BRAZIL BUSINESS BRIEF

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NEWS FROM THE BRAZILIAN CHAMBER OF COMMERCE IN GREAT BRITAIN

CONTENTS

EDITORS' LETTER

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Dear Members,

Welcome to the January 2014 edition of the Brazil Business Brief.

What is the outlook for the Brazilian economy in 2014, and what benefits will hosting the World Cup and the 2016 Olympics bring to the country? You can read the opinions of Bradesco's chief economist Octavio de Barros on those matters, and many others besides, in the interview on page 17.

Our other articles in this issue cover a broad range of topics: biofuels, oil and gas, capital markets, the New Ports Law, and measures to counter money laundering.

We're planning a busy calendar for 2014, including events related to Brazil's economy, political situation, legal system and energy sector. Our networking events will include repeats of the popular House of Commons reception and summer barbecue. A date everyone should put in their diary is 13 May, when our annual gala dinner and Personality of the Year awards will be taking place at the London Hilton on Park Lane. Keep an eye on www.brazilianchamber.org.uk/events for further information.

We wish all our members and friends a very happy new year.

Lena & Alex

ARTICLES

OIL AND GAS IN BRAZIL: NOT ALL PLAIN SAILING

BY GEERT ALBERS AND THOMAZ FAVARO
CONTROL RISKS

After five years of legislative hold-ups, in October the Brazilian government finally auctioned the giant Libra pre-salt field, which is located under a thick layer of salt beneath the seabed and expected to hold between eight and twelve billion barrels of recoverable oil. A consortium run by national oil company Petrobras together with Shell, Total, and China's CNPC and CNOOC won the exploration rights after submitting an offer of 41.65% of 'profit oil' to the Brazilian state.

Although a sole bidder offering the minimum amount of profit oil required by the government might not appear to indicate a successful auction, there was a real achievement simply in the fact that the bidding round took place despite opposition from civil society groups, legislative hold-ups, and a challenging new regulatory environment. The auction will now pave the way for an investment plan worth more than $170bn over the next 35 years, potentially boosting demand for goods and services across the supply chain – if, of course, all goes according to plan.

REGULATORY RISK

The lack of competition among private investors – government officials had expected 40 companies to participate – is indicative of the controversies around increased state intervention in the oil and gas sector. The pre-salt finds in 2007 stirred great expectations within the government, and the ruling Workers' Party, in power since 2003, quickly established a new strategy for taking full advantage of the discovery. In 2010 the government changed the regulatory framework to a production-sharing scheme, ensuring that a larger share of the profit went to the state, and put Petrobras in the driving seat of oil exploration in the area with a 30% minimum stake. Pré-Sal Petróleo SA (PPSA), a new state-owned entity, was granted the power to oversee the operating committee of the consortium. The regulatory design – and a $7bn signature bonus – appears to have been too much of a burden for several major private companies. The lack of interest in the pre-salt fields could potentially force the government to review the terms offered to private investors in the future, even though President Dilma Rousseff was quick to deny there would be any future changes to the regulatory framework.

LOCAL CONTENT AND PETROBRAS

However, the new regulatory framework is not the only challenge for oil companies seeking to operate in Brazil. The government hopes the expansion of oil exploration will promote a restructuring of the industrial landscape and increase demand for industry suppliers, including machinery, equipment and service providers. As a result, complying with local-content requirements, which were voluntary until 2003, has become more challenging with each bidding round. Companies operating in Brazil – including Petrobras – have complained that these are fuelling rising costs and delays; a government-commissioned report found that the local supply chain is only capable of meeting the oil and gas sector's demands in five of 24 key equipment categories.

The increasing politicisation of Petrobras is also a concern. Since 2006 the government has capped petrol prices to fight inflation, forcing the company to sell imported fuel at a loss. An announcement in October by Petrobras officials that a new pricing formula would narrow the gap between local and international fuel costs has been met with scepticism by investors – and in any case will do little to recover the billions already lost. The company was also pushed to build refineries in northeast Brazil so as to provide a boost for the poverty-stricken region. Also, stiff local-content requirements have affected the company: all of the 14 rigs it expected to be delivered in 2012 were significantly delayed. Such problems have had a big impact on the company's profitability, as well its reputation with investors – Petrobras has lost over a quarter of its share value since 2010.

THE INCREASING POLITICISATION OF PETROBRAS IS ALSO A CONCERN. SINCE 2006 THE GOVERNMENT HAS CAPPED PETROL PRICES TO FIGHT INFLATION, FORCING THE COMPANY TO SELL IMPORTED FUEL AT A LOSS

Although political meddling in Petrobras represents a risk for other oil companies, there is no evidence to suggest it will follow the same path as Venezuela's PDVSA, or even Mexico's national oil company PEMEX. The management board recently emphasised the need for greater accountability, including cost controls and performance targets for each platform. Furthermore, Petrobras remains one of the world leaders in deep and ultra-deep oil exploration: despite significant technological challenges the firm pumped more than 100,000 bpd of pre-salt oil in 2012.

WHAT LIES AHEAD

While recent regulatory changes have undeniably given the government more control over local oil and gas resources, Brazil lacks the technology and the financial muscle to exploit its reserves alone. To attract the required investments and to fulfil its potential as an energy powerhouse, government officials are aware that the country needs to maintain a reasonable framework for private firms to operate in. Although the possibility for regula-

ARTICLES

tory improvements exists, it will not all be plain sailing for oil companies operating in Brazil. Key issues such as local-content requirements and the politicisation of Petrobras reflect a political decision to increase state control over this 'strategic' sector and are unlikely to fade away in the short-to-medium term. Oil companies can also expect increased scrutiny when the Clean Company Act comes into effect in January 2014. This far-reaching law, which applies stiff administrative and civil penalties for companies along the lines of the Foreign Corrupt Practices Act (FCPA), also applies to domestic corruption and bid-rigging and is particularly relevant to the oil and gas industry, where interaction with government bodies, regulatory agencies and public interests is substantial. The combination of growing anti-corruption scrutiny by the public at large, strict liability for companies that violate the law, and the broad array of government entities and public prosecutors who can enforce the law, mean that companies are well advised to proactively develop and implement tailor-made local anti-corruption compliance programmes to address the particularities of operating in this complex business environment. ◉

BRAZIL'S SUGARCANE INDUSTRY: LIGHT AT THE END OF THE TUNNEL?

BY ANDY DUFF
RABOBANK

BRAZIL: A BIOFUELS PIONEER

Brazil is by far the world's leading producer and exporter of sugar. However, only half of the sugarcane grown in the country is converted to sugar – the rest is used to produce ethanol, most of which is used as a motor fuel in the domestic market. Unlike their counterparts elsewhere in the world, Brazilian cane mills produce both sugar and ethanol directly from cane. Brazilian cane millers are therefore not just in the food business but also in the fuel business.

Although ethanol was used as a motor fuel in Brazil as early as the 1930s, it was in the 1970s, in the wake of the oil price shock, that the government moved decisively to stimulate the development of fuel ethanol use in the country. In this respect Brazil was a genuine pioneer in the use of biofuels, its transport sector consuming a significant amount of ethanol decades before the US and EU implemented their own policies to encourage the development of local biofuel markets.

Another pioneering development in Brazil's ethanol market took place in 2003 with the introduction of flex-fuel cars: vehicles which can run on pure petrol, pure ethanol or any mix of the two. This marked an enormous change in the fuel ethanol market in Brazil: until the arrival of flex-fuel cars, ethanol had been either a stand-alone fuel consumed in cars designed to run only on ethanol or, in its anhydrous form, it had been blended with petrol to comply with Brazilian legislation which required 20-25% ethanol content in petrol.

THE ETHANOL BOOM

As flex-fuel car sales took off in the years following their launch (they have accounted for over 80% of new car sales in Brazil since 2007), ethanol sales expanded strongly. The outlook for further market growth, plus projections of vigorous growth in exports to the US and the EU (which both implemented major biofuels programmes in 2005) triggered a surge of investment in new industry capacity, powered by a heady combination of euphoric visions of the sector's prospects and a global financial market awash with liquidity.

DEALING WITH A SWEET MARKET TURNED SOUR

The global financial crisis of 2008 brought an abrupt end to cheap and abundant credit, signalling the rapid

ARTICLES

tailing-off of the boom in the construction of new cane milling capacity. This was the beginning of a new and altogether less euphoric phase in the Brazilian cane sector's evolution. The past few years have brought a series of challenges, such as rising costs, unfavourable weather, and perhaps most significantly, the central role of the government in determining fuel prices. Meanwhile, adding to the industry's current woes, a longstanding surplus of sugar on the world market has depressed world prices – bad news for an industry which leads the world in sugar exports, shipping two thirds of its output to destinations around the world.

The array of challenges currently facing the sector has generated heightened uncertainty about the future of the sector. A number of high-profile investors that bought into the sector, either in the pre-crisis euphoria or in what was perceived to be a post-crisis buyers' market, have had to face the uncomfortable truth that the current outlook is very different from earlier expectations.

Given the current uncertainty, there is more interest than ever on the part of industry participants, their partners (including suppliers, financiers and customers), their competitors and potential new investors in the sector to understand what factors, if any, could create some light at the end of the tunnel. Given that the world sugar market is cyclical, it is likely that, while it may take one to two years, world sugar prices will come out of their current trough. But what about ethanol?

FOR THE CURRENT 2013/14 CROP, YIELDS HAVE RISEN CLOSER TO THEIR NORMAL LEVELS AND BRAZIL'S SUGARCANE PRODUCTION HAS REACHED A NEW RECORD LEVEL

FOCUSING ON COSTS, COSTS, COSTS

Sugar and ethanol are commodities. In commodity businesses there is generally little a producer can do to influence the price they are offered; competitiveness is achieved, and margins are sustained, through cost control.

In terms of production costs, raising yields of cane per hectare and raising the utilisation of installed capacity at cane mills have been major objectives for the industry. Yields suffered in the wake of poor weather conditions in the 2010/11 and 2011/12 seasons, and the ensuing lower level of output impacted on capacity utilisation. For the current 2013/14 crop, yields have risen closer to their normal levels and Brazil's sugarcane production has reached a new record level. This has had a beneficial impact on costs.

However, there is much more to do in the future. The dramatic expansion of the total area of sugarcane in the 2006-10 period, and the associated sharp increase in mechanised harvesting, has also impacted on the economics of field operations. More cane was produced in "frontier" regions such as Mato Grosso do Sul, the *Triângulo Mineiro* and Goiás, but the cane varieties planted there had actually been bred to grow in the industry's heartland of São Paulo; many of them do not provide the same yields in the frontier regions. Work is underway to develop new varieties specially tailored to thrive in the frontier regions.

Logistics has long been seen as the Achilles' heel of Brazilian agribusiness, and 2013 has amply demonstrated this. Logistics costs have soared due to a combination of new legislation governing truckers' working hours, higher diesel prices, and the bumper grain crop which exposed a shortage of road haulage capacity. Investment in logistics (including a major ethanol pipeline and further investment in rail transport) needs to be prioritised over the coming years in order to lower the overall costs of sugar and ethanol delivered to ports and to major centres of consumption.

BRAZILIAN FUEL PRICES: SOMETHING'S GOT TO GIVE

Up until January 2013, when pump prices increased by 6%, petrol prices in Brazil had remained virtually unchanged for six years. This is the biggest current issue for Brazil's cane sector, since the petrol price acts as a ceiling for the price of ethanol. Drivers of flex-fuel cars, although free to choose between the two fuels at every petrol station in Brazil, are only likely to choose ethanol if it makes economic sense. In this case it only makes sense to fill up with ethanol if it is sold at a price at least 30% lower than that of petrol – because a litre of ethanol provides 30% less energy than a litre of petrol.

As cane industry representatives are quick to point out, their costs have increased substantially in recent years while petrol prices have remained unchanged. As a result, margins for ethanol production have diminished significantly and the construction of new milling capacity in Brazil has ground to a halt.

The petrol price is pivotal not just for the cane industry but also for Petrobras, Brazil's state-controlled producer, refiner and marketer of oil and fuels. The cane industry's difficulties since 2008 mean that ethanol production has lagged far behind the potential demand that exists as a result of a rapidly growing domestic car fleet, of which flex-fuel cars represent an ever-growing share. As a result, in the last few years, rising car numbers and rising fuel demand has had to be met by boosting petrol supply – largely by increasing imports, given that Petrobras' refining capacity is already stretched to its limits.

The rise in petrol imports has been ruinous for Petrobras' financial performance, since the combination of high international oil and petrol prices and a weakened exchange rate versus a fixed domestic petrol prices means the company has lost money on every litre of imported petrol.

Furthermore, without some sort of change in fuel prices, new mills will not be built and the supply of ethanol is unlikely to increase significantly in the coming years. This creates the spectre of an ever-increasing need to import petrol (at a loss, at least if oil prices remain high and Brazil's currency continues to be weak) to meet the demands of an expanding car fleet. For this reason the current situation appears unsustainable: something will have to give.

LIGHT AT THE END OF THE TUNNEL?

An increase in the domestic petrol price would obviously help to stem the present and future financial haemorrhage at Petrobras. However, this creates a dilemma for the government, which is anxious to keep inflation under control. At the time of writing, a proposal for a new pricing system for petrol sold by Petrobras' refineries, taking account of international prices and the exchange rate, has been tabled for discussion by the board of Petrobras.

The outcome of the discussion will be keenly awaited by the cane industry. Any move in the direction suggested by the proposal could herald not just a significant change in the fuel market but also an improvement in the industry's medium- to long-term prospects.

ARTICLES

INFRASTRUCTURE
THE NEW PORTS LAW

BY VERA H DE MORAES DANTAS
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In August 2012 the Brazilian government launched its Logistics Investments Programme, aimed at stimulating public and private investment in transport infrastructure and promoting the integration of the country's roads, railways, ports and airports.

Subsequently, in December 2012, the government announced a series of measures specifically related to the ports sector, with estimated investment of more than US$27bn over the following five years.

Considering that 95% of Brazil's foreign trade is conducted through its ports, the sector is enormously important. According to the Ministry of Development, Industry and Foreign Trade, Brazil's international trade increased by over 200% from 2002 to 2012 – rising from US$107.6bn to US$465.7bn*. Understandably, the need for greater investment in order to increase the sector's efficiency and further boost exports is widely recognised in Brazil.

With a view to reducing state intervention in the sector, modernising ports infrastructure and increasing private investment (following a long process of discussions in the National Congress), Law 12815 – the so-called New Ports Law – was sanctioned by President Rousseff on 5 June 2013. It sets out the new legal framework applying to the development of ports, port facilities, and the activities carried out by port operators in Brazil, and is regulated by Decree number 8033 of 27 June 2013.

By way of background, the Brazilian federal constitution provides that the state has the right to operate ports, which can be done directly or indirectly through authorisation, concession or permission (article 21, XII, f).

Therefore, according to the new law, ports and port facilities located in a port can be operated by private parties pursuant to a **concession regime**, formalised by means of concession and lease agreements. The law also includes an **authorization regime** for the development of port facilities located outside a port.

Concessions and leases granted under the new law for the development of activities inside a port must be preceded by a **bidding process**. The main criteria applied in selecting the winning bid are cargo handling capacity, smallest tariff, and/or cargo handling time. Development rights will be granted for a period of up to 25 years, which can be renewed, once only, for a length of time not greater than the original period awarded. At the end of the contractual term, goods and facilities must be returned to the granting authority and another public bid will take place.

The Ports Secretariat (Secretaria de Portos da Presidência da República) is in charge of preparing a general plan of concessions and authorisations for the ports sector, and for approving directives applying to port development regulations. In addition, the National Waterways Transportation Agency (Agência Nacional de Transportes Aquaviários – ANTAQ) is in charge of organising and holding all bidding processes under the law, in accordance with directives passed by the Secretariat.

Construction rights outside a port will be granted via authorisations formalised through adhesion contracts, which essentially are boilerplate agreements with no room for negotiations or changes on the part of the grantee. Rights will also be granted for up to 25 years, a period which can be renewed several times provided that the authorised party keeps up with the required investment for modernisation and expansion of the port premises in question. Interested parties can request authorisations from ANTAQ at any time. If this happens, ANTAQ will open a so-called public call process for companies interested in obtaining authorisation to construct a port facility with similar characteristics in the same region and similar features, giving them 30 days in which to come forward?

IN ADDITION TO PERMITTING OPERATORS TO HANDLE THEIR OWN AS WELL AS THIRD PARTIES' CARGOES, LAW 12815/13 ALSO INNOVATED IN ALLOWING OPERATORS IN PRIVATE-USE TERMINALS TO HIRE WORKERS WHO ARE NOT REGISTERED WITH MANPOWER MANAGEMENT AGENCIES

The New Ports Law is especially innovative as regards authorisations for the construction of private-use terminals. Under the previous ports law, authorisations for the construction of a private terminal would only be given to companies which would handle their own cargo, which of course tended to limit the amount of investment in the sector. This restriction has now been lifted and it is expected that investment will increase as a result.

In addition to permitting operators to handle their own as well as third parties' cargoes, Law 12815/13 also innovated in allowing operators in private-use terminals to hire workers who are not registered with manpower management agencies (*Órgãos Gestores de Mão de Obra* – Ogmos), or to use on-call labourers, for an indefinite period of time, provided that the terms of the respective contract, convention or collective work agreements are respected.

It is expected that the new legal framework introduced by Law 12815/2013 will stimulate investment in the ports sector, enabling it to better respond to Brazil's foreign trade demands and thus enhance the country's competitiveness and boost economic growth. With this purpose in mind the government has also announced the creation of credit lines dedicated to transport infrastructure, with a competitive cost linked to the so-called Brazil Long Term Interest Rate (currently 5% per year), a grace period of three years and a 20-year term for repayment of the loan.

*Ministry of Development, Industry and Foreign Trade, *Infrastructure in Brazil: projects, financing instruments, opportunities*, February 2013, page 33

ARTICLES

BRAZIL'S LEGAL FRAMEWORK AGAINST MONEY LAUNDERING: LATEST DEVELOPMENTS

BY DANIEL VARGA
NABAS LEGAL INTERNATIONAL LAWYERS

On 9 July 2012 Brazil laid down new provisions against money laundering with the passing of Law No. 12,683. In amending Law No. 9,613 of 3 March 1998, the principal piece of legislation concerning money laundering in Brazil, the new law closed certain loopholes and strengthened mechanisms of control in line with international standards.

Brazil is a member of the Financial Action Task Force (FATF), an intergovernmental body whose objectives are to set standards and promote effective implementation of legal, regulatory and operational measures for combating money laundering, terrorist financing and other related threats to the integrity of the international financial system. In 1990 the FATF issued recommendations, revised several times in the intervening years, which aim to provide guidance for countries in combating money laundering and the financing of terrorism. The FATF is also responsible for producing reports as a means of monitoring member states' progress in that respect. Brazil was the subject of such as a report on 25 June 2010, when the old version of the AML was still in force. The FATF report addressed several issues related to money laundering, from preventative measures to the performance of the specialised courts tasked with combating this kind of crime. Among its key recommendations it stressed the need to extend corporate civil or administrative liability to legal entities who commit money laundering offences by implementing effective laws and procedures to take freezing action, and by increasing the supervision of non-bank financial institutions.

The new law partly addresses the issues raised by the FATF report and its recommendations. Under the old AML, money laundering was subject to an insufficient list of predicate offences, and therefore criminals escaped prosecution due to a lack of legal provisions. Under the new law, any type of criminal offence serves as a predicate offence. In this respect the new law has actually gone further than the recommendations, which stated that "Countries should apply the crime of money laundering to all serious offences, with a view to including the widest range of predicate offences." While the recommendations focus on serious offences as predicate offences, the new law encompasses all types of criminal offences.

> UNDER THE NEW LEGISLATION, PUBLIC AUTHORITIES CAN HAVE DIRECT ACCESS TO SUSPECTS' PERSONAL INFORMATION HELD BY FINANCIAL INSTITUTIONS, TELEPHONE AND INTERNET PROVIDERS AND CREDIT-CARD ISSUERS.

The new law has also broadened the list of non-financial institutions subject to monitoring and compliance requirements, going beyond the parameters set out in the recommendations. According to the recommendations, real-estate agents, dealers in precious metals and stones, lawyers, accountants and other independent legal professionals, as well as service providers acting as a formation agent of legal entities and related services, are subject to mechanisms of control. All categories provided above are encompassed by the new law (except for lawyers), as well as stock exchanges, dealers in luxury goods and dealers in any transactions which involve considerable amounts of cash. In addition, the mechanisms of control have become much more rigorous. Under the new law, individuals and/or entities under the control mechanisms must report to the competent authorities within 24 hours regarding any transaction exceeding R$30,000, as well as any suspicious transaction, pursuant to the guidelines laid down by the authorities. Nonetheless, law firms are excluded from the control mechanisms because of the duty of confidentiality owed to their clients.

The investigative powers of the police and the public prosecutors have also increased. Under the new legislation, public authorities can have direct access to suspects' personal information held by financial institutions, telephone and internet providers and credit-card issuers. Although these amendments may expedite investigations, they have been subject to criticism from legal professionals. Access to such personal information usually requires judicial authorisation, but from now on, in money laundering cases, public authorities can directly request this information without informing the judicial authorities, which has raised fears in some quarters that the amendment might open the door to abusive conduct on the part of investigators.

Although the new law has raised Brazil's standards in terms of combating money laundering, some important issues were left aside. The FATF report stated that "Criminal liability for ML [money laundering] does not extend to legal persons, due to fundamental principles of domestic law, and Brazil has not made corporate civil or administrative liability directly applicable to legal persons who commit ML, as is required in such circumstances". Indeed, Brazil's legal framework resists the extension of criminal liability to legal entities, which is currently restricted to exceptional circumstances such as environmental offences and bribery. As the new law did not make any changes in this regard, legal entities cannot be criminally liable for money laundering. In addition, although there have been some improvements in the administrative sanctions applicable to entities subject to the mechanisms of control, the entities directly involved in money laundering offences are still not liable in the civil or administrative sphere.

To sum up, the new law's greatest achievements have been to broaden the list of predicative offences – now any criminal offence sanctioned under Brazilian law is eligible as a predicative offense – and to increase the mechanisms of control, adding more weight to the preventative measures. On the other hand, there are still loopholes, as no criminal, civil or administrative sanctions are provided for legal entities directly engaged in money laundering.

*Ministry of Development, Industry and Foreign Trade, *Infrastructure in Brazil: projects, financing instruments, opportunities*, February 2013, page 33

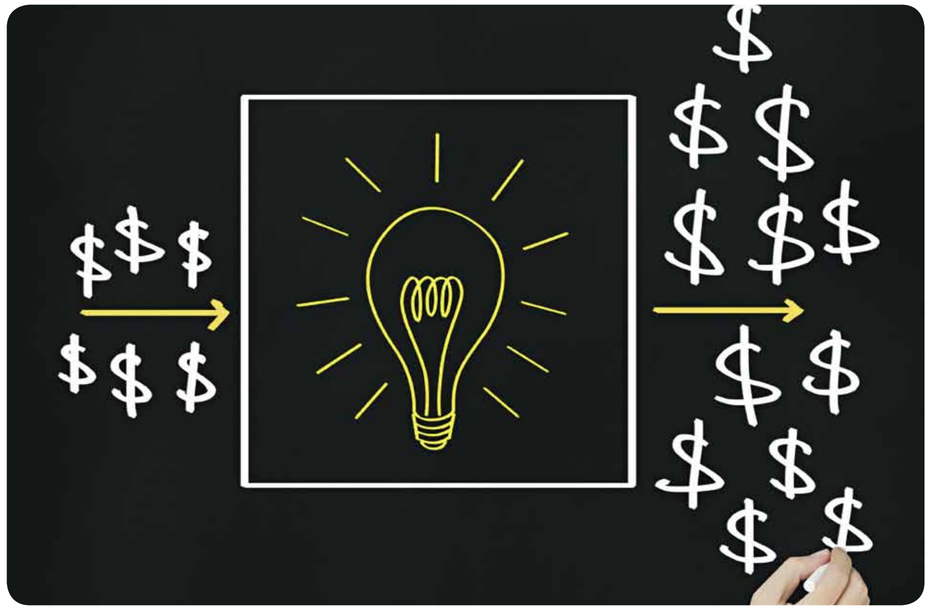
ARTICLES

PROMISING MARKET: SMB ACCESS

BRAZIL IS NOW ONE OF THE MOST ATTRACTIVE MARKETS IN THE WORLD FOR THE ALLOCATION OF RESOURCES

BY CRISTIANA PEREIRA
BM&FBOVESPA

The capital market is an important instrument for financing companies' growth in Brazil, especially in the case of large companies. Take, for example, the IPO of BB Seguridade on 29 April 2013, which raised approximately BRL 11 billion. This shows how Brazil is now one of the most attractive markets in the world for allocating resources, with internal demand powering the growth of companies that want to develop. We are aware, however, that the capital market has not been used very frequently by small or medium-sized businesses.



Between 2011 and September 2013 there were 21 IPOs in the Brazilian market, raising approximately BRL 27 billion, with a median figure of BRL 700 million. Even the smallest of them raised BRL 57 million. But if we look around the world at mature international markets aimed at small and medium-sized businesses, it is clear there is still unexploited potential in the Brazilian capital market's relationship with such companies.

Incentives for entrepreneurship and for private initiative, combined with a lower Brazilian base rate, have obliged fund managers, asset managers and investors (who historically prioritise allocation into fixed-income) to seek investment alternatives in order to reach the desired level of profitability. It is therefore natural that exposure to equities will grow in a synchronised manner, and in particular that SMBs – companies with a market value of under BRL 700 million and net revenue in the financial year prior to the offering lower than BRL 500 million – benefit from an increasingly efficient environment for the execution of their IPOs.

In light of this, BM&FBOVESPA proposes a redoubling of efforts to map, understand and propose catalysing measures so that companies choose to raise more through capital markets. This is particularly relevant for representatives of small and medium-sized businesses, which are motors of growth and innovation in a country's economy.

SMBS AND INTERNATIONAL EXPERIENCE

Considering the importance of small and medium-sized businesses for the country's economy, as well as the challenges they face in finding forms of sustainable financing, in 2011 BM&FBOVESPA led a working group composed of representatives of the Securities and Exchange Commission of Brazil (CVM), the Brazilian Development Bank (BNDES), the Brazilian Industrial Development Agency (ABDI) and the Brazilian Innovation Agency (FINEP). The group discussed ways of fostering the growth of these companies using the capital market.

The group visited seven countries (UK, Poland, Spain, Canada, Australia, South Korea and China) to gain a greater understanding of how the issue is approached elsewhere. Based on meetings with representatives of exchanges, regulators, investment banks, brokerage houses, issuers, investors, lawyers, auditors and consultants, international research was conducted in order to shed light on the lack of demand for the Brazilian alternative investment market. Internationally, local investors are always the main buyers in offerings executed by SMBs; regulatory discounts are not significant for medium-sized businesses; offerings' fixed costs are not barriers, and in Brazil those costs tend to be low; smaller offerings have a simplified prospectus, while registration with the regulatory body is waived; in some markets there have been significant tax breaks for investors; and, finally, the success of smaller offerings has also indicated which intermediaries specialise according to the size of offering.

> THE PROPOSALS SEEK TO MAKE THE MARKET MORE ACCESSIBLE TO SMBS, BOTH IN TERMS OF PREPARATION OF THE OFFERING AND COST REDUCTION

TECHNICAL COMMITTEE FOR SMALLER OFFERINGS

Against this background, a Technical Committee for Smaller Offerings has been created and has helped draw up a Joint Diagnosis containing proposals for mechanisms to encourage investors, as well as cost reduction and simplification for businesses and intermediaries (brokerage houses, investment banks, law firms) in the share offering process. The proposals seek to make the market more accessible to SMBs, both in terms of preparation of the offering and cost reduction.

Looking at the benefits that the changes would bring end investors, the Technical Committee for Smaller Offerings proposes the creation of Stock Investment Funds that encompass eligible companies; mechanisms for stimulating demand among investors, such as the reduction or exemption of income tax on capital gains for shareholders; as well as encouraging the creation of long-term savings by increasing the investment limit of private pension plans.

For businesses, cost reduction and simplification in the public share offering process have been proposed, along with the need to publish documents via different media. Other proposals are to reduce the maintenance costs of being a publicly-traded company, and to develop and implement a stock market training program for businesspeople.

Initiatives have also been drawn up to support and encourage brokerage houses, including training their staff and investors through courses, seminars and other activities; as well as to create a rulebook for procedures in restricted stock offerings, aimed at major investors.

ADVANCES IN THE LISTING SEGMENTS

In October, BM&FBOVESPA's work with its partners in the Technical

ARTICLES

Committee for Smaller Offerings led it to present the market with proposals for advances in their listing segments. This was in order to attract investors to smaller offerings and to grant these companies greater access to the equities market's financial resources. As well as analysing the profile of the company and the offering, and of some of the requirements related to corporate governance, the proposal foresees that quantitative criteria such as free float will also come to determine the company's most appropriate segment on the Exchange.

For the entrance of a company into the Novo Mercado, Level 2 and Level 1, the new rules include quantitative listing parameters (value of free float to be defined between a minimum of BRL 300 million and BRL 500 million); a BRL 15 to BRL 25 price tier for the security; and segmenting the free float rule in accordance with the market value of each company's stock in circulation.

Restructuring also encompasses some important changes to the BOVESPA Mais segment, which is specifically aimed at companies that want to raise funds on the capital market in order to finance their projects while simultaneously raising their profile with investors. The first change is the migration of the BOVESPA Mais segment from the OTC market to the Exchange market. Also, a change is foreseen to the Listing Rules, to divide the segment into two: BOVESPA Mais, which will exclusively allow the trading of common shares; and BOVESPA MAIS N2, which will allow both common and preferred shares. With this initiative the Exchange seeks to

THERE IS A PROMISING SMB MARKET TO BE EXPLOITED IN BRAZIL, AND BM&FBOVESPA HAS ALREADY MADE PREPARATIONS TO OFFER AN EVEN MORE APPROPRIATE ENVIRONMENT FOR SMALL AND MEDIUM-SIZED BUSINESSES TO ACCESS THE CAPITAL MARKET

propose a structure that, for example, also allows companies (for regulatory reasons in the sector in which they operate) to issue preferred shares, with voting rights on specific matters.

NEXT STEPS

During this initial stage the regulatory structure has already been discussed exhaustively with the various stakeholders. But in order to make the Brazilian market more accessible and efficient for SMBs, products and services need to be created which stimulate trading and liquidity, and enhance the visibility of each company's profile. The expectation is that by the end of the first half of 2014 these steps will already have been discussed and put into practice.

There is a promising SMB market to be exploited in Brazil, and BM&FBOVESPA has already made preparations to offer an even more appropriate environment for small and medium-sized businesses to access the capital market. The Exchange understands that by raising financial resources this type of business will be more able to advance and develop their growth projects, which will have a positive impact on the Brazilian economy and on job creation. Furthermore, traditional sources of revenue might not meet demand in Brazil, meaning that the capital market, via BM&FBOVESPA, becomes the most natural and viable path.

INTERVIEW

OCTAVIO DE BARROS

BY IEDA GOMES
THE BRAZIL BUSINESS BRIEF

CHIEF ECONOMIST AT BRADESCO

Octavio de Barros is Macroeconomic Research Director and Chief Economist at Banco Bradesco. In the past he has advised the Brazilian Finance Ministry and worked with the Brazilian Central Bank, as well as being a consultant with the BNDES and a visiting fellow at the OECD (Organization of Economic Cooperation and Development). His latest book, *Brasil Pós-crise: agenda para a próxima década*, co-written with Fabio Giambiagi, was published recently in Brazil.

What is the outlook for the Brazilian economy in 2014? What are the main hurdles and challenges?
The core difficulties are linked to making the transition from a growth model based on non-tradable goods, i.e. services, to one that strengthens the tradable sector, i.e. industrial goods. This transition is complicated as the rate at which the service sector is cooling is much slower than the rate at which the industrial goods sector is accelerating. This means that inflation in the service sector is cooling very slowly, due to the resistance to lower wages, while inflation in industrial goods is speeding up as a result of a 25% depreciation in the currency over the last two years. The job market remains very tight due to Brazil´s very low demographic growth (similar to Europe's) which is reducing the size of the economically active population. The supply of labour is growing at a rate that is systematically well below the rate of demand for manpower in Brazil. The strong resistance to wage cuts means that the only alternative facing the Brazilian economy is to increase productivity sharply at all levels.

What do you think will be the main economic benefits, if any, of hosting the World Cup in 2014?
To be honest, considering the size of the Brazilian economy, I don't think it's relevant at all. I also feel the same

INTERVIEW

about the Olympics in 2016. The impact of these sporting events will be very small bearing in mind the sheer size of the domestic economy and the investment cycle in infrastructure Brazil will have to face in the coming 10 years. The only positive aspect is an educational one as Brazil will be forced to meet deadlines and become more disciplined in terms of timetables. This is an area where Brazil has an awful track record.

We are seeing lots of political developments ahead of the 2014 presidential elections. Which scenarios are the banks currently working with?

The "political risk" has been irrelevant for a number of years as far as Brazil is concerned. It does not make the slightest difference in the long term who wins the elections. We are not going to see any great differences between the likeliest candidates despite their different styles. Some are more reform-minded than others but none of them will stop Brazil from continuing with the solid, steady advances it has been making over the last 19 years. I would just add that, as the Brazilian economy has become more sophisticated, it would be ideal if we could go well beyond mere incremental improvements on the institutional level and have more efficient regulations and extensive reforms.

INSTEAD OF BEING HAILED FOR THE IMMENSE IMPROVEMENTS THAT HAVE BEEN MADE, UNFORTUNATELY BRAZIL IS STILL BEING PENALISED FOR WHAT HAPPENED IN THE PAST

Brazil auctioned the huge hydrocarbon block, Libra, on October 21st, with only one bidding consortium. What is your reading of the outcome of the auction?

Although only one consortium took part in the Libra field auction, I think the final result was satisfactory due to the presence of large European and Chinese companies. The challenge now relates to Petrobras' investment capacity as the shared production model means it will have to make heavy investments. The oil and gas sector has a very important systemic impact on Brazil´s productive structure.

Brazil used to be the darling of the emerging markets but this has changed dramatically over the last 12 months. What do you think needs to be changed for international investors to regain confidence in Brazil?

It's funny how there is always a chronic confidence deficit in Brazil regardless of who is in power. It's not just a problem with this or that government. Brazil is probably the emerging country where the investor has traditionally had the lowest tolerance of any kind of macroeconomic deviation. Any small setback in the fiscal area, for example, sends shock waves across the whole market. Instead of being hailed for the immense improvements that have been made, unfortunately Brazil is still being penalised for what happened in the past. Brazil is tarred with original sin and is seen abroad as a country that only makes superficial progress when it comes to reforms, i.e. the advances are regarded as being merely humdrum and there is no appetite for long-term reforms. Brazil needs a long-term agenda to reduce inflation and discipline its chaotic fiscal budget, which is subject to political pressure and makes it impossible to develop long-term agendas. Confidence is the name of the game and Brazil needs to make itself more trustworthy in the eyes of investors in overall terms.

I BELIEVE THERE IS AN EXTRAORDINARY DIVERSITY OF OPPORTUNITIES THAT SHOULD BE OF GREAT INTEREST TO INVESTORS

As one of the largest banks in Brazil, what is Bradesco's strategy for Europe, and particularly the United Kingdom?

Bradesco Securities currently operates in London as a "broker-dealer". Bradesco Securities UK focuses on fixed and variable income intermediation operations by Brazilian companies for European and global institutional investors. It is active in the buying and selling of shares on the NYSE, NASDAQ, FTSE and Bovespa, and in the distribution of research and public offers created by Bradesco's investment banking area, Bradesco BBI, and in other investment banking activities. In Europe, Bradesco Securities has a strong presence in Luxembourg. The organisation will continue to strengthen these activities in Europe but Banco Bradesco has no strategic interest in commercial banking operations at this time.

You attended the investors road show held in London in the first half of 2013 which was aimed at promoting the upcoming infrastructure bids (roads, railways, ports). Do you see any interest from foreign investors? Will the Brazilian bank sector organise finance for the bidders?

Yes. We are seeing great interest in roads, ports and airports, although less in railways where the regulatory model is still being fine-tuned. The Brazilian banks are heavily involved in financing the infrastructure consortia. Brazil's great challenge, as I've already said, is to improve investor confidence. Initiatives need to be taken to improve the equity conditions. Advances have to be made to encourage the private sector and make it feel more comfortable in playing a leading role in the cycle of infrastructure concessions. I believe there is an extraordinary diversity of opportunities that should be of great interest to investors. The investor just needs to be made more comfortable, that's all.

There is some talk about BRIC countries creating a joint development bank. Do you see this happening? What needs to be done to implement this proposal?

I regard this as just another red herring despite the big political angle that gives the impression of greater cooperation among large emerging countries. In practice I don't foresee it playing any important part in the financing of the emerging countries involved. It is not something that should be taken very seriously.

The FED's announcement of ending quantitative easing sometime in the near future has created lots of turbulence in the emerging markets and the strengthening of the dollar vis-à-vis local currencies. What will be the actual impact in Brazil when the FED finally announces a date?

The fact is that the latest postponement of the tapering has given emerging countries like Brazil a window of opportunity to introduce measures that would ensure a smoother transition to a new global monetary policy cycle. Urgent changes need to be made in the approach to fiscal policy. There has already been a great impact, mainly reflecting the depreciation of the real, but I don't expect monetary stimulation measures in the United States to wind down before the end of the first quarter of 2014 at the earliest. I think good assets will remain liquid at world level and do not really foresee the risk of capital flight

INTERVIEW

that occurred in the past. The Brazilian Central Bank operates extremely competently and independently and the country has US$380 billion in foreign exchange reserves. What has occurred has been a global repricing of assets and I don't expect any new impacts that will affect the Brazilian economy, unless no domestic progress is made in the fiscal area and in combating inflation.

Brazil's economic growth was triggered by the expansion of credit and the boom in the commodities markets. It now seems difficult to sustain this, due to China's economic slowdown and the limited supply of credit. What does Brazil need to do to increase GDP growth to above 4% in the years to come?

Let's be realistic. Brazil has very low population growth and does not need to expand much faster than 3.5% to continue to make great social progress. The world's potential GDP has fallen, as has Brazil's. The cooling of the Brazilian economy is mainly cyclical and driven by the global economy. Idiosyncratic factors only play a small part. China is important as far as iron ore and soybean exports are concerned but bilateral relations between the two countries are not very important in relation to Brazil's GDP. We expect China to grow by less than 7% in the coming two or three years, an expansion rate that will maintain the terms of trade and bring no great losses to Brazil. I don't see any problem over banking credit. There has been a huge improvement in the quality of domestic credit, with steadily declining delinquency ratios. The banking inclusion occurred during the "Lula era" and the marginal growth in credit is currently much lower. This is good news as far as I am concerned. Now is the time to strengthen the domestic capital market and all we need to do is gain greater confidence from investors.

What do you see as exciting opportunities in the years to come?

Brazil has a great advantage over the other emerging countries as its economy is much more diversified, in sector terms, than theirs. Despite this, it is still not highly competitive – so it would be extraordinarily beneficial to all sectors if significant advances could be made in boosting productivity.

Brazil needs to mobilise its productive and social forces to exploit the immense pool of productivity it offers. Furthermore, Brazil is the most internationalised emerging country in terms of the number of transnational corporations doing business there, although on the other hand its economy is not connected to the global value chains. It's a paradox. Opening up the economy further would give a tremendous boost and strengthen investors' appetites in virtually all sectors of activity.

> BRAZIL IS THE MOST INTERNATIONALISED EMERGING COUNTRY IN TERMS OF THE NUMBER OF TRANSNATIONAL CORPORATIONS DOING BUSINESS THERE, ALTHOUGH ON THE OTHER HAND ITS ECONOMY IS NOT CONNECTED TO THE GLOBAL VALUE CHAINS. IT'S A PARADOX

DATES FOR YOUR DIARY

21ST JANUARY	**DISCUSSION: BRAZILIAN AND BRITISH ANTI-BRIBERY LEGISLATION** 8:30 AM
13TH MAY	**GALA DINNER AND PERSONALITY OF THE YEAR AWARDS** AT LONDON HILTON PARK LANE, 7:00 PM
29TH MAY	**SEMINAR: ECONOMIC PROSPECTS AND CAREER OPPORTUNITIES IN BRAZIL** 5:30 PM
2ND SEPTEMBER	**RECEPTION AT THE HOUSE OF COMMONS** 6:30PM

FOR MORE INFORMATION PLEASE VISIT OUR EVENTS PAGE AT **BRAZILIANCHAMBER.ORG.UK/EVENTS**

EVENTS ROUND-UP

THE BRAZILIAN CHAMBER ORGANISES AROUND 20 EVENTS PER YEAR ON A VARIETY OF SUBJECTS, ALWAYS AIMING TO RAISE THE PROFILE OF BRAZIL AND TO PROMOTE NETWORKING OPPORTUNITIES. ON OUR PAST EVENTS PAGE YOU CAN DOWNLOAD PRESENTATIONS, SEE PICTURES AND LEAVE COMMENTS.

FOR MORE INFORMATION PLEASE VISIT WWW.BRAZILIANCHAMBER.ORG.UK/PASTEVENTS

POLITICAL AND SOCIAL RISK IN BRAZIL AND SOUTH AMERICA

SEPTEMBER 18TH 2013

Geert Albers of Control Risks began this presentation by showing how Brazil fares when assessed according to various political and social risk parameters – including nationalisation/expropriation, state intervention, bureaucracy (ease of doing business), trade policy, corruption/integrity and social unrest – and how the country compares to other major Latin American economies in those respects.

The presentation then provided an overview of the operational environment in three of Brazil's key economic sectors, namely oil and gas, infrastructure, and financial services. It concluded by analysing the government's attitude towards companies operating in each sector, and by highlighting to what extent investors are exposed to the aforementioned risks.

MEET BRAZIL IN THE UK: RECEPTION HOSTED BY THE BRAZILIAN CHAMBER OF COMMERCE AND UKTI

OCTOBER 8TH 2013

Organised by UKTI Brazil, a market visit by a group of Brazilian delegates interested in investing in the UK took place from 7-11 October. The participating companies came from a variety of sectors including retail, tourism, ICT, IT hardware, energy and infrastructure. The Chamber organised a networking event so that members and friends could meet the companies' representatives.

Brazilian delegates at Meet Brazil in the UK

EVENTS ROUND-UP

CHRISTMAS RECEPTION TO WELCOME NEW MEMBERS

DECEMBER 2ND 2013

For the fourth consecutive year our Christmas reception was kindly hosted by Herbert Smith Freehills in their Liverpool Street offices.

Members and friends of the Chamber enjoyed live Brazilian music from Trio Bossa. Percussionist Gaio de Lima sparked everyone's curiosity by playing the calabash, an African instrument whose main element is a large gourd (see below). It was our last event of the calendar year and once again proved very popular, with about 150 people attending.

Trio Bossa: Gaio de Lima (percussion), Andrew Woolf (clarinet and saxophone) and Carlos Franco (guitar & vocals)

Our host from Herbert Smith, Nigel Farr

Gerard McNally, Cristina Machado and Brazilian Chamber Treasurer Paulo Guimaraes

Brazilian Chamber councillors Vera Dantas, Flavio Marega and Frances Reynolds

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EVENTS ROUND-UP

EDITORIAL

BRAZIL BUSINESS BRIEF JANUARY 2014

NEWS FROM THE
BRAZILIAN CHAMBER OF COMMERCE
IN GREAT BRITAIN

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BRAZILIAN CHAMBER OF COMMERCE
IN GREAT BRITAIN
PRESENTS

GALA DINNER
PERSONALITY OF THE YEAR AWARDS 2014

13TH MAY 2014

AT THE LONDON HILTON
ON PARK LANE
7.00PM

BRAZILIANCHAMBER.ORG.UK

Brazilian Chamber
of Commerce in Great Britain