in the near future, stricter rules also become mandatory in Brazil once the local market is fully mature.

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